IEO

Independent Evaluation Office
of the International Monetary Fund

IMF EXCHANGE RATE POLICY ADVICE

EVALUATION UPDATE **2017**

ABOUT THE IEO

Established in 2001, the Independent Evaluation Office (IEO) of the IMF conducts independent and objective evaluations of the IMF's policies, activities, and products. In accordance with its terms of reference, it pursues three interrelated objectives:

- To "support the Executive Board's institutional governance and oversight responsibilities" by contributing to accountability.
- To "enhance the learning culture within the Fund" by increasing the ability to draw lessons and integrate improvements.
- To "strengthen the Fund's external credibility" through enhanced transparency and better understanding of the work of the IMF.

For further information on the IEO and its ongoing and completed evaluations, please see http://www.ieo-imf.org or contact the IEO at +1 202 623-7312 or at ieo@imf.org.

This report is the seventh in an IEO series that revisits past IEO evaluations five to ten years after they were first issued. Reports in this series aim to determine whether the main findings and conclusions of the original IEO evaluations remain relevant, and to identify any outstanding and new issues related to the evaluation topic that merit continued attention. The assessments are based on desk reviews of IMF documents and interviews of IMF staff and members of the Executive Board. This report reviews the 2007 IEO evaluation of the IMF's exchange rate policy advice.

IEO

Independent Evaluation Office
of the International Monetary Fund

IMF EXCHANGE RATE POLICY ADVICE

EVALUATION UPDATE **2017**

CATALOGING-IN-PUBLICATION DATA
JOINT BANK-FUND LIBRARY
Names: Stedman, Louellen. | Hicklin, John | International Monetary Fund.
Independent Evaluation Office.
Title: IMF exchange rate policy advice : evaluation update 2017 / this report was
prepared by Louellen Stedman in consultation with John Hicklin.
Description: Washington, DC : Independent Evaluation Office of the
International Monetary Fund, 2017. | Includes bibliographical references.
Identifiers: ISBN 978-1-48432-5-766 (paper)
Subjects: LCSH: Foreign exchange rates. | International Monetary Fund—Evaluation.
Classification: LCC HG3881.5.I58 I444 2017

Publication orders may be placed online, by fax, or through the mail:
International Monetary Fund, Publication Services
P.O. Box 92780, Washington, DC 20090, U.S.A.

Tel: (202) 623-7430 | Fax: (202) 623-7201
E-mail: publications@imf.org
www.imfbookstore.org
www.elibrary.imf.org

CONTENTS

The following conventions are used in this publication:

- An en dash (–) between years or months (for example, 2016–17 or January–June) indicates the years or months covered, including the beginning and ending years or months; a slash or virgule (/) between years or months (for example, 2016/17) indicates a fiscal or financial year, as does the abbreviation FY (for example, FY2017).
- "Billion" means a thousand million; "trillion" means a thousand billion.

Some of the documents cited and referenced in this report were not available to the public at the time of publication of this report. Under the current policy on public access to the IMF's archives, some of these documents will become available three or five years after their issuance. They may be referenced as EBS/YY/NN and SM/YY/NN, where EBS and SM indicate the series and YY indicates the year of issue. Certain other types of documents may become available 20 years after their issuance. For further information, see www.imf.org/external/np/arc/eng/archive.htm.

FOREWORD

This report is the seventh in a series of evaluation updates that return to past evaluations ten years after their completion. The report revisits the 2007 evaluation of *IMF Exchange Rate Policy Advice* following a decade of IMF efforts to grapple with the challenges of fulfilling its role in this area, which lies at the core of the Fund's mandate.

The 2007 evaluation found that the IMF was "not as effective as it needed to be" in fulfilling its responsibilities for exchange rate surveillance in the period 1999–2005. While acknowledging the inherent complexity of surveillance of exchange rates, including the lack of professional consensus on many of the key issues, the evaluation observed serious weaknesses in the IMF's focus on key analytical issues and in its engagement with members.

This update finds that the IMF has substantially overhauled its approach to exchange rate policy advice since 2007. Key steps taken include: adoption of a more comprehensive approach to exchange rate surveillance under the 2012 Integrated Surveillance Decision; development of enhanced analytical tools for assessment of exchange rates and current account balances; and introduction of the annual External Sector Report setting out an integrated picture of the external balances of major economies. Increased attention to spillovers and adoption of an institutional view on capital flow management have also helped enhance IMF work in this area.

Nonetheless, the report concludes that challenges remain that limit the impact of the IMF's work on these issues. The approach for assessing external balances and exchange rates continues to be contentious, in part reflecting differing views across the membership about the process of external adjustment. Consequently, questions persist about the evenhandedness and traction of IMF analysis and advice. There are also ongoing issues about considerations for exchange rate regime choice, the adequacy of attention to policy spillovers, the application of the institutional view of capital flows, and data availability, particularly on intervention.

In view of these persistent concerns, the IEO is now planning to include in our work program a new full-scale evaluation of the IMF's work in the area of external assessment.

Charles Collyns
Director, Independent Evaluation Office

CONTRIBUTORS

This report was prepared by **Louellen Stedman** in consultation with **John Hicklin**, leader of the 2007 evaluation, with contributions from **Roxana Pedraglio**. **Arun Bhatnagar** provided administrative assistance, and **Esha Ray** provided editorial and production management assistance. The report was approved by **Charles Collyns**.

ABBREVIATIONS

ARA	assessing reserve adequacy (IMF)
AREAER	*Annual Report on Exchange Arrangements and Exchange Restrictions* (IMF)
CDIS	Coordinated Direct Investment Survey
CGER	Consultative Group on Exchange Rates (IMF)
CPIS	Coordinated Portfolio Investment Survey
COFER	Currency Composition of Official Foreign Exchange Reserves (IMF)
EBA	External Balance Assessment (IMF)
EME	emerging market economy
ESR	*External Sector Report* (IMF)
EVC	Evaluation Committee
GFSR	*Global Financial Stability Report* (IMF)
G20	Group of Twenty industrial and emerging market countries
ICD	Institute for Capacity Development (IMF)
IEO	Independent Evaluation Office (IMF)
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee (IMF)
INS	IMF Institute (predecessor to ICD)
ISD	Integrated Surveillance Decision (IMF)
LIC	low-income country
MCD	Middle East and Central Asia Department (IMF)
MCM	Monetary and Capital Markets Department (IMF)
MIP	Management Implementation Plan
MTS	Medium-Term Strategy
PDR	Policy Development and Review Department (predecessor to SPR)
PIN	Public Information Notice (IMF)
REER	real effective exchange rate
RES	Research Department (IMF)
SDDS	Special Data Dissemination Standard (IMF)
SGN	Surveillance Guidance Note (IMF)
SPR	Strategy, Policy, and Review Department (IMF)
TSR	Triennial Surveillance Review (IMF)
WEO	*World Economic Outlook* (IMF)

EXECUTIVE SUMMARY

The 2007 IEO evaluation of *IMF Exchange Rate Policy Advice* found that the IMF was "not as effective as it need[ed] to be" in fulfilling its responsibilities for exchange rate surveillance in the period 1999–2005. It acknowledged the inherent complexity of this task, including the lack of professional consensus on many of the key issues. At the same time, the evaluation found a lack of understanding and consensus around the IMF's role in exchange rate surveillance; shortcomings in the coverage and quality of IMF analysis and advice, as well as in the traction of IMF engagement with its members; a strong sense among some member countries of a lack of evenhandedness in surveillance; and issues in the management of work on exchange rates.

This report considers the extent to which the key conclusions of the 2007 evaluation remain issues for the institution. The update is based on a review of IMF documents, including a desk study of a sample of 20 Article IV staff reports, and interviews with IMF staff and Executive Directors, as well as consultations with academic experts. The update is not a full evaluation of the IMF's analytical work, policy advice, or the traction of its advice, which would require a detailed assessment of IMF analysis and judgments, and extensive consideration of the experiences and perspectives of member countries.

The update finds that the IMF has substantially overhauled its approach to exchange rate policy advice since 2007. The 2012 Integrated Surveillance Decision (ISD) led to a more comprehensive approach that is widely accepted as a basis for exchange rate surveillance. The ISD takes into account the range of factors affecting the balance of payments position, as well as the connection between domestic and external stability, and provides for better integration of multilateral and bilateral surveillance to address spillover issues. Following the ISD, the IMF put in place extensive guidance for assessing external policies, and strengthened the analytical basis of advice. An annual *External Sector Report* (ESR), launched in 2012, sets out an integrated picture of the external balances of major economies, including exchange rates, current accounts, international reserves, capital flows, and external balance sheets. Increased attention to spillovers and adoption of an institutional view on capital flow management have also helped enhance IMF work in this area.

Nonetheless, the update identifies a number of ongoing challenges that impact the effectiveness of the Fund's work in this area. The approach for assessing external balances and exchange rates continues to be contentious, in part reflecting differing views across the membership about the process of external adjustment. While recognizing staff efforts and progress made in enhancing the IMF's approach and analysis, Executive Directors continue to raise issues with the models being used, as well as consistency and transparency in the process through which IMF staff arrive at their bottom line assessments. Consequently, questions persist about the evenhandedness and the traction of IMF analysis and advice on exchange rates.

The IEO intends to undertake a full evaluation of the IMF's approach to external sector assessment as part of its medium-term work program, including to examine the results of a methodological review that IMF staff expects to complete before the 2018 ESR.

1

INTRODUCTION

In 2007, the IEO completed an evaluation of *IMF Exchange Rate Policy Advice*. The evaluation addressed issues at the heart of the IMF's work, as laid out by the Articles of Agreement. In particular, the Articles call on the institution to oversee the effective operation of the international monetary system and to collaborate with member countries in promoting growth, stability, and a stable system of exchange rates.[1] This function is carried out through surveillance, a process that provides for periodic dialogue between the Fund and its members, with the IMF providing advice on exchange rate and other policies.[2]

The 2007 IEO evaluation considered how the IMF fulfilled its core responsibility of exercising surveillance over the international monetary system and members' exchange rate policies from 1999 to 2005. It examined the mandate to conduct surveillance, as laid out in the IMF's Articles of Agreement and the 1977 Decision on Surveillance over Exchange Rate Policies, along with guidance provided to IMF staff on how to carry out this role. It assessed the quality and value-added of exchange rate policy advice in the evaluation period, focusing on both the substance of policy advice and procedures for executing it.

It is important to recognize that IMF engagement on exchange rates in the period covered by the 2007 evaluation was—and has continued to be—complicated by divergent views on how to assess whether an exchange rate regime or level is appropriate for a given country's circumstances. Further, the IMF's Articles of Agreement allow member countries considerable freedom in selecting the exchange rate arrangements of their choice. At the same time, the Articles specifically require "firm surveillance over the exchange rate policies of members." Member countries have differed about the right balance for the IMF to strike in assessing member countries' policies in this area, including on exchange rate levels, capital account liberalization, and reserve accumulation.

This report revisits the findings of the 2007 evaluation following a decade of IMF efforts to grapple with the challenges of fulfilling its role in this area—including two major revisions to the legal framework for surveillance, in 2007 and 2012, and extensive work to refine the scope and modalities of surveillance to reflect lessons from the global financial crisis. The update describes changes in the framework for and the conduct of IMF exchange rate policy advice in the period since the evaluation; and assesses the continuing relevance of the evaluation's main conclusions.[3] The update does not undertake detailed assessment of the quality and effectiveness of the IMF's engagement on exchange rate policy—or the quality and traction of its methodological tools, analysis, or policy advice. Such an assessment would require a

[1] Key portions of Article IV describing the IMF's responsibilities and member obligations are excerpted in Annex 1.

[2] The 2007 evaluation also considered advice to member countries on exchange rate policies in the context of program support and technical assistance, which for many member countries are central to their engagement with the IMF.

[3] Recent IEO updates cover closely related areas, for instance: *Multilateral Surveillance: Revisiting the 2006 IEO Evaluation* (IEO, 2017); and The *IMF's Approach to Capital Account Liberalization: Revisiting the 2005 IEO Evaluation* (IEO, 2015).

full-fledged evaluation.[4] The update is based on a review of IMF documents, including a desk study of a sample of 20 Article IV staff reports and interviews with most Executive Directors (all of their offices) and a number of IMF staff, as well as consultations with academic experts.[5]

The balance of this report is organized as follows. Chapter 2 summarizes the key findings and recommendations of the 2007 IEO evaluation. Chapters 3 through 5 describe developments since the 2007 evaluation and discuss the current status of key issues raised by the evaluation in three broad areas: the clarity of the IMF's mandate and "rules of the game" on exchange rate policy advice; the evolution of key elements of IMF analysis and advice on exchange rate and related policy issues; and the management of and accountability for the IMF's work in this area.[6] Chapter 6 concludes with observations about ongoing issues and challenges.

[4] A full-fledged evaluation would require interviews with country authorities, more in-depth analysis of IMF tools and analytical work, and more extensive engagement with staff.

[5] The desk study examined a sample of twenty 2015 and 2016 Article IV staff reports selected to illustrate a broad range of country circumstances (18 countries and 2 country groupings): Botswana, Brazil, Chile, China, the euro area, Germany, Hungary, India, Indonesia, Japan, Korea, Mexico, Nigeria, Russia, Saudi Arabia, Switzerland, United Kingdom, United States, Vietnam and WAEMU. Interviews were conducted in October–November 2016 and April–July 2017.

[6] The IEO evaluation helped catalyze some of these developments, while others would have occurred in any case.

2

KEY FINDINGS AND RECOMMENDATIONS OF THE 2007 IEO EVALUATION

The IEO evaluation of IMF Exchange Rate Policy Advice found that the IMF was "not as effective as it need[ed] to be" in fulfilling its responsibilities for exchange rate surveillance in the period reviewed (1999–2005).[7] The evaluation acknowledged the efforts of staff, as well as the complexity of the task, not least given the lack of professional consensus on many of the key issues in this area. Nonetheless, the evaluation observed serious weaknesses in the IMF's focus on key analytical issues and in its engagement with members—which reduced the traction of IMF advice on countries' policy choices, contributed to perceptions that member countries were not treated consistently, and limited the IMF's effectiveness. The evaluation attributed these shortcomings to gaps in three main areas:

- **Mandate and rules of the game**. Country authorities did not fully appreciate, nor hold a shared understanding of, the formal role of the IMF, as well as the rights and obligations of membership that underlie its exchange rate policy advice. Operational guidance for staff about how to assess exchange rate regimes and levels was also unclear.

- **Quality and focus of analysis and advice.** Clear descriptions of exchange rate regimes remained elusive, and policy advice was insufficiently justified. Although analysis had improved over time, assessments of exchange rate levels remained unclear in too many cases. Analysis of intervention received inconsistent and incomplete attention. Problems with data provision hampered the conduct of surveillance. Discussion of policy spillovers, including the regional or systemic impact of large countries' policies, was infrequent. Further, the scope for countries to act in concert to deal with "global imbalances" was not fully explored, including because the IMF did not lay out potential adjustment scenarios.[8]

- **Management and oversight.** Work on exchange rates was not adequately organized and managed, including because responsibility and accountability for exchange rate issues was not clearly assigned among the area and functional departments. In addition, policies were not in place to guide staff in balancing the tension between, on the one hand, keeping the Board fully informed of the engagement of staff and management on exchange rate policy issues and, on the other, building trust with country authorities to enable a candid discussion of issues.

Executive Directors welcomed the IEO report and broadly endorsed its overall conclusion that the IMF was not sufficiently effective in some important aspects of its exchange rate policy advice in the review period. They highlighted that the IMF "should aim at enhancing

[7] The 2007 evaluation report and accompanying documents, including the Statement by the Managing Director, Response from Staff, and the Summing Up of the Executive Board Discussion, can be found at http://www.ieo-imf.org/ieo/files/completedevaluations/05172007exrate_full.pdf.

[8] The 2007 evaluation did not consider the multilateral consultation conducted by the Fund in 2006–07.

BOX 2.1. IEO RECOMMENDATIONS IN THE 2007 EVALUATION AND INITIAL PROPOSED IMF ACTIONS

The following lists the main recommendations that emerged from the 2007 IEO evaluation and were endorsed by the Executive Board; the arrows following each convey the steps initially proposed to address them in the August 2007 IMF Management Implementation Plan.

Clarify the rules of the game for the IMF and its member countries.

- Adoption of the 2007 Decision on Surveillance. Revision of the Surveillance Guidance Note (SGN) to support implementation of the new Decision.

Resolve inconsistencies and ambiguity over the issue of regime classification.

- The revised SGN would provide clear guidelines on description and analysis of regimes. The September 2007 Review of Exchange Arrangements, Restrictions, and Markets would review recent trends in foreign exchange regimes, and propose measures to improve the existing classification of de facto regimes. There would also be enhanced focus on this issue in the internal review process.

IMF advice on exchange rate regimes should be backed up more explicitly by analytic work.

- Strengthen analysis of exchange regimes. The revised SGN would point to the key dimensions for analysis and stress that analysis of regime choice should be candid, balanced, and comprehensive; should take into account country circumstances; should pay attention to implementation issues when relevant; and should be informed by cross-country experience. Tentatively, review of the stability of the system of exchange rates in 2009 was envisioned as a potential way to distill practical guidance and collect cross-country experience in this area.

To improve assessments of the exchange rate level, the IMF should be at the forefront of developing the needed analytical framework, while more successfully translating existing methodologies into advice that is relevant to discussion of individual country cases.

- Expand and improve work of the Consultative Group on Exchange Rates (CGER) (including refine methodologies and expand it to key low-income countries and producers of exhaustible resources). Enhance knowledge dissemination. Focus on issues in the internal review process and increase the emphasis on assessments of exchange rate levels.

Management and the Executive Board should consider further what lies behind the apparently serious problems of data provision for surveillance, and how incentive structures can be improved.

- Review of data provision to the Fund in late 2007. Improving data provision to the Fund remained a challenge. The planned review of data provision to the Fund in late 2007 was targeted as an opportunity to consider further the scope of the problem and possible remedies in this area.

Incentives should be given to develop and implement guidance for the integration of spillovers into bilateral and regional surveillance.

- Continued implementation of existing initiatives, including through regional outlooks, better assessment of external economic and financial market spillovers affecting individual countries, and discussion of outward spillovers in Article IV staff reports for systemic countries.

Management should address how to bring better focus to the analytical work on exchange rates.

- Strengthened role of the Surveillance Committee and the CGER.

Opportunities for potential multilateral concerted action deserve to be a key strategic management focus.

- Multilateral consultations would continue to be a key vehicle to promote debate on issues of systemic or regional importance.

the effectiveness of its analysis, advice, and dialogue with member countries, as well as address any perception of asymmetry in its exchange rate surveillance" (IMF, 2007a). Directors supported a number of the IEO's suggestions to enhance analysis, including more comprehensive analytical discussions of exchange rate regime choice and better integration of spillover analysis in regional and bilateral surveillance. They also agreed that management should act to ensure that exchange rate work across the IMF is organized and managed effectively and to provide the Executive Board with all the information it needs to conduct surveillance, balancing this duty with the need for the staff and management to serve as a trusted advisor to members. At the same time, Directors expressed diverse views on the need for practical policy guidance on key analytical issues, such as reserve levels, and on the feasibility of developing it.

The IMF set out a Management Implementation Plan (MIP) for taking action on the IEO recommendations that were endorsed by the Executive Board (IMF, 2007d), in accordance with the procedures for following up on IEO evaluations. Box 2.1 briefly describes the steps identified in this plan. The IMF documented progress made in implementing these steps in its "Second Periodic Monitoring Report on the Status of Implementation Plans in Response to Board-Endorsed IEO Recommendations" (IMF, 2008c); subsequent monitoring reports tracked actions still outstanding. Annex 2 summarizes the status of follow-up actions as documented in these monitoring reports, to provide background and context for this update.

This update does not specifically aim to assess IMF actions under the MIP to follow up on the IEO recommendations. Instead, it takes a broader approach to exploring the full range of issues raised by the 2007 evaluation and where they stand now. The following chapters examine in turn each of the three broad areas of weaknesses identified.

3 THE IMF'S MANDATE AND RULES OF THE GAME

The 2007 IEO evaluation pointed out a lack of clarity in the 1977 Surveillance Decision and in the associated guidance for staff. It also noted the need for greater "trust and engagement with the membership on how to deal with new challenges" in order for the IMF to continue to carry out its surveillance mandate effectively (IEO, 2007).

As noted above, two successive decisions adopted since the 2007 IEO evaluation have refined the legal framework for surveillance and sought to clarify the IMF's role with respect to exchange rate policy.

The 2007 Surveillance Decision and ensuing guidance for IMF staff aimed to increase the focus on exchange rate issues in surveillance. It did not create new obligations for members but updated the previous 1977 Decision, including by clarifying the concept of exchange rate manipulation, which it associated with "fundamental misalignment" of the exchange rate, and expanded guidance to members in the conduct of their exchange rate policy to include the recommendation that they avoid policies that result in external instability (IMF, 2007b). The Decision further specified developments that would require a special review and initiation of an ad hoc discussion with the member. Guidance for staff elucidated the requirement for a clear assessment of the exchange rate level in every Article IV staff report and spelled out the requirement that the staff report explicitly state that there was a "fundamental misalignment" causing external instability if found to be "persistent," "significant," and present beyond "any reasonable doubt." The IMF defined "fundamental misalignment" as a departure of the underlying current account from the equilibrium current account, implying that the real effective exchange rate was not at the level that facilitated evolution of the net external asset position "in a manner consistent with the economy's structure and fundamentals" (IMF, 2007b).

However, the 2007 Decision failed to bring about consensus among member countries.[9] In particular, the requirement to declare "fundamental misalignment" was seen by some member countries as an unwelcome "labeling." Further, some observers expressed concern that the Decision resulted in too narrow a focus on exchange rate policies, as opposed to other policies (e.g., fiscal) that may lead to instability.[10]

Persistent dissent about the 2007 Decision contributed to mixed results in increasing the focus on exchange rates. The 2008 Triennial Surveillance Review (TSR) noted long delays in completing a number of Article IV consultations and pointed to a "fear of labelling" in some cases (IMF, 2008b). Concluding that the attempt to apply exchange rate "labels" had "proved an impediment to effective implementation" of the Decision, the IMF issued new staff guidance, in an effort to make the Decision workable, with a revised approach

[9] After several rounds of discussion, the Decision achieved broad support, but not full consensus, in the Executive Board (IMF, 2007c). Blustein (2013) provides an account of these events.

[10] See, for example, Fischer (2008).

that "recognize[d] the uncertainty involved in attributing outcomes to exchange rate policies as opposed to other policies" and dropped the "fundamental misalignment" labeling requirement (IMF, 2009).[11]

Nonetheless, the IMF continued to struggle to implement the 2007 Decision. The 2011 TSR found improvements in IMF analysis of exchange rates but pointed to some inconsistencies in assessments across countries and concluded that "the analysis of risks to external stability in many staff reports still focuses primarily on exchange rate levels and insufficiently on risks arising from the capital and financial account." Interviews with authorities in the context of the 2011 TSR also found continued concerns about the balance of IMF work, with a number concerned about the increased focus on exchange rate issues and a few others expressing the view that greater focus and candor was needed in assessing exchange rates, reserve accumulation, and the challenges that these issues posed for global imbalances (IMF, 2011d). Concurrent with the 2011 TSR, the IMF undertook a review of the 2007 Decision and concluded, inter alia, that the economic framework underlying the 2007 Decision reflected an "exchange rate bias" because it understated the role of "other economic and financial policies and the overall interaction of all policies in determining economic outcomes" and gave "insufficient recognition to the full range of issues that ultimately influence the effectiveness of the international monetary system" (IMF, 2011b).

As agreed by the Board during the discussion of the 2011 TSR and review of the 2007 Decision, the institution sought a new way forward, through a series of staff papers and Board discussions. This effort was motivated by a recognition that the framework for bilateral surveillance "[did] not adequately capture economic realities, suffer[ed] from exchange rate bias, and hamper[ed] the discussion of policy spillovers across countries" (IMF, 2012a). In developing a new legal framework, staff sought to "strengthen the traction of Fund advice and the legitimacy of the legal framework by seeking to rebalance the treatment of external and domestic policies," as well as to provide for more systematic coverage of relevant policy spillovers (IMF, 2012b).

These discussions culminated in a new Integrated Surveillance Decision (ISD), approved by consensus by the Executive Board in July 2012.[12] The ISD set out a broader approach to exchange rate analysis that took into account the range of factors affecting the balance of payments position as well as the connection between domestic and external stability. In addition, the ISD provided for Article IV consultations to discuss issues relevant to multilateral surveillance, while not adding to member countries' legal obligations. Accordingly, it specified that the selection of topics for Article IV consultations should take into account analyses of global risks and policy spillovers from the Fund's multilateral surveillance products.

The ISD led to new expectations and instructions for staff on how to approach an assessment of balance of payments stability in Article IV surveillance.[13] Guidance issued for IMF staff states that staff should provide "a clear bottom line assessment of the member's BOP [balance of payments] stability, drawing from a broad range of perspectives," covering the current account, capital flows and policy measures, exchange rates, reserves and foreign exchange intervention, and external balance sheets (IMF, 2015b). While staff is expected to use judgment in arriving at this assessment, rather than reporting mechanically on quantitative results, any difference between the staff assessment and the model result should be clearly explained. In addition to addressing the potential and actual impact of other countries' policies and global developments on a member's economy (inward spillovers), Article IV consultations are required to discuss outward spillovers "if a member's policies are not promoting its own stability *or* … if the member's policies are promoting its own stability, but they could nevertheless significantly affect global stability" (IMF, 2015b). The guidelines also note that a member country is not obligated to adjust its policies due to concerns about external spillovers as long as these policies

[11] The IEO evaluation of *IMF Interactions with Member Countries* (IEO, 2009) also found that some authorities were concerned that attention to exchange rate policy issues had been at the expense of other topics of interest and was counterproductive.

[12] Although not referenced in the Summing Up, some Executive Directors still expressed reservations or skepticism about the decision and its potential to enhance traction, as reflected in the minutes of the meeting (IMF, 2012d).

[13] A Guidance Note on Surveillance was issued in September 2012; the 2014 TSR led to a new Guidance Note issued in 2015 (IMF, 2012f; 2015b).

promote its own stability, though countries are encouraged to take into account the impact of their policies for others and for the system as a whole. Moreover, the IMF may suggest alternative policy options that "while promoting the member's own stability, better promote the effective operation of the international monetary system" (IMF, 2012c).

The ISD has provided a widely-accepted basis for surveillance of exchange rates. Interviews with Executive Directors and IMF staff conducted for this update found general familiarity with the ISD and acceptance of the centrality of exchange rate surveillance in the IMF's mandate.[14] Staff interviewed for this update also felt that guidance in executing surveillance in this area was clear and well-established within the institution, and they believed that the authorities with whom they engaged understood and accepted the centrality of external stability and exchange rates to the IMF's mandate.

[14] A survey of all authorities for the 2014 TSR found, on the other hand, that only three-fifths of authorities were familiar with the ISD (IMF, 2014a).

4

ELEMENTS OF ANALYSIS AND ADVICE

As the IMF has moved forward under the successive new Surveillance Decisions and also adapted its work to reflect the lessons of the global financial crisis, the institution has invested substantially in enhancing its analysis of, and advice on, exchange rate policy. This chapter discusses specific developments related to exchange rate analysis and policy advice in key areas addressed by the 2007 evaluation: exchange rate regimes; exchange rate levels and external stability; data; spillovers; and evenhandedness.[15]

EXCHANGE RATE REGIMES

The 2007 IEO evaluation identified issues with the classification of exchange rate regimes, including inconsistencies in the way regimes were identified, contributing to a lack of clarity in analysis; cases in which the IMF did not take a clear position on the adequacy of an exchange rate regime choice; and, when regime shifts were advocated, often too little analytical backing for IMF recommendations. The lack of analysis helped contribute to perceptions that the IMF's advice, at times, was based on fashion rather than tailored to the country-specific circumstances. The 2007 evaluation suggested that the weaknesses in this area stemmed in part from the absence of an up-to-date Board-endorsed view to guide IMF staff advice.

The IMF has taken steps to improve its system for classifying exchange rate arrangements—as applied in the *Annual Report on Exchange Arrangements and Exchange Restrictions* (AREAER). In February 2009, the IMF reviewed and modified the AREAER system to make it more rules- and evidence-based in reporting the de facto exchange rate regime of member countries, "with a more clearly circumscribed role for judgment" in order to "allow for greater consistency and objectivity of classifications across countries … and improve transparency" (Habermeier and others, 2009).[16] As input for this update, the IEO compared AREAER and Article IV staff report classifications and found consistency between the two reports in 97 percent of the cases, suggesting that progress has been made on classification issues identified in the 2007 evaluation.[17]

[15] This chapter draws on the results of the IEO desk study described in the introduction.

[16] Changes included clarification of the distinction between managed and independent floating, now referred to as floating and free floating, and introduction of a distinction between "formal fixed and crawling pegs, and arrangements that are merely peg-like or crawl-like."

[17] Comparing the de facto regime classification in the 2014 AREAER with that in the 2015 Article IV staff report for 191 countries, the IEO identified discrepancies in the classification for five cases, or about 3 percent. One of these appeared to result from a change in the exchange rate regime between the time that AREAER and the Article IV report were completed. In addition, there were a number of cases in which the language in the staff report did not fully conform with the AREAER categories; these were not considered to be discrepancies in classification for the purposes of this update although a detailed evaluation could take a different view.

An assessment of the exchange rate regime is now a standard element of bilateral surveillance. Article IV staff reports are expected to "assess the adequacy of the *de facto* regime for maintaining stability" and "take into account the authorities' views, and their readiness and capacity to implement changes", when discussing alternative regimes (IMF, 2015b). About three quarters of the 20 Article IV staff reports examined for this update provided a clear assessment of the exchange rate regime.[18]

IMF advice on exchange rate regimes—whether in the context of surveillance, program design, or technical assistance—is determined on a case-by-case basis, given that the appropriate exchange rate regime for any particular country depends on its circumstances. The IMF has not taken a formal position on the considerations in regime choice to guide country policy decisions and IMF staff advice on exchange rate regimes—a gap identified by the 2007 evaluation.[19] In fact, there remains no unified view within the economics profession about regime choice. IMF staff interviewed for this update noted that they felt well-grounded in providing advice on exchange rate regimes, based on their academic training and professional experience, and supported by the review process at the IMF that facilitated discussion as needed. However, a few Executive Directors suggested that IMF advice on exchange rate regimes would benefit from a clearer framework. Elements of such a framework could include the IMF's views regarding what regimes are suitable in what circumstances, parameters for IMF judgments about whether a country's regime was appropriate, policy and technical considerations for sequencing a change in regime, and guidance for staff in communication on these sensitive issues.

Executive Directors' views varied on the advice provided by staff on regime choice and management. A number of Directors, along with IMF staff, reported productive engagement on regime choice between staff and authorities. They noted an enhanced effort to take into account country circumstances and an increased tendency to respect a country's choice of regime. However, several Directors, representing a significant number of member countries, expressed concern about the IMF recommending that members introduce more flexibility in managing their exchange rate regimes, particularly in the context of programs, without enough attention to country circumstances or to the capacity of the country to manage this shift. While a number of Directors also commented positively on advice on exchange rate management, a few Directors representing low-income countries (LICs) and small emerging market economies (EMEs) indicated interest in more in-depth analysis and advice on technical issues, and greater expertise on staff teams, for instance on the process of transitioning to flexibility, or the issues facing commodity exporters or countries experiencing volatile aid flows.

EXCHANGE RATE LEVELS AND EXTERNAL STABILITY

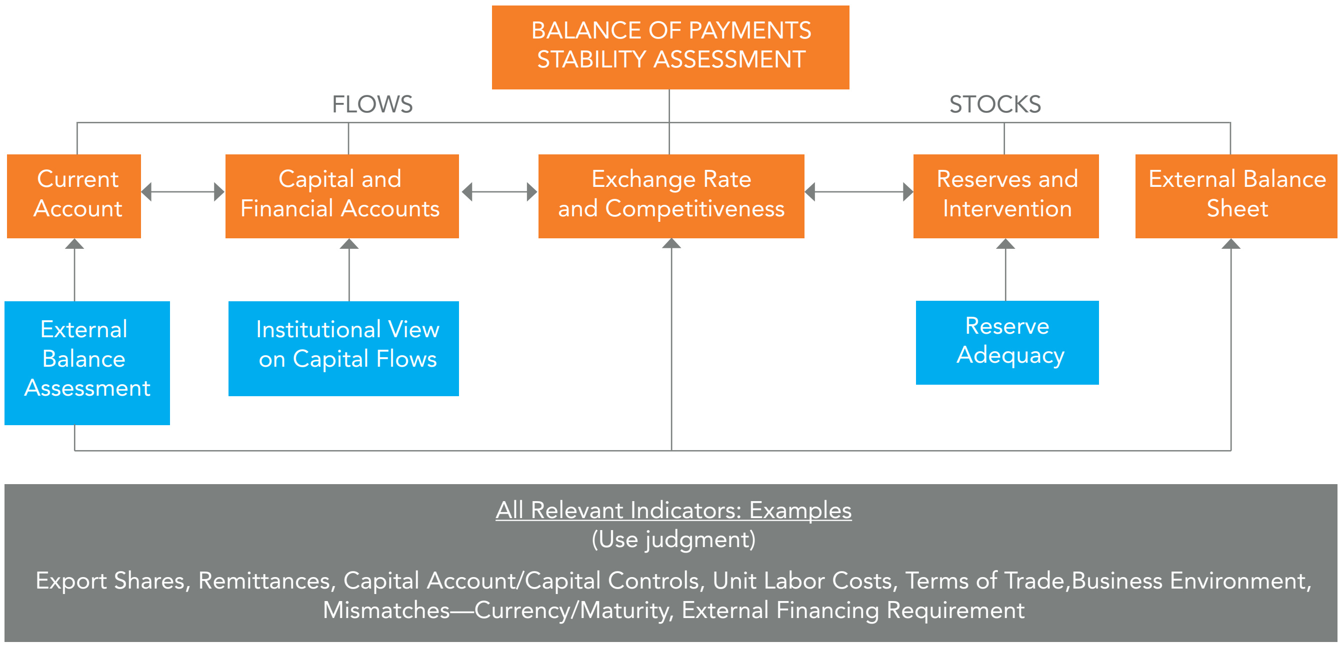
The findings of the 2007 evaluation pointed to a number of weaknesses in the approach for assessing exchange rate levels, including insufficiently clear guidance for staff and the absence of an accepted analytical framework to guide consistent and quantitative analysis across the membership. At times, the report found that the methodology for assessing a particular country's exchange rate level changed from year to year, creating the impression that the choice was arbitrary.

As discussed in Chapter 3, the ISD clarified the IMF's mandate and provided for a broader approach to assessing balance of payments stability, and was followed by detailed guidance for staff. Emphasis under IMF assessments of external stability since the ISD has shifted from assessment of exchange rate levels to an overall assessment of the external position based on analysis of the current account, capital flows and policy measures, exchange rates, reserves and foreign exchange intervention, and external balance sheets. This conceptual framework is conveyed in Figure 4.1 below (IMF, 2015b).

[18] Such a formal assessment was not provided for six countries in which the regime was classified as floating or free floating. In the case of one country with a soft crawling peg, a formal assessment was not provided in 2016, but the 2015 Staff Report concluded that the regime served the country's interests and should be sustained.

[19] A July 2009 IMF staff paper explored exchange rate regime choices and concluded that "a thorough analysis of the cross-country data does not support any single 'prescription,'" although there were "clear trade-offs" in particular regime choices, both for individual countries and, in some cases, for the stability of the global system (Ghosh, Ostry, and Tsangarides, 2010). This paper was discussed informally in a Board seminar but did not yield a Board-approved institutional policy or framework.

FIGURE 4.1. CONCEPTUAL FRAMEWORK FOR BALANCE OF PAYMENTS STABILITY ANALYSIS



Source: IMF (2015b).

The conceptual framework has broad support. Most Executive Directors interviewed for this update recognized the development of a more coherent framework to provide the basis for staff analysis, while retaining some reservations about the specific tools and implementation, as discussed below.[20] Most IMF staff interviewed for this update also believed that the established framework was helpful, as it offered a common basis for analysis, helped them think through the elements contributing to external imbalances, including the role of policy gaps, and provided discipline to this central element of the IMF's work. A number of outside academics consulted for this update also appreciated the overall framework and the substantial enhancements to the underlying analytical tools developed in the past decade, even as they raised questions about technical details.

At the same time, there are differing views about whether the IMF has achieved the right balance in its attention to exchange rate policy issues. In practice, the IMF's approach, relying on the methodology discussed below, has placed the greatest weight on the current account balance, with an assessment of the real exchange rate in many cases derived from that of the current account. While some Directors interviewed for this evaluation expressed the view that exchange rate issues received the right amount of attention, a few believed that exchange rates deserved greater focus, as they sometimes received perfunctory treatment, with little economic reasoning, in the main text of Article IV staff reports. In addition, although capital flows are among the five elements assessed in external sector analysis under the ISD, some Directors questioned whether the IMF's approach sufficiently considered the role of capital flows and financial market factors in assessing external balances. There were also questions about whether the IMF approach provided an adequate basis for considering issues related to assessing real exchange rates and related policies in country members of currency unions. More broadly, a few Directors underscored that the drive to achieve external balance should not be unduly prioritized over domestic policy objectives such as growth and price stability.

[20] The 2014 TSR similarly found that country authorities welcomed the expanded coverage of external sector assessments in the EBA methodology, although some had reservations about drawing policy conclusions from the new approach, which they regarded as still experimental (Boorman and Ter-Minassian, 2014).

The remainder of this section considers key tools and approaches that facilitate external stability analysis under this framework. It also discusses the effort to produce a multilaterally consistent analysis in the annual External Sector Report (ESR).

External Balance Assessment Methodologies

External sector assessments under the conceptual framework described in Figure 4.1 rely on the External Balance Assessment (EBA) methodology and related tools. The IMF adopted the EBA in 2012 to facilitate multilaterally consistent analysis of external balances, expanding on the now discontinued approach developed by the CGER. The EBA provides for assessment of the exchange rate level, along with the current account and external balance sheet, for 49 countries encompassing about 90 percent of global GDP. A parallel tool, the EBA-lite, was introduced in 2014 to enhance the methodology for external sector assessments in a broader group of about 100 countries, building on the EBA but without seeking to ensure multilateral consistency among EBA-lite countries.

The EBA and EBA-lite current account models are used to assess the external position of each country by: calculating a country's cyclically adjusted current account balance; deriving a "norm" for that balance based on country fundamentals and by substituting "desired" policies for actual policies; using judgment to refine the norm as needed to include country-specific factors not reflected in the model(s); and then identifying the gap between the cyclically adjusted balance and the norm (Obstfeld, 2017). The size of this gap determines whether the current account is consistent with, stronger than, or weaker than the norm, and to what extent. IMF staff derive an assessment of real exchange rate gap from the current account gap, applying standard trade elasticities. These results are then compared with results from two other approaches, based on real exchange rate modeling and an external sustainability analysis.[21] Box 4.1 summarizes key features of the EBA and EBA-lite tools.

BOX 4.1. ESTIMATING CURRENT ACCOUNT AND EXCHANGE RATE NORMS

EBA provides a common basis for analysis of the external sector and exchange rate levels in 49 mostly advanced and emerging market economies. Countries included have sizable access to global capital markets and data judged to be of sufficient quality and availability. Countries in which oil exports are a highly dominant share of the economy (e.g., Saudi Arabia, Venezuela), as well as small economies considered to be financial centers (Hong Kong SAR and Singapore) are not included in the EBA. The EBA expands on the earlier CGER approach. Like CGER, EBA comprises three potential methods, two panel regression-based analyses and one "model free" approach based on sustainability analysis. EBA analysis takes into account a broader range of factors—including for instance cyclical and global capital market conditions—that may influence the current account and real exchange rate. IMF staff use the EBA methodology to determine the underlying, cyclically adjusted current account position, derive a "norm" based on country fundamentals and substitution of desired policies for actual policies, and identify the "policy gap" between the two that explains how country policies contribute to external imbalances. First launched in 2012 as a pilot, the EBA was revised in 2013 based on feedback from authorities and IMF country teams. A paper describing the revised methodology in detail was published by staff in 2013 (IMF, 2013c). EBA estimates are published annually online.

EBA-lite. Following the 2014 TSR, which called for gradual replacement of CGER and broader external assessments for a wider set of countries, IMF staff began to develop an "EBA-lite" tool (IMF, 2014a). EBA-lite draws on EBA results and reflects the different characteristics and circumstances of countries outside EBA, for instance adding aid and remittances as explanatory variables while dropping public health spending. EBA-lite provides a tool for staff assessment of the external balance in nearly 100 countries not included in the EBA. A reference note on EBA lite methodology was issued in February 2016 (IMF, 2016a).

[21] IMF staff indicate that the EBA current account model provides a better fit and is less subject to short-term fluctuations than, for instance, the real exchange rate model. Further, they note that the current account model captures factors affecting saving and investment, and the financial/capital account.

The EBA and EBA-lite tools are widely deployed in IMF surveillance to provide assessments of a country's real exchange rate, as well as the current account and related external stability issues. The desk study of 2015–16 Article IV staff reports for this update observed widespread adoption of the broader approach to assessing external stability, drawing on results of EBA or EBA-lite methodologies, and taking a view on the exchange rate and current account levels. This is in line with the findings of the 2014 TSR that nearly all Article IV staff reports contained an external sector assessment that included quantitative estimates based on methodologies from the EBA (or CGER, which was still in place at that point).[22]

However, there is a tension in the IMF's approach between providing for consistency across country assessments and reflecting country-specific circumstances. The aim of the EBA and EBA-lite models is to provide for a standardized, quantitative method that takes into account the range of variables that affect the current account. At the same time, as noted above, the IMF's approach allows for ad hoc adjustments, to the calculated norm to reflect fundamentals not captured by the model, as well as to the cyclically-adjusted current account position to reflect measurement issues or temporary factors. The approach also depends on country teams using judgment in identifying "desired" polices and making their bottom line assessments of imbalances—for instance to what degree the gap between the norm identified and the status quo represents a need for policy adjustment ("policy gap"), and to what degree it represents unidentified factors not included in the model. While IMF staff must explain any differences between the model-based results and the final assessment, this effort remains a work in progress. The 2014 TSR identified insufficient justifications of departures from the model, as well as inconsistencies in the application of the EBA (IMF, 2014a). The desk review for this update also found that staff explanations of adjustments to model results varied across countries in the language used and level of detail provided. In the 2017 ESR cycle, staff continued to work to increase the discipline and transparency of the approach by increasing scrutiny of adjustments in the review process and publishing more information about adjustments made, as discussed in the section "External Sector Report" below.

Most Executive Directors interviewed for this update supported the EBA model in principle and recognized that staff had continued to make progress in strengthening the methodology and transparency of its application. Nonetheless, many expressed continuing doubts about specific features of the EBA and its application to country cases that made it difficult to understand the rationale for, or compare, country assessments. They raised a variety of issues about the construction of the model, for instance: its use of third party indicators for some variables; the use of a financial center dummy variable to represent effects that are not fully understood; shifting approaches to capturing the role of demographic factors; insufficient attention to measurement issues; and inadequate focus on issues such as corporate savings behavior and global value chains. In discussing the 2017 ESR, the Executive Board recognized recent efforts made to enhance the EBA but called for further progress (IMF, 2017e).[23]

Further, while recognizing the need for judgment in adjusting EBA results, many Directors interviewed for this update questioned the adjustments made as well as whether these adjustments were sufficiently explained and justified by staff, still leaving questions about evenhandedness and transparency. A few suggested that there was a tendency to rely on adjustments to the model outcome, without sufficient explanation, to reduce the "gap" between a country's current account or exchange rate and the calculated norm. Academic experts consulted for this update also pointed to a propensity for adjustments to take the norm closer to the status quo, reducing the gap identified and thus appearing to ratify large imbalances. These concerns together contributed to a perception that the model functioned as a "black box" and that its application to country cases was not transparent, which risked undermining confidence in staff's assessments and advice.

IMF staff noted a number of advances of the EBA over the CGER, including its ability to facilitate a better understanding of the role of policies in external imbalances

[22] Use of the CGER was discontinued after the 2014 TSR, with the Research Department no longer providing technical support for the methodology.

[23] "Directors acknowledged that although some improvements had been made to the External Balance Approach methodology, there remains scope for further refinements" (IMF, 2017e).

and the opportunity for country teams to complement quantitative analysis with qualitative insights gained in their country work, increasing their feeling of ownership over the final judgements reached. They noted that adjustments made are generally small (averaging 0.4 percent–0.5 percent of GDP) except in countries with identified measurement issues and that great care is taken to provide for consistent treatment and ensure that adjustors do not compromise multilateral consistency. Further, most staff interviewed for this update felt that the process provided for an adequate balance between consistent application of the EBA model and an effort to reflect the circumstances of individual countries. Nonetheless, some staff shared concerns about limitations of the methodology, including poor fit of the EBA model with some country characteristics, uncertainties in the model's results, and undue focus on point estimates with insufficient regard to the margins of error involved, as well as about the degree of judgment required, or allowed, in interpreting these results. More broadly, a few Executive Directors, as well as a few IMF staff, raised questions about whether the application of the EBA and EBA-lite was contributing to an overly elaborate process that distracted country teams from thinking through the logic of the balance of payments and external accounts.

Staff have indicated that they intend to re-examine the EBA methodology in fall 2017 with the aim of addressing ongoing concerns about its components and transparency, and thereby enhancing buy-in and traction. They intend to consult widely with the membership in conducting this review.

External Sector Report

The 2007 evaluation found that IMF analysis and advice insufficiently reflected interconnectedness in policies across countries. As a result, it concluded, the IMF did not adequately act to convey the urgency of policy responses at the multilateral level, nor effectively facilitate active policy coordination to address imbalances—for example, by providing alternative sets of policy recommendations linked to policy actions in other countries.

At the time that the 2007 evaluation report was completed, the IMF had recently launched a new multilateral consultation mechanism aimed at fostering debate among key country actors and policy actions by them on targeted issues of systemic importance.[24] The IMF conducted one such consultation exercise in 2006–07 among China, the euro area, Japan, Saudi Arabia, and the United States—focused on reducing global imbalances. This exercise culminated in a ministerial level meeting in April 2007 and presentation of a joint document in which the participants each affirmed their shared responsibility for reducing global imbalances in a manner compatible with sustained global growth, and laid out detailed policy plans to implement policies in the future to advance this aim.[25] However, the results of the exercise were underwhelming, and there were questions about key participants' commitment to the exercise as well as its link to the conduct of surveillance by the Executive Board. Although the International Monetary and Financial Committee (IMFC) reiterated the aims and commitments of this exercise in October 2007, the process was not repeated, as the context was increasingly dominated by the emerging global financial crisis.

In 2012, the IMF launched a new pilot exercise to produce a multilaterally consistent ESR.[26] This report uses the EBA approach to provide "a multilaterally-consistent assessment of external balances … [to] help strengthen surveillance and inform the debate on global imbalances, currencies, and policies" (IMF, 2011e).[27] The report integrates analysis from bilateral and multilateral surveillance to track the evolution of global external balances, to assess their drivers, and discuss the external assessments of systemically important economies (28 countries and the euro area). The ESR is accompanied by country pages, detailing multilaterally-consistent quantitative assessments of the real exchange rate and current account positions of each economy, and presenting analysis of foreign asset and liability positions,

[24] These consultations did not constitute surveillance, as no legal framework existed at that time for such consultations as part of multilateral surveillance.

[25] Taking into account this effort, the 2011 IEO evaluation of *IMF Performance in the Run-Up to the Financial and Economic Crisis* concluded that the IMF appropriately stressed the urgency of addressing the persistent and growing global current account imbalances (IEO, 2011).

[26] The Managing Director launched this initiative at the conclusion of the 2011 TSR and Review of the 2007 Surveillance Decision.

[27] The external sector analysis for all but three economies (Hong Kong SAR, Saudi Arabia, and Singapore) in the ESR is based on the EBA.

capital flows and policies, and foreign exchange intervention and reserves levels.[28] Following three pilot reports, the ESR became a regular annual publication beginning in 2015.

The ESR represents a significant innovation for the IMF, as it presents in one publication a multilaterally consistent view of external balances, including the current account and exchange rate levels, and discusses policy measures that could help narrow the gap between actual external balances and the "norm" identified by IMF staff. Executive Directors and IMF staff interviewed for this update saw the ESR as a positive and necessary innovation addressing the heart of the IMF's mandate.

While welcomed in principle, the ESRs have been contentious in practice. According to a number of Executive Directors, questions about technical details of the EBA and its application, as discussed in the previous section, limited authorities' confidence in the report. In this respect, a number of Directors pointed to issues with consistency in the IMF's assessments, for instance in the adjustments made, or not made, to the EBA model results for countries with similar characteristics (discussed above), as well as differences between the policy advice in the ESR and other IMF products.

Several Executive Directors interviewed for this report also raised concerns about process issues related to the assessments, for instance the procedures for ensuring that assessments remained timely, particularly if a country's Article IV staff report including the assessment from the previous ESR was completed or published "off-cycle" from the ESR. Some argued that the external assessments and the communication of them in ESR reports, as well as in Article IVs, did not take into account the potential market impact of assessments presented in the ESR. More broadly, a number of Directors expressed disappointment in the candor of the ESR's messages and its traction—that is, the degree to which it captured the attention of, and motivated action by, country authorities. A few Directors and academics argued that the report was prepared too infrequently to provide timely and impactful analysis and advice.[29] IMF staff pointed out that the annual frequency of the ESR reflects in part the need to integrate the analysis into the annual Article IV consultation cycle and noted that the semi-annual *World Economic Outlook* (WEO) includes a review of external imbalances, drawing on the ESR, and providing an update on relevant developments.

The IMF's work on external sector assessments has continued to evolve over the period considered by this update. Most recently, the 2017 ESR reflects an effort to increase transparency and improve the credibility of IMF analysis. For instance, the 2017 report provides, as an integral part of its presentation, a detailed description of how staff determines norms and arrives at bottom-line assessments (IMF, 2017d). It presents specific information about the role of staff judgment in arriving at bottom-line assessments and includes a table summarizing the policy advice for each individual country. The accompanying country pages discuss the adjustments made in each case, including their rationale and size. Further, for the first time, the report was discussed in a formal Board meeting, providing Executive Directors the opportunity to formally express their views and yielding a published "summing up" of the discussion (IMF, 2017e). At this meeting, Directors appreciated staff's efforts to better describe the methodology and improve transparency, especially in explaining the judgments made in arriving at their assessments in particular country cases. Nonetheless, Directors continued to call for staff to ensure that judgments are transparent, evenhanded, and multilaterally consistent. Directors also pressed for sharpening key messages further for communication to a broader audience, including integration into flagship reports.[30] They welcomed the planned review of the EBA, with inputs from experts and country authorities across the membership and Board members (IMF, 2017e).

Many Executive Directors and IMF staff interviewed for this update noted that there was a perceptible renewal

[28] The external sector assessments presented in the ESR are also included in Article IV surveillance staff reports, often as an annex that is identical to the country page in the ESR.

[29] It was initially envisioned that the ESR would be published bi-annually, with each WEO cycle (IMF, 2011e).

[30] IEO analysis suggests that consistency remains an issue, including in the presentation of the IMF's assessments. For instance, in the individual country pages, the IMF staff assessment of real exchange rates was expressed: in terms of "over/under/fair valuation" for 12 countries; as "stronger than/above or weaker than/below the level implied by fundamentals and desirable policies" for 12 countries; and as a "REER gap" for 4 countries. In 1 country page, the assessment describes the outcome of several models but does not provide a bottom line staff assessment. In 3 countries, the country page indicates that the assessment of the exchange rate reflects temporary factors or is expected to change.

of management attention to global imbalances in 2017. Directors welcomed this effort at a time when concern about global imbalances has again taken on a high profile in some member countries.[31] It remains to be seen to what extent the planned review of EBA methodology and future work on the ESR will succeed in addressing concerns about the IMF's external assessment work, and enhance confidence among the membership in the IMF's analysis and advice, and enhance its traction going forward.

Institutional View on Capital Flows

Assessing capital flows and related polices has become an important component of the IMF's conceptual framework for balance of payments analysis (see Figure 4.1). When these flows or policies have implications for domestic or global stability, IMF guidelines call for them to be discussed in the context of balance of payments analysis (IMF, 2015b). Accordingly, an assessment of capital flows and related policy measures is included as a component of the IMF's external assessments, included in the country pages of the ESR.

The IMF's analysis and advice in this area is governed by an institutional view on the liberalization and management of capital flows endorsed by most Executive Directors in November 2012 as "comprehensive, flexible, and balanced" and a "good basis for Fund policy advice" (IMF, 2012g).[32] The institutional view recognizes that full capital account liberalization may not be an appropriate goal for all countries at all times, and that under certain circumstances capital flow management measures can have a place in the macroeconomic policy toolkit; it does not expand the Fund's jurisdiction over the capital account but instead provides a basis for consistent and well-structured policy advice on capital flows.

The adoption of the institutional view in 2012 helped to bring a broad range of factors to bear in IMF policy advice on capital flows in a structured framework and moderated the perception of the IMF as a doctrinaire advocate of free capital mobility. At the time of its adoption, the view represented a somewhat tenuous consensus that did not resolve fundamental differences within the IMF membership and beyond about the appropriate speed and sequencing of capital account liberalization and use of capital controls to manage flows.[33] By the time of this update, however, the institutional view appeared to have gained greater acceptance as a valuable instrument to guide IMF analysis. In discussing a review of experience with the institutional view in December 2016, Executive Directors found that it remained relevant and did not need substantive adjustment (IMF, 2016h). At the same time, they supported staff's call for clarification in several areas, such as the distinction between capital flow management measures and macroprudential measures and how the institutional view can help achieve greater multilateral consistency in the design of policies for dealing with capital flows Subsequently, staff has continued to work on these issues, notably including the role of macroprudential policies in dealing with large and volatile capital flows and their interaction with capital flow management measures (IMF, 2017b).

The assessment of capital flows and related policy measures in surveillance, including as part of the external sector assessments produced as part of Article IV staff reports and the ESR, was a topical issue at the time of this update. A number of Executive Directors interviewed for the update emphasized that as IMF staff applied the institutional view in country cases, it will be important to duly reflect country circumstances and to carefully explain any judgments made, taking into account the objectives of country policies as well as the costs and benefits of potential alternatives. In discussing the 2017 ESR, some Directors also expressed the view that external sector analysis should focus more attention on capital flows and their impact on imbalances.

[31] According to the April 2017 WEO, preliminary data show flow imbalances holding steady overall in 2016, while imbalances continued to grow on a stock basis. Moreover, the IMF expects this trend to accelerate, given projections that the current account deficit in the U.S. will expand and that large current account surpluses will continue in European creditor countries and advanced Asian economies (IMF, 2017a). The 2017 ESR noted the unusual persistence of large current account surpluses, and the potential for continued growth of stock imbalances going forward (IMF, 2017d).

[32] There was not a full consensus in the Executive Board on adopting the institutional view, as a few Directors noted that it seemed premature and that they would have preferred further work and discussion (IMF, 2012g).

[33] Further discussion of the institutional view can be found in IEO (2015).

Reserve Adequacy

The 2007 evaluation assessed the IMF's approach to analyzing reserve accumulation and the uses and limits of intervention and their implications for exchange rate policy, given the inter-connections between reserves, intervention, and exchange rates. The evaluation concluded that there was insufficient guidance for staff in assessing countries' reserve levels and advising countries on the appropriateness or effectiveness of intervention strategies.

Since the 2007 IEO evaluation, IMF policy and staff guidance have been developed, through a series of staff papers and Board discussions, to provide for consideration of reserve adequacy in assessing external stability and the sustainability of exchange rate policies.[34] In a January 2015 Board discussion, most Executive Directors supported a systematic discussion of reserve adequacy issues in Fund surveillance reports and the methodology developed by staff to guide analysis for different country groupings, while recognizing the need for further refinements to the framework over time (IMF, 2015a). The 2015 Guidance Note for Surveillance thus calls for Article IV reports to assess the "adequacy of reserves for precautionary purposes," reflecting "country circumstances and risks … as well as the authorities' objectives and the cost of holding reserves" (IMF, 2015b). This assessment is to be based on the graduated approach to assessing reserves for mature, emerging market, and low-income country economies developed by staff and approved by the Board in January 2015—referred to as the "ARA metrics" (IMF, 2015a).[35] Consistent with the ISD principle that countries will intervene "if necessary to counter disorderly conditions" and that countries will "avoid exchange rate policies that result in balance of payments instability" (IMF, 2012b), bilateral surveillance is also expected to describe past intervention, to tailor analysis and advice in this area to country circumstances, and to "avoid an overly prescriptive approach" (IMF, 2015b).[36]

Executive Directors interviewed for this update expressed broadly positive views about the incorporation of a wider range of measures for assessing reserves, beyond the traditional import coverage metric. However, some Directors questioned whether IMF staff applied the new metrics consistently across country cases, while others expressed the view that staff analysis did not sufficiently take into account country circumstances. A few expressed the view that the ARA metrics yielded counterintuitive results. There were also questions about how the results of the metrics fed into policy advice, for instance when a country's reserves substantially exceeded the level suggested by the relevant ARA metric, but staff nonetheless advised the country to continue to accumulate reserves.

Several Executive Directors also expressed some doubts about the judgments made by IMF staff in analyzing exchange rate policy and reserve management. One example cited was a case in which IMF staff characterized intervention as "two way" despite the fact that reserves increased substantially during the time period assessed. A few Directors found it incongruous that staff described intervention as a "tool of monetary policy" in one case, while in other cases they underscored that intervention should be limited to avoiding disorderly market conditions.

While assessing the quality of staff analysis in this area is beyond the scope of this report, the update examined coverage and found widespread attention to reserve adequacy in Article IV staff reports. The IEO desk study of 20 Article IV staff reports found that all provided a clear assessment of the adequacy of reserves for precautionary purposes. This represents an improvement over the finding from the 2011 TSR (IMF, 2011c), even if the assessment

[34] The 2012 IEO evaluation of *International Reserves: IMF Concerns and Country Perspectives* documented some of the challenges in developing a standard approach. It noted that some members perceived that the Fund's efforts to introduce a metric for assessing reserve adequacy were specifically aimed at limiting reserve accumulation. These members took the view that countries hold reserves for many reasons, and that a single indicator could not capture the complexities associated with the costs and benefits of holding reserves, which are likely to be weighed differently by each country authority (IEO, 2012).

[35] This constituted, in part, an element of follow up on the 2012 IEO evaluation. The ARA metrics were broadly endorsed by the Executive Board, although some Directors continued to raise concerns about the idea that reserve adequacy issues would be systematically discussed in IMF surveillance, with some contending that such a systematic approach was "premature or unwarranted" and expressing the importance of country circumstances in considering reserve levels (IMF, 2015a).

[36] Following a February 2015 informal seminar in the Board about how to apply the provisions of the ISD in the context of unconventional monetary policies and foreign exchange intervention under disorderly market conditions, staff prepared a reference note, shared with the Board for information, to help guide country teams in analyzing the implications of members' policies in these areas and providing appropriate advice (IMF, 2016b).

of reserve adequacy was often provided solely as part of the external sector assessment in an annex to the report.[37] Discussion of intervention was less common: half of the sample of staff reports discussed the use of intervention, mostly focusing on its objectives.[38] This still represents an increase since the period covered by the 2007 evaluation, which found that Article IV staff reports "rarely" described the nature of intervention activities in any detail. Of note, the 2017 ESR included analysis exploring the relationship between current account positions and reserve accumulation over time, and concluding that the role of the latter in driving imbalances has diminished significantly. Nonetheless, some Executive Directors continued to believe that foreign exchange intervention was among the issues that deserved greater attention in external sector assessments going forward.

DATA

The 2007 evaluation identified serious problems with data provision for the purpose of exchange rate surveillance. In particular, the evaluation found that a lack of reliable data had limited the staff's ability to properly assess intervention, international reserves, and reserve management activities. The evaluation also highlighted a hesitancy among staff to pursue such data issues, due to a desire to maintain good relations with authorities as well as a perception that management and the Board would not support a more demanding approach.

Since the evaluation, the IMF has taken some steps to address data availability. In 2012, the IMF introduced the Special Data Dissemination Standard (SDDS) Plus data disclosure standard targeted at systemically important economies. The SDDS Plus adds nine required data categories (five during a transition period) beyond the SDDS deemed important for monitoring cross-border interconnectedness, including participation in the Currency Composition of Official Foreign Exchange Reserves (COFER) exercise as well as the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS). The CPIS and CDIS collect on cross-border portfolio and direct investment with information on counterpart countries. SDDS Plus adherents must disclose participation in COFER but are not required to publish the data provided to the IMF. Fourteen countries had adhered to the SDDS Plus as of July 2017. The IMF has also enhanced reporting of reserves under COFER, which provides for quarterly dissemination of the composition of reserves in an aggregate format for 146 reporters, consisting of IMF member countries, a number of nonmember countries/economies, and other entities holding foreign exchange reserves.[39] Work is continuing in this area, including as part of the G20 Data Gaps Initiative.

The IMF has also acted to improve staff handling of cases in which there are questions about data provision. This issue was addressed in the 2008 review of "Data Provision for Surveillance," which confirmed the 2007 evaluation's findings about shortcomings in data for exchange rate analysis and resulted in changes to staff instructions (IMF, 2008a). The next review by staff of this topic in 2012 nonetheless found that issues remained with respect to staff highlighting shortcomings in data provision (IMF, 2012e).[40] Accordingly, further changes were made to the taxonomy for classifying data adequacy, with specific instructions that Article IV staff reports should clearly identify "the main data deficiencies that affect surveillance, including data deficiencies that

---

37 The 2011 TSR found that discussions on reserve adequacy levels were either limited or unclear in about 60 percent of sample Article IV staff reports for countries which have their own national currency (IMF, 2011a).

38 The staff report for one country in the sample included a selected issues paper assessing the effectiveness of intervention in reducing exchange rate volatility (IMF, 2016f).

39 This followed questions raised by the 2011 TSR about the sufficiency of data for conducting thorough exchange rate and external balance analysis and concerns expressed by Executive Directors in the context of the 2012 review of data provision about whether the IMF was devoting sufficient attention to collection of timely foreign exchange intervention data.

40 The "2012 Review of Data Provision" found a discrepancy between ratings of country provision of data in Article IV reports and the results of the staff survey about the same issue, "suggest[ing] there may be some hesitancy by teams" to determine that data shortcomings are impeding surveillance (IMF, 2012e).

inhibit the assessment of financial stability or external sector assessments" (IMF, 2013b).[41]

However, data issues continue to be an area of concern, particularly data on reserves and intervention. The 2016 IEO evaluation *Behind the Scenes with Data at the IMF* noted that recent Article IV reports for key emerging market economies had not identified potential data shortcomings related to the availability of reserves as important areas for concern. Relatedly, a few Executive Directors interviewed for this update raised questions about the balance being struck on data issues, expressing specific concern about the continued non-availability of data from some countries on foreign exchange intervention. IMF staff interviewed for the update expressed frustration that intervention data was often not available and emphasized the importance of this data for undertaking a credible assessment of external stability. Indeed, data challenges, along with measurement difficulties, were among issues raised during the discussion of the 2017 ESR.

SPILLOVERS

Policy choices in one country—whether the exchange rate or other macroeconomic variables such as the interest rate—can affect exchange rates and other macroeconomic conditions in other countries. The 2007 IEO evaluation examined IMF analysis of the regional or systemic effects of large countries' policies, including intervention and its cross-border impact, and concluded that discussion of policy spillovers on regional or systemic stability received insufficient and inconsistent attention in IMF surveillance.

The ISD aimed to promote more comprehensive, integrated, and consistent spillover analysis, facilitated by formal legal authority to consider in its Article IV discussions with a member country the full range of spillovers from its policies, particularly when they may have a significant impact on global stability.[42] In addition to addressing the potential and actual impact of other countries' policies and global developments on a member's economy (inward spillovers), Article IV staff reports [must] discuss outward spillovers "if a member's policies are not promoting its own stability or if the member's policies are promoting its own stability, but they could nevertheless significantly affect global stability" (IMF, 2015b). The IEO desk study of 20 2015 and 2016 Article IV staff reports found that half (all 5 of the advanced economies in the sample, as well as the euro area, and 4 of 14 emerging market and developing economies) discussed outward spillovers, including effects of exchange rate policies on other countries.

In addition to increasing the focus on spillovers in bilateral surveillance, the IMF introduced stand-alone Spillover Reports on a trial basis in 2011 to enhance attention to the external effects of countries' policies, focusing initially on systemically important economies.[43] Among other things, these reports provided a prominent vehicle to discuss potential spillovers from monetary policies in systemic economies and to assess the impact of macroeconomic policy decisions in these countries on capital flows and exchange rates in the rest of the IMF's membership. For instance, the 2013 report discussed challenges posed by "undue exchange rate appreciation pressures" in emerging market economies that were often caused by easy monetary conditions in advanced economies. The 2014 report focused on the impact of monetary policy normalization in advanced economies, assessing spillovers associated with different underlying drivers of higher yields. The 2015 report assessed the potential implications of asynchronous monetary policy normalization—in particular between Europe and the United States—including the fallout on exchange rates, given increasing corporate debt in emerging markets.

The spillover report was discontinued as a stand-alone product in 2016, with spillover analysis to be integrated into the WEO. Spillover issues are invariably discussed in the first, overview chapter of the WEO, and, in addition, a dedicated analytical chapter on spillovers is now included in the WEO once each year. This practice began in October 2016 with a chapter that extended the

41 Staff teams are required to choose among the following ratings: (A) data provision is *adequate* for surveillance; (B) data provision has some shortcomings but is *broadly adequate* for surveillance; or (C) data provision has serious shortcomings that *significantly hamper* surveillance (IMF, 2013b).

42 IEO (2017) discusses this issue further.

43 In 2011, separate reports were prepared as background documents for the respective Article IV consultations of five systemically important countries (China, the euro area, Japan, the United Kingdom, and the United States), and a consolidated Spillover Report was also issued, drawing from the individual reports.

scope of analysis to focus on potential spillovers from emerging economies, "Spillovers from China's Transition and Migration" (IMF, 2016e); the October 2017 WEO included a chapter on spillovers from fiscal policies in systemic advanced economies, noting the potential impact on external imbalances. A detailed analysis of the adequacy of treatment is beyond the scope of this update. A standing Spillover Taskforce led by the Research Department (RES) helps sustain focus on these issues and also oversees an ongoing series of Spillover Notes; nine such notes were issued between July 2015 and November 2016.[44] Although attention to spillovers has clearly increased over the last decade, some Executive Directors interviewed for this update expressed concern about whether spillovers from major economies are receiving sufficient attention, both in bilateral and multilateral surveillance. This sentiment was reflected in the December 2016 discussion of experience with the institutional view on capital flows, during which "many Directors encouraged staff to pay more attention in its surveillance to the role of source countries in internalizing policy spillovers" (IMF, 2016h).

EVENHANDEDNESS

Treating similar countries facing similar circumstances in a similar manner and approaching countries across the membership in an even-handed way has been cited as a "cornerstone" of IMF operations, although "there does not appear to be an established definition as to what constitutes even-handed surveillance" (Callaghan, 2014).[45] While the 2007 IEO evaluation identified no clear-cut cases of uneven treatment related to exchange rate policy, it found continued strong perceptions of inconsistency among the membership and argued that more could have been done to counter them. For instance, the evaluation suggested that the IMF could provide better explanations for particular policy advice and take care that similar types of assessments are delivered with similar degrees of analytical detail to preserve an evenhanded approach.

Ensuring evenhandedness is an inherently difficult exercise. The IMF has sought to address evenhandedness concerns identified by the 2007 evaluation. Both the 2008 and 2011 TSRs acknowledged the need for greater attention to evenhandedness in exchange rate assessments and called for steps to enhance work in this area, although without new initiatives. The 2014 TSR undertook a broader study of evenhandedness issues and discussed the importance of focusing on how surveillance is conducted.

An explicit motivation for the IMF's efforts to enhance the analytical underpinnings for IMF exchange rate policy advice has been to help increase consistency of treatment. For instance, the ESR was introduced with the goal of "supporting greater accountability, candor, and evenhandedness" (IMF, 2011a). Underlying this exercise, the EBA provides a common framework for analysis of real exchange rates and external stability, and the IMF makes available detailed information about the models. The introduction of the EBA-lite also aimed to bring greater consistency and evenhandedness to IMF analysis. Yet the need for IMF staff to use judgment in applying the models to country circumstances can lead to questions about evenhandedness and transparency. As noted above, some Executive Directors interviewed for this update saw inconsistencies in the application of the EBA model and noted that greater transparency about the adjustment of inputs or interpretation of results was needed to achieve confidence about balance and evenhandedness. A few highlighted the use of language in some IMF staff

[44] This series of notes can be found at http://www.imf.org/en/Publications/SPROLLs/Spillover-Notes.

[45] Evenhandedness is a concept based in the cooperative nature of the IMF, which under the Articles of Agreement applies consistent rules across the membership, for example, for lending in proportion to member countries' quotas. Guitián (1992) described evenhandedness as a "fundamental" principle of the IMF, "according to which the IMF is expected to act without discrimination: treatment of members must remain equal and comparable, allowing for no preferences in favor of any country or group of countries," although "uniformity cannot be interpreted to mean the provision of equal treatment regardless of circumstances … [but instead] must allow room for taking account of unequal circumstances." Callaghan (2014) noted that, "the discussion during a seminar on surveillance held during the April 2014 meeting of the IMFC made clear that member countries held a range of views on what constituted evenhanded surveillance." As noted in the text, the Executive Board adopted a set of principles for evenhandedness in surveillance in December 2016.

reports in which word choice conveyed a positive view of increasing surpluses.[46]

More broadly, some questions remain about the overall balance of the IMF's approach. A few staff members interviewed for this update noted that they faced a continued perception among some member country authorities that the IMF's work on external sector assessments was driven by the interests of a single major shareholder. There were also perceptions among some Executive Directors of a bias in IMF analysis. Criticisms came from both directions: some Directors insisted that the IMF focused sharp assessments on countries with surpluses, with no attention to deficit countries, while others contended that the IMF put the burden on deficit countries, putting little if any pressure on surplus countries to adjust. A special focus on current account surpluses in the 2017 ESR was welcomed by the latter group but prompted calls from others for a similar focus on deficits in future (IMF, 2017e). A few Directors also felt that IMF external sector assessments focused too narrowly on examining the current account and paying too little attention to, for instance, the role of monetary policy in systemically important countries in affecting exchange rates and contributing to global imbalances.[47]

With respect to these broader questions about the approach as well as more technical issues with the methodology, IMF staff took the view that they had developed a state-of-the-art technique and continued to work to refine and enhance their work to reflect input from the membership as well as developments in the profession. They maintained that they had put in place a rigorous process to ensure the best staff judgments and to apply the external assessment approach in an even-handed manner. IMF staff noted that this year's ESR discussion was characterized by strong attention to the underlying methodology and its evenhanded application, with several Fund members currently engaged in discussions or ongoing (re)negotiations of bilateral and regional trade agreements.

In February 2016, following up on the 2014 TSR, IMF staff and management proposed a set of principles for evenhandedness in surveillance more generally and a new mechanism for authorities to report concerns about specific cases (IMF, 2016c). The principles were intended to help establish a common understanding of what it means to be evenhanded and to provide a tool to help assess inputs and outputs of surveillance—focusing on the allocation of resources, quality and depth of analysis, and form and style of engagement. The mechanism for reporting concerns provides for Executive Directors to submit written concerns, which would be assessed by an interdepartmental committee and addressed by management. Findings and a plan to prevent recurrence of similar issues would be reported to the Director who had submitted the concern, as well as summarized annually in an internal report for the Executive Board. While the principles and mechanism were broadly supported by the Board and are now in place, it is too soon to assess their effectiveness or impact.

[46] For instance, the 2016 ESR stated that "current accounts in euro area improved in most countries, and especially in debtor countries" in a report that described an overall increase in the euro area's current account surplus, contributing to a widening of imbalances. While the 2016 Article IV staff report for Germany clearly concluded that the country's external position was substantially stronger than implied by medium-term fundamentals and desirable policy settings, and called for actions to speed up rebalancing, the report described "improvement in the current account" even as the surplus widened to 8.5 percent of GDP in 2015. The assessment also stated that "the government contributed about ⅓ percent of GDP to the improvement in the current account in 2015" even as the IMF staff recommendation from the previous year called for policy measures to reduce the surplus. The 2017 staff paper on "Euro Area Policies" (IMF, 2017c) used more balanced language, conveying declining current account deficits as a positive development and persistent or rising surpluses as a negative one: "Most net external debtor countries have had current account improvements. By contrast, some large net external creditor countries have failed to curb their large and persistent current account surpluses." Nonetheless, some Directors continued to express a desire for more neutral descriptions of imbalances.

[47] These concerns echo findings of the 2009 IEO evaluation of *IMF Interactions with Member Countries* (IEO, 2009).

5

MANAGEMENT AND ACCOUNTABILITY

The 2007 evaluation found shortcomings in the management of work on exchange rate issues, including a lack of clarity around responsibility and accountability among the area and functional departments, as well as questions about whether there was sufficient accountability to the Executive Board for advice.

IMF management and staff have introduced several new mechanisms for organizing their work on exchange rate policy and related issues as part of implementing the ISD and the new approach to external sector assessments. An external sector coordinating group comprised of area and functional departments prepares the ESR, integrating analysis from multilateral and bilateral surveillance with the goal of producing a consistent, institution-wide view. Discussions within this group are iterative, with attention to individual country assessments as well as the overall view, in order to help ensure consistency between the ESR and Article IV staff reports. The group is led by the RES in collaboration with the Strategy, Policy, and Review Department (SPR) and coordinating with area and other functional departments, helping enhance the connection between advances in theory and modeling tools and the execution of analysis and advice. IMF management is actively involved in the process. The coverage of exchange rate and external sector issues in Article IV staff reports for ESR and non-ESR countries and the quality and consistency of analysis and advice are also subject to review by other departments, with particular focus on external sector issues as well as the overall analysis and advice. An internal website on issues related to external sector assessments provides access to operational guidance, tools, and resources.

Staff interviewed for this update felt that the interdepartmental cooperative arrangement for undertaking external sector assessments generally worked well. They described hashing out different views and adding texture to the ESR narrative, for instance to reflect the role of capital flows in the 2016 ESR. This process was seen as time-consuming but necessary. Staff also reported active engagement between country teams and the methodological experts, particularly on EBA-lite, including via the Knowledge Exchange, an internal system for information sharing. Examples of good practice in external assessments have been made available to country teams via the intranet, as part of the follow-up on the 2014 TSR. Nonetheless, a few staff interviewed for the evaluation noted challenges in developing and maintaining a consistent IMF position on the external sector assessment and appropriate policies for their country. Even after a view was agreed for the Article IV staff report, they said, they felt the need to fight the tendency for others in the institution to advocate a different line in multilateral products or public remarks.

Beyond the organization of IMF staff work on exchange rate issues, the 2007 evaluation raised questions about accountability for exchange rate policy advice. The evaluation acknowledged the tension between providing confidential advice to build trust and increase traction with policy makers in member countries, on the one hand, and fully informing the Board about discussions, on the other. The evaluation nonetheless expressed concern about the absence of a mechanism for Board oversight of advice provided by staff that was not discussed in Article IV staff reports.[48]

The balance between confidential advice and accountability to the Executive Board appears to remain at the discretion of staff and management. A few IMF staff interviewed for this update confirmed that advice is provided to member countries on exchange rate issues on a confidential basis and not reported in Article IV staff reports. These staff members noted that they kept management informed, and that any judgment about sharing information with the Board would be up to management. A number of Executive Directors also indicated that not all discussions on exchange rate policy issues are included in Article IV staff reports; these Directors felt this was appropriate. The "2013 Review of the Fund's Transparency Policy" discussed the principles underlying disclosure of information to the Executive Board, indicating that IMF staff and management were expected to share with the Board the authorities' policy positions and plans in areas that are relevant for Fund surveillance or financial assistance but not hypothetical courses of action discussed informally with the authorities (IMF, 2013a). This paper included an appendix with additional details on the legal framework for the treatment of confidential information. Nonetheless, the question raised by the 2007 evaluation about accountability for policy advice provided without the oversight of the Board has not been addressed.

On a related governance matter, while there has been progress in advancing Board and membership consensus on some key issues raised by the 2007 evaluation, Board engagement on these issues has in some cases been limited, raising issues for accountability. For instance, the Board has not engaged in a formal discussion of issues such as regime choice and exchange rate intervention but instead held informal seminars on these topics.[49] Such informal discussions provide the opportunity for early engagement by the Board, but if this is not followed by a formal Board discussion, IMF policy in key areas may remain uncodified or evolve without the endorsement of the membership. Similarly, the first five ESRs, three of which were pilots, were discussed by the Board only in informal sessions for Executive Directors "to engage," with no subsequent summing up to reflect Directors' views. As noted above, the recent formal Board discussion of the 2017 ESR and publication of a "summing up" in which Directors expressed their support for the process while raising questions about some aspects of the methodology and resulting advice, is an important step that has the potential to enhance the IMF's engagement and impact on global imbalances.

[48] The 2007 IEO evaluation found that intense discussions on exchange rate issues, including regime choice, took place in a number of cases "with little or no documentation in staff reports;" the evaluation highlighted that "the lack of reporting to the Executive Board of substantive issues in the context of Article IV consultations … raise[s] issues of accountability as well as the appropriate bounds of confidentiality." Although the Board did not initially endorse the 2007 evaluation report's recommendation to clarify expectations for staff in this area, the ensuing Management Implementation Plan (MIP) referred to a pending discussion of this issue in the Board's Ad Hoc Committee on Confidential Information. The 2013 IEO evaluation of *The Role of the IMF as Trusted Advisor* found that there was "little clarity" regarding what information about countries' policy positions and intentions must be provided to the Executive Board and noted that "significant variability" in staff practices in this area suggested "ambiguity on how to deal with confidential discussions" (IEO, 2013).

[49] As noted in the section "Exchange Rate Regimes" above, the Executive Board discussed a staff paper on exchange rate regime choices in 2009 in an informal seminar.

6 CONCLUSION

The IMF deserves recognition for the progress over the last decade in overhauling its approach to exchange rate policy advice, enhancing its work in an area central to its mandate. In particular, the 2012 ISD provides for a broader approach to external analysis that aims to address the interrelationships between economies and pay greater attention to the connections between domestic and external stability, which is now broadly accepted. There is now more explicit guidance for IMF staff on assessing balance of payments stability, including alignment of the current account and exchange rate with fundamentals and desirable policies. The IMF has refined methodological tools to enhance this analysis and its consistency across countries, as well as an institutional view to guide assessments of capital flows and related policies. A new External Sector Report provides a multilaterally consistent picture of the external balances of major economies and the policy actions needed to address imbalances. Progress has been made in increasing attention to spillovers, including the outward effects of domestic policies on other economies. The IMF also has taken on board concerns about evenhandedness, raised by IEO reports and confirmed in its own reviews, and recently introduced a mechanism for member countries to report concerns in this respect about surveillance.

Nonetheless, despite the multifaceted work in this area, and ongoing efforts on a number of aspects, this update concludes that challenges remain that impact the effectiveness of the IMF's work in this area. Of particular concern, the approach for assessing external balances and exchange rates continues to be contentious. Executive Directors acknowledge IMF staff's continuing work to enhance the EBA model, as well as the consistency and transparency in the process for arriving at bottom line assessments, but Directors continue to question specific features of the model, and concerns about the evenhandedness of its application persist. There are also questions about the focus on the current account in deriving an assessment of the exchange rate level, with less attention to the capital account, in particular the role of financial market factors. In addition, the absence, identified in the 2007 evaluation, of an up-to-date institutional view on the considerations in countries' choices of exchange rate regimes also persists, as does the lack of consensus about the need for it. More broadly, the update finds continued differences of view across the membership about the process of external adjustment, which contribute to alternative perspectives on the IMF's role on exchange rate issues and doubts about whether its engagement on these and related policy issues adequately addresses the challenges that global imbalances pose for the system.

These ongoing questions merit a full evaluation that goes beyond exchange rates to examine the quality and effectiveness of IMF work on external balances, including the underlying analytical framework and methodologies, the resulting policy advice, and the traction of IMF engagement in promoting stability in the international monetary system. A full evaluation would consider in detail the experiences and perspectives of member countries, as well as IMF staff, management, and the Executive Board. Among other things, it could also examine the results of the current review of the IMF's methodology for external assessment, which the staff intends to complete before the 2018 ESR.

ANNEX 1

EXCERPTS FROM IMF ARTICLES OF AGREEMENT

ARTICLE IV, SECTION 1. GENERAL OBLIGATIONS OF MEMBERS

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

- (i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;
- (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;
- (iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and
- (iv) follow exchange policies compatible with the undertakings under this Section.

ARTICLE IV, SECTION 3. SURVEILLANCE OVER EXCHANGE ARRANGEMENTS

- (a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.
- (b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.

ANNEX 2

STATUS OF IMPLEMENTATION PLAN IN RESPONSE TO BOARD-ENDORSED IEO RECOMMENDATIONS ON IMF EXCHANGE RATE POLICY ADVICE, 2007–16

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
1. **Clarify the rules of the game for the IMF and its member countries.** As discussions proceed on surveillance policy initiatives, a revalidation of the fundamental purpose of surveillance would be an important goal. Central to this is the requirement on countries, and the IMF, to consider the consequence for others of an individual economy's policies, including exchange rate polices and other measures that affect exchange rates. Since relevance and effectiveness cannot be legislated, however, the key lies in ensuring the trust and willingness of countries to cooperate within whatever legal framework is in place.	"Most Directors agreed … that a revalidation of the fundamental purpose of surveillance is an important goal, although views differed on the best vehicle through which this revalidation could occur." "Most Directors noted that the update of the 1977 Decision currently under way should help toward achieving the goal of revalidating the objectives of surveillance." "Some Directors suggested that a periodic statement of priorities and responsibilities would usefully complement a revised Decision."	**Adoption of the 2007 Decision on Surveillance.** The 2007 Decision on Bilateral Surveillance over Member's Policies has revalidated the fundamental purpose of surveillance. The new Decision has made clearer what is expected of surveillance and provided guidance in various areas covered by the IEO report, such as assessment of exchange rate levels and policies, candor, and evenhandedness. To support implementation of the new Decision, the Surveillance Guidance Note (SGN) will be fully revised by end-2007. The revised SGN will fully reflect the expectations set out in the new Decision with regard to Fund surveillance, including in the area of exchange rate surveillance. Guidance on the operational aspects related to the 2007 Surveillance Decision is expected to be made available by October 2007. In the meantime, an Interim Guidance Note was issued and substantial outreach material has been produced to familiarize staff and others with the new Decision. **In discussing the MIP,** Directors noted that the 2007 decision was a centerpiece of the implementation plan and "considered this appropriate ….. Many Directors noted that a number of questions have arisen in the first months of implementation of the 2007 Decision, and stressed the need for their early resolution by developing a clearer and shared understanding of these issues."	**Second PMR (2008).** The 2007 Decision on Bilateral Surveillance, which updates the 1977 Decision on Surveillance over Exchange Rate Policies, has been adopted (PIN No. 07/69) and is being implemented. An Interim Guidance Note to staff on the 2007 Decision was issued in June 2007 (SM/07/228). During the first year of implementation of the new Decision, the record has been mixed in meeting its objectives. In particular, there has been progress in enhancing the focus of surveillance and strengthening attention to exchange rate issues. However, there have been difficulties related to the third objective relating to candor and clarity on external stability and exchange rate issues that was intended to promote a stronger engagement with the membership as well as evenhandedness. To address some of these issues, additional guidance on the operational aspects of the Decision was informally discussed by the Executive Board in July 2008 and published in August 2008. The paper presented procedural and conceptual guidance to better implement the Decision. To ensure evenhandedness, "ad hoc consultations" were proposed in cases where there was significant concern that a member may not be observing a principle for the guidance of members' exchange rate policies, or that its exchange rate may be fundamentally misaligned. An updated Surveillance Guidance Note is expected to be issued after the Board discussion of the Triennial Surveillance Review (TSR). **Third PMR (2009).** Largely completed. Revised guidance on operational aspects of the 2007 Surveillance Decision was issued in June 2009. An updated Surveillance Guidance Note, which reflects both the TSR and the 2007 Surveillance Decision, is expected to take effect in October 2009. **In discussing the Third PMR (2009),** the Evaluation Committee (EVC) considered that progress is still ongoing and more needs to be done to achieve the broader policy objective underlying the specific IEO recommendation. **Fifth PMR (2012).** The 2008 and 2011 TSRs contained recommendations clarifying the content of exchange rate surveillance. Guidance to staff was provided in revised Surveillance Guidance notes following each TSR.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
2. Develop practical policy guidance on key analytical issues. This would be based on the latest research and cross-country experience and would help to ensure an evenhanded approach across the membership. Two priorities would be (see subsidiary recommendations below):	Directors "had diverse views regarding the need for such guidance and on the feasibility of developing it." "Many Directors saw the need for practical policy guidance on specific aspects of exchange rate policy advice, while some Directors underscored the practical difficulties in formulating such guidance." Many Directors noted that "more effort needs to be put into integrating cutting edge techniques into the Fund's country work, and in disseminating such knowledge within the Fund."	Revised Surveillance Guidance Note (by end-2007, note that guidance related to the 2007 Decision may be issued by October 2007). The revised SGN will include guidance on assessing exchange rate levels and on the uses and limits of intervention, emphasizing the need to tailor advice to country circumstances and avoiding an overly prescriptive approach. Expand and improve CGER work (including refine methodologies and expand it to key low-income countries and producers of exhaustible resources). RES will continue to refine the CGER methodology against a gradually increasing stock of experience in applying CGER in exchange rate surveillance. Work planned in this area includes an examination of whether CGER estimates are broadly in line with subsequent real exchange rate movements at different horizons and work on the link between capital flows and real exchange rates. In addition, RES will seek to expand, with the help of area departments, the CGER methodology to key low-income countries and producers of exhaustible resources. Given the significant data limitations and analytical challenges in this project, the results would be expected to be shared with the Board on a trial basis in FY2009 in the context of the semi-annual CGER note. **In discussing the MIP,** a number of Directors "cautioned that significant technical limitations will continue to exist in estimating equilibrium exchange rates, and saw a need to improve further CGER assessments of industrial and emerging markets before expanding the work to other countries." Knowledge dissemination. A coordinated training plan will be developed by INS and PDR in 2008, and a section of examples of best practice in exchange rate surveillance will be posted on the PDR website in late 2007.	**Second PMR (2008).** Guidance on operational aspects of the 2007 Surveillance Decision issued in July 2008 and published in August 2008. Updated Surveillance Guidance Note to be issued after Board discussion of the TSR. Priority in the CGER work program has been given to assessing the performance of past CGER predictions and improving the current methodology. Work is also underway on expanding CGER to LICs and producers of exhaustible resources. Preliminary versions of these methodologies are expected for the spring of 2009. Work on knowledge dissemination is proceeding and most of it is expected to be completed in the summer of 2008. This work has been designed to cover two areas: (1) Information repository; housed in a dedicated web space and to contain relevant information on exchange rate analysis techniques (including templates), historical data sets, and good sample cases in Fund's work (already available from PDR's website). (2) Training materials for CGER methodologies, exchange rate regime classification, and analysis of foreign exchange operations. Analysis of exchange-rate-related issues is being enhanced, including through hands-on guidance on CGER methodologies, and sharing of key datasets and good practices. Emphasis on analytical work on exchange rates at the departmental level has also increased. **Third PMR (2009).** Largely completed. Revised guidance on operational aspects of the 2007 Surveillance Decision was issued in June 2009. An updated Surveillance Guidance Note, which reflects both the Triennial Surveillance Review and the 2007 Surveillance Decision, is expected to take effect in October 2009. A Working Paper outlining a methodology to assess current account balances in exporters of non-renewable resources was issued. A second Working Paper, which presents three CGER-type methodologies for exporters of non-renewable resources, is forthcoming in the fall of 2009. The extension and adaptation of CGER methodologies to low-income countries is also at an advanced stage. Preliminary background notes should be available in the fall of 2009.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
		Dissemination efforts (training, workshops, and seminars) will be further strengthened. Such efforts will ensure that relevant existing knowledge and techniques are translated into operational use by staff teams. While INS already has a strong training program in exchange rate issues, INS and PDR will work together, in consultation with RES and MCM, to develop a coordinated and targeted dissemination plan in early 2008 to ensure that staff teams are familiar with existing techniques for assessing exchange rate levels and regimes and aware of best practices in this area. In addition, a section containing examples of best practice in exchange rate surveillance will be created on PDR's website in late 2007. **In discussing the MIP,** "many Directors also reiterated the need to exercise careful judgment in interpreting CGER estimates, given large methodological uncertainties, and called for better integrating quantitative and qualitative methods, while paying due regard to country circumstances."	**Fifth PMR (2012).** As part of improved guidance and knowledge dissemination, the Surveillance Guidance Note was revised following the 2011 TSR, and a new intranet site has been set up to help provide effective dissemination of guidance and best practice examples. Following Board endorsement of the Managing Director's 2011 Statement on Strengthening Surveillance, Fund staff is preparing an External Sector Report (ESR) that will analyze external sector imbalances on a multilaterally consistent basis. Staff is developing improved exchange rate methodologies, the External Balance Assessment (EBA), building on CGER. These include greater country coverage and address identified shortcomings of the CGER approaches. **Sixth PMR (2014).** The "Guidance Note for Surveillance under Article IV Consultations" issued in October 2012 … indicates that Article IV staff reports are expected to provide a clear assessment of: (i) the current account and the exchange rate level/competitiveness; (ii) developments arising from the capital and financial account that could lead to balance of payments instability for the member or its trading partners; and (iii) the cross-border spillovers from any of the above developments/policies that may significantly impact global stability. The Note establishes that assessments of balance of payments stability in staff reports should include a clear analysis and bottom line view of whether the current account and the exchange rate are broadly consistent with medium-term fundamentals. This analysis should be integrated into the broader assessment of stability and the overall policy mix, and should support clear policy recommendations. Numerical exchange rate estimates should be included in staff reports (drawing from the Pilot ESR, the EBA where available, and the CGER and/or CGER-type estimates), except for countries with serious data limitations, where the assessment may be largely qualitative. **Seventh PMR (2015).** The 2015 "Guidance Note for Surveillance" indicates that staff should provide a clear bottom line assessment of the member's balance of payments based on a broad perspective. The assessment should go beyond surveillance of exchange rate and exchange rate policies, with staff encouraged to cover five key areas: current account, capital flows and policy measures, exchange rates, reserves and foreign exchange intervention, and external balance sheets. BOP assessments should be fully integrated into the staff's advice on the overall policy mix. EBA and EBA-lite methodologies can help identify the contribution of domestic (and foreign) policies to external imbalances, but staff should discuss policy contributions to external imbalances regardless of the methodologies used.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
—**On the stability of the system.** Undertake a periodic Board review of the stability of the system of exchange regimes and exchange rates, taking into account the array of chosen regimes, global liquidity conditions, and other issues. Conclusions would provide an updated framework for guidance in country cases.	"A number of Directors saw merit in a Board discussion on the stability of the system of exchange rates, similar to the one undertaken in 1999. A number of other Directors, however, noted that the WEO already provides a useful platform for such an assessment."	Tentatively, review of the stability of the system of exchange rates in 2009. Depending on resource constraints, a review of the stability of the system of exchange rates is tentatively planned for 2009, similar to the one conducted in 1999. This review—to be prepared by RES and PDR, in consultation with MCM—would focus on implications for international financial stability of trends in exchange regimes and policies, as well as other relevant developments, during the current decade. Results of the review could be useful input for potential further guidance in the area of exchange rate policy advice and regime assessment.	**Third PMR (2009).** Completed. A paper entitled "Toward a Stable System of Exchange Rates" was discussed at an informal Board seminar in July 2009 and will be published as an Occasional Paper in the near future. **In discussing the Third PMR (2009),** the EVC considered that "progress is still ongoing and more needs to be done to achieve the broader policy objective underlying the specific IEO recommendation."
—**On the use and limits of intervention.** As an input to developing guidance to staff, ask authorities during Article IV consultations to describe the range of reserve holdings/public net foreign positions they expect to hold over the period ahead, and the reasons for establishing such a range. Discussion could then take place both on the range presented and on the arguments to justify it, which would provide a benchmark for subsequent discussions.	"On balance, Directors encouraged staff to discuss the uses and limits of intervention wherever relevant from the macroeconomic perspective in Article IV consultations, bearing in mind the importance of flexibility and of tailoring advice to country circumstances and of avoiding an overly prescriptive approach." "Some Directors also underscored the practical difficulties in formulating guidance and the limitations in prescribing optimal reserve levels. Other Directors saw scope for guidance, particularly on intervention."	The revised SGN will include guidance on assessing exchange rate levels and on the uses and limits of intervention, emphasizing the need to tailor advice to country circumstances and avoiding an overly prescriptive approach.	**Sixth PMR (2014).** In January 2015, the Board will be briefed on The Role of Exchange Rate Intervention: Issues and Experiences, which will include a review of country experiences, taking into account specific characteristics, external conditions, and the impact of capital inflows and outflows. **Seventh PMR (2015).** An informal Board discussion on "Foreign Exchange Intervention—Issues and Experiences" was held in February 2015. The discussion focused on key considerations for foreign exchange intervention under disorderly market conditions and for applying the Fund's framework to quantitative easing/quantitative external easing.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
3. Management should give much greater attention to ensuring effective dialogue with authorities. This task should be assigned as much weight as developing the right advice.	"Directors agreed that there remains scope to explore further ways to improve the dialogue with member countries, and to address any perception of lack of evenhandedness … and called for further efforts in this area."	No action proposed in MIP. **In discussing the MIP,** Executive Directors "highlighted some important areas that merit further careful attention by staff and management. Several saw scope for clarifying actions related to improving the effectiveness of dialogue with members and to providing incentives to staff to raise controversial issues in the conduct of surveillance."	**Fifth PMR (2012).** The 2011 TSR recommended greater transparency and explanation of exchange rate assessment methodologies for the country authorities and the public. Staff is currently examining best practice enhancements to CGER to ensure consistency across the membership. In addition, to enhance evenhandedness and promote knowledge dissemination, the Research Department has produced practical guidance to desks on implementing CGER. The ESR report will transparently present assessments of current accounts, exchange rates, capital flows, reserves (including intervention), and net foreign asset positions for 28 major economies plus the euro area. **Sixth PMR (2014).** Pilot ESRs were issued in 2012 and 2013 with the aim of making surveillance of external imbalances more effective. These reports are prepared by an External Sector Report Coordinating Group consisting of representatives from functional and area departments, which is supported by an interdepartmental team. … The analysis broadens external sector surveillance, … combines multilateral and bilateral perspectives, and seeks to integrate exchange rate assessments with the evaluation of the country's overall policy mix.
—Management should develop a strategic approach to identify opportunities to improve the effectiveness of the dialogue, involving senior management and with support, when necessary, from Executive Directors. This would also involve ensuring the staff team has the right kind of expertise, planning whom to engage in discussions and when; calibrating the format of the message to particular needs. In the performance appraisal process, the success of ensuring effective dialogue would be defined and rewarded.	"Directors encouraged management to give consideration to the IEO recommendations in this area, particularly to a strategic approach to identifying opportunities to improve the effectiveness of the dialogue." "Ensuring that missions have the right mix of skills and expertise…was seen by many as requiring further efforts".	(a) Surveillance agendas. The new tool of surveillance agendas is encouraging an early focus on the engagement strategy with the authorities. Staff will be encouraged, whenever feasible, to seek inputs from the authorities on critical policy issues that should be the focus for surveillance, as well as areas where the authorities see potential value-added through technical assistance. In addition, as suggested in the 2004 Biennial Surveillance Review, member countries could be encouraged to prepare policy statements, which would be an input into policy discussions. (b) Ongoing initiatives to strengthen financial sector expertise in Article IV missions will improve the skill mix of staff teams over time. Participation by MCM staff in Article IV missions is being increased, and staff teams are also being encouraged to seek more actively technical inputs from MCM at an earlier stage of surveillance. Moreover, INS and MCM are setting up a financial sector surveillance training program featuring two new one-week courses expected to be attended by about 60 mission chiefs and desk economists a year, with the first deliveries expected in late 2007 and early 2008 respectively; and INS will also provide a one-week course targeted at economist with little or no training in finance, starting in October 2007.	**Second PMR (2008).** Surveillance agendas are prepared for all countries alongside the Article IV cycle. MCM participation in Article IV missions increased to about 60 consultations in FY2008. A decline is planned in FY2009 (40–50 missions), but ongoing training on financial sector issues targeted to country desks and mission chiefs should help ensure that mission teams keep the right mix of skills and expertise. **In discussing the PMR,** the EVC proposed several issues for further reflection and future work and looked forward to reviewing progress in future PMRs. "On initiatives to increase MCM participation in Article IV missions, the financial crisis has clearly heightened the importance of strengthening the Fund's advice on financial sector issues. The EVC looks forward to management's and staff's continued attention to this issue." **Fifth PMR (2012).** Surveillance agendas have been discontinued as they were found to an overly bureaucratic. Instead, the TSR focused on ways to be attentive to members' needs. For example, country teams will exchange views with authorities on key issues for discussion prior to Article IV missions, without compromising their capacity—and obligation—to raise relevant, and at times difficult, issues. Staff produced the first Consolidated Multilateral Surveillance Report (CMSR) in 2011, and a second in April 2012, to promote engagement

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
—Management and the Board need to adjust the incentives to raise controversial issues.	"Staff should be encouraged to raise controversial issues with the authorities, to better understand the viewpoint of national authorities, and to ensure evenhandedness."	The improvement in skill mix will help strengthen understanding of the market underpinnings of exchange rate issues and integrate financial sector analysis in exchange rate surveillance. Clearer expectations and support from Management: Management will help promote candor in surveillance, and the Board too will need to play its part. Management will make clear to staff, for example, through its participation in the Surveillance committee, its expectations that critical issues—including controversial ones—should be adequately raised and covered in surveillance. Management's clearance of staff reports already signals its support for the positions taken by staff on potentially controversial issues, and management will provide support when needed in discussions with authorities or at the Board. With the adoption of the new Surveillance Decision, the Board's role in supporting candor in surveillance is expected to be further strengthened.	at the ministerial level. The 2011 TSR recommended steps to improve engagement including by exchanging views with authorities on key issues prior to Article IV missions and having Article IV reports follow up on past policy advice. These have been included in the updated guidance note and are being implemented. **Second PMR (2008).** The Managing Director has made clear in his Strategic Directions paper that he envisions an IMF more critical in its assessments (especially in good times), and more assertive in communicating its concerns (BUFF/08/27, Rev. 1). **Fifth PMR (2012).** The 2011 TSR emphasized the need for greater candor and that traction could be increased via the steps listed in the Managing Director's statement on Strengthening Surveillance. **Seventh PMR (2015).** Despite progress reported by senior staff, the 2013 Staff Survey showed poor results in the evaluation of risk taking and empowerment among A-level staff.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
4. **Management and the Executive Board should resolve inconsistencies and ambiguity over the issue of regime classification.** Whatever solution is found would benefit from being approved by the Executive Board and would involve removing the stigma of particular labels. For Article IV staff reports for countries with intermediate regimes (all but independently floating rates and hard pegs), the priority should be to have an unambiguous description of the authorities' regime, including how it works in practice. The description could be agreed to by the authorities and staff, or differences of view should be described clearly to the Board. Subsequent Article IV consultations could revalidate the existing description or revise it.	"Directors reaffirmed the importance of a clear description of the de facto exchange rate regime. Many Directors also underscored the need to better understand the factors underlying differences between the de facto and de jure classifications."	(a) Revised Surveillance Guidance Note: the revised SGN will provide clear guidelines on description and analysis of de facto and de jure regimes. It will clarify that the existing requirement of identifying in staff reports the de facto exchange rate regime requires primarily a careful description of backward-looking de facto exchange rate policies, with inputs from the classification maintained by MCM. It will also underscore the importance of discussing clearly the authorities' forward-looking policy intentions. The SGN will also clarify that staff reports should indicate, at least in the Appendix on Fund Relations, what the de jure exchange regime is. MCM will collect and publish information on de jure exchange regimes beginning with the 2008 AREAER. (b) Review of Exchange Arrangements, Restrictions, and Markets in September 2007. The upcoming Review of Exchange Arrangements, Restrictions, and Markets (REARM), planned for September 2007, will be an opportunity to address existing deficiencies in the classification of de facto regimes used for the AREAER. The staff paper will review recent trends in foreign exchange regimes, and propose measures to improve the existing classification of de facto regimes. (c) Focus on issue in internal review process. Coordination between MCM and PDR on issues of classification and description of de facto regimes has been strengthened, with PDR now routinely commenting, along with area departments, on proposed AREAER re-classifications by MCM.	**Second PMR (2008).** Guidance on operational aspects of the 2007 Surveillance Decision issued in July 2008 and published in August 2008. The Review was split in two. The Review of Exchange Arrangements, Restrictions, and Controls was completed in 2007. On methodological issues, an informal Board seminar on the Classification of Exchange Rate Arrangements was held in April 2008; a further Board discussion of classification issues, based on supplementary information, may take place later in 2008 if requested by Directors. Review process strengthened following guidance to staff on reporting of the exchange rate regime classification. Training by MCM on foreign exchange regime classification and analysis of foreign exchange market operations is being prepared in the context of expanding knowledge dissemination on exchange rate surveillance. **Third PMR (2009).** Review of system on Classification of Exchange Rate Arrangements completed. The existing IMF staff classification system has now been modified. The revised classification will be published in the 2009 AREAER and in the IMF's 2009 Annual Report. **Fifth PMR (2012).** The 2008 TSR found 96 percent of sampled reports had a clear description of the de facto exchange rate classification. MCM compiles a list of de facto exchange rate classifications in the Annual Report on Exchange Arrangements and Exchange Restrictions. These classifications are based on the quantitative behavior of the exchange rate rather than desk judgment.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
5. IMF advice on exchange rate regimes should be backed up more explicitly by analytic work.	"Regarding the assessment of members' choices of exchange rate regimes, Directors saw scope for more candid staff assessments while avoiding a mechanistic approach." "In general, Directors agreed that staff's views should, whenever warranted, be explicitly underpinned by more comprehensive analytical discussion of the pros and cons, taking into account country circumstances, the authorities' views, and implementation issues when macroeconomically relevant. Staff advice should be informed by the Fund's considerable cross-country experience."	Efforts will be made in several areas to strengthen analysis of exchange regimes. (a) Revised Surveillance Guidance Note. The revised SGN will point to the key dimensions for analysis and will stress that analysis of regime choice should be candid, balanced, and comprehensive, should take into account country circumstances, pay attention to implementation issues when relevant, and be informed by cross-country experience. (b) Knowledge dissemination (see above). Best practice examples of analysis of exchange regimes will be placed on PDR's website. (c) Focus on issue in internal review process. (d) Tentatively, review of the stability of the system of exchange rates in 2009—could help distill practical guidance and collect cross-country experience in this area.	**Second PMR (2008).** Guidance on operational aspects of the 2007 Surveillance Decision issued in July 2008 (SM/08/236; BUFF/08/112) and published in August 2008. Updated Surveillance Guidance Note to be issued after Board discussion of the TSR. Progress on knowledge dissemination (see above). Review process strengthened in the context of the implementation of the 2007 Decision. Guidance on expectations for exchange rate assessments in Article IV consultations was included in the guidance on operational aspects of the 2007 Decision. The review of the stability of the system of exchange rates is expected to be completed in FY2009. **Fifth PMR (2012).** MCM compiles a list of de facto exchange rate classifications in the Annual Report on Exchange Arrangements and Exchange Restrictions. These classifications are based on the quantitative behavior of the exchange rate. Country teams provide advice on exchange rate regimes taking into account macroeconomic conditions and country-specific circumstances.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
6. To improve assessments of the exchange rate level, the IMF should be at the forefront of developing the needed analytical framework, while more successfully translating existing methodologies into advice that is relevant to discussion of individual country cases.	"Directors welcomed the finding that analysis of exchange rate levels had improved, although in several cases there remained scope for improvement in the quality of the analysis." "Directors generally agreed with the IEO that the Fund should stay at the forefront of developing the analytical framework in this area, including with respect to developing countries. Several Directors advocated caution in the Fund's public communications on its findings on equilibrium exchange rates and misalignments, including those based on CGER assessments. In this context, a few Directors cautioned against over-reliance on model-based estimates of equilibrium exchange rates."	(a) Expand and improve CGER work (including refine methodologies and expand it to key low income countries and producers of exhaustible resources). (b) Knowledge dissemination (see above). (c) Additional research in area departments, including cross-country work on oil producers in MCD. Area departments are planning additional work on exchange rate assessments in the context of bilateral surveillance, using inputs from the CGER methodology, other quantitative methodologies tailored to individual countries, and qualitative analyses. Analytical work on the issue of exchange rate assessment for oil producers has been initiated in MCD. (d) Focus on issue in internal review process—increase the emphasis on assessments of exchange rate levels. This additional emphasis is already coming about as a result of the 2007 Surveillance Decision.	**Second PMR (2008).** CGER work (see above). Progress on knowledge dissemination (see above). Work in area departments (through dedicated working groups) and PDR (real exchange rate benchmarks for oil exporting countries) is ongoing. Review process strengthened in the context of the implementation of the 2007 Decision (see above). **Fifth PMR (2012).** Research has undertaken a major project to improve the CGER approaches via the new External Balance Assessment (EBA). SPR and Area Departments are promoting best practice and adapting exchange rate analysis to countries in specific circumstances (e.g., oil exporters, financial centers). **Sixth PMR (2014).** As an input to the assessment of current accounts and exchange rates, the 2012 Pilot ESR used a first version of the Pilot EBA approach, which is a successor to the IMF's CGER. Following an outreach effort and feedback received on the first pilot, the second Pilot ESR incorporated an enhanced version of the EBA, including a broader analysis of the role of policies. The Pilot EBA methodology provides estimates for current accounts and exchange gaps for a group of 49 advanced and emerging market economies, which are used as inputs in the Pilot ESRs. Countries outside EBA generally rely on older approaches, such as those developed under the CGER. In addition, for economies with special characteristics, country teams often adjust their methodologies to reflect country-specific circumstances. A recent staff paper on "External Assessments in Special Cases" (IMF Departmental Paper, January 2014) reviews different approaches to external assessments for these countries. The paper concludes that while adjustments may be theoretically warranted, they raise questions about multilateral inconsistency, accuracy, and evenhandedness. The paper also presents various tools that could be used by country teams to complement their judgment and considers some data issues that could help enhance external sector assessments. SPR is currently working on extending the EBA methodology to a broader set of emerging market and low-income countries. Training seminars will be conducted once the methodology for non-EBA countries is finalized. **Seventh PMR (2015).** The EBA approach developed by the Research Department provides a multilaterally consistent estimate of current account and real effective exchange rate gaps for around 50 countries. Norms and gaps can be decomposed into contributions from "fundamental" characteristics and policies. To extend the use of the EBA methodology to non-EBA countries, SPR has developed

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
			EBA-lite to replace CGER-based methodologies …. Efforts are underway to assess the scope for developing an EBA-lite type external sector assessment methodology for LICs. An internal External Sector Assessment page provides operational guidance, tools, and resources for current account and exchange rate assessments. Efforts have continued to improve methodological aspects and make the ESR more consistent and better integrated with bilateral surveillance.
7. Management and the Executive Board should consider further what lies behind the apparently serious problems of data provision for surveillance, and how incentive structures can be improved.	"Directors … welcomed the recommendation to consider further the scope of the problem [of data availability] and possible remedies. Thus, they looked forward to the upcoming review of data provision to the Fund."	Review of data provision to the Fund in late 2007. Improving data provision to the Fund remains a challenge. The planned review of data provision to the Fund in late 2007 will constitute an opportunity to consider further the scope of the problem and possible remedies in this area.	**Second PMR (2008).** Review completed in May 2008 (SM/08/76). Directors noted that the approach followed in recent years has been largely effective in resolving concerns that members may not be sharing data to the best of their ability. They pointed, however, to the wide variance in staff's handling of such cases as an area for improvement, and stressed that staff must follow up expeditiously in cases where concerns arise. They endorsed the proposal to clarify guidance to staff regarding steps to follow when there is a concern that a member may not be complying with Article VIII, Section 5, to ensure consistent and evenhanded treatment (PIN No. 08/60). **Fifth PMR (2012).** In September 2012, a review of Data Provision to the Fund for Surveillance Purposes will assess the usage of data and future data needs to strengthen surveillance.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
8. Incentives should be given to develop and implement guidance for the integration of spillovers into bilateral and regional surveillance. In addition to interdepartmental work to improve existing methodologies, a panel of senior officials in member countries could be asked to give advice on policy feedbacks—the "what if" question—that they would find useful to explore. In many cases, greater financial market expertise may be required to inform staff advice and contribute to discussion with authorities.	"Directors underscored the importance of better incorporating the analysis of policy spillovers into regional and bilateral surveillance and welcomed the initiatives recently taken in this area under the aegis of the Medium-Term Strategy."	No new initiatives. Continued implementation of existing initiatives under the MTS. The current initiatives under the aegis of the MTS will continue. The initiatives include a focus on overall regional trends through regional outlooks, better assessment of external economic and financial market spillovers affecting individual countries by drawing on the analysis in multilateral and regional surveillance, and spillovers emanating from systemic countries. The analysis of spillovers has benefited from increased use of the Fund's Global Economic Model and Global Fiscal Model. These initiatives were welcomed by Directors, and no new initiatives are planned. **In discussing the MIP,** "some Directors also suggested that additional action might be warranted to better integrate spillovers into bilateral and regional surveillance … the need for deeper analysis of the link between capital flows and exchange rates was also emphasized."	**Second PMR (2008).** This theme has received renewed emphasis in the refocusing process and in the TSR. The Managing Director's Strategic Directions paper outlines some initiatives to integrate a multilateral perspective in bilateral surveillance. **Fifth PMR (2012).** Spillover Reports—produced in 2011 and again in 2012—for five major economies examined the impact of their policies on other members. The External Sector Report is being prepared that will examine external balances in a multilaterally consistent way, taking account of cross-country effects. Based on 2011 TSR recommendations, a revised Staff Guidance Note encourages greater coverage of inward and outward spillovers in Article IV reports. The recently adopted Integrated Surveillance Decision is designed to take better account of spillovers in the surveillance process. **Sixth PMR (2014).** Spillover Reports were issued in 2011, 2012, and 2013. These reports examine the external effects of domestic policies in five systemic economies comprising China, the euro area, Japan, the United Kingdom, and the United States. They aim to provide an added perspective to the policy line developed in Article IV discussions and an input into the Fund's broader multilateral surveillance. **Seventh PMR (2015).** As noted in the 2014 TSR, the 2012 ISD clarified the scope of risk coverage and spillover analysis (including outward spillovers) in Article IV consultations, supported by coverage of systemic economies in the Spillover Report. The 2014 TSR also recognized that continued efforts are needed to better integrate outward spillovers and spillbacks into policy discussions, and strengthen the analysis of inward spillovers. The Managing Director's Plan for Strengthening Surveillance noted that efforts are made to promote an effective two-way flow of ideas between multilateral surveillances and country/regional analysis to facilitate further integration of multilateral surveillance into bilateral surveillance. In addition, regional analysis and cluster reports would be used more systematically to help integrate multilateral surveillance products with Article IV consultations.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
9. Management should address how to bring better focus to the analytical work on exchange rates.	"Directors agreed with the recommendation that management should ensure that exchange rate work across the Fund is organized and managed effectively, in tandem with ongoing work to integrate financial sector issues into Fund surveillance."	No changes in departmental organization and responsibilities.	**Fifth PMR (2012/13).** The ESR Coordinating Group was a pilot for a new interdepartmental process for integrating views on members' external balances and exchange rates and ensuring information sharing across departments.
—Management should clarify responsibility and accountability for exchange rate policy issues and actively use a forum like the Surveillance Committee to ensure proper focus on key issues, and to discuss a variety of different views and perspectives. A key role of the structure should be to prioritize exchange rate policy issues and initiatives from across the IMF, including a multiyear agenda for policy, research, and statistical work.	"Directors encouraged further strengthening of the existing coordinating mechanisms (including the Surveillance Committee and the CGER), as envisaged by the Medium-Term Strategy."	Strengthened role of the Surveillance Committee and CGER.	**Second PMR (2008).** The Surveillance Committee is being strengthened and is expected to oversee efforts to integrate global perspectives into Article IV consultations, especially in systemically important cases. **Fifth PMR (2012).** Existing team structures are deemed appropriate. The focus has been on developing better analytical techniques and diffusion of these techniques to desks, for example, via ICD/SPR's joint training session on external stability assessments. **Seventh PMR (2015).** As indicated in the last PMR, several actions were taken to promote cooperation and a free exchange of ideas. The Surveillance Committee was revamped and interdepartmental collaboration was strengthened through continued interaction in a number of standing interdepartmental groups and task forces. At the same time, the Spillover and External Sector Reports seek a better integration of bilateral and multilateral perspectives.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
10. An understanding is needed on what are the expectations for inclusion in the Article IV staff report, what may be mentioned orally at Board meetings, and what may be understood to have been discussed between staff and the authorities on the clear understanding that it would not be revealed to the Executive Board.	"Most Directors emphasized that management is responsible for providing the Executive Board with all the information that it needs to conduct surveillance, and is accountable to the Executive Board for how it combines this duty with the need for the staff and management to serve as a confidential advisor to members." "Many Directors had concerns with the IEO suggestion to have an independent party periodically review Fund staff activities that are not reported to the Board."	No new initiatives planned at this time, at least pending the discussion of the Board's Ad Hoc Committee on Confidential Information on a report on related issues in use of Fund resources.	**Second PMR (2008).** No reference. In discussing the Second PMR (2008), the EVC noted that "management's implementation plan envisages that further actions could be considered as part of the follow up to the work of the Board's Ad Hoc Committee on Confidential information on related issues in cases of use of Fund resources. The EVC looks forward to the Board taking up this topic in an appropriate venue." (Moser memorandum, December 12, 2008). **Fifth PMR (2012/13).** No additional guidelines have been issued regarding what information may be shared with the Board. **Seventh PMR (2015).** The Managing Director's Action Plan for Strengthening Surveillance envisaged that Article IV consultations for economies whose policies are likely to have systemic spillovers will include greater quantification of the impact of outward spillovers and spillbacks, which will be discussed with country authorities.

IEO RECOMMENDATION	EXECUTIVE BOARD RESPONSE MAY 9, 2007	IMF MANAGEMENT IMPLEMENTATION PLAN (MIP)[1] AUGUST 16, 2007	PERIODIC MONITORING REPORTS (PMRS)[2]
11. Opportunities for potential multilateral concerted action deserve to be a key strategic management focus. This work should, for the most part, be based on rigorous and compelling analysis of scenarios and involve a strategic plan to build consensus amongst key players.	"Most Directors considered multilateral consultations to be a useful addition to the surveillance toolkit because they helped to improve policymakers' understanding of each other's objectives."	Continued use of the multilateral consultation vehicle. Multilateral consultations will continue to be a key vehicle to promote debate on issues of systemic or regional importance. Created as envisioned under the MTS, the multilateral consultation vehicle has shown that, flexibly applied, it is a valuable instrument to enhance and deepen Fund multilateral surveillance, and to promote an improved understanding among participants of the issues and of each other's positions. It will continue to be used.	**Second PMR (2008).** There is continued monitoring of the conclusions of the Multilateral Consultation in the relevant Article IV reports. The Fund is also playing a useful role in facilitating the dialogue in other areas that require multilateral concerted action. In particular, the IMFC underscored that continued close Fund collaboration with the Financial Stability Forum, the Bank for International Settlements, standard-setting bodies, and national authorities will be essential to ensure that the lessons from the crisis are effectively shared and that agreed policy actions are rapidly implemented. Also, the IMFC welcomed the IMF's initiative to work, as facilitator and coordinator, with sovereign wealth funds to develop a set of best practices. **Fifth PMR (2012).** No additional steps have been taken in this area. **Seventh PMR (2015).** The Managing Director's Action Plan for Strengthening Surveillance proposed that the key messages from the ESR and the Spillover Report will be incorporated in the WEO and the GFSR to strengthen the clarity and coherence of multilateral surveillance messages.

[1] Complete document available at http://www.imf.org/external/np/pp/2007/eng/081607.pdf.

[2] This column provides excerpts from the PMRs prepared by IMF staff; the full reports are available at http://www.ieo-imf.org/ieo/pages/Multiheader.aspx.

REFERENCES

Blustein, Paul, 2013, *Off Balance: The Travails of Institutions that Govern the Global Financial System* (Ontario, Canada: Centre for International Governance Innovation).

Boorman, J., and T. Ter-Minassian, 2014, "External Study: Report on Interviews" (Washington: International Monetary Fund).

Callaghan, M., 2014, "Evenhandedness of Fund Surveillance" (Washington: International Monetary Fund).

Fischer, Stanley, 2008, "Mundell-Fleming Lecture on Exchange Rate Systems, Surveillance, and Advice," *IMF Staff Papers,* Vol. 55, pp. 367–83.

Ghosh, Atish R., Jonathan D. Ostry, and Charalambos, Tsangarides, 2010, *Exchange Rate Regimes and the Stability of the International Monetary System*, IMF Occasional Paper No. 270 (Washington: International Monetary Fund).

Guitián, M., 1992, "The Unique Nature of the Responsibilities of the IMF," IMF Pamphlet Series No. 46 (Washington: International Monetary Fund).

Habermeier, K., A. Kokenyne, R. Veyrune, and H. Anderson, 2009, "Revised System for the Classification of Exchange Rate Arrangements," IMF Working Paper No. 09/211 (Washington: International Monetary Fund).

Independent Evaluation Office of the International Monetary Fund (IEO), 2007, *IMF Exchange Rate Policy Advice* (Washington: International Monetary Fund).

_____, 2009, *IMF Interactions with Member Countries* (Washington: International Monetary Fund).

_____, 2012, *International Reserves: IMF Concerns and Country Perspectives* (Washington: International Monetary Fund).

_____, 2013, *The Role of the IMF as Trusted Advisor* (Washington: International Monetary Fund).

_____, 2015, *The IMF's Approach to Capital Account Liberalization: Revisiting the 2005 IEO Evaluation* (Washington: International Monetary Fund).

_____, 2016, *Behind the Scenes with Data at the IMF* (Washington: International Monetary Fund).

_____, 2017, *Multilateral Surveillance: Revisiting the 2006 IEO Evaluation* (Washington: International Monetary Fund).

International Monetary Fund (IMF), 2007a, "The Chairman's Summing Up, IEO Report on the Evaluation of Exchange Rate Policy Advice, 1999–2005," May (Washington).

_____, 2007b, "Review of the 1977 Decision—Proposal for a New Decision, Companion Paper, Supplement, and Public Information Notice," June (Washington).

______, 2007c, Executive Board Meeting Minutes, "Review of the 1977 Decision—Proposal for a New Decision," 07/51-2, June (Washington).

______, 2007d, "Implementation Plan in Response to Board-Endorsed Recommendations Arising from the IEO Report on The Evaluation of IMF Exchange Rate Policy Advice, 1999–2005," August (Washington).

______, 2008a, "Review of Data Provision to the Fund for Surveillance Purposes," March (Washington).

______, 2008b, "Triennial Surveillance Review—Overview Paper," September (Washington).

______, 2008c, Periodic Monitoring Report on the Status of Implementation Plans in Response to Board-Endorsed IEO Recommendations," October (Washington).

______, 2009, "The 2007 Surveillance Decision: Revised Operational Guidance," June (Washington).

______, 2011a, "2011 Triennial Surveillance Review—Overview Paper," August (Washington).

______, 2011b, "2011 Triennial Surveillance Review—Review of the 2007 Surveillance Decision and the Broader Legal Framework for Surveillance," August (Washington).

______, 2011c, "2011 Triennial Surveillance Review—Health Check and Statistical Information," August (Washington).

______, 2011d, "2011 TSR—External Report on Interviews with Country Authorities," August (Washington).

______, 2011e, "Managing Director's Statement on Strengthening Surveillance, 2011 Triennial Surveillance Review," October (Washington).

______, 2012a, "Modernizing the Legal Framework for Surveillance— Building Blocks Toward an Integrated Surveillance Decision," March (Washington).

______, 2012b, "Modernizing the Legal Framework for Surveillance—An Integrated Surveillance Decision," June (Washington).

______, 2012c, "Modernizing the Legal Framework for Surveillance—An Integrated Surveillance Decision—Revised Proposed Decisions," July (Washington).

______, 2012d, Executive Board Meeting Minutes, "Modernizing the Legal Framework for Surveillance—An Integrated Surveillance Decision—Revised Proposed Decisions," 12/72-2, July (Washington).

______, 2012e, "2012 Review of Data Provision to the Fund for Surveillance Purposes," SM/12/229, August (Washington).

______, 2012f, "Guidance Note for Surveillance Under Article IV Consultations," October (Washington).

______, 2012g, "IMF Executive Board Discusses 'The Liberalization and Management of Capital Flows—An Institutional View,'" IMF Public Information Notice No. 12/137, December (Washington).

______, 2013a, "2013 Review of the Fund's Transparency Policy," May (Washington).

______, 2013b, "Data Provision to the Fund for Surveillance Purposes—Operational Guidance Note," SM/13/155, June (Washington).

______, 2013c, "The External Balance Assessment (EBA) Methodology," IMF Working Paper No. 13/272, December (Washington).

______, 2014a, "2014 Triennial Surveillance Review—Overview Paper," July (Washington).

______, 2014b, "Are Global Imbalances at a Turning Point?" *World Economic Outlook,* October (Washington).

______, 2014c, "2014 Triennial Surveillance Review—Managing Director's Action Plan for Strengthening Surveillance," December (Washington).

______, 2015a, "Assessing Reserve Adequacy—Specific Proposals," April (Washington).

______, 2015b, "Guidance Note for Surveillance Under Article IV Consultations," SM/15/71, March (Washington).

______, 2016a, "Methodological Note on EBA-Lite," EBS/16/8, February (Washington).

_____, 2016b, "Reference Note on Unconventional Monetary Policies and Foreign Exchange Intervention Under Disorderly Market Conditions," SM/16/38, February (Washington).

_____, 2016c, "Evenhandedness of Surveillance—Principles and Mechanisms for Addressing Concerns," March (Washington).

_____, 2016d, "Guidance Note on the Assessment of Reserve Adequacy and Related Considerations," SM/16/125, June (Washington).

_____, 2016e, *World Economic Outlook*, October (Washington).

_____, 2016f, "Selected Issues Papers," IMF Country Report No. 16/349, October (Washington).

_____, 2016g, "Management Implementation Plan for the 2016 IEO Evaluation of *Behind the Scenes with Data at the IMF*," SM/16/305, October (Washington).

_____, 2016h, "IMF Executive Board Discusses Review of Experience with the Institutional View on the Liberalization and Management of Capital Flows," IMF Press Release No. 16/573, December (Washington).

_____, 2017a, *World Economic Outlook*, April (Washington).

_____, 2017b, "Increasing Resilience to Large and Volatile Capital Flows—The Role of Macroprudential Policies," July (Washington).

_____, 2017c, "Euro Area Policies," July (Washington).

_____, 2017d, *2017 External Sector Report,* July (Washington).

_____, 2017e, "IMF Executive Board Discusses the 2017 External Sector Report," IMF Press Release No. 17/303, July (Washington).

Obstfeld, Maurice, 2017, "Assessing Global Imbalances: The Nuts and Bolts," IMF Blog, June 26. Available at http://www.imf.org.

STATEMENT BY THE MANAGING DIRECTOR

ON THE INDEPENDENT EVALUATION OFFICE REPORT ON IMF EXCHANGE RATE POLICY ADVICE: REVISITING THE 2007 IEO EVALUATION

OCTOBER 20, 2017

I would like to thank the Independent Evaluation Office (IEO) for preparing this informative and timely report, which provides an update on the IMF's progress in its approach to exchange rate policy advice since 2007. I am pleased with its main finding that the IMF has substantially overhauled its approach to exchange rate policy advice, and concur that some issues need our continued attention. I would like to note that management and staff remain fully committed to the role of the External Sector Report (ESR) in Fund surveillance.

Exchange rate assessment and policy advice is central to the Fund's mandate. The Fund is charged by its Articles of Agreement to exercise firm surveillance over the exchange rate policies of member countries. This update by the IEO is informative and timely given the central role of the IMF in this area and the extensive past and ongoing work to refine the scope and modalities of external sector surveillance, including to reflect lessons over the last decade.

I am pleased with the report's findings that the IMF has substantially overhauled its approach to external sector assessments and exchange rate policy advice since 2007 and enhanced its work in an area central to its mandate. Indeed, as the IEO points out, the 2012 Integrated Surveillance Decision provides for a broader approach to exchange rate analysis that aims to address the interrelationships between economies, including assessing external positions in a multilaterally-consistent manner, paying greater attention to the connections between domestic and external stability, and assessing external positions taking into account broader considerations. Moreover, the IMF has refined its methodological tools to enhance this analysis and its consistency across countries; and the ESR provides a multilaterally-consistent picture of the external balances of major economies and the policy actions needed to address excess external imbalances and reduce global risks.

Recognizing that the ESR is a well-accepted framework for external sector surveillance, the report points out that some areas continue to be contentious. The Fund has acknowledged since the inception of the ESR the importance of the transparency of the External Balance Assessment (EBA) models and the process for deriving external assessments and has made further progress in increasing transparency, including in explaining staff judgment when adjustments are needed, and will continue its efforts to refine the EBA models. Overall, I would like to note that management and staff remain fully committed to the role of the ESR in Fund surveillance. The findings of this report provide useful insights that can help us further improve moving forward.

IMF EXCHANGE RATE POLICY ADVICE
EVALUATION UPDATE 2017

ISBN-13: 978-1-48432-576-6