BUFF/14/29

March 28, 2014

The Acting Chair's Summing Up
Conditionality in Evolving Monetary Policy Regimes
Executive Board Meeting 14/28
March 26, 2014

Executive Directors welcomed the discussion of monetary policy conditionality in countries with evolving monetary policy regimes. They saw merit in employing a review-based approach to monetary conditionality and broadly endorsed staff's proposal to enhance the existing framework by introducing a monetary policy consultation clause (MPCC) as an option for countries that have the capacity to adjust policy settings in a flexible way to achieve their monetary policy objectives.

Directors noted that many developing countries with scope for independent monetary policy are moving toward more flexible and forward-looking monetary policy frameworks, generally focused around the broad objective of achieving price stability. They observed that a weaker relationship between monetary aggregates and inflation implies a decline in the relevance of monetary aggregates as reliable indicators of the monetary stance in countries with low inflation, changing financial landscapes, and facing exogenous shocks. Moreover, the non-observances of reserve money targets in Fund-supported programs have typically not been correlated with inflation deviations in countries that have already achieved single-digit inflation levels.

Directors discussed the proposed enhancement of the review-based approach to monetary conditionality in Fund-supported programs in the form of the MPCC. Under this approach, the MPCC would be based on a specified central path for a target variable (i.e., monetary aggregate or inflation). This target variable would normally have a single tolerance band. It would be subject to periodic reviews in conjunction with general program reviews, and would include an enhanced monetary policy assessment in the context of a clearly defined monetary policy objective. A formal consultation with the Executive Board would be triggered if the observed outcome of the target variable deviates from the band, and access to Fund resources would be interrupted until the consultation with the Board takes place and the relevant program review is completed. In MPCC regimes selecting inflation as the target variable, a narrower inner band could be an option to serve as an early warning mechanism that would trigger a consultation with staff when the observed outcome of the target variable deviates from the inner band. In the event a consultation with the Executive Board is triggered, the staff report would include a comprehensive assessment of monetary policy explaining clearly the reasons behind the target deviations and proposing prompt remedial actions if deemed necessary.

Directors considered that the MPCC could enhance monetary policy conditionality in programs where countries have a strong track record of policy implementation, a relatively low and stable inflation rate, and adequate technical capacities. In this regard, Directors generally pointed to the importance of de facto central bank autonomy in monetary operations, macroeconomic and financial stability, and the capacity for quantitative analysis of the inflation process, for successful implementation of the flexible monetary policy framework under the MPCC. Directors underscored the importance of evenhanded application of the standard and urged staff to consider, on a case-by-case basis, whether it would be appropriate for a member to use the MPCC, noting that some countries may not currently meet all the institutional guideposts or have other characteristics that make the use of the MPCC premature. In the near term, relatively few arrangements are expected to adopt this new conditionality framework, but it is understood that staff will exercise flexibility in assessing individual cases. For some countries, the MPCC could be considered provided the program includes reforms to address capacity constraints and institutional weaknesses. Directors noted that the decision to implement the MPCC would be the outcome of discussions between staff and the authorities. They stressed that program design—including the features of the tolerance band—should take into account countries' characteristics. Some Directors cautioned that use of the MPCC should not imply a commitment to move toward inflation targeting.

Directors emphasized the importance of the proposed consultation clause in safeguarding the use of Fund resources. They were of the view that maintaining the floor on net international reserves as a performance criterion and, where warranted, indicative targets on indicators such as net domestic assets or net credit to government should provide sufficient safeguards for the use of Fund resources.

Directors considered that the traditional framework for monetary policy conditionality would continue to be relevant for many countries, including those with less-developed institutional frameworks and a track record of relatively high inflation. Nonetheless, the Fund should support developing countries that seek to modernize their conduct of monetary policy. Directors welcomed staff's efforts to build institutional capacity and enhance data provision and analysis in these countries.

Directors supported a measured approach by staff to the introduction of the MPCC in countries where conditions for successful implementation are broadly in place. The Operational Guidance Note on Conditionality will be updated to incorporate the enhancements of the review-based monetary conditionality framework discussed by the Executive Board today. Directors looked forward to taking stock of experience gained from selected countries implementing the new conditionality framework after sufficient experience has been gained.