IMF ADVICE ON UNCONVENTIONAL MONETARY POLICIES

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I. INTRODUCTION

1. This Issues Paper discusses the motivation, scope and themes of an IEO evaluation of IMF advice on unconventional monetary policies (UMP). Since the global financial crisis (GFC), monetary policy has been used aggressively in four major advanced economies (MAE)—the Euro Area, Japan, the United Kingdom, and the United States—to meet domestic goals of closing output gaps and addressing deflationary concerns. These actions have had spillovers on many other advanced and emerging market economies, making their policy choices more challenging. The evaluation will assess the IMF's activities to assist member countries and the international monetary system deal with the challenges of UMP.

2. **Core mandate:** Providing advice on monetary policies is a core IMF activity. In addition to assessing whether a country's policies help meet its domestic goals, the IMF's mandate requires it to consider their consequences for other countries and for the international monetary system. The IMF's Articles of Agreement state that the institution should "promote international monetary cooperation" and serve as "the machinery for consultation and collaboration on international monetary problems" (Article I(i)). The 2012 Integrated Surveillance Decision specifies that bilateral Article IV consultations with countries should consider external spillovers of their domestic polices (IMF, 2012a; 2012b).

3. **Objectives of the evaluation:** The evaluation will take a detailed look at IMF advice to the major advanced economies carrying out UMP and to a selection of advanced and emerging market economies who dealt with the impact of these policies. It will assess whether the IMF provided useful advice on the range of instruments available to central banks, the likely efficacy of monetary policy relative to other policy options and the best policy mix, and broader repercussions associated with these choices for both the originating countries and the countries affected by spillovers. It will also assess how well the IMF performed its core mandate of promoting international monetary cooperation, and was attuned to considerations of evenhandedness and multilateral consistency.

4. **Preparing for the "new normal"?** Taking stock of the quality of Fund's monetary policy expertise and advice is timely for a couple of reasons. First, as economies exit or prepare to exit from UMP, it could help ensure that the Fund provides cutting-edge advice to countries on the exit process. Second, it can help Fund staff provide advice on how central banks should deal with a possible "new normal" in monetary policy, when the use of unconventional monetary policies may become more routine (Ball and others, 2016; Bayoumi and others, 2014).

5. **Structure of the paper**: The remainder of this paper provides some background on the use and effects of UMP (Section II), the themes of the evaluation (Section III) and the work plan (Section IV).

II. Background

6. **The use of UMP:** At the onset of the GFC, central banks in most major advanced economies lowered policy interest rates sharply. As conventional policies approached their limits, and particularly as policy rates approached zero—traditionally viewed as the lower bound—central banks in these countries turned to unconventional instruments, including massive asset purchases, measures to encourage bank lending, and more active forward guidance, and eventually negative policy interest rates.

7. **Spillovers from UMP:** UMP has effects within countries and across borders through multiple channels, including a positive impact on aggregate demand, as well as financial impacts through exchange and other asset markets, and surges in capital flows (Krishnamurthy and Vissing-Jorgensen, 2011; People's Bank of China, 2014; Gagnon, 2015). Economies have dealt with these effects of UMP in a variety of ways. Several advanced economies responded to exchange rate pressures by adopting negative policy interest rates or exchange rate caps. Many emerging market economies used macroprudential and capital flow management measures to address the difficult policy tradeoffs posed by capital inflows (Rajan, 2013, 2015; Carstens, 2015). These economies have also been exposed to volatility associated with shifts in expectations about the unwinding of UMP (Tombini, IMFC, 2013; Chen and others, 2016). For example, when the U.S. Fed signaled in 2013 its intention to taper the pace of its asset purchases, some emerging markets experienced sharp capital outflows and significant market volatilities—the so-called "taper tantrum" of 2013.[1]

8. **Potential longer-term costs of UMP:** Concerns have been raised that potential side-effects and longer-term consequences of unconventional monetary policies may offset their macroeconomic benefits. UMP may have raised financial risks in the originating countries and elsewhere by reducing the supply of safe assets and encouraging speculative investment and possible asset bubbles, particularly in housing markets (Borio and Zhu, 2012; Adrian and Shin, 2014; Bruno and Shin, 2015; Gabriel and Lutz, 2015). UMP may also have distributional effects within the countries where they are implemented (Acemoglu and Johnson, 2012; Bernanke, 2015; Draghi, 2015; Stiglitz, 2016; Voinea and Monnin, 2017).

9. **IMF country-level advice:** Bilateral and regional surveillance—through policy advice and supporting analytic work—has paid considerable attention to the challenges posed by UMP. The Fund has provided country advice on monetary policy implementation as part of Article IV consultations. Examples of analytic work include analysis of the effects of negative interest rates;

[1] More recently, the initial steps to normalize monetary policies in the United States and discussion of normalization in the euro area seem to have had a much more limited market impact.

cluster analyses of developments in housing markets; and advice on the design of foreign exchange interventions.[2]

10. **IMF multilateral response:** The IMF worked actively through multilateral forums—the G-20 in particular—to foster cooperative policy actions in fiscal and monetary policies (Faruqee and Srinivasan, 2013; Bayoumi, 2014) and advocated directly for greater international cooperation to deal with the effects of UMP (e.g., Lagarde, 2013, Jackson Hole speech). Concerns about UMP spillovers prompted adaptations in the IMF's multilateral surveillance framework. In Fall 2010, as quantitative easing in major advanced economies led to talk of currency wars (Mantega, IMFC, 2010a), the IMFC assigned priority to the need to "address the challenges of large and volatile capital movements, which can be disruptive" (IMFC, 2010b). In response, the IMF introduced spillover reports in 2011 for five major economies (China, the euro area, Japan, the United Kingdom, and the United States) to examine the cross-border implications of their economic and financial policies.[3] In July 2012, the IMF's Executive Board adopted the Integrated Surveillance Decision that explicitly requires the Fund to consider multilateral effects of advanced economy monetary policies in the context of bilateral surveillance (IMF, 2012c). Meanwhile, an "institutional view" was formed providing a policy framework for managing capital inflows in recipient countries (IMF, 2012d; IEO, 2015).

11. **Past IEO evaluations:** Some IEO evaluations have touched on UMP as part of their assessment of Fund performance since the onset of the GFC. The evaluation of *IMF Response to the Financial and Economic Crisis* concluded that "the risks of ultra-expansionary monetary policy, including unconventional monetary policy, were not comprehensively discussed until 2013." The report found that the IMF's 2011 and 2012 spillover reports "downplayed the adverse impact of quantitative easing on emerging markets, in terms of financial market and exchange rate volatility" (IEO, 2014). The evaluation of *The Role of the IMF as Trusted Advisor* found in its surveys that "about a third of the country authorities and half of the mission chiefs did not believe that the IMF has become more evenhanded since the onset of the global crisis." The evaluation also concluded that the perception among some country authorities that "the Fund is dominated by the interests of its largest shareholders" had undermined its role (IEO, 2013).

12. **IMF assessments:** In 2013, IMF staff reviewed the experience of unconventional monetary policies in the MAEs and their impact on 13 large recipient countries.[4] They concluded that these policies (i) had largely succeeded at achieving the domestic goals of the MAE and were "especially

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[2] See Vinals and others (2016) for analysis of the impacts of negative interest rates, the cluster report on Nordic economies for a detailed look at housing booms in these countries (IMF, 2013a), and Hledik, Holub, and Kral (2016) for a discussion of IMF advice to the Czech Republic on foreign exchange interventions.

[3] Pilot external sector reports were introduced in 2012 to provide multilaterally consistent assessments of external balances in major world economies (IEO, 2015).

[4] The countries are Australia, Brazil, Canada, China, India, Indonesia, Korea, Mexico, Poland, Russia, South Africa, Thailand, and Turkey. Chen and others (2014) and Bowman and others (2014) also analyzed the impact of U.S. UMP on emerging markets.

effective at the time of great financial turmoil"; and (ii) had "a mixed effect on the rest of the world" and "can give rise to policy strains in recipient countries" facing excessive capital inflows (IMF, 2013b; 2013c). Sahay and others (2014) studied the 2013 taper tantrum and concluded that since "surprises about the future course of monetary policy in major advanced economies have particularly strong effects on emerging markets asset prices and capital flows" it is "important for [MAE] central banks to provide clear communication and adequate market guidance."

III. Scope and Themes

13. **Scope of the evaluation:** There is still a range of views on whether the intensive use of monetary policies relative to other policies was the appropriate response to the crisis; this makes it difficult to judge the quality of the Fund's advice based on whether it turned out to be right. Therefore, the evaluation will focus on judging whether the Fund was able to innovate and develop its monetary policy analysis in the face of new challenges; whether Fund staff followed sound processes in arriving at the policy advice given; whether the advice was consistent with the IMF's broader mandate and surveillance decisions; and whether the Fund's member countries found the advice useful in navigating their way through the challenges since the GFC. We will cover developments over the 2008–17 period but the focus is likely to be on developments since 2012 since the initial phase of the GFC has been covered in previous IEO evaluations. To shed light on some questions, we may go back further in time (e.g., to the experience of Japan in the 1990s).

14. **Themes:** The evaluation will be organized around four themes: (i) the quality and effectiveness of the Fund's advice to the major advanced economies pursuing UMP; (ii) the advice and support provided to other advanced economies and to emerging markets on dealing with the effects of UMP; (iii) the role played by the Fund at the multilateral level to promote policy coordination and maintain global financial stability; and (iv) the extent to which Fund advice on UMP was useful in balancing the benefits and costs of these policies. The following paragraphs list some of the questions to be addressed under each theme.

15. **Fund advice to major advanced economies (MAE):**

(a) How did staff analyze the use of new monetary tools? To what extent did the staff innovate and look for ways to extend the conventional monetary toolkit? How much attention was paid in policy advice to "exit" risks? What was the internal process through which the Fund arrived at the advice given to MAE? Did staff in all the relevant departments feel they were consulted in the process? Did the Fund consider the range of views outside the institution? Were lessons from previous experience with UMPs (e.g., Japan in the 1990s) absorbed in Fund advice?

(b) How influential was the Fund's advice on UMP? Was Fund staff consulted on the policy actions taken by major central banks before they were announced and was the Fund's advice helpful as central banks sought to refine their new toolkit? Before or after the fact, were the Fund's views on these policy actions helpful to central banks in validating the actions taken as central banks moved beyond the conventional toolkit of monetary policy instruments?

(c) Was there cross-country consistency in the advice given to the MAEs? Were any differences in the advice given justified by differences in the circumstances facing each country?

(d) How effectively did the Fund advocate with MAE to take account of the spillovers of their policy actions, as required by the 2012 Integrated Surveillance Decision? Did it propose alternate policy actions—including a different policy mix with more fiscal stimulus and less reliance on monetary easing—that would allow MAE to meet domestic goals while posing fewer challenges for other countries?

16. **Fund advice to other advanced economies and emerging markets:**

For other advanced economies and emerging markets facing the effects of ultra-expansionary monetary conditions in MAE as well as domestic challenges:

(a) What advice did the Fund provide on policy options to deal with the effects of unconventional monetary policies in the MAE?

(b) Was the technical expertise of Fund staff useful to, and relied upon, by central banks in these countries as they took monetary policy actions to deal with the effects of the global financial crisis? Was the advice tailored to the characteristics and circumstances of individual countries?

(c) Was the Fund perceived as a trusted advisor acting in the interests of these countries?

(d) Was the Fund advice on the possible use of capital flow management measures consistent with the Fund's institutional view, and did it provide helpful and appropriate guidance? (Gallagher and Tian, 2017)

17. **Fund advice at the multilateral level:**

(a) Did the Fund's multilateral surveillance products (WEO, GFSR, spillover reports, among others) adequately analyze the likely spillovers from UMP on other economies?

(b) Did the Fund—working with the G-20 and other forums—serve its membership well in the core function of providing the "machinery for collaboration and consultation on international monetary problems"? (Baker, 2014; Inan and Asik, 2014; Mohan and Kapur, 2014; Lombardi and others, 2014; Mishra and Rajan, 2016)

(c) Was the Fund perceived as acting in the interests of its entire membership or as favoring selected shareholders?

18. **Balancing costs and benefits of unconventional monetary policies:**

(a) Did the Fund's advice on UMP strike the right balance between the likely short-term gains of these policies and the potential longer-term costs (e.g., build-up in risk taking and asset price inflation)?

(b) Did Fund advice examine the likely distributional consequences of the adopted policy mix and did it communicate this analysis to member countries?

(c) How did Fund advice reflect longer-term factors affecting monetary policy formulation, for example in the likelihood that the "new normal" entailed low equilibrium real interest rates? (Woodford, 2012; Kocherlakota, 2013; Stein, 2014)

IV. WORK PLAN

19. **Sources of evidence:** The main sources will be: (i) desk reviews of staff policy papers, Article IV consultations and program documents; (ii) analysis of research papers and reports (including an assessment of quality and influence through citation analysis and other tools); and (iii) interviews of IMF staff and Board members, staff at central banks and monetary institutions, as well as other policymakers and stakeholders.

Box 1. Desk Review and Case Study Countries (Tentative)

Major Advanced Economies:

The Euro Area, Japan, the United Kingdom, and the United States.

Other Advanced Economies:

Canada, the Czech Republic, Denmark, Korea, the Netherlands, Sweden, and Switzerland.

Emerging Market Economies:

Brazil, China, India, Indonesia, Malaysia, Mexico, Morocco, Turkey, and the UAE.

20. **Country coverage:** In addition to the MAE, a review will be conducted for a selection of other advanced and emerging market economies. Subject to further deliberation, desk reviews will be conducted for the countries listed in Box 1 and detailed case studies will be conducted for a few from this list.

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