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# ADVICE TO MAJOR ADVANCED ECONOMIES[4]

## CONTEXT

After cutting policy interest rates to zero (or near-zero) after the onset of the GFC, the Federal Reserve and the Bank of England (BoE) quickly moved to UMP.

- The Fed launched four QE programs between 2008 and 2012, which it started to unwind in 2015. In addition, the Fed used various forms of forward guidance to signal that policy interest rates would remain low for an extended period. In May–June 2013, statements by the Fed chairman that it would start to reverse these policies surprised markets, leading to the "taper tantrum," a period of market volatility with considerable impact on EMs. Learning from that episode, the Fed has been careful to communicate clearly about its exit strategy, emphasizing that it would follow a gradual and data-dependent approach. When exit began in 2015 there was little market reaction, although subsequently there have been bouts of volatility associated with shifts in market perceptions about the Fed's likely path.

- The BoE's actions were somewhat similar to those of the Fed, but it also launched an ambitious scheme to directly encourage bank lending to companies and households. The BoE launched QE in 2009 after cutting policy rates to 0.5 percent—which it perceived as the effective lower bound. There were three rounds of QE between 2009 and 2012 and active use of forward guidance in 2013–14. The BoE undertook an additional round of QE in 2016 after the "Brexit" referendum in which the United Kingdom voted to leave the European Union.

After targeted steps in 2008–12, the European Central Bank (ECB) aggressively eased policies more broadly starting in 2013 in the face of a sluggish recovery. The ECB's actions in 2008–09 were focused on support for the banking sector, and over 2010–12 on purchasing government bonds issued by the euro area "crisis countries." In the first half of 2011, the ECB even raised policy interest rates but had to reverse course when economic recovery stalled in the second half of the year. Starting in 2013, the ECB used forward guidance, introduced negative interest rates, and launched a large-scale asset purchase program, as well as introducing multiple schemes to provide low-cost funding for bank lending (IMF, 2013f).

After acting less aggressively than the other major central banks, the Bank of Japan (BoJ) launched a strong program of monetary policy easing in 2013. In contrast to the other MAEs, Japan had already endured a long period of low growth and inflation before the GFC, and policy interest rates were already at 0.5 percent. Through 2012, the BoJ mainly relied on forward guidance and limited asset purchases. The response became much more forceful and coordinated after the election of Prime Minister Abe, with the BoJ launching "quantitative and qualitative easing" programs, adopting a 2 percent inflation target, and the government announcing a package of fiscal support and structural reforms. In 2016, as outcomes remained

[4] This chapter draws on Ball (2019).

disappointing, the BoJ introduced negative interest rates and yield curve control.

## IMF ADVICE

The Fund's advice on UMP in the major advanced economies followed the "corporate view" laid out in Chapter 2 calibrated to the circumstance of the economy and the policy actions of the central bank. Thus, for the United States and the United Kingdom, the Fund was for the most part in a supportive role, generally endorsing central bank decisions and discussing the path ahead. For the euro area and Japan, the Fund pushed for a more aggressive approach by the central banks at times when the Fund perceived them as not doing enough to support recoveries or counter risks of entrenched low inflation.

In the United States, the Fund expressed strong public support for the Fed's actions while also stressing the need to unwind these policies once there was assurance of a firm recovery. Specifically:

- During 2009–11, while the Fund supported the launch of each new Fed program, it also consistently emphasized the need to unwind these extraordinary policies soon. The Fund underlined the need to pivot quickly to fiscal consolidation and for a credible medium-term fiscal strategy. To some extent, the Fund's focus on exit was influenced by its interactions with the G-20, which had tasked the Fund with thinking about "exit principles" as early as 2009. In addition, the Article IV reports sometimes included elements that were implicitly hawkish: discussions of limits on the scope for further monetary easing; the financial stability risks of low interest rates; and the role of structural factors in explaining high unemployment.
- Over 2012–14, there was more convergence in tone between the Fed and the Fund. And by 2015–16, the staff had shifted to advocating policies that were somewhat more dovish than the Fed's, especially in 2016 when the staff advocated an overshoot of the 2 percent inflation target.
- The Fund has generally supported the Fed's strategy for unwinding QE, emphasizing the importance of clear communication. Recently, it raised concerns that the fiscal stimulus provided through the 2018 tax cut package could require a more rapid tightening of the monetary policy stance than otherwise.

In the United Kingdom, the Fund and the BoE's views were generally closely aligned. The views on monetary policy actions expressed in U.K. Article IV reports were typically very close to those of the majority of the BoE's Monetary Policy Committee even though at times there were significant differences of views within the Monetary Policy Committee itself. One striking example of the congruence of staff and BoE views was on the effective lower bound. The BoE did not reduce the policy rate below 0.5 percent out of concern that lower rates would have an adverse effect on mortgage banks. This policy was supported without much probing by Fund staff, even after other central banks started moving to negative interest rates.[5] An example of the IMF encouraging the BoE to do more occurred in 2012, when staff came out in favor of the credit easing measures that were being debated within the BoE at the time. On policy mix, the Fund generally supported the commitment to fiscal consolidation as necessary, but at times also urged for flexibility on the path to avoid posing an excessive drag on growth and adding to the burden on monetary policy.

In the euro area, the Fund encouraged more aggressive monetary policy easing, including an earlier move to QE. Faced with a wide divergence of views on the need for monetary stimulus among member central banks within the euro area and the ECB's governing council during 2012–13, the Fund came down on the side of those advocating greater stimulus. This was not the consensus view at the ECB at the time, and the Fund ended up playing a considerable role in debates on both the broad stance of policies and the operational details, both inside the ECB and in the public discussions. Since 2014, ECB and staff views have been more closely aligned as the ECB has moved to phase in asset purchases. The Fund supported the turn to fiscal consolidation from 2010, while from 2013 onwards also calling for use of space within the Stability and Growth Pact to avoid any excessive drag on growth in response to

[5] The 2012 Article IV report (IMF, 2012b) did question the 0.5 percent lower bound.

increasing concerns about lack of growth momentum (IMF, 2014b).

In Japan, the Fund has consistently urged the BoJ to undertake aggressive monetary policy easing. Until 2012, Fund staff were critical of the BoJ's reluctance to ease more strongly, arguing that the BoJ was too sanguine that its current policy would be successful in ending deflation soon. In 2013, the Fund was a cheerleader for Abenomics and strongly supported the government's strategy, including the BoJ's adoption of quantitative and qualitative easing. However, by 2015, staff had become nervous about the progress of Abenomics, and again pushed the BoJ for more action. The Fund's position was particularly forceful in 2016—the Fund advanced a broad agenda to "reload" Abenomics with a stress on incomes policies as a way of boosting inflation. The Fund lent its support to the BoJ's adoption of negative interest rates and yield curve control in 2016 while continuing to call for incomes policies. Fund staff often gave fairly detailed prescriptions about the easing tactics that the BoJ should use, even more so than in the case of the ECB, and closely monitored the status of previous staff recommendations. On policy mix, the Fund supported the Abenomics stimulus package in 2012—but also the tax hike in 2014 contained in the official medium-term strategy—even though the boost to growth under Abenomics was less than hoped.

## ASSESSMENT

### Advice on UMP

Bilateral advice from the Fund on UMP was generally regarded by officials as useful validation of their actions and as being particularly influential at the ECB. Officials in the major AEs view the Article IV process as generally providing a valuable discussion of their policy framework with respected, well-informed interlocuters. For the Fed and BoE, the Fund's public support of their UMP was valued for fostering broader acceptance of unorthodox central bank policy initiatives; this was particularly so in the U.K. case where the IMF's views draw greater public attention than in the United States. Neither felt that the IMF advice had been ahead of the curve nor had introduced novel ideas, but this was not regarded as surprising or problematic given that these central banks had moved quickly and could draw on their own deep expertise and experience. The Fund had played a more influential role in the euro area where current and former ECB officials give considerable credit to Fund staff in helping them think through some of the design features of QE and building the case for it with governing council members. Officials noted quite frequent interactions not just confined to the consultation cycle, the close relationship with a long-serving mission chief, and the impact of an IMF staff blog on the danger of "low-flation" (Moghadam, Teja, and Berkmen, 2014). As with the ECB, the Fund also urged the BoJ to act more quickly and aggressively, but interviewees felt that the BoJ's eventual adoption of these policies was more the result of the change in the political environment than an indication of the Fund's influence with the BoJ.

Officials regarded the Fund's multilateral products as very helpful in assessing global developments and policies needed for strong global growth. There was near-unanimous appreciation among interviewees for the value of the Fund's multilateral flagships. Though all the MAE central banks have a well-staffed international division that follows the global economy, the Fund's breadth of coverage of global developments, its cross-country work, and technical support for the G-20's work on ensuring strong global growth were regarded as its comparative advantage. Officials, particularly at the ECB and BoE, noted that the Fund's influence on them works as much through its multilateral research and analysis as through the bilateral consultations.[6]

While valuing the Fund's cross-country work in general, officials were less favorably inclined towards the discussion of the likely spillovers of their policies during the Article IV consultations. There was agreement that the analysis of spillovers was part of the core mandate of the Fund, but the presentations of the spillover reports during the Article IV consultations were not considered very useful and tended to overburden the process, an opinion shared by some IMF mission chiefs. Fed officials noted that they had done their own extensive work on cross-border impacts of their policies, recognizing the need to take adequate account of spillbacks onto U.S. conditions, and that there are regular

[6] One example was the 2009 *WEO* chapter (IMF, 2009c) showing that recoveries after financial crises tend to be slower than other recoveries, which played a role in the BoE Monetary Policy Committee's thinking on the appropriate monetary policy stance.

discussions with Fund staff on spillovers through other channels such as workshops and conferences.

## Advice on policy mix

While the IMF Article IV process aims for a holistic view across the macroeconomic policy framework, the Fund could have focused more on thinking through policy trade-offs between UMP and other policies. In the immediate aftermath of the crisis, and again with Japan in 2012–13, the Fund was a strong proponent of fiscal stimulus as part of an all-in approach to support demand. Otherwise, the IMF generally adopted a cautious approach on fiscal stimulus while supporting further monetary support as needed. In particular, the Fund's support of the turn to consolidation in 2010 was consistent with an orthodox view of the paramount importance of ensuring fiscal sustainability. In retrospect, the Fund could have done more to explore the trade-offs involved, given that a more rapid fiscal retrenchment would place greater burden on monetary policy to support demand, at a time when monetary policy was running out of ammunition (Dhar, 2014; Orphanides, 2017). Moreover, an "easy money/tight fiscal" policy mix also implied larger adverse cross-border spillovers through exchange rate and capital flow effects. As economic recovery remained sluggish, the Fund nuanced its message, noting that putting in place a credible medium-term strategy for fiscal consolidation could alleviate the need for upfront adjustment and urging countries to use their fiscal space and to make the needed adjustments "as growth-friendly as possible" (Lipton, 2012). Nonetheless, the overall fiscal message remained predominantly hawkish.