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More Action Needed to Combat Spreading World Crisis, IMF Says

Governments need to take additional coordinated action to revive world financial markets and get credit flowing again, the IMF says, warning that the global economic outlook continues to deteriorate.

In a December 15 speech at the Spanish central bank in Madrid, IMF Managing Director Dominique Strauss-Kahn said that action is needed on three fronts to prevent the current recession turning into a global depression: coordinated government intervention in financial markets to get credit flowing and support bank recapitalization; fiscal measures to offset the abrupt fall in private demand; and liquidity support for emerging market countries to reduce the adverse effects of the widespread capital outflows triggered by the financial crisis.

The major advanced economies are expected to contract by ¼ percent on an annual basis in 2009, marking the first annual contraction in the post-war period for this group of countries. But the IMF has said that it will likely revise downward its global forecast when it announces new numbers next month. (See also article on the IMF work program, page 188.) ■

Zumawirewest/Newscom

Production of laptops in Germany, where growth has been hit hard by the financial turmoil and subsequent recession.

Iceland Gets Help to Recover from Crisis

The financial crisis engulfing the world claimed Iceland—which has a population of just 300,000—as one of its early victims.

In response, Iceland formulated a comprehensive program to tackle the fallout from the crisis, for which it requested IMF support. On October 24, an IMF package totaling $2.1 billion was announced under the Fund's fast-track emergency financing mechanism.

The IMF's Executive Board approved the two-year Stand-By Arrangement for Iceland on November 19, making $827 million immediately available to the country and the remainder in eight equal installments, subject to quarterly reviews. Iceland's economic program envisages that the IMF loan will fill about 42 percent of the country's 2008–10 financing gap. The remainder will be met by official bilateral creditors.

In the following interview, Poul Thomsen, the IMF's mission chief for Iceland and Deputy Director of the IMF's

(continued on page 186)

Xinhua/Newscom

Landsbankinn was one of the three banks that were taken over by Iceland's Financial Supervisory Authority in October 2008.

IMF Survey to Stop Print Edition and Go Online

After a 36-year run, the *IMF Survey* will halt production of its print edition and go exclusively online. Read about the reasons for the switch on page 194.

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With this issue, the *IMF Survey* is ceasing production of its print edition and will produce exclusively an online edition. We hope that you will continue to read *IMF Survey* news and background articles at the *Survey's* website at *www.imf.org/imfsurvey.*

Iceland

(continued from page 185)

European Department, talks about the crisis and the country's plans for dealing with the repercussions.

IMF Survey: What went wrong in Iceland?

Thomsen: Iceland allowed a very oversized banking system to develop—a banking system that significantly outstripped the authorities' ability to act as a lender of last resort when the system ran into trouble. Only a few years ago, Iceland had a banking system that was the normal size. But after the privatization of the banking sector was completed in 2003, the banks increased their assets from being worth slightly more than 100 percent of GDP to being worth close to 1,000 percent of GDP.

When confidence problems intensified this fall, Iceland was one of the first victims because the market realized that the banking system was far too big relative to the size of the economy. As investors started to pull out, it quickly spilled over into trouble for the Icelandic króna. Within a week, three banks collapsed, the króna's value dropped by more than 70 percent, and the stock market lost more than 80 percent of its value. For a small economy that is totally dependent on imports, this was a crisis of huge proportions.

IMF Survey: What is the IMF-backed program hoping to achieve?

Thomsen: In the short run, the program is narrowly focused on stabilizing the króna. Iceland still has a highly leveraged economy. Most of the debt is either denominated in foreign exchange or indexed to inflation, so when the króna depreciates, debt servicing becomes much more expensive. If we don't stop the decline of the króna, we will probably see a wave of defaults in the corporate and household sectors, and that would further harm the economy.

That is why the IMF-backed program is proposing to use monetary and exchange rate policy to restore confidence in the króna over the next couple of months. In the short run, this will mean higher interest rates. Iceland will also have restrictions in place on the movement of capital. We are advising the government not to lift these restrictions before stability returns to the foreign exchange market.

IMF Survey: Isn't it unusual for the IMF to agree to capital controls?

Thomsen: Capital controls have de facto been in place since the three banks collapsed in early October, with only payments for priority imports and other current account transactions being permitted. It is a priority under the IMF program to eliminate all restrictions on both the current and capital accounts so that Iceland can return to the freely convertible currency it had for many years. Indeed, all restrictions on the current account have now been lifted as a first important step toward normalization.

But to prevent large capital outflows from causing a further sharp drop in the króna, existing capital account restrictions will remain in place in the near future. With this in mind, the authorities legally formalized the existing de facto regime during the last week of November to make it more effective, rules-based, and transparent. But as I said, the goal is to lift all capital controls during the program period, as confidence improves.

IMF Survey: Is the IMF asking Iceland to cut back on spending?

Thomsen: We are not telling Iceland to tighten its belt in the middle of a recession. During the first year of the program, automatic fiscal stabilizers will be allowed to work. This means there will be an increase in the primary fiscal deficit from about ½ percent of GDP in 2008 to about 8½ percent of GDP in 2009. We in the IMF are not resisting this because we think it is wrong, in the face of a deep recession, to embark on fiscal consolidation.

Having said that, Iceland will need to consolidate its finances once the recession has bottomed out. Because of the banking crisis, Iceland has gone overnight from being one of the lowest indebted countries in Europe to being among the highest indebted advanced countries in Europe: taking care of the problems in the banking sector will probably cost the public sector about 80 percent of GDP. How exactly the government achieves this consolidation—through either expenditure cuts or higher revenues, or a combination of both—will be up to the Icelandic authorities to decide.

IMF Survey: What will the IMF's role in restructuring the banks be?
Thomsen: It is important to acknowledge that Iceland has expressed its commitment to recognize the obligations to insured depositors, and also to a fair and equitable approach in the bank restructuring process. The government's strategy for dealing with the banking problems has been to adopt a new bank/old bank approach—the "new" banks were allowed to service domestic banking needs, whereas the "old" banks would deal with the difficult task of sorting out most of the foreign liabilities.

The IMF will help Iceland restructure the banks within this broad framework. The strategy includes plans for valuation of the assets of both new and old banks in line with international best practice, compensation from the new banks to the old banks for any discrepancy in the fair value of assets and liabilities taken over, recapitalizing the new banks with the aim of eventually privatizing them, and maximizing asset recovery in the old banks. Bank supervision and regulation will also be overhauled to make sure a banking crisis of this magnitude never happens again.

IMF Survey: So what does the future hold for Iceland?
Thomsen: There is no doubt that Iceland will face a couple of years of hardship. This is a dramatic and unprecedented shock. It could be the most expensive bank restructuring that the world has ever seen relative to the size of the economy. We expect that, even if we succeed in stabilizing the króna, GDP could fall by 10 percent next year, and there might even be a further small decline in 2010.

The good news is that the Icelandic economy is very flexible. Because of its dependence on fishing and aluminum, Iceland has been exposed to rather big shocks in the past, but it has always been able to adjust very effectively. So I suspect that after this relatively sharp downturn, the economy could rebound fairly fast.

IMF Survey: What would success look like?
Thomsen: Success would look like this: within the next couple of months, the government succeeds in stabilizing the króna and normalizing the country's foreign exchange operations so that all companies that export and import have access to the foreign exchange market.

> "The potential for success is very good because the economy is so flexible. I expect that by the end of the two-year program, Iceland's economy will be growing again."
>
> —Poul Thomsen

Once the currency has stabilized, the government should be able to gradually reduce interest rates in 2009, gradually lift the capital controls, and begin to tackle the fiscal problems.

The potential for success is very good because the economy is so flexible. I expect that by the end of the two-year program, Iceland's economy will be growing again.

IMF Survey: What would have happened if the IMF had not stepped in with financing?
Thomsen: The alternative would have been, I am convinced, further significant decline in the value of the króna, significant strain on households that have their mortgages fixed in foreign exchange, a wave of defaults in the corporate sector that has loans fixed in foreign exchange, a much higher increase in unemployment, and an even bigger decline in GDP than the 10 percent currently predicted. ■

Camilla Andersen
IMF External Relations Department

Iceland Program Summary

Long-term growth prospects for Iceland are favorable, in line with the country's very strong fundamentals, not least its highly educated labor force, favorable investment climate, and rich natural resource endowment. The program with the IMF focuses on addressing the key issues at hand:

• ***Preventing further sharp króna depreciation*** by maintaining an appropriately tight monetary policy in the context of a flexible exchange rate policy. Restrictions on capital outflows will remain in the near term.

• ***Developing a comprehensive and collaborative strategy for bank restructuring*** by (i) putting in place an efficient organizational structure to facilitate the restructuring process; (ii) proceeding promptly with the valuation of banks' assets; (iii) maximizing asset recovery in the old banks; (iv) ensuring the fair and equitable treatment of depositors and creditors of the intervened banks; and (v) strengthening supervisory practices and the insolvency framework.

• ***Ensuring medium-term fiscal sustainability.*** Although automatic fiscal stabilizers will be allowed to work in full during 2009, the program includes the development of a strong medium-term fiscal consolidation plan to be launched in 2010. This effort is needed to deal with the very substantial increase in public sector debt that is likely to occur as a result of the budgetary cost of recapitalizing the banking system and fulfilling the deposit insurance obligations to depositors in foreign branches of Icelandic banks.

For further details, please see *www.imf.org/external/np/sec/pr/2008/pr08296.htm*

Financial Crisis Shapes IMF Work Priorities

The IMF's Executive Board has agreed on the Fund's priorities for the period leading up to the IMF–World Bank Spring Meetings in April 2009, focusing on short- and longer-term consequences of the global financial crisis. This work program is in line with requests from the International Monetary and Financial Committee (known as IMFC, the IMF's policy-steering committee) and the Group of Twenty leading industrialized and emerging market countries (G-20).

A main focus of the IMF's efforts will be to ensure continued financial support and policy advice for the growing number of countries that are buckling under the strains of the financial crisis. But the IMF will also devote significant resources to understanding the causes of the financial crisis and identifying reforms needed to improve the international financial architecture.

The discussion of the IMF's short-term priorities takes place against the backdrop of a worsening global economy. In its latest assessment, the IMF cut its forecast for global growth by ¾ percentage point to 2.2 percent for 2009. A growing number of countries are seeking financial assistance from the Fund, and new loans worth a total of $40 billion have been approved in record time for Ukraine, Iceland, Pakistan, and Hungary.

Aligning priorities

The IMFC sets the overall direction for the IMF's work. But the work program, agreed by the Executive Board on November 24, has also been aligned with the outcome of the November 15 meeting of the G-20.

The G-20 has called for both immediate and longer-term actions to stabilize the financial system, stimulate domestic demand, help emerging and developing economies battered by the crisis, and strengthen the regulatory framework.

"The IMFC and the G-20 leaders have emphasized the central role of the Fund as a crisis responder and a developer of ideas," IMF Managing Director Dominique Strauss-Kahn said. "We will take this mandate forward to help restore global financial stability and stimulate sustained economic growth."

Strauss-Kahn stressed that the IMF will be working closely with other international institutions. One such partner will be the Financial Stability Forum (FSF), which plans to expand its membership to include emerging market countries. The IMF and the FSF have published a joint letter saying they intend to step up cooperation in key areas such as early warning exercises and improving supervision and regulation of the financial sector.

Providing crisis loans

One priority for the IMF in the coming months will be to ensure that it continues to provide fast assistance to emerging market and developing countries hit by the crisis, with conditionality tailored to the priorities of addressing the crisis while ensuring that vulnerable sectors of the population are adequately protected.

As the crisis spread, the IMF quickly established a new Short-Term Liquidity Facility (SLF) to help countries with strong fundamentals and domestic policies cope with short-term liquidity pressures arising from external market developments. The Executive Board now intends to examine other elements of IMF lending, such as the scope for innovation and further streamlining of both lending instruments and conditionality. It will also review access limits, maturities, and charges, and whether the IMF will need to supplement its resources.

Lessons learned

The massive scale of the crisis and its costs took many people by surprise. In October 2008, the IMFC asked the IMF to take the lead in analyzing the complex chain of causes and effects that led the world economy into what may turn out to be worst recession since the Great Depression. The G-20 reaffirmed this call. Work will focus on:

Drawing lessons and recommending responses. The IMF is taking the lead in providing a comprehensive analysis of the causes of the crisis and lessons learned for macroeconomic policy and regulation. Informed by this analysis, the IMF is developing recommendations for policy responses, both on how to overcome the immediate crisis and address longer term challenges.

Improving early warning systems. The IMF is intensifying work on early warnings and the monitoring of systemic and country vulnerabilities. The FSF will be an important partner in this work.

Assessing impact on low-income countries. The IMF will monitor closely the impact on low-income countries of overlapping shocks caused by the global financial crisis and strained food and fuel prices. The Fund stands ready to support its low-income members with technical and financial assistance and will be examining whether it needs to adapt its policy advice and loans to better meet their needs.

With its near universal membership, core macro-financial expertise, and mandate to promote international cooperation, the IMF is prepared to participate fully in the overhaul of the rules governing financial markets.

The IMF will contribute to the G-20 working groups on how to enhance sound regulation and strengthen transparency, reinforce international cooperation and promote the integrity of financial markets, and reform international financial institutions.

While the IMF's priorities are focused on the global financial crisis, work on governance reform and modernization will also continue. Strauss-Kahn encouraged member countries to finalize the domestic legislation needed to implement the quota and voice reforms and the new income model agreed in April 2008. The Committee on IMF Governance Reform, headed by South Africa's finance minister Trevor Manuel, is expected to report by April 2009, and will provide further input into this process. ■

First Two Countries Tap IMF Shocks Loans, More Expected

Countries in central Asia and Africa are the first two nations to tap the IMF's revamped borrowing program designed to help low-income countries cope with emergencies caused by events beyond their control.

Several more African nations are expected to request loans in the near future, according to IMF officials.

The IMF's Executive Board on December 10 approved a loan of $100 million for the landlocked, mountainous Kyrgyz Republic in central Asia under the revised Exogenous Shocks Facility (ESF). Previously the Board had approved a one-year $77 million arrangement for Malawi—the first loan since the Board revised the ESF in September.

The 18-month Kyrgyz loan will help the government address several economic shocks, including the rise in commodity prices that continued until mid-2008, a shortfall in hydropower, banking sector difficulties in neighboring Kazakhstan, and an earthquake in the Nura region.

The loan to Malawi, a country in southeast Africa heavily dependent on tobacco exports, will support the authorities in their adjustment to the terms of trade shock caused by rapid increases in fuel and fertilizer prices earlier in the year.

The ESF was established two years ago to enhance the IMF's ability to help low-income member countries deal with sudden and exogenous shocks. To make it easier and faster for members to receive the Fund's support during the worsening of global economic conditions, ESF reviews were accelerated. Surging food and fuel prices have hit low-income countries particularly hard, an IMF spokesman said.

Revision of the ESF aims to provide assistance more quickly, and in larger amounts, to help low-income IMF members cope with events such as commodity price changes (including oil), natural disasters, and conflicts and crises in neighboring countries that disrupt trade.

Siphiwe Sibeko/Reuters

Fishing nets on Lake Malawi: Malawi is adjusting to rapid increases in fuel, fertilizer prices in first part of 2008.

The modifications, which went into effect in late November, also streamlined the conditionality—commitments that borrower governments make on their economic and financial policies—attached to the ESF. The changes respond to a request from ministers at the IMF's 2008 Spring Meetings.

The revamping of the IMF's shocks facility for low-income countries is part of an effort by the IMF to improve its lending toolkit. In October, the IMF announced a new short-term lending facility to channel funds quickly to emerging markets that have a strong track record but need rapid help during the current financial crisis to get them through temporary liquidity problems. For other countries where policy frameworks need strengthening, the IMF has been providing member governments access to traditional lending facilities over longer periods, but on an accelerated basis.

The IMF has launched a review of its financing role in member countries to make sure it has the right instruments to meet countries' needs in a world characterized by growing—and increasingly complex—cross-border financial flows.

The IMF said that a mission team had reached agreement in November with the Kyrgyz authorities on an economic program that aims to address the adverse consequences of the exogenous shocks that have hit the Kyrgyz economy, including the increase in international food and energy prices and the shortfall in domestic power generation due to low water levels in the Toktogul reservoir.

While the focus of the Kyrgyz program is on macroeconomic policies, the authorities will continue to advance their structural reform agenda to improve macroeconomic management and ensure strong growth over the longer term.

The economic program for 2008–09 addresses the consequences of the exogenous shocks and aims to manage the effects on the Kyrgyz economy of the slowdown in regional growth and spillovers from the global financial crisis. The program's objectives are to reduce inflation, sustain economic growth, and protect the poor in the country, which has a population of around 5 million.

In Malawi, which has a population of around 15 million, the authorities requested an ESF arrangement to help them adjust to the terms of trade shocks caused by rapid increases in fuel and fertilizer prices in the first part of 2008.

"Malawi's current low level of international reserves is a concern for financial stability and food security," said IMF Deputy Managing Director Takatoshi Kato.

The economic program to be supported by high-level access to IMF resources under the ESF will help to contain the pressure on the balance of payments and rebuild external reserves, while preserving growth and food security. Financing will be complemented by fiscal and monetary tightening. Additional donor support has been forthcoming and will be critical to facilitate the economy's adjustment to the terms of trade shock. ■

Pakistan Gets $7.6 Billion Loan from IMF

The IMF's Executive Board has approved a $7.6 billion loan for Pakistan to support its program to stabilize and rebuild the economy while expanding its social safety net to protect the poor.

The 23-month Stand-By Arrangement will enable the government to implement a stabilization program that envisages a significant tightening of fiscal and monetary policies to bring down inflation and reduce the external current account deficit to more sustainable levels. The program seeks to address current macroeconomic imbalances while protecting the poor and preserving social stability in the South Asian country of 170 million people.

"By providing large financial support to Pakistan, the IMF is sending a strong signal to the donor community about the country's improved macroeconomic prospects," said IMF Deputy Managing Director Takatoshi Kato.

Pakistan's economic program

"The government's program has two objectives: first, to restore overall economic stability and confidence through a tightening of macroeconomic policies, and second, to do so in a manner that ensures social stability and adequate support for the poor during the adjustment process," said Juan Carlos Di Tata, the IMF mission chief to Pakistan.

The Pakistan authorities have already taken steps to achieve these objectives: energy subsidies have been cut and the interest rate has been increased to tighten monetary policy. The authorities' program for the coming 24 months envisages a number of additional steps:

• The fiscal deficit, excluding grants, will be brought down from 7.4 percent of GDP in 2007/08 (starting July 1) to a more manageable 4.2 percent in 2008/09 and 3.3 percent in 2009/10—in line with what it was three years ago. This fiscal adjustment will be primarily achieved by phasing out energy subsidies and strengthening revenue mobilization through tax policy and administration measures. The reduction in expenditures will create room to increase spending on the social safety net.

• The State Bank of Pakistan (SBP) will act on monetary policy to build its international reserves, bring down inflation to 6 percent in 2010, and eliminate central bank financing of the government. The program includes measures to improve monetary management and enhance the SBP's bank resolution capacity, and avoid the use of public resources to support the stock market.

• Expenditure on the social safety net will be increased to protect the poor both through cash transfers and targeted electricity subsidies. The fiscal program for 2008/09 envisages an increase in spending on the social safety net of 0.6 percentage points of GDP to 0.9 percent of GDP. Pakistan will also work with the World Bank

Mohammed Zargham/PPI

A worker in an iron foundry in Karachi: Pakistan will seek additional support to improve social safety nets.

to prepare a more comprehensive and better targeted social safety net program.

Contribution of the IMF

The financing from the IMF will help to ease the path of adjustment and will provide a strong signal of support to the international community. Of the $7.6 billion loan, $3.1 billion will be made available by the IMF immediately to strengthen the reserve position. And the regular monitoring of the economy by the IMF will show how the macroeconomic objectives set by the government are being met and whether they need to be adjusted in the light of changing circumstances.

"It is important to point out that the program—and its conditionality—is based on the targets and measures that the authorities have themselves set for the next two years. The IMF is convinced that the best-implemented programs are the ones that are home grown and fully owned by the country," Di Tata said.

Alongside the IMF's financial support, there is an urgent need to mobilize additional donor support to strengthen Pakistan's resilience to potential shocks, help finance the expanded social safety net, and allow for higher spending on development programs. "The Fund stands ready to participate in any donor meeting to provide the economic and financial analysis that could underpin expanded support," di Tata added.

Implementation key to success

Success of the program could be affected by a number of factors. They arise from security and implementation uncertainties, a more severe-than-anticipated slowdown in economic activity in trading partners, and lower-than-expected private capital inflows.

"Sustained and forceful implementation will be key to the success of the program," Di Tata stated.

Previous gains

From the early 2000s to mid-2007, Pakistan's macroeconomic performance was robust. During the period 2000/01–2004/05, when Pakistan successfully implemented two IMF-supported programs, real GDP growth averaged 5 percent a year with relative price stability. The improved macroeconomic performance enabled the country to reenter international capital markets in the mid-2000s.

The macroeconomic situation, however, deteriorated significantly in 2007/08 and the first four months of 2008/09 because of domestic and external factors. Adverse security developments, large exogenous price shocks (oil and food), and the recent global financial turmoil buffeted the economy.

Quick IMF response

The IMF has moved quickly to help emerging market and developing countries affected by fallout from the financial crisis originating in advanced economies.

The IMF has more than $200 billion in lendable resources and says it is ready to process loan proposals quickly through its Emergency Financing Mechanism. Japan has offered to provide additional resources to the IMF if needed. ■

IMF Watching Out for Poor in Crisis Loan Talks

In loan negotiations with countries hit by the financial crisis, the IMF is encouraging governments to maintain or develop social safety nets for the poor even as they adjust to the harsher environment of the economic downturn, IMF Managing Director Dominique Strauss-Kahn says.

Speaking in Paris to a meeting of parliamentarians from around the world on November 20, Strauss-Kahn said that the IMF was helping countries affected by the crisis with policy advice and lending to those that needed balance of payments support.

The IMF has recently announced loans to Hungary, Iceland, Pakistan, and Ukraine and is also in talks with several other countries affected by the global crisis.

In a speech and subsequent question-and-answer session with the group of 170 parliamentarians, Strauss-Kahn said that the IMF was trying to limit the conditions attached to its loans to terms that were essential for resolving the country's immediate economic difficulty.

Often in the past, the IMF had included conditions that were felt desirable for the country's prospects, but were not necessarily directly related to the achievement of objectives set under the program.

The IMF was also trying to ensure that economic adjustments agreed with governments in response to the crisis would take into account the impact on the poor and most vulnerable.

"The Fund is trying to implement what I call 'social conditionality'—helping countries develop or maintain safety nets for segments of the population that may be affected by an IMF program," Strauss-Kahn said. "The IMF intervenes when things aren't going well, so reform measures will inevitably be unpleasant. But we have to make sure that these measures affect as little as possible the poorest and most vulnerable populations."

As part of the $16.4 billion loan package for Ukraine, for example, the government envisages an increase in targeted social spending amounting to 0.8 percent of GDP to shield vulnerable groups.

In the Pakistan program, expenditure on the social safety net will be increased to protect the poor through both cash transfers and targeted electricity subsidies. The fiscal program for 2008/09 envisages an increase in spending on the social safety net of 0.6 percentage points of GDP to 0.9 percent of GDP. Pakistan will also work with the World Bank to prepare a more comprehensive and better targeted social safety net program.

While people in advanced economies face a decline in their standard of living or a decrease in purchasing power as a result of the crisis, Strauss-Kahn noted, the world's poor face the prospect of malnutrition and even starvation. He said it was important to look beyond the current financial crisis to the human costs of the other crisis (food and commodities). He invited parliamentarians to attend a conference on Africa that the IMF is co-sponsoring in Tanzania in March.

Strauss-Kahn was speaking at the annual meeting of the Parliamentary Network of the World Bank, which links parliamentarians from 110 countries.


Mohsin Hassan/Reuters

Farmers in Pakistan dry fresh dates. The Pakistan program envisages increased social spending.

Yunus Carrim, a parliamentarian from South Africa, noted in response to Strauss-Kahn's statement that he expected the impact of the crisis on Africa to be severe in terms of lower inflows of foreign direct investment, a rapid decline of commodity exports because of slowing demand from advanced economies, and a decrease in aid flows. He also noted that parliaments needed to play a bigger role in the discussions on governance reform. "It is important to reform the governance of the IMF and World Bank now to enable them to better serve its members," he said.

Michaela Schrader
IMF External Relations Department

IMF Warns Gains Against Poverty Are in Jeopardy

The IMF warned that the gains in poverty reduction in low-income countries around the world are in jeopardy because of the dramatic slowdown in the global economy triggered by the world financial crisis.

"The most serious financial crisis in generations has tipped many of the advanced economies into recession. As the credit squeeze spreads and trade flows slow, developing countries face serious setbacks, through no fault of their own," IMF Deputy Managing Director Murilo Portugal told a United Nations conference.

"For the low-income countries in particular, recent gains in poverty reduction and improvements in living standards are now in jeopardy," he said in a speech on December 1 at the UN Financing for Development conference in Doha, Qatar.

Romeo Ranoco/Reuters

Global downturn means many low-income countries face shrinking export markets, IMF tells UN development conference.

Cumulative impact

Portugal said that the economies of many low-income countries had already been weakened by the cumulative effects of the food and fuel price surges that peaked in mid-2008 and they now faced a second blow from the global downturn. They were confronted with the prospect of declining private capital flows, as well as shrinking export markets.

He urged donor countries "to scale up development assistance, as pledged, despite the strains on their own budgets caused by the financial crisis."

In a statement issued on December 2, Portugal welcomed reaffirmations by donor countries at the Doha conference of their commitments to step up aid "as well as to foster mobilization of private financing, enhance delivery of debt relief, and accelerate conclusion of the current round of trade negotiations."

Spirit of multilateralism

Portugal said the IMF, which has 185 member governments, was doing its part. The Fund has increased its financial support to 15 low-income countries during 2008 as well as reforming its Exogenous Shocks Facility to make it quicker and easier to use.

"This conference has demonstrated that the spirit of multilaterism is very much alive. Indeed, there was wide acceptance of the need for broader representation of developing countries in global economic governance. This is a goal that the IMF fully endorses and is pursuing through its own ongoing governance reforms," Portugal stated.

Portugal said that low-income countries, for their part, have a responsibility to continue improving their policies to lift people out of poverty, including by making the management of aid and other budgetary resources more effective and transparent.

Mobilizing financing

Heads of state and government ministers from around the world gathered in Doha from November 29 to December 2 for the UN's Follow-up International Conference on Financing for Development to assess progress made on the 2002 Monterrey Consensus, a landmark North-South agreement on development principles.

The conference discussed ways of mobilizing financing for low-income countries, and assessed progress on other key inputs for development, such as trade, aid, investment, and debt alleviation. Systemic issues, including the necessary reforms of the international financial system, were also discussed. In addition, the Doha meeting considered emerging challenges that have taken on a higher profile since 2002, such as climate change and food and agriculture.

The task of the conference had become more urgent and more complex because of the global financial crisis, which has caused a sharp downturn in the global economy. ■

Jenny Bisping
IMF External Relations Department

For more information on the International Conference on Financing for Development, visit the conference website at *www.un.org/esa/ffd/doha*

Commodity Prices Slump, Less Appetite for Oil Amid Downturn

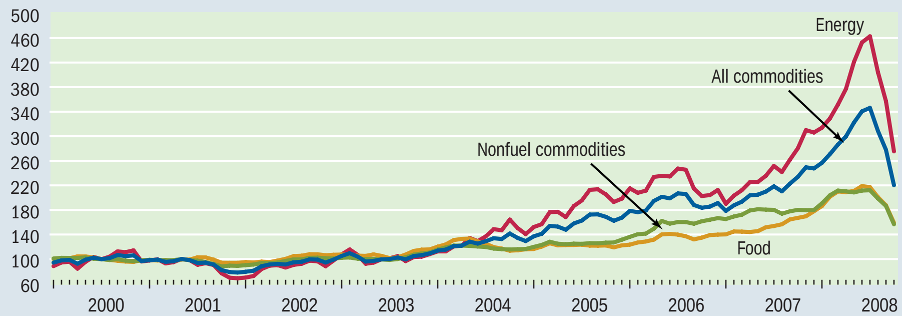
Commodity prices have declined sharply from recent peaks on expectations of a sharp global downturn, as demand for commodities has weakened in tandem with world economic activity.

Chart 1

Down they go

Commodity prices continue to drop but are still above historical levels.

(commodity prices, index, 2000=100)



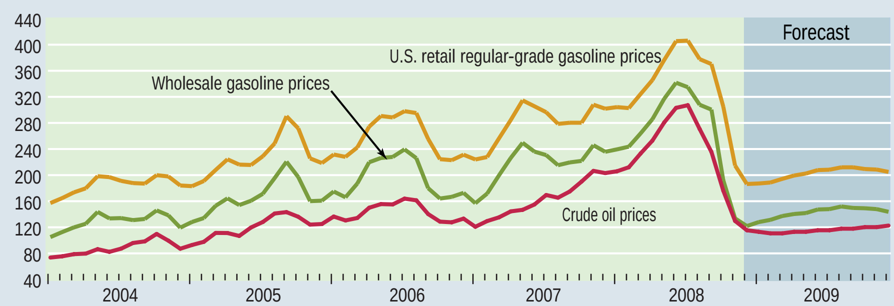
Source: IMF, International Financial Statistics database.

Chart 2

Cheap oil

The average U.S. retail price for regular-grade gasoline has dropped dramatically from its peak in July.

(cents per gallon)

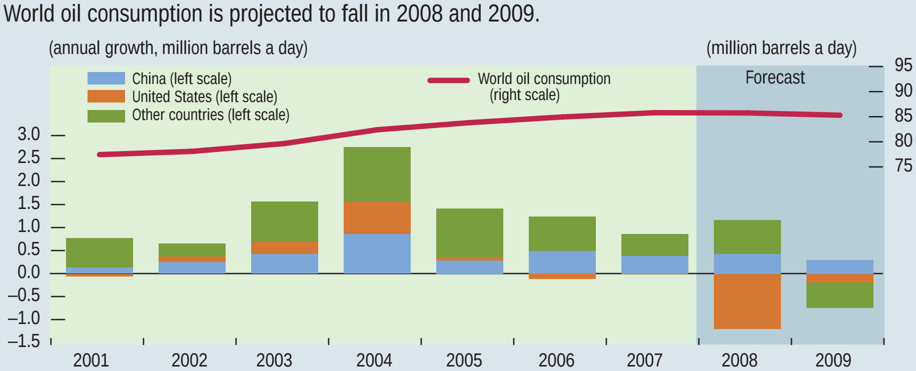


Source: Energy Information Administration.

Chart 3

Slowing oil demand

World oil consumption is projected to fall in 2008 and 2009.



Source: Energy Information Administration.

Commodity prices have plummeted in recent weeks (see Chart 1). The current global downturn has led to a decrease in global energy demand and a concomitant fall in energy prices. Energy prices have dropped at least 40 percent from their peak in July 2008.

Food prices, which were pushed up by a combination of rising demand and weather-related supply shocks, have also seen a sharp drop. They are down by 27 percent from their record high in June 2008.

The average U.S. retail price for regular-grade gasoline—at $2.15 per gallon in November—is more than $1.90 per gallon below its high in mid-July 2008 (see Chart 2). With a weak economy expected to continue through most of 2009, along with lower crude oil prices, the Energy Information Administration (EIA) projects the annual average retail gasoline price in the United States in 2009 will be $2.03 per gallon.

Decelerating activity, along with the continued impact of rising oil prices earlier in the year, have led to declining oil demand in the United States in 2008 (see Chart 3).

World oil consumption is also expected to decline this year—albeit only slightly—by about 49,000 barrels a day or 0.06 percent compared to an increase of 849,000 barrels a day or 1.0 percent in 2007. According to the EIA, world oil consumption is projected to decrease in 2009 by 449,000 barrels a day or 0.5 percent. ■

IMF Data and Statistics

The IMF publishes a range of time series data on IMF lending, exchange rates, and other economic and financial indicators. Manuals, guides, and other material on statistical practices at the IMF, in member countries, and in the statistical community at large are also available.

For a comprehensive listing of data sources, visit the "data and statistics" section of the IMF website at *www.imf.org/external/data.htm#data*

IMF Survey: A Look Back

How did the IMF Survey*, which started as a print vehicle for explaining the IMF's work to the public, end up as an exclusively online source of IMF news and analysis for a large global audience? The editors of the magazine offer a brief history of the publication.*

In August 1972, the *IMF Survey* succeeded the *International Financial News Survey*, which had been a compilation of global economic and financial news items from various sources.

The new publication had a different mandate. It was "aimed at promoting a wider understanding of international monetary problems and the work of the Fund," according to an internal memorandum in June 1971 proposing the *IMF Survey's* launch.

The *Survey*, written and edited by IMF staff, would offer a "current and comprehensive review of major economic and financial news developments, a substantial account of Fund activity, and a section on individual national economies." The publication would serve as a vehicle for disseminating information gathered by staff economists in the course of their work on member countries' economies, according to the proposal.

Then, even more than now, the IMF's work was viewed as esoteric, and few outside the institution understood what the Fund actually did. The IMF needed to make a more systematic effort to explain its work to the public—even the most sophisticated, well-informed members of the public, an early advocate of the *IMF Survey* argued in an internal memorandum. Its audience expanded further after French and Spanish editions started up in January 1974.

The *IMF Survey* began publication at a time when the global economy was undergoing a dramatic transformation. The international monetary system designed at the 1944 Bretton Woods Conference had collapsed with the announcement by the United States in 1971 that the link between the dollar's value and that of gold was to be severed permanently. As a result, par values and dollar convertibility were replaced by a system of floating exchange rates for the major currencies.

The IMF's role in the new monetary system was likewise being redefined. The Committee of 20 on the Reform of the International Monetary System worked between 1972 and 1974 to map out a program for reform—just as the G-20 today is charged with devising changes to the global financial system. One has only to glance at *IMF Survey* headlines from that era—on skyrocketing oil prices, rising inflation, and the world's increasing economic and financial interdependence—to see the parallels with what is happening in the world today.

"The upheaval in the monetary system gave the *IMF Survey* its agenda for its early years: we set out to offer a twice-monthly report on the Fund's reform effort in the broader context of rapidly changing world events," says Charles Gardner, the *IMF Survey's* first Editor-in-Chief.

"Around the world, an audience was growing rapidly with a greater need for regular, accurate information on the Fund," Gardner recalls. "Their numbers included officials in member countries, academics in universities and think tanks, business people in banking and financial services, and journalists in the world's financial press."

For its first 25 years, the *Survey* was the IMF's journal of record, documenting major institutional decisions and publishing IMF press releases, communiqués, and speeches by senior management. The *Survey* also covered pertinent activities in other international financial and economic agencies, such as the Bank for International Settlements, the General Agreement on Tariffs and Trade, the Organization for Economic Cooperation and Development, the United Nations Conference on Trade and Development, and the World Bank.

While duly reporting the work of the institution's dismal scientists, the *Survey* was not completely devoid of humor. In a 1987 piece on a speech by then-Managing Director Michel Camdessus, who had just assumed his post, the *Survey* quoted him as refuting the commonly held view that the Fund sought to impose a "uniform, mechanistic approach to adjustment" on its member countries.

"I must tell you that in my few weeks in the Fund I have searched carefully through the cupboards for such a policy

Moving with the Times

IMF Survey was launched as an online publication in May last year. Since then it has become one of the fastest methods for the Fund to get out its news and analysis. We have been able to cover key events almost in real time. And as the world economic crisis takes hold, it is more important than ever for the IMF to share with a global audience its proposals for addressing weaknesses in the economic system and reviving growth.

Readers of the *IMF Survey* too have found the online articles more convenient and quicker, with many readers shifting from the print edition to online. With this edition, we have therefore decided to discontinue the print version and become an exclusively online publication. We will also continue to strengthen our French and Spanish online editions, as we already have done for the English edition.

We hope that you will continue to read *IMF Survey* news and background articles at our website *www.imf.org/imfsurvey*. We also welcome your views and suggestions. Please send them to *imfsurvey@imf.org*.

Jeremy Clift
Editor-in-Chief

straitjacket," Camdessus said. "I have not found it. And if I had found it, I would have destroyed it."

Throughout the decades, the *IMF Survey* continued to explain the Fund's work as it related to the major events of the day—from the international debt crisis of the 1980s and the 1991 collapse of the Soviet Union to the Asian, Russian, Latin American, and Turkish financial crises of the 1990s and early 2000s.

The *Survey* also shared with its readers the evolving shifts in the institution's work, such as the new emphasis on poverty reduction—beginning in 1999, with the creation of the Poverty Reduction and Growth Facility, and intensifying later with the effort to help low-income countries achieve the Millennium Development Goals.

Twin developments in the mid-1990s led to a major evolution of the *IMF Survey*. First, the IMF's push for greater transparency of its operations and policies resulted in more frequent publication of IMF reports and data. At around the same time, technological advancements permitted the IMF to launch a public website in September 1996. Initially, the website contained IMF press releases, information on IMF lending, the *Annual Report*, and a database of IMF publications. Member country pages were added to the website in 1999.

With the exponential increase in the amount of material on the IMF's website, the *IMF Survey* had outgrown its role as the "journal of record" for the institution by the early 2000s. Instead, the *Survey* took on the role of distilling key messages for its readers amid the wealth of available information.

As the reach and power of the Internet grew, readers wanted faster access to information. The *IMF Survey's* online edition was thus launched in mid-2007, giving the publication the capability of posting fresh stories several times a week. The *Survey* now strives to be a genuine news source for its readers, providing timely explanation and interpretation of IMF activities in a global context.

As the online edition attracts a firm following of readers—and print subscription has declined—the *IMF Survey* will produce only an online edition beginning in January 2009.

The *IMF Survey's* audience has expanded with the globalization of finance in recent years, notes Gardner. "It makes perfect sense to take advantage of the speed as well as the cost savings to serve this enlarged audience exclusively by Internet." ■

Spillover Analysis

Latin America: Greater Resilience to Shocks

For a region that used to be the epitome of recurrent economic crises, Latin America is showing greater resistance to the financial turmoil than other areas of the globe.

Arguably, that is partly explained by a profound change in recent years to the economic and financial linkages between Latin America and the rest of the world.

A new book edited by Martin Mühleisen (Division Chief, IMF Strategy, Policy, and Review Department), Shaun K. Roache (Economist, IMF Finance Department), and Jeromin Zettelmeyer (Director for Policy Studies at the European Bank for Reconstruction and Development) looks at the economic relationships among Latin America, the United States, Canada, and other important economic regions. *Who's Driving Whom?: Analyzing External and Intra-Regional Linkages in the Americas* presents original work by these former members of the IMF's Western Hemisphere Department that sheds light on how linkages in the region have evolved.

In the following interview, Mühleisen and Roache discuss their work.

IMF

From left: Shaun K. Roache, Joy Villacorte (project coordinator), and Martin Mühleisen.

IMF Survey: How did you come to compile this book?

Roache: The book reflects the outcome of what began as a stocktaking exercise on linkages and spillover analysis in the IMF's Western Hemisphere Department in late 2006. A working group of about 15–20 economists set out to have a fresh look at questions of the "if the United States sneezes, Latin America catches a cold" type—with quite astonishing results. The findings of the group—contained in the book's literature surveys and analytical pieces—were also discussed during an IMF research seminar in 2007.

IMF Survey: It is telling that none of the first countries coming to the IMF in the current financial crisis is from Latin America. However, these countries, as you point out in the book, are not immune to the shocks that have hit the global economy. How much do you think Latin American countries will be affected by the current turmoil?

Mühleisen: Latin American countries have done a lot to enhance their resilience to crises over the past years, and the recently ended commodity boom has certainly helped. However, our work also suggests that trade and financial integration have strengthened Latin America's business cycle linkages with the outside world, and thus one would expect the tightening of credit conditions and slowdown in global activity to eventually have an impact.

For example, the book presents an empirical model that sheds light on the contribution of external shocks to output fluctuations in Latin America between 1994 and 2007. It is estimated that the overall impact of an export-weighted world growth shock on Latin America is roughly one-for-one; in other words, for a 1 percentage point decline in world growth we should expect to see a similar decline in regional growth. Having said that, Latin America is of course a heterogeneous region and the effects on individual countries are likely to vary widely, depending on their economic and financial structure.

IMF Survey: With the United States verging on a recession, through which transmission channel will Latin American countries be affected the most?

Mühleisen: There is relatively strong evidence that financial linkages have been the most important transmission mechanism for business cycle movements. Capital market movements have been quite rapid, with asset prices providing the key transmission mechanism. Capital flows have been less relevant, as they typically reverse with some lag. This said, there is reason to believe that the resilience of Latin America to U.S. financial shocks has increased in recent years: the response of sovereign spreads to financial shocks in the United States has been more muted. As economic policies have become more nimble, the amplification of shocks by the financial sector may now be weaker than it was in the past.

IMF Survey: How developed and integrated with the rest of the world are Latin American financial markets? In the current circumstances, is that a plus or a minus?

Roache: A lot of papers have been written on how financial markets in Latin America have developed in recent years, and indeed we found ample evidence for the transmission of financial shocks from global markets to the region. Monetary policy "surprises" in the United States—which are most widely studied—have had an important impact on local equity markets and sovereign credit spreads. These effects were generally found to be stronger for countries with a pegged exchange rate than for countries with a flexible rate. The intensity of equity market spillovers also seemed to be positively linked to the degree of openness and liquidity of financial markets, and the degree of financial and real integration. These spillovers have increased over time, and that's why it has been important to have in place adequate capital cushions and sound regulatory frameworks.

IMF Survey: Over the long term, how can Latin America best take advantage of the potential benefits offered by globalization?

Mühleisen: There is large potential for the region to reap the benefits of globalization without necessarily increasing its vulnerability to external shocks. In general, the findings from our own research and our review of the broader literature suggest that good economic policies—flexible exchange rates, low inflation, and a responsible fiscal stance—tend to produce better growth outcomes, help in the reduction of poverty, and lead to lower degrees of vulnerability.

Indeed, many countries in the region have already made good progress in this direction, both in macroeconomic management and on the structural and institutional front. While the fallout from the crisis will still put some countries in the region to the test, the recent performance of Latin America is testament to the fact that economic and financial linkages between Latin America, the United States, and other regions have undergone profound change. ■

Improved Policies Seen Helping Latin America in Crisis

Although Latin America will not be immune to the financial crisis, many countries in the region are likely to ride out the storm better than previously because they now have stronger economic policies in place, according to Nicolas Eyzaguirre, the new Director of the IMF's Western Hemisphere Department.

Speaking in the Dominican Republic, the former Finance Minister of Chile took a broad look at the causes of the world financial crisis and the global economic slowdown. He said the crisis was already having an impact on Latin America and the Caribbean in a number of ways. These included reduced capital inflows, lower prices for the region's commodity exports, and lower levels of worker remittances, particularly to Central America.

He said the crisis posed a serious challenge for Latin America. "We are seeing now a real-life 'stress test' of the progress that countries of the region have made in terms of building resilience," said Eyzaguirre in his first speech since his appointment as the Director of the IMF's Western Hemisphere Department. He took up his post on November 24.

Lower inflation

At the November 22 seminar, "The Emerging Global Financial Order: A Regional Perspective," he gave two examples of the better policies now being pursued by Latin American countries compared with during previous crises:

• Many Latin American countries have brought down inflation in a credible manner and adopted more flexible exchange rates, while at the same time reducing their balance sheet exposure to currency depreciation.

• Public debt ratios have also come down in many countries—although, in some cases, not as far as might have been possible at a time when soaring commodity export prices boosted government revenue.

Paulo Whitaker/Reuters

Construction of the Octavio Frias de Oliveira Bridge in São Paulo. Crisis is "stress testing" Latin America.

The seminar was convened by Dominican Republic President Leonel Fernandez. Financier and philanthropist George Soros and Nobel Prize-winning economist Joseph Stiglitz also participated in the panel.

Eyzaguirre emphasized that different countries in the region would be affected by the global crisis in a variety of ways. But, in its latest forecast, the IMF still expects positive growth in Latin America next year. Indeed, it was notable that many nations in Latin America were doing better than some emerging market countries in other parts of the world.

Within Latin America and the Caribbean, countries differ in the room they have available for policy maneuver. "I believe that the current crisis will remind us of the value of avoiding procyclical fiscal expenditure patterns," Eyzaguirre said. He reminded the audience of the importance of protecting the poor in the current environment. "I would stress also the importance of social safety nets. A number of countries in the region have made progress in this area in recent years—now is the time to strengthen protection of the most vulnerable."

Improved coordination

With respect to advanced countries, where the financial crisis originated, Eyzaguirre pointed out that the initial "piecemeal approach" had been abandoned in favor of a comprehensive one; most important, using the public sector balance sheet to recapitalize financial institutions. He also noted that policy coordination across countries, that had sometimes been inadequate, had improved recently.

In addition, he said that there was broad agreement that new monetary and fiscal policy initiatives are needed. With respect to the latter, analysis by the IMF suggests that a global fiscal stimulus of about 2 percent of GDP is justified. The Fund considers such a stimulus imperative to sustain global demand and output.

Asian Growth to Slow Sharply in 2009, IMF Says

Growth in Asia, battered by the effects of the financial crisis that began in advanced economies and is now engulfing emerging markets, is expected to slow sharply in 2009, the IMF says.

On an annual average basis, growth in Asia is projected to slow from 7.6 percent in 2007 to 6.0 percent this year and 4.9 percent in 2009, according to the IMF's *Regional Economic Outlook: Asia and Pacific*, which was released on November 24.

"With the recent intensification of the global financial turmoil, any hopes that Asia would escape the crisis unscathed have evaporated. Despite its strong fundamentals—notably a substantial cushion in external reserves and robust corporate and banking sectors—the region is being buffeted by large external shocks," said Jerald Schiff, a Senior Advisor in the IMF's Asia and Pacific Department. He gave two key reasons for the slowdown:

- Global demand for Asia's exports is waning, with the economies of the euro area, Japan, and the United States in a deep slump, and forward-looking indicators pointing to a sharper decline ahead.
- The financial environment has become extremely challenging. Global deleveraging is contributing to tighter financing conditions, capital outflows, depressed equity prices, a weakening of a number of regional currencies, and higher sovereign and bank spreads.

Slowing economic growth and lower commodity prices are already contributing to moderating inflation, and the report expects a continued decline over the course of 2009, with headline consumer price inflation for the region falling from 6 percent this year to just over 3 percent in 2009.

While the baseline scenario for Asia sees recovery beginning in the second half of 2009, risks to the outlook are significantly larger than usual and tilted strongly to the downside, the report warned. A deeper and more protracted global slowdown than currently anticipated, combined with tighter international financial conditions from the ongoing global deleveraging, could have significant spillovers to the region through both exports and a range of financial channels. Most notably, slowing growth is likely to contribute to rising bad loans for regional banks, risking an adverse cycle of tightening credit conditions and deteriorating growth.

It also remains unclear how domestic demand would stand up to a sharp decline in export growth and tighter financial conditions, the report said. Despite Asia's generally strong fundamentals and large foreign exchange reserves, the region is "being rattled by the crisis due to its close trade and financial integration with the rest of the world."

"In this difficult environment, policymakers need to focus on ensuring financial stability and the functioning of credit markets, while using macroeconomic policies to support growth," Schiff told the media. "Countries in the region have already taken a number of positive measures to stabilize financial conditions, including exceptional provision of domestic and foreign exchange liquidity and, in several cases, the extension of guarantees on bank deposits and other liabilities. But more may be needed, including public recapitalization of banks, if this becomes necessary."

With inflation having peaked in most countries, there is room for further monetary policy easing. In addition, progress in fiscal consolidation in recent years will allow many countries to put in place stimulus packages, and a number of countries have already moved in this direction, including Japan, Korea, and China.

The report includes two analytic chapters that address longer-term issues that will affect the region's economies as the impact of the current crisis recedes:

- "The Globalization of Asian Inflation" examines the rising importance of commodity prices in Asia's inflationary process and its potential implications for monetary policy. While inflation in the region could in the past largely be traced back to domestic factors, global relative prices—notably of commodities—have been the driving force behind rising inflation in recent years. Despite the recent downturn, commodity prices are expected to remain high and volatile over the medium term, which would tend to create persistent gaps between core and headline inflation and pose new challenges for policymakers.
- "The Graying of Asia: Demographics, Capital Flows, and Financial Markets" analyzes the impact of rapid demographic change in Asian countries on their external positions and capital flows as well as on financial markets and asset prices. The study shows that vastly different rates of aging across Asia are likely to have sizable effects on current accounts and capital flows—with capital tending to flow "uphill" from younger to older countries. Governments can ease the demographic transition by beginning to take policy measures now, the study says. ■

Slowing pace

Growth in Asia is projected to slow below the 5 percent mark next year.

(real GDP growth, year-on-year percent change)

		Latest projections	
	2007	**2008**	**2009**
Asia	**7.6**	**6.0**	**4.9**
Industrial Asia	**2.4**	**0.8**	**0.1**
Japan	2.1	0.5	–0.2
Australia	4.4	2.4	1.8
New Zealand	3.2	0.7	1.5
Emerging Asia	**9.5**	**7.7**	**8.5**
NIEs[1]	**5.6**	**3.8**	**2.1**
China	11.9	9.7	8.5
India	9.3	7.8	8.3
ASEAN-5	**6.3**	**5.4**	**4.2**
Emerging Asia excl. China	**7.3**	**5.9**	**4.4**
Emerging Asia excl. China & India	**5.9**	**4.6**	**3.1**

Sources: CEIC Data Company Ltd; and IMF, WEO database.
[1]NIEs = newly industrialized economies.

Bosnia and Herzegovina: On the Road to EU Accession

A new agreement signed by Bosnia and Herzegovina opens the door to membership of the European Union (EU).

But after years of solid growth and sound policies the country has to prepare for EU accession during a time of global economic crisis.

Bosnia and Herzegovina signed a Stabilization and Association Agreement (SAA) with the EU on June 16, 2008, opening the door for EU membership. This agreement represents a watershed for the country. It marks the end of a period of about 12 years, during which the country made significant strides toward rebuilding its economy after the ravages of the 1992–95 war.

But the new agreement also means that after years of economic growth underpinned by sound macroeconomic policies, reforms in key sectors, and a favorable external environment, Bosnia and Herzegovina is facing a fresh test: how to get ready for EU accession at a time of extreme turmoil in the world economy.

Bosnia and Herzegovina has made great strides. Postwar reconstruction and expanded public consumption and investment have boosted living standards, with real wages rising 44 percent between 2000 and 2007. The country's currency board has been instrumental in bringing down inflation to a level close to that of the euro area. The banking system has been largely privatized, and international reserves have been boosted substantially.

But economic imbalances have begun to emerge, with capital inflows and rapid credit expansion increasingly driving the domestic demand boom. The current account deficit rose to 12.7 percent of GDP in 2007, and is set to widen further.

Until now, the real effective exchange rate has been stable, and export growth has remained strong. However, inflation accelerated to 10 percent in July 2008. While this largely reflects the effects of global food and energy price shocks, underlying inflation has crept up as well, to about 4 percent. A procyclical fiscal policy has added to these imbalances.

Bosnia and Herzegovina also lags other countries in the region when it comes to creating a friendly business climate. At close to 50 percent of GDP, the public sector is large, and many companies still need restructuring. Privatization has been uneven, and the labor market is characterized by high, mostly structural, unemployment (amounting to 23 percent of the labor force) and low participation rates.

The complex political system complicates decision making. The Dayton Peace Agreement created two largely autonomous entities, Republika Srpska and the Croat-Bosniak Federation of Bosnia and Herzegovina divided into 10 largely ethnic cantons, all held together by a central government with a limited mandate. This structure leads to the duplication of many domestic policy functions and weakens incentives for cooperation.

Because of the global financial crisis, the need to reduce Bosnia and Herzegovina's vulnerabilities has become even more urgent. Deterioration in the financial health of European banks active in the country and a marked slowdown in Europe pose risks for the small, open economy.

For now, the impact of the crisis has been limited. The central bank moved quickly to loosen reserve requirements, allowing commercial banks to meet a sudden surge in deposit withdrawals and helping to restore public confidence unsettled by a spate of negative economic news from abroad.

But there are signs of tightening financial conditions for foreign banks active in the country, which could lead to a scaling back of lending. Some slowing of credit growth would in fact be welcome, as it would help cool domestic demand, but an abrupt halt in foreign lending could undermine growth and external stability. The projected decline in export prices relative to import prices will add to pressures on the current account, raising concerns about external competitiveness.

The recent IMF assessment focused on the need to safeguard macroeconomic stability and strengthen the supply side of the economy. Domestic demand will need to be reined in to contain inflation and reduce the current account deficit.

Because of its currency board, Bosnia and Herzegovina cannot use monetary policy to lean against rising demand, which means it must use fiscal and income policies instead. Aiming for a balanced budget would ensure fiscal sustainability and would be a simple rule to follow in Bosnia and Herzegovina's complex political and economic setting.

Keeping public wage increases in check will also be important: public wages directly affect the overall fiscal position, and set the tone for wage setting in the rest of the economy. On the structural front, top priorities include restructuring the corporate sector, streamlining business regulation, strengthening the rule of law, and making government smaller and more efficient.

All this adds up to an ambitious policy agenda. To make it happen, closer policy coordination will be needed. Although domestic political tensions have frequently distracted governments from the task of policy reform, there have been encouraging signs this year. The Fiscal Council (a body charged with coordination of fiscal policy) has been established, and agreement has been reached on a permanent indirect revenue allocation formula. And the recently signed SAA promises to become a catalyst for a renewed push for reform. ■

Milan Cuc
IMF European Department

Jaime Caruana to Leave IMF for BIS

IMF Managing Director Dominique Strauss-Kahn announced in late November that Jaime Caruana, Financial Counsellor and Director of the IMF's Monetary and Capital Markets Department (MCM), would leave the Fund in April 2009 to become General Manager of the Bank for International Settlements (BIS).

Strauss-Kahn praised Caruana in the press statement, noting that he has been instrumental in strengthening the Fund's work on financial sector issues and on macro-financial linkages.

Until his departure, Caruana will continue to serve as Financial Counsellor but will relinquish his operational responsibilities as Director of MCM.

Spain's Near-Term Prospects Are Somber, IMF Says

Spain's near-term prospects are "somber and uncertain," according to a statement by an IMF mission team in Madrid for the country's annual assessment. "After 15 years of impressive growth led by a housing boom, a gradual correction of accumulated imbalances got under way," the statement said, noting that the global financial crisis has accelerated Spain's slowdown.

"The authorities' response has been forceful and earlier than European Union partners, with market-based banking policies and substantial fiscal measures," the IMF statement said. "Embedding these short-run fiscal measures into a long-run consolidation plan could increase effectiveness and boost confidence."

But recovery in the medium term will also depend on the country's progress with implementing comprehensive structural reforms, the statement stressed, adding that, in absence of such reforms, "Spain could get stuck in a low-competitiveness, slow-growth, extended-deleveraging, and high-unemployment equilibrium, from which returning to lower public debt would be difficult."

IMF Appoints New Human Resources Director

IMF Managing Director Dominique Strauss-Kahn has named Shirley Siegel as Director of the IMF's Human Resources Department.

From 2001 to 2007, Siegel was Assistant Deputy Minister in charge of Human Resources for the Canadian Department of National Defense, where she had responsibility for setting the human resource strategy for a civilian workforce of 24,000.

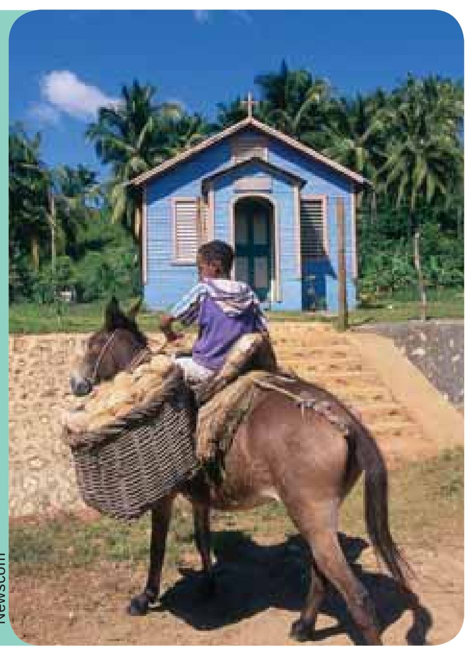
Siegel, a Canadian national, is expected to assume the post in mid-January 2009.

Caribbean Outlook Revised Downward

IMF Managing Director Dominique Strauss-Kahn visited Costa Rica, the Dominican Republic, and Jamaica on December 8–11 during his first official tour of the Caribbean and Central America.

"The outlook for the Caribbean countries has been revised down in recent months," Strauss-Kahn said in an address to the Private Sector Organization of Jamaica in Kingston. "This is certainly true for Jamaica, where current expectations are for relatively flat growth this year and a modest recovery of about ½ percent in 2009."

Strauss-Kahn noted that the projected slowdown would likely reflect weaker foreign remittances and dampened activity in key sectors, such as tourism.



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IMF Set to Lend Latvia $2.4 Billion

The IMF announced plans to lend about $2.4 billion to Latvia to support the country's ambitious plan for stabilizing the economy.

The loan, to be extended as a 27-month Stand-By Arrangement, is subject to final approval by the IMF's Executive Board but could be discussed before the end of this year under the Fund's fast-track emergency financing procedures.

The IMF-backed loan will enable Latvia's government to implement a strong package of policy measures aimed at stabilizing the economy. "The program aims to alleviate immediate liquidity pressures, restore long-term stability, and enhance competitiveness," IMF Managing Director Dominique Strauss-Kahn said in a press release.

Africa Conference

The Tanzanian government and the IMF are jointly sponsoring a high-level conference in Dar es Salaam on March 10–11 to discuss how Africa can meet the challenge of sustaining and building on its recent economic successes and cope with the global downturn.

IMF–World Bank Spring Meetings

The IMF and the World Bank Group will hold their Spring Meetings in Washington, D.C. on April 25–26. Look for complete coverage of the meetings on *www.imf.org*.