International Monetary and Financial Committee

Twenty-Third Meeting
April 16, 2011

Statement by Didier Reynders
Deputy Prime Minister and Minister of Finance, Ministere des Finances, Belgium

On behalf of Austria, Belarus, Belgium, Czech Republic, Hungary, Kosovo, Luxembourg, Slovak Republic, Slovenia, Turkey

Statement by Mr. Didier Reynders
Deputy Prime Minister and Minister of Finance of Belgium
on behalf of
Austria, Belarus, Belgium, Czech Republic, Hungary,
Republic of Kosovo, Luxembourg, Slovakia, Slovenia and Turkey
at the 23rd meeting of the International Monetary and Financial Committee
Washington DC, April 16, 2011

Economic and Financial Developments and Challenges

The global economy continues to recover. In significant parts of Europe growth is becoming increasingly self-sustained. In certain emerging market economies, there are signs of overheating. With the passage of time, the macro-economic policy and financial sector reform agendas have become more urgent.

Unemployment remains high in many advanced economies. A high level of employment creation is a key objective, alongside financial stability and sustainable public finances.

Many advanced economies must reduce high public deficits and debt ratios. Fiscal consolidation would be easier if growth would be higher. But this is no excuse to postpone the adoption and timely implementation of credible fiscal consolidation strategies that also address the rapidly raising entitlement spending in the next decades. Such strategies should preserve or restore creditor confidence, keep funding costs as low as possible, and support growth.

Among advanced economies, fiscal consolidation is progressing at a different pace. The Fund in its analyses and reports should carefully define subgroups of countries when there are important divergent fiscal developments.

Rising energy and other commodity prices are likely to have limited effects on core inflation, even though headline inflation might well be higher for some time. However, further price increases and second-round effects cannot be excluded and would represent a more serious risk in terms of output losses and rising inflation. Countries should combine fiscal consolidation and tighter monetary conditions to maintain price stability.

Global inflation developments may depend on the extent to what the supply and demand-side inflation pressures from emerging market economies transmit to advanced economies. Even though the food and oil price inflation that is currently affecting many emerging market economies originates on the supply side, one should not underestimate how this can migrate through internationally connected value chains – i.e. the same channels that helped lower global inflation in the past – into consumer prices, wages and inflation expectations in advanced economies. Central banks everywhere should be highly vigilant to avoid rising inflationary expectations.

Higher interest rates in emerging market countries are likely to attract even larger capital inflows. The staff has formulated sensible proposals on how countries could implement successful policies to stem excessive and volatile international capital flows.

Sound macro-economic policies, prudent risk management by financial intermediaries and timely macro-prudential measures in both originating and recipient countries are all essential to avoid asset price bubbles when households and corporations contract unsustainable debts financed with foreign capital. In some countries, allowing an undervalued exchange rate to appreciate is an essential component of a successful strategy to avoid distortive capital inflows. Emerging markets should redouble efforts to create well-functioning capital markets while improving financial regulation in line with international standards. Emerging market countries' participation in the FSB and standard-setting bodies is helpful for making good progress in this respect.

We ask the Fund to work further on the important agenda of macro-prudential policies, prudent capital account liberalization, and capital flow management measures, both in originating and recipient countries. Data collection on international capital flows and trans-border assets and liabilities should be further improved. Successfully addressing these agendas is essential for the stable functioning of today's capital markets driven global economy.

Global trade imbalances are projected to widen again. This is worrisome. For the recovery to be sustained, advanced economies must maintain growth while implementing fiscal consolidation. Symmetrically, emerging market economies, and a few advanced economies with large surpluses, must rely less on external demand and more on domestic demand. The Fund has given sensible advice to implement such strategies. Europe's part in this strategy is foremost to focus on reforms that increase potential growth.

Today's meeting should agree that coordination at the global level of carefully designed policies to reduce global imbalances is a must.

As the recovery in advanced economies has taken hold and weaknesses in financial institutions are being addressed, global financial markets have calmed down. However, underlying structural issues remain. Policymakers should not give way to reform fatigue. Remaining weaknesses need to be addressed to fully restore financial stability.

Large public sector indebtedness in advanced economies, weak or non-viable banks in the Euro area and the fragile housing market in the U.S. all represent risks to global financial stability. The sooner these issues are resolved, the earlier macro-economic policies can return to a more sustainable mode and the build-up of new vulnerabilities can be avoided.

The regulatory reform agenda is unfinished. Cross-border bank resolution, the systemically important financial institutions (SIFIs), macro-prudential frameworks, the regulation and supervision of the shadow banking sector and off-balance sheet exposures of banks, all still need to be addressed. The ultimate goal is to create a safer, more sustainable global financial system providing useful financial intermediation.

The political reforms in the Middle East and Northern Africa create economic and social opportunities and challenges. Countries in the region should pursue policies that elevate human capital, create more employment, stronger and sustained per capita growth and more social and economic equality. The regional instability affects tourism receipts, lowers foreign direct investment and increases borrowing costs. Moreover, many countries in the region will face sharply higher import bills for food and energy. The Fund, other IFIs and the international community should assist these countries in their transition to a well functioning, fair economic model.

Global Challenges, Global Solutions: The Role of the Fund

The International Monetary System has become an International Financial System. Capital flows now dwarf trade flows. Most economies are now integrated into world capital markets. Financial sectors have become interconnected and a channel for rapid transmission of crises across regions and at a global level.

The size of international capital flows and of trans-border claims and liabilities requires Fund surveillance to adapt its focus and the way it is conducted.

I will focus on three major topics:

- The analysis of international capital flows and of financial sector stability issues must become more prominent, if not central, in the Fund's surveillance;
- Bilateral surveillance must be complemented with multilateral surveillance;
- The ability and willingness of countries to heed Fund advice, the so-called traction of Fund surveillance, must be improved.

Surveillance, International Capital Flows and the Financial System

The surge in international capital flows is the most profound change in the international financial system during the last few decades. Countries can now finance, for longer periods and with larger amounts, imbalances before adjustment becomes unavoidable. Increasingly large amounts of international credit are intermediated by the financial sector, which assumes large amounts of maturity transformation and credit risks.

Making the financial sector more stable and better equipped to absorb losses is not sufficient. Compliance of individual banks with prudential regulations does not assure the stability of the system as a whole. Macro-financial stability concerns must be kept under constant review. The Fund has rightly recommended that national authorities should receive a clear mandate to preserve macro-financial stability. If not assigned to the central bank, close cooperation with the central bank is essential. In the European Union, the European Systemic Risk Board (ESRB) has been established at the beginning of this year and assumes this important task at an EU-wide level. I see parallelism and potential for synergy between the mandate of the ESRB and IMF surveillance, even if the IMF's surveillance is broader in scope.

The Fund's decision of September 2010 that the 25 countries with a systemically important financial sector will undergo, at least every 5 years, an in-depth assessment of their financial sector, is a welcome milestone. The Board has rightly stressed that financial sector policies are important in all cases of bilateral surveillance.

There is a clear understanding on the division of responsibilities between the financial sector standard setting bodies, such as the Basel Committee, the Financial Stability Board and the IMF. Agreeing and adopting internationally coordinated prudential regulation is certainly the responsibility of national authorities. The Fund must monitor how well countries comply with these rules. The Fund should help identify gaps and shortcomings in the set of international rules and norms to avoid regulatory arbitrage and growing financial sector vulnerabilities.

Multilateral Surveillance

Bilateral surveillance primarily focuses on how national policies must be conducted in the country's own best interest. However, trade and financial integration and economic interdependence are now so far advanced that national economic interests must be pursued in a shared framework of collective stability.

National policies, pursued in the country's own best (short-term) interest, might not be collectively consistent. The emergence of the global imbalances is an important example.

The Fund must better document the positive and negative spillovers of major countries' policies on the rest of the world. To complement bilateral surveillance, the Fund must formulate policy-oriented advice on how to improve the coherence of national policies toward improved collective stability and sustainable global growth.

Traction of Fund Surveillance

The added value of Fund surveillance rests on the political independence of the Fund's opinion. The Fund's analysis puts longer term considerations above short-term political calculus.

The Fund must remain a trusted advisor and avoid public clashes about short-term market sensitive issues. At the same time, the IMF must be pro-active in persuading the public opinion of the long-term costs of unadjusted policies.

In the recent past, we had an intense debate on improving the governance of the IMF and on enhancing ministerial involvement. As I see it, the primary task of the IMFC is to seriously discuss policy-oriented multilateral surveillance reports. This is a task that the IMF Executive Board can only prepare. In the end, it is up to policymakers at the highest level, united in the IMFC and representing the entire membership, to agree on how consistency among countries' policies and policy coordination can be improved. If we are successful in this ambition we will have achieved much in finding global solutions to global challenges.