DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
on the
Transfer of Real Resources to Developing Countries)

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STATEMENT BY THE MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

Attached for information for the Members of the Development Committee is a Statement from the Managing Director of the International Monetary Fund, Christine Lagarde, for the Committee's ninety-third meeting to be held in Washington, DC on Saturday, April 16, 2016.

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INTERNATIONAL MONETARY FUND

DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR'S WRITTEN STATEMENT

April 2016

The outlook for the world economy has weakened further over the last six months, and risks have increased. A durable recovery is not yet established, with many countries adversely affected by protracted low commodity prices, financial market volatility and tightening financial conditions, rebalancing of demand in China, and the fallout from geopolitical conflicts. However, market sentiment has recently improved in response to incoming data, providing policymakers an opportunity to consolidate the recovery by committing to a set of policy actions—as determined by available policy space—that contributes to lift both national and global growth. A three-pronged policy response by member countries in the monetary, fiscal, and structural areas can trigger a virtuous circle, both reinforcing economic activity and reducing macro-financial stability risks. The Fund stands ready to support its members to navigate difficult circumstances and meet their commitment to growth and development as well as to address new challenges.

ECONOMIC OUTLOOK AND RISKS

The global recovery continues moderately, but the outlook has weakened and risks have increased.

The global recovery has weakened.

The global economy grew at a sluggish (annualized) pace of 2.7 percent in the second half of 2015, reflecting an unexpected slowdown in the last quarter of the year, including in the United States, Japan, and other advanced Asian economies. The marked drop in commodity prices has hit many commodity-exporting emerging and developing economies (EMDEs) hard, while the favorable impact of lower prices on commodity importers has been less than expected. Incoming data has shown positive signs, albeit with global growth expected to remain modest at 3.2 percent in 2016.

The recovery in advanced economies continues to be restrained.

Weak demand, unfavorable demographics, and low productivity growth continue to restrain the recovery in advanced economies (AEs). Growth in the United States is flat, owing in part to a strong dollar, while low investment, high unemployment, and weak balance sheets continue to hold down growth in the euro area. A sharp fall in consumption spending pushed the Japanese economy into recession in the fourth quarter of 2015. While accommodative monetary policy and low oil prices will support domestic demand in AEs, still-weak external demand,

and somewhat tighter financial conditions will weigh on recovery. Inflation in AEs is now at very low levels, helped by the large decline in oil prices, and should remain well below central bank targets in 2016.

Stresses in several large emerging economies show no signs of abating.

Risks remain elevated in emerging economies (EMs). A number of large EMs—including Brazil and Russia—are still mired in recession. These, as well as several other oil and commodity exporters (Ecuador, Colombia, Arab States of the Gulf), continue to adjust to weaker terms of trade and tighter external financial conditions. The ongoing rebalancing in China has slowed growth, albeit to a more sustainable level. Some EMs continue to face tighter financial conditions, strains in corporate balance sheets, and associated banking sector risks. Moreover, civil conflict and large movements of refugees have posed severe challenges for several countries (including Jordan, Lebanon, and Libya). India remains a bright spot, with continued strong growth, while activity remains robust in many other emerging Asian economies (such as Indonesia, Philippines, and Thailand).

Low-income developing countries are also facing important challenges.

Having experienced strong growth for more than a decade, economic activity in low-income developing countries (LIDCs) slowed from 6.1 percent in 2014 to 4.5 percent in 2015. Commodity exporters, in particular oil producers, have been hit hardest—for example, the pace of growth in 2015 was halved in Nigeria and Republic of Congo. Countries less dependent on commodity exports have been faring better—with growth remaining above 6 percent in Bangladesh, Tanzania, and Vietnam—although some have been hit by climate shocks and natural disasters (including the Horn of Africa, Liberia, and Nepal). Domestic conflict and difficult security situations have taken a toll in several countries (including Chad, Somalia, and Yemen).

Risks have increased.

The balance of risks to economic prospects for EMDEs is still tilted to the downside; these include potential further weakening of commodity prices, continued uncertainty about the near-term growth and spillover effects from China's transition, and increasing financial turbulence, especially in EMs, which could face a disorderly pull-back of capital flows. Trade growth has slowed significantly and spillovers through the trade channel could exacerbate the weakness in global activity. Also, non-economic shocks—related to geopolitical conflicts, terrorism, refugee flows, and global epidemics—remain a risk factor in several countries and regions, with the potential to have a significant adverse impact on global economic activity.

POLICY CHALLENGES FACING EMERGING AND DEVELOPING ECONOMIES

With limited room for maneuver, policymakers in EMDEs face the challenge of strengthening growth and resilience.

A three-pronged policy response—supported by global cooperation—is vital for strengthening the recovery.

In many EMDEs, the scope to ease fiscal and monetary policies is constrained by a mix of elevated debt levels, inflation concerns, and balance-sheet exposures. A potent policy mix is needed:

- Countries with room for maneuver should use fiscal policy to support growth while safeguarding debt sustainability (as done by Canada with its recent budget). Where fiscal space is limited, policies need to focus on targeted fiscal consolidation and growth-enhancing fiscal reforms, while protecting the vulnerable and maintaining economic inclusion goals.
- In EMs, monetary policy must grapple with the impact of weaker currencies on inflation and private sector balance sheets (as in Turkey). Exchange rate flexibility should be used to cushion the impact of terms-of-trade shocks. Many EMs also need to carefully monitor and contain the rapid growth of leverage–on both household and corporate balance sheets.
- Structural reforms, outlays on infrastructure, and active labor market policies can provide short-term stimulus while also raising long-term economic potential. Given the diversity of country situations, national reform priorities need to be appropriately sequenced, responding to differences in level of economic development and strength of institutions. And in countries highly reliant on commodities, as well as many LIDCs, policies to promote economic diversification are essential.
- Global cooperation is vital to spur a more resilient and sustainable global economy from individual country efforts. Key actions needed include reforms to strengthen the global financial safety net, shore up global trade, tackle corruption, and further the financial regulatory reform agenda.

Domestic and international policies need to address the refugee crisis in both recipient and source countries.

Forced displacement has become a pressing issue for source, transit, and recipient countries alike, against the background of a deepening refugee crisis. Early integration into national labor markets (by allowing asylum seekers to work and receive targeted support to overcome initial barriers to gaining employment) is key to assuring refugee well-being and containing the fiscal cost associated with large refugee inflows. Implementation of international commitments to reduce the costs of sending remittances would provide an important boost for source countries. A concerted effort from the international community—

including through financial assistance, grants and humanitarian relief—is urgently needed to help support EMDEs that are shouldering the burden from the ongoing refugee crises. External support to countries with already-high levels of public debt (e.g. Jordan, Lebanon) should be in the form of either grants or highly concessional loans, if risks to medium-term public debt sustainability are to be contained.

Making progress on the long-term development agenda is crucial.

Notwithstanding macroeconomic adjustment challenges, countries need to press ahead with strategies to achieve their longer-term development objectives. Priority actions typically include measures to strengthen domestic resource mobilization, improve the efficiency of government spending, and deploying policies to promote inclusion. Strengthened public investment management capacity will help ensure that infrastructure investment boosts productive capacity without threatening sustainability, while the deepening of domestic financial markets will expand funding sources, enabling governments to provide counter-cyclical demand support.

FUND SUPPORT

The Fund will continue to help members maintain macroeconomic stability and achieve development objectives, while also tackling new challenges.

Help rebalancing the policy mix and introduce new initiatives to provide better advice.

To assist policymakers take decisive actions the Fund will:

- Promote a concerted approach, identifying cases where fiscal policy can play a bigger role in both supporting demand and augmenting structural reforms;
- Help design, where needed—such as in commodity exporting countries, the necessary fiscal consolidation in a sustainable, equitable, and growth-friendly manner;
- Continue to deepen its analysis of the impact of structural reforms on growth, employment, and macroeconomic stability, and on principles to guide prioritization;
- Strengthen its support for efficient infrastructure investment—including by piloting its new infrastructure policy support initiative—to help countries address infrastructure gaps without imperiling debt sustainability; and
- Review members' experiences and policies in managing capital flows. It will also examine options to reduce the risk of adverse balance-sheet effects from rising private sector indebtedness and unresolved crisis legacies in banks.

Address emerging issues and the long-term development agenda.

In the effort to continue to assist countries in pursuing the 2030 development agenda and to build expertise in issues that are becoming more macro-critical in member countries, the Fund will:

- Assess how redistributive fiscal policies affect domestic demand, potential growth, and income inequality, and deepen its policy advice on inequality issues in pilot countries;
- Continue to analyze the macroeconomic impact of climate change and assist countries in devising appropriate policies and instruments to address it;
- Examine factors that impact medium- and long-term growth, including financial development and inclusion, demographic shifts, gender, and measures to limit corruption; and
- Press ahead with efforts to assess how the Fund can best support growth and boost resilience in small states vulnerable to natural disasters.
- Work with other international institutions to establish the drivers, scale, and impact of de-risking, and support affected countries with customized policy advice, assessments, and capacity-building.

Backstop good policy implementation.

The Fund will support countries' efforts by using its resources to provide a strong financial backstop for policy implementation. The Fund will consider enhancing financial support to assist with diversification and adjustment in countries hit by commodity price declines, while also providing support to countries critically affected by El Niño. Also, to further assist low-income developing countries, the Fund will examine the scope for better tailoring Poverty Reduction and Growth Trust (PRGT) facilities to their evolving needs.

Assist in managing the refugee crisis.

The Fund stands ready to assist countries adversely affected by recent epidemics and at the center of the current epidemics or refugee crises:

- The Fund is expanding its support for fragile and conflict affected member countries, with particular emphasis on helping build core public institutions.
- Fiscal frameworks in Fund-supported programs in recipient countries (e.g. Jordan) have been modified in response to the pressures from refugee-related spending.
- The Fund's Rapid Financing Instrument and Rapid Credit Facility can provide countries with speedy assistance in response to urgent balance of payments needs created by exogenous shocks, including large-scale inflows of displaced persons. The Fund remains fully committed to collaborating closely with other multilateral institutions in the global effort to provide financial and policy support to countries suffering from the refugee crisis and will continue to assess how its resources can be channeled to those

areas with the greatest need.

- To provide the analytical base for action, the Fund will continue to deepen its diagnosis of the economic implications of the refugee surge and migration on growth, labor markets, and fiscal positions in both recipient and source countries.

CONCLUDING REMARKS

Over the last six months, the Fund stepped up financial support, policy advice, and capacity building to its members

Lending

The Fund has provided financing to countries hit by lower commodity prices and natural disasters. New disbursements under the Rapid Credit Facility were approved for Central African Republic, Dominica, and Madagascar; new arrangements were approved for Mozambique (Stand-by Credit Facility) and Kenya (combined Stand-by Credit Facility/Stand-by arrangement). Efforts to raise an additional SDR 11 billion in PRGT loan resources are underway that would enable the Fund to continue providing concessional support to eligible countries for several years to come.

Capacity building and policy advice

Delivery of technical assistance and training to support domestic revenue mobilization efforts are being scaled up, including in handling international tax issues. Staff has reached out to development partners for expanded support for Fund capacity-building activities, including in support of the Financing for Development agenda. Synergies between surveillance and capacity development are being strengthened, including in such areas as revenue mobilization, energy subsidy reform, building social safety nets, Islamic finance, and fiscal data compilation and reporting. The Fund has begun implementing a structured approach for capacity development activities in fragile states tailored to national absorptive capacity, with a focus on training, sustained follow-up, and results-based monitoring. Online learning has been strengthened further with the launching of Spanish and Russian versions of the Financial Programming and Policies course to better serve the needs of members.

Quota and governance reforms

The entry into force of the 14th General Review of Quotas and the Board Reform Amendment resulted in an unprecedented doubling of total quota and a realignment of quota shares to better reflect the changing relative weights of the Fund's member countries in the global economy. Given the importance of a strong, quota-based, and adequately resourced IMF, the Fund will continue to work toward the completion of the 15th General Review of Quotas, including a new quota formula, by the 2017 Annual Meetings.