

Managing Director's Statement on Strengthening Surveillance 2011 Triennial Surveillance Review

After inputs from country authorities, outside experts, and staff; after extensive deliberations at the Executive Board; after further guidance from ministers and governors at the IMFC meetings—after all that, we need to move from diagnosis to action. The goal of making surveillance as interconnected as the world economy remains an inherently long-term endeavor. Nevertheless, building on recent progress, we can do better even in the near term. I want to take this opportunity to put forward some specific measures, based on Executive Directors' many thoughtful comments and suggestions (Table 1).

Interconnectedness

Issue. The propagation of the crisis and subsequent tensions have underlined the case for both bilateral and multilateral surveillance to do more to analyze linkages and spillovers across sectors (e.g., real, financial, fiscal) and countries. We also need to make further progress in taking into account the interplay of global, regional, and country developments.

Actions.

- Upcoming WEOs will cast the chapter on regional developments around policy spillovers and interactions across countries in different regions.
- Following our pilot last summer, spillover reports will be continued next year, with the agreement of the relevant members, for the systemic five economies (China, the Euro Area, Japan, the United Kingdom and the United States) with their Article IVs. The reports will be tailored to the key issues for each country. After this second round of the pilot, we will take stock of the experience and decide on future modalities. Additionally, staff will engage authorities in key financial centers to deepen the understanding of financial interconnections, the propagation of shocks, and the implications for policy.
- Spillovers and cross-country experiences will be given more coverage, as appropriate, in Article IVs, with the support of the review process, and in REOs, with a particular emphasis on intra-regional spillovers. Ultimately, the goal should be to mainstream spillover analysis in relevant Article IVs.
- Work will continue on capital flows and global liquidity, and their implications.
- We will aim to have the Article IV consultations for interconnected countries—for example with strong financial links—discussed by the Board in clusters.

Risk assessments

Issue. The failure to spot the buildup of vulnerabilities in the pre-crisis period is a humbling fact that must be addressed—or, more accurately, continue to be addressed, since there has been important progress in recent years. While we know that neither we nor policy makers

will always get things right, our processes must be improved to bring about a greater focus on risks. We must ensure that policy discussions and advice to members weigh the need to insure against potential risks and consider mitigation policies, should risks materialize. This is no less critical in seemingly quieter times than at the current juncture. To this end, attention to risks must be further stepped-up and our analysis deepened to better identify vulnerabilities, and transmission channels.

Actions.

- Starting with the next issue, WEOs will pay greater attention to risks around the baseline.
- Relevant analyses and findings from the vulnerabilities and early warning exercises, the WEO and GFSR must be taken up in policy discussions with country authorities. The tools underlying multilateral surveillance will be disseminated to area departments to support this effort.
- The upcoming revised surveillance guidance note will stress the need for an explicit discussion of risks in Article IV consultations. This could be supported by risk assessment matrices in Article IV reports akin to those used in financial sector stability assessments.

Financial stability

Issue. Given the potential and speed with which developments in the financial sector can ignite and propagate crises, ensuring effective financial sector surveillance is in the interest of the entire membership. We all agree that financial stability analysis should be better integrated into surveillance; the issue is how to go about this systematically?

Actions.

- To guide the overall effort, staff will prepare for the Executive Board and IMFC discussions a strategic plan for financial sector surveillance. This will cover the objectives of financial sector surveillance, and work on identifying vulnerabilities and risks, transmission channels such as macro-financial linkages, and policy responses including macro-prudential policies.
- In the absence of sufficient support for increasing the frequency of mandatory FSAPs for systemic economies, we need alternative modalities to ensure progress. A financial expert will be assigned to each Article IV team involving systemically important financial sectors. Additional resources will be mobilized for these countries as well as others as needed (e.g., in case of mounting financial vulnerabilities).
- Coverage of financial issues in Article IVs will be further strengthened by (i) stepped-up training and dissemination of vetted tools (e.g., stress-tests) and good practices, including on LIC-specific issues, so that they can be effectively used by country teams and

(ii) cross-country thematic studies (e.g., on interconnectedness and the role of financial deepening). Staff will also intensify efforts to draw cross-country lessons from FSAPs.

- Staff will continue to support the G-20 data gaps initiative and will bring forward to 2012 the review of data provision to the Fund for surveillance (including a review of data for financial sector surveillance and COFER).

External stability

Issue. External stability issues remain at the core of our mandate and a crucial element of interdependencies among countries. The coverage, consistency, and transparency of our external stability—including exchange rate—assessments need to be enhanced.

Actions.

- I propose the publication, with each WEO cycle, of a multilaterally-consistent assessment of external balances, building inter alia on a revamped CGER. While the inherent uncertainty of estimates will be recognized, such a publication will help strengthen surveillance and inform the debate on global imbalances, currencies, and policies. Staff will brief the Board on the modalities and methodological refinements in train, and produce a pilot by the next spring meetings.
- In this document, and in Article IVs, assessments will need to take a broad view of external stability, encompassing an analysis of balance sheets and including coverage of exchange rates, capital flows, and reserve policies.

Legal framework

Issue. The conduct of effective surveillance in an interconnected world requires modernizing the Fund's legal framework to properly recognize those interconnections. In a cooperative institution, it is important that expectations be set clearly to support evenhanded operations. I welcome the strong support for moving ahead with an integrated surveillance decision but also have heard the important concerns some of you have.

Actions.

- A follow up paper on the legal framework will be taken up early next year. It will lay out concrete suggestions for a new decision, aiming to achieve a better integration of bilateral and multilateral surveillance and a broader approach to global stability. Exchange rate issues will remain a central piece of Article IV discussions, whose scope should also encompass other issues relevant to the stability of a member and of the global economy.

Traction

Issue. All the above should improve the quality of surveillance and hence its traction. But equally, for our advice to be heard, we must ensure that the Fund provides candid and

evenhanded advice, appropriately tailored to country circumstances, and communicates it clearly. We must also continue to engage other relevant fora.

Actions.

- To foster ministerial engagement, the practice of preparing a Consolidated Multilateral Surveillance Report for discussion at the IMFC will continue.
- The revised surveillance guidance note will urge better coverage of issues involving unemployment, inequality and inclusive growth, where they are macro-critical, leveraging expertise in other organizations.
- To be attentive to members' needs, country teams will exchange views with authorities on key issues for discussion prior to Article IV missions, without compromising our capacity—and obligation—to raise relevant, and at times difficult, issues.
- To enhance accountability, the review process will ensure that country papers report on the implementation of past advice given in Article IVs and key FSAP recommendations.

Resource Requirements

The resource implications of these actions can be contained. Some entail a shift in emphasis and focus—for example towards risk analysis and away from issues of lesser relevance to economic and financial stability assessments (translating, for instance, into fewer working papers on non-core topics)—without measurable costs. Other initiatives—spillover reports, publishing multilaterally-consistent external balance assessments, the CMSR and increased financial expert involvement—will entail some additional cost. Our preliminary estimate of the *net additional* resources needed for future years (above what is already factored in the current medium-term budget) is \$2.6 million. (The *gross cost* of the biggest ticket items in the TSR is just over \$5million (part of the cost of the spillover reports was met through reallocations and overtime in FY 2011)). In any event, we are confident that the 2013 budget discussion will be able to identify savings to cover the additional resource implications.

Conclusion

The steps outlined here build on our strengths and should improve our surveillance. But to see the job through, a robust mechanism of accountability will also be needed—we cannot wait for the next triennial review in 2014 to see how we are faring. Staff will therefore prepare a short update on where things stand on the above agenda a year from now.

Broader actions are being taken to promote an efficient and effective Fund, including in response to the IEO evaluation of pre-crisis surveillance. Management is committed to lead by example on the value to be attached to candor and evenhandedness. I am taking a number of specific measures to make progress on cross-departmental collaboration, promote diversity

of views and of staff, and address mobility issues. I will further consider ways to focus our work on critical policy areas. The forthcoming work program will reflect this imperative.

Table 1. Enhanced Surveillance: Key Deliverables

