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Deputy Assistant Secretary for the Western Hemisphere Nancy Lee's Remarks to the Latin American Federation of Banks (FELABAN) at the FELABAN Annual Assembly in Miami, Florida

Introduction

Thank you. Good morning, and thank you to FELEBAN and to FIBA for organizing this important forum to discuss the state of the economy in our hemisphere. I am very pleased to have this opportunity to be with you.

We meet as the global economy is making a critical transition away from crisis and toward recovery. I would like to spend some time today taking stock of these developments and their impact on the region's prospects. My plan is to cover three broad topics. First, I will outline the latest developments in the historic work undertaken by the G-20, emphasizing two issues I know are of interest to you: regulatory reform and the framework for strong, sustainable, and balanced growth. Second, I will discuss the outlook for the Western Hemisphere, where we have seen how policy choices made prior to the crisis affected each country's ability to weather the turbulence of the past two years. Policy leaders are once again confronted by important choices which will determine the ability to withstand future volatility and restore robust growth. As you know, most Latin American banks have remained resilient amid the crisis. That strength can now be used to expand financial access, including to small and medium-sized enterprises and poor households. We know that these sectors have enormous untapped potential to drive growth and job creation in the region. I will describe some new initiatives we are advancing in this area. Third, I will close with a review of President Obama's agenda for economic cooperation and engagement in our hemisphere.

Global Response to the Crisis

Let me begin with an update on the global response to the crisis. Less than one year ago, with the global economy facing serious and unprecedented challenges, countries put in place extraordinary measures to stabilize financial markets and support economic activity. The United States has played a leading role in this effort. The Administration enacted a sizeable stimulus plan, and helped marshal resources for emerging markets and developing countries through President Obama's call for large scale resources to backstop the global financial system.

Conditions have improved considerably. Stresses in financial markets have declined, confidence has improved, international trade is recovering, and economic growth has resumed in most countries. While global growth is forecast to accelerate in 2010, output gaps will persist, unemployment may rise further, and downside risks remain. For this reason, G-20 leaders in Pittsburgh agreed to sustain their strong policy responses and not prematurely withdraw fiscal, monetary, and financial sector support until durable, private sector-led growth is firmly achieved. At the same time, strategies for managing the withdrawal from the extraordinary support measures are being prepared. Countries agreed to cooperate and coordinate in developing their exit strategies and to implement them in a way that does not jeopardize the recovery.

Strengthening Financial Sector Supervision and Regulation

Perhaps most dramatically, the crisis revealed gaps in our regulatory system that allowed the build-up of excess leverage and risk within and alongside the banking system. In the United States, we are working to implement reforms designed to protect consumers and investors and create a more stable, resilient financial system.

The U.S. strategy is premised on two realities. On the one hand, regulation is a national activity and the responsibility for sound regulation begins at home. On the other, our financial system is global and financial stress can spread easily and quickly across national boundaries. The United States government remains committed to preserving the benefits of dynamic and efficient global financial markets. Yet the challenge we face is how to preserve the dynamism of our markets while strengthening and respecting the national character of regulation. The answer is to be found in robust regulation at home and strong cooperation internationally, working through standard setting bodies and the informal coordination of the Financial Stability Board. The aim is to ensure more consistent and high-quality approaches and avoid regulatory gaps and arbitrage. Supplementing these efforts, the IMF can bring its critical macroeconomic and systemic focus to bear.

Last year's Washington G-20 Summit produced a 47-point Action Plan to strengthen regulation. The London Summit in April advanced that work. With much already accomplished by the G-20 Summit in Pittsburgh in September, focus shifted toward areas that would strengthen and improve the resilience of the global financial system over the longer term. Accordingly, the G-20 Leaders focused on timetables for action in four key priority areas: capital, compensation, OTC derivatives, and cross-border bank resolution.

- Capital. The Leaders' agreement recognizes that strengthening capital standards is at the core of the reform effort. The agreement tracks closely with Secretary Geithner's views set forth in early September.

- Compensation. Building on the FSB's *Principles for Sound Compensation Practices*, G-20 Leaders endorsed implementation standards to help significant financial institutions and regulators better align compensation with long-term value and risk management.

- Over-the-counter (OTC) derivatives. Recognizing that the OTC derivatives markets also allowed hidden concentrations of risk to build up, G-20 Leaders agreed that by end-2012 standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms and cleared through central counterparties.

- Cross-border banking resolution. G-20 Leaders agreed to establish crisis management groups for major cross-border firms, to require major firms to produce contingency resolution plans, and to strengthen their domestic frameworks for resolution of financial firms.

In addition, the Leaders called on international accounting bodies to redouble efforts to achieve a single set of high quality, global accounting standards. They also reaffirmed their commitment to deal with tax havens, money laundering, and terrorist finance as well as to adopt Basel II.

At St. Andrews earlier this month, G-20 finance ministers focused on full, timely, and consistent implementation of the G-20 reform program and a level playing field. The Ministers emphasized the importance of stronger capital standards, with the aim of implementing those standards by end-2012. They agreed to national implementation of compensation policies and practices to support financial stability and align with long-term value creation. They called for the rapid development of internationally consistent, firm-specific recovery and resolution plans and tools by end-2010. Finally, taking note of the rigorous processes being put in place for identification and peer review of compliance, they welcomed progress made in promoting adherence to stronger standards in the areas of prudential supervision, anti-money laundering and countering the financing of terrorism, and tax information exchange.

These are important achievements. But much remains to be done. Not only must the international community act to make sure that all G-20 commitments are put in place at the international level, each G-

20 country must now intensify its effort to help ensure that these commitments are implemented at the national level.

Forging a Framework for Strong, Sustainable, and Balanced Growth

We know that financial market stability must be underpinned by effective regulation, but global economic stability also depends critically on sustainable growth strategies. The crisis revealed critical weaknesses in the pattern of global growth. Some countries consumed well beyond their incomes, while others relied heavily on exports to generate growth and, in the process, accumulated vast amounts of foreign exchange reserves. This pattern of demand growth and global capital flows was ultimately unsustainable.

To manage the transition to a more balanced pattern of global demand, G-20 Leaders have created a new framework for economic cooperation, called the *Framework for Strong, Sustainable, and Balanced Growth.* G-20 Finance Ministers and Central Bank Governors will work together, through mutual assessment, to help ensure that our individual policies are collectively consistent and more balanced.

Finance ministers launched the Framework at St. Andrews. The first challenge will be the transition from crisis response to forward-looking policies consistent with our goals of sustainable public finances, price stability, stable, efficient, and resilient financial systems, employment creation, and poverty reduction. G-20 members have committed to take policy spillovers into account, and to communicate policies promptly and transparently.

To start the process, individual countries will present their national frameworks for mutual assessment in 2010. The IMF, World Bank, and other international organizations will provide input and analysis consistent with their expertise. In April, the G-20 will discuss any risks caused by inconsistencies in the collective G-20 policy mix. Agreed policy options to address these risks will be presented to leaders for discussion in June and action in November.

We are committed to seeing this cooperative process of mutual assessment work so as to help prevent unsustainable trajectories of debt, credit, leverage, demand, and reserve accumulation. The IMF will play a key role in assisting the assessment of G-20 policies and in providing its view on the likely balance and sustainability of the global economy.

Outlook for the Western Hemisphere

Let me turn now to the outlook for the region. As you know, economic growth in the Western Hemisphere resumed in the second half of this year. Business and consumer confidence has improved. Businesses are starting to invest. And consumers are spending. Global trade is expanding at an encouraging pace. Confidence in the stability of the financial system has been reestablished. These improvements have been more rapid and more broad-based than many anticipated.

At the start of this year, the world was confronting the very real risk of a great depression, global deflation, and financial collapse. Now, the forceful policy response of governments and central banks around the world has put out most of the financial fire and restarted growth in private activity. The IMF and the multilateral development banks have also played a crucial role in restoring stability and supporting the onset of recovery in emerging markets and the poorest countries.

The consensus of private forecasts now anticipates global growth in the range of 3 percent next year. In Latin America and the Caribbean, the IMF projects 2.9 percent growth after a 2.5 percent decline this year. Private sector consensus is even more optimistic, forecasting a stronger recovery of 3.4 percent in 2010.

As you know, the economic shock in the region was not a financial crisis, but rather a severe growth shock transmitted through capital flow reversal, a sharp decline in worldwide demand for exports, remittances, tourism, softening commodity prices, and other transmission channels. For parts of the region--Mexico, Central America and the Caribbean—the magnitude of these shocks was very large indeed.

But the vicious cycle that once plagued this region, beginning with the transmission of an external shock and devolving into financial panic, exchange rate and/or debt crises, and economic collapse, has, fortunately, not repeated itself in this crisis. This has not happened by accident, but rather by deliberate and sometimes difficult policy commitments made by many leaders in the region.

In the past decade, many countries have reduced imbalances, lowered public debt levels, strengthened monetary policy and prudential frameworks, and committed to flexible exchange rates as shock absorbers.

The externalities associated with these policies have led to stronger domestic demand and a more favorable environment for foreign direct investment, one area of capital flows less impacted by the crisis. An emerging middle class now demands a broader base of production in many countries, while conditional cash transfer programs have lifted millions out of poverty.

Countries with strong macroeconomic frameworks have passed the test of international credibility. Foreign investment is returning--both direct investment and portfolio investment. In just one example of international confidence in regional equities, this year's largest IPO in the world originated in Brazil. And, with policy rates forecast to remain low in developed markets, investors seeking yield have an increasing appetite for Latin American public and private debt.

At the same time, we must not understate the role of the international financial institutions, particularly the IMF, in helping countries weather the crisis. In this region, with its mostly restrained macroeconomic imbalances, the need in many cases was for precautionary finance to bolster confidence rather than for gap-filling finance. The IMF needed to be an effective first responder. It needed to be large enough and flexible enough to be regarded as a helpful partner.

The bold U.S. proposal for a tripling of IMF resources through an increase in the New Arrangements to Brorrow (NAB) by up to $500 billion was a key factor in stabilizing financial markets in the region. The NAB provides an insurance policy for the global economy by enabling the IMF to obtain supplemental resources temporarily when the IMF's existing resources are drawn down in circumstances that threaten the stability of the international monetary system.

The dramatic increase in resources was paired with crucial reforms in the design of Fund programs which permitted large precautionary programs with streamlined conditionality. The result has been a sharp increase in IMF programs in this region from 4 at the end of August 2008 to 15 programs in place or under negotiation today. These reforms demonstrated the IMF's responsiveness to country needs, in particular those countries with strong policy frameworks but made vulnerable by external developments, with tangible effects on market perceptions of emerging market risk. To get a sense of the impact, you only need to track the behavior of emerging market bond spreads for this region following the announcement by Mexico of its intention to pursue the new IMF Flexible Credit Line.

For some countries, the crisis generated very real fiscal financing gaps. Here the multilateral development banks have a crucial role to play. The United States and others in the G-20 called on these institutions to "make full use of their balance sheets" to address this need, and they have responded quickly and vigorously. Lending from the World Bank and the Inter-American Development Bank to this region has doubled, from $15.7 billion in 2008 to a projected $31 billion in 2009.

Of course the outlook for 2010 will not be governed only by financial flows, but also by important policy choices. The lessons from this crisis should be clear, and a window for policy adjustment to strengthen economic management has opened. Countries that entered the crisis with strong policies are now challenged to continue building credibility while addressing long-term structural rigidities. We must ensure that exceptional levels of finance remain available if needed from the international financial institutions for countries with sound policies. For countries with unsustainable public spending, large fiscal deficits, high debt levels, limits on external access to credit, and inflexible exchange rates, real challenges remain.

Latin America's financial sector will play an important role in this recovery. In the years leading up to the crisis, many countries made significant progress toward strengthening their domestic financial sectors. In a number of countries, prudential regulation and oversight were enhanced. Banks improved their access to more stable funding sources, including local deposit bases, and maintained capital above regulatory required minimum levels. The IMF and World Bank have assisted through the Financial Sector Assessment Program which seeks to identify the vulnerabilities of a country's financial system; determine how key sources of risk are being managed; ascertain developmental and technical assistance needs; and help prioritize policy responses.

The resilience shown by the banking sector puts it in a strong position to respond as demand for borrowing recovers. But success will mean managing the challenges of rising competition, declining net interest margins, and possible asset quality deterioration that may coincide with the region's economic slowdown and rising unemployment.

Policymakers and international financial institutions can help by taking measures to enhance financial sector deepening and stability. In addition to the priorities identified by the G-20, in many countries there continue to be opportunities to strengthen frameworks for crisis management, ensure the adequate design and funding of deposit insurance frameworks, create credit bureaus, improve bankruptcy frameworks, and further develop local capital markets.

Opportunities to Expand Access to Financial Services

Let me now turn to one specific element of the global financial sector reform effort. In Pittsburgh, the G-20 sought to address the impact of the crisis on the most vulnerable, in part by focusing on financial access for the poor and smaller enterprises. G-20 Leaders committed to two goals: to support the safe and sound spread of new modes of financial service delivery capable of reaching the poor, and to scale up the most successful models of small and medium-sized enterprise financing. As a first step, the G-20 has launched the Financial Inclusion Experts Group to carry out these two goals. The G-20's work in both of these areas can serve urgent needs, as well as chronic long-term growth challenges.

You as bankers know that without access to financial tools like credit, savings and insurance, episodic income volatility can translate into catastrophic long term outcomes for the poor – as assets are sold, livestock are slaughtered, fields go unplanted and children are taken out of school. Technology involved in mobile and agent banking offers the potential to pierce stubborn barriers to the provision of economically-viable financial services to the estimated three billion people that currently lack effective access.

Recent innovations have produced impressive results. For example, in Brazil, major banks have established networks of agents across the country that reach all 5,000-plus municipalities. Today, bank agents beat out branches as the number one point of service for Brazil's bank customers. And in Kenya, mobile phone-based M-PESA allows its six million plus clients to pay their bills, purchase goods and send domestic remittances via their M-PESA mobile phone service.

The success of these innovative models of financial service delivery in attracting customers reflects the groundswell of unmet financial service demand. But penetration of these services to the poorest households is still limited. Preliminary evidence suggests that too restrictive regulation may deter providers from launching new modes of financial service delivery. Through the Financial Inclusion Experts Group, the G-20 will seek to promote successful regulatory and policy approaches in order to facilitate greater financial access for the poor.

At the same time, small firms remain seriously impeded by lack of access to credit. These firms, what many have called the "missing middle", tend to fall into the gap between microfinance providers and established banks and investors that serve large corporate clients. Even before the crisis, 45 percent of small firms in low-income countries identified access to finance as a major constraint. But the current dysfunction in credit markets is clearly exacerbating the problem. Banks are now more worried about portfolio quality. Chronic problems in serving these clients are now compounded by the financial crisis.

Experts generally agree that at the core of the impediments to the flow of finance to the missing middle, particularly long-term finance, are critical information gaps on enterprise creditworthiness, firm profitability, and growth potential, as well as a shortage of firm manager knowledge and skills. Filling these gaps is critical to developing the link between small businesses and formal financial institutions, particularly local banks which are often the most effective institutions for providing finance to small entrepreneurs.

Through the Financial Inclusion Experts Group, the G-20 will launch the SME Finance Challenge, a call to the private sector to put forward its best proposals for how public finance can maximize the deployment of private finance to this sector on a sustainable and scalable basis. The G-20 will provide a mandate for the international financial institutions to implement winning proposals. To date, donor challenges have generally aimed to test the merits of new proposals by funding relatively small pilot projects. The unique purpose of the G-20 SME Finance Challenge is to take the next step by identifying the most successful pilot projects with proven track records and scaling them up. We expect that competitors in the Challenge will welcome the opportunity to shape how the official sector supports SMEs and to be acknowledged on a global stage.

Obama Administration Agenda

Let me turn from the Obama Administration's global economic leadership to its relations with this region. At the Summit of the Americas in Trinidad and Tobago in April, President Obama pledged to seek an equal partnership, with no senior or junior partner in hemispheric relations. Instead, U.S. engagement with the region will be based on mutual respect, common interests, and shared values.

Let me cite a few specifics. The Administration has taken a firm, consistent position in the context of the G-20 for strengthening the voice and vote of dynamic emerging markets in the international financial institutions, an issue of major importance to a number of countries in this region. In fact, the Administration's decision announced at Pittsburgh to support the G-20 as the premier forum for international economic cooperation opens up a whole new era in our relations with the larger emerging markets of this and other regions. There is no clearer sign that we are now prepared to share leadership in the most important global economic fora.

U.S. bold proposals and support for a strong and swift crisis response by the international financial institutions have made a real difference for this region. And we will continue to support active efforts by these institutions to help countries navigate the difficult challenges in the days ahead. This includes in some cases joint bilateral and multilateral assistance efforts. In one key example, we partnered with the Multilateral Investment Fund at the Inter-American Development Bank to address the urgent challenge of restoring stable sources of finance to microfinance institutions in the region. At the Summit of the

Americas in April, President Obama announced the Microfinance Growth Fund, a new source of lending intended to provide up to $250 million in financing to microfinance institutions in Latin America and the Caribbean. Pending approval by the OPIC Board, OPIC will provide a loan of up to $125 million to the facility.

The shift in the U.S. stance on critical global issues like climate change opens up major avenues for greater cooperation in this region. Treasury is actively working with others to address the financial implications of the creation of new emissions markets, as well as strategies to finance carbon reduction.

In the context of the political crisis in Honduras and other recent events, the Administration has taken a consistent and strong stance in support of democratic principles and governance. The credibility generated should help in the future to address some of the political fault lines in the region.

Finally, in April the President announced important changes in policy towards Cuba, including measures to increase contact between family members in the U.S. and Cuba and increase the free flow of information to and from Cuba. The changes ended restrictions on family visits to Cuba and cash remittances to family members in Cuba, expanded the list of humanitarian items that could be sent to the island, and authorized certain telecommunications services and facilities linking the U.S. and Cuba.

Conclusion

As the world begins to emerge from the depths of a severe global recession, many countries of Latin America and the Caribbean offer signs of strength, resilience, and hope for renewed poverty reduction progress. With the right policy choices, the right kinds of support from the international financial institutions, and strong, proactive financial sectors, this region can take its rightful place as an engine of global growth and development.

Secretary Geithner has remarked that we each may not be in the same boat, but we are in the same storm. The United States is committed to preserving the strong international cooperation and convergence that have been the driving forces behind our swift and effective response to this global crisis. We look forward to strong bilateral relationships and growing multilateral engagement to support strong and balanced economic growth and financial sector development. In the words of President Obama, we did not choose how this crisis began, but we do have a choice in the legacy this crisis leaves behind.