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**Statement by Mr. Hilbers, Mr. Tsur, Mr. Voinea, Mr. Manchev, and Mr. Tevdovski on
World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
March 25, 2021**

We agree that the fast development of vaccines and unprecedented policy support brightened the economic outlook. The world is now at a turning point in the COVID-19 pandemic and the Fund's crucial research and policy advice can gradually shift its focus from providing lifelines to the economy to supporting sectoral reallocations towards a green and digital economy during the recovery.

However, divergence and uncertainty are key features of the outlook. Lockdowns are still in place in many countries and in some, they have recently been sharpened, while the roll-out of vaccination programs has been slower than expected. Even within our Constituency, we see wide divergence in the rate of vaccinations. We believe it is imperative that the global community assists countries with limited resources and health capacities in overcoming the ongoing crisis and in ensuring universal access to vaccines and medical treatments at a reasonable cost. The multilateral initiatives promoting more universal access to vaccines and treatments will be crucial to narrow the uneven recovery prospects across countries.

The Fund is well placed to rise to the occasion to provide granular and country-specific policy advice to help the membership to navigate the uncertainty and combat divergence. A combination of strong multilateral cooperation and decisive domestic policies is needed to combat divergence among individual countries, groups of countries, as well as among various economic sectors. Through lending, surveillance and capacity development, the Fund has the expertise to advise countries on policies needed to achieve convergence. This will not be easy, and it will require further finetuning the Fund's advice to country-specifics. Special attention should be given to emerging markets and developing economies (EMDEs) and low-income countries (LICs), where sectors such as travel and tourism are macro-critical and have been heavily hit by the pandemic.

Trade-offs related to fiscal and monetary stimulus become more binding as the pandemic persists, because prolonged stimulus will further increase indebtedness. Unprecedented fiscal

and monetary support, as well as the relaxation of prudential measures in the financial sector policies, has been crucial to stabilize the global economy. However, there is an intertemporal trade-off between supporting near-term growth and medium-term downside risks. We see a need to remain vigilant against side-effects of prolonged stimulus. We ask staff to closely monitor the effects of prolonged periods of expansionary fiscal and monetary policies on financial vulnerabilities and the build-up of risks related to sovereign, corporate and household indebtedness.

Climate change poses a threat to the global economy and the IMF has an important role in advising the membership on policies to ensure a green recovery. It will affect macroeconomic and financial stability and now is the time to act on these risks. The IMF has done important work on climate stress testing in the financial sector. Staff has shown that a policy package increasing carbon prices, green investment, and incentives for R&D can achieve progress on mitigation at limited output costs. We welcome the Fund's efforts to use these analytical insights and step up its advice on fiscal and financial policies to mitigate and adapt to climate change.

We particularly support staff's focus on tackling inequality: giving a fair shot to everyone is one of the most important challenges of our time. We welcome the analysis on the impact of the pandemic on inequality and we are in favor of continued engagement on this issue in surveillance. Prioritizing inclusive policies would not only make sure the recovery benefits all, but also strengthen prospects for the sustainable long-term growth of the global economy. We strongly support the emphasis on equal opportunities. While this pandemic has confirmed the merits of equal access to health care and digital infrastructure, we welcome staff's analysis about the importance of access to education for equal opportunities and long-term productivity. We believe a more active approach is needed for EMDEs, extending beyond strengthening tax capacity. Adopting more progressive tax systems in EMDEs could provide resources to support vulnerable households, and finance public investment in important areas as health, education, renewable energy, and digitalization.

Monetary policy should remain accommodative to support the recovery. We note staff's assessment that inflation pressures remain contained in most countries, based on the presence of labor market slack and the flat Phillips curve. However, in an off-baseline scenario, the unprecedented fiscal and monetary stimulus might result in an uptick in inflation and a need for early monetary tightening. A prolonged period of easy financial conditions contributed to the build-up of vulnerabilities, resulting in a risk of sudden repricing, and spillovers from rising interest rates in advanced economies to EMDEs could be significant. We agree with staff that clear communication by central banks will be key to avoid financial market disruptions. We also welcome the finding in WEO chapter 4 that EMDEs' sensitivity to financial tightening depends on their macro-financial characteristics and policy frameworks. We therefore stress the importance of rules-based medium-term fiscal frameworks and using opportunities to extend sovereign debt maturities.

Fiscal policy should provide a bridge to the recovery, but it should be targeted to allow for reallocation and temporary to limit the impact on sustainability. Policymakers need to balance the risks from large and growing public and private debt with the risks from premature withdrawal of fiscal support, which could slow the recovery. Credible medium-term fiscal frameworks are critical for attaining the right balance, setting a path for rebuilding fiscal buffers at a pace contingent on the recovery. Fiscal policy should also gradually increase market dynamics. The pandemic induced many companies to innovate and quickly digitize their activities. These efforts should be properly supported by government measures to boost investment and initiatives to strengthen efficient reallocation of

capital and labor. We therefore welcome the guidance on the identification of viable firms, and the advice to strengthen debt resolution and insolvency regimes for unviable firms. Temporary and targeted support measures may reduce the build-up of financial vulnerabilities and decrease non-viable zombie firms that might form a drag on the medium-term growth outlook.

The banking sector has withstood the crisis thanks to the resilience built in the post-GFC decade. Nevertheless, we believe that the ultimate impact of the crisis on the banking industry will hinge on the scale and duration of policy support to households and firms. We see a need to remain vigilant as support measures are withdrawn and insolvencies might increase. We agree that banks are not part of the problem, but can they be part of the solution? The GFSR shows that only 5% of the global systemic banks can use their buffers. We could add that an early recognition policy reduces profitability in the short-term but enables banks to raise their profitability in the future. New resource allocation by using buffers cannot take place before adjusting for past resource misallocation by provisioning for problem loans. In this setting, clear communication by the micro – and macroprudential authorities on the capacity to make use of these buffers and on the flexibility as to how they are subsequently rebuilt is essential. This also warrants a reflection on how to strengthen banks' incentive to use released buffers, for example by shifting to conditional buffer release in the short term, and by reconsidering the balance between structural and countercyclical buffers in the medium term. *Staff comments are welcome*

The real estate sector is another place where the crisis has had a divergent impact, between residential real estate and commercial real estate. Residential real estate has rallied while commercial real estate was badly hit due to a move towards remote working and online shopping. For residential real estate, low rates and high valuations still offer a good opportunity to reduce mortgage interest deductibility and harmonize the fiscal treatment of housing wealth with other forms of wealth. Misaligned house prices represent a vulnerability and we encourage staff to address this issue in future analyses.

The non-bank financial sector (NBFS) and the commercial real estate (CRE) sector are potential important shock amplifiers going forward. Therefore, now is the time for targeted macroprudential regulation and policies to prevent further accumulation of vulnerabilities in these segments. However, we also note that the regulators may need access to more granular global data to develop a macroprudential toolkit. Some members of our Constituency have systematically collected granular data and have implemented macroprudential policies targeted to the NBFS. Moreover, the European supervisors have extended their macroprudential stress tests to cover insurance companies, central counterparties (CCPs), and asset managers. We take note of staff's recommendation on the targeted supervisory approaches for CRE risk weights, asset valuation, and loan loss provisions.

Central bank independence is crucial for the ability of central banks to contribute to stable inflation and financial stability. Central banks need to have “the power to say no”, which requires independence from political interference. Against a backdrop of volatile inflation, elevated debt levels and financial vulnerabilities, we reiterate the importance of safeguarding the independence of central banks, and we welcome the Fund's support for this issue.