Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit www.djreprints.com

See a sample reprint in PDF format. Order a reprint of this article now

THE WALL STREET JOURNAL.
WSJ.com

EUROPE NEWS Updated April 20, 2012, 8:19 p.m. ET

IMF Nearly Doubles Its War Chest for Crisis

Nations Pledge Funds Aimed to Help Contain Euro Crisis; U.S. Stands Aside

By SUDEEP REDDY And BRIAN BLACKSTONE

WASHINGTON—The world's top finance officials agreed Friday to boost their shared financial firepower, an effort to protect the global economy as European turmoil threatens the recovery for the third straight year.

Bloomberg News

Christine Lagarde, managing director of the International Monetary Fund, right, and Jose Antonio Meade, Mexico's finance minister, attend a photo session of G-20 finance ministers and central bank governors on Friday.

More

Heard on the Street: Spanish Stock Slump Has Silver Lining

The International Monetary Fund, the world's emergency lender, announced pledges by many of its member nations to nearly double its lending capacity to more than $700 billion, creating what officials dubbed a "global firewall" aimed at containing the euro-zone debt crisis.

The new funds—though not earmarked for any region—could be used for more bailouts of troubled euro-zone economies, setting the stage for more contentious battles in the coming months if large economies such as Spain and Italy need financial rescues.

IMF and government officials applauded the pledges as a sign of the international community's joint commitment to address the financial turmoil stemming from Europe's debt woes, but also agreed the added funds won't end the crisis. European Central Bank President Mario Draghi said the new money would be useless unless governments took steps to rein in their budgets and restructure their economies.

The deal came together as finance ministers and central bankers from the Group of 20 leading advanced and developing economies gathered in Washington. Some officials compared the moment to a gathering during the global economic crisis in early 2009. Nations agreed then to increase the fund's resources, which along with policy moves by the U.S. and other nations helped calm that crisis by showing that governments could band together to fight global threats.

The new agreement marks a victory for IMF Managing Director Christine Lagarde. The former French finance minister, who took her post last July, laid the groundwork from her first months in office for a substantial fundraising effort to elevate the fund's power as European risks mounted.

She overcame resistance from a number of countries—including the U.S., the IMF's largest shareholder, which won't be contributing additional resources—to draw new funds from advanced and emerging economies.

The U.S. welcomed the new funding pledges, but the IMF already had adequate resources, a U.S. official said.

The official told reporters after the G-20 meeting that market reaction to the euro crisis will depend on how well Europe proceeds with a broader response, such as implementing economic reforms, ensuring banks have enough capital and providing support from Europe's own rescue fund.

"This has been a huge effort, but it has been an extraordinary group dynamic," Ms. Lagarde said Friday, applauding the "collective drive" to fight the crisis.

The agreement ends an eight-month debate, which exposed rifts among some of the world's leading economies.

The U.S., China, Brazil and other economies insisted since last fall that Europe would need to vastly increase its own rescue fund before any new money would go into the IMF. Europe late last month expanded its rescue fund to about €700 billion ($925 billion), but it remains below what officials sought. The resistance from some countries led Ms. Lagarde to scale back her fundraising target last week to about $400 billion from her earlier goal of $600 billion.

The U.S. official said Friday that the prospect of an IMF increase at this meeting acted as an incentive for Europe's move last month.

Some nations that opposed the IMF fundraising effort argued it would reduce pressure on the euro zone to take action on its own.

"The notion that the fund's resources are on tap for Europe could become a self-fulfilling prophecy," said Cornell University economist Eswar Prasad, a former IMF official. The additional firepower, for which European nations lobbied heavily, "could give a sense of false comfort to European policy makers that they have done enough to fend off market pressures."

The euro zone already accounts for a disproportionate share of IMF loans after the rescues of Greece, Portugal and Ireland over the past two years. That's generating a backlash among non-European members of the IMF who question whether the fund is overextended to one region of the world.

In a statement, the G-20 members said the new IMF money would be "available for the whole membership." They said any new loans would be subject to the fund's regular borrowing terms, but officials would not rule out any further loans to the euro zone. The IMF would have more than $700 billion available to lend to its members once the fundraising is complete in the coming months, up from its current $380 billion.

Spain in recent weeks has seen renewed volatility in its borrowing costs, pushing the yield on 10-year Spanish government bonds near the psychologically critical 6% level and raising fears that the country might trigger a fresh round of euro-zone turmoil. Italy's borrowing costs have also edged higher, although less dramatically than Spain's. New governments in both countries are trying to push economic policy overhauls to win over markets and end their crises.

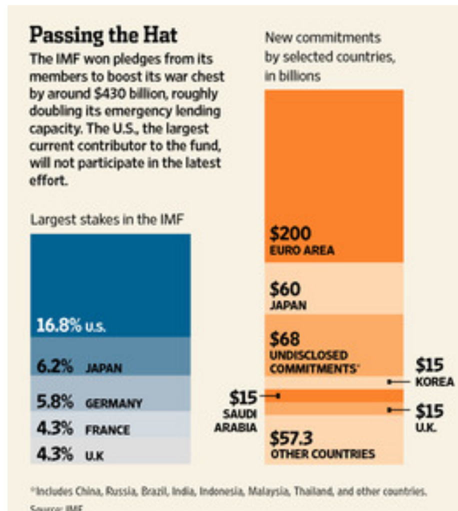
European nations, which became the first to commit to the IMF fundraising effort in December, have pressed other countries to help shore up the fund's resources. Europe's beefed-up crisis fund would likely be insufficient if Italy and Spain—the euro zone's third- and fourth-biggest economies, respectively—needed rescue packages. Many analysts doubt even the two combined firewalls—in Europe and the IMF—would be enough.

"Europeans have achieved our main goal," said European Commission economics chief Olli Rehn, referring to the larger IMF war chest. "This is good news for Europe" and the global economy.

Mr. Draghi, the ECB chief, welcomed the accord, saying Europe's "four-pillar strategy" of structural economic reform, fiscal belt-tightening, expanded firewalls and low inflation "is falling into place."

The ECB has already taken significant steps to stem the debt crisis and spur economic growth. Since May 2010 the ECB has purchased roughly €220 billion in sovereign bonds of Greece, Spain, Portugal and others in Europe's struggling periphery.

Last fall, the ECB said it would extend three-year loans to banks to help them meet their funding needs. The ECB eventually loaned banks a total of over €1 trillion in these loans.



The ECB's policy rate was reduced last November and December, bringing it back to a record-low 1%.

The IMF said this week that the ECB may need to do even more, including additional rate cuts and more cheap loans to banks.

Mr. Draghi was cool to the IMF's recommendations. "It's a free world, so we take note" of the IMF's views, Mr. Draghi. However, "none of the advice that the IMF is offering has been discussed by the governing council, in recent time at least," he said.

Mr. Draghi is hamstrung in part by the ECB's mandate to keep annual inflation at 2%. It is far above that target now, at 2.7%. Additional stimulus measures could also spark furor among the ECB's conservative wing, led by Germany, that worries about the inflationary risk of abundant bank loans and easier monetary policy.

But many analysts think more ECB action is needed to break a vicious cycle of growth-draining fiscal budget cuts and economic recessions already gripping Southern Europe. Unemployment across the 17-member euro bloc is 10.8% and likely to climb higher. It is over 20% in Spain and Greece, where one-in-two youths are unemployed. Many economists expect the euro-zone economy to shrink this year.

"We doubt that a combination of austerity and large bail-outs will solve the region's problems, wherever the bail-out money comes from," economists at consulting firm Capital Economics said in a research note.

—Tom Barkley contributed to this article.

Write to Sudeep Reddy at sudeep.reddy@wsj.com and Brian Blackstone at brian.blackstone@dowjones.com

A version of this article appeared April 21, 2012, on page A7 in some U.S. editions of The Wall Street Journal, with the headline: IMF Nearly Doubles Its War Chest for Crisis.

Copyright 2012 Dow Jones & Company, Inc. All Rights Reserved
This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com