INTERNATIONAL MONETARY FUND

# Bilateral Surveillance Guidance Note

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In consultation with Other Departments

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Boxes



Attachments

## List of Acronyms

| | |
|---|---|
| AML | Anti-Money Laundering |
| AREAER | Annual Report on Exchange Arrangements and Exchange Restrictions |
| CA | Current Account |
| CFT | Combating Financing of Terrorism |
| CGER | Consultative Group on Exchange Rates |
| DSA | Debt Sustainability Analysis |
| EPA | Ex-Post Assessment |
| EREER | Equilibrium Real Effective Exchange Rate |
| EWE | Early Warning Exercise |
| EXR | External Relations Department |
| FSAP | Financial Sector Assessment Program |
| FSSA | Financial System Stability Assessment |
| FSSGN | Financial Sector Surveillance Guidance Note |
| FTN | FSAP Technical Note |
| GFSM | Government Finance Statistics Manual |
| GFSR | Global Financial Stability Report |
| LOE | Languages Other than English |
| MB | Macro-balance |
| NEAP | Net External Asset Position |
| OFC | Offshore Financial Center |
| PSI | Policy Support Instrument |
| PRGT | Poverty Reduction and Growth Trust |
| PRS | Poverty Reduction Strategy |
| PRSP | Poverty Reduction Strategy Paper |
| REER | Real Effective Exchange Rate |
| REO | Regional Economic Outlook |
| ROSC | Report on the Observance of Standards and Codes |
| SIP | Selected Issues Paper |
| SSP | Statement of Surveillance Priorities |
| TA | Technical Assistance |
| TSR | Triennial Surveillance Review |
| UFR | Use of Fund Resources |
| VEA | Vulnerability Exercises for Advanced Economies |
| VEE | Vulnerability Exercises for Emerging Markets |
| WEO | World Economic Outlook |

*This note aims to provide country teams with broad guidance on bilateral surveillance. For convenience and completeness only, it covers all aspects of bilateral surveillance. However, staff are not expected to comprehensively cover all the issues raised here as in a checklist. Rather, selectivity in staff reports is critical, bearing in mind that the Board has identified a need for improvement in four areas defined as operational priorities for surveillance—risk assessments, financial sector surveillance, multilateral/cross-country perspectives (including spillovers), and exchange rates and external stability. While more in-depth guidance on these priorities is also provided here, there is of course scope for staff to innovate and push the analytical content beyond current practices.*

## I. Introduction

1. **This note provides guidance to staff on the conduct of bilateral surveillance, a core activity of the Fund** (Box 1). Surveillance involves the continuous monitoring of members' economic and financial policies, and regular Article IV consultations. During these consultations, staff holds pointed discussions with country authorities on the economic situation, the authorities' policies, and desirable policy adjustments. These discussions are then reported to the Fund's Executive Board for its consideration. The goal is, through thorough analysis, candid discussions, and a peer-review mechanism, to promote the domestic and external stability of members' economies and thereby the stability of the international monetary system as a whole.[1]

**Box 1. The Purpose of Surveillance**

**The purpose of surveillance is set out in the Articles of Agreement. It is to enable the Fund (i) to oversee the international monetary system to ensure its effective operation (traditionally known as "multilateral surveillance") and (ii) to oversee members' compliance with the obligations specified under Article IV ("bilateral surveillance"). Bilateral surveillance is mandatory: members are required to consult with the Fund when requested, and to provide the Fund with the information it may require for this purpose under Article IV, Section 3(b) and Article VIII, Section 5. The 2007 Decision provides more specific guidance on the conduct of bilateral surveillance, as well as guidance to members in the conduct of their exchange rate policies (see also Box 3).**

2. **For effective surveillance, the following qualities are essential and permeate all aspects of surveillance work:**

- **Collaboration.** Surveillance is a collaborative process, based primarily on dialogue and persuasion with country authorities and other stakeholders. In advising members on how

[1] The note replaces the Surveillance Guidance Note of May 2005 and the *Revised Interim Guidance Note on Implementing the 2007 Surveillance Decision* (Attachment I). It is complemented by the *Frequently Asked Questions on the 2007 Surveillance Decision* (Attachment II), including its appendix on Legal Considerations on the Observance of the Principles on Exchange Rate Policies.

to promote domestic and external stability, staff should, to the extent possible, also take into account the member's other objectives.

- **Candor.** Effective dialogue requires candor, both in discussions with the authorities and in staff reports, including about risks.

- **Evenhandedness and regard to country circumstances.** Surveillance must be evenhanded, whether countries are large or small, advanced or not, while also paying due regard to countries' specific circumstances.

- **Practicality.** Staff's advice should be practical. It should be specific and take into account the authorities' implementation capacity.

- **Forward looking.** Staff reports and discussions should take a medium-term view, including a discussion of medium-term objectives and planned policies, especially possible policy responses to the most relevant contingencies.[2]

- **Multilateral perspective.** Bilateral surveillance should discuss important inward and outward spillovers, and draw from experience in other countries.

- **Selectivity.** Surveillance should focus on issues important for stability. Staff should use judgment in selecting the specific issues to cover, and take a risk-based approach. Guidance provided in Sections III and IV is intended to help staff in selecting topics, and should not be seen as a checklist for systematic coverage.

- **Timeliness.** To ensure that staff reports are fresh when discussed at the Board and subsequently published, staff should strive to minimize the time from the end of the discussions with the authorities to the Board discussion.

3. **The note is organized around the following broad issues.**

- **Focus on stability.** The 2007 Decision on Bilateral Surveillance establishes "external stability" as the organizing principle for bilateral surveillance. It also emphasizes the importance of domestic stability for external stability. Article IV consultations should focus on economic and financial policies pursued by members that can significantly influence present or prospective external stability, either directly or through their impact on domestic stability.
- **Operational priorities.** The 2008 Triennial Surveillance Review (TSR) found that the overall quality of bilateral surveillance is generally held in high regard. However, it also

[2] For some issues, e.g. the macroeconomic impact of aging population, an even longer view may be appropriate.

identified areas for improvement. These informed the operational priorities to guide surveillance for 2008-11 in the Statement of Surveillance Priorities (SSP) the Board adopted in October 2008 (Box 2). To help ensure progress on the four operational priorities, a substantial part of this guidance note is devoted to them.

- **Other substantive issues.** This note covers other issues relevant to surveillance where specific guidance is available, as well as matters related to Article VIII and XIV consultations (relating to restrictions on payments and transfers for current international transactions and multiple currency practices).

- **Communication.** Good communication is key to effective surveillance, including with the authorities (to help staff's advice get traction), the Executive Board (to support effective peer-pressure), and the general public (to help gain support for necessary policy adjustments). The 2008 TSR underscored that surveillance messages need to be concise, focused on a few key points, as well as clear, timely, and strategically targeted.

- **Process and formal requirements.** Article IV consultations are underpinned by a number of important procedures, rules, and requirements that are summarized in this note.

4. **This note also serves as a portal to more detailed information.** It is accessible in a web format and is supplemented by the websites on financial sector surveillance and exchange rates and external stability, which provide more information, tools, examples of good practices, and fora for discussions on these issues.

### Box 2. Operational Priorities for Surveillance, 2008–11 [1/]

*In pursuit of its mandate to promote international monetary and financial stability, IMF surveillance will be guided through 2011 by the following operational priorities:*

- **Risk assessment.** Refine the tools necessary to provide clear early warnings to members. Thorough analysis of major risks to baseline projections (including, where appropriate, high-cost tail risks) and their policy implications should become more systematic;

- **Financial sector surveillance and real-financial linkages.** Improve analysis of financial stability, including diagnostic tools; deepen understanding of linkages, including between markets and institutions; and ensure adequate discussion in surveillance reports;

- **Multilateral perspective.** Bilateral surveillance to be informed systematically by analysis of inward spillovers; outward spillovers (where relevant); and cross-country knowledge (as useful); and

- **Analysis of exchange rates and external stability risks.** In the context of strengthening external stability analysis, integrate clearer and more robust exchange rate analysis, underpinned by strengthened methodologies, into the assessment of the overall policy mix.

Management and staff are responsible for delivering on these operational priorities, subject to members' cooperation. Progress will be assessed at the time of the next Triennial Surveillance Review.

[1/] The SSP also includes economic priorities which were revised in September 2009.

## II. Scope of Surveillance: Focus on Stability[3]

5. **The 2007 Decision establishes the concept of external stability as an organizing principle for surveillance, and recognizes the importance of domestic stability in this context** (Box 3). The Fund's mandate is to oversee international monetary and financial stability, which at the level of individual countries translates into external stability. Domestic stability is, in turn, a condition for external stability.

### Box 3. External and Domestic Stability

*External stability*. The 2007 Decision establishes external stability as the overarching organizing framework for bilateral surveillance. It clarifies that the objective of surveillance is to foster a stable system of exchange rates (or "systemic stability"), which is most effectively achieved when each member adopts policies that promote its own "external stability". External stability is a situation where a country's balance of payments position does not, and is not likely to, give rise to disruptive exchange rate movements.

The trigger for disruptive exchange rate movements may come from within the country's own balance of payments or from within that of its partners, and so both deficit and surplus countries can be externally unstable. Whereas an excessive deficit country can suffer an abrupt reversal of capital flows and disruptive exchange rate movements, an excessive surplus country can itself experience a destabilizing capital inflow or contribute to a risk of disruptive exchange rate movements in another country.

A balance of payments position consistent with present external stability is one in which the current account is broadly consistent with equilibrium, and the capital and financial account or external balance sheet position does not create risks of abrupt adjustments in exchange rates. An analysis of prospective external stability also requires an assessment of how other factors (including fiscal, monetary, and financial sector policies) are likely to affect the balance of payments in future, including through their impact on domestic stability.

*Domestic stability*. Members are considered to be promoting external stability when they are promoting domestic stability through the conduct of appropriate domestic policies—that is, when they (i) endeavor to direct their domestic economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to their circumstances, and (ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions.

6. **Staff should assess members' policies from the perspective of external and domestic stability, and discuss recommended adjustments.** This would include *all* policies that can significantly influence present or prospective external or domestic stability. Specifically, surveillance should cover:

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[3] In the remainder of this note, "surveillance" should be understood to mean "bilateral surveillance" unless otherwise noted.

- **Domestic policies.** Staff should always examine monetary, fiscal, and financial sector policies, including macroeconomically relevant structural aspects.[4] Other domestic policies, for example policies to promote high rates of potential growth, should only be examined to the extent that they significantly influence domestic and external stability. In cases where the link of these policies to domestic and external stability is not self-evident, it needs to be explained (not just stated).

- **Exchange rate policy.** The discussion of exchange rate policy should be well integrated in the overall assessment of external stability (see Section III.D). The Principles for the guidance of members' exchange rate policies and the indicators in the 2007 Decision should act as reminders that the related issues should be discussed when relevant (Attachment I).[5]

7. **Staff reports should include a clear analysis and bottom line.** All staff reports should include:

- **Developments and outlook.** A clear depiction of recent economic and, where relevant, political and social, developments and policies and a candid analysis of the short- and medium-term outlook, including risks and vulnerabilities. The assessment should always include an evaluation of developments in the balance of payments.

- **Policy discussion.** A substantive policy discussion, candidly reflecting both the staff's and the authorities' views.

- **Analysis and recommendations.** A pointed summary of staff's analysis and policy recommendations in a staff appraisal.

**Scope of surveillance in low-income countries**

8. **The set of issues potentially relevant for surveillance in low-income countries is generally broader than for other countries.** Surveillance in low-income countries should, as in other countries, focus on whether policies are contributing to domestic and external stability (as described in paragraph 6), but the range of relevant issues is often broader than for other countries:

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[4] Staff reports issued after May 2011 should include presentations of the operations table in the GFSM 2001 format—expanded, if needed, to include key aggregates in the authorities' presentation. Deviations from the GFSM 2001 methodology due to data availability should be flagged in footnotes. (For more details, see Government Finance Statistics to Strengthen Fiscal Analysis)

[5] See the Legal Appendix to the Frequently Asked Questions on the 2007 Surveillance Decision (Attachment II).

- **Issues normally expected to be covered.** These include: macroeconomic management of aid flows; general (non-sectoral) policies to support growth (e.g., policies to strengthen the business climate); financial sector reforms to enhance the effectiveness of macroeconomic policies (e.g., to improve liquidity management and the transmission of monetary policy) or the economy's ability to absorb shock (e.g., through the development of hedging instruments); progress in poverty reduction, priority spending, and monitoring; poverty reduction strategy paper (PRSP) process issues; progress in poverty reduction strategies (PRSs); and collaboration with donors (which are key to secure external financing). The coverage of these issues does not require explicit justification, because their link to external stability is self-evident. The assessment of the impact of major reforms in core areas on the authorities' other objectives, notably poverty reduction, is also normally expected to be covered with no need for an explicit justification.

- **Issues occasionally relevant.** These include: sectoral policies to support growth (including in the area of financial sector development, e.g. access to finance); public financial management issues; trade policy and regime; export diversification; governance issues; and income distribution issues. The coverage of these issues would generally (but not always) require explicit justification, because their link to external stability is generally not self-evident.[6]

**Scope of surveillance in currency unions**

9. **For members of currency unions, the concept of external stability is relevant at the level of the union.**[7] Staff's assessment of policies should be made both:

- **In consultations held at the level of the union**. Surveillance should assess to what extent exchange rate policies and domestic policies implemented at the level of the union (in particular, monetary policy) are promoting the union's domestic and external stability. An assessment of the union's real effective exchange rate should also be included.

- **In consultations held at the level of the individual member**. Surveillance should assess to what extent domestic policies implemented at the level of the member are promoting the member's domestic stability. Surveillance of individual members should always include an evaluation of developments in their own balance of payments and an

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[6] No explicit justification needs to be provided when the relevance to external stability is self-evident (e.g., deeply distortionary trade policies).

[7] The discussion here abstracts from the possibility of exiting the currency union. If such an exit was the result of intolerable balance of payments pressures in one member, it would likely impact "the stable system of exchange rates." A similar risk is present for members who use the currency of another member as the sole legal tender.

assessment of their own real effective exchange rate, which can be cast in terms of either external competitiveness or real exchange rate.[8]

**Scope of surveillance in program cases**

10. **Staff reports and discussions in program countries should address the same issues as in other cases.** Article IV consultations and reports should be used to reassess the contribution of policies to domestic and external stability independently of the program framework, and beyond the scope of program reviews. If an Ex-Post Assessment (EPA) has been carried out for a member since the last Article IV, its results should feed into the discussion.

## III. Operational Priorities for Surveillance

11. **This section provides guidance on the four operational priorities.** The issues and topics listed below are intended to help staff in the conduct of surveillance; their actual coverage, including in staff reports, should reflect staff's judgment on what issues are the most important for domestic and external stability given the country circumstances.

### A. Risk Assessment

12. **An assessment of risks is important to provide members with early warning and to promote policy response, both for purposes of prevention and contingency planning.**[9] This assessment should leverage the analysis of risks conducted at the multilateral or regional levels (World Economic Outlook (WEO)/Global Financial Stability Report (GFSR)/Regional Economic Outlooks (REOs)). As part of this assessment, staff should consider:

- **Risks to the baseline.** Staff reports should discuss risks around the short- and medium-term baseline scenario, and policy implications.

- **Tail risks.** Staff is also encouraged to explore tail risks—low-probability events with serious negative implications—even if their probability is unquantifiable. Although the authorities may be sensitive on these points, exploring tail risks with them is important, so as to draw their attention to the possible macroeconomic impact and discuss how to insure against them through adjustments in policies. In general, staff should ask themselves "what if" questions, while exercising judgment over which risks to highlight to minimize the risk of repeatedly raising false alarms.

[8] See also paragraph 38 and section VI.B.

[9] The paper on *Initial Lessons of the Crisis* also discusses the importance of analyzing risks.

13. **Risk analysis should build on existing Fund tools and initiatives, including as relevant:**

- **Vulnerability assessment.** This should be based on a variety of quantitative and qualitative information inputs, including from the vulnerability exercises for emerging markets (VEE) and advanced economies (VEA) and draw on the broader early warning exercise (EWE). Staff is encouraged to present alternative scenarios (stress tests) and to use the balance sheet approach.

- **Debt sustainability analysis (DSA).** Article IV reports should use specific DSA templates in accordance with the relevant guidance for low-income or for market-access countries.[10] More comprehensive assessments of significant debt vulnerabilities (based, for example, on country-specific alternative scenarios outside the standard stress tests, e.g., to assess the long-term impact of aging) can also be useful.

## B. Financial Sector Surveillance and Real-Financial Linkages [11]

14. **Financial sector surveillance is a key component of bilateral surveillance and should focus on financial sector stability and its linkages to the real economy.** Article IV consultations are the Fund's primary instrument for surveillance of the financial sector in individual countries.

15. **The Financial Sector Assessment Program (FSAP) can help underpin the more continuous surveillance of Article IV consultations.**[12] The FSAP provides comprehensive and in depth, but lower-frequency assessments. When available, staff should draw on the FSAPs' analysis, in particular as reflected in Risk Assessment Matrices, and integrate relevant findings and recommendations in Article IV discussions. When staff is of the view

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[10] For PRGT-eligible countries, a DSA is expected to be produced once a year—jointly with the World Bank in the case of countries that are also IDA-only—normally for an Article IV consultation, and otherwise in the context of program requests or reviews. DSAs for emerging markets should be prepared for all Article IV consultations if developments in the outlook for external or public debt dynamics since the last consultation could warrant a change in policies. For advanced economies, if there are significant risks, DSAs should be discussed in the staff report; otherwise, the report could simply indicate that there were no significant changes from the previous year. The templates should be reported at least every other year.

[11] For more detailed discussion of possible approaches, analytical tools, data sources, and 'best practice' examples, please refer to the Financial Sector Surveillance Guidance Note (FSSGN). See also *Financial Sector and Bilateral Surveillance—Toward Further Integration*.

[12] The FSAP, a joint IMF-World Bank initiative launched in 1999, undertakes comprehensive evaluations of countries' financial systems at multi-year intervals. Formally, FSAPs are technical assistance provided by the Fund at the request of members on a voluntary basis and is not a surveillance activity. Following an FSAP, however, a Financial System Stability Assessment (FSSA) is normally submitted to the Board together with the Article IV staff report.

that a member's participation in the FSAP would be of high priority, staff should say so in the Article IV report, irrespective of the authorities' intentions.[13]

16. **Country teams should seek up-to-date information on the financial sector**, including (i) size, structure, soundness/performance, and cross-border exposures of banks and non-bank financial institutions and financial markets, and characteristics of the investor base when relevant; and (ii) institutional, regulatory, and policy frameworks (payments and settlement system, legal, accounting and corporate governance frameworks, supervision and regulation of risk management practices, systemic liquidity arrangements, financial sector taxation, public debt or reserve management).

17. **Staff reports should present a clear analysis of financial sector stability, and identify policy measures to address any related concern.** The assessment of financial sector stability in Article IV consultations should focus on the stability of the system as a whole, not of individual institutions, unless they have systemic implications.[14] It should pay particular attention to cross-border issues, including, where relevant, off-shore transactions.

18. **The analysis should be based on an assessment of financial sector risks and vulnerabilities, subject to data availability.** Staff should distinguish between potential *risks* to the financial system—events or developments that might trigger a crisis—and the *underlying vulnerabilities* that expose the system to such risks, and determine their likely impact.

19. **The following questions can be useful to help identify and prioritize financial sector stability concerns**. The FSSGN provides more detailed guidance.[15]

- *What are the main sources of risk?* These could emanate either in the financial system itself or in the real economy, at home or abroad.

- *What is the likelihood that the identified risks materialize?* This judgment can be informed, for example, by estimates of probability of default or distress; the extent of

[13] For countries with systemically important financial sectors, FSAP has become mandatory and FSAP stability assessments are formally part of Article IV surveillance. See Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance (Main paper and supplements 1 and 3).

[14] Members have no obligation to provide information on individual institutions under Article VIII, Section 5, but many do provide this information. Furthermore, in particular in the context of information not in the public domain that is highly market-sensitive, staff reports should not name individual institutions.

[15] There is no single, widely-accepted methodology for assessing financial sector stability. However, there is a broadly shared view among regulators on the range of issues that such assessments need to cover. These issues are discussed in more detail in the FSSGN (also, see the external Financial Stability Webpage for examples of approaches used by financial regulators in different countries to assess financial sector stability).

asset price misalignments; concentrated exposures; early warning models for assessing the likelihood of specific crisis events.

- *What are the main vulnerabilities of the financial system and how would the system be affected by a particular event risk?*
- *What policies are needed to address these concerns?* In this context, Article IV reports should also indicate, when relevant, staff's views on priority areas for standards assessments, independently of the authorities' perceived willingness to volunteer for an FSAP.
- *Do the authorities have adequate safety net and crisis management capacity?*

20. **The analysis of real-financial linkages should focus on whether the financial sector is a potential source or amplifier of domestic or external instability.** The following questions can help staff think through these issues:

- *What are the critical channels of interaction between the macroeconomy and financial markets and financial institutions?* Data permitting, staff should seek to integrate balance-sheet effects and stress testing in macroeconomic scenarios to help assess the impact of the scenarios on financial solvency and viability.
- *How do changes in financial conditions affect economic activity?*
- *How does the financial sector affect the conduct of macroeconomic policies?* For example, the role of the financial sector in the monetary transmission mechanism, the composition of the investor base and its implications for public debt management, the risks of contingent liabilities.
- *How might problems in the financial sector potentially cause or amplify external instability?* (For example, by triggering a reversal in capital flows and a balance of payments crisis).
- *For countries with important financial sector links to other countries, what are potential spillovers from real or financial sector developments and policies?*

**Financial sector development**

21. **Financial sector development issues should be covered in Article IV consultations when relevant for domestic or external stability**. Financial development may matter for stability directly, e.g., by strengthening the transmission channels of macroeconomic policy tools (e.g., monetary policy), or indirectly, by promoting sustainable

economic growth which can be important for stability.[16] Financial sector development is more likely to be relevant in low-income countries.

## C. Multilateral Perspective

22. **The Fund's almost universal membership gives it an advantage to bring a multilateral perspective in its economic analyses.** The authorities and the Board value this type of work and would like to see more of it. Bilateral surveillance can incorporate a multilateral perspective in two ways: (i) assessments of linkages and spillovers; and (ii) drawing lessons from cross-country experiences.

### Economic and financial linkages and spillovers across countries

23. **Surveillance should assess how a country is or might be affected by developments and policy actions in other countries.** Where the effects are significant, staff reports should discuss (i) the role of spillovers in recent developments; (ii) the spillover effects in the baseline scenario; and (iii) the possible impact of the materialization of risks identified in other countries or globally. Mission teams should leverage the findings of the WEO, GFSR, Fiscal Monitor, REO and EWE.

24. **Staff reports for members whose economies have substantial impact on other countries need also to discuss the most significant outward spillovers.** The aim is to draw out the implications of the country's developments, policies, and vulnerabilities for the international community, thus providing a basis for discussion among members.

25. **The following questions can help staff think through these issues.**

- *For the most important spillover effects, what are the transmission channels?* An examination of the underlying drivers of critical balance of payments flows, and how they might be influenced by the global environment and the risks identified in the GFSR and WEO or by developments in specific other countries, may be helpful.

- *How might the effects transmit themselves to the domestic economy and affect domestic and external stability?* Given the challenges in gathering reliable data and analyzing different channels, rigorous quantitative analysis may be difficult. Nevertheless, even qualitatively tracing out these linkages can be helpful (see the section on real-financial linkages).

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[16] An example of financial development affecting financial stability directly is the development of markets, e.g. deepening inter-bank or government bond markets. An example of financial development affecting financial stability indirectly through growth is increasing access to credit by productive sectors of the economy.

- *What are the policy implications of the analysis of spillovers?* How is policy flexibility affected? What are the policy options to reduce risks and mitigate their impact?

**Distilling lessons from cross-country experience**

26. **The other component of a multilateral perspective is to highlight lessons from similar experiences in other countries, in support of clear and concrete policy conclusions**. This can include comparison with peers, quantitative analysis, and qualitative case studies. SPR strives to help choose appropriate topics and comparators by providing cross-country notes well ahead of mission in as many cases as possible. Functional departments can also help, including through maintenance of collaborative websites. In addition, country teams should make maximum use of WEO, GFSR, Fiscal Monitor, REOs and EWE's cross-country analyses in discussions with the authorities and, where useful to back an argument, reference them in the staff report.

## D. Analysis of Exchange Rates and External Stability Risks

27. **External stability is at the core of bilateral surveillance (see Section II).** To ensure comprehensive coverage of the relevant issues, staff reports are expected to provide a clear assessment of (i) the current account (CA) and the exchange rate level, and (ii) risks arising from the capital and financial account, including from the composition of inflows and balance sheet mismatches. The analysis of the exchange rate, and of exchange rate policies, conducted in this context is only one part of surveillance, but it is a crucial part, as the Articles give the Fund a unique responsibility in this area. The role of the Principles for the guidance of members' exchange rate policies in the 2007 Decision (see Attachment I) is to undergird this analysis.[17]

**Current account and exchange rate**

28. **Staff should assess whether the current account and, equivalently, the real effective exchange rate are broadly consistent with equilibrium.** The current level of the real effective exchange rate (REER) should be compared to the level that would bring the "underlying" CA in line with the medium-term equilibrium CA. The "underlying" CA is the current account stripped of temporary factors, and assessed on the basis of the current REER and established domestic policies (those in place, as well as policies announced that are, to the best judgment of the team, likely to be implemented). And the equilibrium CA is one that

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[17] The Principles provide guidance to members for the conduct of their exchange rate policies and to the Fund in conducting surveillance over these policies. See the Legal Appendix, Observance of the Principles on Exchange Rate Policies to the Frequently Asked Questions on the 2007 Decision for more details on the role of the principles and possible findings of nonobservance.

leads the net external asset position (NEAP) to evolve in a manner consistent with the economy's structure and fundamentals, relative to other countries, and subject to a multilateral consistency constraint.

29. **If an under- or overvaluation is considered to be temporary, this should be made clear.** This could happen, in particular, in the following cases: (i) if the current level of the REER is affected by temporary factors such as tight monetary policy; (ii) if the economy is considered to be in transition to a new equilibrium NEAP, so that the current account is expected to be temporarily above or below its medium-term equilibrium; and (iii) if the authorities' established exchange rate policies would remove the under- or overvaluation over the medium term.

30. **Recognizing the inherent uncertainties in the analysis of equilibrium exchange rates, the assessments should draw on all pertinent information, including notably:**

- **The indicators in the 2007 Decision** (see Attachment I).

- **Where relevant, assessments made by the Consultative Group on Exchange Rates (CGER).** The Decision and CGER use the same conceptual framework. Of CGER's three methodologies, the macro-balance (MB) approach and external sustainability approach (both of which compare the underlying CA with a measure of medium term equilibrium CA) can be most directly related to the framework of the Decision. Especially given the uncertainties involved in establishing an equilibrium CA, CGER's equilibrium real effective exchange rate (EREER) approach (which relates the REER directly to fundamentals) can provide helpful additional insights. Where available, CGER results are likely to provide useful input for assessing exchange rates under the Decision, including through the provision of multilaterally consistent assessments.

31. **In countries with serious data limitations, the assessment may need to be largely qualitative.** It may be based on a discussion of recent and prospective balance of payments developments, DSA, reserve adequacy, and other factors.

32. **The following are expected of exchange rate assessments in staff reports and policy notes:**

- **Clear bottom line and recommendations**. Policy notes should include the staff's preliminary assessment, and staff reports a clear analysis and bottom line view (while mindful of the inherent analytical uncertainties), of whether the current account and the exchange rate are broadly in line with equilibrium. The assessment should be fully integrated into the broader assessment of external stability and the overall policy mix, and support clear policy recommendations. When there are no *prima facie* concerns, the discussion can be brief.

- **Transparent information**. Information on key assumptions should be transparently provided, and the authorities' views and analysis of the issue clearly presented. Where an indicator described in the Decision is relevant, it should be discussed.

**Capital and Financial Account**

33. **Staff should assess whether developments in the capital and financial account raise concerns about external instability.** This may happen even when the current account and exchange rate levels do not raise concerns. First, temporary fluctuations in the current account may cause liquidity problems, even if the current account is at a level consistent with medium-term equilibrium. Second, a country's external financing structure may create vulnerabilities which could unwind abruptly. Frequent sources of such vulnerabilities are mismatches in the currency or maturity composition between asset and liability sides of external balance sheets, concentration risk, or reliance on short-term funding. In individual cases, concerns about instability emanating from the capital and financial account may well be much more important than any arising from an under- or overvalued exchange rate.

34. **The evaluation of developments in the capital and financial account should include an assessment of:** the size and sustainability of capital flows, against the background of the member's reserves; the size and composition of external assets (other than reserves) and external liabilities; and the access to international capital markets.

35. **The adequacy of reserves is often a critical element in the assessment of external stability.** In analyzing the adequacy of reserves, staff should take into account country characteristics and vulnerabilities. Standard reserve adequacy indicators include ratios of reserves to imports, short-term external debt (remaining maturity), and broad money. Staff is also encouraged, where relevant and feasible, to explore other indicators (such as ratio of reserves to gross external liabilities) and analyze the optimal level of reserves needed to cushion the impact of a sudden stop in capital flows.[18]

**Free Floaters, Currency Unions, and Dollarized Economies**

36. **Staff should assess the real exchange rate level in all cases irrespective of the exchange rate regime.** Thus such assessment should also be undertaken for members who have a freely floating exchange rate (and hence no exchange rate policies), and those who do not have their own national currencies.

[18] Staff reports should also describe clearly the implications of the 2009 SDR allocations. For specifics, see the *Guidance Note on the Treatment and Use of SDR Allocations* (paragraph 18 in particular).

37. **Under a floating exchange rate regime, as in other regimes, the real exchange rate can be under- or overvalued.** This may happen as a result of domestic policies (e.g., a depreciation induced by large fiscal surpluses), as a result of other countries' policies affecting the exchange rate of the country at issue, or because of market imperfections such as a bubble (which may burst in a disorderly way). Thus, even fully market determined exchange rates can result in disruptive adjustments.

38. **In currency unions, the real exchange rate and current account should be assessed both at the level of the union and at the level of individual members.**

- **At the level of the union.** Union-level staff reports are expected to provide a clear bottom line assessment of the union's external stability including the real exchange rate level, and associated exchange rate policies.

- **At the level of the member.** Staff reports for individual members are expected to present an analysis of the country's real exchange rate and balance of payments. The discussion can be phrased in terms of external competitiveness or the real exchange rate, including whether the REER is over- or undervalued.

    - Staff reports on individual members should not include statements suggesting that the nominal exchange rate is over- or undervalued (unless this is the case at the union level).

    - If the real exchange rate of an individual member is found to be over- or undervalued, the staff report for that member should refer to whether the union exchange rate is considered to be over- or under-valued. This helps clarify why policy adjustment in the individual member is or is not recommended. If the misalignment at the member's level mirrors one at the union level, policy adjustment would be recommended at the union level. Otherwise, policy adjustment would be recommended at the level of the individual member.[19]

39. **For members that use the currency of another member as sole legal tender ("dollarized economies"), staff reports should still include a real exchange rate assessment.** The exchange rate discussion can be phrased in terms of external competitiveness or real exchange rate, and it should include a bottom line assessment including whether the REER is over- or undervalued. Where this is the case, the report needs to discuss recommended adjustment in domestic policies.

**Coverage of exchange rate regimes**

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[19] See also paragraph 9 and section VI.B.

40. **Staff reports should identify the *de facto* and *de jure* exchange rate regimes.** The *de facto* exchange regime should be understood as a backward-looking description, as assessed by staff, of the approach followed *de facto* by the authorities in the conduct of exchange rate policies.[20] The description should be as elaborate as necessary to enable the reader to understand how exchange rate policies have been conducted in practice, and should include a classification of the *de facto* regime using the Monetary and Capital Market Department's definitions and categories, as used in the Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER).[21] (This does not mean that the last classification published in the AREAER should necessarily be used, as staff will take a fresh look at the issue during the Article IV consultation process and explain any difference in classification.) Staff reports should also specify the *de jure* regime—namely, the regime that the authorities have reported to the Fund and typically also the publicly announced regime—at least in the Appendix on Fund Relations.[22] If the *de facto* and *de jure* regimes coincide, both can be referred to simply as "the exchange rate regime." Where applicable, reports should discuss changes in the authorities' forward-looking policy intentions.

41. **Reports should also provide a view regarding the adequacy of the *de facto* regime for maintaining domestic and external stability**. Staff should examine the consistency of the exchange rate regime with the policy mix, which can be more important for external stability than the regime itself. This may include where relevant a discussion of the appropriateness of the fiscal stance, the monetary objectives, and the financial sector regulatory framework. Discussion of alternative regimes should reflect the authorities' views, and advice to alter the regime should take into account readiness and adequacy of the implementation capacity.

**Intervention policies**

42. **Staff reports are expected to cover intervention activities to the extent they are important for external stability**. Where relevant, coverage would normally entail a description of past intervention episodes stating their objectives and analyzing their effectiveness, including whether they were coupled with sterilization. Intervention includes outright purchases/sales of foreign exchange or foreign exchange derivatives by the central bank, the ministry of finance, or others working on behalf of these. Staff should assess in

[20] Useful information may include updates on the foreign exchange market setting including whether the authorities operate an allocation system, an auction, or a fixing, and if the interbank market operates over the counter, with brokers, or based on a market maker arrangement.

[21] See Attachment II for further details on the categories.

[22] Members are under an obligation to notify the Fund of the exchange arrangements they intend to apply and of any subsequent changes to these arrangements under Article IV, Section 2(a).

particular whether there are protracted large-scale interventions in one direction in the exchange market.

43. **The analysis and policy advice on intervention policies should be tailored to country-specific circumstances and avoid an overly prescriptive approach.** The assessment should be made against the background of the *de facto* exchange rate regime and the adequacy of the member's reserves. Staff's advice regarding the use of intervention to influence the exchange rate should be guided by the Principles, particularly that intervention should be used to counter disorderly conditions in the exchange market, and should not be used to manipulate the exchange rate to gain an unfair competitive advantage, nor in such a way as to result in external instability (for instance, a significantly over- or undervalued exchange rate).

## IV. Other Topics That May Need to Be Covered

### A. Issues Within the Mandate of Surveillance

44. **Inadequate data provision**. Comprehensive, timely, and accurate data are critical for surveillance, and staff should be familiar with the Guidance Note on Data Provision.[23] Staff reports are required to identify the adequacy of data provision for surveillance purposes in a Statistical Issues Appendix. When data provision has serious shortcomings that significantly hamper surveillance, staff reports should discuss:

- **Deficiencies.** The nature of the deficiencies (coverage, quality, periodicity, timeliness or other aspects of data quality).
- **Implications.** The implications of the data shortcomings for the analysis, in particular policy conclusions that are subject to significant uncertainties.
- **Remedial measures.** In those cases where staff have had to construct key data based on limited information (either because of lack of, or long lags in, official data), specific and prioritized remedial measures, possibly including increased resources to ensure durable progress and proper assimilation of technical assistance.

The extent of discussion of these issues would depend upon the extent of the shortcomings.

45. **Reports on the Observance of Standards and Codes (ROSCs).** The Fund and the World Bank have endorsed eleven international standards and codes of good economic and financial practice in twelve areas, including anti-money laundering and combating the financing of terrorism (see guidance on AML/CFT). Staff should seek information on the observance of those standards that are relevant to country circumstances. Resources

[23] This note also provides guidance on dealing with possible breaches of Article VIII, Section 5.

permitting, ROSCs, including those carried out in the context of FSAPs, are the preferred means of obtaining this information. The ROSCs' findings relevant for domestic or external stability should inform surveillance and be discussed in Article IV documents. In addition, Article IV reports should indicate when relevant staff's views on priority areas for standard assessments, independently of the authorities' perceived willingness to volunteer for such ROSCs.

46. **Trade issues.** Coverage is only expected: (i) where serious trade distortions hamper prospects for external stability; (ii) where balance of payments are vulnerable to trade developments; or (iii) in systemically important countries when trade policies have substantial impact on others (see paragraph 24). The possible impact of trade restrictions in services (including financial services) should not be forgotten.

47. **Governance issues**. When relevant for domestic and external stability, staff should discuss governance issues and reforms with the authorities (see *The Role of the IMF in Governance Issues).*

48. **Political and social developments.** Article IV reports should include information on political and social developments when they are relevant for analysis of economic policies.

## B. Matters Related to Article VIII and XIV

49. **Article VIII and XIV issues**. The Surveillance Decision provides that, in principle, Article IV consultations should include consultations under Articles VIII and XIV. Staff reports should indicate when a member has in place exchange restrictions or multiple currency practices subject to Article VIII or that are maintained under the transitional arrangements of Article XIV, Section 2. If the member does maintain such restrictions or multiple currency practices that are subject to approval under Article VIII, Section 2(a) and 3, the staff appraisal should include an explicit recommendation concerning Board approval of the restrictions.[24] Missions should inform members that their failure to seek the Fund approval or to notify the Fund for the imposition or the maintenance of exchange restrictions or multiple currency practices represents a breach of their obligations. Staff should encourage members who have not yet done so to accept the obligations of Article VIII, Sections 2, 3, and 4, following the relevant guidance to provide such encouragement. In addition, the

[24] The Fund approves the imposition or maintenance of exchange restrictions subject to Article VIII, Section 2(a) provided that the restrictions are imposed for balance of payments reasons, are not discriminatory, and that their use will be temporary while the member is seeking to eliminate the need for them. Restrictions imposed solely for the preservation of national or international security are subject to a different procedure: a member must notify the Fund of the imposition of such restrictions; following this notification, the restrictions are approved unless the Funds informs the member within 30 days that it is not satisfied that the restrictions are imposed solely for security reasons (see Decision No. 144-(52/51)). For multiple currency practices, the criteria for approval are specified in Decision No. 6790-(81/43).

appendix on Fund Relations should note any exchange restrictions imposed for security reasons and required to be notified to the Fund under Decision No. 144-(52/51).

## V. Communication

50. **Communicating well and candidly with all relevant audiences is key to effective surveillance.** The 2008 TSR underscored that surveillance messages need to be concise, focused on a few key points, as well as clear, timely, and strategically targeted. It also emphasized the need to communicate more boldly about risks, while recognizing—and accepting—that this will mean sometimes being proved wrong. It is important to provide clear and candid messages without (unduly) undermining confidence and triggering adverse market reaction

51. **To strengthen communication, area departments are encouraged to develop outreach programs in consultation with the External Relations Department**.[25] Outreach can play an important role in communicating and building support for the Fund's advice. To be effective, outreach should be tailored to match messages and medium to the target audience. In addition, Article IV press conferences at the end of missions and/or Board meetings should be routine, unless departments see specific reasons to hold off (e.g., the authorities do not consent). Staff—as "ambassadors of the Fund"—should also aim to present the global and regional outlooks, and the main global messages of the Fund, to country authorities and to the public, as appropriate.

52. **Staff should encourage all members to publish Public Information Notices, Article IV consultation staff reports, and background documents.** The Fund's transparency policy provides a framework for the publication of these documents, which is voluntary but presumed. The transparency policy allows for deletions and corrections that meet certain criteria.[26] It also gives authorities a "right of reply". Publication in languages other than English (LOE) is also encouraged as appropriate (see the Guidance Note on Translation of Documents for Publication in LOE).

53. **As part of the transparency policy framework, the following guidelines have been established**:

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[25] The External Relations Department has prepared guidance on outreach with civil society, legislators, the media, and the general public, and is maintaining a communication toolkits to help staff in its outreach.

[26] To avoid undue delays in publication, the transparency policy specifies that requests for deletions and corrections are expected to be communicated to the Fund no later than two days before the Board meeting (or the date of lapse-of-time decision) takes place. See guidance note on transparency policy for details on which corrections and deletions are acceptable under the policy and for the procedures to be followed. Appendix II in the guidance note has a table with main deadlines in the publication process of Board documents.

- **No sharing of draft reports.** Staff are not to share draft staff reports (or portions of reports) with country authorities or EDs, with the exception of some specific documents.[27]

- **No negotiated documents.** Staff reports must not be negotiated with the authorities.

- **Candid and comprehensive assessments.** The authorities' publication intentions should not affect the candor and comprehensiveness of staff's papers.

In addition, to avoid unnecessary difficulties with country authorities, staff are encouraged to:

- **Accurately characterize counterparts' views.** The counterparts' views should be properly characterized as official views of authorities, views of institutions, or personal views.

- **Avoid politically sensitive language**. Staff should avoid formulations that may be considered insulting or divisive in the member country, though without shying away from candid assessments of relevant political economy issues.

- **Avoid discussing publication intentions in staff reports.** The publication intentions should be addressed only in the cover page issued by the Secretary's Department for internal circulation.

## VI. Surveillance Process and Requirements

### A. Consultation Cycles[28]

54. **Consultations in countries that do not have an arrangement (other than FCL or PCL) or a PSI with the Fund are normally expected to take place annually (with a three-month grace period).**[29, 30] The Executive Board may decide to place a member that is

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[27] These include drafts of mission concluding statements, selected issues papers, ROSC modules, EPA reports, FSAP aide-memoires and FTNs, OFC assessments aide-memoires, detailed assessments, and TA reports. If staff wish to confirm in writing their understanding of the authorities' views, they may provide the authorities with a minute of the relevant meeting(s) for comment.

[28] This section reflects the new rules adopted by the Executive Board on September 28, 2010 (see *Proposed Decision on Article IV Consultation Cycles*). Consultation cycles for individual members will be set based on these new rules at the time of completion of their first Article IV consultation following the adoption of the Decision or in the context of a Fund arrangement or a PSI.

[29] The 3-month grace period applies only to consultations that take place on the standard 12-month cycle.

[30] The periodicity and "deadlines" for the completion of individual consultations with members are expressed in terms of an "expectation" rather than an obligation. Except where a member is automatically placed on the 12- or 24-month cycle in the context of a Fund arrangement or PSI, the consultation cycle for members is

(continued…)

not under a Fund arrangement or a PSI on a longer cycle, not exceeding 24 months, unless the member: (i) is of systemic or regional importance; (ii) is perceived to be at risk, or is facing pressing policy issues of broad interest to the Fund membership; or (iii) has outstanding Fund credit exceeding 200 percent of quota. The Fund may only place a member on a longer cycle with its consent and after consulting with its Executive Director. To enhance the Fund's policy dialogue with a broad range of economic stakeholders, Article IV consultation cycles should be tailored to national policy timetables, such as budget cycles, to the extent feasible.

55. **Members that are granted a Fund arrangement or a PSI, with the exception of FCL or PCL arrangements, are automatically placed on a 24-month consultation cycle.** In cases where a program review under an arrangement is not completed by the date specified in the arrangement, the next Article IV consultation should be completed by the later of (i) 6 months after the date specified in the arrangement for completion of the review , and (ii) 12 months, plus the 3-month grace period after date of completion of the previous Article IV consultation, unless a review is completed before the later of these dates, in which case the consultation reverts to a 24-month cycle (i.e., should be completed within 24 months of the previous consultation).

56. **Except for FCL or PCL arrangements, members that have completed a Fund arrangement or a PSI (i.e., the arrangement or PSI ended "on track") may remain on the 24-month cycle if they do not meet any of the criteria described in ¶54 above.** At the time of the final review under the arrangement or PSI, staff should assess whether the consultation cycle should be shortened back to 12 months, based on the above criteria. When this is the case, the staff report for the final review should seek the Board's approval of such shortening of the cycle through a recommendation in the staff appraisal (to be reflected in the summing up).[31] If an arrangement expires with undrawn amounts or is cancelled by the member, or if a PSI expires with uncompleted reviews, is terminated, or is cancelled by the member, the member will remain on the cycle it was on, unless the Board determines that a different cycle should apply (which could be done through an ad-hoc decision that the Board could consider on a lapse-of-time basis).[32]

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established by the Executive Board at the conclusion of each Article IV consultation, or at the time of the last program or PSI review, or if necessary, on an ad-hoc basis.

[31] In case the Board decides to shorten the consultation cycle back to 12 months, the first Article IV consultation after the end of the Fund arrangement or a PSI should be concluded no later than 12 months (plus the 3-month grace period) after date of completion of the previous Article IV consultation, or 6 months after the end of the arrangement or PSI, whichever is later.

[32] Such a decision could be adopted by the Executive Board based on a proposal by management made upon cancellation (termination) of the arrangement or PSI.

57. **Members that are granted an FCL or a PCL arrangement are automatically placed on the standard 12-month consultation cycle.** For members that, prior to the approval of an arrangement were on a cycle longer than the standard 12 months, the first Article IV consultation following the approval of the arrangement is expected to be completed by the later of (i) 6 months following the approval of the arrangement, or (ii) 12 months plus a grace period of 3 months, after the date of completion of the previous Article IV consultation. At the end of an FCL or a PCL arrangement, that member will remain on the 12-month cycle, unless the Executive Board determined that a different cycle should apply (which could be done through an ad-hoc decision that the Board could consider on a lapse-of-time basis).

### B. Consultations with Members of Currency Unions[33]

58. **Consultations for members of currency unions should comprise the following:**

- **Individual members.** The frequency of Article IV consultations for individual members is determined by individual country circumstances (e.g. whether or not they currently have a program or PSI in place).

- **Discussions with regional institutions.** Yearly staff discussions should be held with regional institutions responsible for common policies in the currency unions. The discussions are held separately from the discussions with the individual member countries of the currency unions, but are considered an integral part of the Article IV process for each member. These discussions focus on policies under the aegis of the regional institutions and, as relevant, other policies of regional importance.

- **Reports and summing ups at the union level.** An annual staff report on the discussions with the regional institutions is prepared followed by a Board discussion, which are both considered an integral part of the Article IV consultations with individual member countries. Each union level summing up should include language to the effect that the views expressed by Directors in that union level summing up will form part of their discussions in the context of the Article IV consultations for individual currency union members that take place before the next annual Board discussion for the currency union.

- **Informal reports at the union level.** A second round of staff discussion with the regional institutions and an informal report to the Board may be needed to provide adequate context for bilateral consultations with the currency union member countries

[33] See also Section II and paragraph 38.

that do not coincide broadly with the annual Board discussion on the currency union's policies.

- **Clustering.** To the extent possible, Board discussions for the Article IV with individual member countries should be clustered around the regional Board discussions. Such clustering helps ensure better integration of the issues discussed at the regional level in the consultations with individual member countries.

### C. Process and Documentation

59. **The documentation requirements and review process for Article IV consultations are set out below.**

- **Policy Note.** This note (3-4 pages, plus charts and tables) should be prepared ahead of the consultation to lay out the key diagnostics and proposed focus of the consultation and policy advice. It should include background; macroeconomic outlook; policy line on key issues, including surveillance priorities; supportive charts and tables; and note any divergences of views among departments that arose from the policy consultation meeting (see below).

- **Policy Consultation Meeting.** This meeting between the area department and reviewing departments should be held 2 to 3 weeks before the mission to discuss and agree on the content of the Policy Note, before it is sent to management for clearance.

- **Board discussion.** Article IV staff reports are expected to be discussed by the Executive Board within 65 days of the end of the discussions for most countries, and within three months for PRGT-eligible countries. These should be understood as outer limits as staff is expected to finalize staff reports as quickly as possible after the end of discussions.

- **Staff report requirements.** The requirements for staff reports, including word limits, are listed in Attachment II.

- **Background documentation.** Background documentation for Article IV staff reports may be produced, in the form of papers covering selected issues and statistical annexes, i.e. comprehensive sets of historical data tables. The choice of selected issues papers (SIPs) should be guided by their centrality to the discussion, and each SIP should begin with a description of how the papers fit in the consultation discussions. Staff has great discretion on whether or not to produce comprehensive statistical annexes and is expected to make this decision in consultation with country authorities. Statistical annexes need not be produced when data are freely available from other sources, which is increasingly the case.

- **Summing Up.** With the exception of when Article IV reports are considered on a lapse-of-time basis (see below), the Executive Board's conclusion of an Article IV consultation will be reflected in a Chairman's Summing Up of the discussion, which will be communicated to the member concerned.

- **Lapse-of-time procedure**. The lapse-of-time (LOT) procedure will be proposed for Article IV consultations where the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a LOT basis; and (iv) the use of Fund resources is not under discussion or anticipated. The LOT procedure should not be used when: (i) the last Article IV consultation was concluded on a LOT basis; (ii) more than 24 months have elapsed since Board discussion of an Article IV consultation; or (iii) the member is on a 24-month consultation cycle. On the basis of these eligibility criteria, the Managing Director, with the approval of the Executive Director for the member concerned, would propose completion of an Article IV consultation on a LOT basis at the time the staff paper is circulated to the Executive Board. The Executive Director for the member concerned may also propose the completion of an Article IV consultation by LOT no more than two business days after the staff paper is circulated to the Executive Board, and preferably as soon as possible after the staff paper is circulated.[34]

- **Combining reports**. There is usually scope for combining Article IV and UFR papers (requests and reviews), though some may prefer to follow a "two-papers" approach. Under either approach, it is critical that the Article IV coverage remain comprehensive and deal with all relevant issues.

60. **Informal country matters sessions offer opportunities to inform the Board about significant developments between Article IV consultations.** Where warranted, the Board may also be kept apprised of economic developments in a member and of staff's assessment of these developments through issuance of a report in between Article IV consultations (e.g., following a staff visit). Regular provision to creditors or donors of staff assessments of a member's policies can be done through assessment letters, which are delivered upon request.[35]

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[34] When the consultation is concluded on a lapse-of-time basis, the Chairman's Summing Up is replaced by a decision stating that Executive Directors endorsed the thrust of the staff appraisal.

[35] Such assessments do not constitute an endorsement of the member's policy program or a statement that it meets a particular standard.

## 2007 Surveillance Decision: Principles and Indicators

### Principles for the Guidance of Members' Exchange Rate Policies[36]

**A**. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

**B**. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterized *inter alia* by disruptive short-term movements in the exchange rate of its currency.

**C**. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

**D**. A member should avoid exchange rate policies that result in external instability.

### The Exchange Rate Surveillance Indicators

In its surveillance of the observance by members of the Principles above, the IMF shall consider the following developments in a country's economy as among those requiring thorough review and might indicate the need for discussion with a member:

**(i)** protracted large-scale intervention in one direction in the exchange market;

**(ii)** official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;

**(iii)** (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or

(b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

**(iv)** the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

**(v)** fundamental exchange rate misalignment;

**(vi)** large and prolonged current account deficits or surpluses; and

[36] Principle A constitutes an obligation under Article IV, Section 1, while Principles B-D constitute recommendations rather than obligations of members.

**(vii)** large external sector vulnerabilities, including liquidity risks, arising from private capital flows.

## Formal Requirements in Article IV Staff Reports

Article IV staff reports should always include the following elements (those marked with an asterisk can be included in the informational annexes):

- * A classification of **data adequacy for surveillance**, as per guidance, into adequate (A), broadly adequate (B), or significantly hampering surveillance (C) (see paragraph 44 for case C countries). If adequacy is considered (C), this should be discussed in the main text of the staff report.

- *** A Statistical Issues Appendix and Table of Common Indicators Required for Surveillance**.

- A brief **assessment of the authorities' response to the policy recommendations** on the key issues raised in previous Article IV consultations.

- * An accurate description of the **de facto exchange rate regime**, along the following categories: exchange arrangement with no separate legal tender, currency board arrangement, conventional pegged arrangement, pegged exchange rate within horizontal bands, crawling peg, crawling band, managed floating with no predetermined path for the exchange rate, and independently floating.

- A reference to **proposed consultation cycle**.

- A reference to **Article VIII and XIV status** (see paragraph 49).

- * Fund Relations Appendix, IMF- World Bank Relations Annex.

- Staff reports for PRGT-eligible countries should include a table on the Millennium Development Goals.

- The background section of the Public Information Notice.

The following **word count limits apply** to staff reports[37]:

- 5,000 words for stand-alone report for non-systemic countries.

- 8,000 words for stand-alone report for systemic countries.

[37] Word count limits include everything except tables (contents, acronyms, data), figures, proposed decisions, and Debt Sustainability Assessments appendices. Also excluded are informational annexes (which, in the case of routine annexes to country papers are issued separately).