International Monetary and Financial Committee

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Statement by George Osborne**,** Chancellor of the Exchequer, H.M. Treasury, United Kingdom

On behalf of United Kingdom

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Global Economy

Since our last meeting in Tokyo in October, global economic prospects have stabilised and sentiment has improved. Policy actions in the US and euro area have addressed the most worrying tail risks. However, the outlook is still fragile and significant downside risks remain. Financial markets may have seen marked gains but these have yet to feed through into the real world economy. Policymakers cannot afford to relax. If we are to deliver strong and sustainable growth we must follow through with our commitments to implement the difficult but necessary underlying adjustment in the medium term.

The priority for most advanced economies is still to restore fiscal sustainability. Continued consolidation is needed over the medium term, supported by highly accommodative monetary policy. In the UK there are still very large fiscal challenges. The deficit is forecast to be the highest in Europe in 2013 and gross debt is set to reach 100 percent of GDP in the coming years. The UK also has a large and systemically important financial sector, which the IMF described as a “global public good” in the 2011 UK Spillover Report. A strong and credible consolidation plan is therefore essential for global, as well as domestic, financial stability. I will continue to implement my medium-term fiscal consolidation plan, using the flexibility in the fiscal framework to deliver gradual and sustained adjustment, targeting the structural balance and allowing the automatic stabilisers to operate fully. This plan is projected to deliver a structural adjustment of 0.9 percent of GDP on average over the next three years. The IMF judge that, on average, 1 percent of GDP structural adjustment per year remains broadly appropriate for advanced economies.

In the euro area periphery, significant and necessary fiscal adjustment has been underway for some time now and needs to continue given the sheer scale of the challenges. In addition, consolidation needs to be complemented by domestic structural reforms to restore competitiveness, alongside broader institutional reform to deliver greater fiscal integration, budgetary coordination and a robust banking union.

The US took important action to avoid the fiscal cliff in 2012. In Japan, the authorities have just implemented a bold monetary and fiscal stimulus package to fight deflation, but this has meant the postponement of much needed fiscal adjustment and structural reforms. In both countries, credible medium-term consolidation plans still need to be put in place and I look forward to seeing progress on this in 2013.

Further action is needed to repair and reform the global financial system, improve the flow of credit and support the global recovery.
Risks to global financial stability may have receded since October last year, but significant vulnerabilities remain. Developments in Cyprus and uncertainty around the Italian election highlight the risks and ongoing challenges within the euro area. Further action is needed to underpin the recent improvements in confidence.

Most importantly, measures are needed to address balance sheet weakness. The UK has been a strong advocate of actions to strengthen the resilience of the banking sector and robust stress testing. Recent policy recommendations from the UK's Financial Policy Committee to strengthen capital buffers, along with the Funding for Lending Scheme, should improve the supply of credit in the UK. Similar actions are needed elsewhere, particularly in the euro area. More broadly, we should all work to ensure that the agreed Basel III capital and liquidity standards are fully implemented in a consistent and non-discriminatory manner. This will be key to delivering a more resilient financial system that facilitates the safe and free movement of capital and stronger, more sustainable growth.

It also important that momentum is maintained in tackling the risks associated with systemically important financial institutions (SIFIs). As the home of some of the world's biggest banks and the host to many more in one of the world's largest systemic financial centres, the UK is continuing to lead from the front in this area. The Banking Reform Bill is introducing structural reforms to improve the safety of banks, protect taxpayers and ensure a more stable UK financial sector.

In December 2012, the Bank of England published a joint paper with the US resolution authority, the FDIC, on their work on operationalising resolution strategies for the global SIFIs based in the UK and US. This is an important step towards developing an effective and coordinated global strategy for resolution. And the UK has been active on the EU Resolution Directive, which will be a very important step forward to implementing the FSB's global standard for resolution regimes.

A more coordinated global policy response would help facilitate necessary fiscal adjustment and financial repair and the transition to stronger, sustainable and balanced global growth.
If large deficit countries are going to successfully address their domestic imbalances, then large surplus economies (both advanced and emerging markets) will need to help facilitate the process. As national saving and deleveraging increases in the former, the latter will need to shift from external to domestic sources of growth. Policy prescriptions differ depending on national circumstances, but the basic elements are now well-known. As the Managing Director's Global Policy Agenda sets out, the full range of macroeconomic and structural reforms are needed, including greater exchange rate flexibility and financial reform. I would also emphasise the importance of our commitment to free trade and investment, and our

pledge to avoid all forms of protectionism. I hope to see progress on a more cooperative approach in 2013 - this will be key to ensuring a stronger recovery for us all.

Strengthening IMF surveillance

The IMF surveillance toolkit has come a long way since the global economic and financial crisis. We have seen the introduction of the Early Warning Exercise (ESR), Spillover Reports and last year the Pilot External Sector Report, the Financial Sector Surveillance Strategy and an IMF view on Capital Flow Measures. In addition, and perhaps most importantly, the overarching surveillance framework was modernised with the agreement of a new Integrated Surveillance Decision that should bridge the gap between bilateral and multilateral surveillance. The priority now is to effectively operationalise this new toolkit and framework to ensure that this is translated into stronger surveillance on the ground. This process will inevitably take time, but if implemented effectively, should ensure that all Fund products are underpinned by a consistent, coherent and robust analytical approach. The Fund should maintain its focus on the following priority areas:

- Analysis of spillovers, particularly financial interconnectedness. Good progress has been made in building an analytical base but this work is still very much in its infancy. I urge the Fund to continue improving its understanding of financial interconnectedness, including through the 2013 Spillover Report and the work on global financial centres. It is vital that the IMF is in a position to exploit the new financial data that will emerge from the ongoing IMF-FSB Data Gaps Initiative.
- Improving risk assessment. The IMF needs in-depth, country-specific risk analysis. Some progress has been made, but much more still needs to be done. The forthcoming work to study the channels through which financial sector risks can affect public debt sustainability is very welcome. Beyond that, the Fund should also focus on integrating its new multilateral analysis of net capital flows and current accounts with the gross capital flow and balance sheet analysis in Article IV reports.

Making progress in these areas will be critical to delivering the Fund's core mandate and I look forward to reviewing progress at the 2014 Triennial Surveillance Review.

Ensuring the adequacy of IMF Resources

A year ago, a number of IMF members pledged to make further bilateral financial contributions to the IMF, bolstering its financial firepower by over $460bn. The UK contribution to this global effort was $15bn. This action was critical in ensuring that the IMF has adequate resources to support the potential financing needs of its whole membership. I welcome the fact that most have now completed their bilateral agreements and urge those that haven't, to do so as soon as possible. These resources should now be used to support well-designed programmes with appropriate conditionality and risk-mitigation measures.

In Tokyo, I also welcomed the decision to implement a new framework to ensure the long-term sustainability of IMF concessional financing facilities, including the use $2.7bn of remaining windfall gold sales profits. Since then, good progress has been made in seeking assurances required from the membership to allow that decision to be implemented. The UK provided written assurance in December 2012. A final push is now required to complete the process. This will ensure that the IMF continues to play a strong role in monitoring vulnerabilities and providing financial support to low income countries.

Quota and governance reform

The UK remains committed to the full implementation of the historic 2010 quota and governance reform package to maintain the credibility and legitimacy of the Fund.

The membership failed to meet the 2012 Annual Meetings deadline for the 14th General Review and Seventh Amendment to take effect. Two of the three conditions needed have been fulfilled but we still need to reach the 85 percent threshold for ratification of the Board Reforms for these elements to become effective. In this regard, I welcome the recent efforts made by the US towards implementation and hope this process can be completed as soon as possible. The UK was one of the first members to implement these reforms in 2011.

The significant progress made by advanced European economies to deliver a reduction in representation at the IMF Executive Board has now been consolidated following the 2012 Board Elections in Tokyo. The new constituencies are up and running.

I welcome the completion of the comprehensive quota formula review in January this year. The review has identified key elements that could form the basis for a final agreement. I now look forward to achieving a broad consensus on a new formula in the context of the 15th General Review. These interconnected elements will need to be part of an integrated package that reflects a spirit of cooperation and compromise across the membership.