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THE GLOBAL ECONOMIC OUTLOOK:

A CONVERSATION WITH IMF MANAGING DIRECTOR

CHRISTINE LAGARDE

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P R O C E E D I N G S

MR. THORNTON: Good afternoon, everyone. With the great pleasure of having both the International Advisory Council and the Board of Trustees in session together, there can be no better way to make that transition than with our next speaker. And I'm going to turn this session over to the Vice Chairman of our Board of Trustees, Suzanne Nora Johnson.

MS. JOHNSON: Thanks, John.

On behalf of the Brookings Institution, I am honored to introduce you all today to Christine Lagarde, the Managing Director of the IMF. We are very fortunate that she has agreed to visit us again. Her last visit was in April 2012, where she had basically made some very important remarks talking about the importance of seizing the moment, not just to prevent further crisis but also to set a foundation for economic growth and stability. We're grateful that she's agreed to join us today to talk about her perspectives on the global economy and to talk about

the priorities she sees for the IMF going forward.

As you all know, she became the head of the IMF in 2011 after serving as the Minister of Finance for France and, in fact, was the first woman to serve in such a capacity in the G-7. In her capacity as Finance Minister she played a pivotal role in the financial crisis, and, as you all know, in 2011 France had the presidency of the G-20 in which Mme Lagarde was important in terms of spearheading reforms in the international monetary system.

Mme Lagarde will deliver her remarks today for the first 25 minutes or so, and then Kemal Derviş will follow up with a Q&A.

As you all know, Kemal runs the Brookings Global Development Economy Department. He also served as the head of the United Nations Development Program and was a former Minister of Economic Affairs for Turkey.

We'd also very much like to welcome the media with us today. As you all know, the conversation is on the record. We will webcast this

session, and also for all of those of you who Twitter, please know that you can tweet about the event using #IMFLagarde. And with that, I introduce Mme Lagarde.

MME. LAGARDE: Well, thank you very much for this introduction, and I had no idea that Twitter was going to accompany me on this session and that it would be a bridge to any comments that you'd care to make in the process of this address.

Good afternoon to all of you. Thank you very much to the Brookings Institution. Thank you to the members of the board and to the council for inviting me today.

I'm particularly pleased to be hosted by you, Kemal, on the occasion of this Q&A session.

I'm particularly pleased to be here in a different shape than when I came to visit with you back in April. Back in April, I was on four legs recovering from a nasty surgery, and I'm very pleased to be on my two feet this time around. And the passing of time has certainly been helpful to me if it has not necessarily been helpful to all economies

around the world.

Now, what I would like to do is to give you, on the occasion of this short presentation, a snapshot of where we see the global economic trends.

Just about a month ago, at the time of the IMF and World Bank spring meetings, we described a fragile and uneven recovery around the world. And I ventured the concept of the three-speed economy, which certainly I would reiterate today, if not multiple-speed recovery; and I'll come to that in a minute. We had forecast a global growth for 2013 at 3.3. We are still at that number. We don't (inaudible) numbers on a monthly basis. But if you were to ask me, certainly that three-speed recovery is still very much on our radar screen.

We're also seeing a trend that was anticipated back a month and half ago, which is that of upbeat financial markets sitting quite uncomfortably beside a much more downbeat real economy. We are also seeing a global job crisis and a recovery that is not doing enough to lift the prospect

for all people. And that is very much the case in all advanced economies.

We are, however -- and that's a slight difference compared with our spring meetings, for those of you who eventually attended or followed our forecast at the time -- we're seeing some glimpses of more somber trends. Recent data, for instance, suggests some slowdown in growth, and at the same time the downside risks to growth remain as prominent as ever.

So, we could be entering a softer (inaudible). And this only reinforces my core message, which is making policies stronger to stop the global economy getting weaker, because we believe that policymakers can help improve the situation and turn this three-speed multilateral, multiple-speed economy into a full-speed recovery.

Let me just touch on each of these three different groups.

The first group that we see, which is clearly moving forward quite fast and which is driving

growth at the moment and has been driving growth for the last five years or so, is a group comprising the emerging market economies, many of the low-income countries as well; and these countries in the main have entered the crisis in a position of strength. And while many of them have used quite a lot of their buffers, they are still in a position of strength. And in a world of much bad news, we tend to forget about that piece of good news. In fact, for the last five years -- half a decade -- those countries, that group that is moving at fast speed, that group has generated about 75 percent of global growth.

Today, if you look at where it is growing fast, well, you will see the fastest growing countries essentially in developing Asia and in Sub-Saharan Africa. Those are the two fastest-growing regions in the world. Moreover, a recent IMF study suggested that today’s growth in the low-income countries -- and that’s particularly the case in Sub-Saharan Africa -- that growth is more robust than in the past, and those countries are less vulnerable to pitfalls and

setbacks.

Of course, we shouldn't get too carried away by this wave of optimism and this piece of good news that I've just talked about. It's not the culture of the IMF anyway to get too carried away with optimism.

So, how can we be less optimistic about those countries? Well, there's clearly been, including in those countries, emerging market economies in particular, a slower momentum. This is the case in China. We have just slightly revisited the growth forecast for China, which we had set at 8 percent and that we will be setting at 7.5 percent. We've just finished the Article IV in China. The level of activity on the level of growth has been weaker, and growth in our view remains too reliant on credit, property development, and still infrastructure.

Investment prospects also look less bright in key markets like Brazil, like India, like Russia, and like South Africa. These countries need, in our view, to implement policies to protect what they have

accomplished and stay strong. And, in part, that means looking inward and getting to grips with domestic vulnerabilities; structural obstacles to sustained growth, including infrastructure but infrastructure projects where they matter, where they're going to make a difference; and regulatory bottlenecks as well as governance. It also means looking outward, keeping a watchful eye on spillovers from the advanced economies, particularly if they result from an extended period of quantitative monetary policies.

Now, let me turn to that in relation to that first group, because it's clearly an upside as well as a downside. We have done some research on this issue as part of our ongoing work on examining the role and effects of monetary policy during and after the crisis and, particularly, the spillover effects of unconventional monetary policies from the advanced economies onto these emerging market economies.

What did we find? Well, first we found that what we call UMP -- unconventional monetary policy --

has achieved a great deal on the domestic front. It has helped make financial markets work again, and it took the most severe risks off the table. It has also helped growth, although that particular consequence is much more difficult to actually quantify. But think for a second. What would have been the circumstances if the European Central Bank, for instance, had not initiated the outright monetary transaction back in the summer of 2012. Where would we be? Where would spreads be -- including with Central Bank that has not spent much money on that program actually?

But in the main, the domestic effects of those UMPs have been positive at home. Now, what about the rest of the world? We also believe that these policies have had a positive effect on balance, especially through better global financial stability, higher growth in advanced economies, lower interest rates, and lower spreads.

Now, for sure the persistence of easy monetary policy increased the flow of capital to emerging markets, especially to Asia and to Latin

America, and such flows can be extremely beneficial to an economy. But they can also lead to financial stability risks, because even worse than the tide coming in, because you're generally quite satisfied to see those capital flows coming in -- they can be invested; worse than that can be the tide coming out, and that can have serious destabilizing effects on those emerging market economies and those economies with high yields or higher than where they're coming from.

Now, right now, these risks appear to be under control and can be managed with sound macroeconomic policies complemented by macroprudential policies geared toward taming financial excess. In some cases -- and we have gone public and we have changed our views back in the spring -- in some cases capital control on those flows can be necessary if the macroeconomic policies and the macroprudential policies that go with it are not sufficient to resist the hardship resulting from the outflow of capital.

So, let me be clear on this accomodative

monetary policy in advanced economies. We believe that they were positive, that they were efficient, that they were necessary, and they are still necessary today. But we also acknowledge that the longer they last, the larger the volumes are, the higher the risk is. Equally, we also believe that monetary policy, whether conventional or unconventional, should not be asked to do more than what it should normally do and should certainly not be used as an excuse for other policies and other reforms to be undertaken by policymakers. And certainly policymakers in terms of fiscal policies, in terms of structural reforms, should not shelter behind the unconventional monetary policy to not do what they should be doing. But we believe that with the right set of policies on both sides of the equation, advanced economies and emerging markets, which have to do also what they have to do to manage those capital flows, retain them, make sure that they have enough of the financial markets and enough of a stable environment to keep those capital flows. With those two sets of policies, risks can be

managed so that the global economy can continue its forward momentum.

So, I've dealt with the first group here, the group of those that move at relatively fast gear. Let me now turn to the second group, the one that is on the mend. It consists of countries that have suffered during the crisis but that have taken the necessary policy measures in order to rebuild and be able to recover and move a bit faster. What are those countries? The United States but also Switzerland, Sweden, Canada, New Zealand, Australia in the main. And I will focus for a second on the U.S.

The U.S. has come a long way in a short time. Just five years ago, it was triggering the most massive financial crisis that one could think of, essentially geared by excess in the financial markets. And thanks to good progress in fixing the financial system, we're now seeing a steady increase in private demand driven by a recovery in the housing sector but also in the automotive sector and easing financial conditions.

Because of this, we believe that growth in the U.S. will be almost at 2 percent in 2013. Yet, you should say, well, maybe that country should be in group one, but it cannot be in group one because the U.S. is not doing as well as it could be because of self-inflicted fiscal wounds. This year alone fiscal adjustment will constitute an enormous 2½ percent of GDP -- 2½ percent of GDP -- after having gone through several years of fiscal consolidation already. Sequestration alone, if not reversed, could cut a half percentage of GDP from growth so that the 1.9 percent forecast that we have for 2013 could be improved to probably about 2.4 percent had it not been for sequestration.

The problem with it is that it’s not only sequestration in and of itself adding to the fiscal consolidation and bringing it to a higher-than-necessary level, but it’s also blunt and blind, and it cuts across in areas where it’s not necessarily most helpful when it does not touch on those programs that are, for a long period of time, going to increase the

spending in this country.

But if the sequester were to be replaced by more back-loaded measures, growth would certainly strengthen in the second half of the year. I have little hope that that will materialize, but just in case.

Second self-inflicted wound in a way: the issue of the debt ceiling, because the U.S. needs a durable solution. It does not need the volatility or uncertainty and certainty associated with a question mark on the debt ceiling.

Now, turning to the longer-term fiscal horizon, the U.S. has made some steady progress reducing, as I said, by some 7 percentage points its deficit since 2009. So, when I said this year is unnecessarily high with 2.5 percent, since 2009, the U.S. deficit was reduced by 7 percentage points of GDP, which is quite significant. And we believe that the deficit will continue to shrink over the next few years, as revenues will recover with fast economic growth, and the public debt ratio should start

declining in 2015, because we have the combination of growth picking up, therefore revenue increasing and interest rates staying relatively low for the next couple of years.

However, the longer-term debt profile, post-2015 if you will, remains a major concern. Spending on key health care programs and Social Security is expected to increase by 2 percentage points of GDP over the next decade. Interest outlays are also projected to increase by the same amount over this period, as rates gradually will return to neutral levels. These factors could widen the budget deficit and put debt GDP ratio back on the worryingly upward trends, and all of that starting from a relatively high starting point. So, in other words, the next couple of years are going to be quite positive looking.

But if nothing is done about the medium- and longer-term horizons, and if no measures are identified that would reduce spending on those two areas that I've just mentioned, then the picture is a

lot bleaker. This is the major challenge facing the U.S. economy today, and it must be met. Otherwise, the substantial gains that have been made, that are in the process of being made, can too easily be lost.

Now, I'm going to move to the third group. I'm going to spare you Switzerland, Sweden, New Zealand, Australia, and Canada. But I'm going to move to the third group, which is the one that is in the lowest gear, because it's not really mended as it should have, and that group includes the Euro area in particular and, to a point -- and I'll come back to that at the end of my remarks -- Japan, but certainly the Euro area.

Let me just -- and it's not because I originally come from that part of the world, but I think it's just fair and honest to simply acknowledge how much distance that part of the world has traveled from an economic point of view. I look back to the days when I was Finance Minister and what has been done today. It's probably because I wasn't there. But massive achievements. You know, it's the European

stability mechanism endowed with over 500 billion Euros. It’s the outright monetary transaction program put together by the European Central Bank after having used other tools of conventional reducing rates and conventional monetary policy tools with the SMP.

It’s also the steps toward a single supervisory mechanism, which has now been adopted and which is being put in place and will be in effect either at the end of the 2013 or at the beginning of 2014. Just think about it. Seventeen, soon to be eighteen with Latvia joining, authorities deciding that there will be one that will supervise them all when it comes to supervision authority. The agreement to help relieve the debt burden of Greece, not to mention the nascent, finally, European banking authority, which has been already carved out a bit on a Franco-German basis and which hopefully will be pushed by the European Commission and approved by other members of the council.

Yet, despite all these achievements and national measures that have been taken in countries in

the program, as well as other countries such as Spain or Italy that are not in the program, despite that, the Euro area economy is still stuck in low gear. Activities continue to shrink in the beginning of this year, and we expect negative growth of minus .3 percent for the year as a whole. And we have just finished Article IV, which is the annual review of Germany and France, and we have reduced downward our forecast for Germany, which we thought would be at .6 percent. We slashed it down to .3 percent, and we've reduced also the forecast for negative growth for France, which will probably have an impact on the overall forecast for the Euro Zone.

So, overall, that region is operating at zero speed. And going forward, the indicators are not especially encouraging. Lending to firms is rising only gradually in countries like Germany and not at all in countries like Italy or Spain. The periphery of that zone is still mirrored in recession with financial conditions that are unduly tight. Unemployment is still rising. For the zone as a

whole, it’s at 12.2 percent, which is very high and very much higher in certain corners of that zone, particularly in the young population.

Now, this weakness, combined with lingering uncertainty over the Euro area growth outlook and the evolution of the Euro area institutions, is draining momentum even from countries like Germany and France that I’ve just mentioned have been reduced in our forecast.

So, what needs to be done? Well, clearly, the Europeans have set for themselves an agenda that includes, particularly, growth and jobs both at the national level and at the regional level.

And how can that be supported by effective policies? I would submit that, first of all, the financial sector has to be properly addressed and addressed in depth just in the way the U.S. has actually addressed their financial sector, to sanitize it in a way. In the same vein, the Euro area has to conduct the same exercise. That is something that the European Central Bank and the European partners are

planning on doing, consisting of quality asset review, followed by proper stress tests, duly communicated, in order to make sure that everybody knows exactly what is in everybody else's balance sheet, so that the fragmentation that we are observing on the financial market can actually be mended by proper information and certainty about the health of those institutions. And as I had said back in the spring, if that requires recapitalization, so be it. If that requires restructuring, so be it. And if that requires shutting down some of the banks, so be it as well. And this is a process through which the Europeans will have to go.

Likewise, the monetary policy that I had referred to earlier by the European Central Bank, which is accommodative, should remain accommodative as well. And we certainly welcome the recent ECB actions in that vein. And we need to see more of it. And conventional monetary policy is needed in that part of the world in order to reduce fragmentation at the receiving end in particular.

Beyond this, we have said -- and we are very pleased to see that the Europeans are embarking on that project -- we have said that the European Banking Union is a necessity, and not just a single supervisory mechanism, which is obviously the starting point, but also a single resolution authority and deposit insurance backed by common fiscal backstop.

Now, turning to the fiscal policy, while fiscal consolidation is necessary, it is essential that it happens at the right pace, and that right pace is going to be different depending on the country's circumstances. When a country is under financial pressure from the markets, certainly that pace has to continue and steadily. If, on the other hand, a country is not under such pressure, then the pace can be adjusted and can be slowed in order to accommodate for growth. And this is, luckily, the stance that the European institutions are now taking, with allowing a couple more years here, a couple more years there, sometimes a bit less but in order to slow the pace and make sure that growth will kick in.

In addition to that, of course, there are many countries in that part of the world, in the Euro Zone, that need also structural reforms in order to allow growth to materialize and potential to actually unleash. With this package of policies, financial sector, monetary policy, fiscal policies, and structural reform, we believe that the Euro area can get its growth engine up and running again.

And that brings me to this other very large economy, which we have so far put in that third group, which is Japan clearly a country whose economy has indeed sped up over the past few months, and in large part this is due to recent monetary new policy and fiscal stimulus combined with a depreciation of the yen by about 20 percentage points in real terms. In the first quarter alone since that new monetary policy has been decided, Japan has grown at a 3½ percent rate in the first quarter. And we project growth for that country to be at 1.6 percent for the whole of 2013, slightly below the U.S. but not so much.

So, if this trajectory continues, we might

be able to move Japan from the third group into the second group. Yet, there is still some distance to go to make the higher gear permanent. And Japan faces many challenges on the road ahead.

How can it solidify its gains? Well, monetary policy is certainly on the right track, especially with the new quantitative and qualitative easing framework aimed at achieving 2 percent inflation in two years' time with the doubling of the monetary mass. Yet, this new direction for monetary policy needs to be complemented by more balanced fiscal policy. The recent fiscal stimulus will only be effective in the longer term if it is twinned with a credible strategy to bring public debt down. It now approaches roughly 245 percent of GDP. That's the size of the Japanese debt at the moment.

What is necessary to that effect? Well, certainly the plant consumption tax has to be put in place. Currently consumption tax in Japan is 5 percent. The commitment by the authorities is to bring it up to 10 percent over a period of two years,

2014-2015 -- 8 percent 2014, 10 percent 2015.

Shifting to a higher gear also means pressing ahead with structural reforms to unlock productivity, including -- and that is going to be a difficult job, because it's countercultural -- including opening up domestic services and agriculture where, clearly, protections are very, very high.

Japan also needs to provide more employment opportunities for older workers like me and women like me. Actually, we have done a very interesting paper for those of you are interested in the impact of unleashing the female labor force in a particular market with an aging population. It's quite extraordinary.

Labor force participation in Japan is 24 percent lower for women than for men, much lower than in comparator countries. And this is really silly. This is throwing away so much economic potential at a time when it is most needed and in a population that is clearly aging and reasonably resistant to immigration of population.

So, in my view, and in the view of the IMF, Japan should consider policies to attract more women to the workforce, including by stepping up effort to reduce gender gaps in (inaudible) position and providing better support for working mothers.

So, we've covered the three groups. Let me conclude here. We believe that this three-speed economy that I have described for you can look more like a one-speed economy where growth will be more consistent, albeit with different levels and degrees of development of course, and can be focused on that agenda that the G-20 has: a more solid, a more sustainable, a more balanced, and a more inclusive growth.

I've talked about the policy requirements of the three-speed groups, yet there are other overarching issues that lurk on the horizon that will have to be tackled as well. I'm not going to go into that, but I just want to flag them for you:

The financial sector reform on a global basis where about, well, a good two-thirds if not a

bit more -- I would say 80 percent of the work has been done, been completed, but still 20 percent missing, and that has to happen, whether it's derivative markets, whether it's the shadow banking system, better coordinated regulation across regions that is still to be developed. We have other big ticket items, such as climate change, which will have a major impact on the development and the fiscal policies of some very large players. I'm thinking of China in particular. But there are other countries as well that will be affected.

So, a lot is to be done. And what's more, we believe that what needs to be done needs to be coordinated, needs to be concerted, and needs to be organized amongst all players. And certainly to that end the IMF will continue to play its part and to be a source of information, analysis, and guidance.

Thank you very much.

MR. DERVIŞ: -- take off the podium so that everybody can -- well, thank you so much for this very comprehensive and yet concise overview of the world

economy, of the policy scene. Let me start with maybe one or two, depending -- giving you some time to prepare your questions. But let me start with one question. You've emphasized a lot of the monetary -- easing the unconventional monetary policies the major Central Banks Japan, the U.S., the U.K. have engaged in quantitative easing. The European Central Bank has done it somewhat differently by opening large credit windows throughout the European system and the outright loan (inaudible) transaction promise, which is a promise. And all this -- you know, what I remember in my studies and (inaudible) economics at Princeton, I would have said, well, this is going to generate inflation. And it hasn't.

MME LAGARDE: Right.

MR. DERVIŞ: Any comments on that or any views?

MME LAGARDE: Well, we had the same question, and we are -- we were in search of an answer. I'm not sure that we have the right answer, but the IMF published a paper that I think the

Research Department called “Inflation: The Dog that Doesn’t Bark.” And, you know, essentially their findings are, number one, that Central Banks have done such a good job over the many years -- particularly those Central Banks that you’ve just mentioned -- to show their independence and to have that target of price stability, that they have anchored co-inflation anticipation so well that in a way, not withstanding the unconventional monetary policies that they’ve put in place, that co-inflation stays there untouched.

In addition to that, there is also that findings that in advanced economies there is, in a way, a floor of resistance to wage reduction so much so that even in countries that are in the program where internal devaluation is sought in order to improve the situation, there is that level of minimum wage, you know, wage across the board that is resisting the inflation potential.

So, I think those are two explanations that can be advanced for that.

And the uncertainty about the actual size of

the output gap -- that also can explain it

MR. DERVIŞ: And, yet, when the asset side (inaudible) the liquidities are pushing up prices. So, it's a kind of inflation on the asset side that may be happening but not really in the --

MME LAGARDE: Yeah, over -- yeah. Yes, you're quite right, although if you ask the question --

MR. DERVIŞ: Financial assets I mean.

MME LAGARDE: Yeah, financial assets, yeah. But if you ask the question of, you know, bubble formation -- where?, how do you see it?, is it -- most people, at the moment at least, will argue that not yet, not there.

MR. DERVIŞ: That's right.

MME LAGARDE: But to be watched.

MR. DERVIŞ: All right, I'm going to -- because we're running late and I'm sure there are many, many questions, so -- yes, we're running late.

You are the first one.

Maybe what we'll do is take two questions at

a time and then give Mme Lagarde a chance to answer both and then again take two.

You'll be the second.

QUESTIONER: Thank you.

My question is are you worried about an exit from unconventional monetary policies, and are you worried about any other black swans lurking out there for the world economy?

Thank you.

MR. DERVIŞ: All right, and I get -- oh, yeah, please go ahead. It would be nice if you identified yourself.

MR. ELLIS: My name is -- I'm a journalist, Tom Ellis from Kathimerini from Greece. Actually, the question could be to you, too, about Turkey, the situation.

Are you concerned about a possible downturn in their economy, given the fact they have been doing quite well in the last couple of years?

Thank you.

MR. DERVIŞ: I'm going to take a third and

then turn to --

MR. YERGIN: Dan Yergin. In your basket -- your group 3 countries with their difficult plight, in Europe one has noticed over the last six months a rising crescendo of discussion about loss of competitiveness against the United States because of the diversity -- the difference in the energy positions. Has the IMF had a chance yet to look at how that might be affecting the timing and the ability of Europe to recover?

Thanks.

MR. DERVIŞ: Okay.

MME LAGARDE: On the -- the first question you asked about the unconventional monetary policy and the exit terms and conditions and timing, you know, we take the view that the longer it lasts, the bigger the volume, the higher the exposure; therefore, the most critical it is and it will be for central bankers to actually communicate appropriately their stance and their path toward the exit. That's the view we have. Obviously, everybody wants to avoid the 1994 brutal

exit, and you can deduct from that that well-communicated, well-articulated indication of the path is what certainly we would highly welcome.

Now, black swan -- by definition, you don't know what the black swan is going to be, and you have no idea until it's on you, and certainly the -- you know, when we look at the (inaudible) at the moment, the major area of concern is still the Euro Zone and has been the Euro Zone for the last three years or so, certainly since the sovereign debt in the Euro Zone has been under question.

But as I would say in my own language, it has managed its way through. Not fast enough. It's been laborious. It's been contentious. It's given rise to lots of discussions, debates, and arguments -- the Germans against the French, the French against others, and da-da-da-da. But they're getting there.

So, is that sort of slow process going to be an impediment? I wouldn't call that a black swan. So, a black swan is going to have to come from somewhere else.

Let’s see, Turkey. Who else? (Laughter) I said that there has been a bit of monetary policy loosening lately in a landscape that was extremely positive in economic terms --

MR. DERVIŞ: Yes.

MME LAGARDE: -- with, you know, political uncertainty as we see it at the moment. But I wouldn’t, you know, volunteer much more than that, because I’m not familiar enough with the deeply rooted sentiment that probably is driving that. So, I would defer to you Kemal.

MR. DERVIŞ: I don’t think it’s today’s topic. (Laughter) But I wish Greece all the best (laughter), and we are good neighbors now. And, you know, one gets out of crisis eventually, even if it’s very hard.

And then, maybe you have the third --

MME LAGARDE: And then the -- yeah -- the loss of competitiveness issue. I think I’m not the first one to say that. The new energy paradigm, if you will, as a result of Shell gas and the potential

reduction of energy prices in certain parts of the world will affect economic development How much for long I think remains a little bit to be detailed and explored, because it's going to also require massive investment to turn that gas into liquefied gas that will be exported. So, it will certainly change the picture, but, you know, how much and for how long to be seen.

Relative to Europe, it's a bit difficult to say, because you have a different landscape depending on whether you look at France, for instance, which is largely dependent on nuclear power energy -- about 80 percent of its electricity supply is provided by nuclear power -- or Germany, which is clearly dependent on non-nuclear energy or will be depending on much more non-nuclear energy going forward. So, it's a different landscape but clearly where the price of energy is going to factor in, certainly to the benefit of the U.S. relative to Europe. That's, you know, without doubt.

MR. DERVIŞ: Maybe -- follow up on that,

because it’s relevant to the company.

MME LAGARDE: Yeah.

MR. DERVIŞ: You know, when we look at the numbers -- and we always look at IMF numbers, but also the last page of the *Economist* is sometimes very useful for the 12 --

MME LAGARDE: Yes. It’s weekly as well.

MR. DERVIŞ: The Euro -- yeah -- the Euro Zone is almost at the $200 billion surplus. The U.S. is at a $480 billion deficit.

MME LAGARDE: Deficit.

MR. DERVIŞ: So, it complicates the picture a little. And Germany has the largest current account surplus of all countries in the world.

MME LAGARDE: The world, yeah, including --

MR. DERVIŞ: So, when -- you know, there is obviously is some competitiveness there. So, it’s a very -- and yet the Euro Zone is the third group’s core.

MME LAGARDE: Yeah. Yeah.

MR. DERVIŞ: So, we have a strange situation

where that place, you know, is producing a big surplus now, the biggest --

MME LAGARDE: That's a very old picture, because if you look at other numbers, such as deficit for instance, on an aggregated basis, it's very low. It's, you know, as you say -- current accounts, deficit.

MR. DERVIŞ: But if we look at U.S. states, we probably can't come up with the same differences.

MME LAGARDE: Yup, that's right.

MR. DERVIŞ: All right, yes. Go ahead.

MR. HUTCHINS: Glenn Hutchins, Brookings Trustee. I wonder how the IMF analyzes the austerity policies and economic performance in the U.K.

MR. DERVIŞ: Okay, and I'll take one more if possible. Ya?

QUESTIONER: (Inaudible) Montana TV. These days there's a great optimism again in Greece among markets and analysts. Do you agree with those opinions?

MR. DERVIŞ: I see we have a strong Greek

contingent.

MME LAGARDE: Yeah.

MR. DERVIŞ: Okay, I'll take a third one.

There.

MR. MILLER: Hello. My name is Lorenzo Miller from Television of Spain, so my question is about Spain.

You don't like sequestering U.S., Mme Lagarde, which I understand, but actually we are applying sequester in Spain in a permanent way. We are applying a very severe sequester, (inaudible) all the time for quite a long period now. But we didn't see the analyst tunnel. Do you have a positive message for Spain today, Mme Lagarde?

Thank you.

MR. DERVIŞ: So, the U.K., Greece, and Spain. (Laughter)

MME LAGARDE: Okay, on the U.K., we have just completed our Article IV, which is, as I said, the annual review of the economic circumstances. And our conclusion is that the trends are fine but that in

the short term it might be appropriate for the country to anticipate some of the investment programs that were actually planned in the mid-term framework. And that's what we had said last when we were in the U.K.

On the -- excuse me, I'm going to drink -- on Greece, I think on the record I said that while Prime Minister Samaras was talking about a success story, I wish Greece is a success story. But there is still a lot of work to be done. And while the fiscal consolidation that I will talk about in a second on Spain has been enormous, you know, Greece has consolidated by about 15 percentage points of GDP over the last four years, which is huge -- three years actually. So, on that front, I think we're talking about a steady pace but over an extended period of time, and we were the first ones to say Greece needs an extra two years to pursue that consolidation process, added to which the revenue collection and the tax collection in particular is absolutely critical for that program in Greece to be successful. So, it's a question of really being resilient, and I hope the

Greek authorities will continue to be resilient in collecting tax, in fighting tax evasion, in making sure that the tax authorities in Greece are independent and are not, you know, under pressure of any sort. That will be critically important.

Spain. We have also said the same thing, and we're very pleased to see that the commission is now on the same page and is also advocating that Spain be given another two years in order to, you know, slow down the process of fiscal consolidation. I was pleased myself to see the employment numbers that were released I think today, which are, you know, positive news tempered by the (inaudible) that it's a lot of seasonal hiring, but still we are seeing some positive news on that front, because that's going to be absolutely critical for the country to turn around the corner of massive unemployment. But more time and less, you know, brutal fiscal consolidation is, I believe, necessary for Spain.

I was also very pleased to see that Germany and Spain are working together in order to bring the

financing cost for SMEs in Spain down, taking advantage of the low interest rate at which German banks can finance themselves. I think that's an interesting and sort of creative way of bringing the European an the Euro Zone members closer together, short of the Euro bond, if you will.

MR. DERVIŞ: Maybe we have time for -- if there is one more -- all right, one more question. Okay, two, but very quick please.

QUESTIONER: Philip (Inaudible) member.

Europe has a positive external balance. It has vital capital markets. And yet your bank recapitalization doesn't seem to be happening. Who's going to finally make the bank recapitalization, for instance, in Europe happen, which is probably the key to growth in Europe finally starting again?

MR. DERVIŞ: Okay the last --

MS. YUKHANANOV: My name is Anna Yukhananov from Reuters.

I was wondering if you could talk about Cypress. You have some somewhat pessimistic

predictions for growth, but then you expect it to recover after a few years, so I was wondering what you think is going to drive the economy now that the financial system has been mostly decimated. Where do you see the prospects for that?

Thank you.

MME LAGARDE: On the recapitalization of banks, you know, I wouldn't draw as dark a picture as you do, because I think that in some of the Euro Zone numbers the recapitalization process has taken place or is largely underway. If you look at U.K. banks, recapitalization has very much taken place. If you look at France, we've just completed the Article IV. It's very much done. If you look at Spain, the recap has taken place under the auspices of the European Commission, and we've just completed again a banking recap monitoring review, and that has taken place. You know, almost 50 billion have been injected in the Spanish banks. So, I think it's not as global and differentiated as I could assume from your question. I think it's much more fragmented and piecemeal but

needed.

More to the point, my take on it is that an asset quality review has to take place, because, you know, back some four years ago the IMF came to Europe and I was Finance Minister in France, and the IMF said, you need to get rid of all these toxic assets; you've been infected by many of the U.S. banks that have sold to the European banks a lot of these products that really do not fly. At the time, we were very skeptical about the size that was indicated by the IMF. And I wish we hadn't. So, I think, you know, some of the work needs to be completed and that asset quality review could actually do the job, and it will determine what is the actual capital needed in some of those banks.

On Cypress, I would hope that a lot of the service industry that is in Cypress, that is not related to fuzzy financial activity, will survive and will thrive. And I would certainly hope that that country can, you know, get back to a normal business model that will be beneficial for the Cypress

population. But it will take a couple of years and probably most of that two years.

MR. DERVIŞ: Well, thank you very much. You know, you talked about interdependence, and I think all of us active in the international economy and the international political system -- I think everybody realizes how interdependent the world has become. I think the IMF is absolutely critical at the center of the international economic and financial system, and we are lucky to have you at the helm of the IMF. And you have to promise to come once a year to Brookings.

Thank you very much.

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