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**Statement by Ms. Lim, Mr. Mochtar, Mr. Nghiem, Mr. Bautista, and Ms. Susiandri on
2021 External Sector Report
(Preliminary)
Executive Board Meeting
July 16, 2021**

We thank staff for the well-written 2021 External Sector Report. We also appreciate staff's assessment of specific country's external position along with the refinement of the EBA model to better capture the significant impact of the COVID-19 shock. While we broadly agree with the report, we believe that policy advice should be deliberated in light of recent findings to ensure that the Fund advice remains relevant and beneficial to its membership. We would like to offer the following comments for consideration.

External Positions and Policies

On the assessment of global external positions, we agree that current account balances are expected to widen unevenly at country levels due to the impact of COVID-19, amidst the synchronized but varied size of fiscal expansion and the exceptional rise in government borrowing to finance health care and economic support in 2020. The path of fiscal policy will take its cue from a country's most recent initial conditions and how the rest of 2021 will pan out. An immediate and resolute control of the pandemic is most critical to addressing the large risk of greater global external imbalance over the medium term. At the same time, it is important for authorities to work on strengthening their preventive measures for fighting another health crisis in the future.

Given high uncertainties surrounding the course of the pandemic, we remain concerned about whether the widening global imbalances would be temporary in nature. Prolonged crisis in some countries due to their limited capacity to contain the new wave of outbreak might exacerbate global imbalances. In addition, we are of the view that the risk of global imbalances may increase, as the pandemic could have left structural impact on the dynamics of global value chains and certain sectors, such as tourism. We encourage staff to further deepen the assessment, including considering the plausibility of the prolonged four

sectoral shock due to the pandemic as described in the analysis, that could permanently impact external sector developments.

We share staff's view that policy efforts should focus on ending the pandemic at this current juncture. We strongly support the ongoing international cooperation to secure grants and concessional financing for timely and increased vaccinations in addition to the global authorities' resources and enhanced public health measures. A working solution to the global pandemic will ensure a sustainable path to recovery and will compel many countries to implement fiscal consolidation on a more synchronized manner. In this regard, we commend the efforts of the Fund in the approval of the US\$650 billion SDRs and the support from international institutions that help ease some financing constraints. *This said, does staff have a view on the adequacy and sustainability of existing globally available financing given the seemingly more persistent risks to external balance?*

Considering the risk of further external shocks due to a different pace of unwinding of policies, it is critical for authorities to have greater flexibility to deploy their full range of policy toolkits to deal with such risk. In this regard, we note staff's assessment that exchange rate intervention can alleviate disorderly market conditions, particularly if there are shallow foreign currency markets and large balance sheet mismatches. We encourage staff to provide more nuanced policy advice on capital flows management (CFM) measures taking into consideration the Fund's latest research and empirical evidence, which suggest that preemptive and long-lasting use of CFM is justified given the benefits on reducing financial stability risks in certain circumstances. It is important to embrace new lessons from research and experience to ensure that policy advice remains valuable for member countries. Along these lines, we urge staff to provide policy advice to facilitate policy normalization, taking into account potential for adverse cross-border spillover effects, such as capital flow volatility in EMDEs.

As rightfully pointed out by staff, we underscore a growth-inducing approach to reduce global imbalance over the medium term and highlight the need for international cooperation to facilitate the rules-based multilateral trade and roll back of trade restrictions, especially on the medical and health sectors. Widening of current account balances could trigger competitive protectionism and disrupt currency and asset price adjustments. We take positive note that entangling trade and currency issues in international agreements and disputes poses significant risks to the multilateral trade and international monetary systems and should be avoided. The adoption of currency-based countervailing duties is counter-productive, and it can lead to retaliation by other countries. *In this context, staff may provide updates on the progress of ongoing multilateral efforts and identify the remaining gaps on cooperation on trade as well as in addressing trade tensions.*

More targeted fiscal policies focused on investments and aided by monetary and financial policy support, as appropriate and as needed, should support solid recovery. We note the indications of rising global demand from rapid manufacturing-based recovery, rising shipping rates and input prices, and higher costs of oil and other commodities. Trends in the next few quarters will largely depend on the one hand on pent-up demand, partly to

shore up inventories; and individual country capacity, uneven vaccination, and spread of virus variants that restrict activities mainly in services sector on the other hand. Meanwhile, the June meeting of the US Fed appears to open a discussion on scaling back of asset purchases, although noting that a rate lift-off is well into the future as “substantial progress” on economic recovery has yet to be met. *How do staff view the emerging trends in these areas and their respective effect on global external balances?*

We appreciate the staff analysis and summary of individual economy assessments and the recommended policies for each country in Annex Table 1.1.6. **We are aware that the policy recommendations will not only address the external condition but also provide solutions to a more holistic set of country-specific macroeconomic issues.** This said, we emphasize a more country-specific link of policy advice alongside the external balance assessment.

Fiscal Policy and External Adjustment

We agree that current account and exchange rate effects of fiscal policy changes will show exception in capital income taxation and public investment, with larger effects for more open economies, liquidity-constrained households, and less flexible exchange rates. Staff presentation of the different combinations of fiscal instruments provides authorities with useful policy tools that have output and external position outcomes over the medium-term. This includes trade-off between increased pressures of CA balance in the near-term due to higher public investment and improved productivity and potential output for the medium-term, in particular for countries experiencing CA deficit and infrastructure gap. *As the narrative approach in chapter 2 used multi-country databases which included 14 countries in Latin America and the Caribbean together with China and India, would direct application of the findings to countries that are not included in the sample be as straightforward, especially for LICs?*

An unsynchronized and varied size of fiscal consolidation given the uneven regional pace of recovery and fiscal space could lead to greater volatility and imbalance. *Considering that most of the current account surplus economies are expected to recover faster relative to their trading partners, can staff provide views on the likelihood that current account surplus economies will implement faster-than-expected fiscal consolidation and how this will affect EMDEs and LICs, especially their financing requirements?*

Individual Economy Assessment

We understand that where the EBA method was unable to capture country specific issues due to unprecedented shocks, cyclical adjusters were used to estimate the current account gap, consistent with the REER gap, and rightfully expressed in range to account for uncertainties. *Will cyclical adjusters be adopted in the event of a more persistent or prolonged effects of the pandemic?* While we support refinements on the EBA methodology to capture the unparalleled shocks in some sectors during the COVID-19 pandemic, we reiterate our view on the need to go further to review the overall EBA methodology to account for structural

changes caused by COVID and to address model limitations which existed even before the COVID crisis.

We continue to call for great caution in communicating EBA results and its policy implications. We cautiously note that the often large unidentified residuals in the model and the temporary adjustor during crisis might be unable to fully capture the country-specific factors. In addition, there remains uncertainty in the estimated post-COVID parameters due to structural changes currently under way. Staff should provide a nuanced assessment on the external positions and communicate clearly the limitations of the EBA models, rather than just a binary representation of countries' external positions as being 'stronger' or 'weaker' relative to their respective fundamentals. Incomplete assessment could inadvertently have an impact on a country's financial stability, and impediments to its creditworthiness. On the policy implication, staff should avoid overburdening the role of the exchange rate as primary adjusting variable for the implied CA misalignments, as the drivers of nominal and real exchange rate movements could come from many other factors, especially capital account transactions.