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

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September 30, 2007
Growth has been Good Across All Regions of Emerging Markets and Developing Countries

(annual percent changes)
Strong Macro Fundamentals in Emerging Markets as a Whole

(Percent of total emerging market GDP)

Reserves (cumulative since 1985)
Current account
Net private flows


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Emerging Market Stock Indices: A Moderate Correction So Far (daily; Morgan Stanley Capital International)
But are Large Current Account Deficits an Indicator of Vulnerability?

(In percent of GDP, 2006)
Global Growth and Financial Globalization

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

- United States
- Japan
- China
- Rest of the world
- Euro area
- Other advanced economies
- India

**Private Capital Flows**
*(in percent of EM GDP)*

- Gross private inflows
- Gross private outflows
Spreads
(In basis points)

EMBIG (LHS)
US Corporate High Grade (LHS)
US Corporate High Yield (LHS)
Financial Market Volatility
(in percent)

Stock Market Indices (Jan. 2000=100)
- U.S. S&P 500
- DJ Euro Stoxx
- Nikkei 225

Implied Volatilities (percent; 10-day mma)
- Industrial country equities
- Emerging Market Currencies
- Major currencies
Short-Term Funding Markets
(3-month LIBOR minus T-bill rate)
U.S. Spreads Widening: How Much and For How Long?

Mortgage Spreads
(in basis points)

- Conforming (over Treasuries) 1/
- Jumbo (over Treasuries)
- Subprime ABS (over LIBOR; RHS)

Corporate Spreads
(basis points; over Treasuries)

- A-rated
- BBB-rated
- BB-rated

1/ Conforming loans have terms and conditions that follow the guidelines set forth by Fannie Mae and Freddie Mac.
Spreads for European Banks and Corporates Have Widened

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

Impact on Bank Capital
(percent of Tier 1 capital)

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

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

Housing Prices
(2003=100)
Inflation and Inflation Expectations

**Inflation (percent)**

- **U.K. (HICP)**
- **Euro area (HICP)**
- **U.S. (PCE core)**
- **Japan (CPI core)**

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

- **U.K.**
- **Canada (20-yr)**
- **U.S.**
- **Euro area**
- **Japan**

*Graph showing inflation and inflation expectations for various regions from 2004 to 2007.*
Key Current Account Surpluses may Persist, Even if the U.S. Deficit Narrows

(In billions of U.S. dollars)

- United States current account
- China, Japan, and Saudi Arabia combined current accounts
- Other oil exporters combined current accounts
External Imbalances in Select Countries
(Percent of GDP)

United States

Saudi Arabia

Euro Area

China
U.S. Current Account Financing
(in billions of U.S. dollars)

Holdings of U.S. asset-backed securities by foreigners (change in stock)

Current account deficit
China: Bilateral and Real Effective Exchange Rate

- Renminbi per U.S. dollar (LHS; inverse)
- REER (RHS; 2000=100)
Overseeing the international monetary system as a whole

Assessing member countries’ economic policies

Exchange Rates

IMF Surveillance

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

- Misalignment is likely to persist.
  
  Is the underlying current account—stripped of temporary or cyclical factors—in equilibrium?

- Misalignment is significant.

- The judgment of “fundamental misalignment” needs to be “beyond any reasonable doubt”.
CGER Methodology

- **Complementarity of three approaches.**
  - Macroeconomic balance
  - Equilibrium REER
  - External sustainability

- In steady state, answers should be similar.

- This provides confidence in our assessments.

**But...**

- There are large margins of uncertainty around the CGER estimates.
IMF Governance Reform Objectives

- Realign quota shares with members’ relative global economic weight
- Enhance the participation and voice of low-income countries
Integrated program approved by Board of Governors in Singapore:

- Initial ad-hoc increases for a small group of clearly under-represented members
- Second round of ad-hoc increases based on a new quota formula
- Increase in Basic Votes
- Additional resources for African Executive Directors
Thank You