1 OVERVIEW

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With every twist and turn in the global financial crisis that started in 2007, the International Monetary Fund (IMF) has been at the heart of efforts to restore financial stability and return the world economy to sustainable growth. This year was no exception. The Fund was focused intensely on providing the financing, policy advice, and technical assistance that members need to manage economic and financial risks and achieve lasting growth. New nonconcessional financing arrangements were initiated for seven countries. At the same time, the institution was pursuing many strands of work to strengthen its approach to surveillance and policy design, to improve the instruments in its lending toolkit, and to improve the governance structure of the organization.

By the end of the financial year,[1] a significant number of countries had made firm commitments to enhance IMF resources by more than US$430 billion, for crisis prevention and resolution and to meet the potential financing needs of all IMF members.[2] This showed the commitment of the international community to putting the global economic recovery on a sounder footing, and to retaining the IMF at the heart of these efforts.

A FRAGILE AND TEPID RECOVERY

The global economy experienced a period of tentative stability in the first quarter of 2012 after a major setback in late 2011, but the recovery remained fragile as FY2012 drew to a close. Activity in the United States strengthened, and most emerging market economies and low-income countries were continuing to experience solid growth. However, recurring difficulties in the euro area led to significant market stress and volatility at times and continued to pose a key source of vulnerability to the world economy. Growth in most advanced economies was expected to remain weak, held back by concerns about public deficits and debt, the ongoing process of financial deleveraging, and high unemployment. In the emerging market and developing economies, it was expected that growth would continue to be solid, though managing downside risks would continue to be challenging and some countries were facing overheating pressures related to strong credit growth.

POLICIES TO PUT THE CRISIS BEHIND US

With risks firmly to the downside, policymakers faced a challenging balancing act as FY2012 drew to a close. In advanced economies, governments had to address fiscal risks and start to put public debt on a firm downward trajectory without killing growth in the near term. Measured near-term fiscal adjustment was needed, accompanied by strong medium-term consolidation plans that included reforms to entitlement programs. These economies needed to implement structural reforms to labor and product markets to lower unemployment and bring about stronger growth. Subdued inflationary pressures and risks to growth called for continued accommodative monetary policy. For emerging market and developing economies, policymakers needed to find the right balance of macroeconomic policies that would counter global downside risks while, in some cases, keeping overheating pressures in check. All countries needed to work to ensure that the most vulnerable groups in society were protected from the fallout of the financial crisis.

Continued policy cooperation across countries was necessary to build confidence and stability. To make further progress in addressing global imbalances and the deficit in global demand, countries with high saving rates needed to seek to address obstacles that were impeding consumption and investment, supported by more market-determined exchange rates. In addition, a key priority remained the global financial sector, in particular the need for consistent implementation of new financial sector regulations worldwide and for addressing other financial sector weaknesses such as problems related to institutions considered "too complex to fail," the shadow banking system, and cross-border supervision and bank resolution.

FINANCING FOR MEMBERS

The IMF continued in FY2012 to respond flexibly to members' financing needs in an environment of uncertainty and financial market volatility. Demand for Fund resources remained strong and commitments increased further, although at a slower pace than in the previous year. The IMF's Executive Board approved seven nonconcessional financing arrangements during the year. In addition, a new successor arrangement under the Flexible Credit Line (FCL) was approved for Colombia, while existing FCL arrangements remained in place for Mexico and Poland.

Among the Fund's low-income members, 20 countries had arrangements approved or augmented with support from the Poverty Reduction and Growth Trust (PRGT) in FY2012. By the end of the financial year, the IMF had concessional financing outstanding with 64 members. The IMF also intensified its policy dialogue, including possible financing support, with countries in the Middle East and North Africa to assist governments in managing the economic challenges arising from ongoing transitions there since early 2011.

MODERNIZING THE FINANCING TOOLKIT

The Executive Board approved a set of reforms during the financial year designed to increase the flexibility and scope of the Fund's financing instruments. The reforms agreed to by the Board were designed to better equip the toolkit to provide liquidity and emergency assistance to the Fund's global membership. The changes will enable the Fund to respond with more flexibility to the diverse liquidity needs of members with sound policies and fundamentals, but nonetheless affected by contagion risks ("crisis bystanders"), and to address urgent financing needs arising in a broader range of circumstances than the natural disasters and post-conflict situations previously covered.

Under the reforms, the Precautionary Credit Line (PCL) was replaced with a more flexible Precautionary and Liquidity Line (PLL). The PLL can be used under broader circumstances, including as insurance against future shocks and as a short-term liquidity window to address the needs of members with sound economic fundamentals and institutional policy frameworks, including crisis bystanders. The Fund's existing policies for emergency assistance (Emergency Natural Disaster Assistance and Emergency Post-Conflict Assistance) were consolidated and replaced with a new Rapid Financing Instrument, which can be used to support a full range of urgent balance of payments needs, including those arising from exogenous shocks.

STRENGTHENING SURVEILLANCE

Major steps were taken in FY2012 to improve the Fund's surveillance methods and outputs. The Executive Board concluded a comprehensive review of the IMF's surveillance activities—the Triennial Surveillance Review (TSR). While they found that significant progress had been made, since the last TSR in 2008, in the way surveillance is conducted, Executive Directors concurred with the Managing Director's action plan to strengthen it in the following six areas: interconnections, risk assessments, financial stability, external stability, the legal framework, and traction. Of particular note, the Board found that the analysis of external spillovers for the five biggest systemic economies, undertaken for the first time in 2011, had contributed in a useful way to Fund surveillance and recommended that the exercise be repeated prior to further evaluation. The Fund also set out to develop a work plan for financial sector surveillance to lay out the strategic and operational priorities for the Fund's work in this area. In the area of external stability, the Board agreed to continue work to broaden analysis beyond exchange rates to include multilaterally consistent staff assessments of external balances. In terms of the Fund's legal framework for surveillance, the Executive Board began work toward updating the existing legal framework to enable more effective conduct of surveillance, and it was expected that the Board would take this up further in FY2013.

The Fund also issued a new Consolidated Multilateral Surveillance Report in October 2011 and April 2012 to foster discussion among policymakers and strengthen the role of the International Monetary and Financial Committee (IMFC). Executive Directors agreed that the Fund could increase the attention given in its surveillance to inclusive growth, employment, and other social issues that have significant macroeconomic impacts, drawing from the expertise of other institutions. The Fund also focused its work on several broader core areas, including capital flows, modernizing the fiscal framework and debt sustainability analysis, and managing policy challenges for low-income countries in the face of commodity price shocks.

The IMF made further efforts to sharpen its economic risk assessments. In conjunction with the Early Warning Exercise, the Fund continued to strengthen its analytic frameworks tailored to assessing vulnerabilities and emerging risks in advanced economies, emerging markets, and low-income countries. Prepared in collaboration with the Financial Stability Board (FSB) and presented twice a year to the IMFC, the Early Warning Exercise aims to identify (1) low-probability but high-impact risks to the global economy, (2) policy actions to mitigate risks and reduce vulnerabilities, and (3) suggestions for further analysis in subsequent rounds of the exercise.

Building on increased awareness, in the wake of the global crisis, of the crucial role played by data in crisis preparedness and prevention, the IMF in FY2012 continued its ongoing efforts to strengthen the quality of data provided by its members and to increase the accessibility of the data it produces and manages. The Eighth Review of the Fund's Data Standards Initiatives was completed in February 2012, and increasing and improving online access was a particular focus during the year.

TECHNICAL ASSISTANCE AND TRAINING

Amid heavy demand, generous donor contributions enabled the IMF to deliver about 17 percent more technical assistance (TA) in the field in FY2012 than in the previous financial year, serving nearly all of its member countries. As a core function of the IMF, technical assistance reinforces member capacities in the fiscal, legal, monetary/financial markets, and statistics areas. Efforts this financial year focused on helping countries manage the near-term implications of weak world growth, turbulence in Europe, and continued volatility in financial markets. More fundamentally, technical assistance was directed at strengthening policy frameworks and institutions to support sustained growth. TA delivery increased across all areas during the year, with demand for TA on fiscal issues particularly high.

Following a report by a task force charged with assessing the Fund's TA strategy, the IMF announced in early 2012 the decision to merge two existing operational units, the IMF Institute and the Office of Technical Assistance Management, to create the new Institute for Capacity Development. The new department, which began operating in May 2012, provides technical assistance and training to help member countries build capacity and develop key economic and financial institutions.

REFORMING THE FUND TO MEET THE CHANGING PROFILE OF MEMBER COUNTRIES

As noted on many occasions by the IMF's governing bodies and management, the implementation of approved governance reforms is crucial to ensure an institution that is representative, legitimate, and credible. During FY2012, the Executive Board closely monitored progress in members' acceptance of the quota and governance reform package approved by the Board of Governors in 2010, emphasizing the importance of moving rapidly to ensure implementation of the reforms by the 2012 Annual Meetings. They also initiated a review of the Fund's quota formula, which determines members' quotas.

Ensuring the sufficiency of the IMF's resources to meet potential increases in member needs has been an ongoing concern since the beginning of the global crisis, and Fund efforts in this area continued during FY2012. Resources available through the expanded New Arrangements to Borrow (NAB) were augmented (to nearly SDR 370 billion,[3] or US$574 billion, as of the end of the financial year), and the expanded NAB was reactivated twice to ensure ready access to its resources when needed. Member countries pledged, bilaterally, an additional US$430 billion in resources in FY2012. Fundraising to boost resources available for assisting low-income countries also continued during the year, and the Executive Board endorsed the use of a portion of the windfall profits from the IMF's recent gold sales, as part of a strategy to raise additional funds to subsidize the interest rate on concessional financing arrangements provided to low-income members.

There were several changes in the Fund's management during the financial year. In late June 2011, the Executive Board selected Christine Lagarde—the first woman named to the top IMF post since the institution's inception in 1944—to serve as IMF Managing Director and Chair of the Executive Board for a five-year term starting that July. Shortly thereafter, David Lipton was appointed as First Deputy Managing Director to replace John Lipsky, and Min Zhu was appointed to the position of Deputy Managing Director.

COLLABORATION AND OUTREACH

The IMF continued to collaborate with other organizations during the year. Its ongoing work with the Group of Twenty (G-20) advanced and emerging market economies remained of particular significance, and its collaborative efforts with regional financing arrangements, especially in Europe, took on increasing importance in the face of ongoing financial instability. The Fund worked closely with the FSB on risk assessments and data provision issues, and with the World Bank on a day-to-day basis on low-income country issues and financial sector assessments. Also noteworthy was the collaboration between the IMF and the International Labour Organization on issues related to employment creation and social protection floors.

In this spirit, the Fund also continued to place great importance on outreach and engagement with outside stakeholders. Fund outreach provides an opportunity to communicate to the membership the strategic vision for the organization and its key policy priorities; to increase support for policymakers in undertaking national reforms with domestic and global benefits; to strengthen Fund analysis and policy advice by engaging key stakeholders in member countries on issues of concern to them; and to emphasize to members, especially those hard hit by the crisis, the Fund's commitment to providing needed support.