



**Executive Board Minutes 22/35-1**

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**World Economic Outlook; Global Financial Stability Report; Fiscal Monitor**

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

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CEDA OGADA  
Secretary

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<sup>1</sup> 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 Open Archives Policy.

## THE CHAIR'S SUMMING UP

Executive Directors broadly agreed with staff's assessment of the global economic outlook, risks, and policy priorities. They noted that the war in Ukraine has led to a costly humanitarian crisis, with economic and financial repercussions and spillovers—through commodity markets, confidence, trade, and financial channels—that have prompted a downgrade to the global economic outlook and increased inflationary pressures at a time when the global economy has not yet recovered from the COVID-19 crisis. Directors concurred that the sharp increase in uncertainty could make economic projections especially volatile. They agreed that emerging risks—from an intensification of the war, further sanctions on Russia, fragmentation in financial and trade markets, and a sharper-than-expected slowdown in China due to COVID-19 outbreaks—on top of the continued risk of new, more virulent COVID-19 strains have further tilted the balance of risks to the downside. Moreover, Directors noted that the war in Ukraine has increased the likelihood of food shortages and wider social tensions given higher food and energy prices, which would further adversely impact the outlook.

Against this backdrop, Directors agreed that policy priorities differ across countries, reflecting local circumstances and differences in trade and financial exposures. Directors emphasized that the layering of strains—slowing economic growth, persistent and rising inflation pressures, increased food and energy insecurity, continued supply chain disruptions, and COVID-19 flare-ups—further complicates national policy choices, particularly for countries where policy space shrank after the necessary response to the COVID-19 pandemic. At the global level, Directors stressed that multilateral cooperation and dialogue remain essential to defuse geopolitical tensions and avoid fragmentation, end the pandemic, and respond to the myriad challenges facing our interconnected world, particularly climate change.

Directors concurred that, in many countries, fiscal policy is operating in a highly uncertain environment of elevated inflation, slowdown in growth, high debt, and tightening borrowing conditions. While acknowledging that fiscal policy has a role to play in moments of large adverse shocks, Directors considered that, particularly for countries with tighter budget constraints, fiscal support should focus on priority areas and target the most vulnerable. They emphasized that, in countries where economic growth is strong and where inflation is elevated, fiscal policy should phase out pandemic-related exceptional support, moving toward normalization. Directors acknowledged that many emerging markets and low-income countries face difficult choices given limited fiscal space and higher demands on governments due to energy disruptions and the pressing need to ensure food security. In this context, they underscored that a sound and credible medium-term fiscal framework, including spending prioritization and measures to raise revenues, can help manage urgent needs while ensuring debt sustainability. Directors stressed that short-term measures to

mitigate high food and energy prices should not undermine actions to ensure greater resilience through investment in health, food, and cleaner energy sources.

Directors concurred that monetary authorities should act decisively to prevent inflationary pressures from becoming entrenched and avoid a de-anchoring of inflation expectations. They noted that central banks in many advanced and emerging market economies need to continue tightening the monetary policy stance to bring inflation credibly back to target and preserve hard-built policy credibility. Directors stressed that transparent, data-driven, and clearly communicated monetary policy is critical to avoid financial instability. They considered that, should global financial conditions tighten suddenly, emerging and developing economies could face capital outflows and should be ready to use all available tools, including foreign exchange interventions and capital flow management measures, when needed and in line with the Fund's Institutional View on the Liberalization and Management of Capital Flows and without substituting for exchange rate flexibility and warranted macroeconomic adjustments.

Directors agreed that the war in Ukraine will test the resiliency of the financial system. They noted that, although no systemic event has materialized so far, financial stability risks have risen along many dimensions while global financial conditions have tightened significantly. Directors concurred that, in those emerging markets where the sovereign-bank nexus could pose vulnerabilities, it should be closely monitored. They also noted risks of fragmentation of capital markets and payment systems, the creation of blocks of central bank digital currencies, a more widespread use of crypto assets, and more frequent cyberattacks. Directors recommended tightening selected macroprudential tools to tackle pockets of elevated vulnerabilities while avoiding procyclicality and a disorderly tightening of financial conditions. They also called for comprehensive global standards and a multifaceted strategy for crypto assets and for a more robust oversight of fintech firms and decentralized finance platforms.

Directors agreed that strong multilateral cooperation is essential to respond to existing and unfolding humanitarian crises, safeguard global liquidity, manage debt distress, ensure food security, mitigate and adapt to climate change, and end the pandemic. Noting that many countries are coping with higher volatility, increased spending from the pandemic and humanitarian crises, and tightening financial conditions, Directors called on the Fund and other multilateral institutions to stand ready to provide financial support. At the same time, they noted that prompt and orderly debt restructuring, particularly by improving the G20 Common Framework, will be necessary in cases where liquidity support is insufficient. Directors noted that increasingly dire climate change developments heighten the urgency for tangibly advancing the green economic transformation. They stressed the importance of intensifying efforts to implement the COP26 roadmap together with appropriate measures to address energy security concerns. Directors considered that international cooperation in corporate taxation and carbon pricing could also help mobilize resources to promote the

necessary investments and reduce inequality. As the pandemic persists, Directors underscored that prompt, equitable, and wider access to vaccinations, testing, and treatments remains a key priority. They also reiterated that measures to address the scars from the pandemic remain crucial to boost long-term prospects and create a more resilient and inclusive global economy. Above all, Directors called for a peaceful resolution of the war in Ukraine, an end to the resulting humanitarian crisis, and a return to the rules-based international order that helped lift millions out of poverty over the past decades.

**EXECUTIVE BOARD ATTENDANCE<sup>2</sup>**

K. Georgieva, Chair

**Executive Directors**

I. Mannathoko (AE)  
A. Andrianarivelo (AF)

C. Huh (AP)  
A. Bevilaqua (BR)  
Z. Jin (CC)

P. Jennings (CO)  
D. Palotai (EC)  
A. Buisse (FF)  
J. Stephan (GR)  
S. Bhalla (IN)  
D. Fanizza (IT)  
T. Tanaka (JA)  
H. Hosseini (MD)  
M. Mahmoud (MI)  
P. Hilbers (NE)  
M. Pösö (NO)  
A. Mozhin (RU)  
A. BinZarah (SA)  
R. Lim (ST)

S. Riach (UK)  
E. Shortino (US)

**Alternate Executive Directors**

L. Herrera (AG)

A. Guerra (CE)

M. Peter (SZ)

C. Ogada, Acting Secretary  
J. Puig / R. Dall'Orto, Summing Up Officers  
D. Alcantara / E. Mannefred / M. Mehmedi, Board Operations Officers  
L. Nagy-Baker, Verbatim Reporting Officer

**Also Present**

African Department: P. N'Diaye, A. Tiffin. Asia and Pacific Department: A. Gulde, S. Panth, S. Peiris, K. Srinivasan. Communications Department: F. Gimbel, N. Ismail, H. Kruglik, C. Rosenberg, A. Schimmelpfennig. European Central Bank: D. Rakitzis, R. Rueffer.

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<sup>2</sup> For countries in each constituency, please see the Constituency Codes in the annex.

European Department: B. Akitoby, J. Decressin, A. Kammer. Fiscal Affairs Department: J. Fournier, S. Hebous, G. Hong, Y. Kinoshita, W. Lam, V. Louca Rabaca Gaspar, P. Mauro, P. Medas, A. Nguyen, R. Perrelli, A. Senhadji, C. Soares Goncalves, A. Solovyeva, G. Zinabou. Finance Department: Z. Murgasova. Institute for Capacity Development: M. Erbenova, R. Nord. Independent Evaluation Office: C. Collyns. Information Technology Department: C. Parent. Legal Department: K. Christopherson Puh, R. Weeks-Brown. Middle East and Central Asia Department: J. Azour, S. Berkmen, C. Serra Ronceros. Monetary and Capital Markets Department: N. ABBAS, T. Adrian, R. Ajit Singh, U. Das, A. Deghi, A. Garcia Pascual, D. Gautam, M. Khamis, F. Natalucci, M. Qureshi, J. Vandenbussche, J. Williams. Office of Budget and Planning: J. Tyson. Office of Risk Management: B. Boulwood. Research Department: P. Barrett, J. Bluedorn, M. Dao, P. Gourinchas, P. Koeva Brooks, D. Leigh, M. Nabar, J. Natal. Strategy, Policy, and Review Department: S. Danninger, K. Kang, V. Klyuev, C. Pazarbasioglu Dutz. Statistics Department: A. Richter. World Bank Group: M. Kose. Western Hemisphere Department: N. Chalk, I. Goldfajn. Alternate Executive Directors: A. Alhosani (MI), M. Alrashed (SA), C. Amarasekara (IN), H. Azal (EC), L. Dresse (NE), M. El Qorchi (MD), F. Fuentes (BR), A. Grant (AP), C. Just (EC), M. Kashima (JA), A. Marcussen (NO), M. Massourakis (IT), F. Mochtar (ST), W. Nakunyada (AE), R. N'Sonde (AF), F. O'Brolchain (CO), O. Parkyn (AP), V. Rashkovan (NE), C. Roman (FF), J. Romero (CE), D. Ronicle (UK), B. Saraiva (BR), F. Sylla (AF), V. Vumendlini (AE), Z. Zhang (CC). Senior Advisors to Executive Directors: A. Abdullahi (AE), S. Ahmed (MD), H. Andrianometiana (AF), X. Bai (CC), E. Cartagena (CE), M. Choueiri (MI), R. Cunningham (CO), Patterson C. Ekeocha (AE), J. Garang (AE), R. Goyal (IN), P. Harvan (EC), O. Hendrick (AG), M. Ismail (AE), L. Johnson (AP), H. Koh (GR), B. Lischinsky (AG), R. Mahabir (BR), M. Maldi (AE), L. Marek (EC), A. Medearis (US), T. Nguema-Affane (AF), C. Quagliarini (IT), C. Sassanpour (MD), M. Scholer (NE), M. Sidi Bouna (AF), L. Smith (CO), F. Spadafora (IT), S. Spurga (NO), N. Thiruvankadam (IN), A. Tolstikov (RU), S. Tsur (NE), R. Velloso (BR), M. Villeneuve (CO), S. Wongwaisiriwat (ST), B. Yoo (AP). Advisors to Executive Directors: T. Abalala (SA), T. Abdygulov (SZ), N. Abu Bakar (ST), M. Albert (FF), F. Al-Kohlany (MI), P. Al-Riffai (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), Dennis Bautista (ST), S. Belhaj (MD), M. Boehme (GR), B. Boostani (MD), I. Bustillo (AG), Campbell (UK), T. Chrimes (UK), J. Corvalan (AG), R. Karl (AP), P. Khademi (GR), R. Kraavik (NO), F. Kurniawan (ST), C. Kuth (SZ), G. Meizer (EC), M. Merhi (MI), D. Milutinovic (NE), P. Mooney (CO), R. Moral Betere (CE), K. Nelson (UK), I. Ogihara (JA), Y. Qi (CC), A. Rao (US), F. Rawah (SA), D. Shestakov (RU), E. Shimada (JA), B. Singh (IN), B. Slettvag (NO), L. Sturm (US), A. Tola (SZ), C. Westphal (US), O. Zubareva (RU), J. Barroso (BR), B. Commaroto-Roverini (US), M. Law (CC), F. Lopez (CE), A. Mairate (NO), D. de Waziers (FF).

**DISCUSSION RECORD<sup>3</sup>**

*The Chair:*

We are in an extraordinary time to discuss the outlook and the degree of uncertainty we all face. We downgraded the outlook in January already. It was a small downgrade, relatively speaking, and, most importantly, at that time we expected that the impact of Omicron impact would be over soon, and the world economy would return to a path of recovery. That unfortunately has been interrupted by Russia's invasion of Ukraine with a massive humanitarian crisis in the country and spillovers setting back the global economic recovery. This is a very difficult time, but it is also a time when we need to come together and work together as one community.

I want to apologize on behalf of management for the delay in getting the report to the Board. I apologize profoundly, but it is not the staff that we should criticize because staff had to recalibrate the flagships in a very short period of time. We had one trajectory. Now we have a different one, and we, as management, had to review and clear the flagships wrestling with the new information and the new clouds of uncertainty. It is truly an extraordinary effort of staff to bring a high-quality document to the Board.

We would like to focus today's meeting on the economic and fiscal outlook and global financial stability assessment, but I want to stress that we have ongoing work on impact, including on likely balance of payments' financial needs and implications for the use of Fund resources. This work continues, and we will brief the Board separately on these important issues later today. As always, the flagships are key for the discussions at the Spring Meetings, and I am very eagerly looking forward to hearing Directors' views in addition to their very thoughtful, very useful gray statements we have already received, which staff read through very carefully.

Let me recognize the Board's support for an innovation we made some time ago during previous flagship presentations to prerecord the presentation, so Directors have a chance to carefully listen to them, and that, of course, makes it possible for us to step into the meeting with the Board much better prepared as a result.

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<sup>3</sup> Edited for clarity.

*The Economic Counsellor and Director of Research (Mr. Gourinchas):*

As you have seen in the recorded WEMD presentation for the Board, the global economy's recovery was shaken by the Russian invasion of Ukraine. Let me emphasize some of the main takeaways from our analysis presented in the upcoming WEO. The war layers a large negative supply shock upon a global economy that had not yet fully recovered from the pandemic. It is the main driver of a significant downward revision of global economic activity and a large upward revision of global inflation. Slide 1 shows, on the left graph, the path for global output that we are projecting, together with the previous projections as of January 2022. We have a large downward revision driven mostly by the decline in economic activity in Russia, also in the Euro Area caused by the war. Additional factors are the withdrawal of fiscal support in many economies, the tightening of monetary policy in the US and other countries, and a slowdown in China in the context of Omicron lockdowns.

The middle panel on Slide 1 shows that inflation everywhere is revised significantly upwards, and it is expected to persist in the near term. Our projections put inflation, the peak of inflation, at 7.8 percent year-on-year in the second quarter of this year.

We emphasize in the WEO that the risks are to the downside. We have the potential for an escalation of the conflict, the disruption of commodity markets and global supply chains, possible social unrest in many countries due to increase in food and energy prices and the risk of further fragmentation of the global economy, something that is very present in policy discussions. New COVID variants could emerge, and we could have a bigger slowdown in China due to additional lockdowns.

Higher inflation expectations, higher interest rates, and increased debt distress are additional factors, and all these risks could lead to more adverse outcomes. The policy tradeoffs have become ever more challenging in this environment compared to what we were projecting as of January. On the policy front, the first objective for monetary policy in many countries will be to contain price pressures and make sure that inflation expectations remain well anchored. At the same time, monetary authorities will aim to safeguard the recovery.

On the fiscal side, the extraordinary support extended during the pandemic in many countries needs to be removed as the health situation improves, but policy has to strike the right balance between the need to

rebuild fiscal buffers and to protect vulnerable populations. In this environment, multilateral cooperation will be critical to navigate the upcoming challenges.

Let me now turn to our projections (Slide 8). World growth is revised downwards 0.8 percentage points compared to the January WEO, from 4.4 to 6.3 percent with no rebound in 2023. We are cognizant of the uncertainties of making projections in this environment, and the WEO also provides an adverse scenario in a scenario box where we consider more extreme assumptions on the sanctions on Russia, stronger disruptions in energy markets, some moderate upward drift in short-term inflation expectations, and tighter financial conditions. In our simulations, this leads to an additional 2 percent decline in global output by year-end 2023 relative to the baseline.

Among advanced economies, the growth revision is largest in the Euro Area, negative 1.1 percentage point, and also the UK, negative 1 percentage point, due to their strong links in energy trade with Russia and in the case of the UK, a downward revision in investment and consumption in a context of elevated inflation that erodes real income. For the US, the downward revision is more modest, 0.3 percentage point downward, and mainly driven by the faster expected tightening of the U.S. Federal Reserve interest rate path in light of increasing and broadening inflation. The direct impact of the war is quite limited.

Let me now turn to emerging and developing economies (EMDEs). On Slide 9, the growth revision for this group, which can be seen on the first column, negative 1 percentage point to 3.8 percent in 2022 is considerably larger than for advanced economies, negative 0.6 percentage point and is mostly driven by the revision to Russia's growth in 2022, where we were projecting a contraction by 8.5 percent. Large commodity-importing emerging markets like India are also seeing their growth prospects downgraded in the case of India by 0.8 percentage point, as well as commodity-importing low-income countries (LICs), negative 0.7 percentage point in the last column due to the increase in energy and commodity prices.

Commodity exporters as a group stand to benefit from the commodity price booms and are the only group that sees an upgrade to growth in 2022, plus 0.4 percentage point and plus 0.1 percentage point for exporting low-income countries. We want to emphasize there is significant heterogeneity in that group, and some of the countries will also suffer from the negative spillovers due to the financial tightening and rising global interest rates.

China's growth is further downgraded by 0.4 percentage point to 4.4 percent below the authorities' growth target on the back of weakening private consumption due to COVID lockdowns, troubles in the property sector, and some weakening of external demand.

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

Let me briefly turn to global financial stability. I will make four points.

The first point is that global financial conditions have tightened, though there is quite a bit of differentiation across regions (Slide 3). The sharpest tightening is visible in Europe, Middle East, and Africa, excluding Russia and Ukraine, where the tightening was extreme. The only exception here is Asia, where global financial conditions have continued to ease. In much of the rest of the world, including the US, Euro Area, and other advanced economies, as well as emerging markets outside of China, global financial conditions have tightened. In terms of downside risks to global growth, this is firmly tilted to the downside.

My second point is about the transmission of the War in Ukraine on the rest of the world (Slide 4). The main transmission channel is through higher commodity prices, higher food prices, higher metals prices, and higher energy prices (Slide 5-6). This has dealt a significant shock to inflation all over the world in an environment where inflation was already above target in the vast majority of countries. Slide 7 shows, on the right, emerging markets in Latin America and Eastern Europe where clearly inflation is high but is expected to come back down to target. The only exception in terms of inflation again is Asia, where inflation remains below target.

As a result of this additional supply shock, the policy path implied in markets has shifted up sharply all over the world. Slide 8 shows, for example, for the US, in chart on the left, from 2021-end to the latest, there is more than 100 basis points increase in the policy rate one year out. A similarly sharp move is visible for the ECB, Latin America, and Central and Eastern Europe. Again, the only exception in terms of monetary policy is the emerging market, Asia.

My fourth point is about capital flows. We have seen outflows in some countries, but there is a lot of differentiation across emerging markets, and, in fact, some emerging markets have seen inflows of capital. Those that are hit

hardest are frontier markets. Slide 11 shows, in the chart on the left, that many countries are now in distress where we count distress as a spread above 1,000 basis points. The middle chart also shows that commodity importers are hit particularly hard. This is showing the credit spreads here, but we can look at many other matrices as well including in terms of capital flows. Finally, capital flows at risk, so the risk of capital flows reverting is particularly high for some emerging markets (Slide 12).

Now, capital flows have reverted, particularly for China, but as I said earlier, in some emerging markets there is a return of capital. This includes, for example, Brazil and Thailand.

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

I want just to add a couple of points from the fiscal policy perspective, mostly for emphasis. As Mr. Gourinchas too emphasized, the prospects are divergent across groups of countries, and what we see here is that the advanced economies will be very close to their pre-COVID path by 2024, but the same is not true for emerging markets and low-income developing countries. For the latter, the shortfall in growth relative to the pre-COVID-19 path will be in our projections at least, very persistent. The magnitude for emerging markets and low-income developing economies is respectively 5 percentage points and 6 percentage points, and these numbers are different from the ones I quoted in the prerecording. Please accept my apologies. My numbers were not in line with the updated charts.

Focusing on advanced economies, we have the very strong point in the Fiscal Monitor that in advanced economies from 2000 to 2020, public-debt-to-GDP increased, while the interest-to-tax ratio declined. I emphasized in the prerecording that this pattern does not hold for the developing world. There, from 2010 to 2020, we see increases in the public-debt-to-GDP ratio, accompanied by increases in the interest-to-tax ratio. That led me in the prerecording to emphasize debt risks for the developing world. I want here to do the reverse by giving some additional detail on advanced economies.

Slide 3 shows that the distribution of public debt ratios in advanced economies has become bimodal with lots of countries with public-debt-to-GDP ratios below 60 percent. This is the most numerous group in advanced economies and is dominated by relatively small countries. We have a few countries between 60 percent and 100, and a growing number with high debt levels above 100 percent.

What is very important to realize is that the ability to reconcile high levels of public debt with relatively low interest-to-tax ratios depend on price stability. If we look at the last 20-plus years, we see that in the Euro Area and United States, inflation has averaged close to the 2 percent target that these countries have adopted. Meanwhile, just to repeat a point made by Mr. Adrian, Japan had a lower increase in prices. As a matter of fact, during this 20-plus years, Japan did not have a price increase at all.

The point that I want to make for the purpose of this presentation is that this is very important for the demand for bonds on the part of investors. Having low and stable inflation makes the attraction of an asset that promises a safe and stable, nominal cash flow very attractive. In order to preserve that comparative advantage, in order to maintain sovereign bonds as the cornerstone of the financial system, one needs to deliver on price stability, and that is what I call the public debt manager or the treasurer's case for price stability, and I hope that I will benefit from my colleague, Mr. Adrian's approval.

*Ms. Riach:*

We know that much of the material had to be recalibrated over the last few weeks, and the resulting documents are eagerly awaited by the outside world, even more so than usual, and they do not disappoint. Against the tragic backdrop of the War in Ukraine, the documents do an admirable job of sticking to the facts and explaining in measured language the economic ramifications of the Russian President's actions. The careful framing of policy recommendations will be very helpful for policymakers.

We are grateful that staff include a frank analysis of the economic consequences for Russia and for the wider global economy of sanctions, and we tend to agree with Mr. Fanizza that the assumption of no additional sanctions on Russia already appears unrealistic. It is also important to remember that, as Mr. Stephan said in the Board last week, the sanctions are a direct consequence of Russia's unjustified and unlawful invasion of Ukraine, and the way to stop the sanctions is to end the war.

I am sympathetic to Mr. Hilbers's desire for a more granular analysis of the evolving economic situation in Ukraine and in its direct neighbors. Like him, I hope we will be able to cover some of this in the regional economic outlook discussions this week, and I support his suggestions on keeping the Board updated on staff's important work in the region.

Just as the documents do an excellent job of analyzing the impacts of recent events, we must also recall that even before the war, policymakers were grappling with an exceptionally difficult combination of challenges and limited policy space. Some of the risks identified in previous flagships are now crystallizing. These have been accentuated by Russia's actions and by the resulting shocks, including in commodity markets. The consequences for the IMF's most vulnerable members, particularly low-income countries and fragile states who already faced acute challenges, are deeply concerning. With particularly limited policy space and depleted buffers, they face increasingly difficult policy tradeoffs, as Ms. Mannathoko and others outlined. Focus on and support for those members must continue. As the Managing Director has said before, the Fund has a particular responsibility to be strongest for its weakest members.

On inflation, we agree with staff that clear and transparent communication and data-driven policymaking will be key. There are risks from central bank inaction, but we must also be subtle in our reading of inflation and its drivers. Inflation may be high now and higher still as a result of the War in Ukraine, but the pressures from supply-demand imbalances and higher energy and food prices are still projected to slacken under the baseline. Where inflation expectations are most at risk are where the withdrawal of accommodation is still in its early stages. Further withdrawal of stimulus is warranted, but where expectations are at or below target, policy should be set with expected inflation at the relevant horizon in mind, or we risk an overly severe or abrupt correction.

Finally, we underscore that the vulnerabilities exposed in nonbank financial institutions (NBFIs) by the March 2020 dash-for-cash episode still need to be addressed. We thank staff for their ongoing engagement with the Financial Stability Board's (FSB) work and their commitment to include an explicit reference to this important reform agenda in the Global Financial Stability Report (GFSR) in response to our gray statement.

*The Chair:*

I want to recognize what Ms. Riach said about assumptions being outdated when it comes down to sanctions. We too had the same point internally, as Mr. Gourinchas will reflect, but we have to objectively accept that there is a cutoff date as we determine the baseline. The team has done a very good job showing an adverse scenario and what it might mean.

*Ms. Mannathoko:*

We issued a detailed gray statement where we expressed our concern over the costly humanitarian crisis caused by the war and the significant spillovers that have been seen in trade, as well as inflation of costs, and that have really led to this downgrade that we see and fueled food inflation, especially in energy insecurity and food insecurity. For us, securing peace should really be a priority for the international community. Beyond that, multilateral cooperation is now really essential, more essential than ever to address the humanitarian impacts but also to protect the vulnerable and ensure food security and also to help preserve energy securities where this is key and sustain trade by preserving energy security, while advancing the green transition.

In addition, we continue to advocate for an effective Common Framework (CF), an effective debt architecture, and debt relief to help prevent a debt crisis going forward and for adequate global liquidity and flows that will enable recovery from the pandemic but also from this crisis and a return to sustained growth. We remain especially worried by the divergent prospects that were highlighted just now by Mr. Gaspar. The persistent shortfall in growth that is projected for diverging regions like Sub-Saharan Africa for us highlights the importance of finding ways to motivate investment flows to these regions and ensuring that international corporate taxation helps to support revenue mobilization in a meaningful way. We are in broad agreement with the policy prescriptions and especially appreciate the coverage of developing countries in the backing analysis. I will just want to maybe highlight two follow-up questions we raised.

First, on the global supply chain disruptions we had a question, if those disruptions were caused by the COVID waves? We are wondering whether there is some way for member countries to agree in advance on some sort of protocol for dealing with potential new waves to minimize disruptions. We know that sometimes lockdowns are seen as essential but maybe having a sort of consensus on how to deal with this in a less disruptive way would be something that could potentially be discussed.

Second, on international taxation, we had a question on the exclusion of mining companies, but this was in reference to Pillar II. Staff responded but with reference to Pillar I. Pillar II deals with the 15 percent minimum tax; so for us, given the critical importance of mineral revenues for countries in our region, we just wanted to encourage looking at this issue and maybe comparing what the implications would have been if the minimum tax was

applied to mining companies, maybe even at 25 percent, which had been the initial request for Sub-Saharan Africa. We can always talk about this bilaterally.

*Mr. Buissé:*

I can also, of course, very much support the introductory remarks by Managing Director and the counsellors. There is no doubt in my mind that this publication is very much awaited in this fast-moving world, and there will be a lot of comments from the outside world. It is great that we can discuss it today.

First, on our side, it is clear that the outlook has worsened and that the probability of further deterioration is unfortunately high with risks piling up. The pandemic is still very much present, but the War in Ukraine is clearly the main reason for this deteriorated outlook. Let me recall that we strongly condemn the aggression and are deeply worried by the humanitarian situation. The materialization of the downside scenario is every day more and more credible, and we will be looking forward for future economic updates.

A more persistent inflation is a worrying threat. A broad-based de-anchoring of inflation expectation has not been visible yet, and part of the inflation increase should revert with a reduction of supply bottlenecks. However, inflation could remain higher than expected due to second-round effects, and commodity prices remain very volatile. We strongly encourage staff to continue to work on the disentanglement between demand and supply and short-term and long-term factors in order to help to see a little bit more clearly in this very complex inflation outlook.

On other risks, let me fully agree with Tobias on the need to monitor closely the risk of capital flows, and I would add exchange rate depreciations in case of tightening of global financing conditions but also the risks associated to the NBFIs sector, crypto assets, and cyber risks.

Second, last January we emphasize the need to be agile on the policy front. This is even more true today. Restoring peace is the first determinant to boost growth, and vaccination remains key. The balancing act of the policy mix in such uncertainty is an increasingly delicate exercise, and the IMF has a decisive role to play to explain the tradeoffs, and the documents do an excellent job on that.

Just a few thoughts on fiscal tradeoffs. They are exacerbated. We agree on the need for a calibrated withdrawal of pandemic measures, depending on the health and recovery trajectory anchored in a credible medium-term fiscal framework. Appropriate temporary and targeted measures are warranted to cushion the impact of increased food and energy prices and mitigate social tensions without detracting from the urgent energy transition.

Food or debt crisis could materialize, and LICs facing food insecurity are on the frontline. They deserve our greatest attention, and I fully agree with Ms. Mannathoko and Mr. Hosseini about the very difficult path to navigate given the need for fiscal consolidation alongside prioritization of spending. The Food and Agriculture Resilience Mission (FARM) initiative is a concrete action to a prevent crisis in this regard.

On monetary policy, the war pulls demand and prices in opposite directions. Clear central banks communication and guidance to anchor expectations are critical, but we also insist on the need to remain flexible and data dependent. The ECB is acting with optionality, gradualism, and flexibility.

Third, we strongly concur that international coordination will be critical to build resilience in all the areas mentioned by staff. On debt resolution, we echo Mr. Huh in encouraging staff to highlight the benefits for LICs of starting this process early and that G20 members will need to work together to ensure the Common Framework delivers on its potential.

Finally, we thank staff for a more systematic integration of climate issues in the report.

*The Chair:*

Since many Directors mentioned the criticality of dealing with debt before it becomes a debt crisis, I just want to second that and express hopes that we would see the Common Framework stepping up, as it is expected, and even if it does, we might still have to think aggressively about debt resolution. On FARM, we need actions now because if we do not take dramatic actions now, we will see people dying from hunger.

*Mr. Tanaka:*

We join Ms. Riach in reiterating our strongest condemnation against Russia for its aggression against Ukraine, and we would like to emphasize the

adverse effects of the sanctions attribute entirely to Russia's war. I would like to touch upon the following four points for emphasis.

First, regarding the global outlook and policy responses, we note the large downgrade of the outlook due to the war and agree with staff that the uncertainty is significantly high. While we positively note that the inflation risks have been generally well managed, central banks need to carefully monitor price developments and manage the challenging tradeoff between containing inflation and supporting the recovery. As price pressures are likely to further accelerate global tightening, possible negative spillover effects to emerging markets in low-income countries, such as rising funding costs and pressures on portfolio flows, are particularly concerning. Also, we need to stay vigilant to the risks to vulnerable people due to the high commodity prices, increasing rigidities, and the rise in vaccination rollouts.

Secondly, efforts to address long-term growth and climate change should not be halted. As the WEO Chapter 3 highlighted, labor reallocation is a necessary step to achieve the climate goal, and private investments should be guided to pursue greener society. We also fully agree with the staff that strong international cooperation is vital in all areas. We support the Fund's continued efforts in providing well-tailored surveillance, lending, and capacity development, based on its core mandate and expertise.

Third, on the fiscal front, we agree with staff that fiscal policy should be sufficiently flexible under such high uncertainty. Targeted support will remain important, while building fiscal buffers and credible medium-term fiscal frameworks are indispensable.

Regarding the international carbon price floor discussed in Chapter 2 of the Fiscal Monitor (FM), allowing different floors for major emitting companies could jeopardize the path to the 2050 net zero goal. We appreciate staff's response to our question, but we would like the staff to further refine the analysis, adding a new group for major emitters assuming the equivalent ambition towards 2050 net zero and corresponding carbon prices.

Lastly, on the sovereign bank nexus issue raised in Chapter 2 of the GFSR, we greatly appreciate the candid bilateral dialogue with staff on the past discussions at the Basel Committee. While we note that such risks are critical for some emerging countries, the issue of international regulatory standards on sovereign exposures has been particularly contentious and discussed in Bank for International Settlements (BIS) in a deliberate way.

Therefore, we ask the Fund to be extremely careful in its external communication on this issue.

*The Chair:*

Let me just emphasize Mr. Tanaka's point on how important surveillance is. It is always important, even more important in times of uncertainty. Staff recognizes that if we are to give meaningful advice to countries, our bilateral surveillance and now multilateral surveillance have to be prioritized, and that reflects our internal discussions as well.

*Ms. Shortino:*

There were challenges associated with the late arrival of the Chapter 1, but I appreciated having the additional chapters arrive early and conveying our comments electronically and would be open to such an approach in the future to enable a more streamlined set of gray statements and a more focused discussion in the Board.

Turning to the flagship reports themselves, I want to start by reiterating that Russia's unprovoked invasion has dealt the world another blow, a large negative supply shock while we are still struggling against and recovering from the pandemic. This shock was avoidable, and it is having grave consequences and widespread spillovers. I agree with Ms. Riach and Mr. Fanizza on the likelihood of additional sanctions and the fact that these sanctions are the direct result of Russia's actions.

We appreciate staff's effort to forge insightful policy recommendations in this difficult context and take into account the interaction of the impacts of the war and preexisting challenges, along with underlying vulnerabilities. We broadly agree with the messages in the flagship reports and the policy recommendations and the need to carefully calibrate monetary, fiscal, and structural policies. I will raise just a few points for emphasis.

First, on monetary policy, I just want to reiterate the points made that inflation remains a large challenge and agree with Mr. Gourinchas that the policy tradeoffs are quite challenging. Central banks, particularly in advanced markets, do not have an easy task ahead; but as I have said in past meetings, the Fed remains committed to clear and timely communication on their policy changes.

Second, I would like to reiterate the importance of addressing spillovers from this crisis, in particular for those low-income countries that are at risk of a global food crisis and impacted by rising energy prices. I would urge the Fund to move very quickly to incorporate the impacts of these spillovers into surveillance and policy advice, particularly for those countries without fiscal space and at a high risk of debt distress. These spillovers will impact debt sustainability and underscore the importance of implementing, to the fullest extent possible, the Common Framework.

Third, we appreciate the attention to climate issues throughout the reports. I would just make one note on the GFSR, that from our perspective, energy security and energy transition are complementary rather than at odds and should be addressed in tandem. The war on Ukraine and its impact on energy prices clearly highlights the importance of accelerating our transition to energy transition and away from fossil fuels.

Fourth, we welcome the Board and the Fund still agreeing on the priority of tackling the pandemic and accelerating vaccinations and therapeutics, and, importantly, boosting capacity to put vaccines to good use. We need to maintain our focus on efforts to prevent scarring through underlying structural reforms.

Finally, we agree with the need for international coordination and a multilateral approach. Without it, the global economy will struggle to recover, and the world's most vulnerable people will suffer the most.

*The Chair:*

On the pandemic, I would like to note that we are coming up with a more granular understanding, including of what we have learned and how to deal with it thanks to Ms. Gopinath and the coauthors that came with a very substantive report—there is more that we are offering on the advice side and a clear call for what it would take from a funding standpoint to get to putting the pandemic in a less dangerous place, if we are not to eradicate it altogether. I am fully aware that we have a huge responsibility to integrate the looming food crisis and the difficulties low-income countries face in our work. Ms. Shortino, if we put energy security and transition somehow at odds with this, apologies; we will correct it.

*Mr. Pösö:*

Serious risks are clouding the downgraded global economic outlook, and I would like to start by stressing that it is Russia's invasion of Ukraine that is the key source of negative spillovers and risks to the global economy, not the sanctions taken in response. While the heaviest toll falls on Ukraine, the economic effects from the invasion will be felt far beyond Ukraine and Europe, and not least in low-income and developing countries, which will be hard hit by rising food and commodity prices. The importance of global cooperation cannot be overstated in these circumstances, and we fully support the strong and synchronized call for multilateralism through the flagship reports.

We also note that inflation is now expected to remain elevated for longer. We agree that the appropriate monetary policy response should be country-specific, data dependent, and clearly communicated, and we appreciate the emphasis on avoiding de-anchoring of inflation expectations. Indeed, risks to the inflation forecast seem to be firmly on the upside with lagged effect from higher commodity prices possibly combined by renewed supply chain disruptions and pent-up wage increases. We would welcome if staff would elaborate on the factors contributing to the expected softening of inflation in the near term, in particular in advanced economies. When it comes to central banks, it would be interesting to hear staff's reading of financial markets on how much and how long the major central banks need to tighten before their monetary policy stances are not accommodative anymore.

On the energy market developments, it is becoming clear that the demand for Russian energy will diminish over the short- to medium-term. We should keep in mind that energy reliance has many dimensions, such as import share of energy consumption and the structure of the imports, and we would caution against using import shares from Russia as a measure of energy dependence. For example, Lithuania has already stopped all imports of Russian gas, with Estonia set to do so by the end of this year. Also, Finland can hardly be considered as dependent on Russian energy, as most of the implemented crude oil is for refinement, which can be purchased from other producers. In this regard, we would welcome if staff could clarify the intended message of Figure 1.8 on Page 18 in WEO, in particular Panel 3, on energy imports from Russia.

Finally, like Ms. Shortino also said, the recent events have underscored the need for accelerating the transition to green energy. We agree that steep changes in fiscal policy, including on carbon pricing and fuel

subsidy reforms, are more important than ever. Such reforms are, however, challenging when high energy prices risk harming the most vulnerable. We, therefore, appreciate the nuanced policy advice on dealing with the spike in commodity prices in the Fiscal Monitor. That is, avoiding generalized price subsidies, allowing domestic prices to adjust, and providing targeted, temporary, and direct support to vulnerable households.

*Mr. Hilbers:*

As we stated in our gray statement, we regretted a bit that we had limited time to reflect on the analysis and the advice, but we very much appreciate Managing Director's words at the outset of this meeting, and we agree with Ms. Riach and others that the documents did certainly not disappoint after they were sent to us.

Before turning to staff's analysis of the current economic and financial situation, I want to remind my Board colleagues of the continuous human suffering that the unjustified war is causing in Ukraine. On top of these large human costs, the unlawful invasion is also a key source of the significantly worse economic outlook. The war is the problem, not the sanctions. The very best thing that can be done at this point in time is for Russia to end the war, and the sanctions are aimed at that, a point also made by a few proceeding speakers.

While we welcome staff's analysis on the international implications of the war, and while we realize this is not easy, we are a little bit disappointed about the lack of a more granular analysis of the impact on Ukraine itself and other heavily affected countries in the region. All the countries that I represent are feeling indirect effects from the invasion, be it from a massive influx of refugees, impediments to trade and remittances, larger financing needs, or higher energy and food prices. Any further work on that would be highly appreciated by my chair. These economic repercussions add to an already existing set of interconnected challenges that weigh on the world economy. Let me add four points on these challenges.

First, we agree that inflation will remain elevated for longer. Given high uncertainty and many downside risks, this may very well also carry into 2023, including in advanced economies. To avoid the wage price spiral, central banks will need to carefully monitor the situation and be ready to act if warranted by the data by providing clear communication to anchor medium-term inflation expectations. In this context, we also support Mr. Pösö's request for an in-depth analysis of the implications of the war on

global energy demand, supply, and prices, while also the impact on food supply and prices require attention, a point clearly made by Ms. Mannathoko.

Second, tightening monetary policy will add further pressure on already elevated public debt levels, especially in emerging economies and low-income countries. Quick progress on the Common Framework is essential. At the national level, while we agree that fiscal policy should soften the implications from high energy and food prices in a targeted and temporary manner, countries are well advised to keep in mind the importance of medium-term fiscal sustainability.

Third, we agree with Mr. Buissé and others that the current crisis reinforces the case for urgent action to address climate change. Higher food prices may provide a painful glimpse of a future with continued elevated global warming, while the spike in energy prices underlines the need to scale up renewable energy capacity. The Fund's advice on carbon pricing and related compensation measures for vulnerable households will be particularly relevant in the current situation. Incidentally, we very much appreciate Managing Director's leadership role on this issue, as also reflected in her feedback at the outset of this meeting on recent talks with the Egyptian authorities on COP27.

Finally, we agree with Managing Director, that the world has entered a more shock-prone phase. Confronting these shocks calls for renewed dedication to multilateralism. All the evidence points in this direction. Fragmentation of trade networks would further increase commodity prices. Lack of coordinated action on unsustainable debt levels risks a debt crisis that no country can hope to tackle or escape climate change on its own. In short, we need more, not less multilateralism.

*The Chair:*

We recognize we need more granularity, especially where spillovers are most significant. There will be the regional updates, so one would find more granularity in those updates, and the work continues. Thank you for the recognition that when we look at the food crisis now, a big part of it is due to the war, but also to climate shocks that have reduced harvests in many parts of the world already.

*Mr. Hosseini:*

We fully sympathize with staff for the difficulty of assessing the impact of the rapidly unfolding global crisis of yet unknown proportions and duration coming on the heels of a stubborn global health crisis not seen in centuries. We are in general agreement with the staff assessment and recommendation.

These are truly unsettling times with two overlapping global crises. There is a fundamental difference between the two. A strong global cooperation helped us through the pandemic as we faced a common enemy, but now we are facing a divided world and multiple challenges. Regretfully, globalization is giving way to polarization, a process that was already in train before the war but has been significantly accentuated by the war.

We have to recognize at the outset that a strong, rules-based multilateral relationship built on mutual trust is key to global prosperity and security. We have all greatly benefited from globalization over the past decades. Weakening and possibly permanently rupturing the links will be very costly. We are sailing in uncharted water. Wind direction and undercurrents are unpredictable, but we cannot afford to lose sight of the land and control of the water.

We were already anticipating that the world economy emerging from the pandemic would be very different from the one before the pandemic. The war in Europe however is adding another dimension and is likely to result in more fundamental change in the world economic order that we should prepare for. The impact of the war in Europe is already reverberating close and far with vulnerable populations everywhere being hardest hit by the steep rise in food and energy prices initially. Negative spillovers of scarring, however, would go way beyond that. Food insecurity has emerged as a major global concern, and social discontent is already evident on the streets and through ballot boxes, and the trend is worse.

We fully agree with staff that the unique nature of the two crises calls for policy response tailored to individual country circumstances. This has always been the case but more so now because of the uneven impact of the war on different countries, as well as the countries' uneven progress in fighting the pandemic. As we are focusing on the war in Europe, let us not lose sight of the war still being fought against the pandemic. The fact that the vaccination rates in a large number of LICs are still in single digits is very concerning.

Staff growth projection have been scaled back since January WEO and are likely to lower further as downside risk are becoming more apparent. The inflation crisis is also weighing heavily on the outlook, with inflation now anticipated to be higher for longer and to be less transitory than expected only a few months ago. Monetary policy tightening by leading central banks already underway before the crisis is reinforced by the crisis. As staff has pointed out, if the experience of fighting inflation is any indication, the high interest rate environment is likely to persist well beyond the inflation peak. We are concerned about the impact of the protracted period of very tight global financial market conditions on emerging markets and developing countries manifested in capital outflow, currency depreciation, and heavier debt service burden, in some cases setting in motion a troubling vicious circle. We find the tone of the GFSR not sufficiently alarmist regarding intensifying financial stability risks, especially in the light of the growing likelihood of sovereign and corporate defaults. The plight of high indebted LICs with no policy space and significant financing constraint is of particular concern. The steep rise in energy prices has been one of the most visible outcomes of the war. It has also intensified the focus on climate change mitigation policies and on the issue of energy insecurity.

We are all committed to a greener world, but fundamental to policy success as concluded by staff, and I am quoting them here, is ensuring that the pace of divestment from fossil fuel is commensurate with the speed of adoption of renewable energy, and critical to that is close cooperation between energy producers and consumers.

Also, while sharing the same green objective, we have to recognize that the means of achieving them could be different across countries, depending on their circumstances. Oil and gas producers, including those in our constituency, are facing important transitional challenges of their own while remaining committed to global energy balance and security.

*The Chair:*

It is critical that we use the convening power, the fact that we have 190 members, to protect what has served the world so well by continuing to work together. I want to explicitly state that I am behind the statement of staff with regards to the energy transition as they framed it in the report.

*Mr. Palotai:*

As we issued a detailed gray statement, I will just highlight a few points.

The World Economic Outlook rightly centers on the economic ramifications of the Russia-Ukraine war and the exacerbation of preexisting global challenges and tradeoffs. The Fund's risk balance surveillance is instrumental in getting a better understanding on how the main transmission channels will amplify existing risks but also on the new risks. In periods when forecasting comes with considerable uncertainty and downside risks dominate the outlook, we would welcome more scenario analysis with special focus on spillovers.

As for the communication of the flagship reports, considering the gravity of the current situation, we suggest prioritizing messages that call for strengthening multilateral cooperation on pressing global issues. The messaging needs to be synced across the flagships too. Fiscal policy advice should continue to advocate increasingly targeted support for the most vulnerable with due attention to the urgency of addressing looming threats to energy and food security. With the tightening of global financial conditions, however, countries face even harder budget constraints with debt sustainability coming to the fore.

Structural measures to enhance revenue mobilization and prioritizing expenditures will be essential to rebuild buffers. The series of adverse supply shocks are also complicating monetary policy dilemmas. Central banks need to carefully calibrate monetary decisions to prevent further second-round effects and the de-anchoring of the inflation expectations by also avoiding financial conditions that would stifle the recovery. Since monetary policy normalization in advanced economies is putting additional constraints on the financing conditions in EMDCs, clear communication from major advanced economies central banks is imperative to avoid further volatility.

While the post-global financial crisis (GFC) regulatory overhaul increased financial markets resilience, there is no time for supervisory complacency, and we particularly encourage further work on enhancing analysis of macrofinancial systemic risks. The GFSR chapters provide important insight into the financial implications of the current geopolitical tensions, including the type of exporters. We also agree on the need for gaining a deeper understanding of risks stemming from the sovereign bank nexus. However, further dimensions of funding vulnerabilities would also be

addressed with the same thoroughness. Taking a more coordinated multilateral approach, financial authorities, and international standard-setting bodies should also scale up the efforts to address emerging risk of cryptoization and decentralized finance.

Finally, despite the complex set of imminent challenges, we continue to attach great importance to retaining sustainability as a guiding principle of policy decisions.

*The Chair:*

Mr. Palotai brought up the issue of cryptoization. It is actually, indeed, something that this Board wisely gave us more space to work on, the topic of digital money. We will see this impacting payment systems and, overall, the direction of money.

*Mr. Bevilaqua:*

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

We agree that the War in Ukraine and lockdowns in Asia will slow down the recovery and put additional upward pressure on inflation. While for some this may indicate the need for policymakers to proceed with caution and be mindful of policy tradeoffs, we believe the case now is even clearer for monetary tightening and fiscal consolidation.

Let's consider first the so-called monetary policy tradeoffs mentioned in the flagships. The supply-side is even more constrained now than it was during the heights of the pandemic. The demand side continues to be strong and resilient in most economies, especially with tight labor markets. Meanwhile, short- and medium-term inflation expectations are clearly out of comfort zones, and long-term inflation expectations, which tend to be stickier, are starting to waiver. In this context, pretending there is a short-term tradeoff between inflation and output is, to be diplomatic, highly unproductive.

Inflation hurts disproportionately more the most vulnerable, which cannot protect themselves. Indeed, as history shows, time and time again, the cost of re-anchoring inflation expectations once they become unanchored can be extremely high. It is therefore alarming that advanced economies' central banks remain behind the curve with negative real rates projected to persist well into next year. It is also alarming that the IMF flagships, which should

advocate for sound policies, show unwarranted ambiguity even at this late stage when such high inflation rates may rapidly become entrenched in many jurisdictions. To further complicate the outlook, advanced economies may be forced to speed up considerably their monetary policy normalization down the road, heightening the risks of disorderly market conditions. Delaying tightening may only lead to further and faster tightening and to negative surprises later on with much higher costs in terms of growth, employment, and real wages. Ultimately, this boils down to variations on the theme of tradeoffs between inflation and growth, an issue the economic profession has long moved beyond. There are no stable tradeoffs. The best and only contribution of monetary policy to growth is to keep inflation in check and inflation expectations aligned with longer-term goals.

Second, let's consider fiscal policy tradeoffs. Debt levels are extremely high after two years of pandemic-related support measures, while interest rates are bound to increase, not only due to tighter monetary policy but also due to higher term and risk premia. All of this points to the need for fiscal consolidation with focus on revenue mobilization and expenditure rationalization to avoid compromising public investment and social safety nets. It is unfortunate that only a few months ago the Fund was arguing that ultra-low interest rates were here to stay, and the recovery itself created almost unlimited room for fiscal expansion. More than once, we had to defend fiscal consolidation plans in emerging market economies that were doing their homework against Fund advice to the contrary. Unfortunately, the flagships message this time around is not as clear cut as it should, as it leaves room for ambiguity, which may prove highlight detrimental to global economic health.

Finally, I want to touch on the issue of sovereign bank nexus. This is an important issue with potential macrocritical implications that deserves to be fully analyzed by the Fund, but here I want to strongly caution against trying to force the highly diverse situation across jurisdictions into one-size-fits-all recommendations. The analysis of this nexus and related recommendations must remain country specific. For example, having a national central bank that issues its own domestic currency and using treasury bonds instead of central bank bonds for liquidity management purposes in open market operations are critical to determine the riskiness of bank exposures to the sovereign. Similar ratios of government bonds held by banks may indicate quite different risks and vulnerabilities, depending on these other country-specific features.

While efforts to adjust the fiscal accounts and deepen domestic financial markets are key to enhance resilience to shocks, it may take some time to get there. Hence, trying to penalize banks for carrying domestic

sovereign debt may be counterproductive. This may end up increasing vulnerability to shocks and financial instability with the public sector possibly becoming more exposed to foreign exchange mismatches and volatile sources of funding. Moreover, while the analysis of the nexus is welcome, other international fora like the Basel Committee on Bank Supervision are better placed to establishing general recommendations on prudential regulations. Given the sensitivity and heterogeneous circumstances, which could lead to misunderstandings, like Mr. Tanaka, we ask the Fund to be extremely careful with its communication on this issue.

Before concluding, let me support what Mr. BinZarah said in his gray statement about the need to use balanced language on climate issues aligned with the Paris Agreement in our flagships and other reports. Calling for a faster transition without giving due attention to new, reliable, and affordable sources of energy may lead to higher volatility and lower growth, eventually delaying the transition that we all want to accomplish in an orderly fashion.

*The Chair:*

If there is ambiguity, we need to tighten up language so there is none. Just to say that our flagships convey a very straightforward message. We need price stability for growth, and we will make sure that this message comes through. What we heard from Mr. Gaspar today was very much in the same direction.

*Mr. Jennings:*

We also agree with Ms. Shortino on retaining the process of separated comments for the analytical chapters beforehand. I have five brief comments today.

First, we really appreciate the analysis on the effects of the War in Ukraine that is covered across all three reports. As staff analysis makes clear, Russia's decision to invade Ukraine is creating economic impacts globally through a range of channels, including soaring commodity and food prices, that undermine real incomes and household purchasing power, disruptions to trade and economic activity, which is slowing the recovery from the pandemic, and tighter financial conditions that can bring increased risk of financial distress. Russia's invasion of Ukraine is also creating a humanitarian crisis in Ukraine and an influx of refugees in neighboring countries. We strongly agree that a coordinated and multilateral response is required, and as

also noted by Mr. Hilbers, Mr. Hosseini, and others, we would like to see more analysis in support of robust response to address this crisis.

Second, I would like to echo Ms. Riach's comments on the importance of supporting small states, as they face particularly difficult challenges and tradeoffs at this time.

Third, like many others, we are concerned about high inflation and the risk of inflation becoming more entrenched. We broadly agree with the staff's recommendation for monetary policy, especially the emphasis on bringing inflation back to target and contain inflation expectations. In particular, we welcome the analysis of real neutral rates, as this is a key guidepost for monetary policymakers to determine the end point for monetary tightening. We would like to see more discussion of real neutral rates and more detail on staff's models and forecasts of them in future reports.

Fourth, the severe lockdowns in China are likely to prolong the global supply chain disruptions and put additional upward pressure on inflation globally. We think that more analysis on these developments and risk related to China's slowdown is warranted.

Finally, while the analyses in the reports was excellent overall, we found some of the language to be imprecise in the current context. In particular, we disagree with the WEO's characterization of several inflationary shocks, ranging from Russia's invasion of Ukraine to supply chain disruptions, as beyond the control of policymakers. We see ample scope for policymakers to address these challenges, most notably by Russia leaving Ukraine. It would be helpful for the WEO to call for actions to address these challenges, rather than suggest that they are uncontrollable.

*The Chair:*

Since Mr. Jennings echoed Ms. Shortino's recommendation for future distribution of reports in a way that we have done by default, not by design this time, we will take it under consideration.

*Mr. Andrianarivelo:*

We share the staff's overall assessment on the prospects and risks facing the global economy and their key policy recommendations. We have issued a detailed gray statement and would like to make the following comments for emphasis.

The conflict in Ukraine has led a global economic slowdown and has pushed global inflation to worrying high levels, particularly fuel and food prices, complicating the policy tradeoffs faced by many countries. The sharp increase in fuel and food prices are having damaging effects of LICs and have complicated policymaking in those countries, which have to address inflation pressures to avoid greater food insecurity and preserve social peace. Also, growing insecurity in some countries has further exacerbated pressures on food prices and food security. Like Ms. Shortino, we would have liked the food security challenge to be more forcefully addressed in the reports as much as they noted supply disruptions. Therefore, I would like to echo Ms. Mannathoko's point about limited policy options left in LICs, notably commodity importers, to address those challenges. We are already seeing those options being adopted in some countries, which include, among others, posing policy normalization and suspending petroleum price-setting mechanism to avoid social unrest. We would also like to point out that the fiscal policy recommendation to cut subsidies for fiscal consolidation in a context marked by soaring food and commodity prices can only lead to social unrest. In such circumstances, we welcome previous calls from multilateral institutions to aid countries facing greater food insecurity. Providing them with adequate financial support is crucial to preserve macroeconomic stability. We urge management and staff to recognize increasing financial needs from these challenges in program reviews and consider augmentations in ongoing arrangements. LICs' debt problem is also being exacerbated by tighter global financing conditions due to the monetary policy normalization and the War in Ukraine. This as well calls for accelerating the debt resolution agenda.

Renewed domestic effort and reinforced multilateral cooperation are necessary to undertake major structural changes to promote more inclusive and sustainable economies. It is important for all countries to continue to make progress in their digital transformation efforts, as well as their green energy transition. Multilateral coordination will be essential to address those challenges. The IMF has a critical role to play by continuing to provide adequate technical support and the necessary liquidity to members to help prevent the crisis from spreading further and stepping up as a key institution for multilateral cooperation.

*The Chair:*

I am sure one will see in the regional updates for the parts of the world that are particularly at risk —Sub-Saharan Africa, the countries that are neighboring Ukraine— much more detailed analysis of risks and especially

the risks now to food security. I take Mr. Andrianarivelo's point on the augmentation of ongoing arrangements as one that we are already thinking of and in two cases going beyond thinking, acting on it, so the Board in previous discussions did signal to us that the Board wants us to be forward leaning for the most vulnerable countries. We will certainly do that.

*Ms. Lim:*

We issued a comprehensive gray statement, and I will offer two comments today.

First, given the fluidity of the geopolitical situation and the corresponding uncertainty in policy responses, we see merit in preparing a range of diverse scenarios, which can be readily used as the situation unfolds. While we agree with staff that a prolonged conflict in Ukraine will have an important impact in staff scenario analysis, we echo Mr. Bevilaqua on the need to further emphasize its impact on long-term inflation expectations and the resulting need for stronger policy reactions. Also, a scenario which combines the worsening of the war with a more prolonged pandemic or widespread lockdowns in China and other countries in response to COVID-19 developments might be worth exploring to help countries visualize the degree of growth at risk so as to plan the risk of their limited policy space in a prudent manner.

Second, we are concerned that the war might deepen the scarring effects from the pandemic, notably in EMDEs with higher debt and limited policy space. However, we found the analysis of such scarring effects somewhat static and to be lacking in practical advice for these countries. At this critical juncture, we share Mr. Huh's comment that the Fund should be guiding its members on how to tackle near-term challenges in ways that are consistent with medium-term policy goals, particularly in terms of labor market policies. We see the chapter on the labor market as headed in the right direction, but like Mr. Chodos, we would appreciate analysis that is more parent to developing economies as they face greater transition challenges. A chapter on greener labor market is a good starting point, and we hope to see more analysis on how labor policies in developing economies help mitigate scarring effects and help lift their potential growth.

*The Chair:*

Ms. Lim's point about the medium term, the importance of not forgetting that we are not living only in 2022 and that we need to help countries prudently define medium-term policies, is very well taken.

*Mr. Bhalla:*

We broadly agree with the staff's assessment of prospects, risks, and policy advice but would like to raise a few points in the spirit of a healthy discussion.

We agree with the staff that owing to unfolding geopolitical developments, sanctions, and a resurgence of the pandemic in some areas are causing further supply chain disruptions, and world output growth may slow down. However, we feel a closer look is needed at the forecast for individual economies or country groupings. While we agree with the assessment that inflation has moved up, both in advanced and in EMDEs due to geopolitical developments, a rise in energy prices also reflects preexisting conditions resulting from rising global demand, i.e., a recovery from the pandemic.

It may also be useful to examine if the structural factors behind a secular decline in inflation until the pre-pandemic period are still at work or are waning. While in some advanced countries, real policy rates are rising from their low levels in tandem with the closing of the output gap, the assessment of neutral rates may become challenging in the context of emerging economies. The possibility of a sharp uptick in real interest rates makes for difficult policy choices going forward.

In our assessment, India's economic recovery should stay on course. Given its strong economic fundamentals, very limited direct trade exposure to Russia and Ukraine, a diversified trade basket, and a record level of foreign exchange reserves, the impact is expected to be relatively subdued. A distinguishing feature of India's response to the pandemic has been an emphasis on supply-side reforms rather than a total reliance on demand management, and this is expected to pay off in the near to medium-term.

We agree with the observation that there is a risk of tighter financial conditions and capital flow reversal for emerging market economies in anticipation of policy normalization in advanced economies. We endorse the staff's suggestions that emerging economies may need to tighten ahead of time targeting vulnerable segments of the economy and, if required,

employing foreign exchange interventions to address disorderly market conditions. At the same time, we also underscore that these should not be used to gain undue trade advantage or as a substitute for macroeconomic adjustment.

The analytical work on global trade and value chains, the WEO argues that with tariffs declining globally to a low level, there is still ample scope to reduce non-tariff barriers, particularly in emerging markets and low-income countries. It may be noted that though tariff barriers have been reduced, the past few years have seen an increase in protectionism amidst trade wars and sanctions. This has partially offset the benefits that low tariff barriers may have offered, hurting the global trade growth prospects. This calls for renewed efforts for reviving the WTO to establish a fair and rules-based global trade order.

Regarding greener labor market policies, it may be noted that a sizeable transition from emission-intensive manufacturing to the emissions-light services sector took several decades for advanced economies. Unlike these countries where labor is relatively skilled and flexible to move across sectors, reskilling in developing countries is difficult since a large part of the labor force tends to be semi- or low-skilled. In many developing countries where energy production is dependent on fossil fuels, the transition to low carbon may exhibit a chain reaction in many industries or sectors that are dependent on fossil fuel-based energy. This risks massive dislocation of the labor force simultaneously in several industries.

We are not in favor of the imposition of risk-sensitive capital requirements for stricter consideration limits or capital surcharges on bank holdings of the domestic sovereign, as proposed in the analytical Chapter 2 of the GFSR. We believe such measures are likely to create an uneven regulatory landscape and exhibit a lack of evenhandedness in the policy advice. We would also like to understand how the Fund's communication regarding the risk of sovereign bank nexus could alter the markets' risk perception about emerging market bonds at a critical juncture when emerging market economies are facing difficulties in accessing the global capital markets. The sovereign bank nexus needs to be dissected very carefully.

*Mr. Guerra:*

I will focus my remarks only in four points since we have issued a comprehensive gray statement.

First, on the need to continue with the vaccination efforts, the flagships highlight that we are far from reaching the goal for vaccination in low-income and some middle-income countries. This can have devastating implications in a context where the risks of the lack of vaccines and food security mixing. We call for the international cooperation on vaccination efforts to continue, and this should be an important message during the Spring Meetings.

My second point is very much related to what Ms. Lim talked about on the need to have a medium-term view of the policy advice and framework. Without doubt, the IMF has to address the short-term economic effects of the pandemic and the War in Ukraine, and there are sharp spillovers, especially in some low-income countries and middle-income countries that entered this second tail shock with high debt and low policy maneuver.

As Ms. Mannathoko also expressed, we have additional responsibilities, and that is to look at what follows next at the medium-term. In this, our increased structural budget allocation should be a timely support to address the structural reform agenda on financial stability, climate, digital, and increased resilience in vulnerable countries. We also expect that the Resilience and Sustainability Trust (RST) can have a supporting role in this regard, and we can reach an agreement that can address the structural reform agenda in a comprehensive manner in the medium-term.

My third point is that of the risks to multilateralism, and in particular, of fragmentation at the global level. This has at least two phases. One, as expressed recently by Mr. Bhalla on trade, there is the risk of fragmentation at the global level. The chapter in global value chains remind us on the need to keep markets open and agile, and the IMF has to continue the analysis in this regard.

The second risk of fragmentation is that of the digital money. This is something that we have seen because of the pandemic and the War in Ukraine. There has been an accelerated use of digital means of payment, so our current work on cross-border means of payments and central bank digital currencies (CBDCs) will be instrumental and timely to tackle this topic that is highly demanded by our membership.

*Mr. Huh:*

We broadly agree with staff's appraisal, and at the same time we are afraid that serious challenges, even after the pandemic, may allow many

EMEs scant room for preparing to address structural challenges for long-term growth potential. I would like to highlight five points for emphasis.

First, we welcome the acknowledgement of the significant uncertainties in the outlook and its assumption. In addition to further worsening of the geopolitical environment and the pandemic, there are risks around the increased social tension, worsening slowdown in China, and the higher interest rates, leading to widespread debt distress. Considering such uncertainties and diversified environments, we ask staff to update the economic outlook more frequently with more emphasis on bottom-up approach with alternative scenarios. Additional sanctions also seem to be highly plausible.

At the same, time we should not forget the over-pessimistic forecast during the pandemic by not properly reflecting unprecedented policy support. We note that countries' policy response, such as supplemented budget support to address geopolitical spillovers are not yet reflected in the baseline projection. As they also could pose some upside risks, we call on staff to closely monitor them and factor into forecast in a timely manner.

Second, macroeconomic policy is facing critical test from the surge of inflation. Credible frameworks with midterm anchors and effective communication will be critical. The impact of recent developments across of membership will be heterogenous in reflecting the interaction of different shocks, transmission channels, and country-specific features. Considering complex supply shocks are important causes of current inflation, we need some prudent approach taking into account diverse risk to minimize policy tradeoffs. Many EMDCs are still under negative output gap and high unemployment. At the same time, the risk from steep spillovers in the course of uneven normalization of monetary policy among countries should be closely monitored and well-coordinated. The Fund should provide well-tailored, country-specific policy advice to navigate these challenges.

Third, there are urgent need to closely monitor and limit the systemic financial risks. The War in Ukraine and sanctions have tightened global financial conditions and lowered the risk appetite. The work on expanding the policy toolkit to non-bank financial sector will be critical. Given fragilities in this sector, we cannot afford these vulnerabilities evolving into structural issues.

The work on the Integrated Policy Framework (IPF) and the Institution View (IV) on capital flows will be crucial for financial stability in the face of

possible volatile capital flows and diverging risk premiums. The current situation may highlight the value of continued analytical work on the use of outflow capital flow measures (CFMs) outside the imminent crisis circumstances and the effect of financial digitalization.

Fourth, the Fund should continue to assist the fragile members heavily affected by pandemic legacies, including small developing states (SDS). In this regard, Fund support for capacity development (CD) will be crucial for the sustainable recovery, and the Fund should continue to deepen its engagement with SDS through upcoming opportunities provided by the RST and the IEO evaluation on small states.

Finally, like many Directors, we reiterate that multilateral cooperation becomes more important than ever to overcome current extremely complicated challenges.

*The Chair:*

We will reflect on Mr. Huh's point on more frequent updates. Indeed, we are at a time when conditions may change faster, both on the upside and on the downside.

*Mr. Herrera:*

We broadly agree with staff appraisal, so I will make three brief comments this morning.

First, our communication strategy needs to strike a delicate balance between concerns about growth, inflation, and debt sustainability and carefully tailor that message to heterogeneous, regional, and country conditions. I would like to echo Mr. Bevilaqua that as it stands now, the message in the flagships is somewhat confusing or ambiguous. Some parts, like the executive summary and the GPA, lean to the dovish side. The world will slow down the recovery; inflation will rise but largely driven by supply factors beyond the control of policymakers, and central banks should remain vigilant, data-dependent, and flexible. Other parts, like the recorded presentations and today's initial remarks, fall more on the hawkish side. The rise in inflation is broad-based and lately, driven by demand, boosted by still-supportive macroeconomic policies. The worst slowdown is concentrated in Europe, while the inflationary impact is widespread. Medium-term inflation expectations are increasing. Central banks should focus on fighting inflation and act decisively to prevent expectations from de-anchoring.

I think we need to better fine-tune the messages in the WEO, GPA, and the presentations. We echo Mr. Bevilaqua's comments that where the recovery is well entrenched, monetary policy must be resolute in fighting inflation and supported by fiscal consolidation.

Second, the elephant in the room is whether some central banks are behind the curve. As highlighted in the WEO presentation, there are significant nominal wage pressures building up in labor markets and expected increases in policy rates rarely keep pace with the rise in inflation expectations. We echo Mr. Pösö's questions on factors behind the disinflation in advanced economies and Ms. Lim's suggestion to consider alternative scenarios with further monetary tightening. An abrupt tightening of monetary policy in advanced economies is a major risk to the global economy and financial systems. It is good news that so far, the impact of the war on the rising interest rate and financial conditions has been limited. However, we are just beginning to see a tightening process, as we have not seen in two decades or more. It remains to be seen how financial markets, balance sheets, and capital flows respond.

We welcome the analysis in the WEO and the Fiscal Monitor on the interaction of rising interest rates with higher private and public debt, and we would like to see further analysis on the exposure of financial institutions, emerging markets, and international capital flows to rising interest rates.

Third, the spillover effects of the War in Ukraine will slow down growth in food- and fuel-importing EMDCs and aggravate their fiscal and external vulnerabilities. Some low- and middle-income economies will experience greater difficulties financing their external deficit while global financial conditions become tighter. As other Directors, I stress that the Fund must stand ready to provide additional financial support to EMDCs.

*Mr. Stephan:*

Let me join Ms. Shortino, Ms. Riach, Mr. Tanaka in condemning the Russian war against Ukraine. Let me also reiterate that the responsibilities for the economic fallout we are witnessing lie with those who started the war. Therefore, we support the clear language that a peaceful resolution of the war is needed immediately to stop the tragic loss of human lives, to limit the devastating economic effects of the war on Ukraine and other countries, and to prevent economic fragmentation. A peaceful resolution of the war is also

needed to return to the rules-based framework, building on global cooperation and economic integration.

The structure along the five different channels—war, monetary tightening, fiscal withdrawal, China’s slowdown, and COVID-19—that will shape the economic outlook is helpful for policymakers, Ministers and Governors. The reports precisely sketch out the tradeoffs that policymakers are confronted with in a world of lower growth and rising inflation.

We need to address the economic fallout and to provide economic relief to those hit the hardest by rising energy and food prices, and we need to respond to the humanitarian needs, including migration flows, while preserving fiscal sustainability, and we need to resolve supply chain disruptions while alleviating price pressures.

On Germany, we concur with staff’s analysis. The ongoing war in Europe has unveiled some major weaknesses in our economy in times of geopolitical crisis, in particular, regarding our manufacturing sector, which depends on a narrow base of energy supply. And as noted in the report, Germany is determined to reduce its dependence on Russian energy imports to potentially zero by mid-2024.

On the GFSR, we agree with staff that climate change may pose a potential threat to financial stability. A delayed and disorderly climate transition may magnify risks to the financial system.

As regards cyber risk, I would like to emphasize that cyber risks are not only threatening the financial sector and financial stability but also pose significant threats for the nonfinancial sector. We share staff’s assessment of the NBFIs sector situation in the context of the Russian invasion of Ukraine. The NBFIs investment in Russian assets is very small relative to total assets of the NBFIs sector, and in spite of financial market tensions, severe disruptions have not materialized so far. The impact of direct financial exposures with Russia appears to be manageable. Of course, it is difficult to estimate the indirect implications of second- and third-round effects on financial stability of the sector. Therefore, we appreciate any efforts into disentangling and analyzing the indirect effects of current disruptions and potential spillover effects.

Last point, on Fiscal Monitor, we attach great importance to the right communication when it comes to the interaction between inflation and debt-to-GDP ratio recently. The lower debt levels in advanced economies

should not lead to the conclusion that debt levels have been actively reduced. I think careful communication is warranted to avoid drawing wrong conclusions, and therefore I appreciated the introductory remarks by Mr. Gaspar because he focused on a longer time horizon, 2000-2020.

*Mr. BinZarah:*

We issued a detailed gray statement, so today I will focus on a few points.

First, I join other colleagues to note the significant downside risk to the outlook and inflation being more persistent than initially anticipated. This further complicates the very difficult tradeoff facing policymakers. Here, the Fund's role in providing concrete and well-targeted policy advice, financial support, and technical assistance (TA) will be critical in helping members navigate these challenging times. I join Mr. Buisse on the need to be agile during these significant uncertainties. We also look forward to a timely update from staff on new developments and revised baseline assumption and projections.

Second, like others, we underscore the importance of multilateral cooperation to address current challenges and to facilitate structural transformation to promote higher and more inclusive growth. Here, we expect the Fund to play its role in fostering multilateral cooperation within its mandate to preserve global economic and financial stability and support to the most vulnerable.

Finally, on climate, we emphasize the global cooperation based on multilateral consensus is key to achieving climate goals in a timely and orderly manner. The global economy will continue to need all resources of reliable, affordable, and sustainable energy to meet global development needs. The analysis in the commodity special feature in the WEO has rightly underscored the importance of calibrating the pace of divesting from fossil fuel to be in line with the speed of adoption of renewable energy.

Taking action to transition to greener energy sources should take account of the adequacy of the new sources of supply and make realistic assumption about the substitution rate between fossil fuels and new energy sources. Absent these actions, energy supply-demand imbalances will create unnecessary shocks to the economy and delay the transition.

*Mr. Jin:*

We have issued a written gray statement, and I would like to make a few comments for emphasis.

Regarding the WEO, we concur with staff that the possible worsening of the conflict and the escalation of sanctions on Russia are significant downside risks to global outlook. It is very unfortunate to see the unprecedented sanctions after the breakout of the conflict. This is an unfortunate reflection of low confidence and unwillingness on the political level to limit the solution to diplomatic and fewer military fronts. It is important to fully recognize that most of the impact is forced on ordinary and innocent people on both sides of the conflict and around the world. I believe there must be more civilized and less contentious approach to achieve peace. The Fund and its member countries should work together to prevent escalation and contagion and facilitate a peace agreement as early as possible. The Fund should prepare humanitarian assistance to all peoples that have been affected by the conflict.

We welcome staff's analysis of global inflation dynamics and advice on tackling inflation. The disruption in global supply chain will cause greater-than-expected shortage of goods and inflation in all countries.

Regarding China's economic outlook, the Chinese economy is facing increasing short-term uncertainties caused by the spread of Omicron in some large cities and the spillover effects of the conflict in Ukraine. It is helpful that once the very low infection rate of Omicron in China can be confirmed, the handling approach can be adapted, and the economy can resume normal operation timely. We welcome professional advice from staff and share experiences with member countries in combating the variety.

Our authorities will adopt all necessary policy measures to mitigate the negative impact of these larger-than-expected shocks and maintain stability in economic, financial, and social fronts.

*The Chair:*

Staff would be happy to engage in a follow-up bilateral discussion on supporting China's use of experience from other countries for its own domestic containment of COVID.

*Mr. Peter:*

We broadly share the assessment in the flagship reports and would like to convey a few key messages.

First, we reiterate the importance of international cooperation in responding to the risk of economic fragmentation. We join the call by staff and many other chairs for a quick and peaceful end of this war. We share staff's assessment that the War in Ukraine threatens the rules-based frameworks and adds another layer of uncertainty to an already complicated economic situation. As stressed by Mr. Hilbers, neighboring countries and those with close economic ties to Russia are particularly affected in terms of trade, remittances, and the influx of refugees, and require disclose monitoring by the Fund to analyze the implications of these spillovers. International cooperation on these fronts, as well as in tackling longer-term challenges such as climate change and trade barriers, remain essential.

Second, we stress the importance of central bank independence for the credibility of monetary policy. Increasing inflationary pressures, combined with slowing growth rates have raised the specter of stagflation. We agree with staff that the current situation is different from the 1970s, thanks to a large extent to the strengthened central bank independence. The task of central banks is more complicated in some countries with high public debt levels and thus vulnerable to higher interest rates. In this context, I want to agree with Mr. Bevilaqua's and Mr. Herrera's comments on monetary policy and reiterate that the prime task of monetary policy is to ensure price stability. Effective monetary policy requires a strongly forward-looking approach, as well as a constant questioning and adaptation of treasured analytical approaches and models as the underlying structure of the economy evolves. When the time to act comes, prompt and resolute action will reduce the need for sharper policy reactions further down the road and avoid falling behind the curve.

Third, we share staff's call for fiscal consolidation given the high or very high debt levels. This is even more pressing now in an environment of increasing borrowing costs and significant market volatility. We reiterate the need to rebuild fiscal buffers to strengthen the economy's resilience to shocks and to prepare credible medium-term fiscal consolidation strategies. Fiscal support should focus on the most vulnerable to counter the impact of higher food and energy prices.

Finally, like Ms. Riach, Mr. Hilbers, Mr. Jennings, and others, I want to stress the crucial importance of a timely distribution of Board papers in all circumstances and especially in turbulent times like now to give the Board and the authorities the necessary time to prepare our position, especially on such an important part of the Fund's activity as multilateral surveillance.

*Mr. Fanizza:*

We have issued a gray statement. Let me repeat from the gray statement a big issue—the threat that the invasion of Ukraine poses to the economic and financial outlook. The easiest way to solve that is stop it, but that has not happened. Let's talk about what we can do.

Let me come to more economic issues: inflation and fiscal policy, the core of our mandate. This chair has been saying for two years that we need to focus on monetary policy and fiscal policy. I am not saying I was right. Nobody likes people to say "I told you". I am glad that we have come to that point. I like the way in which the report puts it. The message is clear. The message is not all the same all over the membership.

I fully agree with Mr. Bevilaqua, that there are signs are that inflation expectations are getting de-anchored, and that is bad, and one needs to act. And we need to find a way how to do it best. There are other areas where this is not true, and it is the reverse. They go so far to say that in Europe we have seen a remarkable success in re-anchoring expectations, around 2 percent, which was the inflation objective for the last 12 years. The world and the economy will be very different if the central bank in Europe would have not done what it has done. It has been a success with important consequences. In terms of the fiscal position, and the Fiscal Monitor makes it clear, there have been clear favorable, although temporary, impact of inflation on fiscal balances. For instance, in Italy, the authorities are keeping the fiscal target unchanged despite all what has happened and the need to support the economy and people who are in need, thanks to the fact that revenues are much higher than expected because of inflation. It is not going to last like that, but that is important. It is true that while inflation is very low, it is easier to sell bonds, but it happens in a context of very, very low growth. And we do not want to get that. Deflation is not good.

I support what has been said by Mr. Tanaka, Mr. Bevilaqua, and others about sovereign bank nexus. We need to be very careful, and we should be careful not to cast recommendations which are not consistent with what the international for are saying.

*Mr. Mozhin:*

Since quite a few Board members in their written and then oral statements made comments on the geopolitical circumstances, I have no other choice but to also make such comments. My Russian authorities firmly reject the interpretation of the current developments around Ukraine by the Western countries and their representatives in the Board. In the opinion of my authorities, Russia's special military operation in Ukraine was made unavoidable by many years of aggressive anti-Russian policies by Western countries, including but not limited to the following: 30 years of active promotion of Russophobia in Ukraine, and not only in Ukraine, by Western countries. Five rounds of expansion of NATO to the east, eventually all the way to Russia's borders, despite all the promises made in the early 1990s. The bloody, foreign-organized regime change in Ukraine in 2014. Eight years of shelling, shooting, and killing people in the Donbas by the Ukrainian military. The establishment all over Ukraine of over 30 top secret American bacteriological laboratories, similar to the ones—

*The Chair:*

I am very respectful of everybody's opinion always. But I have not heard of anybody around this table to take their time to go into something that is not the subject. I would call on Mr. Mozhin to please talk about the global economy. Any comments Mr. Mozhin has in that regard would be most welcome.

*Mr. Mozhin:*

I have almost finished, but others made comments on geopolitics.

*The Chair:*

They were one-sentence comments. Mr. Mozhin has been a very solid Board member. My job is to make sure we talk about the economy. So, request Mr. Mozhin to continue.

*Mr. Mozhin:*

I will report to my authorities about my inability to convey the message which they requested me to convey.

As the Managing Director suggested, let me now turn to the economic consequences, and here I have one comment and two questions. The comment I have is that the uncertainty, indeed, is very significant. The war of sanctions is in full swing, and Russia has yet to announce its counter-sanctions, which it certainly will do at some stage.

One question I have is to Mr. Gourinchas. The real interest rates remain heavily negative and apparently will continue to be very negative. This is what I called previously the robbery of depositors. And the question I have is how this will affect growth in respective countries, both in the short-run and then the long-term because in the short-run negative interest rates seem to stimulate purchases, especially of long-term goods. But in the end, this leads to the reduction in the wealth of the population, and this must have an effect on growth everywhere.

My second question is to Mr. Gaspar. Of course, there is a very interesting analysis in the Fiscal Monitor regarding how inflation helped the US and apparently the UK to reduce public debt levels, very significant high public debt levels, in the aftermath of the second World War. And then it is stated that the circumstances cannot be repeated—the circumstances prevailing after the end of the second World War cannot be repeated. I understand what is meant because in those previous times there were no market interest rates. Interest rates were fixed. And this is what is called the Financial Repression, so to say. Then there is an interesting language regarding that it is a surprised inflation that can be helpful in reducing public debt and other debt, all debt levels, by devaluing them. So, my question is what are the conclusions from all this? In particular, would it make sense to increase inflation targets in heavily indebted countries?

*The Economic Counsellor and Director of Research (Mr. Gourinchas):*

Let me address some of the points that have been raised, very relevant points that have been made in the comments today.

First, on inflation, I think some of the Directors mentioned the need for data-dependent monetary policy and potentially the risk of overcorrection. Other Directors mentioned the fact that some of the inflation drivers seem to be pointing to rising inflation and therefore for a more forceful action. I will start by mentioning some of the drivers that we have identified in the WEO of inflation developments, and I want to mention five of them very briefly.

Firstly, energy and commodity prices in the context of the Russian invasion of Ukraine are definitely contributing to increased inflation, especially headline inflation. We point out in the report that the markets are forecasting a decline in energy and commodity prices when they are looking forward, so we are near the peak, and prices are expected to come down, which would moderate price pressures, at least on headline inflation. Of course, markets could be warned, but at least that is what we see now.

Second, demand-supply imbalances, they have been with us not just in the context of the war but going back to the pandemic. They are still elevated, and there is a combination both of the supply restriction and in some countries of the strong supportive policies that have contributed to inflation. Going forward, some of this supply-demand imbalances are expected to unwind, and that would also contribute to a reduction in inflation pressures.

Third, the withdrawal of the fiscal stimulus in many advanced economies is another factor that we quantify in the report that will also go towards moderating inflation pressures. All these three forces point in one direction. There are two forces that are going in another direction. One is what is happening with labor markets, especially in some of the advanced economies, in particular the US, and to a lesser extent the UK. We find very strong evidence of very tight labor markets in the context where, as I have mentioned in my WEMD recorded presentation, real wages have not been increasing. In fact, nominal wage growth has been lagging behind a nominal price, a CPI inflation; and therefore, there is a potential for second-round effects or increase in wages that may feed up into other things.

Finally, inflation expectations, which central banks are paying very, very close attention to, and while they have remained mostly well anchored, we see signs—and I have documented some of them again in the WEMD presentation—that they may be drifting upwards. In some cases, talking from a situation where they were below the target, that is what we are seeing in, for instance, the Euro Area but in other cases where it is above the target. Overall, we see a need for a differentiated approach to monetary policy.

What does “tightening” mean here? Tightening means, in central bank jargon, that one needs to bring interest rates above their natural rate. A number of Directors have mentioned the natural rate and what we know about the natural rate. Natural rate has two components. One is the real rate, and the other one is expected inflation. We just talked about expected inflation. Let me mention something briefly about the real rate. Here, we have a box in the WEO that analyzes what we think we know about long run real natural rates,

and all the evidence suggests that the forces that have been pushing real rates down over the last 40 years are still with us and will continue to be with us, demographic forces, the demand for safe assets, regulation, a number of factors that are pushing real rates down, and we expect this environment to continue.

Having said this, it is nevertheless the case that monetary policy in a number of advanced economies is not yet bringing the policy rate above the neutral rate, and so there is some expectation in some countries that inflation will come back down because of the other factors I have mentioned, the supply demand imbalances unwinding, inflation expectations remaining anchored, and the withdrawal of fiscal stimulus.

Let me mention briefly two more things. One, there was a question on global supply chains and how to make them more resilient to future pandemics. The chapter in the WEO on spillovers looks into that question, and I would just point out that there is one very important message from that chapter, which is that diversification is really important to ensure that there are different alternative sources for different inputs going into the global production network and that diversification requires that the economy remains a global economy and does not fragment further.

There was also a question from Mr. Pösö on energy imports from Russia and the relevance as an indicator of vulnerabilities. Here, we want to point out that it is true that countries are adjusting their energy mix on the import side but especially when we are looking at things like natural gas; but even in the case of oil to some extent, imports can be quite sticky in the short run. There are infrastructure aspects, pipelines for gas, long-term contracts maybe for other sources of supply, so we think this is a relevant indicator.

Let me finish by thanking the Directors for the comments on some of the language. Mr. Jennings mentioned that when we talk about supply shocks as being beyond the control of policymakers, this has already been corrected. We meant beyond the control of central banks. Other suggestions will also be reviewed and incorporated. I also want to thank the Directors for suggestions of topics for further and future work.

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

Thanks to Directors for the thoughtful comments. The commodity shock from the War in Ukraine has exacerbated inflation pressures. Headline

inflation runs well above central bank targets in many countries. As a result, short and medium-term inflation expectations have surged dramatically. It is essential for central banks to act decisively to prevent an unmooring of inflation expectations. Many central banks will need to tighten at a faster pace. We agree with Mr. Bevilaqua in that respect that especially economies with weakly anchored inflation expectations need to tighten more aggressively. Many advanced economies also need to tighten a lot faster than what was previously expected. We are not using the language that Mr. Chodos suggested that countries are behind the curve, but we are certainly making the point that countries have to intensify their efforts to bring inflation back to target. We also agree with Mr. Peter that the prime task of monetary policy is to contain inflation.

Now, the normalization process needs to be data-dependent and recalibrated along the way. Clear communication is critical, and we fully agree with Mr. Buisse that communication and forward guidance has to be used in a flexible way. Inflation expectations are very elevated at the short- and medium-term horizon, but they remain well anchored at the five- to ten-year horizon. That is also what we see, not just in markets but also in forecasts.

Where we are going to end up in terms of interest rates depends very critically on neutral real rates, something that Mr. Jennings pointed to; and we are certainly doing work on  $r^*$  and will continue to do work on  $r^*$  and can do more of that in the flagships as well. We agree with Ms. Mannathoko that it would be wise to plan for further potential future supply shocks.

Mr. Palotai in the gray statements asked in particular about monetary policy in Europe. We did not answer that in the reply to the gray statements but just to point out that many countries in the Euro Area have very high inflationary pressures. There are very few countries that don't have those high inflationary pressures, and the drivers of inflation are high food and energy prices in most countries; and it is again in Europe as well extremely important to contain inflationary pressures and prevent an unmooring of inflation expectations, especially in those countries that have less well-anchored inflation expectations.

Turning to climate, Ms. Shortino pointed out that energy, security, and energy transition are complementary, and that is very well aligned with our view. In fact, we highlight in our GFSR that the perception of a tradeoff between energy security and transition and is changing rapidly. There is a risk that the transition to renewables may become more costly, complex, and

disorderly. Given that climate change poses a threat to financial stability, delayed and disorderly climate transition may magnify risks to the financial system; we are fully aligned with Ms. Shortino's points here.

We agree also with Mr. Pösö that high energy prices risk harming the most vulnerable and agree with Mr. Hilbers for the call for urgent action on climate change.

Concerning the non-bank financial intermediation sector, we continue to work with the FSB, with IOSCO, and with standard-setters around the world to improve the regulation of the non-bank financial intermediation sector. A lot of progress has been made, and we expect more to be done in coming months.

On capital flows, Mr. Hosseini felt that the tone of the GFSR was not sufficiently alarmist. We would like to point out that, commodity importers and food importers were hit extremely hard by the war and the consequences of the war, but that other countries have relatively benefited, and we have seen capital inflows in a number of countries. This is why the language is somewhat balanced and takes into account that there are both winners and losers in terms of capital flows, but we are certainly pointing out very clearly in the GFSR that capital flows are at risk, in particular in a context where global financial conditions might tighten sharply at some point. We also agree with Mr. Huh highlighting the importance of the IPF.

Concerning frontier markets, Mr. Hilbers points out that the first order impact of the war is the impact on food supply, and we certainly see that in many countries around the world already, and we are very worried about that.

On digital money, we fully agree with Mr. Palotai's assessment that cryptoization is a key issue. We are monitoring very closely how cryptoization is impacting countries. And on our digital money agenda, regulating crypto assets is very much first order. Developing CBDCs and creating global frameworks to ensure interoperability and better global payment systems is very much first order in all the work that we are doing.

Let me finish with the sovereign bank nexus. We fully concur with Directors that we have to be very balanced in public communication. This is an issue that is divisive within the Basel Committee. It is critical for some countries but not for all countries, and we make this point about the highly diverse situations across countries very, very clear in the chapter, so that different approaches to limit the macrofinancial stability risks arising from a

stronger sovereign bank nexus and so policy measures need to be tailored to country-specific circumstances. That is a very critical recommendation that we are making, and we stress that any measures have to be carefully calibrated to the country circumstances. We certainly note that the Basel Committee is the right standard-setter for all these issues.

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

Thanks all for very good comments that clearly will be reflected in the revised version. I learnt quite a lot from this exchange of views. I will try to be short and selective in the comments that I address and the questions that I answer.

Let me start with international taxation. Ms. Mannathoko asked about our answer to the gray statement and in particular the fact that we focused on Pillar II of the inclusive framework agreement and not Pillar I. We did focus on Pillar I because mining industries are excluded from Pillar I, and rightly so, because Pillar I is about the right of destination markets to have taxing rights, and that would be detrimental for the interests of the countries that have the natural resources, the mining countries.

Under Pillar II, there is a minimum of 15 percent. Most countries do have complementary fiscal regimes for mining companies, and there is nothing on Pillar II that prevents taxation to go well beyond 15 percent. In many cases, that is fully justified in line with the advice that we have been giving over time on rent taxation. We have also engaged with the membership in the context of capacity development when it comes to how to best tax natural resources, and we are obviously completely available to pursue this issue further bilaterally.

On energy and food prices, I will not elaborate more because it is a happy coincidence that in the context of our reporting to the Board on the work of the crisis room, I will be covering those very aspects this afternoon on the basis of a survey conducted by country teams, and therefore area departments, to 129 of our countries, and we have I believe there a very good example of the application of the granular policy initiative. It would take too long for me to report on that now.

In the context of the gray statements, we had a very good question on the relation between the current high prices of energy and our recommendations on investment and carbon pricing. It turns out that, if anything, there is the complementarity between energy security and the

transition to renewables, and many Directors today made that point, which is extremely important. At this point in time, what we see in the energy markets is supposedly a relatively temporary spike; and so in terms of helping us in the transition to deliver on the Paris commitments for 2030, it does not cut it. We did more both in terms of carbon pricing or equivalent measures. I now address my good friend, Mr. Tanaka, to reassure him that the tool that is quoted in the Fiscal Monitor can be applied to other schemes for the international carbon price floor or even to equivalent measures. It is a very flexible tool, and we are ready to explore any alternatives that the membership may find useful; but tackling climate change, as Managing Director has emphasized many times, is urgent, and we are late. So, we can in a sense move gradually. We should move gradually and in a balanced way, but we cannot possibly move backwards.

In my presentation today, I tried to emphasize debt risks and difficult tradeoffs because all country groups are facing spending pressures. They need to reconstruct fiscal buffers, and fiscal space is and is likely to become even more constrained. These tradeoffs are very important to manage for policymakers. They look very different when we go across the membership.

Lastly, on inflation, I have learned a lot from a paper by George Hall and Tom Sargent. They argue that the response, in particular in advanced economies, in particular in the US, to the COVID-19 shock is only comparable to the two World Wars in the 20th century. They discuss the differences. And among the differences are the role of the market mechanism in the functioning of sovereign bond markets, which is much more now than in the previous examples; the fact that central banks are paying interest rates on reserves, and that creates a difference in the structure of the public debt; and, third, in particular in the US, the tradability of the debt and the maturity of the debt makes the sensitivity of the debt service much greater than it was at the end of First World War and Second World War. So those are the main differences right now, and to my mind, it means that the case for price stability that I tried to make at the beginning of the meeting today is stronger now than it was before.

*The Economic Counsellor and Director of Research (Mr. Gourinchas):*

There were a few questions in the gray statement that I have not had a chance to address yet, and I wanted to be able to do so.

First there were a few questions about the impact of the Russian invasion of Ukraine on Fund financing and potential balance of payments

needs. These will be addressed this afternoon in the context of the crisis group informal Board briefing, so I will not expand any further on this.

There were some questions on the monetary fiscal policy mix in light of the war and associated supply shocks. In particular, there was a question on whether some major central banks are falling behind the curve with their current pace of policy rate in the context of increasing inflationary pressures. And so here, I will mention that we view the adjustment in monetary policy in many central banks, especially in advanced economies, in the last six months, over since the October 2021 WEO, as very substantial already. A number of central banks, not just in the US but the UK even, the Euro Area, have pivoted very, very significantly in a way that reflects how the data is changing. Now, it is also the case, and that will echo a point that many Directors have made, that there are significant upside risks to inflation that may in the future lead to a more accelerated tightening, and this is something we are monitoring very carefully.

There were questions about the mix between fiscal and monetary policy in advanced economies and the impact this may have on emerging market and developing countries. I would characterize the analysis as follows: I would say monetary policy first and foremost needs to make sure that inflation expectations remain anchored. Once this is achieved, or if this remains the case, then it has flexibility to adjust slowdown in aggregate demand as needed.

On fiscal policy, the extraordinary measures need to be removed as the health situation improves. In general, it is considered that it is not desirable to try to steer aggregate demand with fiscal policy in a broad and targeted way except when monetary policy is constrained, as happened in the past either at the effective lower bound or for some countries that, for instance, belong to a monetary union and cannot have a monetary policy that is tailored to their individual needs, or when monetary policy is ineffective, as was the case beyond stabilizing the financial system during the COVID pandemic. Lowering interest rates is not going to address lockdowns. Fiscal policy in the current environment needs to be deployed in as targeted a way as possible to protect vulnerable populations, not necessarily in a way that supports aggregate demand except in some very specific cases, as I have just mentioned.

Now, given the above, emerging market and developing countries must prepare for an expected tightening of the global financial cycle coming from central banks in advanced countries but also potentially repricing of risk

by financial markets. That requires a combination of exchange rate flexibility, being able to adjust the monetary policy stance if the depreciation creates inflationary pressures, and, more generally, maybe preparing by monitoring financial vulnerabilities such as foreign exchange imbalances and rollover risk.

There was a question specifically on the policy mix in Europe, but I have already mentioned enough on this. Let me turn to a few questions on the impact of the current energy crisis on our views on carbon pricing and the policy path for the green transition. One question was on the fact that carbon pricing may be less popular when energy prices are high and asking for advice on implementing preannounced carbon price hikes at this juncture.

First, we acknowledge that currently high energy prices do provide incentives for fuel consumers to save energy and substitute to clean alternatives. As soon as world market prices decline, introducing or increasing carbon pricing would reinforce these energy efficiency gains and help switch to low carbon energy. In general, it is important to keep in mind that the purpose of a carbon tax is not just to raise the price of carbon, but it is also to provide a stable and increasing path for carbon price over time that will guide consumers but will also guide firms in their choice of energy mix and will guide innovation in a renewable energy sector; and that stability, increasing but stable, is important and suggests that carbon taxes should move in opposite direction of market prices in order to ensure this stable forward guidance.

The crisis has demonstrated once again that there is very low tolerance of consumers for high energy prices, and it highlights the needs for other measures by governments to engineer a scaleup of low carbon energy sources.

Final question, on the preferred course of action with regard to the use of coal instead of natural gas from Russia in the context of the current crisis. Our view is that the current energy crisis should not stand in the way of the required investment in the green transition. In the very near term, energy supply needs to increase, and that would involve all kinds of energy sources, whether it is nuclear, renewables, or carbon-based sources of energy such as coal. In the latter case, what we would recommend is some provision should be made to offset any short-term increase in emissions so as to stay on the path towards a goal of net zero emissions.

*The Chair adjourned the discussion.*

**ANNEX**

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

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GRAY/22/1006

April 7, 2022

**Statement by Mr. Hilbers, Mr. Scholer, Mr. Tsur, and Mr. Milutinovic on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for their hard work to analyze the complex interplay of the various strong headwinds currently affecting the global economy. While we understand that this was particularly difficult due to exceptional uncertainty and fast-moving developments, **we want to underline that the very late circulation of documents is not conducive to a high-quality discussion and meaningful membership engagement, thus weakening internal governance.** Especially in times of crisis, the membership would benefit from sufficient time to absorb staff's high-quality analyses, which itself would benefit from a thorough debate. In the future, we would prefer to receive drafts much earlier, even if projections may require updates in a second step.

**While we welcome staff's analysis of the channels through which the unjustified invasion of Ukraine is impacting the world economy, we believe the effects on Ukraine itself and the spillovers to direct neighbors – many of which are in our Constituency – should have been explored in more depth.** In that sense, we hope that the Regional Economic Outlooks will provide more detail on these impacts in the most affected regions. While the war in Ukraine amplified many pre-existing vulnerabilities in the world economy, above all it has unnecessarily caused tragic loss of human life, the biggest European refugee crisis since World War II, and devastating economic destruction. We see this as a threat to the very foundation of our international system and call on the Fund to maintain its strong, unwavering support to Ukraine and those affected by direct spillovers, especially countries in Eastern Europe, the Balkans, and the Caucasus. In that vein, we also reiterate our request that the Board is debriefed often and regularly on the economic consequences and financing needs arising from the war – if need be, on some occasions with limited or no interventions by Directors and without distribution of documents.

**The economic repercussions of the war in Ukraine add to a unique set of interconnected challenges that weigh heavily on the outlook for the world economy.** Inflationary pressures have been further intensified through supply-side shocks on energy and food prices, potentially causing social unrest and worsening debt vulnerabilities across the world. While global financial stability has so far been maintained, further repercussions from the war in Ukraine could still materialize as risks have increased on several fronts, including in relation to the fragmentation of payment systems and

the increased use of crypto assets following the introduction of sanctions against Russia and Belarus. International trade, which could have lessened supply-side bottlenecks, is experiencing a significant slowdown, raising concerns about global trade fragmentation. And global warming and extreme weather events continue to underline the urgent need to tackle climate change. This sobering outlook presents countries with extremely delicate tradeoffs in both monetary and fiscal policy. In that context, the Fund will need to assume its role at the center of the global financial system and make full use of its lending toolkit, including emergency financing where needed and appropriate, especially in the regions directly affected by the war. We thus welcome recent steps in this direction as regards the Republic of Moldova. *How does staff assess potential take-up of resources to mitigate balance of payments needs at this juncture?*

**We agree that inflation will likely remain elevated for longer than expected, with negative impacts on purchasing power, confidence, and savings.** Given the high uncertainty surrounding the outlook, we believe that staff is right to emphasize significant downside risks. While we share concerns about elevated inflation, we agree that the current situation differs from the 1970s oil shocks in important respects. In our view, a key difference not mentioned by staff is central bank independence and credibility, often built on inflation targeting. Looking ahead, central banks will need to perform a careful balancing act to manage inflation expectations without unduly dampening economic activity or risking a disorderly tightening of financial conditions. To that end, they should closely monitor signs of de-anchoring of inflation expectations and potential wage-price spirals, including from labor market tightening. We agree with staff's advice that clear, transparent, and data-driven communication on the pace and extent of monetary tightening will be key. Meanwhile, the macroprudential toolkit should be selectively deployed to tackle pockets of elevated vulnerabilities in the financial sector while avoiding broader impacts on financial conditions.

**The current environment also reinforces concerns about historically high debt levels in the wake of the COVID-19 pandemic, as monetary policy tightening in advanced economies may raise risks for debt financing in emerging and low-income countries, of which many are already in debt distress.** This reduced capacity to absorb shocks is now confronted with increasing calls on governments to support vulnerable households and companies. At the international level, we therefore fully support staff's call to step up the application of the Common Framework as a matter of priority and work to enhance debt transparency. In addition, measures aimed at mitigating overreliance on foreign investors, such as the development of domestic capital markets, could be helpful.

**At the national level, we concur that the fiscal policy stance should be a function of a country's exposure to the impact of the Ukraine war, the state of the pandemic, and the strength of the economic recovery while taking into account medium-term fiscal sustainability.** As we do not believe that a return to broad-based support is warranted, we agree that countries should shield economies from high energy and food prices and supply-side bottlenecks in a targeted and temporary manner, primarily aimed at low-income households and vulnerable SMEs. At the same time, these measures should be defined within a credible medium-term fiscal framework. The degree to which countries should support the competitiveness of viable companies by shielding them from war-related disruptions, notably high energy prices and unit labor costs, should be assessed against country specificities and taken up in bilateral surveillance. Where balance of payments stability is endangered, the Fund and other institutions may be called upon to provide financial support. Finally, we note that measures to improve domestic revenue mobilization and

spending efficiency will be crucial to create needed fiscal space, also to finance the necessary green and digital transitions.

**Beyond the direct fallout from the war in Ukraine, it also underlines the urgent need to considerably scale up global ambition and action to tackle the climate crisis.** In this sense, we believe that the WEO could more clearly signal that climate change is an immediate concern that cannot be relegated to the medium-term. If anything, the current crisis has further underlined the vulnerabilities of the global energy system and the need to diversify energy sources and suppliers towards renewable energy. We thus strongly welcome staff's analysis of climate-related aspects throughout the flagship reports. Against the backdrop of high inflation and energy prices, countries should avoid the continuation of distortive subsidies and support the development and adoption of renewable energies. We also agree with staff that the war and the concomitant shock show in fast-forward, and with great intensity, the deep distributive implications of higher carbon prices. *Given that carbon pricing may be less popular when energy prices are high, what is staff's advice on implementing pre-announced carbon price hikes at this juncture?*

**We welcome staff's advice to embrace positive structural changes, though we would argue that the case for addressing pre-crisis structural problems could have been made more forcefully.** Many reforms that were needed before the COVID-19 pandemic, especially those addressing labor market mismatches, product market imperfections, sluggish productivity, competition barriers, and logistical impediments, make just as much – if not more – sense today, as they could facilitate reallocation and address supply-side problems that cannot be solved at their root through monetary policy. From a political economy perspective, the current environment may also present a new window of opportunity for such reforms, making the Fund's advice all the more valuable and timely for the entire membership. For many countries, such advice should also be integrated with well-sequenced and targeted capacity development. At the international level, a similar argument could be made with regard to trade barriers, whose removal could ease supply bottlenecks and inflation pressures.

**Finally, we reiterate that the COVID-19 pandemic remains unpredictable for as long as access to vaccines, tests, and treatments are not guaranteed at a global level.** In this context, we welcome the continued analysis by staff of the long-term risks of COVID-19.

**It is clear to us that all these challenges share a common trait: the best way to address them is through international coordination and multilateral solutions.** The most fundamental risk stemming from the invasion of Ukraine may thus very well be the peril to the multilateral world order, without which we will not be able to solve any of the above concerns on inflation, debt, climate, trade, or COVID-19. It is this spirit of international cooperation that drove the establishment of the Fund at Bretton Woods in 1944, and it is this spirit that needs to be protected today at all costs.

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GRAY/22/1007

April 7, 2022

**Statement by Mr. Fanizza, Mr. Massourakis, Ms. Quaglierini, Mr. Spadafora, Ms. Cerami, Ms. Korinthios, Ms. Mastrapasqua, and Ms. Mateus on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

*We thank staff for a set of excellent Flagship reports. The invasion of Ukraine by Russia is a major geopolitical shock that threatens the rules-based international economic and financial system with unpredictable consequences over the medium term. In the short run, the conflict has already disrupted international economic and financial relations at a time when the global economy was recovering from the Covid-19 crisis. The objective of keeping inflation expectations under control is paramount, but central banks face a more challenging tradeoff with the goal of preserving the recovery. We agree that the appropriate monetary policy response will depend on country-specific circumstances, most notably the credibility of monetary and fiscal frameworks, labor market tightness, and exposure to commodity prices. Given heightened uncertainty and facing likely persistent adverse supply shock, we believe that fiscal policy should buffer private demand through targeted measures, while safeguarding medium-term debt sustainability. Beyond the short-term, the impact of the war risks to hamper structural adjustments, to result in broad-based productivity and competitiveness losses, and to reverse globalization. These likely developments increase the urgency of policies to facilitate the digital and green energy transitions as well as cross-sectoral labor reallocations to boost potential growth. We fully share the staff's view that multilateralism is essential to respond to the humanitarian crisis and the economic and financial consequences of the war, including the food security and refugee crises.*

We offer the following comments:

- **We broadly share the staff's overall assessment of the global macro-financial outlook and risks as well as the policy recommendations.** We much appreciate the staff's detailed – albeit perhaps tentative – assessment of the macro-financial impact of the war and the analysis of its transmission channels and downside risks. The war in Ukraine will result in an even deeper slowdown of global growth in 2022 – notably in Europe – largely because of negative global spillovers through higher commodity prices and supply-side disruptions, which add to pre-existing inflationary pressures and rising

interest rates. While the WEO baseline assumes no additional sanctions on Russia, this hypothesis seems already unrealistic, making the alternative adverse scenario in the Box more relevant. The economic impact of the war on Emerging and Developing Europe is particularly painful, with economies now projected to contract in 2022, in striking contrast with the robust expansion expected in January. For oil exporters the outlook has, however, improved compared to January especially for countries in the Gulf region.

- **The war will impact on the monetary tightening cycle, as higher inflation is expected to persist longer than previously anticipated, amidst a growing fragmentation of the financial system while a potentially severe disruption of energy supplies may escalate financial tensions.** Global financial conditions have further tightened, and risk appetite has declined. On a positive note, longer-term inflation expectations appear, so far, “reasonably” well anchored, reflecting partially the credibility of many central banks and partially the inertia in the wage formation process. However, stronger vigilance is warranted because the risks and costs of de-anchoring cannot be understated. Staff projects (Fig. 1.22 of the WEO) that in Advanced Economies short-term *real* interest rates will remain negative at least by end-2022. In light of the recent inflation dynamics, this deserves careful analysis, putting a premium on clear communication by central banks on the policy path beyond 2022-23. We emphasize the very different conditions between the United States and the euro area regarding the drivers and relative strength of inflationary pressures, which could have deserved further analysis and discussion of the policy implications. *In Fig. 1.3 (panel 1) of the WEO, the path of policy rate expectations for the euro area seems too flat, considering that some current market indicators – e.g., Euribor 3-month futures and euro short-term rate (€STR) – point to rates at around 1 per cent already in mid-2023. Staff’s comments are welcome.*
- **We commend staff for the insightful comparative analysis of the starting conditions of the current tightening cycle in Emerging Market and Developing Economies (EMDEs) with past episodes in 2018 and 2013.** Record-high debt levels in the aftermath of the pandemic constitute a key risk for many EMDEs, although FX reserves coverage of imports has improved, notably in Low-Income Countries, partly reflecting the allocation of SDRs. The greater market differentiation across borrowing countries in terms of increased sovereign spreads should rule out episodes of indiscriminate contagion.
- **We appreciate the clear and concise graphical representation of the main implications of the war in Ukraine for global financial conditions in the opening of the GFSR.** We also appreciate staff’s efforts to explore the broader implications beyond the short-term risks to financial stability. These go as far as to encompass possible changes in the currency composition of foreign reserves, the risks of fragmentation in payment systems, and the creation of blocks of central bank digital currencies. At the same time, we note that heightened concerns over cyber-attacks not only increase the urgency of integrating cyber risks into financial stability analysis but also the costs of the ongoing projects to improve cross-border payments under the aegis of the G20. We welcome that despite the tightening of financial conditions there are no signs – so far – of systemic risks. Nonetheless, we agree that close vigilance is warranted and further macroprudential measures targeted at specific pockets of vulnerabilities might be

needed. Furthermore, the impact of the war on financial markets has underscored the need to broaden the regulatory perimeter to include and improve the visibility over still opaque intermediaries and markets, such as private energy trading firms and the OTC market for commodity derivatives.

- **Given higher uncertainty and a slower recovery, we believe that fiscal policy should remain focused on supporting the recovery while becoming more targeted and agile, as many of the pandemic support measures are being phased out.** At the current juncture, it is essential to mitigate the impact of higher inflation on disposable income for the most vulnerable, although rising interest rates and pressures to extend food and energy subsidies to wider segments of the population will further constrain the room for maneuver. The war is set to impact the depth of the scarring effects from the pandemic – notably in EMDEs – by disrupting trade and supply chain linkages. Additional efforts toward achieving more equitable vaccine distribution and inoculation across countries remain a priority also in light of the beneficial effects on output evidenced by staff in Fig. 1.19 of the WEO. International cooperation will also be key to address the food security and refugee crises, which disproportionately affect lower income countries and those geographically closer to the conflict or facing refugee flows, dampening the risks of social unrest. International coordination will be of the essence to overcome the limits of unilateral actions in areas such as corporate taxation, personal taxation, and carbon pricing.
- **We welcome the Fiscal Monitor’s analyses on the challenges and trade-offs for fiscal policy at this difficult juncture,** which comes after the large shock due to the pandemic that has deteriorated public finances and reduced policy space. We value the analyses differentiated for income country groupings and note that scarring seems to be inversely correlated with the size of the enacted fiscal support packages, being lower in advanced countries that adopted the biggest measures. We appreciate the work on the magnitude of household excess savings across countries, following the pandemic fiscal support; we note that the size of those excess savings seems to be correlated with the amount of support provided during the pandemic. We read with interest the analyses on poverty and inequality following the pandemic support measures, which provide a case for structural improvements of social safety nets to preserve the achieved progress. We also welcome the overview of the measures so far taken to limit the impact of rising energy and food prices, which, if unaddressed risk generating social unrest. We see merit in a continued coordination between monetary and fiscal policies.

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GRAY/22/1008

April 7, 2022

**Statement by Mr. Binzarah, Mr. Abalala, Mr. Abdel-Rahman, Ms. Alshaikh, and Ms. Alhawas on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)**  
**Executive Board Meeting 22/35**  
**April 11, 2022**

We would first like to thank staff for their work on the flagship reports in these challenging circumstances, although it is unfortunate that we received the FM and particularly the GFSR with insufficient time to effectively consult with our authorities.

**High and increasingly persistent inflation is becoming a global phenomenon and needs to be tackled in a firm and timely manner.** Additional broad-based fiscal support, unless in response to a more substantial slowdown in growth than envisaged in the WEO baseline, should be avoided as it could fuel further demand pressures and lead to additional increases in global commodity prices which would undermine monetary policy and eventually growth. Effective policy coordination between the fiscal and monetary authorities is essential to maintain credibility and anchor inflation expectations. That said, we find the projected slower growth outlook concerning and agree that there are substantial downside risks to the outlook. Nimble and timely policy actions will be needed to navigate through the difficult policy dilemma posed by rising inflation and slowing growth.

**We welcome the references to energy security and find the analysis in the Commodities Special Feature of the WEO useful.** We look forward to a more in-depth analysis and more balanced recommendations to ensure a smooth transition to a lower-carbon economy which ensures macroeconomic stability and energy security for all countries. We found the reports to be missing an in-depth discussion of structural reforms which are important to address the scarring effects of the pandemic. We agree that multilateral cooperation is essential to sustain recovery and improve medium-term prospects.

Against this backdrop, we broadly find the substance of the three reports to be timely and relevant to the current juncture, and would like to make the following comments.

### **Global Economic Outlook and International Policy Cooperation**

**We welcome the discussion in the first chapter of the WEO on the main spillover channels from the geopolitical developments and the key risks to the outlook.** We note the downward revision to the global growth projections on the back of these developments and that the impact will vary across regions and countries based on country characteristics, initial conditions, and the type of exposure. The heterogeneous impact across countries remains a legacy from the pandemic that is being exacerbated by the new challenges that have arisen. This finding could be further emphasized in the MD's GPA. As staff rightly indicate, there is an unprecedented combination of factors affecting the outlook and these could interact in ways that are difficult to predict, adding to the significant risks and uncertainties surrounding the baseline assumptions and forecasts. Given the difficulties of making projections in current circumstances, we look forward to timely updates on new developments.

**We underscore the importance of multilateral cooperation to address current challenges and to facilitate structural transformation to promote higher and more inclusive growth.** In the WEO, staff rightly outline several key areas for international cooperation. Among these, we would underscore the importance of providing a coordinated response to the refugee crises in Europe and around the world and ensuring equitable access to COVID vaccines, tests, and treatment. Other areas we would like to emphasize are facilitating access to an emergency liquidity backstop in case of spillovers from the monetary policy tightening cycle and improving the implementation of the G20 Common Framework to ensure an orderly debt restructuring process to bring meaningful debt relief to countries most in need (see below).

### **Monetary and Financial Policies**

**The spillovers from geopolitical events are set to further complicate the already challenging trade-off facing policymakers between fighting inflation and securing the recovery.** In view of the uneven pace of recovery and differences in the type of exposure to the Ukraine conflict, we concur that the appropriate monetary policy response will differ based on country circumstances. And considering the significant uncertainty surrounding the outlook, we emphasize that monetary policy adjustment should be data-dependent and supported by a clear and effective communication strategy to help anchor inflation expectations and limit market volatility. Nevertheless, given we are experiencing the highest inflation in decades, and it is proving more persistent than previously expected, it is important

to recognize that many central banks will need to continue or start to tighten monetary policy, and perhaps by more than is currently expected by financial markets. *We are interested in staff views on the current debate on whether some major central banks are falling behind the curve with their current pace of policy rate increases given high and increasingly persistent inflationary pressures.*

**EMDEs are facing a notable increase in financial pressures, although to varying degrees across countries, and these warrant close monitoring and comprehensive policy actions.** We note with concern that the sovereign-bank nexus has deepened in EMDEs amid elevated debt vulnerabilities, the deteriorating sovereign credit outlook, and weaker growth prospects compared to the pre-pandemic trend, posing risks to macro-financial stability. At the same time, the risk of capital outflows from EMDEs has increased compared to the October 2021 GFSR and the intensification of global financial tightening and the spillovers from the conflict in Ukraine could put additional strains on policymakers, especially in countries where fiscal and financial vulnerabilities are already elevated. Given the heterogeneity across countries, we echo staff's view that policy actions should be well-calibrated to country circumstances, including through tightening or developing selected macroprudential tools to address pockets of vulnerabilities. We call on staff to continue to monitor the situation and closely engage with the membership to ensure timely and well-tailored policy advice and CD.

**With the fast adoption of crypto assets, risks from cryptoization are rising and demand greater regulation to manage.** While crypto assets remain, for the most part, a highly volatile speculative investment, the rise of stablecoins could present a more structural shift toward crypto assets as a means of payment and/or store of value presenting further challenges to policymakers. We agree with staff that strengthening macroeconomic policies is necessary but may not be sufficient to avoid cryptoization. Greater global coordination, including through international organizations, could allow for more effective risk management. Moreover, we share staff's view that central bank digital currencies may help reduce cryptoization pressures that are driven by a need for better payment technologies. Staff's work on CBDC is growing in importance for the membership.

### **Fiscal Policy**

**As the FM makes clear, the global fiscal environment is very challenging as the effects of the conflict in Ukraine and expected U.S. monetary policy tightening add to earlier pressures stemming from the impact of COVID-19.** While there are large divergences in fiscal positions across countries, there are growing concerns about public debt vulnerabilities in many. Here, we agree with staff on the need for fiscal policies to be tailored to country-

specific circumstances and for policy responses to remain agile as developments unfold. In broad terms, we believe that the Fund's policy advice should continue to advocate for increasingly targeted fiscal support in areas where it is absolutely needed to avoid fueling generalized demand which would complicate the job of monetary policymakers in bringing down inflation. Longer-term, reforms to enhance revenue mobilization and strengthen public financial management will be important to bring about fiscal consolidation and rebuild fiscal buffers. Nonetheless, it should be noted that implementing such reforms will be politically and socially challenging and time-consuming and will need strong technical and financial support from the Fund and other development partners to address capacity and resource constraints.

**The pandemic has significantly impacted the fiscal positions of many low-income countries (LICs) who now have little or no room to fund critical social and investment programs.** Indeed, tighter global financial conditions and the spillovers from the conflict in Ukraine have elevated the risk of debt distress in LICs to a level where in many it will not be feasible to restore fiscal sustainability and macroeconomic stability without debt restructuring. Here, the G20 Common Framework will play a key role in helping countries deal with unsustainable debt burdens and maintain sustainability.

**We welcome the focus of the FM on ensuring food and energy security, supporting vulnerable households, and analyzing the sovereign interest rate sensitivity to policy rate changes.** In response to higher prices, we agree that commodity exporters should seize the opportunity to rebuild buffers. However, we recommend that staff also emphasize the importance of economic diversification to increase resilience against future commodity price shocks. *Staff comments are welcome.*

### **Climate Policies**

**We cannot stress enough that global cooperation based on multilateral consensus is key to achieving climate goals in a timely and orderly manner.** At present, the Fund's approach to climate issues and its fixation with carbon taxes is focused on the needs of some of the fossil-fuel consuming countries at the expense of fossil-fuel producing countries. Inviting fossil-fuel producers—who make up a sizeable share of the Fund's membership—to the discussion and reflecting their views on climate policies will be instrumental to the success of a smooth transition to a greener economy, as rightly highlighted in the Commodities Special Feature (the analysis of which should feature more prominently in the main WEO text and other reports). It is very important to acknowledge that for international policy coordination to be effective, it will require multilateral consensus and therefore should be discussed in organizations equipped for this like the WTO and UNFCCC. Here, we also

encourage staff to diversify their sources of data and research on energy markets to include OPEC and EIA publications to bring to bear alternate views on our climate discussion and policies.

**We request that staff revise their statements on the need to reduce investment in fossil fuels which we do not believe are appropriate especially in light of the discussion in the Special Feature** (“clean energy transition requires a substantial reduction in fossil fuel investment” (WEO Chapter 1, page 41) and “short-term responses to high energy prices should avoid investing in long-term and capital-intensive fossil fuel projects” (Executive Summary, FM Chapter 1). The global economy will continue to need all sources of reliable, affordable, and sustainable energy to meet growing development needs. Indeed, analysis in the Commodities Special Feature underscores the importance of calibrating the pace of divesting from fossil fuels to be in line with the speed of adoption of renewable energy. Taking actions to transition to greener energy sources should take account of the adequacy of these new sources of supply and make realistic assumptions about the substitution rate between fossil fuels and new energy sources. Absent these actions, energy supply-demand imbalances will create unnecessary shocks to the global economy and delay the transition. Developments in global energy markets over the past year have been importantly generated by the lack of investment in the industry since 2014 (as pointed out in the Special Feature). Continued under-investment will add to volatility and higher prices in the transition and could put at risk energy security in many countries. Climate policies need to strike a balance between meeting climate goals and securing a smooth transition that maintains stable inflation and growth.

**Staff should use balanced language in the reports and ensure climate policy recommendations are focused on the climate goals of reducing emissions and limiting the increase in global temperatures, as defined by Paris Agreement.** For example, WEO Chapter 1 mentions the terms “reduce emissions” and “coal” only once and four times, against 30, 85 and 50 times for climate, oil, and gas, respectively. Moreover, we urge staff not to insert geopolitics into the discussion to incentivize the replacement of fossil fuels with other sources of energy.

**We reiterate our call to continue to acknowledge the importance of carbon capture technologies as a tool to reduce carbon intensity.** If we are to address the challenge of climate change in the least disruptive way, it is very important that all potential technologies that can reduce carbon emissions are encouraged and considered. Investments that reduce GHG emissions from economic activities are as important as those that go into the development of alternate energy. We also emphasize the importance of international financial support to facilitate the implementation of climate adaptation in developing countries.

**Since the carbon pricing scenarios were first developed, the energy market has witnessed many important developments.** This raises the question about the validity of using these scenarios in the current WEO and FM. Higher energy prices across the futures curve, not just in 2022, makes it imperative to recalibrate the carbon price needed to meet climate goals. Further, we see a need for the argument underlying the carbon pricing policy to be streamlined. The initial argument was that the price facing end-consumers of carbon-emitting products needed to be higher so consumption would decline and investment in renewables increased. The current price level is, to a large extent, equivalent to that with the carbon tax included and has become a test of the effectiveness of carbon pricing policy. In response to that, the argument has now been reversed to warn against the vulnerability of the global economy to higher energy prices and call for “action to transition to clean and renewable energy sources” (FM, page 17). This is because higher energy prices have prompted many countries to delay green initiatives and to rely more on fossil fuels, particularly coal, to address the energy supply-demand gap. *Staff’s comments are welcome.*

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GRAY/22/1009

April 7, 2022

**Statement by Mr. Pösö, Mr. Spurga, Mr. Kraavik, and Mr. Slettvag on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

**We generally concur with the messages in the Flagship reports and note the worsened prospects and the serious negative risks further weighing on the global economic outlook.** Russia's unprovoked, illegal and unjustified invasion of Ukraine is causing a tragic humanitarian crisis and wreaking economic havoc with global repercussions. We note that the heaviest economic toll falls on Ukraine and the most vulnerable. We welcome the strong and synchronised call for multilateralism through the Flagship Reports.

**Russia's invasion is the key source of negative spillovers and downside risks to the global economy at the current juncture, not the sanctions imposed in response.** In an integrated world, dependent on global supply chains and trade, the effects from the invasion and the wider uncertainty will not be restricted to Europe. Moreover, the pandemic is not over either, as the recent lockdowns in China underline, putting even more strain on global supply networks. Vaccinating the world population against COVID-19 remains a priority.

**Global action is needed to ensure that the humanitarian and economic crisis in Ukraine inflicted by the war does not result in a global food crisis.** The steep rises in food prices and potential food shortages, reflecting Ukraine's importance for global wheat and corn supply, will be felt most acutely in food-importing low-income economies. Many such countries are still suffering from the scars from the pandemic and have diminished space for fiscal support.

**The implications of the war on global energy demand, supply, and prices would warrant a more in-depth analysis.** Even without sanctions against Russian energy exports to Europe, demand for Russian energy will diminish over the short to medium term as more countries are looking for ways to end imports of Russian coal, oil, and gas. The fact that

Urals crude trades at a historical discount to Brent crude shows that the global demand for Russian energy is affected. The effects are likely to be long-lasting as Russia's actions ultimately hasten the green transition and limit overall dependency on fossil fuels.

**Accelerated inflation and the significant uncertainty about the inflation outlook require vigilance from policymakers.** Many factors, especially supply-demand mismatches and increasing commodity prices, have contributed to higher inflation, and it is likely that Russia's invasion of Ukraine will add to the current upsurge in inflation. Although the drivers of inflation in many cases are beyond the control of policymakers in the short run, there is a risk that the price pressures will lead to more persistent inflation in the medium term. Avoiding de-anchoring of inflation expectations is crucial in this extremely difficult and uncertain situation, particularly in countries with more fragile monetary policy credibility. Signs of more persistent inflation in the medium term could trigger a faster monetary policy tightening than currently expected. This can weigh on the economy and have negative repercussions especially for emerging market and developing economies with debt vulnerabilities. We agree that the appropriate monetary policy response should be country-specific, data-dependent, and clearly communicated. Maintaining and bolstering central banks' independence and credibility remains crucial.

**The fiscal outlook is subject to high uncertainty, as the pandemic is not over yet and the consequences of the war in Ukraine differ heavily across countries.** Higher borrowing costs, rising commodity prices and high uncertainty about the global outlook reduce fiscal space especially in countries where it is already limited, and we are especially concerned about the heavily indebted low-income countries. The international community needs to stand ready to support countries most in need.

**We agree that fiscal support should be well and directly targeted to the most vulnerable.** Further, the fiscal policy of countries that are less exposed to the war should, along with easing of pandemic-related restrictions, move away from the exceptional support provided during the pandemic to bring the deficits back to sustainable levels. Gradually normalizing fiscal policies and returning to medium-term objectives can also help contain inflation pressures. While we acknowledge the challenge in balancing between rebuilding fiscal buffers and directing targeted support to the most vulnerable, we agree with staff that these objectives are not incompatible.

**Financial market resilience is facing multiple risks from many dimensions.** Financial conditions have tightened but, so far, the materialization of systemic risks has been avoided. The war in Ukraine has had an impact on European financial markets, and spillovers to other regions can be significant through high global uncertainty, inflationary pressures, weakened market liquidity and increased counterparty risk. A significant concern is the global impact of

increased volatility and disruptions in commodity markets. We highlight that these risks and vulnerabilities, as well as potential challenges of global financial system fragmentation, need to be monitored very carefully as the situation is very fragile and financial risks may materialize suddenly.

**Emerging market and developing economies (EMDEs) face tightened financial conditions due to monetary policy normalization in advanced economies and increased market volatility which have elevated the risk of capital outflows.** Elevated financing costs are worrying as investments are needed to address the repercussions of the war for the energy and food security, to safeguard the recovery from the pandemic, and to address multiple structural challenges. We note with concern that the link between emerging market sovereigns and domestic banks has intensified, leading to a higher risk of sovereign bank nexus which can reduce bank soundness and compromise lending to the economy. During the pandemic, the use of fintech solutions and crypto assets in EMDEs has increased, which can increase financial inclusion, but we highlight that policy makers need to be mindful of the associated risks and make use of proper policy tools and a multifaceted policy strategy to maintain financial stability.

**Policy makers and regulators continue to face extremely challenging times where they need to address financial vulnerabilities and the high inflation while safeguarding the economic recovery.** We agree that macroprudential tools should be used to tackle elevated vulnerabilities, but procyclicality and excessive and disorderly tightening of financial conditions should be avoided. It is important to start re-building financial buffers, especially in countries with a robust economic recovery.

**The longer-term goals of fighting climate change, enhancing digital transformation, and supporting multilateralism should not be lost.** Fighting climate change remains the most important global policy challenge of our time and policy action must be accelerated to reach climate goals. Strong efforts are needed to intensify the implementation of the COP26 roadmap. We concur that the transition to green energy as well as carbon pricing and fuel subsidy reforms are more important than ever. Catalysing private climate financing and strengthening the climate finance information architecture are key to carry out the transition to green economies. The pandemic has hastened a digital transformation via new ways of working, and the potential productivity gains should be fully utilized. We underline the need to make use of, and support, the multilateral institutions and global cooperation that have served us well. The adverse consequences from Russia's invasion of Ukraine are a stark reminder of the importance of global cooperation, which is more important than ever to support the Ukrainian refugees and to continue vaccinations against the pandemic, together with focusing investment on cleaner energy sources, food, and health.

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GRAY/22/1010

April 7, 2022

**Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, Mr. Cartagena  
Guardado, Mr. Rojas Ramirez, Ms. Arevalo Arroyo, Ms. Lankester Campos, Mr. Lopez,  
and Ms. Moral Betere on World Economic Outlook; Global Financial Stability Report;  
Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for the comprehensive set of flagship reports. We broadly concur with staff's analysis on the prospects and risks of the global economy and financial markets, along with their main policy recommendations. As the recovery from the COVID-19 pandemic was taking ground, the invasion of Ukraine has entailed a new unexpected and exogenous shock with global and dramatic humanitarian, social and economic consequences. Additionally, it is having an asymmetrical impact across countries, which is aggravating the divergence in the ongoing recovery and the scarring effects from the pandemic. On these grounds, the Fund's analysis and main policy recommendations should remain balanced, calibrated and tailored to country-specific circumstances. We strongly support the defense of multilateralism and international cooperation as the best way to solve the crisis, starting with a call to the international community to peacefully resolve the conflict and contain geopolitical fragmentation, which if not reversed, could trigger further trade and financial tensions, intensifying the impact of the war. On what follows, we offer specific comments on the reports.

**World Economic Outlook**

We commend staff for the detailed work identifying the direct and indirect impact to the most affected countries and the spillovers to the world economy through different channels, namely commodity, food and energy markets, global value chains and international trade, financial linkages, refugee flows, geopolitical fragmentation, and heightened uncertainty more broadly. These forces are slowing down the recovery and putting additional pressure on policy trade-offs and the expected pace of monetary normalization, amplifying the risks of a disorderly adaptation of financial conditions across the membership.

Against this background, we note that staff has reduced its global growth projections for 2022 and 2023, while increasing those on inflation, which is expected to persist at higher levels for a longer period. Uncertainty has increased dramatically, affecting consumption and

investment decisions, international trade, as well as capital flows globally. Moreover, the impact of the geopolitical shock is being asymmetric, aggravating the divergent recovery between and within countries, with a more significant impact on the most vulnerable LMICs, in which, at the same time, the vaccination rates are still at low levels.

Risks to the growth outlook have scaled up and are biased to the downside, with potential additional sanctions to Russia clouding the horizon. Upside inflationary risks are mounting, mainly through supply-side channels, although expectations remain broadly anchored at longer horizons and second-round effects contained in many countries. We also note staff's balance analysis about the "stagflation" risk and its mitigation elements, including the lower prevalence of indexation mechanisms that limit its materialization. All these developments are aggravating the policy trade-offs –between output recovery, inflation control, fiscal sustainability, financial stability, and resource reallocation– faced by the authorities.

The main policy priorities continue to stand at the international level: first, a peaceful resolution of the conflict; second, reinforcing vaccination efforts and the global distribution of vaccines. We agree with staff that the geopolitical tensions impose new threats to the rule-based system and strongly commend staff for their call to reinforce multilateralism and international cooperation to address global challenges, including climate change, free trade, international taxation, and debt treatment and resolution. The IMF should stand ready to fulfill its role at the center of the GFSN, supporting all members with financial and balance of payments needs, and ensuring a well-tailored surveillance and CD, according to the membership's needs.

On the domestic front, we agree that policy recommendations to address the immediate consequences of the war in Ukraine should be tailored to country-specific circumstances and policy trade-offs, accounting for the asymmetric impact of the shock across-countries, and the different policy space, state of the pandemic and the vulnerabilities that countries are facing.

In small LMICs and EMs, the challenges are compounded by limited policy space, high levels of public and private debt, and economic scarring from the pandemic, rising concerns of weakening conditions for the most vulnerable segments of the population. Additionally, the ongoing normalization of major central banks' monetary policy is adding pressures to EMDCs financial conditions, complicating their crisis management response and respective economic recoveries. In the case of advanced economies, central banks will have to adapt monetary policy in a timely manner to maintain inflation expectations anchored. Fiscal policies should remain flexible to sustain the recovery and navigate the current crisis with calibrated and temporary fiscal measures, prioritizing spending towards the most vulnerable groups, while putting in place a medium-term fiscal strategy to confront the already high public debt levels. Maintaining exchange rate flexibility –although well-justified temporary measures could be needed to address specific market distress– and deploying policies to reduce external vulnerabilities, in line with the IPF and the IV, will help absorb the external shocks. Additionally, macroprudential and financial policies should quickly respond to developments in financial conditions or to specific pockets of vulnerabilities to contain potential threats to financial stability.

These policies should be complemented with broad structural reforms to strengthen the fundamentals of the economic systems, increase productivity and facilitate resource

reallocation. Specifically, the focus should be on enhancing market competition, promoting private sector activity and investment, and improving the functioning of labor markets. Equally important, the structural agenda should tackle in a comprehensive way three pressing challenges, namely climate change, digitalization and inequality. All those policies will be instrumental to increase the resilience of economies to future shocks and the sustainability of the growth models while maintaining social stability.

### **Global Financial Stability Report**

The GFSR rightly highlights the array of transmission channels arising from the war in Ukraine, as well as the effects of monetary policy normalization and higher inflationary pressures in financial markets. The tightening of global financial conditions and the increased risks to the downside place further strain to many countries that lack policy space after the pandemic. However, as the Chapter notes, while financial stability risks have substantially increased, it is noteworthy that so far, no systemic event has materialized. We agree with staff that while monetary policy faces a delicate balancing act between mitigating inflationary pressures and supporting the recovery, decisive action is necessary to bring inflation back to target in many countries and anchor expectations. Clear guidance and communication from advanced economies regarding their normalization process is crucial to avoid unwarranted volatility.

We also note the increase in financing costs for many borrowers, which will impact the ability of countries to access markets, and the heightened downside risks for portfolio flows against the backdrop of tighter financial conditions, geopolitical uncertainty and US monetary policy normalization. We also note how the war in Ukraine has highlighted potential shifts and fragmentation in the IMS, and how digitalization has significantly increased its role, underscoring needed actions to analyze the challenges in cross border payments and capital flow measures. *Can staff elaborate on the risks of the creation of central bank digital currency blocks and the possible role of the IMF and other international fora to reduce these risks?*

### **Fiscal Monitor**

We concur with staff that the current context calls for country specific fiscal strategies. Ensuring food and energy access to the most vulnerable groups should be a common priority as this would help avoid social unrest. However, we note with concern that many of the actions carried out by governments can have undesirable consequences on global food and energy markets, which could also entail large fiscal costs. We, therefore, welcome staff's recommendation that public measures should be cost efficient and market friendly. For those countries with high risk of debt distress, governments will need to prioritize spending and strengthen revenue mobilization. Commodity-exporter countries should start to rebuild fiscal buffers, while those with expected stronger growth should start normalizing fiscal policy to help mitigate inflationary pressures.

In addition to higher uncertainty, fiscal policy is operating in an environment of higher inflation, slowing economic growth, increasing debt vulnerabilities and weakening real income for the most vulnerable sectors of the population, raising concerns of social unrest. Although inflation surprises could improve fiscal balances and debt to GDP ratios in the short term, a context of more persistent inflation would finally worsen public performance and undermine medium-term growth through greater debt burdens. The ultimate impact will

depend on each country's debt structure and composition, and on the ability of the central bank to anchor inflation expectations. In any case, we agree with staff that sound medium-term fiscal policies ensuring debt sustainability, anchored on credible fiscal frameworks and robust contingency plans, will be essential to limit borrowing costs. In addition, countries should not delay their structural reform agenda aiming at achieving greener and more digital and inclusive growth. The imminent creation of the RST should support countries' efforts in this direction.

The pandemic and the war in Ukraine have highlighted the need for international cooperation in several fronts. On debt vulnerabilities a timely implementation and increased participation in the G20 Common Framework will be essential.

## **World Economic Outlook Analytical Chapters**

### ***Chapter 2: "Private Sector Debt and the Global Recovery"***

We welcome this timely chapter as it provides an understanding of the public and private debt interactions along cycles, and the vulnerabilities they could represent for growth in a context of high leverage, limited policy space and a move to monetary policy normalization. It also provides evidence on the importance of debt composition and its distribution by debtors. Consequently, country-specific policy advice would be needed, although we acknowledge data limitations and challenges in many countries. Therefore, work remains to be done to enhance the institutional characteristics that allow for better data collection.

In the current context, policy makers should avoid cliff-effects calibrating the pace of fiscal consolidation to country circumstances. If fiscal support is needed, it should be calibrated and targeted to viable firms, whereas restructuring and liquidation should be directed to non-viable firms to limit financial stability concerns. To this purpose, policymakers must enhance restructuring and insolvency mechanisms, while eliminating debt bias in corporate and personal taxation. In emerging economies, it would be useful to differentiate between local and foreign currency denominated debt, since a higher share of the latter would limit the policy space to deal with depreciation, highlighting higher solvency risks and the need to build buffers.

### ***Chapter 3: "A Greener Labor Market: Employment, Policies and Economic Transformation"***

We thank staff for the analysis on policies that can help greening the labor market. We especially share staff's recommendation that the green agenda should constitute a comprehensive policy package, including green investment, and structural reforms to facilitate resource reallocation, among others, and specifically training targeted to lower-skilled workers to incentivize labor supply and reduce inequality.

The chapter provides a novel perspective on the process of resource reallocation required by the green economic transformation, focusing on the environmental properties of jobs rather than on the environmental properties of productive sectors. Although we think the most natural way to look at this process is from the sectoral perspective, we appreciate staff's analysis specially regarding the efforts to improve the sectoral efficiency of the economic activities and production processes and to facilitate resource reallocations within and between sectors. *Could staff comment on the reasons behind the cross-sectors labor*

*reallocation that has partly driven the reduction in the average carbon emissions intensity shown in Figure 3.1?*

A related issue is the choice of the indicators for the environmental properties of jobs. According to Figures 3.2 and 3.3, the primary focus of the analysis should be put on the transitions across sectors as the most relevant dimension for the green transformation. *Staff's comments are welcome.* Finally, staff asseverate that stringent-environmental policies are associated with employment that is greener- and less pollution-intensive, although it is not clear to what extent these polices are primarily affecting sectoral efficiency and therefore employment efficiency as a byproduct. *Staff's comments are welcome.*

#### ***Chapter 4: “On Global Trade and Value Chains in The Pandemic”***

We commend staff for the relevant and timely analysis on the evolution of trade and the role played by Global Value Chains (GVCs) in transmitting the pandemic-related shocks across countries, as well as on the need to assess their resilience. The lessons learnt could be useful in the current context in which geopolitical tensions may foster trade disruptions of similar consequences and put strains on global and regional supply chains. We note that –in addition to demand and relative prices– pandemic intensity, containment policies, and the spillover effects were key drivers of trade patterns throughout the COVID-19 crisis, with the major decline in trade and supply disruptions observed at the early stage of the pandemic. Nevertheless, diminishing effects over subsequent waves of the pandemic suggest a significant capacity for adaptability and resilience of GVCs.

We note broad evidence that international diversification and substitutability can increase resilience to cross-border supply shocks and reduce GDP loses and volatility. While we note that staff find that re-shoring of production may further lower diversification, increasing concentration risk, but also that high diversification may imply exposure to highly correlated shocks, we consider that there are instances in which re-shoring could contribute positively to foster regional trade arrangements. We agree that policy design promoting greater diversification in international sourcing of inputs and greater substitutability in input sourcing could enhance GVC resilience, providing a supportive environment while lowering costs, and resolving informational externalities. Another way public policies could help reduce vulnerabilities to supply chain disruptions is by specifically monitoring and addressing the needs of strategic sectors, such as essential medical supplies and key raw materials. We encourage staff to continue developing their research in this direction.

#### **Global Financial Stability Report Analytical Chapters**

##### ***Chapter 2: “The Sovereign-Bank Nexus in Emerging Markets: A Risky Embrace”***

We welcome the analysis on the interlinkages of the sovereign-bank nexus in emerging markets. We note substantial evidence that under the persistence of vulnerabilities, domestic shocks and changes in the global financial conditions, the sovereign-bank nexus may seriously jeopardize macro-financial stability with significant consequences through several transmission channels.

Emerging markets' banking systems are not new to this reality, as they have already endured several stress tests including the global financial crisis and the pandemic. We agree with the outlined risks coming from the real sector and the need to monitor credit portfolio health as the pandemic abates. In this regard, we support staff's recommendations to design and

implement tailored country-specific policy options to lessen the potential risks and enhance resilience. We agree that, in addition to measures directed to strengthen the banking sector, extending maturities of public debt, avoiding buildup of currency mismatches, diversifying the investor base and further development of the local-currency bond markets is of utmost importance. This policy agenda should be discussed in the Art. IV consultation and be supported by IMF TA.

On the comparisons with advanced economies, it will be important to consider the effect of quantitative easing by central banks. *Can staff comment if, given the deleveraging of sovereign bonds positions by major central banks, we can expect that banks in advanced economies will increase their holdings of sovereign bonds and thus increase the negative feedback loop? How will a more rapid selling of bonds by central banks affect the banking system in advanced economies?*

### ***Chapter 3: “The Rapid Growth of Fintech: Vulnerabilities and Challenges for Financial Stability”***

We acknowledge the rapid growth of Fintechs and note that, for a broad range of small LMICs, these are becoming an effective option to widen financial inclusion and enhance competition, especially in countries with low banking penetration. The chapter underlines the increasing risks and vulnerabilities that Fintechs pose to financial systems. We consider that the analysis should be more balanced by further highlighting how a well-calibrated prudential regulation and supervision could mitigate those risks and vulnerabilities.

We agree that policy action is needed to minimize the potential risks of Fintechs and DeFi. As regards the former, it is crucial to ensure an activity-based regulation proportionate to the risks posed by the different actors. As regards the latter, there is a need to monitor its development and assess regulatory options to address the lack of a centralized governance body. In this vein, coordination at international level and among different national authorities is key to ensure a consistent response. We concur with staff that regulation should focus on the elements that enable the decentralized finances, given the rapid developments in the Crypto ecosystems. Additionally, the IMF and other IFIs should work together to complement their risk assessments with country-tailored advice and CD, specially to small LMICs, directed to strengthen the prudential regulation and broaden the perimeter of financial supervision of Fintechs.

## **Fiscal Monitor Analytical Chapters**

### ***Chapter 2: “Coordinating Taxation Across Borders”***

We are supportive of all the global cooperation initiatives envisaged in this Chapter, being particularly mindful to properly adapt that cooperation to address concerns of equitable treatment by emerging and developing countries. All the three topics raised in the chapter are perfect examples of how effective global cooperation can have beneficial outcomes for all countries, while lack thereof leads to races to the bottom.

We are supportive of an efficient and timely implementation of the OECD/G20 agreement on a minimum global tax rate for multinationals and allocating a portion of tax revenues to their respective market countries, even when multinationals act without a physical presence. We also agree to increasing cooperation to eradicate personal offshore tax evasion and continuing the cross-border work deallocation that the COVID-19 pandemic has accelerated.

Finally, we also believe that globally coordinated carbon-pricing policies could provide support to a more accelerated and successful effort to curb climate change. An agreement with the participation of only the largest emitters worldwide, with all other countries joining gradually thereafter, could be a significant first step. Having enough flexibility to accommodate a variety of carbon-pricing mechanisms and differentiated minimum prices for countries at different stages of development will be important to facilitate the process.

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April 7, 2022

**Statement by Mr. Buissé, Mr. Roman, Mr. Grossmann-Wirth, Ms. Albert, and Ms. de Waziers on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)**  
**Executive Board Meeting 22/35**  
**April 11, 2022**

*We commend staff for the quality of the set of reports. We reiterate France strong support for Ukraine and continue to stand with the overwhelming majority of the international community, in condemning Russia's military aggression and the suffering and loss of life it continues to cause. The war is putting the global economic recovery at risk, undermines the resilience of global value chains and will have severe impacts on the most fragile countries. We call on the international community to take action by fully recognizing Russia's responsibility and protecting the most vulnerable countries, with the support of international and regional institutions. We particularly welcome staff's strong message about multilateral efforts.*

*Risks, challenges for policymakers and tradeoffs are exacerbated in this context of strong uncertainty, accumulation of shocks, and inflationary pressures. More than ever, the situation stresses the need for fine-tuned policies, which should also continue to integrate the perspective of long-term challenges, especially on debt and climate issues.*

*We also thank staff for their bilateral answers to our comments on the analytical chapters.*

**1) Greater inflationary risks and the war in Ukraine are exacerbating the pandemic-related difficulties and the risk of economic divergence.**

**We broadly share staff's analysis on the macroeconomic scenario, characterized by a very large uncertainty.** Because of the war, global growth is projected to slow down, and economies are facing global spillovers through commodity markets, trade and financial channels. *Deepening the analysis on the direct and indirect effects of the war would be useful. Could staff detail the components of the revision in the euro area growth forecasts and especially the impact through the different channels of transmissions of the war (including energy)?* Ukraine being a large cereals exporter, the invasion of its territory leads to direct consequences on food markets. We are concerned by the impact of the increase in food and fuel prices, combined with the additional risk of food shortage, which could generate greater poverty and heighten social tensions. This is particularly worrisome in LICs, where the scars

of the pandemic are already more important. We recall that the implementation of sanctions against Russia takes into account the need to avoid impact on the global agricultural trade. We also note the pessimistic view for China's growth this year, below the authorities' target, but we consider that a supportive policy-mix would help to support growth. On trade, we note that the downward revisions of the world GDP growth and trade growth are the same, and that trade contribution to the 2022 growth is negative. *Does staff consider that the trade volume to GDP ratio will not be impacted by the war in Ukraine, and what is staff's opinion regarding the possibility of a potential positive contribution from trade due to a partial catch up of the export performance after the 2020-2021 losses?* Regarding the labor market, we thank staff for the interesting Box 1.1 on US and UK markets. *Beyond health concerns, could staff elaborate if income effects could help explain this phenomenon?*

**We fully agree with staff that many downside risks are clouding the outlook, and we are particularly concerned about a potential escalation of the war in Ukraine and the inflation risk.** Not only each separate risk can worsen over time, but also, due to their interconnections, there is a potential multiplier effect. This could increase the risk of long-lasting divergence across and within countries. *We thank staff for the useful downside scenario in the box, and we would be interested to get the detail by country. Could staff also provide details regarding (i) the underlying assumptions related to fiscal trajectories, and (ii) the breakdown of the embargo impact between price increases and volume shock associated to supply disruptions?* Moreover, inflationary risks are more important than anticipated. Even if the persistence of inflation has so far been underestimated, it is still reasonable to expect that part of the increase will revert following a lesser impact of supply bottlenecks and an eventual decrease in energy prices, while the volatility surrounding the evolution of commodities prices remains high. But some factors also suggest some prolonged medium-term inflation pressures, such as the effect of recent recovery in economic activity, possible second round inflation effects on wages in some cases, and longer-term structural trends such as green transition costs or "de-globalization" costs. Moreover, we are wondering to what extent the withdrawal of the pandemic-related budgetary support contributes to reduce inflationary pressures, and to what extent could the budgetary support associated to the war increase inflationary tensions. *Could staff comment?*

**2) The war in Ukraine reinforces already difficult trade-offs and calls for strong international cooperation, and tailoring policies to specific circumstances is more important than ever.**

**We agree that the policy-mix should be agile and flexible,** standing ready to react to the evolving economic situation in view of the high level of uncertainty while avoiding weakening the economic recovery, and not losing sight of fiscal and environmental medium-term objectives. The pandemic is still here, and we agree with staff that the new shocks caused by the Russian invasion of Ukraine heightened the fiscal trade-offs for policymakers as well as the serious financing difficulties among countries addressing rising inflation and borrowing costs, lower economic growth, high debt, and disparate budget constraints.

**Different fiscal spaces and growth impacts of the conflict call for a differentiation of fiscal strategies across member countries.** Measures aimed at helping the most affected low-income households as well as on energy-intensive companies, and on measures to

support investments in decarbonization, seem to be the priority. This approach should be well calibrated, temporary, and should limit any new net fiscal impulse, so as not to fuel additional inflation pressures. We also agree that the policy responses should preserve appropriate price signals and market incentives when considering options for dealing with the impact of increased food or energy prices on vulnerable citizens and businesses, and we thank staff for their detailed comparison of concrete policy strategies. This crisis reinforces our determination to meet the goals of the Paris agreement and of the Glasgow climate pact and limit the rise in global temperatures to 1.5°C, by accelerating reduction of our reliance on fossil fuels and our transition to clean energy.

**We also agree on the need to pursue long term goals of sustainable medium-term fiscal strategies and structural transformation.** Credible medium-term frameworks are especially important considering the rising interest rates. We continue to encourage measures to enhance revenue mobilization where appropriate, and incentivize investments that are growth-enhancing, key for green and digital objectives and which increase the resilience and inclusiveness of economies. In the European Union, the effective implementation of the Multiannual Financial Framework 2021-2027 and the Next Generation EU, and in particular the Recovery and Resilience Facility, will significantly contribute to this goal through a combination of investment and reforms, and is complemented at national level by the France 2030 plan.

**We agree with staff that financial conditions have overall significantly tightened, with high differentiation across countries, and downside risks have increased, but that no material systemic event has materialized so far in the financial sector.** We also fully agree that the impact of the war in Ukraine on financial markets (i) occurred in the context of already increasing inflation and monetary policy normalization by many central banks, including the Federal Reserve, and (ii) is a specific shock which affects differently various markets segments. We welcome in this regard staff analysis on the diverging situations of equity and bond markets, as well as the role of volatility. *Given the large part of supply-side factors (including energy and bottlenecks) in the recent increase in inflation, do staff consider that real rates – rather than nominal rates – are a better measure of financial condition/monetary accommodation (as suggested in GFSR chap. 1, paragraph 82)?* Regarding banks' exposure to Russia in several countries including France (paragraph 27 of the GFSR), we would like to ask staff to better qualify the sentence by recalling that direct exposures are small compared to the size of the banks (as evidenced in figure 1.10 of the WEO, with a chart on the ratio of Bank's exposure to Russia to total assets).

**Regarding monetary policy, we fully agree on the recommendation of clear central banks guidance, and we insist on the need to remain flexible and data dependent.** In the euro area, the ECB is acting with optionality, gradualism and flexibility. It is continuing the path of policy normalization but will adapt the speed of normalization reflecting the evolving assessment of the outlook. The ECB expects to conclude net asset purchases under the asset purchase program in the third quarter, as long as the incoming data support the expectation that the medium-term inflation outlook will not weaken. It will hike interest rates sometime after, as appropriate in light of incoming data. Regarding the language in paragraph 20, we stress that the ECB has not communicated on an “acceleration of tapering” but on a continuation of normalization. With regard to paragraph 23 on “risk of market fragmentation in the euro area”, we recall that the increase in spreads has been contained and that if

financing conditions become inconsistent with further progress towards the 2 percent target, the ECB would stand ready to revise the schedule for net asset purchases in terms of size and/or duration.

**The EMDEs seem to have been resilient, while the US monetary policy has tightened: it is good news, but a close monitoring of global financing conditions (GFC) is needed.** The risk of new capital outflows in EMDEs could not be excluded. We note that there is a greater differentiation of spreads increases across borrowers compared to previous episodes, and we remain concerned by the consequences of a tightening of the GFC for countries in debt distress or close to debt distress. We thus agree with staff that action to reinforce their resilience, including using macroprudential tools or increasing debt maturities will help to limit the negative impact of a potential acceleration of the tightening of the financial conditions.

**We also fully support the call to continue to tackle previously identified sources of financial vulnerabilities, such as the NBFII sector, the crypto-assets ecosystem and cyber-risks.** We fully agree on the call for macroprudential tools to tackle pockets of vulnerabilities while avoiding a disorderly tightening of financial conditions. Cyber-risks could deserve a more detailed analysis in further work. We also expect more targeted recommendations on CCP and commodity derivatives market beyond the call for increased transparency.

**Finally, we strongly echo staff's call for avoiding counterproductive unilateral actions and for international cooperation** on several fronts including humanitarian crisis, food and energy security, debt crisis, pandemic preparedness, climate transition and tax revenues mobilization. Regarding the humanitarian impact of the war, the economic consequences of the massive refugees' inflows in European countries will have to be further analyzed in due time, and we thank staff for the first lessons of faster integration policies in the *Fiscal Monitor*. To help people fleeing from the atrocities of the war in Ukraine, the EU recently approved three regulations unlocking more than €20 billion in financing. In addition, to respond to the overwhelming need for food security assistance, the EU announced additional financing support to partner countries in Africa. France, together with partners, presented the Food & Agriculture Resilience Mission (FARM) to establish a dedicated response mechanism to boost agricultural production and ensure that the most vulnerable countries keep access to supply. As the pandemic is still there, France is honoring its pledge to give 120 M Covid vaccine doses by S1 2022, half of which had already been delivered in receiving countries as of January 2022. Tackling debt challenges thanks to a greater cooperation remains also a priority, and we recall our strong commitment to the ongoing implementation of the Common framework for debt treatment. The gains from this framework could be substantial, and the participation of private creditors, in accordance with the principle of comparability of treatment, will be essential to provide debt treatment to countries that have requested it. We are looking forward to meaningful progress in the ongoing negotiations.

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GRAY/22/1012

April 7, 2022

**Statement by Ms. Lim, Ms. Wongwaisiriwat, Ms. Abu Bakar, and Mr. Kurniawan on  
World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

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

**World Economic Outlook (WEO)**

- 1. The war in Ukraine and its repercussions have put a drag on the global economic recovery and risks are tilted to the downside.** We see the need for WEO to provide a timely analysis of the current state of the global economy, as well as plausible scenarios to help authorities prepare the appropriate policy responses. While the report touches on all key risks to the global economy, we would like to highlight the following three areas and welcome staff comments.
  - **On the interaction between the financial system and growth especially in emerging markets:** (1) We note that in anticipation of tighter financial conditions and spillovers from geopolitical uncertainty, staff recommends regulators to take 'early action and tighten selected macroprudential tools' to target elevated vulnerabilities. In practice, however, it could prove difficult to calibrate and select the appropriate tool as, while banks' direct exposure to Russia is small, their indirect exposures are harder to quantify ex-ante. Nevertheless, such indirect exposures could be meaningful and surprise investors once revealed as staff assessed in GFSR Chapter 1. (2) A scenario of Russian default or the removal of Russia assets from global indices is plausible, and could trigger risk aversion and more broad-based capital outflows from emerging markets. In this highly uncertain environment, we should send a clear message that FXI and CFMs remain a necessary part of the toolkit to cope with the volatility in the global financial markets.
  - Given the outlook of more broad-based inflation pressure and currently negative real interest rate in many countries, we welcome more in-depth analysis on structural issues such as the post-pandemic neutral rate, the importance of maintaining positive real interest rates, as well as the guidance on how aggressively central banks should respond to the inflation pressure (for example the appropriate weight that should be given to the classic Taylor principle).

- Unlike high-income and middle-income countries, low-income developing countries (LIDCs) continue to face vaccination shortfalls, and correspondingly face more headwinds on growth while having smaller policy buffers as the pandemic situation is prolonged. We note staff analysis that some 60 percent of LIDCs are already in debt distress or at high risk of distress. Given such vulnerability, we should stand ready to provide not only liquidity support but also orderly debt resolution, especially if the risk of China slowdown also materializes.
2. **We welcome the analysis of private debt dynamic in Chapter 2 as this is critical in determining countries' growth trajectory in the medium term.**
    - While we agree with staff that the pandemic is a key driver of debt accumulation for both households and firms, the situations in certain sectors might have evolved significantly from the onset of the pandemic two years ago, for instance as central banks undertook measures to alleviate or offload debt burden from tourism-related sectors. More importantly, there is an emerging need to investigate the impacts of disrupted global supply chains on manufacturing firms, and the impacts of rising food and energy prices on low-income households. *In this context, it might be worth utilizing the analysis from WEO Chapter 4 and the scenario of a prolonged/worsening war in Chapter 1 and exploring the leverage data of these sectors in a more granular manner as they might have different impact on growth at a macro level.*
    - While we welcome the analysis of debt deleveraging using excess credit as the key indicator, we encourage staff to provide more comprehensive analysis on the interplay between financial and business cycles and better estimates of both cycles. We also see that excess credit is only one of many variables that determine the financial cycle.
    - We appreciate staff for a more granular analysis and employing nowcasting approach is a step forward to provide a more real-time analysis. However, we need to be mindful with the reliability of real-time data especially during the pandemic, such as the presence of systematic data revisions.
    - *Regarding the result of the nowcasting approach, we wonder if staff has an alternative to decile income assessment, such as quintile assessment, so that we can avoid explaining the 'anomaly' of the bottom decile as presented in Figure 2.4 lower panel and have stronger empirical evidence.*
  3. **In Chapter 3, we share the importance of transitioning to a greener economy which also includes the transformation of labor markets.** We welcome the model-based analysis, which suggests that the right policy package can put an economy on the path to net zero emission by 2050 with moderate shifts in employment. However, we are concerned that partially implemented or poorly sequenced policy package could exacerbate income inequality and net employment loss. In our view, this result should be communicated carefully to minimize the political concerns related to green economic transformation.
  4. **We appreciate the in-depth analysis of global value chains in Chapter 4 and see this analytical work as helpful in stimulating policy actions to enhance supply chain resilience over and beyond the pandemic.** Notwithstanding the overall resilience of GVCs, industries like automobiles and electronics continue to face large supply disruptions and elevated shipping costs. While we agree with staff on the need to invest in infrastructure to prevent similar bottlenecks in the future, we are concerned of

the competing need for fiscal space in the near term. In this regard, staff may explore country experiences with public-private collaboration or multilateral trade agreements that help make trade diversification more cost efficient for firms.

### Global Financial Stability Report (GFSR)

**5. We appreciate a comprehensive examination of the sovereign-bank nexus in Chapter 2, as this would help policymakers conduct their surveillance more thoroughly and prepare for the worst-case scenario.**

- It might be useful to apply the WEO's downside risk scenarios and analyze further the impacts on emerging markets through the various channels of transmission that staff outlined in GFSR, as these might differ significantly across countries.
- In the context of bilateral surveillance, the new Sovereign Risk and Debt Sustainability Framework (SRDSF) could also complement this analysis by providing a rigorous assessment of a country's sovereign risks in different time horizons. This should help policymakers detect early any debt distress or a negative feedback loop that could threaten financial stability.
- On policy options to weaken the nexus, we remain mindful of the use of capital surcharges [on banks' holdings of sovereign bonds above certain thresholds] as this might adversely affect the demand for sovereign debt and the ability of the government to raise funds domestically, particularly in a setting where there are few alternative liquid assets available to banks.

**6. On the rapid growth of fintechs in Chapter 3, we agree with staff that this is not necessarily a financial stability concern if they are subject to a level-playing regulatory oversight.** On one hand, regulators should make sure that incumbent banks remain competitive and can adopt fintech-like technologies. On the other hand, prudential regulations for neobanks will need to step up to stem excessive risk-taking behavior. While we appreciate the case study of fintechs in the US home mortgage market, we think it might be useful to also explore country experiences where fintechs have helped enhance financial inclusion and the regulatory challenges faced by domestic regulators.

### Fiscal Monitor (FM)

**7. In light of the emerging risks from the war in Ukraine, fiscal policy now needs to be recalibrated and we welcome the Fiscal Monitor Report at this difficult juncture to help policymakers balance between shorter term needs and long-term agenda.**

- In the near term, we agree with staff that governments should pivot its priority to ensuring food and energy security for the most vulnerable individuals. While experience and technology adoption over the course of the pandemic should enable authorities to target their measures better, we caution that developing countries already have limited fiscal space at this point. In this regard, we see the importance of domestic revenue mobilization, credible medium-term fiscal framework, and international cooperation. *We would appreciate more specific guidance from staff in these aspects, especially in addressing food security and refugee displacements in the near term.*
- Moreover, the ongoing geopolitical tension already adds pressure to inflation and could result in faster monetary policy normalization. This could unravel the elevated

debt legacies that have built up before the pandemic and result in widespread debt distress. While the Fund plays an important role in helping countries resolve debt distress, the gravity of the current crisis might call for more international cooperation in the form of G20 Common Framework. It is thus critical to make the Common Framework fully operational in a timely manner.

8. **In Chapter 2, we agree with staff that international coordination on taxation is necessary and unavoidable given the cross-border nature of businesses.** We also agree with staff that differences among countries' incomes add challenges to coordination. Price impacts of taxes on vulnerable households and firms such as MSMEs present political obstacles to successful implementation. For example, in the implementation of carbon taxes, lower income countries often have limited fiscal space to provide mitigating measures to vulnerable groups. In this regard, we think the coordination on taxation should go hand in hand with coordination on mitigation and adaptation policies among key carbon emitters – and with sufficient financing support from mechanisms such as the RST.

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GRAY/22/1013

April 8, 2022

**Statement by Mr. Bevilaqua, Mr. Fuentes, Mr. Saraiva, Ms. Mahabir, Mr. Velloso, Mr. Barroso, and Ms. Hennings on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for the comprehensive analytical material for the flagships and would like to offer the following comments on each of the documents.

**World Economic Outlook (WEO)**

**The war in Ukraine is adding significant pressures to the global recovery on top of the pandemic's heavy burden.** This is an extremely uncertain time, with downside risks for growth and upside risks for inflation. With a double blow from geopolitical and lockdown shocks, strained supply chains and tighter commodity markets are once again taking center stage. We agree that the slowdown will likely be starker in countries closer to the war in Ukraine or more reliant on commodity imports—with the Western Hemisphere perhaps less directly affected. Economic slowdown is also expected to be significant in Asia given the heightened concerns with the pandemic in the region. At the same time, inflationary pressures are more broadly disseminated, pointing to the need for tighter monetary policy across most jurisdictions. More than two years into the pandemic, fiscal space to accommodate the new shock is also much more limited. In this context, any additional fiscal support to mitigate scarring and protect the most vulnerable needs to be very well targeted and underpinned by credible and responsible policy frameworks, considering the need to maintain fiscal and public debt sustainability.

**High inflation will continue to test monetary policy frameworks and policy makers' resolve to keep inflation expectations anchored.** While many emerging market economies (EMEs) are well ahead of the curve, some advanced economies (AEs) are lagging in the tightening cycle. Rising inflation expectations and the overwhelming evidence of tight labor markets, both of which increase the likelihood of second round effects from the new shocks to headline inflation, are very concerning. In this regard, we welcome the case studies on the US and UK labor markets. We take note of the useful scenarios with additional supply

shocks from a prolonged conflict in Ukraine—although the risk of de-anchoring long-term inflation expectations and the resulting need for stronger policy reaction should have received more emphasis. Given the high level of uncertainty at the current juncture, we agree that clear communication is key to avoid disorderly market reactions and large international spillovers. While we also agree that monetary policy should be data-dependent and forward-looking, and be carefully responsive to the balance of risks, it must be resolute in fighting rising inflation and not allowing a de-anchoring of inflation expectations. The bottom-line is simple: letting inflation unchecked and allowing inflation expectations to become unanchored would be the worst possible outcome for the global economy, especially for the poorer and most vulnerable populations.

**While we broadly agree with the main policy recommendations and the characterization of the policy trade-offs, the need to ensure macroeconomic adjustment should prevail.** On the fiscal front, policymakers must balance any support measures with the need for fiscal consolidation, especially in the context of high debt levels and rising interest rates. Indeed, we would recommend putting even more emphasis on the need for revenue mobilization and expenditure rationalization, even in countries relatively less affected by the geopolitical shock. Likewise, delaying needed monetary tightening would be an unproductive and dangerous strategy at this juncture, ultimately leading down the road to higher costs in the overall dosage. This is a crucial point that is not emphasized enough in the WEO. Macroprudential policies should have already been tightened in many jurisdictions, which now must undertake these measures given the urgency of the situation. On a different but also very important note, efforts to pivot the global economy toward cleaner sources of energy must take into account the more challenging reality on the ground, and the need for adjusting policy prescriptions to the new reality of much higher energy prices that are hurting disproportionately more the poor. On the external front, more vulnerable economies should prepare for increased capital flow volatility and rely as needed on the multiple layers of the global financial safety net. Indeed, multilateral cooperation is essential to avoid further disruptions to an increasingly more fragile and fragmented global economy.

**COVID-19 related fiscal support should continue to be unwound to preserve fiscal and debt sustainability and rebuild fiscal buffers.** We take note of the analysis on the negative impact on growth patterns of high leverage that seems to be concentrated in the most vulnerable households and firms. In these cases, where fiscal space allows, additional well-targeted support could be considered. In any case, having in place an adequate resolution framework would be very helpful. We agree that fiscal consolidation and monetary policy normalization tend to be more contractionary when the private debt-to-GDP ratio is higher. While the authorities should clearly take this into consideration, this should not become an excuse for inaction. Moreover, an important lesson learned is that the authorities should consider the possible long-term effects of crisis support measures, even in emergency situations. We agree with staff's call on enhancing detailed and real-time data collection to improve modeling and policy decisions.

**As economic activities gradually adjust to a less carbon-intensive model, labor markets will experience a substantial transformation, with multifaceted implications for jobs**

**and the labor force.** We note that sectoral efficiency improvements and changes in capital and technology respond for the bulk of the change in emissions intensity in a sample of AEs. However, the reallocation of workers (from higher to lower emission intensity sectors) responds for around one-quarter of the decline. We also note that emission-intensive jobs are concentrated in a few sectors and are usually occupied by low-skilled and rural workers, which could be incentivized to move to more sustainable sectors through a well-designed set of policies. That said, considering that the transition to a low carbon-intensive economy may entail sizable costs, especially for poorer households, the strategies should be modulated to today's more challenging and uncertain environment. Moreover, as widely recognized, transition challenges for EMEs and LICs are more substantial and require strong international support, within the framework of the Paris Agreement, which assumes considerable compensatory flows from AEs that have yet to materialize in full as committed.

**We agree that onshoring is not a desirable solution to supply and international trade disruptions—whether generated by health emergencies, geopolitical risks, possible cyberattacks, and extreme weather events.** Lockdowns and restrictions to international mobility have disrupted supply chains with spillover effects on international trade. We welcome the analysis showing how the global pandemic has changed international trade patterns, favoring trade in goods, while restraining trade in services. Supply shortages due to difficulties with foreign suppliers has been substantial in many cases. However, pandemic related disruptions tend to be transitory and their diminishing impact over time suggests that global supply chains are able to rebuild. Therefore, diversification and substitutability of sources of inputs, and increased supply chain resilience (including by proper management of inventories) is the best way forward.

### **Global Financial Stability Report (GFSR)**

**We take note of the substantial increase in risks to financial stability since the previous GFSR.** The sheer size and scope of market volatility makes clear that direct and indirect exposures to the geopolitical shock are systemic in nature. In commodity markets, volatility has been sufficiently high to take trading to a halt at times and, in this process, expose major counterparty risks. With higher commodity prices, central banks in AEs are even more pressed to normalize monetary policy, including by quantitative tightening which, as highlighted by staff, could have unpredictable effects on asset prices and expose fragilities in the Euro Area. EMEs and LICs have seen higher risks of disorderly market conditions, including higher sovereign spreads and, in some cases, exchange rate volatility. The trends put in motion seem to be persistent and could further escalate with the war in Ukraine. Country specific risks in systemically important economies, including noticeable developments in China real-estate market, could also contribute to global financial instability. In sum, with reduced space for accommodative policy responses, the global economy faces very significant risks of severe amplification of shocks through financial markets.

**We broadly agree with the main policy recommendations to support financial stability.** We welcome the more forceful call for monetary tightening in the GFSR and agree that

avoiding disorderly market reactions should also be a major concern. That said, asset price corrections are a legitimate transmission mechanism for monetary policy and major central banks have instruments to address disorderly conditions, including swap contracts and deployment of international reserves. The IMF itself has an important role to support more vulnerable economies to meet foreign currency liquidity constraints in case of more turbulent conditions. We fully support the deployment of macroprudential policies to reduce financial sector exposures and minimize possibly severe downside risks in case of global systemic events. We also support the call for comprehensive reviews of recent commodity markets failures and fast action to improve resilience, ensure transparency and reduce concentration. Again, we agree that crypto assets and decentralized finance require more stringent regulation and supervision.

**While the pandemic has raised sovereign-bank nexus risks, policy recommendations must remain country-specific.** The pandemic has increased the reliance of governments on domestic banks for their financing needs. The fates of the sovereign and the banking sector are highly intertwined, and staff highlights three channels of transmission: the sovereign exposure channel; the safety net channel; and the macroeconomic channel. While staff analysis underscores the relevance and mechanisms of these different channels, the specific characteristics, inner workings, and riskiness of the sovereign-bank nexus vary significantly across jurisdictions. However, staff provides general advice on how such risks can be minimized, including by developing (or improving) robust resolution frameworks; improving the transparency of banks' holdings of government debt; and diversifying investment opportunities. These recommendations, which are fine with us, point in the direction of deepening financial markets and strengthening their regulatory and institutional frameworks.

**However, we strongly caution against reducing banks' incentives to hold sovereign debt through prudential regulation in the form, for example, of positive risk weighted factor or capital surcharges.** Such blanket approaches tend to overlook the specific features and level of sophistication of each jurisdiction's financial system, as well as other institutional arrangements, including regarding currency and liquidity management. Moreover, the mere adoption of disincentives for banks to hold public debt may not lead to fiscal consolidation and may only further sovereign vulnerability, by shifting indebtedness from domestic to foreign currency debt or to central bank financing, with potential deleterious effects in terms of macroeconomic and financial stability. Finally, while we welcome the examination of the sovereign-bank nexus, institutions such as the Basel Committee on Banking Supervision may be better placed and have more information and experience to guide the development of regulations to minimize such risks.

**Given the growing importance of fintech, we welcome the focus on digital banks (also called neo-banks) and decentralized finance (DeFi).** Staff provides welcome country specific information on these novel forms of finance. However, wider reference to their operations in the global sphere and the underlying reasons for their growth in certain markets would be appreciated. Staff notes that neo-banks are in direct competition with traditional banks, while DeFi circumvents the traditional financial intermediation chain. These forms of financing come with their own risks as they may not be regulated as strictly as traditional

financial institutions or may even be completely unregulated. Staff notes that DeFi is particularly exposed to the traditional risks, while having a higher risk profile regarding cybersecurity, AML/CFT, and volatile crypto asset prices. We therefore support staff's recommendation to better regulate these entities or restrict the exposure of regulated firms to them. However, enacting new regulations in some jurisdictions can take time, and these new forms of finance are evolving rapidly. Staff may wish to explore, in the meantime, innovative ways of mitigating risks associated to fintech activities, perhaps with stronger oversight and, in a first moment, self-regulation initiatives.

## **Fiscal Monitor**

**Heightened uncertainty due to the war in Ukraine and lingering effects of the pandemic have put enormous strain on fiscal balances and require a sensible response.** Most countries' fiscal accounts have emerged with deep scars from the pandemic crisis. Although economic recovery seems generally strong, it remains uneven across countries and sectors, and is losing steam, with notable implications for tax collections. Meanwhile, additional spending might be needed to cushion the impact of the twin crises on the most vulnerable. As the global economy faces mounting inflationary pressures, fiscal policy would ideally play a role in addressing this challenge. Also, limited fiscal space and high public debt in many countries require a firm commitment to medium-term fiscal consolidation. That said, the impact of higher food and fuel prices on the vulnerable should be mitigated by well targeted policies, consistent with fiscal sustainability, making the most of the limited fiscal space still available.

**We take note with concern that, according with staff, the pandemic has increased the great financing divide among countries.** This is particularly worrisome as policy tightening by AEs is likely to have significant spillovers. In this regard, international cooperation, good communication, and information exchange become even more important. Country authorities naturally focus on their own jurisdictions, which may result in missing opportunities to advance global and national welfare through enhanced international cooperation to improve taxation and increase revenues. Of course, the task is not trivial, given the particularities of each tax system and legal constraints. While acknowledging that the Fund is in a privileged position to assess and propagate cooperation initiatives that can benefit global prosperity, we underscore that international tax coordination is not in the Fund's main realm and that there are specific fora better equipped for that.

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April 8, 2022

**Statement by Mr. Chodos, Mr. Herrera, Mr. Hendrick, Mr. Lischinsky, Ms. Bustillo, and Mr. Corvalan Mendoza on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary) Executive Board Meeting 22/35 April 11, 2022**

1. **We thank staff for a set of excellent Flagship reports.** In the wake of the pandemic, the Russian invasion of Ukraine is another negative economic shock, adding stress and uncertainty to the global economy. The Flagship reports rightly focus on its economic consequences and risks for the world economy and the international financial system.
2. **In the short term, the war will hurt global growth, increase inflation, and accentuate existing fault lines in the world economy.** Risks to the global outlook are large and skewed to the downside, particularly for emerging market and developing economies (EMDCs) with limited policy space. We draw attention to the possibility of more severe monetary policy tightening in advanced economies, which could create significant stress across the international financial system and EMDCs. We would like to see more work on alternative policy mixes in systemically important economies to minimize global risks. National authorities will need to strike a difficult balance between multiple policy concerns: sustain the recovery, stabilize inflation, restore fiscal and financial buffers, and protect the most vulnerable, while maintaining medium-term credibility and sustainability. Economic policies need to remain flexible, data-dependent, and tailored to country-specific circumstances, including health, economic and social conditions, and policy space.
3. **In the long term, increased geopolitical tensions threaten the prospects for shared prosperity and stability.** Strong global cooperation and multilateral action remain essential to expand economic integration and inclusive digitalization, address climate change and the transition to a low-carbon economy, improve pandemic management, tackle debt distress, and strengthen global liquidity and the international financial safety net.
4. **The IMF must continue playing a leading role in advising and supporting member countries through these difficult times, while supporting their structural changes towards a more resilient future.** We broadly agree with staff's assessment of the major challenges and

risks at the current juncture, and key policy recommendations, and we offer the following specific comments on the reports.

## WORLD ECONOMIC OUTLOOK

5. **We agree that the invasion of Ukraine will hurt global growth, increase inflation, and accentuate existing fault lines in the world economy.** The timing of the commodity price shock is of particular concern, as it will add to existing inflationary pressures, widen external deficits of fuel and food importing countries, and maintain pressure on public budgets to protect vulnerable households. At the same time, central banks have limited room to accommodate this supply shock. Raising interest rates and tightening external financial conditions will aggravate fiscal and financial vulnerabilities in highly indebted economies. The scarring effects in EMDCs are likely to become worse. We believe that the expansionary impact on commodity exporters is very limited, as higher prices are temporary. *Could staff elaborate on the change in projections for net commodity exporter groups?*

6. **We draw attention to the fact that the threat of a global risk-off/slowdown scenario remains an important concern for emerging market economies, despite muted financial impacts so far.** Even before the war in Ukraine, central banks in advanced economies were preparing to tighten monetary policy. An additional supply shock could generate second-round effects, requiring a firmer monetary policy response. In turn, a tighter monetary policy in advanced economies could trigger high volatility in financial markets and capital flows to emerging markets, induce a global slowdown, and raise sustainability concerns in highly indebted countries. In this context, a well-communicated recalibration of macroeconomic and financial policies, which is well-balanced and coordinated across instruments and systemically important economies, is a priority to soften their impact on the world economy. *Could staff elaborate on its scenario and recommendations for the balance between monetary and fiscal policy withdrawal/tightening in advanced economies, how they compare with the pre-war projections, and the impact of alternative policy mixes on EMDCs?*

7. **We share the view that the path for policy recalibration must remain flexible, data-driven, and tailored to country-specific conditions.** Adequate macroeconomic and financial policies must be tailored to country-specific circumstances, including health, social, and economic conditions, exposure to the conflict in Ukraine, policy space, and fiscal and financial vulnerabilities.

8. **We welcome the timely assessment of the role played by the increase in private sector debt and the links to the global recovery.** The data and analysis presented by staff in Chapter 2 of the WEO shows how the surge in households and firms' leverage may affect the recovery in advanced economies and emerging markets in the next few years. It is worrisome but expected that the impact would be greater in emerging markets, and that these estimates do not include the impact of the war in Ukraine. We agree that a better understanding of how leverage is distributed, and its interactions with rising interest rates and tightening financial conditions, is critical to improve macroeconomic forecasting and policymaking, and better calibrate the unwinding of pandemic-time support.

9. **We highlight that staff's analysis also makes a persuasive case to further enhance restructuring and insolvency mechanisms to promote a rapid reallocation of capital and labor toward the most productive firms.** The data reveals that contact-intensive sectors, as expected, are the hardest-hit sectors and account for about 30 percent of vulnerable firms, affecting economic activity and employment. It is worrisome that at 18 months into the pandemic, the share of vulnerable firms remained higher than in the global financial crisis and concentrated in the hardest-hit sectors, where indebtedness was also relatively higher. Regarding the heterogeneous effect on nonfinancial corporation balance sheets, we noticed in Chart 3 of Figure 2.7, that the share of least-hit industries with an interest coverage ratio of less than one, is higher than share of middle-hit industries, and even equal to the share of hardest-hit industries for 2021 Q2. *Could staff elaborate on the intuition and underlying reasons for this outcome? Are the least-hit industries less profitable or with more debt relative to assets? Staff's comments would be welcome.*

10. **The normalization of monetary policy and the pace of fiscal consolidation should take into consideration households and firms' leverage and overall country circumstances.** We agree with staff's views that the government policy response must be tailored to several key factors including countries insolvency framework, fiscal space, and the strengths of balance sheets. Government support to firms should be limited to circumstances when there is a clear market failure. *On the staff's recommendation for temporary higher taxes on excess profits to lessen the burden on public finances and get back some of the transfers to firms that did not need them. Is staff suggesting, for instance, increasing taxes on energy, mining, and food producer firms that benefit from the high commodity prices? Staff's comments would be appreciated.*

11. **We welcome the chapter on the labor market implications of achieving net zero emissions.** The empirical analysis helps to identify challenges in labor reallocation to greener jobs and sheds light on policies to ease the transition. Staff notes that the analysis is based on a sample of largely advanced economies. However, considering that larger employment shifts are expected in emerging markets where transition challenges and the deficit of decent jobs are greater, we would have liked greater focus on developing economies. In addition, though staff notes the inability to consider the agricultural sector due to lack of data, we emphasize the potential job creation of sustainable agriculture and other sectors including forestry for many developing countries and thus its relevance for future analysis.

12. **With respect to the suggested policy package, staff well notes the urgency of the climate change threat.** *We would appreciate staff's elaboration on whether the listed policies achieve the transition outcomes more quickly than others.* For example, no matter how beneficial it might be, it is not clear how an earned income tax credit would necessarily promote this transition. Moreover, staff notes the potential importance of training programs to help the transition from pollution-intensive to green-intensive employment. *Are there any lessons from the experience with trade-related employee retraining programs that were created to assist the transition to a more open economy?*

13. **In WEO Chapter 4 staff presents a detailed analysis of the drivers of global trade during the pandemic.** As expected, the pandemic was a shock like no other to world trade. Lockdown-induced supply and demand shifts were a key driver of imports and exports goods

and services throughout this period. Countries with more severe mobility restrictions experienced a steeper drop in services imports, while their imports of goods increased despite the contraction in output. Internal restrictions on mobility also affected trading partners through global value chain (GVC) linkages. More surprising is the resilience and flexibility of GVC to reconfigure its geography in a short period of time. *Could staff further elaborate on the implications of the trade analysis for the assessment of external positions during the pandemic and confirm whether these considerations are well-captured in COVID adjusters in the EBA model?*

14. **Diversification, substitution, and export restrictions.** It is intuitive that a greater geographical diversification of suppliers and greater ease of substituting inputs would increase the resilience of GVCs to country shocks. However, the analysis of the factors that explain the “home bias” in GVCs is scant (tariff and non-tariff barriers and strategic considerations). It is not clear how the analysis would differ for regional vs international trade. For example, a particularly shocking event was the severe disruption to medical supplies through the pandemic. Many countries placed restrictions on the export of medical products, including protective clothing, medical equipment, pharmaceuticals, vaccine test kits, and even soap and toilet paper. Although the aggregate impact of these restrictions on global trade was small, as the regression coefficients show, their adverse impact on public opinion in importing countries was significant. Similar concerns are raised about food and energy exports in Chapter 1 of the Fiscal Monitor. *Could staff further elaborate on how to introduce these strategic elements to extend the scope of the analysis and policy recommendations about GVCs?*

#### GLOBAL FINANCIAL STABILITY REPORT

15. **We welcome the GFSR’s focus on near future risks and structural issues** that could put the financial system to the test, as well as the set of global and domestic policy responses to minimize risks. Thus far, no global systemic disruption affecting financial institutions or markets has materialized in the wake of the war. The global financial system seems resilient despite multiple events affecting firms, households, and government balance sheets. However, we remain concerned about the potential impact of significantly higher international interest rates on financial stability and the international monetary system, as both the public and private sectors are more indebted than before the pandemic.

16. **The emphasis on sovereign-bank nexus in EMDCs is timely at this juncture.** The empirical analysis performed to a large sample of EMDCs over the past 20 years about the transmission channels is useful, where the shock originating in the sovereign sector could easily translate to the banking and corporate sectors and not the other way around, given the elevated fiscal vulnerabilities in EMDCs. Figure 2.9 “Sovereign and Bank Default Risk and Tightening of Global Financial Conditions in Emerging Markets” makes the case very clear. *We would suggest staff present in an annex these same graphs but for the different regions that comprise EMDCs.* We agree the Basel Committee on Banking Supervision would play an important role to develop a more risk-sensitive regulatory and supervisory treatments, and data on banks’ sovereign exposures are of an essence.

#### FISCAL MONITOR

17. **The fiscal outlook is still highly uncertain due to still unknown consequences of the conflict in Ukraine and the inflationary movements in both AEs and EMDCs.** Even though fiscal deficits are falling in 2021 with regards to 2020, they remain above pre-pandemic levels. While the average public debt is expected to fall by 2024, it would be higher than 100 percent of GDP due to countries' sustained stimulus and concern to achieve pre-pandemic levels of recovery. On the other hand, debt in EMs would be around 73 percent of GDP by 2024 while it is expected to fall to 48 percent of GDP in LICs.

18. **Uneven recoveries and policy space among countries require a tailored fiscal policy response.** In several cases the response depends on suffering direct spillovers from the conflict in Eastern Europe or on having fiscal space or not. In the latter case, most countries have exhausted their fiscal buffers but still need to support their economies trying not to deteriorate ongoing supply-demand imbalances and price pressures. Fiscal policy can help manage market expectations and maintain low borrowing costs if credible and comprehensive fiscal frameworks are defined for the medium term. One particular concern is the increase of international prices for energy and food, and how to protect vulnerable people and maintain social cohesion without increasing fiscal costs or creating food or energy shortages. We agree that the main lesson is to move faster towards low-carbon renewable energies and accelerate the transition to a greener economy.

19. **We appreciate staff's analysis on international tax policy coordination to address inefficient tax policies and the mitigation of climate change and reiterate the urgency of continued dialogue on the potential coordination of policies to overcome unilateral actions.** However, we want to stress that for this coordination to be most effective and improve welfare, it must consider the interests of all countries, including AEs and EMDCs. To this end, we appreciate the focus on improving existing international coordination arrangements, with special attention to the standpoint of developing countries and recognition that country-specific circumstances raise challenges to coordination.

20. **On corporate taxation, we welcome continued analysis on actions to incorporate the interests of developing countries for a fairer system,** including an examination of how the two-pillar approach could yield meaningful revenues for developing countries. The analysis on policies to address climate change clearly underscores the key role that coordination in a small number of key emitting countries could have on curbing global warming. However, the participation of all countries needs to be considered, since the production and emissions moving to low or no-carbon tax countries remains a serious threat to achieving reduced carbon emissions. Moreover, we stress the need for flexibility in allowing countries to choose the appropriate mechanism – carbon prices or emission-trading systems to reduce emissions.

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GRAY/22/1015

April 8, 2022

**Statement by Mr. Jin, Mr. Zhang, Mr. Bai, Ms. Qi, and Mr. Law on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

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

**World Economic Outlook (WEO)**

**We concur with staff's view that the possible worsening of the war and escalation of sanctions on Russia are significant downside risks to the global outlook.** The impact of the conflict on the global economy is severe. Both Ukrainian and Russian economies have been severely damaged, and the neighboring European countries are also direct victims of the war. The rest of the world economy has suffered and will continue to suffer through channels of energy, food, commodities, and the financial market. Before a peace agreement is reached, the Fund and its member countries should work together to prevent further escalation and contagion.

To boost the global economy and mitigate spillovers of the war and relevant sanctions, we call on the Fund to prepare humanitarian assistance to all the people that have been affected by the conflict. The Fund should also give professional analysis and advice to countries to help them refrain from adopting sanctions that will lead to escalation and contagion of the crisis. It is worth noting that the victims of these sanctions are mostly ordinary people and civilians who are totally innocent and unrelated to the evolution of this war. It is important to address the root cause of the conflict and avoid involving innocent countries and people to pay the price.

**We welcome staff's analysis of global inflation dynamics and advice on tackling inflation.** With headline inflation and inflation expectation rising rapidly over the past few months in major advance economies (AEs) and some emerging markets and developing economies (EMDEs), previous worries on a more persistent and broad high inflation are

materializing. Some EMDEs have already tightened their monetary policy stances. We should be cautious against the risk of triple-hit from the pandemic, worsen BOP position, and tighter financial conditions for EMDEs. History shows that when major AEs tighten monetary policies (including the unwinding of central bank balance sheets and/or increasing policy rates), international capital will likely flow back to the AEs and their currencies will appreciate. This would pose significant spillovers to the EMDEs.

**Moreover, considering negotiations and operations have stalled in the WTO, we support the Fund to play a constructive role, deepen the analysis on trade and help member countries refrain from protectionist measures,** emphasize the critical effect of international cooperation based on the division of labor, provide solutions to unnecessary trade barriers, protectionism, and supply chain disruptions, and continue to promote a rules-based multilateral trade system. These measures are extremely important in the global battle against the ongoing pandemic and increasing uncertainties.

**On China’s economic outlook,** the Chinese economy is facing increasingly short-term uncertainties, including the surge of Omicron in some large cities and spillover effect of geopolitical tensions. We think our growth target of around 5.5 percent in 2022 is challenging but still highly possible, given China’s ample policy space and recent supportive monetary and fiscal policy calibrations.

On page 9 of the WEO chapter 1, staff mentions: “*Recent lockdowns in key manufacturing hubs such as Shenzhen will likely compound supply disruptions elsewhere in the region and beyond.*” As the mid-March COVID outbreak slowed down the pace of life in Shenzhen, effective efforts were exerted to ensure the stability of the supply chain and to mitigate the impact of COVID on production and business operations. People’s daily life and most businesses and factories’ production in Shenzhen were resumed within one week. Shanghai’s COVID development is more complicated than Shenzhen’s, while we have confidence that life and business will go back to normal quickly amid effective supportive measures.

On China’s real estate sector, risks stemming from individual firms in the short term will not undermine the fund-raising function and effective operation of the market in the medium and long run. Housing sales, land purchases, and financing have already returned to normal in China. For example, property investment rose 3.7 percent from a year earlier to 1.45 trillion yuan in the first two months of 2022, following a 13.9 percent slump in December 2021.

### **Global Financial Stability Report (GFSR)**

The unprecedented sanctions against a major economy’s central bank and financial institutions have heightened the risk of fragmentation of the international monetary system. Promoting international financial stability and monetary cooperation is the Fund’s *raison d’être*, and hence it is surprising that the draft GFSR has not prominently highlighted this risk. For example, the draft has now even ranked such risk behind “energy security and

climate transition,” which arguably is not part of the Fund’s core mandate. The *Financial Times* has recently published a detailed two-part series on the “weaponization of finance,” highlighting the risks that “financial warfare” has been increasingly used by some countries to inflict damages on rivals, and this would have “profound implications for the future of international politics and economics.” We expect staff to clearly articulate and prominently highlight such risks, including in the Executive Summary and “Chapter 1 at a Glance,” as well as in external communications.

Global inflationary pressure continued to build and has broadened out across a wide range of goods and services in major AEs, particularly the US, amid demand-supply imbalances and labor shortages. Surging commodity prices and heightened financial market volatility amid the geopolitical conflicts threaten to put further upward pressure on global inflation. The accelerated policy normalization by central banks in the AEs could lead to a sudden tightening of global financial conditions, and disruptive capital outflows could weigh on the recovery of the more fragile EMDEs. The Fund needs to ensure greater global coordination on policy normalization. It also needs to provide more pragmatic policy advice to country authorities where appropriate, including the use of capital flow management measures (CFMs) as part of the policy toolkit, in accordance with the recently revised Institutional View on Liberalization and Management of Capital Flows.

Financial conditions in China have remained basically stable despite the impact of the recent COVID wave and conflict in Ukraine. The stock market has recovered from the recent equity sell-off, and the State Council has pledged to actively release policies favorable to markets and make sure any regulation that could have a significant impact on capital markets is coordinated with the financial authorities in advance. Last week, our authorities have further proposed revised rules to facilitate cross-border regulatory cooperation, including joint inspections, which will help safeguard the interest of global investors in offshore-listed Chinese companies. We will continue with reforms to make the financial system better support the economy.

We strongly welcome the dedicated Chapter 3 on fintech and decentralized finance (DeFi). We take note that emerging market neobanks tend to fare better than advanced economy neobanks (paragraph 17). *Staff’s further elaboration on why business models play a factor is welcome.* While we understand the promise of DeFi to eliminate intermediaries, we are unsure whether DeFi lending platforms are “centralized exchanges” themselves. *Staff’s comments are welcome.* As pointed out by staff, DeFi is increasingly interconnected with traditional financial intermediaries, making more effective regulation and supervision more important. There is a strong need for country authorities to have a better understanding of the inner functions of DeFi. We urge staff to organize more technical briefings to keep the Executive Board abreast of the latest developments. Given the fast-evolving nature and growing importance of fintech, we encourage staff to continue to include a dedicated analytical chapter on fintech-related issues in future GFSRs.

**Fiscal Monitor**

We agree that the fiscal outlook is subject to elevated uncertainties. In the context of the lingering pandemic, higher inflation, and tightening global financing conditions, budget constraints are increasingly binding and fiscal prudence is of greater importance. In this regard, we welcome staff's diverse recommendations for countries facing divergent challenges. Fiscal policies should be adopted in line with fiscal spaces. Meanwhile, it is crucial to recognize that normalization of exceptional support in response to the pandemic should be gradual to protect the most vulnerable households.

We note that the public debt level in emerging markets keeps rising. Debt level is determined by various factors including the economic development, financial system, and governance capacities. China has plenty of room to modernize and upgrade infrastructure in both urban and rural areas which will function as new growth engines and ultimately help to reduce the debt to GDP ratio. Going forward, our authorities will stay vigilant against any potential risks and keep supporting sustainable long-term growth.

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April 8, 2022

**Statement by Ms. Mannathoko, Mr. Nakunyada, Mr. Abdullahi, Mr. Ismail, and Ms. Maudi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)**  
**Executive Board Meeting 22/35**  
**April 11, 2022**

*Spillovers from the war and the resultant downgrade in global growth projected for this year, have made what are already very difficult conditions for some developing regions, even more challenging. Countries now face a further escalation in food and fuel prices, and food security concerns. Unlike more developed economies that have increased fuel subsidies to temper the impact of the fuel price shock, many LICs lack the fiscal space to shield affected firms and households. Any breakthrough in countering pandemic induced income divergence amidst scarring, rising inflation and interest rates, and ongoing climate shocks, requires private sector expansion, including via a major investment drive for lagging regions such as Sub-Saharan Africa, similar to that seen in the U.S., Europe, and Asia, where recovery has been much faster. Alongside stabilization, the IMF has a critical role to play in promoting a global economic recovery that leaves no one behind. Strong multilateral cooperation and an effectively designed rules-based system that promotes trade and financial flows as engines for sustainable global growth, are now even more critical than before. Every aspect of the Fund's surveillance, policy advice, and lending has to be guided by the vision that the IMF has been articulating, of an inclusive, smart and sustainable post-pandemic world economy; even as work continues to help the membership navigate difficult policy trade-offs.*

1. We thank staff for an excellent set of reports and appreciate the hard work that went into incorporating the impacts from the ongoing war in Ukraine and associated spillovers to the global economy, on such short notice. We call for an end to the war and humanitarian crisis in Ukraine to restore peace and create a conducive environment for global economic prosperity. As was recognized when the IMF Articles of Agreement were crafted, peace and prosperity are interlinked. The Articles sought to achieve global prosperity through sustained growth and welfare, contributing to peace. A core purpose of the Fund is therefore to “promote international monetary cooperation” and “contribute... to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.” A focus on building global prosperity will in turn support global social stability and help preserve peace across the globe, even as efforts continue, to end the war in Ukraine.

2. We agree broadly with the assessment and policy recommendations provided in the flagships. Noting the implications of the downgrade in global growth and of increased spillovers, we also highlight considerations pertinent to developing countries.

### **The Outlook**

3. The war in Ukraine has had significant humanitarian consequences, while also slowing down the momentum of the global recovery. Considering the tragic loss of life and displacement of millions, we support the call for strong multilateral cooperation to respond to the ongoing humanitarian crisis and to support national policies to rebuild buffers. The spillover effects of the war are also a concern, as reflected in impacts on trade, tourism, and rising energy and food prices that threaten food and energy security, undermining poverty reduction efforts and worsening social tensions in lower income regions. To this end, global action to address worsening food security in many low-income countries has become an urgent matter. Multilateral efforts also remain critical to support a rules-based trading system and the smooth functioning of supply chains. The exceptional uncertainty that dominates the outlook underscores the importance of having a range of diverse scenarios in the WEO, to help countries counter different aspects that could further delay the return to pre-pandemic growth levels and deepen income and growth divergences. In that vein, global efforts to ensure that the pandemic ends, with adequate vaccination availed to LICs, still remain critical, and we welcome the \$23.4 billion in funding for Access to COVID-19 Tools (ACT) and encourage ongoing progress in related areas.

4. The projected (marginal) improvement in growth expected in Sub-Saharan Africa (SSA) is not representative as it reflects the expected impact of high oil prices on a couple of large oil producers, with the primary influence being one country (Nigeria), where the growth projection is, however subject to debate, since the country's large imports of refined oil tend to skew the terms of trade in the opposite direction. As the region is predominantly (refined) oil importing, the growth forecast masks the significant heterogeneity and adverse impacts among both middle- and low-income oil importers. Channels vary across countries and may arise via trade or tourism disruptions, or food and fuel prices, and financial markets. Ukraine and Russia are major suppliers of grains such as wheat, soybeans, and barley, and fertilizers, to various SSA countries, such that the disruption in supply is bound to exacerbate food insecurity and amplify social tensions. *On fuels, while staff recommends that countries release energy reserves where possible, to cushion against the impact of rising energy prices, many countries in the region don't have this option. Rather than authorities being required in program negotiations to remove remaining fuel subsidies at a time when this is likely to be socially disruptive, on-going subsidy reforms on fuel should also be calibrated to take account of the spillover effects of the conflict on prices and living standards. Staff comments are welcome.*

5. The analysis on global trade and value chains in the pandemic shows that despite a speedy rebound relative to the previous crisis, the COVID-19 shock severely impacted trade and global value chains (GVCs) with supply disruptions contributing to extensive declines in global trade, particularly in GVC-intensive industry and in downstream industries characterized by higher concentrations of the labor force (in addition to fueling inflation via supply shortages). While the drop in global trade has been relatively short-lived given the ability of exporter countries to adapt to novel ways of working, including telework, periodic disruptions have persisted as new COVID-19 variants emerge. The analysis demonstrates the shift in the global trade market share, which benefitted countries with vaccine access that exited lockdowns earlier, while also highlighting the importance of crisis preparedness to cushion against sharp impacts. While we concur with staff that strengthening health care systems is critical to pandemic

preparedness, global cooperation in ensuring immediate wide distribution of vaccines could also reduce supply fragmentation and support timely recovery. *Could staff also comment on whether it would be possible, given that various countries are starting to reach the endemic state, to propose a global consensus on curbing global supply-chain disruptions in the event of new COVID-19 waves? The Fund could promote this by assessing policy options to strengthen resilience of GVCs and global trade?*

6. Geopolitical tensions, cyberattacks, and extreme weather events related to climate change, alongside other economic shocks, also warrant greater efforts to build supply chain resilience. To this end, we encourage staff to explore global policy options and influence global rules that can better foster innovation and the development of digital infrastructure in EMDEs and LICs to help them adjust to changes in GVCs.

### **Policies to Sustain Recovery and Improve Prospects**

7. **Fighting inflation:** Given the trade-off between tackling high inflation and safeguarding recovery, we agree that a data driven monetary stance has become more important. Central banks must be vigilant to the impact of sustained price pressures on inflation expectations. We encourage staff advice to countries on optimal, clear, communication approaches that are informed by behavioral analysis of both backward and forward-looking expectations, to help ensure that communication strategies work in entrenching or shifting expectations, as needed, depending on the country. Beyond this, we also believe fiscal policy in some advanced economies can help to contain inflation and limit spillovers. Figure 1.11 on inflation drivers cites “other” factors as the main driver for inflation in the U.S. and we wonder if this reflects the monetary impact of the stimulus. In this regard, while we agree that large economies that have recovered from the pandemic should shift away from exceptional support toward fiscal normalization, in order to avoid further fueling inflation with added money supply pressures, the appropriate policy mix in Europe, which is directly impacted by the war, may be different. *Do staff have insights on the optimal balance between fiscal and monetary policy stances to maximize growth in these differing contexts?*

8. **Interest rates and financial conditions:** We agree that robust international cooperation will be needed to manage the coming monetary tightening cycle. Care should be taken to minimize the scope for a disorderly tightening of financial conditions. It remains imperative that monetary policy design in advanced economies seek to limit negative spillovers to LICs and EMDEs. Given high uncertainties around the economic outlook and tightening financial conditions in the wake of the war in Ukraine (already evident for Eastern Europe and Middle East countries with close ties to Russia); alongside the effects of ongoing monetary normalization, we note it will be important to tighten macroprudential policies targeting specific sectors with high vulnerabilities, in a timely manner.

9. We thank staff for the excellent April 4, 2022, blog on *How Africa can Navigate Growing Monetary Policy Challenges* from rising inflationary pressures and capital flow volatility. The sizable passthrough effects of higher external prices to domestic inflation in the region makes monetary policy management more difficult, and if not contained could lead to social unrest amid political and security tensions that have worsened in some countries in the recent past. The policy guidance on managing policy responses amidst current unprecedented conditions reflects insightful analysis and is appreciated. In particular we note the guidance on reducing vulnerabilities over time, including by reducing balance sheet mismatches, developing money and foreign currency markets, and reducing exchange rate passthrough by building

monetary policy credibility. Similarly we concur on the value for the region of the IMF's work toward an Integrated Policy Framework that suggests that for near term vulnerabilities, additional tools may help ease short-term policy trade-offs when certain shocks hit. Foreign exchange intervention, macroprudential policy measures and capital flow measures can help enhance monetary policy autonomy, improve financial and price stability, and reduce output volatility.

10. **Fiscal soundness and supporting the vulnerable:** We support the proposals on better targeted support for both households and firms (particularly those affected by the war), and on the integration of refugees amidst debt challenges, as well as on enhanced revenue measures. We also note that the fiscal situation that in many LICs and developing countries was already strained by the adverse revenue impacts from the global pandemic, is being worsened by recent geopolitical developments in Eastern Europe. Authorities have a very difficult path to navigate, with challenging tradeoffs given the need for fiscal consolidation alongside strict prioritization of spending. Thus staff support will be needed to allow countries to prioritize not just social safety nets with effective targeting, but also those capital investments necessary to support the growth required to restore revenues, macroeconomic balance and jobs. The private sector's role remains critical to growth and should be supported by necessary investments and associated structural reforms, to enable its expansion and the job creation needed to reduce high and rising poverty rates.

11. A viable private sector role is critical to growth. We note in particular that a strong fiscal position can mitigate the negative output response following excess credit buildup, especially in emerging market and developing economies, where weak fiscal positions imply a cumulative drag on growth of up to 9 percent over three years. Thus rebuilding fiscal positions has to be a priority, and this in turn requires full resumption of economic activity, and private sector growth to generate revenues. *The work stream to optimize systems for revenue collection and fiscal discipline, via automation and digitalization in LICs and EMDEs where capacity is lower, could also be amped up and prioritized. Staff comments are welcome.*

12. **Resolving debt:** Deterioration in debt dynamics in many developing countries is being exacerbated by rising interest rates and a volatile global environment. Thus while we agree with staff that credible fiscal frameworks would be required in the medium term, the immediate priority is an effective global debt resolution mechanism, this being crucial to help avert a debt crisis. In this regard, we are concerned at the lack of progress with the G20 Common Framework and therefore would welcome staff proposals to improve the efficiency and effectiveness of the framework, including pre-determined and predictable timelines for various stages of the process and suspension of debt service during the negotiations. In addition, concerted measures to ensure private sector participation remain critical for a workable Common Framework.

13. We appreciate the private debt analysis in Chapter 2 of the Fiscal Monitor, and the broad coverage including most of the 23 countries in our constituency. Given the finding that inadequate insolvency and restructuring proceedings account for most of the long-term decline in the stock of tangible private capital, we urge staff outreach and CD to developing regions such as SSA, to increase the use and robustness of restructuring, insolvency and reorganization measures or proceedings in preventing large drops in investment. The finding from the analysis on debt and the private investment needed to expand the private sector in developing countries, that "the investment ratio drops relatively more in EMDEs, with investment spending decreasing following a one percent of GDP persistent rise in debt-to-GDP" is worrying. The investment ratio decreases by a significant 1.7 percentage points in EMDEs and unlike in advanced economies where the cumulated loss gradually decreases after the first year, in EMDEs, the cumulated effect

on firms' investment ratio leads to permanent effects on the tangible capital stock. These worrying findings may help to explain why African private sectors struggle so much to grow over time, as reinvestments following shocks are likely constrained beyond the medium term, by rising debt. The current drive to eliminate fuel subsidies in fiscally constrained developing countries amidst record high fuel prices, will also further compromise private sector growth in these economies.

14. **International taxation:** Given the critical importance of revenue generation for countries whose income is diverging in the wake of the pandemic, we are disappointed that Pillars 1 and 2 under the OECD/G20 BEPS framework have failed to generate substantive new revenue for the SSA region. Many African countries have reservations. Pillar 1 does not in fact reallocate profit evenly worldwide, but rather primarily to residence jurisdictions (predominantly to more advanced economies hosting delineated firms). Likewise, the main benefits from Pillar 2 that would have accrued to SSA, would have come from setting a minimum corporate tax threshold of about 25 to 30 percent on mining companies, as analyses have shown significant BEPS activity in the sector. However, instead, the Pillar exempts these companies, applying a lower 15 percent threshold to other companies when most African corporate income tax rates already exceed 25 percent. *Could staff comment on what the exemption of mining companies and the lower threshold mean in terms of revenue foregone by SSA, compared to the application of a 25 or 30 percent minimum corporate tax threshold to mining companies?*

15. Going forward, we urge staff to build on the analysis in their 2019 Board Paper on international corporate taxation and develop full Pillar 1 and 2 scenarios that would help diverging developing regions recoup substantive revenues. The goal for the region is to recoup annual amounts close to the US\$90 bn estimated by UNCTAD (Economic Development in Africa Report, 2020), to flow illicitly and unfairly out of the region annually. *Could staff clarify what shares of the US\$125 bn reallocated under Pillar 1 and of the US\$150 bn expected to be generated under Pillar 2, will accrue to LICs, and to SSA in particular?*

16. In the meantime, considering that the majority of developing economies were not part of the framework agreement, we continue to urge an inclusive process that promotes participation of all countries in the discourse to ensure that their issues are considered fairly, equitably, and adequately. Even as capacity development takes place around this framework, we see the need for future amendments that will ensure a more meaningful outcome for SSA. Beyond this we also note the need for enhanced global cooperation on personal income taxation through exchange of information to reduce cross border tax base erosion from personal income tax avoidance and outright tax evasion by wealthy individuals. Despite recent successes of the global automatic exchange of information agreement, low-income countries are yet to fully realize the benefits from the agreement mainly because of perceived poor standards of confidentiality and data safeguards as well as an inadequate legal framework and technical capacity. *While we acknowledge that all countries, particularly LICs, need to enhance their capacities in the medium term to take full advantage of the exchange of information, we welcome staff views on what actions can be taken in the interim to reduce the burden on LICs.*

17. **Maintaining financial stability:** We note with concern the elevated macro-financial stability risks from a deepened sovereign-bank nexus on the back of higher domestic borrowing in the wake of the pandemic, with potential significant implications for bank balance sheets, lending, and overall economic activity. For countries with higher fiscal vulnerabilities, there are also considerations around capital expenditure and funding of the non-financial corporate sector. Tightening global financial conditions driven by monetary policy normalization and intensifying

geopolitical tensions, alongside increasing public financing needs could further exacerbate these risks. *We note, however, that the analysis only includes large emerging markets, and ask staff to comment on the differences in significance of transmission channels when considering this nexus for other middle-income countries and frontier markets. It would be helpful to know how similar or different the risk transmission channels for this group of countries are and which channels are likely to dominate for these less developed financial markets, given the likely interest in the findings from this analysis. In our region, growing bank and non-bank financial institutions linkages are also a concern that could amplify macro-financial vulnerabilities.*

18. Given the need to improve the transparency and quality of data on sovereign-bank exposures, we call on the Fund to work closely with standard setters to develop international standards that would encourage banks to disclose data on sovereign exposure, while taking into account the multiple channels of the nexus in their stress tests.

19. Monitoring developments in the Fintech sector remains imperative as fintech has the potential to aggravate vulnerabilities and pose financial sector stability challenges. We are aligned with staff analysis in this regard. Digital money risks due to inadequate regulation in member countries, alongside the search for yield in risky markets, and governance challenges from the decentralized finance (DeFi) markets, need attention. Owing to their potential scalability, Fintechs also carry systemic risks from outages, and underpriced or under provisioned credit risks. Particular attention should be paid to interconnectedness within the financial sector, which could exacerbate financial stability challenges. Sensible prudential regulations as well as more capital, liquidity, and operational risk management regulations remain crucial for neo-banks to address underlying risks. Beyond this, given recent developments, staff will need to continue to monitor the effect of financial sanctions on Russia, on the digital payments system in particular.

20. Adapting financial sector policies to address the changing risk landscape in fintech firms is also important. We note the proposal to level the playing field where this is an issue, given the significant competitive pressure that DeFi may pose to incumbent firms, inciting further risk-taking behavior and accelerating the buildup of systemic risk. As such, a balance in the regulatory burden between that for neo-banks and crypto exchanges on the one hand, which are usually subject to simpler and less comprehensive regulations, and that for internationally active banks that are subject to more stringent Basel III requirements, needs to be struck. At the same time, however, carefully examining the scope to foster innovation through appropriate regulation remains important. Coordination and robust governance structures remain key to improve risk management and allow for safer innovation and growth.

**21. Structural reforms and transformation:** Transformative policies remain critical to build resilience to future shocks, including from climate change. The narrative on preparing for tomorrow's economy, rightly highlights the role of digitalization and climate change, however on the latter, more could have been said on **adaptation needs and climate transition costs for low carbon emitters**. While the focus on climate change mitigation by the largest emitters is important, in parallel with this, it remains essential to ensure a fair transition by making sure that much needed adaptation resources and investments are availed to low carbon emitters in developing countries as they are most impacted by climate change. Monitoring and delivery on pledged climate finance and its accessibility by more countries in heavily impacted regions such as SSA where agricultural and related livelihoods are being eroded by drought and disasters, alongside the destruction of infrastructure, remains critical. Conversely, given that commitments under the current Paris Agreement are not ambitious enough to limit global warming to less than

2°C by 2030 and a global carbon price floor is therefore necessary, the associated mitigation responsibility needed to make an impact, rests with current and past large emitters, not with small developing countries. Thus any carbon price floor arrangement should rightfully target large emitters to accommodate equity considerations in carbon pricing.

18. Rising energy prices and associated consequences also highlight the importance of well-designed and appropriate energy policies to ensure a fair and green transition. We underscore the need to design mitigation plans that limit spillovers to LICs and other low emitters in developing regions, and provide support to hydrocarbon producers that must diversify their economies. In this regard, Fund guidance and capacity development on climate transitioning and international financing remain critical to help SSA countries manage the transition from fossil fuels to renewable energy. While we welcome pledges made at COP 26, we urge full delivery on climate finance commitments with accessibility for other SSA countries, and more support through the proposed Resilience and Sustainability Trust to promote sustainable and resilient outcomes.

22. We welcome the analysis on employment scarring which is of particular concern for us given its contribution to rising poverty and instability, and its drain on growth. The trend of rising vacancies for low-skilled workers is particularly concerning in LICs and SSA. While the WEO rightly acknowledges the flexibility of policy responses available to advanced economies, we missed a corresponding discussion for EMDEs and LICs, where unemployment is higher among low skilled workers who dominate labor markets; in addition to which there is a lack of policy space to provide adequate social safety nets and safeguard human capital. We therefore urge staff to provide country specific guidance on how the labor market sector should adapt in line with the transition to climate friendly sectors.

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April 8, 2022

**Statement by Mr. Huh, Ms. Grant, and Mr. Parkyn on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

*We thank staff for the comprehensive set of reports that clearly demonstrate the significance of the war in Ukraine for the global economy and the main spillover channels. The war has heightened the risks and policy trade-offs in an already uncertain environment where the world has not yet fully recovered from the pandemic. We welcome the acknowledgement of the significant uncertainties in the outlook and the transparency around the assumptions. We agree with the focus on the difficult trade-offs for monetary and fiscal policy, as well as on multilateralism. The Fund will need to continue to play a critical role in highlighting the benefits of multilateralism and in providing well-tailored country-specific policy advice for members to navigate the challenges.*

***Outlook***

**What were previously considered risks have crystallized into the baseline.** The WEO reflects a markedly different outlook to that presented in the Fall. On top of a fragile and divergent global recovery, the current outlook reflects the endemic nature of COVID-19, a stronger inflation surge and the effects of Russia's invasion of Ukraine.

**The war in Ukraine is slowing the recovery and exacerbating inflation pressures.** Global growth is projected to be 3.5 percent in 2022 and 2023 – a large downgrade from the January WEO Update. It is mostly reflected in downgrades to the outlook for Ukraine and Russia and spillover effects via commodity markets, trade and financial channels. Global inflation is projected to be higher, with higher food and fuel prices and added global supply chain pressures. We urge staff to continue to assess risks around inflation expectations. The wedge

in inflation between advanced economies and emerging market and developing economies is projected to widen from 2.9 percentage points in 2022 to 4 percentage points in 2023. *We would be interested in any reflections by staff on this inflation wedge – how it compares historically and how it may affect global economic dynamics.*

**The impact of recent developments across the membership will be heterogenous, reflecting the interaction of different shocks, transmission channels and country-specific features.** All regions are affected by the war in Ukraine, but some are more affected than others. Emerging and Developing Europe, including Ukraine and Russia, as well as Euro Area growth are significantly affected and subject to downward revisions. While higher energy prices and trade disruptions are the main channels of spillovers in Europe, food prices are the most significant channel for countries in the Middle East, North Africa, Sub-Saharan Africa, Caucasus and Central Asia regions. We are deeply concerned about the risk of a food crisis and social unrest in non-oil exporters in Sub-Saharan Africa. Asia, the US and Canada are mainly affected through indirect trade channels. The downgrade to growth in China is an added challenge for Asia, but also significant in terms of global growth. *Can staff please confirm that the downgrade to growth in China is solely due to the latest Omicron outbreak, and not additional factors?* Latin America and the Caribbean are expected to be affected by inflation, policy tightening and the effects on trading partners.

**The Fund will need to be both nimble and focused in its ongoing assessment of the global economy.** With the situation evolving rapidly, the membership will benefit from timely updates from the Fund on emerging developments and risks. At the same time, staff are rightly focused on understanding the lower-frequency, structural forces that will shape the global economy over the coming decades, including trends in the macro environment (such as the neutral interest rate and demographics), climate change, digitalization, inequality and global integration.

### ***Risks***

**There are significant uncertainties around the economic projections.** We note that the economic outlook assumes that conflict remains confined to Ukraine, further sanctions on Russia do not encompass the energy sector, and the pandemic's health and economic impacts abate over the course of 2022. While we welcome the inclusion of the scenario in which the sanctions on Russia escalate further, it may have been helpful to also include a scenario around the length of the period of conflict and a scenario on the pandemic. This would have provided a broader sense of the sensitivity of the outlook to the assumptions underpinning the

projections. *Further, would staff consider noting in the sanctions scenario that there are no assumptions made around how sanctions might reduce the length of conflict or stop conflict spilling over to other countries?* Moreover, the economic spillovers of the war and sanctions may be mitigated by policy responses in countries not directly involved. Many countries are in the stage of preparing policy responses as the effects of the war on their economies have not yet materialized. We note that discretionary policy responses are not factored into the baseline scenario, which may pose some upside risk. *Staff elaboration would be welcome.*

**We agree with the assessment by staff that risks are large and to the downside.** In addition to the risks around the war in Ukraine, a further deterioration in the geopolitical environment and the pandemic, there are risks around increased social tensions, a sharper slowdown in China, and higher interest rates leading to widespread debt distress. Near-term and medium-term risks are significantly intertwined at the current juncture. Geopolitical risks could undermine the ability of the world to address structural challenges such as climate change and debt resolution. A more fragmented global economy would have adverse, long-term implications for trade, investment and productivity. As staff note, it would also leave the global economy with an unpredictable transition path.

**We encourage staff to continue monitoring new sources of instability emanating from the conflict, including the important time dimensions associated with ongoing trade disruptions.** It takes a significant amount of time to shift parts or materials required for manufacturing from one country to another, which leads to further disruptions in global value chains. It will be important to consider what industries are subject to concentration risks with respect to their reliance on certain geographical supply sources and to develop a comprehensive set of policy recommendations that aim to consider potential future shocks. *Staff comment would be welcome.*

### ***Policies***

**The outlook crucially depends on global policy responses.** In the context of multiple shocks, policymakers need to remain resolutely focused on tackling new and pre-existing challenges. Multilateral cooperation is even more important than ever at this time when the global economic and financial system and mutual trust, which have been the foundation of global prosperity, are severely threatened. The proposed agenda for multilateral cooperation, including support for refugees, maintaining global liquidity, orderly debt resolution, achieving climate goals, and global public health goods, are all fundamental issues.

**Withdrawal of macroeconomic policy support is expected and broadly appropriate.** In many economies, swift normalization of monetary conditions will be essential to bring down inflation and keep inflation expectations anchored. The Fund's policy advice will increasingly need to consider not only the pace and extent of interest rate rises, but also the unwinding of unconventional monetary policy. We therefore reiterate the importance of Fund advice about the appropriate 'playbook' for unwinding unconventional monetary policies. It will also be critical to monitor the distributional effects of higher interest rates given the tightening of policy after a lengthy period of low rates. In general, fiscal deficits should be reduced from the emergency levels that were necessary earlier in the pandemic, while targeted fiscal measures can be deployed to support vulnerable groups. The focus of fiscal policy should increasingly shift to structural issues, including green and digital transformations. Policies will need to be prioritized and calibrated for country-specific circumstances. The Fund's capacity development support, especially in the areas of public financial management and domestic revenue mobilization, will be critical in light of debt vulnerabilities and pressures on fiscal space in developing economies.

**Credible frameworks with medium-term anchors and effective communication will be critical.** Macroeconomic stability is being tested with some parallels to the 1970s, although we note that staff are appropriately cautious about comparisons with 1970s 'stagflation'. Central bank independence, inflation targeting and exchange rate flexibility have served many economies well and current challenges will reinforce their value. Medium-term fiscal frameworks and anchors should play a key role in maintaining debt sustainability and rebuilding resilience for future shocks. Effective communication is key to anchoring expectations, maintaining market confidence and improving policy trade-offs. Further deepening of Fund advice on macroeconomic frameworks would be welcome, given evolving structural developments in the macroeconomic environment and limits on policy space. The effective lower bound remains an important medium-term issue for the conduct of macro stabilization policy, although less pressing with global interest rates rising. The membership would benefit from further advice on 'optimal' fiscal policy, especially in light of monetary and fiscal interactions.

**The Fund should be actively monitoring fiscal risks.** We anticipate a significant increase in debt vulnerabilities, and while the Common Framework will assist low-income countries, we are concerned that implementation has been slow. As staff note, the timely and orderly resolution of debt will be important for some countries, but the complicated claims with many lenders can hinder this process. We encourage staff to highlight the benefits to low-income countries of starting this process early. This is especially important given that the

world is entering this tightening cycle with a larger fraction of countries under considerable stress, with a more tentative medium-term outlook and slower potential growth, as well as heightened geopolitical tensions. If debt issues extend to middle-income countries, the Fund and the international community will need to be ready to respond.

**There is also a need to take action to avoid a legacy of vulnerabilities and to limit systemic financial risks.** The war in Ukraine and related sanctions have tightened global financial conditions, lowered risk appetite, and induced a flight to quality. Macroprudential tools will need to be calibrated appropriately, mindful of potential downward shifts in asset prices and debt servicing capacity if interest rates rise further than currently anticipated. Emerging and developing economies should prepare for an increase in advanced economy interest rates through debt maturity extensions where feasible, thereby reducing their rollover needs. They should also implement reforms to help them deal with any adverse impact of capital flow reversals and abrupt increases in funding costs. The work on the Integrated Policy Framework and the review of the Institutional View (IV) on capital flows will be important in this environment where members look to secure macroeconomic and financial stability in the face of possible volatile capital flows. We have called for further analytical work in a range of areas that were not covered in the most recent IV review. The current situation highlights the value of continued analytical work on the use of outflow capital flow measures (CFMs) outside imminent crisis circumstances and the effect of digitalization, although CFMs should not substitute for warranted structural reforms that could build macroeconomic resilience.

**It is important to better understand emerging risks to the financial system.** Work on extending the policy toolkit to the non-bank financial sector will be critical given fragilities in this sector. We cannot afford to have these vulnerabilities evolve into structural issues. While European bank exposures to Russia appear manageable, this warrants close monitoring in the current uncertain environment. Rapid growth in fintech might lead to financial stability risks when the sector eventually reaches a more critical size. It is important to continue monitoring developments and how they might relate to maintaining financial stability, while at the same time developing appropriate regulatory frameworks that can help manage the risks.

**We appreciate staff's analysis of the sovereign-bank nexus.** Further work on the relative benefits and risks of external financing versus domestic financing would be welcome and more practical guidance on funding decisions for EMEs that are faced with multifaceted challenges. For domestic financing, risks from the sovereign-bank nexus should be examined

while for external financing, vulnerabilities from exchange rate mismatches are particularly important.

**The Fund must continue to keep attention on the importance of global access to vaccines, while also upgrading the pandemic policy toolkit.** The baseline assumes that most countries will not attain the target of 70 percent full vaccination in 2022. *We would be interested to hear from staff on how far away from this target most countries are expected to be.* We also note that the possibility of renewed outbreaks is factored into the baseline, with their impact on activity assumed to be less than in earlier waves. *Can staff provide some details on how this assumption applies to China and whether the baseline assumes they will continue with lockdowns?*

**The Fund must also continue to assist countries that are affected by pandemic legacies, with small states facing particular difficulties.** It will be critical for the Resilience and Sustainability Trust (RST) to be designed in a way that entices small states to request financing and that catalyzes additional financing. Limited institutional capacity is likely to hinder access by small developing states, with many members in the Pacific never having had a Fund financial program. We call on staff to be creative and flexible in designing conditionalities that keep country-specific capacity constraints and challenges in mind, and to step up their engagement and communication to help small states better understand the Fund's lending toolkit. It will also be critical to monitor access by small states and to be open-minded to an earlier review of the RST if there are indications that it is not meeting its aims. The Fund, in coordination with other IFIs, will be critical in assisting small states to face the macro-critical challenges of climate change. *We would be interested in the assessment by staff as to how the change in the baseline economic outlook affects the potential demand for concessional financing under the PRGT and RST.* The current environment also highlights the importance of the IEO reviews on small states and the policy response to the pandemic. Further enhancements to the Fund's lending toolkit may be required to respond to developments, but any enhancements would need to be supported by appropriate enterprise risk management.

**There is an important role for the Fund in understanding the macro-critical aspects of inclusion and inequality.** We appreciate staff's innovative work to project the global poverty impacts of macro developments, featured in the Fiscal Monitor. Effective policy responses will require careful diagnosis of the underlying drivers of distributional outcomes and analysis of policy impacts and trade-offs. Deepening the Fund's capacity to advise on the distributional impacts of macro policies would be beneficial to the membership. Given the

central role of human capital for inclusion, there should be continued attention on labor market transitions and addressing education losses of children during the pandemic. In a number of advanced economies, declining housing affordability has contributed to inequality concerns with an intergenerational dimension. Deeper analysis of housing markets would be welcome given their importance for macro-structural, financial stability and social outcomes.

**The Fund should be considering how to tackle significant near-term policy challenges in ways that are consistent with medium-term policy goals.** This is particularly relevant for energy and labor market policies. Articulating the relationship between near-term and medium-term policy choices will ensure choices can be viewed through a lens of complementarities and not only trade-offs. It will also help ensure that medium-term challenges are not continually pushed out as problems for tomorrow. We were interested to see that the discussion on retooling and reskilling workers, and on the puzzle in labor markets, was not significantly linked to facilitating structural change. While the chapter on green labor markets goes some way towards this, it could have more helpfully discussed the transition and the link between the near-term and medium-term. We encourage the Fund to consider carefully what sort of labor market policies, and other policies, may help address both the potential scarring from the pandemic and structural changes. *We would be interested in an update on youth participation rates and whether they still remain well below the participation rates for prime-age workers in both advanced and emerging market economies.* If participation gaps persist, there could be severe medium-term implications.

**It is critical that the Fund continues to provide well-tailored country-specific policy advice and broader global policy advice that supports multilateralism.** Policy choices have become even more difficult. Advice on the policy mix should continue to be tailored to country-specific conditions, aiming for maximum sustainable employment while protecting the credibility of policy frameworks. It should also be mindful of the portfolio of risk exposures across different countries and examine policy changes to build resilience and adapt institutional frameworks to manage risks. The Fund must also support multilateral efforts to respond to the humanitarian crisis, prevent further economic fragmentation, maintain global liquidity, manage debt distress, tackle climate change and contain the pandemic. A further deterioration in the geopolitical environment risks destabilizing the rules-based global order and we all have a responsibility to work towards peace and prosperity.

*Note on the circulation of documents*

We appreciate the impressive work of staff to produce such high-quality publications under exceptional uncertainty. That said, the very late circulation of documents is not conducive to a productive discussion and meaningful membership engagement. In the future, we would prefer to receive drafts much earlier in the process, even if they are subject to subsequent revision. Indeed, meaningful engagement with the Board would entail the possibility of making revisions following feedback.

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GRAY/22/1021

April 8, 2022

**Statement by Mr. Jennings, Ms. Cunningham, and Mr. Villeneuve on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for the excellent set of reports and the timely analysis that underpins them—including on the effects of Russia’s invasion of Ukraine. The significant negative impacts on the global economy are a direct consequence of Russia’s actions. The World Economic Outlook (WEO) should fully acknowledge and make clear Russia’s role as the aggressor in the conflict—in line with the language used in the Fiscal Monitor (FM).

World Economic Outlook

**We broadly agree with the staff assessment of the outlook and the characterization of risks around it.** The global outlook has been revised down substantially, mostly owing to the effects of Russia’s invasion of Ukraine. Faster withdrawal of monetary policy support to contain inflation and slowing in China due to COVID-19 lockdowns are also contributing to a weaker global growth outlook. *Further detail on the relative contribution of each of these shocks to overall global growth would be welcome.* Already-high global inflation rates have been worsened by the effects of Russia’s invasion of Ukraine and new lockdowns in China. As a result, the inflation outlook has been revised up substantially for both 2022 and 2023. *Could staff comment on how much core inflation has been revised up in advanced economies and the relative contribution of different shocks?*

**We welcome the focus on the humanitarian crisis in Ukraine** and of the influx of refugees in neighbouring countries. We also agree with staff’s assessment that a coordinated response to address the humanitarian crisis in Ukraine is necessary. Given the considerable economic and human impacts of Russia’s invasion and the longer-term implications for Ukraine and neighbouring countries, this is an issue that should be explored further and subject to future analysis in order to support the much-needed response to address this crisis.

**We appreciate efforts to assess significant but difficult-to-quantify downside risks** stemming from the destabilization of global governance institutions, pandemic variants, social unrest, climate change, and an escalation of Russia’s invasion of Ukraine. Frank analysis of these major risks provides excellent context for the economic outlook. The scenario box starting on page 32 is a very useful addition, and we believe that additional scenario analyses like this would help to illustrate the uncertainty surrounding the outlook and the magnitude of potential negative shocks.

**We broadly concur with the policy recommendations for tackling inflation and monetary policy.** Given the exceptional degree of uncertainty, optionality, data-dependency and clear communication are crucial guides for the conduct of monetary policy. It is critical to bring actual inflation back to target and contain expected inflationary pressures where there has been an upward drift in inflation expectations. Many central banks have already shifted to a tightening stance, notably in North America and several EMDEs. We agree with the WEO’s emphasis on policy credibility, clear communication, and forward guidance on the policy stance, interest rates and central bank balance sheets.

Staff rightly point out that the end point of monetary tightening will depend heavily on real neutral interest rates, and we welcome the analysis in Box 1.2. Forecasting neutral rates for the post-pandemic period is complicated as savings and investment drivers are in flux. There is a risk that the downward trend that prevailed prior to the pandemic may not continue. *We would urge staff to provide more analysis and further detail on staff models of real neutral rates in upcoming WEO reports.*

**We were surprised to see on page 2 the characterization that Russia’s invasion of Ukraine, sanctions, the pandemic, and supply chain disruptions are “beyond the control of policymakers”.** We see ample scope for policymakers to address these challenges (including by Russia leaving Ukraine), and it would be good for the WEO to call for actions to address these challenges, rather than suggest that they are uncontrollable.

**We would also see merit in a more balanced characterization of the impacts of higher nominal wage growth.** At times, given a focus on potential actions by monetary policymakers, the prospect of further wage increases is characterized as a downside risk. However, it should also be noted that while a wage-price spiral would likely entail important downside risks, nominal wage growth will benefit workers by limiting reductions in real purchasing power—which is especially important where wage growth has been weak in past years, where labour productivity has improved, and where inflation is high.

**We welcome staff’s analysis on global trade and value chains in the pandemic** and found the analysis on spillovers from pandemic containment policies very interesting, including the counterfactual analysis. It would have also been useful to discuss the spillover implications for import costs and, by extension, inflation. *Staff’s comments on this would be welcomed.* We would welcome analysis on the spillover implications of supply chain disruptions on investment in emerging market and developing economies.

**We agree that increasing supply chain resilience is critical in the context of pandemics, geopolitical tensions, extreme weather events, and other shocks.** We note staff's assertion that countries could benefit from higher substitutability between input sources. We would expect that the feasibility of substitutability would depend on many factors and would vary across industries and countries. Therefore, elaboration on the differences in outcomes—including more country specific examples—and lessons for emerging markets versus more advanced economies, as well as countries that are most reliant on imports relative to those that are not, would also be useful. One would also expect that domestic substitutability would be important in the context of sharp increases in shipping costs and times. *Staff's comments on this would be welcomed.*

#### Fiscal Monitor

**We agree that policymakers are operating in a very challenging environment.** Fiscal policy will need to address the effects and spillovers of Russia's invasion of Ukraine, while navigating an environment of rising inflation and interest rates, slower growth, and high debt and borrowing costs. Higher energy and food prices pose many specific challenges, and it will be important for policymakers to help protect vulnerable households and step up actions to ensure energy security and achieve the green transition toward a low-carbon economy.

**Challenges are particularly acute in low- and vulnerable middle-income countries,** where financing needs have increased but fiscal space is very limited. In this context, it will be important for the Fund to continue to support members with policy advice to help address challenges and increase resilience. The Fund will also have an important role in helping countries obtain access to new financing where needed—including through direct IMF financing, as well as by helping catalyze financing from other sources.

**Rising debt vulnerabilities are a key risk.** It seems clear that more countries will fall into an unsustainable debt position. In this context, it is critical for progress to be accelerated in the work to improve the sovereign debt restructuring architecture—including better progress in the existing Common Framework cases, expansion of the Common Framework to other countries, and more widespread adoption of state-contingent debt instruments (including climate-resilient debt instruments).

#### Global Financial Stability Report

**We agree with staff that global financial conditions have tightened notably** as some central banks raise monetary policy rates to address inflation, and downside risks to the economic outlook have increased materially as a result of Russia's invasion of Ukraine, and the resulting sanctions against Russia. While capital outflows so far are concentrated in a few economies, and markets are differentiating across EM securities, broader spillovers and contagion could occur if there is a re-pricing of risk. It is also welcome news that foreign

banks' direct exposures to Russia and Ukraine are modest overall. We appreciate the discussion of potential risks from the rapid expansion of cryptocurrencies and digital finance. Staff note that cyber threats against SWIFT or other large shared market infrastructure could have significant economic effects. *Have staff quantified any of these risks, or are there plans to do so?*

**Market-based inflation expectations bear close monitoring as inflation has risen sharply.** We note that inflation break-evens have pronounced increases at the 5-year horizon, but longer-term horizons seem contained. Staff note that options markets show that probabilities of “high” inflation are over 65 percent in both the US and UK, but the chart only indicates inflation greater than 3 percent. *Could staff clarify to what time period the option market forecasts in Fig. 1.7 refer, and can they provide more specifics on the level of inflation they imply for the US and UK?*

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April 8, 2022

**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 22/35  
April 11, 2022**

We thank staff for the comprehensive flagship reports. The war in Ukraine is putting the recovery from the pandemic-induced crisis at risk by exacerbating existing policy challenges, adding new ones and it could have significant ramifications for global prosperity and development if the world economy were to fragment even further. We fully endorse staff's call that not less, but more multilateralism and global economic cooperation is needed to address the many policy challenges that are global in nature but will require national action. The Fund is at the center of many of these debates and has to remain the advocate of a rules based multilateral system and use its surveillance to help policymakers charting a way forward during these difficult times.

***World Economic Outlook (WEO)***

**The dedicated section on commodities in the WEO appropriately draws attention to the energy security risks** at the center of public policy debates, especially in Europe, as well as to the potential global wheat shortage, which may increase the risks of a food crisis. *Could staff further elaborate on (i) the internal efforts that have been made to date to gain a better understanding of the macroeconomic implications of soaring commodity prices; (ii) how the Fund cooperates with dedicated multilateral institutions, such as the IEA and FAO; as well as on (iii) what steps are taken to make the Fund's policy advice more granular, with special attention how to address short-term spikes for the private sector without undermining the functioning of markets.*

**We appreciate that staff take a broader look at the global supply chain disruptions from the pandemic and the new dynamics of global trade in Chapter 4 and we caution that the increasing fragmentation of the global economy poses a renewed threat to global trade. We would welcome an update to this analysis at a later stage.** While we take positive note that trade in goods has recovered to pre-pandemic levels, we share staff's concerns that the aggregate trends mask considerable heterogeneity and note that some changes in services may be more persistent. Even though global value chains show more

adaptability than in the acute phase of the pandemic, new disruptions give cause for concern. While we agree with staff on the importance of increasing supply chain resilience at the international level, we also note that resilience is partly the result of firms' decisions. While the long-term benefits of resilience-building are clear, short-term costs also need to be addressed. Considering a steady increase in the frequency of shocks, we would also put more emphasis on how trade-related challenges can be dealt with in the most efficient way at country and regional levels too, also considering that the role of public investments in strategic sectors may increase going forward.

**Adverse supply-side shocks do not only generate output losses, but also put additional upward pressure on inflation. The persistently high inflation environment calls for further monetary policy actions in a range of countries; the pace of tightening, however, needs to be carefully calibrated.** We note that the transmission of negative supply shocks largely differs by both regions and country groups. As staff rightly outline, the drivers of inflation are in many cases beyond the control of policymakers. The risks of persistently high inflation, however, need to be addressed even in these cases, with particular attention to the risks of de-anchoring of inflation expectations. *Since inflationary pressure had broken decade-long records in many countries already before the outbreak of the Russia-Ukraine war, greater attention to the underlying inflation developments as well as to the second-round effects of the persistent inflationary shocks would be warranted. The most recent data on inflation expectations also deserve more attention going forward. Staff's comments on these issues are welcome. We also wonder how staff assess the room for maneuver for monetary policy in the context of record high asset prices.* Although a large number of central banks have already started withdrawing from the highly accommodative monetary policy stance, further steps seem warranted to curb inflation. The appropriate monetary policy responses, however, vary across economies, as staff also emphasize. We attach great importance to maintaining the credibility of inflation-targeting frameworks and safeguarding financial stability, and call for a data-dependent approach to policy actions, accompanied by clear communication.

**Record high debt levels necessitate redoubled efforts from economic actors to navigate the current challenges in a sustainable manner. We agree with staff that the rapid buildup of debts in both the public and private sectors merits greater attention. We welcome Chapter 2 and invite staff to conduct further debt- and debt sustainability-related assessments.** We positively note that staff analyze not only the debt levels in terms of private sector indebtedness, but also the composition and concentration of debts as well as the available debt management tools. Chapter 2 also confirms the importance of timely unwinding of policy support, where conditions permit, as well as of laying the groundwork of credible medium-term fiscal plans. At this point, however, we also call for taking a careful and flexible approach to deleveraging processes. If economies are forced into rapid deleveraging, moreover in parallel in the private and public sectors, at a time when monetary policies are on the path of normalization, the excessive burdens on economic actors can put the nascent recovery at risk. Going forward, we would appreciate if staff could also explore in more detail (i) to what extent elevated public debt levels constrain long-term growth; (ii) how to restore debt sustainability in a growth friendly way both for market-access countries and LICs, and (iii) how the international architecture of the debt resolution framework can be

further strengthened. *We learnt from the discussions on the preliminary draft of the medium-term budget as well as of the GPA that staff plan to deepen their work on debt-related issues. Could staff elaborate more on what this means on the side of surveillance and research?* We also note with concern that the recent rapid buildup of debts typically is not associated with an increase in growth potential – in fact, the medium-term outlook has deteriorated in many countries because of the scarring effects of the pandemic – as well as that a larger part of low-income countries is already in or at risk of debt distress. Thus, we see a strong need to reorient the focus of policies towards enhancing debt sustainability. We strongly encourage staff to inform policymakers how unsustainable debt could be addressed in the non-market access countries.

**Policymakers also need to scale up their efforts to tackle imminent challenges in a sustainable way. In this context, we welcome staff’s assessment of the drivers and implications of green employment in Chapter 3, but call for a more pragmatic approach to climate policies.** We take positive note that economic actors are increasingly committed to turn ambitious climate goals into concrete actions. At the current juncture, however, when threats to energy security and the access to affordable energy are increasingly coming to the fore, greater attention needs to be devoted to addressing transition risks too. Despite all these challenges, together with well-calibrated energy policy measures, the current juncture is an excellent opportunity to accelerate green energy transitions. Regarding climate change mitigation policies, we invite staff to give greater scope for green financing and other incentives for green investments in their climate-related assessments, since these policy tools continue to have great potential for moving forward structural transformations, while carbon pricing initiatives continue to require a delicate approach. We agree with staff that the green economic transformation has varying effects on labor markets. Although the strong growth of ‘greener’ jobs provides great opportunities for societies, upskilling and re-skilling programs as well as further incentives are also essential to exploit the envisaged potential. At the same time, it is worth noting that in several cases green initiatives emerge from bottom-up processes. Meanwhile, the authorities should also put a premium on breaking down the barriers for the most vulnerable groups to join the labor market, not losing sight of that the pandemic has also left lasting negative imprints in this regard.

### ***Global Financial Stability Report (GFSR)***

**We appreciate the GFSR’s sharp focus on the transmission channels and potential financial stability impact of the war in Ukraine.** While we positively note that the global financial system has so far proved its resilience to yet another shock after the one caused by the Covid-19 pandemic, it will continue to be tested amid high macroeconomic uncertainty and market volatility amplified by the risk of cross-border contagion. Geographical proximity and macrofinancial linkages are likely crucial in identifying regions and financial sectors facing heightened risk. Gaining greater insight into financial interconnectedness, including all potential spill-over effects, will be instrumental in adopting appropriate supervisory action and keeping financial stability risks contained. We also appreciate staff’s insight into the medium- to long-term structural implications for capital markets, central banks’ FX reserve management and the payment systems’ operation.

**Ensuring price stability while supporting financial sector liquidity will be challenging trade-offs.** Improvements in supervision and the strengthening of banks' capital positions have contributed to smoothly managing first round effects, in particular in Europe. We are however, concerned about second and third round effects both from continuing supply as well as demand shocks. Therefore, striking the right balance between reigning in inflationary pressures through monetary policy normalization, and preventing an abrupt monetary policy tightening with adverse effects on financing conditions will be critical under a scenario of prolonged war. *In the context of the current macroeconomic challenges and differences in real interest rates across Europe, we would welcome staff's views on the most appropriate monetary policy response for the regions' central banks.*

**Despite relatively modest exposure of European banks and non-banks to Russian markets, supervisory vigilance is critical going forward.** The supervisors will need to stay abreast of credit, market and counterparty risk, to ensure that financial risk management for entities with largest exposure to Russian markets is sufficiently robust and flexible to respond to potential liquidity disruptions and asset impairment. *In the context of traditionally substantial activities which some CEE banking groups conduct in Russia, we would welcome staff's additional comments on potential contagion risks for the banking sector in the CEE region and advice on the appropriate policy response.* In order to further enhance resilience of the financial sector, we see merit in incorporating cyber risks into the financial stability analysis and enhance banks' stress testing by including macro-financial feedback from corporate sector indebtedness. The work on buttressing the macroprudential toolkit should continue to keep systemic risks in check.

**The current adverse macroeconomic developments also weigh on the economic position of several emerging market economies (EMEs).** In addition to spillovers from the war in Ukraine, acceleration of global financial tightening and the risks of capital outflows from EMEs, in particular some commodity importing countries, needs careful consideration for policy makers given the heightened macro-financial vulnerabilities. While increasing resilience to external shocks needs to be enhanced through comprehensive structural reforms more broadly, we also concur with staff that country specific assessments should be factored into the policy calibration considering the diverse nature of EMEs. At the same time, we caution against fragmentation of the global financial system and support inclusive and open global trade relations.

### ***Fiscal Monitor (FM)***

We broadly concur on the potential **role of fiscal policy** in helping cushion the impact of the Russian invasion in Ukraine in countries with available fiscal space. However, we underscore that in many countries including advanced economies the policy space has been exhausted leaving only difficult trade-offs and positively note the work on spending prioritization. Fund advice can play a positive role in spelling out credible medium-term fiscal strategies and helping countries avoid costly mistakes with permanent measures aimed at limiting the fallout from high energy and food prices. We note with concern that debt is expected to continue to increase under the current outlook and underscore the likely rise in debt servicing costs as monetary policy normalizes and inflation volatility translates into higher premia.

The emphasis on a tailored and **agile fiscal policy** is well placed in the face of large cross-country differences and high level of uncertainty. The current shock warrants a delay in consolidation in many parts of Europe to address temporary new challenges, cover refugee settlement costs, speed up transition to a green economy and tackle new investment needs in security. *Staff's views on whether announced plans are sized and structured appropriately would be welcome.* We underscore the advice on the need to retain the focus on the medium-term macrocritical challenge of climate change. While fiscal structural reforms can play a positive role in easing some of the tradeoffs, the benefits are less likely to materialize in the short term when credibility has not been established prior to the shock. Staff's work on fiscal implications of rising inflation pressure and inflation surprises is timely. While higher nominal tax bases offer a short-term increase in dividends in some cases, many social benefits are linked to price increases only, with a delay worsening the medium-term fiscal outlook.

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April 8, 2022

**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 22/35  
April 11, 2022**

Russia's assault on Ukraine is an unprovoked, premeditated attack against a sovereign democratic state. The UK and our international partners stand united in condemning the Russian government's reprehensible actions, which are an egregious violation of international law and the UN charter.

Russia's invasion has unleashed appalling human suffering, needlessly exacerbating the exceptional set of challenges already facing the global economy. The flagship documents capture these well. Inflation pressures have been sharpened by further supply chain disruption and energy and food price shocks, worsening already severe monetary policy trade-offs. Fiscal policymakers face an increasingly difficult balancing act as they look to support the most vulnerable, begin rebuilding buffers, and make much-needed progress towards a greener and more sustainable future. Global financial conditions are likely to tighten further and faster, eroding fiscal space, while flight-to-safety dynamics have put strains on the financial system and led to severe localised tightening in financial conditions. Rapidly rising food and fuel prices put particular pressure on vulnerable populations and countries, especially low-income countries that are now facing heightened food insecurity. Millions of people have been displaced, remittance flows will be disrupted and the nascent recovery in tourism has been set back. The global recovery has been weakened and the World Economic Outlook revises growth down everywhere except the major commodity exporters.

Furthermore, we now face an extraordinary constellation of risks: worsening conflict and associated spillovers; new variants of Covid-19; a more severe slowdown in China; de-anchoring of inflation expectations; increased social unrest and geopolitical tensions; pervasive debt distress; and a loss of momentum in addressing the climate emergency. The World Economic Outlook's scenario box illustrates just one of these, but still suggests growth could be 2 percentage points weaker in 2023 and 2024. The Global Financial Stability Report's estimate of GDP at risk suggests central growth outcomes no better than a typical year, with an extreme downside skew – based on financial conditions alone. More than one fifth of sovereign debt issuers have spreads in distressed territory and the risk of capital outflows in emerging markets has risen 10 percentage points since October.

The single most powerful action that could be taken to improve the global outlook and balance of risks would be for the Russian authorities to withdraw their troops and stop undermining global stability and international law.

More widely, three sets of policy priorities are imperative: recalibration of macroeconomic policies; actions to mitigate risks; and actions to build resilience. Each of these will require multilateral action – as staff underscore, the invasion has made this both more pressing and more challenging. We thank staff for the very strong set of flagship documents: the World Economic Outlook offers a compelling narrative of the shocks hitting the global economy; the Global Financial Stability Report articulates the extent of financial risks, and; the Fiscal Monitor illustrates the competing demands on public resources.

### **Re-calibrating policy**

Monetary policy needs to be set with a nuanced consideration of the drivers of inflation, of the lags in policy transmission and of the anchoring of expectations. With demand having picked up strongly in 2021, monetary stimulus can be carefully withdrawn. To do so, we need to be subtle in our reading of inflation and its drivers – inflation may be high now, but the pressures from supply-demand imbalances and higher energy and food prices will slacken under the baseline, even if somewhat later than we had thought prior to the invasion. Where inflation expectations are most at risk or where the withdrawal of accommodation is still in its early stages, further withdrawal of stimulus is warranted. But where expectations are at target (and even more so where they are below), we need to set policy with expected inflation at the relevant horizon in mind, or we risk an overly severe or abrupt correction. To avoid undue volatility, this recalibration of policy, including balance sheet adjustment, needs to be supported with balanced communication, which conveys policymakers' reaction functions without overly determining expectations.

Similarly, for many economies it is now appropriate to start planning the withdrawal of fiscal stimulus, in order to ensure sustainability, anchored in credible medium-term frameworks – though targeted support may still be warranted for the most vulnerable and to smooth the adjustment to higher food and energy prices. Neither monetary nor fiscal policy can reverse the hit to real incomes arising from the negative terms of trade shock being experienced by commodity importers. The Fiscal Monitor is right that market prices are a crucial mechanism for ensuring that demand and supply adjust to new realities. But we also need to recognise the strains on household budgets imposed by sharp adjustments in prices and the potential damage this does to support for wider priorities, such as the climate transition – as noted in the Global Financial Stability Report. In that context, we see some merit in actions taken to smooth this adjustment process, including the use of strategic commodity reserves and fiscal support, both tax and spending measures. As the Fiscal Monitor rightly highlights, countries' experiences of the recovery continue to diverge and ongoing support for social protection will be particularly important in low income countries.

Prudential policies also need to normalise, particularly to ensure that risks can be identified and vulnerabilities clearly assessed in the current challenging environment. The Global Financial Stability Report sets this out clearly. It will mean returning to rigorous stress testing of the banking system. We will need to ensure that non-performing loans are recognised and suitably provisioned and that risk weights accurately reflect risk. Macroprudential policies can be used to target discrete pockets of risk, while in jurisdictions where the financial risk environment is moving closer to normal conditions, it will

be appropriate to begin a well-signalled & appropriately-paced resetting of counter-cyclical capital buffers.

### **Mitigating risks**

IMF surveillance needs to vigilantly track risks and vulnerabilities, globally and in individual members, and we must stand ready to lend to those facing balance of payments difficulties. The Fund has invested significant effort in reviewing key surveillance tools: the Comprehensive Surveillance Review, the Sovereign Risk and Debt Sustainability Framework, the Financial Sector Assessment Program and the Climate Strategy, to name a few. Given the challenging risk environment, those now need to be implemented as a matter of urgency. The Board needs to receive more coherent and timely information on the distribution of risks and vulnerabilities across the membership, including a briefing on the latest results of the Vulnerability Exercise. And we need to ensure that our lending toolkit and policies are adequately calibrated for dealing with the current constellation of shocks affecting our members; the Board will need to be fully involved in this.

The World Economic Outlook rightly highlights that there is a long way to go in many countries before pandemic risks will be effectively mitigated. Tackling this will mean overcoming vaccine hesitancy through effective public health campaigns and making use of the most effective vaccines and therapies. To safeguard the recovery from the pandemic, public health and economic interventions to emerging pandemic-related risks should be dynamic and proportionate, learning lessons from best practice over the past two years.

Financial sector reform efforts should continue at the international level to address shortcomings exposed by the COVID-19 crisis. This includes enhancing buffer usability and addressing the underlying vulnerabilities in market-based finance that amplified the 2020 “dash for cash”. We strongly support ongoing efforts at the FSB and note that, absent policies to enhance the resilience of NBFIs, the financial stability risks exposed in March 2020 remain. The need to advance these reforms is further reinforced by the potential limits central banks will face in liquidity provision under current inflation pressures, given their monetary policy objectives. We were disappointed at the sanguine tone on this topic in the Global Financial Stability Report and the absence of any reference to the FSB process, despite staff’s strong engagement. The Global Financial Stability Report was right to include a focus on the recent volatility in the nickel market, which led to a significant rise in margin calls on derivative positions and a temporary suspension in trading by the London Metal Exchange, further highlighting the importance of making progress on the NBFi agenda. The UK has already announced a review into events at the London Metal Exchange, focused on governance, market oversight and risk management.

The flagships clearly articulate the fiscal sustainability risks facing many emerging markets and low-income countries. While high-quality fiscal adjustments are the key mitigant here, we also need to ensure that mechanisms exist to facilitate timely and comprehensive debt restructurings where necessary. The G20’s Common Framework remains our best opportunity for doing this, but G20 members will need to work together to ensure the Common Framework delivers on this potential.

### **Building resilience**

Recent developments underline the challenges of successfully achieving net zero and meeting the increasingly ambitious Nationally Determined Contributions of Paris Agreement signatories, which are vital to containing the climate emergency. The latest energy market stresses demonstrate the importance of ensuring that the most vulnerable households are protected through the clean energy transition. They also reinforce the point that net zero strategies need to be credible, so it is clear to households and to markets that any near-term measures to smooth volatile energy prices are temporary. As well as articulating strategies for moving away from fossil fuels, as the UK and the EU have done in the past month, we particularly agree with the Global Financial Stability Report's emphasis on scaling up private finance and the climate information architecture, to ensure resources are put to the most sustainable uses. The IMF has a crucial role to play in supporting countries in understanding the challenges of adjustment, including via Article IV reports and FSAPs, and the Resilience and Sustainability Trust will be an important tool to mitigate the potential balance of payments needs that might arise.

The rapidly evolving digital money space presents both challenges and opportunities for policymakers. As digital money becomes more widely available, the membership will need to ensure that risks to financial stability are mitigated. This will require enhanced regulatory and law enforcement frameworks, both domestically and globally. Such frameworks should encourage sustainable innovation while maintaining trust and integrity in the financial system. We look forward to engaging further with staff on the implications of digital money for the international monetary and financial system.

Recent developments are also a further poignant reminder of the need for the Fund to be "strongest for its weakest members". Many countries, particularly low-income countries, are now tackling multiple major shocks with limited policy space and heavy downside risks, including increasing risks relating to rising social and political instability provoked by higher food and fuel prices. The membership must therefore ensure that the PRGT is adequately financed to enable the Fund to effectively support its most vulnerable members. Major and increasing sources of fragility and conflict also place a greater premium on the Fund to effectively implement its new strategy for engaging in fragile and conflict affected states.

### **Board and Membership Engagement**

The flagship documents are the centerpiece of the Fund's external engagement, they are highly valued by our authorities and the wider membership, and they warrant enough time to reflect on and refine. While we recognize the extraordinary circumstances under which these documents were produced, we share the disappointment of other directors at the limited time directors and our authorities have had to engage with their important analysis and policy messages. In these difficult times it is absolutely crucial the Fund gets its messaging right – that means appropriate scrutiny from directors and our authorities. As things stand, that time has been unduly compressed, as has that of staff to respond. We hope management will review internal processes to ensure that they are sufficiently nimble to avoid such outcomes again in future.

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GRAY/22/1026

April 8, 2022

**Statement by Mr. Trabinski, Mr. Peter, and Mr. Tola on World Economic Outlook;  
Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

**We appreciate the staff's new set of flagship reports as an accurate and timely depiction of global economic and financial conditions**, notwithstanding the exceptionally high uncertainty. In addition to the human toll, the war in Ukraine has major economic repercussion, particularly on inflation and growth, which are likely to be quite long-lasting. Countries with close links to Russia and Ukraine will suffer the most and will be confronted with difficult economic and political challenges. But spillovers will be felt globally, in particular through higher energy and food prices.

**Downside risks dominate and—while individually damaging—could become quite disruptive if they were to materialize jointly and reinforce each other.** The global growth outlook has weakened considerably since January and growth prospects could further deteriorate. A protracted war and/or protracted sanctions could cause higher inflation and, subsequently, lead to faster monetary tightening and rising interest rates. This could weaken political support for prudent policymaking, which would further undermine the sustainability of public debt and financial stability, which in turn would hurt growth prospects in the medium term. The deterioration of the geopolitical environment could weaken multilateral cooperation and, thus, make it even more difficult to tackle common challenges, including climate change. In this context, we note that the downside (“stagflation”) scenario depicted in the WEO appears to have become more likely since the circulation of the report. *What would be the implications of such a scenario for (global) financial stability?*

**Pre-existing policy trade-offs have intensified.** The key challenge is to keep inflation at bay and debt sustainable without stifling the recovery or threatening the stability of the financial sector.

- **This challenging balancing act requires, first and foremost, determined and credible monetary policy.** The increase in commodity prices may well be temporary and beyond the control of central banks. Indeed, conventional wisdom suggests that central banks should look through such drivers of inflation. However, when second round effects threaten price stability and inflation expectations risk becoming unanchored, central banks need to react quickly and decisively. It is paramount for central banks to be clear in their communication that price stability is and remains the primary objective, even when markets are volatile and debt service costs are increasing. Delaying necessary policy adjustments risks de-anchoring inflation expectations, which would make the eventual monetary policy tightening all the more disruptive.
- **Preserving financial stability requires vigilant and continuous monitoring.** Financial stability risks have increased. In the face of price volatility and investor losses, policy makers need to remind themselves that their primary task is to ensure that a materialization of risks does not lead to systemic disruptions in financial markets. Clear communication about the outlook and what it implies for monetary and fiscal policy can help manage investors' expectations. Adjustments to the prudential policy mix may help prevent a further buildup of risks. Potential new risks emanating from fintechs also need to be monitored more closely, and we agree that prudential regulations should be reviewed and adapted to address key risks of this sector and to limit the avenues of regulatory arbitrage.
- **Fiscal policy needs to strongly prioritize spending and rebuild buffers.** With global financial conditions bound to tighten, many countries will struggle to preserve debt sustainability. To instill confidence and avoid increasing deficits, policy needs to have a medium-term perspective and focus on rebuilding buffers. Fiscal consolidation will particularly be needed in countries facing tighter financial conditions, in which case fiscal consolidation would also help contain inflationary pressures. Where warranted, targeted and prioritized fiscal support should aim to dampen the direct effects from the war in Ukraine and from a possible resurgence of new coronavirus strains. Fiscal policy should support the most vulnerable and focus on creating suitable conditions for innovation and for capital and labor to adjust to the evolution in consumption and production. Where scope for immediate consolidation is limited, credible "locking-in efforts" through fiscal rules might provide some relief.
- **Pursuing active labor market policies would bring the added benefit of reducing wage pressure.** Whether labor supply can recover without causing significant wage inflation is a key unknown. In many countries, the labor force has not fully recovered, vacancies are abundant, and real wages have fallen. We thus need an array of policies that attract workers who have left the labor market, including through adequate

education and retraining. Increasing labor supply would help reduce inflationary pressures and improve medium-term growth prospects.

- **International cooperation is essential.** This is particularly true when it comes to curbing climate change. Action is needed now, and countries should not postpone measures until international coordination is up and running. International coordination is equally crucial in the area of corporate income tax and exchange of information if we want to achieve effective tax mobilization. We welcome global and consensus-based measures and rules that promote innovation and prosperity and are applied uniformly worldwide.
- **Globalization and multilateralism need to be defended.** We must not allow the pandemic and geopolitical tensions to unwind global economic integration and its landmark achievements in terms of poverty reduction and improvements in living standards. We need to strengthen the resilience of global value chains, not uncouple them. The Fund must remain a strong promoter of an open, rules-based, and transparent international system.

**Surveillance—a key pillar of Fund work—is as important as ever.** The Fund’s economic analysis, candid macroeconomic policy advice, and knowledge sharing are key for members to shape their individual policies, particularly in times of high uncertainty like now. We thank Fund management and staff for their strong commitment and tireless efforts in assisting policymakers around the world.

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GRAY/22/1029

April 8, 2022

**Statement by Mr. Hosseini, Mr. El Qorchi, Mr. Ahmed, Mr. Sassanpour, Mr. Belhaj, and  
Mr. Boostani on World Economic Outlook; Global Financial Stability Report; Fiscal  
Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We commend staff for the high-quality reports and broadly support staff's assessment and policy recommendations. The world is in the tight grips of a global economic crisis precipitated by the tragic war in Ukraine, coming on the heels of a once-in-a-century health crisis. The negative spillovers of the war—in many cases worsening the fragilities left behind by the pandemic—have already been felt across virtually all countries through disruptions in global trade and financial links. More troubling, they have been felt through two key channels that impact vulnerable populations the most: higher food and energy prices. Related social tensions are already evident. The low-income countries (LICs), many already facing significant financing constraints, have been hit the hardest. Polarization is replacing the hard-earned globalization. The sad plight of Ukrainian refugees should bring focus on similar tragic mass human displacements in the Middle East, Africa, Latin America, Southeast Asia and elsewhere.

The global outlook is surrounded by exceptionally high uncertainties related to the evolution of the COVID-19 virus and its potentially deadly mutations, as well as to the depth and duration of the war in Europe. The uncertainties and the multiple channels through which shocks may be transmitted have raised additional challenges to policymaking. The crisis has confronted policymakers with difficult choices and trade-offs in the near term to support growth, contain inflation, and protect their vulnerable populations. Appropriate policy calibration will be needed to sustain recovery and protect the vulnerable segments of the population. Policy calibration should prevent de-anchoring of inflation expectations while at the same time minimize the adverse consequences of tighter global financial conditions on emerging economies and developing countries.

Through policy advice, capacity developments and financial support, the Fund will have a pivotal role to play in assisting its members in economic distress. As this juncture, we also

call for increased international solidarity at this difficult juncture. Restoring international links that had already been frayed at the seams before the war will be very challenging even if the war is ended quickly.

### **World Economic Outlook**

We agree with staff that policies need to be tailored to country circumstances as the impact of the two back-to-back crises have been very uneven across countries. Equally important, countries' policy capacity to respond varies considerably across countries. Bringing a swift and peaceful resolution to the war in Europe, and, in parallel, winning the war on the COVID-19 pandemic are of highest priority. It is very disappointing that more than half of the Fund membership will not be able to meet the Fund targets on vaccination, and that the vaccination rates in many LICs, mostly in Africa, are still in single digits.

Beyond that, tackling high inflation that has become a global threat, maintaining the global economic recovery (albeit at a slower pace) and, in the process, protecting the vulnerable groups are highest priorities. These objectives are closely related and require an integrated policy response. Supporting the recovery will need to pay close attention to carefully calibrating withdrawal of fiscal emergency measures and protecting low-income households through targeted measures. Many LICs that are left with no policy space, significant financing constraints and high debt in the aftermath of the pandemic, and food insecurity because of the war, need sustained international support.

The world is facing an “inflation crisis” not seen in many decades. Inflation forecasts have been scaled up noticeably and price pressures are now expected to last longer and be less transitory than expected only a few months ago. Moreover, the root causes of high inflation have become more complex and mutually reinforcing, and are, in some cases, beyond the control of the authorities. The inflationary factors closely attributed to the war (commodity price increases) have hastened and intensified the monetary policy tightening cycle already in train before the war. This, together with a general flight to safety because of the war, has tightened global financial market conditions, with significant negative pressure on emerging market and developing countries (EMDCs) in the form of capital outflow and currency depreciation, and additionally in the case of high-indebted countries, higher debt servicing. Going forward, data-dependent tightening by leading central banks is clearly warranted, but at the same time the risks to EMDCs should not be discounted. An aggressive tightening could even push over some economies that are on the cusp of recession.

The steep rise energy prices are directly related to sanctions on Russia and to self-imposed sanctions. The underlying market fundamentals have not changed, and the supply and demand were moving toward balance before the war. But the higher energy prices seem to have intensified the debate on climate change and the necessity of moving out of fossil fuels and towards cleaner energy sources. This is a critical debate, but fundamental to its success—

as staff rightly concluded in its high-quality analytical assessment (in Commodities Special Feature)—is close coordination between fossil fuel producers and consumers during the transition, and also ensuring that the pace of divestment from fossil fuels is commensurate with the speed of adoption of renewable energy. While sharing the same green objectives, we have to recognize that the means of achieving them, and the path could be different. The war has also brought to the fore the issue of energy security. The (hopefully transitory) increase in the use of coal is probably more a reflection of energy security than relative energy prices. Oil and gas producers, including those in our constituency, are facing important transitional challenges to diversify their economies while contributing to global energy security in the long march towards net-zero emission target around mid-century.

Strengthening the rules-based multilateral relations in various areas, including trade, finance, health, technology, and migration is an imperative for global prosperity and security. We have all greatly benefitted from globalization; weakening and possibly permanently rupturing these links will be very costly.

### **Global Financial Stability Report**

The war and sanctions on Russia and a generalized risk-off have had a negative impact on asset valuations and Russian defaults would reverberate strongly through financial institutions. We note the higher risks to Europe stemming from the non-negligible balance sheet exposure of some of its banks and other financial institutions to Russian assets and financial markets directly as well as to indirect and undisclosed exposures, including through derivatives and other off-balance sheet transactions. We concur with staff on the need to improve transparency and strengthen overall risk management and prudential oversight, including for nonbank financial intermediaries.

Sanctions are strengthening the call for countries to build resilience. We share staff's concerns about the associated risks of market and payment system fragmentation, undermining decades of multilateralism and cooperative efforts for effective globalization. In addition, the surge in crypto asset trading following the sanctions have raised legitimate concerns about increased "cryptoization" of emerging market economies and their possible impact on financial market integrity and stability. Mitigating these risks should become a policy priority, but without rebuilding trust and international cooperation success in effective regulation will be limited.

The war has also highlighted risks to financial stability from cyber-attacks. We agree with staff that there is an urgent need to integrate cyber risk into financial stability analysis and surveillance. We also concur with the important role that TA from the Fund and other institutions can play in strengthening the capacity of member countries—particularly emerging market economies—to protect their key institutions and systems from cyber risks.

## **Fiscal Monitor**

Fiscal policy is pivotal to addressing the impacts of the pandemic scars and the war in *Ukraine*, particularly to protect the most vulnerable from the impact of high and rising inflation on household budgets.

Countries face uneven effects of the COVID-19 pandemic on households' income and poverty. In contrast to the US and the EU, fiscal support was insufficient to prevent a fall in household income in many developing economies. We note that deficits are falling globally but are expected to remain above pre-pandemic levels. Whereas the average public debt in advanced economies is projected to decline to 113 percent of GDP by 2024, it is projected to continue to rise in emerging markets, reaching 73 percent of GDP by 2024. That said, amid exceptionally high uncertainty, risks of a worse outcome predominate. Effective policies are, therefore, needed to ward off worse outcomes. Policy focus in EMDCs will have to shift toward safeguarding macroeconomic stability and building credibility. We concur that in LICs affected by high energy and food prices, the right approach would be to provide targeted, temporary, and direct subsidies to support vulnerable households, rather than generalized subsidies or transfers which imply large fiscal costs.

**Chapter 2** puts a spotlight on the need for cross-border coordination on taxation to improve desired outcomes at an opportune time when fiscally constrained governments need more resources to finance investments and support vulnerable households. We strongly agree that global cooperation in corporate taxation, transparency, and exchange of information for personal taxation, and carbon pricing can mobilize additional revenues as well as address fairness and equity issues and support tax compliance.

International cooperation on personal income tax can certainly curtail offshore tax evasion by enhancing information sharing across jurisdictions, establishing beneficial ownership registries, and strengthening capacity of tax administrations. However, in our view, the case of corporate income tax seems to be rather complex, making global coordination a relatively more daunting task. Presently, it is incredibly easy for companies to avoid taxes by shifting revenues from high-tax to low-tax jurisdictions or where not taxed at all. Large firms can exploit loopholes in tax codes to reduce their tax liabilities. Multinational corporations deploy complex organizational structures, financial and dividend policies, and expensive tax planning to reduce their tax liabilities asymmetrically. Tax authorities are spending millions of dollars to clamp down on multinationals. *Countries have committed to the OECD G20 global tax plan that would force companies to pay a minimum rate of 15 percent instead of little or no tax at all now. Several countries have been front-centered to these efforts, but it is unclear how soon the plan can be introduced. Staff comments are welcome. Also, could staff elaborate on the revenue implications of the OECD plan, i.e., how much money individual governments will bank?* It seems that countries with a relatively small population will not benefit much, suggesting that the global minimum tax rate should be more than 15 percent

and that legal loopholes must be closed. Unfortunately, corporate tax havens are behind the breakdown of global tax system. About two-fifths of multinational profits are channeled through tax havens. The world is moving on this, but several countries are being left behind. The OECD G20 plan has been years in the making. Governments around the world are struggling to pay for public services and want a bigger share of the revenue pie. In this context, the FM's timely coverage of the broader issues in taxation coordination is welcome.

Compared with corporate and personal taxes, carbon pricing needs more consensus and addressing policy and regulatory gaps by less ambitious countries. Whereas effective coordination in corporate and personal income taxes requires global participation, we concur with staff that an agreement among a small number of key emitting countries could curb global warming.

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GRAY/22/1030

April 8, 2022

**Statement by Mr. Stephan, Ms. Koh, Mr. Boehme, and Ms. Khademi on World  
Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

**We thank staff for the set of reports that capture the wide ranging and significant economic fallout from Russia’s invasion of Ukraine.** The Russian invasion of Ukraine has increased uncertainty at a time when the world is still dealing with the fallout of the pandemic. We join the Fund in demanding a prompt and peaceful resolution of the war which has imposed unacceptable human costs and threatens the rules-based frameworks that have facilitated global economic integration and brought prosperity.

**Highest priority should be given to efforts strengthening the supply side of the economy and promoting price stability.** We note that staff expects global GDP growth to slow to 3.5 percent in 2022 and 2023 and has again revised inflation forecasts substantially upwards with double-digit inflation rates in 2022 now expected in increasingly more countries and regions. This points towards stagflation, a period of absent or even negative economic growth accompanied by high inflation, which would be a dangerous development and leaves policy makers with difficult trade-offs as pointed out in the report.

**We concur with staff that high uncertainty surrounds the outlook.** We welcome the structure along five principal forces that shape the near-term outlook – the war in Ukraine, monetary tightening and financial market volatility, fiscal withdrawal, China’s slowdown as well as the Covid-19 pandemic and inequitable vaccine access. *We would welcome a more specific discussion of the relative importance of these different drivers and sources of risk to the global outlook.*

**We concur that the balance of risks for global growth is tilted to the downside.** A continuation of Russia’s attack on Ukraine causes tragic and avoidable loss of human life. The Russian attack in our view poses the main economic risk to the current outlook as it would exacerbate supply disruptions, further raise global prices and increased volatility in commodity markets. As staff points out, a concurrent further rise in commodity and food

prices could increase the probability of social unrest particularly in emerging and developing market economies.

**We welcome staff's thorough investigation of risks for the global economy via three channels:** commodity markets and supply chains, inflation expectations and tighter financial conditions. We appreciate that this analysis includes possible consequences of additional sanctions on Russia in a distinct scenario, which have been imposed in reaction to the war against Ukraine. In this scenario Russian oil and gas export volumes are assumed to decrease substantially more than in the current baseline and commodity prices would exceed the baseline further. We concur with staff that in such a scenario EU countries would be more affected than other advanced and emerging market economies given their larger exposure towards Russia.

*Could staff provide a more detailed discussion of the assumptions underlying the three channels that would contribute to pushing Russia's GDP down to 15 percent below baseline in 2027 and EU GDP down 3 percent below baseline by 2023?*

**We agree with staff's growth projections for Germany, although the uncertainty surrounding these forecasts remains extremely high.** We take note of staff's sizable downward revisions for Germany and Italy for 2022 on the back of large manufacturing sectors and greater dependence on energy imports from Russia. As for Germany's current account, a surplus in 2022 below the 6 percent mark as projected by staff is in our view plausible because of the sizeable negative terms-of-trade shock due to higher energy prices.

**We share in principle staff's view that the current inflation hike in Germany is temporary, albeit relatively persistent.** Technically, staff's forecasts are more difficult to assess than usual due to the very volatile energy and food components. Compared to the Eurosystem's forecast of 11 March, staff apparently expects energy prices to be higher also in 2023, with stronger effects especially in Germany. This prediction is broadly in line with our most recent update. Still, we would expect a somewhat higher inflation rate of nearly six percent in both Germany and the euro area in 2022.

**We broadly concur with staff's policy recommendations.** Russia's war in Ukraine has exacerbated two difficult policy trade-offs: between tackling inflation and safeguarding the recovery, and between supporting the vulnerable and rebuilding fiscal buffers. On tackling inflation, we welcome staff's recommendation that central banks should carefully monitor the pass-through of rising prices to inflation expectations. We agree that monetary policy should respond to pass-through effects on domestic inflation expectations via appropriate tightening in order to check the cycle of higher prices driving up wages and inflation expectations, and wages and inflation expectations driving up prices.

**Regarding Box 1.1., we broadly agree that lower participation rates in the US and the UK have partly caused tight labor markets.** Covid-related declines in labor force participation among older workers as well as school and daycare closures were key factors

leading to labor market tightness. Changes in workers' preferences also contributed to higher labor churn. Upside risks to future wage and price dynamics in the US and the UK appear to be high, as second-round effects of sustained elevated consumer price inflation may also turn out stronger than usual in the current environment.

### **Global Financial Stability report (GFSR)**

**Overall, we broadly agree with the GFSR's main analyses and conclusions.** Rising commodity prices and disruptions to global supply chains pose further upside risks to the inflation outlook. The financial system is currently vulnerable to an economic slowdown and to an abrupt rise in interest rates. Depending on how current events unfold, macroeconomic setbacks of a greater magnitude cannot be ruled out.

**We agree with staff's assessment that international banks' credit risk from direct exposures to Russia, Ukraine and Belarus is overall limited.** For the banking sector the main risks are related to the massive increase in margin calls in energy derivatives trading as a result of rising energy prices and indirect economic effects including supply bottlenecks, clouding of the macroeconomic situation, inflation and interest rate turnaround.

**We agree with staff's analysis that the Russian invasion of Ukraine weighs on the prospects for corporate sector earnings and increases credit risks.** We share staff's view that financial stability risks stemming from risky segments of credit markets should be closely monitored and demand sound risk management practices of investors. A sharp tightening of financial conditions could increase default risk of corporates further. Nonfinancial firms in high yield corporate bond and leveraged loan markets have increased debt levels in an environment of loose underwriting standards over the past years.

**We welcome Staff's reflections on emerging markets and portfolio flows.** Many emerging market economies face significant vulnerabilities related to large external financing needs and volatile capital flows. The Russian invasion of Ukraine raises food and energy prices globally, and the prospect of monetary policy normalization in the United States and other advanced economies adds to the risk of tightening global financial conditions. This could affect emerging markets and lead to currency depreciation and capital outflows. We therefore agree that current developments are likely to increase the down-side risks for portfolio flows and put countries with heightened debt levels under pressure. For countries facing rapidly deteriorating debt dynamics, limited market access, high external financing requirements or high volatility, pre-emptive and cooperative debt resolution with their creditors may become necessary.

**We concur with staff's analysis on risks in the Chinese property development sector and staff's analysis of developers-at-risk.** We would also welcome an analysis of the risks in the private household sector related to the property sector. There seem to be cases where real estate has been paid in advance by private households, while construction works have

not been completed. In addition, overall economic risks could weigh heavily on private households, eventually making it difficult to pay their mortgage rate.

**Our current analyses do not point to any immediate material risks to the German financial system.** Overall, we assess the situation of the German banking sector as robust, even under adverse stress scenarios. The current situation is being monitored very closely by the supervisory authorities. At present we do not see any reason for concrete supervisory/regulatory action. However, this is a preliminary assessment that is subject to considerable uncertainty. Unfavourable developments for the German financial system have become more likely with the Russian invasion of Ukraine. Depending on how things progress, an adverse scenario could lead to a more serious setback of the economy and substantial losses in the financial system.

**We agree with staff's findings that a systemic evasion of financial sanctions by the crypto ecosystem would not be practicable at present, as market volume and liquidity are relatively low.** This is also supported by the fact that on-chain transactions of bitcoin, stable coins and privacy coins have not increased significantly since the start of the war. However, we cannot rule out that systematic sanctions evasion may become more likely in the future with increasing usage and acceptance points, coupled with the failure to address regulatory loopholes.

### **Fiscal Monitor**

**We appreciate the IMF's call for close cooperation with regard to all the efforts to support the poorest and most vulnerable countries.** It is important that the IMF reminds policymakers of losses in efficiency and effectiveness when actions are taken unilaterally (such as export restrictions).

**We welcome the IMF's current clear communication that the fiscal challenges require spending prioritization and mobilization of revenues.** We appreciate staff's call for measures to manage the effects of high energy and food prices which avoid undesired consequences. We agree that the support provided should be targeted, temporary and direct to vulnerable households with a view to not distort incentives of higher international prices for demand and supply to adjust and to minimize fiscal costs.

**At the same time, we appreciate staff's awareness of the need for fiscal consolidation given high debt levels.** In the current environment, we support the notion that public spending needs prioritizing but should offer well-targeted support for vulnerable populations where necessary. At the same time, we concur with staff that broad-based fiscal support should be withdrawn, and the focus should shift on the reconstruction of fiscal buffers. Particularly in emerging markets and developing economies facing already high levels of

debt, appropriate fiscal consolidation, potentially supported by an introduction of rule-based fiscal frameworks that promote debt sustainability, is of the essence.

**High public debt is a cause for concern.** It is important to learn lessons from the experience made throughout and after the global financial crisis. Many economies have still not restored pre-crisis primary balances before the new crises hit. In our view, the IMF should voice such concerns less cautiously in the future and call more clearly for consolidation. After crisis episodes, public finances require a return to normality, consolidation. It is important to rebuild risk buffers in order to ensure sustainable growth.

**We agree with staff that addressing supply constraints would reduce uncertainty.** This would help the economy and, consequently, improve the health of public finances over time. Strengthening the supply side and productivity growth pave the way to higher economic growth while reducing pressure on prices. Improving the environment for urgently needed private investment is an important step to strengthen the supply side. In particular, this is essential for investments in renewable energies, which also reduces the impact of fossil fuels as price drivers in the medium to long run.

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April 8, 2022

**Statement by Mr. Mozhin, Mr. Tolstikov, Mr. Biriukov, Mr. Shestakov, and Ms. Zubareva on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for their hard work on assessing complex and rapidly changing circumstances in the global economy and providing well-considered recommendations. We believe that, despite the flaring geopolitical tensions, the IMF should strive to uphold the spirit of multilateralism by providing impartial and high-quality analysis and seeking the most effective ways to assist all members, especially the most vulnerable.

**The global economy is under stress, as the post-pandemic recovery is threatened by the unfolding geopolitical crisis.** The conflict around Ukraine, which has already led to a sequence of increasingly suicidal sanctions against Russia will send shock waves around the world economy. Countries in the epicenter of the crisis -- Ukraine and Russia -- will suffer the most, but massive disruptions in the international trade and finance can lead to unintended consequences in both the neighboring and far-away countries. All this will be happening against the backdrop of still lingering COVID-19 risks, which can further complicate the developments.

**We find the 2022 World Economic Outlook report to be somewhat on the optimistic side.** The baseline scenario assumes the 2022 global growth at 3.5 percent, which is just 0.9 percentage points lower than in the January 2022 WEO update. However, the baseline scenario assumed that sanctions would not tighten beyond those announced by March 31. Unfortunately, this assumption has already become outdated. Therefore, the baseline scenario is rapidly becoming obsolete, and the developments in the global economy are rapidly shifting towards the scenario described in the “Scenario Box” on pages 32-34 of the WEO. *In this regard, we would ask staff to provide more details about the assumptions underlying the “Scenario Box” projections.*

**Accelerating inflation is becoming one the most serious threats to global economic and financial stability.** Even before the events in Ukraine, inflationary pressures caused by expansionary macroeconomic policies, labor market tightening, and supply disruptions, had led to significant increase of short-term inflation expectations. Under the conditions of more prolonged supply disruptions leading to further increases in food and energy prices, inflation may rise higher and last longer. We noted that inflation is no longer characterized as transitory in the United States, the euro area, the UK and most EMDEs. There is also a risk that medium-term inflation expectations, still subdued in advanced economies, may rise, which will make inflation even more entrenched and difficult to stop. Monetary policy tightening is now widely expected, with the widespread increases in policy and market interest rates across the globe.

**Persistent inflation and global uncertainty amid an uneven recovery create a hard trade-off for the monetary authorities.** Surging energy and metal prices have exacerbated the supply-chain issues, which caused the entrenched inflation in 2021. We agree with staff that in a period of rising commodity prices and heightened uncertainty central banks are facing a trade-off between resisting inflationary pressures and safeguarding the economic recovery from the pandemic. High food prices create a risk of social unrest. In many countries accelerated monetary tightening is needed to prevent de-anchoring of inflation expectations. The path of monetary policy normalization should remain data-driven, depending on the degree of direct links with conflict-affected countries, external financial conditions, and developments in the terms of trade.

**The global financial system has shown resilience in the face of heightened geopolitical tensions, yet downside risks remain elevated.** A repricing of risks by investors due to expectations of sharper monetary policy tightening in AEs might result in a rapid tightening of financial conditions and lay bare the vulnerabilities accumulated in the real and financial sectors due to the COVID-related support measures. The freezing of Russia's central bank reserves is a game changer for the international financial system that might accelerate structural shifts toward crypto assets and DeFi, which allow for large-scale transfers of value without political interventions. The surge in volatility calls for a swift policy response, including adequate transparency, credible plans for the restoration of declined capital ratios, and strengthening market governance mechanisms to avoid trade disruptions.

**Both sovereign and private debt distress risks will increase in many countries over the coming monetary tightening cycle.** For EMDEs in particular it may also lead to capital outflows, increased borrowing costs and currency depreciations. The pandemic has led to unprecedented increases in sovereign debt, and many EMDEs may find themselves in a very difficult situation. It is worrisome that about 60 percent of LICs are either at high risk or already in debt distress. Moreover, despite the urgent need to support vulnerable populations hit by rising energy and food prices, in many EMDEs fiscal space is largely exhausted.

Under the conditions of extreme uncertainty and large differentiation of the individual country circumstances, policy recommendations should naturally vary across countries.

**On the monetary policy front, to contain inflation, most countries should not delay the necessary tightening, but proceed with caution.** In order to mitigate large negative effects on growth from monetary tightening, its pace should be gradual, calibrated, and data dependent. It should be more decisive in those countries where the recovery is strong and wage pressures are rising – as in the United States, for example. The euro area is facing a more difficult choice, as it may face growth disruptions and price shocks at the same time. In such case, tightening of the monetary conditions can amplify negative supply side effects. Monetary tightening in AEs will force most EMDEs to follow suit or to risk currency depreciation and capital flight. In the economies where inflation pressures are difficult to contain rapidly, the inflation expectations de-anchoring represents the key risk over the medium term. Therefore, central banks should provide clear communication of their commitment to medium-term price stability.

**On the fiscal front, policymakers in many countries are facing a difficult balancing act between mitigating the shock to vulnerable groups and maintaining fiscal sustainability.** Countries with limited fiscal space can try to address this dilemma through spending reallocation towards social support at the expense of non-priority spending. Ideally, social transfers and programs should be well-targeted to use limited resources with a maximum effect. Revenue mobilization should be reinigorated to raise additional fiscal resources. However, in many countries, especially LICs, limited fiscal space does not permit substantial fiscal support, and they may require additional external financing. As more than half of LICs are in debt distress or close to it, the issue of further debt relief for LICs once again comes to the fore.

**Deteriorating debt burdens highlight the need to address the shortcomings of the current framework for sovereign debt restructuring.** Involvement of the private-sector creditors should be enhanced, given their increased share in public debt holdings. Eligibility for support should be extended to other heavily indebted low- and middle-income countries beyond those currently covered. A more proactive approach to policy initiatives targeting debt service relief is needed. In particular, preemptive discussions with creditors should become more common. Evidence shows that in those cases where preemptive debt restructuring is undertaken, the consequences of debt distress are resolved faster than in post-default restructuring cases, lead to shorter exclusion of the country from global capital markets, and are associated with lower decline in output.

**Climate policy agenda is becoming more complicated, as green energy transition has stumbled and may be even temporarily reversed by recent developments.** The rapid rise in global energy prices, which, to a large extent, was the consequence of under-investment in fossil fuel industries, has been further amplified by the geopolitical conflict. We note the staff

recommendations to increase clean energy investment three-fold by 2030 to accelerate decarbonization of the power sector and electrify end users of energy. We also note the staff advice to use carbon pricing to incentivize green private investment. However, these are medium-term solutions, while the disruptions in the energy markets, especially in Europe, have already become an urgent issue. *We would welcome staff comments on the preferred course of actions with regard to the current energy crisis, and staff opinion on the initiatives to increase the use of coal instead of natural gas from Russia.*

**We remain cautious on the international carbon price floor initiative.** Introduction of a carbon tax at this juncture, amidst historically high energy prices, could add to already high inflationary pressures and potentially translate into social unrest. We support a flexible approach to climate mitigation policies, accounting for country-specific circumstances and relying on non-pricing tools. Besides, we believe that the UNFCCC should be a leading platform for the international climate policy coordination.

We welcome the well-written analytical chapters, which complement and deepen the analysis provided in the WEO, GFSR and Fiscal Monitor, and would like to provide a few comments on them.

**Despite the unprecedented turmoil in international economic relations, the need for international corporate tax coordination remains.** Implementation of the two-pillar international tax agreement would reduce tax competition and raise tax revenues. In this respect, we believe that further progress on Pillar One would require the determination of extractive industry exclusion, mechanisms eliminating double taxation, the development of a dispute resolution mechanism. As for Pillar Two, we would encourage the development of an appropriate administrative guidance (on a consensus basis and taking into consideration the complexity of domestic legislative procedures).

**Structural reforms in the labor market area hold promise of facilitating reallocations and mitigating disruptions during the green economic transition.** We find the analysis of the labor market implications of the green transition to be timely, since some of the Fund members have decided to put their economies on the path to net zero emissions within the next 10-30 years. We positively note an application of a task-based modelling framework to quantify the medium-to-long term impact of environmental policies on labor reallocation and factor productivity. The presented analytical framework delivers a rich set of conclusions and might be extended further to incorporate directed technical change and better account for the incentives to invest in green innovations, which might also explain an empirical finding of a rising green earnings premium (Fig. 3.5).

**The intensified sovereign-bank nexus makes EMEs vulnerable to a sharper than expected tightening of global financial conditions.** We commend staff for a clear analysis of the main transmission channels, which amplify shocks and propagate them between

sovereign, banking, and nonfinancial corporate sectors. Both the relative strength of these channels and the size of a shock are highly heterogeneous across countries and any policy reaction should be tailored to individual countries' circumstances. We broadly support the proposed set of the policy options, including strengthening banking crisis management, making regulation and supervision more effective, and diversifying investor base. We would encourage the wider use of the GFSR Chapter 2 framework in stress testing exercises.

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GRAY/22/1034

April 8, 2022

**Statement by Mr. Mohieldin, Mr. Alhosani, Ms. Choueiri, Mr. Al-Kohlany, and Ms. Merhi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

1. We thank staff for the excellent Flagship reports, notwithstanding the exceptional uncertainty that delayed their preparation. The enduring pandemic and ongoing war in Ukraine are resulting in a rapidly worsening outlook for the world economy. Rising food, fuel, and commodity prices are compounding inflationary pressures and weighing on demand. As a result, and given the continuing supply chain disruptions, energy and food security risks have emerged for many members, adding to social pressures. Additional challenges facing members stem from their exposures to the war through trade, tourism, financial linkages, remittances, and refugee flows. We agree with staff that multilateral efforts are needed to respond to the humanitarian crisis, present for the economic fragmentation, maintain global liquidity, manage debt distress, and end the pandemic.

**2. Rising inflation and inflation expectations warrant careful attention.** We support the objective of keeping inflation expectations under control, although the appropriate monetary policy response will need to be country-specific and central banks will need to balance inflation control with safeguarding the recovery. We welcome the discussion in Chapter 1 of the *World Economic Outlook* of the main spillover channels from the current geopolitical developments. We call for continued attention to higher food prices, particularly the price of wheat, the main spillover channels for the Middle East and North Africa (MENA). Monetary tightening in advanced countries could have severe consequences for EMDCs, adding pressure to their financial conditions, complicating their crisis management response, and delaying their economic recoveries. Accordingly, major central banks need to anticipate risks as they decide on their tightening cycle. We also emphasize the need for EMDCs to carefully calibrate policies with macroeconomic stability in mind, and for clear guidance and communication. Safeguarding central bank independence will also remain key. In the MENA region, in addition to spillovers from tighter global conditions, careful attention to reduced tourism is needed.

**3. Fiscal policy needs to balance the objectives of supporting the vulnerable and rebuilding fiscal buffers.** We agree with staff that following a huge and necessary fiscal expansion in many countries during the pandemic, debt levels are at all-time highs and governments are more exposed than ever to high interest rates. Fiscal policies should support the recovery and allow governments to prioritize spending with well-targeted support for the vulnerable, while being mindful to ensuring debt sustainability over the medium-term. Debt vulnerabilities are already high and are expected to increase particularly among many EMDCs, due to the impact of the pandemic mitigation measures and pre-existing vulnerabilities. The repercussions of the war in Ukraine are expected to adversely affect many EMDCs' fiscal positions. We welcome the coverage of private debt in Chapter 2 of the *World Economic Outlook* and call for continued attention to debt vulnerabilities in EMDCs.

**4. Scarring effects are expected to be a much larger in EMDCs than in advanced economies,** reflecting more limited policy support and generally slower vaccination. Against this background, the Resilience and Sustainability Trust would provide essential policy support and affordable long-term financing to support reforms and help address risks to sustainable and inclusive growth while strengthening resilience in eligible EMDCs. In this connection, the scope of the RST could usefully include food security, job creation, more equal opportunities, financial inclusion, refugee and migration flows, economic diversification, and digitalization. The important issue of **energy security**, which is usefully referred to in the *Commodities Special Feature*, was only exacerbated by the Ukraine conflict and will remain relevant in the long term. Like Mr. Binzarah, we look forward to more in-depth analysis and more balanced recommendations to ensure a smooth transition to a lower-carbon economy, which ensures macroeconomic stability and energy security for all countries. The war in Ukraine has brought attention to challenges related to **refugee flows**, an issue that countries in our constituency have been faced with for many years. It would be useful for future Flagship reports to include thorough analysis of the implications of refugee flows, including detailed assessments of the direct and indirect economic costs for hosting communities. This work would be instrumental to the effort to mobilize adequate and timely donor support.

#### **Global Financial Stability Report:**

5. We thank staff for the interesting work presented in the Global Financial Stability Report (GFSR) and we broadly agree with the assessment of risks vulnerabilities discussed in the report, and the related policy recommendations. Notwithstanding the substantially increased financial stability risks resulting from the exposure to the Ukraine conflict and from the effects of monetary policy normalization and higher inflationary pressures in financial markets, we are pleased to note staff's assessment that the financial system appears resilient to withstand liquidity and funding shocks. The sudden and significant increase in external borrowing costs and rising local currency rates are also weighing heavily on financial conditions in some

Emerging Markets (EMs). We encourage staff to remain engaged with these countries to mitigate potential liquidity stress that may arise.

**6. We welcome the focus of the GFSR on the sovereign-bank nexus in EMs and take note of staff analysis of the elevated banks' exposure to domestic sovereign debt,** its adverse effects, and the feedback loop between sovereigns and banks that could threaten macro-financial stability. The analysis is timely given the risk of a higher market borrowing costs and tighter funding conditions for EMs, amid monetary policy normalization in advanced economies and the intensifying geopolitical tensions. These effects are especially prevalent in EMs with high public debt, less-well-capitalized banking systems, and higher fiscal vulnerabilities.

**7. Given the heterogeneity of countries impacted, we call on staff to continue to provide tailored and country-specific fiscal and financial sector polices,** and to support countries' efforts to balance the complex trade-offs. We also encourage staff to extend their assessment and to examine the sovereign-bank nexus in LICs, we look forward to the Fund's further work in this area. We note (in chapter 2, figure 2.7 panel 5) that the banking system of the Middle East and Central Asia region seems comparatively more resilient to sovereign distress, as it would take a much steeper haircut of government securities to generate a bank capital shortfall. *It would be useful if staff could provide additional details on the factors behind the differences between MCD and the remaining regions presented in the graph.*

**8. We agree that supervision and regulation should be strengthened to safeguard against any emerging signs of vulnerabilities in the banking sector and ensure banking sector stability.** Developing robust resolution frameworks should also be a priority, including for non-bank financial institutions, to facilitate orderly deleveraging and restructuring if needed. The recommendations presented in the report on addressing the multifaceted nature of the sovereign-bank nexus should be pursued including to proactively addressing high debt levels and extending maturities of public debt where feasible, adopting credible fiscal policy within sustainable medium-term fiscal framework, closing existing prudential gaps, and strengthen the financial safety net.

#### **Fiscal Monitor:**

**9. As mentioned above, in addition to the COVID-19 pandemic, the war in Ukraine has exacerbated fiscal and debt challenges in many countries including in several EMs and low-income countries (LICs).** In this context of high uncertainty, surging commodity prices, high debt and tightening credit conditions, fiscal policy will need to be agile and tailored to countries' specific circumstances, while putting in place a medium-term fiscal strategy to address high public debt levels. While commodity exporters will benefit from significant revenue windfalls, many countries are facing difficult policy trade-offs due to their limited fiscal space to buffer these new shocks as well as scarring from the pandemic.

**10. Fiscal policy should protect the most vulnerable from the impact of high and rising food and energy prices.** However, many EMDCs are in a very difficult position as they don't have the fiscal space to address the added challenges created by the war nor to prevent a large rise in poverty and income inequality. In this connection, support from the international community to low-income countries with elevated debt levels will be crucial. Moreover, international cooperation will be essential to preserve access to liquidity and expedite orderly debt restructurings where needed.

**11. As mentioned above, the war in Ukraine has brought attention to challenges related to refugee flows.** We need to be more mindful of countries that continue to host refugees and displaced populations, as they are witnessing mounting fiscal pressures on already strained budgets in addition to facing financing constraints. We appreciate that this issue is highlighted in this monitor, however we look forward for thorough analysis of the implications of refugee flows in future flagships. Moreover, the international community should continue its efforts to scale-up concessional financing to strengthen host countries economic and social resilience and help meet immediate needs and access to basic rights.

**12. We welcome the focus in Chapter 2 on considerations for addressing cross-border tax spillovers and how international coordination can improve the taxation of multinationals and individuals and reduce greenhouse gas emissions.** Globalization and digitalization have tax implications which can affect efficient and distribution without adequate coordination. Moreover, as administrations struggle to keep up with tax evasion and tax avoidance, further coordination on information sharing will be crucial in this regard. Regarding the carbon pricing coordination, we would like to reiterate our call that careful consideration should also be given to a broader set of instruments and potential technologies than can reduce carbon emissions to achieve the transition to a low-emission economy and not only focus on carbon pricing considerations.

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April 8, 2022

**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 22/35  
April 11, 2022**

We thank staff for a comprehensive set of flagship reports. The reports give justice to the exceptional conjuncture and risks facing the global economy and financial markets and the policy challenges to be addressed immediately as well as over the medium to long-term. We generally agree with the staff's analysis on the prospects and risks, as well as with the key policy recommendations.

***World Economic Outlook***

**The conflict in Ukraine has slowed the global economic recovery from the pandemic.** A significant slowdown in global growth is projected for 2022, at a time when many countries are emerging from the pandemic. The war has also accelerated a global surge in inflation, particularly fuel and food prices. Both growth and inflation have been revised—downwards and upwards respectively—from the estimates in the January WEO update. We also note that global output and employment will remain below pre-pandemic levels until 2026 and that inflation is forecast to remain high for longer than anticipated—raising the prospects of inflation expectations de-anchoring—although a gradual adjustment of supply-demand imbalances should help alleviate price pressures worldwide. Given the extremely uncertain environment and elevated risks, growth and inflation could significantly deteriorate moving forward.

**Many countries face acute policy trade-offs.** As rightly noted by the report, the spillovers from the war have complicated two major policy trade-offs that countries were already facing as they were recovering from the pandemic. On the one hand, policymakers need to support

the recovery while containing inflationary pressures, and on the other hand, they have to engage in fiscal consolidation while also providing support to the most vulnerable. We fully agree that policy responses should depend on countries' exposure to the war, the state of the pandemic in each country, and the strength of the recovery. However, it should also be noted that many members have limited fiscal policy space to alleviate the impact of the war on their economies, amid elevated debt levels. For those countries, appropriate external support should be available. Governments should continue to provide active support to their economies and resume fiscal consolidation only when the crisis abates, and geopolitical tensions recede. Central banks, as well, should monitor closely the impact of price pressures on inflation expectations while effectively communicating on the outlook for inflation.

**Low-income countries are being disproportionately affected by the spillovers of the war in Ukraine and should seize the opportunity to tackle their long-standing macro-structural gaps.** The scarring effects of the pandemic have already been assessed as being relatively much larger in LICs than in other countries. Output, as well, is expected to take longer to return to pre-pandemic levels in LICs due to the added effects of the war. Moreover, although the sharp rise in fuel and food prices will affect vulnerable populations all over the world, it will have more damaging effects on LICs, with increased risks of social unrest. It is paramount to ensure that those countries address food security challenges, including by accessing the necessary resources to meet their food imports but also investing in their agricultural sectors and developing agro-business industries. *In this regard and in the near term, we would like to invite the Fund to integrate into its policy recommendations the efforts at the international level to strengthen the agricultural strategies of LICs. Staff's comments are welcome.* Furthermore, the increase in interest rates needed to tackle inflationary pressures worldwide, will exacerbate many LICs' debt problems, particularly their capacity to service debt, which calls for accelerating the debt resolution agenda, notably through debt restructuring.

**Despite difficult near-term tradeoffs, major structural changes are needed and require renewed domestic efforts and reinforced multilateral cooperation.** In particular, countries should make further advances in the implementation of their digital transformation agenda, including by ensuring that workers have the adequate skills, as well as in their green energy transition. Multilateral coordination is key to mitigating the immediate and longer-term economic challenges facing policymakers and avoiding economic and trade fragmentation. We agree that efforts in this area are needed to maintain global liquidity, manage debt distress, tackle climate change, and end the pandemic. The IMF has a critical role to play in this regard by continuing to provide the necessary liquidity to members, preventing the crisis from spreading further and stepping up as a key institution for multilateral cooperation.

### *Global Financial Stability Report*

**We note that the war in Ukraine and the subsequent sanctions against Russia have contributed to increase financial stability risks but have not led to the materialization of a major systemic event affecting global financial stability.** These developments together with the ongoing monetary policy normalization in major central banks to quell high inflation has led to tighter financial conditions. This is mostly affecting emerging and frontier markets as reflected by, among others, the increase in sovereign spreads, many of them reaching distressed levels, and the sharp reduction in hard currency bond issuances by those countries. In addition, those countries are facing higher probability of capital outflows. We note the differentiation among emerging markets regarding capital outflows since the start of the war in Ukraine. *Could staff provide more information on the evolution of local stress indices which is missing from this report?*

**We agree that high inflation amid the war in Ukraine is posing difficult policy challenges to commodity-importing developing countries.** The disruption in commodity markets, notably energy and agriculture, stemming from the war in Ukraine, together with continued currency depreciation in some of these countries, is likely to sustain inflationary pressures for the duration of the conflict. We are concerned that a persistent inflation will be holding back the recovery from the pandemic for a while by squeezing consumption. *Staff's comments on the risk of delayed monetary and prudential policy normalization –or even risk of further monetary accommodation--in frontier markets will be appreciated.*

**We note the structural challenges that could stem from the war in Ukraine and encourage close monitoring and further assessment of the potential materialization of associated risks and implications for global financial stability.** We agree that the conflict might accelerate transition toward renewable energy or diversification of energy sources away from Russia in Europe. However, these efforts would not only be costly but also take time to bear fruit due to infrastructural gaps. We urge staff to deepen analysis of the risk of de-globalization and fragmentation of capital markets from recurring geopolitical events, or the prospect of CBDC blocs.

### *Fiscal Monitor*

**We concur that fiscal policy should continue to support the most vulnerable while tackling the effects of the war, rising inflation, high debt and borrowing costs.** The ongoing pandemic and the current geopolitical shock from the war in Ukraine pose a significant risk to the fiscal outlook. In this context, we note that emerging markets and developing countries, notably LICs, are severely affected due to their limited fiscal space as

well as their position as net importers of food and energy. With respect to LICs, and in particular fragile states, we would like to point out the fiscal policy recommendations on subsidies. In a context marked by soaring food and commodity prices, cutting subsidies for fiscal consolidation can only lead to social unrest. Such policies in the current situation can only contribute to the cycle of social and political unrest. *Staff comments are welcome.* At the same time, elevated public debt levels and rising global interest rates represent a major concern amidst growing financing needs. Nevertheless, governments should deploy appropriate and well-targeted support, when necessary, while reinforcing public investment needed for green and digital transformation. We stress that fiscal responses should remain agile and tailored to country-specific circumstances, and support structural challenges including climate change, digitalization, poverty, and inequality. In parallel, implementing a credible medium-term fiscal framework and advancing fiscal reforms are essential to build buffers and limit macroeconomic imbalances.

**We welcome the emphasis on the importance of coordinating taxation across borders, and strongly agree that global cooperation is of the essence.** To achieve development objectives and meet mounting public spending needs to protect the most vulnerable and support the economic and structural transformation, revenue mobilization should be strengthened, both at the country and international level. We concur that effective taxation coordination will help avoid inefficiently lower taxes, tackle inequality, and reduce greenhouse gas emissions. Indeed, global transition to a low-carbon economy reinforces the need for a coordinated approach, both for the largest emitters and the most climate-vulnerable countries. Moreover, most resource-rich African countries have seen revenue from multinationals reduced or forgone due to tax base erosion from profit shifting and tax avoidance, and to tax incentives to attract foreign investment. Therefore, we agree that international coordination on the level or location of taxation is essential to address cross-border tax spillovers, notably on the area of taxation of multinationals and individuals, as well as carbon pricing. To this end, leveraging existing international platforms and fora to overcome the limits of unilateral actions could significantly improve global outcomes. Care should be applied to ensure that such fora and platforms are inclusive to address the needs of all.

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**Statement by Ms. Shortino, Ms. Medearis, Mr. Commaroto-Roverini, Ms. Rao, Mr. Sturm, and Mr. Westphal on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

**Russia's unprovoked and unjustified war on Ukraine has darkened the global economic outlook.** We mourn the senseless loss of lives and livelihoods in Ukraine and the displacement of millions of people. We echo the introductory messages of the reports, namely that Russia's war on Ukraine is destabilizing the global economy by increasing macroeconomic, socio-economic, and financial stability risks and further complicating policymaking.

**The best way to support global economic growth at the current juncture, and for the global economy to avoid the downside scenarios laid out by Fund staff, is for Russia to end its war.** While the economic impact of Russia's war is most severe on Ukraine, the global economy is adversely affected through higher and more volatile commodity prices, trade channels, and financial linkages. We appreciate staff's assessment of spillover channels and the expected uneven impact across regions, noting that further increases in energy and food prices will have the largest widespread negative effects, with disproportionate impact on low-income countries with high debt. The Russian and Belarussian economies are bearing a cost for their unacceptable actions, as many countries are responding to their unprovoked aggression with sanctions. Unfortunately, countries with close economic ties to Russia may see lower remittances, trade, and investment, and many of Ukraine's neighbors are also under fiscal pressures as they shelter the large number of refugees.

**Even as the war and its repercussions remain rightly front and center, we must not let up on efforts to fight the still-evolving pandemic.** The focus must include increasing country readiness to turn vaccines into vaccinations, particularly in Sub-Saharan Africa, in addition to expanding the global provision of vaccines, treatments, and testing. Other critical global challenges confront us, chief among them climate change and rising inequality. Well-coordinated multilateral efforts are needed to respond to these challenges and to address

underlying vulnerabilities. Multilateral cooperation is also essential to safeguard the rules-based international system.

### **Economic Performance and Outlook**

**Staff's WEO projections for global real GDP growth of 3.5 percent in 2022 and 2023 reflect a significant downgrade resulting from the Russian invasion of Ukraine.** The considerably slower global growth outlook is striking and reinforces the severe consequences of Russia's brutal war and the resulting humanitarian crisis for the global economy. Moreover, the invasion comes at a particularly vulnerable and uncertain period, as the global economy is still trying to recover from the effects of the pandemic, and as debt vulnerabilities have risen in many countries due to the counter-cyclical policies required to address prolonged negative impacts from COVID-19. Spillovers from the war and continued COVID-19 outbreaks, especially in China, will remain a headwind to growth, while higher commodity prices and more persistent supply chain disruptions and labor supply effects will keep inflation elevated for longer. In this context, we underscore the need for policymakers to balance the competing issues of weaker growth, rising debt, tighter financing constraints, and higher inflation, while protecting the most vulnerable people.

**Risks are clearly pointed to the downside, with extraordinary uncertainty across many facets of the global economy.** We generally agree with staff's list of key risks facing the global economy, including intensification of the war resulting in an escalation of sanctions, reprisals from Russia, sharper deceleration in China, and new COVID-19 variants, as well as the possibility of rising social tensions. Unfair trade practices also pose a threat to global economic prospects, and we encourage staff to focus on the underlying trade distortions that lead to trade disputes. The WEO correctly describes that the aim of sanctions against Russia is to end the invasion and allow the sovereign country of Ukraine to begin a long road of recovery.

**We note the WEO downgrade in the U.S. growth forecast due to lower-than-expected fiscal support and the beginning of well telegraphed monetary tightening.** While headwinds have risen, the U.S. economy is still expanding at a robust pace, reflecting the reopening of the economy, policy support, and the healthy financial positions of households and businesses. We also note the growth and financial risks to China from COVID-19 outbreaks and property sector issues, as detailed in the GFSR. *Given the recent acceleration in COVID-related lockdowns in China, could staff provide a more up to date assessment of China's growth outlook and possible policy responses?*

### **Policy Recommendations**

**Much like its approach to the pandemic, the Fund will also need to be nimble and adjust to this new conjuncture. Policy recommendations will require careful calibration against a backdrop of heightened risks and diminished policy space.** Debt levels are at a record high, while buffers in many economies are low. Even as the Fund supports countries

in responding to this crisis, it must also take care to provide its members with tailored advice and capacity development to help increase resilience to shocks going forward, including by helping authorities to formulate and enact critical structural reforms, complete pandemic health responses, and invest in green and inclusive recoveries. We emphasize the need for Fund advice on core macroeconomic policies, including structural reforms, to bolster recoveries, mitigate scarring, raise potential growth, and boost productivity. We concur with the flagship reports' sense of urgency in terms of getting policies right, or as close to right as possible, given that every policy lever comes with a non-negligible tradeoff.

**We broadly agree with the Fund's assessment of policy responses to spillovers from the war, including increasing oil and gas supplies and providing targeted fiscal support, as well as the need to carefully weigh rising inflation against weakening economic activity.** We underscore the need for close Fund coordination with other IFIs and international organizations to help low-income countries (LICs) with potentially large financing needs cushion higher prices for imported food and inputs to agricultural production; we would have appreciated further discussion of financing needs to address food security risks in the WEO. In addition, we would have welcomed deeper coverage of the economic impact of Ukrainian refugee flows on host countries, which will be another important area for IFI cooperation. Given the importance of the Fund's policy advice at this challenging juncture, staff could helpfully illustrate how careful policy calibration would potentially attenuate—or how a lack of careful policy calibration could exacerbate—the multiple downside risks outlined in the WEO.

**In their fiscal policy recommendations, staff rightly distinguish between countries with fiscal space and those without.** For countries with limited fiscal space, we stress the importance of more targeted fiscal support and credible medium-term fiscal plans to help create near-term fiscal space and rebuild buffers. We strongly agree that such fiscal pressures should not prevent governments from prioritizing spending with well-targeted support for vulnerable people, including refugees, low-income households facing higher food prices, and those still struggling from the pandemic. Country authorities will also need to continue to manage COVID-19 risks through continued, targeted support for economic activity and advancement of policies to mitigate scarring. Support from the IMF and MDBs could be helpful in this respect.

**We emphasize the importance of monetary policy remaining data-dependent and transparent, and we agree that central banks should pursue sound policies to help contain rising inflation expectations over the medium term.** In the United States, the Federal Open Market Committee (FOMC) is determined to take necessary measures to restore price stability but will also strive to communicate clearly to avoid adding uncertainty to an already uncertain environment. The FOMC has been adapting policy to the evolving economic environment and will be nimble in responding to incoming data and the evolving outlook. We also agree with staff that a simplistic comparison to the “stagflation” of the 1970s is not appropriate for today. Inflation expectations generally remain anchored over the

medium term, despite recent upticks on the short end, due to decades of strengthening central bank independence.

## **Financial Sector**

**We welcome the GFSR's focus on the financial sector implications of Russia's invasion of Ukraine.** Staff correctly point out that the direct impact has been largest in Europe and in emerging markets and developing economies (EMDEs) that import agricultural products from Russia and Ukraine. We agree with the conclusion that global financial stability risks have risen, but we should not discount the fact that the global financial system has thus far proven largely resilient to the shock of Russia's unprovoked invasion. While volatility remains elevated, recent moderate strains in short-term dollar funding markets have largely dissipated, spreads have compressed sharply across many jurisdictions, and equity markets have recovered much of the value lost since the start of the invasion.

**We also agree with staff's framing in the GFSR of potential financial sector risks arising from advanced economy monetary tightening: thus far, financial conditions have remained relatively easy or neutral compared to historical levels.** In aggregate, capital flows to EMDEs have held up relatively well, perhaps due to spillovers being more benign in the context of strong growth or due to aggressive policy tightening by central banks in EMDEs. We note that, despite Russia's invasion of Ukraine, this monetary tightening is accompanied by strong growth, particularly in the United States, which will also have positive spillovers for EMDEs. We continue to encourage EMDEs to implement sound policies as a means to mitigate potential risks to capital inflows; such policies are of great importance for those EMDEs that remain vulnerable to COVID-19 shocks.

**We appreciate staff's discussion of commodity price volatility and its impacts on commodity trade financing and derivatives markets.** Recent events have made clear that we need to better monitor and understand (a) the connections between the commodities complex and financial system, and (b) how pressures in commodity trade finance and derivatives markets may affect the delivery of commodities to the real economy. This latter area is one in which additional staff work may be merited.

**We strongly welcome staff's in-depth coverage of financial sector risks associated with China's highly leveraged property sector.** We agree that China's property sector poses acute risks to China's growth and financial markets, and that these risks are being exacerbated by an acceleration in China's COVID-related lockdowns. We note staff's summary of potential transmission channels within China and would encourage staff to deepen their coverage of potential indirect spillovers, both real and financial, to the rest of the world.

## **Exchange Rates and Capital Flow Measures**

**We appreciate the WEO's approach in outlining the optimal policy mix, including the emphasis on exchange rate flexibility as a first line of defense and careful treatment of possible foreign exchange intervention and capital flow measures.** It is crucial that use of such unconventional measures avoids exacerbating global current account imbalances and creating other spillovers or distortions, especially considering that the Fund has yet to fully develop staff guidance for the application of the Integrated Policy Framework. We encourage staff to continue to be cautious and transparent in any application of the policy changes to the Fund's Institutional View, and to reiterate that CFMs should not be used as a substitute for warranted macroeconomic adjustment.

### **Other Key Issues**

**We agree that global efforts to mitigate and adapt to climate change must remain a top priority for global policymakers.** We agree that this will require mobilizing private finance to achieve climate goals. We urge countries to allow for pass-through of rising energy and commodity costs alongside strengthened social safety net programs, and to accelerate steps to reduce the fiscal burden from inefficient fossil fuel subsidies as part of broader climate plans. We welcome the IMF's support for multilateral efforts such as the Coalition of Finance Ministers for Climate Action work to mainstream climate into macro-fiscal policy, planning, budgeting, and procurement. We agree that coordination on climate mitigation measures is likely to yield notable benefits. In assessing and coordinating climate mitigation policies, it is critical to maintain focus on the emissions-reduction impact of these policies.

**We welcome the focus on corporate tax coordination.** The October 2021 two-pillar agreement under the Organization for Economic Cooperation and Development/G-20 Inclusive Framework on Base Erosion and Profit Shifting will make the international tax system fit for purpose for the 21st century, including by establishing a global corporate minimum tax and an allocation of taxing rights that is consistent with the geography of economic activity. Rather than competing on their ability to offer low corporate rates, countries can more readily focus on investing in human capital and physical and technological infrastructure. Rather than focusing on tax minimization, companies will locate production where it is most efficient economically. This will make firms and countries individually stronger and also improve macroeconomic conditions globally. We must not waiver in our resolve to swiftly implement Pillar 1 and Pillar 2 on the timelines agreed to in the Implementation Plan, and we welcome staff advice on concrete actions. Tax simplification could be a beneficial part of international cooperation on taxation.

**Finally, we remain highly concerned about growing debt vulnerabilities in LICs, with their median debt nearly double the level in 2013, and nearly 60 percent of LICs in or at high risk of debt distress.** We urge the Fund to monitor these vulnerabilities closely, including the implications of spillovers from the war on Ukraine on countries already facing heavy debt burdens. Close monitoring and targeted policy advice are particularly important in this context, given that unsustainable debt levels could hinder the Fund's ability to support

reform programs in these countries. The IMF has a critical role to play in ensuring constructive creditor participation in debt restructuring processes such as the Common Framework.

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GRAY/22/1041

April 8, 2022

**Statement by Mr. Tanaka, Ms. Kashima, Mr. Naka, Ms. Fukuda, and Ms. Ogihara on  
World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

We thank staff for the set of comprehensive April 2022 Flagship Publications, which are well focused on the analysis of the current exceptional circumstances and necessary policy measures, while also emphasizing the importance of addressing structural issues. Russia's aggression against Ukraine is an attempt to unilaterally change the status quo by force and shake the foundation of not only Europe but also the international order as a whole, and constitutes a serious violation of international law. With recovery from the pandemic halfway through, the war is having a destructive impact on the global economy, including further disruption of supply chains, high energy and food prices and associated security concerns, instability in financial and capital markets, and an increasing number of refugees.

These adverse effects make it even more difficult to advance important policy issues highlighted in the recent GPA draft. Rising energy and commodity prices are already affecting the global economy through multiple channels, with vulnerable people being the most affected. Countries with limited fiscal space face a difficult tradeoff between providing the necessary support and rebuilding fiscal buffers. Central banks also face a challenging tradeoff between containing inflation and supporting recovery from the pandemic. Furthermore, energy security issues could delay the smooth implementation of climate change policies. Nevertheless, we must avoid undermining structural reforms that are essential for sustainable growth, while tackling the current pressing challenges. To overcome the challenges that Russia's aggression posed on the global economy, we need to work even more on multilateral cooperation based on rule of law and trust. The Fund, with its macroeconomic expertise, should play an important role in tackling the macroeconomic shock and continue to support member countries through Surveillance, Lending, and Capacity Development (CD) well-tailored to each countries' circumstances.

***World Economic Outlook***

**We note that the global growth for 2022 has been revised downward by 0.9 percentage points mainly due to the direct impact of the Russian aggression and its international**

**spillovers.** We would like to emphasize that the adverse effects of the sanctions attribute entirely to Russia's war. Current developments are generating divergent and complex impacts on the global economy, and we welcome staff's informative analysis on its potential spillover channels. Higher energy and commodity prices and supply chain disruptions will have a broad impact in many regions, while some commodity-exporting countries will be able to offset adverse effects through higher export prices. We also note that developments in the Chinese economy, reflecting the zero-COVID strategy and a slowdown in the real estate sector, could weigh further on the outlook, especially in Asia where supply-demand linkages are strong.

While measures to tackle the pandemic and prevent scarring remain necessary, it is essential to rebuild fiscal space to respond to further shocks. Second round effects of soaring prices beyond central banks' inflation targets could impact inflation expectations, and require close monitoring. With the high risk of market instability, it is also important to have prudential policies that respond to the impact of inflationary pressures and tightening monetary policy cycles in domestic and external terms. We commend staff for their comprehensive analysis on private sector debt and resource reallocation in Chapter 2.

**Amid these significant stresses on the global economy, efforts to address long-term growth and climate change should not be halted, as staff points out.** We welcome that the report emphasizes the need of raising emerging economies' ambitions toward climate change mitigation, in addition to promoting efforts in advanced countries. The current situation highlights the importance of energy diversification, and we should promote climate policies along with ensuring energy security. In addition, as presented in Chapter 3, labor reallocation is a necessary step to achieve the climate goal, and private investments should be guided to pursue greener activities. Also, for inclusive and sustainable recovery, we need to stay vigilant towards the risks and impacts on vulnerable people, such as social unrest due to high commodity prices, increasing refugees, and delays in vaccine rollout, all of which could lead to further inequality. In addition, political fragmentation poses a significant risk, and we fully agree with staff that strong international cooperation is vital in all areas, including pandemic measures, debt measures, trade policies, and climate change. We support the Fund's continued efforts based on its core mandate and expertise.

### *Global Financial Stability Report*

**The geopolitical shock further intensified the preexisting inflationary pressure and upward pressure on yields.** Monetary policy normalization has been progressing both in major advanced economies and emerging economies. While we positively note that inflation expectations are generally under control at this juncture, price developments warrant vigilant monitoring. As global tightening is expected to further accelerate due to the ripple of the war, rising funding costs and pressures on portfolio flows in EMs are particularly concerning. We encourage staff to continue their policy advice to enhance viability of EMs' macroeconomic frameworks.

**The geopolitical shock also caused higher volatilities in financial markets.** Although the shock has not triggered a global systemic event so far, we need to keep a close eye on medium-term financial risks, especially in countries in physical proximity or in close

economic relationships with Ukraine and Russia. Above all, we agree with staff that the uncertain magnitude of indirect exposures in the financial sector is a source of concern. The authorities need to carefully monitor any signs of risk emergence, including in the non-bank financial sectors.

On the risks from sovereign-bank nexus, we greatly appreciate our bilateral dialogue with staff related to the past discussions at the Basel Committee. We note that such risks are critical for some EMs. However, **we must say that risks from sovereign-bank nexus greatly depend on country-specific economic factors.** For instance, the robustness of a banking system, depth of capital markets, and vulnerability to capital flows, which greatly vary among advanced economies and emerging market economies, would have significant implications on the risks stemming from the sovereign-bank nexus. Chapter 2 of the GFSR seems to lack sufficient analysis on such differences, in suggesting the need for an international standard only because “the sovereign-bank nexus has also manifested in advanced economies in the past.” Further, we are concerned that the Fund’s suggestion may send a wrong signal that the Basel III itself could be reconsidered, and thus undermine the momentum for its implementation. Among various banking regulatory issues, the sovereign exposure issue is particularly contentious and dealt by the BIS expertise. As it relates to the fundamentals of fiscal and monetary policies and the smooth functioning of financial markets, for the sake of the credibility of the Fund, we ask the Fund to be extremely careful in its external communications on this issue.

**We note that fintech firms have unneglectable implications for financial systems.** We agree with staff that the authorities should vigilantly monitor and regulate fintech firms in order to prevent negative spillovers to macro-stability while harvesting private innovations. Specifically, the authorities should pay due attention to the growth of neobanks, as increased competition from such entities could put downward pressure on the profitability of incumbents. Regarding DeFi, it is a source of concern that associated risks in crypto markets could transmit to traditional financial markets through increased market interconnectedness. In light of the unique challenges posed by DeFi, we share the staff view that the authorities need to take a multipronged approach, such as imposing regulation on centralized entities and codes of the ecosystem, encouraging the establishment of SROs, and imposing exposure restrictions to regulated entities. We encourage staff to continue timely analysis and provide updates on the development of Fintech and their impact on financial markets, given its rapid growth and rising interest on crypto assets.

### *Fiscal Monitor*

**Many authorities are facing further stress from rising inflation and interest rate hikes, with limited fiscal space due to the pandemic.** Also, amid increasing vulnerabilities among the private and financial sectors, the war in Ukraine and prolonged economic sanctions against Russia could lead to materialization of risks, and require additional support for vulnerable groups. In this regard, we agree with staff that fiscal policy should be sufficiently flexible and targeted support will remain important in the short term. We also note staff’s point that while inflation could temporarily improve fiscal conditions, pressures from inflation volatility and higher effective interest rates would eventually emerge.

It is essential to gradually shift to policy normalization, while closely monitoring economic developments and potential risks arising from the exceptional measures adopted during the pandemic. Efforts to enhance sustainable public finance, through building fiscal buffers and credible medium-term fiscal frameworks, remain paramount.

**Multilateral collaboration is vital also in tax administration**, as emphasized in Chapter 2. For the time being, the top priority is the global and rapid implementation of a new two-pillar plan to reform international taxation rules. We expect the Fund to play an important role in supporting member countries' implementation while coordinating with other organizations.

We would also like to emphasize the following points regarding the carbon price discussed in Chapter 2. International Carbon Price Floor (ICPF) is, from our understanding, the lower limit of the carbon price that would be required in 2030 to achieve the 2 °C target, by country groupings based on income levels, assuming different net-zero achievement timelines for each country. We agree that, under such an international framework, it would be necessary to allow different treatment for the poorest countries, whose emissions are also limited. However, we believe that allowing different floors for major emitting countries could jeopardize the path to the 2050 net-zero and to achieve the 1.5 °C target, and could lead to inadequate efforts. We would like to request the Fund to refine the ICPF analysis on the following three points, so that the ICPF can be used as a practical guide for major emitting countries to recognize the cost of achieving 2050 net-zero emissions.

- (i) In addition to the suggested three groups based on income levels, a new group of major emitters based on their total emissions should be included in the analysis.
- (ii) At least for the group of major emitters, their equivalent ambition of achieving 2050 net-zero and the carbon price to achieve such goals should be assumed in the analysis.
- (iii) For the group of major emitters, the analysis should show the lower limit of the carbon price for each country as a dynamic trajectory, taking into account the gradual increase in marginal abatement cost.

*Also, could staff elaborate more on paragraph 78 which discusses carbon-pricing and a border carbon adjustment? In particular, would imposing border adjustments on the portion that exceeds the floor be compatible with introducing a carbon price floor? Staff comments are welcome.*

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GRAY/22/1042

April 9, 2022

**Statement by Mr. Bhalla, Mr. Goyal, Mr. Natarajan, Mr. Dash, and Mr. Singh on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor  
(Preliminary)  
Executive Board Meeting 22/35  
April 11, 2022**

**World Economic Outlook**

1. We compliment the Staff for this analytically rich document that undertakes the daunting task of making forecasts under continued uncertainty. We appreciate the focused policy advice to the membership on managing the economic recovery. We broadly agree with the Staff's assessment of prospects, risks, and policy prescriptions but would like to highlight a few points.
2. The world output growth has been projected to slow down to 3.5 per cent in 2022 and 2023 – 0.3 percentage points lower than the assessment made in the January update. This largely reflects geopolitical developments and sanctions and resurgence of the pandemic causing further supply chain disruptions that have exacerbated the pre-existing conditions. While we agree with the overall assessment, a closer look may be needed at the forecast for individual economies or country groupings.
3. As noted in the report, the impact of geopolitical developments should largely be restricted to the economies with direct exposure. In our assessment, India's economic recovery should stay on course. Given its strong economic fundamentals, very limited direct trade exposure to Russia and Ukraine, diversified trade basket and a record level of foreign exchange reserves, the impact would be relatively subdued. Moreover, the continued push on capital expenditure and infrastructure would also support the growth process. As such the economic activity has fully revived with the pandemic almost completely ebbed.

4. The report expects inflation to stay elevated for longer than in the previous forecast, driven by geopolitical developments on energy and food prices. Headline inflation has been projected at 5.7 per cent in advanced economies and 8.6 per cent in EMDEs – 1.8 and 2.7 percentage points higher than in the January update. We observe that crude oil prices had started rising in 2021 with a strong recovery in oil demand, and supply was already tight by February 2022. As such, the sanctions do not completely cover fuel exports.

5. Given that the current inflation movement is essentially embedded in the supply-demand imbalances created by pandemic and associated policy responses, we agree that the monetary stance should be data-dependent. The policy space and monetary stance could significantly differ across nations. At the same time, it may be useful to examine if the structural factors behind a secular decline in inflation in the pre-pandemic period, are at work or are waning. While examining the supply shocks and their second-round effects in influencing core inflation, the role of medium to long run well-anchored inflation expectations in shaping inflation trajectory beyond the short run also needs to be considered. Given the current inflation-growth dynamics, there may also be a need to examine the level of neutral interest rates which have been generally falling since the 1980s in most of the advanced economies. While in some advanced countries real policy rates are rising from their low levels in tandem with the closing output gap, the assessment of neutral interest rates becomes challenging in the context of EMEs. The coexistence of large negative output gaps, projections of long-term scarring in both product and labour markets, rising inflationary pressures, and a sharp uptick in real interest rates – all point to a difficult policy diagnosis – posing stronger tradeoffs for central banks in their policy choices.

6. The report identifies the risk of tighter financial conditions and capital flow reversal from emerging market economies in anticipation of policy normalization by advanced economies. We endorse Staff suggestions that emerging market economies may need to tighten the macroprudential tools ahead of time, targeting vulnerable segments of the economy and, if required, employ foreign exchange intervention to address disorderly market conditions. This is in line with the Institutional View that incorporated FXI and CFMs as a necessary tool to guard against financial instability. Nonetheless, these may not be used to gain an undue trade advantage and substitute needed macroeconomic adjustment.

7. Liquidity support from the additional fiscal space created by the G20 DSSI initiative helped many low-income countries and some emerging market economies to direct expenditure towards fighting the pandemic. With the expiry of the DSSI in December 2021, fresh liquidity constraints have emerged as countries are yet to fully unwind support measures but economic recovery faces headwinds. The

Common Framework for debt treatment has become operational but remains saddled with implementation challenges. Lack of debt transparency and capacity constraints in debt management add to the complexity of debt resolution under the Common Framework. We call for faster processing of debt treatment of the countries which have approached under the Common Framework to demonstrate its effectiveness.

8. The report recommends fiscal policy reforms to bring about the steady replacement of fossil fuels with renewables and other low-carbon energy sources. It further observes that a threefold increase in clean energy investment is needed by 2030 to accelerate the decarbonization of the power sector. We would like to underscore that decarbonization efforts and the fight against poverty and access to basic energy need to be considered holistically. Since the economic impact of the COVID-19 pandemic has seriously disrupted electrification efforts, the SDG target of universal access to energy by 2030 is unlikely to be met. Developing countries need necessary financial support to make climate-resilient investment decisions and budgetary allocations. Research suggests that climate-compatible investments often have higher investment needs than conventional measures and may also carry higher financial risks because the technologies are not proven, or the projects have high upfront costs. Ironically, Oxfam's Climate Finance Shadow Report 2020 on progress towards the goal of providing \$100 billion annually by developed countries, reveals that the true value of support for climate action may be as little as \$19-22 billion per year once loan repayments, interest, and other forms of over-reporting are stripped out.

9. Regarding the greener labour market policies (Chapter 3), the conclusion that employment changes required by the green transformation are moderate in a historical, macroeconomic context, is a less persuasive one. It may be noted that a sizable transition from emission-intensive manufacturing to the emission-light services sector took several decades for advanced countries. Occupational switches are not easy and evolve over long periods. Unlike advanced countries, where labour is relatively skilled and flexible to move across sectors, reskilling in developing countries is difficult since a large part of the labor force tends to be semi/low-skilled. Such economies thus may be left behind in transitioning to a greener labour market in the absence of support. For these countries to be able to mitigate the impact of climate change along with the green labour transition, AEs must fulfil their commitment to climate finance of \$100 billion per annum from 2020 onwards, which is meagre compared to the financing needs of the EMEs and LICs. In many developing countries, where energy production is dependent on fossil fuels, the transition to low carbon may exhibit a chain reaction in many associated

industries/sectors dependent on fossil fuel-based energy. This could lead to a massive dislocation of the labor force simultaneously in several industries.

10. The chapter while pointing out the difficulties for workers in more pollution-intensive or neutral jobs in moving up the green ladder, does not say much about the feasibility of such transition for economies in general. How feasible is this policy for EMEs who have not peaked yet? It also does not consider the cost of such transition and the timeframe within which this will be offset. As part of the policy package designed for the economy to achieve net-zero emissions by 2050, the chapter states that "Ad valorem tax on carbon emissions is gradually phased in, starting at about 0.1 per cent per year in 2022 and then rising to 1 percentage point per year from 2029 onwards". Such a proposition assumes homogeneity in the countries' commitments and ignores their constraints. A carbon tax will hurt the EMEs and LICs, especially the ones who rely more on fossil fuels. For example, a carbon tax on fossil fuels is often regressive in its impact- hurting poorer people relatively more than richer ones. Even when it might be progressive, poorer people still suffer a welfare loss when prices rise, making their consumption basket more expensive. Devising transfers to compensate them for this loss is not a simple matter. Compensation systems may not be well developed, and it may be difficult to identify those hurt or to get funds to them.

11. The analytical work (chapter 4) on "Global trade and value chains in the pandemic" states, "*With tariff barriers having declined globally to new levels, there is still ample scope to reduce non-tariff barriers (NTBs), particularly in emerging markets and low-income countries*". In this context, it is to be noted that though tariff barriers have reduced, the past few years have seen an increase in protectionism amidst trade wars and sanctions. This has partially offset the benefits that low tariff barriers may have offered, hurting the global trade growth prospects. This calls for renewed efforts for reviving WTO to establish a fair and rule-based global trade order.

12. The chapter also states that "*To some extent this could favour domestic sourcing and thus tilt the scales against greater diversification (for example, Made in China 2025, Make in India Initiative, United States Innovation and Competition Act of 2021)*". In this regard, it is to be noted that 'Make in India Initiative', started in 2015, and aims at boosting the country's domestic manufacturing capabilities. It is in no manner protectionist or isolationist in nature and hence poses no hindrance to diversification.

13. **The calibration of monetary policy is turning out to be more challenging for EMEs due to weaker recovery, rising inflationary pressures, partly led by food and energy supply shocks, and a tightening of global financial conditions leading to expectations of capital outflows.** While we agree that central banks should act decisively to prevent inflationary pressures from becoming entrenched, it also requires careful communications and actions to prevent a disorderly tightening of financial conditions, which may risk financial stability and growth outlook. Policymakers should tighten macroprudential tools focused on pockets of elevated vulnerabilities to avoid a disorderly tightening of financial conditions. We also find it appropriate that a multifaceted policy strategy is needed to preserve the effectiveness of CFM measures in an environment of increasing the use of crypto assets.

14. In the analytical Chapter 2, suggestion of capital surcharges on banks' holdings of sovereign bonds above a certain threshold appears to be a strong regulatory proposal. **We are not in favour of the imposition of non-zero, risk-sensitive capital requirements or stricter concentration limits, or capital surcharges on bank holdings of the domestic sovereign.** We believe that parallel advocacy of such regulatory measures by the Fund for emerging market and developing countries, outside the ambit of the Basel risk framework, is likely to create an uneven regulatory landscape and exhibits a lack of evenhandedness in policy advice. We would also like to understand how the Fund's communication regarding the risk of 'sovereign-bank nexus' could alter the markets' risk perception about the emerging markets bonds in general at a critical juncture when EMEs are already facing difficulties in accessing the global capital markets?

15. The sovereign-bank nexus needs to be dissected very carefully. **We believe that there are several factors beyond the expansion of fiscal deficit that has led to an increased holding of sovereign debt by the banking system during the COVID-19 crisis.** *First*, as the COVID-19 crisis hit both the formal and informal sectors and led to a permanent loss of production capacity, the credit demand from the corporate sector has turned tepid and forced the banks to rebalance their portfolio. *Second*, since it is challenging for banks to differentiate between the firms facing liquidity constraints from those that have turned insolvent, risk aversion to the real economy has increased, which may have turned banks more risk-averse and thus, forced asset reallocation in favour of safer domestic assets. *Third*, the broader liquidity concerns in the market may have forced banks to invest in more liquid assets, i.e., government bonds, in the domestic market. *Fourth*, high household savings due to the pandemic-related lockdowns made their way to bank deposits, which may have encouraged banks to expand the asset size by investing in government bonds given the lack of investment opportunities elsewhere.

16. The Chapter asserts that rather than only “encouraging” banks to disclose data on sovereign exposures by jurisdiction, currency denomination, and account classification, market discipline would work meaningfully only if this becomes mandatory for all banks. While we agree with the views expressed, we believe that making the data disclosure on sovereign exposure would be contingent upon several factors such as political setup, legal provisions, and capacity. This requires the incorporation of flexibility to adjust and implement such data requirements in the proviso.

17. Chapter 3 summarises the emerging trend in the FinTech ecosystem viz., the emergence of Neobanks and DeFi products along with the benefits and risks accrued by these entities/products in the financial landscape. We generally concur with the view given in the chapter on regulation and policy responses for these newer activities. **In the context of Fintechs and DeFi platforms, the role of standard-setting bodies is very crucial in framing a global standard for regulation of these activities as often the activities of entities transcend borders.** However, in India, as per the current regulation, lending on its balance sheet beyond a threshold by incorporated entities is a regulated activity. Further, if DeFi is allowed to operate in an unregulated sphere, it could pose a serious risk to financial stability as banks will find it difficult to retain borrowers and depositors leading to banking disintermediation. The need for international collaboration in evolving regulations on the DeFi is important considering the borderless nature of their flows. The international collaboration may also be used to reach a global agreement on the suitable structure of the underlying blockchain platform to provide the inter-operability of various DeFi blockchain platforms.

### **Fiscal Monitor**

18. We recognize that fiscal policy is operating in an uncertain environment consisting of slower economic recovery, rising inflation, elevated debts, and geopolitical issues. **Fiscal space has considerably reduced in many countries because of the significant fiscal support provided during the pandemic.** The surge in the global debt by a huge 26 percent in 2020 has limited the space for additional borrowing and worsened debt vulnerabilities.

19. Supply disruptions have led to a dramatic increase in commodity prices. The steep rise in fuel and food prices has debilitating social and economic consequences. Fertilizer prices which have increased by 80 percent in the past 12 months could have a huge adverse impact on agricultural production. **We recognize that the fiscal impact would vary significantly across countries depending on the nature of the economic activity, terms of trade, and benefit the exporters of commodities while adversely impacting the importers.**

20. We note that the fiscal deficit and debt trends are evolving with vast differences across advanced, emerging market economies, and low-income countries due to their divergent nature of recoveries. Both fiscal deficit and debt levels have started declining in advanced countries. The fiscal deficit in emerging market economies has started declining albeit with considerable heterogeneity based on the level of withdrawal of pandemic fiscal support measures. The fiscal deficit across low-income countries has remained stable but exhibited variation between commodity exporters and others.

21. We take note of the impact of inflation on public finances and policies, and that inflation surprises can improve debt dynamics. Inflation has contributed to a reduction of global debt levels by 2 percent in 2020 with a significant 4.2 percent reduction in emerging market economies. However, rising inflation is likely to be followed by rising interest rates and a higher debt burden. This can significantly affect investment and growth, eventually affecting the fiscal space. **From a policy maker's perspective, could this situation provide possibilities for dynamic policy actions to generate an outcome scenario that can optimize growth, fiscal balance and price stability? Staff may comment.**

22. As the energy and food prices have risen rapidly, Governments need to take action to protect vulnerable households. The Government of India has ensured the availability of free or low-priced food grains, pulses, edible oil, and sugar to the poor and vulnerable families through the massive public distribution network. Under the food security welfare program – PM Garib Kalyan Anna Yojana, now extended up to September 2022, the Government provides additional free ration per person per month, over and above the usual entitlement of foodgrains under the National Food Security Act. **Huge budgetary financial support is provided to address various challenges arising from the disruptions caused due to these challenges.** To meet the shortfall of food grains due to the prevailing supply issues, India has substantially increased the supply of wheat in the global market. Apart from meeting the huge domestic demand, the country is taking efforts to step up the global supply of wheat in the coming years.

23. In international cooperation on corporate tax matters, we take note that many jurisdictions have agreed to the inclusive framework. **Recognizing the challenges in implementation, we call for concrete actions to ensure that the benefits reach low-income countries.** All efforts should be directed towards tax simplification measures while strengthening withholding taxes on specific cross-border payments and providing timely access to country-by-country information on multinationals. We agree that domestic tax reforms are key to leveraging the gains from this agreement, including by visiting wasteful incentives and better taxation of monopolistic rent on efficiency, equity, and revenue grounds.

24. International cooperation in the personal income tax sphere would require sharing of information to curtail offshore tax evasion. Recognizing the progress achieved under the Global Forum on Transparency and Exchange of Information for Tax Purposes, we agree on the need for further reforms to ensure the availability of beneficial ownership information to tax authorities & capacity building in low-income countries to promote tax compliance and tax policy changes. **We note that international cooperation in personal income tax would gain traction as a bigger segment of the labor income tax base turns mobile with the expansion of opportunities in cross-border remote work.**

25. On climate, the argument that reinforcing the Paris agreement with a carbon price floor for large emitters can limit global temperature to 2 degrees C appears to be a narrow approach to the energy transition, ignoring the other key pillars of mitigation strategies. A narrowly focused strategy of carbon taxes, without changing the supply response of renewables, could only lead to a global energy crisis, more so for developing countries where access to energy is still very low and per capita energy consumption remains a fraction of what an advanced country citizen consumes. As new technologies bring down solar PV and onshore wind energy costs, wider dissemination of technology, its adaptation, and investment can accelerate affordability, and incentivize consumers and producers to shift from fossil fuel to renewables. **This will require massive global financial flows and scaling up of investment in renewable energy, including the introduction of low emission and low-cost technologies in existing industries.**

26. Unilateral border carbon adjustments are not the solution to the current global warming. Given the current state of the global trading system and disputes, advocacy of such a tax is most likely to harm the global open trade further, leading to increased trade disputes. **Unilateral carbon border adjustments are antithetical to the principles of equity enshrined in the Paris Agreement and risk turning into a climate-based restrictive trade regime, harmful to free global trade.** Recognizing the political sensitivity of this issue, the issue needs to be discussed in the ambit of the WTO.

**Statement by Rasmus Ruffer (ECB Representative), Dimitrios Rakitzis and Sander Tordo  
(Advisors) on the April 2022 World Economic Outlook, Fiscal Monitor and Global Financial  
Stability Report**

**(Preliminary)**

**IMF Executive Board Meeting**

11 April 2022

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 comprehensive manner is commendable, all the more against the backdrop of the ongoing geopolitical and pandemic circumstances. 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 broadly agree with Staff's assessment of the global economic outlook and the fallout from the Russian invasion of Ukraine on global growth for 2022.** Since the October 2021 flagships, global economic activity had continued to recover. However, the Russian war in Ukraine poses significant headwinds to the recovery. Beyond the direct consequences, the conflict has affected confidence and significantly increased uncertainty, intensified supply bottlenecks and added to underlying inflationary pressures. Other global risk factors such as the emergence of new variants and waves of COVID-19 remain present. We stress that the invasion itself – not the sanctions taken in response – remains the key source of spill-overs and downside risks to the global economy at the current juncture. For the euro area, we consider Staff's forecasts as plausible, noting that Staff forecasts for euro area real growth is lower and inflation is slightly higher than what we anticipated in our March projections, possibly reflecting different cut-off dates in the current rapidly evolving economic landscape. Like Staff, we agree it is important to recall that there is considerable uncertainty surrounding the growth outlook, with the impact of the war in Ukraine on the European economy difficult to quantify, and also agree that risks are tilted to the downside.

**We concur with Staff that global inflationary pressures could persist for longer.** More prolonged inflationary pressures at the current juncture could reflect the impact of the war – especially on energy and food prices – as well as the broadening of price pressures. Flare-ups of the pandemic may too contribute to such risks. In this respect, and in line with our risk assessment, Staff also see upside risks to medium-term global inflation if higher commodity prices, including from the war in Ukraine, were to lead to higher inflation expectations and wage demands. However, we also note that demand may also weaken over the medium term, due to adverse terms-of-trade shock and confidence effects. This could also lower pressures on inflation over this horizon. In this respect, we note that Staff see such demand effects to dominate only after 2023. Euro area inflation has increased markedly since mid-2021, reaching 7.5% in March according to the flash estimate, largely driven by temporary factors: the strong rise of energy and food prices and supply bottlenecks as demand outpaced supply with the re-opening of the economy. The impact of these

factors should fade out over time, but in the short run, due to the uncertainty from the war, inflationary risks are tilted to the upside. In addition, price pressures could become more persistent if wages rise as a result of the current high inflation pressure. So far, however, there is no evidence of significant second-round effects through wages and inflation expectations in the euro area remain anchored.

**As to monetary policy in the euro area, the ECB Governing Council is very attentive to the prevailing uncertainties.** In current conditions and amid maximum uncertainty, now more than ever, it is important to maintain optionality, gradualism and flexibility in the conduct of monetary policy. The calibration of monetary policy needs to be data-dependent and reflect the evolving assessment of the outlook. The Governing Council will take whatever action is needed to fulfil the ECB's mandate to pursue price stability and to safeguard financial stability.

**Taking into account the uncertain environment, the ECB is reducing net asset purchases in a step-by-step manner in the second quarter of this year.** If the incoming data support the expectation that the medium-term inflation outlook will not weaken even after the end of the net asset purchases, the Governing Council will conclude net purchases under the Asset Purchase Programme (APP) in the third quarter. If the medium-term inflation outlook changes and if financing conditions become inconsistent with further progress towards our two percent target, the Governing Council stands ready to revise its schedule for net asset purchases in terms of size and/or duration. Any adjustments to the key ECB interest rates will take place sometime after the end of net purchases under the APP and will be gradual.

**We agree that fiscal policies at this juncture are similarly subject to very high uncertainty related to the pandemic and the Russian war in Ukraine.** In this light, we note that as a result of the war in Ukraine, Staff revised down its budget balance projection for the euro area in 2022 compared to January by more than 1.5% of GDP to -4.3% of GDP, although any estimate is subject to unusually high uncertainty. Like Staff, we see that in the euro area the aggregate fiscal stance will remain supportive in 2022, taking into account national budgets and the funding provided by the EU-level Recovery and Resilience Facility.

**Looking ahead, we agree that marked divergences across countries require tailored and agile fiscal policy responses.** In those countries which are hit hardest by the Russian war in Ukraine, fiscal policy will need to shield the economy, respond to the humanitarian crisis, including supporting war refugees, and address disruptions in energy and food supply. Such measures should be targeted at protecting the most vulnerable citizens and firms, allow domestic prices to follow international prices and contain the impact on government budgets and debt. As such, we concur that generalised price subsidies would be costly and distort international food and commodity markets, leading to overconsumption. For the euro area, fiscal strategies need to be differentiated across Member States, contributing to achieving an appropriate aggregate policy stance. Like Staff, we see that if economic activity deteriorates significantly, broader and temporary fiscal support could be appropriate for countries with fiscal space. In those countries where economic growth is stronger and inflation pressures remain elevated, fiscal policy needs to shift from exceptional support in response to the pandemic to normalisation to reduce demand pressures, thus contributing to containing inflation. Whilst surprise inflation can indeed improve debt dynamics in the short run as revenues react more strongly than expenditure, we appreciate Staff's emphasis that these cannot be expected to last, especially if spending pressures rise over time. It is therefore important that temporarily higher revenues are not used for permanent spending increases as this would weigh on fiscal sustainability

going forward. As a result of the pandemic, governments also still face the challenge of managing the potential economic effect of resulting excess savings. These could help buffer the effect of the higher inflation and lower growth, but also add to inflationary pressures if spent quickly.

**We consider the analysis on the coordination of taxation across borders important and timely in view of the recent progress on international corporate taxation.** The chapter demonstrates that international policy cooperation can yield better results than unilateral actions in many areas of tax policy and that international rules can help the global effort to stymie climate change.

**Finally, we appreciate the timely and topical analysis of Staff on trade and greening the labour market.** The pandemic and, more recently, the Russian war on Ukraine, are a powerful reminder of the importance of building resilient supply chains. In this context, we agree that the resilience of Global Value Chains (GVC), underscored by Staff, can be further boosted by international sourcing of inputs, and greater substitutability among inputs. Such a strategy would present a more growth-friendly way forward than reshoring policies. At the same time, it is important to keep in mind that some specific inputs feature intrinsically very low degrees of substitutability. Turning to the labour market chapter, the green transition will certainly require a large-scale reallocation of resources away from carbon-intensive sectors and technologies towards low-carbon activities and smooth adjustments in the labour market with changes in the allocation of workers across occupations and sectors are thereby a critical aspect. Efficient frameworks, such as good conditions for research and the adoption of new skills in the labour force and a favourable environment for the propagation of new technologies, make important and partly mutually reinforcing contributions to a successful transition. We also note that on-the-job training opportunities provide an important dimension not covered in Staff analysis. On the EU side, the effective and timely implementation of the investment and reform plans under Next Generation EU should help modernise EU economies, enhance both long-term growth and economic resilience, and support the green and digital transition.

### **Global Financial Stability Report**

**We are in broad agreement with Staff's assessment on financial stability issues and the risk outlook, as shaped by the war.** We agree with Staff's assessment that the Russian invasion of Ukraine has significantly increased downside risks and financial stability concerns. We also agree that the war had a limited financial stability impact, so far, and has not become a global systemic event. Market functioning has remained relatively orderly, given the limited size and importance of the Russian economy, also facilitated, in the case of the euro area, by the limited financial exposures to both Russia and Ukraine.

**We share's Staff's view that while the financial sector in the EU has proved to be resilient to shocks so far, renewed headwinds arising from the war in Ukraine require sustained close monitoring.** Despite the various challenges over the past years, such as the COVID crisis, or more recent ones, like inflationary pressures and the war in Ukraine, the EU financial sector has continued to perform well and shown high resilience, benefitting from a solid capital position, robust asset quality and high liquidity buffers. After an overall rise of asset prices over 2021, recent months have seen heightened volatility and declines in asset valuations. While near-term financial stress has been limited, a number of medium-term challenges arise from the conflict. As also noted by Staff, the direct exposure of the financial sector to Russia, Belarus

and Ukraine is rather modest. The main direct impact channel for the euro area is via commodity and commodity derivatives markets where we have seen some tensions, with market reactions overall pointing to the expected dampening impact of the war on the global and EU economy. We are therefore monitoring developments carefully, including margining practices in derivative markets. We also agree with the assessment that the indirect impact could be more significant, for example through heightened corporate and household credit risks due to elevated commodity prices combined with supply-chain disruptions, heightened volatility in financial markets and a general deterioration in the macroeconomic outlook. Banks are expected to reflect the direct and indirect impacts of the war and the revised macroeconomic projections in their capital and financial plans. Banks also need to improve their operational resilience and preparedness for cyber risks that might have increased. It is also important to continue pursuing better regulatory and institutional frameworks to make banks more resilient and better able to support citizens and the wider economy under all possible scenarios.

**We echo Staff's call for elevated attention to implications for other existing financial vulnerabilities from the war and support their views on the use of macroprudential policies as a hedge.** In addition to the challenges highlighted by Staff, the implications of the war may interact with previously identified cyclical vulnerabilities that have continued to build in non-financial sectors. We fully support Staff's view that macroprudential policies need to be tightened to address pockets of cyclical vulnerability. In the euro area, country-specific macroprudential policy should be the first line of defence to address heterogeneous real estate vulnerabilities across euro area countries. While high uncertainty calls for caution regarding immediate macroprudential policy action, national authorities should stand ready to act, unless the macro-financial outlook deteriorates substantially.

**Regarding monetary policy, we fully agree on the recommendation on clear central bank communication but would like to stress the need to remain flexible and data dependent.** In the euro area, balancing these risks and faced with high uncertainty, the ECB maintains optionality, gradualism and flexibility. It is continuing the path of policy normalization but will adapt the speed of normalization reflecting the evolving assessment of the outlook. In particular, the ECB expects to conclude net asset purchases under the asset purchase programme in the third quarter if the incoming data support the expectation that the medium-term inflation outlook will not weaken even after the end of the net asset purchases. With regard to the language used in paragraph 20 of Chapter 1, we would like to stress that rather than talking about an "acceleration of tapering", the most recent decisions (March 2022) must be seen in the context of a continuation in monetary policy normalization, in a data-determined fashion, following the December 2021 decisions and February 2022 communication. With regard to references in paragraph 23 on the risks of "tighter financial conditions" and "market fragmentation in the euro area" as a result of lower asset purchases, we recall that, as mentioned further up in our observations on the WEO, if the medium-term inflation outlook changes and if financing conditions become inconsistent with further progress towards the two per cent target, the Governing Council stands ready to revise its schedule for net asset purchases in terms of size and/or duration.

**Regarding the GFSR's analysis on the sovereign-bank nexus in emerging markets, we share the assessment of the associated vulnerabilities from a tightening in monetary policy conditions.** A number of EMEs have built up significant USD-denominated debt positions in recent years, which renders

them vulnerable to the ongoing tightening of US monetary policy. This is especially true amid capital outflows, higher funding costs and a depreciation of local currencies vis-à-vis the US dollar. As already forewarned by Staff in previous flagship vintages, we agree that this channel could trigger debt sustainability concerns across sovereigns and corporates in those EMEs which are heavily reliant on foreign funding sources.

**This analysis becomes even more relevant in the context of rising prices and capital outflows related to current geopolitical tensions.** The issue of the sovereign-bank nexus becomes particularly topical as the war in Ukraine and the related increases in food and energy prices are likely to have a negative impact on the fiscal position of a number of emerging markets, straining the sovereign's ability to finance itself in the market. Staff's analysis on sovereign-bank nexus in emerging markets is also particularly timely in view of the outflow of capital from emerging markets since the start of the war. Outflows from equity and bond holdings may already impose stress on financial systems in certain countries.

**Staff's analysis on the vulnerabilities of the rapid growth of fintech firms and DeFi is timely and comprehensive.** Financial innovation may bring benefits, but at the same time it can also create new sources of risk, especially if the innovators are not subject to appropriate regulation, supervision and oversight, following the "same activities, same risk, same rule" principle.

**We note Staff's concerns regarding the possible risks fintech firms can present for financial stability, and broadly agree with their calls for increased scrutiny.** A rapid rise of fintechs can indeed pose significant risk to financial stability, as they may become too-big-to-fail or may disrupt the traditional financial system in a disorderly manner. We therefore agree with Staff's calls regarding the need for increased supervisory scrutiny of fintech firms' safety and soundness of operations and control systems. In the same context, we also concur with Staff's views on the need for increased supervisory scrutiny of traditional banks' business models, as the latter could be negatively affected by the increasing competition through fintech firms using new approaches to provide financial services. In this regard, we would like to note that the ECB's Banking Supervision has identified this topic as one of the supervisory priorities for 2022-25 and has started a project to analyze these aspects in more detail.

**We also share Staff's assessment that DeFi brings important risks and vulnerabilities,** which is in line with ECB internal analysis. Rather than providing new financial services, DeFi instead mimics traditional financial services in an autonomous digital manner. So far this is done without interfacing with traditional assets, but this may come. As such, it is exposed to traditional financial risks, i.e. it is vulnerable to credit, market and liquidity risks. It may also entail heightened leverage. As mentioned in Chapter 3, on top of this come additional DeFi-specific risks such as the heist of funds through bugs in DeFi smart contracts or the use for money laundering, as participants in DeFi remain quasi-anonymous.

**However, we would caution against placing emphasis on the analysis that DeFi is "efficient",** as argued in paragraphs 35/36 in Chapter 3. Such cost-efficiency is not beneficial unless the services DeFi provides are priced *effectively* in line with risks. Likewise, it is not meaningful to credit DeFi with higher "cost-efficiency" when the services rendered have not yet been appropriately brought within the regulatory scope of their equivalents in the traditional sector.

**An internationally coordinated approach is needed to address the challenges posed by DeFi for policy makers, and time is of the essence.** We agree that DeFi's key features such as anonymity and decentralized nature pose further challenges for policymakers in terms of enforcement and in terms of effective regulation and supervision. In this regard, we see two main priorities: To address the challenges, a first focal area should be the enforcement of existing financial rules on centralised entities. The same entities that have helped the DeFi system to grow may also provide centralised entry points for existing regulation (as described in paragraph 45 of Chapter 3). Regulatory arbitrage should be avoided, and enforcements actions on these centralized entities taken where possible. As a second step, authorities should conduct a gap analysis to see whether regulatory gaps exist and certain functions of DeFi need to be regulated with bespoke regulation. The global nature of DeFi, the dispersion of its stakeholders and the growing interlinkages with the traditional financial sector require international coordination to ensure a consistent approach. International Standard Setting Bodies should step up efforts in performing the gap analysis and, where need, adopt globally consistent regulatory frameworks.

**Staff's Responses to Technical Questions Posed by Executive Directors  
EBM/22/35—April 11, 2022**

**World Economic Outlook**

*Staff's responses to technical questions are below. Broader policy questions in the areas of monetary policy, use of Fund resources, and climate change will be addressed in staff's intervention at the Board meeting.*

**Outlook/Risks**

1. **Does staff consider that the trade volume to GDP ratio will not be impacted by the war in Ukraine, and what is staff's opinion regarding the possibility of a potential positive contribution from trade due to a partial catch up of the export performance after the 2020-2021 losses?**
  - The WEO projects a significant slowdown in global trade from 10.1 percent in 2021 to half that pace (5.1 percent) in 2022, with trade growth marked down close to 1 percentage point compared to January. Demand for durable goods – which tend to be trade-intensive – is expected to moderate in 2022, but still remain robust as consumer spending is supported by excess savings built up over the past 2 years. This provides some partial offset to the drag on global trade volumes expected because of confidence effects and the withdrawal of policy support. As with the headline growth forecast, there is high uncertainty around this projection and risks to trade growth overall are to the downside – even if cross-border services trade and tourism benefit from the pandemic easing its grip.
  
2. **Regarding the labor market, we thank staff for the interesting Box 1.1 on US and UK markets. Beyond health concerns, could staff elaborate if income effects could help explain this phenomenon?**
  - As pointed out, Staff analysis also considered wealth effects from booming housing prices and strong financial markets as a potential factor for elderly workers' labor market withdrawals. However, the data from the UK suggests that elderly workers who moved out of the labor force during the COVID19 are disproportionately low-skilled and also renters rather than homeowners, suggesting that health concerns may be a more important factor than wealth effects. Likewise, households accumulated excess savings in advanced economies because of consumption restrictions and government support schemes, these were temporary, and tended to be concentrated among higher-income households. As such, they are unlikely to be a major factor in determining labor supply choices. Finally, some existing studies also suggest a limited and temporary role of generous Unemployment Insurance benefits, which were mostly phased out over the summer and early fall of 2021, in explaining the incomplete employment recovery.

**3. Moreover, we are wondering to what extent the withdrawal of the pandemic-related budgetary support contributes to reduce inflationary pressures, and to what extent could the budgetary support associated to the war increase inflationary tensions. Could staff comment?**

- The withdrawal of extraordinary pandemic-related support, together with expected tighter monetary policy, is anticipated to slow demand growth and help curb price pressures. War-induced fiscal support will be delivered in the context of weaker private sector confidence and spending, so the overall demand impulse is expected to be consistent with a gradual dissipation of price pressures into 2023. Nonetheless, there is high uncertainty around the inflation projections and inflation could turn out higher than expected. Broader fiscal support in response to the war's impact on aggregate demand should therefore be deployed in ways that avoid exacerbating ongoing demand-supply imbalances and price pressures.

**4. Could staff elaborate on the change in projections for net commodity exporter groups?**

- Strong commodity prices, especially for oil, mean that surpluses for exporters have grown. Current account balances are expected to remain elevated in the near term and narrow thereafter. Although disruptions to Russian exports may be windfalls for other commodity exporters, the net effect on the terms of trade will also depend on higher prices of other goods (e.g. food imports to fossil fuel exporters).

**5. Could staff elaborate on its scenario and recommendations for the balance between monetary and fiscal policy withdrawal/tightening in advanced economies, how they compare with the pre-war projections, and the impact of alternative policy mixes on EMDCs?**

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

**6. We thank staff for the useful downside scenario in the box, and we would be interested to get the detail by country. Could staff also provide details regarding (i) the underlying assumptions related to fiscal trajectories, and (ii) the breakdown of the embargo impact between price increases and volume shock associated to supply disruptions?**

- *Underlying assumptions related to fiscal trajectories.* The scenario presented in the box assumes automatic stabilizers are allowed to operate, resulting in some limited endogenous fiscal response to the various shocks. As a result the path for overall government balances in percent of GDP is moderately lower in most countries, relative to what is embedded in the current WEO baseline, so either less positive or more negative than what is currently being projected by IMF country teams. Outside of Russia, European countries see a larger hit to fiscal balances given the greater impact of the scenario on economic activity in that region.

- *Breakdown of the embargo impact between price increases and volume shock associated to supply disruptions.* Supply disruptions are incorporated in the simulations as both lowering activity and adding to the inflationary pressures. These disruptions are in addition to the direct effects of higher commodity prices on inflation and activity.
- 7. The wedge in inflation between advanced economies and emerging market and developing economies is projected to widen from 2.9 percentage points in 2022 to 4 percentage points in 2023. We would be interested in any reflections by staff on this inflation wedge – how it compares historically and how it may affect global economic dynamics.**
- Historically, the wedge between AE and EMDE inflation has generally been higher than what is projected for 2022-23. The gap has narrowed since the 1990s as inflation in EMDEs has come down. Relatively higher inflation in EMDEs than in AEs over the current WEO forecast horizon in part reflects the relatively higher share of energy and food in EMDE CPI baskets. EMDEs in general therefore face a bigger impact of the commodity price shock. This will disproportionately hurt lower-income households in EMDEs and could increase the risk of social unrest.
- 8. Could staff comment on how much core inflation has been revised up in advanced economies and the relative contribution of different shocks.**
- Relative to the January 2022 forecast, core CPI inflation in advanced economies has been revised up as follows: United States from 5 percent to 5.9 percent for 2022 and from 2.8 to 3.3 percent for 2023; euro area from 2 percent to 2.7 percent for 2022 and from 1.7 to 2 percent for 2023; UK from 4.3 to 5.8 percent for 2022 and from 2.6 to 4 percent in 2023; and Japan from 0.8 to 1.1 percent for 2023 (unchanged at 0.5 percent for 2022). The upward revision reflects persistent goods supply-demand imbalances and second-round effects from higher commodity prices.
- 9. Faster withdrawal of monetary policy support to contain inflation and slowing in China due to COVID-19 lockdowns are also contributing to a weaker global growth outlook. Further detail on the relative contribution of each of these shocks to overall global growth would be welcome.**
- Faster withdrawal of monetary policy support in the United States than previously anticipated is a contributing factor to the downgrade for the US. Similarly, the anticipated impact of more frequent and wide-ranging lockdowns in China to contain the spread of the Omicron variant is also a driver of the growth forecast revision for China. Overall, the contribution to the global growth downgrade for 2022 from these two factors is much smaller than the contribution from the negative impact of the war.

**10. Can staff please confirm that the downgrade to growth in China is solely due to the latest Omicron outbreak, and not additional factors?**

- The downgrade reflects the impact of more frequent and wide-ranging lockdowns on private consumption, slower real estate investment growth, and weaker net external demand due to the war.

**11. Many countries are in the stage of preparing policy responses as the effects of the war on their economies have not yet materialized. We note that discretionary policy responses are not factored into the baseline scenario, which may pose some upside risk. Staff elaboration would be welcome.**

- The baseline incorporates current policies. We agree that larger discretionary policy responses than currently announced represent upside risk to the outlook, although outside advanced economies and China fiscal space is generally constrained and the room for discretionary fiscal support is therefore limited.

**12. We would be interested to hear from staff on how far away from the vaccination target most countries are expected to be.**

- As of 8 April 2022, the share of the population that has been fully vaccinated is 74%, 65%, and 25% for advanced economies, emerging market economies, and low-income developing countries, respectively. About 86 countries missed the end-2021 40% target. Over 100 countries are expected to miss the mid-2022 70% target, while about 54 countries have already met the vaccination target. The global supply of vaccines is not currently a binding constraint. On vaccinations, the key challenge now is demand and absorptive capacity. International partners are providing concerted support to a group of 34 mainly lower-income countries who had coverage levels of less than 10% in January 2022. Since, vaccination rates have increased by a third across the 34 countries and now only 18 remain below 10% coverage. While vaccines remain a critical tool, ensuring equitable access to a comprehensive COVID-19 toolkit of vaccines, tests, and treatments will provide multiple lines of defense, particularly for countries where vaccine demand remains significantly low.

**13. We would be interested in an update on youth participation rates and whether they still remain well below the participation rates for prime-age workers in both advanced and emerging market economies.**

- As documented in chapter 3 of the April 2021 WEO, youth (among other worker groups, such as the lower-skilled) saw drops in participation on average across both advanced and emerging market economies with the pandemic, although the asymmetry was more evident for advanced economies. There are growing signs that the economic recovery is also improving labor market outcomes, although the magnitude of recovery in employment and participation varies across worker groups and economies. According to the latest data available for selected advanced economies (covering 2021), youth participation rates have exceeded their pre-pandemic trend in Canada and a group of European economies, while remaining

below in the US, UK, and Japan (see IMF SDN 2022/01). As more recent data gradually becomes available, a broader cross-country perspective into the labor market recovery across worker groups will become feasible.

**14. We welcome the structure along five principal forces that shape the near-term outlook – the war in Ukraine, monetary tightening and financial market volatility, fiscal withdrawal, China’s slowdown as well as the Covid-19 pandemic and inequitable vaccine access. We would welcome a more specific discussion of the relative importance of these different drivers and sources of risk to the global outlook.**

- The war is the most important factor affecting the outlook. In addition to the war, two other factors affecting prospects in the two largest economies are: faster withdrawal of monetary policy support in the United States than previously anticipated and more frequent and wide-ranging lockdowns in China to contain the spread of the Omicron variant. Overall, the contribution to the global growth downgrade for 2022 from these two factors is much smaller than the contribution from the negative impact of the war.
- Although it is impossible to precisely quantify the likelihood of risks to the outlook ex ante, the ordering of the risks reflects staff’s judgment on their importance for the outlook. The war in Ukraine holds the greatest potential for extreme and impactful surprises, with faster-than-anticipated monetary tightening and resurgence of the pandemic also important risk factors.

**15. We welcome staff’s thorough investigation of risks for the global economy via three channels: commodity markets and supply chains, inflation expectations and tighter financial conditions. Could staff provide a more detailed discussion of the assumptions underlying the three channels that would contribute to pushing Russia’s GDP down to 15 percent below baseline in 2027 and EU GDP down 3 percent below baseline by 2023?**

**16. In this regard, we would ask staff to provide more details about the assumptions underlying the “Scenario Box” projections.**

Answer to #16 and #17.

As discussed in the scenario box,

- Under the adverse scenario, Russia’s oil and gas export volumes are assumed to decrease by an additional 10 percent in 2022 and 20 percent in 2023 relative to the current baseline, and with volumes remaining at their lower 2023 levels through the rest of the forecast horizon. The additional sanctions also affect Russia’s non-oil exports, which decline by 7 percent in 2022 and 15 percent in 2023, again relative to the current baseline, and remaining at their 2023 level through 2027.
- Shortages of several commodities are assumed to lead to additional disruption of supply chains, most notably in Europe, and add to the impact on inflation and

activity. The combination of supply disruptions and higher energy prices leads to weakened confidence, further dampening activity.

- The supply shock in the scenario triggers an increase in short-run inflation expectations over 2022-2023. The increase is more pronounced in countries where inflation is initially higher, such as the US and some EMs, or where the supply shock is expected to be larger, such as in Europe and developing countries. For reference, the increase in one-year ahead inflation expectations in the US is around 70 bp in 2023. The fading of the commodity shock, the endogenous monetary policy response, and the impact from lower demand bring short-term expectations back to target after 2023. An increase in longer-term inflation expectations would amplify the negative macro impact but is not considered here.
- In the adverse scenario, broadening of sanctions will tighten domestic financial conditions in Russia further than has been the case so far. It is also assumed that sanctions halve the value of Russia's positive net foreign asset position, further dampening domestic demand. In the rest of the world, a risk-off episode also generates further tightening in financial conditions. Emerging markets experience an increase in both corporate and sovereign spreads; advanced economies face higher corporate spreads. The magnitude of the tightening is assumed larger in European countries.

**17. We also note that the possibility of renewed outbreaks is factored into the baseline, with their impact on activity assumed to be less than in earlier waves. Can staff provide some details on how this assumption applies to China and whether the baseline assumes they will continue with lockdowns?**

- The forecast for China incorporates the anticipated impact of more frequent lockdowns as the zero-COVID strategy confronts the Omicron variant. Risks are to the downside. If lockdowns last beyond April and become more widespread, there could be scope for further downgrades.

**18. Given the recent acceleration in COVID-related lockdowns in China, could staff provide a more up to date assessment of China's growth outlook and possible policy responses?**

- The growth forecast for China has been revised down to 4.4 from 4.8 percent, reflecting the negative impacts from the war in Ukraine and a surge in local COVID-19 outbreaks unseen in the last two years. Some of the impacts will be offset by the recently announced expansionary policy measures related to the government's 2022 growth target of "around 5.5 percent." The outlook is overshadowed by significant downside risks from the ongoing outbreaks, the potential for further downward revisions in trading partner growth and continued spillover risks of the real estate sector slump. If lockdowns last beyond April and become more widespread, there could be scope for further downgrades. Growth for 2023 has been revised down to 5.1 percent from 5.2 percent because of still-elevated commodity prices and weaker trade partner growth.

**19. We would like to invite the Fund to integrate into its policy recommendations the efforts at the international level to strengthen the agricultural strategies of LICs. Staff's comments are welcome.**

- The current crisis highlights the exposure of low-income countries to food price shocks. Higher overall productivity, not just in agriculture, is the best way to raise living standards and reduce this exposure. Enhancing multilateral cooperation to reduce trade barriers, can also help low-income food importers improve food security.

### **Fiscal Policy**

**20. On fuels, while staff recommends that countries release energy reserves where possible, to cushion against the impact of rising energy prices, many countries in the region don't have this option. Rather than authorities being required in program negotiations to remove remaining fuel subsidies at a time when this is likely to be socially disruptive, on-going subsidy reforms on fuel should also be calibrated to take account of the spillover effects of the conflict on prices and living standards. Staff comments are welcome**

- As noted in the WEO Chapter 1, fiscal policies should depend on exposure to the war, the state of the pandemic, and the strength of the recovery. The need for consolidation should not prevent governments from prioritizing well-targeted support for the vulnerable, including those struggling because of commodity price spikes. However, in general poorly targeted subsidies should be scaled back and the fiscal space created should be repurposed for well-targeted relief and broader social spending.

### **Monetary Policy**

**21. In Fig. 1.3 (panel 1) of the WEO, the path of policy rate expectations for the euro area seems too flat, considering that some current market indicators – e.g., Euribor 3-month futures and euro short-term rate (€STR) – point to rates at around 1 per cent already in mid-2023. Staff's comments are welcome.**

- The chart in question was incorrectly showing old data. This has since been fixed.

**22. We are interested in staff views on the current debate on whether some major central banks are falling behind the curve with their current pace of policy rate increases given high and increasingly persistent inflationary pressures.**

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

**23. Given the large part of supply-side factors (including energy and bottlenecks) in the recent increase in inflation, do staff consider that real rates – rather than**

**nominal rates – are a better measure of financial condition/monetary accommodation (as suggested in GFSR chap. 1, paragraph 82)?**

- Real rates are an important indicator of the stance of monetary policy but not a complete summary. Importantly, the neutral rate  $r^*$  – conceptually, the real rate consistent with the economy operating at full employment and with stable inflation – is an essential benchmark for assessing the stance of policy. The discussion on p.27, including Fig 1.22, emphasizes the importance of central banks communicating their view on the post-pandemic neutral rate and, if needed, their readiness to maintain policy rates above that benchmark for as long as required to bring inflation down to target—giving markets clarity on the likely endpoint for rate hikes.
- 24. Given the trade-off between tackling high inflation and safeguarding recovery, we agree that a data driven monetary stance has become more important. Central banks must be vigilant to the impact of sustained price pressures on inflation expectations. We encourage staff advice to countries on optimal, clear, communication approaches that are informed by behavioral analysis of both backward and forward-looking expectations, to help ensure that communication strategies work in entrenching or shifting expectations, as needed, depending on the country. Beyond this, we also believe fiscal policy in some advanced economies can help to contain inflation and limit spillovers. Figure 1.11 on inflation drivers cites “other” factors as the main driver for inflation in the U.S. and we wonder if this reflects the monetary impact of the stimulus. In this regard, while we agree that large economies that have recovered from the pandemic should shift away from exceptional support toward fiscal normalization, in order to avoid further fueling inflation with added money supply pressures, the appropriate policy mix in Europe, which is directly impacted by the war, may be different. Do staff have insights on the optimal balance between fiscal and monetary policy stances to maximize growth in these differing contexts?**
- On Figure 1.11, “other” factors include supply-demand imbalances, which in part reflects the influence of policy support on aggregate demand.
  - Staff will respond to the question on the appropriate policy mix during the Board meeting.
- 25. Since inflationary pressure had broken decade-long records in many countries already before the outbreak of the Russia-Ukraine war, greater attention to the underlying inflation developments as well as to the second-round effects of the persistent inflationary shocks would be warranted. The most recent data on inflation expectations also deserve more attention going forward. Staff’s comments on these issues are welcome. We also wonder how staff assess the room for maneuver for monetary policy in the context of record high asset prices.**
- We agree that careful diagnosis of inflation developments and monitoring of inflation expectations is crucial and note in the chapter that central banks should remain vigilant to the impact of price pressures on inflation expectations. So far, inflation

expectations have remained reasonably well anchored at longer horizons, rising substantially in only a few emerging market and developing economies, even as they have increased in the near term (Figure 1.14). However, with the already high inflation and rising energy and food prices, the possibility of a widespread increase medium-term inflation expectation is one of the prominent negative risks to the outlook.

### **Multilateral cooperation**

**26. How does staff assess potential take-up of resources to mitigate balance of payments needs at this juncture?**

**27. We would be interested in the assessment by staff as to how the change in the baseline economic outlook affects the potential demand for concessional financing under the PRGT and RST?**

- Ongoing work on this will be presented to the Board shortly, covering the potential implication of the war on Balance of Payment needs and residual financing needs, part of which could be covered by Fund programs.

### **Commodities**

**28. Could staff further elaborate on (i) the internal efforts that have been made to date to gain a better understanding of the macroeconomic implications of soaring commodity prices; (ii) how the Fund cooperates with dedicated multilateral institutions, such as the IEA and FAO; as well as on (iii) what steps are taken to make the Fund's policy advice more granular, with special attention how to address short-term spikes for the private sector without undermining the functioning of markets?**

- (i) Staff has analyzed elasticities based on most recent state-of-the-art analyses of the energy shock on macroeconomic literature using time-series analysis and more structural models. A particular attention has been given to the macroeconomic impact of natural gas shock to economic activity as this topic has been less touched in the literature. Staff also relies on internal estimates of the pass-through from international (producer) food prices to consumer food prices and inflation. (ii) IMF staff is in touch regularly with the IEA in relation to oil market outlook. Staff is also intensifying exchange of view and possibly develop joint project when it comes to food security with the WB and FAO (iii) Staff is studying the effect of major commodity price spikes on commodity market functioning. So far, however, but for the exception of the nickel's market at LME, commodity markets have been functioning notwithstanding major price fluctuations. With respect to the private sector, targeted subsidies are typically preferred to reduction in fossil fuel taxes (or introducing fossil fuel subsidies) which would reduce the price elasticity of fossil fuel demand exacerbating the price impact.

**29. We would welcome staff comments on the preferred course of actions with regard to the current energy crisis, and staff opinion on the initiatives to increase the use of coal instead of natural gas from Russia.**

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

**Analytical chapter: Debt**

**30. We noticed in Chart 3 of Figure 2.7, that the share of least-hit industries with an interest coverage ratio of less than one, is higher than share of middle-hit industries, and even equal to the share of hardest-hit industries for 2021 Q2. Could staff elaborate on the intuition and underlying reasons for this outcome? Are the least-hit industries less profitable or with more debt relative to assets? Staff's comments would be welcome.**

- As is rightly pointed out, this is related to structural differences in the financing structures across types of firms. Moreover, the sample of NFC in Capital IQ used for this analysis (the most up to date) only relates to listed firms and is not fully representative of the whole universe of firms. The average level of the series is then not as informative as the change during the pandemic which is the focus of analysis: as you can see on the chart, the increase in the share of firms with ICR<1 during the pandemic is much larger for worst hit industries as for the least hit.

**31. On the staff's recommendation for temporary higher taxes on excess profits to lessen the burden on public finances and get back some of the transfers to firms that did not need them. Is staff suggesting, for instance, increasing taxes on energy, mining, and food producer firms that benefit from the high commodity prices? Staff's comments would be appreciated.**

- This recommendation is in line with FAD's analysis of potential approaches to meet the extraordinary financing needs following the pandemic while also promoting social cohesion. <https://www.imf.org/-/media/Files/Publications/covid19-special-notes/en-special-series-on-covid19-recovery-contributions.ashx>. As mentioned in the chapter, temporary tax on excess profits is only one possible way to help governments partake in any upside related to the pandemic. The underlying principle is that the pandemic-era transfers resemble equity injections: cash is provided upfront in exchange for a (temporary) share of future profits. The idea is to apply a temporary levy to a temporary shock, not to change the tax system. The recovery contribution targets the burden explicitly on those with high incomes or wealth or the most profitable businesses, that is, those with the greatest ability to pay. This recognizes the importance of social cohesion in coping with the crisis, with much of the burden of the response—exposure of essential workers to health risks, unemployment, short time working—falling on the less affluent. The temporary contribution is not meant to be targeted to a particular sector but rather guided by profitability. The idea is to temporarily tax economic rents. Excess profits taxes have been used by several

countries (including the United Kingdom and the United States) during the two world wars.

**32. We learnt from the discussions on the preliminary draft of the medium-term budget as well as of the GPA that staff plan to deepen their work on debt-related issues. Could staff elaborate more on what this means on the side of surveillance and research?**

- As far as we know, staff work program on debt mentioned in the budget and GPA mainly refers to public debt. Important cross-departmental work is ongoing as detailed in the budget document. Chapter 2 WEO stresses that private debt is important as well. Better data on the distribution of debt across households and firms would allow better surveillance, better calibration of countercyclical policy, and help prevent sudden distress when financial conditions tighten.

### Climate

**33. Given that carbon pricing may be less popular when energy prices are high, what is staff's advice on implementing pre-announced carbon price hikes at this juncture?**

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

**34. Could staff comment on the reasons behind the cross-sectors labor reallocation that has partly driven the reduction in the average carbon emissions intensity shown in Figure 3.1?**

- It is important to note that the decomposition exhibited in Figure 3.1 is not causal, but an accounting decomposition (as described in the Online Annex). The shift in employment toward lower-emissions sectors and the change in efficiency are the result of deeper drivers, including policies and technological changes. The contribution of workers moving from high to low emissions sectors between 2005 and 2015 is consistent with the shrinking of the share of the employment in the sectors characterized by high emissions intensity such as mining, manufacturing, utilities, construction, and transportation. The (median) share of employment in these sectors declined from 28.4% to 22.5% over this period. Some of the forces that could be driving this reduction include: (i) the continuation of the expansion of the services sector's share in aggregate output in advanced economies at the expense of manufacturing industries (as documented in Section 3.2 of the online annex); (ii) automation trends which may have affected the higher-emissions sectors disproportionately (see the analysis in Chapter 3 of the April 2021 WEO); and (iii) the impact of more stringent environmental regulation, which analysis in the chapter suggests can help reallocate workers to lower emissions sectors (Figure 3.8).

**35. A related issue is the choice of the indicators for the environmental properties of jobs. According to Figures 3.2 and 3.3, the primary focus of the analysis should**

**be put on the transitions across sectors as the most relevant dimension for the green transformation. Staff's comments are welcome.**

- The chapter takes the perspective that the environmental properties of jobs are multidimensional, involving the extent to which workers undertake tasks that improve environmental sustainability (green intensity) and the degree to which their work involves activities exacerbating pollution (pollution intensity), as well as the level of emissions generated per worker (emissions intensity, for which data is only available at country-sector level and then matched to employees by sector). It is important to note that within-sector reallocation of labor is a key aspect that would be missed if the focus were solely on shifts across sectors. Within-sector reallocation could happen through workers shifting to lower-emitting/polluting employers/firms within sectors, as well as moving into greener occupations in the same sector. As shown in Figure 3.3, there is substantial variation in the environmental properties across jobs within sector. That is why the empirical analysis of the chapter covers all three dimensions.

**36. Finally, staff asseverate that stringent-environmental policies are associated with employment that is greener- and less pollution-intensive, although it is not clear to what extent these polices are primarily affecting sectoral efficiency and therefore employment efficiency as a byproduct. Staff's comments are welcome.**

- The analysis of the effects of environmental policy stringency shows its positive impact on green intensity at the job level, and its negative impact on both pollution and emissions intensities (again, at the job level; Figure 3.8). Part of this effect likely runs via occupational switches—employers creating greener positions and workers moving into them. Indeed, the analysis in Figure 3.8 (panel 2) shows how countries with more stringent environmental policies see job-to-job transitions into more green and less polluting occupations.

**37. We would appreciate staff's elaboration on whether the listed policies achieve the transition outcomes more quickly than others.**

- Figure 3.10 shows the contributions to labor market reallocation over time from the elements in the policy package in the advanced economy case. In the higher-emissions-intensive sector, the carbon tax is the main contributor to employment reduction. In the lower-emissions-intensive sector, the carbon tax and training both act to increase employment. However, it is important to note that policies are not substitutable. The most important policy to generate reallocation is the carbon tax. A more aggressive carbon tax increase in the near term could accelerate reallocation, but it will come with an output cost. The investment push, training, and EITC aim to reduce the output, employment, and distributive costs of the green transition without inhibiting achieving the net zero emissions path.

**38. Are there any lessons from the experience with trade-related employee retraining programs that were created to assist the transition to a more open economy?**

- Although there is broad evidence that training programs have positive impacts on participants' human capital and medium-term prospects, there is also a recognition that the specific design features of training programs will matter for their success. As noted in the chapter, they must be calibrated to the country and regional context, adapted to address the particular shortfalls in human capital identified for vulnerable workers. For example, Levy-Yeyati, Montane, and Sartorio (2019) find that training programs that are tailored to address specific needs for jobs in targeted industries are associated with better outcomes. This suggests that training programs could be tailored to help those with more pollution-intensive work histories acquire sets of skills that are more useful for greener jobs (see also Online Annex 3.2 for some evidence on general green skills). However, although there is great interest in training programs to ease the green transition (see OECD and Cedefop 2014), there are no comprehensive evaluation studies of such programs and their various design features that we are aware of. This is clearly an area for future research.

### **Analytical chapter: Trade/Supply chains**

**39. We appreciate staff for a more granular analysis and employing nowcasting approach is a step forward to provide a more real-time analysis. However, we need to be mindful with the reliability of real-time data especially during the pandemic, such as the presence of systematic data revisions.**

- We agree with this assessment and note that this is true of any empirical exercise. Please also note the nowcasting approach relies only on aggregate macroeconomic and financial outcomes in 2020. The microdata is from earlier years, which are unlikely to be revised further.

**40. Regarding the result of the nowcasting approach, we wonder if staff has an alternative to decile income assessment, such as quintile assessment, so that we can avoid explaining the 'anomaly' of the bottom decile as presented in Figure 2.4 lower panel and have stronger empirical evidence.**

- The nowcasting approach allows us to present results at any level of disaggregation. Staff assessed that showing results by deciles provided sufficient granularity while also being informative for policy purposes.

**41. Could staff further elaborate on the implications of the trade analysis for the assessment of external positions during the pandemic and confirm whether these considerations are well-captured in COVID adjusters in the EBA model?**

- The chapter's analysis does not have direct implications for assessing external positions. However, the related analysis in the 2021 ESR shows how the pandemic has had large sectoral effects on trade balances, notably via the impact on travel and tourism, household consumption composition, and trade in medical supplies. The

2022 ESR will provide an updated assessment of the pandemic's effects on current account balances and an updated set of COVID-19 EBA model adjusters.

**42. Could staff further elaborate on how to introduce these strategic elements to extend the scope of the analysis and policy recommendations about GVCs?**

- Indeed, the restrictions imposed on trade in certain goods during the pandemic could have a potentially damaging impact on public opinion and the political consensus regarding trade. Although we do not examine this issue analytically, it is certainly an additional concern. The chapter emphasizes in its policy recommendations that policy makers need to provide a stable, and rules-based policy regime in order to expand opportunities for trade and build resilience in GVCs, calling for greater multilateral cooperation at a time when there are significant fragmentation pressures on the world economy.

**43. Could staff also comment on whether it would be possible, given that various countries are starting to reach the endemic state, to propose a global consensus on curbing global supply-chain disruptions in the event of new COVID-19 waves? The Fund could promote this by assessing policy options to strengthen resilience of GVCs and global trade?**

- The chapter proposes concrete policies to build resilience in GVCs against future shocks, by increasing diversification and substitutability in GVCs. Governments would play a key role in this by filling information gaps on the structure and risks in GVCs; and reduce trade costs by lowering barriers to trade and promoting a stable, rules-based trade policy regime.

**44. It will be important to consider what industries are subject to concentration risks with respect to their reliance on certain geographical supply sources and to develop a comprehensive set of policy recommendations that aim to consider potential future shocks. Staff comment would be welcome.**

- We thank you for these valuable suggestions for evaluating risks in supply chains. In our policy recommendations, we note that a key role for governments is to fill information gaps regarding supply chains, which would be helpful to assess sources of risks and helps firms to mitigate them.

**45. It would have also been useful to discuss the spillover implications for import costs and, by extension, inflation. Staff's comments on this would be welcomed. We would welcome analysis on the spillover implications of supply chain disruptions on investment in emerging market and developing economies.**

- The chapter has not focused on the inflationary aspects of the supply shock spillovers. However, we do note in Box 4.1 that the disruptions in global supply chains, particularly as seen strengthening from early in 2021 onwards, coincided with rising import prices, even as import volumes continued to rise, and would have

contributed to inflationary pressures. We also note that this would be a useful avenue for future research.

**46. Elaboration on the differences in outcomes—including more country specific examples—and lessons for emerging markets versus more advanced economies, as well as countries that are most reliant on imports relative to those that are not, would also be useful. One would also expect that domestic substitutability would be important in the context of sharp increases in shipping costs and times. Staff’s comments on this would be welcomed.**

- Indeed, we note in the chapter that measures to build supply chain resilience would mainly be driven by decisions taken by firms as private sector agents, and in principle would depend on a variety of factors that could vary across several dimensions. In the analysis, we have considered substitutability of inputs across different countries (not firms), and shown that on average, it is beneficial to have greater substitutability for countries that are not impacted by a supply shock. We agree that investigating further the differences in outcomes from greater substitutability would be a useful exercise, but this is outside the scope of the current chapter.

### **Regional issues**

**47. Deepening the analysis on the direct and indirect effects of the war would be useful. Could staff detail the components of the revision in the euro area growth forecasts and especially the impact through the different channels of transmissions of the war (including energy)?**

- The euro area growth forecast downgrade mainly reflects the impact of rising energy prices on domestic demand. Higher global energy prices represent a negative terms-of-trade shock, contributing to higher inflation which erodes real disposable income and leads to lower output. Supply chain bottlenecks act as a further drag on growth, particularly in economies with large manufacturing sectors. Weaker confidence effects and higher input costs are also expected to weigh on investment.

## Global Financial Stability Report

*Staff's responses to technical questions are below. Broader policy questions in the areas of the normalization of the monetary policy in Europe will be addressed in staff's intervention at the Board meeting.*

**48. Staff note that cyber threats against SWIFT or other large shared market infrastructure could have significant economic effects. Have staff quantified any of these risks, or are there plans to do so ?**

- Staff has prioritized work on the resilience of payment systems and other financial market infrastructures, including to cyber-attacks. Last year, we published a working paper that begins to quantify risks, and identifies best practices to deal with them. The paper can be found here: [Operational Resilience in Digital Payments: Experiences and Issues \(imf.org\)](https://www.imf.org/en/Publications/WP/Issues/2017/06/01/Operational-Resilience-in-Digital-Payments-Experiences-and-Issues-46820). We also regularly evaluate the resilience of financial market infrastructures (and the banking sector) to cyber and other operational risks in FSAPs, as done recently in South African and Sweden. More work to investigate the exposure of CBDC to cyber and other operational risks is planned.

**49. Given the large part of supply-side factors (including energy and bottlenecks) in the recent increase in inflation, do staff consider that real rates – rather than nominal rates – are a better measure of financial condition/monetary accommodation (as suggested in GFSR chap. 1, paragraph 82)?**

- While monetary policy changes have a first-order impact on short (and longer-term) nominal rates, real rates –nominal rates adjusted for expected inflation—are what essentially matter for spending and investment decisions in the broader economy. In particular, investors use the real rate to determine yields on assets, which in turn, influences their risk-taking behavior. This is also reflected in the fact that equity markets have remained relatively resilient as real rates have remained low. Compared to nominals, real rates are hence a more appropriate metric by which to gauge the degree of (specifically) monetary accommodation, given their bearing on economic activity. The nature of the inflationary shock (energy or supply bottlenecks, for instance) matters to the extent that it influences the degree of persistence of expected inflation. In view of this, the GFSR attempts to assess the stance of real rates over future horizons (GFSR, Figure 1.8 panel 3).
- Please note that the financial conditions indices (Figure 1.5 panels 1 and 2) include the real short-term interest rates as one of the components. In addition, for the US and Germany, the term spreads are used as well to gauge investor risk appetite over longer maturities.

**50. We note that inflation break-evens have pronounced increases at the 5-year horizon, but longer-term horizons seem contained. Staff note that options markets show that probabilities of “high” inflation are over 65 percent in both the US and UK, but the chart only indicates inflation greater than 3 percent. Could staff clarify to what time period the option market forecasts in Fig. 1.7 refer, and can they provide more specifics on the level of inflation they imply for the US and UK?**

- The probability forecasts refer to average inflation over a 5-year horizon. ‘High’ inflation corresponds to inflation in excess of 3 percent. Importantly, these forecasts correspond to ranges of expected inflation outcomes, and hence used to gauge the skew in balance of risks to inflation, as opposed to specific point estimates.

**51. We are interested in staff views on the current debate on whether some major central banks are falling behind the curve with their current pace of policy rate increases given high and increasingly persistent inflationary pressures.**

- The commodity shock stemming from the war in Ukraine has exacerbated inflation pressures across the world, adding to pre-existing inflation concern. The surge in commodity prices has led to a sharp increase in headline inflation, which runs well above central bank targets in several AEs. As a result, short- and medium-term inflation expectations have surged drastically and have also started to pick up in the long-term, particularly in Europe. Therefore, this is essential for central banks to act decisively to prevent inflationary pressures from becoming entrenched and avoid an unmooring of inflation expectations. Major central banks have already engaged in a tightening cycle, increased interest rates, and announced further tightening. Central banks in advanced economies will need to normalize the monetary policy stance at a faster pace than was anticipated only a few months ago to bring inflation credibly back to target. It is also important that the normalization process remain data-dependent and be recalibrated along the way as dictated by the evolution of the economic and inflation outlook and market conditions that are already affected by the war in Ukraine. Finally, in this normalization process, clear communication is critical to avoid unnecessary volatility in financial markets and a disorderly tightening of financial conditions.

**52. Can staff elaborate on the risks of the creation of central bank digital currency blocks and the possible role of the IMF and other international fora to reduce these risks?**

- The international community is increasingly exploring the potential for CBDC to improve cross-border payments. There are already technical experiments in operation. Many open questions and challenges still exist. These are discussed at greater length in a July 2021 report to the G20, on CBDC for cross-border payments (with IMF participation). The report can be found here: <https://www.bis.org/publ/othp38.pdf>

- A risk is that central banks develop platforms ensuring interoperability among CBDCs of a limited group of countries. This may be for geopolitical reasons, or simply because of shared technology.
- Such “CBDC blocs” would lead to a fragmented international payment system, with repercussions on trade, capital flows, and risk-sharing arrangements. They could also alter the configuration of reserve currencies, at least on a regional basis.
- The IMF, and other international organizations, can help in at least four ways.
  - First, by accelerating work on common platforms and standards (such as through work on the G20 Roadmap to enhance cross border payments) so that interoperability between CBDC is built-in from the start, as opposed to being the result of first movers imposing their technology on those willing to adopt it.
  - Second, by facilitating cooperation around flexible platforms and standards, able to adapt to countries’ needs to implement capital flow management measures. This will encourage countries to participate in common arrangements as opposed to limiting access to their CBDC and payment systems from fear of currency substitution.
  - Third, and more generally, by facilitating information-sharing and collaboration between central banks, including those in the wider IMF constituency, to favor interoperability.
  - And fourth, by offering a forum to discuss governance of international payment arrangements, including the treatment of data.

**53. In the context of traditionally substantial activities which some CEE banking groups conduct in Russia, we would welcome staff’s additional comments on potential contagion risks for the banking sector in the CEE region and advice on the appropriate policy response.**

- Indeed, as we show in figure 1.11 panel 2, while banks’ direct exposure to Russia or Ukraine remain modest, direct exposures to CEE regions are substantial. This mainly reflect euro area banks and banks from CEE regions. In light of continuing uncertainty around the war development as well as uncertainties around economic outlook, some banking institutions from CEE regions have announced precautionary increase in loan loss provisions and temporary suspension of buyback or dividend payout activities. We consider such actions timely and appropriate and advise continuing vigilance. While global banking sector has benefited from significant capital and liquidity build-up over the past decade, we note that EM banks are generally of relatively weaker positions compared to AE banks. In addition, the rising sovereign-bank nexus is also evident for banks from CEE regions. Consequently, close monitoring of asset quality and conservative capital distribution appear to be the appropriate policy response for the near term.

**54. Regarding banks' exposure to Russia in several countries including France (paragraph 27 of the GFSR), we would like to ask staff to better qualify the sentence by recalling that direct exposures are small compared to the size of the banks (as evidenced in figure 1.10 of the WEO, with a chart on the ration of Bank's exposure to Russia to total assets).**

- We fully agree with the assessment that banks' direct exposures to Russia are manageable. We reached this conclusion by looking at aggregate direct exposures, as percent of GDP, and as percent of bank assets (figure 1.11 panel 2), in addition to an estimate on the capital impact if banks choose to exit the Russian market entirely. To minimize reputational risks, we have removed country reference in paragraph 27. That being said, we remain cautious on the indirect exposures as well as the second-round effects from prolonged conflict, as they are difficult to quantify.

**55. In the context of the current macroeconomic challenges and differences in real interest rates across Europe, we would welcome staff's views on the most appropriate monetary policy response for the regions' central banks.**

- This question will be addressed orally.

**56. The deterioration of the geopolitical environment could weaken multilateral cooperation and, thus, make it even more difficult to tackle common challenges, including climate change. In this context, we note that the downside ("stagflation") scenario depicted in the WEO appears to have become more likely since the circulation of the report. What would be the implications of such a scenario for (global) financial stability?**

- It's important to note that the global financial system has been able to withstand the impact of the war despite the increase in financial stability risks along several dimensions, as noted in the GFSR. After the sell-off from early February to mid-March, global markets have largely recovered thereafter (Figure 1.3 panel 1). This in part reflects that the global corporate outlook remains positive, despite recent downgrades because of the war and the impact of rising interest rates. The banking sector has continued to function well, thanks to stronger regulation and bolstered buffers after the GFC and relatively manageable exposures to Russia.
- Should interest rates increase in response to inflation or credit spreads widen due to investor risk aversion, a rapid tightening in financial conditions may ensue, potentially leading to a sell-off in equity and bond markets. Liquidity strains that have started to emerge in Treasury and short-term funding markets may exacerbate market price moves. Counterparty risk could rise, especially in commodities market—reminiscent of the GFC. Much lower economic growth coupled with notably higher interest rates would lead to mounting credit losses at banks. These would add to mark-to-market losses in trading portfolios of banks and non-banks. Funds with large liquidity mismatches could be significantly affected and face large redemptions. Risky credit markets would face defaults, a potential withdrawal of high risk-profile investors (such as hedge funds) from new CLOs, and possibly a credit crunch.

- In such a scenario, policy makers would not and should not be passive. The massive and timely policy response to the COVID shock by monetary, fiscal, and financial sector authorities demonstrated that a market sell-off can be contained, bankruptcies forestalled, bank losses and credit crunch prevented. So, a decisive policy response could be quite effective. At the current juncture, central banks would be facing a challenging choice to re-invigorate the economy and tackle inflation at the same time. Fiscal space is vastly different across countries, and emerging and frontier markets would be in a much more difficult and vulnerable position compared to advanced economies. The ability of banks to absorb future losses also varies by jurisdiction, based on capital buffers and past profitability, as discussed in past GFSRs.

**57. Could staff provide more information on the evolution of local stress indices which is missing from this report?**

- We have not updated the local stress indices for this GFSR. Overall, we have not seen a broad and protracted market dysfunction in local currency markets like March 2020 that led to large amount of new asset purchase programs and FXI to improve market functioning.
- It is notable that apart from some significant turbulence in a 2-3 weeks period following the invasion, EM local debt and EM FX has been relatively resilient (obviously excl. Russia and Ukraine). As you can see from the table below some commodity exporting exchange rates (e.g., Latin America) have seen continued appreciation, while the passthrough (“beta”) in local rates from US rates has been below 1 to 1 despite a broad-based increase in inflation risks. CEE stands out as the region where deterioration in local market conditions has been more notable as is highlighted in the GFSR.
- The GFSR does indicate some potential reasons behinds this resilience which include that 1) EM local bonds were already offering significant risk compensation compared to AEs before the invasion as many EMs were at an advanced stage in their hiking cycles and 2) there is less room for large local debt outflows as foreign positioning is at multi year lows for many EMs. In terms of flows March had large outflows in local bonds and equities (~40bn, the largest since March 2020) but a large part has been due to Chinese bonds and equities losing a small fraction of their inflows from recent years. Some local markets have even seen inflows in March (e.g., Brazil equities, Thailand bonds).

### Changes since the start of the invasion

	FX %	LC 10y bps	Equities %
<b>China</b>	-0.4	12	-7.7
<b>Indonesia</b>	-0.2	37	7.2
<b>India</b>	-1.9	49	0.7
<b>Philippines</b>	-0.4	70	-3.8
<b>Thailand</b>	-1.9	37	2.0
<b>Malaysia</b>	-0.8	33	5.3
<b>Brazil</b>	16.0	13	8.6
<b>Chile</b>	-2.0	107	7.0
<b>Colombia</b>	5.4	60	6.7
<b>Mexico</b>	2.1	103	6.0
<b>Peru</b>	3.3	85	5.7
<b>Hungary</b>	-8.9	202	-19.1
<b>Poland</b>	-6.3	157	-8.0
<b>Russia</b>	-3.5	130	-24.6
<b>South Africa</b>	3.1	38	-0.1
<b>Turkey</b>	-8.8	282	19.0
<b>US</b>	4.4	94	2.1

Source: Bloomberg. LC 10y refers to either the local swap rate or the local bond benchmark.

**58. Staff's comments on the risk of delayed monetary and prudential policy normalization –or even risk of further monetary accommodation--in frontier markets will be appreciated.**

- Russia's invasion in Ukraine has clearly increased vulnerabilities in frontiers especially commodity importers. Besides higher inflation risks many frontiers have notable direct and indirect trade links to both Russia and Ukraine (e.g., tourism, remittances, food, energy) and have also experienced reduced access to external funding given elevated fiscal/external vulnerabilities. So far, several frontier markets have taken decisive emergency actions including 1) hiking above market expectations (e.g., Ghana, Egypt) 2) passing fiscal packages and 3) allowed more FX flexibility (e.g. Egypt) and 4) approached the IMF and other multilaterals for support. Others have been more reluctant to take preemptive action and will likely have to follow once the passthrough in CPI and external accounts is more evident in the data. On the positive side we note that external market access has reopened for frontiers albeit a high rates and so far, primarily for commodity exporters (Angola, Nigeria).

**59. We were disappointed at the sanguine tone on this topic in the Global Financial Stability Report and the absence of any reference to the FSB process, despite staff's strong engagement.**

- We very much welcome the comment that the GFSR should highlight the importance of strengthening the oversight of the NBFIs sector, as well as highlight the work of the FSB on the issue -- a workstream that the IMF fully supports. We will adjust the GFSR policy message accordingly.

**Analytical Chapter 2: “The Sovereign-Bank Nexus in Emerging Markets: A Risky Embrace”**

**60. Can staff comment if, given the deleveraging of sovereign bonds positions by major central banks, we can expect that banks in advanced economies will increase their holdings of sovereign bonds and thus increase the negative feedback loop? How will a more rapid selling of bonds by central banks affect the banking system in advanced economies?**

- A discussion of the implications of the reduction in central bank financing in advanced economies is beyond the scope of the chapter. Given space limitations, the chapter does not get into too much detail on the potential role of monetary policy measures in the sovereign-bank nexus and refers to earlier Fund work (Dell’Ariccia et al. 2018) for a discussion on the issue.
- Box 2.1 of the chapter documents that the level of interest rates is a driver of bank’s sovereign bond holdings in emerging markets, and the earlier literature suggests that this has also been the case globally. One would therefore expect that the ongoing monetary policy tightening (including potentially through quantitative tightening) in advanced economies would lead to an increase in banks’ sovereign holdings in these economies, thus deepening the exposure channel.

**61. The emphasis on sovereign-bank nexus in EMDCs is timely at this juncture. The empirical analysis performed to a large sample of EMDCs over the past 20 years about the transmission channels is useful, where the shock originating in the sovereign sector could easily translate to the banking and corporate sectors and not the other way around, given the elevated fiscal vulnerabilities in EMDCs. Figure 2.9 “Sovereign and Bank Default Risk and Tightening of Global Financial Conditions in Emerging Markets” makes the case very clear. *We would suggest staff present in an annex these same graphs but for the different regions that comprise EMDCs. We agree the Basel Committee on Banking Supervision would play an important role to develop a more risk-sensitive regulatory and supervisory treatments, and data on banks’ sovereign exposures are of an essence.***

- We fully agree that there are important differences across emerging market countries that need to be taken into account. However, in the context of Figure 2.9, severe data limitations prevent us from further analyzing regional differences within the cross-sectional variation based on public debt and banks’ sovereign exposure. We leave this as an avenue for future research.

**62. We appreciate a comprehensive examination of the sovereign-bank nexus in Chapter 2, as this would help policymakers conduct their surveillance more thoroughly and prepare for the worst-case scenario. It might be useful to apply the WEO’s downside risk scenarios and analyze further the impacts on emerging markets through the various channels of transmission that staff outlined in GFSR, as these might differ significantly across countries.**

- We agree that this would be an informative exercise and the chapter indeed recommends that future bank stress tests take into account the sovereign-bank nexus. Please note however that such stress tests on a global scale are complex exercises and are beyond the scope of the chapter.
- 63. In the context of bilateral surveillance, the new Sovereign Risk and Debt Sustainability Framework (SRDSF) could also complement this analysis by providing a rigorous assessment of a country's sovereign risks in different time horizons. This should help policymakers detect early any debt distress or a negative feedback loop that could threaten financial stability.**
- We fully agree that the Sovereign Risk and Debt Sustainability Framework is a very valuable tool to assess fiscal vulnerabilities.
- 64. On policy options to weaken the nexus, we remain mindful of the use of capital surcharges [on banks' holdings of sovereign bonds above certain thresholds] as this might adversely affect the demand for sovereign debt and the ability of the government to raise funds domestically, particularly in a setting where there are few alternative liquid assets available to banks.**
- This point is well taken. As noted in the chapter, there are indeed complex policy trade-offs that emerging market economies need to navigate to mitigate the risks arising from a deeper sovereign-bank nexus. Earlier Fund work cited in the chapter (e.g., Dell'Ariccia and others 2018) discusses in detail the pros and cons associated with implementing the various policy measures to weaken the nexus. For example, as also mentioned in the chapter, strict concentration limits on banks' holdings of sovereign debt could generate negative effects as banks tend to hold sovereign bonds for liquidity management. Capital surcharges on bank holdings of domestic sovereign bonds above certain thresholds are more flexible and can target the concentration of risk but the setting of such a surcharge should consider the liquidity needs and availability of other liquid assets in domestic currency, along with the perceived risk from excessive concentration. In addition to mitigate unintended financial stability consequences, the chapter recommends that policy measures aimed at reducing incentives to hold excessive sovereign debt should be considered only when the economic recovery has taken hold and pandemic-related financial sector support measures have been normalized.
- 65. We appreciate staff's analysis of the sovereign-bank nexus. Further work on the relative benefits and risks of external financing versus domestic financing would be welcome and more practical guidance on funding decisions for EMEs that are faced with multifaceted challenges. For domestic financing, risks from the sovereign-bank nexus should be examined while for external financing, vulnerabilities from exchange rate mismatches are particularly important.**
- We agree that assessing the risks and merits of external financing versus domestic financing is an important topic. Due to space limitations, the chapter focuses on domestic banks' financing, and an in-depth comparison of both forms of financing is

left for future research. However, we would like to note that Box 2.2.1 in the Online Annex 2.2 shows that large foreign nonbank holdings can render emerging markets more vulnerable to the gyrations in global capital markets as foreign nonbank investors tend to be particularly fickle in times of global financial market stress. A clear example is provided by the recent COVID-19 pandemic crisis, where mutual funds and ETFs investing in EM assets acted in a highly pro-cyclical pattern as they experienced large outflows, especially those that invested in local currency government bonds. The policy recommendations thus emphasize promoting a deep and diversified investor base to strengthen market resilience in countries with underdeveloped local currency bond markets, noting that such an investor base should include a range of participants with different investment horizons and risk-return preferences to allow the government to spread risk in its debt portfolio.

- Please also note that, footnote 13 acknowledges that a higher share of liabilities denominated in foreign currency (FX) on sovereign/bank/non-financial-corporate (NFC) balance sheets may deepen the nexus, if the shock that triggers the nexus is accompanied by a sharp domestic currency depreciation. To highlight its importance, the analysis presented in Figure 2.10, panel 4, shows that banks with a greater exposure to sovereigns with a higher share of public debt denominated in FX experience larger equity losses and reduction in lending following a domestic currency depreciation. The chapter also documents that official foreign exchange reserves act as a buffer and help to dampen the severity of the shock, presumably by limiting the currency depreciation (p. 15 first paragraph, Online Annex 2.6). Further analyses, especially with regards to currency mismatches on banks/NFC balance sheets, would require detailed cross-country supervisory data, which is largely publicly unavailable.
- 66. Given the heterogeneity of countries impacted, we call on staff to continue to provide tailored and country-specific fiscal and financial sector policies, and to support countries' efforts to balance the complex trade-offs. We also encourage staff to extend their assessment and to examine the sovereign-bank nexus in LICs, we look forward to the Fund's further work in this area. We note (in chapter 2, figure 2.7 panel 5) that the banking system of the Middle East and Central Asia region seems comparatively more resilient to sovereign distress, as it would take a much steeper haircut of government securities to generate a bank capital shortfall. *It would be useful if staff could provide additional details on the factors behind the differences between MCD and the remaining regions presented in the graph.***
- Based on Fitch Connect bank-level data that is used in the analysis, we find that banks' overall sovereign exposures and/or risk-weighted assets for MCD economies are generally lower than for other regions, which explains the differences in the scenario outcomes for banks in MCD relative to other regions. However, as highlighted in the text, please note that this is a simple scenario analysis, where the haircut refers to the required haircut to government securities that would breach the 4.5 percent minimum CET1 capital ratio, assuming that other sources of capital are

unavailable. It is therefore a rather strict approach since it assumes that only the highest quality capital is accessible.

**67. Chapter 2 of the GFSR seems to lack sufficient analysis on such differences, in suggesting the need for an international standard only because “the sovereign-bank nexus has also manifested in advanced economies in the past.” Further, we are concerned that the Fund’s suggestion may send a wrong signal that the Basel III itself could be reconsidered, and thus undermine the momentum for its implementation. Among various banking regulatory issues, the sovereign exposure issue is particularly contentious and delt by the BIS expertise. As it relates to the fundamentals of fiscal and monetary policies and the smooth functioning of financial markets, for the sake of the credibility of the Fund, we ask the Fund to be extremely careful in its external communications on this issue.**

- We agree that there are important differences across countries that need to be taken into account. The various empirical analyses in the chapter take into account cross-country heterogeneity among emerging markets by controlling for country-fixed effects and conditioning the impacts on the different levels of fiscal and financial vulnerability such as the level of or composition of public debt or bank capitalization (e.g., Figures 2.10 and 2.11)
- We agree on the important role of the Basel Committee on Banking Supervision as a global standard setter for the prudential regulation of banks and as the appropriate forum for cooperation on banking supervisory matters, including banks’ sovereign exposures. The revised language in the policy recommendation notes: “the Basel Committee on Banking Supervision could consider resuming its efforts to develop international standards that reflect a more risk-sensitive regulatory and supervisory treatment.”
- On Basel III, we would like to note that its implementation has already been delayed by some members and the hard stop does not suggest that there should not be development of standards relating to imminent and emerging issues. We already expect there to be standards emerging on regulatory treatment of crypto assets; to climate risks; and as the chapter points out, the increased sovereign-bank nexus also poses a major risk.

## Fiscal Monitor

*Staff's responses to technical questions are below. Broader policy questions will be addressed in staff's intervention at the Board meeting.*

### Fiscal Policy Issues

**68. The emphasis on a tailored and agile fiscal policy is well placed in the face of large cross-country differences and high level of uncertainty. The current shock warrants a delay in consolidation in many parts of Europe to address temporary new challenges, cover refugee settlement costs, speed up transition to a green economy and tackle new investment needs in security. Staff's views on whether announced plans are sized and structured appropriately would be welcome.**

- There is still considerable uncertainty both on the economic development and on the fiscal reactions as this is a fast-evolving situation. It is too early to conduct a thorough assessment of fiscal plans or actions. However, as noted in the chapter, the euro area primary deficits are expected to decline by less than 1 percent of GDP in 2022 on average, compared with an expected fall of 2½ percent of GDP before the war (January 2022 World Economic Outlook Update). This projection reflects additional spending in response to the consequences of the war and downward revisions to economic growth.
- More generally, fiscal policy will need to remain flexible as the consequences of the shocks become clearer. Countries may also need to reprioritize spending and mobilize additional revenues as necessary. In addition, while the focus on emergency needs is understandable, it should not detract from moving ahead with the reform agenda – including on the climate agenda.

### Domestic Revenue Mobilization

**69. *The work stream to optimize systems for revenue collection and fiscal discipline, via automation and digitalization in LICs and EMDEs where capacity is lower, could also be amped up and prioritized. Staff comments are welcome.***

- FAD provides capacity building to countries to strengthen tax administration and policy adapted to specific country circumstances—and we will continue to help on the different areas including digitalization. More generally, mobilizing domestic revenues is a multifaceted process that encompasses strengthening tax administration (including through the use of better technology), improving tax policy—to support revenues and inclusive and greener economy—, and upgrade the legal framework. For example, broadening tax bases including with reduction of tax expenditures can provide additional revenues while leveling the playing field.

## Managing High Energy and Food Prices

**70. *In response to higher prices, we agree that commodity exporters should seize the opportunity to rebuild buffers. However, we recommend that staff also emphasize the importance of economic diversification to increase resilience against future commodity price shocks. Staff comments are welcome.***

- We agree on the importance of economic diversification to increase resilience. That is an agenda for the medium term and that we have in the past (and will continue to) recommended to resource-rich countries through both multilateral and bilateral surveillance. However, in the particular situation, our focus in the chapter was on how countries should react to the sudden rise in commodity prices and larger fiscal revenues that could prove temporary.

**71. *In the near term, we agree with staff that governments should pivot its priority to ensuring food and energy security for the most vulnerable individuals. While experience and technology adoption over the course of the pandemic should enable authorities to target their measures better, we caution that developing countries already have limited fiscal space at this point. In this regard, we see the importance of domestic revenue mobilization, credible medium-term fiscal framework, and international cooperation. We would appreciate more specific guidance from staff in these aspects, especially in addressing food security and refugee displacements in the near term.***

- It is important that governments prioritize food security within the available resource envelope to ensure food access. Given the urgency they should use all available instruments, especially expanding the existing social programs as much as feasible and using digital tools to gather information about vulnerable households and provide targeted support. Over time, it would be good to strengthen safety nets.
- Given tight budgetary constraints in many countries, governments will need to make tough choices by prioritizing spending towards the most urgent needs. Revenue enhancing efforts should also be considered.
- International cooperation is also crucial in several respects. Countries should avoid counterproductive export restrictions. Efforts should be made to increase food production, using food reserves when available and prioritizing human consumption over the uses of food crops for other purposes. It will also be important to use multilateral platforms to provide support to low-income countries most affected by the shock.
- Regarding refugee displacements, as discussed in the chapter, a whole-of-the-government approach is warranted, combining health care, education, trainings, social and job search supports. Furthermore, international cooperation to spread the flow of refugees across countries and help refugees to move to places with labor demand for their skills would facilitate access to jobs.

**72. *In a context marked by soaring food and commodity prices, cutting subsidies for fiscal consolidation can only lead to social unrest. Such policies in the current situation can only contribute to the cycle of social and political unrest. Staff comments are welcome.***

- Governments' response to the surge in international commodity prices should give priority to protect the most vulnerable. A critical objective is to avoid a food crisis. This will help keep social cohesion. Given urgency, countries should use the best tools they have available—targeted measures will be more effective in helping the most vulnerable and containing fiscal costs as many countries face very tight budgetary conditions. Countries with well-developed social safety nets can provide targeted and temporary cash transfers to vulnerable groups while allowing domestic prices to adjust. Other countries could allow a more gradual adjustment of domestic prices and use existing tools to help the most vulnerable during this crisis, while taking steps to strengthen safety nets.
- In general, we advise against price subsidies given they are poorly targeted, can involve a large fiscal cost and can create distortions—if many countries try to prevent adjustment in domestic prices, it will exacerbate demand-supply imbalances and push prices even higher and could lead to food and energy shortages especially in low income countries.
- However, in countries where price subsidies exist, governments can adopt a slower pace of pass through to domestic prices. The pace can be differentiated by product depending on the extent to which a particular product is consumer by the poor. In addition, where domestic prices are substantially lower than international prices, the elimination of subsidies could be made gradually, with a well communicated strategy, and should come together with strengthening safety nets. Countries can also explain how the savings from eliminating subsidies will benefit other priorities areas (for example education, health). Such a comprehensive and gradual strategy would help prepare the public and reduce social tensions.

### **International Taxation**

**73. Could staff comment on what the exemption of mining companies and the lower threshold mean in terms of revenue foregone by SSA, compared to the application of a 25 or 30 percent minimum corporate tax threshold to mining companies?**

- Pillar 1 does not reallocate taxes to residence jurisdictions. Pillar 1 reallocates taxes to where consumers are. This means, for example, to the extent companies (such as Facebook or Google) generate revenues from consumers (or users) in SSA without any physical taxable presence in SSA, they can be taxed in SSA. Staff support the exclusion of mining companies from Pillar 1 because natural resources generate location-specific rent which should be taxed in the source countries. Otherwise, natural resources extracted from SSA would not be taxed in SSA but elsewhere. The

existence of a global minimum corporate tax of 15 percent puts a floor on tax competition and does not prevent SSA (or other) countries from imposing a tax rate of 30 percent or higher.

**74. *Going forward, we urge staff to build on the analysis in their 2019 Board Paper on international corporate taxation and develop full Pillar 1 and 2 scenarios that would help diverging developing regions recoup substantive revenues. The goal for the region is to recoup annual amounts close to the US\$90 bn estimated by UNCTAD (Economic Development in Africa Report, 2020), to flow illicitly and unfairly out of the region annually. Could staff clarify what shares of the US\$125 bn reallocated under Pillar 1 and of the US\$150 bn expected to be generated under Pillar 2, will accrue to LICs, and to SSA in particular?***

- The share of revenues will depend on the reactions by countries and firms. Thus, it is difficult to estimate country-specific impact at this stage. For example, if a country continues to offer tax incentives such as tax holidays for a foreign company, then that country would not get the revenues from the minimum tax but the headquarter country would. The agreement is however an opportunity to revisit policies since it puts a floor on tax competition. To reap the benefit from the agreement, low-income countries should assess the implications and revise policies.

**75. *Despite recent successes of the global automatic exchange of information agreement, low-income countries are yet to fully realize the benefits from the agreement mainly because of perceived poor standards of confidentiality and data safeguards as well as an inadequate legal framework and technical capacity. While we acknowledge that all countries, particularly LICs, need to enhance their capacities in the medium term to take full advantage of the exchange of information, we welcome staff views on what actions can be taken in the interim to reduce the burden on LICs.***

- Actions vary from further capacity development of tax administration to better income tax policy to support progressivity and strengthening the legal framework to facilitate exchanging information.

1. *Countries have committed to the OECD G20 global tax plan that would force companies to pay a minimum rate of 15 percent instead of little or no tax at all now. Several countries have been front-centered to these efforts, but it is unclear how soon the plan can be introduced. Staff comments are welcome. Also, could staff elaborate on the revenue implications of the OECD plan, i.e., how much money individual governments will bank?*

- The implementation of the agreement is the object of live political debate in several countries. Pillar 1 is mandatory, while Pillar 2 is optional (model rules were released late 2021), but jurisdictions must accept adoption by others. Further details are being finalized for implementation in 2023. The direct country-specific revenue implications of the minimum tax depends on the reactions of countries and firms. However, by putting a floor on tax competition, the minimum tax gives room for countries to revise

their policies and revisit tax rates possibly. This is an important dynamic benefit from the global minimum tax. Some countries are already discussing or planning to increase their corporate income tax rates (including the US and the UK) or introduce a corporate income tax such as the UAE.

## Climate Policies

### **76. Given that carbon pricing may be less popular when energy prices are high, what is staff's advice on implementing pre-announced carbon price hikes at this juncture?**

- We recognize the high energy price context and the difficulties involved politically with plans to raise energy prices generally and at a time of elevated fuel prices in particular. However, we note that energy prices are volatile and it is not clear how persistent the current shock will be. The climate agenda involves a more sustained and predictable process. Generally, we recommend phasing carbon prices in gradually (at this stage this could imply slowing the pace of fuel price decline if the shock proves to be temporary), while correcting relative prices between higher and lower carbon intensive fuels and raising significant revenues which could be used for various government objectives. Hence we advise emphasizing the gradual nature of the phasing in of carbon prices in communications strategies and that the revenues will be put to good use, notably in supporting lower income households and supporting broader tax cuts such as those on labor. Experience demonstrates that communicating planned carbon pricing reforms effectively—especially on the use of revenues—is critical to their popularity and hence durability. Lastly, governments could emphasize the benefits of increased energy security from efficiency and accelerated uptake of renewables.

### **77. Also, could staff elaborate more on paragraph 78 which discusses carbon-pricing and a border carbon adjustment? In particular, would imposing border adjustments on the portion that exceeds the floor be compatible with introducing a carbon price floor? Staff comments are welcome**

- Indeed Ideally, all major emitters (China, India, EU, US and some other G20 countries) would be included in the price floor arrangement. Estimating the emissions prices consistent with net zero emissions by 2050 is highly speculative however. The focus of the ICPF proposal to get near term global emissions on track with achieving long term temperature goals by 2030—alternative pricing scenarios that achieve this are estimated with more confidence than needed prices for 2050. We agree that in future analyses more attention should be paid to pricing trajectories over time, rather than providing only a snap shot of needed prices for 2030.
- The ICPF proposal envisages that countries meeting the price floor requirement would be exempt from border carbon adjustments by other members of the agreement.



# International Monetary Fund

April 11, 2022

## World Economic and Market Developments

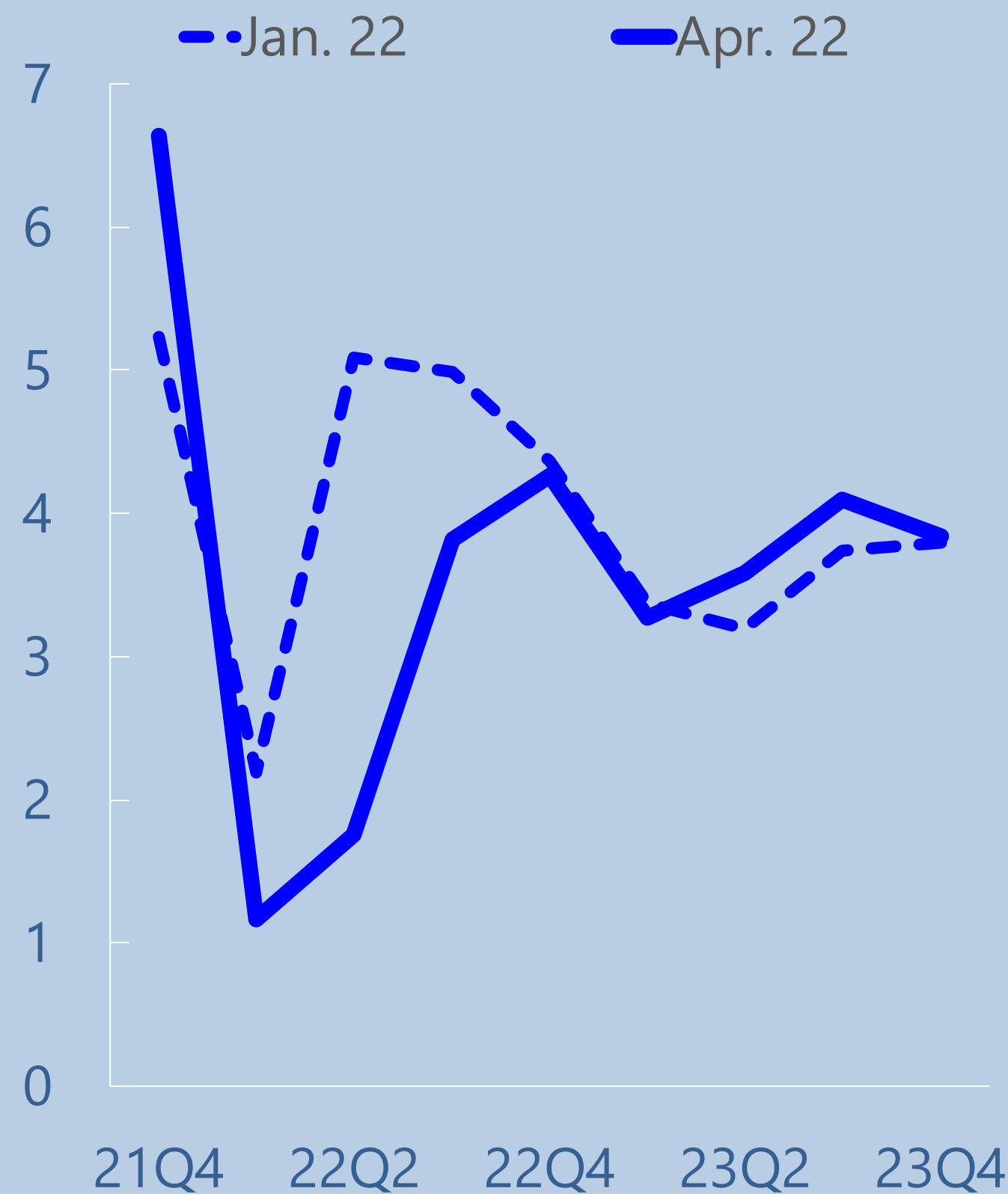
*Pierre-Olivier Gourinchas*  
*Economic Counsellor*

# A global recovery shaken by war

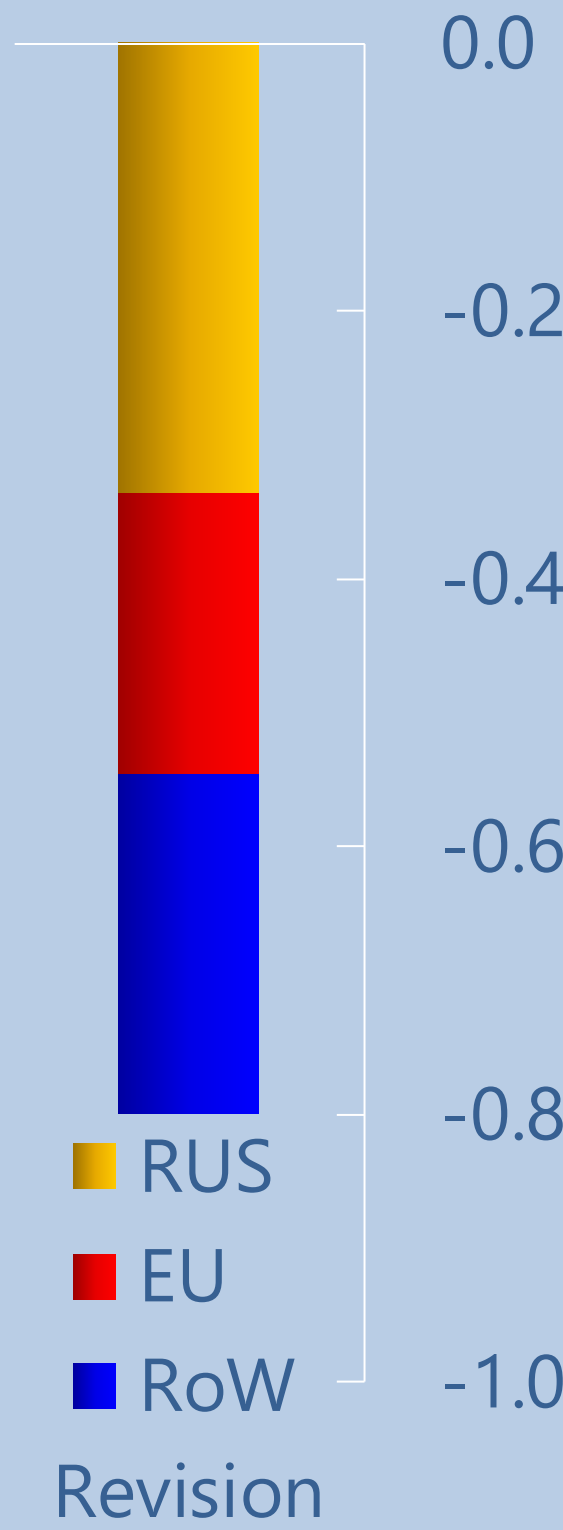
## Supply shock: Slowing growth and higher inflation

### 2022 Growth path

(percentage points; qoq annualized)

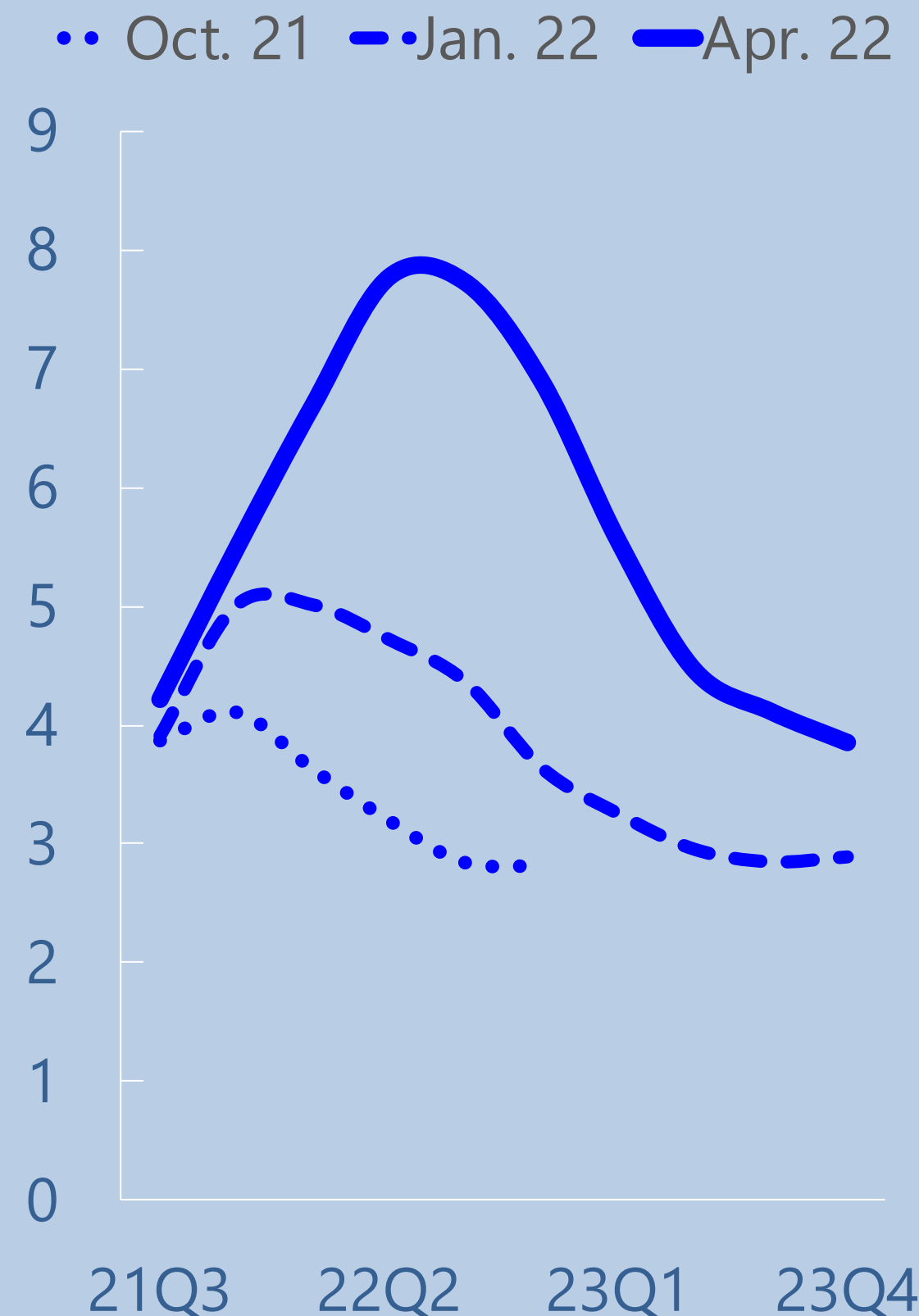


### 2022 Total revision



### Projected inflation path

(headline; percent; yoy)



## Risks to the downside

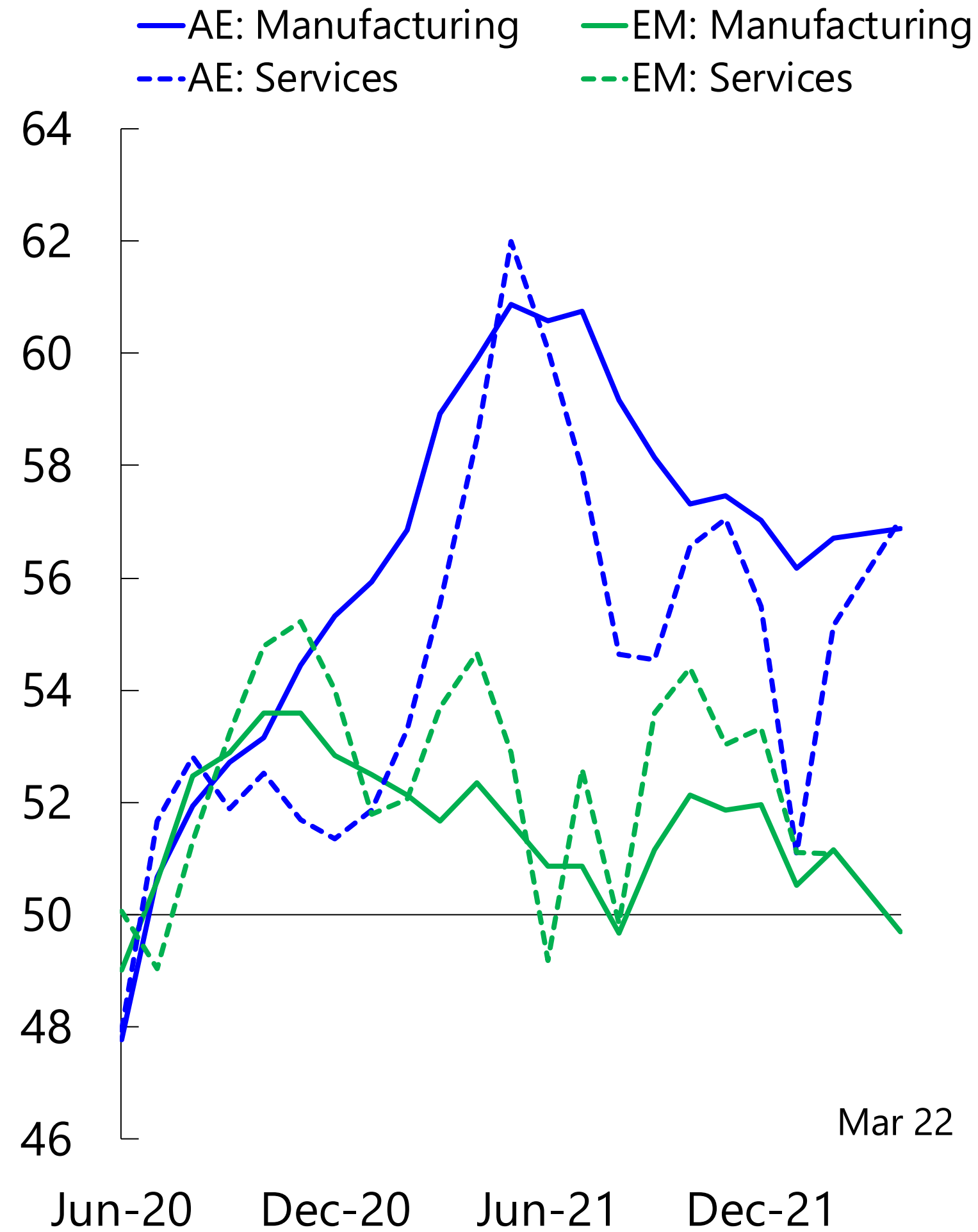
- War escalation: disruptions to commodity markets, supply chains, refugee crisis. Possible social unrest.
- More lethal COVID variants, worsening slowdown in China.
- De-anchored inflation expectations: higher interest rates and debt distress

## Policies

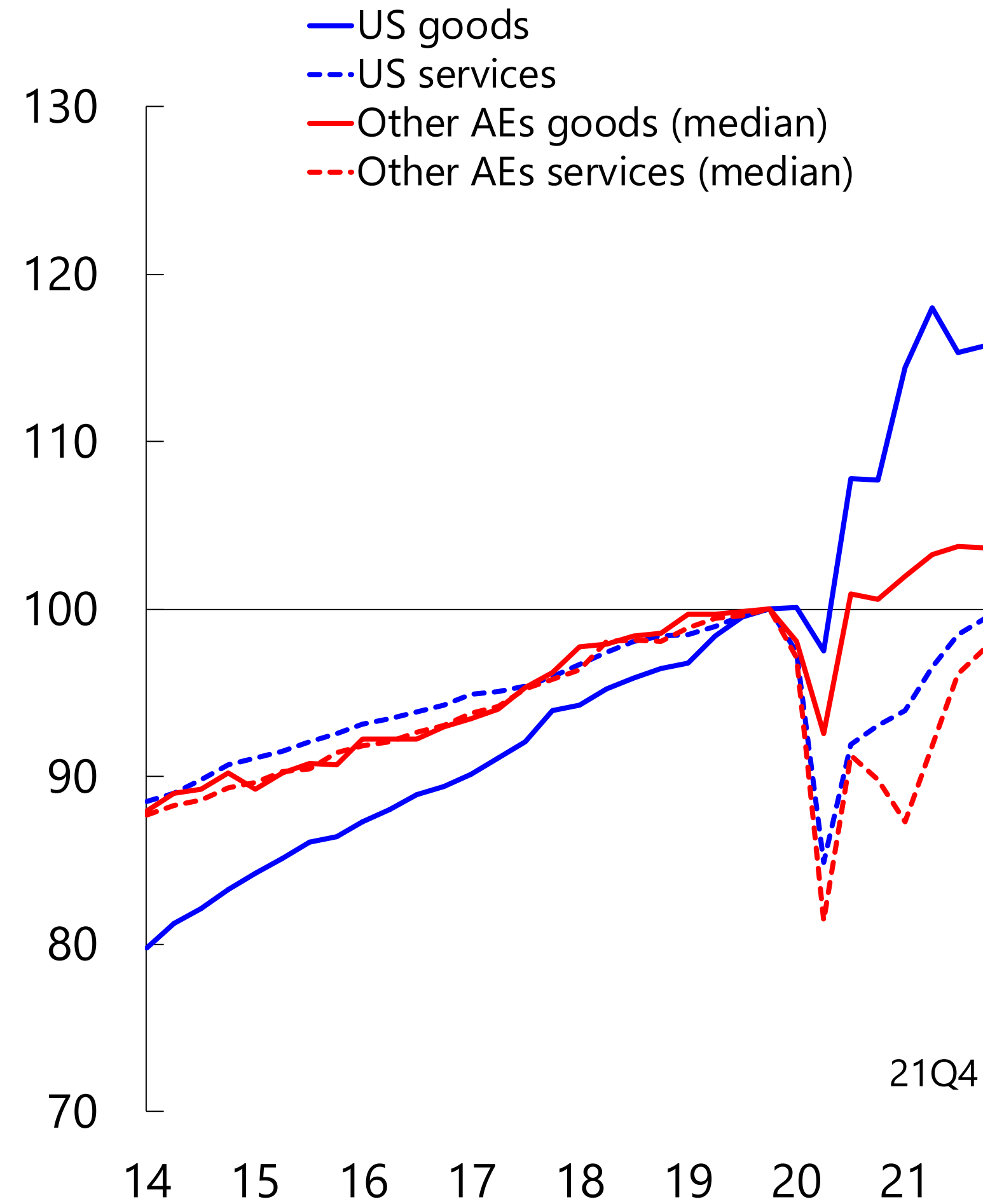
- Calibrate monetary policy to fight inflation while safeguarding recovery.
- Act decisively to prevent inflation expectations from de-anchoring.
- Prioritize fiscal support to the most vulnerable while maintaining fiscal soundness.
- Multilateral co-operation critical

# Recent economic developments

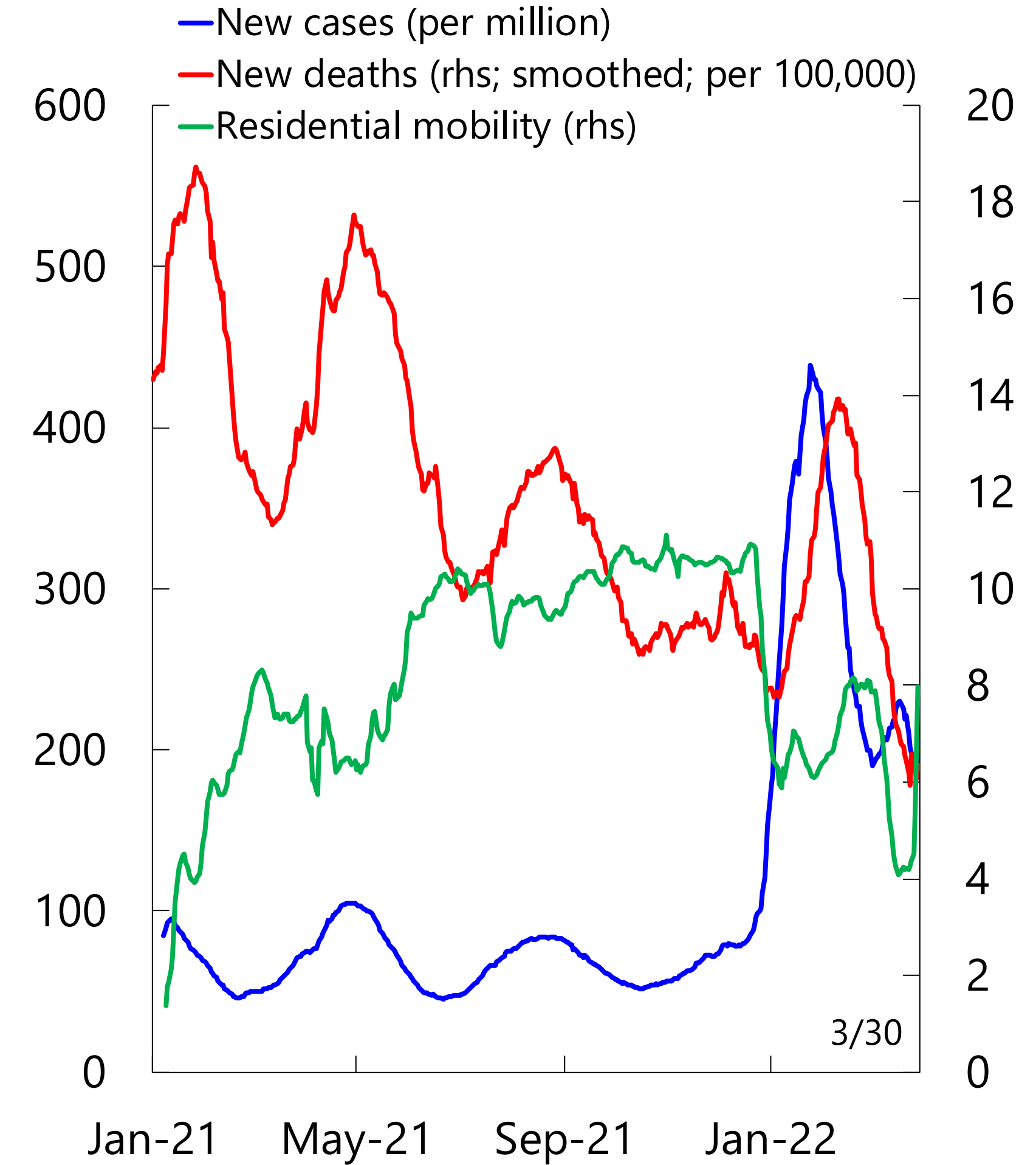
**Manufacturing and services PMI**  
(index; above 50=expansion)



**Goods versus services consumption**  
(2019Q4=100)



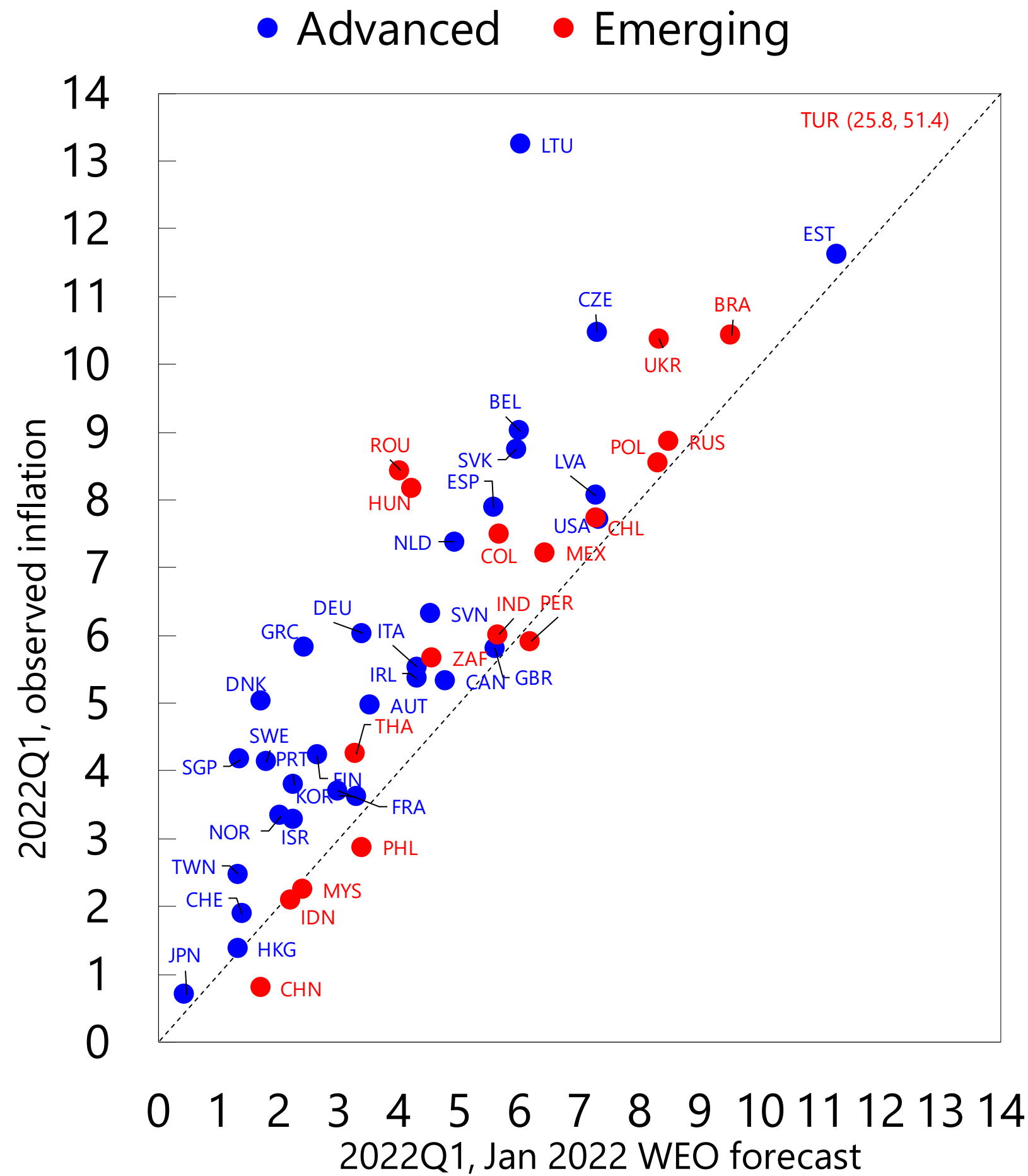
**Emerging from Omicron**  
(world aggregates)



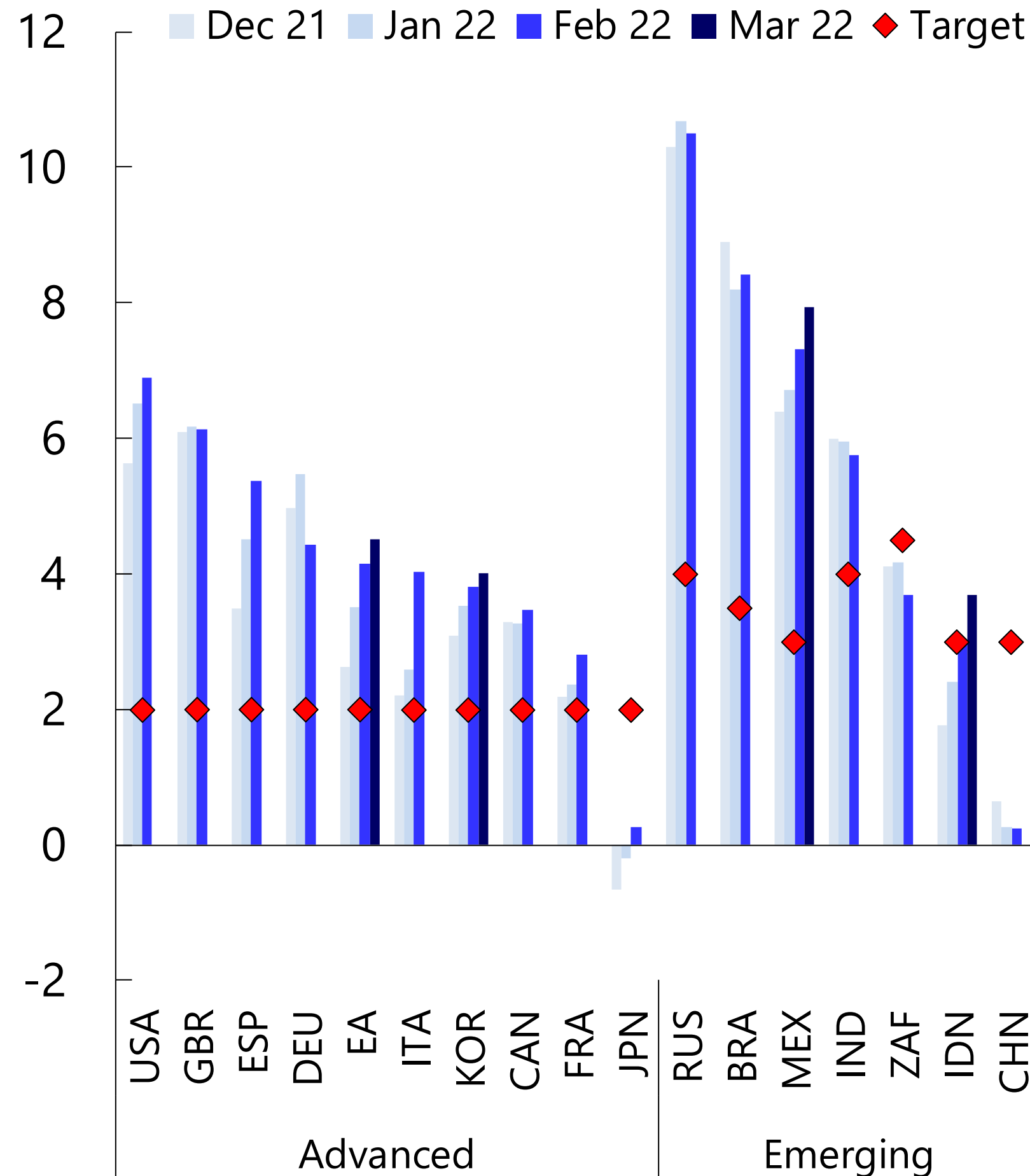
Sources: Haver Analytics; IHS Markit; Eurostat, OECD, U.S. Bureau of Economic Analysis, Australian Bureau of Statistics, U.K. Office for National Statistics; IMF, *Global Data Source*; Our World in Data; and IMF staff calculations.

# Inflation developments: Rising and broadening

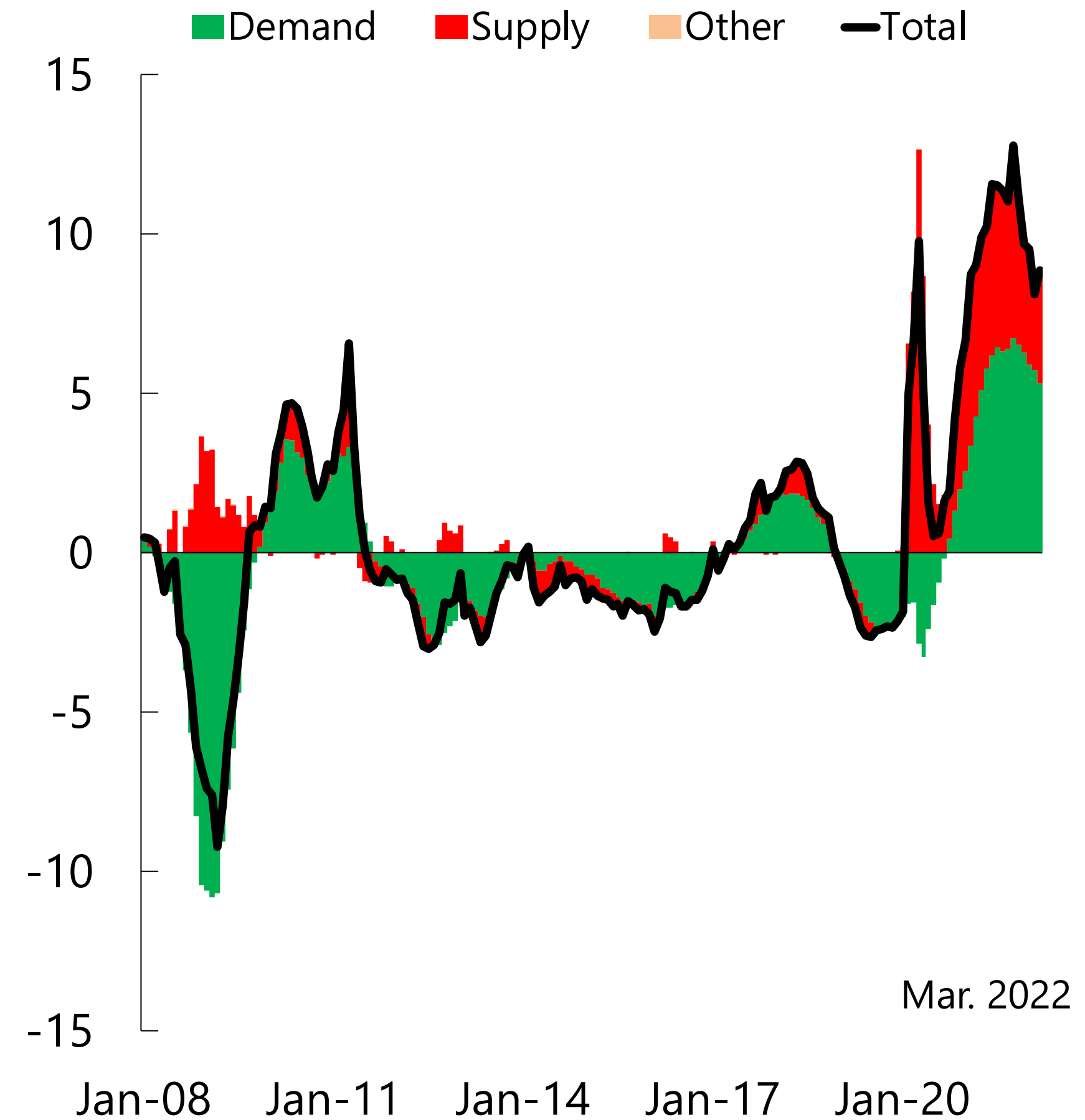
**Inflation surprise 1/**  
(percent; year on year; headline CPI)



**Core inflation**  
(percent; 3m/3m annualized)



**Global supply/demand mismatches**  
(change in supplier delivery time; pct dev. from mean)



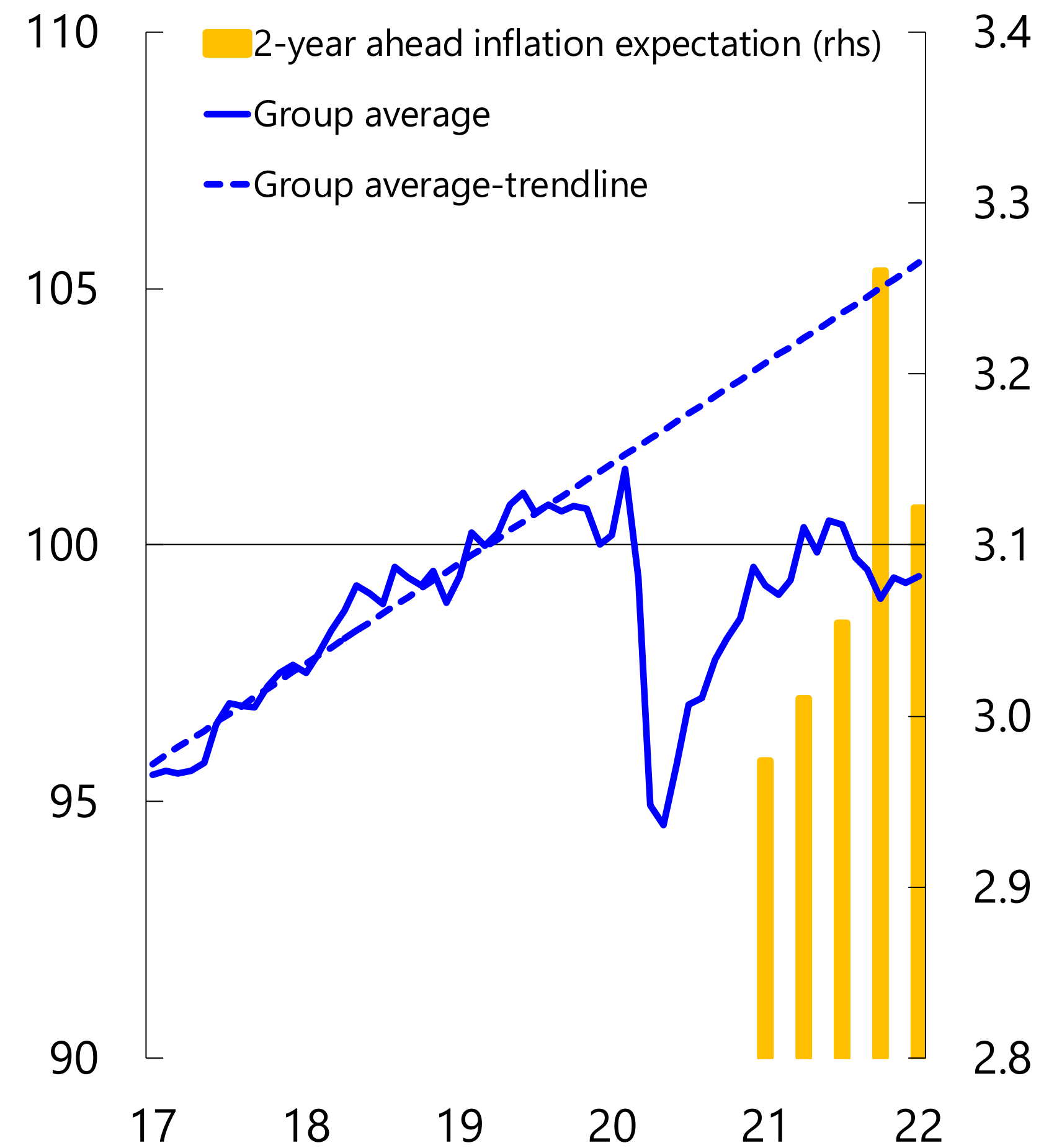
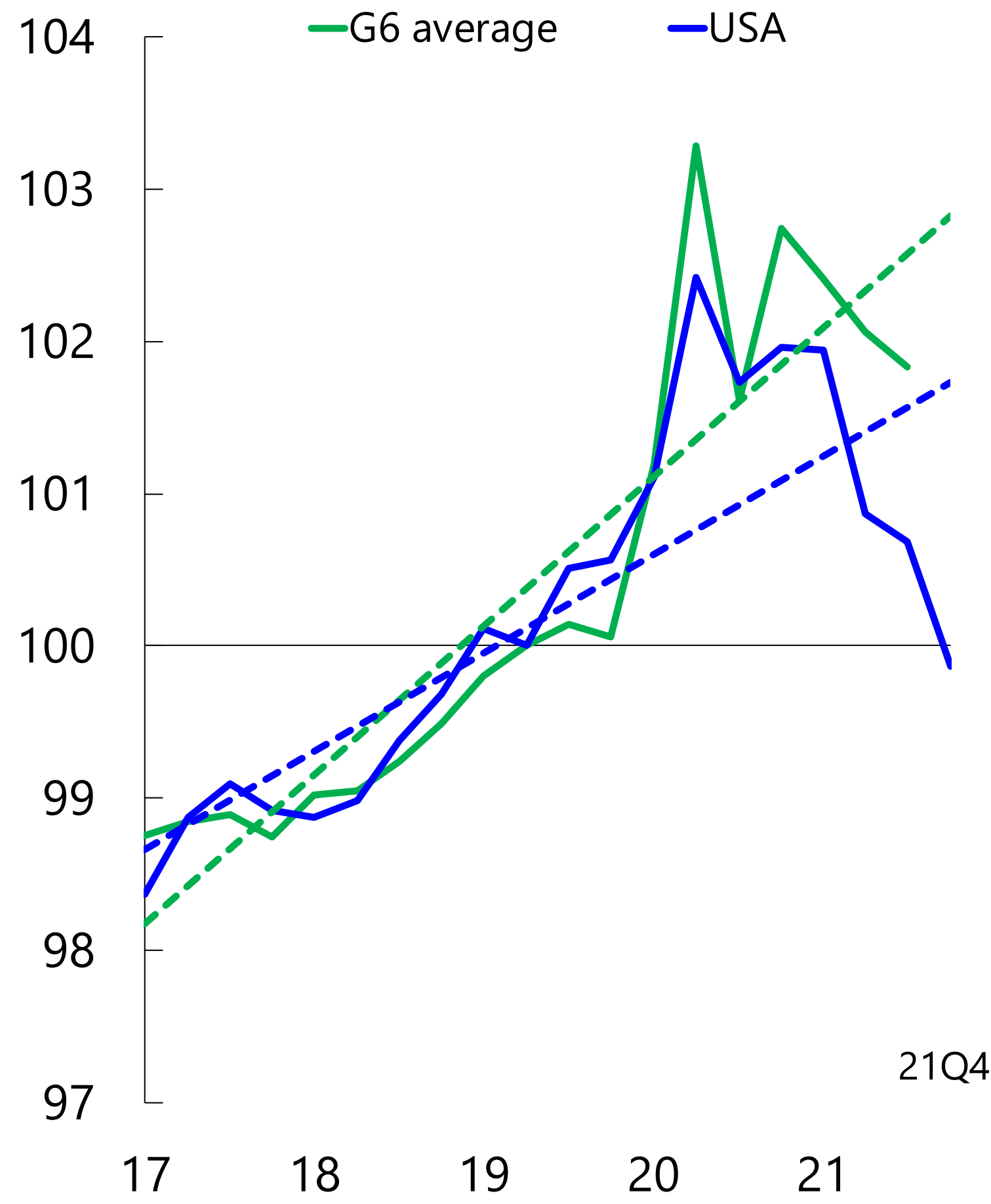
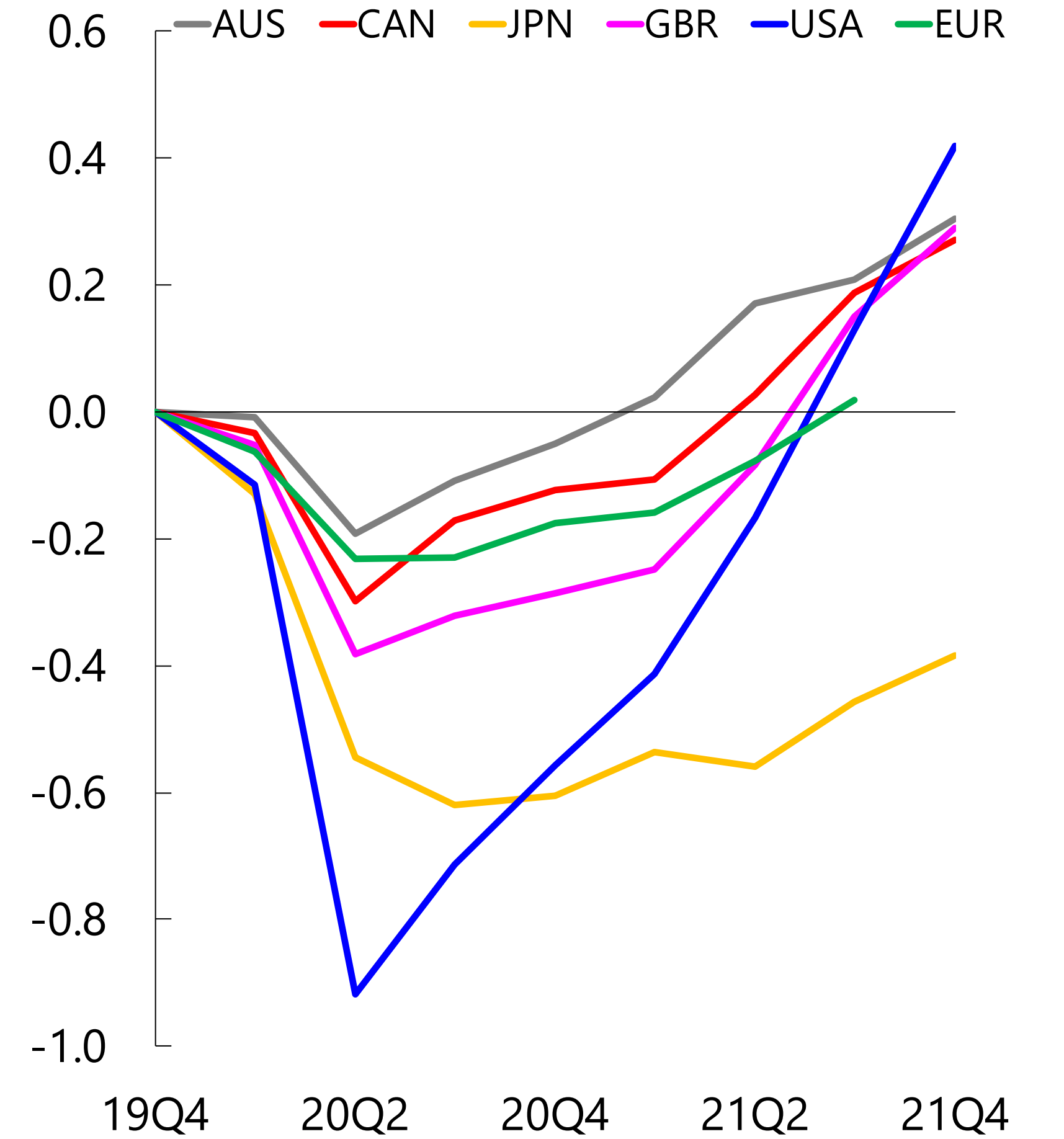
Sources: Haver Analytics; IMF, *Global Data Source*; IMF, *World Economic Outlook*; Markit economics; and IMF staff calculations.  
1/ 2022Q1 observed inflation is average of January 2022, February 2022, and March 2022 where data is available.

# Labor markets tightening and wage pressures building up

**Vacancy-to-unemployment ratios**  
(deviation from 2019Q4; percentage points)

**Real wages in major AE**  
(index; 2019Q2=100)

**Real wages in major EM with tightening labor markets 1/**  
(index; Dec 2019=100)



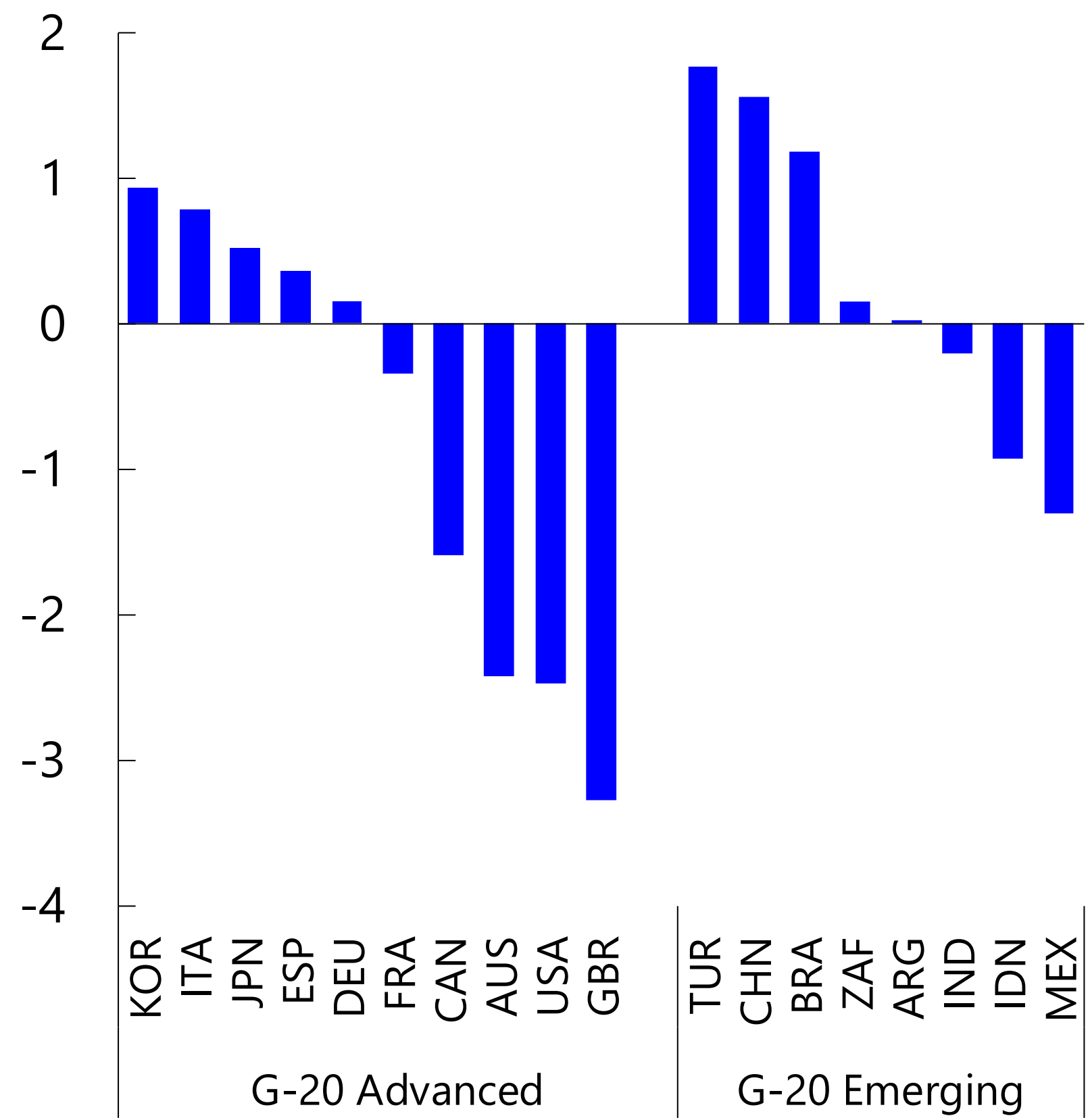
Sources: Haver Analytics; Consensus Forecast; OECD; IMF, *Global Data Source*; and IMF staff calculations.

1/ Includes Brazil, Chile, Colombia, and Peru.

# Fiscal and monetary policies, demand handover

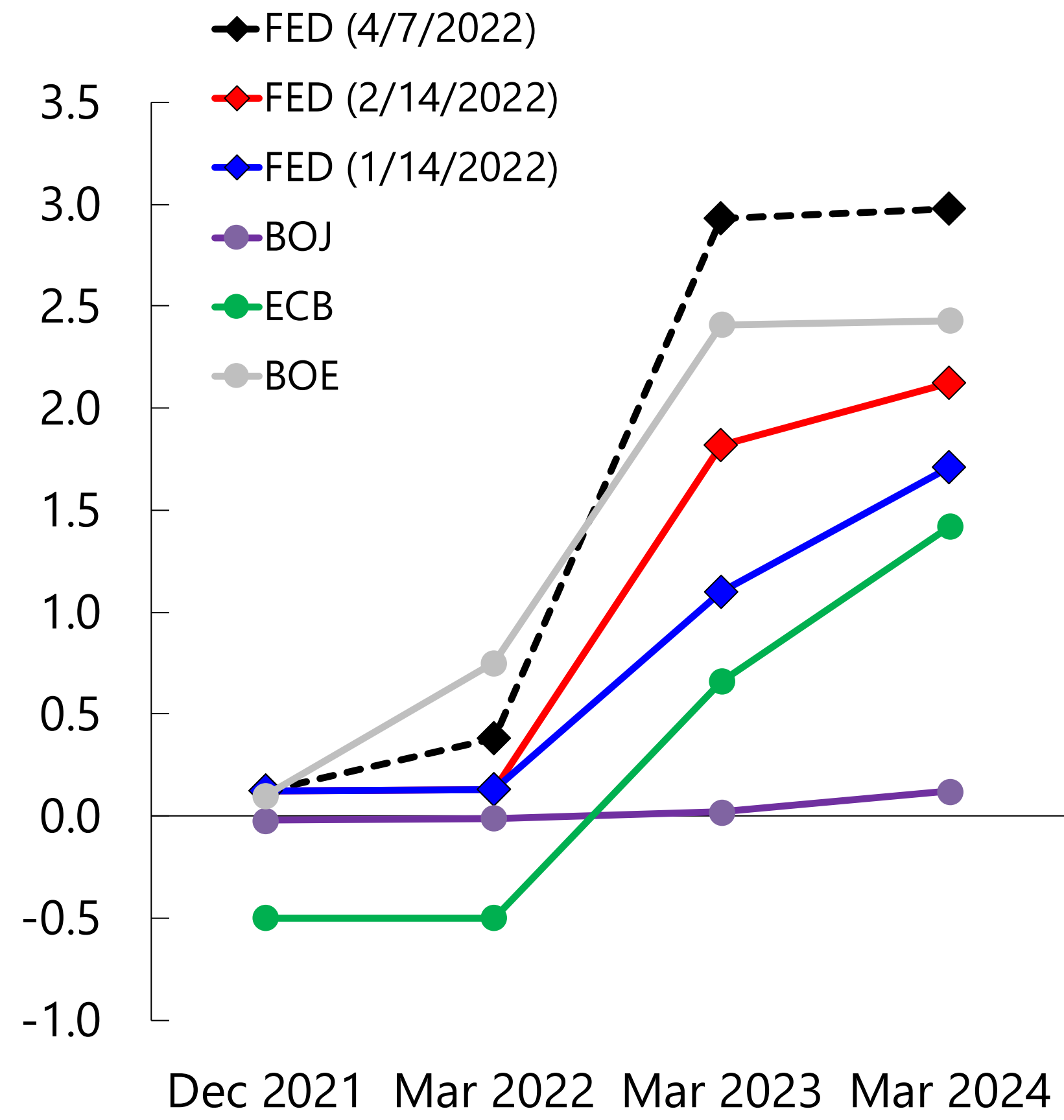
## Fiscal impulse

(percentage points; 2022-2021)



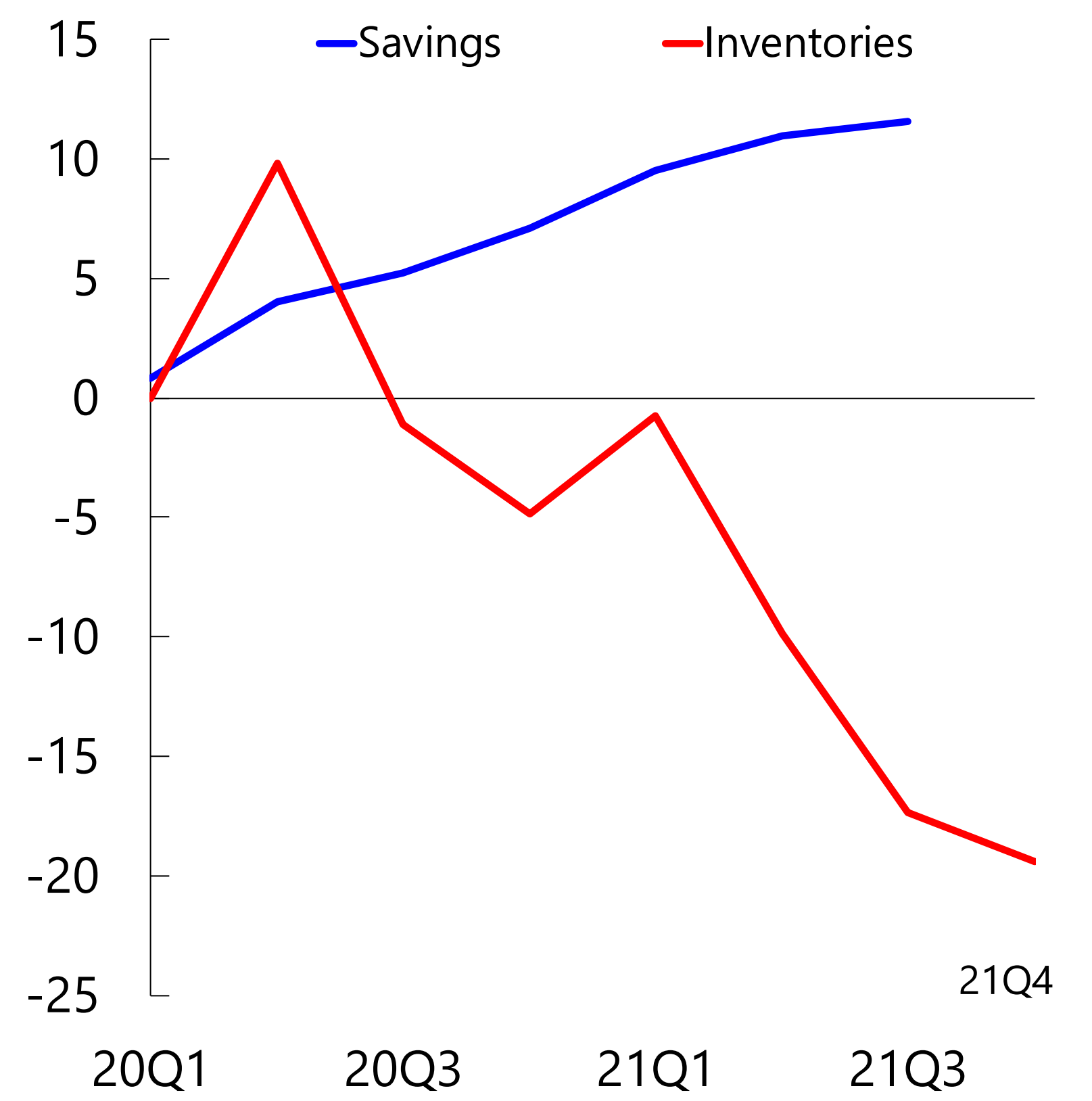
## Fed Funds Futures vs. other policy rate paths 1/

(market-implied; percent)



## Cumulative excess savings and retail inventories 2/

(percentage of 2019 disposable income; percent change relative to 2020Q1 inventory; AE average)



Sources: Bloomberg, L.P.; IMF, *World Economic Outlook*; IMF, *Global Assumptions*; and IMF staff calculations.

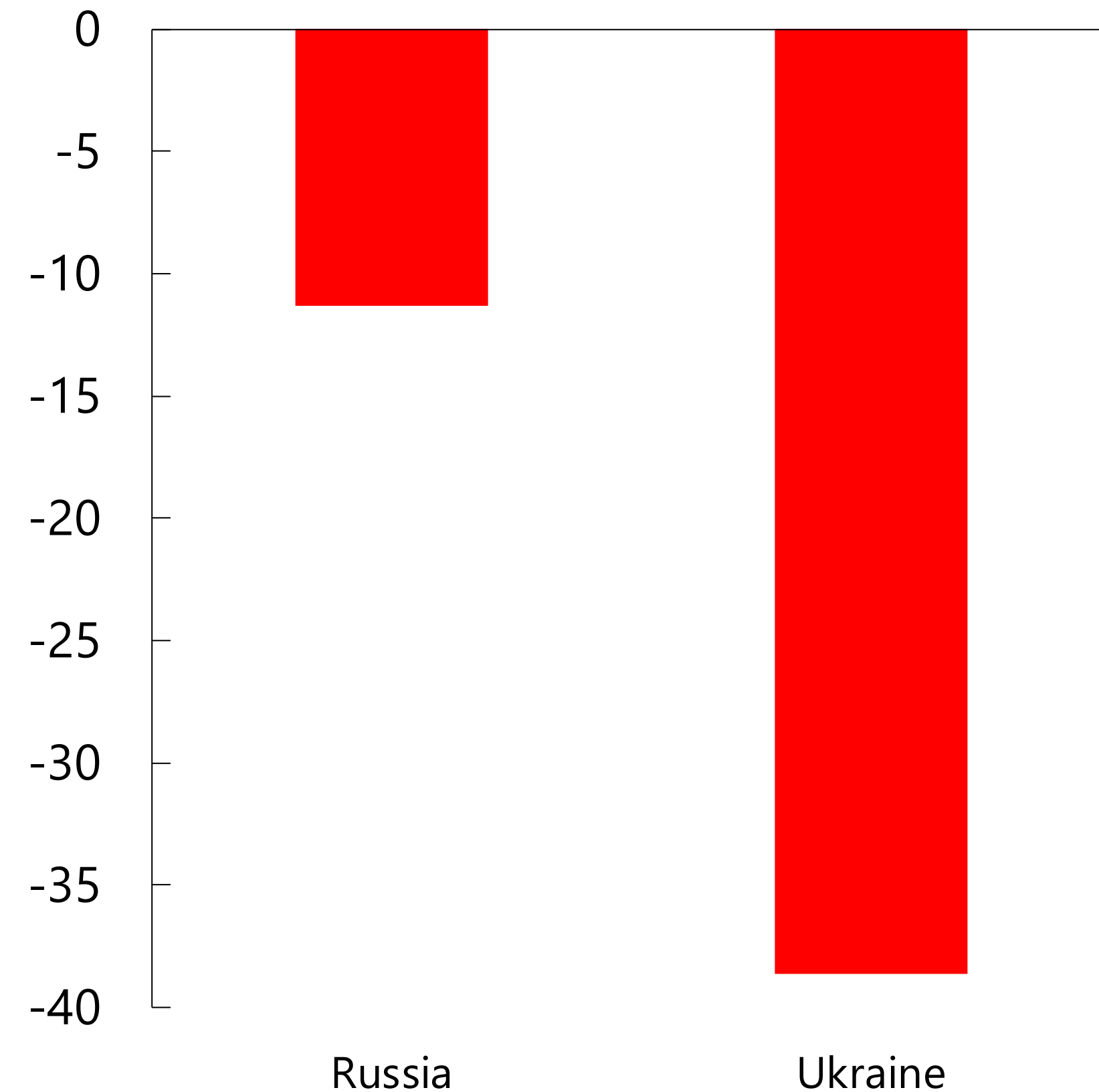
1/ US Federal Fund mid target rate; Bank of Japan Overnight call rate; Euro area ECB Deposit Facility Announcement rate; and Bank of England Official Bank Rate.

2/ Excess savings in each quarter are calculated as realized savings minus realized income x the average 2019 savings rate (all seasonally adjusted). Cumulative excess savings sum these quarterly excess savings from 2020Q1 on. Retail inventories are percent balances from business surveys, reported as changes relative to 2020Q1.

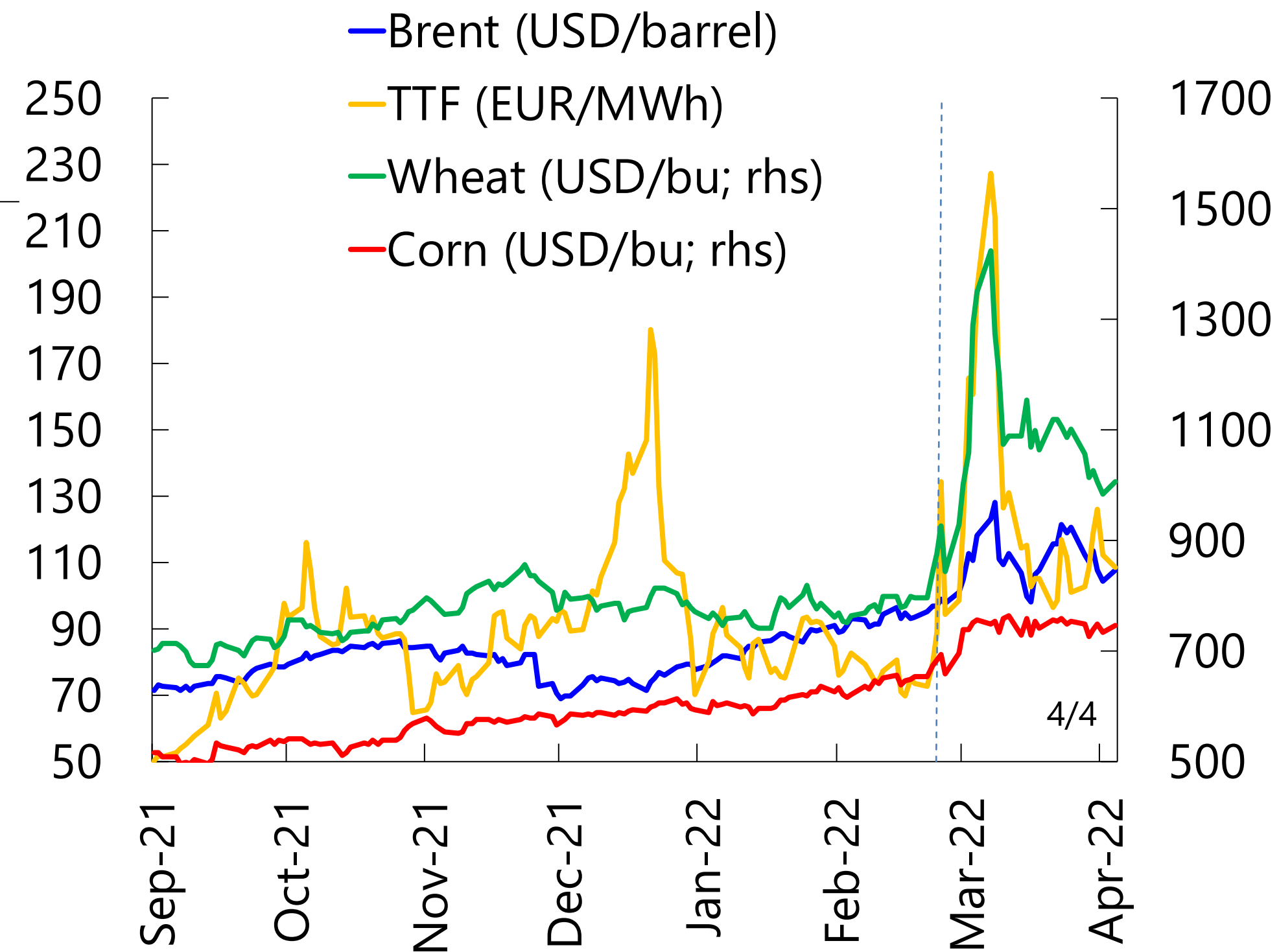
# The Ukraine war: an “economic earthquake”

## Epicenter: Russia and Ukraine

(Real GDP 2022 revision, in percentage points;  
April 2022 WEO vs Jan 2022 WEO)



## Seismic waves



- **Commodities prices surge and volatility**
- **Trade flows, supply disruptions, remittances and refugee crisis**
- **Financial conditions tightening**

## Shift in tectonic plates

- **Challenges to the geopolitical order and possible emergence of economic and geopolitical blocks**

Sources: IMF, *World Economic Outlook*; Bloomberg, L.P.; Haver Analytics; IMF, *Primary Commodity Price System*; and IMF staff calculations.

# Update to <sup>214</sup>WEO baseline assumptions

## The war in Ukraine and sanctions

- Conflict remains limited to Ukraine.
- Sanctions are in place indefinitely, but energy and food trade remains exempt.

## Policy support

- The Fed expected to raise rates 7 times in 2022 & 4 times in 2023, totaling 275 bp.
- Fiscal support across AE and EMs to decline further in 2022-2023, terms of trade shock partly offset by some fiscal accommodation in Europe.

## COVID Pandemic

- Health and economic impacts of the virus start to fade in 2022Q2. But zero-COVID strategy in China entails more frequent local lockdowns.
- Hospitalization and deaths brought to low levels in most countries by end-2022.
- Possible renewed outbreaks less severe than previous waves thanks to improved adaptation.

# Growth projections: <sup>215</sup>Advanced economies

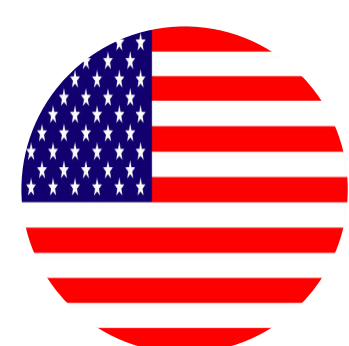
(percent change from a year earlier)



World



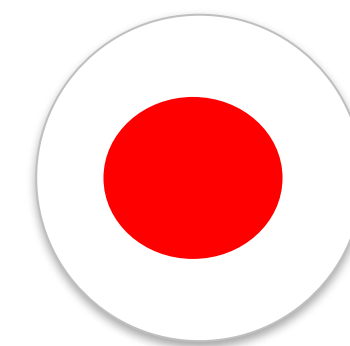
Advanced Economies



U.S.



Euro Area



Japan



U.K.



Canada



Other  
Advanced  
Asia

**2021**

**6.1**

**5.2**

**5.7**

**5.3**

**1.6**

**7.4**

**4.6**

**5.2**

Revision from  
Jan. 2022

0.2

0.2

0.1

0.1

0.0

0.2

-0.1

0.3

**2022**

**3.6**

**3.3**

**3.7**

**2.8**

**2.4**

**3.7**

**3.9**

**3.0**

Revision from  
Jan. 2022

-0.8

-0.6

-0.3

-1.1

-0.9

-1.0

-0.2

-0.3

**2023**

**3.6**

**2.4**

**2.3**

**2.3**

**2.3**

**1.2**

**2.8**

**2.9**

Revision from  
Jan. 2022

-0.2

-0.2

-0.3

-0.2

0.5

-1.1









0.0

0.2

Source: IMF, *World Economic Outlook*, April 2022.

# Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)

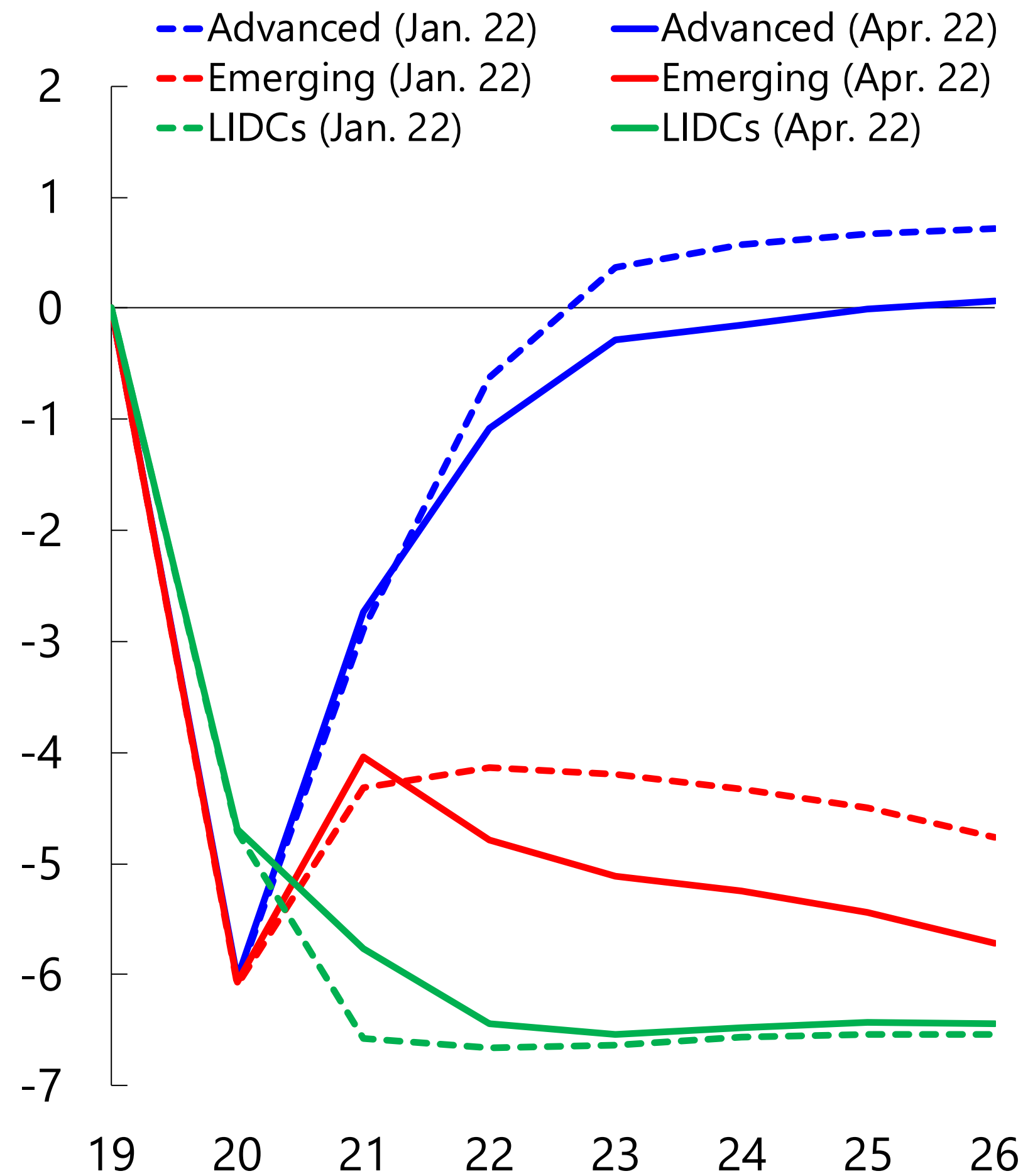
								
	Emerging Market and Developing Economies	China	India	Brazil	Russia	Commodity Exporting Economies (ex Russia)	Commodity Exporting LIDCs	Commodity Importing LIDCs
<b>2021</b>	<b>6.8</b>	<b>8.1</b>	<b>8.9</b>	<b>4.6</b>	<b>4.7</b>	<b>5.4</b>	<b>1.8</b>	<b>4.6</b>
Revision from Jan. 2022	0.3	0.0	-0.1	-0.1	0.2	0.8	0.7	0.5
<b>2022</b>	<b>3.8</b>	<b>4.4</b>	<b>8.2</b>	<b>0.8</b>	<b>-8.5</b>	<b>3.9</b>	<b>3.4</b>	<b>5.3</b>
Revision from Jan. 2022	-1.0	-0.4	-0.8	0.5	-11.3	0.4	0.1	-0.7
<b>2023</b>	<b>4.4</b>	<b>5.1</b>	<b>6.9</b>	<b>1.4</b>	<b>-2.3</b>	<b>3.6</b>	<b>3.8</b>	<b>6.2</b>
Revision from Jan. 2022	-0.3	-0.1	-0.2	-0.2	-4.4	0.1	0.0	-0.3

Source: IMF, *World Economic Outlook*, April 2022.

# 217 Medium-term outlook

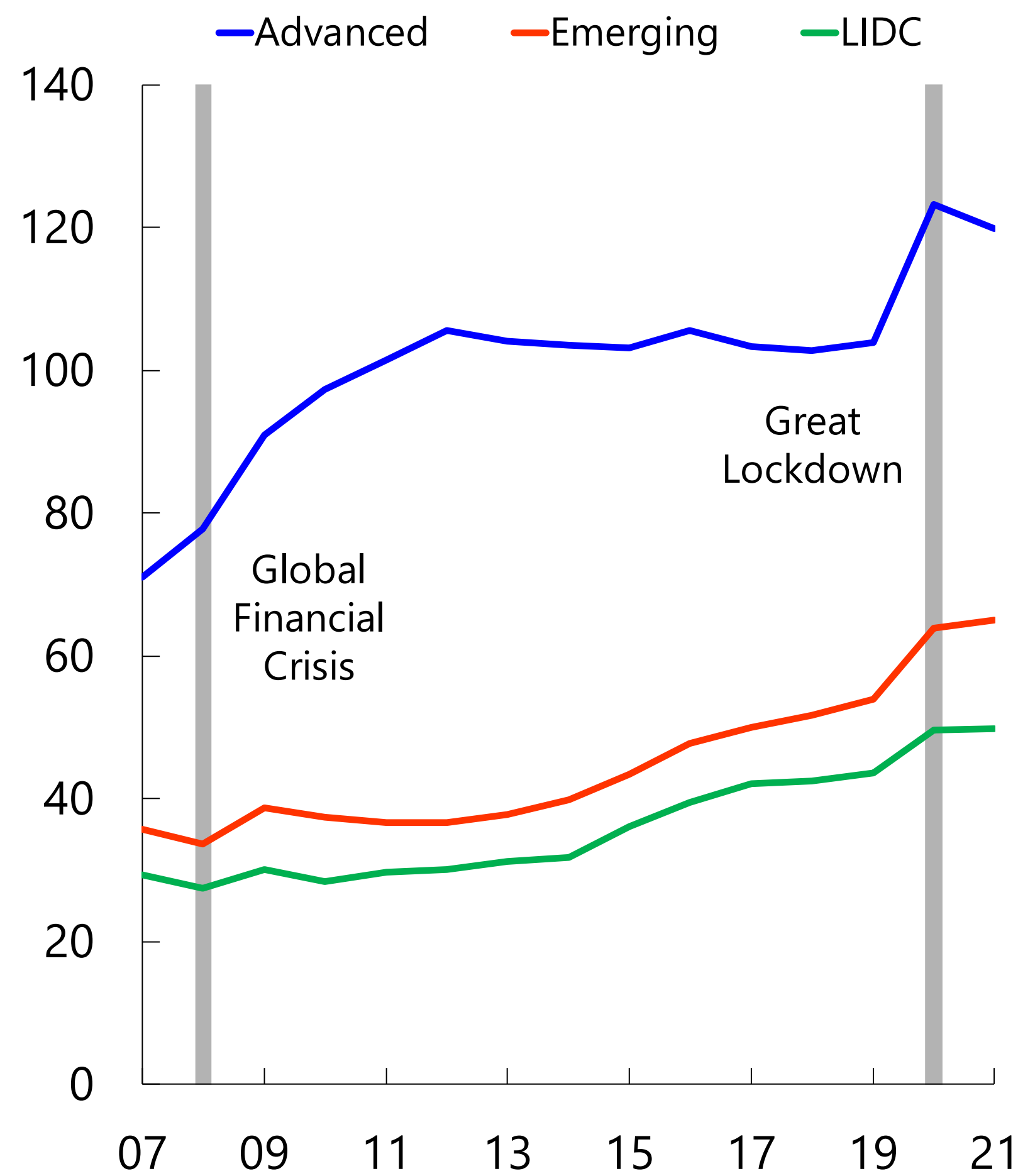
## Medium-term output losses

(percent deviation from Jan. 2020 WEO)



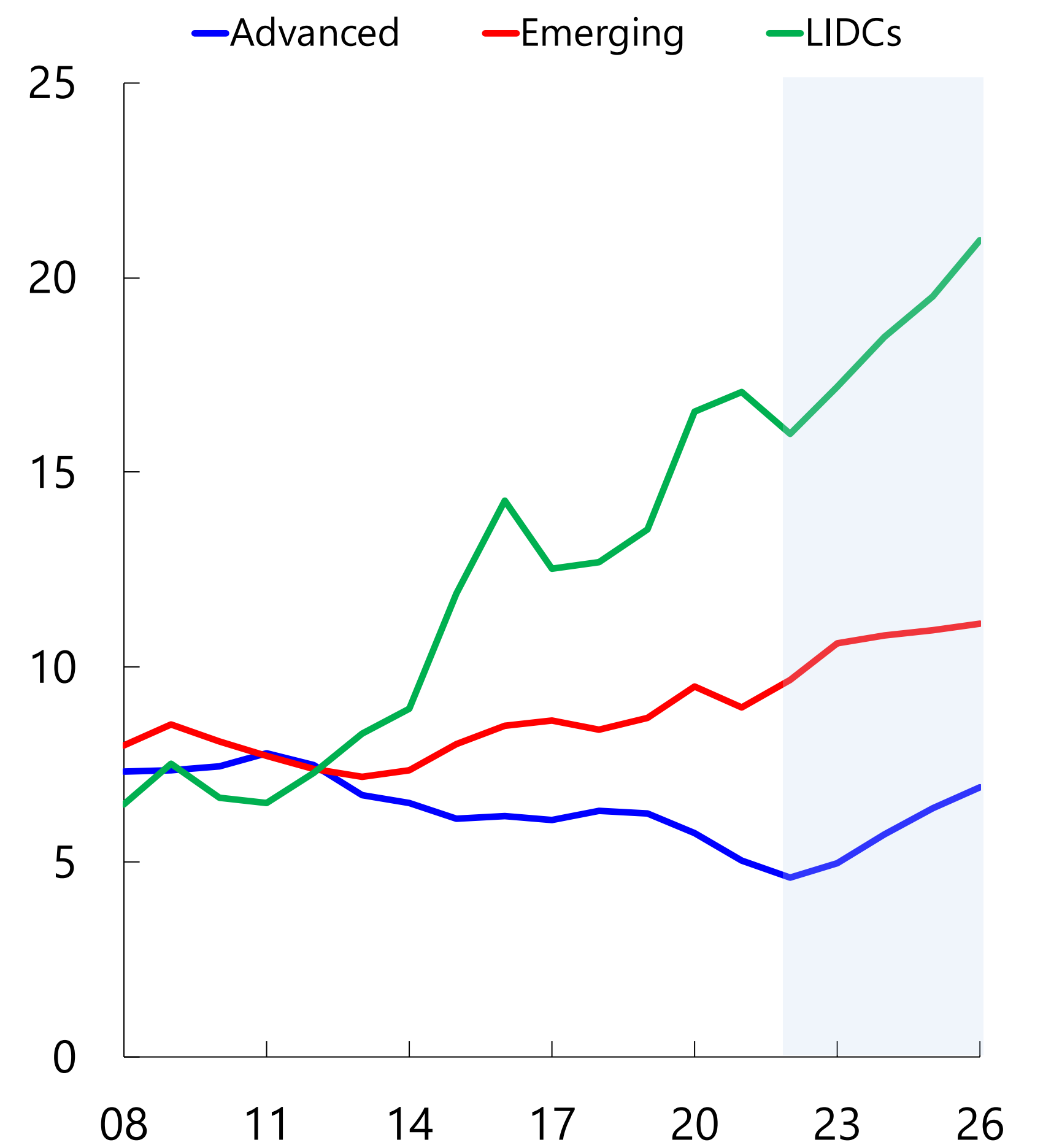
## Public debt

(percent of GDP)



## Interest payments to revenues

(percent)

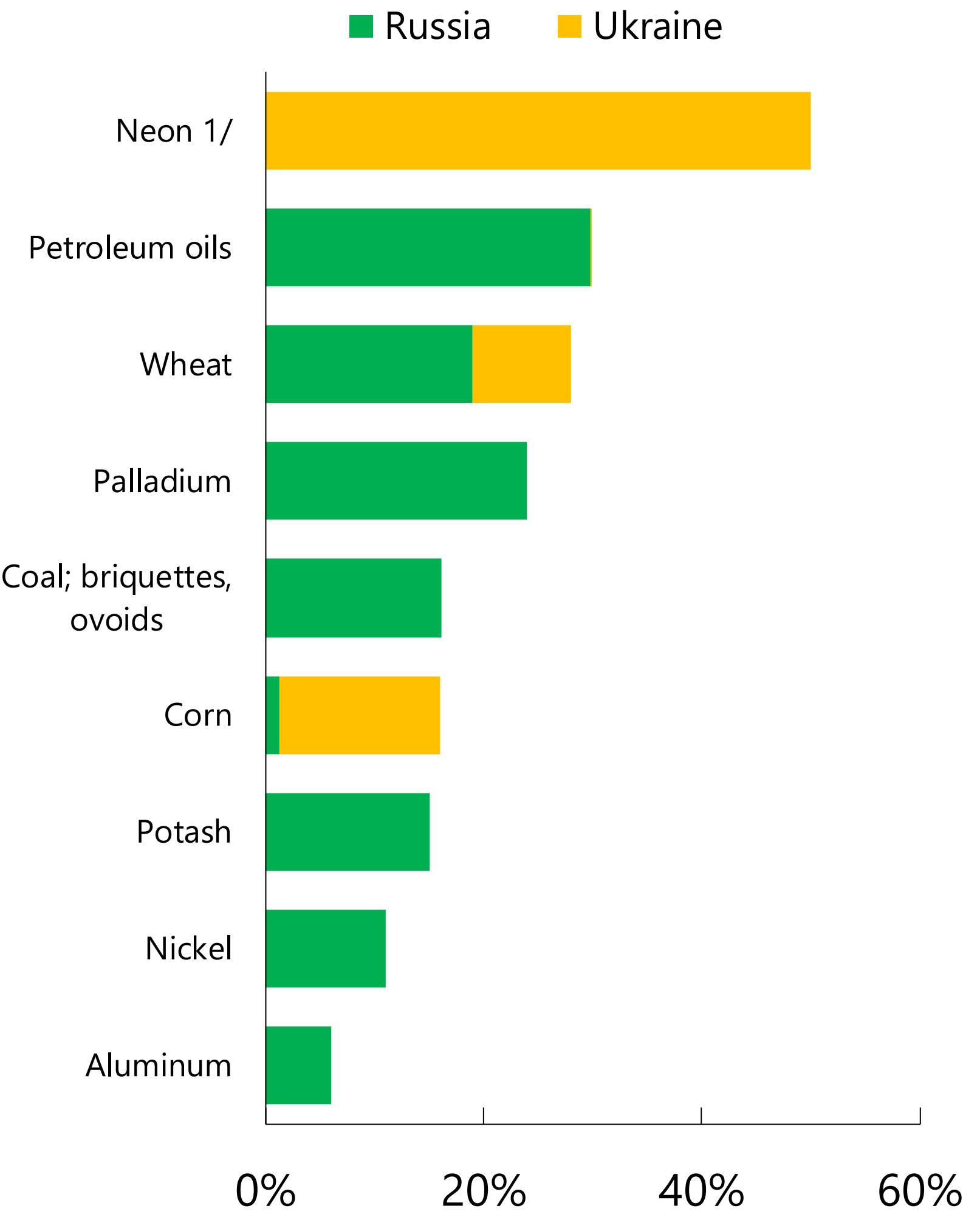


Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

# Spillover from war: Commodities channel

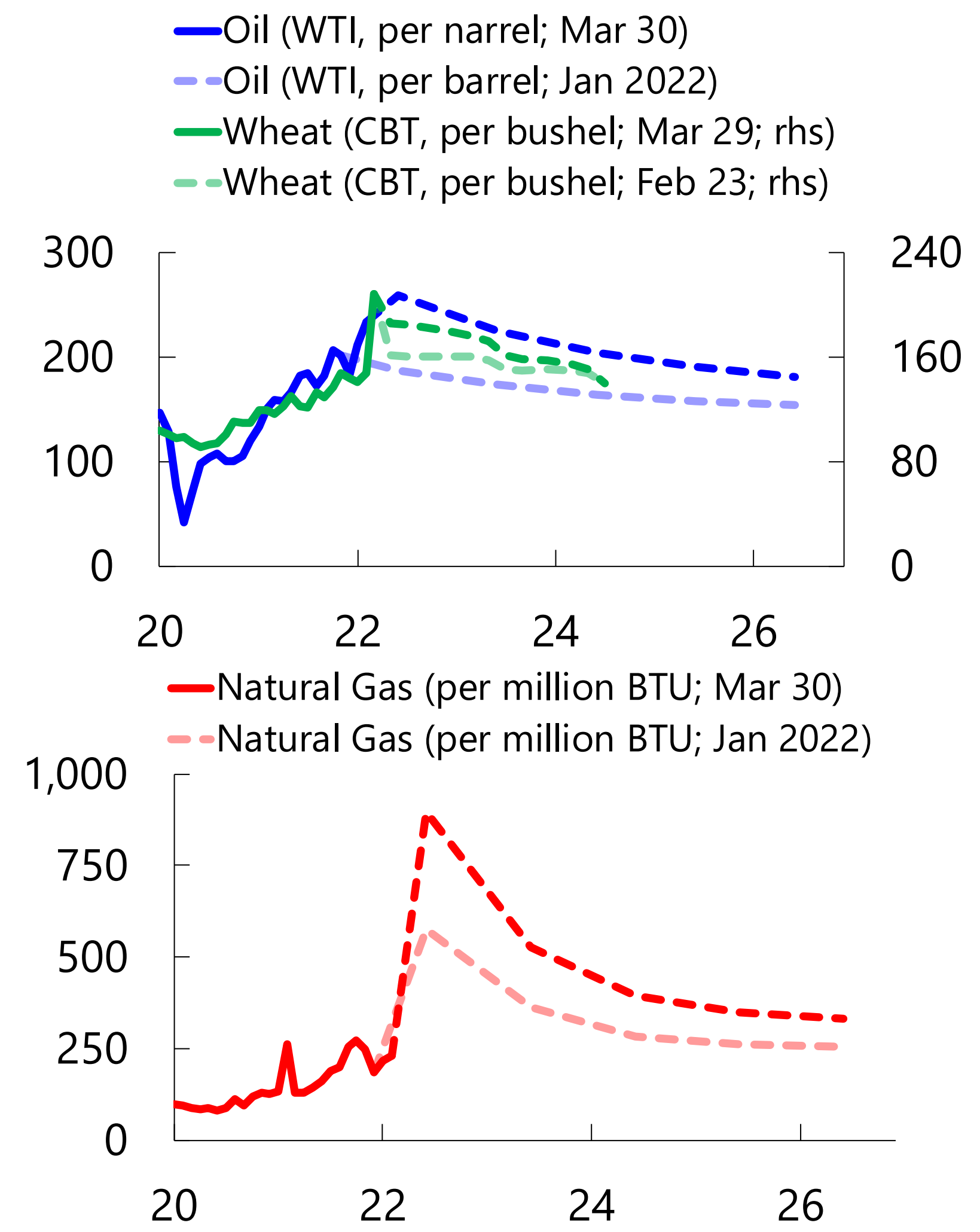
## Commodity exports, 2020

(share of global exports)



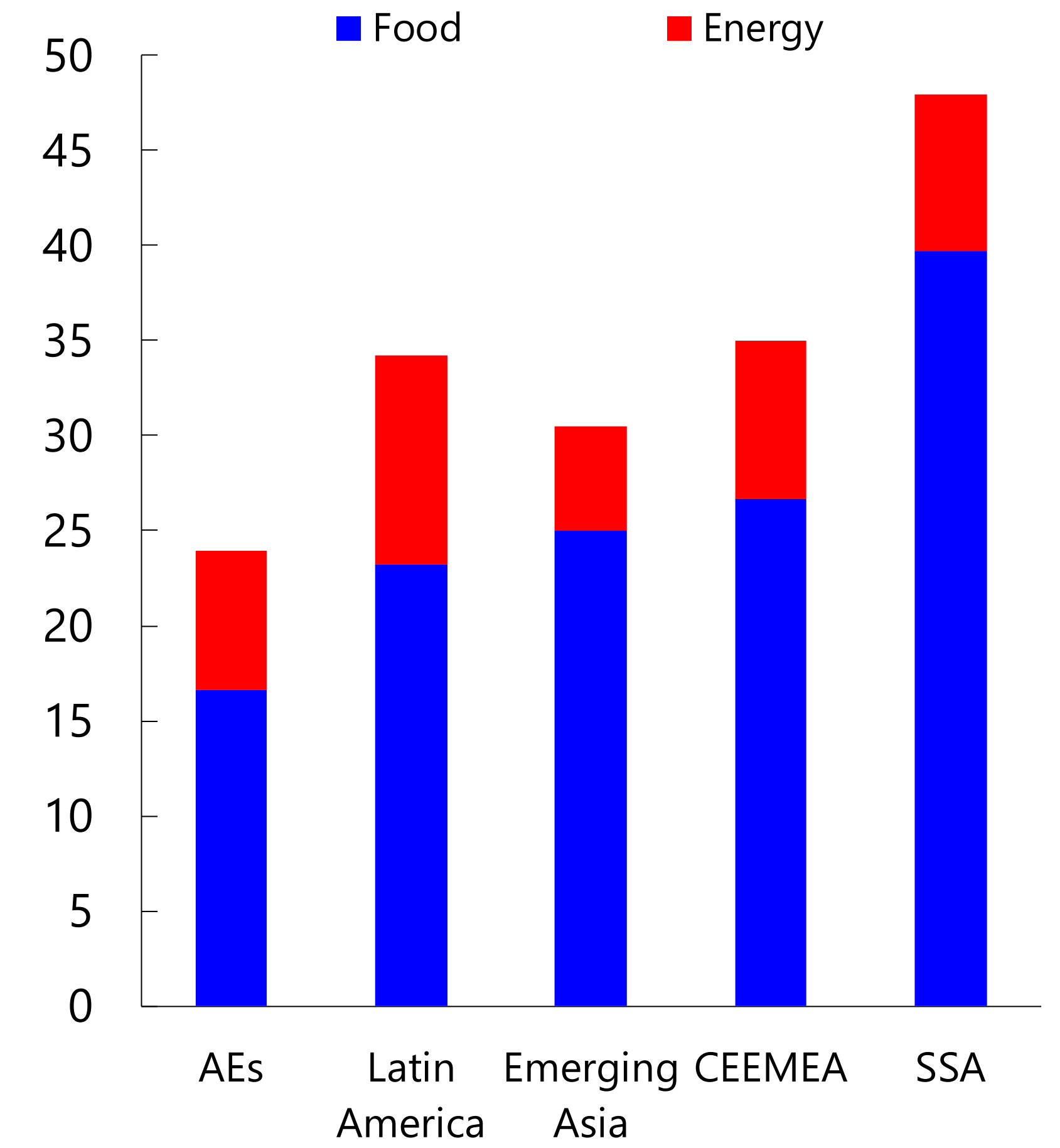
## Commodity prices

(US dollars; 2020=100)



## Share of energy and food in CPI

(percent)

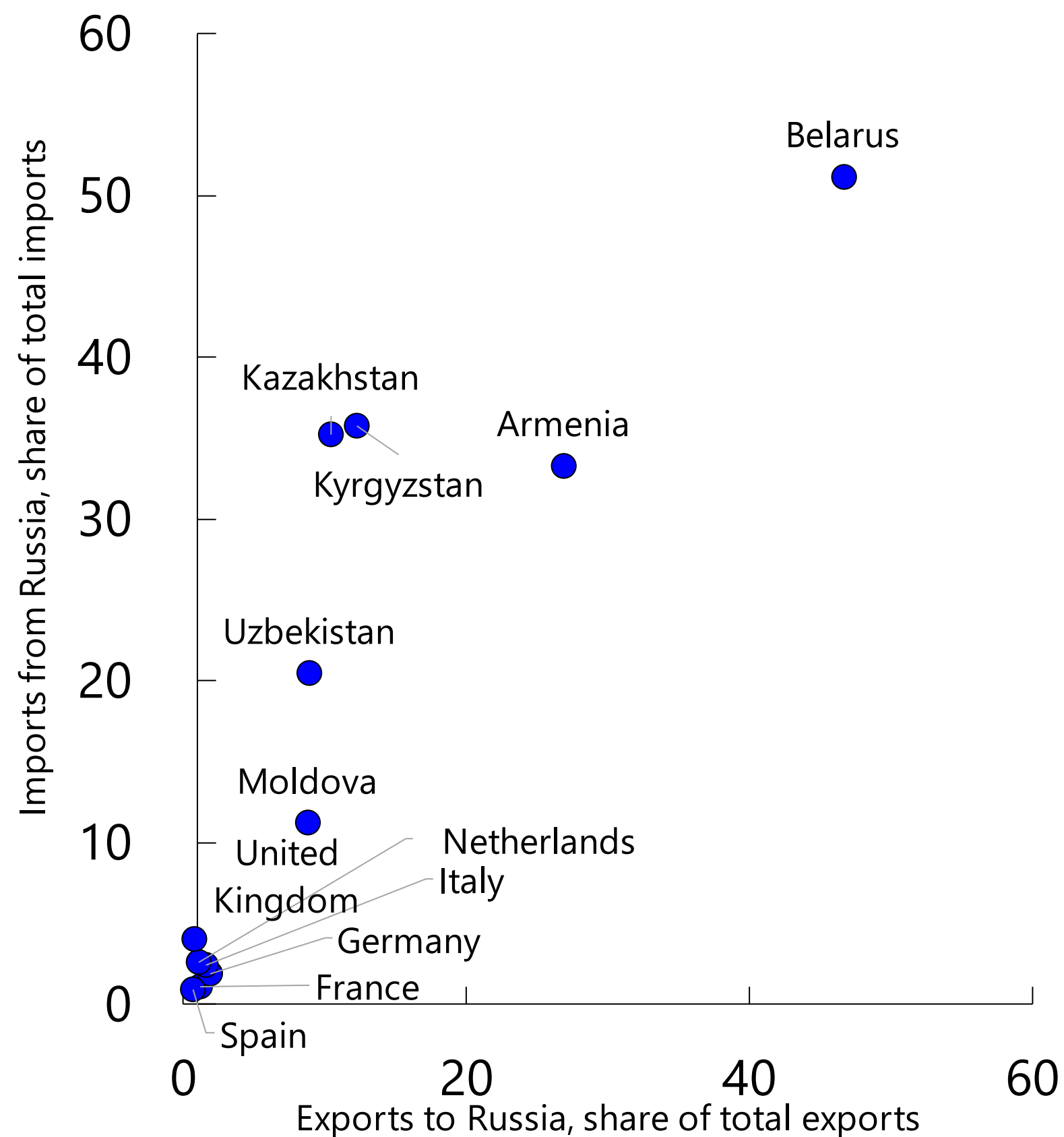


Sources: Bloomberg, L.P.; FT; UN Comtrade; FAOSTAT; WITS; and IMF staff calculations.  
 1/ Estimated share of Ukraine in the world production of semiconductor-grade neon.

# Spillover from war: Trade, remittances, and refugees

## Imports/exports of goods from/to Russia, 2020

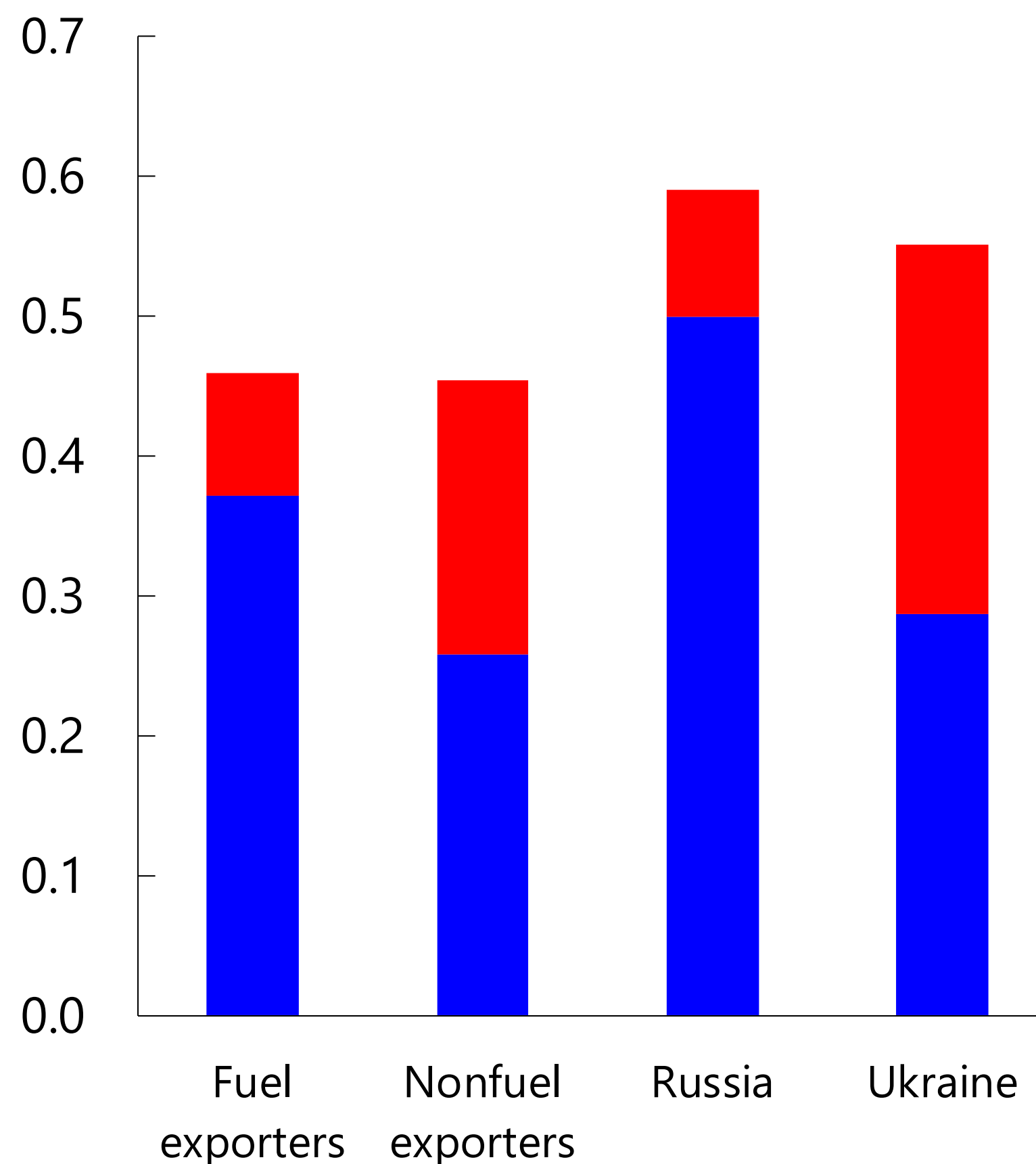
(percent of total imports/exports)



## GVC participation, 2018 1/

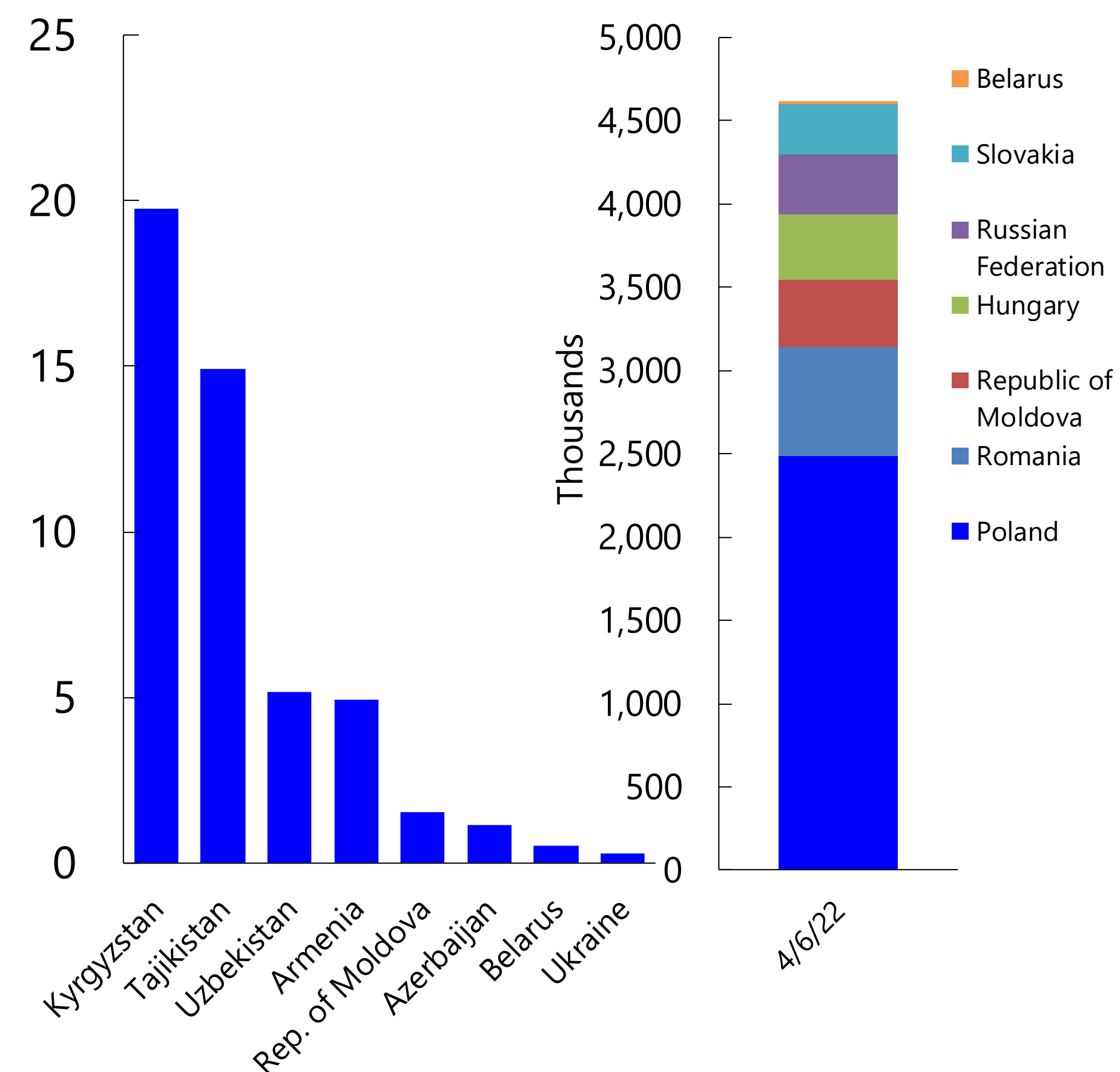
(share of exports)

■ Forward linkages ■ Backward linkages



## Remittances from Russia and Refugees from Ukraine

(2021Q1-Q3; in pct of 2021 GDP)



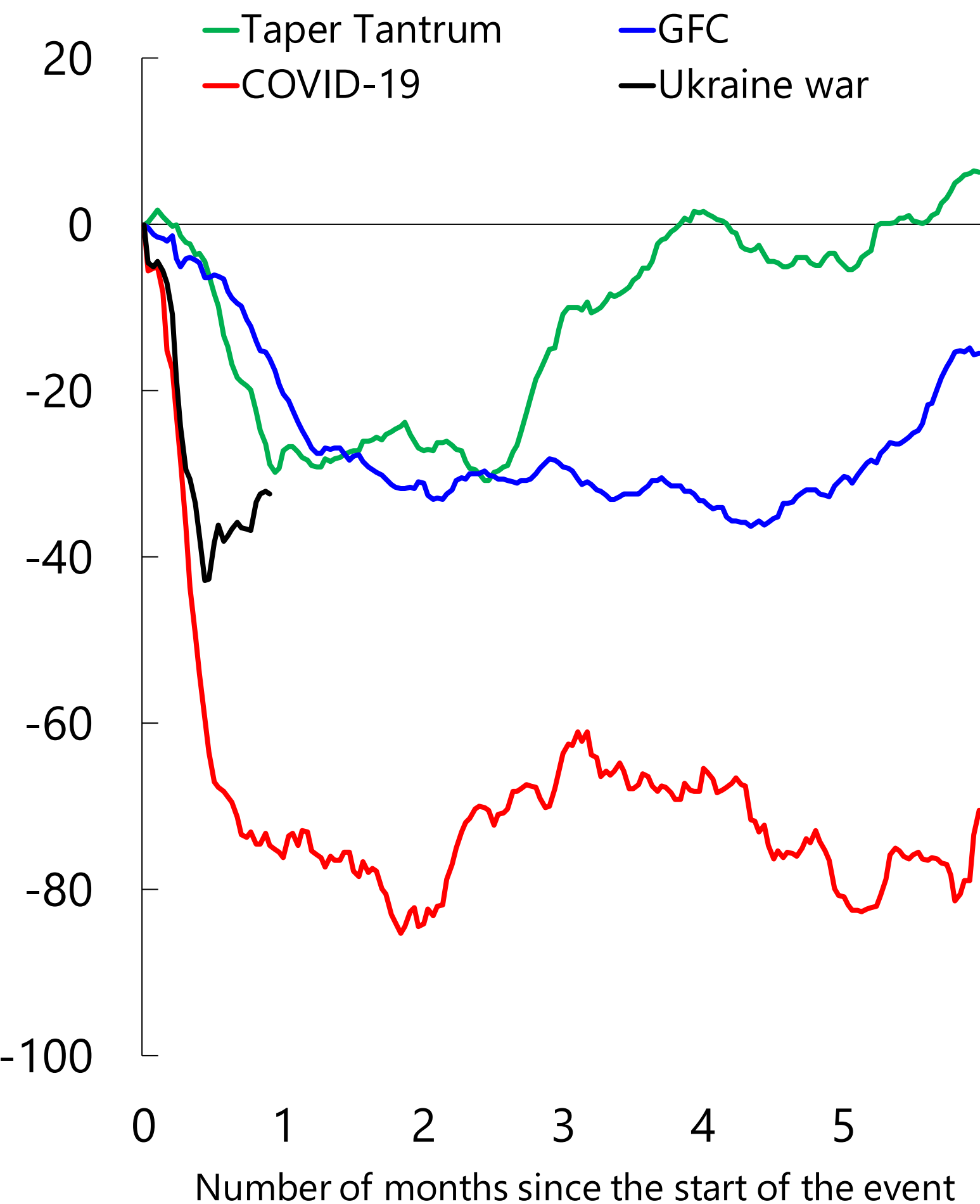
Sources: IMF, *Direction of Trade Statistics* (DOTS); Bank of Russia; UNCHR; UNCTAD-Eora Global Value Chain (GVC) database; and IMF staff calculations.

1/ GVC participation is the sum of backward and forward linkages. The former measure imported intermediate inputs that are used to generate output for exports. The latter measure exports of intermediate goods that are used as inputs for the production of exports of other countries. See Casella and other (2019) for methodological details.

# Spillover from war: Financial channel

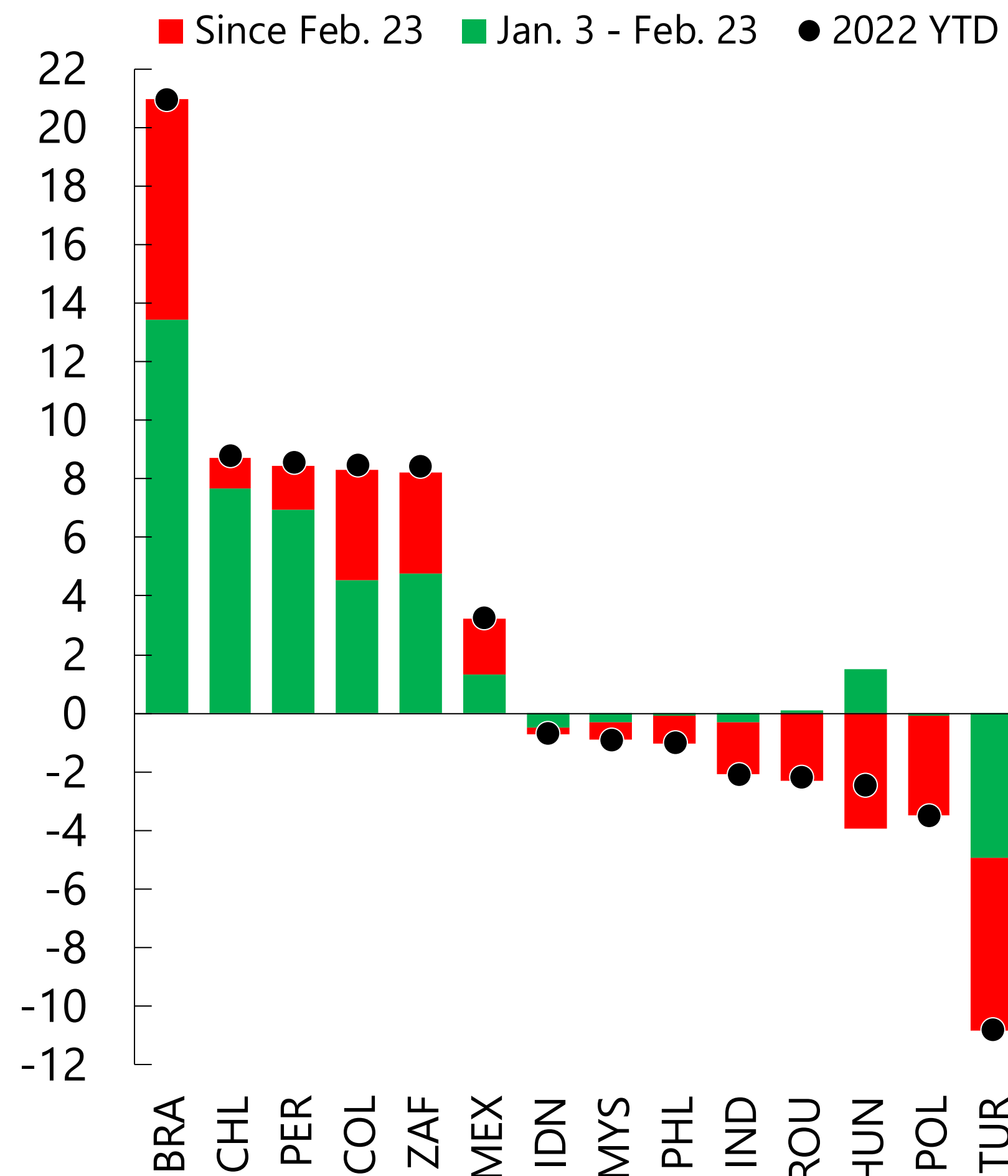
## Capital flows to EMs 1/

(cumulative; US billions; as of April 4, 2022)



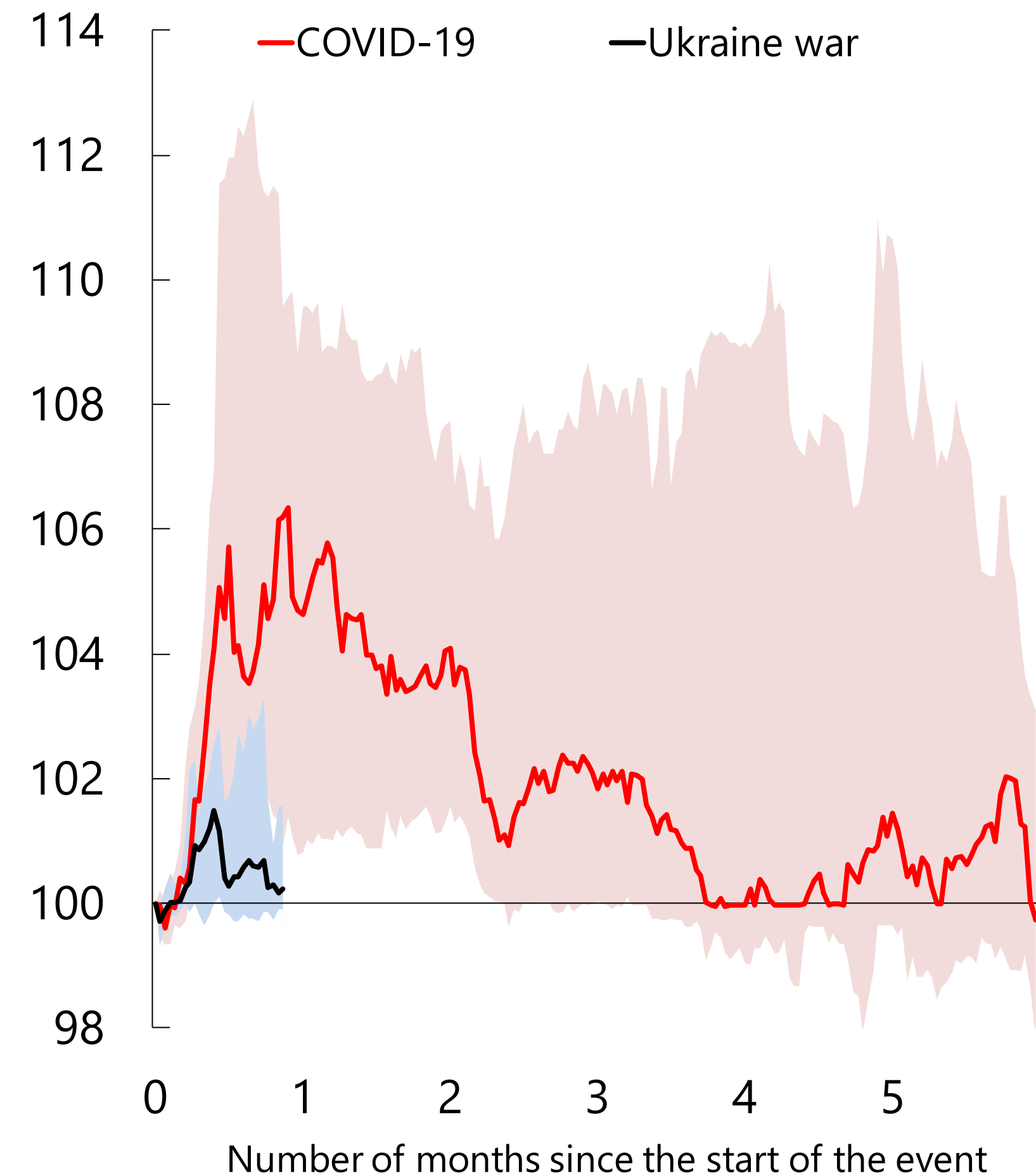
## Exchange rates vis-à-vis US Dollar

(percent change; as of April 4, 2022)



## EM depreciation vis-à-vis the US dollar

(initial start=100; median; as of April 4, 2022)

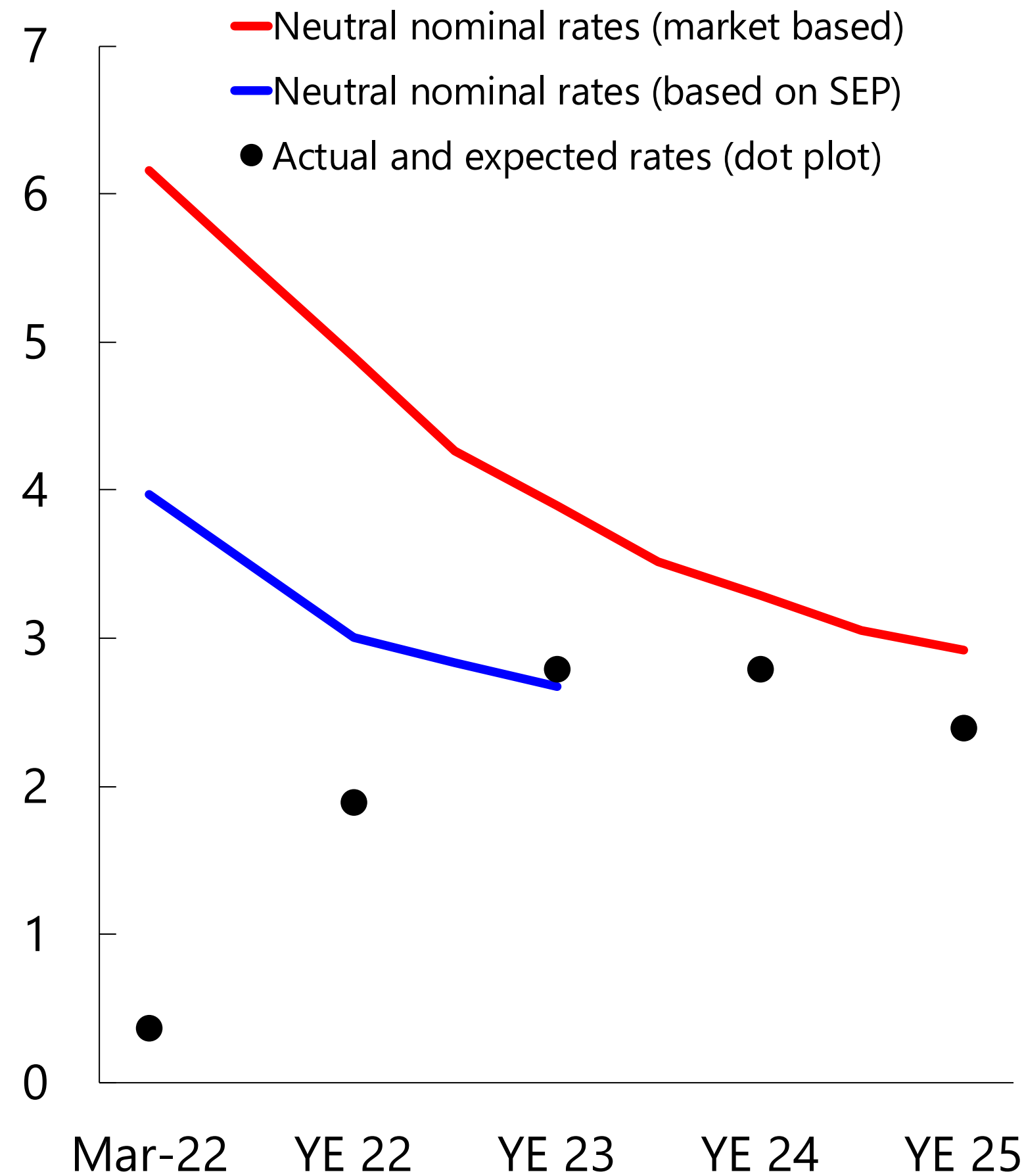


Sources: Bloomberg, L.P.; IMF, *Global Data Source*; and IMF staff calculations.

1/ Start dates are Taper Tantrum: 5/17/2013, GFC: 9/8/2008, COVID-19: 3/2/2020, and Ukraine war: 2/24/2022.

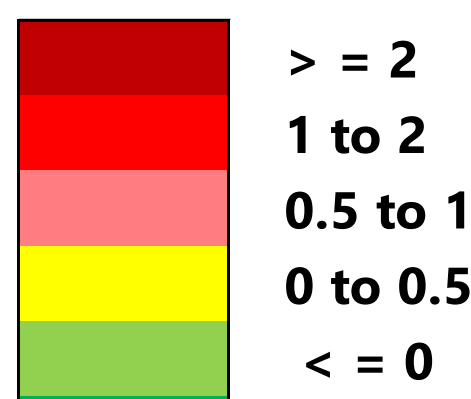
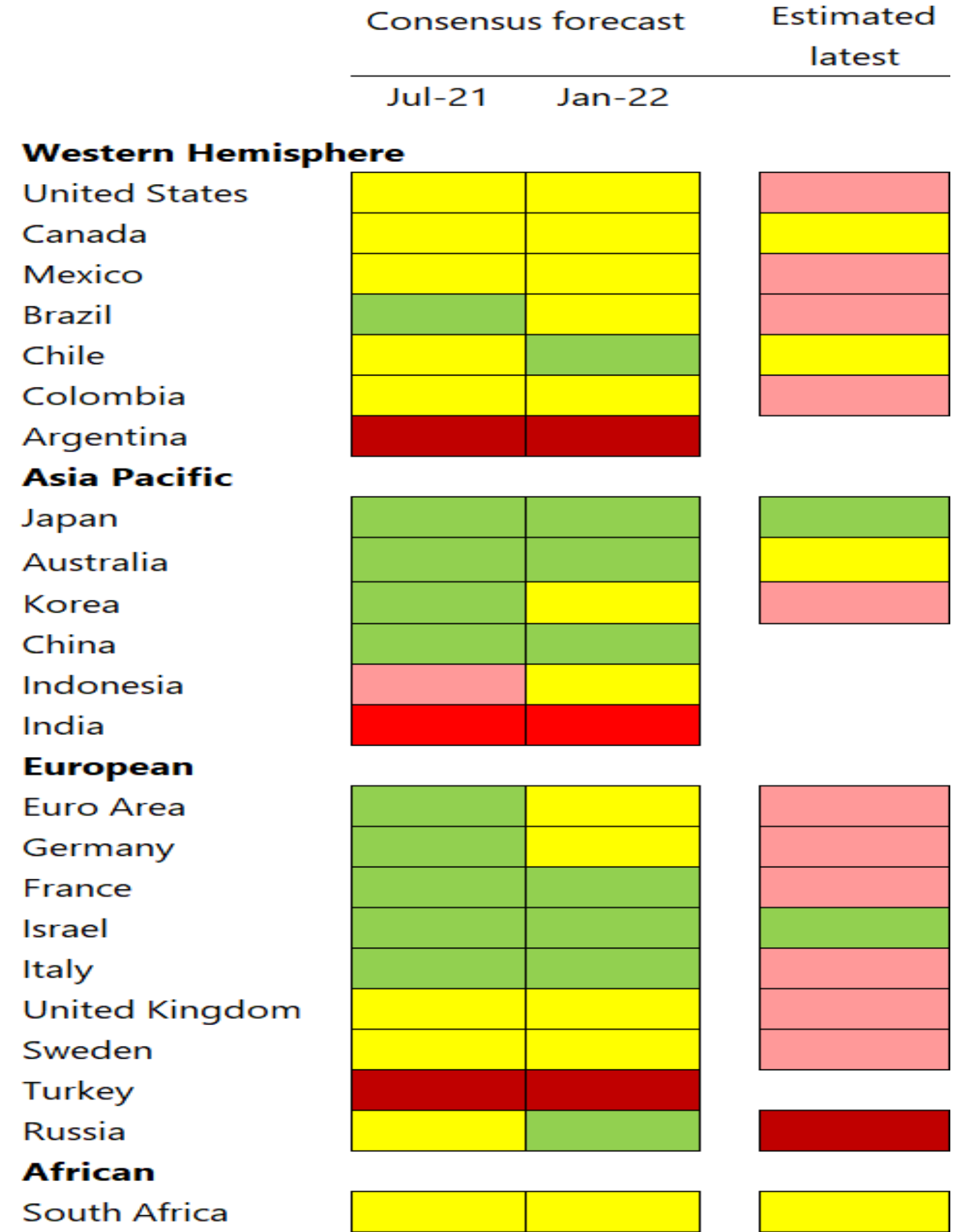
# Policy challenge: combating inflation

## US policy rate vs. short-run neutral nominal rate 1/ (percent)



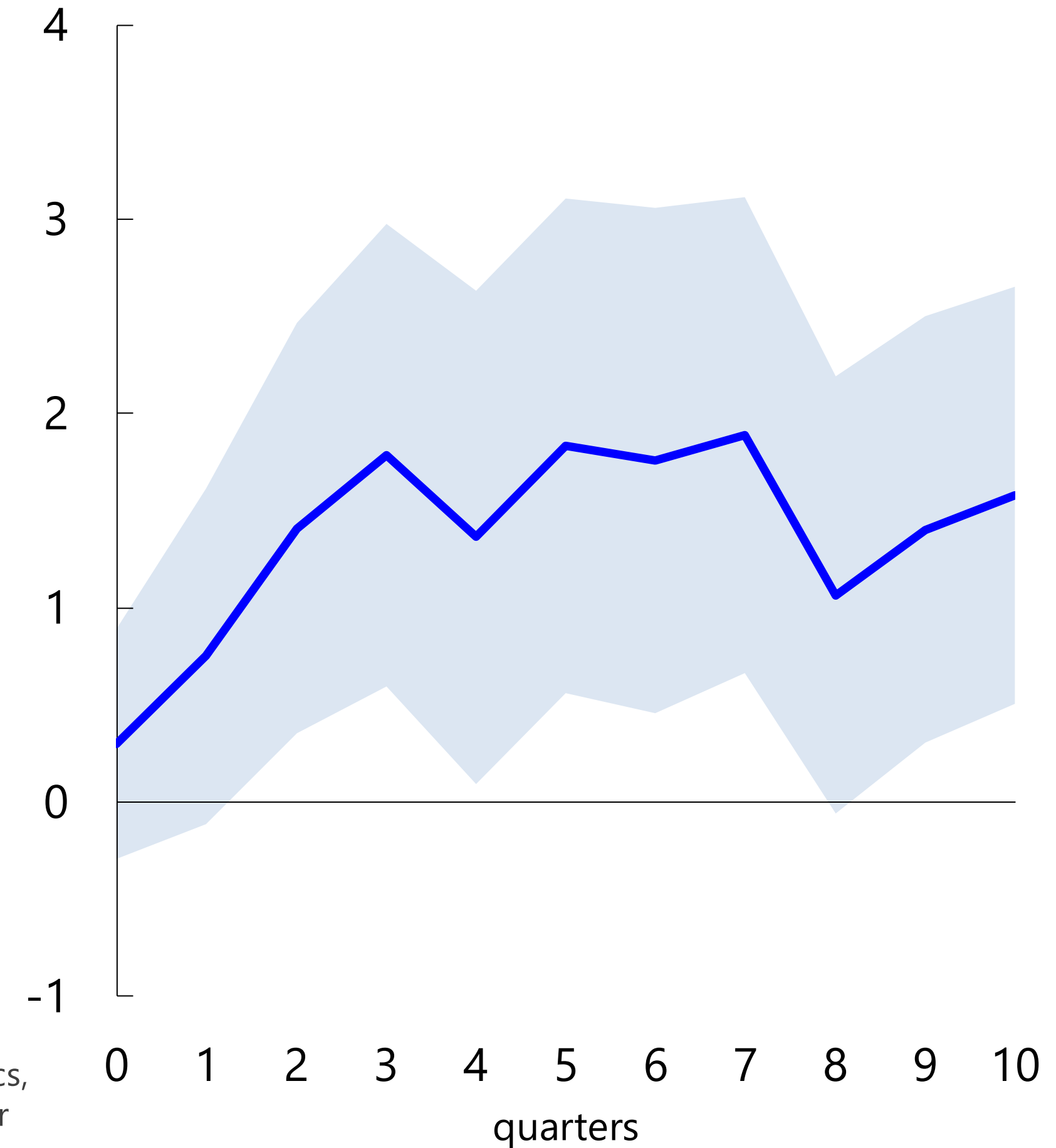
Sources: Federal Reserve SEP; and IMF Yield Curve Manager.  
 1/ Neutral rate:  $i^* = r^* + \text{inflation expectation}$  (market or SEP based).  
 Dot plot for YE25 onwards uses Fed's "longer run" dot estimate.  
 Market-expected CPI inflation retrieved from TIPS (as of 3/22/22).  
 Fed-expected inflation uses implied PCE series from SEP.

## Long-run inflation expectations heat map (ppt deviation from target)



Sources: Consensus Economics, Haver Analytics, Bloomberg. Consensus forecasts are for 5-year ahead inflation. The "estimated latest" column adds the change in long-term break-even inflation expectations since January to the consensus expectations in January. Latest break-even inflation expectation is as of 3/31.

## US monetary policy surprise and EM gov't bond spreads (percent change with 95 pct confidence interval)

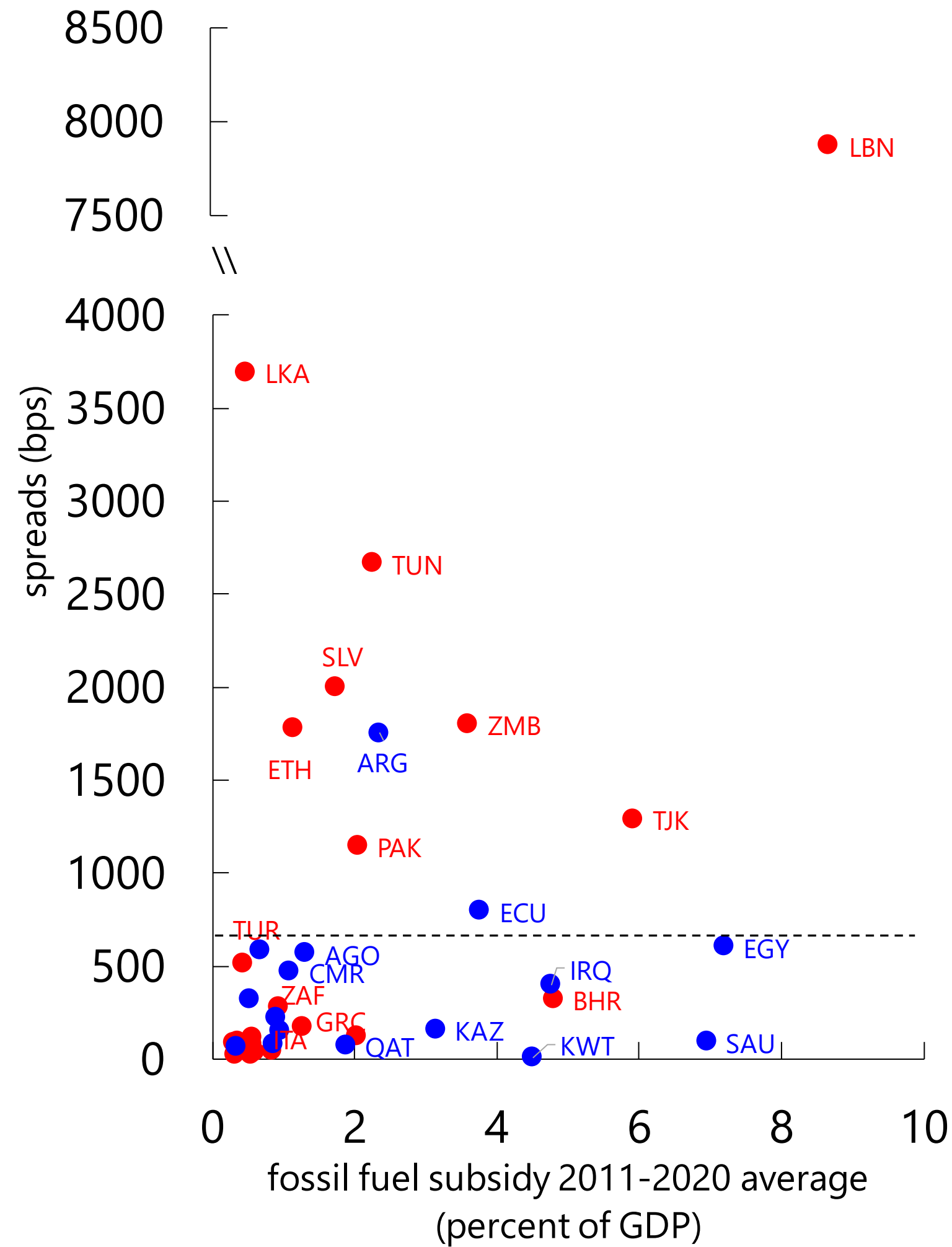


Sources: Gourinchas et al. 2021, "Fiscal Policy in the Age of COVID: 'Does it Get in all of the Cracks?'," prepared for the 2021 Jackson Hole Economic Symposium.

# Policy challenges: manage vulnerabilities in EM and LICs

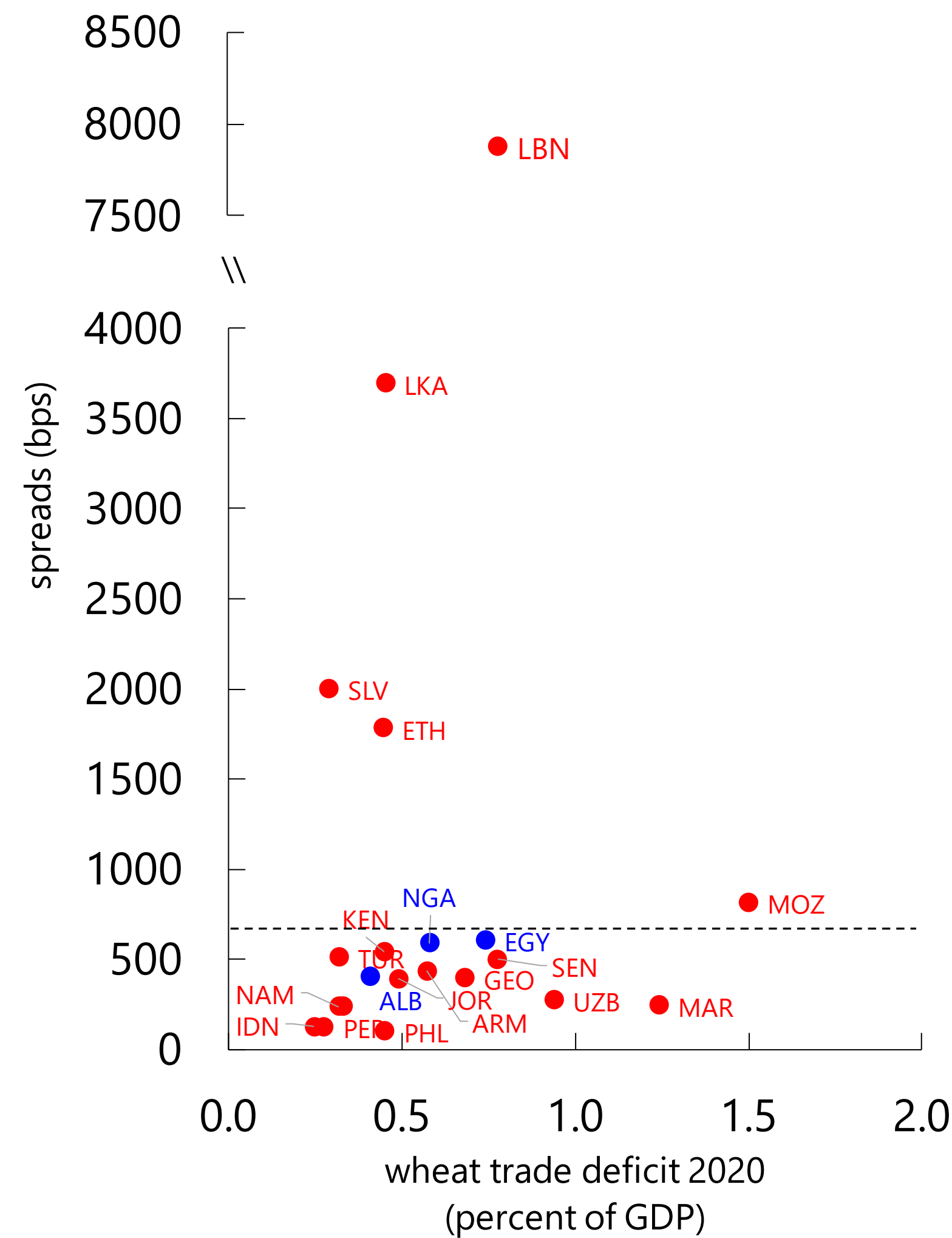
## Fossil fuel subsidy and spreads

(red dots indicate net oil importers)



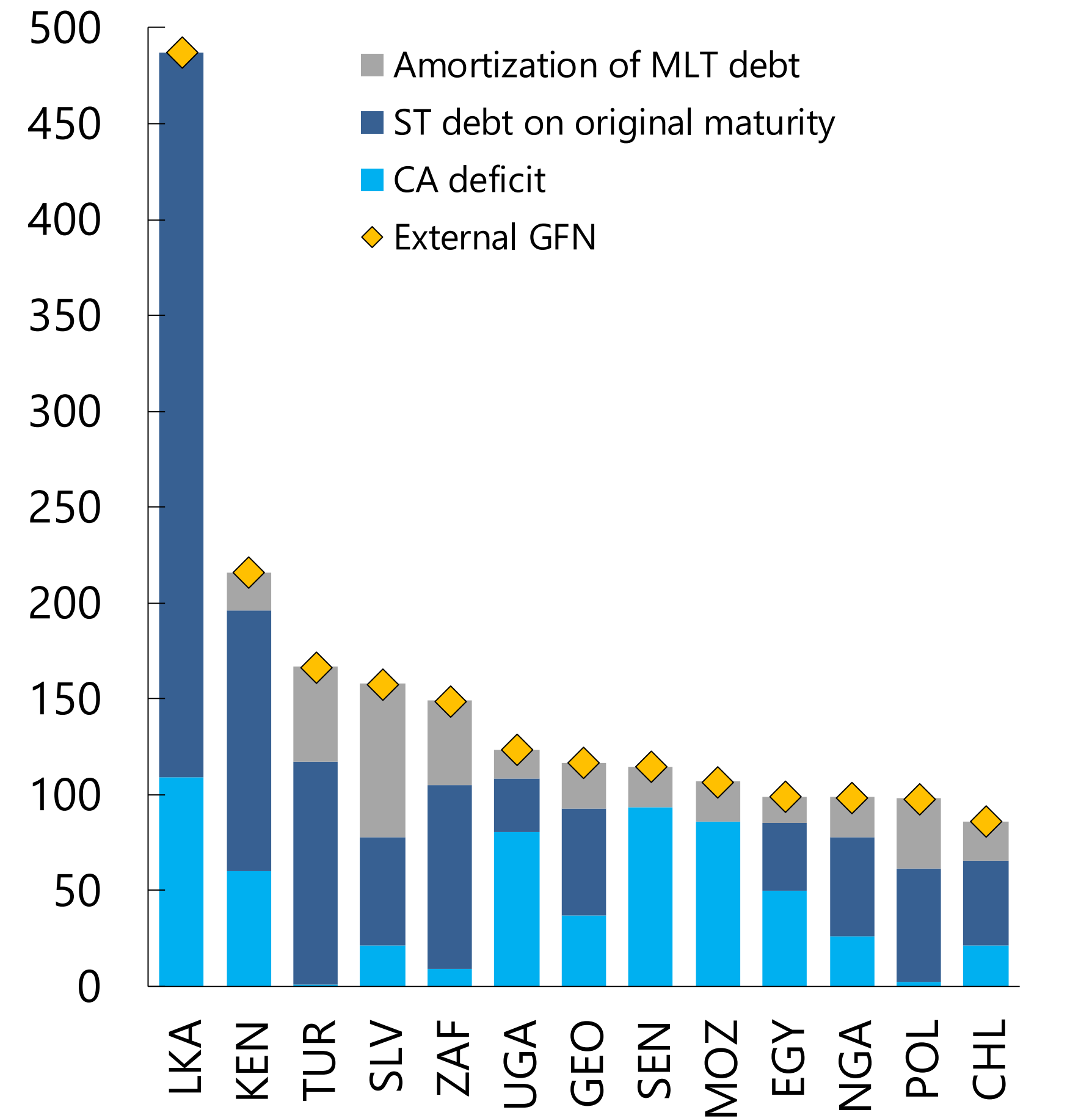
## Wheat trade balance and spreads

(red dots indicate net oil importers)



## Projected external gross financing needs, 2022

(percent of reserves; based on January 2022 WEO)



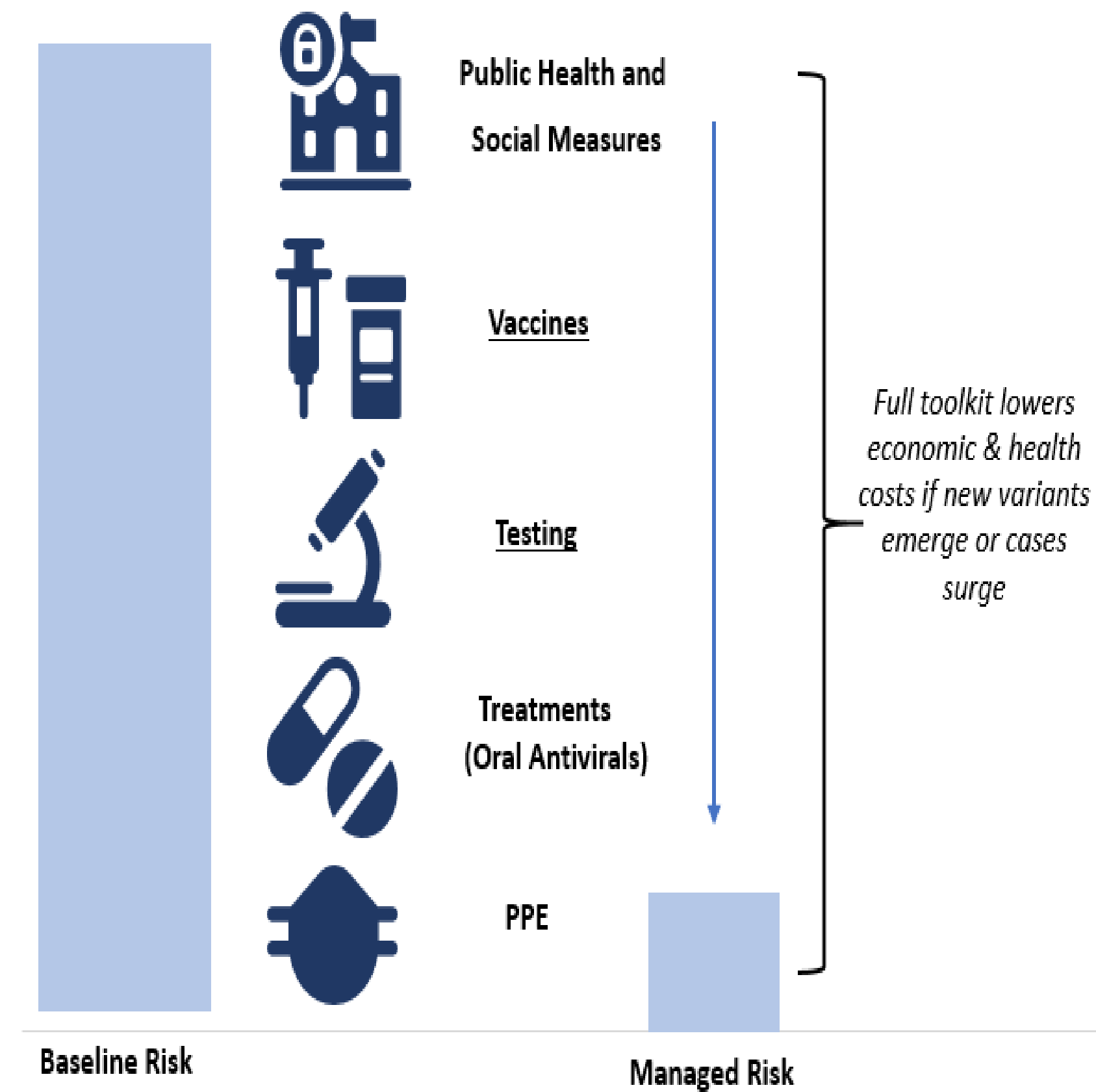
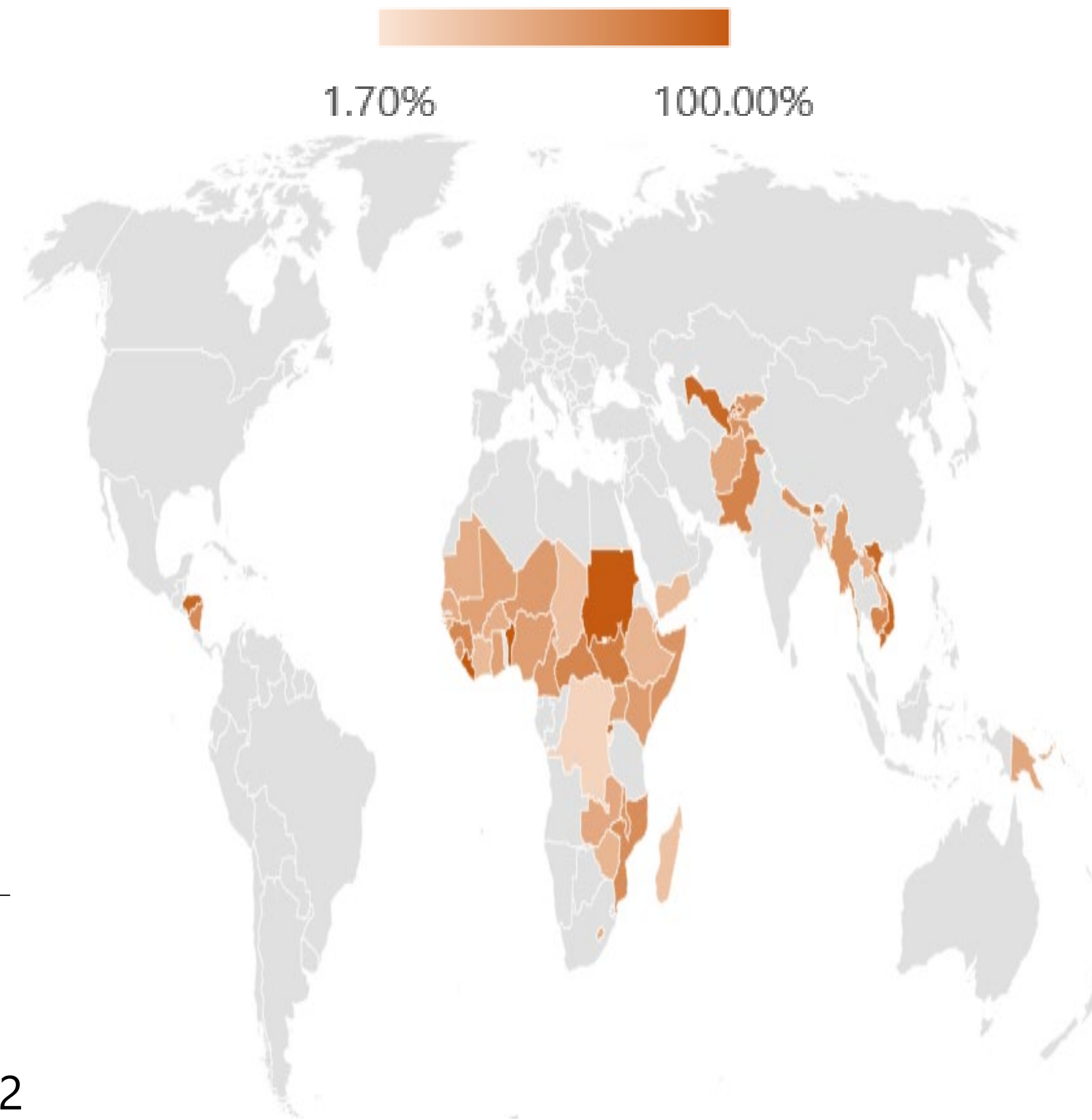
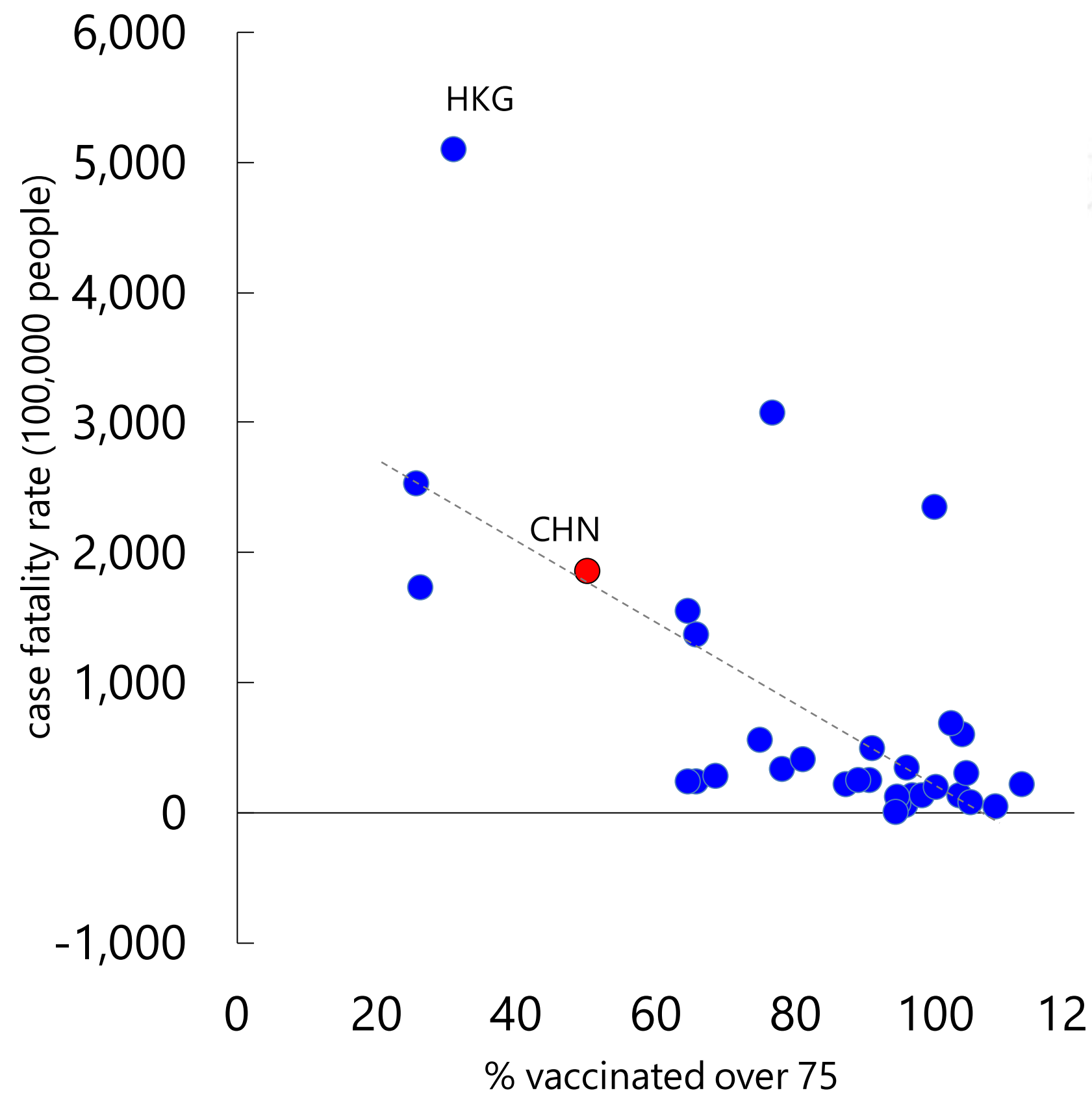
Sources: Bloomberg, L.P.; National Bureau of Statistics Nigeria; and IMF staff calculations.

# Policy challenge: Enhance access to comprehensive COVID tools

**With only 50% of people over 75 vaccinated in China, there are large health risks as Omicron spreads**

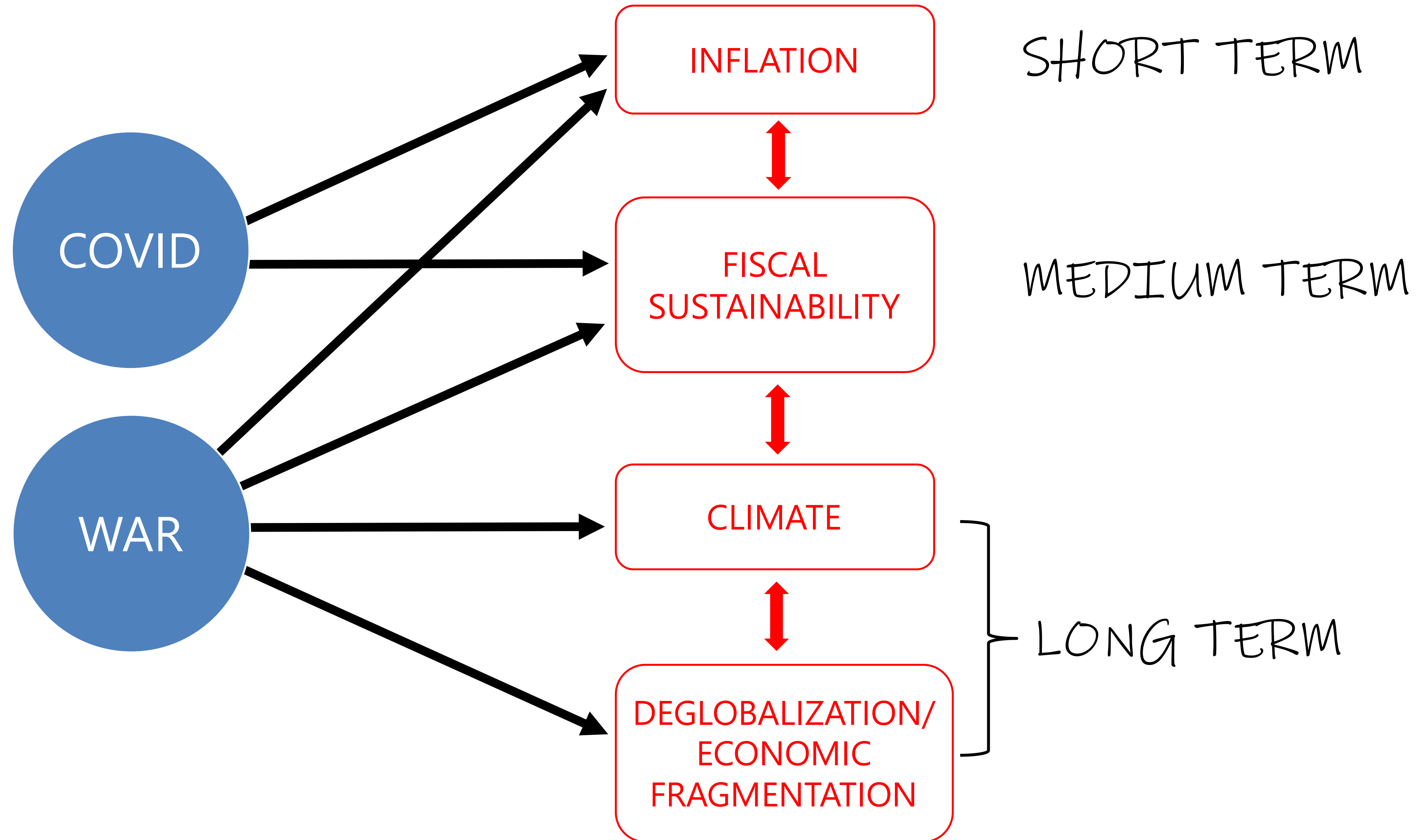
**Median LIC African country administered about 50% of vaccines received**

**Countries should plan on using the full toolkit of available options to lower the impact of future variants**



Sources: Our World in Data, CDC and NHC; and IMF staff calculations.

# Risks and policies interact



# Policy recommendations

*Ending the war and bringing back peace is the first priority. In addition:*

## **Prevent inflationary pressures from becoming entrenched**

- Manage the delicate trade-off between fighting persistent inflation and safeguarding the recovery.
- Act decisively to avoid an unmooring of inflation expectations and bring inflation credibly back to target.
- Remain data-dependent, watch key variables: labor market tightness, inflation expectations, commodity prices.
- Communication is essential to ensure orderly market reaction.

## **Manage spending pressures under reduced fiscal space**

- Where health conditions permit, continue to ease out of broad pandemic-era support towards policy normalization.
- In view of high energy and food prices, use targeted and temporary transfers, or lump-sum utility bill discounts.
- If appropriate, allow gradual pass-through (e.g. for food and cooking fuels); tax breaks need sunset clauses.
- Commit to eliminate fossil fuel subsidies and increase carbon prices gradually to deliver on Paris commitments.
- Priorities should be accommodated within medium-term fiscal frameworks, ensuring fiscal sustainability.

## **Multilateral cooperation and investment in the future**

- Coordinate responses and G-20 support to attenuate the humanitarian consequences and preserve food security.
- Pandemic requires a toolkit: monitoring, tests, vaccines, and treatment. Other diseases should not be forgotten.
- Address the climate crisis in the context of elevated food and energy prices, provide workers and communities with tools to gain from the green transition.
- Maintain global liquidity and improve sovereign debt resolution essential for a well-functioning financial system.
- Enhance international cooperation to support tax revenue mobilization and financing for development (incl. RST)
- Boost long-run productivity by building on pandemic-era digitalization gains.
- International institutions, incl. IMF, must help prevent-economic fragmentation and support poorest countries.



# International Monetary Fund

April 1, 2022



## World Economic and Market Developments

*Tobias Adrian*

*Financial Counsellor and Director  
Monetary and Capital Markets Department*

# Complicated Trade-offs Amid Uncertain Geopolitics

- **The repercussions of the war in Ukraine will test the resiliency of the financial system.**
- **Financial stability risks have risen and the balance of risks to growth has tilted to the downside.**
- **The commodity shock complicates the monetary policy normalization process.**
- **Greater differentiation across EMDEs put further pressure on portfolio flows....**
- **... amid unresolved pandemic-related challenges, high financing needs and limited fiscal space.**
- **The conflict brings several medium-term structural issues to the fore (energy security, Mkt functioning...).**
- **It's crucial to intensify efforts toward the climate transition while addressing energy security concerns.**

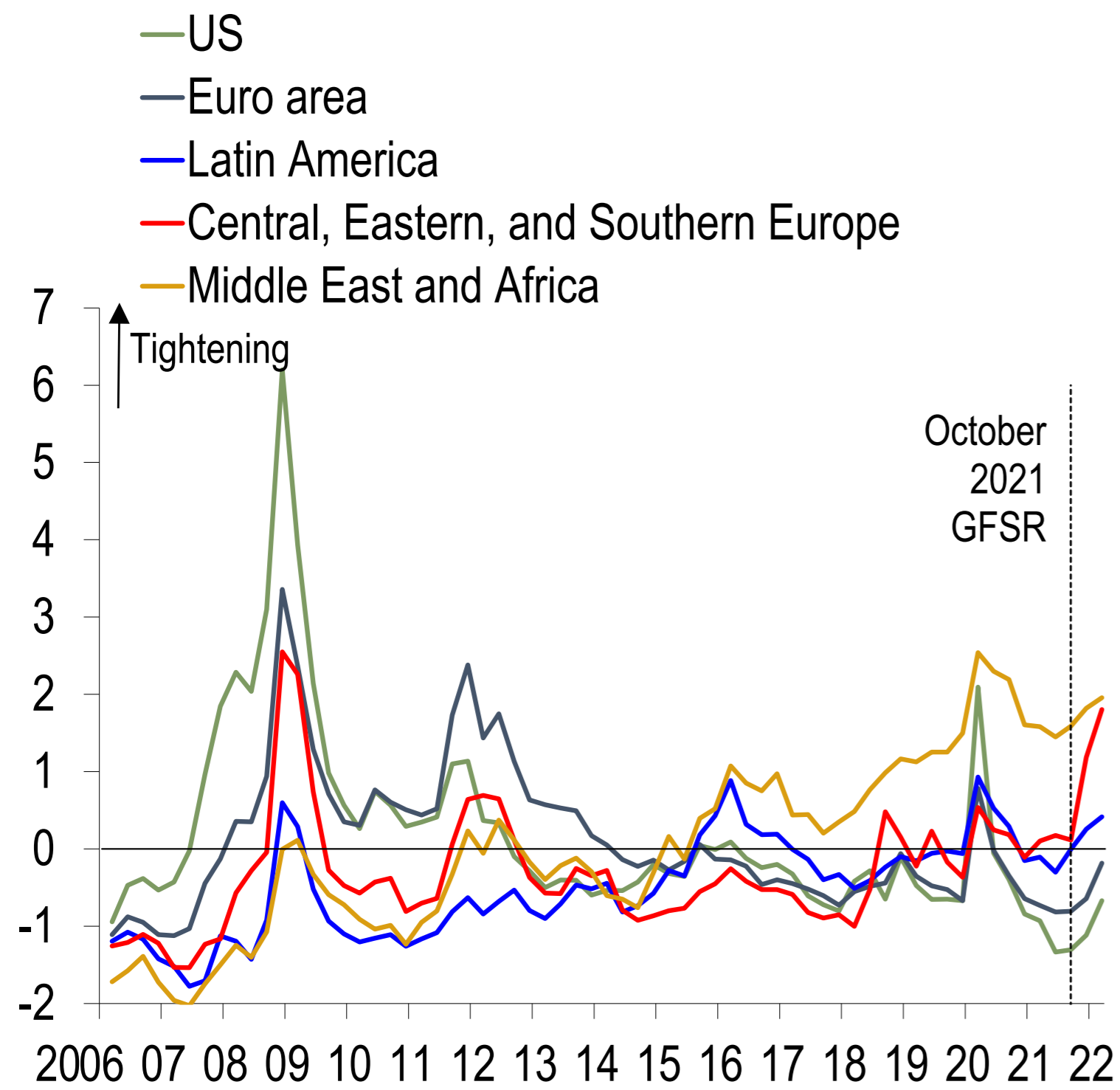
# Tightening of Financial Conditions and Downside Risks to Growth

*Financial conditions have tightened, especially for countries with close ties to Russia*

*Downside risk to growth have increased meaningfully*

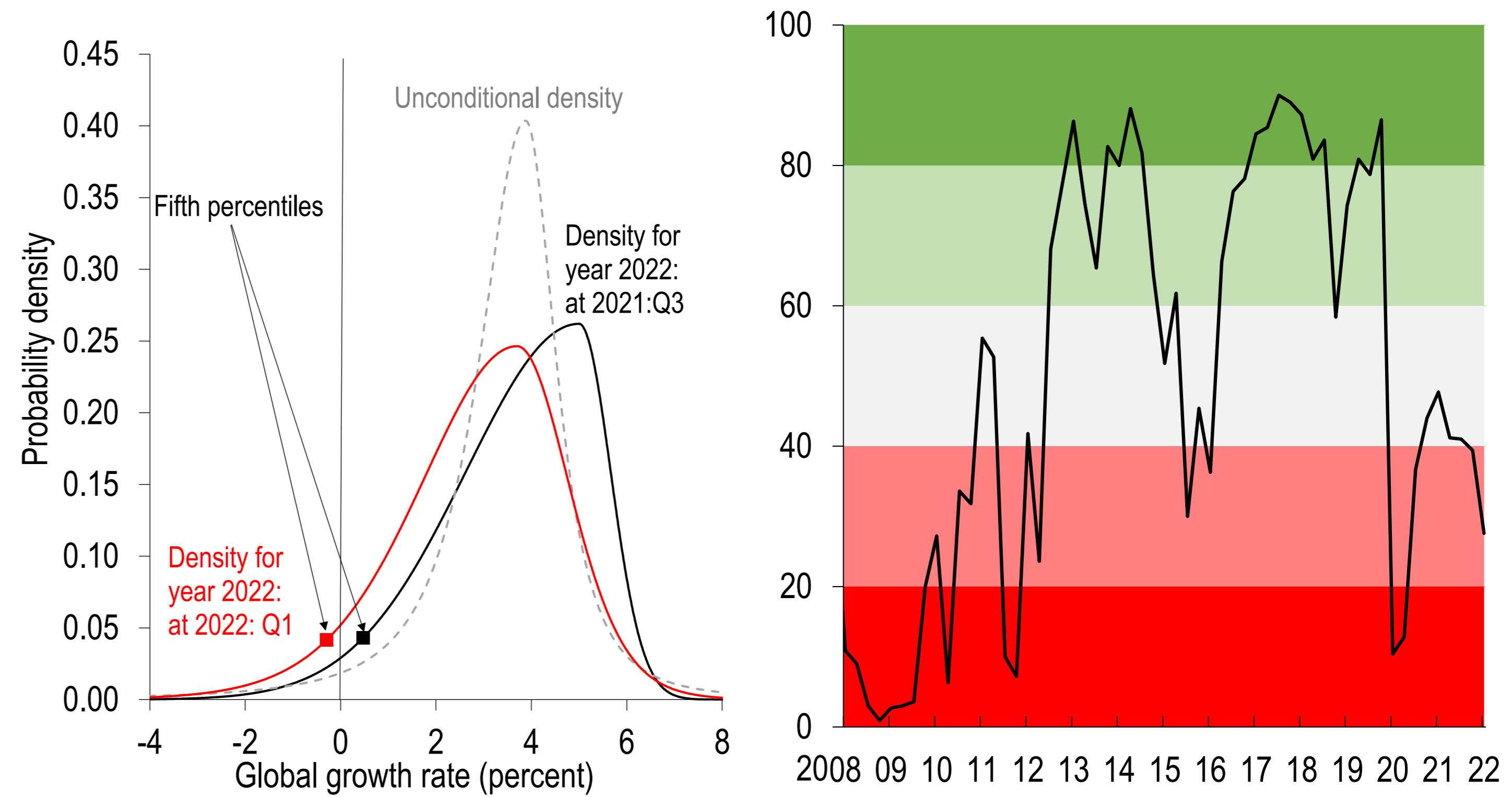
## Financial Conditions

(Standard deviations from the mean)



## Near-Term Growth-at-Risk Forecasts and Densities

(Probability density, Percentile rank)



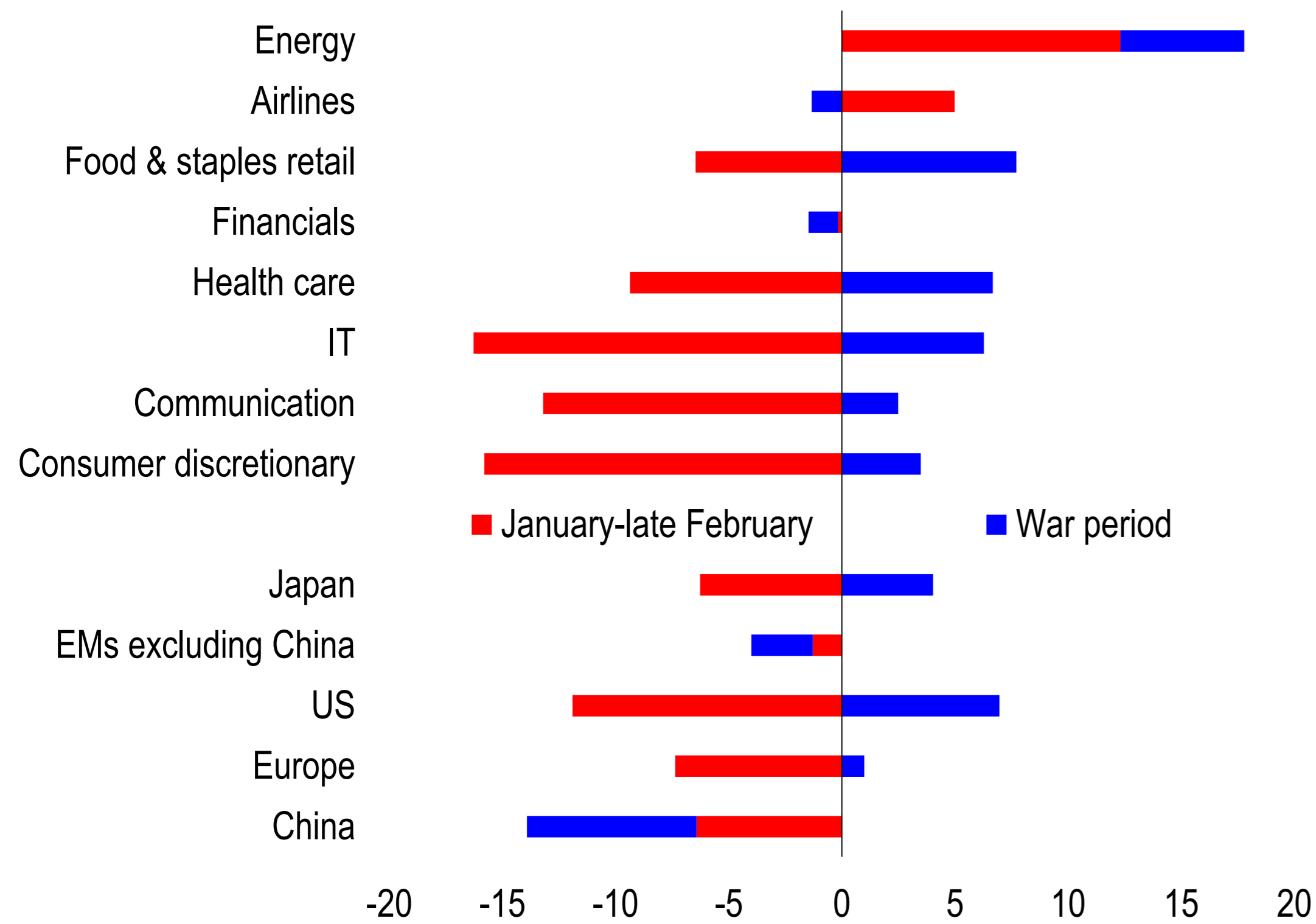
Note: AE = advanced economy; EM = emerging market; GFSR = Global Financial Stability Report.

# Impact of the Russia War in Ukraine on Financial Assets

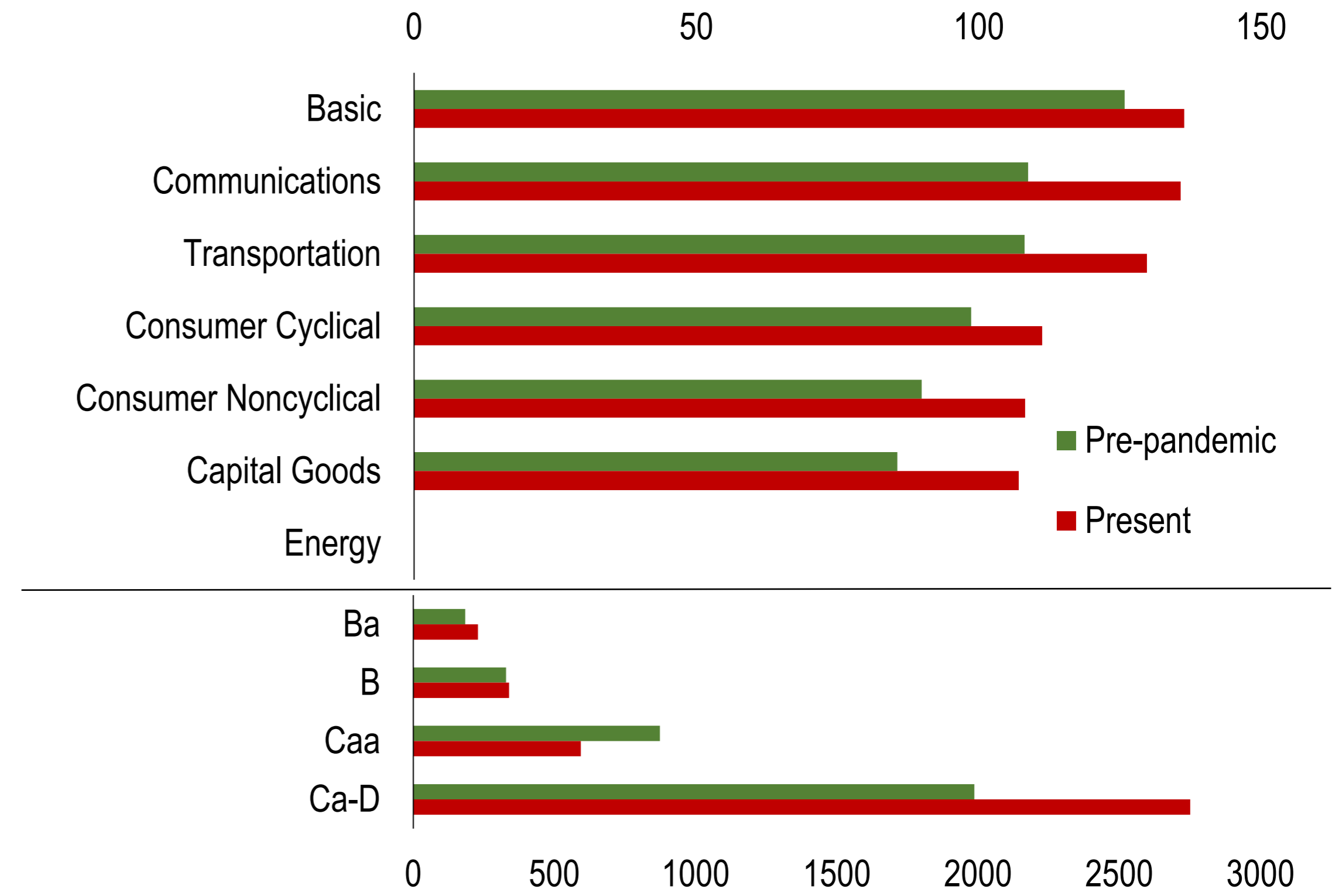
*Equities sold off in the immediate aftermath, particularly in sectors affected by commodity prices and supply chain disruptions concerns...*

*Credit spreads have widened the most in low-rated corporates*

**Global Equity Price Change in 2022**  
(Percent)



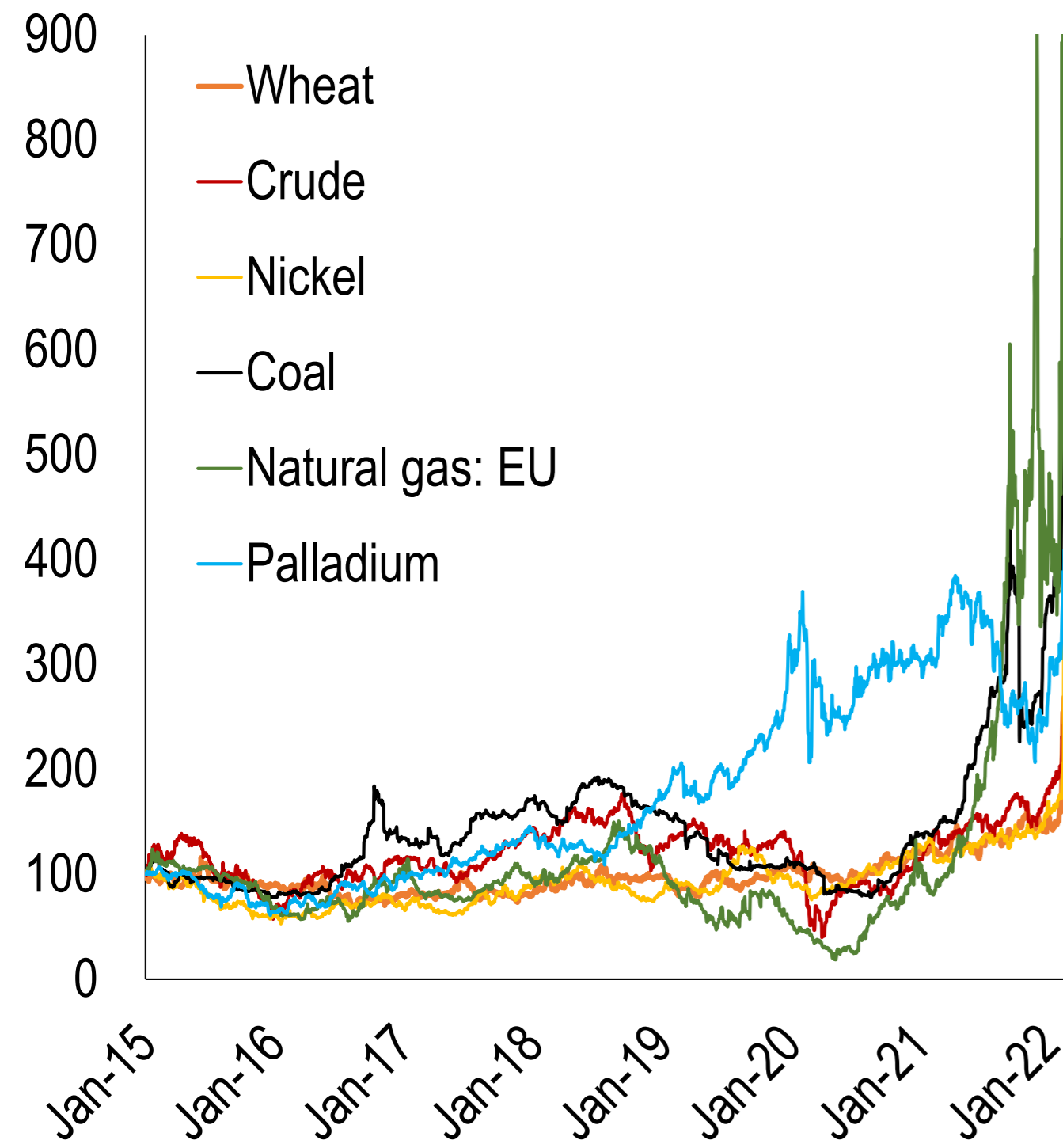
**Credit Spread levels**  
(Basis points)



# Impact of the Russian War in Ukraine on Commodities

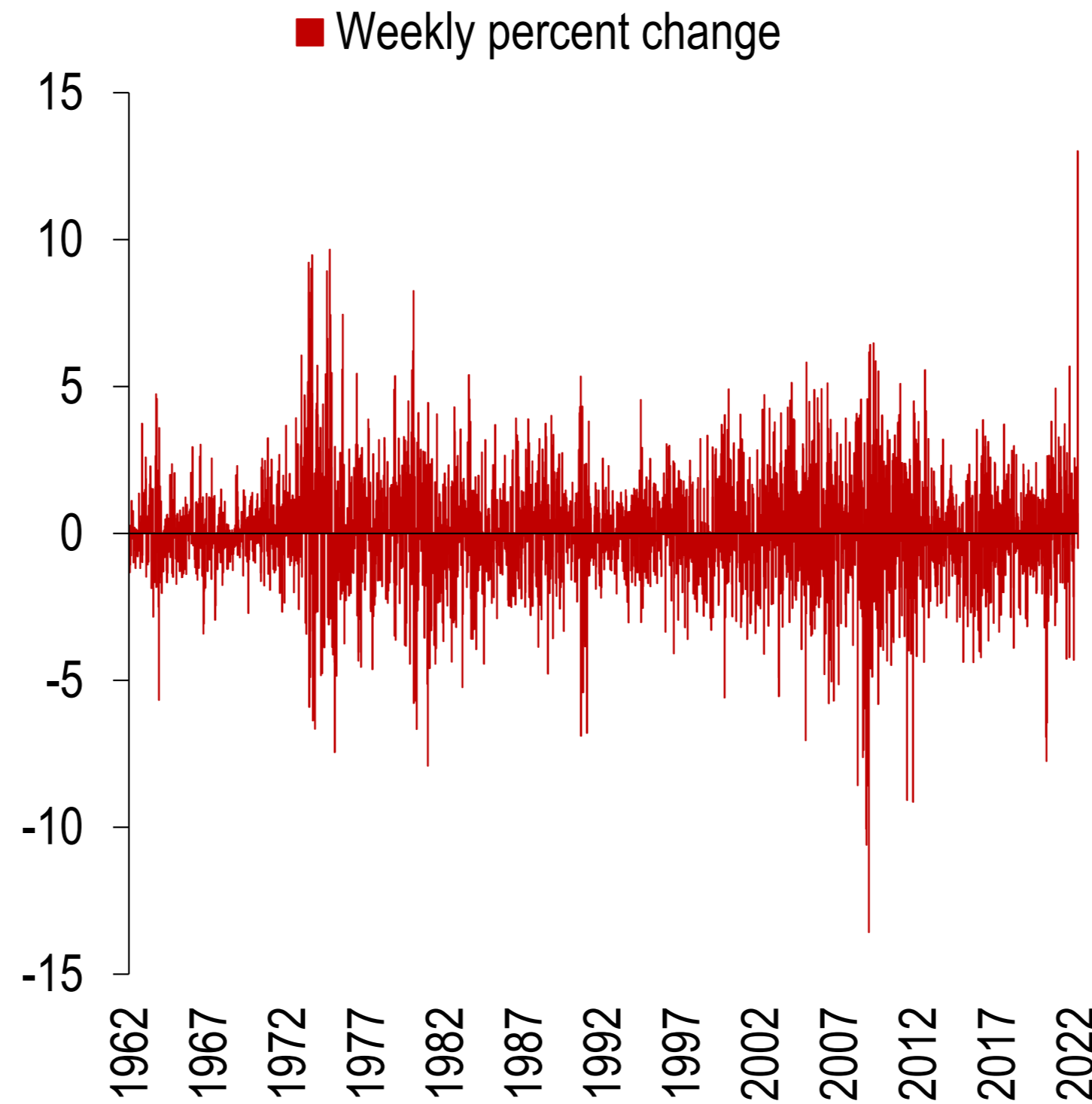
Several commodity prices rose dramatically on fears of supply disruptions

**Commodity prices**  
(Index, January 1, 2022 = 100)



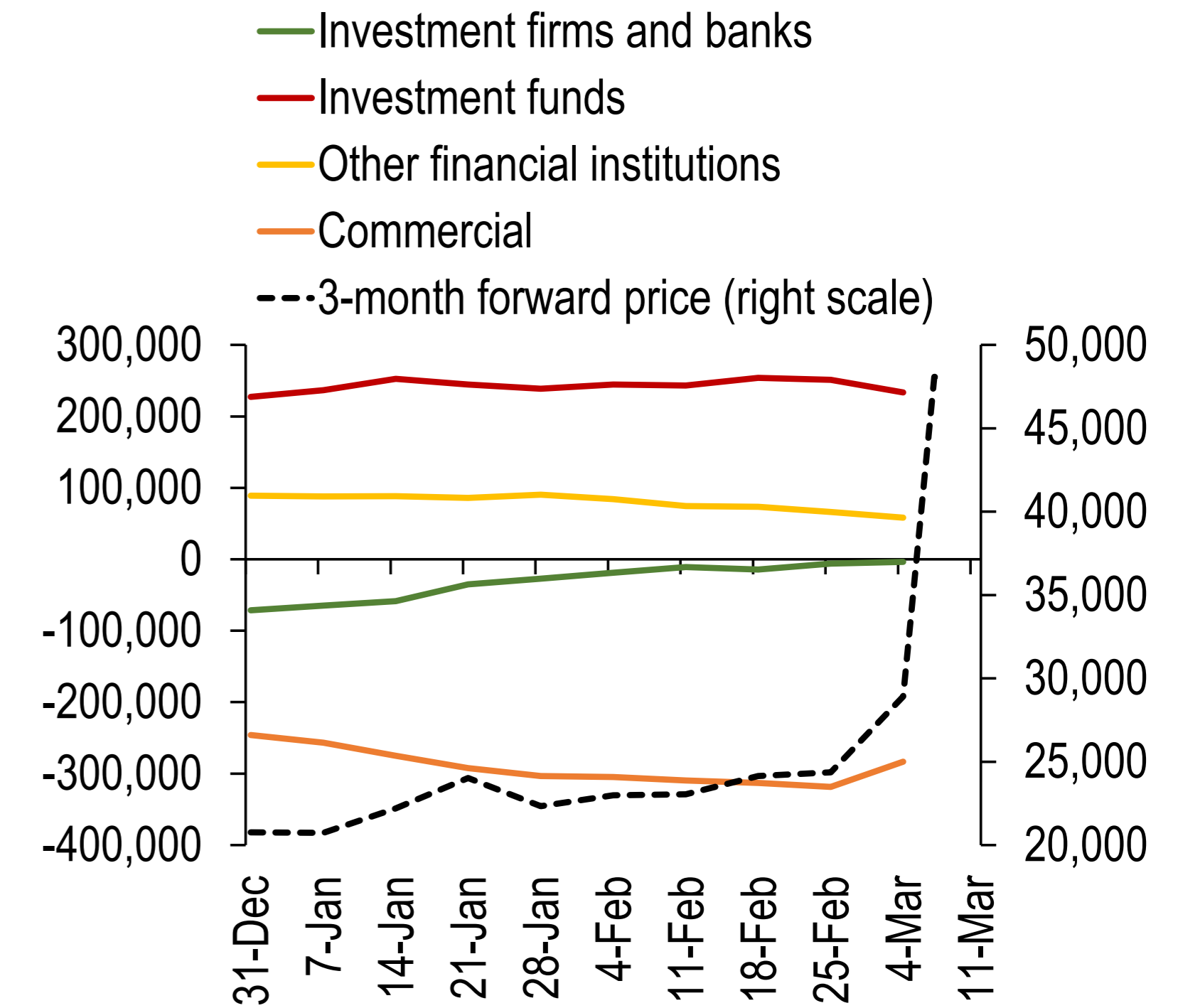
Overall volatility in commodity markets surged

**Commodity price change**  
(Percent)



Nickel producers consistently run a short derivatives position for hedging

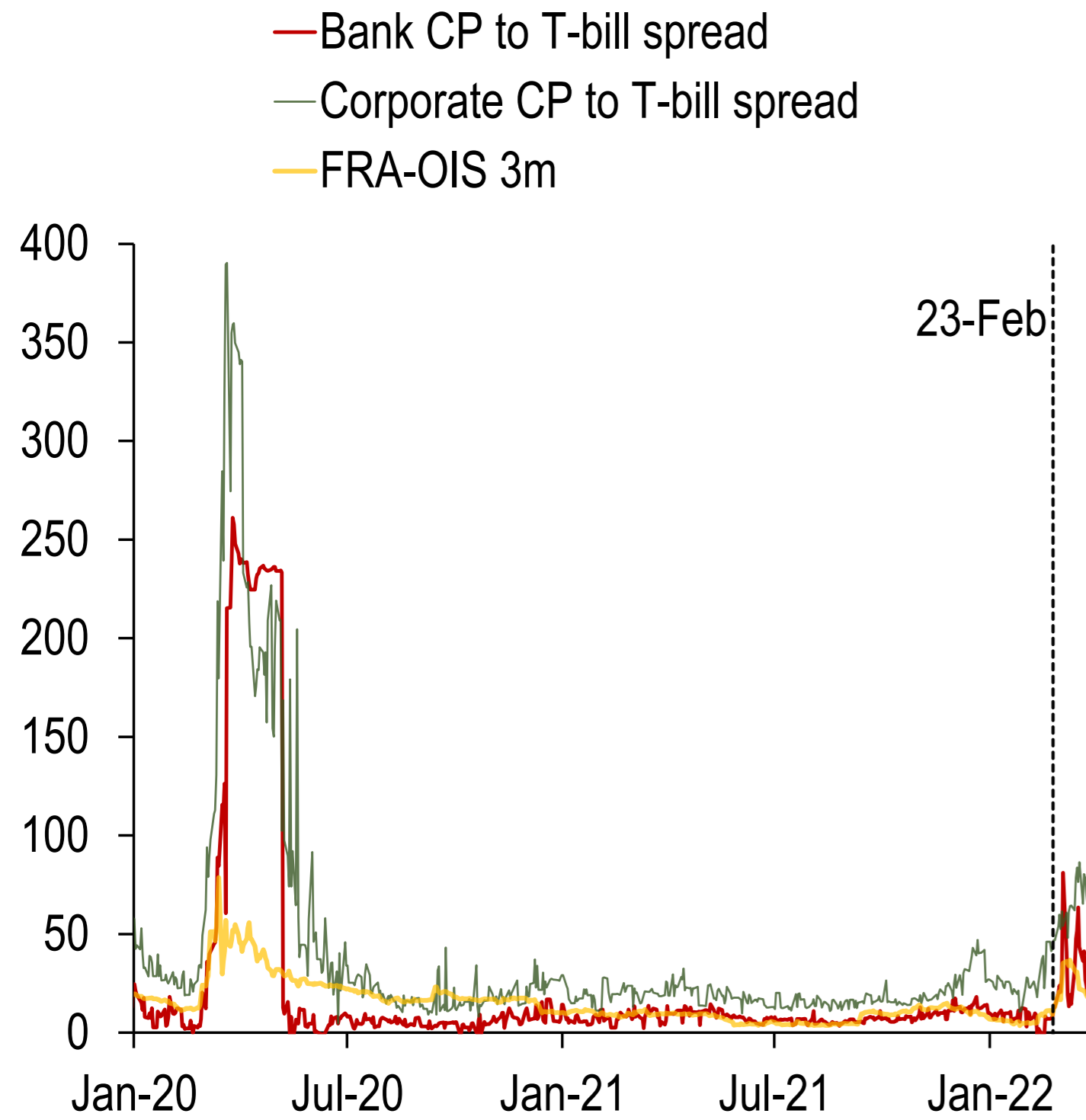
**Net trader positions and forward price of nickel derivatives**  
(Metric tons, left scale; US dollars, right scale)



# Some Short-Lived Tensions on Funding and Liquidity Conditions

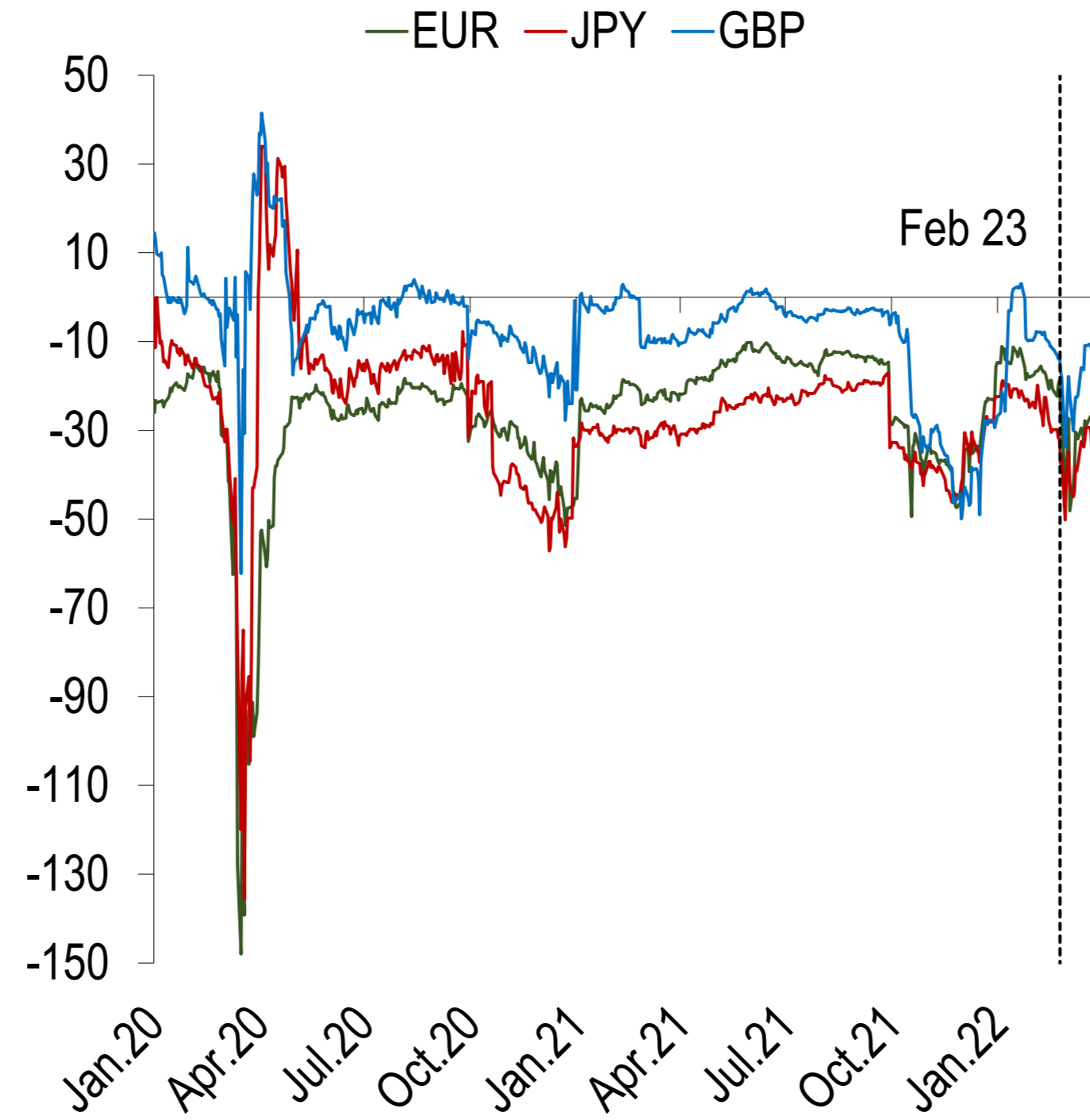
*US money market conditions have tightened while CP market functions well.*

### US Money Market Rates Spread (Basis points)



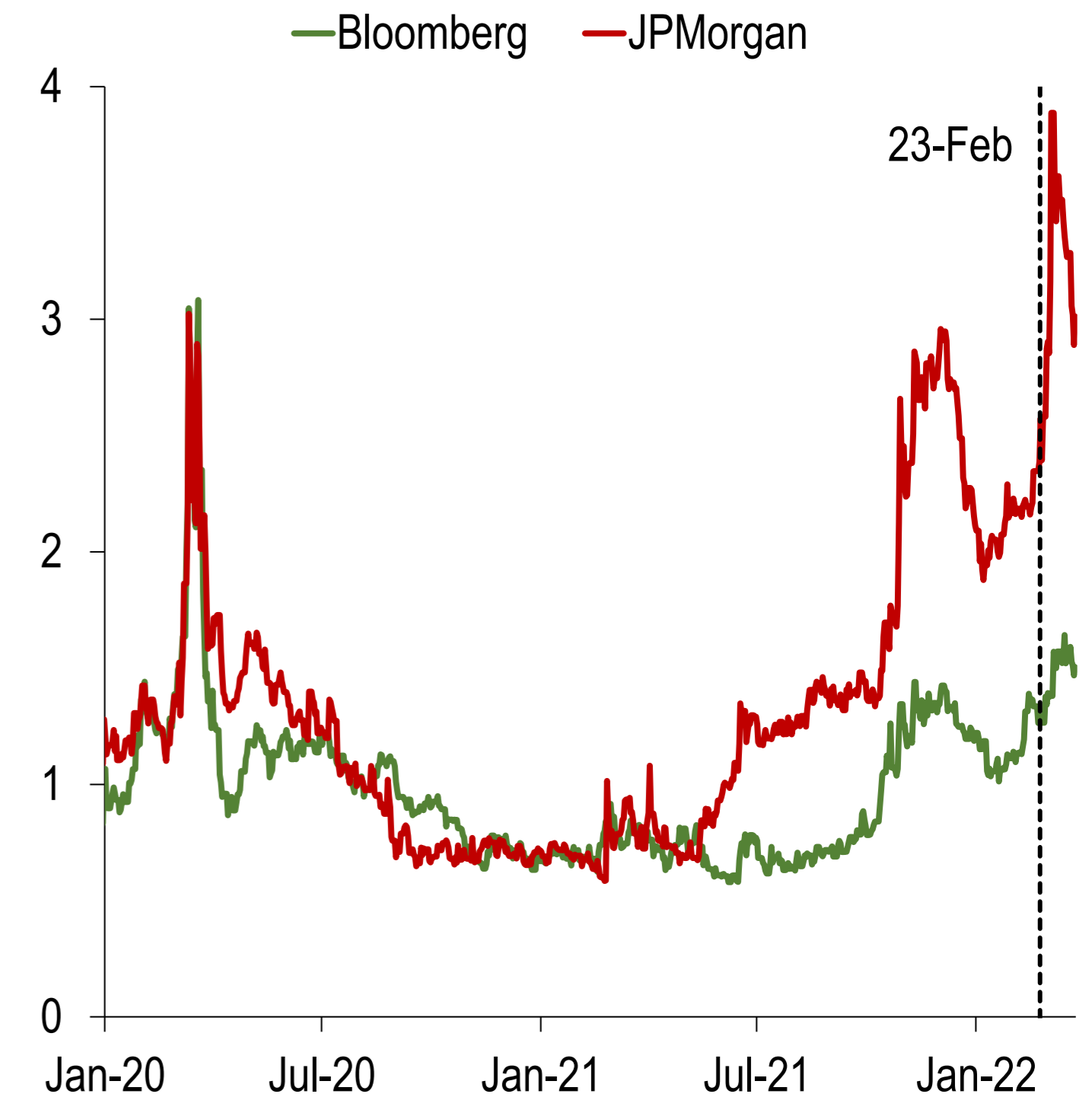
*International dollar funding conditions have also tightened somewhat*

### Cross Currency Basis Spreads 3-month (Basis Points)



*Yield curve estimated models reflect traders' unwillingness to provide liquidity*

### Liquidity Indices: Root Mean Square Error (RMSE) of the Fitted US Treasury Yield Curve (Basis Points)

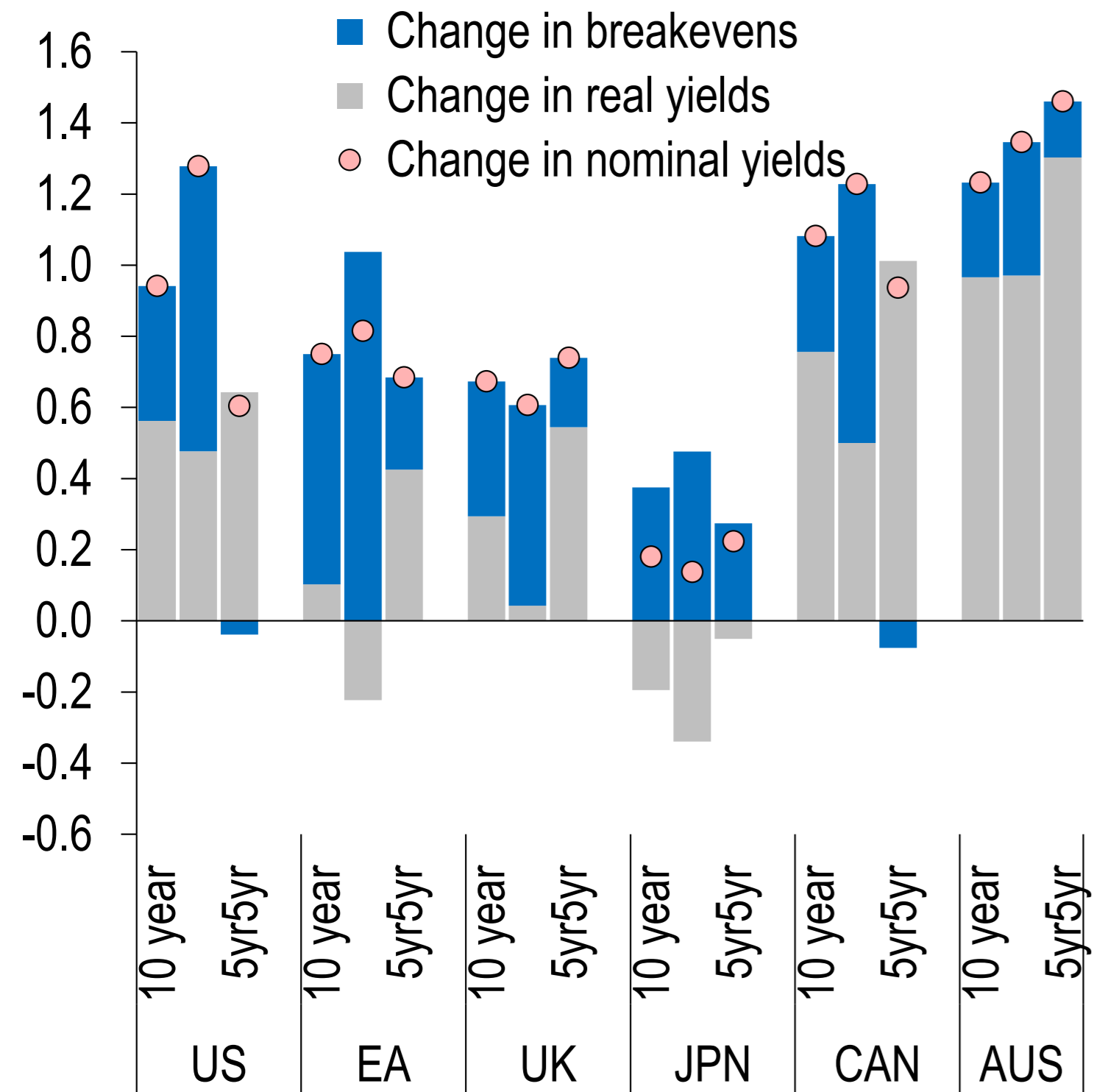


Note: LIBOR-indexed cross-currency basis spreads are used for JPY and GBP prior to October 2020 & Feb 2021, respectively.

# Inflation Pressures Have Continued to Build...

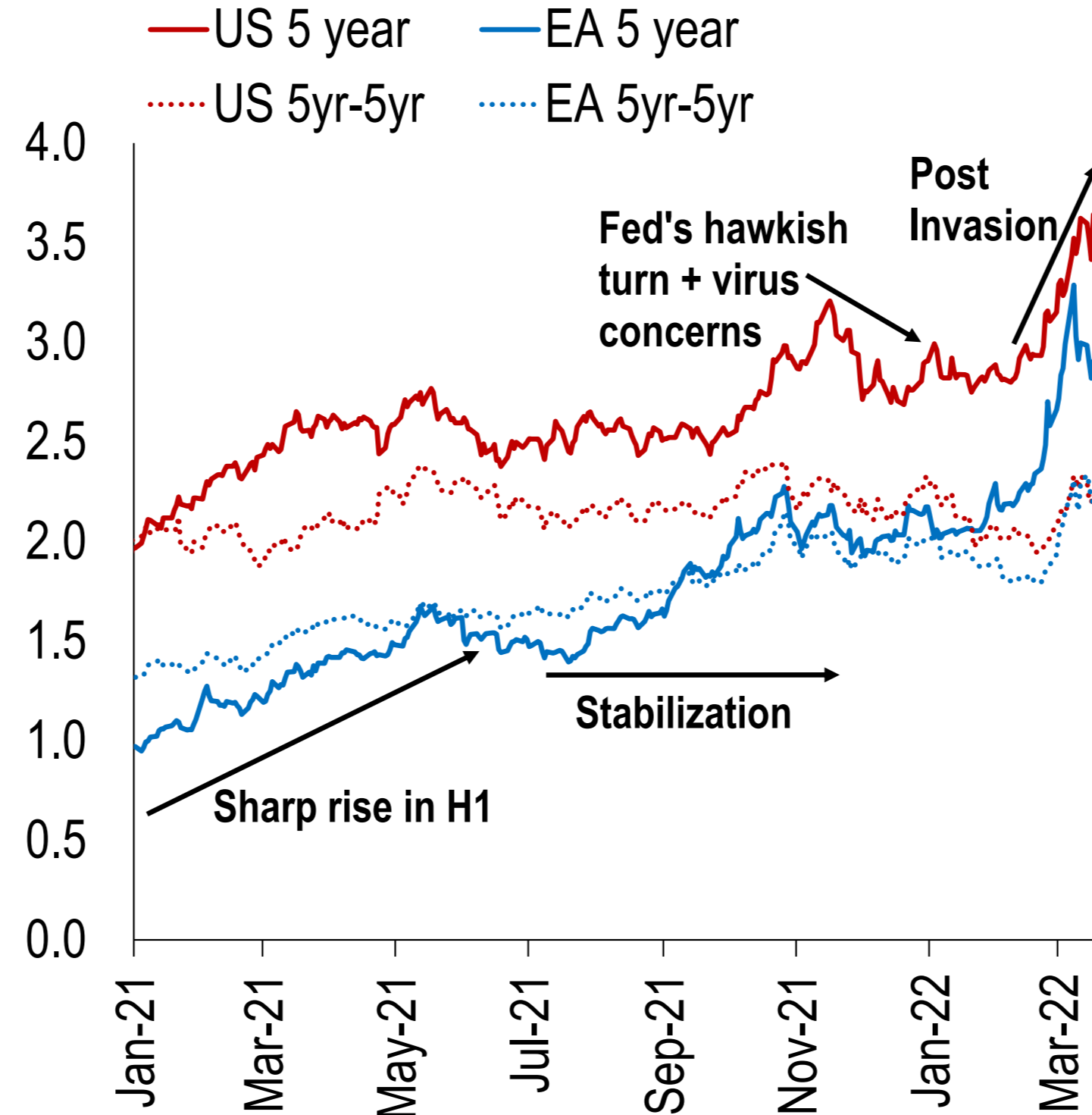
*Nominal yields have increased, mainly driven by rising breakeven, in particular in Europe*

**Year-to-date change in Advanced Economies yields (Percent)**



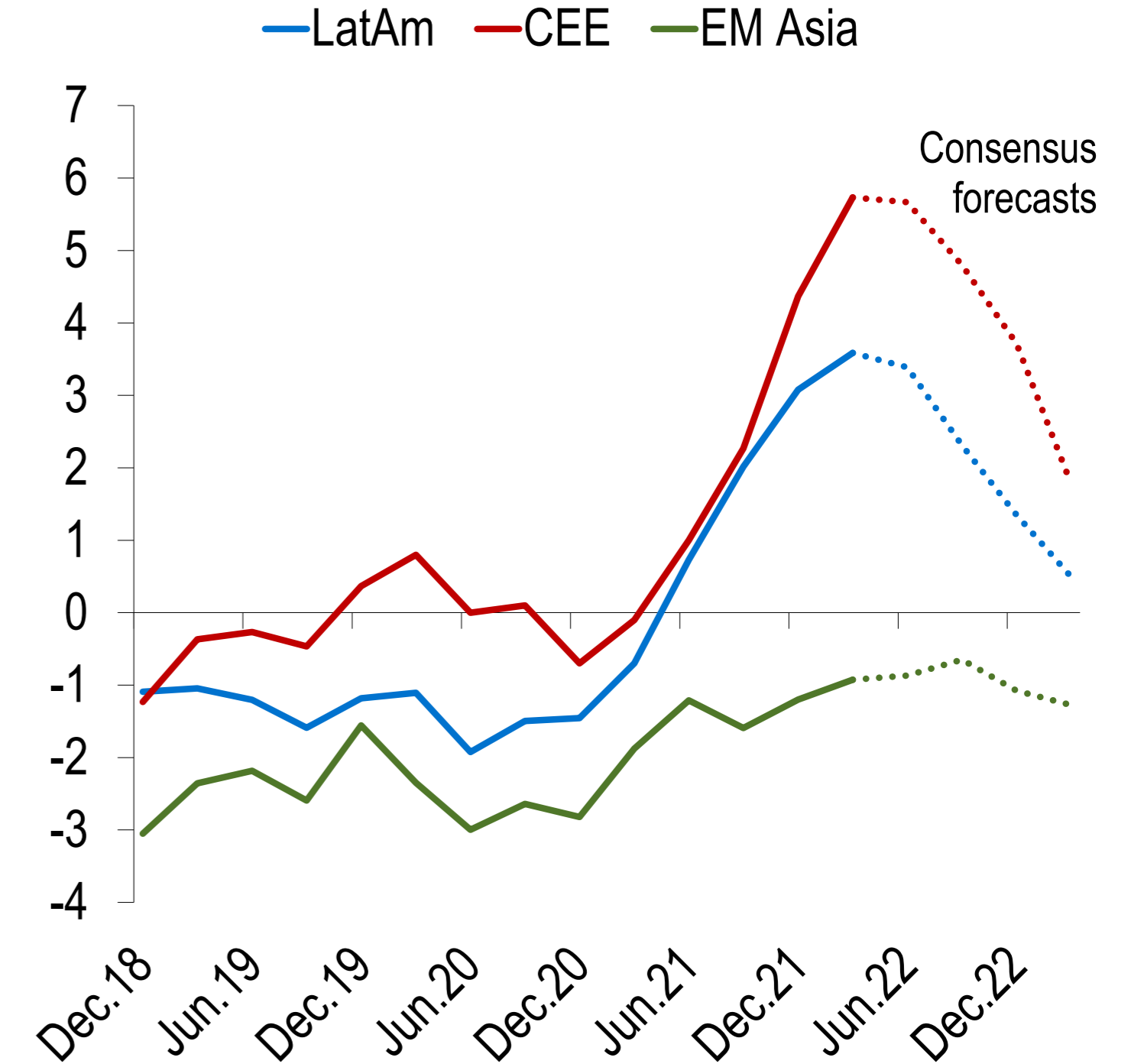
*Breakevens have increased sharply in the 5Y horizon since the invasion*

**Inflation breakeven (Percent)**



*Consensus forecasts that the inflection point for EM inflation is approaching.*

**Deviation from target inflation band (Percent, average)**



Note: Deviations are estimated from ceiling of inflation target band. EM Asia excludes China.

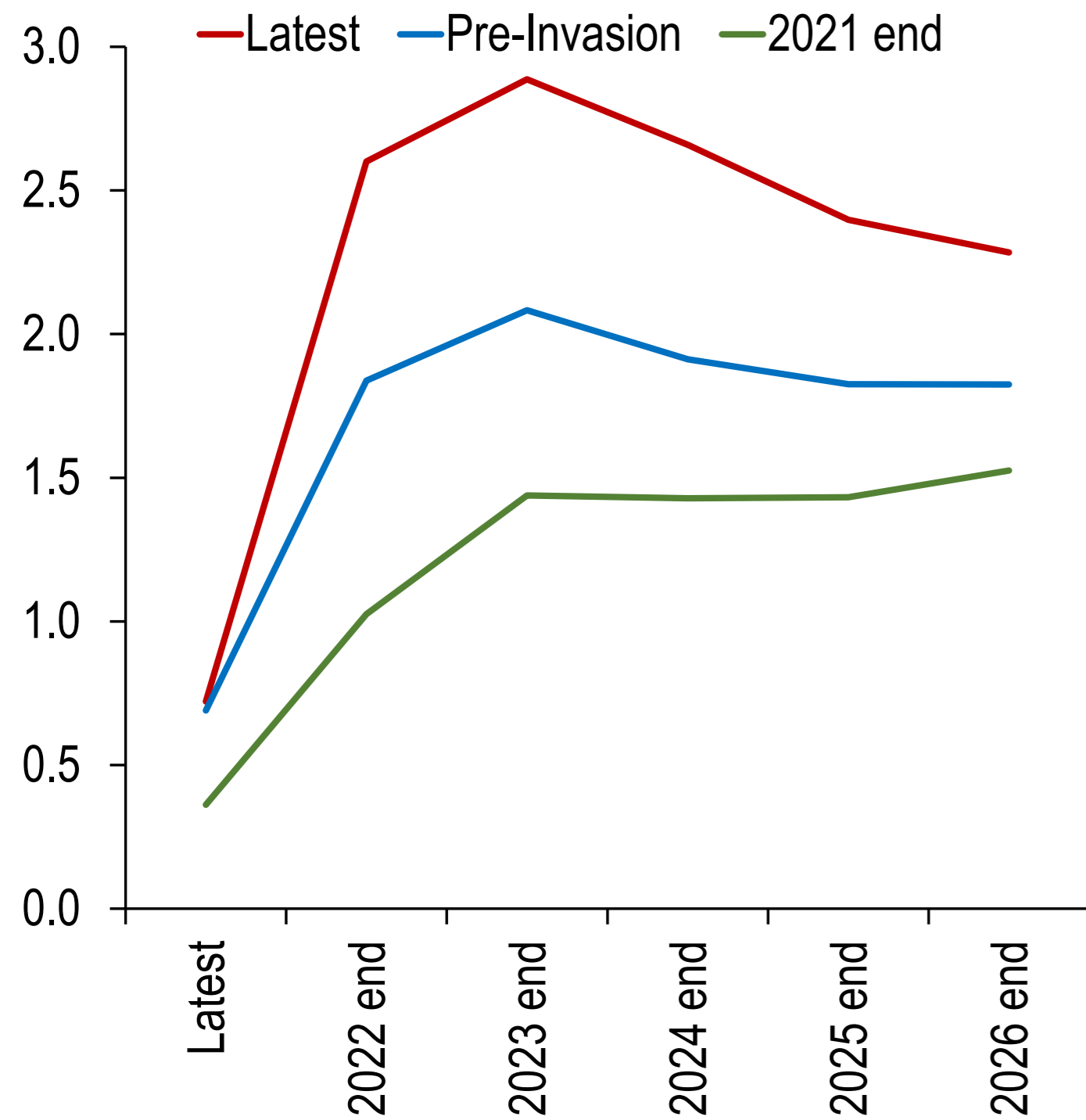
# ...Calling for Decisive Monetary Policy Action

*Expected Fed hikes have moved forward*

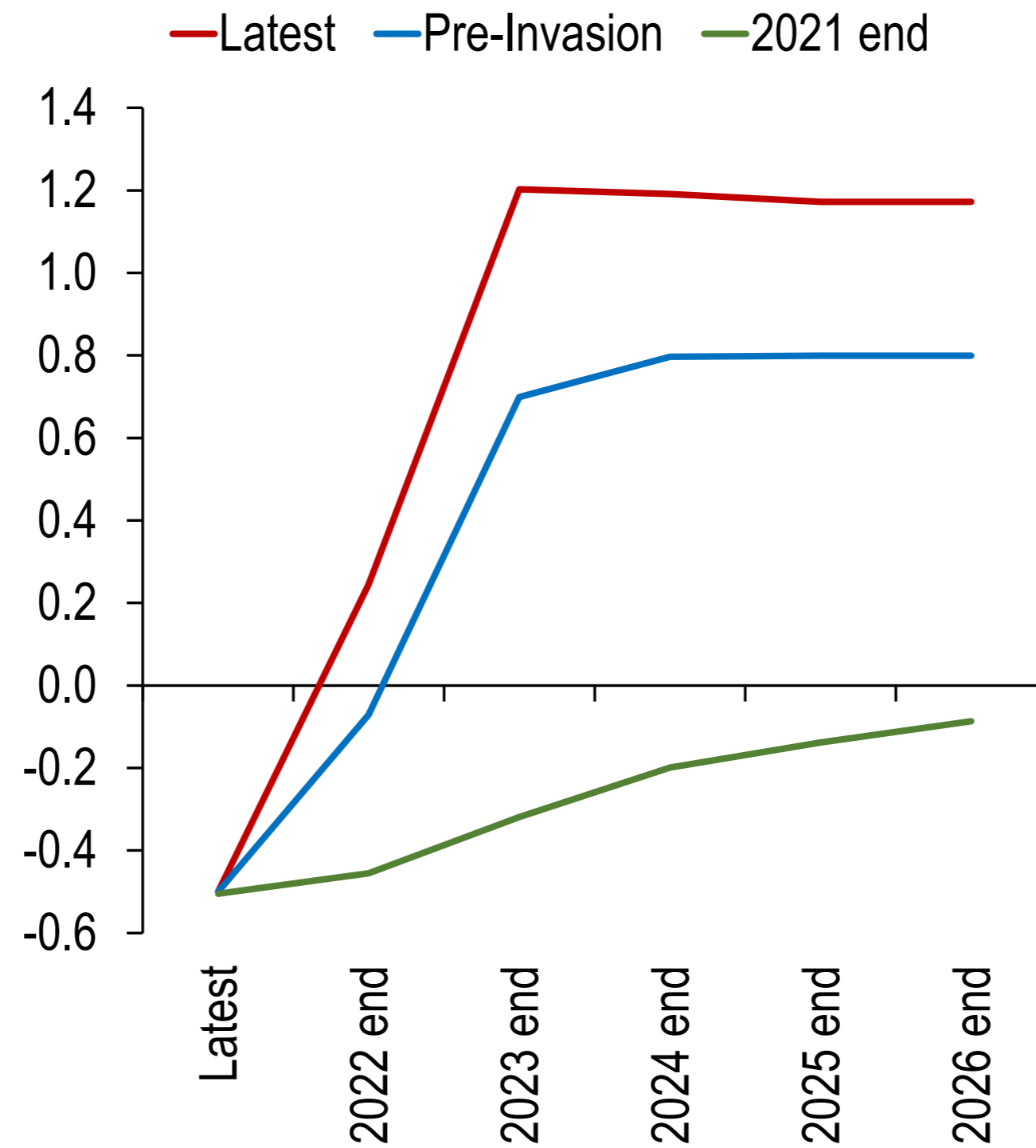
*ECB expectations have shifted higher*

*EMs expected to continue hiking for next year.*

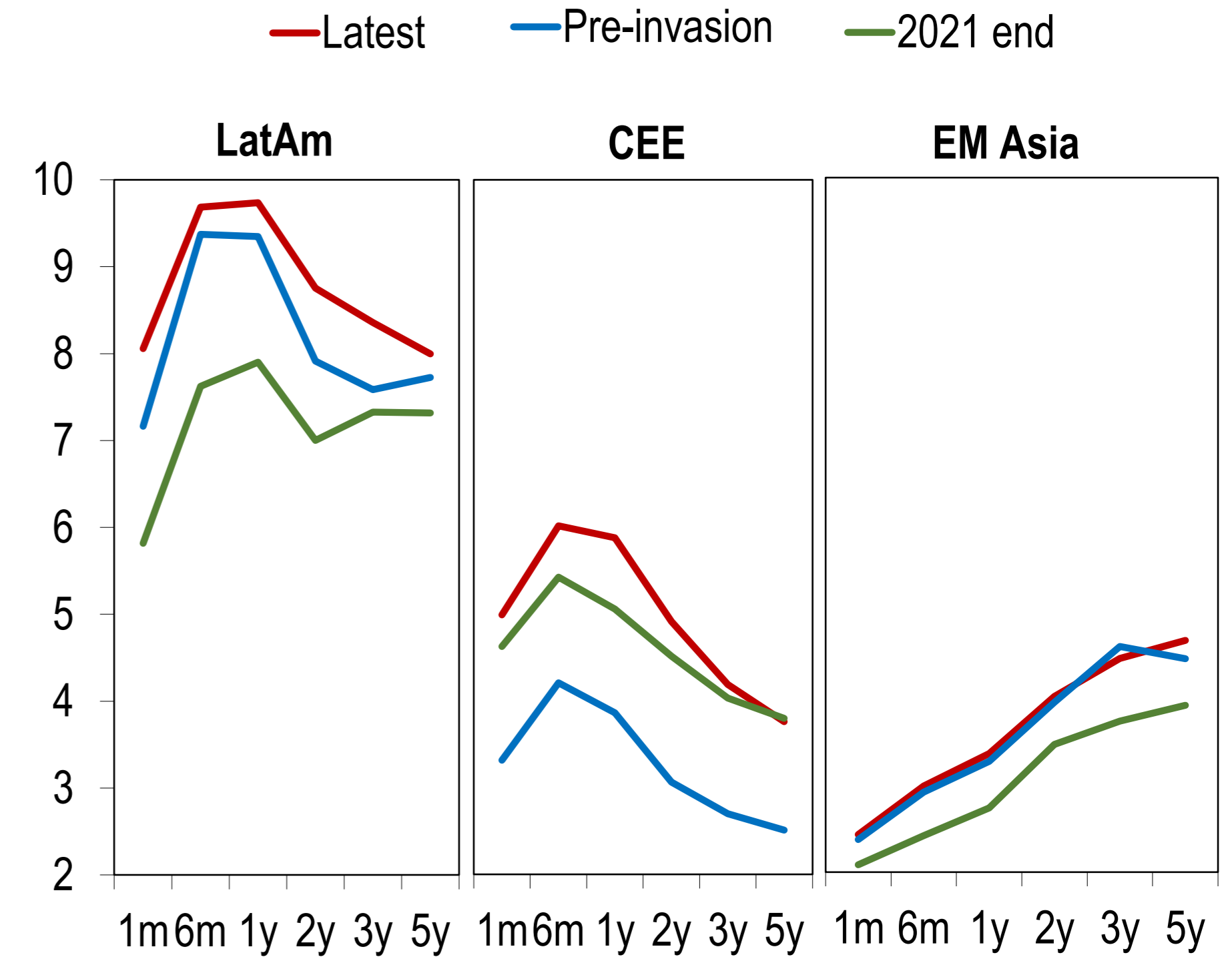
### Market implied policy rate (Percent)



### Market implied policy rate (Percent)



### Market implied policy rates (Percent, average)

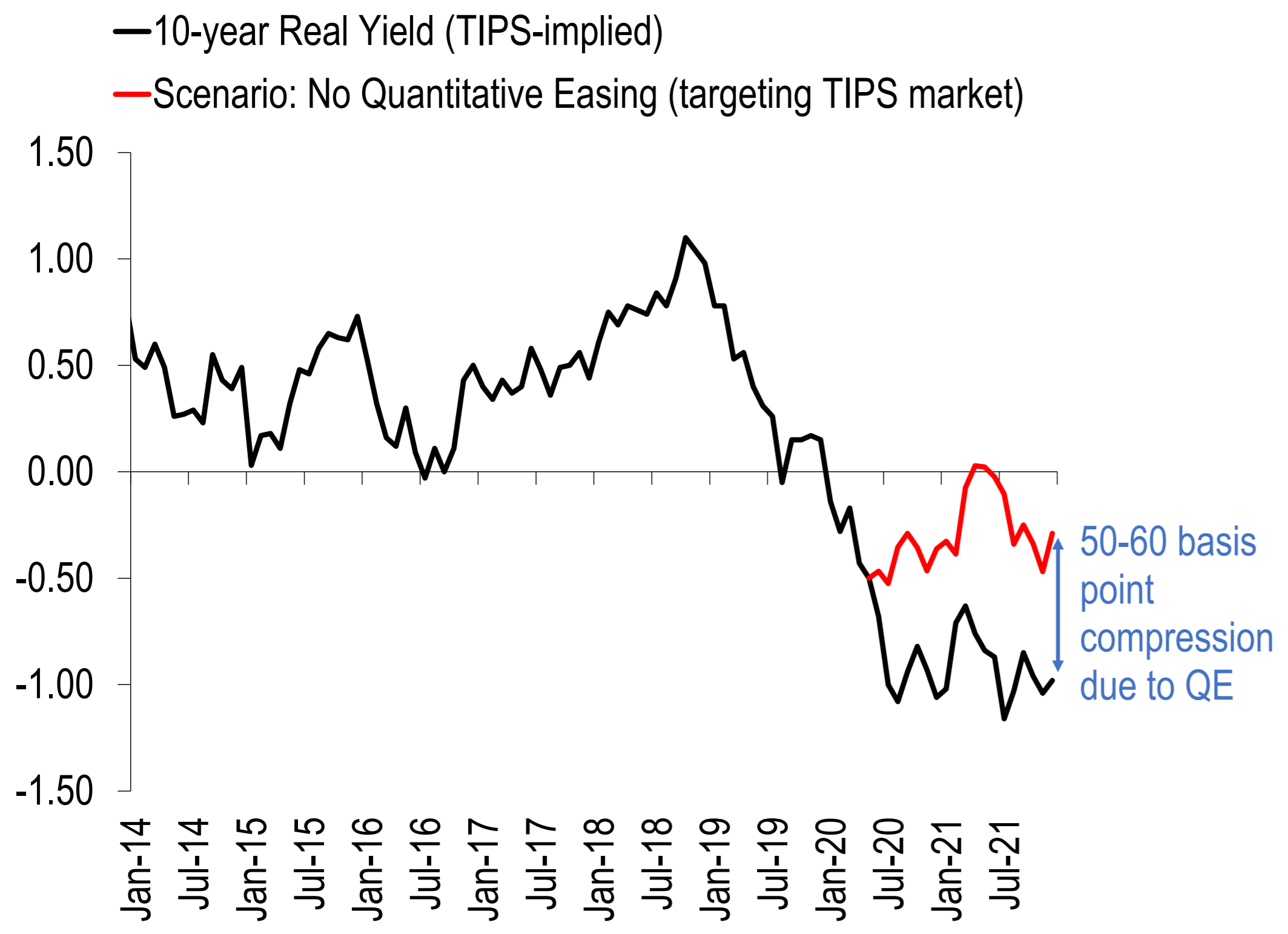


# Trying to Manage a Soft Landing

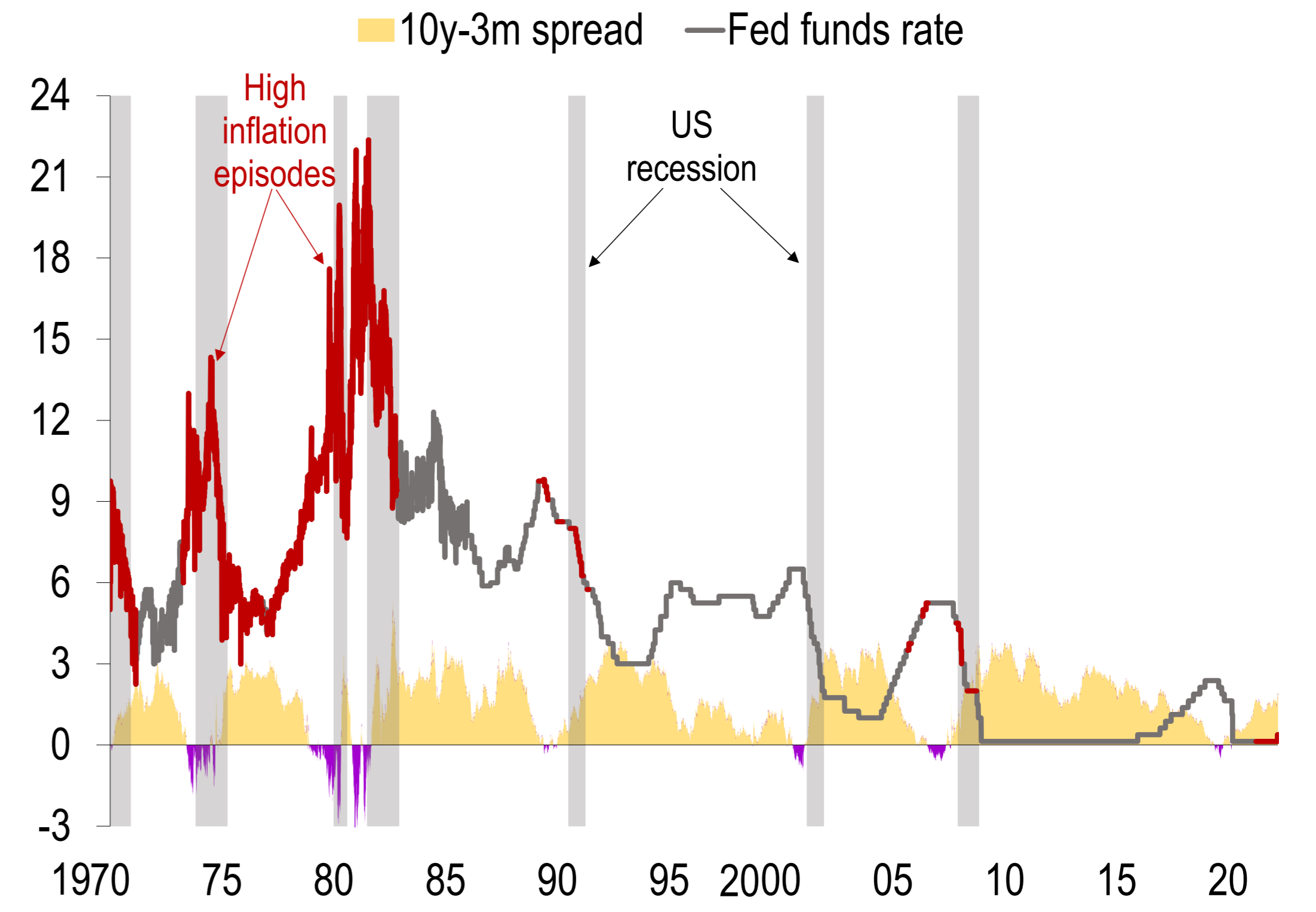
*Potential for risk repricing as the effects of QT on the path of rates remains uncertain*

*Higher inflation along with higher rates may make a soft landing more difficult*

### Impact of QT on real rates, decompression of liquidity premia (Percent)



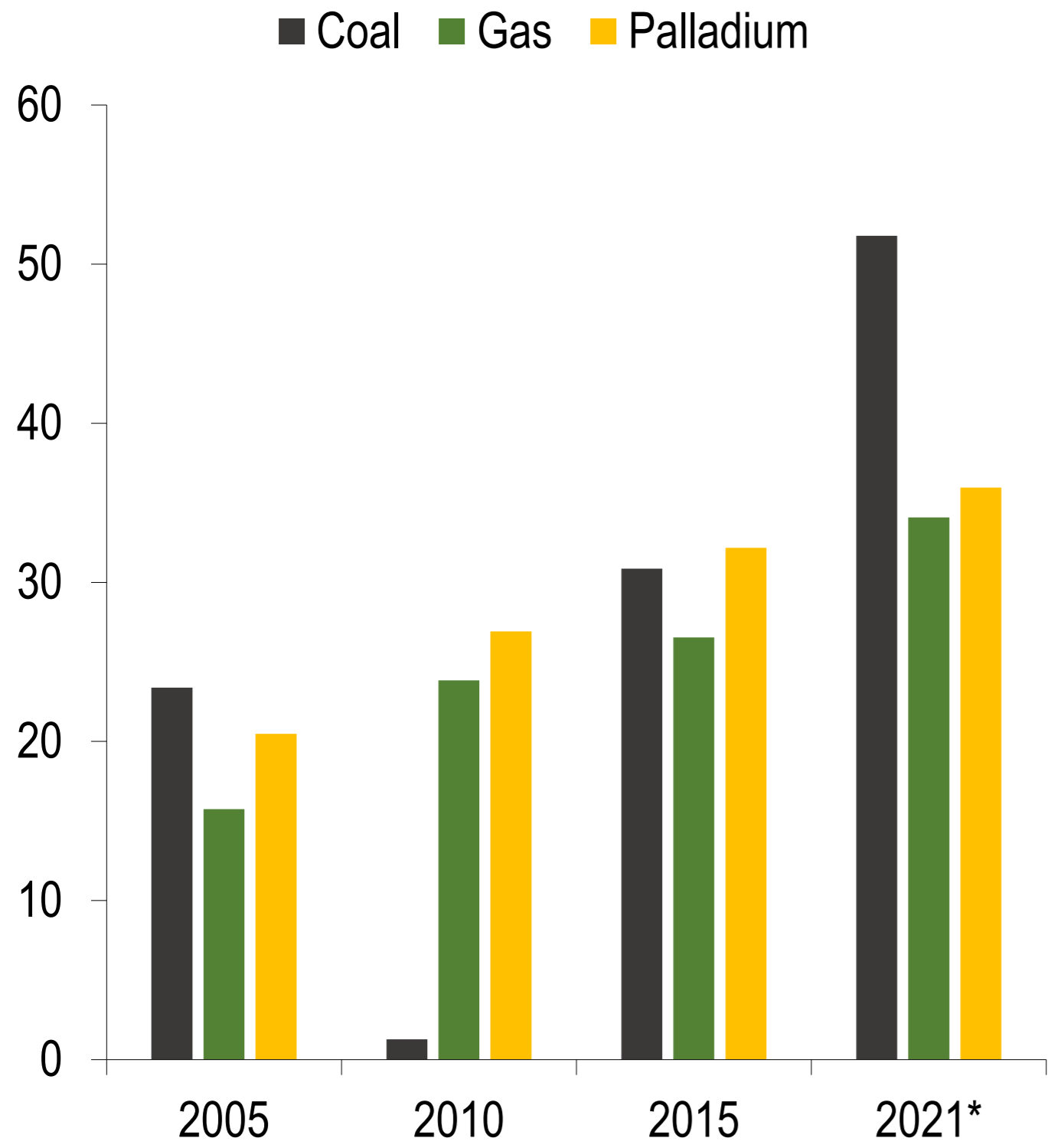
### Effective Fed Funds rate, Treasury curve slope; recession episodes shaded (Percent)



# Climate Challenge: Energy Security Vs. Energy Transition

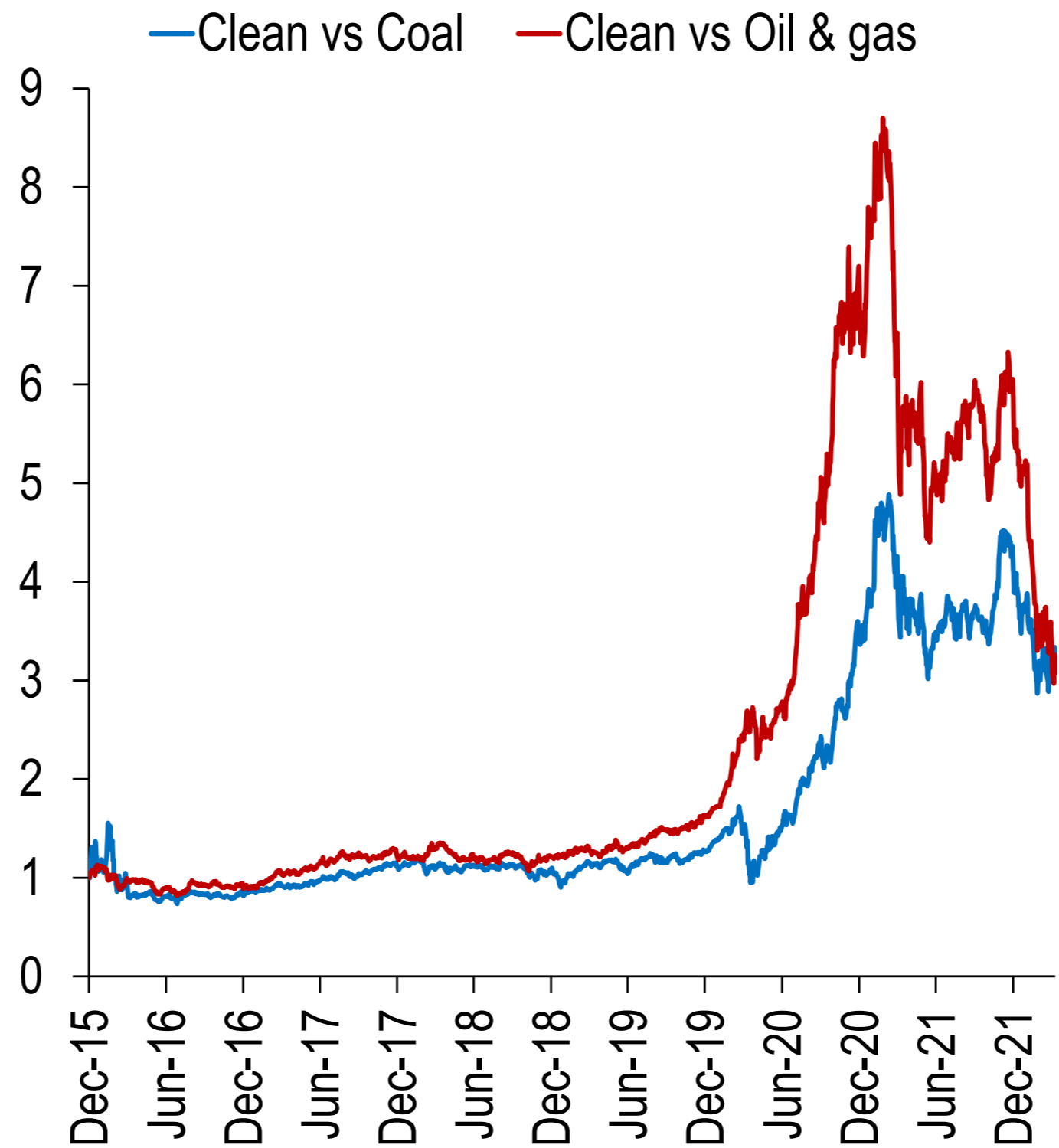
*Europe's reliance on Russia for key commodities is leading to decisive trade-offs in energy policy*

**Share of Russia in respective import volumes in the European Union (Percent)**



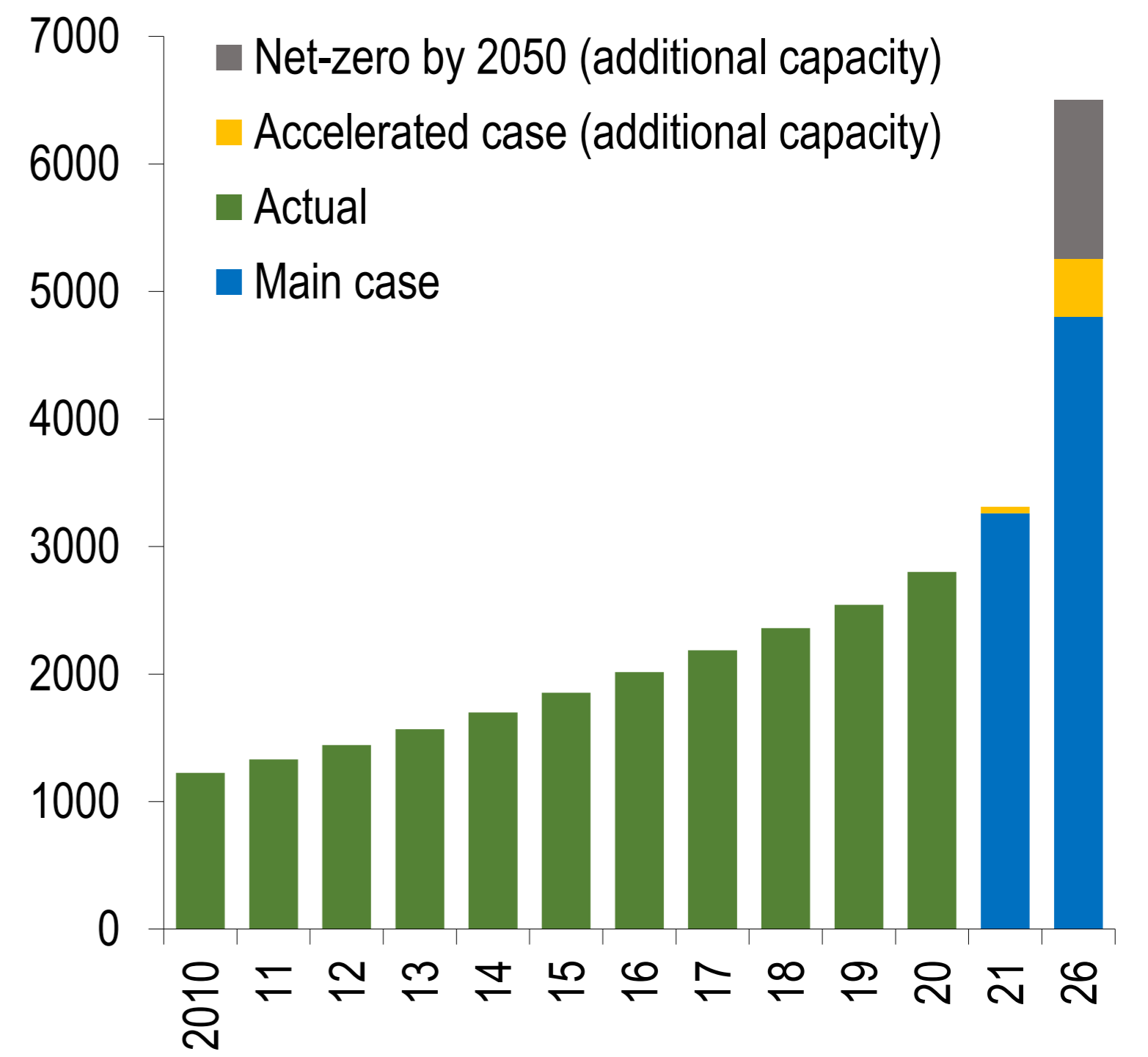
*Performance of renewable energy indices has deteriorated amidst energy security concerns*

**Relative performance of Clean Energy ETF vs (Thermal) Coal and Oil and Gas Index (Ratio)**



*Renewable energy generation capacity should more than double by 2026 in order to reach Net-zero emissions by 2050.*

**Renewable energy capacity actual and IEA forecasts (Gigawatt hours)**



# Differentiation In EM: Commodity Importers Have Been Hit Hardest

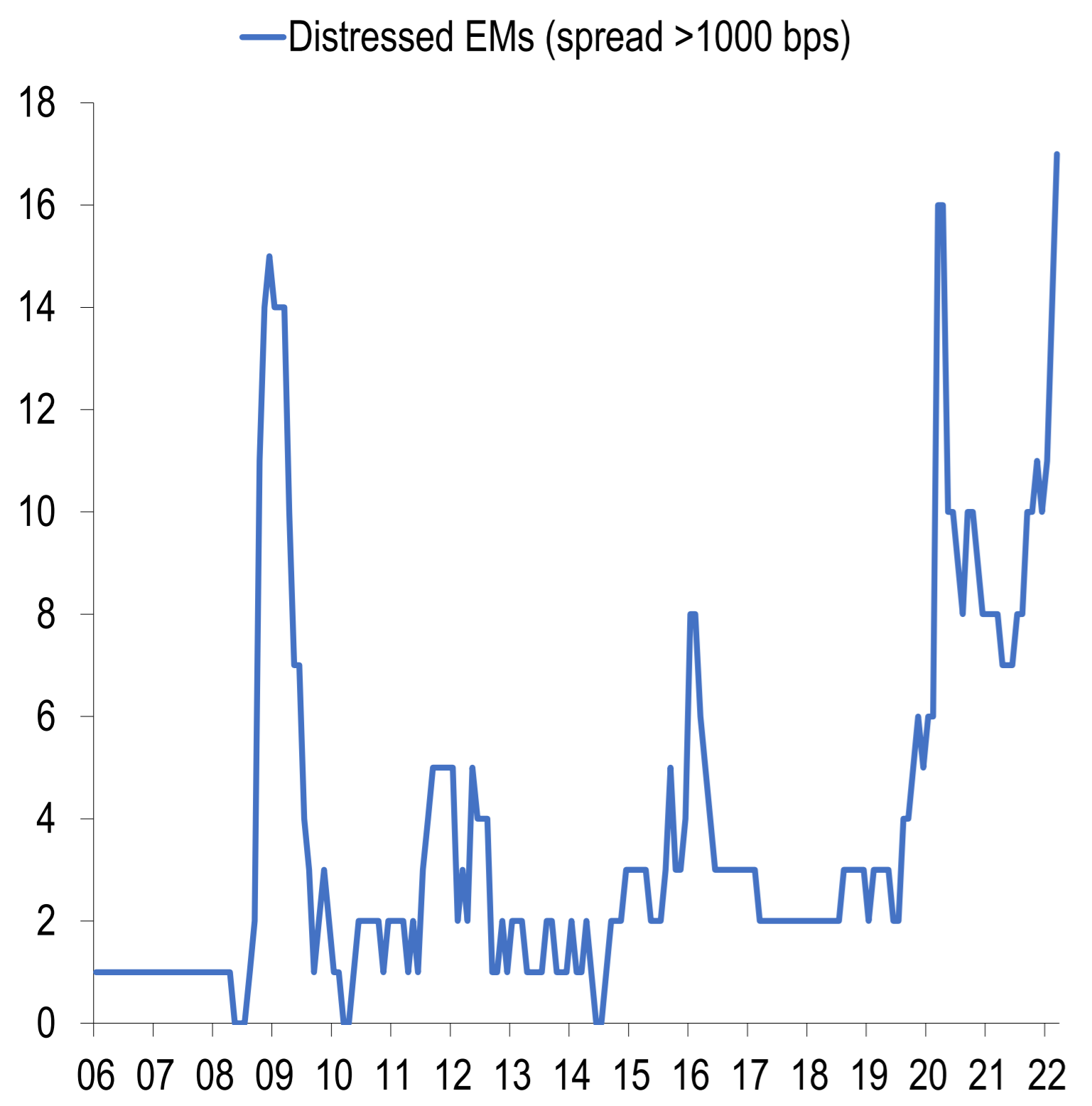
*The number of emerging markets with spreads in distressed territory has risen*

*Commodity importers have seen the largest increase in spreads*

*Equity markets in commodity exporters have outperformed*

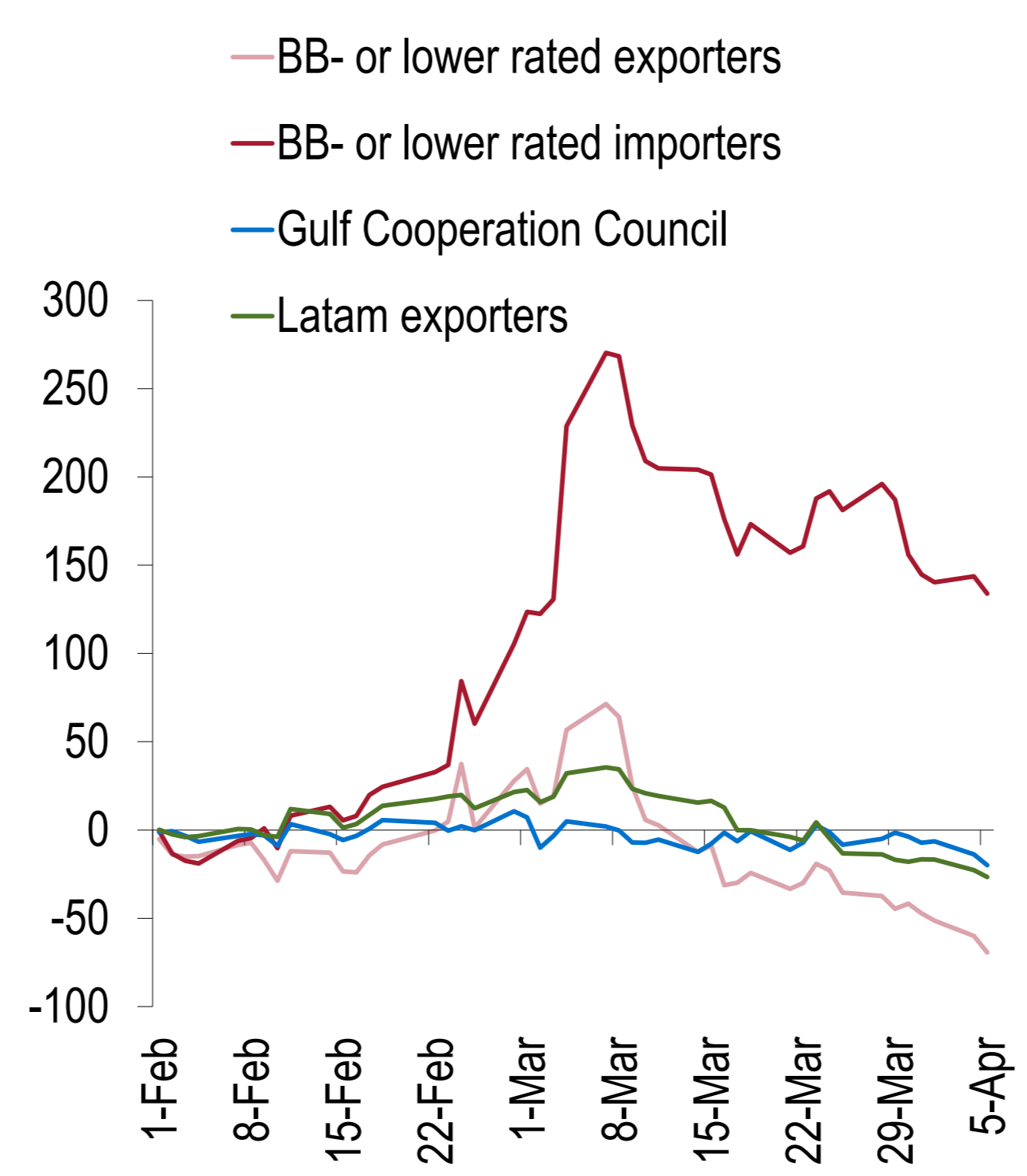
## Distressed sovereign issuers

(Number of economies; percent share)



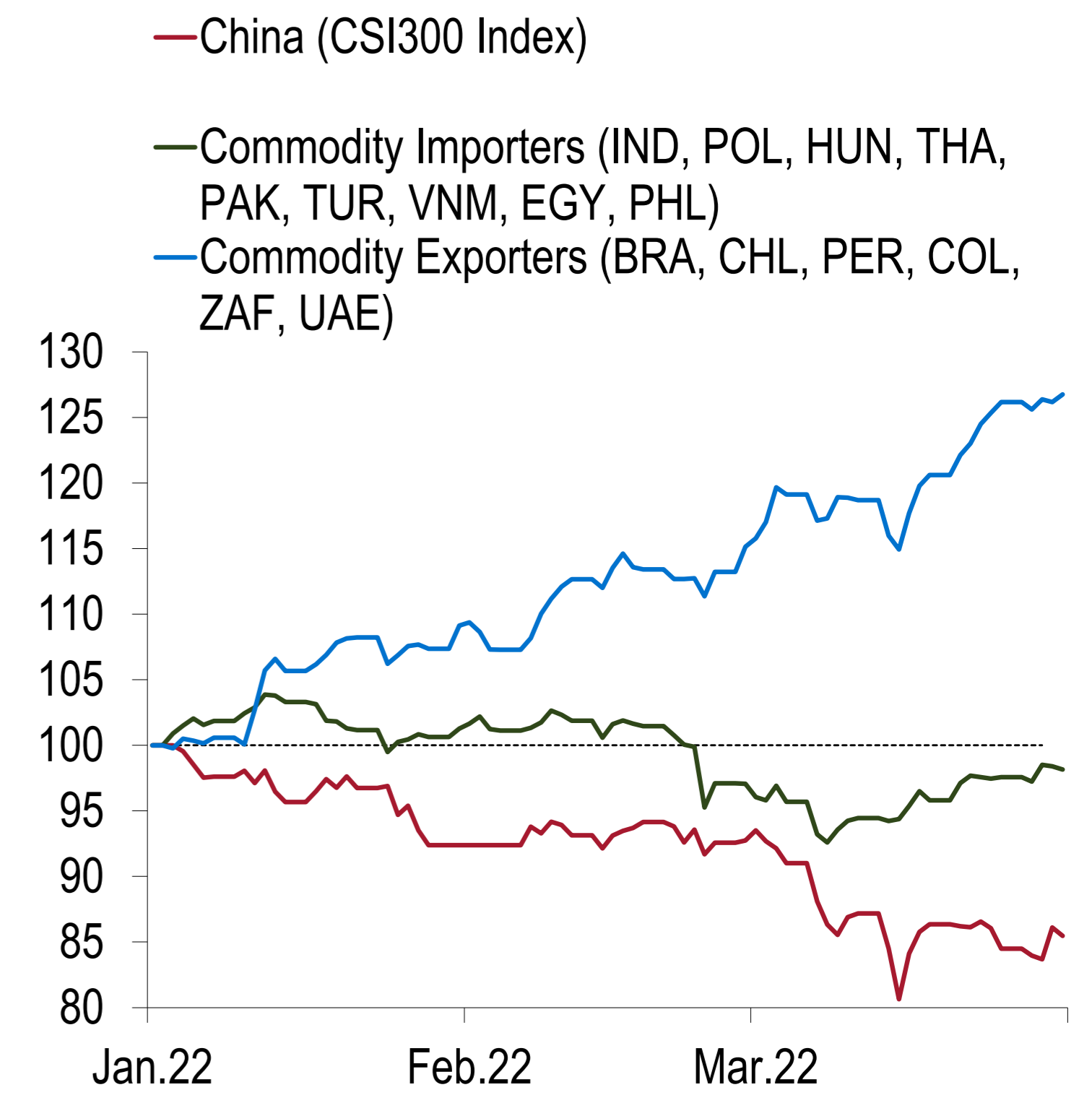
## Credit spreads

(Basis points; change in spreads since Feb 1)



## Equities and commodity exposure

(Net trade and equity performance since Feb 23)



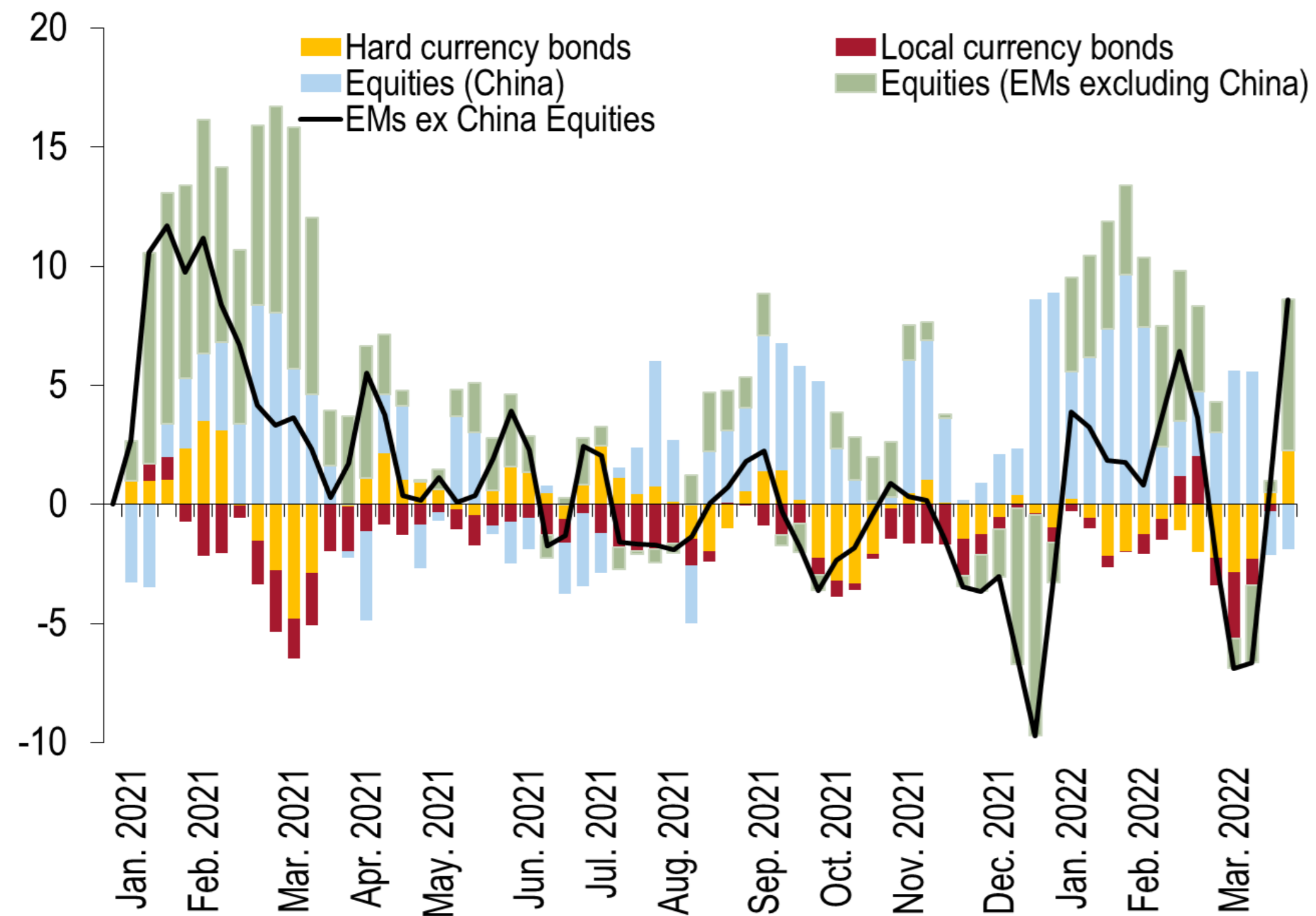
# Portfolio Flow Pressures Intensified

Portfolio flows recovered in early 2022 but have become highly volatile recently

Capital flows-at-risk worsened significantly as a result of the decline in investor risk sentiment.

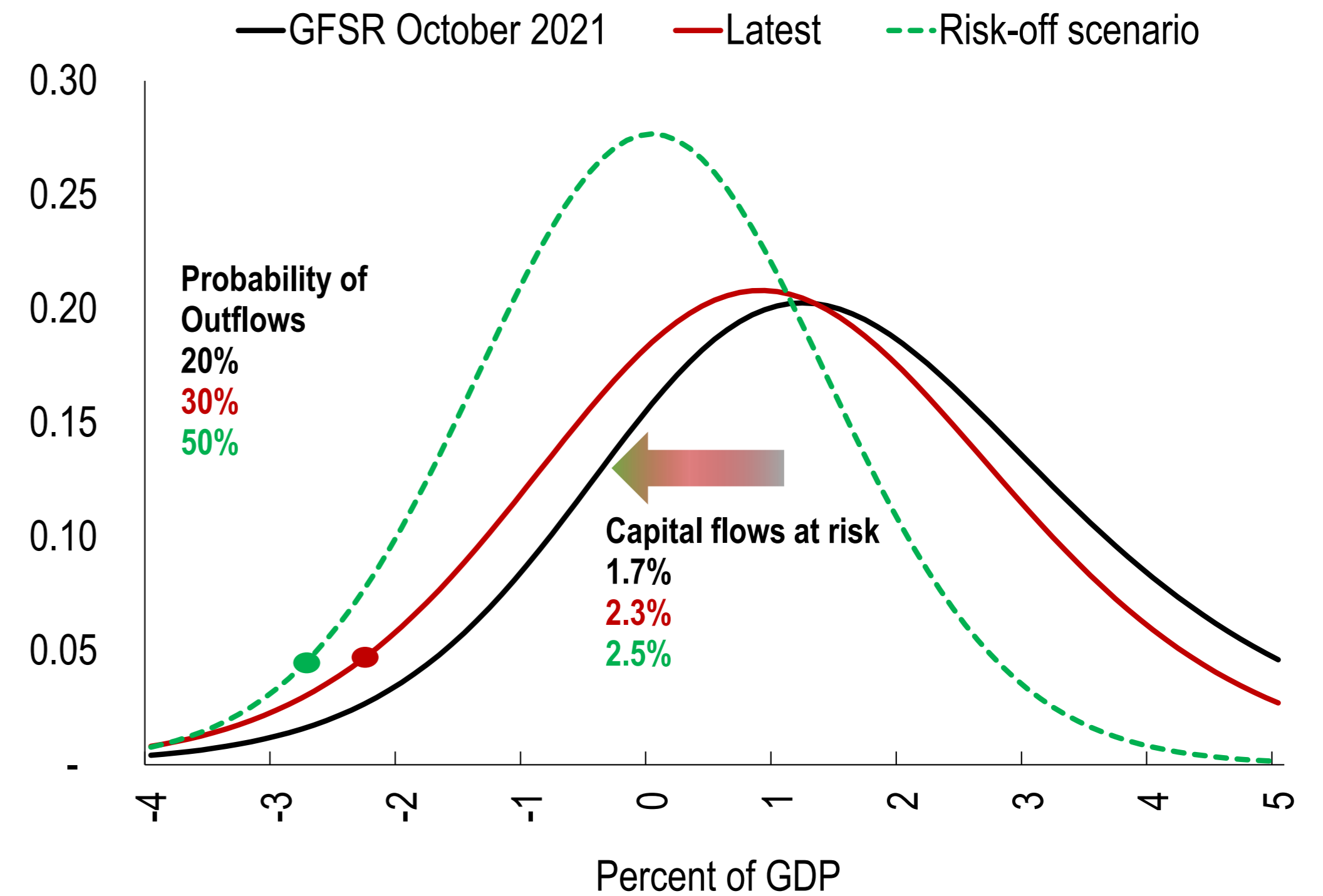
### Fund Flows to Emerging Markets

(USD billions; 2-week moving sum)



### Capital Flows-at-Risk

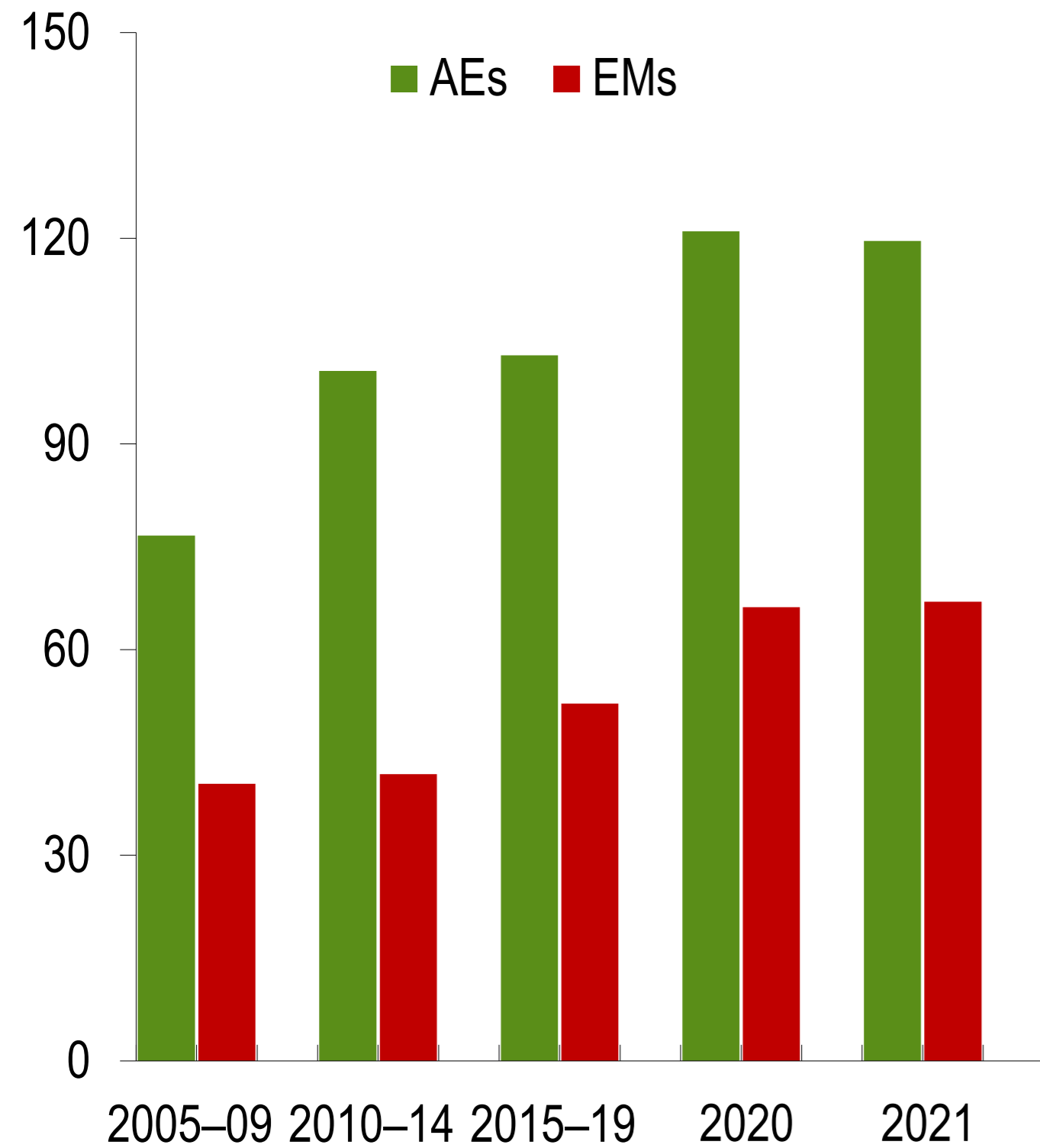
(Density function)



# EM Sovereigns More Reliant on Banks for Funding

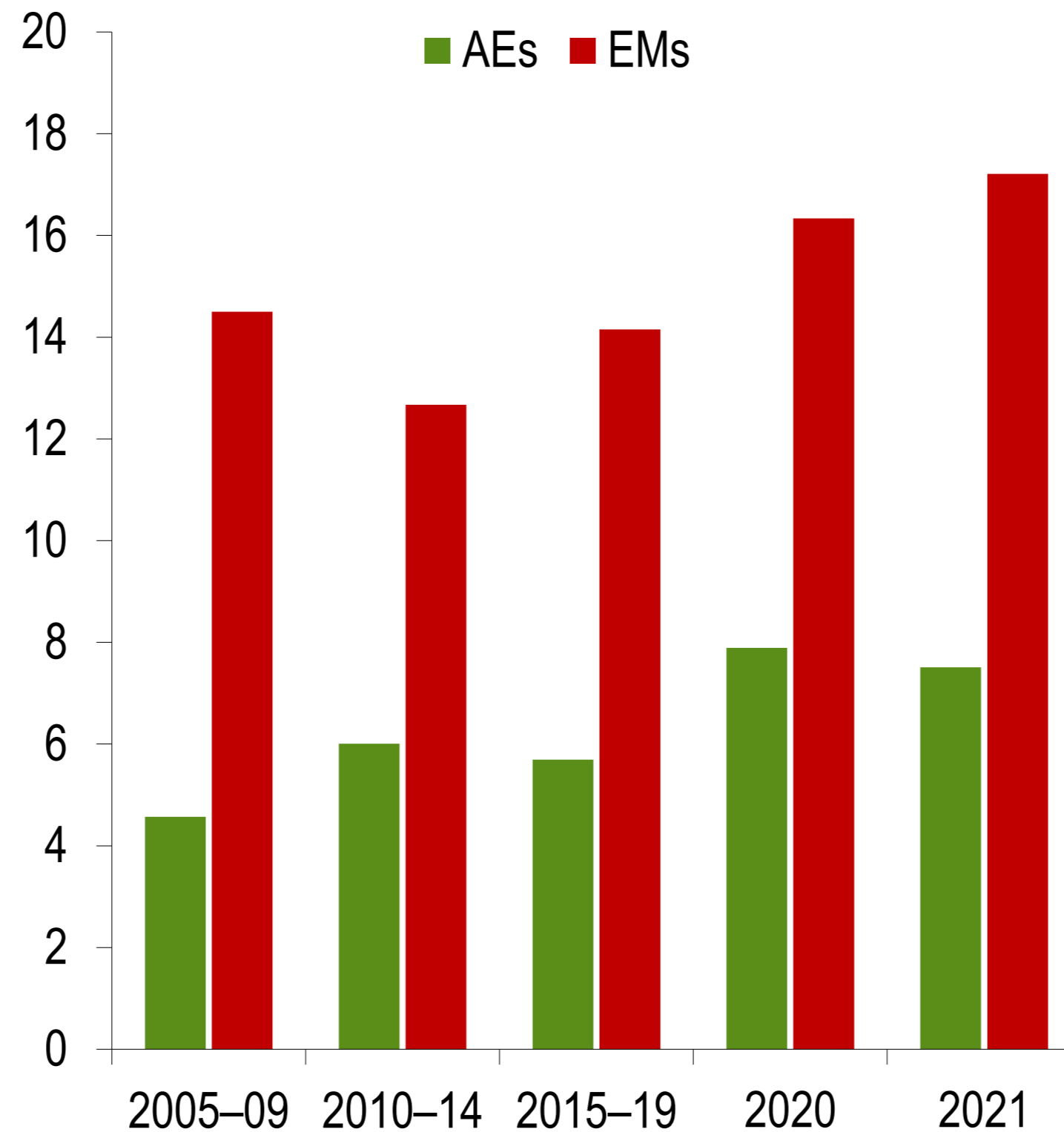
*Public debt has surged in emerging markets..*

**Public debt 2005-21**  
(Percent of GDP)

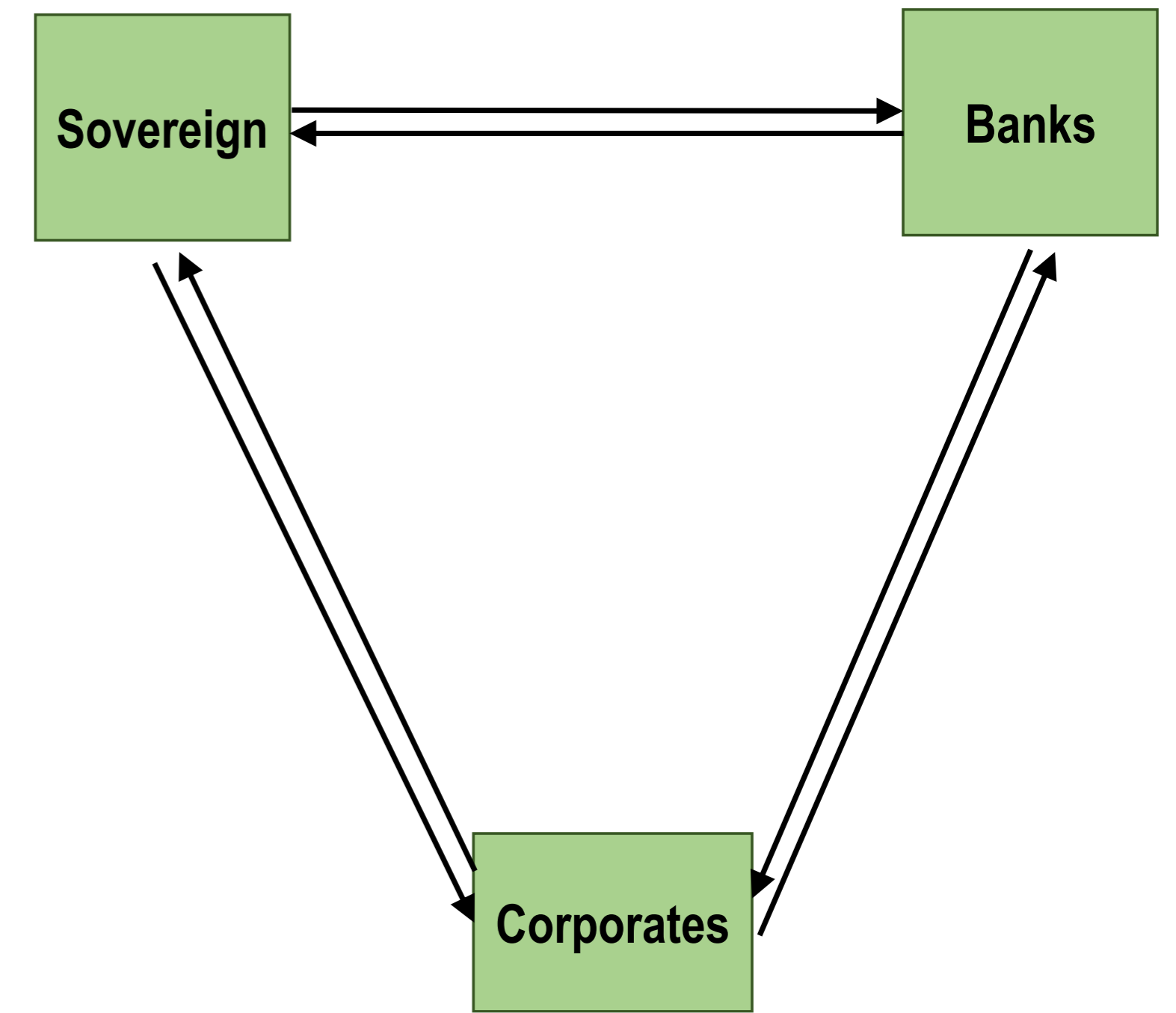


*Bank holdings of sovereign debt have surged to historical highs*

**Bank sovereign debt exposure, 2005-2021**  
(Percent of banking sector assets)



*A high reliance on bank financing can amplify sovereign risks*



# Foreign Bank and Corporate Exposures to Russia and Ukraine

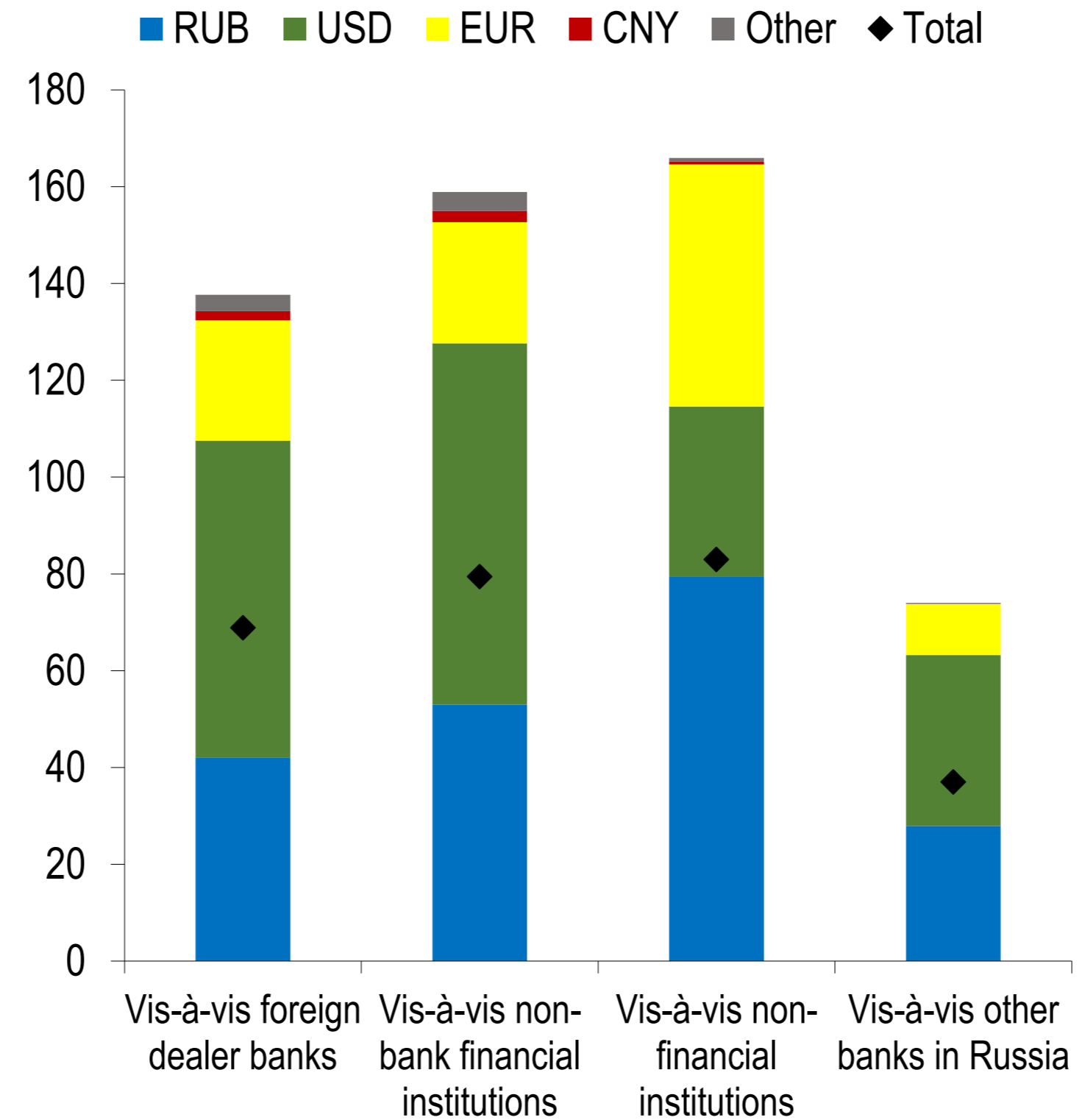
*Direct exposures to Russia/Ukraine are modest in aggregate*

**Foreign Banks' Gross Claims on Russia and Ukraine**  
(Billions of US dollars)



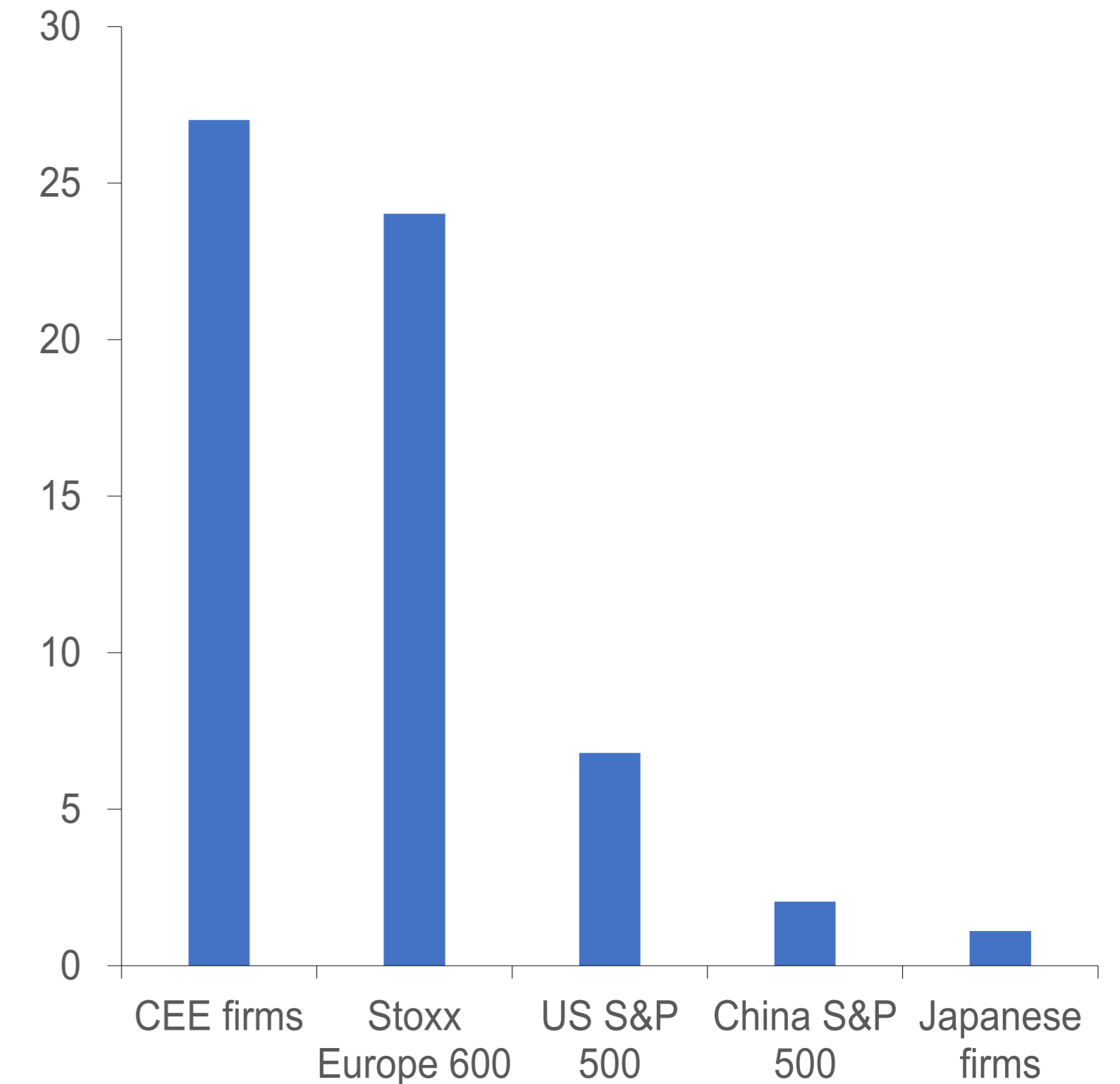
*Indirect exposures are harder to measure but may be significant*

**FX Swaps and outright forwards**  
(Billions of US dollars, gross notional)



*European corporates are more exposed to Russia and Ukraine*

**Percent of firms with meaningful exposure**  
(Percent of firms with > 2 percent exposure)

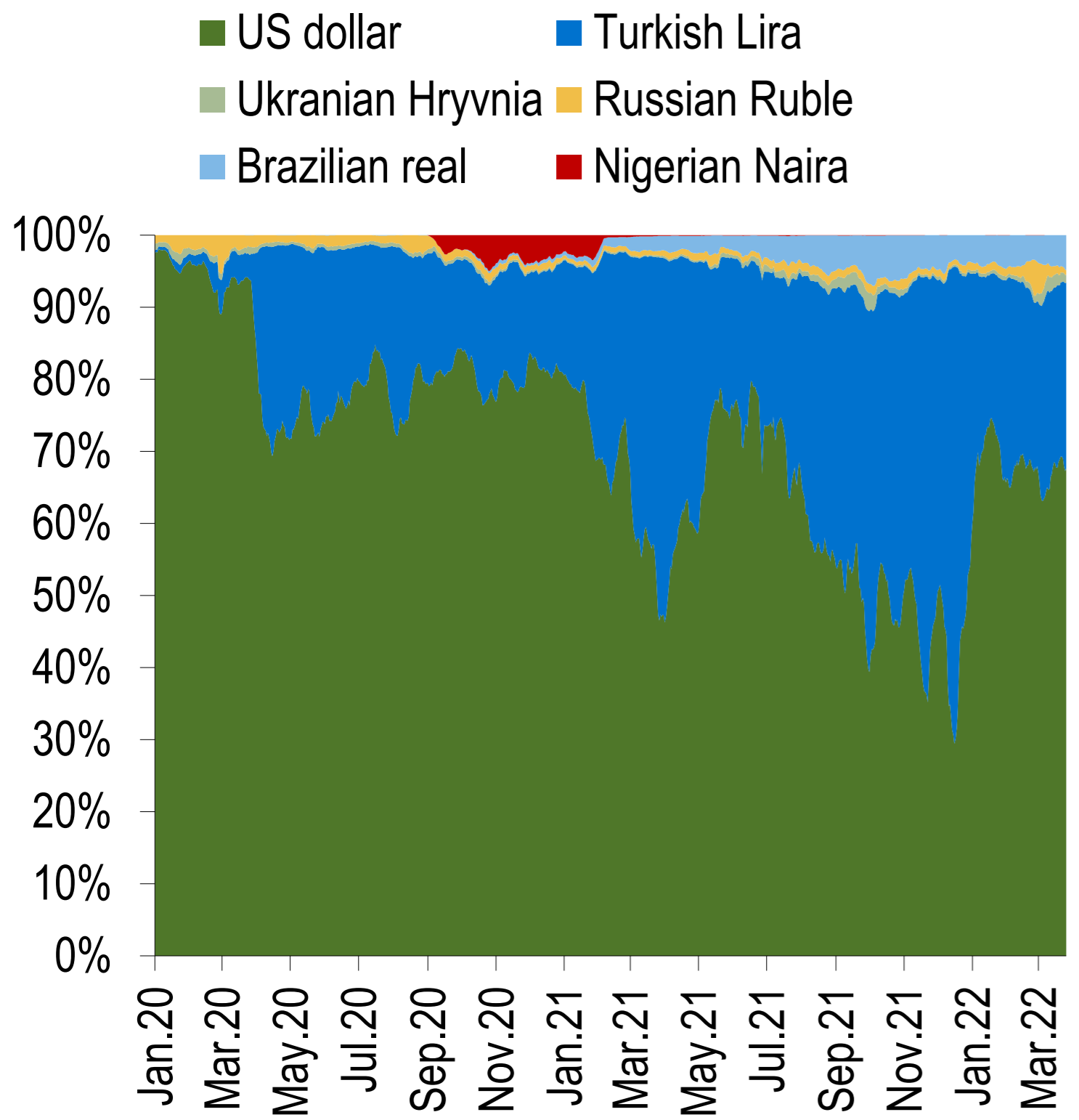


# A Rapid Growth of Crypto Assets and FinTech: A Challenge for Regulators

*Tether trading against EM FX has been on the rise, but mostly in lira*

### Tether trading volume against fiat currencies

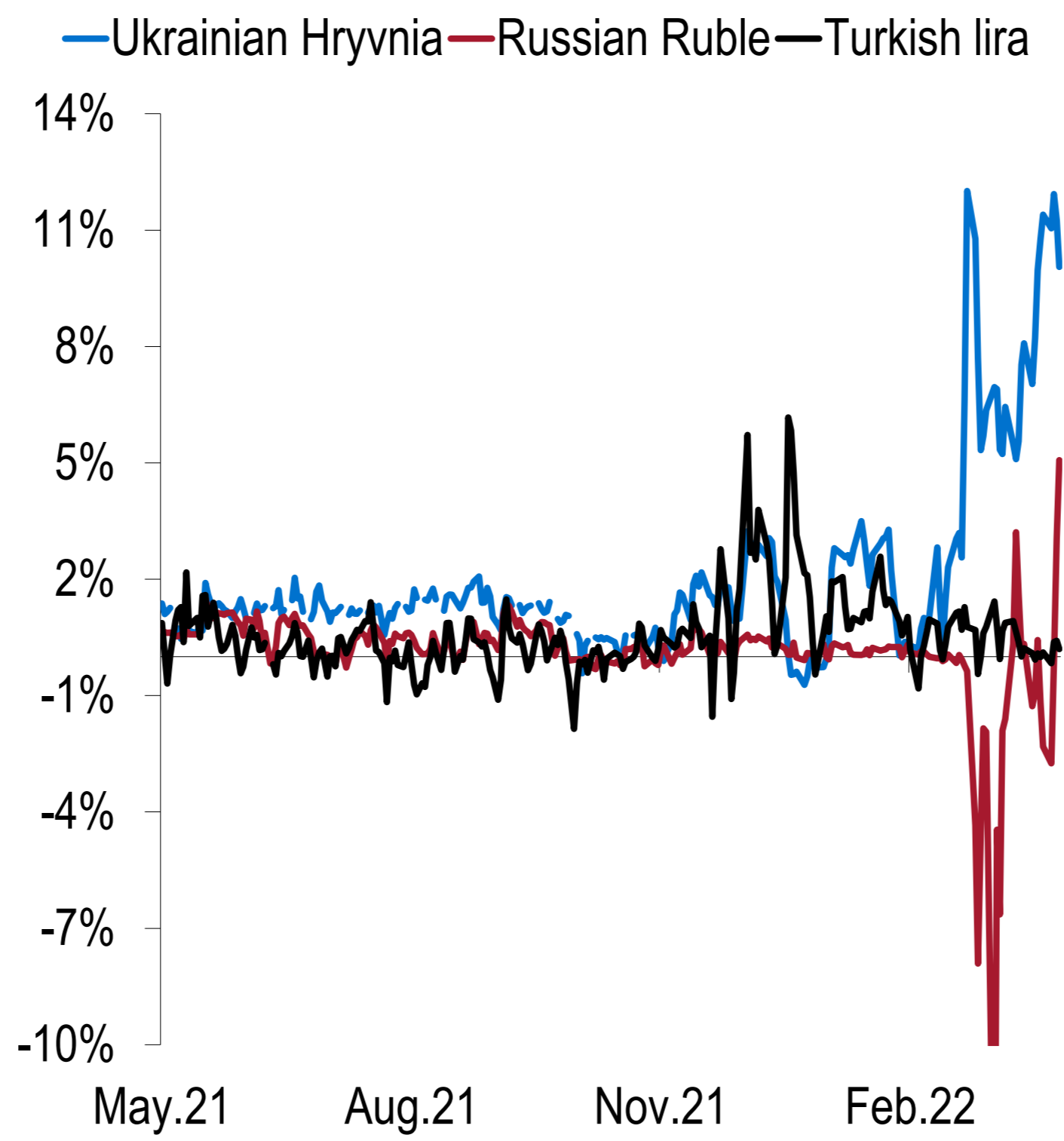
(Share of total, in percent)



*There is little evidence of a premium in the Russian crypto market, though liquidity is thin*

### Premium to buy crypto in different currencies

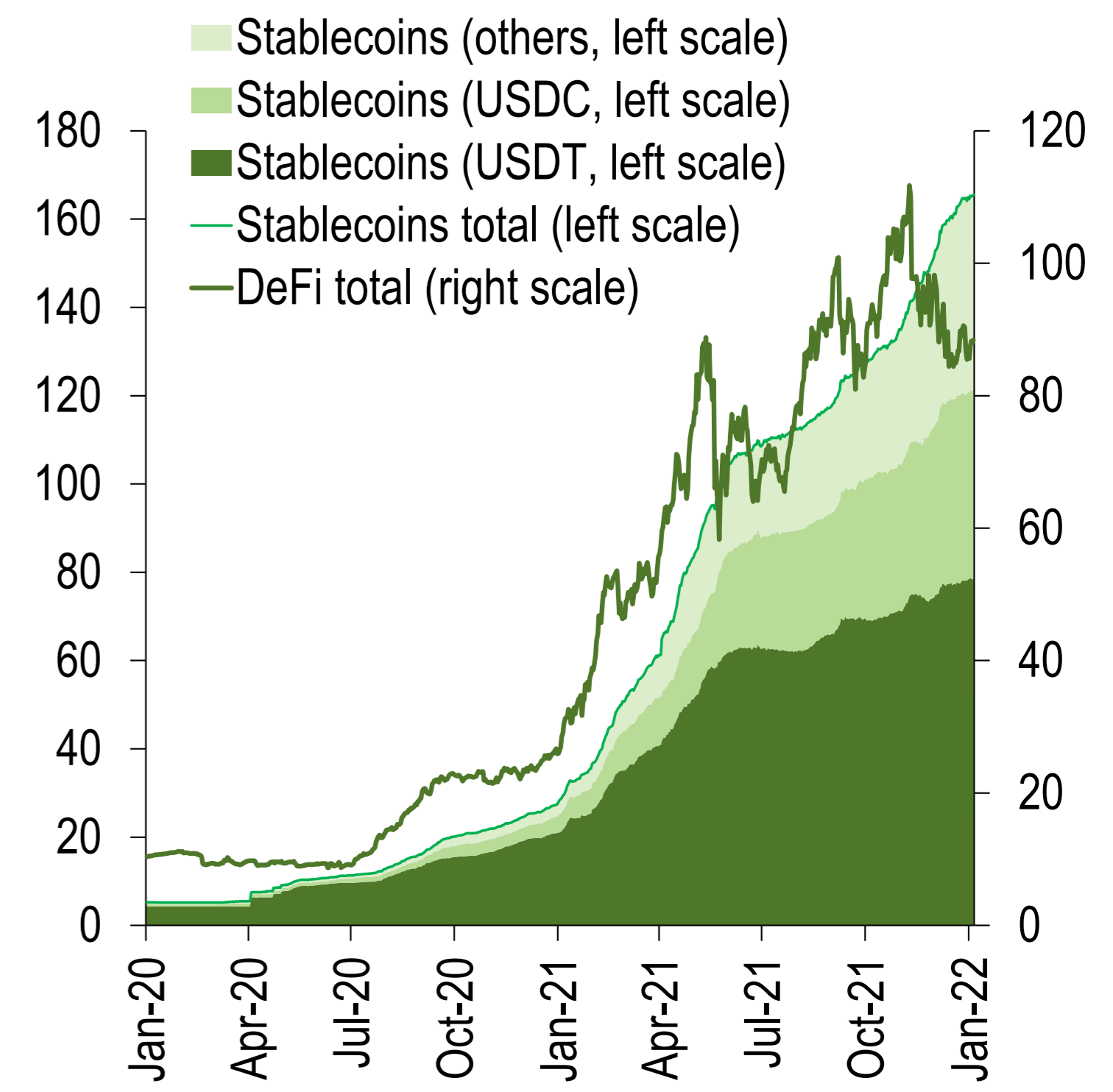
(Percent)



*The rapid growth of FinTech with less regulation can be a financial stability risk*

### Value of DeFi assets and stablecoins

(USD, billion)

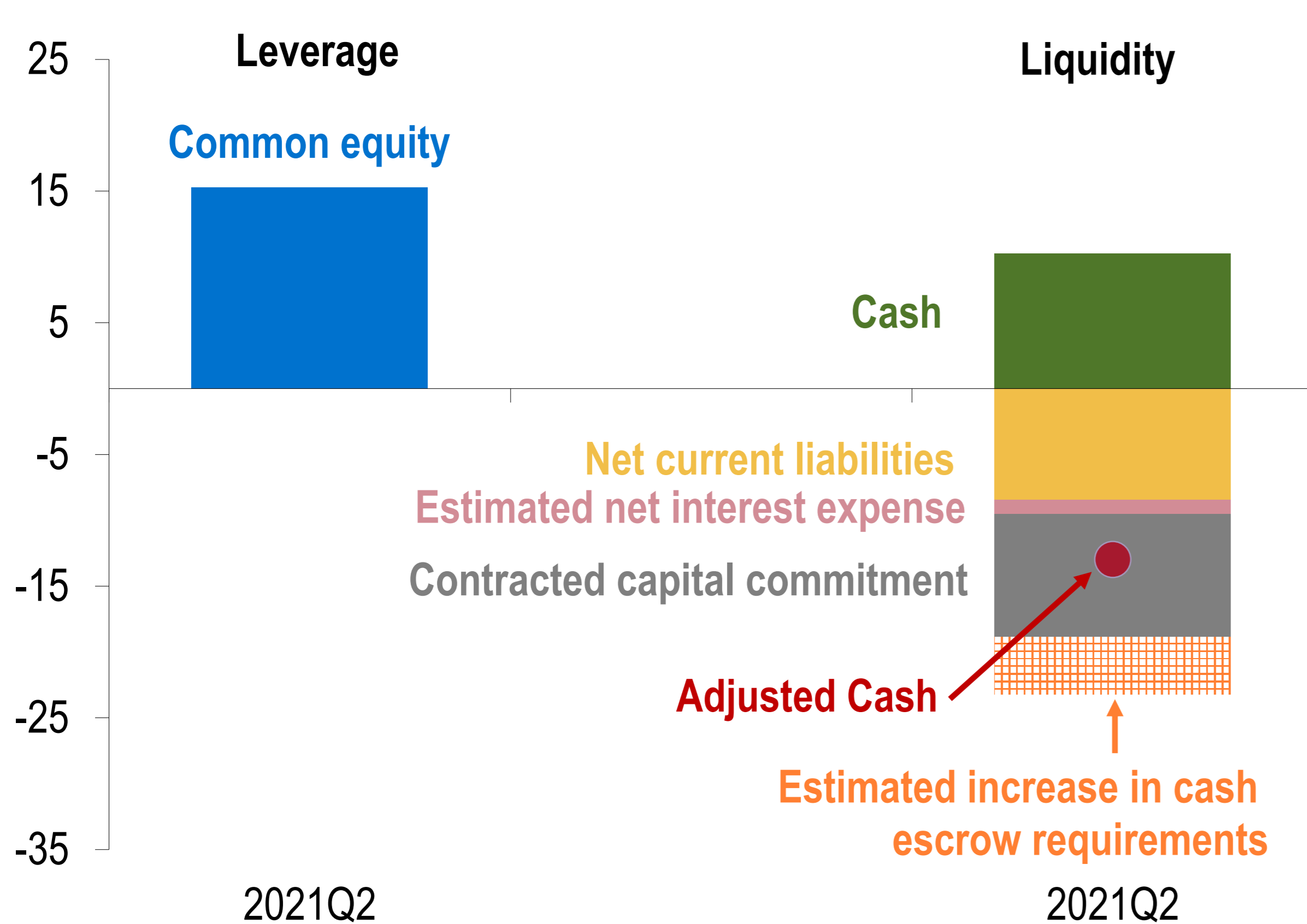


# Financial Vulnerabilities in China's Property Sector

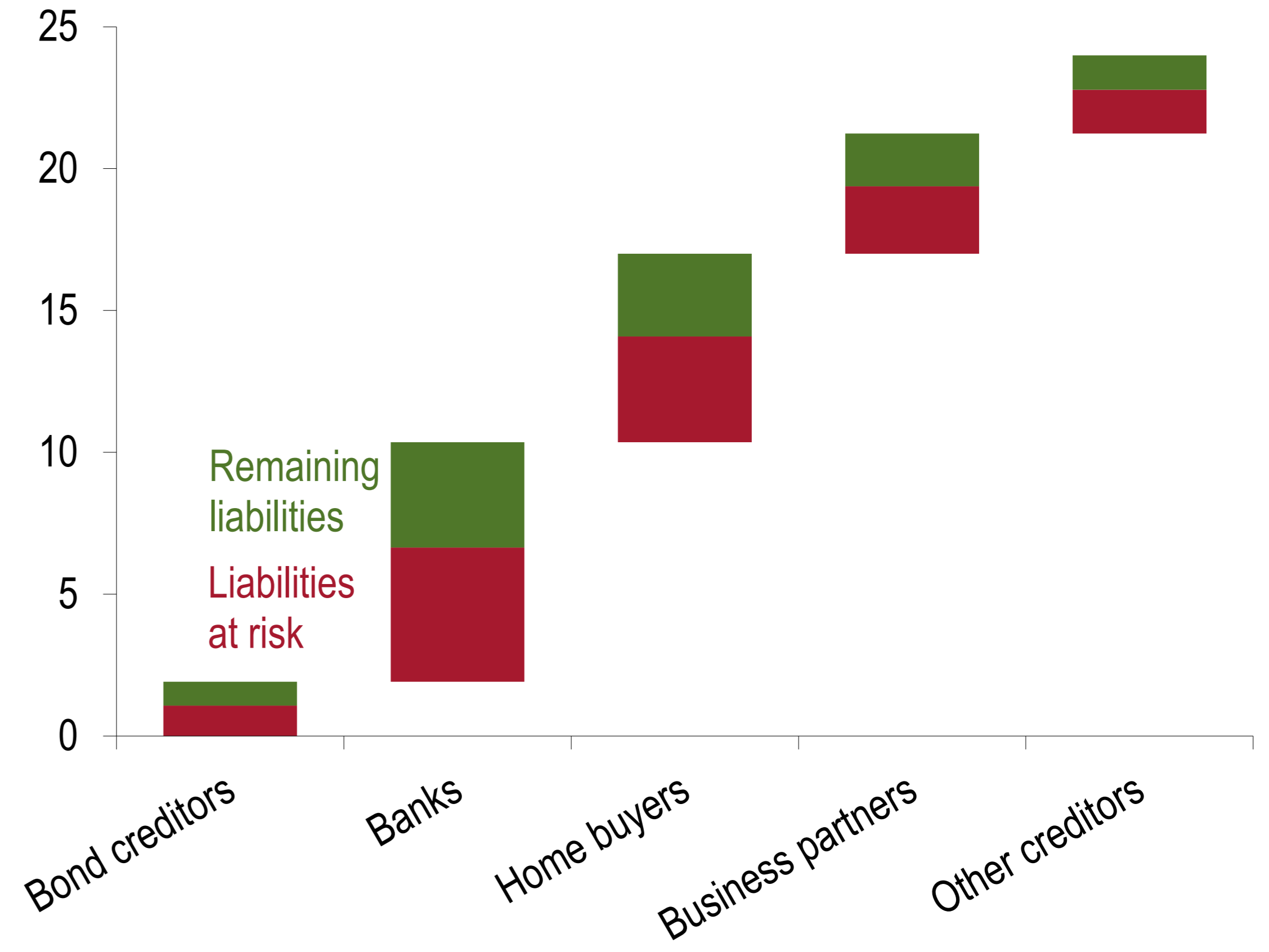
*Leverage concerns and liquidity shocks from tighter escrow requirements*

*Rising defaults can spill over to credit channels and other private sector balance sheets*

**Real Estate Firm Leverage and Liquidity**  
(Percent of total assets)



**Liabilities and Financing of Real Estate Firms**  
(Percent of GDP)



# Policy recommendations

***Ending the war and bringing back peace is the first priority. In addition:***

## **Prevent inflationary pressures from becoming entrenched**

- Manage the delicate trade-off between fighting persistent inflation and safeguarding the recovery.
- Act decisively to avoid an unmooring of inflation expectations and bring inflation credibly back to target.
- Remain data-dependent, watch key variables: labor market tightness, inflation expectations, commodity prices.
- Communication is essential to ensure orderly market reaction.

## **Manage spending pressures under reduced fiscal space**

- Where health conditions permit, continue to ease out of broad pandemic-era support towards policy normalization.
- In view of high energy and food prices, use targeted and temporary transfers, or lump-sum utility bill discounts.
- If appropriate, allow gradual pass-through (e.g. for food and cooking fuels); tax breaks need sunset clauses.
- Commit to eliminate fossil fuel subsidies and increase carbon prices gradually to deliver on Paris commitments.
- Priorities should be accommodated within medium-term fiscal frameworks, ensuring fiscal sustainability.

## **Multilateral cooperation and investment in the future**

- Coordinate responses and G-20 support to attenuate the humanitarian consequences and preserve food security
- Pandemic requires a toolkit: monitoring, tests, vaccines, and treatment. Other diseases should not be forgotten.
- Address the climate crisis in the context of elevated food and energy prices, provide workers and communities with tools to gain from the green transition.
- Maintain global liquidity and improve sovereign debt resolution essential for a well-functioning financial system.
- Enhance international cooperation to support tax revenue mobilization and financing for development (incl. RST)
- Boost long-run productivity by building on pandemic-era digitalization gains.
- International institutions, incl. IMF, must help prevent-economic fragmentation and support poorest countries.



**FISCAL AFFAIRS**

# **World Economic and Market Developments**

**APRIL 2022**

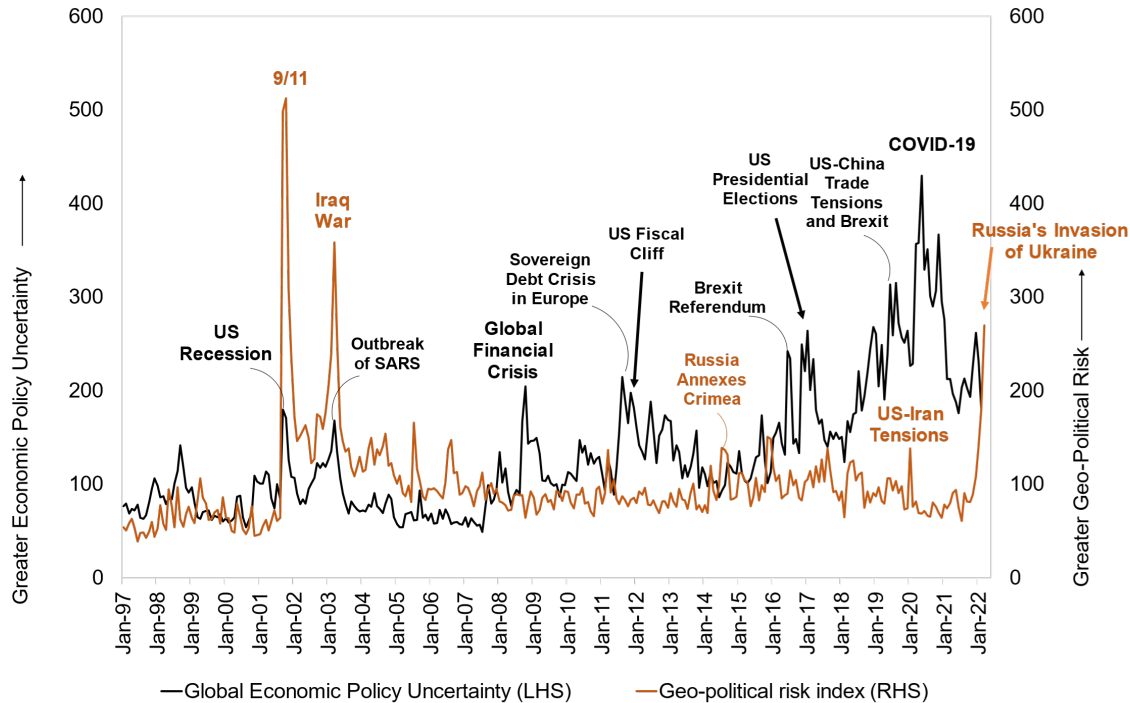
Vitor Gaspar

Director

Fiscal Affairs Department

# Layering Risks and Uncertainties

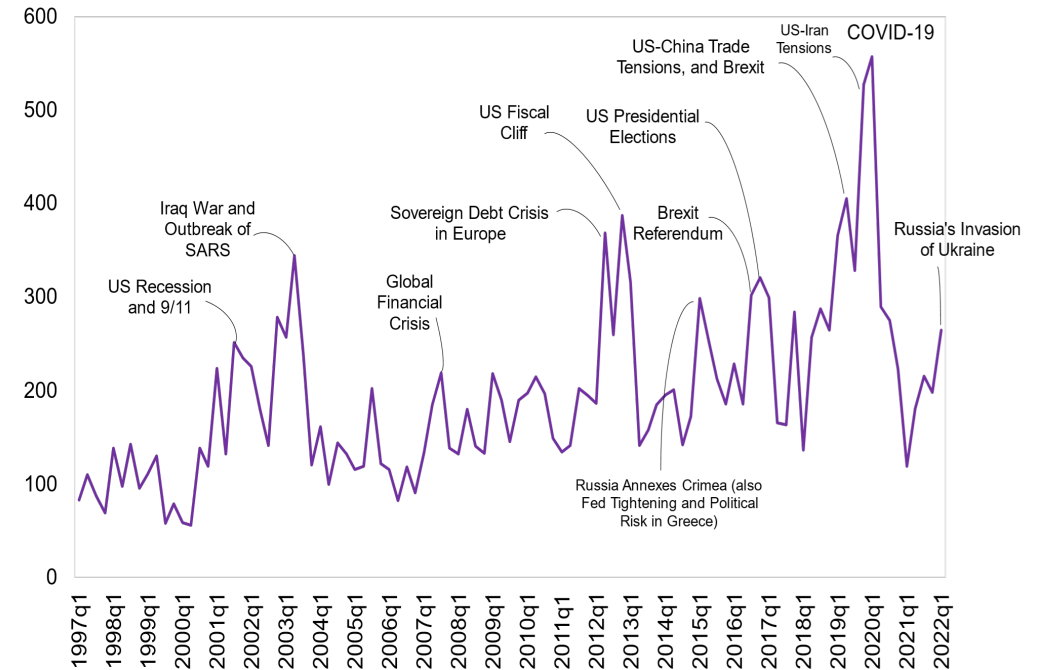
## Economic Policy Uncertainty & Geo-Political Risk Index (Jan 1997 – Mar 2022)



Source: Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," *Macroeconomic Review*, October; Caldara, Dario and Matteo Iacoviello, "Measuring Geopolitical Risk," Working Paper, Board of Governors of the Federal Reserve, November 2021 (forthcoming in the *American Economic Review*) & IMF Staff Calculations

Note: The chart uses monthly frequency and the last datapoint is the month of February 2022 for the GEPU and March for the GPR index. The Global Economic Policy Uncertainty (GEPU) Index reflects the relative frequency of own-country newspaper articles that contain a trio of terms pertaining to the economy (E), policy (P) and uncertainty (U). In other words, each monthly national EPU index value is proportional to the share of own-country newspaper articles that discuss economic policy uncertainty in that month. The Caldara and Iacoviello Geo-political risk (GPR) index reflects automated text-search results of the electronic archives of 10 newspapers. It is calculated by counting the number of articles related to adverse geopolitical events in each newspaper for each month (as a share of the total number of news articles).

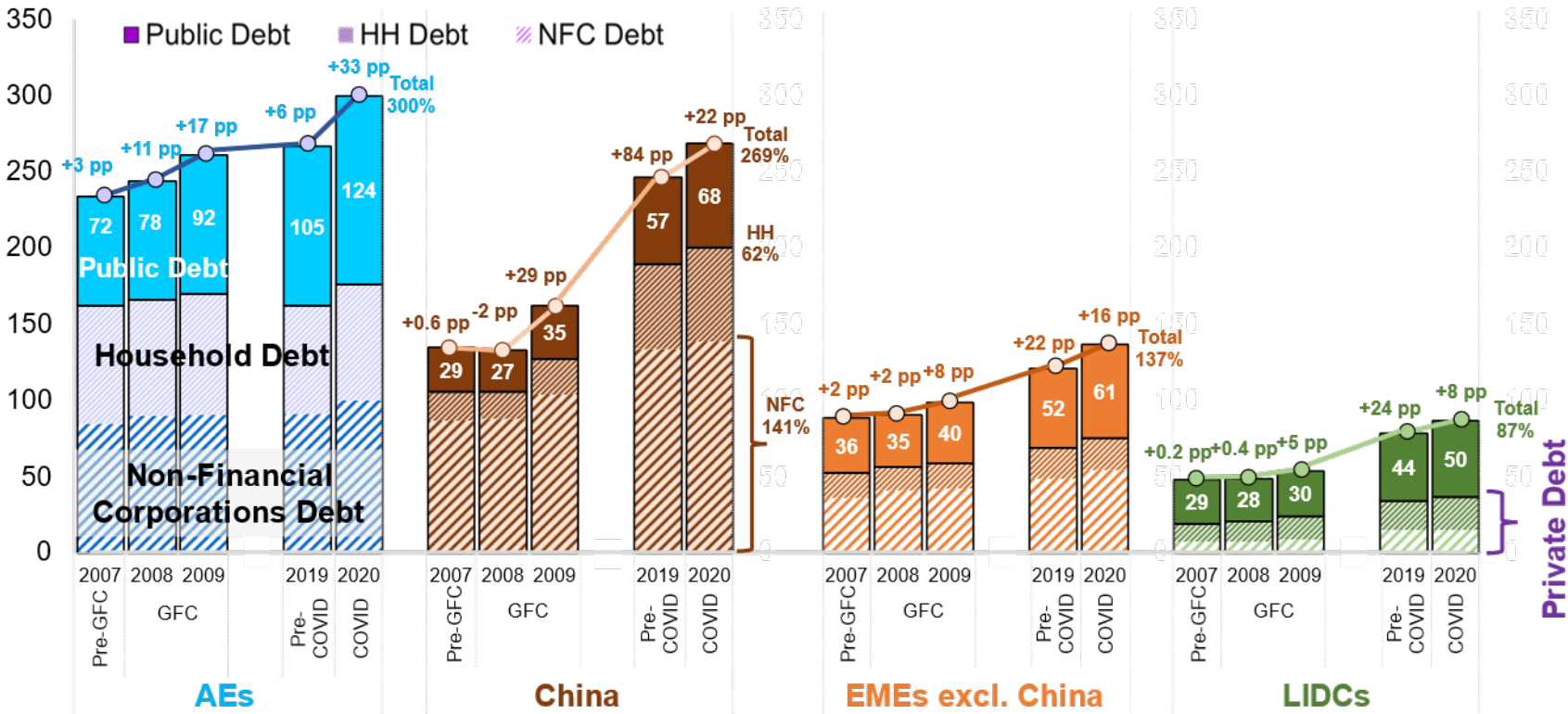
## World Uncertainty Index (1997Q1 – 2022Q1)



Source: Ahir, H, N Bloom, and D Furceri (2018), "World Uncertainty Index", Stanford mimeo.

Note: The chart uses quarterly frequency and the last datapoint is 2022Q1. The World Uncertainty Index covers 143 countries – all countries in the world with a population of at least 2 million. The index uses a single source for all countries, which allows us to compare the level of uncertainty across countries. It captures uncertainty related to economic and political events, regarding both near-term and long-term. The index is constructed by text-mining the country reports from the Economist Intelligence Unit (EIU), a business intelligence company that provides country reports on a quarterly basis. These reports cover the economy, policies, and politics of each country. The methodology follows three steps in constructing the index. First, by compiling country-specific reports on a quarterly basis from the EIU from the mid-1950s onward for 143 countries. Second, then counting the number of times the word "uncertainty" (and its variants) is mentioned in these reports. Third, normalizing the total count of the word "uncertainty" according to the total number of words in each report. Here, we rescale the axis by dividing by 100 for aesthetic and comparison purposes.

### Total Public and Private Debt 2007-2020 (in percent of GDP)

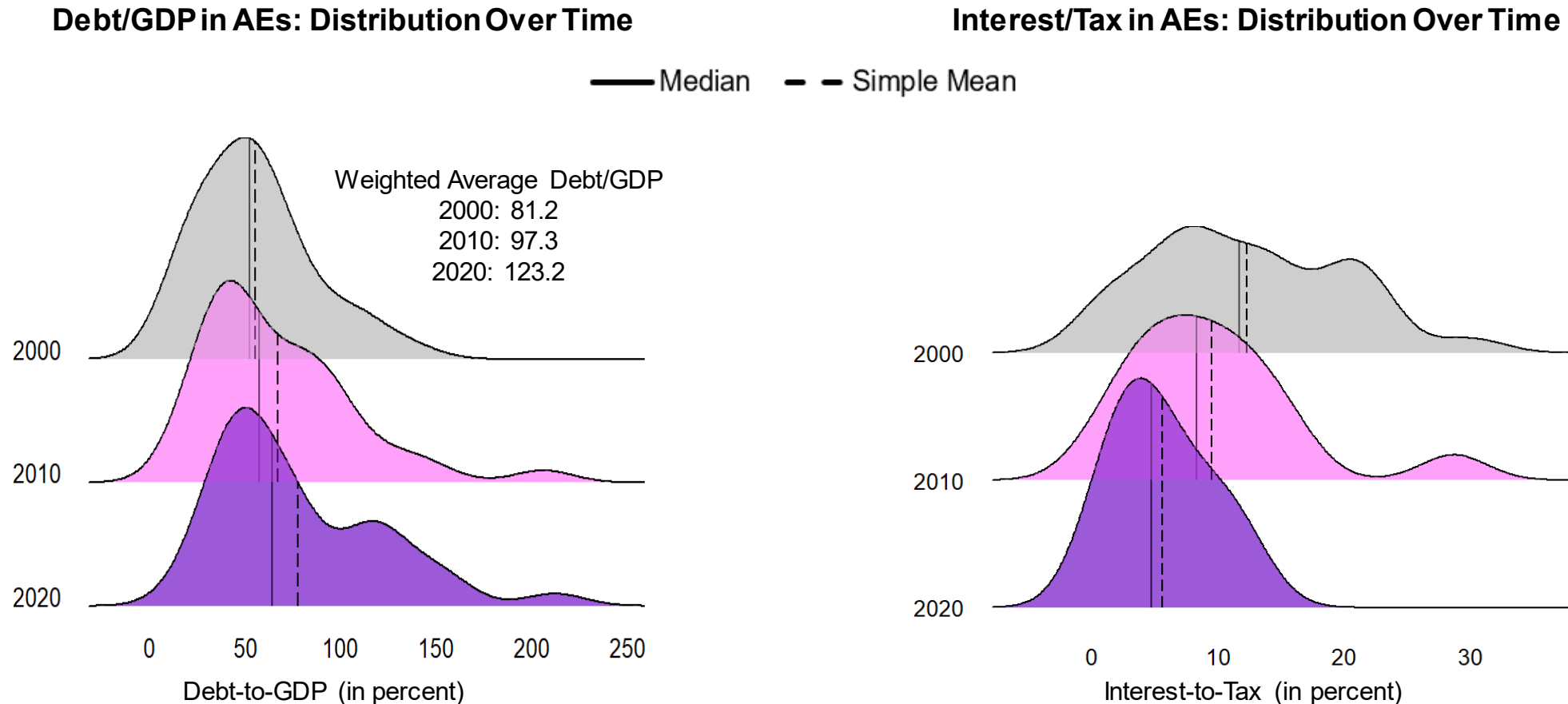


**Source: IMF Global Debt Database (GDD); IMF World Economic Outlook (WEO) & IMF Staff Calculations**

Note: Public Debt refers to the largest category of debt available (Non-Financial Public Sector, General Government and Central government, in decreasing order). Private debt includes only loans and securities. All income and regional groups follow WEO's (World Economic Outlook) methodology. Total Debt (as a percent of GDP) is close but not exactly equal to the sum of the components of public and private debt. This is because of the difference in country coverage for the corresponding variables - which causes the corresponding country weights to differ. Here, Household Debt is used as the residual. Total debt for the World in 2020 is estimated at 256%; AEs at 300%; the United States at 298% and AEs excl US at 301%; China at 269%; EMEs excl China at 137% and LIDCs at 87% of GDP.

NFC = Non-financial corporations; HH = Households; AEs = Advanced Economies; EMEs = Emerging Market Middle-Income Economies; LIDCs = Low-Income Developing Countries; GFC = Global Financial Crisis.

# Rising Debts and Falling Interest Burdens in AEs...

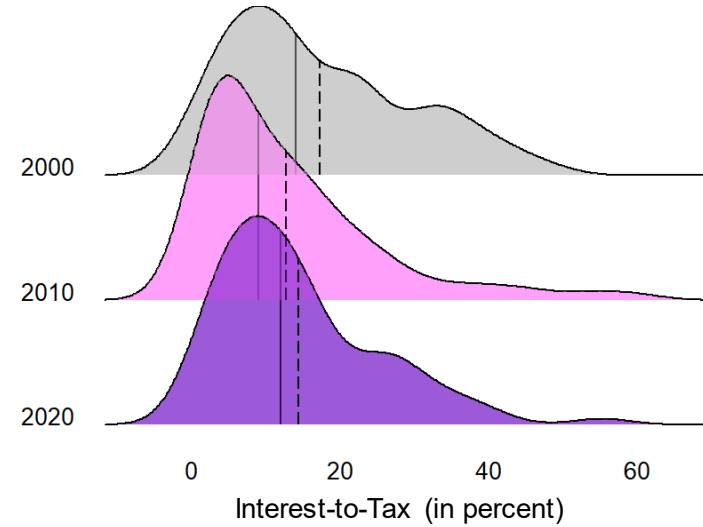
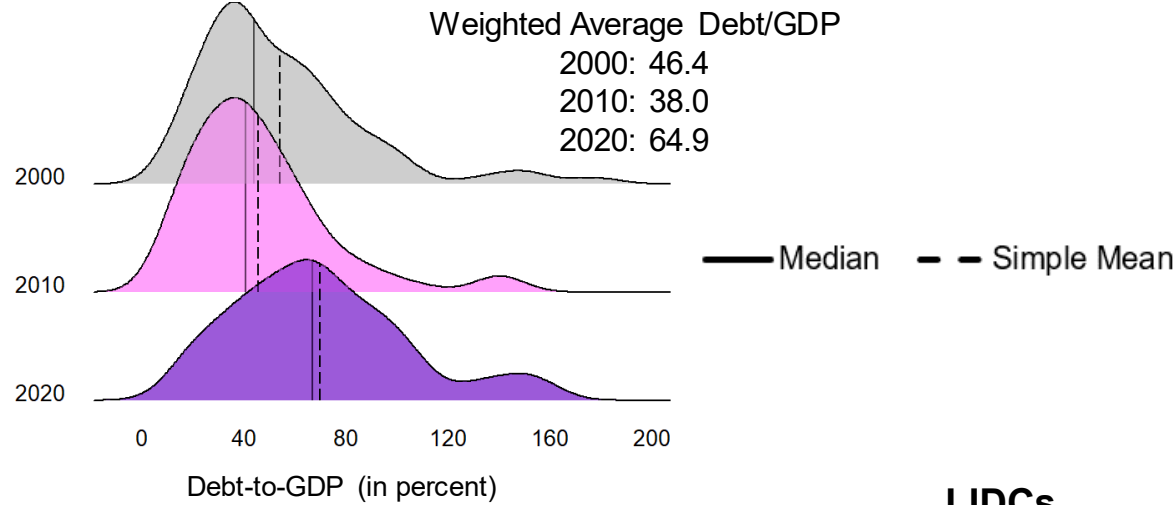


**Source: IMF World Economic Outlook**

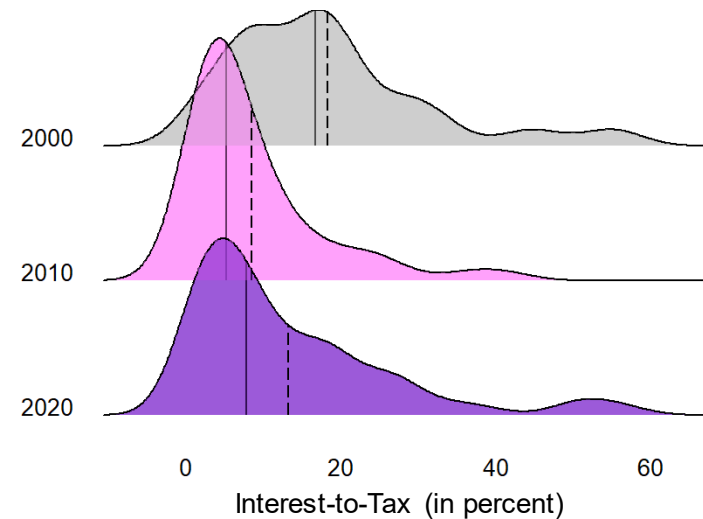
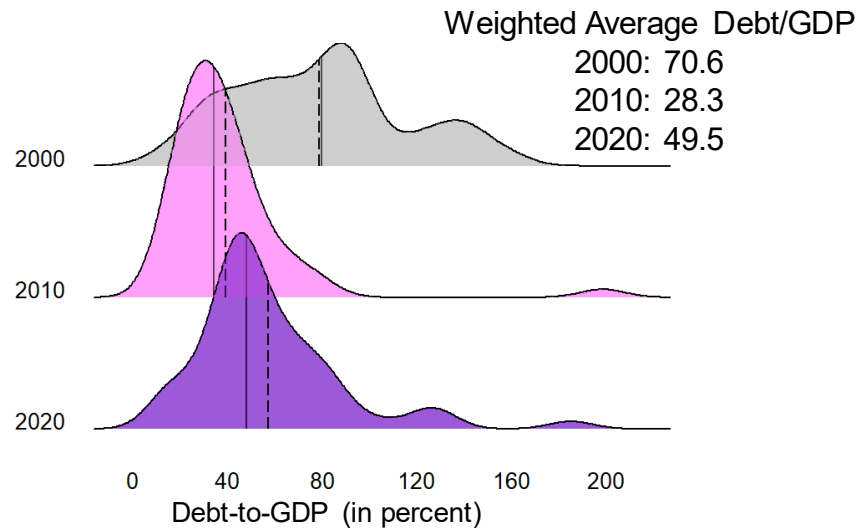
Note: The Weighted Averages of Debt to GDP ratios for Advanced Economies in 2000, 2010, and 2020 are 81.2, 97.3 and 123.2, respectively. Debt to GDP data is missing for 44 countries, constituting 2.93% of global GDP, in 2000; 23 countries, constituting 3.9% of global GDP, in 2010; and 13 countries, constituting 4.8% of global GDP, in 2020. Interest to tax revenue data is missing for 55 countries, constituting 41.5% of global GDP in 2000; 24 countries, constituting 11% of global GDP, in 2010; and 29 countries, constituting 26.7% of global GDP, in 2020.

# ...But not in EMDEs

## EMEs



## LIDCs

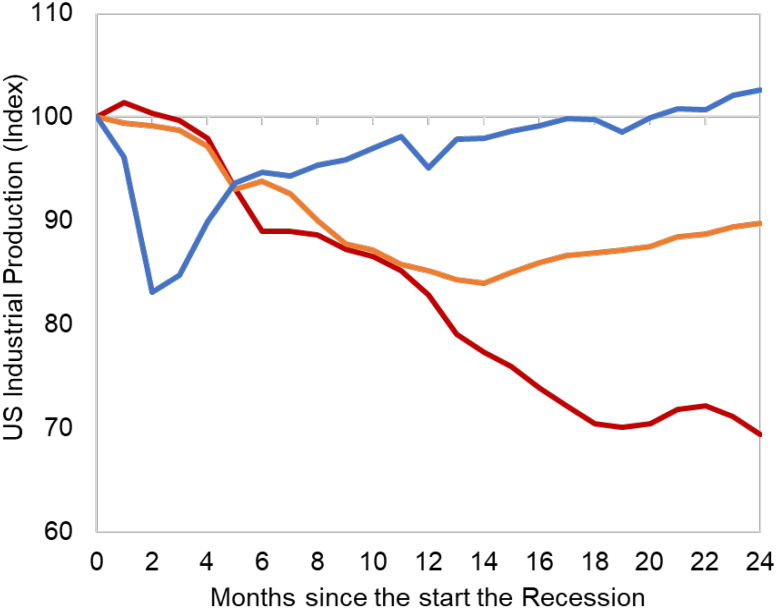


Source: IMF World Economic Outlook

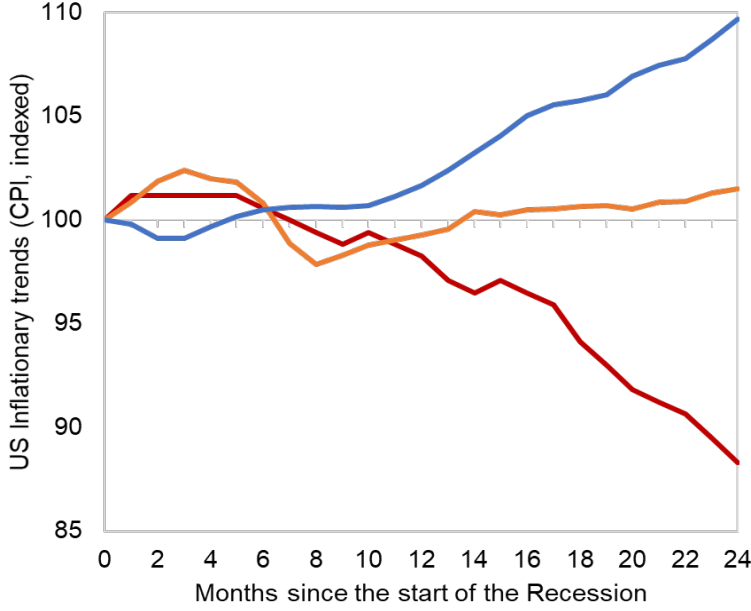
Note: The Weighted Averages of Debt to GDP ratios for EMEs in 2000, 2010, and 2020 are 45.3, 38.0 and 64.9, respectively. The Weighted Averages of Debt to GDP ratios for LIDCs in 2010 and 2020 are 28.3 and 49.5. Debt to GDP data is missing for 45 countries, constituting 23.8% of global GDP, in 2000; 23 countries, constituting 3.9% of global GDP, in 2010; and 13 countries, constituting 4.8% of global GDP, in 2020. Interest to tax revenue data is missing for 55 countries, constituting 41.5% of global GDP in 2000; 24 countries, constituting 11% of global GDP, in 2010; and 29 countries, constituting 26.7% of global GDP, in 2020.

# Bouncing Back

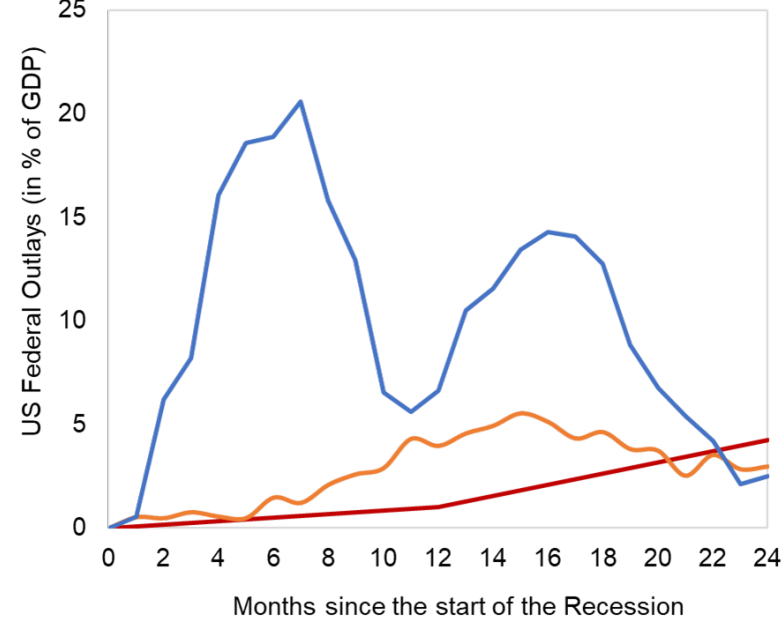
### Industrial Production



### Inflation (CPI)



### Total Government Spending



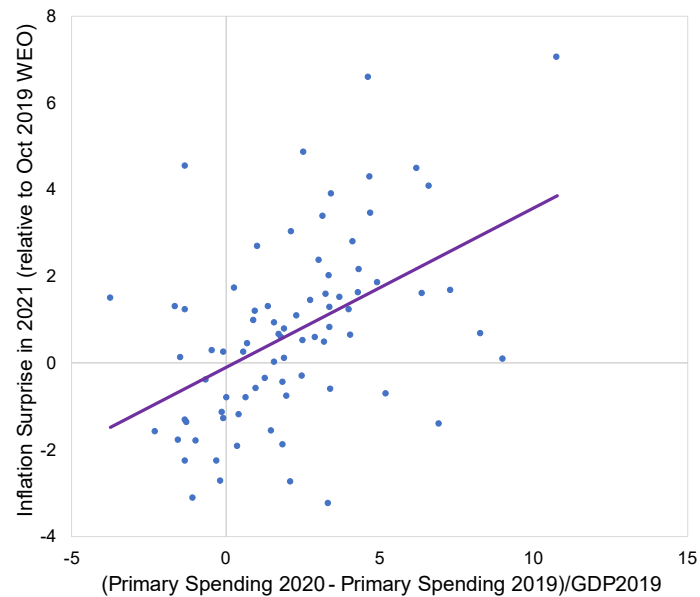
— Great Depression (June 1929=100) — Global Financial Crisis (April 2008=100) — COVID-19 (February 2020=100)

**Source: Federal Reserve (FRED); Bureau of Labor Statistics (BLS); Global Financial Database (GFD); Bureau of Economic Analysis (BEA); Haver Analytics & IMF Staff Calculations**

Note: Figures represent trends in the United States. In each figure, Great Depression in the US (June 1929=100); Global Financial Crisis in the US (April 2008=100) and COVID-19 in the US (February 2020=100) are indexed such that the starting point is at month 0; except for Total Government Spending, for which the start of the Great Depression is coded as 1929. The figures end at month 24 (two years from the start of the crises). The last datapoint for the COVID-19 crisis is February 2022. The charts follow the convention in “A Tale of Two Depressions” by Barry Eichengreen, Kevin O’Rourke (<https://voxeu.org/article/tale-two-depressions-what-do-new-data-tell-us-february-2010-update>).

# Spending, Inflation and Debt

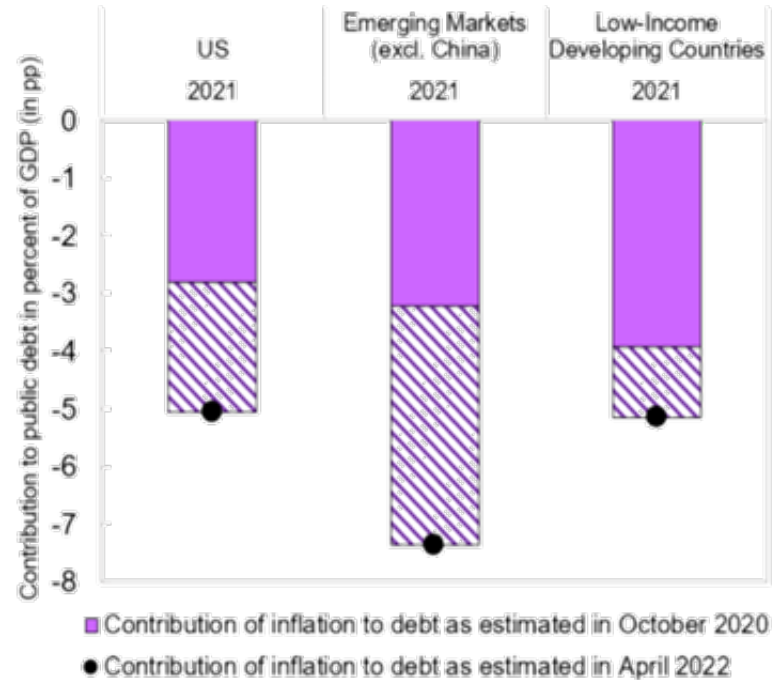
## Pandemic Spending and Inflation Surprises in EMEs



**Sources: IMF World Economic Outlook (WEO) Database and IMF staff calculations.**

Note: Inflation surprise is calculated as the difference between actual inflation (latest WEO vintage) and the projected value for 2021 from the October 2019 WEO vintage. The horizontal axis is calculated by taking the difference between the primary spending in 2020 and the primary spending in 2019 and dividing it by 2019 GDP.

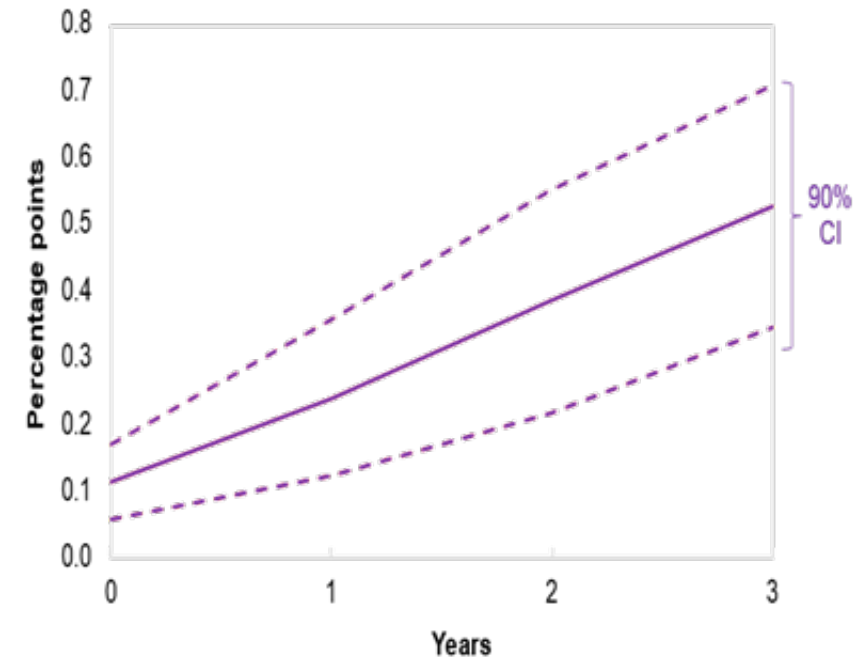
## Contribution of Inflation to Public Debt: Predicted vs. Actual, in Selected Countries



**Sources: IMF World Economic Outlook Database and IMF staff calculations.**

Note: Inflation is defined as the percentage change in GDP deflator. The decomposition of changes in the debt ratio is based on Escolano (2010). The contribution of inflation to debt in October 2020 is estimated with the WEO October database vintage.

## Response of Market Sovereign Interest Rate to Inflation Volatility Shocks (Percentage Points)

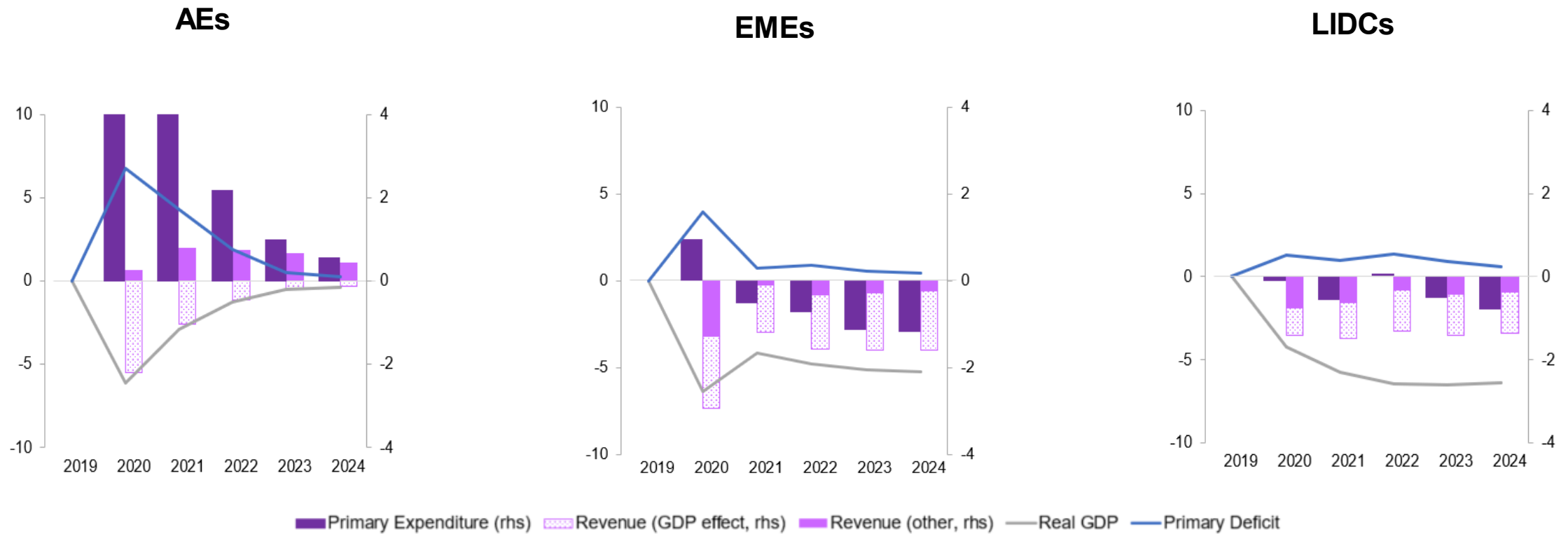


**Sources: Jordà, Schularick, and Taylor (2017), Mauro and Zhou (2021), Ha, Kose, and Ohnsorge (2021)**

Note: Sample 1975-2017, including 16 AE countries. Regressions are based on local-projection method for a dynamic panel. Country and year fixed effects are included.

# Permanent Output Losses in EMDEs

## Effect of the Pandemic on Revenue, Spending, Primary Deficit and GDP

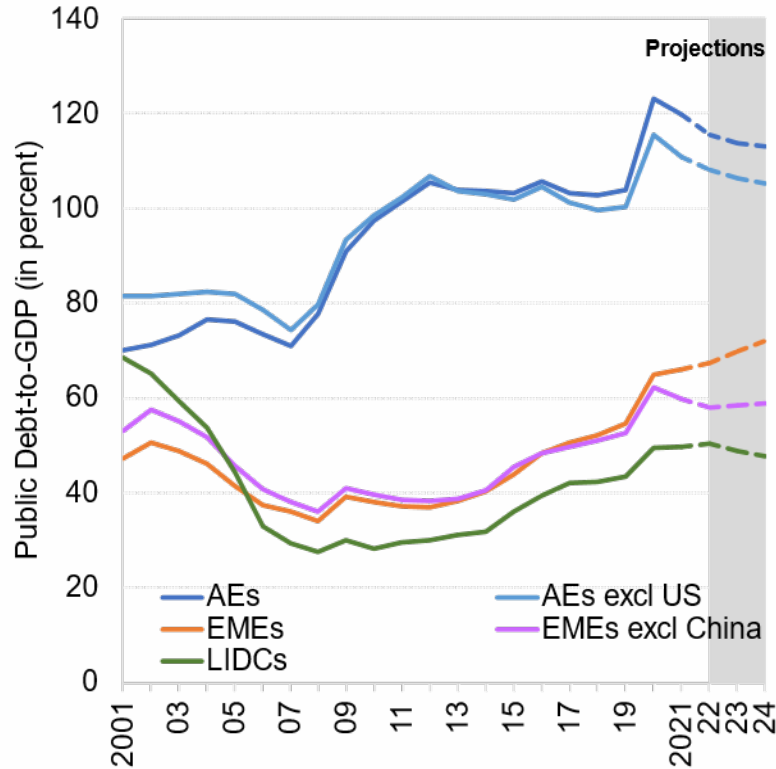


**Source: IMF WEO, Fiscal Monitor**

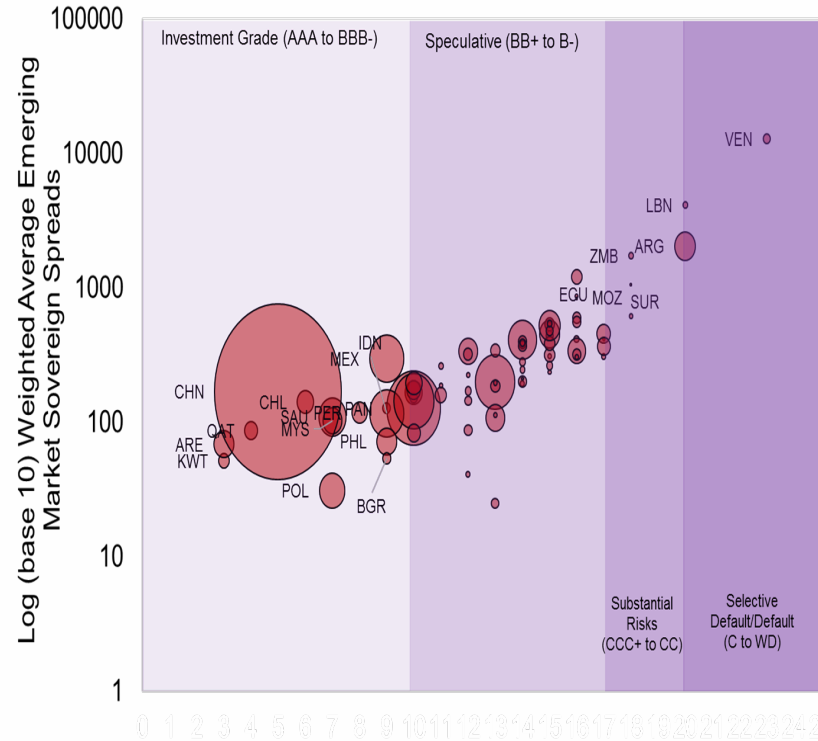
Note: All variables are weighted average real values, deviations from pre-pandemic projections as a percentage of projected GDP.

# Increased Debt Vulnerabilities

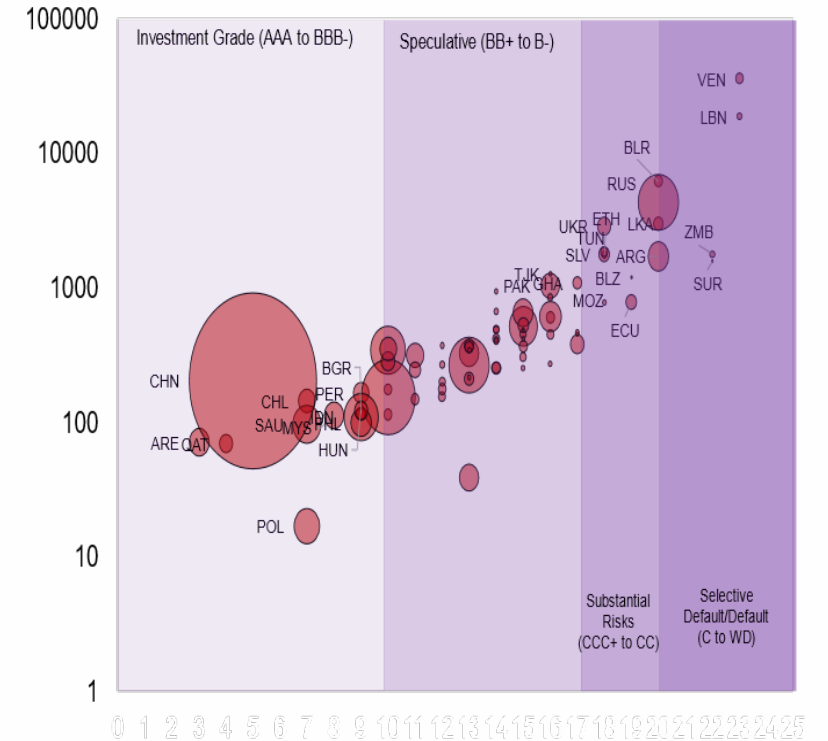
**Public Debt-to-GDP, by Income Groups (in percent, 2001-2024)**



**EMDEs Spreads and Ratings (Feb 21, 2020)**



**EMDEs Spreads and Ratings Current (Apr 5, 2022)**

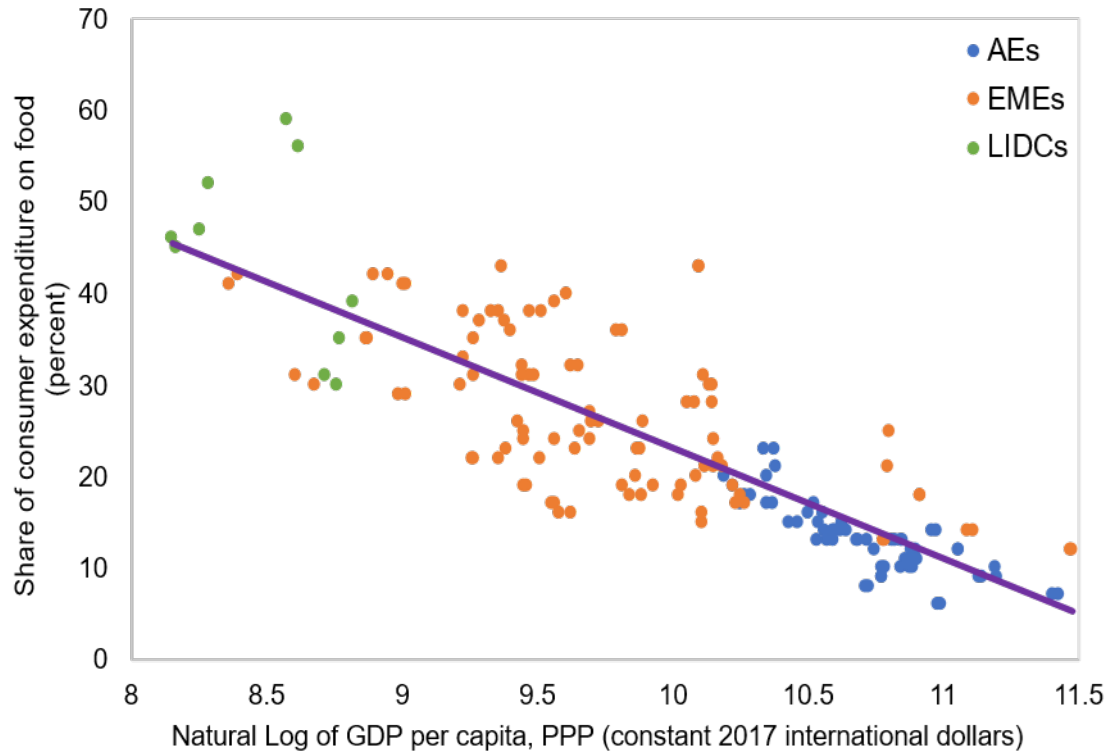


**Source: JP Morgan EMBI Sovereign Spreads, Bloomberg Finance, Moody's Ratings, S&P Sovereign Ratings, Fitch Ratings & IMF Staff analysis**

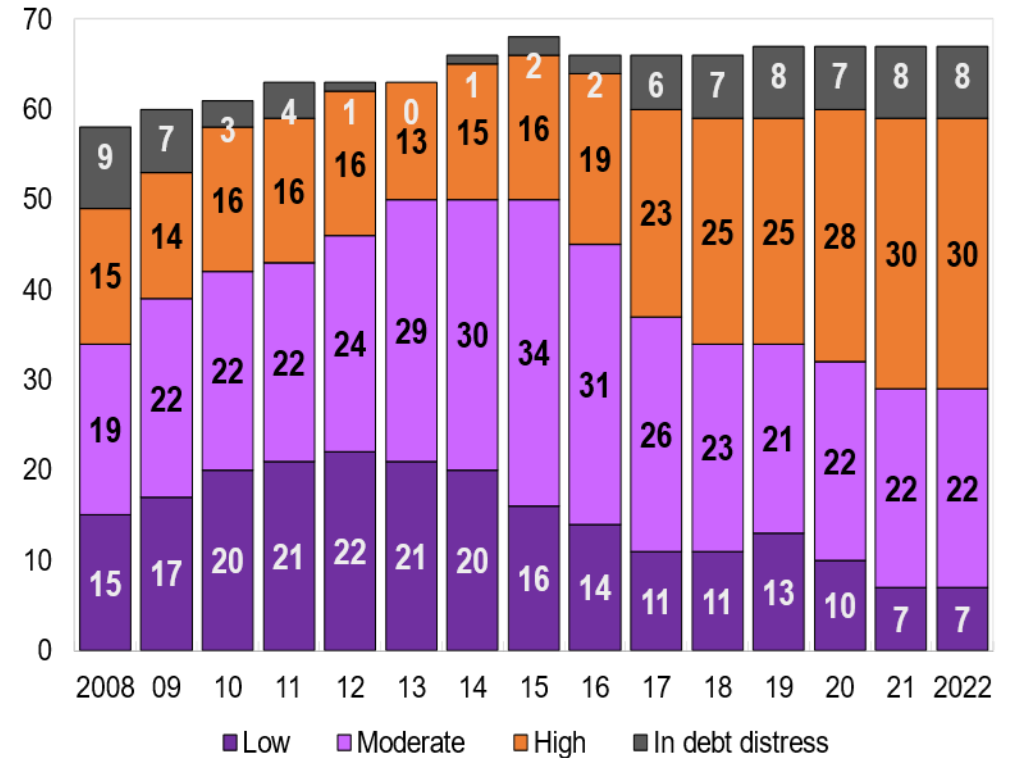
Note: Coverage for the Spreads and Ratings figures span across 63 EMEs and 16 LIDCs. The figures use the Log (base 10) scale on the vertical axis, representing weighted average sovereign spreads on Eurobonds. Bubble sizes represent the country's gross domestic product, in USD, current prices. Labels are only shown for Investment Grade, Substantial Risks or Selective Default/Default categories or countries with spreads over a 1000 bp (in Distress). The credit ratings are the lowest end of month credit ratings on the previous month (Jan 31, 2020, for the middle figure and Mar 31, 2022, for the right-hand side figure) across all three major credit agencies (S&P, Moody's & Fitch). The Ratings classification are standardized to the Fitch Rating hierarchy nomenclature.

# A Perfect Storm in Low-income Countries

### Food Spending and Income



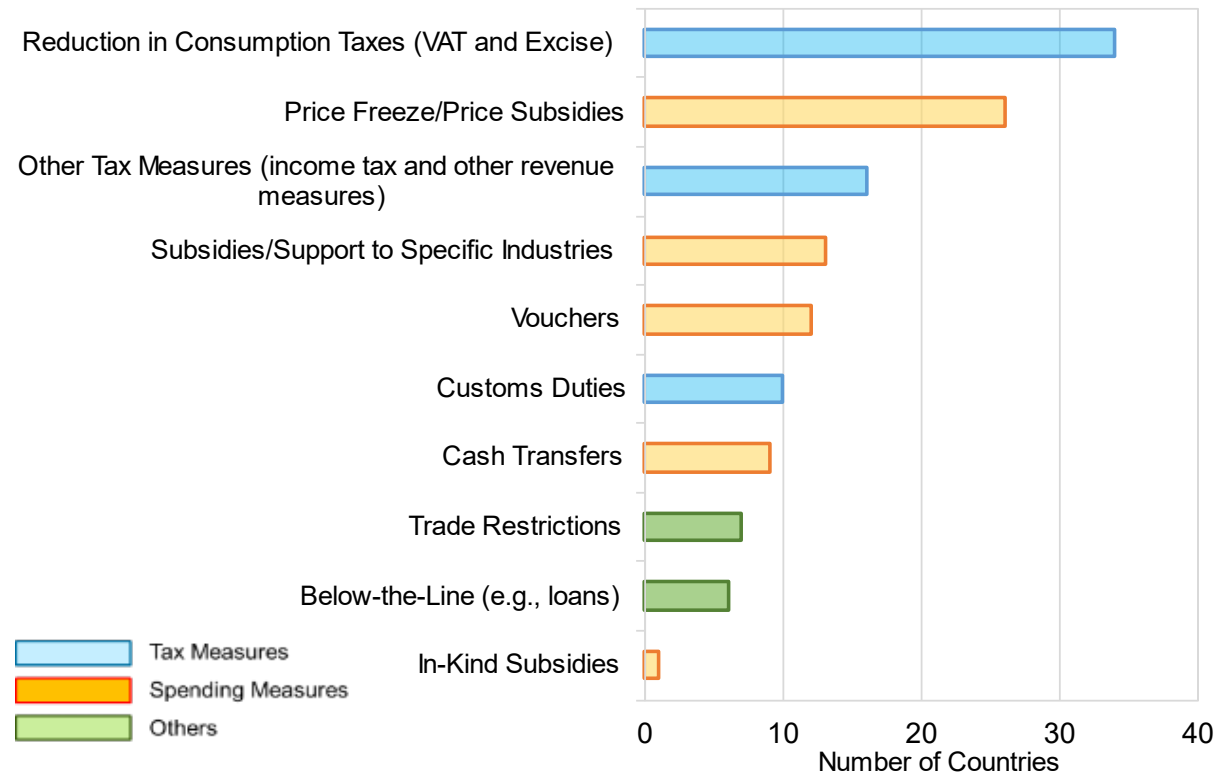
### Evolution of the Risk of Debt Distress (Count of DSSI-eligible LICs with DSAs)



Source: USDA; World Bank; IMF WEO; JP Morgan EMBIG Sovereign Spreads; Bloomberg Finance & IMF Staff Calculations

# Higher Prices and Subsidies<sup>253</sup> for Food and Energy

## Recently Announced Measures in Response to Higher Energy and Food Prices



Source: IMF desk survey for 129 countries conducted during March-April 2022.

Note: includes measures announced after January 1, 2022.

## Helping People while Providing Right Incentives

### In AEs:

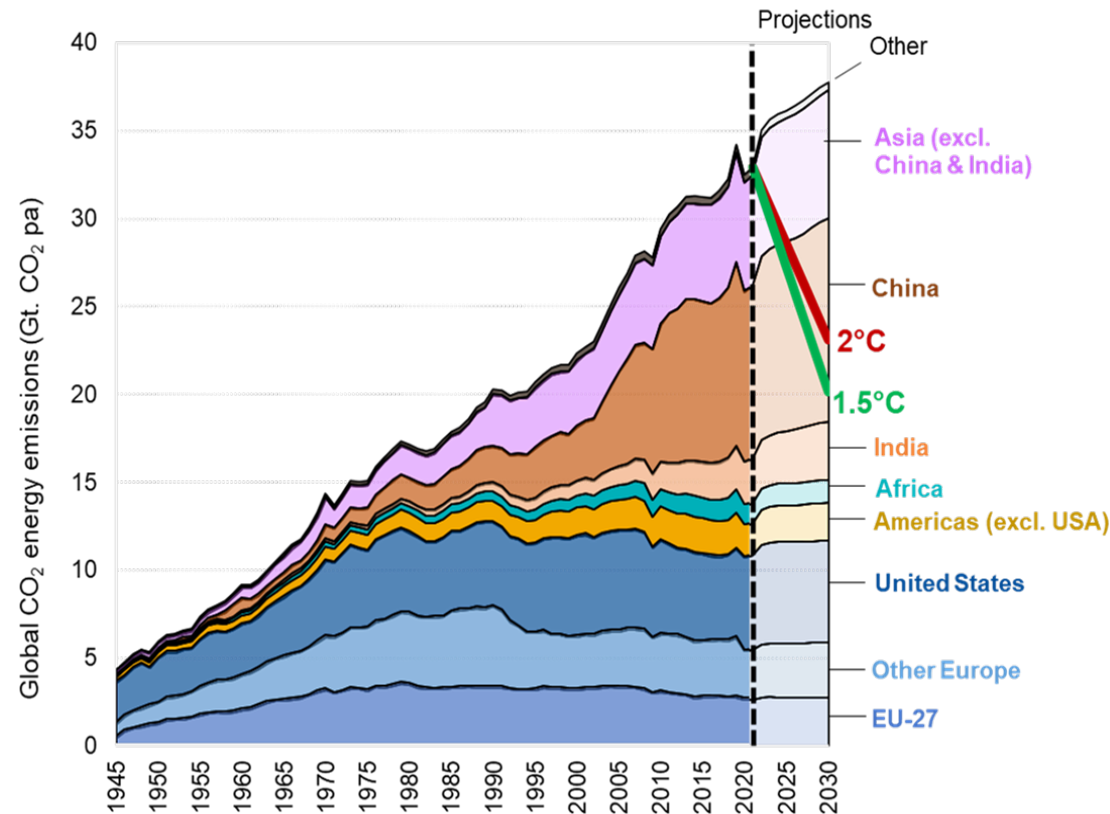
- Provide targeted and temporary transfers while allowing price pass-through
- Rely on existing social safety net programs and information systems

### In EMDEs:

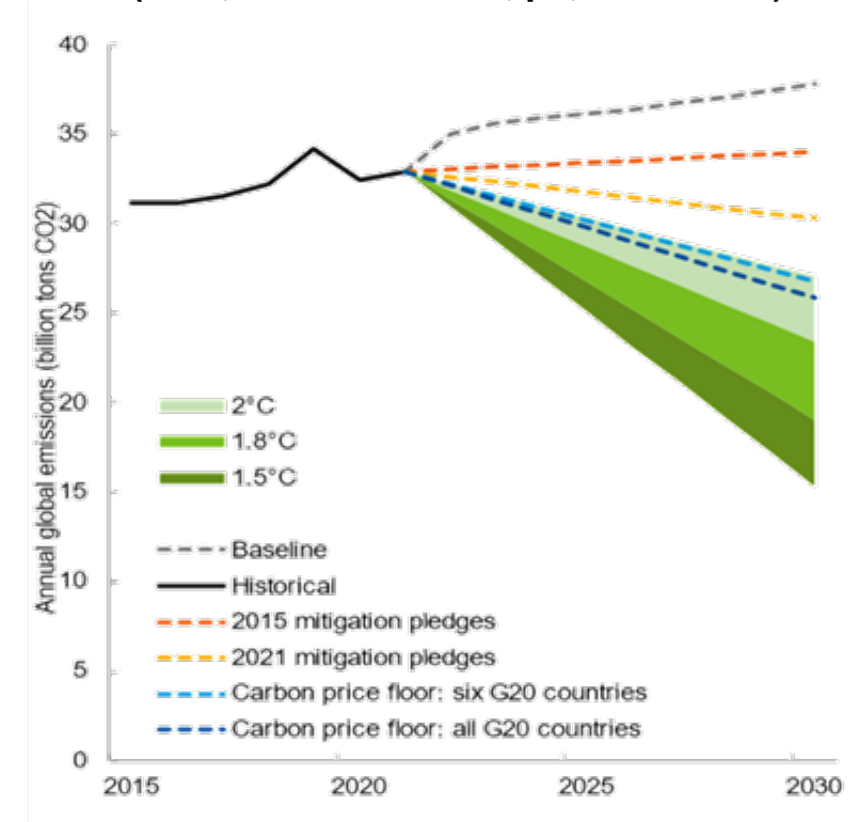
- Expand existing social safety net programs and ensure access to adequate nutrition
- If subsidies exist, phase price pass-through
- Lower education, health or public transport fees
- Adopt other measures with sunset clauses:
  - Smooth energy consumption bills
  - Provide lump-sum utility bill discounts
  - If unavoidable, allow gradual pass-through or tax breaks for food and cooking fuels

# Global Carbon Emissions Are Off-Track

**Global Carbon Emissions by Major Emitter  
(CO<sub>2</sub>, billions of tons, pa, 1945-2030)**



**Global Carbon Emissions with a Carbon Price Floor  
(CO<sub>2</sub>, billions of tons, pa, 2015-2030)**

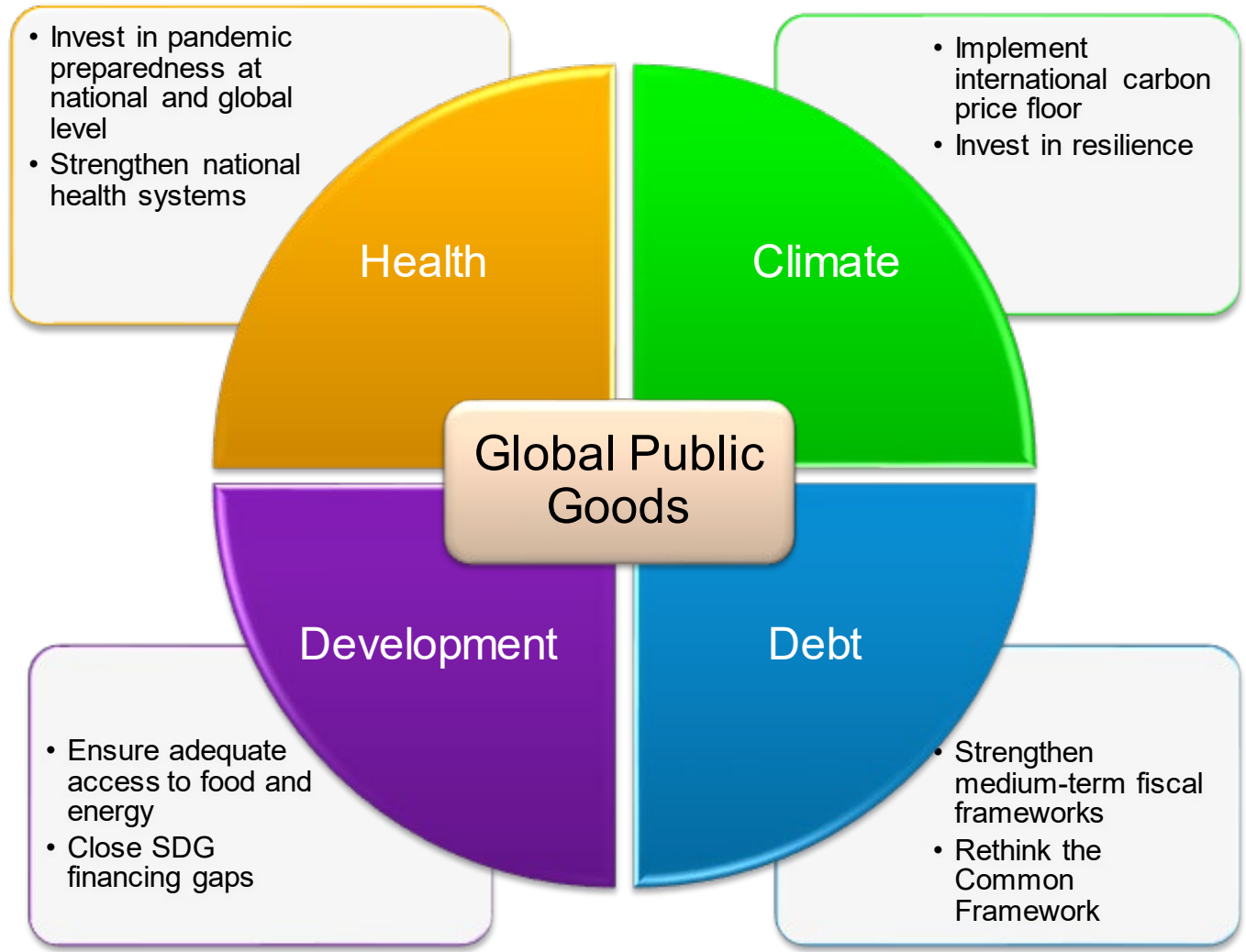


**Source : IMF World Economic Outlook (WEO) October 2017; IMF Fiscal Monitor April 2022; IMF CPAT-Tool; Sustainable Development Needs (2021); Global Carbon Project (2021); Our World in Data (2021); International Energy Agency (2021) & IMF Staff Calculations**

Note: Data uses fossil CO<sub>2</sub> emissions from energy-related and industrial processes, excluding international aviation and maritime. The LHS chart includes an adjustment to country-level emissions that aligns total emissions with those reported in the RHS by distributing the difference in the total proportionally across countries. Baseline projections assume no new, or tightening of existing, mitigation policy. The left figure's projections cover 170 countries and greater than 95% of global emissions in the IMF's CPAT tool. The illustrative computation is for an international carbon price floor on fossil fuel CO<sub>2</sub> emissions in 2030, which is aligned with keeping warming below 2°C. It differentiates prices according to development level: US\$75 per ton for advanced economies, US\$50 per ton for high-income emerging market economies such as China, and US\$25 per ton for low-income emerging market economies such as India.

# Health, Climate, Debt and Development are Global Public Goods

255



# Policy recommendations<sup>256</sup>

*Ending the war and bringing back peace is the first priority. In addition:*

## **Prevent inflationary pressures from becoming entrenched**

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## 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