

SM/12/246
Revision 1
Correction 1

October 26, 2012

To: Members of the Executive Board

From: The Secretary

Subject: **Guidance Note for Article IV Consultations**

The attached corrections to SM/12/246, Rev. 1 (10/11/12) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 29, para. 41, first sentence:

for **"Staff reports are expected to cover intervention activities to the extent they are important for a member's balance of payments stability and global stability."**
read **"Staff reports are expected to cover intervention activities to the extent they are important for a member's balance of payments stability and/or global stability."**

Page 38, bullet on lapse of time procedure:

for **"(ii) policies or circumstances are unlikely to have significant regional or global impact;"**
read **"(ii) policies or circumstances are unlikely to have significant regional or global impact in the near term (i.e. within one year);"**

Questions may be referred to Ms. Koranchelian (ext. 38592) and Ms. Basu (ext. 35686) in SPR.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (2)

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Department Heads

gauge the level of reserves needed to cushion the impact of a sudden stop in capital flows and other extreme balance of payments shocks.³¹

41. Staff reports are expected to cover intervention activities to the extent they are important for a member's balance of payments stability and/or global stability. Where relevant, coverage would normally entail a description of past intervention episodes stating their objectives and analyzing their effectiveness, including whether they were coupled with sterilization. Intervention includes outright purchases/sales of foreign exchange or foreign exchange derivatives by the central bank, the ministry of finance, or others working on behalf of these.³² Staff should assess in particular whether there are protracted large-scale interventions in one direction in the exchange market.

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

Free Floaters, Currency Unions, and Dollarized Economies

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

44. Under a floating exchange rate regime, as in other regimes, the real exchange rate can be under- or overvalued. This may happen as a result of non-exchange rate policies, as a result of other countries' policies affecting the exchange rate of the country at issue, or because of market imperfections such as a bubble (which may burst in a disorderly way). Thus, even fully market-determined exchange rates can result in disruptive adjustments.

45. Currency unions. In currency unions, the real exchange rate and current account should be assessed both at the level of individual members and at the level of the union, and there should be an assessment of any vulnerabilities in individual members that may affect the stability of the union as a whole.

³¹ For additional information, see IMF [Assessing Reserve Adequacy](#). See also [Guidance Note for Fund Staff on the Treatment and Use of SDR Allocations](#) (paragraph 18 in particular).

³² See "Classification of Exchange Rate Arrangements".

- **At the level of the member.** Staff reports for individual members are expected to assess to what extent policies implemented at the level of the member are promoting the member's domestic balance of payments stability and contributing to the stability of the union as a whole. Reports should present an analysis of the country's real exchange rate and balance of payments. The discussion can be phrased in terms of external competitiveness or the real exchange rate, including whether the REER is over- or undervalued.
- Staff reports on individual members should not include statements suggesting that the *nominal* exchange rate is over- or undervalued (unless this is the case at the union level).
- If the real exchange rate of an individual member is found to be over- or undervalued, the staff report for that member should refer to whether the union exchange rate is considered to be over- or under-valued. This helps clarify why policy adjustment in the individual member is or is not recommended. If the misalignment at the member's level mirrors one at the union level, policy adjustment would be recommended at the union level. Otherwise, policy adjustment would be recommended at the level of the individual member.³³
- Significant vulnerabilities apparent at the level of the member should be flagged in both the report of the individual member and in the report of the currency union.
- **At the level of the union.** Union-level staff reports are expected to provide a clear bottom line assessment of whether policy frameworks are adequate, the extent to which exchange rate policies and other policies implemented at the level of the union (e.g., monetary policy, fiscal policy frameworks and financial sector policies) are contributing to the union's stability and should include a bottom line assessment of the real exchange rate level, and associated exchange rate policies.

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

47. Principles for the Guidance of Members' Exchange Rate Policies – For all members that implement exchange rate policies, Article IV missions should assess whether the member is observing the principles for the guidance of members' exchange rate policies set out in the ISD. These principles are described in Annex I.³⁴ However, staff reports for Article IV consultations are not expected to provide an explicit compliance assessment unless a member is found to be noncompliant.

³³ See also [paragraph 9](#) and [B. Consultations with Members of Currency Unions](#).

³⁴ More detailed guidance on the interpretation and application of the principles is available at [FAQs—Guiding Principles](#).

after the date of completion of the previous Article IV consultation. At the end of an FCL or a PLL arrangement that member will remain on the 12-month cycle, unless the Executive Board determined that a different cycle should apply (which could be done through an ad-hoc decision that the Board could consider on a lapse-of-time basis).

B. Consultations with Members of Currency Unions⁵⁰

65. Consultations for members of currency unions should comprise the following.⁵¹

- **Individual members.** The frequency of Article IV consultations for individual members is determined by individual country circumstances (e.g., whether or not they currently have a program or PSI in place).
- **Discussions with regional institutions.** Yearly staff discussions should be held with regional institutions responsible for common policies in the currency unions. The discussions are held separately from the discussions with the individual member countries of the currency unions, but are considered an integral part of the Article IV process for each member. These discussions focus on policies under the aegis of the regional institutions and, as relevant, other policies of regional importance.
- **Reports and summing ups at the union level.** An annual staff report on the discussions with the regional institutions is prepared followed by a Board discussion, which are both considered an integral part of the Article IV consultations with individual member countries. Each union level summing up should include language to the effect that the views expressed by Directors in that union level summing up will form part of their discussions in the context of the Article IV consultations for individual currency union members that take place before the next annual Board discussion for the currency union.
- **Informal reports at the union level.** A second round of staff discussion with the regional institutions and an informal report to the Board may be needed to provide adequate context for bilateral consultations with the currency union member countries that do not coincide broadly with the annual Board discussion on the currency union's policies.

C. Process and Documentation

66. The documentation requirements and review process for Article IV consultations are set out below. For more details on the latter, see “Combined Guidelines for the Review Process” on the review process website. Also see the working with eReview website for country review work.

- **Policy Note.** This note (3–4 pages, plus charts and tables) should be prepared ahead of the consultation to lay out the key diagnostics and proposed focus of the consultation and

⁵⁰ See also [Scope of Surveillance: Focus on Stability and Risks](#) and [paragraph 45](#).

⁵¹ See [Fund Surveillance Over Members of Currency Unions—Proposed Amendments to Existing Modalities](#) for background and further details.

policy advice. It should include background; macroeconomic outlook; policy line on key issues, including surveillance priorities; supportive charts and tables; and note any divergences of views among departments that arose from the policy consultation meeting (see below).

- **Policy Consultation Meeting.** This meeting between the area departments and reviewing departments should be held 2 to 3 weeks before the mission to discuss and agree on the content of the Policy Note, before it is sent to management for clearance.
- **Board discussion.** Article IV staff reports are expected to be discussed by the Executive Board within 65 days of the end of the discussions for countries other than PRGT-eligible members, and within three months for PRGT-eligible countries. These should be understood as outer limits as staff are expected to finalize staff reports as quickly as possible after the end of discussions with the authorities.

Staff report requirements. The [requirements](#) for staff reports are listed in [Annex II](#).

- **Background documentation.** Background documentation for Article IV staff reports may be produced, in the form of papers covering selected issues and statistical annexes, i.e. comprehensive sets of historical data tables. The choice of selected issues papers (SIPs) should be guided by their centrality to the discussion and each SIP should begin with a description of how the papers fit in the consultation discussions. There is scope to cut back from delving into issues that are not clearly at the core of the Fund's mandate and those solely on individual country issues (rather than with a cross-country perspective). Staff has great discretion on whether or not to produce comprehensive statistical annexes and is expected to make this decision in consultation with country authorities. Statistical annexes need not be produced when data are freely available from other sources, which is increasingly the case.
- **Summing Up.** With the exception of when Article IV reports are considered on a lapse-of-time basis (see below), the Executive Board's conclusion of an Article IV consultation will be reflected in a Chairman's Summing Up of the discussion, which will be communicated to the member concerned.
- **Lapse-of-time procedure.** The lapse-of-time (LOT) procedure will be proposed for Article IV consultations where the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact in the near term (i.e. within one year); (iii) in the event a parallel program review is being completed, it is also being completed on a LOT basis; and (iv) the use of Fund resources is not under discussion or anticipated. The LOT procedure should not be used when: (i) the last Article IV consultation was concluded on a LOT basis; (ii) more than 24 months have elapsed since Board discussion of an Article IV consultation; or (iii) the country is on a 24-month consultation cycle and has not been considered by the Executive Board under a program review in the preceding twelve months. On the basis of these eligibility criteria, the Managing Director, with the approval of the