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Amid Credit Market Crunch, Calls for Stronger IMF

With market turbulence exposing fault lines in parts of the international financial system, the IMF wrapped up its 2007 Annual Meetings amid calls for the multilateral institution to strengthen its role as a global financial watchdog and revamp its governance.

Finance ministers and central bank governors from around the world met October 20–22 in Washington, D.C., for the IMF-World Bank meetings at a time of renewed concerns about the fallout from the U.S. subprime mortgage meltdown. Outgoing IMF Managing Director Rodrigo de Rato told delegates from the 185 member countries on October 22 that the resulting market turbulence was akin to "an earthquake in the credit markets."

The meetings also coincided with a watershed in global economic growth. Three major emerging markets—China, India, and Russia—now account for more than half of world growth, according to the just-released IMF *World Economic Outlook*.

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Chris Hondros/Getty

A sudden flight from risk, caused by the U.S. subprime mortgage meltdown, caused credit markets to seize up.

IMF Sees World Growth Slowing

World economic growth is expected to slow next year, with recent turbulence in financial markets triggered by the fallout from the U.S. subprime mortgage market clouding prospects, the IMF said in the October 2007 *World Economic Outlook* (*WEO*) released on October 17.

IMF Photo

Johnson: The greatest risk to world growth is continued turbulence in the financial markets.

Before the turbulence erupted in August, the global economy had been expanding vigorously, with growth running above 5 percent in the first half of 2007, according to the *WEO*. China's economy gained further momentum, growing by 11½ percent. India also continued to grow very strongly at more than 9 percent, and Russia grew by almost 8 percent. In fact, these three countries alone have accounted for one-half of global growth over the past year. Robust expansions also continued in other emerging market and developing economies, including low-income countries in Africa.

Rapid growth in the emerging markets counterbalanced continued moderate growth of about 2¼ percent in the United States in the first half of 2007, as the housing sector continued to exert considerable drag. Among the advanced economies,

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Strauss-Kahn Takes Over as New IMF Head

Former French Finance Minister Dominique Strauss-Kahn began his job as the new IMF Managing Director on November 1 determined to put fresh vigor into reform of the 185-member institution that oversees the global economy. He was welcomed with a handshake at the front door of the IMF by outgoing Managing Director Rodrigo de Rato.

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Subprime fallout clouding prospects

World growth is slowing but is expected to remain solid, supported by the strong momentum of major emerging markets.

(real GDP, annual percent change)

	2005	2006	Projected 2007	Projected 2008
World output	4.8	5.4	5.2	4.8
United States	3.1	2.9	1.9	1.9
Euro area	1.5	2.8	2.5	2.1
Germany	0.8	2.9	2.4	2.0
Japan	1.9	2.2	2.0	1.7
Africa	5.6	5.6	5.7	6.5
China	10.4	11.1	11.5	10.0
India	9.0	9.7	8.9	8.4

Source: IMF, *World Economic Outlook*, October 2007.

Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during August 22–September 19, 2007.

growth in the euro area and Japan slowed in the second quarter of 2007 after two quarters of strong gains.

Solid growth ahead despite turmoil

The IMF expects healthy growth to continue into 2008 (see table), with emerging market economies continuing to serve as the main growth engine of the world economy (see chart, next page). According to the latest forecast, global growth would slow from 5.2 percent in 2007 to 4.8 percent in 2008, down from the 5.4 percent rate registered in 2006. The largest downward revisions to growth are in the United States, and in countries where financial and trade spillovers from the United States are likely to be the largest.

In the United States, growth is now projected to remain at 1.9 percent in 2008, the same rate as in 2007 and a markdown of almost 1 percentage point compared with the IMF's previous projections. The U.S. economy grew by 2.9 percent in 2006. Ongoing difficulties in the mortgage market are expected to extend the decline in residential investment, while higher energy prices and weaker house prices are likely to dampen consumption spending, the IMF said. In the euro area, growth has been marked down to 2.1 percent in 2008, and in Japan it is now expected to be 1.7 percent.

In the emerging markets, economies are expected to continue to expand strongly, although growth is expected to slow from the heady pace of the past two years. The

Higher Food Prices Raise Questions About Biofuel

Commodity prices have risen sharply during 2007, with oil and a number of metal and food items setting new record highs. The rise in food prices raises questions about how to manage growing demand for biofuel.

Futures markets indicate that high prices are likely to continue over the medium term, providing incentives for a surge in biofuel production as a supplement to transportation fuels. This, together with droughts and animal disease, has pushed up food prices and inflation across the globe.

Using biofuel to supplement transportation fuels at modest blends—under current technology—has its pros and cons. Biofuel can supplement traditional fuels while contributing to rural development. However, until new technologies are developed, using food to produce biofuel might further strain already tight supplies of arable land and water all over the world, thereby pushing food prices up even more.

Realizing the potential benefits of biofuel requires better policies. Brazilian ethanol derived from sugarcane, for example, is less costly to produce than corn-based ethanol in the United States, and also yields greater environmental benefits. However, generous tax credits for blenders, tariffs on imported biofuel, and agricultural support for grain farmers in the United States and the European Union make it difficult for low-cost foreign biofuel producers to compete in these markets.

If tariffs and subsidies in the United States and EU were eliminated, biofuel would likely be produced largely by lower-cost producers such as Brazil and other Latin American countries. Similarly, under such a scenario, biodiesel would be produced mostly by Malaysia, Indonesia, India, and some African countries.

In sum, while we wait for more efficient fuel technologies to emerge, the first-best policy would be to allow free trade in biofuel. This would benefit the environment as well as make biofuel economically more viable. ■

Valerie Mercer-Blackman, Hossein Samiei, and Kevin Cheng
IMF Research Department

Chinese economy will grow by about 10 percent in 2008, according to the IMF, and growth will also remain buoyant in other emerging markets.

Risks tilted to downside

The IMF's projections are based on the assumption that market liquidity is gradually restored in the coming months. But there is still a distinct possibility that recent turbulent conditions could have a deeper effect on credit availability than envisaged by the IMF in its baseline scenario, with considerably greater macroeconomic impact. Mortgage lenders are already tightening lending standards, and if financing becomes less readily available, a sharper downturn in housing markets, which look richly valued in some parts of the world, is a clear possibility. Not only would this affect consumption and residential investment spending, but as delinquencies rise it would also hurt the balance sheets of mortgage lenders themselves.

Other risks are linked more specifically to the emerging markets. On the upside, the slowing in growth envisaged in the baseline projections in emerging Asia, particularly in China and India, may not materialize given the underlying strength of domestic demand. The main downside risk to emerging markets is that turbulence in global financial markets could disrupt capital flows to emerging markets and trigger problems

Sean Yong/Reuters

Optical fiber plant in Nanjing, China: Major emerging markets are now leading contributors to global growth.

in domestic markets. Countries in emerging Europe and in the Commonwealth of Independent States are particularly exposed because of their large current account deficits and reliance on bank-related inflows.

The IMF is also still concerned about inflationary pressures. Although such concerns have taken a backseat in advanced economies since the recent bout of financial market turbulence, inflationary risks are more immediate in emerging market and developing countries. Here, rising food prices, dwindling spare capacity, continuing high oil prices, and still strong foreign exchange inflows may mean that monetary policy needs to tighten further to contain inflation pressures. Global oil markets also remain very tight, and with spare capacity still limited, supply shocks or heightened geopolitical concerns could lead to further oil price spikes that could quickly translate into higher inflation.

Large global imbalances

Global imbalances also remain a worrisome downside risk. The U.S. current account deficit is projected to decline only slightly to 5½ percent of GDP in 2008. And while the current account surpluses of oil-producing countries are expected to come down as these countries ramp up spending, China's current account surplus remains very large.

Persistent large global imbalances raise two principal concerns:

- A disorderly depreciation of the U.S. dollar could have severe repercussions throughout global financial markets.
- Sustained large trade imbalances could prompt rising protectionist pressures.

In sum, the global economy has faced a significant test in recent months. Nonetheless, generally sound fundamentals should keep the global economy on course. So while growth in the coming months will be affected by the aftermath of the financial turbulence, at this stage it does not appear that the impact will be dramatic. ■

Tim Callen
IMF Research Department

Emerging Markets Now Main Engine of World Growth

China and India are now making the largest contributions to global growth, overtaking the United States as the world's main growth engine. Growth in emerging markets is expected to remain very strong in the period ahead.

The Chinese economy continues to grow at breakneck speed, making China the single most important contributor to world growth for the first time (see chart). China's economy is expected to grow by 10 percent in 2008.

Other emerging markets are also growing strongly. In 2007, India, China, and Russia accounted for more than one-half of global growth. Rapid growth in these and other emerging and developing countries is expected to counterbalance continued moderate growth in the United States.

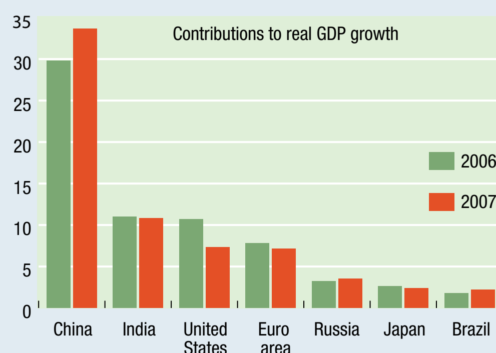
Emerging market countries are reaping the benefits of careful macroeconomic management and are benefiting from favorable external conditions, including high commodity prices. But there are risks.

The main downside risk is that continued turbulence in global financial markets could disrupt financial flows to emerging markets. This is particularly a concern in countries with large current account deficits and substantial external financing needs. But despite these and other risks, the IMF expects emerging markets to remain strong in the foreseeable future. ■

New driving force

The major emerging markets have become the main engines of world growth. For the first time, China and India are making the largest country-level contributions to global growth.

(based on PPP weights, percent of world growth)



Source: IMF staff calculations.

Calls for Stronger IMF

(from front page 193)

This development puts into sharp focus the intended reform to give emerging markets a bigger say in the IMF, where representation, as with many international institutions, still reflects a post–World War II balance of power.

De Rato stressed that the question now is whether the global economy has reached a turning point after five years of strong growth. The IMF is predicting that world growth will slow from 5. 2 percent in 2007 to 4.8 percent in 2008, compared with 5.4 percent growth in 2006. So far, the emerging markets have largely escaped the fallout from the U.S. and European credit crunch. In fact, de Rato noted, "emerging economies have become a source of stability in the global economy—something that would have been unthinkable a few years ago."

IMF Photo

IMFC in session (from left): IMF's John Lipsky, Rodrigo de Rato; IMFC's Tommaso Padoa-Schioppa; IMF's Shailendra Anjaria.

The Group of 24 developing countries also pointed out that "developing countries are a new driving force as well as a stabilizing factor in the world economy," and called on the IMF to strengthen its surveillance of financial systems in advanced economies.

Financial stability 'genies'

Tommaso Padoa-Schioppa, chair of the IMF's policy guiding committee—the International Monetary and Financial Committee (IMFC)—told reporters that although recent market turbulence had been countered by determined action by several central banks, it had also "revealed a number of problems that may be deeper than the specific episode that triggered the tensions."

"There are developments in the financial system which are like genies which moved out of the bottle and are hard to follow," he stated. "There is a clear need for supervisory bodies, and even for the very financial institutions which create these new instruments, to understand better what their creatures are doing out in the market. This is clearly a reason for concern." But he added that the good news was that the disturbance had occurred at a time of abundant liquidity around the world when economies were strong.

> "Emerging economies have become a source of stability in the global economy—something that would have been unthinkable a few years ago."

Many of the discussions over the three days—both in the official meetings and in seminars lined up by the IMF and World Bank and nearby think tanks—centered on what lessons could be drawn from the recent turbulence, the global economic and financial outlook, and the next steps in the agendas of the Fund and the World Bank.

The IMFC said financial innovation and securitization, while having contributed to enhanced risk diversification and improved market efficiency, had also created new challenges "that need to be properly addressed." It pinpointed five areas to be addressed, in particular: risk management practices related to complex structured products; valuation and accounting for off-balance-sheet instruments, especially in times of stress; clarifying the treatment of complex products by ratings agencies; addressing basic principles of prudential oversight for regulated financial entities; and liquidity management.

The IMFC asked the IMF—working with the Financial Stability Forum, the Bank for International Settlements, and others—to deepen its work on these issues and report back at the next IMFC meeting, which will be held in Washington on April 12, 2008. It encouraged the IMF to continue to "broaden and deepen its financial expertise to identify future issues." It asked the Fund to better integrate the findings of its surveillance of the global economy into its monitoring of individual economies and regional groups. In addition, it welcomed the IMF's ongoing work on sovereign wealth funds.

A louder voice

A major focus of the IMFC meeting was progress on the IMF's two-year program to reform the system of quota shares to better reflect members' evolving weight in the global economy. The program, which was launched in Singapore one year ago, began with an ad hoc increase for the four most underrepresented countries: China, Korea, Mexico, and Turkey. Many emerging markets and developing countries expressed concerns about the depth of the reform and the likelihood that they would secure sufficient voice in the running of the institution.

Padoa-Schioppa told reporters that enough progress had been made over the past year to give hope that the essential elements of a reform package could be worked out by the Spring Meetings in April 2008. There is now agreement on the need for a shift in voting shares toward emerging and developing countries as a whole, a total quota increase of about 10 percent, and at least a doubling of basic votes to protect the position of low-income countries. The intention is to achieve final consensus on the reform at the Annual Meetings in October 2008.

The IMFC stressed that the second round of reforms should "be a further increase in the voting share of emerging market and developing economies as a whole." Such a shift will be based on a simpler and more transparent quota formula—the key outstanding item. The IMFC said it supported the inclusion of the following items in a quota reform:

- a GDP variable as the most important element;
- a role for GDP to be measured at purchasing power parity (instead of at just market exchange rates); and
- a role for a compression factor to moderate the influence of economic size.

One other key element of the reform is an overall increase in quotas—which the IMFC said "should be of the order of 10 percent." The IMFC also stressed the importance of enhancing the voice and representation of low-income countries, and called for at least a doubling of basic votes to protect the voting share of low-income countries as a group.

IMF Photo

The IMF's new Managing Director, Dominique Strauss-Kahn, has vowed to press ahead with IMF reform.

Other aspects of reform

The IMFC discussed other areas in which the IMF has stepped up its reforms to cope with a world of highly interconnected markets and ever-expanding capital flows.

Income. The IMFC welcomed the progress made in developing operational guidelines to implement the recommendations of the Committee of Eminent Persons chaired by Andrew Crockett. It noted that both income and expenditure need to contribute to putting the Fund's finances on a sustainable footing. On the spending side, it noted the Fund's ongoing efforts to reduce administrative expenditures but said it saw a need for greater efficiency and saving through Fund-wide priority setting. The IMFC called for specific proposals on the new income model by the 2008 Spring Meetings and agreement on a medium-term budgetary envelope for the FY2009 budget that is consistent with the emerging income and expenditure model. The IMF has already embarked on a 6 percent cut in expenditures in real terms during 2006–08.

Surveillance. The IMFC welcomed the progress on strengthening IMF surveillance, including the June 2007 decision on bilateral surveillance—which involves the advice (including on exchange rates) that the IMF offers its 185 member countries.

Emerging markets. The IMFC said it supported the priority being given in the Fund's policy advice to emerging market economies "in working with them on the timely identification of vulnerabilities, the strengthening of debt management practices and deepening of local capital markets, and the design of policy responses in the face of large capital flows." It noted the work on designing a new liquidity instrument and asked the Executive Board to continue its work on the instrument's design.

Low-income countries. The IMFC welcomed progress on clarifying the IMF's role in low-income countries. This included well-designed financial and policy support in the context of surveillance, Fund arrangements, and technical assistance.

Transition and expenditure restraint

Former French Finance Minister Dominique Strauss-Kahn, who takes over from de Rato on November 1, will have to spearhead the quota reform effort, along with other IMFC requests—including putting the IMF's finances on a sustainable footing.

Strauss-Kahn will be working closely with two other newcomers: World Bank President Robert Zoellick, who took over the reins of the IMF's sister institution four months ago, and Italy's Economy and Finance Minister, Padoa-Schioppa, who was selected last month to succeed the United Kingdom's Gordon Brown as IMFC chair. ■

> "There are developments in the financial system which are like genies which moved out of the bottle and are hard to follow."

Laura Wallace
IMF External Relations Department

IMFC Examines Global Economy, IMF Reform

The International Monetary and Financial Committee held its sixteenth meeting in Washington, D.C., on October 20, 2007, under the chairmanship of Mr. Tommaso Padoa-Schioppa, the Minister of Economy and Finance of Italy. The Committee welcomes Mr. Padoa-Schioppa, the new IMFC Chairman; it expresses its deep gratitude to Mr. Gordon Brown for his invaluable contributions to the work of the Committee and the Fund throughout the eight years of his chairmanship of the Committee, and extends its best wishes.

Rodrigo de Rato talks with new IMFC chairman Tommaso Padoa-Schioppa.

The Global Economy and Financial Markets—Outlook, Risks, and Policy Responses

The Committee welcomes the strong global growth in the first half of 2007. It notes that the global economy continues to be underpinned by strong fundamentals and the robust growth of emerging market and other developing economies. Recent disturbances in financial markets in advanced economies are expected to have a moderating effect on growth in the near term, and downside risks to the outlook have increased. The Committee underscores the importance of sound macroeconomic policies in the medium term and continued vigilance to maintain well-functioning financial markets and to strengthen the foundations for sustained high growth. The Committee notes with satisfaction the resilience of emerging market and other developing economies in the face of recent financial market turbulence.

Central banks in advanced economies have been playing a critical role in ensuring the smooth functioning of money markets by providing necessary liquidity while remaining watchful that financial markets continue to operate effectively. At the same time, monetary policy should focus on achieving price stability while continuing to assess carefully the inflation outlook, taking into account both the inflationary pressures stemming from tight commodity markets and rising oil and food prices, and downside risks to growth.

Ministers and central bank governors had a useful discussion on the lessons emerging from the current episode of financial market turbulence, and are committed to continuing to work together, including multilaterally, to analyze the nature of the disturbances and consider lessons to be learned and actions needed to prevent further turbulence. The Committee agrees that financial innovation and securitization, while having contributed to enhanced risk diversification and improved market efficiency, have also created some new challenges that need to be properly addressed.

The Committee stresses that national authorities, standard-setting bodies, the Financial Stability Forum, the Bank for International Settlements, and the IMF, working together in line with their respective mandates, have complementary roles to play in analyzing financial stability issues, helping to identify and address information gaps, and providing fora for discussions and actions. Areas to be addressed include: risk management practices related to complex structured products; valuation and accounting for off-balance-sheet instruments, especially in times of stress; clarifying the treatment of complex products by ratings agencies; addressing basic principles of prudential oversight for regulated financial entities; and liquidity management. The Committee will take stock of the work undertaken at its next meeting.

The Committee welcomes the progress being made in prioritizing financial sector issues in the IMF's work. It calls for continued efforts to broaden and deepen the IMF's financial expertise to identify future issues, and to better integrate the findings of the IMF's multilateral surveillance in its regional and bilateral surveillance. The Committee also notes the growing importance of sovereign wealth funds in international financial markets. While recognizing their positive role in enhancing market liquidity and financial resource allocation, the Committee welcomes the work by the IMF to analyze issues for investors and recipients of such

flows, including a dialogue on identifying best practices. It stresses the importance of resisting protectionism and maintaining an open global financial system.

The Committee underlines the importance of further action to strengthen the foundations for sustained high growth over the medium term. Many countries need to pursue ambitious medium-term fiscal consolidation plans to address pressures on social spending arising from population aging. Structural reforms to take full advantage of the opportunities provided by globalization and technological advances should include further liberalization of service sectors in advanced economies, as well as further actions to improve infrastructure and the business environment and develop a sound financial sector in emerging market and other developing countries. To address growing income disparities, the Committee stresses the importance of strengthening education, creating jobs in the most dynamic sectors, pursuing well-designed tax policies, and providing adequate safety nets. Further trade opening, improved access to markets, and fulfillment of aid commitments by donors will be key to sustaining their robust growth performance.

The Committee calls for sustained implementation of the policy plans reaffirmed at the spring 2007 IMFC meeting by the participants in the Multilateral Consultation on global imbalances. It reiterates that an orderly unwinding of global imbalances, while sustaining global growth, is a shared responsibility involving: steps to boost national saving in the United States, including continued fiscal consolidation; further progress on growth-enhancing reforms in Europe; further structural reforms and fiscal consolidation in Japan; reforms to boost domestic demand in emerging Asia, together with greater exchange rate flexibility in a number of surplus countries; and increased spending consistent with absorptive capacity and macroeconomic stability in oil-producing countries.

The Committee expresses concern with the continued lack of progress with the Doha multilateral trade round, and urges WTO members to work toward a prompt and ambitious conclusion of the Doha Round trade negotiations launched in 2001 as a development round.

Implementation of the IMF's Medium-Term Strategy: Priorities Ahead

The Committee stresses the critical importance of the implementation of the program of quota and voice reforms adopted by the Board of Governors in Singapore. The Committee welcomes the report of the Executive Board to the Board of Governors, takes note of the progress made on several elements of the program, and urges the Executive Board to continue working to achieve an agreement within the timetable and objectives set forth in the Singapore Resolution. In particular, the Committee supports the inclusion of GDP in the new formula as the most important variable. It also considers that PPP-GDP should play a role, along with a compression factor. The Committee stresses that the total quota increase should be of the order of 10 percent, with at least a doubling of basic votes. The Committee reiterates that the reform should enhance the representation of dynamic economies, many of which are emerging market economies, whose weight and role in the global economy have increased. An outcome of the second round of reforms should be a further increase in the voting share of emerging market and developing economies as a whole. The Committee also stresses the importance of enhancing the voice and representation of low-income countries. The Committee encourages the Executive Board to continue its work in order to allow agreement on all the elements of the package by spring 2008.

The Committee recognizes the need for more predictable and stable sources of Fund income to finance its diverse activities. It welcomes the progress made in developing operational guidelines to implement the recommendations of the Committee of Eminent Persons chaired by Mr. Andrew Crockett. The Committee notes that both income and expenditure will need to contribute to putting the Fund's finances on a sustainable footing. While welcoming the Fund's ongoing efforts to reduce administrative expenditures, the Committee sees the need for greater efficiency and saving through Fund-wide priority setting. This should be achieved within a new medium-term budget envelope, while preserving the effectiveness of the Fund in fulfilling its core mandate. The Committee therefore calls on the Executive Board to develop specific proposals on the new income model and the new expenditure framework by the time of the 2008 Spring Meeting, and to agree on a new and detailed medium-term budgetary envelope for the FY 2009 budget that is consistent with the emerging income and expenditure framework.

The Committee welcomes the progress on strengthening IMF surveillance, including: the adoption of the Bilateral Surveillance Decision in June 2007; the agreement in principle on the adoption by the Executive Board of a statement of surveillance priorities in the context of the 2008 Triennial Surveillance Review, to guide the Fund's surveillance work and enhance accountability;

IMF Photo

India's finance minister, Palaniappan Chidambaram, gets ready to take his seat at the IMFC meeting.

IMF Photo

The Chairman of the U.S. Federal Reserve, Ben Bernanke, was among the participants in the October 20 meeting of the IMF's policy guiding committee.

and the ongoing integration of financial sector issues into macroeconomic analysis and bilateral surveillance. Evenhanded implementation of the new Decision is an essential element of the Medium-Term Strategy. The Committee looks forward to review the progress and experiences in these areas, as well as the upcoming review of experience with streamlined Article IV consultations.

The Committee supports the priority being given in the Fund's policy advice to emerging market economies in working with them on the timely identification of vulnerabilities, the strengthening of debt management practices and deepening of local capital markets, and the design of policy responses in the face of large capital inflows. The Committee notes the work undertaken in designing a new liquidity instrument to help countries' crisis prevention efforts, while providing adequate safeguards to Fund resources. While there has been support on key elements of such an instrument, concerns regarding potential demand for it and important design features still need to be resolved. The Committee calls on the Executive Board to continue its work on the instrument's design, paying due regard to the interaction with existing IMF facilities and to the views of potential users. The Committee looks forward to the follow-up on the review of charges and maturities for Fund financial assistance, and to the review of the Fund's policy on lending into arrears.

The Committee welcomes the progress on clarifying the role of the Fund in low-income countries. This includes well-designed financial and policy support in the context of surveillance, Fund arrangements, and technical assistance. The Committee looks forward to a comprehensive operational framework, which will draw together the various strands of the Fund's work in low-income countries with a view to enhancing the focus and effectiveness of the Fund's engagement with these countries. The Committee stresses the importance of delivering aid for trade commitments and encourages ongoing initiatives by the WTO and other institutions to enhance aid for trade and improve its coordination and delivery. The Committee attaches high priority to helping countries reap the benefits of higher aid and debt relief, while avoiding a new build-up of unsustainable debt. The Committee welcomes recent initiatives to help low-income countries build on the debt sustainability framework to design medium-term debt strategies, as well as efforts to foster sustainable lending. It calls on all creditors and borrowers to use the framework as a key tool for adhering to responsible and transparent lending practices. The Committee urges full participation by all official bilateral and commercial creditors in the HIPC Initiative; it expresses concern about growing litigation against HIPCs, which presents a major challenge to the implementation of the Initiative. The Committee looks forward to urgent progress on financing assurances by member countries to allow Liberia to benefit from debt relief. The IMF is prepared to consider other similar cases in due course.

The Committee welcomes the Joint Management Action Plan on Bank-Fund collaboration, which will foster closer and more efficient cooperation and clear delineation of responsibilities between the Bank and the Fund, including in their work on low-income countries.

Other Issues

The Committee recommends members' acceptance of the Fourth Amendment of the Articles of Agreement for a special one-time allocation of SDRs.

The Committee values highly the contribution of the IEO to the learning culture of the IMF and to facilitating oversight and governance. It welcomes that the enhanced framework for implementing the IEO recommendations endorsed by the Executive Board is now fully operational.

The Committee pays tribute to Mr. Rodrigo de Rato for his skillful and strategic leadership as Managing Director of the International Monetary Fund. As architect of the Fund's Medium-Term Strategy, he has positioned the Fund well to meet the challenges of a rapidly evolving global economy. Mr. de Rato deepened the integration of financial sector issues in the Fund's work and launched a bold reform to strengthen the voice and representation of low-income and emerging market countries in the Fund. He brought clarity to the role of the Fund in its bilateral surveillance and successfully introduced the new multilateral consultation instrument. Mr. de Rato's persuasiveness in convincing the membership of the need for a new income model for the Fund has been instrumental in launching a strategic reflection on the Fund's income and expenditure that will help ensure the Fund's financial sustainability in the new international environment. The Committee wishes to express its thanks to Mr. de Rato for his dedication and vision, which have helped set the Fund on a strong and positive path to the future.

The Committee warmly welcomes the appointment of Mr. Dominique Strauss-Kahn as the new Managing Director, and looks forward to working closely with him in meeting the challenges ahead.

The next meeting of the IMFC will be held in Washington, D.C., on April 12, 2008. ■

Technology Widening Rich-Poor Gap

The global economy has changed dramatically over the past two decades. World trade has grown fivefold since 1980, and its share of world output has risen from 36 percent to 55 percent. Trade integration accelerated in the 1990s as the former communist countries entered the global trading system and developing countries in Asia dismantled trade barriers. The globalization of financial flows has also been rapid. Total cross-border financial assets more than doubled as a share of output between 1990 and 2004, from 58 percent of global GDP to 131 percent. The advanced economies continue to lead the trend in financial integration, but other regions are beginning to catch up.

How have these developments affected people's incomes and the gap between the rich and the poor within countries? A chapter in the IMF's October 2007 *World Economic Outlook*, titled "Globalization and Inequality," offers some tentative answers.

Using newly available data, our research shows that inequality (measured using the Gini coefficient) has risen over the past two decades in most regions, including developing Asia, emerging Europe, Latin America, and the newly industrialized economies of Asia, as well as in the advanced economies. In contrast, it has declined in sub-Saharan Africa and the Commonwealth of Independent States.

Key points

The issue: Is there a link between the increase in inequality seen in most countries over the past two decades and the unprecedented integration of the world economy?

The evidence: Technological advances have made the biggest contribution to widening income inequality. The contribution of globalization is less important. Whereas trade globalization has helped reduce inequality, financial globalization—in particular foreign direct investment (FDI)—has tended to increase it.

Policy considerations: Better access to education and training would help ensure that the increase in incomes fostered by globalization is shared more equally. Policies that broaden the access to finance of the poor would also help, as would further trade liberalization.

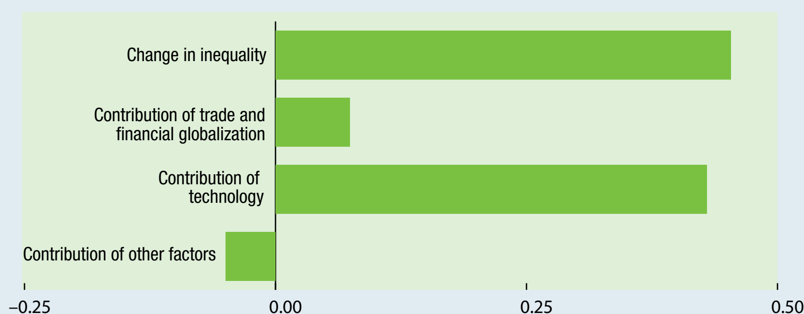
Most people are better off

Despite this observed rise in inequality, per capita incomes have risen across virtually all regions for all segments of the population, including the poorest. As a result, the poor are now better off in absolute terms, although in most cases incomes have risen at a faster pace for those who are already better off.

The great divide

Technological progress has contributed the most to widening income inequality.

(average annual percent change)



Source: IMF staff calculations.

What is contributing to the widening of the income gap within countries? Our analysis yielded four main findings.

First, *the main factor driving the recent increase in inequality across countries has been technological progress* (see chart). This factor alone explains most of the increase in the Gini coefficient from the early 1980s, supporting the view that new technology, in both advanced and developing countries, increases the premium on skills.

Second, *globalization has had a much smaller effect relative to technological change*, reflecting the opposing influences of trade and financial globalization on inequality.

Third, *contrary to common belief, trade globalization has helped reduce inequality rather than increase it.* In developing countries, both rising agricultural exports and tariff liberalization have contributed to improving income distribution. In advanced economies, rising imports from developing countries are associated with declining income inequality, presumably through the substitution of lower-paying manufacturing jobs with higher-paying service sector jobs.

Fourth, *FDI has had a mainly negative effect* on the distribution of income. Higher FDI inflows have increased the demand for skilled labor in developing countries, whereas outward FDI in advanced economies has reduced the demand for lower-skilled workers in these countries.

What do these findings imply for policymakers? Technological change and FDI are associated with higher incomes and should therefore be encouraged rather than suppressed. But because they increase the returns on acquiring skills, we believe increased access to education and training is the key to sharing the fruits of economic growth in a more equitable way. ■

Florence Jaumotte and Subir Lall
IMF Research Department

Ensuring Stability and Continued High Growth

During 2004–06, the world economy enjoyed its most rapid growth since the late 1960s and early 1970s. Global output has on average increased by 5.2 percent per year (see chart). After controlling for increases in the working-age population, world growth has been 3¼ percent—only slightly lower than during the 1960s.

Not only has recent global growth been high, it has also been more stable, even though potentially more volatile emerging market and developing countries account for a rising share of the global economy.

A chapter in the October 2007 *World Economic Outlook*, titled "The Changing Dynamics of the Global Business Cycle," takes stock of what we know about changes in output volatility and in the resilience of expansions. The research, which covers a broad sample of regions and countries, focuses on determining to what extent policy actions have helped bring about a lasting reduction in volatility.

Key points

Background: From 2004 to the present, world growth has been much more rapid than at any time since the early 1970s. It has also been shared more widely across countries and has been more stable.

Analysis: Reduced output volatility and the associated lengthening of economic expansions reflect improvements in monetary and fiscal policy, as well as in broader institutional quality. These changes are expected to keep output volatility low going forward.

Policy implications: Unfortunately, lower volatility does not rule out occasional recessions. The abrupt end to the period of strong and stable growth of the 1960s and early 1970s and the Asian crisis of the 1990s remind us of what can happen if policymakers do not respond to new risks and challenges.

A new golden age?

In important ways, the global economy has recently displayed greater stability than observed even in the 1960s—the last golden age of strong and stable growth. In particular, output volatility has decreased in most countries, with the typical country experiencing a one-third decline between the 1960s and the present. Growth is also more broadly shared across countries than previously observed, with virtually all countries doing well.

Advanced economies in particular improved their stability, and typically experienced long expansions, after the 1970s and the disinflation of the early 1980s.

In contrast, output stabilization in developing countries was more gradual and modest. Until the beginning of this decade they often experienced deep and sometimes recurrent crises, including debt crises (especially in Latin America and Africa) and banking and currency crises (in Asia, central and eastern Europe, and Latin America). Some countries also experienced high volatility during their transition from centrally planned to market economies. On average, output volatility in developing economies remains more than twice as high as in advanced economies.

Institutional improvements

Our analysis suggests that the strong durability of expansions and low output volatility largely reflect changes that are likely to prove permanent. In particular, better monetary policy may explain about one-third of the total stabilization of output fluctuations over time. More stable fiscal policy (in advanced economies) as well as trade liberalization and broad institutional improvements (in developing economies) also helped.

The decline in world output volatility between the 1960s and the present largely reflects lower volatility of consumption rather than of investment. Any explanation for the recent stability should, therefore, include factors that affect consumer behavior, such as the rising availability of financing, which helps smooth consumption over time.

Risks have not gone away

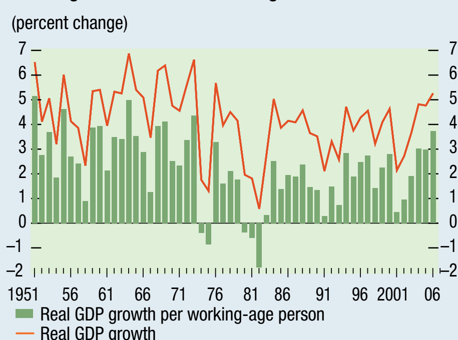
Despite these improvements, future stability should not be taken for granted. Low average volatility does not rule out occasional recessions, and globalized trade and financial flows have generated new risks and vulnerabilities. Most recently, losses associated with the U.S. subprime mortgage market have raised concerns about a possible global credit crunch.

Significant potential risks also arise from global current account imbalances and from the linkages between monetary and prudential policies and sustained asset price booms. ■

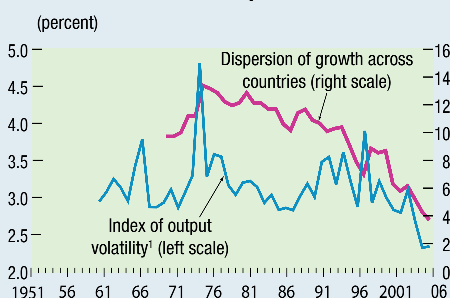
Martin Sommer and Nikola Spatafora
IMF Research Department

A new golden age?

World growth has been strong . . .



. . . stable, and shared by most countries.



Source: IMF, World Economic Outlook.

[1] The index of output volatility is the rolling 10-year standard deviation of detrended real GDP growth in a typical (median) country. The dispersion of growth is measured as the standard deviation of detrended real GDP growth in the sample of 133 countries.

Learning How to Cope with Big Capital Inflows

The strong increase in net private capital inflows to emerging market economies over the past few years is proving to be a mixed blessing. Although these flows help deliver the benefits of increased financial integration, they also create challenges for policymakers because they can lead to overheating, a loss of competitiveness, and increased vulnerability to crisis.

While a number of studies have examined the policy responses to capital inflows in the 1990s, focusing on a limited number of country cases, there have been fewer studies involving recent episodes of capital flows and even fewer attempts to systematically compare how different countries have responded in terms of new policies.

A chapter in the October 2007 *World Economic Outlook* titled "Managing Large Capital Inflows," tries to fill this void.

Key points

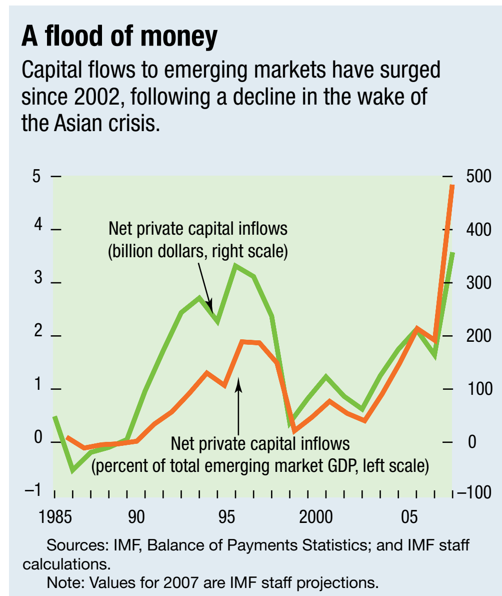
Main question: Private capital inflows can result in long-term benefits if put to good use, but they can also pose significant risks to macroeconomic stability. What policy measures were adopted in the past to counteract instability, and did they work?

Learning from experience: Although the appropriate policy response to large capital inflows depends on a country's specific circumstances, a comprehensive cross-country analysis of policy responses can help us understand what has worked and what hasn't.

Main lesson: Keeping government spending along a steady path—rather than engaging in excessive spending during periods of heavy capital inflows—helps mitigate the adverse effects of large inflows.

Episodes of large capital inflows

There have been two great waves of private capital flows to emerging market countries in the past two decades (see chart). The first began around the early 1990s and then ended abruptly with the 1997–98 Asian crisis. The recent wave has been building since 2002, but has recently accelerated markedly, with flows in the first half of 2007 already far exceeding the total for 2006. How have policymakers dealt with these inflows?



A flood of money

Capital flows to emerging markets have surged since 2002, following a decline in the wake of the Asian crisis.

Sources: IMF, Balance of Payments Statistics; and IMF staff calculations.
Note: Values for 2007 are IMF staff projections.

Key lessons

The "impossible trinity" paradigm of open economy macroeconomics—the inability simultaneously to target the exchange rate, run an independent monetary policy, and allow full capital mobility—suggests that, in the absence of direct capital controls, countries facing large capital inflows must choose between nominal appreciation and inflation. In practice, however, given that capital mobility is far from perfect (even in the absence of direct capital controls), policymakers may have more scope to pursue intermediate options than this paradigm would suggest.

Indeed, the influx of large capital inflows has generally prompted policymakers to adopt a variety of measures to prevent overheating and real currency appreciation, and to reduce the economy's vulnerability. Our analysis focused on four policy measures: exchange rate policy, sterilization policy, fiscal policy, and capital controls.

We identified four key lessons:

- *Countries with relatively high current account deficits are more vulnerable to a sharp reversal of capital inflows* because they are particularly affected by increases in aggregate demand and the real appreciation of their currencies.
- *Keeping public expenditure growth steady* during inflow episodes—rather than ratcheting up spending—*can contribute to both a lower real exchange rate appreciation and better GDP growth performance* in the wake of large inflows.
- *Attempts to resist nominal exchange rate appreciation have generally not been successful in preventing real appreciation* and have often been followed by sharper reversals of capital inflows, especially when these inflows have persisted for a longer time.
- Capital controls might have a role to play in certain cases, but *restrictions on capital inflows have not, in general, facilitated lower real appreciation and a soft landing.*

In sum

Stabilization challenges arising from large capital inflows are most serious for countries with substantial current account imbalances. The most effective tool policymakers have at their disposal to avoid overheating and output instability is likely to be fiscal restraint, especially in the context of relatively inflexible exchange rate policies.

Our research also suggests that even if a central bank intervenes to resist nominal exchange rate appreciation when capital inflows begin, this stance should be progressively relaxed if the inflows persist. As time goes on, central bank intervention is less likely to prevent real appreciation and a painful end to the inflows. ■

Roberto Cardarelli, Selim Elekdag, and M. Ayhan Kose
IMF Research Department

Seminars Look at Globalization and New Aid Architecture

A panel of leading economists grappled with the effects of the financial turmoil triggered by the crisis in the U.S. housing market in a seminar on globalization on October 19, one of three seminars on economic-related issues during the IMF–World Bank Annual Meetings in Washington, D.C.

Others studied the new architecture of international aid and climate change. There were also subsidiary sessions to the main seminars.

IMF Photo

Former chairman of the U.S. Federal Reserve, Alan Greenspan, said policymakers should focus on the overall level of debt rather than just the U.S. current account deficit.

First crisis of globalization

Nouriel Roubini, professor of economics and international business at New York University's Stern School of Business, called the meltdown in the U.S. mortgage market "the first crisis of financial globalization and securitization." When high-risk borrowers in California or Florida defaulted on their home loans, some investors as far away as Europe, Australia, and Asia who had bought securities backed by pools of U.S. mortgages incurred losses.

The source of the problem, as moderator and Governor of the Bank of Israel Stanley Fischer noted, "is very bad lending by those who originate mortgages."

The full extent of the losses is still uncertain, as is the location of many of the securities, according to Larry Hatheway, chief economist at UBS AG, who estimated that some $2 trillion in mortgages are at risk and that overall defaults could reach as high as $200 billion.

As the world grapples with globalization and securitization, "we should expect more of what we witnessed this summer," said Mohamed A. El-Erian, president and CEO of Harvard Management Co.

If the subprime meltdown hits the U.S. economy hard it will be bad for the rest of the world, because the United States still drives the global economy, according to Hiroshi Watanabe, special adviser to the president of the Japan Center for International Finance.

Subsidiary seminars on globalization dealt with the rise of private equity and hedge funds and the need to build support for globalization.

New sources of liquidity

In addition to hedge funds and private equity funds, globalization has spawned other new sources of liquidity, including investors from oil-rich nations, Asian central banks, and sovereign wealth funds. All these players are here to stay, said Tanya Beder, chair of SBCC. She said private equity and hedge funds account for 25 percent of the investments of the world's pension funds.

Some of these new players are helping emerging market countries benefit from globalization, said Garrett Moran, senior managing director for the Blackstone Group.

Supporting globalization

Nancy Birdsall, president of the Center for Global Development (CGD), said that the populist backlash against globalization occurs because there are "winners and losers," mostly because of educational deficiencies.

Multilateral institutions can help by ensuring investment in education, in human capital, and in policy interventions that will enhance the competitiveness of poor countries, said panelist Stephen Roach, chairman of Morgan Stanley Asia.

The new aid architecture

The structure of development assistance has changed dramatically in recent years, reflecting significant increases in the level of aid and the number of development actors.

The scaling up of aid and the proliferation of donors and other players may present some challenges, said World Bank President Robert B. Zoellick, at the main seminar on the new architecture of aid, but fundamentally they open opportunities, bringing fresh ideas, approaches, and innovations, and additional human and financial resources.

The fundamental challenge, said Zoellick, is "to connect all the pieces together in a new aid network," which would improve the effectiveness and national ownership of assistance programs.

The urgent need to improve the mechanisms for delivering assistance was emphasized by all the participants in the plenary session, which was moderated by Richard Manning, chairman of the OECD's Development Assistance Committee.

Birdsall called for a new emphasis on impact evaluation, with aid-receiving countries evaluating their development policies and initiatives, rather than donors assessing their projects; a model of output-based aid, to replace conditionality and the carrot-and-stick approach; more donor financing of global public goods in areas such as health, energy, and climate change; and incentives for skilled workers to stay in public service.

Kwadwo Baah-Wiredu, minister of finance and economic planning for Ghana, urged that reform focus on the composition and volatility of aid, noting the frustration of recipient countries about the lack of freely usable aid and the unpredictability of aid flows.

Alan R. Gillespie, CEO of the International Finance Facility for Immunization (IFFIm) and chairman of Ulster Bank (Ireland)—whose facility has raised over $1 billion selling bonds in the capital markets—said that private philanthropy can galvanize the public sector.

A new 'golden age' of philanthropy?

In a follow-on session, the nature and role of foundations in development were examined. These foundations, which guard their independence from governmental bodies, often reflect the priorities and preferences of individual founders and governing boards. Unlike official development agencies, they can more narrowly focus their efforts and can make much longer-term commitments.

> "Populist backlash against globalization occurs because there are 'winners and losers,' mostly because of educational deficiencies."

They often take more risks in search of innovative approaches, which creates a natural tension with the development community's desire for evaluation and monitoring.

Is health leading the way?

In the second follow-on session, panelists examined the health sector, where much of the dramatic scaling up of aid has occurred. They cited the need to harmonize aid delivery and manage the unpredictability of aid levels, and the lack of compatibility of aid disbursements with national health plans.

Response to climate change

Panelists agreed that the science of climate change is essentially established: the earth is warming because of human activity caused mainly by the emission of carbon from the burning of fossil fuels.

Yvo de Boer, executive secretary of the United Nations Framework Convention on Climate Change, said the next step is a political response, beginning with the conference in Bali in December to establish formal negotiations for a new climate change accord. All Bali has to do, he said, is "get the process going." But if it fails to do that, public interest will slip away, which means trouble, because most scientists think there is a 10–15 year window to deal with the emissions issue.

Valli Moosa, president of The World Conservation Union, said nongovernment organizations are frustrated because governments are slow to do "doable things" such as pushing compact fluorescent lighting, encouraging the use of hybrid vehicles, and establishing more environmentally sound building regulations.

Jon Williams, head of group sustainable development for HSBC Bank, said the private sector is willing and able to play an important role. But investors need a global climate change agreement. When we finance projects over a 20–30 year horizon, investors need long-term certainty about such issues as regulation and tax subsidies, he said. ■

Greenspan Sees Benign Imbalances Outcome

Policymakers have been focusing too narrowly on the U.S. current account deficit, when it is the overall level of debt, not whether it is financed domestically or by foreigners, that influences economic behavior and "can be a cause of system concern," Alan Greenspan, the former chairman of the U.S. Federal Reserve Board, said October 21.

Greenspan, in a lecture sponsored by the Per Jacobsson Foundation—a regular event for more than 40 years at the World Bank-IMF Annual Meetings—noted that the unwinding of balance of payment imbalances may take some time and will not likely disrupt the real economy, but cautioned that protectionism and a drift towards fiscal instability in the United States and other countries could make the adjustment painful.

Greenspan said that "unless protectionist forces drain the flexibility of the international financial system, I do not view the ultimate unwinding of America's current account deficit," about 6 percent of U.S. GDP, "as a cause for undue alarm."

He said the rapid growth in the U.S. current account deficit in the past 10 to 15 years does not indicate a sudden unhealthy shift in behavior by U.S. borrowers—households, businesses, and governments.

The U.S. deficit should not be viewed in isolation; it is the result of U.S. businesses and the government turning to "foreign sources of deficit funding" in place of domestic sources, "and not predominantly the result of an acceleration in the secular uptrend in economically stressful company or government imbalances."

In other words, it represents a shift to foreign rather than domestic sources of funding at a time when foreigners were shedding their "home bias" toward investing locally and saw better opportunities in the United States than elsewhere, mainly because of rapid U.S. productivity growth. These two developments in foreign investor behavior are the most "persuasive" explanation for the outsized U.S. current account deficit. ■

Asia Projected to Maintain Strong Performance

Growth in Asia has trended higher this year and the strong performance is forecast to continue into 2008. For the region as a whole, growth is expected to reach 8.0 percent in 2007 before moderating to 7.2 percent next year, according to the IMF's latest *Regional Economic Outlook* (*REO*) for Asia and the Pacific.

Growth continues to be driven by China and India (see table), while the newly industrialized economies and the ASEAN-5 (Indonesia, Malayisa, the Philippines, Thailand, and Vietnam) have also done well, reflecting a pickup in domestic demand. Following a soft patch earlier this year, export growth, including in the important electronics sector, has increased sharply led by demand from Europe.

According to the *REO*, released on October 19, inflation pressures remain largely under control. While food prices have raised headline numbers in some countries, core inflation has been well behaved. This is particularly true in China, where prices for a handful of agricultural products have spiked owing to supply factors, sending headline inflation to a decade high of 6½ percent. However, there has been little evidence thus far of second-round effects.

Rapid growth

Asia's performance is stronger than previous projections.

(real GDP growth, year-on-year percent change)

			REO April 2007		Latest proj.	
	2005	2006	2007	2008	2007	2008
Industrial Asia	2.0	2.2	2.4	2.1	2.3	2.0
Japan	1.9	2.2	2.3	1.9	2.0	1.7
Australia	3.0	2.5	2.6	3.3	4.4	3.8
New Zealand	2.7	1.7	2.5	2.6	2.8	2.3
Emerging Asia	8.6	9.3	8.5	8.1	9.4	8.5
NIEs[1]	4.7	5.3	4.6	4.6	4.9	4.4
Hong Kong SAR	7.5	6.9	5.5	5.0	5.7	4.7
Korea	4.2	5.0	4.4	4.4	4.8	4.6
Singapore	6.6	7.9	5.5	5.7	7.5	5.8
Taiwan POC	4.1	4.7	4.2	4.3	4.1	3.8
China	10.4	11.1	10.0	9.5	11.5	10.0
India	9.0	9.7	8.4	7.8	8.9	8.4
ASEAN-5	5.5	5.7	5.8	6.0	5.9	5.8
Indonesia	5.7	5.5	6.0	6.3	6.2	6.1
Malaysia	5.0	5.9	5.5	5.8	5.8	5.6
Philippines	4.9	5.4	5.8	5.8	6.3	5.8
Thailand	4.5	5.0	4.5	4.8	4.0	4.5
Vietnam	8.4	8.2	8.0	7.8	8.3	8.2
Asia	7.2	7.9	7.2	6.9	8.0	7.2

Source: IMF, World Economic Outlook database.

[1]NIEs = newly industrialized economies.

Tim Wimborne/Reuters

Coal train in Newcastle, Australia, where GDP growth is projected to accelerate to 4.4 percent this year, easing back to 3.8 percent in 2008.

Big current account surpluses

The region has continued to experience large current account surpluses and continued capital inflows. However, exchange rates have appreciated only modestly in most countries as intervention by central banks has pushed regional reserves past the $4 trillion mark, with China continuing to account for the bulk of the increase.

Asia was not at the epicenter of the global financial market turmoil that broke out in July, and markets and financial institutions in the region have held up well. Direct exposure to U.S. subprime mortgages and, more broadly, to leveraged and complex structured credit was reportedly small, including for hedge funds. Most markets have recovered the losses experienced after the turbulence began, and in some cases have attained new highs.

The outlook for Asia assumes a slowing of external demand from the United States and Europe as well as an effective policy tightening in China. A pattern of somewhat slower export and investment growth across much of the region is expected, with only some delinking from the global cycle. The region's current account surplus is projected to rise to 5 percent of GDP owing largely to China, where the trade surplus continues to surge.

Balance of risks

The risks to this outlook are balanced, although they are not uniform across countries. For China and India the risks are on the upside and relate to the pace of investment—to the extent that investment is currently growing too fast, higher-than expected growth would not necessarily be beneficial. For most of the rest of the region, the risks are on the downside, and relate mainly to sharply slower foreign demand growth in major export markets.

Regarding policies, in the event that growth slows more than expected, the IMF sees scope for easing monetary policy settings in much of the region, except for those few countries where inflation pressures remain relatively high. Most countries also have "fiscal space" available to counter any growth slowdown by letting the automatic stabilizers work.

It is not too early to draw preliminary policy lessons from the recent market turbulence, which will become increasingly important as Asia's financial institutions become more sophisticated. Actions could include strengthening reporting requirements to ensure greater transparency, enhancing pricing and provisioning to reduce liquidity and solvency risks, and improving disclosure requirements to better inform investors of their risk exposures. ■

Paul Gruenwald
IMF Asia and Pacific Department

Sustaining Strong Growth Is Africa's Top Challenge

Growth in sub-Saharan Africa (SSA) is expected to hit 6.7 percent in 2008, up from 6 percent in the current year (see table). According to the IMF's latest *Regional Economic Outlook* (*REO*), SSA is experiencing its strongest growth and lowest inflation in more than 30 years.

The expansion is attributable to rising production in oil exporters and strong domestic investment in oil importers, fueled by progress on macroeconomic stability and reforms in most countries. The region also benefited from strong demand for its commodities, increased capital inflows, and debt relief. The *REO*, released on October 20, organizes SSA's 44 countries into four groups: oil exporters, and non-oil-exporting middle-income, low-income, and fragile countries (those that are generally susceptible to political instability and conflicts).

Growth in the oil exporters should accelerate to about 10½ percent in 2008. The middle-income countries should grow by about 4 percent; low-income countries by 7 percent, fueled by agriculture and construction; and fragile countries by 5½ percent.

SSA countries have kept inflation under control at 7½ percent despite higher commodity prices. Average inflation is expected to drop further in the oil exporters this year, partly because of stabilization gains in Angola and Nigeria. In the middle-income countries, inflation is expected to accelerate to about 6½ percent this year, and in most low-income countries, inflationary pressures are expected to ease further, partly because of a more plentiful food supply and monetary policies that have helped check inflation expectations and the effects of higher oil prices. In the fragile countries, average inflation remains high, albeit with large differences among countries.

Strong growth performance

The expansion cuts across country groups but is strongest in the oil exporters.
(GDP growth, percent)

	2005	2006	Proj. 2007	Proj. 2008
Oil-exporting countries	7.7	5.7	7.6	10.6
Middle-income countries	4.9	4.8	4.7	4.2
Low-income countries	6.7	6.4	6.9	7.0
Fragile countries	2.8	2.5	3.0	5.5
Sub-Saharan Africa	**5.9**	**5.4**	**6.0**	**6.7**

Sources: IMF, African Department Database, October 1, 2007; and World Economic Outlook database, October 1, 2007.

Can SSA sustain the growth?

Sustaining growth, the *REO* says, is one of the region's primary challenges and depends on each country's ability to use higher income to accelerate socioeconomic development. This effort will require continued structural and institutional reforms to increase productivity, strengthen countries' resilience to shocks, and attract private investment to noncommodity sectors.

The region's past growth episodes have generally been shorter than in other regions and often ended with a collapse in output. The causes, says the *REO*, are volatile terms of trade and other shocks and weak institutions. In the current expansion, many oil exporters have saved more of the oil revenue windfall and improved their policies. Many other countries have also continued to grow, even with stagnating or deteriorating terms of trade. The strong growth reflects institutional improvements, structural reforms, and more rigorous policies. Thanks to better economic conditions and greater stability, investment is rising and income volatility is falling.

Risks to the outlook

The *REO* describes a positive outlook but notes that it is clouded by external and internal risks. The external risks stem from the possibility of a global economic slowdown, the internal risks mainly from weak policy implementation and, possibly, security and political problems. In particular, if the prices of nonfuel commodities declined significantly and unexpectedly, output could drop by about 1.5 percent. An unexpected rise in oil prices would worsen the current account and net foreign asset positions of oil-importing countries.

A few SSA countries have recently enjoyed strong portfolio inflows, whose reversal would reduce external financing and hurt growth. So far, most SSA markets have shown little reaction to the turbulence in global financial markets, but this could change. Moreover, the repricing of risk might make it more difficult for African countries to raise funds in global markets or to privatize.

Medium-term priorities

The *REO* notes that some African countries are taking advantage of vigorous global growth and buoyant commodity markets to institute reforms. Still, few are on track to halve poverty by 2015. For many others, it is difficult to even evaluate their progress toward the Millennium Development Goals (MDGs) because statistics are so weak.

To make progress toward reaching the other MDGs, African policymakers should consolidate stabilization gains, improve infrastructure, reduce the costs of doing business and boost productivity, overcome financing constraints, and expand trade and markets.

Grants to the region, excluding Nigeria and South Africa, are projected to be 3 percent of GDP this year, with a slight rise to the low-income countries. Although official development assistance from the industrial countries has been broadly flat since 2003, emerging creditors, particularly China, are giving more, generally in the form of project assistance and export credits. ■

IMF Assessing Economic Impact of Climate Change

The IMF, as part of its strategic effort to understand long-term challenges to the global economy, is stepping up its capacity to assess the macroeconomic implications of—and policies to cope with—climate change. A considerable amount of work on climate change issues is already under way at the IMF, in coordination with its sister organization—the World Bank.

This work comprises, among other things, an appendix in the October 2007 *World Economic Outlook* (*WEO*), which summarizes the state of knowledge and policy debate on the key economic aspects of climate change; a chapter on the implications of climate change for the global economy in the forthcoming April 2008 *WEO*; and a Special Issues Paper on the fiscal implications of climate change.

African Stock Markets Join Global Boom

African stock markets, following in the wake of the surge in world stock markets over the past few decades, are starting to take off.

Although starting from a low base, a recent IMF study shows that the region's stock markets have begun to help finance the growth of African companies but must develop further to offer broader economic benefits.

Montenegro's Boom Continues

Real growth in Montenegro, which became the IMF's 185th member this year, is projected at 7 percent in 2007 and should remain strong in 2008. Retail inflation has edged up on higher electricity and food prices but remains contained, and unemployment has fallen, according to the IMF's annual health checkup of the economy.

IMF Launches Blogs

Simon Johnson, the head of the IMF's Research Department, has launched a blog on the web that drew a lot of attention during the IMF-World Bank Annual Meetings. Take a look at http://blog-research.imf.org.

The IMF's Fiscal Affairs Department has also started a blog on the ins and outs of public financial management. Join the debate at http://blog-pfm.imf.org.

Indonesia: Sustaining the Recovery

Indonesia's economy has made impressive progress in recent years and is now in its best shape since the Asian crisis devastated the country in 1997–98. However, poverty and unemployment remain high. Sustained high growth will be needed to realize tangible improvements in social conditions. With the right set of policies, this should be achievable, according to an IMF assessment. Work is needed to boost public and private investment—in particular, structural reforms to improve the investment climate, support infrastructure investment, and enhance financial intermediation.

Maya Vidon/AFP

Jose Cendon/AFP

IMF, World Bank Launch Joint Management Action Plan

The IMF and the World Bank have launched a joint management action plan designed to improve coordination and communication between the two global financial institutions. According to a paper outlining the plan, discussed informally by the World Bank Board on October 9 and the IMF Executive Board on October 10, the action plan "aims to translate identified good practice approaches to collaboration into standard practices."

The plan is part of the response by the two institutions to the report of a high-level independent committee—established to recommend how the IMF and the World Bank could improve their working relationship—issued last February. It is expected to help the two institutions improve coordination on country issues; enhance communications between the two staffs working on common thematic issues—including financial sector and fiscal issues, and technical cooperation; and improve incentives and central support for collaboration on policies, reviews, and other institutional issues.

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From the mailbag

A Bridge Too Far?

Pépé Andrianomanana of the University of Antananarivo in Madagascar asks whether the IMF should get involved in "mission creep" by expanding its role into the fight against global warming, or, given its scarce resources, it should stick to its original mission.

For full text, see "What Readers Say" at the online *IMF Survey.*

Send us your views

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