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**Statement by Mr. Palotai, Mr. Azal, Mr. Just, Mr. Harvan, Mr. Marek, and Mr. Meizer  
on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting  
March 25, 2021**

**World Economic Outlook**

We highly appreciate staff's work on the World Economic Outlook (WEO), with particular attention to the short- and long-term impacts of the COVID-19 crisis, as well as the main policy areas to avoid a great divergence in the economic recovery. The paths to economic recovery are still mired with uncertainty, while it is also clear that this crisis is accelerating fundamental changes in the global economy. The containment of the pandemic still remains a priority. Meanwhile, countries must be prepared to restart their economic activities, placing greater emphasis on increasing employment and promoting investments. Maintaining stimulus is also warranted; however, as the policy space has narrowed, targeted measures are becoming increasingly important. We believe that the medium-term fiscal consolidation plans should be promoted in a growth-friendly way. Although international institutions can play an important role in supporting these efforts, the international community should also step up cooperation to help end the pandemic by speeding up the production, rollout, and distribution of vaccines.

The recovery paths mainly depend on the race between the virus and vaccines, and we continue to encourage staff to accord high priority to these developments. *We would appreciate staff's clarifications whether recent developments, including the new wave of lockdowns and their impacts on key sectors, were already captured in the report.* Although most of the sectors have adapted well to the changing environment, other sectors are still reeling from the protracted crisis. Special attention should also be given to the disruptions of the global supply chains, which can lead to higher prices globally.

While we take note that staff's forecast marks a slight improvement in the global economic outlook, we call for cautious communication, as high uncertainty surrounds the recovery. Although a positive attitude may in itself help expectations, we also underscore the

importance of maintaining a balanced approach to the projections. We would consider it premature to declare that the COVID-19 crisis could leave smaller scars than the Global Financial Crisis of 2008 (GFC). We would primarily focus on the policy measures to reach this state and build a better future.

The capability to reallocate jobs to more viable economic sectors will have significant impacts on the labor market and the prospects for recovery. We welcome the WEO analytical chapter on the patterns of labor force participation and policy options. In order to sustain high and inclusive employment, the focus of policy reforms in labor markets should concentrate more on fast-growing prosperous economic sectors, such as digitalization and the green economy, than jobs in declining industries. Tailored labor market policy measures such as additional training, education, job search services, and lowering costs for firms to employ new workers, should be used to assist the transition of workers between economic sectors. These steps should be supplemented with measures aiming at improving the business environment and strengthening social safety nets to support the most vulnerable.

Beyond responding to the current social and economic challenges, policymakers should also take steps to address the pandemic's lasting scars to avoid permanent output losses. In this regard, we highly appreciate Chapter 2, which provides helpful insights into the pandemic's after-effects. We suggest better incorporating these findings into the main summary. While the COVID-19 crisis is unique in nature, experience from previous crises can also provide useful lessons on the persistent effects of recessions and how to alleviate them. To ensure a sustainable recovery, countries need to make bold decisions now and redouble their reform efforts. Like staff, we believe that the pandemic's adverse effects can mainly be offset by investments that serve the future and support human capital accumulation. In terms of global imbalances and inequalities, we note with concern that the emerging markets and developing countries (EMDCs) are expected to suffer more scarring than advanced economies, while the EMDCs' room for policy maneuver is also narrower. This also underscores the need for well-calibrated policy measures.

We highly appreciate Chapter 4, also considering that the importance of spillover effects has increased significantly in recent years, in the context of the dynamic growth of emerging markets (EMs). At the current juncture, where a growing divergence is expected, it is critical that the assessments of these impacts remain high on policymakers' agenda. We also agree with staff that clear forward guidance from advanced economies' central banks will be key to maintain investor confidence and avoid a surprise tightening of global financial conditions. Given the more constrained policy space in EMs, we continue to underline the benefits of the unconventional policy measures, with particular focus on targeted liquidity and lending programs. Meanwhile, emerging market economies should also take further steps to reduce their external vulnerabilities, promote debt sustainability, and scale-up their efforts to build credible medium-term budgetary and monetary frameworks. Taking country-specific factors into account is also vital.

### **Global Financial Stability Report**

We thank staff for the detailed Global Financial Stability Report (GFSR), which provides a thorough analysis of potential financial stability risks across different financial market

segments, including a helpful discussion of specific policy trade-offs. The newly added sections on more granular policy recommendations constitute an important guidance for policy makers, which could facilitate their policy response in the next stages of the current crisis. In this regard, we also appreciate the GFSR's analytical chapter on commercial real estate (CRE), explaining the possible extension of macroprudential tools. While the unprecedented monetary and fiscal stimulus was instrumental to prevent the liquidity crisis from turning into a solvency crisis, the withdrawal of supportive measures needs to be gradual to keep emerging cliff-edge effects in check. This is, in particular, critical for those jurisdictions where the recovery is expected to be only modest or delayed going forward. Therefore, a return to policy normality, including potential more restrictive monetary policies in advanced economies, needs to be closely monitored to alleviate potential adverse effects related to rising risk premia and capital outflows from emerging markets.

Banks entered the COVID-19 pandemic with stronger capital buffers owing to the post-GFC regulatory and supervisory overhaul. We note positively that the banking sector in advanced economies has demonstrated its resilience to shocks thus far, facilitated by regulatory relief and crisis-related measures. In the next stages of the crisis, banks will need to adjust their risk management frameworks to withstand potential losses from loans currently under moratoria, and build reserves against credit risks from new loans which will no longer be secured by government guarantees. We note staff's finding that while some segments of banks have ample capital, their incentives to support lending in the real economy are limited, owing to risks stemming from a potential deterioration in credit quality and costs related to restoring their capital buffers, which might weigh on banks' valuations. We underscore that such considerations are particularly critical for EU banks, whose valuations are comparatively low given long-term subdued profitability. Against this backdrop, in order to speed up the capital rebuilding process and support the recovery, EU banks need to consolidate and accelerate their digital transformation.

The corporate sector has benefited from accommodative monetary policies and easy financing conditions amid a mix of supporting measures. However, rising leverage and mounting solvency issues in some segments of the corporate sector are worrying. We welcome staff's analysis of firms' liquidity and solvency strains across different real economy sectors and firm sizes. While policy makers should not withdraw policy support prematurely, it is critical to allow for economic restructuring and avoid the "zombification" of firms unable to adjust their business models. The policy response should, therefore, be well-targeted and designed for firms meeting the required viability criteria. To this end, the GFSR offers a useful guidance for policy makers, in particular, the framework for taking decisions included in the box on page 24 (decision tree). The application of such a framework in practice might be constrained by institutional limitations in countries dealing with capacity issues or lacking expertise in credit risk assessment. *We would welcome staff's views on how such issues could be addressed in different jurisdictions, including a potential outsourcing of the credit risk assessment to the private sector.*

While emerging markets have benefited from central banks' asset purchase programs and Fund-supported financing arrangements, recent volatility in the capital flows indicates that some countries' fiscal positions are fragile. While some emerging countries remained

relatively stable, in view of the elevated indebtedness, rising rollover risks, and vulnerabilities related to lower availability of vaccines, we are concerned that the economic recovery in several emerging markets will be uneven and protracted. While some countries will need to employ debt management operations, including debt service rescheduling or the restructuring of bilateral debt, it will also be critical not to lose sight of fiscal consolidation strategies and structural reforms to address weak economic fundamentals.

The GFSR's analytical chapter on CRE provides a thorough explanation of financial stability risks related to structural trends in the CRE sector, which have been exacerbated by the COVID-19 pandemic. While banks could be substantially impacted through their credit exposure to CRE, insurance companies, pension funds, and other nonbanks are vulnerable to price corrections in their CRE asset holdings. The outlook in the CRE is uncertain, depending on the demand for the future use of commercial premises, post-pandemic health-related restrictive measures, and a potential further shift to e-commerce, which could amplify price misalignments. Macroprudential tools targeted at banks' CRE exposures, such as loan-to-value or debt-service-to-income ratios, could be considered to mitigate the emerging risks, subject to the scope of the authorities' regulatory and supervisory mandates.

### **Fiscal Monitor**

We broadly concur with the FM's message on the need to better tailor the response to the pandemic's impact and align **fiscal support** with the pace of the recovery and medium-term needs.

Global public debt surpassed unprecedented 97 percent of GDP in 2020 and we stress the importance of credible **medium-term fiscal strategy and frameworks** as well as of adequate policy space in the short term. Increased public debt levels should be addressed by implementing sustainable medium-term fiscal strategies rooted in stronger revenue mobilization efforts and increasing quality and efficiency of public spending, while leaving room for raising investment levels and supporting the green and digital transitions. For instance, the EU's Recovery and Resilience Facility (RRF) provides a unique window of opportunity for member states. We further underscore the need to complement credible fiscal rules with binding multiyear operational rules that ensure debt reduction once economies recover to avoid repeating the uneven debt reduction following the GFC. Ensuring full transparency of fiscal costs and existing liabilities remains essential. We stress the role that improved governance and transparency can play in increasing voluntary tax compliance and reducing wasteful spending and positively note the innovative practices highlighted in Box 1.1 of the FM. We are sympathetic to pre-legislating tax increases but are cognizant of the political economy difficulties especially across election cycles. Progress in addressing structural weaknesses in international taxation rules will be an important factor to ensure that highly digital firms contribute their fair share in market countries.

The second chapter of the FM highlights the impact of the pandemic on preexisting **inequalities** in income, wealth and access to quality public services, and usefully identifies the pre-distributive and redistributive policy options. *We would have welcomed more details on a realistic pace improvement observed in countries implementing reforms in the past in*

*closing the sizeable efficiency gaps.* Investing in human capital through more equitable access to education, childcare and healthcare would support a more resilient recovery and avoid deeper scarring while likely being deficit neutral in the long run. The chapter also usefully identifies several options for raising revenues while reducing wealth and income inequalities in the short term and we highlight the potential trade-offs between increasing tax burden on income and tackling tax evasion.