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The Honorable Christine Lagarde

Managing Director

International Monetary Fund

Questioners:

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Ladies and gentlemen, Economic Club Chairman Roger Ferguson and our speaker, IMF Managing Director Christine Lagarde.

Roger Ferguson: Well, good afternoon everyone. And welcome to this, the 429th meeting of the Economic Club of New York. I'm Roger Ferguson, the chairman of the club. The club is now in its 106th year as the nation's leading nonpartisan forum for economic policy speeches. I would like to begin today by recognizing the 185 members of our Centennial Society who have contributed their support to the club. Thanks to all of you for helping to ensure that the club is able to continue to fulfill its mission. I would also like to welcome the students who are with us whose attendance is made possible by our members. Today we are fortunate to have students from Barnard College, Baruch College, The New School, the University of Bridgeport, and The Salisbury School. So welcome to all of the students. We're glad to have you with us.

Throughout the long history of the Economic Club of New York, we've had more than 1,000 guest speakers appear before us establishing a strong tradition of excellence. Today we are fortunate to continue that tradition with Christine Lagarde, the 11th managing director of the International Monetary Fund. Madame Lagarde was appointed to the post in July of 2011 and she is the first woman to lead the IMF. Indeed in many ways she's been a trailblazer throughout her career. Prior to joining the IMF she served as France's Finance and Economic Minister, the first woman to hold that post in any G7 country. She joined the French government in 2005 as Minister for Foreign Trade. Prior to that she was the chairman of the Global Economic, I'm

sorry, the Global Executive Committee, and of the Global Strategic Committee of the law firm Baker and McKenzie. Madame Lagarde received her law degree from Paris West University and her master's degree from the Political Science Institute in Aix-en-Provence. We are quite pleased and honored that she is with us and that she has chosen our meeting to make her annual speech opening the Spring IMF and World Bank meetings. Madame Lagarde, we are eager to hear from you. The podium is yours.

Christine Lagarde, Managing Editor, IMF

Well thank you very much. Merci beaucoup....(speaking in French)...Monsieur President. That's a moment of pause where you think, oh, my gosh, is she going to give her speech in French? And Roger hopes I am. Well, thank you very much to you, chairman, and President Jan Hopkins, for inviting me today. I know that Wendell Wilkie–a presidential candidate back in the 40s–once described the Economic Club as "the foremost non-partisan forum in this country." And that's a blessing. When it comes to the cutting edge of economic policies, I'm sure that that will be the case as well. You actually provide as such an invaluable public service, and you should be thanked for that. And I'm delighted to be joining you today.

Now next week, as you just mentioned, we will be hosting the Spring Meeting at which we welcome the representatives of the 188 members–all countries–that constitute the membership of the IMF. We will then release the latest economic forecasts that we have for the world economy. And unfortunately that will be done next week and in Washington.

But, although I will not mention numbers today, I will try to give you a general sense of what the major issues are based on what we see.

The big question, of course, is where does the global economy stand? Five years after Lehman, is the world finally getting back on a positive path? And I really wish I could give you a very simple answer to that but, unfortunately, the truth is just a bit more complicated, and it looks like a mosaic.

The good news is that after a particularly volatile period, financial conditions are showing signs of improvement. You, of course, have noticed. Thanks to the action of policymakers, the economic world no longer looks quite as dangerous as it did nine months ago. Yet we do not expect global growth to be much higher this year than last year. We are seeing new risks on the horizon and the legacy of some old risks that have not been completely dealt with. In far too many countries, improvements in financial markets have not actually translated into improvements of the real economy and in the lives of the people.

The differences between regions are also starker than ever. We are now seeing the emergence of what I will call a "three-speed" global economy–those countries that are doing well, those countries that are on the mend, and those countries that have quite a bit of distance to travel. And each of these three groups faces different challenges. They are hugely interconnected, but they share the need to put in place policies that will repair the consequences of the crisis and

hopefully will prevent its recurrence.

I'd like to quote Walt Whitman at this point who said it beautifully. "Keep your face always towards the sunshine, and shadows will fall behind you." Apply that to the economy. Make sure that you put policies in place facing the reality, the harsh reality sometimes, and the shadows will fall behind you.

So let me talk about two things today.

First, the policy requirements that are needed for each of the three categories that I have mentioned. And then let me turn to those policies that actually face all countries and transcend those different groups. The whole purpose of the exercise in terms of the different policies and those that transcend the groups is to try to actually stay ahead of the crisis and not behind the curve.

So let me begin with the priorities of the three different groups.

The first "speed" group of the three includes the countries that are doing quite well. And that group is essentially comprising the emerging markets and the developing countries. Why is that? Well, because many had to grapple with their crisis in their own days. They were well prepared, and they entered the crisis from positions of strength with sound policies in place. Think of East

Asia, for instance.

In fact, for the past five years, those countries, emerging market economies and developing countries, have actually shouldered two-thirds of the growth that we have observed. And after a slight slowdown last year, they are back–not bouncing–but they're back a little bit higher and better than last year. Today, developing Asia and Sub-Saharan Africa are the two fastest growing regions in the world, and those countries will legitimately want to consolidate their success.

But at the same time, these emerging market economies are looking at the advanced countries with some serious concern. Many are worrying about the potential fallout from exceptionally loose monetary policy, especially from unconventional easing. And I don't think that I have attended a G20 meeting in the last two years without having heard from the emerging market economy representatives their concern about those policies. It essentially focused around QE 1-2 and so on and so forth. It now includes, of course, the ECB, to a lesser extent the Bank of England, and obviously today the Bank of Japan.

But let me emphasize that from the IMF perspective, under the present circumstances and for the time being, from our perspective it makes sense for monetary policy to do the heavy lifting in this recovery by remaining accommodative. We know that inflation expectations are well anchored. We just published a particular study yesterday that said, the inflation–the dog that

doesn't bark–a particularly tasty title. But that should give central banks greater leeway to support growth.

However, experience also tells us that these monetary policies can have unintended consequences. Low interest rates push people to take on more risks–some of which justified, some of which not so justified.

So across the emerging economies, policymakers worry that exceptionally loose monetary policy will affect exchange rates, will affect capital flows, will threaten financial stability through high asset prices and rapid credit growth. The greatest worry is that "what goes up comes down" applies equally, "what comes in goes out"–a sudden reversal of large and volatile capital flows that can bring down the economy with it. Right now, the risks appear under control. Capital is flowing to emerging markets, also and predominantly because those markets have good policies and good prospects.

But we, and particularly central bankers, must be alert to any warning signs. Let me take just a couple of examples of what effects are produced. Corporations in emerging markets, for example, are taking on more debt and foreign exchange exposure. Over the past five years, foreign currency borrowing by firms in emerging markets has risen by about 50 percent. And over the past year only, bank credit has increased by 13 percent, 1-3, in Latin America and 11 percent in Asia. So when the tide turns, and interest rates will begin to pick up again, these

hidden dangers might well be exposed to the cold light of day.

So what consequences does it have in terms of policies for those countries? They will need to boost their defenses. This includes reconstituting the fiscal policy space that has eroded during the crisis because they had to use it, so they have to rebuild those buffers. And they also have to step up their banking and financial sector supervision and regulations. The right macroprudential policies obviously depend on specific country circumstances. But probably it will take any of these following forms: limiting credit growth in rapidly-expanding areas. And some countries are doing it. When you look at the real estate development market in China, for instance, this is clearly the case. Imposing capital requirements that move with the cycle, we know that some countries have already begun doing it. Reinforcing their local financial markets in order to actually manage this inflow of capital. And closely monitoring foreign exchange exposure.

Those policies will serve them well, but they will also need the cooperation of the advanced economies because they bear responsibility here, in terms of delivering a better fiscal policy and more financial repair–thus relieving some of the burden that is currently shouldered predominantly by the central banks.

Now we can hope that with that cooperation and with the right set of policies on both sides of the capital flow, the risks can be managed, and the emerging markets and developing countries can expect to continue their forward momentum in the "first speed" group of economies.

Let me now turn to the "second speed" group of economies–those countries that are on the mend. Those countries have actually come to grips with some fundamental policy issues. Those countries include the United States of America, but also countries like Sweden and Switzerland.

Let me dwell with the U.S. for a moment. The crisis began here, began here because of financial excess. Now since then, the United States has made rapid and substantial progress in repairing its financial system, as well as the household debt situation. It is paying off. Credit conditions, housing markets, unemployment have begun to tilt up. And we are seeing growth underpinned by solid private demand.

Does that mean that everything is settled? No. Far from it. An outstanding issue is that public finances appear unbalanced. Adjustment is too aggressive in the short term and way too timid in the medium term. This adds to uncertainty and it casts a shadow on the recovery. So the shadow is not behind, it's ahead of us.

Yet, you will say, the fiscal cliff has been avoided. But this year, fiscal adjustment is still, in our view, outsized. At 1.75 percent of GDP, it's too much. Sequestration alone–if not reversed– could cut a half percentage point of GDP from growth. This risks throwing away much needed growth, especially at a time when too many people are still out of a job. By the way, it's also an extremely blunt and blind instrument imposing deep cuts in areas that don't need the deep cuts

and leaving untouched the key drivers of long-term spending.

Turning to these longer-term issues, timing is key. Progress has been made, with the deficit actually–actually that's a number that we tend to forget–with the deficit falling by five percentage points since 2009. Despite this massive reduction by all accounts, the United States deficit still ranks amongst the highest of the advanced economies. In fact, government debt is expected to reach 108 percent of GDP this year. In our view, this path is just unsustainable.

And at this point in the recovery, it is more important than ever to put in place a credible, medium-term roadmap to bring down the debt–a balanced plan that will be based on savings in entitlement spending plus additional revenues.

Such a plan would, in our view, support the recovery in private demand. This is a major policy challenge facing the United States today and it has to be met. Otherwise, the substantial gains that we have are likely to be eroded and possibly lost.

Let me now turn to the "third speed" category of the global economy–the countries that still have a distance to travel. And here obviously I have in mind the Euro Area and Japan.

Starting with the Euro Area, the European policymakers have accomplished a great, great deal of work in the last couple of years–including the European Stability Mechanism, the firewall that

we called for, the European Central Bank's Outright Monetary Policy that came to top off a series of measures that were taken by the European Central Bank and that actually helped prevent a collapse last year, the single supervisory mechanism which has been decided which is underway, and the Euro partners agreement to actually help relieve the debt burden of Greece amongst others. We should applaud this. It is not easy for 17 countries to agree to and implement such major shifts of policy in such a relatively short period of time. I know what you will say. So, but they're at it, and at it, and you hear about it, and it seems to be never over. Well, it's a big road to travel when you actually move from having your own set of policies to having a set of policies, both monetary, currency as a result, fiscal, banking supervision, amongst 17 independent sovereigns.

At the same time, while they have accomplished so much, there is plenty to do. Let me give you the example of the periphery of the Euro Area, not the core, the periphery. Many banks there are still in an early stage of repair with not enough capital and too many bad loans on their books. And even outside the periphery, in the core, there is a need to shrink certain balance sheets, reduce reliance on wholesale funding, and improve business models for some of them.

And that's a real issue. Why is it? Well, because of that situation, the monetary policy which is combative and inventive on the part of the ECB, in a way it's spinning its wheels, meaning that low interest rates that are decided at the European Central Bank level are not affordable, are not translated, are not conveyed, are not transmitted to credit for the people, for the enterprises that

need it. The plumbing is clogged, if you will, and we're seeing more financial fragmentation. A few examples–across the European periphery, credit has contracted by five percent since the onset of the crisis, while at the same time those markets have grown in their active population. So the priority must be to continue to clean up the banking system by re-capitalizing it, restructuring it, or where necessary sizing it down by shutting down some banks. The idea is coming along which was very, very unheard of for many years.

In an economic and monetary union, financial problems are common problems. So the Euro Area needs to find common solutions as well. One option–much debated, not accepted by all–would be the direct re-capitalization by the European Stability Mechanism, the ESM, of those banks that are of systemic nature and size.

Now beyond this repairing and restructuring as it should be, the banking sector, the Euro Area also needs a real banking union in order to strengthen the foundation of their monetary union. This means complementing what they have agreed already which is that single supervisory system, the ESS. It's plenty of E-something, but this one is important, ESS, which will hopefully be completed in the course of 2014. But that will not be enough. In addition to that, they need to have also a single resolution authority, and deposit insurance backed by a common fiscal backstop. We have seen that when trying to deal as adequately as possible and it was difficult in the Cyprus situation. Only .2 percent of total Eurozone GDP, less than a million people, but probably the most complicated issues that we had to deal with when it comes to

Eurozone rescue plan.

And it's only once all those components will be put in place that this poisoned chord between banks and sovereigns will be properly severed and cut. Only then can monetary policy be fully effective and only then can financial stability be fully assured.

I have not touched on the fiscal consolidation process that has to take place in most of those countries. I would need another half hour, Mr. President, so I will skip that. But there is clearly work to be done at an appropriate pace on a country by country basis, not on a one-size-fits-all, and with due respect to the limited growth that needs to be encouraged.

Let's now turn to Japan. The priority here for Japan is to finally break free of this deflation trap and to restore economic vitality. And in this vein, the recently-announced framework of ambitious monetary easing–geared towards achieving a high inflation target–2 percent, and doubling the monetary mass, is in our view a positive step. It's debated. Some people have different views. But under the present circumstances and for the time being, it's a positive step in our view. Japan needs to rely more on monetary policy to kick-start growth because there's not much else.

However, for this to succeed, Japan must also move ahead in other areas–including in fiscal policy, which looks increasingly unsustainable with the public debt now approaching 245

percent of GDP, 245 percent, largely held domestically you will say, but still. So as an urgent priority, Japan needs a clear and credible plan and path to lower public debt over the medium term. The signals that we will hear from Japan concerning their consumption tax, the principle of which has been agreed and should be implemented shortly, will be critical for that matter. It also needs, just like the Euro Area, comprehensive structural reforms to shift the economy into higher gear.

So those are the three sets of policies that these three groups of countries, moving at three different speeds in the recovery, should be adopting through a cooperative process because they need each other and they complement each other.

There is another set of overarching issues that transcend all three groups. And these issues have been with us since the beginning of the crisis. They are familiar. They've been partially addressed but they have not been fully resolved. I've picked those three because they seem critical to us, to unclog the system, and to make sure that countries actually stay ahead of the crisis: financial sector reform, more balanced global demand, and more emphasis on growth, jobs, and equity. Let me first mention the financial sector reform.

The bottom line of this reform that many of you are working on, are concerned about, is that we need a global financial system that supports stability and growth. Until now this has been lacking. And in too many cases–from the United States in 2008 to Cyprus today–we have seen

what happens when a banking system chooses the quick buck over the lasting benefit, backing a business model that ultimately destabilizes the economy.

And in our view, we cannot afford to have a pre-crisis banking system in a post-crisis world. We need reform, even in the face of pushback from the industry which sometimes feels overwhelmed and is not particularly keen to abandon some often very lucrative but very risky and highly leveraged lines of business.

Global policymakers have made quite a lot of progress, whether it relates to capital ratios, to liquidity requirements, capital surcharges on the global mega-banks, as well as clear standards for supervision and resolution. The FSB has done a great job. The Basel Committee is at it in a very unlikely expeditious way and standards are coming out.

To stay ahead of the crisis, we need to see more progress in other important dimensions. What do I mean by that? For a start, the "oversize banking" model is still very dangerous. And I know that many of those that were oversized have significantly shrunk over the last few years. But for some of them, it seems to us that more needs to be done. We must get to the root of the problem with comprehensive and clear regulation, more intensive and sometimes intrusive supervision as well as frameworks for orderly failure and resolution–including across border resolutions, added to which there has to be authorities that are empowered to oversee the process and that have the budget to adequately do so.

What other issues? Well, one comes to mind and it was picked up, I think, by the Times this morning, derivatives which are still the dark side of the financial system. As of last September, one in ten credit default swaps were cleared through central counterparties. Another one, shadow banking, which is still a shady corner towards which risks appear to be gravitating. And this is not just an issue for advanced economies. As we all know, there are some emerging market economies, including China for instance, that are growing this shadow banking sector at an unprecedented pace.

The financial sector reform efforts must be coordinated internationally. We are already seeing countries that are coming up with their own scheme, with their own system, with their own committee of wise men and women–more men than women actually–with a particular scheme. And some of them are very remarkable but they're not very coordinated and they expose us to a disjointed system where there will be space for arbitrage. So completing financial sector reform is the first of the overarching issues that we are facing. And I will say here, job not finished yet.

The second, that transcends all three groups, a more balanced global demand. For too long, the pattern of growth has been a high-wire act between regions with large current account surpluses on the one hand and those with large current account deficits on the other one. And the good news at the moment is that that difference has begun to reduce. It's good news but it's not that great of a good news because a lot of that is caused actually by one side and comes from actually

lower demand in deficit countries, not by higher demand in surplus countries.

And there is a need for that high demand in surplus regions which means different things for different countries and for the different regions. Let's take the example of Germany for instance. It means doing more to boost investment. For China, it means doing more to boost consumption and moving further towards–for both countries actually–towards a services-oriented consumer-based economy. It's not going to happen overnight. It will take time, and the process has begun. The Chinese authorities are very well aware that that process has to continue and that the policy of encouraging investment, for instance, has to be tempered by an eye on the quality of investment that is being made.

In addition to that, China's re-balancing strategy depends also on its financial sector. And reform in this field will actually pursue different goals–supporting more balanced growth, more inclusive growth, and a safer financial system that helps the real economy. The priorities there will include continued interest rate liberalization, improving risk management, strengthening regulation, supervising the shadow banking sector, and controlling the debt that is piling up in some of those local governments and provinces.

Okay, let me finish now with the third issue that transcends all three groups–more growth, more jobs, more equity. In other words, more attention to the issues that actually matter to people. This is something that we take seriously at the IMF.

With over 200 million people out of work today, job creation is an urgent priority. Why? Because a high level of employment is the best guarantee for a vibrant economy and a healthy society. Without this, we risk a wilderness of wasted potential and ruined ambition–particularly those of the young generation.

The best way to create jobs is through growth. This comes first, with the right balance of demand-side and supply-side policies. But policymakers can actually do more. They can deploy labor market policies to spur job creation more directly, while at the same time accepting fiscal policy sustainability. Now what does that include? It includes education, professional training, vocational training, hiring and wage subsidies, public works programs, child care subsidies, lower taxes on labor, and what have you. And it applies across the board, not in advanced economies only. It applies in other countries–particularly in some of the developing countries.

Now this is not enough. In addition to growth and jobs, we need more equity and inclusion. Equity matters because a more balanced distribution of income leads to a more sustained growth and greater economic stability. So it's not only out of human concern for those that are looking for a job, but it makes sense economically, and we have done sufficient research at that point to actually demonstrate that together with more equity and better distribution of the fruit of growth, there is a more sustained economy. Because let's face it, inequality is too high in too many countries, and it has not abated during the crisis, quite to the contrary.

Equity matters also, as tough times continue, we see signs of adjustment fatigue and rising social tensions. And this is not just, or primarily, because of the adjustment itself–because people understand that they cannot live beyond their means for too long–but it's because of that impression that the burden is unfairly shouldered. It is perceived as unfair.

And just as the pains of adjustment have to be shared, the gains of growth have to be shared as well. It matters to people in crisis countries–particularly in the advanced economies that have not been used to that. It matters for the people in the Arab transition countries seeking a new departure based on dignity and justice and who are looking for jobs, who are looking to more fairness. It matters for the two and a half billion people struggling to survive on less than $2 a day.

But there is no magic bullet here, but there are options. Most urgently, and we certainly see that when we design programs in crisis countries, we should protect the people most affected by crisis and make adjustment as fair as possible by protecting basic social services, by assuring progressivity in taxation, and by combating tax evasion.

Let me mention another measure that is also available–particularly for those countries–the subsidies. Hah, but you'll say subsidies....Well, subsidies will help if they are reformed. Take energy subsidies, for instance. Not only do they hurt the planet, but they help the rich at the

expense of the poor. The IMF has estimated that these subsidies, including tax subsidies that go with it, ate up almost $2 trillion in 2011, $2 trillion. That is roughly 2 ½ percent of global GDP. Now clearly these are resources that could have been put to much better use if they had been reformed. I'm not suggesting that they have to be removed completely, but they have to be reformed to actually target those that most need them.

So I've talked essentially about existing risks, sometimes legacy of the way in which we have dealt with risks. I'm sure there are new risks on the horizon, and they will come in due course and materialize. It might have to do with unwinding some of the measures that have been taken. Just as it is hard to unwind the massive global stimulus that was put in place in 2009, the unconventional monetary policy will have to be gradually peacefully withdrawn as well as employment picks up with a due regard for inflation. That's only one of them. There will be more I'm sure.

So let me conclude. The crisis has been long, hard, and bitter on many. And the priority, as we see an improvement in the financial situation, I mean the market is zealous at the moment, is to actually take advantage of that moment when the right policies have been taken–particularly by the central banks–to make sure that others are going to also take the baton so that central banks cannot have to shoulder so much of it. That breathing space is now, and this is the moment. We cannot afford to just let it go. As Rainer Maria Rilke put it–I like to finish with poetry– "The future enters into us, in order to transform itself in us, long before it happens."

So we're not back to the future. We're actually preparing the future that lays ahead of us. And I hope that, for all the students that are attending this forum, we will all together in a cooperative fashion try to do a good job. If not for us, for them. Thank you.

QUESTION AND ANSWER PERIOD

ROGER FERGUSON: Thank you very much, Madame Lagarde, for that very insightful, wide-ranging, and thoughtful speech. We greatly appreciate it. As is our custom, Madame Lagarde will now be questioned by two of our club members. Today we'll have Jane Hartley who is one of our trustees and also CEO of the Observatory Group serving in that role, and also Martin Dickson who is the U.S. editor of the Financial Times. If you wait one minute, we are all going to process to the front so that Madame Lagarde and the two questioners may be seated during the question period. Thank you. So Jane, the first question will be yours.

JANE HARTLEY: Thank you so much for that insightful speech, but most importantly thank you for your leadership role at the IMF during these very, very turbulent times. Okay, I've been instructed...my first question has to do with your "third speed" countries. Many of the periphery countries in Europe–Italy, Spain, Greece, and Portugal–remain mired in recession notwithstanding the efforts they have made to address their economic problems. Can the political and social structures in these countries hold up much longer without clearer signs that

they will exit from the recession soon?

THE HONORABLE CHRISTINE LAGARDE: Well, I'm pleased to talk about exiting from the recession, and nothing else in terms of exit, because I think your question is very much to the point. The other one would not have been. You know it's, as I said, I did not discuss the fiscal consolidation issue and I'm happy to touch on that. We believe that for most European countries fiscal consolidation is a must simply given the level of debt, the deficit that they incur, and the reforms that have to be put in place. Equally we believe that it's a question of pace. They don't have to be brutal and abrupt and massively front-loaded all. Those that are under financial pressure clearly have to demonstrate the ability to do so. They have to be mindful of the social fabric of society. And that's where, you know, there's a balance to be had between how much is called for and how much is tolerable. And it will be, you know, for those governments in power duly elected with appropriate coalition support when they are in coalition, to actually lead, show the way, and have the courage to put in place those measures while depicting what is next and what is after this difficult process. It's probably, you know, I've been in government, it's probably the most difficult thing to do, to actually describe how difficult it's going to be for the short term and be able to consider the longer-term when you are no longer probably in position because you will not have been re-elected.

JANE HARTLEY: It's a very hard challenge politically, a tough political challenge.

MARTIN DICKSON: The short term is always, with politicians. Can we stick with Europe for a moment, and can you say what's the main lesson the IMF has learned from its involvement in Eurozone rescues where I think sometimes, perhaps often, the fund has found itself at odds with the pace and some of the policy recommendations coming out of Europe in rescue efforts?

THE HONORABLE CHRISTINE LAGARDE: Well, first of all, it's always more complicated when you have to agree with others, okay. If you're on your own, you set the terms, you discuss the program with members of government, you hopefully generate the buy-in, and it becomes their deal, their program, their conditions, and their future. In the case of any of those European programs, whether you talk about Ireland, Greece, Portugal, and now Cyprus, we had to agree, because that was the rule of the game, that we had to work as a troika. Yes, it is more difficult. And there have been occasions when we were milder, occasions when we were tougher. I would say that in the main, in terms of fiscal consolidation path and pace, generally we proposed slightly longer duration. It was the case for Greece where I managed to convince the European leaders that a bit more time was needed for them to actually produce the required consolidation. When it came to fiscal or tax reforms, we were generally a lot harder than the other partners, but that's because we've seen it all before and we know that those measures have to be taken up front and quite–I wouldn't say brutally, but you know with great determination–because you know traditions keep creeping in. And if you don't take the hard measures right up front, it doesn't happen. So Voila...

JANE HARTLEY: You mentioned Cyprus in your speech.

THE HONORABLE CHRISTINE LAGARDE: You all talk about Europe....

JANE HARTLEY: I think we have China and Japan too if we have time. Are you concerned that the move to impose a haircut on depositors in connection with the recent Cyprus package is going to have the unintended effect of making people reluctant to invest in banks of other E.U. periphery countries, and therefore, actually make the conditions of these banks worse?

THE HONORABLE CHRISTINE LAGARDE: You know I think there is a process going on in the Eurozone in particular which was needed, which is to actually set the terms and give people, whether they're investors or whether they are depositors, an understanding of what the pecking order is. And to remember that the banking sector, while clearly different from other sectors, is also a sector that has its risks. No investment is completely, you know, resolution-proof. And deposits have a certain degree of guarantees which have to be respected. But I think the process that is at play at the moment in Europe is actually a good one because it's a combination of the restructuring and re-capitalization of the sector, proper assessment of the debts that are in balance sheets, appropriate stress tests that are diligently communicated, and a resolution process that will come into play. So, you know, Cyprus was, as I said and I'm happy to repeat it, it's no template. It doesn't set standards because it was not standard itself. It was vastly different from many banks in other regions and in other countries in Europe.

MARTIN DICKSON: Can we turn to emerging markets where I think in some major markets, there's very much a growing risk of financial bubbles. And you mentioned in your speech today about hidden credit dangers and you offered some policy prescriptions. Clearly China is very important in this respect. And I just wonder do what extent you feel the new government in China is willing to take the tough medicine needed?

THE HONORABLE CHRISTINE LAGARDE: My sense, and I'm no expert on China, and the more you become expert, the more you know that you're not. There was an old Jean Gabin film in which he said...(Speaking French)...which is essentially what I just said. But it seems to me that, number one, they are reformists. Number two, they seem very concerned about the dark side or the downside of the economic development and they want to deal with it, so they say, but they seem to be determined. And my hunch is that they want to avoid the bubbles. I think the monetary policy that we see at the moment, the macroprudential measures that they're taking, the sort of, no residential or one residence per family and not two....it reminds you of something–those were babies–which was also the natality policy and it worked at the time, there is an indication that they are mindful of it, they are watching, and they are prepared to take the measures to prevent it because they know how dangerous it could be. Now there is one sector which they know they have to watch for as well and that's the local government sector.

MARTIN DICKSON: The debt.

THE HONORABLE CHRISTINE LAGARDE: Yes.

ROGER FERGUSON: Madame Lagarde, Jane, Martin, thank you very, very much. Thank you. Ladies and gentlemen, lunch is to be served, but before lunch is served, I would like to remind you that the Second Economic Club of New York Leadership Award will be presented to Paul Volcker at a lunch here at the Hilton on May 29. We will hear from Paul at that time. So thank you all very much for coming today. Please enjoy your lunch. And then for those on the dais who are going to sit at the head table, now is the time to move.