

20100223 IMF Discusses Exiting From Crisis Intervention Policies

Source: IMF

Background

On February 17, the IMF's Executive Board discussed principles for exiting from extraordinary and unprecedented crisis intervention policies implemented by countries across the globe following the onset of the crisis in the summer of 2007. The discussion responded to the request of the International Monetary and Financial Committee (IMFC) to make IMF advice and views on exiting from crisis-related intervention measures [more concrete](#). Drawing on previous and ongoing work by IMF staff, the discussion mostly focused on medium and large advanced and emerging market economies, in which interventions have been more substantial.

Executive Board Assessment

Executive Directors welcomed the opportunity to discuss broad principles for exiting from crisis intervention policies. They noted that the bold, extraordinary measures taken in response to the crisis have helped lessen the severity of the global recession and stabilized financial markets, allowing normalcy to return in many countries. Directors stressed that, to set the stage for strong, sustained, and balanced growth, anchored by price stability, policymakers need to formulate, and begin to implement when feasible, strategies for withdrawing these unprecedented support measures. While broadly endorsing the basic principles outlined in the staff paper, Directors emphasized that their application will have to take account of country-specific circumstances.

Overview of Exit Strategies

Directors agreed that exit strategies should be coherent and credible. To be effective, exit strategies should also be flexible, market-based, and integrated across policy-making entities. Directors generally saw the benefits of clearly communicating to the public overall strategies, with due consideration for the still uncertain domestic and external environment.

Directors recognized that the appropriate timing, pace, and mode of exiting from crisis-related policies depend on the state of the economy and the health of the financial system; synchronization of unwinding amongst advanced and emerging market countries is in general neither possible nor desirable. The key challenge will be to map a course between unwinding such policies too early, which would jeopardize progress in securing economic recovery, and maintaining intervention for too long, which would distort private incentives and create macroeconomic risks. Directors recognized that, for most advanced countries, some fiscal and monetary stimulus may need to be maintained well into 2010, and withdrawal could begin in 2011 if developments proceed as expected. The exit process is already underway in several emerging market and developing countries.

Directors underscored that ensuring fiscal sustainability is a key priority, making it important for consolidation to begin once there is clear evidence of a self-sustaining recovery. Given a path for fiscal consolidation, monetary policy can respond more flexibly to evolving macroeconomic conditions. In advanced economies with sluggish recovery and high unemployment, monetary policy may need to remain accommodative for an extended period so long as price pressures remain subdued. In a number of emerging economies where signs of rising inflation or incipient financial vulnerabilities emerge, including credit booms, monetary policy may have to be tightened relatively soon, and might therefore lead fiscal consolidation. The inter-linkages among fiscal, monetary, and financial sector policies warrant special attention in designing the appropriate mix and sequencing of exit strategies.

Exiting from Fiscal Support and Implementing Long-term Fiscal Consolidation

Noting that the most daunting task is to restore fiscal and debt sustainability, Directors generally agreed that a medium-term adjustment strategy aimed at ultimately reducing debt ratios to pre-crisis levels or below, depending on country circumstances, should be communicated early to reassure markets of policymakers' commitment. Unwinding discretionary support is only a first step. The bulk of the adjustment will require more difficult reforms, largely on the expenditure side, to improve the structural primary balance on a sustained basis. Directors saw the crisis as an opportunity to advance the needed reforms, including in the areas of age-related entitlements and

privatization. They stressed that institutional reforms and reforms with long-term effects on spending and revenues can be undertaken now, insofar as they do not compromise the economic recovery in the short run, and should be complemented by reforms that aim to promote potential growth.

Exiting from Monetary Policies

Directors considered that central banks have the tools to unwind monetary crisis intervention measures, although the methods and sequencing will vary with their circumstances. Central banks have employed a wide range of measures, in many cases unprecedented, resulting in historically low interest rates and substantial changes to their balance sheets. Directors broadly concurred that raising policy interest rates to safeguard price stability does not require the prior unwinding of unconventional measures. They highlighted the importance of preserving central bank independence as crisis measures are unwound, given the potential risk that fiscal adjustment could lead to pressure on some central banks to relax their commitment to price stability, undermining policy credibility.

Exiting from Financial Sector Intervention

Directors supported the view that, to maintain market confidence, financial sector support should be withdrawn gradually and flexibly, based on careful judgment that takes due regard of fiscal costs and moral hazard. This can be facilitated by built-in market incentives and by the judicious use of termination dates. To mitigate future risks, Directors emphasized the need for a new supervisory and regulatory framework, as well as more capital.

International Linkages

Directors agreed that policy coordination and regular exchange of information across countries on unwinding plans and specific financial policies are desirable to prevent destabilizing spillover effects—with due attention paid to the most vulnerable group of countries—and to ensure better outcomes. It is of particular importance that the withdrawal of financial intervention measures, as well as ensuing changes to financial regulations, be consistent across countries with strong financial linkages. Directors noted that some emerging market countries will have to design policies to manage large capital inflows. The right policy responses will differ depending on individual country circumstances, and may include some fiscal tightening where appropriate, exchange rate appreciation or greater flexibility, macroprudential policies aimed at limiting the emergence of new asset price bubbles and, finally when necessary, carefully-designed temporary capital controls.

The Role of the Fund

Directors agreed that, beyond supporting member countries in their adjustment efforts, the Fund should seek to promote international consistency by closely monitoring the exit process and its potential for spillovers as part of the Fund's bilateral and multilateral surveillance activities. These steps will complement other ongoing work on the medium-term consistency of policies among the largest economies.

NovaRes Team