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Statement by the Managing Director on
Fund Policies with Regard to Currency Stabilization Funds -
Preliminary Considerations
Executive Board Meeting
December 14, 1994

As discussed most recently in the context of the review of experience under stand-by and extended arrangements, a fixed exchange rate can be an effective component of an anti-inflationary strategy, provided that it is backed by sufficiently restrained fiscal and credit policies and supported by an adequate cushion of international reserves. In this connection, Executive Directors are aware of the interest of a number of member countries in possible Fund financing for currency stabilization funds (CSFs), which could, in certain circumstances, assist countries adopting a nominal exchange rate anchor in the context of a strong stabilization program.

With the aim of inviting an early reaction from the Board, as Directors have wished, a staff paper outlining preliminary considerations in this area is being issued today. Discussion of this paper will provide an opportunity for Executive Directors to comment on the possible contribution of CSFs, the role of the Fund in financing such operations, and aspects of Fund policies regarding CSFs. Although it is uncertain when it would be necessary to come to a view on such policies, Executive Directors' views will provide guidance to the staff for both the development of more specific proposals, if the Board considers that to be appropriate, and for continued discussions between the staff and member countries that have expressed interest in possible Fund-supported CSFs.

In discussing the staff paper, I would welcome Executive Directors' views on the following key points.

-- Fund financial support for CSFs would be limited to situations where a member adopts a fixed exchange rate as part of a comprehensive strategy to achieve macroeconomic stabilization quickly in the context of a Fund arrangement involving upper credit tranche conditionality. Such support would need to be available to all members in comparable circumstances, but it would be expected that Fund support for CSFs would be infrequent.

-- Credible and strong fiscal and credit policies would limit the need to draw on CSF resources especially if policies are framed with an eye toward encouraging the return of flight capital; where financing is

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provided, it would be for specified purposes, only for a short-period, and would not be a source of general balance of payments financing.

-- Fund support for CSFs would carry high risks particularly when the level of owned reserves is low and outstanding Fund credit is high. In such circumstances there would be a need to assure commensurate safeguards. For instance, there should be tranching of resources; Board approval of access to CSF resources; early repurchase provisions; close staff and Board monitoring of developments and policies; and appropriate and timely data-reporting.

-- Effective management and oversight of the operations of CSFs would require that the Board be prepared to take decisions on short notice, possibly without the benefit of consultation with national capitals, and on the basis of special streamlined procedures.

Finally, GAB participants will recall that in 1991 tentative agreement was reached on the possibility of GAB financing for CSF purposes in the case of the Russian ruble. I would now envisage that Fund support for CSFs would be provided from the Fund's ordinary resources. Following the increase in quotas in 1992, the current liquidity position of the Fund is strong, and I do not think it would be necessary to consider use of the GAB at this time. However, the recent increase in annual access limits together with the possible introduction of Fund financing for CSFs would add to the downward pressure on Fund liquidity. The GAB remains available in case of need and provided the appropriate conditions for use of GAB are met.