2

IMF ADVOCACY OF UNCONVENTIONAL MONETARY POLICIES

USE OF UMP TO SUPPORT GROWTH

The IMF developed a "corporate view" on UMP soon after the start of the GFC. Specifically:

(i) the Fund saw UMP as essential for recovery in the AEs undertaking these policies, and particularly so after these countries turned to fiscal consolidation after 2010, a move that the Fund strongly supported;

(ii) the Fund judged that risks to financial stability from UMP were better managed through macroprudential policies than monetary policy; and

(iii) the Fund assessed that overall UMP were beneficial not just for the countries undertaking them but for others as well, and that countries affected by spillovers should adjust their policies to respond to any challenges created by UMP.

Interviews with informed observers largely confirm that the Fund was successful in conveying these messages through its flagship publications, through other high-profile communication outlets such as press conferences and speeches by IMF management and senior staff, in policy papers to the Executive Board, and in bilateral surveillance, particularly Article IV consultations. Of course, these broad messages always came with caveats, but their thrust was clear and consistent.

The Fund was an early supporter of UMP in the MAEs. Statements expressing support for very accommodative monetary policies were made from 2008 onwards. In the January 2009 *WEO* update (IMF, 2009a), the Fund encouraged central banks to explore alternative policy approaches to ease policy further as policy interest rates approached zero, with a focus on unlocking key credit markets. A more far-reaching statement of Fund support appeared in a joint foreword to the April 2009 *WEO* (IMF, 2009c) and the *GFSR* (IMF, 2009b) which noted that "central banks will have to continue exploring less conventional measures, using both the size and composition of their own balance sheets to support credit intermediation."

When economic recovery remained sluggish and inflation persisted well below target, the IMF continued to support further rounds of UMP and warned that normalization should be cautious and only after inflation goals were clearly being achieved. Statements of support were expressed in subsequent *WEO*s, quite often accompanied by advice to enhance the traction of UMP by measures to strengthen banks' incentives to lend and households' willingness to spend (e.g., by giving mortgage debt relief to households). These messages were reinforced in a policy paper for the Executive Board surveying recent experience with UMP (IMF, 2013b). When talk started of exit from UMP, the April 2013 *WEO* cautioned that because inflation expectations were firmly anchored, "fears about high inflation should not prevent monetary authorities from pursuing highly accommodative monetary policy" (IMF, 2013c).

The Fund advocated macroprudential policies (MPPs) as the first line of defense against financial stability risks from UMP. The second part of the corporate view was that financial stability implications of UMP in the originating countries needed to be monitored but did not overturn the case for these policies, recognizing that some extra risk-taking would be growth enhancing and consistent with the goals of UMP. Several editions of the *WEO* and the *GFSR* noted that there was no evidence of excessive risk-taking but that countries should remain vigilant and use macroprudential tools rather than monetary policy to address them (see, for example, IMF, 2014d). The Fund recognized that the risk-taking could become excessive (e.g., feeding speculative behavior in housing markets) or have deleterious effects on some sectors (e.g., insurance companies and pension funds), and such risks were discussed at length in the *GFSR*. However, the overall messages were consistent with the *WEO* (Zettelmeyer, 2018).

The IMF mounted an intensive effort to analyze spillovers from UMP, reaching the view that, on balance, UMP were beneficial not just for the countries undertaking them but for others as well. The Fund recognized the possibility of adverse spillovers from UMP and, particularly after 2010, took several initiatives to address the rising concerns of EM policymakers in the face of successive rounds of UMP. The spillover reports published in 2011–15 generally supported the Fund's prior that the positive spillover effects of UMP through beneficial effects on trade and the establishment of a solid recovery in AEs were almost sure to dominate the costs (IMF, Spillover Reports, 2011–15). Nevertheless, over time, there was rising recognition of the difficulties facing EMs from volatile capital flows and in 2012 a new Institutional View on Capital Flows (IMF, 2012c; 2012e) was approved to provide coherent advice on addressing these challenges.

After its strong support for a global fiscal stimulus in 2008–09, the Fund generally supported a turn to consolidation, while continuing to urge accommodative monetary policies (Box 1). At the start of the GFC, the Fund initially pushed hard through the G-20 to get agreement on a global fiscal stimulus as part of a comprehensive response to a global recession. By 2010, as the recovery appeared to take hold, the IMF lent its support to the G-20's Toronto Declaration setting ambitious goals to wind down the fiscal stimulus in order to safeguard medium-term public debt sustainability. The *WEO* update of January 2011 (IMF, 2011a) emphasized the urgency of moving toward more sustainable fiscal paths across the AEs, while advising that "at the same time monetary accommodation needed to continue." When the recovery turned out to be more sluggish than expected, the IMF modulated its message, advising countries with fiscal space to use it and those without to make any fiscal consolidation as "growth friendly" as possible, but it continued to put primary emphasis on monetary policy for managing demand.

Assessment

The Fund deserves considerable credit for quickly developing an overall view on UMP and articulating it consistently and clearly. From the vantage of 2019, it does seem that the Fund was fundamentally right to support quick and aggressive actions by the major central banks to fight against global recession in the wake of the GFC, notwithstanding the limited previous experience on which staff could draw. Even among observers who disagreed with the Fund's calls, there was appreciation that "it was clear where the Fund stood."

Views are more critical about the value of IMF analysis and advice on the implementation of UMP, about its risks and side effects, and on its effects on other countries and implications for international monetary cooperation. Despite its strong advocacy of UMP, AE officials generally felt that the Fund was not at the forefront of analysis of how well these policies were working and how they could be reinforced. With the benefit of hindsight, the Fund may also have been too ready to support a quick pivot to broad-based fiscal consolidation, despite the extra burden this put on already stretched monetary policy instruments. Moreover, there remains a sense among many EM officials interviewed for this evaluation that the Fund was ready to support central banks in AEs to do whatever was needed to heal their own economies, while being hesitant to recognize political constraints and to support unorthodox measures by EMs to deal with the challenges of increased volatility through financial channels. These and other topics are taken up in depth in the remainder of the report.

BOX 1. IMF ADVICE ON THE MONETARY-FISCAL POLICY MIX AFTER THE GFC

The GFC elicited an unprecedented monetary and fiscal policy response. The G-20 AEs at the epicenter of the crisis saw their average primary fiscal deficit in structural terms move from 1 percent of GDP in 2007 to 5 percent of GDP in 2010, including in response to coordinated commitments by the G-20. As the effects of the crisis spread, the fiscal positions of many EMs also deteriorated, with the G-20 EMs' average structural primary balance moving from a surplus of 1½ percent of GDP in 2007 to a deficit of 1½ percent of GDP in 2009. In the following years, the stimulus was largely withdrawn in the AEs. By 2014 the average structural fiscal deficit among G-20 AEs had shrunk to a mere 1¼ percent of GDP. By contrast, structural primary deficits in G20 EMs remained more elevated partly reflecting the collapse in global commodity prices.

Early calls for fiscal stimulus. The IMF was among the first to call for fiscal stimulus (Dhar, 2014). In November 2008, it urged G-20 countries to expand their fiscal positions by 2 percent of GDP in structural terms. In these early years of the crisis, the IMF urged that all demand policy levers be eased aggressively to avert a deep downturn in global activity. However, the Fund's advocacy for stimulus was typically couched in terms of the eventual need for exit.

Subsequent calls for fiscal consolidation. In most countries the initial stimulus coupled with the fiscal impact of the economic downturn and banks' bailouts propelled public debt ratios to post-war highs and markets became concerned that public debt was increasing rapidly in many countries. With signs that the global recession may have troughed, the Fund shifted decisively in its 2009 Principles for Policy Exit to a call for fiscal consolidation, leaving to monetary policy the task of stimulating further if needed (G-20, 2009). The G-20's Toronto Declaration in June 2010 called for a halving of advanced economy fiscal deficits by 2013, a position that was echoed in the Fund's bilateral policy advice. The preference for fiscal consolidation was reinforced by periodic shocks to market confidence in government solvency, especially in the euro area and among some EMs, which caused sharp spikes in sovereign bond spreads.

Austerity and fiscal multipliers. In the initial phases of the crisis, the Fund's fiscal policy advice for stimulus was largely predicated on the basis of existing estimates of fiscal multipliers (mostly well below one), implying a modest impact. However, these estimates did not account for the fact that the effect of fiscal policy varies with the state of the business cycle or with proximity to the effective zero lower bound for monetary policy. As consolidation began and recoveries came to a halt, concerns arose inside and outside the Fund that multipliers may be large and state-dependent for economies still operating below potential. Hence, fiscal consolidation risked pushing debt-to-GDP up instead of down because of the extent to which it slowed growth (Batini, Callegari, and Melina, 2012; Box 1.1 in IMF, 2012d; and Blanchard and Leigh, 2013).

Increased focus on fiscal space and growth-friendly consolidation. As growth remained tentative, and beliefs about the impact of demand policies were being reassessed, the Fund started to concede that, in some cases, fiscal consolidation could be slowed or reversed. This shift in advice called for a consistent metric with which to measure space for fiscal support, which was particularly useful for advising euro area countries where budget rules seemed to generate stark growth trade-offs. This quest culminated in a staff paper designing a common tool for assessing fiscal space in IMF surveillance, based on cyclical and fiscal indicators as well on fiscal stress tests (IMF, 2016e). When recommending stimulus or consolidation, Fund staff paid increasing attention to the timing and composition of fiscal packages in order to make sure these maximized positive and minimized negative growth effects while spreading the social costs more broadly, with a specific focus on the long-term consequences of fiscal action (Gaspar, Obstfeld, and Sahay, 2016).

RISKS AND SIDE EFFECTS FROM UMP[2]

Multiple concerns have been expressed about possible risks and side effects from UMP that have amplified as these policies have been extended in depth and duration. First, while UMP could be effective in enhancing monetary stimulus, exit could be difficult and costly for the countries undertaking UMP and could also impose costs on other countries. Second, while UMP may have helped to close current output and inflation gaps, it could raise the likelihood of future gaps by raising the odds of a financial crisis. This concern is particularly salient where there is a buildup of vulnerabilities in the housing sector given the role that stress in this sector has played as a trigger for financial crises in the past. Third, while UMP may have helped close output gaps on average, it may do so by helping some and hurting others, viz., it may have distributional effects that could exacerbate inequality, particularly of wealth.

Over the past decade, the IMF adopted the view that MPPs were greatly preferable to monetary policies in managing financial sector risks, including those arising from UMP. Prior to the GFC, the IMF had devoted attention to the issue of how monetary policy should deal with financial stability risks in an environment of low inflation (see for example, IMF, 2000). The IMF did not rule out "leaning against the wind," that is, raising interest rates to counter a sharp rise in asset prices even when there was little evidence of inflationary pressures. But it warned that such action should not be taken lightly: several conditions were specified that would need to be met and it was recognized that technical and political difficulties could come in the way of taking pre-emptive policy actions. The IMF's view that while the use of interest rates to tackle asset price booms should not be ruled out, it should not be the first resort, was widely shared among central banks.

With the onset of the GFC, and the urgent need to use monetary policy for meeting output and inflation goals, the IMF moved in a consistent fashion on three fronts. First, it threw its intellectual and policy weight behind advocating even more strongly that monetary policy should focus on macroeconomic goals and assign the responsibility of maintaining financial stability largely to other policies, particularly MPPs.[3] Second, it worked hard to develop a framework for making MPPs "the first line of defense" against financial stability risks, including those stemming from UMP. Third, it built up its capacity to monitor and analyze global financial risks, notably in the *GFSR*.

The Fund's view on *Monetary Policy and Financial Stability* was laid out in a 2015 policy paper which posed the question of "whether monetary policy should be altered to contain financial stability risks" and concluded that the "the answer is generally no" (IMF, 2015a). The paper observed that tightening monetary policy would have fairly certain immediate costs from lower output and inflation (if it fell below target) while the benefits would materialize mainly in the medium term (as financial risks are mitigated), and were more uncertain. It argued that in most circumstances the upfront costs outweighed the benefits and thus "based on current understanding and circumstances, the case for leaning against the wind is limited." It suggested that when there was substantial slack in the economy, the evidence was that transmission from easy monetary policy to financial risks was weak and the implementation hurdles of using monetary policy to contain these risks were substantial. In contrast, MPPs could target imbalances and market imperfections much closer to their source than monetary policy. This division of labor would allow monetary policy to focus on its macroeconomic goals, thus simplifying communication and enhancing accountability.

Having proposed MPPs as the first line of defense against financial stability risks, the IMF has spent considerable effort on advising on the proper use of these policies. The 2012 Policy Paper "The Interaction of Monetary and Macroprudential Policies" noted that the latter could be used to build up buffers when financial conditions are easy and then used to keep banks and other intermediaries healthy during periods of financial distress, helping to preserve the effectiveness of monetary policy in financial downturns (IMF, 2012f; 2012g). MPPs could also be adapted to counter unwanted side effects from expansionary monetary policy, which may be particularly important when interest rates are close to zero and the temptation to seek higher leverage

---

[2] This section draws on Turner (2019), Rebucci and Zhou (2019), and Monnin (2019).

[3] See, for example, Quint and Rabanal (2014).

is strong. The IMF has developed a database of MPPs taken by countries (Alam and others, 2019), prepared a guidance note to staff on the use of MPPs (IMF, 2014e), and carried out cross-country studies of the effectiveness of these measures both in-house and in collaboration with other agencies (FSB, 2016).

The IMF has placed particular emphasis on using MPPs to manage risks related to house price booms (IMF, 2014e). Limits on loan-to-value (LTV) ratios, caps on debt service-to-income ratios, and sectoral capital requirements have been the most commonly recommended measures. IMF researchers have also devoted considerable attention to studying the effectiveness of such policies (e.g., Zhang and Zoli, 2016; Cerutti, Claessens, and Laeven, 2017).

While generally supportive of macroprudential measures in the housing market, Fund staff have been less welcoming of some measures that discriminate against foreign residents. A Board paper sought to lay out the basis for staff's classification of measures into three categories: MPPs, CFM, and CFM/MPP, with the last category referring to "policy tools designed to limit capital flows and to reduce systemic financial risks stemming from such flows" (G-20, 2018). Countries using measures classified as CFM, including measures that discriminate against property purchases by foreigners, are advised that these measures be scaled back or maintained only on a temporary basis, consistent with the IV.

More recently, as the global economy has needed less immediate demand support, the IMF has been open to recalibrating its views on the relative roles of macroprudential and monetary policies in managing financial stability risks. The 2015 Policy Paper noted that many experts, including at the BIS, favored "a stronger role for monetary policy in maintaining financial stability" and concluded that the Fund's position should be kept under review as knowledge of the relationship between monetary policy and financial risks evolves and as circumstances change. Recent and ongoing work at the IMF has re-examined the relationship in the context of a global economy in which output risks have been less pressing. For example, Adrian (2018) studied the role that monetary policy can play in lowering the downside risks to GDP and suggested that monetary policy should "lean slightly against the buildup of [financial] risk when the economy is close to potential." In general, Fund staff's recent work has recognized that optimal monetary policy depends "not only on the output gap and inflation, but also on financial conditions" (Chapter 6 in Adrian, Laxton, and Obstfeld, 2018).

The Fund has fostered discussion of the distributional effects of UMP and MPPs, although its own analytical contribution has been limited. As concerns about the distributional impacts of UMP became prevalent in policy circles and the media (Coeuré, 2012; Stewart, 2011), the IMF convened high-level discussions on the distributional impacts of monetary policies at the 2012 Annual Research Conference (Zhu, 2012). However, the Fund staff has done little analytical or empirical work of its own and has not taken a public position on whether distributional efforts of UMP are of concern or how to respond if they are.

Assessment

The Fund's view on the financial stability risks of UMP was clearly articulated and is generally regarded as having provided the right message at the time it was given most forcefully and a valuable contribution to the international discussion on the topic. In retrospect, the overall approach seems to have been well founded as a basis for policy advice in the post-GFC period. The Fund's policy assessment and advice was supported well by its multilateral surveillance of global financial risks, particularly the *GFSR* which is now widely recognized as a world leading product (IEO, 2019). The IMF's 2015 paper on the topic was considered by many outside experts as nicely summarizing the arguments for the view and helping to propagate it. IMF mission chiefs were generally appreciative of the framework as useful in guiding their discussions with authorities, though a few felt it was too constraining in not acknowledging that simultaneous use of macroprudential tools and modest tightening of monetary policies might sometimes be more effective than just using the former.

Complementing its support for UMP, the IMF has been at the forefront of international efforts to develop and assess new MPPs. The Fund's detailed knowledge base on the design of MPPs is generally viewed by policymakers as providing high value added and having considerable traction. Senior policymakers and financial experts appreciated the IMF work on quantifying the effects of MPPs. While other institutions such as the BIS have also made strong contributions, the IMF has become an international clearinghouse for evidence on how different instruments have been designed in different countries and how well they are working.

The Fund's view that the financial stability risks of UMP were not sufficiently serious to undermine the case for these policies seems at this juncture to have been well founded, although it remains to be fully tested. The Fund's judgment that these risks were not serious enough to undermine the pressing case for UMP is widely shared among policy-makers and academic experts. However, those who had expressed concerns about such risks still feel that the adverse effects of UMP remain below the surface although they have not yet manifested themselves; in their view, therefore, it is too soon to conclude that the Fund's judgments have been proven correct. There has also been concern about the financial stability risks as countries exit from UMP. The IMF's openness to recalibrating views as balance of risks shifts is welcome.

The IMF has appropriately voiced concerns about house price booms in some countries. Given the importance of the housing sector for financial stability, Fund staff have worked with authorities in many countries to analyze developments in the sector and the needed policy response. Interviews conducted with authorities for this evaluation provide many examples—among them Canada, France, Germany, Korea, and the Netherlands—where staff work on housing markets was valued by the authorities. The 2013 cluster report on Nordic housing markets was also considered very useful (IMF, 2013e). The IMF also deserves credit for the extensive effort on compiling a database on the use of macroprudential policies to manage housing sector risks, on the detailed operational guidance provided to country teams on appropriate policies, and on the analytic work on the effectiveness of these policies. Although much of the analysis over the past decade was conducted by individual country teams with infrequent knowledge sharing, over the past year there has been greater attention to cross-country work on housing issues, with the recent *GFSR* analyzing downside risks to house prices (IMF, 2019).

The IMF has played more of a convening role than a research or advisory role in assessing the distributional impacts of UMP. This seems surprising given the active research underway at the Fund over the past decade to study the distributional impacts of many other economic policies and the considerable attention that has been paid at major central banks on this issue. Given the other tasks confronting the IMF over the past decade—and the prevailing consensus that monetary policy easing reduces inequality by supporting employment—this does not seem a huge failing. However, since future political and public support for future UMP could well depend in part on perceptions of their distributional impact, the IMF could have been more active on this front (Voinea and Monnin, 2017). Some senior officials also emphasized the need for Fund awareness of the distributional effects of MPPs if it intends to keep them as the first line of defense against financial stability risks. These officials noted that many macroprudential measures have disproportionate impacts on certain groups (e.g., the impact on first-time home buyers from caps on LTV ratios on mortgages), undermining the political support for such measures even though they may be critical for financial stability considerations.