December

2017

Office of the Nordic-Baltic Constituency

VIEWS AND POSITIONS ON POLICY DEVELOPMENTS IN THE INTERNATIONAL MONETARY FUND

Semi-Annual Report

This report is prepared by the Office of the Nordic-Baltic Constituency (NBC), representing Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden in the International Monetary Fund's Executive Board. The purpose is to present the positions taken by the Nordic-Baltic chair in the Executive Board and to update interested audiences on IMF issues. The report is not a thorough review of IMF's work, but aims at presenting the key discussions over approximately the past six months through December 2017. The next report is scheduled for July 2018.

The IMF has 189 member countries. Each of them is represented by an Executive Director on the 24-member Executive Board. The IMF supports its membership by providing:

- policy advice to governments and central banks based on analysis of economic trends and cross-country experiences;
- research, statistics, forecasts, and analysis based on tracking of global, regional, and individual economies and markets;
- loans to help countries overcome economic difficulties;
- concessional loans to help fight poverty in developing countries; and
- technical assistance and training to help countries improve the management of their economies.

For additional information, we generally refer to the IMF's website, www.imf.org, which we have also benefited from while preparing this report.

February 12, 2018

Contents

1 INTRODUCTION

This report provides an overview of the main Executive Board discussions and other IMF related issues during the second half of 2017.

Global economic activity continues to firm up. In January 2018, the IMF published an update of its World Economic Outlook (WEO). The January update confirms that the cyclical upswing underway since mid-2016 has continued to strengthen. The recovery is broad based, and the IMF raised its forecasts for global growth by 0.2 percentage points to 3.9 percent for 2018 and 2019. The revisions reflect the increased global growth momentum and the expected impact of the recently approved tax policy changes in the United States. Risks to the global growth forecast appear broadly balanced in the near term, but remain skewed to the downside over the medium term. Over the medium term, rich asset valuations and compressed-term premia raise the possibility of a financial market correction, which could dampen growth and confidence. The possibility of countries adopting inward-looking policies, and non-economic factors also pose notable downside risks.

The recovery provides a window of opportunity to raise the prospects for sustained growth and enhance the resilience against downside risks**.** At the October Annual Meetings, the Managing Director (MD), Christine Lagarde, urged policy makers to not let the recovery go to waste. She emphasized that "*everyone needs to look at their own house, inspect the roof and determine what parts – what policy areas – need fixing*". The IMF's message was that the world is in an upswing, and this is the time to tackle key challenges, and rebuild buffers, stave off downside risks and make progress with reforms to raise potential output and inclusiveness.

The Fund continued to focus on a number of macro-critical issues. The MD said in her Global Policy Agenda that the global upswing makes it easier to undertake difficult, but necessary, reforms aimed not only at raising productivity, but also at enhancing inclusion and minimizing disruptions to help ensure that everyone shares in the gains from technological progress and integration. As inequality within many countries is increasing, the risks associated with the social and political consequences of such developments have remained high on the Fund's agenda. The Fiscal Monitor is, for example, concentrated on how the right fiscal policy mix can reduce inequality. It provided powerful evidence of how government spending on education and health greatly reduces income inequality over time by promoting social mobility, including across generations. A message strongly supported by the Nordic-Baltic constituency. The IMF has also championed issues such as female empowerment, and is getting increasingly tough on corruption. In a recent speech in Korea the MD talked about how empowering women is not just the right moral choice but "*it is also the right macroeconomic choice. Helping women participate in the economy boosts growth, diversifies economies, reduces income inequality, and mitigates demographic change"*. In regards to corruption, it is in many countries the root cause of the economic injustices people face. During the fall, the IMF continued to discuss how to operationalize these emerging issues – income and gender inequality, climate change, and corruption – into its surveillance and policy advice for members where they are macro-critical.

2 SURVEILLANCE & ECONOMIC POLICY

2.1 Global Economic & Financial Developments

CONTEXT: The IMF's Flagship Reports, World Economic Outlook (WEO), Global Financial Stability Report (GFSR) and Fiscal Monitor (FM), were published on October 10 and 11, and the Managing Director's Global Policy Agenda (GPA) on October 12, in connection with the IMF and World Bank Annual Meetings.

The October **WEO** concluded that global recovery had continued with accelerating growth in Europe, Japan, China, and the United States and buoyant financial conditions across the world. Relative to April WEO forecasts, global growth projections were upgraded by 0.1 percentage point to 3.6 percent for 2017 and 3.7 percent for 2018. For 2017, most of the upgrade in growth was due to brighter prospects for advanced economies; whereas for the upward revisions for 2018, emerging markets and developing countries (EMDEs) played a relatively bigger role. Notably, it was expected that sub-Saharan Africa, where growth in per capita income has on average stalled for the past two years, should improve overall in 2018. The global recovery was viewed as broad-based and more so than at any time since the start of this decade. However, the Fund still viewed the global recovery as incomplete; while the baseline outlook was strengthening, growth remained weak in many countries, in most advanced economies slack had yet to be eliminated as indicated by below-target inflation, and prospects for many EMDEs were considered lackluster. Although short-term risks were broadly balanced, medium-term risks were tilted to the downside. Hence, the IMF's policy messages in the WEO focused on the "window of opportunity" that the short-term recovery offers and encouraged policymakers to seize the moment to tackle the key policy challenges, namely to boost potential output while ensuring the benefits are broadly shared, and build resilience against downside risks. It also called for a renewed multilateral effort to tackle the common challenges of an integrated global economy.

The **GFSR** found that the global financial system continued to improve in response to extraordinary policy support, regulatory enhancements, and the cyclical upturn in growth. Yet, despite these favorable conditions, dangers in the form of rising financial vulnerabilities were emerging. The environment of continued monetary accommodation – necessary to support activity and inflation – was also found to be associated with rising asset valuations and higher leveraging. Financial stability risks had shifted from the banking system towards the non-bank sector and market risks were increasing. Staff highlighted that if left unattended, these growing financial vulnerabilities would continue to mount, threatening to derail the economic recovery should shocks materialize.

The **FM** focused on how policymakers can use fiscal policy to tackle inequality. Staff noted that global income inequality has been declining in recent decades due to countries like China and India's incomes catching-up to advanced economies. However, income inequality *within* some countries has increased, particularly in advanced economies. Similarly, to the WEO and GFSR, the FM pointed out that the global economic recovery offers policymakers a window of opportunity to respond with reforms to tackle inequality, and it showed how the right mix of fiscal policies could make the difference. In particular, the report looked at progressive taxation, universal basic income, and public spending on education and health. It encouraged the notion that fiscal policy can make the difference in tackling inequality, and that efficiency and equality go hand-in-hand.

The **GPA** summarized that the global economic recovery was ongoing, but not complete, and that the more favorable conjuncture offered an opportunity to tackle key policy challenges to stave off downside risks and raise potential output. Countries should undertake well-sequenced reforms to increase productivity, improve governance, and reduce policy uncertainty and future risks. Reforms should also aim to harness the benefits of technology and economic integration, and ensure that their benefits are widely shared. The Managing Director also highlighted that tackling the challenges to the global economy continued to require cooperation and joint action across the membership.

Nordic Baltic Constituency (NBC) view: The NBC broadly agreed with the Fund's assessment of the global economy and financial developments, and strongly supported the headline "window of opportunity" message. The NBC highlighted that the "act now" message, with emphasis on structural reforms and rebuilding buffers, was timely and appropriate given that the medium-term outlook remained clouded by uncertainty and substantial downside risks that called for policy action. In regard to the GFSR, the NBC stressed that global regulatory reforms have made the financial system safer and that it was crucial to avoid a regulatory rollback, and highlighted that following a long stretch of search for yield, risks were building up. The NBC welcomed the focus on inequality and redistributive policies in the FM. It emphasized that progressive taxation and transfers were key components of efficient fiscal redistribution that, together with public spending on education and health, promote equality of opportunities and inclusive growth. In his statement to the IMFC meeting in October, the NBC member highlighted, among other things, that the IMF has an important role in promoting multilateralism and openness, fighting protectionism and preserving the benefits of international trade and finance.

FURTHER READING: World Economic Outlook, October 2017, Global Financial Stability Report, Fiscal Monitor, Global Policy Agenda and IMFC Statement of the NBC**.**

2.2 The Work Program of the Executive Board

CONTEXT: The Work Program (WP) is the IMF Executive Board's agenda for the next twelve months. It reflects the strategic directions and policy priorities laid out in the MD's Fall 2017 Global Policy Agenda (GPA) and the International Monetary and Financial Committee (IMFC) Communiqué. The key priorities of the WP this fall included; guiding the global policy dialogue, supporting efforts to sustain the recovery, and raise prospects for sustained growth, assisting members to broaden the benefits from technological progress and integration, supporting policies that can bolster trust and resilience, promoting cooperation across countries to address shared challenges, and maintaining an agile, integrated and member-focused Fund.

NBC view: The NBC supported continued work on the global productivity challenge, labor market trends, and digitalization while also calling for vigilance with respect to financial sector developments. The NBC welcomed the WP's strong focus on the low-income countries (LICs) and the timely review of the LIC facilities, and highly appreciated the inclusion of emerging issues (income and gender inequality, and climate change). The NBC also valued the Fund's engagement on the issues of governance and corruption which are macro-critical for an important subset of the Fund membership.

FURTHER READING: Statement by the MD on the Work Program of the Executive Board

2.3 Use of Third-Party Indicators

CONTEXT: In November, the Board discussed the use of so called third-party indicators (TPIs) in IMF's surveillance activities to support staff's analysis. This means that the Fund staff draws on other institutions' expertise and estimates to inform their analysis of the business environment, competitiveness, and the quality of governance and institutions in member countries. However, the varied qualities of TPIs present challenges and risks to the Fund's credibility. The Executive Board therefore agreed that a more structured approach to the use of TPIs would promote best practice and ensure consistency and evenhandedness across the membership. They endorsed a new framework with three main elements: (i) a principles-based Guidance Note for staff, (ii) an "Indicators Digest" (a database over the indicators), and (iii) a review process to ensure best practice in Fund reports. The framework will apply to all country, policy and multi-country documents that are subject to the Fund's Transparency Policy.

NBC VIEW:

The NBC supported staff's proposed framework, which should promote the responsible use of TPIs. The NBC finds that the proposed framework appropriately encourages the use of staff's professional judgement, and provides adequate guidelines to ensure the Fund dose not draw flawed conclusions.

FURTHER READING: Use of Third Party Indicators in Fund Reports

2.4 Big Data: Potential, Challenges, and Statistical Implications

CONTEXT: In late August, the Executive Board discussed the Staff Discussion Note (SDN) "*Big Data: Potential, Challenges and Statistical Implications*", which was subsequently published in September. The paper reflects on the potential, challenges, and implications of big data for macroeconomic and financial statistics. It addresses the wide range of stakeholders of "official" data and statistics and covers interested users and producers. Numerous individual applications of big data are already being carried out, but a systematic and structured discussion is lacking and that is what the SDN attempts to offer. It looks at implications for macroeconomic and financial statistics, and concludes that further research and detailed analyses are essential to understand if and how big data can directly and indirectly support IMF surveillance work.

NBC VIEW: The NBC finds it important to take note of the challenges as well as opportunities related to big data and support further Fund work on these issues.

FURTHER READING: SDN on Big Data: Potential, Challenges and Statistical Implications

2.5 Bilateral & Regional Surveillance

CONTEXT: During the reporting period, the IMF Executive Board concluded regular Article IV consultations with two of the Nordic-Baltic countries: Sweden and Finland. Boxes 1 and 2 provide a summary of the findings. Of key economies, the Fund concluded the Financial System Stability Assessment of China and India.

Box 1 IMF Article IV for Sweden

The Art. IV report concluded that Sweden's strong economic growth continues, driven by domestic demand and exports, while robust job creation has lowered unemployment, yet wage rises and inflation remain low. House price increases have moderated somewhat aided by large increases in new dwelling construction. Household credit growth has also eased and the minimum mortgage amortization requirement has led to a modest decline in the share of mortgages with a high debt-to-income ratio. The report mentioned the importance of improving housing affordability over time for inclusive growth and macrofinancial stability. Reforms to reduce construction costs and promote more efficient use of existing property, including reforms of rent control and property taxation, are key. Reducing mortgage interest deductibility, expanding support for construction of affordable rental housing, and enhancing public transportation within regions, would also help. The proposed stricter amortization requirement should be adopted, with further steps, including a possible debt-to-income (DTI) limit, implemented if needed.

A balanced approach to Sweden's fiscal management should continue. Upside revenue surprises lifted the fiscal position into surplus in recent years. The 2018 budget adopts initiatives to address key social goals, resulting in a mildly expansionary fiscal stance. Concerns around overheating are mitigated by uncertainties around the output gap and persistently low inflation. Looking ahead, allowing the surplus to decline to its new medium-term target over a period of a few years would strike a reasonable balance.

Box 2 IMF Article IV for Finland

Economic growth in Finland has picked up considerably, broadening to exports and equipment investment, and is expected to remain strong in the near term. But the prolonged downturn revealed structural weaknesses and the economy will face further pressures, including from adverse demographics and technological change. High employment is crucial for the sustainability of the Finnish model of generous social insurance. The labor market has many desirable features but inefficient matching and low participation rates of some cohorts indicate a need for reform. Policies are being implemented to contain costs and reshape employment incentives. On fiscal policies, staff recommended using the current upturn to rebuild buffers, and saving any further revenue surprises or investing them in growth-enhancing measures. Finland's banking sector is adequately capitalized and profitable, but highly exposed to regional spillover risks. Nordea's decision to relocate its headquarters to Finland increases importance of adequate supervisory resources, discretion to increase capital requirements of needed, close regional cooperation, and completion of the banking union in the EU.

FURTHER READING: Sweden: 2017 Article IV Consultation and Finland: 2017 Article IV Consultation

2.5.1 China's Financial Sector Stability Assessment

CONTEXT: In early December, the IMF Executive Board discussed China's financial sector stability assessment. China's financial system has developed rapidly in size and complexity, and is currently one of the world's largest with financial assets at nearly 470 percent of GDP. The credit needed to generate additional GDP growth has led to a substantial credit expansion resulting in high corporate debt and rising household indebtedness. Demand for high-yield investment products, coupled with strengthening oversight of the banking sector, has led to regulatory arbitrage and the growth of increasingly complex investment vehicles. While non-bank financial institutions have grown even faster than the banking sector, banks continue to be positioned at the core of the system of indirect lending. Risks to the system come via widespread implicit guarantees and moral hazard resulting from a reluctance among financial institutions to allow retail investors to take losses, and the expectation that the government stands behind debt issued by state-owned enterprises (SOEs) and local government financing vehicles. The IMF team recommended a gradual and targeted increase in bank capital. The Chinese authorities recognized the risks and are proactively taking measures like strengthening of systemic risk oversight, improving regulation and moving toward functional supervision.

NBC VIEW: The NBC is encouraged by the Chinese authorities' recent and timely elevation of financial stability to the status of top priority but sees an urgent need to step up the pace in addressing the underlying causes of risks and strengthen the resilience of the financial system.

While improvements have been made in the prudential framework and international benchmarking, supervision and stricter regulations are not enough to slow down credit growth and stave off financial distress unless underlying root causes of risks are addressed. Prudential controls can be circumvented in the shadow banking which has grown the fastest in recent years, spreading hidden risks throughout the economy and blurring the lines with the formal banking system. Despite their declining share of value added, state-owned enterprises (SOEs) continue to play a critical role in the Chinese economy and account for about half of total bank credit. Addressing the debt of distressed SOEs is key and implies a fundamental change and heightened attention to harden budget constraints and gradually resolve implicit guarantees through greater tolerance of defaults. The NBC underscores the importance of looking at the big picture and addressing the underlying causes of risks, not only the manifestation of risks. China's goal oriented track record of successful reforms is a promising indicator of achieving the necessary transformation of the financial sector.

FURTHER READING: People's Republic of China: Financial System Stability Assessment - Press Release and Statement by the Executive Director for People's Republic of China

2.5.2 India's Financial Sector Stability Assessment

CONTEXT: In November, the IMF Executive Board discussed Indian's financial sector stability assessment. The Indian financial system is undergoing a gradual structural shift, with a greater role for nonbank intermediaries and higher recourse to market funding for large corporates. The state retains an important footprint in the system via ownership of large financial institutions, captive government financing, and directed credit to priority sectors. India's key banks appear resilient, but the system is subject to considerable vulnerabilities. Stress tests show that while largest banks are sufficiently capitalized and profitable to withstand a deterioration in economic conditions, a group of public sector banks (PSBs) are highly vulnerable to further declines in asset quality and higher provisioning needs. The IMF assessment took stock of the considerable progress made in strengthening financial sector oversight, and identified areas where scope for further improvement remains.

NBC VIEW: The NBC sees the large role of the public sector in the financial system as an important structural impediment. The current system, with the governance of PSBs, priority sector lending, low asset quality and high rate of non-performing-loans (NPAs), leads to fiscal contingencies. Given the relatively large size of PSBs in the overall banking system, the NBC wondered whether continued public controlled ownership, or indirect public ownership via public pension and insurance funds, remains a hindrance to competition and of these banks returning to a sustainable business model.

FURTHER READING: India: FSSA Press Release, FSSA Report and Statement by the Executive Director for India

3 LENDING

3.1 Adequacy of the Global Financial Safety

CONTEXT: The Executive Board has over the last year been discussing proposals to reform the Fund's lending toolkit, with the aim of further strengthening the Global Financial Safety Net (GFSN). The Board has considered a proposal for a new liquidity facility as well as improvements to the Fund's existing instruments for crisis prevention as part of the Review of the Flexible Credit Line (FCL) and Precautionary and Liquidity Line (PLL). The reforms stemming from these discussions includes the recent introduction of a new Policy Coordination Instrument (PCI) and an enhanced framework for cooperation with Regional Financing Arrangements (RFAs). The Review of the FCL and PLL found that the instruments have been effective in providing precautionary support against external risks, and that successor FCL arrangements, and associated access levels, have been appropriately tailored to country circumstances. To enhance crisis prevention, staff developed a proposal for a new facility, called the Short-term Liquidity Swap (SLS), to provide members with very strong policies with predictable and renewable liquidity support against potential, short term, and moderate capital flow volatility. However, the proposal was not adopted by the Executive Board. Neither was a proposal for a new Time-Based Commitment Fee (TBCF) which was proposed in response to concerns about prolonged use of high-access arrangements on a precautionary basis.

NBC VIEW: The NBC is willing to engage constructively in further discussions based on the SLS proposal should prospects for consensus on its establishment emerge in the future. Over recent years, the NBC have called for strengthening exit incentives from prolonged use of precautionary Fund facilities, often at high access levels. The NBC therefore supported the proposed introduction of a TBCF, seeing the overall design as striking a reasonable balance to increase incentives for gradually reduced access and eventual exit, without materially discouraging the use of facilities when deemed necessary.

FURTHER READING: Policy Paper on Adequacy of GFSN and Press Release.

3.2 Lending Programs

CONTEXT: During the second half of 2017, regular program reviews took place with nine countries under the IMF's concessional lending facilities (Afghanistan, Benin, Cameroon, the Central African Republic (CAR), Ghana, Guinea Bissau, Kyrgyz Republic, Liberia, and São Tomé and Príncipe). These nine countries were all provided funding under the Fund's **Extended Credit Facility (ECF)**, which provides flexible medium-term support to low income countries. Two countries (Mauritania and Guinea) entered into new three-year ECF arrangements.

Under the IMF's non-concessional lending facilities for emerging and advanced market economies regular program reviews under the **Extended Fund Facility (EFF)**, which provides medium-term support for countries facing protracted balance of payment problems, took place for Egypt, Gabon, Moldova, Mongolia, and Sri Lanka. Under the **Stand-By Arrangement (SBA)**, which gives loans to countries facing short-term or potential balance of payment problems, regular reviews were conducted for Honduras, Iraq, Jamaica, and Serbia.

Under the Fund's precautionary arrangements, a regular review was conducted for Morocco's **Precautionary and Liquidity Line (PLL),** Mexico entered into a new two-year **Flexible Credit Line** Arrangement (FCL), while Poland exited from their FCL.

The Seychelles became the first IMF member country to use the new **Policy Coordination Instrument (PCI)**, which is a non-financing tool open to all members. The aim is that the PCI should enable them to signal commitment to reforms and catalyze financing from other sources.

NBC VIEW: Overall the NBC supported all program reviews and requests for new programs.

<u>On the ECF program reviews and program requests</u>: The NBC supported the completion of the second review of **Afghanistan's** program and focused on the importance of fighting corruption as this continues to be a key obstacle to security, political stability, public and international trust, and economic growth. For **Benin,** program implementation has been satisfactory and the NBC commended the authorities' commitment to the reform agenda. For **Cameroon**, the NBC welcomed the CEMAC region authorities coordinated response to the crisis, and the lead the Cameroonian authorities have taken in this cooperation. While acknowledging significant risks to **CAR**'s program, in light of the authorities' efforts and commitment to successful implementation of the program, the NBC supported the completion of the review. For **Ghana,** the NBC supported the completion of the review, but noted program performance had been disappointing, and supported greater use of prior actions to limit further program slippages going forward. Given **Guinea-Bissau's** commendable progress under their program, the NBC supported the completion of the review. The NBC also supported the reviews of **Kyrgyz Republic's** program. Despite **Liberia's** mixed program performance, the NBC went along with the decision to complete the reviews, given the difficult economic background, the temporary nature of some missed targets and the corrective actions taken for some others. The NBC supported the completion of **São Tomé and Príncipe's** reviews and the extension of the arrangement to end-2018, considering recently improved program performance and the authorities' strong commitment to keep the program on track. It was also noted that delays in implementing some of the structural benchmarks were due to capacity constraints. The NBC supported **Mauritania's** request for a three-year ECF, agreeing that the current vulnerable situation calls for an ambitious policy adjustment, with focus on diversifying the economy, greater exchange rate flexibility, fiscal adjustment, and reforms to address debt sustainability concerns. The NBC also agreed to the approval of **Guinea's** request for a three-year program in support of its new National Development Plan.

<u>On the EFF programs</u>: Based on the steadfast implementation of reforms under **Egypt's** reform program, the NBC supported the completion of the second review and the request for the

modification of performance criteria. The three-year arrangement with **Gabon** has provided critical resources to support the authorities' medium-term recovery program following the oil price shock. While recognizing the risk of continuous political uncertainty leading to fiscal slippages and delays in reform implementation, the NBC welcomed the broadly satisfactory program implementation and supported the completion of the review. The NBC also supported the reviews of **Mongolia's** EFF, noting the clearly improved economic performance versus what was expected at the outset of the program and encouraging the new government to use the positive momentum to push ahead with reform measures. The NBC noted **Moldova's** recent political and macro-financial stabilization, supported by the Fund's program and the completion of the review despite mixed program performance. The NBC also supported the completion of the review of **Sri Lanka's** reform program.

On the SBA reviews**:** The NBC supported the reviews of **Honduras'** arrangement, but raised concerns about the high rate of poverty that continues to feed the vicious cycle of inequality and violence. The NBC also supported **Iraq's** review, although performance under the program had been weak. **Jamaica's** review was also supported by the NBC who noted the strong program performance and the authorities' steadfast ownership of the program. Given **Serbia's** improved economic fundamentals, restored fiscal discipline, and the firm downward path of public debt, the NBC supported the completion of their review stressing the importance of building on the achievements, maintaining strong policies, and continuing to pursue convergence with advanced European economies.

The NBC welcomed and supported the approval of the first member country Policy Coordination Instrument (PCI) for **Seychelles**, which will continue the promotion of close dialogue between Seychelles and the Fund. The PCI should safeguard policy discipline going forward after the completion of the successive SBA and EFF programs.

FURTHER READING: Afghanistan**,** Benin**,** Cameroon**,** CAR, Ghana**,** Guinea-Bissau, Kyrgyz Republic**,** Liberia**,** Sao Tome and Principe**,** Mauritania**,** Guinea**,** Egypt**,** Gabon, Mongolia, Moldova, Sri Lanka**,** Honduras**,** Iraq**,** Serbia**,** Jamaica**,** Seychelles**.**

3.3 Mexico's new Flexible Credit Line Arrangement

CONTEXT: The IMF Executive Board Approved a new two-year US$88 billion Flexible Credit Line (FCL) Arrangement with Mexico in December (equivalent to SDR 62 billion (700 percent of quota)). The previous arrangement in the same amount was canceled. Although the global risk environment has improved, Mexico continues to face significant uncertainty regarding the pace and outcome of the negotiations on the North American Free Trade Agreement (NAFTA). A fundamental change in its trade regime with the U.S. could have significant implications on Mexico. This scenario could lead to a sudden pull-back of capital triggered by a re-evaluation by investors of Mexico's growth prospects. Moreover, Mexico is exposed to the risk of renewed volatility in global financial markets, increased risk premia, and a sharp pull-back of capital from emerging markets. The Mexican authorities stated their intention to treat the new arrangement as precautionary. They consider that, in an environment where external risks affecting Mexico remain elevated, an FCL arrangement will play a critical role in supporting their overall macroeconomic strategy, preserving investor confidence, and providing insurance against tail risks. The authorities' exit strategy envisages the gradual phasing out of the use of the facility subject to a reduction in external risks.

NBC VIEW: The NBC supported the Mexican authorities' request for a new arrangement under the FCL. The NBC welcomes the authorities' intention to treat the arrangement as precautionary and the envisioned gradual exit from use of the facility should external risks abate. The NBC shared the concern over the increased financial risks in case of prolonged NAFTA renegotiations, and noted that while the authorities are already implementing fiscal consolidation plan, more ambitious medium-term fiscal targets may be needed to increase resilience to external shocks.

FURTHER READING: Mexico: Arrangement Under the Flexible Credit Line and Cancellation of Current Arrangement - Press Release and Staff Report

3.4 Poland ends the Flexible Credit Line Arrangement

CONTEXT: Poland exited completely from its arrangement under the FCL on November 3, after almost eight years. Over the years, Poland has treated the FCL as precautionary and continued to strengthen its foreign exchange reserves and fiscal position. Poland more than halved its access at the latest approved arrangement as a clear signal of exit intentions. Per staff the financial market reaction to the exit was muted.

NBC VIEW: The NBC welcomed Poland's exit from the precautionary arrangement and commended the authorities for very strong policy and institutional frameworks, noting that maintaining sound institutions and policies would further strengthen Poland's resilience against external risks.

FURTHER READING: Press Release on Poland ending the Two-Year Flexible Credit Line Arrangement with the IMF

3.5 IMF General Arrangements to Borrow to lapse

CONTEXT: Countries participating in the General Arrangements to Borrow (GAB) agreed that it should be allowed to lapse when its current term ends on December 25, 2018, given its diminished and limited usefulness. The GAB participants, which includes Sweden from our constituency, noted that, while the GAB has served a useful role in the past, its importance as a backstop against potential systemic shocks has declined substantially over the years. The size of the GAB, unchanged since 1983, has fallen sharply relative to quotas and the New

Arrangements to Borrow (NAB). The GAB has also not been activated in almost 20 years and the modalities of borrowing under the GAB are less flexible than those under the NAB. Furthermore, the GAB does not add to the Fund's total lending capacity, which remains strong. In light of these considerations, the GAB decision was not renewed by the IMF's Executive Board by December 25, 2017, the deadline for its renewal.

NBC VIEW: All countries participating in the GAB agreed to let it lapse at the end of the current period.

FURTHER READING: IMF General Arrangements to Borrow to lapse in 2018

4 LOW INCOME AND DEVELOPING COUNTRIES / FRAGILE STATES

4.1 Central African Economic and Monetary Community (CEMAC): Common Policies on Member Countries and Policies in Support of Member Countries Reform Programs

CONTEXT: In December, the Executive Board concluded the annual discussions with the CEMAC countries on common policies, and joint policies in support of reform programs. The sharp decline in oil revenues since 2014 continues to impair the region, economic growth has turned negative in the last two years, fiscal and external imbalances have widened, public debt has risen rapidly, and financial sector vulnerabilities have increased. The CEMAC's national authorities are implementing fiscal adjustment policies to restore their external and fiscal stability, with the support of the IMF in four countries: Cameroon, Central African Republic, Chad, and Gabon. Regional institutions also adjusted policies to assist the rebuilding of regional reserves and ensure financial sector stability. Since mid-2017, the decline in reserves has stopped, but the economic situation remains difficult. Main risks relate to an uncertain macroeconomic outlook dependent on oil prices, possible weaker-than-expected policies owing to capacity constraints and/or lack of political support, possible delays in concluding programs, and still difficult security conditions.

NBC VIEW: The arrangements under Fund's lending facilities provide an important anchor for the needed economic adjustment in the individual CEMAC countries. In the special circumstances of the CEMAC, regional institutions play a supportive role in the needed adjustment of individual countries, consistent with enforcing their regional mandate to the region as a whole because of the scale and similarity of adjustment needs across countries. The NBC is encouraged that national budget policies under the Fund-supported programs are broadly on track, but remains concerned about the robustness of fiscal assumption going forward. The NBC welcomes the new convergence framework to prevent the buildup of domestic and external imbalances in the future.

FURTHER READING: CEMAC: Common Policies on Member Countries and Policies in Support of Member Countries Reform Programs and Press Release

4.2 Review of the Low-Income Countries Debt Sustainability Framework

CONTEXT: In September, the Executive Board reviewed the joint IMF-Word Bank Debt Sustainability Framework for Low-Income Countries (LIC DSF). The economic environment has changed significantly since the framework was last reviewed in 2012 and, although the framework has demonstrated its operational value since the last review, there were areas where new features could be introduced to enhance its performance in assessing risks. The Board discussed and agreed on a set of reforms that would make the LIC DSF more comprehensive and transparent, yet simpler, by substantially reducing the number of debt indicators, thresholds, and standardized stress tests. The wide-ranging reforms should strengthen the assessment of countries' debt carrying capacity, facilitate closer scrutiny of baseline macroeconomic projections, and provide richer characterization of debt vulnerabilities.

NBC VIEW: The NBC supported the improved framework for assessing the risks to debt-sustainability for LICs. The NBC emphasized that the new framework should bring advantages to all stakeholders and better help countries avert debt distress situations. It was welcomed that the updated framework provided the basis for a richer dialogue with country authorities on how fiscal policy actions affect debt-related risks. The enhanced role of staff's judgement in the framework was also welcomed, and the NBC noted that the new Staff Guidance Note accompanying the framework should ensure staff's judgement is applied in a transparent and evenhanded manner. The NBC was also concerned about the fact that public debt levels of LICs had been increasing with the composition of debt shifting towards the short term and away from traditional concessional sources and Paris Club creditors, and that the efforts to reduce the number of false alarms should not increase the IMF and the World Bank's tolerance for missed debt-crises.

FURTHER READING: Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms

Office of the Nordic-Baltic Constituency

The Office of the Nordic Baltic Constituency presents the views of our member countries in the IMF's Executive Board in close coordination with our authorities in the eight capitals. The Office also regularly meets with representatives from the member countries' administrations or private delegations. All the positions in the office rotate between the eight member countries according to an agreed schedule and all countries are represented at all times.
As of December 2017, our staff includes:

Thomas Östros	Executive Director, Sweden
Kimmo Virolainen	Alternate Executive Director, Finland
Rimtautas Bartkus	Senior Advisor, Lithuania
Thomas Pihl Gade	Senior Advisor, Denmark
Tove Katrine Sand	Senior Advisor, Norway
Eve Anni	Advisor, Estonia
Gudrun S. Gunnarsdottir	Advisor, Iceland
Agnija Jekabsone	Advisor, Latvia
Maria P. Marin	Administrative Assistant
Tammy Timko	Administrative Assistant

International Monetary Fund. Tel.: 1 202 623 7000
Office of the Nordic-Baltic Constituency. Tel.: 1 202 623 4571, Fax: 1 202 623 5385