Bloomberg

IMF Tells G-20 Exchange Rate Flexibility `Essential' for Growth

By Sandrine Rastello - Nov 12, 2010

Allowing exchange-rate flexibility in major emerging countries is "essential" to achieve the "strong and balanced" economic growth that Group of 20 leaders are seeking, the International Monetary Fund said.

The IMF, in a report prepared for a G-20 summit in Seoul, also recommended further fiscal consolidation in advanced economies and measures to boost productive capacity for all members. While saying that countries such as Brazil and South Africa have allowed their currencies to "substantially" appreciate, it stopped short of naming nations that are resisting stronger exchange rates.

"A breakdown of policy cooperation, involving capital inflows and firm resistance to currency appreciation, or competitive depreciation, could hinder global rebalancing and be damaging," the IMF said in the report.

The IMF's so-called Mutual Assessment Process provides leaders with analysis of how their policies fit together. The report touched on topics that kept up G-20 negotiators deep into the night to wrest a compromise deal as China rejected policy prescriptions that fault its exchange-rate policy and directed criticism at monetary easing in the U.S.

Such a report "faces severe political constraints on its level of candor and specificity," said Eswar Prasad, a senior fellow at the Brookings Institution in Washington and a former IMF official. With a "lack of a mechanism for effective follow- through," that makes the mechanism "a far less powerful tool than the G-20 ostensibly wants it to be."

Bigger Role

The G-20 over the past 19 months has tripled IMF resources, given emerging countries more say in the institution and asked for its help to review one another's economies.

After finance chiefs asked the fund to monitor progress in reducing trade imbalances and exchange rates last month, leaders today said they will need its assistance to develop guidelines to identify large economic imbalances and actions needed to fix them.

IMF Managing Director Dominique Strauss-Kahn told reporters today he hopes to publish country-by-country recommendations in the next version of the report, though it depends on whether the G-20 accepts it.

"Everybody agreed since the beginning of the institution that you need to have a surveillance process, but at the same time countries are still not happy when we come and finger-point some problems," he said.

In the latest report, the fund didn't include an estimate that was in an early version published in June that flexible exchange rates would lead to a 10 percent appreciation of real effective exchange rates in emerging Asian economies and about 5 percent in the rest of the world.

More Specifics

Getting more specific advice is "the next step we need to get to," South Africa's Finance Minister Pravin Gordhan said in an interview in Seoul.

The IMF comments shouldn't be "necessarily prescriptive but more precise and more detailed about what is going to be required to achieve the rebalancing we want to achieve."

G-20 members, in their policies and economic forecasts that were compiled by the IMF, expect current-account positions to return to pre-crisis levels, according to the report.

The Washington-based IMF also said that the G-20's growth forecasts are "distinctly more optimistic than what past recovery would suggest," and said that "envisaged fiscal consolidation could fall short of G-20 commitments if growth falters."

25 Million Jobs

If G-20 members implemented the IMF's recommendations to boost demand in emerging economies, put advanced economies' finances on a "sustainable footing" without hurting growth and made changes to their labor and product markets, they could create an additional 25 million jobs, the fund estimated.

They would also boost global economic growth by 2 percentage points by about 2014, it said. In October, the IMF predicted the world's gross domestic product would rise 4.8 percent this year and 4.2 percent in 2011.

The IMF was asked by the G-20 in September 2009 to help find ways to ensure the global recovery will be more balanced. Policy makers are trying to avoid a repeat of the last expansion, when U.S. consumers relied on borrowing from abroad to finance purchases, contributing to an export boom from Asia.

As China and other Asian nations accumulated dollars from trade surpluses, they bought U.S. Treasury debt and depressed global yields. Lower borrowing costs helped stoke the U.S. housing and credit booms that turned to bust in 2007.

To contact the reporter on this story: Sandrine Rastello in Seoul at srastello@bloomberg.net;

To contact the editor responsible for this story: Christopher Wellisz at cwellisz@bloomberg.net.
