

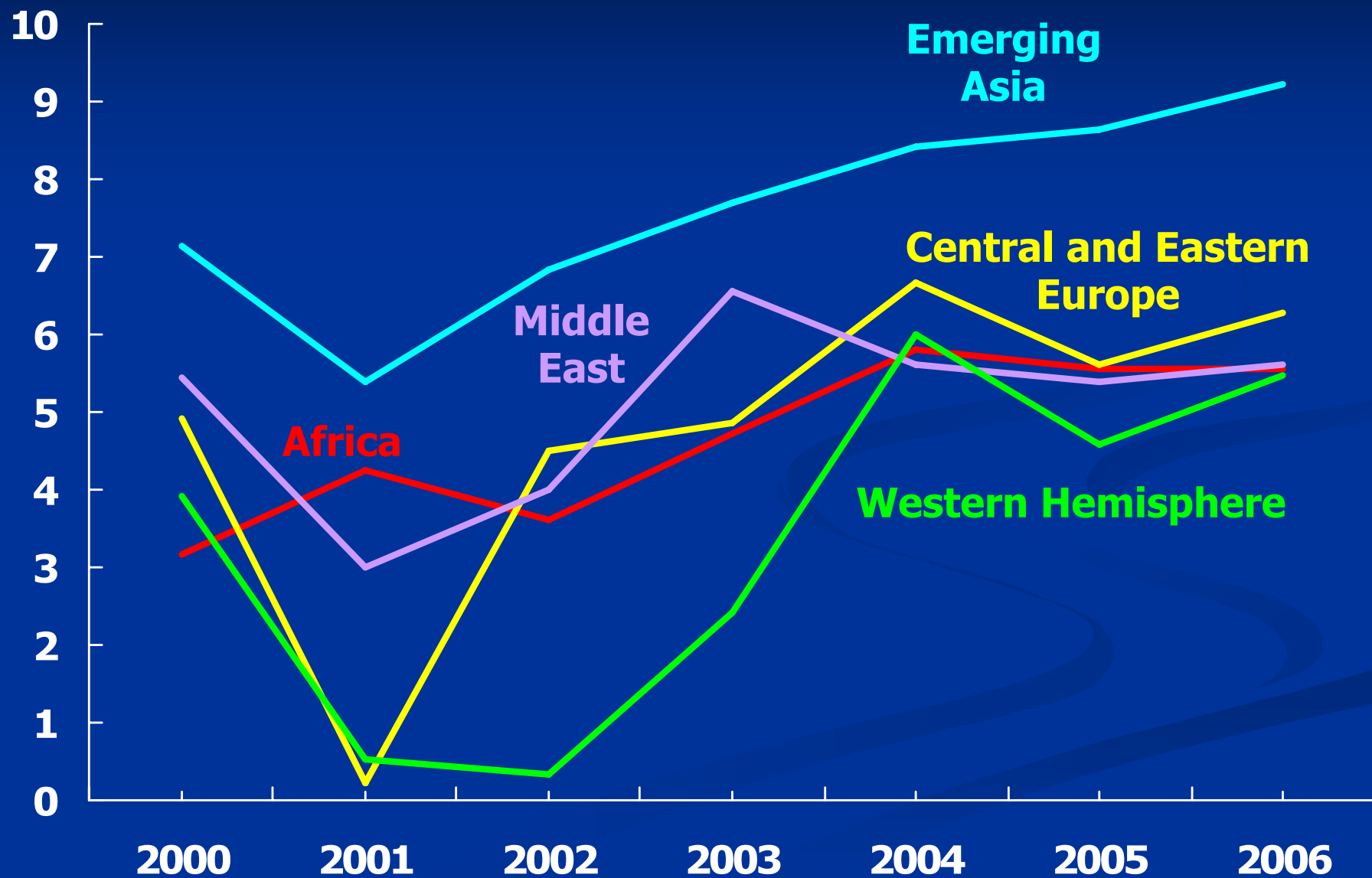
Challenges to the International Monetary System: Rebalancing Currencies, Institutions, and Rates

Takatoshi Kato
Deputy Managing Director
International Monetary Fund

September 30, 2007

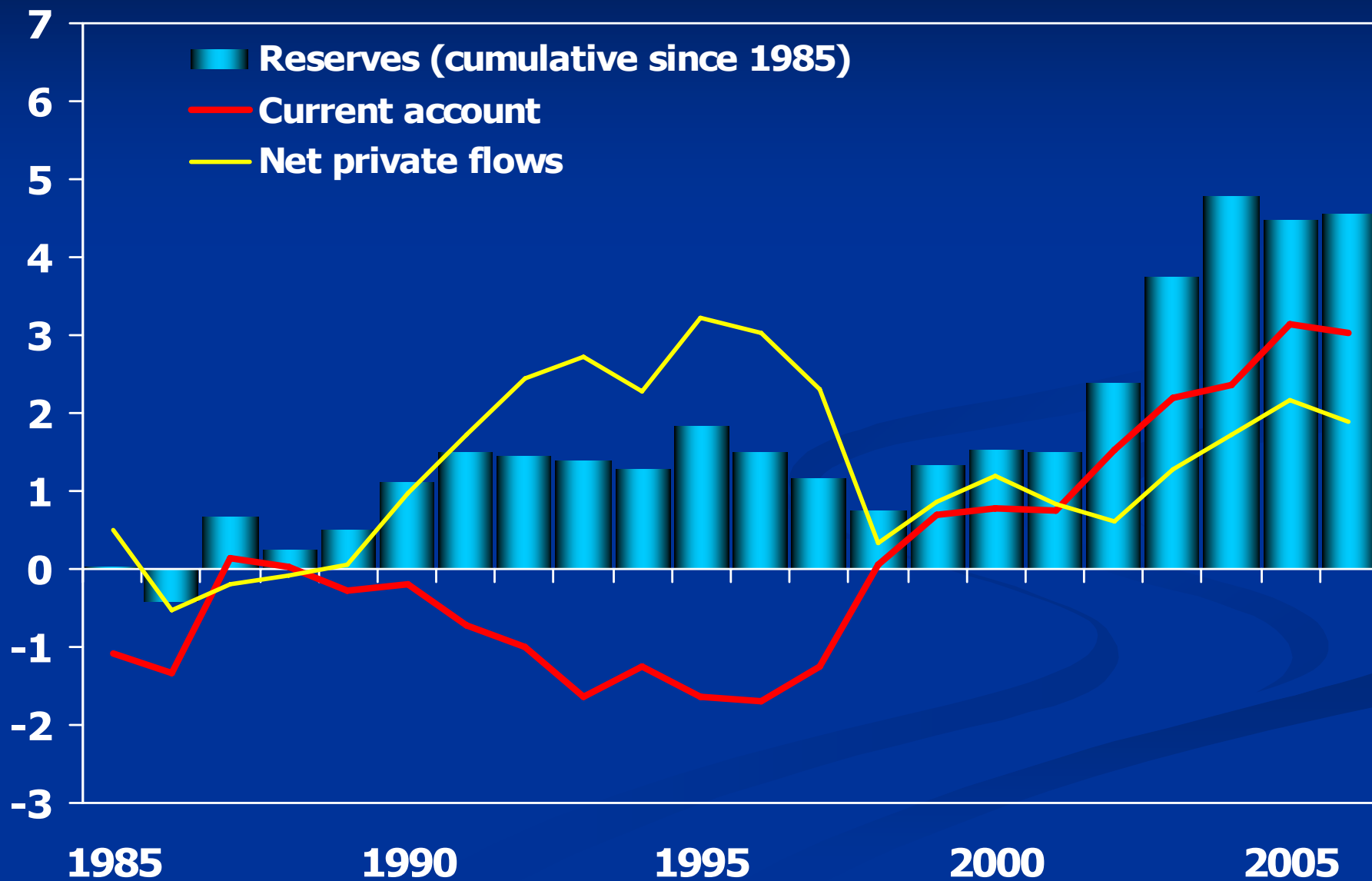
Growth has been Good Across All Regions of Emerging Markets and Developing Countries

(annual percent changes)



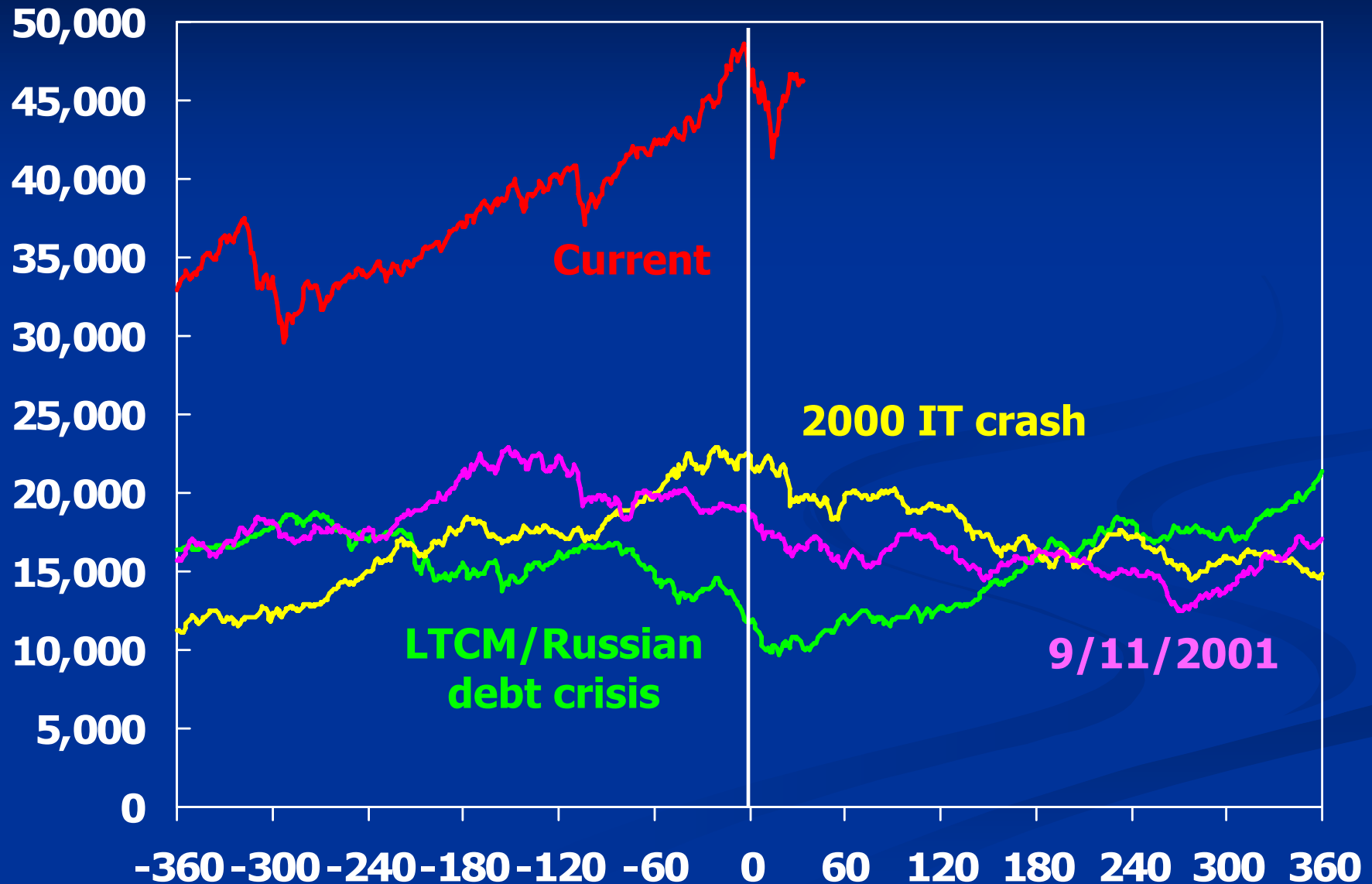
Strong Macro Fundamentals in Emerging Markets as a Whole

(Percent of total emerging market GDP)

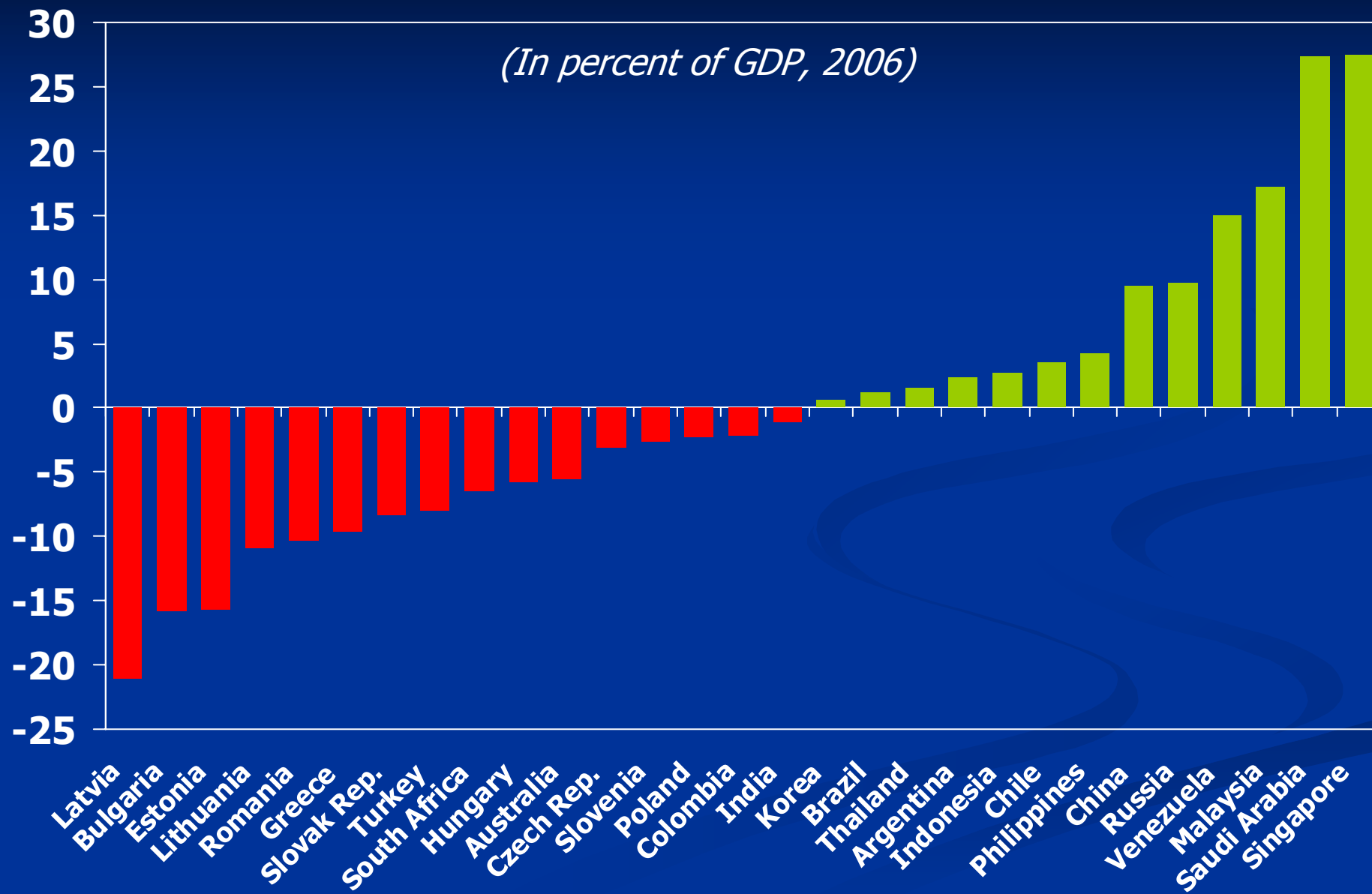


Emerging Market Stock Indices: A Moderate Correction So Far

(daily; Morgan Stanley Capital International)

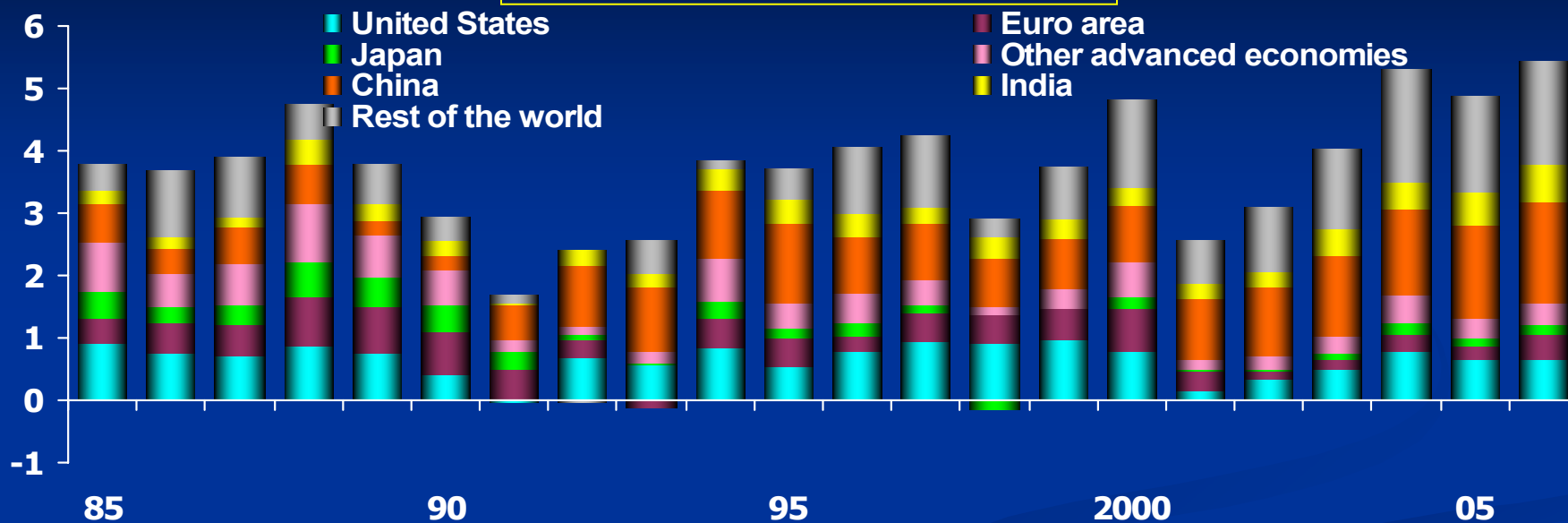


But are Large Current Account Deficits an Indicator of Vulnerability?

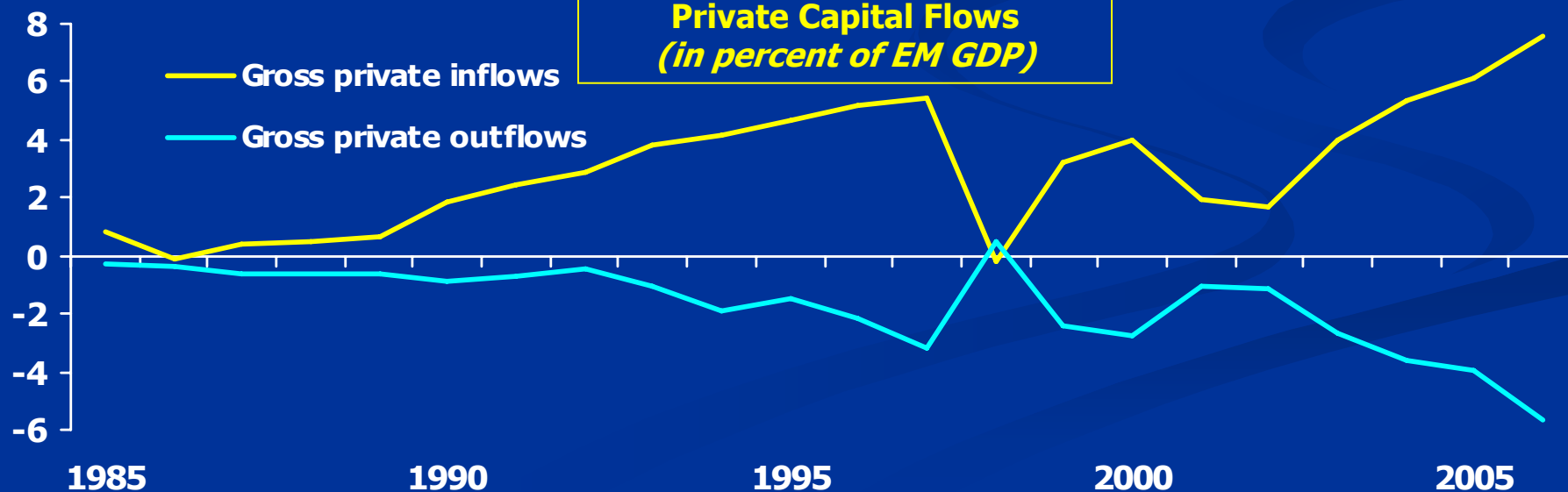


Global Growth and Financial Globalization

World GDP Growth (PPP Terms)
(Annual percent change)



Private Capital Flows
(in percent of EM GDP)



Spreads

(In basis points)



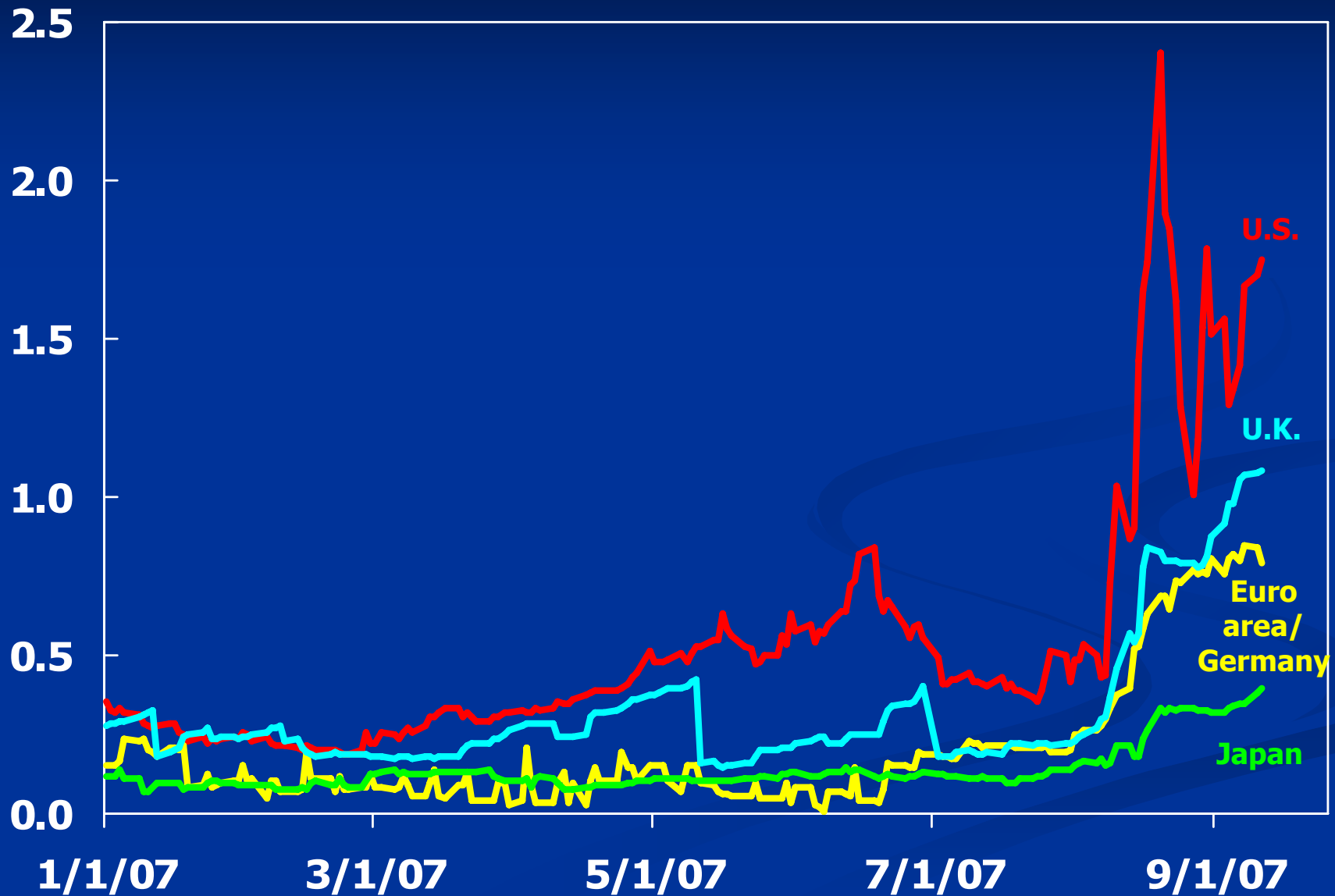
Financial Market Volatility

(in percent)



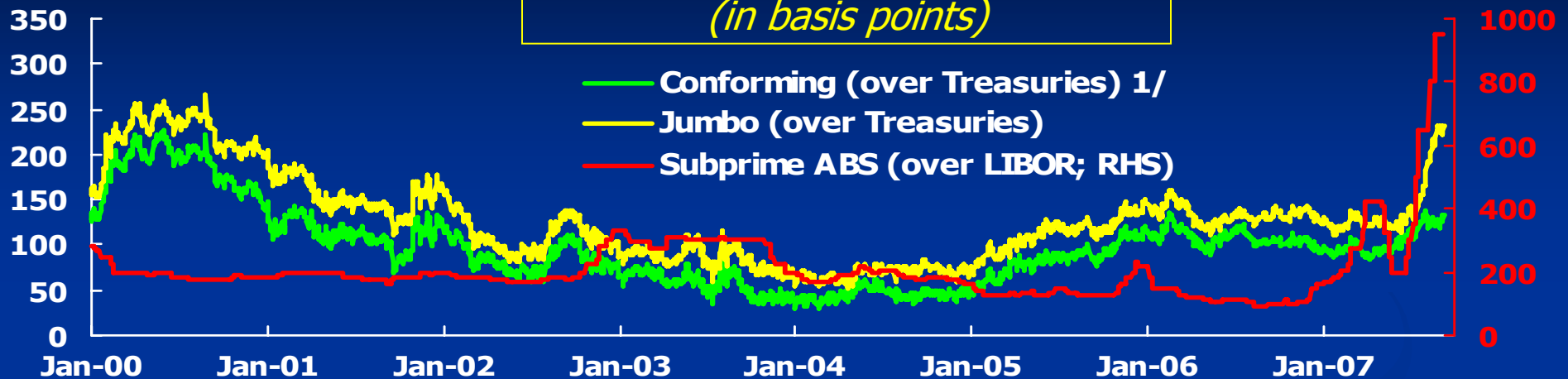
Short-Term Funding Markets

(3-month LIBOR minus T-bill rate)



U.S. Spreads Widening: How Much and For How Long?

Mortgage Spreads (in basis points)



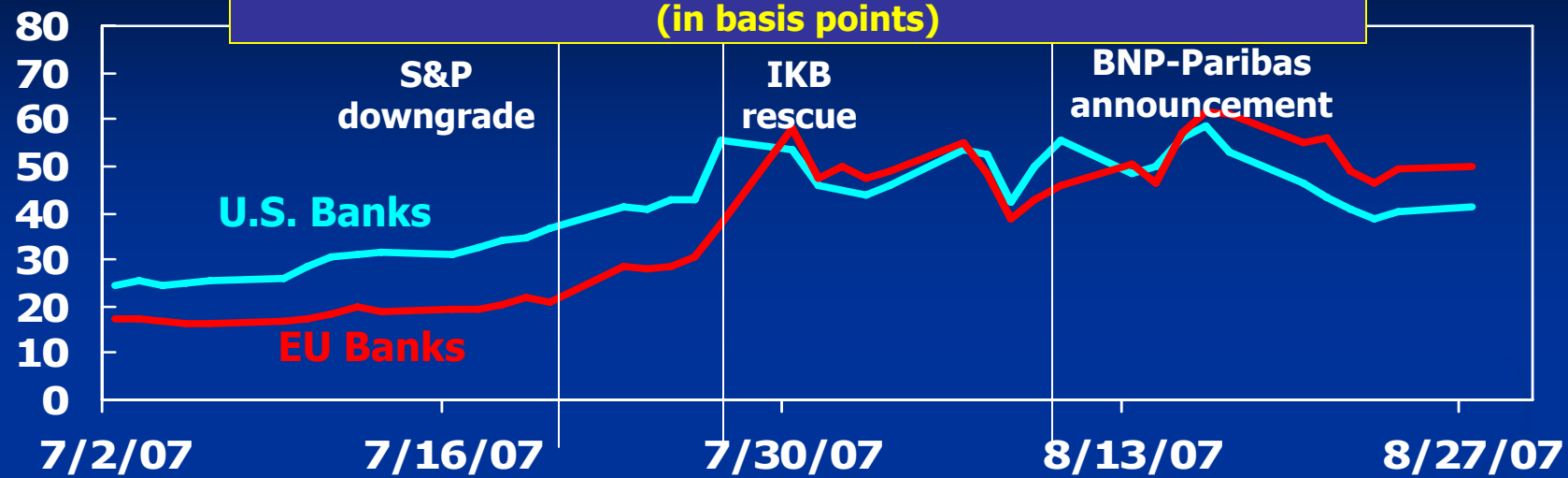
Corporate Spreads (basis points; over Treasuries)



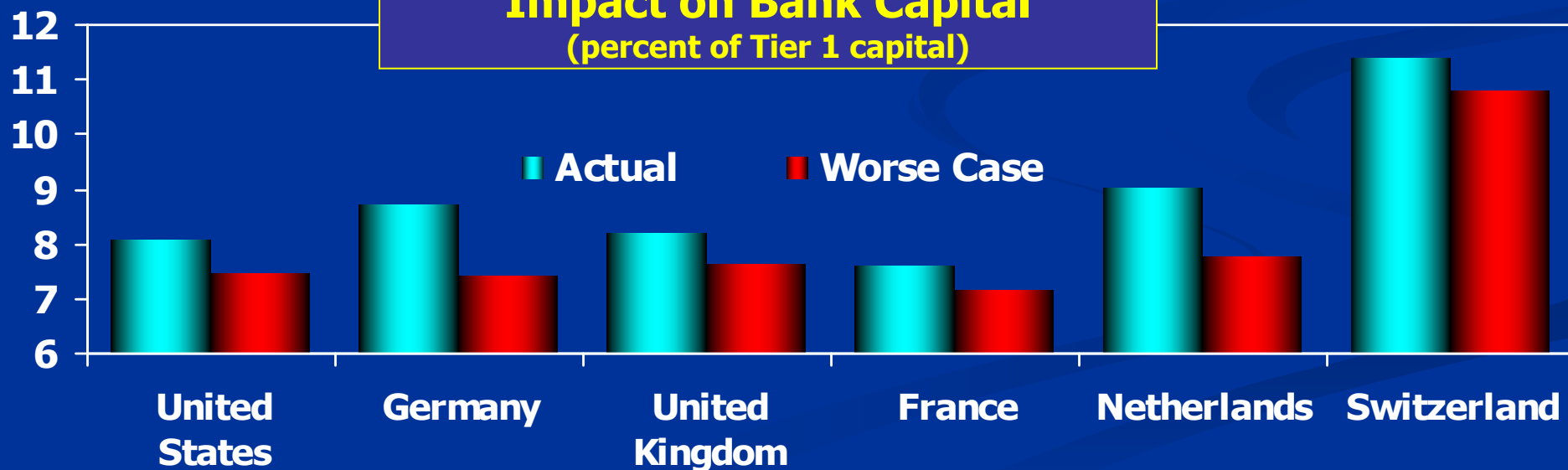
1/ Conforming loans have terms and conditions that follow the guidelines set forth by Fannie Mae and Freddie Mac.

Spreads for European Banks and Corporates Have Widened

CDS Spreads on Selected U.S. and EU Banks (in basis points)



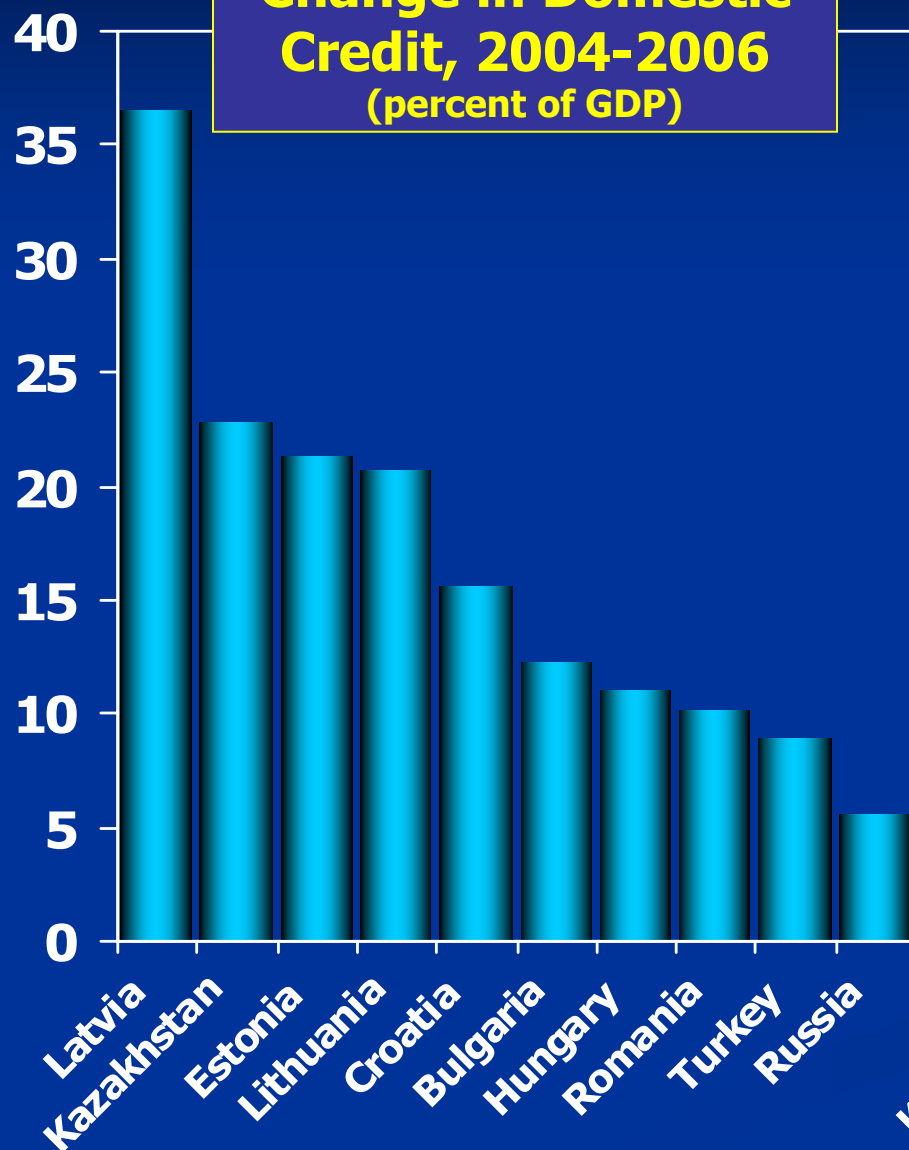
Impact on Bank Capital (percent of Tier 1 capital)



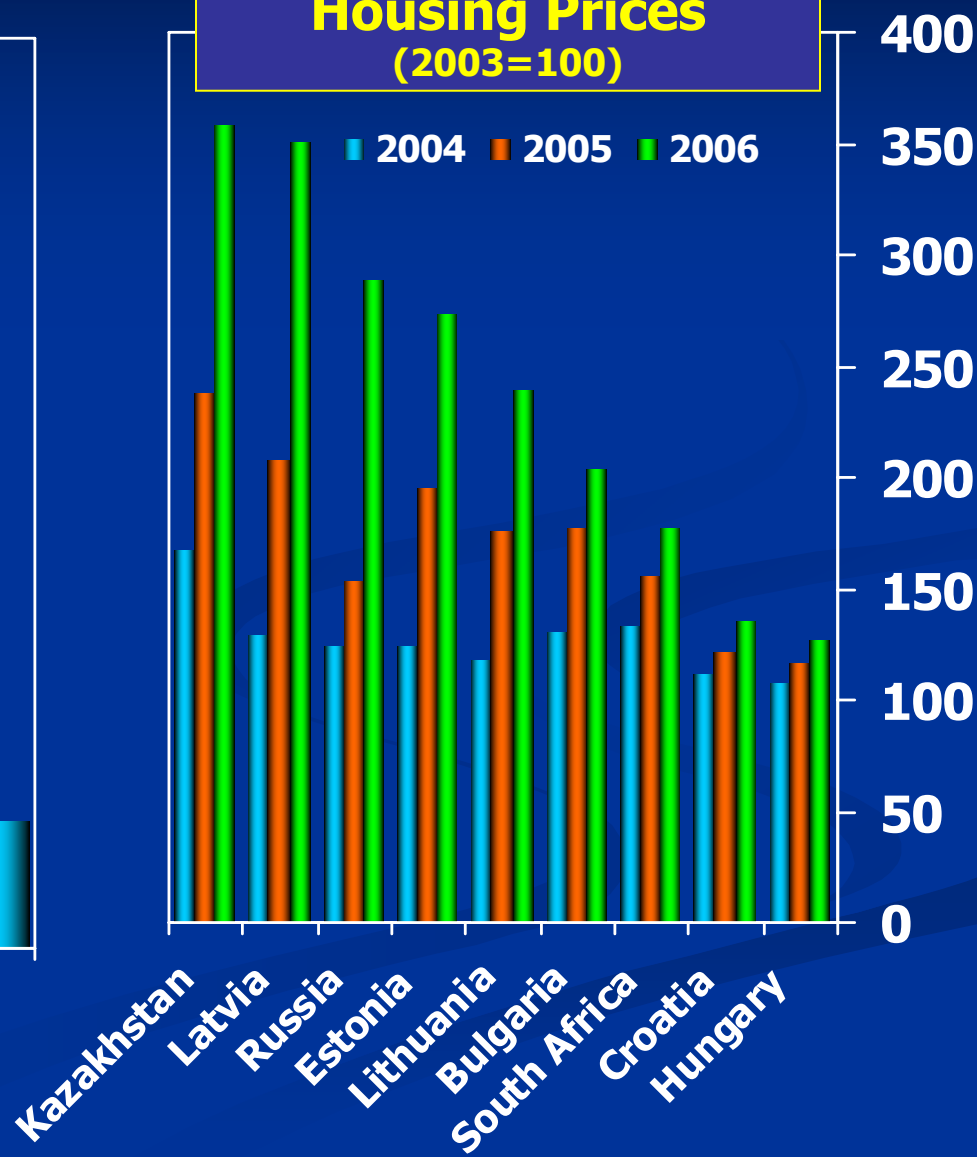
Source: Fitch Ratings, "Asset-Backed Commercial Paper & Global Banks Exposure—10 Key Questions", 9/7/07.

Large External Inflows to EMCs Have Financed Rapid Credit Growth and Asset Price Increases

Change in Domestic Credit, 2004-2006
(percent of GDP)

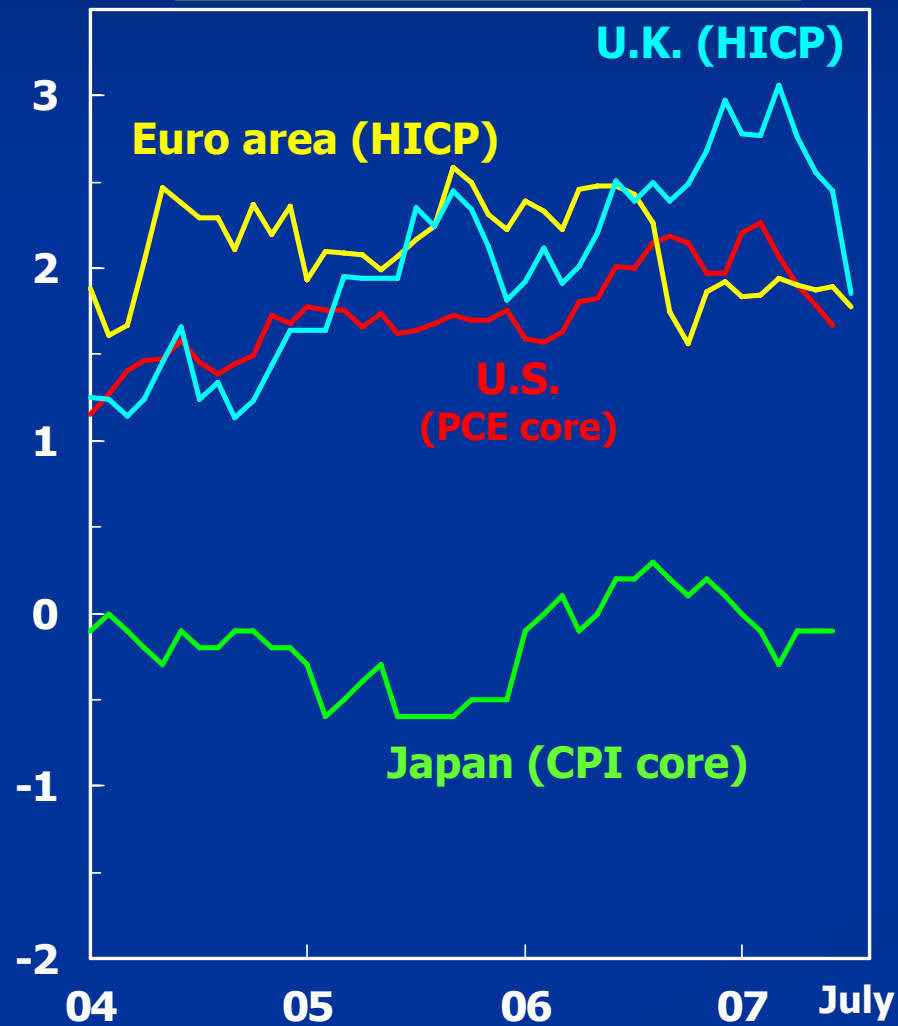


Housing Prices
(2003=100)

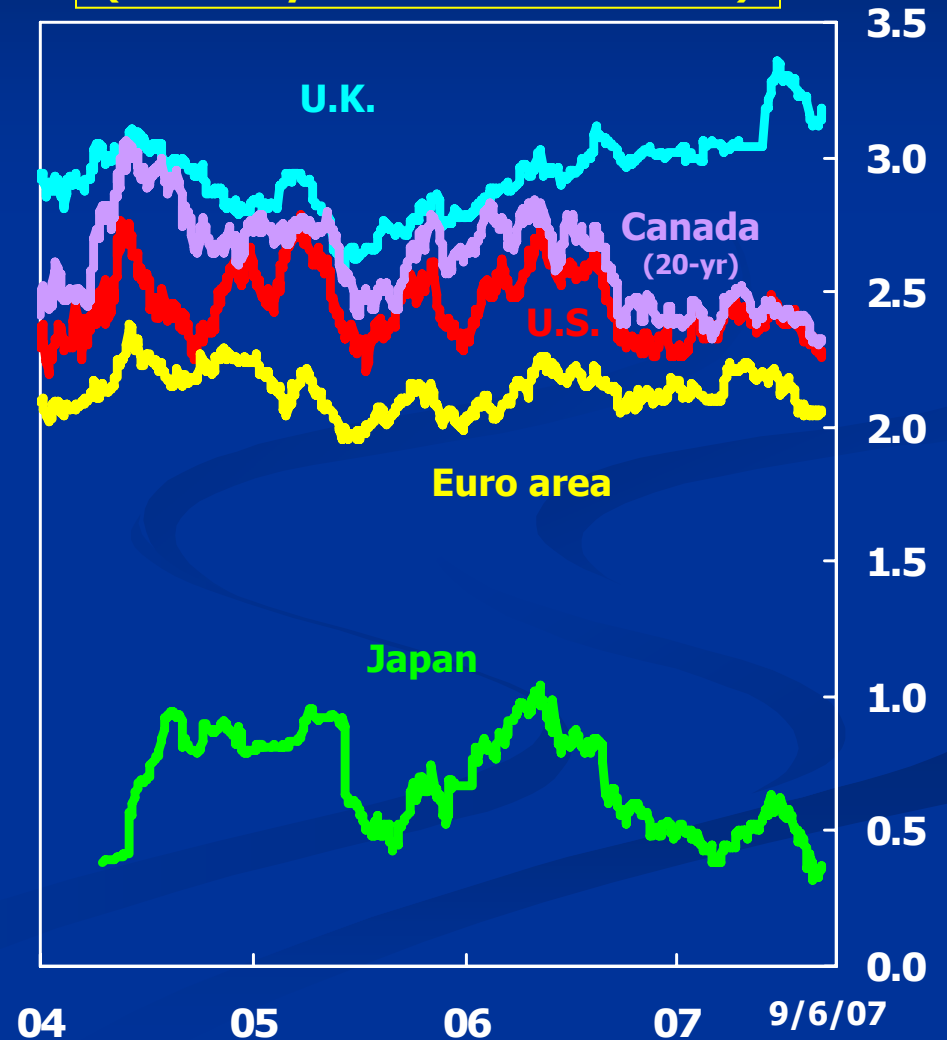


Inflation and Inflation Expectations

Inflation
(percent)

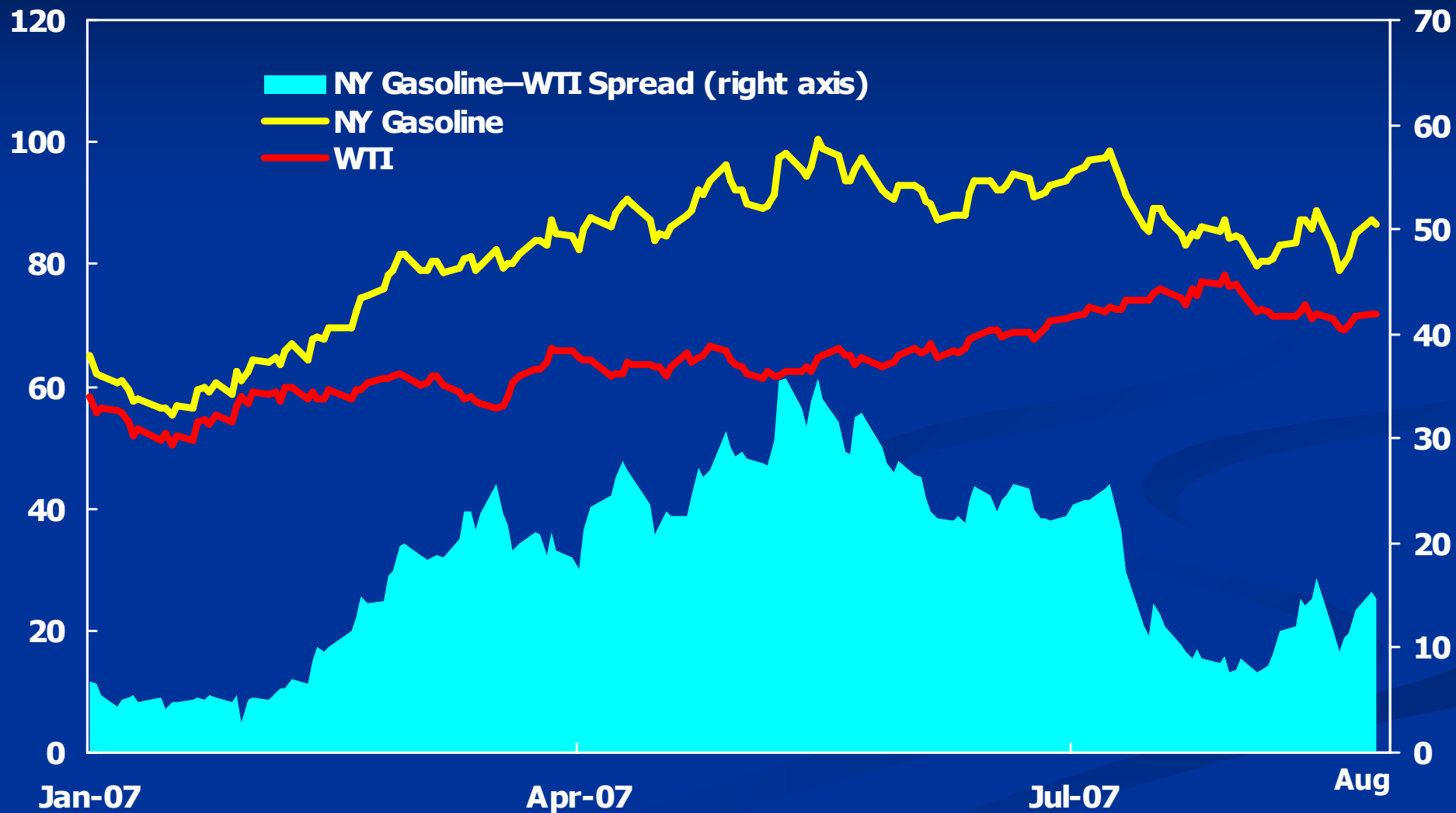


Inflation Expectations
(from 10-year index-linked bonds)



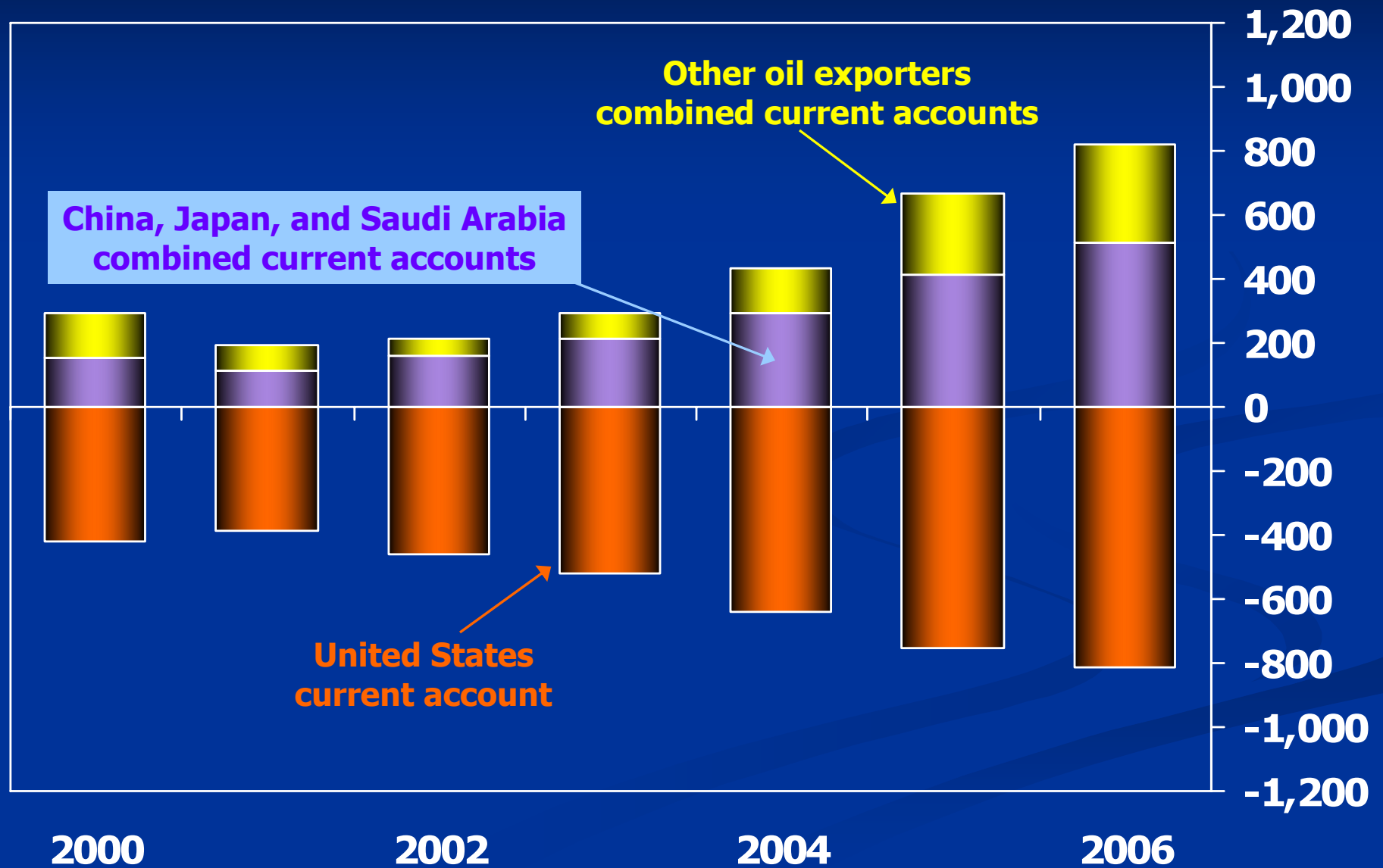
Oil and Gasoline Prices

(U.S. dollars per barrel)



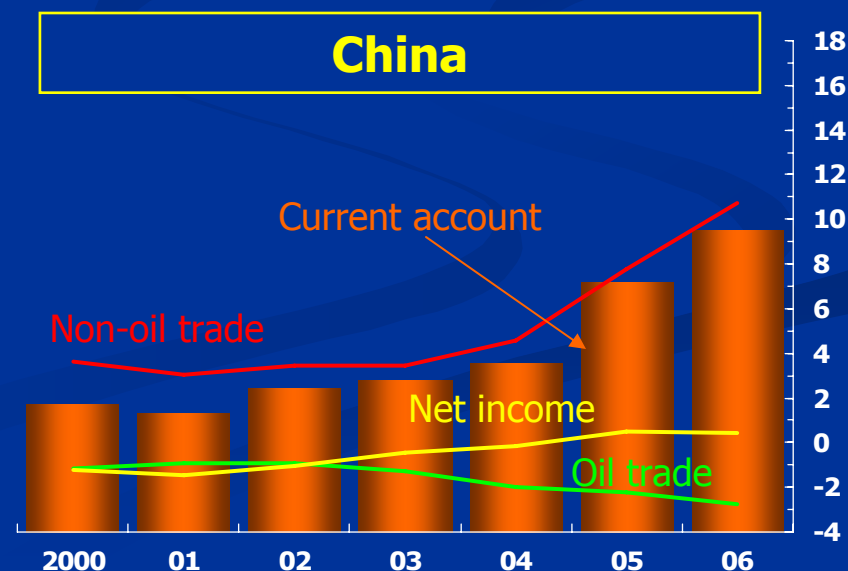
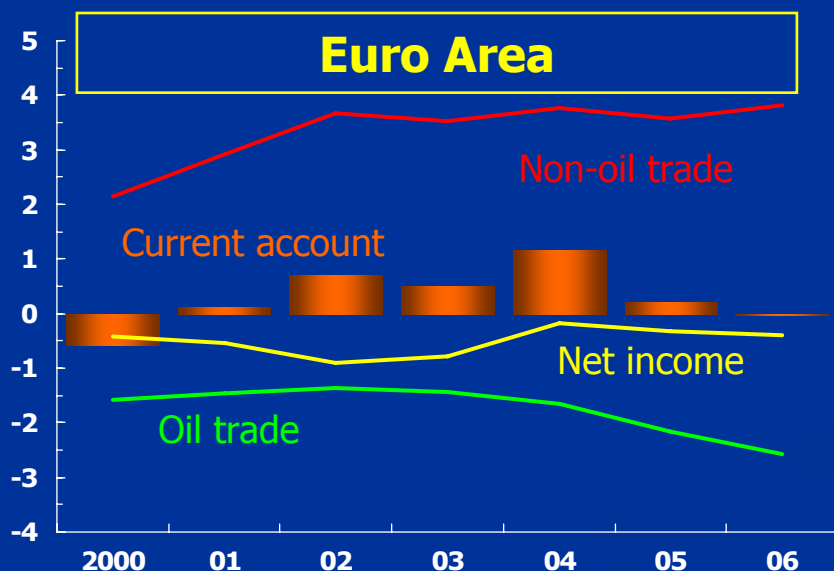
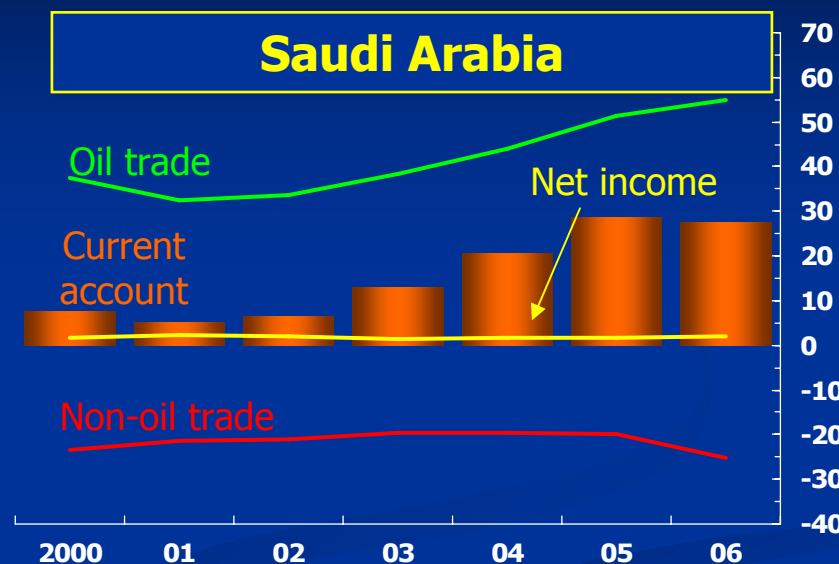
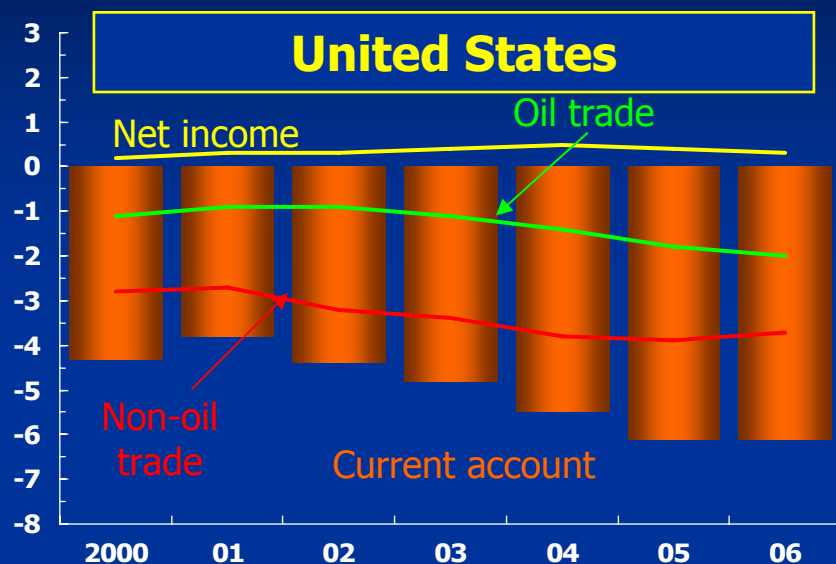
Key Current Account Surpluses may Persist, Even if the U.S. Deficit Narrows

(In billions of U.S. dollars)



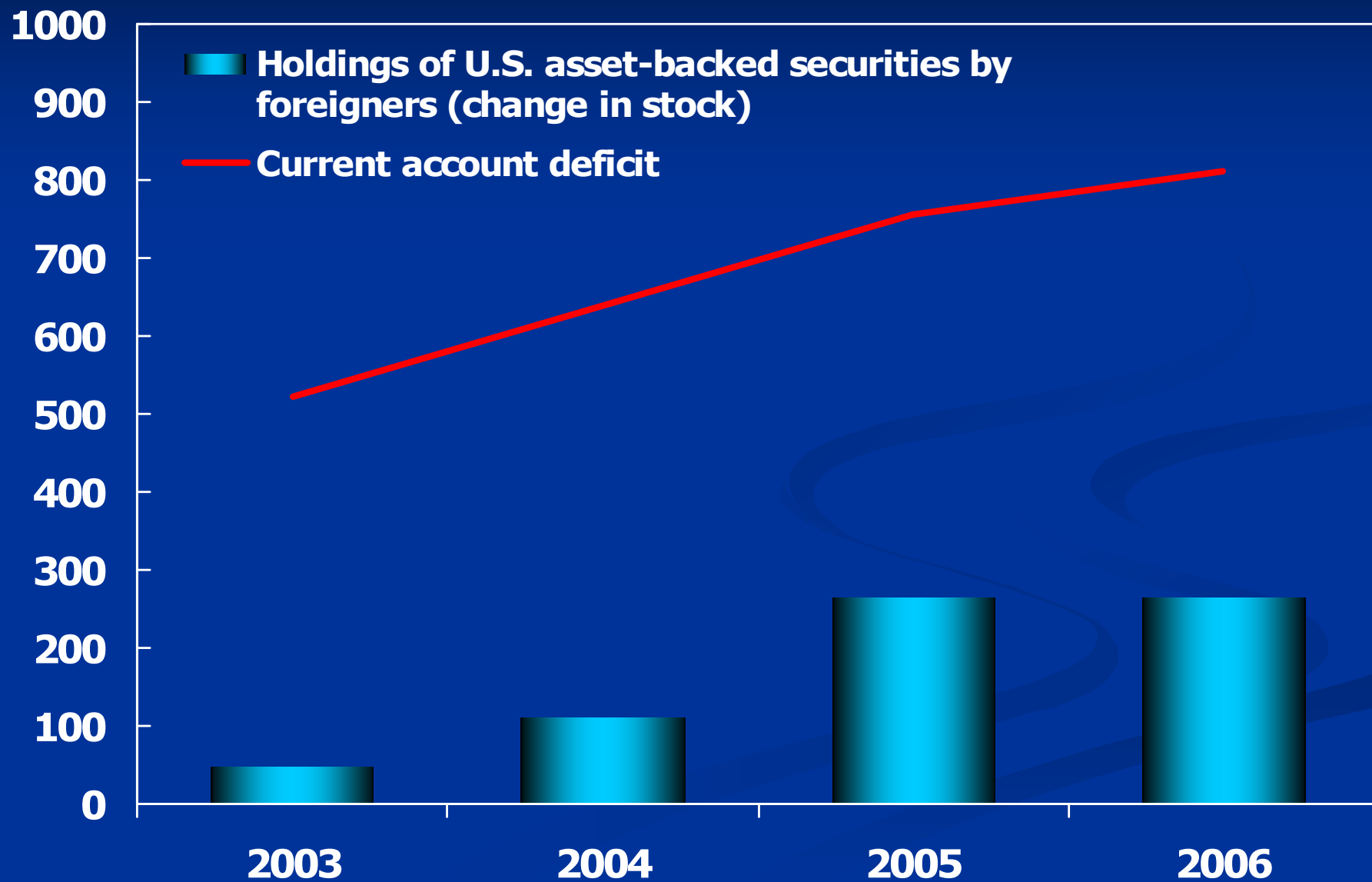
External Imbalances in Select Countries

(Percent of GDP)

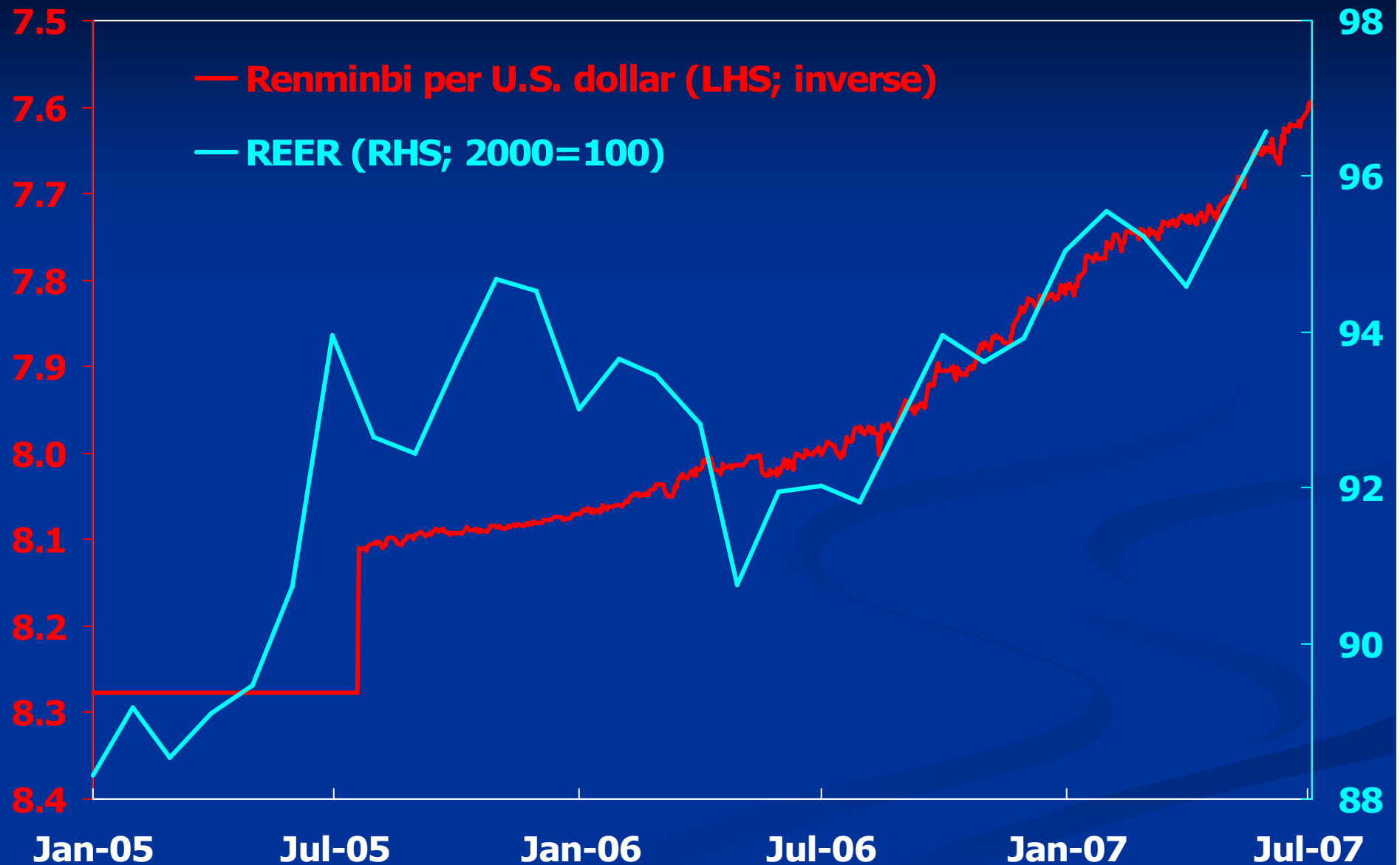


U.S. Current Account Financing

(in billions of U.S. dollars)

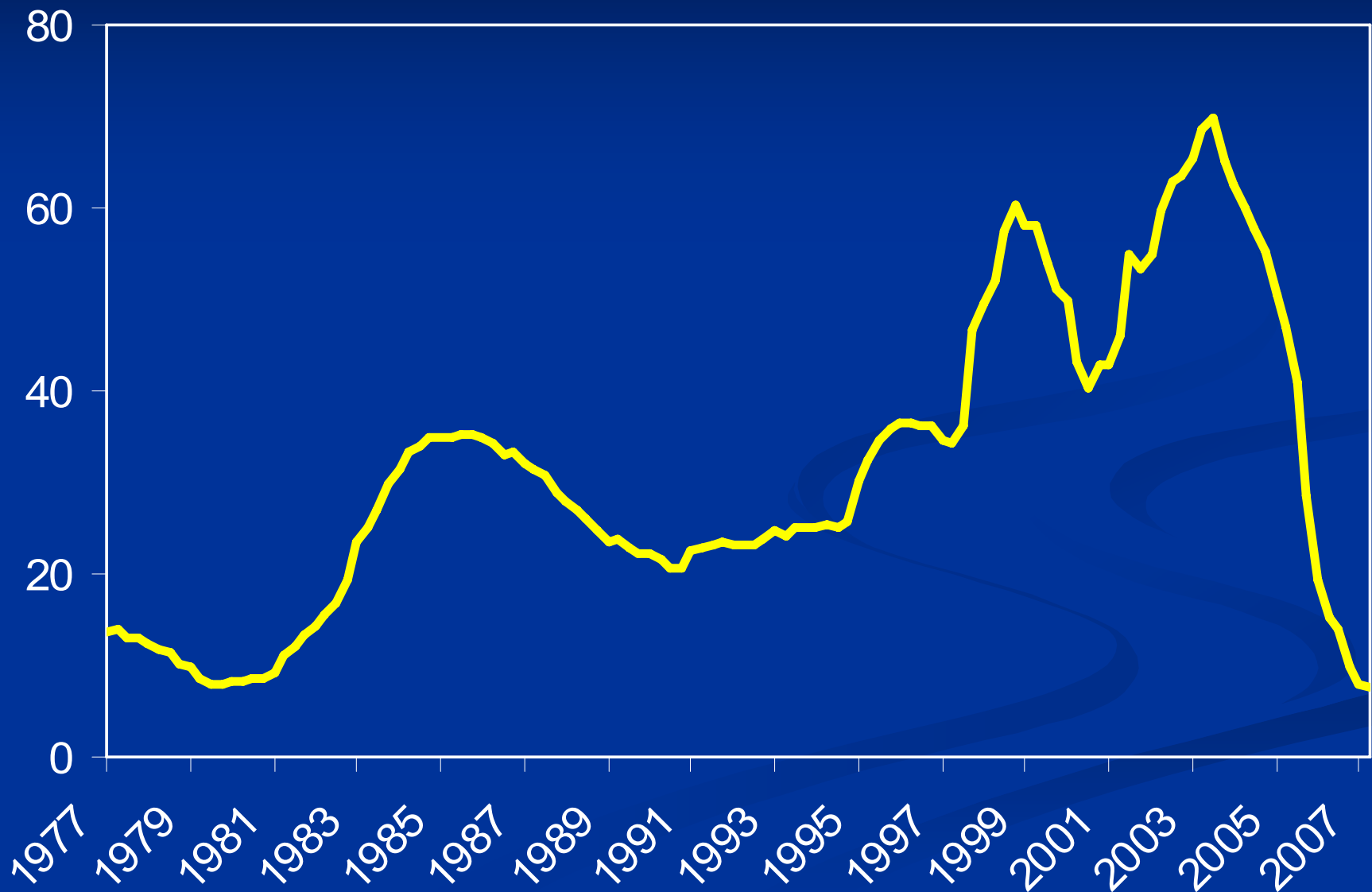


China: Bilateral and Real Effective Exchange Rate

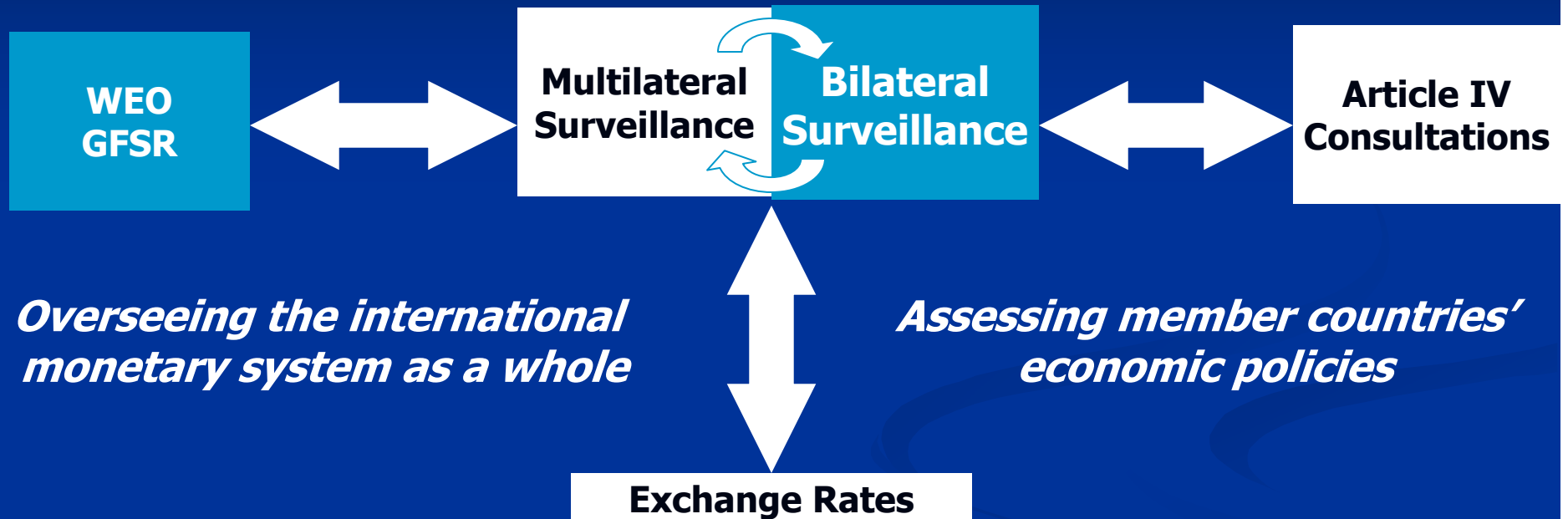


IMF Credit Outstanding in the General Resources Account

(In billions of SDRs)



IMF Surveillance



2007 Decision on Surveillance over Exchange Rates
Consultative Group on Exchange Rate Issues (CGER)

Fundamental Misalignment

- **Misalignment is likely to persist.**
 - **Is the underlying current account—stripped of temporary or cyclical factors—in equilibrium?**
- **Misalignment is significant.**
- **The judgment of “fundamental misalignment” needs to be “beyond any reasonable doubt”.**

CGER Methodology

- **Complementarity of three approaches.**
 - **Macroeconomic balance**
 - **Equilibrium REER**
 - **External sustainability**
- **In steady state, answers should be similar.**
- **This provides confidence in our assessments.**

But...

- **There are large margins of uncertainty around the CGER estimates.**

IMF Governance Reform Objectives

- **Realign quota shares with members' relative global economic weight**
- **Enhance the participation and voice of low-income countries**

IMF Governance Reform: Managing Director's Agenda

- **Integrated program approved by Board of Governors in Singapore:**
 - **Initial ad-hoc increases for a small group of clearly under-represented members**
 - **Second round of ad-hoc increases based on a new quota formula**
 - **Increase in Basic Votes**
 - **Additional resources for African Executive Directors**

Thank You