



International Monetary Fund

The Managing Director's Global Policy Agenda

April 2014



The Global Policy Agenda (GPA), presented semi-annually to the International Monetary Fund and the Financial Committee (IMFC), identifies the policy challenges faced by the membership and outlines policy responses that are needed at the global and country level to address these challenges.



THE MANAGING DIRECTOR'S GLOBAL POLICY AGENDA APRIL 2014

Interconnections, Spillovers, and Spillbacks

Global activity is strengthening, but the recovery is uneven and remains too weak for comfort, with geopolitical tensions injecting new concerns. Key challenges include risks from a lasting rise in capital flow volatility for emerging and frontier economies and very low inflation in advanced economies, especially the euro area. Creating a more dynamic, job rich global economy remains our collective goal. For this, policymakers should manage the recovery more actively and reinforce their cooperation to minimize negative spillovers and promote financial stability.

While specific policy responses depend on each country, broad themes are as follows:

- **Monetary normalization and policy spillovers.** In *advanced economies*, a premature withdrawal of monetary accommodation should be avoided given remaining economic slack, low inflation, and continued fiscal consolidation. Some *emerging economies* and *frontier markets* (financially integrated low-income countries) may have room to loosen monetary policy in response to a growth slowdown, but those with high inflation, limited credibility, or rising financial stability risks should tighten and strengthen policy frameworks. Exchange rates should respond to changing fundamentals, facilitating external adjustment. Where reserves are adequate, intervention can help smooth excess volatility or ease liquidity strains. In *low-income countries*, policy should focus on consolidating recent disinflation gains. Cooperation among central banks and financial regulators could help contain adverse policy spillovers and subsequent feedback to source countries ("spillbacks").
- **Ensuring robust, sustainable growth and reducing vulnerabilities.** The priority for many *advanced economies* is to calibrate the pace and composition of fiscal consolidation within credible future adjustment plans to support the recovery. *Emerging and frontier market economies* with high debt or financing needs should lower budget deficits, while *low-income countries* should use the resilience of their economies to rebuild policy space. All countries should seek to enhance the quality of public spending—including by boosting well-prioritized infrastructure investment—balancing equity, efficiency, and growth objectives. Cohesive and determined structural reforms across the membership are needed to reinvigorate growth and employment, including by opening up product and services markets, addressing supply bottlenecks, and deepening financial markets.
- **External rebalancing and maintaining policy coherence.** Further actions are needed from surplus and deficit countries to ensure that the appreciable declines in external and internal imbalances are sustained, and to lower risks of new turmoil. A strong push to complete national and global financial regulatory reforms remains paramount, as progress in financial sector reforms has slowed.

The IMF's work will focus on a range of policy issues related to shifting growth drivers, spillovers and spillbacks from monetary normalization, the macroeconomic and financial stability implications of global financial regulatory reform, and the role of policy cooperation.

Prompt implementation of the 2010 quota and governance reforms, and completion of the 15th General Review of Quotas by January 2015 remain essential for the Fund's continued legitimacy, financial strength, and effectiveness.

WHEN WE LAST MET

During the last Annual Meetings we emphasized the need for policy action to avoid further growth disappointments.

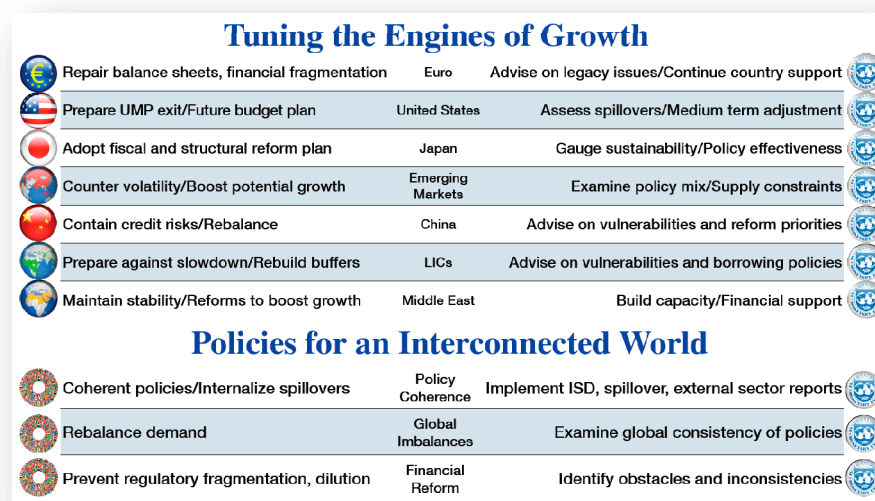
The recovery was subdued

Moving from stabilization to growth remained a work in progress. We highlighted that decisive reform implementation was needed to break the cycle of recurrent growth shortfalls and market jitters that had characterized the recovery thus far.

Multiple transitions needed careful management

The Global Policy Agenda (GPA) set out three areas of transition that would shape the policy priorities for the membership over the following 6–12 months: the shifting growth dynamics from emerging to advanced economies and rebalancing of global demand; the normalization of global financial conditions and associated spillovers; and the completion of global financial system reforms.

Figure 1. Policy Priorities of the Fall 2013 Global Policy Agenda



WHERE WE STAND TODAY

The global recovery has strengthened but remains far from robust.

Relative growth contributions have shifted somewhat

Activity in *advanced economies* has picked up, notably the *United States*, the *euro area core*, and the *United Kingdom*, but is likely to moderate somewhat in *Japan* and will remain sluggish for some time in stressed euro area economies. Still, resources remain underutilized in most countries, with unemployment rates significantly above pre-crisis levels and risks of extremely low inflation emerging in a number of countries.

Growth in *emerging market economies (EMEs)* has slowed but is expected to accelerate slightly going forward, while *low-income countries (LICs)* have generally been able to maintain their growth momentum. Stronger external demand from advanced economies will provide some support for growth but tighter financial conditions and higher market volatility are expected to weigh on domestic demand. Overall, *emerging market economies and developing countries (EMDCs)* will continue to contribute the bulk of global growth.

Growth in *Arab Countries in Transition (ACTs)* has remained subdued, held down by political uncertainties and unresolved structural problems. Official financial support, to a large extent from regional donors, has provided much needed relief, but medium-term financing needs are expected to remain high. *Small developing states* have continued to grow slowly, often constrained by high levels of indebtedness and vulnerabilities to external shocks.

**Too many people
are still out of work**

Overall, global growth is projected to improve further in 2014 and 2015, although remaining below past trends. The costs of continued sluggish growth are clear—there will only be modest income gains and gradual reductions in unemployment.

Members have made some progress in implementing policy priorities but important gaps remain.

**Stabilization has
been achieved but
policies to boost job
creation and growth
are lagging**

In the *euro area*, monetary accommodation was maintained, regulation establishing a single bank supervision mechanism was passed, provisional agreement was reached on a single resolution mechanism, and a comprehensive assessment of banks is underway. However, a common fiscal backstop remains missing. While several banks have improved their capital ratios, including through raising fresh equity, balance sheet repair remains incomplete and fragmentation persists.

The *United States* is proceeding with monetary normalization and has adopted a budget and debt ceiling extension, but supervision of shadow banks should be further strengthened. In *Japan* the consumption tax increase has taken effect, marking an important first fiscal reform measure. However, both the *United States* and *Japan* still need to develop credible and concrete fiscal consolidation plans to ensure medium-term sustainability (Table 1).

Many *EMEs* have allowed exchange rates to adjust in response to less benign external conditions. There has also been progress toward financial market deepening. However, actions in the macroprudential and supervisory areas have been limited, with policymakers in *China* still needing to rein in the shadow banking system to stem financial risks. Moreover, reforms to tackle supply bottlenecks and boost potential growth are needed in many *EMEs*.

In *LICs* policy implementation has proceeded in several areas but should be accelerated going forward. Policy implementation has been particularly slow in the *ACTs*, where the difficult socio-political context has made it hard to advance reforms.

Table 1. Assessment of the Implementation of Member Policy Priorities

| Policy Priorities | Assessment | Comment |
|--|-----------------------|--|
| Completed or on track | Partially implemented | Little or no progress |
| Advanced Economies (summary score) | | Mixed picture |
| United States: Communicate UMP unwinding clearly. Resolve short-term fiscal uncertainties and adopt medium-term fiscal plan. Strengthen financial supervision and shadow bank oversight. | | Communication of UMP unwinding ongoing. Fiscal short-term uncertainties tackled but medium-term plan missing. Progress on financial supervision but more needed on shadow banks. |
| Euro Area: Provide further conventional and unconventional monetary support. Mitigate risks from the high private debt and impaired bank balance sheet nexus. Address the remaining architectural issues to complete the banking union. | | Further monetary easing needed. Comprehensive assessment of banks underway but clear ex-ante recapitalization strategy missing. Progress toward single resolution mechanism, but still no common fiscal backstop, and risks of slippages remain. |
| Euro Area Countries: Labor and product market reforms. More progress in repairing bank and corporate balance sheets. | | Progress on bank/corporate balance sheet repair. Structural reforms to improve competitiveness still needed. |
| Japan: Implement ambitious medium-term consolidation plan and take decisive actions to invigorate growth. Revenue efforts should be complemented with entitlement spending reforms. | | Reforms progressing in some sectors (agriculture, electricity), but slow in labor markets and broader deregulation. Concrete medium-term fiscal strategy still lacking. |
| Emerging Market Economies (summary score) | | Progress on monetary and some fiscal policies but structural reforms trailing |
| Monetary and exchange rate nexus: Exchange rate flexibility with safeguards and adequate liquidity provision. Possible use of capital flow management measures in crisis-type situations along with a broader policy package. Macroprudential measures to address credit quality. | | Many countries allowed exchange rate flexibility and provided adequate liquidity, while a few relied solely on capital flow management measures. Uneven progress on financial regulation and supervision. |
| Fiscal policy: Allow automatic stabilizers to work in countries with strong fiscal positions and gradually build buffers in countries with fiscal vulnerabilities. Elsewhere, pursue sound fiscal management, reorient public spending to support growth and equity, and bring quasi-fiscal operations on budget. | | Appropriate fiscal stance in countries with strong fiscal positions but delayed adjustment in others. Limited progress on reorienting public spending and bringing quasi-fiscal operations into public accounts. |
| Structural issues: Accelerate infrastructure investment, create a more open trade investment regime, deepen financial markets, and reduce labor market rigidities. | | Deepening of financial markets advancing. Progress on improving investment climate and reducing labor market rigidities limited. |
| China: Contain credit risk and transition to consumption-driven growth. Liberalize interest rates and develop a more transparent interest rate-based monetary framework. Enhance financial sector regulation and supervision, including of shadow banks. | | Some progress on containing credit risk, liberalizing interest rates and transitioning to consumption-driven growth. More needed toward transparent monetary framework and safer financial system, especially on shadow banks. |
| Low-income Countries (summary score) | | Faster implementation is needed |
| Fiscal: Build fiscal and foreign reserve buffers; safeguard critical investment programs and mobilize domestic revenues (particularly non-resource for commodity exporters), and scale back costly and poorly-targeted subsidy schemes. | | Several LICs have implemented measures to mobilize revenues but progress on reforming subsidies has slowed. Progress also limited on strengthening fiscal frameworks among commodity exporters. |
| "Frontier market" economies: Prepare contingency plans in the event of a sharp reduction/reversal in capital inflows. | | Some countries need to develop contingency plans to address possible reduction/reversal in capital inflows. |
| Growth: Promote inclusive growth, scaling up public investment, improving public service delivery, and promoting financial deepening/access to finance. | | Many countries have taken steps toward scaling up public investment, and promoting financial deepening and access to finance. Reforms to improve public service delivery slow. |
| Arab Countries in Transition (summary score) | | Limited progress |
| Reviving growth: Strengthen governance/business regulation, improve access to finance, and address labor/product market rigidities. Where fiscal space is available, increase public investment and spending on basic services to support growth. | | Reforms to enhance access to finance proceeding but insufficient progress on improving business climate and labor and product market rigidities. Public spending has increased in several countries with fiscal space. |
| Smart fiscal adjustment: Replace generalized energy subsidies with targeted social protection for vulnerable groups. Keep public wages in check. Strengthen revenue collection, and enhance public investment and public service efficiency. | | Some progress on fuel subsidy reform, improving targeted social protection, and strengthening revenue collection. Measures to streamline public wage bill and enhance public investment and public service efficiency are still lacking. |

Members are assessed on their progress implementing policy priorities as identified in the Fall 2013 Global Policy Agenda (GPA). The income groups are aggregated using PPP GDP weights.

The record on policy cooperation has been mixed

Over the last six months, global current account imbalances have narrowed further, in part reflecting movements in relative prices in the stressed *euro area* countries, as well as changes in energy trade patterns. The slowing pace of global financial reform and inconsistent national implementation, especially of various national structural initiatives, are a growing concern.

Notwithstanding the current global policy dialogue, some members (in particular, major *EMEs*) still see room for more cooperation to mitigate policy spillovers, especially from monetary policies.

The IMF has continued its efforts to support the membership in addressing critical policy challenges.

Support for members has proceeded on multiple fronts

Highlights include successful conclusions of a lending program with *Ireland* and technical assistance to monitor financial sector reform in *Spain*. Several new lending programs have been put in place, including to support *Armenia* and *Albania*, while *Poland*, *Colombia*, and *Mexico* continue to benefit from added liquidity buffers through the Flexible Credit Line. *Myanmar* completed a staff-monitored program that has triggered debt relief from the Paris Club, and a major effort continues to build capacity in key areas of macroeconomic management. A trust fund was established for technical assistance to *Somalia* and our fifth regional technical assistance center for Africa was inaugurated in Accra earlier this year.

Engagement with *ACTs* has also remained intense, with approved financial support of about \$10 bln since 2011 in *Jordan*, *Morocco*, *Tunisia*, and *Yemen*; more than 60 technical assistance missions and three dozen training events in the current fiscal year alone; and major reports laying out a comprehensive regional reform agenda and scaling up scenarios for job-creating investment.

Several GPA deliverables have been completed while work on others is ongoing

The Fund has undertaken analytical work on various topics, including spillovers of unconventional monetary policies on *EMEs*; the role of structural transformation and diversification in enhancing growth and stability in *LICs* (with an online analytical tool-kit); the interplay between fiscal policies and inequality, and growth effects of the latter; the scale and impact of energy subsidies; and the importance of budget institutions in systemic countries. In addition, the FCL/PLL/RFI lending facilities, reserve adequacy assessments, and monetary policy conditionality in *EMDCs* have been or are being reviewed. Work is underway on analyzing policy spillovers and capital flow volatility, debt restructuring, and policies to boost growth.

Following the distribution of reserves linked to windfall gold sales profits, preparations are in train for the final decisions to implement the self-sustained concessional lending framework through the Poverty Reduction and Growth Trust (PRGT).






















Quota and governance reforms remain delayed

A number of tasks outlined in the last GPA have suffered delays, reflecting in part competing work pressures and resource constraints (Table 2). Importantly, some members have yet to deliver on reforms to quotas and governance—the 2010 Quota and Governance Reform still needs to be

ratified by the United States to enter into effect. As a result of the delays, the January 2014 deadline for completing the 15th General Review of Quotas had to be postponed to January 2015.

Table 2: Progress on IMF Deliverables / Reports

(November 2013 – April 2014)

| Completed | Ongoing | Delayed |
|--|--|---------|
| Surveillance | | |
|  Conventional and Unconventional Monetary Policy | | |
|  Cluster based Article IVs | | |
|  Triennial Surveillance Review ¹ | | |
|  Guidance Note on Small States | | |
| Lending/Global Safety Net | | |
|  Liquidity—Issues for Multilateral Surveillance | | |
|  Reserve adequacy (incl. guidance note) | | |
|  FCL/PLL/RFI review | | |
|  Conditionality for evolving monetary policy regimes | | |
| Strengthening Financial Systems | | |
|  Supporting regulatory reforms | | |
|  Systemically important financial sectors list: update | | |
|  Financial Sector Surveillance in LICs | | |
| Deficit and Debt | | |
| |  Sovereign debt restructuring ¹ | |
| |  Debt limits review: proposals | |
| Jobs and Growth | | |
| |  Fiscal Policy and Inequality | |
| |  Long-run Growth in LICs | |
| |  Economic Reform Agenda for ACTs | |
| |  Financial Deepening, Growth and Resilience | |
| Global Imbalances/Spillovers | | |
| |  Policy Spillovers and Capital Flows Volatility | |
| |  Spillovers from regulatory reforms | |
| Governance | | |
| |  Guidance note on Transparency policy | |
| |  2010 reforms/15th General Review of Quotas | |

¹ Committed reports scheduled to be delivered beyond the horizon under consideration; ongoing work.

Source: Fall 2013 Work Program.

Major vulnerabilities and downside risks to the recovery remain.

Disorderly monetary normalization could trigger financial stress

The unwinding of unusually large central bank balance sheets will be complex given uncertain effects on asset prices, including major exchange rates. An overly hasty or miscommunicated unwinding of unconventional monetary policies in the *United States* or elsewhere could lead to a larger-than-expected increase and heightened volatility of global long-term interest rates, which would dampen growth, particularly in countries with high private and public indebtedness, and produce potentially large spillovers via market and exchange rate volatility, especially on emerging and frontier market economies. Such a scenario could be particularly disruptive if financial stability risks from very accommodative monetary policies, including excessive risk-taking and leverage, are left unchecked by supervisory authorities.

Growth in emerging economies and frontier LICs could disappoint

Activity could fall short of expectations due to continued market volatility, further unexpected tightening of financial conditions, more binding investment constraints that lower potential growth, or political uncertainty. Geopolitical tensions that have recently come to the fore could also cloud the growth outlook. Recent rapid increases in leverage in *EME* corporates bear the risk of adverse feedback loops between corporate debt, banks, and growth in case of shocks. A broad slowdown in *EMEs* would hurt the global outlook significantly.

given their rapidly increasing economic weight. The impact, including on other *EMEs*, would be particularly large in case of a hard landing in *China*, where risks and moral hazard related to asset quality continue to build. However, the likelihood of such an event remains small.

Low inflation could persist and deflation could set in

Output gaps and lower-than-expected inflation outturns have increased the risk of a prolonged period of below-target inflation, which could de-anchor inflation expectations, raising real interest rates and triggering further deleveraging that would dampen growth. This risk is particularly relevant for the *euro zone* where unemployment is stubbornly high and economic slack large, especially in stressed economies.

The world could fall into a medium-term growth trap

Beyond the short term, reform fatigue and insufficient policy ambition could push the global economy into a prolonged slump. With growth recovering from crisis lows, pressure for immediate structural transformations could wane and lead to a slowdown or abandonment of reform plans, lowering the global growth potential.

POLICY CHALLENGES AHEAD

The key challenge remains transforming a modest and fragile recovery into more rapid, balanced, and sustainable growth; this is a marathon not a sprint.

More ambitious, carefully tailored policies are needed

Growth dynamics have diverged not only across but also within some of the country groups, while recent market pressures on *EMEs*—which have affected countries with larger imbalances more strongly—have highlighted the importance of sound macroeconomic fundamentals. Against this background, policymakers will have to take bold measures to navigate the recovery and avoid growth disappointments. With space for supportive macroeconomic policies narrowing in many countries, the role of structural reforms as a policy lever will have to increase.

Monetary Policy

The impending unwinding of monetary accommodation carries operational and communication challenges that need to be carefully managed.

Advanced economies should generally maintain an accommodative stance

Remaining economic slack and ongoing fiscal consolidation argue for continued demand support from monetary policy.

More easing, including through unconventional measures, is needed in the *euro area* to raise the prospects of achieving the ECB's inflation objective. The Bank of Japan should persist with its aggressive quantitative easing policy.

Continued tapering of large-scale asset purchases by the Federal Reserve remains appropriate. Effective communication of the unwinding of unconventional monetary support, including forward guidance, will continue to be important to reduce the risk of excessive market volatility.

Enhanced cooperation between central banks and financial regulators can help limit the risk of swings in asset prices—including major currencies—and potential balance sheet implications.

A number of emerging and frontier market economies may need to tighten

Appropriate policies in *emerging and frontier market economies* will differ depending on their vulnerabilities.

- Countries that do not face inflationary pressures and have credible policy frameworks (*Chile, Peru, Thailand*) can use accommodative monetary policy to support domestic demand in response to growth slowdown. But elsewhere, policy rates may need to tighten (including in *Brazil, India, and Indonesia*) and policy frameworks may need to be strengthened to rein in inflation.
- The exchange rate should be allowed to respond to changing fundamentals and facilitate external adjustment. Intervention can help smooth foreign exchange rate volatility and avoid financial disruption if foreign reserve levels are adequate.
- In case of distress in local bond and money markets, the authorities should be ready to provide liquidity to ensure their orderly functioning.
- Capital flow management measures, though an option in certain circumstances, should not substitute for warranted macroeconomic adjustment.

LICs should lock in recent disinflation gains

In most *LICs*, where inflation has been converging to rates observed in *EMEs* and exchange rates remain stable, policymakers should focus on consolidating these gains and strengthening policy frameworks, mindful that sustained exchange rate depreciations—from softening commodity prices or moderating FDI inflows—may pose risks to the inflation outlook.

How will the IMF support the membership?

The Fund will continue to analyze the implications of unwinding extraordinary monetary support by major central banks, and assist members in developing responses to a potentially protracted increase in capital flow and asset price volatility, including macroprudential policies. In this context, the full range of financial facilities, including precautionary instruments, will remain available to members facing actual or potential market pressures.

Looking beyond near-term challenges, the Fund will continue to develop a conceptual framework for the role of monetary policy once financial conditions normalize, and will provide capacity building to strengthen monetary policy frameworks.

Fiscal Policy

Fiscal deficits and debt remain high in many countries and the challenge is to advance with consolidation while safeguarding growth.

Advanced economies need to calibrate the pace and composition of deficit reduction

After faster consolidation in 2013, the fiscal drag in advanced economies is appropriately expected to decline this year and next, although elevated fiscal vulnerabilities limit the scope for maneuver in some cases. In addition, in the *euro area*, low inflation poses risks to the fiscal outlook.

The expected shift toward more expenditure measures is welcome. Where revenue hikes are appropriate, tax base broadening and reduction of distortions should generally be the preferred option. If downside risks materialize, automatic stabilizers should generally be allowed to play and—if consistent with sustainability—growth-enhancing measures such as high-yielding public investment could be considered. Well-specified medium-term adjustment plans continue to be needed for *Japan* and the *United States*. In the *United States*, a more durable solution to the debt ceiling would also help address policy uncertainty.

Declining policy space and market volatility put a premium on consolidation in emerging and frontier markets

While some countries have room for fiscal maneuver, countries with large gross financing needs or debt burdens should act promptly to rein in deficits (*Brazil, Hungary, India, Jordan, Pakistan*). There is also a need for more scrutiny of contingent risks—including from high growth in private credit (*Brazil, China*), large shares of external funding in banks (*Hungary, Romania, Turkey*), vulnerabilities at the sub-national level (*Brazil, China, Pakistan*), and electoral cycles. Addressing rising demand for public services will require emphasis on mobilizing fiscal resources and increasing the efficiency of expending—including by curtailing untargeted subsidies.

Revenue mobilization and smarter spending are priorities for LICs

Fiscal space has declined as rapid—but not necessarily high-quality—spending growth has outpaced revenue mobilization in many countries (*Chad, Ethiopia, Ghana, Honduras, Lao P.D.R., Zambia*). LICs should take advantage of the continued resilience of their economies to strengthen fiscal positions and avoid a buildup of debt. In the face of volatile revenues and spending rigidities, the priorities are to increase revenue mobilization (including from natural resources) and the quality of spending (including from subsidy reform), while safeguarding social safety nets and growth-friendly investment.

ACTs should primarily focus on raising spending efficiency and equity

Arab Countries in Transition face considerable fiscal challenges, reflecting low revenue intakes and rigid expenditure structures (high wages and subsidies, low investment). With little space for deficit increases and a need to provide near-term support for their economies, public spending needs to be redirected toward public investment and targeted transfers (instead of generalized subsidies). Broadening the tax base, strengthening collection, and securing additional external official financing on affordable terms will also be important. To the extent possible, short-term policies should be anchored by medium-term fiscal frameworks to ensure sustainability.

How will the IMF support the membership?

The Fund will continue to work on policy options to support member countries in calibrating fiscal packages to reduce public debt overhangs, support potential growth and mitigate policy uncertainty. Activities will focus on the design of tax and spending reforms, on strengthening institutional arrangements and capacity, and on identifying risks to fiscal sustainability, including from contingent liabilities. Emphasis will also be placed on strengthening natural resource management, stepping up revenue mobilization in low-income economies, and addressing particular challenges faced by small and fragile states.

In addition, the Fund will finalize operational reforms to its debt limits policy, advance reform options on sovereign debt restructuring, and contribute to the global debate on international tax spillovers. The Fund will also provide policy advice on macro-critical issues related to aging, environmental changes, and inequality.

Financial Sector Policies**Policymakers should promote a smooth transition from liquidity- to growth-driven financial markets.****Efforts to reform the global financial regulatory system should be stepped up**

Priorities are: resolving the too-important-to-fail problem, including implementing effective cross-border resolution of systemically important firms; completing the regulatory reform agenda, including further work on risk weighting and accounting convergence; finding ways to address shadow banking risks; and making derivatives markets safer. Inconsistent cross-border approaches, especially with regard to various national structural initiatives need to be actively tackled to avoid increasing global financial fragmentation.

Addressing fragmentation and guarding against risks from easy liquidity are priorities for advanced economies

In the *euro area*, policies taken are helping to address internal fragmentation, but completing the banking union remains critical. Rigorous asset quality review, followed by determined balance sheet repair (including through restructuring distressed corporate loans), is essential to restore credit. In the *United States*, supervisors need to be vigilant to rising corporate leverage and weakening underwriting standards in the context of prolonged monetary accommodation. In addition, it is important to continue monitoring rising redemption risk in credit products and declining secondary market liquidity that could amplify shocks.

Emerging and frontier markets need to adjust to less buoyant financial conditions

Large, sudden exchange rate depreciations may impact balance sheets and cash flows, particularly for domestically-oriented firms and banks that rely on foreign-currency financing. Stronger regulation and supervision are needed to address credit and profitability problems related to exchange rate and capital flow risks. Regulatory authorities also need to ensure that banks maintain adequate buffers to guard against difficulties in the event of further balance sheet stress in the corporate sector. Rapid credit growth in some countries—including through shadow banking and municipal borrowing in *China*—should be closely monitored and corrective action taken as needed.

Deepening markets and strengthening supervision are priorities for LICs

In *LICs*, measures to develop and broaden access to debt markets and other financial products would widen domestic borrowing options, enabling counter cyclical fiscal adjustment when needed and supporting greater effectiveness of monetary policy. There is also a general need to build capacity and strengthen financial sector supervision.

How will the IMF support the membership?

The Fund will continue to assess the global impact of regulatory fragmentation and extra-territoriality, advance the agenda on cross-border resolution regimes, and undertake—with the *Financial Stability Board (FSB)* and standard setters—work on shadow banking systems, including their determinants, impact on financial stability, and the role of policymakers. Moreover, joint work is planned with the *World Bank* and the *FSB* on a methodology for *Key Attributes of Effective Resolution Regimes*, and on assessing spillovers on *EMDCs* from structural measures and other regulatory reforms.

The Fund will also advise on potential macro-financial risks and policy responses; offer technical assistance and training on financial sector oversight by focusing on macro-prudential policy, supervision, and crisis management frameworks; and continue to address data gaps, including through the *G-20 Data Gaps Initiative* and implementation of the *Special Data Dissemination Standard Plus*.

Structural Reforms

Measures to strengthen medium-term growth and to make it more sustainable and inclusive are required across all country groups.

Higher, well-prioritized investment is needed to increase potential output

More public and private investment to address supply bottlenecks is essential in many *EMDCs* (*Brazil, India, South Africa* and across *ASEAN* countries), while some advanced countries should upgrade their existing infrastructure networks (*Germany, United States*). Reducing policy uncertainty would also contribute to lift investment.

Many *EMDCs* need to improve their business and regulatory environments to create better investment conditions and promote private sector led structural diversification. Capacity building to strengthen budget management in the public sector is also needed to support high-quality public investment.

Deepening financial markets is necessary in many *EMDCs* to help sustain medium-term growth. In *China*, where a credit and investment boom has led to emergence of excess capacity, reforms to liberalize the financial sector are needed to improve access and the allocation of credit.

In the euro area, there is also a pressing need for policies to overcome the corporate debt overhang and restore credit flows, particularly in the stressed economies.

Reforms of labor, product, and services markets are key to improve competitiveness

Inclusive labor market reforms are important, particularly for countries where participation of female and older workers needs to increase to counter the effects of aging (*Germany, Japan, Korea*) or where significant parts of the population, especially the youth, are underemployed or unemployed (*Italy, Spain, South Africa*, and many *Middle Eastern and North African* countries).

In *Japan*, the yet-to-be-fired third arrow of *Abenomics* should include more concrete measures on deregulation, particularly in agriculture and services. Across *Europe*, policy priorities include the streamlining of tax systems to improve growth incentives, and the opening of product and services markets to more competition (in particular through the targeted implementation of the *EU Services Directive*).

Strengthening effective, accountable, and rules-based market institutions and removing excessive entry and exit barriers remain important to enhance competitiveness in many *EMDCs*.

How will the IMF support the membership?

The Fund will undertake further analytical work on the interactions between structural reforms and public finances, the importance of financial deepening in supporting growth, the impact of regulatory reforms on long-term financing for infrastructure and SMEs (jointly with the *FSB, World Bank* and *OECD*), and policy options for dealing with the corporate debt overhang in Europe.

For *ACTs*, the analytical focus would be on medium-term growth prospects, including benefits of economic diversification, as well as the link between revenue mobilization, growth and equity. For *LICs*, work will center on ways to broaden economic growth and putting in place policy frameworks that enhance stability through structural transformation and diversification. In this context, two conferences co-hosted by the Fund in Maputo and Amman will discuss challenges faced by *Sub-Saharan Africa* and *ACTs* respectively, and explore policy strategies to foster inclusive growth.

Capacity development will include a focus on improving the coverage and quality of macroeconomic data in *LICs* and facilitating regional integration initiatives. Delivery will take advantage of innovations such as online learning.

Policy Cooperation and Coherence

Subpar growth and repeated bouts of market volatility underscore global interconnectedness and the importance of members working together.

Cooperation at home and across borders can support future growth prospects and limit policy risks

Close cooperation among domestic policymakers can enhance the coherence of the macroeconomic policy mix. In particular, credible medium-term fiscal consolidation plans and structural reforms can ease the burden of monetary policy in supporting demand, reducing financial stability risks.

International policy cooperation can help deliver stronger, more balanced and sustainable growth, including by reducing risks of negative cross-border policy spillovers, as well as subsequent spillbacks to source countries.

- As recent staff work has shown, a joint reform effort to address policy gaps could substantially increase world output in the medium term.
- Moreover, dialogue between financial supervisors in advanced and emerging market economies can reduce the risk of disruptions of cross-border liquidity and credit provision that would hurt the recovery.
- The challenges associated with the unwinding of unconventional monetary policies call for wider central bank discussions of their plans, forward guidance, and contingencies for liquidity support should financial stability be jeopardized.
- Finally, policymakers should come together to prevent fragmentation of the global financial regulation, as uncoordinated national initiatives may lead to inconsistencies and regulatory arbitrage across jurisdictions.

Further actions by surplus and deficit countries are needed to sustain global rebalancing

During 2013, undervalued currencies generally appreciated in real terms and overvalued currencies depreciated. While global current account imbalances have appreciably declined since the crisis, this reflects in part weak demand in advanced economies and changing energy trade. To avoid a reversal, surplus countries need reforms to boost or rebalance domestic demand (*China, Germany, Korea*), while deficit countries should focus on steps to boost external competitiveness (*France, South Africa*) and remove supply bottlenecks (*Brazil, India*).

How will the IMF support the membership?

Through integrated surveillance (including cluster-based Article IV consultations), the Spillover Report, and analytical work to strengthen the understanding of feedback channels, the Fund will continue to promote that source countries internalize their policy spillovers and spillbacks.

Work will also focus on refining the external sector assessment methodology and better integrating the annual Spillover and Pilot External Sector reports, and staff's vulnerability analysis with other surveillance outputs.

Specific analysis is planned on the macro-financial implications of financial sector interconnectedness, including among *Central American countries*, and in the *Caribbean*. The Fund will also make a number of analytical contributions to the multilateral policy dialogue, including in the context of the G-20.

Figure 2. Policy Priorities of the Spring 2014 GPA

| Members | | | |
|--------------------------------------|---|---|--|
| Euro Area | Further monetary easing | Address fragmentation and architectural gaps | |
| United States | Continue taper with clear communication | Medium-term fiscal plan | |
| Japan | Medium-term fiscal plan | Product and labor market reforms | |
| China | Rebalance demand | Reign in shadow banking and municipal borrowing | |
| Emerging and Frontier Markets | Adjust policies flexibly to market volatility | Address growth impediments | |
| Low Income Countries | Consolidate inflation gains | Increase revenue mobilization and optimize spending | |
| Arab Countries in Transition | Raise spending efficiency | Increase revenues | |
| IMF | | | |
| Monetary Policy | UMP spillovers and spillbacks | Future monetary policy frameworks | |
| Fiscal Policy | Options to reduce debt overhangs | Reform of debt limits policy | |
| Financial Sector Policies | Impact of regulatory fragmentation | Cross-border resolution and shadow banking | |
| Structural Reforms | Economic diversification | Financial deepening | |
| Policy Cooperation/Imbalances | Integrated surveillance | Refining external sector assessments | |

STRENGTHENING THE FUND

To remain relevant and effective, the Fund must continue to evolve and adapt to the challenges posed by a rapidly changing global economy.

Implementation of quota and governance reforms remains an absolute priority

The delay in making effective the 2010 reform package is utterly disappointing. The IMF remains fully committed to support the implementation of the 2010 reforms and to finalize the 15th General Review of Quotas. These reforms are essential to ensure the continued legitimacy, relevance, financial strength, and effectiveness of the Fund.

Next steps will build on the advice of the Chairman of the International Monetary and Financial Committee (IMFC) in his consultations with the membership regarding available options to complete the current round of the quota and governance reform process, with the objective of completing the 15th Review by January 2015.

The 15th Review is expected to result in further increases in the quota shares of dynamic economies in line with their relative positions in the global economy, and hence likely in the share of emerging market and developing countries as a whole, while steps will be taken to protect the voice and representation of the poorest members.

Work on entrenching a learning culture and enhancing diversity is ongoing

The Fund is committed to continuous learning through policy reviews and ex-post evaluations, the implementation of recommendations made by the Independent Evaluation Office, and dialogue with the membership and other stakeholders. The Triennial Surveillance Review, to be completed later this year, will assess progress in strengthening bilateral and multilateral surveillance.

Maintaining a diverse, highly skilled, and committed workforce that adjusts to new challenges and changing demands is critical for the Fund's continued

relevance. The corporate workforce planning strategy prepared in 2013 will continue to guide efforts to maintain adequate flexibility, better demographic balance, and a strong knowledge base of Fund staff.

Ongoing efforts to strengthen diversity through recruitment are paying off. In 2013, 40 percent of mid-career hires and two-third of graduate hires through the Economist Program were from underrepresented regions, over half of the participants in the Economist Program and the Fund’s Internship Program were women, and the majority of the Economist program recruits were from the universities outside the United States.

Efforts to align Fund activities with the needs of the membership will continue

The IMF’s strategic management framework is anchored by the GPA and a set of key goals for the institution. These tools guide the budget process and ensure that spending evolves in line with strategic priorities.

In the last few years, internal resources freed from declining work on lending programs and post-crisis reforms to Fund policies and facilities (recorded in the output category “oversight of global systems”) have been re-deployed toward crisis prevention through enhanced surveillance, including more modeling, risk and spillover work, and work on jobs and growth (Table 3). Moreover, following a significant fundraising effort to help satisfy unmet demand from the membership, capacity building has now become the single largest output of the Fund (Figure 3).

Looking ahead, the proposed FY2015–17 budget will maintain constant expenditures in real terms and facilitate a further reallocation of resources to priority areas of work. In addition, the Fund will continue to refine and strengthen its strategic management framework, including by incorporating analysis on long-term trends and uncertainties, and their implications for the Fund and its membership.

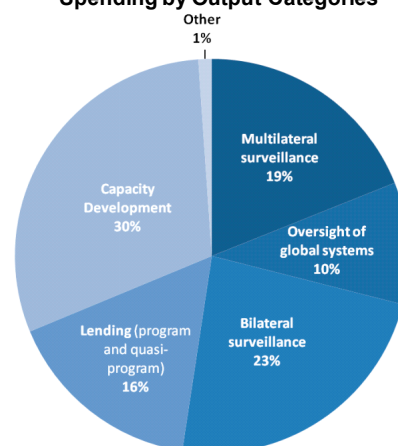
Table 3. Fund-Financed Spending by Output Categories

| | FY2011 | FY2014 Est | Change |
|--|--------|------------|--------|
| Multilateral surveillance | 22.2 | 23.3 | 1.2 |
| Oversight of global systems | 13.2 | 11.7 | -1.5 |
| Bilateral surveillance | 26.0 | 28.1 | 2.1 |
| Lending (program and quasi-program) 1/ | 21.9 | 18.7 | -3.2 |
| Capacity Development | 15.8 | 16.9 | 1.1 |
| Other | 1.0 | 1.3 | 0.3 |

1/ Includes activities associated with programs, debt relief, and non-financial instruments, such as Ex-Post Assessments, Policy Support Instruments, Staff Monitored Programs, etc.

Sources: Office of Budget and Planning, ACES.

Figure 3. Total (Fund and Externally Financed) Spending by Output Categories



Sources: Office of Budget and Planning, ACES.