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"Addressing Global Economic Challenges"

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Introduction

I would like to thank the PSOJ for the opportunity to address you today on such an important topic. The global economy is at a critical juncture. Advanced economies are already in, or near, recession. At the same time, the financial market dislocation and deleveraging, that have driven the unfolding strains on the global economy, persist. The combination of financial stress and lower or negative growth in advanced economies is increasingly impacting emerging market economies—particularly countries like Jamaica that need sustained access to capital markets.

Deepening Global Challenges and Policy Responses

Let me begin with the challenges confronting the global economy more generally. As I have noted, global growth prospects have deteriorated sharply. At the IMF, we now project that the world economy will grow by only 2¼ percent next year, and that advanced economies will contract by ¼ percent over the same period. Growth prospects for many fast-growing emerging economies have also been undermined by the latest declines in commodity prices. We now anticipate that emerging economies will expand by 5 percent in 2009, although with considerable regional variation and significant downside risks. Thus, a priority for many emerging market economies will be to take actions that bolster confidence in their policies while strengthening the social safety nets.

Around the world, the policy responses to unfolding global economic challenges have been varied. Advanced countries have actively sought to address underlying weaknesses through the use of public balance sheets to recapitalize financial institutions, provide comprehensive government guarantees, and extend liquidity provision. Monetary and fiscal initiatives to help support global demand are also being pursued. Indeed, with inflation receding, central banks in advanced and emerging market countries have also taken steps to ease monetary policy.

However, there is a well known asymmetry with regard to monetary policy that needs to be taken into account. When the real economy is growing rapidly, tightening monetary policy through higher interest rates increases the cost of capital, and can reduce the incentive to invest, thereby acting as a brake. However, when the real economy has stalled, loosening monetary policy does not remove the uncertainty that firms face regarding their investment decisions. Therefore, lower interest rates may not necessarily act as an accelerator, the way higher rates act as a brake. This is why looser monetary policy has often been likened more to pushing on a string: until the fundamental underlying engines of the economy begin to exert a pull, looser monetary policy may have only a limited effect. Further, banks in normal times perform the function of intermediating between savers and borrowers. As banks have suffered extensive losses and are primarily focused on repairing their balance sheets, the channel through which monetary policy normally works has now been severely impaired.

Therefore, fiscal policy, where feasible, will also play a role in helping to support domestic demand. Several countries, including the United States, China, and various European economies, have already announced stimulus plans. More broadly, our research suggests that global fiscal stimulus on the order of 2 percent of world GDP is justified. However, as I mentioned previously, counter cyclical fiscal policy is not necessarily advisable in all countries, particularly in those with greater vulnerabilities or where debt sustainability is a major concern. Thus, countries with the strongest fiscal policy frameworks, those best able to finance new fiscal efforts, and those with clearly sustainable debt positions should take the lead in supporting global demand.

While macroeconomic policies are crucial to sustaining demand, emerging economies face an additional challenge. That is to ensure that the unfolding liquidity squeeze does not transform into a solvency crisis. Indeed, deleveraging is now impacting emerging market countries in general, including those with relatively strong fundamentals. Some countries with liquid domestic financial markets, which previously received large capital inflows, have experienced abrupt reversals of external financing flows. Past experience suggests that exchange rate adjustment can help absorb some of the pressures arising from external current account weakening and capital outflows. At the same time, comfortable reserve buffers help ensure the availability of foreign currency liquidity if countries remain under pressure from global financial deleveraging for some time.

Spillovers from the Global Financial Crisis from a Jamaican Perspective

Let me now turn to the implications of the crisis for this region. The Caribbean region will inevitably be impacted by the challenges confronting the global economy, particularly given the region's close ties to the U.S. economy. The slowdown in global economic activity is likely to be reflected in weaker foreign remittances and dampened activity in key sectors, such as tourism. As a result, the outlook for the Caribbean countries has been revised down in recent months. 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. This contrasts sharply with the Fund's outlook earlier this year of growth in excess of 2 percent in both 2008 and 2009. This sharp revision in outlook speaks to the speed at which global prospects have deteriorated.

Jamaica has also fallen victim to pressures associated with ongoing global financial volatility. As in other emerging market countries, spreads on Jamaica's sovereign and corporate debt have widened, while the currency and foreign exchange reserves have come under pressure. Fortunately, decisive and well-coordinated policy action has helped stabilize the situation in recent weeks. Moves by the Central Bank to establish a liquidity window for financial institutions under pressure from external margin calls, and additional steps to tighten monetary policy, were particularly well-placed.

Equally important, is the government's commitment to its fiscal consolidation and reform program. This will not be an easy task in the current weak domestic and external economic environment, but it is necessary, given the underlying risks associated with Jamaica's large debt burden. At the same time, care will need to be taken to protect social spending, including through well-targeted programs for the poor. From these perspectives, the government's concerted effort to strengthen engagement with its multilateral partners is a positive development. Indeed, the development loans under discussion with the World Bank and IDB in support of the fiscal reform program are most welcome and send an important positive signal to market participants.

Let me also assure you that the Fund intends to remain a collaborative partner with Jamaica. Certainly, the Fund's economic reports on Jamaica, which are produced bi-annually as opposed to the conventional yearly Article IV report, speak to the quality of our macro-financial policy discussions with the authorities. Moreover, the Fund has been actively providing technical assistance to help Jamaica overcome challenges associated with unregulated investment schemes and to help the government in the design and implementation of its ambitious fiscal reform agenda. We will continue to do so in the future and make every effort to work closely with your government.

The Role of the Fund

As it is with Jamaica, the international community, including the IMF, has an important role to play in helping all countries – advanced, and emerging - weather the global financial storm. This brings me to the next issue that I want discuss with you, namely the role of the IMF in these very challenging times. The Fund has a critical role to play in helping to minimize the potential severe negative economic and social impact of the current global financial and economic turbulence. I also believe that our actions in recent weeks speak strongly of this commitment. Let me explain:

First, the Fund continues to conduct its regular multilateral and bilateral surveillance and to provide policy advice and technical assistance to members. Our experience with Jamaica under intensified surveillance highlights that this surveillance relationship can be very fruitful.

Second, the Fund has responded to new challenges by creating innovative policy tools. The Exogenous Shock Facility has been made easier for low income members to access it. The Fund also recently created a Short-Term Liquidity Facility (SLF) to help emerging countries with exceptionally strong policy track records navigate short-term liquidity shortages. For other countries where existing policy frameworks need strengthening, the Fund has been providing member countries access to traditional lending facilities over longer periods, but on an accelerated basis.

Third, the Fund has ample liquid resources to support member countries facing financing shortfalls. The Fund has already committed significant financial support to several member countries in recent weeks, including Hungary, Iceland, and Ukraine, and more Fund arrangements are presently under negotiation. The conditions in these programs are—and will be—focused on the immediate challenge of restoring financial stability and growth. Structural conditions are limited to sectors that are at the root of the economic crisis that countries are facing, for example resolving capital deficiencies in banks

Fourth, the Fund can draw on extra resources through standing borrowing arrangements with members, in the event that the crisis continues to spread. One of the important features of the recent G-20 summit in which I participated was a commitment to make sure that sufficient resources remain available to the Fund.

Finally, the Fund has an important role to play in strengthening the financial architecture. Indeed, the crisis has made it clear that new thinking and actions are needed to: (i) improve the design of financial regulation; (ii) strengthen systemic risk assessment; and (iii) develop more effective coordinated response mechanisms. With that in mind, we are strengthening our early warning capabilities. We are also eager to strengthen our collaboration with others to develop new and better operational tools for macro-financial surveillance.

Conclusion

In conclusion, while the evolving global economic crisis poses significant economic and policy challenges, these are not insurmountable challenges. While we face a tough road ahead, a set of coherent, coordinated, and well-targeted policies across the globe can collectively reduce these difficulties. The IMF is bringing its policy expertise and financial resources to not only help countries weather the current macro-financial storm, but to do its part to create a more resilient post-crisis global economy, and a more durable global financial system. Thank you.