

**FOR
INFORMATION**

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DEVELOPMENT COMMITTEE: THE MANAGING DIRECTOR'S WRITTEN STATEMENT

October 2021

An uneven recovery from the COVID-19 pandemic has taken hold: while most advanced economies (AEs) are returning relatively swiftly to their pre-pandemic output paths, prospects for emerging market and developing economies (EMDEs) remain impacted by low vaccination rates and constrained policy space. Inflation rates have surged, driven by supply-demand mismatches and higher commodity prices. While in most AEs, price pressures are expected to subside in 2022, in some EMDEs exchange rate adjustments and weaker policy frameworks hold the prospect for more persistent inflation. High food prices are a concern especially for low-income developing countries (LIDCs), a subset of EMDEs. The first policy priority is to rapidly increase COVID-19 vaccinations across the globe, not only for the sake of public health but also to put the recovery on a firm footing. This requires, inter alia, stepping up vaccine donations, increasing production and distribution of vaccines, and removing barriers to exports. LIDCs also need support with covering financing needs to protect core spending. The rapidly unfolding climate crisis calls for a strong effort to reduce greenhouse gas emissions in order to preserve the foundations of global prosperity.

ECONOMIC OUTLOOK AND RISKS

An uneven recovery...

The fault lines that broke open during the COVID-19 pandemic have become a persistent feature of the global recovery. Broad access to vaccines and large-scale policy support are facilitating a relatively swift economic recovery in most advanced economies (AEs). By contrast, many emerging market and developing economies (EMDEs) face permanent output losses relative to their pre-pandemic growth trajectory. Moreover, the rapid spread of the Delta variant and the lingering threat of new, more virulent versions of the virus have increased uncertainty about how quickly the pandemic can be overcome.

The global economy is projected to grow at 5.9 percent in 2021 in real terms, marginally below the World Economic Outlook's April projection. For 2022, global growth of 4.9 percent is expected, an upgrade of 0.5 percentage point relative to the April forecast that reflects primarily additional policy support and better-than-anticipated health outcomes in advanced economies. After 2022, global growth is projected to return to a trend growth rate of about 3.4 percent.

... led by advanced economies, while EMDEs are lagging behind

AEs are leading the recovery, with projected real growth of 5.2 percent this year and 4.5 percent in 2022. EMDEs are forecast to grow by 6.4 percent this year. Different from AEs, however, output in EMDEs is expected to remain below pre-pandemic projections during the forecast period. This relative weakness reflects inter alia low vaccination rates in many countries that act as a brake on the recovery. Vaccinations

in EMDEs are expected to gradually catch up with AEs over the course of 2022. However, with an expected real growth rate of 5.1 percent, the recovery is projected to remain relatively tepid, reflecting in part that shrinking fiscal space is inducing many EMDEs to tighten fiscal policy.

LIDCs remain particularly hard hit

Low-income developing countries (LIDCs) are in a particularly difficult spot. Many LIDCs entered the COVID-19 crisis with weak health care capacity and very limited policy space to support their economies. Average real growth came to a near-standstill in 2020, with a large number of LIDCs—especially those dependent on tourism and commodities exports—suffering sharp contractions. Weak social safety nets forced millions into poverty, and a lack of vaccines—less than 5 percent of the population in LIDCs is vaccinated at this juncture, compared to about 58 percent in AEs—continues to render LIDCs vulnerable to successive waves of the pandemic. Policy options to support the economy against such adversity are extremely limited, with about half of LIDCs assessed to be in or near debt distress according to the IMF-World Bank debt sustainability assessments.

Overall, growth in LIDCs is projected at 3.0 percent for 2021. This corresponds to 0.7 percent in per capita terms—significantly below the global average of 4.8 percent, and contributing to a widening in global income inequality. In 2022, growth in LIDCs is forecast to strengthen somewhat to 5.3 percent.

Inflation is a risk especially for EMDEs and LIDCs

Inflation has increased in many AEs and EMDEs in recent months. In most cases, the surge reflects pandemic-related supply-demand mismatches and higher commodity prices compared to their low base from a year ago. For the most part, price pressures are expected to subside in 2022. In some EMDEs, inflation may persist, however, reflecting elevated food prices, lagged effects of higher oil prices, and exchange rate depreciation lifting the prices of imported goods. Particularly worrisome for LIDCs is a marked rise in food prices in recent months, with price increases concentrated in countries where food insecurity is already prevalent. Inflation risks are skewed to the upside and could materialize if pandemic-induced supply-demand mismatches continue longer than expected. This could prompt a faster-than-expected monetary normalization in AEs, tightening financial conditions in many EMDEs, complicating their recoveries, and undermining financial stability.

The emergence of new virus variants is the most important threat to the recovery

The key downside risk to the global outlook is a possible emergence of more transmissible and deadly virus variants that would constrain economic activity. Both roadblocks in global vaccine distribution and vaccine hesitancy exacerbate this risk, as they provide opportunities for the virus to mutate and spread further. More persistent supply-demand mismatches that trigger sustained inflation pressures are another downside risk, as they could provoke a more rapid monetary policy normalization in AEs. Especially EMDEs with large foreign currency debts and financing needs would suffer from a tightening of global financial conditions and ensuing exchange rate adjustments. In some EMDEs and LIDCs, including fragile

Climate change poses an acute threat

states, the potential for social unrest poses an additional threat, and could be triggered by social hardship and/or frustration with the handling of the pandemic.

Climate change is presenting itself increasingly as not only a longer-term threat to global prosperity but also as a near-term risk, reflected in more frequent and intense natural disasters whose economic impact extends beyond the areas where the disasters strike initially. LIDCs are often especially vulnerable, as many of them are highly exposed to climate shocks but command limited resources to cope with their impact. Absent forceful and sustained global mitigation action, such risks are bound to intensify in the years ahead.

POLICY PRIORITIES

Boosting vaccination rates is the #1 economic policy priority

The first global policy priority is to boost vaccinations everywhere, and especially in lower income countries where vaccination rates are low. This is not only a public health imperative but also crucial for securing and sustaining the recovery: reducing the risk of infection and the formation of new variants would remove uncertainty and add trillions to the global economy.

The IMF has proposed a plan—endorsed by the World Health Organization, the World Bank, and the World Trade Organization—to vaccinate at least 40 percent of the population in every country by end-2021, and 70 percent by mid-2022. At an estimated cost of about \$50 billion, the plan has the potential to yield enormous economic and social benefits. Action is needed on multiple fronts, including vaccine donations from countries where large shares of the population are already vaccinated, the prioritization of vaccine deliveries to countries that still lack wide access, and the removal of export restrictions for medical equipment, raw materials, and finished vaccines.

LIDCs need support to cover financing needs

The international community also needs to help LIDCs meet their financing needs. Scaling up concessional resources is required to complement domestic reforms, help countries tackle the pandemic, and recover from the crisis. Countries where sovereign debt is not sustainable—or where financing needs are too large and protracted to be met through new lending alone—need debt or debt service relief. The Common Framework for Debt Treatments endorsed by the G20 is an important new forum that can be helpful in this regard, as it helps coordinate all creditors. However, steps are required to ensure speedier implementation.

... while climate change needs to be tackled head-on.

More ambitious measures are also urgently needed to tackle climate change. This includes stronger pledges, backed up by credible action, to reduce greenhouse gas emissions in the context of the upcoming UN climate conference (COP26). Greater financial support for climate adaptation and technology transfers to developing countries are also required. Carbon pricing should be at the center of mitigation policies, supported by instruments such as feebates, regulations, green public investment, and research subsidies for green technology. An international carbon

National policies need to be calibrated carefully

price floor—with parameters calibrated to development needs—would help with coordinating, accelerating and enhancing the efficacy of global mitigation efforts.

At the national level, many EMDEs are facing difficult choices as policy space has shrunk further, often leaving only very limited room to maneuver. Policies need to be calibrated to the stages of the pandemic, macroeconomic vulnerabilities, and available policy space. Health spending ought to be prioritized, including to increase vaccination rates. Laying the foundation for a strong recovery also requires combating poverty, reversing pandemic-induced setbacks to human and physical capital accumulation, and facilitating the reallocation of productive resources.

To generate space for priority outlays, poorly targeted subsidies and recurrent expenditures need to be pared back, and credible medium-term plans are required to boost revenues, strengthen fiscal frameworks, and keep public debt sustainable. Externally indebted EMDEs should prepare for a possible increase in advanced economy interest rates through debt maturity extensions to reduce rollover needs, building reserve buffers, and strengthening macroprudential policies. Where inflation is rising and risks of inflation expectations de-anchoring are becoming concrete, monetary policy may need to be tightened.

IMF SUPPORT

The IMF is providing unprecedented liquidity support,...

The recent general allocation of SDRs boosted reserve assets of the IMF's member countries by \$650 billion at a time of unprecedented liquidity needs. About 40 percent of this amount went to EMDEs. Various options are under consideration to further enhance the impact of the allocation. Countries enjoying strong external positions could channel SDRs voluntarily to (i) strengthen the concessional lending capacity of the IMF Poverty Reduction and Growth Trust, (ii) fund a new IMF-administered Resilience and Sustainability Trust to help poor and other vulnerable countries cope with structural transformations, including climate-related challenges, and/or (iii) support the lending capacity of multilateral development banks. In addition to the SDR allocation, the IMF has, to date, approved financing requests from 87 countries, committing more than \$117 billion.

... while scaling up its lending facilities...

In July, and against the backdrop of an eight-fold increase in demand for IMF financing relative to pre-pandemic levels, the IMF increased the normal annual and cumulative access limits to its concessional financing by 45 percent, together with eliminating hard limits for exceptional access for the poorest countries. The reforms aim at providing support to low-income countries with strong policies and large balance of payment needs at zero interest rates. A large part of future financial assistance is expected to be provided through multi-year arrangements, as countries navigate a long recovery path.

The IMF continues to assist countries with addressing debt vulnerabilities, inter alia by supporting implementation of both the Debt Service Suspension Initiative—

...and helping address debt vulnerabilities.

which has been extended to December of this year—and the Common Framework for Debt Treatments. 31 of the IMF's poorest and most vulnerable members have received debt service relief through the Catastrophe Containment and Relief Trust, and efforts are currently ongoing to secure a final tranche. As part of the multipronged approach to addressing debt vulnerabilities, the IMF is reviewing its lending into arrears and safeguards assessment policies. The IMF is also implementing reforms to its debt limits policy and is deepening the analysis of debt transparency.

IMF surveillance and capacity development are stepping up...

Following the recent Comprehensive Surveillance review, the IMF will strengthen the integration of risks and uncertainties into its surveillance, while improving forecasting and monitoring frameworks as countries navigate the recovery. In the area of capacity development (CD), the IMF is prioritizing support for public financial management, revenue administration, debt management, financial stability, macro-frameworks, economic statistics and legal frameworks. In addition, IMF CD is adapting to meet new and emerging priorities in areas such as climate change, fragile states and inclusion.

...including by integrating climate change systematically into Article IV consultations.

As one outcome of the Comprehensive Surveillance Review, the IMF will integrate climate change related macroeconomic policy challenges systematically into its Article IV consultations. Moreover, the IMF is providing guidance on setting up an international carbon price floor, differentiated according to development needs. IMF staff is also developing advice on border carbon adjustments, green public investment management, and on adaptation. A planned new Climate Macroeconomic Assessment Program will help the countries most vulnerable to climate change analyze gaps in their mitigation and adaptation strategies and identify financing needs. Moreover, a climate module is being added to the IMF's Public Investment Management Assessments.

The IMF is developing a new strategy for fragile and conflict-affected states

To better support its fragile and conflict-affected state (FCS) members, the IMF is developing a new FCS Strategy. The strategy will include inter alia the rolling out of Country Engagement Strategies to better take into account drivers of fragility and conflict in the IMF's engagement, ensure better integration of the IMF's different activities (policy advice, capacity development and lending), and greater coordination between the IMF and other partners, in particular the World Bank. The strategy will also strengthen the presence and expertise of Fund staff working with and in FCS.

More generally, and in response to demands from the membership, the Fund is seeking to scale up work on climate change, digital money, macro-financial surveillance, FCS, and inclusion/gender, which will require appropriate budget resources.