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P R O C E E D I N G S

DR. BRAINARD: Good morning. I'm delighted to see everybody here. For those of you who are standing in the back, you may actually sit down. There are some seats, so please feel free to fill in.

So, it's an exciting time for those of us who are not sitting in one of the big financial institutions or at the IMF on global financial markets. Lots of fun speculation about all kinds of things: The fate of the dollar; whether or not the G-3 has decoupled from the rest of the world; are we in a kind of, sort of mild semi-recession or is this going to be with us for some time to come; how do we battle recessionary pressures here while many of the emerging markets are battling inflationary pressures there and how did those two challenges really get wrestled to the ground if you are sitting over at the fed. So, lots of good stuff to talk about and a few people to talk on it that I can't think of more interesting commentators.

We're going to start first with John Lipsky, who is going to present some remarks on the outlook and on some of the macro imbalances and currencies.

John, for those of you who don't know him -- that's probably nobody in the room -- is the first deputy managing director of the IMF and was previously vice chairman of JPMorgan, and he happens also to share with me and with David Lipton, an alma mater, which is his best quality from my perspective.

Following John's remarks, we're going to have David Lipton speak. David is managing director and head of Global Country Risk Management at Citigroup. He and I worked together closely during the Clinton Administration, where he was really the point person for most of the financial crises that we participated in, in some form or another, and also is a Wesleyan graduate. It happens.

And Domenico Lombardi will then give some remarks as well. He's a Nonresident Senior Fellow here at Brookings but has worked in both financial institutions -- both at the World Bank and IMF -- and writes extensively on these issues.

So, what we'll do is have John come up and give some remarks and then David and Domenico, and we'll open it up pretty quickly to the audience for Q&As.

So, please join me in welcoming John.

(Applause)

DR. LIPSKY: Thanks, Lael. Thanks for the opportunity to be here. It's a pleasure to be at Brookings and to share the podium with such a distinguished panel, and thank you all for joining us.

The global economic and financial landscape, as you all know, is rapidly evolving. Just a year ago, the global economy was in the fifth year of an exceptionally broad-based expansion led by strong growth in emerging economies and accompanied by low inflation, well-anchored -- seemingly well-anchored -- expectations, and low interest rates. Today, of course, the situation is far more difficult, featuring multiple and novel challenges. Energy and commodity prices have soared, exacerbating global imbalances while pushing inflation higher and potentially undermining inflation expectations. Asset prices are falling in many key markets, stunting household net worth while spurring financial market turmoil and raising doubts about recent market innovations. Everywhere confidence about near-term prospects is weakening. Together these factors have created difficult and differing tasks for policymakers. In advanced economies where growth is projected to fall below potential in 2008 and 2009, supporting growth while stabilizing the financial system comprises key objectives.

At the same time, the spectacular energy and commodity price rises have led to notable relative price shifts of unusually uncertain scope and duration. In this context, policymakers' task is to accommodate durable relative price changes while minimizing the resulting overall economic and financial disruption in preventing any deterioration in long-term inflation expectations. In many key emerging economies, combating rising inflation resulting from both strong domestic demand growth and surging commodity prices is the central challenge.

Finally, achieving better balance in demand growth across countries is needed in order to boost confidence by reducing global payments and balances. Overarching global tasks include drawing the appropriate lessons for financial market regulation from the current turmoil; strengthening the international trade system; and protecting the most vulnerable from the potentially dangerous impact of sharp increases for food and fuel.

Under the current circumstances, it's not surprising that many scholars and financial market analysts have been re-examining past episodes of economic and financial stress involving slowing demand and rising inflation in search for precedence and insight. While some valuable lessons no doubt will be uncovered, the seminal shifts that have taken place in globalization and financial market structure also could make historical analogies misleading. For example, questions have been raised about the role that should be anticipated for exchange rate shifts in the international adjustment process. As I will emphasize in my remarks today, exchange rate considerations are likely to be central to confronting today's challenges, but their short-term behavior should not necessarily be expected to closely mimic past experience when market and economic configurations differ in many important ways.

One thing is clear, however. Achieving success in the differing tasks I have described is a shared global responsibility. This simple but powerful conclusion was underscored last year by the participants in the IMF's path-breaking multilateral consultation on global imbalances.

I will return to the issue of shared responsibility later in my remarks, but first I'm going to very briefly outline the IMF's view on the global economic and financial outlook, and then I will provide some perspective on whether the dollar's recent depreciation has contributed constructively to a resolution of the multiple challenges facing the global economy or, rather, added to the problems.

Now, the Fund has just issued its latest World Economic Outlook update, in fact just in the last few days, and you can find this discussed in detail -- presented in detail on the Fund's website (http://www.imf.org/external/pubs/ft/weo/2008/update/02/index.htm). So, just in brief summary, we project global growth to slow to around 4 percent this year and next, compared with 5 percent last year, and activity is expected to moderate across both advanced and emerging economies before recovering gradually next year.

Now, despite this global slowing, growth is still expected to remain at or above trend in emerging economies while advanced economy growth will be below potential for the first time since early in this decade. And of course, the rise in energy and commodity prices has boosted inflation pressures, especially in emerging economies.

In advanced economies, headline inflation rose to 3½ percent in May of this year over a year earlier, but core inflation has remained at 1¾ percent. The risk here is, in the near term, deterioration and inflation expectation. The increase in actual inflation, as you probably are aware, is much more marked in emerging economies where headline and core inflation have risen to 8½ percent and 4¼ percent, respectively. These are the highest rates since the late 1990s, and deterioration in inflation expectations, we see, is a potentially serious risk globally.

As a result, as we discussed in the WEO outlook, monetary policy must aim, first and foremost, to head off inflationary pressure while also being mindful of downside risk to growth. In advanced economies, the risk of second-round effects from the surge in commodities prices and continued stress in financial markets of course is complicating the response to the slowdown. That said, inflationary pressures must be monitored closely, because allowing the past decades' gains in lowering inflation and inflation expectations to be lost would seriously undermine future economic prospects.

In emerging economies, many central banks have raised policy interest rates in response to rising inflation, but interest rates in many emerging markets remain negative in real terms, particularly in countries where exchange rate management has limited monetary policy flexibility. There is a risk that many of these countries have fallen behind the curve in tightening policies. In several countries—especially those where growth remains above trend—monetary policy needs to be tightened further. Greater fiscal restraint and, in some cases, more flexible exchange rate management also may be needed.

Financial market conditions also remain difficult, and the update to our Global Financial Stability Report will be issued in the next few days (http://www.imf.org/external/Pubs/ft/fmu/eng/2008/02/index.htm). Forceful policy responses to the financial turbulence and encouraging progress toward bank recapitalization have represented important positive contributions. Nonetheless, indicators suggest that credit deterioration is widening and deepening as economic conditions weaken. And as advanced economy banks—especially in North America and Europe—de-leverage and rebuild capital, lending is beginning to be squeezed, further pressuring households and clouding the outlook for the real economy and the financial system. Moreover, increased inflation risks have raised economic uncertainty and reduced the flexibility for monetary policymakers to ease financial stress. As we have emphasized previously, advanced economy policymakers may need to employ decisive and innovative measures in order to safeguard financial stability and over time to put the global financial system on a firmer footing. This could include committing the public balance sheet—a policy course we have previously labeled "the third line of defense."

Of course, appropriate structural policy reforms in advanced, emerging, and developing economies alike also have a role to play in restoring demand-supply balances, including in energy markets. This is a topic on which I personally have spoken previously. In our website you can find an address I made to the International Energy Forum in Rome in April (http://www.imf.org/external/np/speeches/2008/042108.htm)

Turning to the U.S. dollar, I will try to put the recent decline in perspective.

As many of you know, the Fund has intensified its efforts to address exchange rate issues. Last year, the Fund's Executive Board revised our framework for exchange rate surveillance, and we have been further developing our tools for analyzing exchange rate levels on a broad, medium-term basis. In this context, understanding the implications of the dollar depreciation over the last few years is a central challenge and responsibility.

The dollar has depreciated by about 25 percent in real effective terms since early 2002 in what has been one of the largest sustained episodes of dollar depreciation in the post-Bretton Woods era. The largest previous such episode, where the dollar depreciated by over 30 percent in real effective terms, took place between 1985 and 1991, also against the background of a large U.S. current account deficit. In both episodes, the pace of depreciation was relatively gradual, with daily changes below 2 to 3 percent in nominal effective terms. In both cases, the U.S. currency in broad terms moved in line with shifts in interest rate differentials. Moreover, in the earlier case, the dollar depreciation ended with the U.S. currency's level roughly consistent with broad, medium-term equilibrium, at least according to the Fund's calculations. Following the post-2002 decline, we assess that the U.S. currency today is the closest to its medium-term equilibrium value in more than a decade.

During the 1985-91 episode, the U.S. current account deficit narrowed from a high of 3½ percent of GDP in 1987 to about balance in 1991. In contrast, the current episode has not been associated with a quick and sharp adjustment in the U.S. current account balances. Indeed, in the recent episode, the current account widened initially to reach an all time high of nearly 7 percent of GDP in late-2005. It began to moderate only in 2006 and remained at around 5 percent of GDP in the first quarter of 2008. This modest shift has created doubts about the impact of exchange rate flexibility. However, when the change in the current account balance over the two episodes is deconstructed, accounting for lags in adjustment of the timing of the export and import responses to the depreciation, we find that it becomes clear that two key factors are driving the differences in the behavior of the current account in these two episodes.

The first is the oil trade balance. In the previous episode, the price of oil initially fell and then remained roughly flat in U.S. dollar terms. This led to a very modest improvement in the oil trade balance of 0.1 percent of GDP between 1987 and 1991. By contrast, oil prices have risen rapidly over the past few years, as you all know, reaching a record high. Thus, between 2004 and 2008, the U.S. oil balance is expected to have deteriorated by 1.3 percent of GDP.

The second key factor underpinning the difference in the current account behavior is the receipt of large transfers associated with the first Gulf War in 1991, amounting to as much as 0.7 percent of GDP. Of course, similar transfers have not occurred in the current episode.

The implication is that after stripping out the oil trade balance and war-related transfers, the change in the U.S. current account between the two episodes in fact appears to have been roughly similar. The underlying current account -- in this case, excluding oil and transfers -- improved by 2.7 percent of GDP in the previous episode compared with 2.4 percent in the current period. Moreover, in the earlier episode, the depreciation was more front-loaded, with the bulk of the depreciation occurring between 1985 and 1989. In the current episode, half the depreciation has taken place since 2006, and given the long lags in the current account response to exchange rate changes, we expect to see further improvements in this underlying current account in the coming years.

If the decline in the value of the dollar is supporting a narrowing of the actual and projected U.S. current deficit, it is thereby helping to promote an inevitable shift in the sources of growth between tradable and non-tradable sectors in both surplus and deficit economies, and it will help to reduce global imbalances. At the same time, however, the currencies of many economies with flexible exchange rates have appreciated markedly. Indeed, in our view, the euro is now *overvalued* relative to medium-term fundamentals, while the currencies of many current account surplus countries, including China, remain substantially *undervalued* despite a small appreciation in real effective terms. The lack of adjustment in the currencies of several economies with inflexible exchange rate regimes and large external surpluses has not been supportive of an adjustment in global imbalances. Moreover, to the extent that real appreciation in these currencies has taken place more recently, it is largely due to accelerating domestic inflation -- hardly an ideal outcome.

Because an orderly adjustment of global imbalances together with sustained global growth would be more likely if countries recognized their shared responsibility for a successful outcome, the IMF in 2006 initiated the Multilateral Consultation on Global Imbalances. A key outcome of these consultations was the presentation of a set of mutually consistent policy plans voluntarily specified by the five participants, including the United States, the euro area, Japan, China, and Saudi Arabia. These plans can still be found easily on the IMF.org website (http://www.imf.org/external/np/sec/pr/2007/pr0772.htm). Key components of these plans include a reduction in the current account deficit in the U.S. through a shift toward greater domestic saving and improved net export performance; structural reforms along with increased flexibility of the renminbi with respect to a basket of currencies in order to support a rebalancing of Chinese growth toward domestic consumption; an increase in infrastructure and social spending in Saudi Arabia to alleviate supply bottlenecks and reduce the current account surplus; further progress on growth-enhancing reforms in Europe; and continued structural reforms, including fiscal consolidation in Japan.

Most recently, of course, the sharp rise in oil prices has outstripped near-term Saudi stabilization efforts. Moreover, fiscal consolidation in the U.S. is being delayed by the U.S. slowdown and the fiscal stimulus package to support the economy and more recently intentionally by measures to support the financial sector. And while China has made some progress in rebalancing its growth, exchange rate flexibility has taken place only incrementally. Thus, global imbalances are projected to remain high in the near term, while global growth slows.

So, what does this imply for policies? For our part, we at the IMF continue to view the policy plans put forth by participants of the Multilateral Consultation on Global Imbalances as relevant. At the same time, we recognize that they will need to be implemented flexibly as circumstances have changed, and we accept that large imbalances will be with us for longer than we had originally envisaged. In particular, high commodity and record energy prices will lead to very large surpluses in oil exporting countries. The implication is that while the dollar depreciation is helping to reduce the U.S. current account deficit, it has not been sufficient to alleviate imbalances and risks. Rather, new misalignments may be emerging and risks may be shifting.

The latest combination of developments has given rise to speculation about potential evolution in the constellation of international reserve currencies. Notwithstanding the dramatic claims by some, there is no doubt that the dollar will retain the central role, even though it may gradually share the stage with other currencies to a greater extent than at present. After all, the past decade has been marked not only by the decline in the value of the dollar, but also by the successful introduction of the euro in the rise of emerging economies.

In the 1985-91 episode of dollar depreciation, there really was no viable alternative to the dollar as the sole reserve currency. The Japanese, German, and U.K. economies were much smaller than that of the U.S., and their financial markets were less developed and far less liquid.

Today, the euro area economy is of a similar size to that of the United States. Each accounts for roughly a quarter of world GDP, based on market exchange rates. Its financial markets are deep and liquid, although not yet equivalent to that of the United States in that regard, and it accounts for a large share of world trade. Thus, while the dollar will not be replaced as the dominant international currency, it is quite likely that, eventually, the dollar will begin to share this role with the euro.

Other currencies are playing a secondary role in the international arena. For example, the RMB eventually may grow in importance as an international currency as the Chinese economy grows in size, but this would also require full currency convertibility; an opening of the capital account; significantly more developed financial markets; and a track record of low and stable inflation—all of which are quite prospective at this time.

For now, the dollar retains its dominant role in both international transactions and as a reserve currency, accounting for nearly two-thirds of central bank international reserve holdings in the first quarter of this year. Emerging economies—a group of great interest because of their rapidly increasing reserve holdings—have an average dollar share of around

60 percent, and this share has remained roughly unchanged since 2004.

In the longer run, the demand for dollar assets and dollar reserves will depend on global developments. For example, if oil prices remain high, current account surpluses of oil-exporting countries are likely to continue increasing rapidly. If those countries seek to invest their surpluses through vehicles such as Sovereign Wealth Funds, which typically hold more diversified portfolios than central banks, demand for dollar assets potentially could decline from this source. That said, our estimates, based on a model-based simulation, suggest that the effect of this type of portfolio shift on the dollar would be very modest.

More generally, the move toward floating exchange rate regimes worldwide suggests that broader diversification of reserves is to be expected over time but that the dollar will continue to play the central role in international reserves for the foreseeable future.

In conclusion, the challenges I have discussed today are eliciting policy responses at both a global and a country level. The multiple and novel challenges facing the global economy suggest that innovative solutions may be needed to address some aspects, particularly with respect to restoring confidence in the financial sector.

At the same time, it is essential that inflation remains under control. This implies that monetary and exchange rate policies should be aligned in order to ensure that this goal is met. Of course, this task is complicated by slowing global demand, and policymakers must be mindful of the risk to growth as well as to inflation. However, more assertive policy tightening will be needed in many emerging economies where underlying inflation is picking up. Activity continues to expand rapidly, and supply constraints are binding. In advanced economies, timely adjustment will be required as economies recover.

With regard to exchange rates, the IMF's view is that the substantial dollar depreciation so far is helping to bring down the U.S. current account deficit and has moved the dollar close to its medium-term equilibrium level. Looking forward, sustaining this outcome while reducing other currency misalignments would make a positive contribution to attaining the dual goals of sustaining global growth while reducing global imbalances.

As I have discussed already, appropriate macroeconomic and financial policies will be required to attain this goal. Not only policy actions are central to this task, however. For example, the impressive flexibility of the U.S. economy will help the adjustment process as will structural shifts in other economies. As the participants in the Multilateral Consultation agreed, ensuring that the adjustment needed to preserve this decade's impressive progress is implemented successfully is a shared responsibility. The IMF plans to play an active and appropriate role in achieving new progress.

Thanks for your attention.

(Applause)

MR. LIPTON: Thank you, Lael, and thanks to Brookings for inviting me here. It's a pleasure to be here.

I'm going to take a slightly different tack to speaking about the state of the global economy. I want to talk about what I think are the two questions we need to answer to understand and to anticipate what is to come -- first, how will the macroeconomic and financial sector stresses play out; but also how will public policies, government policymakers around the world, react to what's going on, and how will that affect the outcome?

The first is, I think, hard enough. The second is becoming a necessary factor as policy tradeoffs worsen and as nontraditional policy recipes are now being put in place in a range of situations, especially here in the United States.

Let me talk first about the macroeconomics (inaudible).

Clearly we have unprecedented problems in the United States and Europe with the combination of banking sector malfunction and the housing slump. In the banking sector -- and these two, of course, interact and each makes the other more problematic. But in terms of the banking sector, we have banks with, at this point, huge balance sheet problems that have to be worked off. And going forward, we have -- with the flight from credit and the flight from credit products, we have in essence a malfunctioning banking sector model, the model of originate package, and distribute is not really functioning, and so the prospects for banks to earn money to recover net worth is impaired.

The housing slump in the United States

obviously is ongoing and has not bottomed out. It's uncertain how that will turn out. While we don't know yet what's going to happen in Europe, I think it's important to recognize that in Europe housing prices in at least 10 countries have gone up by more than in the United States and in at least four countries have gone up by twice as much in real terms as in the United States. And so we probably are going to see housing-related stresses in Europe as time goes on.

Now, predicting from these two factors what's going to happen to the macroeconomy is something that economists are not terribly good at. Economists have a very hard time interpreting banking sector stresses and strains in terms of their impact on the macroeconomy and have to operate, rather than from macroeconomic models, from loan and credit availability surveys and so on. So, I think we have to approach this with a certain modesty as we forecast, but I do think that it's likely that with the problems in banks and the uncertainties around housing that we're looking at a slow-down that is U-shaped. How deep it will be I think is very hard to anticipate but in terms of time probably something that will last for quite a while.

When you add to that the commodity price increase -- which is not just oil but oil, food, metals, and minerals -- one has, as well, an inflation problem of costs increasing for households and for companies, and all of things making policymakers' decisions difficult.

As John has said, this leaves us with the rather peculiar situation of slowdown in the U.S. and Europe but overheating in the emerging markets. Probably a bunch of the overheating in emerging markets comes from the fact that emerging market countries were, at least to some degree in many places, taking exchange rates to the dollar and in a sense have made a mistake similar to what was the case at the time of the Asian crisis. At the time of the Asian crisis, Asian countries pegged their currencies to the dollar at a time when the dollar strengthens because the U.S. economy had very strong fundamentals, and while a strong dollar was good for the United States, it wasn't particularly good for Asia. Now, the pegging of currencies to the United States came at a time when the fed needed to lower interest rates sharply to strengthen -- to undergird the U.S. economy. Well, that easing of monetary policy was good for the United States but led to overheating in Asian countries that had given up much of their control of the monetary policies. So, we have this dichotomy.

Now, in terms of the policy environment, we've seen there is a range of macro policies that are being used here from interest rate policy to liquidity lines to policies that address more directly solvency issues in banks, and I want to talk about each level because I think as this period of turmoil has gone on, authorities are having to move down that spectrum to cope with the degree of difficulty of the problems that we face.

First, in terms of monetary policy, I think we're in a peculiar situation where a year from now we're likely to look back on the monetary policies of today and say that monetary policymakers have made a very, very serious error. The problem is we don't know whether we're going to look back and say they were too loose or too tight.

And let me consider, just for the sake of extricating the issues here, what the two arguments are. For too loose -- which is John's point -- we have at least 20 countries around the world that are inflation targeters and many others that do something sort of similar to inflation targeting. In most of those countries, the central banks are missing their inflation targets right now and are, for I think clear reasons, reluctant to act aggressively to get back within their targets, because they have concerns about the state of their economies. But we may look back and say that they didn't follow their targeting rules; that they undermined the credibility of their regimes; that they let inflation expectations rise and their economies begin to overheat; that, as John pointed out, they've allowed in many cases real interest rates to turn negative. We don't know this will play out, but we know that negative real rates can have all kinds of effects on current accounts, as well as on the health of banking systems. So, that's one possibility.

On the other hand, we might look back and say monetary policy was too tight, that central banks underestimated the depth and breadth of the banking sector and housing problems in the U.S. and Europe. If those problems really do intensify, if they spread to Europe and beyond, if household and corporate balance sheets are impaired and household and corporate spending slows, one would see those effects reverberate, including transmitted to emerging market countries. If, in the course of that capital market, attitudes remain very risk averse or turn more risk averse, one would see capital market transmission, as well, impeding the economic growth in emerging market countries. And we may look back and say that central banks reacted to a relative price change when in fact there really wasn't an inflation process underway, that they tightened at a time when the economy was just slowing and perhaps even in some measure by raising interest rates acted in a way that was post-cyclical and added to the size of the problem. Now, of course, this is different from country to country. Some countries clearly do need to tighten. But I think that there is a range of country situations where it's unclear how this will turn out.

Now, going beyond monetary policy, obviously we've seen the Fed, the ECB, move into the -- into some novel and unprecedented approaches to supporting banking systems with special and new liquidity facilities and, as well, delving into efforts to save financial institutions whose solvency is at risk. And I raise this, because obviously as a risk manager -- and I guess for anyone who's an economist trying to understand the outcome in economies -- one has to first predict what's going to happen in the economy but as well predict how policy reactions are going to affect the course of the economy. And this can matter at the macroeconomic level, but it can also matter, say, for financial firms in terms of key asset prices or the developments in particular sectors.

Let me use as an example -- in the case of Bear Stearns, many people saw that Bear Stearns' situation was worsening. If you were an investor and you decided that you were going to position yourself on the view that Bear Stearns was going to worsen, there are two basic things you could do. You could sell Bear Stearns equity short or you could buy a CDS -- credit default swap -- to get protection in the event that they might default. Well, if you -- given the way the fed rescue package worked, if you were short the equity, that was a winning position, but if you held the credit default swap, that was a losing position, because the way in which the rescue was done all of the debt was actually made more creditworthy and the value of the credit default swap fell.

Now we see another kind of drama that is playing out in the Paulson effort to support Fannie Mae, Freddie Mac, and the FHLB, where clearly equity is being hurt. Preferred shares of the market are sort of aflutter with what's going to happen to those and -- or now the spreads on bonds have not widened very much. What we really don't know, and I think it's going to be very important to watch how this plays out -- is what the Congress will do, what Secretary Paulson will do if he receives the authorization to have funds available either to lend to the agencies or to invest in the agencies, and we'll have to see whether he -- what kind of position or view he takes with respect to the different categories of claimants on these agencies.

Now, that's sort of at the asset level. Of course, what's being considered is also the support of these key financial institutions, so key to our mortgage and housing sector that of course their economic health and well-being is really important to the health and well-being of a range of financial institutions and through those financial institutions to the very macroeconomic situation itself. In any event, I'm just trying to make a point that we need also to think here about how policy actions will affect the course of the economy.

I think we also should be thinking not just about the United States but Europe. The European economies are slowing. The German GDP seems to be surprisingly in decline in the second quarter. I think there's significant slowdown in a couple of other countries and, as I said earlier, probably some housing price decline to come. We don't know that much about the health of European banks, but I think if one considers the question how would the Europeans deal with institutional stress and the strains in financial institutions in Europe, we would at least have to conclude that they'll have a more difficult time dealing with it than the U.S. However arcane our five or six regulatory agency structures are in Europe, which of course it is a single market -- it's a single market in most everything except banking, where there are 27 regulators and 27 finance ministries, and you have banks that are big enough in Europe that home countries probably couldn't take care of a problem in a large bank in their country that does business abroad -- we're speaking across all of Europe. So, there would be the need for coordination of any kind of support operation -- coordination at least among the large market countries, and I think we can anticipate that that would be a process that would be somewhat more cumbersome to coordinate than what we've seen here in the United States.

Let me stop with that.

(Applause)

DR. LOMBARDI: Thank you. Thank you, Lael.

Well, let me take a slight different angle and elaborate more on the challenges that the current economic (inaudible) for the IMF, and in particular I (inaudible) multilateral surveillance and the challenges that advanced economists, national regulators, public sector financial (inaudible) may pose to IMF multilateral surveillance activities, but we have just learned from John's remarks a really (inaudible) toward the IMF activities nowadays. And indeed the IMF was established to serve as a machinery of collaboration for information on monetary problems. This is really spelled out in Article I of the IMF charter, and in a way this has never been fully acknowledge by policymakers, member countries, academics -- even perhaps IMF officials.

Many times the IMF has been regarded as central for its lending functions for collateral technical assistance. But really certainly the future of the IMF lies in much better surveillance activities; in being a forum for international monetary problems. And the current economic landscape I think offers very good opportunities to lay down the challenges for the IMF moving forward.

In particular, let me start from the recent financial turmoil that the global economy has experienced over the latest year. It was originated in the most financially sophisticated economy and then from here was exported to other advanced economies (inaudible) Europe. So, I think the question is, for the IMF multilateral surveillance activities to be effective, to what extent are the advanced economies willing to get the IMF involved? And of course there are various degrees. (Inaudible) one could be just (inaudible) as provider of information or (inaudible) have the IMF as really guiding the interactions among the various key economists and then drop adjustment bonds that the IMF itself will be (inaudible).

So, if we look at the latest decades, and forgive me if I'm not the academic on this, but if we look at what has been the history of the IMF from the second amendment of 1978 until now, the history is that advanced economists have a tradition of not involving the IMF in their own multilateral surveillance activities and then start to rely on the G-7 and other fora. So we draw our advanced economies from the IMF surveillance activities, especially multilateral activities -- has meant that such members have sort of -- have not provided the institution with the adequate authority and political capital needed to carry out to discharge these activities successfully. And I think this is most evident in the case of the multilateral consultations that were concluded by the IMF about a year ago where the members involved essentially (inaudible) some centrally rated, some already well-known physicians, and it is my reading that they did not really take commitments, the implementations of which the IMF could have monitored (inaudible) could monitor as a homeless broker.

However, if the advanced economists decide not to engage fully with the IMF, of course it will be difficult for them to argue that other countries -- and I'm referring to Asia especially -- should be listening to the Fund's advice, and there are already some senior agent officials to -- whom have been spoken to over the last few days. They are very closely monitoring what the IMF is saying and is doing, because they say that they don't want to be the sole target of the IMF's attention if other key systemically important countries among IMF members are not doing the same.

Then I think the current economic situation poses an additional challenge to the IMF I would say more on technological grounds, and that is I think the core of this financial turmoil as has originated from within key financial institutions both in the U.S. and also in Europe as it was (inaudible) were elaborating.

And of course they might have some (inaudible) for seeing the problems as they were mounting, like everybody else, but the Fund has finance ministries and central banks as its many interlocutors. Well, this crisis, this turmoil, really points to the need for the IMF in having access to balance sheet data from systemically important financial institutions that national regulators, I think, would be very hesitant to grant. Not surprisingly, we have seen a larger role played by the Financial Stability Forum where regulators are indeed present.

Finally, I think there's a third challenge for the IMF, and that is with regard to the (inaudible) of public sector financial entities whose weight in the global economy and in international finance is growing very fast. And to the extent that such entities do not disclose fully their data, to the extent that the countries who are such entities are based do not fully disclose data do not really share fully their analytical perspectives with the IMF, I think it's going to be difficult for the IMF to properly assess risk to the global economy and carry out its surveillance function.

So, many times analysts and scholars, as well as the (inaudible) authority, held the Fund accountable for what it does and does not do. But I think in this respect the current situation is actually different, because really the (inaudible) responsibility I would say lies more with the Fund's members than with the Fund itself.

So, these are really challenges that in a way the members of the Fund themselves have to grapple with.

Thank you.

DR. BRAINARD: Terrific.

Let me do the the following. I'm going to ask one or two questions and then just get some discussion between you on some of the points that you individually raised and then turn to the audience to continue the discussion.

One thing that I think I heard John saying is that this episode is a little different from the previous episode. It sustains dollar depreciation. In particular in that there are now serious alternatives to the dollar as a reserve currency, and there are underlying structural reasons why people might want to hold alternatives to the dollar as a reserve currency, and I guess I just want to start with John but then ask David and Domenico to reflect on this as well.

You sounded relatively sanguine about that, but there's a lot of discussion out there about tipping points. To what extent adding that into the mix might make this episode more difficult to manage?

DR. LIPSKY: Good question. For sure it's more difficult to manage, because the relative balance in the world economy has changed substantially. It's clear that in many ways the challenges have been very much unanticipated. I don't think many policymakers or even private sector analysts were seriously considering a year ago that we would have oil between $130-$140 a barrel, that we would see the kind of increases in commodity prices and the implications. Let’s view that then in the context of falling asset prices, which are at the heart of the financial sector turmoil. Asset prices are declining, and that inevitably puts the financial sector under strain. The weakest link broke first, and that was the U.S. subprime sector. David referred to some research that the IMF carried out with regard to assessing residential house prices in the industrial economies, and David was referring to the the possibility of asset price declines more generally in European economies. Already we've seen that occurring in the U.K., Ireland, and Spain. All of these are a rather novel set of challenges that are putting strains on the global community.

My conclusion is that it underscores the need for a multilateral approach to successfully deal with these problems. There's no way to imagine that simply viewing each of these issues in a national context is likely to be successful. That being said, your question also included wondering about the potential existence of alternative reserve currencies and whether that could be complicating. As I said in my remarks, in the long run, underlying developments, fundamental developments will be crucial in determining the attractiveness of reserve currencies. For sure, big changes are possible if policies are run in an unsuccessful way even in a very large economy over time. But in the near term that does not seem to be a significant risk.

DR. BRAINARD: David, do you want to talk about that issue of the dollar's reserve currency a little bit?

MR. LIPTON: Yes, I mean, John described a gradual evolutionary process under which the role of the dollar might change and other currencies would come to be important alongside it. That's certainly the most likely outcome. I think we do have to be cognizant of the possibility that the problems that we see right now worsen in such a way that there could be some more dramatic adjustment of the dollar or of other currencies as well. I think that in that setting, attitudes towards the dollar might shift in a more discrete fashion.

Now, you know, in terms of the role of the IMF, you know, the IMF apart from a couple of special episodes, is in support of emerging market countries or poor countries that are having problems, and I think we have to recognize that if there were -- I mean that world financial markets have become so large -- volumes of transactions and volumes of portfolios are so large that there's very little that the IMF could do with its present arsenal -- its present financial arsenal to stem some kind of discrete or undesirable adjustment of the problem, and so that's a -- you know, in this world of where so many resources are concentrated in the hands of a few sovereign wealth funds whose behavior is hard to predict, I think that's got to be something that's on policymakers' minds.

At the same time, in terms of the overall stability of the global economy, there are factors that go in the other direction. We've seen five very strong years of growth and that's that has led to, in most countries, an economic strength that is, as of yet anyway, not really eroded by what's happened so far. In particular, in emerging market countries, policies have been managed in such an improved fashion since the Asian financial crisis, and the adoption of more floating exchange rates, the accumulation of reserves, and overall better policy management, I think, that the threshold for emerging markets to somehow fall into problems of public finance or public indebtedness -- the threshold for that is much higher.

DR. BRAINARD: That kind of gets to the second question, which is, you know, that we see -- we reflect back on the '90s Asian financial crisis, as you did, David. The IMF had some leverage, because the problem there was the exchange rates that were unsustainable on the opposite direction. Right now we are looking at -- I think all three of you have talked about difficulties with countries with current account surpluses whose exchanges rates need to be more flexible and appreciate. Obviously, China is at the front of everybody's mind. But the multilateral surveillance process only has so many teeth. What are the ways of getting China in particular to engage more constructively, given the stakes that are now present I think for the U.S. policy community more generally?

And, Domenico, you laid out a few ideas there, but why don't I turn to you and then John.

DR. LOMBARDI: Well, I think first of all it would have been important for the IMF to conclude the Article IV consultations with China, that from what I understand were cast by the board two years ago just by China being on (inaudible) cycle of bilateral surveillance. And of course the IMF can try and I think has indeed tried some quiet diplomacy. But still there are rules, and the IMF charter is pretty clear about that. There's this new 2007 surveillance decision that was approved by the board last year and that so far has been implemented with regard to some very small members. So, it would be time I think to carry this forward.

DR. BRAINARD: John, I don't want to confine attention to the IMF. Are there things that other organizations should be doing or that we should be doing bilaterally? Do we need a different kind of structure for the G-8 process or for different governance mechanisms? The IMF only has certain tools at its disposal. Are there other entities that could be pushing this agenda broadly?

DR. LIPSKY: I think the answer is: certainly. It's probably worth mentioning just in this context. I do find it a bit odd that a kind of implicit standard has been offered that -- not here but just in general -- that the sine qua non of the IMF's relevance is the existence of these large-scale funding operations typical in the late '90s or early part of this decade. Frankly, I always saw them at the time not as a failure—in the sense that there was something wrong with what the IMF was doing—but something more of a systemic failure that began in '94 with the Mexican peso crisis. The message was that the tools of crisis prevention and crisis resolution had been rendered dysfunctional by the emergence of a global securitized capital market and that the repeated problems, large-scale problems, were simply symptomatic of the failure to come to grips in an effective way with those changes. Therefore it strikes me that saying the absence of large-scale lending programs means there's no international leverage or something's going wrong is probably not the most productive way to view things. Rather, it should be obvious in the current environment—of, as I call it, true globalization—that the international institutions only since 1990 have become truly global institutions. And with the growth of an international capital market that probably has no historic precedent, that the governance challenges are important, the organizational challenge is important, and the conceptual challenges are important. From the point of view of the Fund, very simply, in this context it strikes me that our role for success inevitably is going to focus on what I've called, in another context, a three-gap model. Certainly with regard to financial issues. The first gap is a gap in data where lack of information can create erroneous decisions. The second gap is in regulatory legislation or supervision, where the structural gaps cause systemic fragility. And the third gap is in the markets, where the problem in essence is asked: “Why can't I buy insurance against a specific risk and is there a need for public intervention that would create insurance against those risks?" None of those are simple questions. Why I bring them up is that all of them require broad participation not likely to be within the power of any one institution or any one governmental authority. It's going to require a multilateral approach with public sector aspects and deep engagement with market forces. Can the G-8 solve all the problems? The answer is self-evidently no. I don't think the G-8 would ever think that it could. But we definitely need to keep pushing forward in terms of improving the forums of global governance and addressing these problems in a cooperative, multilateral and broad focus. And then I could get more specific, but I think that's good enough for right now.

DR. BRAINARD: David?

MR. LIPTON: Well, I think the days where the IMF or U.S. officials go to China and explain to them the economics of exchange rates and somehow the light goes on and they realize oh, we really never understood that and now we're going to -- and now we know what to do -- that's gone by.

And as a general matter in emerging market countries as a whole, the degree of training and experience and talent that you find among economic officials is really excellent and (inaudible) to think if anything we're going to be finding that they'll be providing meaningful critiques of U.S. policy and maybe even IMF policy.

But -- so, I think the reality is that there are two routes to getting China to have a different exchange rate policy. One is that they become comfortable with the idea that a more flexible exchange rate is in their interests in terms of their own macroeconomy. And, frankly, that clearly depends on them feeling confident, not nervous, about the state of their economy. Their worry is that more flexibility and/or a stronger currency will hurt certain sectors of their economy. It's a political and economic judgment call on their part. And the other is that they might feel as though they have some stake in -- some greater stake in the functioning of the international financial system in the distribution of adjustment and in the flexibility with which it functions. And then in that sense they become convinced to be better global citizens, which I think is a larger theme for China in a wide range of areas. I think we need to encourage

China in many realms to take on that kind of a global citizen role as time goes on.

DR. BRAINARD: Let's do the following.

I think we have somebody with the microphone. Why don't you just -- if you have a question just raise your hand and we will -- and please identify yourself. There's one back there.

MR. JONES: Yes, Jim Jones with Minet Jones.

Really a two-part question on oil prices. While the debate here puts a lot of blame on peripheral things, speculators, etc., would you agree that the fundamental demand, supply, imbalance is the root cause; and, if that's the case, what could our national government or multiple governments do to bring that down in a short period of time?

Second part is the belief among some that this is really a bubble about to burst. Do you agree with that? What would cause the bursting of that bubble, and what would be the effect?

DR. BRAINARD: John?

DR. LIPSKY: First of all, as you may be aware, we have done work in this area, as you can imagine. Also, we have been asked specifically by the G-8 to collaborate with the International Energy Agency to provide a report to be concluded in the September-October time frame exactly on the causes and durability of the rise of petroleum prices in particular and energy and commodity prices more broadly. We've been on the record in this context that the basic reasons for the rise in energy prices have been fundamental in nature and have pointed to both the strength of demand growth. David has mentioned this already, but often in the current discussion about the economic environment, it's easily forgotten that the past five years represent the fastest five-year period of global growth in decades, and probably the best distributed global growth in modern times. That growth and demand of course involved very strong growth—particularly strong growth in emerging economies that is much more intensive in energy and commodity usage per unit of GDP than in more advanced economies.

Two aspects have been particularly notable. On the supply side, there has not been a response of investment that might have been anticipated commensurate with the rise in prices. At the same time, on the demand side, we've found that the pass-through to consumers of rising prices has actually declined as the price rises have increased. In other words, in many countries there is a lag, a pass-through, to consumers, so naturally the impact on demand from rising prices has been muted if consumers don't actually face the rise in prices. We think that these have been important elements in driving prices higher. Therefore, we think that while the rise in energy, commodity and food prices more broadly represents a durable shift in relative prices, nonetheless there are very clear policy measures that could ameliorate to some degree the amount of this shift.

DR. BRAINARD: Jo Marie.

MS. GRIESGRABER: Jo Marie Griesgraber, New Rules for Global Finance Coalition, and I wanted to pick up on a phrase that John raised, "protecting the vulnerable." But yet -- that was on the opening remarks, the very lead-in sentence. But then what we've heard is the emerging markets and the developing countries, and my sense is that the decisions are going to be migrating to the Financial Stability Forum even away from the Fund where the attention stays on the emerging markets in the wealthy countries, and the bottom line is what happens in the poor countries -- the excluded, the absent? And I really hope you would think about and consider the consequences for those countries who are not in room.

DR. LIPSKY: Let me make, first of all, one clarification for those who aren't familiar. The Financial Stability Forum is a cooperative group of finance ministry officials, central bank officials, and regulatory supervisory officials in the financial sector from a limited number of countries—but the largest countries. The IMF is a very important member of the FSF and a very active and critical member of the FSF working group that has been working on the regulatory and supervisory financial sector responses to the current turmoil. That working group has promulgated a set of principles and proposals that will be implemented on a voluntary basis and that we, having been an important in their development, are supporting. We think that these principles are broadly applicable not just in advanced countries but in emerging economies as well. But, again, the FSF deals very narrowly with the issues of the financial sector.

Hopefully you've heard our voice repeatedly on the need to protect the most vulnerable from the impact—and especially the humanitarian distributional impact—of the rise in commodity and especially food prices. We have been very supportive in our own actions by amplifying our Poverty Reduction and Growth Facility---our structural lending arrangement with the poorest economies. We've acted, or are in the process of acting, to amplify their access to Fund financing directly. We also have been active in supporting the World Food Program and working with our colleagues in the World Bank and other multilateral institutions in making sure that there is targeted social support for the most vulnerable. This is something that goes above and beyond just macroeconomic considerations and requires very targeted and effective means to ameliorate the difficulties.

DR. BRAINARD: Domenico?

DR. LOMBARDI: Yes, I saw the Financial Stability Forum as (inaudible) that brings together officials with a lot of specialized knowledge on both financial and regulatory issues. But I think it would be -- it is important that the IMF gives a very high profile because even if, you know, on the (inaudible) I have said many times that perhaps it could have been achieved more. It is still a multilateral organization where essentially all the countries in the world are represented one way or another. So, it is still laterally (inaudible) to no other fora that -- like the Financial Stability Forum for instance can bring to the table. And I think this is really the value added of the IMF, and in this sense I am also concerned that, you know, of the fora that advanced economies tend to use more regularly for their own multilateral surveillance activities might sort of get to how you profile them they should have. The IMF is really the only legitimate multilateral organization that should carry out macroeconomic and financial surveillance activities.

MR. LYNCH: I'm David Lynch with USA Today.

John, you mentioned that the global imbalances are going to be with us for longer than the IMF had envisioned -- envisaged -- and that new misalignments might be emerging and new risks might be emerging. Could you elaborate a little bit more on that? More specifically, what misalignments, what risks are you worried about?

DR. LIPSKY: Specifically, as I referred to in my talk, in some cases adjustment in those countries that have fallen behind the curve in adjusting to the new international pressures has come through higher inflation. We worry that that is not stabilizing over the medium term and creates new risks. In addition, as I discussed, and you shall see when we release our Global Financial Stability Report update in the next few days, the financial risks appear to be spreading somewhat. We've seen strong action in the last few days in the United States with regard to the GSEs. As I mentioned in my remarks and we've spoken of before, the risks in the financial sector need to be taken very seriously, need to be addressed potentially with innovative responses, and potentially even through the use of the public balance sheet.

DR. BRAINARD: David, did you want to highlight one or two party misalignments and risks you kind of focused on?

MR. LIPTON: No, I think I don't have anything to add to what John said.

DR. BRAINARD: There's one back there I think -- a hand up and the -- yeah, right in the back there.

MR. BARKLEY: Tom Barkley from Dow Jones. Mr. Lipsky, I was wondering if you could just expand a little bit on the need for flexibility in policy actions to respond to the equivalent balances. You mentioned that rising oil prices are going to exacerbate surpluses in oil producers. What about China? Do we need to be more patient for China to move towards more flexible currency?

DR. LIPSKY: As I stated in my remarks, we consider that much of the shift in relative prices that has been creating the macroeconomic pressures that we've all been talking about is likely to be durable and needs to be accommodated. At the same time, there are risks of rising inflationary pressures that themselves will potentially prove to be more durable and create longer-term problems of stabilization. Those are the kinds of issues that need to be balanced in a creative, flexible, and appropriate way in many countries, including in China. Of course we are in ongoing very close collaborations—especially with our Chinese colleagues—over the appropriate policy response to the current environment.

DR. BRAINARD: Yeah, there's one way in the back.

MR. TRUMAN: Ted Truman from the Peterson Institute.

This is for John and David on this question of exchange rate flexibility and the role in fighting inflation especially. You spent a lot of time on

China, but there is another part of the world, which is the oil producers more broadly, where the predominant message that's come from the International Monetary Fund is keep your pegs, especially in the Middle East, and one would think that if you're worried about Korea in this regard or even Russia in this regard, which is a slightly different case where the Fund has been (inaudible) peg, that the silence on the issue of inflation in the oil-producing countries broadly defined is a bit of a problem, because -- not just for the system as a whole but for the system as a whole as reflected -- what would be the consequence of a sustained period of double-digit inflation in oil-producing countries in terms of their economic and financial stability?

DR. BRAINARD: David?

MR. LIPTON: Yes. I think we've long treated the oil-producing -- the Middle Eastern oil-producing countries as though their economies are really quite simple, just a big pot of oil, and that as a result the exchange rate regime was really unimportant. But, obviously, as these countries accumulate huge wealth and have to decide where to invest that money in terms of overseas financial investments or domestic physical investments, their economies are becoming more complex and the kinds of problems we always ask about other economies become pertinent -- are there distortions that arise as a result of their exchange rate regime? I guess in the end of the day my view on this is that really it is best for them to -- like the conclusion I think that came from thinking about this subject after the Asian crisis -- that it's best for countries to be at one end of the exchange rate spectrum, (inaudible) or the other, a really flexible exchange rate system, that the more problematic situations arise when you're in the middle. So, you know, by that standard I think the Middle Eastern countries really have to decide whether to stick to these pegs and live with the consequences, understanding that there will be Dutch disease-style consequences in their countries, including inflation problems that they'll have to cope with, or to go to the other end of the spectrum, and in time I imagine that they will, as their economies become more complex, move in the direction of flexibility.

DR. LIPSKY: Thanks, Ted, for that very good question.

If you imply a difference in the attitude towards Asian economies and some oil exporters,China's own policy, as described in the multilateral consultation, is increasing flexibility of the exchange rate with regard to a basket of currency. That's the policy we're discussing with them. In the case of key oil exporters—for example, Saudi Arabia—their stated policy is to preserve the peg. So the relevant near-term question of course is how to do that successfully. If that's the policy, what are the implications for a successful application? And, of course, in the current context, in fairness, certainly there's no reason to believe that the oil exporters, any more than anybody else, anticipated the dramatic rise in prices, which is, of course, creating management problems that you could say jocularly are high-class problems. But they nonetheless are management problems that threaten stability. We can see, for example, in the peg economies in the region you're discussing, rapid increases in inflationary pressures that need to be handled. At the same time, it's also associated with the rapid buildup of large reserves in these economies. They are cooperating with each other and with the IMF in what we call the International Working Group of Sovereign Wealth Funds and discussing what we're calling the generally accepted practices and policies. What I'm trying to signal here is that we're in a hopefully fruitful dialogue with these economies with regard to the challenges of their management of this unexpected situation. This is not only in terms of their domestic policy management to preserve domestic balance under these circumstances but also to make sure that their large reserves are managed in a way that is supportive and beneficial of stability and progress in the global economy.

DR. BRAINARD: Why don't we do the following because we're just about out of time. I'll take the last question or two and then we'll turn to the panelists for a kind of wrap-up. So, why don't we take these two questions right here.

MS. SCOTT: Thank you. I'm Heather Scott with Market News International.

Following up on your comment just a moment ago that you're working with the Chinese on the best policy response and your repeated statements from the IMF officials that China recognizes the need for increased flexibility in the exchange rate, what tools do you have available to encourage, you know, a faster movement in that area which you said is what needs to happen, not just in China but in other countries with exchange rates that need to be more flexible?

DR. BRAINARD: And then this question over here, then we'll turn to the panel. It's right over here.

MR. MILLER: Rich Miller at Bloomberg.

Both of you are -- all three of you talked about committing the public balance sheet in one form or the other. I wonder -- maybe just a couple of interrelated questions. What -- maybe you could expand on that and what does history tell us is the best way or what other examples of this in the past shows the best way of doing that. And, two, if that does occur, what are the implications of that for current account balances and the dollar? It would strike me -- obviously you could have a potentially big expansion in the U.S. budget deficit, big expansion in the savings investment and balance in the United States, and that might have a feed-through effect on the dollar.

DR. BRAINARD: All right, let's just go right down the line.

DR. BRAINARD: All right, we'll start with Domenico.

DR. LIPSKY: If Lael asks I got to answer it.

Question one was what tools are available, and I'm not sure exactly what that means.

MS. SCOTT: Other than (inaudible).

DR. BRAINARD: Other than jaw-boning and data and consultations, are there tools that the IMF has in instances like this to induce more rapid exchange rate movements?

DR. LIPSKY: Let's put this more broadly. The 2007 surveillance decision that Domenico referred to may be a bit arcane. But to cut to the conclusion, our membership has told Fund management and staff that every one of our so-called Article IV consultations should evaluate both the appropriate exchange rate regimes and exchange rate levels and do so in a frank way, recognizing the inevitable uncertainty about what represents the best regime and appropriate exchange rate levels. The Article IV consultations are the central hallmark of membership in the IMF. They are a regular process of bilateral consultation regarding economic policies in the context of the undertakings of the IMF member countries. That approach to the Article IV consultation will give rise to a discussion of some frankness at the Executive Board, which represents a unique gathering of international political authority to discuss the economic policies of each of the member countries. I don't know if you want to call that a tool, but there has been a reaffirmation of the centrality of exchange rate evaluation and exchange rate policies among the Fund membership in a mutual context, in a technical context. Let's just say it's a refreshed and focused set of instructions from our membership to the IMF.

DR. LIPSKY: The second question was about the public balance sheet. I'll pass the buck a little bit over to David to talk about this, but the point is it should be used in exceptional circumstances. It has some potential implications– as you've described—that have to be taken into account. But given the centrality of financial sector stability for the global economy and the current environment in the foreseeable future, we shouldn't shy away from taking the actions necessary to avoid potentially much more negative outcome.

Now, that may sound like boilerplate, but inevitably it will come down to cases. So rather than some broad blanket statement saying you ought to nationalize every financial institution that ever has any trouble or, on the other hand, to say it's caveat emptor all the way and let them fail and let's see what happens, it always comes down to cases.

DR. LOMBARDI: I think, Rich, there are plenty of examples of how the public balance sheet can be very important in staving off a problem of systemic instability. Those are mainly in emerging market countries, although there are some in industrial countries. The question that would arise if there weren't intensification of difficulties would be to define carefully the criterion of what is the threat to financial stability and what would be the alternative to inaction. I think at that point, if one were to reach it -- to get to your question about what the implications, say, might be about the exchange rate -- that swift and convincing action is going to be something that's going to be more supportive of the financial system, the economy, and as a result the exchange rate and then dithering, and that of course there will be implications for public finances, but they may in the end -- they probably in the end would be less dire than allowing the risk of greater financial instability. Of course, that's taking as a presumption something that shouldn't be, that John mentioned. I mean, really, the details matter a lot. The choices would be difficult. The recipes would have to be tailored to the particular problems that one faces.

DR. BRAINARD: Domenico.

DR. LOMBARDI: Yes. So, I think this greater focus on the exchange rates from the side of the Fund of course is very much welcome, as John was indicating. And also this growing (inaudible) between macroeconomic and financial sector surveillance at the IMF is also working on it, of course, (inaudible). But at the same time, I mean, we ought to be realistic, and we have acknowledged that China is not a lender, is not a borrower of the IMF. So, politically the IMF has no leverage, has no political source of pressure, and this source of pressure must come from key members of the IMF membership, and here I have to say that certainly (inaudible) towards the dollar perhaps much less than the fundamental (inaudible) required. But, really, vis-à-vis the euro, there's been -- there's a lack of flexibility. If anything, the (inaudible) depreciated. And this of course raises an issue that policymakers in the euro area should consider. The euro area is still among the monetary union and not a single country, and for various reasons there is still a lack of -- the monetary project has not been still completed. And one of the outcomes of this get is really the (inaudible) disconnect between the monetary policy internal to the euro area whereby vis-à-vis it has given a strong delegation in terms of pursuing price stability, and the external dimension of the monetary policy, whereby the euro area has not really fully (inaudible) exchange rate policy for the euro. And, of course, the euro area has been hesitant so far in really pulling its political weight behind the IMF and supporting the IMF in finding a political (inaudible) to the IMF that could be spent on China.

DR. BRAINARD: Terrific.

Well, I think we're going to wrap up. Sometimes you have these events and you end and feel really good. I must say I think the appropriate mood today is perhaps sobered. But I am very appreciative of the insights that all of you brought to this set of issues and think it's important to release you to go back to manage several of these challenges. So, thank you.

(Applause)

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