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World Economic Outlook; Global Financial Stability Report; Fiscal Monitor

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Staff: Gaspar, FAD; Adrian, MCM; Gopinath, RES

Length: 2 hours, 36 minutes

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CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Transparency Policy and Open Archives Policy.

THE CHAIR'S SUMMING UP

Executive Directors broadly agreed with staff's assessment of the global economic outlook, risks, and policy priorities. They welcomed the continuing recovery despite the resurgence of the pandemic driven by more contagious new variants of the virus and the ongoing supply shortages which brought the inflation risk to the forefront. Directors acknowledged that economic divergences, especially between advanced economies and low-income countries, brought by the pandemic seem more persistent, a reflection of differentiated vaccine access and early policy support. In this context, Directors highlighted the importance of global cooperation to ensure universal access to vaccines and a strong financial safety net. To ensure a successful exit from the crisis these efforts will need to be coupled with sound policy frameworks and ambitious domestic reforms, which would facilitate new growth opportunities, including from digitalization and green technology, while confronting climate change and rising inequality.

Directors concurred that uncertainties around the baseline projections remain large and that the risks to growth outcomes are tilted to the downside. They stressed that the economic outlook continues to depend heavily on the path of the health crisis and the speed at which widespread vaccination can be reached. Directors also acknowledged that the uncertainty surrounding inflation prospects—primarily stemming from the path of the pandemic, the duration of supply disruptions, and how inflation expectations may evolve in this environment—is particularly large. They noted that while inflation expectations appear well-anchored, inflation risks could prompt a faster-than-anticipated monetary normalization in advanced economies. Higher debt levels and large government financing needs in many countries are also a source of vulnerability, especially if global interest rates were to rise faster than expected.

Directors highlighted that policy choices have become more difficult, confronting multidimensional challenges—subdued employment growth, rising inflation, food insecurity, the setback to human capital accumulation, and climate change—with limited room to maneuver. They stressed that multilateral efforts to avoid international trade and supply chain disruptions, speed up global vaccine access, provide liquidity and debt relief to constrained economies, and mitigate and adapt to climate change continue to be essential. Directors further agreed that it is crucial to ensure that financially constrained countries can continue essential spending while meeting other obligations and highlighted the expected contribution of the recent General Allocation of Special Drawing Rights in providing the much-needed international liquidity. At the national level, Directors agreed that policy priorities should continue to be tailored to local pandemic and economic conditions, aiming to overcome the still evolving health crisis and promote an inclusive recovery while protecting the credibility of policy frameworks. As the recovery progresses, policymakers will need to shift to measures that aim to reverse scarring from the crisis.

Directors noted that fiscal policy should remain supportive, but needs to be well-targeted, carefully calibrated, and tailored to country-specific circumstances. In countries with high levels of vaccination and low funding costs, fiscal policy should gradually shift from pandemic-fighting emergency measures toward promoting a transformation to more resilient and inclusive economies. In countries with lower vaccination rates and tighter financing constraints, health-related spending and protecting the most vulnerable will remain top priorities. As countries converge back to pre-crisis GDP trends, the focus should shift toward ensuring fiscal sustainability, including through establishing credible medium-term fiscal frameworks, which would also promote fiscal transparency and sound governance practices. Given likely long-lasting negative impacts on budget revenues in developing economies, further efforts will be needed to mobilize revenues in the medium term and improve expenditure efficiency. While recognizing that the international community provided critical support to alleviate fiscal vulnerabilities in low-income countries, Directors noted that more is needed, including through debt relief in the context of early and timely implementation of multilateral initiatives, such as the G20 Common Framework.

Directors concurred that monetary policy should remain accommodative where there are output gaps, inflation pressures are contained, and inflation expectations are consistent with central bank targets. However, they noted that central banks should be prepared to act quickly if the recovery strengthens faster than expected or if inflation expectations are rising. Directors stressed that transparent and clear communication about the outlook for monetary policy is critical at the current juncture to avoid de-anchoring of inflation expectations and prevent financial instability.

Directors noted that financial vulnerabilities continue to be elevated in several sectors–including nonbank financial institutions, nonfinancial corporates, and the housing market–masked in part by the very substantial policy stimulus. They highlighted that a prolonged period of extremely easy financial conditions, while needed to sustain the economic recovery, may result in overly stretched asset valuations and further fuel financial vulnerabilities. Directors agreed that policymakers should act preemptively to address vulnerabilities and avoid a buildup of legacy problems. They should also tighten selected macroprudential tools to tackle pockets of elevated vulnerabilities while avoiding a broad tightening of financial conditions.

Directors agreed that some emerging and frontier markets continue to face large financing needs. While the outlook for capital flows has improved and monetary conditions remain still broadly accommodative, a sudden change in the monetary policy stance of advanced economies may result in a sharp tightening of financial conditions, adversely affecting capital flows and exacerbating pressures in countries facing debt sustainability concerns. They concurred that the policy response in these countries will need to be centered on implementing structural reforms, rebuilding buffers, and strengthening financial market governance and infrastructure.

EXECUTIVE BOARD ATTENDANCE[2]

K. Georgieva, Chair

Executive Directors	Alternate Executive Directors
I. Mannathoko (AE)	
A. Andrianarivelo (AF)	
	L. Herrera (AG)
C. Huh (AP)	
A. Bevilaqua (BR)	
Z. Jin (CC)	
P. Moreno (CE)	
	F. O'Brolchain (CO)
	C. Just (EC)
A. Buisse (FF)	
J. Stephan (GR)	
S. Bhalla (IN)	
D. Fanizza (IT)	
T. Tanaka (JA)	
H. Hosseini (MD)	
M. Mahmoud (MI)	
P. Hilbers (NE)	
M. Poso (NO)	
A. Mozhin (RU)	
	B. Alhomaly (SA)
R. Lim (ST)	
	M. Peter (SZ)
S. Riach (UK)	
E. Shortino (US)	

C. Ogada, Secretary
V. Sola / S. Kalra, Summing Up Officers
E. Mannefred / D. Alcantara / M. Mehmedi, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: P. N'Diaye. Asia and Pacific Department: A. Gulde, J. Ostry. Communications Department: J. Kearns, C. Rosenberg. Office of the Managing Director:

[2] For countries in each constituency, please see the Constituency Codes in the annex.

R. Sahay. European Central Bank: D. Rakitzis, R. Rueffer. European Department: J. Decressin, A. Kammer, M. Pradhan. Fiscal Affairs Department: R. Espinoza, W. Lam, S. Lizarazo Ruiz, V. Gaspar, P. Mauro, P. Medas, A. Peralta Alva, R. Perrelli, R. Piazza, A. Senhadji. Finance Department: Z. Murgasova. Institute for Capacity Development: S. Coorey, M. Erbenova, R. Nord. Independent Evaluation Office: C. Collyns. Legal Department: N. Rendak. Middle East and Central Asia Department: Y. Abdih, S. Berkmen, T. Koranchelian, C. Serra Ronceros. Monetary and Capital Markets Department: N. Abbas, T. Adrian, D. Drakopoulos, A. Garcia Pascual, F. Natalucci, E. Papageorgiou, M. Qureshi, F. Suntheim, J. Vandenbussche, A. Yokoyama, X. Zheng. Office of Budget and Planning: A. Schimmelpfennig. Office of Risk Management: B. Boultwood. Research Department: J. Bluedorn, S. Chen, M. Chivakul, M. Comunale, M. Dao, A. Gloe Dizioli, G. Gopinath, N. Hansen, P. Koeva Brooks, M. Nabar, J. Natal, D. Sandri. Strategy, Policy, and Review Department: F. Bornhorst, P. Dohlman, P. Garcia Martinez, T. Gudmundsson, K. Kang, V. Klyuev, N. Meads, M. Mrkaic, C. Pazarbasioglu Dutz, N. Suryakumar, J. Trevino, A. Tuladhar, D. Velculescu, H. Ward, D. Zakharova. Statistics Department: P. Tumbarello. World Bank Group: M. Kose. Western Hemisphere Department: N. Chalk, J. Roldos. Office of Executive Directors: W. Keller, U. Nielsen. Executive Directors: S. Chodos (AG), D. Palotai (EC). Alternate Executive Directors: A. Alhosani (MI), H. Azal (EC), L. Dresse (NE), M. El Qorchi (MD), F. Fuentes (BR), A. Grant (AP), A. Guerra (CE), M. Kashima (JA), M. Massourakis (IT), F. Mochtar (ST), W. Nakunyada (AE), R. N'Sonde (AF), L. Palei (RU), O. Parkyn (AP), C. Roman (FF), J. Romero (CE), D. Ronicle (UK), B. Saraiva (BR), J. Sigurgeirsson (NO), F. Sylla (AF), Z. Zhang (CC). Senior Advisors to Executive Directors: W. Abdelati (MI), S. Ahmed (MD), H. Andrianometiana (AF), K. Badsi (MD), X. Bai (CC), E. Cartagena (CE), M. Choueiri (MI), R. Cunningham (CO), R. Goyal (IN), P. Harvan (EC), O. Hendrick (AG), M. Ismail (AE), L. Johnson (AP), H. Koh (GR), B. Lischinsky (AG), R. Mahabir (BR), M. Maidi (AE), L. Marek (EC), Son T. Nghiem (ST), T. Nguema-Affane (AF), C. Quaglierini (IT), C. Sassanpour (MD), S. Senich (US), F. Spadafora (IT), N. Thiruvenkadam (IN), A. Tolstikov (RU), R. Velloso (BR), M. Villeneuve (CO), L. Voinea (NE), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: T. Abalala (SA), A. Abdullahi (AE), M. Albert (FF), F. Al-Kohlany (MI), , D. Andreicut (UK), A. Arevalo Arroyo (CE), Bah, R. (AF), Dennis Bautista (ST), S. Belhaj (MD), A. Biriukv (RU), M. Boehme (GR), B. Boostani (MD), E. Boukpessi (AF), K. Carvalho da Silveira (AF), T. Chrimes (UK), M. Coronel (BR), J. Corvalan (AG), V. Djokovic (SZ), R. Edwards (CO), C. Eijking (NE), T. Iona (AP), R. Kraavik (NO), V. Lankester Campos (CE), R. Lopes Varela (AF), T. Manchev (NE), G. Meizer (EC), M. Merhi (MI), R. Moral Betere (CE), I. Ogihara (JA), A. Olhaye (AF), B. Piasecki (SZ), E. Shimada (JA), B. Singh (IN), B. Slettvag (NO), S. Spurga (NO), L. Sturm (US), D. Tevdovski (NE), A. Tola (SZ), I. Valdes Fernandez (NO), C. Westphal (US), Y. Zhao (CC), J. Barroso (BR), B. Commaroto-Roverini (US), M. Law (CC), F. Lopez (CE).

DISCUSSION RECORD[3]

The Chair:

We are at a point where the recovery continues but so do divergences, and they are looking more persistent. We are facing uncertainties around the baseline that are getting particularly large, and we face quite significant risks.

We all have experienced the significance of new variants, with the Delta variant spreading all over the world, including right here, where we live and work, and so the risk of new variants remains quite significant. This is where the attention on fighting the pandemic remains, not only as a health issue but also as an economic issue.

What is clearly a theme now is the role supply disruptions, caused by this stop-and-go that we face in so many places, are manifesting themselves, how they impact the world economy, and, also, what role they play in terms of inflation pressures.

We also know that today, the policy space in many countries is smaller than it was when we had our Spring Meetings. As a result, the policymakers are confronted with much more complex challenges--how to balance short, medium, long-term objectives; how to make these policy choices.

It is not a surprise that, in the flagships, we talk about the global picture, but we also address the differentiated impact of factors determining the status of the world economy and the policy recommendations associated with them. I know that we will have, during the Annual Meetings, a great deal of interest in the flagships' assessment of the global outlook and the policy recommendations they outline. In that sense, today's meeting is incredibly important to hear your views, so we can go to the Annual Meetings with our very best assessment and our very, very best recommendations for our membership.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath):

As I said in my recording, the global recovery continues; however, it remains hobbled by the pandemic. And our projections for this year and next are mostly unchanged. What we have, for instance, in the global economy for

[3] Edited for clarity.

this year is 5.9 percent this year, which is minus 0.1 percentage point lower than our July forecast; and for 2022, we do not have any revision.

Now, the slight revision down for this year reflects a downward revision for advanced economies (AEs), which is minus 0.4 percentage points, and it is driven by downward revisions for countries like the United States, Germany, and Japan, all of which have been hit, to different extents, by the pandemic and/or supply disruptions. For the euro area as a whole, however, we do have an upgrade, reflecting particularly sizable upgrades, significant upgrades for France and Italy because of stronger-than-expected numbers for the second quarter.

On emerging and developing economies, we have a very slight upgrade for that income group, of 0.1 percentage point. That reflects small upgrades across most regional groupings, with the exception of emerging Asia, for which we have a slight downgrade. Overall, we are seeing a significant downgrade that we have is for low-income developing countries (LIDCs), where we are downgrading the forecast by minus 0.9 percentage points, and this reflects the negative impact of the pandemic and the fact of their limited access to vaccinations, which remains the case.

Again, looking ahead, the problem that we have been flagging for several quarters remains, which is a dangerous divergence in recovery prospects. We can see this in the left chart, with the medium-term output losses, where we are projecting almost no scarring for advanced economies into 2025 and significant scarring for low-income countries (LICs) and many emerging markets and developing economies (EMDEs).

Another challenge that we are projecting is the fact that the labor market recovery is falling behind the recovery in general economic activity and output levels. Now, this is not uncommon. It tends to follow most recessions. But this time around, the divergences are somewhat larger. And also, and partly because of a reflection of the fact that we are still living with the pandemic and for certain contact-intensive sectors, it is harder for labor to return to full-time work.

In terms of what needs to be done--and there were a few questions that we did not respond to in the gray statements. Let me just give some quick responses.

The foremost action that is needed is to accelerate vaccinations around the world. Several Directors asked about how the world was doing, relative to the pandemic plan staff discussion note. The point is that we have many low-income countries, heavily concentrated in the African continent, where we expect to see them falling short of the 40 percent target by the end of this year. The boosters that are now being given out in some countries pose an additional challenge to equitable access to vaccines in the near-term. I think next year, it will be in better shape. But, at the same time, I think it is still possible to get to those targets. It will require about another 500 million doses to be made available to COVAX to go to low-income countries.

In terms of the grant–in terms of the financing gap, the plan at $50 billion, $15 billion was concessional financing, for which there is now facilities that exist; $35 billion were grants. Given all the pledges, including the most recent at the Biden COVID-19 summit and following that, is where grant financing gap has come down to about $20 billion. That is, again, tentative because we are still adding up the numbers; but, importantly, on October 4, we will be giving Board a full update on the pandemic and the pandemic proposals. We will answer many more questions over there.

In terms of other, more general policies, it is about taking a tailored, calibrated approach. This applies both to monetary policy and fiscal policy.

The Financial Counsellor Director of the Monetary and Capital Markets Department (Mr. Adrian):

The title of the Global Financial Stability Report (GFSR) this time are the three Cs, COVID, crypto, and climate; and those three Cs correspond to the three chapters. The first chapter starts with the observation that financial conditions remain easy, particularly in advanced economies but also in emerging markets (EMs). And, of course, much of that is due to the easy monetary policy, the asset purchases. Many Directors asked about the risks of another taper tantrum and the potential spillovers to emerging markets. We have just seen in the past week that Treasury yields have increased by about 10 basis points, and there is certainly a risk that remains.

In terms of inflation, inflation has accelerated, but medium-term inflation expectations do remain well anchored for the moment in advanced economies. Emerging markets have tightened monetary policy in order to counteract this rise in inflation. On the right chart, we can see that real policy rates are expected to increase--they have already increased, and they are expected to increase quite substantially. That, of course, can be a problem for those countries. Inflation is expected to come down, but the higher real rates are a problem both for aggregate demand and, in some countries, for debt sustainability.

Turning to the Chapter 2 theme on cryptoassets. There was a tremendous run-up in valuations of cryptoassets this year, a sell-off, another run-up, and another sell-off. There is tremendous volatility here. These are not quite systemic at the global level; but certainly, for some countries, we are detecting capital flows associated with crypto transactions that are macro-critical. This space might develop into systemic financial stability concerns fairly quickly. The right-hand chart shows that there is a lot of leverage that is deployed in this space, so the leveraging up and leveraging down is certainly amplifying the price movements.

Turning to stablecoins. Stablecoins are not all that stable. Some of them are runnable, and we have seen a run on the stablecoin earlier this year, in June. We are certainly concerned about the stability of some of the stablecoins, and we are asking for more regulatory actions in this space.

Finally, turning to the third C, on climate. Climate funds are growing, but they are still fairly small sliver, relative to the total outstanding conventional funds, shown in gray on the left chart. Sustainable, excluding the environment, in red. The climate funds are in green. And we can see it is a fairly small share.

Having said that, the sensitivity of investor flows to climate is very large. The sensitivity is shown in the right panel here. The marketing of climate funds is certainly a good business these days.

When we look at the voting support, we can see that climate funds and environmental funds, more broadly, are taking more favorable climate-related resolutions in Annual Meetings. There has been a trend over time. So even conventional are more likely to take climate actions, but environmental funds are much more likely than the conventional funds to take those climate actions.

Finally, we can also see that flows into greener or sustainable funds do benefit firms that are relatively greener. It does not necessarily help with carbon intensity, but it does help those firms that have higher e-scores.

The Director of Fiscal Affairs Department (Mr. Gaspar):

The question I want to address is, after a year and a half that COVID-19 was declared a pandemic, what are the main fiscal developments and prospects?

First of all, we have already heard from Ms. Gopinath that the world is still confronted with significant uncertainty coming from the developments in COVID-19 and its variants. The "great vaccine divide" that Ms. Gopinath emphasized is a clear and present danger. Climate change, that was covered by Mr. Adrian, is also surrounded by uncertainty; but its dynamics are much slower but much more persistent than COVID.

Climate change and preventing and managing pandemics are both global problems, and they both require effective action at the global level. Because of COVID-19 and the policies put in place to respond to it, debt levels are at historical highs. High levels of public and private debt are associated with risks to financial stability and risks to public finances. Those are covered in the GFSR and the Fiscal Monitor (FM) respectively.

I want, first, to focus on global debt, given that we now have preliminary estimates from the global debt database for 2020. The debt of governments, households, and nonfinancial corporations added up to $226 trillion in 2020, $27 trillion above 2019. Debt almost doubled since 2007, just before the global financial crisis. Advanced economies and China contributed more than 90 percent to the accumulation of worldwide debt in 2020. The remaining emerging markets and LIDCs contributed about 7 percent. These numbers reflect sharp differences in access to finance around the world. This will be a guiding threat to understand fiscal developments and prospects.

The increase in public debt in 2020 was fully justified by the need to respond to COVID-19 and its economic, social, and financial consequences. But the increase is expected to be one-off. Debt is expected to decline this year and next. After that, it is projected to stabilize at about 97 percent of GDP. That reflects, first, a strong contribution from nominal GDP growth, accompanied by a much more gradual reduction in the primary deficit. Differences across country groups appear when looking at fiscal policy and economic developments. Advanced economies are projected to gradually recover to the pre-COVID growth path, and that is the absence of scarring that Ms. Gopinath spoke about. Fiscal support will persist, but spending and revenues will gradually approach the pre-COVID path.

In contrast, low-income developing countries' spending has never changed by much, although the composition did shift toward the health emergency. These countries, however, experienced substantial shortfalls in revenues, which are expected to be persistent. These shortfalls mimic a persistent fall in growth, relative to pre-COVID prospects. Lower growth and shortfalls in revenues are major concerns, from the viewpoint of the indication of poverty. They also threaten further delays in delivering the Sustainable Development Goals.

The differences between country groups are accompanied by significant heterogeneity within groups. That is why policy advice has to be carefully tailored to country-specific circumstances. But for all countries, public finance credibility is a precious asset, and this is the focus of Chapter 2 of the Fiscal Monitor. In Chapter 2 of the Fiscal Monitor, we show that, where fiscal frameworks have high credibility, it is possible for countries to access bond markets at lower yields. Moreover, at time-- budget announcements in countries with high credibility benefit from a secondary transitory effect on the cost of financing.

Bottom line: Committing to fiscal responsibility pays off. Finance in times of COVID-19 provides a dramatic illustration.

Mr. Buissé:

Strong actions, both at the national and global levels, are necessary to overcome this pandemic. I would like to offer three sets of comments.

First, we share the staff's view on the outlook. We remain concerned by the risk of increasing growth divergence and inequalities. The situation in LICs deserves specific attention, with low vaccination, more scarring effects, food insecurity issues, and sovereign risks. Multilateral actions through a Special Drawing Right (SDR) rechanneling and a successful implementation of the Common Framework will be essential. I would also like to emphasize the need to systematically integrate an analysis on the use of SDRs in bilateral surveillance.

Divergence is also visible regarding inflation trajectories, as underlined, and we value very much the staff's analysis on this topic. While the baseline assessment did not change compared to April, the staff put more emphasis on downside risks this time. A potential disanchoring of inflation expectations, a deterioration of financial conditions, and overheating of some real estate markets are, indeed, critical areas to monitor very carefully.

Vigilance is also needed regarding the crypto ecosystem and financial stability risks. In line with the G-7, we think that no global stablecoin project should begin operations until it adequately addresses, really, the legal, regulatory, and oversight requirements.

The labor market's recovery and education losses deserve specific attention, with a clarification on temporary and scarring effects to design the best reallocation policies.

In the past, most countries have been quite unsuccessful to support a rapid and efficient reallocation of labor, following technological revolutions or economic crisis. The forecast actually includes a substantial scarring on the labor market. We need to work even more with the membership to prove these forecasts wrong through the appropriate economic policy. We need to do better; and for that, the staff's very pragmatic and tailored advice will be extremely helpful to countries.

My second point is on differentiation. The greater differentiation of economic trajectories between advanced and emerging market and developing countries (EMDCs) calls for more differentiated policy mix actions. Optimal combinations are to be found, based on each country's specific circumstances and position in the economic cycle. More precisely, we fully share the staff's view on the need for transparent and clear communication from central banks. It is simply a prerequisite.

On fiscal, the tailoring of recommendations will be key, as the size of the fiscal space is smaller than before the crisis, for all countries; but also the threat very diverse from country to country. Vaccinations remain, of course, a top priority for all, like all Directors said. Addressing health and social issues through high-quality investments in human and physical capital will underpin the recovery.

We read with great interest the chapter dedicated to post-COVID fiscal frameworks. We share the staff's view that fiscal transparency and credibility are decisive for the good conduct of fiscal policy and that fiscal rules should respond to complex country-specific trade-offs. The staff's work to help countries think through these issues will be extremely valuable to the membership, and I look forward to a formal discussion on this.

My third and final comment is to commend the integration of climate issues across the flagships. As eloquently illustrated in the presentations, concrete actions remain largely insufficient. This is, unfortunately, not a surprise. And we support the staff's recommendation, hoping that the United Nations Climate Change Conference (COP26) will be a decisive step in the right direction. The chapter on the role of the investment fund industry is also very useful, and we would be interested to hear from the staff about their future work in this area.

The Chair:

I want to pick up on what Mr. Buissé said about labor markets. If we are to not take active policy steps, there can be quite a lot of trouble down the road. And, of course, I completely agree that the staff has gone into quite a comprehensive understanding of the present challenges and all that we need to wrestle with in the future.

Mr. Bevilaqua:

As we have issued a detailed gray statement, I will touch upon a few points for emphasis.

The resurgence of the pandemic is an important threat to the ongoing recovery. Service sector demands have yet to make a full comeback and so have employment and labor market participation. Also, supply constraints point to more persistent inflation. And an earlier-than-expected tightening in global financial conditions could limit the upside potential of the world economy.

On a positive note, vaccination has steadily progressed in many emerging market economies (EMEs), mitigating the risk of economic scarring. Also, as mobility increases with vaccination rollouts, informal labor markets will likely support employment, a point not stressed enough in the flagships. It is crucial to reduce vaccine hesitancy in advanced economies and to improve access to vaccines in low-income countries. Progress in vaccination rollouts everywhere is key to putting the global economic recovery on a stronger and sounder footing.

Policy support has been key to minimizing the downturn and planting the seeds of recovery. While very well-targeted fiscal policy measures may still help to leverage the recovery in labor markets, the focus should be increasingly concentrated on the sustainability of medium-term fiscal frameworks. Monetary policy is being tightened in several emerging market economies, while advanced economies have signaled the need to start tapering their unprecedented liquidity support to financial markets. As policy support cannot be expected to continue at the current level, it is crucial to unlock growth potential through an acceleration of market-friendly structural reforms.

While tax cooperation at the international level may be productive, the process must be mindful and fair to the needs of emerging and developing economies. This also applies to carbon market development and regulation, an issue that does not command broad consensus at the Board.

Our constituency has been vocal about inflation risks since, at least, the Spring Meetings. While the flagships have moved in the right direction, the tone of the reports should be more forceful. Sure, core inflation is below headline inflation, but not by much. And core inflation has been trending up as well. I understand the dilemma. But the risk here is the staff's assessment and policy recommendations becoming behind the curve and raising the economic cost of a faster catchup down the road.

That said, we acknowledge that SDRs will help emerging and developing economies fight the pandemic, support recovery, and improve buffers. Relatedly, let me stress again the crucial role SDR rechanneling could play, not only for global macroeconomic and financial stability but also to support a stronger and transformational recovery in many developing economies.

Finally, we are deeply concerned with the vulnerabilities created by easy financial conditions in advanced economies, which have clearly led to excessive leverage and asset prices misalignment in several segments. Unfortunately, macroprudential policies have been underwhelming. Most recently, developments in China suggest that financial tightening needs to be matched with strong frameworks to handle potential difficulties in some large players.

Ms. Mannathoko:

Our main concern, of course, is the divergence in incomes determined by limited vaccine access and limited policy support, and this is expected to really leave a lasting imprint on medium-term performance, with economies in poorer regions growing more slowly and scarring much more, as Ms. Gopinath just mentioned, than advanced regions. A multilateral commitment to end the pandemic globally is critical. We want to urge the staff to really help the Multilateral Leaders Task Force, with adding to their analysis on how to best address the specific bottlenecks that are hampering the acceleration of vaccine access. In our region, only 2 percent of the population is fully vaccinated, so the 40 percent vaccination target does not seem reachable right now. But the task force could find ways to facilitate production, even in developing countries, maybe lifting trade restrictions, et cetera. I hope the staff will continue to provide that support.

Given the ongoing impact of the pandemic in LICs, in other developing countries, multilateral efforts to ease financial constraints and provide liquidity, especially to low vaccine jurisdiction states, is still critical.

The channeling of SDRs to bolster the Poverty Reduction and Growth Trust (PRGT) and to Fund the Resilience and Sustainability Trust (RST) will help. We just wanted to urge advanced economies and those EMs with large SDR allocations, in excess of their needs, to really on-lend through these trusts, to the extent possible, to support these trusts to really bolster developing countries and help them out. And, also, possibly to contribute to supporting a liquidity and sustainability facility that could provide regions like Africa, which does not have a repo market, access to a facility which acts like that and reduces the cost of borrowing on markets.

Both financing and tailored measures are needed to reverse scarring and enable a recovery and transformation in the developing world because policymakers are facing very difficult trade-offs. An effective debt resolution architecture, with a successful and efficient G-20 Common Framework remains really important--it has to be a priority--to support sound debt management strategies and a sound medium-term fiscal framework.

Beyond this, let me just say a couple of points on other aspects.

On inflation--I think Mr. Bevilaqua mentioned this--Fund advice will need to give increased attention to the risks and developments in country-level advice. This is becoming increasingly important.

Like Mr. Mohieldin, we also just want to emphasize that the Integrated Policy Framework (IPF) and a timely Review of the Institutional View remain crucial to provide EMDCs with additional support in managing the risks that could stem from sudden capital flow reversals. I think Mr. Bevilaqua mentioned that macroprudential measures (MPMs) alone are not really adequate now.

On the crypto ecosystem, we just want to appreciate the analysis. We continue to encourage further work to deepen Fund expertise and provide meaningful structured advice to countries in this area. We echo Mr. Moreno on the need to remain strongly engaged with country authorities on this, on cryptoassets. And I think it was Mr. N'Sonde--we want to just underscore the importance of the close monitoring of stablecoins--Mr. Adrian referred to that--and to inform early development of policy and regulatory frameworks at the country level.

On the recovery and economic transformation, we want to urge attention to policies that support jobs. This is really becoming critical for social stability and poverty reduction in the medium-term. The drive for green and environmental, social, and governance (ESG) investments we feel could also be accompanied by IMF advice at the country level for developing countries on effective ESG investment planning, accessing sustainable--and using sustainable funds, et cetera, and just helping with the adaptation and transition plans and challenges.

Ms. Riach:

We agree with the headline messages, and we appreciate the insights provided by the well-targeted Analytical Chapters.

As the dynamics of the pandemic and the available policy space evolve, we welcome the more nuanced and tailored messages offered in these reports. Support is still needed; but as Ms. Gopinath said this afternoon, a more tailored and calibrated approach will be needed for both fiscal and monetary policy. And this must increasingly be contingent on country circumstances.

These flagships make a serious contribution to the debate by seeking to break down the policy challenges and offering a differentiated set of recommendations.

As everybody who has spoken this afternoon has said, vaccines have really opened the way to a strong rebound in global economic activity. We welcome the World Economic Outlook's (WEO) message, that while the path ahead is not at risk, the recovery seems to have taken hold in advanced economies. The WEO cites the United Kingdom's experience to show that widespread vaccination can help disrupt the path of the pandemic, improve health outcomes, and support economic recoveries. Vaccines alone are not a panacea, but the evidence shows that they are now the most important tool for fighting the pandemic.

As the vaccine rollout picks up in emerging market economies, like Mr. Bevilaqua, in his gray statement, we would have liked to have seen a greater emphasis on the positive impact that this could have on reducing scarring. We would perhaps have expected a greater positive impact on growth forecasts for emerging market economies.

We agree with staff that the pickup in inflation is likely to be temporary, as the pace of the recovery runs up against supply constraints. In this context, we welcome the staff's efforts to offer more granular monetary policy advice. And we support all of those who make clear the need for transparency and communication in monetary policy.

Meanwhile, the situation in low-income and developing countries remains alarming. In her gray statement, Ms. Mannathoko reminded us of the extremely difficult policy trade-offs that low-income countries face, between spending on lives and livelihoods and investments in the future and reaching development goals. So here, we join Mr. Buissé in urging the staff to follow poverty indicators closely. We agree with the staff that international cooperation will be essential to ensure global access to vaccines and to help low-income countries meet their financing needs.

In this context, I hear Ms. Mannathoko's comments on the importance of rechanneling SDRs. Like her, I hope that we will be able to make progress at the Annual Meetings, both through specific funding pledges for the PRGT to support LICs in meeting immediate crisis-related financing needs and through a broader commitment to the development of a Resilience and Sustainability Trust to support longer-term transformational spending.

We welcome the staff's analysis of the global financial conditions in the GFSR, and we found the COVID crypto climate theme to be well-focused. We had expressed some concerns in our gray statement, that the GFSR could have more prominently referenced the Financial Stability Board's (FSB) work to strengthen investment funds and the G-20's work to enhance cross-border payments. And I would like to thank the staff for the constructive bilateral engagement on these issues and for considering our concerns.

We thank Mr. Adrian for his comments on Evergrande in the prerecorded presentation. As we said in our gray statement, the GFSR's update on financial vulnerabilities in China was timely; but given how dramatic the developments with Evergrande have been in the past week, we would be interested in further staff views. We think that the GFSR would benefit from explicit coverage of the issue.

I will end, as I so often do, with climate. The macroeconomic implications of climate change are increasingly evident and urgent across the membership. We welcome a suite of recently announced plans, including by the United States on climate finance and by China on phasing out coal. We hope to see further ambition between now and November's COP26 in Glasgow. Both ambition and sustained, well-calibrated policy implementation are needed to effectively address this unprecedented global challenge.

The same dynamic is true for the IMF. The staff have brought us a long way and need to build on the positive momentum to continue to deepen their expertise and tailor their advice to member countries, upping ambition and implementation in parallel.

The Chair:

Since the United Kingdom was the first country to actually step into on-lending SDRs from before--not in this new allocation--I am sure UK will do that again.

France has announced its intention to on-lend 20 percent of its newly acquired SDRs. It would be great, if, during the Annual Meetings, we have a better sense as to how this is shaping up.

Mr. Hilbers:

Given the still highly uncertain environment, I am sure that policymakers worldwide will look very much forward to the Fund's views on the world economy and hot topics, such as fiscal frameworks, inflation dynamics, housing markets, climate, and cryptoassets. Let me just make a few points for emphasis.

First, one thing on the tone of the report. Overall, it is very balanced, I would say; but we should be careful with providing regions with too much comfort in the current circumstances. On pandemic developments and the related economic recovery, we are right to stress the expected divergence between advanced economies and emerging markets and developing economies, both due to vaccine access and to policy support. I can substantiate that firsthand, based on my experiences in my own constituency. Divergent economic developments pose a risk, in itself, to the global economy, as it could lead to a tightening of global financial conditions, at times when many economies still need accommodative financial conditions;

but for advanced economies too, the development of the COVID-19 pandemic still remains uncertain. Let's err on the safe side here, I would say.

That brings me to inflation dynamics, which we need to keep a very close eye on. We very much welcome the focus of the reports on this important and challenging issue for our central banks. It seems that the world is becoming less certain on the temporariness of this phenomenon. How long can something be classified as "temporary" as the situation prolongs? With expectations being a snapshot that could be different tomorrow, we need continuous close monitoring. While a sudden tightening would certainly be felt through the markets, there is also a risk in being behind the curve.

Second, an even greater emphasis should, in our view, be given to the staff's plea for establishing credible fiscal frameworks. Credible medium-term fiscal frameworks would help balance the trade-offs between advancing long-term goals, the need to rebuild buffers, and any cyclical support, where needed.

Third, on climate, the call for a green recovery should be translated into well-elaborated policies. And we must ensure that wide public support for the massive economic transformation that is needed is there. To that end, future updates of the flagships could even focus more on how environmental sustainability penetrates all areas of economic policymaking. Let me also add that I am very pleased with the strong attention paid to the issue of climate in all three flagship reports.

Fourth, and finally, on real estate markets. We would like to thank staff for the elaborate analysis on housing prices and the house prices at risk model. Sharply increased house prices deserve attention, given that it is such a broad-based phenomenon across jurisdictions. Eventually, as the staff rightly points out, we need stress tests to assess the magnitude of the financial stability risks of this phenomenon, and these tests can estimate the potential impact of a sharp fall in house prices on household balance sheets and, ultimately, on financial institutions.

Finally, an issue maybe not so much in the flagships now but is certainly also relevant, certainly for those who are parents of 20- or 30-somethings. Housing markets not just have an impact on the real economy and on financial stability but also on social issues, like inclusion and intergenerational equality. Therefore, we would favor attention being paid also to housing affordability, an issue clearly related to a prolonged surge in house prices. And this is very much an issue also within the countries in my constituency.

Mr. O'Brolchain:

We generally agree with the staff's assessment and the broad policy prescriptions. I would like to highlight five points.

First, and reflecting what other speakers have already said, the reports underscore the continued need for multilateral efforts to end the pandemic and support vulnerable countries. While the global recovery is well underway, the WEO shows a substantial divergence in economic prospects for high- and low-income countries. Differences in vaccine access and policy constraints account for most of this divergence. We note that vaccination rates are very low in low-income countries and the pandemic has tended to exacerbate poverty. Therefore, the top policy priority remains to accelerate vaccination rates globally to save lives and support the economic recovery. Unsustainable sovereign debt burdens in some low-income countries will also need to be reduced. We echo the staff's call to urgently improve the implementation of the G-20 Common Framework, ahead of the Debt Service Suspension Initiative (DSSI) expiry this year.

Second, domestic policymakers should ensure that support is not withdrawn before the recovery takes hold. As the health crisis eases, fiscal measures should be targeted to vulnerable groups. Credible fiscal consolidation plans will be needed to ensure fiscal sustainability in the medium term. The WEO projections show a relatively rapid fiscal consolidation in some EMDEs. These appear optimistic in some cases, given the growth in revenue outcomes. Within the context of credible fiscal frameworks, structural reforms and investments to address long-term challenges and enhance potential growth should take priority in the medium term. We agree with Ms. Shortino, in her gray statement, on the importance of limiting the scarring effects on potential GDP. The low interest rate environment provides a good opportunity, in some cases, for infrastructure investment, which could raise growth potential, including through increased digitalization and shifts to greener growth. This should, of course, be done within a sustainable medium-term fiscal framework.

Third, we appreciate the detailed analysis of inflation in the WEO, and some of the current conditions resemble previous inflation scare episodes. We agree with the recommendation that central banks be ready to act preemptively if there are tangible risks of inflation expectations becoming unanchored.

Fourth, we agree with the staff's assessment of financial vulnerabilities in the GFSR, and we welcome the discussion of vulnerabilities in China. We would appreciate more on the economic impacts of these and other risks to China's outlook, given its importance for the global economy.

Finally, we value the focus on climate change issues in these reports, including the full chapter on green finance in the GFSR. We look forward to assessments of the impact of COP26 in future reports.

Mr. Tanaka:

First, let me touch upon the global outlook and policy responses. We agree with the staff that the global economic and social situation has become more divergent and risks are rather downside, vaccination is a dominant source of uncertainty and should be given top priority, and authorities still need to strongly address the impact of the crisis. In addition, vigilance will be required for the inflationary developments. We would highly appreciate an analysis on inflation from various angles, highlighted in Chapter 2. We have a further deepened understanding on the importance of anchoring and clear communications by central banks, as such. The spillover effects of an earlier-than-expected tightening of advanced economies should be closely monitored.

At this juncture, as the staff noted, fiscal and monetary authorities will need to carefully calibrate their policies. Also, international cooperation is vital to tackle the crisis and long-term challenges. To this end, we further encourage the Fund to provide policy advice in a tailored and specific manner, with various measures based on the core mandate.

We support efforts toward climate change by the Fund from macro-critical viewpoints. We have a strong concern with regard to the International Carbon Price Floor (ICPF) adjusted to country circumstances, discussed in WEO Chapter 1, given that it could exacerbate carbon leakage and cause market distortions. The ICPF should be treated in a uniform and evenhanded way.

Second, on the global financial system's stability. As the report rightly points out, authorities are urged to delicately navigate through different trade-offs, on the back of the current uneven recovery and uncertainties. In particular, central banks should vigilantly assess the extent of recovery and persistence of inflation, and policy prospects should be communicated in a careful and accountable manner.

Market boom with elevated leverage is increasing asset price misalignment and corporate indebtedness, including a sharp revival of collateralized loan obligations (CLOs). We, therefore, concur with the staff's view that the authorities should be aware of vulnerabilities against sudden reassessments or repricing and the market sentiment getting more cautious in recent months.

Looking ahead, we see merit in the Fund's further analysis on the possible impacts for financial stability in Chapter 2 on the cryptoassets ecosystem/crypto ecosystem and Chapter 3 on investment funds, which account for an increasingly bigger portion in the markets. Such studies would provide member countries with guiding principles to navigate through rapid changes.

On the fiscal front, we note that the deficits are projected to decrease in the medium-term in the Fiscal Monitor report, but returning to the pre-pandemic levels of accumulated debt is now a global challenge. Long-term efforts will be necessary with a credible fiscal framework and clear communication, and we believe the fiscal consolidation plan should be based on conservative assumptions, such as higher interest rates or other adverse scenarios, not taking the current favorable financial market conditions as a given. In this regard, some long-term fiscal targets presented in the report, public sector balance sheet (PSBS) or interest expense measures, need careful attention to adopt, especially under the current uncertainty. We expect the staff will continue to make well-calibrated and tailored policy advice for a sound fiscal framework.

Mr. Alhomaly:

Since we issued a detailed gray statement, I will be brief and elaborate on two key issues today.

First, on the economic and financial developments, we take note of the preliminary estimates that indicate a sharp increase in the global debt in 2020, above that of the global financial crisis. This, of course, poses risks to financial stability and public finances; therefore, it should continue to be reflected in the IMF's policy priorities, particularly the rollover risks in emerging markets, which deserve close monitoring.

Also, the increasing risk of the lasting scarring on emerging market and developing economies does not come as a surprise. In this context, we see scope for the policy recommendations to focus more on how to limit scarring, by advocating for the relevant policy priorities and structural reforms. And here, strengthening institutional capacity, with the help of the Fund's technical assistance, will be paramount going forward.

Another area of attention concerns the new developments regarding the inflation outlook and unexpected move in monetary policy, particularly in advanced economies, which could further exacerbate the difficult conditions in emerging markets and developing economies. Therefore, a continued close monitoring of inflation risks remains a key priority. In particular, for countries with limited policy space, we would have welcomed more elaboration on the policy mix to safeguard financial stability and maintain the credibility of policy frameworks, taking into account, of course, the country-specific circumstances, as elaborated by Mr. Buissé and a number of Directors today.

My second point today will focus on climate policies. We take note of the staff's answer to our question regarding the content of Table 1.2 and the net zero emissions scenario, which is subject to many questions and requires a more careful analysis, especially on the policy implications. Also, we see the need for a reference to energy security, which is increasingly becoming more relevant today, especially with the recent developments in the energy market, which you are all aware of, and the severe impact of COVID-19 on poverty and development. I believe a number of Directors today highlighted the need to carefully monitor the deteriorating poverty indicators. We would encourage the staff to thoroughly examine these indicators and to fully evaluate the increasing risk of poverty and energy in future reports. Also, as mentioned by Mr. Tanaka, we need to be mindful of the unintended consequences of advocating for a certain policy tool that focuses on sources, rather than emissions, which, of course, goes against the principles of the Paris Agreement.

Mr. Herrera:

We broadly agree with the staff's assessment on the outlook, risks, and policy recommendations, so I will offer a few comments for emphasis.

First, the global recovery remains on track, despite the resurgence of the pandemic and persistent supply disruptions. We welcome the upgrade of growth projections for Latin America. However, we remain concerned about new virus variants, unequal vaccine access, and the uneven nature of the global recovery.

Second, we welcome the focus of the flagships on the inflation outlook and monetary policy. We concur with the staff, that the main drivers of the recent inflation surge are temporary; however, these supply shocks are happening at a time when monetary stimulus is already extraordinary, fiscal policy remains accommodative, and demand in advanced economies is projected to return to its pre-pandemic trend in the coming quarters. Some monetary tightening in the near term seems warranted.

In the case of emerging markets, the staff analysis confirms that inflation scares can lead to higher inflation expectations and persistent deviations from targets. Central banks in emerging markets are already withdrawing monetary stimulus, concerned about this possibility. The consequences of higher interest rates, in the context of record high public and private debt, will require careful monitoring and credible commitments to fiscal responsibility.

So far, international financial conditions remain accommodative. And as the global monetary stimulus unwinds, clear communication from major central banks will be crucial to avoid a sudden stop in emerging and frontier markets. Additionally, a well-resourced and accessible global financial safety net will remain critical to limit negative spillovers and tail risks in EMDCs, including new mechanisms for rechanneling SDRs, as the Resilience and Sustainability Trust.

Finally, we welcome the focus on the agenda toward a greener, more digital, and productive economy. The commodities special feature in the WEO presents an interesting analysis of the opportunities of a low-carbon economy for energy transition metals and metal exporters. The WEO presents a favorable outlook for metal prices, which compares well with the last commodity supercycle. However, we highlight the high uncertainty around these projections due to uncertainty about the pace of mitigation policies and technical progress.

Mr. Pösö:

We consider the overall picture of a recovering global economy, with downside risks to growth and upside risks to inflation, as appropriate. At the same time, we find the national-level policy advice somewhat cautious. I will elaborate a bit on this in my comments today.

First, like Mr. Herrera before me, we welcome the focus on inflation developments. The thorough analysis in WEO Chapter 2 will likely serve as a reference for many looking to understand the inflation dynamics. In particular, we took note of the scenario with more adaptive inflation expectations, which clearly shows the serious implications, if expectations become de-anchored. After a year of significant upward revisions in inflation forecasts, the risk of temporary factors becoming more persistent should be taken seriously in the Fund's communication on inflation and monetary policy.

Moreover, faster inflation and the restoration of fiscal sustainability bring timing issues related to fiscal-monetary interactions to the forefront. Tighter fiscal policy might allow monetary policy to ensure favorable financing conditions for longer; otherwise, independent monetary policy might have to move sooner and then create additional challenges on the fiscal side. In any case, fiscal planning over the longer term should not count on permanently low interest rates, and risks of fiscal dominance need to be taken seriously.

Second, low interest rates have been important also for the exceptionally strong housing market dynamics globally. Like Mr. Hilbers, we welcome the thorough analysis of supply-and-demand factors in the GFSR. The increasing risk of corrections in the housing market is a major financial stability risk for many countries, and affordability concerns have intensified further. Another risk that requires expedited response is the growing importance of non-bank lenders.

This takes me to macroprudential policies. We agree that our authorities should take preemptive actions to tackle pockets of elevated financial vulnerabilities, but we find that the GFSR could have added some depth in its macroprudential policy recommendations. While it is true that such policies should be tailored to country-specific circumstances, we feel that more nuanced and concrete recommendations would be helpful for the current policy discussions. Could the staff explain in more detail what is meant by the recommendation, "to build buffers outside macroprudential tools"?

Turning to the Fiscal Monitor, it paints a rather bleak picture of a continued divergence between low-income countries and the rest of the world. Despite the increased gross financing needs, the share of interest payments to revenues will remain below pre-COVID levels in advanced economies. In low-income countries, however, this share will increase sharply. Could the staff comment on the historical precedents for such severe fiscal pressures on low-income countries?

I would like to end by commending the staff for the excellent and timely specialized chapters in each of the reports. The WEO Chapter 2 on inflation, which I mentioned already. Chapter 2 of the GFSR on cryptoassets, with a focus on emerging markets, and a July blog post on the same topic spotlight the key issues. Chapter 2 of the Fiscal Monitor is just as timely. Indeed, fiscal frameworks need to credibly embed future deficit reduction so that countries can have much-needed policy space in the short term.

Ms. Shortino:

I agree, I think the chapters hit on the right topics. I also think that, overall, the report struck the right tone in terms of emphasizing the need for strong multilateral actions, but that needs to be combined with well-calibrated domestic policy actions to prevent scarring and really solidify the recovery. We agreed with the message that policymakers should stand ready to act, should downside risks materialize.

I will just emphasize a few points from our gray statement, and picking up on what others have said.

First, I think it is very clear from the gray statements and the conversation today that we all agree that accelerating the pace of vaccinations and deploying lifesaving therapeutics is really key to the recovery. We very much welcome the emphasis on this issue in the WEO. I will just take a moment to reiterate the strong U.S. commitment on this front, including our recent announcement to donate another 500 million vaccines to low- and lower-middle-income countries.

Second, I just want to echo the staff's caution around fiscal support being withdrawn prematurely but would also agree that fiscal policy needs to be well calibrated to country circumstances. Countries that do have fiscal space should leverage this space with measures to raise growth and productivity, but countries with limited fiscal space, as we can all see, face difficult policy trade-offs. And this particularly applies to low-income countries. So, really, there needs to be country-specific and very tailored advice on how to target spending, in particular, on health, education, social safety nets. I want to also agree with Mr. Buissé and Ms. Riach on their comments around the SDR allocation and the importance of advice and guidance from the Fund on how to use this effectively, as well as ways in which we could reach agreement on SDR channeling for the PRGT and the new RST, which I think could help complement all of this.

On that same note, with regard to low-income countries, I want to just support the emphasis there around the key risks of divergence. In that light, addressing the debt issues there and the large debt burdens is really important. I just want to reiterate that executing on the Common Framework is going to be quite critical, and having more countries take advantage of the Common Framework will be an important aspect of this strategy as well.

We agree with all the fiscal advice and much of what is in the document. I just wanted to say, we were a little surprised there was not more focus on the broader infrastructural reforms. Of course, climate and digitalization are priorities. But we did take note that others, like Mr. Bevilaqua and Ms. Mannathoko, called for the upskilling and reskilling of workers, and there were some comments made on the labor market. So we cannot lose sight of that, and I think that needs to be an area of focus going forward as well.

Just a couple of extra points. One is on climate. I want to just agree with Mr. Buissé in terms of praising the staff for incorporating it across all three flagships. It really is the biggest policy challenge of our time. And I thought the analysis on issues such as green jobs and green investment was quite helpful, insofar as it can help contribute to the discussion and the dialogue and inform countries in their efforts to meet nationally determined contributions (NDCs).

Finally, I thought the chapter on inflation was quite well done. We agree that inflationary pressures are mainly transitory, but policymakers need to remain vigilant, particularly with regard to the potential for a de-anchoring of expectations. I have said this before, and I will say it again--I am just going to conclude on this point--that the Federal Reserve is very cognizant of the impact of its policies on global markets and is very committed to communicating any changes in policy clearly and well in advance to help smooth transitions. But in that light, at the same time, emerging market economies clearly need to be cognizant of these risks and take steps to address their own risks of tightening external financial conditions.

The Chair:

To give Ms. Riach, and Mr. Buissé comfort, on the SDRs, already, mission chiefs are engaged with countries to make sure what they get as SDRs is used appropriately, prudently, and with the highest possible transparency.

Mr. Peter:

We broadly share the assessment and would like to add just a few points to our gray statement.

First, we share the WEO's recommendation on the need to continue policy support until the recovery is entrenched. This support should be increasingly targeted to specific sectors of the economy, providing liquidity to viable firms, while facilitating an orderly resolution process for the nonviable ones. This process should be accompanied by measures that help the reallocation and retraining of workers to mitigate the social impact. Looking ahead, we join Mr. Pösö in encouraging the staff to reflect on the policy challenges emanating from limited fiscal and monetary policy space in future reports.

Second, the spillovers from the massive policy support in advanced economies have helped avoid a more serious downturn in many EMDCs. Going forward, these--and, in fact, all countries should use this crisis as an opportunity to implement deep reforms to address pre-pandemic deficiencies and put their economies on a durable growth path and ensure fiscal sustainability. In this context, we found the analysis in Chapter 3 of the WEO, on the role of applied research in raising productivity and growth, very useful.

Third, we strongly share the key message in the reports about the importance of clear communication on inflation, and this has also been stressed by many of my colleagues. Inflationary pressures are accelerating in a number of economies, especially in EMDCs. Monetary policy tightening may be warranted to avoid falling behind the curve, which could lead to a de-anchoring of expectations. Considering the high uncertainty surrounding inflation prospects, central banks should stand ready to adjust their policy rapidly, if needed. In this context, strong central bank credibility and clear communications are paramount to ensure orderly market reactions.

Finally, like Mr. Stephan, among others, we cannot emphasize enough the importance of strong international cooperation, which is essential to ensure broad global access to vaccines and bring an end to this pandemic. In the post-pandemic world, a strong rules-based multilateral trade system will help defuse trade and technology frictions, eliminate supply disruptions, and foster the productivity growth that we need so much.

Mr. Hosseini:

The global economic recovery is continuing, but the outlook is fraught with uncertainty and risk. The sustainability of the recovery critically hinges, first and foremost, on our earnest collective efforts to end pandemic everywhere. So far, the progress has been highly uneven, and the vaccination targets set out in the IMF's plan are clearly unattainable for many countries. Getting anywhere close to the targets requires a strong push on the part of the G-7 and other vaccine producers to meet their commitments. The two-track vaccination progress is leading to a two-track recovery path that is bound to further widen the income gap between rich and poor nations. The recovery will also be highly dependent on tailored policy support as we emerge from the crisis.

Fiscal support played a pivotal countercyclical role in supporting economic activity, preserving jobs, and protecting the vulnerable population during the crisis. It will continue to be equally detrimental but with proper calibration to ensure that the recovery is not derailed, given the high degree of uncertainty. For many low- and middle-income countries--some already beset by pre-existing fragilities, high financing needs, and elevated debt levels, all exacerbated by the crisis--the options are much more limited, in the absence of policy space. Sustained high levels of international financial support and debt relief will, hence, be critical to their transition and beyond. And the Fund, as always, should play its key catalytic role.

Inflation has emerged as a major global concern. The steep rise in international food prices, in particular, has brought food insecurity to the forefront for millions of people. We would tend to agree with the staff, that the underlying inflation factors are likely to be transitory, but the possibility of a costly de-anchoring of inflation expectations cannot be ruled out.

Monetary policy for leading central banks has become a fine balancing act, with major risks on both sides, and with significant outward spillover effects on EMDC capital flows and exchange rates.

Beyond near-term macroeconomic policies, the world economy is facing a number of defining longer-term challenges. Climate change has emerged as a serious existential global threat. As we move beyond the advocacy phase, in the planning and implementation phases, we also have to be more cognizant of the policy options and potential policy conflicts, as brought out by the flagship reports.

An issue related to climate change, but of greater relevance to the Middle East region, is the deepening water crisis that deserves closer attention in bilateral and multilateral discourse.

Finally, we benefited from the staff's quantification of the cost of the global economy, of decoupling of longstanding global technology links, underscoring the urgent need for the leading countries to address fair trade and technology disputes, for the benefit of all.

Mr. Stephan:

We also concur with the analysis and the outlook. We also think that the focus was right on the important issues.

Like others have highlighted, we are witnessing this growing divergence in terms of recovery paths across many countries. Also, the reason has been pointed out that we have a continued resurgence of the pandemic and that we have no equal access to vaccines, which hampers the outlook. With this kind of high uncertainty about the path forward and declining room for maneuver, it is very difficult policy challenge for the policy makers and very complicated trade-offs they are facing right now.

I agree with others, that we need targeted fiscal support, and this should be continued as long as necessary. But, also, of course, fiscal policy should be mindful about preserving long-term fiscal sustainability. And this has been pointed out by others, like Mr. Hilbers, Mr. Tanaka, and Mr. Pösö. We have seen, in particular, also in Germany, that fiscal buffers are important during crisis times. Mr. Gaspar has emphasized fiscal sustainability is an asset; I would subscribe to this.

We support the staff's view that high-quality transformative public investment will be necessary to build back better in the aftermath of the crisis, because public investment can trigger substantial additional private investment. In this regard, a particular emphasis should be placed on efficiently targeting sustainable and growth-enhancing investment, structural reforms to foster green and digital transformations, as well as to strengthen social cohesion.

On the analysis of inflation dynamics, this was a very well-done chapter. We think, however, that the unexpectedly rapid recovery of global demand probably played a somewhat stronger role than acknowledged.

On the one-hand side, we had these emerging supply-side bottlenecks, which not only increased producer price for intermediate inputs but also caused shortages and drastic price hikes for specific consumer products. Also, labor shortages became apparent in many advanced economies, even though unemployment rates remained well above pre-crisis levels. We would be very much interested in further analysis in this regard and the implications for wage growth and the inflation outlook.

On house prices, which we also found very interesting, we agree that they might pose general upward risks to consumer price inflation. Although in Germany, it is a bit different. It is rather limited because this pass-through of house prices to Germans rents, for instance, is rather delayed and small.

Mr. Andrianarivelo:

We share the key messages and policy recommendations in the reports. After following the three presentations, I would like to make the following comments.

On the World Economic Outlook, first, we broadly share the assessment on the Global Economic Prospects, which are still impacted by the fallout from the pandemic. While the global economy is projected to recover in 2021, on the back of higher immunization rates and policy support, we note the elevated uncertainty around the global outlook stemming from supply disruptions in advanced economies and the cloudy future course of the pandemic, with medium-term risks skewed to the downside. In this connection, we reiterate our call for global efforts to tackle the pandemic everywhere and equitably.

LICs and vulnerable countries require special attention during this recovery and resilience-building period, including making vaccines available to them, ensuring the affordability of those vaccines as a public good, and accelerating the progress on important initiatives to ease debt burdens and address debt vulnerabilities, particularly with the G-20 Common Framework, which has yet to be operationalized.

We agree that credible monetary and fiscal policies will be critical to avoid inflation scares, keep expectations anchored, and support the recovery and transformation. As inflationary pressures are building up across the board, we remain concerned about the narrow room available for monetary policies to keep expectations anchored. It is paramount that policymakers continue to strengthen monetary frameworks and avoid abrupt monetary policy tightening, which could derail the global recovery underway and be particularly detrimental on emerging market and low-income countries.

Turning to the GFSR. We appreciate the explanation on the three key risks to financial stability and concur with the need to tighten the use of macroprudential tools to promptly address pockets of elevated vulnerability in the financial system. This includes the recent Evergrande event. A close monitoring of the development of the crypto ecosystem is also warranted to better ascertain areas where early development of policy and regulatory frameworks is needed.

Finally, as highlighted in the presentation, the new SDR allocation, SDR rechanneling is much important, as it was stressed by others, and concessional financing is critical to help members achieve development objectives and safeguard the confidence in the functioning of the international monetary system.

Mr. Just:

It is quite striking that the reopening of economies has turned into such a challenging and difficult exercise. Uneven access to vaccines obviously contributes to an asynchronous recovery and heightens downside risks. We fully share the views by others, that an accelerated vaccine rollout and targeted policy measures are, therefore, imperative to underpin the recovery. But, still, policymakers will continue to face intricate trade-offs, especially in emerging markets, as they will continue to face uncertainty, how the withdrawal of support measures, possible structural supply-side changes will affect economies.

To avoid a further deepening of divergence, a more thorough understanding of the lasting imprints of the pandemic is needed. In this sense, like Ms. Lim and Mr. Buissé, we also encourage the staff to monitor the pervasiveness of supply chain disruptions more closely.

What surprised us probably the most is inflation, from rapidly rising food, commodity, and energy prices to transportation but, also, increasingly, wages. And price increases continue to surprise on the upside. Several emerging market central banks have recently taken action to keep inflation under control and avoid a de-anchoring of inflation expectations, while major central banks have left the door open to higher inflation. We appreciate the staff's timely analysis on the inflation dynamics in the special chapter. However, the risks of more persistent inflationary pressure deserve even more attention, in particular, in our forecasts. Here, we would also see an increasing need to factor in the impact of higher carbon prices, as well as regulatory climate change measures that will push up prices.

In view of the lingering uncertainties, like other Directors, including Mr. Huh, Mr. Pösö, and Mr. Bhalla, we call, also, for some caution in the interpretation of underlying inflation trends. Where we differ a little bit with the staff is on the policy advice, of quickly adjusting (audio distortion), should there be a de-anchoring of expectations. In view of the leverage in financial markets and spillovers to capital flows and exchange rates, major central banks should continue to follow a well-communicated and gradual tightening approach.

A gradual withdrawal of fiscal stimulus measures may also contribute to a dampening amount.

Rising house prices across several jurisdictions is also concerning. Here, we agree with Ms. Shortino, that while these developments have not led to increased risk taking in the financial sector, the tide could turn quickly, so inclusive supervision is called for.

We also agree with Mr. Tanaka and Mr. Stephan on the need for the Fund to put more work into the nonfinancial sector.

Like Mr. Tanaka and Ms. Shortino, we strongly support the Fund's work on debt transparency and accuracy, and would underscore the importance of government accountability for public finance credibility. Here, we highlight the positive role of independent fiscal councils.

Like Mr. O'Brolchain, we note the needed fiscal efforts to bring debt to pre-COVID levels; but given that few countries have been able to reduce debts to pre-global financial crisis levels prior to the pandemic, we wonder about the optimal debt level, to begin with.

Mr. Moreno:

Let me just highlight a few areas where we have some nuances or where we think that the communication deserves particular attention.

First, on projections, there should be a focus on the remaining high levels of uncertainty and the very worrisome divergent recovery, especially affecting countries are low vaccination rates. This vaccine divide, like Mr. Hilbers has pointed out, also has potential implications in terms of global stability risks. We think that we should emphasize the message that vaccinations work, also for the recovery, to counteract hesitancy, and to be very outspoken on the need to accelerate vaccinations on a global scale. It is a global public good. We need to facilitate an equitable distribution of vaccines, as stressed by Ms. Gopinath. This includes eliminating restrictions to exports and liberating pharmaceutical companies from contracts in advanced economies or large economies where there are secure vaccines way above the population needs, so that vaccines can be delivered to low- and middle-income countries.

Here, we welcome and support Chair's role in cosponsoring the Multilateral Leaders Task Force to try to speed up global vaccine access. We also support the work of the Fund on the SDR rechanneling, and I would just echo here Mr. Bevilaqua's comments.

Second, I want to emphasize, once again, the importance of country specificity in the communication. For instance, there is scope to better reflect the heterogeneity of the revisions of growth among countries, specifying if the regions are associated with past negative surprises or, rather, with a weakening of economic prospects going forward. The same applies to policy recommendations. The policy mix should be very well calibrated in each country.

Here, a link to the fiscal space. I think that the Fund should be very outspoken in supporting the reform and in the implementation process of the international taxation rules to ensure that multinational companies pay a fair share of tax, leaving a fair portion in the market's jurisdiction.

Third, on inflation, I think that the focus should be to emphasize that the baseline continues to be that it has risen, mainly driven by base effects and temporary factors, which is also aligned with market expectations. Naturally, inflation deserves close monitoring; but here, I would highlight the importance of distinguishing between advanced and emerging economies, that risks seem to be concentrated in emerging economies. In this context, the credibility of the monetary frameworks and adequate and timely communication strategies are critical to preserve price stability. Here, we have particularly liked Box 1.3 and the Inflation Scares chapter in the WEO.

Fourth, on risk, and more for future reports; and for now, we would welcome more attention on three issues going forward. One, the demand-supply mismatch and supply bottlenecks, which have proven to be more persistent than anticipated. Two, a close monitoring of the financial sector although banks entered the pandemic in a strong position, potential losses may emerge from a more protracted pandemic and the impact of the spillovers from policy changes in leading economies. Three, the intensification of geopolitical tensions that could lead to higher trade and other associated tensions going forward.

Finally, we have found Chapter 2 of the Fiscal Monitor particularly relevant. Indeed, the post-COVID recovery calls for country-specific timing of fiscal adjustments and also for revisiting fiscal targets and rules, including a fiscal forward guidance to better anchor fiscal credibility. This is a key area where strong and timely capacity development assistance from the IMF will be necessary.

One final word, just to echo Mr. Buissé, on the inclusion of climate change issues in all the flagship reports.

Ms. Lim:

I would just like to stress a few points.

First, and more generally, this global pandemic has underscored the importance for multilateral efforts to secure global economic resilience. As the divergence in global growth widens on the back of uneven access to vaccines, we share Mr. Pösö, Mr. Hilbers, Mr. Mohieldin, and (audio distortion)'s view for a continued commitment to multilateral efforts that go beyond the resolution of this pandemic for both social and economic reasons. This includes strong complementary multilateral efforts in areas of climate change, and digitalization.

Second, with continued uncertainty around the sustainability of growth, we underscore appropriate and timely assessments and use of policy tools to guard against policy missteps. As many colleagues highlighted, the close monitoring of inflation sources and expectations, asset price overvaluations, potential financial spillovers, and debt sustainability are vital. As such, it is important to have a sensible grasp on the output gap and the scarring effects. We would also welcome future research on the impact of the global recession on the labor market, particularly with respect to contact-intensive sectors. In addition, tailored policy advice from the staff and the timely conduct of capacity development and technical assistance on the use of policy tools will help to bolster policy confidence and secure medium- to long-term economic sustainability.

Third, countries should be mindful of the trade-offs in balancing near-term support for the vulnerable, while working on the right structural policy mix to address longer-term risks amid limited policy space. Fiscal policy should be calibrated within a feasible framework that articulates more clearly the road map to enhance revenues and consolidate expenditures, and aimed at debt sustainability and rebuilding buffers over the medium term while keeping an eye on spillovers from AEs. The policy response should be timely and preemptive, and clear expectations and preserve credibility. In this regard, we encourage the staff to recommend appropriate strategies to help strengthen monetary policy transmission amid abundant global liquidity. EMDEs will likely face policy constraints to support accommodative monetary policy.

To preserve financial stability, greater flexibility to deploy the full range of tools, guided by the IPF framework, is key. We share Mr. Chodos' view on the need to recalibrate financial policies and strengthen corporate balance sheets, especially in EMDEs. We also welcome clear forward guidance and communications by major central banks to mitigate negative policy spillovers.

I will just end by underscoring that structural reforms should be geared toward more sustainable and inclusive growth, given that vulnerable segments of the economy have been more adversely affected by pandemic.

Mr. Huh:

We broadly agree with the staff appraisal and would like to emphasize the following points.

First, it is deeply concerning that the divide between countries continues to widen, including vaccine accessibility. These times are especially challenging for small developing states. Most Pacific Island Countries (PICs) in my constituency have kept their borders closed, with no foreign visitors over the past six quarters. Alongside challenges from the pandemic, they also face structural changes, vulnerability to natural disasters and climate change, and limited fiscal space. The Fund's strong support, in close coordination with the World Bank and other multilateral development banks, is vital, especially considering they have not requested upper-credit-tranche-quality programs.

Second, we agree that the balance of risks is to the downside, with uncertainty of the future pandemic developments, global divergence, and inflation dynamics. Policymakers face increasingly difficult trade-offs and spillovers. Well-tailored country-specific policy advice is needed to navigate challenges. The extent of economic scarring is still unknown, and the policy choice will be critical. We expect an increase in their debt vulnerabilities, which is not yet fully realized, with underlying economic scars. While the G-20 Common Framework will assist low-income countries, we are concerned about the slow implementation.

Third, we welcome the focus on credible monetary and fiscal frameworks in the flagship papers. These are critical for managing the trade-offs. We agree with the staff that it will be important to look through transitory inflationary pressures, so long as inflation expectations are well anchored. The pace of withdrawing fiscal support and rebuilding buffers should depend on economic conditions and country-specific factors. Fiscal rules and anchors will need to be recalibrated carefully.

Fourth, we should carefully monitor the labor market and its structural changes. Through the period of long-lasting pandemic, widespread virtual working has already crowded out considerable part of traditional working, changing the working behavior, which means a rapid structural change of the labor market. The labor market, after the pandemic, including the wage structure, will be radically transformed. Considering the sustained pressure on inflation mainly comes from the labor market, we need to carefully monitor the structural change of the labor market, in addition to macro variables. We welcome the analysis in this respect.

Finally, there is a need for early action to prevent a systemic financial crisis--financial risks. Given the financial vulnerabilities accumulated during the pandemic and the potential spillovers of the policy normalization in large economies, macroprudential policy should be well calibrated in advance. We encourage the staff to work with the members to build buffers in the financial system and to guide the proper use of IPF tools. Work on cryptoassets risks and digitalization risks, more broadly, will also be important in helping members deal with operational and financial integrity risks.

Mr. Alhosani:

We issued a comprehensive gray statement; and here, I would like to focus on four issues.

First, on growth divergence. The persistence of diverging growth paths is of great concern and was emphasized in our gray statement. Persistent output losses are anticipated for EMDCs, as a group, due not only to slower vaccine rollouts but also to the limited policy space, compared to advanced economies. The risks arising from the persistent divergence should be further emphasized in the report and in the context of the upcoming meetings. As this great divergence deepens, there will be regional and global spillovers, as people may not continue to suffer in silence, with considerable spillovers to their neighbors and to the global outlook. Governors attending the IMFC, G-20, and other meetings during the Annual Meetings should be mindful of these concerns and discuss potential steps to address it. There are other complications and concerns that affect the policy sphere, namely, rising inflation, lagging job creation, food insecurity, and, of course, climate change. On climate change, I would like to echo the comments made by Mr. Alhomaly, particularly on climate policies and energy.

Second, my point is on inflation and the inflation risk. There has been a growing concern in recent weeks and months. We would like to, of course, hear the staff's updates--or the staff's views on that. Rising inflationary pressures could trigger an abrupt correction of monetary policy in advanced economies, with clear concerns for EMDCs stemming from the resulting tightening of financial conditions and volatile capital flows. Clear central bank communications and forward guidance are needed to avoid such outcomes.

Reflecting concerns of an imminent tightening, there is a sudden spike in euro- and dollar-denominated issuance this past week, four times the average of the previous 10 weeks. The Fund should also be ready to support EMDCs as they charter what some expect to be increasingly turbulent market conditions, including through tailored and well-calibrated policy advice, as well as rapid and flexible financing, when needed.

On the SDGs, the Fund must help members to reverse the pandemic-related setbacks to human capital accumulation, poverty and inequality, and to accelerate the process of transformation through digitalization, and pursuing the achievement of the Sustainable Development Goals. Like others, we are concerned about the growing and uneven burden of debt, as noted in the Fiscal Monitor. The impact of high levels of debt can already be felt by many middle-income and low-income countries. The high debt service constrains their capacity to finance needed support for their recovery and jeopardizes the hard-won gains made in achieving the SDGs.

Finally, to return to its pre-crisis debt levels by 2045, emerging market economies would need to have a higher annual primary balance by 1 percent of GDP, relative to their pre-crisis levels. This should not come at the expense of growth-enhancing spending. Instead, countries must continue to strengthen their fiscal frameworks, improve domestic revenue mobilization, and enhance the efficiency of their current spending, while targeting their capital spending to facilitate an inclusive, sustainable, and transformational recovery.

Mr. Fanizza:

I will repeat some of the points we have in the gray statement because, given the size of the gray statements, I do not think many people have actually had the chance to read all of them.

I want to make basically two points. One concerns maybe the most important issue that is inflation. What I want to say is, at the end of the day, is that inflation expectations do not depend on the latest headline inflation figures but, instead, depend on the credibility of both monetary and fiscal policy.

When we judge inflation, we need to make an assessment on the stance of monetary and fiscal policy, and they are consistent. In other words, people and markets need to be convinced that the current unprecedentedly loose stance of monetary policy will not continue in the future because of the fiscal side. Currently, the unprecedentedly large government financing needs will be eventually reined in. That is one thing. The second thing is that the increase in government spending has been put to a good use. It will enhance our quotas. So, in countries where we see the debt, we can say that inflation is not a big problem, but there are other countries where that is not clearly true. And that, I think, is the crux of the issue on where we will need to focus on assessing.

I am very encouraged by the fact that, in the WEO projections, the debt-to-GDP ratio for Italy is set to decline already this year.

Second, I make will the second point very quickly. I would like to commend the staff for the analysis of the role that the financial sector should play to support the transition toward renewable energies. This is important because the Fund has traditionally stressed more the risks when, in fact, supporting green investment is the part of the efforts to limit the exposure.

Mr. Palei:

We issued a comprehensive written statement, and I would like to make just a few additional points. And they are not to criticize the reports but just to focus the attention on something that concerns us.

We remain concerned about insufficient differentiation within the groups of countries in the reports. Other Directors and our chair made this point on several prior occasions, most recently during the presentation on the emerging market economies. The Fund should avoid simplistic messages, that the advanced economies have plenty of room for any kind of policies and will be fine soon, while the emerging market economies are constrained in their policy responses and, moreover, gloom to a dismal future in terms of growth and in many other terms.

The advanced economies are usually lumped together with the United States, although many advanced economies appear to still be rather anemic and behave differently. Many of them have limited fiscal space and limited help from the monetary policy. The large fiscal stimulus during the pandemic led to a major hike in public debt. As Mr. Gaspar reminded us today, it will be close to 100 percent, the public debt only.

And more than a decade of extremely easy monetary policies is associated with the vulnerabilities and slow productivity in the private sector.

According to the Fund's pre-pandemic position, high debts, including public debt, and the lack of structural reforms are not conducive to growth. So even if the staff are correct, that most advanced economies will return to their pre-pandemic slow growth path, it may not be a happy ending. Indeed, low real interest rates offer reasons for us to worry about the future.

And, of course, scarring comes in many different forms. It may come through a proliferation of zombie companies. It may come through disparities in wealth accumulation and income distribution. And the staff, I think, agreed with our gray statement, in the answer to question, I believe, No. 54. I think we should avoid simplistic messages here. This is about advanced economies.

At the same time, for emerging market economies and developing countries, China is systematically excluded from this group, and the rest of the group is subject to gloomy stories about diversion and so on. Yet, we have seen many growth surprises in this group--in Brazil, in Chile, in Eastern Europe, in Russia. Macroeconomic policy frameworks worked well in many countries, and many emerging market economies strengthened these frameworks further during the crisis. They also intensified their structural reforms.

The staff should give credit where it is due, instead of fostering the image of a weak group of countries. Many emerging market economies are still growing much faster than the advanced economies, and convergence in incomes remains dynamic for many of them.

Russia is a good example of it, not to brag but just to make a point and use it as an example. A flexible exchange rate, inflation targeting, fiscal rule, low public debt provided confidence during the crisis. And hopefully, thanks to the authorities' proactive response, scarring will be limited down the road.

My authorities did not feel constrained by the limited fiscal space or fragility of the banking or corporate sectors. The economy is already on the pre-pandemic trajectory, not just exceeding the pre-pandemic peak output level, but it returned to the pre-pandemic growth path.

One more related point is on the COVID situation and the so-called "great vaccine divide," the way Mr. Gaspar put it today. Today Bloomberg had an article praising the European model in dealing with the pandemic, including the example of Ireland, which had a lot of troubles at the beginning of the year but now has 90 percent of its population vaccinated. The article mentioned the United States economy, the most economically dynamic in the group of advanced countries, as being at No. 28 in the ranking of the resilience to COVID. Countries like Colombia and China are ranked above the United States. They are more resilience. Right after the United States, we see Japan, at No. 29. And then right next to Japan, we see Poland, Chile, Brazil, and Mexico.

So according to this third-party indicator--admittedly, maybe a suspicious one--but there is no drastic difference in this area as well. We should avoid these catchy phrases, the great divide and so on.

I intentionally did not touch upon the issues in low-income countries because the situation may be different for a subgroup of these countries, but I am sure that it is not homogeneous as well.

We would reiterate our call on the staff for additional differentiation within the groups of countries and more nuanced analysis, especially in the outreach exercises we are going to have.

Mr. Bhalla:

We broadly agree with the staff's assessment and policy prescriptions. We have issued a detailed gray statement but would like to highlight a few points for emphasis.

The pandemic has given rise to many uncertainties. One of them has been the inflation conundrum. The recent inflation surprises in some EMEs have led to apprehensions about inflation expectations becoming entrenched. This has led some central banks to raise their policy rates; while others, where inflation risks are moderate, continue to maintain an accommodative stance. The outcome is a significant divergence in interest rates across EMEs. Even though, as noted in forward survey estimates, inflation is expected to start trending down soon and be within range in the next 6 to 12 months.

In this context, the report rightly underscores the point that the rapidly tightening cycle in some economies and declining inflation beyond the short run imply real rates returning quickly to their pre-pandemic level in some countries and even higher in some others. In our view, in the presence of a negative output gap persisting in many EMEs over the medium term, such a sharp tightening of real rates may emerge as a new source of risk to investment and economic recovery.

On inflation forecasts, there is a new wrinkle for the staff to consider. Recent research reports by some Fed Scholars question the role of inflation expectations while starting an end point for many analyses pertaining to the determinants of inflation. Indirectly, this development does support the staff's forecasts, that inflation spikes may be temporary and short-lived.

We take positive note of the observations with regard to climate change. I quote from the report, multilateral support via cross-border technology transfer and climate finance initiatives can help ensure that the transition is not limited only to countries that can afford such mitigation measures, end of quote. We are gratified that the point this chair has been making several times before the Board finds an echo in the staff's recommendations.

My final point refers to the interesting analysis of scarring, as contained in the WEO. The WEO report has explained on pages 14 and 15 that scarring, defined as medium-term economic performance below pre-shock projections, is expected to be pervasive and pervasive so outside the advanced economy group. According to Figure 1.15, output losses, relative to the pre-pandemic trend, are expected to be as high as 9 percent for Asia, the highest in the world. The recent indicators suggest there has been a significant bounce-back in activities in many South and Southeast Asian economies. We would suggest that a more appropriate measure of scarring can be obtained by comparing actual medium-term GDP growth preceding the pandemic and comparing it to the forecast of medium-term growth after the pandemic.

The WEO report -- somewhat unusually and, in our view, somewhat controversially--assesses output loss based on the forecasted level of output before the pandemic, the forecast on GDP growth after the pandemic; that is, in other words, it is a comparison of a forecast with a forecast and conclusions derived. We believe the approach based on good performance would be a more appropriate yardstick to assess the so-called scarring estimates.

The question arises then as to whether the larger forecasted decline for EM output, noted and emphasized by the WEO, is an artifact of the unusual computation method of assessing the long-term impact of the pandemic, rather than what, in reality, should be expected at this highly uncertain and speculative stage.

Mr. Jin:

We appreciate the staff for the insightful analysis and the well-targeted advice in the flagship reports. In addition to our written gray statement, I would like to briefly make a few comments.

On the WEO, we would concur with staff, that a major source of concern is that more aggressive COVID variants could emerge before widespread vaccination is reached. We appreciate the Fund's efforts to strengthen multilateral cooperation on vaccination, and China is working actively to join the global efforts.

The staff's analysis on technology decoupling in Chapter 3 is very important. From a very frank multilateral point of view, a blockade on technology is another type of apartheid policy, which is based on the demonization of a whole country and its people. Multilateral institutions should make it clear that knowledge of science and technology is a commonwealth of the entire human beings. Any attempt to monopolize and manipulate technologies by a small group of people or a small group of countries, no matter under whatever beautiful names, is immoral and is against the spirit of multilateralism.

On the GFSR, the biggest risk in the near horizon is the change in monetary policy in both advanced economies and large emerging market economies. The high debt level and the overvalued asset price associated with the easy monetary policy in dealing with the pandemic crisis will face the challenge of how to deleverage or deflate smoothly.

In dealing with the excessive leverage of Evergrande, market observers noticed that Evergrande, itself, still has quite a large amount of assets, such as land reserves, and that the authorities have the necessary resources and instruments to avoid a damaging shock to the economy.

China is determined to achieve carbon neutrality. It is now clear that – it is a great challenge for China to manage the carbon reduction-related consequences in industrial production, employment, financial stability, and overall economic growth. So international cooperation and international support, including support from multilateral institutions, will be very helpful and important.

The report has mentioned a number of times about the implicit guarantees in China's state-owned enterprises (SOEs). I wonder if those many zombie companies in many other countries also enjoy implicit guarantees. We have emphasized in the past that China's SOEs are separate commercial entities, and the implicit guarantee applied uniquely to China is completely perception-based and has no legal grounds. Investors who make their investment decisions based on the Fund's argument of an implicit guarantee should bear potential legal and financial consequences by themselves.

We also welcome the dedicated chapter on cryptos and associated risks.

On the Fiscal Monitor, looking forward, robust economic growth is the ultimate way to digest the record high debt level. In this regard, it is very important to promote the affordable debt issued for productive investment and to limit expensive debt issued for nonproductive expenses. We encourage the Fund to promote growth-friendly fiscal policies in its policy recommendations and adopt a balance sheet approach for Debt Sustainability Analyses.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath):

I heard one question, from Mr. Pösö, about building buffers outside macroprudential tools. I think that is for Mr. Adrian, so I will leave that to him.

I will just make a couple of comments, one on the topic of inflation that came up a lot. We have been very vigilant on this front. I think our projections, actually, bear out well. Let me give you an example.

By around June of this year, we had projected the core personal consumption expenditures (PCE) inflation for the U.S. for this year, Q4 over Q4 would be 4 percent at a time when the U.S. Fed was projecting 3 percent--at around the same time, they were projecting 3 percent. Since then, I think our numbers have borne out quite well, and the U.S. Fed has moved their projection now to 3.7 percent. It is still short of ours, but that is where it is.

We have been tracking developments on the inflation front. We have said that they are transitory, but they are at an elevated level for a few quarters. We are not talking about months but quarters.

We will continue to pay very close attention to this, including the paper Mr. Bhalla raised, which I took a look at already, which is the paper by Mr. Jeremy Rudd from the Fed on inflation expectations, which is very interesting.

I think the way we have to think about the world, or at least the way I think about it, in terms of the inflation picture, is there are many good arguments for the transitory story; but, overall, the risks are to the upside. While we do believe that we have credible monetary policy, we are working in a time which puts some constraints on policymakers because of asset markets being in this incredibly, Goldilocks kind of situation, with fiscal constraints in some countries. So, again, this is going to be a challenge, and it is going to be an interesting challenge to navigate for policymakers.

The second point I will make, which is something that Mr. Palei brought out on the divergence not being uniform, even within emerging and developing economies. And that is a point well taken. I should have said that at the beginning when I was making my points.

On the point about the great vaccine divide, here, I will say that there is, indeed, that divide. But it is about low-income and developing countries, where the coverage is 4 percent or 5 percent at this point for countries in that group.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian):

We have answered most of the questions in the gray statements.

Let me start with inflation and the potential change in monetary policy and some of the major advanced economies. Messrs. Pösö, Hilbers, Just, and Jin have mentioned that.

As Ms. Gopinath already mentioned, there are supply constraints and logistical bottlenecks that are leading to an increase in inflation. We expect that inflation is going to moderate, so that this high inflation is likely temporary. Having said that, we need to continue close monitoring to make sure that monetary policy does not fall behind the curve. That is also the point that Mr. Hilbers made. Still, monetary policy is expected to remain broadly accommodative for many countries.

Having said that, a number of emerging markets have started to tighten, to counter rising inflation and preempt a possible de-anchoring of inflation expectations. Whether countries remain easy or they start tightening, any monetary policy changes should be well telegraphed in order to avoid uncertainty and disorderly market conditions.

There is still a risk of a taper tantrum, something that Mr. Pösö discussed in his gray statement. It is very difficult to forecast what interest rates are going to do. For example, in the past week, longer-term interest rates have risen by about 10 to 15 basis points, depending on the country. That is associated with a rise in real interest rates, both in the medium-term and the longer term, and they could well reflect worries about the path of monetary policy going forward and potentially a tapering by a number of economies.

Turning to rising inequality, something that Director Buissé mentioned, easy monetary policy certainly benefits households because unemployment is going down. Employment is going up, so there is more income. On the other hand, of course, asset valuations are rising, and asset valuations can get stretched. There are imposing opposing impacts on inequality, but we do certainly see, in a number of countries, that inequality has increased recently.

Talking more broadly about asset valuations, we do see stretching in many countries. And, of course, a rise in asset valuations is an attendant consequence of easy monetary policy, to some degree. The question is, is it an excessive stretching of asset valuations? And is there a risk of a sharp adjustment or a sell-off?

Our recommendation is that monetary policy should aim at macroeconomic objectives, such as inflation and real activity, and that macroprudential tools should be used in order to make sure that underwriting standards are not deteriorating and that leverage is not excessive. Macroprudential tools should particularly be tightened in the area of leveraged lending, underwriting, and housing markets.

Now, in terms of the question that Ms. Gopinath also pointed to, of what other buffers could be built. There are macroprudential buffers; but there are, of course, also fiscal buffers, central bank reserves, and savings, more broadly, that can be built.

Turning to real estate markets. There are many real estate markets where asset prices have run up very quickly. Again, macroprudential policies can be used to make sure that underwriting standards are not deteriorating in parallel with the increase in housing prices. And we have seen in many studies that that can be effective in terms of mitigating housing at risk, but, of course, jurisdictions also have to conduct more granular stress tests.

Concerning investment funds, Ms. Riach mentioned investment funds. Of course, the FSB is currently working on both money market funds and open-ended funds. And we are contributing to this work through the working groups. We do hope for a common approach, such as a global minimum standard in this area. We published, two weeks ago, a departmental paper on investment funds that is covering money market funds, open-ended funds, and emerging market funds, where we are laying out our positions.

When I listen to the FSB discussions, what I hear is that regulating non-bank financial institutions (NBFIs) in a way that minimizes the moral hazard of central bank backstops is certainly first-order goals, at least for central banks. Hence, a macroprudential approach to investment funds is on the agenda. Let me just note that we have changed the language in the

Executive Summary to talk more about the investment funds and our views on that topic.

Concerning the crypto regulations, Director N'Sonde mentioned those in the gray statements. There is an urgent need to regulate stablecoins, wallet providers, and to offer legal frameworks, in some cases. Crypto valuations have risen, and they are very volatile. Regulations should balance both benefits and risks.

Finally, we have started to provide technical assistance on crypto. We are doing both market regulations on cryptoassets, as well as technical assistance on central bank digital currencies (CBDCs) and payment infrastructures. There is a huge amount of demand, as this is a very rapidly changing field, where many countries need help.

On climate finance, better data, better disclosures, and better taxonomies are certainly on the agenda. And we are starting work with the World Bank and the Organisation for Economic Co-operation and Development (OECD) to think about frameworks for taxonomies.

On Evergrande, as Mr. Jin pointed out, the Chinese authorities are doing everything to contain any damage. Evergrande has been downgraded by all major rating agencies. It has missed several payments to suppliers. Hopefully this will not give rise to broader market developments, and hopefully it is not a canary in the coal mine for broader real estate developments in China. But markets are certainly concerned and have certainly reacted very sharply to the news on Evergrande.

The Director of Fiscal Affairs Department (Mr. Gaspar):

I want to start by emphasizing that the "great vaccine divide" expression that Ms. Gopinath has introduced in this debate is a very apt image, and it does have implications that go beyond vaccination, in the sense that this idea of the great divide applies to the contrast between advanced economies and low-income developing economies that we do find in our projections.

From that viewpoint, it is not only the World Economic Outlook; it is also the Fiscal Monitor that has found that comparing paths with forecasts pre-COVID allows one to have an idea of the magnitude of scarring but also about the conduct of macroeconomic policies over time, including, obviously, fiscal and monetary. It is a very useful tool. It does work. In our experience, it has performed substantially better than possible alternatives. We do have a number of charts that use deviations from pre-COVID-19 paths, and that has served us well.

In our policy recommendations, we emphasize vaccination, and that was very much supported. We emphasize climate change. And we emphasize the constraints on financing of vulnerable countries that often are low-income countries. These three global challenges are very correlated when it comes to low-income developing countries, and that creates an urgency in the development challenge for this group of countries. And the emphasis on the SDGs was made by a number of Directors, and that is a very important priority for the Fund, including in the context of the rechanneling of SDRs.

We also have put a lot of emphasis on the use of fiscal policy as a development tool. We are emphasizing, in the context of the Sustainable Development Goals, the importance of having a coherent macro-fiscal financial framework, very much in line with what Directors have supported in this dialogue.

In terms of future work, we have work in the pipeline on fiscal rules and frameworks. We are going to continue working on that because it is one of the most relevant topics that most policymakers around the world want to see deepened. And, of course, we have quite substantial work on climate also in the pipeline, and we expect to have the resources, allowing us to expand and deepen in the future.

Mr. Palei:

I just wanted to clarify that, of course, we do not deny that access to vaccines, vaccinations, and all the broader issues involved are extremely important. In fact, in our written statement, we were very explicit that we fully support the initiative by Ms. Gopinath, Chair, the Fund and other international organizations. And we also welcomed the creation of the task force, that was a recent development, to support this initiative and take it further.

I was talking just about the differences between the emerging market economies and advanced economies, which are not that stark, from our point of view. I just wanted to clarify this one issue.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian):

When I discussed Evergrande, I forgot to mention that a number of Directors asked us to add a paragraph on Evergrande in the GFSR, which we are happy to do.

The Chair:

We propose WEO and the Global Financial Stability Report to be published on October 12, 2021, and the full Fiscal Monitor on October 13, 2021. The Analytical Chapters of the WEO, the GFSR, and the FM will be released ahead of time, in advance of the publication of the full documents.

The Chair adjourned the discussion.

ANNEX

- Gray Statements
- European Central Bank Statement
- Staff Responses to Executive Directors' Technical Questions
- Presentations
- Constituency Codes

GRAY/21/2735

September 23, 2021

**Statement by Ms. Lim, Mr. Mochtar, Mr. Nghiem, Mr. Bautista, Mr. Chea, and Ms. Yoe on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021**

We appreciate staff's comprehensive assessment of the global economy.

World Economic Outlook

The global economy continues to recover despite persistent challenges, but downside risks remain, as economic slack prevails. As such, continued vigilance in monitoring and risk assessment is critical. We share the view of staff that global economy could recover less than projected from the July review. The extent of negative supply disruptions should be more carefully assessed especially as regards impact on trade and inflation in EMDEs, which are already facing labor mobility constraints due to resurgences in infections. On top of the risk factors identified in the WEO, uncertainties on return to normalcy in travel, tourism, and remittances should be carefully analyzed to see how they will play up to the balance of risks, and we would welcome staff detailed analysis in this regard in the next update.

The prevailing uncertainties and widening gaps in recoveries within and across countries call for stronger international efforts for a more aggressive vaccine deployment to manage the health crisis. *On adequacy of financing, staff may comment on the implementation of the 40 percent target vaccination for 2021 and 60 percent for 2022 under the Fund-proposed $50 billion plan, given country initiatives, vaccine donations, and the potential need for booster shots.*

Policies that help diffuse innovation, adopt technology, and promote and enhance digitalization, will raise long-term productivity. Together with policies that prioritize climate change mitigation, these will hasten recovery to pre-pandemic levels and contribute to global economic resilience. The identified factors to adoption and diffusion such as investments in R&D, collaboration, education, state of financial markets should be complemented by country-specific factors for more accurate, targeted, and effective policy interventions.

Meanwhile, national policies should be well-tailored and balanced, contingent on the state and prospect of the pandemic and the existing policy space. Central banks should look beyond temporary inflationary pressures and avoid tightening policies prematurely until there is more clarity on underlying price dynamics, conditional on expectations remaining firmly anchored. While we broadly agree with the medium- and long-term policy recommendations in the WEO, we encourage staff to reflect in future reports, the policy challenges confronting countries and potential approaches under the IPF. The policy challenges could include limited fiscal and monetary policy space given the need for further stimulus to contain the scarring effect of the pandemic, measures to address volatile capital flows post the massive QE in AEs, and medium-term policies in addressing climate change and digitalization. To bolster economic resilience to supply chains disruption, countries could also explore means to diversify the supply network, switch locations, or reconfigure their business models.

We urge staff to monitor even more closely the key indicators used to forming policies, especially the assessment of economic slack. In this context, the Fund's surveillance tools, technical assistance and timely policy advice are critical. Meanwhile, some authorities may encounter difficulty in data collection and quality, as the need to respond to the pandemic may have diverted resources away from surveillance. In this regard, the automation, digitalization, and related efforts that help advance data management and enhance efficiency in some jurisdictions justify their wider applications.

While the WEO presents a downward revision in economic outlook, ASEAN5 posts significantly larger reduction for 2021 while EMDEs shows an upgrade. *Staff may explain the key reasons behind this divergence.* Our authorities believe that careful calibration of exit strategies is crucial and should depend on evolution of domestic and global developments and spillovers.

Global Financial Stability Report

We welcome the well-chosen theme of "Navigating the three Cs: COVID, crypto and climate" for the GFSR. These three trends have the potential to reshape the global financial system and clearly warrant policymakers' attention. We commend staff for the well-balanced analysis of the topics, pointing out the financial stability risks and vulnerabilities that could stem from them if left unchecked as well as the opportunities.

On the pandemic response, we agree that policymakers should take early actions including through tightening selected macroprudential tools to address financial vulnerabilities. As the pandemic continues unabated, prolonged policy support and accommodative monetary policy has started to put upward pressure on inflation in some countries as well as result in overly stretched asset valuations. Policymakers need to gradually normalize and withdraw unprecedented support while keeping an eye on potential tightening of financial conditions that could interact with elevated financial vulnerabilities and put growth at risk in the medium term. To guide policymakers to better implement monetary policy normalization, we welcome staff to recommend appropriate monetary operation strategies that will strengthen monetary policy transmission amid abundant global liquidity. Having better monetary policy efficacy will be helpful for policymakers to achieve stability and guard against volatile liquidity conditions.

EMEs need to guard against the risk of capital flow volatility amid an increasingly asynchronous global recovery. As noted in the GFSR, sharp tightening of global financial condition could trigger large and sudden capital outflows from emerging markets. EMDEs should rebuild buffers as appropriate and implement structural reforms to strengthen their resilience against the adverse impact of capital flow reversals. That said, as structural reforms will take time, EMDEs will need tools in the near term to address the risks of capital flow volatility. We thus look forward to the implementation of IPF and the review of the IV to equip EMDEs with greater flexibility in dealing with sudden and large capital outflows with an optimal policy mix.

Fiscal Monitor

We broadly agree with the thrust of the report which aims for global fiscal policy to address on-going challenges and support the transformation of economies to boost productivity and economic growth in the medium term. Fiscal policy should also be designed to build economies that are more resilient to future shocks. Given the divergence in fiscal and economic developments across countries, we underscore that designing of fiscal frameworks, including the choice and calibration of the long-term fiscal target should depend on country-specific characteristics. However, at this current juncture, start-stop economic recovery due to the spread of Delta variant has made some EMDEs pivot their fiscal policy to fight pandemic, and expenditure priorities have been shifted toward pandemic-related emergencies in the short term. Nimble fiscal policy adapting to new circumstances is therefore warranted.

Fiscal policy should continue to be supportive as economic recovery is jeopardized by prolonged pandemic with the spread of new virus variants. Emergency spending needs to be accompanied by measures that ensure transparency, accountability, and efficiency of public spending. While we agree that medium-term fiscal frameworks should be put in place to ensure fiscal sustainability, the imposition of taxes on property, progressive income taxation, and corporate and capital taxation needs to be in accordance with the stages of economic recovery with forward-looking communication strategy.

Downside risks are elevated given the course of the pandemic and its impact on long-term economic growth remains uncertain. For EMDEs, shorter maturity of public debt and low tax revenues constrain governments' capacity to service debt. Borrowing costs could also rise faster than expected once central banks start to remove the exceptional monetary support. In this regard, we encourage staff to engage closely with the authorities to tailor policy mix for a smooth exit of support measures to ensure sustainable recovery in the medium term.

We welcome staff's analysis on the spillover effects that originated from AEs, especially from the EU and US support packages. Negative spillovers will depend on the response of monetary policy in those countries towards their domestic inflation; and highly leveraged countries that are susceptible to changes in financing costs would be harmed by higher interest rates.

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GRAY/21/2736

September 24, 2021

Statement by Mr. Chodos, Mr. Herrera, Mr. Hendrick, Mr. Lischinsky, Ms. Bustillo, and Mr. Corvalan Mendoza on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

1. **We thank staff for the comprehensive set of flagship reports.** We broadly agree with staff's assessment of the major challenges and risks at the current juncture, and key policy recommendations. Global economic recovery continues despite the resurgence of the pandemic, while international financial conditions remain benign despite rising inflation. However, significant gaps in recovery prospects persist between country groups amid sharp differences in vaccine access and policy support.

2. **As the pandemic approaches two years and uncertainty about its end persists, emerging market and developing countries (EMDCs) are facing difficult trade-offs** as their policy space has shrunk, social conditions have deteriorated, and global financial conditions could tighten in the short term. At the same time, major structural challenges related to climate change, digitalization, and rising inequality demand the urgent attention of authorities. Global cooperation to ensure universal access to vaccines and a strong international financial safety net, together with sound policy frameworks and ambitious domestic reforms, are key elements to ensure a successful exit from the crisis and advance the transformational agenda. These issues are clearly highlighted in the flagship reports and, especially, in the analytical chapters, which address several of today's major challenges. However, we would have preferred to focus at least one of the GFSR analytical chapters on the immediate challenges to recalibrate financial policies and strengthen corporate balance sheets, especially in EMDCs where fiscal support has been weak, recovery is slow, and financial conditions are tightening.

In the following, we offer some specific comments on recent economic and financial developments and policy recommendations.

World Economic Outlook

3. The WEO projection for global activity is almost unchanged since July but the balance of risks is tilted to the downside. Recent economic activity data has fallen somewhat below expectations in advanced economies (AEs) and China, offset by improvements in commodity exporters. We welcome the upward revision of growth projections for Latin America and the Caribbean. The improvement reflects not only external factors, such as the recovery in world trade and export prices, but also domestic factors such as progress in vaccination and policy support. We highlight the slow recovery of employment and labor participation across many economies with different income levels and different labor policies. Likewise, the employment of youth, women, informal, and low-skilled workers in EMDCs continues to lag other groups, especially in Latin America. These developments deserve further research, as well as tailored policy advice. On the balance of risks, we highlight the emergence of new virus variants and the possibility of a sudden stop to emerging market economies (EMEs) as the main downside risks ahead.

4. The main novelty in the WEO refers to the generalized increase in inflation across the membership. Since the Spring meetings, inflation figures in advanced economies and many EMDCs have surprised significantly to the upside, although recent data has been more subdued. Average inflation in AEs is now projected to be at 3.5 percent by the end of in 2021 compared to less than 2 percent in April. Similarly, inflation projections for Latin America, Emerging and Developing Europe, and Sub-Saharan Africa have been significantly revised upwards. The focus in WEO Chapters 1 and 2 on inflation and its drivers is timely and highly relevant. Uncertainties are fueling worries that inflation could stubbornly exceed central bank targets and unmooring expectations is a serious threat. Case studies confirm that persistent “inflation scares” could lead to higher inflation expectations. The materialization of this risk would dent households’ income purchasing power, hurting especially the vulnerable in emerging markets.

5. We concur with staff’s assessment that the main drivers of rising inflation are pandemic-related supply bottlenecks, one-time service fee corrections, and higher commodity prices. Staff analysis concludes that, even under extreme scenarios, on average, headline inflation is expected to converge to trend by early 2024. However, there is great uncertainty about inflation prospects. While the report recommends that “central banks can generally look through transitory inflation pressures and avoid tightening until there is greater clarity on underlying price dynamics”, with due warnings about monitoring expectations, many central banks in EMEs are already withdrawing monetary stimulus concerned that inflation may linger for a longer time in some EMDCs, because of elevated food prices, lagged effects of higher oil prices, and exchange rate depreciation. We encourage staff to put more weight on the balance of risks, as seen by central banks in EMEs. Box 2.3 on policy responses and expectations in inflation acceleration episodes is handy at this juncture. Clear forward guidance and communications from major central banks will be crucial to avoid a sudden stop situation in EMEs. The unwinding of monetary stimulus will require close monitoring from the Fund to mitigate adverse financial spillovers effects.

6. At the multilateral level, the most urgent task is to accelerate universal vaccination. We welcome the reference in WEO Chapter 1 to the IMF proposal to speed up universal vaccination. We also support the call to strengthen the global financial safety net, ease financial constraints to struggling countries, and tackle debt vulnerabilities. As countries unevenly emerge from the crisis, tensions in the global financial system will increase. The extraordinary efforts to provide financial assistance to low-income countries (LICs) are essential to resume their development paths. At the same time, many middle-income countries are facing financing constraints and unsustainable debts that limit their policy response to the pandemic. The recent SDR allocation has helped alleviate immediate liquidity pressures among the most vulnerable members, but new rechanneling mechanisms through the PRGT and the proposed RST will be essential. Also, more needs to be done through grants, concessional loans, and initiatives such as the G20 Common Framework for debt relief and the extension of the DSSI, as well as the relief of Fund surcharges during the pandemic.

7. We welcome the focus on the transformational agenda towards a greener, more digital, and productive economy. WEO Chapter 1 provides an interesting analysis on the labor market implications of the transition to a low carbon economy (Box 1.2), and the *Commodity Special Feature* presents an analysis for "energy transition" metals (copper, nickel, cobalt, and lithium) and their implications for decarbonization and commodity exporters. We highlight, however, the wide confidence bands around these long-term projections due to uncertainty about future mitigation actions and technical progress.

8. WEO Chapter 3 addresses the vital role that basic research plays in increasing productivity and long-term economic growth. Basic research and scientific knowledge are critical components of innovation and their diffusion is wider and longer lasting than applied research. We broadly concur with the finding that innovation in EMDCs has particularly benefited by access to international research, both basic and applied. Cross-country citations in patent applications provide valuable clues about the drivers of the international knowledge transfer. Staff analysis of the economic consequences of scientific decoupling illustrates the importance of maintaining a cooperative, symmetrical, and transparent framework for sharing basic research and scientific knowledge. The analysis could be complemented by further exploring the role of corporations in facilitating or slowing down the dissemination of knowledge in EMDCs. See also, Box 3.3. Intellectual Property, Competition, and Innovation. At the same time, we encourage further analysis of how to improve access and transfer basic research and how to better adapt it so it can be translated into innovation that supports economic growth and development.

9. We highlight that positive spillovers and underinvestment in basic research and scientific knowledge is also an important concern for EMDCs. We would welcome further analysis on effective actions to encourage research in EMDCs, particularly given that policy levers may be more restrictive than in AEs. A more general discussion of the relative effectiveness of alternative instruments beyond subsidies to fund basic research directly or to encourage the private sector is needed, including how to foster an effective interaction between governments, academia, public research institutes, and the private sector. The success and failures of these three sectors' interaction have been analyzed in Box 3.1. mRNA Vaccines and the Role of Basic Scientific Research of the report.

Global Financial Stability Report

10. GFSR Chapter 1 presents a positive of the baseline scenario for global financial conditions and credit. Despite the resurgence of the pandemic, somewhat weaker economic data, and rising headline inflation, global financial conditions remain relatively benign across AEs and EMEs. Long-term international interest rates have declined since the spikes around the Spring meetings. Corporate balance sheets have strengthened amid the global recovery and improved operating cash flows and the compression of risk premiums, while bankruptcies in AEs have fallen short of expectations. Capital flows to emerging and frontier economies have continued as sovereign, and corporates tap international bond markets. The capital position of global banks remains strong and can support international credit. At the same time, we agree that credit measures should become better focused and tailored to hard-hit sectors, while strengthening the framework to address debt-overhangs and facilitate efficient capital reallocation in EMDCs where fiscal support has been limited, and the recovery will take longer. We missed further development of these issues in the GFSR.

11. However, we agree that financial risks remain elevated. The global recovery is lopsided across countries and sectors. There is lingering uncertainty about the length of pandemic and the strength of the ongoing recovery. Rising inflationary pressures could trigger an abrupt correction of monetary policy in AEs at a time of high public and private debt and stretched valuations in financial and housing markets. Our main concern is a sudden tightening of financial conditions and capital flows to emerging and frontier markets. We also share concerns about the buoyancy of house prices across many jurisdictions.

12. The rise of the crypto ecosystem presents new opportunities and challenges, but systemic risks to global and national financial stability still appear limited at the current conjuncture, in line with the assessment of the Financial Stability Board (FSB) in 2018. GFSR Chapter 2 provides evidence that, in just a few years, the reach and breadth of the crypto ecosystem has grown and expanded rapidly, opening important micro prudential issues to ensure the integrity, security, and privacy of new means of payment. However, we are skeptical about the immediate threats of the new digital landscape for the stability of the domestic and international monetary and financial systems. It is an open question whether these developments will have generalized macro-critical implications and over what horizon these changes will occur.

13. The Fund can play an important role to ensure that the international monetary system (IMS) and financial system remain stable and efficient, including its near-universal membership, core focus on macro-financial policies, broad expertise, and links with monetary, fiscal, and financial authorities through surveillance and capacity development. A gradual and prioritized strategy focused on the most pressing narrow issues around policy definitions and capacity development is preferable, with a focus on the needs of EMDCs. We agree that regulation should become proportionate to new risks and surveillance should focus on those economies with less sophisticated financial systems, where this new ecosystem might represent a macro-critical problem due to bank disintermediation or currency substitution.

14. We broadly agree that the sustainable investment fund sector can complement the transition towards a greener economy, but the sector is still small to make an impact. As GFSR Chapter 3 notes, important challenges lie ahead to foster its development, including advancing harmonized disclosure and audit standards, generally accepted classifications, and indicators of green activity. We highlight that the same challenges apply to other financial instruments and sustainable investment funds aimed at fostering inclusive economic and social development in EMDCs. Considering the nature and size of sustainable investment funds, their financial risks are clearly not macro-critical but could hamper their future development.

FISCAL MONITOR

15. We welcome the focus on the challenges for fiscal policy in a still highly uncertain environment. An effective framework needs to adjust swiftly to changing circumstances, particularly with regards to the pandemic conditions, ongoing social and economic developments, and available policy space. If private demand recovers more rapidly than expected in AEs, fiscal policy should be tightened, as this would reduce the risk of a sudden correction of monetary policy. In the case of EMDCS, in addition to the low availability of vaccines, the recovery is held back by reduced fiscal space that, in many cases, is aggravated by severe borrowing constraints and financing costs sensitive to sovereign debt risk interest rates and global financial conditions. As staff notes, debt is expected to remain high with significant increases in government financing needs in the coming years, therefore, strengthening medium-term fiscal frameworks is key to foster a sustainable recovery. Governments need to buttress their medium-term fiscal frameworks, while maintaining well-targeted fiscal support, rebuilding buffers, and making progress on transformational reforms.

16. We concur that fiscal policy needs to focus on protecting the poor and enhancing growth prospects. In this regard, we stress the importance of strengthening social protection systems, which help to mitigate the impact of the pandemic in countries. On the revenue side, measures to improve the efficiency of tax collection, avoiding evasion and elusion, and strengthening the progressivity of tax systems should be an increasingly important part of the fiscal effort to rebuild more equitable economies. At the multilateral level, a global minimum corporate tax and a meaningful reallocation of taxing rights to source countries would also facilitate efforts towards a more resilient and inclusive recovery.

17. Fiscal Monitor Chapter 2 explores the challenges faced by the membership to strengthen the credibility of public finances in the coming years. Fiscal support has been critical to protect lives and jobs, but the legacy of higher public debt has increased fiscal vulnerabilities. All countries, with different degrees of urgency, need to convey the message that governments cannot continue indefinitely to finance their spending through debt. They need to restore fiscal buffers for future crises and convince markets of their commitment to sound fiscal policy, while spending related to the pandemic and borrowing is still ongoing.

18. There is not a solution that fit all cases, and each country will need to adopt the best strategy in line with their specific circumstances. As staff correctly points out, prior to the pandemic, some economies already had legacies issues like aging population in AEs or developments needs in LICs and EMEs. On top of that, and particularly for EMEs and LICs, expected tightening of monetary policy in AEs will have a negative impact on countries with high debt levels. In many cases, recovering fiscal sustainability was already a major challenge prior to the pandemic. Thus, it is a big question mark how these issues will be addressed in the future.

19. We agree that a credible fiscal framework will make the transition easier and less costly in term of financing cost and speed of the adjustment. Again, we believe that the answer depends on each country's characteristics, their current public debt level, existing fiscal space, growth prospects, and future revenues. In turn, these factors will help to outline the fiscal targets and rules that work better in each country. The question is how to establish a fiscal framework that is credible and sustainable for all parties involved, including but not restricted to investors. History, leadership, and institutions are also critical to build a credible fiscal framework. A clear communication is essential too, but this comes after some degree of credibility is already in place. As recognized by staff, it is not easy to achieve the three overarching goals of an ideal fiscal framework: sustainability, economic stabilization, and simplicity.

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September 24, 2021

Statement by Mr. Bevilaqua, Mr. Saraiva, Ms. Mahabir, Mr. Velloso, Mr. Barroso, Mr. Coelho, and Mr. Coronel on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the comprehensive analytical material that will comprise this Annual Meetings' flagships and would like to offer the following comments on each of the documents.

World Economic Outlook (WEO)

The global economy continues to recover – with a narrower gap between emerging and advanced economies – despite lingering concerns with a resurging pandemic. Renewed pandemic-related restrictions combined with a strong rebound in demand have led to global supply bottlenecks, dampening the pace of recovery and putting upward pressure on inflation. On the positive side, commodity exporting emerging market economies (EMEs) have benefited from improved terms of trade fostering their growth prospects. The vaccine rollout gap between advanced economies (AEs) and EMEs is closing, reducing scarring in EMEs – a point that could be better emphasized in the WEO. While we take note of the upward revisions in potential growth for some AEs due to higher public investment, we point to equally important structural reforms in EMEs, where the focus is shifting from emergency assistance to well-targeted support and medium-term fiscal frameworks. That said, low-income countries (LICs) still face sizeable vaccination rollout challenges, including from limited access to vaccines, and should receive full support from the international community to improve not only their economic and health prospects but also the global resilience to the pandemic.

Labor market performance is expected to improve moving forward. As vaccination coverage progressively improves and income support measures become better targeted, labor market participation will tend to increase and service sector employment opportunities will pick up. Governments can facilitate this transition in segments that could take longer to rejoin the labor market, such as the youth and women by promoting, for example, the safe resumption of school and pre-school services. As mobility increases, informal labor markets in EMEs and LICs could surprise on the upside, leading to a faster than expected reduction in unemployment. This point could be usefully stressed in the WEO. As the labor market improves more consistently, governments should try to close the gap between informal and formal markets, boost fiscal revenues, and better fund and enhance the coverage of social protection schemes. Better targeted spending and higher revenues would improve fundamentals and buffers to withstand the shift towards tighter global financial conditions once the recovery takes hold.

Inflation pressures have been broad-based and persistent in many countries, raising the stakes for monetary policy in the context of a still fragile recovery. Goods price inflation has been significant and encompasses core items in the consumption basket. The lagging response of labor market participation could also add pressures to service sector inflation. Several central banks in EMEs are tightening monetary policy, as needed, to anchor inflation expectations and ensure that potential growth is not hurt by adverse inflationary dynamics, a significant threat in several economies. Central banks in major AEs have so far stressed the temporary nature of the inflation acceleration while signaling the intention to taper large-scale asset purchase programs as the recovery strengthens. Tapering and future liftoff of quantitative easing in major AEs should be carefully calibrated and communicated to avoid disruptive market dynamics and spillovers, as well illustrated in the corresponding adverse scenario in the WEO. Although there may have been cases of smooth tightening of global conditions, this is not the historical norm. We therefore must remain mindful of potential disorderly movements as the world economy transitions away from a prolonged period of extremely easy financial conditions. Even if initially constrained to more vulnerable economies, contagion may become widespread down the road. In addition, possible spillbacks from disturbances in emerging and developing markets, not only from volatile capital flows but also from a further resurgence of the pandemic, should be taken very seriously.

We broadly agree with the policy recommendations to support the recovery. On the domestic front, this includes well calibrated monetary and fiscal policies – including stronger medium-term frameworks with more efficient revenue and spending profiles. On the global front, coordinated financial support to the most vulnerable economies remains high on the agenda, not only to boost vaccination that is crucial for removing threats to the global recovery, but also to increase fiscal and financial resilience with improved buffers. The IMF's role in this global effort cannot be overstated. Trade and tax cooperation are crucial for sustainable investment and inclusive growth. Here we voice our concern that emerging market and developing economies need to be treated fairly in any such arrangements. Admittedly not the lead actor in these areas, the IMF should engage with key partners and support its membership, as needed, in line with the discussions in more specialized fora.

We caution against specific recommendations to mitigate climate change that preempt discussions at the Board. Implementing an international carbon price floor may have unintended economic consequences, with significant spillover effects on development and growth, income distribution and poverty. Before the Executive Board takes a stance on the desirability of adopting such policy, we would encourage further analysis by staff on possible tradeoffs and spillovers for establishing an international carbon price floor, especially in emerging markets. Having said that, while we welcome the call for compensation mechanisms, we believe it would be necessary to go beyond the domestic dimension by offsetting any impact of climate change mitigating measures on global inequality. Furthermore, it is difficult to discuss financing and compensation options when many countries still lack the institutional tools to develop their own carbon markets.

We take note of the detailed analysis of the risks to the inflation outlook in Chapter 2. We agree that the scenarios for inflation are highly sensitive to a host of factors that are difficult to assess, including economic slack, supply shocks and both fiscal and monetary policy credibility. That said, the ongoing recovery, recurring bottlenecks and highly accommodative policy stances suggest upside risks to inflation. The empirical link between slack and inflation explored by staff points in this direction. The evidence from proxies of good anchoring and the historical episodes of de-anchoring of inflation expectations also suggest the importance of policy credibility. We welcome the consistent progress towards higher monetary policy credibility in emerging market economies – a key factor enhancing resilience going forward.

We welcome the analysis on research and innovation (Chapter 3) and encourage staff to explore policy options to boost cooperation between advanced and developing economies. We highlight the importance of international knowledge spillovers to foster innovation in emerging market and developing economies. The analysis rightly states that facilitating technology transfer, collaboration, and the free flow of ideas across borders are critical. We encourage staff to explore not only the policies and institutional reforms that could bolster research and innovation domestically, but also how IFIs could play a catalytic role in promoting cooperation between advanced and emerging markets in sharing basic and applied knowledge. International channels for cross border technology transfers are key drivers of innovation and productivity, sustaining global convergence over time.

Global Financial Stability Report (GFSR)

We take note that financial vulnerabilities are broadly unchanged from the previous GFSR. Indeed, financial conditions remain accommodative on the back of continued public support to cope with a resurging pandemic. While credit conditions have not deteriorated, tail risks continue elevated, mainly in sectors lagging in the recovery, and particularly in China where regulators have been more concerned with excessive leverage and less willing to provide a public backstop. As argued in the GFSR, easy financial conditions could also be leading to excessive leverage and unsustainable asset prices, particularly in nonbank financial institutions.

On the other hand, the resilience of the well capitalized banking sector has been key to cope with the pandemic. Banks have adopted efficient screening services, with no evidence so far that credit extended with public support has been riskier than other credit lines. In this respect, we disagree with the GFSR assessment that the WEO growth projections are too high relative to loan market projections. Indeed, we see projected bank lending in line with projected economic growth, considering the tail risks for growth and sector specific credit risks.

We broadly agree with the policy recommendations to support financial stability. Financial conditions cannot be expected to remain at the current level for much longer. Central banks in major AEs should be transparent and craft a careful communication strategy about normalization prospects to avoid wrong footing financial markets. In addition, AEs should urgently develop macroprudential tools to cope with the build up of risks in asset prices and credit markets, with transparent response functions for worst case scenarios. On top of that, in line with the recommendations to strengthen the recovery, EMEs should improve their fundamentals to better cope with volatility in international markets. Also, EMEs should not hesitate to rely on exchange rate flexibility when appropriate and, under specific circumstances in case of significant disruptions, targeted foreign exchange interventions or capital flow management measures.

Financial stability risks due to developments in the crypto-assets eco-system continue to be of concern. Since the rise of bitcoin, there has been a rapid development of products in the crypto universe. At present, some of the key questions surround the impact of stablecoins, decentralized finance, and central bank digital currency. These new technologies bring with them a host of issues for financial stability – e.g., their impact on payment systems, AML/CFT frameworks, regulation, and data gaps. There are numerous risks associated with the adoption of new products, including operational, cyber, and governance risks. Staff's policy recommendations seem sensible and in line with those from various other international organizations examining closely the issue of crypto assets. We highlight that country authorities have been extremely cautious with new developments and have the right incentives to rise to the challenges.

We welcome staff's investigation into the links between investment funds and the greening of the economy. As climate change issues have become more prominent, there has been a movement towards directing investments into green sectors. Staff notes that while the number of sustainable investment funds is relatively small, this sector has been growing. We have seen some sovereign wealth funds, for example, divesting from the fossil fuel sector, while others now disclose the share of investments into this sector in the overall portfolio. We appreciate staff's development of indicators of exposure of investment funds to transition opportunities and carbon intensity, a basic check on the green credentials of investment funds, and the initial study of their link to greener outcomes at the firm level. At the same time, we wonder about the ease with which other institutions would be able to apply the methodology to undertake their own examination of exposure. Also, the industry is in flux with the shift of investor preferences, and further assessment will be necessary to uncover long-run effects of these developments. As always, we underscore that market-based solutions, which tend to be more efficient and long-lasting, would be preferrable.

Fiscal Monitor

We welcome staff's well documented analysis and advice regarding fiscal developments in the aftermath of the pandemic as well as suggested strategies moving forward. Though fiscal and debt strategies and their timing will ultimately depend on country specific factors – including debt level, fiscal space, and access to financing – we agree with staff on the fundamental approach. First, it remains critical to commit to medium-term fiscal sustainability, which can buy flexibility in the near term, as needed. Second, it is key to strengthen fiscal frameworks while increasing the credibility of fiscal policy to enhance market confidence and facilitate access to financing. And third, it requires mapping out medium- and long-run strategies to preserve (or restore) a healthy and sustainable debt level while remaining mindful of the risks. Ultimately, the approach should strike a balance between (i) avoiding premature tightening of fiscal and monetary policies that could delay and weaken the recovery, and (ii) preventing fiscal slippages that could erode market confidence and worsen the fiscal and debt outlooks.

The road ahead is mired with challenges and difficult tradeoffs. Such dilemmas could be further complicated under conditions of a pandemic resurgence, lower revenue mobilization, and limited external financing. In addition, as countries gradually move towards a post-pandemic fiscal rebalancing and stabilization, several risks must be considered. Among them, a prolonged period of high uncertainty, lower than expected growth, increased fiscal vulnerabilities, scarring, more frequent and severe climate-related shocks, and possibly sooner and sharper interest rate hikes. Given the probability of one or more of these risks materializing, fiscal buffers need to be rebuilt. The task ahead seems daunting. According to staff, to bring debt to pre-crisis levels by 2045, the average annual primary balance during 2024–45 must be higher than in 2010–19 by 0.3 percent of GDP for AEs, 1.0 percent of GDP for EMEs, and 0.6 percent of GDP for LICs.

The pandemic has exacerbated underlying global asymmetries. The massive and wide-ranging fiscal responses to the pandemic, particularly by AEs and some EMEs with larger buffers, ample access to financing, or solid pre-pandemic fiscal positions, have been appropriately proportional to the unprecedented shock. However, many EMEs and most LICs have generally had more difficulty in sustaining a strong fiscal support to deal with the recurrent waves of contagion and their human and economic consequences. In these countries, scarce resources and supply issues have also prevented an adequate vaccination deployment. Countries that have already overextended their limited fiscal and financing capabilities and are still struggling to control the pandemic are frequently left with insufficient resources and access to vaccines. In this context, global vaccine solidarity could play a decisive role for many developing countries. Hence, we welcome the recent commitment by major AEs to ensure access of vaccine to all, globally.

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September 24, 2021

Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, Mr. Cartagena Guardado, Mr. Rojas Ramirez, Ms. Arevalo Arroyo, Ms. Lankester Campos, Mr. Lopez, and Ms. Moral Betere on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the comprehensive set of flagship reports. We largely concur with staff's analysis on the prospects and risks of the global economy and financial markets, along with their main policy recommendations. The recovery is taking ground, amid worrisome surges of the COVID-19 pandemic, which are deepening economic scarring—especially in countries with low vaccination rates—and keeping uncertainty at high levels. Furthermore, in a globalized world, uneven vaccination developments are having worldwide implications through health spillovers and economic channels, such as international trade and travel or supply chain disruptions, with negative consequences for global economic activity and prices. Therefore, the already tested success of vaccination to contain the virus and to facilitate the recovery should be at the center of our message to the public. The uneven scares of the pandemic and challenges ahead call for the Fund and IFIs to remain closely engaged with authorities in advising and supporting economic policies based on country specificities. The Fund's communication narrative and the policy recommendations in the flagships should remain well-tailored considering that one-size doesn't fit all. Finally, we believe that the IMF should send a strong message to the international community on the need to resolve trade tensions and reverse the trade restrictions that have been accumulated. The IMF should give more relevance to the topic of how global value chains are changing and adapting to the post-COVID economy. Following that, we offer some specific comments on the reports.

World Economic Outlook

We note the minimal downward revision in the world growth rate during the projection period, although with a heterogeneous pattern between and within regions. The aggregate growth figure masks significant downward revisions in individual country forecasts, especially in advanced economies, some large emerging economies and LICs, in contrast with upward revisions in other countries. This heterogenous pattern should be better reflected in the report, specifying if the downward revisions are associated with past negative surprises or with a weakening of economic prospects going forward.

Vaccination continues to be the top policy priority. The intensity of the rebound in activity after the gradual reopening of the economies is still largely dependent on public policy support and, more importantly, on vaccination developments. Both variables are consolidating a divergent recovery between and within countries, with lower growth rates seen in countries where the incidence rate of the virus is higher, vaccination rates are lower, and policy space is limited. The success of vaccination is a determinant of health and economic developments. The Fund must be outspoken on the need to accelerate vaccination at a global scale.

Risks remain high and skewed to the downside. We appreciate staff's analysis of risk scenarios, especially on inflation dynamics and pandemic developments. We also see significant risks related to an increase in policy trade-offs, due to the persistence of the pandemic, in a context where policy choices are constrained and the room to maneuver is fading. The risks associated with economic divergence during the recovery and a faster than expected tightening of monetary policy in AEs, with unintended consequences for global financial conditions, are still very relevant and merit close and continuous monitoring.

We appreciate staff's analysis on inflation prospects and risks. We agree that inflationary pressures are temporary in the baseline projections, and mainly related to supply bottlenecks and surges in commodity prices. Nevertheless, inflationary pressures, even those motivated by external and exogenous shocks, also respond to country-specific circumstances, which could lead to more persistent and generalized movements in a number of LMICs. A differentiated and tailored analysis of inflation dynamics is therefore guaranteed to assess future developments, risks, and the adequate policy response.

On policy recommendations, multilateral efforts are paramount to address global challenges with significant spillover effects. A coordinated multilateral action is needed to accelerate vaccination in vulnerable countries—while ensuring financial support if needed, including dealing with debt vulnerabilities—along with cooperative efforts to recover past trade liberalization trends, finalize agreements on international taxation, and coordinate policies on climate change mitigation and transition.

At the national level, policy recommendations should be country-specific and adapted to pandemic developments and the economic context. Policy options are becoming limited in the context of a more persistent crisis. The economic policy mix should be well coordinated and calibrated to support the economy and avoid cliff effects. Comprehensive indicators of the pandemic situation will help to place a timely shift in policies from crisis to recovery mode. Fiscal policy support should be gradually adapted to the specificities of each country and targeted to the most vulnerable groups and sectors. At the same time, policy makers should strengthen the fiscal frameworks in the medium term to ensure sustainability, including a rationalization of expenditures and revenues based on growth-friendly budgets, along with reforms to enhance public governance and institutions. On monetary policy, it is essential to preserve the credibility of the policy frameworks, while supporting the economy with a clear communication strategy to underpin policy actions (in this respect, we welcome Box 1.3).

The recovery will benefit from policies focused on ensuring inclusive and sustainable growth. During the recovery, fiscal policy should prioritize resource reallocation to limit scarring, as well as adequate levels of social and education spending to improve potential growth. Active labor market policies, along with policies to reduce informality and improve the investment climate, and the implementation of public investment plans to support the digital and green transitions, should be core elements of a comprehensive reform strategy.

Global Financial Stability Report

The pandemic has proven to be a longer than expected resilience test for the global financial system. We broadly concur with the overall assessment, policy advice and vulnerabilities highlighted in the report, particularly for countries with a narrow policy space. We are concerned about the negative effect a sharp tightening of the monetary policy stance of advanced economies may have on capital flows and financial pressures in frontier economies, especially those with debt sustainability concerns. These will be the most vulnerable economies of our membership and their medium-term growth is at risk. We strongly support the call that central banks, in particular in advanced economies, must be timely and clear in their communication. Major central banks have had an instrumental role in supporting the global economy by providing liquidity. Their guidance about future policy stance is key for the abovementioned and for anchoring inflation expectations.

Policy makers around the globe face a trade-off between near-term growth and medium-term financial stability, but the Fund's risk analysis and policy advice must be tailored to country-specific characteristics. Going forward, macroprudential policy should gradually emphasize the medium-term resilience of the financial systems while supporting the banks' capacity to lend. Also, the Fund will have a large role to play in closely assessing the soundness of the financial systems and the impact of spillovers from policy changes in leading economies.

Banks entered the pandemic in a strong position, although potential losses may emerge. A more protracted pandemic, along with rising levels of public and corporate debt, may impose longer-term structural vulnerabilities on banks' balance sheets. Regarding the corporate sector, risks have somewhat faded, although pockets of vulnerabilities remain among small firms, which deserve close monitoring and a more comprehensive assessment. Finally, on the housing market, we agree that this market should be further monitored, and the authorities should be ready to deploy macroprudential tools if needed, although banks' underwriting standards for mortgages remain seemingly sound so far.

Fiscal Monitor

Fiscal policy should prioritize pandemic-related expenditure and support a sustainable recovery, while taking due account of the country-specific fiscal space and the challenges to fiscal sustainability. We note with concern the uneven fiscal priorities among countries, given the different phases of the pandemic and the available fiscal space. In advanced economies, fiscal policy has started to shift towards supporting the recovery through long-term investments (digital transition, green economy, and economic inequality) and they will have to address the demographic challenges. In many LMICs, the focus remains on supporting households due to the low availability of vaccines. In addition, many LMICs have limited fiscal space, high financing gaps, and low access to international or domestic capital markets or access at such a high cost that it could lead, as staff rightly points out, to rising poverty, inequality, and ultimately to social and political unrest. Many emerging markets face important policy tradeoffs given the increased debt levels and the need to attend to the necessary fiscal consolidation while keeping the economic recovery process.

Although positive spillovers from the fiscal response in advanced economies are expected, we concur with staff that international cooperation remains instrumental in supporting the recovery of the most vulnerable countries. In this regard, we commend the IMF for taking a leading role and co-sponsoring the Multilateral Leaders Taskforce to try to speed up global vaccine access to promote economic recovery, and for its engagement with LMIC. We also share staff's view that further assistance through grants, concessional financing, SDR re-channeling and, in some cases, debt restructuring, will be needed. In this regard, we welcome the achievements made within the DSSI and urge quick implementation and increased participation in the G20 Common Framework.

Risks stemming from large public deficits and elevated debt-to-GDP levels (including the realization of contingent liabilities) remain high. The Fund must remain vigilant about countries' exposure to swings in global interest rates. In this regard, we support staff's call for a good mix between fiscal and monetary policy, particularly in advanced economies, by re-tuning fiscal policy if inflationary pressures increase.

World Economic Outlook Analytical Chapters

Chapter II: "Inflation Scares"

We welcome this very timely chapter, as the current juncture of potential "inflation scares" poses a substantial and tangible threat to the recovery, mostly for emerging markets that could suffer the effects of higher inflation and the spillover effects of a monetary tightening in advanced economies. Against this backdrop, understanding the drivers of the inflation outlook and its risks is of utmost importance. In that vein, we are encouraged by the analysis noting that inflation is expected to revert to pre-pandemic levels in the short term and that so far, long-term inflation expectations continue to be anchored. Nevertheless, given this is subject to uncertainty, a stocktaking of the dynamics, outlook and risks and its effects on inflation expectations' anchoring is warranted. We broadly agree with the policy implications, in particular with the need to have country-specific policy advice. However, in addition to credible communication, we would continue to underscore the importance of putting in place strong monetary policy frameworks that include central bank transparency and independence. In this regard, we positively note that emerging markets have had exceptional progress in anchoring expectations in the past decades, but in some cases, work remains to be done to enhance the institutional characteristics that allow for better anchoring. We would also highlight the role of flexible exchange rate regimes, which, when in hand with a credible monetary policy track record and independence, make countries better suited to absorb external shocks with a lower exchange rate pass-through to consumer prices and without potential de-anchoring of expectations.

Chapter III: "Research and Innovation"

We praise staff for the analysis on the role of basic research in fostering innovation and productivity growth within an endogenous growth theory framework. It is a timely analysis in a global context in which productivity growth has been slowing, despite increasing innovation efforts, over the last decades. The main findings show that basic research impacts favorably on innovation and productivity growth, both directly and through international spillovers. We welcome the fact that supporting private research through subsidies, as well as fostering public research expenditure, could improve growth in the post-pandemic era. This may help support higher public debt levels and additional social expenditure in a post-pandemic world. We also share the view that deeper financial markets and better education systems are key facilitators for cross-border technology adoption, helping promote scientific collaboration across borders, especially in emerging economies.

Global Financial Stability Report

Chapter II: "The Crypto Ecosystem and Financial Stability Risks"

The analysis of the crypto ecosystems and financial stability is timely. We welcome the insightful staff's assessment of the crypto ecosystems, especially the focus on EMDEs, with a well-balanced discussion between their opportunities and macrofinancial risks. It is also worth noting that crypto adoption has been higher in these countries. In this vein, we underscore the importance for the Fund to remain strongly engaged in the discussion on this topic with country authorities as it is increasingly relevant. We acknowledge that for countries that are lagging behind in financial deepening, these developments may be perceived as useful means through which productivity and financial inclusion may be enhanced. We find summary table 2.1 insightful as a road map to approach the dialogue and advise members on financial stability concerns and policies to address those issues. We underscore that further research on this topic, as well as a balanced approach of potentialities and risks by mission teams, will be instrumental for a constructive engagement with country's authorities. Further efforts to provide advice on regulation and supervision of the financial system, considering the macro-linkages and a wider perimeter of regulated entities, will be crucial to reduce risks in countries that consider embracing these developments. In addition, an adequate set of tools to deliver sound and tailored CDs to the membership will be instrumental in timely responding to these new topics of discussion. *We note the mention of inadequate operation and regulatory frameworks in EMDEs. In this regard, it would be useful to understand how EMDEs can work towards stronger investor protection risks and regulation in cases where crypto exchanges are not registered in their own jurisdictions.*

Chapter III: "Investment Funds: Fostering the Transition to a Green Economy"

Green finance is crucial to the climate change challenge. We particularly welcome this chapter and thank staff for their conceptual framework and empirical analysis on assessing the transition towards sustainable funds. We concur with their appraisal of the role of the financial sector as a catalyst of private investment towards these funds. However, more emphasis on cross-border collaboration to address challenges and scale up the process is needed. We concur with staff on the importance of requiring clear regulatory frameworks to avoid greenwashing. Therefore, we emphasize the staff's urgent call to policy makers for a global climate information architecture, particularly the investment fund labels as we believe they are key for their upscaling, and for the design of a proper regulatory oversight; accountability is crucial for the sustainable funds' medium-term growth.

Fiscal Monitor

Chapter II: "Strengthening the Credibility of Public Finances"

We found that the discussion contained in chapter two of the Fiscal Monitor is very topical and relevant. We concur with staff that the post-COVID period provides an opportunity to revise fiscal targets and rules, and that the pace and timing of fiscal adjustments primarily depend on country-specific factors. We also agree that fiscal frameworks should seek to achieve three overarching goals: sustainability, economic stabilization and, for fiscal rules in particular, simplicity. Fiscal frameworks should include realistic and transparent goals to build and preserve credibility, which at the same time is crucial for buying time and flexibility, allowing policy makers to devise a more gradual adjustment. In addition, building credible fiscal frameworks would allow a better understanding of the difficult trade-offs that policymakers face. Against this backdrop, strong and timely assistance from the IMF will be crucial for countries with capacity constraints. *We encourage staff to further work on how countries should re-design their fiscal frameworks to achieve new and more realistic objectives, considering the reforms and investments envisaged in the recovery while preserving credibility. Some preliminary insights are welcomed.*

We concur that a low (r-g) situation will likely persist for a long time, notwithstanding the need to be mindful of the risks of a potential reversal arising from both sides (r and g), and of non-linearities in the relationship between debt and growth at high levels of debt. Regarding the capacity of EMEs to carry debt, we concur with staff that many of them have entered the pandemic with better fundamentals and institutions, and with a more favorable composition of public debt. *However, they have also seen a large increase in corporate debt, especially denominated in foreign currency, over the past decade. Could staff comment on the effects that this may have on rollover risks and therefore on the capacity to carry debt?*

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GRAY/21/2739

September 24, 2021

Statement by Mr. Huh, Ms. Grant, and Mr. Parkyn on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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Executive Board Meeting 21/96
September 28, 2021

We thank staff for the comprehensive and well-integrated set of reports that emphasize that the recovery remains broadly on its expected track, but with heightened challenges and uncertainties. There has been some slowing in economic momentum given the resurgence of the pandemic and supply disruptions. It is concerning that the divide between countries continues to widen. We welcome the focus in the reports on fiscal and monetary policy frameworks, as credible frameworks will help navigate increasingly difficult policy choices. The Fund will need to continue to provide well-tailored, country-specific policy advice to navigate challenges.

Outlook

The global economy continues its gradual recovery. Projected economic growth of 5.9 percent in 2021 has been downgraded slightly since the July 2021 WEO Update and projected growth in 2022 remains at 4.9 percent. However, this masks a widening global divergence, with a downgrade of 0.6 percentage points for low-income developing countries due to slower progress on vaccinations and more limited capacity to provide policy support.

The widening global divergence is concerning for both social and economic reasons. As a constituency that spans advanced and emerging market economies, as well as small island states, we clearly see the differences that arise from the strength of health systems, social safety nets and economic diversification. Near-term divergences are likely to leave lasting impacts, with persistent output losses for emerging market and developing economies. Tourism-dependent economies are expected to suffer large, persistent reductions in activity compared to pre-COVID forecasts. We stress that economic scarring is still a big unknown and that policy choices will be an important determinant.

Labor markets have been hit hard and their recovery is expected to lag the output recovery. Women, youth and lower skilled workers have been most adversely affected in emerging market and developing economies. Youth participation rates have declined much more than the participation rates for prime-age workers in both advanced and emerging market economies. If participation gaps persist, there could be severe medium-term implications. Scarring may also be compounded by structural shifts. Staff project that economies will reach their pre-COVID output levels by the end of 2022, while only two-thirds will regain their earlier employment levels. *Can staff elaborate on the structural causes of sluggish employment growth by region or country income group? What signs are staff seeing of labor reallocation in economies and how is it shaping labor market outcomes?*

Output and labor market dynamics face potential further complications from inflation dynamics. Inflation has risen significantly in the US and some emerging market and developing economies with supply-side factors playing a key role. Inflation is projected to return to pre-pandemic levels by mid-2022 in most economies, but this depends on the supply-side factors being transitory, which partly depends on the pandemic, and inflation expectations remaining well anchored. We urge staff to continue to assess inflation indicators, the persistence of supply-side factors and risks around inflation expectations. It is also noted that structural factors affecting inflation, including automation, are expected to continue. *Staff comments would be welcome on whether the return of 'pre-pandemic' inflation means a return to the structurally low inflation environment that persisted before the pandemic, and the influence of the pandemic on structural trends, particularly saving, consumption and investment behavior.*

Risks

We agree with the assessment that growth outcomes over both the near- and medium-term are more likely to disappoint than surprise on the upside. The continued use of scenarios is most welcome, although the endemic scenario seems plausible given recent outbreaks of the virus. Policymakers are increasingly confronting challenging tradeoffs in maintaining near-term support and preventing the build-up of medium-term risks. The Fund's policy advice will need to keep these risks and difficult trade-offs firmly in mind.

There are significant risks around the trajectory of the pandemic and global divergences. We note the assumption that broad vaccine access is achieved in the advanced economies in 2021, in most countries by end-2022 and by some in 2023. If advanced economies recover more quickly and withdraw stimulus earlier, this may hit emerging market and developing economies through interest rate shocks, heightened debt rollover risks, and potentially destabilizing capital flows. These risks are heightened given the upside risks to inflation. We expect these risks to be mitigated through clear communication by central banks.

Financial stability risks remain elevated from pockets of excessive risk-taking and possible overvaluation of financial and property assets. In the current environment of low interest rates and ample liquidity, greater use of financial leverage to boost returns could prompt volatility in financial markets. House prices have increased sharply in many advanced economies. If house prices overshoot sustainable valuations, there is a risk that debt overhangs and resource misallocation weigh on potential growth. Fund advice should also take account of the structural features of different housing markets, including supply-side constraints and restrictive regulation.

Fiscal risks also continue to build. There is less policy space at this stage of the crisis to handle further setbacks and large government financing needs are a source of vulnerability, especially in emerging markets and low-income developing countries. The realization of contingent liabilities could also lead to unexpected increases in public debt. We anticipate a significant increase in debt vulnerabilities, and while the G20 Common Framework will assist low-income countries we are concerned that implementation has been slow. Further, should debt issues extend to middle-income countries, the Fund and the international community will need to be ready to respond.

Policies

Efforts to speed up global access to vaccines are critical, alongside increasing widespread testing and investing in therapeutics. The flagship documents continue to make a compelling economic case for widespread distribution of vaccines. The documents also rightly highlight that the increase in international liquidity provided by the historic general SDR allocation may also assist with vaccine and health measures. The impact of the allocation could be further enhanced through voluntary SDR rechanneling from countries with strong external positions to the most vulnerable members. Further enhancements to the Fund’s lending toolkit may also be required to respond to developments, but any enhancements would need to be in line with the Fund’s mandate and supported by appropriate enterprise risk management.

The Fund must continue to provide well-tailored country-specific policy advice. Policy choices have become even more difficult. Advice on the policy mix should continue to be tailored to country-specific pandemic and economic conditions, aiming for maximum sustainable employment while protecting the credibility of policy frameworks. It should also be mindful of the range of possible shocks facing different countries and examine policy changes to build resilience and adapt institutional frameworks to manage risks.

Fiscal policy needs to correspond to economic conditions. For some economies, this will mean measures remain focused on addressing the economic and social fallout from the pandemic, while for those with broad vaccine coverage it will mean a shift towards sustaining the recovery and structural reforms. The pace of withdrawing support and rebuilding buffers will depend on country-specific economic conditions, considerations of the overall macroeconomic policy mix and fiscal vulnerabilities. While the crisis is not yet over, especially for emerging market and low-income economies, and support should remain in place, there is an increasingly delicate balance needed to reduce debt and financial stability risks. This is critical for those members who entered the pandemic with already weak economies and limited policy space. As such, the focus in the Fiscal Monitor on medium-term frameworks is welcome. Credible medium-term fiscal frameworks can improve tradeoffs between providing cyclical support now, building buffers for future shocks and advancing long-term structural goals. The Fiscal Monitor provides a good discussion of issues and tradeoffs, including the trade-off between fiscal rules and flexibility. *Staff comment on how the Fund plans to assist members with fiscal frameworks would be welcome.*

Credible monetary policy frameworks are critical. We agree with staff that it will be important to look through transitory inflation pressures so long as inflation expectations are well anchored. Monetary policy should remain accommodative to support the recovery while safeguarding medium-term financial stability risks. Macroprudential policy should be used to address specific financial stability concerns and to help avoid an unduly broad tightening of financial conditions. We encourage staff to work with members to assist them to find ways to build buffers to protect the financial system. Work on extending the policy toolkit to the non-bank financial sector should also begin immediately given rising fragilities in this sector indicate a deterioration in stability foundations. We cannot afford to have these vulnerabilities evolve into structural issues. Further, the Fund's surveillance and analytical capability will increasingly need to consider the unwinding of unconventional monetary policy.

There is also a broader need to take early actions to avoid a legacy of vulnerabilities and to limit systemic financial risks. Emerging and developing economies should prepare for an increase in advanced economy interest rates through debt maturity extensions where feasible, thereby reducing their rollover needs. They should, while leveraging the allocated SDRs, rebuild buffers and implement reforms that build resilience to capital flow reversals and abrupt increases in funding costs. The Fund should be prepared for its work on the Integrated Policy Framework (IPF), and the review of the Institutional View on the liberalization and management of capital flows, to be placed into the limelight to guide the use of IPF tools to secure macroeconomic and financial stability in the face of possible volatile capital flows. The work on crypto asset risks in the GFSR is also important in helping members deal with operational and financial integrity risks, with the priority of this risk being country-dependent.

Structural reforms should focus on sustainable and inclusive growth. Public investment in physical capital, human capital and healthcare, and strengthening social safety nets, would be beneficial. Structural reforms will also need to be mindful of any scarring from the pandemic, requiring clear diagnosis of its extent and causes. There are key challenges and opportunities around facilitating new growth opportunities related to green technology and digitalization. Mitigating and adapting to climate change will require a range of different policy measures, and the WEO highlights that investments in basic research may have green benefits.

Support for multilateral frameworks will also be important for sustainable and inclusive growth. Through the flagships and broader multilateral surveillance, the Fund can present a strong case for open and transparent trade and highlight the negative effects of trade frictions, protectionism and disrupted supply chains. Diffusing and resolving trade and technology tensions and strengthening the rules-based multilateral trading system, as well as completing the global minimum corporate taxes agreement, will be important for global economic potential.

In the current complex and uncertain environment, small developing states face particular difficulties. High quality grants and concessional financing are critical for LICs and SDS where they have limited or no access to markets. For Pacific Island countries, the Fund cannot play its traditional catalytic role as they have not requested UCT programs, which puts greater emphasis on delivering support through surveillance and capacity development and providing advice on how to respond effectively despite very limited fiscal space. Where travel is constrained, potentially for sustained periods, the Fund will need to invest in hybrid models for delivery. Key policy issues with which the Fund could assist, in coordination with other IFIs, include how to support health systems, invest in human capital and most importantly how to face the macro-critical challenges of climate change, where the most pressing issues are transition and adaptation, rather than mitigation.

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September 24, 2021

Statement by Ms. Riach, Mr. Ronicle, Ms. Andreicut, Ms. Campbell, Mr. Chrimes, and Ms. Nelson on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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The pandemic recovery continues to evolve; supply disruptions have brought inflation to the fore across much of the membership, while the earlier challenge of achieving broad vaccine coverage remains. **We commend staff for an excellent set of papers that have adapted the Fund's focus to the changing landscape of the pandemic without losing sight of ongoing challenges.** Although the emergence of inflation is an important development, the central challenges facing policymakers remain unchanged: vaccinate populations globally; recalibrate policy as the recovery evolves amid ongoing uncertainty; and act to achieve a sustainable and inclusive longer-term global recovery, including by addressing climate change. These challenges come out clearly in these flagships, complementing the focus in the Managing Director's Global Policy Agenda.

We broadly share staff's assessment of the near-term outlook. Vaccines have opened the way to a strong rebound in global economic activity. The rapid recovery in demand, supported by accommodative policy stances, has run up against supply bottlenecks, generating temporarily higher inflation. Ongoing vigilance to ensure that these trends do not become more persistent is crucial. It is encouraging to see that the combination of vaccine rollout and policy support will allow advanced economies to return to their pre-pandemic growth path, even if we see a downside risk to the staff projections from the likelihood of smaller fiscal action than anticipated in the US. We were struck by the expectation that emerging market output will remain materially below the pre-pandemic path as late as 2025; *with the pace of vaccine rollout in emerging markets accelerating, could staff elaborate on why this gap is not expected to close, unlike the projections for advanced economies.*

The outlook for low-income countries is sobering. In a context where extreme poverty has already risen, vaccine coverage stands at only 4%, expected growth has been revised down and food and commodity prices are now rising. Human capital has been set back and disparities are growing, with the young and low-skilled particularly badly affected. Moreover, it is notable that upside risks to the baseline forecast are broadly applicable to wealthier countries, while downside risks crystallizing would leave lower income countries even more vulnerable – so divergence (against pre-pandemic projections) could be even more severe than the central case implies.

Vaccinations are key to putting the global recovery on a stable footing and powering the recovery. We must not underestimate how far we have come, and how fast. The first vaccine programmes were initiated at the start of this year; today over 6 billion doses have been administered globally and one billion people have been vaccinated in just the past month. Nevertheless, low-income countries are being left behind, with only 4% of the population fully vaccinated; addressing this should be a global imperative. We welcome the IMF's "Plan to End the Pandemic" and the focus in the flagships on the role of testing and therapeutics; we look forward to further updates on the monitoring of progress, including from the Multilateral Leaders' Taskforce. Staff set out a compelling health case for rapid global vaccination – the WEO could perhaps have done even more to draw out evidence on the economic benefits of vaccination.

Beyond vaccines, further multilateral action is required to underpin the recovery. The general SDR allocation represents a vital financial shot in the arm for the global economy. Nuanced policy advice from staff on how countries should use these SDRs is a priority in the coming months. This support must be reinforced by channelling SDRs to help vulnerable countries finance more resilient, inclusive and sustainable economic recoveries and health related expenditures. The PRGT must be adequately resourced to ensure that the IMF is able to support low-income members with appropriate levels of concessional financing. Successful implementation of the Common Framework, with timely and substantive engagement from all key creditors, is critical, with a growing number of members at high risk of debt distress and vulnerable to a deterioration in economic and financial conditions.

As the recovery progresses, the private sector should increasingly drive growth, facilitating the recalibration of policy support. We need to recognise that policy recalibration is not just a technical challenge, but also a political one, particularly against a backdrop of rising poverty, ongoing uncertainty and limited policy space. This will be especially true in contexts where spending needs are imminent but where reforms will take time to yield a dividend. Being sensitive to these political economy constraints will be critical for ensuring realism in policy advice.

- **Fiscal policy should be increasingly targeted to where it is most needed, as private sector demand picks up and savings are unwound.** Ongoing support should be anchored in credible medium-term frameworks, which may warrant restatement. Committing in advance to specific tax and spending measures will reinforce the credibility of such frameworks. We agree that extending debt maturities and reducing balance sheet mismatches where possible will help in preparing for tighter global financial conditions.
- **Monetary policy will need to be nuanced and flexible to deliver on mandates.** Staff's more granular advice in these flagships is very welcome. With inflation pressures likely to be temporary (with inflation returning to pre-pandemic ranges in 2022 in most cases), policymakers should be able to look-through recent developments, especially where inflation expectations are well-anchored or remain below-target and policy frameworks are well-established. Nevertheless, in economies where hard-won credibility is at risk and where inflation expectations are materially above target, the trade-off is sharper and there may be a case for tightening now, as we have already seen in a number of prominent emerging markets. In all cases clear communication will be essential.
- **Prudential policy will also need to adjust.** We agree that the banking system has played an important role in sustaining economic activity. But where the recovery is taking hold and where pockets of vulnerability are emerging, support will need to be more focused and targeted macroprudential actions may be warranted.

Multilateral action will be even more crucial in achieving a truly transformational recovery, tackling both long-standing issues and new ones revealed by the pandemic.

***Climate change* remains the most serious collective challenge we face, with profound implications for macroeconomic and financial stability.** With the window for effective action closing fast, COP26 is a critical opportunity for countries to renew their commitment to keeping global warming below 1.5C. Backing this up will require difficult and concrete actions – though with global borrowing costs at historical lows, now is the time to invest in the climate transition and strengthen policy plans for the transition. We welcome the policy recommendations in the WEO and coverage of sustainable investment funds in the GFSR, and we encourage staff to consider the role that other parts of the financial sector can play in the transition to net zero. We would also have liked to see a dedicated climate chapter in the WEO, in line with previous calls, though we recognise the prominence of climate analysis in recent flagships. Further tailored and well-calibrated policy advice on the macroeconomic implications of climate change must be an important part of IMF global and bilateral work going forward. We welcome the attention in the commodities special feature to metals linked to clean energy transitions; as the world moves towards necessary net zero targets, the dynamics of commodity markets will inevitably shift too, so more analysis on these sorts of issues is helpful.

***Safe openness* will be vital to sustaining the recovery, allowing countries to reap the benefits of supply chain integration and capital flows.** We agree that trade barriers should be reduced and WTO reform accelerated. We welcome the analysis of global financial conditions in the GFSR, including the "Key Highlights" innovation. We broadly agree with the policy recommendations and found the focus on vulnerabilities in China, climate and crypto particularly timely. However, we think that the GFSR could have highlighted more clearly that underlying vulnerabilities in the investment funds sector remain, as exposed by the March 2020 "dash for cash" episode. In this context, we stress the ongoing efforts of the FSB and highlight that the immediate priority should be to raise the ex-ante resilience of investment funds against liquidity risks, as the development of macroprudential tools will take time.

We welcome much of staff's analysis on the crypto ecosystem and financial stability implications, but had some concerns that parts of the chapter could be interpreted as inadvertently endorsing crypto assets. We consider that a more cautionary tone would be appropriate, particularly when thinking about EMDEs who are considering the adoption of crypto assets. In particular, the chapter would benefit from references to the G20 workplan on improving cross-border payments, which aims to address issues in existing payments infrastructures and delivers on many perceived benefits of digital money without relying on riskier and untested technology.

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Statement by Mr. Fanizza, Mr. Massourakis, Ms. Quaglierini, Mr. Spadafora, Ms. Cerami, Ms. Korinthios, Ms. Mastrapasqua, and Ms. Mateus on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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We thank staff for a set of excellent Flagship reports. The global recovery continues, despite the resurging pandemic in parts of the world. However, this favorable development takes place amid large differences in vaccination rates that may pave the way for diverging near-term economic and social prospects. The downward revision in projections for Low-Income Developing Countries (LIDCs) in 2021 reflects the impact of the differentiated access to vaccines. Moreover, some LIDCs are also suffering from a significant increase in food prices. Policy support efforts to achieve more rapid inoculation and even access to vaccines remain paramount to sustain the recovery. Policy tradeoffs have become more difficult, because of uncertainties on the nature of recent inflation upticks. We welcome the more nuanced emphasis on inflation risks and the analysis of possible drivers. We broadly share staff's advice on monetary policy, notably the role of central banks' hard-won credibility in shaping up timing and magnitude of their policy response, with a view to keeping inflation expectations well-anchored. We also support the advice on fiscal policy and the stress on credible policy frameworks.

We offer the following comments:

Outlook and Monetary Policy

- **We broadly share staff's overall assessment of the global macro-financial outlook and risks, as well as their policy recommendations**. Current and potential pandemic-related developments – including vaccine hesitancy – remain the main risks to the recovery and keep defining the priorities of the policy responses. We are, however, encouraged that recent economic indicators point to a significantly stronger-than-expected rebound in activity in Europe and justify a more sanguine outlook both for 2021 and 2022.
- The presence of higher inflation risks – despite substantial slack in activity – constitutes the key novelty of the macroeconomic landscape. We agree that the inflation outlook remains highly uncertain at this juncture. Whether inflation expectations stay anchored

depends on the credibility of both monetary and fiscal policies. Markets need to be reassured that: (a) the current exceptionally loose monetary policy stance would not continue indefinitely; (b) government financing needs would be reined in; and (c) government resources would be used effectively to enhance growth prospects through infrastructure investment and policy reforms. **For this reason, we believe that staff's debt projections for countries in our constituency augur well, because they envisage declines in the public debt-to-GDP ratio starting already from this year**.

- **We would like to highlight that there appears to be a case for the surge in inflation to reflect relative-price adjustments** to the economic transformation spurred by the pandemic. To the extent that this is the case, the issue of whether the current rise in inflation is temporary or permanent may lose relevance and it questions the rationale for monetary policy reacting to it. Moreover, the ability of monetary policy to steer inflation driven by sectoral price changes, rather than generalized price co-movements, is at best limited, as shown by a recent BIS paper[1]. *Staff's comments are welcome.* We appreciate staff's analysis (WEO Chapter 2) of the drivers underlying price pressures. The recovery proceeds amidst rising commodity prices and supply chain bottlenecks. However, demand and supply shocks are no longer simultaneous, but patterns are increasingly diverging both across sectors and countries, reflecting differences in the business cycle and supply disruptions. To the extent that supply shocks will dissipate before demand fully rebounds, the recent increase in headline inflation can be expected to subside rather quickly. We concur that this benign scenario seems more likely, especially in Advanced Economies (AEs). The timing and magnitude of the policy response will need to provide scope for "looking through" transitory inflation uptick rather than react to temporary deviations of inflation from their policy targets.
- **Strong monetary and fiscal frameworks, as well as sound and credible communication, are key to anchoring inflation expectations.** While we agree that a faster-than-expected normalization of monetary policy might trigger a tightening of global financial conditions, clear communications by central banks can help mitigate risks. We would also stress the role of supply-side measures – such as product and labor market reforms and trade liberalization – in alleviating bottlenecks.
- **The WEO (Section on "Employment Growth Projected to Lag Output Recovery")** states that, for a variety of reasons, employment is expected to lag output growth for a large share of economies. All advanced economies are set to regain pre-Covid output levels by the end of 2022, but only two-thirds of them to regain their employment levels. The analysis on recent employment developments across groups of countries highlights differences by workers' characteristics, such as age, gender, and skill. In examining these patterns, it would be worth also looking at the types of newly created jobs, i.e., whether job creation has been increasingly tilted towards fixed-term positions. *Staff's comments are welcome*.
- **We very much welcome the GFSR's analyses of developments in financial markets and risks to financial stability**. Since April financial conditions in AEs have further eased despite a resurgence of the pandemic and waning optimism. This suggests that

[1] *Monetary policy, relative prices and inflation control: flexibility born out of success,* BIS Quarterly Review, September 2021.

central banks communication on monetary policy has been effective. Policy tradeoffs and risks to financial stability are broadly the same as in April; the latter reflect: (a) robust risk appetite: (b) stretched asset valuations; and/or (c) possible inflation surprises leading to a faster-than-expected normalization of monetary policy in AEs. In this regard, we concur with staff that early and selective activation of macroprudential tools can address pockets of elevated vulnerability while avoiding a broad tightening of financial conditions.

- **Improvements of profitability in the corporate sector in both AEs and EMDCs constitute favorable developments**. Credit quality has also improved, and the expected wave of bankruptcies has not materialized. However, risks in the housing markets have risen, driven by exuberant house price increases and an expanded role of nonbank financial institutions (NBFIs). In this regard, we welcome staff's analysis of the expected credit intensity of growth (Chapter 1, Paragraphs 53-60), whereby the estimates of banks' loan growth turn out to fall short of the "GDP-consistent" loan growth. This points out that an expanded role of NBFIs can produce also benefits, not only to risks.

The Role of Fiscal Policy

- **We share staff's analyses and policy recommendations in the well-written Fiscal Monitor**, which we find well attuned to the current juncture and balanced. In a context of still high uncertainty, fiscal policy should remain focused on containing the impact of the pandemic, limiting scarring, and wherever possible facilitating the recovery and transformations to make economic systems more productive and resilient. Climate change, digitalization and inequality remain key priorities that also provide opportunities to be seized upon.
- **We agree with staff that fiscal policy should adapt to rapidly changing conditions**. The pace of withdrawing fiscal support will have to depend on country-specific economic conditions and vulnerabilities, in light of the progress in the recovery. We note that, on average, most of the announced government guarantees have not been used in several countries, therefore limiting the size of contingent liabilities. However, economic divergences have been growing, with advanced countries being able to deploy a larger support than emerging economies and low-income economies.
- **We welcome staff's analysis on the spillovers from both the EU and US recovery plans**. Nevertheless, we would have expected a clearer recognition of the importance of the EU response in shaping the recovery in the region, because of the progress in the implementation of the Next Generation EU Plan, since many EU countries already got the approval of their Resilience and Recovery Plans and some countries benefited from disbursements. **The EU package could transform European economies and make them more resilient against current and future challenges**, because it focuses on public investments and green and digital transitions.
- **We appreciate staff's discussion on how to strengthen the credibility of fiscal frameworks** to address the delicate balancing act of supporting the recovery while ensuring debt sustainability. Communication is certainly essential to convey a credible

message, together with independent fiscal institutions and transparent public finances. As many countries have applied escape clauses to their fiscal frameworks, we welcome staff's elaborations about whether and under which conditions it would be appropriate to consider revising those frameworks.

Analytical Chapters

- **We welcome Chapter 3 of the WEO that looks at basic research as a key driver of innovation and productivity**, and, ultimately, of growth. The share of basic research has been steadily declining over the past three decades; thus, we stress the importance of science for innovation and growth. In fact, a lesson from this pandemic is that research spending carries significant payoffs.
- **Staff point out that the benefits of basic research** are diffuse and difficult to internalize for private firms. Staff's suggestions to increase public research expenditure and doubling subsidies to private research seem well motivated. We underscore the criticality of ensuring the free flow of ideas and scientific collaboration across borders.
- **We appreciate the analysis in Chapter 3 of the GFSR on the contribution of private sector investment to greening the economy**. A more sustainable economic model and a successful transition require mobilizing private finance in a large scale. We take the recent increase in assets under management of sustainable funds as an encouraging sign of investors' appetite for environment-friendly assets. **We particularly welcome the opportunities to the corporate and financial sectors in the transition to a more sustainable economy**.
- **The findings that investors in sustainable funds** have a longer-term investment horizon is reassuring for both sustainable financing and financial stability. We agree on developing a **climate information architecture to provide investors with more reliable information and avoid greenwashing**.

GRAY/21/2742

September 24, 2021

Statement by Mr. Alhomaly, Mr. Keshava, Mr. Abalala, Ms. Alzamel, Mr. Rawah, and Ms. Alhawas on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the well-written reports, which rightly focus on the economic and financial consequences of the health crisis as pandemic-induced divergences are deepening. Although the worst phase of the crisis could be behind us, concerted multilateral and national efforts are still needed to allow for a rapid return to normalcy and for a more focused efforts on the medium- and long-term challenges. With many effective vaccines now available, the immediate global priority is to accelerate the rollout of vaccines, including through ramping-up production, facilitating exports, and donating excess doses to achieve global vaccination targets. Addressing the immediate social and economic impact of the pandemic while safeguarding financial stability is also a near-term priority. At the same time, rising inflation across a number of economies and the difficult trade-offs facing policymakers require careful attention. Against this backdrop, we would like to offer the following comments.

World Economic Outlook

We welcome the continued global economic recovery despite the persistence of the pandemic, albeit the recovery remains subject to high uncertainty. Also, we take note of the slight downward revision of the global growth projection for 2021 reflecting the lower growth prospects in AEs and LICs. Here, we welcome the report's focus on the key factors influencing economic growth, including access to vaccines, supply disruptions, and global trade restrictions. We consider that trade-related issues deserve particular attention as the Fund continues to shape its policy agenda going forward. In addition, we note with concern that divergent output and employment recoveries are more prominent in EMDEs than AEs mainly due to the limited policy space and low vaccination rates. If left unchecked, these developments would result in long-lasting setbacks to the global gains against inequality and poverty with disproportionate impact on the vulnerable groups. Therefore, we urge the Fund to remain vigilant and keep its focus on achieving durable and synchronous recovery. Furthermore, collaboration with other IOs would be critical going forward especially during this multidimensional crisis facing the global economy. Analyzing the role of research and innovation, in Chapter 3 of the WEO, is a welcome contribution to advance global discussion on how to boost productivity and growth potential.

We find the focus on inflation dynamics timely and relevant. We particularly welcome staff's analysis of the downside scenario of the risk of rising US inflation expectations. Here, we take note that if this risk materializes triggering a sudden policy tightening by the Fed, the global growth projections will be negatively affected with EMEs suffering disproportionally. What would be of a more concern, though, is the limited room for the EMEs to support recovery in the wake of tightening financial conditions. *Staff are invited to comment on the potential risk of rising inflation and unemployment simultaneously - "stagflation" - and the policy implications, taking into consideration the path of the pandemic, the duration of supply disruptions, and the possible evolvement of inflation expectations.* Despite the perception that inflation pressures would be transitory, close vigilance and monitoring are particularly warranted due to the significant uncertainty. On the same note, we share staff's views that the spillovers especially from asynchronous monetary tightening must be at the core of the multilateral policy discussions. In this regard, it is critical for the monetary policy to remain data dependent and attentive to evolving conditions with careful communication about the envisaged path of monetary policy.

We broadly share staff's views on the policy recommendations to strengthen recovery. We agree that both national and multilateral efforts are needed to strengthen global economic prospects. National policy response should continue to be adaptive to evolving pandemic and macroeconomic conditions. To that end, the Fund's active role in providing tailored policy advice and capacity development would be instrumental especially for countries where institutional capacity remains a challenge. Beyond the current pandemic-crisis, we reiterate our support to the global efforts to collectively address long-standing challenges, including inequality, fragility, digital transformation, and climate change. On climate specifically, we are surprised to find the international carbon price floor under the recommended multilateral actions as part of the ideal policy mix while, in fact, it simply lacks multilateral consensus and goes against the basic principles of the Paris agreement. In this regard, we look forward to the outcomes of the upcoming COP26 to further coordinate the global efforts towards achieving climate targets. *On the same note, we ask staff to elaborate on the underlying* *assumptions for the oil prices and revenue implications outlined in Table 1.SF.2 as well as the basis for these assumptions.*

Global Financial Stability Report

We take note that financial vulnerabilities remain elevated and broadly share policy recommendations to secure recovery while mitigating financial stability risks. We agree that policy actions need to be commensurate with country-specific circumstances and the evolution of the pandemic. Proactiveness in addressing areas where financial vulnerabilities are building up is also warranted. While it is encouraging to note that capital flows outlook for emerging and frontier markets has improved, sudden monetary policy tightening in advanced economies would have negative repercussions. In particular, possible capital flow reversals and the rapid increase in debt burden could exacerbate existing weaknesses, and hamper economic growth, especially where macroeconomic fundamentals are weak. In this vein, strengthening resilience to external shocks, including through reinvigorating pro-growth structural reforms as well as rebuilding buffers, are key. In addition, pursuing prudent debt management practices and adopting strong debt management frameworks would be important, especially where debt sustainability is a serious concern. In this context, the Fund's close engagement and tailored support would be an important enabler to promote such efforts.

We welcome the analytical work on crypto ecosystem, in Chapter 2 of the GFSR, and agree that it presents both opportunities and risks. In this connection, while risks are not yet systemic, as noted by staff, they could potentially increase in instances where the crypto market is expanding at a fast pace while the regulatory and supervisory operations remain insufficient. The Fund, therefore, should continue monitoring these issues closely and deepening its expertise and the analytical work to support the membership leverage opportunities while safeguarding against macro-financial stability and financial integrity risks.

Fiscal Monitor

We appreciate the staff's assessment regarding key challenges and risks to the fiscal outlook and broadly share the outlined policy priorities. We would like to stress the enormous task facing many countries, especially LICs, to conduct their fiscal policies in ways that must meet four key objectives at the same time, namely (1) supporting the economy during the ongoing COVID-19 pandemic; (2) bringing back the economy on the pre-COVID trajectory through fiscal stimulus; (3) scaling back public debt levels: and (4) investing in green infrastructure. Here, we would underline that these objectives cannot possibly be achieved without appropriate assistance from the international community, including in particular from the international financial institutions. The new SDR allocation and debt service relief, through the CCRT and the G20 DSSI and Common Framework provide critical support especially to LICs. In this context, we thank staff for the analysis on the recent fiscal developments in countries participating in the DSSI in Chapter 1 of the FM (Box 1.2), and positively note that the initiative has helped countries increase their Covid-19 spending and lower sovereign bond spreads. On the G20 Common Framework, we believe it can be further supported by the Fund and the Bank through providing timely information to relevant creditors, including the joint DSA and the estimation of the financing gaps.

Staff have rightly highlighted the importance of developing sound medium-term fiscal frameworks to help inform policy choices, ensure fiscal sustainability and access to finance. We therefore appreciate staff's timely analysis and valuable policy advice in Chapter 2. We concur that flexibility in the fiscal frameworks is important during this challenging period to support exit from the crisis, and that as economies stabilize, fiscal policy actions need to be further anchored on a credible fiscal framework. As fiscal outlook is subject to major risks, continued monitoring and decisive actions, including with regard to potential contingent liabilities, are warranted to address vulnerabilities.

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GRAY/21/2743

September 24, 2021

Statement by Mr. Hilbers, Mr. Voinea, Mr. Manchev, and Mr. Tevdovski on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
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September 28, 2021

The main messages from the April 2021 Flagships remain valid, even though new challenges and policy trade-offs have arisen in the meantime. The recovery will not be complete and remains uneven as long as the virus continues to spread and mutate. While high uncertainty continues and divergence of the recovery has widened, the Fund's research, surveillance, lending and SDR allocation will remain crucial. Not only to provide lifelines to economies but to support structural changes towards good governance and sustainable green and digital economies. In this regard, we particularly welcome the in-depth analysis of the important role that investment funds can play in fostering the transition to a green economy.

Strong multilateral cooperation will be critical during and beyond the pandemic. We believe that multilateral efforts can achieve better results in addressing both the health and economic challenges during the ongoing recovery, given the global nature of the COVID-19 shock and the cross-cutting issues across countries like climate change and digitalization. In the near-term, the top priority remains ensuring rapid and universal distribution of vaccines and treatments. The fact that this is in everyone's best interest could be underlined even more in the report. We agree that enhanced access to vaccines and treatments should be coupled with increased financial assistance and debt relief to vulnerable countries, including through SDR re-channeling, and/or debt restructuring. Priority should also be given to keeping borders open for trade, especially in essential goods, and avoiding export restrictions or other protectionist tendencies – especially in the context of disruptions to global supply chains. Building strategic stockpiles is a better option than invoking trade restrictions.

We could not agree more with the message that global challenges, like climate change, require global solutions. This means both international and national efforts, as international commitments need to be translated into national policies. For the Fund this means that climate should be embedded in the Fund's advice on macro-economic, fiscal, and monetary policies as well. The message of 'a green recovery' should be translated into green policies for the recovery phase. For example, fiscal support for reallocation in the recovery phase could be explicitly linked to the reallocation of resources towards greener activities in or between sectors. We acknowledge that this is a relatively new area in which the Fund might still be building up its expertise, but if we really want to achieve environmental sustainability, climate has to become more embedded in all areas of economic policy making and thus in all areas of the Fund's policy advice. It cannot be seen in isolation and cannot remain a separate topic in the Fund's reports. *Staff comments are welcome.*

We take note of the fact that the global outlook remains stable, although the relatively large revisions for some individual countries or country groups are somewhat worrisome. This is owed in large part to unequal vaccine-access combined with virus resurgence in various regions. Not only does this entail a bleaker near-term outlook for affected countries, but staff notes this also exacerbates medium-term scarring. We therefore concur with staff that it is imperative to speed up global vaccination efforts and reiterate continued support to the ACT-A initiative and its COVAX facility. Given that the extent of policy support remains among the main drivers of divergence in the recovery, interaction between fiscal and monetary policy could be further explored in the reports. In particular, the IMF should have a view on "optimal" sequencing for fiscal and monetary policy normalization, and whether different sequencing patterns could have divergent economic effects**.** In addition, Chapter 3 of the WEO provides interesting and useful insights on how basic research can become an essential input for innovation, with wider-ranging international spillovers and longer-lasting impact than applied research. However, the communication of this chapter should also highlight the need for innovation and research subsidy programs to be well defined to ensure that they do not disproportionately benefit large players and reduce creative destruction.

The current environment could be exploited for protectionist purposes, thereby posing a risk to the global outlook. Supply chain bottlenecks may incentivize reshoring practices by governments in their attempt to ensure supply security. However, a large share of the supply issues currently at play stems from supply-demand mismatches, as pointed out by staff. Import-substitution policies, for instance, should be used with caution as such measures can lead to increased international tensions. Beyond the pandemic, authorities should address gaps in the rules-based multilateral trading system as well as economic issues underlying trade and technology tensions.

The Phillips curve remains alive and the current increase in inflation stems for the most part from transitory pressures. We welcome staff's increased focus on this topic and broadly agree that an inflation spiral is not likely to occur, and by mid-2022 inflation will come down across most economies given that the labor market slack remains large and price sensitivity to the shrinking slacks has declined due to structural factors. However, channeling of excess savings could impact inflation dynamics, either directly through pent-up demand in case of inelastic supply, or indirectly by channeling towards housing. This could contribute to upward price pressures for housing which may materially impact inflation dynamics through actual and imputed rent, as demonstrated in box 1.1, p. 29 of the WEO. The impact of COVID-19 has also been very heterogeneous across the sectors, thus a sectoral approach on inflationary impact seems important. *Staff comments and assessments are welcome on how these risks may shape the inflation outlook.*

We agree with staff that transparent and clear monetary policy communication is a key condition at the current juncture given the high level of uncertainty. An unexpected tightening of monetary policies in AEs poses risks of an abrupt tightening of global financial conditions in EMDEs, which may expose existing debt vulnerabilities, especially in many highly indebted LICs. The reinforcement of the ECB's forward guidance is a welcome adjustment as it facilitates a clearer response function of monetary policy within the Euro Area. At the same time, we underline the importance of flexibility when it comes to monetary policy responses. They should remain dependent on the incoming information on inflation, with both the inflation forecast and inflation expectations being considered. We agree that central banks with a dual mandate, like the US FED, should give priority to their inflation objective to preserve their credibility. In this regard, we wonder how much longer the central bank monetary policy can remain accommodative in countries where inflation is contained, inflation expectations are below the central bank inflation target, and labor market slack remains. Long periods of very loose monetary policies increase the risks of asset bubbles, excessive debt build-ups and fiscal dominance. These risks evolve non-linearly over time, and central banks should be ready to exit their highly accommodative stance in case the balance of risks alters. *Staff comments on these concerns are appreciated.*

Fiscal policy should be agile and tailored to countries' stage of recovery and ensure medium-term fiscal sustainability. While policy action was and is appropriate to address the crisis effects, it is crucial that countries commit to credible fiscal paths that ensure medium-term sustainability. In these circumstances, the granular and country-specific policy advice by the Fund can play a very important role. In economies where the recovery is already well advanced, support measures should be increasingly targeted. The focus of fiscal policy should gradually shift towards rebuilding buffers ahead of the next shock, given that high debt levels lower the capacity to absorb future shocks and increase the vulnerability to interest rate increases. Revenue mobilization is a must for successful fiscal consolidation. The observed decline of revenues in the LICs is worrisome since it can strain debt servicing capacity and increase vulnerability to tightening of global financing conditions. Against this background, the staff recommendation to move towards a more progressive tax system in these economies is helpful. The distributional analysis in the FM of the American Families Plan can support tax reforms elsewhere.

We underscore the important role of credible fiscal frameworks in the macro-policy mix and for optimal policy normalization going forward. The commitment to fiscal sustainability with a set of rules and institutions that guide fiscal policy can provide significant benefits not only by anchoring households and business prospects,' but also by raising market confidence, lowering borrowing cost and improving governments' access to finance, especially in EMDEs, where financing conditions are sensitive to global interest rates and central banks have begun to raise the short-term interest rates. An important step here is the selection of a long-term fiscal target, because 'credibility is low and difficult to acquire, but fast to lose'. Reforms to fiscal frameworks should therefore be careful to incorporate any negative effects they could have on credibility. *Regarding the numerical fiscal rules, could staff provide a preference for an appropriate fiscal rule? Or should we rather have country-specific targets at this stage of the recovery, to pave the way for more formal rule-based fiscal policy when the pandemic abates?*

An increasing number of EMDEs face growing short-term gross external financing needs, which makes them particularly vulnerable in case of an abrupt tightening of global financial conditions. At the current juncture, it is important that these countries take the necessary measures to insulate themselves from external financial spillovers, given that central banks in major AEs set policies based on their domestic mandates. Against this background, EMDEs need to further develop domestic capital markets and seize the opportunity to extend maturities and reduce roll-over risks at relatively low cost. As highlighted by staff, local currency funding costs are more sensitive to domestic fundamentals and growth compared to hard currency spreads.

We welcome the well-written and comprehensive GFSR. It is good to note that banks have remained resilient due to pre-crisis reforms and that the investment fund sector has quickly recovered from the volatility in early 2020. We also commend staff for introducing and explaining a unified taxonomy for the crypto ecosystem and for sustainable investment funds – which should set the stage for any further analysis in these areas. However, this GFSR provides limited information on the interconnectedness between sovereigns, corporate and banking sectors, and associated risks. The pandemic introduced the corporate sector as an important player in the bank-sovereign nexus. So far, the timely and sizable government support measures prevented bankruptcies of many firms. Although solvency issues have not appeared yet, these could trigger negative feedback loops with banks (through credit losses) and governments (via public support measures and guarantees). *Could staff elaborate on the relevance of these channels and on the risks associated with potential losses on (explicit loan) guarantee schemes, especially in countries that are already facing limited fiscal space.* In the same vein, we also believe that staff's recommendation that central banks should be able to provide emergency liquidity support to NBFIs, as well as the recommendation to issue digital currencies could be better grounded.

Real estate markets continue to require close monitoring. We would look forward to an in-depth discussion on how risks, exposures, and vulnerability to shocks in the commercial real estate (CRE) market have evolved since the last update. There are significant differences in developments in various segments. Demand and prices of industrial real estate generally continue to increase, whereas those for retail and offices are lagging. Especially institutional investors have substantial CRE-exposures and are relatively vulnerable to shocks, especially because coverage ratios are already low due to the low interest rate environment. On the housing market, which has a well-deserved high profile in GFSR, we recognize the issue of stretched valuations in many countries. Higher interest rates and/or a premature withdrawal of fiscal support could result in payment difficulties by a substantial number of borrowers which would have a negative impact on banks' credit portfolios. Drawing final conclusions on financial stability risks looks premature without correlating the distribution of the excess savings accumulated during the pandemic with the distribution of borrowers at risk. Finally, further work would be welcome on housing affordability among different income categories and social groups in the aftermath of unwinding fiscal support.

GRAY/21/2744

September 24, 2021

Statement by Mr. Pösö, Mr. Kraavik, Mr. Slettvag, and Mr. Spurga on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

- We thank staff for the very insightful and thorough flagship reports. We find the overall picture of a recovering global economy faced with downside growth risks and upside inflation risks appropriate. The analysis clearly lays out the issues we have ahead of us despite the successful countermeasures taken in the crisis so far. As a general comment, we think that the flagship reports could benefit from a common summary chapter or a key highlights section at the beginning of the reports.

World Economic Outlook

- **Action is needed to limit the divergence between countries.** While global economic recovery continues, risks remain elevated and divergences between countries are looking more persistent. The medium-term outlook reflects the unevenness in growth outlooks where the AEs are forecasted to reach the pre-pandemic medium-term output projections while EMDEs and LICs are expected to suffer persistent output losses. While we broadly agree with staff's projections, we expect somewhat stronger growth in the EU in the near term.

- **Vaccinating the world population remains the number one policy priority in a pandemic** as divergences in health and economic outcomes will further grow until vaccines are available for everyone. This has been and remains a key priority also for the EU. Multilateral efforts are important to speed up the global vaccine access and to achieve the goal to vaccinate 40 percent of the population in each country by end-2021 and 60 percent by mid-2022. It is therefore crucial to continue to support the ACT-A collaboration and its COVAX facility to ensure global distribution of vaccines and close its financing gap urgently.

- There are a number of risks that can compromise the recovery and expose it to a start-stop cycle. The main downside risk for growth is that aggressive virus variants may spread before widespread immunity is reached globally. **Addressing critical**

health spending remains important especially in countries with low vaccine coverage. We also share the concerns about the significant risks stemming from social unrest and climate change, which both could increase cross-border migration and cause further divergences especially in low-income, developing, and emerging economies.

- Moreover, inflation risks are rising, reflecting the prevalent supply-demand mismatches, increased commodity prices and policy-related developments[2]. We welcome the extensive analysis of inflation developments in the reports and note that the recent inflation peak in most AEs and EMEs is assessed to be transitory, and that price pressures are expected to subside in 2022 as supply bottlenecks resolve. Additionally, the role of base effects in currently high inflation figures calls for some caution in their interpretation. However, if supply disruptions continue longer than expected, inflation pressures may become more persistent, potentially raising concerns about a risk of faster than expected monetary policy normalization. For low-income and developing countries, elevated food prices can create more persistent inflation which could further harm their recovery and push more low-income households to poverty. While long-term inflation expectations are assessed to remain anchored, there is high uncertainty related to inflation prospects. **Thus, avoiding a de-anchoring of inflation expectations is paramount in this uncertain situation, in particular, in countries with more fragile monetary policy credibility.**

- On the upside, productivity growth could accelerate in the medium to long term. Public investment programs alongside growth-enhancing structural reforms in the US and the EU could lift the growth outlook. Moreover, while we agree that labor shortages can constrain growth, they could also work as an incentive for companies to increase automation and result in productivity increases. *Does staff have any views on this? Are there signs of companies substituting labor with machines, potentially accelerating productivity growth and limiting price pressures?*

- The losses in full-time jobs have been significant since the beginning of the Covid-19. To avoid adverse outcomes to inequality in the medium term**, it will be especially important to focus on job reallocation policies for the young, low-skilled workers, and women in some regions** whose employment is still lower than pre-pandemic. In addition, restrictions to education have been particularly worrying considering their impact on the labor markets and long-term productivity.

- The unprecedented policy actions have been essential in managing the crisis, limiting even worse economic outcomes, preventing a systemic financial crisis and enabling the economic recovery. Going forward, policy choices are becoming more constrained and challenging, as the recoveries are uneven, and policy space is limited especially

[2] E.g. expiration of temporary tax cuts and increase in the shelter component of US consumer prices as moratoriums expire

in many emerging, developing, and low-income countries. Furthermore, the trade-offs between further policy support and inflation risks are becoming much more complex. Higher debt levels also limit responses to any further setbacks and expose many countries to financial stability risks. Hence, **it is highly important that policy advice is timely and well targeted to country specific circumstances.** Too early policy withdrawal and cliff-edge effects should be avoided.

- Central banks have managed to maintain price stability throughout the crisis, and it should not be compromised during the recovery. **In these uncertain times, upholding and bolstering central banks' credibility is crucial.** The combination of increased inflation and higher than pre-pandemic unemployment put policy makers into a difficult situation. As recent inflation uptick represents largely transitory factors, continued policy support is still warranted, but in the case of a stronger than expected inflation outturns, central banks need to be prepared to act quickly. We note that inflation in some parts of the world has undershot their targets for some time. Overshooting the target for a time could, in line with recent monetary policy strategy updates, help to more clearly anchor price and wage expectations in a way that is compatible with close-to-target inflation in the longer run. *Staff's comments are welcome.* **Clear communication on inflation developments and monetary policy outlook continue to be crucial in shaping the expectations.**

- **Policy priorities should gradually shift to preparing for the post pandemic economy. Fighting climate change is the biggest global policy challenge of our time, requiring accelerated policy action**. Recent reports and events confirm an even more alarming picture of the threats posed by global warming. At the same time greenhouse gas (GHG) emissions continue growing and concrete policy action and commitments are grossly insufficient. There is no time to waste. Ambitions must be raised to achieve a strong reduction in GHG emissions by mid-century. **Another focus area is long-term challenges related to digitalization of the financial system and reversing the setbacks in human capital that need to be addressed**. We are also worried that many of the cross-border trade and technology tensions that predate the pandemic remain in place and **urge countries to work together to remove trade restrictions, address the roots of long-standing disputes, and strengthen the rules-based multilateral trading system.**

- Addressing debt challenges is becoming more topical as the most acute phase of the pandemic passes. **Structural reforms are necessary in dealing with high debt and low productivity growth**, while ensuring policy space for public investments in green and digital transformation. Debt accumulation especially in LIDCs is worrisome and should be monitored closely. Necessary debt restructurings should be done in good time to avoid additional setbacks to economic recovery.

- The analysis in chapter 3 on the importance of research for productivity growth is very interesting, and it is worrisome that the share of basic research has been declining over the past decades. *We agree with the importance of foreign knowledge for emerging market and developing economies, and wonder if staff have any views on how the size of the country relates to the role of foreign research and reliance of research diffusion, also for advanced economies?* One could expect that the role of foreign research and reliance on research diffusion is larger for small countries. *If there are increasing returns to scale in research, do large countries have an advantage, and can they rely more on domestic research output than smaller countries? Also, given the importance of international spillovers from research, is there a free-rider problem concerning basic research in particular? Would some countries find it optimal to focus solely on applied research and rely on spillovers for basic research?*

Global Financial Stability Report

- The global financial system has continued to weather the COVID-19 crisis well and has provided support to economies amidst very challenging conditions. **However, in the context of prolonged easy financial conditions the build-up of vulnerabilities needs to be monitored**. Emphasis on the heterogeneity of conditions across countries, sectors, and population cohorts is warranted for early identification of stability risks and for better targeting of macroprudential tools. This is particularly the case going forward as extraordinary policy stimulus is withdrawn.

- **Stretched valuations across many asset classes and abundant risk appetite pose a risk to financial stability.** Sudden changes in global investor sentiment or expected monetary policy developments may lead to considerable market correction. Many asset prices seem to rely on continuing low interest rates and ample liquidity conditions.

- **We would welcome further analysis of the implication of various inflation scenarios for financial vulnerabilities both short- and long-term.** We note that the decrease of US yields over the summer has occurred despite inflation accelerating, which could imply growth concerns or growing comfort with a transitory nature of higher inflation. Even the prospect of stagflation has recently reared its head, although this can be considered as a tail risk at present. *How does staff assess the risk of some moderate version of stagflation?*

- In the vulnerability assessment of emerging market economies and frontier markets differentiation between countries is required as conditions and vulnerabilities as well as the support provided vary. **We fully agree with the importance of structural reforms as well as continuing to develop local markets and foster a more diversified investor base**. In some EMDEs higher inflation and its implications for monetary policy and domestic financial conditions warrant monitoring, particularly in countries with less credible policy frameworks. *How does* *staff assess the risks of another "taper tantrum"? Does the early monetary policy normalization in some EMDEs help contain this risk?*

- Continued positive development with corporate bankruptcies amid stronger earnings provides comfort. However, **we agree with the concern over elevated corporate vulnerabilities particularly due to higher debt levels and reliance on policy support.** Also, earnings may deteriorate, increasing debt to income ratio further. Heterogeneity of the recovery makes it particularly challenging to assess the outlook for the corporate sector as a whole, especially as uncertainties over longer-term prospects in some sub-sectors continue. Rapid changes in pricing of the corporate credit risk may expose these vulnerabilities.

- **The surge in house prices in many countries raises concerns over risks emerging in the housing market**, although better financial positions of households and banks support resilience. We agree with the assessment of the main reasons for house price increases in the report, but also note the effects of buy-to-let demand, in particular, as there is evidence that the relative share of residential real estate investments in professional property portfolios has been increasing. This may have negative consequences by also potentially crowding some households out of the market in terms of affordability.

- The banking sector has been resilient and able to support households and businesses. Past reforms and solid capital positions have been supportive in this respect, and continuing progress of timely implementation of Basel III is warranted. **The implication of elevated debt vulnerabilities in some corporate sectors for the banking sector warrants attention in particular as support measures are withdrawn.** In addition, there is an ongoing concern that banks' non-performing loans will start to grow. Banks are facing a difficult balancing act between providing needed credit and avoiding low-quality credit.

- We broadly agree with the policy recommendations in the report. In particular, **we support the conclusion that authorities should take early and appropriate actions to tackle pockets of elevated financial vulnerabilities.** Timely action is indeed needed with macroprudential tools due to the long lags. When developing new tools – for example for nonbank financial (NBFI) sector – one should strive for a level-playing field, including across sectors and borders, while at the same time recognizing the heterogenous developments across sectors and countries. We believe that activity-based regulation and tools are more desirable than entity-based regulation and tools. **We further note that international cooperation is paramount to avoid regulatory arbitrage**.

- We welcome the analysis of the evolving crypto ecosystem **in chapter 2,** as new sources of risks as well as policy and regulatory issues may emerge. The focus on potential implications for EMDEs is warranted, particularly in countries where the use of crypto assets use has risen rapidly, exposure to dollarization is higher and fundamentals and regulatory framework are weaker. The emphasis of the policy messages on consistent standards, good data, and focus on risk management perspectives is welcome. We particularly **highlight the importance of addressing data gaps for the crypto ecosystem.**

- It is fair to say that the **global financial sector plays a crucial role_in catalyzing investment and accelerating the transition to a low-carbon economy**. However, we should be mindful that the financial sector can only support the transition policies implemented by the governments and not remedy inadequate climate policies around the world. We appreciate the focus on the growing importance of sustainable investment funds **in chapter 3**, but we also need to monitor the more significant role of funds without a sustainability objective in the transition to a green economy. If these funds continue investing in brown, it will be impossible for the sustainable funds to compensate for this. We note that demand for sustainable investment products is growing rapidly, but it is not evident that the supply is growing adequately, which may risk creating a bubble in sustainable investments. We agree that data and standards are still a challenge that needs to be tackled as soon as possible. Global taxonomy and sustainable disclosure requirements are needed. In different jurisdictions they may not need to be identical, but they need to be interoperable.

Fiscal Monitor

- We agree with the main messages of the Fiscal Monitor. The elevated risks to the fiscal outlook are worrying, but the pandemic is still not over; therefore, fiscal support is still needed and premature withdrawal of support measures should be avoided. **The focus at the moment should be on ensuring that support is well-targeted and temporary, while strongly anchoring support measures to a credible medium-term fiscal framework**. In addition, public investments should be channelled to projects that enhance future growth prospects.

- Going forward, more emphasis should be put on **bringing deficits back to sustainable levels once the recovery is firmly entrenched**, seizing on the improving economic outlook to rebuild fiscal buffers. We underline that **debt sustainability and optimal calibration of fiscal policy are closely related**. Fiscal policy should be counter-cyclical, and additional support should be wound down as private demand recovers.

- **Fiscal planning over the long term should signal commitment to fiscal sustainability** and not count on permanently low interest rates. As shown by the **Fiscal Monitor Chapter 2**, building trust with credible fiscal frameworks that embed future adjustment, ensures predictability of fiscal policy, reduces fiscal procyclicality, and ultimately increases fiscal space.

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GRAY/21/2745

September 24, 2021

Statement by Mr. Tanaka, Ms. Kashima, Mr. Naka, Ms. Fukuda, and Ms. Ogihara on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the set of comprehensive October 2021 Flagship Publications, which are well focused on the analysis on the pandemic crisis and uneven recovery, while paying attention to the post-COVID-19 challenges. We highly commend staff for their hard effort to make comprehensive reports, including the informative Analytical Chapters, amidst the continuing exceptional and uncertain circumstances.

The global economic and social situation has become more divergent due to unequal progress in vaccine rollout and other factors, and countries are seeking unprecedented paths to recovery under great uncertainties. While we recognize the steady progress made so far to tackle the pandemic, thanks to strong policy responses by member countries, rapid vaccine rollout, and extraordinary policy responses by international institutions including the Fund, various risks and uncertainties remain such as new variants, delay in vaccination plan, accumulated government debt, and increasing inflationary pressures. Possible timeline regarding the end of the pandemic remains unclear, and the authorities of member countries are facing extremely difficult situation to balance reallocating policy resources and seeking an exit from the current policy supports. Under these circumstances, it is of utmost importance to accurately understand the latest situation, risks, and outlook of the world and individual countries' economic and financial systems, which will serve as the basis for policy responses by member countries and the Fund. We encourage staff to continue to monitor the impact of the pandemic on various aspects and to continue comprehensive analysis, timely updating the Board.

In order to achieve a stable recovery and sustainable growth toward post-COVID-19, it is essential to address mid- and long-term challenges and raise potential growth. Developing comprehensive but well-targeted policies will be essential to build a strong foundation for long-term growth. We support the Fund's continued efforts in fiscal, monetary and financial policies, as well as its contributions in climate change and digitalization based on its core mandate and expertise. The Fund has played an important role in the COVID-19 crisis and should continue to play a central role in the next phase of the global economic recovery by providing integrated Surveillance, Lending, and Capacity Development (CD) utilizing its macroeconomic expertise. Japan will also continue to strongly support the Fund's various initiatives.

World Economic Outlook

Global economy is gradually recovering, but still facing high uncertainty. We note that the global growth for 2021 has been revised downward mainly due to supply constraints in AEs and the lingering impact of the pandemic in LICs. We agree with staff that the risks are tilted to the downside, amid growing concerns over variants and the pace of vaccine rollout which are leading to increased divergence among countries. *In this regard, can staff elaborate on the prospects of vaccine rollout in light of the continuing supply constraints?* Vaccination is an urgent issue that should be given top priority for resilient and inclusive recovery, and the Fund is expected to contribute from a macroeconomic perspective. We fully agree with staff that strong international cooperation is vital to promote vaccine access and tackle other urgent and long-term challenges.

In addition, fiscal and monetary authorities will need to closely monitor country-specific situations and calibrate their policies in line with the phase of recovery. Along with the current response to the crisis, authorities need to address the risks posed by the pandemic and long-term challenges such as uneven impact on unemployment, inflation pressure, human capital development and climate change, while being mindful of the remaining policy space. As for increasing uncertainty of inflation, it is essential to closely monitor price trends associated with supply constraints, labor market mismatches, commodity prices, and economic recovery. In this regard, we welcome the comprehensive analysis of inflation development under COVID-19 in Chapter 2. We agree with staff that in times of uncertainty, credible communication and clear guidance are important, while paying close attention to de-anchoring of inflation expectations. Also, the Fund’s role is key in providing liquidity support to LICs and sovereign debt relief, and we expect the new SDR allocation will further help to improve international liquidity. We encourage staff to provide well-tailored policy advice based on its core mandate, while having close dialogues with authorities as well as careful external communication.

Strategic policy planning and implementation is important to achieve sustainable growth. In the midst of a highly uncertain recovery, it is an important attempt to discuss the role of basic research for long-term growth in Chapter 3. As staff notes, basic research is generally perceived as an area where government spending is likely to be supported. However, the importance of basic research by private companies’ mid- and long-term strategy is rapidly increasing, and boundaries between basic research and R&D are blurring. A more comprehensive approach through corporate governance reform and review of incentive mechanisms is necessary to promote basic research. In addition, as we have seen severe floods, drought, and wildfires in the past few months, the risks posed by climate change should be seriously considered by all countries, and we support the Fund to further strengthen its engagement with climate change. Regarding the International Carbon Price Floor (ICPF) discussed in Chapter 1, it should be treated in a uniform and evenhanded way, and it is inappropriate to promote ICPF "adjusted to country circumstances", which could exacerbate carbon leakage and bring about market distortion.

Global Financial Stability Report

We welcome the staff's appraisal that financial stability risks have been contained thanks to accommodative policies so far. However, **authorities face difficult policy tradeoffs, such as fiscal sustainability, inflationary pressure, and corporate zombification**. Shared view with vigilance is warranted that financial vulnerability—inflation, misalignment of asset pricing, and weak capital inflow--is increasing on the back of uneven recovery and high uncertainty. In fact, some EMs have started to raise policy rates in response to inflation and to strengthen macroprudential policies. While we regard these actions as appropriate, it is increasingly important for central banks to vigilantly assess the extent of recovery and persistence of inflation, and provide clear guidance to avoid perceptions of a sudden policy change.

Elevated leverage highlighted in market boom is another concern. We also note that market sentiments have become somewhat cautious due to recent resurgence of pandemic in EMs. Authorities should build resilience against sudden unwinding of risk sentiment, while avoiding moral hazard among investors for protracted policy accommodation.

As such, the comprehensive analysis on financial systems in Chapter 1 is insightful and appreciated as always. We would like to touch on some issues related to corporate financing, which we believe important in transitioning to private-led sustainable growth after withdrawal of accommodative policies:

- Capacity and resilience of the financial sector. we welcome staff analysis that banks have remained resilient even after playing a critical role in providing credit flows during the pandemic. However, it is concerning that their loan underwriting standards remain restrictive, which raise questions on their ability and willingness to support financing needs after withdrawal of temporary relief measures. In this regard, we note with interest staff's analysis on the relationship between economic growth and bank loan increase, which implies that share of bank loans would fall compared to non-bank loans. We encourage authorities to urgently establish frameworks to monitor the non-bank financial sector and assess its risks. It is also important for the Fund to closely collaborate with FSB and to deepen analysis on the sector in future FSAPs and GFSRs.

- Increasing issuance of corporate bonds. We noted the large increase of hard-currency corporate bond issuance of more than 20% in 2021. The report also shows investment in lower-rated bonds have increased in the low-for-long environment and re-expansion of CLO issuance. Such increased indebtedness could add to vulnerabilities to future shocks, and thus warrant close monitoring.

- Development of domestic bond market. We note that domestic bond absorption is still under pressure with weaker non-resident inflow than pre-crisis, even though investments of domestic banks and life insurers have increased. *Could staff elaborate more on prioritization in addressing bottlenecks for further market development?*

We welcome the analysis in Chapter 2 on the financial stability risks of crypto assets. Although expansion of the crypto ecosystem mainly in EMs could potentially benefit end-users through lower transaction costs and financial inclusion, it is expanding the policy frontier for authorities with likely impacts on monetary and fiscal policies and the financial system. In particular, we note staff's warning that unsound macro policies and inefficient payment systems could drive cryptoization. This underscores the importance of Fund surveillance and CD to strengthen macroeconomic policy as well as in the area of digital money including CBDCs. Such comprehensive analysis is essential to facilitate international coordination for the development of consistent standards and effective regulatory and supervisory enforcement.

Empirical analysis on financial risks in private sustainable investment in Chapter 3 is very informative. Over the past two decades, the rapid growth in the amount of capital flowing into investment funds has been a key driver of nonbank financial institutions increasing their share of global financial assets. Investment funds can foster transition to a green economy through their investment decisions, but may also possibly amplify transition risks. In this regard, consistent global policies precluding regulatory arbitrage are needed to secure financial stability through stress testing and supervision. *Among staff's recommendations, strengthening the information architecture, which includes objective and comparable metrics and framework for continuous data collection, seems persuasive but challenging. We expect staff elaboration on possible engagement of the Fund on this front.*

Fiscal Monitor

Fiscal responses should remain supportive, but need to be well-targeted, carefully calibrated, and tailored to the country's specific circumstances. Also, building a credible and sustainable fiscal framework and fiscal consolidation are inevitable tasks in the normalization from the crisis, and these should be implemented with appropriate external communication.

Returning to pre-pandemic levels of accumulated debt is a global and long-term challenge, and we thank staff for their informative analysis of the fiscal framework in Chapter 2. While large-scale and decisive fiscal policies prevented critical economic declines during the crisis, fiscal deficits and public debt in many member countries increased to unprecedented levels. Financial market conditions are more favorable than in past crises, however, we also need to be mindful of the increased vulnerability of fiscal positions to market changes, and thus we are concerned that over-emphasizing the flexibility in the fiscal framework may delay fiscal consolidation. Long-term efforts will be necessary to restore accumulated debt to pre-crisis levels, and fiscal consolidation should be based on more conservative assumptions. On this basis, we would like to emphasize the following points regarding the long-term fiscal target;

- Interest expense should only be considered as an indicator for very limited countries where the debt-to-GDP ratio and inflationary risk are extremely low in the long run. Especially under the current situation whereby there is much uncertainty regarding financial market developments and rising financing costs as discussed in the GFSR, it is unsuitable to argue that interest expense will be an advantageous indicator without mentioning the risks to fiscal sustainability and the debt-to-GDP ratio. Although the scope of the focus on interest expense is quite limited to few countries, the Fund should carefully and consistently suggest this issue. In addition, it is inappropriate to associate rollover risks with central bank backup in light of central bank independence and fiscal dominance concerns. Furthermore, the risk of excessive liquidity supply needs also to be considered. *Staff comments on these points are highly welcome.*

- Public sector balance sheet (PSBS) measures should be used as a complementary tool, as many directors pointed out in the FM meeting in fall of 2018. There are a number of limitations in PSBS measures, such as the quality and availability of data and valuation of public assets. In particular, non-financial assets such as roads and rivers are non-tradable and not appropriate to consider when discussing fiscal soundness.

For a sound fiscal framework, there can be different approaches and the best policies will vary depending on each country's situation. We expect staff to continue to monitor the public finance situation of member countries and make well-calibrated and tailored policy advice for fiscal consolidation, through close communication with the authorities.

We also strongly support the Fund's efforts to deepen its analysis on debt transparency. We expect the Fund's further effort to provide CD to ensure debt transparency and accuracy and to facilitate Debt Data Reconciliation, which will help debtor countries enhance their capacity to properly manage their debt.

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Statement by Ms. Shortino, Ms. Senich, Mr. Commaroto-Roverini, Mr. Sturm, and Mr. Westphal on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
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This Fall's WEO, GFSR, and Fiscal Monitor come almost two years into a pandemic that continues to present significant risks to the international community and to the broader outlook for the global economy. The uneven rate of vaccinations and rapid spread of new COVID variants will continue to have negative domestic and global impacts on health, wellbeing, and livelihoods. That said, progress on vaccinations and further adaptation of policies should increasingly lead to improvements in economic activity, already evident to some extent in advanced economies. **To this end, we should redouble our efforts to defeat the pandemic by accelerating the pace of vaccinations and deployment of life-saving therapeutics globally.** On the part of the United States, President Biden recently announced that the United States is purchasing an additional 500 million Pfizer COVID-19 vaccines to donate to low- and lower-middle income countries around the world, bringing the U.S. donation total to 1.1 billion doses of COVID-19 vaccines, free of charge, no strings attached.

At the same time, **we must continue to take strong policy actions now to improve output and employment to reduce the extent of future scarring.** In this regard, we strongly support staff's recommendations for broad-based demand support and remedial measures to address the scars from the shock. The recovery has been uneven, and countries with less access to effective vaccines are experiencing stronger headwinds and shrinking policy space, making careful calibration of policies essential. However, where policy space remains, countries should amplify support to help fully entrench their domestic recoveries and bolster the global one. Countries with limited policy space should prioritize support to the most vulnerable groups. All countries should vigorously pursue structural reforms to bolster future growth prospects.

Economic Performance and Outlook

While the WEO projections for global growth of 5.9 percent in 2021 reflects a modest downgrade for advanced economies and for low-income developing countries, the growth outlook for 2022 remains firm, underscoring the effectiveness of the global policy response. We emphasize the need to avoid premature policy tightening which could risk undermining the recovery and worsening headwinds for those economies where the recovery has yet to take hold.

We believe the outlook would be even stronger if countries with negative or zero-interest rates, especially those with current account surpluses, were to ramp up funding in longer-term public investments aimed at boosting productivity and growth. In the United States, we are investing in infrastructure, human capital, clean energy, housing, and healthcare. While noting U.S. public investments, the WEO downplays the role that strong U.S. private demand relative to the rest of the world is playing in the U.S. share in global imbalances. More generally, we would have welcomed more coverage on the importance of reducing excess imbalances in a growth-friendly way, as reflected by the *2021 External Sector Report*. These findings support the immediate priority for excess surplus economies to help restore their economies to pre-pandemic trend growth. Without such measures, the burden of adjustment falls solely on excess deficit economies, which will be required to strike a delicate balance between supporting domestic growth and, in some cases, fiscal sustainability. Moreover, we are concerned that private demand in some countries may be insufficient to support growth when fiscal policy tightens. A robust and more even global recovery will require more economic activity and more public investment by all economies.

We welcome that the WEO identifies the positive spillovers to EMDCs from stronger U.S. growth, particularly for major U.S. trading partners, but thought this could have been given greater emphasis. While the Fiscal Monitor rightly points to the significant global effect of supportive U.S. fiscal policy, we do not share the assessment that the additional spending would cause global interest rates to rise. On the contrary, structural investments will increase U.S. competitiveness and help ease inflationary pressures over the long term. Also, while faster-than-anticipated monetary policy normalization in AEs could lead to a sudden tightening in global financial conditions, the stronger U.S. growth that is inspiring a potential normalization in monetary policy has had profoundly positive spillovers on the global economy and global financial conditions. We appreciate that the GFSR's message that authorities in emerging markets should continue improving their domestic policies as a means to mitigate potential risks to capital inflows, including as AE policy moves toward normalization.

In the GFSR, we agree with staff's assessment of immediate and emerging vulnerabilities facing the global financial system, including those related to the effects of COVID-19, crypto-assets, and climate change-related financial risks. We appreciate the analysis of vulnerabilities associated with rapidly rising housing prices in a number of jurisdictions. While we agree that this trend has thus far not been accompanied by increased risk-taking in the financial sector, the tide could turn quickly, and we will need to closely monitor this emerging vulnerability including in EMDCs where relevant data is sparser. We note that the GFSR could have focused more on the rise in debt levels across sovereigns, non-financial corporates, and households during the pandemic and its potential implications for financial stability both in the near and medium term.

Policy Recommendations

We broadly agree with staff's policy priorities as outlined in the WEO, particularly the need for international cooperation on vaccines and climate. In response to current and potential new variants and the lag in vaccine access, the WEO correctly emphasizes that the most important thing that countries can do to exit the crisis is rapid vaccination. In this regard, we strongly support the Task Force on COVID-19 Vaccines, Therapeutics and Diagnostics for Developing Countries, which can help to resolve bottlenecks and address operational issues to delivering and administering vaccines, proper therapeutics, diagnostics, and personal protective equipment on the ground in low and middle-income countries.

At the same time, we emphasize that the WEO should not lose track of the importance of core macroeconomic policies, including fiscal, monetary, and structural reforms, that countries need to take to exit this crisis, limit scarring, and boost potential growth. Many countries have fiscal space which they should utilize until the recovery is firmly entrenched. In other cases, fiscal policy will need to be more calibrated but could still, if well-targeted, yield benefits domestically and globally. In the case of low-income countries, the tradeoffs between the need for additional fiscal support and the strains on debt sustainability will need to be carefully weighed. We are concerned with the implications of staff's projections that reductions in deficits in emerging markets and low-income developing countries will occur largely through lower spending. In our view, this underscores the importance of ambitious efforts to strengthen revenue mobilization, including through a broader tax base, improved tax administration, and enhanced public financial management. Staff should continue to encourage vulnerable countries to implement fiscal reforms that can bolster economic resilience and guarantee fiscal support to the most vulnerable, especially in adverse scenarios. While a rapid recovery in private demand may necessitate tightening, we would have expected greater attention to the consequences of prematurely withdrawing support, a more likely near-term risk.

Fiscal reforms will need to be paired with ambitious structural reforms. Staff's external sector analysis finds that the negative effects from the COVID-19 pandemic have been compounded by underlying structural weaknesses, but this WEO provides little coverage of the importance of advancing structural reforms. **In this regard, we urge countries to more aggressively fund longer-term public investments that can boost productivity and growth in order to build back better.** Domestic policy responses should support progress on structural challenges like tackling climate change, reducing inequality, and improving digitalization. On this topic, we welcome Chapter 3 of the WEO highlighting investing in basic and applied research as another channel for countries to raise productivity and growth, and staff's work demonstrates the important benefits such investments can provide domestically and internationally. The American Rescue Plan provided a critical injection of support to families, small businesses, and local communities. But more can be done, and the United States is taking this opportunity to address long overdue structural investments in clean energy, housing, and healthcare that will make the U.S. economy stronger. We appreciated the Fiscal Monitor's Box 1.1 analyzing the long-term distributional impact of the American Families Plan.

Fiscal Monitor: We endorse staff's focus in the Fiscal Monitor on enhancing transparency to help raise government accountability to the public. Transparency helps boost the effectiveness of emergency spending by strengthening the credibility of the overall fiscal framework and incentivizing policy makers to show it targets those most in need. We note, however, that the corrosive effects of corruption are absent from the discussion in the Fiscal Monitor. Since corruption saps an estimated 2-5 percent from global GDP, we recommend future work include policy recommendations on anti-corruption measures that can further catalyze the effects of fiscal outturn.

We also appreciate the analysis in Chapter 2 of the Fiscal Monitor on how credible frameworks help build buffers and promote countercyclical responses to crisis. We agree with staff that effective communication strategies on the scope, timing, and conditions for the eventual unwinding of fiscal support strengthen credibility of fiscal frameworks, and we would welcome a discussion of best practices at the country level that could serve as a model for those seeking to establish and improve their fiscal frameworks.

GFSR: We strongly agree with the GFSR's conclusions that fiscal authorities should continue their efforts to tailor support to country-specific circumstances, particularly as heterogeneous financial sector risks emerge in different countries. While we acknowledge that macroprudential tools may need to be tightened in some contexts to address certain emerging vulnerabilities, we would have appreciated greater focus on the need to continue improving microprudential supervision, particularly as asset quality issues often materialize after prolonged forbearance from financial institutions. We agree with the Fund's conclusion that crypto assets do not pose global systemic risk currently, but that risks related to these developments require close monitoring. Changes in the market and technology could develop quickly, while regulatory adjustments can require time to catch up.

Other Topics

Debt: We strongly support the WEO's focus on tackling debt vulnerabilities. We agree with staff that efforts are needed to improve the Common Framework, and staff rightly emphasize that timely and orderly debt restructurings can avoid the higher cost of protracted debt crises. It will be critical that, moving forward, the international community help ensure full and transparent implementation of the Common Framework. It is time for the world's largest official creditors to demonstrate their commitment to addressing the crippling effects of unsustainable debt levels among the world's poorest nations by swiftly and effectively implementing debt treatments.

Climate: We welcome the WEO's focus on climate change as an important multilateral policy issue and in particular with regards to the Fund's support for countries that are most vulnerable to climate change impacts. Regarding work on an international carbon price floor, any such work should take into account implicit price policies as well as explicit pricing, and we would urge avoiding qualifiers such as "adjusted to country circumstances," as we do not view the IMF as the appropriate venue to determine countries' relative contributions to fighting climate change. We reiterate our strong encouragement for the World Bank and the IMF to deepen their collaboration and partnership on this critical issue reflecting their individual mandates.

We appreciate the GFSR's attention to sustainable finance and the meaningful role it can play in the transition to a green economy. We agree with the need for considerable progress in terms of data, disclosures, and approaches to identifying climate-aligned investments for savings to be channeled smoothly and sustainably towards the transition. We further appreciated the GFSR's emphasis on elevated financial vulnerabilities in China, including the sharp increase in debt and challenges related to China's transition to a low-carbon economy. We would have welcomed additional coverage of the potential broader consequences for the global economy and financial system should those vulnerabilities materialize, and recommendations for measures authorities in other countries should be doing to mitigate potential spillovers in the near term.

Monetary policy and inflation: We broadly agree with WEO Chapter 2's findings on inflation including that current inflationary pressures are mainly transitory, with still significant labor market slack, well-anchored inflation expectations, and the continuation of global disinflationary forces leading to inflation subsiding some next year. The factors pushing up inflation, including global supply chain constraints, commodity prices, and base effects, should not sustain these rates of inflation over the medium term. We agree that policymakers should look past transitory inflation pressures, but remain prepared to act quickly if the risks of rising inflation become tangible, particularly given the balance of risks are skewed to the upside.

In the United States, while the factors pushing up inflation are expected to be transitory, ongoing disruptions related to the virus may mean inflation could remain above the 2 percent longer-run objective longer than initially anticipated. Inflation expectations—which appear broadly consistent with the 2 percent objective—are an important part of the Federal Reserve's new framework for monetary policy. If there were signs that the path of inflation or longer-term inflation expectations were moving materially and persistently beyond levels consistent with its goal, the Federal Reserve has stated it would be prepared to adjust the stance of policy.

As for the current policy stance, the Federal Reserve has indicated that if progress on its inflation and employment goals continues broadly as expected, a gradual tapering of asset purchases that concludes mid-next year may soon be warranted, though at that stage policy will still support accommodative financial conditions. The Federal Reserve is aware that its policies affect global markets and foreign economies and is highly cognizant of the importance of communicating any changes in policy clearly and well in advance to help smooth the transition domestically and internationally.

We support the WEO's recommendation that emerging market economies should plan for possible tightening of external financial conditions now through lengthening maturities and reducing currency mismatches. The results of the Integrated Policy Framework have shown that traditional policy tools remain appropriate in the vast majority of country cases. Flexible exchange rates will continue to play an important role as a shock absorber. Financial sector deepening and foreign exchange market development should play an important role in countries' structural reform priorities and plans, and we would caution against using foreign exchange intervention and capital flow measures in place of macroeconomic adjustments.

SDR allocation: We welcome the recent SDR allocation as a tool to help create policy space for authorities during this time of heightened uncertainty. We look forward to further amplifying the benefits of the SDR allocation by agreeing to lend SDRs to low-income and vulnerable countries through the PRGT. Moreover, the proposed Resilience and Sustainability Trust (RST) provides a rare opportunity to help vulnerable countries fund structural transformations that will help to strengthen public health systems and create more resilient economies. We urge support for the establishment of the RST and for close cooperation with the World Bank to make it an effective tool to support sustainable, medium-term growth.

Conclusion

Despite the positive growth outlook, the worldwide recovery from the pandemic remains in danger of stalling if the global community does not act forcefully to vaccinate the world's population. In the interim, economic support should not be withdrawn too quickly, and countries should prioritize policies that can help to transform their economies to allow for greener and more-inclusive growth. Even as we emerge from this pandemic, the world will face significant medium-term challenges. Global cooperation will be critical if we are to successfully address unsustainable and rising debt levels, reverse destabilizing increases in inequality, protect the world from climate change, and leverage technology to its full benefit.

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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
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The global economic recovery continues against the background of waves of the resurging pandemic. The recovery reflects ongoing and complex adaptation of the economies and societies to the pandemic and associated restrictions. The baseline scenario assumes global growth at 5.9 percent in 2021 and 4.9 percent in 2022. The pace of recovery is uneven with many advanced economies still struggling to achieve pre-COVID output levels, while many emerging markets have already reached them, and most are expected to exceed them by the end of 2022.

Overall, the prospects of the global economy are positive, but they remain highly uncertain. In addition to persistent uncertainty related to COVID-19 mutations, the risks of accelerating inflation and subsequent monetary policy tightening are becoming more prominent. The increasing number of central banks in emerging market and advanced economies are tightening their monetary stance. Many observers also believe that growing inflationary pressures may bring forward policy normalization in the United States, which is likely to have substantial repercussions across the globe. Other risks to global growth include more persistent supply disruptions and further intensification of global trade conflicts and geopolitical rivalry.

On the pandemic-related risks, we agree that strong multilateral efforts are required to accelerate vaccination, reduce the loss of human lives, and diminish the risks of more dangerous virus mutations. We fully agree with the strong view of Staff and Management on the huge economic benefits for all countries of faster and more inclusive distribution of vaccines. In this regard, we fully support the joint efforts of the IMF-WBG-WTO to boost vaccinations and welcome the recent creation of the special task force within the Fund to focus on this initiative. At the same time, we note with concern that even when vaccines are abundantly available, it may be difficult to reach the required thresholds for herd immunity due to relatively large shares of population refusing to vaccinate. Therefore, the stop-go recovery from the COVID-19 infection may well continue in the future, and the economies will have to adjust to this new reality.

Uncertainty around the recent surge in global inflation poses a difficult trade-off to the monetary authorities. The rapid rise of inflation since the beginning of 2021 both in advanced economies and emerging market economies begs the question of whether this rise is transitory and will subside later on or may become persistent. At this stage, the answer is not clear, and continuous review of the evidence is necessary. It is essential to prevent possible de-anchoring of inflation expectations. In case of persistent rise in inflation, there is a risk of monetary easing becoming extended for too long, which would undermine the credibility of central banks and further boost inflation expectations. In this adverse scenario, the eventual tightening of monetary policy will need to be much more pronounced, which may disrupt financial markets and arrest growth. On the other hand, premature withdrawal of monetary stimulus might derail the recovery and/or shift the burden of support to fiscal policy. The latter would be challenging considering shrinking fiscal space due to the extraordinary fiscal response to the pandemic.

Inflation expectations de-anchoring represents a key medium-term risk and mitigating this risk requires clear communication on the part of central banks to broader audience. The modified framework of the Federal Reserve made legitimate a modest overshoot of inflation above target over an extended period, given that it previously undershot for many years. However, the deliberate overshooting is underemphasized in many discussions, which seem to be dominated by inflation scares. On the upside, most of the population in advanced economies has not lived through the experience of high inflation at the levels similar to the ones observed during the late 1970s and the early 1980s. Since people tend to expect the continuation of inflation trends experienced during their lifetimes, risks of de-anchoring might be relatively contained. On the downside, de-anchoring is a "tipping point" phenomenon, and lost credibility can be hard to regain. We believe that inflation expectations de-anchoring represents a key risk over the medium term, and broader analysis should be conducted in this area going forward, especially on the role of central bank communications in mitigating these risks. This analysis should rely more on structural instead of purely macroeconometric models. The circumstances differ across countries, but it is essential to avoid a simplistic presentation of the risks in terms of EMEs vs. AEs.

A sharp rise in global natural gas (NG) prices came to the forefront relatively recently and is reflected upon in the WEO only briefly. Taking into account growing attention to this issue, we would encourage staff to share their views on the key factors behind NG price growth, prospects of prolonged high NG prices, and potential inflationary impact of such a scenario.

We agree that fiscal policy should support the recovery, but availability of the fiscal space and divergent spending priorities call for carefully tailored medium-term strategies. As the recovery gains traction, the authorities in most economies are shifting their fiscal expenditures away from emergency measures towards long-term priorities with a goal of facilitating greater resilience, green transition, and digital transformation. Slow withdrawal of fiscal accommodation and projected structural fiscal expenditures are the main reasons why, according to staff, global debt would remain at its record high levels until 2026. In many countries reduced fiscal space, combined with vulnerability to tightening of the global financial conditions, may force premature fiscal consolidation. The IMF members face a difficult balancing act in this area. Wherever possible, these fiscal consolidations should remain gradual to avoid risks of scarring.

From this point of view, the Fiscal Monitor presents timely and useful analysis of how to design an appropriate fiscal framework that can provide some breathing room for the Fund members. We agree that strong and transparent fiscal frameworks can strengthen the credibility of public finances, improve market confidence, and reduce borrowing costs. We also agree that the fiscal frameworks should depend on country-specific conditions and the pandemic-related developments. At the same time, the Fund should provide additional analysis of how to recalibrate the fiscal rules after the COVID-19 crisis. Under the current complex circumstances and considerable uncertainty, it is risky to be over-optimistic about the ability of strong fiscal frameworks and lower risk premiums to postpone fiscal adjustments at the time, when so many countries are facing the growing risks of adverse debt dynamics. Staff rightly pointed out a weakened relationship between spreads and fiscal fundamentals, growing exposures to abrupt changes in global interest rates, and elevated fiscal risks from contingent liabilities, bailouts, and exchange rate depreciations. However, market perceptions may change, while political economy considerations in implementing fiscal consolidations call for caution.

We note broadly positive developments since the April 2021 GFSR. In advanced economies financial conditions have eased, corporate balance sheets have strengthened on average, household financial positions have improved. In emerging market economies financial conditions have changed little, but the outlook for portfolio flows has improved and issuance of hard currency bonds has rebounded strongly. We also note that global banks capital positions remain solid, and stress tests point to the overall resilience of the banking sectors in most economies.

Despite seemingly benign recent developments in the financial sector, the fundamental challenge confronting policymakers remains the same – how to ensure medium-term financial stability, given the many years of accommodative monetary policies. Stretched asset valuations make some market segments, in particular, stock and real estate markets, extremely vulnerable. In this respect, we regret that the new GFSR offered few specific policy recommendations for dealing with global financial market misalignments. Last year the Fund openly warned about the growing disconnect between financial markets and the real economy. Since then, the S&P index has increased by almost 50 percent while our analysis of the disconnect between the financial and real sectors has been toned down. *Staff comments would be appreciated on another important aspect of the high asset valuations--the distribution of wealth in advanced economies and its effects on future income inequality. The IMF used to be vocal on the links between income and wealth inequality, on the one hand, and institutional capacity to implement reforms, on the other hand. Did the COVID-19 pandemic aggravate the risks in this area?*

We note with concern the signs of financial vulnerabilities in China. In particular, the country's real estate sector has recently captured international attention due to the liquidity challenges of the world's largest property developer, China Evergrande Group. Evergrande is entangled with many other businesses, prompting concerns about possible contagion. *Could staff share their preliminary thoughts regarding the developments around Evergrande and implications of its possible default for the Chinese and global economies?*

We find staff analysis of the Crypto Ecosystem and Financial Stability Risks (GFRS, Chapter 2) to be relevant and well-timed. The crypto ecosystem is growing rapidly, creating new economic opportunities, but also posing substantial challenges to policymakers and regulators. We note divergence in approaches to these developments, as some countries are fully embracing privately issued cryptocurrencies, while other outlaw them. The risks of *cryproization* are looming large and need to be dealt with. We welcome staff's analysis and recommendations as an important contribution to a search for an international consensus on the optimal ways to deal with growing crypto ecosystem. *We look forward to the Fund's further work in this area.*

We agree that *sustainable investment fund* sector can become an important driver of the transition to a green economy in the future (GFSR, Chapter 3). We support the key principles of the global climate information architecture: a consistent set of disclosure standards, reliable data on climate-related metrics, and agreed-upon principles for sustainable finance classification. Such an architecture would help the sector expand and mobilize private financing necessary for accelerating the transition towards sustainability. We see the drive towards sustainability as self-reinforcing, as advances in technologies are making renewable energy sources a cheapest option for increasing number of locations, attracting private financing with promises of even higher returns.

With regard to clean energy transition, we find particularly interesting the WEO analysis of demand and price forecasts for *critical metals for green technologies*. It shows that for the *net zero emission scenario* the price of four critical metals (nickel, copper, lithium, and cobalt) will increase dramatically. In such a scenario the value of critical metal production will increase sixfold – up to $12.9 trillion over the next two decades. High metal prices could delay energy transition, which may somehow cool down demand and prices. The uncertainty is very high, because a lot will depend on governments' policy decisions on climate-related issues. In any case, the developments in this area may have a substantial effect for metal producers, especially in low-income countries. According to staff, the value of critical metals may even rival the potential value of global oil production. *We would encourage staff to continue monitoring and analysis of the developments in this area and provide an update to the Board.*

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GRAY/21/2748

September 24, 2021

Statement by Mr. Palotai, Mr. Azal, Mr. Just, Mr. Harvan, Mr. Marek, and Mr. Meizer on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the comprehensive set of flagship documents, which give valuable insights into the changing global landscape and appropriately put emphasis on calibrating macrofinancial policies to the pace of recovery and economic conditions. We broadly concur with the main conclusions and thrust of the reports and offer the following remarks for emphasis.

World Economic Outlook (WEO)

We take positive note that the global economic recovery remains on track, and more and more economies return to pre-pandemic levels. Many sectors and economies have adapted to the new stage of the pandemic better than previously expected. Nevertheless, we are concerned that the outlook for countries with less room for maneuver has worsened and the balance of risks for growth is titled to the downside. Furthermore, the large divergences across and within countries and the COVID-19-induced uncertainty continue to be a cause for concern. We stress that faster vaccine rollouts in emerging market and developing countries (EMDCs) must continue to be a high priority to control the pandemic everywhere and avoid persistent output losses. Meanwhile, there is also great need for further targeted policy measures to address the pockets of vulnerabilities, rebuild buffers and support potential growth.

We deem it particularly important that policies and the policy mix should continue to be tailored to the current stage of the pandemic and the local economic conditions. As the recovery is still fragile in many countries, policymakers need to strike a delicate balance between the aspects of macrofinancial stability, monetary policy and economic growth. We encourage staff to be more vocal on what trade-offs countries face at this point. Although the historic SDR allocation also helps ease financing constraints in a wide range of countries, the Fund should continue to explore how it can best support its membership in a changing global environment, within its mandate.

Further efforts are also needed to rebuild jobs and advance in re- and upskilling, especially since the employment recovery is expected to lag behind output for a large share of economies. While we welcome that automation is picking up in several sectors, as rightly highlighted by staff, in the absence of active labor market policies focusing on the most vulnerable (women, youth and low-skilled workers), the COVID-related structural shifts may result in a further increase in inequality and social tension. *We note that, compared with the previous decade(s), labor productivity has risen rapidly in many countries during the pandemic. It would be useful to learn more about the current drivers of labor productivity, and how lasting the cyclically induced growth in capital deepening can be. Staff's comments are welcome.*

The evolution of inflation dynamics requires close monitoring, and in particular the persistence and second-round effects of the present inflationary forces, as well as the drivers of underlying inflation. Reopening of the economies, along with unleashing pent-up demand and rising commodity prices, inherently push inflation higher; however, at the current juncture, the inflation pressure has also been magnified by the pandemic-related supply chain disruptions. It is becoming increasingly clear that the surge in inflation, which was considered to be transitory in the first half of the year, may take longer than previously expected, and poses new policy challenge across a wide range of countries, while we also acknowledge that cross-country heterogeneity is significant. We agree with staff's assessment that one of the key questions is how long it will take supply to catch up with accelerating demand. If underlying inflation trends require it, policymakers need to take timely steps to avoid a prolonged period of high inflation and prevent a potential de-anchoring of inflation expectations. Upside risks must be monitored closely.

We appreciate the chapter on assessing inflation developments but given that this assessment is subject to high uncertainty, we would have preferred more emphasis on risk scenarios. Inter alia, we consider it important to highlight that the substantial fiscal stimulus and changing consumer behavior in advanced economies may have a more lasting effect on inflation than in the baseline forecast. A better understanding of inflation trajectories and the expected path of monetary policies in advanced economies is also essential to better capture the spillover effects of potential monetary policy normalization on EMDCs. In this regard, we also stress the importance of clear forward guidance and communications from central banks. A number of emerging market central banks have already taken proactive measures and started withdrawing monetary stimulus to keep inflation rates under control, which could have also been discussed in more detail in Chapter 2. *Overall, we would like to better understand why staff consider current inflationary pressures to be still transitory in a wide range of countries, not losing sight of the fact that inflation surprised on the upside in many countries in recent months. Relatedly, we would also appreciate staff's further elaboration on the uncertainties around the baseline inflation forecast.* While we welcome the comprehensive coverage of rising commodity and food prices, along with housing price shocks, the increased prices of industrial goods would also deserve more attention in the analysis. Furthermore, on the Commodity Special Feature, it might also be worth examining the prospects of a new commodities supercycle.

Given that supply chain disruptions largely influence the macroeconomic environment through multiple channels, we would place even greater emphasis on the supply side impacts of the pandemic in the WEO. Even if the duration of pandemic-induced supply-demand mismatches depend on many aspects, the Fund should put a premium on exploring potential structural changes in this regard, considering that supply chain disruptions are already having a significant impact on macro-financial stability. However, in this context, it would also be helpful to shed more light on the outlook for consumption.

In view of the lasting scars of the pandemic and the underlying structural trends, it is particularly important to also explore those policies which can increase growth potential in the post-COVID era. We note with concern that there are still large differences in medium-term economic losses, and scarring is expected to be pervasive outside of advanced economies. This projection calls for support measures targeting the most vulnerable. While we have read with great interest Chapter 3 on the overarching role of basic research, at the current juncture, we would see further scope for better outlining how R&D&I activities can help restore and boost potential growth in the shorter term too, with special focus on increasing productivity. We also see scope for tailoring policy advice much more to countries' circumstances, as different country groups have different space to promote R&D&I activities. We concur that further strengthening of public-private cooperation is key to foster the catalytic role of basic research, especially in the current circumstances, where digital technology and climate-related innovation can result in sweeping structural changes, and also agree that promoting human capital development must be an integral part of new growth models.

Global Financial Stability Report (GFSR)

We also thank staff for the informative GFSR, which presents an insightful account of key financial stability risks across financial market sectors. The report's detailed focus on the crypto asset ecosystem and sustainable investments in the GFSR analytical chapters is timely and well-elaborate. The following GFSR editions could also benefit from greater analysis of cyber risks and the role of shadow banking in credit channeling, including the implications for systemic financial stability. **We broadly agree with the thrust of staff's appraisal and offer our comments on a few specific issues.**

We note the build-up of risks in the housing sector, which are driven by rising prices on the back of substantial COVID-19 related support to households, affordable credit in the low-for-long interest rate environment and substantial supply side bottlenecks, including the rising labor shortages and the price of materials. The increasing supply and demand mismatches resulting into substantial overvaluation in the housing sector pose a risk of sudden price adjustment once the pandemic support to households have been discontinued and monetary policy normalization unfolds. Against this backdrop, we note with concern staff's remark on certain similarities with the GFC in terms of potential credit losses incurred in particular by the non-bank mortgage lenders. We therefore underscore the need to closely monitor financial sector institutions' exposure to the housing sector and adopt adequate regulatory and supervisory response, including through macro-prudential tools.

Similarly to the housing market, we note staff's assessment of the corporate sector risks. While the risks seem to be moderating compared to the April GFSR owing to the extended period of fiscal support and relief measures, near-term solvency and liquidity risks have remained elevated in particular in sectors most severely affected by repeated lockdowns. As the ability of firms to withstand liquidity shocks is contingent on their size, existing buffers and ability to access credit, more vulnerable firms in particular in the SME segment might take a toll going forward. While capital reallocation and business sector restructuring are supportive of innovation, it is critical to buttress national insolvency frameworks and promote access to private funding going forward.

While we positively note that some emerging market economies (EMEs) were able to increase their local currency bond issuance owing to increasing global risk appetite, rising fiscal needs will lead to roll-over risks. Monetary policy normalization in advanced economies might dampen capital inflow to EMEs, putting pressure on the exchange rate, which would further weigh on foreign-currency denominated debt. The authorities will therefore need to adopt the right monetary policy stance in support of foreign capital inflows, without undermining the still nascent economic recovery. While foreign banking operations in EMEs through branches and subsidiaries are critical for extending credit to the real economy and supplementing domestic financing, inter-bank capital flows optimization calls for supervisory vigilance and diligent stress-testing.

We note the rising, albeit volatile global value of crypto assets and increased crypto asset-related activities in particular in EMEs. While different types of crypto assets are associated with a different set of risks and opportunities, a number of transmission channels might increasingly weigh on financial stability going forward. In this regard, staff's focus on operational risks, cyber risks such as hacking-thefts, and governance weaknesses related to inadequate transparency of token issuance, is warranted. As the volumes of crypto asset trading have been expanding, consumer fraud needs to be addressed. Further regulatory work should be guided by deep understanding of the underlying technologies and well-elaborate legal crypto-asset classification, which are both instrumental in developing targeted financial regulation and AML/CFT rules. Against this backdrop, it is also pivotal to monitor risks related to decentralized finance (DeFi), where the products complexity poses transparency and governance issues. *We note staff's analysis of both push and pull factors potentially explaining rising crypto adoption in EMEs, including why it has outpaced that of AEs. We would welcome their view on whether they consider these developments an opportunity or a threat for the EMEs.*

We positively note the assets growth in the climate and sustainable funds sector. While the efficient operation of the sector critically depends on the availability of data and credible sustainable finance classification, it is pivotal to avoid green washing and ensure that asset quality disclosure will be based on sound ESG scores. We welcome staff's analysis of transition risks and their potential impact on the investment fund sector, and see merit in climate-related risks stress testing to assess the sector's vulnerability. Climate-related stress testing targeting physical and transition risks is also relevant in other financial market sectors going forward, including the banking and insurance sectors.

Fiscal Monitor (FM)

We broadly concur with the Fiscal Monitor assessment and underscore the scale of the challenge to reduce debt to pre-pandemic levels and rebuild fiscal buffers as well as the significant downside risks and policy tradeoffs usefully highlighted throughout the report. While keeping policies country-specific, the focus on medium term considerations and transformations needs is well placed and we positively note the estimated spillovers from

EU and US modernization stimulus packages. Assessing the effectiveness of the pandemic response to limit scarring so far would be also useful.

We note the large differences across countries and agree on the continued need to keep policy advice country specific and dependent on pandemic and economic conditions. However, we highlight the more precarious starting position for many economies compared to the GFC, the exhausted policy space in many EMs and LICs, permanent losses of revenues and rising vulnerabilities and risks of debt distress already in the short term, which makes applying lessons learned for the duration of support less straightforward and put a greater premium on rebuilding fiscal buffers. A more nuanced view on financing needs could be useful to distinguish urgent/cyclical BOP needs from pre-existing structural challenges and SDGs financing ambitions. At this point we also emphasize again that vaccine rollout remains a key urgent priority and we fully support the calls to ensure broad access through multilateral facilities. In this context, we highlight the contribution by the EU which is sharing half of its vaccine production with the rest of the world. So far more than 700 million doses were already provided to more than 130 countries.

The discussion on the role of public finance credibility and the fiscal framework reforms in Chapter 2 is timely and advice should be guided by country specific factors including performance of existing frameworks in reducing debt before the pandemic. We are less optimistic that current reforms are likely to provide significant policy space in the short term in countries without an established track record in the pre-pandemic period. Fund efforts to improve debt transparency can play a useful supporting role.

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September 24, 2021

Statement by Mr. Stephan, Mr. Fragin, Ms. Koh, and Mr. Boehme on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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We thank staff for the informative set of reports illustrating the heterogenous state of the global economy and the multifaceted challenges ahead. After a restrained recovery in the spring, economic activity has recently been able to regain momentum. The current situation, nevertheless, remains subject to different countervailing developments. Prospects of re-opening on the back of a progressing vaccination campaign are encouraging but are fraught with high uncertainty, while continued resurgence of the pandemic amid unequitable access to vaccines hamper the outlook. Policy support should therefore continue to foster the recovery in a targeted fashion and facilitate structural transformation. At the same time, policymakers should be attentive to the declining room for maneuver and the need to rebuild buffers.

We agree with staff's call for strong multilateral policy actions to strengthen the prospects for a post-pandemic global economy. Providing confidence in stable, transparent and predictable trade and investment policies and regulatory coherence across jurisdictions would foster positive spillovers and productivity gains in the medium to long run. It would also contribute to a smooth and efficient adaptation of supply chains, thus facilitating the correction of supply chain bottlenecks.

A more ambitious, coherent and internationally coordinated policy response is needed to successfully address the threat posed by climate change.

World Economic Outlook

We share staff's view on the global economic outlook and concur with staff's assessment that the balance of risks for global growth is tilted to the downside. Global real GDP growth was marginally stronger than projected in the first half of 2021, but highly uneven. Going forward, a continued rapid recovery in the US and other advanced economies is expected in 2021, though with renewed uncertainties and downside factors related to the spread of the Delta variant, as well as supply-side disruptions. We agree that the economic recovery should be supported by targeted fiscal measures for as long as necessary. Particular emphasis should be placed on efficiently targeting sustainable and growth-enhancing investments, structural reforms to foster the green and digital transformations, as well as to strengthen social cohesion. Fiscal reforms should help to fund these policy priorities and contribute to the long-term sustainability of public finances as tighter fiscal resources will be a legacy from the pandemic. There is a risk in waiting too long with restoring policy buffers which might raise doubts about fiscal sustainability in the longer term. On the monetary policy side, increasingly divergent policy stances – necessitated by different cyclical positions – might weigh on the global economic recovery in the short term.

To avoid "scarring" and support potential growth, governments should focus on promoting innovation and structural change through primarily market-based incentives, provision of public goods, training re-skilling, and a sound regulatory framework for businesses.

Supply-side bottlenecks overshadow and dampen the upswing in global manufacturing. Uncertainties remain regarding the durability of supply-side effects and potential knock-on effects. *Staff comments on the nature and evolvement of supply-chain disruptions would be welcome.*

We generally agree with staff's growth projections for Germany. However, the potential dampening effects of the fourth wave of infections and especially the pervasive supply-side bottlenecks in manufacturing may hold the economy back even more than expected in 2021. Private consumption could rebound even stronger in 2022 on the back of broad vaccination uptake in case it allows an (almost) full lifting of containment measures. Both, given the prospects of strongly rebounding domestic demand and the likely boost to services imports, the current account surplus could turn out lower than projected in 2022.

We concur with staff that temporary factors were a key driver of the recent surge in inflation rates across the globe and share staff's view about a hump-shaped inflation picture with high uncertainty and strong upward risks. These include *inter alia* further upward price pressure from upstream stages and a stronger pass-through of these, a stronger than expected impact of pent-up-demand, and effects of climate policies, in particular higher carbon prices. While there are no particular signs of broad-based wage pressures to date, labor shortages and their implications for wage growth and the inflation outlook would have benefited from a more thorough analysis. Germany's inflation rate is noticeably elevated by one-off effects. In light of recent upward surprises in upstream price pressures in 2021, we would expect a considerably higher rate in 2022.

Overall, high vigilance is warranted with respect to possible signs of more persistent inflationary pressures, including second-round effects. In this context, **we welcome the nuanced presentation in the main chapter of the challenges facing central banks worldwide at the current juncture.**

We welcome staff's focus on the challenges resulting from a highly uneven, divergent global recovery. In particular, the extent to which the recovery in EMDEs (without China) is lagging behind is striking. The fragile nature of the recovery implies that policymakers in EMDEs might ultimately face intricate trade-offs, should domestic inflation expectations show signs of de-anchoring amid the normalization of policy support in AEs. While many EMDEs have improved fundamentals in comparison to the "taper tantrum" episode (e.g. with respect to external balances), vulnerabilities from both public and private indebtedness have increased, heightening susceptibility to tighter global financing conditions. This underscores the criticality of transparent and cautious central bank communication, particularly in key advanced economies, as well as sound and prudent policies in both AEs and EMDEs. Macroeconomic adjustment may be needed in EMDEs coupled with a judicious mix of macroprudential and exchange rate policies and possibly temporary capital flow measures. As for debt overhangs, these may require timely and effective debt restructurings and reprofilings, in addition to necessary fiscal adjustment measures.

The COVID-19 vaccines have proven successful in preventing severe diseases and human suffering, and, in doing so, acting as a formidable economic policy instrument. In addition, their rapid development and deployment is testimony to the potential of innovation, partnership of states and businesses, and cross-border cooperation more broadly. We welcome the innovation-related analyses in **chapter 3** and concur with the basic findings. However, the swift and universal availability and distribution of affordable and effective vaccines, and their broader uptake where supply is no longer a binding constraint, are critical for the global recovery by allowing a collective level of immunity that ensures a safe re-opening. To achieve the widest possible deployment of vaccines also in EMDEs, efforts to step up access through financial contributions, dose sharing and donations as well boosting production capacities and ensuring smooth logistical and trade procedures are of the essence.

<u>Global Financial Stability Report</u>

We broadly agree with the GFSR's main analyses and conclusions including the assessment of the current downside scenarios. A resurgence of lockdown measures in response to renewed virus outbreaks could weigh on the economic recovery, triggering a sharp repricing of risk-asset prices and a tightening of financial conditions. Similarly, an abrupt reassessment of the inflation outlook could provoke a tightening of financial conditions. In light of heightened sovereign debt sustainability challenges, we would have welcomed a deeper analysis on related potential financial stability risks for emerging markets.

We concur with staff's analysis on risks to the inflation outlook and on the challenges of the monetary policy normalization process. Any such process needs to provide clear guidance on its future stance while at the same time ensuring that developments diverging from expectations can be adequately addressed. We agree that the level of risk taking in financial markets is high and that investors appear to increasingly make use of high financial leverage.

We welcome the analysis on emerging market capital flows. In line with staff's findings, we see that hard-currency flows have rebounded strongly, while local currency bonds did not. Against the backdrop of the increasingly important role of domestic investors for local currency bond markets, we encourage staff to further analyse benefits and drawbacks of a higher share of domestic investors for financial stability, as for example the financial-sovereign nexus.

We agree with staff's analysis that conditions in the corporate sector have improved. Comprehensive policy interventions have prevented an economic meltdown and also supported the functional viability of the financial system. The economic recovery is also reducing solvency risks for the German corporate sector and associated credit risks for the banking sector. Recent survey data suggest that sectors, which have been particularly hit by the pandemic, have also improved their liquidity positions substantially. While aggregate insolvencies in Germany have so far remained below pre-crisis levels, we see a noticeable increase in enterprises' indebtedness particularly in strongly affected sectors. We therefore see the focus of attention shifting from immediate short-term risks stemming from the immediate fallouts of the pandemic, towards more medium-term risks.

We concur with staff's findings that the growth of economic activity appears to relate more closely to overall credit growth instead of the growth of bank loans. This suggests that capital markets may play an important role in supporting the recovery. However, in Germany with its predominantly bank-based financial system, credit extension via bank loans is still an essential prerequisite for economic growth. We agree with staff's view that policies that reduced uncertainty about the economic outlook and credit risk are very relevant to support loan growth and that this might be even more important for economic recovery than improving bank capital ratios.

We share staff's recommendation, that monetary and fiscal policy support should be tailored to country-specific circumstances and that macroprudential authorities should act pre-emptively to address vulnerabilities where needed. Rebuilding buffers or a tightening of specific macroprudential tools to tackle elevated vulnerabilities in specific sectors will be helpful with a view to ensuring financial stability.

We generally concur with the staff's analysis of the life insurance sector. The prevailing low-interest rate environment challenges life insurers to meet their nominal return targets and fosters a search for yield. A strong increase in yields could lead to the emergence of policy surrenders, forcing life insurers to liquidate investments.

We share the view that fintech lending and other activities by the nonbank financial institution sector may be a useful resource to reach a broader range of customers. To address potential risks of undermining financial stability we support a monitoring of activities and risk management practices of the sector. Such monitoring provides the basis for a risk assessment and helps to analyse whether the regulatory environment is appropriate or needs to be adjusted.

We agree that it is important to find a balance between enabling financial innovation of crypto assets and addressing risks. We share the view that financial stability risks emanating from the crypto eco-system are not yet systemic. Still, closely monitoring and regularly evaluating these seems advisable given the global implications and the lack of adequate operational and regulatory frameworks in most jurisdictions. Due to the global character of crypto assets, we concur with the view that regulatory requirements should be set at the international level to address gaps and inconsistencies between them and to avoid regulatory arbitrage.

We welcome the focus on challenges that an ongoing cryptoization process will cause in emerging markets and developing economies. The rapidly evolving crypto ecosystem takes dollarization and its challenges to the underlying economy a significant step further, as exchange rate restrictions may not apply and the storage of and access to foreign assets becomes easier. Cryptoassets may also facilitate the circumvention of existing capital flow management measures. In addition, the ongoing cryptoization process might give rise to increased international financial spill over effects. Hence, we agree with the IMF that countries need to strengthen the credibility and reliability of their domestic policies, while the existing regulatory framework for capital flow management measures may be broadened in order to cover these types of capital flows as well.

We welcome staff's analysis on financial stability risks emanating from the transition to a green economy. Notwithstanding the ability of investment funds, and the financial system at large, to become a driver of the transition, risks may arise from exposures to sectors sensitive to the transition. For example, investment funds may face sudden outflows when a large repricing of the climate-sensitive assets occurs. We furthermore share the view that preventing greenwashing is essential for the fund sector to become an effective driver of the transition. We also agree that scenario analysis and stress testing are appropriate tools to assess climate-related vulnerabilities of the investment fund sector. These tools should also be applied to explore climate-related vulnerabilities in insurance corporations and banks.

Fiscal Monitor

We thank staff for their insightful analysis in the Fiscal Monitor. As the report shows, discussions on fiscal policy are entering a new phase, focusing in particular on more targeted forms of support. Thereby, it is important to focus on promoting investment and sustainability. At the same time, any cliff-effects should be avoided by withdrawing support measures gradually.

We support staff's view that high-quality transformative public investment will be necessary to "build back better" in the aftermath of the crisis as public investment can trigger substantial additional private investment. This effect is even stronger during recessions and in times of high uncertainty. At the same time, public investment is essential to achieve carbon neutrality and manage the digital transformation by investing in key infrastructure and by bridging cost gaps for green investment in the private sector. With a view to achieving carbon neutrality and climate goals, the report rightly notes that, going forward, we should replace ineffective and expensive subsidy-based policies with an intelligent system of taxes, levies and charges as well as regulatory measures.

We agree that fiscal policy can contribute to the resilience of economies and societies via various channels. Building fiscal buffers widen the policy space in times of crisis and enable an adequate response to an adverse shock. Fiscal policy can then also reduce uncertainty in times of crisis and disruptions by committing to high levels of public investment, e.g. in the areas of research and development or "lighthouse-projects". Such activities are likely to increase the resilience to future crises. Being "fiscally responsible" (here in a sense of "maintaining and gradually phasing-out fiscal support if appropriate while committing to future adjustment") might at times imply higher fiscal deficits. However, we share staff's caution that low financing costs should not be assumed to last forever. Highly indebted countries, in particular, need to take this into account. Focusing on the quality and composition of public expenditure and revenue might provide a feasible solution in these cases. Overall, we encourage staff to ensure that their advice is tailored to each individual country case, taking into account its specific situation and characteristics.

On fiscal rules, we emphasize that they should be transparent and designed in a way that they can be applied and enforced in a credible manner. We note that the introduction of fiscal rules is per se not a sufficient condition to ensure prudent policies. On a more technical note, the report mentions that fiscal rules focusing on structural balances are complex and difficult to monitor due to uncertainty about the business cycle. Furthermore, it argues that an expenditure rule would be easier to monitor. However, expenditure rules have to follow a certain goal (e. g. reducing or stabilising the debt level). In order to reach this goal, it is also necessary to make assumptions about the underlying business cycle. Hence, an expenditure rule is not necessarily easier to monitor.

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Statement by Mr. Trabinski, Mr. Peter, and Mr. Tola on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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We thank staff for this valuable and informative set of documents. Fostering the recovery requires a combination of national policies and international cooperation. As medium-term prospects are uncertain, the Fund's strong support for a solid, open, rules-based and transparent international system with well-functioning markets remains essential.

Outlook

We broadly share the Fund's global growth outlook. The recovery is still ongoing but momentum has weakened, and investors are more concerned about medium-term prospects. Moreover, the divergence in recovery prospects continues as a result of differences in policy support and access to vaccines across countries.

Inflation risks have increased. We broadly share staff's assessment of global inflation developments and outlook. We agree that the impact of factors driving inflationary pressures in most economies will likely subside in 2022. However, there is considerable uncertainty around the assessment of these factors, in particular with respect to the output gap. If the rise in inflation in major advanced economies persists, it may lead to an unexpected monetary policy normalization, potentially disrupting financial markets and hurting recovery prospects for the rest of the world.

Financial vulnerabilities continue to be elevated, partly masked by the massive policy stimulus. Asset price valuations appear stretched in many markets and public and private debt levels are very high and rising. This increases the risks of a sharp asset repricing and tightening of financial conditions, thus reducing the room for policy to maneuver going forward.

Policy priorities

We agree on the need to tackle the significant differences in vaccine access. Insufficient access to vaccines poses a direct threat to the unvaccinated populations and it may also lead to the emergence of new and even more transmittable and deadly variants of the virus. Vaccine access is also the main reason for the downgrade in the growth forecast for low-income developing countries. Increased efforts are needed to ensure faster global vaccination. Looking ahead, mitigating scarring effects and fostering sustainable growth requires structural policies that promote competition, innovation, and sustainability.

Monetary policy should closely monitor inflation developments and react to signs of expectations de-anchoring. We agree that monetary policy should look through transitory inflation pressures. Yet, certain market segments in advanced economies, such as the housing market, warrant close monitoring. Inflation is accelerating in some EMDEs, leading to monetary policy tightening. When inflation expectations show signs of de-anchoring, a tightening of monetary policy is appropriate even if labor market slack remains.

Fiscal policy should be targeted and forward-looking. While care is needed not to roll back policy support prematurely, fiscal support should be targeted and consistent with medium-term prospects. Policy support needs to reduce unwanted side-effects and strengthen the resilience to future shocks. As countries converge back to pre-crisis GDP trends, the focus should shift toward ensuring fiscal sustainability.

Credible medium-term fiscal policy frameworks and strong institutions are necessary to foster confidence in the sustainability of current policies, especially in the context of greatly reduced policy buffers. We welcome the analysis on fiscal rules and agree that they should be flexible and easy to enforce. Their design is key to incentivize counter-cyclical policies, and they offer flexibility in cases of a severe downturn. The operational target of a fiscal rule should be adapted to domestic institutions and should be chosen such that it can be implemented in a consistent way over time.

Policymakers need to be mindful of domestic and international policy spillovers. Careful communication will be key to supporting the credibility of the inflation target and avoiding financial market disruptions and capital flow reversals, particularly in EMDEs, from an unanticipated withdrawal of monetary accommodation. EMDEs should continue strengthening the credibility of monetary policy, safeguarding central bank independence, and maintaining a sound fiscal position.

We welcome the additional analysis on the role research and innovation may play in fighting the pandemic and boosting long-term growth. We take good note of staff's new quantitative evidence supporting the view that there is likely too little R&D spending. We agree that more investment in innovation could have an important impact on productivity. To this end, fostering international scientific collaboration and the free flow of ideas across borders could be useful. *We would be interested in staff's further and more detailed elaboration on the role innovation and research can play in increasing productivity and growth.*

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GRAY/21/2751

September 24, 2021

Statement by Mr. Buissé, Mr. Roman, Ms. Gilliot, Ms. Albert, and Ms. de Waziers on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We commend staff for this excellent set of reports. The risk of the pandemic becoming more endemic is increasing, with more downside risks and more structural shifts than expected initially. While the world economy continues to navigate in troubled waters, the greater differentiation of economic trajectories between advanced and EMDEs economies calls for more differentiated policy-mix solutions. Policymakers should be prepared to act in case new turbulence materializes, including the inflation risk, which could have damaging consequences on the most vulnerable economies. Policymakers should address both new and old challenges, and in particular the debt and climate issues, while continuing to protect the most vulnerable and accelerating vaccine deployment.

1) **In a context of increasing economic divergence, monitoring closely the labor market situation and downside risks, in particular inflation, is paramount.**

We broadly share staff's view on the macroeconomic scenario, which highlights the need to pay a specific attention to LICs and more globally to the labor market recovery. As the pandemic lasts, the risk of long-lasting divergence across and within countries is increasing, and the downward revision of LICs' growth projections this year is not reassuring. We thus encourage staff to follow closely the indicators of poverty in LICs. On the advanced economies, we note that the baseline incorporates the US global package, but there is still uncertainty surrounding the fiscal impulse, and we encourage staff to closely monitor its composition. We also appreciate staff's insightful analysis of its global spillovers in the Fiscal Monitor, as well as the Next Generation EU plan in Europe. More broadly, the evolution of the corporates' financial situation is still unclear, in particular in emerging economies characterized by more vulnerabilities, and will need to be monitored carefully. *What is staff's view regarding insolvency regimes in EMDEs?* We note that trade should remain dynamic and that commodities prices have substantially increased, more than expected in April, and we thank staff for their box on the impact of the green transition on the metal prices. The labor market should remain under scrutiny, with low skilled, young workers and women more affected, and a large presence of informality in the EMDEs. We note that despite the fact that all advanced economies should regain their pre-Covid output levels by the end of 2022, one third will not regain its pre-pandemic employment level. Health fears of some workers, increasing reallocation effects, greater automation… may be part of the explanation. *Could staff elaborate more (i) on the determinants of this lag and the relative role of each factor; (ii) on the difficulties to recruit in some advanced economies, and to which extent this issue is included in the baseline?*

We share staff's analysis on the dominant downside risks. Beyond the variant and the vaccination issues, the attention dedicated to inflation is particularly appropriate. We agree with staff that despite a reassuring baseline with an inflation peak this autumn and a normalization after, inflation risks deserve to be closely monitored. The downside scenario, with rising US inflation expectations, is particularly relevant, and the tightening of the financial conditions needs to be monitored, with potential negative impacts on vulnerable countries, considering food securities issues. Transparent and clear communication from central banks will be paramount. We see the risk of a disanchoring of inflation expectations as an important one. A better understanding of exogeneous and endogenous aspects, as well as the impact of the fiscal stimulus on inflation, would be useful. *Could staff clarify how policymakers could better assess the transitory aspects of each determinant?* However, we note that according to figure 2.7, there was no increase in fiscal deficits in the advanced economies before inflation acceleration episodes, and annex 2.3 does not report results to support a sharp increase in inflation expectation during inflation scares. *Could staff comment?* We thank staff for the box on house prices, and *we would be interested to understand better the transmission assumptions between house prices and inflation*. For example, in European countries, the price-to-rent ratio does not appear to be stationary in the long run, and rents tend to follow household incomes, independently from housing prices. Finally, we encourage staff to continue to work on supply chain disruptions effects.

2) **More differentiated recoveries between countries calls for more differentiated policy-mix solutions, and policymakers should be prepared to act in case downside risks materialize.**

Policymakers have to face difficult trade-offs, notably in the fiscal and monetary areas. They are becoming more complex now considering the inflation issue, at a time where the recovery is not yet fully entrenched. Policy recommendations are globally the same compared to the April Flagships, and the GPA's message "vaccinate, calibrate, accelerate" is essential. Nevertheless, we recognize staff's efforts to describe more country-specific policy-mix recommendations, according to the stage of the pandemic, the country's constraints, and their structural characteristics. So, in case downside risks materialize, the message "be prepared and ready to act" is probably the most important motto. Accordingly, as countries start to exit from the crisis, the Fund's advice on a balanced combination of fiscal and monetary policies in the bilateral surveillance remain crucial to support a sustainable recovery, rebuild policy buffers and ensure debt sustainability over the medium term. *In a fragile context marked by massive stocks of public debt and central bank buyback programs, we would welcome staff's further insight on the appropriate normalization of the policy-mix. In particular, what would be the best combination of tools for the EMDEs under the Integrated Policy Framework?*

We agree with staff on the key role of the fiscal policy tailored to local pandemic and economic cycle, especially considering the elevated risks to the fiscal outlook. We concur that fiscal policy should remain flexible, and targeted on households, viable firms and the most affected sectors, to tackle resurgences of the pandemic, and be gradually tightened in case of a stronger-than-expected acceleration of private demand generating inflationary pressures. *We would be also interested in staff's analysis of fiscal policy tools to mobilize the accumulation of private savings.* Regarding priorities, we fully agree that the vaccine deployment should remain the top one. Addressing health and social issues remains paramount, and we agree on the merit of selective fiscal stimulus aiming at improving productivity and growth, through high quality investments in human and physical capital. We also strongly welcome the recent multilateral support for a fairer and modernized international corporate taxation, and we highlight the necessity to implement the agreement.

Helping the most fragile members should remain our top priority. In LIDCs, low availability of vaccines and constrained fiscal space strain the capacity to support economic growth, and gross debt trajectories through 2026 have been revised upwards. We strongly agree with staff on the need to pursue international cooperation to ensure global access to vaccines and help LIDCs meet their high financing needs, which includes limiting long-term scarring and making progress towards climate mitigation and the SDGs. On top of improving domestic resources mobilization and exploring options for SDR channeling through the PRGT, RST and MDBs, we encourage exploring how to stimulate private capital mobilization. We encourage countries at high risk of debt distress not to delay structural adjustment and to engage with their creditors and the IMF to request UCT programs and start a debt treatment process under the Common framework process where necessary.

While monetary policy should continue to support the recovery wherever possible, policy makers should be prepared to the potential materialization of risks, and deal with financial vulnerabilities. We fully share staff's view regarding the importance of a transparent and clear communication from the central banks on the path of normalization and future stance. This should avoid unintended adverse spillover effects, such as bouts of volatility in emerging financial markets. The dual mandates for some central banks to deal with an increase in inflation and labor market slack underlines the necessity to anticipate and be prepared to act to maintain credibility. It is important not to consider monetary and fiscal policies separately, but to take into account their interactions. Moreover, a ranking of inflation determinants according to their transitory nature would be useful for policymakers. Despite progress in credit outlook, easing in global financial conditions and prospects of economic rebound, vulnerabilities remain in the global financial system, including high asset valuations in financial markets and potential correction in the housing market, and we agree with staff on the necessity to act preemptively to contain the effects of prolonged accommodative policies and financial conditions. The residential real estate risks should be kept under close watch with policymakers standing ready to tighten macroprudential tools if necessary, like in France where measures have been implemented to avoid a potentially sharp deterioration of lending standards and encourage healthier fundamentals in this market.

Finally, maintaining global financing stability while supporting innovation should encompass an appropriate regulation of the fast-growing market of crypto assets. Their growing systemic implications warrant a close monitoring. The rapid growth of the crypto ecosystem poses new challenges in terms of operational risks, market integrity, data availability and cross-border activities. We fully subscribe to staff's recommendations on the need for an appropriate regulation and supervision at the domestic and global level of crypto-assets, and more specifically stablecoins. In this regard, a strong coordination between national jurisdictions and at the multilateral level should be considered as a priority to avoid overlaps and negative cross-border spillovers and deepen the work of competent bodies and fora. Echoing the G7's call that no global stablecoin be launched unless it is properly regulated, we strongly emphasize the role of the FSB's High-Level Recommendations for global stablecoins arrangements in the design of future regulations. The Fund's monitoring on crypto-asset risks should be enhanced in critical areas for global financial stability including so-called "cryptoization" in some EMDEs and the related risks of currency and asset substitution. They warrant adequate country-specific regulations, such as the enactment of de-dollarization policies and sound fiscal positions. EMDEs should also consider the pros and cons of the issuance of Central Bank Digital Currencies (CBDCs), which also applies to advanced economies. Country-tailored policy advice remains critical to help EMDEs maintain full control of their monetary policies and financial regulation. We also reiterate the importance for the Fund to refine its assessment of risks related to Big Techs and the use of global stablecoins and digital payment infrastructure, considering their capacity to reach out to a very large number of clients and as such to grasp rapidly a systemic and macrocritical influence. We also agree with the need to address data gaps on exposures to crypto assets to better assess their impact on capital flows.

3) The lack of certainty about the scarring effects of the pandemic on growth should not prevent policymakers from answering to the new challenges stemming from the pandemic, but also to continue to increase traction on the older ones.

We continue to encourage staff to work on the hysteresis effects of the pandemic. The report underlines that the uncertainty surrounding the output gap is greater than before, as the pandemic could become more endemic. This is a considerable source of concern, and structural policies should be more fine-tuned over time, with more sectorial analysis to help design policies for the needed reallocation's strategy. Despite this uncertainty, policymakers should boost their action from now on to build a more resilient, inclusive and green growth. In particular, we continue to encourage specific attention to the reduction of inequalities. This dimension should be systematically taken into consideration in the elaboration of macroeconomic policies, through more redistributive policies and social protection systems in EMDEs. Moreover, we commend staff for their excellent focuses over time in the flagships about key factors influencing potential growth. We value the originality of the chapter on research and innovation, and we agree with the idea to increase the support towards basic research. However, we are wondering how to identify in practice the most appropriate areas to target subsidies and the best incentives to help collaboration between public and private research. Public and private research have different goals and cultures, present asymmetric information, and the costs and results of the transfers between them are uncertain. *Could staff elaborate on the necessary framework to develop an optimum basic research, and in particular the best governance framework to allocate resources to the most promising projects?*

Overcoming the debt level issue, strongly exacerbated by the pandemic, will be paramount and we thank staff for their useful guidance on post-Covid public finances anchored in credible and sound fiscal frameworks. Fiscal transparency and credibility of the fiscal framework are decisive for the good conduct of fiscal policy and in return for the sustainability of public finances, especially with regard to markets perception. We agree that it can reduce borrowing costs. We also concur that there is no such thing as a perfect fiscal rule and the design of each indicator responds to complex tradeoffs between sustainability, stabilization, and simplicity. As it is impossible for a quantitative rule to take into account all the contingencies, some well-thought discretion is key to allow an effective application, i.e. rules should be flexible enough to adapt to changing economic situations. In addition, we share staff's assessment that fiscal sustainability must be assessed holistically, integrating many factors: the public debt ratio cannot be considered as an ultimate indicator of sustainability. We agree with staff on the need to continue to reflect on the optimal design of fiscal frameworks to adapt to the needs of post-Covid economies, where appropriate, and, like staff, we favor country-specific fiscal targets, considering in particular the initial debt level and the macroeconomic environment.

On climate, we insist on the necessity to transform commitments into actions and we fully agree with the sense of urgency described in the report. We commend staff for the effective integration of the climate issue across the Flagships. As rightly emphasized by staff, actions to reduce emissions are urgent. Reversing the declining trend of tax revenue (as a share of GDP) related to environmental goals, increasing the related expenditures, promoting carbon border adjustment mechanism as well as deepening the work on an international carbon price floor, pushing for greener investment and targeting transfer schemes to offset negative impacts of climate policies on households… are critical tools to build a greener recovery, and we are looking forward to seeing ambitious outcomes from the COP26. More specifically, on the sustainable finance landscape, the investment fund industry is likely to play an important role in accelerating the transition to a green economy while being also subject to climate-related vulnerabilities which need to be properly evaluated. The crucial role of the global financial sector in catalyzing private investment in favor of a faster transition, the scaling-up of sustainability considerations in investment strategies, the importance of sustainability labels in attracting fund flows and the need to have sufficient ESG data to be able to draw adequate conclusions from quantitative analysis, are critical. Policy efforts through the NGFS have been actively geared toward developing climate scenarios that are used to assess and manage financial stability risks and bridging the data gaps. Moreover, the EU is moving steadily towards the implementation of EU harmonized sustainability reporting standards, green taxonomy and the already adopted new rules setting out minimum technical requirements for the methodology of EU climate benchmarks. Climate-related disclosure standards allow for an adequate pricing of climate-related risks by markets while ensuring a more efficient allocation of capital and should be shared at the global level, provided they are interoperable, consistent, and comparable, across the domestic or regional regulations. Reporting standards should cover the full range of sustainability issues, including disclosure on the impacts of entities on people and the environment as well as sustainability-related risks to the entity. Transparent and comparable taxonomies are also a cornerstone to the efficiency of climate disclosures, and we encourage work on further harmonization across countries.

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GRAY/21/2752

September 24, 2021

Statement by Mr. O'Brolchain, Ms. Cunningham, and Mr. Villeneuve on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank Staff for the excellent set of reports. We generally agree with their assessment of the global economic outlook and risks, as well as the broad policy prescriptions. While a global economic recovery is underway, short- and medium-term prospects vary widely across countries and are highly uncertain due to the continuing and evolving pandemic. Domestic and multilateral efforts must strengthen the pace of global vaccination against COVID-19, support for vulnerable countries including with reducing unsustainable debt burdens, and policy measures to accelerate economic growth and boost resilience.

World Economic Outlook

We are broadly in agreement with the Staff outlook and the characterization of risks in the WEO. Staff rightly emphasize the divergence in recovery of high- and low-income economies caused mainly by the differences in vaccination rates and policy constraints. The Scenario Box provides helpful insights into the key downside risks: endemic COVID-19 and higher inflation expectations in the US and related spillovers. The baseline outlook includes further anticipated fiscal support in the US, which substantially increases its future potential growth. *Since less fiscal spending is a possible risk, could Staff comment on how much it affects the potential growth?*

The pandemic continues to have a disproportionate impact on women, young people, racialized people, and other vulnerable groups. The WEO notes that the pandemic's impacts the labour force participation of women in advanced economies are now in line with impacts on men, but women's overrepresentation in low-wage and contact-intensive sectors, as well as societal pressures encouraging greater labour market exit when care needs are high, leaves them relatively more vulnerable to employment disruptions (e.g., if public health surprises on the downside). It would be useful to note this context.

More analysis of growth challenges in China would have been welcome, given the contribution of that economy to global growth. *Could Staff expand on the statement that "China's prospects for 2021 are marked down slightly due to stronger-than-anticipated scaling back of public investment"?* It is not immediately clear that less public investment is the main driver of China's slowdown during the second half of 2021, as there were also COVID-19 lockdowns, flooding, and other factors.

We agree that speeding up global vaccination efforts should be the top policy priority. This will help save lives and accelerate the global economic recovery. We note that the WEO text occasionally includes somewhat cautious language to describe the effectiveness of vaccines (e.g., "given that vaccines seem to protect against severe illness"). There is overwhelming evidence that vaccines do protect against severe outcomes and it would be useful for the WEO's language to reflect this, and not risk sending mixed messages.

We value the report's focus on climate change inaction, and its observation that only one-fifth of global emissions are covered by carbon trading or pricing schemes. The global community must strengthen its efforts to combat climate change, including through COP26. We note that LICs and small island developing states 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. 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 agree with Staff's assessment that most increases in inflation are likely transitory, but upside risks remain. Commodity price pressures or supply disruptions could last longer than expected or passthrough from producer prices may be stronger than anticipated. Box 1.1 indicates that recent rapid house price growth could also contribute to rising inflation. However, some advanced economies have had strong house price growth for several years prior to the pandemic with seemingly little effect on inflation. *Could Staff comment on this?* Box 2.2 suggests that food price increases may stem from local shortages, worsening food insecurity in some of the most vulnerable countries. *Do Staff see food insecurity becoming more widespread?*

Inflation expectations for the medium and long term remain relatively well-anchored, but current economic conditions present important risks. Staff rightly warn that current conditions have similarities to previous inflation scares: large and persistent inflation shocks, high sovereign debt and deficits, and exchange rate depreciations in some EMDEs. We appreciate the tail risk scenario in Chapter 2 which analyzes the effects of strong increases in commodity prices, sectoral shocks, and backward-looking (unanchored) inflation expectations. It generates double digit inflation in advanced economies and has inflation peaking at 20 percent or more in EMDEs. *This scenario suggests there would be high costs for real economic activity. Could Staff provide further details how monetary policy reacts and the impacts on global GDP?*

We strongly agree that central banks need to be vigilant and stand ready to act pre-emptively if there is evidence that inflation pressures are becoming more permanent, for example due to wage-price spirals or de-anchoring of inflation expectations. Clear and credible communication is also crucial to contain inflation expectations and spillovers.

We welcome the analysis in WEO Chapter 3 around the linkages between research and innovation, and long-term growth, which provides a useful overview of the challenges facing policymakers in this regard. The mRNA technologies utilized in some of the vaccines to fight against COVID-19 provide a graphic illustration of how prior scientific discoveries can provide a basis for the development of important new technologies.

We note the conclusion that it is important to ensure the free flow of ideas and scientific collaboration across borders. *Can Staff outline their understanding on the extent to which the infrastructure to facilitate such a flow currently exists, either at a regional or global level?* Staff conclude that investments in frontier science could help speed the transition toward a cleaner economy. *Can Staff elaborate on the most effective incentives to assist in bringing new clean technologies to market?*

Fiscal Monitor

We agree that the fiscal response going forward should continue to be agile to reflect changing economic conditions driven by the continuing and evolving pandemic. As the health situation improves and restrictions ease, fiscal measures should shift towards more targeted actions, reforms and investments to address longer-term challenges and enhance productivity to promote a resilient, inclusive and sustainable recovery, within a fiscally sustainable medium-term framework. However, fiscal support should not be withdrawn until the recovery has firmly taken hold and may need to be broadly extended in many countries due to new waves of the virus.

The forecast medium-term consolidation of emerging market and middle-income economy deficits seems unduly optimistic relative to the narrative on fiscal developments for this group. Average primary balances for this group are forecast to be one percentage point of GDP lower than their pre-pandemic level at the edge of the forecast (i.e.,

-1.9 percent in 2026 vs. -2.9 percent in 2019) despite expectations for a durable decline in growth and government revenues, which could be made worse by a number of serious fiscal downside risks. The anticipated fiscal consolidation appears to be predicated on expenditure reductions, which could be at risk of fiscal slippage given the spending pressures that are likely to characterize the post-pandemic era (addressing increases in poverty, meeting the challenge of climate change, etc.).

We appreciate the report's frank recognition that sharp increases in poverty could foment social discontent in EMEs and LICs. We echo the report's concern that social and political challenges could affect governments' ability to meet medium-term fiscal consolidation targets.

We regret that the Fiscal Monitor continues to exclude unfunded pension liabilities of government employee's defined-benefit pension plans from reported debt statistics. This approach understates the true extent of public liabilities and undermines cross-economy comparability. It also appears inconsistent with the direction of international accounting standards and the Fund's priority to promote transparency and comprehensiveness in public debt reporting. *Staff comments welcome.*

Fiscal credibility can be strengthened through strong fiscal frameworks that are tailored to country circumstances. As the Fiscal Monitor highlights, this trade-off can be less painful by strengthening the credibility of the public finances. For market access countries, fiscal credibility makes it easier to finance large deficits and rollover debt, buying time to undertake fiscal adjustment. For countries with limited market access, fiscal credibility fosters private investment and macroeconomic stability. We note that long-term fiscal targets can serve as an important pillar of fiscal frameworks and highlight Staff's conclusion that anchors that go beyond the traditional debt-to-GDP ratio could be given more weight in fiscal frameworks. We also underscore the importance of underlying fiscal institutions and procedures in improving fiscal credibility. For example, comprehensive medium-term budgets that reflect all planned fiscal activities reduce risks of hidden debt and help ensure plans are consistent with fiscal objectives.

While we found the calculations on the fiscal effort needed to bring debt to pre-COVID levels to be an interesting exercise, we caution that it is not clear that pre-COVID debt levels were optimal to begin with. The decline in global interest rates since the global financial crisis may have led to an increase in debt carrying capacity, particularly in advanced economies. At the same time, pre-COVID debt risks were already elevated in many emerging and low-income countries. In these countries, incremental fiscal space could help protect against a potential sharp fall in global savings or sudden jump in interest rates, as well as provide a buffer to address future budgetary pressures.

In cases where sovereign debt is not sustainable, the G20 Common Framework provides a potential mechanism for timely and orderly debt restructurings in low-income countries. Unfortunately, its implementation in the initial country cases has been far too slow. We echo Staff on the need for urgent improvements ahead of the expiry of the DSSI at the end of 2021.

Global Financial Stability Report

The infographic preceding the executive summary is excellent and will likely make the report more intelligible to the lay audience. Perhaps this very effective method of communication could be extended to the Fund's other flagship reports in the future.

Financial vulnerabilities have eased somewhat since the April GFSR, although some sectors and EMDEs continue to face elevated vulnerabilities. We generally concur with the assessment of vulnerabilities and risks discussed in the GFSR, and the related policy recommendations. The risk of tighter global financial conditions underscores the importance of rebuilding buffers (including with the SDR allocations) and structural reforms to develop and deepen markets in EMDEs. We welcome the discussion on housing sector vulnerabilities. We remain concerned that that highly levered households are vulnerable to shocks to income or rising interest rates, even though the report notes that declining mortgage rates have improved affordability. We also appreciate the analysis of possible downside risks to the outlook from weak loan supply growth. *Staff note that changes in credit intensity of growth can affect financial stability risks. Do they also see implications for monetary policy?* In future reports, we suggest also considering other relevant vulnerabilities such as cyber threats, spikes in demand for liquidity (such as occurred at the onset of the pandemic), and the risks of "zombification".

We welcome the discussion in Chapter Two on the crypto ecosystem, which provides a useful discussion on the opportunities and risks associated with crypto currencies. We broadly agree with Staff's assessment of regulatory challenges and associated recommendations. In particular, we agree that national regulators should prioritize implementation of applicable global standards and for jurisdictions to coordinate with each other and with standard setting bodies, to maximize enforcement of measures and mitigate regulatory arbitrage.

We appreciate the Fund's contribution in mapping out the financial stability implications of the rapidly growing crypto ecosystem. Further considerations would also be welcome on macro-financial stability policies for the coordinated regulation of crypto exchanges, not only crypto assets themselves. Moreover, given that in some jurisdictions local banks have been considering issuing their own stablecoins, guidance on the regulation and balance sheet treatment of local stablecoins will also be helpful to regulators. The Fund will have to play an important role in building capacity and providing technical assistance in surveillance, identifying macro, financial and cross-border risks, as well as developing policies to effectively contain these risks. This is especially true for developing economies that wish to safely reap the benefits of this innovation but have limited capacity.

We welcome the dedication of an entire chapter to the challenges of financing the green transition. It is imperative that countries pursue a green and sustainable recovery and accelerate the pace of transitioning to low greenhouse gas emissions if the potential catastrophic impact of the climate change is to be managed. Notwithstanding improved and less expensive technology, the cost of that transition is significant and cannot be borne solely by the public sector. The contribution of the private sector is essential and as such we agree with Staff that there is a role for the financial sector in catalyzing private financing to support the transition without jeopardizing financial stability. *Can Staff indicate what actions will be taken to monitor and assess the impact of COP26 on potential investments in climate change?*

GRAY/21/2753

September 24, 2021

Statement by Mr. Mohieldin, Mr. Alhosani, Ms. Abdelati, Ms. Choueiri, and Mr. Al-Kohlany on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We appreciate staff's insightful and articulate assessment of the global economy and challenges.

The global economic recovery continues to a large extent as anticipated, but with challenges from several fronts, and a number of downside risks. Key among these challenges is the resurgence of the pandemic infection rates—and the potential for lasting fault lines on medium-term performance stemming from near-term divergences. In addition, concerns related to rising inflation, lagging job creation, food insecurity, and the effects of climate change—complicate the policy sphere. Continued careful monitoring and risk assessment are crucial.

An important key message of the WEO is the need for more aggressive vaccine deployment to manage the health crisis, which would otherwise prolong the prevailing uncertainties and continue to widen gaps in recovery paths across countries. In this regard, *we would welcome staff update on the likely achievement of the financing and vaccination targets for 2021 and 2022 in the Fund proposed plan of $50 billion to end the pandemic*.

A second important message is the concern over the persistence of diverging growth paths. In particular, persistent output losses are anticipated for EMDCs as a group due not only to slower vaccine rollout but also the limited policy space compared to AEs. However, looking at growth projections by country grouping in Table 1, the impact of the pandemic has been larger on AEs and the recovery more modest than for the EMDCs on average when looking at 2020-2021-2022 relative to 2019 levels. This partly reflects the impact of China's growth path on the average EMDC growth, which mask setbacks in a majority of other EMDCs. The Middle East and North Africa region performed well below the average for EMDCs. *Beside the pace of vaccine rollout and limited policy space, what are the* *characteristics of countries that are more likely to have persistent output losses and widening divergence?*

The risks arising from this divergence should be further elaborated and emphasized in the report and in the context of the upcoming meetings. It is reported that 8 out of 10 families that have fallen into poverty over the past 18 months are living in Middle Income countries, and many face continued hardships. As this great divergence deepens, there will be regional and global spillovers as people will not continue to suffer in silence. Governors attending the IMFC, G20 and other meetings, should be concerned about this and discussing what can be done to address it.

Detailed analysis of inflation dynamics in Chapter 2 speaks to rising concerns over the possible persistence of recent increases in headline inflation rates, as also discussed in the GFSR. Staff analysis suggests a low likelihood of a de-anchoring of inflation expectations, and they headline that inflation expects to return to pre-pandemic levels by mid-2022 for both AEs and EMDCs under the baseline scenario, but with risks. We note the substantial uncertainty with respect to economic slack, which requires careful monitoring, as well as the extent of further supply disruptions. In addition, inflationary risks have been a growing topic of concern in recent days, and we would like to hear an update of staff views, and if more recent data changes staff assessment as this could have devastating spillover effects on EMDCs?

A third important message is that even if a sudden tightening is not expected in the near-term, EMDCs can prepare for the eventual interest rates increases and possible tightening of market financing by extending debt maturities now to reduce the need for rollovers in 2023-2024. Reflecting concerns of imminent tightening, however, we note reports of the sudden spike in euro and dollar-denominated issuance this past week, amounting to $36 billion compared to an average of $9 billion in the previous 10 weeks, which underscores the extent of concern. Under staff's baseline scenario, with effective communication and readiness to respond to any inflation triggers, inflationary expectations are expected to remain anchored, and financial tightening is not likely to be a concern before mid-2022. EMDCs should nonetheless remain vigilant, especially with respect to macroeconomic policies that affect market risk perceptions to plan for such eventuality. Meanwhile, the Fund should be ready to support EMDCs as they charter what some expect to be increasingly turbulent market conditions (as further discussed below).

A fourth message to highlight is the need to reverse the pandemic related setbacks to human capital accumulation, poverty and inequality, and to accelerate the process of transformation through digitalization and pursuing achievement of sustainable development goals.

The importance of innovation and adoption of new technologies as a driver of productivity is a fifth message that is well-presented in the analytical work in Chapter 3. Investing in natural sciences and engineering could also help speed the transition toward a cleaner economy. It will also be key for longer-term growth prospects and underscore the need for increasing research funding for all countries, as well as better education and deeper financial markets for EMDCs to help convert innovation to productivity enhancing technology. We appreciate the finding that these investments tend to pay for themselves within a decade. *Could staff comment on the experience with technology transfer and what obstacles need to be addressed?*

Global Financial Stability Report:

1. We appreciate the interesting work presented in the October 2021 Global Financial Stability Report. The COVID-19 pandemic is rightly featured in the title of the report as the rapid spread of Delta and the threat of new variants have created greater uncertainty about the strength of the recovery, particularly in emerging market and developing economies (EMDCs). We agree with staff's assessment that policymakers are confronted with a challenging trade-off: maintaining near-term support to the global economy while preventing unintended consequences and medium-term financial stability risks. Unprecedented policy responses in advanced and emerging markets economies have eased financial conditions considerably and may result in stretched valuations and rising financial vulnerabilities that could jeopardize growth unless addressed in a timely manner.

2. The report appropriately highlights rising price pressures in many countries. These pressures may be more persistent than expected and could de-anchor inflation expectations. As a result, in addition to several large EMDCs, some major central banks have started to tighten monetary policy. Faster than expected normalization of monetary policy in advanced economies could, in turn, result in large and sudden capital flow volatility in EMDCs. The Fund should be prepared with tailored and well-calibrated policy advice. Moreover, as most EMDCs do not have access to swap lines or regional financing arrangements, we see a role for a rapid and flexible response by the Fund in providing financial support where and when needed. Implementation of Integrated Policy Framework and the review of the institutional view on capital flows could also provide EMDCs with additional support in dealing with sudden and large capital outflows.

3. We support a central role for the Fund in digital money-related issues. This includes the implications of Central Bank Digital Currencies (CBDCs) and privately issued digital money on the domestic and international financial systems, as well as an assessment of the risks of digital money to financial stability and integrity. We, therefore, appreciate the focus in the report on the crypto ecosystem and financial stability risks. We concur with staff's advice to EMDCs that are faced with cryptoization to prioritize strengthening macro-economic policies, and we appreciate staff's recommendations in this regard (Chapter 2). Staff also recommends that these countries consider the benefits of issuing CBDCs. Can staff

elaborate on the benefits that CBDCs would provide in the aforementioned cases, and whether concerned EMDCs may have the adequate infrastructure to introduce them?

Fiscal Monitor:

1. We welcome staff analysis and policy recommendations in this Monitor, which focus on how countries can reinforce the credibility of public finances and outlined considerations for improving fiscal frameworks, including fiscal rules. We agree that immediate priority for fiscal policy should remain on health spending, including on vaccination efforts and the infrastructure needed for its distribution and storage. International support will be required in economies where fiscal constraints, limited local capacity, or fragility are impeding further actions to save lives and livelihood. Fiscal policy mix going forward should remain tailored to country circumstances depending on the stage of their economic recovery. Measures need to be focused on addressing the economic fallout of the pandemic and on supporting productivity and economic growth through green and digital transformation and other longer-term investments.

2. The report's finding highlights the growing divergence in countries' fiscal space and their capacity to use fiscal policy to address the economic impact of the pandemic and stimulate recovery and growth. We note that in emerging markets and low-income developing countries the cost of borrowing is higher, and growth is held back as governments are shifting expenditures toward addressing pandemic-related priorities, while the advanced economies' amble fiscal space and low-cost borrowing are maintaining accommodative policies with positive spillovers on their close trading partners. Higher interest rates and lower government revenues are also limiting the capacity of low-income developing countries to provide much-needed fiscal support. The Fund must continue to advocate strongly for supporting financially constrained economies.

3. Debt vulnerabilities have increased across all income groups as the unprecedented fiscal responses to the pandemic have resulted in higher gross financing needs and significantly elevated debt levels. Ensuring debt sustainability should be a priority going forward, focusing on strengthening fiscal framework, implementing public finance management reforms to improve domestic revenue mobilization, and the efficiency and targeting of current spending to create room for high return public investment spending. The G20 DSSI, the Fund's CCRT and other initiatives that helped countries temporarily tackle the debt burden at the height of the pandemic are drawing close to an end, which brings to focus the need for the international community to double its effort to address the rising global debt vulnerabilities.

GRAY/21/2754

September 24, 2021

Statement by Mr. N'Sonde, Mr. Nguema-Affane, Mrs. Raoilisoa Andrianometiana, Mr. Carvalho da Silveira, Mr. Lopes Varela, and Mr. Olhaye on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the very informative and comprehensive conjunctural chapters of the three flagship reports. We also welcome the focused policy analysis and recommendations, which are well-ranged with the Fund's prescriptions on ensuring economic recovery and financial stability.

1. World Economic Outlook

We broadly share the assessment of the global economic prospects and associated risks. We take positive note of the projected recovery of the global economy by 5.9 percent in 2021 from its worst recession since the Great Depression, primarily driven by fast vaccine rollout—at least in advanced economies–and continued accommodative fiscal and financial support. However, it is slightly lower than in the forecasts of the July WEO Update by 0.1 percentage points due mainly to supply disruptions in advanced economies and the repercussions of the pandemic in low-income and developing countries. We note that global growth is forecast to moderate to 3.3 percent beyond 2022, reflecting a pickup in growth in advanced economies. The WEO analysis makes evidence of divergence whereby advanced economies are expected to return to pre-pandemic levels while emerging market and developing countries will take much longer to revert to their pre-pandemic levels due to a more limited macroeconomic policy space to support the recovery and much lower vaccination rates if any.

We agree that credible monetary and fiscal policies will be critical to avoid inflation scares and keep expectations anchored. We take note of **chapter 2's** findings that inflationary pressures are building up across the board in advanced, emerging and developing economies on the back of surging demand. We appreciate the indication that inflation expectations have stayed relatively stable thus far while de-anchoring risks appear somewhat limited. Notwithstanding, we remain concerned about the narrow room available for monetary policy to keep expectations anchored, given that inflationary pressures may prolong. Soaring house prices, input supply shortages, and currency depreciation are among the factors driving these pressures. Going forward, policymakers should continue to strengthen monetary frameworks and stand ready to take action should early signs of inflation risks start to emerge. This also implies gradually taking steps and avoiding abrupt monetary policy tightening, which would derail the global recovery underway and be particularly detrimental to emerging market and low-income countries. A clear and well-thought communication strategy on the part of central banks should complement these efforts.

We appreciate the WEO's extensive evidence of the positive impact of vaccination on global recovery and the need to strengthen cooperation to improve access to vaccines and financing, particularly for low-income and vulnerable countries. The slow pace of vaccination in emerging markets and developing economies can certainly affect the global recovery and increase the odds for more infectious and deadly variants to appear if not addressed. *It would be helpful if staff could elaborate further on why only 12 percent of the total doses pledged by the G-7 have been received. It would also be useful for staff to provide a sense of the following steps envisaged to ensure that the proposed vaccination targets for the end of 2021 and mid-2022 can be met.* On a domestic level, we agree that the policy mix should continue to be tailored to countries' health situations and pandemic stages. The recent SDR allocation has provided liquidity to resource-constrained members mainly to pay for the high burden debt service and Covid-related expenses but scaling up the capacity of the IMF and other multilateral institutions to meet the needs of LICs and vulnerable countries in this recovery and resilience-building period remains an open question. Sub-Saharan Africa, in particular, requires close attention. The support of the international community to those countries should ensure that adequate financing is available to tackle medium- and longer-term challenges, including digitalization and climate change.

Boosting long-term growth in the post-pandemic global economy will require preparation and investments. Regrettably, the pandemic and its economic impacts are proving to be worse than anticipated, including the recent re-intensification of the virus due to new variants. This will likely deepen scarring, including loss of human capital, and disproportionally affect developing and low-income countries' medium to longer-term growth prospects. We find it appropriate to create and formulate policies that address the impediments to higher productivity in a post-Covid economy. In this connection, we welcome **Chapter 3's** model-based analysis and its focus on the benefits of increased investment in basic research to boost innovation and productivity, and ultimately enhance long-term growth prospects. In this respect, we heed countries that have devoted resources for greater financial development and a more educated labor force.

2. Global Financial Stability Report

While global financial conditions have improved since the last GFSR, recent pandemic developments call for continued vigilance and better policy communication. Financial vulnerabilities remain elevated, stemming from a few sectors, notably the housing market, where downside risks have increased. In a context of greater uncertainty about the pandemic path following recent rises in infection cases, investors' concern about weaker economic growth, notably in EMDEs, is to be expected. Supporting the recovery while containing financial stability risks amid inflationary pressures has become a very delicate balancing act for policymakers in many countries. Persistent uncertainty about the timing and pace of monetary policy normalization by central banks from both advanced and emerging economies to avoid de-anchoring of inflation expectations underscore the need to improve communication and reduce risks to growth from undesirable spillovers to EMDEs. These risks arise from higher borrowing costs and capital outflows.

We find Chapter 2 on the crypto ecosystem and related financial stability risks very informative and timely, given their fast growth. We recognize the potential benefits of crypto activities, including providing better financial services and fostering financial inclusion. However, we note their potential risks for the FX market and fiscal revenue by facilitating capital outflows and tax evasion, notably in EMDEs. While growing fast, this ecosystem remains nevertheless relatively small, and related risks to financial stability are not yet systemic. That said, we agree that close monitoring of the development of this ecosystem is warranted to better ascertain areas where early development of policy and regulatory frameworks is needed to preserve financial stability. The role of the Fund in this area should be clearly defined. *In particular, technical assistance to strengthen surveillance of an emerging crypto ecosystem should be developed and made available to the membership. Staff comments are welcome.*

We also find very informative the analytical Chapter 3 on sustainable investment funds and their potential to foster transition to a green economy. We are pleased with the increasing growth of sustainable investing, which is outpacing that of conventional investment. *We would like staff to indicate whether the pandemic has had an impact on sustainable investment growth*. The limited impact of climate-related news on fund flows and returns and on financial stability could be explained by the small size of sustainable investment. The growing importance of environmental, social, and governance considerations in investment decision-making is quite encouraging. Going forward, we agree that there is a need to address data gaps and develop robust standards that would strengthen sovereign and corporate data reporting, and better inform sustainable investors about the climate, social and governance aspects they are supporting. We, therefore, appreciate the construction of two key indicators to measure scores of transition opportunity and carbon intensity. As this chapter focuses more on the climate aspect of sustainable investment, we look forward to similar analyses on the social and governance factors of sustainable investment as well.

3. Fiscal Monitor

We share the view that fiscal policy should continue to address the ongoing pandemic and support the economic recovery and transformation. Government expenditures are gradually shifting from measures to fight the pandemic toward supporting green and digital recovery. However, we note from staff analysis that significant differences across countries in fiscal and economic developments and stage of the pandemic remain. While ample fiscal support in AEs has fostered the resumption of output growth and employment, EMDEs and LICs still lag due to low vaccine availability and limited fiscal space. Lower government revenues and limited access to financing have constrained the capacity of EMDEs and LICs to provide the necessary fiscal support. At the same time, their financing needs are more pronounced, and with rising global interest rates, governments' debt is projected to rise to a new all-time high. We take positive note that the general allocation of SDRs can bring valuable relief, in addition to the DSSI and the Common Framework. But the operationalization of the latter remains a challenge. Although fiscal deficits remain well above pre-pandemic levels, they are projected to decrease over the medium-term. We stress that the gradual withdrawal of policy measures should be aligned with countries' specific economic conditions and fiscal vulnerabilities.

We broadly agree with the set of fiscal policy recommendations outlined in the Fiscal Monitor. We strongly support the view that fiscal policy should remain nimble and adapted to the pandemic and economic conditions. Policymakers should balance ongoing support against rising vulnerabilities and avoid sharp changes in policies. In this context, we welcome the proposed differentiation of recommendations depending on a country-specific situation, including the levels of vaccination rate, access to the financial market, and the path of recovery. We concur that the priority must be centered on addressing the impact of the pandemic where the virus is still spreading rapidly, and vaccination rates are low, and on sustaining the recovery where widespread vaccination has been achieved. Moreover, we share the view that in countries that face tight borrowing constraints, fiscal policy will need to strike a balance between mitigating the pandemic, supporting the recovery, containing the public debt, and managing social tensions. Likewise, recalibrating fiscal policy to the economic cycle and the recovery speed while supporting the transformation of economies is appropriate for advanced economies and should be at the forefront of policy design.

International cooperation is of the essence. We note with concern that the pandemic has exacerbated income inequality and that the number of people in poverty has augmented, with the challenges more acute in EMDEs and LICs. In this context, we fully agree that international cooperation is vital to address cross-country inequities in the availability of vaccines as a public good. At the same time, public investment in physical capital, health, and education should be strengthened.

We appreciate the analysis on the need to strengthen the credibility of public finances within credible fiscal frameworks. Unprecedented fiscal supports have triggered a surge in debt levels in many countries, AEs, EMDEs and LICs alike. Although the DSSI has provided much-needed temporary fiscal space, a gradual fiscal consolidation is needed to restore fiscal sustainability. To bring debt on a downward path, we agree that committing to fiscal sustainability with credible fiscal frameworks is of paramount importance.

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GRAY/21/2755

September 25, 2021

Statement by Ms. Mannathoko, Mr. Nakunyada, Mr. Odonye, Mr. Ismail, Ms. Maidi, and Mr. Abdullahi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

As noted in the World Economic Outlook, divergences in income are being determined by vaccine access and the size of early policy support. However, these near-term divergences are expected to leave lasting imprints on medium term performance, with economies in poorer regions growing more slowly than advanced regions, and expecting to suffer from more scarring, slower recovery and lower medium-term growth as growth potential remains suppressed by inadequate infrastructure, among other things. Given projected impacts from rising interest rates alongside climate change and the climate transition on regions such as sub-Saharan Africa, prospects may not improve without a major investment drive, similar to those currently planned for the US and Europe. Guidance and support to capitalize on greening the economy, green energy, and energy transition metals investments, including for small producers, is important.

1. **We thank staff for the excellent and insightful flagship report**s, and broadly share the assessment of the current conjuncture and recommendations on policy actions needed to durably exit from the crisis induced by the pandemic, and achieve a robust recovery driven by global economic transformation. While noting the favorable progress made in more advanced economies, our gray also highlights factors and concerns pertinent to developing countries

World Economic Outlook

2. **While the strong rebound in global growth in 2021 is welcome news, economic recoveries continue to diverge dangerously, with disparities widening between wealthy countries and poorer ones.** With the lowest GDP growth recorded in the least developed regions and divergence likely to be exacerbated by the virus resurgence and insignificant vaccination levels, bold measures are needed. For example, while per capita GDP contracted by 3.9 percent last year in Sub-Saharan Africa (SSA), it has only grown by a projected 1.4 percent in 2021. More broadly, we note that the initial recovery

momentum in advanced economies is waning due to supply disruptions, while in developing countries it reflects worsening pandemic dynamics alongside delays in vaccinations. The threat of new variants, and resultant differentiated impacts on regional growth rates, adds to the prospect of widening income divergence and slower or delayed recovery in regions where it is most needed. Alongside the importance of "a big solution" from the development community to support investment and avert regression, this underscores the need for a careful pro-growth approach to the fiscal consolidations already underway in many fiscally constrained countries, alongside reforms that will boost jobs and incomes.

3. **With just three months left to go before the end of 2021, the IMF Staff's May 2021 Proposal to end the COVID-19 Pandemic needs concerted global attention.** In particular, we encourage staff to highlight in their WEO outreach why the 40 percent vaccination target for all countries in 2021 will not be met and what things will need to change drastically over the next three months. Without drastic change in vaccine access to enable truly global reopening of economies, LIDCs and many small MICs will likely face a further growth downgrade in 2022. In sub-Saharan Africa (SSA) for example, only 2 percent of the population are fully vaccinated as at September 2021 (compared to 4 percent for LIDCs as a group), with only 3.8 percent of SSA having at least one vaccine shot. As staff note, pledges on paper are not translating into deliveries to countries.

4. **The recently launched Multilateral Leaders Task Force will therefore have a critical role to play in strengthening international coordination and ensuring prioritization of vaccine delivery to countries in need**. We urge the Task Force to advance international cooperation to address inequities in the availability of vaccines, treatments, therapeutic, and protective equipment. We agree with staff, furthermore, on the need to remove restrictions to exports of relevant raw materials and finished vaccines, and to diversify production and distribution capabilities including into SSA, and *wonder if staff can provide further insights into what is preventing faster progress in each of these areas, as well as in vaccine delivery? The likely failure to meet the 40 percent vaccination target alongside the fact that broader downside risks are increasing, while developing countries have limited scope to insure against these risks, seems a critical concern. Could staff comment on the implications of such slow vaccination for EMDE growth outcomes in the endemic COVID scenario?*

5. **It is of particular concern that worse than expected employment prospects are concentrated in developing and emerging markets, given the predominantly young populations in many of these markets.** Alongside tailored policies that support jobs and incomes until recovery is entrenched – including in the informal sector, going forward, an emphasis on creating new opportunities for digital and green jobs in developing countries will be important. Fiscal and investment policies will need to find ways to support further expansion of investments in digital infrastructure and in hydro, solar, wind, and water and waste management in developing countries. At the same time, upskilling the many unemployed university graduates in professional digital fields and for relevant professional and scientific jobs that involve green tasks remains important. Unemployed low skilled labor can also be reskilled towards lower skill greening activities such as reforestation and recycling. *To what extent do staff expect the phasing out of pandemic*

benefits such as added unemployment income and furlough to reverse labor supply incentives and make up for the decline in labor participation, particularly in view of the reskilling initiatives underway in some countries to reduce skill mismatches?

6. **As the global community prepares for COP26, it will be important to ensure a fair transition to a low carbon economy; one where the interests of developing countries are also taken into consideration at each step of the decision-making process.** Staff analysis shows that net-zero emissions by 2040 implies a reduction in fossil fuel revenues to just 27 percent of current levels, globally. This implies major output and fiscal transition costs. We therefore urge staff to guide all fossil fuel dependent developing countries with suitable advice and help to frame (if necessary, together with the IFC) effective transition plans that include well designed ESG project proposals that help to ensure energy security and sustain export and fiscal receipts. Support will be needed to design and fund green public investment programs in lagging regions that are being further marginalized by economic divergence; with a focus on more hydroelectric, solar, carbon-capture and other green investments. In addition, a differentiated application of the international carbon price floor recognizing different levels of development and different emissions levels, and with careful consideration of the transition speed implications for developing countries as carbon financing is phased out, remains essential.

7. **Commodity price projections should also translate into timely policy advice for developing regions.** With oil prices projected to decline beyond 2022, policy advice to oil exporters will need to help them prepare for the medium term, as well as for the energy transition beyond that. On the other hand, advice to all small developing country producers, of energy transition metals such as copper, nickel, cobalt and lithium, should be about exploiting this opportunity now to expand mine capacity and scale up production in time to benefit from higher demand and prices in the medium term. Staffs' econometric analysis suggests that a 15 percent persistent increase in the IMF metal price index could add an extra 1 percentage point of real GDP growth for metal exporters. Like staff, we also see a role for a new international institution focused on metals, analogous to the IEA for energy, which could ensure adequate data dissemination and analysis to support country policies, alongside standards and cooperation. It would be important for smaller metal producers (not cited in the WEO report) to also be represented in such a body, given that it's decisions would impact all producers.

8. **Beyond this, we agree that at the global level, research and innovation, if properly wielded, can be a powerful policy tool; whether it is to enable a swift exit from the pandemic or to boost growth potential and long-term productivity.** We have already seen how much difference digital and green technologies, alongside new vaccines, can make in both developing and advanced economies; further innovations will help generate more new opportunities. We urge policymakers to prioritize investment in research and innovation with the specific goal of facilitating its operationalization for the public good, to enhance post-pandemic sustainability and growth prospects for the global community.

Fiscal Monitor

9. **Fiscal policy will continue to play a central role in addressing the sustained effects of the COVID-19 pandemic exacerbated by the limited access to vaccines in developing countries**. Fiscal policy will need to be carefully targeted and able to adapt swiftly to rapidly evolving conditions. That said, credible fiscal frameworks with a set of rules and strong institutions are key to ensuring fiscal sustainability and continued work on this is important, while addressing near term priorities occasioned by the pandemic. Particular attention should be paid to country-specific circumstances in the design and execution of these fiscal frameworks. A flexible framework able to respond to emerging priorities will be needed to help countries navigate the crisis. Furthermore, effective fiscal strategies, catering to both the short and medium term are essential, and Fund support in this regard remains especially important. Currently, policy makers face extremely difficult policy choices and untenable tradeoffs between prioritizing spending on lives and livelihoods, and investment in the future and SDGs. We concur, therefore, that fiscal policy, will need to find the means to focus on saving lives, while supporting the economy in order to mitigate long-term scarring from the pandemic, and exploring appropriate financing options to contain worsening debt dynamics while investing for the future.

10. **Subdued output, low tax revenue outturns, and rising debt service costs continue to undermine LIDCs' and other developing countries' capacity to provide sustained fiscal support**, **thus addressing these challenges requires a collective global effort to overcome the crisis everywhere and enable the recovery of output, external stability and revenues in these countries.** The Fiscal Monitor's indication that deficit reduction efforts in LIDCs will for the most part be accommodated by lower spending, implies pro-cyclical fiscal consolidation which could prove counterproductive and further exacerbate divergence. We therefore stress the importance of pro-growth fiscal consolidation measures that seek to collect more revenues with more efficient systems, and limit recurrent spending while prioritizing capital expenditure wherever possible, in fiscal frameworks calibrated to ensure sustainable investment. Given that the literature shows that the contractionary impact of fiscal consolidation in our region tends to be concentrated in the first couple of years, it will also be important to protect targeted spending during this time, on health, education, agriculture, and social safety nets to address scarring and distributional concerns and manage social tensions.

11. **With gross government debt projected to remain high in the near to medium term driven by elevated gross financing needs and pandemic related contingent liabilities, and the potential for worsening debt dynamics, the issue of an effective and efficient debt resolution architecture is critical.** In this regard, we agree with others that the very limited progress in the effective operationalization of the G20 Common Framework (CF) is a concern, especially for potential participants. The framework's inability to deliver fully so far is a disincentive that could also delay timely and effective debt restructurings going forward. The current two CF cases (Ethiopia and Zambia) will be important tests of the ability of the framework to address past implementation problems that caused substantial delays costing program countries program completions and timely disbursements. We welcome renewed attention by the Paris Club and G-20 members to this issue and are hopeful for timely and successful outcomes in the current two CF cases. As a stop-gap measure, we have appealed for the consideration of an additional six-

month extension of the DDSI beyond December 2021 to sustain debt relief as the countries continue to navigate the pandemic and crisis. The increase in policy rates in response to rising inflation as well as the risk of tighter global financial conditions, may also increase debt challenges in emerging markets (EMs) and LIDCs and requires close monitoring and planning in the context of fiscal strategies.

12. **We support the FM's message that cooperative efforts are required to tackle the shared global challenges from the current health pandemic**. Beyond the IMF proposal to end the pandemic, we welcome the general allocation of SDRs that has helped boost reserves and supported LIDCs efforts to tackle the pandemic. We continue to encourage countries with strong external positions and sizable SDRs to re-channel their SDR allocations towards supporting vulnerable countries; in particular by contributing to the USD50 billion required to "End the Pandemic", as well as to the PRGT, RST, the liquidity and sustainability facility or LSF for frontier markets and MICs that would give Africa access to a repo market (SDR30 billion), and possibly to support recapitalization of regional development banks critical to recovery in less developed regions.

Global Financial Stability Report

13. **We remain concerned that financial conditions are tightening in emerging and developing markets due to investor concerns about the strength of the recovery amid the recent surge in infections associated with new virus mutations and uneven access to vaccines.** We, therefore, stress the importance of maintaining policy support until the recovery is firmly established. To ensure sustainable and inclusive recovery, monetary and fiscal policy should reflect jurisdiction-specific circumstances and needs, given the heterogenous recovery pace across countries.

14. **As recent monetary policy tightening in response to inflationary pressures in some countries has offset gains in risky asset prices, with adverse effects on financial conditions, we underscore the need for clearer guidance by central banks** on future policy stances to avoid a de-anchoring of inflation expectations and abrupt tightening of financial conditions. This has become increasingly important in the wake of fears about risks of higher inflation amid elevated supply disruptions and shortages of labor and materials with the potential to feed into wage dynamics. We also urge more tailored IMF advice to developing countries on how best to manage the transitory nature of current food price shocks. We seek IMF guidance for developing economies on dealing with global inflation synchronization given that it accounts for almost a quarter of changes in national annual inflation rates. We also note the need to carefully weigh tradeoffs between tighter monetary policy stances to contain rising inflation and countercyclical policy to support recovery and jobs and guard against stagflation.

15. **It is encouraging that the strong build-up of bank buffers in the aftermath of the global financial crisis has supported the resilience of the banking sector in the face of the ongoing pandemic,** nevertheless, notwithstanding substantial monetary policy support to back economic activity, downside risks to the credit outlook remain, including from restrictive loan underwriting standards in many countries, with potential adverse impacts on the flow of bank credit and economic recovery. At the same time, policy makers face a difficult tradeoff between supporting near-term economic recovery and

addressing unintended risks to financial stability over the medium-term, precipitated by the prolonged period of very easy financial conditions. In this context, we favor maintaining policy support to nurture a sustainable and inclusive recovery, while ensuring tighter macroprudential policies to help address heightened financial vulnerabilities without a broad tightening of financial conditions. Relatedly, we call on the Fund to step up the provision of capacity development and policy guidance to facilitate and address challenges to the design and operationalization of macroprudential tools within existing frameworks.

16. **The improved global outlook for portfolio flows buoyed by the continued recovery and robust global risk sentiment is welcome and** has facilitated a strong rebound in foreign currency issuance, with many lower-rated issuers returning to capital markets. However, we wonder how long this will last and highlight that staff needs to provide clear sustained advice to advanced economies to help avert an abrupt and painful reversal of flows. We note with concern that a sudden normalization of the monetary policy stance in advanced economies could lead to tightening financial conditions, with adverse effects on capital flows to emerging, frontier market and various middle-income economies, especially those with high debt vulnerabilities. While leveraging the general SDR allocation, these economies should press ahead with the implementation of structural reforms needed to rebuild buffers and insure against risks stemming from capital flow reversals and an abrupt surge in funding costs. To this effect, there is need for tailored policy advice on the appropriate use of capital flow (CFM) and macroprudential measures (MPMs). We therefore look forward to the finalization of the review of the Fund's Institutional View and proposals incorporating Integrated Policy Framework (IPF) tools and new guidance on CFM measures to better manage volatile capital flows. *In this regard, we would appreciate hearing more on staffs' sense of potential tightening of monetary policy in advanced economies in light of the rising inflation rates especially in the US, and amid elevated supply constraints.*

17. **We welcome the increase in flows into sustainable investment funds as awareness of catastrophic event risks rises and urge the Fund to advise developing regions on better positioning themselves to use such Funds for green and general ESG investments**. We also urge support for fairer incentives that will reduce risk perceptions and promote ESG flows to developing regions most in need of investment. Catalyzing private investment to bolster the transition to a low-carbon economy is critical and more needs to be done to expand the currently small sustainable investment fund sector, foster the climate finance market including for developing countries, and in so doing facilitate an equitable transition to a green global economy. Convergence is also needed on a global climate information architecture, resolving climate data constraints, and adopting fund labels and sustainable classifications to help reduce information asymmetry and related risks of greenwashing, while attracting sustainable financing and inflows. Once again, we underscore the importance of the Fund facilitating an evenhanded and orderly transition to a global green economy that will avoid putting low carbon emitters and countries with low capacity to address transition-related spillovers, at a disadvantage

18. **The wide-spread adoption of crypto assets has brought about new risks, with significant domestic and cross-border implications for financial stability, including**

in developing and emerging economies with relatively weak regulatory frameworks, highlighting the urgency of policy and regulatory preparedness in the developing world. We concur with the need to prioritize implementation of global standards germane to crypto assets, address data gaps, control risks from crypto assets, safeguard coordination around stable coins to ensure they are fit for purpose and proportionate; and ensure appropriate legal and regulatory measures and effective implementation of CBDCs. We appreciate the increased prominence attached to work on CBDCs by the IMF and stress the need to equip country teams (alongside TA experts) with corresponding guidance and tools to ensure they remain abreast of fast-changing developments, while providing appropriate and consistent policy guidance to authorities seeking support. There is also a need to reconsider capital flow restrictions in the digital money era, especially with respect to supervision, effectiveness, and enforcement as well as enhancing regional and cross-border collaboration to address digitalization related risks. Strengthening central bank independence and monetary policy credibility will also be important to avert risks posed by digital dollarization. *Could staff comment on the available global regulatory standards that provide reference points for developing domestic regulatory standards?*

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September 25, 2021

Statement by Mr. Hosseini, Mr. El Qorchi, Mr. Ahmed, Mr. Sassanpour, Mr. Belhaj, and Mr. Boostani on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the comprehensive analytical material that will comprise this Annual Meetings' flagships and would like to offer the following comments on each of the documents.

World Economic Outlook

The global economic recovery is on track, but with the recent surge of more infectious and deadlier virus variants and a highly uncertain dynamics of the pandemic, we are still deep in uncharted territory. The recovery is highly tentative and uneven, and a stop-and-go recovery cannot be excluded with stronger waves of the virus. What is certain is that sustained economic recovery critically hinges on steady progress in vaccination that has been very uneven across country groups. Vaccination rates in low-income countries, some in low single digits, have been highly disappointing and it is difficult to envisage how the vaccination targets of 40 percent of the population by year-end and 60 percent by mid-2022, in every country, could possibly materialize. Vaccine hesitancy is a luxury of the rich; the problem of the poor is chronic vaccine shortages that are unlikely to be addressed soon. We again endorse the Fund proposal to end the pandemic, including through vaccine donations. The fact that only a small fraction of the doses pledged by the G7 to needy countries have been delivered so far does not lend room for optimism. We stress that for a durable economic recovery ending the pandemic everywhere should be at the top of the global agenda. Greater vaccine access for low-income countries should be part of a broader multilateral effort, also importantly including concessional financing and debt relief for financially constrained economies.

The two-track vaccination progress is creating a two-track recovery between the rich and the poor countries, that is likely to further widen the already-large income gaps between them. The pandemic has also exacerbated inequality within countries, even in AEs, as employment growth is lagging behind the economic recovery, and the vulnerable groups (youth, low-skill workers, women) have been disproportionally disadvantaged with dim prospects. The uneven availability of sufficient policy space is also a contributing factor to economic divergence across countries as many highly indebted EMDCs cannot afford to sustain their countercyclical support policies longer, and many are in fact tightening policies into 2022 despite sluggish growth.

For AEs and EMDCs with sufficient policy space, policies, and especially fiscal policy, should be calibrated to the pace of the recovery and be increasingly oriented towards vulnerable households and firms until the economic and employment growth are on firm grounds. Conducting monetary policy has become more delicate as it balances subdued employment with rising inflation, particularly for central banks with dual objectives. For EMDCs there are additional considerations, including the impact on capital flows and exchange rate movements. Acting preemptively to get ahead of inflation, while in general sensible, is very much state-contingent and country specific.

The rising inflation and its multiple dimensions are appropriately of high concern worldwide. The nature of inflation during the current crisis is, in many ways, different from previous crises. We commend staff's high-quality analytical work in Chapter 2 on the dynamics of inflation and inflation expectation in an environment of high uncertainty and major supply disruptions. While staff's empirical work supports the robustness of Phillips curve relationship between slack and inflation, using the framework for extrapolation should be viewed with great caution given the uniqueness of the current crisis and the unpredictability of the recovery path. It is comforting that staff's analysis suggests that long-term inflation expectations are still relatively firmly anchored around central bank targets, and that adverse sectoral and commodity price shocks will likely be transitory. It is important because the cost of being wrong or late in response are very high. It is worth stressing that the social tolerance for a steep rise in inflation even for a fairly short duration might be limited.

We took note of staff's two independent downside scenarios: rising US inflation expectations and an endemic COVID, in both cases entailing a sizable dip below the global, AE, and EM real GDPs compared to baseline. The likelihood of the two scenarios materializing concurrently however is not insignificant. *We would appreciate staff comments on the likely combined impact.*

The commodity price boom over the past year has helped to assuage the impact of the crisis and ease the external financial constraints of producers and exporters. The Commodity Special Feature refers to "backwardation" of crude oil price futures at current high global prices compared to an upward sloping futures curve when market prices were much lower in 2020. That should not be surprising since the expectations of international market clearing price have remained anchored around US$55-60 per barrel despite major swings in demand and supply over the last 18 months. *Staff may wish to comment.* We take special note of staff's analysis of the evolution "clean energy metals" and the multifold frontloaded increases in their prices over the next two decades under policies to meet net zero emission in 2050. *In our view, such a scenario might impede the pace of progress towards greener global economy, and we would welcome staff comments on how best to address this potential conflict*. Natural gas is also considered a clean energy source and we see a greater scope for it in the future global energy mix. The concentration of supplies of the four strategic clean energy metals in a handful of countries is likely to create more market sensitivity than is the case with crude oil and OPEC.

Our constituency has been one of early advocates of Fund involvement in climate change issues. Climate change has many aspects, and the policy emphasis so far has been on reduction of greenhouse gases. An issue of great importance to the Middle East is water shortage which deserves more attention in the dialogue on climate change.

The progress in globalization over the past few decades significantly raised global welfare, narrowed income gaps between the rich and the poor, and pulled millions of people out of poverty. The progress was interrupted for few years recently because of rising trade and technology tensions between the two leading economies, followed by the devastating impact of the pandemic that pushed many millions back into poverty and derailed the plans of many EMDCs to achieve their Sustainable Development Goals. International trade was, and will be again, an important element of global prosperity as the recovery takes hold. For that to happen, however, a strong commitment to a multilateral rule-based trade system is imperative. We welcome staff's analysis (in Chapter 3) that for the first times quantifies the cost of decoupling of the US-China technology links on the global economy. We also endorse staff's emphasis for governments to boost productivity through public investment and by creating enabling conditions for private investment in innovation and new technology. *We would welcome staff assessment of the innovation and new technology content of the massive US infrastructure package under consideration*. Spillovers from AEs to EMs are potentially significant, and other countries with limited resources and technical know-how stand to benefit from cross-border technology transfers and adaptation.

Global Financial Stability Report

We welcome the themes addressed in the report and broadly support staff's policy recommendations, which we find well targeted and differentiated according to country circumstances. Supportive monetary and fiscal policies and the rebound in the global economy earlier this year have been important in containing risks to the global financial stability. They mask however several financial vulnerabilities which they have contributed to create, including distortions in asset prices and excessive risk-taking behavior.

For advanced economies, we agree that the unprecedented monetary and fiscal support measures pose risks to financial stability particularly if they are maintained beyond what is necessary. This is especially the case as inflationary pressures are building up and other undesirable consequences of excess liquidity in the markets are noticeable. We therefore agree that a gradual normalization of policies, where conditions permit, should be contemplated and a clear direction for future monetary policy is needed, to avoid financial market volatility and an abrupt tightening of financial conditions in emerging markets. We are of the view that central banks in advanced economies should consider spillover effects of their policy actions on the rest of the world. They should also internalize feedbacks from the global economy due to higher interconnected financial markets. We welcome the specific recommendations made for emerging and frontier markets, which are rightly centered on structural reforms, building reserve, and strengthening financial market governance and infrastructure.

Soaring housing prices are becoming a global phenomenon; the recent woes of the Evergrande Group have highlighted the risks that an uncontrolled expansion of the property sector can pose to households and banks at the national level, but also to the global financial markets if the failing companies have a critical size and are highly indebted to international banks. We note that the banking sector remains well-capitalized and is implementing strict underwriting rules and procedures. However, the nonbank financial institutions may not be as well capitalized and are not following prudent procedures as banks. Therefore, the unprecedented period of low rates may exacerbate their vulnerabilities and cause spillovers into other sectors. Against this background, we encourage policy makers and supervisory authorities to design and implement, if necessary, appropriate macroprudential measures to address those risks.

We find the chapter on the crypto ecosystem very rich and informative. The phenomenal growth of crypto-assets in recent months and their rampant use on a global scale is a wake-up call that should alert and mobilize policymakers and financial regulators. They should anticipate and mitigate the risks to financial integrity, consumer protection, and financial stability. The report is formulating well-thought and sensible policy recommendations, and regulation may become unavoidable as these assets become mainstream. However, we encourage a balanced approach to regulating crypto assets, which should avoid excessive conservatism that may hurt innovation, and ultimately distort competition and harm growth. We agree with staff that part of the "cryptoization" problem especially for some EMDCs, is the lack of credible monetary policy, weakness of fiscal positions, and ineffective restrictions on capital flows in a globalized and deeply intertwined world. Addressing these macroeconomic issues would be part of the solution and the Fund can play a central role in developing capacities and supporting EMDCs in dealing with these new challenges.

Fiscal Monitor Report

We broadly share the assessment of the fiscal outlook, risks, and policy conclusions. Fiscal policy is pivotal to addressing the impacts of the pandemic and the outlook is dominated by the still evolving pandemic and its intensity. We agree with staff that, amid the exceptionally large degree of uncertainty caused by the interplay between vaccines and the virus and its variants, risks of a worse outcome predominate. Effective policies are, therefore, needed to ward off worse outcomes. Supporting measures implemented over the last year and a half should be scaled back gradually and flexibly as the pandemic fades. Once containment measures can be lifted, policy focus will have to shift to securing a robust recovery while ensuring that debt overhangs do not weigh on activity over the medium term.

We note that, by and large, fiscal policy remains supportive. Deficits have fallen by 2 percentage points of GDP, on average, in 2021, and projected to decrease further by 3 percentage points in 2022. Thanks to the exceptionally large fiscal stimulus, GDP is expected to mostly recover in advanced countries. By contrast, it will be much lower than expected before the pandemic in emerging markets and low-income developing countries, and revenues will also suffer. We are concerned that in many EMDCs growth is constrained by vaccine scarcity and expenditure shifting to pandemic-related priorities.

Global public debt is expected to remain at a record high level of almost 100 percent of GDP over the medium term. Fiscal support provided by the governments during the pandemic has resulted in higher gross financing needs and elevated debt levels. This would require larger primary fiscal surpluses to reduce debt levels to pre-pandemic levels—a task complicated by crisis-related spending, pre-existing vulnerabilities, development needs, and resistance to raising revenues in the low-income and middle-income countries. As such, the deficits reduction will occur largely through spending cuts. Many low-income developing countries will likely need further international assistance and in some cases, debt structuring beyond the DSSI. In parallel, fiscally responsible governments need to commit to fiscal sustainability and manage critical risks within credible fiscal frameworks to make debt stabilization or reduction less painful. Indeed, fiscal frameworks should seek to achieve sustainability and economic stabilization whilst setting fiscal targets against the magnitude and source of fiscal risks faced by individual countries.

We agree with staff assessment that in smaller EMDCs large financing needs are a potential source of vulnerability where financing conditions are sensitive to global interest rates and central banks have begun to raise short-term interest rates. In such situations, fiscal policy will need to be nimble to respond to the challenges and facilitate the inclusive, greener, and transformational recovery.

We concur with the policy guidance provided in the FM (Chapter 1) to rebuild fiscal buffers and make progress towards the SDGs. In particular, international cooperation is vital to addressing cross-country inequities in the availability and distribution of vaccines. The general SDRs allocation and the DSSI have provided liquidity support to low-income developing countries, however, more support is needed through grants, concessional loans, and debt relief. In this context, we see that demand for UCT quality programs is likely to rise further and Fund-supported reform programs will become pivotal to underpin the recovery and address the structural issues exacerbated by the crisis. At the same time, governments should increase public investment in high-quality physical capital, education, and healthcare, and better target fiscal transfers toward social safety nets. It would be equally important to calibrate fiscal policy to the cycle and speed of the recovery and achieve a judicious mix between fiscal and monetary policies. Fiscal policy should be tightened if private demand recovers faster than anticipated, in order to reduce the risk of a sudden rise in interest rates. Furthermore, governments should strengthen the credibility of their fiscal policy by focusing on revenue mobilization in the medium term and enhancing expenditure efficiency.

GRAY/21/2757

September 26, 2021

Statement by Mr. Bhalla, Mr. Goyal, Mr. Natarajan, and Mr. Singh on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

I. World Economic Outlook

1. We compliment the Staff for an excellent document. While we appreciate its analytical depth and rigor as always, we do take a positive note of its very forthright and focused policy advice to the membership on managing the pandemic and post-pandemic recovery. We broadly agree with the Staff's assessment of prospects, risks, and policy prescriptions, but would like to highlight a few points.

2. The world output growth has been projected at 5.9 percent for 2021 a shade lower than the July 2021 estimates. This largely reflects downward revisions among advanced economies (AEs) facing supply disruptions and resurge in infections. This is a matter of concern. But we expect these downside factors to be offset by the strong policy initiatives including infrastructure bill and anticipated strengthening of the social safety net in US and Next Generation European Union grants and loans to EU economies. Moreover, AEs have already vaccinated nearly 50 percent of their population. Are there some other factors that led to downward revision in growth projections going forward?

3. As noted in the report, demand supply mismatches are one of the key downside risks to the recovery. While the unprecedented policy support and containment of pandemic has led to a pick-up in demand in AEs, supply seems to be lagging. Apart from several other structural changes within the domestic economies, is the lagging supply a reflection of the fact that a significant part of supply chains operates outside the advanced world?

4. Report observes that employment around the world remains below its pre-pandemic levels. Further, Latin America, Caribbean and South Asia are among the regions where declines are particularly large. The employment estimates are likely to be very tentative for many emerging market economies (EMEs) on account of data issues. It will be instructive to know the underlying methodology to arrive at these conclusions. How much of the policy

support extended by the governments has been factored into the estimates? Further, how individual economies have coped with the pandemic is important. India, during the second wave, increasingly adapted to the work environment under COVID-19 with enhanced use of digitalization and a switch towards electronic and online mode and the containment measures, this time, were more focused and localized.

5. We note that headline inflation rates have increased, in 2021, in both advanced and emerging economies. It has been reported that to a large degree, this increase in inflation reflects a combination of pandemic induced supply-demand mismatches, and rising commodity prices, expiration of special pandemic related policy dispensations and exchange rate depreciations. Can staff elaborate on the relative contribution of these underlying factors in the different regions of the world?

6. With regard to policy actions to strengthen the recovery, we welcome the very focused policy advice in the outlook. With regard to fiscal policy, outlook suggests that it should be undertaken within medium-term frameworks to improve tradeoffs between cyclical support now and building buffers to address future shocks. Where fiscal space is limited, a targeted approach should be followed and initiatives should be taken to strengthen tax compliance and administration.

7. With regard to financial sector policies, reports suggest that support can be focused on viable banks and firms where recovery is lagging due to health-related concerns. Resolution mechanisms should be reinforced to facilitate capital reallocation and to reduce risk of keeping zombie firms afloat.

8. On monetary policy stance, reports observe that central banks can generally look through transitory inflation pressures and avoid tightening until there is more clarity on underlying price dynamics. However, that monetary policy tightening may be needed even though the recovery is delayed is an arguable proposition.

9. Report further recommends that EMDEs should prepare for policy normalization by AEs by reducing rollover risks and containing balance sheet mismatches. Also, the foreign exchange intervention and temporary CFMs may be useful. Noting that US baseline forecast is very strong, the Staff recommends that the Federal Reserve should communicate a scaling back of asset purchases and begin tapering in late 2021 to prepare for a policy rate liftoff in late 2022.

10. We agree that rapid vaccination is key to recovery and the global community needs to increase its efforts to vaccinate adequate numbers everywhere. As observed in the report, the case of the United Kingdom is instructive in the effectiveness of large-scale vaccination campaigns, even against highly contagious variants. Notably, India has embarked upon a drive to vaccinate its large population of 1.3 billion; supply constraints had hindered the progress initially, but at the current pace, the target to fully vaccinate at least 60 percent of its population by the end-December 2021, is on track.

11. Outlook has highlighted the mitigation efforts toward climate change. It states that a green infrastructure push at the current conjuncture is a win-win strategy that can strengthen the recovery from the pandemic through investment with high returns. We take a very positive note and welcome further observations made in this regard in the outlook. It notes that *"At the same time, multilateral support via cross-border technology transfer and climate finance initiatives can help ensure that the transition is not limited only to countries that can afford such mitigation measures".* We are gratified that the point this chair has been making before the board in earlier discussions finds a mention.

12. Nonetheless, we would like to point out that India attaches prime importance to climate change concerns from the perspective of long-term sustainability. This is reflected in our actions as India is among the few countries that are 2 degrees compliant and has taken many decisive actions to fight climate change. India is targeting a reduction in emissions by 33-35% of its gross domestic product (GDP) by 2030 from 2005 levels and 40% of installed power capacity from non-fossil fuels by 2030 by rapidly scaling up the renewable energy capacity. At present, India has the largest renewable energy program and has just nearly tripled its commitment from 175 GW before to 450 GW.

13. Finally, some observations on the results and data presented in the chapter:

   a. On output gaps (Figure 1.15, page 15), the report may provide details on the methodology being used by the IMF for estimation of potential output and output gap in view of challenges in their estimation after the outbreak of COVID-19.

   b. In Table 1.1 (page number 9), real GDP growth of India for Q4 2019 and Q4 2020 are 3.0 per cent and 1.6 per cent, respectively, instead of 2.8 per cent and 1.5 per cent, respectively.

   c. In Table A4 (page number 32) of the Statistical Appendix, average real GDP of India for 2003-12 works out to be 7.0 per cent at 2011-12 base year instead of 7.9 per cent.

II. GFSR

1. We welcome the analytical rigor of the GFSR and broadly agree with the key conclusions. During the current pandemic, unlike the AEs, several EMEs are caught between feeble recovery and increases in inflation rates. At the same time, asset valuations in both the housing market and financial assets are close to their historic peak. While for some EMEs, monetary easing continues to provide the necessary support to fragile economic recoveries, elevated asset prices may indicate the need for tightening of macroprudential policies to contain financial stability risks. **What could be, in the staff's view, the practical constraints for central banks in deploying macroprudential tools as these may dampen the effect of monetary-fiscal easing and slow down the pace of recovery?**

2. Within EMEs, there is now a divergence between the growth path and inflation paths. Inflation prints in some EMEs have been above their tolerance level and there are apprehensions of inflation expectations becoming entrenched. This fear has led some EMEs to raise their policy interest rates, while others, where inflation risks are moderate, continue to maintain an accommodative stance. The outcome is a significant divergence in interest rates across EMEs, even though, as noted in forward survey estimates, inflation is expected to start trending down soon and be within range in 6-12 months (GFSR, Ch.1, para 16). **What is the risk that this divergence can affect the reallocation of portfolio flows, particularly the debt flows within EMEs? Does the staff also see the evidence of divergence of economic recoveries within EMEs influencing the pattern of equity flows to EMEs?**

3. It is expected that the solvency risks in certain sectors may re-emerge once the policy support is withdrawn. From the April assessment of WEO/GFSR, the economic recoveries in many EMEs have been better than expected. Many large EMEs seem to be exhibiting a strong rebound, though the risks from subsequent waves of viruses cannot be ruled out. **Nevertheless, if the economic recoveries are progressing at the current pace in some EMEs, how may it have a procyclical effect in containing the expected insolvencies as upside to growth may provide a positive boost to the value of firms' collaterals?**

4. Spreads in credit markets have remained tight, reflecting a more favorable view on credit default and insolvencies. It would be interesting to understand as to what extent these benign credit spreads are driven by the continued liquidity support of the central banks and guarantees by the governments on the one hand, and improved growth expectations on the other?

5. **We are indeed concerned about the tendency of increasing dollarization threat posed by the crypto assets**. **We fully agree with the need for cross-border collaboration to address technological, legal, regulatory, and supervisory challenges given the multi-jurisdictional nature of such business/transactions.** On regulatory aspects, there is an urgent need for the evolution of global standards to enable innovations within the regulated financial perimeter to avoid regulatory arbitrage. A legal framework needs to be devised with global consensus that details the regulatory compliances and clear-cut accountabilities that must be followed to balance the objectives of efficient payments and reduced costs and the associated risks. There is also a need to pay attention to the disclosures about the collaterals held by the digital coin issuers/exchanges as the retail investors may be exposed to significant risks if the collateral themselves are subject to higher market volatility. We also fully agree with the need for ensuring an adequate regulatory framework for the credit, liquidity, and operational risks for the widely used stable coins. Besides, cybercrimes and frauds underscore the urgency of global cooperation on regulation and strengthening of AML/CFT standards. Data collection, sanitization, and aggregation by sectors and residency are of paramount importance to assess the systemic importance of the growth of this industry for global financial stability.

6. The GFSR assessment suggests that benefit transfers from governments have boosted the income of households and have thus supported housing demand. We understand that the

benefit transfers were mainly focused on low-income households, who suffered the most during the pandemic due to the job losses (in the informal jobs) and face a very adverse house price to income ratio. It would be important to understand the distribution of demand for housing, i.e., low-cost to high-cost dwellings. **The key question is whether the savings from the higher-income percentile of households flow to the housing market given their better credit history to avail loans from the banking system and low return on their excess savings vis-à-vis the housing assets.** It is possible that even the housing demand generated due to work from home is coming from relatively higher-income households who are in technology or tech-enabled sectors and who need to work remotely.

7. Regarding the role of sustainable investment funds in catalyzing green investments, we would like to underscore that the research suggests that **climate-compatible investments often have higher investment needs than conventional (fossil fuel) measures and may also carry higher financial risks because the technologies are not proven, or the projects have high upfront costs.** Thus, private capital/investments, particularly in developing countries, may be difficult to be attracted to such projects, unless there is some mechanism of risk pooling/risk reduction by a global institution.

III. Fiscal Monitor

1. The fiscal monitor provides an important perspective of the emerging divergences in the fiscal landscape of advanced, emerging, and low-income countries. The analytical work on the recent developments in fiscal situation and drivers of fiscal outlook over different time horizons provides a sound basis for calibrating the fiscal strategy for the future. **The reasons for the differential evolution of fiscal outlook are primarily because of the variation in the intensity of the health crisis, low availability of vaccines in low-income and emerging market economies and skewed fiscal space in favor of advanced economies even before the pandemic but worsening after the pandemic**. Addressing these challenges requires appropriate national priorities in deploying the limited fiscal resources and effective international cooperation pivoted on meaningful financial and non-financial support by the advanced economies.

2. In the low-income countries, recovery is affected by low availability of vaccines and narrower fiscal space. The debt vulnerabilities remain high as the debt service to tax is rising even as tax revenue is expected to remain sluggish. Difficulties in scaling up expenditure in human and physical capital could damage the gains made in achieving the sustainable development goals. *Can the staff provide the quantum of direct and indirect financial support especially financial aid and grants provided by advanced countries to low-income countries during the pandemic and how it compares with the pre-pandemic levels?*

3. Availability of strong fiscal buffers have helped the advanced countries to move with bold measures in providing ample support to people and businesses. Still, it may not be adequate to compensate for the increased inequality in labor earnings as the employment rates have rebounded strongly for high-wage workers but remain lower for low-wage workers. We welcome the multiyear plans like the Next Generation EU (NGEU) and "build back better" under American Families Plan (AFP) and the American Jobs Plan (AJP). **These plans have huge potential to increase public investment, strengthen social safety nets, build resilience against future health challenges and address climate change.**

4. EMEs have generally provided adequate supportive measures during the pandemic. However, the limited vaccine coverage and resurgent waves of infection combined with tightening fiscal situation due to increase in debt, limit the ability of governments to boost investments and plan medium-term consolidation. EMEs have exhibited enormous divergence in their response to pandemic as well as outlook in the post-pandemic future.

5. In this regard, India has significantly boosted vaccine production and vaccine administration. The country is well on track to achieve full vaccination for more than 40 percent of eligible population and at least one dose for 60 percent before end-2021. **Bold structural reforms undertaken by India in Labor and Agriculture and the most recent reforms in telecommunication are aimed to boost investment and growth. The privatization and National Monetization Pipeline (NMP) are expected to boost efficiency in the real sector and boost private-sector investment.**

6. **The analysis on global spillovers from the fiscal packages in the European Union and the United States provides some important insights.** The direct effect will be their impact on international trade and international prices, especially commodities and high interest rates. The positive spillovers are expected to be limited to countries with strong commercial ties and oil producers. However, developing economies are expected to face higher inflation and interest rates. It is also expected to dampen investment and consumption in emerging G20 economies.

7. We welcome the work on strengthening public finances which is extensively covered in the chapter 2 of Fiscal Monitor. Commitment to fiscal sustainability with credible fiscal frameworks can help the Governments to finance fiscal deficits and prudently manage the public debt. **Rebuilding the fiscal space should take into account the different critical elements at different periods of time: pandemic phase, level of fiscal multiplier and debt composition among other factors.**

8. In considering the effectiveness of fiscal measures taken during the pandemic, *can the staff provide a comparative assessment of the effectiveness of direct financial support measures to businesses and indirect support measures like guarantees and deferments?* As the emerging economies confront constrained fiscal space, this analysis can help in not only effectively targeting the beneficiaries but also help to optimize the combination of fiscal measures which can provide maximum socio-economic benefit while mitigating the overall fiscal risks.

9. In managing the fiscal risks, the ability of the country to undertake countercyclical fiscal policies with fiscal frameworks embedding future deficit reduction can signal commitment to fiscal sustainability and help in reducing the risk premium. The fiscal frameworks with elements including long-term fiscal targets, fiscal rules, and fiscal institutions can help to achieve fiscal sustainability, macroeconomic stability, and public accountability.

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The contents of this document are preliminary and subject to change.

GRAY/21/2766

September 27, 2021

Statement by Mr. Jin, Mr. Zhang, Mr. Bai, Ms. Zhao, and Mr. Law on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/96
September 28, 2021

We thank staff for the set of flagship reports and broadly agree with staff's assessment of the global economy and risks.

World Economic Outlook (WEO)

We concur with staff's view that the major source of concern is that more aggressive COVID variants could emerge before widespread vaccination is reached. To achieve sustainable and inclusive recovery, the current priority is to contain virus mutations and deploy worldwide vaccines quickly and equitably. We appreciate the Fund's efforts to strengthen multilateral cooperation on vaccination, and China is working actively to join the global efforts. We suggest countries with adequate vaccines share vaccines with low-income countries (LICs), and facilitate vaccine related trade.

We welcome the analysis on global inflation dynamics in Chapter 2. *We appreciate staff's analysis on the impact of supply chain disruption, and welcome staff to make more explanation on the impact of monopolistic pricing in some mining sectors.* With headline inflation rate rising rapidly over the past few months in major Advance Economies (AEs), some emerging markets and developing countries (EMDCs), especially with the expectation of additional fiscal support, worries on a more lasting and broad inflation are increasing. Some EMDCs have already tighten their monetary policy stances. We should be cautious against risk of double hit from pandemic and tighter financial conditions to EMDCs. History shows that when major AEs tightens monetary policies, international capital will likely flow back to the AEs and their currencies will appreciate. This would pose significant spillovers to the EMDC.s

We appreciate staff's analysis in Chapter 3. Technology innovation, rapid technology transfer, the free flow of ideas, and collaboration across borders are key to boost productivity and the post-COVID global economy. The illustrative model indicates that the reversal in scientific integration of major economies would damage global economy growth, and decoupling of basic scientific research between the United States and China could have big negative effects on global productivity. We support the Fund to continue its constructive role in establishing a conducive environment for trade, financing, and exchange of ideas, including the trade of technologies.

We concur with staff that the international community should resolve trade tensions and reverse the trade restrictions implemented in 2018-19, and strengthen the rules-based multilateral trading system. It is essential to strengthen the international cooperation based on comparative advantage, division of labor in the battle against pandemic.

Moreover, we appreciate the Fund's efforts to explore practical options to help vulnerable countries. To ensure adequate international financing and mitigate sovereign debt risk in LICs, we support the Fund to promote all stakeholders, especially private creditors to participate debt treatment to LICs during the implementation of G20 DSSI and Debt Treatment Common Framework. We encourage staff to elaborate on the implication of the proposed SDRs channeling to the economic growth projection and debt sustainability analysis for LICs.

Although some regional COVID outbreaks and severe floods have disrupted domestic consumption in the summer, China continues resilient recovery, and we have particularly noticed that high-tech manufacturing and private investment are accelerating. China's external trade also registered steady and strong growth, which once again showed that trade with China has been one of the most reliable one in the global supply chain.

Global Financial Stability Report (GFSR)

We broadly agree with the GFSR's main conclusion that financial stability risks have been contained so far, reflecting ongoing monetary and fiscal policy support and the rebound of the global economy. However, the asynchronous and divergent recovery between AEs and EMDCs continues to be a key concern. For AEs, a prolonged period of extremely easy financial conditions results in overly stretched asset valuations and has fueled financial vulnerabilities. For EMDCs, the main risk in the near horizon is a sudden capital flow reversal amid the possible change in the monetary policy by AEs. The Fund must step up its surveillance work on cross-border spillover effects of AEs' policies. The review of the Institutional View should be completed in a timely manner to allow the Fund to provide more appropriate policy guidance to its membership.

Financial conditions in China have remained basically stable despite the impact of the pandemic. The People's Bank of China has maintained a prudent monetary policy that is flexible, precise, reasonable, and moderate. China has continued with reforms to make the financial system more market-based that can better support our economy. With one of the world's highest economic growth rates, China has ample policy room to address financial vulnerabilities, including by maintaining liquidity in the banking system. In this regard, Chapter 1's coverage of China's financial vulnerabilities seems disproportional when compared to some other major countries with even more stretched asset prices.

The report has suggested the Chinese authorities to gradually phase out "implicit guarantees" to state-owned enterprises (SOEs). Our authorities have repeatedly stressed over the past few years that the SOEs are separate commercial entities from the government, and that there is no such guarantee. China will continue its market oriented SOE reform. The "implicit guarantees" is misleading to the market, and irresponsible to global investors. Investors who purchase bond issued by SOEs or provide credit to SOEs in China based on the perception of "implicit guarantee" should bear potential legal and financial consequences by themselves.

We welcome the dedicated Chapter 2 on crypto ecosystem and financial stability risks. Digital moneys—cryptos in particular—is a fast-moving policy area and deserve regular coverage in the GFSR going forward. Cryptos pose not just significant financial stability risks, but also environmental risks. In the past year, our authorities have issued a series of bans on energy-intensive "mining" activity. Our authorities have also announced recently (Sept 24) that all financial transactions involving cryptocurrencies will become illegal in China. We agree with staff that the adoption of a "non-stablecoin crypto asset" as the main national currency carries significant risks and, in most cases, outweighs the benefits. However, *could staff clarify whether it implies the benefits of a stablecoin crypto asset may outweigh the costs?* Furthermore, while the focus of Chapter 2 was on EMDCs, it should be noted that the risks posed by cryptos on AEs are equally large. As pointed out by the chapter, the size of decentralized finance (DeFi) has grown over sixfold in the past nine months. DeFi can have profound implications to AEs' financial system, and we encourage staff to look deeper into such risks in the next GFSR.

Fiscal Monitor

We support that fiscal policy should not only respond nimbly to the pandemic, but also facilitate a more productive and sustainable global economy going forward. Robust economic growth is the ultimate way to digest the accumulated debt. In this regard, we welcome staff's proposal to encourage high-quality public investment for countries with fiscal space. While the low interest rate has helped to contain the cost of borrowing, the potential rise of interest rate could cause significant burden to the record-high public debt.

We take note of staff's concern on financial risks stemming from the SOEs. Our authorities have made notable progress in regulating local government debt financing and local SOE-associated risks. China also has plenty of room to modernize and upgrade infrastructure in both urban and rural areas which will boost new growth engines and ultimately help to reduce debt to GDP ratio. Going forward, our authorities will stay vigilant and continue to strengthen our financial regulatory to deal with financial risks stemming from local government and SOE debt.

Statement by Rasmus Rüffer (ECB Representative), Dimitrios Rakitzis and Sander Tordoir (Advisors) on the October 2021 World Economic Outlook, Fiscal Monitor and Global Financial Stability Report

(Preliminary)

IMF Executive Board Meeting

28 September 2021

We thank Staff for this extensive set of flagship publications. The commitment and dedication of IMF staff and management to deliver substantial and well-coordinated analysis in a timely and efficient manner is commendable, all the more against the backdrop of the ongoing pandemic. We broadly agree with the main thrust of the reports regarding diagnosis, risks and policy recommendations, and would like to make the following observations:

World Economic Outlook / Fiscal Monitor

We share Staff's overall assessment about the global economic outlook. While output levels are estimated to be back at pre-pandemic levels in advanced economies, particularly in the US, economic growth in emerging market economies (ex. China) is lagging. For the euro area, we broadly agree with Staff's assessment of the current situation and outlook, noting that their forecasts for euro area growth and inflation are slightly below the paths for both real GDP growth and inflation in 2021 and 2022 anticipated in our September projections.

We also see that risks to the global outlook for growth are tilted to the downside, but we view the risks to the euro area growth outlook as balanced. A continued rapid recovery in the US and other advanced economies is expected in 2021, albeit subject to renewed uncertainties and headwinds related to the spread of the Delta variant, as well as supply bottlenecks that weigh on the economy. Whilst we also see considerable uncertainty surrounding the growth outlook, we would characterise risks as broadly balanced for the euro area, rather than to the downside, as envisaged for advanced economies as a group. While trade in goods continues to rebound, it may be useful to also acknowledge the potential impact of supply bottlenecks for the trade outlook.

The overall narrative presented by Staff for inflation developments in advanced economies corresponds to that which we have for euro area inflation. We welcome Staff's extensive analysis of inflation in this WEO and also consider that the Covid-19 pandemic led to a combination of unprecedented factors which raised inflation this year that are likely to wane in the course of 2022. Pandemic-related demand-supply mismatches and higher commodity prices are the main drivers behind rising inflation, especially in the United States and some EMEs. For the euro area, the gradual increase in euro area inflation will be supported by the economy returning to operating at full capacity further ahead. We also acknowledge that we are experiencing considerable uncertainty, and certain upside risks to the inflation outlook need to be monitored closely, such as those related to developments in inflation expectations and wage negotiation. At the same time, as in other advanced economies, euro area inflation expectations are contained, wage pressures are moderate and economic slack is expected to absorb only gradually. Finally, like Staff, we also observe that Phillips-curve-type mechanisms are still at play, including for the euro area.

As to monetary policy in the euro area, the ECB maintains an accommodative monetary policy stance to help the economy shift to a sustained recovery and bring inflation to the inflation target of two per cent over the medium term. In its recent monetary policy strategy review, the Governing Council agreed on a symmetric inflation target of two per cent over the medium term. It recognised that to maintain symmetry, the Governing Council needs to take into account the implications of the effective lower bound on nominal interest rates. In proximity of the lower bound, this will require an especially forceful or persistent monetary policy response. Therefore, in support of its inflation target and in line with its monetary policy strategy, the Governing Council revised its forward guidance on interest rates. It now expects the key ECB interest rates to remain at their present or lower levels until it sees inflation reaching two per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at two per cent over the medium term.

Purchases under the pandemic emergency purchase programme (PEPP) continue to preserve the favourable financing conditions which remain essential for the current rebound to turn into a lasting expansion and to offset the negative impact of the pandemic on inflation. At the same time, targeted longer-term refinancing operations continue to support bank lending conditions, helping to sustain credit flows to households and firms. The Governing Council stands ready to adjust all of is instruments, as appropriate, to ensure that inflation stabilises at our target over the medium term.

Regarding fiscal policies, we echo Staff's call for support to not be prematurely withdrawn, avoid cliff-edge effects and remain nimble to the rapidly evolving landscape of the COVID-19 pandemic. Fiscal policy should be calibrated to the economic cycle and the speed of the recovery. The uncertainty and changing economic conditions associated with the pandemic necessitate fiscal policy to remain agile. Like Staff, we see that the fiscal policy stance in the euro area will remain expansionary in 2021, supported by the fiscal impulse from the recovery instrument Next Generation EU (NGEU), thereby contributing positively to the economic rebound, and providing significant positive international spill-overs. In the context of Staff's review of fiscal frameworks, we note that one of the conclusions of the ECB's monetary policy strategy review was that fiscal policies are important for macroeconomic stabilisation, especially in the proximity of the effective lower bound on interest rates. In such circumstances fiscal policy can effectively complement monetary policy.

Fiscal policy should also support the transformation of economies to boost productivity, increase economic potential and contribute to an inclusive and sustainable recovery, while safeguarding fiscal sustainability. As the health situation improves and restrictions are eased, policy measures should gradually shift to addressing longer-term structural issues and facilitating a reallocation of capital and labour towards sectors with favourable opportunities, in particular those driving the green and digital transitions. In this vein, NGEU, and the Recovery and Resilience Facility at its centre, present an opportunity for EU Member States to boost investments that accelerate these transitions whilst supporting the implementation of growth-enhancing reforms, thereby enabling such a reallocation of resources. In turn, it will also help public finances to return to more favourable positions in the near term and will contribute to strengthen growth, job creation, and the sustainability of public finances in the medium and long term.

Global Financial Stability Report

We broadly share the IMF staff's overall assessment of financial stability risks. An improving economic environment has contributed to a notable decline in near-term vulnerabilities for corporates and banks. However, the global financial sector continues to face serious challenges, due to some structural challenges and the consequences of the pandemic amid persistently low interest rates. At the same time, vulnerabilities in financial markets and property markets have increased, amid strong risk exposure by non-bank financial institutions. The outlook remains uncertain, as the pandemic leaves a legacy of higher debt, which together with the risk of renewed containment measures weighing on the recovery prospects.

We echo Staff's view that policymakers face a challenging trade-off between maintaining near-term support to the global economy and preventing unintended consequences and medium-term financial stability risks. We concur that a prolonged period of very easy financial conditions, while needed to sustain the economic recovery, may contribute to overly stretched asset valuations and contribute to financial vulnerabilities. Financial market vulnerabilities could unravel in a disorderly manner if there were to be a premature withdrawal of policy support or a rapid change in market expectations of monetary policy leading to tighter financial conditions.

Turning to financial market risks, we share Staff's concerns regarding equity price misalignments and tight pricing conditions in credit markets. The combination of historically low real yields and elevated valuations leave high-yield bond and equity markets vulnerable to both interest rate and growth shocks. Recent supply chain problems in the manufacturing sector and renewed lockdowns amid rising Delta variant concerns serve as reminder that the strong rebound in corporate fundamentals may not persist.

We seethe observed decline in real yields as being driven by factors beyond investor concern regarding the economic outlook. The optimism that had buoyed markets in the first half of 2021 has faded somewhat and, as staff suggest, the decline in investor optimism may have been a factor behind declining yields. However, we do not consider it as the key driver, as real yields started to decline at a time when growth and inflation data were coming in above consensus. The decline in real yields, may be lacking a fundamental catalyst, and could therefore also be attributed to technical and liquidity factors.

We agree with Staff that a reassessment of the inflation outlook may pose risks to financial stability. Such as reassessment could trigger an abrupt increase in interest rates, trigger a tightening of global financial conditions, interacting with existing financial vulnerabilities and resulting in a decompression of market volatility and a sharp fall in asset valuations.

With regard to the housing market, we share Staff's concerns about strong residential price growth and would also like to emphasize the risks from a sudden correction. Residential real estate (RRE) prices have continued to increase in many euro area countries, and this has led to a further build-up of medium-term vulnerabilities. With price and lending dynamics having outpaced household income growth, they led to increases in household indebtedness with property valuations looking increasingly stretched. Our internal analysis suggests that downside risks to house prices appear to recede as the economy recovers. Having said that, the observed strong house price increases can be expected to have increased the probability of a price correction in the medium term.

However, we would like to note a number of risk-mitigating aspects from a euro area perspective. First, compared to developments in the run-up to the Global Financial Crisis, price and lending developments in the euro area are less dynamic. Second, the majority of euro area countries have activated macroprudential measures addressing residential real estate risk, which contribute to increased resilience of both borrowers and lenders. Going forward, as Staff suggests, additional macroprudential measures should be considered to address vulnerabilities in housing markets. However, their primary prudential objective should be to build resilience against rising vulnerabilities, as the effects on house prices and on the credit cycle are uncertain.

On the corporate sector, we also see a marked improvement regarding near-term risks; however, from a euro area perspective, we do not fully share Staff's emphasis on bankruptcy trends. We assess near-term risks to have subsided, against the back of aggregate profitability in the euro area corporate sector having recovered to the pre-pandemic level. That said, like Staff, we also observe this recovery has been uneven, as sectors hardest hit by the pandemic still show revenues well below their pre-pandemic level. Although bankruptcies are rising, especially in the hardest-hit sectors, like accommodation, we would like to point out that according to our analysis – and in contrast with the IMF staff's emphasis on the recent increase in bankruptcies – they have overall remained well below their pre-pandemic level in the euro area. We do agree with Staff, nonetheless, that the bankruptcy developments reflect factors such as the continued impact of policy support measures and the backlog in insolvencies due to legal pause on insolvencies in some countries, as well as lengthy insolvency procedures.

We agree with Staff's analysis on the main risks for the corporate sector and wish to echo their call for early and determined policy action to avert the build-up of further balance sheet vulnerabilities in the sector. We share Staff's view that the main risk for the corporate sector in the euro area would be a delayed reopening, or a tightening of containment measures. In that case, the current problems in the sectors hardest hit by the pandemic and small business could morph into solvency issues. As the euro area corporates predominantly rely on bank lending, imposing new containment measures could renew the demand for guarantees and moratoria. However, higher vaccination levels should limit the probability of a new lockdown. Like Staff, we also see a need for early and determined action to avoid the build-up of non-performing loans in the light of the increased corporate debt levels. Proactive recognition of increased credit risk in the banking sector has already been a focus area for bank supervisors in the euro area. In addition, policy action should focus on measures to increase the efficiency of court-based insolvency procedures and measures to foster the development of market-based solutions to corporate debt overhang and bank asset quality issues.

In reference to the banking sector, we broadly share Staff's analysis on concerns and risks facing the sector. We agree with Staff's concerns that banks remain vulnerable to asset quality deterioration. Bank asset quality trends have been benign so far and the outlook for asset quality has improved over the past six months, but there is a risk that corporate insolvencies and thus bank credit losses will rise – even if less than earlier feared - once support measures are phased out. Against this background, it is vital that banks continue being able to operate on the basis of strong capital positions, as over the medium term, such sufficient capitalisation is an indispensable condition for continued sufficient lending. While we broadly agree with the IMF that the risk of subdued lending growth remains, we also note that credit standards in the euro area have stabilised recently.

We share Staff's concerns about the increased risk-taking and rising fragilities in the non-bank financial (NBFI) sector. Key vulnerabilities include a growing mismatch between asset liquidity and the redemption terms of investment funds, pockets of significant leverage in the investment fund sector, which can amplify a market sell-off, and increased interconnectedness within the non-bank financial sector as well as between non-banks and bank. The NBFI sector has been challenged by the low interest rate environment. To boost returns, the investment, insurance and pension funds and the sectors have taken on credit, duration and liquidity risks, which leave them more vulnerable to future market shocks.

We agree with Staff's analysis on the crypto ecosystem and financial stability risks and find it very timely. We share the conclusion that financial stability risks so far are not systemic given the still limited interlinkage with the traditional financial system. However, vulnerabilities have increased, and vigilant monitoring is warranted. If the developments and increased institutional activity continue at this pace in the future, the conclusion on risks to financial stability might need to be nuanced. In our view, it will be important to have robust global prudential and oversight standards to minimise the risks to financial stability and the smooth operation of payments and prevent regulatory arbitrage. International Standard Setting Bodies should step up their efforts to come to an agreement on robust standards that are commensurate with the potential risks of crypto-assets and in particular, stablecoins.

We share Staff's views on the sustainable investment fund sector and its role for the green economy. The IMF analysis on the role of sustainable funds in financing the transition to a green economy is timely. We share the view of the IMF that the sustainable investment fund sector can be an important driver of the global transition to net-zero emissions. A substantial amount of investment is required to meet the EU goal of carbon neutrality by 2050, and capital markets are key in effectively channeling financing towards sustainable investments. We also share the assessment of the risks related to greenwashing.

Staff's Responses to Technical Questions Posed by Executive Directors
EBM/21/96—September 28, 2021

World Economic Outlook

Staff's responses to technical questions are below. Policy questions in the areas of the vaccine rollout (financing and progress) and monetary policy frameworks will be addressed in staff's intervention at the Board meeting.

Vaccine Rollouts

1. **On adequacy of financing, staff may comment on the implementation of the 40 percent target vaccination for 2021 and 60 percent for 2022 under the Fund-proposed $50 billion plan, given country initiatives, vaccine donations, and the potential need for booster shots.**

- Staff will respond during the Board meeting.

2. **We agree with staff that the risks are tilted to the downside, amid growing concerns over variants and the pace of vaccine rollout which are leading to increased divergence among countries. In this regard, can staff elaborate on the prospects of vaccine rollout in light of the continuing supply constraints?**

- Staff will address this question at the Board meeting.

3. **In this regard, we would welcome staff update on the likely achievement of the financing and vaccination targets for 2021 and 2022 in the Fund proposed plan of $50 billion to end the pandemic.**

- Staff will address this question at the Board meeting.

4. **It would be helpful if staff could elaborate further on why only 12 percent of the total doses pledged by the G-7 have been received. It would also be useful for staff to provide a sense of the following steps envisaged to ensure that the proposed vaccination targets for the end of 2021 and mid-2022 can be met.**

- Staff will address this question at the Board meeting.

5. **We agree with staff, furthermore, on the need to remove restrictions to exports of relevant raw materials and finished vaccines, and to diversify production and distribution capabilities including into SSA, and wonder if staff can provide further insights into what is preventing faster progress in each of these areas, as well as in vaccine delivery? The likely failure to meet the 40 percent vaccination target alongside the fact that broader downside risks are increasing, while developing countries have limited scope to insure against these risks, seems a critical concern. Could staff comment on the implications**

of such slow vaccination for EMDE growth outcomes in the endemic COVID scenario?

- Staff will address this question at the Board meeting.

Outlook and Risks

6. **We took note of staff's two independent downside scenarios: rising US inflation expectations and an endemic COVID, in both cases entailing a sizable dip below the global, AE, and EM real GDPs compared to baseline. The likelihood of the two scenarios materializing concurrently however is not insignificant. We would appreciate staff comments on the likely combined impact.**

- When the shocks underlying the two scenarios are combined, the resulting double-downside scenario responses relative to the baseline are essentially the sum of the deviations from baseline from the two source scenarios. This means that all the adverse effects on economic activity are amplified. However, it is important to recognize that COVID-19 becoming endemic would interact with agents' inflation expectations, bringing them down further (with activity being more depressed for longer) and dampen the monetary policy tightening and the associated output slowdown. At the same time, it could lead to more prolonged supply disruptions, exacerbating inflation concerns. Given these potential interactions, the more-adverse scenario as a simple combination of the two downsides seems less likely.

7. **AEs have already vaccinated nearly 50 percent of their population. Are there some other factors that led to downward revision in growth projections going forward?**

- The global growth forecast downgrade for 2021 reflects a downward revision for two groups: advanced economies (in part due to supply disruptions) and low-income developing countries (in part due to worsening pandemic dynamics). This is partially offset by stronger near-term prospects among commodity-exporting emerging market and developing economies.

8. **Staff are invited to comment on the potential risk of rising inflation and unemployment simultaneously - "stagflation" - and the policy implications, taking into consideration the path of the pandemic, the duration of supply disruptions, and the possible evolvement of inflation expectations.**

- As discussed in Chapters 1 and 2, there is considerable uncertainty around the WEO's inflation projections, related to the path of the pandemic, the duration of supply-demand mismatches, and how inflation expectations will evolve. Clear central bank communications on the outlook for inflation and monetary policy are of paramount importance to guide expectations. In some settings where inflation is rising against the backdrop of subdued employment growth and there is a tangible risk of inflation expectations rising, central banks should be prepared to act quickly.

They should therefore aim for maximum sustainable employment while protecting the credibility of their policy framework. As noted in the case studies and scenario analyses in Chapter 2, when expectations become de-anchored, inflation can quickly take off and be costly to rein back in. Policymakers therefore must be ready to act swiftly were expectations to show early signs of de-anchoring. Where it becomes necessary for central banks to act to get ahead of price pressures, fiscal policy will need to take on more of the responsibility of supporting the employment recovery subject to available space.

Inflation Prospects and Monetary Policy

9. **Staff comments would be welcome on whether the return of 'pre-pandemic' inflation means a return to the structurally low inflation environment that persisted before the pandemic, and the influence of the pandemic on structural trends, particularly saving, consumption and investment behavior.**

- Beyond 2021, consumer price inflation in emerging market and developing economies is expected to average around 4.2 percent over the rest of the forecast horizon and around 2 percent for advanced economies.

  There is considerable uncertainty around the projections, related to the path of the pandemic, the duration of supply-demand mismatches, and how inflation expectations will evolve. As discussed in Chapter 2, the factors underlying the recent increases in inflation are largely expected to be transitory (pandemic-related supply disruptions, sharp increases in commodity prices, large base effects, etc.). However, significant uncertainty remains over the level of long-run inflation. For instance, faster investment in digital technologies, automation and green infrastructure could push up demand and inflation. The recent policy frameworks adjustments of the European Central Bank and the Federal Reserve could also prove successful in guiding long-term inflation expectations and mitigating deflationary risks. However, the sharp increases in public and private debt levels could lead to structurally lower investment from debt overhang, which could entail a return to low inflation.

10. **Moreover, the ability of monetary policy to steer inflation driven by sectoral price changes, rather than generalized price co-movements, is at best limited, as shown by a recent BIS paper[1]. Staff's comments are welcome.**

- We agree with the principle that central banks should steer policy based on generalized co-movements of prices. Nonetheless, to the extent that sectoral price dispersion can affect inflation expectations, they should be taken into consideration when setting policy. As the analyses in Chapters 1 and 2 show, for now medium-term inflation expectations remain well-anchored for most advanced economies. Central banks in those countries can therefore generally look through transitory price pressures and avoid tightening until there is more clarity on underlying price dynamics. However, in some settings, where inflation is rising and there is a tangible risk of inflation expectations increasing, central banks should be prepared to act quickly to get ahead of price pressures.

Our analysis in Chapter 2 further shows that the crisis indeed triggered large price movements in some sectors, notably transportation, food, clothing, and communications. However, overall sectoral price dispersion so far has remained relatively subdued by recent historical standards, especially compared with the global financial crisis. This is driven by somewhat smaller and shorter-lived swings in fuel (transport), food, and housing prices, which are the three largest components of consumption baskets, on average.

11. The impact of COVID-19 has also been very heterogeneous across the sectors, thus a sectoral approach on inflationary impact seems important. Staff comments and assessments are welcome on how these risks may shape the inflation outlook.

- As discussed in Chapters 1 and 2, an unusual combination of factors has lined up over the course of the past several months: accelerating demand colliding against production constraints as supply has been slower to ramp up; the potential further release of pent-up demand and excess savings—including into durable goods and housing; renewed outbreaks leading to factory and port restrictions, which have exacerbated supply shortages; labor shortages in some sectors in part due to health concerns and skills mismatches due in part to possible structural changes in labor demand. In terms of Chapter 2's quantitative assessment of what that implies for contributions to inflation from slack, staff relies on country desk-provided estimates of unemployment paths over the coming years. We emphasize the uncertainties of the short-term evolution of potential output in shaping our assessment in the concluding policy recommendations as well the large cross-country heterogeneity through interquartile ranges in the graph. In terms of sectoral dislocations, this is the focus of the last part of Chapter 2. The analysis embeds the current dislocations in historical context to gain a sense of magnitude. In advanced economies, housing is indeed a large part of the consumption basket and some inflation contributions from imputed rent are likely going forward. A key consideration is how medium-term inflation expectations—which are currently anchored at central bank targets for the most part—evolve in this environment. Risks around the baseline inflation projection are to the upside.

12. Long periods of very loose monetary policies increase the risks of asset bubbles, excessive debt build-ups and fiscal dominance. These risks evolve non-linearly over time, and central banks should be ready to exit their highly accommodative stance in case the balance of risks alters. Staff comments on these concerns are appreciated.

- Staff will respond to this question during the Board meeting.

13. Overshooting the target for a time could, in line with recent monetary policy strategy updates, help to more clearly anchor price and wage expectations in a way that is compatible with close-to-target inflation in the longer run. Staff's comments are welcome.

- Staff will respond to this question during the Board meeting.

14. **Overall, we would like to better understand why staff consider current inflationary pressures to be still transitory in a wide range of countries, not losing sight of the fact that inflation surprised on the upside in many countries in recent months. Relatedly, we would also appreciate staff's further elaboration on the uncertainties around the baseline inflation forecast.**

- Staff's view that inflation pressures are likely transitory for the most part is based on the judgment that (1) labor market slack remains and employment levels are still below pre-pandemic levels; (2) medium-term inflation expectations are generally well-anchored at central bank targets; and (3) structural factors—such as automation—that have reduced the sensitivity of price pressures to changes in slack are still operative. Nonetheless, in some EMDEs, elevated food prices, the lagged effects of high oil prices, and currency depreciations could cause inflation pressures to persist for longer.

  An unusual combination of factors has lined up over the course of the past several months: accelerating demand colliding against production constraints as supply has been slower to ramp up; the potential further release of pent-up demand and excess savings—including into durable goods and housing; renewed outbreaks leading to factory and port restrictions, which have exacerbated supply shortages; labor shortages in some sectors in part due to health concerns and skills mismatches due in part to possible structural changes in labor demand. A key consideration is how medium-term inflation expectations—which are currently anchored at central bank targets for the most part—evolve in this environment.

  Risks around the baseline inflation projection are to the upside. In Chapter 2, staff considers alternative risks scenario around this baseline forecasts. As shown in the chapter, prolonged supply disruptions, commodity and housing price shocks, longer-term expenditure commitments, and a de-anchoring of inflation expectations could lead to significantly higher inflation than predicted in the baseline. Considerable uncertainty surrounds these forecasts, particularly related to the assessment of economic slack, meaning inflation could take off earlier than anticipated if scarring is deeper and more widespread than the current baseline. Sharply rising housing prices and prolonged input supply shortages in advanced and developing economies and continued food price pressures and currency depreciations in emerging markets could keep inflation elevated for longer. Simulations of a tail risk scenario with continued sectoral disruptions and large swings in commodity prices show that headline inflation could rise significantly higher than the baseline. Simulations including a temporary de-anchoring of inflation expectations lead to even higher, more persistent, and volatile inflation.

15. **A better understanding of exogeneous and endogenous aspects, as well as the impact of the fiscal stimulus on inflation, would be useful. Could staff clarify**

how policymakers could better assess the transitory aspects of each determinant? However, we note that according to figure 2.7, there was no increase in fiscal deficits in the advanced economies before inflation acceleration episodes, and annex 2.3 does not report results to support a sharp increase in inflation expectation during inflation scares. Could staff comment? We thank staff for the box on house prices, and we would be interested to understand better the transmission assumptions between house prices and inflation.

- Analysis of sectoral data and the contributions of individual sectors to overall inflation (including cross-sectoral correlations through intersectoral linkages) can be helpful to assess the extent to which the pressures are likely to be transitory. The contribution to overall inflation from sectors relatively more affected by the pandemic (e.g. used cars in the US or the contribution of semiconductor shortages to overall inflation) versus others can help with this assessment. Supply-demand decompositions of price drivers can shed light on the likely degree of persistence of price pressures. In Chapter 1, for example, an analysis of the Baltic Dry Index—an index of expenditures related to international shipping—suggests that the bulk of its rise over the past few months has been due to supply factors. As supply adjusts, the shipping cost pressures are accordingly expected to abate.

  Regarding Figure 2.7: indeed, unlike the emerging market and developing economy estimates, fiscal balances in advanced economies did not deteriorate on average prior to inflation acceleration episodes, suggesting that aggregate demand shocks could have driven both fiscal performance and inflation in advanced economies. The case studies, however, demonstrate the role of sustainable finances in keeping expectations anchored. Annex 2.3 did not report the evolution of macroeconomic variables and inflation expectations due to space constraints. In the longer episodes (those where inflation remained elevated for six quarters or more), 3-year ahead expectations rose by almost 1 additional percentage point compared to shorter episodes (lasting 2 or 3 quarters).

  Regarding the box on house prices, the exercise relies on a purely econometric setup, letting the data speak as to the pass-through from house prices to housing-related components of inflation. Conceptually, the transmission could happen as owner-equivalent rent starts reflecting the cost of acquiring a dwelling or is adjusted to reflect information from observed and anticipated market rents. While price-rent ratios may not be stationary due to a range of reasons (e.g. segmented markets and/or rent controls), household income remains a driver of both rents and housing prices.

16. **However, some advanced economies have had strong house price growth for several years prior to the pandemic with seemingly little effect on inflation. Could Staff comment on this? Box 2.2 suggests that food price increases may stem from local shortages, worsening food insecurity in some of the most**

vulnerable countries. Do Staff see food insecurity becoming more widespread?

- The econometric exercise in box 1.1 on house prices and inflation captures the average across 45 countries over five decades. Deviations from this estimated norm in certain countries and in certain times is entirely plausible. As the box notes, the magnitude of pass-through to overall inflation and the degree of persistence remain uncertain and depends on financial conditions as well as supply-demand conditions.

  The COVID19 shock led to a major spike in the number of food insecure in 2020—an increase between 65 to 83 million of insecure people on a global scale (IMF; USDA)—and its effects are being felt even more in 2021 (an increase of 290 million people, USDA), as income has remained below pre-pandemic levels in several LICs and high food and energy commodity prices and endemic supply chain bottlenecks are being passed through to consumer food prices.

  Based on our findings, we expect that food prices may remain high as the pandemic still unfolds, particularly in EMDEs. In countries with high currency depreciations, lower fiscal space, and local supply disruptions, this may further imply widening food insecurity. This is in line with the longer-term trends of food insecurity across countries, reflecting various factors including climate change. According to the FAO, between 2017 and 2020, the average prevalence of food insecure people has increased across emerging markets: 14.5% to 16.5% in lower-middle income economies and 25.1% to 26.2% in low income countries.

  The recovery in household income (especially in EMs and LICs) will be crucial to help pull millions out of poverty and reduce food insecurity. A slowdown and partial reversal in global food producer (commodity) prices will also help reduce the number of food insecure household but to a less extent.

17. **It generates double digit inflation in advanced economies and has inflation peaking at 20 percent or more in EMDEs. This scenario suggests there would be high costs for real economic activity. Could Staff provide further details how monetary policy reacts and the impacts on global GDP?**

- The empirical exercise was focused on forecasting inflation, assessing the balance of risks to the outlook and conducting scenario analyses. Consequently, the chapter did not delve into the implications of the sectoral, commodity and expectations shocks to the real economy. Policy variables were also not included in the VAR analysis due to time constraints.

18. **We would like to hear an update of staff views, and if more recent data changes staff assessment as this could have devastating spillover effects on EMDCs?**

- The majority of the historical analysis in the chapter reflects data through July 2021, and inflation forecasts incorporate the most recent data available as of mid-September 2021. As such, staff's assessment remains as elaborated in the chapter. Headline inflation is projected to peak in the fall of 2021, with inflation expected back to pre-pandemic levels by mid-2022 for both advanced economies and emerging markets, and long-term inflation expectations are projected to remain anchored in the baseline forecast. Given the recovery's uncharted nature, considerable uncertainty remains, however, and risks are tilted to the upside. Prolonged supply disruptions, commodity and housing price shocks, longer-term expenditure commitments, and a de-anchoring of inflation expectations could lead to significantly higher inflation than predicted in the baseline.

19. It has been reported that to a large degree, this increase in inflation reflects a combination of pandemic induced supply-demand mismatches, and rising commodity prices, expiration of special pandemic related policy dispensations and exchange rate depreciations. Can staff elaborate on the relative contribution of these underlying factors in the different regions of the world?

- In general, pandemic-induced supply-demand mismatches and oil prices rising well above their base of last year are relatively larger contributors to inflationary pressures among advanced economies. Within advanced economies there is more of a supply-demand mismatch in the US and less supply-demand mismatch inflationary pressure in the euro area and Japan. In some EMDEs, elevated food prices and currency depreciations are also further adding to inflationary pressure.

  An unusual combination of factors has lined up over the course of the past several months: accelerating demand colliding against production constraints as supply has been slower to ramp up; the potential further release of pent-up demand and excess savings—including into durable goods and housing; renewed outbreaks leading to factory and port restrictions, which have exacerbated supply shortages; labor shortages in some sectors in part due to health concerns and skills mismatches due in part to possible structural changes in labor demand. A key consideration is how medium-term inflation expectations—which are currently anchored at central bank targets for the most part—evolve in this environment. Risks around the baseline inflation projection are to the upside.

Supply Disruptions

20. Uncertainties remain regarding the durability of supply-side effects and potential knock-on effects. Staff comments on the nature and evolvement of supply-chain disruptions would be welcome.

- Since late-2020 supply chain disruptions have emerged across the world. Suppliers' delivery times have increased in Developed Markets and to a lesser extent in Emerging Market. The issue is especially prevalent in Europe, the US, and a few other advanced economies. The disruptions came on the back of a strong bounce-back in global goods trade and supply-side scars from the pandemic within manufacturing and distribution. Analysis in the forthcoming WEO suggests that demand factors were driving the increase in shipping costs in the early part of the recovery, while supply factors recently have dominated. The strong increase in global goods trade and lingering supply issues have sent shipping costs soaring. This is especially true for container lanes from China to North America and Europe. The supply chain disruption has constrained production through a lack of materials. In the Euro Area and the United States, more than 20 percent of all manufacturing businesses in 2021Q2 reported that their production was constrained by a lack of materials. Among the most affected sectors are Motor Vehicles, Wood, Rubber and Plastic, Electrical equipment, Electronics, and Furniture.

21. Apart from several other structural changes within the domestic economies, is the lagging supply a reflection of the fact that a significant part of supply chains operates outside the advanced world?

- International shipping costs have seen an increase—both for bulk dry goods and container shipping—over 2021. As noted earlier, analysis in the WEO suggests that demand factors were driving the increase in shipping costs in the early part of the recovery, but more recently, supply factors have dominated (e.g., supply constraints on cargo space along desirable routes and port congestion). Costs have increased particular for container lanes from China to North America and Europe. In some cases, these disruptions have led to bottlenecks in production due to a lack of materials. In the Euro Area and the United States, more than 20 percent of all manufacturing businesses in 2021:Q2 reported that their production was constrained by a lack of materials. Among the most affected sectors are Motor Vehicles, Wood, Rubber and Plastic, Electrical equipment, Electronics, and Furniture.

Fiscal Policy

22. Since less fiscal spending is a possible risk, could Staff comment on how much it affects the potential growth?

- As noted in the WEO, if the actual fiscal support delivers a smaller fiscal impulse than assumed, US growth and spillovers to trading partners would be lower than envisaged in the baseline forecast, with the effect spread out over several years. In terms of the impact of a smaller package on potential growth, however, the composition of the package is an important consideration. How the spending is allocated and how it is financed through taxes will be key—for instance, a smaller package with smaller increase in taxes but where more of the spending was on infrastructure that helps boost the public capital stock could deliver broadly similar macro effects to what is currently assessed in the baseline. The increase in the public capital stock currently envisaged in the baseline would raise the level of potential GDP by around 1 percent by 2026.

23. We would welcome staff assessment of the innovation and new technology content of the massive US infrastructure package under consideration.

- The infrastructure package mainly contains traditional elements, such as roads, bridges, ports, and public transport. The most innovative parts are 15bn investment on electric vehicle chargers as well as zero and low-emission buses and ferries. This comes together with investment in clean power infrastructure. However, proposals in the area of innovation and technology are likely to be included in the USD 3.5tn reconciliation bill that is being discussed in Congress. Although negotiations are ongoing and uncertainty on the perimeter of the reconciliation bill is large, proposals in this area seem to enjoy bipartisan support, as reflected in the blueprint provided by the bipartisan passage of two recent bills (the "National Science Foundation For The Future Act" and the "United States Innovation and Competition Act"). Among other proposals, the bill could include USD 45bn for spending on various science and innovation initiatives, e.g. for applied energy or NASA.

Policy Mix

24. **In a fragile context marked by massive stocks of public debt and central bank buyback programs, we would welcome staff's further insight on the appropriate normalization of the policy-mix. In particular, what would be the best combination of tools for the EMDEs under the Integrated Policy Framework?**

- In some settings where inflation is rising against the backdrop of subdued employment growth and there is a tangible risk of inflation expectations rising, central banks should be prepared to act quickly. They should therefore aim for maximum sustainable employment while protecting the credibility of their policy framework. Clear central bank communications on the outlook for inflation and monetary policy are of paramount importance to guide expectations. Where it becomes necessary for central banks to act to get ahead of price pressures, fiscal policy will need to take on more of the responsibility of supporting the employment recovery subject to available space.

  From the perspective of EMDEs preparing for possible tighter external financial conditions, as discussed in Chapter 1, the recovery in advanced economies presages an eventual end to extraordinary monetary support in those countries. Emerging market and developing economies should prepare for a possible increase in advanced economy interest rates through debt maturity extensions where feasible, thereby reducing their rollover needs. Regulators should also focus on limiting the buildup of balance sheet mismatches. In countries with deep financial markets and low balance sheet mismatches, exchange rate flexibility can help absorb shocks while also permitting monetary policy to address domestic macroeconomic conditions. Foreign exchange intervention and temporary capital flow management measures may be useful, however, in some circumstances in countries with balance sheet vulnerabilities and market frictions. These measures can increase the autonomy of monetary policy to respond to domestic inflation and output developments (Adrian, Gopinath, and Pazarbasioglu 2020) but they should not substitute for needed macroeconomic adjustment.

Employment Recovery

25. Can staff elaborate on the structural causes of sluggish employment growth by region or country income group? What signs are staff seeing of labor reallocation in economies and how is it shaping labor market outcomes?

- The sluggishness of the employment recovery is a common feature across economy groups, in part reflecting the specific effects of the COVID-19 shock on both the labor demand and supply sides compared to a more conventional economic downturn. These include: (a) increasing automation, particularly in contact-intensive sectors (to reduce contagion across workers); (b) continuing fear of infection in returning to onsite work with the prolonged pandemic; (c) ongoing childcare constraints; (d) early retirements and exits from the labor force as workers reassess, lowering participation; and (e) search and matching frictions in reallocating workers across jobs. In general, economies with less stringent labor market regulations, greater assistance for job search and matching, and active labor market policy measures—such as training programs and hiring subsidies—that ease any skill mismatches and encourage job creation are better placed for speedier recoveries.

  Signs of labor reallocation are evident across economies on average, with contact-intensive sectors and sectors more-vulnerable-to-automation (e.g., accommodation and food; transportation) shrinking and employment in less contact-intensive and less vulnerable-to-automation sectors (e.g., information technologies; finance and insurance) growing. These recent employment shifts are consistent with an acceleration of the pre-existing trend towards greater automation (see also chapter 3 of the April 2021 WEO).

26. The analysis on recent employment developments across groups of countries highlights differences by workers' characteristics, such as age, gender, and skill. In examining these patterns, it would be worth also looking at the types of newly created jobs, i.e., whether job creation has been increasingly tilted towards fixed-term positions. Staff's comments are welcome.

- The picture on the quality of jobs (including contract-types where that is relevant) created across countries remains incomplete, as the underlying labor force and employer surveys that include this information typically arrive with delay of several quarters. Early evidence in the EU suggests that employment on temporary contracts dropped sharply with the crisis and has since increased, but remains below the pre-pandemic levels as of 2021:Q1. In the US, another dimension of job quality—wages—shows some improvement, with incomes among sectors with lower-skilled employment in particular showing larger upticks over 2021.

27. We note that despite the fact that all advanced economies should regain their pre-Covid output levels by the end of 2022, one third will not regain its pre-pandemic employment level. Health fears of some workers, increasing reallocation effects, greater automation… may be part of the explanation. Could staff elaborate more (i) on the determinants of this lag and the relative

role of each factor; (ii) on the difficulties to recruit in some advanced economies, and to which extent this issue is included in the baseline?

- As noted in the WEO, employment around the world generally remains below its pre-pandemic levels. This reflects a combination of negative output gaps, worker fears of on-the-job infection in contact intensive occupations, childcare constraints, labor demand changes as automation picks up in some sectors, replacement income through furlough schemes or unemployment benefits helping to cushion income losses, and frictions in job searches and matching. Separating these factors into individual contributions is difficult at this stage. As shown in Fig 1.15, panel 4, lasting effects on the employment recovery are expected in most countries, suggesting that employment is a major channel through which economic scarring is expected to register.

28. To what extent do staff expect the phasing out of pandemic benefits such as added unemployment income and furlough to reverse labor supply incentives and make up for the decline in labor participation, particularly in view of the reskilling initiatives underway in some countries to reduce skill mismatches?

- There have been concerns that unemployment insurance and other income support measures—deployed vigorously in many countries to dampen the COVID-19 shock—are reducing workers' incentives to reengage with the labor market, exacerbating the labor supply decrease. However, some early evidence from the U.S. (based on the differential expiry of unemployment benefits across U.S. states) does not suggest that depressed work incentives from such measures have been a major contributor to reduced labor supply. Instead, other factors—including lingering concerns by workers about the pandemic's health effects—may be more significant. Training and reskilling initiatives should help with addressing the skills mismatch that has increased with the acceleration of automation. However, such human capital investment may take some time and is not likely to be a quick fix to boost employment.

29. The employment estimates are likely to be very tentative for many emerging market economies (EMEs) on account of data issues. It will be instructive to know the underlying methodology to arrive at these conclusions. How much of the policy support extended by the governments has been factored into the estimates?

- The WEO forecasts include the policy support implemented so far and staff's judgment of policies whose implementation is imminent.

Medium-term Outlook and Structural Issues

30. With the pace of vaccine rollout in emerging markets accelerating, could staff elaborate on why this gap is not expected to close, unlike the projections for advanced economies.

- Besides vaccine rollout, differences in the extent of early policy support to limit scarring also play a role in accounting for the divergence in medium-term prospects across country groups. Because of more limited policy space entering the crisis, emerging market and developing economies in general have been relatively more constrained for example in the amount of fiscal support they have been able to provide than advanced economies have been able to. This difference in policy support is expected to have long-lasting implications for the extent of scarring and persistent losses from the initial shock (also see April 2021 WEO Chapter 2).

31. **We acknowledge that this is a relatively new area in which the Fund might still be building up its expertise, but if we really want to achieve environmental sustainability, climate has to become more embedded in all areas of economic policy making and thus in all areas of the Fund's policy advice. It cannot be seen in isolation and cannot remain a separate topic in the Fund's reports. Staff comments are welcome.**

- Climate change mitigation and adaptation are critical policy objectives, heavily embedded in the WEO's multilateral policy advice and country recommendations regarding longer-term structural challenges. Analysis of the economic consequences of climate change and policies to address it feature in many recent WEOs (e.g., the October 2020 chapter 3; current WEO box on jobs and the green economy; current WEO commodity special feature on the role of climate change in metals markets; among others). It is expected that climate change and related considerations will continue to be integrated into the report going forward.

32. **Moreover, while we agree that labor shortages can constrain growth, they could also work as an incentive for companies to increase automation and result in productivity increases. Does staff have any views on this? Are there signs of companies substituting labor with machines, potentially accelerating productivity growth and limiting price pressures?**

- The COVID-19 shock has engendered a rise in automation, reinforcing pre-existing trends, as firms attempt to address workforce vulnerabilities to infection and, more recently, labor supply shortages. Labor productivity has increased as automation has increased, but it remains unclear how much of that will persist as employment rises slowly back towards pre-pandemic levels. To the extent that it reflects a permanent improvement, increased productivity could help limit price pressures over the medium term.

33. **We note that, compared with the previous decade(s), labor productivity has risen rapidly in many countries during the pandemic. It would be useful to learn more about the current drivers of labor productivity, and how lasting the cyclically induced growth in capital deepening can be. Staff's comments are welcome.**

- It remains unclear how much of the increase in labor productivity represents a cyclical effect versus a more structural shift from greater automation and increased capital intensity and technology. In particular, as employment improves and slowly move back towards pre-pandemic levels, it seems likely that labor productivity will decrease. However, how much it will change and how persistent these changes will be remains to be determined. Moreover, there is the possibility for longer-term scarring to productivity to eventually manifest, with the widespread schooling interruptions from the COVID-19 crisis causing a setback to human capital accumulation. It will take some time for the transitory and permanent productivity effects to be disentangled.

34. **Beside the pace of vaccine rollout and limited policy space, what are the characteristics of countries that are more likely to have persistent output losses and widening divergence?**

- Recent revisions in medium-term projections point to the critical role of speedier vaccination rollouts in boosting the medium-term outlook and reducing scarring. Other characteristics that are associated with greater medium-term output losses include tourism-dependence and lower levels of policy support provision in the early stages of the crisis (see chapter 2 of the April 2021 WEO). More services-intensive economies appeared early on to be more susceptible to scarring from the acute pandemic. However, as adaptation and automation have increased, services-intensive production no longer shows such a strong association with medium-term losses (as evinced also by the lower levels of scarring expected for advanced economies compared to emerging market and developing economies).

35. **On output gaps (Figure 1.15, page 15), the report may provide details on the methodology being used by the IMF for estimation of potential output and output gap in view of challenges in their estimation after the outbreak of COVID-19.**

- Country teams use a combination of production function and multivariate filter approaches to estimate potential output. During the COVID crisis, additional emphasis has been placed on the sectoral aspects of the shock and inter-sectoral linkages to estimate effective production capacity.

Innovation and Productivity

36. **We agree with the importance of foreign knowledge for emerging market and developing economies, and wonder if staff have any views on how the size of the country relates to the role of foreign research and reliance of research diffusion, also for advanced economies? One could expect that the role of foreign research and reliance on research diffusion is larger for small countries. If there are increasing returns to scale in research, do large countries have an advantage, and can they rely more on domestic research output than smaller countries? Also, given the importance of international spillovers from research, is there a free-rider problem concerning basic**

research in particular? Would some countries find it optimal to focus solely on applied research and rely on spillovers for basic research?

- On the first question, we have not conducted any formal analysis on the importance of the size of countries for basic research. However, looking at the pattern of citations to scientific article by region (Reliance on Science database), it appears that the lion share of basic research is conducted in the US, Europe and large Asian countries. There is also home bias by region (see Annex figure 3.1.1). Also, to the extent that AEs are larger (in economic terms), it indeed appears that AEs tend to rely much more on homegrown basic research than EMDEs (see figure 3.5 panel 3) for whom technological diffusion is a more important source of innovation.

  On the later questions, there has been a general decline in the relative importance of basic research funding over the last three decades, and the issue is present in AEs and EMDEs alike (see figure 3.1, panel 3). While firms lack the incentive to invest in basic research, focusing instead on commercially-oriented applied research, some governments have increasingly pursued narrower goals as well and increasingly focused their support towards emerging technologies (cyber-security, nanotechnologies, etc …) and their commercialization. The goals are short-term, strategic and commercial but this might come at the expense of the more basic form of research, the outcome of which is unpredictable but forms the basis for ground-breaking innovation.

37. We would be interested in staff's further and more detailed elaboration on the role innovation and research can play in increasing productivity and growth.

- The chapter's main findings are that i) basic scientific research is a key driver of innovation and productivity, and basic scientific knowledge diffuses internationally farther than applied knowledge; ii) a 10 percent increase in domestic (foreign) basic research is estimated to raise productivity by about 0.3 (0.6) percent on average; iii) international knowledge spillovers are more important for innovation in emerging market and developing economies than in advanced economies; iv) easy technology transfer, collaboration, and the free flow of ideas across borders should be key priorities.

38. Could staff elaborate on the necessary framework to develop an optimum basic research, and in particular the best governance framework to allocate resources to the most promising projects?

- By definition, basic research is "directed toward fuller knowledge or understanding … without specific applications toward processes or products in mind." It should then not be for governments to decide what the most promising projects are since basic research leads to breakthrough innovation in unpredictable ways. Our analysis suggests there could be important synergies between public and private basic research, and funding for both should be increased. Subsidies to private basic research efforts can alleviate the incentive problem and be combined with competitive basic research grants for universities and public labs (based on the scientific merit of the project). More detailed recommendation regarding the shape and form of the governance framework would require more analysis and would have to be country-dependent.

39. We note the conclusion that it is important to ensure the free flow of ideas and scientific collaboration across borders. Can Staff outline their understanding on the extent to which the infrastructure to facilitate such a flow currently exists, either at a regional or global level? Staff conclude that investments in frontier science could help speed the transition toward a cleaner economy. Can Staff elaborate on the most effective incentives to assist in bringing new clean technologies to market?

- Because research is published in scientific journals and researcher exchange via conferences and cross-country research projects, the free-flow of ideas has contributed importantly to innovation and growth globally. Our analysis shows that the deterioration of such conditions could have very detrimental effects on innovation and growth. Interestingly, there still seems to be some regional home bias in the international circulation of ideas and potential for improved diffusion. Note also that the diffusion of basic knowledge decays with distance (Figure 3.4) suggesting that some barriers to the free flow of ideas still remains at the global and regional level.

  Our analysis finds that clean innovation, relies more on newer basic research and research in engineering and technology than dirty innovation. This suggest that public investment in basic research is a powerful tool to help bring new clean technology to market. This can be seen as the "technology push" side, which can also be complemented by demand-pull mechanisms (e.g. tax credits for adopting clean technologies) which improves the incentives for innovators as it scales up the potential market.

40. Could staff comment on the experience with technology transfer and what obstacles need to be addressed?

- Technology transfer has intensified in recent decades and has been a key driver of innovation and productivity. However, more recently, concerns about intellectual property protection, data privacy, and national security as well as a renewed attention to industrial policies may lead to higher barriers to trade in high-tech sectors or other restrictions related to participation in 5G infrastructure, cross-country R&D, foreign direct investment, access to software, patents and academic exchanges. Our analysis shows that such restrictions could lead to decoupling in research efforts and to significant headwinds for innovation and productivity growth.

Commodity Developments

41. On the same note, we ask staff to elaborate on the underlying assumptions for the oil prices and revenue implications outlined in Table 1.SF.2 as well as the basis for these assumptions.

- The exercise shown in Table 1.SF.2 is not a forecast but serves the purpose of highlighting some plausible implications of the IEA's Net Zero Emissions Scenario: it provides a yardstick for the order of magnitude of the results for the four metals and compare them with an illustrative back-on-the envelope calculation of the value of fossil fuel production in the IEA's Net Zero Emissions Scenario. The IEA assumes that consumption of oil drops by 54%, natural gas by 45% and coal by 80% between 2020 and 2040. Based on this, the CSF assumes that oil prices are on average $30 per barrel (in 2020 terms) between 2021 and 2040, which is about half the average real term price from 1970 to 2020. Similarly, coal prices are assumed to average $40 per metric ton from 2021 to 2040, which is about half of the average real term price from 1979 to 2020. As global LNG trade will likely continue to increase in importance and there is a structural break due to the shale gas revolution, the CSF assumes that natural gas prices are on average half of 2020 prices between 2021 and 2040.

42. Taking into account growing attention to this issue, we would encourage staff to share their views on the key factors behind NG price growth, prospects of prolonged high NG prices, and potential inflationary impact of such a scenario.

- A perfect storm is hitting the natural gas market and, in turn, the power sector. A harsh winter (including the Texas freeze) and hot summer in the Norther hemisphere (Europe and Asia) led to a high demand for natural gas (and electricity) while world natural gas production was below expectations. In particular, the US natural gas production, which represents about 25 percent of world total production, was strongly affected by the 2020 collapse in energy prices and the subsequent cut a cut in energy investment. As of today, the US natural gas production is still below its 2019 peak, while natural gas demand is above pre-pandemic levels. An imbalanced market, in turn, has led to a depletion of natural gas inventories—which are usually built during the summer in preparation for the winter. Depletion was felt particularly in Europe also due to below-average wind energy production while low hydropower output in Brazil and West US reduced the LNG cargoes for the both the European and Asian markets. As we are entering the Fall in the Norther Hemisphere, the low level of inventories has introduced a risk premium in natural gas prices which is also driving up coal (and carbon emissions) prices. Tightness in energy markets is, thus, expected to continue till 2022Q1 as positive demand shocks for power could lead to further spikes in energy prices. The pass-through of natural gas and coal prices to CPI inflation is usually limited as the share of electricity consumption is relatively modest (about 2-5 percent) and retail prices are usually regulated. However, price spikes in the wholesale electricity market or, continued high natural gas prices can pose a financial risk for some power companies, in absence of government support. Finally, some industries, including the fertilizers sector, could see input cost pressure.

43. According to staff, the value of critical metals may even rival the potential value of global oil production. We would encourage staff to continue

monitoring and analysis of the developments in this area and provide an update to the Board.

- Staff can provide updates of the metals market analysis in case there are changes in the climate policy scenarios.

44. That should not be surprising since the expectations of international market clearing price have remained anchored around US$55-60 per barrel despite major swings in demand and supply over the last 18 months. Staff may wish to comment.

- The WEO has a baseline assumption for crude oil prices of $65.7 per barrel in 2021, and $64.5 in 2022, before falling to $56.3 in 2026 – which is based on futures prices as of August 24, 2021. More recent market data suggest even slightly higher oil prices for this year and next, at $$68.3 and $70.2, but largely unchanged prices over the 3 to 5-year horizon. This shows that the backwardation remains in place, with higher oil prices for nearby contracts relative to far-out futures contracts. Most analysts point to the tight supply-demand balance over the short term (in part induced by the OPEC+ production curbs and a modest shale oil rebound) as a reason why the term structure is downward sloping, with the longer term prices more reflective of longer term market fundamentals, such as production costs and a structural change in oil consumption due to the energy transition.

45. We take special note of staff's analysis of the evolution "clean energy metals" and the multifold frontloaded increases in their prices over the next two decades under policies to meet net zero emission in 2050. In our view, such a scenario might impede the pace of progress towards greener global economy, and we would welcome staff comments on how best to address this potential conflict.

- One of the goals of the analysis on "green metals" is to raise awareness of the issue: For a clean energy transition moving at a high pace, we should minimize supply bottlenecks or remove other obstacles to the transformation. In the Special Feature, we highlight some possible policy recommendations such as reduce green policy uncertainty, as it may hinder mining investment and increase the chances that high metal; have a credible, globally coordinated climate policy; introduce high environmental, social, labor, and governance standards (since some mining operations have found to have low standards); reduced trade barriers and export restrictions as they would allow markets to operate efficiently and direct investment to sufficiently expand metal supply. We also note that a new international institution focused on metals—analogous to the IEA for energy and the Food and Agricultural Organization for agricultural goods—could play a pivotal role in data dissemination and analysis, industry standards and international cooperation. Studying alternative scenarios that would imply a different pace for the energy transition (e.g., using natural gas in the initial phase) is beyond the scope of the analysis, also given the tight space constraints. The October 2020 WEO devotes a chapter on climate which includes an analysis of various alternatives.

Specific Regional Questions

46. While the WEO presents a downward revision in economic outlook, ASEAN5 posts significantly larger reduction for 2021 while EMDEs shows an upgrade. Staff may explain the key reasons behind this divergence.

- For the ASEAN5 economies, the revisions largely reflect the worse than anticipated 2021:H1 outturns and the effects of an intensification of the pandemic and associated mobility restrictions (Indonesia, Philippines, Malaysia, Thailand). In the case of Thailand, these pandemic effects were also exacerbated by the further deterioration in tourism prospects. These downward revisions were offset by increases among other emerging market and developing economies. In these other economies, the first half of 2021 was better than had been expected on average. Moreover, many commodity exporters also saw their projections upgraded with an improving commodity outlook.

47. Could Staff expand on the statement that "China's prospects for 2021 are marked down slightly due to stronger-than-anticipated scaling back of public investment"?

- Relative to the July WEO forecast, fiscal policy in China is now expected to be even more contractionary. The July WEO forecast already included lagging private consumption throughout 2021 on account of periodic outbreaks and the authorities' strict containment strategy, as well as negative growth of real estate investment in 2021H2 on account of the tighter stance toward the real estate sector that started in September 2020.

Global Financial Stability Report

Staff's responses to technical questions are below. Broader policy questions the areas of monetary policy, the recent developments about Evergrande, and some issues about the role of crypto in Fund surveillance", will be addressed in staff's intervention at the Board meeting.

48. We note the mention of inadequate operation and regulatory frameworks in EMDEs. In this regard, it would be useful to understand how EMDEs can work towards stronger investor protection risks and regulation in cases where crypto exchanges are not registered in their own jurisdictions.

- As the chapter highlighted, EMDE users are actively using crypto exchanges domiciled abroad, which could prevent effective supervision and enforcement actions. However, the EMDE authorities can still take number of actions even with existing regulatory framework. For example, many jurisdictions have issued public statements warning about the risks of crypto assets, highlighting additional risks to use foreign crypto exchanges. EMDEs authorities can also issue public warnings to such crypto exchanges which provide the services to their residents, ideally with close coordination internationally, especially with the home regulators of the crypto exchanges, if they exist. The authorities may also take enforcement actions if the crypto exchanges continue to provide the services without appropriate regulatory approval. Some authorities have also taken indirect actions by restricting transactions of their domestic commercial banks with unauthorized foreign crypto exchanges.

49. Although solvency issues have not appeared yet, these could trigger negative feedback loops with banks (through credit losses) and governments (via public support measures and guarantees). Could staff elaborate on the relevance of these channels and on the risks associated with potential losses on (explicit loan) guarantee schemes, especially in countries that are already facing limited fiscal space.

- Chapter 4 in the October 2020 GFSR contained a detailed analysis of bank capital buffers under COVID scenarios. It found that capital ratios would decline as a result of the COVID-19 crisis, but remain, on average, comfortably above regulatory minimums. However, there were found to be differences across and within regions. In an adverse scenario, there would be a weak tail of banks that might fail to meet minimum regulatory capital requirements, mainly in EMDEs. A recent MCM update of the Global Stress Test indicates that the October 2020 results remain broadly valid: there is still a weak tail of banks, mainly in EMDEs.

- This GFSR—relying on the framework presented in Chapter 1 of the April 2021 GFSR—as well as a plethora of default and bankruptcies data and other corporate indicators found that solvency risk has continued to edge lower, on average.

However, there is a differentiation by country, sector, and firm size. Importantly, after progress achieved in spring, the affected sectors have been lagging again due to the spread of the delta variant. Hence, the economies with a large share of the affected sectors such as hospitality and transport face greater risks to the overall corporate sector and to their financial sector.

50. Amid limited fiscal space, policy makers should take a great care in making future fiscal support more targeted, as discussed in Chapter 1 of the April 2021 GFSR and well calibrated as discussed in the Fiscal Monitor. Even the prospect of stagflation has recently reared its head, although this can be considered as a tail risk at present. How does staff assess the risk of some moderate version of stagflation?

- Against the backdrop of an asynchronous nature of global recovery, along with rising inflation, it is possible that we see a relatively low growth coupled with high inflation scenario play out many countries. However, stagflation is its strictest sense – recession coupled with high inflation – does not seem to be a potential steady-state outcome in our assessment. Our current baseline is the recent sharp rise in inflation seen in many regions is, to a large extent, a function of certain factors such as: accelerating demand running up against temporary supply shortages and logistical bottlenecks, as well as rising shipping costs. These frictions are expected to be temporary and should subside as economies continue to re-open. Hence inflation is expected to moderate over the near- to medium-term, while the still-substantial fiscal support, in addition to accommodative monetary policy in place in most advanced and emerging market economies, should serve to reinforce growth trajectories. That said, resurgence of the Delta variant and weak vaccine access (in many regions) continue to pose downside risks to growth.

51. How does staff assess the risks of another "taper tantrum"? Does the early monetary policy normalization in some EMDEs help contain this risk?

- Will be addressed in oral intervention.

52. We note that domestic bond absorption is still under pressure with weaker non-resident inflow than pre-crisis, even though investments of domestic banks and life insurers have increased. Could staff elaborate more on prioritization in addressing bottlenecks for further market development?

- These are structural issues that the Fund has been recommending (and working towards) for some time. The pandemic has further shown the importance of a deep investor base and a liquid domestic market. Some of the specific measures include (1) developing efficient money markets, (2) strengthening primary market practices to enhance transparency and predictability of issuance, (3) bolstering market liquidity, (4) developing a robust market infrastructure, and (5) establishing a sound legal and regulatory framework for securities.

53. In this regard, consistent global policies precluding regulatory arbitrage are needed to secure financial stability through stress testing and supervision. Among staff's recommendations, strengthening the information architecture, which includes objective and comparable metrics and framework for continuous data collection, seems persuasive but challenging. We expect staff elaboration on possible engagement of the Fund on this front.

- In a recently published IMF Staff Climate Note we argue for the strengtheing of the global climate information architecture, which consists of: (1) high-quality, reliable, and comparable data; (2) a globally harmonized and consistent set of climate disclosure standards; and (3) globally agreed upon principles for climate finance taxonomies and other classification approaches to align investments with climate goals.

- The IMF plays an active role in supporting the development of this climate information architecture. First, through extensive analytical work that is being carried out arguing for better disclosures and more standardization, such as in this GFSR chapter. Second, the IMF's Climate Change Indicators Dashboard brings together climate-related data needed for macroeconomic and financial policy analysis. Third, the IMF is incorporating climate risk analysis in the Financial Sector Assessment Program, to raise awareness and to support increasing the resilience of the financial sector to climate-related risks. Fourth, the IMF actively supports international efforts, including at the FSB, and NGFS where MCM is co-chairing the workstream on bridging data gaps. Fifth, together with the World Bank and the OECD, the IMF aims to develop principles for classification systems to harmonize existing approaches and support the development of sustainable finance markets.

54. Staff comments would be appreciated on another important aspect of the high asset valuations--the distribution of wealth in advanced economies and its effects on future income inequality. The IMF used to be vocal on the links between income and wealth inequality, on the one hand, and institutional capacity to implement reforms, on the other hand. Did the COVID-19 pandemic aggravate the risks in this area?

- Asset valuations indeed rose substantially during the pandemic. Our measures of equity price misalignments have edged lower recently partly because of improved corporate profitability but remain at elevated levels. We have not explored the issue of wealth distribution and inequality recently, but this is an important topic for future research. Indeed, the issue could have important policy implications both from a monetary and fiscal perspective, although dealing with the problem has been less prioritized in the battle during the pandemic. The increase in equity prices has indeed benefitted the wealthy the most, and in many countries only a small share of population hold tradable assets. However, it's important to note that fiscal policy support has been provided to low-income population and to small firms in many countries during the pandemic, which partly offset the rise in inequality due to asset price appreciation.

- Indeed, various aspects of inequality, including the inequality of wealth and income, are related and mutually reinforcing. For example, by looking at the relationship between the wealth inequality and the labor income inequality in the context of the wealth tax the analysis presented in Box 2.1 of April 2021 Fiscal Monitor (and also the working paper) finds that that labor income inequality would have been 1 Gini point higher without a recurrent wealth tax.

- It is still early to fully assess the persistent impact of the COVID-19 crisis on inequality and ability to implement reforms. However, the rise in poverty and inequality could adversely affect the popular perception in how effectively the government delivers public services (and protects people during crises), this could reduce trust in government. The lower trust in government can in turn weaken the government's ability to implement reforms. As the April 2021 Fiscal Monitor notes governments need to take an holistic approach to gain support for reforms. Given that public support for better access to basic services, financed through higher taxes, has been strong and is likely rising with the pandemic, governments need to announce comprehensive policy packages, embedded in medium-term fiscal frameworks, that gives everyone a fair shot and strengthens trust in governments. Such reforms can support inclusive growth, strengthen trust, and build social cohesion.

55. Could staff share their preliminary thoughts regarding the developments around Evergrande and implications of its possible default for the Chinese and global economies?

- Will be addressed in oral intervention.

56. We welcome staff's analysis and recommendations as an important contribution to a search for an international consensus on the optimal ways to deal with growing crypto ecosystem. We look forward to the Fund's further work in this area.

- In January 2020, the Fund published 'Fintech Note 3: Regulation of Crypto assets'. The Note explored some of the key risks in the crypto asset ecosystem, and proposed approaches national regulators may want to take to explore these risks and use existing tools to mitigate these risks. Since its publication, the global crypto asset market has grown and evolved substantially. Trading volumes are moving toward a smaller number of offshore exchanges, the use of stablecoins has grown quickly and extensively to access key parts of the crypto assets ecosystem, and new protocols have allowed for the use of crypto assets in new and innovative ways. Furthermore, in many EMDEs we have also seen a greater retail involvement in crypto asset markets and this has also led to several high profile incidents where investors have lost money. In light of these developments, the Fund is currently working to update its Fintech Note 3 to reflect changes in the market, and provide more specific thoughts in how some of these risks might be addressed. The Fund also continues to work with Standard Setting Bodies to help progress the debate internationally and help develop global standards that can be adopted by national regulators.

57. **A sharp rise in global natural gas (NG) prices came to the forefront relatively recently and is reflected upon in the WEO only briefly. Taking into account growing attention to this issue, we would encourage staff to share their views on the key factors behind NG price growth, prospects of prolonged high NG prices, and potential inflationary impact of such a scenario.**

- The sharp rise in NG prices is understandably described as a natural storm. Key factors include limited supply from Russia and Norway (which supply almost half of Europe's gas), high demand from Asia, outages at U.S. production facilities, and lack of wind for wind turbines. Energy suppliers hedge input costs which helps to smooth over spikes in spot prices but also creates more persistence over time, with the potential impact likely to be more visible next year (note: some analysts estimate an upside risk of 60-70 bps to forecasts for headline inflation in 2022).

58. **We note staff's analysis of both push and pull factors potentially explaining rising crypto adoption in EMEs, including why it has outpaced that of AEs. We would welcome their view on whether they consider these developments an opportunity or a threat for the EMEs.**

- Crypto assets have the potential to deliver benefits to EMEs, and in some jurisdictions can provide financial inclusion, a more trusted store of value, and can allow citizens to bypass restrictions. However, in the absence of a robust regulatory framework that covers the unique risks of crypto assets, crypto assets can be a threat for EMEs. A lack of regulatory protections can lead to fraud (through the sale of fraudulent tokens, for instance), money laundering (through the use of privacy tokens, mixers or a lack of AML regulation), market manipulation (through pump and dump schemes), and the possibility of losses when the price of a crypto asset collapses. Furthermore, where exchanges and wallet providers aren't subject to regulatory oversight, poor cyber and operational resilience can lead to losses through hacking or system downtime. Where regulated financial institutions are holding crypto assets in EMEs, a lack of appropriate prudential regulation could lead to losses should risks around hacking, volatility or operational resilience occur.

59. **What is staff's view regarding insolvency regimes in EMDEs?**

- The main problem in assessing the situation of corporate debt, including solvency, in all countries (including emerging economies) is that unlisted companies are those that have been most affected by the crisis, and there is not a lot of public information on their financial status (and in those countries where there is, the time lag is considerable). On the point of the status of insolvency regimes in EMDEs, it is not easy to generalize, but many EMDEs have embarked in broad reforms of their insolvency regimes in the past decade. However, a series of problems remain in particular, there is a pressing need to improve the institutional framework of insolvency regimes (i.e. ensuring that judges have expertise, courts are appropriately resourced and insolvency administrators are competent and properly regulated). In terms of the procedures, staff have observed that reorganization procedures have improved in many EMDEs (but some technical issues, like financing of reorganization, could improve) but liquidation remains inefficient and results in heavy losses for all participants. There is scope for improvement in the implementation of hybrid restructuring procedures (i.e., those that combine informal negotiation with limited judicial intervention).

- Staff are analyzing these and other issues in a SPR/LEG Departmental paper that will be published shortly ("Policy Options for Supporting and Restructuring Firms Hit by the Covid-19 Crisis").

60. Staff note that changes in credit intensity of growth can affect financial stability risks. Do they also see implications for monetary policy?

- Banks remain resilient in most countries (this is the key conclusion of the latest update of MCM's global stress test). Banks should be able to withstand a downside stress scenario, except for a weak tail of institutions, mainly in EMDEs. However, while they may be resilient even in a downside scenario, banks also seem reluctant to lend, as they are worried about the uncertain outlook according to most recent bank lending surveys (i.e. concerns about covid variants that may further delay the recovery; and concerns about the negative impact on borrowers that the lift of support measures may have on debtors' ability to repay their loans). Evidently weakness in bank lending conditions may have a macroeconomic impact, as most jurisdictions remain bank centric. So, banks' risk appetite about lending will be important in securing the economic recovery, which in turn could influence the timing of monetary policy normalization.

61. Can Staff indicate what actions will be taken to monitor and assess the impact of COP26 on potential investments in climate change?

- MCM staff plans to continue monitoring sustainable finance developments on a regular basis, in terms of sustainable funds / climate funds' assets under management and flows as well as in terms of green bond issuance. Some of the findings will be reported through the quarterly ESG monitor circulated with the Global Markets Monitor.

62. Staff also recommends that these countries consider the benefits of issuing CBDCs. Can staff elaborate on the benefits that CBDCs would provide in the aforementioned cases, and whether concerned EMDCs may have the adequate infrastructure to introduce them?

- CBDC could offer a low-cost, easy-to-use, and widely accessible digital means of payment that could rival privately issued payment schemes, including cryptoassets. CBDC would be considerably more stable as a store of value, and more convenient as a means of payment, if anything by virtue of being legal tender. However, the issuance of CBDC is not a replacement for appropriate macroeconomic policies, credible institutions, and efficient legal systems in building trust in the domestic currency versus a foreign currency. Moreover, evaluating and implementing CBDC requires considerable capacity and resources, which are not always available to EMDCs. The Fund hopes to be in a position to help these countries evaluate the appropriateness and feasibility of introducing CBDC, and to evaluate complementary policies and macrofinancial implications. This includes risks of currency substation from the adoption of a foreign CBDC or privately issued form of money, and ways to counter these pressures in the short-term, before policies can be improved.

63. The role of the Fund in this area should be clearly defined. In particular, technical assistance to strengthen surveillance of an emerging crypto ecosystem should be developed and made available to the membership. Staff comments are welcome.

- Will be addressed in oral intervention.

64. We are pleased with the increasing growth of sustainable investing, which is outpacing that of conventional investment. We would like staff to indicate whether the pandemic has had an impact on sustainable investment growth.

- While not explicitly analyzed in the chapter, the ongoing COVID-19 pandemic appears to have raised awareness about the possibility of catastrophic events, including climate change, and shifted the momentum (see the October 2020 Global Financial Stability Report for an analysis of the possible effect that the pandemic crisis could have on firms' environmental performance).

65. In this regard, we would appreciate hearing more on staffs' sense of potential tightening of monetary policy in advanced economies in light of the rising inflation rates especially in the US, and amid elevated supply constraints.

- Will be addressed in oral intervention.

66. Could staff comment on the available global regulatory standards that provide reference points for developing domestic regulatory standards?

- Global standards are being introduced for crypto asset markets, however, these are currently limited in scope and there is considerable room for further development. Chapter II explores current standards for crypto assets (the Financial Action Taskforce's guidance on anti-money laundering, and the proposed prudential treatment of banks' crypto asset exposures developed by the Basel Committee on Banking Supervision) as well as standards focused primarily on global stablecoins (such as those proposed by the Financial Stability Board). However, further work is needed to develop standards around conduct regulation, particularly in areas of acute risks, such as wallets, exchanges, issuers and interaction of crypto assets with regulated financial institutions. Nonetheless, many authorities can make use of existing standards regarding resilience of payments systems and financial resilience (such as CPMI-IOSCO and BCBS Operational resilience standards) to various components of the crypto-asset ecosystem. The Fund continues to lead the policy debate through the publication of Fintech Notes (Fintech Note 3: Regulation of Crypto Assets – as well as a proposed update of this Note in late 2021), and through actively participating in Standard Setting Bodies to help set global standards and recommendations.

67. What could be, in the staff's view, the practical constraints for central banks in deploying macroprudential tools as these may dampen the effect of monetary-fiscal easing and slow down the pace of recovery?

- From a macroprudential policy perspective, while elevated asset prices may be an indicator to consider when taking macroprudential action, the objective is not to counter increases in asset prices but rather to control procyclical feedback that may lead to unsustainable debt burdens in the household or corporate sector (see IMF 2013: Key Aspects of Macroprudential Policy). In the current conjuncture, tools that want to maintain the ability of households or firms to continue servicing debt through a scenario of future increases in interest rates are likely to be useful. Recent analysis (Brandao, Gelos, Narita and Nier, 2020) confirms that macroprudential policy tools that can help achieve this have a favorable cost-benefit trade-off, in that they can reduce tail risks to GDP growth further down the line, without this coming at undue costs to output growth in the short term. This research finds that this is the case in particular for so-called borrower based tools, such as loan-to-value, loan-to-income or debt-service-to-income ratio caps. Moreover, for these tools, the benefits are found to exceed the costs even more strongly when asset prices and credit are elevated. However, authorities may well find that these tools are not popular in situations where affordability of residential real estate is already stretched by elevated valuations, since these tools will constrain the ability to purchase assets from available resources. Bringing in such constraints early (before asset prices have grown strongly) can be useful to counter such resistance.

68. What is the risk that this divergence can affect the reallocation of portfolio flows, particularly the debt flows within EMEs? Does the staff also see the evidence of divergence of economic recoveries within EMEs influencing the pattern of equity flows to EMEs?

- Staff sees a significant impact of underlying fundamentals on the portfolio flow outlook and divergence within the EMs. As discussed in GFSR April 2021, probability of outflows for countries with worse fundamentals is at 25%, while that for better fundamentals is 15%. This is also becoming evident over the last few months with divergence persisting across countries and asset classes – reflecting the differentiated role of sensitivities and underlying fundamentals.

- Debt flows, particularly in local currency, face two counter-acting drivers. Latin America and EMEA region are seeing very high inflationary pressures which has resulted in a significant hike in policy rates. Asia is at the other end with less inflationary pressures and less market expectations of policy rate tightening. This could have a material impact on the reallocation of portfolio flows. On the other hand, staff analysis also shows that local currency debt flow is highly sensitive to domestic fundamentals. This is also reflected in the high divergence between flows to China vs other EMs; as well as the overall divergence between local currency and hard currency debt flows. It is thus key for EMs to make sure that they address the underlying vulnerabilities sooner and get the growth back on track which may have a long lasting impact on the portfolio flow outlook than just raising policy rates.

- Staff research also shows that equity flows are highly sensitive to domestic shocks as compared to for instance – hard currency debt flows – which are more levered to external risk sentiment. This sensitivity implies that a large economic growth divergence might also lead to a different in the pattern of equity flows. We are seeing some initial signs of that. Equity flows to South Africa have been very weak reflecting the weak macro. On the other hand, equity flows to China (and to some extent India) have remained strong reflecting their faster growth improvement.

69. Nevertheless, if the economic recoveries are progressing at the current pace in some EMEs, how may it have a procyclical effect in containing the expected insolvencies as upside to growth may provide a positive boost to the value of firms' collaterals?

- If the economic recovery continues unabated, corporate revenues willl continue to grow, generally lifting corporate profits. Higher profits—especially at weakened firms that had suffered from both a decline in sales and a surge in debt and interest costs—would help cover interest costs and thus avoid defaults. The increased profits will also allow the affected firms to rebuild their equity position, and thus reduce the risk of insolvency. Finally, as the economy recovers, firms‘ values would generally rise, thus making collateralized lending somewhat cheaper (through higher collateral values) and, in the worst case scenario, making loss given default lower—which would help banks recover losses quicker and provide credit flow to healthy firms.

70. Spreads in credit markets have remained tight, reflecting a more favorable view on credit default and insolvencies. It would be interesting to understand as to what extent these benign credit spreads are driven by the continued liquidity support of the central banks and guarantees by the governments on the one hand, and improved growth expectations on the other?

- Corporate bond spreads have been even narrower than pre-pandemic levels reflecting an optimistic default outlook. The benign views have been supported by unprecedented policy supports and improved corporate earnings. Our valuation models suggest that corporate bond valuations have been less stretched relative to fundamentals even without considering policy support factors. But this does not necessarily mean that the central banks' support no longer drives credit spreads. Although their direct impact on spreads has become less pronounced, their indirect effects could remain prominent. The improvement in growth expectations has been partly supported by the liquidity support measures and something beyond what they are, for example, central banks' willingness to intervene in the market.

71. We agree with staff that the adoption of a "non-stablecoin crypto asset" as the main national currency carries significant risks and, in most cases, outweighs the benefits. However, could staff clarify whether it implies the benefits of a stablecoin crypto asset may outweigh the costs?

- Stablecoins are crypto assets and are part of the crypto ecosystem. It is difficult to ban crypto assets and only allow stablecoins. For example, the most common blockchain used to transact stablecoins is Ethereum and Tron. To transact with stablecoins in these blockchains users need to hold the native coin for transaction costs (ETH and TRX respectively). Stablecoins (and crypto asset more generally) indeed have potential benefits such as cheaper and faster payments, greater access to a broader array of financial services, and financial inclusion more generally. But there are also risks as discussed in the report especially linked to financial integrity but also around design of stablecoins.

- The relevant balance of the two (benefits vs costs) depends on policy choices and the degree of use: policymakers need to balance enabling the financial innovation with ensuring that financial integrity, consumer protection and financial stability are preserved. In the absence of a regulatory regime and international cooperation, the risks will likely outweigh the potential benefits. In particular, EMDEs would be exposed to additional risks (such as cryptoization) and thus policy measures (such as design of capital flow restrictions in a digital world) would need to be reconsidered with close coordination mechanisms between the home and host regulators.

Fiscal Monitor

Staff's responses to technical questions are below. Broader policy questions in the areas of fiscal policy will be addressed in staff's intervention at the Board meeting.

Fiscal Policy

72. We encourage staff to further work on how countries should re-design their fiscal frameworks to achieve new and more realistic objectives, considering the reforms and investments envisaged in the recovery while preserving credibility. Some preliminary insights are welcomed.

- Staff is engaged in several areas of work on fiscal frameworks, including in surveillance and analytical products, and remains ready to continue to provide support through capacity development. As discussed in the *Fiscal Monitor*, that reflects work done in the Fiscal Affairs Department, among the main messages are the trade-offs countries have to navigate in choosing fiscal anchors and selecting fiscal rules, a discussion of the principles that should guide the decision whether to re-calibrate an old framework, and the importance of transparency and good communication of changes in fiscal frameworks.

- Substantial uncertainty during the pandemic also makes revising fiscal frameworks challenging. An approach would be steering fiscal policy gradually toward sustainability without abrupt adjustments if financing conditions allow. The fiscal framework should also reflect overall policy priorities—for instance, if investment is a priority, governments would need to account for such spending in the framework by reprioritizing expenditures, raising taxes, or borrowing as appropriate.

- There are several elements of a medium-term fiscal framework that can strengthen fiscal credibility. These include committing to a medium-term fiscal anchor with well-designed escape clauses, setting fiscal guardrails conditional on recovery during the first years when uncertainty remains elevated (e.g., the budget could underscore that the adjustment will depend on the recovery and labor market conditions), developing quality measures consistent with the broad policy goals (e.g., pre-legislating future revenue measures to demonstrate a commitment of fiscal discipline). At the same time, upgrading risk management, promoting fiscal transparency, and strengthening external oversight such as through independent fiscal council can help foster public support during the transition period.

73. Regarding the capacity of EMEs to carry debt, we concur with staff that many of them have entered the pandemic with better fundamentals and institutions, and with a more favorable composition of public debt. However, they have also seen a large increase in corporate debt, especially denominated in foreign currency, over the past decade. Could staff comment on the effects that this may have on rollover risks and therefore on the capacity to carry debt?

- High corporate debt is a source of fiscal risk, as has been noted in past and recent Fund research (e.g., FAD work on fiscal risks). In the event of heightened economic pressures, governments might decide to directly help firms to prevent widespread bankruptcies or incur in higher levels of debt to provide stimulus measures, that will improve the financial health of the firms. Independently of the nature of the support to firms, as contingent liabilities are more likely to materialized when growth is slow, large corporate leverage (and exposure to FX) will increase the fiscal risks in periods of crisis, like the current pandemic, and could make it harder for governments to incur in additional debt at low borrowing costs (especially for highly indebted countries). Countries that build fiscal buffers prior to the pandemic are in better place to provide support to households and firms.

- On the other hand, in part, the higher pre-crisis levels of corporate debt in EMs reflected deepening of corporate bond markets, and the diversification of their financing options. In such cases, firms might be able to better manage shocks, reducing the likelihood of seeing extensive bankruptcies and the realization of large contingent liabilities.

74. Staff comment on how the Fund plans to assist members with fiscal frameworks would be welcome.

- The Fund provides advice to countries through Surveillance and CD delivery. Past and ongoing research help further develop our advice. FAD also provides different types of CD in this area, including technical support to build macro-fiscal analytical capacity, strengthen macro-fiscal forecasting and fiscal risk analytical capacity, design and implement rules-based fiscal frameworks and develop medium-term budget frameworks.

75. As many countries have applied escape clauses to their fiscal frameworks, we welcome staff's elaborations about whether and under which conditions it would be appropriate to consider revising those frameworks.

- Chapter 2 includes a discussion of some principles that governments could consider when deliberating on whether to revise fiscal frameworks. These include: (i) the extent to which converging back to an old rule would require excessive fiscal consolidation (ii) whether an intermediate transition regime is feasible; the extent to which revising the old rule was already under consideration pre-pandemic. (iv) whether past reforms of fiscal frameworks have hurt credibility (v) the capacity to agree with a broad coalition of stakeholders on revised objectives. The chapter also notes the importance of good communication and transparency for the credibility of revised frameworks. The capacity of a government to communicate well on a potential revision should thus also be taken into account.

76. Regarding the numerical fiscal rules, could staff provide a preference for an appropriate fiscal rule? Or should we rather have country-specific targets at this stage of the recovery, to pave the way for more formal rule-based fiscal policy when the pandemic abates?

- The design of a fiscal rule needs to be country specific, taking into account economic, historical, and institutional features. In general, the choice of rules needs to balance three objectives that are difficult to achieve simultaneously: (1) sustainability of public finances; (2) stabilization of the economy; and (3) simplicity. FAD has developed principles and tools that can help in the selection and calibration of fiscal rules, as discussed in the Chapter and earlier work (Eyraud and others 2018, SDN 18/04; Eyraud and others, How-to-Notes 2018). Applying such principles, staff regularly provides country-specific advice either in Surveillance or CD work.

- The current juncture poses additional challenges as fiscal rules were suspended in many countries, with the path of economic recovery still highly uncertain and uneven across countries. A transition regime with interim targets that are consistent with eventual convergence to an old or revised fiscal rule is one of the options.

77. **In addition, it is inappropriate to associate rollover risks with central bank backup in light of central bank independence and fiscal dominance concerns. Furthermore, the risk of excessive liquidity supply needs also to be considered. Staff comments on these points are highly welcome.**

- We agree that fiscal dominance is a significant risk especially in countries where monetary policy is not sufficiently credible or where fiscal policy is not sustainable. The risk with high debt is highlighted prominently in the report. Given the possible misinterpretation, in the revised version of the report, the reference to the central bank backup being the main factor protecting countries from rollover risk has been removed.

78. **We would be also interested in staff's analysis of fiscal policy tools to mobilize the accumulation of private savings.**

- Governments have different tools that can affect the degree of private savings depending on the issues being faced (cyclical, structural). In the current crisis, policy support measures have saved life and livelihoods and prevented a deeper recession. Nonetheless, many households have increased their precautionary savings due to the pandemic and the uncertainty about future prospects. As uncertainty abates and the recovery gains steam, private savings are likely to fall, possibly to similar levels as pre-pandemic. If private demand rises faster than expected, this will allow governments to also unwind their exceptional support faster and reduce their deficits. Fiscal and monetary policy can adjust depending on the strengthen of the recovery in the private economy, including contain excessive inflationary pressures if needed.

- There may also be structural reasons that could result in higher or lower private savings (and imbalances with private investment) than desirable. These situations are country-specific and governments can take different policies to tackle the issues. For example, "high" level of savings are adequate in some conditions (for instance in economies with aging populations) or reflect limited social safety nets; or the savings-investment imbalance may instead reflect “low” investment due to lack of productive opportunities. In other cases, “low” levels of savings might also be desirable outcome (for instance in young and rapidly growing economies with ample investment opportunities), or could instead be due to the inability of part of the population to gain access to financial services. Depending on the specific issues or imbalances, governments can take appropriate measures. For example, reforms to strengthen social security and safety nets would results in less need for precautionary savings and allow for more consumption and resilience to shocks. Conversely, structural policies that promote financial inclusion and financial deepening can increase the level of savings.

79. We regret that the Fiscal Monitor continues to exclude unfunded pension liabilities of government employee’s defined-benefit pension plans from reported debt statistics. This approach understates the true extent of public liabilities and undermines cross-economy comparability. It also appears inconsistent with the direction of international accounting standards and the Fund’s priority to promote transparency and comprehensiveness in public debt reporting. Staff comments welcome.

- The international fiscal statistical standards (i.e., the Government Finance Statistics Manual, version 2001 and 2014) require that unfunded pension liabilities of government employees’ defined-benefit pension plans should be recorded as liabilities. The Public Sector Debt Statistics Guide in 2011 also recommends that these unfunded pension liabilities be included in government gross debt. Notwithstanding this guidance, very few countries currently compile these data and include it in national debt data. Therefore, it remains very difficult to present cross country comparable data on gross debt that includes unfunded pension liabilities. Continued IMF capacity development would also help to improve data availability in this area.

80. Can the staff provide the quantum of direct and indirect financial support especially financial aid and grants provided by advanced countries to low-income countries during the pandemic and how it compares with the pre-pandemic levels?

- It would take time to do a comprehensive survey of all the aid measures. One partial measure, according to a new methodology developed by Staff, is that official development assistance (ODA) from members of the OECD Development Assistance Committee (DAC) is estimated to have reached USD161 billion in 2020, corresponding to a 6.3 percent increase, after a decline of 1.2 percent observed in 2019. Looking at the underlying trends over the past decade, the pace of growth of ODA remains quite modest, considering the development challenges. As a share of donor GNI, ODA is estimated at 0.32 percent in 2020, falling far short of the 0.7 percent UN target.

81. Can the staff provide a comparative assessment of the effectiveness of direct financial support measures to businesses and indirect support measures like guarantees and deferments?

- It is still too early to make a comprehensive assessment given that the crisis is not over. As noted in past Fiscal Monitors, tools serve different purposes and can be complementary. For example, tax deferrals are useful to deal with temporary liquidity needs and can be quickly applied and benefit all firms. Some tools can be used to address issues related more to specific sectors (e.g., standardized loans/guarantees to hardest hit sectors or groups of firms such as SMEs), while others may be needed to address solvency concerns or specific problems in systemically large firms (e.g., through equity or equity-like instruments).

82. We would welcome staff assessment of the innovation and new technology content of the massive US infrastructure package under consideration.

- The infrastructure package mainly contains traditional elements, such as roads, bridges, ports, and public transport. The most innovative parts are 15bn investment on electric vehicle chargers as well as zero and low-emission buses and ferries. This comes together with investment in clean power infrastructure. However, proposals in the area of innovation and technology are likely to be included in the USD 3.5tn reconciliation bill that is being discussed in Congress. Although negotiations are ongoing and uncertainty on the perimeter of the reconciliation bill is large, proposals in this area seem to enjoy bipartisan support, as reflected in the blueprint provided by the bipartisan passage of two recent bills (the “National Science Foundation for the Future Act” and the “United States Innovation and Competition Act”). Among other proposals, the bill could include USD 45bn for spending on various science and innovation initiatives, e.g., for applied energy or NASA.

FISCAL AFFAIRS

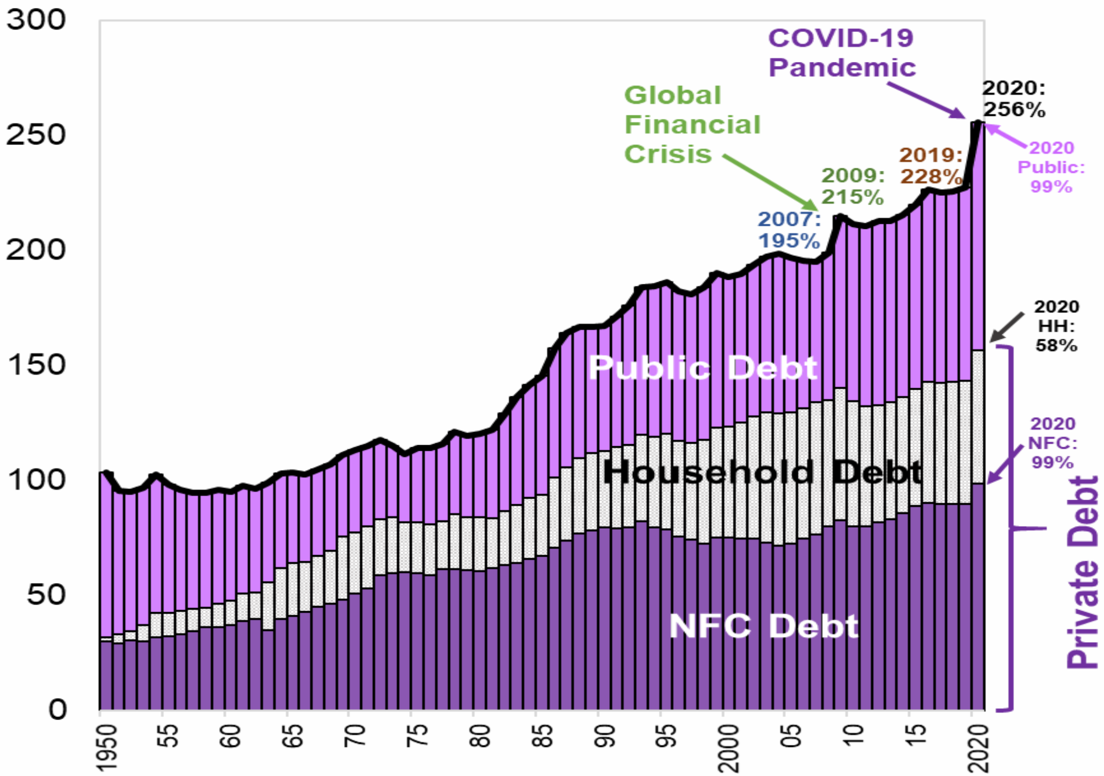
World Economic and Market Developments

SEPTEMBER 2021

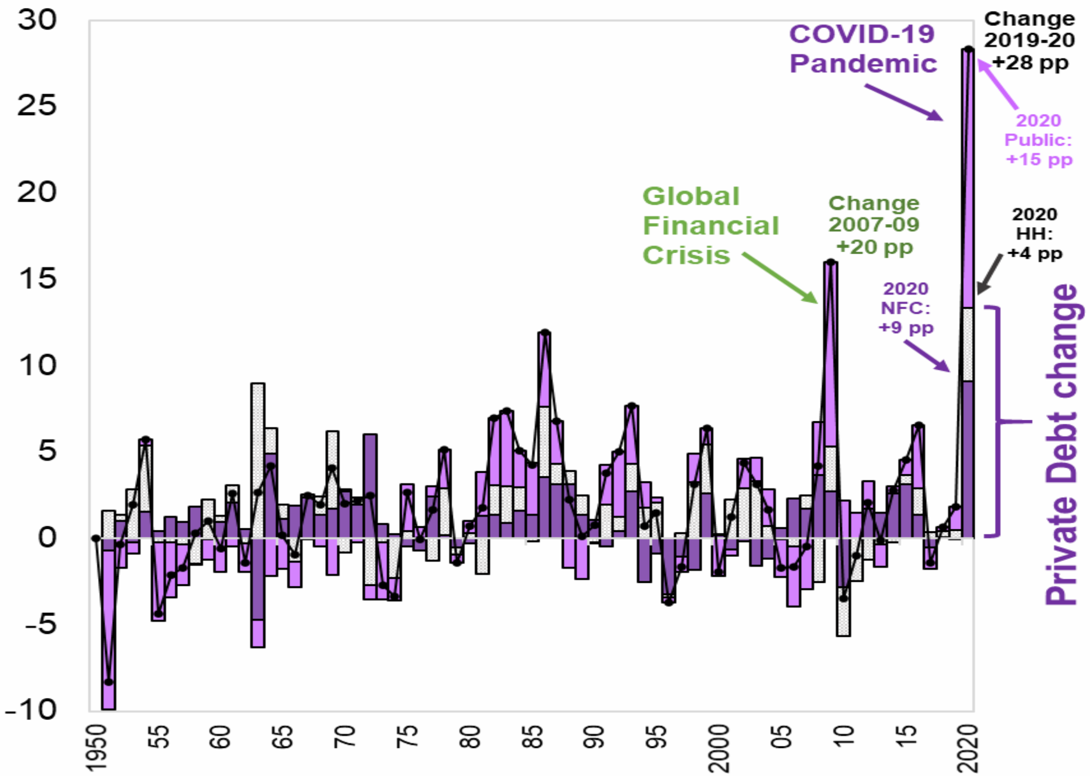
Vitor Gaspar
Director
Fiscal Affairs Department

Mounting Debts

Global Debt Stock: Levels of Total Public and Private Debt 1950-2020 (in percent of GDP)



Global Debt Stock: Annual Changes in Public and Private Debt 1950-2020 (in percent of GDP)



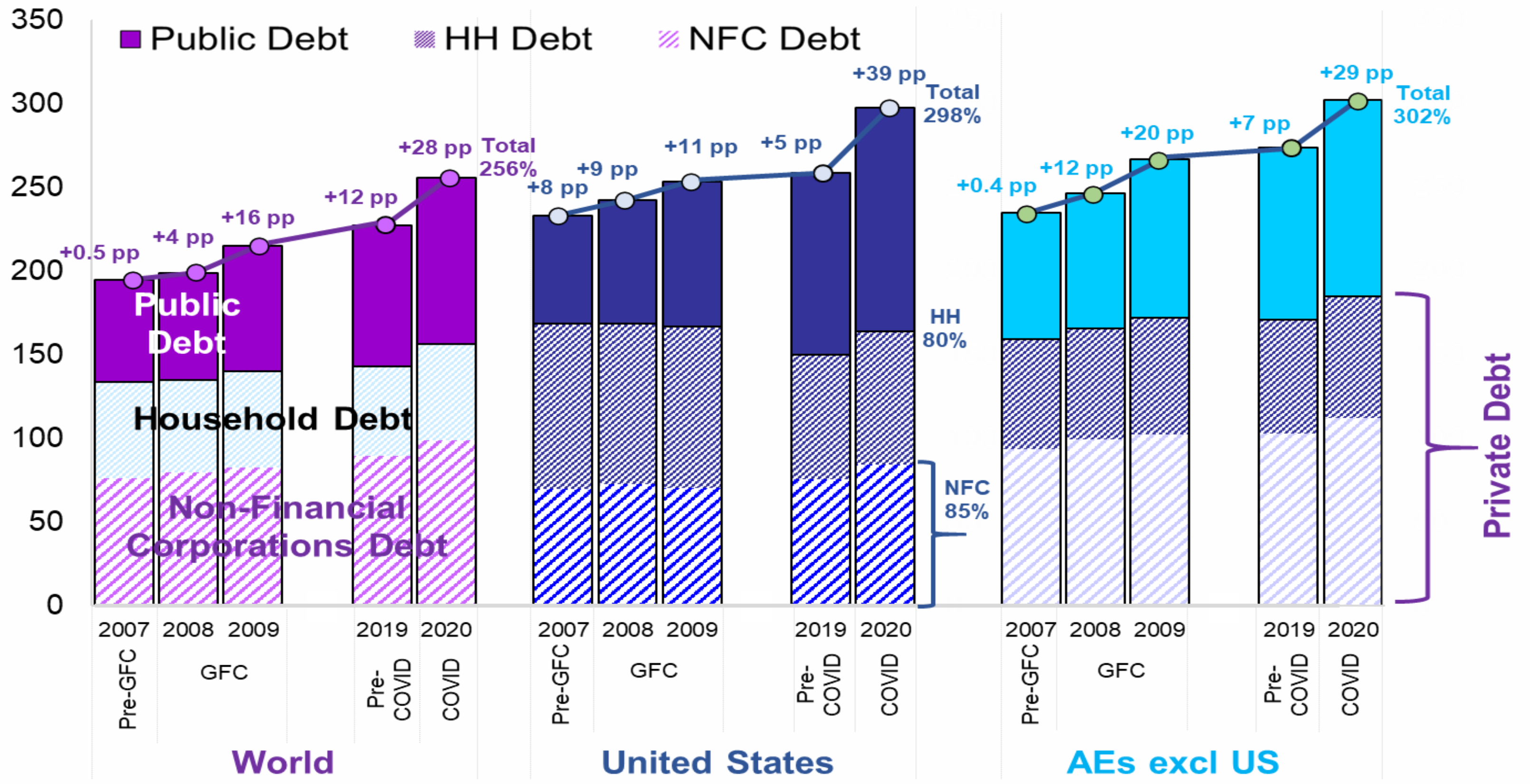
Source: Global Debt Database (September 2021, preliminary estimates)

Note: Public Debt refers to the largest category of debt available (Non-Financial Public Sector, General Government and Central government, in decreasing order). Private debt includes only loans and securities. All income and regional groups follow WEO's (World Economic Outlook) methodology. Total Debt (as a percent of GDP) is close but not exactly equal to the sum of the components of public and private debt. This is because of the difference in country coverage for the corresponding variables - which causes the corresponding country weights to differ. Here, Household Debt is used as the residual.

NFC = Non-financial corporations; HH = Households

Mounting Debts

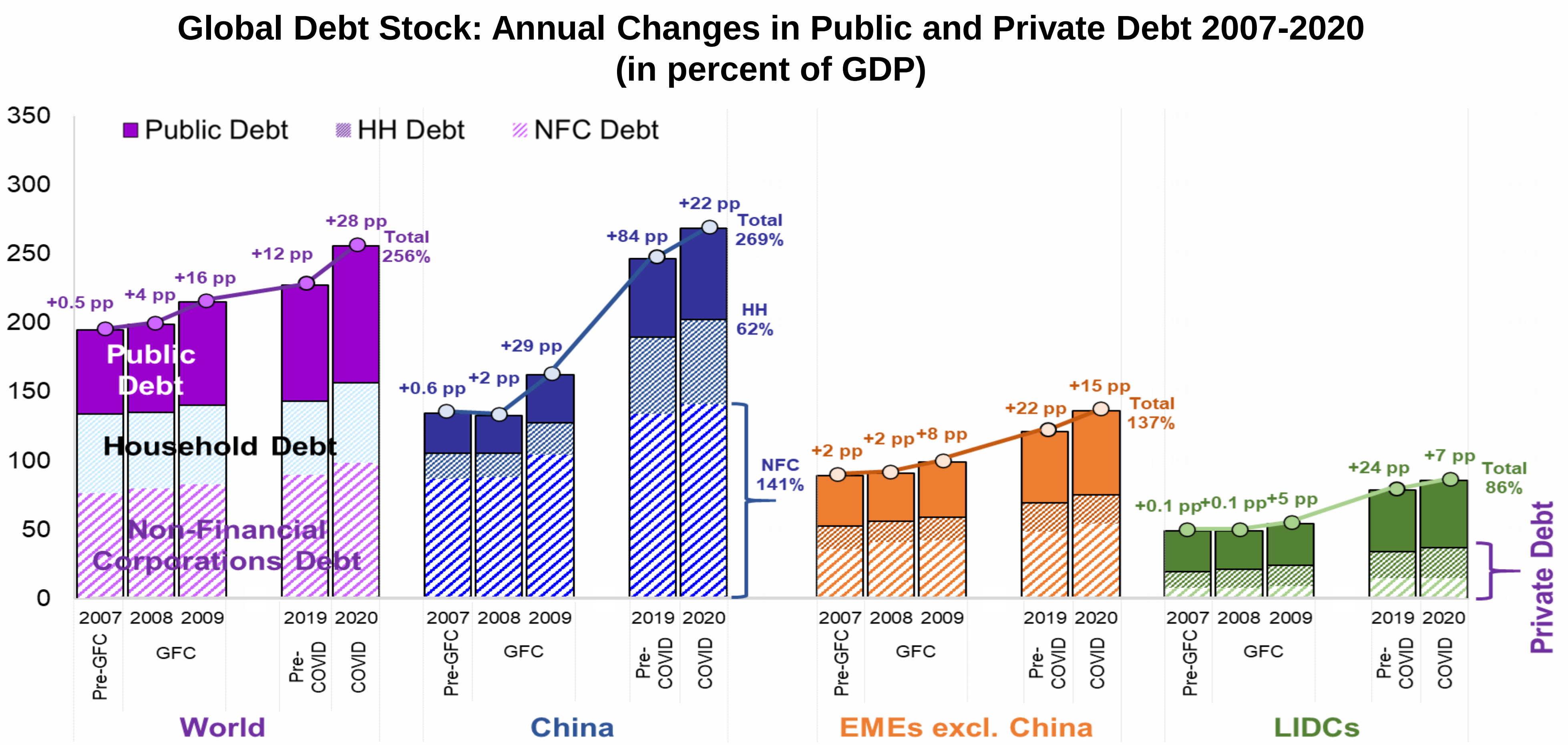
Global Debt Stock: Annual Changes in Public and Private Debt 2007-2020 (in percent of GDP)



Source: Global Debt Database (September 2021, preliminary estimates)

Note: Public Debt refers to the largest category of debt available (Non-Financial Public Sector, General Government and Central government, in decreasing order). Private debt includes only loans and securities. All income and regional groups follow WEO's (World Economic Outlook) methodology. Total Debt (as a percent of GDP) is close but not exactly equal to the sum of the components of public and private debt. This is because of the difference in country coverage for the corresponding variables - which causes the corresponding country weights to differ. Here, Household Debt is used as the residual. Total debt for the World in 2020 is estimated at 256%; the United States at 298% and AEs excl US at 302%. NFC = Non-financial corporations; HH = Households; AEs excl US = Advanced Economies excluding the United States.

Mounting Debts in China

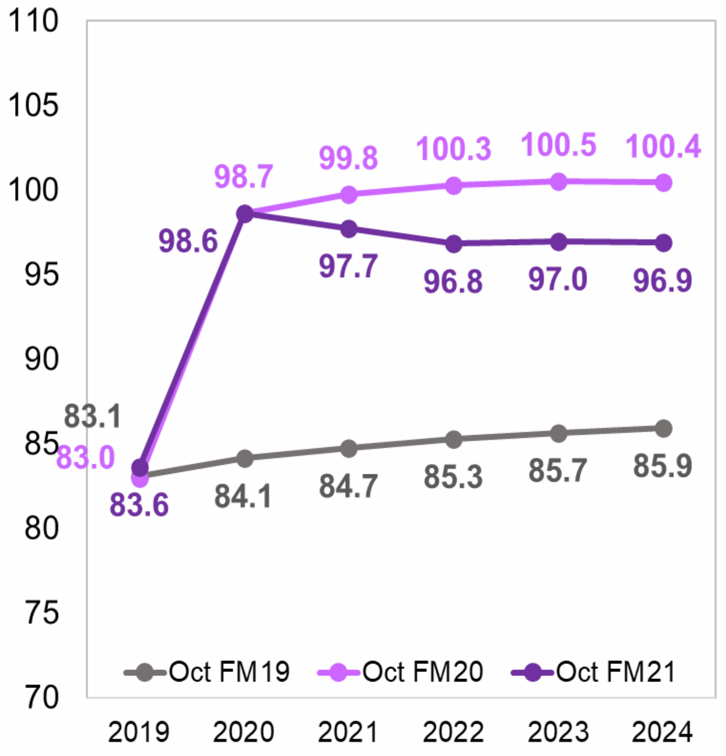


Source: Global Debt Database (September 2021, preliminary estimates)

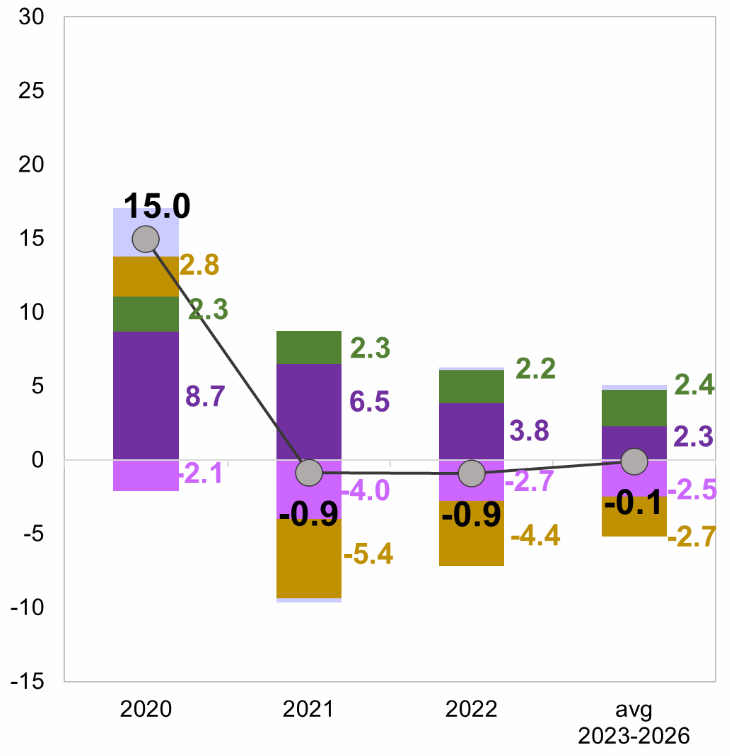
Note: Public Debt refers to the largest category of debt available (Non-Financial Public Sector, General Government and Central government, in decreasing order). Private debt includes only loans and securities. All income and regional groups follow WEO's methodology. Total Debt (as a percent of GDP) will be close but not exactly equal to the sum of the components of public and private debt. This is because of the difference in country coverage for the corresponding variables - which causes the corresponding country weights to differ. Here, Household Debt is used as the residual. Total debt for the World in 2020 is estimated at 256%; China at 269% and EMEs excl China at 137% and LIDCs at 86%.
NFC = Non-financial corporations; HH = Households; EMEs excl China = Emerging Middle-Income Economies excluding China; LIDCs = Low-Income Developing Countries

Debt is projected to stabilize

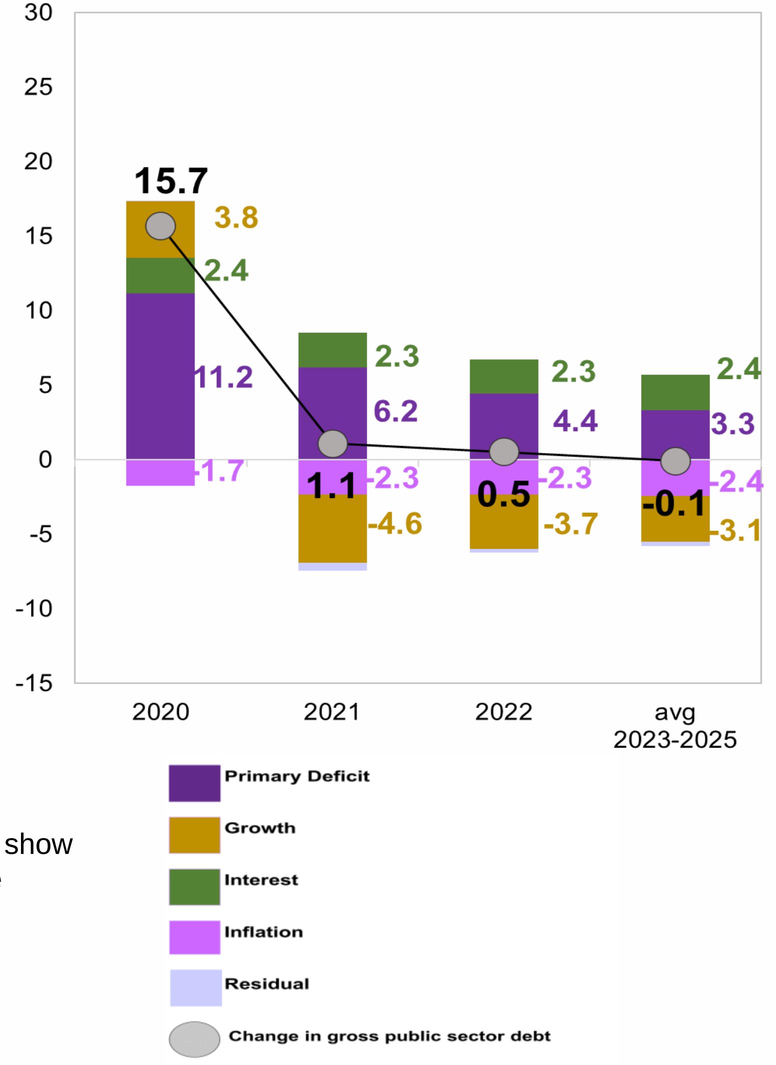
Public Debt (in percent of GDP)



Debt Decomposition (FM Oct21)



Debt Decomposition (FM Oct20)

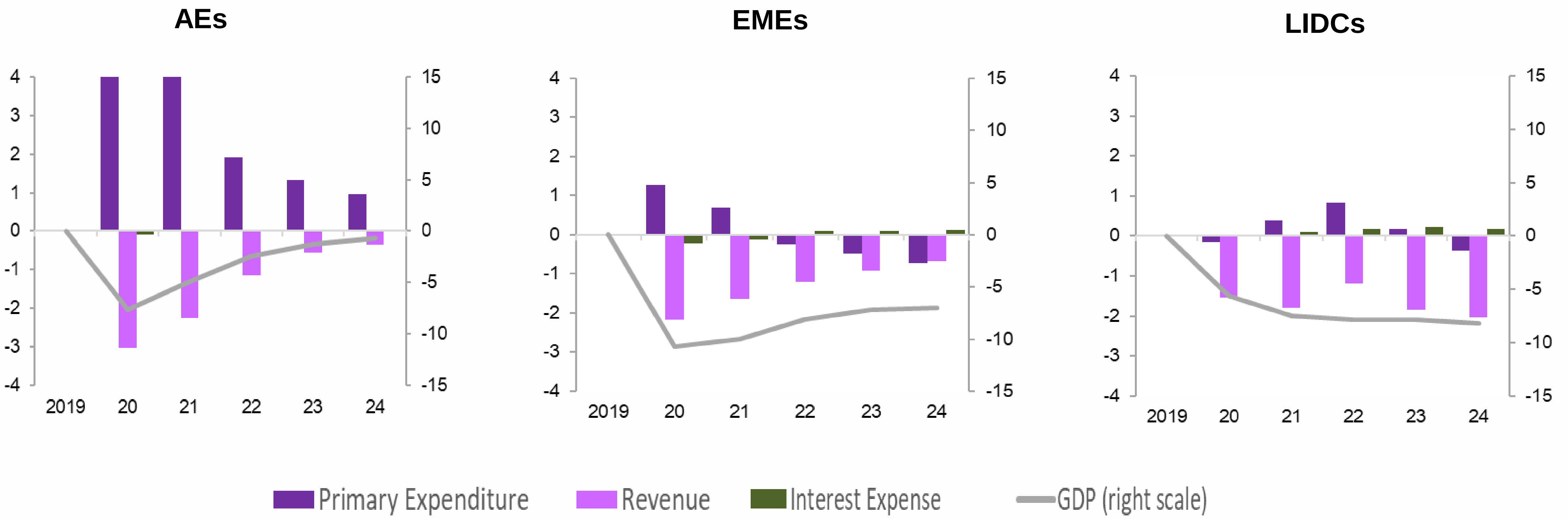


Source: IMF Fiscal Monitor (FM) & Staff Estimates.

Note: Data labels in the debt decomposition charts in black show the change in debt (in percentage points); labels in yellow show the contribution of growth to the change in debt, labels in green show the contribution of interest and labels in pink show the contribution of inflation. The blue stacked columns are the residual.

Diverging Polices and Prospects

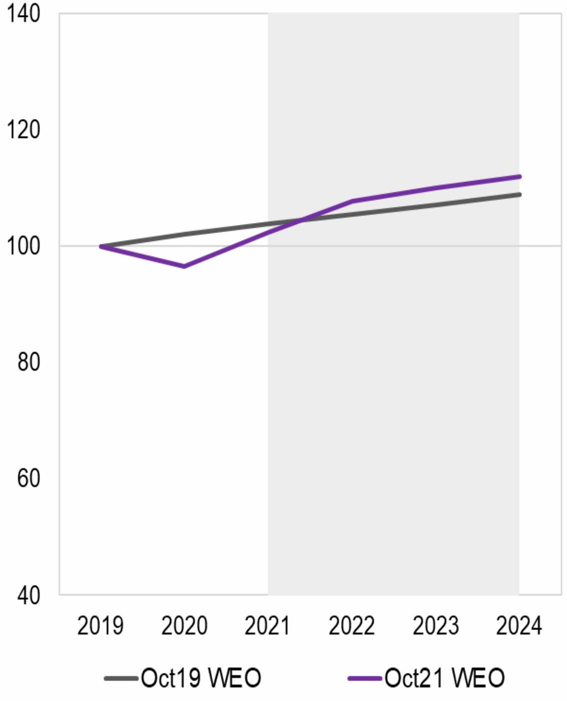
The Effect of the COVID-19 Pandemic on the Forecasts of Fiscal Aggregates and GDP
(Real values, deviation from projection as a percentage of 2019 GDP, simple average)



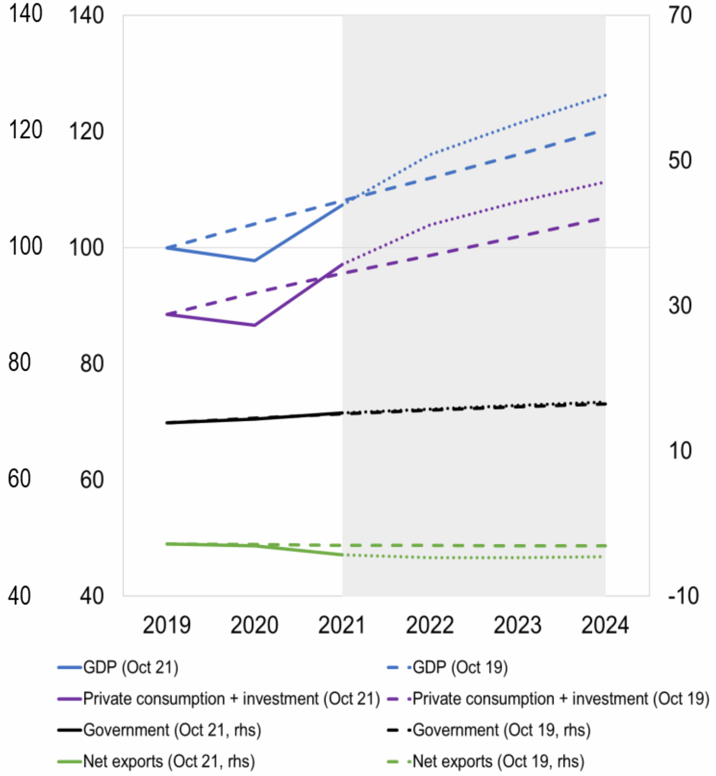
Source: IMF Fiscal Monitor (FM)

Fiscal Response in the United States

Real GDP (in Billions USD, 2019=100)

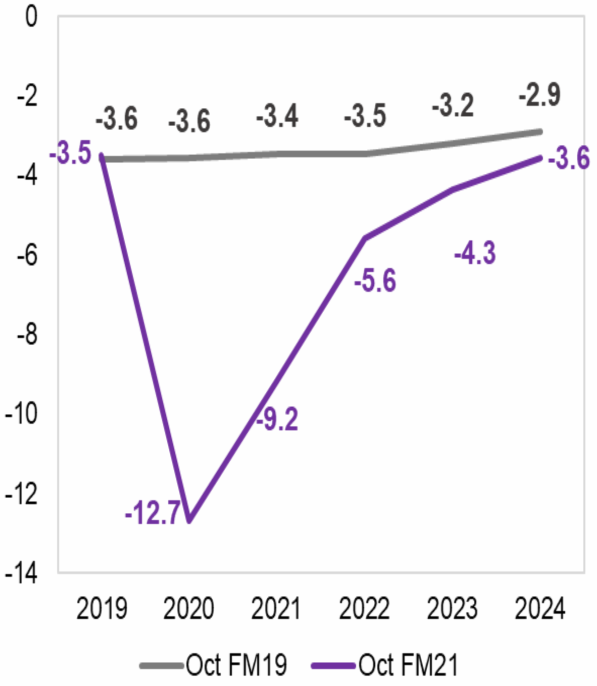


Nominal GDP Components (2019=100)

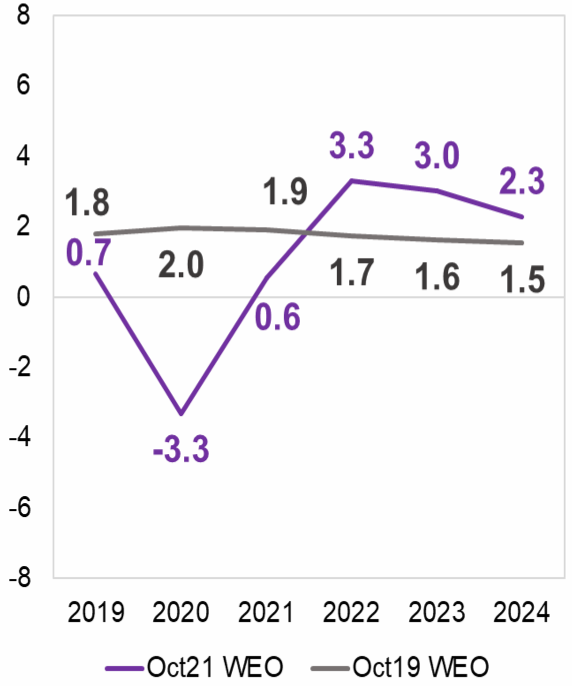


US Fiscal Response

Primary Balance (in percent of GDP)



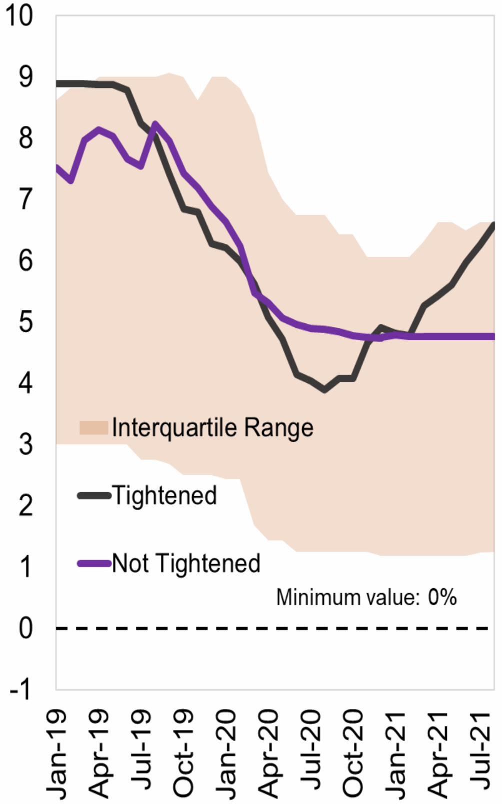
Output Gap (in percent of potential GDP)



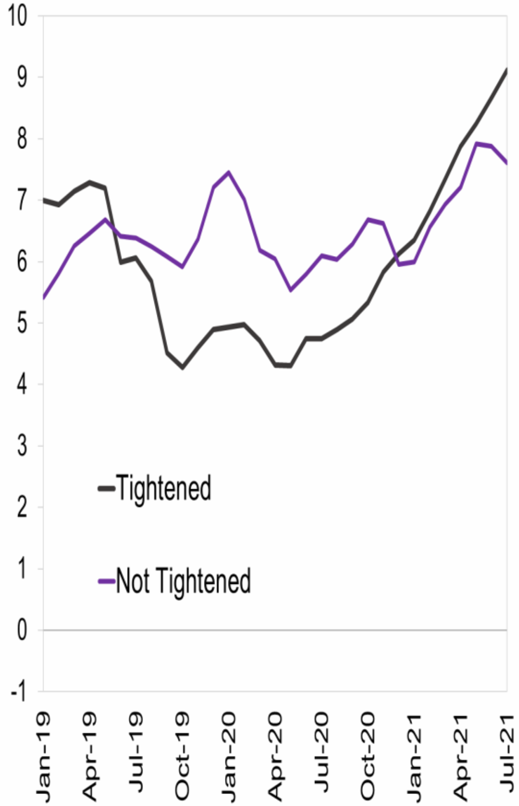
Source: IMF World Economic Outlook (WEO) and Staff Estimates.

Spending, Inflation, and Macroeconomic Policies

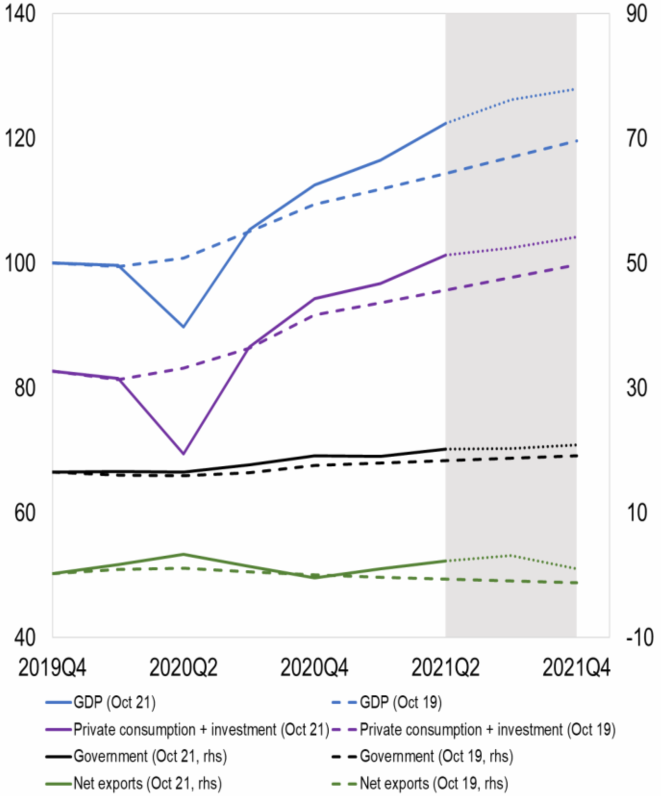
Average Central Bank Policy Rate (percent)



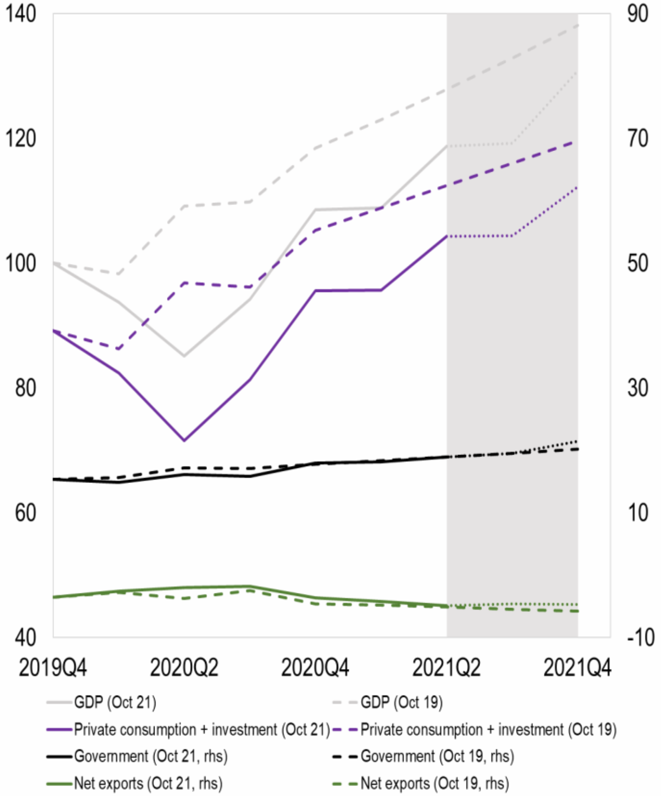
Inflation (percent)



Countries that tightened, Nominal GDP Components



Countries that did not tighten, Nominal GDP Components

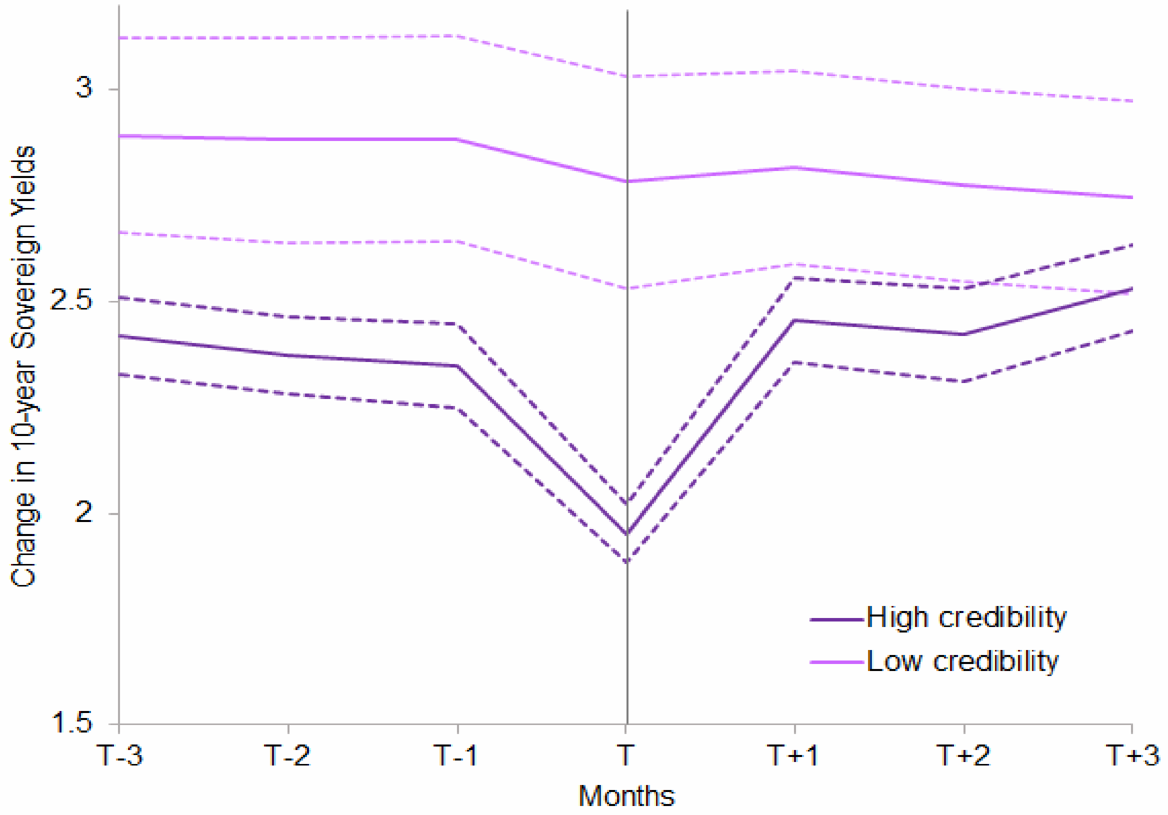


Source: Bank For International Settlements (BIS)/Haver Analytics, National Sources, Global Financial Database (Finaeon), IMF World Economic Outlook (WEO), IMF Consumer Price Indices (CPI) dataset & Staff Calculations

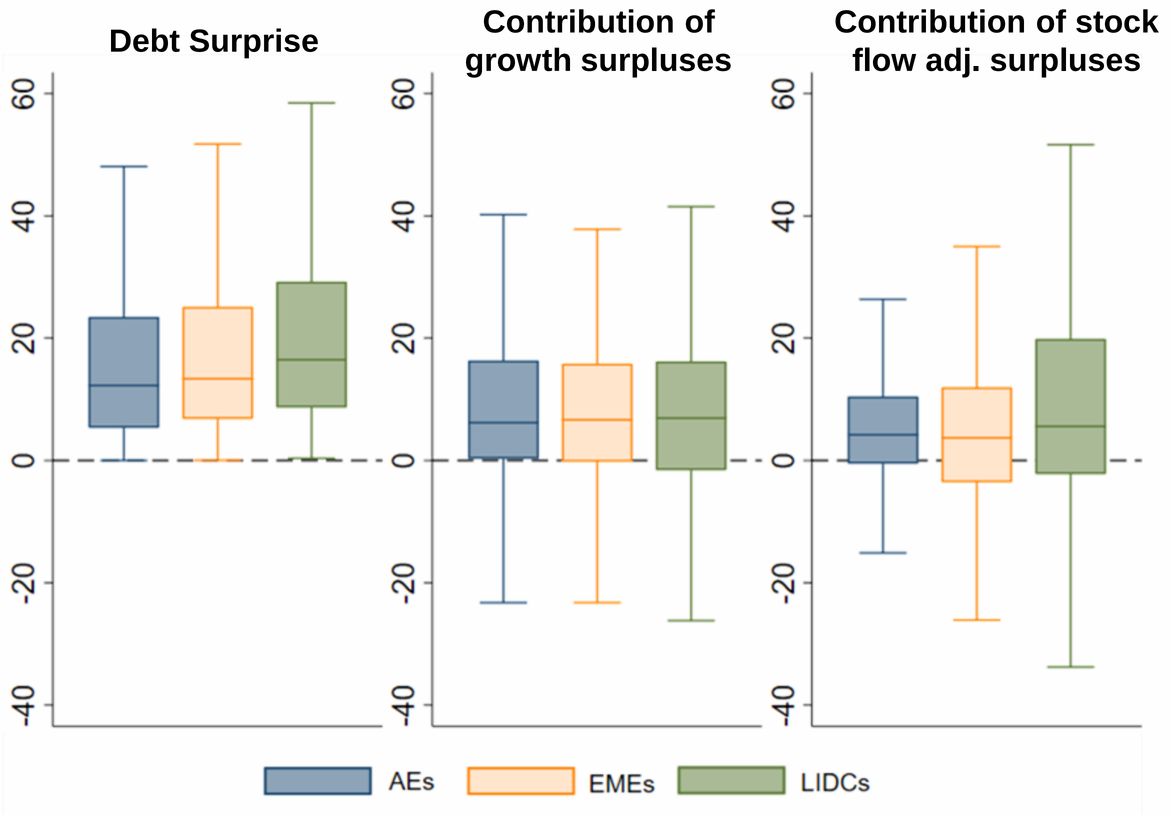
Note: The leftmost chart on the panel shows the weighted average central bank policy rates for Emerging Market Developing Economies (EMDEs) excl. China and the interquartile range. The latest datapoint is August 31, 2021. Inflation shown in the middle (left) chart shows the year-on-year non-seasonally adjusted (NSA) inflation in EMDEs excl. China, in monthly frequency. The latest datapoint is July 31, 2021. Tightened countries are classified as countries that have raised their Central Bank Policy rates since the beginning of the year (year-to-date, YTD). The EMDEs income group follows WEO's methodology.

Committing to Fiscal Responsibility Pays off

Impact of Budget Announcements on 10-year Sovereign Yields



Drivers of Unexpected Jumps in Debt in 5-year Windows (percent of GDP)

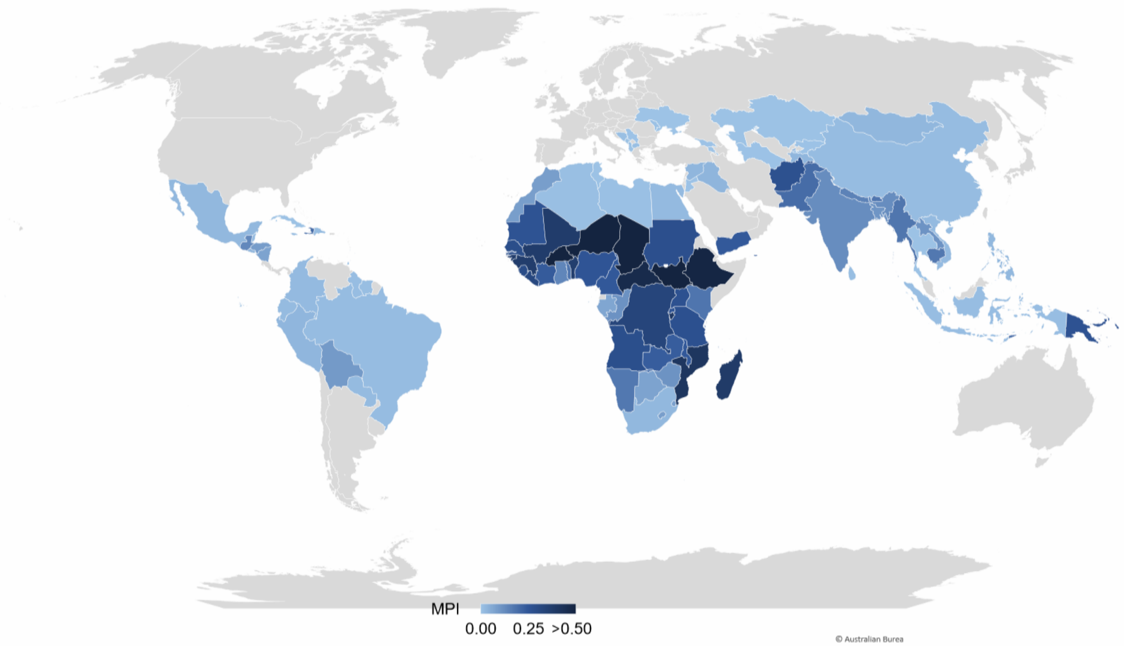


Source: Bloomberg Finance L.P., IMF Fiscal Monitor (FM) & Staff Estimates.

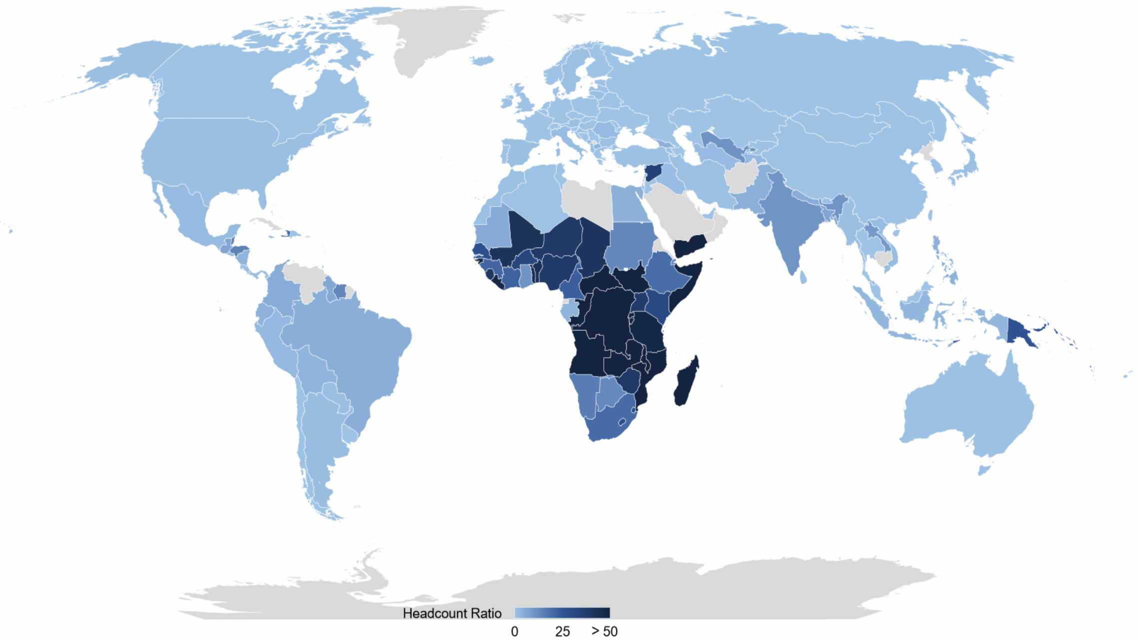
Note: Credibility of budget announcements is measured using the difference between official projections for the balance and private projections. High credibility includes the 25 percent of the countries with the smallest difference between official and private projections; low credibility includes the 25 percent of countries with the largest difference between official and private projections. The dotted lines represent the one standard deviation confidence interval. For the unexpected Jumps figure, The decomposition uses annual observations for projections at the 5-year horizon, obtained from the World Economic Outlook October vintages released over the period 1995–2019. The actual changes in debt at a 5-year horizon are computed for each year for each reporting country and are compared to the contribution of unexpected changes in the main components of the debt's law of motion. The contribution of economic growth includes its impact on the primary fiscal balance via the impact of automatic stabilizers, as in (Mauro and Zilinsky 2016).

Where do the poorest live?

Global Multidimensional Poverty Index (0-1 worst)



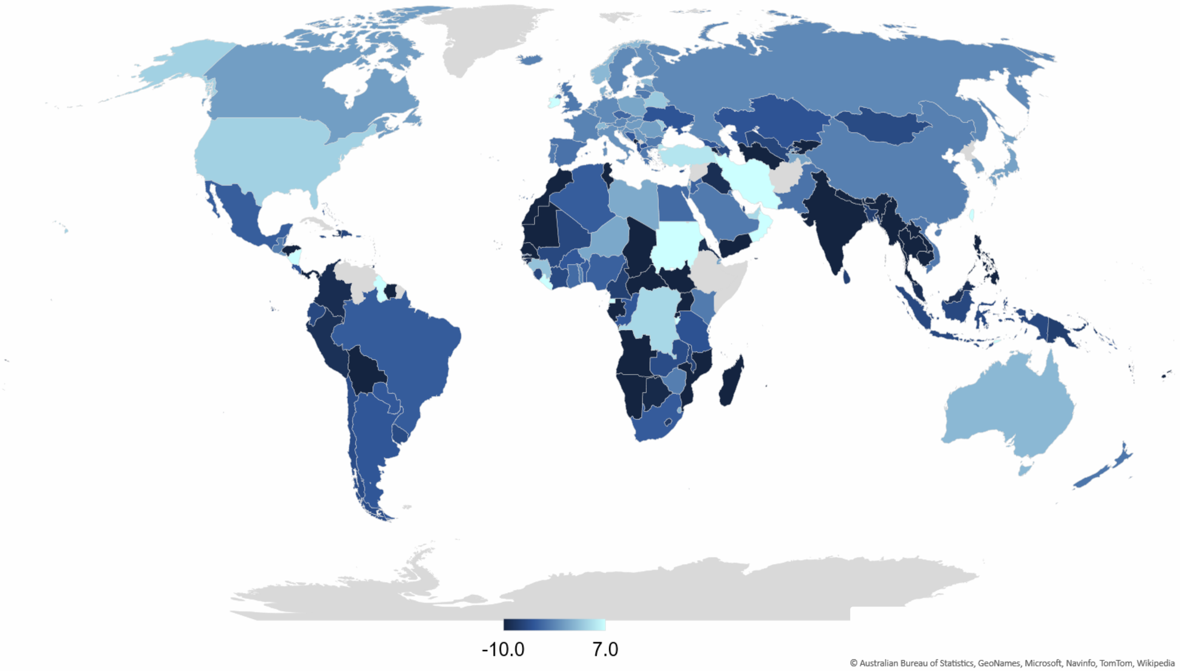
Poverty headcount ratio at $1.90 a day (2011 PPP, percent of population)



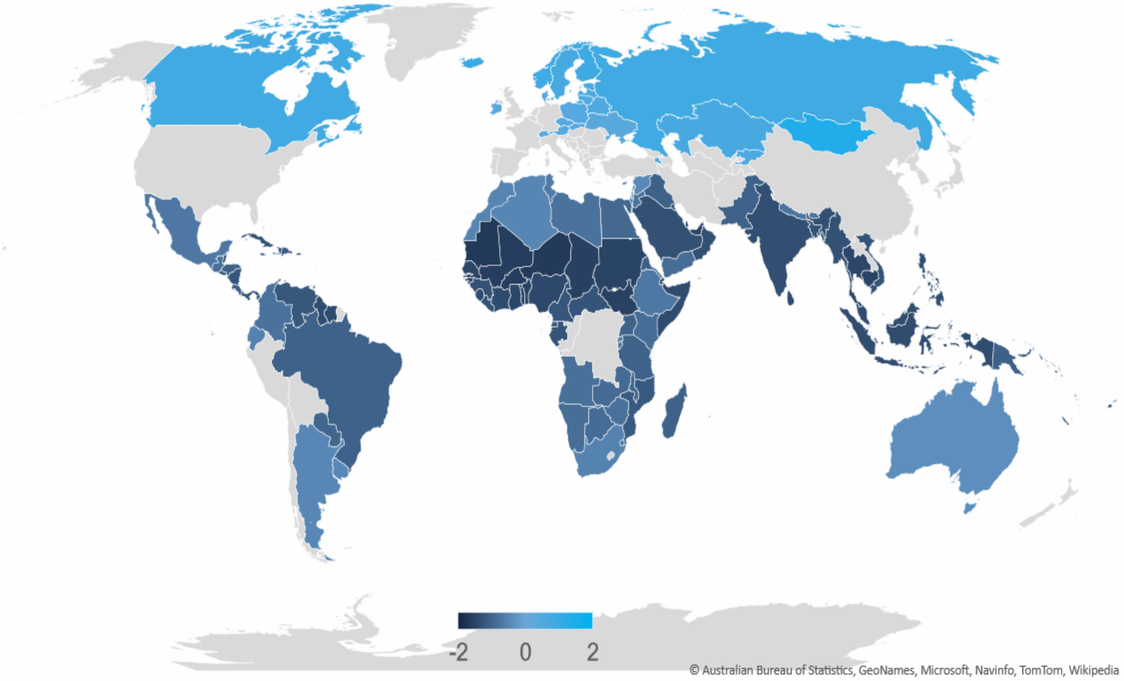
Source: UNDP and OPHI (2020), '*Global Multidimensional Poverty index 2020 – Charting Pathways out of Multidimensional Poverty: Achieving the SDGs*'. Report. United Nations Development Program and Oxford Poverty and Human Development Initiative; IMF WEO; Lakner et al. (2020), PovcalNet & Global Economic Prospects.

..in regions most affected by COVID-19 and Climate Change

Effect of COVID-19 on Real per Capita GDP (in percent)



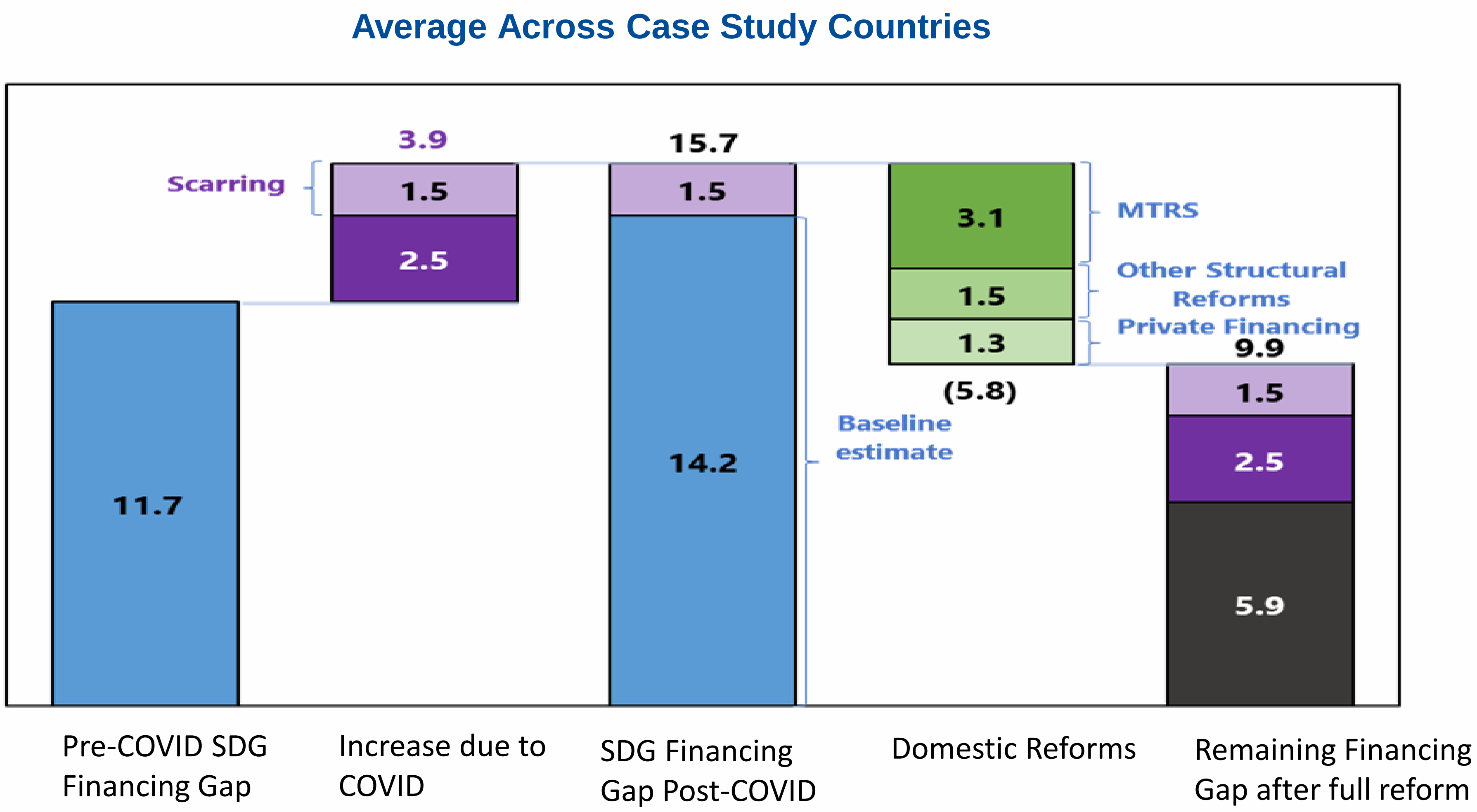
Effect of Temperature Increase on Real per Capita Output (in percent)



Source : IMF World Economic Outlook (WEO) October 2021, October 2019 & October 2017 publications.

Note: The effect of COVID-19 on GDP is measured by comparing the forecasts for 2024 from the October 2019 WEO (the pre-pandemic baseline) vs October 2021 WEO.

SDGs Financing Gap



Source: IMF Staff Calculations.

Note: Values are the average across case study countries, percent of GDP per year. Case study countries: Rwanda, Nigeria, Pakistan & Cambodia.

Policy recommendations

- **Adopt the global plan to bring COVID-19 under control:**
  - Work towards the **goal of vaccinating at least 40 percent in every country by end-2021**, as recommended by the IMF/WB/WHO/WTO Task Force on COVID-19 vaccines and **at least 60 percent by the first half of 2022**
  - **Countries deliver on pledged doses in a timely manner**
  - **Vaccine manufacturers prioritize deliveries to COVAX** (only 10% of procured doses delivered so far)
  - **Remove remaining restrictions on exports** of medical equipment, raw materials and finished vaccines
  - **Diversify and increase vaccine production and distribution capabilities**
  - **Close $25 billion grant financing gap** for vaccines testing, tracing and therapeutics and scale up genomic surveillance.

- **Agree on concrete policy actions to tackle climate change at the UN COP26 this November:**
  - Policy actions should include:
    - **International carbon price floor** adjusted to country circumstances
    - **A green public investment** program and research subsidies
    - **Targeted transfer schemes** to households adversely affected by the climate policies
    - **Advanced economies should deliver on their pledge to mobilize USD100 billion annually in climate finance to support developing nations**
  - Strengthen the **global climate information architecture** (data, disclosures, taxonomies)

- **Ease financial constraints to vulnerable countries:**
  - The recent **general allocation of SDRs** contributes to the liquidity of the international monetary system and through rechanneling may provide support to the most vulnerable countries
  - **Urgent improvement in the implementation of the Common Framework for Debt Treatments** is needed, in particular, given the expiry of the DSSI at the end of December 2021

Policy recommendations

Tailor policy mix to the stage of economic recovery and to country-specific characteristics, while ensuring credibility of fiscal and monetary policy frameworks.

- **Fiscal policies:**
  - Continue to **prioritize spending to end the pandemic**
  - **Reorient away from poorly targeted subsidies and recurrent expenditure, where fiscal space is more limited**, particularly in some EMDEs, to make room for needed health, social spending and infrastructure outlays
  - **Strengthen tax capacity** and improve revenue administration

- **On monetary policy, central banks should:**
  - Act decisively to **prevent a de-anchoring of inflation expectations** when the risks become tangible
  - Remain accommodative where inflation pressures are contained, inflation expectations are below target & labor market is slack
  - **Provide clear guidance about the future policy stance** to prevent unwarranted tightening of financial conditions
- **Financial sector policies:**
  - **Tighten selected macroprudential tools** to tackle pockets of vulnerabilities
  - Expedite resolution of debt overhangs. **Strengthen insolvency frameworks** and expedited, out of court, restructuring mechanism

- **Emerging and frontier markets should rebuild buffers** as appropriate and implement structural reforms to insulate themselves from the adverse impact of a possible tightening of external financial conditions

- **Invest for the longer term to achieve a durable and inclusive structural transformation. Global and national policies must be complements in order to**
  - Facilitate new growth opportunities: Greening the economy and facilitating digitalization
  - Reverse the setback to human capital accumulation due to school closures
  - Reduce inequality
  - Address sovereign debt overhangs

International Monetary Fund

September 28, 2021

World Economic and Market Developments

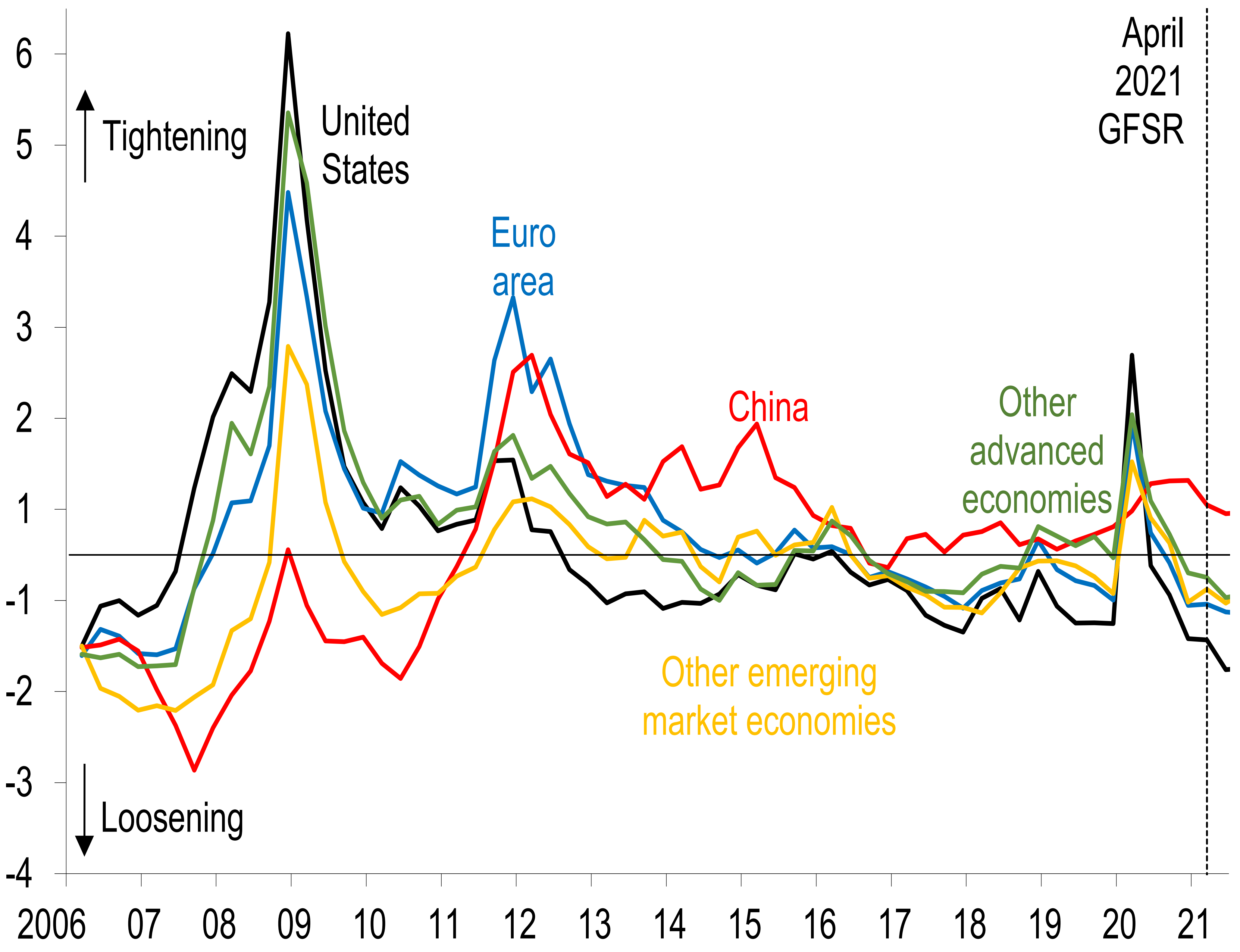
Tobias Adrian

Financial Counsellor and Director

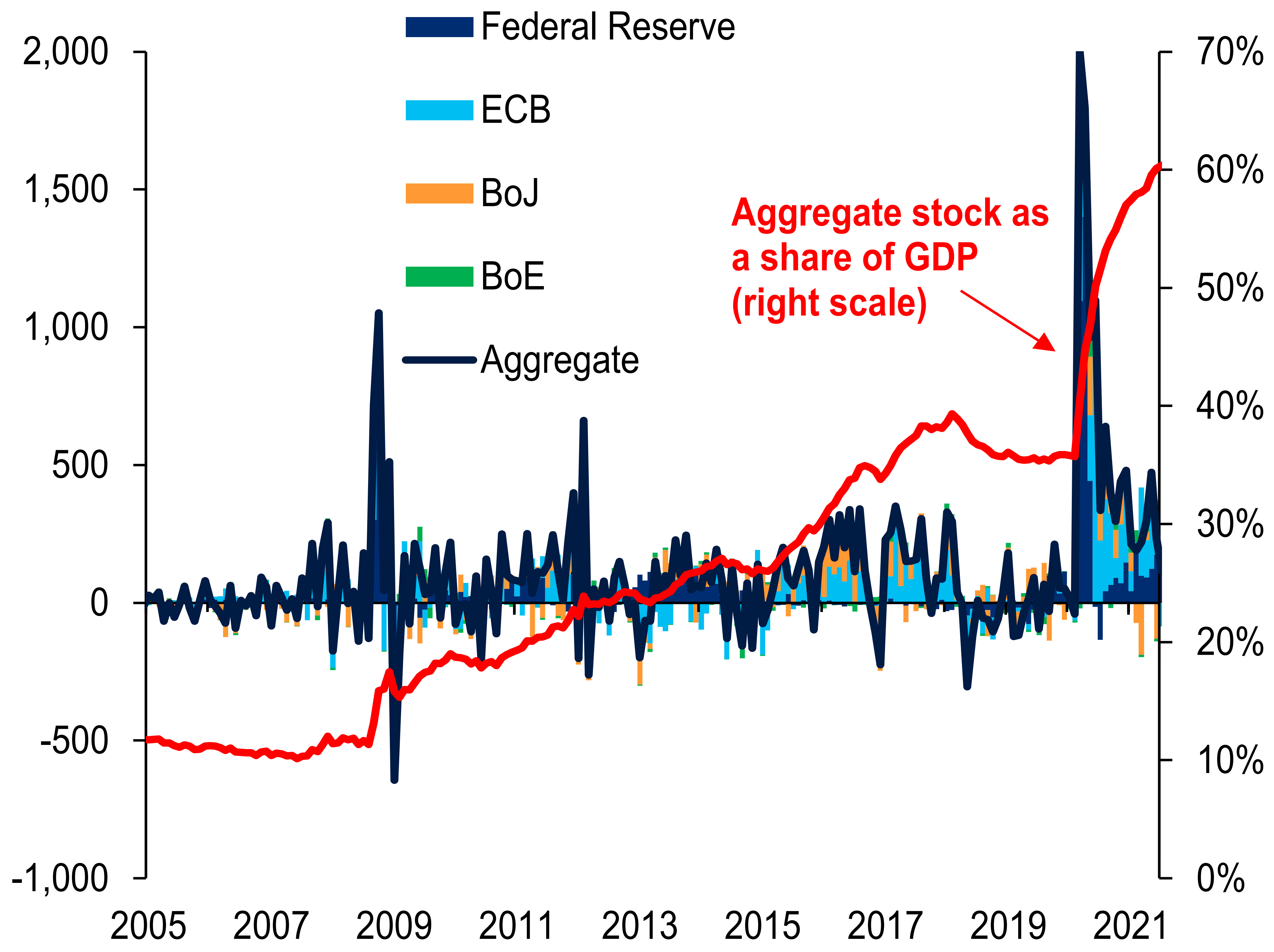
Monetary and Capital Markets Department

Chapter 1: A Delicate Balancing Act

Global Financial Conditions Indices
(Standard deviations from mean)

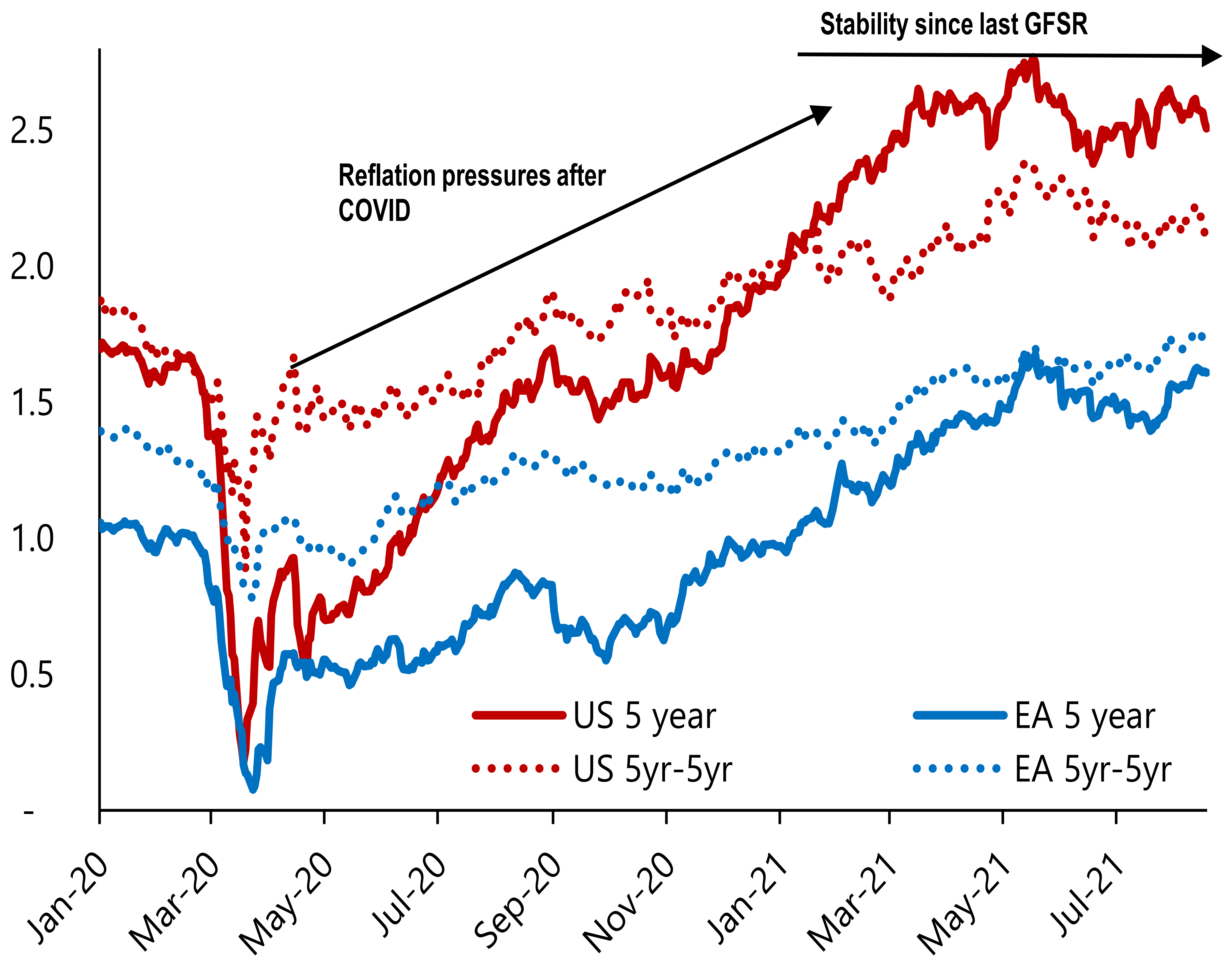


Change in Central Banks Balance Sheet Assets
(Month-over Month change, in Billions of USD, Percent of GDP)

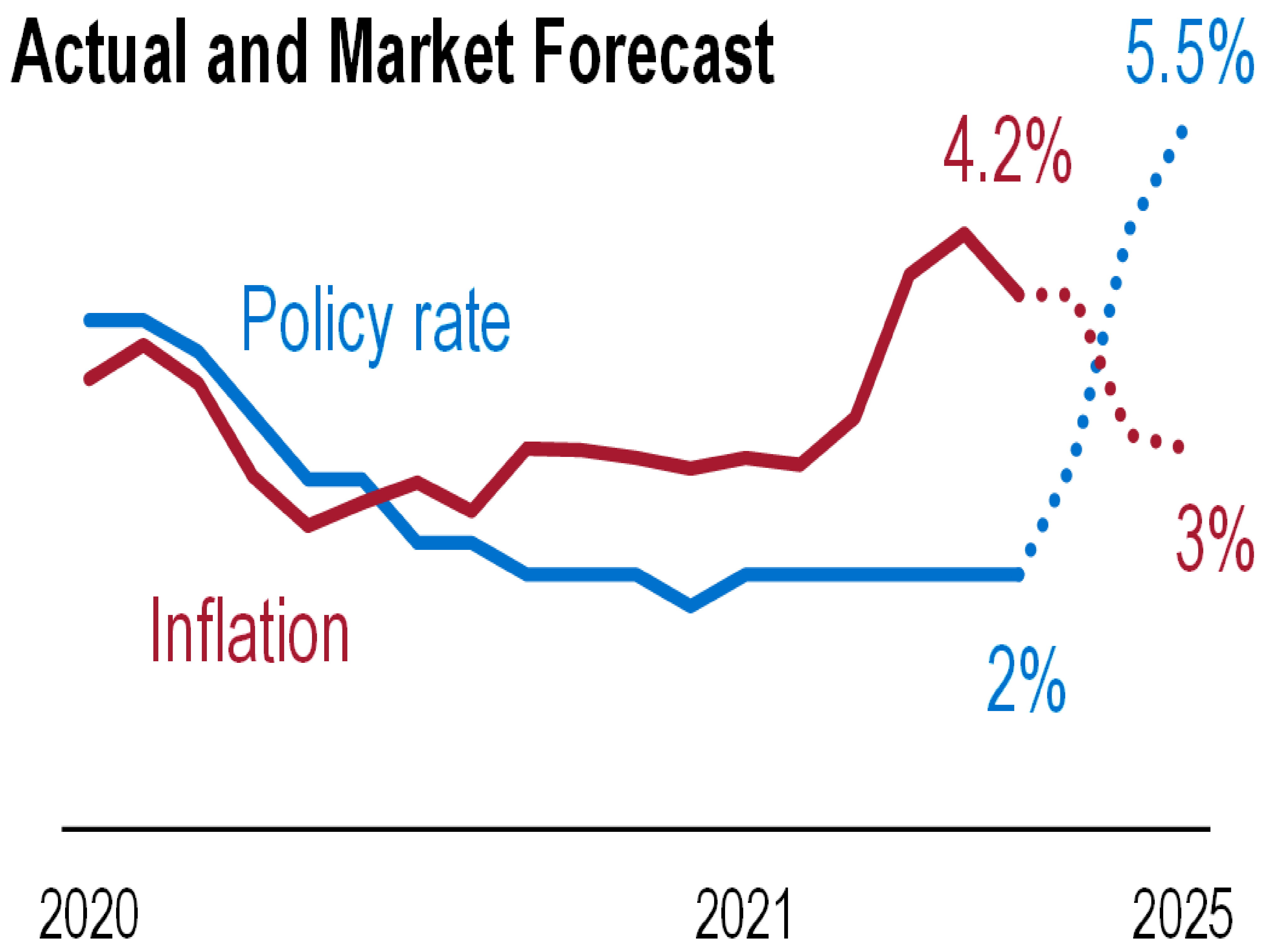


Chapter 1: Inflation Risks, Tapering and Funding Costs in EMDEs

Market Pricing of Inflation Expectations, US & EA
(Percent)

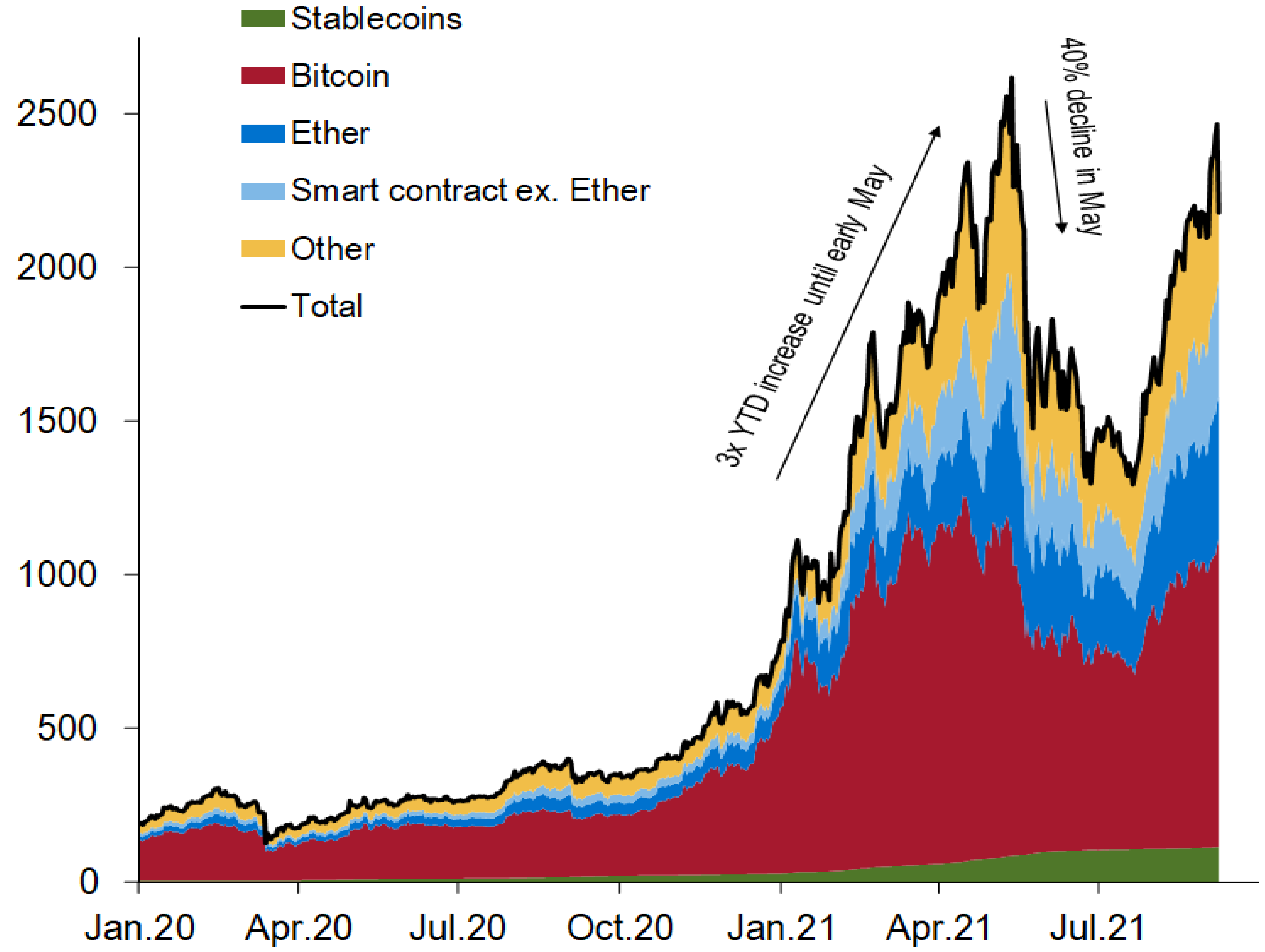


Real Policy Rates Expected to Increase in EMDEs
(Dotted line = market implied)

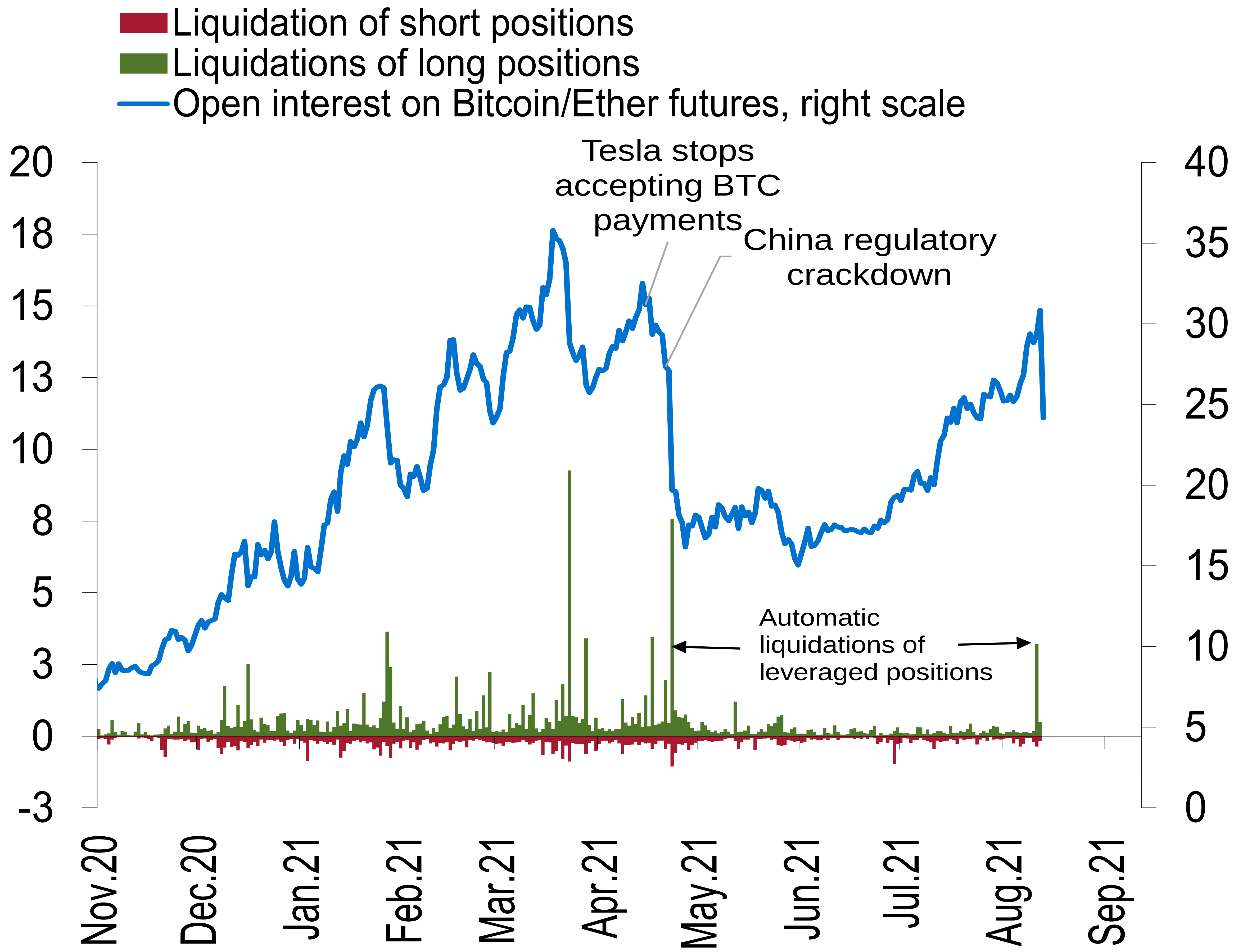


Chapter 2: The Rise of the Crypto Ecosystem

Market cap of Crypto Assets
(USD billion)

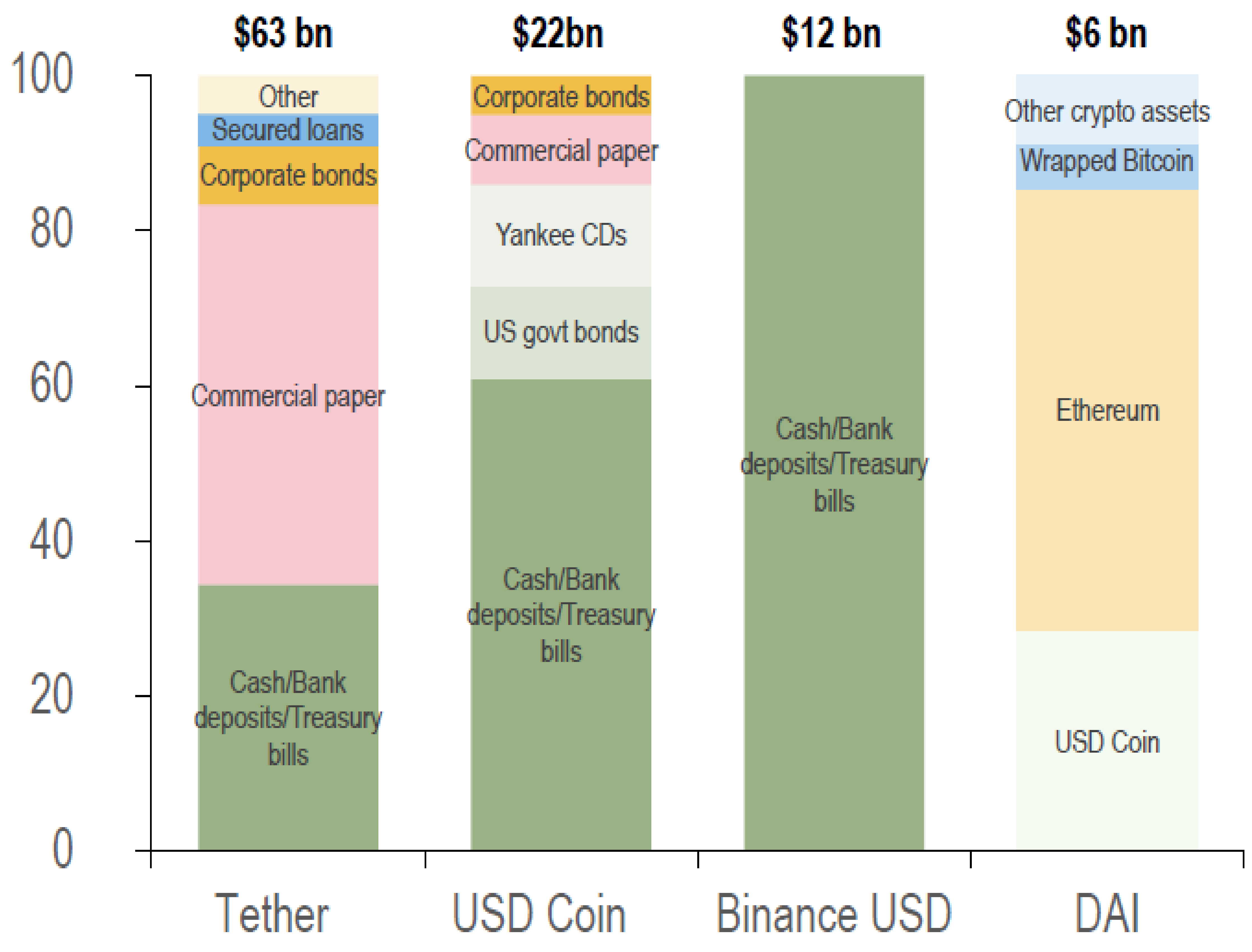


Crypto Assets: Derivative Positions
(number of positions)

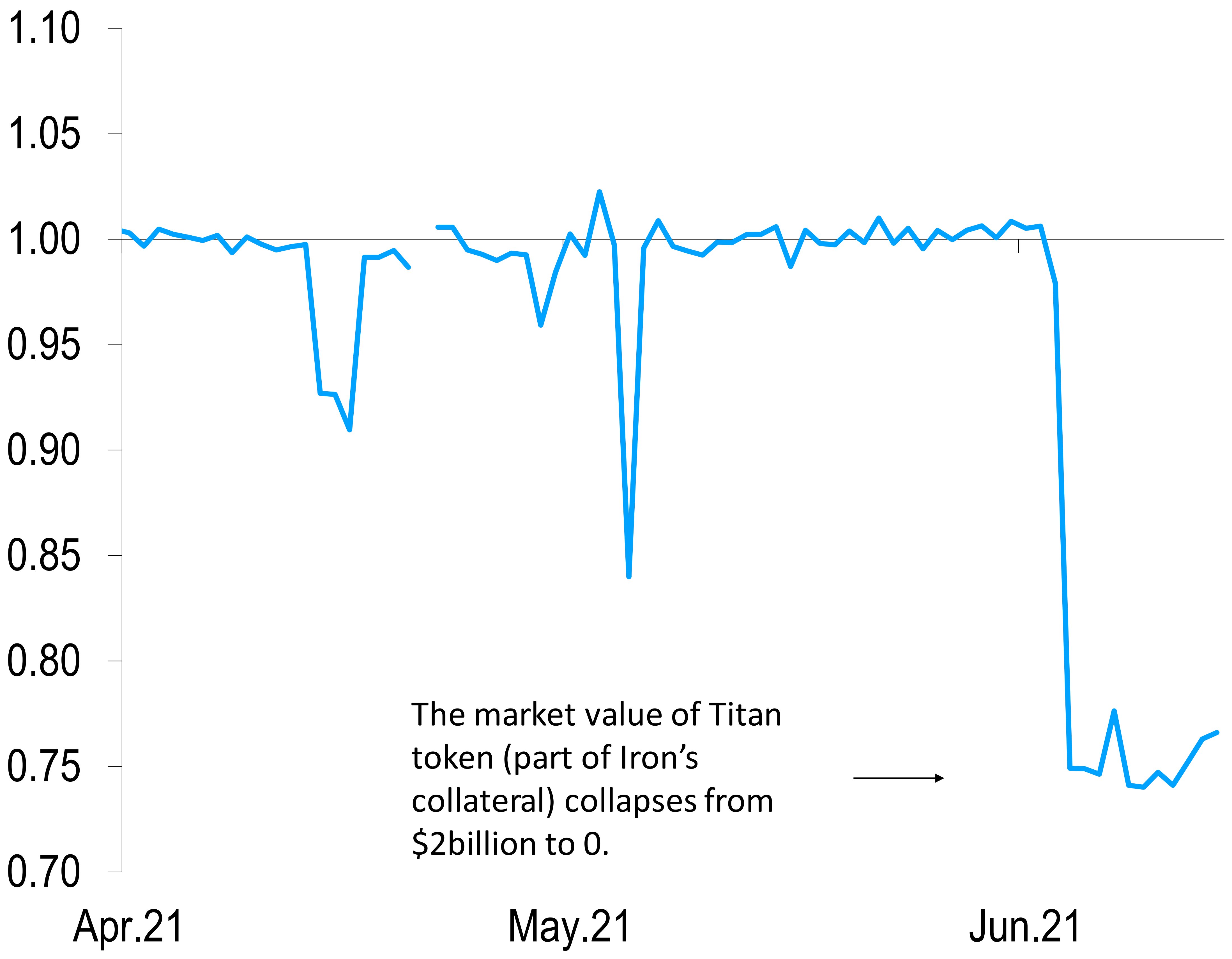


Chapter 2: How Stable are Stablecoins?

Reserves of the Top Stablecoins
(share)

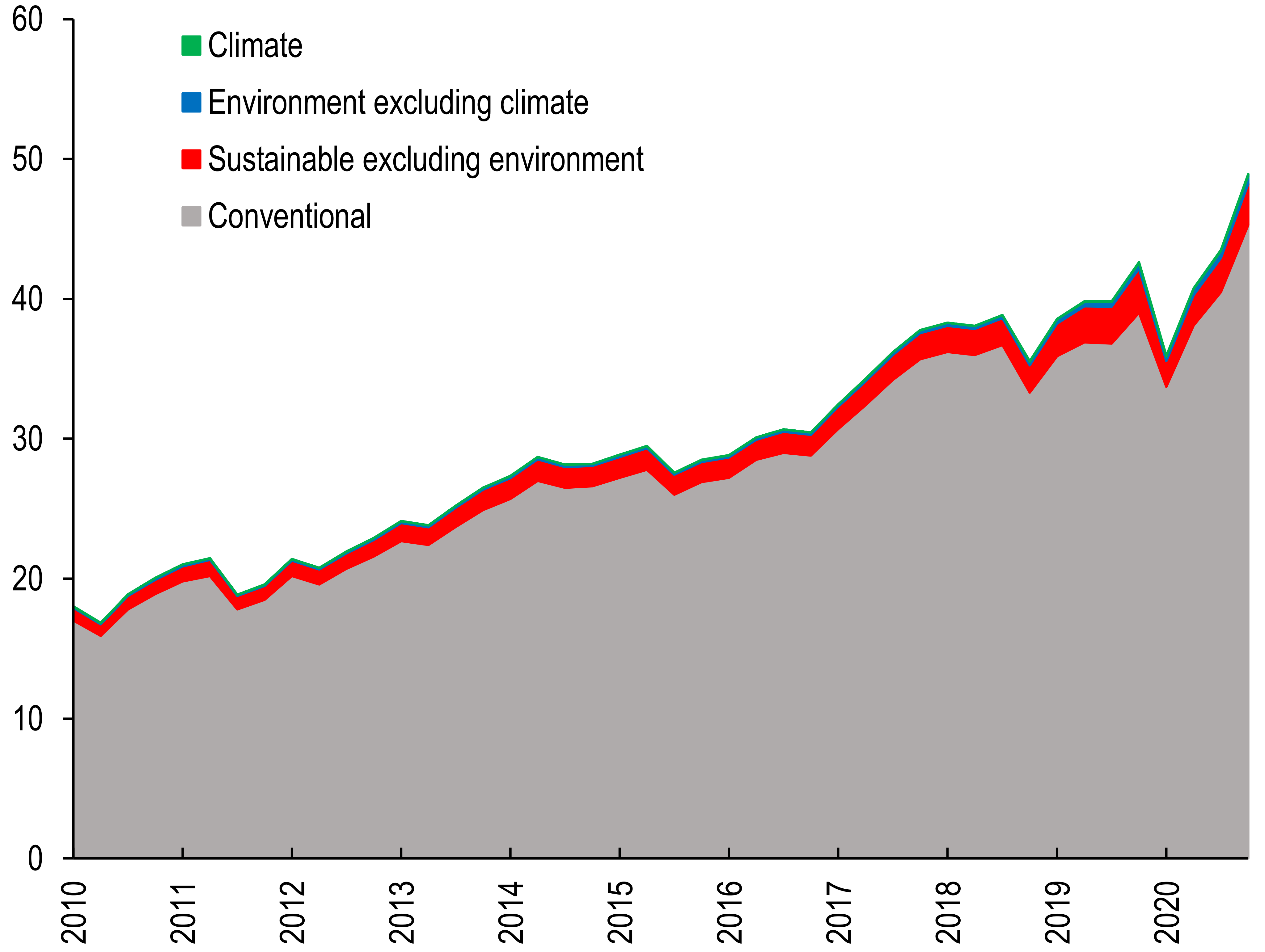


Price of Iron Stablecoin (crypto backed)
(USD)

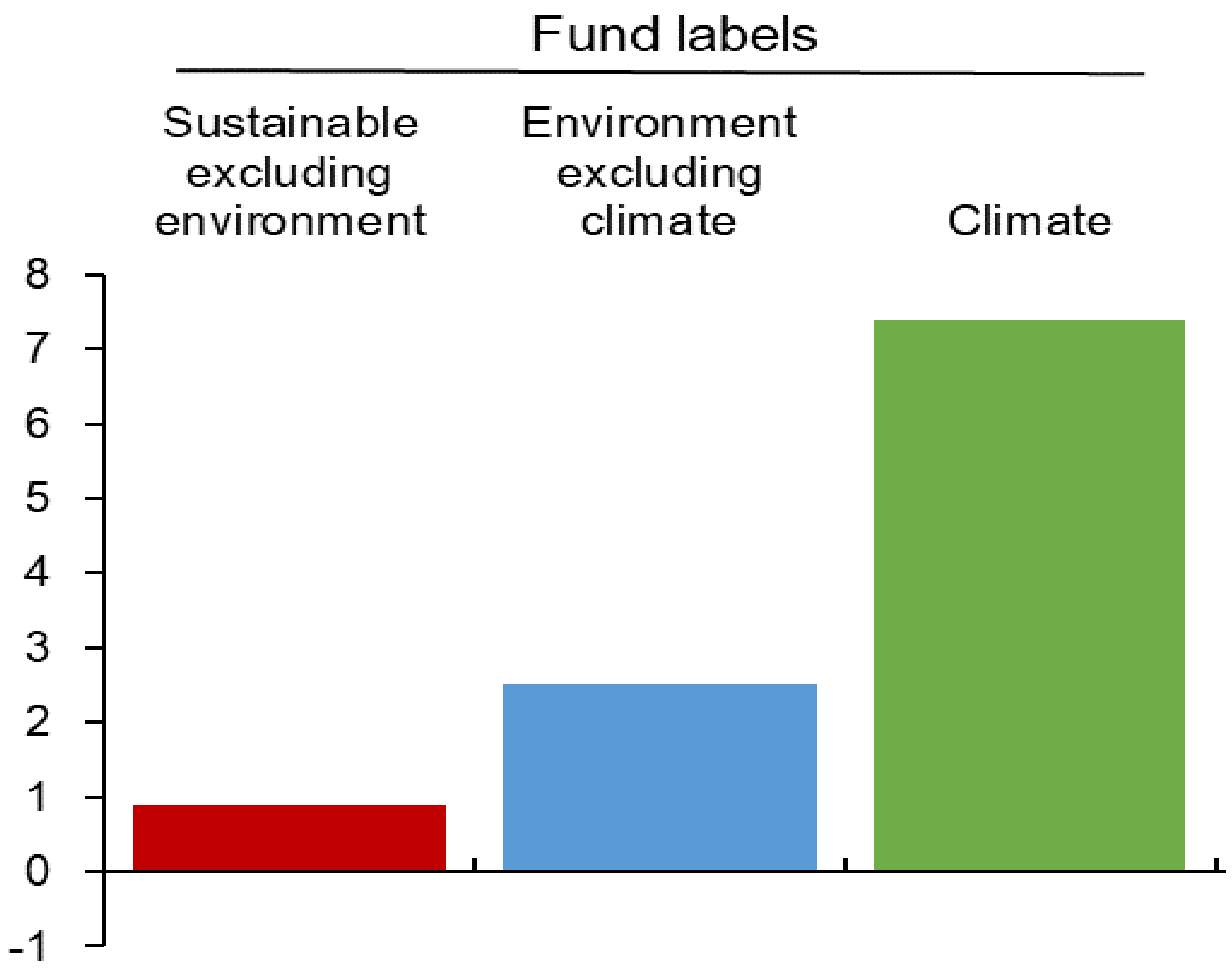


Chapter 3: Investment Funds and Climate Finance

Assets under Management by Fund Label, 2010:Q1-2020:Q4
(Trillions of US dollars)

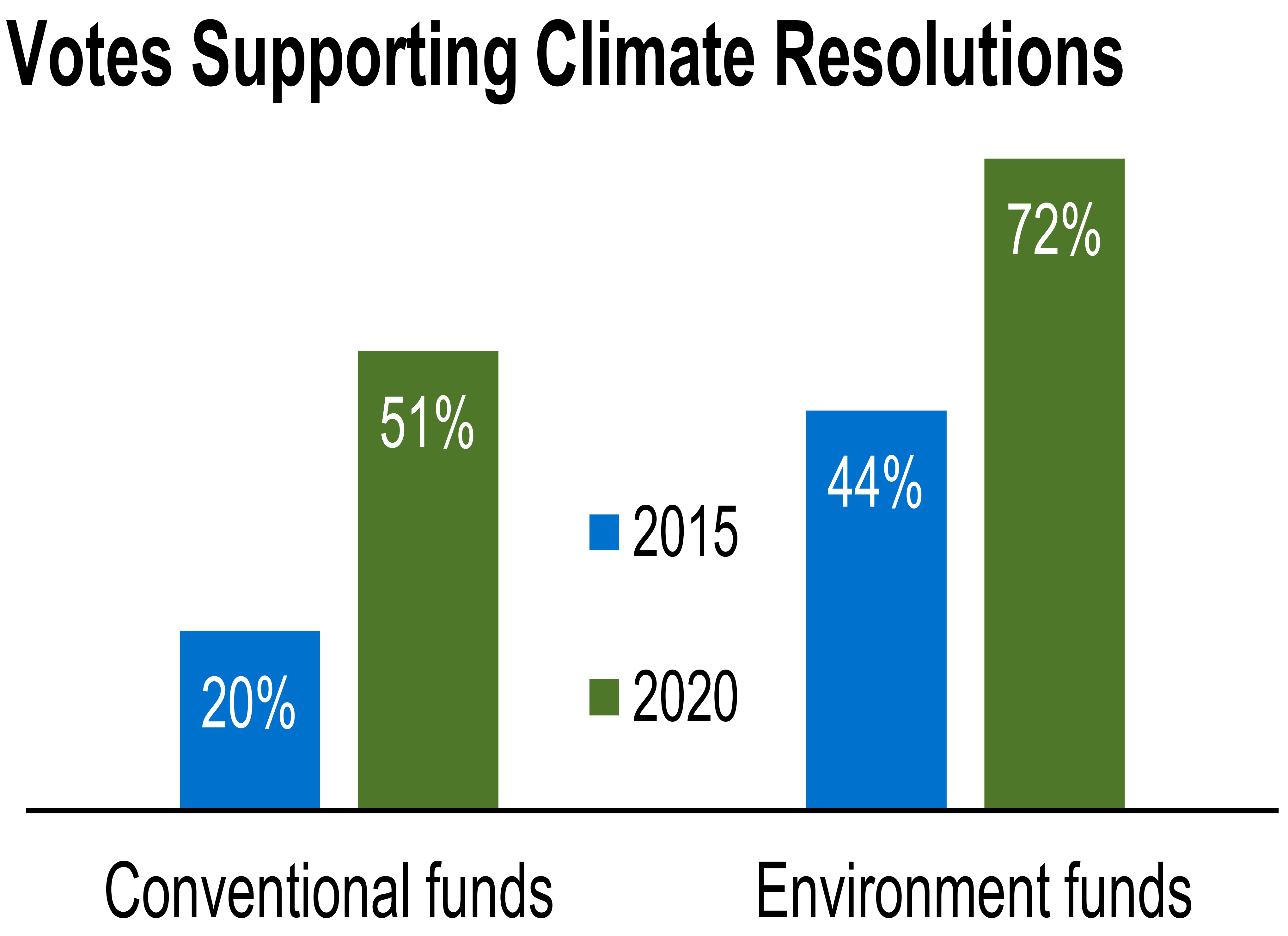


Sensitivity of Quarterly Flows to Fund Labels
(Percent of lagged total net assets)

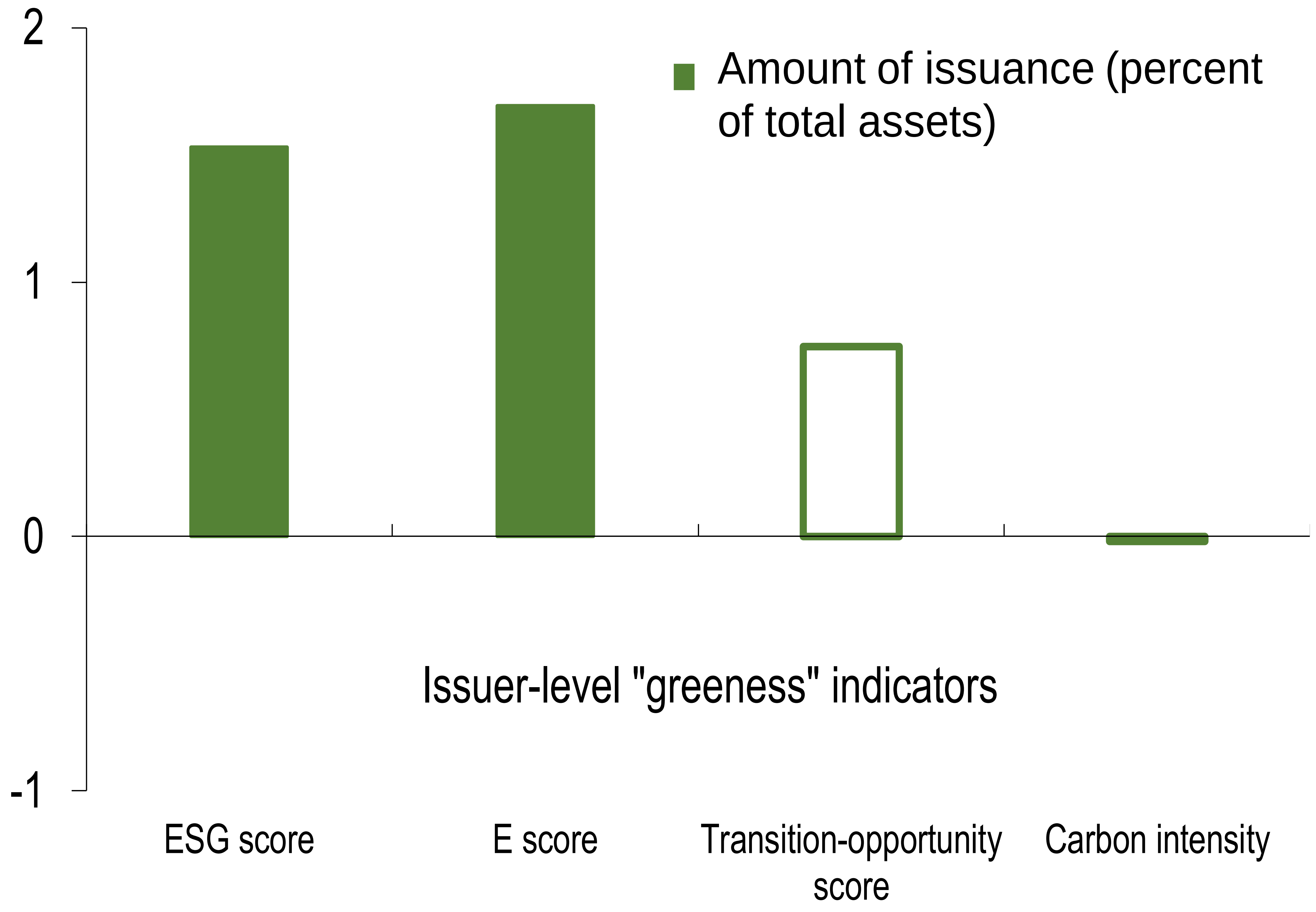


Chapter 3: Sustainable and Climate Investment Funds can Facilitate the Transition to a Green Economy

Share of Votes in Favor of Climate-Related Resolutions, by Fund Label
(Percent)



Effect of Inflows into Sustainable Funds on Amount of Quarterly Bond Issuance by "Greener" Firms
(Percent)



International Monetary Fund

Sep 28, 2021

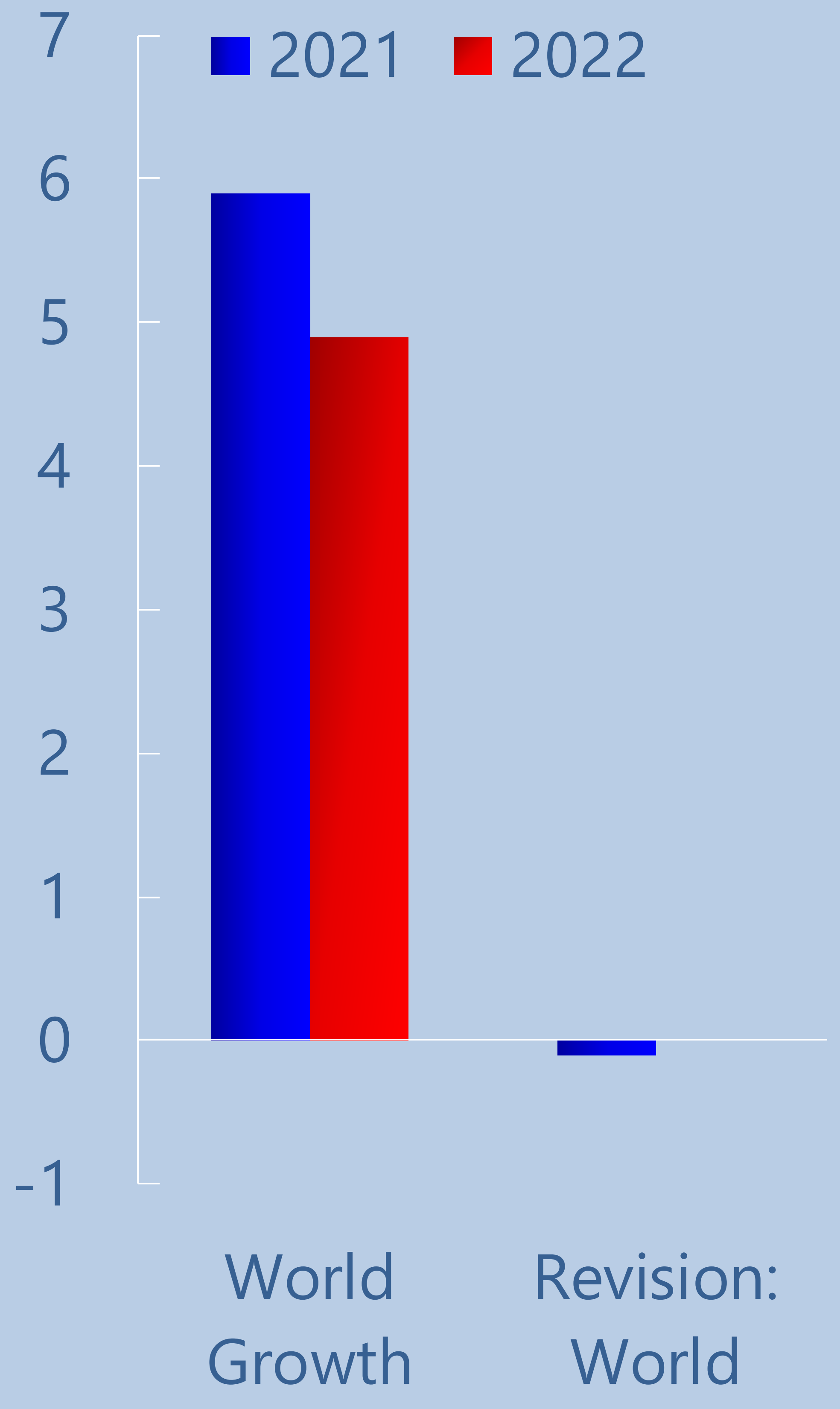
World Economic and Market Developments

Gita Gopinath
Economic Counsellor

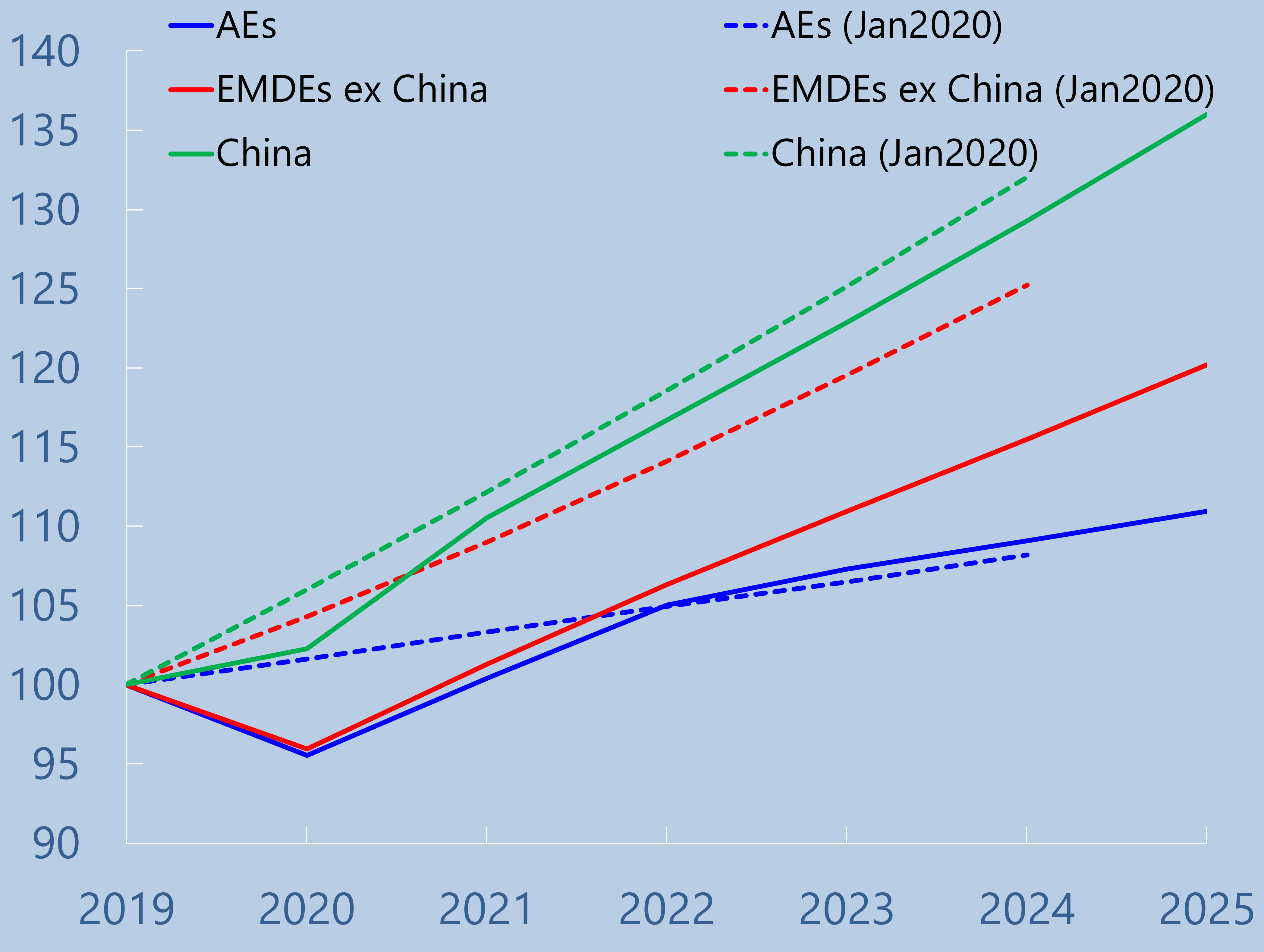
Global recovery continues hobbled by pandemic, fault lines persist

Growth and growth revisions

Growth1/
(percentage points)



Projected output paths
(index, 2019=100)



Risks to the downside

- **Aggressive virus variants could derail recovery**
- **Higher inflation risks could materialize if supply-demand mismatch persists**

Policies

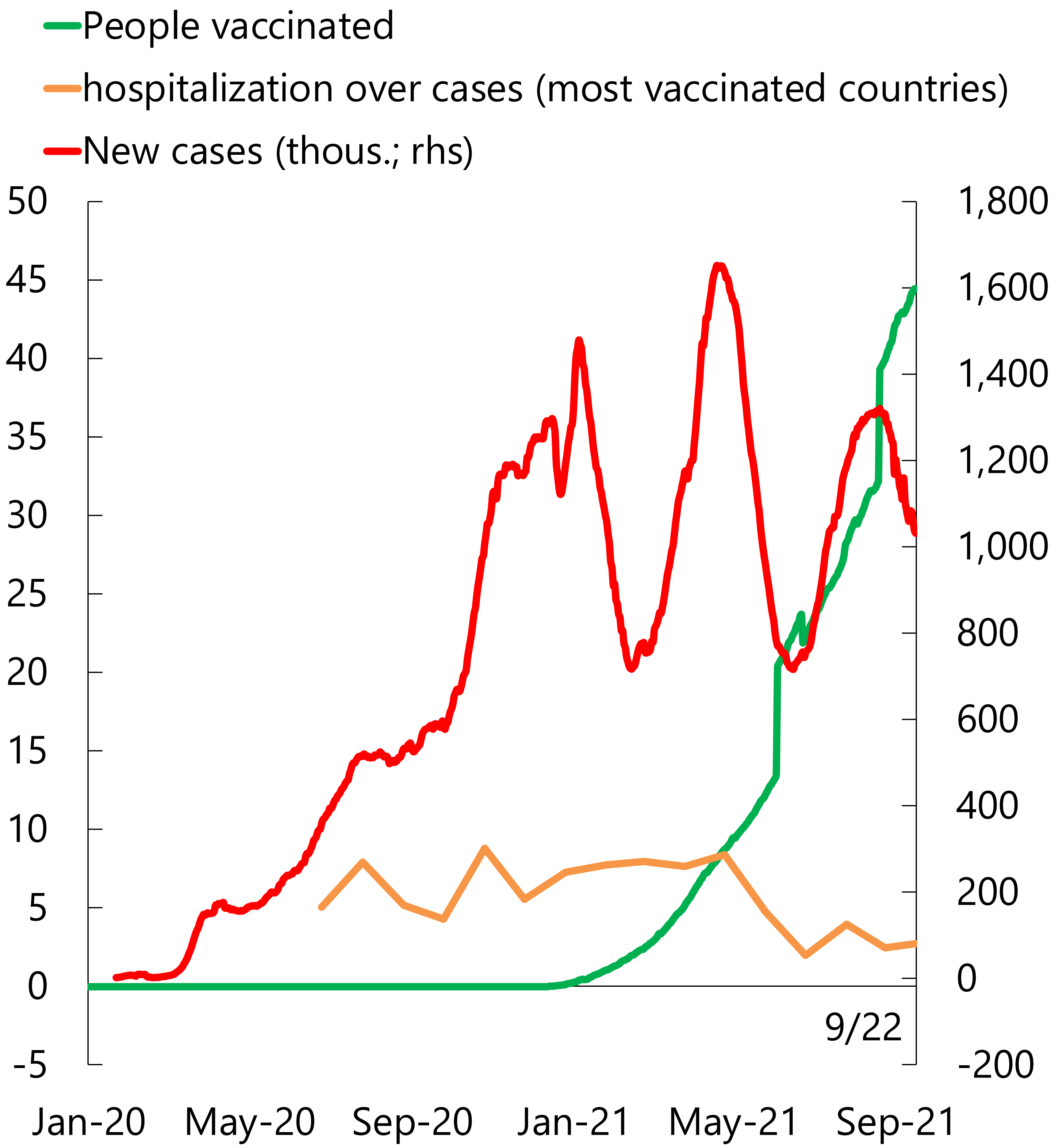
- **Speed up vaccination of world**
- **Calibrate policy mix to health, economic conditions, policy space**
  - **embedded in medium term fiscal frameworks**
  - **Central banks should act quickly if tangible risks of de-anchoring inflation.**
- **Invest for the longer term**
  - **Climate, digital, education**

Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Revisions show the difference between projections in WEO Live and July 2021 WEO. A positive number indicates that growth has been revised up.

Rise in pandemic uncertainty

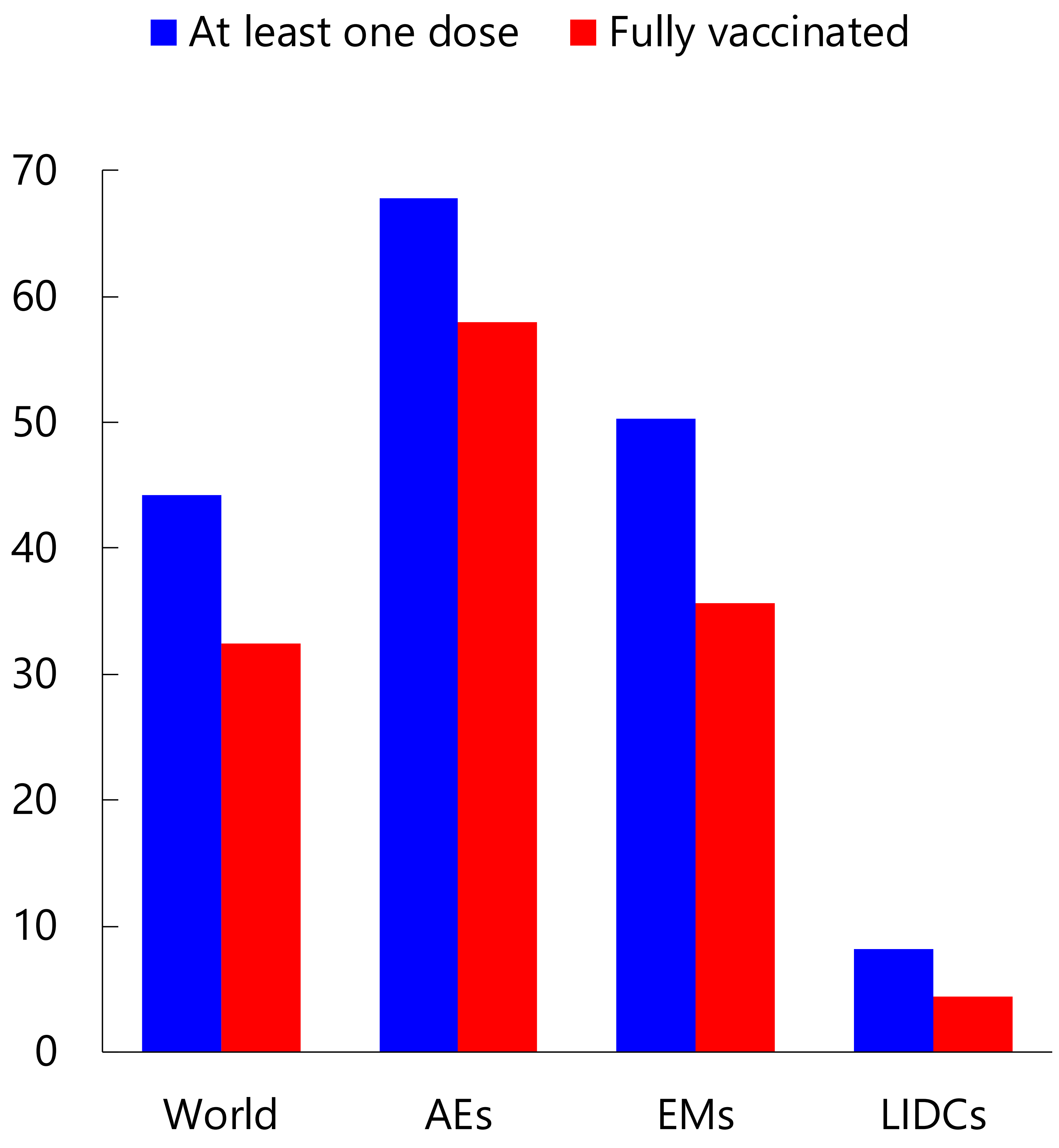
COVID-19 1/

(percent; unless otherwise indicated)



The great vaccination divide 2/

(Percent of population)



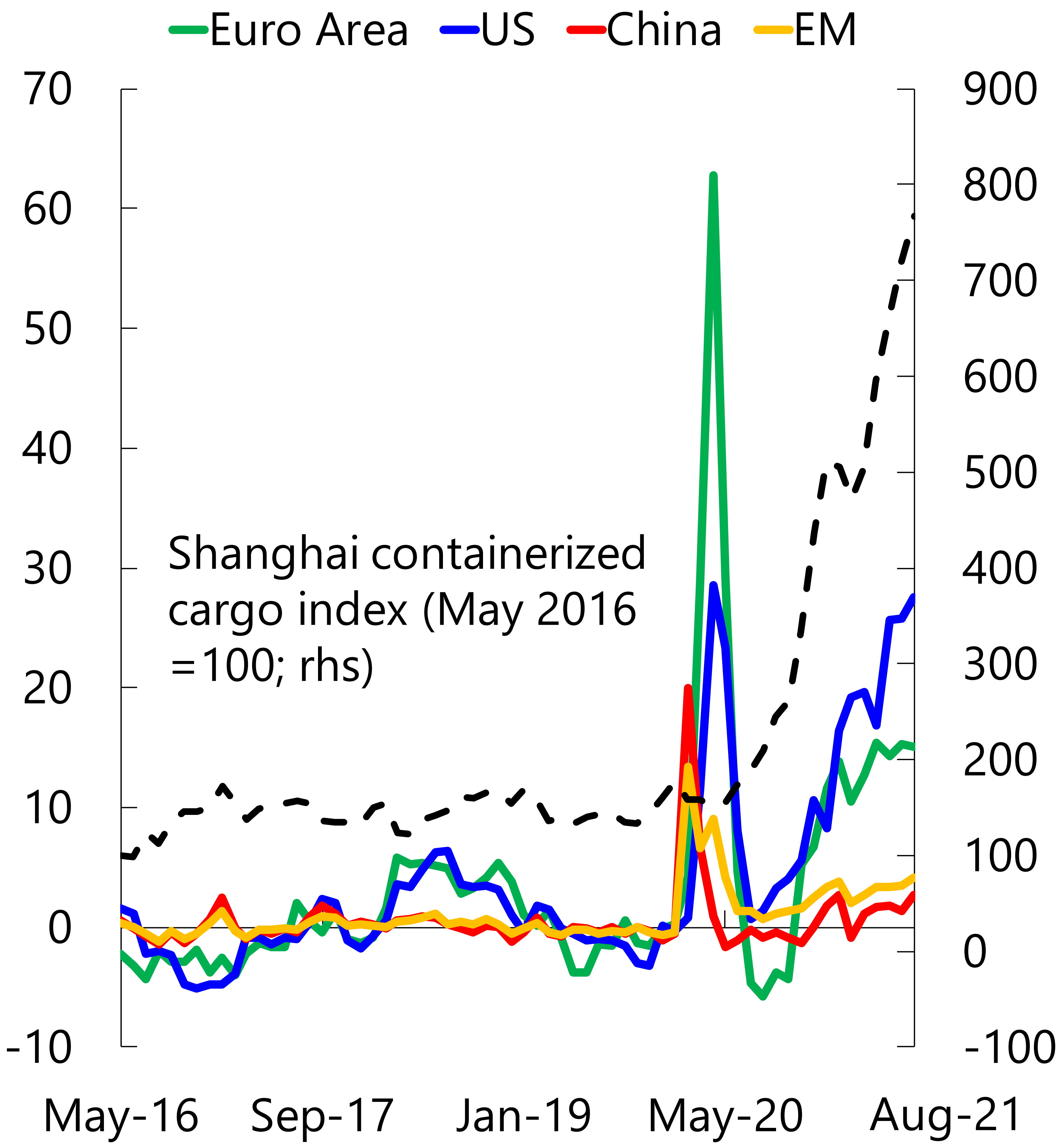
Israel: August vaccine effectiveness against deaths

	Deaths per 100,000		Efficacy against deaths	
Age cohort	**Fully vac**	**Not vac**	**Fully vac**	**Booster**
<40	0.00	0.01	100%	100%
40-49	0.00	0.01	100%	100%
50-59	0.01	0.11	90%	96%
60-69	0.08	0.54	85%	98%
70-79	0.27	1.00	73%	97%
80+	1.88	5.76	67%	98%

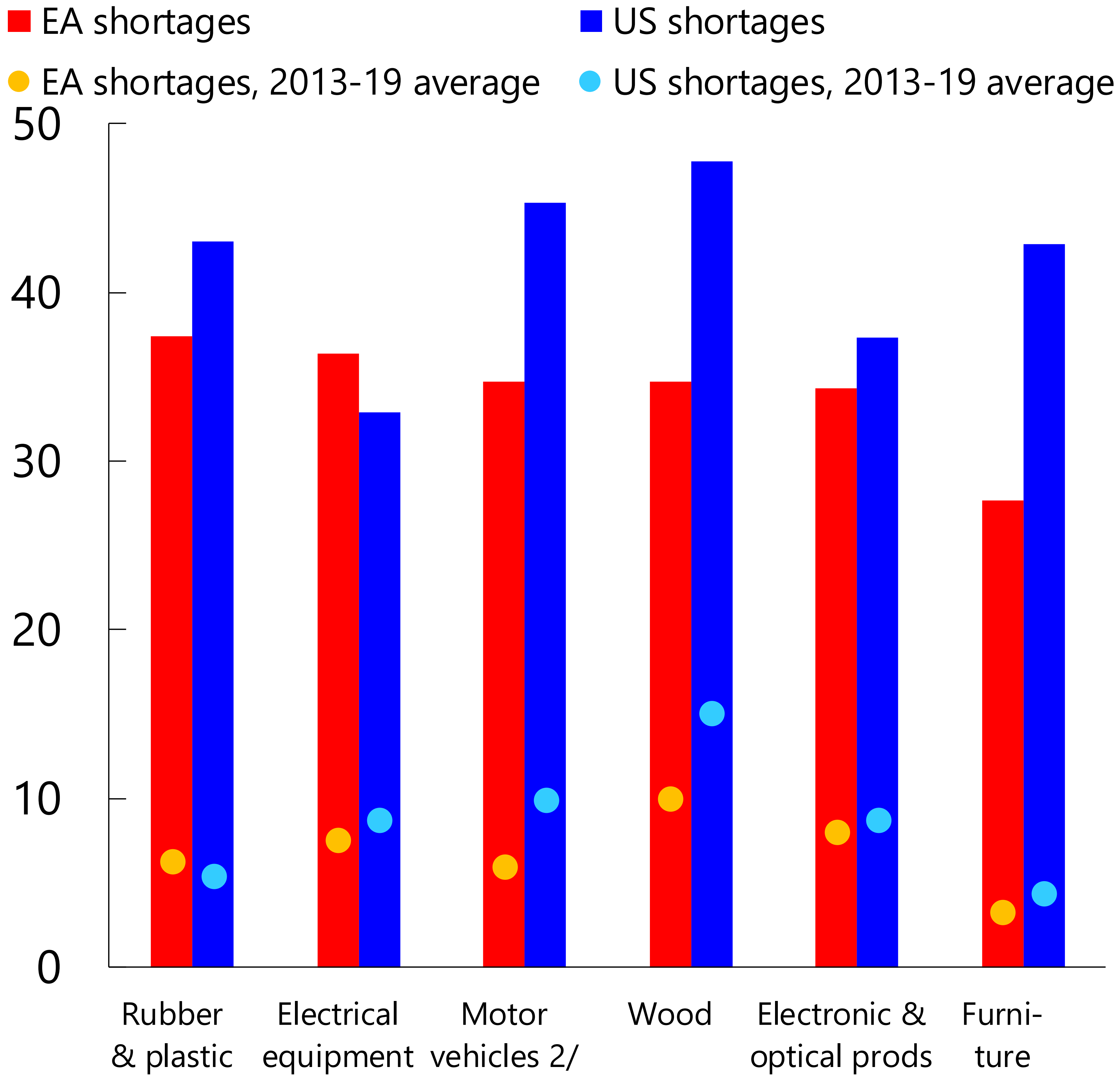
Sources: Our World in Data; Israel Ministry of Health, and IMF staff calculations.
1/ Hospitalization rate is for countries that have vaccinated 50% by July 2021.
2/ Data as of September 22, 2021. Fully vaccinated are people who received all the doses prescribed for a full vaccination cycle (typically 2, but 1 for Johnson&Johnson and Cansino). There are a few cases where recorded one-dose numbers are less than fully-vaccinated numbers due to reporting lags. For these cases, we make a minimal consistency adjustment, setting one-dose numbers equal to fully-vaccinated numbers.

Supply-demand mismatch persists

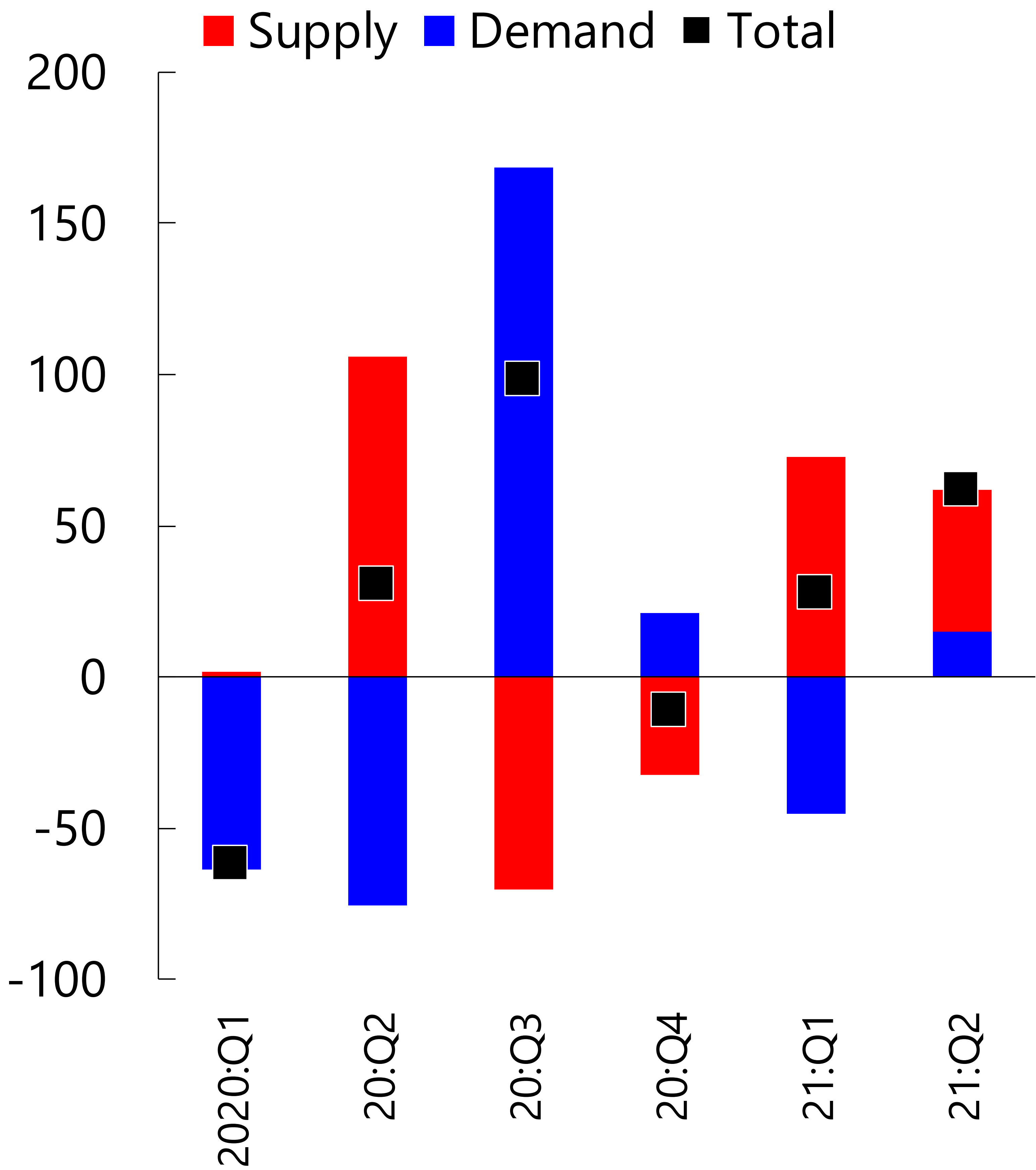
Supply chain disruptions 1/
(index)



Widespread shortages
(percent of businesses reporting equipment shortages limiting production; 2021Q2)



Supply and demand drivers of shipping expenditure growth
(percent, Baltic Dry Index)



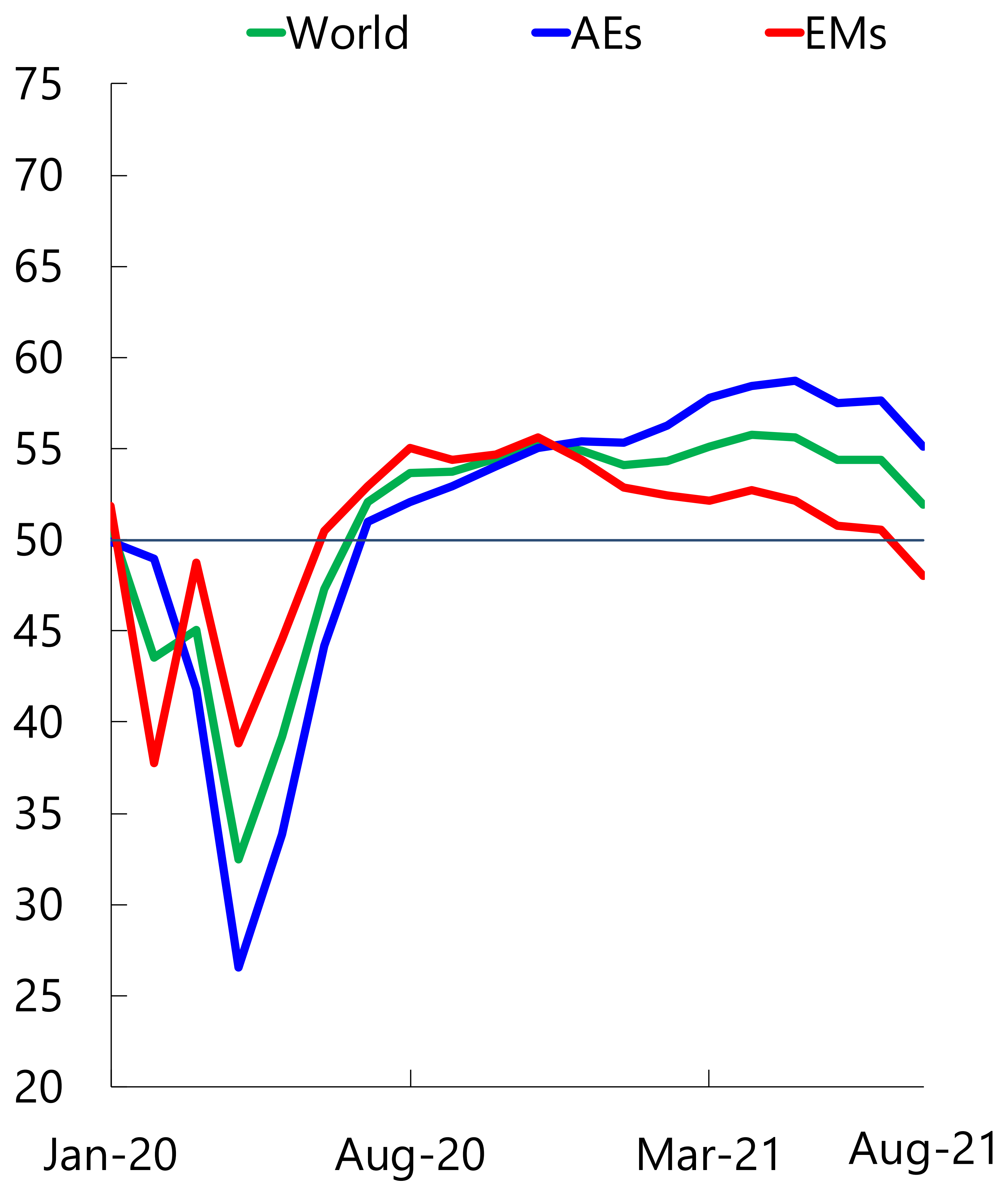
Source: Bloomberg, L.P.; Haver Analytics; IHS Markit; Beige Book, Federal Reserve Board; U.S. Bureau of Economic Analysis; Eurostat; U.S. Census Bureau; U.S. Bureau of Labor Statistics; and IMF staff calculations.,

1/ Supply Chain Disruptions are calculated as the difference between the supply delivery times sub-index in the PMI and a counterfactual, cyclical measure of supply delivery times based on the manufacturing output sub-index in the PMI.

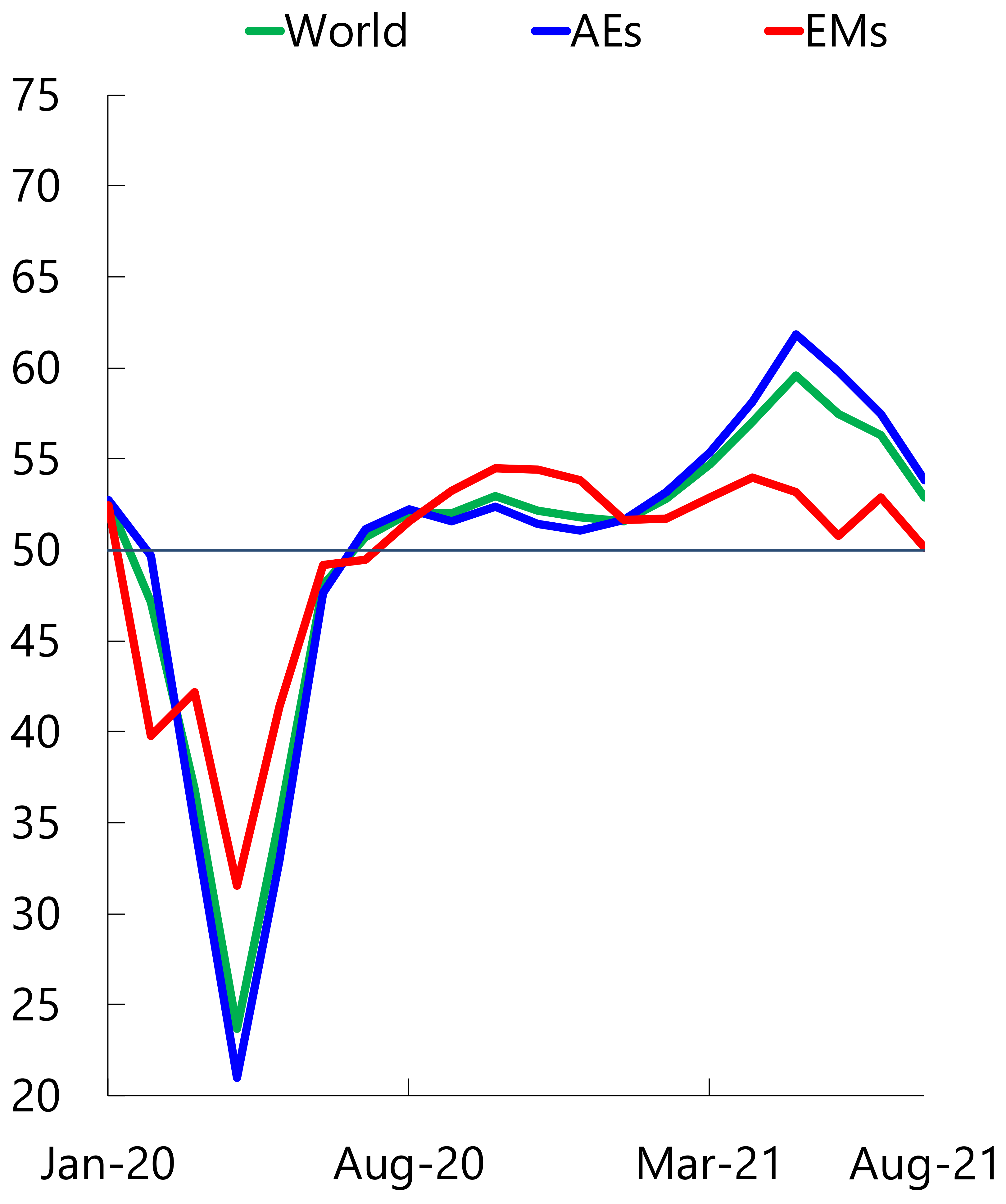
2/ Denotes "Transportation Equipment Manufacturing" for the US and "Motor Vehicles and Trailers" for the EA.

Delta and supply disruptions weighing on the outlook

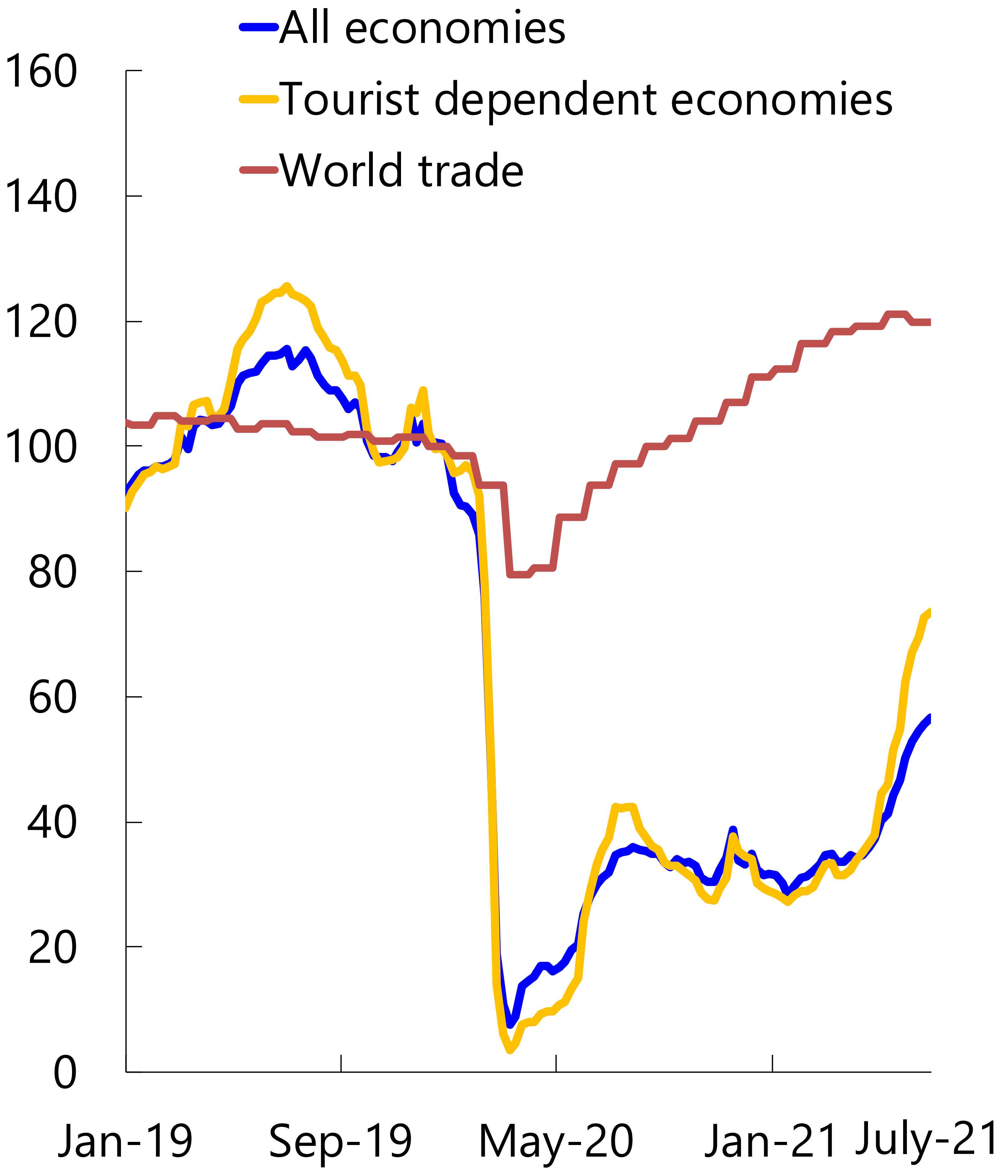
PMI manufacturing
(index; >50 = expansion)



PMI services
(index; >50 = expansion)



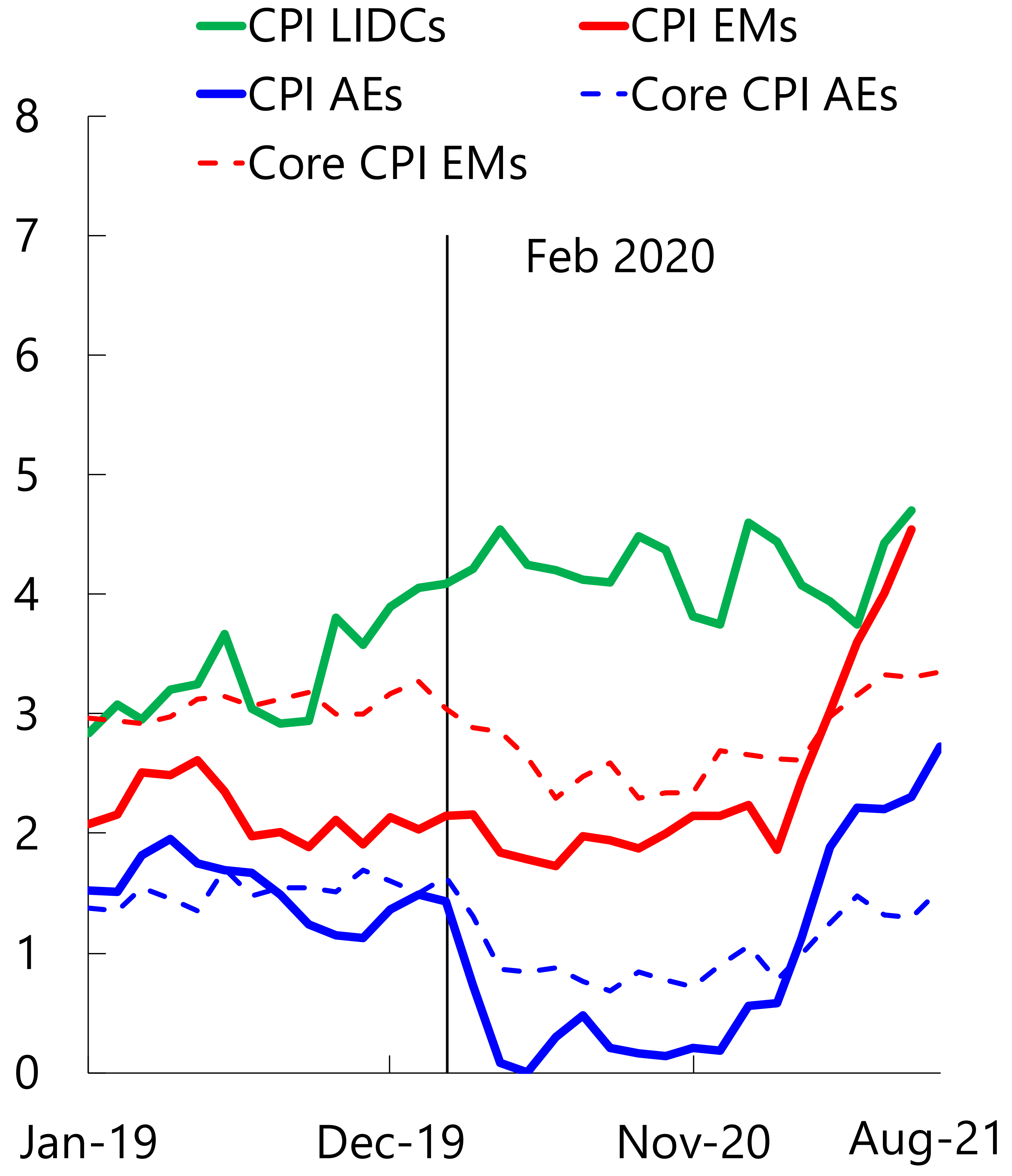
World Trade and Plane passengers, international travel 1/
(Index, Jan 2020=100)



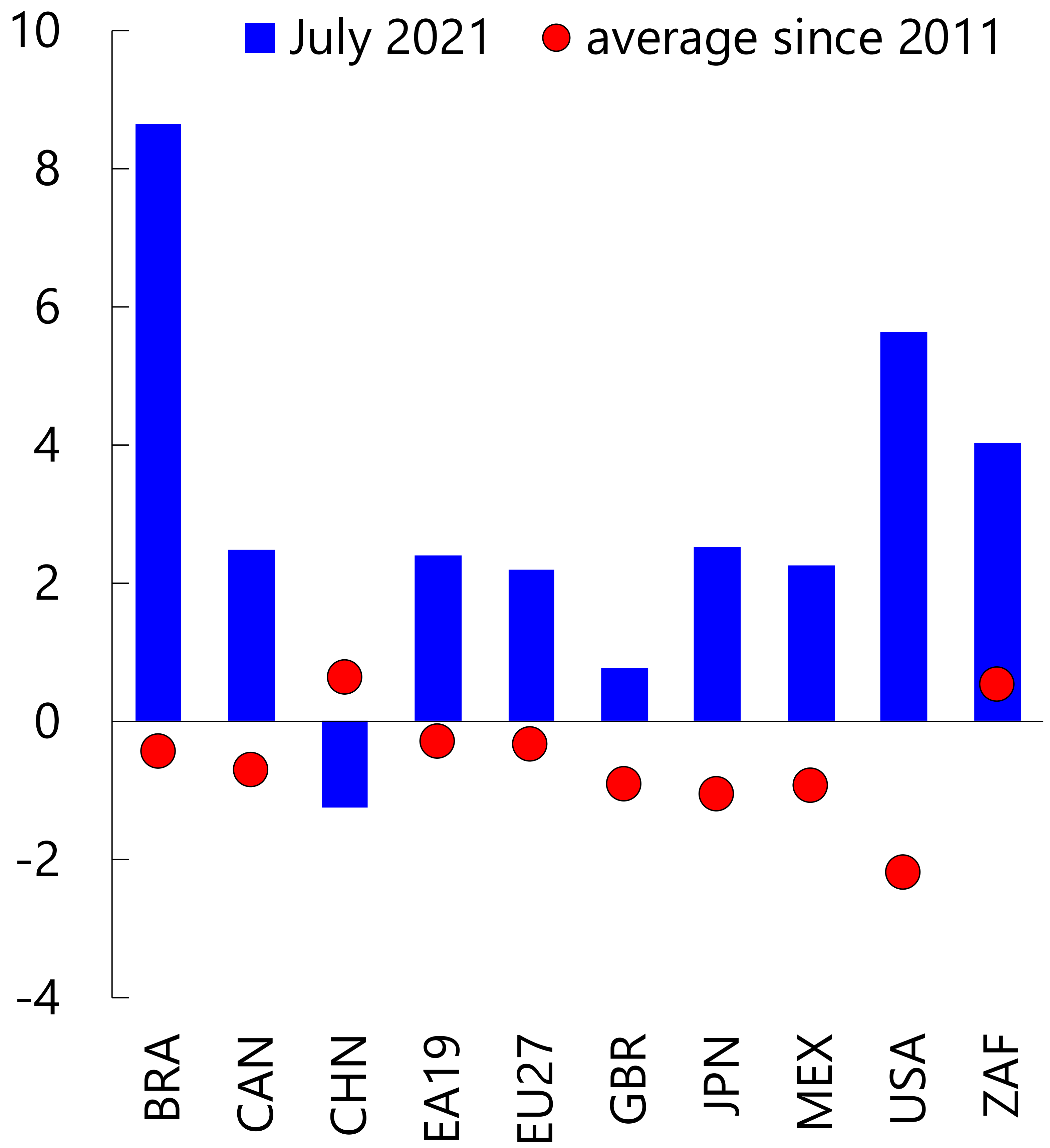
Sources: IHS Markit; IMF, *Global Data Source*; Haver Analytics; and IMF staff calculations.
1/ World trade actual up to July. The chart shows the total passenger capacity of daily flights by arrival country. Tourist dependent economies are defined as those with a direct contribution of tourism to GDP above 5 percent (75 percentile).

Elevated inflation with cross-country heterogeneity

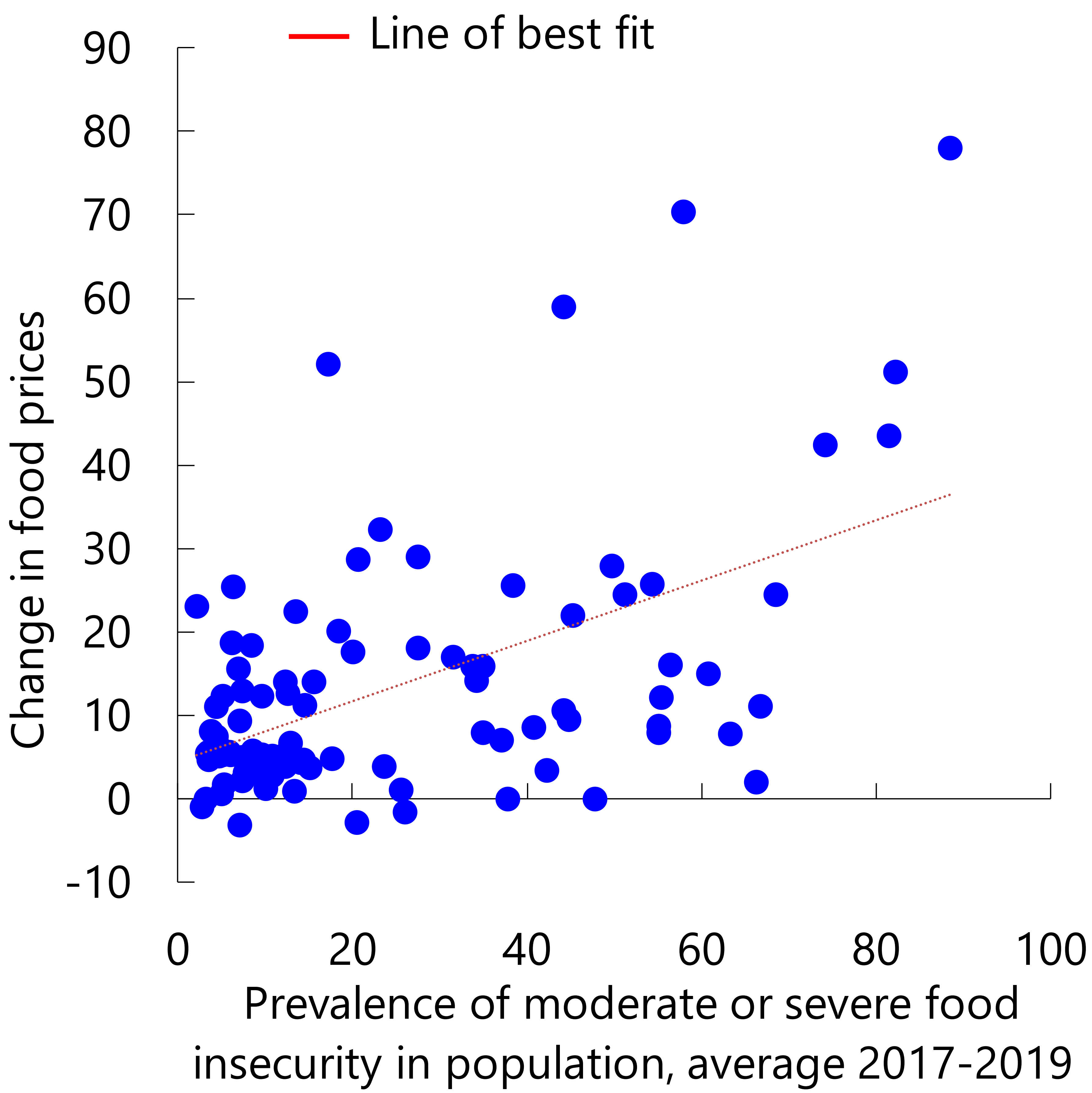
Consumer price inflation
(percent; yoy; median)



Excess of goods over services inflation 1/
(percent per year)



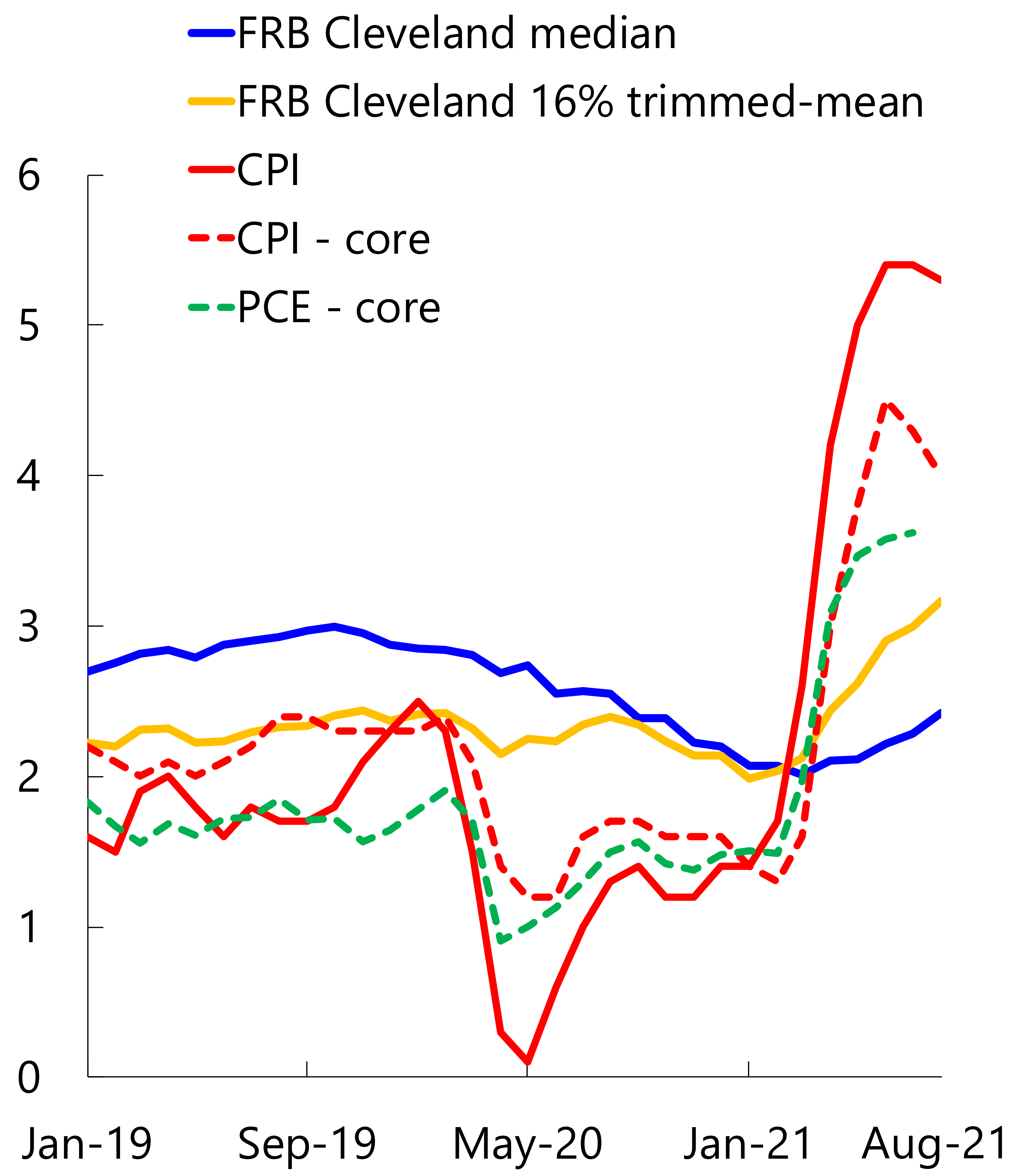
Change in food prices and food insecurity 2/



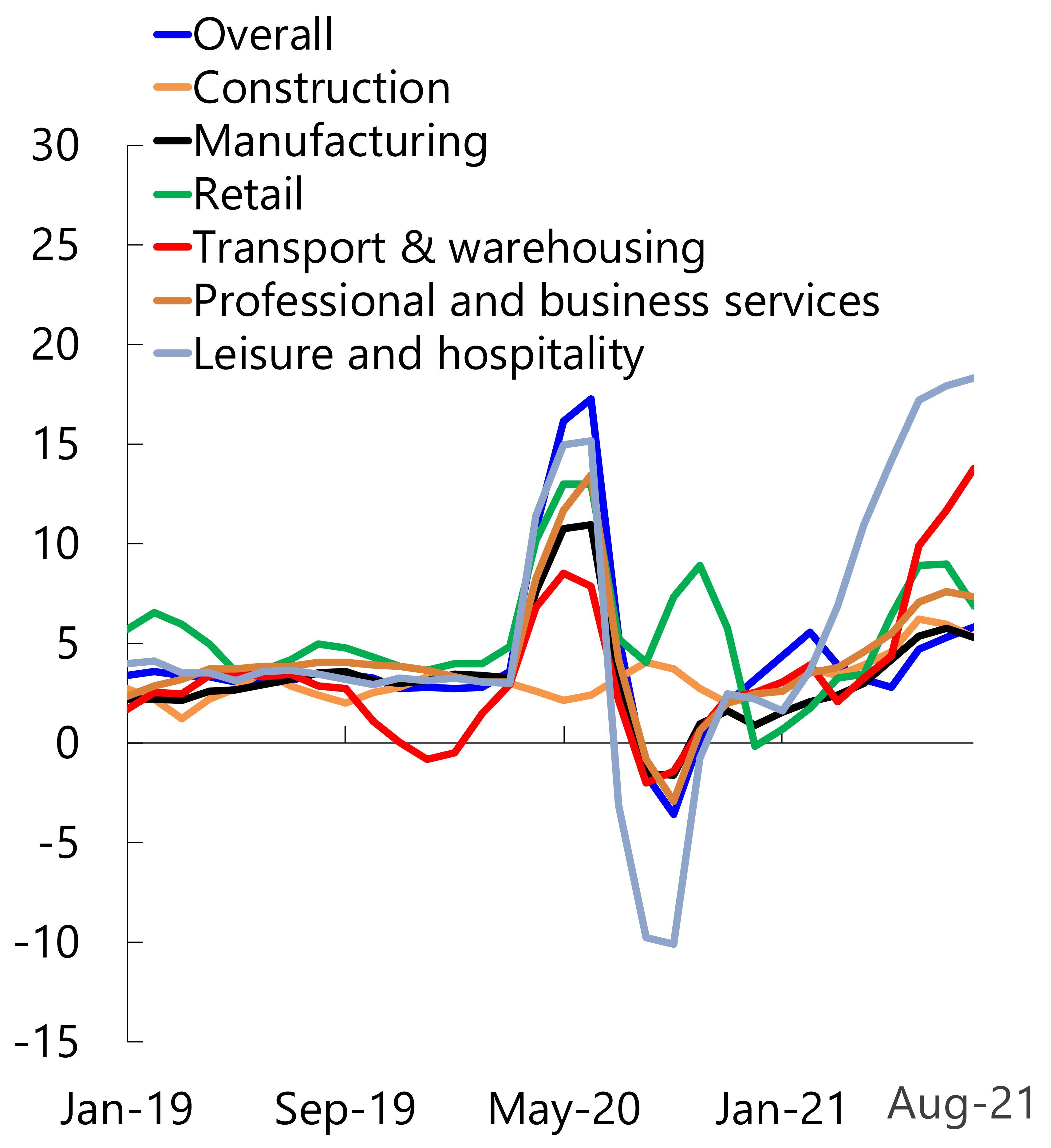
Sources: Bloomberg, L.P.; IMF *Global Data Source*; IMF *STA CPI Database*; Haver Analytics; IMF, *World Economic Outlook*; Food and Agriculture Organization of the United Nations; and IMF staff calculations.
1/ JPN average since 2016.
2/ Food prices percent change from March 2019 to March 2021.

US inflation tentatively peaked, with upside risks

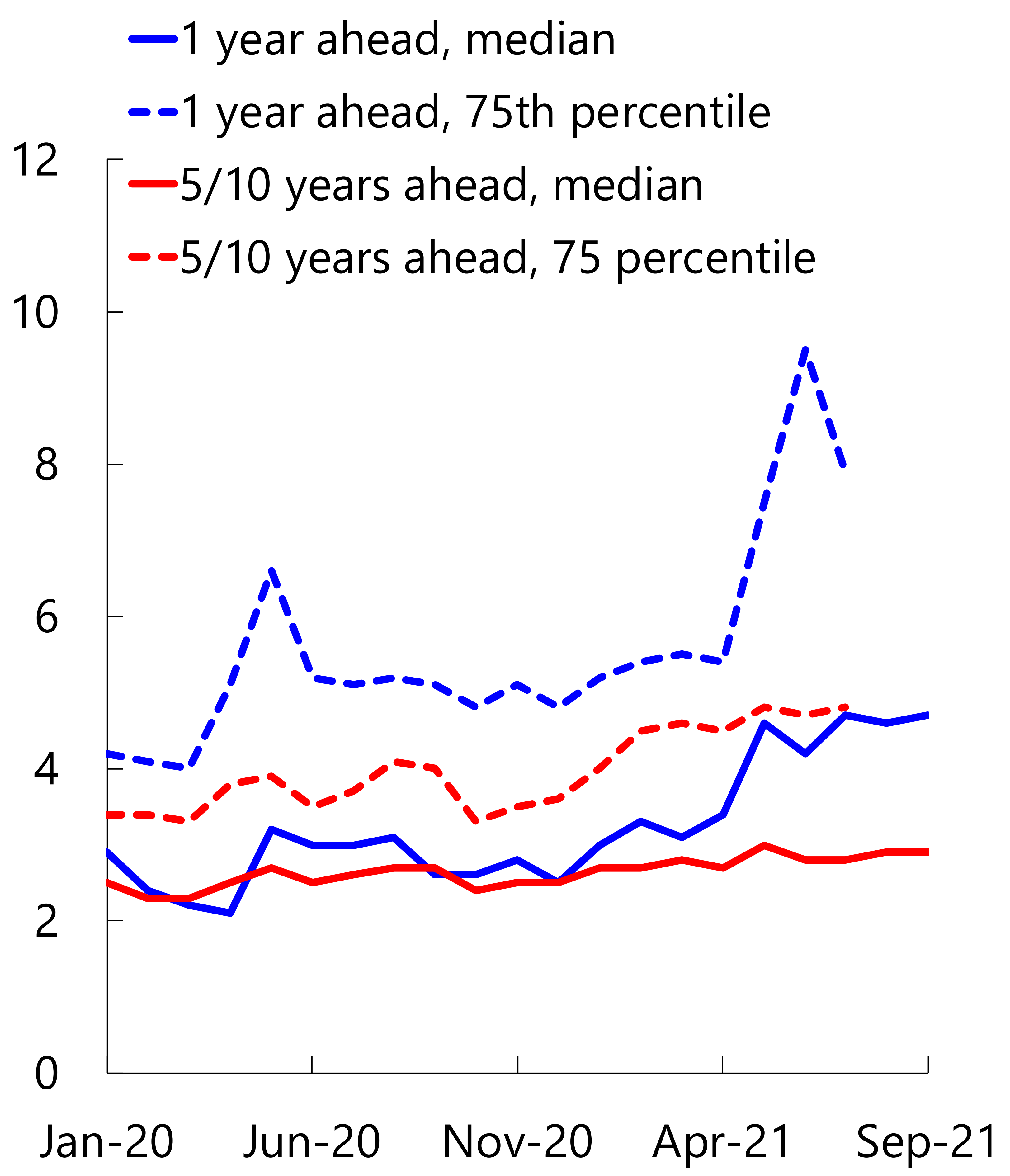
US: Inflation
(percent, yoy)



US: average hourly earnings: total and selected sectors 1/
(percent change; SAAR)



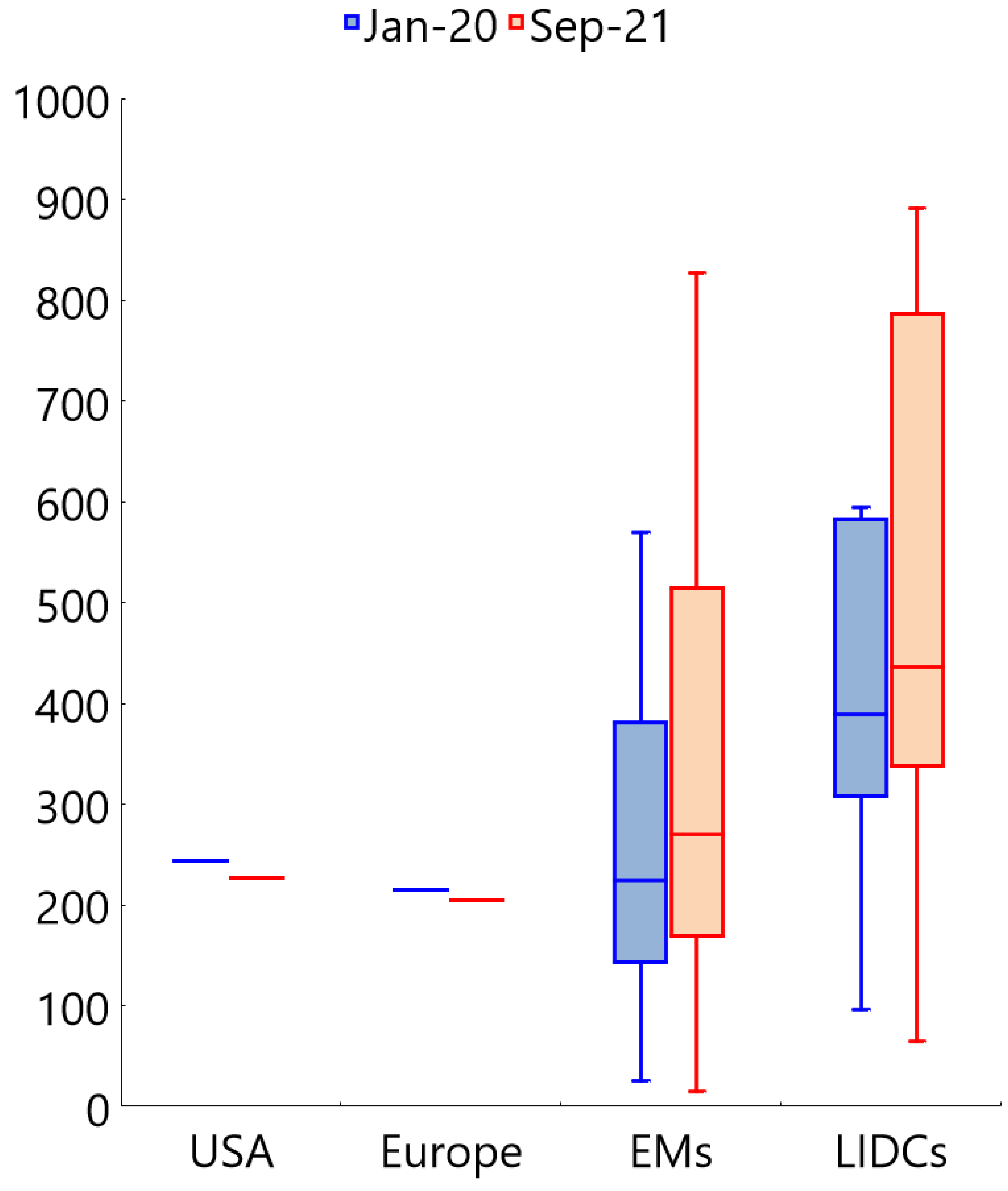
US households' expected inflation
(percent)



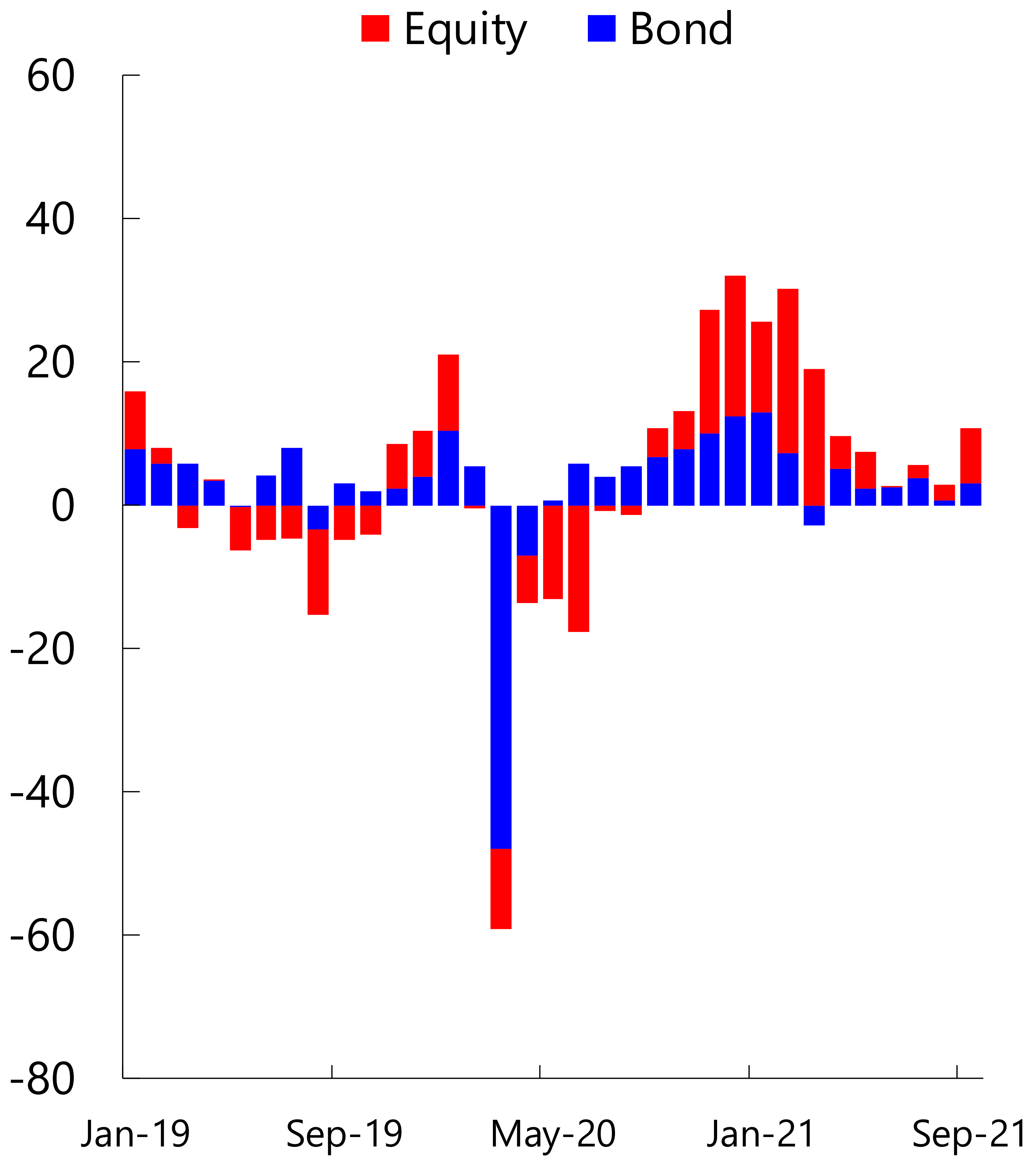
Sources: Surveys of consumers, University of Michigan; Haver Analytics; and IMF staff calculations.
1/ 3-month percent change for 3-month moving average of hourly earnings for all employees.

Accommodative financial conditions with large increase in asset prices

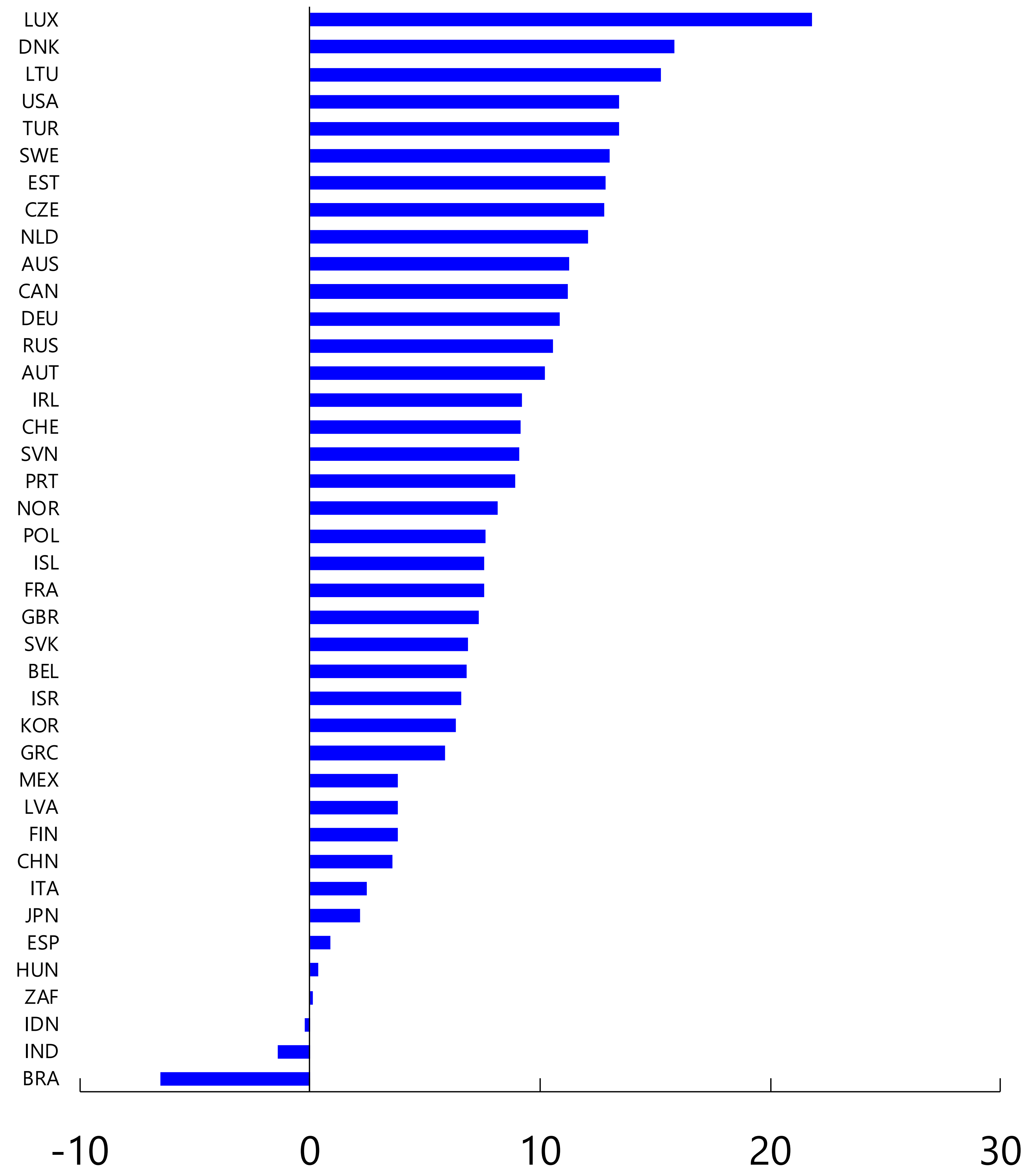
Spreads of risky bonds 1/
(basis points)



EMs net flows in emerging market funds
(billions of US dollars)



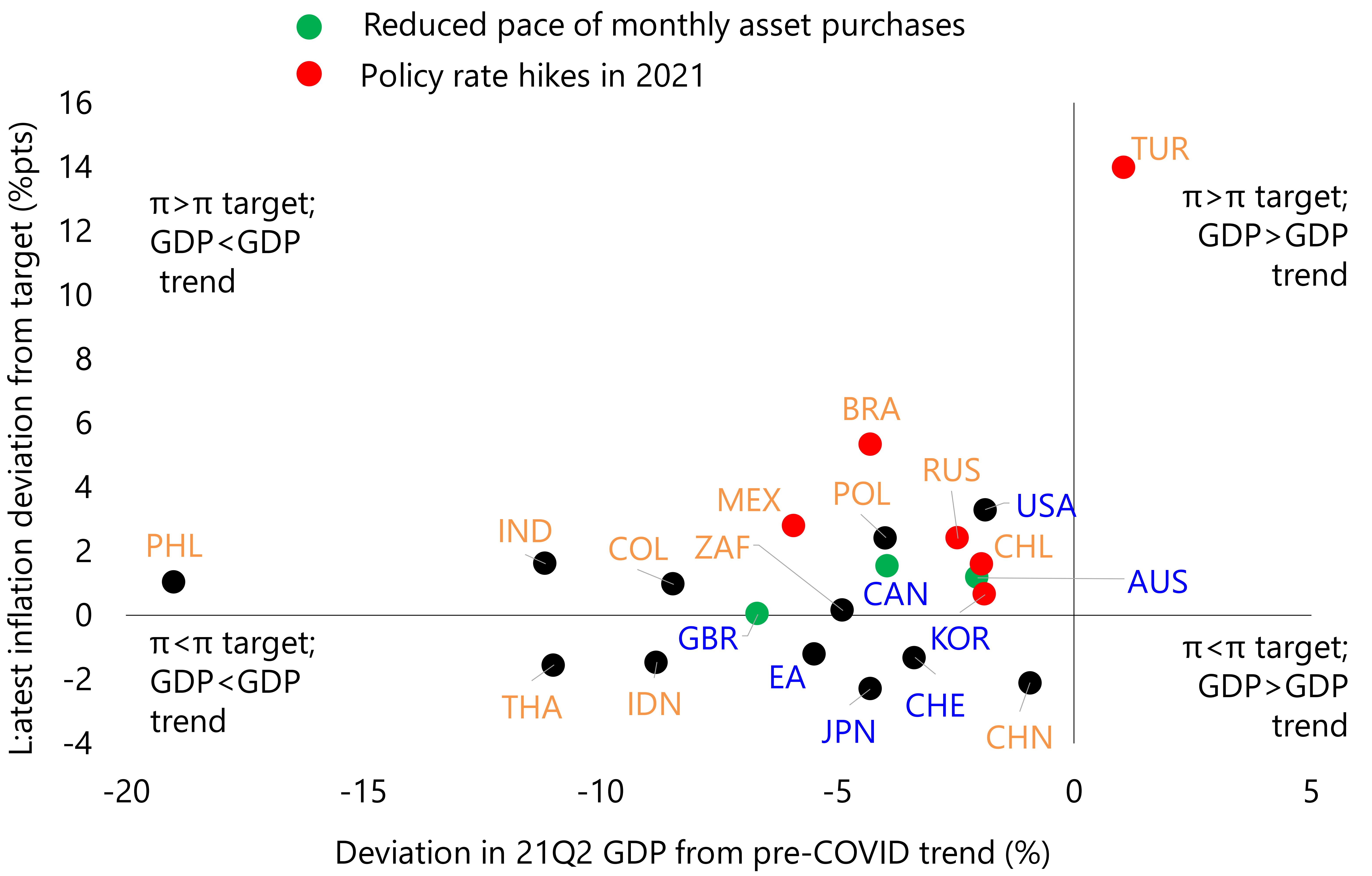
Cumulative real housing price change over the past 18 months
(as of 2021q1)



Sources: Organization for Economic Co-operation and Development; Haver Analytics; Bloomberg, L.P.; World Tourism Organization; and IMF staff estimates.
1/ Sovereign spreads of EMs and LIDCs, and high yield spreads for the US and Europe.

Emerging markets leading exit from accommodative policies

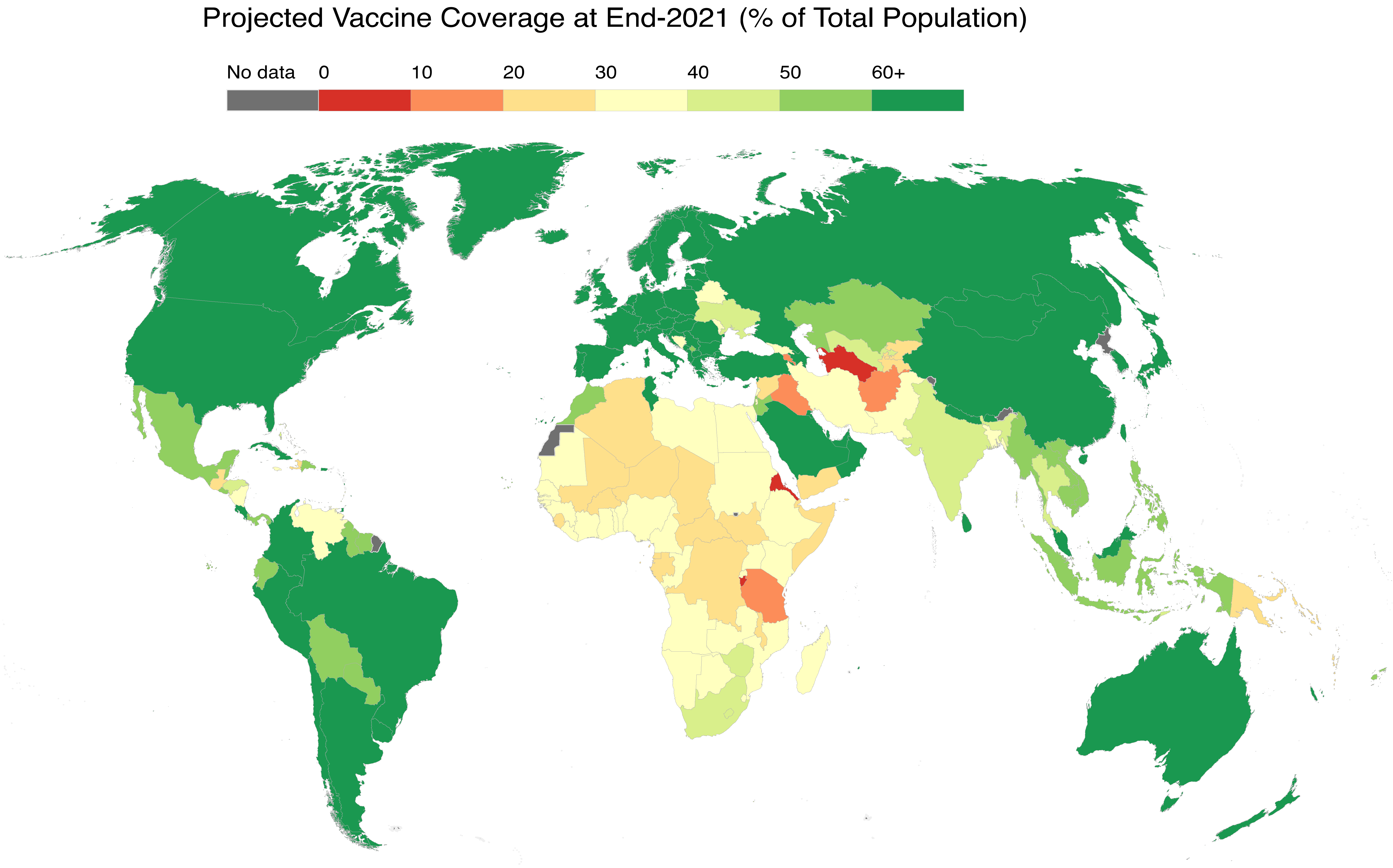
Policy trade-offs 1/
(percent deviation)



Fiscal stance
(fiscal balance, percent of GDP)

Sources: IMF, *World Economic Outlook*; Haver Analytics; IMF *Global Data Source*; and IMF staff calculations.
1/ EMs are labeled in orange; AEs in blue.

Under business-as-usual scenario, several LICs may not meet 40% target by end-2021



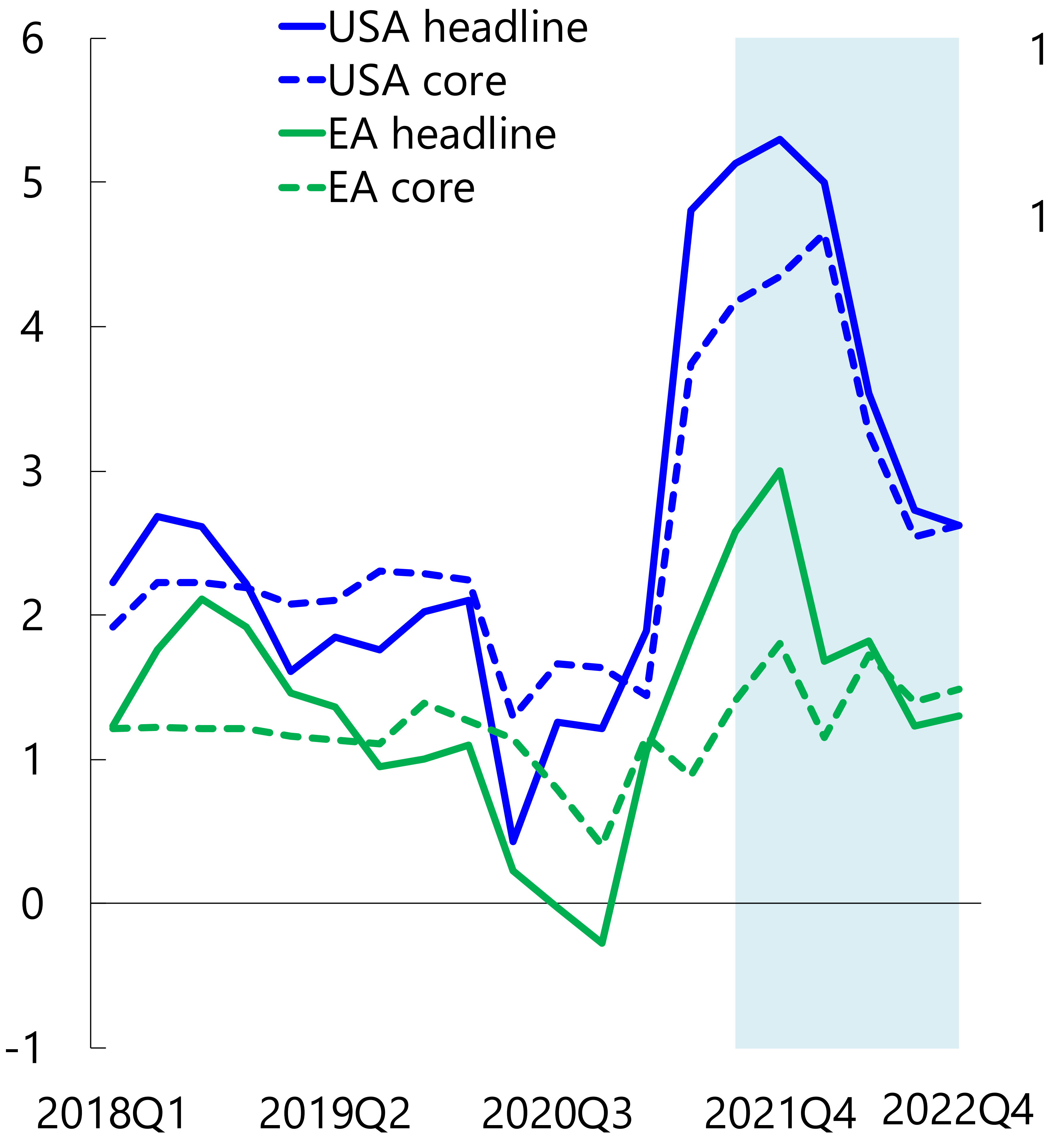
Source: IMF Staff calculations.

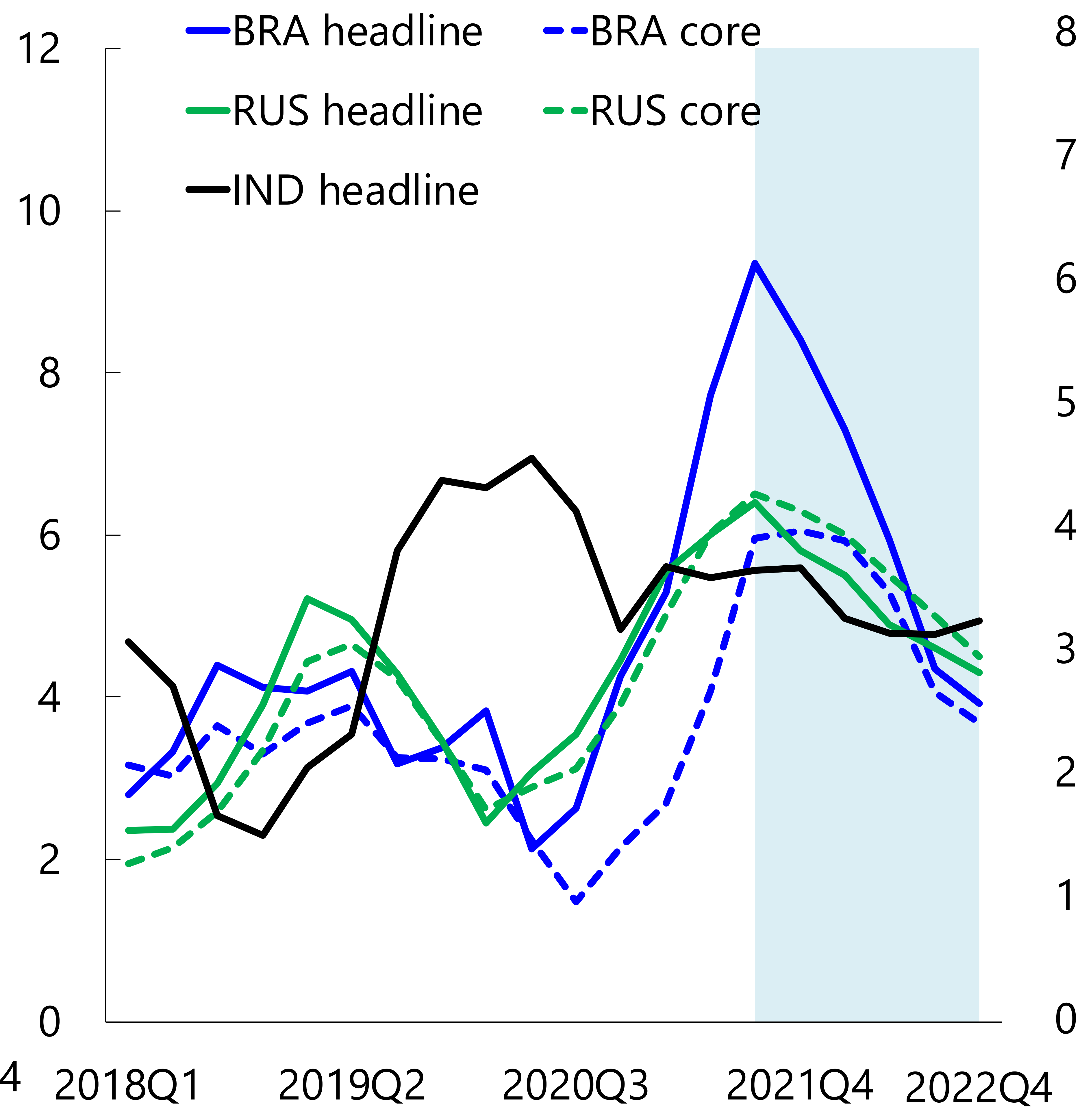
Reaching the 40% target in all countries requires COVAX to receive at least 1.75 bn doses by end-2021. G7/G20 countries will need to:

1. Fulfill existing dose donation pledges to COVAX of 400+ mln immediately
2. Make available additional 400 mln doses through dose swaps (swap near-term vaccine delivery schedules with COVAX) or donations.
3. Eliminate trade barriers to the export of inputs and finished vaccine. Enable SII to deliver 150 mln additional doses to COVAX by end-2021

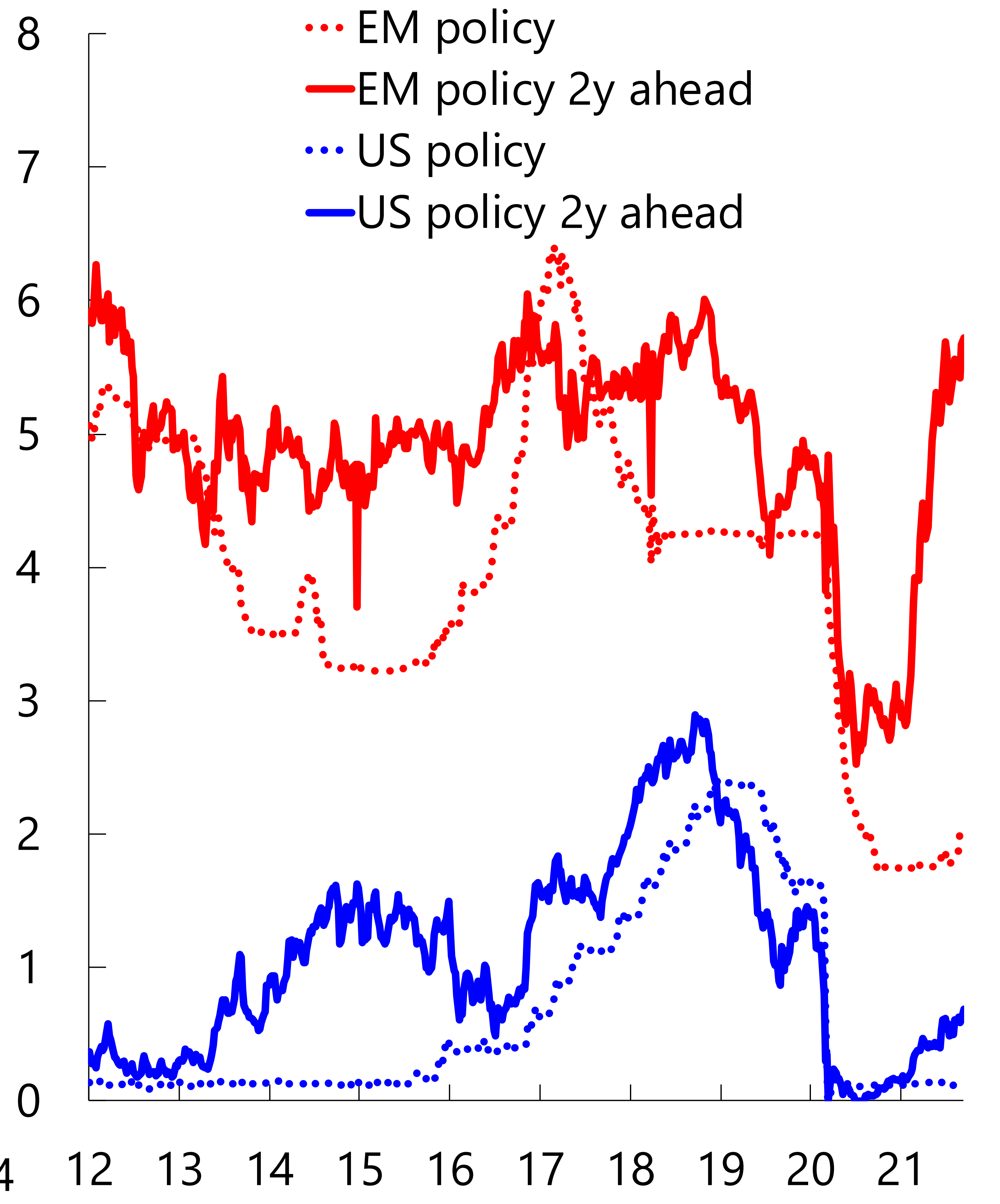
Inflation expected to revert to normal ranges by end-2022

Headline and core inflation
(percent; yoy)





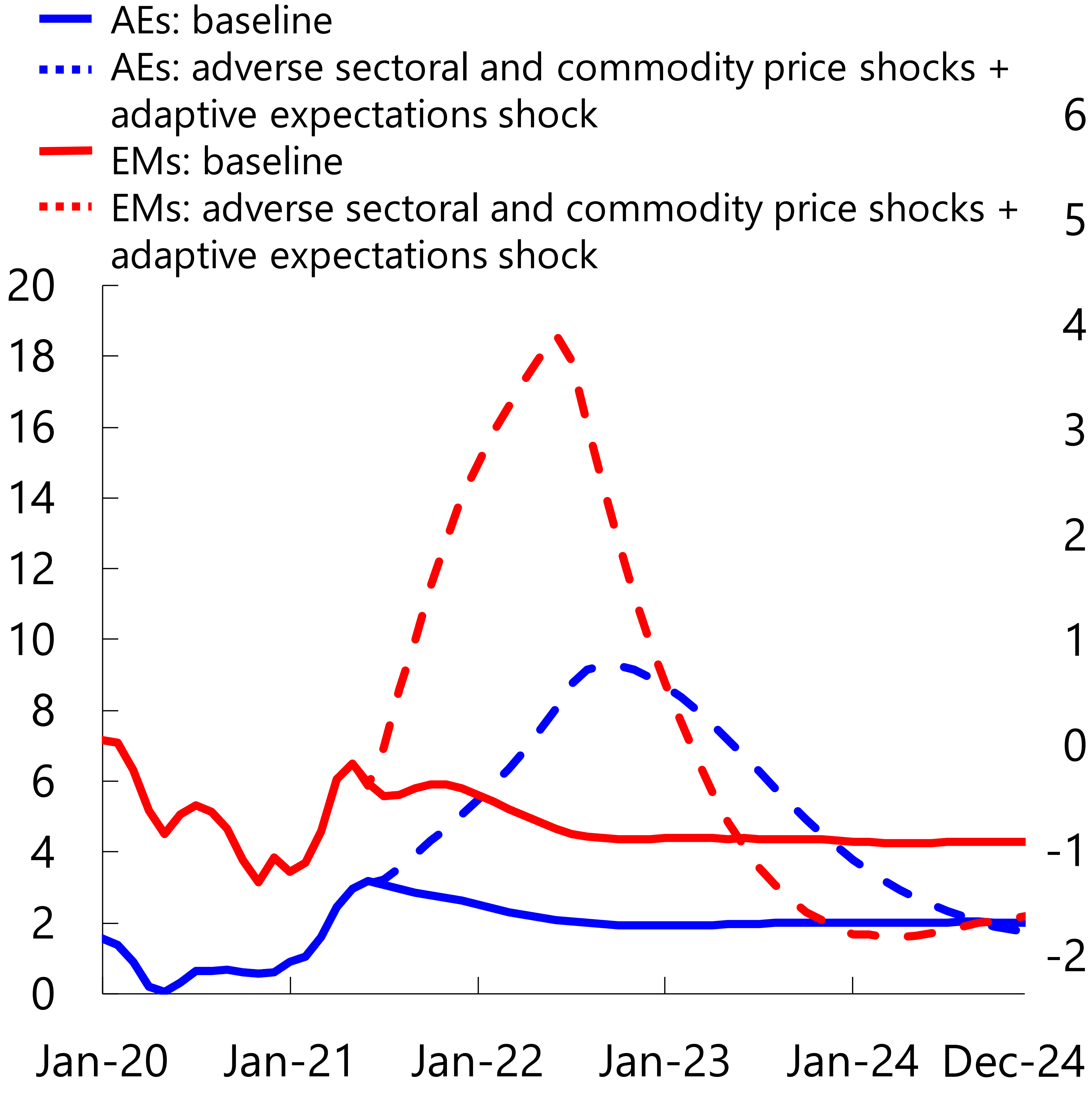
Policy rates and 2-year ahead market expectation
(percent)



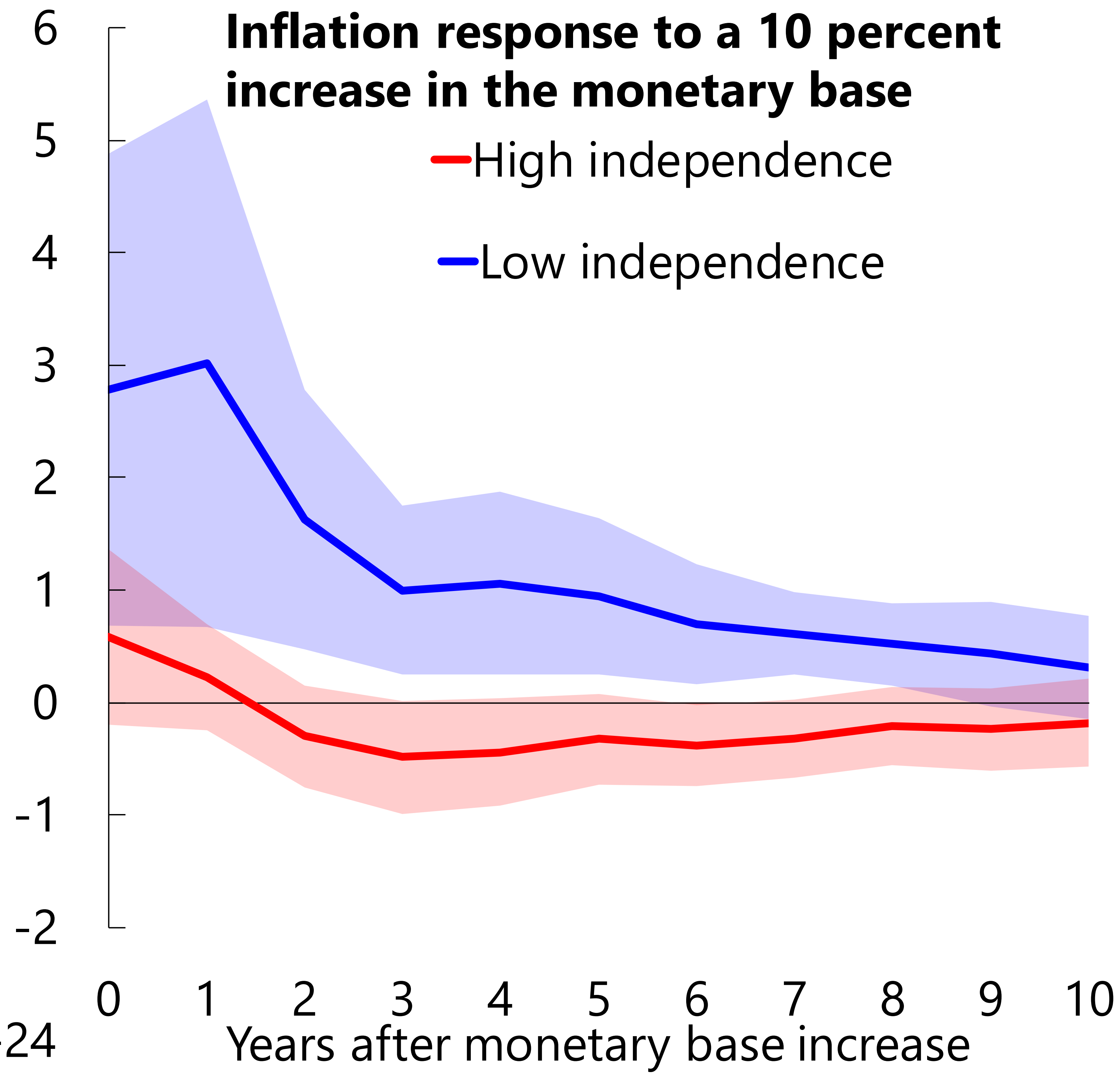
Sources: Bloomberg, L.P.; IMF, *World Economic Outlook;* and IMF staff calculations.

Inflation scares

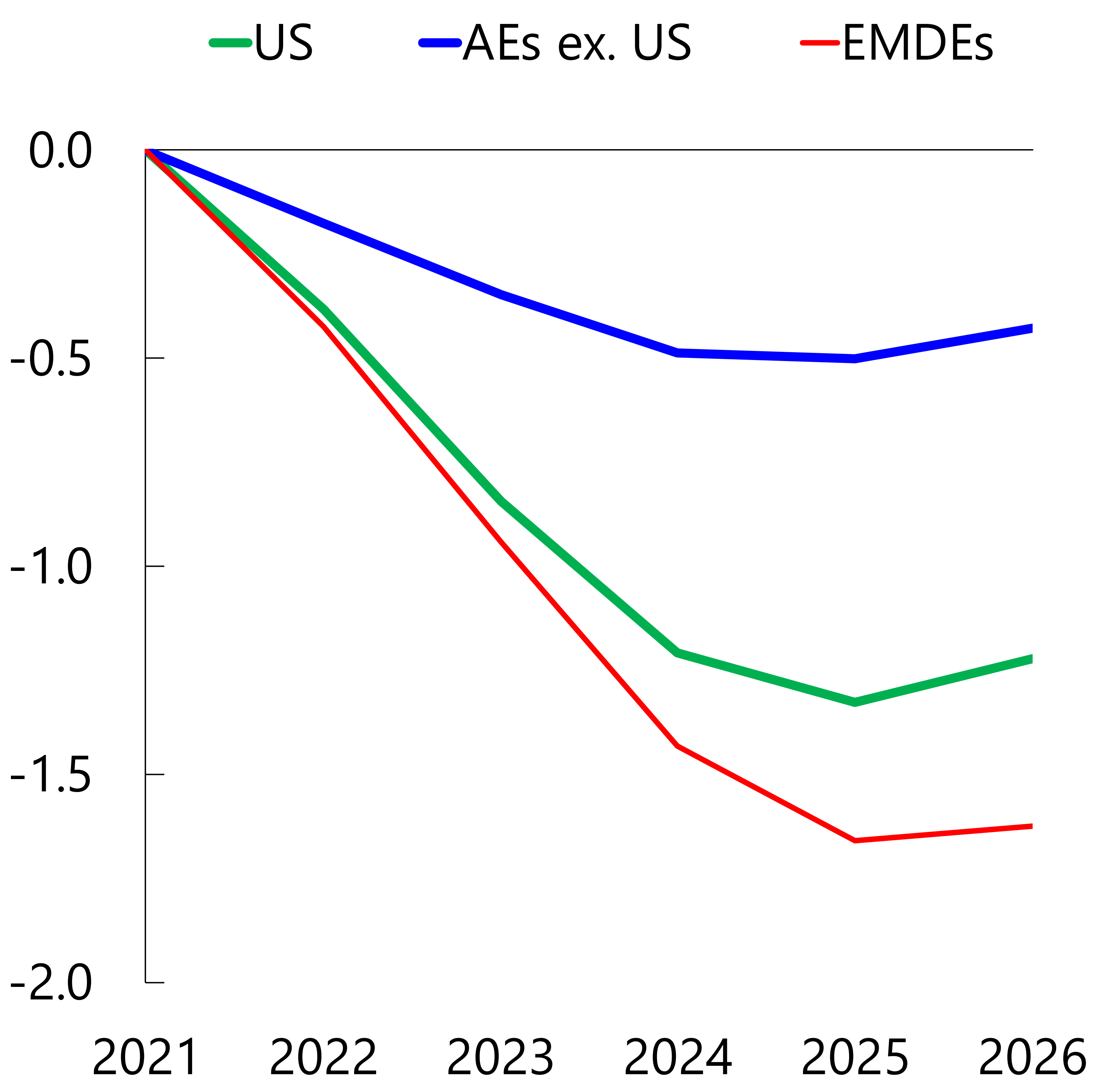
Perfect storm 1/
(inflation, yearly average, percent)



Central bank independence important 2/
(inflation, percent)



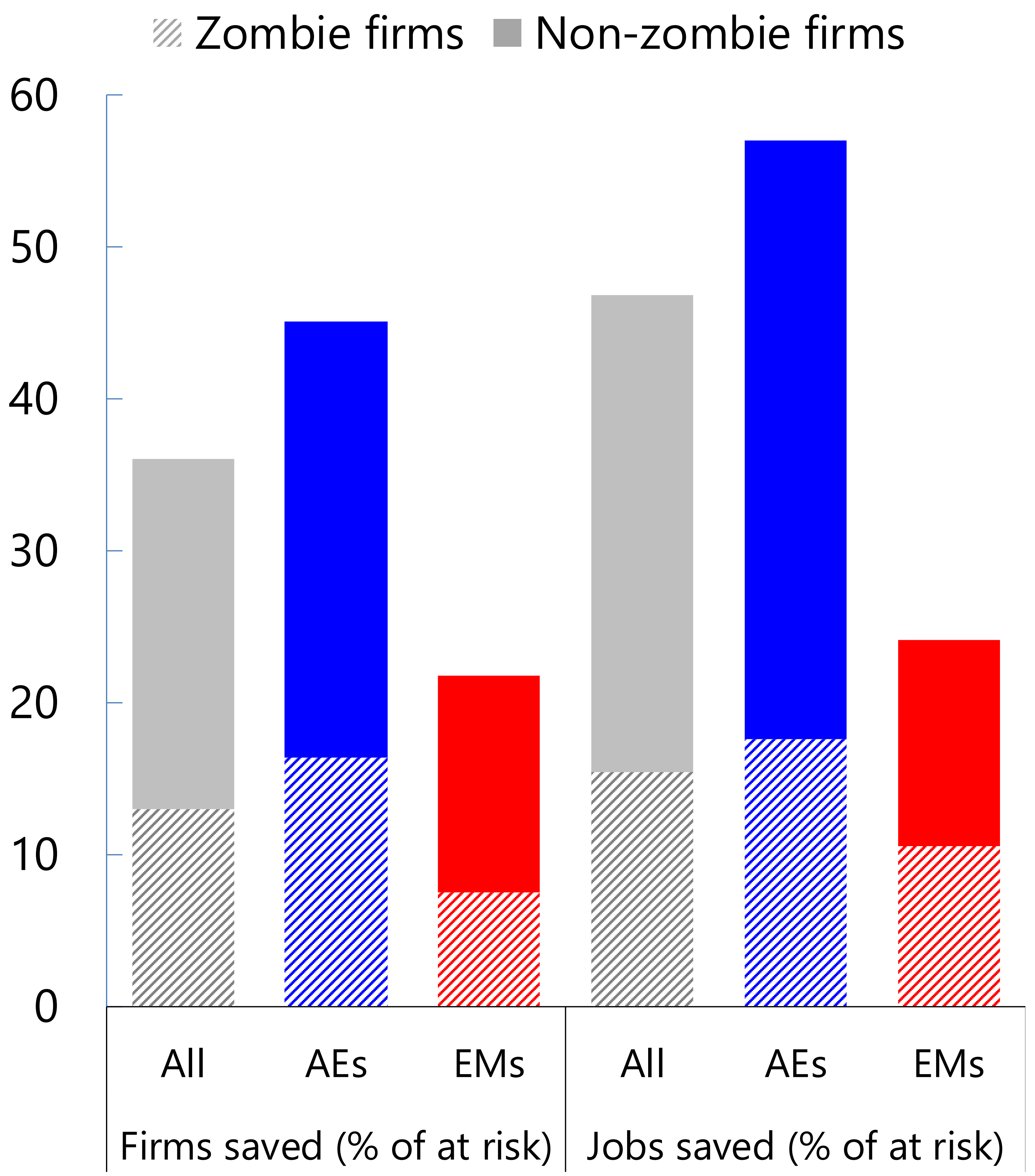
Risk of rising US inflation expectation 3/
(real GDP, percent deviation from baseline)



Sources: Agur et al. (2021), forthcoming; G-20 model simulation; IMF, *World Economic Outlook; Consensus Economics; Haver Analytics; and IMF staff calculations.*
1/ The chart illustrate the inflation scenarios in Chapter 2 of the WEO. Both risk scenarios assume a strong rise in commodity prices and sectoral inflation dispersion over the next 12 months, whose likelihood is less than 0.01 percent based on historical data. The most severe risk scenario also assumes that inflation expectations become adaptive for 12 months.
2/ The analysis used data are for 157 countries from 1950-2020.
3/ Increase in US inflation expectations and US policy response plus increase in Emerging Market risk premiums.

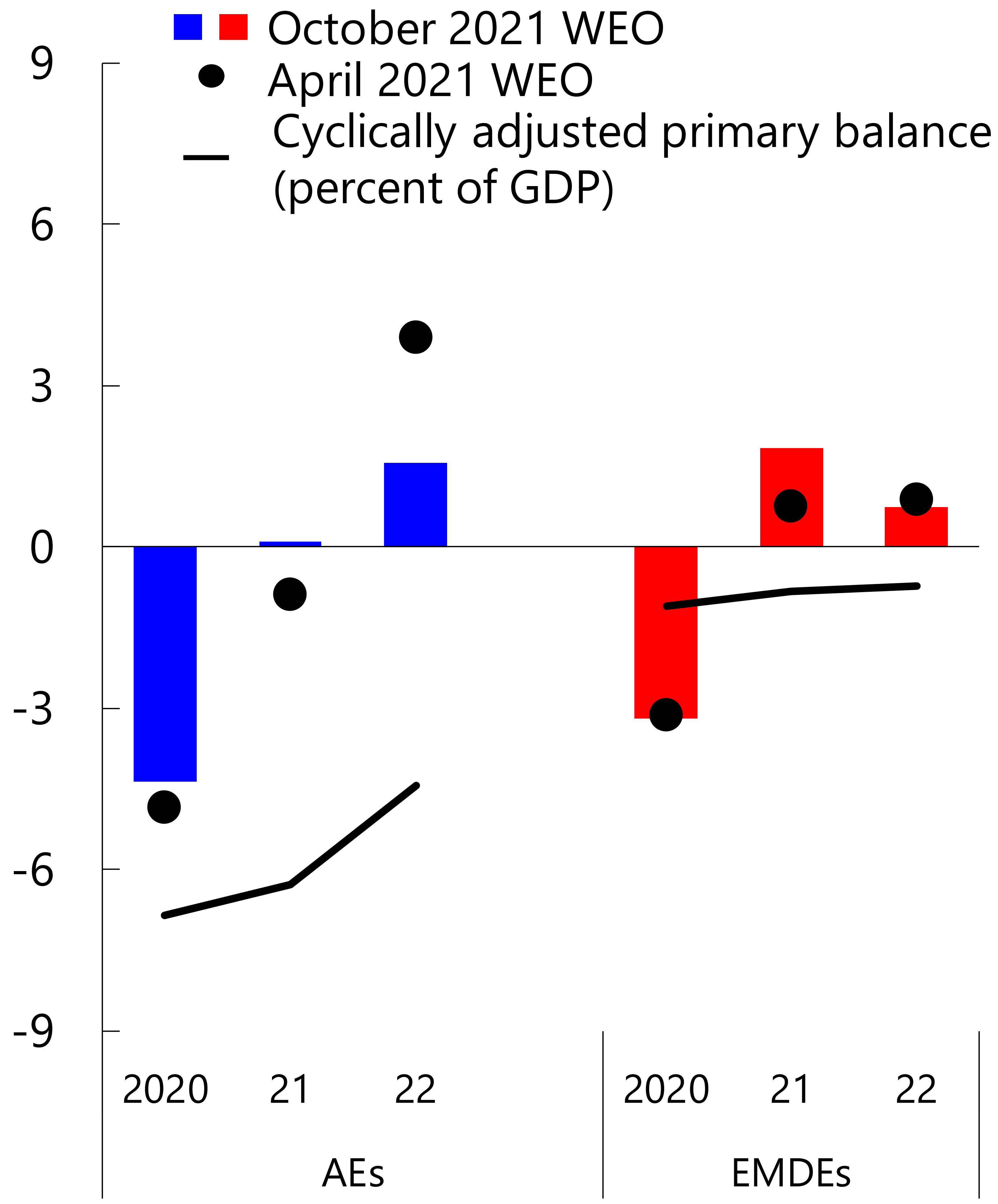
Fiscal tightening already underway for those with less fiscal space

Fiscal policy saved firms/jobs



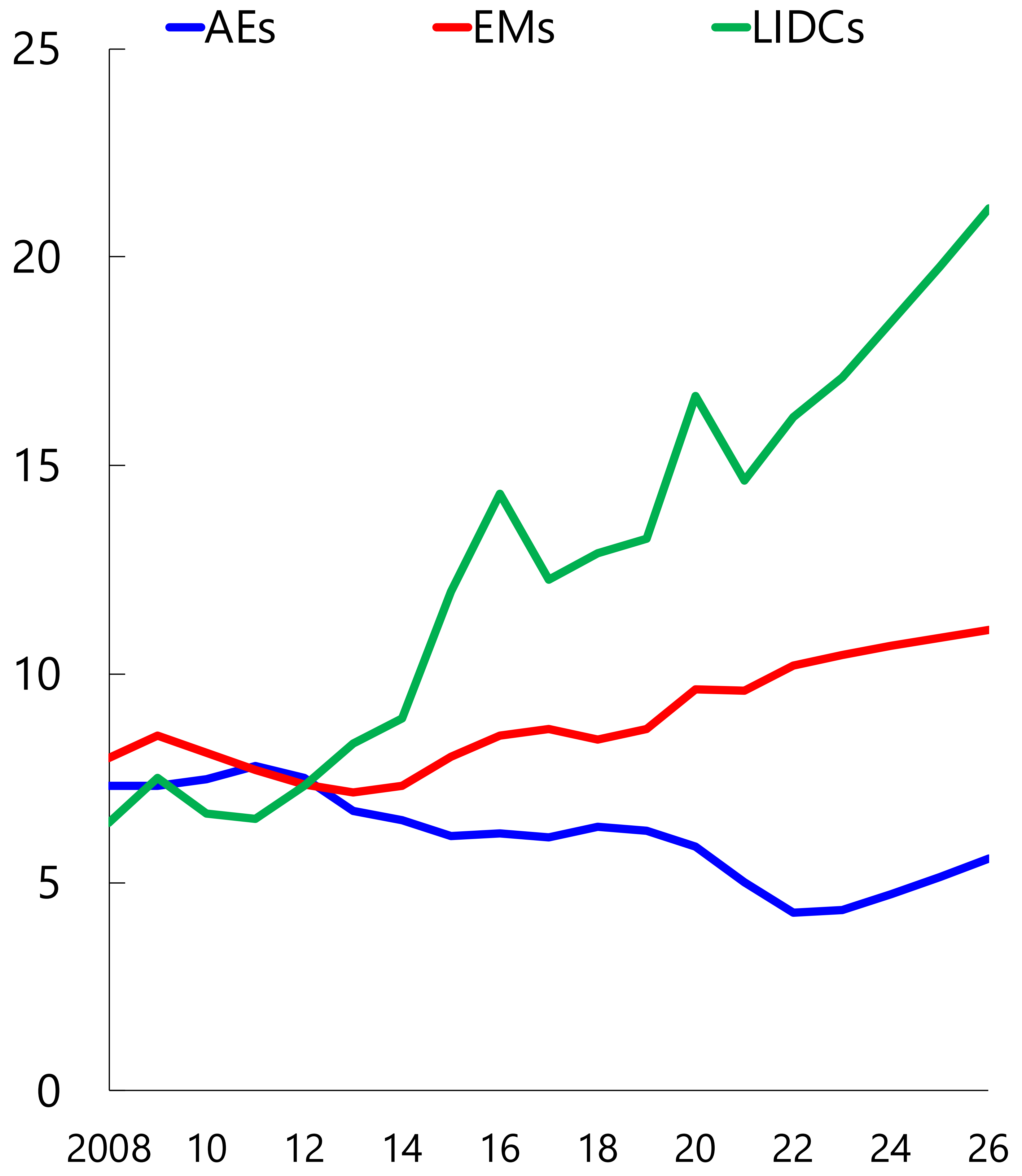
Fiscal tightening

(change in structural primary fiscal balance, percent of potential GDP)



Interest payments to revenues

(percent)

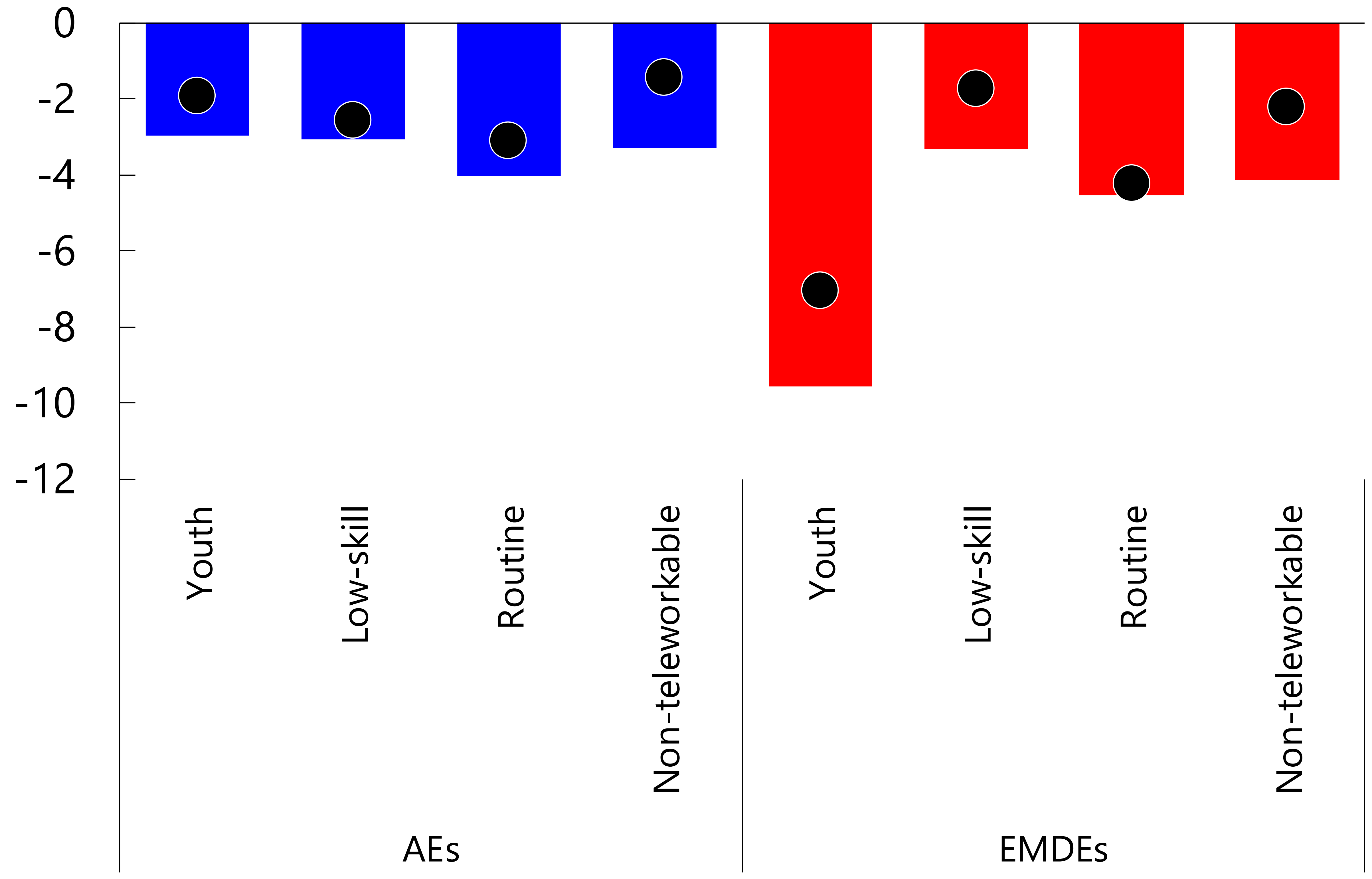


Sources: Gourinchas et al. (2021); IMF, *World Economic Outlook;* IMF, *Fiscal Monitor*; and IMF staff calculations.

Address labor market's lagging recovery, remedy learning losses

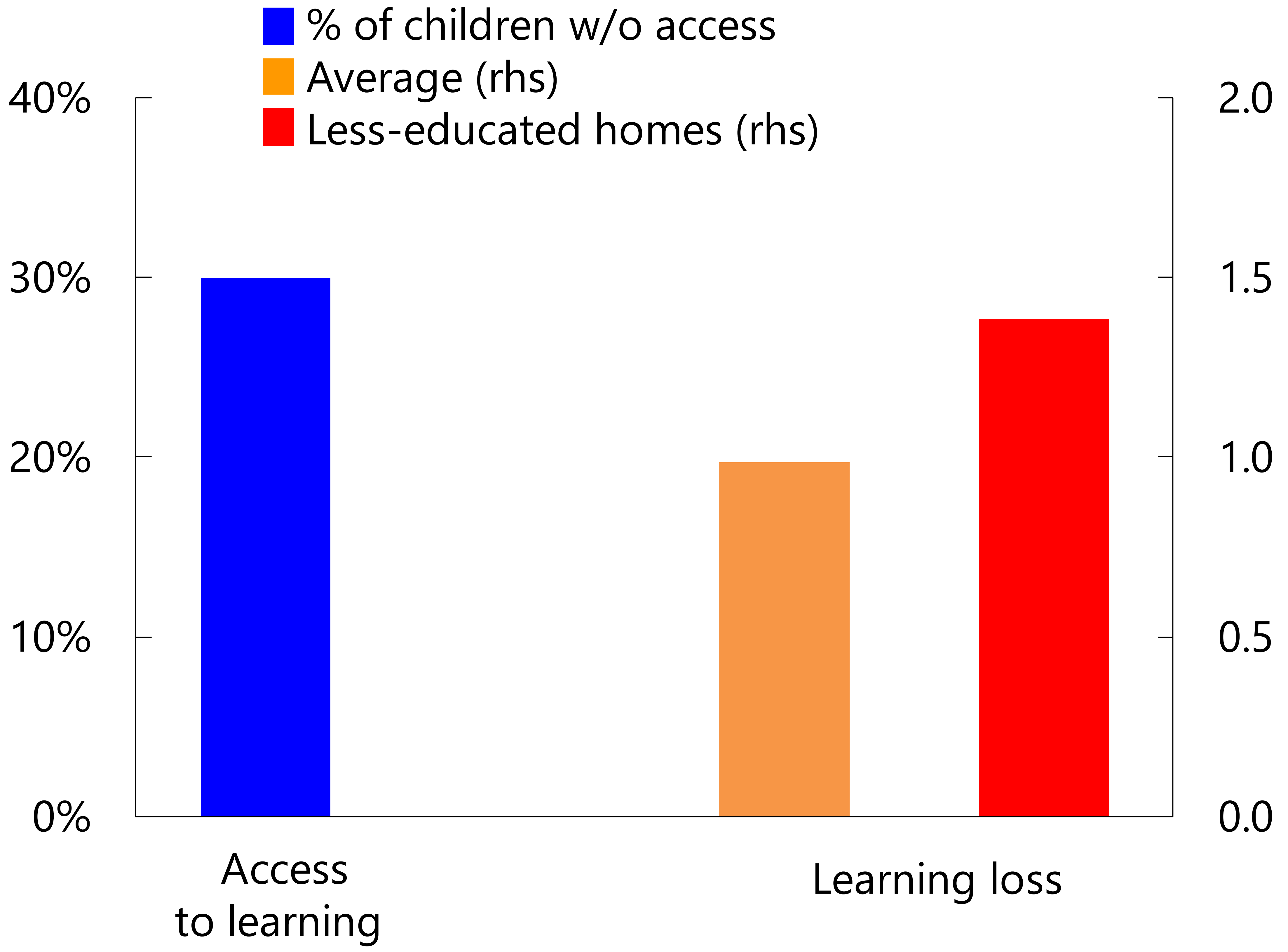
Unequal employment impact 1/

(average change in employment rate, 2020Q1 vs 2021Q1: total (bars) and relative to counterparts (dots))



Learning loss 2/

(LHS: % of children without access, RHS: # of weeks of learning loss per week of school closure)



Sources: ILO; OECD; Statistics Canada; US BEA; UNICEF; Engzell and others (2021); IMF, *World Economic Outlook*; and IMF staff calculations.

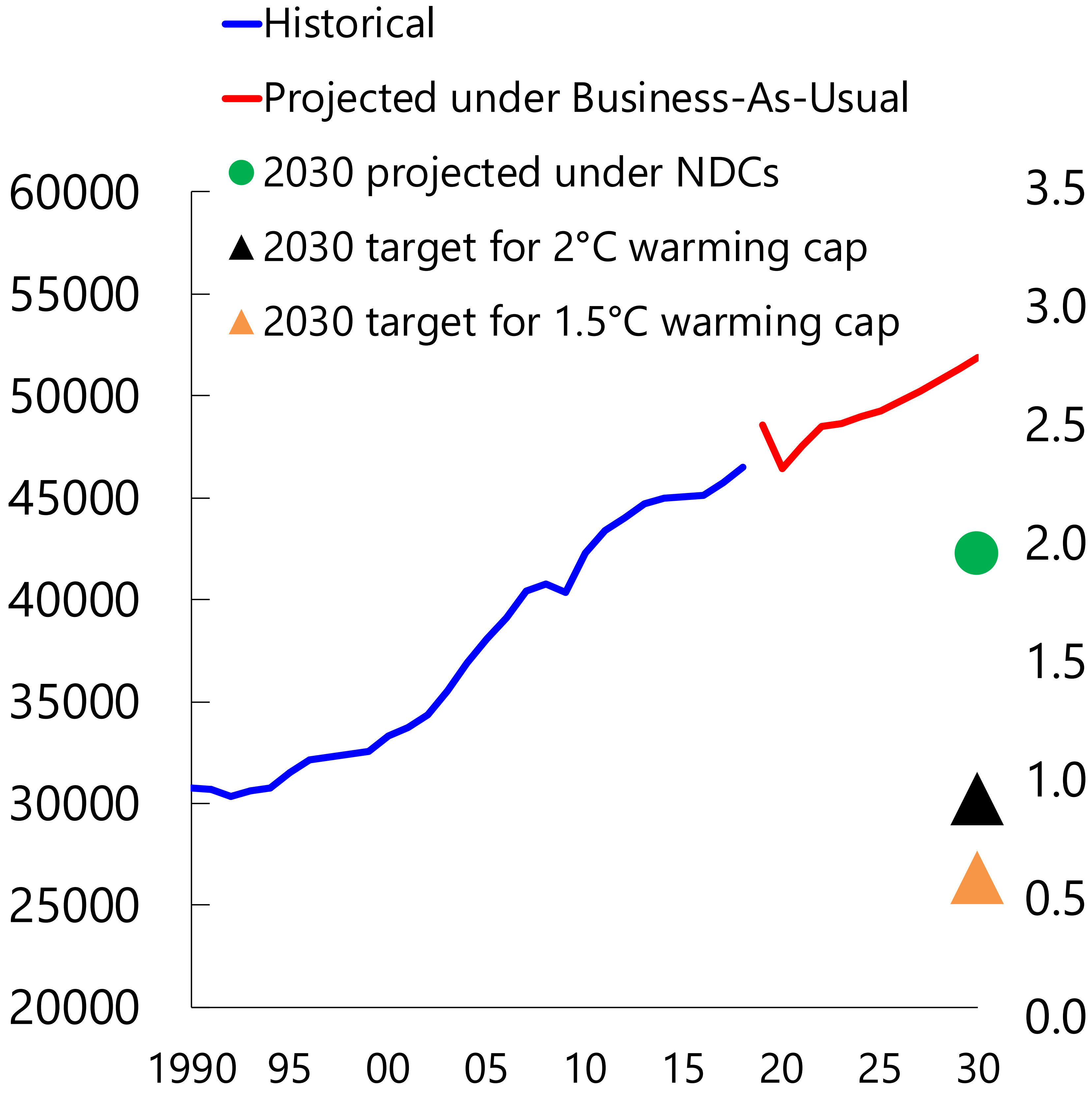
1/ Low-skill = above secondary and non-tertiary education and below. Youth = 15 to 24 years old. Sectors are classified according to ISIC Revision 4 and as routine/nonroutine or teleworkable if more (less) than half their share of employment is in occupations classified as highly exposed to routinization/teleowkable (Carrillo-Tudela and others 2016, Dingel and Nieman 2020). The sample includes 26 AEs and 13 EMDEs.

2/ Weeks of learning loss are based on the estimates from the Netherlands in Engzell and others (2021)

Invest in climate actions and raising productivity

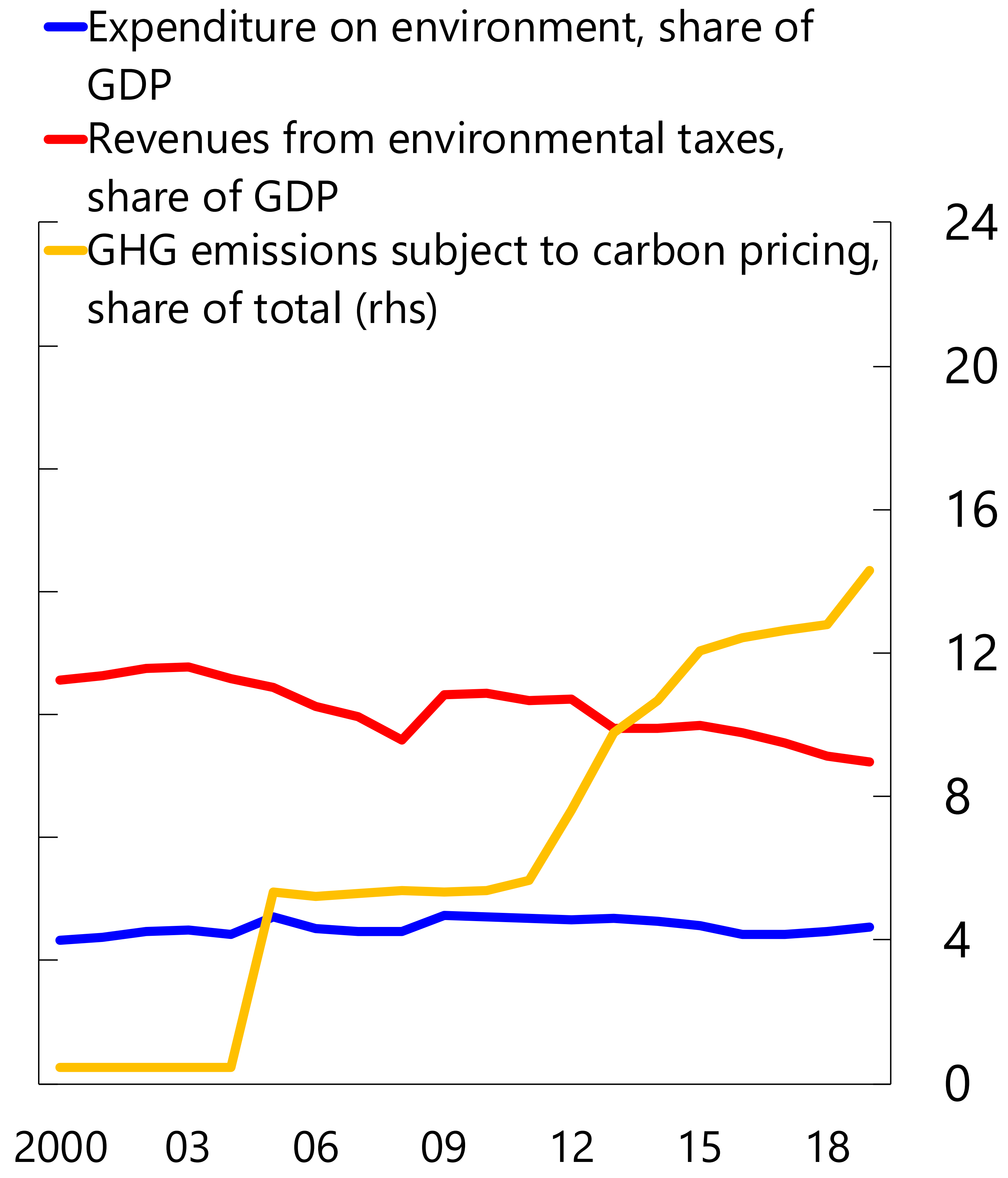
Global GHG Emissions: Historical, Projected, NDCs, and Targets 1/

(Million Metric tons of C02 equivalent)

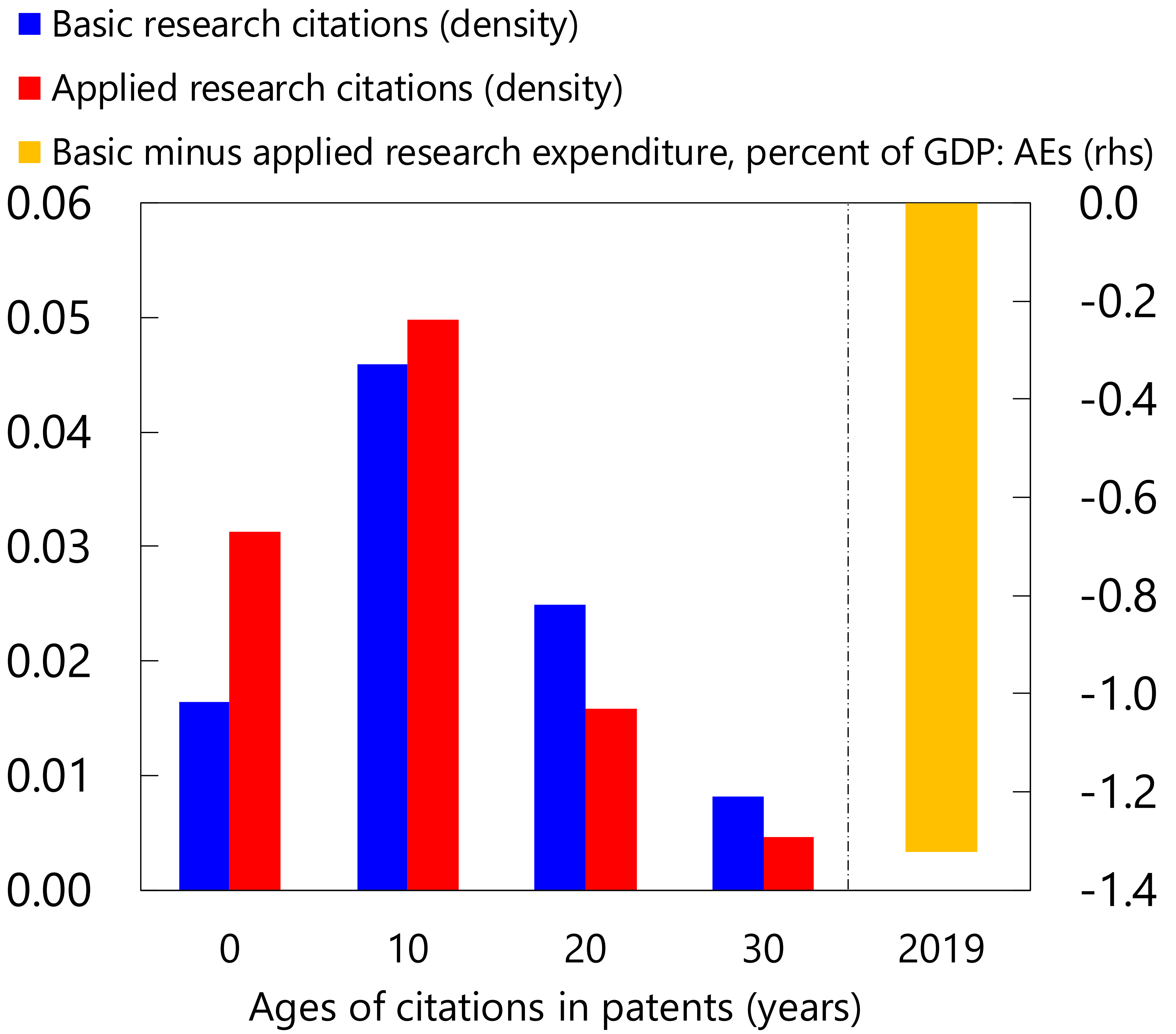


Environmental policy actions

(Percent)



Basic science diffuses further than applied science in time but is under-provided 2/



Sources: IMF Climate Data Dashboard; Parry, Black, and Roaf (2021); World Bank Carbon Pricing Dashboard; PATSTAT; Reliance on Science; ; OECD Science and Technology Indicators; and IMF staff calculations.

1/ Total GHG emissions exclude potential effects from land use, land-use change, and forestry. NDCs are based on the IMF estimates of current commitments as of August 2021. Estimates of the emissions targets under warming caps are CO2-only estimates from Parry, Black, and Roaf (2021) scaled up to account for past non-CO2 GHG (about 30 percent). GHG = greenhouse gases; NDCs = nationally-determined contributions.

2/ The sample for the left four bars is restricted to patents applied for during 2010–19. Axis truncated at 30 years. The right bar shows the average difference in funding.

Policy recommendations

- **Adopt the global plan to bring COVID-19 under control:**
  - Work towards the **goal of vaccinating at least 40 percent in every country by end-2021**, as recommended by the IMF/WB/WHO/WTO Task Force on COVID-19 vaccines and **at least 60 percent by the first half of 2022**
  - **Countries to deliver on pledged doses in a timely manner**
  - **Vaccine manufacturers prioritize deliveries to COVAX** (only 10% of procured doses delivered so far)
  - **Remove remaining restrictions on exports** of medical equipment, raw materials and finished vaccines
  - **Diversify and increase vaccine production and distribution capabilities**
  - **Close $25 billion grant financing gap** for vaccines testing, tracing and therapeutics and scale up genomic surveillance.

- **Agree on concrete policy actions to tackle climate change at the UN COP26 this November:**
  - Policy actions should include:
    - **International carbon price floor** adjusted to country circumstances
    - **A green public investment** program and research subsidies
    - **Targeted transfer schemes** to households adversely affected by the climate policies
    - **Advanced Economies should deliver on their pledge to mobilize USD100 billion annually in climate finance to support developing nations**
  - Strengthen the **global climate information architecture** (data, disclosures, taxonomies)

- **Ease financial constraints to vulnerable countries:**
  - The recent **general allocation of SDRs** contributes to the liquidity of the international monetary system and through rechanneling may provide support to the most vulnerable countries
  - **Urgent improvement in the implementation of the Common Framework for Debt Treatments** is needed, in particular, given the expiry of the DSSI at the end of December 2021

Policy recommendations

Tailor policy mix to the stage of economic recovery and to country-specific characteristics, while ensuring credibility of fiscal and monetary policy frameworks.

- **Fiscal policies:**
  - Continue to **prioritize spending to end the pandemic**
  - **Reorient away from poorly targeted subsidies and recurrent expenditure, where fiscal space is more limited**, particularly in some EMDEs, to make room for needed health, social spending and infrastructure outlays
  - **Strengthen tax capacity** and improve revenue administration

- **On monetary policy, central banks should:**
  - Act decisively to **prevent a de-anchoring of inflation expectations** when the risks become tangible
  - Remain accommodative where inflation pressures are contained, inflation expectations are below target & labor market is slack.
  - **Provide clear guidance about the future policy stance** to prevent unwarranted tightening of financial conditions

- **Financial sector policies:**
  - **Tighten selected macroprudential tools** to tackle pockets of vulnerabilities.
  - Expedite resolution of debt overhangs. **Strengthen insolvency frameworks** and expedited, out of court, restructuring mechanisms

- **Emerging and frontier markets should rebuild buffers** as appropriate and implement structural reforms to insulate themselves from the adverse impact of a possible tightening of external financial conditions

- **Invest for the longer term to achieve a durable and inclusive structural transformation. Global and national policies must be complements in order to**
  - Facilitate new growth opportunities: Greening the economy and facilitating digitalization
  - Reverse the setback to human capital accumulation due to school closures
  - Reduce inequality
  - Address sovereign debt overhangs

Constituency Codes

OEDAE
Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF
Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP
Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR
Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC
China

OEDCE
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO
Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC
Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF
France

OEDGR
Germany

OEDIN
Bangladesh, Bhutan, India, and Sri Lanka

OEDIT
Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA
Japan

OEDMD
Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE
Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO
Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU
Russian Federation and Syrian Arab Republic

OEDSA
Saudi Arabia

OEDST
Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ
Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK
United Kingdom

OEDUS
United States