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GRAY/21/824

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March 23, 2021

**Statement by Mr. Mozhin, Mr. Palei, Mr. Potapov, Mr. Tolstikov, Mr. Biriukov, and Mr. Shestakov on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
March 25, 2021**

The COVID-19 pandemic continues to take a heavy toll on the global economy, and the outlook, while improved, is still uncertain. Vaccine rollouts in many countries seem to be on the upside of previous projections, but the medium-term adjustment costs for different countries due to the pandemic will only be known over time. Additional sizeable fiscal support in some advanced economies is likely to boost both their own growth and that of their trading partners, although new related risks to financial stability are emerging. In many EMDEs projections have also improved even despite a much more moderate fiscal stimulus and due to the prompt response from their healthcare systems and overall policy packages.

The headline notion in the WEO of lasting divergence in growth prospects between advanced economies and emerging market economies is somewhat artificial and fails to account for variation within the three main country groups. Given the impact that communication from the Fund has on market sentiments, we would welcome a more balanced approach to presenting and contextualizing WEO projections. Uneven growth is a long-standing phenomenon, and some economies may be affected by the pandemic harder than others. However, we see little evidence that it correlates with the income level. Based on our bilateral conversations with staff, we would like to make several observations. First, we understand that in terms of GDP per capita, in 2021-2026, EMDEs in Latin America, Sub-Saharan Africa, and the Middle East are expected to grow somewhat slower or similarly to the per capita growth rates in advanced economies. However, the EMDEs in Asia excluding China and China itself are expected to grow about three times faster than advanced economies. The projected per capita growth rates in emerging Europe are also significantly higher. The regional differences are huge, and, in our opinion, the WEO should not lump all the countries together, let alone send a message which might be confusing to readers. With

somewhat closer examination, to a large extent the divergence story turns out to be a stretch. *We ask staff to provide a corresponding chart in their written responses to Directors.*

Second, the speed of recovery can be measured in more than one way. One way is to compare forecasts before the crisis and now. Another way is to look at the return to the pre-crisis GDP peaks. The latter shows that the EMDEs are doing much better than the advanced economies. It would be particularly true if the United States was treated as an outlier in the group, similarly to the way China was treated for the EMDEs. *Here, again, we would ask staff to provide a corresponding chart to Directors.* Moreover, we note that within the advanced economies the speed of recovery differs substantially, the group is not homogeneous. Recalling economic performance after the Global Financial Crisis, we note that, for the euro area, the envisaged performance follows the “lost decade” of the previous period. *Staff comments on the advanced economies would be appreciated.* Overall, we believe that a more balanced presentation of the outlook would significantly benefit the WEO.

On balance, for the world economy as a whole, the fiscal policy stance is expected to tighten in 2021 as the pandemic-related policy support is phased out and the effects from the automatic stabilizers decrease. However, there is a significant heterogeneity between advanced economies, which have announced additional fiscal support packages. The fiscal package in the US at \$1.9 trillion is expected to deliver strong growth, while fiscal packages in other advanced economies, including Japan and advanced Europe, while also sizeable, are lower compared with the US and will be spread throughout the recovery phase. China and other large EMDEs, while gradually reducing their budget deficits, will still continue to provide stimulus to their economies over the medium term. These measures combined with the output reduction will increase the debt-to-GDP ratios from already high levels accumulated during the pre-pandemic and pandemic debt-surge waves. Vulnerabilities to protracted economic downturn and possible abrupt tightening of global financial conditions are heightened, and in some countries addressing these vulnerabilities amounts to fiscal consolidation starting as early as 2021, with risks of slowing down the recovery and increasing the persistent economic damage from the crisis. With difficult trade-offs that are faced by policy makers, there is no one-fits-all solution.

Accommodative monetary policy remains necessary, but it now has to take into account new developments in the fiscal area as well as possible market overreaction. Many respected observers pointed out that a new policy mix augmented inflation risks, and we see a special challenge in communicating any policy stance, including possible tightening. In this respect, we find Chapter 4 in the WEO to be particularly informative on the risks of unexpected monetary tightening in the advanced economies, especially in the US. In many countries unprecedented fiscal stimulus packages are now estimated to go further than simply closing pre-pandemic output gaps, which may generate inflationary pressures. We understand that, under the baseline scenario, the inflationary response is likely to be

-muted as a result of anchored inflation expectations and Phillips curve relationship weakened by the global market integration. However, if inflation does materialize, central banks should avoid rushing into a preemptive tightening, and enhance credibility of their new monetary policy frameworks, which allow inflation to stay somewhat above the target for some period of time. Throughout the process, clear and transparent communication from central banks will be the key.

Staff appropriately highlight a very challenging environment for the EMDEs, especially considering that the risk premium across the EMDEs compressed significantly following last year's aggressive rate cuts. The recent rise in the US yields is broadly in line with the average rises during the previous episodes. However, its impact seems to be relatively stronger on EM assets, and in particular on fixed income assets this time. Against this background, we think it is important to reduce the risk of fiscal dominance concerns by considering credible fiscal consolidation plans once the pandemic allows. *At the same time, we doubt that, in case of tightening of international financial conditions, the effects are likely to be limited to the EMDEs only. What will be the effects on advanced economies lagging behind the US in their business cycles?*

Advice for more inclusive growth is becoming more prominent in the IMF flagship reports. Chapter 2 of the Fiscal Monitor makes a strong case for more socially oriented policies, including higher public spending for social and development purposes, higher and more progressive taxation. “For the recovery period and beyond, policies will need to aim at giving everyone a fair shot at lifetime opportunities by reducing gaps in access to quality public services. For most countries, this will require mobilizing additional revenues and improving the delivery of services while fostering inclusive growth”.

While the socially oriented approach looks attractive, it was not accepted universally before the pandemic and for good reasons. Low- and middle-income countries are lacking the resources required for maintaining the European-style social models. High income economies outside Europe, led by the US, mostly preferred less paternalistic approach. As the pandemic drew attention to the scale of inequality and poverty within the advanced economies, the attitude may be changing, including in the US. However, as the pandemic has sharply reduced fiscal space for many countries, the problem of limited fiscal resources has only become worse. Without sustained economic growth supported by deep structural reforms it would be challenging to address these issues.

In a more constrained fiscal environment, increasing social support for the poor and vulnerable is mainly possible through redistribution and more focused support. First, targeting of social measures must be improved, reducing the share of those that may benefit the middle class and the rich. Second, staff advised that the rich strata of the society should pay more, mostly through higher taxes. Staff also advised to impose “temporary COVID-19 contribution levied on the incomes of the rich”. Previously, the efforts to increase tax

pressures on the wealthy and powerful were constrained by the ability of the rich to avoid taxation through tax heavens and other methods of tax optimization. At the same time, we agree that the ongoing digitalization provides more opportunities to identify and trace financial flows and tax property. Also, international tax reforms and cooperation in the tax area, if successful, may further reduce the possibility to avoid and evade tax payments. Most likely, this will be a long and difficult struggle, and we should not expect substantial gains in the near term. *Could staff comment on the prospects for increasing progressivity of taxes and tax compliance of high-income households in the major economies?*

More EMs have resorted to unconventional monetary policy measures, and some may consider adopting new monetary policy frameworks. According to staff, asset purchase programs (APPs) were more likely to be announced in countries with greater exchange rate flexibility, greater central bank transparency, and more rules-based fiscal policy frameworks. The interpretation of this finding is less clear: perhaps, in countries with better monetary policy frameworks APPs are more effective, or due to globalization their neutral policy rates move together with those of advanced economies. Given that so many advanced economies are conducting a review of their monetary policy frameworks with greater emphasis on “make-up strategies” (average inflation targeting, price level targeting), the option of adopting a new framework along these lines instead of increasing central bank balance sheets even further might be considered.

Investment in green infrastructure, accelerated shift to digitalization and expanded social safety net would limit persistent economic damage from COVID-19. We agree with staff on the key policy steps that might limit scarring, which are focused on recuperating losses from educational disruptions and preparing the economy for the post-COVID environment. We consider the description of the COVID-19 shock as a massive initial supply shock combined with a large decline in demand propagated through production networks to be broadly accurate.

Active labor market support has been focused on job retention during the active phase of the crisis and should be focused on job reallocation during the post-pandemic recovery. There is some conflict between job retention and job reallocation policies, which is underemphasized in the WEO. During the recovery phase many countries might find productivity growth slowing down because inefficient matches on the labor market were retained throughout the crisis. We also note the finding in Chapter 3 that employed workers that switched occupations increased their earnings, while unemployed workers that switched occupations faced a sizeable earning penalty. This penalty is likely explained by those cases when the job search within the occupation is unsuccessful forcing the decision to switch, and the individual’s human capital specific to previous occupation is lost. The loss of the human capital is less pronounced for younger and low-skilled workers, which explains why these categories gain the most from reallocation programs. These switching costs might indicate

that not every reallocation is desirable, and many of the job switches in fact constitute misallocations for people unable to search within the occupation for longer.

With vaccinations in sight, it is time to look for an effective economic exit strategy into the post-COVID era to safeguard global financial stability. Ultra-easy economic policies, while having cushioned the pandemic’s blow, spurred excessive risk taking on the global financial markets and public debt buildup both in AMs and EMEs. As policy makers gradually shift their attention from the recovery to medium- and long-term prospects of their economies, appropriate pace and sequence of policies’ normalization will have important implications for the global financial stability.

We encourage staff to be more vocal on policy recommendations for dealing with global financial market misalignments. Last year the Fund was among the first to warn about the growing disconnect between financial markets and the real economy. At the same time, policy advice has hardly gone beyond statement of facts and broad advice to enhance regulatory approaches. We also see merit in a deeper analysis of the cryptocurrency markets, taking into consideration growing public companies’ exposures to the bitcoin.

We find a proposed framework in Chapter 1 of the GFSR for determining viable firms to be of great analytical value. Leverage in the corporate sector reached historic highs for many economies in the run-up to the virus outbreak and the subsequent recession has turned many firms into new “zombie companies”. The developed framework proposes a simple approach to facilitate exit of non-viable companies.