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**SEMINAR ON STRATEGIC ISSUES LINKED TO THE MEASUREMENT OF
INTERNATIONAL TRANSACTIONS**

SESSION I: POLICY DRIVERS

GLOBAL SITUATION AND POLICY CHANGES

Note by the International Monetary Fund¹

1. It is a great honor to be invited by Steve Landefeld and Rob Edwards to address this most distinguished gathering. As an economist, speaking to such a group of eminent statisticians, I know I am a bit out of my depth in many areas, but I thought that I might be able to say something useful on how statistical issues impinge on some of the main challenges of the current international economic and financial policy debate. The International Monetary Fund, and economic and financial policy makers meeting at the highest levels, are facing a series of difficult and novel problems, and I believe that the statistical community can make a vital contribution to resolving or managing them.

2. I will start by giving a few salient features of the configuration of economic and financial policy challenges that are raised within the G7, the FSF, at the BIS, the OECD, in the G20, and

¹ Text of the keynote speech by Mark Allen, Director, Policy Review and Development Department, International Monetary Fund. The views in this paper are personal views of the author, and not necessarily those of the International Monetary Fund or its staff.

in the IMF's International Monetary and Financial Committee. Then I shall go into some of these challenges in a little more detail, focusing on where statistical gaps cloud the analysis and where there may be payoff from improvements. Finally, I will say a little about how statistics and data are used in the resolution of international economic issues.

3. In the time available, my rundown of the current international challenges will be a rather superficial, but I hope it will serve as a framework in which to see how the various problems we are now facing are interconnected. The single most important development of the last decade has been the emergence of the huge US current account deficit. Until very recently, this deficit has continued to widen, and its financing has absorbed the lion's share of the world's savings. It has been a tremendous support to demand in the world, giving us some of the strongest growth the world has seen for many years.

4. The underlying causes of this phenomenon are not well understood. It has been characterized by a sharp decline in the US savings rate, especially that of the household sector. The decline in investment in those Asian countries affected by the crisis of the late 1990s has meant that there were plenty of savings available to finance the US. The situation has been characterized with some truth as reflecting a savings glut, particularly in Asia, and inadequate investment levels. Two other factors have certainly played a major role in creating the current situation. The first is the entry of China, and now India, in the world economy, adding large amounts to the world labor supply. The second is the explosion of new financial engineering techniques, based on derivatives and allowing the creation of innovative financial products.

5. These elements have given us a challenging set of problems, making each day's Financial Times rather exciting reading.

6. The pattern of balance of payments surpluses and deficits that has been created is unsustainable, and must adjust sooner or later. But the combined forces just listed have created other unsustainable phenomena. The vast amount of liquidity captured in the balance of payments surpluses that correspond to the US deficit has fueled the asset price increases worldwide, a process facilitated by new financial engineering techniques. We see asset price bubbles in housing, particularly in the US, but in other countries too, and in high stock valuations. More generally, we see financial institutions exposed in new and not fully understood ways. Asset price inflation has not been mirrored in general price inflation, until recently, probably because the emergence of China, India, and others has kept downward pressure on manufactured goods prices. But we have seen a strong boom in commodity prices, including fuels and food, and this is now creeping into general price levels. The pattern of surpluses has led to massive accumulation of international reserves by some countries, a number of which are now diversifying their asset holdings by setting up sovereign wealth funds, that could become major players in the international financial system.

7. To summarize, the main issues on the agenda of international financial policy makers are: how to achieve an orderly unwinding of the global patterns of surpluses and deficits; how to reduce risk of catastrophic failure among overextended financial institutions; how to counter a global resurgence of inflation, or to prevent high commodity and oil prices from generating inflation, a recession, or a combination of the two; and how to accommodate the new distribution of financial assets that the rise of sovereign wealth funds typifies.

8. Let me turn now to some of the statistical and data questions that bear on this set of issues.
9. I plan to touch data on international investment positions, financial sector data, price and monetary data, and oil sector data.

I. INTERNATIONAL INVESTMENT POSITIONS

10. Despite the enormous amount of work that has gone into compiling and reporting countries' international investment positions, the underlying data remain weak. When they are used to analyze global flows and balance sheets, the lacunae become very apparent. As a result, it is hard to determine what are temporary phenomena and what are more permanent shifts. The US has some of the best international investment data, and yet it has been hard for academics and policy makers in recent years to form an incontrovertible opinion on the underlying sustainability of developments in the net international investment position, since the US seems to earn so much more on its external assets than it pays on its external liabilities. If this return differential is a permanent phenomenon, then the US could afford to run a large current account deficit indefinitely, but if it is spurious, more correction is called for.
11. The problem of international investment positions is becoming more complicated with the accumulation of very large reserves by many Asian countries and oil exporters. What are the implications of this accumulation for international financial stability and does the transfer of some of these assets to sovereign wealth funds make any difference? The fact that we know so little about these holdings raises the anxiety level of voters and policy makers, even if there is actually little going on that is of concern.
12. One fear is that decisions on the currency composition of reserves may have a destabilizing effect on exchange rates. We have some data on currency composition of a large part of international reserves, supplied on a confidential basis to the Fund through a process known as COFER. These show that while there has been a shift from dollar reserves to Euro in recent years, it has not been a rout. But some of the main holders of international reserves do not report COFER data, and the aggregate data are becoming less reliable.
13. Sovereign wealth funds are established for various purposes, including a diversification of assets beyond those permitted for international reserves. In principle, we should be collecting data on the aggregate assets and on the income flows of sovereign wealth funds as part of the data supplied on international investment positions. But this is not always the case, and in some cases, even the size of sovereign wealth fund assets, let alone their currency or other composition, is not revealed. This will increasingly complicate the problem of analyzing global imbalances and systemic stability. The IMF is working with a number of sovereign wealth funds to help them establish a set of good principles and practices for their operations. I hope that this initiative will bear some fruit later this year.
14. It would be ideal if we could have a global IIP matrix, showing assets and liabilities by country, by currency and by maturity. This would allow policy makers to assess their interactions and linkages with other countries and markets and their vulnerabilities in a far more robust way than they can do today. But this will probably take a long time to come about.

II. FINANCIAL DATA ISSUES

15. Policy makers work primarily in the national context, asking how developments affect the people and institutions for which they have responsibility. But financial markets are increasingly international, with national boundaries playing a diminishing role. It has been striking to see, as the sub-prime crisis unfolded, just how banks and financial institutions all over the world have been affected, virtually regardless of location. The picture this gives is of an industry competing in and dealing with the same products, and running the same risks, regardless of any national affiliation. How are we best to arrange the collection and processing of financial data to serve the needs of national policy makers?

16. Since the Asian Crisis struck, we in the International Monetary Fund have devoted a lot of attention to assessing the vulnerability of emerging markets to financial crises. I believe that for this group of countries we have quite a good handle on the vulnerabilities of their public finances – the risk of sovereign distress – and of their banking systems. The areas that are still weak, and where lack of data holds back the analysis, is the vulnerability of their corporate sectors and of their household sectors. Sometimes the balance sheets of these sectors incorporate considerable exchange rate and interest rate risk that could have macroeconomic consequences.

17. There are also calls for the IMF and the Financial Stability Forum to extend their work on vulnerabilities into industrial countries and mature markets. While we do seek to identify risks in particular financial markets and to sets of institutions, and risks of untoward macroeconomic developments at the global level, it remains very difficult on the basis of available data to pinpoint the risks to individual countries from financial market developments.

18. Financial markets themselves rely on data, and the collection and provision of such data is in many cases performed by the market. There are large numbers of proprietary databases that are available for substantial fees. But can we rely on the markets to provide the data that policy makers need and guarantee its quality? We have traditionally regarded the compilation of data as a public good: are we comfortable that the public interest is fully served in this private market?

19. The rapid development of financial markets and new instruments has resulted in a burgeoning superstructure of derivative financial claims sitting on top of a much more limited set of primary financial assets and liabilities. This development of derivative products, and the combination of such products into marketable securities was cited as one of the main achievements of recent years. The argument was made that it allowed the risk in the underlying transactions to be distributed efficiently to those most capable of bearing it and willing to do so.

20. But this dispersion of risk and the associated strengthening of the financial system remained an article of faith, rather than something that could be observed. And when the sub-prime crisis struck, the depth of our ignorance about where the risk had actually gone became apparent. No one knew who was holding the default risk (or even the market risk) on the underlying assets. In a gigantic game of Old Maid, where everyone is afraid their partner is going to give them the Queen of Spades, financial institutions stopped lending to each other and market liquidity dried up. While central bank actions to supply liquidity averted the worst, nine months later, we are still discovering where some of this paper has gone. A statistical light needs

to be shone through the huge superstructure of derivatives and synthetic products so that the underlying risks can be seen clearly.

21. The financial industry has wielded and continues to wield huge political power, and the watchword of recent years has been light regulation or self-regulation. But the clear failures of this regulation-lite regime have created a backlash. As Morris Goldstein put it recently, “self-regulation is to regulation as self-importance is to importance.” The FSF and the IMF have already made a number of proposals for improvements in this area. But this may also be an opportunity to improve the base of financial statistics that national policy makers work with. The socialization of costs during the current financial market turmoil, not to mention the political fall out, means we may have a rebalancing of the cost-benefit calculus of collecting data from the private sector.

III. MONETARY AND PRICE DATA ISSUES

22. The last ten years or so have been marked by a sense that central bankers knew all there was to know about inflation. Central banks presided over a period of low inflation, and the central bankers took credit for this, arguing that it had been made possible by the independence they had been given, and their sophisticated monetary policy frameworks. While some also mentioned productivity growth as having been a downward force on inflation, with hindsight, the international economic conditions that I mentioned earlier may also have played a bigger role than central bankers admitted.

23. The situation now is very different. Inflation is creeping up everywhere, particularly in the emerging market countries, but also in industrial countries. The monetary policy course between the Scylla of inflation and the Charybdis of recession looks more difficult. And central bankers are being called to task for permitting asset price bubbles to develop on their watch. And these problems give rise to some challenging data and analytic issues.

24. Price statistics usually distinguish between core inflation, seen to be endogenous, and headline inflation, which in addition to the core covers non-core, apparently exogenous items, typically food and fuel prices. The task of monetary policy was seen as controlling core inflation and preventing the exogenous elements of headline inflation feed into core inflation. With the current high and rising levels of food and oil prices, this approach is less tenable. Wolfgang Münchán recently remarked that the central bankers’ statement today that “core inflation is well contained”, was the modern equivalent of “let them eat cake.” Food and fuel prices cannot be ignored.

25. But from each national policy maker’s perspective, these are exogenous prices that have to be taken as given. Yet for the world as a whole, food and fuel prices are endogenous – they reflect the level of global monetary demand. So the challenge is to supplement national approaches to inflation and demand management with a stronger international perspective. Could it be that the stance of the world’s combined demand management policies has been too expansionary? How could one assess this? What statistical and analytical tools are needed? I am not saying that we are soon going to see coherent global demand management, but we do need to develop the conceptual and statistical tools. Eventually, this may permit better coordination of

national policies, bearing in mind the need to reduce global imbalances. The EU experience in this area might help us produce global indexes of monetary aggregates and price pressures.

26. The appropriate reaction of central bankers to asset price bubbles is somewhat more complicated. It is not obvious that target price indexes should be expanded to include asset prices in some form. Nor is it clear that the appropriate reaction to inflation in certain asset prices is to induce deflation in the prices of other goods and services. Here the problem is whether the monetary policy should be assigned as the instrument to control both current prices and asset prices. We are already seeing more suggestions that regulatory policy and the capital cushions of financial institutions should reflect an assessment of bubbles in the prices of the assets they hold. This is a promising area, and may require the development of more reliable asset price series.

IV. OIL DATA ISSUES

27. Given the international strategic importance of oil and the impact of its price and availability on everyday life and national political processes, it is amazing how poor data on oil are. Efforts to improve the data have been under way for some time, for example, the Joint Oil Data Initiative (JODI). But the results have been meager compared with the importance of the issue.

28. Data for world production of oil is not too bad, I believe, but data on stocks at all stages in the process are very poor. And data on production capacity and reserves are very unreliable indeed, as is information on consumption within the producing countries. As a result, it is hard to analyze the precise cause for the recent spectacular increase in the oil price or to assess how permanent a change it is. And it dooms international discussions on how to deal with the problem to be most unproductive.

V. USE OF DATA AND STATISTICS IN INTERNATIONAL POLICY DISCUSSIONS

29. This brings me to my last point on the role that statistics play in discussions between national policy makers. Of course there will be conflicts between the interest of one country's policy makers and those of another about what ought to be done to resolve a given set of issues. Oil-producing countries and oil-importing countries may have very different views on the appropriateness of a particular price. In resolving global imbalances or dealing with the decline of the dollar, the major countries involved may see the balance of responsibilities for action and the advantages very differently. But this is in the nature of such discussions.

30. An international organization like the Fund can play a crucial role here, since it comes armed with objective analysis based on the facts, and these in turn are based on the most reliable statistics available. The IMF can be an analytical honest broker in such discussions, but its ability to do so is constrained by the quality of the data it uses. Once it can quantify and present issues numerically, it can create the basis for compromise, taking the arguments away from the basic facts and into the realm of who should do what, and how burdens should be shared. And if there is a will to solve the problem, the creation of the solution is greatly facilitated.

31. The international macroeconomic and financial problems that I have outlined this morning are quite intractable. But your efforts to get us better statistics on a range of topics will greatly contribute to rational and steady solutions.

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