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The IMF in a world of private capital markets

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Abstract

In analyzing the IMF attempts to stabilize private capital flows, we contrast cases where banks and bondholders do the lending. Consistent with banks' natural advantage in monitoring, they reduce spreads as they obtain more information through repeat transactions with borrowers. By comparison, repeat borrowing has little influence in bond markets, where publicly-available information dominates. But spreads on bonds are lower when they are issued in conjunction with an IMF-supported program, as if the existence of a program conveys positive information to bondholders. The influence of IMF monitoring in bond markets is especially pronounced for countries vulnerable to liquidity crises.

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1. Introduction

Catalyzing private capital flows to emerging markets has been an objective of the International Monetary Fund since the 1990s, if not before.[1] The Fund provides public monitoring services and negotiates programs that enable the borrowers to reveal their commitment to sound macroeconomic policies. In addition, its own lending may stabilize capital flows by providing bridge finance for creditworthy countries experiencing liquidity crises, the resolution of which may be difficult to coordinate for atomistic lenders.

In this paper, we seek to better understand the roles of IMF monitoring and lending and provide new evidence of their effects. We analyze the impact of IMF-supported programs on market access and the cost of funds, building on three insights.

- First, if banks are already engaged in monitoring as part of their normal operation, then IMF monitoring should have a relatively limited impact when bank syndicates do the lending.
- Second, private capital flows should be particularly sensitive to the magnitude of IMF financial commitments when the likelihood of debt restructuring is high.
- Third, precautionary programs are a mechanism through which governments can use their relationship with the IMF to signal their commitment to strong policies. Differences in the impact of precautionary and regular IMF programs should therefore be useful for distinguishing the Fund's monitoring and lending roles.

Our analysis is based on more than 6700 loan transactions between emerging market borrowers and international bank syndicates and some 3500 new bond issues placed between 1991 and 2002. We analyze the frequency of transactions and the spreads charged. Among the explanatory variables are a measure of repeat borrowing that proxies for creditor learning about borrower characteristics, as well as the existence and size of IMF programs. Because we analyze individual transactions rather than aggregate capital flows or other macroeconomic conditions, our findings are less susceptible to causality running from the outcome to the decision to initiate an IMF program.[2]

Important differences between bank loans and bond issues have been documented in the domestic context.[3] Banks act as delegated monitors on behalf of investors who cannot easily observe and discipline borrowers (Diamond, 1984). The information they acquire can be used to limit the use of funds and for pricing loans. In contrast, individual bondholders lack the incentive to incur the costs of securing expensive private information about borrowers. Instead, public information – for example, the

[1] See for example IMF (1999).

[2] High-frequency data also allow us to capture the timing of programs more precisely than is possible in aggregate studies using annual data to analyze the influence of IMF programs.

[3] This difference between bank and capital markets has been well documented in the domestic US context (see, for example, Fama, 1985; James, 1987, and Petersen and Rajan 1994 and 1995).