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**Statement by Ms. Levonian and Ms. Vasishtha on World Economic Outlook; Global
Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
March 25, 2021**

We thank staff for the excellent set of reports and welcome the rich and timely analysis underlying these reports. We generally agree with the staff's assessment of the global economic outlook and risks as well as the broad policy prescriptions.

The global economy is recovering from the economic effects of the COVID-19 crisis, albeit with divergent impacts across countries and sectors and still-elevated uncertainty. The recovery is projected to be faster in advanced economies but lagging in many EMDEs, due to uneven access to vaccines, limited policy space, pre-existing vulnerabilities, and structural rigidities. Output losses have been particularly large for countries reliant on tourism and commodity exports as well as those with limited policy space. Despite extraordinary policy support, divergence within countries is also growing and profound effects on labor markets are visible, with youth, women, low-skilled workers, and contact-intensive sectors being disproportionately impacted. Meanwhile, continued divergence between asset markets and the broader economy raises financial stability risks. Prospects for a multispeed recovery raises concerns that an asynchronous withdrawal of monetary policy could tighten financial conditions for EMDEs. We concur with staff that determined policy action is needed to support a sustained and inclusive recovery, minimize scarring, and address long-term challenges. Strengthened global coordination is needed to end the health crisis everywhere by ramping up vaccine production and distribution.

In what follows, we provide specific comments on each of the three reports.

World Economic Outlook

We broadly agree with the staff outlook and the characterization of risks and uncertainty around it. The alternative scenarios presented in the Scenario Box are very informative in highlighting the importance of a swift rollout of vaccines for re-opening and aggregate demand. Regarding emerging and developing economy commodity exporters, staff's outlook appears to be somewhat pessimistic considering the sharp recovery in global manufacturing and the outlook for commodity prices. *Staff's views are welcome.* Staff projects global growth to moderate to 3.3 percent over the medium-term, reflecting projected damage to supply potential as well as forces that predate the pandemic, such as slower labour force growth related to population aging. *Could staff elaborate on the extent to which the medium-term growth moderation is being attributed to the pandemic?*

Staff's conclusion that the pandemic is likely to leave smaller scars than the 2008 global financial crisis, owing to extraordinary policy support and the absence of a systemic financial crisis, might be too bold to make at this time. The analysis rightly acknowledges that the pandemic presents unique challenges relative to previous recessions, such as educational disruptions and the rapid shift to teleworking. However, it seems to be missing some risks that are difficult to quantify, such as the potential adverse repercussions from rising poverty, inequality, and social unrest as well as uncertainty regarding the long-term effects of extraordinary policy support measures. Further, while the sharp contraction in the manufacturing sector and international trade during the pandemic was short-lived compared to the 2008 global financial crisis, recovery in the services sector and trade in services are expected to remain subdued. Since services industries account for the bulk of employment in many countries, this could exacerbate the lingering uncertainties around the outlook.

The analysis in Box 1.2 is a stark reminder of the risks posed by ongoing climate change to the global economy, with more adverse impacts on low-income countries and small island states. LICs are the most exposed to negative effects of climate change and are also the ones with the least capacity to adapt and address these vulnerabilities. Staff analysis highlights that weather-related disasters could have persistent medium-to long-term effects, with losses not recovered even 20 years after tropical cyclones hitting small island economies and coastal regions of bigger countries. The unique macro vulnerabilities and exceptional financing needs facing small developing states underscore the need for the Fund to provide adequate support to its smallest and most vulnerable members.

We strongly welcome the insightful analysis in Chapter 2 on the impact of the crisis on scarring and the channels through which it may occur. The pandemic will result in more severe scarring for tourism-dependent countries and LICs, and in contact-intensive sectors, highlighting the criticality of well-targeted social support, especially in light of limited fiscal space. Box 2.1 on the impact of the COVID-19 crisis on the hotel and restaurant sector is very telling. *We wonder why the Caribbean was not specifically highlighted here given the*

significance of these sectors for the region and the severe contraction in economic activity resulting from the pandemic. Could staff elaborate on the rationale for the chosen approach and the countries included in the ‘tourism dependent countries’ category? Staff’s analysis highlights the pressing need for reforms focusing on diversification, upskilling the labor force, and strengthening viable industries. We agree that sufficient resources must be directed to healthcare, developing education programs, strengthening digital literacy, and leveraging digitization. Moreover, countries with higher propensity for scarring will need assistance, by way of financing, capacity development, and policy recommendations to support an inclusive recovery.

The analysis around recessions and recoveries in the labor market provides valuable insights into the challenges facing policymakers in this regard. As the crisis abates, policymakers will need to closely monitor the impact of the withdrawal of support measures to limit scarring. In staff’s analysis, retention and reallocation policies are assumed to be readily scalable. While this assumption makes sense for a policy such as a wage subsidy, other policies (e.g., retraining programs) involve large overhead fixed costs and therefore have a minimum viable scale. This is important since staff advocates a policy mix that may not be fully feasible due to non-linearities in the cost of certain policies. In particular, the analytical framework does not incorporate the degree of available fiscal space which may be a key consideration for countries in designing appropriate retention and reallocation programs if fixed costs restrict the set of feasible policy options.

Employment has declined more steeply in sectors that are more vulnerable to automation, consistent with trends in past recessions. That said, a discussion of how COVID-19 is affecting the mechanisms driving automation would have been helpful. For example, recent research has shown how social distancing policies and lockdowns have resulted in temporary labour shortages that presumably encourage some firms to automate to make up the lost labour input.¹ Likewise, overlap between viral transmission risk and automation potential makes some occupations, primarily staffed by women with less education and lower wages, more vulnerable to pandemic-induced automation.² This would seem to suggest that COVID-19 and the policy responses to it, which were not present in other recent recessions, may increase the rate of automation relative to past recessions.

We welcome the analysis on the spillover effects of monetary policy on EMEs which provides important insights for forward-looking analysis and framing policy. Staff’s findings emphasize the need for EME’s to strengthen monetary policy autonomy and ensure

¹ Autor, David and Elisabeth Reynolds. 2020. “The nature of work after the COVID crisis: Too few low-wage jobs”, Essay, Brookings Institute.

² Chernoff, Alex, and Casey Warman, 2020. “COVID-19 and implications for automation”, Working Paper 27249, National Bureau of Economic Research.

effective policy toolkits to mitigate any negative spillover effects. Actions to improve confidence about the sustainability of medium-term debt can also help reduce the sensitivity of domestic financial conditions to spillovers from monetary policy in advanced economies. At the same time, as the recovery progresses, clear and effective communication by advanced economy central banks will be a critical for reducing the risk of a surprise tightening in global financial conditions.

Global Financial Stability Report

We broadly agree with staff’s characterization of financial sector vulnerabilities and risks, and their related policy implications. While unprecedented and timely policy responses have maintained the flow of credit and prevented adverse macro-financial feedback loops, extraordinary policy support may have unintended consequences. Excessive risk taking in markets is contributing to stretched valuations and rising financial vulnerabilities which may morph into structural problems if left unaddressed by policymakers. We would highlight the financial stability risks posed by the increasing importance of nonbank financial institutions (NBFIs) and echo staff’s call for efforts to urgently develop the macroprudential toolkit for NBFIs.

We would welcome broadening the discussion of global financial system vulnerabilities to include key new and emerging risks, some of which may have become more prominent since the start of the pandemic. Highlighting these risks will also help strengthen the integration between the Fund’s bilateral and multilateral surveillance efforts. The pandemic has increased the incidence of remote working/learning and has led to an increasing number of major cybersecurity events in recent months. While these incidents have not yet resulted in significant disruptions with systemic impacts, such attacks, if targeted at financial institutions or infrastructures have the potential to significantly disrupt the global financial system.³ Likewise, the pandemic has accelerated the digitalization of the economy and financial services more generally. The risks associated with the development of financial technologies prior to COVID-19 are becoming more relevant and may even get exacerbated in the post-pandemic world. Rapid technological change also bodes new and unforeseen risks to financial stability.

The further increase in leverage in the non-financial private sector during the pandemic, and the associated vulnerabilities it poses for financial stability, is a key concern for policymakers. We welcome staff’s focus on estimating the impact of changes in financial conditions on leverage and that of leverage on growth at risk. In terms of future work, we would appreciate a broader discussion of the implications for policymakers of the

³ The BIS has recently published an [excellent report](#) on the cyber risks for the financial sector.

presence of non-linearities between financial conditions, leverage, and financial stability risks.

We welcome the Fund’s insights on the risks stemming from the commercial real estate market. The distinction between short-term cyclical developments and possible structural transformations to the sector is particularly interesting. We echo staff’s view that targeted macroprudential measures could help contain vulnerabilities in the commercial real estate sector in the presence of large price misalignments. Going forward, it would be useful to expand this analysis to the residential market to examine how the crisis has impacted market dynamics, for instance, through a move from cities into the suburbs, which could create imbalances in certain residential market segments and exert upward pressure on prices.

Fiscal Monitor

We agree with staff that continued, flexible fiscal support – tailored to country-specific circumstances – is needed until a sustained recovery takes hold. As economies regain their footing, fiscal and other policy support measures should be withdrawn in a gradual and data-dependent manner. Policymakers should continue to place priority on targeted policy measures, especially support that boosts demand and improves the wellbeing of the most vulnerable, including youth, women, and low-skilled workers.

Unprecedented fiscal responses, along with lower revenues, have raised public debt and deficits to record levels and reduced the policy space to respond to future shocks. Policymakers need to balance the risks from large private and public debt burdens with the risks from premature withdrawal of policy support, which could slow the recovery and leave deeper economic scars. As such, credible medium-term fiscal frameworks are critical for tailoring fiscal responses, rebuilding buffers, and reducing debt vulnerabilities. As economies stabilize, these efforts could be supported by fiscal rules. As part of the recovery efforts, fiscal policy should also enable green, digital, and inclusive growth.

Low-income countries face particularly challenging trade-offs. We echo staff’s finding that achieving debt sustainability while addressing development needs requires raising domestic revenues, improving spending efficiency, and facilitating private sector activity through structural reforms and improving governance and the rule of law. We would add that these efforts should be bolstered with international support. Beyond the DSSI, the swift implementation of the G20 and Paris Club Common Framework will be critical in addressing debt vulnerabilities and providing additional relief. Furthermore, the pandemic’s impact on public finances reinforces the need to improve public debt management and transparency – a global public good. Further efforts are also needed to address the risks posed by the increasing complexity of public debt structures.

The pandemic has exacerbated pre-existing inequalities in income and access to basic services like health and education, both within and across countries. As vaccinations proceed and economies gradually recover, policymakers should place priority on strengthening social safety nets in a cost-effective manner to address rising inequality and poverty resulting from the pandemic. Measures to reduce the impact on the vulnerable and efforts to preserve the gains made in achieving the Sustainable Development Goals are therefore crucial. Finally, since the strength of the recovery hinges on when the pandemic is controlled, it is paramount to ensure that health care systems are adequately resourced and that global cooperation on the production and distribution of vaccines to all is reinforced.