Statement on Behalf of the World Bank Group
STATEMENT TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE ON BEHALF OF THE WORLD BANK GROUP

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The Global Economy

The recovery of the global economy has continued to strengthen despite growing tensions and potentially disruptive events. Developing country GDP grew 7.3 percent in 2010, and after a pause in the third quarter of that year, industrial production and trade are once again expanding rapidly. The recovery in high-income countries, though less advanced, has strengthened further with improving labor market conditions increasing its self-sustaining nature.

The World Bank projects growth to remain strong in 2011 through 2012, despite rising inflation, high international food and fuel prices, the political turmoil in the Middle-East and North Africa and the natural disaster in Japan. GDP in developing countries is projected to increase by more than 6 percent in both 2011 and 2012.

Although the momentum of the recovery has strengthened, significant risks continue to cloud the outlook:

- A worsening of conditions in the Middle-East and North Africa could derail global growth. Though by themselves the economic disruptions directly associated with the Middle-East and North African political turmoil (or the earthquake, tsunamis and nuclear crisis in Japan) should have minimal impacts at the global level. GDP growth in Egypt and Tunisia is expected to come in at around 2.5 and 1.5 percent respectively, about 3 percentage points lower than expected 3 months ago. If oil prices were to rise sharply and durably—either because of increased uncertainty or due to a significant disruption to oil supply, global growth could slow by between 0.3 and 1.2 percentage points in 2011 and 2012, respectively.

- High food and fuel prices pose a threat to global inflation, and hence growth and poverty reduction. Policy tightening currently underway worldwide should prevent an inflationary spiral. If not, a sharper tightening of policy may be required in 2012—implying a weaker outlook in that year for those countries most directly affected.

- A poor crop in 2011 or a sharp rise in oil prices could cause domestic food prices in developing countries to rise much higher, with dire consequences for poverty. To date, food prices in most developing countries have increased 6.6 percent since June 2010, much less than the 42 percent increase in international dollar prices. The difference is explained mainly by still low rice prices, and good crops in many developing countries (more than 80 percent of food is locally produced). If local conditions in developing countries worsen over the coming agricultural season, requiring greater imports, aggregate effects on jittery international markets and their pass-through could bring significantly higher prices to the poor in many developing countries that have so far avoided the worst effects of the run up in international prices.

In the past few weeks, agricultural and oil prices have suffered from even higher volatility than has become the recent norm, driven largely by the tragic events in Japan.
and continuing unrest in the Middle East and North Africa. There was a widespread sell-off across markets starting March 7th, due to increased risk aversion and market concern that rising crude oil prices could cause a slowdown in global economic recovery. This was exacerbated on March 11th, as the world became aware of the unfolding disaster in Japan. Between March 7th and 17th, international grains prices posted major losses, especially in wheat, which declined 20 percent while the price of maize fell by 15 percent. During the same period, oil prices declined 7 percent.

Since then, both oil and agricultural markets have posted strong price recoveries. Corn reached its 2008 price level on April 4th, with the stocks-to-use ratio (5 percent) in the U.S. at its lowest since the 1930s. Wheat has regained its highs of summer 2010. Soybeans remain over 50 percent more expensive than a year ago, despite bumper crops in South America. Crude oil remains over $100/bbl, with Brent recently breaking through the $120/bbl level. This roller-coaster is not good for business and—particularly with respect to food prices-- is potentially catastrophic for the world’s poor. For this reason, the World Bank Group is working intensively to help improve food security for the poorest and most vulnerable. World Bank President Robert Zoellick has set out a 9-point plan to increase long-term agricultural productivity and resilience, address some of the most pressing weaknesses in international food markets and improve the efficiency and effectiveness of humanitarian food aid with the overarching goal of ensuring the most vulnerable populations are not closed out of access to adequate and nutritious food.

Strengthening the international monetary system

Policy makers—particularly in many emerging markets and developing countries—have reaped the benefits of having pursued sound policies—both macroeconomic and structural—over the past decade and in the years leading up to the global financial crisis. As a result, resilience in the face of volatile capital flows has been enhanced. At the national level, mutually reinforcing improvements in public debt management, more developed local currency bond markets, reduced debt burdens, low and steady inflation, and (in many developing and emerging markets countries) more flexible exchange rates have helped many countries deal with rapidly changing external conditions—from acute global liquidity shortages in late 2008, to a subsequent overabundance of capital more recently. The World Bank Group continues to support the efforts of its client countries to enhance their resilience, including through its work to help improve debt management capacity, develop local currency bond markets, deepen financial markets and develop their financial sectors, and address structural impediments to more open and flexible national economies.

But while better preparedness has been instrumental in helping countries cope in an environment of large and rapid capital movements, the challenges faced by economic policy makers have not been negligible. This, alongside broader considerations related to the origins of the global crisis, rightly underpin the desire of the international community to strengthen the international monetary system.

Experience in the wake of the global financial crisis has led to a reconsideration of the importance of capital flow management policies. The renewed appreciation of the contribution that temporary capital flow measures (CFMs) can play alongside appropriate macroeconomic policies and macro-prudential measures is grounded in successful experience with their use by a number of emerging market economies. As the international community
learns from their experience and policy makers continue to innovate, it will be important to ensure that this knowledge and experience is shared widely.

For this reason, the international community would be well served to work toward a broadly agreed set of principals or a framework for the use of policies on the management of capital flows. This will help ensure that policy makers—both present and future—have ready access to a menu of good practice in the management of capital flows that takes into account the potential externalities associated with national policies. It will also facilitate the provision of consistent and even handed economic policy advice from international organizations like the World Bank and IMF and reduce the potential market stigma associated with the use of capital controls as markets come to better understand the positive contribution that well designed and temporary CFMs can make to longer-term monetary and financial stability and economic growth.

The international community can also contribute to the stability of the international monetary system by ensuring that the surveillance framework is adequate to identify and address—frankly and in a balanced way—the externalities that national policies, particularly of the largest economies, have on other countries, and the international monetary system more broadly. In this regard, the World Bank Group is committed to supporting the G20’s Mutual Assessment Process (MAP) and we are supportive of efforts to ensure that the IMF’s surveillance framework is adequate to the demands of an increasingly interconnected global economy.

The agenda for reform of the international monetary system is broad, complex and challenging. Making progress will therefore require significant political will, long-term vision, and an ability on the part of leaders to see beyond narrow short-term national interest. But the severity of the global financial crisis underlines the importance of taking tough decisions. In this regard, we need to ensure that the breathing space provided by the emerging recovery does not lead to a sense of complacency, with important but difficult reforms being put off to some future date.