What Is IMF Advice on the Exchange Rate Policy?

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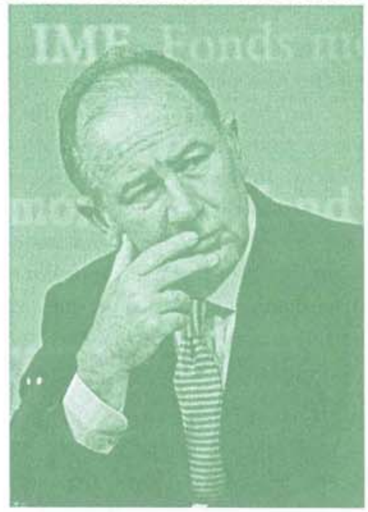
Recently, the IMF has introduced a new method of estimating the exchange rate policy and given an advice on the implementation of this policy to its members. According to its estimate, Vietnam is considered as inclined to change from the conventional fixed peg to the floating, including the managed floating, systems. This remark, thus, matches a recent statement made by Trương Văn Phước – Chief of the Foreign Exchange Department of the SBV – that "The SBV is making the exchange rate flexible by degrees," and "in the managed floating system (chosen by the SBV) the floating degree is on the increase." This shows that the exchange rate policy adopted by the SBV has received approval from the world's most important monetary institution.

The IMF is designed to maintain stability of the exchange rate and solve conflicts between countries in terms of exchange rate policies. Originally, the IMF mission was to ensure success for the fixed, but adjustable, exchange rate. In 1976 when its Articles of Agreement were changed and beefed up allowing its members to decide on their appropriate exchange rates, the IMF had a mandate to oversee (i) the international monetary system to ensure its effective operation, and (ii) each member's compliance with the obligations to direct its policies toward fostering orderly economic growth with reasonable price stability, to seek to promote stability by fostering orderly underlying economic and financial conditions, and to follow exchange rate policies in keeping with these objectives. Although its members are free to choose their exchange rate policies, they are under obligation to cooperate with the IMF in ensuring the stability for the international monetary system and the balance of payments, or ensuring competitive advantages for its members.

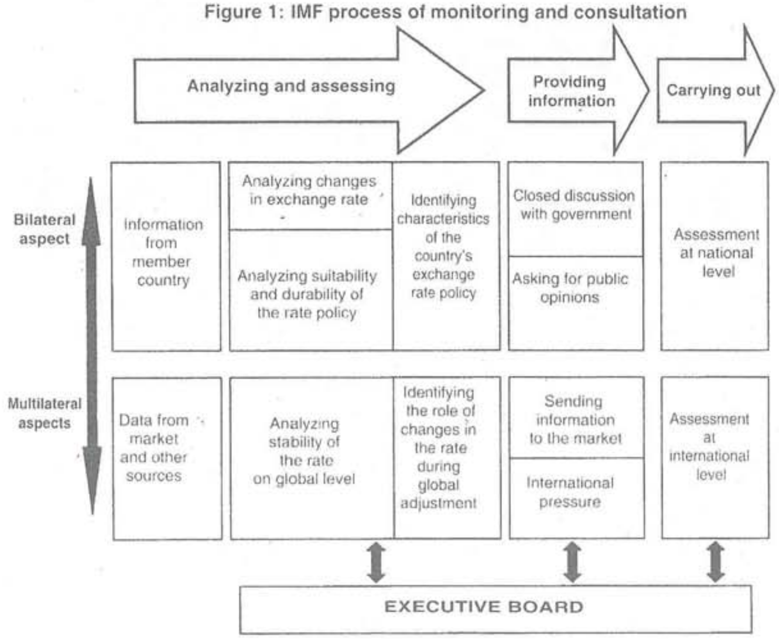


Rodrigo Rato, IMF Director

1. IMF surveillance over and advice on the exchange rate policy

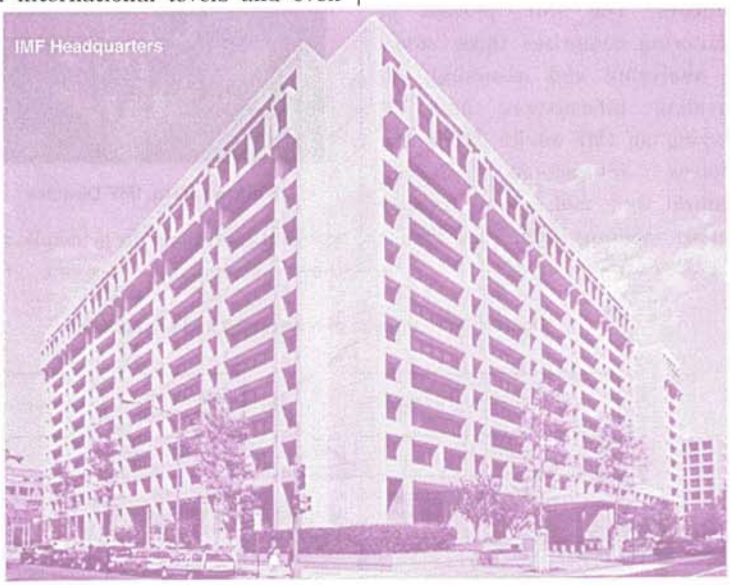
Surveillance over the exchange rate is a continuous process including links between input impacts by the IMF and output results from its members. The IMF process of monitoring comprises three steps: (1) analyzing and assessing; (2) providing information; and (3) carrying out IMF advice. Each step involves interactions between bilateral and multilateral aspects that are inherent in the surveillance over the exchange rate.

Figure 1: IMF process of monitoring and consultation



In the first step, IMF economists visit the member country and assess the suitability and durability of the exchange rate policy by examining its compatibility with other policies and external conditions. In principle, after these economists present their opinions about the exchange rate policy in a report, this report is discussed by the Executive Board. After discussion and approval, the Board's views become the IMF official ones. One of the most important factors of the assessment is the supply of necessary information by the government. This is stipulated in the Section 5 of the Article VIII on effects of quality of information supplied on IMF advice on the rate policy.

In the next step when official views take shape, related authorities are informed. The IMF experts use various channels of information, such as experts' direct discussion, assessment of the Executive Board, discussions of policies at national and international levels and even discussions of market laws. To achieve the effectiveness, the IMF will select the most appropriate channel of information for each of its message, and consider discussions with governments as a basic source of information as distinct from sensitive reactions of the market and differences between theoretical and practical analyses in order to reach the most exact and reliable remark on the exchange rate policy of a country.


IMF Headquarters

The last step includes tasks done by the government according to advice given by the IMF to gain development at home and abroad. The assessment will serve as input data for the next process of monitoring and consultation, and as criteria for receiving technical assistance and supporting programs from the IMF.

2. Principles and tools for surveillance over the rate policy

Some main principles and tools stipulated by the Articles of Agreement and adjusted by the Executive Board over time are as follows:

- There is no exchange rate policy is best suitable for all countries in all circumstances.

- A member country can choose an appropriate policy on the exchange rate it wants to apply to fulfill obligations required by Section IV of Article 1, except the gold standard system.

- The IMF tries to give clear and transparent advice to member countries based on conditions and policies they chose, and obligations set by the Articles of Agreement.

The tools used by the IMF for surveillance, assessment and consultation are diverse and erudite: real exchange rate, export market share, PPP and saving-investment balance, choice of appropriate exchange rate policy based on the theory of optimal currency area. Ability to sustain external debt and public debt is analyzed; the mechanism for warning the monetary crisis is used for assessing the sustainability of the exchange rate policy and its compatibility with other policies. Analyses of the balance sheet are also used from calculating imbalance in credit maturity and structure of financial liabilities and assets of a country.

We see that with such a system that is well standardized and developed, the IMF can carry out effectively its surveillance and consultation to member governments in implementing their exchange rate policies in order to achieve stability and effectiveness of the international monetary system, especially when the globalization is taking place at full speed with huge flows of capital. By doing so, the IMF can enhance its prestige and position as an international financial institution after being criticized because of the 1997 Asian financial crisis and 2002 Argentine monetary crisis.

As for Vietnam's exchange rate policy, the IMF welcomed the authorities' intention to explore in a forward-looking manner ways to introduce more flexible exchange rate management, and noted that greater exchange rate flexibility will facilitate adjustment to exogenous shocks, reduce external vulnerability, and create incentives for economic agents to improve their management of exchange rate risks. The Fund also advised that exchange market intervention be limited to addressing disorderly market conditions, and that full use be made of the flexibility embedded in the current exchange rate system ■