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

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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 the assessment of the global economic outlook, risks, and policy priorities. They welcomed the better-than-anticipated performance in the second half of 2020, which helped to dampen the sharp drop in global growth. Directors acknowledged that the synchronized, extraordinary policy support deployed across economies has played a critical role in helping mitigate the crisis and foster the conditions for recovery. However, they agreed that the shock may have persistent effects. Medium-term output losses in emerging market and developing economies in general are likely to be larger than those in advanced economies compared to pre-pandemic projections, although emerging market economies as a whole will continue to grow faster than advanced economies. Directors noted that the crisis has also likely worsened inequalities within countries, with young people, women, and those with lower levels of education being hit harder.

Directors noted that uncertainties around the baseline projections remain large. The economic recovery depends heavily on the path of the health crisis, including the effective deployment of vaccines and treatments and the potential evolution of the virus. Other factors include the effectiveness of policy actions in forestalling economic scarring, developments in financial conditions and commodity prices, and the ability of economies to adjust to the shock. The impact of additional fiscal support and whether pent up savings built up during the pandemic translate into sharp increases in demand pose an upside risk.

Directors emphasized that accelerating vaccinations and distributing vaccines at affordable cost to all countries remains the key priority. The macroeconomic policy responses will need to be tailored by country, depending on the stage of the epidemic locally, the strength of their recovery, available policy space, and the structural characteristics of their economies. Prioritizing health spending, providing well-targeted fiscal support, and maintaining accommodative monetary policy as warranted, while monitoring financial stability risks, remain key while the pandemic continues. As the recovery progresses, policymakers would need to emphasize measures that limit scarring from the crisis, shrink inequality, and boost productive capacity (such as public investment). The transition from support measures would need to be managed carefully to avoid sudden cliffs that could derail the recovery. Particular attention to reallocation in labor markets will be important. The IMF's tailored policy advice will be crucial.

Directors stressed that until the pandemic is brought under control globally, fiscal policy must remain flexible and supportive of health systems, the worst-affected households and viable firms, and the economic recovery. The need and scope for fiscal support varies across economies, depending on the effect of the pandemic and the ability of countries to access low-cost borrowing. The targeting of measures must be enhanced and tailored to countries' administrative capacity, and fiscal transparency and governance practices should be improved.

Directors stressed the need to balance the risks from large and growing public and private debt with those from premature withdrawal of fiscal support, which could slow the recovery. Credible medium-term fiscal frameworks can help set a path for rebuilding fiscal buffers at a pace contingent on the strength of the recovery. Enhancing debt transparency and management will also be important and some countries may require debt relief or other treatment. Directors agreed that fiscal policies should enable a green, digital, and inclusive transformation of the economy, while long-standing weaknesses in public finances should be tackled once the recovery is firmly in place. Policies should reduce gaps in access to quality public services, such as social protection, more and better health care, and education. Strengthening tax capacity, gradually expanding the base for corporate and personal income taxes and ensuring a more progressive tax system, along with improvements in spending efficiency, can help mobilize additional resources for basic services and for the Sustainable Development Goals.

Directors agreed that decisive policy action eased financial conditions and helped contain financial stability risks. They noted, however, that the support measures may also have unintended consequences. An extended period of extremely easy financial conditions could result in stretched valuations that may worsen financial vulnerabilities and put growth at risk. A multispeed recovery between advanced and emerging market economies poses a risk that financial conditions in emerging market and developing economies may tighten markedly, especially if advanced economies move toward policy normalization and rates rise rapidly. In this context, clear guidance from advanced economy central banks, together with sound policies in emerging markets, will be important in preventing financial disruption in those economies. Some Directors also noted that emerging market economies may need to resort to policy tools considered in the Integrated Policy Framework. Directors noted that in many economies the corporate sector is overindebted and weakened, especially smaller firms.

Directors agreed that ongoing support remains necessary to complete the recovery. Most Directors noted the need to prevent financial vulnerabilities from turning into legacy issues by tightening selected macroprudential policy tools to tackle pockets of elevated vulnerabilities, while avoiding a broad tightening of financial conditions. Some Directors also emphasized the need to further develop tools targeting nonbank financial institutions.

Directors highlighted that emerging market and developing economies with market access should take advantage of easy financing conditions while they can. They agreed that corporate balance sheet repair is a priority, and noted staff's analysis that firms facing temporary liquidity risks may need policy support while nonviable firms would need resolution. Directors observed that the ability of banks to lend will be crucial for the success of the recovery.

Directors emphasized the importance of continued international cooperation to overcome the pandemic and strengthen the recovery. In addition to ramping up production

and ensuring access to vaccines worldwide, ensuring that financially constrained countries have adequate access to international liquidity will be important. Collective solutions are also essential in the areas of climate change, international tax policy, and international trade. The IMF will continue to play a critical role.

EXECUTIVE BOARD ATTENDANCE²

K. Georgieva, Chair

Executive Directors

I. Mannathoko (AE)

C. Huh (AP)

A. Bevilaqua (BR)

Z. Jin (CC)

P. Moreno (CE)

L. Levonian (CO)

D. Palotai (EC)

A. Buisse (FF)

S. Bhalla (IN)

D. Fanizza (IT)

T. Tanaka (JA)

H. Hosseini (MD)

P. Hilbers (NE)

M. Poso (NO)

A. Mozhin (RU)

M. Mouminah (SA)

A. Mahasandana (ST)

P. Trabinski (SZ)

S. Riach (UK)

E. Shortino (US)

Alternate Executive Directors

F. Sylla (AF)

L. Herrera (AG)

K. Merk (GR)

A. Alhosani (MI)

C. Ogada, Acting Secretary

J. Morco/V. Sola, Summing Up Officers

D. Alcantara / A. Lalor / E. Mannefred, Board Operations Officers

L. Nagy-Baker, Verbatim Reporting Officer

Also Present

African Department: V. Kramarenko, P. N'Diaye. Asia and Pacific Department: D. Furceri, A. Gulde, J. Ostry, S. Peiris. Communications Department: J. Lundgren, C. Rosenberg. European Central Bank: D. Rakitzis, R. Rueffer. European Department: J. Decressin,

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

A. Kammer, M. Pradhan. Fiscal Affairs Department: D. Amaglobeli, F. Brollo, R. Espinoza, J. Fournier, W. Lam, V. Gaspar, P. Mauro, P. Medas, A. Peralta Alva, R. Perrelli, M. Raissi. Finance Department: Z. Murgasova. Institute for Capacity Development: S. Coorey, M. Erbenova, F. Fischer, K. Westin. Independent Evaluation Office: C. Collyns. Information Technology Department: E. Anderson. Middle East and Central Asia Department: S. Berkmen, T. Koranchelian. Monetary and Capital Markets Department: N. Abbas, T. Adrian, A. Barajas Estrada, Y. Chen, A. Deghi, A. Garcia Pascual, D. Gautam, F. Natalucci, P. Nowak, E. Papageorgiou, M. Qureshi, J. Vandenbussche, A. Yokoyama. Office of Budget and Planning: A. Schimmelpfennig. Office of Risk Management: I. Ivaschenko. Research Department: J. Bluedorn, O. Celasun, M. Das, S. Das, P. Engler, G. Gopinath, F. Grigoli, A. Habib, N. Hansen, P. Koeva Brooks, M. Nabar. Strategy, Policy, and Review Department: R. Duttagupta, M. Kaufman, S. Panth, C. Pazarbasioglu Dutz. Statistics Department: G. Quiros Romero. World Bank Group: F. Ohnsorge. Western Hemisphere Department: N. Chalk, J. Roldos. Executive Directors: A. Andrianarivelo (AF), S. Chodos (AG), M. Mahmoud (MI). Alternate Executive Directors: B. Alhomaly (SA), H. Azal (EC), M. El Qorchi (MD), F. Fuentes (BR), S. Geadah (MI), A. Grant (AP), A. Guerra (CE), Y. Indraratna (IN), C. Just (EC), M. Massourakis (IT), F. Mochtar (ST), W. Nakunyada (AE), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), V. Rashkovan (NE), J. Romero (CE), D. Ronicle (UK), P. Rozan (FF), B. Saraiva (BR), J. Sigurgeirsson (NO), C. White (AP), Z. Zhang (CC). Senior Advisors to Executive Directors: W. Abdelati (MI), S. Ahmed (MD), H. Andrianometiana (AF), X. Bai (CC), M. Choueiri (MI), J. Damgaard (NO), I. Fragin (GR), M. Gilliot (FF), R. Goyal (IN), P. Harvan (EC), O. Hendrick (AG), M. Ismail (AE), L. Johnson (AP), S. Keshava (SA), B. Lischinsky (AG), M. Maidu (AE), L. Marek (EC), Son T. Nghiem (ST), T. Nguema-Affane (AF), C. Quagliarini (IT), F. Rivera Molina (CE), C. Sassanpour (MD), A. Sattler (GR), S. Senich (US), M. Sidi Bouna (AF), L. Smith (CO), F. Spadafora (IT), N. Thiruvenkadam (IN), T. Shay (NE), G. Vasishtha (CO), R. Velloso (BR), L. Voinea (NE), J. Weil (CO), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: M. Albert (FF), F. Al-Kohlany (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), S. Belhaj (MD), M. Bernatavicius (NO), A. Biriukv (RU), Campbell (UK), E. Cartagena Guardado (CE), T. Chrimes (UK), J. Corvalan (AG), R. Edwards (CO), T. Krahnke (GR), T. Manchev (NE), G. Meizer (EC), R. Moral Betere (CE), T. Nagase (JA), K. Nelson (UK), K. Osei-Yeboah (MD), B. Piasecki (SZ), D. Shestakov (RU), M. Shimada (JA), B. Singh (IN), B. Slettvag (NO), D. Tevdovski (NE), A. Tola (SZ), I. Valdes Fernandez (NO), C. Westphal (US), S. Yoe (ST), J. Yoo (AP), Y. Zhao (CC), T. Abalala (SA), J. Barroso (BR), M. Law (CC), F. Lopez (CE).

DISCUSSION RECORD³

The Chair:

We have offered Directors our most up-to-date view on the outlook, on risks, and on policy priorities. That is, fortunately, an update that brings a bit more positivism but still in the context a great deal of uncertainty and growing divergence. The economic fortunes within countries and across countries are not the same for everyone, and that is the moment for us to see what we can draw out of it to provide good policy advice so everybody can benefit from what is now shaping up as a process of, while still challenging, but a promising recovery.

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

Directors saw my recording, and my recording said there were a few mystery slides that I would show them live at the Board meeting, and this is what I am going to do.

In my recording, I made the point that, overall, we are seeing an improved outlook for the global economy. However, we are seeing multi-speed recoveries. Here is the table for our projections. Presently for 2020, this is our estimate of growth for 2020 for the world. It was -3.3 percent, and I should say that through a happy coincidence, this is exactly what we had projected a year ago, once we updated for the new PPP numbers.

We have growth projected to rebound this year, in 2021, to 6 percent before moderating to 4.4 percent. So, we have a significant upgrade for 2021 of about 0.5 percentage points; and this reflects three things and probably in this order, which is, first, the considerable U.S. fiscal package, the American Rescue Plan (ARP). The second is the rebound in commodity prices that is helping commodity exporters. And, third, which is that there were countries that saw second waves and had restrictions, but economic activity held up somewhat stronger than we might have expected in January.

What we can see here from this table is that all of this upgrade of 0.5 percentage points is coming from advanced economies, almost all of it, so that is a 0.8 percentage point upgrade for advanced economies; and it is driven to

³ Edited for clarity.

an important extent by the US, for which we have a considerable upgrade of 1.3 percentage points.

Again, what we see in this table is different speeds of recovery, diverging speeds of recovery. We can see that, for instance, the euro area also is rebounding from 2020, however, at a somewhat slower pace. For instance, while the US is expected to surpass its pre-COVID trend this year, for most of the other countries, advanced economies, we have them reaching pre-COVID levels only next year or maybe even later.

We have also significant upgrades for Canada because of the commodity price exports going up, prices going up, and also because of restrictions coming off a little sooner, and similarly, for UK, a little more growth-friendly budget than was expected.

The second table is on emerging and developing economies. We have a much smaller upgrade, reflecting a kind of a small upgrade for India, which reflects continuing recoveries after re-openings, and also again upgrades for commodity-exporting countries. As one will note, we actually have a downgrade for low-income and developing countries of -0.8 percentage points, which reflects the fact that vaccinations are going even slower than we projected. Now it is supposed to go into 2023, lesser fiscal space at this point, and some tourism-dependent economies being very hard hit.

Again, this is the same story as in the previous slide, which is of diverging recoveries, with China coming back very, very strongly, while for most other countries, the cumulative hit, if one looks at it relative to the pre-COVID trend, is quite substantial. (Slide 10) So, this is a slide that was in my deck that one saw in my recording; but again just to flag the diverging speeds of recoveries, the left graph shows, over the period 2020-2024, the average per capita income loss relative to the pre-crisis trend is much larger for emerging markets and low-income countries as compared to advanced economies, again something quite different from after the Global Financial Crisis (GFC), which is what is generating this difficult picture of many more entering extreme poverty and being undernourished.

Again, we have to remind ourselves that this crisis is still far from over. There is still tremendous uncertainty. While there are upside scenarios with faster vaccinations, which would be good for the global economy, especially if one can get it everywhere quickly, there are also significant downside scenarios if, indeed, this race against the virus with the vaccines does not work as well as we are hoping it will.

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

I have just some slides to share with the Board, and then I will answer a few questions that Directors asked in the gray statements.

(Slide 1) On the financial stability update, the first very significant evolution since we met in January is the increase in yields. On the left chart, we show the yield curves for Germany, the United States, and for emerging markets, so this is one year all the way out to 30 years. The solid line is the current yield curve in each of the three regions. The little dots are the January 2020 line, and the dashes are the November 2020 lines. What one can see is that the yields have steepened particularly in the US, and basically in the US now at the longer end, the yield curve is back to where it was in January 2020, but at the short end it continues to be extremely low.

In Germany, one also sees a steepening but not quite as large as in the US, and in emerging markets one sees a steepening that is either as much or even more than what has happened in the US. In particular, in emerging markets, it is not only the long-end that has steepened; it is also the short-end that has moved up quite a bit, and so that is certainly a concern from the emerging markets' perspective, and it is the current focus of any financial stability concerns.

Before turning to emerging markets in more detail, let me just shine a light on the US yield curves. The middle chart gives the two-year yield, so this is basically average yields, average market-implied yields, zero to 2 years out. This is the usual horizon that we consider for monetary policy stance and monetary policy, and to see that market-implied yields are pinned to zero for the number of the yield while break-evens have come out, so break-evens are the market-implied inflation. As a result, the real yields are extremely negative, and so this is the oomph from monetary policy, from having expansionary monetary policy. Really it is very low. This is a consequence of easy money, and the rise in inflation, of course, is also a consequence.

The chart shows 5y5y forward yields. These are market-implied yields on average 5 years in the future, 5 through 10 years into the future on average. And here again, one can see that the nominal yields have increased back to about 2 1/2, and that is exactly where they should be. This is CPI index, so the Treasury Inflation Indexed securities are CPI index. The inflation target is on

the CPE, which is about 0.4, 0.5 percent difference, so at 2.5 you are pretty much at target.

Now, what has concerned us is that the real yields have also started to move up. We saw break-evens move up slowly, and that is very good and very intended; but real yields have also moved up, and much of that is due to term premia, so the interest rate risk premia that has been battered in these longer-term maturities has moved up, and that is a reflection of uncertainty about the future path of asset purchases.

(Slide 2) Let's now take a look at what that meant for emerging markets to date. Here, again, one sees in the left chart, the time series since 2011 of the emerging market yields, the US yield, and then we are separating out the US term premia and the emerging market term premia and to see that the upward move in US yields is most recently due to term premia, so that is the risk premium embedded in longer-term yields. For emerging markets, it is also the case to a large extent, and so the emerging markets yields have tightened.

To date, we do not see a tightening of spreads, so the hard currency funding costs for emerging markets or frontier economies are basically the US yield plus the spread, so the spreads have not widened. Of course, we do worry that spreads could widen at some point, but neither do we see that yet nor in sovereign in the middle or in the corporates.

(Slide 3) Now turning to the flows, and this is where, as I said earlier, the concern is, this could trigger an outflow of portfolio flows or capital flows from emerging markets. And one can see a little bit of that in the hard currency fund flows, but there would be a very long way to go to have anything comparable to the 2013 Taper Tantrum, and local currency fund flows really have not moved yet.

Focusing more on the local currency funding, the chart shows one of the highlights of this forthcoming Global Financial Stability Report (GFSR), i.e., who bought the issuance in domestic currency sovereign bonds in emerging markets. Well, it is domestic banks. The sovereign bank nexus has intensified quantitatively to a large degree in emerging markets. Of course, in terms of frontier economies in a few emerging markets as well, here we show the frontier economies rollover needs over coming years are going to be large as well.

With that, let me answer a few questions about macroprudential policies. A number of Directors asked specific questions on macroprudential policy, and so let me share our thinking around that. Of course, there are many gaps on macroprudential policy, particularly in the non-bank financial sector (NBFS), but also in the corporate sector and in many countries in the household sector. Macroprudential policies should aim for three goals. Firstly, to ensure resilience of the financial system against shocks. Secondly, to limit the buildup of systemic vulnerabilities over time. Thirdly, to contain structural vulnerabilities. For example, third is about the resilience of market infrastructures, while the second one is more about cyclical macroprudential tools, such as the countercyclical capital buffer; and the first one, ensure resilience, is really about the overall level of capital.

We recommend in the GFSR that certain targeted measures could already be applied in some countries, and, indeed, in New Zealand and Norway, we do see a debate on potentially tightening of a few of the macroprudential tools. In the US, the supplementary leverage ratio (SLR), which was relaxed during the crisis by excluding reserves and treasury securities from the SLR, that is going to be phased out by the end of March.

Two missing areas are the non-bank financial intermediation. We do see a lot of risk appetite in market-based finance, and the macroprudential toolkit is somewhat incomplete in that area. In the corporate sector too, of course, we are pointing many times in the GFSR to the rise of vulnerabilities, and there is certainly an incomplete toolkit there. There was also a question about bitcoin, and I am going to defer on answering that to the end of the discussion.

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

I want to highlight just two themes that I believe come from the Fiscal Monitor, but they are of broader policy relevance, and I want to conclude by making a correction and elaborate a little bit on a point that I did not cover as I should have in my recorded presentation.

One of the themes that I believe is going to mark the Spring Meetings is this sound bite of a fair shot. That is the title of Chapter 2 of the Fiscal Monitor, and in the Fiscal Monitor, we make the case that Ms. Gopinath has emphasized as well, that probably investing in vaccines and vaccination is the highest return public investment ever identified. And it is a crucial aspect to the recovery, so that is one aspect of the fair shot.

Chapter 2 argues that there are two dynamic forces that play out. Preexisting inequalities made COVID-19 worse, and COVID-19 aggravated inequalities. The possibility of a vicious cycle looms large. To avoid painful social cracks and give everyone a fair opportunity for life flourishing, the Fiscal Monitor argues for universal access to basic public services, health, education, social safety nets, and to strengthen redistributive policies. In a few cases, this will require considerable improvements in the efficiency of public spending and increases in tax capacity.

Another very important aspect is the emphasis on the need for tailored policy advice. Countries are fundamentally different, and in the current stage of COVID-19 and economic and financial development, it is crucial to adapt policies to the specific circumstances of the countries. We do discuss in the various fact sheets, various stages of the COVID-19 and its economic, social, and financial repercussions, but those are stylized, are subject to considerable uncertainty, a topic that both Mr. Adrian and Ms. Gopinath have emphasized. Reversals are possible. Countries will not be synchronized. At the same time, we do have risks of divergences in economic and financial development. Countries are different in terms of their structural characteristics and institutions, and so one size does not fit all, and we need, indeed, to go for very differentiated policy advice, and we have examples of that in all flagships.

Ms. Shortino:

Overall, we felt like the flagship reports appropriately captured the key challenges facing the global economy at this juncture. We issued a very comprehensive gray statement, and I will try to stay brief and highlight a few of our most important points.

First, I would like to stress that while the global outlook is improving, the recovery will ultimately depend on how rapidly vaccines can be rolled out globally. We would echo Ms. Riach and her colleagues' gray statement that the global community must ensure adequate global vaccine production and worldwide rollout at affordable prices, and we need to support access in all countries and to all sectors of the population. We also welcomed the analysis that was just cited in the opening presentation that vaccination is the highest return public investment. I think that is quite important.

Second, even with this improved outlook, we want to reiterate our view that the risk of premature withdrawal of policy support outweighs the risk of doing too much. Ms. Levonian, for example, in her gray statement

rightly points out that the conclusion that the pandemic could leave smaller scars than the global financial crisis, while a welcome one, may still be premature. For many countries, this crisis is far from over and the lack of sufficient policy support could still result in deep and lasting scarring to our economies. It is for this reason that one of the first actions taken by my new administration was to advance the American Rescue Plan, which will return the US to full employment by the end of next year.

Third, we fully agree on the need for tailored fiscal policies, which will be critical in this next phase of the crisis, and in particular to help reverse the increase in inequality. We agree with Mr. Merk in his gray statement that investing in support of structural adjustments of our economies will be imperative, and we see a chance to shape policies to support green investment, infrastructure, and promote greater equality.

I welcome what Ms. Gopinath highlighted at the beginning on the American Recovery Plan (ARP) being a key driver of the recovery for the US. The ARP importantly not only boosts the U.S. outlook, but also provides support to those most severely impacted, including women, children, and minority groups, and aims to reduce child poverty by 20 percent. Over the coming months, the administration will also be developing another targeted package of investments to address inequality and support infrastructure, essentially to build back better.

With regards to emerging markets and low-income countries, we agree with the conclusion in the reports that the risk of divergence within and across countries is high. The downgrade in the outlook for LICs is particularly concerning. I would point out briefly that the conclusions in Chapter 4 of the WEO importantly note that emerging markets with lower macroeconomic vulnerabilities tend to be less vulnerable—I should say with stronger macroeconomic policies, tend to be less vulnerable to external financing shocks. That said, we caution staff on recommending proactively capital flow measures and exchange rate intervention as a way to minimize disruptions that could arise from capital flows except in very limited cases where this may be appropriate.

On low-income countries, I would reiterate while in emerging markets as well Mr. Tanaka's points in his gray statement, that debt issues will remain critical for all member countries. This underscores the need for us to double down on our efforts to enhance debt transparency and ensure a smooth implementation of the Common Framework.

Finally, while our base case is that monetary policies in advanced economies will remain accommodative for some time, we support the recommendations that emerging market and developing economies need to prepare themselves for tightening global financial conditions by continuing to improve macroeconomic policy frameworks. We found the GFSR's analysis around the corporate zombie companies helpful but would have appreciated more discussion about specific tradeoffs of different macroeconomic policies.

Ms. Mannathoko:

As always, the flagships are well-written and insightful. They are a valuable IMF product with our capitals but also just for analysts at large. We also want to thank staff for the detailed responses to questions.

While the flagships indicate some hope for a global recovery, the extended crisis, and risks of scarring for many LICs and MICs is estimated to be significant and creating these divergent outcomes. As noted just now by Ms. Shortino, the immediate priority is, of course, vaccines, equitable, affordable, and timely access to vaccines for the developing world. We wanted to urge the international community to strengthen cooperation mechanisms in this area and enable better supply and distribution of affordable vaccines.

As highlighted in our gray statement, we also just urge strong support to vaccine manufacturing capabilities in Africa, as we believe this will help ensure faster local supply of vaccines which are critical to curbing the current strain. We would rather have vaccine rollout in 2021 than 2023.

We also just appreciate the focus in the reports on poverty and inequality really reflecting the divergence story. Like other Directors, we are concerned that the challenges are more severe in LICs and small MICs from COVID, and we appreciate the financing gap estimates in the LIC reports that we will be discussing tomorrow, and also the ones in the SDN on the Staff Discussion Note on the SDGs.

Grants and concessional resources will be needed to fill large financing gaps that persist in LIDCs, and we welcome the broad support for the general SDR allocation to supplement global liquidity, but we just want to emphasize as well the need for strong international coordination to secure the necessary financing for a green, smart recovery for all and to support investments that would reverse divergence.

As noted during discussions on the general SDR allocation, we also look forward to considering proposals on options to redistribute excess SDRs and help finance countries in need. We broadly share the assessment on the need to sustain policy measures to support the recovery but note that for emerging market and developing economies, LICs, they cannot sustain the level of policy support that is needed because they entered the crisis with limited policy space; so really going forward a solution is needed for this elevated financing.

A combination of policies to support investment and recovery alongside multilateral efforts will be essential to accompany developing countries as they step up efforts to boost domestic revenue mobilization and also the hope that with more effective global cooperation, some of the leakages that still happen will be curbed.

To complement fiscal adjustments efforts being undertaken, debt relief and timely debt restructuring remain critical just to minimize the likelihood of distress. Affected countries in this regard will be looking at current restructurings that are happening under the G-20 Common Framework. We are all hoping for successful and effective outcomes from the early cases. Here we also just wish to highlight the need to consider how support can be given to non-DSSI-eligible countries in the broad debt resolution agenda.

We want to express our appreciation for the discussion on output losses for commodity and tourism-dependent countries. For many countries in our region, these two sectors are important sectors, primary sources of foreign exchange; and therefore, in addition, we also welcome the emphasis on policies to prioritize digital infrastructure needed to facilitate recovery and development. All these issues are especially important in our region.

We broadly support the analysis of financial developments and global financial stability risks and concur with the need to prioritize tools required to navigate the transition to normalcy. Like Ms. Riach and Mr. Merk alluded in their statements, we want to encourage authorities to monitor risks arising from nonbank financial institutions. These are emerging as well in some of our countries, the risks that have migrated to less monitored and risky areas in search for yield. Above all, authorities should develop a responsive macroprudential toolkit for the sector for nonbank financial intermediaries that have gained prominence over the years. Increasingly we believe this will be key in ensuring financial sector stability.

Finally, we just want to urge vigilance regarding risks that emanate from U.S. policy normalization. In this context, we do agree that EMDEs should watch for risks and closely monitor portfolio outflows and vulnerabilities linked to high indebtedness and watching the sensitivity of debt service to interest rate movements, et cetera. Broadly containing liquidity and solvency risks, as well as addressing cross-border spillovers, will be essential.

The Chair:

I recognize that we have a unique opportunity to link the analyses with other discussions this Board is pursuing for the benefit of the membership.

Ms. Levonian:

We actually thought the choice of topics for the analytical chapters was very well aligned with the pressing policy challenges. The reports are packed with insights and granular policy advice, which our authorities will find very valuable. We just want to emphasize a few points that stood out for us.

First, we could not agree more that addressing the health crisis is the key priority for recovery, and as the Fiscal Monitor argues and Mr. Gaspar and Ms. Shortino also mentioned, there is no better investment than vaccines at the moment. It is paramount to ensure that healthcare systems are adequately resourced. Strong global cooperation is needed to prevent export restrictions and expedite the production and distribution of vaccines. The findings of the WEO scenario box clearly reinforce this message as well.

Second, divergence between and within countries in an environment of elevated uncertainty is a key theme in the flagships, and prospects for a multi-speed recovery, as was mentioned, could lead to significant global financial volatility and tightening of financial conditions for EMDEs. Here, we echo staff's call for determined policy action to avoid a legacy of vulnerability, limit systemic financial risk, and support sustained and inclusive recovery. LICs and small developing states face even more severe challenges and policy tradeoffs, as clearly highlighted by both the WEO and the Fiscal Monitor.

Tourism-dependent countries and commodity exporters have been hit particularly hard, requiring well-tailored support by the Fund that consider their unique macro vulnerabilities, weak capacity to adapt, and the exceptional financing needs.

Turning to divergence within countries, the disproportionate impact on women and youth is a major area of concern. This should continue to be an area of focus for future work.

Third, the pandemic continues to exacerbate debt sustainability risks in many countries. Credible medium-term fiscal frameworks will be critical for tailoring fiscal responses, rebuilding buffers, and reducing debt vulnerabilities. Countries facing acute financing constraints should not delay the needed adjustment. In this regard, the swift implementation of the G-20 Common Framework (CF) will be critical.

Fourth, as we enter the recovery phase, focus will turn to recalibrating policies. The flagships provide a good preliminary insight in this regard, as was noted in Ms. Riach's gray statement. Further consideration of the intertemporal tradeoffs associated with official sector support will help to inform the policy discussion on the exit from support measures.

Finally, strong international cooperation and close coordination between international financial institutions (IFIs) is needed more than ever for overcoming the shared challenges of this crisis. With its universal membership, of course, the Fund has an important leading role to play in this regard.

Mr. Poso:

We broadly agree with Ms. Gopinath's assessment of the current situation and the improved outlook for the global economy. We especially thank for the strong call for universal access to vaccines. This has been a high priority for the European Union (EU), which is the largest COVID-19 vaccine exporter in the world. While the EU has delivered 70 million doses to its citizens so far, it has also exported 43 million vaccines to the citizens of 33 other countries during the last 7 weeks.

From the 381 export authorization requests received by yesterday, only one has been refused. More vaccine exporters are needed to help, especially low-income countries, as Ms. Mannathoko also mentioned. The forceful fiscal and monetary policy responses have been crucial to support economic and financial conditions during the crisis. Going forward, we need to increasingly consider the paths to normality, and we welcome the strong emphasis on tailoring policies and policy advice to countries characteristics and the different stage of the recovery. Mr. Gaspar also emphasized this in his opening remarks.

While a premature withdrawal of fiscal support should be avoided, fiscal policies should shift towards more targeted measures. On monetary policy, we take positive note of the clear communication by major central banks so far, but as Mr. Adrian showed us, the bond yields are driven also by other factors than central banks. It is important that the Fund stands ready to provide timely advice on less accommodative macroprudential and monetary policies once the crisis abates.

We note positively that the expected scarring, although sizeable, is less than what was experienced following the global financial crisis. This is definitely one of the most noticeable positive messages in the WEO. On the risk assessment, we agree that risks are now more balanced and wonder whether the strengthened upside risks to growth also warrant a broader discussion on the upside risks to inflation. These upside risks could be related, for instance, to a still constrained supply-side, as indicated in the most recent PMI releases.

That said, the improvement in outlook and risks is very much concentrated among advanced economies. It is noteworthy that while the 2021 and 2022 growth forecasts are increased for advanced economies and emerging market and middle-income economies, they are now lowered for low-income developing economies.

The pandemic has hit unevenly across sectors and households, and very importantly, the unprecedented scale of school closures has led to significant education losses, with the largest losses accrued to children from poorer and less-educated families. All this could exacerbate preexisting inequalities in a way that could leave long-lasting scars to societies and lead to rising polarization and erosion of trust, posing risks to macroeconomic stability. We very much welcome the holistic approach to policy recommendations and tackling rising inequality.

Mr. Hilbers:

I would like to emphasize a few points in addition to our gray statement. First, on tone, we liked the focus on two specific aspects of the current outlook, which are uncertainty and divergence. Plus, even if we were to return to the pre-COVID real economic conditions without too much scarring, we find ourselves in a situation with much higher debt ratios than before the pandemic. In light of these challenges, we see an important role for granular and country-specific policy advice by the Fund.

Second, the flagships have rightly given more focus on the need for green and digital transformations in the recovery phase of the pandemic. However, while the recent focus of the global community has been much on efforts to supply low-income countries, it is important to also pay sufficient attention to middle-income countries which faced the highest output losses during the pandemic. This is also relevant when we discuss options for the voluntary reallocation of SDRs.

Third, I would like to echo Mr. Buisse's point that granular advice is needed on how to address inequalities in emerging economies. Further strengthening of the tax capacity, including where possible through progressive taxation, in these countries is particularly important to create room for investing in public goods and human capital.

Fourth, we welcome the discussion on the need to act on climate change in the WEO and the emphasis on fiscal policies to enable a green, digital, and inclusive transformation in the Fiscal Monitor. However, despite highly relevant contributions in previous editions, which we very much welcomed, the word climate hardly shows up in the GFSR this time. Incidentally, the word green does at least ten times I noticed, but generally just to refer to the color of the bars in the charts. I can well understand that repeating the same mantra every six months is not helpful to the cause, but a few more references to climate risk would, in our view, have been welcome.

Turning to the financial sector, just three brief points. I agree with Ms. Riach and Mr. Merk that the flagships could have stressed the urgency of financial regulatory reforms to prevent further accumulation of vulnerabilities in the nonbank financial sector, a point incidentally also made frequently by the Financial Stability Board (FSB).

Second, the increasing sovereign bank nexus in emerging economies, as highlighted by Mr. Adrian, is worrying and given also the regulatory treatment—or maybe I should say the lack of regulatory treatment—in this area, my question is what does staff recommend here?

Third, and we note a divergence, and this is another divergence, within the real estate markets in many countries between on the one hand, commercial real estate (CRE), and on the other hand, residential real estate. Commercial real estate was often badly hit by the pandemic, the effects of which come on top of already existing developments, such as the impact of internet shopping on retail and change of work patterns on demand for office space.

In many countries—some of this is surprise maybe—residential real estate is doing quite well, including in this country due to very low mortgage rates, higher savings rates, and a need for more space as a result of working from home. Given that real estate markets have been a determining factor, if not the cause of financial trouble and even crisis in the past, we would welcome further work by the Fund on risks related to housing markets and housing market valuations.

My final, and maybe somewhat surprising, point is on central bank independence. To put it bluntly, the concept of central bank independence was invented to enable central bankers to say no in difficult times, but saying no is not always easy, and it may become increasingly difficult if we need to normalize not just monetary but also micro and macroprudential policies in the years to come. We see pressures building up in different countries, including in my own constituency. Let me emphasize that we very much appreciate Chair's personal commitment to this issue.

The Chair:

I agree with the points Mr. Hilbers made. I also recognize that we will be faced with potentially more pressure on central banks, and it was very informative for me to have a discussion with the central bank governor of North Macedonia, an illustration of this is a problem likely to become bigger, not smaller. I want to comment on Mr. Hilbers' climate consideration and say two things. We would look into ways to be sure that this is a core issue for us. Stay tuned for what is coming in the fall. The Fund will be coming very, very strongly just before COP 26.

Mr. Tanaka:

As staff emphasized in the reports, it is vital to strengthen the international cooperation to tackle the crisis and realize a resilient and inclusive recovery of the economy.

Let me firstly touch upon the global outlook and policy responses. We support staff's point that forceful policy responses to tackle the crisis should remain necessary until the pandemic abates in light of continued high uncertainty and downside risks.

On the other hand, it is also important to keep in our mind that unprecedented policy actions could cause unintended side effects, and we must carefully move to the more well-targeted and calibrated policies and reallocation of resources to mitigate such side-effects. We should keep

vigilant on the spillover effects of the policy measures by a few large economies and their interactions with financial markets under divergent trend. In addition, regardless of the phases of the crisis, we need to steadily tackle the existing pre-pandemic structural issues, such as decline in the potential growth rate, as well as macrocritical emerging issues like climate change. We should seek every opportunity to achieve a greener, fairer, and more durable recovery.

To this end, we would like the staff to provide tailored and concrete policy recommendations depending on the country-specific circumstances and to make clear and careful external communication, which should also prevent unintended adverse market reaction.

Secondly, on the global financial system and its stability, it is essential to maintain accommodative financial conditions and smooth credit flows to support the recovery. However, these accommodative monetary policy and financial sector measures could have intertemporal tradeoffs in terms of financial stability, as GFSR rightly points out. We broadly agree with the staff recommendation that we need to implement the macroprudential policy measures to mitigate possible intertemporal tradeoffs.

However, macroprudential policy tools are not silver bullets. Given its limitation as well as the necessity to consider country circumstances of the real economy, it would be a difficult judgment to decide the timing and stress as well as the choices of specific tools. In this regard, we expect staff for their continued effort to study and improve MPP toolkits and have constructive dialogues with authorities in bilateral surveillances.

Let me move on to the third point on fiscal fronts. Although there is a significant divergence among countries, we positively note that the bold fiscal policies have prevented the larger economic fallout. However, fiscal deficits and public debts have increased to the unprecedented levels due to the crisis. To appropriately respond to the crisis while securing fiscal sustainability, it is indispensable to efficiently reallocate the policy resources and implement well-targeted, timely, and temporary policies. At the same time, it is also important to build and steadily implement a credible medium-term policy framework for realizing sustainable growth.

Debt issues remain a critical challenge. To tackle the structural debt issues of the developing countries is the highest priority for both public creditors and private creditors to steadily implement the Common Framework

with transparency. Efforts to secure the debt transparency and debt sustainability have never been more important.

Last but not least, the Fund should continue to play a central role in formulating policy direction, utilizing its macroeconomic expertise. It is paramount for the Fund to provide continued update of information and holistic analysis, as Mr. Poso put, on impacts of the crisis, strength and divergence of recovery momentum, and policy ramifications, including spillover effects.

Ms. Riach:

Taken together, these documents identify and respond to the major challenges of the moment. Divergence in prospects between members and within member countries is the key characteristic of the outlook, and that is very well illustrated, in particular by the analysis in Chapter 1 of the WEO.

All being well, at Spring Meetings we will announce a significant package of support for low-income countries, but the Fund also needs to remain focused on the challenges facing advanced and emerging market members, and many of those members will be increasingly focused on how and when to recalibrate policy as we move through the recovery period and how to ensure that the recovery is transformational, building in structural reforms to protect the poorest and most vulnerable members of society and to ensure a green and climate-focused recovery.

The Fund must support its members as we grapple with these policy challenges domestically and as an international community. We have seen this discussion begin over the last few months with the gradual return to Article IVs, and in our view, these flagship documents, including the well-targeted policy chapters, are a very valuable addition to the debate.

In this spirit, we found staff's description of the phasing of the recovery to be helpful, but I also support Ms. Shortino's comments in her gray statement that there will be an overlap between those phases and that we need to think about future phases as part of our current policy discussions. I am, therefore, grateful to staff for their consideration of the broader impact of the US fiscal stimulus package, including in their written answers to questions. Policymakers need to think about the present and the future in their decision-making to ensure that we can build forward in a sustainable and durable way. As Mr. Palotai said in his gray statement, we recognize the importance of

medium-term fiscal strategy and frameworks, as well as the adequate policy space in the short term.

As we said in our gray statement, we very much appreciate having the report on macroeconomic developments in low-income countries published alongside the flagships. We have always struggled to ensure that LICs are properly covered in the flagships documents, and for us this seems like the obvious solution. As we said in our gray statement, given the urgency and importance of the issues facing low-income countries, we will want to consider how to ensure appropriate coverage for our discussions in the fall.

We will discuss the substance of the LICs report tomorrow, but I do want to echo the important points made by Mr. Buisse in his gray statement on considering how private flows can be mobilized to stimulate private-sector development in LICs and his related point about the importance of encouraging countries to address underlying debt vulnerabilities and not to delay adjustment in institutional reforms.

We strongly support the message in the Fiscal Monitor on the importance of vaccine rollout, and we join other Directors in making clear the importance of a comprehensive vaccination strategy to cover the most vulnerable populations. The UK has contributed 540 million pounds to COVAX and has committed to share any future surplus with the COVAX procurement pool. As Mr. Gaspar made clear this afternoon, vaccines offer hope of an escape from the pandemic, but global access and rollout need to progress rapidly to arrest new waves of infections and any deterioration in the outlook.

To make some detailed comments on the GFSR, as ever, the Bank of England are keen to ensure that the language is just right, and here we support the comments from Mr. Fanizza and from the ECB representative in their gray statements.

On capital and liquidity buffers, we appreciate the existing constraints to buffer usability, but consider it critical for banks to use their buffers in order to support the recovery. On macroprudential policy, we are concerned that the message in the executive summary could be read as a general message to tighten, which would be inconsistent with the Fund's overall policy advice not to withdraw support too quickly. On both issues we agree with staff's analysis and simply emphasize the importance of nuanced language, including in the Executive Summary.

Finally, I would like to echo the points made by many Directors in their gray statements on the importance of the Fund's work on climate change and the important role that the Fund can and must play in advising the membership on a green recovery. Here I very much welcome the remarks that the Managing Director just made, and I very much look forward to the October flagships.

The Chair:

I recognize the point that Ms. Riach made and others that we have to be very prudent in how we balance attention to the most vulnerable low-income countries, some emerging markets with particular vulnerabilities, but also attention to the rest of the emerging markets, to advanced economies, in this still highly uncertain environment. I can assure Directors that in our internal discussions, we try very hard to build that fairness in the way we treat countries. Of course, I appreciate the attention that comes from central banks through Directors to balance the clarity of messaging.

Mr. Bevilaqua:

We have issued a detailed statement, and I want to add the following remarks.

Despite high uncertainty, the recovery may be less gloomy and less divergent than what the WEO currently expects. As a matter of fact, the global outlook continues to improve between WEO updates. This pattern seems to require some reflection on our part. Of course, it is sensible to make conservative assumptions during uncertain times, but we also need to learn from experience and give proper weight to the evidence.

In January, during the last update, the global economy was clearly headed for a strong round of fiscal stimulus. Industrial output and global trade were already showing signs of pickup. At that point, the WEO forecasts were clearly conservative. This time around, countries lagging in vaccination or imposing new containment measures, may once again resort to effective policy action. Hopefully, this may lead to activity surprising on the upside with the cumulative effect of new rounds of stimulus and the release of pent-up demand. Advanced economies fit this pattern better, while emerging market economies and low-income countries tend to face more binding fiscal constraints. Yet, there are important mitigating factors.

First, binding constraints usually provide a strong incentive to reform. For instance, in Brazil, Congress has just approved emergency spending coupled with medium-term fiscal adjustment mechanisms. Congress also approved the formal autonomy of the Central Bank. I am certain that other countries have similar examples.

Second, informal labor markets are large in emerging market and low-income countries, and their recovery may surprise on the upsides. The key point is to ensure that a large fraction of the population is vaccinated so that contact-intensive activity can be restored. Formal labor markets have also reacted well to fiscal and especially credit support measures implemented in several countries. In Brazil, for instance, we saw net creation of formal jobs last year.

Third, the international community is gradually moving in the direction of providing additional support to the most fragile economies. The Fund is moving quite fast to implement a general SDR allocation that will relax external constraints where they are binding. The COVAX initiative continues to gain traction and more engagement is expected. Of course, there are still important downside risks to this scenario, such as an abrupt tightening of global financial conditions on the back of a faster-than-expected recovery, especially in advanced economies. We welcome staff's analysis on monetary tightening in response to good news, claiming that the effects may not be as bad as widely believed.

Having said, that monetary tightening in key global economies often unleashes a period of turbulence affecting emerging markets economies. One must also acknowledge that uncertainty is unusually high, which could lead to overreactions in financial markets, as Mr. Adrian properly reminded us today. In this context, we welcome the policy advice that countries should rely on exchange rate flexibility, when possible, but not hesitate to use official reserves and prudential buffers to counter unstable dynamics.

One note of caution about how to look at the sovereign bank-nexus in emerging market economies. I agree that this is an issue that requires close attention. However, we need to go beyond headline figures and understand the particular workings of the domestic public debt market of each country. Similar ratios of public bonds held by banks may hide quite different situations in terms of risks and vulnerabilities. In most countries which issue their own currencies, public debt remains the risk-free asset par excellence.

Let me finish, with a few words about Brazil. The Emergency Aid Program was designed to provide quick and effective crisis support to households and businesses. It was not conceived as a tool to provide standard fiscal stimulus to the economy. However, as a result of fiscal and financial emergency support, Brazil has been one of the fastest economies to recover from the lockdown recession last year. Currently, vaccination procurement has been relatively slow, and a new wave of the pandemic is hitting the country very hard. But there are upside risks. As the supply of vaccine picks up, deployment will be relatively faster and effective given Brazil's proven track record in mass vaccination campaigns.

Finally, as I mentioned before, the new round of emergency financial aid came together with a constitutional provision for medium-term fiscal adjustment mechanisms. Nevertheless, the risk premium in Brazilian assets has been considerably high, and this has led to a higher than usual passthrough of international commodity prices to domestic inflation by hindering the traditional buffer channel of exchange rate appreciation. The central bank has reacted recently, raising the policy rate to prevent potential second-round effects of higher current inflation and keep inflation expectations in check. There are important challenges ahead, but with vaccination picking up, my country will be on a sound ground to pursue a strong, sustainable, and inclusive recovery. I will stop here.

Mr. Mouminah:

Let me commend Ms. Gopinath, Mr. Adrian and Mr. Gaspar on the ability to forecast given the level of uncertainty and the new approach used, and I think that was actually quite impressive to give the numbers, at least to the best of their knowledge, to the level they did. Also, the cohesiveness of the messages between the three reports, that was very much appreciated this time around, so highly appreciate that. I will speak shortly on two issues: trade and financial sector, and then a few other comments as well.

On trade, we see acceleration in the global trade due to the rebound in merchandising volume, a very positive development for the global economy. Global trade that is more open and less restrictive would be instrumental in a fast recovery and for building back better. In this context, facilitating a supply of health products and vaccines and its free movement across borders should be an immediate priority to beat the virus worldwide and exit the crisis and, more importantly, to prevent the risk of new mutation.

More broadly, enhanced global trade can underpin sustained economic growth and development. It can be a key to help aid emerging market developing economies increase investments, job opportunities, and ease balance of payments pressures. As Managing Director rightly underlined in her recent speech, a rebound in trade if it is managed well can lift growth and living standards in developing world, just as it did over the past four decades when the world experienced eleven-fold expansion of global trade. In this connection, structural reform in emerging market developing economies will be of paramount importance to further improve the business climate, promote competitiveness, and ensure a level playing field governed by transparent and predictable rules.

Second, on the financial sector, while accommodative monetary policy and liquidity support helped in easing global financial conditions to mitigate the immediate impact of the pandemic, it increased the downside risks in the longer-term, as staff rightly highlighted and reemphasized by Mr. Adrian in his presentation.

Depending on the country circumstances, tightening of selected macroprudential tools will be key to addressing emerging risks. At the same time, we take note that the development of general framework for targeted macroprudential policies for nonbank financial intermediaries is still in the early stage with FSB and the Fund and various other bodies weighting in. I thank Mr. Adrian for elaborating on this again during his presentation.

We agree that there is a need for greater emphasis on the risk associated with a premature withdrawal of policy support, but the key question is: how to distinguish viable firms from nonviable, when withdrawing policy support will be critical during the post-pandemic recovery. Here, low institutional capacity in many countries will be a challenge and can lead to unintended consequences. In particular, the divergence impact of the pandemic on certain nonfinancial sectors and on the job reallocation, which can result in re-deepening firms that are not viable. While we agree that the private sector is often better equipped to examine the viability of businesses than the public sector, more granular staff advice in country cases will be helpful with respect of withdrawing support for nonviable firms.

I have two other observations in the form of question. Did we evaluate the role that automatic stabilizers play during the pandemic phase? And how can we utilize country experiences to expand it and to be a shock absorber going forward?

Second question is, even with availability of vaccine, we heard a lot of continued resistance from people and groups to take some of these vaccines, but can we advise actually on how to prioritize after getting the priority groups vaccinated based on contact-intensive sectors or based on economic activity? How to guide some countries of how to push that to make economic recovery better, a point that has been made by Mr. Bevilaqua before me.

In Chair's comments on climate change, I think that is coming strong. I think this is very much welcome, but let's keep in mind that in our approach, we need to be inclusive to all membership and take a consensus-driven approach using principles agreed on the Paris Agreement. We agree with the vaccine to be the best return on investment.

Mr. Buisse:

Let me make a few comments to complement my extensive gray statement.

First, we share staff's slightly more optimistic view of the outlook. As Chair rightly pointed out, the global economy is at a fork in the road, and the question is whether we are going to succeed in preventing the great divergence. The projections of per capita income losses are quite striking, especially for the LICs, which is a strong call for action.

Second, on the macro, I would like to insist on, one, monitoring the risk of taper tantrum and markets correction. It will certainly remain important to closely monitor asset prices and any sign of early stretched valuations; second, paying attention to commodity prices. With higher prices helpful for exporters, of course, they are contributing to food insecurity and exacerbating poverty challenges.

Finally, I share staff view that on inflation there is not a lot to worry about in the short-term, but, of course, we have to remain vigilant.

Third point, we fully support the importance of maintaining an accommodative policy mix and a smooth transition in an incredibly uncertain environment. We clearly learned from the GFC. However, fiscal policy should remain agile and adjust to the pace of the recovery with a gradual shift towards more targeted actions, as well as more sustainable fiscal frameworks once the recovery is underway.

We call on staff to continue to help our authorities phase the tradeoffs, namely fiscal support versus sustainability, monetary support versus financial risks, and risk of zombification. It is very adequate to call for fiscal anchors in the medium run and for enterprise support triage, but the Fund's help is needed to specify and tailor this advice. Rising inequalities have to be taken into account, of course, and we would like to see further details on labor reallocation in future surveillance work. The WEO rightly stresses that automation trends have accelerated. Whereas countries are precisely usually not that efficient and pretty slow in retraining people for new skills, this is particularly worrying, in my view.

Fourth, we commend staff for their work on a more granular approach to policy mix and on scarring effects. We are also looking forward to the External Surveillance Review to have an even better view of the global imbalances and their implications. We remain concerned with the high gross financing needs of a few emerging and LICs. The difficulties a few countries have, to service that debt, are obvious. The DSSI has been most helpful, and now we call for the swift implementation of the Common Framework. It is also clear that the swift SDR allocation is badly needed and that we need to drastically step up the Fund concessional financing. For some frontier markets in particular, the role of domestic factors in the sovereign spread increase and near-term debt vulnerabilities are a reminder that countries' commitment to act on the domestic front is paramount.

Finally, we fully agree with staff that international cooperation is vital to make progress, including on vaccination, climate, trade, and international taxation. Let me follow Mr. Poso in recalling that the EU and its member countries provide over half of all global development, and the EU is the largest vaccine exporter in the world. We can only succeed together.

Mr. Merk:

We generally share staff's view on the global economic outlook. We agree that fiscal policy must be flexible and supportive of health systems, vulnerable households, and the economic recovery until we make enough progress towards sufficient inoculation of our societies.

We agree that targeted and transformative public investment and structural reforms should be important elements of the policy stance. Expansive policies are the right course of action in the crisis and cannot be abandoned prematurely. At the same time, we need to be aware of debt sustainability in the medium- and long-term. In times of economic upswing, it

will be key to rebuild fiscal buffers. On monetary policy, I would like to echo Mr. Hilbers and stress that the credibility of monetary policy frameworks remains vital to keep inflation expectations well anchored.

On financial stability, we note the unprecedented policy support may have unintended consequences by creating potential macrofinancial stability risks down the road. However, in order to avoid cliff effects, support measures should not be terminated prematurely and simultaneously. Macroprudential policy should act preemptively.

We agree with staff that inequality is a critical topic. In this respect, we underline the importance of better incorporating inclusive growth and inequality in the Fund's surveillance.

Lastly, Ms. Shortino and many other Directors rightly underlined the importance of the global rollout of vaccines, and we thank Mr. Poso and just right now Mr. Buisse for highlighting the European Union and its member states' decisive global response to that end.

Mr. Sylla:

We have issued a gray statement in which we indicated that we share the key messages and policy recommendations in the reports and would like to make the following comments for emphasis.

We very much welcome the strong recovery of the global economy in 2021 projected in the World Economic Outlook report. However, all risks are tilted on the upside due in part to the vaccine rollout in several countries. Like many Directors, we emphasize the importance of avoiding a premature withdrawal of policy support given that uncertainty remains very high.

The support provided by the Fund and the broader international community during these unprecedented times should be maintained until the world economy fully recovers. The pandemic continues to have severe and long-lasting socio-economic effects on emerging market economies and low-income countries, accentuating their divergence with advanced economies.

Easing access to vaccines will be key to a strong and sustained recovery. In this regard, we welcome the multilateral effort to support the COVAX initiative. Like Managing Director rightly said, we are all in this together.

We fully support staff's key policy advice in the Fiscal Monitor on the need for a careful calibration and tailored policy support to country circumstances to achieve macroeconomic and equity objectives. Policymakers are confronted with broad tradeoffs, especially the low-income countries, which entered the pandemic with preexisting vulnerabilities and limited policy space. The first major dilemma is finding the right balance between continued policy support of the economy and protecting the most vulnerable of their population while preserving debt sustainability.

As mentioned by many Directors, we would like to emphasize that strong global cooperation is critical for LICs to gain access to affordable COVID-19 vaccines, as well as grants, concessional financing, and where it is feasible, debt restructuring, so to ensure durable recovery and limit divergences across countries and within countries. Most importantly, the new SDR allocation and the successful implementation of the G-20 Common Framework are necessary to help support economic recovery and meet development goals in those countries.

Let me again thank staff for the deeper analysis of developments in frontier markets in the GFSR. My main takeaway from the report is the candid recognition that many frontier markets with large financing needs and high debt vulnerabilities do not benefit from recent debt relief initiatives because they are simply not low-income countries. Their exclusion from those initiatives is hard to explain in our view. When access to international capital markets is constrained for those countries, despite favorable financial conditions, we cannot also let them out of the international debt relief initiatives in this exceptional pandemic environment.

Something must be done to help them get through, and we strongly urge the Fund to take the need for this front like it has done on several occasions during this crisis and making those international initiatives available for these countries. Our Chair, with others, has already reached out regarding small middle-income countries which present peculiar circumstances, most of them being frontier markets.

We look forward to management consideration of ways to support this group of countries and accept future reports to further deepen their analysis of frontier markets. I will end by commending Managing Director for her leadership and the Fund staff during this crisis. The Managing Director has done so much that, as one of my seniors in my village in Africa used to say, the reward for a good job, is more work.

Mr. Palotai:

We greatly appreciate the high-quality work on these reports and also the comprehensive responses to technical questions and the prerecorded presentations.

Let me first comment on the new forecast, which shows a slightly improving economic outlook. We caution that the new waves of the pandemic are posing new near-term challenges to many countries, which could not yet have been fully recovered in the WEO. Even though certain sectors are adapting better to recurrent lockdowns, the new virus strains and the slow vaccination campaigns threaten the recovery. Given that rapid and widespread vaccination is key to exit the crisis, we would place even greater emphasis on what the global community can do to scale up vaccine production capacity and accelerate the access to this global public good.

There is a great need for ambitious development plans to restart the economies, as this crisis significantly exacerbates divergence across and within countries, as rightly highlighted in the WEO. In our view, priority should be accorded to jobs recovery, and policymakers should also redouble the efforts to promote frontloaded investments in key sectors, also paying attention to stages of recovery. Otherwise, the hard thing of convergence in GDP per capita could have serious implications for the vast majority of EMDCs, which also make them more exposed to spillover effects.

We do appreciate staff's emphasis on the long-term effects of the pandemic, both from the economic and health points of view. Going forward, we would see the benefit in more granular policy recommendations to mitigate scarring and facilitate resource allocation.

Let me just say briefly on monetary policy normalization, which in advanced economies will pose a challenge to emerging markets owing to the risk of capital outflows and rising debt service costs, as well as to currently highly leveraged nonfinancial corporations in both advanced economies and emerging markets, all this has been reflected in the recent increase in sovereign bond spreads.

On fiscal policy, enhancing resilience of emerging markets' fiscal position will be crucial in the next stages of the pandemic. While the buildup of vulnerabilities in the corporate and commercial real estate sectors could be mitigated, practical policy obstacles would, however, need to be overcome.

As the new macroprudential measures in several jurisdictions, including the European Union, take time to put in place, the leaning-against-the-wind argument becomes slightly less feasible and convincing. Adopting a risk-based approach distribution of support to firms will be critical to avoid the zombification of the real economy and prevent a buildup of NPLs in the medium term.

Finally, with divergent pandemic effects and recovery path, the policies need to be country-specific and tailored to circumstances, while not losing sight of the need to transform the economies and tackle risks stemming from the buildup of financial and fiscal responsibilities. Corporate sector conditions will remain vulnerable and should usefully guide decisionmakers on the pace of rolling back emergency support and beefing up policies to smoothen the reallocation of labor and capital.

The Chair:

Just to recognize that the Board would see in our upcoming work a great deal of attention of these potential risks that may come if we are not well prepared for the gradual withdrawal of support, and especially the problem of zombie firms. So, thanks to Mr. Palotai for emphasizing that particular issue.

Mr. Trabinski:

We broadly share their assessment, and I would like to add just a few very brief points for today's discussion.

First, we join all other Directors in stressing the importance of quick progress with vaccine production and distribution for a return to normalcy, and as Mr. Huh and others, we would like to emphasize the importance of international cooperation for a successful outcome, especially to help emerging markets and developing countries.

Second, we agree on the need to calibrate policies to the phases of the pandemic and recovery and to prepare credible medium-term fiscal frameworks to tackle increasing debt levels. The pandemic crisis has exposed longstanding structural vulnerabilities, and the exceptional policy support helped to mitigate the impact of the crisis, but it cannot be expected to last for long.

On the positive side, the experience from previous recessions such as the crisis could prevent an opportunity to tackle structural deficiencies, also

increase productivity and improve the allocation of productive resources, thus setting the foundations for a sustainable recovery. We see the Fund as playing a key role on policy advice in this regard.

Third, we fully share the message that fiscal policy support should be geared towards viable firms and growth-enhancing sectors, and this point has been very well tackled by other of my predecessors, including Mr. Palotai. We agree on the need for a gradual withdrawal of support to avoid sudden cliff effects and allow for enough time for the sectoral reallocation of resources. Policymakers should use this time to upgrade debt resolution regimes for distress firms.

Finally, we agree with staff that public investment, given its higher multipliers, should remain an important policy element to ensure strong and durable recovery. This is specifically important in the context of the gradual transition to a greener and more digitalized global economy. We note that the Fiscal Monitor recommends using higher carbon taxes to help finance investment projects aiming at mitigating climate change. However, since carbon taxes tend to be regressive in many countries, revenues from them should be primarily used to address redistributive issues. In our view, such investment projects should be funded by the ordinary budget.

The Chair:

Just one small footnote on carbon tax. Yes, it is regressive. The more incentive one provides, the less emissions there are, but they could also be progressive if one has a gradually increasing carbon price, a carbon tax that offsets the decline in emissions. Just to be sure that we recognize the ambition of the Paris Agreement in such that progressivity and regressivity may be a bit more mixed.

Mr. Hosseini:

We have issued a comprehensive gray statement. There are many issues, but I will limit myself to a few key points for emphasis.

First, the COVID-19 crisis has been like no other, and the global policy response has also been like no other. As tragic as the human toll and as significant as the economic costs have been, the global, synchronized, nimble, and forceful policy response prevented a much worse outcome. Still, tens of more million people were pushed into extreme poverty and food insecurity on the top of millions already struggling. The uneven recovery has also widened

the income gap between and within countries and worsened age, skill, and gender-based inequalities.

Second, we are encouraged by the signs of global recovery, but significant uncertainties cloud the near-term outlook. Most notably, we are very concerned about the third wave of the virus, its mutations and unpredictability, and the uphill battle to contain it in some regions. A few countries have procured enough vaccines to cover their entire population, and in a few cases many times over. At the same time, there are many financially strapped low-income countries that have to rely on vaccine donations and COVAX. Recent reports of bans on export of vaccines and related medical supplies are very disappointing. Vaccine nationalism has no place in this crisis.

Third, the coordinated global policy response helped to pull the world economy back from the edge of the crevice. It should also lead us through the recovery. The withdrawal of stimulus should be synchronized and be implemented in a calibrated manner in tandem with the pace of the recovery. It is advisable to err on the side of caution because the cost of failure is immense.

Fourth, financially constrained low-income countries are facing a daunting task to bring their economies back on track and meet their development goals while managing their debt overhang. The 2030 SDGs are probably already beyond the reach of many of them, this despite their best efforts to mobilize domestic revenue and improve governance. As it did during the emergency phase, the Fund must again rise to the challenge and serve its pivotal catalyst role. Bilateral and multilateral financial support on concessional terms and grants has been critical for low-income countries during the emergency phase and will remain equally, if not more, critical in the recovery phase.

Finally, the expansion of the Fund's toolkit and debt service relief extended important lifelines to many countries during the pandemic. The Fund must be adequately resourced to meet the upcoming challenge and the large financing needs of the EMDCs in the post-pandemic period. We welcome the new round of SDR allocation and its angle of supporting the low-income members. The Fund's main resource base is, however, its quotas, and with that in mind, we look forward to successful completion of the 16th General Review of Quotas.

Mr. Bhalla:

Making forecasts under the most uncertain and unknown times is an unmanageable task, and the staff through the reports have excelled. We broadly agree with the staff's assessment of prospects, risks, and policy prescriptions, and I will make just a few observations.

The key theme emerging from the presentations and the reports is the divergent recovery paths across the advanced economies, emerging markets, and low-income countries. Slides on the global economy vividly bring out the point that the scale of the fiscal support measures very likely put a floor on the collapse of growth. There are striking differences in the fiscal support across the advanced economies, emerging economies, and LIDCs. How far the differences in fiscal stimulus explain the "divergences" in the medium-term outlook losses across these groups of economies is something that can provide insight for future crises. An assessment of whether the fiscal responses, particularly of the emerging economies, were limited by the fiscal space available to them, or was there an overall fiscal conservatism in expanding the support would also be useful.

The outlook has highlighted mitigation efforts towards climate change. As in the case of the October 2020 WEO, we reiterate our position that any discussion on mitigation necessarily needs to be accompanied by climate finance, requiring significant coordination across the countries. In a situation when many of the developing countries are falling far behind the SDG goals and are facing long-term pandemic scarring, the challenges of meeting adaptation and mitigation can be minimized but if and only if the developed countries follow the principles of distributive justice, equitable burden-sharing, and adhere to their commitments of providing accelerated climate finance and low-cost technology transfers to the developing world.

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 two degrees compliant, and it has taken many decisive actions to fight climate change. India's targeting of reduction in emissions by 33 to 35 percent of its gross domestic product by 2030 from 2005 levels and 40 percent of installed capacity from non-fossil fuels by 2030.

India's vaccination program demonstrated strong indigenous capabilities and productive global cooperation. Apart from administering a massive domestic vaccination program, our authorities have been expanding

global vaccine supply by providing about 60 million supplies to 76 countries, mostly low-income and emerging markets. This includes the supply of about 17 million doses to COVAX global initiative to provide equitable access to vaccines.

It now appears that there may be an excess supply of vaccines for the world at large but not in its distribution. This is a challenge for the international community to make good in its goal of equality.

Mr. Fanizza:

We were really clear in our gray statement, maybe a too-long gray statement, but the bottom line is that we agree with almost everything, and we support very much the policy advice that comes out of the report, tailoring, as many people already said, policy advice to the conditions of the fight against the pandemic, which is different according to different countries. That is the bottom line.

I would say one point, reading the report recently in light of the recent developments, I would say the tone, which is rightly upbeat because it stresses the importance of the progress in the economic outlook that is there and the situation in many countries where actually they are in the grip of the problems from the pandemic. In Europe, frankly, we are exactly where we were a year ago in terms like that, and that is very frustrating, and for a moment I thought that maybe we need to be a bit careful on the communication, not going to be too upbeat. That is a minor suggestion, but I think we should keep that in mind.

Everybody has said the top priority is accelerating vaccinations. I couldn't agree more, but I just wanted to share for the discussion a sense of the size of that issue. I ran into some market research that points out that each week of delay in vaccination rollout reduces quarterly nominal GDP growth by .04 percentage points. This means that practically for Europe where the delay is estimated at 5 weeks of delay, this has a cost of a 2 percentage, already of 2 percentage points less growth in terms of nominal GDP. In other words, the rate of return of vaccinations is 400 percent. That I think simplifies the importance of putting all energies into that. The important thing we have to do is taking care of people, and making sure that firms continue to operate and do not disappear; and at this point, frankly, I do not think this is quite an issue of demand management, but it is just of helping people and maintaining a live economy. Then when things will improve, we start to think about

everything else, and we fully agree on all the issues that have been raised and on which I do not want to dwell.

Another thing I wanted to point out, we fully agree with the stance taken by the flagship. That said, it is a little bit early to cry wolf about the inflation. It is true there have been some increase, but they are still small, far away from the targets of many central banks in advanced economies, and very likely will be temporary. Actually, I wish these will become a more stable trends because it means the economy will change. Problems in the financial sector and also in debt sustainability will increase. I mean, the real problem in there is the lack of growth and as we have said many times.

The last point that I wanted to raise is what I usually call a parochial point, and it refers to mentioning single countries. When we talk about tourist-dependent economies, I would advise against doing that. We can still talk about the dependence because it is an issue, but if one is trying to think of a country, immediately two of my countries were singled out in the text. We very much appreciate that we did not do that because immediately then the question is why us and not the others? Things like that. It is a percentage.

With that, thanks again for an excellent job and excellent leadership on providing sound policy advice to our countries.

Ms. Mahasandana:

As we have issued a detailed gray statement broadly supporting the assessments and the policy priorities, I will focus my comments on policy advice and the role of the Fund to ensure sustained and inclusive recovery.

First, while the global economic outlook is improved, uncertainties remain high. Members need to ensure that withdrawal of policy support is done appropriately at the right time. Premature withdrawal of policy support could disrupt recovery and deepen scarring, while prolonged policy support could result in macroeconomic and financial instability and inflationary pressures in the medium-term for a few countries.

Although I agree that the current situation may be too early to communicate on the exit policy, but member countries should be prepared. In this regard, we view that Fund advice on the near-term policy support and the plan for policy normalization, particularly on timing, sequencing, communication strategy, is imperative to support smooth global recovery. We

fully support that this should be done on the approach of the country-specific tailored policy advice, as highlighted by Mr. Gaspar in his opening remarks.

This leads me to my second point on divergent recoveries between advanced countries and emerging market economies as a cause of concern. From a risk perspective, divergent recovery and earlier-than-expected policy normalizations in advanced economies could trigger large capital flows and exchange rate volatilities for emerging markets similar to the Taper Tantrum episode. In this regard, we look forward to implementation of Integrated Policy Framework (IPF) and the review of the Institutional View (IV) to equip emerging markets with greater flexibility in employing an optimum policy mix to address volatile capital flows in current challenging environments.

The Fund should also closely monitor potential spillover from policy changes in major advanced economies on the emerging market economies, especially those with large external financing needs. It can also play an active role to foster global coordination when the times comes for policy normalization.

From the distributional perspective, emerging markets and low-income countries are falling further behind advanced economies with rising inequality and poverty. This calls for stronger members to provide more assistance to help weaker members recover from the crisis, including through the use of their SDR allocations. The Fund should also double its support for members hit hard by the pandemic, including giving greater focus on issues faced by low-income countries, small island states, and tourism-dependent emerging economies in surveillance and policy advice.

Third, close coordination between macroprudential policy and monetary policy normalization is key to ensure smooth exit from the crisis. We encourage staff to deepen analysis on the interactions of macroprudential policy with other policy tools. This will help enhance Fund's advice on appropriate policy mix to ensure favorable financial conditions for recovery while containing buildup of risk.

Mr. Herrera:

I will echo Mr. Fanizza that there are reasons for joy and sorrow in the spring reports; joy that vaccination is already happening and making progress day by day; joy that the looming recovery of advanced economies appears to be strong and is expected to be almost complete by the end of next year, and joy that many of the lessons of past crises have been learned. Policy support in

advanced economies has been timely and unprecedented in scale and appears to have avoided lingering scars this time around.

However, there are also reasons for sorrow in these reports; sorrow that vaccine availability remains highly uneven across countries, and global inoculation will take at least two more years; sorrow that the recovery of EMDCs will be slow and incomplete due to limited policy support, slow vaccination and scarring effects; and sorrow that the pandemic crisis is hitting harder the most vulnerable groups within countries.

In terms of the priorities and policy advice, I would echo other Directors and stress the importance of sustaining strong international cooperation to ensure a solid, sustainable, and broad-based recovery. Three key areas are vaccine distribution, policy coordination, and liquidity support.

First, as many Directors have stressed before me, international cooperation is vital to ensure a fast rollout of vaccines across the world, which in turn will hasten the recovery and limit the sting of scarring effects in these countries and also reduce the risk of new variants of the virus.

Second, international coordination of exit policies will be critical in a multi-speed recovery with differential policy space across countries. The calibration of future policy actions in advanced economies must carefully consider both domestic conditions and international spillovers. Clear forward guidance and communication from advanced economy central banks will be crucial to avoid an abrupt reassessment of financial conditions, public debt sustainability and capital inflows into emerging markets. I would also echo Ms. Mahasandana that coordination between macro and macroprudential policies in advanced economies, will be also important for this goal.

Finally, the international community must also ensure that those members that are facing severe financial constraints get adequate and timely access to external liquidity. We agree that many countries will need to strengthen the macro policy framework to rebuild buffers or to build additional policy space, but this will take time. In the meantime, these countries need a continued and frontloaded support to finance critical health expenditures, maintain adequate social policies, support aggregate demand, and limit scarring effects. We must avoid a lot of decade for EMDCs and especially for low-income countries.

Finally, the Fund must remain well-resourced to provide additional liquidity support to its members and flexible to continue adjusting its lending

tools as needed. A new allocation of SDRs will help to alleviate the external liquidity pressures among the most vulnerable members.

Mr. Moreno:

We have particularly liked the very well-chosen topics of the analytical chapters. Let me stress three broad issues, which we think are the main themes of this flagship cycle.

First, on the recovery, the reports are placing the right focus on divergence both within and between countries. And this was also highlighted by Ms. Gopinath at her intervention. Managing this divergence is the main economic policy challenge going forward. Notwithstanding that we still have a very high degree of uncertainty, and we are still seeing the risk of new contagion waves, of more contagious strains of the virus, the central scenario remains that advanced and large emerging economies with broader access to vaccines and larger stimulus packages are leading the way in an asymmetric recovery faced across countries, which will increase the already observed divergence, mainly with middle and low-income countries, and we can attest to that in our own constituency.

Our policy advice is going to become more complicated. We share the main theme of country specificity, primary focus on fighting the pandemic, gradually unwinding and better targeting support measures, and avoiding cliff effects; but the reality is going to become much more complicated, especially in countries with limited policy space and those more prone to spillovers from tightening financial conditions and rising interest rates in advanced economies, particularly in the United States.

We have already seen worrying signs in some emerging economies which are having to tighten, sharply tighten the monetary policy. Under this scenario, we have particularly welcomed the thematic chapters in monetary policy, spillovers, and risks to macrofinancial stability. We call on staff to strengthen the analysis and surveillance, peer pressure on these issues, but also in other key areas, and we would particularly highlight international fiscal coordination, which I think is not sufficiently mentioned in the report, to facilitate countries building their own fiscal space, the Common Framework for debt, which was highlighted by many others; and I would also stress the regulation of the nonbank financial sector, which was highlighted by Mr. Adrian at the beginning, which is at the center of the international capital movement, and a new look at the bank sector buffers to foster the usability.

Second, on the medium-term growth, resilience and sustainable growth are the main targets, and it should become a constant guidance in our policies. Again, large advanced and emerging economies are engaging in large transformational packages, including green and digital transitions. Here, we will stay tuned for the Fund's engagement on climate change. These countries are also engaging in new social welfare systems and pre-distributive measures to protect and improve the living standards of the most vulnerable segments of the population. Here we welcome Mr. Gaspar's signaling of the first subchapter, and we would like to Ms. Levonian's comments on taking a look at gender and the youth.

The transitions are going to be key to ensure medium-term macroeconomic stability, and they will widen the gap again with middle-income and low-income countries unless we support them. Here I would like to echo Mr. Sylla on the need to strengthen our efforts in these countries and also Ms. Mannathoko's calls for securing as much recovery for those.

The Fund is the main provider of advice, capacity development (CD), and finance to these countries, and we need to strengthen our efforts, including on strengthening the financing, the resources for capacity development, and the lending resources for more sustainable, inclusive growth, including the use of the SDRs, and we welcome Chair's leadership on these areas.

Finally, on international access to vaccines, they are the priority and the best investment. Mr. Fanizza has given us new numbers just now. The Fund has to be very outspoken in the importance of providing vaccines to our countries, including eliminating restrictions to exports. Here I would just like to echo Mr. Poso because I think there has been too much noise in the messaging of the vaccines within the European Union. I think we are having internal distributional problems, and we are addressing them, but it is important to highlight that the European Union is at the forefront of the contribution to COVAX, and it is the largest exporter of vaccines in the world, the only major OECD country that still has exports at a large scale. Mr. Poso has mentioned the figures. Let me highlight them again. We have delivered 70 million vaccines for European Union countries but also 43 million doses for 23 non-European countries. I think that the European Union has been a strong advocate of export of vaccine distribution and even distribution, and we are delivering on it.

The Chair:

Of course, it is fair to look at the picture of vaccinations with an eye on how we think of the bigger public good, how we all step up. I do hope that as advancements are made, there would be more willingness for even higher stepping up to accelerate vaccinations everywhere. The reality remains that we have 16 percent of the population in advanced economies that have booked 50 percent of vaccines at this point, and that is understandable in the first months because everybody has responsibility to their domestic constituency. We cannot ignore the fact that in Europe, people are not yet quite where they would like to be in vaccinations. I have family in Europe, and I can tell you it is hard, but at the same time we need to seek that sense of the collective, the force of the collective, and not to allow victory to turn into a defeat. We had an unbelievable success with our scientists working collaboratively. We have 11 vaccines that have passed Phase 3 trials and are getting into people's arms, and yet the sentiment is being built that somehow, we have not been paying our dues to that success.

I will share my personal view; it is that we have to turn our attention to production; not how we cut the pie, but how we expand the pie, and to be relentless on learning from each other how to identify barriers and remove these barriers. Directors called on us, and we are doing it. We are a very loud voice on the importance of vaccine policy, on the importance of getting vaccinations.

We are not the right institution to lift it up because there are others that are better than us, so I guess that was a long way for me to say because members here are members of all possible organizations, shareholders everywhere, keep everybody's feet to this fire because otherwise we will be in October, and we will be still talking about how we cut the pie, not how the pie has become bigger.

Mr. Huh:

All in all, we concur with most of the analysis in the flagship documents. As we issued a comprehensive gray statement, I would like to briefly highlight a few points for emphasis.

First, with uneven vaccine distribution and the policy space issues, upside risks are as important as downside risks. In particular, the instability of global financial markets seems to be rather higher in the case of upside risks with uneven recovery. Higher interest rates with the possible normalization of

the UMP could increase the burden of developing countries and possibly increase the volatility of capital flow with network and spillover effects.

Rapid financial digitalization could also strengthen such trends. In this vein, the debt vulnerabilities should be systemically addressed for a considerable time. At the same time the Integrated Policy Framework, Institutional View on Capital Flows, and macroprudential policies will be also important to properly respond to increased risks of nonbank financial institutions and international capital market. The policy advice should be granular while customized, comprehensive, forward-looking with sufficient CD support.

Second, with the rapid change of industrial structure on the labor-saving digitalization, the reform of labor markets, as well as liquidation of nonviable zombie firms will be main structural issue. The active labor market policy should be strengthened with education reform and remote work environment. At the same time, for social cohesion, enhanced and broadened social safety net, perhaps including the universal basic income scheme, should be considered to support flexible transition toward digital and green economy.

Finally, considering the pandemic brought serious damage on global and regional economic corporate system, the rules-based multilateral trading system as well as impaired value chains need to be strengthened.

Mr. Alhosani:

I would like to add our voice to other chairs in emphasizing the need for greater global cooperation to ensure global access to vaccines and to prevent new waves of infection and any related deterioration in the outlook for the pandemic. We concur with staff that the principal policy challenge for all countries is first to overcome the health and economic threat of the pandemic and then to recalibrate policies throughout the different phases of the recovery and to prepare medium-term policies for transforming economies toward more sustainable and inclusive growth.

The GFSR rightly echoes the main message of the flagship documents about the prospects of an asynchronous and divergent recovery between members. We particularly appreciate staff's work on the possible spillovers on EMDCs from a tightening of global financial conditions. If faced with sharp tightening of global financial conditions or large portfolio outflows, some EMDCs will have no choice but to resort to further asset purchase programs as well as the multiple tools considered in the Integrated Policy Framework,

as most of them do not have access to swap lines or regional financing arrangements.

We envisage a critical role for the Fund through rapid and flexible responses to provide financial support where and when needed. The potential SDR allocation and a program to voluntarily reallocate SDRs from countries with a surplus to those in need would also be of great assistance. We welcome the Fiscal Monitor's focus on the central role of fiscal support and preventing a more severe global economic contraction and in containing the pandemic's socioeconomic fallout. Continued flexible fiscal support is needed until a durable recovery is underway, and we join other Directors who cautioned against prematurely withdrawing support before the pandemic has receded.

Further, we concur with the report on the need for fiscal support to remain flexible and supportive of health systems, households, and viable firms. Public investment has an important role in fostering post-pandemic recovery, creating jobs, and increasing productivity. We agree with staff that fiscal policy should be geared to narrow these longstanding inequalities by strengthening social safety nets and improving effectiveness and efficiency on health and education.

Finally, I would like to second the comments made by Mr. Bhalla and Mr. Mousin on climate. After all, the nobility of the objectives of both protecting the climate and environment for the reasons we know makes it imperative to put the preservation of climate in the right operational framework, which when aided with political support, will respond to the aspirations of the public. This effort should be part of a comprehensive approach to the 2030 Agenda of Sustainable Development which deals in an integrated and interdependent manner with the achievement of human development and inclusive economic growth for all. Within a framework of governance and international participation, the effective implementation of this integrated framework should not be selective or partial.

Mr. Mozhin:

I would like to underline the very high quality of analytical chapters in each of the three reports. I believe that it is rather unfortunate that at this meeting we are simply unable to pay due attention to what is in these analytical chapters. Perhaps, we could consider repeating the experience of six months ago when we discussed analytical chapters in a special session at the quieter time after the end of the Annual Meetings. I would be interested in repeating this experience again in any format so that we could have a separate

discussion on analytical chapters.

The chapter on nonviable companies, the famous zombie companies, or the living dead, as they used to be called in the times when Japan was singled out and attacked by everybody for allowing those living dead to mushroom, is a very innovative and interesting chapter. The chapter on the ways and means of addressing the rapidly growing inequality I think is also quite remarkable and deserves a more focused consideration. This is, if you will, a proposal. Let's come back to these chapters and have a more comprehensive conversation on the findings which they present.

Regarding the main message of the Fund's projections, we have very much focused on this in our written statement. This message is about divergence in prospective growth rates, and I think that we really need to somewhat adjust this message and make it more balanced. Yes, it is true that there will be divergence, but divergence between whom? Divergence between regions and within regions. If we talk about divergence between advanced economies on the one side and emerging market economies and low-income countries, on the other, this message, first of all, can be harmful because this will be a signal to the markets. Secondly, it is simply incorrect and could be attacked by the outside observers. Even from today's presentations we see that many emerging market economies, in particular those in East Asia and Eastern Europe, will grow faster than advanced economies. About half of the countries will grow faster than advanced economies. There will be a continuation of convergence rather than divergence. I think we should speak about a divergence between regions and within regions rather than country groupings. That is my first point.

My second point is on the risks associated with the possible increase in market interest rates. This has already been addressed by other speakers, but I would want to add one specific angle and, perhaps, address it to Mr. Gaspar. I wonder what impact any growth in interest rates will have on the cost of debt service. Let's say 100 basis points increase in interest rates, what will be the additional cost for the debt service? At this stage, I am asking simply whether such estimates are possible at all and whether the Fiscal Affairs Department could take a look at this issue.

Finally, Ms. Gopinath showed us the projections for the main economies, and I wonder whether these projections, to what extent they are different from those in the Chapter 1 of the World Economic Outlook report. Such updated projections are what all our authorities are waiting for. I know very well that these projections remain confidential until such time when they

become no longer confidential, but this is something the authorities are very eager to receive from us. And I noted that presentations made today have already been circulated but without the projections. So maybe Ms. Gopinath could simply tell us to what extent they differ from what was provided in the Chapter 1 of the report, which also remains confidential.

Mr. Jin:

In addition to our written gray statement, I would like to briefly make several comments.

We welcome a possible faster-than-expected recovery in developed countries. Among these developed countries, a few countries such as US, UK, Korea, and Israel may recover even faster. The consequence of this imbalanced recovery, however, should be expected and understood correctly. Specifically, the impact of unprecedented fiscal and monetary stimulus adopted in the US will widen or will very likely widen its current account deficit and raise inflation sooner or later. The consequent withdrawal of supportive policies in the US could be earlier than the other advanced economies and emerging market economies. The world will very likely witness a coexistence of widening US current account deficit and a stronger US dollar before the imbalance eventually moderates.

As the Federal Reserve tightens its monetary policy, capital inflow will reverse in emerging market and developing countries, and their currencies will depreciate, so sharp currency depreciation and the capital outflow may trigger financial instability in some countries. To smooth out a possible dramatic up and down, the deficit countries should lift many excessive restrictions on goods and services, open tourist market, based on effective COVID control and cooperative mutual vaccination recognition.

Surplus countries could further open their market and facilitate import. We strongly suggest the Fund to send a clearer early signal in its flagship reports to help member countries form a rationale expectation and prevent damaging protectionist rhetoric. A timely issuance of SDR can alleviate the transitory shortage of international liquidity. We call for countries with vaccine production capacity or relatively more storage to share vaccines with EMDCs, and that will facilitate a more synchronized recovery of the world economy. China, together with several other countries, has provided millions of vaccines to dozens of countries. We believe it is important to avoid politicizing these humanitarian efforts.

The financial conditions in conditions in China have remained stable despite the impact of the pandemic, and like most other countries, China has implemented measures over the past year to help the most vulnerable people in the society. There are inevitable costs and buildup of financial vulnerabilities in implementing such policies, and this is not a unique tradeoff in China.

Thanks to the effective COVID control, the early and robust economic recovery has helped our country to gather more resources as early as possible to gradually alleviate and remove vulnerabilities. Taking this opportunity, I would like to clarify one more time that the Chinese government does not provide implicit guarantees to our SOEs. Any investor who purchased bonds issued by SOEs or make credit to SOEs in China based on perception of implicit guarantee should bear potential legal and financial consequences by themselves. We hope the official documents of the Fund can help investors to avoid unnecessary misunderstanding in this regard.

I welcome the methodology used in the Fiscal Monitor in estimating the public debt of China. I think this approach more pragmatic and reasonable than the approach underlying the augmented government debt used in China Article IV report.

We welcome the analysis in income inequality in Chapter 2. China has made considerable efforts in addressing income inequality. Around 770 million Chinese people have been lifted from absolute poverty since the reform and opening up in 1978, accounting for 70 percent of global poverty reduction during that period. I think this is also China's contribution to global efforts to protecting and elevating human rights. We will be always grateful to those who helped us in other parts of the world in this process, and in return, we will be able to make more contribution to promote development and stability of the world economy.

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

Thanks, everyone, for the very thoughtful comments. Let me respond in the three buckets of the outlook, risks and policies.

On the outlook, relative to what is in the version Mr. Mozhin has, global growth is now at 6 percent for 2021 as opposed to 5.9, and there is no change for 2022. The reason for the 0.1 percentage point increase is mainly coming from China where we have China going from 8.1, which is what is in

the version Directors have to 8.4, but otherwise not many other major changes.

On the question of divergences, Mr. Mozhin was very clear in his gray statement. It is absolutely right that the divergences, like I said, is not only an across-income-block divergence, but it is true within advanced economies. It is true within emerging markets. There are diverging speeds of recoveries. But we do have the case that about 50 percent of emerging markets and developing economies that were projected to converge to advanced economy per capita incomes based on our projections pre-COVID, are now expected to diverge, so there are a bunch of countries where that is, indeed, happening.

Importantly, while it is the case that many emerging markets will obviously grow in the medium-term at a higher per capita rate than advanced economies, the point is that they are falling well behind where they would have been in the absence of this crisis, and so since one is starting from per capita levels which are lower than advanced economies, and they are getting a bigger hit for several of them, this is an important issue. I agree with Mr. Mozhin that there are divergences all over the place, and so we have to be careful about how that comes across.

Mr. Bevilaqua asked about whether we were being conservative again, which is interesting. The IMF is usually critiqued for being too optimistic. I think we are getting the view we are being too pessimistic. The change between January and now really comes from the US package. In January, while it was clear that there would be a package, we were not in a position to tell what the magnitude it would be and what shape it would take. So just through consistency of practice and how we do our forecast for other countries, we could not possibly have put that in there. The change is really to a large extent the US package.

Mr. Mouminah asked about the estimate of the impact of automatic stabilizers. I do not have a number, but we do know that all the discretionary fiscal support and financial condition support and all of that prevented global growth in 2020 from being three times worse so like around -9 percent; and that is including the automatic stabilizers. We know that the automatic stabilizers played a very important role, especially in the euro area. The policy support was quite considerable.

Mr. Bhalla asked about fiscal policy and the diverging prospects, and this is there in Chapter 2 where we show that all else equal, countries that did more above-the-line fiscal support are expected to have somewhat faster

recoveries. There are many moving parts here, but there is evidence that shows that controlling for a bunch of other things, that this is, indeed, the case.

In terms of risk, Mr. Fanizza brought out the third wave in Europe. That is an important issue. I do not think we are out of the woods. We still have the likelihood of a serious third waves. I think the plus is that we, in at least parts of the world while vaccines are widespread, we can see that they are working, and we still do not have a variant that seems to completely escape the vaccine. I think that is the hope, but we are certainly not out of the woods.

Let me jump to policies, and here I want to respond to a couple of questions that came up in the gray statements that we did not respond to in writing but I want to do so in person.

If we think again on policies, which are the top five policy measures, I will say, the first five are vaccines. It is almost entirely about getting that right. Given the fact that multiple vaccines have succeeded in terms of their efficacy, if one looks at the projected production that is coming online in 2021, it is at least 10 billion doses, and so that is what companies are projecting that they will have out there in terms of the supply of doses, 10 billion, and the planet has 7 billion people, so 10 billion is not a bad number.

The problem, of course, is that what the vaccine industry is trying to do is 10 billion plus what the normal non-COVID year it would have produced 5 billion doses of other kinds of vaccines; so they tried to produce 15 billion, which is three times the number of doses they produce in a normal year. It is not surprising at all that we are running into production difficulties, input scarcities; and, in fact, they had spillovers to other drugs because there are a few inputs that go into vaccines that get used in other drugs, so other important drugs are not being produced.

This problem will only be solved if countries and companies work together so that one can think ahead about where the bottlenecks are, because they will happen. It is highly unlikely that we will have a smooth rollout for 10 billion vaccines between now and the end of the year. Unless there is that absolutely coordinated action across countries and with companies in the production state of the vaccine, but also the input suppliers, one will constantly see that the targets are not being met. I worry that such a kind of collaboration still does not exist.

The second issue is the inequity in access, and there is no clear mechanism or agreed-upon mechanism for how to transfer the surplus vaccines, how to make that at least equitable. There is a very strong case to make sure that 20 percent of the population everywhere in the world, the most vulnerable, get the vaccine. That is the best way to avoid variants, and, again, that has not been solved. Unfortunately, the problem is very clear, and what needs to be done seems somewhat clear, but it is not happening.

The second question that comes up is in terms of how do you deal with policy, in general, in these times of high uncertainty when people are at multi-speed recoveries and deciding when to withdraw support and so on. I think this is obviously a big challenge and a social risk going forward. Again, I think the issues are one is uncertainty. Uncertainty means basically being flexible. One is going to have to say that if I have to come back in and re-provide support, I am going to have to do that. Even if I have decided that I am going to cut back on spending this year, one might have to change their plans.

Countries that have high debt, where they were already accumulated, nobody can accuse anybody of not repeating the mistakes of the GFC. This is off the charts compared to the GFC in terms of the support that was provided. The crisis is not over if countries have high levels of debt. The way one can manage that risk is having a credible medium-term fiscal framework, being very clear about how is it that one can support the kinds of expenditure that has been done at this point. And because we see very diverging recoveries even within countries, I think tailoring is crucial. Tailoring to country conditions is very crucial. Tailoring to within the country. One will see some workers getting back to work very quickly. A few others will be falling behind, so targeted support will continue to be needed.

Again, policies that kind of have an automatic feature to it, which is as the labor market improves, they automatically come off, those are easier ones. The ones that do not have cliff effects, that go from 100 percent to zero, those are the ones that work a bit better; and at least for this pandemic, there are a few clear markers which is if one gets into certain levels of vaccination and one is seeing durable levels of declines in number of hospitalizations, and hospital spare capacity is back to where it was before this crisis for some period of time, so if those markers all come together, then there is a very good argument for one to make the transition.

The last thing I will talk about is a point that came up from several Directors about the Integrated Policy Framework and about what should

countries do in a situation of these diverging speeds of recovery, the possibility of faster normalization in monetary policy in the US than was expected last year, how should countries respond. So obviously this requires all the players to be involved. Let me just very briefly speak to this, and we can go into detail more in bilateral discussions.

Let's start with, for instance, the emerging market block and how they should be responding. First thing, what the IPF makes very clear is how one responds depends upon the shock, and it depends on the country characteristics. As I see, there are three scenarios here. One scenario is one could think of is where we are now, which is interest rates have gone up, but they have gone up gradually. We are seeing some reversal in flows, but we are not seeing a massive reversal at this point. Emerging markets will gradually move to the world with higher interest rates, which is what we should expect will happen over time, and, of course, some part of it will have to be absorbed by emerging markets, and so one will need—major markets will have to rely on exchange movements to absorb gradual increases because those are fundamentals, and they are changing.

One could have a situation where it does not go smoothly and one has disorderly adjustments and if it's a country which does not have very big trade ties with the US and it has a large amount of mismatch on their balance sheets and it does not have deep FX markets, that is when the other IPF tools clearly play an important role.

Then, of course, there is a third scenario, which is more like what happened in the last quarter of 2020 when we had record numbers of portfolio inflows into emerging markets. So that could happen where if interest rates stay low for some time, we see a surge in portfolio flows, and then we have the concern of a reversal and, again, there the policy response has to be different. Again, there are a lot of details, and exactly how to do it, it is country-specific, and it is shock specific. So, I will not be able to go into all of that.

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

Let me go over ten points that are noted. I will be very short, though, on each of them.

First of all, on the rise in yields, part of the rise in yields is due to a return of inflation expectations to target, and that is a desired outcome; but

part of it is a rise in term premia embedded in yields, and that could be reflective of uncertainty about the future path of asset purchases, so that is more problematic.

In a number of emerging markets, we have seen interest rate increases or announcements of further interest rate increases due to inflationary pressures that are starting to emerge, something we did not see last year.

I fully agree with the point that stimulus should not be withdrawn too early. We have to bridge to the end of the recovery, but that end is visible in some countries but certainly not in all.

Turning to the monetary policy more specifically, monetary policy normalization will be a challenge in weak countries with weak firms. I fully agree with that point. There are certainly a number of countries where vulnerabilities in terms of debt at the sovereign, the corporate, and in some countries even at the banking sector, are worrisome and that could interact with monetary policy. I fully agree also with the point about the intertemporal tradeoffs. Easy financial conditions are transmitted to the real economy via growing vulnerabilities. Credit is extended, and that could give rise to medium-term financial stability problems.

That brings me to the macroprudential advice. Macroprudential policy should certainly not be tightened preemptively or too early. Preemptively possibly, but not too early. Ms. Riach pointed to the language in the executive summary that has been negotiated in detail with many parties. We feel fairly strongly about the wording in both the executive summary and in the policy conclusions on macroprudential policy. The issue is that for a few countries, the time has come to remove the crisis measures. As we were sitting in this meeting, the Federal Reserve announced that it would remove, for example, the suspension of dividend payments as of June 30; it had already earlier announced that the exemptions from the leverage ratio would be removed by the end of March, and there are a number of other countries that have either announced such things or will be announcing it. For many countries that would not be appropriate, but the language is reflecting the fact that for some countries it starts to be appropriate; for others it does not, so it is a careful balancing act.

On the sovereign bank nexus, there is no clarity at the Basel Committee level. The negotiations are sort of ongoing for many, many years and might keep on going. But there are a number of countries where the sovereign bank nexus has been deepened, where sovereign debt sustainability

issues are also of concern. We are not saying that these are magnitudes like the euro crisis in 2012, but it is certainly something to watch. In many FSAPs we are focused on these issues, and we have given very country-specific advice in many countries on this. One particular FSAP to look at is about three years ago or two years ago, we had a deep dive on this issue in Romania.

On the financial crisis policies, it is again very country-specific whether the crisis-related financial policies are ready to be removed or not. We think that relaxation of the accounting requirements and international capital and liquidity requirements that are not compatible, so the relaxation of the requirements that are not compatible with accounting standards or capital and liquidity standards should be phased out. Using the flexibility within the standards is one thing. Going beyond this flexibility, we think should be phased out; it is potentially dangerous. How quickly that is being done depends, and even the usage of the regulatory and the accounting flexibility should be phased out eventually, and the appropriate speed depends on the country.

In terms of NPLs, at some point the forward-looking nature of NPL provisioning should be phased back in. That has been removed temporarily in many countries, or it had been phased in, and the phase-in was slowed down. Forward-looking NPL reserving is something that we view as desirable. In those countries where NPLs are expected to rise quickly, management capabilities, plans and tools for NPL resolution and management is, of course, first order.

In terms of moratoria in government guarantees, progressively stricter eligibility criteria should be phased in over time. Again, the appropriate time path is very different across countries, but what you do not want to end up with is that balance sheets look fine, but the true economic state of the balance sheets is not. The loss of transparency is quite dangerous.

And finally, in terms of profitability and capital distribution restrictions, as I mentioned already, at least one jurisdiction has moved towards removing the restriction, and over time we would expect that this would also be appropriate for other countries.

On the bank buffer usability, absolutely, banking buffers should be usable. There is a debate going on already at the Basel Committee, and that debate will surely intensify. Our contribution in the chapter takes a particular crack, and that has resonated very well with capitals in some of the major and other jurisdictions.

On the corporate sector policies, we fully agree that resolution regimes could become overwhelmed, and it is very much first order to try to adjust the resolution regimes to not get to that point.

In terms of the indicators to distinguish between viable and nonviable firms, we put out some of that in the chapter. We will follow up with a paper soon as well, and Research Department also has a paper; ours is focused on firms that have either publicly issued debt or equity, while the Research Department work is more focused on SMEs that do not have publicly traded debt or equity. These analyses are, of course, very complementary. In our view—and that is shared across the Fund certainly—public support should be conditioned on further investments going forward.

Ms. Gopinath has covered all the issues on the IPF. On NBFi reform, absolutely, NBFi reforms are crucial, in particular from the point of view of emerging markets; so some of the role that we play in the FSB in these working groups on NBFi reform is to represent emerging markets and the broader membership where NBFi reforms are very important for capital flow purposes.

On climate finance and ESG, we do a tremendous amount of work on that within the department and around the Fund, and the lack of a chapter or so is not a reflection of a lack of work that we are doing, but rather of the limits on pages. We have very tight limits on how much we can put out. That means that we cannot cover everything in any one report. As the Managing Director just announced, we will certainly have a lot of that coming out in the GFSR in other flagships in the fall but also in various papers until then.

On the Common Framework, we fully agree that eligibility should be broadened. There are many countries that are currently not eligible, and eligibility would certainly be advantageous if it was available much more broadly. The high debt levels, of course, make that more important, and the SDR allocation potentially relaxes some of these borrowing constraints and has very advantageous implications as such. Let's hope that this will happen quickly enough to help our countries to get started again.

I will stop here, and fully agree with Mr. Sylla; the reward for good work is more work, and we are very much looking forward to that.

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

I will have to be selective, but I hope that I will cover the most important topics. If not, we are ready to engage informally or formally at Directors' convenience, as always.

The first remark that I want to make has to do with vaccines and vaccinations and complements the remarks made by Ms. Gopinath. I am actually concerned that at this point in time, it is very hard to have a clear picture of the process of vaccination, treatments, tests, that is in the pipeline. I just want to remind the Board that the scenarios that have been used by most organizations that are involved in the effort of vaccination in low-income developing countries have objectives of vaccination of between 20 to a maximum of 27 percent of the population, which having listened to Directors' comments around this virtual table, would be disappointing.

Production of vaccines and distributions of vaccines, access to vaccines, is obviously a very strong priority, but one does not get inoculated by looking at a vaccine. One actually has to get a shot in the arm. It turns out that the costs of the vaccination are a multiple of the costs associated with the production and distribution of vaccines, so we have to be very, very careful about how we put all of this together. My understanding is that our Chair has quite a lot of experience about how one manages these type of logistical operations that I, for example, lack. I have been trying to find information. It is very hard to come by.

The second point that I want to make is about policies and how our policy advice has evolved. Ms. Gopinath has already covered the point on fiscal policy, but I want to repeat for emphasis, clearly given the uncertainty associated with the pandemic, fiscal policies have to be agile and flexible so as to support vulnerable households and firms. That is just commonsensical. It is also commonsensical that one should avoid premature withdrawal of support. But many of Directors made the point, which is extremely important, that vulnerabilities associated with accumulated public debt and depletion of fiscal buffers have been heightened by unprecedented debts and deficits and so a balance has to be struck.

The balance is not universal; it is clearly country-specific. And in our advice, we emphasize this time that fiscal support should be framed in the context of the medium-term fiscal framework so that the intertemporal tradeoffs that so many Directors commented on, can be tackled in quite an explicit way. In the context of low-income countries, it is very important that

development gets the deserved emphasis, the Sustainable Development Goals provide a good frame, and in the context of the SDN that we have informally presented to the Board a few days ago, there is a way of making these various requisites consistent. I believe that is quite important.

We got a very explicit question about whether we examine automatic stabilizers. We have used, in the presentation that I recorded to the Board, used an historical benchmark for fiscal responses to business cycle developments that we used as a benchmark to compare fiscal responses; and fiscal responses compared to the benchmark have been much greater. That is true for the United States, Japan, the euro area, China and Brazil. I could continue, but I would be basically mentioning all countries. In this systematic response, automatic stabilizers are very important, but they are not the only factor that moves.

We have argued a few years ago, and I think that point has become even more important in the current circumstances, that it is important to look at the macroeconomic implications from automatic stabilizers. It is very important to look at the macroeconomic implications from social safety nets, and I believe that that is a topic that is going to be very important going forward.

Ms. Gopinath has already commented on how the issue of fiscal policy has been constrained by fiscal space and how that has correlated with macroeconomic performance. Indeed, one of the points that we have been making from January is that there is a very strong correlation between the strength of the response and the existence of fiscal buffers or and access to market financing, so the correlation looks extremely strong. The mapping to economic developments also seems persuasive. It is too early to reach definite conclusions about what is going on here.

Impact of developments of interest rates on the costs of debt, we have the possibility of producing those types of estimates for all countries. They differ a lot. They depend on the maturity of debt. They depend on the currency denomination of debt. They depend upon the degree of monetary and financial stability. There are many factors, but it is very easy to engage and give one meaningful answers to any question that one may have pertaining to Russia or any other country that we cover on a regular basis.

On the comment on the concept of debt used in the Fiscal Monitor, I would actually ask for Mr. Jin's understanding and cooperation. The approach in the Fiscal Monitor, as in the World Economic Outlook, is exactly the same,

is ad hoc. It is one which is very difficult to defend on conceptual grounds. We have used it as a transitory approach for pragmatic reasons. We are still very interested in engaging with the Chinese authorities, the Ministry of Finance, the central bank, the statistical office, to be able to produce a methodology that will improve quite substantially the quality of the information that we have available concerning the developments in debt and deficits in China. I am sure I can rely on Mr. Jin's collaboration.

The Chair:

I have three small points to make before I read the Summing Up. The first one is after Mr. Mozhin spoke, I did not explicitly recognize that he suggested to think about follow-up on the analytical chapters, something that we see can bring value, but then we have to think about it, how that may be done. The reason being that between now and the Spring Meetings, we have only that many Board engagements. Perhaps we can link it to a substantive discussion after the Spring Meetings, if would still be of interest.

My second small point is to just make us step back and think of what Ms. Gopinath is flagging as a difference between the recession we have been living through and what this recession could have been without the power of policy response done in a coordinated and, I would say even more, a synchronized manner. Three-times deeper recession, bringing us around -9 percent. Perhaps if that stays for a long enough period of time, it would be no recession anymore. It would be depression. That did not happen.

I do believe we should give credit where credit is due. We do not have a way to measure what percentage of that benefit of a less severe recession comes from collaboration, comes from us having the IMF and the World Bank meetings, having the G-20, having the various fora to coordinate. How much of the information that this very team that is presenting to the Board today has helped to serve as a transmission line of policy action. We do not know, but we know it has added incrementally to putting the protection against a collapse of the world economy.

Finally, I fully recognize the responsibility we have to calibrate policy advice in the future and that to a certain degree, this policy adequacy is going to be harder as we move in this divergence of recoveries that we talked about; but we would do our utmost best, as we will do in terms of staying with the countries through the recovery.

We would have discussions at the Board, very important discussions, on how we can sustain the degree of support that is required; but I want to be able with Board's help to say very simply to the countries that are most dramatically impacted and have the least space for action—some of the emerging markets and almost everybody in the low-income countries category—I want to be able to say we are there for them through the recovery at the same level of commitment we have had during the previous phase.

We propose that the full World Economic Outlook and the Global Financial Stability Report documents be published with appropriate revisions on Tuesday, April 6, 2021, and the full Fiscal Monitor be published on Wednesday, April 7, 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 document.

The Chair adjourned the discussion.

ANNEX

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

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GRAY/21/775

March 22, 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
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for an excellent set of flagship documents which, together with the report on macroeconomic developments and prospects in low income countries, identify and respond to the major challenges of the moment. Divergence in prospects between members is the key characteristic of the outlook, and the principal policy challenges remain: escaping from the pandemic; recalibrating policy through the recovery period; and securing a transformational recovery. These issues come out of the flagships clearly and we particularly welcome the choice of analytical chapters which each speak to a central element of current challenges.

Economic data for the second half of 2020 surprised to the upside and the global outlook has improved accordingly, but with clear divergences between country groups. It is striking that while revisions are strongly positive in advanced economies, they are only modestly so in emerging markets and are negative for the poorest countries. WEO chart 1.16 starkly illustrates the consequences of this divergence – by 2024, advanced economies are in aggregate expected to have largely made-up the shortfall in output relative to pre-pandemic expectations, while shortfalls elsewhere will remain material. Global experience of the pandemic is diverging sharply; vaccines offer hope of an escape from the pandemic, but international cooperation is needed to ensure global access and to prevent new waves of infection and any deterioration in the outlook. Close to 90 million people are expected to fall into extreme poverty during 2020-21, compared to pre-pandemic projections, and the crisis has increased inequalities between and within countries. Risks are mostly two-sided, though remain large.

Policymakers face daunting challenges and multiple trade-offs – and overall, these flagships speak well to those challenges. Policymakers will need to understand which phase of the virus they are in – and the difficulty of doing so will mean that policies should be designed to be robust to multiple states of the world. We found the framework outlined by staff helpful, organised around the phases of the pandemic and recovery, and we agree that getting policies right will depend on: 1) the stage of the pandemic; 2) the strength of the recovery; 3) the country’s structural characteristics.

Escaping the clutches of the pandemic remains the paramount task facing all of us. The importance of vaccine rollout cannot be overstated – and we fully endorse the Fiscal Monitor’s argument that there is no better investment than vaccines at present. International cooperation is needed to ensure adequate global production and worldwide rollout at affordable prices, and to support access in all countries and to all sectors of the population. Policy will need to remain accommodative while vaccines are rolled out and until a recovery takes hold – and that will mean preserving and finding policy space.

The WEO and GFSR covered this particularly well for emerging markets; accommodative financial conditions have restored market access, and we agree with the GFSR that emerging markets should use this to lock in lower financing costs through active debt management strategies. We found WEO Chapter 4 both well-timed and reassuring, given recent market volatility – though it underscores the importance of clear communications from advanced economy policymakers as they recalibrate policies through the recovery phase. And we agree that should global financial conditions tighten sharply or volatility rise, then emerging markets may need to be creative in making monetary policy, potentially including forward guidance and asset purchase programs, as well as the measures considered in the Integrated Policy Framework (IPF), in line with the guidance laid out in the Institutional View. The Fund will also need to respond to such stresses creatively, using the new tools in the IPF and Sovereign Risk & Debt Sustainability Framework, responding to financing requests nimbly and flexibly and keeping the adequacy of GRA resources under review.

The challenge is substantially more acute for low income countries, where policy space remains limited and widespread access to vaccines looks a long way off. With limited policy space and constrained market access, LICs need financing, to respond to immediate pressures, to help mitigate scarring and to restart the process of convergence. We support the recommendations in the Fiscal Monitor, to “make the most of what you have” by raising tax compliance, eliminating loopholes and reducing subsidies. This will need to be complemented by ambitious and broad domestic reforms. The G20’s Debt Service Suspension Initiative and Common Framework can bring valuable additional relief and it’s

imperative that all parties collaborate to make these work. An SDR allocation will also help relieve constraints by boosting reserves and through potential recycling. Nevertheless, LICs will need further support, as illustrated in the report on macroeconomic developments and prospects in low income countries, and we look forward to upcoming discussions on the Fund's role in this. The publication of the LIC report alongside the flagships sets a positive precedent and leaves this group of the membership better served with IMF advice. These needs will not diminish, so we see clear value in temporarily moving the LIDC report to the same twice-annual frequency as the flagships. *Staff comments welcome.*

As countries exit the pandemic, the next task will be to recalibrate policies and the policy mix. This task is no less daunting than escaping the pandemic, and these flagships make a good starting point for those discussions. Policymakers will need to balance ongoing support against rising vulnerabilities and avoid sharp changes in policy. Tightening should begin where vulnerabilities are most evident. Policies should be embedded in credible medium-term frameworks, which may need reviewing or restating. And early communication of changes – including pre-commitment where possible – will provide valuable guidance and help those affected adjust. This all requires careful thought and planning, and where authorities can, they should prepare for these actions now – supported by Fund advice through bilateral surveillance and further engagement with these topics in future flagships.

The flagships apply these principles well to monetary policy and fiscal policy advice. On fiscal policy, we support the recommendation for legislating future tax measures now, working within credible frameworks and focusing on social safety nets. Fund surveillance must support members as they balance the risks from large and growing public and private debt, with the risks from premature withdrawal of fiscal support, which could put the recovery in jeopardy. As noted above, we fully endorse the need for creative deployment of monetary policy tools, clear communication, and anchoring policies in credible frameworks.

Nevertheless, we have misgivings on some elements of the financial sector advice in the GFSR, where some headline messages could be read as advocating premature (and procyclical) policy tightening. We welcome the detailed analysis of macroprudential policies in the GFSR, but the headline messages to “take early action” and “tighten selected macroprudential policy tools” fail to capture the nuance of the analysis later in the document, where the focus is more clearly on narrow pockets of vulnerability. Similarly, while the analysis of the constraints that banks face in using their buffers is helpful, it remains crucial that banks are encouraged to use them (where prudent) to support recovery, not least because in doing so they strengthen the recovery and indirectly their own capital positions. The GFSR could helpfully reinforce the internationally agreed Basel position in this area, namely that a

measured drawdown of capital and liquidity buffers in the current period of stress is appropriate. This is consistent with the objectives which underpin Basel III buffers: absorbing losses in times of stress and helping to maintain the provision of key financial services to the real economy in a downturn by reducing incentives for banks to deleverage abruptly or excessively. Once the crisis abates, supervisors should provide banks with sufficient time to rebuild their buffers, taking account of economic, market and bank-specific conditions.

Countries also need to act now to limit scarring and foster a truly transformational recovery. Again, and building on previous editions of the flagships, these documents have much to offer. WEO Chapter 2 sets out clearly for the first time the Fund's thinking on scarring, something we have called for previously and very much appreciated. WEO Chapter 3 offers insights on job retention and reallocation efforts as the pandemic evolves, while the Fiscal Monitor's analytical chapter proposes a menu of policy options to address the inequality and poverty challenges exacerbated by the pandemic. In combination with the clear and helpful approach to triaging firms in the GFSR, these flagships offer valuable advice when it comes to adjusting policies to facilitate the reallocation of resources, something that will be vital to restoring productivity growth and convergence.

Nevertheless, policy messages could have been stronger in some key areas of advice, including climate, trade and non-bank financial institutions. We fully support the advice in these flagships on climate change, which builds on strong recent analytical work – but, in a year when there have been renewed commitments to the Paris Agreement and when Nationally-Determined Contributions will be strengthened for COP26, we hope to see more extensive coverage later in the year, including in the October Flagships. We agree that trade disputes should be resolved, but think the WEO could have gone further to point out that reducing trade barriers would help mitigate some of the negative consequences of diverging recoveries by strengthening demand spillovers. We very much appreciated the reiterated support for work to strengthen NBFIs, but thought that the GFSR's executive summary could have stressed the urgency of doing so and placed more emphasis on the need for reforms which increase the base level of resilience in the NBFIs sector.

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GRAY/21/787

March 22, 2021

Statement by Mr. Buissé, Mr. Rozan, Ms. Gilliot, Ms. Albert, Ms. de Waziers, and Mr. Roman on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting 21/31
March 25, 2021

We commend staff for their very well-written reports, and their efforts to have a more granular approach with regards to policy recommendations. While maintaining strong policy support is still a priority in many countries, preparing for a transition as smooth as possible (in particular with targeted measures), to avoid sudden cliffs effects, represents a critical challenge. While continuing to adapt and be agile, policymakers should systematically take into consideration issues related to inclusivity, climate and digital transformation in their decisions, to mitigate the risks of divergence within and across countries. Specific attention should also continue to be paid to the evolution of financial stability risks and still unclear scarring effects. The vaccination pace will be the main uncertainty surrounding the outlook, therefore highlighting the need for strong international cooperation on this front, particularly to the benefit of the low-income countries, to avoid deep economic and social scarring.

1) As uncertainty remains high on the recovery path, monitoring closely the risk of divergence and to financial stability is critical.

We broadly share staff's analysis on the macroeconomic scenario and the rising concerns about economic divergence across and within countries. In particular we note that the pace of return of the GDP to its pre-pandemic level will differ significantly among countries, and we would be interested to hear more about differences within the euro area. We note the United States should recover quickly due to the sizeable stimulus package recently adopted. However, this package contains little public investment, and the US administration hopes to pass a second bill dedicated to this later this year. *What is staff's view on the composition and effect of the recent policy package voted by Congress?* While output gap estimates are uncertain, we share staff's view of a prolonged environment of low inflation, though inflation expectations and their underlying factors need to be monitored closely. Moreover, more analysis is needed on the evolution and future use of the significant savings accumulated in advanced economies, as it could boost consumption or be invested in assets. *Could staff detail their assumption on the pace of the dissaving in the baseline?*

The very large policy-mix support has had a key mitigating impact on global activity, and we particularly appreciated staff's quantitative estimate of this impact. In addition, contrary to the GFC, the financial system has remained resilient, a clear illustration of the efficiency of regulatory reforms. However, for LICs and emerging countries, several factors are limiting their policy response (less policy space, large informal sectors, more limited integration in the financial system, pace of vaccination), and the risks of divergence are growing. The situation of women and low skilled and young workers is an even greater challenge than in advanced economies, which could be exacerbated if rising food prices generate food insecurity and social unrest. More specifically, we would have seen merit in a more disaggregated analysis between commodities and non-commodities exporters, which are also themselves heterogeneous categories. We note that the price of oil in the baseline is lower than the current price and although the oil futures curve is now in backwardation, a higher oil price could also represent an upward risk for oil exporters.

We share staff's view on risks and their balanced vision in the short term, and emphasize the risks of market correction and asymmetric recovery across firms. Vaccination (with risks surrounding distribution and variants) will of course remain the greatest uncertainty for the outlook. On the financial side, the risk of the disconnection between markets and the real economy is still present, among other side effects of the current risk-free rate environment, and it will be important to closely monitor asset prices and any sign of overly stretched valuations. Moreover, the global improvement in financing conditions does not guarantee a lower differentiation between investment grade countries and high yield ones as suggested in the report. Indeed, this differentiation could be more durable than expected given the limited capacity of high yield countries and frontier markets to adjust to the crisis. Regarding China, we share staff's view that the rapid recovery came at the cost of an increase in financial vulnerabilities and deeper fragmentation. We nevertheless believe that the latter may also reflect a better pricing of the underlying risks, which is at the core of authorities' strategy to gradually reinforce financial stability.

Dealing with risks associated with an increase in corporate debt will also be a key challenge. Non-financial sector vulnerabilities should remain under close watch, and the quantitative assessment of financial sector vulnerabilities in the GFSR could have focused more on US NFCs and considered the great heterogeneity of the corporate sector. We also thank staff for their insightful analysis of the commercial real estate (CRE). We would have been interested in a more granular approach beyond the US, and we encourage staff to provide more details through a cross-country analysis on key areas including exposures by financial market segments, and categories of CRE policies implemented/recommended. We also see merit in a broader discussion on the use and trade-offs of macroprudential policies (objectives, practical feasibility, advantages and drawbacks, robustness to arbitrage across sectors) to cover these risks.

- 2) **While countries should avoid prematurely withdrawing support, ensuring a smooth adjustment during the second phase and targeting measures are the main challenges ahead.**

We fully share staff's policy recommendations and value their efforts to develop a more granular policies approach in this flagship reports.

We strongly agree with staff that global vaccination is the first global priority to avoid uneven recoveries and strengthen activity. France continues to be highly committed to ensuring the rapid, effective, equitable and universal access to vaccines, including through the COVAX facility.

In parallel, we agree that the fiscal policy response must remain flexible and be maintained until a firm recovery is underway. The first wave of fiscal response was effective thanks to the very rapid implementation of largely non-targeted measures given the urgency of the crisis. We fully agree that support measures should be temporary and gradually targeted towards supporting growth and employment and the most vulnerable households (with a specific attention to women, young and low skilled workers), and viable firms. However, while a better targeting is desirable, this is not always an easy thing to do. For households, we strongly support staff's call to address gaps in cost efficiency, coverage and adequacy of social protection systems to reach vulnerable households, including in the informal sector. For companies, greater targeting of fiscal and financial support will be key to ensure that adequate support is directed to viable firms and growth-enhancing sectors. We thank staff for their focus on this important issue both on the Box 1.2 of the Fiscal Monitor and in the GFSR. We fully agree that an adequate "triage" process is essential, though designing the right process will be challenging (in terms of criteria, timing, process, concrete division of responsibility across authorities). For viable firms, strengthening shareholders' equity remains crucial in the short term. Small firms that do not usually open their capital should seek support through equity-like injections backed by public resources, while also involving the private sector. *To identify non-viable firms, could staff further detail their recommendation regarding the partnering with the private sector as well as other concrete recommendations to reach this goal, and in particular who are the actors who should intervene and their respective role in the triage process?* More regulation (and enforcement) to fight concentration risk and ensure a level playing field will also be important. More generally, a smooth, progressive and carefully calibrated withdrawal of support will be necessary to avoid "cliff effects" and should take into consideration countries' specificities. We are looking forward to having an even deeper, tailored policy advice as part of the bilateral surveillance.

We fully share the importance of maintaining accommodative monetary policies along with a rigorous monitoring of financial stability risks. More specifically in EMs, the resilience of the monetary policy frameworks has improved over the last decade, and the policy response has been commendable during the crisis. Swaps lines and precautionary instruments have also reinforced the EMs' toolbox. While we recognize the risk of an asynchronous recovery between advanced economies and emerging markets facing capital outflows, very accommodative global liquidity conditions and a smooth and progressive increase in long term rate could help cushion the impact, especially when compared to the 2013 tantrum. Chapter 4 of the WEO underscores well the need to normalize gradually, as well as the importance of the Fed's communication. However, we would have appreciated more country specific analysis, as beyond the push factors, the pull factors play a major role in the change in financial conditions and the reaction of EMs monetary policy.

We agree with staff on the warranted deepening of the macroprudential toolkit and effective use to counter the impact of loose financial conditions and we insist on the importance for countries' authorities to work on its extension to NFCs, NBFIs and MMFs.

More emphasis could have been put on the allocation of debt increase to finance productive investment, increase precautionary cash holdings or for on-going business. *We would be interested in staff's analysis of the decomposition of the use of debt to support short and long-term growth. Besides, what are staff's views on the timely implementation of the different macroprudential instruments (some of them being at an exploratory stage while other largely implemented) and the articulation with their objectives?*

Most EMs and LICs countries will see their poverty progress reversed and have to deal with large financing gaps. Given limited fiscal space and administrative capacities, as well as a slower path of vaccination, we agree that well-designed and timely fiscal packages are paramount. To accommodate crisis related needs, but also to bridge the gap towards achieving the SDGs, financing needs will remain exceptionally high in the wake of the crisis. Several sources will need to be stepped up: official financing, in the form of grants and concessional financings are necessary. In this regard, the Fund will continue to play a catalytic role, and the PRGT will have to be strengthened and reinforced to ensure adequate level of financings in the medium term. An SDR general allocation would also be a key liquidity support. But the international community will also need to look at how private flows can be mobilized, in particular to stimulate the development of the private sector in LICs. Given the rise in debt vulnerabilities over the past ten years, countries with the most acute financing constraints should not delay adjustment and engage with the creditors; in this regard, the swift implementation of the G20 Common Framework (CF) will be paramount. This is key to recreate the fiscal space needed to tackle structural issues, with the assistance of longer-term IMF engagement when needed, and move towards sound macroeconomics and governance and long term sustainable and inclusive growth. Beyond external financing, further efforts should be made in domestic revenues mobilization through more progressive taxation or development of domestic markets, in particular in large emerging economies that are facing high financing pressures. Finally, the report could have emphasized the importance of institutional reforms in the emerging economies that have more fiscal constraints.

3) To limit scarring, policies will need to systematically take into consideration the reduction of inequalities and the fight against climate change.

Deepening the analysis on scarring effects will be key to fine-tune our structural policies. The interesting chapter 2 of the WEO indicates that a loss of GDP of about 3 percent is expected in 2024 compared to the pre-crisis projections. However, we would have appreciated more discussion about the loss of potential growth. The World Bank for example analyzed in its Global Economic Prospects that a loss of 0.3 pp per year for global growth (0.6 pp for emerging countries) could be expected during the next decade. *Could staff offer some quantitative elements to assess the loss of potential growth?* Moreover, to better understand the economic shock, the model could have been complemented by other variables, such as technological and adjustment capacity of the private agents. In addition, we are wondering to which extent consumer preferences will be structurally different in the future (development of the ecommerce; impact on consumers' trust in the future...). More work on sectorial analysis will be useful, especially to understand the structural output changes, to help design policies for the needed reallocation's strategy. Furthermore, the acceleration of the automation and digitalization could boost productivity, but we remain concerned by the rising risk of market concentration as the recent IMF work made

abundantly clear. Not only could it have impact on the dynamic of growth and jobs, but it could also limit innovation and thus impede productivity growth. On external imbalances, we would be interested to understand better the influence of the structural changes due to the crisis, and in particular on GVC, and we encourage staff to keep a specific attention on this topic, as the ESR recommendations play a key role in the design of policies.

Rising inequalities within countries is a major concern and should be at the center of policy making. First on the labor market, chapter 3 of the WEO offers very precious analysis showing that labor reallocation policies will need to pay specific attention to the inclusion of those most affected by the crisis. In particular, dealing with the acceleration of preexisting employment trends (hastening a shift away from sectors that are more vulnerable to automation, and in particular, low-skilled workers) deserves further analysis and recommendations. *Could staff elaborate on these recommendations, in particular how to design the training policies and adapt them to the accelerated labor market changes?* For EMs and LICs, the crisis exacerbated the challenges of informality, which require further focus on education as well as social protection system. We welcome the significant progress in this last area during the crisis, as many countries have adopted support to cover the informal workers and have also accelerated financial inclusion through digitalization. Second, we support staff's recommendations on predistributive and redistributive measures enhancing public services spending, social safety nets and tax reforms to ensure more progressive, inclusive, and effective schemes. The increasing progressivity of the French tax and transfer system has contributed to dampening the increase in income inequality, leading to a quite stable level of post-tax income inequality since the early 1980s. Modernizing the international tax system will be important to provide much needed resources and adapt it to the reality of the digital economy. France is actively committed to these negotiations under the OECD's inclusive framework. Staff's estimate of the impact of the taxation of wealth on inequalities could be usefully complemented by an integration of behavioral, dynamic effects. Finally, in the context of the crisis, high-frequency data are very useful to assess short term effects on inequalities.

We agree with staff that once the recovery is firmly under way, fiscal policy will have to tackle legacy debt through the implementation of credible medium-term fiscal frameworks and transparent fiscal governance. The definition of such frameworks upfront can also help countries with limited fiscal space reinforce policy credibility and ease access to international markets (and in particular, EMs). Nevertheless, the definition of what should be the new fiscal anchors for these frameworks is not obvious and we encourage staff to work on this issue. *Staff assessment of revised anchors calibrated both to the new current economic outlook and to structural aging pressures would be welcome.*

We reiterate our message that now is the time to build a green recovery and that more will have to be done to tackle climate change. A lot of analytical work has been done in the previous flagships, feeding into Fund surveillance, and we encourage staff to continue to deepen their work on how to build a green and inclusive recovery. We continue to strongly support green public investment policies as well as adequate carbon pricing as a key component of the toolkit to advance mitigation, which should be associated with measures to offset potential negative impacts.

Finally, we share staff's view on the need to reinforce global cooperation to face the crisis in the areas highlighted in the report. A cooperative approach will only bring

greater benefits for all. The Fund remains has a leading advocacy role to play in this regard.

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GRAY/21/807

March 22, 2021

**Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, Ms. Rivera Molina, Mr. Rojas Ramirez, Ms. Arevalo Arroyo, Mr. Cartagena Guardado, Mr. Lopez, and Ms. Moral Betere on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for the comprehensive set of flagship reports. We concur with staff's analysis on the prospects of the global economy, the balance of risks and main policy recommendations. Vaccination developments provide solid grounds for hope—although we have strong concerns on its uneven global distribution—and uncertainty remains high as policy trade-offs are building up and risks coming from divergent recovery paths cloud the horizon. In this difficult environment, caution in driving policy actions is of the essence and multilateral cooperation is needed more than ever. In the following, we offer more specific comments on recent economic and financial developments and main policy challenges.

World Economic Outlook

We note the improved world economic outlook during the projection period, after the upward revision in January's update and a better than expected outcome in 2020. Nevertheless, two relevant factors call for caution. First, the high degree of uncertainty associated with the pandemic and vaccination developments with the shrinking policy space and uneven degree of true scarring, which could be less pronounced than expected in countries with broader access to vaccines and strong policy support, but more prominent in others. Second, the divergence in the impact of the pandemic and expected recovery paths, both across and within countries, with some economies, sectors, and population groups more vulnerable than others. Ultimately, divergence is closely linked to vaccination rollout, sectoral structure of economies, adaptability to changing conditions, and the size and effectiveness of public support.

We are concerned about three elements of the WEO's central scenario and risk assessment that could have been further developed in the report. First, the way precautionary savings will behave after the pandemic and its impact on aggregate demand and on the balance of risks, especially in a context of sectoral reallocation that could create temporary supply constraints. Second, the impact and potential spillovers from the new US fiscal package, particularly on EMEs. And third, the potential deterioration of non-financial corporations following withdrawal of policy support—including non-linear effects on credit conditions—which in our view is not adequately treated in the staff's risk assessment. Staff's comments are welcomed.

Divergence and uncertainty shape a complex and challenging context for policymakers, especially in countries where recovery lags and where policy space is very constrained. Furthermore, divergence creates new risks, especially among several EMDCs, as policy normalization differs across countries in line with asymmetric recoveries, with potentially significant spillovers on financial conditions and capital flows. Maintaining credible policy frameworks and transparent communication strategies of central banks will be essential to safeguard financial stability during the process.

In this context, we agree with staff that policies should be country-specific and modulated to the different phases of the recovery, making them more focused and targeted as the pandemic becomes under control while managing policy trade-offs and ensuring sustainable medium-term policy frameworks. Consequently, policy tools should be timely adapted from a primary focus on fighting the pandemic to a recovery-oriented mode, avoiding cliff effects while gradually unwinding public support, helping resource reallocation and shaping the recovery to address structural challenges in inequality, inclusion, climate change and digitalization.

We must bear in mind that many countries lack the institutional capacity, fiscal space, or market access to accommodate their policy stance and articulate a comprehensive set of policies adapted to the different phases of the recovery. The IMF must be ready to assist these countries with technical and financial assistance if needed. In the same vein, we want to stress the importance of multilateralism to boost the recovery, mitigate divergence and ensure a sustainable and inclusive growth worldwide. A primary and urgent area of collaboration should be guaranteeing affordable and swift vaccination for all. In this regard we call on advanced economies and major emerging market economies to strengthen their support to vaccination through a comprehensive common strategy to cover the most vulnerable population, including through COVAX financing and lifting of export restrictions that could

undermine vaccination prospects. Further cooperation is also needed for a rules-based trade system, climate change mitigation and transition, coordination of international taxation, along with fostering the Sustainable Development Goals (SDGs) and facilitating financial support to LMICs.

Global Financial Stability Report

We share the staff's assessment on global financial stability risks. Policy support measures have contributed to the stability of the global financial system during the COVID-19 crisis, and financial institutions have played a key role in facilitating credit and providing liquidity buffers to firms and households. Nevertheless, intertemporal trade-offs are building up as financial vulnerabilities increase. Excessive risk taking and high leverage in the non-financial sector, combined with a potential upturn in long-term interest rates, may result in a sudden tightening of financial conditions, with significant consequences on specific countries, sectors and financial intermediaries in a context of divergent recoveries. Additionally, while banks have been resilient so far, the phasing out of support policies could impact their capital positions and generate a tightening in credit conditions, slowing down the recovery. Going forward, macrofinancial policies should gradually focus on ensuring medium-term resilience of financial systems, while supporting banks' capacity to lend. We concur with staff on the importance of rebuilding buffers, including adequate provisioning in the banking system. Moreover, macroprudential and regulatory measures will be helpful in tackling the sharp increase in corporate debt, fragilities in nonbank financial intermediaries, and potential weaknesses in the banking sector. Policies should facilitate balance-sheet repair of non-financial firms, including targeted support for viable firms and upgrading debt-resolution regimes for distressed firms. Given the asynchronous and divergent recovery noted in the chapter, special focus should be directed to financial stability in countries left with limited policy space. Fund support may be needed in providing policy advice, technical assistance and adequate financing for the recovery and soundness of financial systems in more vulnerable countries.

Fiscal Monitor

We strongly concur with staff that global vaccination is a key priority for the recovery. Until the pandemic is under control, fiscal policy should remain supportive of the most vulnerable people and viable firms. Nevertheless, IMF policy advice should be carefully tailored and differentiated between advanced economies and EMDCs. In this regard, we acknowledge that fiscal response has been varied across countries. In many advanced economies and

several emerging market economies massive liquidity provisions and asset purchase programs have facilitated the fiscal response. And despite debt reaching record levels, low average interest payments have allowed further margin for maneuver. However, in many EMDCs, financing restrictions have been a major constraint and countries need to maintain or, if required, use available fiscal space prudently given the uncertain scenario going forward. This becomes more important as many countries will not be able to broadly vaccinate their population during 2021. For these cases, we share staff's view that assistance through grants, concessional financing, and in some instances debt restructuring, will be needed. In this regard, we welcome the achievements within the DSSI and support a quick implementation of the G20 Common Framework.

We are aware of the vast uncertainties surrounding the outlook, mostly related to the evolution of the pandemic and vaccination. Guaranteeing universal access through global cooperation is paramount to foster recovery and reverse the deterioration of public finances worldwide. In the meantime, tailoring fiscal measures to country-specific conditions is crucial to ensure their sustainability and effectiveness, facilitating full transparency and good governance. In addition, building credible fiscal frameworks would allow a better understanding of the difficult trade-offs faced by policymakers. Against this backdrop, strong and timely Fund assistance will be crucial for countries with capacity constraints.

Finally, once recovery is underway, countries should pursue tax reforms and fiscal strategies that allow for a more inclusive, greener, and digital economy while reinforcing efforts to improve social safety nets and advance the SDGs agenda. These national efforts should be accompanied with strengthened international tax coordination, including on the OECD/G20 Inclusive Framework on BEPS.

World Economic Outlook Analytical Chapters

Chapter II: "After-Effects of the Covid-19 Pandemic: Prospects for Medium-Term Economic Damage"

We join staff in raising concern on the impact and divergences of the pandemic, especially on EMDCs, and we want to highlight the long-lasting scarring already evident in LMICS. We concur with staff that the COVID-19 pandemic exacerbated structural gaps in output per-capita, fiscal stance, employment and living standards, among others, within and across countries. We are particularly concerned about scarring in high-contact and tourist-dependent countries where the sharp drop in international and local mobility hurt production and

income levels. Special attention is also deserved by the less technology-intensive countries that suffered reversals of past human-capital gains that may take long to recover. We expect that policy measures implemented by countries to protect labor markets, investment, and productivity, be helpful in reducing the likelihood of prolonged scarring, as underlined in the analysis of historical recessions.

However, we are concerned that staff's analysis may underestimate the true scarring since the COVID-19 presents a unique shock, not even comparable to past pandemic episodes given its high incidence and the unprecedented containment measures adopted. Additionally, the crisis could potentially trigger financial instability with amplifying effects on medium-term economic growth. On the other hand, the crisis could accelerate resource reallocation, productivity gains or structural changes, such as digitalization and greener economies, with positive effects on sustainability and potential growth, albeit, for many countries, significant resources are needed to foster these transitions. *All these elements should have been explored further in staff's analysis. Staff's comments are welcomed.*

Lastly, Fund's deep engagement, mainly with the countries falling behind, will be instrumental to help reduce gaps and tackle social challenges. It is paramount that the international community assures timely and affordable provision of vaccines worldwide as well as fostering of the SDGs agenda, which broadly encompasses resilient and sustainable growth challenges.

Chapter III: "Recessions and Recoveries in Labor Markets: Patterns, Policies, and Responding to the COVID-19 Shock"

We agree with staff's view that the COVID-19 pandemic has caused a downturn in the labor market around the world despite broad policy support. Labor market distortions from the pandemic have impacted workers unevenly, with women, young and low-skilled workers the most affected, consistent with the stronger impact on sectors where those groups are represented in higher percentage. We welcome the model-based analysis, illustrating how job retention and job reallocation policies can be implemented to mitigate damages to the labor market and help reallocation during the recovery. The main policy challenge is managing the trade-off of supporting the economy in the short term while creating resource allocation inefficiencies in the medium term. We agree with staff that authorities should carefully monitor pandemic and vaccination developments to ensure a smooth transition and avoid cliff-effects. *However, this model seems difficult to apply in many developing economies characterized by large informal sectors, where adjustment to shocks is slower and more*

difficult hence the increase in poverty and inequality larger. Staff comments are welcomed.
 In these countries, more support is needed to address informality and design flexible policies that can be adapted to specific circumstances and help react to exogenous shocks.

Chapter IV: “Shifting Gears: Monetary Policy Spillovers During the Recovery from Covid-19”

We particularly welcome this chapter since our chair has reiterated the need for further work on Monetary Policy issues and a deeper evaluation of spillover effects on emerging markets. We agree with staff that monetary policy in advanced economies still has a large impact on financial conditions in EMs, which can be benign but also a trigger of undesirable effects. Clear policy guidance from AEs’ central banks will be crucial to avoid financial disruption. We also note that the release of good news on the US economy, even if accompanied by expectations of monetary tightening, is relatively benign for financial conditions in emerging markets.

Notwithstanding clear guidance, we have noticed market uneasiness on the future of monetary policy, particularly in the US, with long-term bond yields rising in light of growth optimism. This, in hand with fears of a potential new taper tantrum, has been putting pressure on EMs currencies and capital flows. *While the chapter finds that a surprise tightening could be the trigger and that good news are relatively benign, we wonder if we are witnessing a context in which the expectations, not the actual surprise tightening, could potentially cause a negative financial shock in EMs. Staff comments are welcome.*

We also take note of the importance of the “risk channel” in transmitting spillovers. We deem these findings relevant in the context of the IPF policy advice. And, we found interesting that there is no direct evidence that high financial openness is an amplifier of a US monetary policy surprise.

We fully agree that flexible exchange rates, more transparent central banks, and rule-based fiscal and monetary policy frameworks are essential and desirable for EM economies. However, we would be more cautious to make a causality argument, as presented by staff, that all of these characteristics, in hand with announcing an APP, imply that some economies had a better ability to support domestic activity and deploy larger monetary policy accommodation amid the pandemic shock. We believe that country-specificities, such as domestic conditions and legal frameworks, should also be considered when assessing central banks’ policy response in this context. Furthermore, we miss analysis of the possible costs

and vulnerabilities of the use of APP in EMEs. *In this regard, can staff comment on the differences potentially faced by central banks in EMS compared to those in advanced economies regarding risk assessments coming from the use of APP, including by the possible effects of an increase in interest rates?*

Global Financial Stability Report Analytical Chapters

Chapter II: “Loose Financial Conditions, Rising Leverage, and Risks to Macro-Financial Stability”

We welcome staff’s analysis on the interlinks between financial conditions, non-financial private sector leverage and macrofinancial stability. We note the high increase in leverage since the GFC, facilitated by loose financial conditions and, more recently, by policy measures to support firms and households during the pandemic. While policy support has been instrumental to sustain economic activity, we share staff’s concern that increasing leverage has exacerbated intertemporal policy trade-offs and brought about financial stability risks in the medium term. In a context of necessary monetary and fiscal accommodation to fight the pandemic and ensure a sustainable recovery, macroprudential policy can play an important role in leaning against the wind and mitigating financial stability concerns. These actions should be country-specific and targeted, accounting for the structure of sectoral exposures and financial intermediation. Given policy transmission lags, we concur with staff that early actions would be advisable to contain risks in a timely manner. To this purpose, macrofinancial authorities should work to solve current limitations in the macroprudential toolkit, including actions to mitigate risks in less regulated segments of the financial system. *The key concern is whether the current level of financial vulnerabilities—including potential scarring from the pandemic—is too high for macroprudential actions to be sufficient. Staff’s comments are welcome.*

Chapter III: “Commercial Real Estate”

Risks in the Commercial Real Estate market (CRE), seemingly exacerbated by the pandemic, may compromise macro-financial stability. We note staff’s findings identifying the downside risk of the CRE price misalignment due to its deep market funding reliance through financial and non-financial (NBFI) institutions and its interconnectedness with the real economy. Evidence suggests that CRE price declines, although uneven across different segments, could weaken bank soundness and compromise corporate investment. The COVID-19 pandemic may be exacerbating structural shifts—deteriorating demand for some commercial

properties and declining fair valuations—compromising economic performance, creditworthiness, and financial stability.

Against this background, we deem policy response appropriate in the near term by supporting banking sector resilience, safeguarding capital adequacy, and building buffers for CRE exposures, including banks' CRE valuation provisions. In the medium term, once the impact of the pandemic is extensively assessed, policymakers should implement targeted macroprudential measures, including on NBFIs, to address risk and prevent CRE price misalignments.

Fiscal Monitor Analytical Chapters

Chapter II: “Fair shot”

Staff's analysis sheds light on a broad fiscal policy framework to phase out inequality and poverty and mitigate their pervasive effects, exacerbated by the COVID-19 pandemic. This comprehensive framework aims to guide short-term policy actions to strengthen health systems and social safety nets and, more importantly, to tackle inequality and inclusive growth in the long term. We share staff's main messages that governments should focus on addressing weaknesses in the existing policy framework, reforming institutions with a permanent scope. We especially welcome staff's analysis on pre-distributive measures, complemented by redistributive policies, to improve health and education, ensure equal opportunities and access to basic services, fight poverty, and reduce unfair inequalities.

Despite staff's comprehensive analysis, we would have welcomed a deeper discussion on two additional issues: (i) immigration and the impact on inequality, taking into consideration the higher vulnerability of foreign workers; and (ii) the structure and degree of development of safety nets and the heterogeneous effect on inequality across generations. We invite staff to continue working on these issues.

On policy recommendations, building trust and creditworthiness in the public sector is a prerequisite for a successful strategy to fight inequality and poverty. In this sense, governments need to improve governance, transparency, accountability, and public management to ensure appropriate delivery of their economic and social policy actions. Additionally, it is paramount to strengthen state capacity to deliver policy actions, especially in EMDCs. We also see merits in promoting country-specific tax reforms to support growth, improve progressivity and increase revenue mobilization. Furthermore, authorities should

enhance efficiency in the provision of public services and prioritize reallocation before scaling up spending. All these measures should be anchored in sustainable and credible medium-term fiscal frameworks.

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GRAY/21/815

March 22, 2021

**Statement by Mr. Bevilaqua, Mr. Saraiva, Ms. Mohammed, Mr. Velloso, Mr. Barroso,
Mr. Coelho, and Mr. Coronel on World Economic Outlook; Global Financial Stability
Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

World Economic Outlook

The global economy continues to surprise on the upside on the back of continued fiscal and financial support. While the recovery has been uneven and subject to high uncertainty, we see countries improving at different paces rather than diverging. Fiscal policy has provided strong stimulus globally and growth has surprised on the upside in several countries, and may continue to do so, especially in some advanced economies (AEs) which still have significant policy space. China has significantly withdrawn policy support, but this was timed with an early and well-entrenched strong recovery. Vaccine rollout has been slower in emerging market economies (EMEs) and low-income countries (LICs) and, without stepping up vaccine distribution, the recovery may lose steam in those countries. With limited fiscal space, support measures in those economies are more constrained, with debt sustainability becoming a major concern in many EMEs and LICs.

We also see economic sectors improving at different paces, with the ones more closely related to the production of goods clearly leading the recovery and improving expectations for other sectors. As highlighted in the WEO, industrial output, trade in goods, and commodity prices have been leading features of the global recovery. Services (including trade in services) are recovering at a slower pace, but nonetheless improving from their troughs despite targeted lockdowns. Indeed, such improvement is clear evidence of adaptation to mobility constraints in the most affected sectors. There are some clear pockets of pressure on inflation, probably more than what is apparent in the figures reported in the WEO. The degree of future price pressures crucially hinges on the fate of labor markets, which remain weak, along with the amount of scarring and countervailing policies affecting potential growth. Uncertainty is high, but business confidence has been improving in services and the gradual progress in vaccination tends to support this trend.

The growth upside surprise in 2020 with respect to WEO's June projections was not totally unexpected. By mid-2020, the scale and forcefulness of the policy response by large AEs and EMEs already indicated a reversal of the initial sharp downturn that followed the pandemic shock. Furthermore, as mentioned above, adaptation of different economic sectors to the measures taken to restrain the spread of the disease played a significant role. In the case of Brazil, both official and private sector forecasters had projected then a contraction in line with the actual outcome (-4.1 percent) and significantly smaller than the IMF projection (-9.1%). Clearly, the outcome was not a surprise for most analysts. It suggests that staff grossly underestimated the effect of the main mitigating factors which were known and already at play. Attributing growth exceeding expectations in Brazil to the “global manufacturing rebound in the second half of 2020” (WEO, Ch. 1, p. 15) conflicts with the available evidence and misses again the main reason for the much better outcome than projected by staff.

While the pandemic remains the major risk, further tightening of financial conditions may become a more relevant risk as lagging sectors accelerate. We welcome WEO's upside and downside scenarios and agree that risks are more balanced, while tilted to the upside in the medium term. Beyond vaccines and lockdowns, the report explores additional risks, including geopolitical tensions and social unrest. Furthermore, we highlight the risk of inflation and bond yields moving higher and faster than assumed in the baseline, for example, due to stronger than expected fiscal impulses, the release of pent up demand, or the impact of higher inflation expectations. We take note of the policy advice that EMEs should rebuild buffers and be ready to use foreign exchange intervention and other measures to cope with tighter conditions. On top of that, structural reforms to fiscal and monetary frameworks would increase countries' resilience to external shocks. In this sense, the welcoming steps in this direction taken by some EMEs despite challenging political environments deserved more recognition in the WEO.

Scarring from the pandemic might be lower than originally expected. The relatively faster recovery and resilient financial systems have so far contained the prospects for more permanent damage to the economy. The longer workers stay out of the labor force, students stay out of classrooms, and firms delay investments, the more economic scarring results. We take note of the WEO assessment that EMEs and LICs face higher scarring risks given deeper recessions and more vulnerable households. In contrast, we highlight that informal labor markets prevailing in those economies tend to be relatively more adaptable. Contrary to previous recessions that hit formal markets harder, the lockdown recession affected mostly the informal market, possibly containing scarring and helping speed up the recovery. That said, we broadly agree with the call to proceed as gradually as warranted with removing support measures while the economy is not fully recovered although we caution that this approach might be very challenging in many countries given less policy space.

Financial sector resilience during the pandemic has been key to minimize scarring, and well-designed policies in this area continue to be important. As documented in the IMF policy monitor, several EMEs and AEs strengthened financial sector resilience and the flow of credit, for example, with liquidity lines and guarantees. Such policies minimized the risk

of financial instability and preserved viable firms (and future jobs). We agree with the WEO's recommendation that financial intermediaries should be encouraged to identify and manage distressed borrowers while governments should expedite restructuring and bankruptcy procedures. With banks likely to reduce risk taking going forward, further credit enhancing measures by governments, as suggested by staff may face constraints, including risk bearing capacity and distorting of private incentives.

We welcome the analysis on country-specific channels of resilience or scarring, with vaccines playing a key role moving forward. However, we note that data on the different recovery trajectories and the specific challenges facing each region or country are still partial. As more data become available, further analysis will be necessary in the next WEO cycles. For most countries it seems that meeting the SDGs has become more challenging. Fund support to countries' macroeconomic adjustment and structural reforms efforts, enabling a path of strong, sustainable, and inclusive growth, is of the essence. In this connection, strengthened mechanisms for channeling that support should be considered. More urgently, overcoming divergence and scarring will require global action on scaling up vaccine production, financing the logistics for vaccination, and directing assistance where needed.

As labor markets recover in major economies, monetary policy spillovers may become more pressing constraints under specific country circumstances. We welcome the analysis on spillovers of AE monetary policy on EME financial conditions. According to the evidence presented, AE monetary policy tightening may potentially have positive repercussions in EME financial conditions when motivated by positive economic news, including on progress in vaccines. Of course, surprise tightening events have adverse effects, pointing to the relevance of careful communication on the part of major central banks and of continuing efforts to further improve monetary policy frameworks in EMEs. That said, major EME central banks are already decreasing monetary policy accommodation given higher than expected inflation, the perspective of tighter monetary policy in major economies, increases in commodity prices and relatively fast recoveries in economic activity.

Global Financial Stability Report

With vulnerabilities on the rise, keeping financial stability on check is crucial. We agree that the macroprudential toolkit could be improved and macroprudential stance carefully tightened to address excessive increases in asset prices and credit misallocation given very easy financial conditions. China offers an interesting perspective on the tradeoffs at later recovery stages. According to the GFSR, Chinese markets have been more volatile amid policy tightening and lower expectations of government guarantees. Growth is therefore expected to slow down. The recent mild tightening of global financial conditions, which led to high asset prices and capital flows volatility, offers another glimpse into future pressures. Slow recoveries, high external financing needs and limited financial market depth all contribute to higher capital flows volatility, once again stressing the need for robust policy frameworks and adequate buffers. Furthermore, the global financial safety net needs more buffers to cope, at some point, with tighter global financial conditions, while vulnerable economies may require international support to deal with solvency issues.

We welcome the proposed decision tree approach to support viable firms under temporary stress while limiting the fiscal cost of measures. As countries gradually move into stronger phases of the recovery, governments need to reduce their footprint, allowing markets to heal with limited support. However, this needs to be an informed decision. As documented in the GFSR, solvency constraints are large, widespread, and not limited to small and medium-sized firms, which makes for a challenging environment for policymakers to remove support measures. Further cooperation with country authorities is needed to strengthen the framework with more detailed country-level data and expertise to identify liquid, solvent, and viable firms. We also support the GFSR call for developing strategies to deepen capital markets, encourage consolidation and develop distressed debt markets, including for SMEs that have been hard hit by the pandemic and will be key to support job creation going forward.

We also welcome the very useful analysis of the risks to macro-financial stability posed by rising leverage in the non-financial private sector. Leverage ratios have continued to increase to historically high levels with loosened financial conditions during the COVID-19 crisis. In a context of prolonged accommodative policies, policymakers should stand ready to use relevant prudential tools while being mindful that they may not be as effective, since they generally do not cover the nonbank financial institutions. Hence, we support the call for further development of the toolkit to address this gap. That said, the timing of deployment of macroprudential tools should be adapted to country circumstances, including the pace of recovery. Moreover, as noted by staff, due attention must be given to the time lag from taking measures to reaching tangible results, which calls for earlier action. We would appreciate further elaboration on how the optimal level of buffers would be determined given the interplay of different sectoral needs.

Fiscal Monitor

Fiscal responses were key determinants of macroeconomic outcomes across countries but a more nuanced analysis would be welcome. The policy response has substantially mitigated the effects of the COVID-19 shock and helped avert scarring, by focusing on expanding health and social safety nets, protecting jobs and incomes of vulnerable households, and supporting SMEs. Yet, wide-ranging fiscal responses across countries, to a large extent determined by different initial conditions, may have contributed to country-specific results, and may continue to do so as we move along the next stages of the pandemic crisis. The analysis should try to discern complexities and multifactorial drivers affecting the dynamic of the shock and its fallout across countries, including pre-crisis quality and access to health services, demographics, level of urbanization, access to financing, pre-crisis fiscal space and buffers, strictness of containment measures and, lately, availability and pace of vaccination.

The race to vaccinate also reflects underlying global asymmetries and calls for stronger international cooperation. The availability and pace of vaccination is a key factor to accelerate recovery and, hence, fiscal rebalancing. Different paces of vaccine rollout magnify asymmetries between countries and, in many cases, deep-seated inequalities within national

borders. This generally implies that developing countries (especially LICs and small and medium-sized MICs) are facing greater challenges. Some countries have limited market access and little scope to raise revenue in the near term and have already overextended their limited fiscal and external financing capabilities. In this regard, Fund's advice should be clear that fiscal policy must prioritize, to the extent that countries have fiscal space, supporting measures while vaccination proceeds and the recovery strengthens. However, some LICs and small and medium-sized MICs will require further international support to leverage their recovery. In this regard, we welcome staff's call to scale up global cooperation, not only to help accelerate vaccination at affordable cost in all countries, but to support macroeconomic adjustment and structural reform efforts to foster a strong, sustainable and inclusive recovery.

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GRAY/21/816

March 22, 2021

**Statement by Mr. Huh, Ms. Grant, and Mr. White on World Economic Outlook; Global
Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

OUTLOOK

We thank staff for a comprehensive and well-integrated set of documents which paints a picture of a world economy that is recovering from the pandemic more quickly than previously expected. A global contraction of 3.3 percent in 2020, versus the 5.2 percent expected in the June 2020 WEO, is a testament to the impact of swift and extensive policy support. So far so good, and this stronger base positions the world to lessen scarring effects going forward.

The speed and extent of vaccine production, distribution and take-up, and its effectiveness, are central to the outlook. This is not just a health issue. It has very real economic implications both nationally and globally. Taken collectively, the flagship documents highlight the complex interlinkages between national and global outcomes: they make a compelling economic case for widespread and equitable distribution of vaccines and the return on investment the world can expect as a result. The scenario box on vaccine rollout in the WEO is helpful in highlighting the asymmetric impact on the downside, and that this is larger for emerging market and developing economies than for advanced economies.

We welcome that staff forecasts global growth to jump to 5.9 percent in 2021 and to settle at 3.3 percent in the medium-term. But this optimism is tempered by two caveats.

First, the recovery is, and will continue to be, uneven. As a constituency that spans advanced economies and small island states, we clearly see the differences that arise from the strength of health care systems and social safety nets, and the degree of economic diversification. The longer the pandemic lasts, the larger the public finance challenges will be for all members, but this bites most for those who do not have fiscal space. The disproportionate impact on Pacific Island countries, for example, is vividly illustrated in Box 2.1 of the WEO: the shock

to hotels and restaurants alone will leave GDP 3 percent below trend in 2023. Now more than ever, the Fund needs to find ways to support its weaker members.

Second, the extent of economic scarring, and how this links to preexisting vulnerabilities, is still a big unknown. We are cautious about the conclusion that scarring will be more limited than after the GFC, noting the differences between the two crises, especially in the financial system. We hope this proves to be the case, but the important point is that policy choices (and avoiding policy missteps) will continue to determine this outcome.

RISKS

The conclusion that risks are balanced in the short term and to the upside in the medium term seems a fair one to draw from the WEO in respect of the real economy, but the GFSR leaves us less convinced that this is true for the financial sector and its intertemporal implications for the real economy.

Beyond the direct health risks of the pandemic, three things stand out. We are concerned about the rising risks to financial stability from excessive risk-taking and possible over-valuation of financial, and in some places property, assets. Second, we anticipate a significant increase in debt vulnerabilities, and while the G20 DSSI and Common Framework will assist low-income countries, should debt issues extend to middle-income countries, the Fund and the international community will need to be ready to respond. Third, we share staff's assessment of the risks around global divergence. All countries experienced the pandemic shock, and introduced stimulus, at broadly the same time. But if advanced economies recover more quickly and withdraw stimulus earlier, this may hit emerging market and developing economies through interest rate shocks, issues in refinancing debt, and potentially destabilizing capital flows. The Fund's policy advice will need to keep these risks firmly in mind.

POLICIES

While vaccine distribution is clearly not the Fund's role, it should continue to strongly advocate the economic case for strengthened international cooperation to accelerate distribution in emerging market and developing economies. *We would be interested in staff's comments on how to maximize impact in this space.*

Country level advice

With many difficult choices and trade-offs ahead for members, the Fund's policy advice will play a critical role. As the world responds to this unprecedented crisis, the lines are blurred between policy areas – fiscal and monetary, monetary and macro-prudential – and with its global perspective the Fund can assist members in navigating new challenges. Advice must

be granular and tailored to individual member circumstances, taking account of the mix and extent of accommodative macroeconomic policy in the context of available policy space, the structure of the economy, financial market conditions, and the starting point for individual members.

Perhaps the hardest choices relate to the timing of changes in direction. Members need to continue to strike a balance between focusing on exiting the crisis in the short term and, in the medium-term, avoiding scarring and addressing structural issues including developing new growth engines and driving the transition towards green, digital and inclusive economies. We stress that the crisis is not yet over and there are risks around ensuring policy support remains in place as long as needed – too much is still better than too little – especially, where possible, for smaller and fragile members. But we are increasingly alert to the delicate balance needed to avoid debt and financial stability risks so introduce a note of caution too. This is critical for those members who entered the pandemic with already weak economies and limited policy space to respond.

On fiscal policy, members will need advice on what sustainability looks like, when to start consolidating and what expenditure and revenue measures to take, and this will vary member by member. Appropriate fiscal rules for example – which need to balance these issues – are likely to look very different for advanced economies and emerging market and developing economies.

We broadly agree with staff's recommendations to maintain accommodative monetary policy wherever possible until the recovery takes hold and use tighter macroprudential policy tools to tackle specific, elevated vulnerabilities and safeguard financial stability. Clear forward guidance for monetary policy will be important in lowering risks and, once the time to unwind monetary policy arrives, the Fund may be able to assist the many members who are in uncharted territory with unconventional monetary policy, noting that history shows this can be a delicate challenge. Unwinding extraordinary support requires more than the usual degree of vigilance in the normalization phase.

Minimizing scarring will require difficult judgements on which firms to support and for how long, as well as when and how to support the reallocation of labor. We welcome the GFSR framework on identifying viable firms which will provide practical assistance to members. The pandemic is accelerating changes to industry structures and the nature of work, particularly through digitalization, and this pattern of greater digitalization is repeated in many other areas including, for example, tax and currencies. Staff analysis and policy advice on these issues would be welcome.

In terms of financial stability, the key factor will be vigilance to growing risks. The timing of the use of macroprudential measures will be important in two ways. First, it needs to be well coordinated with monetary policy so as not to impose de-facto tightening that works against needed stimulus. And second, work on extension of the toolkit to the non-bank financial sector should begin immediately: this will take time to land and implement as it is, again, new territory.

Global level advice

We are pleased that the Fund is moving ahead with decisions on a general allocation of SDRs which will provide much needed liquidity to many emerging and developing economies that will assist them to stabilize external positions and build reserves. The impact of the allocation could be further enhanced through well-coordinated structures to recycle the holdings of countries with strong external positions on a voluntary basis to the most vulnerable members. In addition, further enhancements may be necessary to the Fund's lending toolkit that respond to ongoing lessons from the pandemic and these would need to be supported by appropriate enterprise risk management given the changing shape and size of the lending portfolio.

On top of country level advice, the Fund needs to step back and consider the global picture. If, as envisaged by the WEO, advanced economies recover more quickly giving rise to a move towards monetary policy normalization and rising interest rates, policymakers may need to respond to heightened global financial volatility. We agree with staff that there is a pressing need to take early, preemptive actions to avoid a legacy of vulnerabilities and to limit systemic financial risks. Divergent recoveries could drag the Fund's work on the Integrated Policy Framework (IPF), and the review of the Institutional View on capital flows, into the limelight on a faster timeframe to allow members to benefit from the appropriate use of IPF tools to secure macroeconomic and financial stability in the face of possible volatile capital flows. We also found staff's analysis in Chapter 4 interesting, but it raises broader questions about Fund policy advice on monetary policy frameworks and how they may change in a low R^* environment, whether we are learning to live with structural trends and what role automatic stabilizers should play. *Staff comments are welcome.*

Finally, as the world emerges from the enforced isolation of the pandemic, it will be important to return to rebuilding support for multilateral frameworks and, in particular, reduce trade tensions and repair the global system for trade. Through the flagships and broader multilateral surveillance, the Fund can present a strong case for open and transparent trade and highlight, through scenario analysis, the negative effects of trade frictions, protectionism and disrupted supply chains.

Policy issues for low income countries and small developing states

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 much 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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GRAY/21/819

March 22, 2021

**Statement by Mr. Andrianarivelo, Mr. N'Sonde, Mr. Sylla, Mr. Nguema-Affane, Mrs. Raoilisoa Andrianometiana, and Mr. Sidi Bouna on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

At the outset, we would like to thank staff for a comprehensive and insightful set of flagship reports. As the world economy continues to strive to emerge from the deep crisis caused by the pandemic, we share the overall analysis contained in the reports, as well as the key messages and policy recommendations. That said, we would like to see a better synergy between the core message of the Global Policy Agenda (GPA) on addressing divergence and those contained in the flagships.

1. World Economic Outlook

While we welcome the projected strong global economic rebound in 2021, a premature withdrawal of policy support should be avoided amid highly uncertain global outlook. Swift and strong policy support across all countries has helped mitigate the social and economic impact of the pandemic in 2020. Continued accommodative fiscal and monetary policies in 2021 are expected to increase global growth by 5.9 percent this year. Over the medium-term, however, we note that global growth is projected to decelerate to 3.3 percent due to the adverse impact of the pandemic on countries' potential growth, and the effects of aging populations on labor supply in advanced economies. That said, it is reassuring to note that upside risks have risen due in part to the vaccine rollout in several countries, as well as the abundant savings accumulated worldwide. Given the uncertain path of the pandemic and the uneven vaccine coverage—which is much more widespread in advanced economies than in emerging market economies and low income-countries—, we agree that policies moving forward should be tailored to country circumstances depending on the stage of their economic recovery. Addressing the longer-term effects of the pandemic will be particularly challenging moving forward. The insights provided in **chapter 2** are very helpful in that regard. Furthermore, we share the call to take actions to address the longer-term challenges of supporting productivity-enhancing investments and strengthening resilience to climate change while also reducing inequalities within countries which have been exacerbated by the pandemic.

The social and economic damages caused by the pandemic on emerging market economies and low-income countries are more severe than in advanced economies and are likely to be longer-lasting, thus accentuating the risk of divergence and requiring high and sustained support from the international community. Several emerging market economies and low-income countries entered the crisis with very limited fiscal space and elevated debt levels, which hampered considerably their efforts to fight the pandemic and protect the poor, with women and the youth being hit the hardest. We welcome the analysis in **chapter 3** on the unequal effects of the pandemic on employment, including in the informal economy, and concur that careful monitoring of the intensity of the pandemic will be required to determine the appropriate timing for the removal of job retention support. Moreover, many countries have experienced major setbacks in their achievements of recent years in key social areas and poverty reduction. The restrictive measures to reduce the spread of the virus have further weakened the most vulnerable segments of the population in these countries, particularly due to the lack of, or insufficient, digital infrastructure for remote working and education. Therefore, the challenge of losses in human capital accumulation should be reflected more acutely in the WEO report. While emerging market economies and low-income countries should continue to actively support their economies and resume their pre-pandemic structural reforms as soon as feasible, multilateral and bilateral partners should remain closely engaged and support these countries' policy efforts. As advanced economies emerge more rapidly from the crisis, they should also be mindful of the spillover effects of monetary policy tightening on emerging market economies and low-income countries, particularly on capital flows, as highlighted in **chapter 4**. Easing access to vaccines is key to a strong and sustained recovery, and we welcome the efforts by the international community to assist in vaccine purchase and distribution, including through multilateral efforts to support the COVAX initiative.

The support provided by the IMF during these unprecedented times has been significant and should be maintained until the world economy fully recovers. While the Fund's sizeable financial assistance provided to the membership has been commensurate to the severity of the crisis, many low-income countries will require substantial financing to tackle the additional significant challenge of reducing the growing divergence in their living standards with advanced economies caused by the pandemic. It should also be noted that, low-income tourism-dependent and commodity exporters have suffered disproportionately from the current crisis and will require a tailored approach of Fund support to those countries that takes into account their particular circumstances and needs. More generally, providing low-income countries with the liquidity they need to narrow the convergence gap and enable them to invest in priority expenditures in health, education, key infrastructure, social protection, including for self-employed and informal workers, as well as contributing to the massive needs required to achieve the SDGs is primordial. A new SDR allocation and redistribution will contribute to more rapid progress towards those important goals. We welcome a reference to the broad support expressed by the membership in that regard and look forward to discussing soon the implementation modalities of such allocation and reallocation.

2. Global Financial Stability Report

We note that unprecedented policy measures have eased financial conditions and helped contain financial stability risks but also have stretched valuations and increase financial vulnerabilities, including from highly indebted firms and households.

Policymakers should monitor closely and address those unintended consequences to protect the recovery and preserve global financial stability. We agree that emerging and frontier markets with market access should take advantage of the favorable conditions to restructure their debt given the large financing needs and the risks of financial conditions tightening and capital outflows associated with a policy normalization from advanced economies.

Many frontier markets are facing external financing challenges due to various idiosyncratic factors, which are weighing on external funding costs. The report rightly highlights the challenges of those frontier markets not eligible to participate in the two G20 debt relief initiatives, i.e. the DDSI and the Common Framework. This is a significant gap in the ongoing international efforts to address debt vulnerabilities in countries with large financing needs and limited policy space. We urge the Fund to review this matter and lead on more inclusive international debt relief initiatives.

We welcome the analytical chapter on the nonfinancial private sector. Policy responses to the COVID-19 has led to further leverage from nonfinancial private sector which was already highly indebted prior to the pandemic. Greater vigilance is needed going forward as low interest rates worldwide could fuel further leveraging by the nonfinancial private sector and increase downside risks to growth. The deployment of targeted firewall macroprudential measures should be considered and implemented depending on country circumstances. A gradual unwinding of support measures should also be part of the policy mix to reduce incentives for further debt buildup. The application of this analytic framework to frontier economies in future GFSR, or during Article IV surveillance should be encouraged. *Staff comments will be appreciated.*

We find the chapter on commercial real estate (CRE) insightful. We recognize the financial risks stemming from financial exposures to the CRE, which has been hit by the pandemic. The overvaluation of the commercial real estate is quite surprising given the past economic contraction and tepid economic recovery. *We wonder whether prospects of a rapid recovery by all actors (banks, investors and owners), leasing contracts or accounting rules could explain this CRE price misalignment? Staff comments are welcome.* A slower-than-expected recovery could trigger a large sell off of CRE-linked assets and a sharp price correction which could be costly to the CRE. We agree that targeted macroprudential measures to contain borrowing could be used, but would be limited to the domestic market, whereas access to external funding is possible and could be source of additional risks. *Is there a country already acting on that front? We would also appreciate if staff could indicate whether the residential real estate is following the same trend?*

3. Fiscal Monitor

The widespread economic fallout from the pandemic has highlighted the important role of fiscal support in mitigating the impact and supporting the most vulnerable. We note

that while governments in advanced economies have implemented bold revenue and spending measures, fiscal support in emerging economies and low-income countries has been smaller and frontloaded, with a large share of measures expiring. Given high uncertainty to the outlook, we agree that fiscal policy should remain flexible and supportive of the most vulnerable households and viable firms. That said, striking the right balance between continued policy support and preserving debt sustainability should be paramount to preserve market confidence.

Fiscal responses have resulted in a debt-level record high, exacerbating preexisting vulnerabilities. While the low interest rate environment in AEs and EMEs has facilitated the purchase of government bonds, financing large deficits in LICs continues to be challenging given their limited market access and little scope to raise revenue in the near term. Therefore, we see merit in assisting those countries through grants, concessional financing, or in some cases, debt restructuring. This is essential to preserve debt sustainability and allow for much-needed investment in social protection, human capital, and infrastructure, including in digitalization.

We welcome the focus of the analytical chapter on inequality, which highlights the importance of social safety nets to tackle rising inequalities and growing poverty. We share the view that inequalities in access to basic services (health care, quality education, and digital infrastructure) can lead to persistent income gaps from generation to generation. This leads to social tensions that undermine the prospects for inclusive growth. Therefore, meeting the rising demand for public services and ensuring more inclusive policies is crucial for policymakers to strengthen public trust and support social cohesion.

Going forward, policy support needs to be recalibrated and adjusted to country specific circumstances while addressing inequality. To that end, we concur that policymakers should implement credible medium-term fiscal frameworks to set the path for rebuilding buffers depending on the course of recovery. Furthermore, fiscal policy should be geared toward additional revenue mobilization, improved service delivery and enhanced social protection systems for the vulnerable. In addition, strengthening public financial management and improving transparency and accountability will reinforce trust in the government.

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GRAY/21/820

March 23, 2021

**Statement by Ms. Levonian and Ms. Vasishtha on World Economic Outlook; Global
Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

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

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

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

World Economic Outlook

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

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

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

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

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

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

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

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

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

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

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

Global Financial Stability Report

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

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

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

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

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

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

Fiscal Monitor

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

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

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

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

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GRAY/21/822

March 23, 2021

**Statement by Mr. Fanizza, Mr. Spadafora, Ms. Cerami, Ms. Korinthios, Ms. Mateus, and Mr. Persico on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for a set of excellent Flagship reports. We much appreciate the emphasis on tailoring policies to each countries' pandemic conditions with a view to counteracting divergences and supporting the recovery. For many countries, even among AEs, the two paramount priorities remain: (a) to accelerate vaccine distribution to reach mass immunization; and (b) to continue providing support to people and firms in need. Countries that have made substantial progress in immunization should gradually shift toward more targeted support – while avoiding “cliff effects” – and tackle medium-term challenges, such as boosting productivity and addressing climate change. We fully agree that the scope for monetary accommodation has not narrowed in most AEs, given that inflation remains well below target, the recovery has not yet taken hold, and the evidence, if anything, points to declining inflation pressure. We very much welcome the call for multilateral action to provide policy space to EMDEs that face significant constraints in dealing with the crisis.

We offer the following comments:

Outlook and Policies

- **We broadly share the staff's overall assessment of the global macro-financial outlook.** The pace of the recovery and the extent of medium-term scarring remain dependent on the much-uncertain evolution of the Covid-19 pandemic and on policy actions. Nevertheless, the improvement of the global growth outlook since the October 2020 WEO constitutes a **major progress** towards a stronger, sustained, and inclusive recovery. Against this broadly favorable background, we stress that differences in **vaccine distribution and inoculation** will translate into substantial differences across countries on both the exit times from the crisis and the strength of the recovery.
- **We commend staff for quantifying the vital contribution of the policy response** in mitigating the severe impact of the Covid-19 pandemic. Regrettably, as noted in the Fiscal Monitor, fiscal policy support in **Low-Income Countries** has remained more

constrained both by pre-existing vulnerabilities and the adverse impact of the pandemic on revenues. This calls for increased international cooperation to mobilize financial assistance and speed up even access to **vaccination that will “more than pay for itself”** by boosting growth, employment, and tax revenues.

- **We strongly agree that vaccines constitute a global public good that must be made available for all on equitable and affordable terms as a key near-term priority.** The disproportionate economic and social impact of the pandemic on the most vulnerable groups is most worrisome and calls for strengthening social safety nets.
- **We share the main message of the Fiscal Monitor** (Chapter 1) that, until the pandemic is brought under control globally and recovery strengthens, **fiscal policy must remain flexible and supportive.** The battle against Covid-19 is not won yet and we must avoid a premature withdrawal of emergency lifelines, given the still uncertain paths of the pandemic.
- We broadly support the staff’s policy recommendations and the guiding principle that in each country **policies need to be tailored** to the stage of the pandemic, the strength of the recovery, and the structural characteristics of the economy. This implies that countries that are experiencing high rates of infection should focus on: (a) accelerating the distribution of vaccines to foster mass immunization; and (b) providing support to people in need. Instead, countries already experiencing declining infection rates thanks to substantial progress in immunization should start to: (a) shift to more targeted support measures, while avoiding detrimental cliff effects; and (b) adopt “robust” policies, such as expanded access to unemployment insurance, strengthened healthcare systems, and investment in greener infrastructure. We are confident that fiscal policy will play a pivotal role in helping pursue a **greener digital, and resilient recovery in a post pandemic world** and look forward to seeing the full benefits of the use of the **Next-Generation-EU** resources in Europe.
- **We are not persuaded of the need to discuss consolidation strategies or reinstating fiscal rules at this stage,** given the substantial outlook uncertainty. This is true especially in **Europe, which** is still struggling to contain the pandemic. The suspension of fiscal rules has provided many countries with flexibility in accommodating fiscal support during the pandemic, preventing a more severe economic contraction and higher social costs. We believe that this crisis may offer the opportunity to start discussions on **how to adapt the EU fiscal framework to the new reality by drawing on the experience of the pandemic.**
- **We support the staff’s advice that monetary policy needs to remain accommodative** and share the view that inflation will remain overall contained (if anything, trimmed-mean inflation rates point to declining inflation pressures), although the expected increase in commodity prices might result in some short-lived volatility of headline figures. Against this background, references to **“normalization” of monetary policy are clearly premature.**
- We commend staff for timely addressing two overarching questions going forward: (a) whether a repetition of the **2013 “taper-tantrum episode”** is a concrete risk; and (b) how to avoid that it materializes. The sensitivity of financial markets to expectations about the monetary policy stance in the US – and its potential spillovers to EMEs – has

not changed much since 2013. If anything, Chapter 4 of the WEO finds that this sensitivity is even stronger than before the Global Financial Crisis, particularly for countries with higher perceived sovereign risk. We thus agree that **clear monetary policy communication in AEs will be key** to preventing unintended shifts in global risk sentiment and instability of capital flows to EMEs. We also concur that managing these flows will be more challenging for EMEs, to the extent that they will lag behind in their economic recovery. However, staff's policy advice to these economies focuses mainly on conditions that would allow for a stronger monetary response, namely transparent and credible monetary and fiscal frameworks, which cannot be easily adjusted in the short run. Staff could have placed more emphasis on policy levers that can be quickly activated in response to capital flows in line with the Integrated Policy Framework. *Staff's comments are welcome.*

GFSR

- **We very much welcome the complementary attention that both the WEO and the GFSR pay to the potential impact of cyclical divergences on monetary policy in EMEs**, although we notice some nuanced differences in their respective assessments. Chapter 4 of the WEO acknowledges that the impact of rising interest rates in the US depends to a relevant extent **on the source underpinning the rise**, namely better growth prospects versus monetary policy surprises, with the former usually beneficial to EMEs; the **GFSR seems to take a slightly more pessimistic view**, underscoring that an early tightening of global financial conditions is expected *per se* to adversely impact EMEs and may potentially trigger capital outflows. *Staff's comments are welcome.* We also regret that, in noting the potential risk of a sovereign-bank nexus in some EMEs (GFSR paragraph 17), staff does not recognize the role played by domestic banks in stabilizing the sovereign debt markets and the favorable impact of declining sovereign interest rates on the balance sheet of banks with significant sovereign exposure.
- **Clear communication by central banks in AEs will play a key role in steering market expectations**, which in turn will help contain risks of adverse spillovers to financial markets in EMEs. In this regard, we share the view (WEO Chapter 4, p. 3) that a number of factors can mitigate the impact of monetary policy in AEs on EMEs' financial markets. At the same time, the uncertainty on the underlying drivers of tightened financial conditions may give rise to bouts of market instability, such as in late February. Besides, on the staff's assessment that investors are now expecting a return of US long-term interest rates to pre-pandemic levels in the coming month (GFSR Chapter 1, p. 6), it is necessary to specify what in staff's view is the target level that investors may have in mind: in fact, the 10-year US Treasury bond yield was in the range 1.8-1.6 percent in January 2020 but as high as 3.2 percent in October 2018. If the former yield was the intended benchmark, the recent market nervousness about rising interest rates would be somewhat puzzling. *Staff's comments are welcome.*
- **We much appreciate the GFSR's continued focus on risks in the corporate sector**, most notably a wave of defaults and insolvencies that may negatively impact banks as well as governments that provided guarantees. Despite notable differences depending on firm size and sector, in our view, if unaddressed, these are the risks with perhaps the

greatest potential for consequences of a systemic nature. While the strengthening of the equity positions at many firms is a welcome development, we agree that **supporting balance sheet repair in the corporate sector is a key priority** to help foster a sustained recovery. At the same time, the **overall soundness of banks** across both AEs and EMEs – which has underpinned the resiliency of the global financial system through the Covid-19 crisis – is a **major risk-mitigating factor**.

- **We commend staff for the analysis** (paragraphs 59-62) **of the drivers of banks' usability of capital buffers**, which sheds light on an important and perhaps unexpected piece of evidence from the response to the Covid-19 crisis. Low profitability emerges as a key constraint to buffer usability. Since low profitability is a structural rather than cyclical issue, incentives to draw down buffers are set to remain weak, which should contain the risk of deleveraging. Against this background, staff's concerns about the banks' willingness to provide an adequate flow of credit during the recovery and attendant **expectations of a slowdown in lending may be pessimistic**. The staff's characterization (paragraph 51) of the alleged reluctance of banks to ease lending standards for SMEs – notably in EMEs – when credit demand resumes needs to be qualified as it seems unduly negative and perhaps somewhat at odds with the call to avoid “zombification”. *Staff's comments are welcome.*
- **We are wondering whether the recommendation on macroprudential tightening might not be sufficiently targeted**. First, the recommendation should be **clearer about the timing** of the tightening: until the pandemic is not reigned in, policymakers should allow banks to use their buffers to continue providing the necessary credit to the economy, while maintaining adequate lending standards. Second, we think the recommendation should be **more focused** in terms of tools to be used and financial intermediaries to be covered. As staff recognizes, macroprudential tools are applicable mostly to banks. However, currently banks are much better positioned to deal with risks, as strong capital and liquidity buffers and an appropriate regulatory response have allowed them to navigate well the Covid-19 crisis. We should avoid that the recommendation to early tighten macroprudential tools is perceived as requiring banks to increase **capital and liquidity buffers during the crisis**, notably when banks endogenously refrain from using capital buffers given uncertainty and concerns over prospects for future profitability. Staff rightly makes the case for aiming directly at borrowers to tame the build-up of leverage. However, not all borrowers are intermediated by the banking sector. Hence, we strongly support the call for **developing macroprudential tools for non-bank** financial intermediaries. *Staff's comments are welcome.*

WEO Analytical Chapters

Demand and Supply in a Low-Contact Economy: A Primer on the Pandemic Shock

- **Staff highlights that the pandemic might lead to permanent demand shifts and productivity losses in the economies more reliant on services**. Moreover, this conjuncture is likely to take a toll on the labor market and interconnected industrial districts more than in previous crises. In this regard, when reviewing the four determinants of medium-term scarring identified by staff – pandemic path, impact on

high-contact sectors, business adaptation, and policy response – we would like to highlight that broader public policies (e.g., investment in technological infrastructures, regulations, etc.) are key to promote adaptation to low-contact working and can support the recovery. *In this regard, we wonder if staff is considering specific policy advice on post-COVID work's transformation.*

Recessions and recoveries in the labor market: patterns, policies and responding to the Covid-19 shocks

- **We welcome the insightful analysis by staff on such topical issues. We note that the impact of the pandemic on employment has been highly unequal across groups of workers**, with youth and lower-skilled workers hit harder on the average across advanced, emerging market and developing economies. We are a bit surprised to read that, while in emerging market and developing economies **women's unemployment** has risen more than men on average, in advanced economies there is little difference in average unemployment across genders. Since we are seeing women across the globe (also in AEs) exiting the workforce at a faster rate than men, **further research on women's unemployment trends would be helpful.**
- **We welcome the focus on the specific policies – mainly job retention and worker reallocation, ideally in a comprehensive policy package – that can help mitigate the damage done by the pandemic.** As underscored in the report, the *Cassa Integrazione Guadagni* program in Italy is an example of how important such job retention measures can be while the shock is ongoing. As the recovery gets under way, a significant effort to facilitate effective reallocation of workers is paramount. This calls for **investments in retraining and human capital** to help workers switch occupations effectively and timely. Since the pandemic has accelerated trends in remote work, e-commerce and automation, workers should try to adapt to the post-Covid economy, considering that some old jobs may not be coming back: it is time to be more ambitious without leaving anyone behind. **Fast action to reemploy and reallocate workers across sectors and occupations is key** to prevent the risk of stigma and skill obsolescence.

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GRAY/21/823

March 23, 2021

**Statement by Ms. Shortino, Ms. Senich, Mr. Gudicello, Ms. Robitaille, and Mr. Westphal
on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

This spring's WEO, GFSR, and Fiscal Monitor come at an important inflection point in the pandemic. Now, more than any other time since the crisis began, there is a case for cautious optimism, with vaccines being rolled out and potential pent-up demand ready to be unleashed in economies as case numbers decline. At the same time, many countries remain deeply entrenched in this crisis, and delays in the provision of vaccines to emerging markets and low-income countries represent a significant downside risk. **Our first priority must remain to address the health crisis:** making vaccines and therapeutics available globally to stop the virus, while also countering potential mutations.

It is imperative that we continue – and where feasible amplify – strong policy actions to support jobs and incomes until the crisis abates. In the absence of continued policy support, we face the risk of a prolonged recession and deeper scarring of the global economy. While we appreciate the focus of the flagship documents on the need to carefully calibrate the unwinding of policy measures, we would have welcomed greater emphasis on the risks associated with premature withdrawal of support. As these risks cut across fiscal, monetary, and financial policies, we continue to believe that there could be even greater integration of the documents.

As we move into the later stages of the crisis, we agree with staff that there are a variety of pending risks with our economic recovery, whether it be significant divergence between recoveries in advanced and emerging and low-income economies, increasing inequalities within countries, rising debt burdens, and/or looming policy unwinding that unnerves the financial sector. Particular attention will need to be paid to emerging market and developing economies (EMDEs) to help ensure countries maintain access to financing for vaccination and economic recovery and that debt resolution processes, where necessary, are comprehensive and efficient. Structural changes to the economy that support green investment, infrastructure, and promote greater equality could have a lasting impact.

Economic Performance and Outlook

Despite the extreme uncertainty at the beginning of the pandemic, staff's forecasts for global growth turned out to be prescient, with the 2020 Spring WEO forecast for -2.9 percent in 2020 compared to current estimates of -3.3 percent. We welcome the improved growth outlook in the April 2021 WEO forecasts as compared to January's forecasts, a reflection in part of over performance of Q4 results. **Decisive fiscal and monetary policy responses to the pandemic, particularly by advanced economies, along with the swift action to develop vaccines, have driven this improvement in global economic conditions.** We highlight the WEO's finding that the pandemic policy response has been greater than what was done during and following the Global Financial Crisis.

We appreciate staff's analysis showing that the recent American Rescue Plan (ARP) should raise global growth this year by a full percentage point and should close the U.S. output gap over the next several years. We note that staff's forecast for U.S. growth is in line with other recent projections, although we expect the United States to return to full employment by the end of 2022. We agree with staff that the strength of the recovery will vary considerably across countries, and the risk of a divergent recovery remains high. We also welcome and agree with staff's assessment that despite significant fiscal support and monetary easing worldwide, inflation in most countries is likely to remain subdued.

With regards to the external sector, we found the WEO Chapter 1 discussion of current account developments lacking in detail. Staff's forecasts suggest that current account imbalances will widen sharply in 2021, narrow sharply in 2022, and remain stable into the medium term. Staff project the U.S. current account deficit, for example, to expand sharply to 3.9 percent of GDP this year (from 3.1 percent in 2020) before narrowing back to 3.1 percent next year. Germany's surplus jumps and then contracts sharply too. *Could staff provide additional information on what is driving the sharp narrowing of imbalances next year?* Staff also increased its forecast for China's 2021 current account surplus from 0.9 percent of GDP in the January 2021 Article IV to 1.6 percent in the April WEO. *Could staff also provide background on this shift?*

Policy Recommendations

Uncertainty remains high due to the potential emergence of COVID-19 variants and significant lag times before the whole world can be vaccinated. The WEO and the GFSR correctly emphasize that the most important thing that countries can do to exit the crisis is rapid vaccination, including the expansion of vaccine production capacity. A near-term priority will be for the global community to support countries to employ all available measures including speeding vaccination campaign implementation to accelerate the recovery in the face of new variants.

We broadly agree with staff's policy priorities as outlined in the WEO, particularly the need for international cooperation. We appreciate that staff broke down the policy recommendations into various phases that can apply to countries as they reach different levels of recovery. However, some of the recommendations from Phase 3 (Investing in the Future) could have also been incorporated in Phases 1 and 2. Many countries, including the

United States, are embracing the call to “build back better” in the wake of this pandemic. Near-term fiscal support aimed at investing in infrastructure, health, education, and climate change mitigation and adaptation will be pivotal in boosting productivity and growth over the medium-term. The current low global interest rate environment makes this an optimal time to make such investments.

We also agree that there is a strong risk of divergent recovery paths within and between countries, and we urge staff to provide global thought-leadership on how to resolve these issues. We agree with staff’s analysis in the Fiscal Monitor that the main fiscal challenge facing countries over next few years will be striking the appropriate balance between maintaining adequate support in the near-term while moving to sustainable frameworks by mid-decade. We would appreciate more analysis from staff to identify what specific measures can be put in place to reduce scarring in emerging markets and mitigate the risk of divergence.

As countries build back better, well-crafted fiscal policies can help do so in a way that is both sustainable and equitable. Targeted revenue policies will be particularly important for many emerging markets and most low-income countries that face limited policy space and constraints to market access. To this end, we agree with WEO Chapter 1 and Fiscal Monitor Chapter 2 recommendations to reform tax systems over time and rebuild fiscal space gradually and in a more equitable way. The Fiscal Monitor projects the need for a massive fiscal adjustment over the medium term – on the order of 7 percent of GDP for advanced economies and 5 percent of GDP for emerging markets and developing economies – in order to restore fiscal sustainability and address high debt levels. This projection underlines the importance of a strong policy response now to support a growth-led recovery. We also emphasize the need for strong government ownership, clear communication on needed reforms, enhanced public financial management and transparency, and strategies for deploying adjustment in a fair and sustainable manner.

The GFSR’s key policy recommendations are generally sensible. We agree that emerging market and developing economies need to prepare themselves for a tightening in global financial conditions in part by continuing to improve their macroeconomic policy frameworks. We took note of the recommendations in Chapter 1 that it may be desirable for countries with “low reserve adequacy to put in place a transparent strategy to accumulate reserves, to the extent that it does not undermine the inflation objective,” and believe the report could have been clearer about what low reserve adequacy means, as countries may view this as a recommendation for foreign exchange intervention when this may not be the first best policy. We would also note that the contemplated general SDR allocation will raise reserve holdings.

We agree that financial policy support must become more targeted, to avoid the adverse side effects of broad policy support, including misallocation of resources and a less resilient financial system. We found somewhat reassuring that staff’s analysis in Chapter 1 concluded that the end of loan moratoriums and phase-out of government guarantees looks manageable, but banks will need to increase provisions and risk weights on loans. We note the recommendation to improve bankruptcy and resolution procedures, but the report does not

appear to have provided guidance on the question of how banks can help promote economic recovery. To say it differently, staff did not appear to answer their question that if banks are not part of the problem this time, can they be part of the solution.

Other Topics

Inequality: Staff correctly note that the impact from COVID has not been evenly felt and that the pandemic only worsened already existing divisions in our societies. We note that the American Rescue Plan aims to reverse the increase in the U.S. poverty rate. Both the WEO and the Fiscal Monitor aptly describe how women and low-skilled workers have borne the brunt of job losses, and students from low-income families risk paying a high price for the extended school closures. We agree that the need to continue to support vulnerable households and finance rapid and widespread health efforts means countries should carefully target expenditures and leverage scarce resources as effectively as possible. As the world exits this crisis, robust support for health and education will also remain vital. We strongly encourage emerging markets and developing countries to develop robust reform agendas and to leverage the support of the international financial institutions, including through lending and capacity development, in executing these agendas.

Debt: Staff note in Chapter 1 of the Fiscal Monitor that the fiscal surge in 2020 has raised public debt to unprecedented levels. While many advanced economies have benefited from exceptionally low interest rates, for many low-income nations fiscal adjustment alone will be insufficient to return debt to sustainable levels. The Debt Service Suspension Initiative has provided much needed, but temporary, fiscal space, and the Common Framework will help to facilitate future debt relief. It will be critical that, moving forward, the international community help ensure full and transparent implementation of the Common Framework, and we encourage creditors to work expeditiously to facilitate swift and effective implementation of debt treatments. Recent cases of delayed restructurings and limited creditor participation have also reaffirmed the need for greater debt transparency, particularly with regards to complex debt instruments and collateralized debt.

We share staff's concern in the GFSR Chapter 1 over small and medium-sized enterprises' access to credit and the difficulties surrounding loan syndication currently. We too are aware that the private credit market has grown substantially, but the analysis did not leave us with a clear picture of (1) how much of the credit gap private credit has filled and (2) what policy prescriptions staff would advise.

We would have also appreciated greater granularity in the GFSR's analysis of emerging market economy vulnerabilities, particularly with respect to gross external financing requirements (GEFRs) and the sovereign-bank nexus. In the past, we found estimates of individual countries' GEFRs compared to their corresponding bond spreads to be useful indicators of future stress. Also, we were left questioning the extent of the risks surrounding the sovereign-bank nexus without accompanying data, including (1) overall levels of sovereign debt concentration on emerging market economy banks' balance sheets, (2) a baseline for which to compare the debt concentrations, and (3) indicators of banks' liquidity.

Chapter 2 of the GFSR also highlights the significant increase in nonfinancial private sector (nonfinancial firms and households) debt in most countries since the global financial crisis. We note that staff define leverage as the reliance on debt in relation to income. It might be useful to examine this data alongside other variables, such as debt service ratios which may provide a more accurate picture of vulnerabilities in the current environment of lower real interest rates and can help inform the extent to which higher leverage threatens financial stability.

Monetary spillovers: We recognize that monetary actions by the Federal Reserve and other major central banks can impact financial conditions worldwide, as discussed extensively in the WEO. Fund staff label this a “risk channel” and attribute it primarily to a “push” factor, but spillovers due to emerging markets’ vulnerabilities is also a negative “pull” factor. These issues are not new, and the best preventative measure for emerging markets is to implement sound policies now that build market confidence. The Federal Open Market Committee has stated its commitment to maintain accommodation until it fully achieves its objectives of maximum employment and inflation that averages 2 percent over time. In the meantime, the strengthening U.S. economy is already boosting U.S. imports from other economies, improving global sentiment, and helping to support commodity prices. In this way emerging market economies also benefit from higher growth, offsetting the drag on some economies from the rise in global bond yields.

Given these dynamics, we are surprised that Chapter 1 of the WEO was so positive on capital flow measures and exchange rate intervention as ways to minimize disruptions that could arise from capital flows. Such measures, if adopted, could also be counterproductive by hurting business confidence, disrupting efficient capital allocation, and preventing exchange rates from adjusting appropriately during an already fragile moment in the global economy. We fear the caveat in the text that “such policies should not substitute for needed macroeconomic adjustment” may not be sufficient to deter broader use of foreign exchange intervention by countries seeking a competitive trade advantage. We expect staff to incorporate these considerations more thoroughly into future writing on this topic.

We appreciate that Chapter 1 of the GFSR identifies countries’ varying recovery rates as a risk to emerging and frontier economies. Rising interest rates in advanced economies could pose a risk to capital flows to emerging market economies, particularly as central bank accommodation in these countries is reduced as a result of their recovery outpacing that of developing countries. Now is the time, before interest rates rise, for policy makers to strengthen their macroeconomic policy frameworks so that they can make more use of a stronger global economy.

Asset Purchase Programs (APP): We appreciate the additional attention to APPs in emerging market economies in Chapter 1 of the GFSR. The authors find that APPs were effective in reducing bond yields. *Could staff clarify if the results shown in this chapter differ from the earlier findings and from results found in outside research?* In addition, it would be helpful if staff could distinguish between APPs that were undertaken to address market disfunction rather than to promote economic recovery or improve monetary policy transmission, as was the case for the advanced country APPs. This self-extinguishing feature of the APPs in most

emerging market economies could explain why they were successful—financial market participants understood that the asset purchases would end.

Conclusion

Recovery from the pandemic is within our reach. However, the global community needs to act forcefully to vaccinate the world's population before we can fully close out this crisis period. As countries enter into this recovery phase, they will need to address structural transformations and disruptions accelerated by the pandemic and challenges with unwinding support. It will be incumbent upon the global community to work together, and with robust support from international institutions, to build back better: addressing unsustainable and rising debt, reversing destabilizing increases in inequality, taking measures to protect the world from climate change, and leveraging technology to its full benefit.

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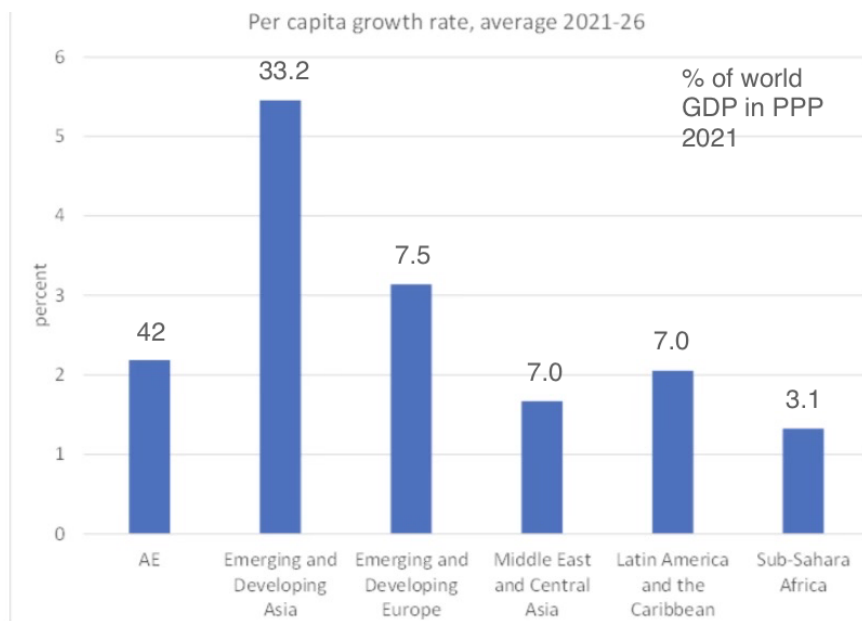
**Statement by Mr. Mozhin, Mr. Palei, Mr. Potapov, Mr. Tolstikov, Mr. Biriukov, and Mr. Shestakov on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

The COVID-19 pandemic continues to take a heavy toll on the global economy, and the outlook, while improved, is still uncertain. Vaccine rollouts in many countries seem to be on the upside of previous projections, but the medium-term adjustment costs for different countries due to the pandemic will only be known over time. Additional sizeable fiscal support in some advanced economies is likely to boost both their own growth and that of their trading partners, although new related risks to financial stability are emerging. In many EMDEs projections have also improved even despite a much more moderate fiscal stimulus and due to the prompt response from their healthcare systems and overall policy packages.

The headline notion in the WEO of lasting divergence in growth prospects between advanced economies and emerging market economies is somewhat artificial and fails to account for variation within the three main country groups. Given the impact that communication from the Fund has on market sentiments, we would welcome a more balanced approach to presenting and contextualizing WEO projections. Uneven growth is a long-standing phenomenon, and some economies may be affected by the pandemic harder than others. However, we see little evidence that it correlates with the income level. Based on our bilateral conversations with staff, we would like to make several observations. First, we understand that in terms of GDP per capita, in 2021-2026, EMDEs in Latin America, Sub-Saharan Africa, and the Middle East are expected to grow somewhat slower or similarly to the per capita growth rates in advanced economies. However, the EMDEs in Asia excluding China and China itself are expected to grow about three times faster than advanced economies. The projected per capita growth rates in emerging Europe are also significantly higher. The regional differences are huge, and, in our opinion, the WEO should not lump all the countries together, let alone send a message which might be confusing to readers. With somewhat closer examination, to a large extent the divergence story turns out to be a stretch.

We ask staff to provide a corresponding chart in their written responses to Directors.

To the chart provided by staff we added the share of each group of countries in the World GDP in PPP terms. The combined share of the rapidly growing Emerging and Developing Asia and Emerging and Developing Europe is almost equal to that of the advanced economies. Hence, the convergence largely continues.



Second, the speed of recovery can be measured in more than one way. One way is to compare forecasts before the crisis and now. Another way is to look at the return to the pre-crisis GDP peaks. The latter shows that the EMDEs are doing much better than the advanced economies. It would be particularly true if the United States was treated as an outlier in the group, similarly to the way China was treated for the EMDEs. *Here, again, we would ask staff to provide a corresponding chart to Directors.* Moreover, we note that within the advanced economies the speed of recovery differs substantially, the group is not homogeneous. Recalling economic performance after the Global Financial Crisis, we note that, for the euro area, the envisaged performance follows the “lost decade” of the previous period. *Staff comments on the advanced economies would be appreciated.* Overall, we believe that a more balanced presentation of the outlook would significantly benefit the WEO.

On balance, for the world economy as a whole, the fiscal policy stance is expected to tighten in 2021 as the pandemic-related policy support is phased out and the effects from the automatic stabilizers decrease. However, there is a significant heterogeneity between advanced economies, which have announced additional fiscal support packages. The fiscal package in the US at \$1.9 trillion is expected to deliver strong growth, while fiscal

packages in other advanced economies, including Japan and advanced Europe, while also sizeable, are lower compared with the US and will be spread throughout the recovery phase. China and other large EMDEs, while gradually reducing their budget deficits, will still continue to provide stimulus to their economies over the medium term. These measures combined with the output reduction will increase the debt-to-GDP ratios from already high levels accumulated during the pre-pandemic and pandemic debt-surge waves. Vulnerabilities to protracted economic downturn and possible abrupt tightening of global financial conditions are heightened, and in some countries addressing these vulnerabilities amounts to fiscal consolidation starting as early as 2021, with risks of slowing down the recovery and increasing the persistent economic damage from the crisis. With difficult trade-offs that are faced by policy makers, there is no one-fits-all solution.

Accommodative monetary policy remains necessary, but it now has to take into account new developments in the fiscal area as well as possible market overreaction. Many respected observers pointed out that a new policy mix augmented inflation risks, and we see a special challenge in communicating any policy stance, including possible tightening. In this respect, we find Chapter 4 in the WEO to be particularly informative on the risks of unexpected monetary tightening in the advanced economies, especially in the US. In many countries unprecedented fiscal stimulus packages are now estimated to go further than simply closing pre-pandemic output gaps, which may generate inflationary pressures. We understand that, under the baseline scenario, the inflationary response is likely to be muted as a result of anchored inflation expectations and Phillips curve relationship weakened by the global market integration. However, if inflation does materialize, central banks should avoid rushing into a preemptive tightening, and enhance credibility of their new monetary policy frameworks, which allow inflation to stay somewhat above the target for some period of time. Throughout the process, clear and transparent communication from central banks will be the key.

Staff appropriately highlight a very challenging environment for the EMDEs, especially considering that the risk premium across the EMDEs compressed significantly following last year's aggressive rate cuts. The recent rise in the US yields is broadly in line with the average rises during the previous episodes. However, its impact seems to be relatively stronger on EM assets, and in particular on fixed income assets this time. Against this background, we think it is important to reduce the risk of fiscal dominance concerns by considering credible fiscal consolidation plans once the pandemic allows. *At the same time, we doubt that, in case of tightening of international financial conditions, the effects are likely to be limited to the EMDEs only. What will be the effects on advanced economies lagging behind the US in their business cycles?*

Advice for more inclusive growth is becoming more prominent in the IMF flagship reports. Chapter 2 of the Fiscal Monitor makes a strong case for more socially oriented policies, including higher public spending for social and development purposes, higher and

more progressive taxation. “For the recovery period and beyond, policies will need to aim at giving everyone a fair shot at lifetime opportunities by reducing gaps in access to quality public services. For most countries, this will require mobilizing additional revenues and improving the delivery of services while fostering inclusive growth”.

While the socially oriented approach looks attractive, it was not accepted universally before the pandemic and for good reasons. Low- and middle-income countries are lacking the resources required for maintaining the European-style social models. High income economies outside Europe, led by the US, mostly preferred less paternalistic approach. As the pandemic drew attention to the scale of inequality and poverty within the advanced economies, the attitude may be changing, including in the US. However, as the pandemic has sharply reduced fiscal space for many countries, the problem of limited fiscal resources has only become worse. Without sustained economic growth supported by deep structural reforms it would be challenging to address these issues.

In a more constrained fiscal environment, increasing social support for the poor and vulnerable is mainly possible through redistribution and more focused support. First, targeting of social measures must be improved, reducing the share of those that may benefit the middle class and the rich. Second, staff advised that the rich strata of the society should pay more, mostly through higher taxes. Staff also advised to impose “temporary COVID-19 contribution levied on the incomes of the rich”. Previously, the efforts to increase tax pressures on the wealthy and powerful were constrained by the ability of the rich to avoid taxation through tax heavens and other methods of tax optimization. At the same time, we agree that the ongoing digitalization provides more opportunities to identify and trace financial flows and tax property. Also, international tax reforms and cooperation in the tax area, if successful, may further reduce the possibility to avoid and evade tax payments. Most likely, this will be a long and difficult struggle, and we should not expect substantial gains in the near term. *Could staff comment on the prospects for increasing progressivity of taxes and tax compliance of high-income households in the major economies?*

More EMs have resorted to unconventional monetary policy measures, and some may consider adopting new monetary policy frameworks. According to staff, asset purchase programs (APPs) were more likely to be announced in countries with greater exchange rate flexibility, greater central bank transparency, and more rules-based fiscal policy frameworks. The interpretation of this finding is less clear: perhaps, in countries with better monetary policy frameworks APPs are more effective, or due to globalization their neutral policy rates move together with those of advanced economies. Given that so many advanced economies are conducting a review of their monetary policy frameworks with greater emphasis on “make-up strategies” (average inflation targeting, price level targeting), the option of adopting a new framework along these lines instead of increasing central bank balance sheets even further might be considered.

Investment in green infrastructure, accelerated shift to digitalization and expanded social safety net would limit persistent economic damage from COVID-19. We agree with staff on the key policy steps that might limit scarring, which are focused on recuperating losses from educational disruptions and preparing the economy for the post-COVID environment. We consider the description of the COVID-19 shock as a massive initial supply shock combined with a large decline in demand propagated through production networks to be broadly accurate.

Active labor market support has been focused on job retention during the active phase of the crisis and should be focused on job reallocation during the post-pandemic recovery. There is some conflict between job retention and job reallocation policies, which is underemphasized in the WEO. During the recovery phase many countries might find productivity growth slowing down because inefficient matches on the labor market were retained throughout the crisis. We also note the finding in Chapter 3 that employed workers that switched occupations increased their earnings, while unemployed workers that switched occupations faced a sizeable earning penalty. This penalty is likely explained by those cases when the job search within the occupation is unsuccessful forcing the decision to switch, and the individual's human capital specific to previous occupation is lost. The loss of the human capital is less pronounced for younger and low-skilled workers, which explains why these categories gain the most from reallocation programs. These switching costs might indicate that not every reallocation is desirable, and many of the job switches in fact constitute misallocations for people unable to search within the occupation for longer.

With vaccinations in sight, it is time to look for an effective economic exit strategy into the post-COVID era to safeguard global financial stability. Ultra-easy economic policies, while having cushioned the pandemic's blow, spurred excessive risk taking on the global financial markets and public debt buildup both in AMs and EMEs. As policy makers gradually shift their attention from the recovery to medium- and long-term prospects of their economies, appropriate pace and sequence of policies' normalization will have important implications for the global financial stability.

We encourage staff to be more vocal on policy recommendations for dealing with global financial market misalignments. Last year the Fund was among the first to warn about the growing disconnect between financial markets and the real economy. At the same time, policy advice has hardly gone beyond statement of facts and broad advice to enhance regulatory approaches. We also see merit in a deeper analysis of the cryptocurrency markets, taking into consideration growing public companies' exposures to the bitcoin.

We find a proposed framework in Chapter 1 of the GFSR for determining viable firms to be of great analytical value. Leverage in the corporate sector reached historic highs for many economies in the run-up to the virus outbreak and the subsequent recession has turned

many firms into new “zombie companies”. The developed framework proposes a simple approach to facilitate exit of non-viable companies.

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GRAY/21/826

March 23, 2021

**Statement by Mr. Hosseini, Mr. El Qorchi, Mr. Ahmed, Mr. Sassanpour, Mr. Belhaj, and Mr. Osei Yeboah on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

The global health crisis has demonstrated that coordination and international cooperation are key for steering the global economy towards recovery. Given that all countries are still facing the fallout of the COVID-19 pandemic, it is important to support EMDCs dealing with short and medium-term economic problems and fragilities ranging from emergency financing needs, debt sustainability challenges, to economic and social reforms. Sustainable recovery requires bringing COVID-19 under control in all countries. The availability of vaccines at affordable prices across the globe is already putting the international cooperation to the test.

The World Economic Outlook

The synchronized negative supply and demand shocks caused by the COVID-19 pandemic were truly unprecedented in nature, scale, and breadth. The coordinated, forceful, broad-based, and timely policy response on the part of major economies prevented a substantially worse outcome, but the damage to incomes, employment, and social conditions were still significant in virtually all countries. The upside growth surprise in more recent months, in part reflecting improving sentiments associated with vaccine rollouts, provides ground for optimism, but significant uncertainties, notably regarding the path and duration of the pandemic and risks of permanent scarring, weigh heavily on the outlook.

The recent surge of the virus and its mutations in different parts of the world and the struggle to contain it in some regions are alarming. The difficulties faced by many developing countries to procure sufficient vaccines and inoculate enough of their population to attain herd immunity is a cause for serious concern. International cooperation would be strongest when vaccines are made available at affordable prices across the globe, including through the COVAX project.

We broadly agree with staff analysis and policy proposals focusing on the three phases of the pandemic and recovery through the medium term. The uneven economic recovery across countries as well as within countries, however, presents different set of challenges for different country groups that cannot be captured by general policy prescriptions. We were expecting more idiosyncratic analysis and granularity in policy options facing different country groups going through the same three phases, but with significantly different starting positions, at different paces, and with different policy options and constraints. *We welcome staff comments.*

One of the disconcerting features of the current crisis is the sharp income divergence between rich and poor countries and the loss in a matter of few short months of economic and social gains that many developing countries had achieved over few decades. Low-income countries (LICs) and small island economies, heavily reliant on tourism and remittances, were particularly hit hard. Some of the loss maybe reversible, but probably not all, or at least not quickly. In virtually all countries, youth, women, unskilled workers, and underprivileged have paid the highest price, widening the social and economic rifts within many countries.

The immediate as well as the medium-term outlook for poorer countries, in a context of global uncertainties, is also more bleak given their ongoing struggle to stop the spread of the virus and reverse the economic downturn while addressing their social and development goals with limited policy space and tighter financial conditions. Another important dimension of international cooperation is for richer countries and IFIs to ensure adequate access to international liquidity and debt relief for financially constrained poorer economies. The expansion of Fund's toolkit with emphasis on concessional and emergency financing, and debt service relief operations through the CCRT and the G-20's DDSI, have provided important lifelines for LICs during the crisis. An expeditious and sizable general allocation of SDRs will help meet the urgent liquidity needs of developing countries, providing an important buffer against shocks, current and future.

No dimension of the current pandemic has been more pronounced than its human toll. The pandemic has pushed tens of millions of people into extreme poverty and throes of serious food insecurity. The plight of fragile and conflict affected states and displaced persons and the daunting challenges they face seeking food, shelter and security should not be lost in the big picture. We welcome the WEO's special feature on food security and encourage staff to weave it into its ongoing workstreams on poverty and income inequality.

As the synchronized policy response of major economies at the onset of the crisis pulled the world economy away from the edge of the abyss, a similarly coordinated strategy is needed to support the nascent global recovery and maintain its momentum. In this regard, we encourage AEs with untapped fiscal space to also use them in support of a stronger global recovery and to minimize scarring of their economies. While policy interest rates in AEs and some leading EMs are now at their effective lower bounds, well communicated monetary

policy accommodation could continue through expansion of central balance sheets as long as there is considerable economic slack and inflation expectations are firmly anchored close to target rates.

A key challenge facing AEs and EMs as they emerge from the crisis is to boost productivity and potential growth as a part of a broader transformational recovery, that would include investments in human capital, infrastructure, and green energy. Recognizing the difficulty of assessing medium-term potential growth in the midst of great uncertainty, a constant factor is encouraging higher labor force participation, especially of women and youth, by providing comprehensive child care programs, and retraining and retooling in line with the changing requirements of the post-COVID economy.

The abrupt and almost simultaneous supply and demand destruction at the onset of the pandemic set in motion sharp swings in prices of commodities and food prices. International oil prices initially plunged, but within months recovered to pre-pandemic levels in response to coordinated output cuts by OPEC+ countries. These policies stabilized the oil market and removed the threats of a major durable shock for the oil exporters in our region as they were struggling with health and economic fallouts of the pandemic. The fact, however, remains that wild swings in oil prices, and commodity prices in general, are not in the interest of neither the consumers nor the producers. The balance sheets problems of shale oil producers provide testimony.

We support Fund's increasing attention to macro-critical dimensions of climate change. The impact of global warming due to climate change is universal, but LICs and small island states have been hardest hit despite their negligible carbon footprints and their limited ability to build resilience toward climate change. They deserve closer attention and financial support, when needed.

Global Financial Stability Report

We broadly agree with the GFSR analysis and concur that the rapid and unprecedented support and the extraordinary prudential treatments have provided critical relief to households and businesses. Such measures pose, however, significant potential risks to the financial sector through excessive profit-seeking behavior, that could result in asset bubbles that warrant careful monitoring and redress.

Policy makers face important challenges, requiring delicate trade-offs to normalize policies while sustaining the recovery and macro-financial stability. Accommodative monetary policy and historically low interest rates have fueled a hunt-for-yield behavior causing a disconnect between certain market asset prices and their fundamental values, particularly for equities, real estates, and crypto-currencies. We note with concern the excessive risk-taking

tendencies by non-bank financial institutions and caution against a repeat of a behavioral pattern that led to the subprime crisis in 2008.

We recognize the risks stemming from the large financing needs for many emerging and frontier economies, and the refinancing challenges they will face if the yield curve steepens further or financial conditions tighten. While various strategies have been adopted, such as asset purchase programs and reliance on domestic banks participation in government securities, they raise concerns about structural legacy problems in the domestic money market if not timely reversed.

We agree with staff assessment that corporate over-leverage from the favorable low rate environment present notable dilemma for policymakers, weighing short-term boost to economic activities against downside risk to growth. With respect to banks, the phase-out of policy support programs could have an impact on their profitability and appetite for credit creation. Uncertainties about credit losses could prompt them to deleverage rather than use their capital buffers, with adverse feedback loops to the real economy and possible spillover effects on the financial system.

We broadly agree with staff policy recommendations emphasizing continued policy support until the recovery is well established. However, support should be more targeted and efficient, and promote policies that foster sustainable and inclusive growth. The tapering of support measures should be gradual and in line with the state of the economy, and avoid the risk of dampening the recovery. We agree that for some economies appropriately timed and selective macroprudential policy tightening to address areas of high fragility is warranted. To avoid policy slippages while fostering resilience, measures should be complemented by building buffers when possible. More generally, policymakers will need to properly manage debt sustainability, encourage balance sheet repairs, address NPLs, and improve safeguards and tools for prompt recognition of risks.

The Fiscal Monitor

The FM also provides a sobering account of the recent trends and developments, and policy choices dilemmas facing countries. We broadly agree with the thrust of the analysis and policy recommendations presented by staff.

We note that many advanced economies are implementing sizeable spending and revenue measures in 2021, whereas support in emerging market economies, and especially in LICs has been smaller and is dwindling with many countries constrained to withdraw the emergency support. We also note that the size, composition, and duration of fiscal support has varied across countries and has influenced its effectiveness (¶FM, Chapter 1, Figure 1.7). That highlights the dilemma of determining the appropriate size and focus of the fiscal policy response to promote sustainable growth in a downturn. We underscore that policy makers

should prepare for an extended period of fiscal support to return economies to pre-pandemic levels of output and employment. *We note that some advanced economies are likely to recover faster, not only because of the controlled spread of disease, but mostly because of enormous economic stimulus. We, therefore, consider that countries need to provide targeted relief more than indiscriminate emergency spending with large fiscal stimulus package. Staff comments are welcome.*

COVID-19 has worsened preexisting inequalities and *vice versa*. We welcome the coverage of FM (Chapter 2) on the rising inequalities and divergences across and within countries. *In this context, we wonder if the Fund could possibly integrate distributional national accounts in its analysis, instead of restricting itself to using GDP numbers, in order to take into consideration and address distributional issues in member countries.* While the analysis provides useful insights on the effects of the COVID-19 pandemic on trends in inequalities, public policy choices offered to reduce inequality and enhance opportunities are essentially similar to those that would have been appropriate before the pandemic. In this regard, we agree that policy responses should recognize various aspects of inequality (income, wealth, opportunity) which are mutually reinforcing, and thus interventions need to combine pre-distributive and redistributive policies. For lower-income economies that face multifaceted challenges and severely constrained fiscal space, sustained international support to aid reform efforts in achieving SDGs by 2030 would be crucial. In all countries, tailored policy responses can include a combination of investing more and better in education, health, and basic services; strengthening social safety nets; tax revenue mobilization; and improving transparency and accountability to enhance public trust. Nonetheless, we underscore the need to enhance progressivity of taxation in all countries. We support the suggestion for advanced countries—where wealth distribution is even more unequal than the income distribution—to consider re-introduction of wealth taxes, while in developing countries the focus of tax reforms should be on increasing efficiency, equity, and simplicity of tax regimes, including by reducing reliance on indirect and withholding taxes, and modernizing tax machinery. Similarly, more progressivity can be achieved by raising additional tax revenues to finance further social spending. We concur that consumption taxes can play a role in supporting equity if they are used to finance basic public services, such as health care, education, and infrastructure. In parallel, reallocating public spending, increasing its efficiency, aligning it with public choices will be key to sail through the pandemic without political instability.

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March 23, 2021

**Statement by Mr. Tanaka, Mr. Chikada, Mr. Naka, Mr. Nagase, and Mr. Shimada on
World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for the set of comprehensive April 2021 Flagship Publications, which are well focused on the analysis on the COVID-19 crisis, while also paying appropriate attention to the medium- to long-term global challenges such as debt and climate change issues. We highly commend staff for their hard effort to make comprehensive reports, including informative Analytical Chapters, amidst the continuing exceptional and uncertain circumstances.

We fully agree with staff that strong international cooperation is vital to achieve the resilient and inclusive recovery of the global economy. We believe the Fund should continue to play a central role on this front. It has been fifteen months since we started the fight against the COVID-19 pandemic and the global economy has been severely hit by the crisis. We must realize “Build Back Better” by gathering our collective wisdom. Japan has been strongly supporting the Fund’s various efforts and is willing to continue to contribute.

The Fund should continue to strongly support the member countries by strategically providing Surveillance, Lending, and CD utilizing its macroeconomic expertise. Thanks to the unprecedented policy actions taken by the member countries, the Fund, and the other international institutions, we have been able to avoid far worse outcomes of the global economy, and we believe we are steadily approaching the end of the crisis. However, the pandemic continues to spread among the world and the global economy remains under high uncertainty. Furthermore, divergence is growing among the member countries reflecting the difference of the impacts of the crisis and speed of the vaccination. Possible timing regarding the end of the pandemic remains unclear, and the authorities of the member countries are facing extremely difficult situation to balance the virus containment and economic recovery. Especially, reallocating the policy resources appropriately and seeking the exit of the current extraordinary policy responses, while avoiding the premature withdrawal of policy supports,

would be a big challenge. Therefore, we expect the Fund to continue providing necessary support for them to tackle these problems.

Timely update of information and analysis by the Fund are paramount. Given the current high uncertainty and increase of divergence, accurate understanding of the latest situation, risks, and outlook of the global economy and individual countries are more important than ever as a basis of the policy decision of the member countries and the Fund. We encourage staff to continue to conduct comprehensive analysis on the impacts of the crisis on various aspects, including the real economy, fiscal situation, financial systems and financial markets, and frequently update the results to the Board.

Building and steadily implementing credible medium- to long-term policy frameworks, while tackling the emerging issues like climate change and digitalization are also important. In order to achieve the resilient, inclusive and sustainable post-COVID-19 global growth, it is critical for the member countries to have a credible policy framework from a medium- to long-term perspective and to accelerate the productivity and tackle the emerging issues by promoting targeted investment and policy reforms. On this point, we support the Fund's continued efforts in its traditional core area as well as its recent engagement on macro-critical emerging issues.

World Economic Outlook

Global economy is gradually recovering, but still facing high uncertainty. We positively note that the growth projection of the global economy was revised upward to 5.9 percent in 2021 reflecting additional fiscal support in a few large economies and expected vaccine-powered recovery. In addition, we welcome the staff's analysis that unprecedented policy responses have contributed to prevent the anticipated larger economic contraction, and the COVID-19 recession is likely to leave smaller scars than the Global Financial Crisis. However, the uncertainty and risks surrounding the global economy remain high, and divergence is widening among the world. From this perspective, we broadly agree with the staff's view on the risks and policy priorities and encourage staff to continue their efforts to support the member countries to realize the economic recovery and sustainable growth. Related to this point, *we'd like staff to elaborate their views on the spillover effects (positive and negative) of the additional fiscal expenditures in a few large economies and their interactions with financial markets. Are the effects under the current crisis different from those under normal circumstances?* We note staff pointed out the large increase of the saving during the current crisis as an upside risk, but we need to be careful that a rapid expansion of the revenge consumption could be a downside risk by causing temporary spike in inflation and unexpected impacts on the financial market.

We reiterate our support on the staff's view that the multilateral cooperation is crucial to tackle the current crisis effectively and efficiently and to realize the resilient global recovery. For example, we agree with staff that adequate production of the COVID-19

vaccine and its universal and affordable distribution would be the key to ensure the global recovery, and we strongly encourage the Fund to contribute from its core mandate to this front by effectively collaborating and sharing roles with the other international organizations like WHO and the World Bank. On this point, we welcome the WEO Analytical Chapters on the size of the shocks of the pandemic, impacts of the crisis on the labor market, and spillover effects of the monetary policies taken by some countries to tackle the crisis. We understand these analytical works are useful for the authorities of the member countries to take necessary policy responses to deal with the current pandemic and prepare for future potential crisis, thus we would like staff to continue their effort.

Strategic policy planning and implementation would be important to achieve both the crisis response and sustainable economy. We support staff's point that the policy responses of the member countries to tackle the crisis should remain supportive until the pandemic abates. On the other hand, it is also important to keep in our mind that unprecedented policy actions could cause side-effects like supporting unproductive zombie firms, and we must gradually move to the more well-targeted and calibrated policies to mitigate such unintended side-effects. We note the staff's proposal to consider the necessary future policy responses depending on the three different phases. On this point, given the divergent situations of the infection and economic recovery among the member countries and the fact that there is no clear break between each phase, each country should respond to the crisis flexibly in light of each circumstance. In addition, regardless of the phases of the crisis, we need to steadily tackle the existing pre-pandemic structural issues such as the decline in the potential growth rate due to the rapid progress of aging. From this point of view, for example, Japan has implemented long-term measures to promote reallocation of labor and capital from the phase 1 in addition to the short-term crisis responses. In this regard, we would like staff to provide tailored and concrete policy recommendations to the member countries in light of country specific circumstances and based on close dialogue, and to make clear and careful external communication.

Global Financial Stability Report

We agree with staff that near-term global financial stability risks have been contained thus far. Unprecedented and timely implementation of fiscal, monetary and financial sector policies by member countries, especially by advanced economies, has helped maintain the flow of credit to the economy and avoided adverse macro-financial feedback loops, even though the pandemic has led to the worst global recession since the Great Depression. We see it particularly important amid the crisis that the accommodative financial conditions have been warranted mainly in advanced economies by the decisive policy actions.

However, we recognize that the authorities in many countries are facing intertemporal tradeoff between supporting the economic recovery in the near term and financial system stability risks in the medium to long term. We note with concern that in the event of a sudden reprising of risks in markets, the overly stretched valuation in asset prices such as

equity markets caused by excessive risk taking, could have knock-on effects on confidence and endanger macro-financial stability, while it is essential to maintain accommodative financial conditions to support the recovery from the pandemic.

Against this backdrop, **we broadly agree with the staff recommendation that the macroprudential policy measures are appropriately implemented to mitigate the financial vulnerabilities.** However, we need to keep in mind several factors such as (i) we should maintain credit flows to the real economy in order to support the recovery from the pandemic, (ii) the (current) macroprudential measures would not effectively cover some credit channels, namely non-bank sector as well as direct financing from global financial markets, and (iii) there are time lags as well as untested uncertainty regarding the tightening of macroprudential policy and its intended effects. Given those factors and in light of country specific circumstances, **it would be difficult judgement for the authorities to decide the timing as well as the choices of specific macro prudential tools.** In this regard, we would expect that staff and the authorities have more detailed and constructive discussion in bilateral surveillances.

We will provide the following specific comments on the chapters.

- We welcome that staff provides a comprehensive framework to identify viable firms (Chapter 1). We see it essential to shape the more targeted policy support for the corporate sector in light of preventing the increase of zombie firms and promoting sectoral reallocation. At the same time, we recognize that the operationalization of the framework would be a difficult task, given that we need to consider (i) still high uncertainty around possible permanent impacts on some economic sectors, (ii) each country's fiscal space, and (iii) each country's capacity of the court system for the debt resolution as well as effectiveness of out-of-court framework for debt restructuring.
- We welcome the analysis on the macro-financial implication of rising leverage in corporates as well as households (Chapter 2). The analysis effectively shows that the appropriate use of macroprudential measures would help contain or reverse leverage buildups, thereby mitigate downside risks to future economic activity, by utilizing the Growth-at-Risk model. As mentioned above, macroprudential policy toolkits should be tailored to the country specific characteristics, however, we would expect staff to stock-take implementation and effectiveness of macroprudential tools among the member countries, especially those for non-financial sector, which have been rarely implemented.
- We welcome the analysis on the commercial real estate sector, which could affect the financial system mainly by three channels (Chapter 3). Especially, we need to monitor the effect on the bank lending through the collateral channel, given there has already been some concern whether banking sector, which is suffering lower profitability in many countries, could provide enough credit to the economic recovery (as mentioned in Chapter 1).

Fiscal Monitor

Fiscal responses should remain supportive, but need to be well-targeted. We welcome the staff's detailed analysis on the impact of the policy responses made by the member countries and necessary fiscal policies to realize the post-COVID-19 economic recovery. We positively note the staff's analysis that bold fiscal policies taken by the member countries have supported the most vulnerable and have prevented the larger economic fallout, including the rapid increase of unemployment. However, as staff pointed out in the report, the fiscal deficit and public debt of the member countries have increased to the unprecedented levels due to the current crisis. To appropriately respond to the crisis while securing the economic sustainability, it is indispensable to efficiently reallocate the policy resources and implement well targeted, timely and temporary policies. In this regard, we expect staff to continue to closely monitor the situations of the member countries, especially those received the emergency financing by the Fund, and provide appropriate policy recommendations to ensure the effective and efficient fiscal policy, if needed.

Debt issues remain critical challenge for the member countries. In recent years, the debt vulnerability of the developing countries has further increased due to the increasing reliance on non-concessional borrowing and untransparent financing from some part of private creditors and emerging creditor countries. Now, the risk surrounding this problem has become apparent in the current crisis. To tackle the structural debt issues of the developing countries, it is necessary for both public creditors and private creditors to implement the debt treatment based on the Common Framework with transparency as agreed last year, and we also recognize that this is the highest priority in the current phase. Efforts to secure the debt transparency and debt sustainability have never been more important. Especially, securing transparency and accuracy of debt data from the normal times is necessary to ensure stable capital flows to the developing countries and will contribute to the resilient economic growth. From this point of view, we encourage the Fund to continue to make efforts to implement the Debt Data Reconciliation and to enhance the capacity building of the debtor countries closely collaborating with the World Bank.

Building credible medium- to long-term policy framework is key for the member countries. We note the staff's recommendations to develop a credible fiscal consolidation strategy. Given the current fiscal situation of Japan that has been deteriorated by the negative impact of the pandemic and aging, we agree with staff that we need to re-anchor to the medium-term fiscal policy to secure the debt sustainability. Japan will continue efforts to secure fiscal sustainability by promoting the transformation of the economic structure to increase the potential growth rate and responding structural issues like aging, while carefully avoiding the premature withdrawal of the fiscal responses by closely analyzing the development and impacts of the pandemic. In this regard, from the viewpoint to enhance the resilience against future pandemic, we recognize it is important for the developing countries to consider the Universal Health Coverage (UHC), including the development of sustainable health finance system and medical and health infrastructure in the context of building a

credible medium- to long-term fiscal framework to realize sustainable and resilient economic recovery. We would like staff to deepen their analysis on this policy area and provide concrete policy recommendations to the member countries cooperating with the other international organizations which have expertise on this front like the World Bank and WHO.

We welcome the analysis on inequality and poverty, which have been expanded by the current crisis, and necessary policy responses to tackle these issues in the Chapter 2 of the Fiscal Monitor. We strongly support the staff's view that we must stop the vicious cycle on this front. We recognize that bottlenecks and necessary policies to tackle those problems vary from country to country because the environment surrounding those countries such as their existing structural challenges, impacts of the current pandemic, and the situations of the vaccine distribution are different. As we understand there is no one-size-fits-all solution on these issues, we would like staff to conduct careful surveillance on the situations of the member countries and provide tailored policy recommendations to them by having close dialogues with the authorities of the member countries. To support the developing countries to tackle those problems, actively providing CD by the Fund to improve the administrative capacity of those countries to enhance the revenue mobilization and the Public Financial Management would be also important. We would like to reiterate the importance to closely collaborate with the other relevant international organizations on this front as well.

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March 23, 2021

**Statement by Ms. Mannathoko, Mr. Nakunyada, Mr. Odonye, Mr. Ismail, Ms. Maudi,
and Mr. Sitima-wina on World Economic Outlook; Global Financial Stability Report;
Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

1. We thank staff for the comprehensive set of flagship reports, providing valuable analysis to the membership and informing the direction global policy as countries work towards exiting from the crisis and investing in the future.

World Economic Outlook

2. **While the improvement in the global economic outlook driven by the recovery in large economies, is good news as it will resuscitate global demand, we are concerned at the divergent path of countries in poorer regions such as Sub-Saharan Africa (SSA).** Advanced economies have suffered much smaller per capita income declines than poorer regions and have seen less scarring post-COVID, than was recorded in the wake of the global financial crisis; whereas the reverse holds for poorer regions such as SSA where scarring is significantly higher this time around. While poorer countries were on a path of income convergence with advanced economies leading up to 2019, that has now been reversed. Various staff reports indicate that economic development in poorer regions is likely to be set back several years, with higher poverty and food insecurity, larger human capital losses and further digital divergence. Thus, prospects of recovery remain uneven with high uncertainty for many emerging market and developing economies, due to uneven access to vaccines, limited policy space and affordable financing, and pre-existing vulnerabilities.
3. **It is critical that international cooperation on supply of affordable vaccines is strengthened, and production capacity in SSA is enhanced.** Countries in the region are in their second and third COVID-19 waves, propelled by new variants of the virus, with rising death rates, alongside delays in accessing vaccines. The duration of the crisis is a concern. In addition to further international efforts to make available affordable redistributed (excess) vaccines, support towards boosting vaccine manufacturing capabilities on the African continent would help to ensure a steadier supply of COVID-19

vaccines to meet regional demand. One plant among five potential SSA centers, estimates an initial \$200 million would be required to start upgrades to manufacturing capacity for full COVID-19 vaccine production capability in Africa (www.theafricareport.com, Feb.22, 2021).

4. **Strong international coordination is still needed to ensure an inclusive global financial safety net, and effective debt and trade architectures.** A coordinated effort supported by innovative instruments, is necessary to support an inclusive recovery and to address long standing pre-pandemic vulnerabilities, related to climate change, SDGs, debt and more recently, trade protectionism. While we welcome a new SDR allocation that will provide developing countries with much needed liquidity to support stabilization and recovery, and urge broad support in this regard, their allocated shares of SDRs (based on quotas) are small, and will need to be augmented through long-term solutions to development financing and debt challenges.
5. **We welcome the analysis on output losses for countries reliant on commodity and tourism exports, as these are both major sources of foreign exchange in many of our countries.** We thank staff in particular for the interesting special feature on commodities, including the analysis on food insecurity. As indicated, timely vaccine rollout will be critical to enable commodity exporters to re-establish production at a level that can optimize benefits from the recovery in commodity prices. At the same time, we note that subdued global food production has led to increases in food prices that are expected to force large segments of the population below the extreme poverty threshold, with disproportionate impacts on youth, women and children, worsening inequality. Therefore, policies for recovery need to target youth and women alongside low-skill and informal workers, including in the adoption of climate-resilient production methods in agriculture to mitigate against food insecurity. Strengthening social safety nets also remains a necessity. Tourism dependent economies in the SSA region, as elsewhere have also been hard hit. Those dependent on both commodities and tourism, doubly so. Policies for recovery also need to guide such economies in rebuilding safe tourism.
6. **Tailoring and sequencing policies to the various stages of the pandemic and ensuring a smooth transition out of exceptional support to firms remains essential.** Despite the improved global outlook, output and incomes in emerging market and developing countries (EMDEs) including low income countries (LICs), will remain below the pre-pandemic level for a while. We therefore agree with the need to sustain policy measures guarding against a steep rise in bankruptcies and financial stress. Policy support needed to ensure a more resilient recovery for the EMDEs and LICs will however, continue to be constrained by limited fiscal space and the large share of informality, necessitating broadened social programs such as unemployment insurance and targeted cash transfers.
7. **Policy solutions should be designed around digitalization as much as possible.** Given the surge in the use of online platforms and teleworking during the pandemic, the associated opportunity and economic costs for businesses, workers, and students, of limited access to the requisite digital infrastructure, point to the importance of bridging

the digital divide and the need to accelerate digital transformation in developing countries. In this regard, we welcome emphasis on digital infrastructure as a critical element to facilitate the recovery.

Global Financial Stability Report

8. **The unprecedented global policy response to the COVID-19 crisis that helped ease financial conditions after sharp tightening in the first quarter of 2020, has however heightened risk-taking, and increased vigilance in the financial sector supported by appropriate macroprudential policy is now required to guard against risks.** We agree that with risks rising, policy makers should take early action to allow for the lag between activation and impact of policies, by tightening macroprudential policy tools and supporting balance sheet repair as needed. Continued credit flow to firms and households has alleviated liquidity pressures and supported economic recovery in some countries; however financial stability risks have risen, reflected in the buildup of leverage and stretched asset valuations associated with excessive risk taking. The intertemporal trade-off between nurturing economic recovery and addressing elevated financial vulnerabilities could be further amplified by current credit booms, with negative feedback implications for medium-term growth prospects. This highlights the need for targeted policies that safeguard financial stability and temper risks emanating from eased financial conditions. We support tightening macroprudential policies (MPPs) to tame leverage build-ups, while strengthening borrower resilience. We however underscore the need to tailor the deployment of MPPs to country peculiarities, tackling pockets of elevated vulnerabilities, with due attention to the pace of recovery and availability of policy instruments.

9. **The divergent recovery between advanced and EMDE/LIC economies could be exacerbated should risks related to policy normalization materialize, thus vigilance is also required in navigating the transition to normalcy.** The challenge will be more acute in frontier markets and LIDCs where access to markets remains significantly limited and costly. Eventual global interest rate normalization will also pose particular risks, requiring policymakers to closely monitor portfolio flows and prudently manage debt financing and debt service which remain sensitive to interest rate movements. Policymakers should also stand ready to contain liquidity, solvency, and spillover risks. Meanwhile clear communication on policies and strategy during the transition will be needed, including on aspects such as exiting implicit loan guarantees and withdrawing policy support, once the recovery is firmly underway. *Could staff elaborate on good practice to capture zombification, considering that there are dynamics which make it hard to separate zombies from non-zombie firms?*

10. **Considering the prominence of non-bank financial institutions (NBFIs) and their increased leverage, in the absence of suitable MPPs for non-banks, it would be advisable to build buffers while close monitoring of NBFIs risks and development of tailored macroprudential tools is underway.** We also note the effects of the pandemic on the commercial real estate sector with adverse implications for the banking sector and cross-border investment in some jurisdictions. Emerging signs of overvaluations in the

sector could pose financial stability risks. It will be likely be necessary, therefore, to maintain the flow of credit and stimulate demand and recovery in the commercial real-estate sector. Strengthening supervision and tightening macro-prudential policies to contain macro-financial risks, will be important. We also note that digitalization and fintech use have accelerated due to the pandemic, across several industries, a trend that is expected to persist during the post-pandemic era. Given the pace and significance of digitalization, it might be worthwhile to highlight the financial sector and cybersecurity risks. *Staff comments are welcome.*

11. **We agree that EMDEs and LIC frontier markets need to use still favorable financing conditions to improve the composition of their debt structure, and urge the Fund to support efforts to reduce information asymmetry challenges that have elevated the perceived risk premium for countries in regions such as SSA, raising their borrowing costs.** For deeper restructurings, we also urge an effective design and timely implementation of the G20 Common Framework, that will ensure that propitious debt operations including private sector participation can take place without costly delays for countries. We highlight that countries lacking market access will continue to need concessional assistance.

Fiscal Monitor

12. **Grants and concessional resources will be needed to fill large financing gaps that persist in LIDCs in the face of an extended crisis.** The collapse of revenues following disruptions in economic activity has led to large fiscal deficits. Against this background, financing large deficits remains a daunting challenge amidst limited tax capacity in the context of large informal sectors and low rates of digitalization. While LIDCs are stepping up efforts to boost domestic revenue mobilization, global cooperation also remains critical to address leakages through illicit financial flows and challenges in international taxation (base erosion and profit shifting). The pre-crisis financing gap to meet the Sustainable Development Goals (SDGs) has also been worsened by the pandemic. In the absence of support, the reprioritization of spending from public investment projects towards pandemic related needs is undermining the infrastructure development needed to strengthen the business climate and draw private investments required to advance progress towards SDGs.
13. **In the wake of the COVID-19 pandemic, policymakers in LIDCs face the delicate task of balancing risks from large and growing public and private debt against those from premature withdrawal of fiscal support, which could slow recovery and exacerbate poverty and inequality.** The pandemic has limited access to markets and restricted the ability of countries to increase revenue in the near term, resulting in the continued rise in deficits and debt levels. While fiscal adjustment efforts can contribute to debt reduction; debt relief and restructuring remain critical to minimize the likelihood of distress. Countries, therefore, rely on successful and effective outcomes from restructurings that will happen under the G20 Common Framework.

14. **Amidst the uncertainty over the duration of the pandemic – especially in developing regions where vaccines remain limited, saving lives remains a key priority.** We, therefore, welcome the Fiscal Monitor’s broad policy messages of ensuring that fiscal policy actions remain flexible and supportive of health systems, vulnerable households, and viable firms. That said, careful thought should be given to the way forward, as weaning off some beneficiaries from expanded and donor-funded social support programs that cannot be sustained without international support, could risk triggering social unrest in some countries.

15. **We concur on the need to better target and tailor support measures to countries’ administrative capacity.** This calls for added efforts to boost the institutional capacity building needed to ensure efficient delivery of public services. For LICs with little or no fiscal space, whilst the primary focus is on preserving lives and livelihoods, continued efforts to use resources in an efficient and accountable manner remain important. Enhancing public investment efficiency will also help improve public investment-to-GDP ratios that were already declining before the pandemic. Fiscal support should continue to benefit vulnerable households and firms while ensuring that highly profitable firms are appropriately taxed. Where fiscal space allows, green investments and digitalization can bolster growth.

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GRAY/21/829

March 23, 2021

**Statement by Mr. Mouminah, Mr. Alhomaly, Mr. Keshava, Mr. Abalala, Mr. Rawah,
and Ms. Alzamel on World Economic Outlook; Global Financial Stability Report; Fiscal
Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for the well-written set of flagship reports, which come at a time of hope that the global economy could see the light at the end of the tunnel, despite high uncertainty. A number of Covid-19 vaccines have proven to be safe and effective. The economic outlook continues to improve, and the global economy is now on a trajectory that seems to be geared towards exiting the crisis. However, we see the period ahead still marked by high uncertainty depending on the evolution of the pandemic. In this regard, we need to monitor the current spike in Covid-19 cases in many countries and the lockdowns. The scenario analysis in Chapter 1 of the WEO is particularly useful given the uncertainty surrounding the race between the virus and the vaccine rollout. In this connection, strong global cooperation remains essential for addressing many challenges, particularly on the health front.

We broadly share staff’s assessment of the global economic outlook. The focus on divergent recoveries amid high uncertainty is appropriate. This reaffirms our support to the title of the Managing Director’s preliminary GPA, namely “*bolstering the recovery, countering divergence*”, which reflects what needs to be done at this stage. In this connection, we note with concern the reversing of a two-decade-long trend of global poverty reduction with close to 90 million more people expected to fall below the threshold of extreme poverty by the end of 2021 compared to pre-pandemic projections. In particular, LICs face the risk of “great divergence”, given the lack of fiscal space and limited access to financing. Here, we look forward to the upcoming discussion on macroeconomic developments and prospects in LICs and to the finalization of the Fund’s assessment of the

external financing needs of LIDCs over the medium-term and the associated financing options.

On the positive side, there are some encouraging signs, but risks remain. Global manufacturing has seen V-shaped recoveries across both advanced and emerging market economies as illustrated in Box 1.1 in Chapter 1 of the WEO. Financial sector has remained resilient, thus far, though financial stability risks need to be closely monitored. Inflation pressures are expected to remain contained in most countries. **On the other hand,** in terms of output losses, the pandemic has more profound impact on tourism- and export commodity-dependent economies and those with limited policy space to respond, which clearly explains the divergent recoveries across countries. Moreover, elevated unemployment remains a risk that imposes social strains worldwide as certain groups continue to be disproportionately affected by the pandemic, including the poor, youth, women, the informally employed, low-skilled workers, and those in contact-intensive services sector. We also note with concern recent staff analysis, which suggests that food price volatility could play a key role in triggering unrest. Against this background, we would like to make the following comments on the proposed policy priorities.

We broadly share the policy priorities and agree on the need for countries to tailor their policy responses to the stage of the pandemic and strength of recovery. Given the high uncertainty surrounding the outlook, maintaining policy support, where possible, remains a priority but in a more efficient and targeted manner with more focus on viability. Some of the important areas are:

- Overcoming the health crisis is key to recovery. Notably, more coordinated global efforts are needed to remove export restrictions and barriers and expedite the vaccine production and rollout. In this context, the international community must act swiftly in contributing more to the funding the COVAX facility and ensuring accelerated access to vaccine. On its part, Saudi Arabia has so far contributed 400 million US dollars to muster international efforts to fight the pandemic.
- Fiscal measures should be used flexibly, where feasible, to provide important lifelines, better calibrated to country circumstances and the stage of the pandemic. In parallel, targeting, coverage, transparency and cost effectiveness of fiscal measures should continue to be improved where warranted. We agree with staff that actions are needed to address income and access to basic services gaps, and broadly support proposed policy responses set forth in Chapter 2 of the Fiscal Monitor. Indeed, strengthening social safety nets while scaling up investments towards enhancing

access to education and healthcare, especially for disadvantaged segments including women, would help further improve productivity and labor market participation and reduce income inequality.

- To prevent scarring, Chapter 2 of the WEO rightly emphasizes that policies that reverse the setback to human capital accumulation, boost job creation, and facilitate worker reallocation are key. Given the limited fiscal space in many countries, we agree that policymakers should target their support to the most affected sectors and firms. Also, as rightly mentioned in Chapter 3 of the WEO, support for retraining and reskilling should continue even as recovery takes hold.
- The essential fiscal support has pushed deficits and debt-to-GDP ratios to unprecedented levels posing difficult tradeoffs between promoting recovery and developments objectives and ensuring debt sustainability. This is particularly important for countries with sizable financing needs and are financially constrained. To create fiscal space, growth friendly consolidation strategies need to be developed anchored on credible medium-term fiscal frameworks. To this end, the Fund has an important catalytic and financing role and should continue to provide tailored policy advice and technical assistance to support countries' reform efforts, including in the areas of domestic revenue mobilization, public financial management, public investment management, debt management frameworks, local capital market development, and business environment reform.
- We agree with staff's assessment that clear forward guidance and communication from advanced economy central banks is crucial not only for calibrating domestic monetary accommodation, but also to minimize adverse spillovers to EMDEs. Chapter 4 of the WEO provides useful recommendations in this regard. In particular, maintaining credible fiscal and monetary frameworks, along with sound and deep financial system, is essential for EMDEs to be able to support domestic activity amid unexpected negative shocks. The GFSR also rightly underlines that countries with market access should take advantage of favorable financing conditions to improve the composition of their debt structure.
- On climate change, global cooperation is of paramount importance. To that end, we believe that broad consensus on the climate change policies will be crucial to establishing cooperation and mobilizing the needed efforts. Here, we reiterate our position against top-down approach that lacks consensus and imposes a one-size-fit all solution despite the marked heterogeneity across countries. Furthermore, green

investment needs to be clearly defined. Here, we consider that green infrastructure investment should include all investments that lead to reducing GHG emissions. In this regard, attention should be paid to advanced and cleaner fossil fuel technologies such as Carbon Capture Storage and Utilization, which are embedded under the Circular Carbon Economy endorsed by the G20.

- We positively note the significant progress made under the G20 DSSI implementation, including the breathing space provided for the poorest countries and the contribution made to support greater transparency of public debt. Furthermore, the G20 Common Framework provides much-needed platform for coordination among creditors to facilitate timely and orderly debt treatments for beneficiary countries on a case-by-case basis while ensuring fair burden sharing. In this regard, it would be critically important that the IMF provide full technical support to facilitate the debt treatment process under the Common Framework. We also look forward to a general SDR allocation, which will particularly benefit credit-constrained EMDEs.

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GRAY/21/830

March 23, 2021

**Statement by Mr. Hilbers, Mr. Tsur, Mr. Voinea, Mr. Manchev, and Mr. Tevdovski on
World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

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

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

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

Trade-offs related to fiscal and monetary stimulus become more binding as the pandemic persists, because prolonged stimulus will further increase indebtedness. Unprecedented fiscal and monetary support, as well as the relaxation of prudential measures in the financial sector policies, has been crucial to stabilize the global economy. However, there is an intertemporal trade-off

between supporting near-term growth and medium-term downside risks. We see a need to remain vigilant against side-effects of prolonged stimulus. We ask staff to closely monitor the effects of prolonged periods of expansionary fiscal and monetary policies on financial vulnerabilities and the build-up of risks related to sovereign, corporate and household indebtedness.

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

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

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

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

targeted support measures may reduce the build-up of financial vulnerabilities and decrease non-viable zombie firms that might form a drag on the medium-term growth outlook.

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

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

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

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

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GRAY/21/831

March 23, 2021

**Statement by Ms. Mahasandana, Mr. Mochtar, Mr. Nghiem, Mr. Dacharux, and Ms. Yoe
on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for the well-written set of reports and insightful analysis. We broadly share the assessment and recommendations, and offer the following comments.

World Economic Outlook (WEO)

We welcome the improved outlook but remain cautious of the risks and uncertainty ahead. The availability of vaccines alongside falling COVID-19 infections and economies adapting better to new ways of working have helped shed light at the end of the tunnel. That said, global recovery could be bumpy and uncertain depending on the path of pandemic and the effectiveness of policy response at limiting economic scarring.

- In contrast to most regions, growth projections for 2021 in ASEAN-5 have been revised downwards from the January 2021 WEO update. Apart from better-than-expected 2020 GDP, *can staff elaborate on why 2021 growth outlook for ASEAN-5 has weakened even as vaccine rollout is progressing across ASEAN? Does staff view the rise in new COVID-19 cases as posing risk growth such that it offsets the positive impact of higher global growth to export?*
- We note that staff's assumption in the baseline is for local transmission to be reduced to low levels everywhere by end-2022. Despite the progress towards normalization, staff has projected that global growth would moderate in 2022. *Can staff elaborate on the drivers of the slowdown in growth in 2022? Other than the base effects, we also wonder whether policy normalization, fiscal consolidation as well as expectation of these policies play a role in influencing these forecasts?*
- We appreciate staff's analysis of the scarring effect on contact-intensive sectors in Chapter 2. Tourism-dependent economies have been severely impacted by the pandemic, and scarring effects on these economies will deepen as the pandemic continues to drag on and restrictions on international travel remain slow to ease. *What is staff's baseline*

assumption on when international travel will normalize and the recovery profiles of the tourism-based economies?

- We continue to encourage staff to deepen the analysis on issues faced by small states and low-income developing countries (LIDCs) in future WEO, as this group of countries which has been hardest hit by the pandemic will benefit most from Fund advice and support.

Divergent recoveries across countries highlight the need for international cooperation to ensure universal access to vaccine and to coordinate exit strategies by advanced economies. We note with concern that vaccines will remain unavailable for most of the many emerging market developing economies (EMDEs) in 2022. This could further widen the divergence between advanced economies (AEs) and EMDEs, especially as extended pandemic restrictions would increase the likelihood of scarring on EMDEs. To secure faster and stronger recovery for the global economy, we strongly support swift actions by the international community to support broad access and distributions of vaccines. At the same time, we are concerned that EMDEs could face a marked tightening in global financial conditions when recovery has yet to take hold, in the event that faster recovery in AEs prompt their central banks to exit accommodative monetary policy. In such a scenario, what would be the impact on EMDEs and what can they do to mitigate the shocks? *Staff comments are welcome.*

We find that the policy priorities tailored to the different stages of the recovery are appropriate. We agree with staff that policy priorities should focus on containing the pandemic in the near term, addressing economic scarring while promoting efficient reallocation of resources in the recovery phase and investing in a resilient, green and inclusive economy for the future.

- We share the concerns that the pandemic has exacerbated income inequality. In this regard, we support the call for fiscal policy to continue providing targeted support to the most vulnerable households and workers as well as to invest in education and vocational trainings to help narrow the inequality.
- We welcome the analysis in Box 1.2 which showed that low-income developing countries and small island economies are most affected by the impact of weather-related disasters. The risks of more frequent and catastrophic natural disasters thus call for require urgent global policy actions to address climate change. Vulnerable countries should also take immediate actions to enhance climate resilience as policies to foster greener economy will take time to bear fruit. In this regard, we also encourage the Fund to explore options to provide financing support to these members to enhance climate resilience.

We agree with staff's recommendation to tighten macroprudential policy as recovery takes hold and to implement a carefully managed exit strategy to avoid any cliff effects. While the global financial system has shown remarkable resilience so far despite significant shocks from the pandemic, we remain concerned that stretched asset valuations and elevated financial vulnerabilities including high debt levels across household, corporates and sovereigns, could derail the recovery and pose financial stability risks. To contain risks to future financial stability, we agree that the policymakers should look to tighten macroprudential policies to prevent excessive buildup of leverage. *To avoid sudden cliff effect, can staff share how the MPP would work as part of a policy mix to ensure the appropriate financial condition? In addition, should loan repayment moratoriums be extended for small and medium firms especially those in most affected sectors?*

We are concerned about the spillover of the AE monetary policies and the risk of tighter financial conditions triggering large capital flows volatilities and portfolio outflows from EMDEs. This highlights the challenges facing EMDE policymakers with limited policy space. As such, we 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. We also encourage staff to watch this risk closely especially through Article IV surveillance and support members with appropriate policy advice.

We find the analysis on the corporate sector and the associated policy advice very practical and useful. We agree with staff's observation that governments tend to have limited expertise and capacity to assess the viability of firms. The comprehensive framework to identify viable firms can provide a high-level overview of the sectors or types of firms that need targeted policy support. We think it would be useful for MCM to develop tools to help country teams replicate the analysis at the country level. *Staff's comments are welcomed.* The decision tree also provides a useful framework to assess how firms could meet their financing needs with different instruments. Regarding provision of policy support for firms, *we wonder whether support for firms should be tied to conditions such as job preservation and wage guarantees for employees to help minimize scarring in the economy while cushioning household income? We welcome staff's comments.*

Fiscal Monitor (FM)

We agree with staff's assessment on the crucial role of fiscal support in helping to cushion the global economy from more severe contractions from the pandemic. Meanwhile, it also raises concerns over the debt sustainability as government debt and deficits surged to unprecedented high levels in many countries. We encourage staff to closely engage with the authorities to maintain targeted fiscal support anchored within credible medium-term frameworks. We also welcome staff's recommendation to gear support policies

towards structural transformation for green, digital and inclusive growth as economies open up.

While the medium-term fiscal framework requiring higher taxes is needed, it should be well-designed and well-timed to minimize the impact on private sector and avoid social tension. Households and firms have been affected severely by the pandemic and facing numerous difficulties. *We welcome staff's further elaboration on this issue and whether other revenue mobilization policies could also be used while tax base expansion should be applied according to country specific factors.*

We concur with staff's analysis on the pre-distributive policies to reduce the market income inequality and foster inclusive growth. We also agree that redistributive policies can enhance long term growth as public spending on school and basic services will help improve human capital accumulation.

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March 23, 2021

Statement by Mr. Chodos, Mr. Herrera, Mr. Hendrick, Mr. Lischinsky, and Mr. Corvalan Mendoza on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary) Executive Board Meeting 21/31 March 25, 2021

We thank staff for a first-rate set of reports, delivering sound economic analysis and apt policy advice to members amid a unique crisis such as the COVID-19 pandemic.

One key message in the flagship reports is the emerging divergence observed between and within countries. The world economic outlook has improved since last October and global growth projections have been upgraded. However, the upward revision is primarily due to better performance of AEs, while the revision for EMDCs is modest. Further, this performance gap is projected to remain in the medium term. Advanced economies (AEs) are expected to quickly return to their pre-pandemic trend on the back of unprecedented policy support, and vaccination completed in 2021. In contrast, the recovery of emerging market and developing countries (EMDCs) is expected to be slow and incomplete due to limited and declining policy support, slow vaccine coverage, and emerging scarring effects. Staff projections indicate that EMDCs will remain 6 percentage points below their pre-pandemic trend by 2024. Within countries, contact-intensive sectors will remain depressed for some time, limiting job opportunities for youth, women, informal, and low-skilled workers. Income inequality and poverty are likely to rise.

Another key message is the importance of sustaining strong international cooperation to ensure a solid, sustainable, and broad-based recovery. Key areas are vaccine distribution, policy coordination, and international liquidity support. Multilateral collaboration is vital to ensure a fast rollout of vaccines across the world, which in turn will hasten the recovery and limit the extent of scarring. International coordination of exit policies will be critical in a multi-speed recovery. The calibration of future policy actions in AEs must carefully consider both domestic conditions and international spillovers into EMDCs. Also, the international community must ensure that those members facing severe financial constraints get adequate and timely access to international liquidity. These countries will need continued support to finance critical health expenditures, maintain adequate social policies and public services, support the recovery of their economies, and limit scarring effects. The Fund must remain well-resourced to provide additional liquidity support to its members and

flexible to adjust its lending tools as needed. A new allocation of SDRs will help to alleviate the external liquidity pressures among the most vulnerable members.

World Economic Outlook

We broadly concur with the staff's assessment of the global economy but highlight the differences in the outlook and risks across country groups. World output projections for this year and next have been raised. Global GDP by the end of 2022 is now expected to be 2 percentage points above the level projected last October. However, we highlight that the upward revision primarily reflects the improvement in AEs (+3 pp), while the upgrade in EMDCs is more modest (+1½ pp). At the same time, downside risks remain significant, including new waves of infections and lockdowns, new vaccine-resistant variants, tighter financial conditions, extended scarring, intensified social unrest, as well as pre-pandemic risks such as natural disasters, geopolitical, trade, and technological risks. Upside risks are linked primarily to faster vaccine rollout. We agree with the staff's assessment of the global balance of risks, but we wonder about its composition across country groups. The analysis of the alternative scenarios seems to indicate that the balance for EMDCs is tilted to the downside due to late vaccination, reduced policy space to maintain fiscal and monetary support, and larger scarring effects. *Could staff elaborate on the balance of risks for EMDCs in the short term and the medium term?*

We broadly agree with the staff's views on policy priorities and welcome the tailored advice to the pandemic-phase and country-specific conditions. Health spending and vaccine cooperation are critical in the near term. Monetary and fiscal policies must remain accommodative whenever possible until the global recovery is firmly entrenched and broad-based. We see merit in the staff's advice to improve fiscal frameworks and back-load adjustments through pre-approved tax reforms, but these measures will take time. **In the near term, fiscal strategies must remain realistic about institutional and political constraints, debt vulnerabilities, volatile financial conditions, and high uncertainty regarding the length of the pandemic, especially in EMDCs.** Monetary policy should also remain accommodative wherever possible, but again policy advice needs to be tailored to country-specific circumstances. Exchange rate flexibility, macroprudential policies, and, in some specific cases, capital flow measures can provide EMDCs central banks with additional policy space. **More important, clear forward guidance and communications from AEs' central banks will be crucial to avoid an abrupt reassessment of financial conditions, public debt sustainability, and capital flows to EMs.** *Could staff elaborate on the role envisaged for macroprudential tools vs. monetary normalization in AEs through the recovery?* Finally, important pre-pandemic challenges remain to be tackled: sluggish productivity growth, climate change mitigation, inequality, market concentration, aging populations, and automation.

Medium-term scarring effects are more likely in EMDCs, but their scope can still be limited. We welcome the analysis in Chapter 2 of the WEO about scarring effects after the pandemic crisis. So far, unprecedented policy support has successfully minimized scarring effects in AEs. In contrast, they are more likely to happen in EMDCs where policy support has been more limited, lockdown measures have been more extensive, the economic and employment contraction has been deeper, and the recovery is expected to take longer. In these countries, high unemployment, weakened household and corporate balance sheets, and disruptive sectoral spillovers could produce long-lasting damage, as

reflected in the staff's medium-term projections. Furthermore, at the national level, these scarring effects are likely to be concentrated in youth, women, informal, and less-skilled workers, which will increase inequality and poverty. We stress that it is still early to reach definitive conclusions on the scope of scarring effects in EMDCs. **Much remains to be done to improve the medium-term outlook.** The staff's analysis provides useful advice on policies to contain the scope of scarring effects: targeted support in hard-hit sectors, strengthening unemployment insurance, retraining, job search, efficient debt resolution schemes, and others. EMDCs will need technical assistance, capacity development and, in some cases, external financial support to implement these measures and minimize scarring effects.

Chapter 3 in the WEO highlights that the heterogeneous impact of the COVID-19 crisis on labor markets across countries, sectors, and workers. Despite the extraordinary policy support in many countries, the pandemic strongly impacted labor markets, accelerating existing trends, and, continues to cause economic problems and disruptions. In EMDCs, where fiscal support during the pandemic was, on average, between three and fivefold less than in AEs, youth, and less-skill-intensive workers, mostly informal, were and are suffering high unemployment or low labor participation. We highlight that in many EMDCs, job protection schemes have had limited success due to the informal nature of vast sectors of workers. Once the pandemic subsides, many of them will remain unemployed or out of the workforce. It has been especially difficult for new workers to gain access to the job market. Before the pandemic, average youth unemployment in EMDCs was above 20 percent and since the pandemic it has reached almost 25 percent. Women have also found more difficulties to remain in the job market during the pandemic, as their unemployment rate has increased far more than for their male counterparts over the last year. Part of the explanation lies in that sectors like construction and manufacturing were not so affected as in past recessions, while this time round employment fell sharply in wholesale and retail trade, transportation, hospitality and food services, and in the arts and entertainment sectors. Jobs for high-skilled workers in information and communication, finance, and insurance sectors have increased during the last year.

The labor share of income has been on a continuing descending trend since the 1980's in AEs and the 1990's in EMDCs, as reported and studied in the April 2017 WEO. The decline of the labor share sharpened last year as unemployment increased and wage pressures subsided for some important groups of workers, although in many countries declining labor income was offset by rising government transfers or unemployment insurance. Moreover, it must be noted that employment no longer lifts people out of poverty. Going forward, countries will need to strengthen labor market policies, shifting from blanket retention schemes to targeted programs in hard-hit sectors with viable prospects but slow recovery, as well as reallocation, including (re)training, and improving skills among the youth.

We welcome the timely and important analysis of monetary policy spillovers during the recovery from COVID-19 in Chapter 4. AEs are recovering faster than most EMEs and LICs. Staff makes a solid case to show that an uncoordinated withdrawal of monetary policy in AEs has potential risks to tighten financial conditions for the other economies through the "risk channel". Shifts in monetary policy by the Fed seem to have greater impact than shifts by the ECB. We take note that only an unexpected communication of higher future US policy rates, which is not driven by improvements in economic conditions in the US, could lead to a tightening of financial conditions in emerging markets. Positive news on US economic activity through the "trade channel" or even upside

surprises on US inflation appear to have a benign impact on the rest of the world. *Given the important systemic impact of the Fed's decisions in the rest of the world, does staff believe that the Fed will incorporate this consideration into its policy reaction function? Can targeted macro-prudential measures be expected to prolong the period of low interest rates in AEs? In staff's view, what factors may disrupt a gradual and well-telegraphed normalization of US interest rates?*

During the COVID-19 crisis, EMEs implemented countercyclical monetary policy responses with a variety of tools and different aggressiveness, depending on their room for maneuver prior to the pandemic. We agree that countries with transparent central banks, flexible exchange rates, and rule-based fiscal and monetary policy frameworks were able to cut the policy rate more and were able to engage in asset purchasing programs (APP) or substantial increases in repo operations, as done by several countries in our constituency. We take note that other policy actions, like the Fed's temporary US dollar swap line facility provided to Brazil and Mexico, were also effective in stabilizing financial conditions in these two countries, as shown in Figure 4.11. *We would like to ask staff if a similar finding is applicable to the other seven countries to which the swap line was also offered. Also, does it see a similar impact on countries which requested a Flexible Credit Line (FCL) or other Fund facilities during the pandemic?* In any event, it is clear to us that a strong international financial architecture, including a robust mechanism for liquidity support for countries, and strong international cooperation, will play a key role for a smooth exit of the economic and financial impact of the pandemic.

Global Financial Stability Report

We agree with the staff's analysis in Chapter 1 of the GFSR, which rightly points to the divergence between countries with better fundamentals and higher vaccine coverage from those with little buffers left or limited access to vaccines. The recovery in 2021 will not be synchronized and will see many countries with less ammunition to support their social and economic programs. This starting point in 2021 may become much more complicated in emerging markets if financial tightening occurs sooner rather than later. Government, households, and firms' balance sheets could easily deteriorate if abundant liquidity is abruptly mopped up or key interest rates in AEs are suddenly increased.

Regulatory and financial tools available in emerging markets are limited and should be used wisely. We go along with the idea to take early action and to tighten macroprudential tools to mitigate well-identified pockets of risks, bearing in mind not to tighten financial conditions that could jeopardize growth. In the same vein, tools for nonbank financial intermediation should be created and implemented to broaden the perimeter of the regulation and supervision of the economic system. *We would like to hear more details from staff on other important tools like development of distress debt and nonperforming loan markets, augmentation of out-of-court restructuring, fast-track resolution frameworks, and insolvency regimes in order to seek market-based solutions for distressed firms.*

We have some reservations about the proposal summarized in Figure 1.13 "Overall Assessment of Viability by Sector and Firm Size" As we see it, any immediate, firm-specific direct government support entails high fiscal and monetary risks, especially for most emerging markets. We agree that the large presence of small and medium-sized firms is often observed in emerging markets, with limited access to capital markets. However, the justification for direct-firm-specific support might not be the correct policy response for governments for various reasons. First, the banking system seems

capable to deal with households and firms' balance sheet risks. Second, a more robust regulation and supervision in past decades in LAC helped the region's banking system endure difficult tests, for example, the Global Financial Crisis, and third, the buildup of an institutional capacity to deliver appropriate administrative controls, transparency, and accountability in the use of public resources for direct-firm-specific support still might be not ready. *Having said that, we encourage staff to share some thoughts on how to communicate this message to the broader audience when this document is published to avoid ill interpretation.*

Chapter 2 provides a nice illustration of the difficult trade-offs that policymakers will face going forward as the recovery firms. The staff's analysis shows that, in an environment of ample fiscal and monetary support, leverage buildups are likely to rise, while the nonbank financial sector expands its intermediation role. The empirical negative relationship between an increase in leverage and future economic activity is interesting. Once the recovery takes hold, the mingling of a period of easy financial conditions and leverage buildup, which increased further during the pandemic, could amplify any adverse shock in the future. The corollary is that the planning for a post-COVID-19 exit strategy should be clearly monitored, rightly executed, and well communicated. Finally, there will a huge burden and responsibility on macroprudential policy tools to safeguard financial stability and lean against the wind (to offset the increasing leverage buildup), while keeping an overall expansionary monetary stance to support the global recovery.

Fiscal Monitor

We welcome the focus of the Fiscal Monitor on the policy response to the pandemic and the call for maintaining fiscal support until recovery is firmly in place. We agree that a timely and aggressive fiscal response, in line with each country's policy space, was the right response to the pandemic. The lifeline to the most needed households, small and medium-sized business, and to the health system, including securing vaccines for the whole population, were the right priorities. We fully support the need to provide the necessary funding to health care systems everywhere and to ensure that vaccines are available to all countries at affordable prices. **As staff clearly shows in the upside scenario with faster global vaccination, the global gain in GDP and tax revenues more than compensates for the investment needed to properly tackle the pandemic worldwide.** Two-fifths of the gain in global growth takes place in AEs, so the financial support from these countries to the rest of the world would not be a charity but a very profitable investment, with an excellent return on investment for public money.

At the same time, the unprecedented increase in public debt worldwide calls for a cautious approach to discretionary spending, while maintaining and enhancing credible medium-term fiscal frameworks. It is concerning that average global public debt will stabilize close to 100 percent of GDP in 2021, with a higher percentage for AEs than EMEs or LICs. Hopefully, all economies will take appropriate measures to resume a sustainable debt trend after the pandemic is under control. Countries with fiscal space should continue to use it in an effective and targeted manner, saving some space due to the uncertainty surrounding the pandemic and other unknown shocks. This is particularly true for EMEs and LICs. Even with growing public debt, countries with less fiscal space can send signals to the markets about their commitment to fiscal sustainability in the medium term, including by adequate recalibration of fiscal rules and considerations for increasing the tax base, once their economies are on a clear path to recovery. However, strategies in EMDCs must remain realistic about

institutional and political constraints, debt vulnerabilities, volatile financial conditions, and high uncertainty about the pandemic.

We commend staff and management for the relevant analysis on inequality and poverty in Chapter 2 of the Fiscal Monitor. The pandemic helped to increase preexisting inequalities and poverty and has shown the importance of adequate social safety nets. As well pointed out in the report, inequalities are not only in income and wealth; inequalities include a variety of issues, like access to vaccines, health, education, digital infrastructure, finance services, and shelter, for instance. Economic inclusion, in a way, refers also to equal access to quality public goods. In a bidirectional causation, inequality and poverty have worsened due to the pandemic, and, in turn, the health and economic impact of the pandemic have increased due to poverty and inequality existing prior to the pandemic. When half the population of a country lives in a room with an average 4.5 people, contagion spreads quickly. With school closures, disadvantaged children have suffered the most, as they do not have notebooks or internet access, nor do they receive newspapers at home.

The response to the various aspects of inequality and poverty must be comprehensive at the national and international level. It must consider general policies before redistributive tax, and it must also consider redistributive tax and government spending policies. In this regard, we support investment in human development, food, education, health, childcare and early childhood development, as well as structural reforms to increase potential growth, quality jobs, and public revenues. Strengthening the social safety nets and active labor market policies are essential under the current circumstances, even though the immediate priority is vaccines for all. Another avenue is to enhance tax capacity and increase progressivity of income taxation, inheritance/gift taxes, and property taxation. In these pandemic times, some countries have implemented wealth taxes and excess corporate profit taxes. At the same time, a medium-term fiscal framework, improvements to public financial management, and transparency and accountability are of the essence.

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GRAY/21/833

March 23, 2021

**Statement by Mr. Pösö, Mr. Damgaard, Mr. Bernatavicius, Mr. Slettvag, and Mr. Valdes
Fernandez on World Economic Outlook; Global Financial Stability Report; Fiscal
Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for an excellent set of reports and welcome the emphasis on policy priorities, including on tailoring policies to the different stages of recovery. This discussion is important and imminent, as some members are already recovering while many others still lag behind. These are unprecedented times with more uncertainty and risks than usual. The menu of potential policy measures and combinations of them are similarly large. We believe that the discussion of how measures within the fiscal, monetary, and macroprudential space could be combined to address both downside and upside risks could be improved if it was presented more comprehensively in one report.

World Economic Outlook

Upward revised growth figures indicate a gradual convergence to a post-pandemic normal in some parts of the world. Many economies seem to be coping better with the new rounds of containment measures. Nevertheless, still high rates of infections and deaths together with new mutations cloud the near-term outlook. Developments are uneven across sectors, with contact-intensive services hit the hardest, and across countries, driven by differences in health crisis management, vaccinations, policy support and sectoral compositions. At the EU level, we expect the recovery to gain traction from the third quarter of this year, when the majority of adult population will have been vaccinated, allowing for a gradual lifting of restrictions. At the same time, growth in the US seems to be accelerating, also due to a massive additional fiscal stimulus. *How big of a boost to the US and the global economy does staff expect from the stimulus?*

Recovery in the global economy will likely be asynchronous and bumpy. In many advanced economies and some larger EMEs, like China, policy measures have so far been efficient in mitigating the impact of the crisis and medium-term scarring is expected to be somewhat milder than previously expected. 2020 output losses in emerging markets and developing countries also turned out to be less severe than anticipated. It is, however,

worrying that that the recovery in many of these countries is expected to lag behind, leaving them with potential larger economic scarring from the pandemic. Over the medium-term, high debt burdens and potential difficulties in addressing persisting scarring, inequalities and sectoral dislocations are key concerns. There are major risks of business defaults and credit losses when emergency crisis support is unwound, and high public debt ratios may put fiscal sustainability at risk, particularly for vulnerable countries.

The outlook is subject to significant uncertainties particularly related to the race between vaccinations and virus mutations. Significant risks both on the upside and downside persist, but overall risks have become more balanced. Financial conditions are vulnerable to sudden changes given elevated valuations and protracted reliance on large-scale policy support. Reassessment of accelerating inflation could trigger market volatility, hamper confidence and lead to tighter financing conditions. On the upside, significant household savings may provide scope for pent-up demand to be released at a short notice. Combined with a still constrained supply side, this could also lead to a more sustained rise in inflation.

Accelerating vaccine production and distribution at affordable prices to save lives and livelihoods must be the top global priority. Uneven access to vaccines is a significant worry and sustainable global recovery will continue to be hampered until the virus is in retreat everywhere. It is therefore crucial to support for the ACT-A collaboration and its COVAX facility to ensure global distribution of vaccines. Strong national and global surveillance systems are necessary. Help from the global community is also needed to support financially constrained low-income countries through the crisis. The EU and its Members are at the front of the global response, having provided over 40 bn EUR for international support in the fight against COVID-19 – with more than 2.2 bn EUR through COVAX-, and being the largest vaccine exporter in the world. The current expectation of 90 million people falling into extreme poverty and that lower-income countries could be left with the largest medium-term damage should not be an accepted outcome.

Policy support should not be prematurely withdrawn but should be regularly reviewed and adjusted as the health conditions and economic circumstances evolve. Timely and well-targeted fiscal support is still needed to help the hardest hit sectors and households, including the young and low-skilled, while safeguarding fiscal sustainability. Monetary policy should remain accommodative to maintain favorable financing conditions and help the recovery take a firm hold. We need to be aware of potential financial stability risks. As economies open, the transition from crisis measures to policy normalization and longer-term policy agendas should be managed carefully to avoid policy cliff-edge effects causing unnecessary volatility in economic or financial conditions. The recovery will inevitably move at different speeds in different parts of the world, requiring close monitoring and tailored policies to avoid adverse spillovers and spillbacks. As risks have become more balanced, a more thorough analysis of policies to address upside risks would have been helpful.

Reinforcing longer-term efforts to build stronger and more inclusive and sustainable economies is necessary. The focus should be on broad-based investment and reform agendas to boost productivity and employment, while seizing the opportunities stemming from a green and digital transformation, as in the EU Recovery and Resilience Facility. Building human capital through investments in education and retraining is key to counteract the effects of school closures and to aid relocation of workers whose jobs are permanently lost. In the longer term, climate change and the rapid loss of biodiversity are pressing concerns. We strongly support the recommendations on enhanced cooperation on carbon pricing and supporting the areas most affected by climate change. Multilateral focus to reform the WTO and the rules-based multilateral trading system would be beneficial to provide greater economic opportunities to countries in the recovery phase.

The focus on persistent economic scarring due to the pandemic **in chapter 2** is welcome. Supply-side damages and demand-side impacts are difficult to disentangle, but important to understand, in order to make the right policy choices. While continuing targeted policy support in the near-term is key to limit scarring, medium-term policies and investments to support sustained recoveries and necessary reallocations also have an essential role.

The analysis in **chapter 3** provides important insights to better understand the labor market consequences of the pandemic. We take note of the finding that the Covid-19 shock is more pertinent to sectors vulnerable to the longer-term trend of automation, making it less likely that these jobs will be regained afterwards. In the past, increased automation has affected particularly middle-income jobs, leading to a “hollowing out” of the job distribution. *Are there signs of similar patterns during this crisis?* Assessment of the role of job retention and reallocation policies in different phases of the crisis and recovery provides helpful insights. In practice, however, the distinction of temporary and permanent shocks to particular sectors and choosing the optimal timing and phasing of the policies may be difficult.

Diverging paths of recoveries and policies may create challenges for many EMDEs at the current juncture. In this regard, the analysis in **chapter 4** provides a useful framework for analyzing spillovers from advanced economies to financial conditions and monetary policy in EMDEs. That said, the uniqueness of the current crisis and policies may also create unusual spillovers, and any attempts to extrapolate lessons from past experiences must be taken with caution. Going forward the implications of the significant fiscal stimulus in the US is topical, in particular in light of elevated debt levels and higher external vulnerabilities in many EMDEs. *Could staff comment on the possible spillovers from the fiscal package? We would also welcome staff's comments on how the “news”-effect of the approval of the package compares with the general findings in the chapter about effects from positive news on US economic activity.*

Global Financial Stability Report

Overall, the financial sector has endured well through the pandemic with policy support measures being crucial in supporting favorable economic and financial conditions. The regulatory reforms initiated after the Global Financial Crisis have played their part by

improving financial sector resilience, particularly in the banking sector. **Going forward, policymakers face a trade-off between supporting short-term economic growth and potentially creating medium- or long-term financial stability risks.** Optimizing the timing on when to start rebuilding buffers will be key.

At the same time, some financial vulnerabilities, including stretched asset valuations, are increasing as a result of the extraordinary policy support. **It is crucial that the withdrawal of policy support is done in a careful and well-planned manner to minimize risks to financial stability.** If financial conditions tighten too rapidly in an environment of uneven and fragile recovery, the negative implications for financial stability may be grave.

We agree that emerging and frontier market economies face large financing needs amidst the pandemic and share the concern of risks associated with possible tightening of global financial conditions. While many EMEs have stronger macroeconomic frameworks, the risks remain elevated and the differences between countries are significant. The volatility of portfolio flows, the pressures on local currency term premia, increased rollover risks, and the pressures on external funding costs should be monitored carefully going forward. The increased indebtedness of EMEs further complicates their economic situation.

The fast growth of corporate debt is worrisome, and as funding sources vary by country, risks will be carried by different parts of the financial sector. In regions where banks provide most corporate debt financing, the associated risks can have an adverse effect on the banking sector. In other regions, the burden from potential future corporate insolvency issues will affect bond investors relatively more. **The outlook of NFCs may prove key for recovery as well as for financial stability.** It is important that policy support is aimed at viable corporations, while facilitating orderly restructuring in nonviable sectors/firms. *Identifying viable firms is a point in time analysis and it would be useful if staff could elaborate on how they believe the indicator system in the proposed framework would work under normal conditions or in a crisis context.*

The good capital position of banks has been crucial in maintaining confidence in the banking industry during the pandemic, but the sufficiency of provisioning needs to be monitored carefully as alternative indicators of credit quality reveal that credit quality is deteriorating somewhat in some regions. The sufficiency of provisioning is also related to **the ending of moratoria** that will provide much-needed visibility as regards the development of non-performing loans.

We agree that a prudent approach would be to take early action with tools that target the elevated vulnerabilities while avoiding a broad tightening of financial conditions. *Could staff specify what type of tools could be tightened without affecting financial conditions more broadly?* **The analysis of banks' use of their buffers** is interesting and may lead to a shift in how supervisors approach buffers or eventually

regulatory changes in the future. For example, a positive neutral level for the countercyclical buffer without reducing other buffers could be set in more countries than in the past. Regarding the **non-bank financial intermediaries, it is important to bear in mind that this group comprises extremely heterogeneous actors** which complicates the assessment of any potential regulatory actions. Overall, the Fund could take a fresh look at the existing MPP framework, including novel ways of applying MPP tools with regard to non-financial corporate debt.

We find the analysis in **chapter 2** highly topical and helpful in providing information on the upcoming policy trade-offs. With regards to potential risks related to corporate leverage, macroeconomic indicators measuring corporate indebtedness are difficult in many dimensions. It would be also important to know how much of the new debt that has been used for investments and how much for fighting the pandemic.

We agree with the **chapter 3** that Covid-19 has created a sizeable negative shock to the global Commercial Real Estate (CRE) market. So far, the market has been able to manage the crisis surprisingly well thanks to the significant policy actions. We underline that the negative impact to CRE in the current COVID-19 crisis has been more heterogeneous than in previous crises. Also, the leverage or LTV levels seem to be somewhat lower today. In addition, central banks' accommodative monetary policy stance and loan moratoria by lenders have been vital to support debt service capacity of CRE borrowers. *Has staff analyzed the debt service capacity of borrowers when moratoria ends?*

We think that the policy recommendations in **chapter 3** could be complemented with supervisory actions like sufficient provisioning and solvency of banks. Also, strategies to tackle rising NPL levels should be planned as soon as possible, however avoiding the use of state-aid in order not to undermine market competitiveness. We would also like to note that capital flow management measures are probably not feasible in all jurisdictions like in the EU. Concerning macroprudential measures, more international cooperation is needed to expand MPMs to cover non-bank originated loans. Lastly, there is a need for closing data gaps in monitoring the CRE market globally.

Fiscal Monitor

While the scale and modalities of support measures differ across countries, we have witnessed unprecedented levels of fiscal support globally during the last 12 months. **Vaccinations at the global level are the spending category with the highest fiscal multipliers.** *Given the importance of the message, we would propose to put more emphasis on the staff calculation of how much spending on global vaccination could strengthen the global economy.*

The scope to continue the necessary fiscal support is globally very uneven. Current low debt service costs in advanced economies provide more fiscal space compared to the situation in many emerging and developing economies. Getting the balance right on limiting the risks from premature withdrawal of support and safeguarding debt sustainability is not an easy task and needs to be managed carefully. While the exceptional low interest rates in advanced countries provide breathing space, countries should also

ensure fiscal resilience in case the interest rate environment changes. Sustainability risks, including from ageing, also persist and should receive due attention.

The topic of inequality in **chapter 2** is timely and important. Large pre-existing inequalities have worsened the effect of Covid-19 and that the crisis, in turn, has escalated these inequalities. We agree that various aspects of inequality are mutually reinforcing and can create vicious cycles. This can lead to rising polarization, erosion of trust, and social unrest, posing risks to macroeconomic stability and the functioning of society. No country is immune to these risks. We welcome the holistic approach to policy recommendations, combining predistributive policies with redistributive policies and including more and better investments in health and education and focus on strengthening social safety nets. Generating the necessary public revenues to address inequality issues is important and the best policy options will likely vary between countries.

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GRAY/21/835

March 23, 2021

**Statement by Mr. Merk, Mr. Fragin, Mr. Sattler, and Mr. Krahnke on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

We thank staff for an informative set of reports that covers very well the state of the global economy one year into the pandemic. The pandemic triggered a deep global recession, causing massive economic and social disruptions, and setting the fight against global poverty back years. Swift and strong policy responses worldwide, supported by international cooperation, have helped to limit the economic damage, but recovering the lost ground and building back better will be a challenge.

The swift development of vaccines is cause for optimism and will increasingly allow cautious steps towards normality – both in terms of everyday lives and the functioning of the global economy. However, there is still great uncertainty surrounding the future course of the pandemic and its economic repercussions. Access to vaccines needs to be broader and more equitable. Exceptional assistance by governments worldwide will remain indispensable for the time being. Also vital is that all emergency measures are well-targeted and limited in duration without distorting financial and fiscal stability or hindering necessary structural change.

World Economic Outlook

We generally share staff's view on the global economic outlook. The recovery path continues to be dominated by the pandemic and will vary across countries and sectors. We expect global economic activity to accelerate in the second half of 2021, fuelled by a supportive macroeconomic policy mix and easing restrictions on the back of a growing share of the vaccinated population. While AEs are expected to regain much of the ground lost at the peak of the pandemic, GDP levels through 2024 for most countries are very likely to remain well below pre-pandemic projections, reflecting only gradually subsiding economic slack. Many EMDEs (excluding China), on the other hand, tend to have slower rollouts of vaccination campaigns and are more exposed to long-lasting knock-on effects due to constrained scope for policy support. Uneven

availability of vaccines could potentially cause a start-stop rhythm along the recovery path in many countries.

We broadly concur with staff's projection for the euro area. **On Germany, we think that staff's GDP projection is a plausible scenario but forecast uncertainty remains high.** Overall, we expect the recovery to be merely delayed by domestic lockdown measures. Once a sufficient number of people has been vaccinated and lockdown measures are lifted, the economic recovery should resume.

We concur with staff's analysis of the V-shaped recovery in the global manufacturing sector. The relatively robust performance of trade and manufacturing, which no longer experience significant interruptions as seen in the early days of the pandemic, indicate that many businesses have successfully adjusted in recent months and hence appear less sensitive to the stringency of containment measures. *In this context, we would appreciate further comments by staff on the role that supply-side bottlenecks (e.g. containers, semiconductors) might play for the near-term trajectory of global manufacturing.*

We generally agree with staff's assessment of the underlying forces of the broad-based commodity price increases in recent months. However, with respect to the oil market, we consider the sizeable voluntary production cuts by OPEC+ members to be of similar importance as the prospect of the global recovery gaining momentum.

We concur with staff that risks are overall balanced in the near-term but more to the upside further out.

- A strong recovery led by AEs, primarily the US, as well as by China, and the release of pent-up demand amid accelerating vaccination campaigns represent noteworthy upside risks to the global recovery. The same holds true for the impact of (existing and possible additional) fiscal support, including that of the recent package in the US.
- The main downside risk factors include pandemic resurgence from new viral strains and slower vaccination rollout, as well as financial vulnerabilities exposed e.g. by a repricing of financial assets. Concerning EMEs, the impact of tighter financial conditions due to a sudden reassessment of market fundamentals or spillovers from abrupt market adjustments in the US could be considerable, notably in countries with weak fundamentals. Furthermore, higher than foreseen damage to potential output, including from severe setbacks in human capital accumulation, poses significant risks over the medium term.

The policy response should continue to effectively combat the pandemic, sustain economic lifelines of those hard-hit by public health measures and support a sustainable and inclusive recovery.

- **Fiscal support to the real economy needs to be responsive to evolving circumstances, while avoiding premature withdrawal of fiscal support before the health crisis is brought under control and the economic recovery is firmly underway.** The current stage is still marked by extensive government-mandated lockdowns that restrict effective participation in the market process of some sectors. Therefore, continued income replacement to severely affected firms and households seems justified. We agree that an eventual rollback of such fiscal lifelines should be done in a cautious manner avoiding sudden cliff effects. However, there is a strong rationale to

phase-out sectoral support measures when restrictions are lifted and demand picks up. As noted by staff, it is essential even in this crisis phase not to bind future budgetary margins by committing to permanent and inefficient spending outlays, and extraordinary spending needs to be balanced with debt sustainability in cases of limited fiscal space.

- **Emerging from the crisis, investing in support of structural adjustments of our economies and alleviating the uneven impact of the crisis will be imperative.** Improving the composition of public spending, with emphasis on high-quality investments in support of education as well as the green and digital transitions, should feature high on the policy agenda. This should be fostered by credible fiscal frameworks, including commitments to return to compliance with fiscal rules, as noted by staff, and the state scaling back its direct footprint in the economy. It is also worth noting that due to the nature of the crisis and of support measures adopted, interpreting the fiscal stance might be inherently difficult and probably inconclusive, with a tightening not necessarily reflecting a material drag on the economy. However, it will only be possible to determine the precise scope of fiscal consolidation needs once the uncertainty about the further course of the crisis and the long-term consequences on potential growth path become clearer.
- **The level of persistent damage to the economic fabric is so far uncertain and likely masked for the moment by exceptional policy measures.** Expediting reforms to facilitate insolvency and restructuring procedures in conjunction with lowering barriers to entrepreneurs are particularly important to avoid large-scale “zombification” should the number of business failures rise. Persistent scarring is a particular threat in relation to human capital, both through prolonged separation from labour market participation and through the disruption of educational pathways with knock-on effects on lifetime incomes. While hysteresis is potentially lower than in previous crises in many AEs thanks to extensive use of job retention schemes, labour market policies will need to gradually shift course towards supporting effective reallocation of jobs.

We broadly agree on the outlook for inflation as presented by staff. The credibility of monetary policy frameworks remains vital to keep inflation expectations well-anchored, not the least in the current environment of high and rising government debt. We concur that where institutional frameworks safeguarding central bank autonomy are well-established it is unlikely that inflation expectations and inflation will increase rapidly.

We concur with staff that the interest rate of the Federal Reserve represents the main push factor affecting capital flows and that rising US policy rates can have substantial repercussions especially on portfolio flows, depending on the triggers for such a rise. Analysis conducted in the Eurosystem finds significant spillbacks from US and European monetary policy. Thereby, repercussions are somewhat more important for the Fed than for the ECB. However, our analysis confirms staff’s findings that external financial vulnerability in EMEs is very heterogeneous and primarily depends on domestic parameters, supporting the case for sound and prudent policies in EMEs as the first line of defense (Bundesbank, *Global Financial Interconnectedness and Spillovers Between G20 Countries*, Monthly Report September 2020, p. 53-73).

We agree that special care must be taken by monetary authorities in AEs at the current juncture when communicating their policy stance. Given some EME’s elevated vulnerabilities due to increased financing needs, the limited effectiveness of flexible exchange rates to act as a stabilizing tool and the

increasing importance of outward spillovers from EMEs, it is a shared interest to avoid monetary policy surprises emanating from AEs that might set the stage for currency or financial crises in EMEs. At the same time, sound macroeconomic and financial conditions at home are the best way in which AEs can contribute to external financial stability in EMEs. Monetary policy should therefore focus on price stability at home while keeping in mind possible spillbacks from abroad.

Global Financial Stability Report

Overall, we concur with the GFSR's analysis of the possible unintended consequences of policy support as well as the potential adverse effects of an asynchronous and divergent recovery on financial stability. The unprecedented policy support may have unintended consequences by creating potential macro-financial stability risk down the road. However, in order to avoid cliff effects, support measures should not be terminated prematurely and simultaneously. Macroprudential policy should act pre-emptively.

We also concur that as long as the path of the pandemic and the economic recovery remain unclear, the banking sector should refrain from dividend distributions. For particularly robust and well-capitalized banks, exceptions should be possible under certain conditions in order to maintain the competitiveness of European banks. Deferring payouts to more certain times is unlikely to harm the wealth position of shareholders but increases resilience of the banking sector in this period of high uncertainty.

We share the view that global coordination is needed when developing macroprudential tools for the non-bank financial sector. In general, new macroprudential tools require careful ex-ante analyses. Tools that strengthen systemic resilience overall should be preferred over potential new tools that might create contagion risks between sectors in the financial system, as for example NBFITools that relocate risks to the banking sector.

We agree that a strong increase in risky assets' prices in the past few months has raised concerns about high valuations and excessive risk taking. Extensive policy measures have helped to mitigate the impact of the pandemic, but might have contributed to stretched valuations, distortions in implied risk premia, and a rise in vulnerabilities.

We welcome staff's analysis on emerging markets' financing needs and capital flows. We agree that despite the recent episodes of rebound, capital flows remain somewhat fragile, as the currently high volatility in emerging market portfolio flows indicates. Emerging markets with weaker fundamentals and limited access to vaccines may be hit hardest by a shift in investor sentiment and tighter global financial conditions. Similar to the taper tantrum, a policy normalization in advanced economies could again lead to a snapback in term premia in emerging markets.

As regards the banking sector, we agree that banks should use capital buffers in case of increasing losses to continue lending to the real economy. Staff predominantly explains the reluctance to use buffers with profitability considerations. At least for the Euro area in general and Germany in particular, extensive fiscal support shielded the financial system from the direct implications of the pandemic and its economic fallout. Insolvencies are still low (even lower when compared to pre-crisis levels) and no significant increase of loan losses has been recorded. As a

result, until now there has been no apparent need for the banking sector to dip into regulatory capital buffers, like the Capital Conversation Buffer. Preliminary results from empirical work (using European or German data) also do not suggest that banks were reluctant to use buffers. However, from a more conceptional angle our analysis suggests that reluctance might also be related to the interplay of various requirements. Binding constraints in other parallel requirements, e.g. the leverage ratio requirement, might render macroprudential buffers ineffective. According to latest surveys, banks are tightening lending standards. While staff emphasizes this as a potential headwind to recovery, it could also be a prudent reflection of rising credit risks and prospective phasing out of support measures.

We concur with the staff's findings on corporate vulnerabilities and share the assessment regarding the solvency risks of small and medium enterprises. We also agree with the assessment regarding the importance of involving private lenders when allocating public support to firms. Private sector expertise can be particularly valuable when assessing the viability of firms. However, we recommend a cautious approach with respect to the conclusions drawn from the analysis. The coverage of the European non-financial business economy is very small. This limitation could be made more transparent in the text, possibly by an appropriate disclaimer.

As staff rightly accentuates, increasing debt levels in the non-financial corporate sector are a cause of concern. Extensive policy measures have shielded the financial system from a wave of corporate insolvencies and corresponding losses. While the flow of credit meeting the liquidity demand of the real economy was mostly unimpaired, this has come at the cost of higher indebtedness in parts of the corporate sector. The current situation is challenging for macroprudential policy, as it must deal with a potential materialization of risks without losing sight of a further build-up of vulnerabilities. We agree that based on sound empirical analyses the macroprudential toolkit could be expanded to include nonbank financial intermediaries.

We concur with the view that the COVID-19 shock is likely to reinforce structural changes, impacting CRE in the medium term. As in other countries, we also observe in Germany that certain CRE segments like retail, hotel, and office have been the most affected by the COVID-19 shock, while others have rather profited (e.g. logistics space). However, up to now the pandemic has not yet caused strong price declines on the German CRE market in contrast to those observed for the EU as a whole.

In line with staff's findings, we agree that it is important to ensure an adequate CRE risk provisioning by banks and other financial intermediaries with the aim to strengthen their financial resilience against future market adjustments and a possible increase in NPLs once fiscal support measures are phased out. While the banking channel is the most relevant channel for shock transmission in case of a significant deterioration in CRE markets, the role of NBFIs, especially real estate investment funds has grown. The exposure of insurance companies to CRE investments has increased over time, but is still moderate in relation to their assets. In our view, appropriate macroprudential instruments for CRE loans would need to reflect diverse CRE financing structures. In addition, as credit growth rates are already slowing in reaction to the COVID-19 shock, one should take into consideration that introducing macroprudential measures at such a point in time could restrict financing for the real economy in a procyclical way.

Fiscal Monitor

We welcome the fiscal policy analyses and recommendations of the IMF Fiscal Monitor 2021.

The stabilization of aggregate demand was one important goal of fiscal stimulus to counteract the economic impact of the pandemic. As most countries relied on debt financing of stimulus packages, fiscal policy stances were expansionary, thus cushioning the adverse effects of the pandemic shock. In Europe, we agree with staff that efficient use of Next Generation EU can stimulate economic recovery and facilitate the ongoing digital and ecological transformation of the economy.

We agree with the assessment that targeted and transformative public investment should be an important element of the economic policy stance. This will not only help achieve important SDGs, but will also increase future growth potentials and contribute to debt sustainability. In the current environment, public investment is expected to have significant multipliers. As a result, public investment is a crucial ingredient for strong and sustainable growth after the pandemic.

We agree with the assessment that a swift vaccination of our societies offers the best chance to overcome the pandemic. We agree that fiscal policy must remain flexible and supportive of health systems, vulnerable households, viable firms, and the economic recovery, until we make enough progress towards sufficient inoculation of our societies. We subscribe to the strategy of continuously monitoring the pandemic and economic situation, targeting fiscal measures to the specific needs. In any case, fiscal policy should remain supportive until the pandemic subsides and economic recovery has sufficiently gained momentum. As the IMF analysis points to spillovers of COVID-19 related policy measures, countries with ample fiscal space should pursue a prudent approach when deciding about exit strategies for fiscal support. We must avoid potential cliff effects in case fiscal support would be withdrawn too early.

Higher fiscal deficits and debt levels worldwide are the results of the internationally coordinated policy response, which was necessary to cushion the economic downturn. While the expansive policy stance is the right course of action in the crisis, and which should not be abandoned prematurely, we have to be aware of debt sustainability in the medium and long term. In times of economic upswing, it will be key to take the necessary actions to ensure debt sustainability and rebuild fiscal buffers. In this respect, one possible way forward would be to make progress on unresolved issues in international taxation, in particular regarding base erosion and profit shifting. We welcome the support of the IMF for a political agreement on the G20/OECD Base Erosion and Profit Shifting project, which will be important to avoid harmful tax competition and unilateral measures.

On Chapter 2, we agree with staff that inequality is a critical topic. We concur with the view that improvements in education, health and early childhood development are crucial factors for progress. Staff could make its call to align distributive choices better with people's preferences more prominently. An important contribution would be deeper country-specific analysis, including possibilities to tackle tax evasion. **We underline the importance of better incorporating inclusive growth and inequality in the Fund's surveillance, including within the Comprehensive Surveillance** **Review.**

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GRAY/21/837

March 23, 2021

**Statement by Mr. Trabinski and Mr. Tola on World Economic Outlook; Global
Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

In spite of the ongoing pandemic and the related uncertainty, growth prospects are improving. At the current juncture, it seems crucial to reflect on how to navigate the trade-offs related to continued policy support., including the challenges related to scarring, legacy issues, and possible international spillovers from an asynchronous recovery.

Global outlook and risks

We broadly share the Fund’s global growth outlook. The global economic outlook has improved over recent months as a result of the progress in vaccinations and the announcement of additional fiscal support in several major economies, among others. While the recovery is expected to gain momentum during 2021, its speed is highly uncertain. Risks abound, reflecting foremost the ongoing race to develop and roll out vaccines for new virus strains, structural rigidities, as well as the exacerbation of preexisting vulnerabilities, notably high public and corporate debt levels.

Policy priorities in the near term

Proceeding quickly with vaccinations should remain a priority while policy support is justified until the crisis abates. The exceptional roll-out of policy support has been instrumental to avoid a much larger contraction. Of particular importance at the current juncture is fast progress with vaccinations, which are crucial to the resumption of a normal economic activity.

Policy support should be mindful of future risks and costs. Short-term financial market support may excessively stretch credit valuations and allow nonviable corporates to linger on. Fiscal support today may constrain countries’ ability to cope with shocks in the future.

We agree that such trade-offs are country-specific, and likely to vary across different policy tools and over time. *We would nonetheless appreciate staff's views on the implications of cross-policy differences in these trade-offs for the coordination and sequencing of the eventual policy normalization.*

We welcome the calls to improve the intertemporal trade-off of policy support.

Improving the targeting of measures, where possible, can help reduce costs. The early adoption of macro- prudential measures and the roll back of temporary regulation can reduce risks, particularly if this does not materially tighten overall financing conditions. Medium-term fiscal frameworks are more crucial than ever and need to be revised to commit to fiscal soundness. A credible and well communicated framework with a consistent approach to short-term support as well as long-term objectives would strengthen the expectation of a strong and sustainable recovery consistent with a sustainable fiscal stance.

The IMF will continue to play a key role in the recovery. With legacy issues and delicate policy normalization ahead, the role of the IMF and international cooperation will remain crucial. Close cooperation between the IFIs will remain key. The IMF has supported the fast and synchronized policy reaction by sharpening our understanding of existing challenges and providing financing to members for whom access to other sources of financing was constrained. Yet, the IMF will also need to consider the longer-term sustainability and resource implications of its support, in addition to being mindful of its operational capacity.

Policies in the medium term

The removal of policy support – when appropriate – should be made gradual, to avoid sudden cliff effects. Adequate coordination among domestic institutions will be essential to assure that the removal of policy support does not create unexpected headwinds for the recovery. International cooperation would be similarly beneficial.

We see scope for analyzing international spillovers and how they might impact the speed and the strength of recovery across countries. While the timing of a policy normalization is likely to differ across countries, even within country groups, the expectation of pent-up demand increasing consumer prices has already lifted inflation expectations and long-term interest rates. While potentially healthy and welcome, a rapid and persistent rise in rates could create new challenges and scope for disruptions. In this context, we would appreciate the Fund's analytical work on such spillovers.

Longer-term challenges

Persistent negative effects from longer interruptions of schooling and labor market dislocations risk curtailing the recovery. Policies should shift their focus from protecting existing relationships to supporting the structural transformation that will help shape our

future. This requires credible and adequate structural policies that allow for the necessary and mindful reallocation of resources, while fostering competition and innovation.

IMF surveillance and policy advice will remain crucial for addressing longer-term global challenges. Dealing with global shocks requires a combination of national policies and international cooperation. The IMF must continue to be a beacon for an open, rules-based and transparent international system with well-functioning markets and free movement of capital and goods. The IMF work will also remain essential to better understand the macroeconomic implications and different policy options related to inclusiveness, digitalization, and climate change.

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March 23, 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 21/31
March 25, 2021**

World Economic Outlook

We highly appreciate staff's work on the World Economic Outlook (WEO), with particular attention to the short- and long-term impacts of the COVID-19 crisis, as well as the main policy areas to avoid a great divergence in the economic recovery. The paths to economic recovery are still mired with uncertainty, while it is also clear that this crisis is accelerating fundamental changes in the global economy. The containment of the pandemic still remains a priority. Meanwhile, countries must be prepared to restart their economic activities, placing greater emphasis on increasing employment and promoting investments. Maintaining stimulus is also warranted; however, as the policy space has narrowed, targeted measures are becoming increasingly important. We believe that the medium-term fiscal consolidation plans should be promoted in a growth-friendly way. Although international institutions can play an important role in supporting these efforts, the international community should also step up cooperation to help end the pandemic by speeding up the production, rollout, and distribution of vaccines.

The recovery paths mainly depend on the race between the virus and vaccines, and we continue to encourage staff to accord high priority to these developments. *We would appreciate staff's clarifications whether recent developments, including the new wave of lockdowns and their impacts on key sectors, were already captured in the report.* Although most of the sectors have adapted well to the changing environment, other sectors are still reeling from the protracted crisis. Special attention should also be given to the disruptions of the global supply chains, which can lead to higher prices globally.

While we take note that staff's forecast marks a slight improvement in the global economic outlook, we call for cautious communication, as high uncertainty surrounds the recovery. Although a positive attitude may in itself help expectations, we also underscore the importance of maintaining a balanced approach to the projections. We would consider it premature to declare that the COVID-19 crisis could leave smaller scars than the Global

Financial Crisis of 2008 (GFC). We would primarily focus on the policy measures to reach this state and build a better future.

The capability to reallocate jobs to more viable economic sectors will have significant impacts on the labor market and the prospects for recovery. We welcome the WEO analytical chapter on the patterns of labor force participation and policy options. In order to sustain high and inclusive employment, the focus of policy reforms in labor markets should concentrate more on fast-growing prosperous economic sectors, such as digitalization and the green economy, than jobs in declining industries. Tailored labor market policy measures such as additional training, education, job search services, and lowering costs for firms to employ new workers, should be used to assist the transition of workers between economic sectors. These steps should be supplemented with measures aiming at improving the business environment and strengthening social safety nets to support the most vulnerable.

Beyond responding to the current social and economic challenges, policymakers should also take steps to address the pandemic's lasting scars to avoid permanent output losses. In this regard, we highly appreciate Chapter 2, which provides helpful insights into the pandemic's after-effects. We suggest better incorporating these findings into the main summary. While the COVID-19 crisis is unique in nature, experience from previous crises can also provide useful lessons on the persistent effects of recessions and how to alleviate them. To ensure a sustainable recovery, countries need to make bold decisions now and redouble their reform efforts. Like staff, we believe that the pandemic's adverse effects can mainly be offset by investments that serve the future and support human capital accumulation. In terms of global imbalances and inequalities, we note with concern that the emerging markets and developing countries (EMDCs) are expected to suffer more scarring than advanced economies, while the EMDCs' room for policy maneuver is also narrower. This also underscores the need for well-calibrated policy measures.

We highly appreciate Chapter 4, also considering that the importance of spillover effects has increased significantly in recent years, in the context of the dynamic growth of emerging markets (EMs). At the current juncture, where a growing divergence is expected, it is critical that the assessments of these impacts remain high on policymakers' agenda. We also agree with staff that clear forward guidance from advanced economies' central banks will be key to maintain investor confidence and avoid a surprise tightening of global financial conditions. Given the more constrained policy space in EMs, we continue to underline the benefits of the unconventional policy measures, with particular focus on targeted liquidity and lending programs. Meanwhile, emerging market economies should also take further steps to reduce their external vulnerabilities, promote debt sustainability, and scale-up their efforts to build credible medium-term budgetary and monetary frameworks. Taking country-specific factors into account is also vital.

Global Financial Stability Report

We thank staff for the detailed Global Financial Stability Report (GFSR), which provides a thorough analysis of potential financial stability risks across different financial market segments, including a helpful discussion of specific policy trade-offs. The newly added sections on more granular policy recommendations constitute an important guidance for

policy makers, which could facilitate their policy response in the next stages of the current crisis. In this regard, we also appreciate the GFSR's analytical chapter on commercial real estate (CRE), explaining the possible extension of macroprudential tools. While the unprecedented monetary and fiscal stimulus was instrumental to prevent the liquidity crisis from turning into a solvency crisis, the withdrawal of supportive measures needs to be gradual to keep emerging cliff-edge effects in check. This is, in particular, critical for those jurisdictions where the recovery is expected to be only modest or delayed going forward. Therefore, a return to policy normality, including potential more restrictive monetary policies in advanced economies, needs to be closely monitored to alleviate potential adverse effects related to rising risk premia and capital outflows from emerging markets.

Banks entered the COVID-19 pandemic with stronger capital buffers owing to the post-GFC regulatory and supervisory overhaul. We note positively that the banking sector in advanced economies has demonstrated its resilience to shocks thus far, facilitated by regulatory relief and crisis-related measures. In the next stages of the crisis, banks will need to adjust their risk management frameworks to withstand potential losses from loans currently under moratoria, and build reserves against credit risks from new loans which will no longer be secured by government guarantees. We note staff's finding that while some segments of banks have ample capital, their incentives to support lending in the real economy are limited, owing to risks stemming from a potential deterioration in credit quality and costs related to restoring their capital buffers, which might weigh on banks' valuations. We underscore that such considerations are particularly critical for EU banks, whose valuations are comparatively low given long-term subdued profitability. Against this backdrop, in order to speed up the capital rebuilding process and support the recovery, EU banks need to consolidate and accelerate their digital transformation.

The corporate sector has benefited from accommodative monetary policies and easy financing conditions amid a mix of supporting measures. However, rising leverage and mounting solvency issues in some segments of the corporate sector are worrying. We welcome staff's analysis of firms' liquidity and solvency strains across different real economy sectors and firm sizes. While policy makers should not withdraw policy support prematurely, it is critical to allow for economic restructuring and avoid the "zombification" of firms unable to adjust their business models. The policy response should, therefore, be well-targeted and designed for firms meeting the required viability criteria. To this end, the GFSR offers a useful guidance for policy makers, in particular, the framework for taking decisions included in the box on page 24 (decision tree). The application of such a framework in practice might be constrained by institutional limitations in countries dealing with capacity issues or lacking expertise in credit risk assessment. *We would welcome staff's views on how such issues could be addressed in different jurisdictions, including a potential outsourcing of the credit risk assessment to the private sector.*

While emerging markets have benefited from central banks' asset purchase programs and Fund-supported financing arrangements, recent volatility in the capital flows indicates that some countries' fiscal positions are fragile. While some emerging countries remained relatively stable, in view of the elevated indebtedness, rising rollover risks, and vulnerabilities related to lower availability of vaccines, we are concerned that the economic

recovery in several emerging markets will be uneven and protracted. While some countries will need to employ debt management operations, including debt service rescheduling or the restructuring of bilateral debt, it will also be critical not to lose sight of fiscal consolidation strategies and structural reforms to address weak economic fundamentals.

The GFSR's analytical chapter on CRE provides a thorough explanation of financial stability risks related to structural trends in the CRE sector, which have been exacerbated by the COVID-19 pandemic. While banks could be substantially impacted through their credit exposure to CRE, insurance companies, pension funds, and other nonbanks are vulnerable to price corrections in their CRE asset holdings. The outlook in the CRE is uncertain, depending on the demand for the future use of commercial premises, post-pandemic health-related restrictive measures, and a potential further shift to e-commerce, which could amplify price misalignments. Macroprudential tools targeted at banks' CRE exposures, such as loan-to-value or debt-service-to-income ratios, could be considered to mitigate the emerging risks, subject to the scope of the authorities' regulatory and supervisory mandates.

Fiscal Monitor

We broadly concur with the FM's message on the need to better tailor the response to the pandemic's impact and align **fiscal support** with the pace of the recovery and medium-term needs.

Global public debt surpassed unprecedented 97 percent of GDP in 2020 and we stress the importance of credible **medium-term fiscal strategy and frameworks** as well as of adequate policy space in the short term. Increased public debt levels should be addressed by implementing sustainable medium-term fiscal strategies rooted in stronger revenue mobilization efforts and increasing quality and efficiency of public spending, while leaving room for raising investment levels and supporting the green and digital transitions. For instance, the EU's Recovery and Resilience Facility (RRF) provides a unique window of opportunity for member states. We further underscore the need to complement credible fiscal rules with binding multiyear operational rules that ensure debt reduction once economies recover to avoid repeating the uneven debt reduction following the GFC. Ensuring full transparency of fiscal costs and existing liabilities remains essential. We stress the role that improved governance and transparency can play in increasing voluntary tax compliance and reducing wasteful spending and positively note the innovative practices highlighted in Box 1.1 of the FM. We are sympathetic to pre-legislating tax increases but are cognizant of the political economy difficulties especially across election cycles. Progress in addressing structural weaknesses in international taxation rules will be an important factor to ensure that highly digital firms contribute their fair share in market countries.

The second chapter of the FM highlights the impact of the pandemic on preexisting **inequalities** in income, wealth and access to quality public services, and usefully identifies the pre-distributive and redistributive policy options. *We would have welcomed more details on a realistic pace improvement observed in countries implementing reforms in the past in closing the sizeable efficiency gaps.* Investing in human capital through more equitable access to education, childcare and healthcare would support a more resilient recovery and

avoid deeper scarring while likely being deficit neutral in the long run. The chapter also usefully identifies several options for raising revenues while reducing wealth and income inequalities in the short term and we highlight the potential trade-offs between increasing tax burden on income and tackling tax evasion.

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March 23, 2021

**Statement by Mr. Mohieldin, Mr. Alhosani, Mr. Geadah, Ms. Abdelati, Ms. Choueiri,
and Mr. Al-Kohlany on World Economic Outlook; Global Financial Stability Report;
Fiscal Monitor
(Preliminary)
Executive Board Meeting 21/31
March 25, 2021**

1. We thank staff for an excellent set of papers that touch on all the relevant matters for the global outlook, which remains highly uncertain, and near-term policy challenges.
2. Uneven prospects and divergences, between and within countries, characterize this round of the WEO, reinforcing the need for strengthened multilateral cooperation. As we celebrate the upward revision of the growth outlook for many major economies due to extraordinary policy support and rapid advances in terms of vaccine production and dissemination, many are left behind. Staff's latest forecast provides a sobering picture of continued uncertainty regarding the path of the pandemic, but also the realities of the uneven access to emergency support and to vaccine rollout. The divergence also creates potentially significant spillovers on financial conditions and capital flows.
3. While we fully appreciate staff's emphasis on divergence and the need to motivate and advocate for more multilateral cooperation, we should also avoid simplifying the headline message as one between advanced economies and emerging market and developing economies. There are differences between regions and within regions. Therefore, the appeal of a simple message should be balanced with avoiding a potentially misleading representation of country prospects. Even within our own constituency, each country has its own economic structure, income level, emergency policy response, pace of vaccine rollout, and capacity to support reallocation and adjustment in the post-pandemic era. To give one figure for the MENAP region would miss a lot of these country specific factors. *We would appreciate staff clarification of how they will mitigate against this potentially misleading simplification.*

4. Having said that, we emphasize the urgent need for greater global cooperation to ensure global access to vaccines and to prevent new waves of infection, new strands, and any related deterioration in the outlook for the pandemic. International cooperation is needed to ensure adequate global vaccine production and worldwide rollout at affordable prices and to support access in all countries and to all groups of the population. The pandemic has eroded the gains over the past decade in terms of poverty reduction and has set back country standings with respect to meeting the SDGs. Global action is needed to arrest the increasing number of people, 90 million people so far estimated, that are expected to fall into extreme poverty in 2020-21, and not only in low income countries. Within countries, the pandemic has increased inequalities. The Fund needs to be a strong voice joining others in the call for joint action to address the challenges of divergence and setbacks to the SDGs.

5. The flagship reports rightly draw attention to the daunting challenge of getting the policy mix right at different stages of the pandemic, although these stages may well overlap even within a country. We agree with staff that the principal policy challenge for all countries is first to overcome the health and economic threat of the pandemic, then to recalibrate policies throughout the different phases of the recovery, and to prepare medium-term policies for transforming economies toward more sustainable and inclusive growth.

6. We appreciate staff's work in the WEO Chapter 2 on persistent damage (scarring) from the pandemic and policies to limit the damage. Clearly, the adjustment costs of the pandemic for different countries depend on the structure of the economy and will only be known over time. However, given the size of the emergency support packages, staff reasonably predict that EMDCs are expected to suffer more scarring than advanced economies. We agree that remedial policies will be needed to address the setbacks to human capital accumulation and to facilitate reallocation through investment in order to rebuild resilience, address the increases in inequality, and address sustainability (achieving the SDGs) more broadly.

7. The Fund must, through its surveillance and program work, support members as they balance the risks from rising public and private debt with the risk of insufficient support to the economy or early withdrawal of support. In doing so, it will be important to take into account not only the stage of the pandemic and strength of the recovery, which will be subject to uncertainties, but also the specific country circumstances and structural characteristics.

8. For Emerging Economies (EMs), we agree that policies need to remain accommodative for the time being while vaccines rollout continues, and that these countries should use the current opportunity of lower financing needs to lower their financing costs through active debt management. In this regard, however, *we would like to hear more from staff on which EMs have seen lower financing needs and which have not*, noting that average EMBI spreads have remained relatively elevated (Figure 4.3), and the average may mask the special cases of those economies that benefit from ECB policies. We appreciate staff's work

on the possible spillovers from monetary policy changes of major central banks, and we agree that clear guidance will be necessary to avoid financial disruption to emerging markets.

9. For low-income countries, the challenge is even greater as the policy space was considerably more limited, and accordingly for many there has been a substantial setback in terms of per capita income expected in 2025 compared to the pre-pandemic area. We appreciate staff's work and updates on the *Macroeconomic Developments in LICs*, where staff anticipate rising financing needs for LICs to recover from the pandemic, maintain adequate reserves, as well as additional investment spending to build resilience and help with convergence. We note staff's estimate of \$450-\$550 billion for 2021-2025, while noting that five countries account for 45 percent of the total financing need; *staff may wish to comment on the implications of financing this concentration from domestic resource mobilization and official aid*. Clearly, the SDR allocation would only provide a small fraction of these financing needs, leaving a large part that needs to come from other sources.

10. In both EMs and LICs, the pandemic has exacerbated the challenges of informality. WEO Chapter 3 provides valuable analysis on the labor market impact of the pandemic and targeting policies to help reduce separations, particularly for the lower-skilled would help limit unequal impacts, while using other measures or subsidies to support worker reallocation to ease the adjustment to the permanent effects of the pandemic. We would encourage further staff work in the area of informality, especially in terms of the design of training and digitalization policies to facilitate labor reallocations to new activities—and reduce the digital divide. *What are staff's plans for further work to help guide countries to seize the opportunity of rebuilding after the pandemic to accelerate the transition to leverage digitalization, and build greener economies?* The pandemic has also highlighted gaps in social protection systems and the need to enhance social safety net.

Fiscal Monitor

11. Fiscal support played a central role in preventing a more severe global economic contraction and in containing the pandemic's socio-economic fallout, although this support varied across economies. We note that Low Income and Developing Countries' fiscal response was only a fraction (seven percent) of Advanced Economies'. *We would appreciate staff elaboration on the estimated impact of the direct fiscal response on the output of the different country grouping, directly or through the spillover channel.*

12. **Public Debt:** The unprecedented fiscal actions exacerbated pre-existing debt vulnerabilities. Government deficits widened across all country groups and the public debt level surged to a record high of 97 percent of world GDP. We note staff assessment that many EMDCs continue to face challenges financing their large deficits due to limited market access and little scope to raise revenue in the near term, in contrast to Advanced Economies, which have ample access to low-cost borrowing. We welcome staff emphasis on the need to address elevated debt levels and to restore debt sustainability.

13. **MICs:** In this context, while we welcome the positive role of the DSSI and the Common Framework in alleviating some of the debt challenges in low-income countries, attention to the debt challenges facing many middle-income countries is also needed. In this regard, we see a need to reform the international debt architecture to be able to identify and quickly resolve debt problems. We look forward to a continued and close engagement with staff and management on the important topic of debt. Addressing debt management in the next few years will be critical not only to ensure a sound recovery, but also to create the space for transformational change towards sustainable development.
14. **SDGs:** Fiscal policy needs to continue to be supportive in the near term and be anchored in a credible medium-term policy framework, focusing on achieving Sustainable Development Goals and leveraging digitalization to achieve a smart, green, and inclusive recovery of the economy.
15. **Fiscal Support:** Fiscal spending remains crucial to fostering the post-COVID-19 economic recovery and continued and flexible fiscal support is needed until a durable recovery is underway. We caution against prematurely withdrawing support before the pandemic has receded, which could undermine recovery and growth. Further, we concur with the report on the need for fiscal policy to remain flexible and supportive of health systems, households, and viable firms.
16. **Domestic Resource Mobilization:** Reliance on high-multiplier expenditure, including on high-quality public investment, and measures to mobilize domestic revenues can raise growth and create the fiscal space needed for social spending and mitigate income inequality, while containing the increase in public debt over time. As the recovery takes hold, actions are needed to address the unequal burden of the crisis on the poor and vulnerable households, which exacerbated preexisting inequities.

GFSR

17. We appreciate the rich work presented in the *April 2021 Global Financial Stability Report*. The title of the report appropriately echoes the main message of the flagship documents about the prospects of an asynchronous and divergent recovery between members. Unprecedented policy responses in advanced and emerging markets economies have eased financial conditions and helped to contain global financial stability risks, although risks about stretched valuations and rising financial vulnerabilities have emerged. Against this background, we support the call on policymakers to act to avoid a legacy of vulnerabilities and to support balance sheet repair to foster a sustainable and inclusive recovery.
18. We fully share the assessment that monetary policy should remain accommodative, while carefully monitoring financial stability risks. The report rightly highlights the risk of an asynchronous recovery between advanced economies and emerging markets, particularly if accompanied by a move toward policy normalization in advanced countries and rapidly rising interest rates. If faced with sharp tightening of global financial conditions or large

portfolio outflows, some emerging market and developing economies (EMDCs) may need to resort to unconventional measures. This includes further asset purchase programs, as well as the multiple tools considered in the Integrated Policy Framework. Moreover, most EMDCs do not have access to swap lines or regional financing arrangements. Accordingly, we see a role for a rapid and flexible response by the Fund in providing financial support where and when needed. The envisaged SDR allocation and a program to voluntarily reallocate SDRs from countries with a surplus to those in need would also be most helpful, as we indicated above.

19. We appreciate the continued focus in the report on the corporate sector, which is likely to emerge from the crisis with higher debt levels, with large differences across sectors and firm sizes. Staff's work on a firm-level assessment to better target future policy support, as well as a framework to identify viable firms, is very useful. Assessing liquidity, solvency and viability are essential, although it is not clear to use what agencies will carry out such work and how it could be operationalized in most EMDCs, particularly in the case of small firms. *Staff's comments would be appreciated.* We look forward to country-specific discussions on the corporate sector in the context of Article IV surveillance.

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**Statement by Mr. Bhalla, Mr. Goyal, Mr. Natarajan, and Mr. Singh on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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March 25, 2021**

World Economic Outlook

1. We compliment the Staff for an excellent document. We appreciate its analytical depth and rigor. It analyses global prospects and risks and undertakes a daunting task of making forecasts under these continued uncertain, and unknown, times. We broadly agree with the Staff's assessment of prospects, risks, and policy prescriptions, but would like to highlight a few points.
2. The growth estimates have been revised further to the upside since October 2020 and January 2021, essentially reflecting early availability of vaccines and therapeutics thanks to the relentless efforts of our scientists and medical community and extended fiscal support by key advanced economies. In the baseline scenario, global growth during 2021 has been estimated to be at 5.9 percent compared with 5.5 percent projected just a month earlier (January 2021). The report also observes that the pace of recovery across nations is expected to stay uneven largely depending upon the availability of vaccines. The extent of policy support and structure of the economy are other reasons which will determine the recovery path. We note that the staff growth forecasts for global as well as individual countries are conditional upon assumptions regarding the speed and extent of pandemic spread and expected recovery path.
3. We fully endorse the view that recovery hinges on control of pandemic by securing access to vaccines and therapeutics. In fact, the universal availability of vaccines and a medical solution is a necessity and not an option. We would like to inform about the efforts made by India in this regard. It has scaled up the production of vaccines and medical supplies not only for its citizens but also to support the international community and, in particular, to support the vulnerable developing economies.

Vaccines are being exported to more than 70 countries worldwide, and medical supplies from India are reaching out to more than 100 countries. We are aiming to export nearly 300 million doses by the end of July 2021.

4. Regarding policy support, we agree that fiscal space is relatively constrained in developing and emerging market economies. Notably, debt ratios are exceptionally high in several advanced European economies as well. Nevertheless, we believe that the policy accommodation must continue till the recovery gains traction. A premature withdrawal of policy support could trigger liquidity shortfalls and insolvencies and undermine the recovery. However, as recovery takes shape, policy support needs to be reoriented and focused toward hard-hit sectors. The rollback of blanket loans and credit guarantees would be required, so that incentive to work and efficient allocation of resources is not a casualty. But this is a very delicate balance that poses a significant challenge to the policymakers.
5. We agree that international policy cooperation remains essential for continued access to liquidity. This would guard against the curtailment of critical health and social spending due to external funding and BoP pressures. In this context, we support G20 Debt Service Suspension Initiative and debt restructuring efforts under the Common Framework.
6. We note that the baseline scenario of the WEO assumes that financial conditions are expected to remain broadly supportive in advanced economies and to continue improving for emerging and developing economies. Further, emerging market spreads would remain broadly at the current level over the forecast horizon. Are these assumptions realistic? Chapter 4 of the report discusses prospects of multispeed recovery which can potentially cause significant disruption in developing and low-income economies. Reflecting these concerns, GPA observes that "... when advanced economies start to normalize monetary policy, clear communication will be essential to minimize spillovers to EMDEs." We believe the Fund should gear itself for a larger role and far bigger support to its membership during the post-pandemic period.
7. Outlook has highlighted the mitigation efforts toward climate change. As in case of October 2020 WEO, we reiterate our position that any discussion of mitigation necessarily needs to be accompanied by 'climate finance' requiring significant coordination across the countries. In a situation when many of the developing countries are falling far behind the SDG goals and are facing long-term pandemic scarring, the challenges of meeting adaptation and mitigation can be minimized – depending upon the developed countries following the principles of distributive justice, equitable burden sharing and adhere to the commitments of providing accelerated climate finance and low-cost technology transfers to the developing world.
8. Nonetheless, we would like to point out that India attaches prime importance to climate change concerns. This is reflected in our actions as India is among the very 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.

Global Financial Stability Report

9. We agree with the broad thrust of the report that actions taken during the pandemic may have unintended consequences such as stretched valuations and rising financial vulnerabilities. We also agree that repricing of risk in markets and a sudden tightening in financial conditions could be an important source of risk for emerging market economies.

10. The issues raised in the report that the credit quality of hard-hit borrowers and the profitability outlook are likely to weigh on the risk appetite of banks during the recovery are important challenges. The question arises as to **whether the suggestion that policymakers should take early action and tighten selected macroprudential policy tools refers to only stretched asset prices or also to bank/non-bank credit?** This assumes importance from the viewpoint that early tightening of credit standards may have implications for recovery.

11. The report argues that the sovereign bank nexus has worsened in emerging markets as domestic banks have absorbed the bulk of increases in domestic debt. It is well understood that unprecedented fiscal stimulus and accumulation of public debt in AEs has been financed by a large expansion in the balance sheets of the central banks. **Whether the absorption of government debt by the banking system vis-à-vis central banks will have greater adverse macroeconomic effects is an important policy question.**

12. Currently, indicators point to continued risk-taking as investors actively search for yield. At the same time, global speculative-grade corporate defaults have substantially increased, which seems to be creating the conundrum of high risk-taking amid rising insolvencies. In a situation where risks are elevated an early withdrawal of policy may lead to greater insolvencies. **An important policy question to address is the “optimum” sequencing between the phasing out of policy support and tightening of macroprudential policies.**

13. A big challenge during the current crisis is that the SMEs have been hit hard. This assumes more serious dimensions considering that around 50-70 percent of formal SMEs in developing economies are estimated to be unserved or underserved by the formal financial sector. **As these are the firms that may face the highest liquidity and solvency problem, what could be the policy advice concerning such enterprises?**

14. Many supervisors encouraged banks to use regulatory capital buffers, allowing banks to operate temporarily below the capital requirements. Banks, however, do not appear

to have drawn down their capital buffers. While we agree with the factors cited in the report for this reluctance of banks, an additional reason for the banks' reluctance in drawing down buffers could be the decline in capital ratios impinging on their capacity to distribute profits to their shareholders. **An important question that needs further exploration is how does this development during the current crisis somewhat dilutes the countercyclical properties of capital buffers and the perception about their effective use during a crisis?**

Fiscal Monitor

15. Significant fiscal interventions have been made by countries to support the healthcare system, households, business, and economic recovery in response to the pandemic. **These fiscal actions have prevented a more severe economic contraction, job losses and social costs.** Even as the vaccination is picking up pace, targeted fiscal measures are required for a durable recovery. With focus on this, the fiscal monitor provides useful insights into the targeted fiscal measures, public debt dynamics, public finance challenges, and the need for an urgent and equitable vaccination.
16. **Fiscal response, in terms of magnitude and nature has varied across country groups.** Advanced Economies have been able to provide huge support measures despite sharp falls in revenues resulting in an increase in fiscal deficit by about 9.5 percent in 2020. With limited fiscal appetite, the emerging economies could provide moderate support which was even lower in case of low-income countries, where fiscal deficits increased by about 5.5 percent and 1.5 percent.
17. **Global cooperation in the production and distribution of vaccination can facilitate a speedy vaccination which could bring an end to the pandemic sooner.** This will allow governments to unwind support measures and provide prioritized and targeted support during the transition. Some of the advanced economies with larger spending and revenue actions have experienced smaller output contractions. However, the emerging economies and LICs have limited policy space to endure a prolonged crisis. The premise that emerging economies benefited from the spillovers of monetary and fiscal responses of AEs by easing global financial condition, limited capital flows to emerging markets and supported global demand is interesting but requires deeper analysis.
18. **Policymakers have the unenviable task of balancing risks from the growing public debt and providing adequate fiscal support.** Global public debt is estimated to have increased by about 13 percent in 2020 and expected to increase gradually thereafter. However, average interest payments are expected to remain lower for AEs and many emerging markets due to decline in market interest rates and low central bank rates. *We request the staff to bring out a detailed analytical paper on the benefits, costs and risks of external market borrowings and a medium-to-long term strategy - as this can be helpful to emerging market and low-income countries. Staff may comment.*

19. **The analysis in effectiveness of discretionary fiscal policy responses to COVID-19 is helpful in evaluating the efficacy of different fiscal measures.** Going forward, we concur that the support measures should focus on the vulnerable households that include workers in the low-paying jobs and informal sector. On assistance to businesses, it is crucial to have proper allocation of resources by supporting firms that are viable and productive.
20. **India undertook timely fiscal support actions to help individuals and households, and stimulus measures for businesses - in immediate response to COVID-19.** Support for individuals and households includes healthcare, food security, direct benefit (cash) transfer, pensioners and women, payment to farmers and debt moratoria. Businesses have been provided debt moratoria, liquidity support and tax deferrals. **With the easing of restrictions, well calibrated policies were taken under self-reliant India initiative to boost investment and consumption.** Key structural reform measures undertaken include reform in labor laws, production linked incentives (PLI) to boost investment, and reforms in agricultural marketing. The recent annual budget for 2021-22 has given thrust to healthcare and vaccination, investment in infrastructure and manufacturing, agriculture, job creation, inclusive development, and private sector participation.
21. **India's approach to the vaccination program demonstrates strong indigenous capabilities and exemplifies global cooperation.** Apart from administering a massive domestic vaccination program, the country has been expanding global vaccine supply providing about 59 million supplies to more than 70 countries in the neighborhood, LICs, emerging market countries and AEs, till mid-March.
22. Finally, we thank the staff for the extensive and well written paper on fiscal monitoring providing important insights into efficacy of fiscal measures, tackling debt and public finance issues, fiscal rules and addressing inequality in income and access to services.

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GRAY/21/864

March 24, 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 21/31
March 25, 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)

COVID-19 has been an unprecedented shock to the global economy. From the second half of 2020, global recovery has been gaining momentum; however, the near-term economic outlook is still fraught with substantial uncertainties, and downside risks remain sizeable. Future containment of the pandemic depends on vaccine distribution. The pace of vaccination in most Emerging Markets and Developing Countries (EMDCs) is lagging, and many low-income countries (LICs) are facing severe fiscal constraints for vaccine procurement. Against this backdrop, we should prevent “vaccine nationalism,” and promote a cooperative, balanced, and inclusive vaccination and recognition process across countries in order to achieve a more synchronized global recovery.

Based on the baseline projection in the latest WEO, the pace of recovery in advanced economies (AEs) is picking up more rapidly than most EMDCs, and in the medium term, AEs losses are expected to be much lower than in EMDCs. Therefore, it is highly possible that the withdrawal of supportive policies in AEs is earlier than in EMDCs. History shows that when the Fed tightens its monetary policy, international capital will flow back to the US and the dollar will appreciate. This would pose significant spillovers to the EMDCs, through channels including capital flow reversals and FX markets. As observed by staff in the GFSR (more discussion below), EMDCs face daunting challenges given their large external financing needs, and signals of any change of monetary stances by AEs can quickly reverse market sentiment and lead to sharp adjustments in markets. Moreover, many EMDCs face preexisting challenges such as less developed financial markets, large foreign currency debts, and foreign currency mismatch on their balance sheet. As such, sharp currency depreciation

and capital outflow may trigger financial instability in these countries. Therefore, we welcome the IMF to closely monitor potential spillovers from policy changes in major AEs to EMDCs. The Fund also needs to work to ensure global coordination on the eventual policy normalization. In addition, as pointed out in the previous paragraph, we suggest countries with adequate vaccines share vaccines with trade partners and make vaccines a global public good, which would facilitate the convergence of global recovery and mitigate potential shocks to EMDC's FX markets and balance of payments.

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 in debt treatment to LICs during the implementation of the G20 DSSI and Common Framework for Debt Treatments. Moreover, we encourage staff to reflect on the implication of the forthcoming SDR general allocation and SDR recycling to the economic growth projection and debt sustainability analysis for LICs. Considering the huge challenges that the LICs and the global economy are facing, we call on the Fund to implement the SDR allocation as soon as possible.

To mitigate COVID-19 shocks and prevent potential scarring, China supports the economy in a balanced manner, and from both the supply and demand side. For the supply side, measures are taken to support market entities and firms, and to keep their normal operation. This has proved to be an effective way to protect employment and households in a sustainable manner. From the demand side, China promotes public investment on infrastructure, digitalization, and greener development, which will help lift productivity in the medium and long term.

Global Financial Stability Report (GFSR)

Large-scale fiscal and monetary accommodation has helped mitigate the impact on the economic and financial conditions, but the potential longer-term side effects stemming from the debt build-up and “low-for-long” monetary policy remain to be seen. With ultraloose monetary policies and increased investor optimism of an economic rebound, financial markets have continued to reach new heights since the publication of the last GFSR, further increasing its divergence from the real economy. The low interest rate environment will continue to put pressure on banks' profitability, which may motivate banks to engage in yield-searching activities in the shadow banking system to the detriment of financial stability. Meanwhile, the rapid expansion of central banks' balance sheets in the AEs could risk undermining their credibility in maintaining price stability in the longer term. The recent rise in longer-term bond yields shows that inflation expectation needs to be carefully anchored.

Financial conditions in China have remained basically stable despite the impact of the pandemic. Like many other countries, China has implemented measures over the past year to help direct credit to support the most vulnerable sectors and groups. There are inevitably costs and tradeoffs in implementing such policies, and this is not a unique challenge for

China. Because of the coordinated supportive measures together with the successful containment measures, however, the Chinese economy has recovered from the pandemic more rapidly than most other countries, as pointed out by staff in the Executive Summary and Chapter 1. The strong economic growth would alleviate and reverse the buildup of vulnerabilities in the financial system and provide the Chinese government with more resources and buffers to respond to future shocks. Our authorities will stay vigilant and continue to strengthen our financial regulatory and supervisory framework going forward.

As for the implicit guarantees to Chinese state-owned enterprises (SOEs) mentioned in Chapter 1, it is important to note that the SOEs are separate independent entities from the government. Our authorities have stated repeatedly in the past that there is no such implicit guarantee. The recent default by some SOEs is a continuation of an existing trend. It has made the pricing of SOE debt more efficient and will help SOEs to be subjected to greater credit discipline. This is a healthy development in China's SOE reform and will ultimately benefit the Chinese economy.

The recent surge in price of crypto assets had drawn many investors' attention and may pose financial stability risks. Crypto assets also raise several broader policy issues, such as AML/CFT regulation and supervision, regulatory measures to prevent tax evasion, and the need to avoid circumvention of capital controls, etc. As crypto assets are becoming more mainstream, we suggest the GFSR to have more discussion in this area going forward. *Staff's views are welcome.*

Fiscal Monitor

We take note that government debt has risen to unprecedented levels in the context of large-scale fiscal responses, with government debt for advanced countries reaching 120 percent of GDP on average in 2020. In this regard, abrupt changes in financing conditions and rising interest rates may aggravate interest burdens on government debt and even threaten debt sustainability. Therefore, we encourage staff to closely monitor the fiscal risks facing developed countries going forward. For developing countries, with relatively smaller fiscal packages and debt increase, monetary policy should play a more important role in supporting the economy and private capital should be fully motivated.

We welcome the detailed description of methodology used to estimate the public debt in China in Chapter 1. While this estimation is still different from that of the authorities, we see merit in this estimation as opposed to the approach of "augmented government debt" used in the China Article IV, as the former is more pragmatic and realistic than the latter. We also take note of the projected upward trajectory of China's public debt over the medium term. The Chinese government will take effective measures to stabilize the macro leverage and closely monitor the path of the public debt going forward.

The analysis on income inequality in Chapter 2 is very important, especially in the context that large preexisting inequalities in many countries have amplified the damaging effect of the pandemic. China has carried out various fiscal policies to support low-income groups during the pandemic through measures in securing jobs and enhancing public investment. In recent years, China has made considerable effort in addressing income inequality, with more than 10 million people lifted out of poverty each year since 2012. Around 770 million Chinese have been lifted above the poverty line since the reform and opening up in 1978, accounting for 70 percent of global poverty reduction during that period.

Statement by Rasmus Ruffer (ECB Representative), Dimitrios Rakitzis and Kleopatra Nikolaou (Advisors) on the April 2021 World Economic Outlook, Fiscal Monitor and Global Financial Stability Report

(Preliminary)

IMF Executive Board Meeting

25 March 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. 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 agree with the overall view that the global economy has recovered from the pandemic-induced recession faster than expected. While projections for the global economy still fall short of the path expected before the pandemic, and prospects are uneven across countries, policy support, progress with vaccination and learning to work under pandemic circumstances have led to a faster than expected recovery in output. We broadly agree with Staff's assessment of the current situation and outlook for the euro area, both regarding growth and inflation.

However, the recovery projected for 2021 notwithstanding, like Staff, we also consider that uncertainties surrounding the forecasts still remain at high levels. While the year 2021 is a year of expected recovery as reflected in both the WEO and the ECB March 2021 Staff macroeconomic projections, we agree that there remains substantial uncertainty surrounding the near-term economic outlook. We acknowledge positive base effects from a stronger-than-expected end 2020, owing to economic developments, policy support in large economies, vaccination campaigns and the release of pent-up demand in several parts of the world. However, substantial risks still remain, related, in the near term, to the dynamics of the pandemic and the speed of vaccination campaigns. We agree with Staff that the adjustment capacity of economies, financial conditions and the effectiveness of policy actions play an important role in determining the pace of the recovery in the coming years. In view of such unprecedented uncertainty, discussing alternative scenarios remains particularly relevant and we consider that the presentation of both more positive and negative pandemic paths is an appropriate way of representing this uncertainty; the underlying narratives used by Staff are similar to the ones used in our own recently published scenario analysis.

We concur with Staff's view that the utmost priority is to overcome the immediate health crisis and share their concerns about the increased heterogeneity across and within countries. We agree with Staff that, while the pandemic continues, policies should first focus on exiting the crisis, prioritising health

spending, providing well-targeted fiscal support, and maintaining an accommodative monetary policy, while monitoring financial stability risks. Policies should be adjusted flexibly in line with the evolution of the health situation and the pace and robustness of the economic recovery, avoiding a premature withdrawal of policy support. Over the medium-term, country-specific circumstances should guide policy measures in order to limit the scarring effect of the crisis on the long-term potential of economies. Like Staff, we also note with concern that the crisis has substantially increased heterogeneity across countries, sectors and income groups related to differences in pandemic exposure, containment measures and policy responses.

Regarding fiscal policy, we concur that, in view of the high degree of uncertainty, fiscal policy must remain flexible and supportive at the current juncture, while becoming more targeted going forward.

We agree with staff that risks to the fiscal outlook are unusually high. On the upside, faster-than-expected vaccinations could bring an end to the pandemic sooner and allow governments to unwind fiscal support earlier. Downside risks relate to a more protracted economic downturn, abrupt tightening of financing conditions amid high debt and the materialisation of contingent liabilities from liquidity support measures. Supporting economic activity and mitigating scarring effects through timely, temporary and targeted measures is key to longer-term fiscal sustainability. Premature withdrawal of fiscal support should be avoided, and, in the case of the EU, we fully agree that fiscal policies should remain supportive in 2021 and 2022, taking into account the grants from the Recovery and Resilience Facility (RRF). Fiscal policy should remain agile and effectively adjust as the health and economic situation evolves. Once the health situation improves and restrictions ease, fiscal measures should gradually shift towards more targeted actions to promote a resilient and sustainable recovery. The measures should be adapted to the pace and strength of the recovery in each country and underpinned by a continuing commitment to fiscal sustainability.

In that light, we also note that once the recovery is firmly under way, the focus should gradually shift to bringing public finances on a more sustainable path while staying the course on supporting the green and digital transitions. Once recovery holds firm, actions should be taken to address the increased public debt levels by implementing sustainable medium-term fiscal strategies, with an emphasis on improving the quality of public finances, raising investment levels and supporting the green and digital transitions. In this respect, the EU's RRF provides a unique window of opportunity for EU Member States to channel investment into areas where it is needed the most, and to support growth-enhancing reforms, thereby contributing to fiscal sustainability.

As to monetary policy in the euro area, preserving favourable financing conditions over the pandemic period for all sectors of the euro area economy remains essential to reduce uncertainty and bolster confidence. This will encourage consumer spending and business investment, ultimately underpinning economic activity and safeguarding medium-term price stability. Purchases under the pandemic emergency purchase programme (PEPP) are conducted with a view to preserving favourable financing conditions and to support the smooth transmission of monetary policy. The Governing Council expects a significantly higher purchase pace under the PEPP over the second quarter than during the first months of this year. Moreover, the targeted longer-term refinancing operations are supporting euro area bank lending conditions, helping to sustain credit flows to households and firms. The Governing Council

continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry.

We share Staff's assessment that transparent and clear monetary policy communication by major central banks is important for the global economy. We concur with the staff assessment that spill-overs from ECB monetary policy to EMEs are much weaker than spill-overs from US monetary policy, an asymmetry rooted in the dominant role of the US dollar in global financial markets. However, ECB monetary policy is likely to impact those countries with tighter economic and financial linkages to the euro area, as is the case for Central and Eastern Europe. In that context, we would like to recall that the ECB has set up liquidity lines with several non-euro area central banks to alleviate euro funding risks.

Global Financial Stability Report

We welcome the analysis of the GFSR and its well-chosen focus; we broadly share the assessment of financial stability risks. While extensive and unprecedented policy support has been necessary to maintain financial stability, vulnerabilities in the non-financial sector and in the financial system remain elevated. Their evolution is uncertain and highly dependent upon fiscal and monetary support measures which have been put in place to provide a bridge until the economy returns to a path towards durable recovery. In financial markets, recent bouts of volatility highlight uncertainties and possibilities of (further) re-pricing. The GFSR rightly points to two key emerging themes which cloud the financial stability outlook: excessive risk-taking in financial markets, and asymmetric recovery across countries and economic sectors.

A number of factors suggest that risks to growth stemming from the build-up of leverage in the non-financial sector may be less pronounced than suggested by historical regularities; the usual intertemporal policy trade-offs may therefore be less pronounced. Debt accumulation to meet crisis-related liquidity shortages and fund working capital needs can differ conceptually from the slow build-up of excessive leverage on which the historic analysis is based. First, firms increased, in aggregate, their liquidity buffers substantially, alleviating the need to deleverage in the future in order to meet increased debt obligations. Second, the composition of firms which increased their leverage in the past year is likely to be less concentrated among high-risk borrowers with relatively weak fundamentals and thus more resilient to a sudden tightening of credit conditions. Third, given the likelihood of a K-shaped recovery, firms with solid earnings prospects may be relatively well positioned to cope with higher debt burdens in the medium term. Finally, the increase in leverage has a strong denominator component related to the sharp drop in GDP, suggesting a partial reversal as GDP recovers (in the euro area the decline in GDP accounts for approximately 57% of the increase in corporate debt-to-GDP ratios in the first 3 quarters of 2020). A careful assessment of intertemporal trade-offs is essential in order to avoid a counterproductive tightening of macroprudential policies.

We welcome the thorough analysis of the financial stability implication of the COVID-19 crisis for the global commercial real estate (CRE) markets and broadly concur with the results of the analysis.

In particular, we welcome the emphasis given to the non-bank sector, which plays an important role in European CRE markets. Going forward, developments in the CRE sector should be closely monitored and existing data gaps should continue to be closed, notably with respect to secondary assets. Caution is required with a potential use of borrower-based measures (BBMs) in order to avoid pro-cyclicality in an environment where CRE risks are materialising and funding may be tight; BBMs may also be less effective in this market segment compared to the residential real estate market.

Going forward, we agree that improved targeting, careful timing and sequencing of COVID-19 measures is crucial for sustainable support, while being mindful to avoid a premature withdrawal of support. The report rightly stresses the need for increased tailoring of support measures, based on a distinction between viable and non-viable firms. Likewise, the timely adjustment of future policy support remains a challenge. In view of prevailing uncertainties, the risks associated with an early withdrawal of support may turn out to be more significant than those related to a somewhat delayed withdrawal. We therefore see a need for a flexible, state-contingent approach in policy adjustment to address the remaining uncertainties.

We support a gradual and cautious phase-out of support measures; in that context, there are some factors that may reduce the risk of cliff effects. While we agree that banks may face “cliff effects” in terms of additional provisioning needs upon the expiration of moratoria and run-off of guarantees, a number of positive developments are also worth highlighting. First, the clear reduction in the volume of loans under moratoria through December and the strong performance of loans exiting from moratoria so far (with 96% of these loans remaining in the performing category) suggests that impact estimates from expiring moratoria might be too high. Second, the expected gradual recovery in banks’ income generation capacity in the next few years could help offset some of the negative capital impact from the run-off of guarantees. Third, the calculation of the risk-weighted asset effects from guarantees might potentially overestimate the capital impact, especially for IRB banks. Moreover, issues related to cliff effect are relevant for many countries and the analysis should therefore be broadened beyond the largely European sample (Figure 1.15).

The complementarities among fiscal, monetary and regulatory measures have proven to enhance the effectiveness of the individual policies for the euro area and are an important consideration in the process of unwinding support measures. For instance, the risks of ‘cliff effects’ mentioned in the context of the termination of individual support policies such as moratoria and guaranteed loans always have to also be seen in conjunction with other relevant support measures.

As to macroprudential policies, we would like to emphasise the need to retain supervisory flexibility in case of deteriorating conditions and avoid at this point a premature tightening before this is justified by circumstances. The appropriate timing and modalities of an “exit” from supportive measures, including accommodative macroprudential policy, are key policy questions. In that respect, the GFSR could usefully provide some additional clarifications regarding its recommendations for macroprudential policy in order to avoid possible misunderstandings which could lead to broader unwarranted tightening of financial conditions. In addition, the recommendation to build buffers elsewhere, given the challenges to “design and operationalise” macroprudential tools, should also be further clarified.

We share Staff's concerns about a possible insufficient use of capital buffers. The wide-spread use of buffers could have important macroeconomic second-round effects which may ultimately limit the impact of individual banks' capital ratios. Our internal analysis suggests that euro area banks avoid dipping into capital buffers and regard the combined buffer requirements as a hard minimum, generating pro-cyclical behavior which may potentially impact credit supply. Several factors beyond profitability are important in this respect, such as expected replenishment paths and the significant economic uncertainty. Importantly, the pro-cyclical behavior observed for banks closer to the combined buffer requirement suggests that wider improvements to the functioning of the prudential capital framework, especially in period of distress, are needed.

We would like to emphasize the need for macroprudential authorities to ensure that capital buffers are usable in the case of need to absorb losses and support lending. Usability of buffers can both maintain the provision of key financial services to the real economy and absorb losses whilst avoiding abrupt and excessive deleveraging that would be harmful for the economy. Ample room for loss absorption is available to all banks under supervision by the Single Supervisory Mechanism (SSM), also considering that the buffer flexibility granted includes the capital conservation buffer and remains valid until at least the end of 2022. In addition, given the importance of banks' expectations regarding the need to replenish buffers, the SSM has clearly announced a tilt towards a cautious rebuild of buffer. The rebuild process will only start once the peak in capital depletion has been passed and the SSM stands ready to postpone the timeline to rebuild buffers if doing so would help the sector to quickly process the expected increase in NPLs.

In the medium term, there is a need to reconsider the balance between structural and cyclical capital requirements. Preliminary evidence suggests that impediments to buffer usability such as market stigma or automatic distribution restrictions could lead to procyclical adjustments in banks' balance sheets. If widespread, such adjustments can induce adverse feedback loops, with negative effects on lending, economic growth, and ultimately financial stability. Releasable buffers address these impediments by allowing banks to operate with lower capital ratios without breaching the buffer requirements, thus enhancing their ability to absorb losses while maintaining the provision of key economic services.

As long as uncertainty remains high, we support continued prudence towards capital distributions. The impact of the pandemic on banks' balance sheets has not manifested itself in full yet, due to the ongoing public support measures and temporal delay in recognition of credit impairments. Relevant EU authorities have therefore requested financial institutions to apply extreme caution and limit distributions in the form of dividends, share buy-backs and variable remuneration up to a conservative threshold, until 30 September 2021.

**Staff's Responses to Technical Questions Posed by Executive Directors
EBM/21/31—March 25, 2021**

World Economic Outlook

Staff's responses to technical questions are below. Broader policy questions in the area of global coordination on vaccine production will be addressed in staff's intervention at the Board meeting.

Outlook/Risks

1. How big of a boost to the US and the global economy does staff expect from the stimulus?

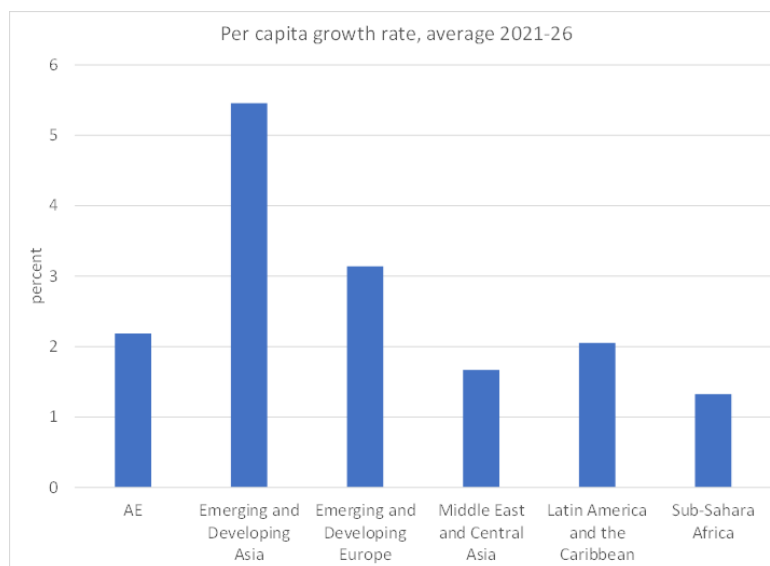
- Staff estimates that the American Rescue Plan will add around 5 percent to the level of GDP in 2021-23, implying a multiplier of about 0.6 for the package as a whole. By returning the U.S. more quickly to full employment and providing liquidity during the period that vaccines are deployed, the policies should also help lessen scarring and raise medium-term output. Trade spillovers are particularly significant for key trading partners such as Canada and Mexico.

2. What is staff's view on the composition and effect of the recent policy package voted by Congress?

- Staff estimates that the American Rescue Plan will add around 5 percent to the level of GDP in 2021-23, implying a multiplier of about 0.6 for the package as a whole. By returning the U.S. more quickly to full employment and providing liquidity during the period that vaccines are deployed, the policies should also help lessen scarring and raise medium-term output. This faster speed of recovery is expected to add only modestly to core PCE inflation. After incorporating growth and inflation effects, the federal government deficit would be around 7 percent of GDP larger in 2021 -2, adding about 5 percent of GDP to federal government debt by 2025. These estimates assume that a share of transfers to households is initially saved and other spending (e.g. on vaccines, testing, support for state and local governments) is executed only gradually. Staff's estimates of the effects on activity are broadly consistent with a similar assessment by Brookings staff.
- The fiscal package rightly provides significant resources to tackle the public health crisis (including through vaccinations) and targets resources to those most in need (including through unemployment benefits, the EITC and child tax credits, food assistance, and specific programs for public transit, schools, and small businesses). All in all, staff would have seen scope for a smaller and more targeted package that would have allowed fiscal resources to be used to address some of the longstanding challenges the U.S. faces (e.g. improving infrastructure, facilitating the transition to a low-carbon economy, investing in education and training, supporting basic research, tackling poverty, and expanding health care coverage for low income individuals).

3. **...the impact and potential spillovers from the new US fiscal package, particularly on EMEs. Staff's comments are welcomed.**
 - Spillovers from the US fiscal package will affect EMEs via trade and financial channels, with indirect effects via commodity prices. Highly leveraged EMEs with limited trade links to the US could face net negative effects as rising core yields lift borrowing costs across the risk spectrum.
4. **We'd like staff to elaborate their views on the spillover effects (positive and negative) of the additional fiscal expenditures in a few large economies and their interactions with financial markets. Are the effects under the current crisis different from those under normal circumstances?**
 - Given the extent of excess capacity in most economies, outward trade spillovers from fiscal expansions at the current conjuncture could be smaller than under normal circumstances as the increase in demand may be largely absorbed domestically. In addition, the more recent empirical regularity of the very mild responsiveness of inflation to demand conditions in many advanced economies suggests that monetary authorities are unlikely to respond strongly once spare capacity has been exhausted.
5. **The recovery paths mainly depend on the race between the virus and vaccines, and we continue to encourage staff to accord high priority to these developments. We would appreciate staff's clarifications whether recent developments, including the new wave of lockdowns and their impacts on key sectors, were already captured in the report.**
 - The baseline projections do take into account any restrictions announced through early March. More generally, the baseline assumptions include the possibility of occasional restrictions before vaccines become widely available. These restrictions are expected to have less impact on activity than in the previous waves because of their likely more targeted nature, adaptation to remote work, and a more subdued starting point for contact-intensive activity than was the case in the first half of 2020.
6. **Regarding emerging and developing economy commodity exporters, staff's outlook appears to be somewhat pessimistic considering the sharp recovery in global manufacturing and the outlook for commodity prices. Staff's views are welcome.**
 - The forecasts do take into account the prospects for commodity prices and the recovery in manufacturing, but there are also other factors driving country-specific projections, including sectoral exposure to the pandemic, vaccine rollout speed, and extent of policy support. These factors together account for the variation in forecasts across countries and (via the PPP-weighted average of individual projections) also across groups of countries.
7. **Can staff elaborate on why 2021 growth outlook for ASEAN-5 has weakened even as vaccine rollout is progressing across ASEAN? Does staff view the rise in new COVID-19 cases as posing risk growth such that it offsets the positive impact of higher global growth to export?**

- The downgrade for ASEAN-5 relative to January WEO forecasts reflects in part still high caseloads in a few large economies in 2021 Q1 (Indonesia, Malaysia, and the Philippines), which is expected to slow the pace of normalization in contact-intensive sectors. The outlook for tourism is also expected to remain subdued, affecting prospects in Thailand. These developments are partially offset by the global recovery, with favorable effects on goods and commodities exports from the region.
- 8. The regional differences are huge, and, in our opinion, the WEO should not lump all the countries together, let alone send a message which might be confusing to readers. With somewhat closer examination, to a large extent the divergence story turns out to be a stretch. We ask staff to provide a corresponding chart in their written responses to Directors.**
- We think the perspective in the WEO – comparing current projections with pre-pandemic projections – is a useful way to document persistent damages from the pandemic and to compare prospects across regions and income groups.
 - The alternative representation requested also shows divergence between AEs and three regions (LAC, ME&CA, SSA). AEs are projected to grow faster than 3 regions (ME&CA, SSA, and slightly faster than LAC) over 2021-26. Living standards in AEs are therefore expected to increase relative to these three regions over the projection horizon.

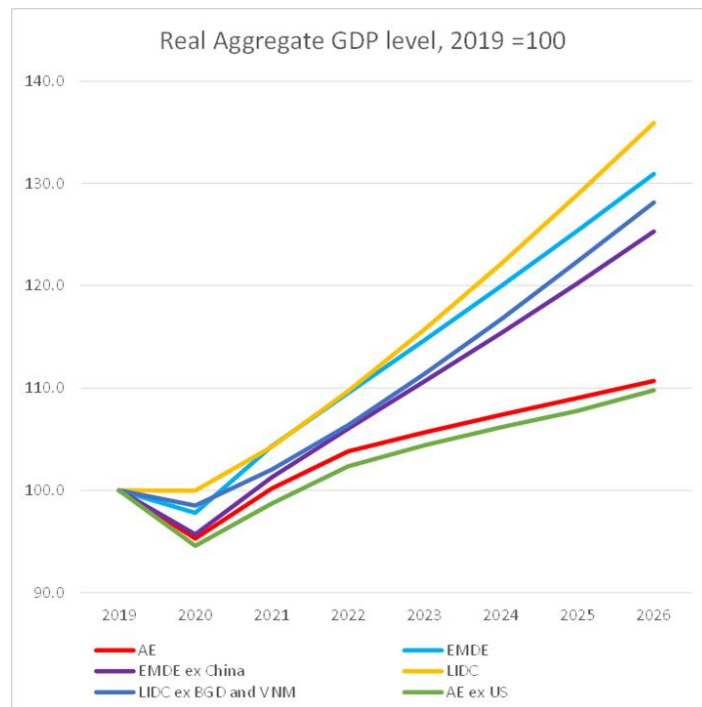


- This representation however misses important aspects of the crisis and recovery phase, including the additional population expected to fall below the threshold of extreme poverty compared to pre-pandemic expectations. It also misses the within-country divergence that follows from uneven impacts of the crisis on different groups (women, youth, and low-skilled workers more acutely affected). The 2020 shock has been much larger in EMDEs (ex-China). Staff representation shows that faster growth in 2021 and

after – not surprising following a large negative shock -- will not be sufficient to overcome the initial shock in EMDEs by 2026.

- Nonetheless, we accept that regional differences are important to consider. Charts in chapter 1 and 2 demonstrate these differences in prospects and losses relative to pre-crisis trends in GDP levels.
- 9. ...we should also avoid simplifying the headline message as one between advanced economies and emerging market and developing economies. There are differences between regions and within regions. Therefore, the appeal of a simple message should be balanced with avoiding a potentially misleading representation of country prospects... We would appreciate staff clarification of how they will mitigate against this potentially misleading simplification.**
- We agree country circumstances can differ vastly based on initial (pre-pandemic) structural factors and vulnerabilities, pre-existing trends, severity of the pandemic, recovery speed, policy space, and effectiveness of policy support. The accompanying Regional Economic Outlooks are better suited to take deep dives into individual country details, precluded by the WEO's space constraints.
 - In WEO Chapter 1, the discussion of the outlook notes cross-country variation in prospects based on severity of the pandemic, sectoral exposure to the pandemic shock, effectiveness of the policy response, structural characteristics and initial conditions. This is done both for the advanced economy and emerging market and developing economy groups, drawing attention to differences in behavioral and public health responses to infections, flexibility and adaptability of economic activity to low mobility, preexisting trends, policy response, and structural rigidities predating the crisis.
- 10. The speed of recovery can be measured in more than one way. One way is to compare forecasts before the crisis and now. Another way is to look at the return to the pre-crisis GDP peaks. The latter shows that the EMDEs are doing much better than the advanced economies. It would be particularly true if the United States was treated as an outlier in the group, similarly to the way China was treated for the EMDEs. Here, again, we would ask staff to provide a corresponding chart to Directors.**
- The chart below shows the aggregate real GDP level by income groups. The chart also shows sub-groups excluding key economies (AE ex US; EMDE ex China; LIDC ex Bangladesh and Vietnam).
 - The differences reflect to a large extent the differences in pre-existing trend growth rates and return of projected growth rates to those previous averages. It is therefore not surprising that by the end of the forecast horizon, income groups with higher trend growth rates (namely EMs and LIDCs) should end up at higher multiples of pre-crisis aggregate income levels compared to slower-trend-growth AEs.
 - As with the response to the previous question, this alternative representation misses the differential losses relative to pre-crisis trends in GDP levels.

AE, EMDE, LIDC levels, 2019-2026



11. Recalling economic performance after the Global Financial Crisis, we note that, for the euro area, the envisaged performance follows the “lost decade” of the previous period. Staff comments on the advanced economies would be appreciated.

- The discussion of the outlook notes cross-country variation in prospects based on severity of the pandemic, sectoral exposure to the pandemic shock, effectiveness of the policy response, structural characteristics and initial conditions. This is done both for the advanced economy and emerging market and developing economy groups. Among advanced economies, the discussion points to differences between prospects for the United States and others, based on differences in behavioral and public health responses to infections, flexibility and adaptability of economic activity to low mobility, preexisting trends, policy response, and structural rigidities predating the crisis.

12. Could staff detail their assumption on the pace of the dissaving in the baseline?

- Savings rates have indeed increase in AEs in 2020, reflecting a combination of precautionary savings and the impossibility to spend due to recurrent lockdowns and curbs to activity in many contact intensive services. The baseline assumes that as the pandemic gradually recedes, consumption will start rotating from durables goods towards services. Saving rates are assumed to gradually decline back to long-term averages temporarily boosting consumption and growth over 2021 and 2022. Tremendous uncertainty surrounds this scenario given the risks associated with the path of the pandemic and the efficacy of vaccines against new virus strains. At the same time, as acknowledged in the risk section of the report, should vaccines be rolled out faster and hospitalization rates drop quickly, confidence could resume faster and consumption (dissaving) and investment be more frontloaded.

13. We would appreciate further comments by staff on the role that supply-side bottlenecks (e.g. containers, semiconductors) might play for the near-term trajectory of global manufacturing.

- The near-term outlook for global manufacturing remains positive, as seen in recent manufacturing purchasing managers' index indicators, which point to a continuing expansion, albeit at a slower pace. Nonetheless, if shortages of critical components such as semiconductors and shipping cost pressures intensify, this could pose headwinds for the recovery.

14. Could staff elaborate on the balance of risks for EMDCs in the short term and the medium term?

- High uncertainty surrounds the forecast and much will depend on the path of the pandemic. In EMDEs (as in AEs), risks appear balanced in the short term but tilted to the upside in the medium term. Under the baseline, significant scarring occurs in many EMDEs, related to access to vaccines and extent of policy support. This highlights the scope for greater international cooperation (on vaccine distribution and on financial assistance) to significantly improve the medium-term outlook particularly among the most vulnerable EMDEs.

15. The way precautionary savings will behave after the pandemic and its impact on aggregate demand and on the balance of risks, especially in a context of sectoral reallocation that could create temporary supply constraints. Staff's comments are welcomed.

- We agree this is a critical element in the uncertainty around the outlook, as discussed in the report. Pent-up savings could be released once normalization is more fully underway, driving output higher than in the baseline, and price pressures could emerge amid supply bottlenecks. But some of the savings could be used for balance sheet repair, in part offsetting these spending impulses. The outcome of these competing forces will depend on the extent of balance sheet deterioration.

16. The potential deterioration of non-financial corporations following withdrawal of policy support—including non-linear effects on credit conditions—which in our view is not adequately treated in the staff's risk assessment. Staff's comments are welcomed.

- The deterioration in non-financial corporate balance sheets is discussed as one of the downside risks (see bullet, "Tighter financial conditions"). Indeed, it could lead to deteriorating asset quality in the financial sector, with possible further implications (via sovereign-bank nexus) for sovereign balance sheets. We have covered aspects of this risk in the current and previous WEO downside scenarios, and the current policy section highlights the importance of acting promptly to avoid such unfavorable outcomes.

17. Could staff elaborate on the extent to which the medium-term growth moderation is being attributed to the pandemic?

- The persistent damage to supply potential mostly affects the level of medium-term output (and medium-term losses relative to pre-pandemic projections). The medium-term global growth rate is broadly similar to pre-pandemic projections, although EMDE potential growth is projected to be smaller than in our pre-pandemic projections.

18. Can staff elaborate on the drivers of the slowdown in growth in 2022? Other than the base effects, we also wonder whether policy normalization, fiscal consolidation as well as expectation of these policies play a role in influencing these forecasts?

- Global growth for 2022 is projected at a still strong 4.4 percent. As the recovery takes hold, extraordinary discretionary policy support and the effects of automatic stabilizers are assumed to unwind.

19. We would like to hear more from staff on which EMs have seen lower financing needs and which have not

- In the three months to March 22, sovereign bond spreads have risen in all countries with data. Lebanon, Zambia, Sri Lanka and Suriname have seen the largest increase in sovereign bond spreads, while China, Kuwait and Poland have seen the smallest increase in sovereign bond spreads. Chapter 4 finds that the ECB monetary policy has stronger spillovers to economies with closer trade ties to the euro area. The chapter did not aim to quantify countries' financing needs.

20. We appreciate staff's work and updates on the Macroeconomic Developments in LICs, where staff anticipate rising financing needs for LICs to recover from the pandemic, maintain adequate reserves, as well as additional investment spending to build resilience and help with convergence. We note staff's estimate of \$450-\$550 billion for 2021-2025, while noting that five countries account for 45 percent of the total financing need; staff may wish to comment on the implications of financing this concentration from domestic resource mobilization and official aid.

- The LIC report does not provide a quantitative assessment on how best to fill the estimated and identified financing gaps for LICs. However, the report emphasizes the importance of domestic reforms, especially the critical role in raising domestic revenues and increasing the efficiency of spending. This is the case for all LICs and not only those countries that are found to have a large share in the overall financing needs.
- Regarding official aid, many LICs are already at high levels of debt, and grants and concessional bilateral loans will be necessary. While grants and concessional loans will be undoubtedly limited by fiscal constraints in donor countries, there would be scope to increase official development assistance (ODA). The IMF has a crucial role to play, including via its catalytic role in mobilizing sources of financing. Further scaling-up of MDBs' concessional financing and risk mitigation instruments to crowd-in private finance will be also needed.

21. We would nonetheless appreciate staff's views on the implications of cross-policy differences in these trade-offs for the coordination and sequencing of the eventual policy normalization.

- **[ORAL INTERVENTION]** This question will be addressed by staff during the meeting.
- 22. We were expecting more idiosyncratic analysis and granularity in policy options facing different country groups going through the same three phases, but with significantly different starting positions, at different paces, and with different policy options and constraints. We welcome staff comments.**
- We agree country circumstances can differ vastly based on initial (pre-pandemic) structural factors and vulnerabilities, pre-existing trends, severity of the pandemic, recovery speed, policy space, and effectiveness of policy support. Given the range of circumstances, for tractability and ease of exposition, we found it useful to group policy recommendations according to the stage of the pandemic with specific guidance tailored accordingly and while being mindful of available policy space. The Regional Economic Outlooks are better suited to take deep dives into individual country recommendations, precluded by the WEO's space constraints.
- 23. Could staff elaborate on the role envisaged for macroprudential tools vs. monetary normalization in AEs through the recovery?**
- The WEO baseline assumes unchanged policy frameworks in AEs over the forecasting horizon. In the baseline, policymakers are expected to tighten selected macroprudential instruments as warranted to tackle pockets of vulnerability while avoiding unnecessary tightening of financial conditions. Monetary policy is expected to remain accommodative over much of the period and to be tightened only gradually as the recovery takes hold.

External Position

- 24. Staff's forecasts suggest that current account imbalances will widen sharply in 2021, narrow sharply in 2022, and remain stable into the medium term. Staff project the U.S. current account deficit, for example, to expand sharply to 3.9 percent of GDP this year (from 3.1 percent in 2020) before narrowing back to 3.1 percent next year. Germany's surplus jumps and then contracts sharply too. Could staff provide additional information on what is driving the sharp narrowing of imbalances next year?**
- Global deficits and surpluses widened in 2020, reflecting in part exceptional policy support in deficit countries (which lifted durable goods spending) and a surge in pandemic-related exports from surplus economies. Deficits and surpluses are expected to widen further in 2021. Among CA deficit economies, additional fiscal support in the US under the American Rescue Plan contributes to a notable increase in the US deficit and also lifts surpluses of trading partners, including producers of durable goods. From 2022 onward, global deficits and surpluses are projected to narrow toward pre-pandemic ranges. This reflects fading fiscal impulses from exceptional support as the recovery strengthens in deficit economies and the unwinding of pandemic-related factors that have buoyed goods exports of surplus economies.

25. Staff also increased its forecast for China’s 2021 current account surplus from 0.9 percent of GDP in the January 2021 Article IV to 1.6 percent in the April WEO. Could staff also provide background on this shift?

- China’s 2021 current account surplus has been revised up relative to the Article IV, reflecting a slower assumed unwinding of pandemic-related durable and medical goods exports from the surge in 2020 as well as a stronger external environment than projected in January. A slower resumption in outbound tourism is assumed than at the time of the Article IV reflecting somewhat slower-than-expected pace of domestic vaccinations; this further contributes to the upward revision of the 2021 CA surplus. Higher oil prices partly offset this upward revision.

Structural Issues

26. What are staff’s plans for further work to help guide countries to seize the opportunity of rebuilding after the pandemic to accelerate the transition to leverage digitalization, and build greener economies?

- We agree and these are areas we plan to work on further in forthcoming WEOs. As noted in this current WEO, priority areas in the category of “Phase 3: Investing in the Future” include boosting productive capacity (with an emphasis on green infrastructure and digitalization) and strengthening social and health spending to close gaps in the safety net. Our policy analysis in the next WEO and subsequent ones will be guided by these priorities.

Multilateral cooperation

27. While vaccine distribution is clearly not the Fund’s role, it should continue to strongly advocate the economic case for strengthened international cooperation to accelerate distribution in emerging market and developing economies. We would be interested in staff’s comments on how to maximize impact in this space.

- This question will be addressed by staff during the meeting.

WEO Analytical Chapter II – After Effects of the COVID-19 Pandemic

28. Deepening the analysis on scarring effects will be key to fine-tune our structural policies... Could staff offer some quantitative elements to assess the loss of potential growth?

- The medium-term outlook envisions potential output losses of about 3 percent for the world economy in level terms. These losses are of the same magnitude as those for actual real GDP reported in Chapter 2. In terms of growth rates, potential output growth for the world is projected to be 0.2 percentage point lower in 2024 compared to pre-pandemic projections. The decline in potential growth rates is concentrated among EMDEs. For G-20 EMs for instance, projections are for 0.6 pp lower potential growth in

2024, while AEs as a group return to their pre-pandemic potential growth rate of 1.6 percent.

29. However, we are concerned that staff's analysis may underestimate the true scarring since the COVID-19 presents a unique shock...All these elements should have been explored further in staff's analysis. Staff's comments are welcomed.

- We agree that COVID-19 is a unique shock and note in the chapter (1) the exceptional uncertainty around the outlook and (2) the expected medium-term output losses are based on the assumption of a sustained recovery from the current crisis in which financial stability risks remain contained. Indeed, the extent of resource reallocation and structural transformation, as well as accelerated digitalization, will affect potential growth and can be aided by policy measures. Deeper analysis of these elements was constrained to some extent by data availability (need for broad country coverage given the global focus of the chapter) and the scope of the chapter, but they will be explored further in other staff analyses (e.g., an upcoming analytical note for the G-20 on Boosting Productivity in the Aftermath of COVID-19).

30. What is staff's baseline assumption on when international travel will normalize and the recovery profiles of the tourism-based economies?

- The baseline assumption is that the combination of growing vaccine coverage, improved therapies, and precautions helps bring local transmission of the virus to low levels everywhere by the end of 2022. This will allow cross-border travel to normalize thereafter.
- Assumptions about the reopening of tourism-based economies are country-specific and based on desks' assessments. They will depend on the local spread of the virus, access to vaccines as well as new lockdowns and other pandemic containment measures. In addition, they will also depend on how quickly trading partners can resume normal levels of activity.

31. We wonder why the Caribbean was not specifically highlighted here given the significance of these sectors for the region and the severe contraction in economic activity resulting from the pandemic. Could staff elaborate on the rationale for the chosen approach and the countries included in the 'tourism dependent countries' category?

- Countries were included in the analysis based on (1) tourism dependence (2) data availability, in particular the data necessary to model these economies using staff's Flexible System of Global Models (FSGM) modules.

32. We would like to highlight that broader public policies (e.g., investment in technological infrastructures, regulations, etc.) are key to promote adaptation to low-contact working and can support the recovery. In this regard, we wonder if staff is considering specific policy advice on post-COVID work's transformation.

- We agree that, in addition to targeted fiscal support to workers and firms in the high-contact most-affected sectors, other policies can help adapt to a low-contact working environment. And these would be particularly important in countries with a larger share of high-contact sectors. The analysis in the chapter does not result in specific adaptation recommendations, but it does recommend public investment in infrastructure, investment in digital literacy, and measures to facilitate resource reallocation as part of the policy package to limit scarring and boost medium-term output.

WEO Analytical Chapter III – Labor Markets

33. Could staff elaborate on these recommendations, in particular how to design the training policies and adapt them to the accelerated labor market changes?

- A meta-analysis of the large literature on active labor market policies suggests that training programs modestly boost labor market prospects for participants over the medium term on average, particularly for women, youth, and the longer-term unemployed (Card, Kluve, and Weber 2018). Programs may also be targeted at historically disadvantaged groups to enhance their employability and help create a more equal job market. As noted in the chapter, human capital investments typically take time for their returns to materialize, suggesting that such interventions are not suited for dealing with the immediate consequences of an adverse shock, but are better at responding to trend changes (like automation). In general, successful programs address an identified market failure (such as persistent skill mismatches which lead to lower productivity and reduced capacity for labor reallocation) and are regularly reassessed to ensure that they continue to meet cost-benefit criteria (Ahn and others 2019).
- Recent work suggests that in-demand worker skills are shifting with automation, favoring social and emotional skills (that facilitate teamwork) and technological skills (Bughin and others 2018; World Bank 2019). Specific design choices of programs—including content, duration, private/public provision, and delivery modality (on-the-job/outside-work; online/in-person)—can matter for program effectiveness. These parameters have to be responsive to local circumstances and capabilities (for example, Hirshleifer and others 2016 highlight the importance of alignment with private sector skill demands).

34. However, this model seems difficult to apply in many developing economies characterized by large informal sectors, where adjustment to shocks is slower and more difficult hence the increase in poverty and inequality larger. Staff comments are welcomed.

- The form of job retention support to help firms and workers weather the pandemic shock may need to be adapted to local conditions and capabilities. Where informality in employment is large, cash transfers may be better able to provide income insurance and help informal workers weather the shock (see also Diez and others 2020 for a discussion on these and other modalities for support to informal workers during the pandemic). As with more formal job retention measures, maintaining the support through the acute phase of the pandemic provides an important bridge for workers to the recovery of the labor market. Studies of economies with larger shares of informal employment indicate that they tended to suffer initially sharper declines in employment from the pandemic,

consistent with the Director’s statement (see also Alfaro, Becerra, and Eslava 2020; Balde, Boly, and Avenyo 2020; Kesar and others 2020; and Levya and Urrutia 2020). However, these studies also suggest that the speed with which informal jobs can be (re)created point to a high likelihood that these economies may experience faster labor market recoveries after the pandemic. That said, the lower productivity and higher exposure to income shocks of informal jobs point to the importance of reducing labor market dualism and encouraging the creation of more formal jobs over time (including through greater flexibility in the formal labor market—see Cho and others 2012, Ahn and others 2019, and Duval and Loungani 2019 for discussion).

WEO Analytical Chapter IV – Monetary Policy Spillovers

35. While the chapter finds that a surprise tightening could be the trigger and that good news are relatively benign, we wonder if we are witnessing a context in which the expectations, not the actual surprise tightening, could potentially cause a negative financial shock in EMs. Staff comments are welcome.

- The financial market tightening since the beginning of the year went along an improved outlook for the United States. This is broadly consistent with chapter 4’s finding of a news driven increase in interest rates which may be benign for an average emerging market economy. However, financial market expectations about recovery could run ahead of real economic improvements (ahead of the stimulus package coming online) and cause a disruptive tightening for emerging markets. Moreover, as explained in the chapter, while the effects are benign on average, countries with limited trade ties with the faster recovering economies and high borrowing needs could experience some tightening in a scenario where interest rates rise in advanced economies because of a stronger outlook.

36. We are concerned that EMDEs could face a marked tightening in global financial conditions when recovery has yet to take hold, in the event that faster recovery in AEs prompt their central banks to exit accommodative monetary policy. In such a scenario, what would be the impact on EMDEs and what can they do to mitigate the shocks? Staff comments are welcome.

- This question will be addressed by staff during the meeting.

37. We believe that country-specificities, such as domestic conditions and legal frameworks, should also be considered when assessing central banks’ policy response in this context. Furthermore, we miss analysis of the possible costs and vulnerabilities of the use of APP in EMEs. In this regard, can staff comment on the differences potentially faced by central banks in EMS compared to those in advanced economies regarding risk assessments coming from the use of APP, including by the possible effects of an increase in interest rates?

- Asset purchases potentially expose central banks to credit, liquidity and currency risks. These risks are heightened in emerging market economies, given higher sovereign risk, lower liquidity and the prevalence of foreign currency government debt. Asset purchases can also raise questions about central bank independence and fiscal

dominance, depending on whether the asset purchases are seen as being initiated by the central bank or central government. Given that higher risks could lift interest rates, asset purchases by emerging market economy central banks may be ineffective at lowering domestic risk premiums. Markets may perceive that less credible central banks would be less likely to respond to rising inflation with higher policy interest rates if those central banks hold significant quantities of government bonds, which could de-anchor inflation expectations. A note published by MCM staff in September 2020 explains conditions, including credible frameworks and good governance, under which asset purchase programs in emerging economies are likely to

be more effective: <https://www.imf.org/-/media/Files/Publications/covid19-special-notes/enspecial-series-on-covid19unconventional-monetary-policy-in-emerging-market-and-developing-economies.ashx>

38. Given the important systemic impact of the Fed's decisions in the rest of the world, does staff believe that the Fed will incorporate this consideration into its policy reaction function? Can targeted macro-prudential measures be expected to prolong the period of low interest rates in AEs? In staff's view, what factors may disrupt a gradual and well-telegraphed normalization of US interest rates? We take note that other policy actions, like the Fed's temporary US dollar swap line facility provided to Brazil and Mexico, were also effective in stabilizing financial conditions in these two countries, as shown in Figure 4.11. We would like to ask staff if a similar finding is applicable to the other seven countries to which the swap line was also offered. Also, does it see a similar impact on countries which requested a Flexible Credit Line (FCL) or other Fund facilities during the pandemic?

- To minimize the risk of a sharp tightening of financial conditions in EM, Chapter 4 stresses the importance for the Federal Reserve to continue to emphasize its policy approach and how it will implement its new monetary policy strategy to anchor expectations about its policy reaction.
- Macroprudential measures are designed to reduce systemic financial market risks. They can help limit the buildup of financial vulnerabilities when conditions are easy; any effect they may have on interest rates is, therefore, indirect. WEO Chapter 4 advises emerging market economies to use macroprudential policies preemptively to address pockets of vulnerability. Previous staff analysis found that macroprudential policies implemented by EMs can be effective at addressing global financial market volatility and enhances EM's monetary policy autonomy by allowing a more countercyclical response to global financial shocks (April 2020 WEO Chapter 3).

In the baseline, staff do not expect monetary policy surprises in the United States, but there is a risk that they occur, given the still low level of interest rates, the uncertain outlook, and the Fed's new operating framework.

- The chapter did not study the effects of swap lines on AEs. The Box 2 in the 2014 review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument found that the FCL was effective in insulating economies during the 2013 taper tantrum: <https://www.imf.org/en/Publications/Policy->

[Papers/Issues/2016/12/31/Review-of-the-Flexible-Credit-Line-the-Precautionary-and-Liquidity-Line-and-the-Rapid-PP4846](#)

39. At the same time, we doubt that, in case of tightening of international financial conditions, the effects are likely to be limited to the EMDEs only. What will be the effects on advanced economies lagging behind the US in their business cycles?

- We agree that an increase in yields in response to rising US yields would not be limited to EMDEs alone. Indeed, we have already seen this for example with rising yields in the euro area in recent weeks. However, advanced economies are likely to be less impacted by tighter external financial conditions than EMDEs. The large advanced economy central banks, in particular, can in principle offset this external tightening with well-communicated use of their toolkit to a greater extent than central banks in small open emerging market and developing economies can. Yield curve control by some advanced economy central banks (e.g. Bank of Japan, Reserve Bank of Australia) is one example of this relatively greater autonomy to influence domestic financial conditions in the face of tightening external financial conditions

40. Could staff comment on the possible spillovers from the fiscal package? We would also welcome staff's comments on how the "news"-effect of the approval of the package compares with the general findings in the chapter about effects from positive news on US economic activity.

- As discussed by Ms. Gopinath in her presentation, The American Rescue Plan is expected to lift demand in the United States, with positive trade spillovers to economic activity in other countries. In this sense, staff expects it to lift interest rates in emerging market economies on expectations of higher domestic economic activity there. However, the method used for the chapter's analysis of spillovers from economic news is not directly applicable to news about the approved fiscal packages. This is because a significant portion of fiscal packages are anticipated before they are announced, making it difficult to isolate the 'surprise' portion of the fiscal package and statistically identify its impact on financial conditions.
- In a separate follow-up analysis, staff found that the financial market spillovers from the February US non-farm payroll releases, which surprised strongly on the upside, were broadly in line with the findings presented in the chapter.

41. We also found staff's analysis in Chapter 4 interesting, but it raises broader questions about Fund policy advice on monetary policy frameworks and how they may change in a low R* environment, whether we are learning to live with structural trends and what role automatic stabilizers should play. Staff comments are welcome.

- In a low-for-long interest rate environment, monetary policy rates are likely to hit the zero-lower bound, forcing the central bank in question to turn to unconventional monetary policy instruments (e.g., forward guidance, quantitative easing and negative interest rates). If monetary policy is close to exhausting these options, with inflation stuck

below target, then fiscal policy would have an important role to play in restoring inflation expectations.

42. Staff could have placed more emphasis on policy levers that can be quickly activated in response to capital flows in line with the Integrated Policy Framework. Staff's comments are welcome.

- This question will be addressed by staff during the meeting.

Other Issues

43. The publication of the LIC report alongside the flagships sets a positive precedent and leaves this group of the membership better served with IMF advice. These needs will not diminish, so we see clear value in temporarily moving the LIDC report to the same twice-annual frequency as the flagships. Staff comments welcome.

- The LIC report has not previously been produced on a fixed timescale, and Directors will recall that the last version of the report was discussed in November 2019. This report responds to a one-off request from the IMFC to assess LIC financing needs for 2021 - 2025 and presents options to cover them. It serves as a background assessment for the different initiatives that are currently under discussion (including a possible SDR allocation, scaling up of the PRGT, debt initiatives, MDBs financing etc.) – all generally considered to be time-limited initiatives. Given the resources involved in preparing the report, staff propose retaining the flexibility in publication to ensure that the output continues to feed into policy discussions.

44. In the past, increased automation has affected particularly middle-income jobs, leading to a “hollowing out” of the job distribution. Are there signs of similar patterns during this crisis?

- We are not aware of any studies of job polarization and automation during this pandemic as of yet, but that may reflect both delays in data (on employment history and income at individual-level) and the nascent nature of labor market recoveries in most countries. Based on past patterns, it seems likely that job polarization would increase alongside automation (Goos, Manning, and Salomons 2014). A recent study from the US suggests that losses of jobs that are more vulnerable to automation and that were middle-income largely occurred during recessions (Jaimovich and Siu 2020). These studies suggest close monitoring of the recovery from the pandemic to see whether similar labor market dynamics are evident.

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Global Financial Stability Report

Staff's responses to technical questions are below. Broader policy questions in the areas of macroprudential policies will be addressed in staff's intervention at the Board meeting.

Global Financial Stability Report

Emerging Markets

45. Chapter 4 of the WEO acknowledges that the impact of rising interest rates in the US depends to a relevant extent on the source underpinning the rise, namely better growth prospects versus monetary policy surprises, with the former usually beneficial to EMEs; the GFSR seems to take a slightly more pessimistic view, underscoring that an early tightening of global financial conditions is expected per se to adversely impact EMEs and may potentially trigger capital outflows. Staff's comments are welcome.

- We agree that a gradual rise in rates on the back of improving growth prospects may be healthy for the financial system and potentially global risk appetite. GFSR notes however that a “rapid and persistent” increase in rates (especially real rates) may result in a repricing of risk and a sudden tightening in financial conditions. Such a rise may stem from market expectations (rather than actual Fed communication) for a faster than expected monetary policy normalization by the Fed. This scenario is consistent with the WEO description of “monetary surprises” that estimates large spillovers to EM local bond yields.
- Relatedly, it's worth noting that even though US yields have been increasing since August 2020 it was only after the fast increase in real yields since February 2021 that we saw spillovers in EM local bond yields and non-resident flows (see GFSR figure 1.7.1). These spillovers have come during a period that market has re-assessed both US growth prospects higher but also the probability of an earlier than expected monetary policy normalization by the Fed. The challenge for EM policymakers that GFSR underscores is that such spillovers are occurring against a backdrop of a divergent global economic recovery and more limited policy space in Emerging markets.

46. The 10-year US Treasury bond yield was in the range 1.8-1.6 percent in January 2020 but as high as 3.2 percent in October 2018. If the former yield was the intended benchmark, the recent market nervousness about rising interest rates would be somewhat puzzling. Staff's comments are welcome.

- Thank you for your remark. Our emphasis is primarily on the pace of market's reassessment of rate expectations (“rapid and persistent”), the drivers (see previous question) and less so on the absolute level of rates. The market expectations assessment references the figure 1.4.2. which shows the options implied probability distribution of 10-year swap rates in 6 months. The main change that has occurred

since the start of the year is that markets have priced-in higher probability of rates returning to pre-pandemic levels (i.e. 1.70% and above area in this context). We see similar picture from subjective probabilities of forecasters where given mean expectation of 1.70% for Q4 2020, 20% of forecasters expect rate above 2% as compared to only 10% below 1.4%.

47. We appreciate the additional attention to APPs in emerging market economies in Chapter 1 of the GFSR. The authors find that APPs were effective in reducing bond yields. Could staff clarify if the results shown in this chapter differ from the earlier findings and from results found in outside research?

- We should clarify that there are no new empirical results presented on the impact of APPs in chapter 1 of the GFSR. Our assessment is based on the GFSR chapter 2 Oct 2020. The WEO chapter 4 highlights that their their results are broadly consistent with the literature including GFSR chapter 2 Oct 2020 and the subsequent working paper.

48. The report argues that the sovereign bank nexus has worsened in emerging markets as domestic banks have absorbed the bulk of increases in domestic debt. It is well understood that unprecedented fiscal stimulus and accumulation of public debt in AEs has been financed by a large expansion in the balance sheets of the central banks. Whether the absorption of government debt by the banking system vis-à-vis central banks will have greater adverse macroeconomic effects is an important policy question.

- EM banks in our sample absorbed the bulk of new issuance in 2020 (over 60%), while central banks also played a key role in some cases amid weak foreign flows. The ability of the domestic financial sector to absorb larger deficits during a crisis can be a positive, particularly given the importance of health spending during a pandemic. Encouragingly, bank lending to corporates and households held up reasonably well, particularly in contrast to the post GFC period. In part this represents policy choices, as many emerging markets launched targeted lending and credit relief programs. On the downside, a lack of credible medium-term fiscal plans could erode investor confidence, and the banking sector would take a prolonged hit through the balance sheet channel. If foreign inflows remain weak, the risk of crowding out private sector lending will increase as credit support measures fade and/or financial repression measures become more prominent. Rebuilding fiscal and capital buffers, sounds public debt management, and effective banking supervision and regulation remain should be key areas of policy focus in the coming years. Regarding the risks from APPs we have discussed this issue in chapter 2 of the October 2020 GFSR.

49. For Emerging Economies (EMs), we agree that policies need to remain accommodative for the time being while vaccines rollout continues, and that these countries should use the current opportunity of lower financing needs to lower their financing costs through active debt management. In this regard, however, we

would like to hear more from staff on which EMs have seen lower financing needs and which have not, noting that average EMBI spreads have remained relatively elevated (Figure 4.3), and the average may mask the special cases of those economies that benefit from ECB policies.

- Thank you for this note. We agree with your comment. The EMBI spread has remained elevated, but the aggregate measure masks important country level differentiation. As we show in the GFSR chapter 1, within emerging markets, frontier economies have especially seen wider spreads in contrast to the higher-rated (investment-grade) EMs that have seen a sharp decline in their external financing costs. For instance, EMBI spreads for some higher rated countries below their 2019-end levels and enjoy very favorable market access. GFSR Chapter 1 also does a driver analysis for these groupings. The analysis finds that higher-rated EMs have benefitted especially from external risk sentiment and actions of the AE central banks. This has greatly offset the drag on financing costs due to weaker fundamentals. Frontier economies, on the other hand, witnessed a very high impact due to weaker fundamentals (as well as many idiosyncratic developments and political concerns) with external risk sentiment offsetting only a quarter of that impact. Please also note that chapter 1 discusses financing costs in local markets as well. Several sovereign issuers still face significant funding needs in their domestic bond market. One example mentioned with elevated financing costs is South Africa. Similarly, the Brazilian yield curve has been pricing significant bond supply risks.

Banking Sector

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

- We agree that early loan-loss recognition may raise near-term provision costs but support longer-term profitability, and we understand and generally support the rationale for changes such as IFRS 9 and Current Expected Credit Loss accounting.

We also agree that adequate provisioning for legacy asset problems is a precondition for sustained higher levels of lending in future. The question of how to strengthen banks' incentives to use available capital buffers is exceptionally difficult. Ultimately, we believe, rational bank managements will not deploy available capital unless the return exceeds the cost of that capital in a magnitude which is large enough to offset the negative impact (on the bank's equity value) that the capital shortfall from the buffer draw-down generated in the first place. Policy design probably cannot improve sustainable returns on capital, at least in the short term (comment: It can, by lowering CET1 requirements). There is some possibility that greater clarity regarding the "path" of capital rebuilding could, by lowering uncertainty, reduce the cost of capital slightly. MCM will continue to collaborate with the Basel Committee to develop policies for an effective capital buffer framework.

- The non-bank financial sector (NBFS) and the commercial real estate (CRE) sector are potential important shock amplifiers going forward. Therefore, now is the time for targeted macroprudential regulation and policies to prevent further accumulation of vulnerabilities in these segments. However, we also note that the regulators may need access to more granular global data to develop a macroprudential toolkit. Some members of our Constituency have systematically collected granular data and have implemented macroprudential policies targeted to the NBFS. Moreover, the European supervisors have extended their macroprudential stress tests to cover insurance companies, central counterparties (CCPs), and asset managers. We take note of staff's recommendation on the targeted supervisory approaches for CRE risk weights, asset valuation, and loan loss provisions.
- While some jurisdictions indeed developed macroprudential measures, also in particular for the areas of stress testing exercises, concerning the mitigation of FX exposures or risks around the real estate sector, the development of a general framework for targeted macroprudential policies for non-bank financial intermediaries is still at its early stage with the FSB, the IMF and various other supranational and national organizations and authorities weighing in. Within MCM there is currently a departmental paper in the drafting process covering such issues for MMFs, fixed-income investment funds, but also for ETFs and other related entities, also taking the experience during the March 2020 turmoil into account. To avoid potential discrepancies or inconsistencies in our proposals we kept the recommendations for macroprudential, or, more generally, the broader regulatory, toolkit for non-bank financial intermediaries for the moment at a more generic level.

51. The staff's characterization (paragraph 51) of the alleged reluctance of banks to ease lending standards for SMEs – notably in EMEs – when credit demand resumes needs to be qualified as it seems unduly negative and perhaps somewhat at odds with the call to avoid "zombification". Staff's comments are welcome.

- Paragraph 51 does not assert that banks will be reluctant to ease credit for SMEs. Rather, banks do express willingness to ease credit for SMEs; but, at this point,

bankers who respond to the surveys believe that easing of lending standards will be less pronounced than strengthening of demand for loans as economies recover. Furthermore, evidence suggests that this is driven mainly by concerns about prospects for credit risk.

52. An important question that needs further exploration is how does this development during the current crisis somewhat dilutes the countercyclical properties of capital buffers and the perception about their effective use during a crisis?

- We fully agree on the need for further exploration of banks' management of capital buffers during stress episodes and the effective design of policies to induce countercyclical capital management. During this pandemic and economic downturn, however, actual capital positions in most countries remained stable and adequate. Indeed, in most countries that provide loan officer survey data on the drivers of bank lending standards, bank capital and liquidity are not regarded as the most important constraints. Rather, willingness to lend is constrained mainly by perceptions of heightened macroeconomic and borrower credit risk.

Nonfinancial Corporate Sector

53. We would like to hear more details from staff on other important tools like development of distress debt and nonperforming loan markets, augmentation of out-of-court restructuring, fast-track resolution frameworks, and insolvency regimes in order to seek market-based solutions for distressed firms.

- The GFSR shows that countries with developed distressed debt markets, such as the United States, can benefit from market-based solutions, can take a full advantage of easy financial conditions, and thus would require less fiscal resources to address weak firms.
- The special Covid-19 note on private debt resolution was published last year and is available on the Fund's page: <https://www.imf.org/en/Publications/SPROLLS/covid19-special-notes#Legal> . LEG also gave an informal briefing to the board a few months ago. In essence, out-of-court frameworks supplement the capacity of the court system, and can be scaled up much more easily than the court system. Hybrid restructuring involves informal negotiations supported by minimal court intervention, and this also rationalizes the use of judicial resources. General insolvency regimes need to be modernized to include new developments, such as the insolvency of enterprise groups.
- On the development of NPL markets, a number of papers have been published; please see e.g. https://www.imf.org/-/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2015/_wp1524.ashx and https://www.imf.org/-/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2015/_wp1524.ashx . Generally, NPL markets require the removal of obstacles (such as tax rules or legal

rules affecting the transfer of NPLs), the regulation of debt servicers, and rules enabling the securitization of NPLs.

54. Could staff elaborate on good practice to capture zombification, considering that there are dynamics which make it hard to separate zombies from non-zombie firms?

- The so-called zombification comes back to the viability assessment we provide in the April 2021 GFSR to distinguish viable from non-viable firms based on a wide range of indicators used in the literature. The definition of insolvency and non-viability (zombification) is close but different. While solvent status can be defined as the present value of profits exceeds the current debt, viable status can be defined as the present value of profits exceeds the recovery value (Blanchard et al. 2020), that is, whether the benefits of continuing a business exceed the costs, or conceptually, whether future profits exceed the liquidation value of viable firms. Past studies of zombie firms have used several definitions; Caballero et al. (2008) define zombie firms as those receiving subsidized bank credit. Fukuda and Nakamura (2017) added a profitability criterion to improve it. Other approaches include McGowan et al. (2017) defining zombies as firms with interest coverage ratios less than one for multiple years and aged ten years or older. The age restriction is to distinguish real zombies from young innovative start-ups, which is difficult to be captured based on profitability measures.
- Nevertheless, measuring corporate viability is challenging, especially under uncertainty. Both future earnings and recovery rates are heavily affected by the macro and micro-economic situation and their outlook. One way to address uncertainty is to use the power of collective intelligence, such as analysts' earnings forecast. Another is to use market information such as stock prices, which mirror the firm's future profitability. That being so, a metric to see a firm's stock price relative to the value of the holding assets, price-to-book ratio (Banerjee and Hofmann, 2018), is a way to measure listed firms' viability under uncertainty as carried out in the April 2021 GFSR.

55. To identify non-viable firms, could staff further detail their recommendation regarding the partnering with the private sector as well as other concrete recommendations to reach this goal, and in particular who are the actors who should intervene and their respective role in the triage process? (Buissé)

- The private sector is often better equipped to examine the viability of businesses than the public sector. Even if solvency support programs are public, they can rely on expert reports produced by the private sector. The forthcoming RES/LEG SDN on SMEs (EDs received a presentation) also mentions that investment by the private sector should be a requirement for support programs, as a strong indication that the enterprise is viable.

56. Identifying viable firms is a point in time analysis and it would be useful if staff could elaborate on how they believe the indicator system in the proposed framework would work under normal conditions or in a crisis context. (Pösö)

- Policymakers could extend the framework backward in time and examine vulnerabilities before the COVID crisis to gauge how much of the weak tail of firms is attributable to the shock. The GFSR carried out an assessment using the latest available information on balance sheets and markets prices in a given point in time because at a time of stress both pre-existing and new vulnerabilities may result in defaults and bankruptcies and need to be assessed and tackled.
- The framework provides a wide range of indicators that could be used as a monitoring device under normal conditions. Then, carrying out an assessment of firms during a future crisis will be less time- and resource-consuming given that there is already a framework in place. Developing and having the framework during normal time has another benefit—it will help authorities to understand data gaps, especially with respect to small firms—which are shown to be in the epicenter of the crisis, and take steps to close or at least reduce them.
- At a time of a crisis, government resources are already stretched. Nevertheless, the proposed framework is simple and robust enough to establish and to be used to target fiscal spending on weak firms.

57. The comprehensive framework to identify viable firms can provide a high-level overview of the sectors or types of firms that need targeted policy support. We think it would be useful for MCM to develop tools to help country teams replicate the analysis at the country level. Staff's comments are welcomed.

- We agree. It would be a useful monitoring and policy device indeed. Please see the comments above on the use of the framework during normal times and in a crisis.

58. The application of such a framework in practice might be constrained by institutional limitations in countries dealing with capacity issues or lacking expertise in credit risk assessment. We would welcome staff's views on how such issues could be addressed in different jurisdictions, including a potential outsourcing of the credit risk assessment to the private sector.

- Please see the comment above on the involvement of the private sector.
- Governments generally have limited capacity to provide support such as loans and guarantees to a large number of firms (loans, guarantees). To address this constraint, governments can work together with the private sector (banks) to provide support. For example, partial government guarantees offered under standardized umbrella guarantee programs can encourage banks to lend to large groups of firms that otherwise may be seen as too risky, and encourage the banks to undertake appropriate due diligence before lending as the bank would suffer a loss in the event

the firm does not repay the loan. Another avenue to manage the constraint is to provide loans to firms through a policy or development banks (if they exist), which typically have more credit assessment expertise and established networks than government budgetary units. In all cases, regular and detailed reporting of the firms that receive support is important to ensure that government support is channeled to the intended beneficiaries and the size of the contingent liability accruing to the government.

- The framework is simple and robust enough to be carried out in countries with limited resources. On the limited expertise in credit risk assessment, the framework could be scaled down further. For example, each of liquidity, solvency, and viability risk measures has at least 4 indicators. In the absence of data or resources, 1 or 2 available indicators could be used for simplicity.

59. Assessing liquidity, solvency and viability are essential, although it is not clear to use what agencies will carry out such work and how it could be operationalized in most EMDCs, particularly in the case of small firms. Staff's comments would be appreciated.

- Please see the comment above on the involvement of the private sector.
- Having good data is key to having a workable framework and having a proper targeting of fiscal spending. Thus, closing or at least reducing data gaps is important. In a crisis environment, if good data is lacking, several practical steps could be taken. To gauge general financial conditions and the ability of markets to provide support to weak firms (at least large ones), market data on large firms could be used. If firms' balance sheet data is limited, the available sample could be broken down by firm size and by sector, and then the firms with lacking data could be proxied by the corresponding aggregates. Analysts' projections are likely unavailable for small firms. Then, projections for large firms by sector could be used. Finally, if own projections by sector are unavailable, projections from peer countries for relevant sectors could be used.

60. Regarding provision of policy support for firms, we wonder whether support for firms should be tied to conditions such as job preservation and wage guarantees for employees to help minimize scarring in the economy while cushioning household income? We welcome staff's comments.

- The use of the proposed framework is demonstrated in an illustrative exercise for firms, aiming to point to general areas of vulnerability that require additional support, such as SMEs which are found to be weak across the board. In practice, the overall assessment of financial viability will allow for better use of budgetary resources. Governments could also consider support in cases where the closing of a firm would have severe negative impacts on the economy (e.g., trade networks or provision of key inputs). Governments should also consider partnering with private sector to help assess viability of firms and improve resource allocation. This is particularly relevant

for support to small and medium-size enterprises. It is also necessary to have adequate safeguards in the provision of government support. Namely, special attention should be given to public equity-based funding as government equity stakes in firms come with potential costs related to governance (including political interference) and potential to create competitive distortions (April 2020 Fiscal Monitor).

- The government's overall policy objectives will influence conditionality considerations. If the purpose of government support to firms is to preserve economic linkages during the lockdown phase of a crisis, then conditioning support on the preservation of jobs or maintaining a certain level of the pre-pandemic wage bill makes sense. For example, the U.S. Paycheck Protection Program provides loans to small firms that can be forgiven if the firm satisfied certain employment conditions. Also, it makes sense to attach conditions (caps on senior executive pay and dividends) to government equity or equity like support to firms to encourage use of the support for firm-related activities. However, depending on country characteristics and stage of the crisis, governments will need to tailor measures to achieve their policy objectives (e.g. expand social safety nets to support the most affected households; facilitate structural transformation, promote skills to help workers find new jobs in the post-Covid economy).

61. As these are the firms (SMEs) that may face the highest liquidity and solvency problem, what could be the policy advice concerning such enterprises?

- We agree that SMEs may face the highest liquidity and solvency problems. If the firms are deemed as having a low viability risk, and assuming the SMEs are more likely to have limited access to capital markets, the policy advice is for direct and targeted, firm-specific support if policy space exists. Targeted support may take many forms, depending on the firm size. For smaller firms, hybrid instruments, such as profit participation loans, combine the provision of solvency support with adequate safeguards of the public interest.

62. The justification for direct-firm-specific support might not be the correct policy response for governments for various reasons. First, the banking system seems capable to deal with households and firms' balance sheet risks. Second, a more robust regulation and supervision in past decades in LAC helped the region's banking system endure difficult tests, for example, the Global Financial Crisis, and third, the buildup of an institutional capacity to deliver appropriate administrative controls, transparency, and accountability in the use of public resources for direct-firm-specific support still might be not ready. Having said that, we encourage staff to share some thoughts on how to communicate this message to the broader audience when this document is published to avoid ill interpretation.

- The framework applies to firms that seek government support. It could also be used as a monitoring device to gauge risks down the road, as mentioned in the responses above.
- If banks are fully capable to provide liquidity support, the assessed liquidity risk (which includes cash reserves among other variables) would likely be low. Indeed, this is the case for large firms—thanks to banks as well as favorable market conditions. We agree that banks are in a better position to lend compared to the post-GFC period thanks to improved regulation and supervision. However, small firms still often face tighter lending conditions as reported by banks in lending officers' surveys.
- It is true that in many countries, the capacity to assess credit risks and provide direct lending is limited. They face this issue nevertheless. We envisage several steps to alleviate additional pressures on government resources. First, as part of the framework, we advise assessing market conditions for firms, and if they are good, weak firms should access the bond and equity markets where needed and reduce the need for government lending. Second, the goal of the framework is to provide targeted support. So, the firms that are deemed non-viable would not qualify for government support, and thus, beyond the risk assessment stage would not consume government resources. Third, we recommend the involvement of the private sector—which can help with risk assessment and co-lending. We fully acknowledge the downsides related to government involvement and ownership, and suggest it only in limited cases and on a temporary basis.
- It's important to emphasize that the liquidity and solvency risks assessed in the GFSR are substantial, especially for small firms, and if the government decides to stay aside, the impacts of bankruptcies and economic scaring could be substantial. Thus, policymakers should strive to first comprehensively assess these risk and then get involved to the extent needed.

Nonbank Financial Intermediaries

63. Given the pace and significance of digitalization, it might be worthwhile to highlight the financial sector and cybersecurity risks. Staff comments are welcome.

- Agreed. The development of targeted macroprudential policies for non-bank financial intermediaries is still at its early stage with the FSB, the IMF and various other supranational and national authorities weighing in. Within MCM there is currently a departmental paper in the drafting process covering such issues for MMFs, fixed-income investment funds, but also for ETFs and other related entities, also taking the experience during the March 2020 turmoil into account. We also agree that the trend of increasing digitalization pose cybersecurity risks, which have been discussed in previous GFSRs (see Box 1.2 of the October 2017 GFSR). For a more granular

discussion, MCM colleagues recently published an IMF departmental policy paper on cybersecurity risk supervision (Adelmann et al, 2019).

64. The issues raised in the report that the credit quality of hard-hit borrowers and the profitability outlook are likely to weigh on the risk appetite of banks during the recovery are important challenges. The question arises as to whether the suggestion that policymakers should take early action and tighten selected macroprudential policy tools refers to only stretched asset prices or also to bank/non-bank credit?

- The GFSR does not advocate early tightening of credit or credit standards. We recognize that the nascent recovery remains vulnerable to interruption and that policies to support credit extension should be maintained until economies have clearly attained “escape velocity.” Indeed, the chapter highlights our concern that banks will be overly cautious in availing themselves of the flexibility to draw down capital levels and thereby stifle adequate flows of credit to borrowers. Having said this, we remain mindful of the ongoing need to balance intertemporal risks and benefits of vigorous credit extension.
- A catch-all recommendation concerning the tightening of the conditions for non-bank credit extension appears premature as the global recovery remains in its early stage, is still fragile and the large heterogeneity of non-bank lenders across jurisdictions and sectors preempt such general recommendation. Any macroprudential (or, indeed, prudential), measure applied to non-bank lenders should aim for the mitigation of specific systemic (for macroprudential measures), or substantive idiosyncratic (for prudential measures) vulnerabilities. To ensure that such measures are in place, a harmonized international toolkit for prudential policies is needed. For these reasons, we highlighted in the draft GFSR that the IMF is currently actively contributing to an internationally coordinated enhancement of the framework of prudential policy options available for the nonbank financial intermediation sector.

Macroprudential Policies

65. We would be interested in staff’s analysis of the decomposition of the use of debt to support short and long-term growth. Besides, what are staff’s views on the timely implementation of the different macroprudential instruments (some of them being at an exploratory stage while other largely implemented) and the articulation with their objectives?

- *Will be addressed in oral intervention.*

66. We agree with staff’s recommendation to tighten macroprudential policy as recovery takes hold and to implement a carefully managed exit strategy to avoid any cliff effects. While the global financial system has shown remarkable resilience so far despite significant shocks from the pandemic, we remain concerned that stretched asset valuations and elevated financial vulnerabilities including high debt levels across household, corporates and sovereigns, could

derail the recovery and pose financial stability risks. To contain risks to future financial stability, we agree that the policymakers should look to tighten macroprudential policies to prevent excessive buildup of leverage. *To avoid sudden cliff effect, can staff share how the MPP would work as part of a policy mix to ensure the appropriate financial condition? In addition, should loan repayment moratoriums be extended for small and medium firms especially those in most affected sectors?*

- *Will be addressed in oral intervention.*

67. Currently, indicators point to continued risk-taking as investors actively search for yield. At the same time, global speculative-grade corporate defaults have substantially increased, which seems to be creating the conundrum of high risk-taking amid rising insolvencies. In a situation where risks are elevated an early withdrawal of policy may lead to greater insolvencies. An important policy question to address is the “optimum” sequencing between the phasing out of policy support and tightening of macroprudential policies.

- *Will be addressed in oral intervention.*

68. Currently, indicators point to continued risk-taking as investors actively search for yield. At the same time, global speculative-grade corporate defaults have substantially increased, which seems to be creating the conundrum of high risk-taking amid rising insolvencies. In a situation where risks are elevated an early withdrawal of policy may lead to greater insolvencies. An important policy question to address is the “optimum” sequencing between the phasing out of policy support and tightening of macroprudential policies.

- *Will be addressed in oral intervention.*

69. Could staff specify what type of tools could be tightened without affecting financial conditions more broadly?

- *Will be addressed in oral intervention.*

70. Staff rightly makes the case for aiming directly at borrowers to tame the build-up of leverage. However, not all borrowers are intermediated by the banking sector. Hence, we strongly support the call for developing macroprudential tools for non-bank financial intermediaries. Staff’s comments are welcome.

- *Will be addressed in oral intervention.*

Other issues

71. The publication of the LIC report alongside the flagships sets a positive precedent and leaves this group of the membership better served with IMF

advice. These needs will not diminish, so we see clear value in temporarily moving the LIDC report to the same twice-annual frequency as the flagships. Staff comments welcome.

- The LIC report has not previously been produced on a fixed timescale, and Directors will recall that the last version of the report was discussed in November 2019. This report responds to a one-off request from the IMFC to assess LIC financing needs for 2021-2025 and presents options to cover them. It serves as a background assessment for the different initiatives that are currently under discussion (including a possible SDR allocation, scaling up of the PRGT, debt initiatives, MDBs financing etc.) – all generally considered to be time-limited initiatives. Given the resources involved in preparing the report, staff propose retaining the flexibility in publication to ensure that the output continues to feed into policy discussions.

GFSR Chapter II – Nonfinancial Sector

72. Macrofinancial authorities should work to solve current limitations in the macroprudential toolkit, including actions to mitigate risks in less regulated segments of the financial system. The key concern is whether the current level of financial vulnerabilities—including potential scarring from the pandemic—is too high for macroprudential actions to be sufficient. Staff's comments are welcome.

- Macroprudential policies should work in conjunction with efforts at balance sheet repair and debt resolution measures described in Chapter 1 as a means to limit scarring from the pandemic. While the chapter's analysis confirms significant effectiveness of macroprudential tightening in ameliorating macro-financial stability risks, the chapter recognizes that continuing effectiveness will hinge crucially on the ability to target nonbanking financial institutions, as more and more intermediation migrates to this sector.

73. The application of this analytic framework to frontier economies in future GFSR, or during Article IV surveillance should be encouraged. Staff comments will be appreciated.

- We concur that it would be very useful to apply the chapter's analytical framework to frontier economies, but the main limitation is data. The chapter aimed to cover the largest sample of countries for which the key variables—in particular, nonfinancial private sector leverage and sufficient market variables that would permit the construction of a financial conditions index—are available.

74. We would appreciate further elaboration on how the optimal level of buffers would be determined given the interplay of different sectoral needs.

- While the chapter's analysis does not address the appropriate size of buffers, for nonbank financial institutions these could be determined much as the banking system's capital and liquidity buffers have been established, using scenario analysis such as stress tests in which the different sectors are subjected to sharp but

plausible adverse shocks. In addition, this analysis would benefit from incorporating interlinkages between nonbank institutions and banks, as well those between different types of nonbank financial institutions.

GFSR Chapter III – Commercial Real Estate

75. We wonder whether prospects of a rapid recovery by all actors (banks, investors and owners), leasing contracts or accounting rules could explain this CRE price misalignment?

- We agree that overoptimistic expectations of market participants could be a reason behind the estimated price misalignment. Additional factors may also be relevant to explain the sluggishness in CRE price adjustment during the COVID-19 pandemic including the huge uncertainty surrounding the economic outlook, natural lags in the valuation process, a lack of transactions for appraisers to accurately assess fair values when transaction volume slows, policy support, and the time it takes for CRE cash flows — much of which is based on long fixed-term lease contracts — to adjust immediately to weaker economic conditions.

76. We agree that targeted macroprudential measures to contain borrowing could be used, but would be limited to the domestic market, whereas access to external funding is possible and could be source of additional risks. Is there a country already acting on that front? We would also appreciate if staff could indicate whether the residential real estate is following the same trend?

- a. In some economies where the recovery has gained momentum such as China and New Zealand, macroprudential measures pertaining to the real estate sector have been already tightened in recent months. Similarly, Norway announced a tightening of the systemic risk buffer on domestic exposures at end-2020 (from 3 percent to 4.5 percent), partially in reaction to large banks residential real estate and commercial real estate exposures, and high prices in both sectors.
- b. Staff analysis for Chapter 3 does not cover residential real estate. Within the CRE sector, multifamily and apartments have been also affected, since many owners lost rental income plus ancillary income from waived fees, deferred rents and delinquencies. However, the multifamily segment generally suffered relatively less than some other CRE segments such as retail and office buildings, registering a smaller price decline during the pandemic.

77. Has staff analyzed the debt service capacity of borrowers when moratoria ends?

- We agree that the end of loan moratoria could have a significant impact on CRE borrowers. However, we were unable to conduct a quantitative analysis on this issue because of limited data availability.

Fiscal Monitor

Staff's responses to technical questions are below.

78. While the scale and modalities of support measures differ across countries, we have witnessed unprecedented levels of fiscal support globally during the last 12 months. Vaccinations at the global level are the spending category with the highest fiscal multipliers. Given the importance of the message, we would propose to put more emphasis on the staff calculation of how much spending on global vaccination could strengthen the global economy.

- This will be a key part of staff's communication strategy. Under the WEO upside scenario in which faster global vaccination brings the virus under control sooner, the global gain in GDP is \$9 trillion cumulatively through 2025, with two-fifths of that gain accruing to advanced economies. Assuming the tax-to-GDP ratio of 30 percent on average and unit elasticity of revenues with respect to output, this would translate to a \$1 trillion cumulative gain in revenues for advanced economies, plus additional savings from reduced spending on lifelines for people and firms. Such an increase would provide an excellent return on investment for public money, paying for itself, given that the cost of global vaccination is estimated in the tens of billions of dollars.

79. We note that some advanced economies are likely to recover faster, not only because of the controlled spread of disease, but mostly because of enormous economic stimulus. We, therefore, consider that countries need to provide targeted relief more than indiscriminate emergency spending with large fiscal stimulus package. Staff comments are welcome.

- Government fiscal actions have prevented a more severe global economic contraction and employment losses. In general, countries with larger spending and revenue actions (whose size has been correlated with level of economic development and access to financing) have experienced smaller output contractions relative to pre-COVID-19 trends. Many economies have also benefited from international spillovers from massive monetary and fiscal policy responses, which have eased global financial conditions and supported global demand (despite supply disruptions). Given limited fiscal space and high debt levels in many countries, the Fiscal Monitor recommends countries to improve the targeting of the fiscal support and tailoring it to countries' administrative capacity and institutional features, while trying to maintain the fiscal support for the duration of the crisis—considering an uncertain and uneven recovery. These would help provide the necessary support while limiting debt vulnerabilities. Some practical options to improve targeting are listed in the section “Near-Term Policies: Win the Vaccination Race and Target Support More Effectively” and Box 1.2.

80. We would appreciate staff elaboration on the estimated impact of the direct fiscal response on the output of the different country grouping, directly or through the spillover channel.

- Empirical analysis suggests that government spending and revenue actions have prevented a more severe global economic contraction. By one estimate reported in the Fiscal Monitor, at the global level, such actions have mitigated the fall in global growth in 2020 by 2 percentage points. Across regions, advanced economies have benefited more from above-the-budget-line fiscal support in 2020 than emerging market economies. For individual countries, the effects depend on country-specific factors, cross-border spillovers, and the size and composition of policy support. Region-specific and individual-country results are reported in Chudik, Mohaddes, and Raissi 2021.

81. The definition of what should be the new fiscal anchors for these frameworks is not obvious and we encourage staff to work on this issue. Staff assessment of revised anchors calibrated both to the new current economic outlook and to structural aging pressures would be welcome.

- Staff plans to intensify work on these issues, including on rules-based fiscal frameworks (see a preliminary assessment of the latter in Box 1.3). Many countries have activated the escape clauses or suspend the fiscal rules to provide the flexibility in providing fiscal support. To avoid undermining the credibility of rules-based fiscal frameworks, countries should clearly communicate pathways for reinstating the rules and reducing deficits and debt.
- More broadly, higher debt levels, the need to build buffers against future shocks, and spending pressures related to aging would call for a recalibration of fiscal anchors in the post-COVID-19 era. This will, in turn, depend on medium-term growth potential of countries, their fiscal efforts, and prevailing effective interest rates which can all be better pinned down when the crisis is over. Key priorities would therefore include developing credible multiyear frameworks for revenue and spending and committing to revisit the fiscal rule frameworks after the pandemic is over. Governments need to assess if the existing fiscal anchors (for example, debt ceilings and spending/deficit limits) are appropriate, and if not, recalibrate to new levels. Caution is needed when changing fiscal rules as frequent revisions may weaken fiscal discipline.

82. While the medium-term fiscal framework requiring higher taxes is needed, it should be well-designed and well-timed to minimize the impact on private sector and avoid social tension. Households and firms have been affected severely by the pandemic and facing numerous difficulties. We welcome staff's further elaboration on this issue and whether other revenue mobilization policies could also be used while tax base expansion should be applied according to country specific factors.

- Developing credible multiyear frameworks for revenue and spending (including strengthening fiscal positions over the medium term to build buffers against future shocks) will be vital to strike a balance between providing fiscal support now and keeping debt at a manageable level over the long term. Medium-term frameworks

could also be used to program an increase in government spending that helps improve access to basic public services. This effort could be supported by “preapproving” future tax reforms for implementation when the recovery is well entrenched (e.g., United Kingdom) as well as by seeking durable spending efficiency gains. How to reform tax systems and with which high-quality measures are indeed country specific. The timing will depend on political economy as well as financing circumstances. In general, revenue collection should be bolstered through a medium-term revenue strategy in which both tax policy and revenue administration efforts are well coordinated. A menu of tax reform options are discussed in Chapter 2 of the FM with details [here](#).

83. We request the staff to bring out a detailed analytical paper on the benefits, costs and risks of external market borrowings and a medium-to-long term strategy - as this can be helpful to emerging market and low-income countries. Staff may comment.

- Staff has been analyzing debt dynamics and vulnerabilities, including through the revision of Debt Sustainability Analysis for market access countries (MAC-DSA). The framework will include an analysis of the cost and risks of external borrowings and how debt structure affects the sustainability analysis. Many past studies, including by staff, have pointed to the benefits of domestic currency, long-term issuance, and the role of well-anchored low inflation expectations in making that possible. Fund staff has recently edited a book on sovereign debt (edited by Abbas, Pienkowski, and Rogoff 2020), which provides an overview of sovereign debt issues across countries and medium-to-long term strategies to reduce debt, particularly for emerging market and developing economies. For IMF-supported programs, the Fund policy paper No.2020/061 discusses the reforms of the policy on public debt limits. Staff will continue these types of analyses and inform the Board in a timely manner.

84. Could staff comment on the prospects for increasing progressivity of taxes and tax compliance of high-income households in the major economies?

- Staff have long been engaged in work on improving revenue administration and tax compliance in a wide range of countries. On average, staff sees room in several countries for increasing income tax progressivity, in particular by lowering tax expenditures benefiting higher income, raising top marginal tax rates in some countries, and addressing capital income taxation loopholes. Strengthened enforcement will be key to prevent tax avoidance and evasion by high earners. Recent developments in automatic exchange of tax-related information led by the Global Forum on Transparency and Exchange of Information for Tax Purposes are promising in enabling significant reduction in cross-border tax evasion (2019 Board Paper on International Corporate Taxation). Automatic exchange of information (AEOI) frameworks have reduced foreign-owned deposits at offshore jurisdictions by about 25 percent (Beer, Coelho and Leduc, 2019). While over 100 jurisdictions are currently engaged in AEOI, increased participation by many developing countries in the framework is still ongoing work, in particular through technical assistance from the Global Forum. Notwithstanding, there has already been remarkable progress in the past few years. Both the Global Forum (for non-EU members) and the EU

publish lists of jurisdictions deemed non-cooperative in these areas, and the G-20 and the EU respectively have raised the possibility of countries adopting ‘defensive measures’ on this basis.

85. The second chapter of the FM highlights the impact of the pandemic on preexisting inequalities in income, wealth and access to quality public services, and usefully identifies the pre-distributive and redistributive policy options. We would have welcomed more details on a realistic pace improvement observed in countries implementing reforms in the past in closing the sizeable efficiency gaps.

- Indeed, as the chapter 2 of Fiscal Monitor documents, spending inefficiencies are sizable, particularly in low-income developing countries and especially in the area of public investments. Building strong institutions is crucial for cutting waste and reducing inefficiencies. For example, by adopting strong public investment management institutions an average country (from a sample of 25 advanced, emerging and low-income countries) can close 2/3rd of the distance from the efficiency frontier, according to the [IMF 2015 Board Paper](#). Reforms that generate significant efficiency gains by strengthening institutions and legal frameworks and development of new skills take time and depend on political will and the capacity of the government to implement such reforms. Increases in spending efficiency in certain areas, such as subsidies and public wage bills, can be achieved relatively quickly in most cases.

86. In this context, we wonder if the Fund could possibly integrate distributional national accounts in its analysis, instead of restricting itself to using GDP numbers, in order to take into consideration and address distributional issues in member countries.

- Distributional analysis and work on inequality more generally have become more prominent in Fund work in recent years. Since 2018, following the completion of the pilot initiative (43 country studies), the Fund mainstreamed inequality. Since then inequality issues are routinely addressed in surveillance when they have significant macroeconomic implications. Given that inequality usually does not change very fast, in-depth coverage is not expected at a high frequency. However, in the context of COVID-19 pandemic, inequality issues have come to the fore of policy discussion and have become macroeconomically critical in many countries. The guidance to the Fund staff provides a framework on how to think about inequality and distributional issues from a macroeconomic perspective and provides an overview of good practices including a discussion on how to leverage expertise of other institutions and other stakeholders. Over many years the Fund has also developed considerable amount of analytical knowledge and tools that country teams can draw on when analyzing inequality.



FISCAL AFFAIRS

World Economic and Market Developments

March 25, 2021

Vitor Gaspar
Director
Fiscal Affairs Department

A Fair Shot

COVID Vaccine Timeline

January 10, 2020 Genomic Sequence of the SARS-CoV-2 is posted in Virological.org, by a team lead by Professor Yong-Zhen Zhang, Fudan Univ., China.

January 10-11, 2020, Graham and McLellan design the proteins underlying the mRNA vaccines,

January 13, 2020 Graham and McLellan they turn their scheme to Moderna for manufacturing.

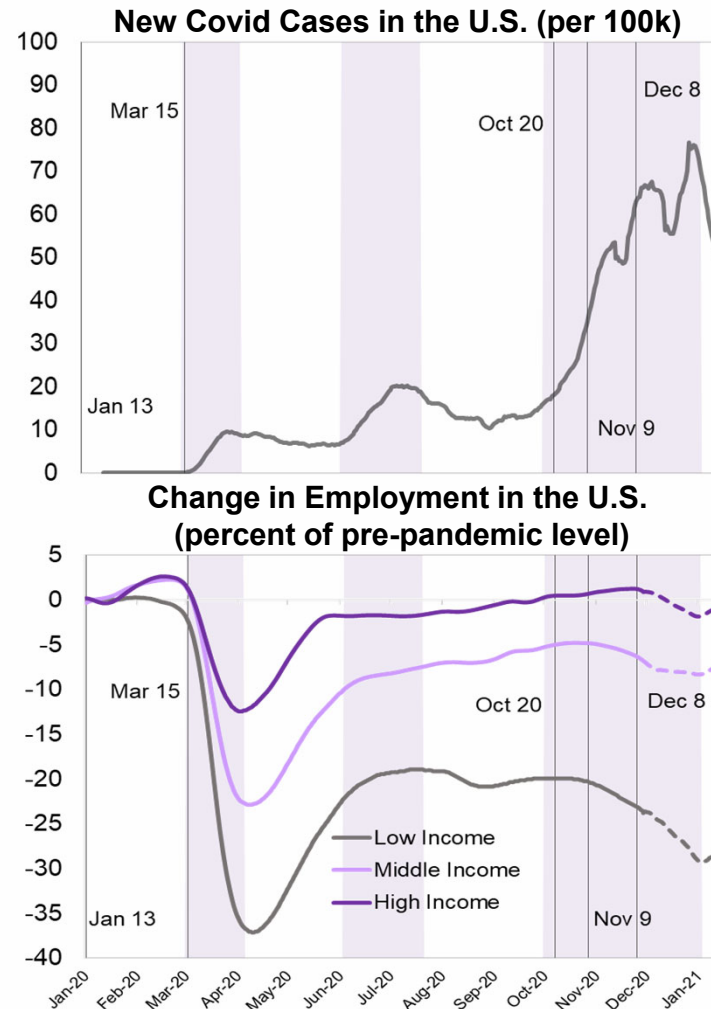
March 15, 2020 First human trial begins.

October 20, 2020 Pfizer and Biontech start mass manufacturing of their vaccine.

November 9, 2020 Pfizer-BioNTech announce their vaccine candidate has shown high effectiveness in clinical trials.

December 8, 2020 Margaret Kennan is the first person to receive the Pfizer jab in the UK

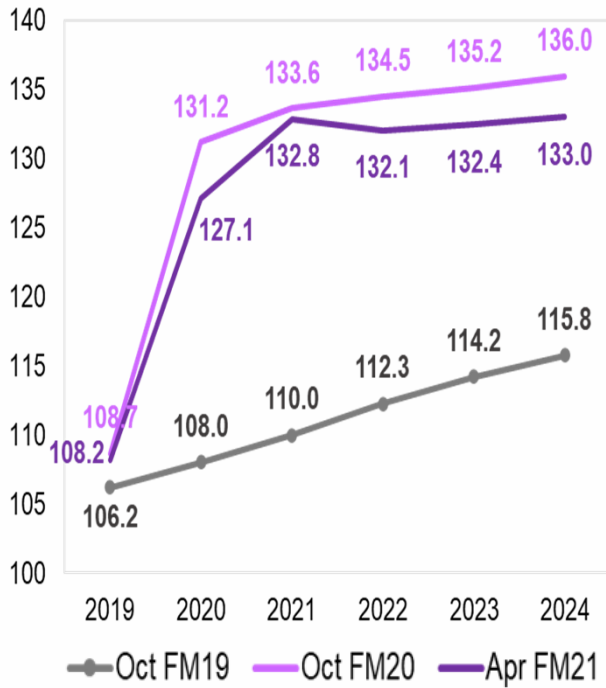
As of today, the number of people who have been vaccinated world-wide is approaching 400 million.



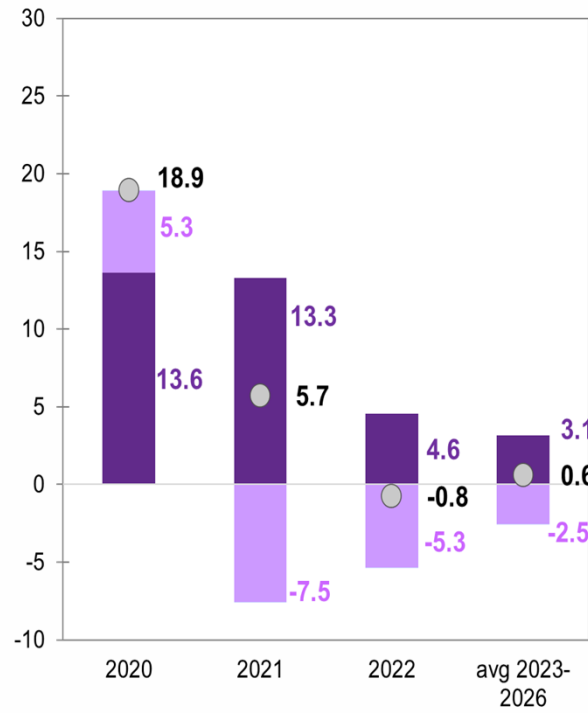
Sources: John Hopkins University; and Economic Tracker: Chetty, Friedman, Hendren, Stepner, and the Opportunity Insights Team (2020); data from Earnin, Intuit, Kronos and Paychex.

Debt and Deficits in the US

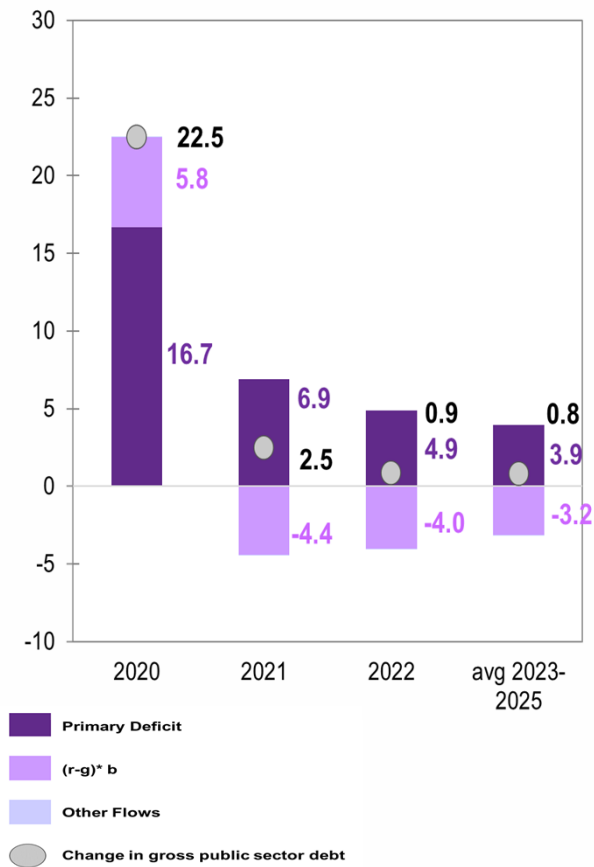
Public Debt (% GDP)



Debt decomposition (FM Apr21)



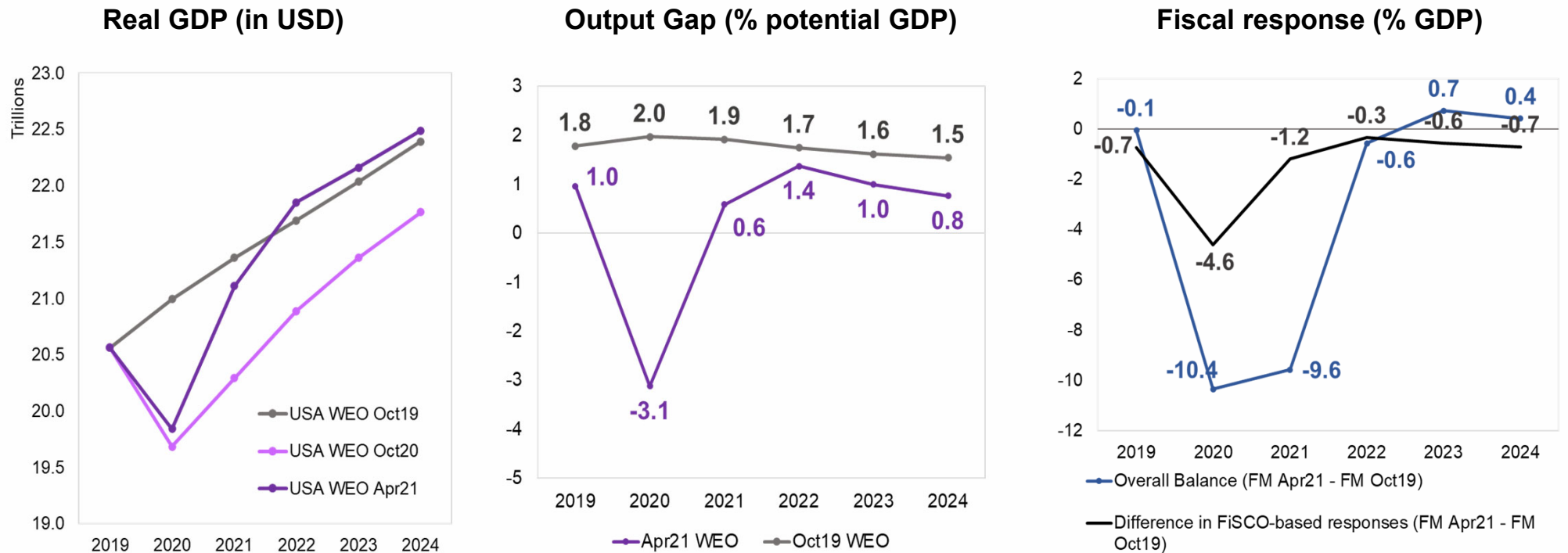
Debt decomposition (FM Oct20)



Source: IMF Fiscal Monitor (FM) & Staff Estimates.

Note: FM Apr21 data as of March 19, 2021. Data labels in the debt decomposition charts in black show the change in debt (in percentage points); labels in pink show (R-G)*b; labels in purple show primary deficit.

Fiscal Response in the US

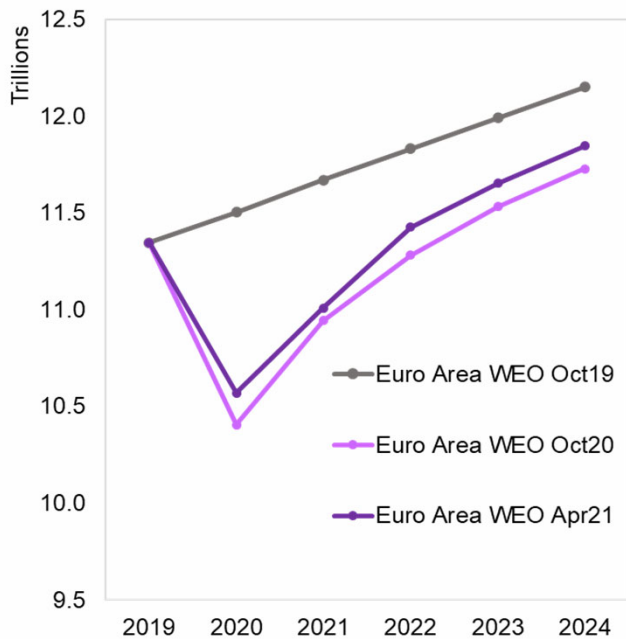


Source: IMF World Economic Outlook (WEO); Fiscal Monitor (FM) April 2021 & April 2015 publication & IMF Staff Estimates.

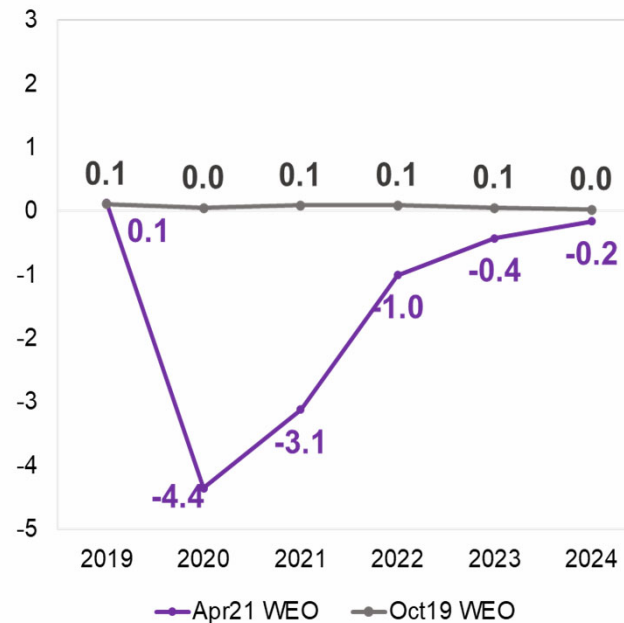
Note: FISCO refers to Fiscal Stabilization coefficient. FISCO are from the FM April 2015 publication. The rightmost chart in the panel shows the difference in FISCO based estimated responses using the output gap estimated in the Oct 2019 WEO and Apr 2021 WEO. FM Apr21 & WEO Apr21 data as of March 19, 2021.

Fiscal Response in the EA

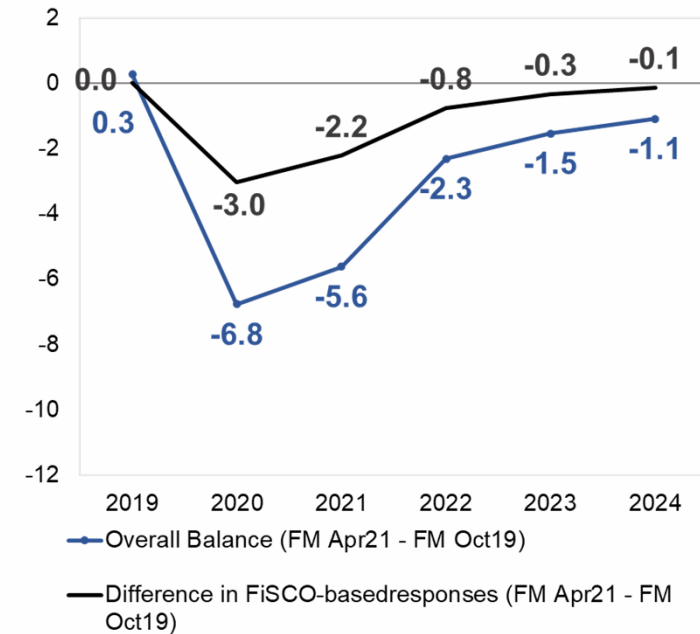
Real GDP (in euros)



Output Gap (% potential GDP)



Fiscal response (% GDP)

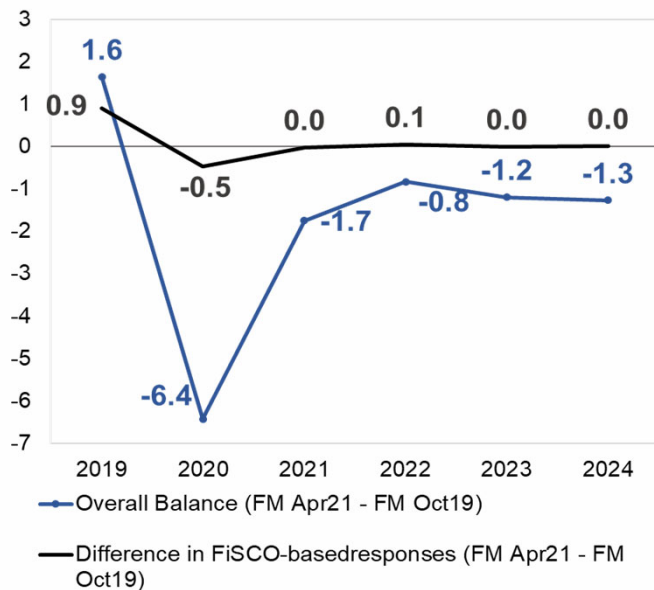


Source: IMF World Economic Outlook (WEO); Fiscal Monitor (FM) April 2021 update & April 2015 publication & IMF Staff Estimates.

Note: FISCO refers to Fiscal Stabilization coefficient. FISCO are from the FM April 2015 publication. The rightmost chart in the panel shows the difference in FISCO based estimated responses using the output gap estimated in the Oct 2019 WEO and Apr 2021 WEO. FM Apr21 & WEO Apr21 data as of March 19, 2021.

Public Debt and Inflation in Brazil

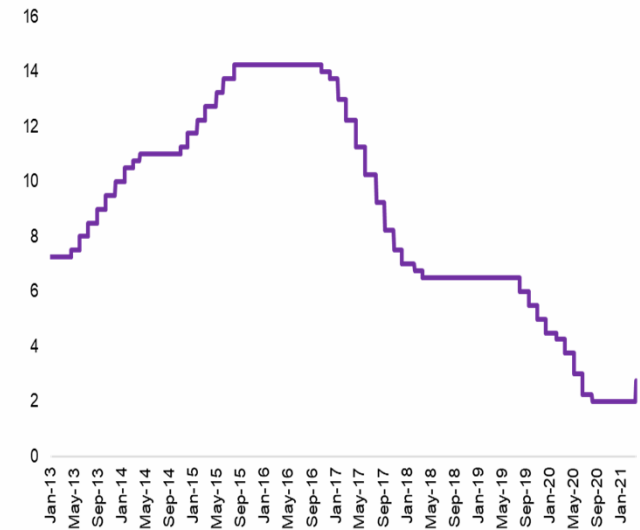
Fiscal response (% GDP)



Local Currency Government Bond yields (%)



Selic Rate (% annual)



Source: Banco Central do Brasil (Sistema de expectativas de mercado); IMF World Economic Outlook (WEO); Fiscal Monitor (FM) April 2021 update & April 2015 publication & IMF Staff Estimates.

Note: FISCO refers to Fiscal Stabilization coefficient. FISCO are from the FM April 2015 publication. The leftmost chart in the panel shows the difference in FISCO based estimated responses using the output gap estimated in the Oct 2019 WEO and Apr 2021 WEO. Data as of March 19, 2021.

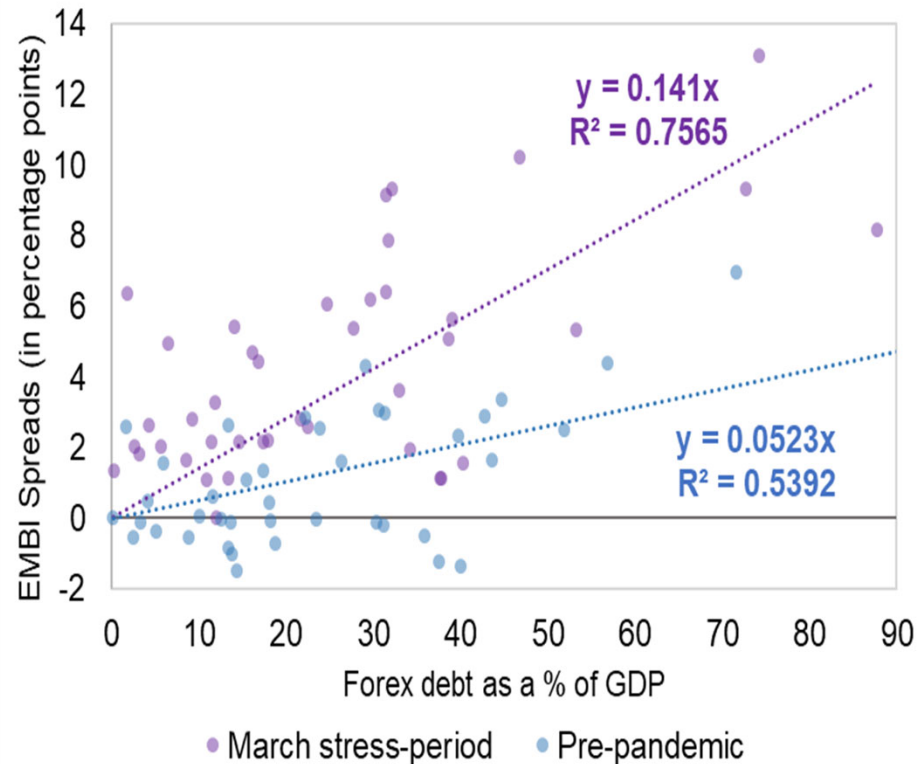
New MAC DSA

Predicting sovereign stress with greater accuracy with a multidimensional approach

- Institutional Quality,
- stress history,
- cyclical variables,
- debt burdens,
- and global conditions.

Focusing on early warning properties.

EMBI Spreads and Forex Denominated Debt

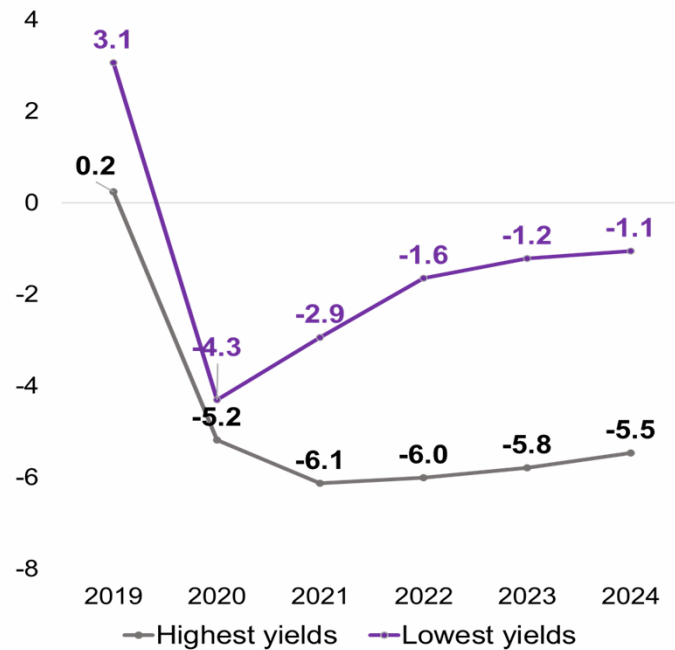


Source: Bloomberg, JP Morgan EMBI Index, IMF World Economic Outlook (WEO) & IMF Staff Estimates

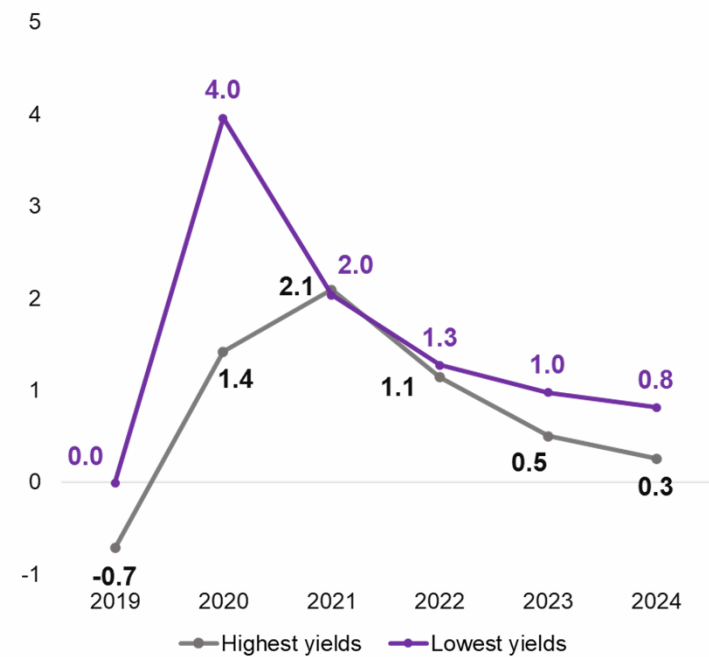
Note: Forex debt as a % of GDP are from the IMF WEO. EMBI spreads are from Bloomberg. A zero constant is imposed in the figure. A zero constant is imposed to allow for easier comparison. Outlier values for Argentina, Venezuela, Zambia, Ecuador and Lebanon are excluded from the analysis for both periods considered. The pre-pandemic period considers the average values from the last quarter of 2019 while the March-stress period consider the average across the month of March 2020.

GDP per capita and Primary Spending

GDP per capita, PPP International Dollars
(Difference FM Apr21 and FM Oct19, log scale)



Primary Spending
(Difference FM Apr21 and FM Oct19, % GDP)

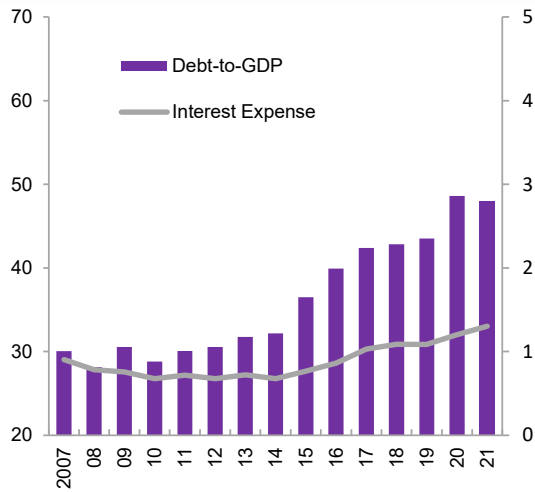


Source: IMF Fiscal Monitor (FM) & Staff Estimates.

Note: FM Apr21 update data as of March 19, 2021. Countries with the lowest & highest yields are ranked as of their yields on March 8th, 2021. The 15 countries with the lowest yields (in increasing order) are: Poland, Croatia, Philippines, Hungary, Vietnam, Malaysia, Serbia, Peru, Uruguay, India, Chile, Panama, Russia, Kazakhstan & Romania. The 15 countries with the highest yields (in increasing order) are: Ukraine, Belarus, Egypt, Nigeria, Ghana, Costa Rica, El Salvador, Iraq, Mozambique, Angola, Ecuador, Argentina, Belize, Sri Lanka & Zambia. Argentina is excluded due to lack of forecasts for the whole period.

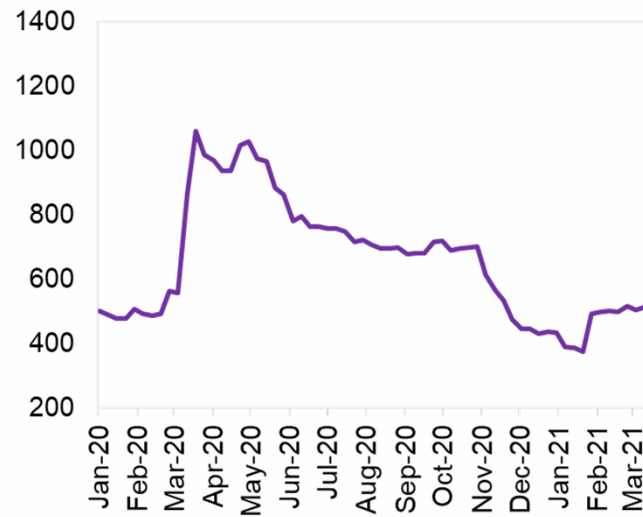
Debt and Interest Rates

**Low-Income Developing Countries
(Median For Interest-to-tax)**



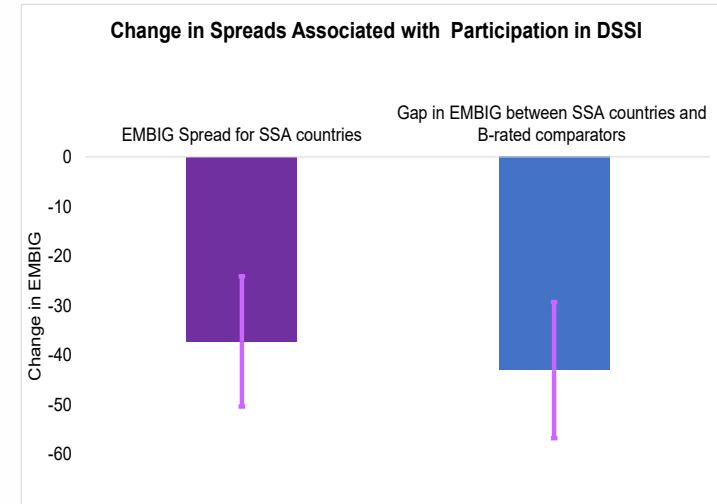
Source: IMF Fiscal Monitor, Apr 21, Fig. 1.1.

Benin Sovereign yields (bps)



Source: JP Morgan EMBI Index, Bloomberg.

Impact of DSSI

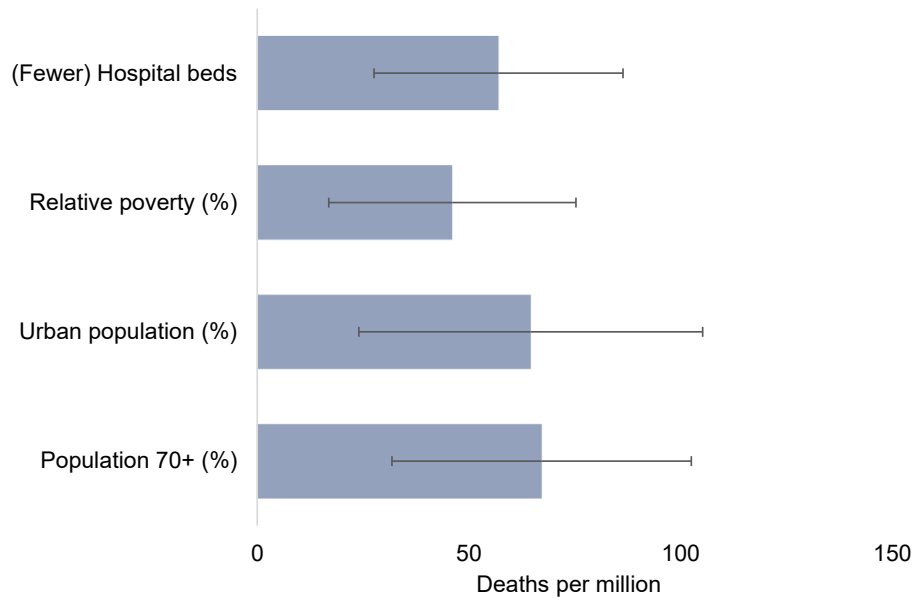


Source: IMF Staff Calculations

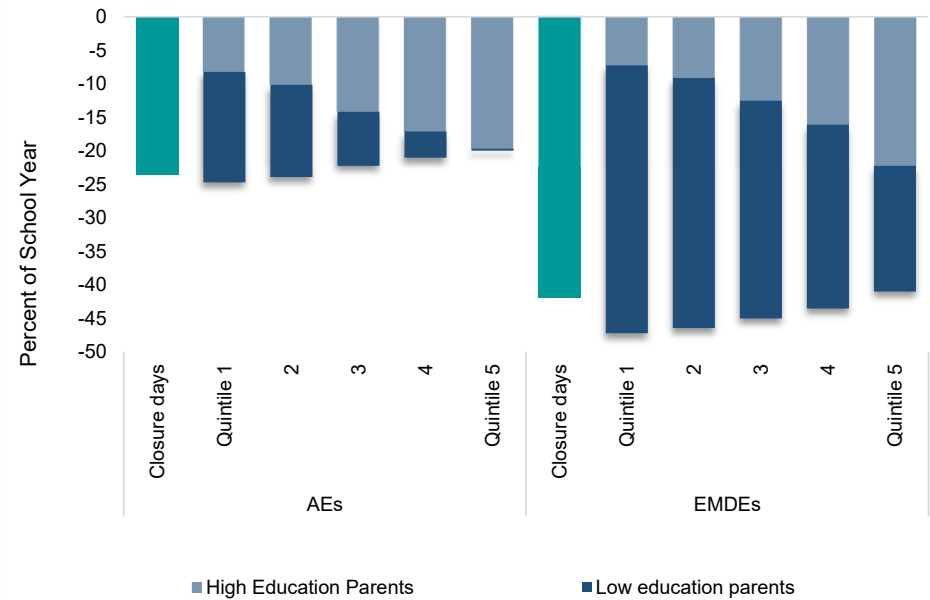
Note: This figure shows a difference-in-difference analysis after accounting for the countries' fundamentals and global market conditions as well as time and country fixed effect.

Inequalities Made COVID-19 Worse

Fewer hospital beds, relative poverty, shares of the elderly and of the urban population



Education losses



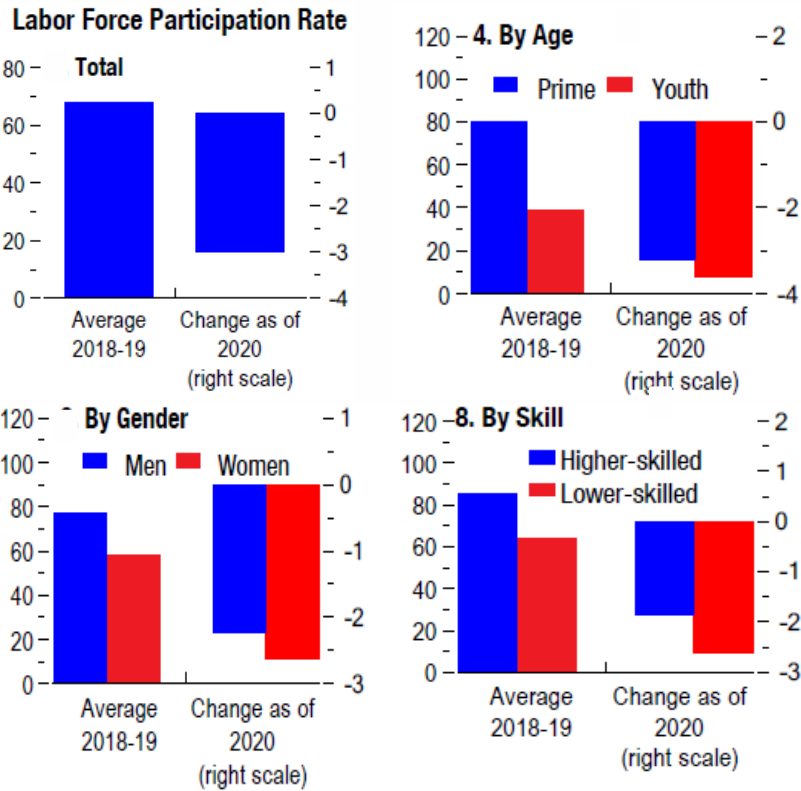
Sources: Our World in Data, OxCGRT, World Bank, and IMF staff calculations

Note: Average impact of one-standard deviation increase in respective factors on the number of COVID-19 deaths, based on cross-country regression estimates controlling for government containment measures, the number of cases and log GDP per capita.

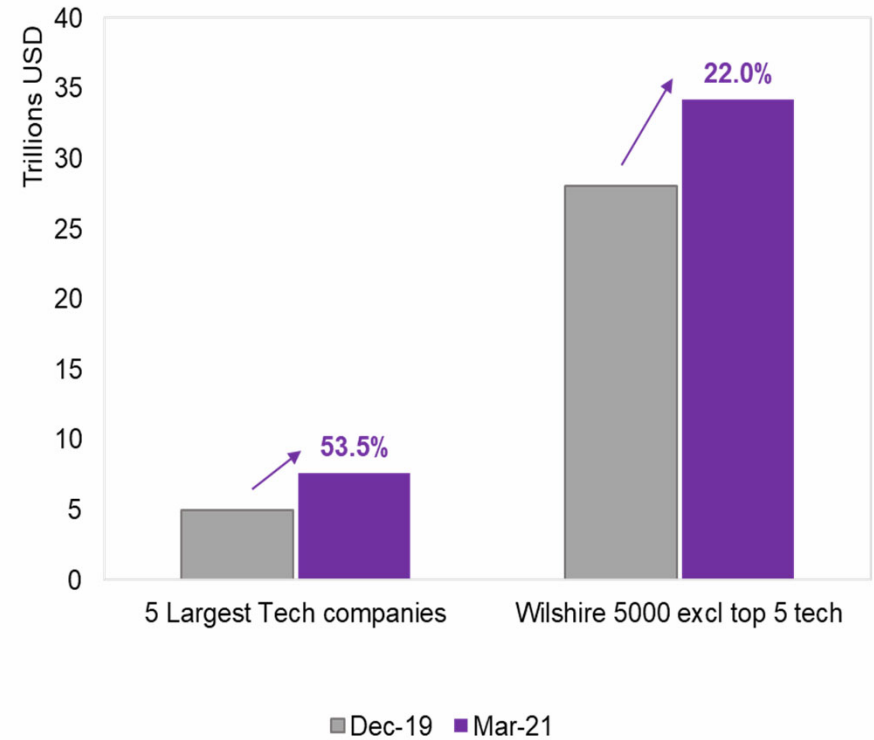
Source: IMF Fiscal Monitor, Apr 21, Fig. 2.5.

COVID-19 Made Inequalities Worse

Labor Force Participation



Stock market valuations



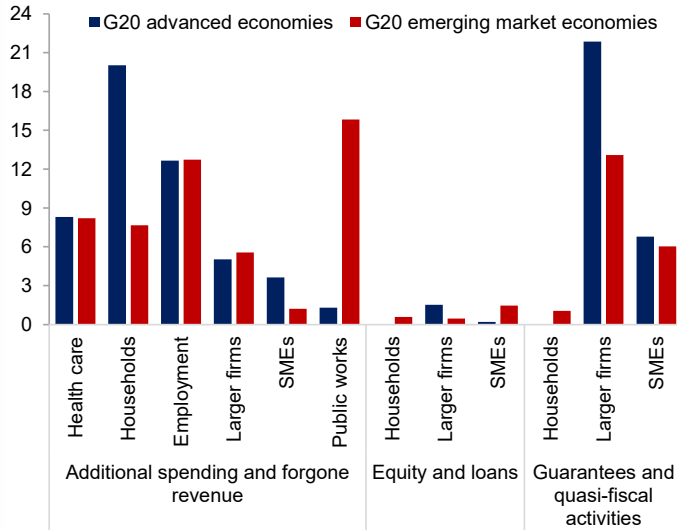
Source: Left panel, IMF World Economic Outlook Apr 21, Figs 3.1 and 3.2; Right figure Thomson Reuters Datastream & IMF Staff Estimates.

Note: WEO Apr21 update data as of March 19, 2021.

Fiscal Policy Safeguarded Incomes

Government Fiscal Support in Response to COVID-19, 2020–21

Types of beneficiaries (percent of total)



Changes in Employment and Incomes by Gender and Age Group (2020 Q3 - 2019 Q3)

Brazil



United States



Sources: Left panel, IMF Fiscal Monitor, Apr 21, Fig. 1.7; Right panel, Al Masri, and others, IMF WP (2021), and IMF Staff Calculations.

Policy Recommendations

Policymaking under High Uncertainty to Limit Divergences

Tailor policies to country circumstances, including the stage of the pandemic, strength of recovery, and structural characteristics. Short-term support should be anchored in credible medium-term frameworks.

Phase 1. Escaping the crisis.

- Ensure adequate **vaccine production and distribution**
- **Target fiscal policies** to the most affected;
- **Maintain monetary accommodation** until mandated policy objectives are achieved and provide clear forward guidance and communication.
- Take **early action and tighten selected macroprudential tools** to address specific pockets of vulnerabilities and safeguard financial stability.
- In EMDEs flexible exchange rates can help absorb impact of gradual increase in interest rates. In response to disorderly market conditions FXI and CFM/MPMs can help in countries with shallow FX markets.

Phase 2. Safeguarding the recovery.

- As pandemic durably recedes and recoveries strengthen, government **furlough and short-time work programs should be scaled back** (but avoid fiscal cliffs), supplemented with income support to manage transition and targeted hiring subsidies.
- Support **retraining and reskilling**.
- Remedial policy actions will be needed to **reverse the setback to human capital accumulation**.

Policy Recommendations

- **Support balance-sheet repair for a sustainable recovery, by expediting bankruptcy procedures to facilitate reallocation, strengthening NPL management, disposing of problem assets through market-based solutions.**
- **Where space permits,** fiscal support should be deployed with an emphasis on **green and digital infrastructure,** research, education.
- **Rebuild fiscal space** through increased revenue collection, greater tax progressivity including possibly a temporary COVID-19 recovery contribution levied on high incomes or wealth, and by reducing wasteful expenditures.

Phase 3. Investing in the future.

- Build a more inclusive economy through strengthening social assistance and social insurance.
- Build an environmentally sustainable economy through investing in climate mitigation, carbon pricing, and adaptation
- Resolve debt overhangs.

Strong international cooperation is vital at every phase for achieving these objectives and limiting divergences-

- To ensure universal access to vaccines and therapeutics; to give confidence through availability of international liquidity; provide ordered procedures for debt reprofiling and restructuring;
- To mitigate climate change;
- To resolve trade and technology tensions;
- And, in the area of international corporate taxation, to limit cross-border profit shifting, tax avoidance and evasion, and to agree on a reform that modernizes international corporate taxation, avoiding tax competition and unilateral measures.

The new SDR allocation and concessional financing for LIDCs are necessary to strengthen trust and confidence in the functioning of the international monetary system and to help the attainment of development objectives.



International Monetary Fund

March 25, 2021



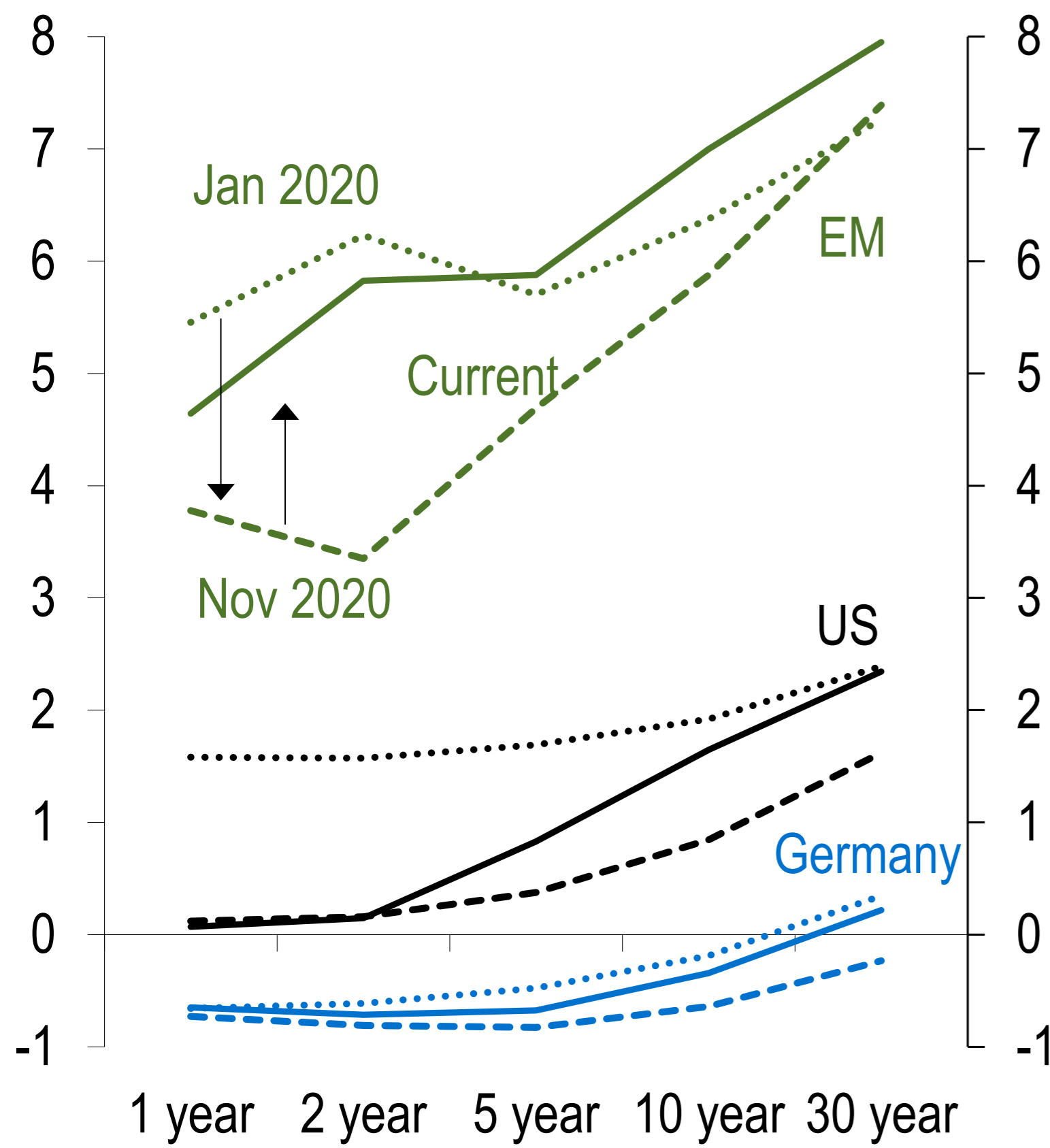
World Economic and Market Developments

Tobias Adrian

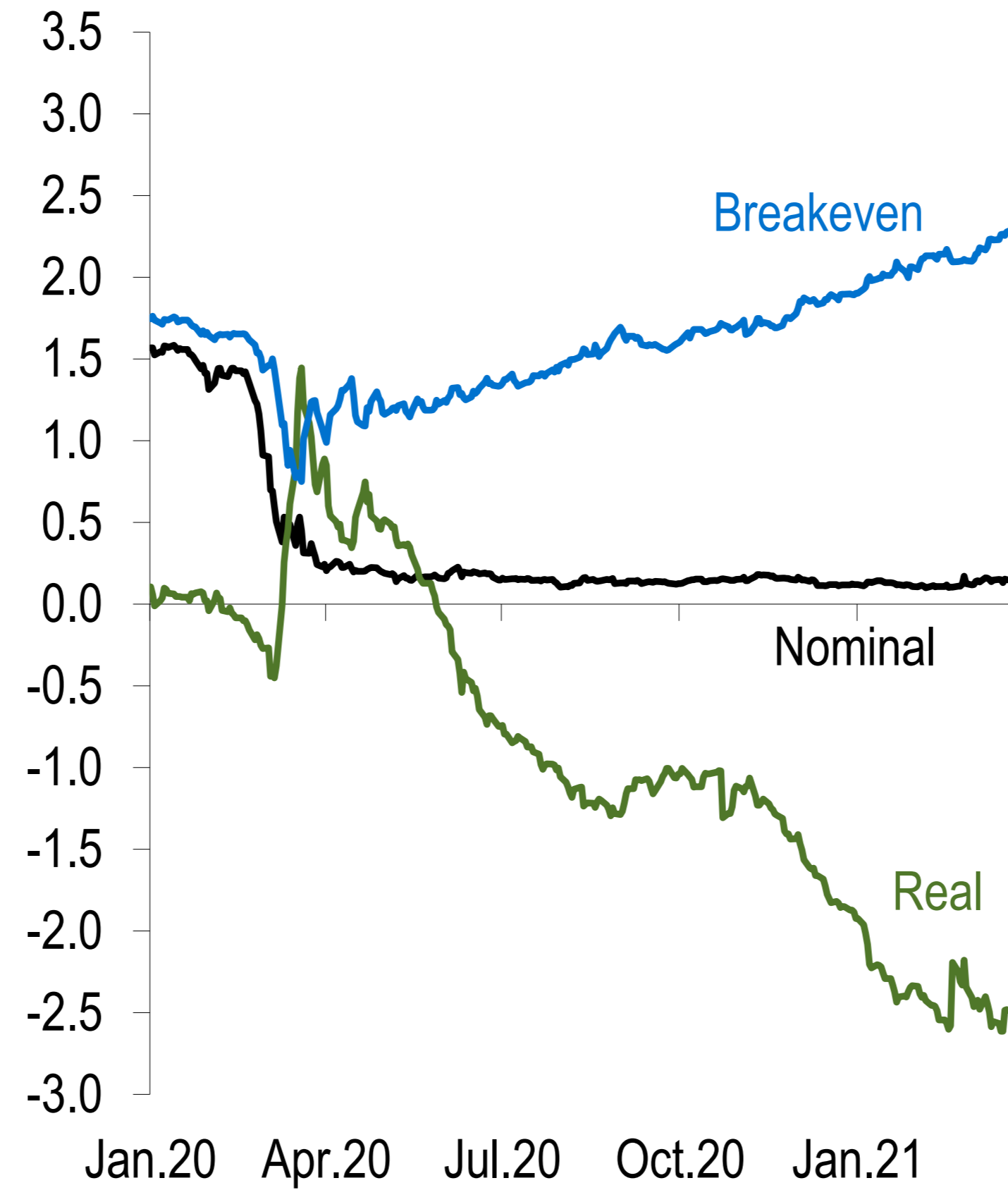
*Financial Counsellor and Director
Monetary and Capital Markets Department*

US Yields Surged Rapidly On Higher Growth And Inflation Expectations

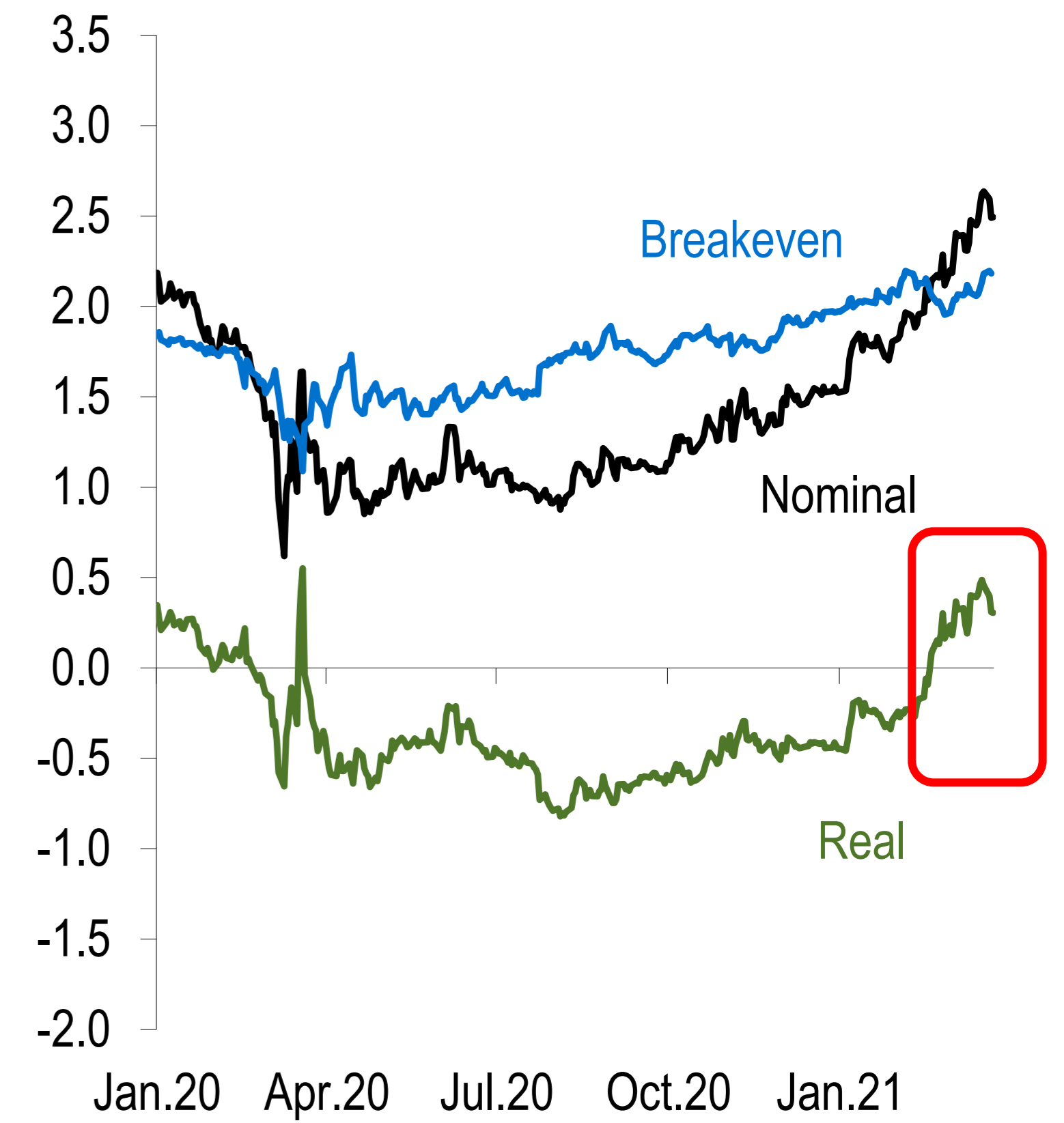
Global Sovereign Yield Curve (Percent)



US Short-term Rates (Percent, 2Y)

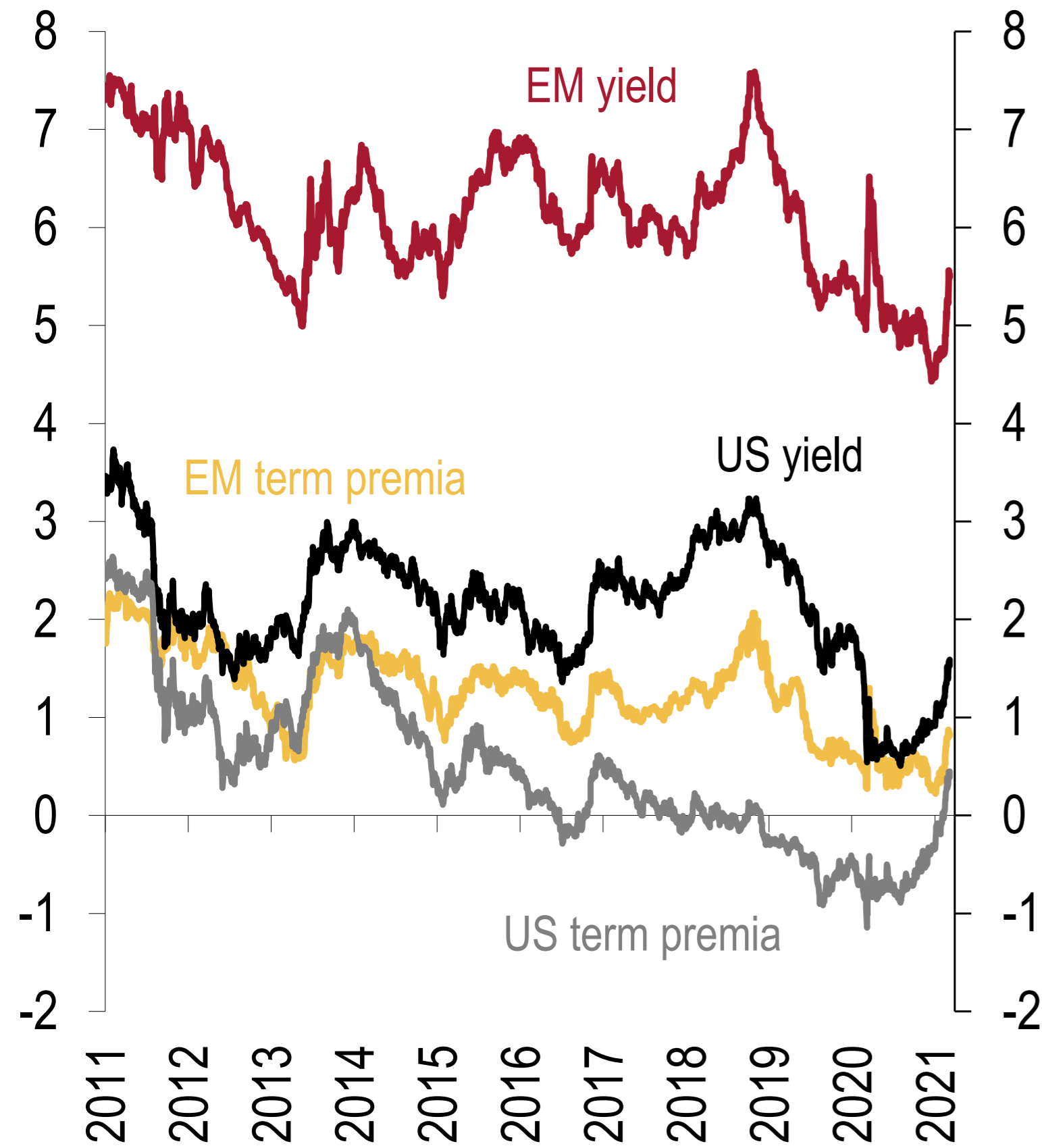


US Treasury Long-term Forward Rates (Percent, 5Y5Y forward)

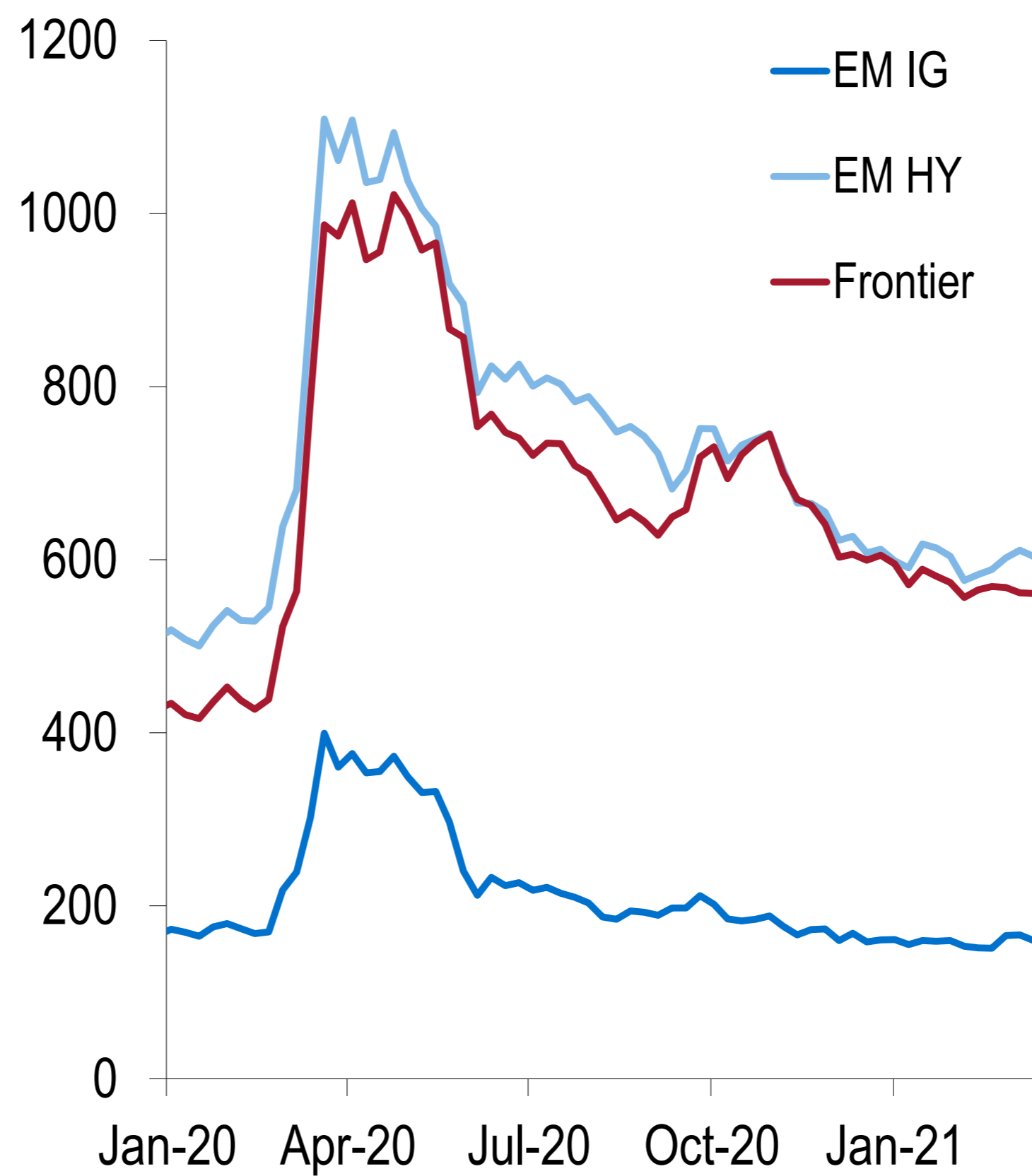


EM Local Rates Most Directly Affected; Credit Remain Resilient So Far

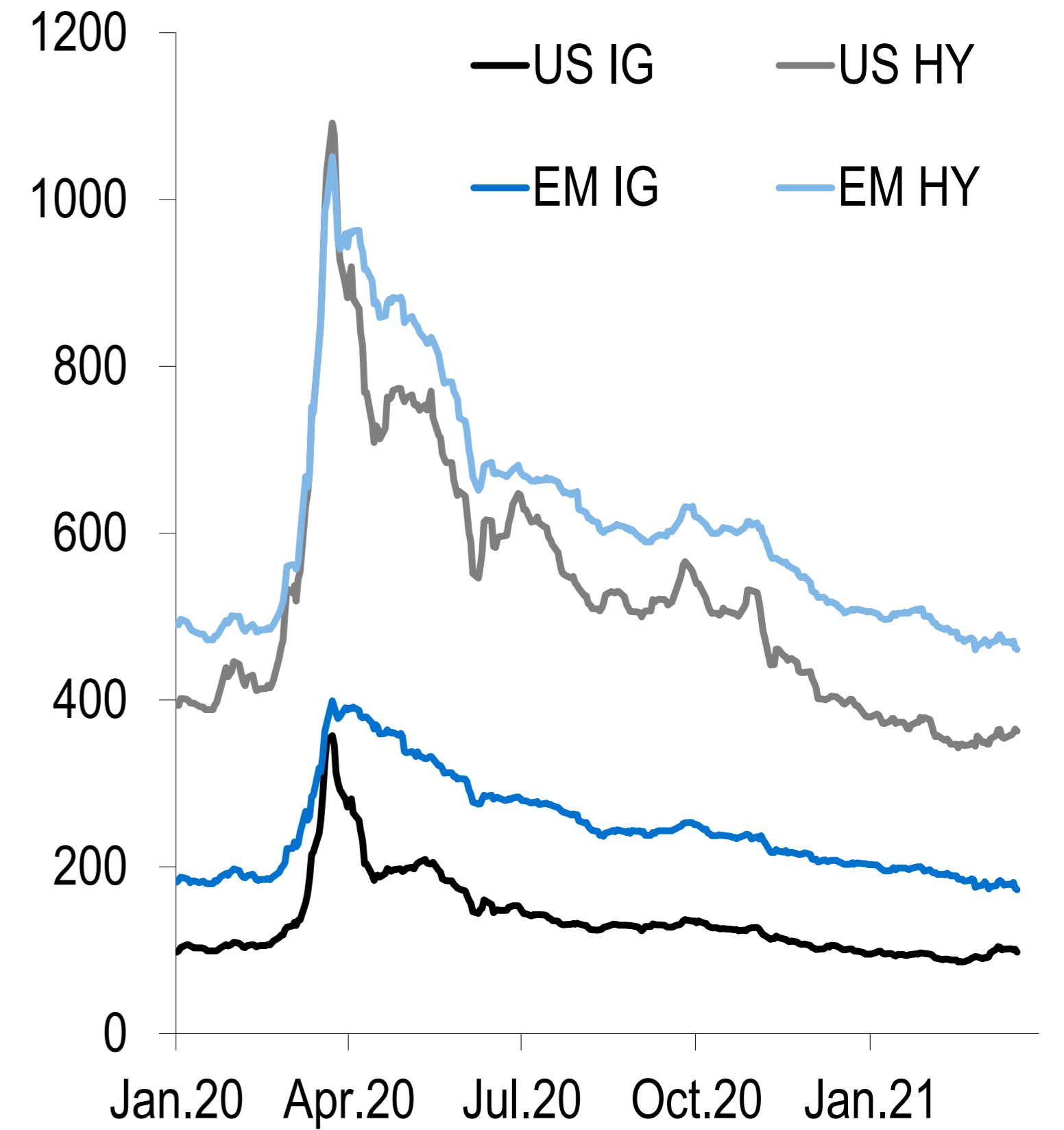
US and Median EM 10-year Yields and Term Premia
(Percent, as of Mar 10, 2021)



EM and Frontier Hard Currency Sovereign Credit Spreads
(Basis points)



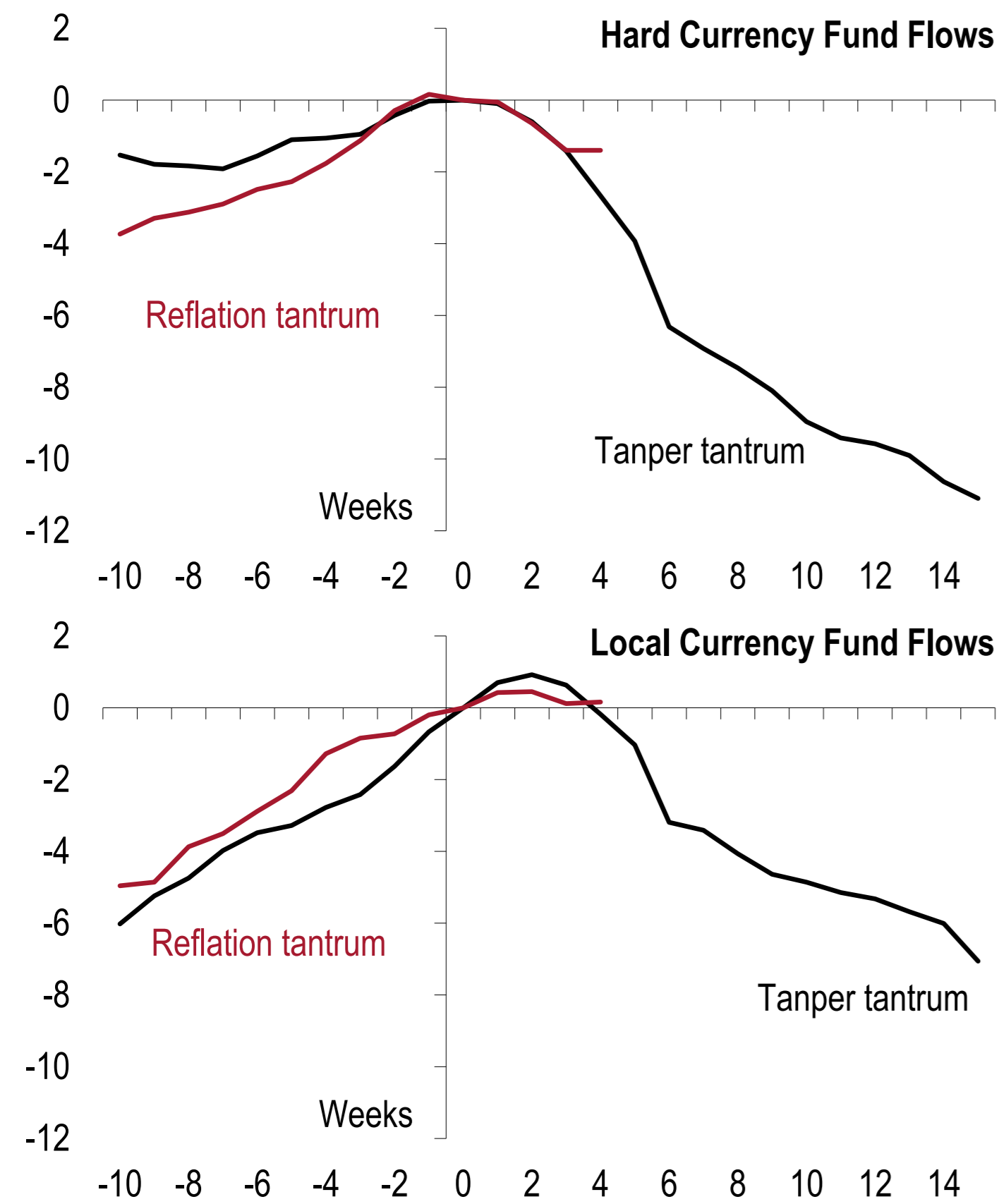
US and EM Hard Currency Corporate Credit Spreads
(Basis points)



Portfolio Flows Help Considerable Financing Needs, but Not Equally

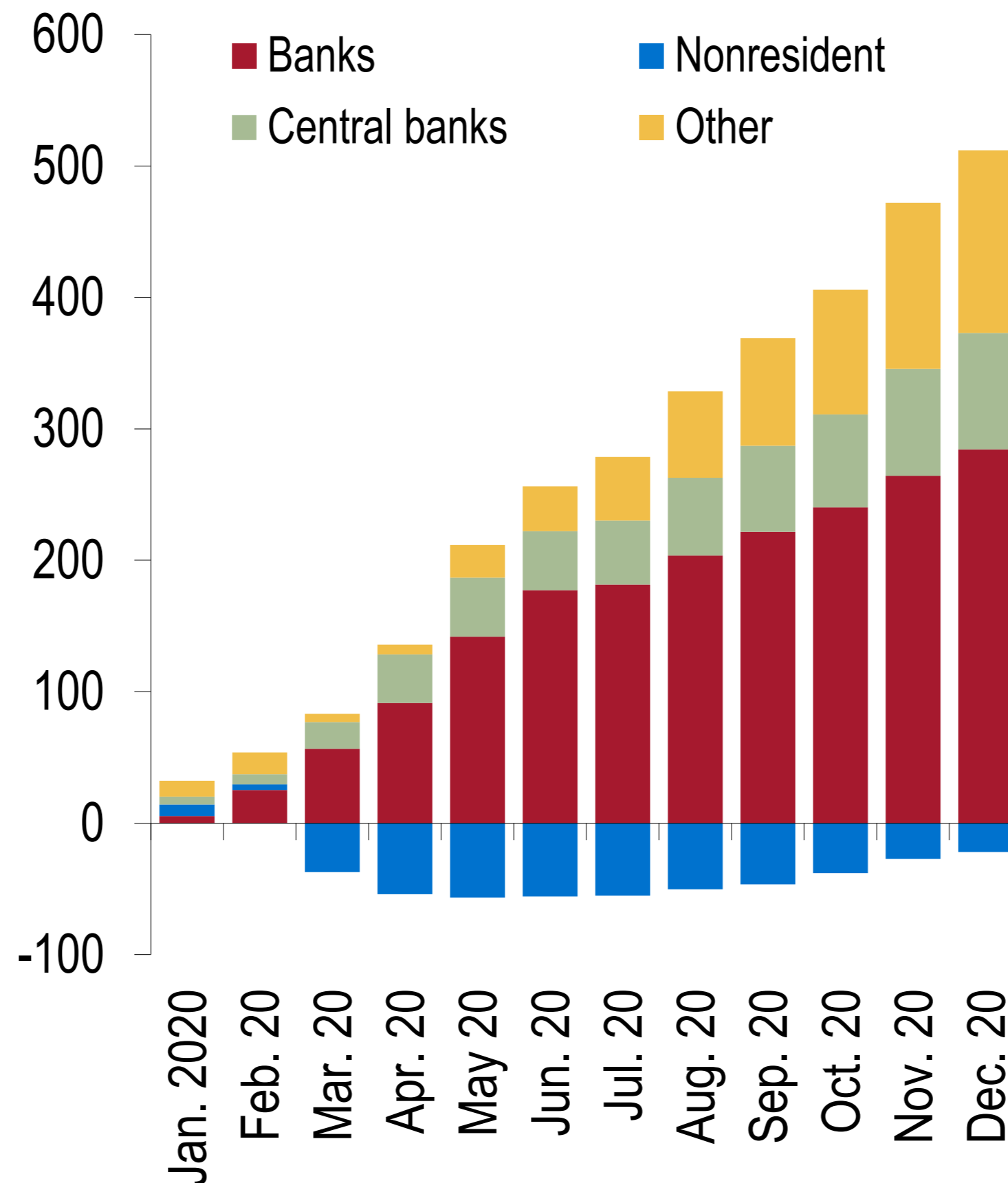
Portfolio Flows

(Percent of asset under management)



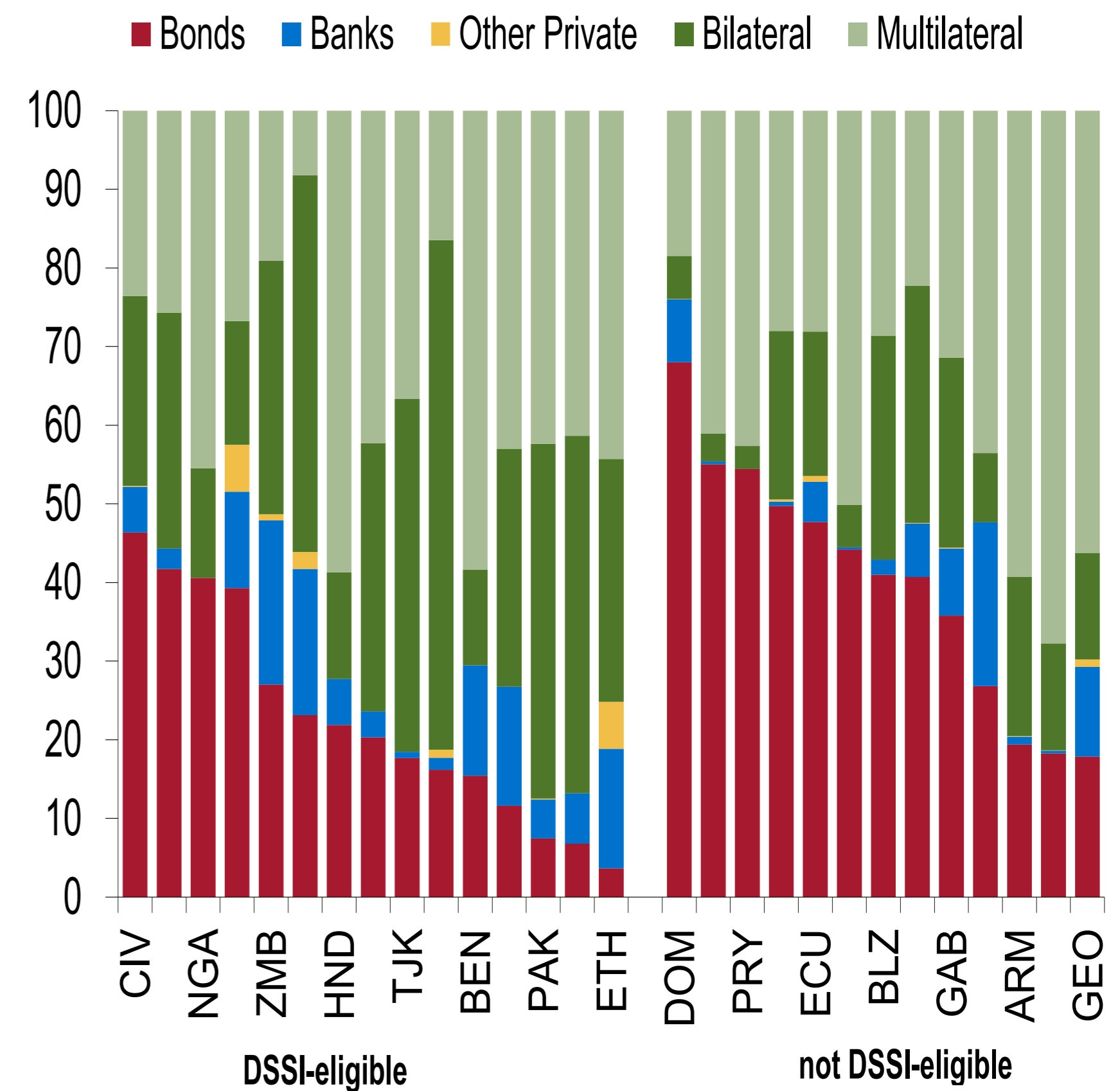
Change in Domestic Sovereign Bond Holdings

(Cumulative, billions of US dollars)



Frontier Markets: Outstanding Public and Publicly Guaranteed External Debt

(2019, percent of total)





International Monetary Fund
March 25, 2021

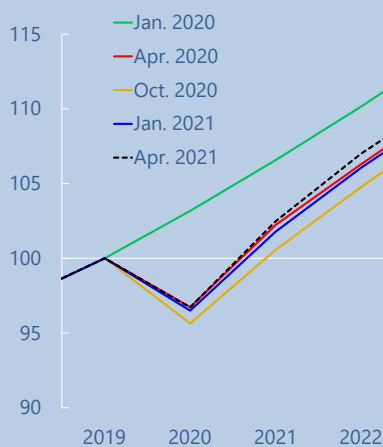
World Economic and Market Developments

Gita Gopinath
Economic Counsellor

Overall outlook improves but divergences grow

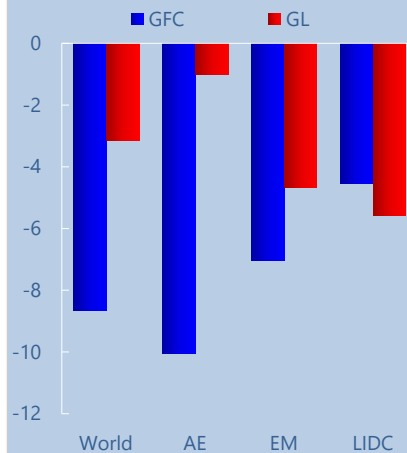
GDP

Improved outlook (index; 2019=100)



Output losses

Medium-term output losses 1/ (percent deviation from precrisis trend)



High uncertainty

- Virus dynamics, vaccine rollout
- Effectiveness of policy actions
- Evolution of financial conditions

Policies

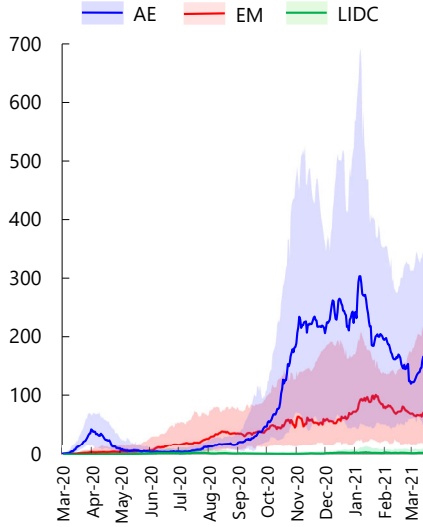
- Accelerate vaccine production and universal access
- Continue tailored policy support
- Anchored in medium-term fiscal frameworks
- Maintain accommodative financial conditions. Support to LIDCs

Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

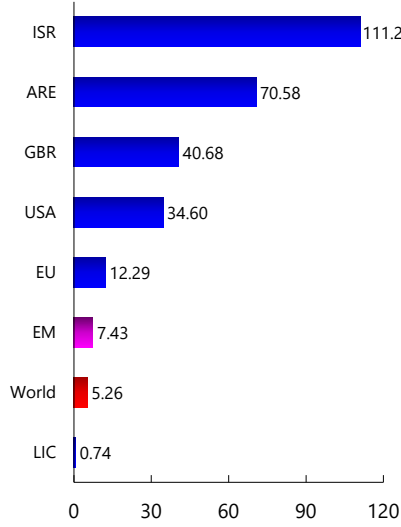
1/ Bars show the difference in real output four years after the crisis and anticipated output for the same period prior to the crisis for the indicated regional group.

Mixed progress in beating back the pandemic

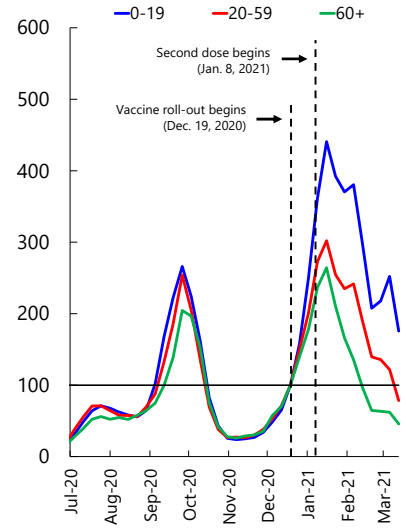
New cases 1/
(per million population)



Total vaccines administered
(doses per hundred population, as of 3/18/2021)



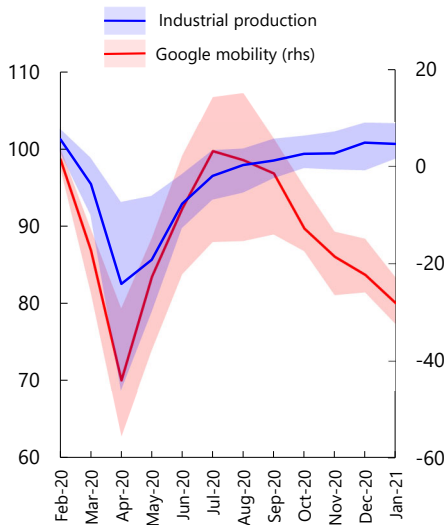
Vaccine effectiveness
(Israel: infections before and after vaccines by age group; Dec. 19, 2020= 100)



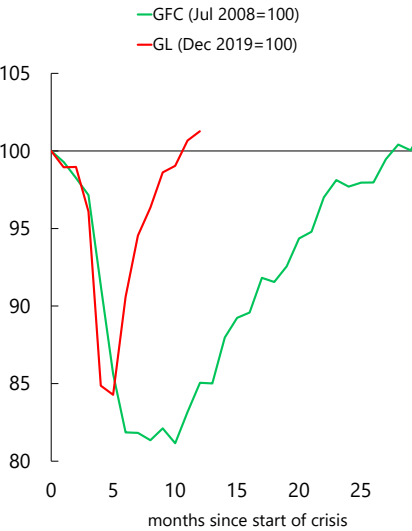
Sources: OxCGRT; Our World In Data; Israel Central Bureau of Statistics; and IMF staff calculations.
1/ Lines denote median of 7-day moving averages. Shaded areas are interquartile ranges.

Activity strengthening as economies adapt, but divergences remain

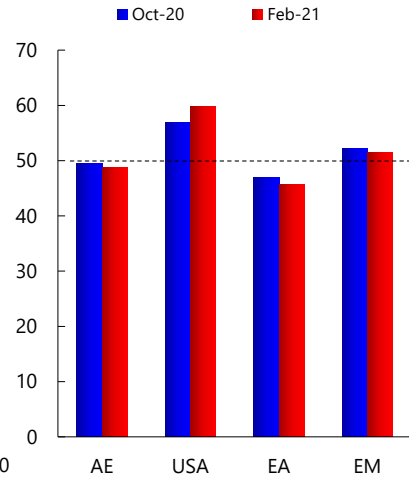
Industrial production and mobility 1/ (index)



Trade volume
(world trade volumes; seasonally adjusted)



Services PMIs
(median; index; >50 = expansion; sa)

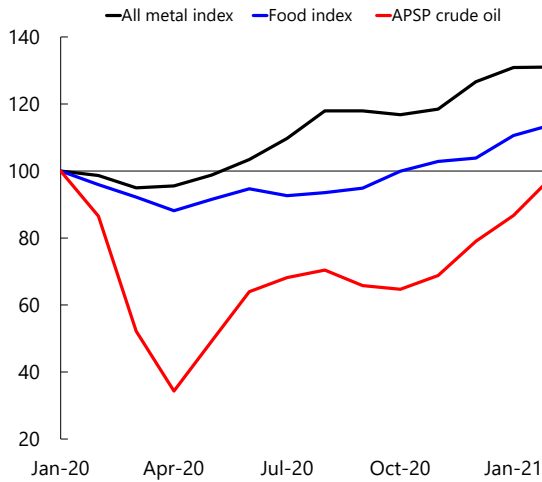


Sources: IMF, Global Data Source; Google, COVID-19 Community Mobility Data; CPB World Trade Monitor; Haver Analytics; and IMF staff calculations.
1/ Lines denote medians. Shaded areas denote interquartile ranges.

Inflation broadly contained, even as oil prices rebound

Commodity price indices

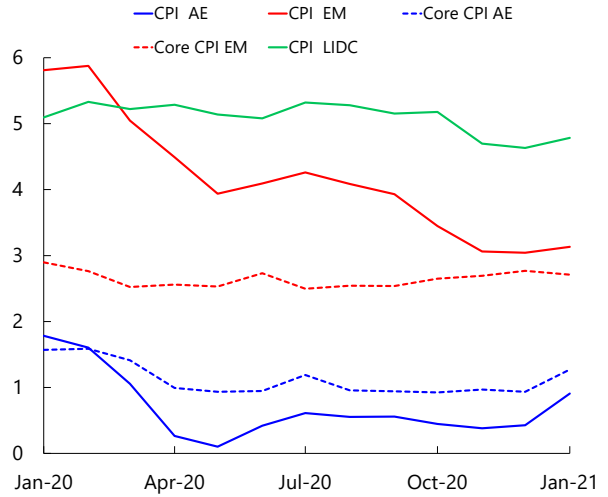
(index; Jan 2020=100)



Sources: Bloomberg, L.P.; and IMF staff calculations.

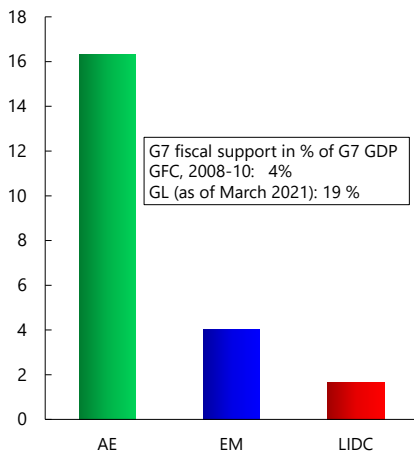
CPI inflation

(percent; year over year)

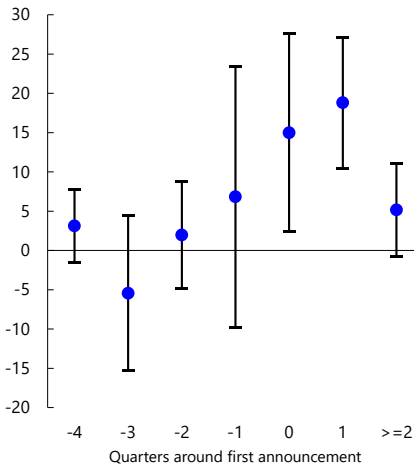


Policies put a floor on the collapse and supported the recovery

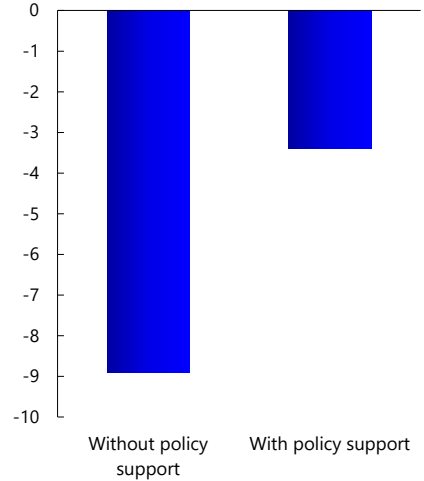
Fiscal support in response to COVID-19 1/ (percent of 2020 GDP)



Credit guarantees and credit growth 2/ (bps; low-capitalized banks compared to high-capitalized banks)



Estimated impact of policies on 2020 global real GDP growth (percent)



Sources: IMF, *Fiscal Monitor*; Central bank websites; Haver Analytics; Dealogic; IMF, *COVID-19 Policy Survey*; and IMF staff calculations.

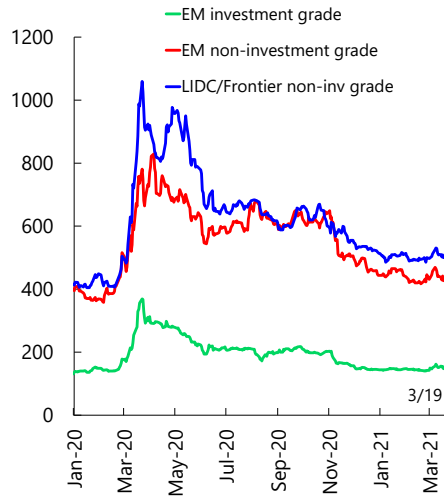
1/ Above the line measures; includes the U.S. American Recovery Plan.

2/ Results from regressions using bank-quarter data for 1,590 banks in 51 countries with controls for shifts in macro expectations, country conditions, bank characteristics, and past loan growth. Standard errors correct for time series and cross-bank dependence.

Financial conditions broadly accommodative despite risks of tightening

EMBIG spread

(median; basis points)



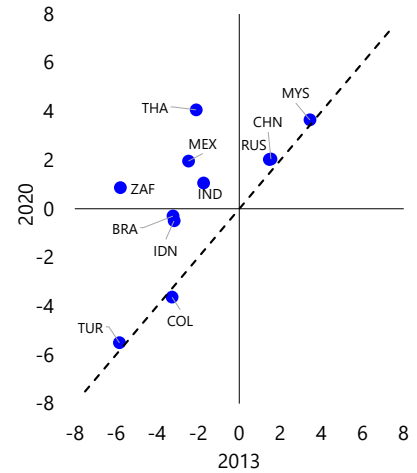
Capital flows to EMs and government bond yields

(USD billions; 4-week moving averages)



Current account balance

(percent of GDP)



Sources: Bloomberg, L.P.; Institute of International Finance; Haver Analytics; IMF, *World Economic Outlook*; and IMF staff calculations.

WEO baseline assumptions

Uneven access to vaccines

- Broad vaccine availability in AEs and some EMs in the summer of 2021 and across most countries by the second half of 2022
- Vaccine deployment will be staggered across regions, with some countries exiting the crisis sooner, and with occasional lockdowns before widely available vaccines

Policy support and financial conditions

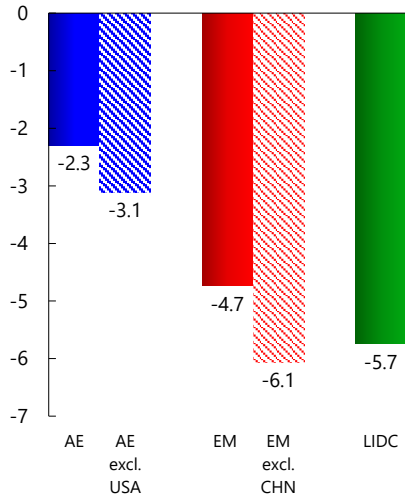
- In AEs, the United States and Japan have announced sizable fiscal support for 2021. In EMDEs deficits are generally expected to decline.
- Financial conditions to remain broadly supportive for AEs and EMDEs

Commodity prices

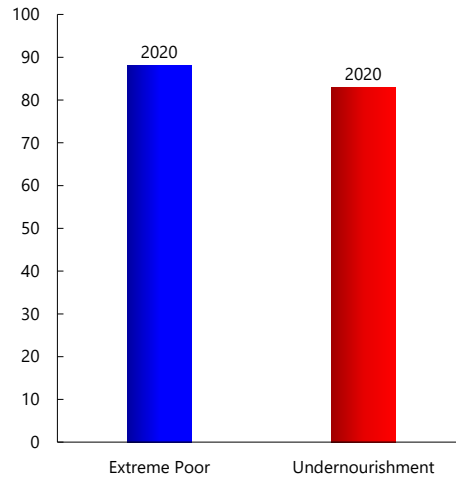
- Oil prices are expected to grow 30 percent in 2021
- Metal prices are projected to grow strongly in 2021

Larger income losses in developing countries, risks remain high

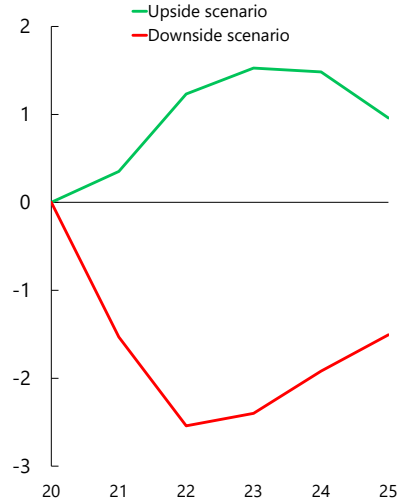
Average per capita income loss over 2020-24
(percent deviation from pre-crisis trend)



Extreme poor and under-nourished population 1/
(millions)



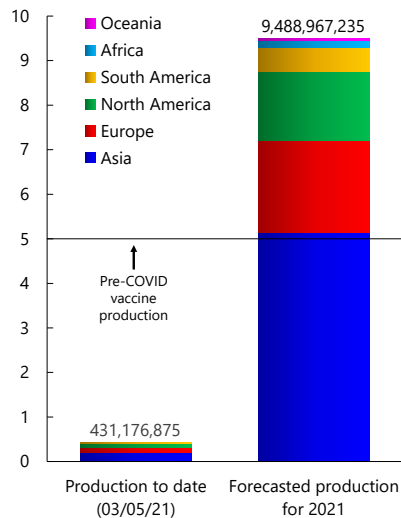
Global real GDP scenarios
(percent deviation from baseline)



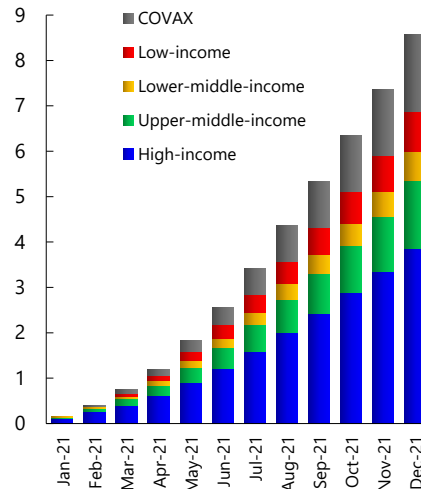
Sources: IMF, *World Economic Outlook*; World Bank; IFPRI, *COVID-19 Policy Survey*; and IMF staff calculations.
1/ The undernourished population and extreme poverty are the year-to-year projected increase from 2019 to 2020.

Need coordinated action to address vaccination challenges

COVID-19 vaccine production
(billions)



Vaccines purchased
(billions of doses, based on current supply deals; as of Mar. 16, 2021)



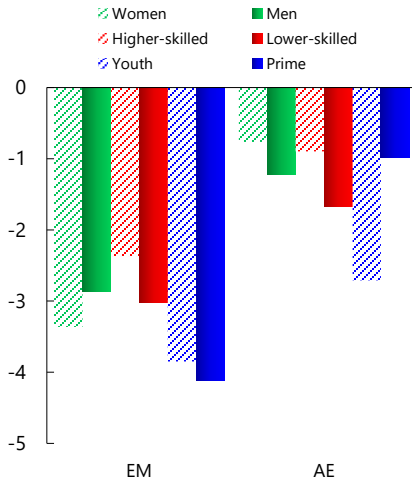
Policy priorities

- Prevent vaccine wars and export controls. Better coordination and transparency on production
- Cooperatively address input scarcity
- Create mechanism to equitably distribute surplus vaccines
- Close funding gap for COVAX. Logistics funding, personnel training in poor nations
- Increase vaccine acceptance; and surveillance of variants
- Advance purchase commitments for 2021

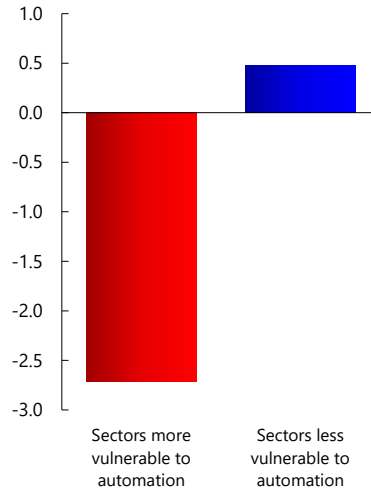
Sources: Airfinity; Our World in Data; and IMF staff calculations.

Address unequal recoveries in labor markets

Change in employment rates 1/
(percentage points)

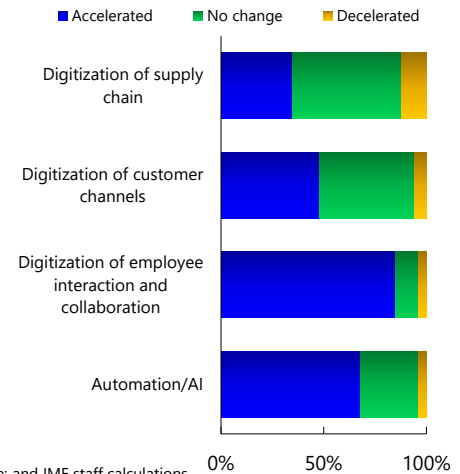


Sectoral employment growth 2/
(percent; average 2020:Q1-Q3 yoy)



Digitalization and automation during COVID-19

(percent; survey of 800 executives, July 2020)



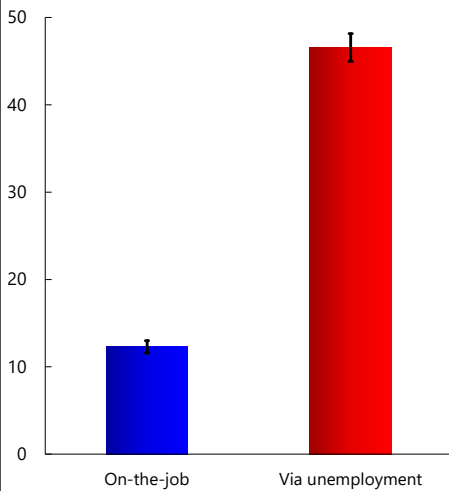
Sources: ILO; OECD; IMF staff calculations for Chapter 3 of the April 2021 *World Economic Outlook*; McKinsey Global Institute; and IMF staff calculations.

1/ Change is the average change in the variable across countries in the group, relative to its average value over 2018-19. Higher-skilled = tertiary education and above; lower-skilled = above secondary and non-tertiary education and below. Prime age = 25-54 years; = 15-24 years. To account for sample coverage changes, the average within group over time is calculated from the normalized time fixed effects of a regression of the indicated variable on country and time fixed effects (Karabarbounis and Neiman 2014).

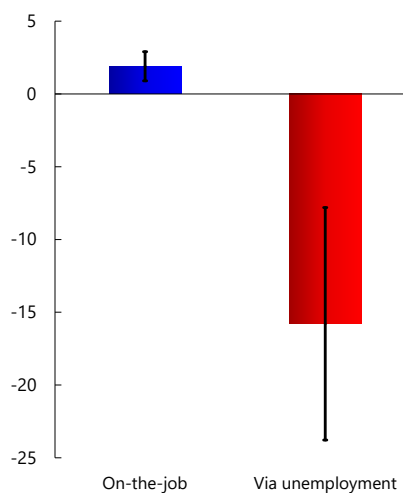
2/ Sectors are more (less) vulnerable to automation if more (less) than half the employment share are in occupations highly exposed to routinization (Carillo-Tudela et al 2016).

Need appropriate mix of job retention and worker reallocation measures

Occupational switch probability
(percent)



Earnings change from occupational switch
(percent; deviation of switchers from stayers)



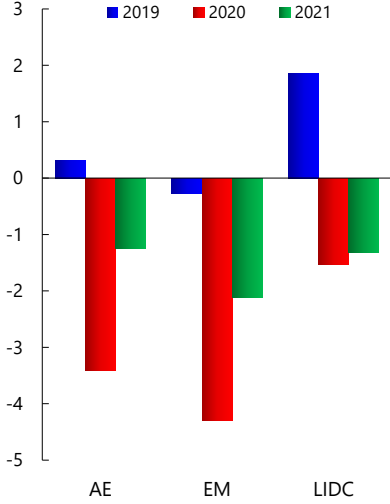
Policy priorities

- Job retention measures best while the health crisis is acute and social distancing high to preserve viable job matches
 - Tie to duration and intensity of pandemic
 - Target most affected workers
 - Cash transfers for informal workers
- As recovery strengthens and pandemic is beaten back
 - Switch to reallocation policies to adjust to permanent effects of COVID shock
 - Income support in transition.
 - Targeted hiring subsidies, retraining and reskilling

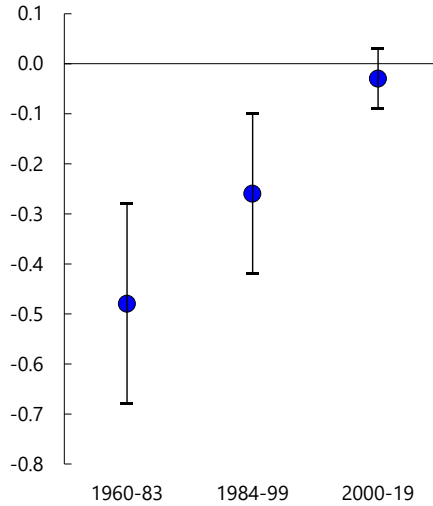
Sources: ILO; OECD; IMF staff calculations for Chapter 3 of the April 2021 *World Economic Outlook*.

Inflation expected to remain contained in many countries

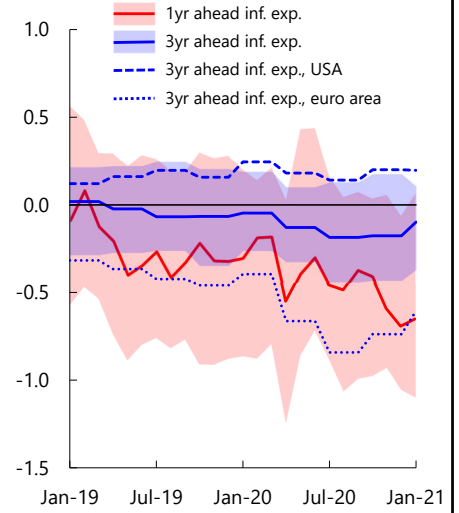
Output gap
(percent of potential GDP)



Elasticity of inflation to slack 1/
(United States; 1960-2019:1; percentage points)



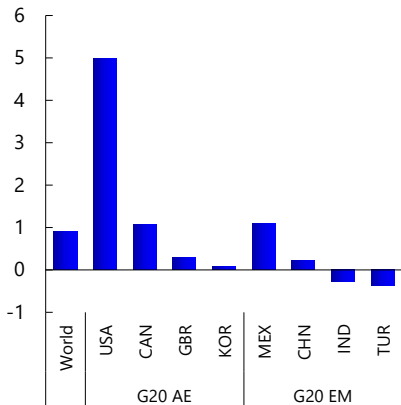
Inflation expectations 2/
(deviation from targets; percentage points)



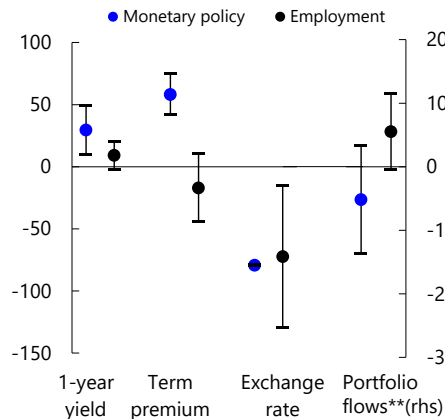
Sources: Haver Analytics; Consensus Forecasts; Stock and Watson (2020); and IMF staff calculations.
 1/ Dots represent regression estimates, whiskers represent 95 percent confidence intervals.
 2/ Lines denote medians. Shaded areas denote interquartile ranges.

Divergent recoveries could lead to unexpected policy spillovers

Estimated cumulative 2021-22 impact of American Rescue Plan on real GDP 1/
(percent)



Impact of US monetary surprises and positive news on EMs 2/
(basis points; **=basis points of annual GDP)



EM response to a US interest rate hike: Perspectives from the IPF

Gradual rise in U.S. interest rates

- ER flexibility (↑ or ↓ depends on US trade versus FX mismatch)
- Sharp depreciation if low US trade and high FX mismatch
- If so, prepare early: FCL; SDR; help private FX debt ↓, hedging ↑, maturity ↑

Tantrum episode

- Shallow FX markets: sell FX, ease CFMs and MPMs
- Deep FX markets: allow ER flexibility except in severe cases
- Prepare early: monitor UIP premia, FX hedging

US

- Forward guidance to communicate better fundamentals & avoid tantrums

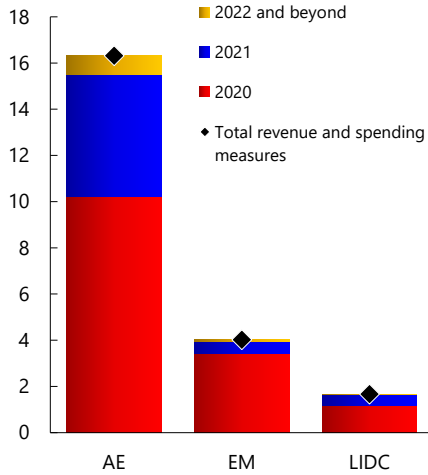
Sources: IMF staff calculations for Chapter 4 of the April 2021 *World Economic Outlook*; and IMF staff calculations.

1/ Impact takes into account term premia and its impact on Real GDP levels.

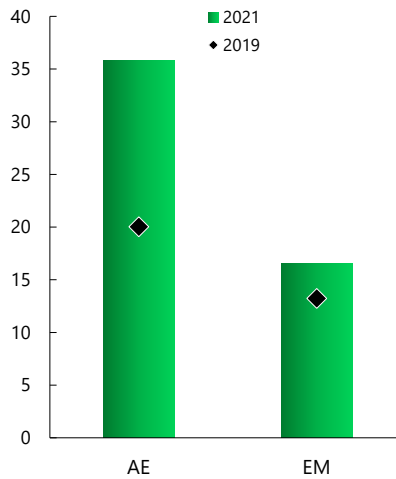
2/ The blue dots show estimates of the effect of a 72-basis point US monetary policy surprise and the yellow dots show estimates of the effect of a surprise increase in US employment of 1,135,000 jobs. Estimates suggest that each of these two surprises would be consistent with a 50 bps increase in yields on 10-year US Treasury securities. The whiskers show 90 percent confidence intervals. An increase in the exchange rate denotes an appreciation against the US dollar. Term premia are calculated at the 5-year maturity and data are only available from 2016.

Flexibly adjust fiscal support, anchor in medium-term frameworks

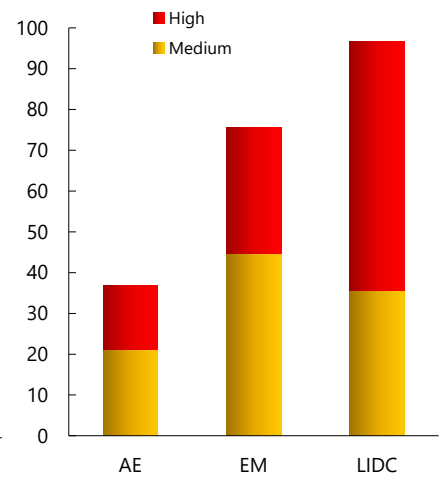
Government fiscal support in response to COVID-19
(revenue and spending measures; percent of GDP)



Gross financing needs
(percent of GDP; PPP weighted average)



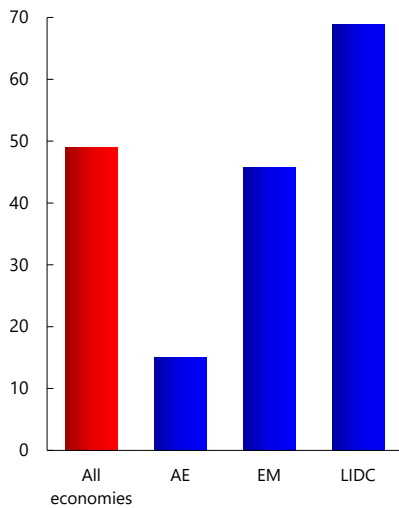
Fiscal vulnerabilities in EM and LIDCs
(percent of total countries)



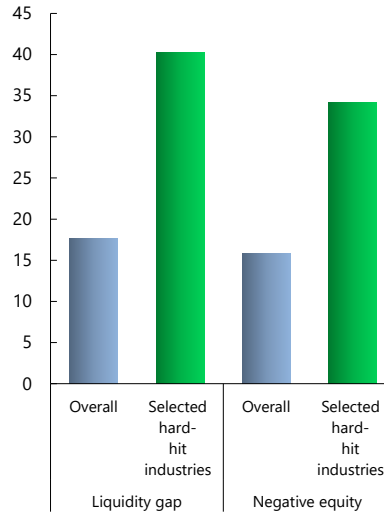
Sources: IMF, *Fiscal Monitor*; IMF VE database; and IMF staff calculations.

Adopt measures to minimize scarring

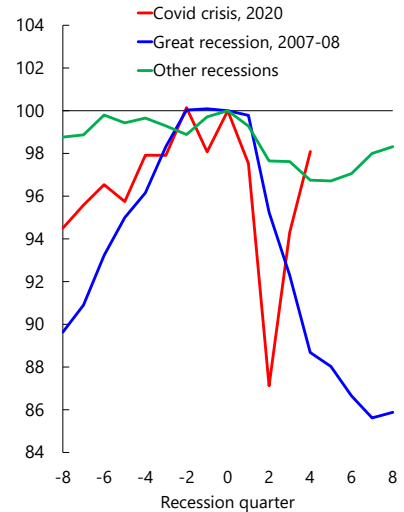
Losses in human capital investment
(average missed days of instruction 2020)



Liquidity and insolvency risks for SMEs in 2020-21 1/
(percentage points)



Real investment
(index; last pre-recession quarter=100)

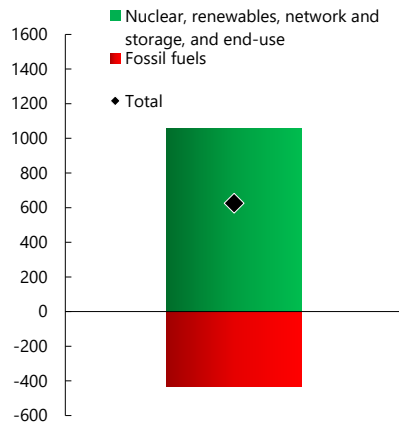


Sources: UNESCO, IMF, *World Economic Outlook*; Diez et al. SDN forthcoming "Insolvency Prospects Among Small and Medium Enterprises in Advanced Economies: Assessment and Policy"; and IMF staff calculations.

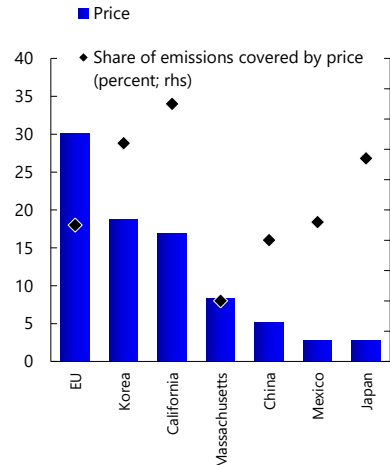
1/ Overall refers to all industries within a country and then taking a weighted average across countries.

Invest in a sustainable and inclusive future

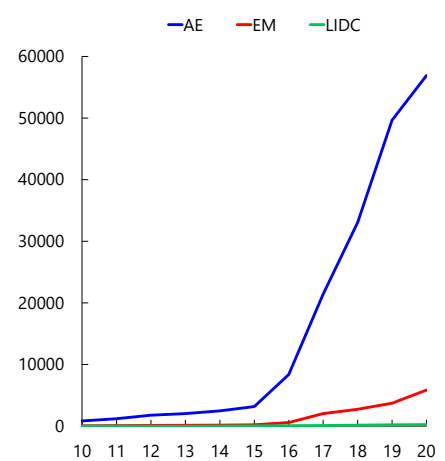
Change in investment needed in 2021-30 for sustainable development 1/ (billion 2019 USD; annual average)



Prices in implemented carbon pricing initiatives 2/ (carbon price US\$/tCO₂e)



Digital divide: Internet servers (average number of servers per million population)



Sources: International Energy Agency; World Bank, *Carbon Pricing Dashboard*; IMF staff calculations.

1/ The figures show the difference between the annual average investments in the decade 2021 to 2030 in the Sustainable Development Scenario (SDS) and the historical annual average investments in the decade 2011 to 2020. The investments include both public and private investment. The IEA's Sustainable Development Scenario envisages universal access to energy, tackling air pollution, and keeping warming to less than 2 degrees Celsius above pre-industrial levels.

2/ The October 2019 Fiscal Monitor estimates a US\$75 per ton carbon tax is consistent with staying within 2 degrees Celsius warming.

Policy recommendations

Policymaking under high uncertainty to limit divergences

Tailor policies to country circumstances, including the stage of the pandemic, strength of recovery, and structural characteristics. Short-term support should be anchored in credible medium-term frameworks.

Phase 1. Escaping the crisis.

- Ensure adequate **vaccine production and distribution**
- **Target fiscal policies** to the most affected;
- **Maintain monetary accommodation** until mandated policy objectives are achieved and provide clear forward guidance and communication.
- Take **early action and tighten selected macroprudential tools** to address specific pockets of vulnerabilities and safeguard financial stability.
- In EMDEs flexible exchange rates can help absorb impact of gradual increase in interest rates. In response to disorderly market conditions FXI and CFM/MPMs can help in countries with shallow FX markets.

Phase 2. Safeguarding the recovery.

- As pandemic durably recedes and recoveries strengthen, government **furlough and short-time work programs should be scaled back** (but avoid fiscal cliffs), supplemented with income support to manage transition and targeted hiring subsidies.
- Support **retraining and reskilling**.
- Remedial policy actions will be needed to **reverse the setback to human capital accumulation**.

Policy recommendations

- **Support balance-sheet repair for a sustainable recovery, by expediting bankruptcy procedures to facilitate reallocation, strengthening NPL management, disposing of problem assets through market-based solutions.**
- **Where space permits**, fiscal support should be deployed with an emphasis on **green and digital infrastructure**, research, education.
- **Rebuild fiscal space** through increased revenue collection, greater tax progressivity including possibly a temporary COVID-19 recovery contribution levied on high incomes or wealth, and by reducing wasteful expenditures.

Phase 3. Investing in the future.

- Build a more inclusive economy through strengthening social assistance and social insurance.
- Build an environmentally sustainable economy through investing in climate mitigation, carbon pricing, and adaptation
- Resolve debt overhangs.
- **Strong international cooperation is vital at every phase for achieving these objectives and limiting divergences-**
 - To ensure universal access to vaccines and therapeutics; to give confidence through availability of international liquidity; provide ordered procedures for debt reprofiling and restructuring;
 - To mitigate climate change;
 - To resolve trade and technology tensions;
 - And, in the area of international corporate taxation, to limit cross-border profit shifting, tax avoidance and evasion, and to agree on a reform that modernizes international corporate taxation, avoiding tax competition and unilateral measures.

The new SDR allocation and concessional financing for LIDCs are necessary to strengthen trust and confidence in the functioning of the international monetary system and to help the attainment of development objectives.

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