

## Annual Meetings to discuss IMF reform

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The Annual Meetings of the IMF and the World Bank, in Singapore on September 19–20, will review developments in the global economy and assess progress in implementing the IMF's new medium-term strategy. Key issues include reform of Fund governance, especially the representation and voice of member countries in the institution; adapting the IMF's surveillance; and creating a new financing instrument that emerging markets can use if capital market conditions suddenly worsen.



Singapore Tourism Board

## Asia and the IMF: strategies for the future

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Asia's dynamism will be on the minds of those attending the upcoming Annual Meetings. The Singapore setting is apt, with the region playing a more prominent role in the world economy and the Fund committed to meeting the evolving needs of its members in the region. David Burton, head of the IMF's Asian and Pacific Department and of a Fund staff team that has drafted proposed changes in members' voice and representation, underscores the importance of a vibrant Asia and a strengthened IMF.



Steve Allen/Picture Arts

## WEO analyzes Asian growth, metals price boom

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What must Asia's surging emerging market economies do to reach the income levels of advanced economies? What has spurred the recent boom in the prices of nonfuel commodities—particularly metals—and is it sustainable? Two analytical chapters in the IMF's latest *World Economic Outlook* examine these topics, spotlighting improved productivity as the key to Asia's future growth and pointing to rising demand as the force behind the boom, which it says is unlikely to last.



HALEY/SIPA

## Rebounding global markets face downside risks

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International capital markets recovered quickly from modest market turbulence in May–June, and the IMF's new *Global Financial Stability Report* projects continued global growth and contained inflation. But downside risks could be triggered by developments like oil price swings. Policymakers should continue to strengthen financial market infrastructure, and emerging market countries will need to bolster risk management structures to deal with rapid household credit growth.



Christien Charisus/Reuters

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# What's on

## SEPTEMBER

- 12** Organization of the Petroleum Exporting Countries Conference, Vienna, Austria
- 12** IMF's September 2006 *Global Financial Stability Report* released
- 14** IMF's September 2006 *World Economic Outlook* (Chapters I and II) released
- 14–15** High-Level Dialogue on International Migration and Development, United Nations General Assembly, New York, United States
- 14–15** Raffles Forum on Good Governance and the Wealth of Nations, Singapore
- 18** 2006 Small States Forum, Singapore

**19–20** IMF–World Bank Annual Meetings, Singapore

**19–20** United Nations General Assembly, High-Level Meeting on the Review of the Brussels Program of Action for the Least Developed Countries, New York, United States

**21** Launch of the World Bank's *World Development Report 2007: Development and the Next Generation*, Manila, Philippines

**21** Launch of the *Report on Economic Development in Africa*, United Nations Conference on Trade and Development, Geneva, Switzerland

**25–26** World Trade Organization Public Forum, "What WTO for the 21st Century?" Geneva, Switzerland

## OCTOBER

**11–12** Eighth Roundtable on Capital Market Reform in Asia, Organization for Economic Cooperation and Development/Asian Development Bank, Tokyo, Japan

**23–27** IMF High-Level Seminar on Current Issues in Monetary and Financial Law, Washington, D.C., United States

## NOVEMBER

**6–7** IMF Symposium on Integrity Supervision of Financial Sector Firms, Washington, D.C., United States

**9–10** Jacques Polak Seventh Annual Research Conference, IMF, Washington, D.C., United States

**17–18** Rio 6: World Climate and Energy Event, Rio de Janeiro, Brazil

**18–19** 14th Asia Pacific Economic Cooperation Economic Leaders' Meeting, Hanoi, Vietnam

**23–24** World Economic Forum, "Connecting Regions—Creating New Opportunities," Istanbul, Turkey

**26–28** World Economic Forum, "India: Meeting New Expectations," New Delhi, India

## JANUARY 2007

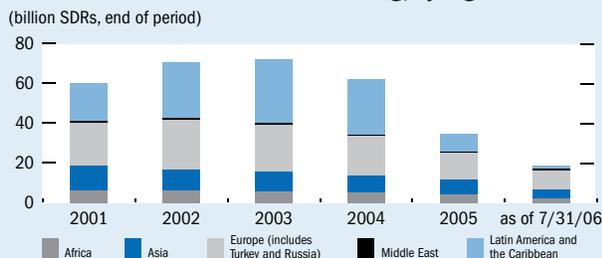
**24–28** World Economic Forum Annual Meeting, Davos, Switzerland

### IMF Executive Board

For an up-to-date listing of IMF Executive Board meetings, see [www.imf.org/external/np/sec/bc/eng/index.asp](http://www.imf.org/external/np/sec/bc/eng/index.asp).

# IMF financial data

## Total IMF credit and loans outstanding, by region

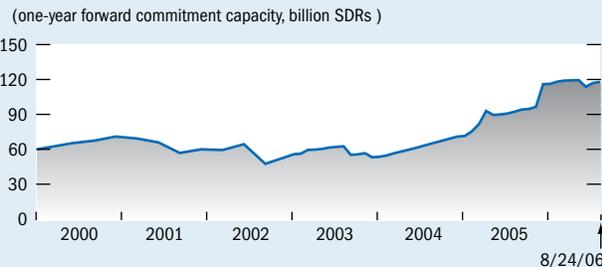


## Largest outstanding loans

(billion SDRs, as of 7/31/06)

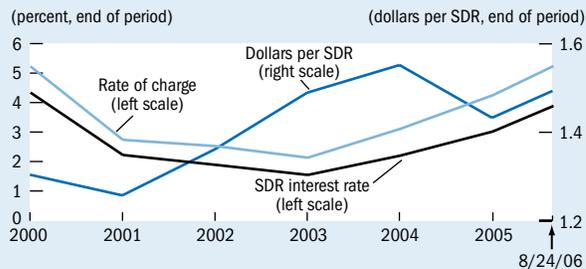
Nonconcessional		Concessional	
Turkey	7.59	Pakistan	0.96
Indonesia	2.43	Congo, Dem. Rep. of	0.55
Uruguay	1.35	Bangladesh	0.28
Ukraine	0.68	Yemen, Republic of	0.16
Serbia, Republic of	0.49	Georgia	0.16

## Available IMF resources



## Related rates

SDR interest rate, rate of charge on IMF nonconcessional loans outstanding, and dollars per SDR



Note: Special Drawing Rights (SDRs) are an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. SDRs are allocated to member countries in proportion to their IMF quotas. The SDR also

serves as the unit of account of the IMF and some other international organizations. Its value is based on a basket of key international currencies.

## IMF–World Bank Annual Meetings

## Spotlight on IMF reform and globalization in Singapore

Economic and financial policymakers, bankers, and other business and opinion leaders from around the world converge on Singapore September 14–20 for a series of formal sessions and informal gatherings and seminars centered on the Annual Meetings of the Boards of Governors of the IMF and the World Bank. Ministers, central bank governors, and officials from 184 member countries will review developments in the global economy and assess progress in implementing a new medium-term strategy for the IMF that was endorsed in April. They are expected to give the go-ahead to proposals for a phased reform of the global institution's governance structure.

It is the first time since the 1997–98 Asian financial crisis that the meetings are being held in Asia. Close to 16,000 delegates and observers are expected to attend the meetings, which are being held in the Suntec Singapore International Convention and Exhibition Center. Since the crisis, the world's most populous region has bounced back sharply. Asian growth is forecast at 7¼ percent in 2006 and 7 percent in 2007. Global growth is also strong, despite high oil prices, and credit outstanding to the IMF is at a 25-year low—partly reflecting the relatively rosy international picture.

Heavy security will be in place throughout the island state of 4.5 million people, which is an important business and trading hub for the region. The week's events get an early start on September 12 with the release of the IMF's *Global Financial Stability Report*, which provides semiannual assessments of global financial markets and addresses emerging market financing in a global context, followed on September 14 by the release of its *World Economic Outlook*, which analyzes global and country growth trends.

A series of meetings and seminars will be capped by the two-day plenary session of the Boards of Governors of the IMF and the World Bank that will be opened on September 19 by Singapore Prime Minister Lee Hsien Loong, following the meetings of the IMF's main advisory committee of governors, the International Monetary and Financial Committee (IMFC), on September 17, and the joint IMF–World Bank Development Committee on September 18. Ministers and central bank governors from the Group of Seven industrial countries are also scheduled to meet in Singapore.

**Implementing the strategy**

The Singapore meetings will take up several issues central to IMF Managing Director Rodrigo de Rato's medium-term strategy for the Fund. The strategy is designed to redirect the institution's work to strengthen its effectiveness. Key issues include reform



Merlion Park is named for the half-lion, half-fish sculpture that is Singapore's national icon.

of the governance of the Fund, especially the representation and voice of member countries; adapting the IMF's surveillance so that it can be more effective in addressing risks to financial stability and economic growth, including by sharpening the focus on financial sector and exchange rate issues, and international spillovers; and creating a new financing instrument for emerging markets to use if capital market conditions suddenly worsen. For low-income countries, following implementation in January 2006 of the Multilateral Debt Relief Initiative for 19 of the poorest countries, the focus will be on helping governments make the best use of stepped-up aid.

**Reforming governance**

The Executive Board has recommended to the IMF Board of Governors a package of reforms on quotas and voice in the IMF to better align the Fund's governance regime with members' relative positions in the world economy and to make it more responsive to changes in global economic realities. Equally important, the package also seeks to enhance the participation and voice of low-income countries in the IMF. The Board of Governors is being asked to vote on the package of reforms by September 18, in time for the Annual Meetings in Singapore.

Commenting on the package, Managing Director Rodrigo de Rato said, "the Executive Board's decision represents an endorsement of fundamental reform that will enable the Fund to evolve to meet the challenges of a changing global economy. To meet global challenges, we need to make sure the voice and representation of members is appropriate and the system that determines governance of the Fund is as transparent as possible."

The quota and governance reforms are designed as an integrated two-year program that should be completed no later than the Annual Meetings in 2008. The reform package consists

of the following elements: initial ad hoc increases in quotas for a small group of the most underrepresented countries comprising China, Korea, Mexico, and Turkey; a work program after Singapore involving agreement on a new formula to guide the assessment of the adequacy of members' quotas in the IMF; a second round of ad hoc quota increases based on the new formula; and an increase in the basic votes that each member possesses to ensure adequate voice for low-income countries in the IMF.

A member's quota determines its financial commitment to the IMF, plays an important role in determining its voting power, and has a bearing on its access to IMF financing (see box).

### Stepping up surveillance

While the global economy is strong, the IMF has been taking steps to improve its regular surveillance of economic and financial developments at the global, regional, and national levels. Analytical tools are being bolstered, and the IMF has added a new vehicle—multilateral consultations—to help resolve issues of systemic or regional relevance. De Rato is likely to brief governors on progress in the first consultation, which is focusing on how to address global current account imbalances while maintaining robust global growth. These imbalances are seen as most likely to be unwound in a smooth, market-led way, but also to be potentially dangerous for the world economy.

As part of this first multilateral consultation, IMF staff have held initial talks separately with China, the euro area, Japan, Saudi Arabia, and the United States on how to curb the imbalances while maintaining global economic growth. In the coming months, it is envisaged that the IMF will orga-

nize multilateral talks jointly with the five participants. But de Rato has cautioned that the imbalances cannot be resolved swiftly. "Global imbalances are a complex problem that took many years to build up; it would be unrealistic to expect the problem to be resolved through a magic bullet."

Also on the agenda is contingent financing. The IMF is looking at ways to adapt its financing facilities to the evolving needs of emerging market countries. Many of them have in the past been big borrowers from the Fund, but have recently not needed to borrow IMF resources. De Rato said in a speech at the Brookings Institution on September 5 that it was important that emerging market countries still be able to come to the Fund if financial market conditions worsen. "For this reason, I have proposed that we develop a new instrument to provide liquidity for emerging market countries that have strong fundamentals but remain vulnerable to shocks."

### Reviving trade talks?

As for the stalled Doha trade talks—a topic likely to surface in Singapore—de Rato said, in a September 8 speech in Calgary, Canada: "there is now a need to ensure that the current impasse marks a brief pause, rather than a collapse, in the negotiations." He called for pro-trade voices to be heard more loudly. "It is untenable, for instance, that in rich countries, farm interests that account for less than 4 percent of employment are effectively able to block a deal to open new markets for services and manufactures, which account for over 90 percent of employment," de Rato declared. ■

Jeremy Clift

IMF External Relations Department

### Why is a country's IMF quota important?

A country's quota in the IMF determines how much it must deposit at the IMF as a capital subscription, and how much it can borrow under the IMF's various facilities and policies when it has a balance of payments need. It also plays a role, together with basic votes, in determining voting power in decision making at the Fund.

- **Subscription.** A member must pay its subscription in full on joining the Fund: up to 25 percent of its quota must be paid in the Fund's unit of account, called special drawing rights (SDRs), or widely accepted currencies (such as the U.S. dollar, the euro, the yen, or the pound sterling); the rest is paid in the country's own currency.

- **Voting power.** Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of its quota. Accordingly, the United States has 371,743 votes (17.1 percent of the total), and Palau has 281 votes (0.013 percent of the total).

- **Borrowing.** The amount of financing a member can obtain from the IMF (its access limit) is based on its quota. For nonconcessional lending, a member can borrow up to 100 percent of its quota annually and 300 percent cumulatively. However, higher access may be granted in exceptional circumstances.

Basic votes are intended to ensure that all members, however small, have some weight in influencing the Fund's policies and operations. But because basic votes have not changed since the IMF was established, while quota-based votes have risen through several general increases in quotas, basic votes as a proportion of total votes have steadily eroded. Basic votes now account for 2.1 percent of total votes, compared with 11.3 percent in 1945 and a peak of 15.6 percent in 1958.

The IMF's Thirteenth General Review of Quotas is scheduled to be completed by January 2008.

## Interview with David Burton

# Asia and the world have much to gain from a strong IMF

The upcoming IMF–World Bank Annual Meetings in Singapore will take place against a backdrop in which Asia is playing an increasingly dynamic role in the world economy and the IMF is reforming its governance, policy advice, and operations to meet globalization’s challenges and its members’ evolving needs. David Burton—Director of the IMF’s Asia and Pacific Department and head of the Fund working group on quota and voice reform—speaks with the *IMF Survey* about the significance of progress on voice and quotas in the IMF and about the opportunities and challenges that the future has in store for the Asian region.

**IMF SURVEY:** What will an adjustment of members’ quotas and votes in the IMF mean for China and Korea and, ultimately, for the Asian region? And what do you say to critics who charge that this will not alter the status quo in the IMF?

**BURTON:** On August 31, the IMF’s Executive Board agreed on an important package of quota and voice reforms, which it has proposed to the Board of Governors for approval (with the vote to be completed by September 18). The broad goals are twofold: to make progress in realigning members’ quotas with their weight in the global economy—this should benefit a number of emerging market economies, including some in Asia—and, equally important, to enhance the voice and participation of low-income countries.

We’ve been able to move ahead on this issue because the membership sees these reforms as vital for the future effectiveness and credibility of the IMF. Countries also recognize that this is not a zero-sum game. The reforms will strengthen the Fund; and all countries, not least those in Asia, will gain. China and Korea, as well as Mexico and Turkey, will receive initial ad hoc quota increases. But other dynamic emerging market countries will benefit from the further reforms that are part of the package.

What would I say to critics? The proposed reforms will bring about significant progress in realigning members’ quota shares over the next two years, and they will allow for more flexibility of quota shares in the future. The reforms call for the first increase in basic votes since the Fund was established and create a mechanism to preserve the share of basic votes in total voting power. While the proposed reforms are far

reaching, the structure of voting power will not change dramatically overnight: the IMF is a cooperative institution, and change has to be measured and respectful of the interests of all members.

**IMF SURVEY:** What is the IMF’s strategic role in Asia?

**BURTON:** The Fund welcomes Asia’s strong recovery from the 1997–98 crisis and impressive economic growth record, which stands out as the best among emerging markets in recent years. The IMF’s role has now returned to a more normal and desirable position, where it focuses on its traditional role of conducting surveillance.

We believe Asia, like other regions, benefits from effective IMF surveillance, including through the new multilateral consultation instrument. As an economic region that is very open to both capital flows and trade, Asia has much to gain from global financial stability and healthy global economic growth—two goals that a strong Fund can promote.

As part of the IMF’s medium-term strategy and in response to calls from Asian policymakers, the Fund is focusing its advice on crisis prevention, improved financial sector surveillance, and strengthened regional and global surveillance. Also, many countries in the region still face challenges related to large fiscal deficits and high public debt, and in many cases more progress needs to be made on structural reforms, strengthening financial systems, and improving the investment climate. These are areas where the Fund’s knowledge and cross-country experience can be helpful.

Asia’s emerging market economies would also benefit from having access to IMF financial resources in times of need. While some countries have amassed ample reserves and strengthened regional economic ties, holding large reserves is costly, and regional financing arrangements, although complementary to Fund financing, have limits. The IMF is considering a new liquidity instrument that would allow emerging market members with strong policies to benefit from added protection while reducing the need for large precautionary reserve holdings. We clearly see some interest in such an instrument in Asia.

**IMF SURVEY:** What are the prospects for increased financial integration in the region?



Burton: “Strengthened intraregional financial linkages are a high priority for Asian governments that want to better use the region’s record-high savings.”

Eugene Salazar/IMF

**BURTON:** Asia's economies are, by most metrics, well connected with global financial markets. But regional financial integration—as measured, for instance, by cross-border banking or portfolio flows—is much less advanced. Strengthened intraregional financial linkages are a high priority for Asian governments that want to better use the region's record-high savings, and they can serve as an added catalyst for intraregional trade.

The IMF strongly supports initiatives under way to deepen local bond markets, further develop market infrastructure, harmonize financial regulations with international best practice, and provide financing through the Chiang Mai Initiative. Cross-country financial ties are also being established largely in a bottom-up, market-driven process: regional banks, firms, and investors increasingly favor a pan-Asian focus in their expansion, financing, and portfolio decisions. But regional policy initiatives are playing an important enabling role.

I have little doubt that market-driven integration, bolstered by appropriate institutions, will gather steam in the foreseeable future. In fact, deeper domestic and regional markets will stimulate greater intraregional capital flows and lead to greater market depth and breadth. These stronger financial linkages may eventually lead to monetary cooperation, but a single currency is a distant goal, at best. Convergence of the region's economic and legal structures is far from complete, and it will take considerable time before the requirements for monetary unification are met.

The immediate challenge for Asian governments is to adopt policy frameworks that balance the need for stable exchange rates—to promote intraregional trade of goods and capital—with the need to cope with international capital mobility that arises from financial integration, including the risk of sudden changes in investor sentiment. In my view, this balance is best achieved through flexibly managed exchange rate systems.

**IMF SURVEY:** *Is the suspension of the Doha talks likely to intensify the push to form regional trade arrangements?*

**BURTON:** The suspension is disappointing, because the world is missing an important opportunity to boost the global economy and raise growth prospects in poorer countries. And, yes, it is likely to galvanize efforts to forge and deepen regional or bilateral trade agreements.

Such trade agreements may have benefits, of course, to the extent that they promote customs cooperation, spur the harmonization of standards, and further the integration of the economies concerned. But they may also distort trade. To mitigate these risks, the agreements should have broad-based product coverage; emphasize complementary liberalization based on most-favored-nation status; and implement transparent, consistent, and liberal rules of origin. Even at their

best, though, regional trade deals are no substitute for successful multilateral reform. Getting the Doha Round moving forward again is therefore of great importance.

**IMF SURVEY:** *Asia, despite its rapid growth, has a large portion of the world's poor. How can the IMF help Asia reduce poverty?*

**BURTON:** Our goal remains to work closely with Asia's 17 low-income countries, which are a diverse group with diverse problems. Don't forget that China and India, despite significant progress in poverty reduction, are still home to millions of poor people. The IMF is helping in various ways. In some countries, Fund financing is supporting adjustment and reform programs. In others, we work closely through surveillance, extensive technical assistance, and collaboration with donors and other agencies. The IMF recently provided debt relief to Cambodia.

An important aspect of the IMF's medium-term strategy is to ensure that our engagement in low-income countries is more effective. Our work must support market-oriented policies and economic institutions conducive to sustained growth, trade, and poverty reduction. We're working with countries to ensure that macroeconomic policies are geared toward debt sustainability, durable economic growth, and maximizing the ability of these economies to absorb aid and benefit from debt relief. The aim is to achieve higher growth and attain the MDGs [Millennium Development Goals]. All of Asia's low-income countries have made some strides toward poverty reduction, but much more remains to be done.

**IMF SURVEY:** *Are there lessons that developing countries in Asia and elsewhere can draw from the economic successes of China and India?*

**BURTON:** Absolutely. It's incontestable that sustained reforms and openness to trade are worth the effort and that regulatory reform and the reduction of red tape pay off. Look at the very different performances of India's manufacturing sector, which has languished under the burden of government regulations and licensing requirements, and its services sector, which has flourished under a much freer regulatory regime.

Infrastructure is essential, too, and governments need the fiscal space to develop adequate infrastructure. This is still very much an issue for India. Also, you see how crucial human capital can be. India's investment in higher education has paved the way for its success in information technology and other high-skill businesses.

Finally, to cope with a globalized world in which production is constantly shifting and technology is constantly changing, economies have to become increasingly flexible. Businesses must be able to adapt quickly, and that's why it is critical to minimize the burdens of regulation and red tape. ■

## Bolivia needs to cement macroeconomic gains and boost growth

Over the past year, Bolivia experienced major political changes, culminating in the election in December 2005 of its first indigenous head of state. The government of Evo Morales inherited a favorable macroeconomic situation. In 2005, according to the IMF's latest economic review, GDP growth exceeded 4 percent, the fiscal deficit was 2.3 percent of GDP, and inflation was below 5 percent. Financial sector stability improved, the balance of payments was strong, and official foreign exchange reserves rose. The Multilateral Debt Relief Initiative reduced Bolivia's public debt. But key social indicators continued to lag.

Executive Directors agreed that, partly because of strong prices of hydrocarbons exports, Bolivia's short-term prospects are favor-

<b>Bolivia</b>	2003	2004	Prel. 2005	Proj. 2006 <sup>1</sup>
		(percent change)		
Real GDP	2.9	3.9	4.1	4.1
Consumer prices (end-period)	3.9	4.6	4.9	4.0
		(percent of GDP)		
Total public debt	74.0	77.2	70.1	50.8
Overall balance	-7.9	-5.6	-2.3	-0.1
Gross international reserves <sup>1</sup>	1,266	1,474	2,019	2,564

<sup>1</sup>In dollars. Excludes reserves from Latin American Reserve Fund and includes offshore liquidity requirements.  
Data: Bolivian authorities and IMF staff estimates and projections.

able, but they noted that medium-term challenges remain. They encouraged the government to cement recent macroeconomic gains, enhance the business climate, and promote growth. Directors stressed the importance of fiscal prudence and strengthened public expenditure management, and recommended that attention be given to enhancing domestic taxation.

Expressing concern about large explicit and implicit subsidies, Directors urged that domestic petroleum product prices be moved gradually to international levels and that a part of the resulting fiscal savings be used to protect vulnerable groups.

Directors observed that, in the hydrocarbons sector, considerable uncertainty surrounds the modalities for implementing the recent nationalization decree. They urged the authorities to work toward achieving mutually acceptable arrangements with the oil companies concerned.

Directors welcomed the government's emphasis on greater equity, transparency, and accountability. However, they saw the parallel emphasis on an increased role for the state as risking the environment for private investment. Directors recommended that the authorities maintain a careful balance between government interventions in the economy and the preservation of appropriate incentives for private investment to support growth and raise employment and living standards. ■

## Accelerated reforms will help reduce poverty and unemployment in Indonesia

The IMF's recent economic review found that, despite devastation caused by earthquakes and tsunamis, Indonesia has made steady economic progress over the past few years, with growth reaching a nine-year high in 2005. Macroeconomic vulnerabilities have also declined: public debt has continued to fall, banking sector performance has improved, and corporate vulnerabilities have diminished. Sound macroeconomic management has helped reestablish policy credibility and resulted in large capital inflows. Reserves have thus reached record highs, enabling Indonesia to make partial early repayments to the IMF in June 2006.

Growth slowed in early 2006, reflecting domestic fuel price and interest rate increases introduced last fall to help restore financial market confidence. With inflation trending down, however, interest rates are expected to fall and, thanks in part to the expected acceleration in government spending, real GDP growth is expected to reach

<b>Indonesia</b>	2003	2004	2005	Proj. 2006
Real GDP (percent change)	4.8	5.1	5.6	5.2
Consumer prices (percent change; end-period)	5.2	6.4	17.1	7.0
Gross reserves (billion dollars; end-period)	36.3	36.3	34.7	40.8
Total external debt (percent of GDP; end-period)	57.7	54.0	47.6	39.0

Data: Indonesian authorities and IMF staff estimates.

5.2 percent in 2006. That said, downside risks remain. Further tightening in global financial markets could prevent the planned easing in domestic interest rates, and higher international oil prices could have an unfavorable impact on the budget, growth, and inflation.

Executive Directors commended Bank Indonesia for its cautious approach in cutting interest rates and agreed that the pace and timing of further cuts would need to take into account global financial market developments. They welcomed the government's efforts to improve the transparency of public spending while continuing to improve budget execution. They also welcomed authorities' intentions to address banking sector vulnerabilities and strengthen financial intermediation in the context of the recently announced financial sector reform package. In particular, they stressed the importance of dealing with problems at the two largest state banks, where nonperforming loans have risen considerably in the past year and governance remains weak.

Looking ahead, Directors emphasized that the key challenge is to boost economic growth to help alleviate poverty and reduce unemployment. To this end, they commended the authorities for adopting an impressive structural reform agenda but stressed that forceful implementation would be key to enhancing investor confidence and promoting private sector-led growth. ■

For more information, please refer to IMF Public Information Notices Nos. 06/77 (Bolivia) and 06/91 (Indonesia) on the IMF's website ([www.imf.org](http://www.imf.org)).

## Asia is rising, but the next steps may be the hardest

Over the past three and a half decades, Asia's growth has been nothing short of dazzling. Most of the region is progressing steadily toward advanced levels of per capita income. But securing full convergence will require continued productivity gains and action to tackle poverty rates, which remain high in some countries. Chapter III of the September 2006 *World Economic Outlook (WEO)* examines the progress Asia has made thus far and outlines the crucial next steps.

Since 1970, output per capita has grown, on average, by 4 percent a year in the 18 Asian economies that the *WEO* analyzed (see box). The study finds that growth in most of these countries has been driven by the fast accumulation of physical and human capital (see chart below), as well as by rapid increases in total factor productivity. These developments, in turn, attest to the region's generally strong policy environment.

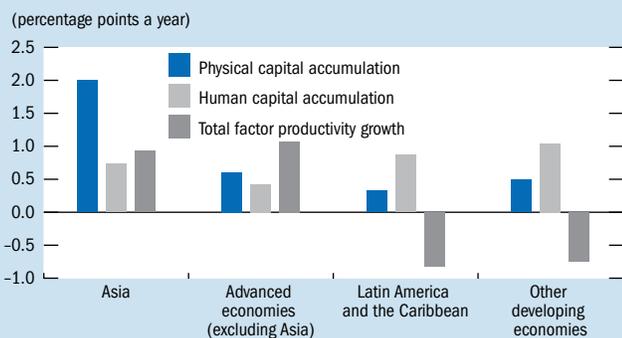
### A long way to go

Achieving convergence with advanced-economy per capita income levels, however, will require significant measures on several fronts. The *WEO* highlights the following key steps:

- **Boosting productivity.** Asian countries are continuing to catch up to advanced-economy productivity levels in manufacturing, but this process has come to a halt in the services sector (see chart, right). To encourage competition and productivity growth in this increasingly important sector, Asian countries will need to remove barriers to entry (both domestic and foreign), streamline regulations, and strengthen human capital.
- **Reducing surplus rural labor.** Many Asian countries still have significant potential to shift surplus agricultural labor to industry and services. Since 1970, such labor shifts have

### Growing more productive

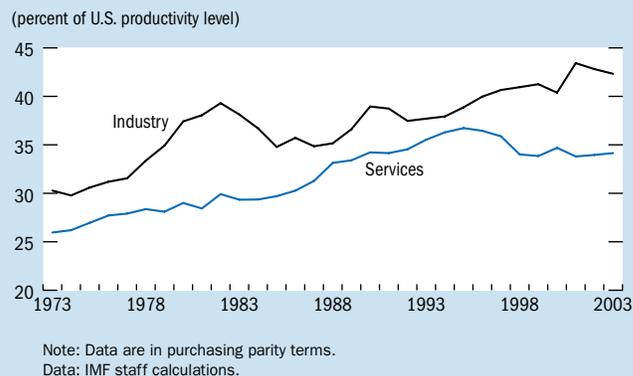
Asia's rapid development has been propelled by striking gains in labor productivity.



Data: IMF staff calculations.

### Room for improvement

Asia's productivity levels still have a way to go, however, before they can catch up with those in the United States.



accounted for about one-fourth of Asia's catch-up to U.S. productivity levels. The share of agriculture in employment remains large in most of developing Asia, however. Fortunately, the same measures that are likely to stimulate productivity growth in industry and services will also help these countries transform their economies and reduce rural poverty. These crucial reforms will entail further liberalizing trade, broadening and deepening financial systems, strengthening human capital, and remedying widespread weaknesses in infrastructure. Fostering flexible labor markets while establishing social safety nets will also be a key element in the reform process.

### Recipe for growth

In sharp contrast with Asia's performance, the world's other developing countries have seen their GDP per capita grow since 1970 by a meager 1 percent a year. There are important lessons here for late-developing countries in both Asia and other parts of the world. In particular, the *WEO* study argues, the Asian experience shows that stable macroeconomic frameworks, openness to trade, strong institutions, and well-developed financial systems are vital ingredients in achieving strong and sustained growth. ■

Florence Jaumotte and Nikola Spatafora  
IMF Research Department

The study drew data from 18 economies: Bangladesh, Cambodia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Lao P.D.R., Malaysia, Myanmar, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan Province of China, Thailand, and Vietnam.

The full text of the analytical chapters of the September 2006 *World Economic Outlook* is available on the IMF's website ([www.imf.org](http://www.imf.org)).

## Why the boom in nonfuel commodity prices may not last

The recent dramatic increase in many commodity prices has stimulated debate over what may be driving it and questions about whether it can be sustained. Chapter V of the IMF's latest *World Economic Outlook* takes a closer look at developments and argues that average prices will recede.

Among nonfuel commodities, price increases have been particularly strong in metals. In July 2006, metals prices were, in real terms, 180 percent above their average value during 2002—outpacing even the real price of oil, which rose by 157 percent (see chart). There is no doubt about the boom, but there is considerable debate about its causes.

### The price of rising demand

Drawing on its analysis, the *WEO* sides with those who argue that rapid growth of demand, particularly in China, is driving metals prices. Quite simply, demand has outpaced the speed at which supply can be expanded. Consumption of aluminum, for example, grew by 7.6 percent a year during 2002–05, compared with 3.8 percent a year during the previous decade. Given long investment gestation lags, prices can rise significantly in response to unexpected demand increases.

How much of this is driven by China? According to the *WEO*, that country accounted for about half of the increase in net world consumption of the main metals (aluminum, copper, and steel) over the past four years. Yet Chinese demand is not out of line with fundamentals—in per capita terms, its consumption of metals is now similar to that of Japan and Korea during their initial development phase. Given its fast growth and rising share in the world economy, China is expected to retain its critical role in driving commodity markets.

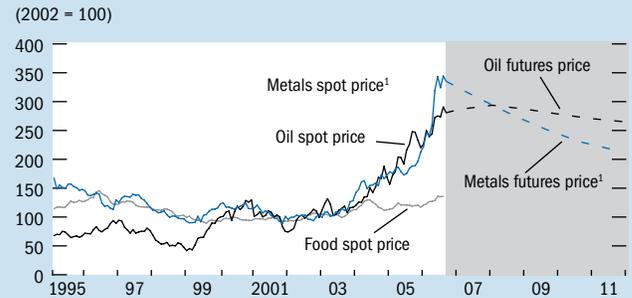
For food and other nonfuel commodities, the price response to strong global growth has been much less dramatic. Consumption of agricultural commodities has grown more slowly than that of metals, and agricultural supply has responded considerably faster to demand growth.

Have financial investors also had a hand in driving up nonfuel commodity prices? Apparently not. The *WEO* notes that speculative investments in commodity futures markets have increased significantly over the past several years, but finds that investors have built long and short positions that have effectively offset each other in terms of price movements.

There is also little statistical evidence that net speculative positions drive changes in spot prices. On balance, investors seem to follow rather than create price trends. Interestingly, net speculative positions in the copper market declined during the run-up of copper prices earlier this year. ■

### Rise and fall

Metals prices have shot up recently but are likely to shed much of this gain over the next few years.



Note: Monthly data in nominal terms.

<sup>1</sup>Weighted average of aluminum, copper, lead, nickel, tin, and zinc prices.

Data: Barclays Capital; Bloomberg Financial Markets, LP; and IMF, Commodity Price System database and staff calculations.

### What next?

As for the future, the *WEO* sees little likelihood that current highs in metals prices can be maintained. Metals prices are above sustainable levels under various assumptions about global growth, additions to productive capacity, and the price responsiveness of supply and demand. In the baseline scenario, the real prices of aluminum and copper are forecast to decline by 35 and 57 percent, respectively, by 2010.

Metals prices tend to converge to production costs in the medium term, and current prices are well above production costs. At present, the ratios of market prices to costs are between 1½ and 2¾ for the main metals. Futures markets are consistent with this situation, predicting a gradual price decline for most metals over the next five years.

For food and other agricultural commodities, real prices are likely to follow the longer-term downward trend as continued technological progress offsets rising input costs. Possibly bucking this trend are the commodities closely linked to energy, such as sugar and corn (through ethanol production for flex-fuel vehicles) and natural rubber.

Finally, the temporary nature of the current boom holds significant implications for policymakers in exporting countries. For the longer-term well-being of these economies, it will be critical that income windfalls be either largely saved or used to support future growth in noncommodity sectors. ■

Martin Sommer  
IMF Research Department

## Strong capital markets weather turbulence, but risks loom

The world's financial system is expected to benefit from continued growth and contained inflation over the coming months, but it will also be subject to downside risks, according to the IMF's new *Global Financial Stability Report (GFSR)*. The biannual report cautions that higher inflation and further monetary tightening, oil price surges, a larger-than-expected decline in the U.S. housing market, or a disorderly unwinding of global imbalances could lead to market corrections. Market features, such as "crowded trades" and illiquid secondary market conditions for some structured credit products, could amplify a downturn. The report also highlights the rapid rise in household credit in many emerging market countries, noting that household and bank balance sheets could suffer, particularly in the absence of adequate risk management and prudential infrastructure.

Prices retreated and volatility increased in global financial markets in May and June, but the market correction was short lived. Investors appeared to be readjusting their risk positions in response to monetary tightening, rather than reassessing economic fundamentals.

The global economy and international financial markets have been performing well in recent years, mainly because of low interest rates in major countries. In many countries, corporations and financial institutions, marked by strong balance sheets and substantial liquid assets, have been quite profitable. Many emerging market countries have improved their fiscal positions, accumulated reserves, and strengthened public debt structures.

### Dealing with downside risks

According to the report, the recent turbulence is a timely reminder for policymakers to strengthen macroeconomic policies and pursue structural reforms to reduce vulnerabilities. In the same vein, market participants should intensify their risk-management efforts, and financial supervisors need to improve market infrastructures to limit the amplification of market corrections. Emerging market countries that rely heavily on external financing should reduce vulnerabilities and pursue reforms that will help them sustain their current growth performance.

There is good reason for policymakers, market participants, and supervisory agencies to be more alert. The *GFSR* weighs the potential risks:

**Growth slowdown.** While projections are for continued strong global growth, risks are tilted to the downside, and a lower-than-expected growth outturn could result in a correspondingly negative outcome for financial markets. In particular, a rapid deceleration of house price growth could

increase the financial burden of heavily indebted households in many countries, reducing personal consumption and affecting asset markets adversely.

**Interest rates and risk premiums.** Sustained high rates of global growth have absorbed spare capacity, raising inflationary pressures, with moderate inflation increases in the United States and Europe. The use of higher policy rates to counter such pressures, should they intensify, could increase the downside risks (see chart, this page). Inflation expectations have generally remained within a narrow range in recent years, and, although there has been some increase in long-run inflation expectations in the United States, term premiums have not gone up. However, if the risk premiums for future inflation increase, asset markets could come under pressure. Supply shocks and geopolitical tensions could make investors retract, forcing risk premiums higher and eroding business and consumer confidence. Corporate and sovereign spreads, which are linked to volatility, could widen. A repricing of credit risk could be amplified by illiquid secondary market conditions for some structured products, which have become popular and useful in dispersing credit risk. Risk-management practices by banks' trading desks and hedge funds should be monitored closely, the report says.

**Disorderly dollar adjustment.** The market view is that any dollar adjustment is likely to be limited and orderly. Forward bilateral exchange rates indicate that the dollar's real effective exchange rate is expected to remain relatively stable, with Asian currencies expected to appreciate over the medium term

### Tighter liquidity

Past tightening episodes suggest that volatility may rise as liquidity is withdrawn.



<sup>1</sup>Includes the U.S. monetary base and foreign official holdings at the Federal Reserve Bank of New York, leading 12 months.

<sup>2</sup>VIX is a measure of the implied volatility of stock index options. Expressed in percentage points, it represents the market's expectation of annualized volatility over the next 30-day period.

Data: Bloomberg L.P. and IMF staff estimates.

and non-Asian currencies expected to weaken. A gradual and orderly adjustment will depend on a credible policy framework for resolving global imbalances over the medium term. The *GFSR* notes that, although the depth, liquidity, and breadth of U.S. financial markets have played an important role in attracting capital inflows and thereby financing imbalances, this advantage may diminish over time as foreign holdings of U.S. assets continue to rise and global markets continue to develop. At the same time, there is a broad trend of liberalization of private capital outflows and diversification of official reserves, particularly in Asia, that should help smooth adjustment.

**Pressure points in emerging markets.** Private capital flows, including foreign direct investment, to emerging markets remained strong in the first half of 2006 despite the recent turbulence. The *GFSR* projects continued capital flows in the months ahead but notes that their composition has changed because of credit booms and related increases in current account deficits in a number of countries. As a result, debt flows to private sector borrowers have increased, while debt flows to public sector borrowers have declined.

### Household credit soars

In many emerging market countries, household credit is growing rapidly, albeit from a low base. This growth is typically beneficial: better access to credit reduces the volatility of household consumption, improves investment opportunities, eases constraints on small businesses, and diversifies household and financial sector assets. When risk management and prudential infrastructure are inadequate, however, rapid credit growth can weaken household balance sheets, contributing to asset price bubbles and creating vulnerabilities for financial systems.

According to the *GFSR*, household credit in emerging market countries has a range of characteristics:

**Level and growth rate.** The average ratio of household credit to GDP in emerging market countries is about 18 percent, with considerable variation among countries (see chart below). Credit growth has been encouraged by the restructuring of banks' asset portfolios and business models in the wake of the financial crises of the late 1990s. In several Asian and Latin American countries, postcrisis bank lending has been led by household credit rather than corporate credit.

**Composition and structure.** The average share of housing loans in total household credit is lower in emerging market countries than in mature market countries, reflecting high and volatile interest rates and hindrances such as an inadequate legal framework for enforcing mortgages. Consumer loans are generally extended at fixed rates, whereas housing loans can carry either fixed or floating interest rates. Although longer terms for housing loans are becoming more common, the tradition of short-term loans persists in many countries despite moderate inflation expectations.

**Providers.** Banks are the largest providers of household credit. Foreign banks have played an important role in the growth of household credit but, in the face of certain restrictions, they have focused on the market for credit cards and personal loans. Government-sponsored lending institutions, particularly in the housing market, are increasingly competing with commercial banks. In many countries, nonbank finance companies and, to a lesser extent, the informal credit sector are often the only available source of household credit.

### Sound policies can lower risk

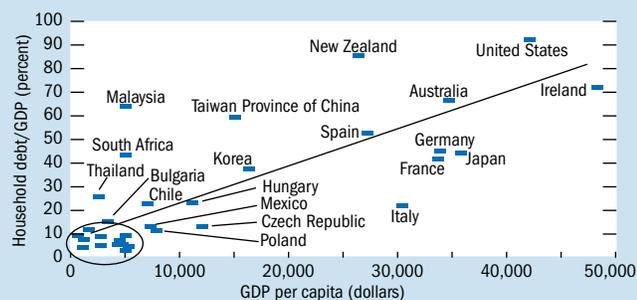
Emerging market household credit has grown during a period of low mature market interest rates and falling emerging market interest rates. If these trends are reversed, weaknesses in household balance sheets could undermine financial sectors, weaken property prices, and slow consumer spending. Excessive mortgage lending could also contribute to the inherent vulnerability of property markets to boom-bust cycles and to cyclicalities in the banking system. Policymakers can minimize the risks associated with rapid credit growth by ensuring a sound macroeconomic policy environment, implementing appropriate prudential regulation, and improving the capacity to assess vulnerabilities. A key step is to improve data availability—particularly on the buildup of credit and exchange rate risks in household credit portfolios at all levels. ■

Ina Kota

IMF External Relations Department

### Catching up

Improved bank lending and restructured asset portfolios have encouraged household credit growth in emerging market countries.



Note: The circled cluster of countries includes Argentina, Brazil, China, Colombia, India, Indonesia, Peru, Philippines, Romania, Russia, Turkey, and Venezuela.  
Data: IMF, September 2006 *World Economic Outlook*, and staff calculations based on data from country authorities; and CEIC.

Copies of the September 2006 *Global Financial Stability Report* are available for \$54.00 each (\$51.00 academic price) from IMF Publications Services. The full text of the latest issue of the *Global Financial Stability Report* is available on the IMF's website ([www.imf.org](http://www.imf.org)).

## Without deeper reforms, euro area's recovery may be short lived

**A** buoyant economic recovery is finally under way in the euro area. But anemic productivity growth and low labor utilization bode ill for Europe's ability to deal with the challenge of population aging. Only through a concerted reform effort, especially designed to lift sagging productivity, will the euro area be able to make a transition to faster, yet sustainable, growth.

After several false starts, the long-awaited euro area recovery has finally arrived (see chart, this page). Real GDP growth should reach about 2½ percent this year and could even turn out to be higher. But the good news is tempered by a weak labor market outlook and still-sluggish productivity growth, which could hold back domestic demand. Moreover, the risks to growth—slowing global growth, unresolved global imbalances and the related potential for euro appreciation, continued high oil prices, and flight from risk in capital markets—will become more pronounced in 2007.

The current upswing has implications for monetary policy. A stubborn tendency for headline inflation to remain above the European Central Bank's (ECB's) inflation objective of "close to but below 2 percent" has understandably prompted the central bank to raise official interest rates after keeping them on hold for two and a half years. The ECB's key rate now stands at 3 percent, with markets expecting another 50 basis points of increases before year's end. Headline inflation is projected to remain above target, so some further tightening will likely be necessary if the expansion proceeds as expected. But caution is needed, given the

risks to growth and given that underlying inflationary pressures are still well contained.

### Long-term outlook remains precarious

Beyond the current cyclical upswing, the euro area still has a long-term growth problem. Lackluster growth, rooted in low productivity growth and insufficient labor utilization and threatened further by the looming demographic shock, offers little scope for catching up with living standards in the United States. Certainly, employment growth over the past decade has been relatively strong, matching that in the United States (and exceeding it in private sector job creation). But productivity growth has slowed dramatically while soaring in the United States through the early years of this decade (see chart, next page).

Why the poor productivity growth? Part of the explanation is Europe's success in moderating labor costs and adopting reforms that stimulate labor-intensive production. But this is not the whole story. Sluggish productivity growth is also related to high job-turnover costs and a lack of competition in product and services markets. Recent research points to a positive correlation between deregulation and productivity growth. This correlation is especially evident in telecommunications and transportation, two sectors that have already seen some liberalization. But deregulation in other sectors, especially in wholesale and retail trade, as well as in the financial sector, is still lagging.

### A strategy for growth

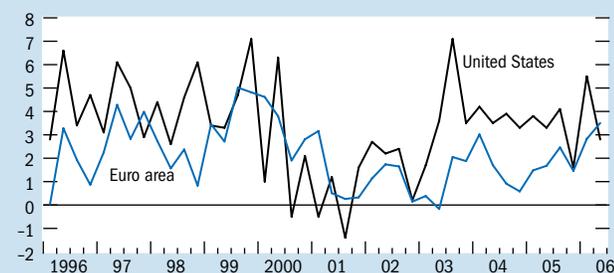
The euro area needs to boost both productivity and employment. But where should it begin? IMF research suggests that fiscal adjustment, combined with more flexible labor and product markets, would allow wage moderation to translate into jobs rather than rents (profits captured by industry insiders because of a lack of competition).

Overall, national reform programs based on the rejuvenated Lisbon Agenda (the European Union's (EU's) blueprint for improving competitiveness) offer new hope for structural reform. But countries continue to shun difficult decisions—particularly decisions that would have the greatest potential payoff. For instance, countries have focused on active labor market policies and lower payroll taxation rather than on reforming employment protection legislation, which is much more controversial. Similarly, they have been much more eager to increase spending on research and development than to tackle barriers to more open and competitive markets.

### Finally turning a corner

After years of lagging behind the United States, the euro area is enjoying a nascent recovery.

(quarter-on-quarter percent change in real GDP growth, annualized)



Data: IMF, *World Economic Outlook* September 2006.

### Allowing for more competition

Reform of the services sector, where rents (stemming from the lack of competition) are still rife, should be a top priority. Services account for about two-thirds of the EU's GDP, but less than 8 percent are currently traded across borders. Following much controversy, a new services directive (drawn up by the European Commission to liberalize trade in services and endorsed by member states) was finally adopted. The directive is a promising start even though the country-of-origin principle, which would have allowed a service provider abiding by the rules of its home country to operate in another country without having to also apply that country's rules, was dropped, and even though services provided by architects, lawyers, notarists, and other professions were excluded.

Given the imminent onset of rapid population aging in Europe, fiscal adjustment is more important than it has ever been. Recent estimates suggest that public expenditure will rise by 3¼ percent of GDP through 2025, and this estimate may be on the low side. Countries would therefore do well to aim for structurally balanced budgets by 2010.

The Stability and Growth Pact, following its reform in 2005, is regaining some leverage over national fiscal policies, but Europe still needs to overcome the temptation to loosen fiscal policy during good times. Better governance mechanisms, such as independent fiscal committees that monitor developments at the behest of national parliaments and offer nonpartisan advice, could help.

**Nearly half the productivity growth gap between the euro area and the United States can be attributed to the financial services sector.**

### Stepping up financial sector integration

The euro area can foster productivity growth partly by chipping away at the remaining barriers to financial sector integration. Estimates suggest that nearly half the productivity growth gap between the euro area and the United States can be attributed to the financial services sector.

While there has been some progress toward integration under the EU's financial services action plan, numerous factors still hold back the development of Europe-wide capital markets. These include fragmented payments systems as well as clearing and settlements systems, divergent tax procedures, consumer protection rules, and contract law. Too often, special interests have succeeded in capturing legislative initiatives, turning integration into something more similar to a collection of national practices than to best practice.

The segmentation of the supervisory framework is increasingly at odds with the changing nature of financial risk. Coordination problems between home and host country supervisors are exacerbated by legal and regulatory differences and by differing incentives, making it difficult to identify risks early enough and to formulate the best policy response.

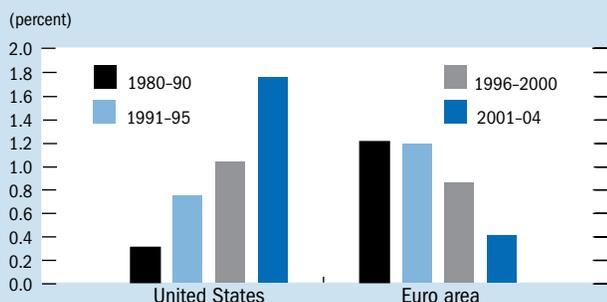
The latest steps to improve financial sector supervision deserve support and must be implemented quickly. Europe should focus first on improving information flows between supervisors, including by establishing a central repository with up-to-date information on financial institutions that have systemic importance. Such a repository could also serve as a platform for crisis coordination. More fundamentally, postponing political decisions on key issues, such as the nature and size of fiscal bailouts following a crisis, continues to slow integration.

The economic news from the euro area suggests that the region may have turned a corner. But action in areas ranging from fiscal policy and labor market legislation to financial sector integration will be necessary if the recovery is not to be cut short. Meaningful reform in the product and services sectors—including the all-important financial sector—would instill new energy, allowing the region to catch up with living standards in the United States.

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IMF European Department*

### Improving productivity remains a top priority

Productivity growth in the euro area, as measured by total factor productivity, continues to lag behind that in the United States.



<sup>1</sup>Euro area: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.  
Data: IMF Country Report No. 06/287, *Euro Area: 2006 Article IV Consultation*.

Copies of *Euro Area: 2006 Article IV Consultation*, IMF Country Report No. 06/287, are available for \$15.00 each from IMF Publication Services. See page 272 for ordering details. The full text is also available on the IMF's website ([www.imf.org](http://www.imf.org)).

## U.S. capital inflows persist despite low expected returns

With the U.S. current account deficit at a record high, concerns have increased about how long financing conditions will remain favorable and how the expected external adjustment will eventually take place. Particularly in light of increasing globalization, how that adjustment takes place has important ramifications for the rest of the world as well as for the United States. A recent IMF Working Paper takes a closer look at the reasons that U.S. assets have remained attractive and the implications for resolving global imbalances.

Following a steady widening since the early 1990s, the U.S. current account deficit reached a record-high 6.5 percent of GDP in 2005. Although the deficit has been financed without putting significant pressure on U.S. interest rates, many analysts and policymakers have cautioned that the current trajectory of U.S. net foreign liabilities is unsustainable, suggesting that market sentiment toward U.S. dollar assets could weaken significantly.

Prominent economists like Olivier Blanchard and Paul Krugman have suggested that a 2–4 percent annual real depreciation of the dollar over the medium term will be necessary to achieve a sustainable current account position. Yet long-term real interest rates in the United States are not 2–4 percentage points higher than in other major industrialized regions, suggesting that investors are accepting low or negative risk premiums on dollar assets. Is this irrational, and, if so, will the dollar have to depreciate faster than markets expect to make the U.S. net foreign asset position sustainable?

### Accepting a lower return

The study defines a dollar risk premium as the difference between one- or two-year interest rates on assets denominated in U.S. dollars and interest rates on assets with corresponding maturities denominated in other currencies, adjusted for consensus forecasts of the respective bilateral dollar exchange rates. A negative risk premium implies that investors accept a lower expected return on U.S. assets than on assets denominated in nondollar currencies. The risk premiums on U.S. dollar assets estimated against various currencies are also used to construct global risk premium measures.

The authors find that risk premiums on the U.S. dollar have generally been negative in recent years, possibly reflecting such advantages of U.S. financial markets as their depth, liquidity, innovativeness, and robust investor

protection. Overall, risk premium movements generally reflect swings in expected exchange rate changes. In the past few years, however, the extraordinary increase and subsequent withdrawal of monetary stimulus in the United States has also been an important part of the story (see chart, this page). When measured against the Japanese yen and the euro, the dollar premium shows large fluctuations. Specifically, the risk premium on the dollar vis-à-vis the euro declined to about –10 percent in 2000 but has now moved closer to zero. The dollar risk premium against the yen has generally been positive but has turned negative in recent years—consistent with studies that find Japanese home bias (an apparent preference among Japanese investors for domestic over foreign assets) declining from extremely high levels in the past.

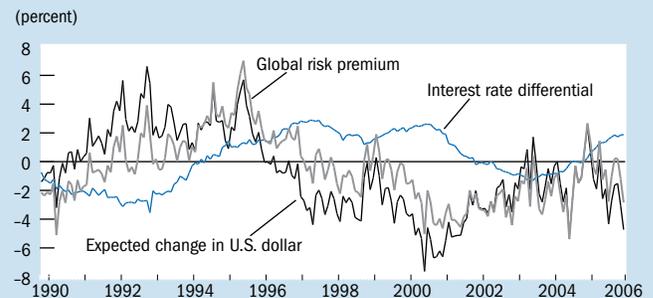
### Negative risk premiums, rising capital flows

Data from the U.S. Treasury International Capital System suggest that capital flows have been increasingly directed toward fixed-income securities, which were purchased largely by investors in the euro area, Japan, and emerging Asian economies. European investors acquired mainly corporate bonds and equity, whereas Japan and emerging Asia invested primarily in U.S. treasury bonds.

The fact that capital flows continued—and, indeed, increased to record-high levels—amid negative risk premiums (see chart, next page) suggests that other factors have helped drive capital flows apart from interest differentials

### In the negative

Expectations of dollar depreciation since the late 1990s have led to negative risk premiums.



Note: Global risk premium, interest rate, and expected appreciation measures are trade-weighted averages of their bilateral measures against pound sterling, Canadian dollar, euro, and Japanese yen.  
Data: Consensus forecasts and IMF staff estimates.

on government debt and expected exchange rate changes. Investigating further, the authors find that risk premiums appear to be largely unrelated to macroeconomic developments, such as debt sustainability indicators and economic growth differentials between the United States and other countries.

On the other hand, differences in regional risk appetites, and the aftermath of the Asian crisis, appear to have had a measurable influence on dollar sentiment. In particular, an increase in risk appetites in the United Kingdom and the euro area—as measured by investors’ revealed preference for purchasing corporate bonds over safer U.S. treasury assets—has tended to go hand in hand with a decline in risk premiums on the dollar.

The relationships seem to fit the euro more closely than the yen, something that other studies find when trying to estimate the role of capital flows in exchange rate equations. One potential explanation is that, given the fragility of the Japanese financial system, banks or insurance companies may have been more focused on their capital bases than on maximizing rates of return. This may have been compounded by structural impediments to portfolio outflows—such as restrictions on holdings of foreign assets by government-run financial institutions and the pension system—leading to a high level of home bias. Reassuringly, some of these impediments have been removed, and home bias is declining in Japan.

**The Asian financial crisis created a large pool of savings searching for relatively riskless investment opportunities.**

**Continued attractiveness of U.S. assets**

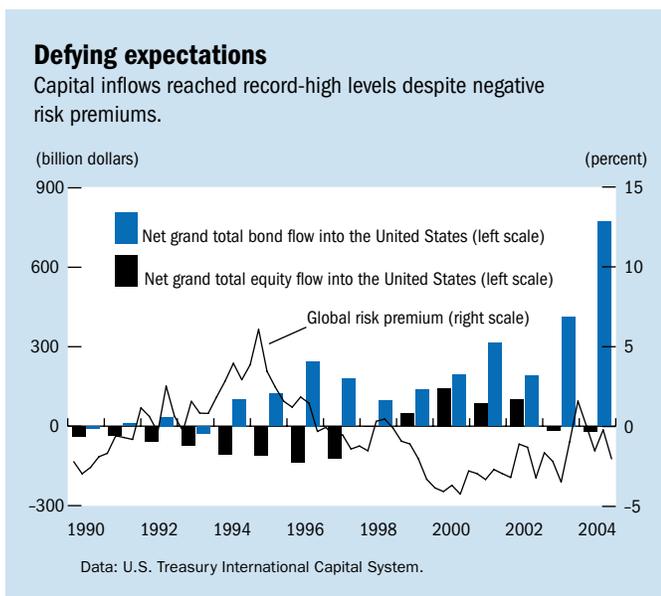
The presence of negative dollar risk premiums amid record-high capital inflows could mean that investors may favor U.S. assets for structural and other reasons. Of course, some analysts and policymakers have suggested that markets could have simply been irrational by investing in U.S. assets despite the negative expected returns, given prevailing interest rates and exchange rate expectations. The study sets forth another explanation, however—namely, that the Asian financial crisis created a large pool of savings searching for relatively riskless investment opportunities. This need was met by deep, liquid, and innovative U.S. financial markets with robust investor protection. These same strengths could also help explain the continued attractiveness of U.S. financial markets to European investors, who were, by contrast, searching for riskier investment opportunities.

**External adjustment: orderly or disorderly?**

Looking ahead, adverse adjustment scenarios would include a risk that foreign investors might buy fewer U.S. treasury bonds unless risk premiums on the dollar increase sharply, driving dollar depreciation as well as increases in relative interest rates in the United States. In particular, official flows into treasury bonds may decline as some major emerging market central banks approach their desired levels of reserves.

The risks of such an adverse scenario are likely to be reduced, however, by the dollar’s role as a reserve currency and by the attractiveness of the U.S. financial system. Of course, this will require U.S. financial markets to continue innovating to retain their advantage over other financial markets. An orderly scenario for resolving global imbalances would also be supported by improving economic prospects and, consequently, increasing risk appetite in other regions, which should lead to a demand for riskier U.S. assets; and a continued reduction in home bias in Japan, which could lead to substantial portfolio flows, including to the United States. ■

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This article is based on IMF Working Paper No. 06/160, “U.S. Dollar Risk Premiums and Capital Flows.” Copies are available for \$15.00 each from IMF Publication Services. Please see page 272 for ordering details. The full text is also available on the IMF’s website ([www.imf.org](http://www.imf.org)).



## Singapore smiles as meetings get under way

The IMF–World Bank Annual Meetings, the focal point of activities being held in Singapore on September 14–20, will be the largest international event that the country has ever organized. To ensure the success of the meetings, the government and the city-state’s four million people are going all-out. It’s not just a matter of providing space, Internet access, phone lines, and air-conditioning for the 16,000 expected participants. It’s also a matter of showcasing Singapore’s renowned restaurants and service culture.



Kimbley Yegorich/Reuters

Singapore’s newly refurbished convention and exhibition center also boasts 1,000 temporary offices for use at the Annual Meetings.

### Customer service

Prime Minister Lee Hsien Loong took it upon himself to improve the country’s customer orientation, which dropped in rank from 8th in 1998 to 17th in 2005, according to the World Economic Forum’s 2005 *Competitiveness Report*. In January 2006, the government created a program under which US\$2.8 million was devoted to training 28,000 workers, including 18,000 employees of stores, hotels, and restaurants in key shopping areas, Changi Airport, and other tourist destinations, as well as 10,000 public transport workers.

As part of this effort, the government is exhorting its citizens to be polite to foreign guests. In June, Lee launched the “Four Million Smiles” campaign. Photos of smiling citizens are being made into a digital mural that will welcome the visitors.

### Getting ready

The smiles will be on display when the world’s finance ministers and central bankers, investment bankers and others from the private sector, and the international media descend on Singapore. The country (Singapore Island and 63 smaller islands) has an area of about 700 square kilometers and a population density (as of July 2005) of 6,333 persons per square kilometer. How will Singapore handle all these visitors?

The Suntec Singapore International Convention and Exhibition Center—dubbed Suntec Singapore—has over 1 million square feet of space, ample room for the 1,000 offices, 27 large meeting rooms, press center, and registration area the meetings require. Plus, more than 1,000 two-story temporary offices are being built in Suntec Singapore, with 960 kilometers of cable being laid to provide them with Internet access. In addition to 12,000 wired network points, there will be wireless “hot spots” in the visitor’s center. To ferry the participants to the meetings and other events, more than 400 limousines and 230 buses will be pressed into service.

### Showcasing Singapore

The intensive preparations for Singapore 2006 should be well worth the time and effort for all parties. Indeed, a World Bank official said “the organization side . . . is proceeding better than any Annual Meetings we’ve had.” The event gives Asia an opportunity to showcase its economic dynamism and the significant developments that have taken place in the region since 1997, when the Annual Meetings were last held in the region. The Singapore economy expects to see a boost of some US\$100 million from hosting the events.

For the IMF and the World Bank, there is value in holding their meetings overseas every third year. Because the meetings are a onetime event for the host country, there is both a desire to promote that country’s facilities and a willingness to allow additional time for full-scale meetings. In Washington, D.C., security concerns have constrained the length and scale of the meetings since 2001, and the abbreviated meetings there seem likely to continue for the foreseeable future. ■

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