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Publication

In reporting on the decision of the International Monetary and Financial Committee (IMFC) to ask the IMF to conduct its surveillance multilaterally, the IMF's Morning Press summary stated that

> member countries welcomed efforts to enhance monitoring of exchange rates, but most said they were hesitant about the IMF publishing analyses on the theoretical fair value of currency rates because it was market sensitive.

It is therefore clear that the issue of whether the set of agreed reference rates should be made public is an important one. Indeed, if one does not wish the IMF to be given the power to impose hard rules on the fiscal and monetary policies that countries adopt, the power to influence the markets by publishing estimates of "fair values" of currencies may well be the most potent instrument that the Fund might wield. However, it should be acknowledged that a staff estimate that the dollar was overvalued by 15 to 35 percent in the 2006 Article IV consultation document with the United States appears not to have produced a ripple in the markets.

Whether publication of exchange rate analysis is a good idea depends very much upon the nature of the exchange rate system. It would certainly have been a very bad idea (at least from the standpoint of taxpayers) to publish the results of such studies during the old Bretton Woods days, when countries had an obligation to hold their exchange rates within narrow bands unless and until they decided that they faced a "fundamental disequilibrium." Anything that helped the market decide when a parity change was likely to occur would have been liable to add to a run on (or into) a country's currency, which the authorities would have been obliged to resist

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up to the moment when they were ready to announce a parity change, and they would in consequence have lost more money to the speculators.

How about when the exchange rate is floating but the float is disciplined by a reference rate? Is it harmful to announce the reference rate and/or the analysis that underlies it?

One feature of floating is that at any time the weight of buyers in the market is equal to the weight of sellers, admittedly including any official intervention purchases or sales that may be taking place. Normally authorities intervene only when they believe the market exchange rate to be inappropriate, in a direction calculated toward correcting the misalignment. For example, they might buy reserves when the currency is in their judgment overvalued, or they might sell them when they believe the currency to be undervalued. Establishment of a reference rate system (most clearly, the monitoring zone variant) would simply limit intervention to circumstances when one of those conditions was satisfied and oblige it to be in a stabilizing direction.[1] Publication of the reference rates would do something to tell the market when it might expect such intervention.

Suppose, to take the extreme case, that publication enabled the private sector to know exactly when and on what scale intervention was to be expected. If the private-market participants believed the market rate was in fact going to move in accordance with the authorities' wishes, they would be motivated to anticipate the authorities' intervention by preemptively pushing the rate in the desired direction. Their market actions would reinforce the intentions of the authorities, meaning that publication would be advantageous. Accordingly publication would tend to lighten the needed actions by governments. Only if the market believed that the market rate was likely to move against the authorities' wishes, further from the reference rate, would they have an incentive to exploit knowledge of impending intervention. The extreme case is when the authorities decide to defend a certain rate, and the market can blow aside that rate; then knowledge of the authorities' intentions could indeed lead to increased activity by the private sector, the counterpart of which would be costly purchases and sales by the central bank. But the point of floating is to avoid precisely this type of situation. If the market has views of where the rate will go that are at variance with the wishes of the authorities, the latter have the option of simply letting it go there. This option is in no way precluded by announcing a reference rate, because the latter by definition implies no obligation to intervene.

The most important point is that a well-reasoned explanation of the set of reference rates, such as one would expect the IMF to supply, will increase

1. As asserted previously, it would be possible also to allow tactical intervention to counter disorderly market conditions when this condition was not satisfied, but the test of whether intervention satisfied this condition is that there should be no large trend change in reserves.

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the information available to the private sector. It is well known that, in determining the buy and sell decisions that in turn give rise to exchange rates, the private sector gives little weight to the sort of long-term considerations that underlie equilibrium exchange rates. One explanation of this is that it is simply too costly for any individual market participant to undertake analysis that could lead to a remotely convincing diagnosis. But if such an analysis were undertaken by the official sector—especially by the relatively credible experts of the IMF's research department—and made available to the private sector, then the latter might be happy to utilize it by factoring it into its decisions. Simply by publishing its official estimates of reference rates, one would expect the IMF to provoke a public debate, out of which one might hope that something of a consensus view on the likely long-term exchange rate between a pair of currencies would emerge.

Perhaps the problem conceived by those authorities opposed to publication is fear that the IMF estimates would run counter to their policy preferences. Suppose, for example, that the US authorities believe their own propaganda about the virtues of a "strong" dollar, rather than believing that the dollar should be valued at an equilibrium level. In that case it is quite rational for them to resist publication of an IMF estimate that they might expect to diminish market willingness to continue holding an overvalued dollar. At least, it is rational given their irrational beliefs. It is quite another matter to agree that publication would be contrary to the interests of the United States. If one thinks that it is in the interest of US citizens that the dollar should not be overvalued, then the essence of the problem is that the US authorities are not correctly representing the interests of their citizens. A curtailment of their power is devoutly to be desired, even if it is not clear that it will be readily forthcoming.

Another possible basis for opposing publication would be skepticism regarding the possibility of making sensible estimates of equilibrium exchange rates. If the market took seriously published estimates that were more wrong than the figures implied by the market's unguided outcome, it is not only possible but in fact likely that publication would be harmful. This is one of the reasons for believing that the authorities should operate within a wide (implicit or explicit) band, such as a monitoring band. It is wrong to intervene to influence rates unless one is sure that one will be pushing them toward rather than away from equilibrium. A published estimate of the equilibrium rate that is 5 or 10 percent different from the actual market rate should not justify an official reaction, and in that case it is unlikely to provoke a market reaction. It is when the estimates suggest disequilibria of 15 or 20 percent that reactions become likely. While it is clear that markets have on occasion generated misalignments that large,[2] it

2. Think of the weak euro in 2000–2002 or the strong yen in 1995.

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seems unlikely that estimates that have to go through an elaborate bureaucratic process could be that wrong.

While most currencies now float, there are some that still peg. Presumably pegging would not avoid the naming of a reference rate, and—unlike most pegs, which are usually bilateral pegs to some other currency—this would be expressed in terms of an effective exchange rate. A move of third currencies against the peg currency could then raise the likelihood that the peg would need to be adjusted, and publication would make this likelihood evident to the market. One could understand the authorities of such a country objecting to publication, although it is also relevant to note that they could avoid any problems by making small and timely changes in their official peg.

Last but unfortunately not necessarily least, some authorities may oppose publication because of unwillingness to accept that their policy objective ought to be an equilibrium exchange rate. In particular, they may wish to maintain an undervalued exchange rate because of a belief that this is the way to nurture export-led growth. The fallacies in this view have already been discussed, but that does not mean that it will not influence policy.

Past experience suggests that officials are even more reluctant to name equilibrium exchange rates when current market rates are far away from equilibrium. For example, at the time of the Plaza Agreement, the only thing agreed was the desirable direction of change, whereas at the time of the Louvre Agreement, officials agreed on a set of reference ranges (centered on the existing rates). Publication when the estimates of the reference rate are far from the prevailing market rates may look a more daring act, since it has been argued that it poses a danger of lost credibility if the market does not respond promptly. However, it is not clear that it is therefore rational to time announcements to coincide with times when the market exchange rates are close to their estimated equilibria. It may do more to establish the credibility of the system if the authorities have the courage to publish rates that are out of line with current market expectations but that are shown to make sense in the longer term.[3] If these estimates are both reasonably correct and taken seriously by the private sector, publication would certainly do more good.

I have argued above the positive case for publication of the IMF's figures for reference rates and the analysis that supports them. But the alternative of keeping the figures and the analysis secret appears totally impractical in this day and age. If the figures are not published, they will leak. But the leaked

3. A Brazilian journalist once reminded me that I had estimated the real's FEER against the dollar as about 2.5 at a time when the market was forecasting that the real would stay over 3 to the dollar. Subsequent history suggests that if anything I underestimated the equilibrium value of the real, but I clearly got brownie points for looking beyond my nose.

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version cannot be corrected, as incorrect versions of a set of published figures can be. The informational advantage of supplying the market with informed analysis would be squandered. The IMF would open itself to the charge of resisting transparency, one of the good things of our day. It is difficult to believe that the representatives at the IMFC were really so committed to playing King Canute as the account of their deliberations suggests. Any market sensitivity of reference rates is something to be exploited, not an embarrassment that should lead to the reference rates being hidden. The contrary views still being expressed by parts of the official sector are a historical hangover from the days of the Bretton Woods system. They are an anachronism that deserves to be swept aside in the world in which we now live.

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