2014 TRIENNIAL SURVEILLANCE REVIEW—REVIEW OF IMF SURVEILLANCE PRODUCTS

EXECUTIVE SUMMARY

- The Fund has made steady progress toward strengthening surveillance over the past several years. In particular, the scope of the Fund's analysis and policy advice has improved broadly in the five priority areas identified in the 2011 Triennial Surveillance Review, with most progress made toward a sharper focus on risks.

- Concerted efforts to integrate bilateral and multilateral surveillance—through the Integrated Surveillance Decision and new initiatives such as Spillover Reports and the Pilot External Sector Reports—have reinforced the importance of consistency and rigor in the Fund's policy advice.

- Importantly, the focus on priority areas and integrating surveillance has not compromised attention to country-specific issues. However, it is unclear whether this reorientation in the Fund's focus has detracted from the depth of analysis.

- Surveillance has also responded to new challenges. Fund-wide efforts to reexamine policy frameworks have better supported analysis in traditional areas, such as fiscal policy, and helped new thinking gain ground in Fund policy advice (e.g., macroprudential policies and capital flow management).

- There is considerable scope to build on this progress. As the Fund gains experience with new approaches, this should enhance the depth and consistency of analysis. However, additional steps could also help to deepen and better integrate analysis and policy advice that focuses on priority issues and each country's needs.

  ➤ Greater use of analytical tools or developing new tools to help boost the effectiveness and traction of analysis and policy advice on risks and spillovers (including from the financial sector).

  ➤ More comprehensive and better integrated external assessments, based on consistent analytical approaches and a clear bottom line. Better integrate the external assessments of currency unions and their members.

  ➤ A more cohesive approach to analysis and policy advice, with more attention to inter-sectoral connections (e.g., macro-financial linkages), policy coordination, and integrating analyses in each policy area into a comprehensive discussion.

  ➤ Better use of multi-country risk and vulnerability analyses in bilateral surveillance, ensuring consistency of approach and deeper analysis of inward spillovers.

  ➤ Greater use of cross-country policy lessons to add value to country-specific advice and ensure greater consistency of advice across countries.

- While there has been progress on improving traction (e.g., reporting the authorities' views), further steps could be taken, including by highlighting differences of views between authorities and staff, and explaining why advice differs across countries.

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INTRODUCTION

1.   As part of the 2014 Triennial Surveillance Review, IMF staff reviewed a range of recent IMF surveillance products to assess how well the Fund is implementing the priorities identified in the 2011 Triennial Surveillance Review (2011 TSR) and responding to new challenges. It also attempts to gauge the evenhandedness and traction of Fund policy advice. While progress in these areas is ongoing, this paper summarizes the findings of the review of recent surveillance products and provides a broad snapshot of Fund surveillance during 2013.

2.   Scope and Methodology of the Review. This review covers a range of bilateral and multilateral surveillance products. It focuses primarily on reports for 50 Article IV consultations (hereafter 'Article IV reports') that were considered by the IMF's Executive Board between January and December 2013 (Annex I).[1] The review also considers the consistency and implementation of surveillance priorities across the Fund, including in a selection of multilateral surveillance products considered by the Board in 2013.[2] Staff's assessment of these surveillance products was based on a series of structured questions and involved some element of judgment. In some instances, these questions sought to gauge the depth of discussion or analysis in certain areas, and the responses were based on three categories: extensive; some; and little or none.[3]

3.   Structure. The paper is organized as follows. The paper first sets out the context for this review. The subsequent section assesses the scope and depth of Fund surveillance in several priority areas, including those identified in the 2011 TSR and some that have emerged as the crisis evolved. The paper then examines the internal consistency and cohesion of surveillance and the overall integration of surveillance across the Fund. The final section considers some elements to help track the evenhandedness and traction of the Fund's policy advice.

CONTEXT FOR THE REVIEW

4.   The 2011 TSR sought to address shortcomings in the coverage and depth of IMF surveillance that had been revealed by the global economic and financial crisis. Specifically, the 2011 TSR recommended actions to strengthen the Fund's policy analysis and advice in five priority areas: (i) *interconnections* through the analysis of inward and outward spillovers, and cross-country experiences; (ii) *risk assessments* through deeper analysis of risks, their transmission channels and

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[1] The 50 economies were selected as a stratified random sample, with a view to being as representative as possible of the IMF's wider membership (see Annex I). The review of Article IV reports did not include Selected Issues Papers.

[2] The World Economic Outlook, Global Financial Stability Report, and Fiscal Monitor, as well as relatively new products such as Spillover Reports and the Pilot External Sector Reports.

[3] The structured response categories are defined broadly as follows: **"*extensive*"** coverage includes deeper analysis of the causes, mechanisms, results, and policy advice; **"*some*"** coverage includes basic analysis or discussion of the topics, but lacks detail; and **"*little or none*"** refers to no discussion or a passing reference only. The assessment recognizes that "extensive" analysis is not needed for every topic, but is dependent on whether an issue is a core element of Article IV surveillance and/or a priority area for the country concerned.

possible policy responses; (iii) *financial stability* by strengthening financial analysis and more attention to macro-financial linkages; (iv) *external stability* by assessing a broad range of indicators; and (v) *greater traction* with member countries through more candid and evenhanded advice that is tailored to country circumstances.

5.   **At the same time, the crisis continued to evolve, raising new questions about the conduct of economic policies and posing new challenges for policymakers and the Fund.** These issues are, in part, closely related to the legacies of the crisis, such as high sovereign debt and protracted low growth. Others reflect the need to reassess traditional policy frameworks, so the Fund can be more flexible and responsive to changing circumstances or the changing needs of member countries (e.g., capital flows and macroprudential policy). A key challenge has been how to effectively integrate new thinking in these areas into Fund surveillance.

6.   **While these priorities cover an expansive range of topics, this review recognizes that not every economic or policy issue is equally relevant to all countries.** Some differentiation in approach is appropriate for both bilateral and multilateral surveillance. For instance, each multilateral report should address the issues most relevant to its audience and objectives. Similarly, the coverage of analysis and advice in Article IV consultations should reflect the priority needs of each country. Other factors, such as data limitations, can also affect the extent to which more extensive analysis is possible. This review considers the depth and consistency of analysis where covered (and as understood to be country-relevant), as well as the broader balance between integration and country-tailoring.

SCOPE AND DEPTH OF FUND SURVEILLANCE

The coverage of priority issues has improved and new thinking is gaining ground in the Fund's policy advice. The focus on risks in staff reports, for instance, has improved. However, several aspects of surveillance could be strengthened further, particularly as analysis often remains most extensive in well-established or traditional areas. In others, the depth of analysis could benefit from further experience with new approaches, including greater use of analytical tools or even developing new tools, more attention to intersectoral linkages, and better integrating analysis from each area into a comprehensive policy discussion.

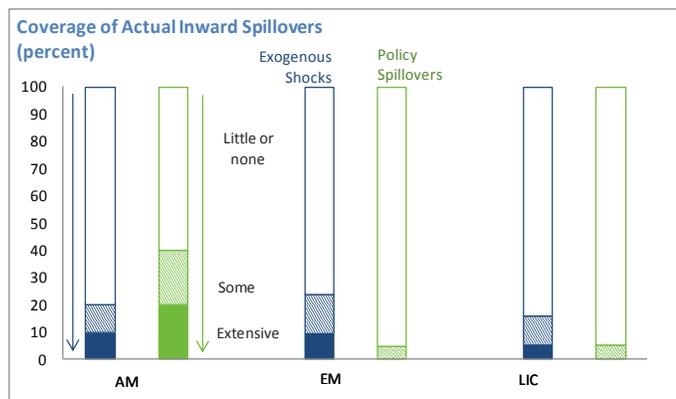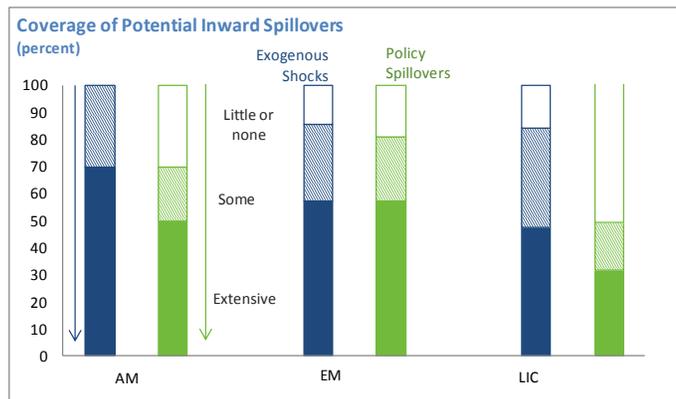## A. Interconnectedness: Spillovers

Inward Spillovers

7.   **In general, the coverage of inward spillovers in Article IV reports has improved over the past three years.**[4] More than 90 percent of the reports in the sample include some discussion of inward spillovers, compared to less than 80 percent at the time of the 2011 TSR. However, the

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[4] The analysis of potential spillovers is also closely interrelated with the assessment of risks, which is taken up in the subsequent section.

depth of these discussions could be improved, as only around half of all reports include an extensive discussion of inward spillovers.

8.   Much of the emphasis remains on potential inward spillovers from exogenous shocks rather than policies.
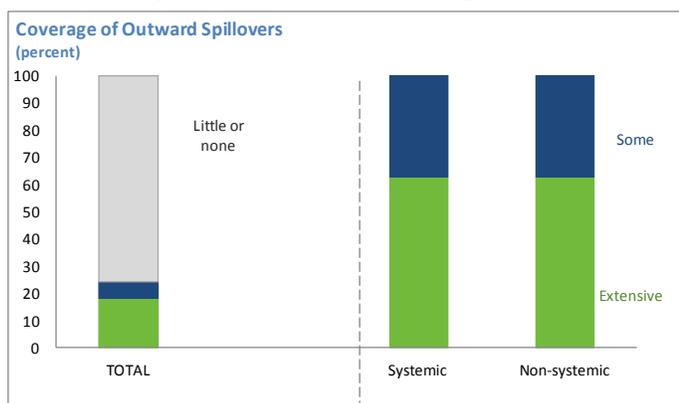
- Nearly 90 percent of reports discuss *potential* exogenous shocks (e.g., a commodity price shock or a growth slowdown in another country or region). Among these, 56 percent discuss the issue extensively and 32 percent have only some discussion.

Coverage of Actual & Potential Inward Spillovers
(percent)

- Just over 60 percent of reports cover *potential* inward spillovers from policies of other countries (e.g., exit from unconventional monetary policy). For 46 percent of reports this discussion is considered extensive.

- In contrast, the coverage of *actual* spillovers from both exogenous shocks and policies remains relatively thin— 10 percent and 20 percent of reports, respectively.

Coverage of Potential Inward Spillovers
(percent)

- Consistent with the focus on risks and stability, the vast majority of analysis focuses on negative spillovers or downside risks, although some reports also cover positive spillovers, such as the benefits of higher commodity prices for commodity exporters or more favorable global or trading partner growth.

Coverage of Actual Inward Spillovers
(percent)

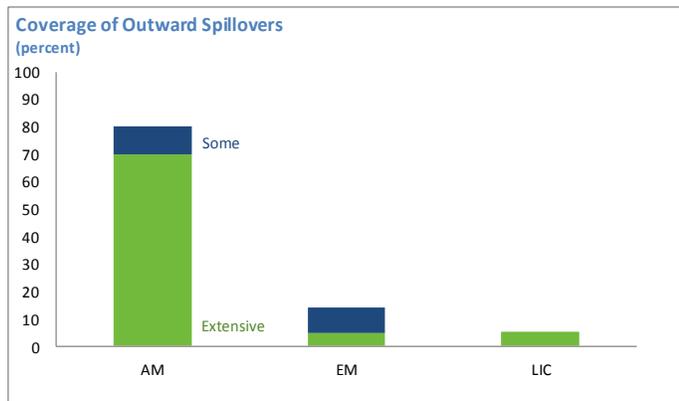**9.   While there has been some progress in expanding the analysis of inward spillovers, there is significant scope to broaden the analysis and the use of quantitative methods.** As reports for recipient countries mostly discuss inward spillovers in the context of exogenous shocks rather than inward policy spillovers, the depth of this analysis is reported in the section on risk assessments below.

Outward Spillovers

10.   Most reports for economies that could have systemic implications cover outward spillovers. Across the entire sample, almost one quarter of the reports include some discussion of *outward spillovers* (12 of 50). However, the focus on outward spillovers, as expected, bears close relationship to the size and systemic nature of an economy. The sample includes eight reports for economies whose policies could have systemic implications (hereafter "systemic economies"). Of these, six reports include some discussion of outward spillovers, with five examining the issue extensively.[5] Similarly, the vast majority of the sample reports for advanced markets (AMs) (70 percent in detail; another 10 percent include some discussion) provide some coverage of outward spillovers.
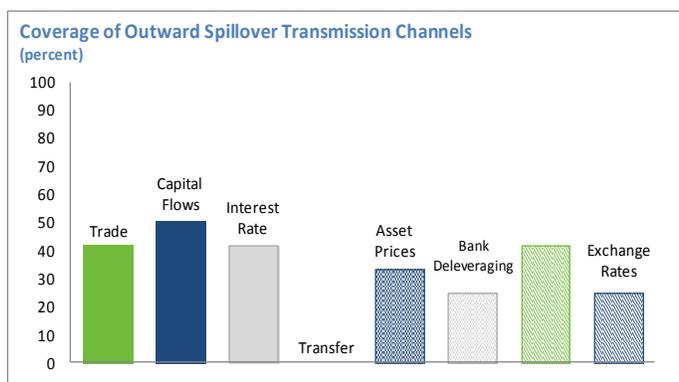
Coverage of Outward Spillovers
(percent)

11.   However, awareness of outward spillovers is also gaining ground among other economies. Around 15 percent of the remaining economies in the sample (6 of 42 non-systemic economies) discuss outward spillovers, including some smaller AMs, some non-systemic emerging markets (EMs), and one low-income country (LIC). These reports generally focus on regional or bilateral spillovers.

Coverage of Outward Spillovers
(percent)

12.   The range and depth of analysis of outward spillovers varies widely. The vast majority of reports examine the causes (75 percent) and impact (92 percent) of outward spillovers, as do all the reports for systemic economies. Transmission channels also receive good attention in most reports that discuss outward spillovers. The range of transmission channels discussed is balanced, with the greatest emphasis on capital flows (50 percent), trade in goods and services (42 percent), and interest rates (42 percent). Systemic economy reports tend to focus on capital flows and

Coverage of Outward Spillover Transmission Channels
(percent)

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[5] Of the two reports for systemic economies that did not include an explicit discussion of spillovers, one was prepared and published in early 2013, before the Integrated Surveillance Decision came into effect.

interest rates (each issue is discussed in two thirds of reports). Channels related to bank deleveraging, exchange rates, and asset prices are discussed in some reports (25-33 percent).

13.   There is scope to strengthen the use of analytical and quantitative tools in examining outward spillovers. Of the six systemic economies in the sample that discuss outward spillovers: (i) two reports are not clear about the quantitative methodology used; and (ii) the other four reports include a more explicit discussion of the different analytic tools used.

- DSGE models are used most often (three of the systemic economy reports), given their ability to capture some types of interconnectedness (e.g., the impact on output, but not the financial implications).

- The use of other quantitative tools is more variable, with macroeconomic framework scenarios, traditional macroeconomic models, and panel regressions each used in one systemic economy report. Other quantitative methods—stress tests and VARs—are used in reports for non-systemic economies (one report each).

- Where quantitative scenarios are used, reports for systemic economies mostly use scenarios from the relevant Spillover Report, those developed by the country team, or scenarios drawn from other analytical work (e.g., IMF working papers).

	OVERALL Model Usage	Macro framework scenarios	Traditional Macro Models	DSGE	VAR	Panel Regressions	Stress test	Other	Passing Reference
Outward Spillovers - Quantitative Tools Used in 2013 Article IV Reports [1]									
Systemic	**67**	17	17	50	0	17	0	0	33
Non-Systemic	**50**	0	0	17	17	0	17	17	17
TOTAL	**58**	8	8	33	8	8	8	8	25

1/ In percent of reports reviewed. The color coding indicates the relative frequency of use of each approach, ranging from red (none or very few reports) to green (more than half).

14.   The broader discussion of policy advice is beginning to take account of outward spillovers. Of the six reports for systemic economies that discuss outward spillovers, four reports explicitly refer to the spillover in discussing policy advice in the main text and the staff appraisal. However, the authorities' views are only discussed in three of the systemic economy reports (and one non-systemic economy report). Around half the reports for both systemic and non-systemic economies discuss policy alternatives to mitigate the impact of outward spillovers.
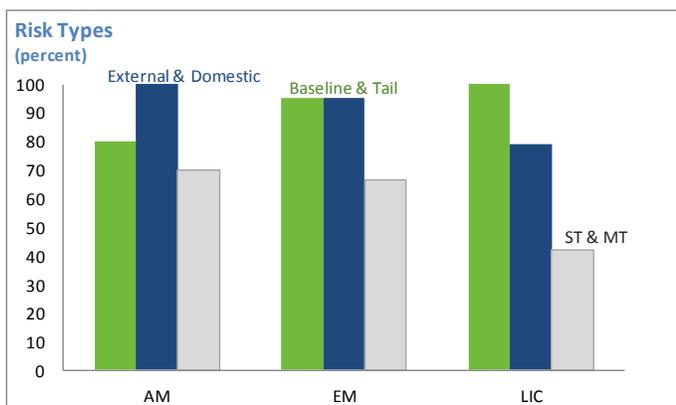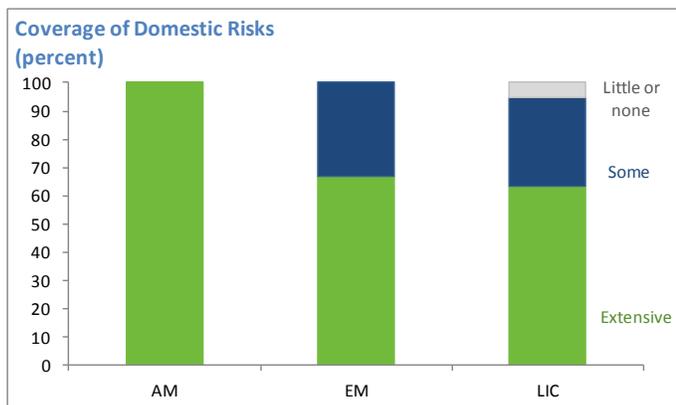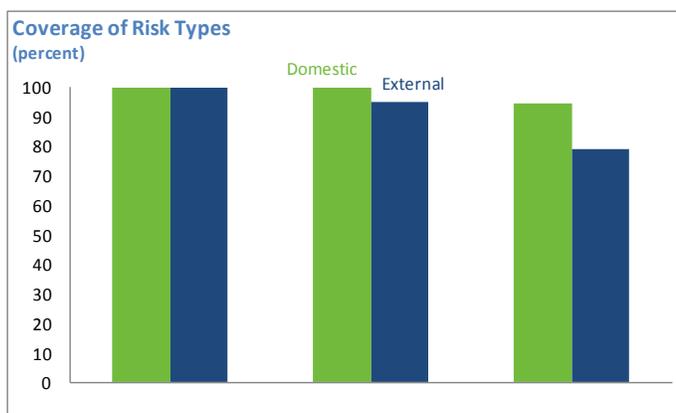

SPILLOVER ANALYSIS—GOOD PRACTICE EXAMPLES:

Comprehensive and well-integrated discussion of global spillovers—United Kingdom: The report assesses the impact of outward spillovers combining information drawn from different models and staff's judgment regarding the impact of spillovers through channels not captured by the models. Spillovers are integrated in policy discussions and staff suggests alternative policies.

Thorough discussion of regional spillovers—Sweden: The report draws on analysis from the Nordic Regional Report to discuss both inward and outward spillovers. Given the strong cross-Nordic activities of Swedish banks, a rise in non-performing loans or funding costs could reduce lending across the Nordics. Conversely, sudden deteriorations of household financial health elsewhere could pose risks for Sweden, with possible negative regional feedback loops.

B. Assessment of Risks

15.   The coverage of risks in Article IV reports has improved significantly. This, in part, parallels the growing emphasis on potential inward spillovers from external risks, but also reflects attention to domestic risks.

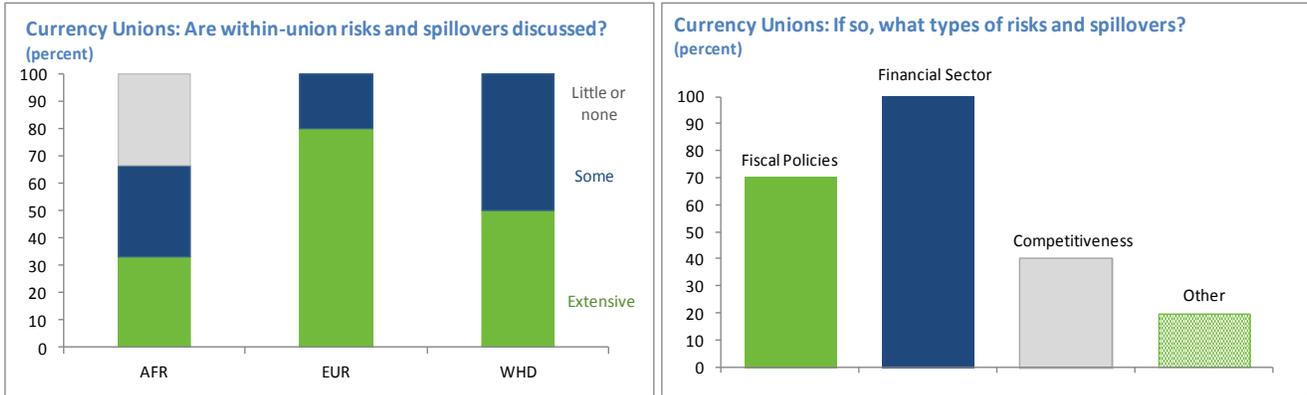**Coverage of Risk Types**
(percent)

- External risks are covered in all AM reports, all but one EM report, and in more than 80 percent of LIC reports. This coverage is more than the 76 percent of all reports recorded as having an adequate discussion of risks in the 2011 TSR.

- Domestic risks are covered in all but one LIC report (98 percent coverage), although the analysis of domestic risks is more detailed in around three quarters of reports (all AM reports, and two thirds of EM and LIC reports). There is tremendous variety in the types of domestic risks discussed— ranging from issues related to political/social stability to asset prices/financial stability to fiscal adjustment and reform fatigue— reflecting considerable tailoring of risk assessments to individual country circumstances.

Coverage of Domestic Risks
(percent)

Risk Types
(percent)

- Most reports also distinguish baseline versus tail risks (94 percent) and, to a lesser extent, short- versus medium-term risks (58 percent). LIC reports are least likely to draw the distinction between short- and medium-term risks (42 percent).

16.   Another advance has been the more comprehensive coverage of risks within currency unions. All three currency union reports in the sample (the Euro Area, ECCU, and WAEMU) examine risks within the union, albeit with varying degrees of analysis, particularly with regard to financial sector and fiscal policies. For example:
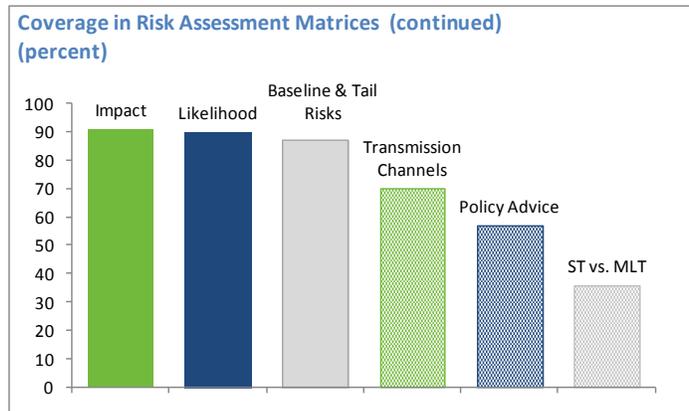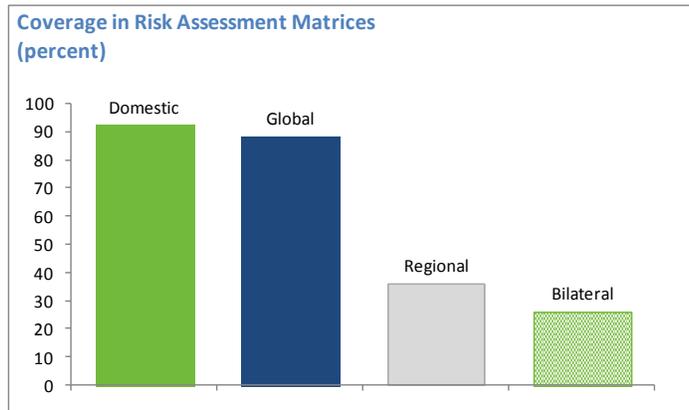
- The ECCU report points to the worsening of government financing conditions and financial sector health across the union.

- The Euro Area report discusses the potential for the re-emergence of financial stress in the event of stalled or incomplete delivery of policy commitments at either the national or Euro area level.

- The WAEMU report discusses a range of risks across the union as well as risks from the crisis in Mali to the broader union.

Currency Unions: Are within-union risks and spillovers discussed?
(percent)

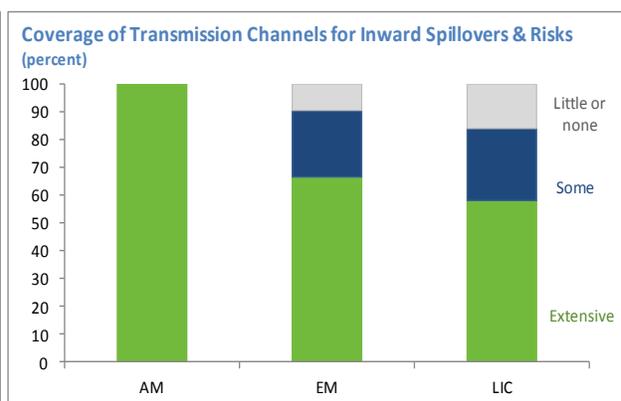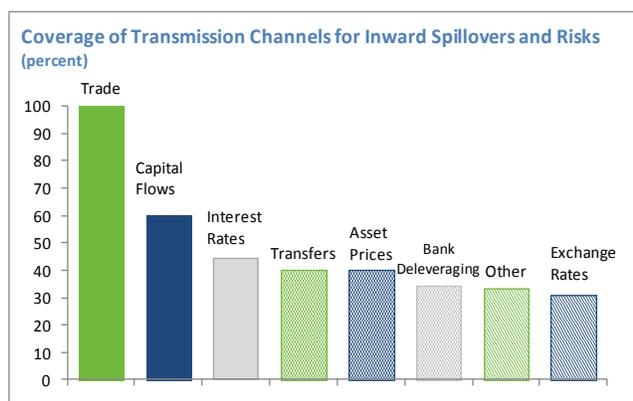**Currency Unions: If so, what types of risks and spillovers?**
(percent)

17.   Risks are more likely to be assessed comprehensively, with most reports now covering a wider range of factors.

- Since their introduction, risk assessment matrices (RAMs) have become nearly universal in Article IV reports (96 percent of the sample). RAMs have helped to improve risk assessments through attention to global and domestic risks, and in some cases (30 percent) regional and bilateral risks. As expected, RAMs give more attention to the likelihood and impact of risks (both 90 percent of reports) than transmission channels (70 percent) or policy advice (60 percent). Transmission channels and policy advice are often dealt with in more detail in the text. However, there is scope to improve the consistency of risks between RAMs and the main text. For example, more than 40 percent of reports—across all country groups—identify one or more major risks in the text that are not included the RAM. While not all risks in the RAM warrant discussion in the text, RAMs should be comprehensive and *major* risks should be covered in both the RAM *and* the text.

Coverage in Risk Assessment Matrices
(percent)

Coverage in Risk Assessment Matrices (continued)
(percent)

- More than 80 percent of reports discuss *at least one* element of risk—i.e., the likelihood, impact, transmission channels, or policy response—and, importantly, more than half the reports examine *all* of these factors. Beyond evaluating the likelihood and impact of risks (90 percent), the discussion of risks in the text also emphasizes transmission channels and policy responses (also around 90 percent on average). However, the proportion of reports that discuss these issues extensively is somewhat lower (around 70 percent on average). Except for the likelihood of risks, the coverage varies across country groups. Specifically, AMs give more attention to the impact, transmission channels, and policy responses than those for EMs or LICs.

Coverage of Risks and Spillovers (percent)

Coverage of Transmission Channels for Inward Spillovers and Risks (percent)

Coverage of Transmission Channels for Inward Spillovers & Risks (percent)
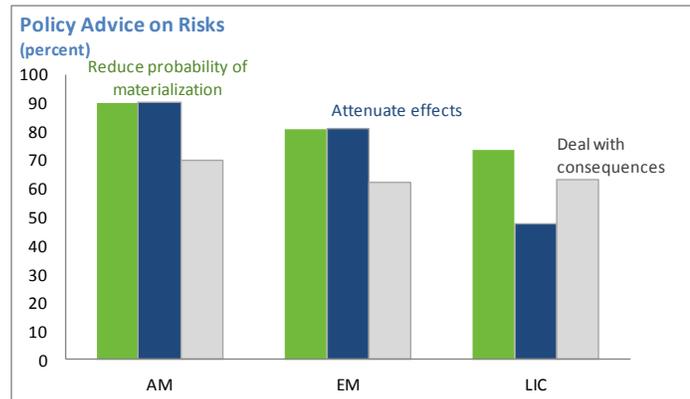

18.   Notwithstanding progress in deepening the analysis of inward spillovers and risks, there is still significant scope for greater use of quantitative methods. Nearly 60 percent of risk assessments use analytical tools, but this is skewed toward AMs. The most common approach to quantitative analysis in this area is the use of alternative macroeconomic scenarios (55 percent of reports using analytical tools). Quantitative scenarios are most often developed by country teams (76 percent), with few drawn from multilateral products, such as the G-RAM or Spillover Report. The use of other quantitative methods (such as DSGE models, VARs, panel regressions, or stress tests) is less frequent (10-25 percent of reports that use models). Reports for LICs tend to rely more on panel regressions and stress tests.

Inward Spillovers & Risks - Quantitative Tools Used in 2013 Article IV Reports[1]									
	OVERALL Model Usage	Macro framework scenarios	Traditional Macro Models	DSGE	VAR	Panel Regressions	Stress test	Other	Passing Reference
Systemic	**100**	25	0	25	0	0	0	63	13
Non-Systemic	**50**	67	5	10	33	14	24	19	0
TOTAL	**58**	55	3	14	24	10	17	31	3

1/ In percent of reports reviewed. The color coding indicates the relative frequency of use of each approach, ranging from red (none or very few reports) to green (more than half).
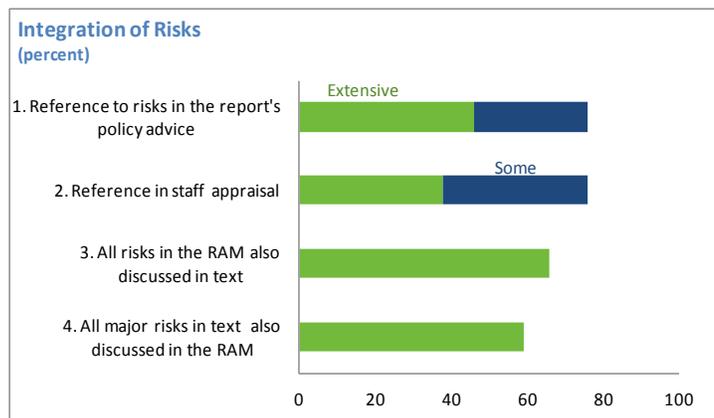
19. **Around three quarters of all reports—and 90 percent of reports for AMs—discuss policy responses to address risks.** The range of advice covers policies to reduce the probability of a risk materializing (80 percent), policies to mitigate the effects of a risk (70 percent) or contingent policies to deal with the consequences of a risk should it occur (64 percent). Fewer than 60 percent of reports discuss all three elements of a policy response, more so in AMs (70 percent) than EMs (57 percent) or LICs (47 percent).

Policy Advice on Risks
(percent)

20. **Gaps remain in how well risk (and spillover) analyses are integrated into the formulation and presentation of policy advice.** Around half the reports refer extensively to the risk assessment in setting out staff's policy advice; another third of reports mention of risks. In this regard, reports for LICs and for program countries appear to have the most room for improvement. Fewer than 40 percent of reports include an extensive discussion of risks in the staff appraisal, although another 38 percent make some mention of risks. Similarly, risks are often not used to justify policy advice. And, as previously noted, the discussion of risks in the text is not always consistent with those in the RAM.

Integration of Risks
(percent)

RISK ASSESSMENT—GOOD PRACTICE EXAMPLES:

Good use of quantitative methods and coverage of transmission channels—El Salvador: The analysis is based on a multi-country VAR to quantify potential inward spillovers from growth shocks to the country's four largest trading partners. It also quantifies the impact on external financial and growth via trade, remittances, investment, and banking channels.
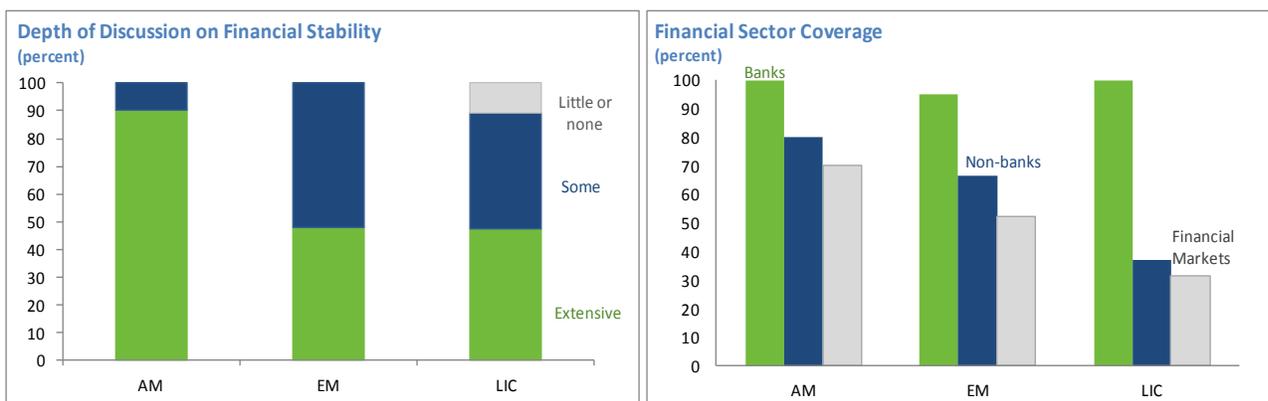
Analytical approach, innovative, and well-integrated RAM—Germany: the report covers a wide range of risks (and outward spillovers) and transmission channels, including financial-fiscal and supply chain. It also explores the role of uncertainty as a channel. The analysis builds on the RAM, examining the interrelated and mutually reinforcing nature of risks, (presented in an innovative risk flow chart).

Comprehensive discussion of risks—WAEMU: The report differentiates risks according to the timeframe, tail vs. baseline risks, as well as domestic, regional, and global risks. It also traces out the transmission mechanisms and discusses possible policy responses. Two appendices discuss in more detail: (i) risks from the crisis in Mali; and (ii) "shock convergence" within WAEMU.

Well-integrated analysis of risks and spillovers—Hong Kong: The thematic organization of the report helps to draw out the analysis of risks across sectors and topics. The report assesses risks and potential spillovers emanating from one market both individually and in the discussion of other sectors (e.g., an in-depth assessment of property market risks and the potential interrelationship with financial sector risks).
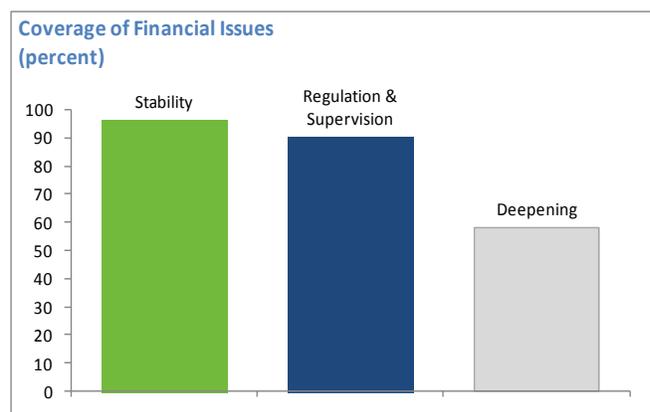
C. Focus on Financial Stability

21.   While there has been progress toward strengthening financial sector surveillance, there is scope to build on this through deeper analysis that is well tailored to country circumstances. More than 90 percent of reports provide a clear bottom line on financial risks and vulnerabilities, up from around three-quarters at the time of the 2011 TSR. While most reports include some discussion of financial sector issues, the depth and breadth of analysis varies across countries and types of institutions. Specifically, 90 percent of reports for AMs include an extensive analysis of financial stability compared to around 50 percent of reports for EMs and LICs. This may reflect, in part, the relative size and importance of the financial sector in AMs. In this regard, the coverage of different issues among country groups broadly reflects their financial structure and the macroeconomic relevance of financial sector issues. Coverage of institutions continues to focus primarily on banks (all country groups). However, reporting on non-bank financial institutions and financial markets has improved since the 2011 TSR (increasing from 50 to 58 percent and from 42 to 48 percent, respectively), particularly for AMs and EMs.

22.   The Financial Sector Assessment Program (FSAP) provides an important base for financial analysis and policy advice in Article IV reports. There is follow up on FSAPs, with FSAP recommendations well addressed in reports for economies that had an FSAP in the past 5 years (50 percent of the sample). While difficult to gauge in many cases, the advice in Article IV reports is generally consistent with Financial System Stability Assessment recommendations, but Article IV reports tend to give more weight to regulatory and supervisory issues.

23.   The coverage of financial surveillance seems well attuned to country priorities. Reports for AMs give most weight to analyzing financial stability (90 percent) and, to a lesser extent, regulatory and supervisory issues (80 percent). Reports for EMs also cover both issues, although the analysis tends to be less extensive. Financial analysis for LICs is oriented more toward financial deepening (63 percent), an appropriate tailoring of policy advice.
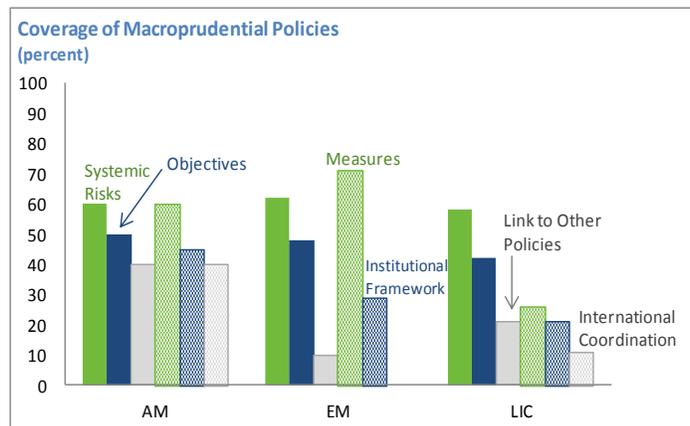
24.   For countries where financial stability is a pressing issue, more could be done to boost the analytical underpinnings of financial analysis.

- Most reports tend to rely most heavily on a qualitative discussion of financial risks (96 percent), such as the implications of real sector developments or bank soundness. There is considerably less use of quantitative analysis (25 percent of reports) in assessing financial stability, with surprisingly little variation among AMs and EMs. The more limited use of quantitative financial sector analysis in LIC reports likely reflects data limitations or that the smaller size of markets may make financial stability issues less of a priority issue. However, even where reports for AMs examine intersectoral linkages (see below), this is backed by quantitative analysis in only 50 percent of the reports.

Methods Used to Assess Financial Risk (percent)

- Moreover, a significant share of reports (40 percent) do not incorporate financial risks identified in the RAM into the discussion and analysis of financial sector issues.
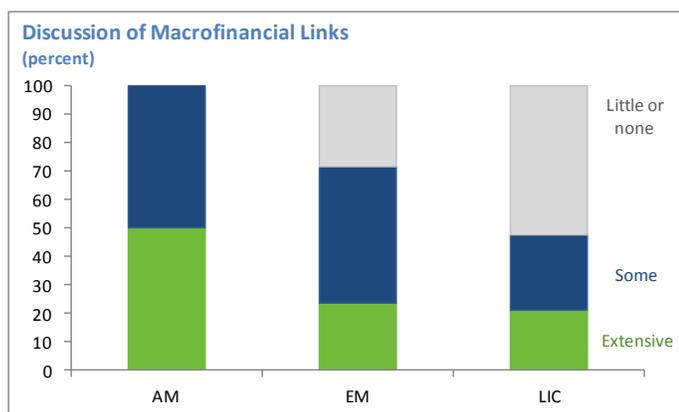
25.   Financial sector policy advice focuses mostly on regulatory and supervisory improvements, and less on macroprudential policies.[6] Compared to the widespread discussion of general financial risks across all country groups, even the reports for AMs and EMs discuss systemic risks and macroprudential policy objectives much less frequently (about 60 percent and 50 percent, respectively). About half the reports discuss macroprudential policy tools, but this typically focuses on specific aspects rather than a more comprehensive discussion of options. In general, staff's advice in this area is discussed for all country groups, although the discussion and analysis is notably—and appropriately—deeper for both financial centers and large EMs.

Coverage of Macroprudential Policies (percent)

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[6] The crisis underscored the potential costs of systemic vulnerabilities and the importance—as part of a broader suite of policies—of macroprudential policies for financial stability. In recent years, several IMF papers have examined the role and use of macroprudential policy In recent years, several IMF papers have examined the role and use of macroprudential policy. (For example, see _Key Aspects of Macroprudential Policy_, June 2013; _The Interaction of Monetary and Macroprudential Policies_, January 2013; _Macroprudential Policy: What Instruments and How to Use Them? Lessons from Country Experiences_, October 2011; and _Macroprudential Policy: An Organizing Framework_, March 2011.) For the Fund and for countries developing macroprudential policies, this area remains work-in-progress.

26.   Financial sector analysis could be more fully integrated with the policy advice in

Article IV reports. Overall, only about one-third of reports include extensive coverage of macro-financial linkages. However, this varies across countries, with AM reports typically giving them more attention. The more limited coverage in LIC reports may reflect less developed financial systems or limited data availability.[7] Overall, reports discuss the implications of financial issues for the real economy (over 40 percent) more than the implications of real sector developments for the financial sector (around one quarter). Reports rarely provide intersectoral analysis covering fiscal-financial links (8 percent), and this is almost entirely limited to AM reports. Limited discussion of transmission channels and/or the implications of shocks are also common weaknesses. While many reports discuss macroprudential measures, less than a quarter discuss their implications for the macroeconomy.

Discussion of Macrofinancial Links
(percent)

FINANCIAL STABILITY—GOOD PRACTICE EXAMPLES:

FSAP Follow up—Brazil: The report discusses the status of the previous year's FSAP recommendations (e.g., improving financial safety nets), paired with broad advice on the effectiveness of the macroprudential framework, and policies to strengthen oversight of insurance and pensions.

Comprehensive and tailored financial analysis—WAEMU: The report presents an in-depth analysis of the financial sector, backed by cross-country measures of members' financial depth and financial soundness, that provide a basis for advice on policy priorities and tackling obstacles to financial deepening.

Quantitative analysis of financial stability—Montenegro: An appendix estimates a disequilibrium model to identify impediments to credit growth. Another appendix analyzes vulnerabilities of private sector balance sheets (banks, corporate sector, and households).

Quantitative macro-financial analysis—Hong Kong: The report uses an asset pricing model to assess the sustainability of house prices. The analysis covers links to fiscal and structural issues (i.e., land supply and income distribution), and the macroprudential and other policy responses.

Comprehensive and well-integrated analysis of macro-financial linkages—Euro area: The report examines financial, monetary, fiscal, and real sector links (e.g., the adverse impact of financial market fragmentation on monetary transmission, credit to SMEs, and growth). It recommends measures to reduce financial fragmentation, as well as monetary easing and slower fiscal consolidation to boost growth.

Well-integrated and deep analysis of outward spillovers by non-systemic economy—New Zealand: The report examines financial interlinkages with Australia, drawing on stress tests to support the conclusions. The analysis cites similar risk profiles (geographic and economic similarities) and Australian banks' ownership of much of the New Zealand banking sector.

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[7] However, concerns about data adequacy for assessing financial risks and vulnerabilities revealed relatively little variation among advanced (30 percent), emerging (19 percent) and low-income (37 percent) economies.

D.   External Sector Assessments

27.   While assessment methods and the breadth of indicators have improved, further progress is needed to achieve more consistent and better integrated external sector assessments. In particular, the introduction of the External Balance Assessment (EBA) methodology and the pilot External Sector Report (ESR) are facilitating the transition to a more robust framework that includes a wider range of indicators (Box 1). However, too often the judgment about how these inputs contribute to the overall external assessment is not explained well. For example, reports do not explain why different quantitative methods give different results or how staff uses other indicators to arrive at its bottom line assessment. Reports also still regularly express the assessment narrowly (e.g., in terms of the exchange rate) rather than in terms of a broad overall assessment, despite the use of broader indicators. Importantly, external assessments are not well integrated in policy discussions and even reports for EBA countries do not yet effectively use the resulting policy gaps in providing policy advice.

Box 1. Evolution of Methods for External Sector Assessment

Approaches to external assessments have evolved since the 2011 TSR. The emphasis on better assessing external stability led to revised guidance on the coverage and integration of external assessments, the development of the External Balances Assessment (EBA), and publication of the Pilot External Sector Reports. With respect to methods:

- **CGER**: At the time of the 2011 TSR, the main approaches to obtaining quantitative estimates for external assessments were three methods from the Consultative Group on Exchange Rate issues (CGER). These three approaches used economic fundamentals or balance sheet relationships to estimate current account and exchange rate norms. Deviations from these norms were interpreted as misalignments.[1] Using these methods, the IMF's Research Department estimated multilaterally consistent CGER gaps for 54 economies. Gaps for other countries not included in CGER were estimated by country teams using "CGER-like" or country specific estimates.[2]

- **EBA**: The new EBA builds on CGER to address conceptual and methodological limitations in CGER. It covers 50 large AMs and EMs.[3] The three CGER methods were improved by expanding the number of explanatory variables and decomposing external gaps into those arising from domestic and foreign policy gaps and a residual. Currently, teams for non-EBA countries continue to use "CGER-like" estimates.

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[1] See Jaewoo Lee et al, *Exchange Rate Assessments: CGER Methodologies*. IMF Occasional paper No. 261. Washington, D. C., 2008.
[2] "CGER-like" estimates took the coefficients from CGER and country data to estimate current account and exchange rate gaps.
[3] Compared to the CGER, the EBA adds 4 countries and the euro area, and drops 9 countries (Algeria, Venezuela, Croatia, Slovak Republic, Slovenia, Hong Kong, Luxembourg, Singapore, and Taiwan Province of China).

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28.   Nearly all staff reports (96 percent) contain an external sector assessment that includes quantitative estimates based on methodologies from either the EBA or its precursor from the Consultative Group on Exchange Rate issues (CGER).

- Progress toward including EBA methodology has been satisfactory. In EBA countries, 80 percent of reports present EBA approaches—current account (CA), equilibrium real exchange rate (ERER), and external sustainability (ES). However, given this is a transitional period, EBA and CGER

coexisted for part of the time as the former was being developed. Accordingly, reports for EBA countries often also present CGER methods (50-60 percent of reports). These rates were similar across AMs and EMs. A striking issue is that, despite the availability of EBA estimates, reports for EBA countries are less likely to present quantitative estimates than reports for non-EBA countries.

- For non-EBA countries, the use of CGER (or CGER-like) estimates was higher, ranging between 80-95 percent for each of the three approaches. Among this group, AMs are slightly more likely than EMs and LICs to report CGER results.

EBA &CGER - Exchange Rate Assessments by Method (percent) — EBA Countries / Non-EBA Countries

EBA & CGER Countries - Total Number of Methods Used (percent) — EBA Countries / Non-EBA Countries

29.   However, reports are often selective in the approaches they apply and staff does not explain these choices well.

- Different choices in the approaches used raise questions of consistency. A substantial share of reports (almost a third of reports for EBA countries and over 20 percent of reports for non-EBA countries) do not include all three approaches. Only around 20 percent of reports account for the choice of approach or explain why other approaches are omitted. Two reports in the sample do not provide any quantitative estimates.[8]

- However, staff adjusts quantitative estimates, tailoring them to country-specific circumstances in about a quarter of reports (e.g., excluding FDI-related imports or accounting for the temporary nature of resource revenues), although there is scope to better explain adjustments in some cases. Adjustments are most common for resource-rich countries (half of the reports, although reports for EMs are almost twice as likely to do this as LICs).

- There are also differences resulting from the introduction of EBA. Almost two-thirds of EBA countries use both EBA and CGER methods, and the remainder use only EBA methods. While partly due to the transitional period, the choice to use one or both methods is not clear, raising questions about the consistency of approach. There is also a difference between EBA and
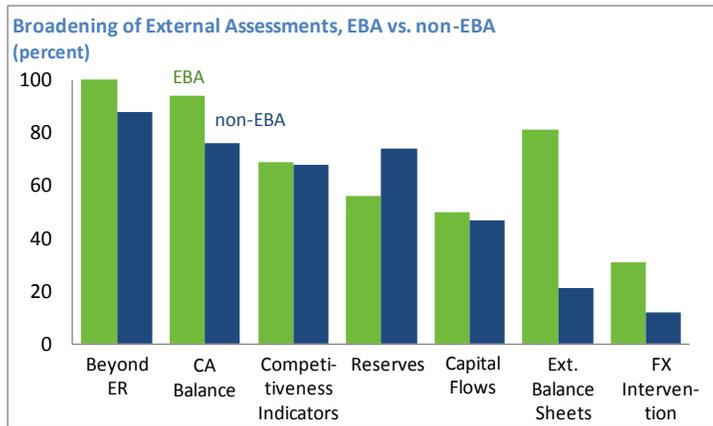
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[8] One report is for a LIC subject to data limitations. The other is for an AM for which EBA estimates are available and it is not clear why the report does not provide these quantitative estimates.

non-EBA estimates, but those different methods for quantitative assessments may be unavoidable until EBA methods are available for a larger group of countries.

30.   External assessments now incorporate a broader range of indicators, but the choice of indicators is not always explained clearly or does not always appear to cover the issues most relevant for a country.

• Almost all reports (94 percent) include some indicators that go beyond exchange rates. All but one EBA report and 85 percent of non-EBA reports provide a broader set of indicators. The remaining reports (all for LICs) report CGER estimates only.
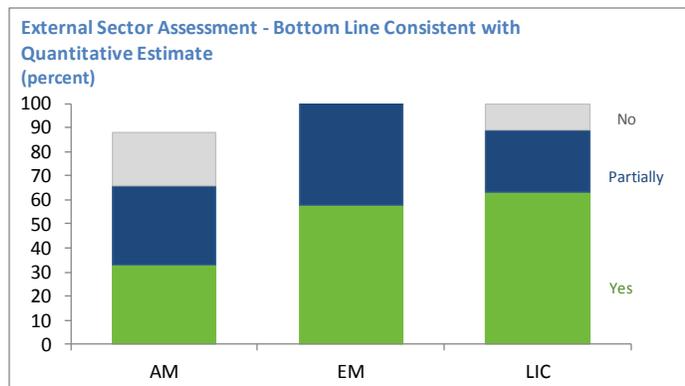
• The indicators most likely to be reported are the current account (82 percent of reports), competitiveness and international reserves (both 68 percent), capital flows (48 percent), and external balance sheets (40 percent). On average, fewer reports discuss foreign exchange intervention (18 percent).[9]

Broadening of External Assessments, EBA vs. non-EBA (percent)

• Despite staff guidance to discuss all relevant indicators, many reports appear not to discuss significant aspects of a country's external position. For example, capital flows appear relevant to most EMs, but are discussed in only 60 percent of EM reports. Similarly, even in countries with managed exchange rates, fewer than 18 percent of reports examine foreign exchange intervention.

31.   Almost all reports (94 percent) provide a clear bottom line assessment, although different approaches often point to different results, and differences between the assessment and the quantitative results are too often not explained.

External Sector Assessment - Bottom Line Consistent with Quantitative Estimate (percent)

• Three reports provide no clear bottom line on the member's external position. Two reports—one AM and one EM—omit a bottom line

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[9] These numbers should be interpreted with caution. Capital flows may not be an important issue for some countries and balance sheet data are lacking for many others. For example, both these issues are less likely to be discussed in reports for LICs that generally have less access to international capital markets and lack IIP data. Similarly, AMs that are part of the Euro Area do not have separate reserves, and reserves are generally considered less important for reserve currencies and countries with freely floating exchange rates.
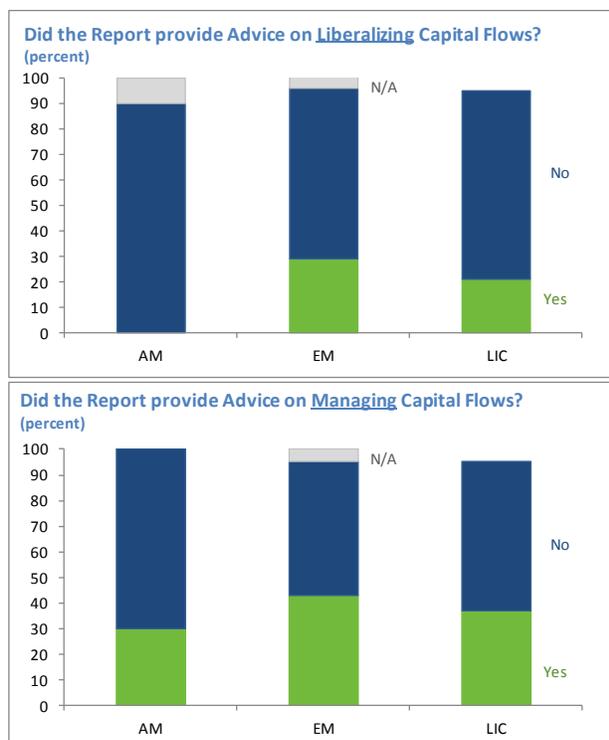
altogether. Another AM report indicates that it is not possible to make a judgment as the estimates are uncertain.

- Reports rarely explain why quantitative estimates differ across methods. The three approaches (under either EBA or CGER) produce divergent results in almost 80 percent of reports and, of these, half do not explain or account for the differences. This share is higher for AMs, where over 60 percent of reports do not explain differences. Also, in half the reports for EBA countries, the EBA and CGER estimates point in different directions. Yet only two reports explicitly discuss why this might be the case.

- Just over half the reports (55 percent) present a bottom line assessment that is fully consistent with the quantitative estimates. This share is even smaller for AMs (around 33 percent). While there might be good reasons for differences (e.g., consideration of trends, other indicators), only half of these reports provide a clear justification of the differences.

Box 2. Institutional View on Capital Flows

The liberalization or management of capital flows is discussed in almost half the reports, underlining the importance of greater inclusion in external assessments.

- The *liberalization of capital flows* is discussed in about 25 percent of reports for EMs and LICs.[1] Of these reports, 80 percent discuss sequencing, and appropriate financial sector regulation and supervision. About 60 percent also discuss the role of institutions.

- The *management of capital flows* is discussed in 30 percent of reports for AMs, 43 percent for EMs, and 37 percent for LICs. Of these reports, 94 percent discuss the role of macroeconomic policies and about 60 percent discuss appropriate financial sector supervision and regulation. Surprisingly, only 17 percent discuss the use of capital flow management measures. However, reports that discuss liberalization and management of capital flows often touch on these policies only briefly, suggesting scope for deeper policy analysis and advice.

Did the Report provide Advice on Liberalizing Capital Flows? (percent)

Did the Report provide Advice on Managing Capital Flows? (percent)

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[1] No reports for AMs discuss liberalization, likely because most AMs have already liberalized capital flows.

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32.   Despite broadening external assessments to encompass other indicators, reports often still present the external sector assessment narrowly in terms of the exchange rate rather than as a broader overall assessment. About 50 percent of the reports express the bottom line in terms of exchange rate over- or undervaluation rather than in terms of the external position. Even for

countries that are part of the Pilot ESR, which is oriented toward assessing countries' overall external positions, half the reports present the bottom line in terms of an exchange rate assessment. Another 14 percent of reports describe the bottom line in terms of both exchange rates and the current account, including some instances where the exchange rate and current account assessments provide divergent results and are not explained. In this regard, it is not clear whether the wider range of indicators (¶31) is being used meaningfully to support a more comprehensive assessment.

33.   There is also scope to provide more comprehensive external assessments in currency unions, including by better explaining how the members affect the union as a whole and vice versa. Two of the three currency union reports in the sample use quantitative analysis to provide a clear bottom line of the external stability of the union. However, none of the reports discuss how the external positions of individual members affect the external stability of the union as a whole. At the same time, external assessments for individual members do not analyze the suitability of the union's exchange rate for their country, nor do they refer to the external assessment for the union.

34.   External sector assessments are not often used effectively to offer policy advice, even where the assessment identifies an imbalance. Many reports do not provide policy recommendations to address external imbalances. For example, for countries whose external positions are assessed to be stronger or weaker than suggested by fundamentals and desired policies, on average 15 percent of reports do not provide specific policy recommendations. This share is even higher for EBA countries and—around 60 percent and 30 percent, respectively. Another area of concern is that reports for EBA countries are not reporting policy gaps. One of the significant improvements of EBA compared to CGER is that it calculates policy gaps (e.g., fiscal, social spending, capital controls, change in reserves, and credit) that contribute to external imbalances and can distinguish between gaps arising from domestic and foreign policies. These estimated policy gaps can be used to identify policies that may need adjustment. However, only one of the 16 EBA reports presents the estimated policy gaps.

Bottom Line Assessment of External Position Relative to Fundamentals and Desired Policies (by Income Group) (percent)

Bottom Line Assessment of External Position Relative to Fundamentals and Desired Policies (for EBA and non-EBA countries) (percent)

35.   Further effort is needed to integrate external sector assessments with discussion of other polices.

- Only 40 percent of reports fully integrate external issues in the policy discussion in the main text. The remaining reports tend to treat the external assessment as a separate exercise (e.g., an

annex or box). In these reports, the staff appraisal may discuss the exchange rate or external position but in a separate paragraph without significant reference to other policies.

- On average, less than half of reports clearly discuss how other policies (e.g., fiscal, monetary, or structural) could support external stability. While no group was particularly effective in presenting a well-integrated external assessment, reports for EMs and LICs appear somewhat better integrated than reports for AMs. Surprisingly, countries that are expected to provide an integrated discussion as part of the Pilot ESR do no better than the average.

EXTERNAL ASSESSMENTS—GOOD PRACTICE EXAMPLES:

Clear and comprehensive assessment—Morocco: *The report presents a clear bottom line and policy advice, backed by a broad assessment (covering the reserve level and changes, REER, ULC, IIP, debt, EBA, ease of doing business, structural issues, bond issuance).*

Good use of non-exchange rate indicators—Cameroon: *The report includes an appendix that assesses external competitiveness using alternative indicators of the price competitiveness of domestically produced goods as well as survey measures from the World Bank and World Economic Forum.*

Comprehensive and well-integrated assessment—El Salvador: *The external assessment is integrated in the main text as part of the broader examination of risks. This draws on analysis in an annex that covers an exhaustive range of issues, including CGER methods, export performance, remittances, the business environment, capital flows, reserve adequacy, and external assets and liabilities.*

Effectively uses policy advice—Algeria: *The report places external sustainability in the broader context of overall macrostability and uses the external assessment to support policy advice with regard to the mix of exchange rate, fiscal, and monetary policies.*
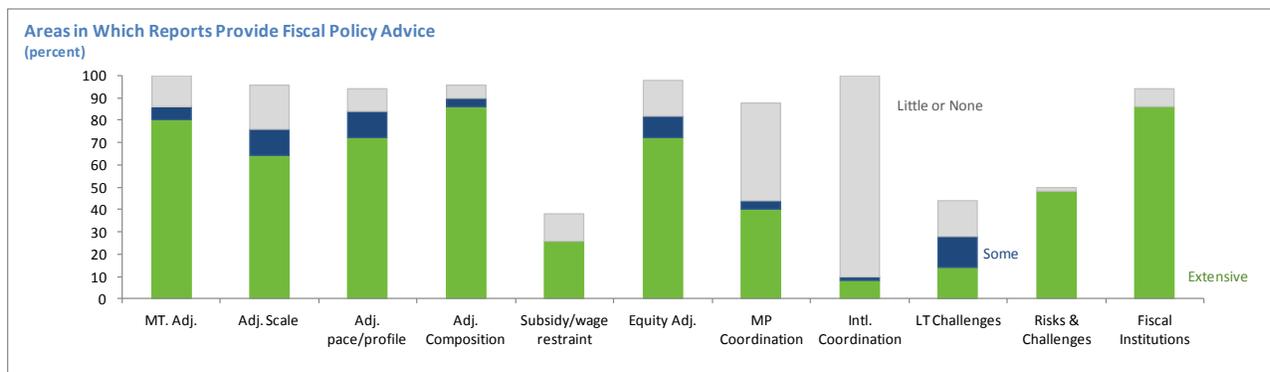

E.   Fiscal Policy

36.   In response to the dual challenges of high public debt and protracted low growth, the Fund has called for a more balanced approach to fiscal adjustment.[10] All reports in the sample contain extensive analysis and advice on fiscal policy and fiscal adjustment was generally well integrated with the policy recommendations. However, the specificity and comprehensiveness of fiscal advice varies across reports. In some cases this reflects tailoring to country circumstances, yet it also suggests scope to communicate more clearly the analysis supporting policy advice.

- While a significant majority of reports (76 percent) set out a **medium-term plan for fiscal adjustment**, a sizeable share does not. Moreover, around half the reports do not provide a clear **anchor for fiscal adjustment**. In around a third of reports, fiscal advice is guided by a **medium-term target**, specifying either an annual percentage point adjustment or a target to be achieved over 3-5 years. Another 22 percent of reports used a **structural or cyclically-adjusted balance** as the policy anchor.

- **Different indicators** are used in different groups. The use of structural fiscal targets is higher for AMs (50 percent), relative to EMs (25 percent) and LICs (5 percent). While this might reflect the

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[10] For example, see *Ten Commandments for Fiscal Adjustment in Advanced Economies* by Olivier Blanchard and Carlo Cottarelli (2010)

authorities' preference for simpler deficit measures, the distribution among country groups suggests that it also relates to data limitations or the feasibility of cyclical adjustments. Reports for LICs and program countries are more likely to present medium-term fiscal targets. (The conditionality for IMF-supported programs generally includes a fiscal target.)

- There is relatively limited coverage of **long-term fiscal challenges**—such as pension reforms, social security, health care, or aging. Only 14 percent of reports discuss longer-term issues in detail, while another 14 percent provide more limited analysis. Coverage is somewhat higher for AMs, possibly reflecting analysis more tailored to countries' needs. For example, pension and social security issues are discussed in 70 percent of AM reports compared to a quarter of LIC reports. Around half of all reports discuss other long-term fiscal risks, which may reflect risks arising from age-related spending.

- The vast majority of reports (86 percent) address the **composition of tax and expenditure measures**, possibly reflecting the increased attention to the impact of fiscal measures on growth. A similar share of reports across all country groups put emphasis on the **equity of fiscal adjustment** (over 80 percent), including measures to mitigate the impact of adjustment on the poor).

Areas in Which Reports Provide Fiscal Policy Advice (percent)

FISCAL POLICY—GOOD PRACTICE EXAMPLES:

Clear and concrete fiscal anchor—Montenegro: *The report articulates clearly a specific fiscal anchor, proposing a quantified, phased and time-bound public debt target.*
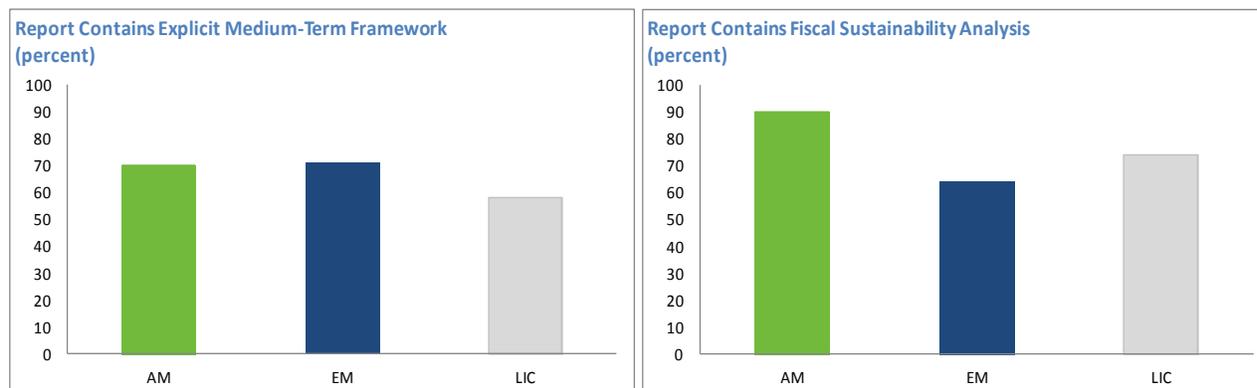
Justification for the use of an anchor—Belgium: *The report emphasizes the merits of anchoring policies on a structural target, so as to reduce reliance on one-off measures and allow more predictable policies.*

Composition of adjustment based on equity considerations—Colombia: *The report discusses the impact of the tax and pensions system on inequality.*

F. Growth and Structural Reforms

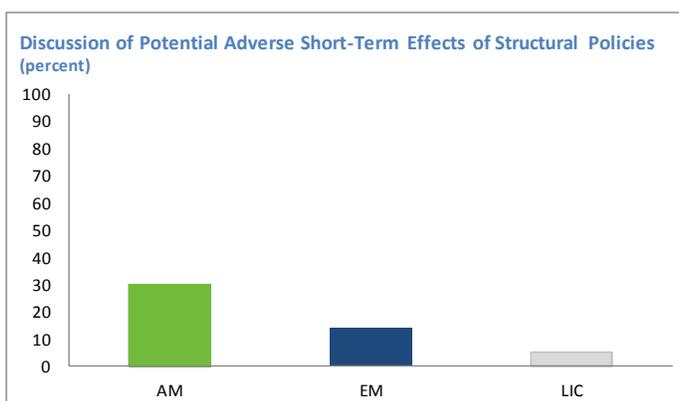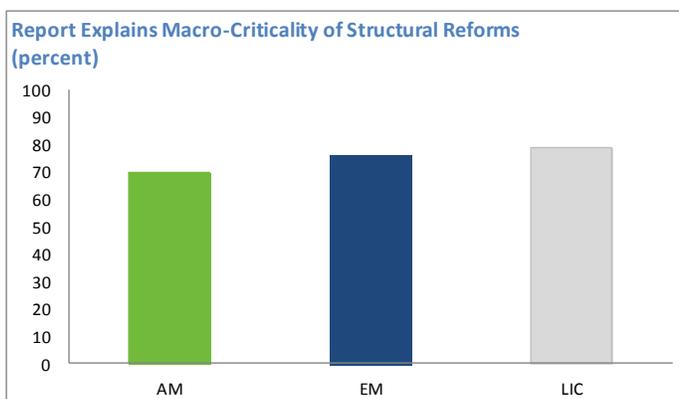**37.   The majority of reports explicitly discuss the medium-term macroeconomic framework and sustainability.** However, assessments of sustainability focus mostly on fiscal sustainability (80 percent), with fewer reports analyzing external or financial sustainability. Sustainable growth is, on average, discussed extensively in 65 percent of reports, yet it receives little or no attention in

AMs (30 percent). European countries in the sample are the exception, registering the highest share of extensive analysis of growth issues (90 percent).

Report Contains Explicit Medium-Term Framework (percent)

Report Contains Fiscal Sustainability Analysis (percent)

38.   While growth and structural reforms are receiving more attention in Article IV reports, deeper analysis in these areas could boost the impact of the Fund's policy advice.

- Most reports include an extensive discussion of country-specific structural issues and the macro-criticality of reforms (65-80 percent). In most cases, this is motivated by medium-term macroeconomic stability and the need to enhance growth (around 90 percent; somewhat more for EMs and LICs, and less for AMs). External stability is also a motivating factor in about half the EM reports.

Report Explains Macro-Criticality of Structural Reforms (percent)

- The Fund's advice regarding structural policies is related to fiscal and financial reforms in more than 70 percent of reports (or over 80 percent for LICs). Around two thirds of reports also discuss reforms linked to competitiveness, often related to infrastructure investment or the business climate. Labor market reforms are discussed in 70 percent of reports for AMs and EMs (20 percent for LICs), covering a wide array of issues ranging from job training and education, to social protection, to skill mismatches and labor mobility.

Discussion of Potential Adverse Short-Term Effects of Structural Policies (percent)

- In almost 90 percent of reports, the advice on structural policies is supported by evidence. However, only around half the reports provide concrete evidence, such as cross-country analysis

or case studies. The advice of other agencies (e.g., OECD, ILO, or World Bank) is rarely mentioned in support of structural reforms.[11]

- Only about 20 percent of reports discuss in detail the possible adverse short-term effects of structural reforms and only 14 percent of reports include policy advice to address these issues.

GROWTH AND STRUCTURAL REFORMS—GOOD PRACTICE EXAMPLES:

Macro-critical and country-specific justification—Vietnam: *Noting the predominance of state-owned enterprises in many key economic sectors, the analysis focuses on reforms of the state sector to contain fiscal risks, reduce vulnerabilities, and boost productivity and growth.*

Analytical backing for structural advice—Cameroon: *An appendix to the report has a comprehensive and in-depth analysis of fuel subsidy reform based on Cameroon's subsidy system as well as a cross-country analysis of alternatives. It also provides simulations of the impact of staff advice under different scenarios.*

Analytical backing for structural advice—Algeria: *An appendix presents simulation results on the employment content of growth to make a case for labor market reforms and measures to boost non-hydrocarbon growth.*

Balancing short- and medium-term considerations—Botswana: *The report identifies the short-run impact (reduction of social programs) of the medium-term goal of reducing the non-mineral primary deficit.*

Dealing with demographic pressures—Saudi Arabia: *The report identifies the rapidly growing and young population as a key policy challenge. It examines measures to boost inclusive growth, and labor market policies aimed at raising private sector employment by improving skills and investing in education.*

CONSISTENCY AND INTEGRATION

For Fund surveillance to be most effective, it is critical that its analysis and policy advice offered to each country is internally consistent. The review did not identify any systematic gaps in the internal consistency of the Fund's policy advice to individual countries. However, a more holistic and integrated approach—that focuses more on connections across sectors, the coordination of policies, and consistency of policy advice over time—could strengthen further Fund surveillance.

Consistency can also be viewed from a broader perspective—that the Fund's policy advice should be cohesive across all levels of surveillance. In this regard, concerted efforts to integrate bilateral and multilateral surveillance, including initiatives since the 2011 TSR, have helped reinforce the consistency and rigor of the Fund's policy advice across countries. However, there are opportunities for the Fund to build on this progress. For instance, there is scope to better integrate institution-wide risk and vulnerability analyses into the different levels of surveillance. As the Fund's thinking on emerging policy issues evolves at an institutional level, further experience with new approaches should improve the consistency of analysis and advice. Importantly, efforts to better integrate Fund surveillance have not compromised the focus on country specific issues.

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[11] While the Fund has sought to engage other international organizations to improve its policy advice on growth and structural issues, this is most often done at an institutional level rather than a regular part of dialogue with countries.

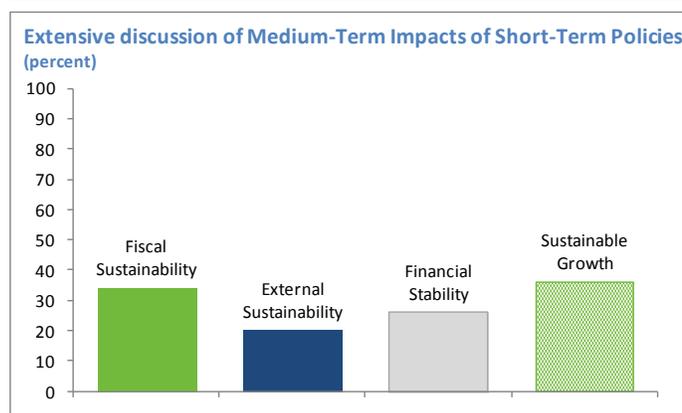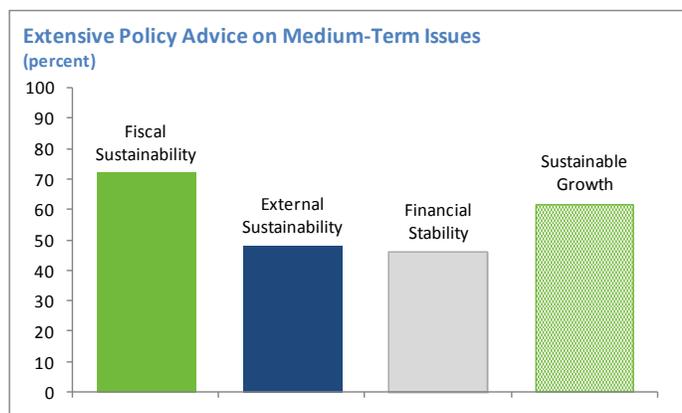## A.   The Internal Consistency and Cohesion of Surveillance

Policy Mix and Inter-Sectoral Links

39.   Only half of the reports explicitly discuss the policy mix and one third do not discuss it at all. Often reports imply a policy mix by listing a set of policy recommendations rather than providing an integrated discussion. Where the policy mix is discussed explicitly, it includes fiscal and monetary policies in more than half of the cases, and financial, external, and structural policies only in about 30 percent of the cases. Moreover, the coverage of external and structural issues in the policy mix varies significantly across country groups, with AMs being the outlier (11 percent).

40.   However, there is scope to improve the analysis of connections across sectors. Reports tend to discuss each sector or issue (risk assessment, monetary, fiscal, external, financial, structural reforms) individually, without systematically making linkages across sectors. For instance, fewer than half the reports include an extensive discussion of inward spillovers and risks as part of policy discussions. Similarly, only about a third of reports give extensive coverage to macro-financial links, while they rarely provide a more holistic inter-sectoral analysis that also covers fiscal-financial linkages (8 percent)—and this is almost entirely limited to reports for AMs. Also, around 44 percent of reports still treat external assessments as discrete exercises.

41.   There also appears to be scope to provide more explanation of the coordination of policies and the implications for policy advice. Fiscal analysis is, for example, relatively well integrated into the broader policy discussions, yet fewer than half the reports discuss clearly the coordination of fiscal and monetary policies. Also, although most reports cover medium-term sustainability issues (see above), they are not always used as extensively in justifying policy advice—fiscal sustainability and sustainable growth are used to support policy advice in 70 percent and 60 percent of reports, respectively; external and financial sustainability issues are used in less than half the reports. There is, however, a sense that staff reports based on a thematic presentation of policy challenges do a better job of presenting a more integrated and cohesive policy discussion.

42.   The relationship—or possible tensions—between short- and long-term policies could also receive

Extensive Policy Advice on Medium-Term Issues
(percent)

Fiscal Sustainability · External Sustainability · Financial Stability · Sustainable Growth

Extensive discussion of Medium-Term Impacts of Short-Term Policies
(percent)

Fiscal Sustainability · External Sustainability · Financial Stability · Sustainable Growth

more attention. For example, there is little or no discussion of the medium-term effects of short-term policies in around half the reports. Similarly, the trade-off between fiscal sustainability and growth is not often discussed, although this is somewhat more common in reports for AMs (about half) than for EMs or LICs (about one-third).
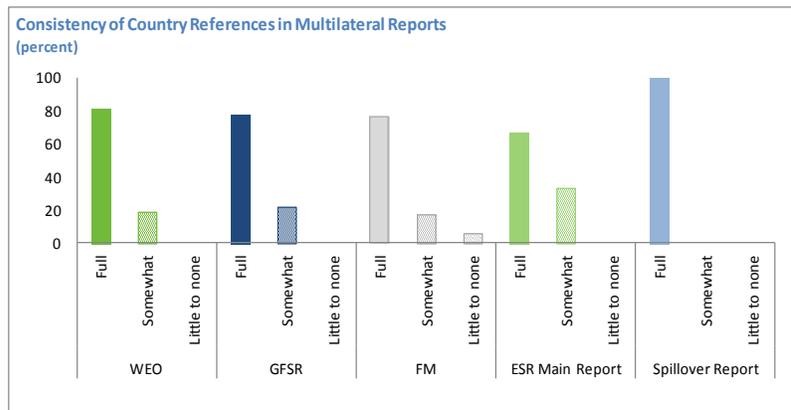
Time Consistency

43.   **Time consistency does not suggest that policy advice should remain unchanged from year to year, but there is scope to better explain shifts in Fund advice in response to changed circumstances**. While staff is encouraged to discuss the authorities' response to past Fund advice, it is rare for reports to reflect on the appropriateness of staff's earlier advice or mention country authorities' success in policies not advised by the Fund. In the sample, very few reports (16 percent) mention the need to change policies due to changed circumstances since the last report. Moreover, only one report sets out in detail the rationale for a shift in Fund policy advice in addition to the typical supporting analysis.

B. Integrated Surveillance

Consistency of Bilateral and Multilateral Surveillance

44.   **The review did not reveal any systematic inconsistencies between the Fund's bilateral and multilateral policy advice.**
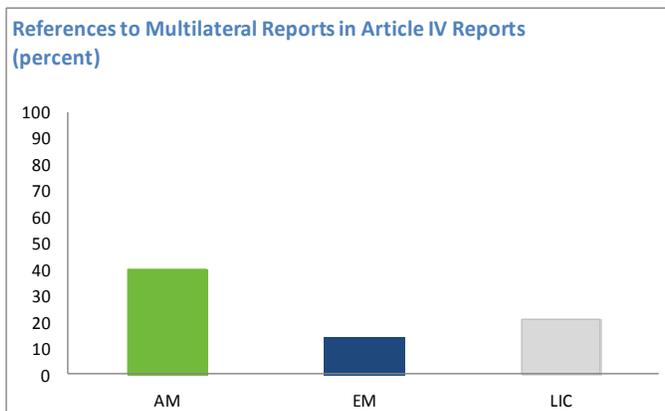The language in multilateral products is often necessarily more general than the degree of specificity in bilateral surveillance. Moreover, in virtually all cases— 90 percent or more—across all major multilateral products, the policy advice is broadly consistent. The Fund's flagship publications have

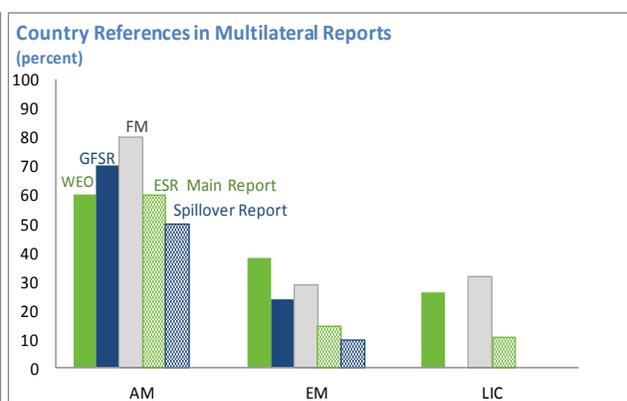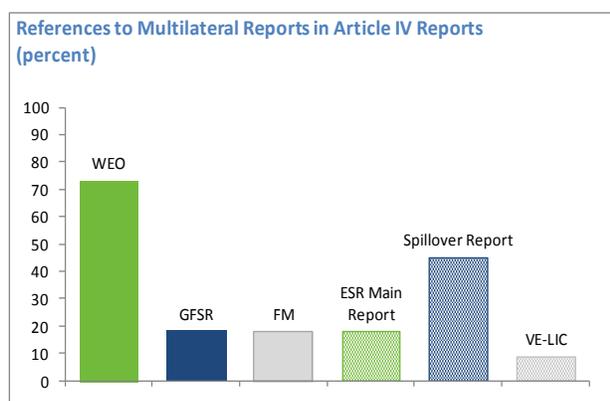Consistency of Country References in Multilateral Reports
(percent)

well-established procedures to ensure consistency. For instance, the WEO forecasting and review processes ensure a degree of consistency. Typically, country teams also have an opportunity to comment on drafts of multilateral reports and to correct any inaccuracies. There are however occasional inconsistencies that, ideally, should be avoided. For example, the assessment of corporate health in one EM appears to vary between the pilot External Sector Report (high corporate leverage was creating vulnerabilities) and the Article IV report (healthy corporate balance sheets as a reason for resilience). Fortunately, such inconsistencies are rare and may reflect changes in staff's assessment between reports issued at different times.

45.   **Examining cross-references between multilateral and bilateral surveillance products also indicates broad consistency.** However, the use of multilateral analysis to inform and reinforce Article IV advice is not particularly common.

- On average, around 22 percent of Article IV reports refer to at least one of the multilateral products; reports for AMs are twice as likely to do so. While not required, in some cases staff's references to analysis within multilateral products (e.g., WEO downside scenario or GFSR analysis on corporate indebtedness) effectively supports bilateral policy advice.

References to Multilateral Reports in Article IV Reports
(percent)

- References in multilateral reports to individual countries are common, but focus on AMs. Virtually all AMs in the sample and around half the EMs and LICs were mentioned in at least one multilateral report. These references are broadly consistent with the relevant Article IV reports, although country references in multilateral reports tend to be fairly general. In the rare instances where consistency may be in question, this does not appear skewed towards one particular country group.

References to Multilateral Reports in Article IV Reports
(percent)

Country References in Multilateral Reports
(percent)

46.   New initiatives since the 2011 TSR have provided additional impetus toward deeper integration of bilateral and multilateral surveillance. These initiatives include new products such as Cluster Reports (which look at groups of economies and consider policies in an integrated way), as well as the Spillover Reports and Pilot External Sector Report (Pilot ESR). There is good consistency between external assessments in the Pilot ESRs and the Article IV reports for ESR countries—80 percent of reports are fully consistent and the remaining reports are partially consistent (although partial consistency could reflect differences in the level of detail or timing, rather than substantive differences). However, among the 20 percent partially consistent, there were more cases for AMs (40 percent) and EMs (10 percent). Cluster Reports have also improved consistency of analysis. For example, the German-Central European Supply Chain Cluster Report examines a number of regional issues that provide the basis for more consistent coverage of issues for two countries in the sample reviewed. The German Article IV report draws on the cluster analysis in discussing the regional impact of fiscal spillovers and German balance sheets. Similarly, the report

for the Slovak Republic builds on the cluster analysis with a box on Slovakia's integration into the regional and global supply chain and business cycle synchronization.

47.   In a similar vein, the concerted institutional effort to rethink macroeconomic policies seems to have helped reinforce consistency. In several policy areas where the Fund has been rethinking its policy approach—fiscal policy, capital flows, and macroprudential policies—the policy advice in the sample Article IV reports was assessed to be consistent with the Fund's institutional views. In cases where there were apparent differences, the policy advice was generally well justified and well articulated (e.g., the discussion of CFMs in the Brazil report). At the same time, consistency of bilateral surveillance can take time to gain momentum during the earlier stages of reorienting our multilateral policy advice. In traditional areas, such as fiscal policy, the advice is generally comprehensive and well substantiated, whereas the integration and depth of analysis of CFMs or macroprudential policies is gaining ground. For example, only around 20 percent of reports discuss broadly the relationship between macroprudential and other policies.

Integrating Risk and Vulnerability Assessments

48.   While there has been a significant investment in institution-wide risk and vulnerability exercises, there is scope to better integrate these assessments across different levels of surveillance.

- The coverage of risks varies across the different multilateral reports. The Fall 2013 round of multilateral and regional products identify around 17 broad risks, of which 8 are covered in 7 or more of the products (i.e., around half of the risks appear in half the reports). Some risks are covered comprehensively by virtually all multilateral products (e.g., risks from exit from unconventional monetary policy in the United States or protracted low growth in Europe), others are covered more selectively (e.g., incomplete global regulatory reform). The Global Policy Agenda, the Global Risk Assessment Matrix and flagship reports cover the risks most comprehensively. Targeted reports, like the Regional Economic Outlooks (REOs), are more selective in their coverage of risks. Each multilateral or regional report naturally focuses on the risks, and the aspects of those risks, that are most relevant to its respective mandate, audience, and objectives. However, discussion of key risks is sometimes buried in the reports rather than highlighted prominently (for example in the overview chapter). The consequent differences in the description and prominence of risks across reports can complicate interpretation and give the impression of inconsistency.
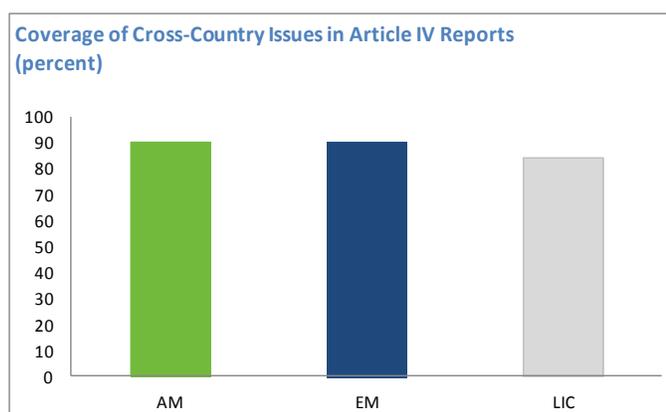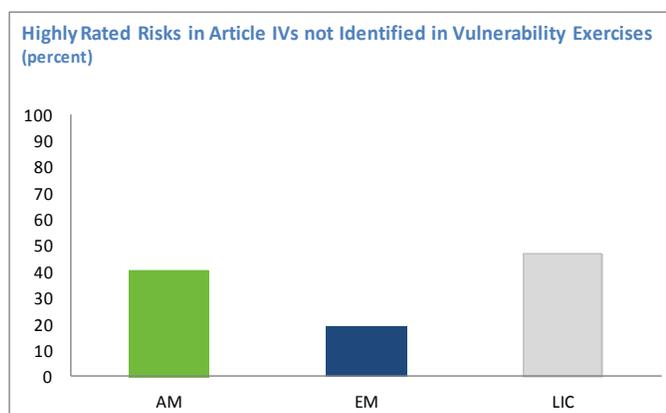
Source of Risk	Multilateral Reports 1/								REOs 1/				
	GPA	GRAM	FM	GFSR	WEO	Spillover Pilot Report	ESR	VE-LICs	AFR	APD*	EUR*	MCD	WHD*
World													
Global growth slowdown	■				■				■			■	
Global oil price shock (increase)		■			■				■			■	■
Sustained decline in commodity prices	■	■	■		■				■			■	
Incomplete global regulatory reform			■	■									
Geopolitical risks	■				■							■	
Advanced Economies													
Fiscal policy shock in the United States (e.g. debt ceiling)	■	■	■	■	■					■		■	■
Economic and financial volatility from UMP exit	■	■	■	■	■		■		■	■	■	■	■
Insufficient fiscal consolidation & structural reform in Japan	■	■	■	■	■					■			
Market stress in US or Japan due to lack of fiscal sustainability	■	■	■	■	■								
Financial stress in the euro area re-emerges	■	■	■	■	■						■		
Protracted period of slower European growth		■	■	■			■	■			■		
Distortions from UMP/low interest rates	■	■	■	■	■	■	■						
Emerging and developing economies													
Rapid credit growth and shadow banking in China	■		■	■	■								
Sharp growth slowdown in China		■	■		■	■				■			■
Lower than anticipated emerging market growth potential	■	■	■	■	■			■	■	■		■	■
Fiscal and financial vulnerabilities			■	■	■	■			■	■	■	■	
Security concerns or socio-political tensions	■				■			■	■			■	

1/ Fall 2013 editions used for all multilateral and regional reports, except for the Summer 2013 Spillover and Pilot External Sector reports.

* *Regional Economic Outlook (REO) Updates* for APD and WHD. EUR REO for Central, Eastern and Southeastern Europe only.

Check marks shaded in gray (■) tend to be less prominent or not presented in the main discussion of risks.

- Most vulnerabilities that are rated high in the Fund's cross-country vulnerability exercises are discussed in country reports. However, in around 18 percent of the sample countries there was little or no discussion of "high" vulnerabilities from the Fund-wide exercises. Moreover, coverage of risks from the Fund-wide vulnerability exercises was more extensive for AMs and EMs (100 percent and 83 percent, respectively) than for LICs (44 percent). The majority of high-rated vulnerabilities flagged in Article IV reports were fiscal and external, with fewer macro or financial risks, and significantly less attention to political risks (little or no coverage in 50 percent of reports even where they had been included in the Fund-wide exercise).

- There is also scope for more coverage of inward spillovers of other countries' policies as relevant. For example, one report in the sample cites possible spillovers from rebalancing in China to argue for policies in a neighboring

Highly Rated Risks in Article IVs not Identified in Vulnerability Exercises (percent)

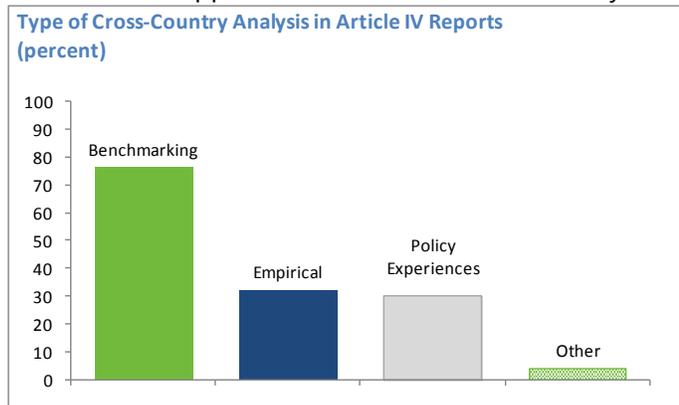**Coverage of Cross-Country Issues in Article IV Reports (percent)**

country to reduce vulnerabilities to an external shock. Deeper integration through more focus on spillovers from other countries' policies or through more cross-country analysis of policy lessons (discussed more below) is an avenue through which to bolster cross-country consistency. Also, there is scope for country reports to make more use of the scenarios in the G-RAM and Spillover Report.
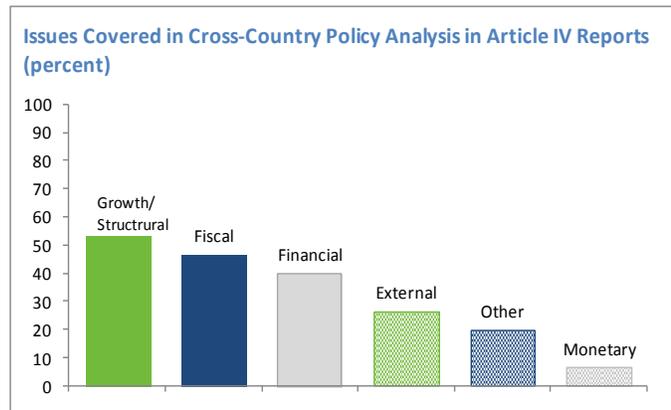
Cross-Country Analysis

49.   The vast majority of reports—around 90 percent across all country groups—include some form of cross-country analysis. The most common approach is to benchmark a country's performance against its peers based on a relatively straight-forward presentation of common indicators (nearly 80 percent of reports). The use of in-depth analysis of policy experiences or quantitative methods, such as panel regressions, is more limited (about one-third of reports). This suggests that there is scope to better integrate experiences across the Fund's membership both to add value to country-specific policy advice and to ensure greater consistency of policy advice across countries.

Type of Cross-Country Analysis in Article IV Reports (percent)

50.   The aspect of cross-country analysis where most could be gained is through greater discussion of policy lessons—what has and has not worked in developing an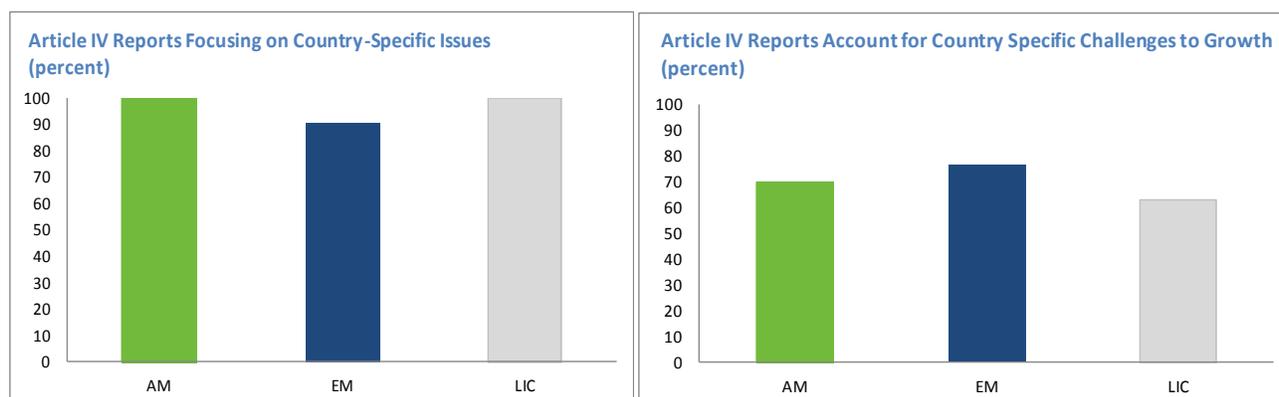d implementing similar policies in other countries. Although only around one-third of cross-country analyzes focus on policy experiences, they cover a variety of policy issues. Most often the focus is on growth or structural issues (around half), whereas experiences with fiscal policies (e.g., subsidy reform) or financial policies (e.g., bank restructuring) are examined less frequently (47 percent and 40 percent, respectively). External sector policy lessons (e.g., capital flow management measures) are least often discussed (less than one-third of reports). That said, there are variations in the depth of cross-country analysis of policy lessons.

Issues Covered in Cross-Country Policy Analysis in Article IV Reports (percent)

Balancing Integration and Country Tailoring

51.   Efforts to better integrate Fund surveillance do not appear to have compromised the focus on country-specific issues. The vast majority of reports identify—and provide strong rationale for—a limited number of issues as being important for the country in question (almost
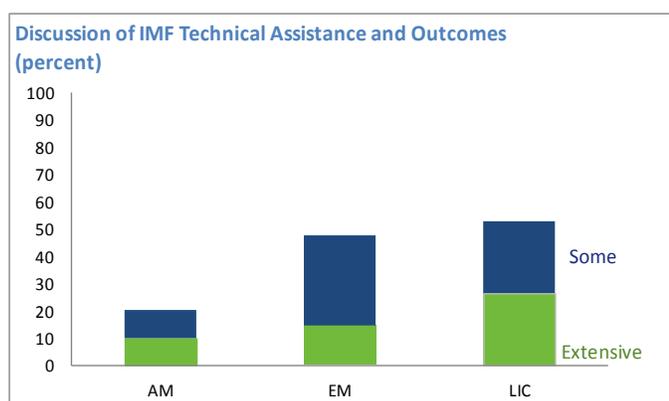
90 percent). There were no meaningful differences among country groups in the degree of country-tailoring of advice. Reports often balance well the coverage of country specific issues as well as covering the 2011 TSR priorities. For example, China's report examined environmental challenges and Swaziland's report looked at the impact of the high incidence of HIV/AIDs. Other topics of special interest included subsidy reform, natural resource management, and economic diversification.

Article IV Reports Focusing on Country-Specific Issues (percent)

Article IV Reports Account for Country Specific Challenges to Growth (percent)

52. **Indeed, some multilateral or cross-country products have helped to often reinforce country-tailoring.** Cluster reports, for example, have deepened analysis of country specific issues. In this regard, the Nordic Regional Report identifies common risks (e.g., household balance sheets, house prices, and regional financial sector integration) and offers coordinated policy advice (e.g., on macroprudential policies and cross-border financial cooperation). Sweden's Article IV report expands this to analyze the country-specific implications. In addition to the Fund's flagships and REOs, many other activities enhance the Fund's dialogue with and advice to country authorities. These include regional surveillance papers and specialized papers for particular audiences such as the G-20 or regional fora such as the Gulf Cooperation Council Ministerial meeting.

53. **There is, however, greater scope to support the specificity of advice through more integration of technical assistance (TA) where relevant.** Most Article IV reports do not benefit from or refer extensively to TA. While references to TA are skewed in line with provision of TA across the membership, in all cases the share of reports is still quite low—20 percent of AMs, almost half the EMs, and over 50 percent of LICs include some discussion of TA, and shares with more extensive discussion of TA is roughly half of this. In

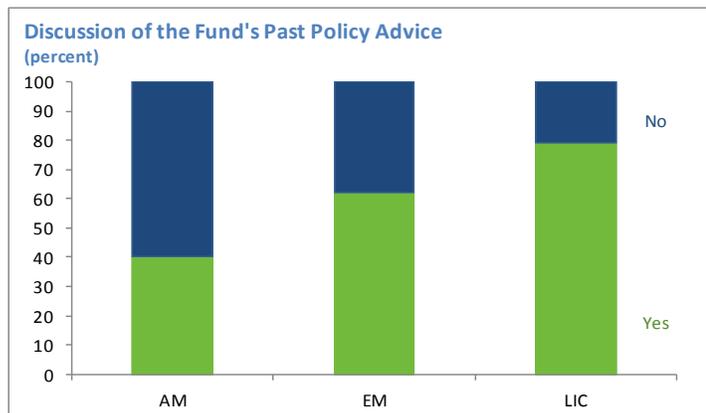**Discussion of IMF Technical Assistance and Outcomes (percent)**

keeping with this, TA outcomes are not well integrated in the policy advice in reports for all country groups, but particularly for AMs and EMs (only 10 percent). That said, these results may underestimate the extent to which staff implicitly incorporates TA into their policy advice without referencing the TA report directly.

EVENHANDEDNESS AND TRACTION

The focus, depth and consistency of the Fund's policy advice—issues covered thus far—are all essential ingredients for effective surveillance. However, the evenhandedness of the Fund's dialogue with member countries can be as important for its policy advice to gain traction. In practice, it is more feasible to assess the means by which to improve traction, rather than traction itself. In this regard, the review reveals some areas of progress as well as opportunities for further actions to promote traction.
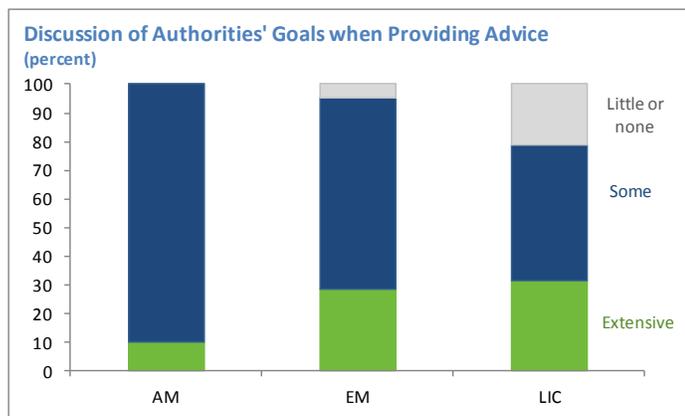
54.   The 2011 TSR recommended that Article IV reports discuss the implementation of previous policy advice as a means to better understand its impact. Just over half the reports in the sample discuss progress on past policy advice. However, coverage varies considerably with income level, with past policy advice discussed much less frequently in reports for AMs. Moreover, any differences of views between staff and country authorities are discussed even less frequently (only 14 percent of reports on average and marginally higher for AMs at 20 percent).

Discussion of the Fund's Past Policy Advice
(percent)

55.   While all reports refer to the authorities' views, the authorities' goals and the views of other stakeholders are much less likely to be presented, which can potentially detract from efforts to build greater traction.
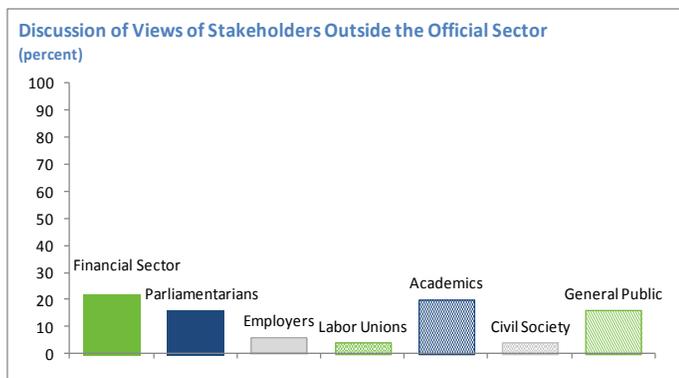
- For example, the policy analysis is not always anchored on the authorities' goals. While the vast majority of Article IV reports mention the authorities' goals (90 percent), these goals are much less likely to be discussed in any detail when giving policy advice (26 percent).

Discussion of Authorities' Goals when Providing Advice
(percent)

- Also, reports rarely present the views of stakeholders outside the official sector.[12] For example,
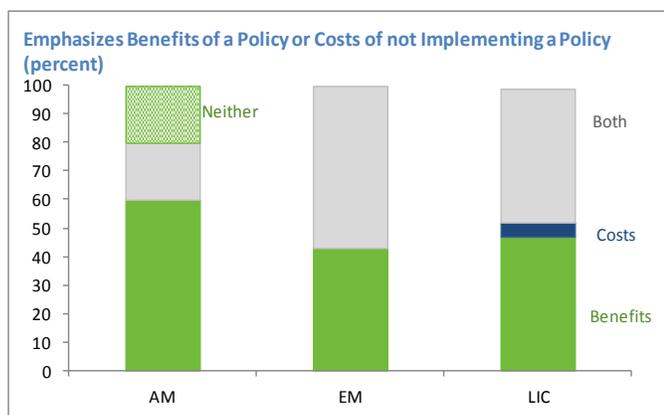
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[12] It is not clear whether this reflects lack of contact or lack or reporting.

the views of labor unions and civil society receive little or no coverage (4 percent), and even for those stakeholders whose views are somewhat better represented—financial sector, parliamentarians and academics—the degree of coverage is relatively low (around 20 percent).

Discussion of Views of Stakeholders Outside the Official Sector
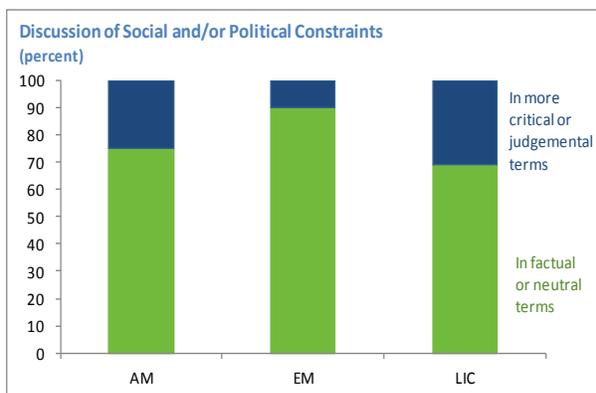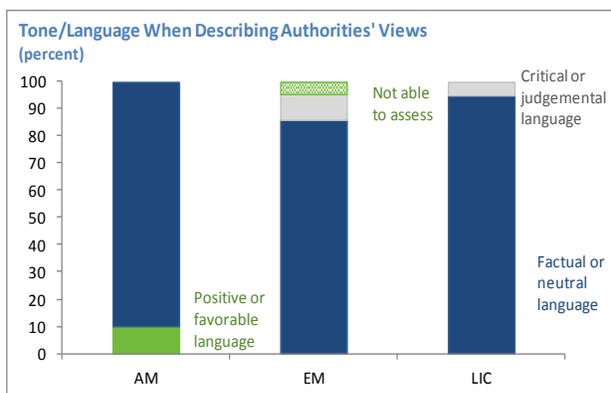(percent)

56.   The review did not find any systematic or sizeable differences in the tone or choice of wording in reports across countries. For example:
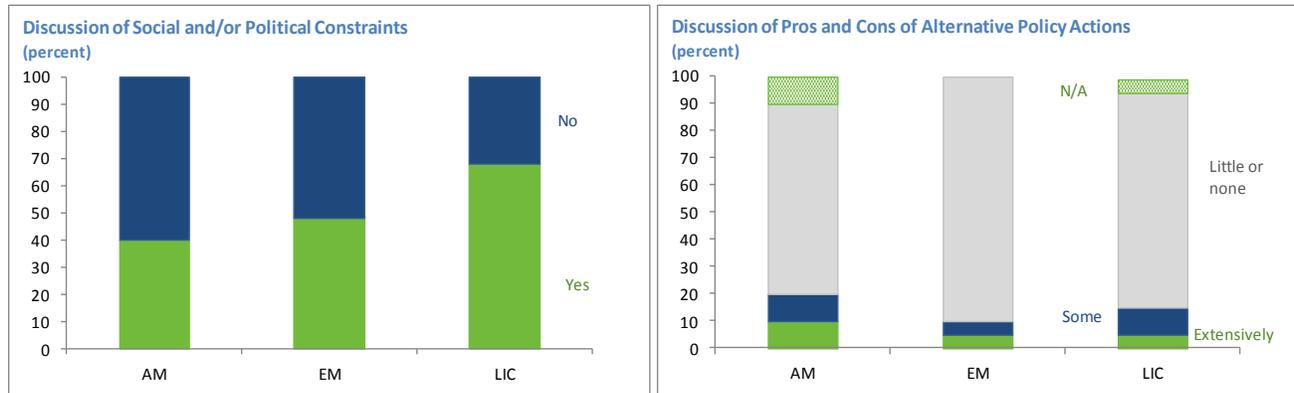
- Reports were assessed to determine whether staff emphasized the **benefits of their policy advice** or the costs of not implementing it (where focusing exclusively on the costs could be interpreted as a more 'lecturing' tone). Virtually no reports focus exclusively on the costs. Around half of the reports focus on the benefits, and the remainder have a balanced discussion of costs and benefits. There

Emphasizes Benefits of a Policy or Costs of not Implementing a Policy
(percent)

is however a tendency for AM reports to give slightly more emphasis to the benefits (60 percent compared to 43 percent in EMs and 47 percent in LICs).

- The language used to present the **authorities' views** is neutral in almost all reports (90 percent), with negligible variation among country groups. Similarly, where reports describe potential differences of view between staff and the authorities, there are virtually no differences in tone across country groups.

Tone/Language When Describing Authorities' Views
(percent)

Discussion of Social and/or Political Constraints
(percent)

57.   **Policy constraints and options are not often well articulated in Article IV reports.** One way for the Fund to gain traction is, where possible, to offer a range of policy options, which may be particularly helpful if the authorities face social or political constraints. On average, just over half of the reports in the sample mention such constraints, but this is less likely to be the case for AMs (40 percent) and more likely for LICs (68 percent). Moreover, only around half of these reports (or one quarter of the full sample) explicitly account for the political economy and social context in their policy advice. Also, most reports are unlikely to set out alternative or second best policy options, or to discuss the pros and cons of alternative policy options (fewer than 10 percent).

Discussion of Social and/or Political Constraints (percent)

Discussion of Pros and Cons of Alternative Policy Actions (percent)

EVENHANDEDNESS AND TRACTION—GOOD PRACTICE EXAMPLES:

Past policy advice—New Zealand: The report includes a matrix of advice from past Article IV reports and the authorities' policy actions.

Consideration of social issues and political constraints—Bahrain: The report discusses a range of social issues including: (i) promoting growth and employment, (ii) labor market reforms, (iii) social indicators, and (iv) governance. It is also candid about the impact of political tensions.

Annex. Sample of Article IV Reports for the Review

The review of Article IV reports was based on a stratified random sample of reports for 50 economies that were discussed by the IMF Executive Board during calendar year 2013.

The process of random selection was aimed at ensuring that the sample was as representative as possible of the Fund membership. In this regard, reports were grouped by income level and region, and were selected randomly within each category. This preliminary list was evaluated against a number of other characteristics, including program and non-program countries, systemic and non-systemic financial sectors, and G20 and non-G20 countries. Some economies were replaced by random selection within categories to improve the overall representativeness of the sample, including in some cases for economies with idiosyncratic or special characteristics that made them less representative (e.g., civil conflict). The sample also includes reports from currency unions.

Table A1 presents the economies whose reports are included in the sample. Table A2 compares the characteristics of the sample and IMF membership.

Table A1. Economies with Reports in the Article IV Sample

Advanced Market Economies	Emerging Market Economies	Low-Income Countries
Belgium	Algeria	Bangladesh
Euro Area	Bahrain	Cameroon
Germany	Belarus	Cote D'Ivoire
Greece	Botswana	Ethiopia
Hong Kong	Brazil	Gambia
New Zealand	Chile	Haiti
Slovak Republic	China	Mali
Sweden	Colombia	Mongolia
United Kingdom	ECCU	Mozambique
United States	El Salvador	Myanmar
	Georgia	Sierra Leone
	Guatemala	St. Lucia
	Hungary	Tajikistan
	Kazakhstan	Uganda
	Montenegro	Vanuatu
	Morocco	Vietnam
	Namibia	WAEMU
	Saudi Arabia	Yemen
	Serbia	Zambia
	Swaziland	
	Thailand	

Table A2. Characteristics of Sample Compared to the IMF Membership
(In percent)

INCOME GROUP	Sample	Membership
AE	20.0	18.5
EM	42.0	42.1
PGRT	38.0	39.5

SYSTEMIC FINANCIAL SYSTEMS	Sample	Membership
Systemic	16.0	8.7
Non-Systemic	84.0	91.3

REGION	Sample	Membership
AFR	26.0	25.1
APD	18.0	16.9
EUR	22.0	22.6
MCD	16.0	16.9
WHD	18.0	18.5

G-20 COUNTRIES	Sample	Membership
G-20	14.0	10.3
Non G-20	86.0	89.7

PROGRAM COUNTRY	Sample	Membership
Program	22.0	24.6
Non-Program	78.0	75.4

FRAGILE STATES	Sample	Membership
Fragile State	20.0	21.5
Non-Fragile State	80.0	78.5

EBA COUNTRIES	Sample	Membership
EBA	32.0	25.6
Non-EBA	68.0	74.4