



ONE YEAR AFTER THE 2011 TRIENNIAL SURVEILLANCE REVIEW—PROGRESS REPORT

KEY POINTS

November 5, 2012

Overview. Good progress has been made on the priorities of the 2011 Triennial Surveillance Review. The Fund has modernized its legal framework and taken forward a number of initiatives that lay the ground for effective implementation of the surveillance priorities. The next steps entail full implementation of these priorities in Article IV consultations and multilateral and regional reports.

Interconnectedness. An analytical base on interconnections has been built up, shedding light on linkages across countries and sectors; and the Integrated Surveillance Decision should help to strengthen spillover analysis in Article IV reports and the focus on systemic stability. The modalities for clustering Article IV consultations for interconnected countries still need to be worked out. Further advances are also needed to increase the leverage of spillover analysis and cross-country work.

Risk assessment. A sharper focus of surveillance on risks, including the use of risk assessment matrices in staff reports, appears to have bolstered the process for identifying risks at an early stage, and improved consistency of messages across various surveillance products. Going forward, the quantification of global risks would provide a basis for country teams to identify the impact of global risks on individual economies.

Financial stability. FSAP recommendations are being more consistently followed up in Article IV staff reports, but more could be done to integrate assessments of macro-financial linkages in surveillance. The Financial Surveillance Strategy provides a basis for further progress, including on developing a more systematic approach to macro-financial issues; deepening understanding of financial interconnections and the implications for policy; improving financial sector expertise; and closing data gaps.

External sector. The broadening of external sector analysis, the improved methodology under the Pilot External Balances Assessment, and the Pilot External Sector Report appear to be supporting a more comprehensive monitoring of countries' external sector. Going forward, assessment methods need to be refined further, and the new approaches extended to the wider membership.

Traction. It is too early to gauge progress on traction, but there is some evidence that the Fund is generating more public debate, including in advanced countries. Going forward, progress in each of the above-mentioned priorities should help to generate more traction.

This Report provides an assessment of progress implementing the recommendations of the [2011 Triennial Surveillance Review](#) and the Managing Director’s [Statement on Strengthening Surveillance](#). Based on this assessment it makes recommendations to address remaining gaps.

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CONTEXT

1. **This progress report provides a short update on the first year of implementation of the 2011 Triennial Surveillance Review (TSR) in line with the [Managing Director’s Statement on Strengthening Surveillance](#) of October 2011.** The report does not provide a comprehensive review of surveillance—which will be done in the 2014 TSR. Instead, its purpose is to establish, at an early stage, whether the new operational priorities are being implemented, set out key areas of progress, and discuss the challenges raised in their implementation. The report also identifies areas where further efforts may need to be directed—particularly following the change to the legal framework—to ensure even implementation and delivery of effective surveillance. The report recognizes that, while some measures have been implemented over the past year, others will take more time to come to fruition.

2. **The progress report is based on feedback from within the IMF and a selective review of a small sample of reports.** Feedback was drawn from roundtable discussions among staff on the challenges of implementing the surveillance priorities; and a review of multilateral surveillance reports and a sample of 15 Article IV staff reports for 2012 (referred to hereafter as *sample review*).¹ The small sample makes it difficult to draw firm conclusions, but the review can serve as an indication of the direction in which surveillance is moving. It is also clear that Article IV reports are not expected to cover in depth all the TSR priorities and selectivity is critical.

3. **The report is organized around the overarching theme of the TSR—to make *Fund surveillance as interconnected as the global economy*—and the five operational priorities.** These operational priorities are: interconnectedness, risk assessment, financial stability, external stability and traction. Section II describes the initiatives taken so far to facilitate the implementation of these priorities; Section III assesses progress in each of these areas in line with the Managing Director’s Statement on Strengthening Surveillance; and Section IV discusses the challenges raised in carrying out the TSR agenda. Remaining measures to ensure the implementation of these priorities are highlighted in Section V.

¹ The review of multilateral reports focused on those produced in Spring 2012 as the Fall 2012 reports were not finalized when this progress report was conducted. The sample review of 15 reports includes the latest 3 reports from each area department concluded by the Executive Board before August 2012 (Botswana, Brazil, Cameroon, China, Republic of Congo, Grenada, Japan, Kazakhstan, Russia, Saudi Arabia, Singapore, Spain, Tunisia, United Kingdom, and United States). These criteria were adopted to have a random selection of reports, while allowing enough time since the adoption of the 2011 TSR priorities. Compared to the review of 50 Article IV reports in the 2011 TSR (which was stratified to reflect the composition of the membership), this sample contains a larger share of advanced and emerging market economies and lower share of developing economies. The smaller sample and this potential bias are taken into account in the analysis in the report.

INITIATIVES: LAYING THE GROUNDWORK

Two initiatives—the updated legal framework, and guidance to Fund staff and outreach—are expected to help facilitate the implementation of the TSR priorities, and to adapt Fund surveillance to the rapidly evolving needs of an integrated global economy.

A. The Updated Legal Framework

4. **The TSR saw the need for a major reform to support more effective surveillance.** It argued that the system was heavily tilted toward exchange rate policies as the primary contributor to external imbalances, failed to sufficiently integrate bilateral and multilateral surveillance, and suffered from a serious legitimacy deficit.

5. **The change to the legal framework will allow the Fund to properly recognize interconnections and better capture economic realities.** In July 2012 a key change to the legal framework—the Integrated Surveillance Decision (ISD)—was adopted, which will come into effect on January 18, 2013. Once effective, the ISD will allow for more systematic coverage of spillovers from members’ economic and financial policies in Article IV consultations and enable better integration of Fund surveillance over individual economies and global developments. The ISD does not change the scope of member countries’ obligations. It allows the Fund to advise members on how their policies affect not only their own domestic and balance of payments stability, but also global economic and financial stability. As such, it is expected to increase the Fund’s ability to detect vulnerabilities and risks at an early stage, engage members in a dialogue about these vulnerabilities and risks, and provide timely policy advice.

B. Guidance and Outreach

6. **Over the past year, a number of steps have been taken to communicate the changes to the surveillance priorities and to the legal framework (both internally and externally) in order to get broad buy-in and ensure their proper implementation.**

- The [Bilateral Surveillance Guidance Note](#) (BSGN) was revamped and published in July 2012, providing practical ways to operationalize the five priorities set by the TSR. It was updated to a [Guidance Note for Surveillance Under Article IV Consultations](#) in October 2012 to take into account the changes to the legal framework which will come into effect in January 2013. Also, a revised internal website was launched to provide links to guidance, key tools, and best practice examples.
- Extensive outreach has helped to walk external stakeholders and staff through the TSR priorities, and get their feedback and inputs to strengthen their implementation.

PROGRESS THUS FAR

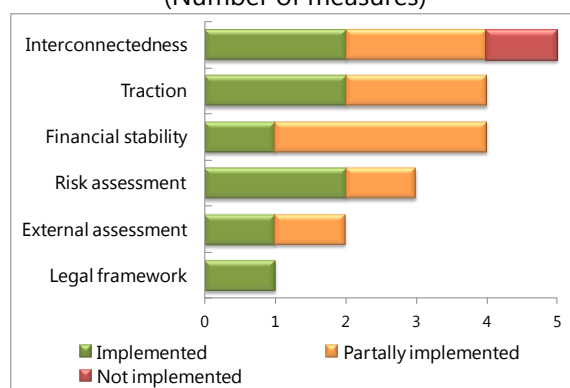
Since the 2011 TSR, there has been a tangible improvement in the focus of surveillance on risks, coverage of interconnectedness, external stability, and to a lesser extent of financial stability have also increased (Figure 1). Nonetheless, there is greater scope for better integration of the priorities in Article IV discussions and multilateral and regional reports. More time is needed to gauge progress on traction.

A. Interconnectedness

7. The overarching theme of the TSR was increased focus on interconnections.

Surveillance was seen as too fragmented. The review found that there was a need to better leverage the Fund's universal membership, its cross country expertise and macro and financial expertise into a more integrated view. More was needed to analyze linkages and spillovers across countries and sectors taking into account the interaction of global regional and country level developments and to make spillovers mainstream analysis in Article IV reports.

Figure 1. Status of Measures in the Managing Director's Statement on Surveillance
(Number of measures)



8. **Good progress has been made on building an analytical base on interconnections.** In addition to including systematic coverage of spillovers relevant for regional economic outlooks (REO) and in Chapter 2 of the WEO since the April 2012 WEO, the overall analytical base on interconnectedness has been strengthened (Box 1):

- Spillover Reports.** The [2012 Spillover Report](#), focused on spillovers from: the Euro area crisis, uncertain US fiscal policy, loose monetary policy in advanced countries, a possible slowdown in China or Japan, and the complications arising from financial reforms. It provides specific policy recommendations for each scenario consistent with the relevant Article IV consultations and notes that coordinated policy action can be more effective at mitigating downside risks than individual action alone.
- Understanding financial interconnections.** Several multilateral surveillance papers have examined macroeconomic and financial interlinkages, and looked to apply the lessons across countries. Similarly, cluster analysis—mapping out key financial and trading links—has examined analytical frameworks and channels for the propagation of financial shocks. However, these analyses are preliminary, focus solely on networks, and more needs to be done to understand causal linkages for how policies are transmitted through networks or, going beyond this, an assessment of the implications for overall stability.

Box 1. Strengthening Analytical Capacity on Spillovers and Cross-Cutting Issues

World Economic Outlook: The [April 2012 WEO](#) has a special feature on cross-border spillovers from Euro area bank deleveraging.

Global Financial Stability Report: The [April 2012 GFSR](#) examines how derivatives markets link US banks and European counterparties. It notes direct effects via US holdings of derivative claims and indirect effects via feedback loops between counterparty risk, hedging, and market funding.

Fiscal Monitor: The [April 2012 FM](#) looks at the appropriate pace of fiscal adjustment around the world. It argues that countries with fiscal space should calibrate fiscal adjustment to avoid undue pressures on economic activity and employment. But short-term caution should not be used as an excuse to delay medium-term reform efforts.

Enhancing Financial Sector Surveillance in Low-income Countries: Financial Deepening and Macro-Stability (April 2012): This [paper](#) analyzes the interplay between financial deepening and macro-financial stability in developing economies. It looks at the policy and institutional impediments in LICs that have a bearing on the effectiveness of macroeconomic policies, macro-financial stability, and growth.

Enhancing Surveillance: Interconnectedness and Clusters. (March 2012): This [paper](#) uses network analysis to examine global interconnections. It finds that countries can be grouped into one or more main categories: (i) a global *core*, comprising the major systemic economies; (ii) *clusters* or groups, within which economies are more connected to one another than those outside the group; and (iii) *gatekeepers*, or economies that link clusters to one another or to the core. Different channels are examined (e.g. trade, bank wholesale funding) through which economies impact one another.

Multilateral Aspects of Policies Affecting Capital Flows (October 2011): This [paper](#), the third in a series, provides a multilateral perspective on the key issues and policy concerns related to capital controls and prudential policies covering both source and recipient countries. Attention is drawn to the impact of monetary, regulatory, and supervisory policies of advanced economies on others.

Liberalizing Capital Flows and Managing Outflows (March 2012): This [paper](#), the fourth in a series, draws on country experiences to formulate a comprehensive but flexible approach to the management of capital flows. The paper develops an operational framework for liberalizing capital inflows and managing capital outflows. It notes that understanding of these issues has advanced over the past decade but remains far from complete.

Cross-Cutting Themes in Advanced Economies with Emerging Market Banking Links (November 2011): This [paper](#) looks at the growing presence of banks headquartered in advanced economies (AEs) expanding into emerging markets (EMs) and examines whether: (i) the presence of AE banks benefits EM banking systems, (ii) AE banks have a funding cost advantage and the implications, and (iii) banking links increase the transmission of macro-financial risks.

The Challenge of Public Pension Reform in Advanced and Emerging Economies (December 2011): This [paper](#) discusses considerations that should guide pension reform, including economic growth, fiscal consolidation needs, and the functioning of equity and labor markets. Also, health care costs are a key driver of budgetary expenditure globally and are central to fiscal stability.

Global Liquidity Management—Possible Indicators to Monitor Global Liquidity (November 2011): This note aims to help policymakers better understand developments in global liquidity, their macro-financial implications, and the rationale for monitoring them. It highlights indicators for monitoring liquidity, including: (i) those that distinguish between core (e.g. deposits) and noncore (e.g. securities) liabilities of financial intermediaries, complemented with BIS cross-border banking statistics; and (ii) new measures of the price of core and noncore liquidity (spreads).

- **Regional Economic Outlooks.** REOs have also examined spillovers, both from the world to regions and within regions. Table 1 shows spillovers analyzed in REOs prepared for Spring 2012.²

Table 1. Spillovers included in Regional Economic Outlooks (Spring 2012)

Africa Impact of global financial stress on African banks
Asia Impact of bank deleveraging on Asian banks Impact of equity markets spillovers Impact of regional integration on Asian LICs and Pacific island nations
Western Hemisphere US exposure to Europe Latin American countries' exposure to foreign banks Regional spillovers from Brazil and Mexico

- **Capital Flows and Global Liquidity.** The Fund's effort to develop an approach on managing capital flows is well underway.³ A paper on The Liberalization and Management of Capital Flows: An Institutional View was discussed by the Executive Board later in November 2012. This paper summarizes current views and seeks the Board's endorsement of an overall approach to Fund advice on capital flows. Work on monitoring global liquidity is also underway in the context of the vulnerability exercises and external sector analyses.

9. **However, the analytics on spillovers have yet to be better leveraged in Article IV staff reports and there is greater scope to draw on cross-country experience.**

- **Coverage of spillovers appears to have increased in the sample review, but the results are uneven, and few reports have an in-depth discussion of the potential policy implications.** Most of the 15 reports reviewed had at least some analysis of inward spillovers (Figure 2), including via risk assessment matrices. Similarly, most reports for the systemic or gatekeeper economies in the sample (e.g. Brazil, Russia, Saudi Arabia, United Kingdom, and United States) included some analysis of outward spillovers. In some cases, reports referenced only inward

Figure 2. Inward and Outward Spillover Analysis

	Inward Spillovers	Outward Spillovers	Policy Implications
Botswana	Extensive Analysis	No Analysis	Extensive Analysis
Brazil	Extensive Analysis	Extensive Analysis	Extensive Analysis
Cameroon	Some Analysis	No Analysis	Extensive Analysis
China	Some Analysis	Extensive Analysis	Extensive Analysis
Congo, Republic of	Some Analysis	No Analysis	Extensive Analysis
Grenada	Extensive Analysis	No Analysis	Extensive Analysis
Japan	Extensive Analysis	Passing Reference	Extensive Analysis
Kazakhstan	Extensive Analysis	Extensive Analysis	Extensive Analysis
Russia	Some Analysis	Extensive Analysis	Extensive Analysis
Saudi Arabia	Passing Reference	Extensive Analysis	Extensive Analysis
Singapore	Some Analysis	Extensive Analysis	Extensive Analysis
Spain	Passing Reference	Passing Reference	Extensive Analysis
Tunisia	Some Analysis	No Analysis	Extensive Analysis
United Kingdom	Some Analysis	Extensive Analysis	Extensive Analysis
United States	Passing Reference	Extensive Analysis	Extensive Analysis

Extensive Analysis
Some Analysis
Passing Reference
No Analysis

Source: IMF staff estimates, no color = not applicable.

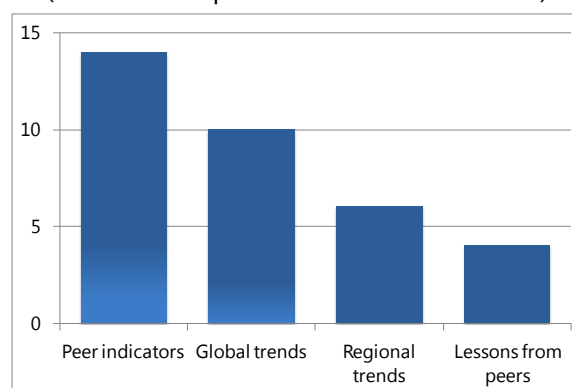
² Regional Economic Outlooks were not prepared for Spring 2012 covering Europe and the Middle East and Central Asia.

³ [The Fund's Role Regarding Cross-Border Capital Flows; Recent Experiences in Managing Capital Inflows—Cross-Cutting Themes and Possible Policy Framework; The Multilateral Aspects of Policies Affecting Capital Flows; Liberalizing Capital Flows and Managing Outflows.](#)

spillovers and these could have been covered in more depth, including advice on policy responses. Feedback from roundtable discussions indicated that member countries, particularly LICs, would appreciate deeper analysis of inward spillovers.

- Cross-country analysis appears to have gained less ground, especially with regard to analytical depth.** Surveys of country authorities conducted for the 2011 TSR indicated that they would like to see the Fund drawing policy lessons from its extensive cross-country experience. Research at the IMF has proceeded on a number of cross-cutting issues, in particular on capital flows and financial interconnectedness, and several initiatives were taken to improve information-sharing across and within departments (Appendix II). However, the sample review suggests that cross-country analysis is still limited, often to a comparison of peer group indicators such as fiscal deficits or credit growth. Only a few reports made extensive use of cross-country findings and drew on cross-country policy experiences to support their analysis (Figure 3).

Figure 3. Types of Cross-Country Analysis in Article IV Reports
(Number of reports out of 15 that include:)



Source: IMF staff estimates.

10. **Internal feedback supports these findings:**

- Departments thought further research and stronger coordination was needed to improve the discussion of spillovers.** Research should aim to improve understanding of spillover channels, the range of countries affected, and the magnitude of likely effects. Disseminating more information on potential inward spillovers and on global economic and financial risk scenarios would help departments to deepen analysis, and stronger coordination among country teams on sources and recipients of spillovers would also be helpful. The Financial Surveillance Strategy also emphasizes the need for further research on financial spillovers and real financial linkages.
- Departments saw scope to strengthen the analytical base and foster sharing of cross-country experiences beyond regional boundaries.** They highlighted a demand for more information on cross-country experiences of thematic policy issues going beyond regions.

11. **Finally, the goal of discussing Article IV consultations together for interconnected countries has yet to be realized.** The main challenges are logistical. Mission timing must account for different budget cycles and preferences of authorities and when countries are covered by different departments, coordination becomes more difficult. To date, teams have not overcome these coordination difficulties. Greater clustering would help to promote and facilitate greater cross-country analysis by drawing together analysis on common themes across similarly-placed countries.

B. Risk Assessment

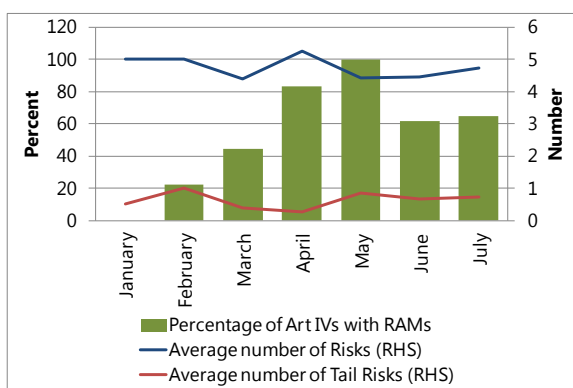
12. **The TSR sought to bring about an in-depth assessment of risks and possible mitigating policy responses.** Recommendations were to: step up risk discussions in Article IV reports, including through encouraging use of a risk assessment matrix; pay greater attention to risks in multilateral surveillance products; and take up analyses from the vulnerabilities, and early warning exercises in policy discussions with country authorities.
13. **Risk analysis appears to have strengthened both in staff reports and in multilateral surveillance.** This is expected in the current crisis environment.
14. **In Article IV reports, the coverage and identification of risks appear to have increased.** In line with the 2011 TSR recommendation, risk assessment matrices (RAMs) have been included in many Article IV reports (Box 2). In the *sample review*, 12 out of 15 reports included RAMs. RAMs appear to have helped to sharpen risk assessments, with all RAMs covering the likelihood and impact, and almost all including a brief description of transmission channels (Figure 5). Potential policy responses—to reduce the probability of risk materialization or to deal with their consequences—were not always covered, although in some cases they were reported in RAMs, and in others discussed in the main text (e.g., staff reports for the US and Kazakhstan).

Box 2. Risk Assessments and Risk Assessment Matrices (RAMs)

Many Article IV staff reports have experimented with risk assessment matrices (RAMs). RAMs have been included in over half of all staff reports concluded by the Executive Board during the first seven months of *the year*, and in around 70 percent of cases in April–July (Figure 4).

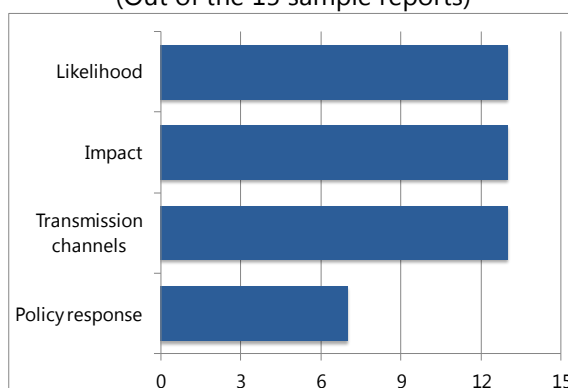
RAMs generally covered baseline risks but fewer reports included tail risks. RAMs typically covered 4–5 risks and examined: (i) global risks (e.g. the Euro area crisis, oil price shocks), (ii) regional risks (e.g., stalled transitions in MENA countries), and (iii) country-specific shocks (e.g., sovereign defaults, political risks). However, tail risks were mentioned in less than half of the RAMs.

Figure 4. Percent of Reports with RAMs
(Percent)



Source: Article IV reports issued since Jan. 2012.

Figure 5. Discussion of Risks in Article IV Reports
(Out of the 15 sample reports)



Source: Sample review of Article IV reports.

15. **Staff feedback has highlighted that in most cases, the use of RAMs has helped to improve discussion of risks with country authorities.** Nevertheless, at times, such discussion has proved to be difficult, partly reflecting transitional costs or due to lack of supporting quantitative analyses, or publication sensitivities. Departments also see a danger that RAMs could become a mechanical exercise and discourage country-specific analysis.

16. **A new interdepartmental initiative is helping to better leverage risk analysis exercises in bilateral surveillance.**

While it is difficult to gauge the extent to which the Early Warning Exercise and the vulnerabilities exercises are being used directly in policy discussions with authorities, staff has begun to draw more on these assessments. More recently, an interdepartmental working group has begun to assess key global/regional risks and their probabilities. This may help to promote a more consistent treatment of global risks across reports (Table 2).

Table 2. Coverage of Global Risks in Bilateral Surveillance (Summer 2012)

	GFSR Update	WEO Update	Article IV Reports
World			
Strong intensification of the euro area crisis	■	■	12
Increase in oil/energy prices		■	6
Fall in commodity export prices			6
Stagnation of global growth	■		3
Lack of credible fiscal consolidation plans		■	2
Advanced Economies			
Stagnation of growth in Europe			2
US fiscal cliff	■	■	1
Increase in Japanese govt bond yields			1
Emerging Markets			
Capital outflows/higher interest rates in EMs	■	■	3
Hard landing in China			3
Credit booms/asset bubbles in EMs	■	■	2
Lower than expected budget support for		■	0

17. **In multilateral and regional surveillance products, risk analysis has become more prominent, with a number of major risks being flagged by more than one product.** For example, most of the multilateral reports for Spring 2012 flagged risks arising from an intensification of the euro area crisis, large deficits and high debt levels in advanced markets, and credit booms and busts in emerging markets (Table 3). Given the different mandates, audiences, and objectives, each report covered appropriately the relevant risks within their mandates. Nevertheless, in some cases where similar topics were discussed, relevant risks appeared in one publication but not another. For example, the risk that market participants shift their concerns to the US or Japan appeared in the WEO, but not in the GFSR or the Consolidated Multilateral Surveillance Report (CMSR).⁴ Similarly, the risk of excessive bank deleveraging was a risk scenario mentioned in the GFSR and FM, but not in the WEO or CMSR.

18. **Risk scenarios could be presented more clearly in multilateral and regional surveillance products.** In terms of presentation, the CMSR, EWE, FM, and Spillover Reports, and WEO laid out the risk scenarios clearly. But in other publications, risk scenarios were often not explicit, although they were often implied (e.g. via recommended policy responses). A more systematic approach to developing risk scenarios would help in this respect. More could also be done in those publications to make it easier for the reader to identify the risk scenarios.

⁴ The CMSR was recently expanded to include commentary on proposals to address the IMF's work program and consequently renamed the Global Policy Agenda.

Table 3. Coverage of Risks in Multilateral and Regional Surveillance* (Spring 2012)

	Multilateral Reports					REOs			
	CMSR	EWE	FM	GFSR	WEO	Africa	Asia	Middle East (Update)	Western Hemisphere
World									
Renewed escalation of the euro area crisis	■	■	■	■	■	■	■	■	■
Sharp oil price increase	■	■			■	■	■	■	■
Weak medium-term growth	■	■			■			■	
Advanced Economies									
High medium-term public deficits & debt	■		■	■	■				■
Market concerns shifting to US or Japan					■				
Too rapid policy adjustment		■	■						■
Financial sector, e.g. excessive bank deleveraging		■	■	■			■		■
Return of economic & financial protectionism		■							
Emerging & Developing Economies									
Credit booms & busts	■	■		■	■			■	
Stalled transitions in MENA countries		■							
Fall in commodity export prices						■			
Rising internal tensions						■			
Political tensions linked to transfers of power						■			
Climatic shocks						■			
Hard landing in China							■		■
Regional spillovers from conflict in Syria								■	

* A dot indicates the risk scenario was discussed in the report. Full REOs were not produced for Europe or the Middle East and Central Asia.

C. Financial Stability

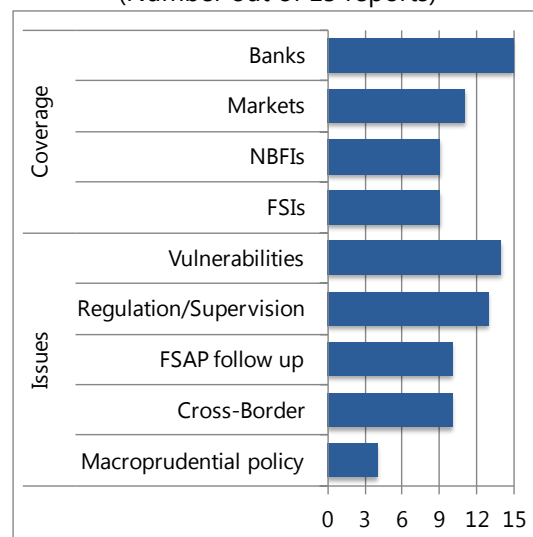
19. **While the TSR found that financial stability analysis had advanced, further measures were proposed to systematically integrate it into bilateral and multilateral surveillance.** To guide the overall effort, the Managing Director's Statement recommended developing a strategic plan for financial surveillance. To strengthen the coverage of financial issues in Article IVs, the Statement also recommended mobilizing financial expertise for teams for systemically important financial sectors and as needed for vulnerable economies; stepping up training and disseminating vetted tools and good practices (including cross-country lessons from FSAPs); and preparing cross-country thematic studies. The review of data provision to the Fund for surveillance purposes was brought forward to 2012.

20. **A number of these recommendations have already been carried forward.** A [Financial Surveillance Work Agenda](#) was published in April 2012 and this was followed by a full [Financial Surveillance Strategy](#) in September 2012. The three-pronged strategy aims at: strengthening the underpinnings of macro-financial risk assessments and policy advice; upgrading financial surveillance instruments and products to foster an integrated response to risks; and engaging more actively with stakeholders—particularly to promote an early diagnosis of systemic risk. Financial expertise has been added to Article IV teams for systemic financial sectors and more frequent FSAPs are now being considered for vulnerable economies. Staff has also reviewed the cross-cutting lessons of FSAPs. The review of data provision proposes measures to establish better reporting of financial sector data shortcomings in Article IV reports. Finally, significant work has been done on financial stability and development in LICs, including a policy paper on [Enhancing Financial Sector Surveillance in Low-Income Countries](#).

21. **Coverage of financial sector issues has broadened somewhat in Article IV reports, prompted by follow-up on FSAPs, but there is scope to deepen and integrate the analysis.**

- Coverage.** As in the 2011 TSR, the *sample review* found that all reports describe the structure of the financial system, including the banking sector. Reports have also stepped up reporting of information on markets and nonbank financial institutions. (Figure 6). However, discussion varied—issues related to regulation and supervision were covered in nearly all reports (the same as in 2011), and key vulnerabilities were identified, but discussion of macroprudential policy options was contained in only 4 of 15 reports. As was the case in the 2011 TSR analysis, use of the financial soundness indicators tables (FSIs) was also patchy—six reports did not discuss the FSIs in the staff report.

Figure 6. Financial Surveillance: Coverage and Issues Raised
(Number out of 15 reports)



- Follow up on FSAP recommendations.** There was notably more consistent follow-up of FSAP recommendations in the *sample review* compared to the 2011 TSR. This may partly reflect the very high proportion of recent FSAPs in the *sample review*. In the eight cases where FSAPs were conducted in the past three years, FSAP recommendations were covered in the reports and drawn upon in the discussion. Pertinent issues from earlier FSAPs were also followed up. Better follow-up on FSAPs was accompanied by concrete policy recommendations—particularly relating to regulation and supervision.
- Analysis of macro-financial linkages.** The depth of analysis of macro-financial linkages and cross-border linkages varied considerably across reports in the *sample review*. In a couple of cases, brief coverage was appropriate as the financial system was substantially underdeveloped. In other instances, while vulnerabilities were clearly identified, potential transmission channels and the implications of a shock were not explained (or were covered only very briefly in the RAM), instead reports sometimes jumped straight to policy recommendations. In-depth coverage of macro-financial or cross-border financial risks was more sporadic (8 out of 15 Article IV reports contained substantive discussion at least on macro-financial link and two other reports contained a short explanation of the linkages). Few reports appeared to use analysis available in multilateral surveillance products (with the exception of the Spillover Report).

22. **Departments' feedback indicated a need to deepen understanding of macro-financial linkages and policy transmission channels.** Some felt that more work was needed on the effectiveness of macroprudential policies and their coordination with monetary policy. They viewed the availability of expertise for financial surveillance as being stretched and inhibiting more granular

in-depth analysis, in particular of cross-border spillovers. Financial deepening and growth was also considered to be an important topic for future Article IV consultations.

D. External Sector

23. **The TSR recommendations focused on broadening the assessment of external stability and ensuring better integration of analysis and policy advice in staff reports.** The Managing Director's Statement proposed the publication of a multilaterally-consistent assessment of external balance with each WEO cycle. There was also a need for assessments to take a broad view of external stability, encompassing an analysis of balance sheets and including coverage of exchange rates, capital flows, and reserve policies. Emphasis was also placed on discussing the overall policy mix, including the external assessment, rather than discussing it separately.

24. **In line with the recommendation, a Pilot External Sector Report (ESR) has been developed, which draws upon the Pilot External Balances Assessment (EBA)** (Box 3). Staff is engaged in outreach on the new report and pilot methodology to seek ways to enhance and develop both the method and future reports. Nonetheless, the early indications are that the Pilot ESR appears to have helped broaden the coverage of the external positions for the economies covered in the report, while the Pilot EBA methodology deepened quantitative analysis for a wider group of 50 economies (Figure 7).⁵ These innovations carried over from the Pilot ESR to the Article IV reports for the ESR countries.

25. **Less progress has been made extending these innovations to other economies.** Economies not in the EBA still use CGER-like methods to assess exchange rates and current accounts. While external assessments for non-EBA countries are generally quite good, they rely more on basic indicators (e.g. PPP exchange rates, export shares) and less on coverage of external vulnerabilities (e.g. capital flows, changes in reserves, or external assets/liabilities). For example, 75 percent of reports for EBA countries discussed external vulnerabilities but in only 21 percent of reports for other countries (Figure 8). This gap in coverage of external vulnerabilities may shrink over time. Best practices from the ESR may provide a demonstration effect for other country teams. At the same time, work is ongoing to develop better quantitative techniques for other economies. In particular, staff is examining how to incorporate improvements from the EBA into assessments for other economies and to account for significant country specific factors (e.g. exports of non-renewable resources, financial flows) while maintaining consistency and evenhandedness. Lack of data remains a challenge for assessments in some countries, particularly LICs.

26. **More could be done to consistently integrate the discussion of external and other policies.** In many reports, the external sector is treated separately and not linked to other (e.g. fiscal, monetary, or structural) policies.

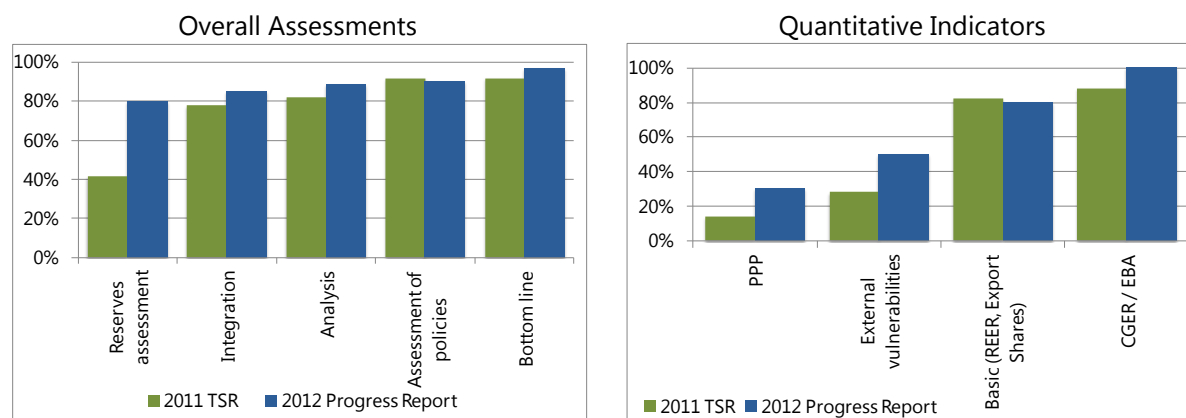
⁵ The country coverage of EBA is mainly advanced and emerging market economies, reflecting data availability as well as wide structural differences with respect to low-income economies, including access to financial markets.

Box 3. New Initiatives in External Sector Assessment

Pilot External Sector Report (ESR). This [Report](#), issued July 2, 2012, was designed to broaden external sector surveillance by systematically assessing exchange rates, current accounts, balance sheet positions, reserves adequacy, capital flows, and capital flow measures. It combined multilateral and bilateral perspectives and provided a multilaterally consistent analysis of the external positions of 28 large economies and the Euro Area. The report aimed to ensure that assessments are candid and evenhanded. The same methodologies are applied to all countries and assessments for individual countries are multilaterally consistent. At the same time, country teams provide in-depth knowledge of country-specific factors to identify those not captured by models. The pilot report also analyzes policy gaps and points to potential responses to address external imbalances.

Pilot External Balances Assessment (EBA). This approach, under development by the Research Department, is used as an input in to the assessment of current accounts and real exchanges rates in the Pilot ESR. The EBA builds on and improves previous methods. The approach strips out the influence of cyclical factors and allows one to identify the impact on a country's current account of policy distortions in fiscal policy, social protection, capital controls, and reserve accumulation. The approach can also identify whether the home country's policies need to change or whether other economies should change course. An [overview of the methodology](#) is provided in Appendix I of the Pilot External Sector Report, and an [extended description](#) is available online.

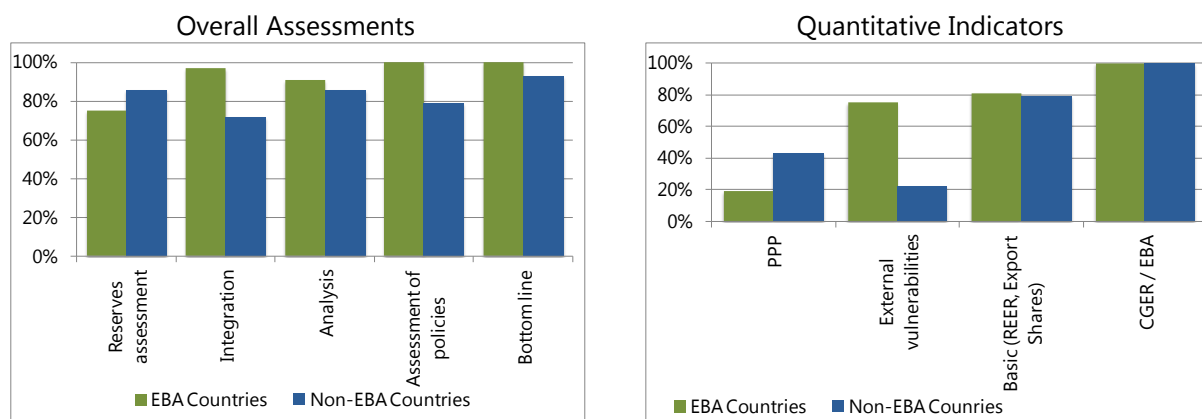
Figure 7. Article IV Review: Improvements in External Sector Assessments since the 2011 TSR
(Percent of reports that have adequate:)



Source: IMF staff estimates. Based on a sample of 50 countries for the 2011 TSR and 30 countries for the 2012 Progress Report.⁶

⁶ The sample for the external assessments was a stratified random sample designed to include equal numbers of advanced, emerging, and low-income countries and equal numbers from Africa, Asia, Europe, Latin America, and the Middle East. It included: Bolivia, Botswana, Brazil, Burundi, Cameroon, China, Rep. of Congo, Czech Rep., Grenada, Guatemala, Israel, Japan, Kazakhstan, Kuwait, Malawi, Mauritania, New Zealand, Nicaragua, Pakistan, Philippines, Russia, Saudi Arabia, Singapore, Spain, Tunisia, Ukraine, United Kingdom, United States, Vietnam, and Zambia.

Figure 8. Article IV Review: Quality of External Assessments
(Percent of countries including adequate:)



Source: IMF staff estimates.

E. Traction

27. **The TSR argued that high quality analysis as well as candid, evenhanded advice tailored to country circumstances could improve traction and communication with stakeholders.** To foster ministerial engagement, the Managing Director's Statement included maintaining the practice of discussing the Global Policy Agenda at the IMFC. Regarding bilateral surveillance, the plan urged better coverage of issues involving unemployment, inequality, and inclusive growth in Article IV reports when macro-critical; exchanging views with country authorities on key issues for discussion prior to Article IV missions, and reporting on implementation of past advice in Article IV reports.

28. **As changes to surveillance take time to implement, it is still early to assess whether reforms have improved traction.** But some of the recommendations of the 2011 TSR are being implemented, including:

- During the 2012 Spring Meetings, the IMFC discussed the [April 2012 CMSR](#) and during the 2012 Annual Meetings the IMFC discussed the October 2012 Global Policy Agenda (an expanded report that addresses the work agenda). These reports helped to communicate the Fund's key surveillance messages to ministers and senior policymakers.
- The suggestion to staff in the guidance note is to discuss with authorities macro-social issues (e.g., employment and income distribution) that are critical to macroeconomic stability, and to draw on the expertise of other institutions (e.g. ILO, OECD, World Bank). The *sample review* found that over half provided some in depth analysis of labor and employment issues as these were macro-critical.

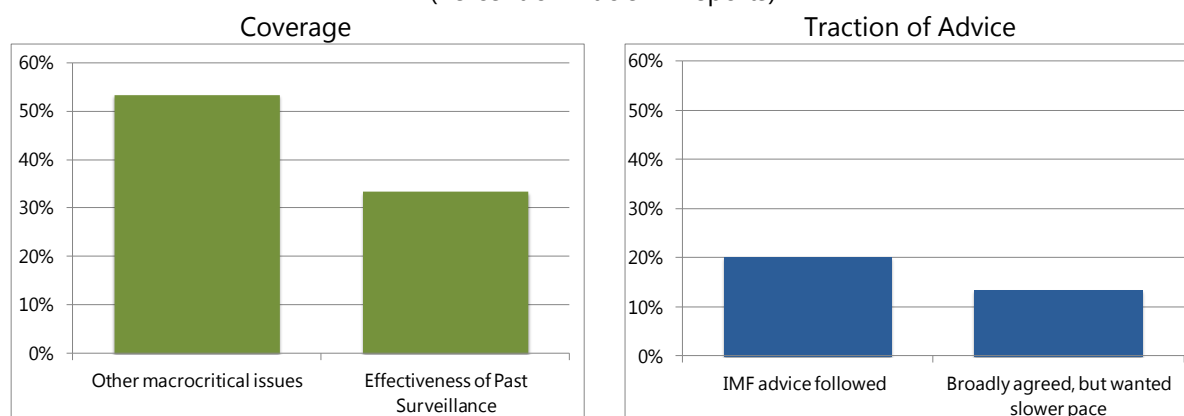
29. **Follow-up of past policy advice in Article IV reports seems to have remained uneven.** Only half of the reports reviewed included follow-up to past Fund advice (Figure 9). Of those, none indicated whether the authorities considered the advice inappropriate or not valued. When advice was not implemented, legal, technical, or capacity issues were highlighted as reasons. Follow-up was

weaker for advanced countries, with only one report commenting on the effectiveness of past surveillance.

30. **There is some evidence that the Fund is generating more public debate and media interest, including in advanced countries.** The 2012 Annual meetings recorded the highest number of participants (11,597) and press attendance (1,667) for meetings held outside Washington in the past decade; and views on iMFDirect blog registered by 35 percent in 2012. In addition, the Fund's communications on Europe are generating large coverage, especially with regard to Spain and Greece, and radio interviews on the US Article IV consultations reached 16.5 million listeners in 2012, compared to 15 million in 2011.

31. **Nevertheless, feedback from Fund staff suggested more needs to be done to improve traction and to monitor progress.** Roundtable discussions suggested that Fund advice is taken into account particularly in countries where vulnerabilities are emerging. They believed that more cross-country policy notes on lessons from other countries could help to strengthen traction.

Figure 9. Article IV Review: The Coverage and Traction of Fund Advice
(Percent of Article IV Reports)



Source: IMF staff estimates

IMPLEMENTATION CHALLENGES

The implementation of the TSR priorities is at an early stage: some measures are underway, but bringing the task fully to fruition will take time, requiring deepening further the Fund's understanding of interconnections and developing new techniques and new data.

32. **Several teething problems are delaying progress in the implementation of the 2011 TSR priorities. In particular:**

- **Understanding of interconnections and cross-border linkages is in its infancy.** The analytical base on interconnections, spillovers, risks, and macro-financial linkages has been built up, but

these have not yet been fully channeled into Article IV consultations. Further research and in-depth quantitative analysis on the transmission channels for spillovers would help to guide the work of country teams in this area.

- **Data gaps.** Despite recent initiatives, lack of data remains an impediment to macro-financial and spillover analysis in the Fund.
- **No structured approach to cross-country analysis.** Cross-country analysis is often prepared separately by country teams with no formal mechanism for information-sharing or support from functional departments. Several initiatives to improve knowledge management are currently underway, but gathering cross-country experience continues to rely heavily on informal networks and individual experience.
- **Lack of quantified risk scenarios.** While multilateral surveillance products include alternative scenarios, coherent quantified risk scenarios are generally not available for integration in Article IV reports.
- **Adequate macro-financial analytical frameworks yet to be fully developed.** The pre-crisis focus on macroeconomic models that ignored or could not capture financial channels needs to be rectified. However, the level of linkages and feedback has reached such a complexity that it would be difficult to expect a single model to capture all likely effects. As highlighted in the Financial Surveillance Strategy, there is a need to further develop analytical frameworks and different approaches to identify systemic risks. Adequate dissemination of tools remains a challenge.
- **Limited depth of financial surveillance.** The varied depth of analysis may be linked to the degree of complexity of topics to be covered. Departments view the availability of expertise for financial surveillance and support from functional departments as too stretched to provide the expertise country teams need to conduct analysis of sufficient depth, although there is some scope to draw more on analysis used in the GFSR/WEO and Spillover Reports. The Financial Surveillance Strategy also highlights the need to build expertise in the financial sector.
- **Questions on the new methodologies for external assessments and their limited use for countries not covered by the EBA.** The pilot EBA and ESR have raised questions regarding the methodology and translation of results into assessments. Moreover, extending the EBA methodology to cover more economies requires additional data as well as quantitative techniques that will be better suited for taking into account country-specific factors.
- **Resource constraints.** Finding an adequate balance between implementing the 2011 TSR and devoting sufficient attention to country-specific issues, including LICs, is a challenge within the current resource envelope. The implementation of the ISD and financial surveillance strategy will put further strains on resources.

REMAINING MEASURES

This first year after the 2011 TSR has focused mainly on putting in place the tools and laying the groundwork to facilitate implementation of the priorities. In a number of areas, additional steps are needed to fully implement the measures in the Managing Director's Statement on Strengthening Surveillance (see Appendix I).

33. **Next steps should focus on fully integrating TSR priorities in staff's analysis.** Progress to date provides for better integration of priorities across country and multilateral products, as well as across the priorities in individual reports. Going forward, the different strands of work on interconnections, spillovers, risks and macro-financial linkages need be tied together in a more comprehensive manner. Also, some measures set out in the Managing Director's Statement on Surveillance are still to be completed.

Interconnectedness

- **Understand transmission channels.** Work on interconnectedness can be developed beyond the mapping of interconnectivity to the analysis of transmission channels in order to better inform policy debates.
- **Leverage the analysis of spillovers in Article IV consultations.** Staff is evaluating the experience with spillover reports. While future approaches have not yet been fully determined, following adoption of the Integrated Surveillance Decision, staff will ensure that significant outward spillovers are adequately covered in Article IV consultations. Such analysis would be based on staff judgment, and informed by inputs from functional departments, multilateral products, and consultations with country authorities.
- **Cluster country consultations.** Considering policies of interconnected countries in an integrated way can help highlight to policymakers how shocks propagate. A pilot exercise based on common selected issues papers would help to clarify the costs and benefits of clustering Article IV consultations.
- **Greater use of cross-country policy lessons.** A more structured approach is needed to deepen cross-country analysis, especially with regard to policy lessons, by leveraging initiatives undertaken by functional departments and setting new standards for knowledge management.

Risk Assessments

- **Continue to deepen risk analyses in Article IV consultations.** Staff should continue to aim at conducting a full and candid discussion of risks in country reports, including tail risks. The experience so far has shown that RAMs have improved the focus of surveillance on risks, although the tradeoffs of their publication in staff reports are still being evaluated.
- **Quantify global risks.** While qualitative assessments continue to be critical, translating global risks into quantitative scenarios will help teams better gauge their implications for individual economies and facilitate greater coherence of global risk assessments across products.

Financial Stability

- **Fully implement the Financial Surveillance Strategy.** The Strategy is geared towards deepening the analysis of macro-financial linkages, better integrating financial surveillance in Article IVs, bridging identified gaps, encouraging systematic risk analysis, and supporting a more effective communication of the Fund's views.
- **As part of the strategy, enhance analysis of global financial hubs.** In line with the TSR recommendations, staff could engage authorities with key financial centers to deepen its understanding of global financial intermediation, propagation of shocks, and policy implications.
- **Continue to address data gaps,** including in the context of the [G-20 Data Gaps Initiative](#) and SDDS to increase policymakers' ability to connect the dots. The [2012 Review of Data Provision to the Fund for Surveillance Purposes](#) proposed follow-up on the quality of financial sector data for surveillance.

External Sector Assessments

- **Fully embed the results of the Pilot ESR and EBA in Article IV consultations.** The public consultation on the pilot exercise will inform further refinements to future reports and the EBA methodology. More systematic use of the assessments in Article IV reports should follow and the analysis could be deepened with a focus on the contribution of policy gaps to imbalances. Within reports, there is still scope to improve the integration of external sector analysis into the assessment of the overall policy mix.
- **Improve external assessments for economies not covered in the Pilot ESR and EBA.** This will require extending technical innovations to a much wider set of economies, including taking account of policy gaps and country specific characteristics (e.g., for non-renewable resource exporters, financial centers, and large foreign aid or remittance recipients). Strengthening data availability will also be important for LICs.

Traction

- **Enhance communication to policymakers on key messages and risks.** A Consolidated Multilateral Surveillance Report synthesized key multilateral messages. In the fall of 2012, this report was expanded to form the Global Policy Agenda by including commentary on how the Fund proposes to tackle issues under its work program. Going forward, the Global Policy Agenda could strengthen its focus on risks and appropriate policy actions.
- **Focus on follow up in the review process.** Staff should make certain that the review process adequately follows up on issues raised during previous Article IV consultations.

ISSUES FOR DISCUSSION

- Do Directors' agree with the staff's assessment of the progress made on the TSR operational priorities?
- Do Directors' view the next steps as appropriate; do they see other areas of the priorities as requiring special emphasis?
- Do Directors have any additional insights that they would like to share on how the Fund could improve its traction with member countries?

Appendix I. Status of Measures in the Managing Director's Statement of Surveillance, October 2011

Measures	Status
Interconnectedness	
Upcoming WEOs will cast a chapter around policy spillovers and interactions across countries in different regions.	Implemented. April 2012 WEO contained special feature on cross-border spillovers from Euro area bank deleveraging.
Spillover Reports will be continued next year for the systemic five economies, with the agreement of the relevant members. Additionally, staff will engage authorities in key financial centers to deepen the understanding of financial interconnections, the propagation of shocks, and the implications for policy.	Implemented. The 2012 Spillover Report was discussed by the IMF Executive Board in July 2012. Staff will take stock of the spillover exercise and recommend future actions. Engagement with financial centers is ongoing.
Spillovers and cross-country experiences will be given more coverage, as appropriate, in Article IVs, with the support of the review process, and in REOs, with a particular emphasis on intra-regional spillovers. Ultimately, the goal should be to mainstream spillover analysis in relevant Article IVs.	Partially Implemented. Coverage of spillovers in Article IV reports has increased, but the results are uneven and reports need more discussion of policy implications. With the implementation of the ISD, more systematic coverage of spillovers is expected. Progress in cross-country work is not tangible, calling for further measures.
Work will continue on capital flows and global liquidity, and their implications.	Partially Implemented. A paper on multilateral aspects of capital flows was discussed by the IMF Executive Board in November 2011. A paper on capital flows is expected to be discussed in late 2012.
We will aim to have the Article IV consultations for interconnected countries—for example with strong financial links—discussed by the Board in clusters.	Not Implemented. Modalities are still being discussed as clustering Article IV consultations has been logistically difficult.
Risk Assessments	
Starting with the next issue, WEOs will pay greater attention to risks around the baseline.	Implemented. The April 2012 has clear scenarios for downside risks (intensification of the Euro area crisis and an oil price shock) as well as tail risk scenarios.
Relevant analyses and findings from the vulnerabilities and early warning exercises, the WEO and GFSR must be taken up in policy discussions with country authorities. The tools underlying multilateral surveillance will be disseminated to area departments to support this effort.	Partially Implemented. Some of the risks identified in the WEO have been included in Article IV RAMs. The data underlying the vulnerability exercises has been made available to country teams.

<p>The upcoming revised surveillance guidance note will stress the need for an explicit discussion of risks in Article IV consultations. This could be supported by risk assessment matrices in Article IV reports akin to those used in financial sector stability assessments.</p>	<p>Implemented. The bilateral surveillance guidance note emphasizes the need for explicit discussion of risks in Article IV reports. RAMs are being included in most Article IV reports and an interdepartmental assessment of global risks resulted in improving consistency across RAMs.</p>
<p>Financial Stability</p>	
<p>Staff will prepare for the Executive Board and IMFC discussions a strategic plan for financial sector surveillance.</p>	<p>Implemented. A Financial Sector Strategy was discussed by the IMF Executive Board in September 2012.</p>
<p>A financial expert will be assigned to each Article IV team involving systemically important financial sectors. Additional resources will be mobilized for these countries as well as others as needed (e.g., in case of mounting financial vulnerabilities).</p>	<p>Partially Implemented. Financial experts have been added to the Article IV teams of systemic financial sectors. More frequent FSAPs are being considered for vulnerable economies.</p>
<p>Coverage of financial issues in Article IVs will be further strengthened by (i) stepped-up training and dissemination of vetted tools (e.g., stress-tests) and good practices, including on LIC-specific issues, so that they can be effectively used by country teams and (ii) cross-country thematic studies (e.g., on interconnectedness and the role of financial deepening). Staff will also intensify efforts to draw cross-country lessons from FSAPs.</p>	<p>Partially Implemented. Staff reviewed cross-country lessons emerging from FSAPs. Further progress has been made on vetting tools and looking at approaches to stress testing, including training through the MCM toolbox seminar series. For developing countries a pilot exercise is to be conducted to focus attention on the linkage between financial deepening, macroeconomic policy effectiveness and volatility. Progress was also made on the coverage of financial stability and development in LICs, including a policy paper on Enhancing Financial Sector Surveillance in Low Income Countries. The Financial Surveillance Strategy provides a base from which to improve risk identification, macro-financial policy analysis, and further strengthen the coverage and integration of financial surveillance issues in Article IV consultations.</p>
<p>Staff will continue to support the G-20 data gaps initiative and will bring forward to 2012 the review of data provision to the Fund for surveillance purposes (including a review of data for financial sector surveillance and external stability assessments).</p>	<p>Partially Implemented. The 2012 Review of Data Provision (including review of data for the financial surveillance and external stability assessments) is expected to be discussed by the Board in November 2012.</p>

External Sector Assessments	
Publication, with each WEO cycle, of a multilaterally-consistent assessment of external balances, building inter alia on a revamped CGER. Staff will brief the Board on the modalities and methodological refinements in train, and produce a pilot by the next spring meetings.	Implemented. Staff briefed the Board on the EBA methodology, and the Pilot External Sector Report, incorporating the results of the pilot External Balances Assessment was published in July 2012.
In this document, and in Article IVs, assessments will need to take a broad view of external stability, encompassing an analysis of balance sheets and including coverage of exchange rates, capital flows, and reserve policies.	Partially Implemented. The Pilot ESR and related Article IV reports include a broader range of indicators for external assessments. New approaches need to be extended to non-ESR country's Article IV reports.
Legal Framework	
A follow up paper on the legal framework will be taken up early next year. It will lay out concrete suggestions for a new decision, aiming to achieve a better integration of bilateral and multilateral surveillance and a broader approach to global stability.	Implemented. The Integrated Surveillance Decision adopted by the IMF Executive Board in July 2012, and will take effect on January 18, 2013. A guidance note for Article IV consultations was discussed with the Executive Board informally.
Traction	
To foster ministerial engagement, the practice of preparing a Consolidated Multilateral Surveillance Report for discussion at the IMFC will continue.	Implemented. CMSRs were prepared for the IMFC in April 2012. A Global Policy Agenda was prepared for the IMFC in October 2012.
The revised surveillance guidance note will urge better coverage of issues involving unemployment, inequality and inclusive growth, where they are macro-critical, leveraging expertise in other organizations.	Implemented. Revised surveillance guidance note issued in June 2012 places emphasis on macro-critical social issues and leveraging expertise in other organizations.
To be attentive to members' needs, country teams will exchange views with authorities on key issues for discussion prior to Article IV missions, without compromising our capacity—and obligation—to raise relevant, and at times difficult issues. Country teams are encouraged to discuss their research agenda and SIPS with the authorities before the Article IV missions either through ED's offices or during staff visits.	Partially Implemented. Many teams already consult with authorities on agenda and research topics prior to missions. Staff should ensure that this practice is consistently applied by all teams.
To enhance accountability, the review process will ensure that country papers report on the implementation of past advice given in Article IVs and key FSAP recommendations.	Partially Implemented. More Article IV reports are following up on past economic and financial advice.

Appendix II. Integrating Bilateral, Regional, and Multilateral Surveillance

Area departments have taken several steps to revamp country work to better account for global, regional, and country interactions. New initiatives have included:

The African Department developed a series of research papers on broad regional or cross-country issues. The department also adapted surveillance and program engagement to help members manage adverse spillovers by analyzing vulnerabilities, identifying financing needs, and formulating appropriate policy responses. Moreover, the department is stepping up analysis of regional spillovers, e.g., from South Africa or Nigeria to the rest of Sub-Saharan Africa.

The Asia & Pacific Department intensified its work on interconnectedness and external stability in the context of the Regional Economic Outlook, by mapping financial links to the Euro area. It also considered the potential impacts of outward spillovers from developments in China and Japan and continued collaboration with the ASEAN+3.

The European Department is developing a near-term forecasting exercise for the Euro area and its four largest countries and work on linkages between emerging and advanced Europe has been stepped up. The Department is also focusing on ways to reduce spillovers from the Euro area to emerging markets. Lessons from the crisis in emerging Europe are being distilled in a book to be published [later this year]. In addition, EUR is exploring the scope for regional approaches to surveillance beyond the Euro area.

The Western Hemisphere Department established analytical groups to focus on key priorities, such as growth, regulatory reform, macro-financial linkages, exchange rate issues, and challenges for the Caribbean.

The Middle East & Central Asia Department issued a regional paper in October 2011 covering key economic policy issues in the GCC countries. The analysis highlighted interconnections between the GCC countries and the global economy—not just via the price of oil, but also through expatriate labor, financial markets, and fiscal and monetary policies in advanced economies. This analysis was taken up in the Article IV discussions of several GCC countries. The Fall 2012 REO includes financial spillovers from the Euro Area to the CCA region, and output spillovers from Russia and the Euro Area to CCA.