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July 7, 2022

**Statement by Mr. Fanizza, Mr. Spadafora, and Ms. Cerami on United States
(Preliminary)
Executive Board Meeting
July 11, 2022**

We thank staff for an excellent report and Ms. Shortino, Ms. Medearis, and Mr. Sturm for their insightful Buff statement. We agree that the US authorities face a quite difficult policy challenge: calibrating the policy mix to bring inflation back toward the Fed target, while avoiding a deep recession. The costs from not getting this policy mix right may be substantial in terms of both domestic economic activity and spillovers to the global economy. The exceptionally large fiscal stimulus over 2020-2021 may still be placing significant pressures on prices, despite its partial withdrawal in 2020. A speedier withdrawal of fiscal stimulus could lower the risk of an excessive tightening in financial conditions by reducing the extent to which the Fed policy rate will need to rise to bring inflation under control. Supply side policies, and in particular the removal of trade barriers that were introduced during the last 5 years, would also help to achieve the disinflation objective. We appreciate the staff's analysis and support their policy recommendations. We offer a few comments.

- **The staff's baseline scenario that the strong underlying momentum in the U.S. economy is expected to wane over the next two years before gradually picking up into 2024 seems now to constitute the best-case scenario.** Its materialization hinges on medium-term inflation expectations remaining well-anchored, whereas in fact these have already started to drift upward.
- **We appreciated the analysis on the possible monetary policy paths to bring inflation back to target,** all of these path require the federal funds rate to rise and remain above its neutral level for at least one year. State-of-art estimates of the impact of higher federal funds rates point to a relatively smaller impact on inflation than on industrial production and unemployment.¹ Thus, it would have been useful to complement the analysis with a comparison of the sacrifice ratios implied by the different paths.

¹ See Valerie A. Ramey, *Macroeconomic Shocks and Their Propagation* (NBER working paper 21978, 2016, p. 44)

- **On fiscal policy, the primary balance is still expected to remain deep in negative territory** in the coming years, despite the unwinding of pandemic support. Moreover, the general government debt is set to continue growing as percent of GDP over the medium term. We agree with the staff that there is scope for further consolidating public finances, by rationalizing the expenditure structure, removing existing loopholes and distortions introduced by various tax exemptions; moreover, further attention should be paid to the medium-term fiscal impacts of demographic change and healthcare costs, as well as to the high sensitivity of debt trajectories to growth and interest rates.
- **We concur with staff that both trade policies and measures to bolster supply can help mitigate inflationary pressures** and contain the risks of an excessive tightening of financial conditions. Trade restrictions introduced before the pandemic should be removed, because these have contributed to exacerbating supply bottlenecks and their impact on prices. We also invite the authorities to restore open trade and engage constructively with trading partners to strengthen the multilateral rules-based system centered around the WTO. On the supply side, the focus should be on strengthening the social safety nets, improving labor market participation, and fostering productivity.
- **We share the staff's view that more action is needed to make progress toward achieving the authorities' climate goals.** We see merits in the staff's recommendation to devise a more effective strategy based on a combination of instruments, including broad-based carbon pricing, sectoral feebates, and regulatory actions. We recognize that, like in other countries, the transition to a low-carbon economy presents several challenges – notably a redeployment of workers – that need to be addressed by means of concerted policy effort that buy in support from civil society.