INTERNATIONAL MONETARY FUND

FACTSHEET

IMF Crisis Lending

Economic and financial crises can take many forms. The IMF assists countries hit by crises by providing them financial support to create breathing room as they implement adjustment policies to restore economic stability and growth. As crisis prevention can be more effective than crisis resolution, the Fund also provides precautionary financing to help prevent and insure against crises. The IMF's lending instruments have evolved in recent years to meet countries' changing needs.

Why do crises occur?

The causes of crises are varied and complex, and can be domestic, external, or both.

- **Domestic factors** include inappropriate fiscal and monetary policies, which can lead to large economic imbalances (such as current account and fiscal deficits and high levels of external and public debt); an exchange rate fixed at an inappropriate level, which can erode competitiveness and lead to persistent current account deficits and loss of official reserves; and a weak financial system, which can create economic booms and busts. Political instability and/or weak institutions can also trigger crises.
- **External factors** include shocks ranging from natural disasters to large swings in commodity prices. These are common causes of crises especially for low-income countries, which have limited capacity to prepare for such shocks and are dependent on a narrow range of export products. Also, in an increasingly globalized economy, sudden changes in market sentiment can result in capital flow volatility. Even countries with sound fundamentals could be severely affected by the impact of economic crises and policies in other countries.

Whether the cause is domestic or external in origin, crises can take many different forms: balance of payment problems occur when a nation is unable to pay for essential imports or service its external debt repayments; financial crises stem from insolvent or illiquid financial institutions; and fiscal crises are caused by excessive fiscal deficits and debt. Often, countries that come to the IMF face more than one type of crisis as challenges in one sector spread throughout the economy. Crises generally result in sharp slowdown in growth, higher unemployment, lower incomes and greater uncertainty which cause a deep recession. In acute crisis cases, defaults or restructuring of sovereign debt may become unavoidable.

How IMF lending helps

IMF lending aims to give countries breathing room to implement adjustment policies in an orderly manner, which will restore conditions for a stable economy and sustainable growth. These policies will vary depending upon the country's circumstances. For instance, a country facing a sudden drop in the prices of key exports may need financial assistance while implementing measures to strengthen the economy and widen its export base. A country suffering from severe capital outflows may need to address the problems that led to the loss of investor confidence—perhaps interest rates are too low; the budget deficit and debt stock are growing too fast; or the banking system is inefficient or poorly regulated.

In the absence of IMF financing, the adjustment process for the country could be more abrupt and difficult. For example, if investors are unwilling to provide new financing, the country would have no choice but to adjust—often through a painful compression of government spending, imports and economic activity. IMF financing facilitates a more gradual and carefully considered adjustment. As IMF lending is usually accompanied by a set of corrective policy actions, it also provides a seal of approval that appropriate policies are taking place.

Historically, for emerging and advanced market economies in crises, the bulk of IMF assistance has been provided through Stand-By Arrangements (SBAs) to address short-term or potential balance of payments problems. The Standby Credit Facility (SCF) serves similar purpose for low-income countries, providing financial assistance at zero interest rates. To support members with already sound policies to help prevent or mitigate crises and boost market confidence during periods of heightened risks, the IMF recently introduced the Flexible Credit Line (FCL) and the Precautionary and Liquidity Line (PLL). Other new instruments, such as the Rapid Financing Instrument (RFI), and the corresponding Rapid Credit Facility (RCF) for low-income countries, were created to provide rapid assistance to countries with urgent balance of payments need, including from commodity price shocks, natural disasters, and domestic fragilities.

IMF lending in action

The IMF provides financial support upon request by its member countries. Following such a request, an IMF staff team holds discussions with the government to assess the economic and financial situation, the size of the country's overall financing needs, and agree on the appropriate policy response.

Typically, a country's government and the IMF must agree on a program of economic policies before the IMF provides lending to the country. A country's commitments to undertake certain policy actions, known as policy conditionality, are in most cases an integral part of IMF lending. Progress is typically reviewed by monitoring the implementation of these policy actions. However, for some arrangements, countries can use IMF resources with no or limited conditionality as they have already established their commitment to sound policies (FCL, PLL) or where they are designed for urgent and immediate needs, for instance, because of the transitory and limited nature of the shock or where policy implementation capacity is limited, including due to fragilities (RFI, RCF). In general, a country's return to economic and financial health ensures that IMF funds are repaid so that they can be made available to other member countries.

Once an understanding has been reached on policies and a financing package, a recommendation is made to the IMF's Executive Board to endorse the country's policy intentions and extend access to IMF resources. This process can be expedited under the IMF's emergency financing procedures (see box).

Rapid IMF Lending During Past Crises

The Fund has emergency procedures in place to help provide financing at short notice. The RFI was used in 1997 during the Asian crisis; in 2001 for Turkey; in 2008-09 for Armenia, Georgia, Hungary, Iceland, Latvia, Pakistan, and Ukraine; and in 2010-13 for Greece, Ireland, Portugal and Cyprus.

When can it be used? When a member country faces an exceptional situation that threatens its financial stability and a rapid response is needed to contain the damage to the country or the international monetary system.

How does it work? (i) The Executive Board is informed about a member's request for assistance; (ii) a staff team is quickly deployed to the country; and (iii) as soon as staff reaches an understanding with the government, the Board considers the request to support a program within 48-72 hours.