

Characteristics of IMF Exchange Rate Surveillance: A Full Review of Country Documents

1. This background document describes how exchange rate issues were treated in the last two Article IV consultations of the 1999–2005 period.¹ For this purpose, the IEO reviewed the following Article IV consultation-related documents:

- Staff reports;²
- Those selected issues papers, finalized between 2001 and mid-2006, that primarily addressed exchange-rate-related issues;
- Briefing papers and back-to-office reports;
- In the case of program countries, staff reports, briefing papers, and back-to-office reports for use of Fund resources missions that fall in the same period; and
- Other documents, including comments received from departments and management on draft papers.

2. In addition to the documents on member countries, the IEO also reviewed the corresponding documents for Aruba—Kingdom of the Netherlands, Hong Kong SAR, Macao SAR, Netherlands Antilles, and West Bank and Gaza, as well as for the Central African Monetary and Economic Union (CEMAC), Eastern Caribbean Currency Union (ECCU), euro area, and West African Economic and Monetary Union (WAEMU). All in all, the assessment included a total of 191 economies.³ The data sets (constructed as the responses to standard questions) compiled from the review are attached as annexes to this background document.

¹Most (but not all) of the missions took place in 2004 or 2005.

²The document of reference was the latest version of the Article IV report available (i.e., the published version for those that are published); these were then checked for corrections and/or deletions to confirm whether relevant changes had been made from earlier versions.

³The assessment excluded entities with which no Article IV consultation took place (Somalia and West Bank and Gaza), but included those for which only one consultation had been completed in recent years (Iraq and Grenada), as well as countries in the process of redefining their political and economic boundaries (Serbia and Montenegro).

Coverage of Exchange Rate Issues

3. Every Article IV staff report and mission brief mentioned exchange rates, but the extent of coverage varied (Figure A4.1). Consistent with the standard template, the staff reports always described the exchange rate arrangement in a policy discussion section as well as in an appendix; they often devoted one or more paragraphs to the exchange rate in sections describing economic developments and outlook, as well as in the staff appraisal. The number of paragraphs in staff reports referring to exchange rate issues ranged from 3 percent to 50 percent of total. In contrast to the staff reports and mission briefs, the back-to-office summaries (which were sent to management) show an even greater variation in their treatment of exchange rate issues, because they are less template-driven and tend to highlight those points that the mission chief considers particularly important for management. Exchange rate issues were absent from the back-to-office summaries in 86 cases. Finally, IMF staff prepared at least one selected issues paper on exchange rate issues for 132 (out of the 191) economies during 2001 to mid-2006.

Figure A4.1. Exchange Rate Coverage Across Countries
(Percent of paragraphs)

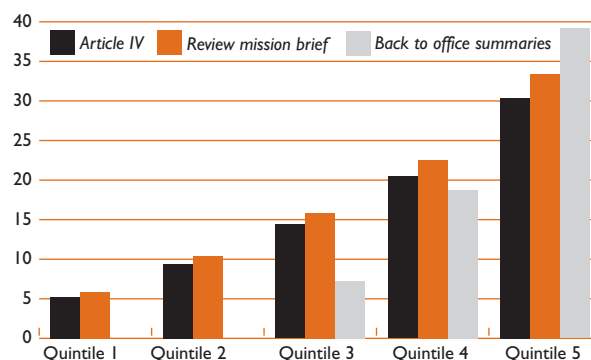


Figure A4.2. Elements in Staff Exchange Rate Assessment

(Number of cases)

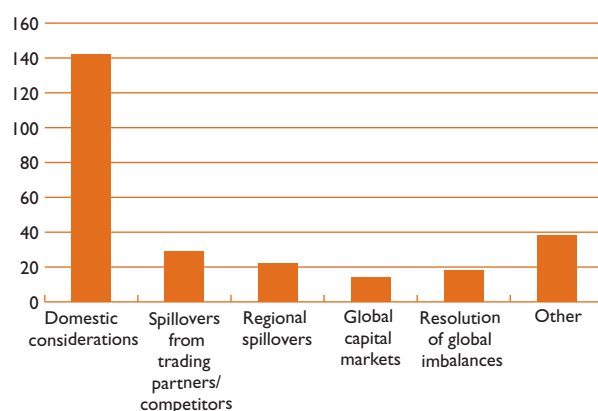
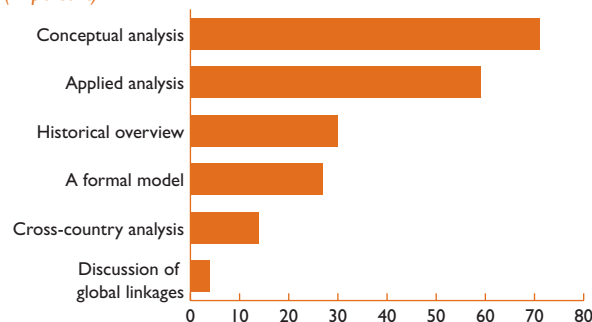


Figure A4.3. Elements in Selected Issues Papers, 2001–06

(In percent)



Content of Exchange Rate Coverage

4. In more than 100 cases,⁴ competitiveness considerations prompted a discussion on exchange rate levels. For most of the IMF membership, the staff exchange rate assessments did not focus on spillover effects, global capital markets, or global imbalances (Figure A4.2). Especially for small countries with limited integration into global capital markets, the discussion of exchange rates limited itself to domestic considerations, such as the implications of the prevailing exchange rate regime for fiscal policy or the impact of exchange rate movements on domestic inflation and competitiveness.

5. In a majority of the country cases, the orientation of the exchange rate discussion was predominantly forward looking. For example, such discussion included projections or scenarios of possible exchange

⁴In at least one of the two consultations reviewed.

rate developments, with associated upside and downside risks to the economy. Only in two cases was the discussion exclusively backward looking. The discussion was frequently linked with other elements of macroeconomic policy, in many cases exploring either the likely implications of various domestic developments for the exchange rate or pointing out the implications of an exogenous exchange rate development for fiscal and monetary policy.

6. Similar patterns were observed in the selected issues papers. A large majority (about 70 percent) contained conceptual analysis that outlined a framework for thinking about the issue at hand (Figure A4.3). This was often linked to specific country circumstances through applied analysis (about 60 percent), in which staff presented empirical data to illustrate an issue or to support arguments. Formal models were used in about 30 percent of the cases. Literature surveys and historical overviews played supporting rather than central roles. The IEO review found only seven papers that contained neither conceptual nor applied analysis. It was, however, rare to find cross-country analysis in selected issues papers that dealt primarily with exchange rates, and in only 4 percent of the exchange-rate-related selected issues papers (11 papers, as listed in Table A4.1) was there a discussion of global linkages.⁵

Description of De Facto Exchange Rate Regimes

7. Eight categories of de facto exchange rate regimes were identified in Article IV documents. In at least 12 country cases (some 6 percent of the sample), the IEO found inconsistencies between MFD/MCM’s de facto regime classifications and the descriptions provided in either the body of staff reports or their appendices on IMF relations (Table A4.2).⁶ Over the period examined, the review noted changes to de facto exchange rate regimes in 15 countries (or about 8 percent of total).

Exchange Rate Advice

8. In about half of the country cases, the staff appraisal section of Article IV reports suggested that the

⁵Several global-linkages-related selected issues papers for major countries, particularly the United States, did not focus directly on exchange rate policy. Such papers are not included in Table A4.1 or Figure A4.3.

⁶Of these 12 cases, 8 cases involve retroactive reclassification by MFD/MCM; in many of these, classification lags resulted from a difference of opinion about the appropriate regime classification between departments or between staff and the authorities.

Table A4.1. Global Linkages in Selected Issues Papers, 2001–06

Economy	Year	Paper Title	Description of Contents
Canada	2005	The Effects of U.S. Shocks on the Canadian Economy: Results from a Two-Country Model	Minimalist presentation that models spillovers
China	2003	Some Implications of China's Growth and Integration with the Global Economy	Sees no sign of misalignment, but links integration with global economy to need for flexibility
China	2006	Implications of Greater Exchange Rate Flexibility in China and Other Asian Emerging Market Economies	Summary of <i>World Economic Outlook</i> , GEM model for 5 percent appreciation scenario in China and Asian emerging markets (<i>WEO</i> 9/2005)
Euro area	2001	Why Has the Euro Been So Weak?	Explores theories, leans toward shift in portfolio behavior and surge in equity values
Euro area	2002	Euro Area Trade Flows and the Exchange Rate: How Much Disconnect?	Explores why current account did not strengthen during euro depreciation
Euro area	2003	Exchange-Rate Pass-Through and External Adjustment in the Euro Area	Thorough model-based empirical analysis of effects of exchange rate shock in Europe; cross-country comparison, discussion of global imbalances
Euro area	2004	Global Rebalancing of Current Accounts: A Euro-Area Perspective	Euro area should boost domestic demand, attract foreign capital, increase competitiveness through structural reform, ease monetary stance
Japan	2001	Japan and Asia: Policies and Prospects	G-Cubed regional model used to assess transmission of shocks and policies (including quantitative easing and yen depreciation) between Japan and neighbors
Japan	2005	The Domestic and Global Impact of Japan's Policies for Growth	Extended version of GEM model used to generate baseline plus two alternative scenarios assessing impact of fiscal, structural reforms on Japanese and world economies
Mexico	2003	Explanations for the Recent Behavior of the Mexican Peso	Surveys global exchange rate links. Cross-country analysis and policy shock of change in reserve management strategy
Thailand	2005	The Role of Interest Rates in Business Cycle Fluctuations in Emerging Countries: The Case of Thailand	Uses GEM to argue that more exchange rate flexibility helps economy to better absorb U.S. interest rate shocks

Table A4.2. Cases of Inconsistent De Facto Exchange Rate Regime Classifications

Economy	Classification (2004–05)			
	MFD/MCM classification ¹	Description from staff report ²	Description from appendix on Fund relations ²	Reference document
Argentina	Managed float	Peg	Managed float	2005 staff report
Azerbaijan	Peg ³	Peg	Managed float	2004 staff report
Egypt	Peg ³	Not explicit	Managed float	2005 staff report
Ethiopia	Managed float	Crawling peg	Managed float	2005 staff report
Iran, Islamic Republic of	Crawling peg ³	Managed float	Managed float	2005 staff report
Liberia	Managed float ³	Not explicit	Independent float	2005 staff report
Madagascar	Managed float ³	Managed float	Independent float	2005 staff report
Nigeria	Managed float	Horizontal band	Managed float	2005 staff report
Pakistan	Peg ³	Peg	Managed float	2005 staff report
Papua New Guinea	Managed float ³	Independent float	Not explicit	2005 staff report
Tanzania	Independent float	Managed float	Not explicit	2004 staff report
Yemen	Managed float ³	Not explicit	Independent float	2004 staff report

¹IMF, Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) database, March 2006; regime classification corresponds to year of IMF staff report.

²As inferred by the IEO from the description in the text of the staff report or the appendix on Fund relations.

³De facto regime was retroactively reclassified by MFD/MCM; information in table thus differs from the classification published at the time.

Table A4.3. Exchange Rate Advice and Its Analytical Basis*(Number of cases)*

Nature of Staff Advice	Number of Cases With/Without Staff Advice ¹	Regime Sustainability or Suitability Analyzed ²	Formal Exchange Rate Level Analysis ³	Currency Deemed Overvalued or Undervalued by Staff
More flexibility	51	7	20	11 (10)
Less flexibility	1	1	0	0 (0)
Implementation; management of existing regime	24	4	11	2 (6)
No specific advice	128	14	38	8 (4)

¹Advice has been given to 63 economies overall (in 13 cases, advice on flexibility and management of the regime was given simultaneously), of which 2 were advanced economies, 10 were large emerging market economies, and 51 were other emerging market and developing economies.

²Based on tools such as optimum currency area criteria and analysis of economic shocks.

³Analysis of exchange rate level explicitly involved tools other than interpretation of real effective exchange rate charts.

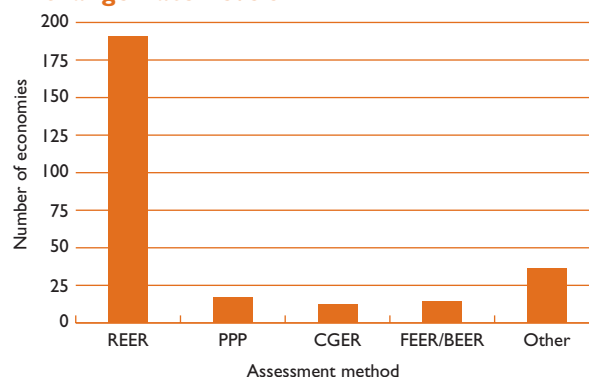
exchange rate was a live policy issue. In 63 out of the 191 economies (about one-third of the sample), IMF staff provided country authorities with exchange rate advice, overwhelmingly in favor of greater exchange rate flexibility (Table A4.3). In part, advice for greater flexibility appeared to amount to advice for exchange rate adjustment.⁷ Such advice was provided in 11 out of 19 cases (net of double counting) where the exchange rate was deemed overvalued, and in 10 out of 15 cases where the exchange rate was deemed undervalued. In about half of these cases, the IMF advice was not accompanied by formal analysis, either of exchange rate regime sustainability or appropriateness of the exchange rate level.

Analytical Basis for Exchange Rate Advice

9. A standard feature of every Article IV staff report is a plot of the real effective exchange rate (REER) index. It is rare, however, to use a more analytical tool of exchange rate level assessment, such as purchasing power parity (PPP), fundamental equilibrium exchange rate (FEER), and behavioral equilibrium exchange rate (BEER) models. In the Article IV staff reports for 191 economies, the IEO review found 17 cases of PPP-based econometric assessments, 12 cases citing the results of the regular CGER exercise,⁸ 14 cases using FEER or BEER models, and 36 cases used other meth-

⁷A similar interpretation was suggested in a recent Board paper prepared by staff. See “Treatment of Exchange Rate Issues in Bilateral Surveillance—A Stocktaking,” EBS/06/107, August 2006, footnote 26.

⁸The Consultative Group on Exchange Rate Issues, an interdepartmental working group within the IMF, produces a semiannual report on the exchange rates of the euro area and 10 industrial countries. For greater details on the CGER exercise, see Background Document 3.

Figure A4.4. Analytical Tools Used to Assess Exchange Rate Levels

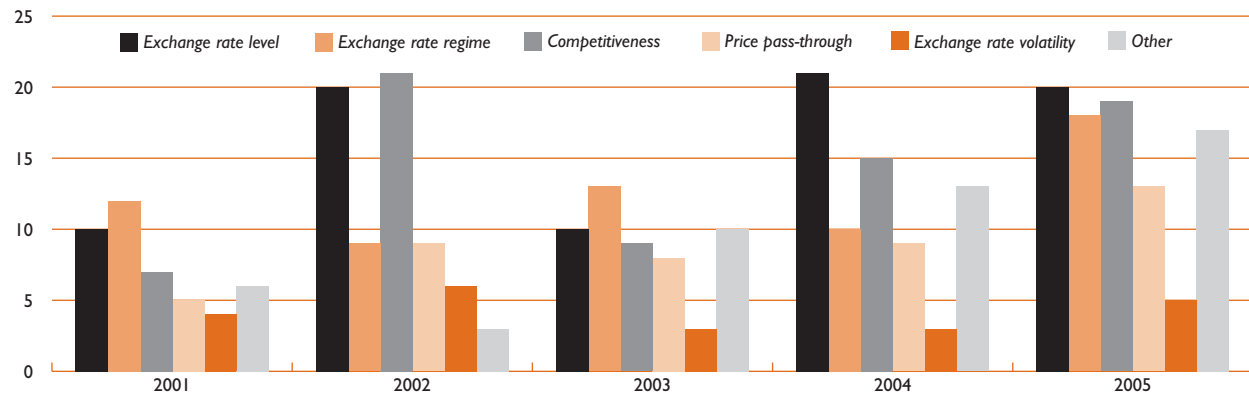
ods (Figure A4.4). Multiple methodologies were used in 15 cases, including for Germany, China, Malaysia, and the CEMAC.⁹

Topics in Selected Issues Papers

10. The most frequent topics in the selected issues papers reviewed were exchange rate level and competitiveness, followed closely by exchange rate regime; less attention was paid to considerations of exchange rate volatility, and exchange rate pass-through into inflation—possibly reflecting the absence of major inflation episodes in recent years (Figure A4.5). While the total number of selected issues papers on exchange-rate-related issues more than doubled

⁹See Background Document 3 for a more detailed analysis, though based on a slightly different coverage of country documents.

Figure A4.5. Exchange-Rate-Related Topics in Selected Issues Papers, 2001–05
(Number of cases)



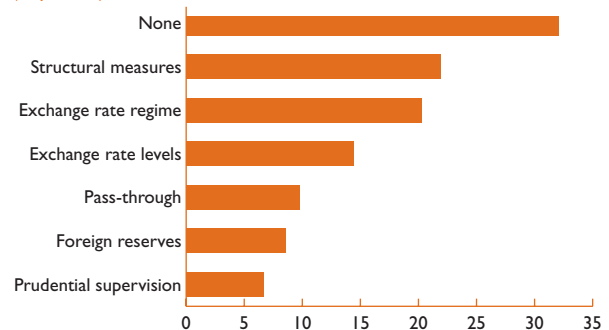
between 2001 and 2005, the distribution of topics discussed did not change markedly.

11. Although selected issues papers are not meant to be the main vehicle for delivering policy recommendations, they drew policy inferences in about two-thirds of the cases (Figure A4.6). The most common policy inferences concerned structural measures in the context of the need to increase competitiveness. Many of them suggested exchange rate adjustment (devaluation or revaluation), and they generally made a theoretical case for greater exchange rate flexibility. Of the 175 selected issues papers in which staff drew policy inferences, fewer than half spelled out alternative policy options.

Reaction of Authorities to IMF Advice

12. Finally, the IEO tried to ascertain from the documents whether national authorities agreed or disagreed with the staff's exchange rate advice. The review of the documents suggests 39 cases of agreement (out of 191), 26 cases of agreement with qualifications, and 14 cases of disagreement. How to interpret these results, how-

Figure A4.6. Policy Inferences in Selected Issues Papers, 2001–06
(In percent)



ever, is not straightforward. Staff advice on exchange rates cannot be distinguished cleanly from other advice on fiscal, monetary, and structural policy. Even when there is broad agreement on risks, desired reforms, and the overall stance of macroeconomic policy over the medium term, IMF staff and national authorities may disagree over a specific policy action in the short run, and such disagreement is documented with varying degrees of clarity.

Annex A4.1

Exchange Rate Surveillance in Article IV Consultations

(Full sample of 191 economies for two consultations through 2005)

1. How many paragraphs (percent of total) mention exchange rates?		
Article IV staff reports:	16 percent	
Mission briefing notes	18 percent	
Back to office	13 percent	
2. Were there any exchange-rate-related selected issues papers?		
Yes (99)	No (92)	
3. What is the current “de facto” exchange rate regime?		
Independent float (30)	Crawling band (4)	Currency board (9)
Managed float (49)	Crawling peg (4)	Monetary union (44)
	Horizontal band (9)	
	Other fixed peg (42)	
4. What is the monetary framework?		
Exchange rate anchor (92)	Inflation targeting (22)	Other (52)
Monetary targeting (28)		
5. Does the staff appraisal in Article IV reports identify the exchange rate as a live policy issue?		
No (99)	Exchange rate regime issues (46)	Volatility issues (14)
	Exchange rate level issues (45)	Other (22)
6. Is the overall exchange rate discussion forward looking?		
Mostly forward looking (105)		
Mostly backward looking (39)		
Exclusively backward looking (2)		
Not clear/can't tell (45)		
7. How intensively does the appraisal discuss exchange rate issues?		
Prominently (54)	Briefly (121)	Not at all (16)
8. Does the prominence of coverage in the Article IV report differ noticeably from coverage in internal documents?		
Yes (12)	No (175)	
9. The staff exchange rate assessment mentioned the following elements:		
Resolution of global imbalances (17)		
Global capital markets (14)		
Prospective spillovers from trading partners/competitors (31)		
Prospective regional spillovers (23)		
Domestic considerations (144)		
Other (20)		
None of the above (21)		
10. In the discussions of exchange rate issues, is there explicit reference to:		
Fiscal policy (53)	Monetary policy (121)	None of the above (48)
Banking/corporate balance sheets (44)		
11. In the discussions of which other policy areas is there explicit reference to implications for exchange rates?		
Fiscal policy (51)	Monetary policy (94)	Banking/financial (35)
Structural (43)	None (60)	Other (18)
12. Did the Fund advise a regime change/adjustment? If so, in what direction?		
No (128)	More flexibility (51)	Less flexibility (1)
Inflation targeting (8)	Monetary targeting (5)	Other (11)
13. In 2004–05, was the economic environment calm or turbulent?		
Calm (122)	Turbulent (31)	Can't tell (38)
14. Have there been changes to the de facto regime over 2003–05? What was the old exchange rate regime?		
No (176)	Managed float (5)	Other fixed peg (4)
Crawling band (1)	Horizontal band (5)	
15. If the answer under 14 is yes, what was the old monetary framework?		
Exchange rate anchor (9)	Monetary targeting (3)	Other (3)
Inflation targeting (0)		
16. Is there any formal analysis of regime sustainability/choice? If yes, on what basis?		
No (167)	Analysis of economic shocks (10)	Other (13)
Optimum currency area (5)	Cost-benefit analysis (4)	

Annex A4.1 (concluded)

17. At any stage in the process, are there any changes in regime-related issues identified?	No changes across documents (168)	Particular issues dropped (11) Particular issues added (8)	Other changes (3)
18. The exchange rate has been explicitly identified in the text as:	Overvalued (19) Misalignment not assessed (70)	Fairly valued (87)	Undervalued (15)
19. At any stage in the process, are there any changes in levels-related issues identified?	No changes across documents (169)	Particular issues dropped (8) Particular issues added (7)	Other changes (4)
20. What are the analytical tools used to discuss exchange rate levels?	REER charts (191) FEER/BEER (14)	PPP estimates (17) CGER estimates (12)	Other (36)
21. Does Fund analysis point out the limitations/caveats of its tools?	No (159)	Yes (32)	
22. What prompts the discussion on exchange rate levels?	Current account developments (46) Capital account developments (22) Fiscal developments (27)	Competitiveness considerations (107) Appears to be template driven (48) Other (38)	
23. Is there any reference to the “pointers”/procedures in the 1977 Surveillance Decision?	None (172) Exchange rate manipulation, protracted interventions (3) Interventions to counter disorderly conditions (16) Explicit policy action for balance of payments purposes (0)		
24. Was there a discussion of alternative exchange rate policy options?	No (134)	Yes (57)	
25. Where is any formal analysis on levels/regimes reported?	Article IV reports (19) Issues papers (42)	Pre-mission briefings (5) Back-to-office reports (0)	Other (15) N/A (123) ¹
26. How did the authorities react to any policy advice on exchange rates given?	Agree (39) Agree, but with qualifications (26)	Disagree (14)	Can't tell/doesn't apply (112)
27. Does the country have a Fund-supported program?	Yes (68)	No (123)	
If yes, are exchange-rate-related issues part of conditionality?	Yes (9)	No (59)	
28. Was data availability an issue?	Yes (90)	No (101)	

¹The code N/A refers to a situation where no formal analysis was reported in the documents reviewed.

Annex A4.2

Selected Issues Papers on Exchange Rate Issues

(Full sample of 256 papers)

1. How long is the paper?	
<5 pages (5)	2 percent
5–9 pages (61)	24 percent
10–14 pages (83)	32 percent
15–19 pages (55)	21 percent
20+ pages (52)	20 percent
2. The paper contains the following elements:	
Literature survey (33)	13 percent
Conceptual analysis (183)	71 percent
Applied analysis (152)	59 percent
REER- or PPP-based analysis (100)	39 percent
A formal model (69)	27 percent
Formal cross-country comparative analysis (37)	14 percent
Discussion of global linkages (10)	4 percent
Historical overview (76)	30 percent
3. The paper materially deals with:	
Exchange rate regime (69)	27 percent
Exchange rate levels (92)	36 percent
Exchange rate volatility (25)	10 percent
Price level pass-through/inflation (46)	18 percent
Competitiveness (78)	30 percent
Other (51)	20 percent
4. Any policy inferences that are drawn deal materially with:	
Exchange rate regime (52)	20 percent
Exchange rate levels (37)	14 percent
Exchange rate volatility (6)	2 percent
Foreign reserves (22)	9 percent
Price level pass-through/inflation (25)	10 percent
Structural measures (56)	22 percent
Prudential supervision (17)	7 percent
Other (24)	9 percent
No policy inferences drawn (82)	32 percent
5. Are there explicit caveats to the analysis?	
Yes (85)	33 percent
No (171)	67 percent
6. Does the selected issues paper analysis take account of country-specific factors in its bilateral assessment?	
No (37)	14 percent
Structure of the economy (112)	44 percent
Institutional frameworks (80)	31 percent
Political constraints (15)	6 percent
Trade patterns (69)	27 percent
Extent of integration into global capital markets (29)	11 percent
Balance sheet characteristics (29)	11 percent
Dollarization (34)	13 percent
Policy shocks (37)	14 percent
Other (39)	15 percent
7. Is there evidence of policy dialogue between the IMF and authorities?	
Yes (17)	7 percent
No (239)	93 percent
8. Does the paper spell out alternative policy options?	
Yes (84)	33 percent
No (172)	67 percent
