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GUIDANCE NOTE FOR SURVEILLANCE UNDER ARTICLE IV CONSULTATIONS

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May 31, 2022

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EXECUTIVE SUMMARY

Fund surveillance continuously adapts to the evolving economic and financial landscape. The 2021 Comprehensive Surveillance Review laid out priorities for Fund surveillance, both in terms of content and modalities. Timely and topical policy advice is key to ensuring traction with Fund members. Fund surveillance will need to remain focused and selective, prioritizing issues and policies that are most relevant to member countries.

This note provides guidance to country teams for surveillance under Article IV consultations superseding the 2015 Guidance Note and its supplement.

- *Scope and requirements.* The note lays out the coverage of, and formal requirements for, Article IV consultations and staff reports. It also outlines best practices aimed at enhancing the traction of Fund analysis and policy advice.
- *Priorities and focus.* The 2021 Comprehensive Surveillance Review identified four surveillance priorities: (i) confronting risks and uncertainties, (ii) preempting and mitigating spillovers, (iii) ensuring economic sustainability, and (iv) adopting a more unified approach to policy advice. The note also provides guidance on sharpening the focus and selectivity of Article IV staff reports.
- *Policies.* The note discusses the content of surveillance in the areas of fiscal policy, macrofinancial analysis and financial policies, monetary policy, external sector policies, and macrostructural policies.
- *Applications.* The note considers several applications of such policies, such as with respect to the Integrated Policy Framework and climate change.
- *Process and procedures.* The note describes the Article IV consultation cycle and process; lays out drafting and publication guidelines for staff reports; and covers the treatment of confidential information.

This note should not be viewed as a checklist for what to cover in Fund surveillance. Country teams are expected to exercise judgment with respect to coverage in order to tailor surveillance to country circumstances, while still adhering to the formal requirements laid out in Executive Board decisions.

What is New in the 2022 Guidance Note?

This box highlights the main changes from, and additions to, the content of the 2015 Guidance Note. This note:

- Maintains relevant content from the 2015 Guidance Note, in particular with respect to the legal foundations (Annex 1), and presents a summary of requirements (Section II.B, Box 3).
- Updates guidance on policies covered in the 2015 Guidance Note (fiscal, monetary, external, financial, and macrostructural policies, in Sections IV.A, IV.B, IV.C, IV.D and IV.E). It contains updated references and updated guidance on analytical frameworks and tools such as the Debt Sustainability Analysis (Box 10), External Sector Assessment (Box 12), and more specificity on how to integrate FSAP findings and recommendations in Article IV staff reports and a new process to facilitate it, and a new requirement on including a well-articulated view about systemic risk (Section IV.B).
- Reflects the surveillance priorities identified in the 2021 Comprehensive Surveillance Review (CSR)—related to risks and uncertainties, economic sustainability, spillovers, and unified policy advice—and provides guidance on how these priorities inform surveillance (Section III.A).
- Specifies guidance on the coverage of climate change (Section V.B), gender issues (Section V.C), inclusion (Box 7), governance (Box 13), and other topics that were not extensively covered in the 2015 Guidance Note.
- Adds a section on topics that involve the interaction of multiple policy levers, such as the Integrated Policy Framework (Section V.A).
- Contains a focused discussion of the coverage of Article IV consultations and staff reports (Section II.A), including how to assess macrocriticality (Box 2).
- Offers guidance on how to make Article IV staff reports more focused on some policies while meeting formal requirements (Section III.B).
- Updates guidance on the processes and procedures of surveillance (Sections VI.A, VI.B, VI.C, VI.D, and VI.E), including the treatment of confidential information (Section VI.D).

Approved By
Ceyla Pazarbasioglu

Prepared by the Strategy, Policy, and Review Department in collaboration with other Departments, coordinated by Javier Arze del Granado and Masashi Saito (SPR) and with contributions from Mahir Binici, Peter Dohlman, Stefania Fabrizio, Julia Faltermeier, Valentina Flamini, Kevin Fletcher, Gavin Gray, Russell Green, Dalia Hakura, Tristan Henning, Elizabeth Van Heuvelen, Sandile Hlatshwayo, Parisa Kamali, Roland Kpodar, Lisa Kolovich, Brad McDonald, Murna Morgan, Pablo Morra, Manrique Saenz, Silvia Sgherri, Baoping Shang, Niamh Sheridan, Alexander Skinner, Martin Sommer, Geremia Palomba, Fabian Valencia, Johannes Wiegand, Juan Yepez, Yunhui Zhao (all SPR), Anna Bordon, Niall Feerick (ICD), Julianne Ams (LEG), Naomi Griffin, Heedon Kang, Piyabha Kongsamut, Jiri Podpiera (MCM), Ratna Sahay (OMD), Justin Matz, Daniela Marchettini, Patrizia Tumbarello (STA), and under the overall guidance of Fabian Bornhorst, Stephan Danninger (all SPR), and Sanjaya Panth (now APD).

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List of Acronyms

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AREAER	Annual Report on Exchange Arrangements and Exchange Restrictions
BSA	Balance Sheet Assessment
BOP	Balance of Payments
CBDC	Central Bank Digital Currency
CD	Capacity Development
CFM	Capital Flow Management Measure
CFT	Combating the Financing of Terrorism
COM	Communications Department
CPA	Consistent Policy Assessment
CSO	Civil Society Organization
CSR	Comprehensive Surveillance Review
DMC	Disorderly Market Conditions
DSA	Debt Sustainability Analysis
EBA	External Balance Assessment
ESA	External Sector Assessment
ESR	External Sector Report
EWE	Early Warning Exercise
FCL	Flexible Credit Line
FCS	Fragile and Conflict-affected States
FSAP	Financial Sector Assessment Program
GaR	Growth-at-Risk
GFSR	Global Financial Stability Report
GHG	Global Greenhouse Gas
GPI	Granular Policy Initiative
G20	The Group of Twenty
G-RAM	Global Risk Assessment Matrix
IFI	International Financial Institution
ILO	International Labour Organization
IMS	International Monetary System
IPF	Integrated Policy Framework

ISD	Integrated Surveillance Decision
LEG	Legal Department
LICs	Low-Income Countries
LIC DSF	Debt Sustainability Framework for Low-Income Countries
LOT	Lapse of Time
MAC	Market Access Country
MAC SRDSF	Sovereign Debt and Sustainability Frameworks for Market Access Countries
MCM	Monetary and Capital Markets Department
MPM	Macroprudential Policy Measures
NDC	Nationally Determined Contributions
NBFS	Non-Bank Financial Sector
OECD	Organization for Economic Co-operation and Development
PCI	Policy Coordination Instrument
PFA	Post Financing Assessment
PFM	Public Financial Management
PLL	Precautionary and Liquidity Line
PPP	Public-Private Partnerships
PSI	Policy Support Instrument
PRGT	Poverty Reduction and Growth Trust
RAM	Risk Assessment Matrix
REER	Real Effective Exchange Rate
SDG	Sustainable Development Goal
SDS	Small Developing States
SEC	Secretary’s Department
SEI	Selected Economic Indicators
SIP	Selected Issues Paper
TA	Technical Assistance
TPI	Third Party Indicators
UFR	Use of Fund Resources
VE	Vulnerability Exercise
WEO	World Economic Outlook

SECTION I. INTRODUCTION

1. Article IV consultations are a key vehicle through which the Fund exercises economic surveillance. The Fund's Articles of Agreement provide the legal basis for the conduct of Fund surveillance, which involves the continuous monitoring of members' economic and financial policies and the global economy. In Article IV consultations, staff discusses with authorities about the economic situation, outlook, and risks. Staff also discusses the authorities' current and planned policies, and how these affect the domestic and balance of payments stability, as well as global stability through spillovers where relevant, and recommended policy adjustments. Staff usually also engages with other stakeholders (e.g., private sector, civil society) and, in many cases, other international organizations and development partners. These discussions are presented to the IMF's Executive Board in a staff report, which is considered by Executive Directors. The report, together with the Executive Board's views, is subsequently published, barring the member's objection. The goal, through thorough independent analysis, candid discussions, and peer review, is to promote the stability of individual members' economies as well as global economic and financial stability, which is necessary for the effective operation of the international monetary system (IMS).

2. This note provides guidance to staff on how to conduct surveillance in the context of Article IV consultations, alongside other guidance notes that cover specific topics. This note replaces the 2015 guidance note and its supplement and reflects the surveillance priorities identified in the 2021 Comprehensive Surveillance Review (CSR) and other developments. The overarching objective of the CSR was to enhance the quality and traction of Fund analysis and policy advice, and to modernize surveillance modalities. The CSR identified four surveillance priorities to help promote strong, sustainable, and inclusive growth, while being robust to alternative futures (Box 1). This guidance note serves as an umbrella note for surveillance under Article IV consultations, and is complemented by, and often refers to, other guidance notes that cover specific topics in more detail.

3. Consultations should focus on issues that are relevant for balance-of-payments and domestic stability as well as global stability, with clear advice on the appropriate mix of policies. While this note is comprehensive, staff is not expected to cover all issues in every consultation and should avoid a check-list approach. Rather, selectivity is critical, and the focus should be informed by the individual members' circumstances. Analysis of intersectoral connections, policy interactions, and tradeoffs forms the basis for providing unified policy advice.

4. Continuous engagement and effective communication with members and other stakeholders are critical for surveillance to be relevant and add value. Engagement and consultations with the authorities go beyond producing the Article IV staff report. The continuous relationship should be characterized by a direct and two-way dialogue and reflect close integration with other areas of importance to the member, for example capacity development and considerations of regional or global developments. The Fund's ability to gain traction with its policy advice also depends on the confidence and trust its advice inspires, which is influenced by the perceived evenhandedness of surveillance and understanding of country-specific challenges and constraints. This understanding is enhanced by the dialogue with non-governmental stakeholders. Policy advice is most useful when it is specific, practical, granular, and timely. Effective policy dialogue requires candor, both in discussions with country authorities and in staff reports. Key messages must be communicated clearly and candidly, while avoiding politically charged language. Better informed advice also requires learning from other countries' experiences and collaborating closely with external partners.

Box 1. 2021 Comprehensive Surveillance Review

The 2021 Comprehensive Surveillance Review (CSR) identified the following surveillance and operational priorities.

Surveillance Priorities

- *Confronting risks and uncertainties.* Consider the range of potential outcomes and provide more proactive advice on mitigating and managing risks.
- *Preempting and mitigating spillovers.* Ensure consistent coverage across members, enhance coverage of outward spillovers, strengthen the link between bilateral and multilateral surveillance, use the Fund's convening power to encourage discussion among members, and engage on new types of spillovers.
- *Ensuring economic sustainability.* Cover salient trends and policies that may impact longer-term stability and sustainability, including those related to demographics, technological changes, inequality, socio-political and geopolitical developments, and climate change.
- *Adopting a more unified approach to policy advice.* Better integrate advice across policy areas and policy tools.

Operational Priorities

- *Enhancing traction.* Improve the extent to which the Fund and its members engage in a constructive dialogue. Understand country-specific challenges and constraints, while ensuring evenhandedness and bringing in cross-country perspectives. Enhance the quality of staff analysis and policy advice.
- *Modernizing modalities.* Make policy advice more timely, topical, targeted, interconnected and informed. Make Article IV consultations more focused, while continuing to cover the required elements for Fund surveillance. Integrate surveillance with capacity development (CD). Improve access to data.

5. This note is structured as follows. The following section explains the scope of Fund surveillance, including key elements of the Integrated Surveillance Decision (ISD) and how surveillance can be applied to specific country groups. The section also discusses the requirements for Article IV staff reports and the expectations around surveillance. The next section describes the priorities and focus of surveillance as identified in the CSR, followed by detailed guidance for each of five policy areas (fiscal, macrofinancial, monetary, external, and macro-structural). The following section considers applications of the guidance, from the Integrated Policy Framework, to climate change and gender. Finally, the last section outlines processes and procedures for Article IV consultations.

SECTION II. SCOPE AND REQUIREMENT

A. Scope

6. **Stability is the organizing principle for bilateral and multilateral surveillance, which are rooted in the Fund's Articles of Agreement.** Bilateral surveillance involves the Fund's surveillance over an individual member's conduct of exchange rate and domestic economic and financial policies and its related obligations. Multilateral surveillance examines the impact of the member's policies on global economic and financial stability and the IMS. Article IV consultations are a vehicle for both bilateral and multilateral surveillance. Specifically, Article IV consultations assess whether a member's policies are promoting its own balance of payments (BOP) and domestic stability as well as global economic and financial stability (Annex I). The Fund shall also, to the extent permitted under Article IV, take into account the member's other objectives and shall respect its domestic social and political policies.

7. **The CSR's surveillance priority of ensuring economic sustainability is closely related to both bilateral and multilateral surveillance activities.** Economic sustainability can be defined as the set of conditions that will support sustained, balanced, and inclusive growth over time, without requiring disruptive adjustments to the BOP or domestic stability, or to global stability. Thus, ensuring economic sustainability falls within the IMF's stability mandate (Section III.A).

8. **In fulfilling the bilateral surveillance mandate, Article IV consultations should cover economic and financial policies that affect the member's present or prospective BOP or domestic stability**. As clarified in the ISD, domestic stability means "orderly economic growth with reasonable price stability" and BOP stability means "orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions." The ISD establishes that Article IV consultations should always cover exchange rate policies, as well as monetary, fiscal, and financial sector policies—both their macroeconomic aspects and macroeconomically relevant structural aspects. Other policies, such as policies related to growth, job creation, income distribution, digitalization, climate, and gender, should be examined only to the extent that they significantly affect present or prospective BOP or domestic stability. This is known as the "macrocriticality" criterion. Whether an issue or policy meets the macrocriticality threshold can only be determined on a case-by-case basis, reflecting country circumstances. The coverage of these other policies in surveillance will depend on their macrocriticality and whether the Fund has expertise in the area (Box 2). Coverage of policies usually consists of analysis, discussion, an assessment of policies and policy advice by staff, and, if offered, the authorities' views on the issue.

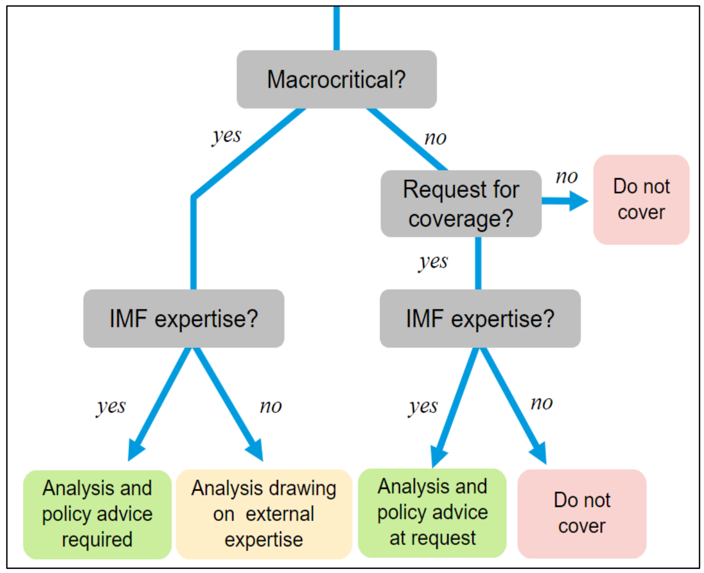
9. **In fulfilling the multilateral surveillance mandate, Article IV consultations should discuss policies that are conducive to the effective operation of the international monetary system.** These include spillovers from members' economic and financial policies that may significantly influence the effective operation of the IMS (e.g., by undermining global economic and

financial stability). Global economic and financial stability is best understood through examples of instability, including the malfunctioning of the international monetary system, global recessions, and global financial crises.

Box 2. Macrocriticality and Coverage in Article IV Consultations

Policies other than the those indicated in the ISD will be covered only to the extent that they are macrocritical. As there can be many macrocritical policies or issues for each member, the discussions are expected to be selective and focused, and limited to areas in which the Fund has expertise.

Determining macrocriticality is a country-specific undertaking. Whether an issue is macrocritical, i.e., whether it significantly influences present or prospective balance of payments or domestic stability, will depend, inter alia, on the members' income level, structural characteristics, and institutional capacity, and the assessment may vary over time.



Whether to provide analysis and/or provide policy advice depends on the macrocriticality of issues and the Fund's expertise.

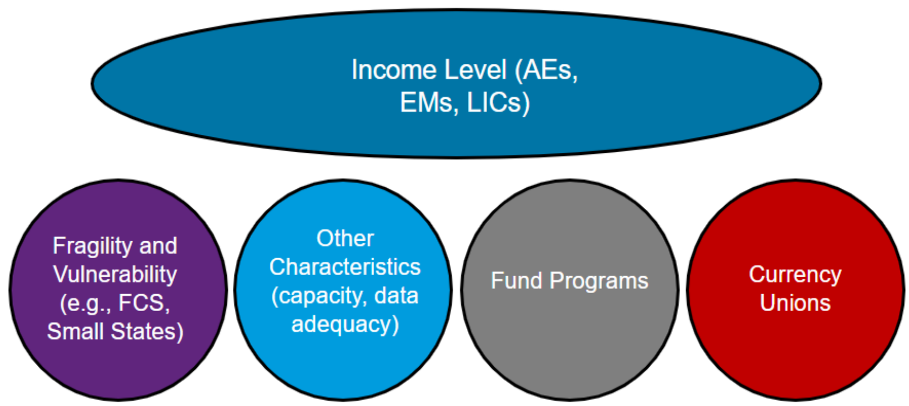
- *For issues that are macrocritical and where the Fund has expertise*, staff analysis and policy advice are required.
- *For issues that are macrocritical but where the Fund does not have expertise*, staff should analyze the issue, drawing on the expertise of, and in collaboration with, external partners as needed, but staff is not expected to provide specific policy advice.
- *For issues that are not macrocritical but for which the Fund has expertise*, staff may provide analysis and policy advice if requested by the member.
- *For issues that are not macrocritical and where the Fund does not have expertise*, analysis and policy advice should not be provided.

Macrocritical issues need to be covered in bilateral surveillance, but not all macrocritical issues will be covered in the same depth in every Article IV consultation. Once staff identifies an issue as macrocritical, the ISD requires it to be discussed in Article IV consultations to the extent that the Fund has expertise; the authorities' views on coverage should be reported, as needed. Depth of coverage will depend on factors such as relevance, severity, and urgency relative to other issues.

One example of how staff can think about the assessment of macrocriticality and coverage in Article IV consultations is social spending. Social and political challenges related to demographics, rising inequality, and poor access to health and education can undermine macroeconomic stability. Social spending to address these pressures could be macrocritical through three channels: fiscal sustainability, spending adequacy, and spending efficiency. Using these channels as a guide, staff should close any analytical gaps, develop advice in consultation with the authorities and collaborate with development institutions in the design of social programs. However, where the Fund does not have expertise, specific policy advice on implementation and delivery would be left to other institutions that have the necessary expertise.

10. While the surveillance obligations and requirements apply uniformly across the membership, Article IV consultations are expected to be tailored to country circumstances. Such a tailored coverage is understood to be evenhanded as long as members in similar circumstances are treated similarly (Section II.C). Here, relevant country circumstances can include, but are not limited to, the income level, fragility and vulnerability of the members, institutional capacity, data adequacy, and whether the country member is engaged in Fund-supported programs or is a member of a currency or other economic union (Figure 1). These dimensions are not mutually exclusive. Staff may tailor surveillance to reflect circumstances and members' needs, which may include:

Figure 1. Considerations for Tailoring Surveillance



Source: IMF staff.

- *Income level*. The focus of surveillance may vary depending on the extent of financial market development, trade and financial integration with the rest of the world, the systemic importance and thus the relevance of outward spillovers, structural economic and social conditions, as well as capacity and institutional strength, among others. These factors may be correlated with the income level. For example:

  Low-income countries (LICs) (Annex II). Countries in this group may, in general, be characterized by shallow financial markets, lower financial integration and restricted access to global financial markets, lack of fiscal space and limited access to financing, higher risk of debt distress, and/or weaker institutions, and thus have greater capacity development needs. In addition, LICs place more emphasis on economic development and poverty reduction as policy objectives, striving to achieve the Sustainable Development Goals (SDGs).[1] Article IV surveillance in these members thus may warrant greater attention to fiscal policies, the quality of public spending, debt management and other structural policies, including institutional and governance issues, and be supported by an integrated approach to capacity development. Data availability may also be

[1] See for example the IMF's annual LICs report "Macroeconomic Developments and Prospects in Low-Income Countries."

more limited in these member countries, and Article IV consultations should take into account data limitations, including in the application of tools and frameworks, while coordinating with the Fund's CD activities to enhance data adequacy.

Advanced economies (AEs). On the other hand, in members with strong institutions and high capacity, including AEs, achieving value-added and traction of Fund surveillance requires rebalancing analysis towards other areas, including fiscal and monetary policy normalization, external policies, and macrofinancial analysis.[2] Outward spillovers from a member's current or prospective policies are more prevalent among large, systemic economies. Surveillance in AEs would normally consider policies relevant for more complex financial system and deeper financial markets, as well as policy instruments related to the exchange rate and capital flows.

Emerging market economies (EMs). Surveillance in this heterogenous group may consider exposure to inward spillovers (especially capital flows), exchange rate policies, and policies aimed at strengthening policy frameworks (fiscal, monetary and financial). These countries may also share many characteristics of AEs and/or LICs. The focus of surveillance could be tailored accordingly.

- *Fragility and vulnerability* (Annex II). Surveillance in fragile and conflict-affected states (FCS) can build on an identification of the roots and drivers of fragility, and policy advice could take into account capacity constraints and limited data availability. It would generally focus on macro-fiscal issues, inclusive growth, institution building, and governance and corruption. Surveillance in small developing states (SDSs) may recognize their limited ability to benefit from economies of scale, vulnerability to external shocks, and tendency to experience high macroeconomic volatility. Policy advice could focus on policies aimed at promoting growth and job creation, building resilience, developing often thin financial sectors, and ensuring debt sustainability.

- *Members with Fund-supported programs.* Article IV consultations in these cases provide an opportunity to step back from immediate program aspects and take a fresh and comprehensive look at the member's economic challenges and policies. At the same time, recognizing that key macroeconomic policies implemented in the context of Fund-supported programs are likely to have important bearings in the medium term, their implications for growth and stability (for example, of fiscal consolidation that is undertaken) should be addressed. Article IV reports can be combined with program documents or post financing discussions (e.g., PFAs, PFAs, and EPEs). However, any combined report should meet the same Article IV requirements as for members without Fund-supported programs.

- *Members of currency unions* (Annex III). Members' obligations are unaffected by their devolution of authority over policy areas to supranational entities. The Fund will discuss relevant policies with these entities. Surveillance in currency unions, where monetary and exchange rate policies

[2] For example, the CSR background paper on traction indicated that traction of Fund surveillance tends to be weak for monetary and external sector policy advice in AEs, possibly due to the available expertise in these members.

have been delegated to the union, thus requires discussions with the regional institutions on common policies as part of the Article IV consultations with individual members.

- *Globally or regionally systemic events*. In addition to tailoring Fund surveillance to country-specific circumstances, the focus of Article IV surveillance on globally or regionally systemic events may be necessary. For example, following the COVID-19 pandemic, emphasis shifted towards savings lives and livelihoods in the context of crisis management relative to long-term issues.

B. Requirements

11. Article IV consultations and staff reports should meet the requirements determined by the Fund's legal framework for surveillance. Requirements arise from the Articles of Agreement, Board Decisions, Board-approved policy papers and frameworks, and guidance from management. The authority to modify requirements rests with the Executive Board. Within the limits set by formal requirements, Management will approve further staff guidance and staff-level guidelines on how to fulfill these requirements.

12. The requirements translate into specific elements for an Article IV staff report. The main elements of Article IV reports are a discussion of recent economic and macrofinancial developments and policies, discussion of the outlook and of risks, reporting on policy discussions with the authorities, the authorities' views, and a staff appraisal that summarizes staff's views and policy advice. To enable this discussion, staff reports are built on a set of macroeconomic medium-term projections that form the baseline scenario. This projection is consistent across sectors, reflects staff's assumptions about the authorities' policies, and incorporates current Fund-wide assumptions about global economic developments. The application of a number of common frameworks and tools, such as the debt sustainability analysis, the external sector assessment, and other tools, is also required. Formal requirements for an Article IV staff report are specified in Box 3.

13. Article IV staff reports are expected to be self-contained documents but can be supported by judicious references to previous staff reports and background documentation. Relevant developments, outlook, risks, and policies should be discussed in the main text of the report. The bottom-line assessments of the external sector, debt sustainability, macroeconomic and systemic financial risks should be included in the main text, while analysis based on tools and frameworks can be further detailed in annexes, which are an integral part of the staff report. Judicious references to previous staff reports are encouraged; in areas where there are no substantive changes relative to recent Article IV staff reports, a concise statement can fulfill formal requirements (Section III.B). Selected Issues Papers (SIPs) can be prepared to explore topics that are important for the consultation. However, SIPs do not generally include policy advice on its own.[3]

[3] Analytical work related to the staff analysis can also be published as IMF Working Papers and referenced as such, but these do not form part of the Article IV documentation.

Box 3. Formal Requirements for Article IV Staff Reports[1/]

- *Recent developments and policies.* These cover economic and financial issues, but also political and social areas where applicable.
- *A clear and candid assessment of the outlook and risks.* Staff should produce a baseline medium-term projection, along with an analysis of risks, vulnerabilities, and spillovers. Analysis should be informed by, and consistent with, a multilateral framework that incorporates relevant aspects of the global economic and financial environment and its projections, including exchange rates, international capital market conditions, and key linkages among members. Staff reports should include an external sector assessment (ESA, Box 12)* and a debt sustainability assessment (DSA, Box 10)*, each with a bottom-line assessment, a risk assessment matrix (RAM, Box 6)*, as well as a well-articulated view on systemic risks (¶62).
- *A substantive and candid discussion on policies.* Building on staff analysis, the discussion should cover policies that affect the country's BOP and domestic stability as well as those that may significantly impact global stability. Policy recommendations should be concrete and actionable. Staff reports should include, and clearly identify, the authorities' views on the main issues and on staff's main policy recommendations.
- *Coverage of areas as required and applicable by Board approved frameworks (e.g., climate change, gender issues, governance, fiscal space, and AML/CFT).*
- *A staff appraisal.* Staff's analysis and policy advice should be summarized in a pointed staff appraisal. The staff appraisal will only cover issues discussed with the authorities and in the main report (¶129-130).
- *An assessment and classification of data adequacy for surveillance* (¶14).*
- *A Statistical Issues Appendix, including a Table of Common Indicators Required for Surveillance* (¶14).*
- *A brief assessment of the authorities' response to key policy recommendations in previous Article IV consultations,* highlighting areas where the authorities implemented policies that differed from staff advice (¶23). This can be presented in a flexible format, including an annex. However, important findings should be discussed in the main text.
- *A brief summary of the implementation of previous FSAP recommendations in the main text and a table in the Annex* (¶73)*.
- *A description of the de jure and de facto exchange rate regime* (¶91).*
- *A reference to the proposed consultation cycle* (Section VI.A).
- *A reference to Article VIII and XIV status (as well as a description of any multiple currency practices and exchange restrictions)* (¶93).*
- *Fund Relations** (¶15) *and relations with the World Bank and other International Financial Institutions (IFIs) where appropriate.**
- *A set of tables,* including tables on selected economic indicators (SEI), fiscal, monetary, and BOP, with recent developments and medium-term projections, and a table of Financial Soundness Indicators (¶12).

1/ Those marked with an asterisk (*) can be included as annexes, some of which are often combined into the Informational Annex.

14. Article IV staff reports must assess whether data provided by members to the Fund are adequate for surveillance. Article VIII Section 5 and Annex A to the 2004 Decision specify data categories that members are obliged to provide to the Fund, except when capacity is a binding constraint (in requesting information, the Fund shall take into consideration the varying ability of members to furnish the data requested). Assessment of data adequacy involves deciding whether (i) data provision is adequate for surveillance (category A), (ii) data provision has some shortcomings but broadly adequate for surveillance (category B), (iii) data provision has some shortcomings that somewhat hamper surveillance (category C), or (iv) data provision has serious shortcomings that significantly hamper surveillance (category D). For members in category C or category D, Article IV staff reports should discuss the data adequacy issues in the main text, and staff should discuss with the authorities how to strengthen data provision to the Fund, including possible CD. Major deficiencies (in countries classified as category D) will also need to be discussed in the staff appraisal, including to ensure that readers can appreciate the extent to which data weaknesses might undermine the robustness of staff analysis and policy advice. Staff reports should include an up-to-date Statistical Issues Appendix and Table of Common Indicators for Surveillance.

15. Article IV staff reports should summarize the financial relations of the member with the Fund. Specifically, staff report should include (i) information on a member's quota, (ii) information on a member's holding of SDRs and the cumulative SDR allocation to the member, and (iii) information on total credit outstanding to the Fund, the latest year of and nature of any arrangement with the Fund or receipt of other Fund financing, scheduled repayments and repurchases, and the presence of protracted arrears to the Fund, if any.

Integrating Capacity Development

16. Capacity development (CD) should be integrated with surveillance. When institutional and capacity weaknesses constrain the adoption of recommended policies, these constraints should be covered in surveillance, and, if the Fund has technical expertise, CD targeted to address them. Where capacity constraints prevent achieving surveillance objectives, country teams are expected to develop a coherent CD strategy, in collaboration with CD departments, and discuss it with the authorities. This facilitates integration of CD with surveillance and ensures that CD resources are directed to areas of greatest impact. Article IV policy advice should take into account the institutional and capacity constraints of the authorities in implementing policies and reforms.[4]

17. Article IV staff reports should cover the CD strategy, when capacity constraints are linked to macrocritical issues and the Fund has technical expertise to address them. Heavy CD recipients should report on their CD Country Strategy Note.[5] Where this is the case, regular and close dialogue between the country team and CD departments is essential. The nature of capacity gaps and the adequacy of CD plans should be assessed jointly with CD departments and discussed

[4] A CD strategy review was conducted in 2018 and internal guidelines have been developed.

[5] Country teams for major recipients of CD prepare a CD Country Strategy Note (CD-CSN). The CD-CSN would take into account the authorities' reform priorities, traction, risks facing the country, and the activities of other CD providers.

at an early stage of Article IV consultations to inform policy dialogue. In addition to the CD strategy, Article IV staff reports should report on the discussions with the authorities regarding the implementation of CD-supported reforms, if relevant to macrocritical areas or the country is a significant CD recipient.

C. Traction, Evenhandedness, and Best Practices

Traction

18. **The effectiveness of Fund surveillance critically depends on the quality and the uptake of policy advice.** The goal of surveillance—to promote the stability of individual members' economies and global economic and financial stability through thorough independent analysis, candid discussions, and peer review—can best be achieved by offering policy advice that is valued and implemented by members and understood by a broader stakeholder community.

19. **Traction of Fund surveillance is the relevance and value-added of the Fund's analysis and advice in support of Fund members' stability as well as global stability.** Specifically, traction depends on both (i) the extent to which the Fund and its members engage in a constructive dialogue and (ii) the extent to which Fund advice influences policy making, as elaborated below and in the CSR background paper on traction.

20. **Policy advice should be candid, concrete, granular, and actionable.** Without compromising the substance, integrity, or independence of staff's views, policy advice should be formulated while being mindful of the broader country context and constraints. Policy advice should also be concrete and granular, offering specific and actionable recommendations tailored to circumstances. To achieve this, selectivity and focus are key. Messages on risks and spillovers should be candid, but without undermining confidence. For systemic economies, messages should properly reflect their systemic implications. The quality and timeliness of analysis are key to achieving traction.

21. **Surveillance informed by cross-country experiences and perspectives and integrated with CD also helps improve traction.** Members within and across geographical regions may share specific policy challenges. Where possible, staff is encouraged to leverage lessons of peer countries, synthesize them and formulate timely and topical advice based on these experiences. Integration of surveillance with CD can help tailor policy advice to member's implementation capacity and result in more concrete and actionable advice, improving traction.

22. **An open, responsive, and collaborative approach can help staff develop a continuous, two-way policy dialogue and relationship with the authorities.** Listening to and striving to understand members'concerns helps build trust and tailor analysis and advice to their needs. Staff is encouraged to engage with members well ahead of Article IVs and maintain a continuous dialogue, including through staff visits, seminars, and workshops, and making use of new technologies.

23. A strong relationship with the authorities depends on two-way accountability. Members are responsible for meeting their surveillance obligations and being accountable for their response to the Fund's recommendations. Staff is expected to take ownership of the Fund's analysis and advice and record the following in the staff report: (i) a substantive policy discussion, reflecting the views of staff and the authorities (especially where there is disagreement), (ii) the authorities' response to past Article IV or FSAP recommendations, (iii) significant changes in Fund advice, including retiring advice that is no longer relevant, and (iv) instances where members have successfully implemented policies that departed from Fund advice.

24. Engaging with the broader community, including non-governmental actors, strengthens staff's understanding and the understanding of the Fund's position and advice. Staff is encouraged to routinely request meetings with political leaders (e.g., parliamentarians), trade unions, business representatives, and civil society organizations (CSOs). Staff should seek to understand their views and explain the Fund's analysis and policy advice, and staff reports can reflect non-government actors' views where appropriate. In turn, such an engagement will enrich staff's understanding of country circumstances, offer Fund views to opinion formers, and stimulate public policy debate more generally.[6]

Evenhandedness

25. Evenhandedness is essential for effective surveillance. Evenhandedness means treating members in similar circumstances in a similar way. An actual or perceived lack of evenhandedness can undermine the legitimacy and credibility of the Fund's analysis and advice. Whether economies are large or small, advanced or developing, Fund surveillance should be evenhanded, paying due regard to country circumstances. The approach laid out in IMF (2016) provides an objective basis for thinking about evenhandedness, reflecting not just the "outcomes" (i.e., policy advice), but the underlying "inputs" to surveillance, as discussed in the 2014 TSR. The internal review process helps ensure the evenhandedness of Fund surveillance. The Fund also has a formal mechanism for members to report concerns about evenhandedness.

26. Evenhandedness does not imply a one-size-fits-all approach, and surveillance should be tailored to country circumstances. Judgments about surveillance inputs would normally reflect domestic and/or systemic risks (i.e., they should be appropriately risk-adjusted) and be tailored to country circumstances. This could include choices about: (i) the focus of resources; (ii) the depth of risk and spillovers analysis; (iii) the analytical approaches and tools; (iv) the selection of policy themes; and (v) the approach to contentious issues. Staff is encouraged to articulate and clarify their approach when it appears to differ from that taken for members in similar circumstances, in order to address perceptions of a lack of evenhandedness. Evenhandedness and best practices in surveillance are summarized in Box 4.

[6] See guidance on outreach with civil society and legislators.

Box 4. Best Practices in Surveillance

The following qualities should permeate all aspects of surveillance work.

- *Collaboration*. Surveillance is based on a direct dialogue with country authorities and other stakeholders, and effective use of persuasion. While this dialogue should be continuous, it is particularly important to seek country authorities' opinions on issues of interest to them before an Article IV consultation. Staff can also draw on the expertise of other international institutions.
- *Candor*. Effective dialogue requires candor, both in discussions with country authorities and in staff reports, including about risks.
- *Evenhandedness*. Surveillance should be evenhanded, treating countries in similar circumstances in a similar way.
- *Data and analysis Integrity*. The membership and other stakeholders look to Fund analysis to inform their economic, financial, and other policy decisions; safeguarding staff's expert, independent, and technical analysis is critical.
- *Practicality and granularity*. Advice should be specific and consider country-specific circumstances and implementation capacity, leveraging Fund CD where appropriate.
- *Consistency of forecasts and risk analysis*. Staff reports should be based on realistic projections and discuss short- and medium-term objectives and policies as well as possible policy responses to the most relevant contingencies.
- *Cross-country experiences and multilateral perspective*. Surveillance can draw from experiences in other countries. Where relevant, Article IV consultations should discuss actual or potential spillovers.
- *Selectivity and focus*. While this guidance note presents the issues in a comprehensive manner, it should not be viewed as a prescriptive check list. Staff reports should be focused and selective, except for certain issues that must be covered (Box 3). Staff is encouraged to exercise judgment in selecting issues for in-depth coverage.
- *Timeliness*. To ensure that staff reports are up to date when discussed at the Board and published, staff should minimize the time between the end of discussions with authorities and the Board meeting.

Data and Analysis Integrity

27. The integrity of data and staff's analysis is critical for the provision of accurate, well-tailored and evenhanded policy advice. Staff, relying on a variety of data sources, applies quantitative tools, frameworks, and informed judgement to arrive at policy recommendations. Processes and practices supporting staff's analysis are governed by frameworks and policies that have evolved over time and are periodically reviewed. Their application is carefully examined, including through the interdepartmental review process.[7]

Collaboration with other IFIs

28. Collaboration with other IFIs, in particular the World Bank, where applicable in surveillance can maximize synergies between each institution's area of comparative advantage. The 1989 Concordat on Bank-Fund Collaboration and subsequent refinements such as

[7] See *Data and Analysis Integrity at The Fund: Stocktaking and Recommendations (forthcoming)*.

the Joint Management Action Plan (JMAP) provide the umbrella framework for collaboration; each institution should rely as much as possible on the analysis and monitoring of the other institution in their areas of primary responsibility, while safeguarding the independence of institutional decisions. Close collaboration with the World Bank is necessary in certain policy areas, especially where the Fund can leverage external expertise (Box 2). These may include certain macro-structural issues, climate change including climate-related risks and policies (Section V.B), governance issues such as identification and prioritization of key governance and corruption issues (Box 12), gender issues such as the identification of potential macrocritical issues (Section V.C), and issues related to LICs and Fragile and Conflict-affected States (Annex II). Information sharing between the two institutions can support effective surveillance, while adhering to each institution's existing policies and legal frameworks governing information sharing.[8]

SECTION III. PRIORITIES AND FOCUS

29. While Article IV staff reports should meet the formal requirements and expectations outlined earlier, they should be focused and selective. In deciding the focus, staff is encouraged to take into account specific country circumstances and be guided by the four surveillance priorities identified in the CSR (Box 1). This section first summarizes the CSR surveillance priorities, and then turns to operational questions of how staff reports can be focused, while still meeting requirements and expectations.

A. CSR Surveillance Priorities

Surveillance Priority 1. Confronting Risks and Uncertainties

30. Confronting risks and uncertainties is a key surveillance priority. Fund members are operating in an uncertain environment shaped by complex interactions among several long-term trends (e.g., climate change, technological innovation, and demographic transition). Surveillance must therefore be adaptable and analyze how these trends interact with underlying domestic vulnerabilities and affect domestic and external stability as well as risks to stability, drawing on resources inside and outside the Fund. The analysis would then underpin policy advice that is robust to a range of potential outcomes, thereby helping members seize upside opportunities, manage downside risks, and prepare for possible adverse scenarios.

31. In this context, risk assessments consider a range of potential outcomes. The selection of key risks around the baseline considers their likelihood and impact (e.g., on growth, inflation, and fiscal and external accounts), with thorough analysis of transmission channels and consideration of possible correlation and/or compounding of risks. Risk assessments should cover not only downside risks but also upside risks. Greater use of quantified scenarios or fan charts (or other representations of predictive densities), drawing on the suite of analytical tools, helps illustrate the impact of potential shocks—both negative and positive—under various risk management policies (Box 5). Staff

[8] See *Guidance Note on Information Sharing between IMF and World Bank Staff*.

is also encouraged to consider high-impact (but plausible) tail risks as well as longer-term uncertainties in their assessments. Where data are limited, risks can be embedded in policy advice through conceptual or qualitative exercises.

Box 5. Vulnerabilities and Risks

It is useful to distinguish between vulnerabilities, risks, and uncertainties. *Vulnerabilities* represent weak economic and financial fundamentals which, if unaddressed, could interact with state-contingent risks to stability. *Risks* are potential *shocks* that have some probability of materializing with an impact on macroeconomic or financial conditions in a country or across countries. They can be domestic or external, and they can be related to exogenous or policy shocks. *Uncertainties* arise from events (which may or may not happen), potential impacts on objectives (both negative and positive), and ambiguity and lack of information. One example of uncertainty is the imprecise understanding of the mechanisms governing the functioning of the economy.

The Fund has frameworks and models to support the assessment of vulnerabilities and risks, including:

- *The Growth-at-Risk (GaR)* model links macrofinancial conditions to the distribution of future GDP growth and helps quantify downside macroeconomic risks in terms of growth (the severity and the likelihood of a sharp economic slowdown in the future). GaR helps understand key drivers of future growth, the inter-temporal trade-off between growth and build-up of vulnerabilities, and policies to mitigate negative impacts on growth.
- *The Vulnerability Exercise (VE)* is another tool to support the assessment of vulnerabilities and risks. VE is an interdepartmental process that provides a comprehensive bottom-up, multi-sectoral assessment of the likelihood of economic stress events 1-2 years ahead. The framework encompasses a variety of global, regional, and country-specific risks. Final assessments of VE reflect the judgment of country teams, informed by consistent, cross-country quantitative models and country-specific contexts.

Box 6. Risk Assessment Matrix

A Risk Assessment Matrix (RAM) provides a structured framework for guiding risk discussions with country authorities. The RAM helps to guide risk identification, assessment, and management and should include: (i) key global, regional, and country-specific risks that could result in a deviation from the baseline scenario; (ii) the relative likelihood of realization of each risk; and (iii) assessments of the economic impact should these risks materialize. A RAM must be included in Article IV staff reports and it is optional in program request/review documents. There is a strong presumption that staff will share and discuss the RAM with authorities during Article IV consultations.

The design of the RAM is flexible, but global and systemic regional risks should be drawn from the latest Global Risk Assessment Matrix (G-RAM) to ensure consistency across Fund products.[1] The G-RAM is updated semi-annually (or as needed), drawing on an interdepartmental consultation process, and takes effect once approved by management. Staff can select which global and systemic regional risks are sufficiently relevant to be featured in a country's RAM. However, once included, their broad description and likelihood should fully align with the G-RAM (staff can undertake minimal editing to shorten the description but not add details, given the need for cross-country consistency). That said, staff can nuance global and systemic regional risks in the main text of the staff report. Teams have discretion to assess the impact of each global and systemic regional risk on their respective countries, as well as full discretion on domestic and non-systemic regional risks.

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1/ FSSAs also include a RAM, which should be consistent with but not identical to Article IV RAMs. RAMs in FSSAs are expected to focus on the financial sector and may also include tail risks that would have large impact on financial stability.

32. Staff is encouraged to discuss trade-offs, aiming for policies robust to a range of possible outcomes. Considering a range of quantified scenarios (rather than overly focusing on the baseline) will help make baseline policy advice more robust to risks and encourage a mindset of internalizing risks in policy design. Policy discussions should cover both downside and upside risks (e.g., fiscal and monetary policy advice in response to stronger-than-expected cyclical conditions). Staff policy discussions could weigh trade-offs, including intra-temporal considerations (e.g., risk mitigation through a 'self-insurance' buildup of buffers vs. economic diversification and enhancing market flexibility) and inter-temporal considerations (e.g., providing immediate support to economic activity at the cost of higher longer-term risks), uncertain opportunity costs (e.g., investing in disaster-proof infrastructure at the cost of forgoing investment with more immediate benefits, for example, to address the digital divide), and policy implementation capacity. A customized Risk Assessment Matrix (Box 6), a requirement for Article IV policy notes and staff reports, provides a structured framework for presenting risk assessments and possible impacts and guiding the discussion of robust risk mitigation policies, though risk assessments should be well-integrated throughout staff reports, including the staff appraisal.

33. Clear communication regarding risk and uncertainty is essential. Staff will need to balance candor with avoiding unintended consequences for real world outcomes. Contingent policy advice is expected to be discussed only for selected critical risks (both downside and upside). If such advice is discussed, care must be taken to avoid dilution of baseline advice with a multitude of possible eventualities. Communication will benefit from strengthening the link between risk analysis and policy advice, and clarity about the nature of risks, the costs of addressing them, and associated growth-stability trade-offs. This will also help policymakers in their domestic communications about policy choices and risk preferences (e.g., some adverse outcomes can be tolerated while others are to be avoided if at all possible), and later assessments of outcomes.

Surveillance Priority 2. Preempting and Mitigating Negative Spillovers

34. The sources and channels of spillovers have increased and expanded, sometimes beyond traditional areas of Fund expertise, including climate change (CSR overview paper and CSR background paper on spillovers). Article IV consultations should cover inward spillovers, outward spillovers, and spillbacks where appropriate and guided by the ISD, as outlined in Section II.A and Annex I.

35. Staff is encouraged to assess sources and channels of inward spillovers that affect a member's BOP or domestic stability. Inward spillovers can arise from external shocks or policy actions in other countries. There can be *actual* spillovers from policies already adopted or shocks materialized or *potential* spillovers from prospective policies or shocks not yet materialized. The analysis of inward spillovers requires an understanding of the sources and channels for spillovers. The channels may include trade, links through the financial system and markets, FDI, and commodity prices. Staff should evaluate the channels and quantify their impact to the extent possible, while noting that inward spillovers often interact with pre-existing domestic vulnerabilities.[9]

36. Staff should examine outward spillovers from a member's economic policies if (i) the member's policies are not promoting its own domestic or external stability or (ii) the member's policies are promoting its own stability, but they could nevertheless significantly affect global stability.[10] While the Fund cannot require members to change their policies when these promote the member's own stability but adversely affect global stability, the Fund may recommend alternative policies that would improve global stability.[11,12] Members are only obliged to change their policies for the promotion of their own stability. Thus, when there is a conflict between policies needed to promote a member's own stability and policies needed to minimize outward spillovers, the member's own stability takes precedence.

37. When Article IV consultations cover outward spillovers, the analysis should be integrated into staff's assessment of the current conjuncture, policy discussions, and staff appraisal. While analysis of negative outward spillovers is required under certain conditions (see above), staff may also discuss positive spillovers. As in the case of inward spillovers, staff is encouraged to analyze the sources and channels of spillovers. Model-based scenario analysis can help sharpen the analysis.

38. Outward spillovers can have "spillback" effects. Spillbacks arise when one country's outward spillovers affect other countries and trigger adverse feedback effects on the source country. Discussing actual and potential spillbacks can strengthen the traction of policy advice on outward spillovers, particularly when policies generating the initial outward spillovers are not promoting the source country's own stability. Spillbacks are often underestimated, as they tend to occur through channels not adequately captured in the existing frameworks or models due to their complexity. When analyzing spillbacks, staff can consider alternative policies that could reduce outward spillovers and spillbacks.

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[9] Inward spillovers and their impact are of particular relevance in the context of covering climate change adaptation and transition management, see Section V.B.

[10] The ISD (paragraph 26) clarifies that Article IV consultations "shall include a discussion of the spillover effects of a member's exchange rate and domestic economic and financial policies that may significantly influence the effective operation of the international monetary system (IMS), for example, by undermining global economic and financial stability." Judgment is required to assess whether a country's policies are sufficiently powerful to affect global stability. Outward spillovers are deemed significant if by themselves, or in combination with spillovers from other members' policies, or through their regional impact, they would affect the macroeconomic policies and considerations of members representing a significant portion of the global economy. Spillovers with smaller impact can be discussed on a voluntary basis, unless the member objects.

[11] The ISD (paragraph 9): "the Fund may not and will not require a member to change its policies in the interests of the effective operation of the IMS. It may, however, discuss the impact of a members' policies on the effective operation of the IMS and may suggest alternative policies that, while promoting the member's own stability, better promote the effective operation of the IMS."

[12] See Section V.B for a discussion on how outward spillovers provide an angle to cover climate change mitigation in Fund surveillance.

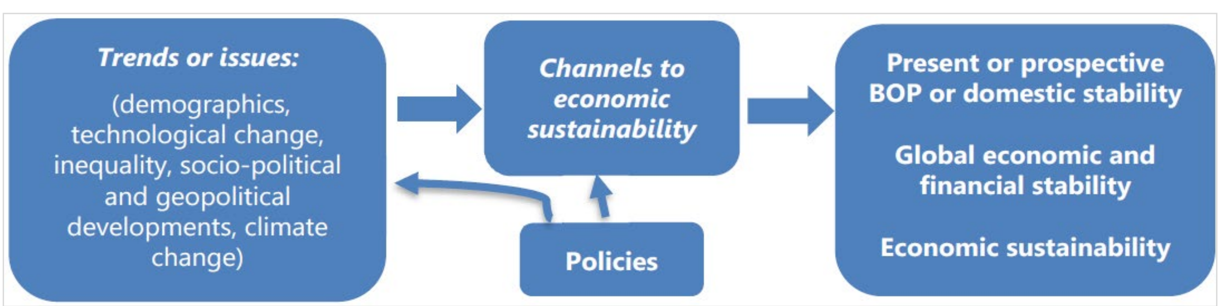
39. The Fund's flagship publications, policy frameworks, and analytical tools help identify and analyze spillovers and allow for consistent and evenhanded coverage in Article IV consultations. The Fund's coordinated forecasting process ensures that projections across the membership are consistent and in line with the global economic and financial trends as laid out in the World Economic Outlook (WEO) and the Global Financial Stability Report (GFSR). Thus, policy spillovers that occur in the baseline are reflected in individual desk projections. The Fund's policy frameworks and analytical tools, including the External Balance Assessment (EBA) and EBA-lite methodologies, the Institutional View on the Liberalization and Management of Capital Flows, and the Integrated Policy Framework, support spillover analysis. Additionally, the G-RAM, the VE, the Early Warning Exercise (EWE) on tails risks, and activities of the interdepartmental Spillover Task Force help identify spillover issues. Recent efforts aim at improving the discussion of spillovers that are reflected in the Fund's baseline projection to help teams with a consistent analysis of the main global spillovers at the country level.

Surveillance Priority 3. Ensuring Economic Sustainability

40. Economic sustainability is closely tied to the Fund's stability mandate. Economic sustainability is defined as a set of conditions that, under realistic assumptions, will support sustained, balanced, and inclusive growth, without requiring large or disruptive adjustments to the BOP or domestic stability. While this implies that sustainability ensures stability, stability over the short- and medium-term does not necessarily ensure sustainability: it is possible that stability in the short term could harm "prospective" stability. Sustainability depends on a broad range of factors, including distribution and inclusiveness, health and education, environment and climate, pandemic preparedness, and socio-political and geopolitical factors.

41. Trends such as demographics, technological change and digitalization, inequality, socio-political and geopolitical developments, and climate change can have a first-order macrocritical impact on economic sustainability, as explained in the CSR background paper on economic sustainability (Figure 2). These trends are increasingly shaping the economic landscape, and the COVID crisis has exacerbated pre-existing trends, such as rising inequality. Staff can pay attention to these trends and their interactions with one another (e.g., between technological change and inequality).

Figure 2. Trends and Channels to Economic Sustainability



Source: IMF staff.

42. Coverage of issues related to economic sustainability may require a broader perspective and longer time horizon than has been typical for Fund surveillance. Debt sustainability and governance and institutional issues have already become an integral part of surveillance related to economic sustainability (Box 10 and Box 13). The sources and channels through which certain trends and issues impact economic sustainability can include non-economic factors or distributional factors, and understanding of interactions also requires a broad perspective. Issues related to economic sustainability can go beyond the IMF's standard surveillance horizon of five years, as some trends or issues are slow-moving (e.g., demographics, inequality) and some policies may involve inter-temporal tradeoffs over the long-term (e.g., costs and benefits of climate policies).

43. When covering issues related to economic sustainability, staff can first assess the *sources* and *channels* through which economic sustainability and stability are impacted. Other sources and channels below are not exhaustive, and relevant sources and channels would differ across countries and can evolve over time:

- *Demographics,* such as aging and declining population growth, can impact economic and fiscal sustainability and stability through: changing the size of the labor force; weakening incentives for capital accumulation; increasing pension and health expenditures and public debt; reducing the natural rate of interest and thus monetary policy space; impacting the saving-investment and external balances; and affecting cross-border labor and capital flows including immigration.
- *Technological change,* such as digitalization and automation, can impact economic sustainability through: enhancing productivity growth; reducing the labor share of income and raising income inequality; increasing corporate market power; inducing shift from tangible to intangible capital; increasing efficiency but also risks in the financial sector; and changing macro policy effectiveness.
- *Inequality* in income and opportunities, including in gender, can be detrimental to sustained growth and stability through: weakening aggregate demand; hampering human capital accumulation; worsening allocative efficiency and aggregate productivity in the economy; reducing social and political stability; and widening external imbalances (Box 7).
- *Socio-political and geopolitical factors*, including declining social capital and trust on the government, political polarization and fragmentation, and cross-country tensions, can limit the scope for sustained growth through: weakening macroeconomic management and governance; stalling necessary reforms and policy actions; increasing fiscal and external imbalances; and limiting gains from trade, technological spillovers, and financial integration.
- *Climate change* can pose threats to economic sustainability through: more frequent and severe natural disasters; destruction of physical capital; deterioration in human health; loss in productivity and output; increase in inequality and social instability; rise in fiscal and financial instability; climate migration and cross-border capital flows (Section V.B).

Box 7. Inclusion

Inclusion issues and policies to address them can be critical to preserve macroeconomic and financial stability and support sustained and inclusive growth. In addition, advice in fiscal, monetary, financial or other policies can have important distributional implications. Recent surveys indicate that inequality is among the top three policy concerns of the Fund's membership (SEC's 2021 Spring Meetings Survey).

Inclusion is a broad and multifaceted concept. Staff engages in inclusion issues when these are macrocritical. Engagement has focused on four areas: economic inequality, social spending and taxation, financial inclusion, and gender disparities. In most of these areas, staff's analysis is guided by existing frameworks and strategies:

- *Inequality*. Engagement on inequality has over the years covered both inequality of opportunities and inequality of outcomes (e.g., income inequality, wealth inequality, and intergenerational inequality). The 2018 note on *How to Operationalize Inequality Issues in Country Work* provides an overview of good practices and resources available to staff as well as guidance on how inequality should be covered in country work. More recently, analysis is gearing toward building expertise on the distributional impact of macroeconomic policies, and economic transformation, such as population aging, digitalization, and climate change.
- *Social spending*. The Fund has been engaging for many years on social spending as this is a key instrument for tackling inequality and vulnerabilities. In 2019, *A Strategy on IMF Engagement on Social Spending* was formally approved by the IMF's Board. The strategy identifies when social spending issues can be considered macrocritical and provides the principles for an effective discussion of social spending issues. To support the implementation of this strategy, staff has published a technical note on pensions, and additional notes on social safety nets, education and health spending are being developed.
- *Taxation* is important for inclusion because it may enable higher social expenditures and, where feasible reduce inequality through progressive taxes. A 2020 note on "Tax Policy for an Inclusive Recovery" provides guidance to staff on tax design for inclusion, while specific tax issues arising with respect to gender inclusion are captured in the recent paper "Gendered Taxes: The Interaction of Tax Policy with Gender Equality".
- *Financial inclusion*. Financial inclusion disparities are a form of inequality, with respect to access to financial services, by different groups such as income, region, or gender. Fund engagement on financial inclusion has been mostly in the form of analytical work, focusing on its measurement and implications for macroeconomic outcomes and financial stability, as well as policies to help improve financial inclusion such as Fintech. A 2020 departmental paper, "The Promise of Fintech: Financial Inclusion in the Post COVID-19 Era," shows how digital finance is increasing financial inclusion, discusses its benefit including amid the COVID-19 crisis, and highlight potential risks and policy implications.
- *Gender disparities*. Gender disparities are a special form of inequality and refer to inequality of opportunities and outcomes, from the perspective of gender (Section V.C).

Collaboration with external partners is important to leverage their expertise and sectoral knowledge (e.g., social registries and mobile payment systems) when critical for policy implementation. Tackling inequalities and promoting inclusion requires both macroeconomic and microeconomic expertise. Staff collaborates with key development partners and stakeholders at the country, regional and global level, including the World Bank and other multilateral development banks, the International Labor Organization (ILO), the World Food Program (WFP), U.N. Women, OECD, Civil Society Organizations (CSOs), bilateral and private donors, and academia.

44. Staff could consider two types of policy responses. Some policies may directly impact trends or issues, addressing the problem at the source (e.g., climate mitigation to reduce CO2 emissions), while other policies may help reduce the consequence (e.g., climate adaptation to build resilience against disasters). After identifying the sources and channels to economic sustainability (see above), staff can use these as a guide to develop specific policy advice. Coverage of policies in staff reports is guided by their macrocriticality (Box 2).

45. Data availability is critical for identifying macrocritical trends and understanding their channels to economic sustainability. The CSR background paper (especially Box 2 in that paper) notes indicators related to demographics, technology, inequality, and climate change that are available from existing internal and external sources, including those contained in the Sustainable Development Goal (SDG) indicators. In addition, the Fund is improving data availability, including through its Climate Change Indicator Dashboard. Use of external data in Fund surveillance is guided by the Fund's policy on the Third Party Indicators (TPI) (Section VI.E). When appropriate, it is encouraged to include a table on SDGs in staff reports.

Surveillance Priority 4. Adopting a Unified Approach to Policy Advice

46. Staff is encouraged to take a holistic and coherent view on the overall policy mix, considering the effectiveness of each policy tool and the synergies and trade-offs among policy tools. Article IV consultations should consider whether a member's economic and financial policies, *taken as a whole*, are conducive to the members' BOP and domestic stability. Simultaneous activation of multiple policy tools has become more common, as more complex shocks and challenges occur in an environment of limited policy space.

47. Examples of the policy mix include: (i) the combination of monetary, exchange rate, macroprudential, and capital flow management policies to guard against external shocks, (ii) the relationship between monetary and macroprudential policies in achieving inflation and financial stability objectives, (iii) the fiscal-structural policy coordination and fiscal-monetary policy interactions in an environment of subdued growth and limited policy space (Box 8).

48. Staff can utilize analytical frameworks to understand synergies and tradeoffs among policy tools, mindful of country specific circumstances. For example, the Integrated Policy Framework (IPF, Section V.A) provides an analytical framework for considering the appropriate policy mix in the face of external shocks. Macrofinancial analysis should be well-integrated in the staff report and linked to the advice on the policy mix, with the latter including financial sector policies. Integrating FSAP findings and recommendations, when available and still relevant, supports this objective (Section IV.B). The Fund's Consistent Policy Assessment (CPA) serves a useful tool to assess the appropriateness of the policy mix. Insights from analytical frameworks (ESA, DSA, RAM) are expected to be well-integrated into staff's analysis of the overall policy mix and policy advice, with the analyses using these frameworks conducted at an early stage of the preparation of the macroeconomic framework underpinning the Article IV consultation.

Box 8. Fiscal-Monetary Policy Interactions

Policy advice may consider interactions between fiscal and monetary policies where relevant. Traditionally, fiscal policy's objectives include aggregate demand management, maintaining debt sustainability, and achieving structural objectives such as distributional outcomes, while central banks have a price stability mandate (complemented by financial stability and full employment goals in some countries). However, in countries where interest rates are close to or at the effective lower bound, central banks alone may not be able to fulfill their mandate. In these situations, greater interactions between fiscal and monetary policies could be considered to provide adequate support to the economy.

When constraints on policies are binding, the benefits of greater policy interactions tend to be larger. In such cases, one policy instrument can create additional space or improve the effectiveness of others. For example, the equilibrium real interest rate could be increased by higher fiscal spending, increasing monetary policy space and increasing the extent of monetary accommodation. Conversely, a new monetary policy framework or a commitment to keep policy rate low, may improve the effectiveness of fiscal expansion in some situations. Conversely, when monetary policy rates are already at a very high level, fiscal tightening may play a larger role in macroeconomic management.

B. Focused Article IV Consultations and Reports

49. For effective surveillance in an evolving economic landscape and increased surveillance requirements, staff needs to balance selectivity and comprehensiveness. Requirements for Fund surveillance and areas of Fund expertise have grown over time, expanding the topics and areas for Article IV consultations. At the same time, Fund resources are limited, and the length of surveillance documents remains restricted. Against this background, selectivity and focus in the coverage of Article IV consultations are key to respond to evolving and member-specific surveillance needs and to provide targeted and granular policy advice that adds value. As with other aspects of surveillance, country-specific circumstances will be decisive in determining the areas and degree of focus. For example, in some members, Article IV staff reports provide a unique source of information and analysis, making a regular, comprehensive coverage of issues and policies desirable.

50. Operationally, when a focused coverage and presentation is appropriate, staff can consider the following options for Article IV consultations and the presentation of staff reports, which are not mutually exclusive.

- *Selective in-depth coverage*. For policy areas where the issues, policy advice, and the authorities' views have not changed materially since the last consultation, staff can briefly discuss the issue with the authorities and staff reports can reference judiciously discussions and policy advice from previous reports. While macrocritical policy areas other than those specifically identified in the ISD (exchange rate, fiscal, monetary, and financial policies) are more likely to be suitable for such a treatment, staff can also consider covering these identified policy areas or parts thereof in a streamlined manner, when appropriate.

- *Thematic lens*. Article IV consultations could be framed around certain overarching topics (e.g., demographic developments), and key policy areas such as fiscal and external policies could be covered through a thematic lens (e.g., how public debt or the current account balance can be viewed in view of an aging population). Organizing staff reports around a certain topic is likely to be more effective when there are pressing, cross-cutting policy challenges, and in cases where repeated in-depth coverage of policies indicated in the ISD adds limited value.

- *Provide concise coverage of other topics.* When an Article IV report is focused on a theme or the in-depth coverage of a certain policy area is extensive, the discussion and presentation of some formal requirements can be significantly shortened and presented in a concise form (Box 9). This presentation should provide clear and unambiguous statements reflecting staff views, policy recommendations, as well as the authorities' views. This would be appropriate in cases and for policy areas where the analysis is straightforward, and the assessment and recommendations are shared with the authorities. This would also allow staff to focus on selected policy areas, allowing for extensive and granular policy discussions.

- *Tailor minimum requirements to country circumstances.* Staff reports are expected to reflect country circumstances, such as the income level, the degree of fragility and vulnerability, institutional capacity and data adequacy, to tailor the focus of surveillance on macrocritical dimensions (Box 2). For example, in countries where data availability is limited, the application of frameworks and methodologies (e.g., EBA-lite model, DSA, the Fund's reserve adequacy assessment) may be difficult. In such cases, the staff's assessment will rely on more basic information and discussions in staff reports may need to be more descriptive and qualitative. Likewise, while coverage of macrofinancial issues is required, for members where the financial sector is under development, coverage on those issues may be brief (Annex II).

Box 9. Concise Coverage in a Focused Article IV Staff Report: Example

This example illustrates a possible discussion of selected required sections in a focused Article IV report in a concise format in line with requirements. This would be most appropriate when the analysis is straightforward, and the assessment is shared by the authorities.

Recent Developments

Real GDP grew by—percent in 20—(accelerating from—percent in 20—), driven by a rebound in fixed investment and private consumption. The output gap is gradually narrowing but remains slightly negative this year, at around —percent. Inflation, at—percent, was only slightly below the central bank's target rate (of—percent). Labor market policies contributed to a further decline in unemployment. The monetary policy stance remains accommodative. The financial system is sound and the tightening of a variety of macroprudential measures was effective in slowing lending to households and house price increases. The current account deficit widened marginally from—percent of GDP in 20— to —percent of GDP in 20—, reflecting an increase in imports of capital goods, which more than compensated for a rise in exports. In line with the budget, fiscal policy continues to be slightly expansionary. Public debt remains sustainable (Annex DSA). The government made steady progress in the implementation Public Financial Management (PFM) reforms (see last year's Article IV). The 20—external position was assessed to be broadly in line with medium-term fundamentals and desirable policies (Annex ESA). The authorities have implemented policies along the line of past policy advice (Annex—). The authorities are taking steps to implement the 20—FSAP recommendations (Box).

Box 9. Concise Coverage in a Focused Article IV Staff Report: Example (Concluded)

Recent Developments

Policy discussion (*Includes the staff's assessment and recommendations in the policy areas that are required to be covered in staff reports*)

Monetary: Given the slightly negative output gap, the currently accommodative monetary stance remains appropriate as long as inflation and inflation expectations remain well anchored. Staff recommends maintaining monetary accommodation and exchange rate flexibility. Considering upside risks to inflation, the authorities should stand ready to assume a tighter monetary stance, if necessary.

Fiscal: *Country_x* has some fiscal space. The 20—budget provides adequate support to the ongoing economic recovery. Staff advised to reduce the primary deficit to its new medium-term target of—percent of GDP, over—years, staring next year, which is needed to ensure public debt sustainability. Staff recommends a reallocation of resources to strengthen the social safety net.

Macrofinancial: Staff's empirical analysis shows that the banking system is resilient to severe negative shocks stemming from high household indebtedness due to the rapid buildup of mortgage debt over the past years. The recent tightening of the macroprudential stance is effectively containing risks to the housing sector and remains appropriate.

External: Exchange rate flexibility should continue to serve as the main defense against external shocks and capital flow volatility.

Macro-structural: Staff welcomes progress in PFM reforms but encourages the authorities to redouble efforts on the remaining priority reform areas highlighted in the previous Article IV consultation report (No.—), thus unlocking new drivers of growth and employment.

Authorities' Views: The authorities agreed with staff views on monetary and fiscal policies, reiterating that monetary policy remains data dependent and that the central bank would consider tightening monetary policy if inflationary pressures materialize. They agreed that there is no need to adjust macroprudential policies at this stage but the authorities should remain alert to vulnerabilities from housing prices. They agreed with the recommended path of fiscal consolidation towards the new medium-term fiscal target, as well as the importance of strengthening the safety net and increasing efforts on the structural reforms areas highlighted by staff. They agreed that the flexible exchange rate serves as the main defense against external shocks.

SECTION IV. POLICIES

51. **This section provides guidance on fiscal, macrofinancial, monetary, external, and macro-structural policies.** While the guidance here is comprehensive, staff is encouraged to exercise judgement as to which aspects of these policies are most relevant for a particular Fund member at a particular point in time.

A. Fiscal Policy

52. **Fiscal policy is vital to maintaining a country's external and domestic stability and possibly global stability.** Fiscal imbalances are often key drivers of internal and external imbalances, and fiscal policy is one of the main levers to address structural challenges such as subdued growth, high inequality, and offers tools to address other challenges such as climate change.

53. Staff reports should include a clear bottom-line assessment of public finances and fiscal policies and provide concrete policy advice. This involves assessing ongoing fiscal policy, identifying vulnerabilities and challenges to stability, and providing fiscal policy advice that is well integrated into an overall policy mix. Policy advice is expected to take into account relevant trade-offs (e.g., between debt sustainability and supporting growth, and between efficiency and equity).

54. The assessment of public finances is encouraged to be comprehensive. Staff is encouraged to use the broadest definition of government available, and can focus on the general government or an even broader perimeter of the public sector where feasible.[13] Where quasi-fiscal operations are significant, related fiscal costs should be included in the measure of the deficit. Staff should consider contingent liabilities as relevant. The following elements could be considered in the assessment, where relevant:

- *Fiscal policy stance* along the cycle, with a discussion of its appropriateness. It is often useful to look at a measure of the fiscal balance that removes cyclical and one-off factors (e.g., structural balance), in addition to the overall fiscal balance.[14]
- *Composition of fiscal expenditure and revenue*, including discussions of the efficiency of public expenditure[15] and the design of tax policy.[16]
- *Sovereign assets and liabilities,* including identifying and mitigating sovereign risk exposures, and presenting data on sovereign assets and liabilities (broader coverage than the central government given data availability), to have comprehensive understanding on the public sector.
- *Financing needs and financing sources*, and possible economic and financial implications.[17] Staff can also monitor arrears and their impact on the economy and the financial sector.
- *Fiscal sustainability*. The debt sustainability analysis provides a useful framework (Box 10). When data are available, balance sheet analysis could be used to assess fiscal sustainability more broadly. In resource-rich economies, analyzing the impact of commodity prices is important.
- *Fiscal risks*, associated with macroeconomic outlook, policy implementations, and contingent liabilities (from public and publicly-guaranteed loans, public-private partnerships (PPPs)), as well as broader risks such as those from SOEs, natural disasters, and pandemics. Staff can consider feedback loops between the public, private, and financial sectors where relevant.

[13] The statistical issues annex should discuss cases where general government data are unavailable. See also Review of the Implementation of Government Finance Statistics to Strengthen Fiscal Analysis.

[14] See Bornhorst and others (2011) and templates in the FAD's webpage.

[15] See IMF pamphlet No. 48, IMF WP 10/202.

[16] See IMF pamphlet No. 55.

[17] For example, fiscal deficits can lead to inflation if they are monetized, while financing from the domestic banking sector can crowd out private investment. External financing may lead to exchange rate appreciations and loss in competitiveness.

- *Fiscal space*—the ability to provide fiscal stimulus without jeopardizing the sustainability of the financial position or the stability of the economy—based on the Fund's fiscal space framework and including a bottom-line assessment in the staff report (Box 11).

Box 10. Debt Sustainability Analysis

This box outlines operational guidance and references on the debt sustainability analysis (DSA). Article IV staff reports should integrate the DSA with the overall policy advice.

MAC DSA. The Debt Sustainability Framework for Market Access Countries (MAC DSA) helps identify a member's vulnerability to sovereign stress, in order to steer the member away from such stress. In Fund-supported programs, which often take place after the stress has developed, the DSA helps determine if sovereign stress can be resolved via a combination of IMF financing and economic reforms, or if measures such as debt restructuring are needed to deliver medium-term debt sustainability.

- *New framework*. The MAC DSA was reviewed in 2021 and it was renamed Sovereign Risk and Debt Sustainability Framework for Market Access Countries (MAC SRDSF). New features of the MAC SRDSF include: (i) it has the General Government debt as the default and expected coverage, while there are circumstances where a narrower or wider coverage may be appropriate; (ii) it has a longer projection horizon, and it provides new tools to assess sovereign risks at three horizons (short, medium, and long term); and (iii) it supports probabilistic debt sustainability assessments to account for full range of uncertainty.
- *Requirement*. For non-program countries, a sovereign risk analysis is needed at the time of the Article IV consultation, while undertaking and publishing a debt sustainability assessment is optional. For countries with Fund arrangements involving GRA resources, both a sovereign risk and a debt sustainability analysis are required. These should be done at the time of program approval and subsequently once a year (unless developments warrant a more frequent analysis), except for exceptional access cases, which require an updated DSA with three-zone sustainability analysis in every program review.
- *Presentation*. In both surveillance and program cases, the write-up for the MAC SRDSF should follow the format indicated in the 2021 Review Policy Paper (especially Box 6 of the paper).

LIC DSF. The Debt Sustainability Framework for Low-Income Countries (LIC DSF) was developed by IMF and World Bank staff. The last review of the framework was conducted in 2017, and a guidance note was published in 2018. The LIC DSF aims to: (i) guide fiscal policy and borrowing decisions of low-income countries in a way that matches their need for funds with their current and prospective ability to service debt; (ii) improve World Bank and IMF assessments and policy advice; (iii) provide guidance for creditors' lending; and (iv) serve as input to the IMF debt limit policy (DLP) and the World Bank sustainable development finance policy (SDFP) for and grant allocation decisions. DSAs using the LIC DSF should be produced for all PRGT-eligible countries with access to IDA resources and all countries eligible for IDA grants.

- *Requirement*. A full LIC DSA should generally be produced at least once every calendar year. The Article IV consultation should be accompanied by a DSA. For non-program countries on longer surveillance cycles, the frequency would match the surveillance cycle. Even when an annual DSA requirement is met, a new DSA should be produced in certain situations for program countries (see Section II.C of the guidance note).
- *Presentation*. Presentation of LIC DSF should follow the guidance provided in the guidance note (especially Section II.D and Appendix II). The LIC DSF comprises a self-contained written analysis, accompanied by a standard set of tables and charts. The DSA write-up must always include the authorities' views, including any disagreement with staff's main findings. The DSA write-up may be streamlined in limited circumstances, when more than one DSA is required in a calendar year and circumstances have not changed significantly (this does not apply in the event of a new program). In such cases, the write- up can focus on the main changes in assumptions and summarize their impact on debt indicators.

Box 11. Fiscal Space

The Fund's fiscal space assessment framework and its 2018 Update and Stocktaking takes a comprehensive approach, incorporating judgment. Countries covered by the fiscal space framework should provide a clear bottom-line assessment in the staff report. A country is assessed as having fiscal space when it can raise spending or lower taxes without endangering market access and debt sustainability.

The framework rests on three broad considerations: (i) liquidity (market access at reasonable conditions); (ii) solvency (public debt sustainability); and (iii) dynamic analysis (whether the actual use of fiscal space remains consistent with liquidity and solvency). Specifically, the framework considered the following questions:

- *Is liquidity at risk for unchanged policies?* Conventional DSA indicators related to the cost and reliability of market access are used to assess this.
- *Is sustainability at risk under unchanged policy?* Again, conventional DSA indicators are used, including the level and trajectory of debt and gross financing needs, as well as the realism with which staff's projected adjustment can be achieved.
- *Are liquidity and sustainability risks materially different if discretionary fiscal policy is actually enacted?* The answer could depend on various factors, such as the economic slack, monetary policy stance, fiscal credibility, the nature of spending needs, and complementarity between fiscal policy and structural reforms.

An assessment on fiscal space requires judgment weighing these considerations, supported by quantitative and qualitative information. The credibility of future fiscal plans, including the role of fiscal rules in enhancing the credibility, is an important judgment, as is the desirability of temporarily deviating from targets, including using the flexibility under most existing fiscal frameworks.

55. Fiscal policy advice is expected to be concrete and specific, reflecting country circumstances. The following elements could be considered in providing policy advice, as relevant:

- *Policy anchor*, which can be specified in terms of levels (e.g., fiscal balance, debt stock) or changes (e.g., size of fiscal adjustment). Cyclically-adjusted indicators could be used where useful.
- *Size and pace of proposed fiscal measures*, which will depend on initial conditions including the state and composition of public finances, available fiscal space, fiscal risks, and inter-temporal policy tradeoffs (e.g., between short-term cyclical conditions and medium-term sustainability objectives), and the size of fiscal multipliers.[18]
- *Role of automatic stabilizers and the composition of discretionary measures,* including whether automatic stabilizers are to be allowed to operate freely or modified, the balance between revenue and expenditure measures, and the mix of temporary and permanent measures.

[18] See Staff Discussion Note and IMF-WP 14/93. For fiscal consolidations, see Reassessing the Role and Modalities of Fiscal Policy in Advanced Economies and the informal guidance on fiscal consolidation.

- *Consistency with the overall policy mix*, considering complementarity and tradeoffs with other policies (e.g., the pace to withdraw fiscal support in the recovery phase, given the stance of monetary policy and economic conditions such as inflation and debt sustainability risks).

- *Institutions, political economy, and implementation constraints.* Policy advice is expected to be practical and implementable. Appropriate timing and sequencing of policies, as well as consideration of mitigating measures, can help to reduce the negative impact of certain fiscal policies such as subsidy reforms and tax increase on the economy and to gain public support for those policies.[19] Well-designed fiscal institutions and frameworks can enhance fiscal policy credibility and transparency.[20, 21] Advice on how to strengthen the effectiveness of fiscal institutions could build on TA findings, where relevant.

56. Policy advice can reflect the role of fiscal policies in achieving broader public policy objectives, including the SDGs, environmental, social and governance (ESG) ambitions in public investment decisions; climate objectives (e.g., net-zero emissions) in designing carbon taxation and revenue mobilization for green investments; and designing the tax system to enhance gender equality and boost female labor force participation (e.g., eliminating tax-induced disincentives for spousal work). More broadly, staff could provide granular fiscal policy advice in areas of the Fund's expertise, building on CD activities where appropriate, including public financial management, tax policy and revenue administration, natural resource management, energy reforms, pension reforms, and public health care.

B. Macrofinancial Analysis and Financial Policies

57. Macrofinancial analysis is an integral part of Article IV consultations, both in the baseline projections and the assessment of risks. It involves an integrated analysis of macrofinancial linkages and systemic risk. These two dimensions of macrofinancial surveillance need to be conducted jointly, as they represent different sides of a dynamic feedback loop that links the financial system and the macroeconomy (Figure 3). The analysis should consider how the overall policy mix affects macrofinancial developments through different transmission channels ("macrofinancial linkages"), as well as how the assessment of systemic vulnerabilities and financial sector resilience ("systemic risk assessment") helps anchor the policy advice.

58. The range of approaches facilitates accommodating country-specific circumstances. The Fund policy and operational guidance emphasize a flexible and pragmatic approach when conducting the analysis, reflecting the diversity and evolution of financial systems across countries,

[19] See WP 15/250 for international experiences in reforming fuel subsidies.

[20] See Fiscal Rules—Anchoring Expectations for Sustainable Public Finances, Function and Impact of Fiscal Councils, Reassessing the Role and Modalities of Fiscal Policy in Advanced Economies, and Fiscal Frameworks for Resource Rich Developing Countries.

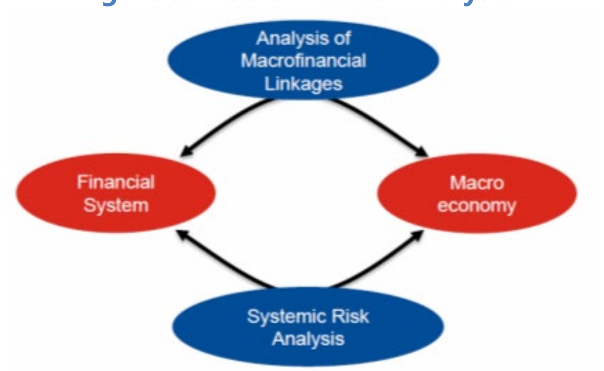
[21] Fiscal transparency is critical for effective fiscal management and accountability. The IMF's Fiscal Transparency Code is the international standard for disclosure of information about public finances.

as well as uneven data availability (IMF 2014, IMF 2017). While simplified analytical approaches are preferred in data constrained environments, such as in low-income countries, there is greater need for a combination of approaches in data-rich environments where the financial system is large, interconnected, or concentrated.

Macrofinancial Analysis in the Baseline

59. Article IV consultations should identify key macrofinancial linkages and ensure consistency between financial conditions and the baseline macroeconomic outlook. The analysis would evaluate how effectively the financial system, comprising financial markets and financial institutions (banks and non-banks), facilitates the channeling of funds between borrowers, lenders, and investors and support economic growth. It would also assess whether any disruptions in the functioning of this intermediation process or any excess in the provision of credit could cause negative consequences for the baseline outlook. Furthermore, the analysis would also examine how current macroeconomic developments impact financial conditions and the stability of the financial system. Where possible, this analysis could consider the balance sheet health of households, the corporate, and the government sectors. When deemed macrocritical, this analysis could also consider how financial deepening or other structural changes, in the way financial markets and institutions operate, impact growth over a longer time horizon. This analysis may be more suited for EMDEs and LICs, as countries in these groups may, in general, be characterized by shallow financial markets, lower financial integration and restricted access to global financial markets.

Figure 3. Macrofinancial Analysis



Source: IMF staff

60. Macrofinancial analysis in the baseline can usefully be guided by the following questions:

- *Recent developments.* What are the key macro and financial trends (e.g., evolution of key asset prices, sectoral leverage indicators, lending standards) and how are these related to the baseline? To what extent do financial conditions drive macroeconomic developments? Do financial conditions influence the effects of macroeconomic policy? And vice versa: to what extent do macroeconomic developments and policies drive financial conditions and financial decisions (e.g., leverage, liability composition)?

- *Real-financial sector consistency.* Is the baseline outlook for the real and financial sectors internally consistent in the short run and over the medium term? Are credit projections consistent with growth projections? Are the financing needs of corporates, households, and the public sector in line with the financial sector's capacity to provide credit or with access to external financing?

- *Financial system contribution to macroeconomic stability.* What are the key financial factors affecting macroeconomic stability? Does the financial system function normally or contribute to macroeconomic instability (e.g., credit/asset price booms and busts)? Are trends in financial inclusion and any financial stability trade-offs properly considered in the baseline projections?

- *Assessment of current policy stance.* How does the current policy mix affect financial conditions, the availability of credit, the health of balance sheets, and economic growth? Are there any structural policies in place that are expected to lead to improved financial deepening?

61. Staff's baseline projections can also be informed by an assessment of the country's position in the 'financial cycle' and the risk entails. The term "financial cycle" is used in this note to signify the level and evolution of slack or excess in the financial sector. This analysis is important as (i) indicators for liquidity and solvency risk (e.g., debt-to-income and debt-to-equity ratios) are typically procyclical, making some risks in the build-up phase difficult to detect (Iossifov and Schmid, 2021) and (ii) knowing the current position and direction in the financial cycle helps inform advice on corrective policies (e.g., macroprudential) and understand the implications of financial factors for economic activity. Staff could gauge a country's position in the financial cycle by comparing credit to its expected structural level, examining developments in asset prices, risk spreads, and lending standards, or jointly estimating the position in the financial cycle with the business cycle (Krznar and Matheson, 2017).[22] This can help inform whether economic growth is consistent with financial stability, or conversely whether risks are growing, leading to a buildup ofsystemic risk whose materialization could induce a severe credit crunch and negative consequences for growth. This analysis can be used to examine, for example, whether the banking system is under significant deleveraging pressures or feeding a credit boom.

Systemic Risk Analysis

62. Beyond the baseline, Article IV consultations should present a systemic risk analysis that identifies and quantifies risks to the stability and functioning of the financial system. Systemic risk is defined as the risk of disruption in the provision of financial services caused by an impairment of the financial system with serious negative effects for the real economy (IMF-BIS-FSB, 2009). It emerges from the presence of financial distortions that can lead to a buildup of vulnerabilities over time and/or to structural vulnerabilities within the financial system. These vulnerabilities increase financial stability risks and could amplify negative aggregate shocks from within or outside the financial system, with potentially serious adverse effects for the real economy

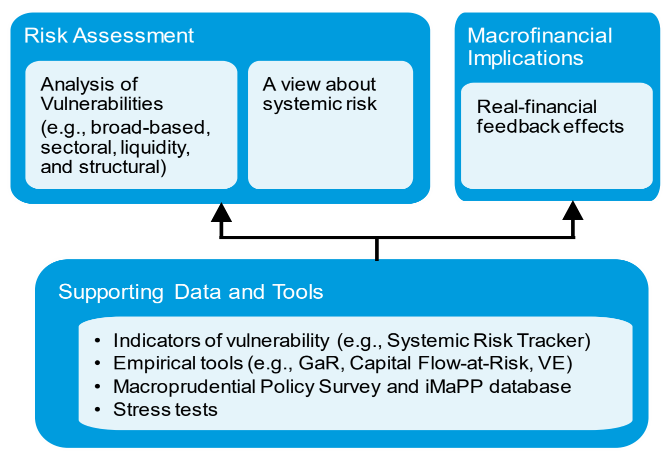
[22] Borio (2012) argues that the financial cycle is empirically best captured by the joint behavior of credit and asset prices, in particular property prices, and can be complemented by the developments in key financial variables in addition to the usual credit and real-estate price indicators. It is important to look at multiple indicators to extract better signals about the state of the financial cycle. To this end, financial conditions are usually proxied by an financial conditions index (FCI) that combines variables such as private sector credit growth, leverage ratios, and the shape of the yield curve to assess the overall state of financial variables affecting the economy (IMF, 2017b). Krznar and Matheson (2017) proposes a model-based approach, with a variety of commonly used statistical methods and a small semi-structural model, to jointly estimate the financial and business cycles in a consistency way.

through two-way negative feedback loops. Systemic risk is multi-dimensional: it can be rising in one dimension while falling in another dimension. Therefore, staff's financial and macrofinancial surveillance needs to provide a comprehensive and rigorous analysis of systemic vulnerabilities to form a view about the extent of systemic risk and its sources (IMF, 2014).

63. Staff can rely on multiple approaches for systemic risk analysis, data permitting. Article IV staff reports should provide a well-articulated view about systemic risk, grounded in a rigorous analysis of financial vulnerabilities (IMF 2021a). The steps below can guide staff's analysis (Figure 4):

- *Staff can start by assessing the relevant vulnerabilities in the economy.* These vulnerabilities can be time-varying or structural and can be broad-based or sectoral. To assess the buildup of systemic vulnerabilities over time, the analysis should consider, where relevant, economy-wide vulnerabilities arising from excessive growth in credit, sectoral vulnerabilities and the potential for macrofinancial feedback loops, and vulnerabilities from excessive maturity and currency mismatches. To assess structural vulnerabilities, the analysis could consider domestic and cross-border linkages within and across financial intermediaries, financial markets, and market infrastructures. In line with the 2012 AML/CFT Guidance Note on inclusion in Surveillance and Financial Stability assessment[23] and the IMF 2018 AML/CFT Strategy, risks surrounding financial integrity issues are expected to be discussed, as necessary, as these would have material implications on the stability of the financial system and its broader economy. Threats to financial stability and macroeconomic performance can be directly attributable to money laundering and terrorist financing in certain cases, resulting, for example, in destabilizing inflows and outflows. Furthermore, AML/CFT vulnerabilities could also result in increased monitoring by the Financial Action Task Force (FATF "grey listing") and pressure on correspondent banking relationships.[24] Staff should address the effects of money laundering, terrorism financing, or related predicate crimes in Article IV reports when they (i) in the context of bilateral surveillance, undermine the relevant member's domestic or balance of payments stability, or (ii) in the context of multilateral surveillance, give rise to spillovers which may significantly influence the effective operation of the IMS, including by undermining global economic and financial stability ("global stability").

Figure 4. Systemic Risk Analysis



Source: IMF (2021).

[23] See AML/CFT – Inclusion in Surveillance and Financial Stability Assessments- 2012 Guidance Note and 2018 Review of the Fund's Strategy on AML/CFT

[24] See 2017 paper on recent trends in correspondent banking relationships: further considerations.

- *Staff's analysis needs to be forward looking and go beyond the banking sector, where relevant.* This means considering the overall evolution of the macrofinancial landscape over the near to medium-term (for example, would a low level of nonperforming loans today remain so once policy support is normalized?). It also means assessing relevant sources of systemic risk outside banks, for instance, risks stemming from financial markets (e.g., misalignment of asset valuations); other financial corporate sector (e.g., insurers, financing companies, and investment funds); the non-financial corporate sector, especially as government support deployed during the pandemic is withdrawn;[25] and households. Identifying the linkages between the financial sector as a whole and the real economy would allow country teams to form an opinion on vulnerabilities arising from contagion.[26]

- *The analysis needs to be supported by data, and where feasible, by appropriate tools.* Many analytical approaches are available to staff to support the systemic risk analysis (for instance, financial soundness indicators, econometric analysis, stress tests, and SWIFT data) both on the cyclical and structural dimension of vulnerabilities: Conditional Value-at-Risk, Balance Sheet Analysis (BSA), network analysis, the Systemic Risk Tracker, the Growth-at-risk (GaR) framework, and the Global Bank Stress Test tool (see IMF (2021) for additional tools).

- *Anchored on the above analysis, staff reports should provide a well-articulated view on systemic risk.* This requirement amounts to having an explicit statement or view on the resilience (or lack thereof) of the financial system to aggregate shocks, given the identified systemic vulnerabilities and the strength of macrofinancial feedback effect in the event of real or financial shocks. It can refer to the direction of change or level of systemic risk in the economy, based on the underlying analysis. The statement or view needs to be supported by data and quantification where feasible but should be also informed by judgment.[27]

64. The FSAP risk analysis is an important resource that can inform systemic risk analysis in Article IV consultations when available. The conclusions of the FSAP risk analysis can serve as a useful reference for country teams' own analysis. Simple stress testing tools, such as those mentioned above, can support Article IV teams' efforts to update FSAP risk analysis, notwithstanding their lower level of granularity than the FSAP analysis. It would be expected that the Article IV staff report's "well-articulated view" is informed by and fully consistent with the analysis and findings presented in the Financial System Stability Assessment (FSSA) if both documents are discussed at the Executive Board at or around the same time.[28]

[25] Whether to extend the analysis beyond the banking system will depend on whether it is judged a source of systemic risk, which would mean it is also macrocritical.

[26] See for instance Araujo and others, 2022, "Policy Options for Supporting and Restructuring Firms Hit by COVID-19 Crisis," SPR/LEG Departmental Paper.

[27] The multidimensional nature of systemic risk implies that in arriving to a view, country teams need to look at multiple indicators/tools simultaneously, since risks do not necessarily cancel each other out.

[28] The integration of Article IV consultations and FSAPs would work in both directions, at least for the 47 jurisdictions with systemically important financial sectors (SIFS). In this regard, the FSAP/FSSA is expected to build on and follow up on Article IV consultations and vice versa.

65. Systemic risk may arise in sectors or areas where quantification remains work in progress. The toolkit and expertise to evaluate new forms of systemic risk, such as those associated with fintech, cyber security, and climate change, will need to adapt as experience is gained. Country teams may therefore need to exercise judgment and flag risks when deemed to be macrocritical, at least qualitatively. The Fund has laid out strategies to deepen its engagement in several of these areas, including to better understand their financial stability implications.

66. The guidance in this section is not a checklist, and country teams can focus on the issues that are relevant for financial stability in each country. In countries in which financial sector activity is highly concentrated in only a few systemically critical institutions, particular attention could be given to the health of those institutions' balance sheets. In line with the objective of focused Article IV consultation, country teams can state the assessment and refer to analysis in previous Article IVs if conditions remain broadly similar and the conclusions of the analysis are still valid. Country teams do not need to replicate the entire analysis.

Digital Money

67. New forms of digital money are a fast-evolving area both in reach and complexity (IMF 2021). The term "digital money" generally encompasses both public and private digital forms of money that serve as a new means of payments, store of value, or unit of account. Digital money (in particular the private forms) enables financial and payment services to take place outside the traditional bank-centered financial system. Significant network externalities can facilitate quick adoption for domestic and cross-border use and give rise to first mover advantages (e.g., in design and regulation). The underlying technologies also enable synergies between infrastructures, big data, digital money, payments and financial activities, and a host of other applications, impacting market contestability.

68. The diversity of digital monies, their different uses and their growing reach comes with complex and evolving challenges that could become macrocritical. Coverage in surveillance needs to be tailored to country circumstances and assessments of macrocriticality. Topics for Article IV surveillance may include:

- *Central Bank Digital Currencies (CBDC).* It is important to monitor the objectives behind introductions or issuances of a CBDC, design options and features, implications for monetary policy and financial stability (domestic and international), and potential risks (central bank operational and reputational risks, financial integrity risks, data privacy and legal risks, and cybersecurity). Furthermore, the issuance and cross-border use of CBDCs could have significant spillover effects across the membership.

- *Digitalization and financial inclusion.* Digital payments including through e-money are often a central component of wider digitalization strategies, and these could be related to financial inclusion or structural reforms (e.g., benefit and cost of doing business, innovation, competition, market integration, etc.). Risks may stem from legal, regulatory and supervisory challenges, and relate to areas such as consumer protection, financial integrity, legal and governance, and operational resilience and cybersecurity.

- *Crypto assets/stablecoin activity*. A wide adoption of crypto assets including stablecoins, including for remittances, can pose risks to monetary sovereignty, capital outflows, or the effectiveness of CFMs. They could also suffer from loss of confidence and, if widely used, could present systematic concerns on a domestic level. Global stablecoins could also have a potential impact on global financial stability if they are widely adopted across borders. Discussion could focus on monetary policy, financial stability and integrity, and external stability. As with CBDC, consumer data protection needs to strike the right balance between two objectives. On the one hand, it should protect privacy and entice private sector participation. On the other hand, it should prevent market manipulation and ensure financial integrity in line with the Financial Action Task Force (FATF) standards.

- *Spillovers*. Countries may experience spillovers from digital money adoption in other countries. Availability of a foreign CBDC or stablecoin could facilitate currency substitution, leading to a loss of policy effectiveness or emergence of crypto tax havens, risking financial stability and integrity.

69. Monitoring, as relevant, the cross-border implications of digital money adoption in Article IV consultations can help with early detection of associated risks. The risk of fragmentation and of a global digital divide is stark. International cooperation is key to ensure interoperability and the common setting of standards, which are essential to digital moneys facilitating cross-border trade and financial flows, while closing opportunities for regulatory arbitrage. Increased efforts in these directions are being made in international fora, for example in terms of setting common high-level principles for CBDC issuance (see G7 Public Policy Principles for Retail Central Bank Digital Currencies). The IMF, jointly with other international bodies, needs to play a key role to promote international coordination in areas pertaining to digital money.[29]

70. Guidance for surveillance is evolving. In 2021, the Fund adopted a Strategic Plan to develop the knowledge and expertise to help members reap the full benefits and manage the risks associated with digital money. Policy discussions may involve domestic and international dimensions. For example, domestic dimensions may include legal and regulatory frameworks and cyber and other operational risks. Broad domestic dimensions may include monetary policy and financial stability implications, financial inclusion, structural policies (competition, innovation), and fiscal implications. International dimensions may include financial integration, capital flows (including effectiveness of capital flow management measures), spillovers, reserve currency configurations, backstops, and the stability of the IMS.

[29] The Draft Workplan for a New Data Gaps Initiative led by the IMF in close cooperation with the Inter-Agency Group on Economic and Financial Statistics and the Financial Stability Board, includes a recommendation on Digital Money. The objective is to develop a common data collection framework on new forms of digital money and crypto assets used as a means of payment, including CBDCs and global stable coins to improve measurement of money and liquidity aggregates as well as cross-border transactions using digital money.

Financial Sector Policies

71. A sound risk assessment helps anchor financial sector policy recommendations. Financial sector policies may range from prudential and AML/CFT regulation and supervision to crisis management and resolution. Country teams should identify where financial and macrofinancial risks and vulnerabilities are rising, elevated, and/or concentrated. Such assessment can inform policy advice to manage the risks and vulnerabilities.

72. The Fund's macroprudential policy framework provides operational guidance for staff's policy advice (IMF, 2014)**.**[30, 31] Key elements of macroprudential policy advice include an assessment of existing macroprudential tools (costs and benefits, effectiveness, and leakages); mapping from systemic vulnerabilities to specific policy tools; calibration (deployment, tightening or relaxing); an appropriate policy mix and communication; and the institutional framework. This is not a checklist. Article IVs can focus on the issues that are relevant for financial stability, taking account of country circumstances. For low-income countries, not all of the issues listed in this paragraph will present themselves, but staff is likely to encounter at least some of them. The combination of limited data availability, volatile economic conditions, and weak institutional capacity may mean that simple approaches are to be preferred over an active recalibration of policies. In formulating financial sector policy advice, teams can draw from guidance by international standard-setting bodies such as the Basel Core Principles, IOSCO Principles of Securities Regulation, and the FSB Key Attributes of Effective Resolution Regimes.

73. Country teams should leverage key FSAP recommendations on macroprudential and other financial policies through an adequate follow-up in Article IV consultations. Many FSAP recommendations are structural in nature, involving institution building and introduction of new or improvement of existing systems that can take several years to materialize. Therefore, FSAP recommendations often remain valid for many years and should be followed up on in subsequent Article IV consultations. Against this backdrop, early engagement of country teams and FSAP teams will facilitate the follow-up of FSAP findings and recommendations (IMF 2021a). When the Article IV consultation is concluded at the same time or shortly after an FSAP, the expectation is that country teams cross-reference in the main text of the Article IV staff report the recommendations presented in the FSSA.

C. Monetary Policy

74. Monetary policy is encouraged to be discussed as an integral part of the overall policy mix, including in relation to external and macroprudential policies.

[30] Macroprudential policy, designed to limit systemic risk, is complementary to and distinct from microprudential policy, designed to mitigate risks at individual institutions.

[31] See also IMF (2014) for detailed guidance on macroprudential instruments as well as IMF (2016) for considerations for LICs.

- *Relation with external policies.* For countries with flexible exchange rate regimes, monetary policy would usually focus on the internal balance (inflation close to target and output gap close to zero) and whether real interest rates are consistent with the economy's cyclical position. Using monetary policy to counter pressures on the exchange rate can be justified, however, if pass-through from exchange rate depreciation or appreciation hinders achievement of the inflation target (IMF 2020). In fixed exchange rate regimes, foreign exchange intervention is endogenous, and if the capital account is open, room for independent monetary policy is limited.

- *Relation with macroprudential policies.* The costs of tightening monetary policy to guard against financial stability risks are generally perceived to outweigh the benefits in most circumstances (IMF, 2015). However, there can be a case for using monetary policy to "lean against the wind" when the coverage of macroprudential measures is inadequate and leakages contribute to the buildup of financial vulnerabilities, even as the thrust of staff advice would be to seek to address those limitations.

75. Staff is expected to align monetary policy advice with macrofinancial analysis. Focusing on the policy rate (typically the short-term rate) may be appropriate when interest rates are not close to the effective lower bound. However, when that is not the case, unconventional monetary policy (UMP), including the central banks' asset purchases, would need to be considered. Since the UMP may operate and transmit to the real economy and the financial system through broader channels, an in-depth analysis of balance sheet linkages and financial conditions, as well as the institutional and operational framework of the central bank conducting UMP, may become more important. Staff could also consider effectiveness of monetary policy and financial stability risks in a low interest rate environment.

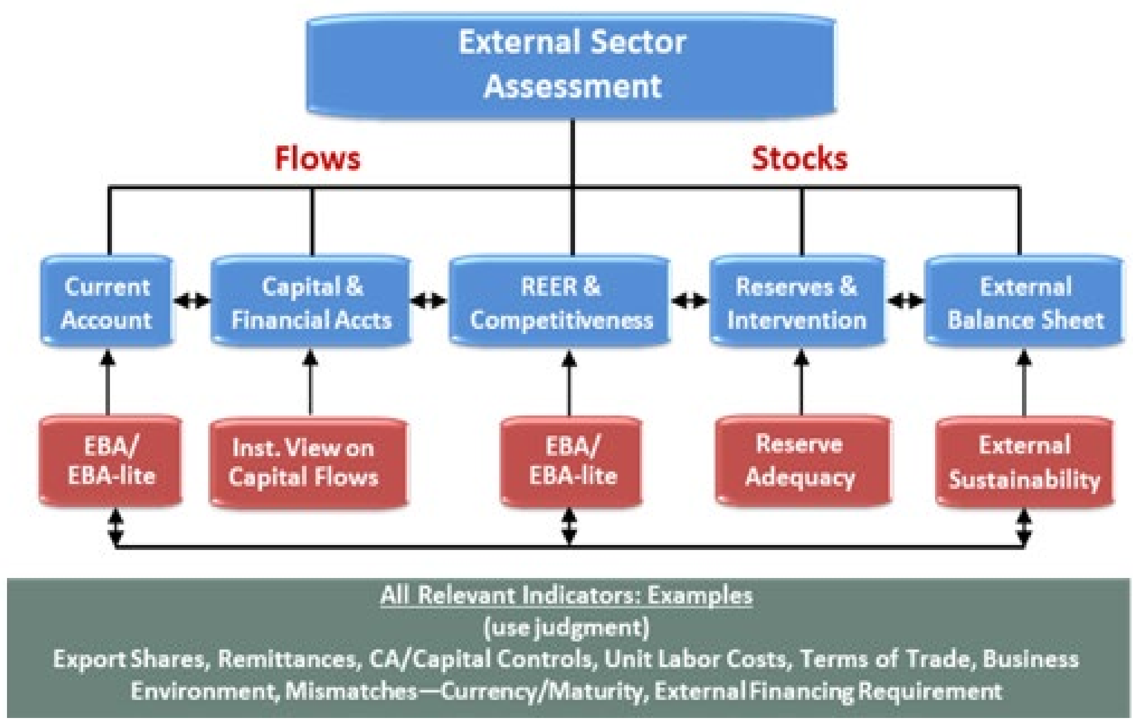
76. The discussion on monetary policy may need to pay attention to spillovers. For example, a monetary policy tightening or an exit from UMP by systemic countries may generate outward spillovers through capital flows and the impact on asset prices, which may pose challenges for macroeconomic management of other countries. As indicated earlier (Sections II.A and III.A), staff should examine outward spillovers from a member's policies in two circumstances: (i) the member's policies are not promoting its own domestic or external stability or (ii) the member's policies are promoting its own stability, but they could nevertheless significantly affect global stability. In some circumstances, spillback effects may be relevant for discussions of monetary policy.

D. External Sector Policies

77. Global stability depends, to a large degree, on the BOP stability of individual countries. BOP flows are linked to movements in exchange rates, interest rates, asset prices, and foreign exchange reserves, and so can catalyze economic and financial crises. The IMF has a mandate to promote a stable system of exchange rates, exercise firm surveillance over exchange rate policies, and help correct maladjustments in members' BOP. Thus, every Article IV report should assess the member's external position and its impact on the stability of the member and, where relevant, global stability.[32]

78. Staff should provide a clear bottom-line assessment of the member's external position, drawing from a broad range of perspectives. Staff can draw on all pertinent information, while acknowledging the inherent uncertainties. The external sector assessment (ESA) should assess and discuss recent developments of five key areas: (i) the position and trajectory of foreign assets and liabilities, (ii) current accounts, (iii) real exchange rates, (iv) capital flows and policy measures, and (v) foreign exchange intervention and reserve levels (Figure 5). Quantitative estimates such as those derived from the Fund's External Balance Assessment (EBA) or EBA-lite methodologies would underpin the assessment (Box 12). Assessments can be tailored to country circumstances and focus on the most important issues, with the depth of coverage reflecting the degree of concern. The bottom-line assessment must be consistent with the numerical inputs from the EBA models as well as analytically grounded judgment and country-specific insights.

Figure 5. Conceptual Framework for External Sector



[32] External sector assessments (ESAs) should be done annually, even if Article IVs are done less frequently. The assessment year should be the year prior to the Board discussion. For example, Board discussions taking place in year N should include an assessment for year N-1.

Box 12. EBA and EBA-Lite Methodologies

The Fund's framework for external sector assessments (ESA) is anchored by the External Balance Assessment (EBA) and EBA-lite methodologies.

External Balance Assessment (EBA). A multilaterally consistent estimate of current account and real effective exchange rate (REER) gaps. Norms and gaps can be decomposed into contributions from fundamentals and foreign and domestic policies. EBA countries should report EBA results. If other methods (such as EBA-lite) are deemed more suitable for a particular EBA country, country teams can base their assessment on these results in consultation with RES and SPR. The External Sector (ES) model may also be applied to EBA countries as appropriate.

EBA-lite. The EBA-lite suite of models applies to a broader group of countries (147 including EBA countries). The EBA-lite sample is more varied by type of economy and range of external positions. Building on the EBA approach, the CA and REER models include explanatory variables more relevant to smaller and lower-income economies, such as financial deepening, natural disasters, and a proxy for remittances. Models specific to commodity exporters are available to apply considerations of inter-generational equity and investment needs. The External Sustainability (ES) model may also be applied to EBA countries as appropriate.

Other Methods. Countries with special circumstances, such as financial centers, may use other relevant methods and information. Countries with serious data limitations may need other approaches, including use of qualitative information (e.g., recent and prospective BOP developments, the DSA, reserve adequacy, or others).

79. Insights from the ESA should be integrated into staff's advice on the overall policy mix and discussed in the main text of the staff report. The ESA can inform discussions on exchange rate and domestic policies and the policy mix more generally. Recommended macro and structural policies in the ESA should be consistent with the ESA overall assessment, well-integrated with the report's overall macro-framework and policy recommendations and should address the underlying causes of any identified imbalances. Moreover, as an integral part of the staff report, the bottom-line external sector assessment should be included in the staff appraisal.

Foreign Assets and Liabilities: Position and Trajectory

80. Staff should assess whether the stocks of gross external assets and liabilities are consistent with a sustainable external position. In examining balance sheet vulnerabilities, and data permitting, staff would analyze both gross and net positions—especially gross debt obligations, the composition of external assets and liabilities (e.g., debt vs. non-debt), and mismatches arising from currency, liquidity, or maturities, and draw on the results of external debt sustainability frameworks. The External Sustainability model should be applied to countries with large, negative net international investment positions or other indicators of sustainability concerns. It should be reported and could form the primary basis of the assessment when it indicates sustainability concerns. More generally, staff should highlight sustainability or other risks associated with the external stock positions and reflect such factors, where macroeconomically relevant in the overall assessment.

Current Account and Real Exchange Rate

81. Staff should assess whether the current account and real exchange rate are broadly consistent with their EBA/EBA-lite benchmarks. The EBA/EBA-lite framework produces multilaterally consistent estimates for current account and real exchange rate norms (benchmarks), which depend on country fundamentals and desired policies (Box 12). Staff can estimate current account and real effective exchange rate gaps by comparing actual current accounts (stripped of temporary components) and real effective exchange rates with their IMF staff–assessed norms, using analytically grounded judgment and country-specific insights where appropriate. The principles for the guidance of members' exchange rate policies are set out in the ISD (Annex I).[33]

82. Staff is expected to assess the level of the real exchange rate irrespective of the member's exchange rate regime, including those with a freely floating exchange rate (and hence no explicit exchange rate policies) or those without national currencies. A current account or real exchange rate gap can occur in free floats, as in other regimes. In currency unions, the REER and current account should be assessed at the level of both the union and the individual member, and staff should determine if vulnerabilities of individual members could affect the stability of the entire union (Annex III).

83. The basis for staff's assessments should be quantified clearly and explained in policy notes, staff reports, and discussions with country authorities. Results could differ across models, for example due to emphasis on different explanatory factors, or lags between exchange rate movements and changes in the current account. Model results should not be averaged. Rather, staff should identify which estimate is most plausible and anchor the assessment on it. Other factors can supplement and aid the interpretation of the EBA and EBA-lite methodologies. The EBA and EBA-lite methodologies can help identify domestic (and foreign) policy contributions to external imbalances, but staff should discuss domestic policy contributions to external imbalances regardless of the methodologies used.

84. To promote transparency and evenhandedness, staff should report the methods and key assumptions used in assessments. This includes assumptions behind the current account and exchange rate estimates and adjustments (if any) made to standard methods. Adjustments can be appropriate to avoid distorted assessments but should be quantified, well-justified, and, where possible, multilaterally consistent.

Capital and Financial Accounts: Flows and Policy Measures

85. Staff should assess developments in the capital and financial account of the BOP.[34] The assessment would cover developments in gross and net capital flows, their size, composition, and sustainability, whether there is likely an inflow surge or disruptive outflows, and their impact and the

[33] Article IV staff reports should assess compliance with Article IV commitments only if the member is found to be non-compliant. For detailed guidance on the interpretation and application of the principles, see FAQs—Guiding Principles.

[34] Capital flows can have substantial benefits for countries, including by enhancing efficiency, promoting financial sector competitiveness, and facilitating productive investment and consumption smoothing. However, they can also carry risks, which can be magnified by gaps in countries' financial and institutional infrastructure.

challenges they may pose for macroeconomic and financial stability. Staff should also consider how the authorities have adjusted policies in response to the capital flows, including macroeconomic policies, macroprudential policy measures (MPMs), or capital flow management measures (CFMs), and whether they have announced or implemented measures to liberalize capital flows.

86. Staff reports should discuss capital flows and related policies when these have implications for the member's domestic or BOP stability, or if they have implications for effective operation of the IMS. The discussion should be based on the Fund's Institutional View (IV) on the Liberalization and Management of Capital Flows.[35] It should accurately characterize the measures implemented to manage capital flows, distinguishing between CFMs, MPMs, and CFM/MPMs, and assess their appropriateness under the IV.[36, 37] Staff should also highlight any potential or actual outward spillovers if they may have significant implications for global stability, i.e., for the effective operation of the IMS.

87. Where relevant, staff reports should discuss proposed or implemented plans to liberalize capital flows. The discussion should be based on the Fund's IV on the Liberalization and Management of Capital Flows, which proposes guidelines for capital flow liberalization without presuming that liberalization is always an appropriate goal for all countries. The discussion could cover: (i) how the authorities' liberalization approach compares with the IV's "integrated approach," taking into account country circumstances; (ii) the soundness of the financial sector and institutions, bearing in mind the need to handle the flows resulting from the liberalization; and (iii) any potential or actual outward spillovers resulting from the liberalization if it may have significant implications for global stability.

Reserve Adequacy and Foreign Exchange Intervention

88. As part of the ESA, Article IV reports should discuss reserve adequacy, and provide a bottom line on the adequacy of reserves for precautionary purposes. The discussion would reflect country circumstances and risks relevant for assessing reserve needs, the authorities' objectives (including non-precautionary objectives for holding reserves), and the cost of holding reserves. Adequacy metrics (e.g., months of imports, reserves to short-term debt, or the Fund's metric) can be supplemented by scenario analysis.[38] Potential short-term drains to reserves (including from derivative transactions from central bank FX liabilities to residents) should be covered when they could significantly affect available buffers. Consideration should be given to

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[35] See Liberalization and Management of Capital Flows: An Institutional View (2012).

[36] CFMs are measures that are designed to limit capital flows, while MPMs are primarily prudential tools that are designed to limit systemic financial stability risks. Measures that are designed to limit systemic financial risks stemming from capital flows are classified as CFM/MPMs. An interdepartmental group works with country teams to ensure consistent and evenhanded classification of measures, while also ensuring that the policy recommendations are adequately guided by the Fund's frameworks on capital flow management and macroprudential policies.

[37] See Guidance Note for the Liberalization and Management of Capital Flows (2013), Managing Capital Outflows - Further Operational Considerations (2015), and Review of the Institutional View on the Liberalization and Management of Capital Flows (2022).

[38] Additional guidance, including accommodation for special cases, can be found in Assessing Reserve Adequacy—Specific Proposals (2015) and Assessing Reserve Adequacy--Further Considerations (2013).

exclude from reserve assets those that are pledged, collateralized, or otherwise encumbered. Non-reserve buffers, including contingent financing, the use of Fund resources and derivative transactions, can be taken into consideration.

89. Foreign exchange intervention can also be relevant to a member's BOP and global stability. Intervention should be used, if necessary, to counter disorderly market conditions (DMCs), which may be characterized *inter alia* by disruptive short-term movements in the exchange rate.[39] Staff should document the DMCs, ideally with objective market measures. Intervention could also be an appropriate part of a member's policy toolkit outside of narrowly defined DMCs. Analysis and advice on intervention policies should be tailored to country characteristics and the nature of shocks, taking into account possible domestic side effects, cross-border spillovers, and interaction with other policies (Section V.A, IPF).[40] Important country characteristics to consider include the extent of balance sheet exposures and currency mismatches, the depth of the FX market, the degree of central bank credibility, whether the currency is over- or under-valued, and the effective lower bound on monetary policy. Staff would also support measures to foster market development and reduce balance sheet vulnerabilities, thereby avoiding persistent use of intervention.

90. Intervention should not be used to manipulate the exchange rate to prevent effective balance of payments adjustment, to gain an unfair competitive advantage, or in a way that gives rise to BOP instability.[41] The ESA can be used to judge whether countries are using intervention to pursue competitive advantage. Also, staff should discuss with the authorities protracted large-scale one-sided interventions and excessive and prolonged official or quasi-official accumulation of foreign assets for balance of payment purposes. The Fund's assessment of reserve adequacy should be used to analyze whether there are sufficient reserves to allow intervention or if reserve accumulation is warranted during inflow episodes.[42]

Exchange Rate Regimes

91. Staff should identify the *de facto* and *de jure* exchange rate regimes. The *de facto* exchange regime refers to the actual conduct of exchange rate policies,[43] which may differ from the de *jure* regime. Both the de jure and de facto regimes must be specified in the Fund Relations appendix.[44] Where applicable, staff reports should discuss changes in the authorities' future policy intentions. The Monetary and Capital Markets Department (MCM) provides the Article IV team with the most up-to-date classification of the de facto regime.

[39] See Decision No. 15203-(12/72) (2012), paragraph 21.

[40] See Toward an Integrated Policy Framework (2020).

[41] See Decision on Bilateral and Multilateral Surveillance (2012), Part II - Principles for the Guidance of Members' Policies.

[42] Liberalization and Management of Capital Flows: An Institutional View (2012), Section III.A discusses intervention in the context of capital inflows.

[43] The regime should be classified according to Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER) definitions.

[44] If the de facto and de jure regimes coincide, staff can refer to both as "The exchange rate regime is [___]."

92. Reports should assess the adequacy of the *de facto* regime for maintaining stability. Staff should examine the consistency of the exchange rate regime with the policy mix, considering the appropriateness of the fiscal stance, monetary objectives, and the financial sector regulatory framework. Discussion of alternative regimes should take into account the authorities' views, and their readiness and capacity to implement changes.

Exchange Restrictions and Multiple Currency Practices

93. Staff must determine whether a member has introduced or is continuing to maintain exchange restrictions or multiple currency practices (MCP) that require Fund approval.[45] Any exchange restrictions or MCPs subject to Article VIII or maintained under the transitional arrangements of Article XIV, Section 2 should be identified in staff reports.[46] For newly introduced or modified exchange restrictions or MCPs subject to Article VIII, Sections 2 (a) and 3, the staff appraisal should make a recommendation concerning Board approval.[47, 48] If staff recommends Board approval, the staff report should explain whether the approval criteria are met. Staff should inform members that failure to notify and seek Fund approval would be a breach of their obligations. In cases where a member is found to be in breach of obligation under Article VIII, Section 2(a) or Section 3, staff should *always* seek an explicit view from the authorities on this finding when initially made, for inclusion in the staff report. For those members that haven't yet accepted these obligations, staff should encourage them to do so. For members that continue maintaining transitional arrangements under Article XIV, Section 2, the staff report and informational Annex

[45] Exchange restrictions are restrictions on payments and transfers for current international transactions. Multiple currency practices occur when official action causes exchange rate spreads and cross rate quotations to differ unreasonably from those that arise from the normal commercial costs and risks of exchange transactions. Staff is encouraged to work closely with MCM and LEG to assess the economic aspects of restrictions or practices and determine if they violate the Articles of Agreement. For more information, see Articles VIII and XIV of the Articles of Agreement and Decision No. 6790-(81/43) (1981) on multiple currency practices.

[46] Where an exchange restriction or MCP is identified for the first time and/or the existing measures have been changed but not discussed in the preceding published country reports, the description should be in the main body of the staff report and in the informational annex. Thereafter, the description may be in the body of the staff report or solely in the informational annex, at the team's discretion.

[47] The Fund may approve the imposition or maintenance of exchange restrictions subject to Article VIII, Section 2(a) provided that the restrictions are imposed for balance of payments reasons, are not discriminatory, and their use will be temporary while the member is seeking to eliminate the need for them. More detail can be found in Guidance on the Procedures for the Acceptance of Obligations of Article VIII, Sections 2, 3 and 4.

[48] The Fund may approve multiple currency practices subject to Article VIII, Section 3 when such practices are:

(1) introduced or maintained <u>for balance of payments reasons</u>, provided that the member represents and the IMF is satisfied that the measures are *temporary* and are being applied while the *member is endeavoring to eliminate its balance of payments problems*, and provided that *they do not give the member an unfair competitive advantage* over other members or discriminate among other members;

(2) introduced or maintained principally for <u>non-balance of payments reasons</u>, provided that such practices *do not materially impede the member's balance of payments adjustment*, *do not harm the interests of other members*, and *do not discriminate among member*s. Approval on this basis would also be temporary while the IMF would continue to urge members "to apply alternative policies not connected with the exchange system". (Decision No. 6790-(81/43), March 20, 1981, as amended).

should mention these measures and a decision on concluding the annual Article XIV consultation will be proposed. Members must also notify the Fund if they impose exchange restrictions for security reasons.[49]

Trade Policy

94. Executive Board guidance has called for robust attention to trade policy in Fund surveillance, even before the severe trade tensions that began in 2018.[50] Executive Directors have called specifically for greater emphasis in multilateral surveillance on the global effects of trade policies in systemically important countries (including the global impact and risks of trade conflict) and, for all countries, for bilateral surveillance to address macrocritical trade policy issues while ensuring that advice is evenhanded. Directors have emphasized that trade reforms can complement other structural reforms, spur investment, and support stronger policy and institutional frameworks.

95. The Reference Note on Trade Policy, Preferential Trade Agreements, and WTO Consistency provides detailed guidance on certain areas of trade policy. Key aspects of this guidance include: (i) strongly discouraging resorting to trade taxes for revenue purposes, as they are inefficient revenue sources and spill over negatively to trade partners; (ii) the Fund opposes import surcharges on economic grounds in the vast majority of cases; when used, they should be phased out rapidly according to a pre-announced timetable; and (iii) policy reversals should be avoided, as a backtracking on previous trade policy reforms, even with relatively minor policy reversals, promotes policy uncertainty and encourages rent-seeking.

96. The 2015 Review of the Role of Trade in the Work of the Fund emphasized ways that the coverage of trade policy issues in Fund surveillance could be further tailored to the needs of specific countries and country groups. In many advanced economies, for example, a key issue is how to advance new trade policy areas such as services, regulations, and investment. Many emerging market economies could benefit from further reforms in traditional trade policy areas to better anchor into global value chains. Greater integration for LIDCs requires sustained efforts to reduce trade costs, including by upgrading trade-related infrastructure, and improving national and regional economic institutions.[51]

E. Macro-Structural Policies

97. Structural reforms are central to promoting domestic and global stability. Structural reforms also include policies that help ensure economic and fiscal sustainability. Article IVs should cover structural policies that are macrocritical, focusing policy advice on those in which the Fund has expertise (Box 2).

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[49] Restrictions imposed solely for the purposes of national or international security are subject to different procedures. More details can be found in Decision No. 144-(52/51) (1952).

[50] The Acting Chair's Summing Up - IEO Evaluation of IMF Involvement in Trade Policy Issues - Executive Board Meeting 09/57 - June 8, 2009.

[51] The Chairman’s Summing Up - Review of the Role of Trade in the Work of the Fund - Executive Board Meeting 15/21 - February 27, 2015.

98. Conceptual frameworks and analytical tools have been developed to provide more granular policy advice on a number of macro-structural policies. A pilot exercise was launched in 2017 to enhance the focus on structural reforms in the macroeconomic context. A conceptual framework developed by staff helps achieve this objective and contributes to greater consistency of macro-structural surveillance across members.[52] To further enhance the quality of analysis and policy advice on macro-structural issues, staff is encouraged to leverage the expertise of other organizations as appropriate (IMF 2021).

99. Identification of key bottlenecks to inclusive growth helps determine where structural policies have the greatest impact on stability and growth. Staff can assess how far the country stands with respect to the efficiency frontier, and target areas where Fund analysis and policy advice will likely have the most value added.

100. The overall policy mix and outlook should be considered when determining a structural reform agenda. Staff can carefully assess the impact of structural reforms on the economy and integrate the reform agenda in the outlook and fiscal discussions, as appropriate. Staff may also consider prioritization and sequencing of structural reforms, considering country-specific circumstances and the cyclical position, available policy space, and synergies with demand policies (IMF 2015). For example, in circumstances with a negative output gap and limited policy space, structural reforms that support growth in the short-term and at the same time can be implemented in a budget neutral fashion could be considered. Product market reforms, such as reductions in barriers to entry in the services sectors, may serve this role in some cases. Additionally, staff could consider a package of policies to mitigate the possible negative short-term impact of structural reforms on the economy—for example, reforms on employment protection legislation can be combined with active labor market policies to mitigate possible worker displacements (IMF, 2017).

101. Policy advice could consider synergies and complementarities between fiscal and structural policies. This includes the impact of structural policy on fiscal positions, and complementarities and tradeoffs among policies. Many structural reforms, such as labor and product market reforms, can have a positive impact on output, and this in turn may improve fiscal positions and debt dynamics over the medium term, potentially paying for themselves.[53] Conversely, especially under weak cyclical conditions, targeted fiscal support may facilitate structural reforms by alleviating transition and social costs. Also, fiscal policies may have implications for fiscal space and the need for structural policies. Assessments on these issues can be based on empirical analysis where possible.

[52] IMF 2016. "Staff Note for the G20— A guiding Framework for Structural Reforms". A macrostructural pilot repository including good practices in macrostructural analysis and diagnostic note is available at the Fund's Knowledge exchange page for Structural Reforms and Growth. The Fund's Research Department has a unit to advance analytical work related to structural policies.

[53] IMF, 2017. "Labor and Product Market Reforms in Advanced Economies: Fiscal Costs, Gains and Support," SDN/17/03.

102. The range of structural issues that could be covered in an Article IV should reflect country circumstances. Impediments to efficient production of goods and services and the efficient allocation of resources are considered structural issues, and a thorough analysis of structural policy gaps may be warranted. Such impediments may arise from price setting, public finance, state-owned enterprises, financial sector regulation, labor market regulation, social safety nets, or institutions. After identifying key structural policy gaps, staff can assess a menu of structural reforms and prioritize policy advice considering country circumstances and other factors (e.g., policy objectives, implementation capacity).

103. Some structural issues that staff may consider include:

- *Jobs and growth*. The Fund's work on jobs and growth includes a Board paper, case studies, a guidance note, and a toolkit. Key areas are: (i) assessing whether domestic policies keep the economy operating at capacity, (ii) identifying binding constraints for growth, (iii) providing advice on labor market policies, and (iv) integrating policy advice to create jobs and boost labor force participation. These may be discussed around various topics, such as productivity, inequality, and demographics.

- *Infrastructure*. Investment in public infrastructure could raise output, particularly in periods of economic slack when investment returns are high and borrowing costs are low. In discussing infrastructure investment, staff could consider its growth and fiscal impact, its quality and expected returns, the risks from partnerships with the private sector, and the quality of public institutions.[54] Staff can also consider discussing public infrastructure related to climate change when appropriate, drawing on climate PIMA.

- *Labor markets*. Skill mismatches, high social security contributions, and high minimum wages may lead to high unemployment rates. Staff could explore policies related to worker training and education, as well as other labor market and structural policies, drawing on the expertise from other organizations such as the ILO and the OECD.

- *Social spending*. The Fund has developed a strategy for engagement in social spending. Social spending—defined as social protection, health, and education spending—is a key policy lever for promoting inclusive growth, addressing inequality, protecting vulnerable groups during structural change and adjustment, and stabilizing demand after economic shocks.

- *Public pensions*. These provide insurance for income replacement and poverty alleviation for labor force withdrawals related to old-age and disability. Public pension spending is already a large part of fiscal spending in some countries, and it is projected to increase owing to demographics.

[54] For examples, see an overview of infrastructure issues in chapter 3 of the April 2014 World Economic Outlook (WEO) as well as Infrastructure, Natural Resources Key to Inclusive Growth in Africa and Sustaining Development in Low-Income Asia: Infrastructure Investment and Financial Sector Development.

- *Public sector enterprises*. They make up a considerable share of the economy in some countries and can imply significant fiscal risks when they operate inefficiently and become a drain on public finances and carry significant liabilities.[55] Staff may consider options such as improving productivity and management of those enterprises, as well as privatization.

104. Article IV staff reports should discuss governance vulnerabilities and corruption issues when they are macrocritical. The IMF has developed a framework and guidance for engagement on governance issues (Box 13). Staff reports would suggest specific, concrete, and actionable policy measures to reduce vulnerabilities identified, also drawing on capacity development work when available. Staff may also discuss how political economy and governance considerations could affect the appropriate packaging, tailoring, and sequencing of structural reforms.

Box 13. Governance

Fund engagement on governance and corruption issues is guided by the 1997 guidance note on The Role of the IMF in Governance Issues, and The Framework for Enhanced Fund Engagement on Governance, which was adopted by the Board in 2018. The framework is designed to promote more systematic, deeper, candid, and evenhanded engagement with members on governance vulnerabilities, including corruption, that are considered macrocritical. It establishes a centralized process for assessing governance weaknesses and related reform priorities implemented by the interdepartmental Governance Working Group (GWG). For each country, the GWG forms a consensus on the main areas of weakness and the overall severity of corruption, which is then approved by management.

Coverage. All of the main governance weaknesses identified by the GWG are expected to be covered in depth at some point during the course of a medium-term surveillance cycle. A medium-term surveillance cycle is normally three years, starting from adoption in April 2018. A stocktaking of the experience with the 2018 Framework is planned in the context of the formal review of the Framework scheduled for early 2023.

Content. Article IV staff reports should discuss the identified governance vulnerabilities and suggest specific, concrete, and actionable policy measures to reduce them. If corruption risks are high and a well-defined governance reform agenda does not already exist, country teams are encouraged to request a governance brainstorming session well in advance of the mission with experts from functional departments and the World Bank to identify and prioritize key governance and corruption issues and plan how best to address them.

Capacity development. Surveillance on governance issues can draw on available capacity development work as necessary, and it can help to identify needs for such assistance. Governance diagnostic missions can be provided at the authorities' request, subject to resource availability. These missions typically involve multiple functional departments led by FAD/LEG, take a deep dive into some or all of the key state functions related to good governance (fiscal governance, financial sector oversight, central bank governance, market regulation, rule of law, AML/CFT, and anti-corruption frameworks), make specific and prioritized reform recommendations, and actively seek to promote country ownership of reform efforts, including by engaging with civil society. These reports are published in most cases, often as the government's own report or in conjunction with a government action plan based on the report's findings.

[55] The Fund has developed a note on how to assess fiscal risks from state-owned enterprises.

Box 13. Governance (Concluded)

Follow-up. In cases where all governance issues have been adequately covered in previous Article IV reports, the remaining reports in the surveillance cycle would be expected to at least (i) briefly note key governance issues identified (this could be done by cross-referencing the previous report(s) for details, though more discussion could be added if there have been major developments since the last report), and (ii) provide a candid discussion of any progress (or lack thereof) in implementing key recommendations on governance and anti-corruption issues from past reports, which could be done in the standard annex on implementation of past Article IV advice. In general, the depth of follow-up discussions would be proportional to the severity of governance weaknesses

Transnational aspects of corruption. The Fund also encourages all members—regardless of whether they experience severe corruption themselves—to volunteer to have the Fund assess the degree to which their legal and institutional frameworks (i) criminalize and prosecute bribery of foreign public officials and (ii) have effective AML systems that prevent foreign officials from concealing corrupt proceeds in their countries. The expectation is that each consultation systemically assesses progress in at least one, and ideally both, area(s). To avoid duplication of work, these assessments draw heavily on existing analysis by the FATF, OECD Working Group on Bribery, and/or the UNODC, as relevant.

SECTION V. APPLICATIONS

105. This section discusses several applications where different policies covered in the previous section are often combined to deal with economic and financial issues. As in the previous section, staff is encouraged to exercise judgment as to whether and how to cover these issues in Article IV consultations.

A. Integrated Policy Framework

106. The Integrated Policy Framework (IPF) aims to provide a systematic analytical approach to considering an appropriate policy mix for achieving macroeconomic and financial stability, for countries experiencing shocks. It jointly considers monetary, exchange rate, macroprudential, capital flow management, and fiscal policies, as well as their interactions. It helps Fund surveillance provide a more comprehensive assessment of wide range of policy tools used by members and strengthen coherence of policy advice.

107. A key insight of the IPF is that the optimal policy mix in response to shocks depends on country characteristics, type of shocks, and initial conditions. They usually do not take the form of complete reliance on exchange rate flexibility for all circumstances for all countries. Neither do they take the form of "anything goes" (an indiscriminate use of policy tools). Key country characteristics considered in the IPF include balance sheet mismatches, the depth of FX markets, monetary policy credibility, and the currency of trade invoicing, while other factors may be relevant for the choice of optimal policy mix.

108. In Article IV consultations, the following questions could be considered where relevant, drawing insights from the IPF:

- What are *country characteristics* relevant for the IPF (key characteristics are mentioned above), and what are the policy frameworks of the country (e.g., exchange rate regime, monetary policy framework)?
- What were the *initial conditions* of the economy prior to the shocks (e.g., reserve adequacy, external sector assessment, cyclical conditions)?
- What was the *type of shock* that the country experienced (real or financial, transitory or persistent)? Relatedly, what were the economic and financial developments around the shocks (e.g., the exchange rate, capital flows, domestic activity including inflation and inflation expectations, other indicators that are relevant for the IPF such as deviations from the uncovered interest parity condition)?

109. In policy discussions, staff could be mindful of additional considerations that the authorities may have in deciding on policy responses. These may include reputational concerns in using some policy tools, and country characteristics other than those highlighted in the IPF. Additionally, staff could be mindful of data limitations when applying the IPF insights, although such limitations are not unusual in policy analysis.

B. Climate Change

110. Climate change is an existential threat to global prosperity with significant macroeconomic and financial implications. Without meaningful action towards mitigation, adaptation, and transition to low-carbon economies, climate change would weaken growth prospects and increase fiscal sustainability and financial stability risks. Moreover, while in many countries it will take several more years or decades until the full economic and financial impact materializes, policies often need to be taken within the next few years to address such risks effectively.

Policy Challenges

111. Climate change confronts policymakers with multiple macroeconomic policy challenges, with the relative importance depending on country circumstances.[56]

- *Transitioning to a low-carbon economy,* which includes the following:
  - *Achieve domestic mitigation targets.* Many countries need to sharply reduce global greenhouse gas (GHG) emissions in the coming years if they are to achieve specific targets they committed to in the context of the Paris agreement (nationally determined contributions or NDCs). Reaching these targets can require far-reaching fiscal, financial, and regulatory policy changes and accompanying social and labor market policies.

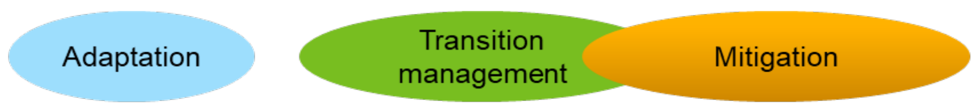
[56] This section provides further guidance building on the principles as to when and where to discuss climate change as outlined in the CSR Background Paper on Integrating Climate Change in Article IV Consultations.

- *Managing implications from the global transition to a low-carbon economy*. This is a challenge in particular for countries heavily dependent on the production and export of fossil fuels. Tourism-reliant economies or economies that rely on remittances and other inflows from fuel-exporting countries are also affected. Other countries may be affected through the exposure of financial institutions to (potentially) stranded assets. For some countries there may also be upside risks (e.g., exporters of lithium and cobalt, which are essential for the green transition).

- *Adaptation and resilience building*. This is a challenge for almost all countries, but especially for lower-income countries and small states located in regions that are already hot or suffer from natural disasters (IMF, 2019). Adaptation often requires generating fiscal space through re-prioritizing expenditures, raising revenues, and attracting (concessional) financing.

Among these policy challenges, only the first (achieving a domestic mitigation target) is a purely domestic challenge. The other two are related to *inward spillovers*: managing implications from the global transition is related to spillovers from the policy response of other countries to climate change, while adaptation and resilience building are related to the effects of climate change itself. All these policy challenges fall under the IMF's bilateral surveillance mandate to the extent they are macrocritical for a given country (Section II.A and Annex I).

Figure 6. Coverage of Climate Change in Article IV Consultations



What does it mean?	Building resilience against effects from climate change	Adjusting to the global low-carbon transition	Achieving domestic emission targets	Contributing to the global mitigation effort
Why cover in Article IV consultations?	Domestic policy challenge and inward spillover	Domestic policy challenge and inward spillover	Domestic policy challenge	Outward spillovers
Where to cover? 1/	Macrocritical, esp. the most vulnerable countries	Macrocritical	Macrocritical	Strongly encouraged for 20 largest emitters, encouraged for others

1/ Coverage on a voluntary basis is always possible.

112. *Global* climate change mitigation goes beyond the realm of an individual country. No country can mitigate climate change by itself—countries can only make an adequate contribution to the global mitigation efforts. The contribution is more important when a country's contribution to GHG emissions is larger. Insufficient mitigation policies, especially by large emitters of GHGs, can trigger destabilizing *outward spillovers* to other countries. Outward spillovers are covered by the multilateral surveillance mandate of the IMF (Annex I).

Coverage in Article IV Consultations

113. For bilateral surveillance, mandatory coverage is guided by the assessment of macrocriticality.

- *For achieving domestic mitigation targets,* macrocriticality will depend especially on the ambitiousness of a country's NDC or of other domestic mitigation targets such as achieving net zero emissions by a certain date (i.e., it will depend on the difference between a country's baseline emissions path or business as usual (BAU) and the path implied by the target). The larger the difference, the larger the necessary re-calibration of macro policies. Since NDCs and other domestic mitigation targets are fast-evolving targets, staff needs to re-assess macrocriticality constantly.

- *For managing implications from the global transition to a low-carbon economy,* an assessment of macrocriticality can start with an analysis of an economy's vulnerability to the global transition. For fossil fuel exporters, helpful statistics may include the share of fossil fuel exports or fiscal revenues in GDP. The larger the fossil fuel dependency, the more significant the policy challenge.

- *For adaptation and resilience building,* macrocriticality is primarily a function of a country's exposure to climate risk and the economic and financial impact that materialization of such risks would have. The larger the possible impact, the more significant the policy challenge.[57]

114. Coverage in Article IV consultations should be selective and climate change does not need to be covered in every consultation. While staff should seek to engage regularly on macrocritical climate issues, the frequency of engagement would depend on both the severity of the policy challenge and the pace at which it evolves. For example, fossil fuel dependency may be persistent, while domestic mitigation targets may change rapidly and require frequent policy recalibration. Where in-depth coverage is possible only every few years, staff reports in between in-depth assessments would update on recent developments. As in other surveillance topics, Article IV consultations should focus on policies where the Fund has expertise. Climate-related financial risks would be covered in some FSAPs.

115. For the 20 largest GHG emitters, a discussion of these countries' contribution to the global mitigation effort in Article IV consultations is *strongly encouraged*, as these countries account for the bulk of emissions and hence contribute disproportionately to spillovers to other countries. Moreover, coverage cycles for mitigation should be no longer than three years. "Strongly encouraged" means, ultimately, voluntary: while there is an expectation of coverage, if the authorities refuse to engage, staff reports would not cover it. At the same time, only the coverage of the country's contribution to the global mitigation effort is voluntary: other aspects of climate change, including policies to achieve a domestic mitigation target, should be discussed under the bilateral surveillance mandate if, in staff's assessment, they are macrocritical (see above).

[57] A list of 64 particularly climate vulnerable countries is contained in IMF (2019).

Topics in Article IV Consultations

116. Discussions on climate-related policy challenges may include the following:

- *Assessment of macrocriticality.* In-depth coverage of climate-related policy challenges in Article IVs could be preceded by an assessment that analyzes a country's exposure to climate change and the global transition, the impact that these processes would have, and the ambitiousness of domestic mitigation targets in order to establish macrocriticality. In many cases, the time horizon for the macrocriticality assessment may be longer than the typical 3-5 years for Fund surveillance.

- *Achieving domestic climate mitigation targets*. The starting point for in-depth coverage would be a country's NDC or other domestic policy target (such as climate neutrality by a certain date), and an assessment of the deviation of emissions under business as usual (BAU) from the target to identify a (possible) mitigation gap. To anchor the policy discussion, a useful reference point would be an estimate of the carbon price that would align mitigation policies with the domestic mitigation target (stressing the uncertainty that necessarily surrounds such estimates). At the same time, staff reports should refrain from assessing the adequacy of individual country targets, as it is the prerogative of the Paris process and the UNFCCC.[58] Staff reports would then take stock of existing mitigation policies, describe and discuss the authorities' mitigation plans, and analyze to what extent these are conducive to closing the mitigation gap. Where appropriate, staff would propose additional or alternative (more efficient) mitigation policies. Staff reports would also discuss complementary public investment and social and labor market polices to reinforce the effectiveness of mitigation policies or mitigate social impact. For EMDEs, an assessment of financing needs to manage the transition may be warranted, including the extent to which such needs could be covered from domestic sources (such as carbon pricing revenue). In some cases, the impact of mitigation policies on financial stability may merit coverage, especially where mitigation measures can generate sizeable stranded assets.[59]

- *Managing implications from the global transition to a low-carbon economy.* For fossil fuel exporters, the analysis would usefully start with an assessment of a country's vulnerability to a permanent price decline from a fiscal, BOP, and financial angle. Vulnerability will thereby depend not only on the share of fossil fuel receipts in exports or fiscal revenues, but also on extraction cost and margins. In many fossil fuel exporting countries, an analysis of exposure of the financial system to potentially stranded assets is warranted. Staff reports would then discuss the authorities' plans to manage the transition, including steps to diversify financial exposure to fossil fuels (e.g., through investment policies of sovereign wealth funds) and to diversity

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[58] Staff can assess internal consistency, however: for example, whether a country's NDC is consistent with a net-zero target if the latter exists.

[59] The analysis can stretch also into other areas such as the fiscal and economic welfare impacts of pricing, incidence analysis, trade-offs between different mitigation policy instruments (taxes, ETS, regulations, clean technology subsidies), supporting measures—feebates, policies for forestry, methane emissions, measure to address competitiveness impacts.

economic exposure (e.g., diversifying energy supply), and to protect the financial system. In economies that are affected by the global transition in other ways—tourist destinations, or countries that receive remittances and other financial flows from fossil fuel exporting countries—the analysis could start with the sensitivity of external and fiscal revenue streams to lower fossil-fuel driven activity, and cover policy options for sustainable finance where appropriate.

- *Adaptation and resilience building*. The analysis would ideally start with an assessment of exposure to climate risk and the possible impact that the materialization of such risks would have. It would then discuss policies to strengthen resilience to climate change and identify, to the extent that the information is available, corresponding financing gaps—these will likely differ regarding the type of adaptation challenge (e.g., slow- or fast-moving, immediate or in the medium term). Staff reports would discuss options to cover such gaps, including re-prioritizing expenditures—including through strengthening public investment management—, strengthening revenue collection, and accessing more financing. The discussion would be anchored by the DSA and factor in issues such as policy implementation capacity, especially for fragile states, as well as placing adaptation in the country's overall development context. The discussions would also explore how to enhance financial resilience, including through fiscal buffers and possibly insurance and contingency finance, and touch upon needed institutional arrangements (PFM, rules, regulations). In some cases, an Article IV may need to cover the potential impact of climate change on financial stability and elaborate on issues such as migration and the corresponding economic cost.

- *Contribution to global climate change mitigation effort*. An in-depth analysis would typically include all the elements listed under achieving domestic climate mitigation targets above. It would add to this discussion a multilateral component. This would typically include (i) an analysis of the country's contribution to global GHG emissions and the expected path of GHG emissions; (ii) a comparison of a country's NDC with that of peers—while avoiding a direct assessment of the country's target (see above), (iii) a discussion of the country's participation in global mitigation initiatives. Some context on the Paris process may also be needed—for example, whether NDCs in the aggregate suffice to achieve the Paris objectives of limiting warming to 2C (and preferably 1.5C) above pre-industrial levels. As noted above, discussion of multilateral component of mitigation policies is voluntary but strongly encouraged. Therefore, while Article IV consultations should cover policies related to adaptation and transition management if staff considers those policies macrocritical, including for the largest 20 emitters of GHGs, country authorities have no obligation to discuss the multilateral component of mitigation policies.

C. Gender

117. Fund policy advice on gender issues as part of Article IV consultations is to be included when such issues are considered macrocritical (Box 2). In the context of bilateral surveillance, macrocriticality relates to issues and policies that can significantly influence present or prospective balance of payments and domestic stability. As demonstrated by a growing body of literature, including analytical work by IMF staff, narrowing gender gaps in key areas and promoting women's economic empowerment can increase economic growth and influence BOP and domestic stability, including through lower inequality, increased productivity, better financial sector outcomes and greater financial stability. Conversely, the economic disempowerment of women, gaps in access to education, health, and financial services, and legal barriers to women's economic participation can all negatively impact macroeconomic and financial stability and countries' ability to achieve strong and sustainable economic growth. This implies that gender gaps can be macrocritical and, as such, are relevant for the Fund's exercise of its bilateral surveillance powers under Article IV, Section 1.

118. The macrocriticality assessment will necessarily vary depending on country circumstances. Once macrocriticality has been established, in addition to policies related to fiscal, monetary and financial sector that have an impact on gender outcomes, bilateral surveillance discussions should also cover other policies, such as those directly related to narrowing gender gaps and promoting women's economic empowerment. The COVID-19 pandemic has further exacerbated pre-crisis gender gaps and highlighted weaknesses in safety net systems, making even more urgent the need to bring a gender lens to IMF surveillance.

119. Staff can assess existing gender gaps in Article IV consultations through benchmarking exercises. Relevant areas to consider include female labor force participation, gender gaps in access to education, health care, and financial services, female representation in managerial and leadership roles, legal barriers, and violence against women. Cross-country comparisons are useful for assessing whether these gaps are large in any given country.

120. Once gender gaps have been identified, staff should consider whether gaps are macrocritical. Studies have repeatedly shown how improving women's access to opportunities and decision-making roles can raise economic growth, lower inequality, and enhance macroeconomic and financial stability. However, this does not mean that gender issues are macrocritical for all Fund members at all times. An assessment of macrocriticality would be based on whether gender gaps have material impacts in their country. Available data, existing literature, and past country engagements can guide such assessment.

121. Fund policy advice should be tailored to reducing macrocritical gender gaps. Staff needs to be cognizant that all measures, not just those that are gender targeted, can disproportionately affect women if they have an incidence on those sectors where women are more represented, such as informal, part-time, and low-paying jobs. Policy advice is expected to be as granular as possible and consider the incidence of policies across sectors as well as the nature of existing gender gaps. When gender-sensitive policies are considered, their macroeconomic impact would be analyzed and fed into the macroframework. When pertinent, the links between gender and other issues such as climate change, digital money, or fragile and conflict states could be analyzed to exploit synergies and provide a more comprehensive and tailored policy advice.

122. Close collaboration with the authorities and external stakeholders helps advance gender policies and improve traction. Staff can benefit from early engagement with the authorities on potential macrocritical issues. Collaboration with key external stakeholders (e.g., World Bank Group and UN Women) can help leverage their expertise and resources as Fund expertise is developing. Staff can make use of work by other reputable institutions and sources for the analysis (see the 2018 How-to-note). While a comprehensive strategy at the IMF is in the making, significant resources within and outside the Fund are available to support engagement on gender issues. This includes databases, templates, toolkits, and models. Support for the application of analytical tools and capacity development are being developed.

SECTION VI. PROCESS AND PROCEDURES

A. Consultation Cycles and Delays

123. Article IV consultations are generally expected to take place on a 12-month consultation cycle, with some exceptions.[60] Based on the Articles of Agreement, members are obliged to consult with the Fund on their exchange rate and domestic policies. For members without a Fund arrangement, the standard consultation cycle is 12 months, with an additional 3-month grace period. Members that are granted a Flexible Credit Line or a Precautionary Liquidity Line are also on the standard consultation cycle, while those with other Fund arrangements (including a Policy Coordination Instrument or a Policy Support Instrument) are placed on a 24-month cycle. Some members can be put on a longer cycle, up to 24 months, but only upon their consent and provided they are not of systemic or regional importance, are not perceived to be at some risk because of policy imbalances or particular exogenous threats or facing pressing policy issues of broad interest, and do not have outstanding credit to the Fund above 145 percent of quota.

124. Excessive delays of Article IV consultations should be avoided. An Article IV consultation is considered delayed when it is not concluded by the Executive Board within the relevant timeframe (including any grace period).[61] If an Article IV has been delayed by more than 12 months beyond its expected date of completion (including the grace period), it is deemed to be excessively delayed, and the Fund will initiate formal steps to address the delay.[62] Specifically, the Managing Director may notify the member in writing of the delay, with the notification calibrated to the circumstances of the member and, where appropriate, reminds the member of its obligation to consult. Subsequent notifications are sent to the member at 12-month intervals, as long as the Article IV consultation has not been concluded and staff discussions with the member have not been completed. The Fund, at intervals of six months, publishes a list of all members whose Article IV consultation has, as of the date of publication, not been concluded within 18 months of the expected deadline for conclusion. Further, whenever an Article IV consultation for a member has not been concluded within 18 months of the expected deadline for conclusion, staff is required, except in certain circumstances, to informally brief the Executive Directors on the economic developments and policies of the member.

[60] The rules governing consultation cycles are set out by the Executive Board (Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96) as amended, pp. 111-3). The periodicity and deadlines for the completion of individual consultations with members are expressed in terms of an expectation rather than an obligation.

[61] Consultation cycles other than the 12-month cycle do not have a grace period.

[62] Proposed Steps to Address Excessive Delays in the Completion of Article IV Consultations (Decision No. 15106-(12/21) as amended).

B. Consultation Process

125. Article IV consultations follow broadly the following process:

- *Early engagement with authorities on focus and topics*. Consultation should be consistent with Fund policy frameworks and country strategies, including in the areas of CD, FCS, and climate change. Staff visits and continuous engagement lay the groundwork for a forthcoming consultation. The country team may request necessary data and send a questionnaire to the authorities ahead of mission meetings.

- *Preparation of a Policy Note*. The Policy Note is an internal document that lays out all relevant issues and policy advice that staff intends to discuss during the mission. The note is prepared by the country team and undergoes an internal review process to ensure consistent and evenhanded application of Fund policies and coverage of surveillance priorities, as well as consistent policy advice, and to reflect other departments' expertise and comments before it is sent to management for clearance.

- *Article IV mission*. The discussions—held in person or virtually—are a set of meetings in which staff engages in in-depth discussions with country authorities, private sector, CSOs, external partners, and other stakeholders. The mission receives new data and information and finalizes its analysis and advice, in consultation with departments as needed. The mission team prepares a concluding statement which summarizes the main findings and discusses it with the main interlocutors in a concluding meeting. Publication of the concluding statement or a press release, and media engagement is encouraged, but requires the authorities' consent (Section VI.C).

- *Preparation of the staff report*. Following the mission, staff prepares a staff report that is reviewed by departments. Building on the Policy Note and the findings during the mission, the staff report includes a succinct assessment of policies and reports the authorities' views. After management clearance, the report is issued to the Executive Board ahead of the Board meeting, at which point any changes to the staff report are governed by the Fund's Transparency Policy.

- *Board meeting*. The Executive Director's office of the member issues a statement on the issues raised in the consultation and the staff report (BUFF statement). During the Board meeting, which is chaired by the Managing Director or one of the Deputy Managing Directors, the other Executive Directors review the member's policies and staff responds to their questions. The Board meeting constitutes formal surveillance, or peer review, and it concludes the Article IV consultation. The Executive Directors' views are reflected in the Chairman's Summing Up. If the criteria for a Lapse of Time (LOT) consideration are met, the report is expected to be discussed on a LOT basis, in which case specific considerations apply.[63]

- *Publication of a post Board press release and of the staff report* (Section VI.C).

[63] See Lapse of time procedure for Article IV Consultations.

126. Staff should minimize the time between the end of the discussions and the Board meeting. This will help ensure timely advice and that staff reports are up to date when considered by the Board. The Board has established norms that Article IV consultation Board meetings for PRGT eligible cases should take place within 90 days of the end of the conclusion of staff discussions and within 65 days for other cases. The staff report should be up to date at the point it is issued to the Board: any significant information that becomes available after issuance to the Board should be issued as a *staff statement* if the information does not affect the staff appraisal, or a *staff supplement*—including revised projections as needed—in case there are significant changes.

127. Discussions can be continued or re-opened if warranted. If new economic or policy developments occur or any other new information with wide-ranging implication arises, staff could update and revise the concluding statement and solicit the authorities' reactions. If management considers that further discussions with the authorities are appropriate even after issuance of the staff report to the Board, the discussion of the Article IV staff report and the conclusion of the consultation by the Executive Board could be delayed and/or a new staff report issued. Conversely, if staff believes it has all the necessary data and has held adequate policy discussions, the staff report can be presented to the Board even if the authorities prefer to continue discussions. In all such cases, staff is encouraged to coordinate closely with country authorities.

C. Drafting and Publication

128. Article IV surveillance outputs, including concluding statements, press releases, and staff reports, should clearly articulate the central messages. These products are encouraged to be as concise and accessible as possible.

129. Drafting of Article IV surveillance output should follow the following guidelines:[64]

- *Non-negotiation of documents.* It is a paramount principle of the Fund, aimed at safeguarding the independence of staff views, that staff reports must not be negotiated with member authorities.
- *No sharing of draft staff reports.* Staff should not share draft staff reports, annexes, or portions thereof, with country authorities or Executive Directors. Staff can confirm in writing their understanding of the authorities' views.
- *Sharing of select surveillance elements and outputs.* Staff may share tables, charts, the Risk Assessment Matrix, and other *factual* elements of the analysis with the aim of facilitating the discussion and ensuring accuracy. Mission concluding statements, drafts of press releases, and factual Selected Issues Papers can also be shared with the authorities.

[64] These guidelines are applicable to documents pertaining to Article IV consultations. For Fund drafting guidelines pertaining to other documents, see the next paragraph and the guidance note on the Transparency Policy.

- *No surprises.* Staff should ensure that all issues covered in the staff report and accompanying documentation (e.g., Selected Issues Papers) have been discussed with the authorities and that the authorities are clear on staff's positions.

- *Candid and comprehensive assessments.* The authorities' publication intentions should not affect the candor and comprehensiveness of staff reports and other documents.

- *Accurate characterization of counterparts' views.* The counterparts' views should be clearly identified and presented as views of the authorities, institutions, or personal views, as applicable.

- *Avoidance of politically charged language.* Staff should avoid formulations that may be insulting or divisive in the member country, without shying away from candid assessments of relevant political economy issues.

- *Avoidance of discussing publication intentions in staff reports.* The publication intentions should be addressed only in the cover page issued by SEC for internal circulation.

130. Publication of Article IV surveillance outputs follows the principles laid out in the Fund's Transparency Policy.[65] In general, publication is voluntary but presumed. Media engagement, including through press conferences, should be routine at the end of a mission or after a Board meeting. Staff should encourage the timely publication of press releases, Article IV staff reports, and background documents. The following principles apply: [66]

- *Publication of Article IV staff reports.* Publication requires consent from country authorities.

- *Post-mission concluding statement and press release.* Missions are expected to issue either a concluding statement or a press release, but normally not both, to minimize the risk of diffuse messaging. Concluding statements require the consent from the authorities for publication and should include a clear attribution, noting that they represent the preliminary views of staff and that views are subject to Board discussion and decision. The authorities' consent is not required for the release of an end-of-mission press release.

- *Post-Board press release.* The press release consists of a background section with factual information on the economy of the member (including a table of economic indicators) and the final version of the Summing-Up with the deletion of the first sentence (which indicates the Executive Directors' endorsement of the thrust of the staff appraisal) and the last sentence (which indicates the consultation cycle). Where a staff report has been issued on a lapse of time (LOT) basis, the Executive Board Assessment is the staff appraisal. The first sentence of the press release should read "In concluding the [year] Article IV consultation with [country], Executive Directors endorsed staff's appraisal as follows:" The Executive Board's Assessment in the press

[65] The Updated Guidance Note on Transparency Policy outlines the corrections and deletions that are acceptable under the policy and the procedures to be followed. Appendix II in the transparency guidance note has a table with the timeline for the publication process of Board documents. Post-publication modifications are generally not permitted.

[66] See also Transparency Policy Guidance Note (¶45-48) and Communications Strategy, SM/14/188 (¶12-14).

release should follow the staff appraisal verbatim, except for changes to accommodate corrections or deletions permitted by the Fund's Transparency Policy. The authorities' consent is required for the publication of a press release following the Board meeting.

- *Deletions and corrections before publication if they meet certain criteria.* To avoid undue delays in publication, the Transparency Policy specifies that requests for deletions and corrections are expected to be communicated to the Fund no later than two days before the Board meeting (or the date of lapse-of-time decision) takes place.[67] It also gives the authorities "a right to reply."

D. Treatment of Confidential Information

131. The Fund has a fully developed framework for the treatment of confidential information provided by the authorities, and this should be followed. Staff should ensure a common understanding of what should remain confidential, including whether the information is meant to remain confidential within staff/management, or whether it can be shared with the Board and/or with the public. Staff is encouraged to share with country authorities the relevant aspects of the Fund's framework for treatment of confidential information (Box 14 and Transparency Policy Guidance Note, Section II.E. and Appendix IX)).

Box 14. Treatment of Confidential Information

The Fund has a fully developed framework for the handling of confidential information in order to effectively play its role as a confidential advisor.

Treatment of Confidential Information Vis-à-vis the Public

The Fund's Executive Board, management and the staff may not disclose information that a member or other person has provided in confidence, unless that party consents to disclosure and such disclosure is consistent with Fund rules. Pursuant to the immunities of the Fund under Article IX of the Fund's Articles of Agreement, information and documents provided by members (or any other party) to the Fund form part of the Fund's archives which is inviolable. "Inviolability" has been applied to mean that all non-public information or documents generated within or received by the Fund from members or other parties are protected by the Fund's immunities and would only be disclosed (including in response to a subpoena) with the approval of that member or other party and in accordance with the Fund's policies. Further, pursuant to the Fund's Rules and Regulations, the Staff Code of Conduct, and relevant General Administrative Orders, staff is prohibited from making unauthorized disclosures to third parties of confidential information obtained in the course of their service to the Fund. Appendix IX of the Transparency Policy Guidance Note provides further detail on this framework.

[67] While requests for modifications submitted later will be considered, stricter rules apply to requests for corrections after the Board meeting.

Box 14. Treatment of Confidential Information (Concluded)

Treatment of confidential information within the Fund

In order to appropriately safeguard information, staff and information providers should reach common understandings on how specific information should be classified: Public, For Official Use, Confidential, or Strictly Confidential. These classifications will limit sharing even within the Fund. However, management and staff cannot agree to withhold information from the Fund's Executive Board that is required to be reported under the Articles of Agreement or a Board-established policy or that is critical for the Board to exercise its responsibility in a meaningful way. Such information includes the authorities' policy positions and plans in areas that are relevant for Fund surveillance or financial assistance but generally excludes information on hypothetical courses of actions that have been informally discussed with the authorities.

In drafting Board documents, Fund staff exercises caution not to inadvertently include confidential information, unless it is of the type that must be reported to the Executive Board. Paragraphs 40-44 and Appendix IX of the Transparency Policy Guidance Note provide more detail on when disclosure to the Board is required. Even in circumstances where information must be provided to the Board, confidentiality vis-à-vis the public remains.

The Fund—including the Board, individual Executive Directors, management, and staff—may not publish non-public information provided by a member unless that member consents.

Confidential information is provided to the Executive Board via a secure platform that allows access by each Executive Director and individually authorized member country officials. All such confidential information made available in this manner is encrypted to prevent further distribution to non-designated individuals. Executive Directors are also governed by a Code of Conduct requiring them to protect the security of any confidential information provided to, or generated by, the Fund. Authorities are obliged to ensure that the applicable Fund restrictions on access to these documents and information are respected, including limitations on internal access in accordance with the material's classification as well as no public disclosure or citation of any confidential information. For the most sensitive information, Executive Directors are provided access via uniquely identifiable encrypted documents that may not be copied or shared.

E. Third-Party Indicators

132. Use of third-party indicators (TPIs) should follow the TPI guidance note. A TPI is an indicator compiled by other organizations (i.e., other than the Fund or member country authorities). Use of TPIs should follow the principles of best practice by ensuring transparency on the selection of indicators and how they feed into staff's analysis and policy advice. Staff's analysis and policy advice informed by TPIs should also ensure robustness, and when TPIs inform analysis, staff should discuss their findings with the authorities and other relevant stakeholders. TPIs would not replace, but rather supplement, an open, candid, robust, and well-documented discussion with the authorities. The Fund's TPI Digest could be used to understand statistical characteristics, strengths, and weaknesses of commonly used TPIs and how to use and present TPIs in staff reports.[68]

[68] The assessment in the TPI Digest is not a validation exercise, nor is it intended to present an ex-ante positive or negative list of indicators acceptable for use in staff analysis and Fund products. Staff should not refer to the TPI Digest in external publications, as it is intended for internal use.

Annex I. Legal Framework and Principles for Fund Surveillance

Article IV of the IMF's Articles of Agreement provides the legal basis for the conduct of bilateral and multilateral surveillance by the Fund. The Decision on Bilateral and Multilateral Surveillance (or Integrated Surveillance Decision (ISD)), adopted by the Fund's Executive Board in 2012, establishes a comprehensive framework for integrating bilateral and multilateral surveillance and provides guidance for the Fund and the members in the conduct of surveillance.

Legal Framework for Fund Surveillance

1. Bilateral Surveillance. Article IV, Section 3(a) and (b) requires the Fund to oversee members' compliance with the obligations specified under Article IV, Section 1 and to exercise firm surveillance over members' exchange rate policies ("bilateral surveillance"). Article IV, Section 1 specifies members' substantiveobligations in this regard. It establishes a general obligation that each member shall undertake to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. It also sets forth more specific obligations, including those relating to the conduct of domestic economic and financial policies by members (Article IV, Sections 1 (i)–(ii)), which are of a "soft nature"- where members are only required to exercise "best efforts," and those relating to the conduct of exchange rate policies by members (Article IV, Sections 1 (iii)–(iv)), which are of a "hard nature"- where members are required to achieve results rather than just exercising best efforts.[1] In addition to the substantive obligations, members also have procedural obligations to consult with the Fund, and to provide certain information deemed necessary by the Fund for carrying out its bilateral surveillance mandate.[2]

2. Multilateral Surveillance. Article IV, Section 3(a) also requires the Fund to oversee the international monetary system to ensure its effective operation ("multilateral surveillance"). In contrast to bilateral surveillance, the Articles of Agreement do not establish any substantive policy obligations of members in connectionwith the Fund's multilateral surveillance mandate. Pursuant to the ISD, members are encouraged to implement exchange rate and domestic economic and financial policies that, in themselves or in combination with the policies of other members, are conducive to the effective operation of the international monetary system. They have, however, no obligation to change their domestic economic and financial policies that may give or are giving rise to spillovers that may have a significant impact on global stability, as long as they promote their own domestic or balance of payments stability. Members have, however, a procedural obligation to

[1] See The Fund's Mandate—The Legal Framework (January 22, 2010), paragraph 10; see also 2011 Triennial Surveillance Review of the 2007 Surveillance Decision and the Broader Legal Framework for Surveillance (August 29, 2011), paragraph 8.

[2] Under Article VIII, Section 5, the Fund may require a member to report information it deems necessary for its activities, including surveillance. See Modernizing the Legal Framework for Surveillance – An Integrated Surveillance Decision, (June 26, 2012) at n. 12. While the Fund may rely on Article IV, Section 3(b) to require members to provide information necessary for its firm surveillance over members' exchange rate policies, the Fund has so far relied upon the general reporting obligation under Article VIII, Section 5 to request information to conduct surveillance. See The Fund's Mandate - The Legal Framework, (January 22, 2010) at n. 8.

consult with the Fund and toprovide relevant data so that the Fund can exercise its multilateral surveillance responsibilities.[3]

Annex 1. Box 1. Article IV of the Articles of Agreement, Sections 1 and 3

Article IV, Section 1. General Obligations of Members

Recognizing that the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates. In particular, each member shall:

(i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to its circumstances;

(ii) seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions;

(iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members; and

(iv) follow exchange policies compatible with the undertakings under this Section.

Article IV, Section 3. Surveillance over Exchange Arrangements

(a) The Fund shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations under Section 1 of this Article.

(b) In order to fulfill its functions under (a) above, the Fund shall exercise firm surveillance over the exchange rate policies of members, and shall adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members.

Principles and Guidance of Members' Policies

3. Article IV Section 3(b) requires the Fund to adopt specific principles designed to give guidance to members in the conduct of their exchange rate policies in accordance with their obligations under Article IV, Section 1. Although not required to do so under the Articles of Agreement, the Fund may also adopt principles for the guidance of members with regard to the conduct of their domestic economic and financial policies. In light of this context, and recognizing that a member's overall mix of economic and financial policies including both exchange rate and

[3] See Modernizing the Legal Framework for Surveillance – An Integrated Surveillance Decision, (June 26, 2012) at paragraph 15 and n. 12. The Fund may, by Executive Board decision, require members (either all members or individual members) to provide information that it needs for multilateral surveillance, pursuant to Article VIII, Section 5. See id. at n. 11; see also The Fund's Mandate - The Legal Framework (January 22, 2010) at paragraph 25.

domestic policies, contributes to the member's balance ofpayments and domestic stability and may impact the stability of the international monetary system, the ISD provides guidance to members with respect to the conduct of their exchange rate policies (Principles A to D) and also with regard to their domestic policies (Principle E). It also offers, for the purpose of multilateral surveillance, guidance that provides encouragement to members in the conduct of their economic and financial policies with a view to ensuring the effective operation of the international monetary system.

Principles for the Guidance of Members' Policies in Bilateral Surveillance

4. Principles A through D are intended to provide guidance to members in the conduct of their exchange rate policies, and the new Principle E is intended to provide guidance to members in the conduct of their domestic economic and financial policies in accordance with their obligations under Article IV, Section 1. Among all five Principles, only Principle A sets forth an obligation of members as its language simply repeats the language of the corresponding obligation set out in Article IV, Section 1(iii). Principles B through E constitute recommendations rather than obligations of members, and a determination by the Fund that a member is not following one of these recommendations would not create a presumption that that member is in breach of its obligations under Article IV, Section 1. However, a member that follows all Principles would be deemed to be in compliance with its obligations under Article IV, Section 1. Thus, observance of the Principles would constitute a "safe harbor" for members.

5. Under the ISD, the Fund is required to apply these Principles evenhandedly and pay due regard to the circumstances of members. Members are presumed to be implementing policies that are consistent with these Principles and, in determining whether a member is observing these Principles, the Fund must give the member the benefit of any reasonable doubt. In circumstances where the Fund has determined that a member is implementing policies that are not consistent with these Principles and is informing the member as to what policy adjustments should be made to address this situation, the Fund is required to take into consideration the disruptive impact that excessively rapid adjustment would have on the member's economy.

List of Principles:

A. A member shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members.

B. A member should intervene in the exchange market if necessary to counter disorderly conditions, which may be characterized inter alia by disruptive short-term movements in the exchange rate of its currency.

C. Members should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene.

D. A member should avoid exchange rate policies that result in balance of payments instability.

E. A member should seek to avoid domestic economic and financial policies that give rise to domestic instability.

6. For the purposes of the Fund's surveillance over a member's observance of the Principles, the ISDalso identifies certain developments (indicators) that would require thorough review and might indicate the need for discussion with a member. The indicators are only a "filter", indicating the need for thorough review and discussions with a member; their triggering would not, in itself, lead to the conclusion that a member was not observing a Principle. The list is not intended to capture all developments that will be useful for Fund surveillance.

List of Indicators:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) fundamental exchange rate misalignment;

(vi) large and prolonged current account deficits or surpluses; and

(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows.

Guidance in Multilateral Surveillance

7. The ISD provides guidance to Fund members with regard to the conduct of their exchange rate and domestic economic and financial policies in the context of multilateral surveillance. This guidance does not relate to members' compliance with their obligations under the Articles but provides a basis for policy discussions in the multilateral surveillance context on issues that go beyond members' obligations under Article IV Section 1. Recognizing that a member's policies may have a significant influence on other members and on global economic and financial stability, the ISD encourages members to implement exchange rate and domestic economic and financial policies that, in themselves or in combination with the policies of other members, are conducive to the effective operation of the international monetary system.

Annex II. Surveillance in Low-income Countries, Fragile and Conflict-Affected States, and Small States

Low-Income Countries

1. Because of their high vulnerability to external shocks and high levels of debt, as well as relatively limited outward spillovers, surveillance in Low-Income Countries (LICs) is normally geared towards promoting BOP and domestic stability, rather than global stability. While adhering to the general requirements for Article IV consultations, the focus and range of issues to cover would reflect LICs' specific circumstances. Many LICs have narrow export bases, low productivity growth, limited fiscal space and access to financing while relying heavily on foreign aid. LICs' absorption capacity constraints also limit the feasibility of scaling up investment spending. This leaves them vulnerable to adverse external shocks such as commodity price shocks, natural disasters, growth shocks in partner countries, as evidenced by the significant impact of the COVID-19 pandemic. Surveillance may focus on the following key areas:

- *Job creation and growth* are at the center of surveillance in LICs, with a particular focus on sectoral policies to alleviate structural bottlenecks that can lead to weak and even negative total factor productivity growth.[1]
- *Debt sustainability* merits close attention in LICs, where risks of debt distress have increased, and in-depth discussion of policies and debt management is necessary for highly indebted LICs. Debt sustainability constraints in LICs often impose limits on budget financing through new borrowing.
- *Financial markets* in LICs tend to be thin and not integrated into international capital markets. Macrofinancial surveillance can focus on deepening financial markets and strengthening supervisory and regulatory capacity (including for AML/CFT), and filling information gaps that impede a proper macrofinancial analysis (IMF 2014).
- *Poverty reduction*, economic inclusion, human capital development, and governance issues need particular attention.
- Fiscal policies are often aimed at: preserving or rebuilding buffers while supporting potential growth, ensuring that enough resources are devoted to poverty-reducing spending and productive investment; improving spending quality and efficiency, budget execution and PFM, improving revenue collection (notably by broadening the tax base), and managing financing constraints (notably making sure that public financing needs do not crowd out private sector needs).

[1] See 2021 Macroeconomic Developments and Prospects in Low Income Countries Report. See also Section V. B on gender issues for the link between gender gaps, job creation and growth, and poverty reduction.

2. Article IVs should discuss capacity constraints, and surveillance is expected to be well integrated with capacity development. In many LICs, institutions and administrative capacity are weak, limiting the range of policies that can be implemented and impeding necessary reforms. Fund policy advice could take into account such constraints, and staff is expected to discuss progress with capacity development. Staff can leverage the expertise of the World Bank and other development agencies as necessary.

Fragile and Conflict-affected States

3. Article IV consultations are the main mode of engagement with fragile and conflict-affected states (FCS) when they do not have a Fund-supported program.[2] Fragility and conflict can hamper macroeconomic management and deteriorate countries' internal and external balances. Surveillance in FCS is expected to be well aligned with the overall objective of the FCS strategy, which is to support FCS achieve macroeconomic stability, strengthen their resilience, promote sustainable and inclusive economic growth, and help them exit from fragility. The IMF has a comprehensive Strategy to strengthen IMF support to FCS in accordance with the Fund's mandate and comparative advantage.

4. Surveillance for FCS needs to be well tailored to their needs and integrated with capacity development. Surveillance in FCS could build on a clear diagnosis of the roots and drivers of fragility, and policies to address macroeconomic implications and restore stability. The diagnostic could draw on the teams' Country Engagement Strategies (CES), updated to reflect recent developments and dialogue with key stakeholders. For FCS, there is a premium on providing granular advice on how reforms can be implemented and integrating policy advice with capacity development.[3] Policy advice should take into account capacity constraints and limited data availability. Conversely, surveillance can inform CD priorities and future program engagement.

5. Article IV consultations for FCS generally focus on macro-fiscal issues, inclusive growth, institution building, financial integrity, and governance and corruption.[4] Debt sustainability is usually a key issue in FCS. Financial sectors in FCS are often not developed, and financial sector issues are closely related to fiscal issues. In FCS, most impactful risks tend to be domestic rather than global risks. Advice on macroeconomic policy and reforms, including how to implement policies and reforms under weak institutions, should take into account the drivers of fragility and conflict, and governance and institutional issues, including AML/CFT and anti-corruption frameworks.

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[2] Most IMF members have annual Article IVs, but many FCS are on a 24-month cycle either because they have programs or they are non-systemic countries. A number of FCS have not had Article IVs for several years due to political or security reasons. Even in the absence of Article IVs, staff continues analytical work on such countries, where feasible, and regularly informs the Board through informal sessions.

[3] This may require an in-depth analysis on corruption and governance issues, drawing on governance diagnostics where available.

[4] The key findings of the Fund's strategy on social spending are relevant for most FCS. See also IMF 2017. "Building Fiscal Capacity in Fragile States" IMF Policy Paper. Washington DC: International Monetary Fund.

6. Surveillance in FCS can leverage the work of external partners. The close engagement with the World Bank and other development partners (including CSOs) can inform Fund surveillance. The integrity of the Fund's work, however, will hinge on remaining a trusted advisor, in line with its mandate. To enhance traction of Fund advice, staff can explore ways to disseminate its work, including blogs and publication in local language, as well as communication through external partners such as CSOs.

Small States

7. Small developing states (SDS) have limited economies of scale, are vulnerable to external shocks, and tend to experience high macroeconomic volatility.[5] The lack of economies of scale hampers the provision of public goods and services, including key public infrastructure. Many SDS lack competitiveness, have narrow export bases, and rely heavily on imports and trade tax revenues. These challenges make SDS highly vulnerable to external shocks. SDS are also subject to large emigration and brain drain, natural disasters, and climate change (extreme weather events and slower-motion shocks such as rising sea levels). About a third of SDS are characterized as "fragile," according to the Fund's institutional definition. SDS often have limited policy tools to respond to shocks, partly due to their pegged or heavily managed exchange rates. Their non-bank financial sector (NBFS) or under-regulated financial intermediaries (e.g., microfinance) tends to play a significant role, whereas the banking system is typically thin and vulnerable, with high NPLs, poor asset quality, heavy lending to the public sector, and weak supervisory and regulatory institutions including for AML/CFT. Some SDS present vulnerabilities in relation to financial centers with non-residents deposits and the creation of opaque legal entities (e.g., companies) and arrangements (e. g., trusts) by gatekeepers (e.g., lawyers, accountants and trust and company service providers) that are poorly regulated and supervised for AML/CFT purposes. These may also pose cross-border spillover issues.

8. Surveillance in SDS may focus on the following areas:

- *Growth and job creation.* Article IV discussions may focus on policies aimed at generating robust growth that facilitates achievement of the SDGs. Staff could discuss the effects of macroeconomic policies, migration, and remittances on GDP growth and employment. Other important issues include sectoral policies (including health), the private sector's contribution, and labor market issues (including gains from gender equity, where relevant). Drivers of growth could be identified and discussed, particularly if key sectors are foreign-owned and gross national income (GNI) and GDP provide different information.[6]

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[5] Small states are defined as countries with a population of fewer than 1.5 million. There are 43 Fund member countries that meet these criteria. The IMF's analytical work and policy advice have been focused on the subset of small developing states (SDS). The list of SDS was operationalized in 2014 and comprises 34 countries with a population of fewer than 1.5 million, excluding advanced market economies (WEO definition) and fuel-exporting countries classified by the World Bank as "high income". See the 2017 Staff Guidance Note on the Fund's Engagement with Small Developing States.

[6] IMF, 2013, Macroeconomic Issues in Small States and Implications for Fund Engagement.

- *Resilience to shocks*. Staff is expected to be ready to discuss risks from shocks, such as supply-chain disruptions, terms of trade shocks, and climate change (see the Section V.B on climate change), as well as transmission channels of these shocks and buffers against them. The latter includes natural disaster preparedness.[7] More broadly, Fund advice may focus on macroeconomic policies to increase soundness and resilience, including through mitigation and adaptation, investments in resilience-building infrastructure, and insurance mechanisms (self-insurance and fiscal and external buffers).[8]
- *Workable fiscal and debt sustainability options*. Advice may focus on debt sustainability, through sustained fiscal consolidation in tandem with supporting policies and structural reforms (e.g., strengthening fiscal frameworks). When the fiscal adjustment needed to restore debt sustainability is not feasible or adequate, or when financing is not available, staff may discuss debt restructuring options.
- *Thin financial sectors*. Discussions may focus on deepening and developing the financial sector and improving access to finance. The roles of the public sector and the NBFS, AML/CFT to prevent pressure on correspondent banking relationships, regulation and AML/CFT-based supervision/monitoring of enablers to prevent the misuse of entities and making beneficial ownership available, and digital developments could be covered, if relevant. Country teams may also assess progress in developing the capacity to properly regulate and supervise the financial sector.

9. Fund surveillance and policy advice should be tailored to country circumstances. For example, while Pacific Island SDSs are less prone to public debt sustainability issues than those in the Caribbean, they usually have lower growth and income and rely more heavily on aid. Staff is encouraged to provide granular policy advice to tackle challenges and integrate surveillance with capacity development.

[7] Preferably through formal disaster resilience strategies. See the 2019 Board Paper IMF Policy Paper, Building Resilience in Developing Countries Vulnerable to Large Natural Disasters, the Climate Change Policy Assessments (CCPAs) jointly prepared by the IMF and World Bank for Seychelles (2017), St Lucia (2018), Belize (2018), Grenada (2019), FS of Micronesia (2019), and Tonga (2020), and the Disaster Resilience Strategy for Dominica (2021) and Grenada (2021).

[8] External buffers include sovereign insurance mechanisms (e.g., the Caribbean Catastrophe Risk Insurance Facility and the Pacific Catastrophe Risk Insurance Pilot Program), international financial institutions, and aid.

Annex III. Consultations with Members of Currency Unions

The obligations under the Articles of Agreement of members of currency unions are unaffected by their devolution of authority over a subset of economic and financial policies (i.e., monetary, and financial sector policy) to the currency union. Surveillance in currency unions requires discussions with the regional institutions responsible for devolved policies. Those discussions help provide context for bilateral discussions with individual members. Article IV consultations play an important role in integrating country-level and union-wide surveillance.

1. Staff should assess policies at the level of the currency union and at the level of the individual member and consider interactions. At the level of the currency union, staff should assess whether the policies implemented at the level of the currency union are promoting the stability of the union and global stability. At the level of the individual member, staff should assess whether the member's policies are promoting its BOP and domestic stability and contributing to the stability of the currency union. Staff should consider the interactions between developments at the level of the individual member, the currency union, and the global economy.

2. Consultations for members of currency unions comprise the following:

- *Discussions with individual members.* The frequency of Article IV consultations is determined by country circumstances (e.g., whether they have a Fund-supported program or a PCI or a PSI).
- *Discussions with regional institutions.* Staff should hold discussions at least annually with regional institutions responsible for common policies in the currency unions.[1] While the discussions are held separately from the discussions with the individual members, these are considered an integral part of the Article IV consultation for each member.
- *Reports and summing ups at the union level.* An annual staff report on the discussions with the regional institutions is prepared, and it is followed by a Board discussion. These are considered an integral part of the Article IV consultations with individual members. Summing ups at the union level should indicate that Directors' views in the summing ups form part of their discussions for the Article IV consultations for individual 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, in order to provide adequate context for consultations with the individual members, when the consultations with the individual members do not coincide with the annual Board discussion on currency unions.

[1] Staff is required to hold annual discussions with the regional institutions responsible for common policies in the Central African Economic and Monetary Union (Decision No. 13654, as amended), the Eastern Caribbean Currency Union (Decision No. 13655, as amended), and the West African Economic and Monetary Union (Decision No. 13656, as amended). Staff is required to hold twice-yearly discussions with European Union institutions responsible for common policies in the euro area (Decision No. 12899, as amended).

3. External sector assessments should include the following:

- *For a member of a currency union*, staff should assess whether the member's policies promote BOP stability for the member and the union as a whole. Staff should analyze the current account, capital and financial account, real exchange rate, and external balance sheet. The nominal exchange rate, intervention, and reserve adequacy would be assessed at the union level. If the member's real exchange rate is over- or under-valued, staff should indicate whether the union exchange rate is over-or under-valued.[2] If the misalignment at the member level mirrors one at the union level, staff would recommend policy adjustment at the union level. Otherwise, staff would recommend policy adjustment by the member. Significant vulnerabilities of a member should be indicated in the reports of both the individual member and the currency union.

- *For a currency union*, staff reports should assess the five key areas and the adequacy of policy frameworks, as well as whether the union's exchange rate and other policies (e.g., monetary, fiscal, and financial policies) contribute to the union's stability. Staff should provide policy advice to address any external gaps.

[2] Staff reports for members of a currency union should not suggest that the *nominal* exchange rate is over- or undervalued, unless this is the case at the union level.