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September 29, 2022–10:00 a.m.

World Economic Outlook; Global Financial Stability Report; Fiscal Monitor

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Staff:	Gourinchas, RES; Gaspar, FAD; Adrian and Natalucci, MCM
Length:	3 hours, 46 minutes

ISSUED: January 2, 2024
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CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's 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 broadly concurred that high inflation and associated tightening financial conditions resulting from policy normalization; the effects of Russia's war in Ukraine, particularly on food and energy prices; and the lingering COVID-19 pandemic, with its related supply chain disruptions, have all contributed to a weakening in global economic prospects. Directors recognized that risks to the outlook are unusually high. They agreed that the most prominent risks—including policy divergence and cross-border tensions, further energy and food price shocks, an entrenchment of inflation dynamics and a de-anchoring of inflation expectations, and debt vulnerabilities in some emerging markets—tilt the distribution of likely growth outcomes to the downside. Moreover, Directors recognized that the current environment of high inflation, slowdown in growth, and heightened uncertainty about the economic and policy outlook poses particularly difficult tradeoffs and challenges for policymakers, making the likelihood of a policy mistake higher than usual.

Against this backdrop, Directors agreed that the appropriate policy responses differ across countries, reflecting their local circumstances, their inflation and growth outlooks, and differences in trade and financial exposures. For most economies, they considered that tighter monetary and fiscal policies are necessary to durably reduce inflation. At the same time, they emphasized that these policies should be accompanied by structural reforms that improve productivity, expand economic capacity, and ease supply-side constraints. Directors recognized that many emerging market and developing economies (EMDEs) face tougher policy choices, as higher food and fuel prices, the need to support the recovery and vulnerable populations, and rising costs of market financing from tighter global financial conditions and US dollar appreciation can pull in different directions, necessitating a difficult balancing act.

Directors stressed that monetary authorities should act decisively and continue to normalize policy to prevent inflationary pressures from becoming entrenched and avoid an unmooring of inflation expectations. They agreed that central banks in most advanced economies and EMDEs would need to continue tightening the monetary policy stance to bring inflation credibly back to target and to anchor inflation expectations. Directors stressed that maintaining central bank independence and policy credibility will be essential to secure price stability. They also emphasized the importance of continuing to assess the impact of the simultaneous monetary tightening by central banks and, in particular, its implications for EMDEs. Directors stressed that clear communication of both policy functions and the unwavering commitment to achieve price objectives is crucial to preserve credibility and avoid unwarranted market volatility. They considered that, should global financial conditions tighten in a disorderly manner, EMDEs could face capital outflows and should be ready to use all available tools, including foreign exchange interventions and capital flow management measures, guided when appropriate by the Integrated Policy Framework and in line with the Institutional View on the Liberalization and Management of Capital Flows and without substituting for exchange rate flexibility and warranted macroeconomic adjustments.

Directors concurred that fiscal policy is operating in a highly uncertain environment of elevated inflation, slowdown in growth, high debt, and tightening borrowing conditions. They stressed that, where inflation is elevated, a tighter fiscal stance would send a powerful signal that policymakers are aligned in their fight against inflation. Such a signal would, in turn, reduce the size of required interest rate increases to keep inflation expectations anchored and would help keep borrowing costs lower. Directors emphasized that fiscal support to address the surge in cost of living from high food and energy prices should primarily focus on targeted support to the most vulnerable segments, given the criticality of preserving price incentives to promote energy conservation. Some Directors considered that additional but temporary energy policies may be needed in countries that face exceptionally high and volatile energy prices owing to Russia's war in Ukraine.

Directors broadly agreed that fiscal policy has a role in protecting people against loss in real incomes in moments of large adverse shocks, but that requires healthy public finances. Building on the experience of the pandemic, they considered that governments should invest in social safety nets and develop policy strategies and tools that can be readily deployed under various scenarios. Directors concurred that a sound and credible medium-term fiscal framework, including spending prioritization and efforts to raise revenues, can help manage urgent needs from high food and energy prices, rebuild fiscal buffers to cope with future crises, and make progress in long-term development needs, such as investment in renewable energy and health care, which can also foster economic resilience.

Directors noted that, although no material systemic event has materialized so far, financial stability risks have risen along many dimensions, which highlights the importance of containing a further buildup of financial vulnerabilities. Being mindful of country-specific circumstances and near-term economic challenges, they agreed that selected macroprudential tools may need to be adjusted to tackle pockets of elevated vulnerabilities. Directors noted, however, that striking a balance between containing the buildup of vulnerabilities and avoiding procyclicality and a disorderly tightening of financial conditions is important given heightened economic uncertainty and the ongoing policy normalization process.

Directors reiterated their urgent call for global cooperation and dialogue, which are essential to defuse geopolitical tensions, avoid further economic and trade fragmentation, and respond to challenges in an interconnected world. They agreed on the criticality of multilateral actions to respond to existing and unfolding humanitarian crises, end Russia's war in Ukraine, safeguard global liquidity, manage debt distress, mitigate and adapt to climate change, and end the pandemic. Noting that many countries are contending with tighter financial conditions, high debt levels, and pressures to protect the most vulnerable from surging inflation, Directors called on the multilateral institutions to stand ready to provide emergency liquidity to safeguard essential spending and contain financing crises. They also called for greater debt transparency and better mechanisms to produce orderly debt restructurings—including a more effective Common Framework—in those cases where insolvency issues prevail. Acknowledging that recent energy and food price shocks may have undermined the green transition, Directors stressed that achieving energy security and addressing the climate agenda go hand-in-hand, including by addressing the significant climate financing needs of EMDEs and investing in renewable energy and energy efficiency. Even though the COVID-19 pandemic is starting to fade, Directors called for decisive actions to address the continued inequity in access to healthcare and vaccinations worldwide and reduce the threat of future pandemics.

EXECUTIVE BOARD ATTENDANCE[2]

K. Georgieva, Chair

Executive Directors	**Alternate Executive Directors**
I. Mannathoko (AE)	
	F. Sylla (AF)
	L. Herrera (AG)
	O. Parkyn (AP)
A. Bevilaqua (BR)	
Z. Zhang (CC)	
P. Moreno (CE)	
	F. O'Brolchain (CO)
D. Palotai (EC)	
A. Buisse (FF)	
J. Stephan (GR)	
	C. Amarasekara (IN)
D. Fanizza (IT)	
J. Mizuguchi (JA)	
H. Hosseini (MD)	
M. Mohieldin (MI)	
P. Hilbers (NE)	
M. Poso (NO)	
	S. Potapov (RU)
A. BinZarah (SA)	
	F. Mochtar (ST)
	A. Tola (SZ), Temporary
S. Riach (UK)	
E. Shortino (US)	

C. Ogada, Secretary
R. Dall'Orto, Summing Up Officer
B. Zhao / D. Alcantara / M. Guerra Bradford, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: L. Eyraud, A. Tiffin. Asia and Pacific Department: D. Furceri, S. Peiris, K. Srinivasan. Communications Department: C. Abdallah, J. De Haro, R. Elnagar, N. Mombrial, A. Schimmelpfennig. European Central Bank: D. Rakitzis, R. Rueffer.

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

European Department: H. Berger, A. Kammer. Fiscal Affairs Department: G. Hong, W. Lam, S. Lizarazo Ruiz, V. Louca Rabaca Gaspar, P. Mauro, P. Medas, M. Poplawski Ribeiro, J. Ralyea, J. Roaf, A. Senhadji, J. Toro Rivera. Finance Department: Z. Murgasova, E. Rots. Human Resources Department: C. Purfield. Institute for Capacity Development: M. Erbenova, R. Nord. Independent Evaluation Office: C. Collyns. Legal Department: K. Christopherson Puh, Y. Liu. Middle East and Central Asia Department: T. Koranchelian, C. Serra Ronceros. Monetary and Capital Markets Department: N. Abbas, T. Adrian, R. Ajit Singh, P. Ananthakrishnan, M. Catalan, C. Cohen, T. Ehlers, A. Garcia Pascual, C. Gardes-Landolfini, O. Harrison, D. Iakovlev, J. Kramer, H. Kraus, F. Natalucci, M. Qureshi, F. Suntheim, J. Vandenbussche. Office of Risk Management: B. Boultwood. Research Department: J. Bluedorn, B. Carton, S. Chen, M. Dao, P. Gourinchas, P. Koeva Brooks, D. Leigh, J. Natal, D. Noureldin, R. Portillo Ocando. Strategy, Policy, and Review Department: C. Pazarbasioglu Dutz, N. Shenai, D. Velculescu, D. Zakharova. Statistics Department: A. Kroese. World Bank Group: M. Kose. Western Hemisphere Department: N. Chalk, R. Garcia-Saltos, I. Goldfajn. Executive Director: A. Andrianarivelo (AF), S. Bhalla (IN), S. Chodos (AG), C. Huh (AP), P. Jennings (CO), R. Lim (ST). Alternate Executive Director: A. Alhosani (MI), M. Alrashed (SA), H. Azal (EC), L. Dresse (NE), M. El Qorchi (MD), F. Fuentes (BR), A. Grant (AP), A. Guerra (CE), C. Just (EC), M. Kashima (JA), A. Marcussen (NO), M. Massourakis (IT), W. Nakunyada (AE), R. N'Sonde (AF), C. Roman (FF), J. Romero (CE), B. Saraiva (BR), M. Trott (UK), V. Vumendlini (AE). Senior Advisors to Executive Directors: A. Abdullahi (AE), S. Ahmed (MD), K. Badsi (MD), X. Bai (CC), E. Cartagena (CE), M. Choueiri (MI), R. Cunningham (CO), T. Doss (AP), Patterson C. Ekeocha (AE), V. Grossmann-Wirth (FF), E. Hagara (EC), O. Hendrick (AG), T. Krahnke (GR), B. Lischinsky (AG), R. Mahabir (BR), L. Marek (EC), A. Medearis (US), S. Nghiem (ST), T. Nguema-Affane (AF), C. Quaglierini (IT), H. Saeed (SA), C. Sassanpour (MD), D. Shestakov (RU), M. Sidi Bouna (AF), S. Spurga (NO), A. Tolstikov (RU), S. Tsur (NE), R. Velloso (BR), B. Yoo (AP). Advisors to Executive Directors: T. Abalala (SA), N. Abu Bakar (ST), Z. Ahmed (CO), N. Akosah (MD), M. Albert (FF), F. Al-Kohlany (MI), P. Al-Riffai (MI), D. Andreicut (UK), R. Bah (AF), S. Belhaj (MD), A. Biriukov (RU), B. Boostani (MD), I. Bustillo (AG), Campbell (UK), E. Choi (AP), T. Chrimes (UK), M. Coronel (BR), J. Corvalan (AG), S. Dash (IN), M. Day (CO), R. Edwards (CO), M. Ghalanos (NE), R. Kraavik (NO), T. Manchev (NE), C. Mastrapasqua (IT), G. Meizer (EC), M. Merhi (MI), R. Moral Betere (CE), A. Nainda (AE), I. Ogihara (JA), G. Ogmundsdottir (NO), Y. Qi (CC), C. Ramos Capaquira (AG), A. Rao (US), E. Shimada (JA), B. Slettvag (NO), L. Sturm (US), S. Verhelst (NE), C. Westphal (US), F. Lopez (CE).

DISCUSSION RECORD[3]

The Chair:

We all know why we are assembled. We have the World Economic Outlook (WEO), the Global Financial Stability Report (GFSR), and the Fiscal Monitor, the three flagships that always generate significant interest prior to and during the Annual Meetings.

I want to thank Directors. All have issued gray statements with very thoughtful views on the materials you have received.

We have the representatives from the World Bank and the World Trade Organization in attendance. The European Central Bank (ECB), as always, is part of the assembly today, and the ECB representative also issued a statement.

We had our last discussion on the topics in front of us in July. Unfortunately, the downside risks we had outlined at that time continue to materialize. Inflation remains stubbornly high. It is leading to more accelerated than expected monetary tightening. We have the shocks from Russia's war in Ukraine continuing to drag down economic activity and disrupt commodity prices. Borrowing costs for many emerging market and developing economies (EMDEs) have risen sharply, exacerbating what has been already a strained debt position for many countries.

Just yesterday, the President of Malawi was here. Finding a pathway to help a country that is so severely burdened by debt is not an easy task. What we know is that dollar appreciation adds to this difficulty in many EMDEs and is not irrelevant for advanced economies as well.

What we now reflect on are high-frequency indicators that are not providing comfort. They are confirming that the global economy is in a broad-based slowdown. We have an outlook that remains decidedly gloomy, especially for 2023, and uncertain—on average, worse than what we had in July.

What is more important is, where is the Fund taking its policy advice and how we can, in this environment, be the most helpful to our members.

[3] Edited for clarity.

We will have Mr. Gourinchas, Mr. Adrian, and Mr. Gaspar, make their presentations on the latest analyses and forecasts, and then we will listen to your views.

AI do keep in mind Ms. Shortino's point, that it is tough, but we have to think through what can be done. I would welcome your views exactly in that direction.

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

Welcome to the World Economic and Market Developments.

The global economy faces persistent challenges. (Slide 1) The outlook continues to worsen, with lower projected growth in 2023, while inflation remains stubbornly elevated, squeezing real incomes. As you can see on the left, growth in 2022 is broadly unchanged, but this masks significant upgrades for emerging Europe and the euro area, and a downgrade for the U.S. For 2023, growth is revised downwards by 0.2 percentage points, and the downgrade is broad based.

The slowdown in 2023, to 2.7 percent, will push many countries, representing about 30 percent of global output, into a technical recession. That is two quarters of negative growth. For the first time, we are also providing a risk assessment around the baseline, as you can see in the middle chart.

While negative global growth is highly unlikely, there is a 25 percent chance that growth will fall below 2 percent in 2023—which happened only very rarely in the past—and a 10 to 15 percent chance it will fall below 1 percent, corresponding to a decline in real income per capita. Such an outcome would also be reached under our model-based adverse scenario. Inflation has been revised up yet again and is expected to peak at 9.5 percent in 2022 Q3.

The risks remain firmly to the downside—disinflation proving more costly, or policy miscalibration, the dollar strengthening, and tighter financial conditions, the slowdown in China, or the Russian invasion of Ukraine further destabilizing energy markets.

The priorities remain broadly unchanged since July. First, it is imperative to tame inflation, even as the economy slows down. Second, fiscal policy becomes even more challenging, especially for countries confronted with the energy or food price crisis. It should remain targeted and not work at cross-purpose with monetary policy. Finally, progress must be made to address common challenges, such as mounting debt distress in low-income countries (LICs), the climate transition, and policies to avoid further geo-economic fragmentation.

Downside risks are materializing. (Slide 2) The global outlook is still shaped by the same three powerful economic forces we highlighted in previous forecast rounds—persistent and broadening price pressures, the Russian invasion of Ukraine, and the slowdown in China. Persistent inflation pressures are squeezing real incomes and prompting a significant tightening of monetary policy, as we can see on the left for the U.S. and the euro area.

In the middle, we see that, as a consequence of the war in Ukraine, the associated economic sanctions, and countersanctions, Russian gas flows to Europe have dwindled to less than 20 percent of their 2021 levels.

On the right, we see the collapse in the number of buildings sold in China and in consumer confidence in that country, a major source of weakness for the Chinese economy going forward.

Turning to inflation (Slide 3), its persistence is deepening the cost-of-living crisis. In many countries, part of the inflation surge was driven by elevated commodity and food prices, as you can see on the left. Of late, as the global economy shows signs of cooling off and some supply restrictions are lifted—for instance, the Black Sea grain deal—commodity prices have been coming down. Looking ahead, this should contribute to moderate headline inflation further. One exception is natural gas in Europe, which is more than 15 times as high now as in 2020. The geopolitical realignment caused by the war implies that high and volatile energy prices will persist for a long time. It will require a structural adjustment by households, firms, and governments.

Across the G20, inflation was initially high in goods and subdued in services, reflecting restrictions on spending, coupled with strong income support. As the economy reopened, we have witnessed some stabilization of goods inflation but an increase in services inflation, as you can see in the middle graph. Going forward, this contributes to fueling and broadening overall inflation.

As we see on the right, world headline inflation has been rising strongly in 2021. As a result of easing commodity prices and stabilizing goods inflation, headline inflation has come down recently. However, core inflation continues to push upwards on a sequential basis, suggesting that the inflation pressures are now quite broad.

Turning to labor market developments, there are some signs of resilience. (Slide 4) First, labor market conditions remain very strong in many advanced economies. For instance, in the U.S., the ratio of vacancies to unemployment is historically high, as you can see on the left, with almost two jobs for every unemployed worker.

Looking ahead, reducing labor market tightness may well require both a reduction in vacancies and also an increase in unemployment. At the same time, such labor market tightness suggests that the economy is some distance away from a recession. Furthermore, as we show in Chapter 2 of the WEO, analyses of previous historical episodes similar to the one we are experiencing now, with rapid increases in prices and wages, find that these often do not generate wage-price spirals, as you can see in the middle graph. Often nominal wage growth moderates, maybe in part because of subsequent tightening of monetary policy. The risk of wage-price spirals is also contained by the fact that real wage developments have been reasonably aligned with productivity growth at the industry level. While wage growth so far has not caught up with inflation, industries that experienced higher productivity growth, particularly tele-workable professional services, have also tended to see higher real wage growth, as you see on the right.

Turning now to policies. (Slide 5) First, we are witnessing an unprecedented cycle of tightening of monetary policy, as much in advanced economies as in emerging markets. This tightening is critical to ensure a stable future macroeconomic environment. Inflation is a regressive and very unpopular form of taxation, hurting the poor disproportionately. This is associated, as will be discussed in great detail by Mr. Adrian, with a sharp tightening of financial conditions, as you can see in the middle, although these are not yet particularly tight, especially in advanced economies.

Finally, zooming in on the fiscal side in Europe, the region is experiencing a severe terms of trade shock, which we estimate between 2 and 6 percent of GDP, due to the surge in energy prices, as you can see on the right. As the figure illustrates, the fiscal stance softened significantly more in countries with larger terms of trade shocks. This is likely to extend further when new fiscal packages to shield households from the energy crisis will be announced.

For emerging markets, vulnerabilities are rising but unevenly. (Slide 6) Looking first at dollar exchange rates, while the dollar has risen sharply since last year, this has been primarily against other advanced economies. With respect to emerging markets, the rise has been uneven, with some countries even appreciating against the U.S. dollar, as you can see on the left. Since July, however, most currencies lost ground, and the dollar has sometimes reached levels last seen more than 20 years ago.

Turning to spreads, in the middle chart, there is no sign of a broad taper tantrum so far. Median spreads have increased, but the dispersion has become much larger. About 60 percent of low-income developing countries (LIDCs) and frontier economies are now close to or in debt distress, many of them in sub-Saharan Africa. Consistent with this, we also see differentiated capital flow patterns across emerging markets. For instance, some countries, like China, have seen massive outflows, while other countries, especially in Latin America and emerging Asia, have seen net inflows, as you see on the right. Overall, portfolio flows to emerging markets have been persistently negative since the start of the war.

You will have seen our assumptions for this round of projections summarized on this slide (Slide 7) and elaborated in Chapter 1 of the WEO. Let me just point out that, in addition to the baseline, we also have articulated a model-based adverse scenario, where some key downside risks materialize. Let me now turn to those projections.

First, with the headline numbers under the baseline scenario. World growth is unchanged in 2022, compared to the July forecast, at 3.2 percent. Global growth slows down to 2.7 percent in 2023, a negative 0.2 percentage point revision from July. The slowdown is concentrated in advanced economies, with a growth of 1.1 percent projected for 2023 and some European economies experiencing negative annual growth, in particular, Germany and Italy. The U.S. is revised downward significantly in 2022, bringing the economy very close to a recession in 2023, and with unemployment projected to rise to 5.6 percent in 2024. Growth is stalled in the euro area and the United Kingdom for 2023.

Under the adverse scenario—these are the numbers in parenthesis—growth falls to 1.1 percent at the global level, bringing the world economy into recession territory. Most major advanced economies would be in a recession.

Emerging markets and developing economies proved to be resilient in 2022. We have a plus 0.1 percentage point upward revision, offset by modest downward revision in 2023 of negative 0.2 percentage points. We project a significant upwards revision for Brazil this year, on the back of the reopening of services, fiscal expansion, and favorable commodity prices; Russia, on the back of resilient energy exports and stabilized domestic demand, as well as commodity exporters outside Russia. By contrast, China is revised downwards both in 2022 and 2023.

Under the adverse scenario, growth in EMDEs is almost halved to 2 percent, with China seeing a severe slowdown on par with COVID-19 in 2020, at 2.3 percent.

Let us now turn to policy challenges. (Slide 8) For monetary policy, there is both a risk of overtightening and under-tightening. However, we view the distribution of costs as asymmetric. At this juncture, the risk of under-tightening, especially at the first sign of slowdown, is more relevant. This happened in the United States in 1979 and 1980. The situation now is in some ways similar, with a persistent and rising inflation rate, as you can see in the top left.

After hiking aggressively, starting in August 1979, the Federal Reserve eased the policy rate between April and May 1980, as you can see in the top right graph; but a combination of a slight slowdown in headline inflation and a significant output contraction seemed to have prompted Fed to reverse course. This was a policy mistake. While headline inflation did peak in March 1980, core inflation was still rising, and inflation expectations remained high and unanchored. With the job unfinished, the Fed needed to hike again, taking the federal funds rate to about 19 percent by year's end and precipitating a deep recession in 1981/82.

One important difference between then and now is that inflation expectations were largely unanchored in 1979, while they are well anchored now, but the general principle remains. Now, as in the early 1980s, central banks need to stay the course.

A second policy challenge is that the main source of inflation pressure is different in the U.S. and the euro area. (Slide 9) In the euro area, the rise in energy prices accounts for 70 percent of the increase in headline inflation, from August 2021 to August 2022. In the U.S., the corresponding figure is 39 percent, as you can see on the left. The associated terms of trade shock in Europe is already squeezing real incomes and slowing activity. In that context, it is natural that the ECB policy moves at a more measured pace than the Fed in the near term, as can be seen in the gap between the policy rate and the nominal neutral rate in the U.S., shown in red, and the euro area, shown in blue, in the middle figure.

While the U.S. is expected to be in tightening territory by the end of this year, this will happen only by the end of next year in the euro area, according to these calculations. However, as the euro area inflation remains elevated, this runs a significant risk of inflation expectations de-anchoring. From that perspective, the latest movements in consumer inflation expectations, which you can see on the right, are worrisome. While inflation expectations are re-anchoring in the U.S., they are drifting upwards in Europe. This may well force the hand of the ECB, amplifying the slowdown.

A further challenge is to formulate and calibrate the proper fiscal policy in an environment with persistent price pressures and an energy crisis that is hurting people. (Slide 10) First, observe that the surge in surprise inflation in 2021/2022 is reducing public sector liabilities, just as it compresses household net worth. We see this on the left. This, and the withdrawal of extraordinary fiscal measures from the pandemic, helped to rebuild fiscal buffers. This is a common pattern in the aftermath of war financing, something Mr. Gaspar will talk about in more detail.

Countries hit by the energy crisis may wish to use part of that restored fiscal space to smooth the energy shock; however, there are three things to keep in mind. First, it is important not to work at cross-purpose with monetary policy. Second, fiscal measures need to account for the fact that the energy crisis is persistent. It will not be over for many years. Third, the shock from the war and energy crisis is substantial but far smaller than that of COVID, as you can see in the middle chart.

Overall, the fiscal stance should not become expansionary. Fiscal policy has an important role to play in protecting vulnerable households. Importantly, it should not do this in ways that exacerbate the energy crisis. Price signals are a critical way to reduce demand, as the graph on the right illustrates. Open-ended, untargeted subsidies, sometimes introduced on the ground so that they may help to temporarily reduce headline inflation, are costly, hard to unwind, and worsen the energy crisis.

For emerging markets and LICs, an important challenge is the appreciation of the dollar. (Slide 11) While sovereigns have been able to issue more local currency debt, limiting their dollar exposure, private debt in dollars has been rising markedly, as you can see on the left. A strong dollar negatively impacts corporate and bank balance sheets in emerging markets. The dollar strength has also contributed to imported inflation across major emerging markets, with more inflation pressure to come if the dollar appreciates further, as you can see in the middle. This sharp dollar appreciation is pushing many emerging markets to intervene in foreign exchange (FX) markets, sometimes heavily, such as the case of India or Turkïye, as you can see on the right. In our assessment, most of the dollar appreciation so far reflects fundamental forces, such as the size of the terms of trade shock or the stance of monetary policy. These adjustments are likely to persist since the shocks themselves are persistent. In situations like this, it is appropriate to let the exchange rate adjust, wherever possible.

Using FX interventions at this juncture risks depleting reserves that could become useful if the situation really worsens, for instance, in case of a risk-off episode for countries with shallow FX markets. It would be much preferable for countries to use the precautionary facilities of the Fund, when eligible, and/or combine different tools from the Integrated Policy Framework (IPF) to address external vulnerabilities and shocks.

Let me now turn to climate. (Slide 12) As evidenced by the news headlines over the summer, the climate transition is already upon us. The only question is whether it will be mitigated and managed or left uncontrolled. Looking ahead, we can expect more drought days and a more volatile climate, especially in LICs, if carbon emissions continue unabated, with direct implications for agricultural yields, as we can see on the left. Chapter 3 of the WEO explores the near-term cost of the climate transition. As we can see in the middle, these costs are not zero, yet they remain modest in comparison to the calamitous cost of global warming, itself. Importantly, these costs become much larger if climate action is delayed, as this would force a much steeper climate transition.

Finally, as we see on the right, energy independence—through heavier investments in renewables, for instance—is compatible with reduced energy dependence. Even if renewables are intermittent and require complementary sources of energy, the direct and primary effect is that they reduce the overall dependence on imported energies, such as gas.

Before I turn it over to Mr. Adrian, let me reemphasize the main messages. (Slide 13)

First, the outlook is darkening further, especially for 2023. Downside risks are materializing, and many countries may experience a recession next year. Inflation is persistent and broad based, squeezing real incomes.

Second, inflation remains the major threat that most countries face. The main risk remains that central banks ease too early when output slows down and before inflation has come down. It remains paramount to stay the course until price stability is restored. Fiscal policy should remain targeted and temporary and not work at cross-purpose with monetary policy.

Third, the appreciation of the dollar is creating severe headwinds for many countries, especially emerging markets. Improving resiliency and building buffers is important.

Finally, most risks are firmly to the downside.

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

Let me now turn to the global financial stability assessment.

To open, I am showing you here a chart with distributions of inflation across countries. (Slide 1) The dark blue in the top is the share of countries with inflation of 6 percent or more, and you can see that share has risen dramatically in recent months. You have to go back to the 1980s, that Mr. Gourinchas already mentioned, to see such a high share of countries with high inflation. As a result, fighting inflation is the No. 1 goal of central banks.

Fighting inflation means that monetary conditions are tightened, and an important transmission mechanism of monetary conditions is the tightening of financial conditions. (Slide 2) Here, you will see that, very broadly around the world, financial conditions have tightened. The left chart shows advanced economies. The right chart shows emerging markets. The one country that is an exception is China, where monetary policy has eased, and other measures, such as underwriting standards in the housing markets, have been eased as well. Outside of China, in emerging markets, financial conditions have tightened, and that is particularly sharp in Europe, the Middle East, and Africa, shown in red in the right chart.

Recent weeks have seen particularly dramatic moves. (Slide 3) What I am showing here is data that is looking at changes in yields, in the left; equities, in the middle; and G10 and emerging market currencies, on the right.

These are changes between August 26 and September 23, so it is just before this week, and I am going to talk about this week throughout the slides.

What you can see is that yields in just one month have increased dramatically. The chart indicates historical 25 and 75 percent intervals in these box plots, and these movements are way outside historical norms. For the U.K., the move up to September 23 was over 100 basis points. These are very stressful scenarios and realizations.

The middle chart shows the equity returns there as well for the S&P 500, a 10 percent decline in just a month. The euro stock index is down sharply as well, though not as much as the S&P 500. Then with the G10 currencies, you can see the continued pressure, appreciation of the U.S. dollar, downward pressure on most G10 and emerging market currencies.

The overall theme in terms of global financial stability is fourfold. (Slide 4)

First, more tightening is priced in most countries—again, China being a notable exception here—but in the vast majority of countries, when you look at the yield curves, you will see more monetary tightening priced in, as central banks are fighting inflation.

Second, again, as explained by Mr. Gourinchas, stagflation threats loom globally. There is a high likelihood of recession in many countries, in an environment of high inflation. And the energy crisis is particularly acute in Europe, as well as in a number of EMDEs.

Third, vulnerable EMDEs could face defaults and difficult restructurings.

Finally, global housing risks are intensifying. I will show you some quantitative assessments of that. In China, there is already severe stress in the property market.

Turning to the evolution of the tightening of central banks. (Slide 5) On the left chart, you see the number of central banks that are changing policy rates. In 2019 and particularly in 2020, there was a synchronized easing of monetary policy around the world. Now we have a synchronized tightening of monetary policy that is extremely strong by historical standards. As a result, the right-hand chart shows you that the correlation among yields—yield changes for the two-year maturity has increased tremendously. There is a big commonality in terms of the direction of monetary policy, as seen in yield curves. As a result, the dollar has strengthened. (Slide 6) The left chart shows you the dollar against the euro, the pound, and the yen—these are the major financial market centers of the world. And the axes are such that dollar appreciation is up. There is a very sharp dollar appreciation against those three major currencies recently.

Against emerging markets, the picture is more mixed. Against Latin American countries year to date, there has been a dollar depreciation, particularly against Brazil, Mexico, and Latin America, as a whole. But against other emerging market areas, such as Central and Eastern Europe and Asian emerging markets, there has been a broad dollar appreciation. We have already heard some of the implications of that dollar appreciation. It puts further inflationary pressures, which is triggering a further tightening in many countries.

One important finding—and that is related to the theme of financial conditions and what is driving financial conditions—is a decomposition of equity returns for the S&P 500, but that is also true more broadly in many equity markets around the world. (Slide 7)

There are three basic ingredients to equity valuations. No. 1, the level of interest rates and the 10-year Treasury yield has increased dramatically since last year, over 200 basis points. Secondly, earnings expectations—because equities give future cash flows through earnings. Then the third component is equity risk premium.

The right-hand chart shows the cumulative returns to the S&P 500, in black, and the two components that have dragged down those returns—earnings are lower and interest rates are higher, but risk premia, on the other hand, have not compressed that much. That goes with the theme that there has been a tightening of financial conditions, but it has not yet been disorderly. We could certainly see a disorderly tightening. We could see another dash for cash, very wide market illiquidity and we got a bit of a taste of that this week.

Turning to monetary policy. (Slide 8) Mr. Gourinchas showed you the expectations of monetary policy in the shorter term. I am focusing on the expectations in the longer term. What I am showing here for the U.S. and the euro area are the nominal yields, in gray, the break-even inflation, and then the difference between the nominal, reals, and break-even inflation, which are the interest rates. As economists, we believe that it is the real interest rate that matters for real decisions, such as consumption decisions, investment decisions. And you can see that real yields are now positive across the yield curve in the U.S. and in the euro area, but the yield curve is not very sharply inverted yet. If you think that the stance of monetary policy is very tight, you would imagine that the real yield curve would be inverted.

Now, they are different measures of inflation, and I will show, for the U.S., two alternative measures, relative to the break-even inflation. One is the primary dealer survey expectation. The other one is the median survey from the economic projections of the Federal Reserve. Those would lead to slightly lower implied inflation; hence, slightly higher real interest rates and also slightly more inverted real interest rates. It does indicate a slightly tighter stance of monetary policy, if you look at these alternative metrics. But, clearly, we are still in the process of tightening.

In Europe, as well, there is a positive real interest rate, but it is not extremely downward-sloping, and that could change over time. In particular, that could change if upside risks to inflation were to realize. Here, we are looking at household expectations of inflation for the U.S., U.K., and Germany, in the left chart, and the option-implied distribution of inflation for the euro area, on the right chart. (Slide 9) The left chart shows that the median across all the survey respondents is well above the inflation target, which we know well, but furthermore, there is a huge upside risk in this inflation forecast distribution. There is a big skewness to the right.

This is also visible in the inflation options here. You can see that the mode of the options was about 2 percent as of 2018. Then as of April 2022, it shifted to 4 percent, and now it is sort of bimodal, with one mode at 2 percent, one mode at 4 percent. There is certainly quite a bit of upside risk, relative to the target priced in. This is for both charts at the one-year horizon.

Turning to specific risks in the euro area and the United Kingdom, there has been pressure. (Slide 10) The backdrop is the high energy prices, shown on the left chart. Energy prices have come down a bit, but they are still extremely elevated by historical standards. That has put pressure on inflation, and it has triggered a tightening of monetary policy. In the middle chart, you can see the German benchmark yield in the euro area, in blue. As monetary policy has been tightening, the German yield has come up; spreads of the southern European countries have also come up. The ECB has taken important action in terms of introducing the transmission mechanism tool, which is expected to contain this fragmentation risk.

Turning to the U.K., and this concerns what has happened this week, in particular. What we have seen in recent weeks is a very sharp depreciation of the pound vis-à-vis the dollar. Here, it is shown in the usual direction. Depreciation is a drop here in the blue line, and that has happened against the backdrop of very quickly rising yields. That is an unusual picture. Normally, when interest rates are rising, your currency is appreciating, while in this case, the currency was strongly depreciating.

Last week a new fiscal package was announced, and that put further upward pressure on yields. There is a financial stability concern that arose in the U.K., where liability-driven investors—these are pension funds and insurance companies that are taking on leverage in the gilt market to increase returns—have gotten under pressure through margin calls. Now the Bank of England was faced with a tradeoff between financial stability and price stability goals. On the one hand, price stability had led the Bank of England to announce quantitative tightening earlier this year, so the sale of gilts; but the short-term financial stability pressures are one where the rise in yields puts financial stability concerns in the financial sector. So for a temporary time period, until October 14, the Bank of England now announced that it will buy gilt yields. That has led to a very sharp drop in yields—by historical magnitudes, extremely sharp. It has been successful in terms of stabilizing the markets. But the question is going to be, what will happen on October 14? How will the policy be followed going forward? Because this tension between inflation objectives and financial stability, or between the empathy and the efficacy, in some sense, is going to remain. I would be happy to discuss that more in the discussion.

Turning to emerging markets. (Slide 11) There is an expectation that some emerging markets are starting to ease fairly soon, particularly in Central and Eastern Europe and in Latin America, while other emerging markets, particularly in Asia, are still tightening.

I do want to note that term premia—the risk premium in longer-term yields—has increased quite dramatically in Eastern Europe, shown on the right chart.

There is quite a bit of differentiation across emerging markets. (Slide 12) For high-rated emerging markets, the investment-grade emerging markets, in red, the spreads have not come up. Yields have come up. But spreads have not come up. While for lower-rated emerging markets and frontier economies, spreads have widened quite dramatically. There is differentiation. But for riskier countries, such as frontier markets, there are very large financing needs going forward. That is shown on the right chart. Many countries are already trading at distressed levels, with 800 or 1,000 or more basis points.

Turning to housing markets. (Slide 13) The left chart shows the price-to-income ratio across many countries. These are the black diamonds. By historical magnitudes, these black diamonds are at the upper range of the price to housing markets. Housing valuations are stretched in many countries, and there is certainly downside risk in terms of housing valuations.

In the U.S. case, on the right chart, where we have very high-frequency indicators, you already see that with a rise in mortgage rates, the existing home sales are dropping very quickly, and that is certainly going to put pressure on valuations as well.

That has led us to look at our house price at risk decomposition. (Slide 14) The left chart shows that there is particularly this affordability, so the risk premium embedded in the price of housing, that has a lot of downside risk. When you look at emerging markets, in red on the right, and advanced economies, in green—these are like assessments across all the membership—you can see that the downside risks to housing have increased to fairly high levels, particularly in emerging markets.

Turning to China. (Slide 15) Housing risks are already materializing in China. The government is taking very strong measures to ensure that this is not going to have macroeconomic consequences, but the housing sector is a very large sector of the economy. The sales of pre-sold homes are going down, and the share price of developer bonds, in orange—these are offshore prices—those are going down very dramatically as well.

The right chart shows you potential credit losses in downside risk scenarios. This incorporates both the losses from exposures to developers and to households; and, in particular, for smaller banks, there is certainly the potential for losses.

Let me turn to our global bank stress tests. (Slide 16) In advanced economies and for globally systemically important banks, we do have a lot of resilience. But in emerging markets, about 30 percent of banking assets are at risk of being undercapitalized under a severely adverse scenario. Emerging market banks are less safe than the advanced economy banks.

Capital flows are at risk. (Slide 17) The risk to capital flows has risen tremendously over time. That is shown on the left. And the macro-financial amplification of downside risks, measured by our growth-at-risk, is also at very low levels. There is a lot of downside risk, shown by the red area on the right chart.

The sustainable finance market in emerging and developing economies is growing very rapidly, shown in the left and middle charts. (Slide 18) There is a particularly important role that international financial institutions (IFIs) can play, shown on the right, where public-private partnerships for EMDE sustainable finance can be very important to fill financing gaps.

Finally, we have a chapter on open-ended investment funds. (Slide 19) A lot of reform efforts have been undertaken at the Financial Stability Board (FSB). We are taking a very close analytical look at the amplification mechanisms in the open-ended fund sector—these are mutual funds—and we are discussing policy options, including swing pricing.

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

This time around, fiscal is very exciting, and I will try to be as telegraphic as I can.

We have a very strong transition from 2020 to now. (Slide 2) As both Mr. Gourinchas and Mr. Adrian have emphasized, we have very high inflation now. You may recall that in 2020, we were concerned with the possibility of inflation running too low.

Mr. Adrian and Mr. Gourinchas said that for advanced economies, on the left-hand side, inflation is at levels that had not been seen since the 1980s. But then, when you consider emerging markets and other developing economies, the levels of inflation are even higher.

The right-hand side of this slide shows that when it comes to bond yields, the same type of pattern emerges, with the enormous movements that Mr. Adrian reported being dwarfed by what is happening in the developing world.

Mr. Gourinchas promised that I would briefly look at COVID-19 as a war. (Side 3) The U.S. provides a very good illustration, where you actually see that the response in the U.S. during the first year of COVID-19 was on the scale of what was done at the beginning of the Second World War. Given the speed of the response, if one goes by monthly data, the impacts are even stronger.

I will not comment on the V-shaped recovery of industrial production, the right graph shows how close the developments of inflation in the U.S. are to what happened at the time of the Second World War. The analogy of the response of COVID-19 as a response to war is useful, as Mr. Gourinchas emphasized.

I love this chart, so I hope you will love it, too. (Slide 4) The left-hand side shows the coincidence of fiscal and monetary loosening in 2020—appropriate, as I have argued. In the middle chart, there was already a withdrawal of fiscal stimulus and the impact of macroeconomic developments on the fiscal stance. Look at all the balls on the vertical line. Then in 2022, in most places, there was monetary tightening and fiscal tightening in tandem, which is appropriate, as Mr. Gourinchas emphasized, but it is also what typically happens after a war.

You have seen this slide many times. (Slide 5) This shows the tightening of fiscal policy and the return of deficits to pre-pandemic projections. But what we see now is that, in all country groups, there is permanent scarring, and that GDP projections are considerably below pre-pandemic projections—shown in gray, below the line—and for the developing world, there is a significant and persistent deterioration in tax capacity.

That makes a very good transition to the issue of LIDCs and the importance of food price shocks in these countries. (Slide 6)

The left-hand side shows that the share spent in food declines sharply with the increase in income. Then you see the consequences of that fact for food insecurity under the current circumstances. Food insecurity is particularly dramatic in sub-Saharan Africa. The chart ends in 2021. But then if you look at the estimates of the global undernourished, the trend has actually accelerated in 2022. This is a cause for concern.

In the Fund, we have conducted a survey of country teams. (Slide 7) The Fiscal Affairs Department (FAD) has benefited from the collaboration of all area departments. One of the points that one sees in this slide is that, for advanced economies, most of the action is on the energy side. For the developing world, most of the action is on the food side. The bulk of measures do not align with our policy advice because they are not targeted transfers for the most part. What we emphasize, very much in line with what Mr. Gourinchas has already said, is that the countries most affected should provide primarily targeted support to the households significantly impacted by the high prices. The preferred instrument is temporary cash transfers. Additional support to households and firms should be linked to measures to increase energy efficiency and move to renewable sources of energy.

Mr. Gourinchas has emphasized that it is very important that price signals are allowed to play their role. (Slide 8) We say further that if governments decide to smooth the pass-through from large spikes in international prices, the adjustment should, nevertheless, be quick to avoid a costly rationing and a misallocation of resources and/or large budget costs. Solidarity taxes, including on high-income households, could play a role in this context. That is basically the text on the right-hand side of the slide.

When we look at Europe, Mr. Gourinchas has already made the point that terms of trade shocks are very large. When terms of trade shocks are very large, adjustment is unavoidable; and, therefore, the macro- and micro-design of energy packages is crucial.

On the right-hand side, I illustrate that the prices that we see in the current crisis are very different from those that would result from the gradual increase of carbon taxation—from, say, \$10 now to \$70 in 2030. The current expected path of fuel prices is in yellow, and the carbon tax path is dashed blue. A spike would not occur with the carbon tax; It would be gradual over time. There is a major mispricing in the relative price of the various fuels, with the increase in the price of fuels that are more intense in CO2, particularly coal, too low.

In this slide, we have another very good example of collaboration in the Fund. (Slide 9) The left-hand side chart shows a survey of opinion conducted this summer by our colleagues in the Asia and Pacific Department. What it says to the Fund is that, when people are informed about the benefits of measures, they become more responsive, more open to the fight against climate change through particular instruments. In the case of this chart, we focus on carbon pricing; we focus on carbon taxation.

The middle chart shows the urgency of action in the climate sphere. We have two gaps identified, the implementation gap of what is going on, relative to the action that will be necessary to limit the temperature increase to 1.5 degrees, and the ambition gap, which is not as large, but it is the difference between the same objective for temperature and what countries have committed to in their nationally defined contributions. The right-hand side shows that the financing commitments of the advanced world have been lacking in terms of its overall amount.

FAD has also benefited from a collaboration with the World Bank. (Slide 10) This is confidential information from the World Bank Macro Poverty Outlook. The authors have kindly allowed us to use their data, on the left-hand side, which shows a shocking development, which is the interruption in the downward path of extreme poverty. There are three decades of steady declines that the pandemic has interrupted, another very good example of the priority that should be given to LIDCs. The right-hand side shows our traditional estimate of financing gaps to attain the Sustainable Development Goals by 2030.

We also have estimates from the global debt database. (Slide 11) For 2021, we see that global debt has come down in 2021 from the extremely high levels of 2020. They have come down by about one-third. The right-hand side shows that China has become a very important country in terms of its contribution to global debt. The increase in debt during the pandemic was mostly explained by advanced economies plus China. The rest of the world did not contribute much to global debt.

My last two slides are about debt vulnerabilities and fiscal risks. Slide 12 shows what Mr. Gourinchas and Mr. Adrian already noted, which is credit ratings have deteriorated. That is shown on the horizontal axis, and the dispersion of bond spreads has increased. There is a very sharp differentiation of countries at this point in time. Mr. Adrian has referred to numbers of countries in stress, and that has increased sharply.

Now let us look at fiscal risks. (Slide 13) Colleagues in FAD some years ago produced a forecasting model based on machine learning to look at fiscal crises. They have identified for emerging markets—just one example—public debt services, crisis history, public debt, and external debt service as the most important groups of variables. Externally denominated public debt is the single most important indicator. When we look at our forecasts, we see that all these determinants have deteriorated, which means that we should expect a higher incidence of fiscal crisis in individual countries; we should expect a higher sensitivity of market developments to deteriorating fundamentals; and we should expect a stronger international propagation of disturbances.

I will now conclude with the policy recommendations agreed by FAD, the Monetary and Capital Markets Department (MCM), and the Research Department (RES). (Slide 14)

The three main blocks of the recommendations are on inflation, the role of fiscal policy, and the need for multilateral cooperation to manage elevated risks.

The main policy priority, as formulated by Mr. Adrian, is to fight inflation and to mitigate financial distortions. Decisive policy actions are needed to bring inflation to target and avoid a de-anchoring of expectations. Premature monetary easing will require more painful policy actions in the future, as explained by Mr. Gourinchas. The IPF should be used to avert crises. Combining targeted foreign interventions and other actions can smooth the exchange rate, reducing financial stability risks. Macroprudential policy adjustments may be needed in some cases.

Fiscal policy should protect the vulnerable, while aiding the monetary tightening. Targeted temporary measures can cushion the impact of the cost-of-living crisis on the most vulnerable. Fiscal policy must support monetary policy where there is excess demand, inflation expectations are at risk of de-anchoring, or there are risks to public credit. For most countries, deficit reduction is appropriate. Attempts to control prices directly are costly and, ultimately, ineffective.

The last block of recommendations is on multilateral cooperation, which is needed for crisis prevention and investment in the future to help with debt restructuring, to implement and broaden the G-20 Common Framework, maintain global liquidity in the context of tightening financing conditions, and accelerate the green transition to prevent catastrophic climate change. Delays will magnify the transition costs. The Fund stands ready to deliver with the existing and new tools, including a special drawing rights (SDR) channeling, the Resilience and Sustainability Trust (RST), Rapid Financing Instrument (RFI), and the new Food Shock Window.

Mr. Buissé:

It was very clear in the slides, the most vulnerable are always the hardest hit by crises, climate disruptions, pandemics, and rising food prices. To navigate these turbulent times, we definitely need more multilateral cooperation. Let me just offer some comments.

First, as feared, the economic outlook is worsening, and stagflation concerns are very much present. Lasting high inflation is at the heart of our concerns. Growth has also taken a strong hit. With Russia's war in Ukraine, in addition to the loss of human lives, its spillovers can be felt everywhere.

Purchasing power losses and food security issues are increasing, leading to exacerbated social tensions. Avoiding food export bans is paramount, and we are looking forward to the operationalization of the Food Shock Window.

In this dire context, we welcome the additional downside scenario and the work on confidence bands around the baseline. We interestingly note the lower potential output from persistent disruptions in the labor market. This is a key topic, on which we would support further work to better analyze the hysteresis effects of the pandemic and the war.

Second, on the policy recommendations, we broadly agree with them, but I want to stress the importance of an appropriate calibration of policy mix actions, based on country-specific circumstances. The staff is clear about the need to act decisively to fight inflation to avoid a more costly adjustment later, and we fully agree with that and on the importance of closely monitoring the risk of wage-price spirals. But we also consider that granular advice is paramount. Not every country or region is in the same situation. Tailored advice can avoid unnecessarily costly overadjustments, too. While a tightening of monetary policy is clearly needed to limit demand pressures, an emphasis should also be put on supply-side policy.

High inflation demands higher interest rate hikes, at least to the neutral rate, regardless of whether this inflation stems from demand or supply shocks. But the policy advice cannot stop there and should be complemented by supply-side policies. As Mr. Gaspar said, fiscal policy should also try to help to increase supply, not diminish demand. Micro-policies have to be mobilized.

On interest rate hikes, I agree that the risks are asymmetric, and doing too little is riskier. But we also have to take into consideration the impact of the current synchronous tightening of the policy mix and monitor carefully the potential materialization of financial stability risks. Moreover, vigilance is also needed regarding the crypto system.

On fiscal policy, designing the right price is delicate, to say the least. We agree about the necessity to complement monetary policy, while protecting the most vulnerable in a targeted manner and building more resilient societies. We encourage more work on operational advice to improve this targeting. Income targeting, for example, is not a refined enough triage to ensure political buy-in by the population, where some people have no other alternative than to take their cars to go to work. The situation is also not the same for countries where, let's say, public spending represents 50 percent of GDP, with large automatic stabilizers, and more than half of them being already indexed on inflation, in a country where public spending is 20 percent of GDP and there are practically no social safety nets.

As the number of countries in debt distress will increase with higher borrowing costs, let me emphasize again the imperative need to continue the progress on the G20 Common Framework.

Finally, let me congratulate the staff, who did a great job with the Analytical Chapters, highlighting the need to act now to fight climate change. The later we act, the costlier it will be. The same stands true for the collapse in biodiversity. In the current energy security context, accelerating the transition to decarbonize sources of energy is critical, but energy sobriety should also become a greater priority.

The Chair:

Mr. Buissé mentioned labor markets as well as supply-side policies on the relevance to balance our focus on the immediate risks with how we can reduce future risks, and your point on country-specific circumstances.

Mr. Bevilaqua:

We acknowledge the sober, but realistic, tone of the flagship reports and welcome the call for staying the course of monetary policy tightening and fiscal consolidation plans. Unfortunately, and in great part due to the late response of policymakers to rising inflation, these needed policies now come with higher risks, not least of financial distress and a global recession.

Regrettably, the Fund was among those that came late to the conclusion that rising inflation was not only a temporary blip, but indeed, a key macroeconomic development due to strong underlying factors related to supply and demand imbalances associated to the pandemic shock and the highly accommodative policy response to it.

Just a year ago, the WEO stated that any increase in headline inflation will be, and I quote here, “expected to subside to pre-pandemic ranges by mid-2022 in the baseline.” This flawed expectation led the Fund to provide misguided policy advice in the context of bilateral surveillance, downplaying information on the ground to the contrary and facing, in some cases, heated discussions with local authorities already concerned with the possibility of persistently high inflation.

Going forward, it is more important than ever for the Fund to have a clear message, grounded on sound analysis, and stand ready to support the authorities in their efforts to fight inflation and to manage the multiple threats to the global economy.

As properly noted by Mr. Gourinchas in his helpful opening remarks, inflation is a deeply regressive tax, impacting the poor disproportionately.

Let me briefly touch on some of the key policy challenges.

First and foremost, central banks must continue to tighten monetary policy and keep policy rates above neutral for a prolonged period. Moreover, frontloading monetary tightening may be required to align expectations or break inertia, especially where wage and price expectations are more backward-looking. Targeted and temporary liquidity support measures should be implemented in case of disorderly market conditions. For some countries, this might include foreign exchange intervention, and possibly international support.

We take positive note of the WEO's analysis of inflation forecast errors. That said, there is no room for hopeful thinking in this area. We must be suspicious of optimistic arguments, such that central bank credibility is a given in advanced economies, or that profit margins can absorb wage pressures, or that lower real wages on balance can help to anchor expectations. I worry that the needed disinflation will prove to be more costly than expected, especially so if policymakers hesitate.

Second, the authorities must commit to a credible fiscal consolidation, including by being realistic about future growth and interest rate paths, and certainly much more realistic than recent Fund assessments in this area. In case of new rounds of supply shocks, including from energy and food prices, the authorities may still need to offer targeted support to the most vulnerable.

Third, financial sector policies must fully acknowledge the much higher risk environment. This calls for more severe stress testing requirements, more intensive monitoring, and properly calibrated macroprudential policies. That said, since most of these levers are country-specific, it is important to recognize the limitations of the GFSR's multilateral approach, perhaps explicitly so in the documents, and base the policy dialogue and recommendations more grounded on country specific surveillance. On top of that, the IMF continues to be central to support vulnerable economies in meeting their foreign currency liquidity needs.

Let me finish with a few words on Brazil.

After the pandemic shock, Brazil swiftly provided a strong policy response, which protected the most vulnerable segments of the population and averted a more pronounced contraction. While the Fund projected a plunge of more than 9 percent in real GDP in 2020, the economy contracted by less than 4 percent in that year. Moreover, while policies were continuously calibrated given the evolving challenging conditions of 2021, inflationary pressures were felt since the second half of 2020, which called for a more cautious stance from the central bank. Brazil was one of the first, if not the first, large economy to start monetary policy normalization already in the first quarter of 2021. Brazil is well ahead of most countries in the tightening cycle, and the public debt-to-GDP ratio is converging rapidly to pre-pandemic levels.

While around the world, inflation has been revised up and growth revised down, the opposite takes place in Brazil. Indeed, projected inflation for end-2022 is lower than in the majority of advanced economies, and growth is being revised by much more than could be justified by any eventual fiscal expansion or because of an unexpected resilience of the economy. I believe here, as on previous occasions, large forecast errors associated with past projections probably account for most of the staff's revisions. This needs to be investigated more systematically.

The Chair:

I would like to share with the Board something that came out of the discussion we had internally, preparing for today's Board meeting. That was the importance of humility. There is a high degree of uncertainty. We all have to be mindful that, at a point of high uncertainty, we have to calibrate conclusions and recommendations with that sense of humility.

I also want to stress that it is not usual for us to include a downside scenario in our projections for 2023. This year we did it. That was thoroughly discussed, exactly because of the high level of uncertainty. I can say it is great to have economies that do really well, especially at a time when conditions globally are so difficult.

Ms. Shortino:

We issued a very comprehensive gray statement, so I will try to keep my comments brief. We also broadly agree with the assessment of the outlook and the main policy recommendations, so I will just make five comments.

First, I want to underscore that Russia's war against Ukraine is a key factor in the global economic slowdown, high inflation, and downside risks to the outlook, so I very much welcome that the flagships are clear on this point. The Fund and all of its members should hold Russia accountable and continue to push for an end to this senseless conflict.

Second, on inflation, the flagships all note correctly and emphasize that bringing down high inflation must remain the top policy priority through monetary policy tightening but also through complementary fiscal and structural measures. And on this note, I want to reiterate that the Federal Reserve is committed to moving purposefully to retain the anchor of price stability, and they have recently indicated that restoring price stability will likely require a restrictive policy stance for some time.

As staff notes, monetary policy risks are two-sided. The risk of under-tightening is quite key. But I do think the Fund should continue to assess the impact of the simultaneous tightening by central banks. It is important to differentiate policy advice to fit country situations, given the drivers of inflation differ across countries.

Third, on the strength of the U.S. dollar, I want to state something that was recently said by Treasury Secretary Yellen, that fundamentals and particularly interest rate differentials and safe haven flows are mainly driving the appreciation of the dollar against these other currencies. That said, we do recognize that dollar strength poses challenges, including rising import costs of dollar-priced commodities and, for emerging markets and developing markets, high debt burdens. But here, the Fund can play a very good role by providing sound policy advice, underpinned by the IPF, as to what appropriate policy measures countries can take in response to these pressures.

Fourth, on fiscal and debt, I have to agree with Mr. Gaspar, that this is an exciting time for the Fiscal Monitor and fiscal policy advice. Now more than ever is the time for the Fund to provide sound, tailored advice on fiscals, as countries are facing all of these pressures.

I would offer, it would be good to continue thinking about what strategies the Fund can deploy to help persuade countries to implement more targeted measures, because we have seen over and over that not all of that advice is being taken.

On debt, the rising borrowing costs and debt pressures just underscore the importance of all bilateral creditors cooperating toward solutions for countries facing debt challenges and for the IMF to continue to play a critical role in enhancing debt transparency and helping countries manage debt burdens.

Finally, I just wanted to note that we appreciate the attention to climate in the flagships, and I will stop there.

The Chair:

We do face an environment today that is very different from 2020, when central banks are intensively talking with each other and there is a great deal of harmonization, whereas on the fiscal side, that is not quite happening in the same way.

We have the Annual Meetings. This is usually our best platform to bring everybody together, but we do need to think more about how to ensure that policy harmonization—or rather, policy coordination, is more profound on the fiscal side. I take all your points as very relevant.

Clearly, the work that Ms. Gopinath led, together with Mr. Adrian, on the IPF proved to be very timely, given the circumstances we face today.

Ms. Riach:

We broadly welcome the tone of the documents, against a deeply troubling global context. The Analytical Chapters are impressive and both well-judged and well-timed to influence key multilateral debates.

Our gray set out our views on the drafts, and the Chair suggested that we focus our comments on the implications for policy discussions. I am happy to do that.

The flagships underscore the urgency of action in crucial areas and also the importance of working together. Many LICs are facing a desperate situation. The documents underscore the immediate acute pain of the food crisis. This reinforces the need for us to reflect holistically and soon on whether the Fund can and should do more to sharpen its toolkit to deliver sustainable support.

The response so far of emerging markets can be seen with a glass-half-full or a glass-half-empty perspective, but at this stage of such a pronounced cycle of tightening in advanced economy monetary policy, we must be watchful of the implications for emerging market economies of sharply tightening global financial conditions. As Mr. Gourinchas has said, the tools of the IPF and the Fund's precautionary instruments are important here. The current context offers a real test case for the value of IPF guidance, given that the appropriate policy mix will be sensitive to specific national circumstances. We should encourage and welcome a timely use of the Fund's precautionary facilities. We also keenly anticipate the upcoming review of precautionary facilities.

As Mr. Adrian set out, it has been a turbulent few days in the United Kingdom, and I wanted to say a bit about what has been happening.

On Friday last week, the government announced a package of fiscal measures designed to provide support in the face of the energy price shock and to shift the United Kingdom onto a higher growth path, after modest potential supply growth over many years. Given the rising cost-of-living pressures, the recent leadership election, and the fact that government backing for some of these measures was widely anticipated, the prime minister and chancellor judged it helpful to announce and cost key policies quickly. That does mean that some parts of the usual processes will follow later. Notably, the chancellor has been clear on his commitment to a fiscal event with full independent forecasts on November 23. Perhaps there are lessons for all of us to learn on the importance of well-established processes and institutions.

The urgency behind the announcement partly reflected a need to provide support in the face of the energy price shock. The nature of the response should be seen in the context of pressures which apply a long way up the income distribution and policy needing to be easily understood to reassure households and businesses and to support wider confidence. The government has been clear in its aspirations to prioritize growth. Tax cuts should not be seen just as intended to boost demand but as a policy choice and within an overall agenda of tax simplification to boost supply, in conjunction with other measures.

Monetary policy will likely need to be tighter than would otherwise have been the case. The government has reaffirmed that Bank of England independence is sacrosanct and that the authorities are in open dialogue. The government's view is that, by boosting actual and potential growth, the new fiscal package will leave the U.K. economy on a stronger footing once monetary policy has brought inflation back down toward target.

As Mr. Adrian set out, following pronounced movements in the gilt market, the Bank of England yesterday announced a time-limited operation to enable U.K. pension funds to reorganize their balance sheets to avoid the need to offload gilts quickly, but we would not recognize his characterization of a tradeoff between financial stability and monetary policy objectives. This is a targeted financial stability intervention not aimed at lowering the general level of gilt yields. As a regulator, the Bank of England is working with U.K. pension funds to ensure that they are able to reorganize their pension funds before the end of the operation, on October 14.

Many of you will also have seen that on Tuesday evening, the Fund issued a statement, commenting on developments in the U.K. and on the government's fiscal strategy. It is the role of the Fund to give frank and independent advice to member states, particularly during challenging moments, and there will be times when that includes making public comment. But I would question whether it is helpful for the Fund to step in, in a way that makes us part of the story, as has happened in the U.K. this week. At a minimum, we should all expect that staff and management would speak to the authorities before speaking to the press.

The Chair:

The attention in the room to what you presented was very high. I also want to say that we value very much our relations with the United Kingdom. It is sometimes a moment when pressure on the Fund to speak up is such that it demands a response because, the absence of a response is also a response.

Mr. Mizuguchi:

I would like to touch on three points.

First, regarding the outlook and the policy responses, the global economy has slowed significantly as a consequence of heightened energy and fuel prices, monetary tightening, and Russia's war against Ukraine. Tackling inflationary pressures, while continuing to support to the most vulnerable, will require a careful calibration and coordination of monetary and fiscal policies. Additionally, the ongoing geopolitical fragmentation has heightened the importance of global cooperation in all areas, and we expect the Fund to contribute to global efforts, as well as to provide timely support to member countries.

Second, the authorities need to maintain vigilance toward the negative spillover effects from tighter global financial conditions. Market liquidity and price volatility warrant close monitoring. We ask the staff to pay particular attention to heterogenous spillovers, especially in small-sized emerging markets and frontier markets. The staff's tailored policy advice is critical in such times of heightened volatility, also taking into account the lessons learned from the IPF.

While we are comforted by the overall robustness of the banking sector, the authorities should be cautious toward pockets of vulnerability in the financial system. A macroprudential toolkit may be useful in curtailing the risks arising from the housing market and mortgages. We also note that the analysis on the risks arising from open-ended funds in times of market distress and ask the staff to closely monitor the risks potentially accumulated in the non-bank financial sector, while taking into account the differences in policy frameworks among countries.

Third, on the fiscal front, we agree with staff on the increased fiscal risks from higher inflation and financial tightening, such as the rising borrowing costs, risks associated with foreign debt, and spending pressures. Governments will need to provide temporary and well-targeted support to those most impacted by the rising energy and food costs, while avoiding an increase in demand pressures. It is also vital to rebuild the medium-term fiscal framework and pursue fiscal consolidation to build fiscal buffers to absorb future shocks and boost structural resilience.

We also commend the staff's informative analysis on the policy effects of the support measures during the COVID-19 pandemic, which could provide valuable guidance in designing fiscal policy measures, in response to future crises.

The Chair:

The situation we face everywhere is quite complicated. I want to recognize that, in addition to China, which was mentioned previously, Japan is in a somewhat different place with regard to monetary policy tightening, something that we did not quite recognize before.

Mr. O'Brolchain:

We found the flagship reports to be very thorough. We agree with the staff's assessment of the global economy and risks. We have issued a gray statement, so I will make a few points today.

First, like Ms. Shortino, we appreciate the use of appropriate language regarding Russia's invasion of Ukraine, and we encourage the editors to ensure the wording is consistent throughout.

We support the points raised in the gray statements of my colleagues, from the U.K., U.S., and elsewhere, that Russia's invasion of Ukraine accounts for much of the gloomy outlook that the WEO presents. Ending Russia's invasion of Ukraine would alleviate much of the human suffering and also reduce pressures on the global economy.

Second, we very much welcome the extensive coverage of monetary policy and inflation, including food inflation. In their policy advice, staff rightly focus on the amount of monetary policy tightening required to control inflation and link that to the neutral interest rate, so we would be interested to hear further analyses of the estimates of the neutral interest rate and how that may have changed since the pandemic.

We also agree with staff that economic policy errors represent an important two-sided risk to the outlook. In the context of monetary policy, while the report seems to focus mostly on the risk of not tightening sufficiently to control inflation, it is also necessary to focus on overtightening risks, particularly in the context of many central banks tightening simultaneously. There could be important spillovers that slow inflation more than expected in some countries, and if we add to that fiscal tightening, the issue could be enhanced further. And there, I am reflecting the comments made also by Mr. Buissé.

Thirdly, on unemployment, I would just comment and ask for an elaboration on the contrast between the sharp contraction in growth in advanced economies this year and next, and what appears to be a considerably less than commensurate change in unemployment at the aggregate level.

On policy conclusions, a clear policy conclusion here is consistency of fiscal and monetary policy. Also, it is important for the Fund to understand the impact of its message. Mr. Buissé talked about granularity in terms of countries and their capacity to implement targeting on that. It is also important to understand how that message is received outside central banks and finance ministries, where a message about "spend more" is heard very differently compared to our usual limited audience.

I think there are clear implications on demand for IMF resources.

I welcome, in the policy conclusions, the reference to structural policies. It could be much stronger and take a greater emphasis. Structural policies have a lot to answer for in terms of the current inflationary trends, and there could be an explicit reference there to trade. Trade dislocation is also an important aspect. We talk about fragmentation, and that is it.

Finally, we welcome the coverage of climate risks throughout the report, including for emerging market economies. Even as other shocks seem more urgent, we encourage the staff to continue to provide analyses of different dimensions of climate risk and the transition to a lower carbon global economy. In particular, I would note Mr. Gaspar's comment about the importance of communicating the benefits of addressing climate change and how that improves traction for the measures needed.

Mr. Mochtar:

We have issued a gray statement and would like just to offer three brief comments today.

First, the flagship reports underscore the complex challenges in the global economy. The consecutive downgrades in global forecasts since October 2021 are concerning, and have contributed to increasing the requests for the Fund's financial and advisory support. In this regard, we would like to re-emphasize the need to ensure that the Fund is well-equipped to support the member countries, including to have adequate and resilient quota resources.

Second, the complex challenges also imply that careful policy calibration and clear communications are crucial to re-anchor inflation and exchange rate expectations. A careful policy collaboration is required to obtain the optimum policy mix to lessen the impact of the uncertainty, including reducing FX market volatility. Like Mr. Mohieldin, we view that the impacts of such volatility will be felt most keenly by the EMDEs. In this regard, we agree with the presentation this morning, on the use of the IPF to help avert the crisis, and we look forward to an early operationalization of the IPF, with the close involvement of relevant area departments so that they can produce relevant and country-specific advice to member countries on the appropriate policy mix.

Clear communication is also needed to enhance the policy efficacy, including to lessen volatility in the financial markets, as mentioned by Mr. Andrianarivelo in his gray statement. In this context, we view that practical input from the Fund on the monetary policy communication in the period of high uncertainty would be beneficial for the member countries.

Third, we continue to be concerned about the deepening scarring effects from the shock of the pandemic and the war in Ukraine, which are much larger in EMDEs than in advanced economies. Like Mr. Bevilaqua, Mr. Buissé, Mr. Bhalla, Mr. O'Brolchain, and others, we view that intensifying structural reforms is critical to bolster resilience and long-term growth opportunities. We view that strengthening multilateral coordination and peer sharing of the expertise are paramount, as the global problem we face today knows no boundaries and could only be solved when we act together. As such, we share Mr. Moreno's call for the Fund to stand as a firm defender of multilateralism, international cooperation, and coordinated policy action, as the best way to solve the current crisis.

The Chair:

We are already seeing a significant uptake of demand for staff to work on policies and also to work on programs, and the most difficult year is still ahead of us; it is not behind. You are absolutely right. We need to prepare for a more intensive engagement with the members. We will have a chance, during the Annual Meetings, to do exactly what you are calling for, strong multilateral cooperation to ease the pain on countries and on people. Actually, I call on your authorities to be doing exactly that, to help us together to have a better chance to withstand the difficulties we face.

Mr. Hosseini:

We broadly share the staff's analysis and policy recommendations, most of which we have already reflected in our gray statement. I will be brief.

This, the fourth consecutive WEO downgrade of global growth, is a reflection of the turbulent times we are going through and the unprecedented uncertainties we are facing. Our collective resolve and coordinated policy actions helped us navigate the previous crisis, but this time could be different.

There is a high risk that the current geopolitical fragmentation could become entrenched, with deep and durable adverse implications for global trade and finance, technology transfer, and the fight against climate change. We need global cooperation now more than ever.

In fact, following your recent Global Policy Agenda, with "Acting Now, Acting Together" as its underlying theme, the flagship reports could have stressed more the cost/benefits of multilateral cooperation, or lack thereof.

High inflation, the cost-of-living squeeze, and food insecurity are global threats that must be confronted head-on. Digressive monetary policy tightening by a major central bank is appropriate, but it is equally essential that policies maintain the delicate balance in the inflation-growth tradeoff, with the recognition that there is no room for policy mistakes. The negative spillovers of the steep tightening of global financial conditions are already evident in most EMDEs via various channels.

Fiscal policy also has an important role in support of monetary policy, while remaining the major candidate to support vulnerable households during the crisis. Most LICs, however, have no fiscal room to maneuver, while facing highly adverse external financing conditions. The very challenging conditions call for generous financial support and global frameworks for resolving their sovereign debt crises.

The recent events should have convinced us that no country is immune to the effects of climate change. As most of the countries in our constituency are facing historical droughts, others are overwhelmed by historical floods and humanitarian catastrophe. The time to act is now but with the understanding that there could be different paths toward the same objective.

Finally, the Fund responded swiftly, proportionally, and flexibly to the pandemic by expanding its resources and toolkits. We expect no less now. The Fund's financial support is critical in helping the members to build a strong resilience to future shocks, which are expected to be more frequent and more severe.

The Chair:

We fully recognize our responsibility. Tomorrow we will have a chance to make a step exactly in the direction of a swift response to worsening conditions as we discuss the Food Shock Window.

Mr. Pösö:

As Mr. Hosseini just said, this is the fourth consecutive downgrade of the growth outlook, with adverse risks still dominating. Near-term growth-at-risk forecasts very well summarized the challenging situation that policymakers are facing currently.

I would like to make five brief points today. Starting with inflation, we note that the upside risks to the inflation are largely linked to the de-anchoring of inflation expectations. While short-term expectations remain elevated in many countries, longer-term expectations seem to have remained generally stable so far. Against this backdrop, I would be interested in hearing whether staff have seen any indications of a change to the direction of more adaptive expectations that should cause concern.

On monetary policy, I fully agree with the message that central banks need to act decisively to bring inflation down. Stressing the importance of maintaining central bank independence and credibility has never been as important as now. At the same time, like Mr. Moreno and Ms. Mannathoko, I think the reports could have benefited from giving more attention to the effects of the synchronized monetary tightening at the global level and the related spillovers. Mr. Buissé, Ms. Shortino, and others have also made this point.

Second, Russia's war against Ukraine has exacerbated the risks for global financial stability. The many unfolding risks will test the resilience of financial sectors in the coming months. In this high-risk environment, policymakers will need to be mindful of the risks if financial conditions were to tighten in a disorderly way. We also welcome the emphasis on the importance of market liquidity and maintaining it.

Third, on fiscal policy, we support the clear message to policymakers that they need to be aligned in the fight against inflation. Broad price subsidies on energy not only make reducing fiscal deficits much harder, as discussed in the Fiscal Monitor, but untargeted subsidies become self-defeating and simply translate into higher demand and increased commodity prices.

Here, and related to the policy recommendations, I wonder if the Fund would continue to advocate for fiscal policy to support monetary policy in case we enter a more negative scenario for growth but continue to face inflationary pressures. Comments from the staff would be appreciated.

Fourth, we note the significant slowdown in global trade, also relative to GDP, with global trade growth exceptionally falling below the global GDP growth next year. This is a truly worrying development, with possible wide-ranging implications also for the inflation outlook. Could staff elaborate on whether the slowdown in trade mostly results from temporary factors and lower growth or have staff considered also more structural changes to trade intensity?

Lastly, like Ms. Shortino and Mr. O'Brolchain, we highly welcome the staff's focus on climate issues in the reports. We fully agree that policy action must be accelerated, including through carbon pricing and fuel subsidy reforms. Moreover, we echo the importance of private climate finance to achieve climate mitigation and adaptation goals more effectively. The Fund should continue finding ways to support these efforts.

Mr. Hilbers:

Staff's work was done against the background of a gloomy economic outlook and complex policy dilemmas. Let me briefly discuss a few of them; but before doing so, let me reiterate your point about humility. I very much appreciated that term. It is rightly chosen. At the same time, let us also realize that the world is looking at us at the moment. They will look to the Fund, what the Fund's views are. They will look to the Fund, what the Fund's recommendations are. I would say let us be humble but also steadfast. The reports are very well done, very consistent. The picture is consistent. I think we can have a very good Annual Meetings on that basis.

First, and foremost, Russia's unprovoked war against Ukraine continues to take a tragic humanitarian toll and a tremendous economic burden on the people of Ukraine. In these circumstances, engagement with the Fund is now, more than ever, of the utmost importance for Ukraine. But words also matter. I call on staff to consistently use language that reflects Russia's aggression. Plus, Russia ending this war would not only bring an end to human suffering but would also contribute to effectively solving many of the economic issues that we are currently faced with.

On inflation, a topic mentioned by many, we concur with staff that monetary policy must prioritize price stability and firm anchoring of expectations, even at the cost of slowing activity in the short run. At the same time, central banks around the world should signal their future policies to minimize negative spillovers and to avoid excessive restraint of global demand, as flagged inter alia by Mr. Buissé and others.

An encouraging key difference—and I am making this point because the comparison was made many times—between the inflation spike in the 1970s and today's rise is central bank independence and credibility. This advantage, however, is not guaranteed. As the short-term negative effects of rising interest rates on growth become clear, public pressure and political interference, I expect, will intensify and will challenge monetary policy. We, therefore, reiterate that central bank independence is essential to securing price stability, as emphasized also by Mr. Pösö. I would also like to add to this that, in addition to the other considerations about central bank independence, the interest rate hikes may also have an impact on balance sheets and the profitability of central banks. That may even add to their challenges. The Fund should squarely support central banks in these probably difficult times for them to do what is the right thing to do.

Then onto fiscal policy. Given the magnitude of the energy affordability crisis, temporary government measures to dampen the erosion of people's disposable incomes are needed. As Mr. Moreno suggests, temporary measures to contain energy prices also help fight inflation. However, these measures should be largely offset via other policy measures to maintain fiscal sustainability and also to help restore price stability.

On financial stability, the Fund should stress the role of global regulatory coordination and good governance. Like Ms. Shortino, we emphasize the need to continue implementing the final stages of Basel III, given the clear benefit of these international standards in limiting financial contagion risks.

Meanwhile, house price increases have been sizable in many countries, and financial stability risks posed by the housing market are significant. I was very pleased with the attention paid to housing markets. We have discussed this before in this group, and it is very rightly chosen to focus on that particular market as well. In this context, a premature reversal of borrower-based measures may lead to households potentially accessing additional credit. I would argue for a careful approach with a recommendation. I do not disagree with it, but we should be careful and not be too quick with this particular recommendation.

Last but not least, we agree with staff that policies to fast-track the green transition will have long-term payoffs for energy security, with lower mitigation and adaptation costs. Recent extreme weather events are another wake-up call to treat the issue of climate change with great urgency. In this regard, we welcome the staff's analysis of the cost of the green transition, which suggests that this transition need not be inflationary and can be achieved with a manageable impact on GDP.

Lastly, we very much support the work done by RES, FAD, and MCM in this area. Let me also support Mr. O'Brolchain, with his point about the importance of communication on the climate issues.

The Chair:

I can give the Board full confidence that we will do our job and we will speak up. This is to be expected from us. A quiet Fund, a passive Fund is a useless Fund at a time of crisis. My point is just to say that we recognize there is a great deal of uncertainty. We are very mindful of it. Thank you for recognizing that work has been done on housing markets in a very timely manner. Now is the moment to signal what is happening, what may be happening. Not when it is too late.

Mr. Sylla:

We thank staff for the flagship reports and the counsellors for their excellent presentations. We broadly share the assessment of the global economy made in the reports, as well as the risks. And we support, overall, the policy recommendations. Allow me to make the following remarks.

The staff's sobering assessment of the global economy rightly highlights the increasing number of countries that are experiencing a sharp economic slowdown amid elevated inflation, driven by high energy and food prices. Bringing inflation back to target is one of the key challenges of the moment. Like many Directors, we find the WEO policy recommendations to be overall appropriate.

Central banks should deploy all their instruments to deal with the large money supply of the past decade. Fortunately, with a well-capitalized banking system, governors of central banks do not have to be concerned too much about the financial stability.

Fiscal authorities should focus on actions that facilitate the restoration of supply chains and abstain from quick actions, like untargeted subsidies and cutting taxes for competition proposals or imposing trade restrictions.

The current extremely challenging environment is affecting LICs disproportionately, and these countries could be further impacted by the unintended consequences of the policy actions in advanced countries.

We emphasize the importance for the international community to provide adequate financial support to LICs. Helping them build production capacity in agricultural sectors is critical to enhancing their resilience to shocks. The proposed new Food Shock Window under Fund instrument should be put in place as swiftly as possible to help alleviate the impact on balance of payments.

One aspect of food insecurity mentioned—in sub-Saharan Africa—by Mr. Gaspar that is not often covered in our reports is largely due to the internal conflicts and terrorism. These conflicts not only push populations out of production areas but put pressure on fiscal financing. They also push many of our youth into the emigration path to Europe, and that also generates some extremists on the Europe side. This challenge should not be in our blind spot for our analysis, despite the pandemic and the war in Ukraine. After all, if the war in Ukraine has taught us one thing, it is that war is costly.

Ukraine was not very well developed, but it was a developed country. But imagine this kind of recurrent conflict in a country like a sub-Saharan one. In your analysis, mainly during the multilateral surveillance, staff should consider the constraints our authorities are having to accommodate this war's impacts. There should be plenty of flexibility, like not just say it but to integrate it into their analyses.

Finally, on debt vulnerabilities, more rapid progress is needed in the implementation of the Common Framework. While we are encouraged by the recent positive developments made by the official creditors of Zambia, much more remains to be done, as other African countries are awaiting more meaningful progress. If nothing is done on the debt front, our efforts to adapt our toolkit to the current challenges will be in vain, for the simple reason that a majority of our clients will have a debt sustainability problem.

The Chair:

You touch on a number of points, but two are worth reflecting on in the future as well. One, the pressure from military expenditures. I hear this from leaders and finance ministers in Africa. It is the cost of security that is disproportionately high for some countries. Two, how we prioritize debt. On this latter point, Ms. Gopinath is leading the work at the Fund. We have a comprehensive agenda, and it is one that we will use the Annual Meetings to advance.

Mr. Moreno:

We share the central message of the reports, the emphasis on inflation. It is not only a macroeconomic concern but also a social one, as it affects prominently the cost of living of the larger middle- and low-income populations. We also share the policy recommendation to act promptly and decisively, accepting that the cost of overreacting and correcting afterwards will be lower than to fall short on the tightening.

Having said this, we should also stress that this general message needs to have the necessary nuances to take into account country specificity. I would highlight four of them, also taking into account what Mr. Hilbers was pointing out, that the world is really looking at us.

The first nuance is that, on monetary policy, the pace of monetary policy normalization should depend on the balance between demand and supply-side drivers. It should also take into account the parallel widespread tightening of most central banks, that it magnifies the global impact of national policies. For many countries, demand-side-driven inflation is common, but really, the common denominator for most countries is a supply-side-driven component, a monetary policy has limitations in the context of cost inflation.

This brings me to the second point. We really miss a reference to the complementary role that energy policy can play in this current context. It is basically the same thing that we did with the pandemic. There was a health crisis. We needed a health policy. I take the point. And we share that, in the longer term, prices need to work, not only because of the climate transition, but there is a debate on the persistency. I do not fully share the stance of the staff on the persistency on the energy prices.

In any case, the staff is underestimating the usefulness of temporary adjustments in pricing mechanisms, not only can they help the vulnerable, but they can also help contain inflation and, thereby, ease monetary policy tightening and also reduce the financial cost of fiscal policy.

Third, on fiscal policy, we also share the message, but the message should be more of consistency with monetary policy, not so much subordination to monetary policy. The general policy stance has to help inflation and control fiscal sustainability in the medium term, but fiscal policy still has to face many other challenges, including the cost of living and the pandemic. It should do it in a targeted way, but there are limitations to targeted ways. In some instances, you need to have a wider approach because the cost of living is affecting the wider middle class population.

Two messages are important on fiscal policy. One is, the instrumental role of a resilient revenue base, including the importance of implementing the agreement on global tax on corporates to advance also on fiscal coordination. Second, the need to have burden sharing among taxpayers in the cost-of-living crisis.

Finally, on macroprudential policy, we need to avoid being procyclical here with the monetary contraction. There is also room to have a message of well-targeted measures. Also, macroprudential may be targeting those specific sectors of focus of vulnerabilities.

One final comment, just to echo my colleagues, that I very much welcome the emphasis on climate. This should be a constant of all flagship reports from here on out.

The Chair:

Mr. Adrian will react on your point on consistency versus coordination. I am not a native English speaker, but the word "coordination" raises a question, who coordinates whom? If you go to Mr. Hilbers's very important point on central bank independence and the risk of this independence being eroded, perhaps using coordination would send also an unhelpful message in that regard.

Mr. Herrera:

We broadly agree with the global outlook and policy priorities presented in the flagships.

We issued a comprehensive gray statement, so I will make four brief comments.

First, I want to highlight the importance of domestic and international policy coordination when faced with significant global uncertainties. We agree that central banks must act decisively to restore price stability and anchor expectations. However, as Mr. Buissé, Mr. O'Brolchain, Mr. Pösö, and many others have highlighted, there is a danger that an uncoordinated tightening will end up exaggerating the global response to inflation, and increase the risks to the world economy and the international financial system. We would appreciate staff's comments on the importance of increased coordination among major central banks and the consideration of feedback loops, spillovers, and spill-backs in their conduct of monetary policy.

Second, there is also an international dimension of achieving good fiscal and monetary policy coordination at the domestic level. An adequate policy mix, especially in major economies, is critical to achieve a well-balanced adjustment of global demand and limit negative spillovers from high interest rates to domestic and international financial stability.

Third, we agree with the comments that the appreciation of the U.S. dollar at the aggregate level reflects fundamentals, but the adjustment to a stronger U.S. dollar is not always smooth across currency markets. On occasion, a sharp appreciation of the U.S. dollar creates market-specific disturbances, margin calls and others, that can amplify exchange rate volatility and hamper the transmission of monetary policy or create financial and price stability risks. This situation warrants a temporary foreign exchange intervention, in line with the IPF.

Finally, we appreciate the work on decarbonization policies and their short-term macroeconomic impact in Chapter 3 of the WEO. However, we are concerned about the negative representation of Uruguay's climate policy in Box 3.2 of the WEO. In the last decade, Uruguay has been at the forefront in the transition to clean energy and implementation of climate policies. Their leadership was highlighted in the last Article IV report on Uruguay, January 2022, which praised the authorities' strong commitment to tackle climate change under an extensive agenda on climate change policies. This praise was also reflected in the Board's assessment of Uruguay's Article IV report.

The views on Uruguay's policies in Box 3.2 are not aligned with those in the latest Article IV report. The authorities have sent detailed comments to the staff, which we expect will be reflected in the final version of the WEO.

The Chair:

We will look into Uruguay. It is true, Uruguay has taken very decisive steps recently, so we will make sure that they are adequately reflected. I personally praised Uruguay, especially on the decision to go for a carbon tax.

Mr. BinZarah:

We have issued a detailed statement, and I would like to add the following points.

First, the messages of the three flagship reports are very clear and consistent. However, we believe that the discussion we had in July on the External Sector Report (ESR) is also very relevant to the important topic, we understand the bigger picture of how the world can address global macroeconomic challenges. Going forward, we may need to think about how the ESR discussion can help to better inform our discussions during the Annual Meetings.

Second, as advanced economies are further tightening their monetary policies, many EMDEs are grappling with how to maintain macroeconomic and financial stability, which can be undermined by capital outflows and currency depreciation, and ultimately, raising borrowing costs and debt vulnerabilities, as highlighted by the Chair in her introductory remarks. We encourage the staff to ensure the importance of clear communications and forward guidance by major central banks to avoid surprises and ensure stability in global markets. That is a comment that was also raised by Mr. Zhang in his gray statement.

We also emphasize that facilitating the implementation of the G20 Common Framework is becoming increasingly important to bring together main, official, and private creditors, to ensure timely and orderly sovereign debt restructurings in LICs, as noted by Mr. Buissé.

We welcome the timely focus on the global food shock, which is a major contributing factor to high headline inflation, and we stress that multilateral cooperation is paramount to addressing food insecurity.

Third, we very much appreciate the revised text on the issue we raised in our statement, regarding the climate policies. We offer further linking the sentence to recent extreme climate events and without targeting the source, to be fully in line with the climate objectives to ensure a just transition to net zero.

Finally, we welcome the useful discussion of the GFSR on housing market vulnerability, in line with the tighter monetary policy and rising borrowing costs. We agree that crypto markets present a growing risk, which necessitates increased monitoring, as well as comprehensive and consistent regulation.

Strong international cooperation is also essential to provide guidance, ensure consistent implementation, and contain spillover risks. Here, the IMF should be at the forefront in addressing these issues, in line with its mandate.

The Chair:

I want to recognize Saudi Arabia's retained interest in supporting the Common Framework that was created under its G20 presidency.

Mr. Palotai:

We share our colleagues' concern about the state of the global economy. Well-targeted domestic policies and strong multilateral cooperation are critical to safeguard stability and build resilience to shocks, but the membership must also find ways to de-escalate the geopolitical tensions.

In this current context, where the balance of risks remains firmly tilted to the downside, adverse scenarios must be closely examined. As Mr. Gourinchas showed us, the respective fan chart suggests that a global recession can still be avoided under the severely adverse scenario. While this is an average figure, in a range of countries, there are very severe risks of stagflation, aggravated by the synchronous slowdown and monetary tightening in advanced economies.

We fully agree that central banks must stay the course to bring the multi-decade high inflation under control. Monetary policy measures, however, need to be carefully calibrated and sequenced, paying due attention to both country-specific circumstances and international spillovers. More aggressive monetary tightening could also have drawbacks, which is already reflected in the excessive volatility of financial markets. Like Mr. Buissé, we also emphasize that fiscal and monetary policy should walk hand in hand and be built on targeted measures. The overall policy stance needs to be tilted to gradual consolidation. Like Mr. Stephan emphasized in his gray statement, we also stress that relying on inflation to reduce elevated public debt is not a feasible option. Meanwhile, structural reforms should also be scaled up in critical sectors, with the explicit aim of easing the supply-side constraints.

We value the staff's analyses on the role of credible climate policies. However, we would have also expected more focus on the immediate needs of bridging the energy security risks. I fully share Mr. Moreno's call on the importance of energy policy measures.

Finally, we welcome the themes selected for the GFSR and share many of the recommendations. The analytical focus on the Chinese real estate sector is well-warranted, given the potential financial implications for the local banking sector. We thank Mr. Zhang for giving further insights into the stabilization measures. In general, we encourage staff to continue to follow up on these developments in systemically important financial sectors and to pay even greater attention to their interconnectedness.

Mr. Fanizza:

Look, I am not going to bore you with rehashing what we have written in our gray statement, which is very clear, and I clearly said what we think. We agree, basically, on the message. I have two main points.

First, this is a very delicate moment. We have to pay utmost attention to communication. Our central role is global financial stability. That is our job. I agree that we are all on climate. But that is what we do. The first rule, let us not rattle markets.

I have heard what Ms. Riach said, but I am also concerned about the political change that has taken place in my country. Please, be careful when you talk.

First, no harm. That is the main point. Let me be clear on that. Of course, we look forward, not backward.

My second point is on energy. I agree with Mr. Moreno that energy policies are very important, but not because of inflation. Inflation is an immediate thing. But those, for growth and for the outlook, are essential.

My country—and with Mr. Stephan, we have the record—we are the only countries with a recession projected for 2023, basically, because of the idea that there will not be gas.

I think we are a bit pessimistic, but the situation is serious. There was a very good report on the status on the Article IV countries explaining the situation, and the situation now has changed radically. Today I was reading 95 percent of the gas requirement has been secured. It is already there. I have the impression that, at least in the countries in my constituency, we have been a bit overly pessimistic, and maybe it is worthwhile to look at it.

Mr. Potapov:

We issued a comprehensive gray statement and will limit our comments today to a few points for emphasis.

As highlighted in the report, the global outlook remains clouded by the continued adverse impact of multiple shocks, including pandemic-related vulnerabilities, rising inflation, higher food and energy prices, geopolitical tensions and sanctions, as well as climate change and natural disasters. We broadly agree with the key policy recommendations provided in the flagship reports and share the view that stronger global cooperation is critical.

The key challenge facing policymakers is to bring inflation back to target and to restore fiscal buffers, while protecting the most vulnerable. Restoring price stability is paramount. The tightening cycle in many countries has started too late and proceeded too slow, leaving major central banks behind the curve in fighting inflation, fueling the risk of a global recession. Now we strongly support the emphasis on frontloaded monetary tightening to prevent inflation expectations from de-anchoring, although sizable spillovers from these actions are worrisome.

The gradual reduction of fiscal deficits is necessary to help tackle inflation. However, the higher level of accumulated debt may create an incentive problem for policymakers, as they may become less inclined to address the inflationary shock. This may become an issue for central bank independence.

We know that substantial improvements in the debt sustainability in some advanced economies have been already achieved due to a prolongation of elevated inflation. We also welcome today's discussion on the fiscal package in the U.K. and its potential impact on debt, growth, and inflation.

Tighter global financing conditions and the surge in the U.S. dollar increased the risk of more widespread emerging market debt distress. We agree with staff that policymakers should act now to contain a further buildup of financial vulnerabilities and strengthen debt resolution approaches.

Food prices, as well as other commodity prices, have shown a decline in recent times. This development could help policymakers, although more focus should be placed on trade restrictions that affect global food and energy distribution.

As the current experience proves, sanctions and the different forms of restrictions will continue to adversely impact global food and energy security. A possible introduction of an oil price cap will impact the energy markets in a dramatic way.

Mr. Amarasekara:

We join the other chairs in commending staff for the high-quality analytical work in drafting the Fund's flagship publications at a time when the global economy is facing multiple shocks and extreme uncertainty.

The cross-cutting themes covered in the three reports have well-established the key priorities for global policymakers. These include taming globalized high inflation, preventing a prolonged recessionary trend, maintaining close cooperation between fiscal and monetary policymaking, addressing the longer-term challenge of climate change and, perhaps most importantly, avoiding fragmentation and furthering multilateral cooperation.

Before specifics, we would like to add a general point about the ongoing world crisis. As this chair has repeatedly emphasized, it is important to recognize the differences in this global crisis from those that happened earlier. The most unusual circumstance—of developing economies showing a lower increase in inflation and lower currency depreciation—needs to be sufficiently accounted for. In addition, as many have noted, where the world would be if we were not witnessing a war in Europe, may be an interesting departure for analysis.

We have issued a comprehensive gray statement, and we would like to provide the following three points for emphasis.

First, addressing the cost-of-living squeeze is high on the agenda of global policymakers, and the publications provide useful analytical inputs on dissecting this issue. Food prices, as well as other commodity prices, have shown some decline in recent times. This development could help policymakers tame inflation with appropriate macro policy adjustments, although a longer-term focus must remain on tackling disruptions to agricultural production from climate change. We would like to add that disruptive trade practices that affect global food distribution must also be dealt with in addressing food shocks.

Second, like many other chairs, we agree with the view expressed, particularly in the WEO, that the risk of monetary policy miscalculating the right stance to reduce inflation is high, and mistakes are possible, either under- or overtightening of monetary policy. However, decisive monetary policy measures are essential to bring inflation back to more desirable levels, particularly by preventing a de-anchoring of inflation expectations for too long. Fiscal policy should play a supportive role of maintaining the overall tightness of policies, while protecting the poor and the vulnerable through targeted support.

Third, widespread debt distress in vulnerable economies remains a key risk to the global outlook. Policy space in many of those economies has been exhausted by tackling the pandemic. Increased uncertainty and volatility have dampened the global risk appetite. Global policy normalization, amidst high food and energy prices, has severely weakened the balance of payments positions and market access of such countries. The realization of further shocks and a further deterioration of risk perception could trigger a widespread debt crisis and increase the risk of a global recession. In this context, we agree that urgent action is needed for a well-functioning debt resolution mechanism.

Finally, as always, we found the overall analysis, as well as the country examples given in the reports, extremely valuable for the authorities to assess the adequacy of their own policy measures and learn from policy innovations and policy mistakes.

Mr. Parkyn:

We thank our counsellors for their very insightful presentations, and we also thank staff for the comprehensive set of reports that clearly demonstrate the difficult policy tradeoffs at a time when pressures have intensified on the back of Russia’s invasion of Ukraine and the prolonged pandemic. We broadly agree with the staff appraisal and will just emphasize the following points.

First, we acknowledge compounding uncertainties on the outlook, and we agree with staff's assessment that risks are tilted to the downside. Near- and medium-term risks are significantly intertwined at the current juncture, and an extreme scenario of a global recession cannot be excluded. We welcome the staff analysis regarding the confidence bands around the baseline projections, in conjunction with the adverse scenario, and also welcome the reflection prompted by recent forecast errors.

Tighter financial conditions and a stronger U.S. dollar exacerbate the risks of financial instability, substantial capital outflows, and debt vulnerability, especially in emerging market and developing economies. Risks are exacerbated for countries that have little or no policy room remaining to respond.

The real estate market in several countries needs special attention. Like Mr. Hilbers, I acknowledge the timely and useful analysis, both on the risk to house prices and also the discussion of affordability issues. In particular, continued monitoring of the potential spillovers from China's real estate sector is warranted.

There is a risk that a more fragmented global economy, stemming from Russia's war against Ukraine, could have adverse implications for trade, investment, and productivity, and undermine the ability of the world to address structural challenges, such as climate challenge and debt resolution.

Second, the Fund should sharpen and refine its policy advice to help member countries navigate the unprecedented multiple shocks. There is no doubt that the priority is to maintain monetary tightening to restore price stability and avoid de-anchoring inflation expectations. Fiscal policy advice needs to be carefully tailored to country-specific circumstances, and we welcome the messages in the Fiscal Monitor.

While welcoming the useful policy guidance, in line with the IPF, and the further elaboration in staff's written responses, the current extraordinary economic situation and FX market developments may warrant a further refinement of the Fund's policy toolkits in a more granular fashion. Structural reforms can help address supply-driven inflation, while supporting more sustainable and productive growth. It is particularly important to identify policy complementarities between the macro and structural conjunctures, in particular, policies that would alleviate supply shortages.

Third, multilateral cooperation is even more critical than ever at this time, and I would join others in reinforcing that message. We welcome the strong message on this throughout the flagship publications. The Fund will need to continue to play a critical role in highlighting the benefits of multilateralism.

We echo calls from other chairs to restore global value chains and support a free, open, and rules-based international trade system. Combating climate change is another area that desperately calls for international cooperation. We welcome the staff analysis of climate finance. We urge the Fund to implement reforms to the delivery of capacity development (CD) and to their engagement with small developing states to support vulnerable countries to develop their capacity to access the RST, which will unlock climate financing from other sources.

Mr. Zhang:

The flagships should focus on the right and urgent issues, in accordance with their global importance, in order to maintain the evenhandedness and reputation of multilateral surveillance, which is much different than bilateral surveillance.

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

On the WEO, the pandemic remains a key risk at the current juncture. Global new cases and deaths are still high. Safeguarding people's health and lives should remain a priority and enhancing international cooperation in accelerating vaccines. Vaccination will be key to ensure a safe and orderly reopening of the economy.

The worsened high inflation situation in many countries is a top concern. We encourage staff to carefully study all the factors driving up the current inflation when assessing the future inflation path and earnestly draw lessons from last year, when the Fund asserted that inflation would be transitory.

On policy response, we agree that monetary policy should play a major role in containing inflation, but it is an open question whether we can control inflation by solely using interest rates. Overreliance on monetary policy can bring big problems, domestically and externally. Many of these problems have already emerged. We believe this should have a better policy mix in coping with inflation. We encourage staff to provide more targeted advice on how to use fiscal policy and structural policy to address supply bottlenecks to help reduce inflation pressures. We hope the WEO can have more discussion on these two important issues, both in the main text and by adding a box.

We concur with staff that risks of further fragmentation and supply chain disruptions are rising. The Fund should increase its voice and decisively reduce these risks. We would like to align ourselves with Mr. BinZarah's point that the Fund should continue to fulfill its mandate on advocating free trade and enhancing a rules-based multilateral trading system.

On the GFSR, it would be more useful to focus not only on what was mentioned but on what was not mentioned. We found little discussion on the risk of a currency depreciation in some advanced economies. We do acknowledge that some even took place after the circulation of the draft report, including those in the U.K. We expect staff to substantially beef up their analysis after the Board meeting. We would also be interested to hear staff's view on the new bond buying program by the Bank of England. This is purely our technical question.

We feel that the Fund may be, once again, behind the curve, this time in running against the risks in the rapid increase in interest rates in the advanced economies, particularly in the U.S. This is, again, related to the faster-than-expected interest rate hike.

We hope the Fund could give tailored advice for the emerging market and developing countries, how to cope with their difficulties from this development in the interest rate world.

We wonder why the GFSR no longer mentioned the risk of fragmentation of the international monetary system, as this risk has further deteriorated since the April GFSR. Staff's views would be welcome.

On the Fiscal Monitor, I would like to briefly touch on the debt issue in two aspects. One picture is that, according to the data on the eligible Debt Service Suspension Initiative (DSSI) economies, among their debt, 48 percent was held by the multilateral development banks (MDBs), 32 percent was held by bilateral officials, and 20 percent was held by private creditors. To ensure meaningful debt restructurings, against this picture, we must bring MDBs and private creditors together to act collectively to engage and to participate in the debt restructurings. Otherwise, if you only count on the official creditors, you only can resolve 32 percent of the debt issue.

Second, we would like to draw another picture. When we focus on the debt restructurings, we also need to focus on the need for the LICs' development and, hence, the financing need for development. At the current juncture, as the staff calculated, private capital is flowing out of the LICs. The grants and official development assistance official lending is also decreasing to LICs. We need to think about how to bring new financing to the LICs to help meet their development needs.

Finally, I would like to briefly touch on some Chinese issues.

On China's economic outlook, since the July WEO update, many of the recent economic indicators in China have beaten market expectations. Most importantly, for the first eight months, China's foreign trade increased by 10.1 percent and FDI inflows increased by 16.4 percent, showing that China's economic ties with the world further strengthened.

China is one of the reliable pillars of the stable global supply chain. This has been proved once again by the bond trade data. Therefore, the risk of potential pandemic-related supply-side disruptions from China should not be overemphasized. What really matters for the supply chain is the artificial trade and supply restrictions over parts and components in some key sectors. We call for the Fund to play a constructive role in reducing supply restrictions and to have a more balanced assessment on supply chain disruptions.

We note with regret that there were too many places in the WEO that mentioned COVID-19 lockdowns in China. We call for the staff to be more evenhanded in the assessment of pandemic policy among member countries. The WEO only mentioned the lockdowns, which is just an element of China's pandemic policies and focuses only on the negative impact of lockdowns, which does not comprehensively and accurately reflect the holistic picture of China's pandemic policy. Given China's large population and huge density, the current pandemic policy is the best option, which effectively avoids huge hospitalization and massive losses of human lives.

China contributed to the global fight against inflation by its exports and during the pandemic and also in the current juncture. We have laid out our rationale comprehensively in our gray statement.

On China's property sector, my authorities are fully aware of the potential risks and the stress in the property market. The property market, for a long time, has had very high speculation, so we need to destocking, deleveraging. In this regard, the decrease in the investment is a natural adjustment. This can avoid a hard landing of the property sector.

The authorities have plenty of policy room and tools to maintain the effective operation of the overall property market now and in the medium to long term. It is not appropriate to label the current Chinese property sector situation as a crisis. The risk of the property market is overstated in the WEO and the GFSR, compared to other major risks facing the global economy. We also have laid out our rationale comprehensively in our gray statement, so I will not repeat that here.

Finally, I would like to say that my authorities appreciated our comprehensive discussion during the Article IV consultation, with all the different issues.

Ms. Mannathoko:

I have a tiny point on the WEO presentation. There was a slide on real growth, which was titled EMDEs and LIDCs, but there was no data in the slide on LIDCs. Maybe before it goes for the outreach, the LIDC data could be added. But I thought the presentations were excellent.

We broadly share the assessment and the policy priorities and the assessment of challenges. I note that what we do and say now, as the Fund, at this point in time really matters, perhaps more than at any other time since 1945. Messaging is critical.

This leads me to the issue of what our communications strategy is. It is clear that markets expect worse. For the strategy going forward, it will be especially important that we have this at the back of our minds so that we do not generate an overreaction that worsens outcomes and potentially leads to stagflation. In this regard, I was just wondering what the plan is with the adverse scenario, whether it might be risky if we are planning to publish it.

To instill confidence, though, on the positive side, we also need to communicate what we got right—namely, we did spend 2021 urging an unwinding of support measures throughout, and this is reflected in the data, because inflation would have been worse if we had kept that stimulus in there.

Others have spoken about the synchronized tightening of monetary policy. We also discussed this in our gray statement. We note staff have modeled this. However, as tightening continues, we do remain a bit concerned, given the lagging inflation response to the tightening, whether second-round effects might still come into play, generating pressures.

In the context of spillovers, the risk of these worsening conditions is worrying. We wanted to also encourage messaging in that regard to avert this.

As noted by staff, with the interest rate normalization, there is the issue of spillovers that can be quite substantial for developing economies with significant shares of dollar-denominated debt and with short debt maturities. It is critical, on the debt side that these countries have an adequate understanding of the IPF, when to apply it in the face of such shocks. We welcome the discussion on this. We hope for a timely outreach, including to our region, in terms of managing capital flows and other spillovers, with the IPF guidance note.

I probably sound like a broken record on the IPF, but we are really happy. We have been raising it since Ms. Gopinath first presented it when she was still Economic Counsellor. We appreciate the progress on this and see it as an important tool.

On food and inflation, we are especially aware that persistent inflation is fueling the cost-of-living crisis and food insecurity, especially in our region, and as noted by Mr. Gaspar. We appreciate the attention to the policy advice in this area.

I just wanted to highlight that we have been talking about supply-side measures, in relation to agriculture and climate shocks, so we agree on the whole narrative on supply-side measures. It is especially important, but at the same time, it is important on the fuel side because there are food and fuel insecurity issues.

As noted, on debt, with the incidence of debt distress in countries, more countries now are seeking to restructure debt, so this incidence is rising. Mr. Adrian mentioned that more countries are trading at stressed levels. The work that the Fund is doing to facilitate an effective and efficient Common Framework is even more critical now. We encourage a focus on this and possibly an update on the progress in the design later in the year.

We continue to highlight the rising debt vulnerabilities, and we are glad about the discussion of this and the implications that this will have. These were well covered in the presentation.

At the global level, in our gray statement, we had a question on the discussion of inflation in the U.S. now versus 1994. Our question was about the role of oil prices in this dynamic. We did look at Box 1.3, but it was focusing on a different take. Because, in 1994, part of the decline, the success was due to oil prices having peaked and come down.

A quick word on recovery in LIDCs. We agree that IFIs and MDBs have a very important role to play on the sustainable finance area, especially LIDCs that are particularly vulnerable to climate change impacts.

Finally, also related to this, we wanted to agree with the recommendations that are mapped up on strong multilateral cooperation. This will be critical to avert debt, food, climate-induced crises, and ensuring adequate and affordable financial flows go to regions that need it, ensuring that investment flows return to regions that need it. All this effective collaboration, including with the WTO and with member countries, where there are constraints in global trade, we feel all this is critical at this time.

Finally, revenue mobilization is especially important in our region. We appreciate the discussion on this to stem the deterioration in tax capacity, and we see effective CD with digitalization as having a critical role in this area.

Mr. Stephan:

The Fund's policy advice in these times is of the utmost importance to the whole membership and, therefore, this is much appreciated.

I stumbled over a quote by the famous American children's author and cartoonist, Dr. Seuss, who said, "Sometimes the questions are complicated, and the answers are simple."

Right now, it is the opposite. The questions we are confronted with seem very simple, but the answers are very complex. For instance, we ask ourselves how to bring down inflation, seemingly a straightforward question but a complex one, given that we are facing a mix of supply-and-demand shocks and that, in some parts of the world, we are in the midst of an energy crisis. We are, thus, facing a lot of uncertainty and very difficult tradeoffs.

Having said this, we agree with staff that the cost of monetary policy mistakes are asymmetric. We, therefore, welcome that the new upside surprise to inflation and possibly monetary policy mistakes feature prominently in the report.

On the way forward, we, thus, share the staff's assessment that in the current situation, an under-tightening of monetary policy would be much more detrimental than an overtightening. Of course, this may lead to a de-anchoring of inflation expectations.

Second, a related and seemingly simple question is how fiscal policy should react in the current environment. Most of us would agree with staff that keeping or implementing a tight fiscal stance is needed to avoid offsetting monetary policy disinflationary effect. At the same time, fiscal policy plays a crucial role in cushioning the impact of the energy crisis and the disinflationary transition on the most vulnerable. But what would be the best way to do so? The Fund's policy advice seems pretty clear. A pass-through of higher international energy prices to domestic users should be allowed but, at the same time, vulnerable households need to be protected.

In the Fiscal Monitor, staff recommends avoiding limiting the price increases through price controls, subsidies, or tax cuts. Mr. Gaspar pointed out the attempts to control prices are ineffective.

We agree in principle. I would be interested in staff views on an alternative set of policies in the current situation. I recall a recent panel discussion, where our former chief economist Olivier Blanchard questions whether the Fund's recommendation is really the right approach. I recall him saying, "It is far from obvious whether this is the right policy in the current environment, especially in Europe." He pointed to the general need at the current juncture of limiting first- and second-round effects of very high energy prices, as well as to the need to avoid contributing to any de-anchoring of inflation expectations.

Hence, maybe a combination of those policy measures—that is, some pass-through combined with certain price caps—would be better suited. Having also that objective in mind, I would be interested in the staff's view on that.

Third, and last, another simple question that we are confronted with is whether we should delay the necessary measures to achieve a decarbonization of our economies, given the high inflation environment that we are in. Here, we agree with the main finding in the third WEO chapter. If the right measures are implemented immediately and phased in gradually over the next years, the costs will remain manageable and dwarfed by the immense long-term cost of inaction.

In this context, let me join others in applauding staff for the development of the Fund's Global Macroeconomic Model for the Energy Transition which, as Ms. Riach has pointed out, is genuinely world-leading.

Let me finish my intervention by using another quote from Dr. Seuss. He was of the view that "there is an inherent moral in any story."

As regards the flagships that we are discussing today, we take positive note of the carefully crafted language, which does not leave the reader to decide who is responsible for a large part of the current economic and humanitarian hardship that the world is facing now.

We all know that stopping Russia's war against Ukraine would be the single most effective measure to improve the global economic outlook and solve many of the questions that have been raised before.

The Chair:

It is, indeed, a heavy burden on the world economy that comes from it.

Mr. Mohieldin:

We issued a gray statement, and many members of the Board shared some of the issues that I was intending to emphasize, but I still have three.

About policy recommendations and going back to the very important point raised earlier by Mr. Buissé—that it is very much the case-specific and initial conditions of the country that will make the recommendations valued more—I think he referred eloquently to the issue of being case-specific and the initial condition that, definitely, when I read the policy recommendations, and try to fit them in some of the countries that I serve, many would find difficulties in just applying them, given the initial conditions. Many others could be more comfortable pushing even beyond the recommendations.

The first point is basically about the role of fiscal policy. As always, we appreciate the work of Mr. Gaspar and his team. But the matters related to prioritizing vulnerable groups need more attention, especially the work that we need to have for middle-income households. We know more or less how to better target lower-income groups through a variety of support, but now the vulnerability of the middle-income countries—not just in the low income but, indeed, the middle-income countries—warrants better suggestions. I bet during the Annual Meetings, you will be getting lots of questions from minister of finance and others about how best we can tackle that.

Not leaving the issue of middle-income, Mr. Gaspar mentioned that the deterioration in poverty and the vulnerability in debt warrants more attention to LICs, which is true. But as we know, the majority of the poor, including the extremely poor, are residing in middle-income countries. That will need some attention as well. I am not saying we do less for LICs, but we need to extend the support for the low- and middle-income countries.

The second point, I appreciate the work in the chapters on the climate agenda. It is reflected nicely in the third chapter of the WEO and the second chapter of the GFSR. What I would hope for is more examples from emerging markets and developing economies.

What I would have hoped, as you did well in the challenges of monetary policy, is more discussion of issues related to the impact on budgets and fiscal implications, especially on the adaptation. Perhaps this could be a subject to the next WEO, given that the staff already did a great job on adaptation and the budget implications for many countries, including countries in my region.

The very final point could perhaps be the most controversial, trying to adjust what we just heard about being practical, pragmatic, using humility, coordination. The strong recommendation is do not yield to pressure to ease monetary tightening. This is a policy recommendation No. 2. Here, in the context of discussing central bank independence, with a reference to the work of Paul Tucker, the former Bank of England Deputy Governor, he said that the objectives of any independent agency must enjoy a high degree of support and they have to be tested before its creation.

Of course, central bank independence, for very good reason, needs to be respected. But the issue is about having support beyond just issuing press releases and communication with sophisticated elite and concerned parties because, I would like to put it in a very positive context here, the news coming from the Fed is competing in many villages in my country with the news coming from FIFA, and they are waiting for it.

I am not asking the Fed to communicate as FIFA does, but I would say that there are transmission mechanisms through the Central Bank of Egypt and others to communicate that.

When I say, "do not yield to pressure," I am getting advice from Professor Stiglitz, a very well-respected friend of the Fund, saying let us wait and see, which is his advice to the central bankers. When he says that, this is directed to him, but nobody will be listening to his advice.

When I say my good friend Mohamed El-Erian, I am talking about the issue of the credibility of central banks worldwide and about the intended and unintended consequences of monetary policy measures.

To make room for accommodation and in seeking the support not just from the professionals but from the general public, some better understanding of how these policies are being conducted, their impact, and how to mitigate their outcomes, would be very much appreciated.

Mr. Tola:

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

First, we agree with the WEO's main policy recommendation that the priority must be to tackle persistently high inflation. This is by no means an easy task, and policymakers have to walk a fine line between under- and overtightening monetary policy. However, given historically high inflation in many countries, the risk of tightening too little outweighed the risk of overtightening. Persistent high inflation would have dark consequences for many countries, especially those affected by high food and energy prices. As Mr. Bevilaqua mentioned, the poorest will suffer the most. Moreover, the credibility of the central banks will also suffer.

Second, as Mr. Mizuguchi noted in his gray statement, the current situation, in which financial market conditions are tightening and debt and deficits are high, requires timely and clear communication by central banks about the outlook and what it implies for monetary policy in order to avoid excessive and disorderly market reactions that could threaten financial stability. In this context, an adaptation of the existing analytical approaches and models may also be necessary to reflect the current special circumstances and evolving economic situation.

Third, we strongly share the view expressed in the WEO that fiscal policy should prioritize consolidation. While this will affect the cost of living in the short term, reducing high budget deficits and debt would bring significant savings in the form of lower borrowing costs and create the much-needed fiscal space. Moreover, it would help central banks tackle inflation by curbing excess aggregate demand. Fiscal support should be targeted and focused on the most vulnerable. Like Mr. Pösö and Mr. Stephan, we believe that countries should not rely on price controls or blanket subsidies or transfers that could interfere with price signals.

Finally, like Mr. Jennings, we see scope for more detailed analysis of the financial stability risk posed by unbacked cryptoassets and stablecoins.

Mr. Zhang:

I would like to use this opportunity to touch upon the implementation of the Common Framework. I just came back from Beijing. We note that some politicians usually like to publicly criticize China for the DSSI last year and this year on the Common Framework's implementation, and say China is blocking these things. That is not true.

For the current Common Framework, there are three cases—Ethiopia, Zambia, Chad. Two of them, Ethiopia and Zambia, the Ex-Im Bank co-chaired together with the other members. The truth is that some creditors want to push these cases faster. They do not want the other case to move ahead. My Ex-Im Bank colleague told me that last year they managed to hold several creditors' meetings, but some creditors did not move ahead with that. So even though they have several meetings, there is no achievement on this front. In the future, they very much doubt whether we can move ahead in the case of Ethiopia.

I want members to be balanced, not to point fingers at others. You need to think about what you have done. This is one point.

Another point is that we really hope the world sincerely thinks about our call for a systemic resolution to bring multilaterals, bilateral officials, and private creditors together to have resolution for the LICs at issue.

The Chair:

I want to praise China for taking a constructive role in Zambia. You mentioned Ethiopia where, for different reasons, there is no progress. It is more the domestic political environment that is creating difficulties. We are being briefed that progress has been made on Chad, so hopefully we will go to the Annual Meetings with Chad and Zambia being behind us.

As for the engagement of multilateral organizations, our job is to make sure we provide positive flows. Being lenders of last resort—and in this case, I talk about the Bretton Woods Institutions—we have to be able to tell you that your trust in us to guarantee that countries will be able to repay needs to be high. That has led to the recognition that if you—collectively, 190 of you—trust us to be a lender of last resort, you also collectively would like to see us being in a position to do our job properly. That is where the treatment of the Bretton Woods Institutions has come from.

But I completely agree that bringing a broader participation, getting the private sector to participate on equal footing in the Common Framework is absolutely crucial and that we should be asking the Fund, the Bank, other MDBs to do all we can for countries to have sound fundamentals so they can move forward their development, because, ultimately, this is what we are talking about.

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

First, I want to thank the Board for the very rich discussion. This is very helpful for us, and we will take all of this on board.

Let me maybe address a few of the points that have been raised. Mr. Adrian and Mr. Gaspar will come in as well and address some of them.

First, there were a number of questions raised about the risk of overtightening, in particular, due to the synchronization of monetary policy. That is certainly something that we mention as a potential risk. But let me explain why we are not putting that risk at the top of the list.

First, let us remember that inflation is at 9-plus percent right now. The idea that we somehow should be close to the peak of our tightening cycle seems very premature. Even if headline inflation is moderating, core inflation is still pushing upward.

Second, underlying the argument there could be excess tightening is the view that somehow each central bank is doing its own thing, without taking into account what is happening in other parts of the world. That is not what we hear from how central banks are operating. They are constantly talking to each other. The models they are using take into account the impact of what is happening in the rest of the world and how it will impact their own domestic economy. Even if they have a domestic mandate, if everyone else is tightening and that is bringing a global slowdown, that will affect inflation at home—and they will take that on board when they are making their policy recommendations. We are not seeing this as a particularly important channel.

Now, I do very much agree with the point that we are at a very delicate moment, and it is very important to avoid shaking the boat or rattling the cage or rattling markets. That means that monetary policy communication is going to be very important. It needs to be clear. It needs to be transparent. It also needs to be very clear how it articulates with fiscal policy. We have seen that when there are tensions between fiscal and monetary policy, that is the kind of thing that can generate tensions in the market.

There was one question about the neutral interest rate and what is our advice and guidance on this.

I am very glad that this question was asked. We are doing a deep dive on this. One of the Analytical Chapters in the April 2023 WEO will look into this.

There are a number of forces that are driving natural interest rates. It is hard to get very precise estimates at this point. We do provide estimates in the current Chapter 1, figure 1.23. But we recognize that more work is needed, and we are engaging on this.

On inflation expectations, there was a question as to whether they are becoming more adaptive or whether we should be concerned. This is clearly a place where a lot of attention is being put, looking at the different indicators. None of the indicators are perfect, whether you are looking at consumers or markets. They are all imperfect in some ways. But everyone is looking at them very carefully.

The point I would want to make is that the credibility of central banks and anchoring of inflation expectations is a key asset. It has to be protected. Once it is gone, it is too late. It will be very costly to bring back that credibility and to re-anchor inflation expectations. We cannot wait and decide that we are going to be accommodating until the point that we see inflation expectations moving. That is going to be too late. There needs to be a risk management approach to monetary policy, in a sense. That is one of the reasons we put the risk of easing too early or stopping the tightening cycle too early at the top of the list.

Let me say something on fiscal policy. There were a number of questions on whether fiscal policy can play a role at the current juncture. Yes, in principle, fiscal policy can play a role. If we need to contract aggregate demand, which is what monetary policy is doing, you could imagine doing it with fiscal policy instead of doing it with monetary policy. That would call for a more contractionary fiscal policy. This is not what the current tradeoff is. The current tradeoff is about using fiscal policy to try to address the energy crisis. It is moving in the other direction.

The energy policy is very important. What should the good energy policy do at this juncture? It should reduce demand and increase supply. There is clearly a need for that. That is not going to be resolved any time soon. This is why we are seeing the energy crisis as persistent.

As a number of you have mentioned, gas storage is high in Europe right now, but it has been designed for a world in which there are Russian supplies of gas after the winter. Where are the Russian supplies of gas going to come from next spring, next summer, as we get into next fall? How are we looking at gas prices for the following winter? Even if this winter is maybe OK, the next winter will be challenging. We need to recognize this when we are designing fiscal policy.

This is another reason why we think it is dangerous to use fiscal policy to try to do the task of reducing inflation. Subsidies can reduce inflation. Subsidies on energy can reduce headline inflation. That can help maybe for second rounds, but it comes at a very high fiscal cost. And if the shock is persistent, you are going to have to be able to carry that fiscal cost going forward. That is going to be very difficult. If you do not carry that cost, then that inflation will be materialized maybe in 12 months, so you just delay the inflation. You have not neutralized it completely.

On Uruguay, our team has been engaged with the authorities. I hear that the comments are now fully reflected in the latest version, so this should not be an issue at all.

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

When I look at the GFSR, we are flagging many financial stability risks. The overall assessment is quite disconcerting.

Let me flag five, in particular: the risk of disorderly tightening of financial conditions, amplified by deleveraging and market illiquidity; the potential for macro-financial feedback loops, where the tightening of financial conditions feeds into the macro economy and back into financial markets; the risk of housing market declines; and then for, emerging market, risks in the banking sector; and for emerging markets and developing economies, capital flow risks and sovereign risks. That is quite a concerning financial stability assessment.

Mr. Bevilaqua asked whether we could do more country-specific advice. It is difficult to do that in multilateral flagships. We have the Financial Sector Assessment Programs for financial stability, Article IV consultations for broader policy assessments. We can do a certain amount of country-specific assessments in the GFSR and the WEO, but there is a limit to how much we can do. It is supposed to be multilateral.

On regulatory policies, Mr. Moreno and Mr. Tola point to the language around macroprudential policy. There is quite a bit of heterogeneity in terms of what is needed in different countries in terms of underwriting standards—in the housing market, in particular. We are very careful in the wording, but there is no one-size-fits-all.

In terms of regulatory coordination, we fully agree. It is first order, and we work closely with the Financial Stability Board (FSB) on regulatory issues—in particular, on crypto markets regulation, which was mentioned by Director BinZarah, and where we have just put out two fintech notes by staff on crypto regulation this week.

On monetary policy, the IPF is country-specific. It depends on shocks and initial conditions for each country. Under certain circumstances, a certain degree of FX intervention or capital flow measures might be appropriate. Area departments have started to put the IPF into practice in country-specific circumstances. We also provide technical assistance on developing tools to help implement the IPF in central banks and other agencies.

On synchronous tightening, Mr. Gourinchas already made the point that we still have very high inflation in many countries. In most countries, it does not look like we are close to the end of tightening.

On de-anchoring of inflation expectations, Mr. Gourinchas already made the point that this is watched very closely, including not just the point distribution but the whole distribution implied from options and surveys.

On climate finance, I am glad that this resonates with many of you. We are certainly doing more work on climate finance, particularly on this question of public-private partnerships.

On debt and debt resolution, we fully agree with the comments that this is very first order and there is a lot of work focusing on debt.

Finally, on financial sector fragmentation, we are working on this question of how to quantify fragmentation and how it evolves over time, but this is still a work in progress. It is too early to report back to you on where we are.

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

Mr. Mohieldin raised the issue of the lack of attention to middle-income countries. That is not the case in the published version. When you look at these dramatic tradeoffs, they are, unfortunately, strongly correlated negatively with GDP per capita. When we concentrate on food security and poverty, I thought it would make sense to focus mostly on low-income developing countries. But I am completely aware that, in terms of numbers, given the distribution of population, you are absolutely right that most of the poor are actually in middle-income countries. There is no difference in substance at all.

Mr. Zhang raised the issue of how can we mobilize finance for the development of countries, where development is a main priority. From a fiscal viewpoint, Ms. Mannathoko actually gave the answer. Something which is very important is to develop tax capacity to enable state capacity. Then there is an empirical complementarity with the development of the financial system and the ability to attract investment from abroad.

Mr. Stephan referred to the possibility of tradeoffs in the design of the energy policies. Indeed, the world is today full of painful tradeoffs. We do, in our policy recommendations, recommend the adjustment in demand and supply that Mr. Gourinchas already referred to, but we say that, in case countries want to smooth, they should be aware that smoothing cannot be too long-lasting because distortions pile up, and fiscal costs pile up. In such circumstances, the initial favorable impact on measured headline inflation is paid with interest in higher inflation persistence and higher inflation later on, which creates challenges for the dynamics.

The first-order aspect to bear in mind is that, with very high inflation in many countries, including in Europe, the perceived conflict between monetary and fiscal policy will erode credibility and has the potential to create turmoil and turbulence in markets and very high costs in terms of the disinflation process.

My last comment will be on a very important point made by Ms. Riach concerning what is going on in the U.K.

Ms. Riach made a statement with which I completely agree, that well-established processes, procedures, and institutions have high value, and probably better outcomes could have been expected, if that had been the case.

When we look at the details of the mini budget, the measures are very far reaching. They are very complex. They are hard to cost. When we go systematically through, for example, the tax package from where very strong growth effects are estimated, we do see a number of important question marks. The very prestigious Office for Budget Responsibility could have had a very positive contribution in this context—at least that is how I see it.

Ms. Mannathoko:

I know we have the FSB in the financial sector and regulation. Do we have the equivalent of a global Monetary Policy Committee (MPC)? Because there was a lot of talk about coordination.

I also appreciate MCM really for the IPF model.

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

Central bank governors meet regularly at the Bank for International Settlements, and I represent the IMF there. This is where views are shared around the table on what central bank governors see and what their assessments are of the current situation.

Ms. Mannathoko:

What I had in mind was, what would the MPC decisions be for the global economy, and then you can discuss the individual thing.

The Chair adjourned the discussion.

ANNEX

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

Statement by Mr. Stephan, Mr. Krahnke, Mr. Bruns, and Mr. Schmelzer on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the informative and well-written set of reports. It offers an insightful assessment of the current state of the global economy, risks to the outlook, as well as clear policy advice. Notwithstanding some heterogeneity in revisions for 2022, the overall picture is bleak. We note significant downward revisions to growth in 2023 and again substantial upward revisions to inflation projections. Downside risks continue to dominate, in particular, given the continued Russian war of aggression in Ukraine. We welcome staff's initial assessment of recent forecast errors for inflation as well as the clear language on risks of new upside surprises to inflation and asymmetric costs of monetary policy mistakes.

We broadly concur with staff's projections for the world economy and acknowledge the high uncertainties surrounding the outlook. We note that staff projects global GDP to increase by just 3.2 percent in 2022, confirming its forecast from the July WEO Update, while in 2023 global growth is expected to decline further. This projection entails a marked slowdown in European economies, ongoing weakness in the US, and a muted recovery in China. In our view, the projections for euro area GDP growth are plausible and we concur with the direction of revisions to the growth outlook for Germany. According to our own estimates, GDP growth for Germany could turn out even lower than the WEO forecast.

We share staff's assessment that downside risks to the global outlook continue to dominate. We concur with staff's assessment that Russia's war against Ukraine, stubbornly high inflation, tighter financial conditions, as well as lingering and renewed supply chain disruptions are key factors. We share the view that a complete halt to all Russian gas supplies would likely cause another spike in energy prices and could lead to disruptions in Europe.

As staff rightly notes, the costs of monetary policy mistakes are asymmetric. We welcome that new upside surprises to inflation and possible monetary policy mistakes feature prominently in the report. We share staff's assessment that in the current situation an "undertightening" of monetary policy would be much more detrimental than "overtightening" as it may lead to a de-anchoring of inflation expectations.

We agree with staff's recommendation that monetary policy must give priority to normalizing central bank balance sheets and raising real policy rates above their neutral level fast enough and for long enough to keep inflation and inflation expectations under control. In this context, we also welcome staff's initial assessment of recent inflation forecast errors. As inflation has repeatedly been underestimated by the WEO during 2021 and 2022 by an abnormally large amount, a candid assessment – informed also by well-known challenges to estimate output gaps in real time as well as to gauge the efficacy of fiscal stimuli – seems important to draw the appropriate lessons for Fund surveillance going forward. Moreover, the work should not only focus on core inflation but on headline inflation, for which forecast errors are still rising. The repeated overshooting of inflation may undermine the credibility of forecasters and increase risks of a de-anchoring.

On fiscal policy, keeping or implementing a tight fiscal stance is needed to avoid pushing inflation further upwards. Redistributive policies may be appropriate but need to be offset to reduce high debt ratios. Moreover, it would be helpful to qualify the usual stance indicator: For instance, in the euro area the change in the cyclically adjusted primary balance is largely driven by the phasing out of temporary measures, which worked similar to automatic stabilizers. Hence, these indicators may mask the fact that fiscal policy at its core is still rather expansionary.

We broadly agree that a tightening in global financial conditions may translate into capital outflows from emerging market economies. We acknowledge that staff suggests that under certain circumstances measures to reduce foreign exchange mismatches and the probability and severity of any subsequent capital flow reversals may be appropriate. These measures, however, should be considered with caution and against the background of potential negative side effects. Foreign exchange interventions, in particular, should only be considered under dysfunctional market conditions.

We welcome staff's comprehensive analysis on wage dynamics and wage-price spiral risks as carried out in chapter 2. The findings suggest that monetary policymakers should respond aggressively to such inflationary shocks, particularly in the current environment with high and rising inflation and wage growth being sensitive to inflation expectations. We concur that a firm monetary tightening is appropriate in response to cost-push shocks in the context of high and rising inflation to minimize the risks of de-anchoring. However, we take the result of the short-lived effect of supply-chain disruptions on prices with a grain of salt as it is based on a sample with low inflation rates and may not be transferable to the current episode of prolonged supply-chain disruptions. We note the finding that when wage and price expectations are more backward looking, monetary policy tightening needs to be more frontloaded to minimize the risks of inflation de-anchoring. Due to its importance for the risks of de-anchoring, we would welcome further analysis by staff on the formation of inflation expectations at the current juncture.

We appreciate the insightful analysis on the near-term impact of decarbonization policies and like to commend staff for the analytical approach. We broadly agree with key arguments made in chapter 3. This concerns, in particular, the importance of an orderly transition scenario with policy measures being implemented early and gradually becoming more stringent, as well as the need for properly balanced and country-specific climate actions and the role of a credible monetary policy in facilitating the transition. With great interest, we have also noticed the use of the IMF's novel Global Macroeconomic Model for the Energy Transition (GMMET) and look forward to future applications of this model to inform member countries' policies on the necessary energy transition.

Global Financial Stability Report (GFSR)

Overall, we agree with staff's assessment that risks for financial stability have increased during the last six month. We concur with staff that conditions in financial markets reflect a high degree of uncertainty about future inflation, interest rates and growth. European financial markets might be particularly vulnerable due to their high exposure to the energy crisis caused by Russia's war against Ukraine. We also agree with the assessment that market liquidity has decreased across many asset classes. Low market liquidity has been a shock amplifier in past crises and may continue to be so in the future.

We share staff's concerns on risks emanating from the Chinese property sector. The real estate sector is an important part of the Chinese economy and contributed significantly to its growth. A downturn of this sector could hit banks, local governments, households, and also the global economy. Therefore, we see the need of increased transparency and monitoring.

We agree with staff's recommendation to closely monitor banks' assessment of credit risks and loan-loss provisions – also in advanced economies. In a downturn, debtors may not be able to service their debt and banks' securities portfolios might lose value. Banks' risks models might not adequately reflect these risks because they are based on historic low-default data. As a result, adequate capital buffers would become essential. Even though the Global Bank Stress Test signals higher risks for banks in emerging than in advanced economies, this should not be interpreted as an all-clear signal for advanced economies.

We agree with staff's assessment that emerging market and developing economies will need significant climate financing to reduce their greenhouse gas emissions and to adapt to the impacts of climate change. To achieve this, a significant scaling up of private sources of climate financing is required. Otherwise, a rising exposure to systemic climate-related risks might impair financial stability. We agree that the IMF should help strengthening the climate information architecture and provide support regarding the design and implementation of climate policies, including carbon pricing. The establishment of an international carbon market, as envisioned in the Paris Agreement, could foster climate finance in emerging market and developing economies.

We agree with staff's assessment of rising vulnerabilities in the global open-end fund (OEF) sector. Herd behaviour of investors might lead to concentrated outflows from investment funds and could put OEFs at risk, in particular, when they are predominantly invested in relatively illiquid assets. We would like to add that inter-connectedness of OEFs through direct crossholdings and indirect interconnectedness via portfolio overlaps imposes a further risk for the stability of the sector as these might even exacerbate the mechanisms described in the chapter.

We also agree with staff's assessment that further policy action is needed to mitigate the risks associated with OEFs. For OEFs holding a significant share of less liquid assets, it should be ensured that either appropriate price-based tools are used on a continuous basis or, if this cannot be achieved, the possibility of daily redemption is restricted. To achieve this policy outcome and to better assess the effectiveness of price-based tools in mitigating increased vulnerabilities in the future, we believe it is critical that National Competent Authorities closely monitor the appropriate implementation of these tools. For funds investing in inherently illiquid assets, we share the view that restrictions on redemption of units should be established. In Germany, we had good experiences with restricting the right to redeem shares in (retail) real estate funds by introducing a mandatory 12-month notice period to limit the degree of liquidity transformation.

Fiscal Monitor

We appreciate that the IMF presents timely and well-balanced considerations on fiscal policies in times of severe crises and on building economic resilience going forward. Our main takeaway is that countries' fiscal policies now need to create room for maneuver and that fiscal tightening needs to start immediately.

We welcome that staff stresses the importance of fiscal policy adjustment and highlights that relying on inflation is not a viable option to reduce debt. Building buffers and tightening fiscal policy requires prioritizing spending among competing needs and mobilizing revenues in a growth-friendly way.

We support the notion that currently fiscal policy decisions must be made under very difficult trade-offs. As staff points out, fiscal policy should not undermine the fight against inflation, and it should support monetary policy at keeping inflation expectation anchored. At the same time, fiscal policy should also support the most vulnerable facing real income losses. We concur in principle with staff that governments should avoid price controls, subsidies, or tax cuts, as they are costly and largely ineffective.

While we agree that it is important to try to prepare for the future, staff could mention the limitations of the suggested approaches more prominently in the text. Otherwise, expectations could be too high. The risks and difficulties related to company support measures are well covered. Yet, costs and limitations of semi-automatic stabilizers as well as policy measures to attain more efficient social safety nets could also be included.

Statement by Mr. Hosseini, Mr. El Qorchi, Mr. Ahmed, Mr. Badsi, Mr. Sassanpour, Mr. Akosah, Mr. Belhaj, and Mr. Boostani on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the excellent set of reports and thorough analysis and discussion of the multiple risks to the global economy.

World Economic Outlook

The global economy is going through turbulent times. The three major overlapping global crises—the supply-demand shock of the pandemic and its lingering effects, the fallouts from the war in Ukraine, and the "inflation surprise"—are presenting policymakers with a unique set of challenges, with little historical precedents to fall back on. Price pressures, reflecting a strong post-pandemic demand-driven recovery and persistent pandemic-related supply bottlenecks, were already evident in late 2021, but were accentuated by supply disruptions related to the war. While the surges in food and energy prices were most visible, the "cost-of-living squeeze" was broad based, hitting all vulnerable countries and vulnerable households in every country the hardest. The October 2022 WEO is appropriately focused on challenges and trade-offs in bringing the multi-decade high and complex inflation under control, quickly and durably, and keep inflation expectations firmly anchored. We agree with the thrust of staff recommendations. Close monetary policy coordination between major transatlantic central banks is critical, not least to prevent further US dollar appreciation and avoid cross-border tensions. Such policy coordination should factor in different transatlantic wage-price dynamics that could affect the timing and strength of monetary policy tightening (WEO Chapter 2). Policymakers should also recognize that the current inflation episode is quite unique due to medium-term scarring and structural shifts in the output and labor markets caused by the pandemic. The uncertain path and duration of supply chain normalization could also create a bias in favor of over-tightening. Most importantly, however, there should be the clear recognition that there is virtually no room for policy slippage, in either direction, given the very high economic and socio-political costs of policy mistakes.

It is important to recognize the implications of the current aggressive front-loaded monetary tightening by major central banks (US Fed in particular) for emerging market and developing economies (EMDEs). The swift tightening of global financial conditions and the real appreciation of the US Dollar are already being reflected in capital outflows, higher spreads, and currency depreciation in EMDEs, increasing their financial stability risks and lowering growth prospects for many highly indebted countries with large US Dollar-denominated debt.

The more recent easing of global food prices may have provided a temporary respite, but no major relief for most low-income countries as many continue to face acute food insecurity.

Food prices could again surprise on the upside and, as staff suggests, the timing and the magnitude of the price pass through from global to domestic prices make grain-import dependent low-income countries particularly susceptible. A strong US Dollar is adding to the pressure as most globally-traded foodstuffs are denominated in US Dollar. In these circumstances, ensuring unencumbered flow of grain and other essential foodstuff across borders, as well as generous food aid and low-cost financing of food imports are international responsibilities and moral imperatives. The proposed introduction of a food price shock window by the IMF has been very timely and is welcome. Buildup of global food stocks over the medium term to smooth out future fluctuations in international food prices, as suggested by staff, merits serious consideration by the international community.

We found the WEO's Special Feature on drivers of food inflation informative and broadly agree with staff on reasons for the co-movement of food and energy prices in the past, but would stress the different nature of supply shocks and market structures in the two markets. International oil and gas prices have eased markedly from their peaks earlier this year, in part due to the higher OPEC oil and gas production and exports. Fuel-importing countries would further benefit from lower prices by removal of sanctions on some major OPEC oil exporters, as recognized by the Special Feature. Additionally, we would have welcomed an update of staff's projections of prices of "energy transition metals" in the Special Feature or in Chapter 3 on climate change; prices of these metals (e.g., copper) seem to be more responsive to cyclical factors than to structural greening factors.

WEO global output growth projections have seen four consecutive downgrades since October 2021, with the balance of risks still continuing to be firmly tilted to the downside, and with a non-negligible chance that the global growth could fall below 2 percent. Such a prospect is indeed very alarming, as it would imply that many countries would slip into long and deep recessions that the world can ill afford so soon after the dramatic pandemic output contractions. Unlike previous reports, the latest WEO offer no alternative scenarios to baseline projections. A plausible adverse alternative to baseline projections would have been useful, especially considering that the balance of risks are still heavily tilted downward. The fan charts of risk assessment around the baseline projections are very useful, but are no substitute to articulating an alternative scenario. *We would welcome staff comments.*

We welcome the background Chapter 3 on macroeconomic impact of de-carbonization policies. Given the tepid progress in climate policy so far globally, the 2030 GHG transition goals are probably already beyond reach for most countries, but the 2050 targets are achievable if policy actions are accelerated. Policy actions would, however, be more effective when global inflation stabilizes at low levels and there is a greater visibility in the energy market. At this juncture, higher GHG taxes would put undue pressure on low-income households everywhere and are likely to complicate the delicate monetary policy normalization. We would request staff to include in future reports analysis of the macroeconomic impact of global de-carbonization on fossil fuel producing countries, which are going through transitions of their own. *Could staff comment on any progress on this front?*

Following the October 2022 Managing Director GPA's stress on "acting now and acting together", the latest WEO, in our view, could have placed more emphasis on multilateral cooperation. The current geopolitical fragmentation runs the risk of becoming entrenched even after the war in Ukraine ends, with durable adverse implications for global trade, technology transfer, and our collective ability to address climate change. That would set us back many decades.

Global Financial Stability Report

The tightening of global financial conditions and the real appreciation of the US Dollar are putting significant pressure on the external borrowing costs of EMDEs and has already shut out some countries from access to external financing. The increased risk of default for a growing number of member countries is real and indeed worrisome. We echo staff in stressing the need for cooperative global policies to address the growing debt burden, including through enhancing the G20's common debt resolution framework. Through policy advice and financial support, the Fund will have an important role to play in assisting its distressed members in the period ahead, including through the Integrated Policy Framework, where a carefully calibrated combination of macroprudential tools, capital flow management measures and targeted foreign currency interventions would prove instrumental in reinforcing financial stability in vulnerable countries facing difficult policy trade-offs.

We note with concern the deterioration of liquidity conditions across all asset classes and in particular in the traditionally highly liquid sovereign bond markets of major advanced economies. *Could staff elaborate further on best policies to mitigate market liquidity risks, and their views on increasing calls to review regulatory capital regulations adopted after the GFC?*

Tighter financial conditions are slowing the recent upward spiral in housing prices, which is a positive development. We welcome staff's assessment that risks to banks' balance sheets from the housing sector are generally contained, except in China, where the real estate sector is very vulnerable to the growing risk of developer insolvency. We agree with staff's recommendation for the Chinese authorities to make every effort to prevent any spillovers to the global financial system and undertake the needed overdue reforms to reduce excessive leverage in the property sector and strengthen the supervision of financial institutions, including non-banks.

We note positively that the global banking sector is broadly resilient and that most banks in advanced economies successfully pass the IMF's Global Bank Stress Test. However, a third of emerging market banks appear vulnerable, which calls for greater vigilance on the part of supervisory authorities. More generally, risk management and prudential oversight of the financial system should be strengthened to minimize the negative fallout from a debt or liquidity crisis and to prevent risks from the growing non-bank financial sector by subjecting it to stricter supervision and transparency requirements.

On cryptocurrency, we share staff's call for more regulation and appropriate supervision of critical stakeholders to mitigate risks to market integrity and stability, stressing that success in effective regulation would need close international cooperation.

Finally, given the significant investments needed for climate change adaptation and mitigation, we commend staff for the informative background Chapter 2 on climate finance, which would help authorities to take stock of financing options, both currently available and potentially forthcoming, to facilitate their climate change efforts. Strategic guidance and advice from the relevant IFIs, including the Fund, and the potentially catalytic role of the RST, will be crucial especially for vulnerable countries with limited fiscal space and elevated capacity constraints.

Fiscal Monitor

We broadly share the assessment of the fiscal outlook and agree with the set of policy prescriptions under various scenarios presented in the FM. Fiscal policy is pivotal to addressing the impacts of the sharp rise in food and energy prices, exacerbated by the war in Ukraine. Food and energy prices remain well above the pre-pandemic levels. The UN FAO's Food Prices Index for August 22, which was 45 percent higher than in 2019, is worrisome. These developments have raised the cost of living for households and thus reduced their *real* incomes across most countries, pushing more people into poverty. Many emerging markets and low-income developing countries—net importers of energy and food—have been hit hard by elevated international prices, putting pressure both on growth and public finances, while some countries may be at risk of a food crisis. The WFP estimates that more than 340 million people are at risk of food shortage in the short term is extremely troublesome. These countries are already operating in a constrained policy environment. Indeed, fiscal policy responses in such countries will be shaped against the challenging and multifaceted backdrop of high and rising inflation; slowdown in growth; debt vulnerabilities; and tightening global financial conditions.

We note that in 2021 and 2022 fiscal deficits have fallen globally reflecting the unwinding of pandemic-related measures amid rising inflation, but are expected to remain above pre-pandemic levels. Meanwhile, the average deficit for low-income developing countries has hardly contracted due to mild fiscal response to the pandemic. On the other hand, thanks to higher oil revenues, many oil exporting countries are running fiscal surpluses.

Average public debt has decreased because of fiscal deficit reduction, ongoing economic recovery, and inflation shocks. Nonetheless, global government debt is projected to be 92 percent of GDP in 2022—9 percentage points of GDP above the pre-pandemic levels–despite the recent reduction in the debt ratio for many countries. We note with concern that almost 60 percent of the lowest income economies are in or at high risk of debt distress, highlighting the need for improving global frameworks for resolving sovereign debt crises to facilitate countries' faster recovery from debt distress.

Against this backdrop, effective policies are needed to ward off worse outcomes. Policy focus in EMDCs will have to shift toward safeguarding macroeconomic stability and building resilience. We agree that when inflationary pressures are high, fiscal policy should protect the most vulnerable, while reducing deficits to help tackle inflation and address debt vulnerabilities. Limiting price increases through price controls, subsidies, or tax-cuts, should be avoided as these are costly and ineffective at protecting the most vulnerable. Instead, governments should allow prices to adjust. We concur that in low-income developing countries 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. For these countries, food security should be prioritized within the existing fiscal envelope. In this context, at the global level, facilitating trade and lifting export restrictions on the purchase of food for humanitarian assistance will support low-income countries at risk of food crisis.

We take note of the interesting research findings based on a firm-level survey across 74 emerging markets and developing countries to suggest that government support to ensure the resilience of firms in extraordinary times should be triaged based on an assessment of firms' viability. Well-defined exit strategies, sound legal frameworks, good governance, and sound management of fiscal risks are crucial to contain fiscal costs. Fiscal costs can also be reduced by sharing risk with private banks through partial guarantees.

Statement by Mr. Binzarah, Mr. Alrashed, Mr. Abalala, Mr. Abdel-Rahman, Ms. Alshaikh, and Ms. Alhawas on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

The flagship reports come at a time when the global economy is facing substantial headwinds. Multiple intertwined shocks are posing significant challenges and requiring difficult policy trade-offs across the membership. Inflation has soared to multidecade highs while economic growth is slowing on the back of the supply bottlenecks, food and energy price increases, and tightening monetary and financial conditions. Household balance sheets are weakening, fiscal risks are rising, and external imbalances are increasing. Moreover, the impact of these multiple shocks will likely linger beyond the current juncture to affect medium-term growth potential. Against this backdrop, we broadly concur with the thrust of the macroeconomic and financial policy discussions, and would like to make the following comments.

Global Economic Prospects and Multilateral Cooperation

We find the forecasts, particularly those related to the predicted pace of disinflation, rather optimistic. As staff rightly note, global economic prospects are being shaped by interactions between the path of monetary policy tightening, unfolding geopolitical developments, and the lingering impact of the pandemic. While the first factor is domestically controllable for some countries, the other two are largely influenced by external conditions which require effective multilateral collaboration. Risks include the ability of policy makers to judge the right pace and scope of monetary tightening. In the same vein, divergent policy paths across countries have contributed to significant currency movements which have the potential to affect inflation dynamics and competitiveness as highlighted by staff. On the outlook, we have seen a pattern this year of baseline WEO forecasts being presented together with warnings about substantial downside risks. Then the next WEO revises down the baseline, and again warns of substantial downside risks. We wonder if it would be more realistic and credible if the baseline forecast was revised down to a level where staff believe the distribution of risks to the outlook is more balanced. *Staff comments are welcome, including on how they would characterize the level of risks now compared to the April 2022 WEO.*

Averting the risk of fragmentation and enhancing multilateral cooperation is paramount to address the sizable challenges facing the global economy. Multilateral consensus and global cooperation are imperative to implement the needed WTO reforms to support free and fair international trade, ensure equitable access to COVID vaccines, tests, and treatment, ease food supply constraints, address climate change, and improve the implementation of the Common Framework (CF). Current circumstances only increase the urgency for concerted efforts by the international community to address the growing debt problems in developing countries before they turn into a large-scale debt crisis.

On a related note, we are particularly disappointed that the Fund's multilateral policy advice on climate-related issues is motivated in part by geopolitics as in the WEO chapter 1. We disagree in principle with the notion that the Fund can support the elimination of the exports of a large segment of its members whether it is fossil fuel, food, or any other commodity. This approach risks further increasing global fragmentation and goes against the basic principle of this institution which is to promote the exchange of international goods and services. We therefore emphasize that the Fund's policy advice must be only guided by macroeconomic considerations that serve the broad interest of the membership in line with the Fund mandate. **Hence, we request a revision of the relevant text accordingly so that the climate agenda is only guided by climate objectives in line with the Paris agreement.**

Macroeconomic and Financial Policies in Light of Persistently High Inflation

We agree that the overarching policy priority is to rein in inflation. To this end, realistic and focused domestic policies will need to be well-coordinated and anchored in a medium-term macroeconomic framework supported by enhanced communications with stakeholders for successful implementation. Structural reforms that address supply constraints in labor and product markets and promote more resilient supply chains will complement monetary and fiscal policy actions.

Central banks need to be decisive and resolute to "get ahead of the curve" to maintain credibility and stay the course until inflation is back under control. Clear and effective communication of policy actions and objectives is needed to keep inflation expectations well-anchored. In this context, positive real rates need to be established to reverse the path of surging inflation. *Here, we would appreciate staff's elaboration on the assumed monetary policy path in the advanced economies in the WEO baseline and whether this is still realistic given the latest round of policy tightening and guidance from central banks. We would also have welcomed further analysis and guidance in the WEO and GFSR on the desired* *monetary stance relative to the neutral rate for countries to achieve timely disinflation. Staff comments are welcome*.

The emphasis in the FM on strengthening social safety nets without fueling inflationary pressure is timely and an appropriate guide for fiscal policy. In countries with persistently high inflation, fiscal policy should complement monetary policy in addressing excess demand. Here, the reports could have emphasized more the implications of ineffective domestic policy coordination that is caused by fiscal policy easing amidst rising inflation. *Staff comments are welcome, including on the recently announced plans and proposals in the UK and EU to mitigate the impact of higher energy prices*. Support for the most vulnerable needs to be well-targeted through carefully designed redistributive measures. Even here, there may be macroeconomic consequences given different marginal propensities to consume across income levels. *We would welcome staff comments on whether policies to strengthen the safety net may add to excess demand pressures in current circumstances even if fiscally neutral.*

The importance of fiscal sustainability is underemphasized in the reports despite rising financing needs and debt levels in many member countries. The concurrent diminishing policy space and rising borrowing costs in many EMDEs on the back of higher interest rates and the appreciated US dollar are increasing fiscal and debt vulnerabilities. This underscores the importance of both effective domestic fiscal policy and concerted multilateral efforts to advance the G20 debt resolution mechanism. We stress that while prudent fiscal policies should remain the main anchor for countries to achieve debt sustainability, effective and efficient debt restructuring is likely to become even more important in the period ahead. We therefore welcome the progress made on Zambia's debt restructuring and look forward to building on this momentum to accelerate the implementation of the CF. We appreciate the guidelines in Table 1.2 of the FM that show how the appropriate mix of multiple fiscal instruments and more proactive public interventions can be deployed in response to major shocks. Furthermore, greater use of digitalization and big data should be utilized to increase public spending efficiency.

We welcome the focus on addressing rising global financial stability risks on the back of the tightening of macroeconomic policies and financial conditions. While tighter financial conditions are necessary to restore price stability, the resulting vulnerability should be mitigated by timely and effective macroprudential policies. Here, we concur that policies should contain a further buildup of financial vulnerabilities, considering country-specific circumstances and near-term economic challenges. A balanced and country specific approach that capitalizes on the IPF and IV on capital flow management is warranted to reduce financial stability risks and maintain appropriate monetary policy transmission. This is particularly important for EMDCs as they design their policy response to the tightening of global financial conditions and capital flow volatility. Here, we underscore that exchange rate flexibility is not a panacea that works well all the time in all circumstances. We also highlight the important role of the IMF in providing prompt and reliable access to liquidity to facilitate and support the implementation of adjustment measures in an orderly manner.

Climate Mitigation Policies

We note with concern the continued partial discussion by the Fund on climate mitigation policies. The full range of available policies are not comprehensively covered in the analysis and the focus is on those policies that lack multilateral consensus. In particular, the Fund continues to place too much emphasis on carbon taxes without considering the limitations including in the context of differences between advanced and developing countries nor does it offer alternatives. Moreover, the climate-related discussion continues to underemphasize the importance of abatement technologies in mitigating GHG emissions to timely achieve climate targets. More broadly, we remain of the view that the UNFCCC is the appropriate forum to lead the discussion on contentious mitigation policies within the parameters of the Paris Agreement. *Here, we invite staff to provide an update on their coordination with the UNFCCC secretariat on the policies being proposed by the Fund*.

An important takeaway from the current crisis is that climate policies should be carefully calibrated to pursue climate targets while not unduly affecting households and businesses nor delaying necessary disinflation. Many countries have recently faced social unrest due to the rise in end-user energy prices. Both AEs and EMDEs are facing rising wage pressures and increased friction in employer-employee relations as rising energy prices have pushed consumer prices higher. This has increased the risk of a wage-price spiral that will require a stronger and more costly monetary policy response.

We therefore emphasize that the Fund has the responsibility according to its mandate to undertake comprehensive policy discussions that reflect the views of the wider membership. We believe that this has not been the case on the climate front as the policies advocated by the Fund will have an unduly negative impact on a large number of member countries. We would like to make the following specific comments:

The WEO Chapter 3

On assumptions, assuming equal responsibility for all countries for emissions reduction is incompatible with the Paris Agreement. Therefore, the chapter may be detached from the reality of climate action in developing countries and as such will have decreased relevance.

Moreover, assuming the complete shift away from currently polluting activities is unrealistic. Hard-to-abate sectors, which exist in carbon-intensive economies (particularly prevalent in developing countries) will need to employ abatement approaches to manage emissions in the context of socio-economic considerations.

On methodology, grouping countries into four blocks (US, China, EU, and rest of the world) to assess the impact of mitigation policies on macroeconomic variables needs to be revisited. The ROW block comprises a wide array of heterogenous countries and inferences cannot therefore be applied to individual countries. The value of the information provided is therefore very limited. The comparison of different blocks operates at the country level at times (US and China), multilateral level with relative homogeneity (EU area), and multilateral level with high heterogeneity (rest of the world). For the IMF, this grouping is very unfortunate as it further reinforces the view held by many that the Fund's advice on climate policies is driven by a small group of homogenous countries, particularly when the main text of the chapter underplays the implications on the ROW.

On results, the annex of Chapter 3 of the WEO shows that the US, Euro Area, and China are all better off if the ROW takes part in the common policy package of increasing carbon taxes, but the ROW block is worse off and would do better by not implementing these policies. These results get to the crux of the difficulties on agreeing how to move forward with climate policies at the global level. Yet the negative impact on the ROW bloc is conveniently ignored and hardly covered in the text of the WEO. This is unfortunate as thinking about how to reduce this negative impact is central to the global climate discussions.

On fundamental issues, the chapter contextualizes the topic using a EU and North American centric approach. This overplays the issue of energy independence, and underplays critical issues for poor and developing members relating to energy access and poverty eradication. On a related note, we emphasize the importance of ensuring adequate financial and technological support for developing and low-income countries and underscore that adaptation to climate change is an equally important and urgent issue that warrants more attention in global climate discussions and the Fund's climate work.

GFSR Chapter 2

Regarding ESG, the chapter explains that average ESG scores in developing economies are lower than in advanced economies, and provides a limited rationalization centered on the size of companies in developing economies. We believe that climate considerations and standards cannot be applied with the same expectations globally as contributions to climate change and climate action are differentiated as per the Paris Agreement. We call on staff to consider that the ESG frameworks and scoring methodologies were developed primarily by advanced economies, in view of their climate and economic conditions and circumstances, so they might inherently favor companies operating in these countries by virtue of them sharing the same challenges and employing similar solutions.

Since the chapter adopts a one-size-fits-all approach, we remain cautious about the climate-related financial policy recommendations. Here, we particularly refer to the assumptions that all fossil fuel subsidies and investments should be removed, and carbon pricing should be implemented universally with convergence in approaches. This approach misses key socio-economic considerations, particularly in relation to the energy trilemma (energy access, economic growth, and climate action). Access to energy, sustainable development, and eradication of poverty are all impacted by carbon pricing and the removal of fossil fuel subsidies, and each country has varying levels of energy access, impoverished citizens, and levels of economic development. That is why we believe a top-down policy approach cannot work. Lastly, we note that in numerous places, the chapter makes normative statements that are not sufficiently justified or explicitly explained.

Statement by Ms. Shortino, Ms. Medearis, Ms. Rao, Mr. Sturm, Mr. Westphal, and Ms. Styczynski on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

The October 2022 flagship reports confirm a general slowdown in global economic growth coupled with persistently high inflation, continued fiscal pressures, and sizeable downside risks to the outlook. While we welcome that staff's projections show most economies avoiding recession in 2023, heightened uncertainty and increased volatility warrant careful calibration of policies going forward. Given the wide variation in growth, inflation, fiscal, and financial sector challenges across countries, policymakers must balance competing issues, weigh policy tradeoffs, and adopt appropriate policies to match their specific needs. The Fund has a key role to play at the current juncture in providing tailored advice and assistance to individual members that also will collectively contribute to more balanced and sustainable global growth.

Russia's war against Ukraine continues to inflict significant harm on the global economy, at a time when it is still dealing with the aftershocks of the COVID-19 pandemic. As rightly emphasized on page 8 in the WEO, Russia's war against Ukraine is exerting a human and economic toll, including on Russia itself. We also appreciate that staff has used appropriate terminology in the flagship reports with respect to *Russia's* war against Ukraine. The Fund needs to consistently deliver a clear message about the damaging impact that Russia's senseless war is having on the global economy, and on emerging market economies reliant on commodity imports in particular, through increased energy and food prices. The surest way to improve the troubling global outlook is for Russia to end its war, and thus we urge the Fund and its members to do all they can to hold Russia accountable and help arrive at an end to this conflict.

Outlook and Risks

We broadly agree with the WEO projections, including forecasts for a broad-based slowdown in the global economy. In addition to Russia's war on Ukraine, staff rightly identify tighter monetary policy around the world in response to rising inflation and China's lockdowns with related supply disruptions as being the three main factors driving the weaker global outlook. Monetary policy tightening is essential to bring down inflation. The tightening has resulted in tighter financial conditions and dollar appreciation, particularly against advanced economy currencies, driven by fundamentals. These developments may pose economic challenges in particular for many emerging market and developing economies. We also welcome the clear attention to the risks to the outlook from China's

COVID policy lockdowns and property sector issues. Staff emphasize the longer-term impact of scarring from the pandemic, but also expect the Chinese economy to slow in the medium term as the country deemphasizes growth targets and as its infrastructure-led development model fades. *We welcome staff comment on the external spillover impacts associated with the medium-term slowdown in Chinese growth.*

We generally agree with the WEO outlook for advanced economies, noting that the downward growth revisions from July are more pronounced for advanced economies (AEs), with further nuances by region. The downgrade in the U.S. growth forecast for 2022 reflects the unexpected U.S. contraction in the second quarter, driven by huge drags from net exports and inventories that offset strong private domestic demand. However, we would note that the very robust U.S. labor market, with the unemployment rate near a 50-year low, suggests an economy that is not in recession. That said, U.S. GDP growth is likely to continue to be relatively slow in 2023 as the intended effects of monetary policy tightening feed through a broader range of economic activity and work to help lower inflation. Looking to Europe, we note that staff's forecast for growth in the euro area reflects a wide divergence in member state growth rates, with Germany and Italy facing a particularly weak 2023. *We welcome staff comment on the likely uneven impact of energy supply disruptions on European economies, and staff views on what role the IMF and other IFIs can play to support countries that may face macroeconomic instability as a result in the near term.*

We strongly concur that downside risks dominate, and uncertainty continues to cloud the outlook and complicate forecasting. *We would, however, be interested in staff's assessment of potential upside risks to growth in the baseline, including from measures to stabilize global energy supply like the proposed oil price cap that could allow for Russian oil flows to remain on the market after European restrictions take effect.* With respect to downside risks, the WEO stresses in the Executive Summary the possibility of overtightening of monetary policy, but later in the report notes correctly that the risks are two-sided. Given current historically elevated inflation rates, the risks appear to be greater that central banks could under-tighten in the short run. However, we stress that the Federal Reserve has made clear its strong commitment to bring inflation back down to its two percent target. Many other central banks are also making their own resolve clear in a synchronized fight to tame inflationary pressures. We agree with the conclusion of the informative WEO Chapter 2 that well-anchored inflation expectations are a necessary condition for avoiding a wage-price spiral. To that end, we note that inflation expectations in the United States appear to be well-anchored, despite exceptionally tight labor markets and persistently low labor force participation. This supports the likelihood of a relatively benign scenario in which inflation decelerates without a recession or a large increase in unemployment.

Policy Recommendations

The Fund will need to be agile and tailored in its policy advice. Policy recommendations, including fiscal, monetary, and the interaction of the two, will

require careful calibration in the context of higher inflation, weaker growth, and higher debt. We agree that fighting inflation remains the top priority and central banks must restore price stability. We also agree that fiscal policy should act in conjunction with monetary policy to address inflation and debt vulnerabilities, while prioritizing protecting the most vulnerable groups and taking concurrent steps to avoid exacerbating inflation. In this context, we strongly echo staff advice to countries to forgo, ease, and end food export bans. Finally, we emphasize the importance of continuing to invest in social safety nets and social protection, which will help to facilitate more cost-effective support to the most vulnerable in the face of higher costs of living.

The Federal Reserve is committed to moving purposefully to retain the anchor of price stability. With another 75-basis-point increase on September 21, the Federal Open Market Committee has brought the Federal Funds rate to a range of 3 to 3¼ percent and is continuing the process of significantly reducing the size of its balance sheet, which plays an important role in firming the stance of monetary policy. The Committee noted that it anticipates that ongoing increases in the policy rate will be appropriate, though the pace of those increases will continue to depend on the incoming data and the evolving outlook for the economy, and that restoring price stability will likely require a restrictive policy stance for some time. Globally, for inflation expectations to remain well-anchored, it is paramount that monetary authorities remain committed to price stability. We welcome staff analysis of the impacts of simultaneous monetary tightening across many countries.

Given the rising impact of COVID-19 related lockdowns from China, we agree with staff advice on warding off pandemic risks. We welcome the attention to continuing vaccination efforts as well as continued investment in research and health systems. Over the medium term, operationalizing the RST for pandemic and health preparedness could be helpful, alongside assistance from other institutions, for those countries with underdeveloped health systems.

We appreciate staff's attention to medium-term policies including to improve frameworks for debt resolution and prepare for tighter financial conditions, and we strongly support staff advice for countries to intensify structural reforms to improve productivity and economic capacity. However, we would have welcomed a more in-depth discussion of structural policies to mitigate inflation pressures, such as product and labor market reforms and policies aimed at reducing supply bottlenecks. In addition, we would have welcomed more details on the use of macroprudential tools to help mitigate against financial stability risks. We also fully agree on continuing efforts toward a green energy transition.

Fiscal Sector

In the Fiscal Monitor, staff rightly emphasize the importance of national-level pre-crisis planning, including the need to build fiscal buffers during "good" times. We note staff's analysis that energy subsidies may not substantially insulate economies from negative terms-of-trade shocks, and we agree that targeted transfers are a better tool than blanket subsidies, which in some contexts are regressive in nature. We appreciate staff's presentation in the Fiscal Monitor of various case studies on responding to economic shocks, particularly with respect to targeting support to the most vulnerable. While stressing the importance of timely fiscal support during crises, we would caution against governments providing credit or support in distortionary ways, and we echo staff on the need to include an exit strategy and consideration of fiscal risks in those programs.

Financial Sector

Against the backdrop of energy and food market strains arising from Russia's war against Ukraine, and the resulting inflation and tightening monetary conditions, we agree that financial sector risks have increased since the April GFSR. Staff have covered several sources of potential financial sector risk with clarity and candor, though we would have appreciated more explicit acknowledgement that Russia's invasion is the primary driver of several of these trends and that its actions are responsible for the resulting sanctions. Despite decisive tightening from central banks, financial markets continue to function smoothly, in large part due to the financial regulatory reforms adopted in the wake of the Global Financial Crisis. We encourage continued progress on implementation of the final stages of the Basel III reforms given the clear benefit of Basel III standards in limiting financial contagion risks.

We generally agree with staff's recommendations for financial authorities and regulators to limit the build-up of financial sector and debt vulnerabilities going forward. We note with concern staff's conclusion that in a large global slowdown 29 percent of emerging market banks may broach minimum capital standards. We would welcome additional insights from staff regarding how to balance this risk while avoiding potentially pro-cyclical regulatory responses. We encourage staff to examine and provide recommendations regarding the efficient allocation of losses during a potential downturn, as this topic is likely a comparative advantage of Fund staff. We also agree that sovereign borrowers in developing economies and frontier markets should work to contain risks associated with high debt vulnerabilities.

We particularly appreciate the deeper coverage of spillovers from China's housing sector to the rest of China's financial sector and real economy. We agree that the acute liquidity stress is raising broader solvency concerns for developers. Chinese global-systemically important banks (G-SIBs) remain resilient to a potential housing sector-driven shock. *We would appreciate insights from staff regarding the risks to the G-SIBs' balance sheets from potentially absorbing the domestic-systemically important banks (D-SIBs) and other smaller banks during this housing market downturn. Could staff also elaborate on the linkages between banks and non-bank financial institutions (e.g., trusts) with respect to property exposure?* Going forward, we would encourage staff to undertake deeper analysis of financial stability risks associated with local government financing vehicles and risks that these entities pose to the broader Chinese economy.

External Sector

We continue to see scope for greater emphasis on exchange rate flexibility as a first line of defense and to emphasize that unconventional policy measures, including capital flow measures (CFMs), should not be used to substitute for warranted macroeconomic adjustment. Even in the context of global capital outflows from EMDCs, we expect staff would also stress the benefits of capital account liberalization. We were surprised by the mention of de-anchoring of inflation expectations in the context of foreign exchange intervention and CFMs without alluding to tighter monetary policy. Recognizing, however, that currency depreciations are adding to inflationary pressures in many countries, we welcome staff's views on how they see the policy tradeoffs for EMDCs.

Food Security and Debt

Low-income countries, especially those facing food insecurity and grappling with high debt, are likely to suffer the most from spillovers from Russia's war against Ukraine. The Fund needs to make sure it is working in lock step with development and other partners to support those countries facing food security issues. We welcome the Fiscal Monitor's timely focus on how governments can help foster resilient societies that enable households and firms to swiftly recover from shocks, reflecting on the experience of the COVID-19 pandemic. This is all the more relevant in the context of the heavy burden that rising food and energy prices stemming from Russia's war against Ukraine are placing on emerging market and developing countries. We strongly agree with staff that multilateral efforts like the Common Framework are useful to help countries buttress against shocks and regain stable economic footing. Similarly, Box 1.1's discussion of the importance of investments in healthcare and pandemic preparedness highlights the importance of the World Bank's recently established financial intermediary fund for pandemic prevention, preparedness, and response as well as the operationalization of the Resilience and Sustainability Trust.

It is imperative that creditors deliver timely debt relief, including through full and rapid implementation of the G20 Common Framework. The immediate priority for creditors is to conclude the ongoing Common Framework cases as quickly as possible. In this context, we welcome positive developments in Zambia, but concur with staff that more is needed for the Common Framework to realize its full potential. In particular, we need to advance concrete options to enhance the speed and predictability of the Common Framework process. We concur with staff's call to address debt challenges in a broader set of emerging market and developing economies, and to that end we support expanding the Common Framework to middle-income countries facing debt distress. More broadly, we stress that the IMF has a critical role to play in supporting borrowers in their efforts to engage with creditors, manage debt burdens, and enhance debt transparency.

Climate/Energy

We appreciate staff's in-depth coverage of climate issues in the WEO and the GFSR, and we continue to believe that such analysis and policy recommendations will help us transition to a greener global economy. We note that the Inflation Reduction Act (IRA) is likely to reduce U.S. greenhouse gas emissions in line with global goals by the end of this decade. While we recognize the efficient nature of carbon pricing, given the importance of countries implementing climate policies that are tailored to the national context and politically feasible, we encourage staff to assess climate policies based on their impacts.

We agree that private finance will play a crucial role in facilitating whole-of-economy transitions that also support the most vulnerable. We agree with the GFSR that scaling up sustainable finance instruments, with a focus on accessibility and affordability, will be an essential part of attracting private investors. This was a key pillar of the G20 Sustainable Finance Working Group's workplan this year. We support the discussion of blended finance as one way to mobilize private capital. We would appreciate candid recognition from staff that in practice blended capital can mean that public finances subsidize private capital. We recommend weighing the efficiency of such investments compared to other investments that could also mitigate climate change, as well as considering any potential market distortions. Finally, we view taxonomies as one tool among many, and we would prefer to focus on principles-based approaches to climate alignment and risk management.

We agree that environmental, social, and governance (ESG) scores that measure sustainability impact may be helpful to certain investors. We also believe that ESG ratings need to be transparent in their purposes and methodologies, and ESG fund providers must be truthful in their advertising. We caution against suggesting that regulators and supervisors must shift ESG ratings toward measuring sustainability impact given different domestic regulatory mandates across jurisdictions.

Statement by Mr. Bevilaqua, Mr. Saraiva, Ms. Mahabir, Mr. Velloso, Mr. Barroso, Mr. Coronel, and Mr. Fisher Hogan on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the comprehensive draft October 2022 flagship reports.

World Economic Outlook

The global economy is contending with very high inflation and economic slowdown, with risks stemming from tightening financial conditions, supply-chain disruptions, and the war in Ukraine. Monetary policy is becoming tighter at a faster pace in some advanced economies to address strong underlying inflation pressures. Tighter financial conditions are at the early stages of cooling down economic activity and are beginning to trickle down into the global economy, with growth forecasts revised down in most regions. The risks of financial distress in domestic and international credit markets have significantly increased. The pandemic continues to be a concern, particularly in countries with lower vaccination rates or strict lockdown policies, with negative impact on activity and supply chains, as well as human and physical capital accumulation. The war in Ukraine persists, with a devastating human and economic toll, and its spillovers go well beyond the European continent.

With limited policy space to address downside risks, there are valid concerns with the sustainability of the recovery. We take note of the many downside risk factors listed by staff and the sobering quantitative risk assessment. While a global recession is still not part of the WEO's baseline scenario, both the WEO's global growth fan chart and the GFSR's global growth-at-risk indicators show a significant risk of a global recession next year. Actual risks might be even higher than suggested by quantitative indicators given the lack of a proper historical comparator for the triple challenges facing the global economy.

We underscore the need for careful analysis and strong resolve by central bankers in the fight against inflation. We take note of staff's analysis of forecast errors in WEO's inflation projections in the recent past and agree that demand surprises have been a major driver. That said, at the time those forecasts were made, concerns about advanced economies' (AEs') central banks being behind the curve were already being voiced, including here at the Board. We also highlight that staff's recent upward revisions to inflation came after significant withdrawal of monetary and fiscal stimulus, suggesting even larger mistakes in the previous projections. Accordingly, we remain skeptical with staff's optimistic view that profit margins could absorb much of the wage price pressure that may occur in the coming quarters absent a meaningful slowdown in economic activity. We also take note of staff's belief that inflation in AEs will move faster to the target range than in emerging market and developing economies (EMDEs) due to higher central bank credibility in AEs. On that note, we highlight that some EMDEs were ahead of the curve this time around, and that AEs' central banks are tightening at a faster pace exactly to regain some lost credibility.

We broadly agree with the WEO's main policy recommendations. Central banks must show resolve to keep inflation expectations well anchored. We take positive note of staff's warning that failing to anchor inflation expectations now would come at a much larger cost in the future. Fiscal policy must remain consistent and not lose track of needed consolidation even if making room to support vulnerable households, as warranted. EMDEs facing the risk of negative spillovers and capital outflows can generally benefit from exchange rate flexibility, even though the most vulnerable economies are well advised to ease capital inflow constraints and, in face of disorderly market conditions, make use of foreign exchange interventions. We take note of the high and increasing economic scarring from the pandemic and the war in Ukraine. We therefore see a valuable role for structural reforms to build a more stable macroeconomic environment and pave the way for investments in improving resilience and promoting growth opportunities.

We remain cautious about possible threats of wage-price spirals if policy response is not forceful enough. The analysis in Chapter 2 shows that since the pandemic nominal wages have been driven predominantly by capacity constraints and supply shocks, while savings and pent-up demand have been major factors behind prices. That said, inflation has kept real wages flat or declining, despite nominal wage increases, and inflation expectations have become more critical in determining wage-price dynamics, as we move forward. While the chapter minimizes the risk of de-anchoring inflation expectations, based on historical events and the stabilizing role of decreasing real wages, we caution against any complacency as the Fund tries to rebuild its own credibility in this area.

Monetary policy is crucial to align expectations and break inertia, and frontloaded monetary tightening is required. Chapter 2 shows that the formation of expectations is key to determine inflation dynamics. Moreover, it suggests that, in EMDEs, inflation expectations tend to be more backward-looking. Indeed, exchange rate and debt shocks tend to boost inflation expectations in emerging economies by a far greater amount than in AEs. In any case, given the nature of the shocks and the possibility of structural breaks, we would favor stronger and frontloaded monetary policy response in both EMDEs and AEs to more easily dispel the unmooring of inflation expectations.

Global cooperation in climate adaptation and mitigation strategies is sorely needed. While staff recommends rebates to low-income households, we reaffirm the main principles of the Paris Agreement, whereas AEs must lead in providing financial assistance to EMDEs in their fight against climate change (see below). Furthermore, we remain skeptical about additional central bank responses to complement the management of supply-side costs in climate transition, which could dangerously lead to conflicting mandates.

<u>Global Financial Stability Report</u>

We take note of the substantial risks to financial stability in the context of a slowing economy and tighter financial conditions. The faster pace of monetary policy tightening in AEs (particularly in the US) is leading to higher volatility, lower valuations, and higher spreads in several key financial markets. Tighter financial conditions are also impacting credit markets and raising the likelihood of a sharp correction in housing markets or corporate failures in more vulnerable sectors. The confluence of these factors in China continues to pose a challenge to global financial stability despite the efforts of the authorities to ease liquidity pressures in those markets. More broadly, as highlighted in the GFSR, we are concerned with the diminishing liquidity in several financial markets and the possibility of further deterioration given the prospects of quantitative tightening in major central banks. The high levels of sovereign debt accumulated during the pandemic, particularly when denominated in foreign currency, leave many governments exposed to disorderly market conditions, especially in EMDEs with limited buffers to accommodate external shocks.

We broadly agree with the policy recommendations to support financial stability. We strongly support the view that central banks should act resolutely to bring inflation back to the target range and use other policy tools to tackle disorderly market conditions, as needed. Relatedly, it is important to enhance monitoring, transparency and data availability of trading infrastructures and market participants to minimize the risks of disorderly liquidity events. The IMF continues to be central to support vulnerable economies in meeting their foreign currency liquidity needs in case of turbulent conditions. In the meantime, as suggested by the GFSR, multilateral cooperation should be strengthened, and vulnerable economies enhance contact with creditors. We support the call for more stringent stress tests of housing markets and flexibility to adjust related macroprudential policy depending on market developments. We take note of the global bank stress test's results and support the call for strong supervision and data intensive monitoring. In this regard, we underscore that the national supervisors have more information than what is available to staff who prepared the GFSR, and the former's assessment should be emphasized whenever diverging from the GFSR stress test results. More broadly, the analysis and policy recommendations must strive to remain country-specific and to incorporate context-specific amplification channels and vulnerabilities.

Climate change adaptation and mitigation measures require significant funding that often cannot be sourced entirely from the EMDE budgets While we appreciate the reference to the Resilience and Sustainability Trust (RST) as a potential source of financing, this instrument should be used to catalyze other climate related funding, given that it is limited by eligibility and conditionality criteria as well as quota size. We thank staff for highlighting the various challenges to scaling up private climate finance. An important point to stress is that the financing gap is assessed to be the largest in developing countries most vulnerable to climate change. We agree with staff that the authorities can undertake some measures to help build the infrastructure for climate financing. For example, there is need for high-quality, reliable, and comparable data, climate-related corporate disclosures, and improved analysis of the funding gap. However, we must caution that in many of the economies where the need for climate financing is large, capital markets are thin and unlikely to be able to generate the complex instruments being advocated.

We take note of the analysis showing open-end investment funds (OEFs) as a possible source of financial instability especially in the current period of global tightening. The risks stemming from these instruments, according to staff, have grown in importance for the non-bank financial sector, while risks to the financial sector relate to the asset liquidity mismatch of OEFs. We thank staff for identifying the way in which OEFs can impact the financial sector in the event of a sudden unexpected outflow of funds, leading to a vicious cycle of asset sales and asset value declines. This negative spiraling effect may eventually impact on other financial institutions that were not initially impacted by the run on OEFs. We take note of the various proposals to mitigate the possible negative impact of OEFs, including liquidity management tools such as anti-dilution levies and swing pricing. However, as staff notes, these tools may be available in only a limited number of jurisdictions. These and other measures including greater transparency by OEFs should be assessed and implemented where appropriate. We also note that while Fig. 3.1.1 of the Online Annex suggests a high vulnerability of the Brazilian non-bank financial intermediation sector to OEFs, this is not the case because this sector in Brazil has very low leverage and is highly liquid.

Fiscal Monitor

While we welcome the Fiscal Monitor's structural approach to building resilience to shocks and enhancing protection against income and employment losses, we missed a macroeconomic analysis of fiscal policy in the current challenging environment. The global economy has been subjected to several overlapping shocks. Economic growth is slowing down amidst record-high inflation and tightening financing conditions. Within this context, policymakers in most countries are being called to strike a delicate balance, pursuing resolute consolidation to ensure fiscal sustainability, consistent with the policy priority of fighting inflation, while protecting the most vulnerable households from the rise in cost of living. While each downturn will continue to accentuate the tradeoffs among competing priorities, we fully agree that "fiscal consolidation sends a powerful signal that policymakers are aligned in their fight against inflation." However, we regret that the critical analysis of the macroeconomic effects of fiscal stimuli during the pandemic crisis was not undertaken and that the discussion about the more immediate challenges for policymakers on the fiscal front was restricted to a handful of paragraphs in the Executive Summary.

The world faces yet another shock, and in most countries the fiscal accounts remain under strain. Many countries have been facing the latest headwinds—emanating from the war in Ukraine, high energy and food prices, and the highest global inflation in four decades—with weak fiscal positions, including high debt and reduced or exhausted buffers. Almost three in five low-income countries (LICs) are already in or at high risk of debt distress, which uphold the case for more effective use of the Common Framework for debt restructuring.

The sharp rise in food and energy prices, triggered by the war in Ukraine, will continue to put a strain on government budgets, and we welcome the IMF's efforts to help the most vulnerable countries deal with this issue. LICs have incurred the highest relative cost for new food-related measures, which could—in some cases—open a gap in their external current accounts, potentially triggering the need for IMF financial assistance. To complement these efforts, we encourage the membership to prepare fiscal strategies to deploy their available fiscal tools in a sustainable and targeted way. Staff analytical support through technical assistance and during Article IV consultations should play a key role in helping countries articulate adequate policy responses to such economic and socially disruptive shocks.

Statement by Mr. Parkyn, Ms. Doss, and Mr. Yoo on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the comprehensive set of reports that clearly demonstrate the significant challenges and difficult trade-offs for policymakers stemming from multiple shocks. Many economies and financial markets are facing pressures on prices, interest rates and foreign exchange rates on the back of the prolonged Covid-19 pandemic and Russia's war in Ukraine. Since the last update, a further challenge is the emerging impact of the withdrawal of monetary accommodation, and the need to find the right balance. We welcome the acknowledgement of compounding uncertainties on the outlook and the transparency around the assumptions. We agree with the policy priority of fighting inflation along with preserving multilateralism and the momentum for structural transformation. The Fund will continue to play a critical role in helping member countries navigate the challenges through well-tailored country-specific policy advice and financial support.

Outlook

We need to place more emphasis on the further reduction in growth forecasts for 2023 to assess current economic developments. The global growth projection for 2022 remains the same as in the July WEO update despite near zero global growth in Q2 due to better-than-expected performance in the Euro area offsetting contractions in the US, China and Russia and eastern European countries. In 2023, a broad-based economic slowdown is anticipated. We are deeply concerned that over 70 percent of economies are expected to show weaker growth than in the April 2022 WEO and that about a third of the global economy is facing at least two consecutive quarters of negative growth. *Can staff comment on implications for unemployment and participation in the countries projected to experience an output contraction given recent labor market tightness in many countries?* Ongoing analysis of the long-term effect of shocks on economies is needed, taking account of any scarring effects on the global economy, particularly undermining the growth potential of EMDEs.

Inflation rates have exceeded the Fund's recent forecasts and remain at decade-highs in many countries. Global inflation was revised up further from July estimates and we note staff's analysis on the correlation between forecast errors and the size of Covid-19 related fiscal stimulus packages. Core inflation is expected to increase, reflecting the pass-through of energy prices, supply chain disruptions and tight labor markets. Staff analysis that business markups have contributed little to current inflation and make wage-price spirals less likely is interesting and informative, but continued monitoring is warranted.

Monetary policy normalization in advanced economies is starting to tighten global financial conditions, led by the US Federal Reserve's policy stance. Further monetary tightening is expected and will have important implications for global financial conditions and capital flows. It will be important for the Fund to carefully communicate that policy interest rate increases to date have largely unwound existing monetary policy stimulus but have not yet reached sufficient levels to reduce inflation rates in line with targets. As advanced countries move into this phase over the forecast horizon, financial market conditions might shift further toward instability.

The outlook for affordable climate finance for much needed climate mitigation and adaptation projects is a source for concern, especially for emerging markets, low-income countries, and small developing states. There is little scope to deviate from the drive to mitigate climate change and delays attributable to current financial market volatility should be addressed. We urge the Fund to implement reforms to the delivery of capacity development and to their engagement with small developing states to support vulnerable countries to develop the capacity to access the RST, once operationalized.

Risks

We agree that risks to the outlook are substantial and tilted to the downside, and that policy decision-making is more difficult than ever. Pricing the recent unprecedented combination of shocks is challenging and reflected in market volatility. It is difficult to envisage an outlook where that volatility abates substantially. Risks are exacerbated for countries that have little or no policy room remaining to respond.

The Fund's global surveillance is profoundly important for risk management at this critical juncture. Along with close monitoring of the global financial system for emerging risks, it would be valuable for the Fund to further deepen its analysis of the future risk environment. This would help to communicate a 'risk narrative' that brings greater coherence to the inter-related issues of uncertainty, forecast errors, proneness to shocks and fragility. This would support continued analysis of any gaps and potential improvements in the Fund's surveillance, lending, and capacity development approaches.

A key risk is higher than expected inflation for a protracted period of time, in conjunction with improperly calibrated monetary and fiscal policy responses. Noting that it takes time for food and energy prices to pass through to consumer prices and takes more time to bring down service prices, there remain risks of core inflation staying high for longer than expected. It is important that the Fund learns lessons from the inflation surprise – albeit in common with most forecasters – and we commend the dissection of recent WEO forecast errors in Chapter 1. *What is staff's assessment of the timeliness and appropriateness of monetary policy normalization to date compared to the Fund's past advice to members, and are there lessons for how the Fund's advice can be improved?*

Tighter financial conditions and a stronger US dollar exacerbate risks, particularly in EMDEs. Staff indicated that the divergent pace of normalization between the US, Euro area and Japan has contributed to the USD's strength. The capital-flows-at-risk framework is very informative, but we wonder about the important role of expectations in that much of the tightening is now well anticipated and factored into markets. Tighter global financing conditions and a stronger USD increase the risk of more widespread emerging market debt distress given these countries' reduced capacity to access international financial markets, large external financing needs and greater balance sheet vulnerabilities. Close engagement is needed to support the membership to manage these pressures, particularly as they pertain to small, low-income countries that traditionally have had less engagement with the Fund on lending.

The real estate market in several countries continues to warrant close monitoring to preserve macroeconomic and financial stability. Staff note the risks associated with China's real estate sector and it will be important to understand the extent of any potential impacts and spillovers. *Can staff comment on the global implications of the risks to China's real estate sector, with consideration of channels, timing, and other countries most likely to be affected?* For all countries, advice on policies directed at ensuring orderly adjustment in housing need to be carefully tailored as a greater share of households in some countries will have larger buffers to absorb price moderations and rising interest rates than in others. Attention to broader, macro-critical housing affordability issues is also important.

Policies

Monetary policy should stay the course to restore price stability and keep inflation expectations anchored. We agree that central bank action to address inflation is necessary and urgent while taking account of data and inflation expectations. The past credibility of central banks that was established over many decades of inflation targeting, particularly in advanced economies, should act as a mitigating factor that helps to anchor inflation expectations. While clear and forward-looking communication by authorities is required, care must be taken not to create a sense of false precision in highly uncertain times. Authorities must weigh up what communication is complementary to achieving stability.

Fiscal policy advice needs to be carefully tailored to country circumstances. Fiscal policymakers need to ensure fiscal sustainability, while implementing measures to improve efficiency, ensure adequate social protection and address structural challenges. Fiscal consolidation will be appropriate in most contexts at this juncture. We welcome the focus on the role that medium-term fiscal frameworks can play in supporting fiscal sustainability and how fiscal rules should be recalibrated. Food and energy security are important priorities for low-income countries, and support measures should be temporary, well-targeted and clearly communicated alongside appropriate exit strategies over the medium-term. The overall fiscal stances should be calibrated to avoid pro-cyclical impulses that could exacerbate inflation in the near term.

We welcome the Fund's granular policy advice in line with the Integrated Policy Framework (IPF) according to country-specific circumstances. This is especially important for emerging countries where economies are fragile, financial markets shallow, and policy instruments and space are both limited. The IPF should be deployed to assist in a smoother and more orderly adjustment in markets to unprecedented shocks. However, in the current situation where FX market fluctuation and rates of currency depreciation against the USD are high, some policy recommendations do not seem to work effectively. FX intervention by individual countries may not be sufficient to stabilize the FX market, nor do currency swaps seem to be effective in all circumstances. *Can staff comment on what additional measures could be considered by individual authorities or through international cooperation?* We see merit in refining the policy toolkits under the IPF taking account of the current economic situation and FX market developments.

International coordination to contain negative external spillovers should be intensified. The G20 Common Framework has been developed to address debt distress issues in debt vulnerable countries through collective efforts by creditors. We welcome the recent progress for Zambia under the G20 Common Framework and look forward to further discussion on the proposals to facilitate more effective functioning of the Common Framework. Financial policy cooperation should be strengthened through close communication and currency swaps.

Structural reform is needed in many economies to support more sustainable, inclusive, and productive growth. Multilateral cooperation continues to be vital for the global economy and we reiterate the desirability of an open, rules-based international trade system. Staff analysis rightfully highlights policy interactions and complementarities. In this regard, addressing supply-driven inflation would benefit from policy reforms that alleviate supply shortages by upgrading infrastructure, removing regulatory constraints, and improving supply chain resilience.

Statement by Ms. Mannathoko, Mr. Nakunyada, Ms. Vumendlini, Mr. Abdullahi, Mr. Ekeocha, and Ms. Nainda on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

The global economy is being buffeted by multiple shocks that, alongside scarring, have led to the highest inflation in decades, alongside tightening global financial conditions reacting to the normalization of monetary and fiscal policies. The Fund's policy advice on managing complex policy tradeoffs thus has a central role at this juncture (alongside its financial support), in safeguarding both global monetary and financial stability, and growth, in line with the purposes stated in the Articles of Agreement. We highlight the need to continue to strengthen the Fund's role in surveillance, policy advice, lending, and capacity development, and the importance of building up collective action. Both demand and supply-side options must be considered in tailored country-specific advice to tackle inflation pressures, without inducing recession. Policy trade-offs are especially challenging now, in the face of constrained fiscal space, elevated debt vulnerabilities, and the socio-economic effects of rising food and energy prices, particularly in EMDEs. A variety of policy approaches is needed to contain inflation while reducing the effects of economic scarring, closing gaps in inequality, and boosting growth over the medium term.

1. **We thank staff for the insightful flagship reports.** Some sections include excellent analysis. We broadly share the assessment of the current conjuncture and recommendations on policy actions needed from major economies to exit from the current high inflation environment; but have some questions. While noting the favorable finding on a lower than initially expected likelihood of a global recession, we highlight that policy actions going forward will play an important role in safeguarding this outcome.

Global Economic Slowdown and the Forecast

2. Major economies notably the US, Europe, and China are estimated to slow down markedly in 2022, weighed down like others, by the spillover effects of Russia's war in Ukraine. Growth prospects in emerging market and developing economies (EMDEs) also remain challenged by subdued activity in China owing to pandemic restrictions and real estate sector developments. We therefore welcome the scenarios around the baseline forecasts as presented by staff in the WEO fan chart (Box 1.3). We, agree that steadfast and congruent monetary and fiscal policies are needed to support successful disinflation efforts while cushioning the impact on the most vulnerable, of the erosion of disposable incomes. In addition, it remains critical that Fund workstreams be effective in helping countries build resilience to shocks while containing inflation, without risking recession and further economic divergence. *We note the sharper decline in US growth compared to the EU while the latter is experiencing the direct effects of the war, including energy supply constraints. Could staff elaborate on the contrasting growth contraction?*

3. We note the three assumptions underlying the baseline forecasts, namely no further reduction in natural gas flows to Europe in 2022, long-term inflation expectations remaining stable, and monetary policy tightening not inducing widespread recession. *Could staff comment more on the probability of the inflation expectations assumption given recent trends? We further note that*

policy actions will play a significant role in determining the two latter assumptions. Could staff also clarify why, in Table 1.1 on page 10 of the WEO, PPP GDP growth data for sub-Saharan Africa and LICs is missing? Is the data not available? Including an explanation in the Table notes would be helpful.

Food and Fuel Market Spillovers to Sub-Saharan Africa

4. Spillovers and related shocks are an ongoing concern for developing countries such as those in Sub-Saharan Africa (SSA). We therefore appreciate the WEO feature on commodity markets and food inflation. Multiple shocks have worsened food insecurity and energy costs, with significant repercussions for SSA economies. The lingering COVID-19 pandemic and Russia's war in Ukraine, have led to the rise in global cost-of-living, with a surge in global food and energy prices. In SSA, this has been compounded by frequent and increasingly severe climate shocks that destroy or hamper agricultural output. In this regard, our understanding is that it is climate and temperature extremes that impact agricultural productivity, thus a more accurate risk measure in Figure 1.5 might be the average *hottest* temperatures rather than the annual mean temperature which is reduced significantly by the very cold dry winters in semi-arid climates. With SSA having the most vulnerable food systems in the world, elevated food and energy prices are worsening food insecurity, entrenching deeper scarring, and straining social cohesion in many countries. Food inflation has eroded global living standards, and in SSA, the situation has been exacerbated by high energy costs, which show up both directly and indirectly through higher transportation and cooking costs, highlighting the need to cushion vulnerable households. Manifold challenges underscore the centrality of collective action needed to address such global challenges and avoid reverse spillovers down the road. *Could staff elaborate on the differential effects of commodity price trends on SSA and LAC?*

Tackling Inflation

5. The narrative on pages 4-8 provides helpful guidance especially in the context of large central banks that are coming out of unconventional monetary policy and monitoring the evolution of the natural rate of interest and the implications for monetary policy transmission. We also welcome the ECB's recently introduced Transmission Protection Instrument to improve monetary transmission and tackle fragmentation risks in the Euro-Area. *Could staff also offer analytical guidance on policy intervention and limits to avoid recession, for those developing countries that have higher inflation and high unemployment in regions such as SSA, and most of which did not face deflation during the great moderation. Did they have a similar evolution in their natural rate of interest due to the pandemic's impact on potential output, or were there other factors of note?*

6. As noted by the FDMD at Jackson Hole last month, the pass through from price shocks and exchange rate changes to inflation is higher and more persistent in developing countries than elsewhere, making policy trade-offs starker and more difficult to manage. This is very real for countries in our region. Rapid dollar appreciation is also amplifying inflationary effects. Consequently countries that are barely starting to recover from the pandemic and the deepest global recession since 1945, and have yet to reverse scarring, must now raise interest rates even more aggressively than most to curb inflation, further constraining their growth. *Robust analysis and policy advice to central banks on managing these tradeoffs is therefore essential for developing countries at this juncture. Could staff brief us on plans in this regard?*

7. We appreciate the recognition that supply-side measures can also support monetary policy in reducing inflation. Beyond the examples given of infrastructure and supply chains, this is also

pertinent in the context of food and fuel prices and insecurity in regions like SSA. Supply side measures in the agricultural and energy sector, building resilience to shocks in both cases, can make a significant and lasting difference.

8. On monetary-fiscal policy coordination, we note the importance of efficient fiscal spending and well targeted measures to cushion the impact on the vulnerable, given the simultaneous need to reduce fiscal deficits and debt vulnerabilities. *Staff note that the cost-of-living crisis may put pressure on governments to give in to above inflation wage demands, generating second round effects. As this is already the case in various countries in our region, staff insights on how to stem this and disincentivize labor unions from going this route, would be valuable.*

From Inflation to Growth

9. While a third of the world faces technical recession in 2022, the good news is that two-thirds of the global economy does not. It is important, therefore, that even while disinflationary monetary policy tightening is unavoidable, we should also offer policy advice that seeks to ensure that it does not induce broader recession. While the probability analysis around growth projections is encouraging (pointing to only a 25 percent chance of recession), ultimately a positive outcome is reliant on policy actions. *As we noted before, with central banks around the world all currently raising key interest rates in widespread tightening of monetary policy, this could end in recession if the collective impact on global demand is not factored into policy guidance. Have IMF models mapped out how impacts from this simultaneous tightening will play out across the globe? Could staff comment further on this?*

10. We note from the United States analysis in the WEO (page 24) that the 3-to-4-year lag between interest rate hikes in a tightening cycle (on one hand) and lower inflation (on the other) implies the need for carefully framed communication and forward guidance to contain inflation expectations, with the guidance probably reliant on insights from real time nowcasting given the uncertain times we live in. When the Federal Reserve announced early this year that it would have successive rate hikes through 2022 of a cumulative 250 bp (which has since increased), they indicated then that the plan was to slow US growth but not stall it. Given that rate hikes have continued beyond 250 bp, we find it especially important now that communications temper growing expectations of recession. Some analysts have argued that historically, since the 1960s, efforts by the US to curb inflation with successive rate cuts have resulted in recession eight out of nine times. *Could staff comment on conditions pertaining in 1994, the one time that inflation came down without recession? Were there factors other than monetary policy at play (such as oil prices peaking then falling), and if so, might this be replicated this time around since futures markets point to a fall in oil prices starting next year? If so, this would be good news for the global economy, helping to avert recession and reducing current BoP and inflationary pressures (including in developing countries), from elevated energy prices. Perhaps outreach messaging could also highlight the positive / optimistic scenarios that countries can aspire to (beyond the baseline), so that we are constantly communicating a way out of both inflation and recession?*

Spillovers from Tightening Global Financial Conditions

10. With interest rate normalization underway, negative impacts such as elevated debt vulnerabilities (hikes in debt service costs), and large, sustained capital outflows from EMDEs are already evident raising external sector risks. Capital flow reversals alongside the depletion of reserve buffers, and currency pressures highlight the importance of pro-active measures to mitigate financial stability risks in emerging and frontier markets. Thus we welcome the spelling out of IPF measures in the report, because for countries with shallow foreign exchange markets, as securities investors begin to sell off local assets it is important that authorities are well informed

on what their potential options are. Developing country authorities many of whom face very volatile external sector conditions, alongside area department staff, should be up to speed on the application of both the IPF and updated IV so that authorities are not forced into situations where they feel they must resort to extreme actions in the face of shocks, when other (albeit limited) options exist. With this in mind, we call for consistent application of the IPF across all countries. *Could staff comment on whether the sharp jump in yield spreads for SSA sovereign bonds in 2022 has been influenced by the ongoing reporting on common framework delays and expectations of private creditors regarding their required participation in SSA debt restructurings? We would also be interested to hear more on outreach plans for the IPF guidance note including to SSA, and how this can be folded into contingency planning. Could staff also comment on whether there is scope to coordinate normalization and the messaging that goes with it in major economies, to help contain inflation expectations globally, and further negative spillovers to developing countries from an extended normalization?*

11. On rising debt vulnerabilities, we agree on the critical importance of improved, effective frameworks for debt resolution to avert a downward spiral towards a broad-based debt crisis. In addition to policy normalization, the appreciation of the US dollar is exerting additional pressure on government budgets via rising external debt service costs. With the increase in borrowing costs compounding debt vulnerabilities in some countries, growing risks remain concerning, and as such, we support the call for pro-active engagement with creditors to avoid defaults and sustain market access. As medium-term fiscal strategies keep getting interrupted by new shocks, orderly adjustments that avert debt distress are becoming more difficult. Furthermore, the experience for PRGT countries is that even though the authorities may approach the Fund early for UCT-quality programs, it can take over a year for the country to come onto a program, during which time conditions continue to deteriorate and financing needs including from the Fund, rise. Systems for timely debt resolution and flexibility of IMF area department and review staff are both important to ensure that pursuit of perfect or first best preferences does not become the enemy of the good (closing out viable second-best solutions that would counter the high cost of inertia). Timely global cooperative efforts will be needed to avert a major debt crisis. We agree that addressing debt transparency through the joint IMF/World Bank multipronged approach is important. In the same vein, a robust, timely and effective global debt resolution architecture is critical, and we reiterate our call for continued efforts to address the limitations of the G20 Common Framework.

Containing the Build Up of Financial Sector Vulnerabilities

12. Emerging financial vulnerabilities in some advanced and emerging market banks, point to the need for stronger macroprudential and supervisory frameworks**.** Priority should also be accorded to closing capital deficiencies in emerging market banks to enhance their resilience, including under a severe stagflation scenario. Concurrent efforts to strengthen the macroprudential toolkit should be intensified to tackle the buildup of financial sector vulnerabilities in both the bank and non-bank sectors. Sound liquidity risk management practices will be important to counter market liquidity risks and moderate their amplifying effects on shocks. We agree that now, more than before, policymakers need to remain attentive to financial stability risks from potential corporate defaults and bankruptcies, as well as to adverse housing market dynamics. Given the increasing size and importance of non-banks, alongside demands of managing digital money, and the downturn in crypto markets, we call for the urgent development and rollout of appropriate supervisory and regulatory frameworks to safeguard financial stability. Beyond this, building capital buffers, and mobilizing private climate financing will go a long way to helping to address climate transition issues while helping central banks strengthen financial sector stability.

Addressing Fragmentation and Promoting Trade

13. For the IMF to comply with its purpose of promoting trade, as articulated in the Articles of Agreement, the means has to be found to improve the rules-based multilateral trading system while limiting fragmentation and protectionism. Since movement away from globalization often stems from geopolitical issues, future IMF analysis demonstrating how peace, trade, and broader globalization together have enabled a positive-sum game to play out in the past, benefiting everyone, may be helpful. Supply chain realignment along geopolitical fault lines is increasing de-globalization risks, with potential costs for all countries, especially developing economies. In this regard, international cooperation remains essential especially in efforts to address urgent global issues such as food and fertilizer shortages and those of other production inputs, so as not to further constrain growth. Therefore governments should unwind pre-pandemic trade restrictions in line with commitments to the World Trade Organization. Removing all pandemic-era restrictions to allow unfettered access to food and fertilizer supplies is essential to avert food insecurity in sub-Saharan Africa. We therefore encourage ongoing WTO reforms and urge the WTO to restore the system for resolving trade disputes and to clarify the rules in areas such as agricultural and industrial subsidies. *As supply chain disruption has also been contributing to the slowdown in global trade growth with China being a critical node, in Spring we asked staff if it was possible to share effective third country approaches and work with the Chinese authorities to seek a solution to the supply chain disruptions linked to Chinese supply. Could staff comment on progress in this regard?*

Climate Transition

14. We support the urgent call to action to facilitate a smooth transition to a more carbon-neutral global economy over the next eight years**.** The current fuel crisis has reminded us of the broad-based global costs of an energy crisis and should accelerate green energy investments, including in developing regions. We recognize that the hesitation to move expeditiously with climate mitigation policies often centers around energy security concerns and mounting inflationary pressures on the back of rising oil and gas prices. Climate transition challenges and a lack of consensus around the right mix of climate change policies to bring about desired effects without jeopardizing macroeconomic stability also complicates things. We hope such differences will be resolved at COP26 this year. In the meantime, expediting green investments remains beneficial. Global Macroeconomic Model for the Energy Transition (GMMET) analysis of short-and medium-term budget-neutral climate policies, and the near-term macroeconomic costs of policies, in advanced economies and large carbon emitters informs the policy debate and is particularly helpful. We welcome the identification of specific policy measures that, if phased in progressively and implemented in a timely manner, would pave the way for achieving the 2015 Paris Agreement targets. We concur with the recommendations for a mix of credible climate and monetary policies to avoid stop-and-go policies and keep macroeconomic costs of the transition away from carbon, in check. Beyond this, as noted elsewhere by staff, for low-emission developing regions faced with huge adaptation needs for agriculture and energy resilience, global cooperation is also needed to boost green financing, as is the concessional financing needed to catalyze growth-enhancing reforms and help developing countries meet their climate targets. Given limited fiscal space measures to motivate private finance for climate transition and adaptation while filling ESG investment information gaps, particularly in the SSA region, remain important.

Helping People Bounce Back

15. While we broadly support the policy prescriptions proposed in the Fiscal Monitor, we note that limited fiscal space, particularly in FCS and LICs, constrains the mileage derived from these policy options. Such mileage is needed to entrench recovery and stem divergence. Alongside constrained fiscal space, we find that expensive and limited access to capital markets, high debt with rising debt vulnerabilities, and underdeveloped social protection schemes, all constrain LIDCs' capacity to respond effectively to current complex challenges.

16. There has been clear need in many countries, for policymakers to contain scarring and foster resilience by helping vulnerable firms and households bounce back from the fallout following recent shocks. We therefore welcome the focus of the Fiscal Monitor on measures needed to guard against large income and employment losses in the wake of large shocks. Such measures have a vital role in providing timely and appropriate protection for human and social capital. We agree that strong social protection systems, well targeted and adequate social safety nets and effective, targeted, job retention schemes serve as crucial income (and social) stabilizers in times of crisis. The challenge, however, has been how to ensure these income and social shields can be adequately rolled out in countries that most need them, but where resources are stretched and there is limited fiscal space.

17. That said, we nevertheless endorse the call to prioritize building robust social protection systems that can be scaled up quickly during crises, including by capitalizing on digitalization. A well-functioning social protection system with reliable, high frequency indicators, and pre-legislated ready-to-deploy actions with specified triggers, would be a valuable addition. While we agree with the need to avoid price controls, management of energy and food subsidies needs to be carefully weighed in the current crisis context to preserve social cohesion and avoid adding to economic instability. Efforts to increase economic formality and the use of government technology will also enable countries to expand the reach of government support to vulnerable individuals and firms. Given the increasing frequency of shocks, we agree that greater effort is needed to promote the private sector use of insurance to support resilience.

18. While financial support to firms has been instrumental in preventing significant economic scarring and severe real income losses, it may not have been possible in LIDCs where it was most needed. We do, however concede that exceptional financial support to firms should be only in exceptional contexts, given the risk that scarce fiscal resources could be wasted on non-viable zombie firms that fail to sustain production and jobs once support is withdrawn. We also recognize that not all innovative fiscal responses adopted in response to the recent multiple crises worked well and taking stock of what worked and what did not is important.

17. In the face on successive shocks, rebuilding fiscal buffers in the context of a viable medium-term fiscal strategy that preserves debt sustainability, remains critical. Carefully calibrated fiscal policy within frameworks that have robust fiscal anchors, is important for fiscal sustainability. Given the challenging policy tradeoffs many low-income developing countries face, growth-friendly fiscal consolidation anchored on raising additional revenues, including by enabling growth in the tax base, alongside expenditure control is often the only path to create space for critical public investments and to preserve medium-term debt sustainability. We concur that prioritization of spending, including for green and digital investments that will help secure climate resilience and food and energy security, will be paramount. Priority should also be accorded to policies and programs that save lives, including vulnerable households that face rising food insecurity.

Statement by Mr. Mohieldin, Mr. Alhosani, Ms. Choueiri, Mr. Al-Kohlany, and Ms. Merhi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

World economic outlook

1. We thank staff for the well-written Flagship reports, which outline the severe challenges facing the global economy. Tightening financial conditions, the implications of the conflict in Ukraine, and the lingering pandemic, all weigh heavily on the global economic outlook. The challenges facing the global economy are particularly acute for Emerging Markets and Developing Countries (EMDCs). These countries are faced with the simultaneous challenges of tackling rising inflation, addressing food insecurity, and preserving fiscal and debt sustainability. At the same time, the global tightening in financing conditions could trigger widespread emerging market debt distress, while geopolitical fragmentation could further hinder their trade and capital flows. Many EMDCs in our region face the additional challenges of fragility and hosting large refugee flows. The October *World Economic Outlook* (WEO) expects global growth to slow sharply from 6% in 2021 to 3.2% in 2022 at a time when upside inflation pressures remain. The Fund has downgraded global growth and revised up inflation projections four times since last October and risks to the outlook remain unusually large and to the downside.

2. Against this sobering background, we broadly agree with the policy priorities identified in the WEO. Importantly, the report rightly stresses that successful multilateral corporation is needed to avoid fragmentation that could reverse the gains in economic well-being from thirty years of economic integration. We would like to make the following points:

3. **More frontloaded and assertive monetary tightening is needed, with careful attention to spillovers to EMDCs**. Staff's work in Chapter 2 suggests that more frontloaded and aggressive monetary tightening is critical to avoid inflation de-anchoring and prevent an erosion of incomes and worsening of inequality. 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 clear guidance and communication from advanced economy central banks, which are essential to avoid unwarranted market volatility and mitigate spillovers.

4. **Fiscal policy should prioritize vulnerable groups, although increased attention to middle-income households is warranted**. We agree with staff that fiscal policy should prioritize vulnerable groups through targeted near-term support to alleviate the burden of the cost-of-living crisis felt across the globe. However, increasing pressures on the middle class

are visible in several of our member countries, where high food and energy prices are the main spillover channels from geopolitical developments. This calls for careful attention to the capacity of this group to continue to withstand increasing borrowing costs as well as high energy and food prices. The WEO rightly highlights the risks of debt distress in more than 60 percent of low-income countries (LICs) and over 25 percent of emerging markets (EMs). We, therefore, appreciate the Fund's enhanced work on debt and agree with staff on the need for timely, effective, and well-coordinated debt resolution mechanisms. We believe that the difficult global economic environment calls for a **review of the IMF's surcharges policy and look forward to detailed discussions of the policy following the Annual Meetings**. We support the proposals to improve implementation of the G20 Common Framework and call for mechanisms to address the risks of debt distress in vulnerable middle-income countries. We support the Fund's work on enhancing the global debt architecture as well as debt transparency and sustainability.

5. **Structural reforms and policies with longer-term benefits need to address the priorities of the entire membership**. We concur with staff that policies that expand supply can boost economic activity while easing inflation. Structural challenges facing a large portion of the membership, notably EMDCs, include employment, especially youth and women employment, more equal opportunities, as well as economic diversification. More careful consideration of these challenges in the analytical work and policy recommendations is therefore needed, alongside work on climate change. This is all the more important that post-pandemic and geopolitical developments scarring effects are expected to be a much larger in EMDCs than in advanced economies.

6. **Chapter 3 examines energy transitions and macroeconomic costs, and we would have appreciated a particular focus on the transition costs of hydrocarbon-exporting countries, which are expected to be the highest (online Annex 3.3)**. The chapter also looks at the credibility and design of climate policies, notably the way alternative policy packages fare in terms of their effects on employment, investment, consumption and output growth, inflation, and income distribution. However, the chapter assumes that all policy packages are financed by greenhouse gas taxation only. We strongly encourage the Fund to consider a broader set of instruments to achieve the transition to a low-emission economy. This is due to the diverse policies employed by members to achieve the low-emission goal. For instance, the UAE and other countries in our constituency are making important strides in green technologies investments.

7. We support the views of Mr. Binzarah and his colleagues, in particular on managing a just climate transition, with this being guided at the Fund by macroeconomic considerations that serve the broad interest of the membership. Specifically, we expect the Fund to be guided by the Paris Agreement, UNFCCC process, and the specific Nationally Determined Contributions.

Global Financial Stability Report

8. We thank staff for the analysis in the Global Financial Stability Report (GFSR), which presented a sobering account of the increasing global financial stability risks since the April GFSR. Amid higher inflation, spillovers from geopolitical developments, and an uncertain outlook, central banks in advanced economies have accelerated the pace of normalization, and emerging market and frontier market economies continued to keep pace with rising inflation and currency pressures while regional differences remain. The immediate priority should remain for the central banks to act firmly to bring inflation back to target. Measures to ease supply side bottlenecks are also necessary. *Could staff provide further details, and their views, on the decision of many central banks in AE to abandon forward guidance (FG). We also appreciate staff comments on the applicability of FG by other central banks in the current environment.*

9. In emerging markets, rising interest rates and spillover from the AE monetary policies and tighter financial conditions are triggering large outflows and pushing up borrowing costs. EMs policymakers are faced with limited policy space and difficult tradeoffs. The rise in global food prices and the higher inflation calls for tighter monetary policy, but supporting the most vulnerable would require additional fiscal space or expenditure reprioritization. We agree with staff advice that some EMs would benefit from a combination of targeted foreign exchange interventions and capital inflow measures to help smooth exchange rate adjustments and maintain effective monetary policy transmission. As such, we look forward to operationalizing the Integrated Policy Framework (IPF) and stress the need for the IPF to accommodate country-specific conditions to guide the optimal policy mix. Fund policy advice to these countries should be complemented with financing support when needed.

10. We note, with concern, Staff analysis that the number of emerging and frontier market countries either in default or at distressed levels would continue to grow unless market conditions improve. It is also expected that many of these countries will seek new bilateral or multilateral financing, including IMF-supported programs. Risks of sovereign defaults highlight the need for the Fund, at the center of the global financial safety net, to continue to be adequately resourced, agile and responsive. Stressed countries could also resort to debt reprofiling and restructuring. Here, as mentioned in the WEO section, we emphasis the need to make further advances in the global debt agenda, improve the international debt architecture, enhance debt transparency, and assess countries' debt sustainability and debt restructuring needs.

11. Chapter 2 of the GFSR discussion of the need to scale up private climate finance is important and timely. The chapter estimates adaptation costs alone for emerging market and developing economies will require up to $300 billion a year by 2030. These estimates are expected to rise sharply to $1.75 trillion annually after 2050 if the progress in curbing emission remain below targets. EMs and developing countries will require significant climate

financing in the coming years. Climate finance needs will require significant official as well as private sources of finance, and we welcome staff analysis of challenges and opportunities around this topic. The IMF has an important role to play in undertaking financial stability risk assessments and by providing financing through the newly established RST. The upcoming COP27 in Egypt is also an opportunity to further advance the discussion around private climate finance. Staff indicates that carbon pricing is an effective tool to make high emitters pay for the climate costs they cause. As mentioned earlier in the statement, we strongly encourage staff to consider alternatives to carbon pricing given the diverse policies employed by members to achieve the low-emission goal.

Fiscal Monitor

12. We welcome staff's analysis and policy recommendations in this Monitor. **The sharp rise in food and energy prices in addition to the tightening of monetary policies have exacerbated fiscal and debt challenges in many countries including in several EMs and LICs**. Rising interest rates have increased potential risks of debt distress in many countries. These risks, together with additional challenges stemming from food shortages, energy insecurity, remittances, and refugee flows, have added to social pressures in many member countries, including some in our constituency. Given the high inflationary pressures, fiscal policy has an important role to play to avoid overburdening monetary policy in tackling inflation. Reducing deficits will therefore be necessary to help tackle inflation and address debt vulnerabilities and will require careful prioritization of spending among competing needs in order to tighten the fiscal stance, while ensuring it is growth friendly.

13. **We concur with the Monitor that fiscal policy priority should be to protect the most vulnerable from the impact of high and rising food and energy prices through targeted support to alleviate the burden of the increase in the cost of living, although middle classes are facing increasing pressures, as noted above.** We see merit in improving the targeting of social safety nets as well as in reforming existing subsidies to support inclusive growth wherever needed. However, many low-income and fragile countries are in a very difficult position due to their limited fiscal space to buffer the energy and food price shocks and prevent a large rise in poverty and income inequality. Fiscal policy will therefore need to strike a difficult balance between protecting the most vulnerable under tight fiscal constraints and high debt burdens, while maintaining medium-term sustainability. Moreover, food security has become very concerning in many countries, and governments might need to resort to other temporary steps such as price subsidies or distribution of staple foods. In this connection, support from the international community to low-income countries with elevated debt levels will be crucial, in order to provide emergency financing, humanitarian assistance as well as to ensure unhindered trade. Multilateral cooperation remains therefore essential to address the food and energy crises, preserve access to liquidity, avert debt distress and expedite orderly debt restructurings where needed.

14. **We would also like to highlight, in this regard, the growing financing need 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. It will be crucial for these countries that the international community 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.

15. **Finally, we welcome the lessons learned from the pandemic, and agree that policymakers can and should develop strategies and tools that can be immediately deployed when needed.** We see merit in the policy recommendation to encourage the private sector to build its own resilience through insurance or learning new skills to limit government intervention to support firms, which can be risky in countries that suffer from weak governance structure and from limited capacity to properly assess and monitor firms' viability.

Statement by Mr. Chodos, Mr. Herrera, Mr. Hendrick, Mr. Lischinsky, Ms. Bustillo, Mr. Corvalan Mendoza, and Ms. Ramos Capaquira on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

1. **We thank staff for a set of excellent and well-written Flagship reports.** We broadly agree with the key messages in the reports. The stakes are high for the world economy amid a confluence of adverse shocks, increased debt vulnerabilities, political polarization, geopolitical fragmentation, and extreme weather events due to climate change. Multi-decade highs in inflation, Russia's war on Ukraine, high food and energy prices, tighter global financial conditions, and persistent COVID-related supply-side restrictions create a highly challenging environment for the membership. Global activity is headed for a significant slowdown in the coming quarters, while inflation is expected to gradually decline, and global imbalances are expected to widen. Risks to the global outlook are unusually large and biased to the downside.

2. **The Flagships rightly highlight the importance of careful and timely recalibration of the policy mix to address these challenges.** Central banks must resolutely focus on restoring price stability and defend their credibility. Fiscal actions should support monetary policy and put public debt on a sustainable path, while providing targeted help to cushion the impact of cost-of-living increases on the most vulnerable. At the international level, fragile economies will need timely and flexible financial support and/or expeditious debt relief and restructuring to navigate this complex juncture.

3. G**lobal cooperation remains critical to help the most vulnerable members and face shared challenges.** Multilateral action is critical to overcome the food crisis, keep agricultural markets open, address emergency needs, increase production and improve distribution. A strong and responsive global financial safety net is needed to help vulnerable countries weather the risks of slowing growth, tighter financial conditions, and rising geopolitical tensions. Multilateral cooperation between official creditors and constructive engagement with the private sector will be required to strengthen the debt resolution framework. Clearly, global cooperation is the only way to meet the long-term challenges associated with climate change, pandemics, and digitalization. **The Fund, at the center of the global financial safety net, must continue adapting and expanding its reach to ensure a stable international monetary system and world economy.**

WORLD ECONOMIC OUTLOOK

Chapter 1: Global Prospects and Policies

4. **The global outlook is challenging and risks to the downside dominate.** The baseline scenario forecasts that economic growth will halve in advanced economies (AEs) and decline (slightly) in emerging market and developing economies (EMDES), except for emerging Europe, where recovery is expected. Nearly a third of countries is expected to go through a technical recession in 2022-23. Although rate rises are necessary to quell inflation, there is a significant risk that the global economy enters a recession hurting the most vulnerable countries. Some commentators have highlighted the parallels between the current situation and the early 1980s, when rising global interest rates, the strengthening of the US dollar, and the decline in global trade triggered a widespread debt crisis in EMDEs. So far, the increase in sovereign spreads in major emerging economies has been moderate. We highlight that current policy frameworks in EMDEs are much stronger than in the early 1980s, but debt levels are higher. *We would appreciate if staff would elaborate on the possibility of another debt crisis in EMDEs and the ability of the global financial safety net to meet this challenge.*

5. **Central banks must act resolutely to curb inflation and maintain inflation expectations well-anchored, but international feedback loops, spillovers, and spillbacks must be considered.** We agree that clear and forceful communication is critical to maintain credibility and provide reassurance about the priority to curb inflation. At the same time, amid great uncertainty about inflation expectations, labor markets, supply shocks, and international financial conditions, we must recognize that central banks prefer to keep their future course open and data dependent. The danger is that uncoordinated monetary tightening could end up overstating the global response to inflation, as major central banks respond to each other's actions and reinforce their contractionary impact on aggregate demand. *We would appreciate if staff would elaborate on avenues to enhance international policy cooperation among major players, including monetary policy and foreign exchange interventions in key currencies.*

6. **In a world of rising interest rates and high debt, fiscal consolidation is necessary to support macro adjustment at home and rebuild buffers for the future.** Fiscal support to cushion the cost-of-living crisis is warranted. However, fiscal actions must be temporary, targeted at the most vulnerable, and preserve price signals to guide the reduction of energy consumption. They should not increase aggregate demand or hinder monetary policy adjustment, especially in those countries that are experiencing overheating. If monetary

policy must bear the full brunt of the macro adjustment or worst, offset expansionary fiscal policies, that will increase stress on interest rates, exchange rates, capital flows and trade imbalances. Achieving an adequate mix of monetary and fiscal adjustment, especially in major economies, will be critical to achieve a well-balanced adjustment of global demand and limit negative spillovers from high interest rates through domestic and international financial markets.

7. **We agree on the importance of structural reforms to maintain high, inclusive, and sustainable growth at the center of the policy response to economic, financial, social, and institutional challenges.** The combination of weak output growth, tight labor markets, and high inflation observed in recent quarters suggest a productivity slowdown and lingering problems on supply-chains. The need to improve the supply-side, promote greater labor participation, and build resilience to climate change and pandemic emergencies is an economic and social priority.

Chapter 2: Wage Dynamics Post-COVID-19 and Wage-Price Spiral Risks

8. We welcome the staff's timely and comprehensive analysis of the wage and price dynamics post COVID-19 and the likelihood of persistent wage-price spirals. The world was taken by surprise with levels of inflation that has not been seen in almost 40 years in many economies. Staff makes a persuasive case, using a mix of empirical and model-based analysis, that even though labor market conditions remain relevant drivers for wage growth, the importance of inflation expectations has increased. Therefore, the relatively rapid increase of the policy rates by most central banks in developing economies and emerging markets is seen as the right approach to lower the risk that inflation becomes de-anchored from its target, and more so in those cases where price expectations are more backward-looking. With the benefit of hindsight, it is now clear that forecasters and policy makers underestimated the impact of the strong economic recovery in 2021, supported by strong economic stimulus packages in many advanced and emerging economies, while supply chains were gummed up and labor markets tight.

9. We take positive note of staff's assessment that the chances of persistent wage-price spirals emerging appear limited. The data shows that on average, nominal wages take time to increase in response to inflation, leading real wages to decline and acting as a brake on demand, as shown in Fig 2.1. However, this may be one of the cases where it is important to remember that what happened in the past will not necessarily repeat in the future. Thus, policy makers should remain vigilant of developments in the labor market, because as also explained by staff, changes in inflation expectations and labor market slack explain wage dynamics in the second half of 2001, and to the extent that price expectation become more backward looking, the greater the chance that inflation could de-anchor to a higher-than-target level.

Chapter 3: Near-Term Macroeconomic Impact of Decarbonization Policies

10. Implementation of the 2015 Paris Agreement has lagged its stated objectives and, currently, the world is not on track to achieve its goals by 2030. Though there is little consensus on the costs of transition to a low-carbon economy, the long-term costs of delay and inaction could be massive. Avoiding catastrophic climate disruptions will require a swift transition to a low-carbon economy and putting in place a broad range of policy measures, including greenhouse gas (GHG) emission taxes, regulations on emissions, and investment in low-carbon technologies. Whatever policy packages are used, mitigating undesirable distributional consequences will be critical for feasible and sustainable decarbonization strategies.

11. The appropriate policy mix should depend on country-specific circumstances and constraints. In addition, with respect to Box 3.2 on experiences with carbon pricing notes, we believe that one size does not fit all. In the case of the member in our constituency, the carbon tax is one policy instrument recently added to the countries' strong track record on climate action policies. Over the past 30 years, Uruguay has substantially reduced its Greenhouse Gas (GHG) emissions while taking steps to preserve its natural capital being one of the world's leading countries in sustainable electricity generation. *We have several objections to the characterization of Uruguay's climate policies in Box 3.2. We have sent technical comments to staff which we appreciate will be considered for the publication of the document.* Overall, developing countries face complex challenges in transitioning to a low carbon economy and in fostering a shift from high-to low-carbon intensive activities with employment generation. In addition to adequate policies, increased financing from multiple sources will be needed.

GLOBAL FINANCIAL STABILITY REPORT

Chapter 1: Financial Stability in The New High Inflation Environment

12. Since last April, the risks to global financial stability have increased. Recent developments in the stock market and the aggressive increases in interest rate by the Fed, signal more difficult times ahead for policy makers, corporates, and households. Prices on risk assets are very volatile. Financial conditions are tightening in Advanced Economies (AEs) and in Emerging Markets and Developing Countries (EMDCs). Preexisting vulnerabilities are deepening while investors expect inflation to remain elevated and flight to security, leading to capital outflows from many emerging and frontier market economies. We concur with staff's assessment that there is a risk of a disorderly tightening of financial conditions that may be amplified by vulnerabilities built over the years. We welcome measures to avoid fragmentation risks and maintain transmission of monetary policy, as the recent "Transmission Protection Instrument" by the ECB, as clearly explained in Box 1.2. The Fund must stand ready to continue helping the membership not only with financing but also to provide leadership among major shareholders for a synchronized "smooth landing' and greater international cooperation to exit the global crisis with the best outcome for the membership.

13. EMDCs are particularly affected by these developments that configure a "perfect storm". Many of them have used up most fiscal and external buffers to deal with the negative effects of the COVID-19 pandemic and many must increase public debt to help finance stimulus packages. After the rebound in many economies, growth prospects are not very good for many EMDs, due to the scarring effect, and complicating authorities' efforts to restore long-term fiscal and external sustainability. Nevertheless, it is important to acknowledge the large differences across countries and regions in terms of their fundamentals, and the time and speed of the policy reaction to stubborn inflation, higher global uncertainty, and ongoing policy tightening in advance economies. We are concerned that 17 countries are in default, or close to it, and if conditions do not improve, risk of sovereign defaults in frontier markets will materialize. The good news is that several large EMs issuers have proved resilient, that investors are able to differentiate across emerging markets so far, and risks associated to China housing market have abated thanks to policy intervention.

14. Considering the global tightening and risks to the outlook, we agree with staff that the Fund´s Integrated Policy Framework provides useful guidance to deal with the current crisis. Under certain specific circumstances, FXI, CFMs and MPMs could prove to be useful in reducing volatility and financial risks. This could also help the effectiveness of monetary policy transmission. Financial vulnerabilities need to be addressed with urgency considering the scope of near term-challenges, although care is needed to avoid a negative impact on the real economy which could jeopardize the goal towards financial stability.

15. The crisis is also affecting the corporate sector with potential spillovers for the financial sector and growth momentum. The fall in equity prices is a warning sign. Small firms' bankruptcies have already increased in advanced economies. There are signs of overheating in the housing market in several countries, and house prices could fall sharply if mortgage rates continue to increase. Stress tests of banks at the global level shows that a severe downturn scenario could affect minimum capital requirements in close to 30 percent of EMs banks, while in AEs, banks would continue resilient. Corporate credit is also under pressure of default and several sub-investment grade firms exposed. Box 3 and Fig 1.11 shows the relationship between monetary policy tightening and recessions in the last 60 years. *At this point in time, and given available information, we would like to ask staff about their views on the likelihood of a recession taking place in the United States and how soon could the economy return to positive growth.*

Chapter 2: Scaling Up Private Climate Finance in Emerging and Developing Economies: Challenges and Opportunities

16. We welcome the analysis of the important issue of how to address the challenges of climate finance. This issue has a strong relevance for development, and reduction of poverty, hunger, and malnutrition for many million inhabitants in the world, particularly in EMDCs. However, the first sentence of the Chapter 2, "Emerging market and developing economies account for two-thirds of global carbon emissions", does not provide any historical context about cumulative global emissions, which began with what are now Advanced Economies (AEs). Furthermore, a few decades ago when many contaminating activities were moved from AEs to EMDCs, very few voices complained about it. We agree with staff that EMDCs will need important amounts of climate finance to deal with both the reduction of GHG emissions and to adapt to the negative effects of climate change on lives and livelihood. However, the internal economic impact in the near- and medium-term of both are very different and we would encourage staff to deepen their analysis on this important issue.

17. We believe that not only private finance is key to achieve climate objectives, but official finance is also critical. In this regard, we welcome the acknowledgement in paragraph # 52 about the importance of AEs allocating sufficient resources to climate funds, such as the UNFCCC Green Climate Fund and others, to fill the financing gap, in line with pledges under the Paris Agreement. At the same time, we agree on the importance of enhancing the climate information framework to scale up climate finance, as well as improving the methodologies to assess funding gaps. As mentioned in this chapter, international financial institutions and MDBs will continue fostering initiatives that help channel climate funds to EMDCs. The role of the IMF will be very important in assisting countries in capacity development, in improving the architecture of climate information and finance taxonomies and, in coordination with other IFIs, will play a catalytic role to induce climate-related investment. In this regard, the RST with its long-term finance, beyond its available funds and reduced access, could have a crucial performance in supporting countries to reduce risks, among others, those related to climate change catalyzing official and private sector finance for climate-related projects on adaptation and carbon reduction.

CHAPTER 3: Asset Price Fragility in Times of Stress: The Role of Open-End Investment Funds

18. Amid increasing uncertainty, the liquidity vulnerability of open-end investment funds (OEFs) could exacerbate the risks to global financial stability. Therefore, policies to mitigate their effects are of key priority. We welcome the staff analysis in the GFSR Chapter 3 on OEFs and their potential impact on global financial stability. The current juncture of tighter financial conditions and the overall uncertainty are impacting these funds, having experienced during the first half of the year significant outflows, with a higher effect in emerging markets. Hence, strengthening supervisory and regulatory framework of OEFs is highly relevant, both at a national and international level, which can help address liquidity risks. We take positive note of the available liquidity management tools outlined in this chapter. *In this regard, we would appreciate if staff would further elaborate on the reasons behind the low use of price-based tools and advice on how jurisdictions could overcome obstacles.* At the same time, we notice that there are social benefits from OEFs, such as pooling idiosyncratic liquidity risks, which can broaden investor participation and reduce funding costs for smaller firms, at least in normal times. *We would also appreciate if staff would elaborate on the potential impact of the proposed measures on investor participation, financial intermediation competition, and the cost of capital for those companies that rely more heavily on OEFs as a source of financing.*

FISCAL MONITOR

Chapter 1: Helping People Bounce back.

19. As of this year, competing priorities for policy makers are mounting, the urgency for debt stabilization, protection of the most vulnerable, and investment for the future are some clear examples of the complexity of the current situation. Despite the limited fiscal space in most countries after the COVID-19 pandemic, a set of new measures to help people bounce back were introduced in 2022. To mitigate the cost-of-living squeeze due to food and energy price spikes, many countries deployed measures like price subsidies, tax cuts, and cash transfers, which according to the report, in many cases have proved ineffective and a drain of valuable fiscal resources.

20. The size and mix of policy tools to confront large crises, as presented Figure 1.8 "Simulated effects of discretionary support and time-varying automatic stabilizers" are useful for the analysis. Whether automatic stabilizers or discretionary measures were in place, a well-designed social protection system, job retention schemes, well-targeted subsidies or protection to viable firms' schemes must be part of the standard policy toolkit for the future. We see sufficient space for the IMF to support the membership and explore how domestic measures can be complemented by global cooperation to foster economic resilience. Having said that, coordinated global efforts to provide emergency financing, technical and humanitarian assistance, as well as trade facilitation are warranted.

Statement by Mr. Jennings, Mr. O'Brolchain, Ms. Cunningham, Ms. Smith, Ms. Ahmed, Mr. Day, and Ms. Edwards on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the excellent set of reports and thorough discussion of risks to the global economic outlook. We appreciate the IMF's use of the phrase "Russia's invasion of Ukraine" in the WEO executive summary and the Fiscal Monitor. We strongly encourage consistent use of this phrasing throughout the reports to place appropriate emphasis on Russia's culpability and its ability to end the war.

World Economic Outlook

We broadly agree with the staff assessment of the global economic outlook and risks. Key factors shaping the global outlook are monetary policy tightening to control inflation, ongoing effects of Russia's invasion of Ukraine, and supply disruptions, including lockdowns in China. The outlook has deteriorated further since July, with real global growth revised lower and more inflation. Staff expect that global inflationary pressures are likely to peak in 2022 and remain higher than previously expected throughout the forecast horizon.

We welcome the extensive analysis of inflation in the October WEO, including food inflation. The discussion of forecasting errors for inflation, including those in IMF forecasts, helps to shed light on the drivers of inflation shocks, as well as the complexity of current inflation pressures. We agree with staff's view that supply constraints are going to continue to be a key factor in shaping the global economy and inflation pressures. For many countries, these external supply disruptions can be difficult and costly to try to address with domestic policies to weaken demand. *Could staff also provide their view on the size of the global output gap and its role in driving global inflation currently?*

Chapter 2 concludes that current conditions do not appear likely to induce a wage-price spiral. The report indicates that inflation expectations seem to remain anchored (p.19), but it is concerning that many near-term expectations remain well above target in many regions. Chapter 2 also points out that real wage stability or declines can attenuate inflation pressures; however, it could also acknowledge that this entails adverse effects (reduced real disposable income) for households. It would be useful to also show more disaggregated analysis on wages by income group and the distributional effects of inflation on income inequality, as this could help to nuance policy.

Risks to growth are predominantly on the downside. While we agree with the two-sided nature of risks that monetary policy over-tightens or under-tightens, the report should more clearly explain why the risks of not tightening enough are more severe. We would appreciate more analysis of the case where too little weight is put on disinflation, since there is a risk of groupthink if all view the risks of under-tightening as larger. Indeed, we may have recently seen how a mutually reinforced belief in transitory inflation could lead to a delayed assessment of the underlying shock and policy response. Furthermore, foreign monetary policy could also help cool domestic inflation. Policymakers may not fully appreciate the aggregate effect of simultaneous tightening of monetary policy across many countries. Staff analysis quantifying spillover effects from large economies' monetary tightening would therefore also be helpful.

We commend the authors for bringing attention to the ongoing pandemic risks noted by firms and the low rate of COVID-19 vaccinations in lower-income countries, especially Africa. Further discussion of the outlook and risks to small developing states, such as those in the Caribbean, would be welcome, including the risks from a continuing pandemic. The reports would also benefit from more discussion of the economic impacts of potential adverse scenarios related to Russia's invasion of Ukraine, beyond downside risks related to European energy supply.[1]

We broadly concur with the policy recommendations. Monetary policy should continue to be tightened in many countries to control inflation and re-anchor inflation expectations and bring inflation back to target. *Could staff elaborate on how monetary policy can best affect expectations formation and the best strategies to balance the inflation-output trade-off while prioritizing price stability? When should central banks with relatively strong credibility pause, and how should that be communicated to minimize the impact on output? How are staff estimates of the neutral rate arrived at for most countries? Have neutral rates changed materially since the pandemic?*

We also agree that monetary policy and fiscal policy should be complementary, and fiscal support to address inflation impacts should be temporary and well-targeted to the most vulnerable to avoid adding to inflation pressures. However, more nuance on how to do so would be welcome. We note that policy recommendations from the IPF model are prominent in the October WEO. Since many of the recommendations entail foreign exchange market intervention or imposing capital flow measures (CFMs), the WEO should also emphasize the need to ensure these policies are temporary and not intended to replace other needed macroeconomic adjustments, consistent with the Institutional View.

We welcome the continued emphasis on climate change in the reports. The frequency and intensity of climatic events and resultant damage underscores the need for urgent action to mitigate and adapt to climate change and its impacts. Global action is needed to have a chance of achieving the Paris commitments. *How does staff see Russia's invasion of Ukraine affecting ~~assessments of climate transi~~tion risks?* We agree with staff's finding in Chapter 3 that the

[1] The WEO is somewhat vague about why Russian gas flows to Europe are falling. Clarifying that the main cause is Russia's weaponization of its energy exports would help underscore the importance of adverse geopolitical developments to the economic outlook.

longer it takes to tackle climate issues, the more costly it is, and we would stress this is especially the case for countries like those in the Caribbean that feel the full brunt of climate change. We would welcome more clarity on the underlying assumptions, and we look forward to the forthcoming working paper. Feasible and transparent climate policies that balance the need to limit output losses against the effects from higher taxes, while protecting vulnerable households and ensuring that those contributing less to emissions are not made to bear a disproportionate share of the transition costs, are needed. Several Caribbean countries' actions to increase generation of energy from geothermal, solar, and wind go in the right direction, but these initiatives require the financial and technical support from more advanced economies. Access to concessional and grant financing is key.

Fiscal Monitor

The Fiscal Monitor rightly focuses on how fiscal policy can help build resilience to shocks. Resilience is especially relevant to many poor and vulnerable countries, including small developing states, that are at greater risk of shocks, such as climate change. We welcome the analysis of effectiveness on automatic stabilizers and discretionary measures deployed during the pandemic. For developing countries, where automatic stabilizers are less common and the informal sector plays a larger role, we welcome further consideration of how these countries can more efficiently identify eligible recipients and deliver timely fiscal support. Similarly, on job retention schemes, while the advantages are well noted, the report could further underscore the need for careful targeting and phase-out plans to avoid subsidizing unviable firms or firms not in need of support.

We generally agree with the recommendation to prepare a fiscal strategy in advance to improve the ability to target those most in need of support during times of crises. That said, legislating "semi-automatic stabilizers" that are activated in times of crisis requires appropriate thresholds to be set to minimize waste of resources and disincentives. We also welcome discussion on food and energy prices and the recommendation to build fiscal buffers. The report should also clearly encourage sound fiscal management—including good governance, transparency, and adherence to fiscal targets as key elements of any long-term fiscal strategy. We note with concern that the Fiscal Monitor continues to exclude unfunded pension liabilities of government employees' defined-benefit pension plans from reported debt statistics. This exclusion understates the true extent of public liabilities and undermines cross-economy comparability. *Staff comments welcome.*

Increasing levels of debt distress underscore the crucial need for improvements to the debt restructuring architecture. The Common Framework process needs to be more efficient and timelier, and there is a need for improved creditor coordination for debt restructuring where the Common Framework is not applicable. While the Report calls for a "robust Common Framework" we would stress that there must also be timely follow-through and implementation of the Framework. This, along with policies to strengthen debt management and transparency, will be important to ensure long-term debt sustainability.

Global Financial Stability Report

The GFSR correctly emphasizes significant short-term risk, including the risk of a sudden, disorderly tightening in financial conditions. This would also affect sovereign refinancing conditions, though not uniformly. The economic situation and rising debt-servicing costs also create financial strains for some households and non-financial corporates, which may lead to rising non-performing loans. Some financial market segments show higher volatility and lower liquidity, which warrants close monitoring. We would welcome more discussion of vulnerabilities from household indebtedness. We are particularly concerned that a reversal of excessive risk taking and further abrupt tightening in global financial conditions could lead to of a sharp decline in household income and house prices.

We strongly welcome the analysis on scaling up private climate finance in EMDEs, given public budgets strained following the pandemic and borrowing conditions have tightened. The annex on innovative financing instruments can be especially beneficial to small developing states with high debt burdens and difficulties accessing resources to finance climate adaptation and stimulate growth. Capacity development is also important so that countries are prepared to navigate these highly technical instruments and access global climate funds. *Can staff comment on the success and challenges of small developing countries in utilizing appropriate instruments to support adaptation?* We look forward to continued work on this important topic—including on the role of global policy institutions and multilateral development banks. We would also be interested in work on vulnerabilities to the global financial system from physical and transition risks, which have the potential to lead to large and sudden repricing of assets tied to climate-related sectors.

We also appreciate the analysis on risks and vulnerabilities in the open-ended investment funds (OEFs) in Chapter 3. We note the recent large outflows from market equity and bond funds and potential for adverse spillovers to EMDEs. We agree with staff that liquidity management tools can potentially reduce the vulnerabilities associated with OEFs and mitigate their potential to amplify price fragility, although staff focus heavily on swing pricing, with less emphasis on ex post tools and liquidity buffers. Examples of countries where there has been effective implementation of liquidity management tools and monitoring would also be of interest.

Further discussion of cryptoasset risks would also be welcome. Although the GFSR discusses the large price movements of cryptoassets in recent months and the need for swift global regulation, it would benefit from further discussion of the risks to financial stability posed by unbacked cryptoassets and stablecoins.

Statement by Ms. Lim, Mr. Mochtar, Mr. Nghiem, Ms. Abu Bakar, and Mr. Kurniawan on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

We thank staff for the high quality and insightful analysis in the set of Flagship reports. The reports provide a valuable lens by which to frame the discussions on developments and potential policy implications.

World Economic Outlook

Elevated headwinds from persistent inflationary pressures, tightening financial conditions, heightened debt distress and on-going spillovers from the war in Ukraine continue to place the global economic and financial outlook in a fragile position. **Against these headwinds, we underscore that continued vigilance on risk assessment and country-specific recommendations are critical.**

- Ensuring price stability and addressing the stubbornly high inflation remains one of our top priority. We concur with staff that central banks must decisively tighten monetary policy in real terms to bring inflation back to target and avoid de-anchoring of inflation expectations.

- However, its timing, pace and magnitude will require careful calibration and coordination both domestically and across borders to limit spillovers and avoid a hard landing. Overtightening risks sending the global economy into recession, which could be materialized in 2023 as illustrated by the IMF's Global Bank Stress Test. *Taking into account elevated borrowing costs and deteriorated market access in EMDEs stemming from the spillovers effect of AEs' aggressive monetary policy tightening, we would appreciate staff's views on policy trade-offs faced by EMDEs.*

- The negative feedback to capital flows movement and volatility in exchange rates also present a major source of concern for macroeconomic and financial stability in EMDEs, which we are already seeing as a result of recent hikes in interest rates in the US. We underscore that FXI and CFMs should remain necessary instruments as appropriate, to cope with the volatility in the global financial markets. In this regard, we welcome staff's highlights of some situation-specific measures that could be taken under the Integrated Policy Framework (IPF).

- With supply issues contributing a big factor to inflationary pressures, we share the view that strengthening multilateral cooperation to address the supply bottlenecks are ever more important. *While recommendations are centered on G2G cooperation, would staff have any views on possible public private partnerships recommendations to ease supply constraints?*

While risks to the global economic outlook are significantly tilted to the downside, we view that the messaging in the flagship report could be more balanced with some

discussion on potential upside risks. As pressures on oil and food prices have been eased and supply chain bottlenecks have been improved, Covid-19 pandemic being relatively well-contained by now and banking system remaining resilient with good capital buffers could provide some of the upside against the heterogeneity in central banks' conduct of monetary policy (easing vs tightening) and market conditions, and divergent recoveries on external balances across the globe. *Regarding the global economic growth forecast, we seek staff's clarification on the difference in projection in WEO (3.2%) and GFSR (3% in Chap 1 para 16).*

We thank staff for the interesting analysis in Chapter 2 on comparison of wage-price dynamics during COVID-19 and historical trends. We note that with COVID-19 being an exception, the expectations formation process plays a critical role in shaping prices and wages. There are, however, sparse discussions on the differences in wage impact between shorter-term and longer-term inflation expectations. We view that the shorter-term expectations still play an important role in wage demand even if long-term expectations are well-anchored, giving importance to well-calibrated and communicated monetary-fiscal policy stance.

We appreciate the analysis in chapter 3, and welcome the use of a model-based analysis to illustrate the costs of delayed actions. It would have been useful for the analysis to explore practical solutions for developing economies that face competing financing needs to make sizeable investments in renewable and low carbon energy. These countries will also have limited political buy-in to undertake GHG taxes at a time where fuel prices are already at high levels. Yet, at this juncture, we view that it is critical to start establishing groundworks to address data gaps such as making GHG reporting mandatory so that decarbonization policies can be quickly initiated when needed. Successful case studies on decarbonization policies in LIC and MIC economies would also be helpful in building confidence and traction in this area.

Global Financial Stability Report

We welcome staff's selected themes on scaling up private climate finance in EMDEs to tackle the huge climate financing gaps. The United Nations Environment Program (UNEP)'s expert report also confirmed the huge gap in climate financing with adaptation costs of developing countries to reach between US$140 billion and US$300 billion per year by 2030.[2] In view of the large gap in climate financing and challenging fiscal conditions in most EMDEs highlighted by the increase in government debt burden, scaling up of private sources of financing, albeit difficult, is highly warranted as the cost of green financing may further rise should efforts to reduce emissions fall short of global objectives set by the Paris Agreement. We take note that exploring private finance for climate change mitigation and adaptation should go hand in hand with appropriate climate policies in order to achieve climate policy goals.

[2] Source: The trillion dollar climate finance challenge (and opportunity) | | UN News dated 27 June 2021

We agree that risks stemming from the growing corporate debt market could jeopardize financial stability if transparency and appropriate supervision tools are not enhanced. We note staff's recommendation that restructuring, and insolvency tools should help ensure efficient and orderly exit of non-viable firms facing structural challenges and that some firms and sectors facing credit constraints may still need short-term fiscal support to prevent market access failure. *In this regard, we would appreciate staff's elaboration on qualifications for such support against the backdrop of high inflation and the ongoing fiscal consolidation efforts across the globe.*

While Open-End Investment Funds (OEFs) are an important component in the global financial markets, it could also amplify stress to financial markets and pose risks to financial stability. With the rapid growth in OEFs, excessive asset price volatility could adversely affect the balance sheets of both financial and non-financial institutions. In addition, fluctuating asset prices may lead to an undue tightening of financial conditions, exacerbating liquidity mismatches. It is therefore crucial that liquidity management tools be timely deployed in anticipation of and during elevated market stress to mitigate potential risk amplifications and financial ramifications to the rest of the economy.

Fiscal Monitor

We welcome the focus of the Fiscal Monitor that fiscal policy needs to adjust, given the current challenging situation and limited policy space. However, the room to maneuver is more limited and fiscal policy trade-offs, especially for high debt countries, are more complex. With global financial condition tightening, the interest expenses and sovereign spreads, especially in EMDEs, will continue to rise. This will complicate efforts to reduce deficits necessary to address debt vulnerability and help tackle inflation. In this situation, prioritizing policies and programs based on country specific conditions, such as the available policy space, social safety nets system, and the severity of debt distress is crucial. We agree that during the adjustment, the top priority is protecting the vulnerable from cost-of living crisis. Fiscal policy must lessen the impact of inflationary impulse that would affect the vulnerable group.

Implementing a credible medium-term fiscal framework is essential to rebuild fiscal buffers. As highlighted in the report, fiscal policies have been more active during large crises and can be powerful if policy spaces are available. Unfortunately, the deployment of fiscal tools in EMDEs was more muted compared to advanced economies which may contribute to some scarring in growth outlook. Therefore, we agree that building fiscal buffers, especially for EMDEs, is a pre-requisite for policies to respond flexibly during crises without jeopardizing access to financing. We acknowledge the difficulty in balancing between building buffers and protecting the vulnerable, especially in low-income developing countries given other pressing needs and limited capacity. In this regard, we encourage staff to have further engagement and assistance to help members design credible medium-term fiscal strategies and advancing fiscal reforms based on country specificities and cross-country experience.

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
Executive Board Meeting 22/82
September 29, 2022

We thank staff for a set of excellent Flagship reports, whose cross-cutting theme is the substantial deterioration of the global outlook since April. This deterioration takes places in a context of: (a) large and persistent inflation surprises that risk deanchoring expectations; (b) major disruptions caused by Russia's aggression against Ukraine; and (c) lingering effects of the post-Covid recovery that result in still strong demand, particularly in services. There are no doubts that bringing inflation under control has become the paramount policy priority, as low and stable inflation constitutes a necessary condition for the global outlook to improve. We have below a few comments on the main policy messages in Chapter 1 of the WEO; we have included comments on the other Flagships and on Chapters 2 and 3 of the WEO in an Annex.

- **Policy mix.** We would have liked more emphasis on the need to ensure consistency between fiscal and monetary policies. We agree on the three main sources of risk that the WEO identifies: (a) the possibility that synchronous tightening of financial conditions trigger episodes of debt distress, particularly in emerging markets and low-income countries; (b) a worsening of the real estate crisis in China that could hit the domestic banking sector, exacerbating the slowdown in growth with major global spillovers; and (c) the adverse impact of increasing geopolitical fragmentation on trade and capital flows. To that, we would, however, add the possibility that the burden of curbing inflation falls on monetary policy only, with fiscal policy not contributing to bringing aggregate demand in line with supply. Under these circumstances, the disinflation process could take much longer and could require a larger than desirable monetary tightening with substantial risks, including a disorderly adjustment of financial conditions and an abrupt repricing of risk, with possible adverse consequences for financial stability.
- **Monetary policy.** We agree with staff that taming inflation will come at a cost**,** and therefore the objective of engineering a soft landing – which avoids both turmoil in financial markets and a deep recession – may prove elusive. Indeed, it is unlikely that disinflation takes place without a substantial increase in real interest rates, an outcome that it is difficult to assess whether central banks have delivered, under the current high uncertainty about where markets' inflation expectations stand. Moreover, despite the substantial extent of monetary tightening since April 2022 in Advanced Economies, there is no doubt that real interest rates generally remain below their pre-pandemic levels. Under these circumstances, the call for a data-driven approach to monetary policy seems justified, together with less reliance on forward guidance.

- **Fiscal Policy.** Policymakers have to balance the need to provide needed support to those hardest hits by the increasing cost of living, with the need not to impart further stimulus, which could complicate disinflation and jeopardize medium-term debt sustainability. Thus, we fully support the Flagships' call for shifting away from generalized fiscal support in favor of targeted measures toward those who need it the most. Moreover, in the event a significant contraction in economic activity materializes, fiscal policy should avoid taking a procyclical stance that could make things worse, as it happened a decade ago during the European crisis.
- **Structural policies.** Supply shocks – including, but not only, surging energy and food prices – have played a key role in rekindling inflation. Therefore, we fully agree that supply-side policies should complement fiscal and monetary policies in the task of bringing inflation down. However, structured reforms cannot substitute demand management, because they take time to be implemented and yield results. In fact, the materialization of adverse permanent supply shocks makes the case for demand tightening even more compelling.
- **Energy transition and security**. The impact of the war on oil and gas markets has made the transition toward renewables even more urgent, because it fosters energy security by lowering dependency from oil and gas imports. Energy-price developments have boosted returns from renewables, particularly in the EU because of its pricing system for electricity. It is, however, clear that, on the one hand, the favorable impact on the production of renewable is taking time, whereas, on the other hand, energy demand has proved little elastic to prices. Thus, we believe these developments provide food for thought for Fund's policy advice on how policies can foster the transition. We think it is time the discussion goes beyond the broad statement in favor of carbon pricing that, by itself, may not do the trick.

ANNEX

1. **GFSR**

- ✓ We welcome the outcome of the Global Bank Stress Test and the staff's assessment that, on aggregate, banking sectors are resilient and, with high levels of capital and ample liquidity buffers, capable of withstanding a severe stagflation scenario without impairing financial intermediation. This is the notable outcome of the regulatory reforms adopted in response to the Global Financial Crisis. We also recognize the heavier impact of this adverse scenario on emerging market banks, on account of their greater sensitivity to macrofinancial shocks. Improved net interest income and profitability are facilitating the rebuilding of loan-loss reserves, for the first time after the pandemic, in the face of rising risks in the housing and corporate sectors.
- ✓ We agree withs staff that policymakers should act to contain a further buildup of financial vulnerabilities. We share the recommendation that macroprudential policies should be deployed to address pockets of elevated vulnerabilities while avoiding being procyclical. We recognize that striking the right balance depends on country-specific circumstances and challenges. In this regard, the nonbank financial

institutions appear to be more vulnerable, and we thus support the staff's call on developing macroprudential instruments and enhancing regulation (including on liquidity risk management practices).

- ✓ The GFSR underscores a deterioration of market liquidity as a result of increased uncertainty and volatility amidst monetary policy tightening. However, we do not see these risks as an immediate concern in a context of still abundant liquidity and sustained expected supply of high-quality assets to finance public debt. Furthermore, several measures have already or are being taken to improve market functioning in key markets. We also emphasize and welcome that there are no signs of stress in international dollar short-term funding markets, which were flagged as a source of potential liquidity risk in the Spring GFSR.
- ✓ We very much appreciate the staff's analysis in Box. 1.3 of the GFSR, which elaborates on the historical evidence suggesting that policy rates above their neutral level in the U.S. are usually followed by a recession. While it is highly uncertain whether "*this time is different*", some factors – notably the strength of the labor market and healthier households and corporate balance sheets – may provide some cautious support to the chances of a soft landing. At the same time, greater investor uncertainty on the likely inflation outcomes in the U.S. and the euro area signals worries that a hard landing – i.e., a significant recession sometime in 2023 – remains a clear possibility.
- ✓ With specific regard to the asset management sector, we agree that open-end investment funds offering daily redemptions at funds' net asset value while holding illiquid assets are vulnerable to investor runs and can trigger asset fire sales. We, thus, support the recommendation to introduce measures to limit their liquidity mismatches and concur that price-based measures, such as swing pricing, can be most effective at reducing the first-mover advantage.

2. Fiscal Monitor

- ✓ We welcome the Fiscal Monitor's focus on the most relevant policy issues, including the role of government actions and social protection systems to protect households and firms against large losses of real income and employment.
- ✓ We appreciate the analysis on the COVID-19 policy response, the workings of automatic stabilizers, their distributional impact, and discretionary measures. We note the effectiveness of the measures adopted by European countries which, on average, have been able to compensate for most of the drop in income and broadly stabilize consumption.
- ✓ Regarding the discretionary measures, the effectiveness of the Brazil's Emergency Aid and the U.S. CARES Act are noteworthy[3]. Some of these measures may have overcompensated households, although it was crucial to avoid the opposite risk of under achievement. Looking forward, policy makers should learn from the pandemic

[3] See also *Unemployment Insurance in the U.S.* https://www.bancaditalia.it/pubblicazioni/qef/2022-0673/index.html?com.dotmarketing.htmlpage.language=1

packages – which had to be devised in a short time frame, in a context of high uncertainty, and at times really from scratch – and better target future schemes with the aim of making the best use of taxpayers' money and preventing possible frauds and misuse of public funds, which are a serious concern in any public scheme.

- ✓ Digitalization can be a powerful tool to design and implement social programs, taking advantage of the availability of big data. Table 1.1 interestingly shows that websites and digital networks have been widely used to better target social programs in several emerging and developing economies. Sharing this experience with other possible interested countries with the help of Fund's capacity development could be important. Job retention schemes have proved to be very useful in the pandemic, including the *Cassa Integrazione Guadagni* scheme in Italy.
- ✓ We note staff's insight (p. 9) that the pandemic did not bring the overwhelming structural transformations that were envisaged at the beginning. We would encourage staff to keep working on the gains from structural economic transformations taking advantage of digitalization and to explore options for facilitating financial integration, especially in developing countries. Also, we see merit in developing semi-automatic stabilizers, as staff suggest, despite it may be uneasy ex-ante to identify the specific triggers for shocks that are unknown or difficult to anticipate. Along the same line, we agree with staff that strengthening social safety net could be useful but would require additional infrastructural preparatory work ahead of future crisis.

3. WEO Analytical Chapter 2: *Wage dynamics post-Covid-19 and wage-price spiral risks*

- ✓ We appreciate the analysis of wage and price dynamics around the pandemic and welcome the conclusion that based on historical episodes exhibiting similar dynamics to the conjuncture, the risks of wage-price spirals appear limited. This conclusion is also supported by the ongoing simultaneous tightening of monetary policy among both advanced and emerging economies. We also concur with the finding that expectations play a critical role in shaping wage and price dynamics and that, as a result, frontloading monetary tightening can help maintain inflation expectations well-anchored and minimize disinflationary costs, particularly in a context of partially adaptive expectations. At the same time, monetary policy should remain data dependent and the passthrough of wages to prices should be closely monitored and further analyzed given the uncertainty over the evolution of the process post-pandemic and the role of market power. The latter, in fact, as noted in box 1.2, could explain a stronger capacity to absorb costs but also to shield profits from cost increases.

4. WEO Analytical Chapter 3: *Near-term macroeconomic impact of decarbonization policies*

- ✓ We welcome the staff's analysis of decarbonization policies and their near-term macroeconomic impact, notably on inflation and the conduct of monetary policy. We share the sense of urgency conveyed by staff given the costs of procrastinating implementation of key climate policies, including on the output-inflation tradeoffs. We particularly appreciate the evidence on the role played by policy design in defining the final impact of climate policies on output, inflation, and income distribution. We share the staff's recognition that the first-best option of establishing an institutional arrangement – an analogy with independent central banks – to achieve the credibility of climate policies is too ambitious; however, the focus of future research should be on whether there is a case for devising alternative "*disciplining devices*" – notably for (automatic) redistribution – that can provide second-best solutions by fostering the adjustment of investment in the electricity sector. *Staff's comments are welcome*.

✓ We concur that the efforts towards reaching climate goals should be global; in the same vein, we agree that, to allow a faster but also more effective decarbonization, greenhouse gas taxation should be implemented in the context of a coordinated approach. At the same time, we are of the view that we should rethink more broadly the energy transition and allow the private sector to play a greater role, but for this to happen it would be important to address existing obstacles and possible regulatory barriers that might prevent private companies from investing in renewable energies.

Statement by Ms. Riach, Mr. Trott, Ms. Andreicut, Ms. Campbell, Mr. Chrimes, and Ms. Nelson on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

Overall this set of flagships is excellent, combining well-judged overviews of a deeply troubling global outlook with analytical chapters that demonstrate the Fund's intellectual leadership and that should help advance important debates.

There is no need to recap in full the reasons for that outlook being so gloomy, with projected growth lower and financial stability risks even higher than in April. Those are well understood and nicely captured in the drafts. The primary reason is Russia's invasion of Ukraine (an accurate description, which we would like to thank staff for using). Amongst its many damaging consequences, the economic fallout from that invasion has meant that, after almost fifteen years, exceptional monetary stimulus is being withdrawn more rapidly than would otherwise have been necessary, and against the backdrop of a worsening risk outlook rather than of strengthening global growth. Many of the issues discussed in the flagships pertain to how the tightening in global financial conditions resulting from this unusual combination will weigh on growth, and whether it will expose pockets of vulnerability in the global financial system. Ending the Russian war would be the most effective way to alleviate these costs and pressures.

On macroeconomic policy, the WEO rightly argues that monetary tightening has been appropriate to mitigate inflationary pressures, and that policymakers should "stay the course". Two important nuances warrant emphasis. First, while "front-loaded and aggressive monetary tightening" is now required, this was not as obviously so prior to Russia's invasion and the resulting spike in commodity prices. After over a decade with policy rates close to their effective lower bounds, and with the robustness of the recovery after Covid highly uncertain, there was a strong case for tightening cautiously (i.e. following a "risk management" approach, in the jargon of the policy literature). The otherwise excellent Chapter 2 of the WEO might helpfully note this line of thought, to help balance any impression that monetary policy was clearly "behind the curve" in 2021. Second, in places the projected growth slowdown is too closely attributed to tighter monetary policy, whereas the direct impact of the squeeze in real incomes is also a crucial factor (the dominant one, for the UK). The framing of macroprudential policy in the GFSR is well judged, capturing the need to further bolster resilience as risks increase while standing ready to release buffers if needed. On fiscal policy, the attempt to draw lessons from Covid support measures in the Fiscal Monitor is timely and we broadly support its main conclusions.

The powerful overview of the situation confronting LICs provided across the flagships underscores the need to consider further multilateral support. For many countries the price of food and energy imports remain sharply higher in local currency terms following Russia's invasion of Ukraine, debt levels are elevated in a large number of cases, and the costs of external finance have risen markedly. For instance, the WEO notes that more than two-thirds of sub-Saharan African countries now face sovereign debt yields in excess of 700bp. We strongly support calls in the WEO to enhance the effectiveness of the G20 Common Framework for debt resolution. Moreover, the combination of shocks and stresses hitting the poorest and most vulnerable countries described across the flagships highlights the need to reflect holistically, and as a matter of urgency, on what more the Fund can do to support them through this current crisis.

Both the WEO and GFSR strike an appropriate balance in highlighting the risks to EMEs posed by tightening global financial conditions, without sounding alarmist. When interpreting events to date one could be pessimistic, noting the scale of capital outflows from emerging and frontier markets highlighted in the GFSR when there is likely much more tightening in global financial conditions still to come. A more positive perspective might emphasize how progress in deepening domestic financial markets has helped countries to weather a challenging period, as almost fifteen years of unprecedented monetary stimulus starts to unwind. The overall tone of the flagships handles this nicely. *We would, though, welcome elaboration for the Board as to how much comfort or concern staff have drawn from recent events, relative to what one might have expected based on historical relationships, such as those embodied in their capital flows at risk model*.

Policy advice pertaining to EMEs could usefully be augmented, especially in the GFSR. There are two parts to this suggestion. The first is to make more of the precautionary toolkit available to Fund members, and the value of using such facilities when facing a tightening in global financial conditions which could have a lot longer, and further, to run. Both provision and use of these facilities constitute crucial global public goods, helping individual countries to navigate an especially challenging period while also strengthening the overall global financial safety net. The second is that recommendations for domestic policies informed by the Integrated Policy Framework could usefully be expanded upon, given how important these are at the current juncture and the dependence of such advice on circumstances. More specifically, the possibility of capital outflow controls in the event of stress cited in the main text of GFSR Chapter 1 seems more appropriate than the looser inflow measures in the chapter summary. All else equal, timely use of precautionary facilities can reduce the chances of needing either.

Emerging, frontier and lower income countries are not the only ones facing financial stability risks as global financial conditions tighten. Some vulnerabilities and amplifiers are global in their reach. **It is helpful that the GFSR highlights the urgency of coordinated policy actions to redress vulnerabilities pertaining to both non-bank financial intermediaries and to market fragility.** While reforms since the global financial crisis have bolstered the resilience of the global banking system - as attested by the latest Global Banking Stress Test – similar progress remains a pressing priority across many areas of non-bank finance. The choice of open-ended funds as a focus for Chapter 3 of the GFSR is a sensible one. So too are its broad policy prescriptions. Namely, a first line of defense involving calibrating tools (e.g. 'swing pricing') to ensure that the implications of redemptions under stress for wider markets are taken into account, backed up in areas where such tools prove infeasible by the possibility of measures to reduce the liquidity funds offer to their investors. These conclusions accord with thinking in other multilateral fora, and it is helpful for the Fund to explain and to support them. Promotion of the agenda to enhance the resilience of financial markets – to address potential structural fragilities, as well as realized volatility in prices – is also welcome.

We welcome that the mitigation of climate change, and its associated economic and financial risks, forms a prominent theme running through the flagships. The Fund's GMMET model – and especially its use for the sophisticated modelling of policy options for mitigating climate change – is genuinely world-leading. The fact that both the model and WEO Chapter 3 engage with differential policy implications according to a country's stage of development is an especially impressive, and important, innovation. This material is an exemplar of how the Fund is increasingly exhibiting intellectual leadership in the macroeconomic analysis of climate issues, and it is a valuable public good to showcase it in the WEO.

Discussion of the interactions between climate and traditional macroeconomic policy levers is valuable, though the messaging may need nuancing in places. In particular, the inference that climate mitigation policies would pose limited trade-offs for monetary policymakers is quite strongly stated and will attract external attention. While we hope this proves the case, there are risks that such trade-offs are somewhat bigger. The dependence of this conclusion on climate policies being introduced gradually and credibly is clear, but is also sensitive to a number of modelling assumptions.

Stepping back to look across the flagships in the round, we strongly welcome the onus on the risks associated with fragmentation, and the value of multilateralism. A breakdown in multilateralism would undermine our collective ability to response to the current crisis and to provide global solutions, including on climate change. It is right that the flagships address this issue head on, and champion cooperation.

Statement by Mr. Andrianarivelo, Mr. Nguema-Affane, and Mr. Sidi Bouna on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the new set of flagship reports which provide an accurate representation of global economic conditions with an appropriate emphasis on the current exceptionally high uncertainty resulting from the war in Ukraine. We broadly agree with the staff's assessment of the global economy and risks and support the key policy recommendations contained in the reports.

World Economic Outlook

The spillovers from the war in Ukraine and the protracted pandemic continue to have a severe impact on the global economy. Many countries are experiencing a sharp economic slowdown while inflation worldwide remains elevated driven by high energy and food prices affecting the poor and vulnerable the most. Financial conditions are tightening amid elevated debt levels worldwide. Also, global growth prospects have deteriorated with world GDP projected to decelerate sharply in 2022, compared to 2021, and weaken further in 2023 driven by slowing economic growth in the largest economies. Inflation is expected to rise strongly in 2022 compared to 2021 but will slow gradually over the medium term. In addition, significant downside risks are weighing on the global outlook: energy and food price shocks could intensify, leading to further spikes in inflation; tightening financial conditions could provoke debt distress in emerging markets; European economies could be further weakened by disruptions in gas supplies from Russia; the dollar could appreciate more if large economies continue to diverge; and the international cooperation needed to tackle climate change could stall due to geopolitical fragmentation.

Low-income countries are disproportionately affected by the repercussions of the war in Ukraine and the pandemic and are experiencing acute food insecurity amid limited fiscal space and elevated debt levels. In Sub-Saharan Africa, growth has been further revised downward resulting from the effects of adverse commodities terms of trade and a slowdown of trading partners' economies. High international food pieces are contributing to a rise in malnutrition, as highlighted in Chapter 1. This follows the damaging effects of the pandemic on populations' health and education in the region, reversing many decades of human capital build up and represents a major setback. We emphasize the importance for the international community to provide adequate assistance to low-income countries in their efforts to address food insecurity and alleviate debt vulnerabilities. Helping build production capacity in agricultural sectors is critical to enhancing resilience to shocks. In the nearer term, efforts should focus on facilitating trade of fertilizers and food. The proposed new food shock financing window under Fund instruments should be put in place as swiftly as possible to help alleviate the impact on balance of payments. To address debt vulnerabilities in the region, more rapid progress is needed in the implementation of the Common Framework. While we are encouraged by the recent positive developments made by the official creditors of Zambia, more remains to be done for this to translate into effective restructuring to alleviate the burden on this country, as other African countries are also awaiting more meaningful progress in this area.

We share overall the WEO's key policy recommendations. Monetary policy should continue to focus on containing inflation and breaking the spiral of inflation expectations while financial policies should be geared towards preserving macro-financial stability. *While we share the view that monetary policy tightening should be sufficiently aggressive, the current labor market dynamics, with decelerating real wages as discussed in Chapter 2, requires that monetary policy tightening be carefully calibrated and should not "overkill", and also be accompanied by clear communication to anchor expectations. Staff comments are welcome.* Fiscal policy should focus primarily on protecting the vulnerable and sustaining activity. To create more fiscal space while ensuring a fair burden sharing, more emphasis should be put on raising tax revenues from sectors that are performing well within the current environment, particularly the energy sector. Regarding the climate agenda, we agree with the main message of Chapter 3, that swift energy transition to a more carbon-neutral society will limit the already high costs of decades of inaction. Finally, we share the emphasis put on strengthening international cooperation, given the exceptionally uncertain outlook and numerous shocks faced by the global economy. We continue to value multilateralism as the best vehicle to addressing shared challenges.

Global Financial Stability Report

As most central banks are pursuing a monetary policy tightening to tame persistent and higher-than-expected inflation worldwide, global financial conditions have tightened significantly and, together with the uncertain growth prospects, they present emerging and frontier markets with significant policy challenges. The massive capital outflows due to higher US interest rates and uncertainty about global and domestic growth outlooks have increased currency pressures and debt-related costs in those countries. While we agree that price stability around the world is crucial for maintaining macro-financial stability, that bringing inflation back to target will likely come at the cost of an economic recession and disruptions in financial markets. The financial stresses and higher prices of risk assets in emerging and frontier markets are likely to intensify, and demand for Fund resources could increase. Against this background, central banks in advanced economies should reassess the pace and effectiveness of current monetary policy tightening to avoid unintended consequences on the economic activity. Further monetary policy tightening should proceed more carefully depending on the source of inflation. Clear communication on prospective monetary policy actions by central banks is key to reduce volatility in financial markets. Emerging and frontier markets, notably those with weaker fundamentals and large sovereign spreads, should reduce risks from high debt vulnerabilities, notably exchange rate and rollover risks. Financial sector supervision should be more vigilant to ensure adequate bank capital and liquidity positions.

We welcome the analytical chapters on private climate finance and asset price fragility in times of stress. We find them very informative and the recommendations appropriate. On the private climate finance, we agree that raising such finance will be particularly challenging given the difficulties encountered to raise private finance in general and would require setting up a strong climate information and governance frameworks to attract investors, including through ESG funds and other innovative finance instruments. We expect the Fund through the RST, policy advice and capacity development to support structural reforms related to these shortcomings. Until such framework is in place, we share the view that MDBs or other international organizations could play a critical role to channel climate financing through climate projects. The UN-supported Central African Forest Initiative (CAFI) is in our view a good example of how climate finance can be channeled to developing countries.

We appreciate the analytical chapter on growing open-end investment funds (OEF) that explores their role in asset price volatility in times of stress. We note that recipient countries, notably emerging markets, could face systemic risks associated with OEFs, including investor runs, in times of stress. We welcome the useful policy recommendations to address their vulnerabilities and limit spillovers to financial markets. In particular, we take note of the staff recommendation that policymakers should consider adopting more extensive regulation of investment funds, in line with Fund's Institutional View, and enhanced disclosure, especially in the absence of adequate liquidity management practices. We support their call for greater regulatory coordination at the global level.

Fiscal Monitor

We share the Fiscal Monitor's emphasis on the importance of government policies to foster resilience during these difficult times. We welcome the analysis of different policy options and strategies to gradually normalizing fiscal policies while protecting the most vulnerable from the impact of the sharp rise in food and energy prices and responding to development needs. We believe that fiscal policy should continue to play an important role in addressing the spillover effects of the war in Ukraine, particularly by directing targeted support to the most vulnerable. Given these difficult policy tradeoffs, defining a credible medium-term fiscal framework is paramount to avoid increasing deficits and limiting the fallout from high energy and food prices. In this regard, we see the importance of domestic revenue mobilization, spending prioritization, and international cooperation. Challenges are particularly acute in LIDCs, where financing needs have increased but fiscal space is very limited. In this context, we stress that greater global effort is critical to help address challenges and increase resilience, notably through emergency financing, humanitarian assistance, and open trade.

We concur that fiscal policy could foster resilience by helping households and firms bounce back, as emphasized in the analytical chapter. We very much welcome the analysis outlined in Box 1.2 on government support to firms in the event of large shocks, including the proposed design considerations as well as the choice of fiscal instruments and strategy that could be more readily deployed. We agree that developing a strategy that sets out desirable policy responses under different scenarios can help governments mitigate tradeoffs and share the view that building fiscal buffers in normal times is essential to be able to respond flexibly in times of crises. In this regards, Fund policy advice and support is essential to help countries with limited capacity strengthen resilience.

Statement by Mr. Pösö, Mr. Spurga, Mr. Kraavik, and Mr. Slettvag on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the very insightful and thorough flagship reports. We find the overall assessment of a slowing global economy faced with downside risks to growth and upside risks to inflation appropriate. The reports clearly lay out the numerous challenges facing the world economy and bring valuable insights to the difficult policy tradeoffs ahead. We thank staff also for very timely and relevant analytical chapters.

World Economic Outlook

We concur with the very bleak prospects for the global economy and the substantial negative risks further weighing on the outlook, stemming especially from Russia's war of aggression. The world has been going through a period of extreme uncertainty since the onset of the COVID-19 pandemic, including widespread disruptions in global supply chains, accelerated inflation, as well as tightening financial conditions. Due to the unjustified invasion of Ukraine by Russia and the war's repercussions, especially in energy and food sectors, the global community continues to face exceptional challenges. We underline the need for multilateral cooperation and global action in working against harmful fragmentation and ensuring that the Russian invasion, along with climate-related events such as heat waves and severe droughts in other parts of the world, do not result in a global food crisis.

High inflation is an immediate challenge for the global economy. Headline and core inflation are high both in advanced and emerging countries, indicating that inflation is broad-based. The pandemic-induced disruptions in global supply networks and the faster-than-expected recovery in demand, aggravated by the implications on energy and food prices of Russia's war, are the main reasons behind broad inflationary pressures.

It is of utmost importance that central banks bring inflation back to targets. Central banks need to act decisively by sufficiently tightening monetary conditions and maintaining a tighter stance for long enough to bring down inflation and keep inflation expectations anchored. Data-dependent and well-communicated monetary policy decision-making will be needed. We recognize that monetary tightening will likely dampen demand in the short term, but its negative effects are far outweighed by medium- to-long-term benefits of price stability. Maintaining central bank independence and credibility will be essential in securing price stability.

We agree that fiscal policy needs to adjust to the new environment of rising inflation and interest rates. Gradual normalization of fiscal policies implemented during the pandemic is needed to contain inflation pressures and to avoid overburdening monetary policy. Ways to tackle the cost-of-living squeeze are needed, but it is important that fiscal measures are temporary and targeted to the most vulnerable and do not work against the efforts to decelerate inflation. More recommendations on labour market policies and how to increase labour supply would be welcome, as such measures would also help dampen inflationary pressures. Prioritization of policies becomes even more relevant in tighter financial conditions, and measures that interfere with price signals, such as limiting price increases through price controls, as well as price subsidies, or tax cuts should be avoided.

We agree that the risks to the outlook are unusually large and to the downside, warranting vigilance from policymakers. We note that inflation is expected to moderate next year. However, further upward shocks to inflation from energy and food prices or wage-price spirals cannot be ruled out. We note that the risk of Russia halting gas exports to the EU has, to a large extent materialized, whereas at the same time EU countries have managed to fill gas storage sites to an 80 percent target level. As Russia has weaponized its energy exports, even more emphasis should be put on energy-saving measures to ease price pressures on decreased global energy supplies. We note the risk of worse-than expected developments in China, due to the zero-COVID policy and real-estate market instability. On methodology, we welcome the innovation of quantifying uncertainty around the baseline projection by fan charts (Box 1.3). Although risks are skewed to the downside, we note that there are also upside risks.

Policy prioritization towards 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. We concur that the transition to green energy, as well as carbon pricing and fuel subsidy reforms, are more important than ever. The pandemic has hastened a digital transformation via new ways of working, and the potential productivity gains should be fully utilized. The multilateral, rules-based world order, must not be allowed to crumble in the face of geopolitical tensions and economic fragmentation.

Global Financial Stability Report

We concur with the overall assessment that financial stability risks are rising amid historically high inflation and tightening financial conditions. The outlook is subject to heightened uncertainty and volatile interest rates and asset prices. Policymakers need to act resolutely to bring inflation back to target, while at the same time be wary of signs of a disorderly tightening of financial conditions and liquidity on global and domestic financial markets. The effects of tightening global financial conditions and strengthening US dollar can have detrimental effects on debt sustainability in vulnerable emerging market and developing economies and require careful monitoring. Capital outflows from emerging and frontier markets with weaker economic fundamentals also need to be monitored closely and the necessary policies implemented to guard against the negative effects of capital flow volatility.

We agree that the significant worsening in market liquidity across asset classes is an important source of fragility and a potential shock amplifier. Liquidity conditions could deteriorate further as central banks continue to tighten. Less resilient market liquidity can pose serious risks to financial stability as witnessed in March 2020. It is important to ensure that all relevant market participants have adequate liquidity buffers in place. Transparency on the interconnections in the global money markets should be improved, including by more detailed data sharing between different jurisdictions. In addition, we also agree that policy action is warranted to mitigate vulnerabilities and risks associated with open-end investment funds.

The energy crisis can pose a threat also to financial stability. We could be facing a prolonged period of tight energy supply and high prices, which will continue to strain the energy markets with potential spillovers to financial markets. It is important to address the immediate liquidity needs of electric market companies and their obligations towards central counterparty clearing houses' (CCP) margin calls. It is also important to analyse current market practices and seek solutions to ensure commodity market functioning in times of stress.

House prices in many developed countries have increased rapidly and the risk of a significant fall in prices has amplified. We note that a range of factors, some specific to the pandemic, have contributed to these price gains and have led to high valuations in many countries. Higher borrowing costs, affordability pressures, and deteriorating economic prospects could trigger potentially large declines in asset prices, including house prices. In an adverse scenario, house price movements could be amplified if households are forced to deleverage in a falling market.

Fiscal Monitor

We welcome the focus on how fiscal policies can effectively support and build a resilient society in times of stress. The rapid evolvement of the energy crisis reduces the time available for calibrating the best solutions for support that would not result in too much distortion in the price mechanisms. The COVID-19 crisis showed the value in being able to quickly leverage existing policy tools and institutions, but it also showed that such an approach may lead to less-than-optimal outcomes. There could be a trade-off between support being timely and effectively targeted. On some occasions, in the interest of speed, discretionary fiscal support may be directed to firms or households that are not most in need of support. Support measures can also have adverse effects, e.g. through slowing productivity growth or distorting incentives to work.

We agree on the need to build back fiscal buffers and to bolster the resilience of public finances. We note that the problem of limited fiscal space is especially acute for emerging and developing economies, but this may increasingly be an issue for many advanced economies as well. In circumstances where large discretional additional fiscal spending decisions are made due to a crisis, there is a risk of other fiscal spending being "camouflaged" into such spending, when the opposite, reducing non-crisis-related fiscal spending, would be necessary.

More in-depth analysis on how to rebuild fiscal buffers effectively would be warranted. Specifically, we would welcome analysis on how fiscal support should be financed in the short run, and in the longer run, which structural reforms best enhance the resilience of public finances and the wider society. Finally, we encourage analysing the green transition from the point of view of fiscal sustainability. We welcome the concept of semi-automatic stabilizers, which cushion economic shocks, while being less costly than conventional stabilizers. We encourage staff to continue their work on designing effective semi-automatic stabilizers.

Statement by Mr. Bhalla and Mr. Amarasekara on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We compliment staff for their rigorous analytical work in drafting the World Economic Outlook, the Global Financial Stability Report and the Fiscal Monitor, at a time when the global economy is facing sequential economic shocks. Cross-cutting themes covered in the three reports adequately establish the key priorities for global policymakers, including the taming of globalized higher inflation, preventing a prolonged recessionary trend, maintaining closer cooperation between fiscal and monetary policymaking, supporting the vulnerable, reaping the benefits of digitalization while mitigating associated risks, addressing the longer-term challenge of climate change, and perhaps most importantly, avoiding fragmentation and furthering multilateral cooperation.

We would like to provide the following comments for emphasis:

World Economic Outlook (WEO)

The WEO projects global growth to slow from 6.0 percent in 2021 to 3.2 percent in 2022 and 2.6 percent in 2023. The projected slowdown is more prominent in advanced economies (AEs). The growth in emerging market and developing economies (EMDEs) is also expected to slow from 6.6 percent in 2021 to 3.7 percent in 2022 and 2023. India remains the only large economy with sustained growth of above 6 percent in 2022 and 2023.

The reasons for the global growth slowdown in the next couple of years include multi-decade-high inflation, normalization of monetary and fiscal policies, the war in Ukraine, and scarring from the COVID-19 pandemic. The WEO crucially notes that downside risks to the outlook are unusually large and the global economy's future health rests critically on the successful calibration of monetary policy, the war in Ukraine and its global spillovers, including high food and energy prices, and possible further pandemic-related supply disruptions. If risks materialize, there is a possibility of global growth falling below 2.0 percent in 2023.

Understandably, addressing the cost-of-living squeeze is high on the agenda of global policymakers, and the WEO provides useful analytical inputs on dissecting this issue. Food prices, as well as other commodity prices, have shown some decline in recent times. This development could help policymakers tame inflation, although longer-term focus must remain on tackling disruptions to agricultural production due to climate change. We would like to add that disruptive trade practices that affect global food distribution must also be dealt with in addressing food shocks.

We agree with the WEO view that the risk of monetary policy miscalculating the right stance to reduce inflation is high, and policy mistakes are possible on either under- or over-tightening of monetary policy, although decisive monetary policy measures are essential in bringing inflation back to more desirable levels, particularly by preventing a de-anchoring of inflation expectations for too long. A key observation presented in the WEO is that food and energy inflation may not be the only dominant drivers of inflation, as reflected by high core inflation and rising services inflation. The WEO engages in a helpful self-evaluation on why high inflation in 2021 and 2022 could not be predicted by forecasters, including the Fund (Box 1.1). The explanations include the faster than expected recovery of the global economy in 2021, supported by fiscal and monetary policy stimulus.

With inflation breaching the single-digit threshold even in some AEs, the focus of monetary policy must remain on taming inflation, whereas fiscal policy should play the supportive role of maintaining overall tightness while protecting the poor and the vulnerable through targeted support. The financial system stability must be preserved through appropriate macroprudential policies. We would like to highlight that the role of timely communication on policy changes would be very important for managing the economy, especially from the systemic AEs.

We also note that the impact of inflation on lower-income groups in developing economies is disproportionally high. In particular, lower-income earners are severely affected by high food inflation, an issue which cannot be addressed through monetary policy tightening alone. The WEO special feature on “Market Developments and Food Price Inflation Drivers” provides additional insights on the spillover effects of the war in Ukraine across the globe, although it may have been appropriate to point out that upward movements in commodity prices commenced before February 2022.

As the WEO notes, widespread debt distress in vulnerable economies remains a key risk to the global economic outlook. Increased uncertainty and volatility have dampened global risk appetite. Policy spaces in many of these economies have been exhausted in tackling the pandemic. Global policy normalization amidst high food and energy prices has severely weakened the balance of payments position and market access of such countries. The realization of further shocks and a further deterioration of risk perception could trigger a widespread debt crisis and increase the risk of a global recession. In this context, the WEO stresses the urgent need for a well-functioning G20 debt resolution mechanism.

We also note the significant expected slowdown in global trade growth from 10.1 percent in 2021 to 4.1 percent in 2022 and a mere 2.5 percent in 2023. Global trade outlook is also tilted to the downside with the appreciation of the US dollar and geopolitical tensions. Excessive external imbalances could trigger trade tensions and protectionist measures, which could exacerbate trade and current account imbalances further.

We found the listing in the WEO of policy actions over different horizons to move the global economy out of a high-inflation, low-growth position to a low-inflation, high-growth trajectory useful. Policies with immediate impact include those to fight inflation, with due regard to timing of costs and benefits of disinflation, international capital flows, and monetary and fiscal policy coordination; policies to protect the vulnerable during the adjustment; and warding off pandemic risks. Policies that could have medium-term payoffs include improved frameworks for debt resolution, preparing for tighter international financial conditions, and structural reforms focusing on the labor market, education, business climate and digital infrastructure. Policies with longer-term benefits, as listed in the WEO include climate policies and those focused on strengthening multilateral cooperation and avoiding fragmentation. We would like to emphasize that those policies with longer-term benefits are equally urgent, and efforts to stabilize the global economy in the near-term must not divert attention of global policymakers from these long-term priorities and essential structural reforms. In this regard, we fully endorse the WEO's view in Chapter 3 that decades of procrastination have transformed a smoother shift to a more carbon-neutral society into a likely challenging transition.

The analysis presented in Chapter 2 on Wage Dynamics Post-COVID-19 and Wage Price Spiral Risks is of vital importance. As noted in the WEO, unemployment rates alone may not be sufficient to assess the labor market conditions. On the other hand, there is a need to limit second-round effects of inflation occurring through wage price spirals, while providing income support to the workforce in the wake of high food and energy costs. We broadly agree with the Chapter's conclusion that anchoring expectations is critical in shaping wage and price prospects.

On terminology used in the WEO, we observe that the WEO refers to China's "property sector crisis", whereas the GFSR, which analyses China's housing market in greater detail, avoids the use of the term "crisis" and instead refers to China's "property sector downturn" or "housing market risks". In addition, the title of Figure 1.18 reads "Inflation Likely to Stabilize Next Year", an observation that is not supported by the WEO analysis, where inflation in AEs and EMDEs is projected at 4.3 percent and 7.8 percent, respectively, in 2023. Staff may comment.

Global Financial Stability Report (GFSR)

The ongoing tightening of monetary policy in most parts of the world has amplified global financial stability risks that have been accumulated since the GFC amidst ultra-low interest rates and low volatility. Global financial conditions have tightened in response to monetary policy normalization by major-economy central banks and rising risk aversion of investors. In this context, we agree that a number of downside risks highlighted in the April 2022 GFSR have crystallized, while the balance of risks has further deteriorated as a result of heightened uncertainty on economic and macro policy outlook.

The pace and the magnitude of monetary policy tightening by EMDE central banks have been mixed due to the variety of shocks that each region faces. The large emerging market economies (EMEs) have displayed greater resilience to external shocks, although domestic financial sector vulnerabilities have become apparent in some countries.

Meanwhile, the frontier markets are disproportionately challenged by higher global interest rates and refinancing constraints, while the likelihood of default is high amongst many of these countries with poor fundamentals as noted in GFSR. According to the estimates presented, further tightening of global financial conditions could raise the number of distressed sovereigns from 17 to 31, and nearly 40 countries would have spreads exceeding 700 bps, thereby severely restricting their market access as well. Furthermore, hard currency bonds issued by frontier markets are expected to mature in increasing volumes over the next several years, while on the other hand, frontier market hard currency issuances have declined sharply in 2022 to below US dollars 10 billion, from around US dollars 30 billion on average over the past five years. These concerns, as well as the rise in frontier market debt to GDP ratios and interest-to revenue ratios over the past decade, highlight the need for preemptive measures to reprofile and restructure debt of such countries. As the GFSR has highlighted, we note that the experiences of several countries including

Chad, Ethiopia, Zambia, Suriname and Sri Lanka point to the complexity of debt restructuring. In this regard, we reemphasize the importance of streamlining the processes of implementing the G20 common framework for the 69 eligible low-income countries in order to expedite debt treatment, and of exploring the pros and cons of expanding this framework to middle-income countries in distress. We endorse the policy recommendation that sovereign borrowers should enhance efforts to contain risks associated with their high debt vulnerabilities, through early contact with their creditors, multilateral cooperation and support from the international community, while displaying their own commitment through the implementation of credible medium-term fiscal consolidation plans.

With regard to the Fund's advice on monetary policy, the WEO appears to be more pragmatic than the GFSR. The GFSR emphasizes that resolute action by central banks is required to credibly bring inflation back to target and avoid a more painful and disruptive subsequent tightening, and states that policymakers should heed the lessons of the past, namely historical experience of the US monetary policy in the 1970s and early 1980s. We believe that monetary policy tightening is essential to tame inflation early and decisively; at the same time, it would be useful to have an analytical framework that establishes that core inflation is affected by volatile non-core prices. It cannot be ignored that monetary policy tightening has significant spillover effects on all aspects of the economy, including sovereign, corporate and household debt as well as on the financial sector. *Therefore, we are of the view that it is appropriate to maintain language consistency between the GFSR and the WEO, where the latter also includes warnings on possible policy miscalculations in taming inflation. Staff may comment.*

We agree with the policy recommendation that some EMEs could intervene in the foreign exchange market and relax capital inflow measures to manage the global tightening cycle, thereby reducing financial stability risks. This is supported by the GFSR observations that foreign reserves buffers are generally healthy in most emerging markets. We also observe that this recommendation must not be generalized, as reserve adequacy levels remain breached in many EMEs while these levels have depleted faster in others.

The global corporate sector has not been spared from emerging vulnerabilities. Recession fears and rising costs have affected profitability of large firms, while bankruptcy risks have risen amongst smaller firms. Given high levels of leverage, such heightened risks could translate into financial stability concerns, particularly in economies with weaker financial sector buffers. In this regard, the Global Bank

Stress Test results of the Fund presented in the GFSR are important. According to stress tests, a global recession in 2023 would result in close to 30 percent of emerging market banks breaching capital requirements and requiring considerable recapitalization.

We note the analysis presented on housing market vulnerabilities. House prices have surged by more than 20 percent in some economies since the onset of the pandemic, and markets are at risk of declines in many economies. It is observed that the emerging market potential decline over the next three years is 23.5 percent, and the real house price declined could be significant. Appropriate macroprudential tools are essential to address a further buildup of such vulnerabilities.

The extreme volatility in the crypto market has underlined the inherent riskiness of this market and entities therein, which have no underlying cash flows or intrinsic value and are akin to Ponzi Schemes. Strong international cooperation is essential to provide guidance and contain spillover risks in managing the crypto market. We believe that the Fund should take the lead role in mobilizing international cooperation and providing consistent advice and technical assistance to its membership to prevent the occurrence of a global financial market meltdown, if activities in the crypto market are allowed to continue functioning across the globe.

We thank staff for the analytical chapter on climate finance. Funding requirements to meet global climate targets are staggering. We agree that underinvestment in climate change mitigation and adaptation in EMDEs may lead to global financial stability risks through greater exposure to systemic climate-related financial risks. Given the underdeveloped nature of green financial markets and climate information architecture in many EMDEs, they could benefit from closer engagement with multilateral development banks and development finance institutions in developing the necessary infrastructure, introducing new instruments, and mobilizing private finance for green ventures. The operationalization of the Resilience and Sustainability Trust (RST) will further enhance the Fund's role in climate risk mitigation.

Chapter 3 provides useful insights on the behavior of open-end investment funds and associated risks. In particular, the liquidity mismatch between the assets and liabilities of open-end investment funds poses threats to global financial system stability. We note that most open-end investment funds are located in AEs, with a rising share of such funds being invested in EMs. We agree that this trend could lead to significant contagion effects and require enhanced surveillance by financial sector supervisors and regulators, particularly in EMs which have seen an increase in investment by such funds.

Fiscal Monitor (FM)

The level of fiscal space available to different countries determines how governments maneuver fiscal policies to address the numerous challenges in a world economy experiencing high food and energy prices and resultant inflation, monetary policy tightening, recession concerns, geo-political tensions, and rising social unrest. According to the FM, such fiscal spaces have diverged since the onset of the COVID-19 pandemic. Following mass-scale fiscal support extended during the first year of the pandemic, fiscal deficits have fallen sharply in many advanced and emerging market economies in 2021 and 2022. Many oil exporters experience fiscal surpluses. High-debt countries which exhausted fiscal space in responding to the pandemic are facing the challenge of fiscal consolidation at a time when economies require fiscal support to weather the multitude of shocks facing them.

The FM appropriately sets its perimeter of discussion to the subset of fiscal policies that help people and firms rebound from job and income losses after a large crisis, *i.e.*, fostering resilience. We agree that the experience gained during COVID-19 pandemic and also the global financial crisis, would provide fiscal policymakers guidance in managing large adverse shocks and making society more resilient. This experience in handling of fiscal and monetary levers of an economy would help the authorities to fight inflation through coordinated monetary-fiscal action, while using fiscal policy to protect the most vulnerable segments of the economy through speedy action.

Increasing food and energy prices have added pressure on fiscal policies. In order to avoid possible social unrest, governments have provided fiscal support though price subsidies, tax cuts, and direct cash transfers to the needy, in addition to regular fiscal expenditure on the provision of economic and social services. Staff estimates the additional expenditure to amount to more than 0.5 percent of GDP. In low-income developing countries, such support has broadly focused on food-related measures, indicating the intensity of the global food crisis and its disproportionate impact on the poor.

The FM estimates global government debt in 2022 to be 92 percent of GDP, 9 percentage points higher than before the pandemic. Higher inflation has contributed to debt reduction in the few countries where debt levels decreased during the year. We agree with the conclusion that inflation must not be used as a strategy to lower debt. Persistent high inflation is bound to raise borrowing costs, which will add to fiscal pressures, particularly in low- and middle-income economies which are already in or at high risk of debt distress. Similar to the WEO and the GFSR, the FM also repeats the call for a streamlined Common Framework for debt relief for countries in distress.

We agree that consistent medium-term policy frameworks for the post pandemic world is essential to improve the global fiscal situation, particularly in countries where fiscal space is exhausted and there is a need to rebuild buffers. The FM correctly notes that fiscal consolidation also provides a powerful signal that fiscal and monetary policymakers are aligned in their fight against inflation, thereby reducing the required size of monetary policy adjustments to keep inflation expectations anchored. Such coordinated signaling would also help keep debt servicing costs lower than otherwise.

With regard to policy implementation, particularly after prolonged support for economies to face various headwinds, there is a need to revamp fiscal rules enabling the return of investor confidence. As the FM suggests, we agree that such prolonged fiscal stimulus is best unwound through gradual fiscal trimming, rather than an abrupt fiscal pullback if an economy experiences a loss of market confidence.

The FM usefully summarized the experience of the COVID-19 pandemic that led to innovative and forceful fiscal responses. These include the examples of a) social protection systems that enabled rapid disbursement of support to the needy, including through digital innovations and inclusive strategies as observed in India and several other EMDEs (Table 1.1), b) well-targeted job-retention schemes, which allowed income stabilization, c) avoiding general prices subsidies and controls in favor of targeted relief to the needy, and d) exceptional liquidity support to firms, which needs to be limited to major crises.

We thank the staff for the insightful Box articles titled a) “Building a Resilient Future” focusing on investing in health care and pandemic preparedness, enhancing equal access to opportunities and adapting to climate change and improving resilience to natural disasters, and b) “Designing Government Support to Firms During a Crisis”, which focuses on policy priorities, sequencing, assessing firms’ viability, targeting support, choosing appropriate policy instruments, exit strategy and managing fiscal risks. We find the country examples given in these box articles, as well as elsewhere in the report useful for the authorities to assess the adequacy of their own policy measures, policy innovations, and policy mistakes.

We agree with the views expressed in the FM on the role of the private sector as well as the need for greater global cooperation to foster resilience. With regard to the private sector, incentive mechanisms to encourage the private sector to build its own resilience will enable governments to focus on protecting the most vulnerable. Channeling financial assistance, particularly grants, to the vulnerable economies and removing excessive barriers to trade are two important global policy measures that can be used to support economies that are facing multiple waves of crisis.

Statement by Mr. Moreno, Mr. Guerra, Mr. Romero Tarazona, Mr. Cartagena Guardado, Mr. Rojas Ramirez, Ms. Lankester Campos, Mr. Lopez, and Ms. Moral Betere on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

We thank staff for the comprehensive flagship reports. We broadly concur with staff's analysis on the prospects and risks of the global economy and financial markets. The world economy has experienced successive and overlapping global exogenous shocks with dramatic humanitarian, social and economic consequences. Russia's war against Ukraine has entailed a new and unexpected shock which has stalled the uneven recovery from the pandemic, aggravating some vulnerabilities and scarring effects, while triggering a combined food and energy crisis with dramatic consequences in many vulnerable countries. Moreover, the war is adding new threats and uncertainties to the global economic and financial systems, including a generalized growth slowdown, protracted global supply chain restrictions, widespread inflationary pressures, and economic and geopolitical fragmentation. Policy makers have reacted to these developments conducting a faster than projected normalization of monetary policies, adding new challenges as financial conditions tighten and COVID-related fiscal support unwinds.

On these grounds, the Fund must stand as a firm defender of multilateralism, international cooperation and coordinated policy action as the best way to solve the current crisis. On what follows, we offer specific comments on the reports.

World Economic Outlook

We note the generalized slowdown of the global economy during the first half of 2022, while uncertainty remains extremely high and inflationary pressures are peaking. Compared to the April 2022 WEO, staff has downgraded global projections for 2022 and significantly for 2023, pointing to one of the weakest growth forecasts in decades. By regions, we observe certain heterogeneity between the downward revisions for advanced economies and the more contained revisions for EMDCs.

We concur with staff on the main drivers of these projections. The spillovers from the Russia's invasion of Ukraine, mainly through indirect effects on energy and food prices, compounded by potential energy supply restrictions, are severely impacting Europe and they are spreading globally. Soaring inflation is eroding confidence and the purchasing power of households, especially of the most vulnerable groups, increasing inequality, and delaying development goals. The generalized and faster than expected normalization of monetary policy, especially in the US, is inducing a significant tightening of financial conditions and a large appreciation of the dollar in a context of high levels of debt, which is exacerbating debt vulnerabilities in many countries. Pandemic-related outbreaks and lockdowns in China are adding pressure to the global supply chains. All in all, these developments are affecting the economic activity and dampening international trade and capital flows globally.

Staff's forecasts for 2022 and 2023 are based on plausible but delicate assumptions. Uncertainty continues to be the most prominent feature of the economic outlook. Risks are mainly tilted to the downside, mostly related to the Russia's war in Ukraine, disruptions of gas supply to Europe, potential policy calibration mistakes, debt distress in vulnerable countries, or potential outbreaks of the pandemic. In addition, we agree with staff that fragmentation is one of the most prominent risks to the global economy which could exacerbate the energy and food crisis, trade and capital flows restrictions, and political and social conflicts.

We appreciate staff's analysis on inflationary forces. Past forecasting errors point to excess demand as the main driver in 2021, while in 2022 supply-side factors are playing a prominent role. We also note that mark-ups, despite their rapid increase in past decades, are not having a significant effect on current inflation, while wage pressures continue to be contained in most countries, helping to limit second-round effects and to maintain inflation expectations broadly anchored. Inflation forecasts have been significantly revised upwards since April, and they are projected to peak in the third quarter of 2022 and moderate significantly going forward. The question is how a potentially protracted increase in production costs could exacerbate the pass through to underlying inflation and entrenched broad inflation in the future, in a context of counterbalancing forces related to monetary policy normalization and growth slowdown.

We continue to underscore that the main policy priorities stand at the international level. First, a peaceful resolution of the war in Ukraine; second, invigorating multilateralism to avoid fragmentation; and third, reinforcing vaccination efforts in the most vulnerable countries. The Fund should remain a strong advocate of international cooperation to address global challenges, including the energy and food crisis, climate change, digitalization, free trade, and debt treatment and resolution. The IMF should stand ready to support all members with financial needs and ensure a well-tailored surveillance and CD.

On the domestic front, policy makers confront difficult trade-offs in an extremely uncertain environment. Policy actions should be tailored to country-specific circumstances and framed within an adequate policy mix that includes structural reforms and sectoral policies. We agree with staff's call for fighting inflation as a priority —given its negative consequences on growth, inequality and financial stability— while protecting the recovery and mitigating spillovers to the most vulnerable. These policy dilemmas make more prominent the need for an adequate policy mix.

The pace of monetary policy normalization should depend on the balance between demand- and supply-side drivers. Policy makers should be aware of the risks and effectiveness of excessive policy rates movements when calibrating their response. Developing and emerging economies should also consider the costs of not acting in a timely manner to contain inflationary pressures. *Additionally, the current context of synchronized monetary tightening at the global level calls for caution when calibrating the adequate policy stance. Disregarding the spillover effects from other central banks' actions could lead to a policy overshooting, increasing the risks of a global recession. Staff's comments are welcome.*

Fiscal policy should maintain certain degree of flexibility while ensuring fiscal sustainability. The authorities should respond to the ongoing and potential shocks with focused and targeted measures, especially in countries with negative output gaps, although the general policy stance should be aligned to ensure inflation control and fiscal sustainability in the medium term. Additionally, macroprudential and financial policies should respond to developments in financial conditions and should also be targeted to specific sectors or pockets of vulnerabilities to contain potential threats to financial stability.

This policy mix should be complemented with energy policy and structural reforms to strengthen the fundamentals of the economic systems. Although in the current environment fiscal and monetary policy coordination becomes even more necessary, we miss some references to the need for complementary sectoral —notably energy policies— and structural policies to deal with inflation given its significant supply-side component. In this vein, temporary measures to contain energy prices can also be helpful for the inflation strategy and to reduce the need for additional monetary policy tightening, while supporting investment for structural energy supply diversification, as well as for promoting the green transition, should remain a priority. Equally important, the structural agenda should tackle climate change, digitalization and inequality in a comprehensive way. All those policies will be instrumental to increase the resilience and sustainability of the growth models while maintaining social stability.

Policy challenges in small LMICs and EMs are larger than those in advanced economies. We share staff's views that the ongoing shocks are exacerbating the scarring effects from the pandemic. At the same time, the food and energy crisis are spurring social and political tensions, while the ongoing monetary normalization is adding pressures to EMDCs financial conditions, which complicates policy trade-offs and crisis management. Exchange rate flexibility and polices to reduce external vulnerabilities would help to absorb external shocks, although well-justified temporary measures, in line with the IV and the rational of the Integrated Policy Framework, could be needed to address specific episodes of market distress.

Global Financial Stability Report

The GFSR rightly highlights the array of sources generating extraordinary uncertainty to the global economy. From the war in Ukraine, monetary policy normalization and tightening, higher inflationary pressures in financial markets to volatility in the price of risk assets and recession fears. The balance of risks is skewed to the downside.

Inflation is a major risk to financial stability and to social stability in many countries due to its perversive negative effects in the most vulnerable population. Central banks in advanced and emerging economies have taken actions to reign on inflation but the uncertainty regarding the possible path of inflation is compounding the challenges for policy makers. In this regard, we see the risk that inflation may stay high for longer than expected, and markets are starting to recognize this.

Monetary policy normalization should continue decisively but cautiously according to specific domestic circumstances. We agree with staff that moving slowly to reign on inflation can prove to be more costly in the medium term, and that decisive action is necessary to bring inflation back to target in many countries and anchor expectations. For the latter, a clear communication strategy from central banks is key. Also, central banks, both in advanced and emerging markets, should consider deploying different tools to address market disruptions while considering the medium-term effects of those policies and the negative spillovers to other countries.

In the Euro Area, the authorities have been taking swift actions to ensure that monetary policy is transmitted evenly across its member countries. An example of these efforts is the recent announcement of the Transmission Protection Instrument. Clear guidance and communication from advanced economies regarding their normalization process is crucial to avoid unwarranted volatility. **Emerging and developing economies are also facing very challenging times.** Global financial tighter conditions and the increasing flight to quality have been reflected in exchange rate depreciations, adding to inflationary pressures. It is worrisome that there is a risk for further sovereign defaults in frontier markets.

Many countries lack policy space after the pandemic. The IMF should closely follow developments in developing and frontier markets to support member countries in managing the debt crisis risks. Also, we welcome staff´s analysis and recommendations regarding the promotion of the development of local markets. The current context of increased volatility and tighter financial conditions in global markets is a remainder of the important role that developing local domestic markets have in securing a more stable external position and a more resilient domestic financial sector.

Policy makers should reinforce data collection and financial regulation to mitigate financial stability risks, including in the Fintech world. Having sufficient and reliable data to analyze financial vulnerabilities is essential for horizon scanning and supervision by prudential authorities. This includes the collection of data on cross-borders exposures of private debt markets and nonbank financial institutions. Furthermore, policymakers need to address Fintech risks to users and investors, to market and financial integrity and to macro-financial stability not only in crypto asset markets but within digital financial instruments in the overall. *Can staff elaborate on the risks' related to the use of central bank digital currencies, in particular in developing economies? What role could CBDCs have in financial deepening?*

Fiscal Monitor

Rising inflation and higher interest rates have exacerbated fiscal policy trade-offs and accentuated the divergence across countries. We agree with staff that persistent high inflation could negatively impact public finances, undermine medium-term economic growth and result in greater debt burdens. In the medium term, the need for a consolidation strategy and credible fiscal frameworks is clear to help rebuild fiscal buffers and trigger confidence that will allow a better and more flexible response during any future crises.

Certain degree of fiscal policy flexibility is important to mitigate the impact of the crisis, especially among the most vulnerable. In this regard, we appreciate the analysis made by staff of the fiscal responses to protect households during the pandemic, and the reassessment of policy tools based on the lessons learnt. The effective stabilization achieved by job-retention schemes, the capacity of firm guarantees to avert widespread bankruptcies, or the reach of unemployment insurance schemes show the importance of developing the right tools, social safety nets, and strategies in advance. However, the analysis is mainly backward-looking, and it does not consider how these actions might have helped to fuel current inflationary pressures, which is a key question when designing future interventions in times of crisis. *Staff's comments are welcome.*

We concur with staff that ensuring food and energy access to the most vulnerable groups should be a priority. We note that staff prioritize support to low-income households over price subsidies or controls. Although we agree that fiscal support should be designed in a way such that market incentives are preserved, and costs remain contained, divergences across countries call for diverse fiscal strategies. In most countries, high inflation is already affecting a wide segment of the middle-class population in addition to the most vulnerable. Further, in the case of some emerging markets and developing economies without strong social safety nets, targeted support is not always feasible and there is a need to appeal to costly price subsidies adding to already over-stretched budgets. Global support to these vulnerable countries becomes of the essence.

The pandemic and the war against Ukraine have highlighted the need for global cooperation to enhance resilience. As with the pandemic, cooperation will be crucial to overcome the consequences of this new shock and the main economic challenges ahead, such as energy and food disruptions, climate change, or debt sustainability. Regarding the latter, a quick implementation and increased participation in the G20 Common Framework will be essential to address debt vulnerabilities. In addition, the operationalization of the Resilience and Sustainability Trust will be key to support climate adaptation in vulnerable countries. Finally, we strongly support the proposal for a New Food Shock Window Under the Rapid Financing Instrument and Rapid Credit Facility and we look forward to the future Board discussion.

Analytical Chapters

WEO Chapter 2: "Wage Dynamics Post-COVID-19 and Wage-Price Spiral Risks"

We appreciate staff's analysis on wage-price spirals. This is a very relevant topic in the current inflationary environment where second-round effects, although broadly limited so far, may fuel additional inflationary pressures, and therefore condition the intensity of the current tightening stance of monetary policy. We are somehow reassured by staff's findings that in past episodes of similar wage, price, and labor market dynamics, the economy did not show signals of subsequent wage-price spirals. Model simulations also show that even when cost-push shocks occur, negative real wage gaps —as in the current context— help to anchor inflation. In any case, we must be aware that these results are sensitive to structural breaks and country-specific circumstances related to the structure and flexibility of the economy, the wage setting mechanisms, the market power of firms, or the cyclical situation of the labor market among other factors. We share staff's views that the formation of inflation expectations is another relevant factor to explain price-wage dynamics. As shocks become perceived as less temporary and more protracted, economic agents may adapt to the new context of more persistence inflation with a more backward-looking perspective. In this case, monetary authorities' credibility becomes an even more relevant factor to facilitate driving inflation back to target.

WEO Chapter 3: "Near-Term Macroeconomic Impact of Decarbonatization Policies"

We share staff's concerns on the procrastination of policies to a more carbon-neutral society and on the need to catch up and swiftly implement policies over the medium term to make costs manageable. We must acknowledge that climate change continues hitting especially the most vulnerable LMICs, eroding people's well-being and wealth and affecting the government's budget. In this vein, a more carbon-neutral society can make the difference for the most vulnerable countries of the Fund membership. We missed in this chapter further developments on how the geopolitical tensions may additionally delay the 2015 Paris agreements. The chapter briefly notes that the rise in geopolitical tensions related to the war in Ukraine, and the deterioration of China-US relationships may hurt global cooperation on climate goals; in this vein, deeper insights on this front may complement the analysis. It would also be worth to further ponder how the scares left by the COVID-19 pandemic in the fiscal accounts of some of the most vulnerable countries, coupled with the fiscal and monetary impact of the geopolitical tensions, may delay not only the cooperation but also the ability to approach the decarbonization agenda. The international cooperation would also be instrumental for a faster pace on clean and renewable energy generation, especially in countries that are falling behind the Paris Agreement´s goals.

GFSR Chapter 2: "Scaling up private climate finance in emerging markets: challenges and opportunities"

We broadly concur that to reduce the greenhouse gas emissions (mitigation finance) and to adapt to the physical effects of climate change (adaptation finance), emerging markets and mainly the small and most vulnerable LMICs economies need significant financing in coming years. We also share the concern that adaptation finance, despite its significant benefits for societies and for the world, often does note generate sufficient private financial returns. In this field, the IMF must continue to play a catalytic role, not only through capacity development, but also providing financing through the RST to address longer-term structural challenges, including climate change. In this vein, we highlight that RST should be tapped to develop a conductive investment climate promoting reform measures to improve the regulatory environment and increase the resilience of the infrastructure to address climate change. Further cooperation with other IFIs for widening the options for financing mainly the small LMICs (and most recurrently shocked by climate change events) is key in this area.

GFSR Chapter 3: "Asset Price Fragility in Times of Stress: The Role of Open-End Investment Funds"

We agree with staff that the Open-End Investment Funds (OEF) vulnerabilities and market stress may amplify the risk of liquidity mismatches, compromising global financial stability. OEFs offer daily redemptions, but at the same time maintain significant holdings of illiquid assets, which increases asset price fragility, especially in periods of high financial conditions or monetary policy uncertainty. The report shows how OEFs that invest in illiquid assets such as corporate fixed income are more prone to runs, provoking cascading effects onto other mutual funds which are critical to canalize household savings. We agree with staff on the need for monitoring liquidity risk management policies, enforcing the application of liquidity management tools. Specifically, the chapter proposes several measures to eliminate the first-mover advantage that the first investors to redeem their positions currently enjoy, such as swing pricing, redemption fees and gates, or mandatory requirements on minimum liquidity buffers or on illiquid assets positions. We encourage staff to further advance in this matter to generate consensus on the effectiveness of these regulatory tools and their full implementation. We agree on staff´s recommendations to policymakers on investigating the viability of exchange-traded funds (ETFs) as an alternative to OEFs, implementing policies oriented to enhance liquidity management tools and disclosure.

Statement by Mr. Mizuguchi, Ms. Kashima, Mr. Naka, Ms. Fukuda, and Ms. Ogihara on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

Significant price increases and energy supply shortages due to Russia's war against Ukraine, recovery from the pandemic and persistent supply constraints are posing severe challenges to the global economy. Some countries have experienced inflation spikes not seen in decades, which has had substantial impacts on households, business activities, and financial conditions. In many countries, monetary policies have tightened, while fiscal buffers have become more limited, making it even more important to carefully calibrate and coordinate policies. Ending Russia's war against Ukraine is of the utmost importance in addressing the humanitarian and food crises caused by the war. International cooperation is becoming more crucial, as fragmentation deepens and the debt crisis in fragile countries becomes a greater threat. In this context, **we appreciate staff's continued efforts to provide valuable flagship reports with informative Analytical Chapters, which are well focused on the analysis of the current exceptional circumstances of severe downside risks and growing uncertainty, while also providing guidance on the necessary policy measures.** In order to tackle the unprecedented challenges, we expect that the Fund will continue to provide member countries with tailored surveillance, lending, and CDs, while utilizing its macroeconomic expertise.

World Economic Outlook

The global economy has slowed significantly as a result of rising inflation, monetary tightening, and Russia's war against Ukraine. The risks to the outlook continue to be on the downside, and the majority of countries' growth projections for 2023 have been revised downward since the previous update. Although some economies, such as commodity-exporting countries, are performing relatively well, there are substantial concerns regarding the slowdown in major economies, including the U.S., Europe, and China, and negative spillover effects to other countries. Under the current challenging circumstances, continuing support towards vulnerable groups is crucial, but fiscal policy must maintain its tightening stance and avoid overburdening monetary policy. In addition, as highlighted by staff, the ongoing shock could increase medium- and long-term scarring on productivity and human capital, especially in emerging markets and developing economies. Consequently, it is even more vital that the Fund provides tailored policy advice and surveillance taking into account each country's unique circumstances.

While decisive monetary policy in tackling inflation should be a top priority, policymakers should remain vigilant towards economic developments in order to avoid overreacting or underreacting. Effective coordination of fiscal and monetary policy is crucial than ever, and we expect the Fund to provide timely and practical policy advice to member countries. Although long-term inflation expectations have remained relatively stable in most major economies, there is a great deal of uncertainty surrounding the price outlook, including pressures from the recovery of demand, the escalation of the war, and China's pandemic policies, as well as their impact on supply constraints. In addition, the transfer of supply-side inflation to consumer prices and its spillover effects on wages need special attention taking structural factors into account; we appreciate staff's thorough analysis of wage and price dynamics in Chapter 2. Especially, the study indicates that inflation expectations have a greater impact on wage outlooks than labor market conditions, and thus highlights the need for more upfront and decisive monetary policy. Given the concerns toward high market volatility as analyzed in the GFSR, price spillovers across countries should also be carefully monitored.

Volatility in the foreign exchange market has intensified to historical levels, and rapid and asymmetric fluctuations in the Japanese yen have also been observed, in part due to speculative activities. Exchange rates are determined by the market in principle, but excessive volatility driven by speculation could have adverse effects on the economy and financial markets, which is often considered to exacerbate risks associated with inflation, capital outflows, and debt. In this context, the recent intervention by the Japanese government is consistent with the understanding agreed upon by the G7, G20, and IMFC, which is that "excessive volatility or disorderly movements in exchange rates can have adverse implications for economic and financial stability".

The ongoing geopolitical fragmentation has heightened the importance of global cooperation and resilience in all areas, including the pandemic, debt risks, food crises, and free trade. Progress in the Common Framework will reduce debt and financial risks of developing economies and enhance their fiscal capability. In addition to addressing urgent legislative actions, it is vital to prioritize structural reforms to strengthen long-term resilience and raise potential growth, such as an upgrading of energy supply structures and decarbonation initiatives. In this regard, we appreciate the relevant and informative analysis of the short-term macroeconomic costs and long-term social benefits of climate change policies provided in Chapter 3. Specifically, we agree with the necessity of feasible and well-balanced climate policies, as well as the importance of monetary policy credibility to ensure that climate programs do not contribute to an acceleration of inflation.

Global Financial Stability Report

While monetary policy tightening is a necessary response to persistent inflation, we note with concern that tighter financial conditions have been leading to increased global market volatilities especially in recent quarters. Considering the staff observation that funding liquidity has already started to deteriorate, we encourage staff to continue careful monitoring of market liquidity. Furthermore, aggressive rate hikes in advanced economies, particularly in the U.S., have been causing heterogeneous spillovers especially in small-sized EMs and frontier markets with fiscal and financial vulnerabilities. In this regard, we expect staff to provide further sharpened and well-tailored advice, drawing on the knowledge of the Integrated Policy Framework.

- **We cannot stress more the importance of clear communication by central banks, as they tighten their monetary policies, so as not to trigger disorderly market reactions**. Although it may be difficult under elevated uncertainties to give a rigid forward guidance on the policy outlook, indication of a strong commitment to tame inflation remains key.

- **Preexisting vulnerabilities in financial systems warrant close attention, as they could be further exacerbated by interest rate hikes.** We positively note the overall robust result of Global Banks Stress Test, but the authorities should be well prepared to deal with the scenario in which potential weaknesses in the corporate sector would materialize and erode the soundness of banks' balance sheets. In fact, concerns have been raised toward some global banks' capital inadequacy under the stress scenario. We encourage relevant authorities to ensure adequate management of loan quality through vigilant supervision. We also encourage the authorities to effectively use macroprudential toolkits as warranted, carefully assessing the impact of rate increases on households and housing prices, particularly in countries with large shares of floating-rate mortgages.

The analysis on liquidity mismatches in open-ended funds (OEFs) in Chapter 3 is extremely relevant to the current financial situation. We note the policy implication that ex-ante price-based mechanisms would be effective in avoiding and mitigating investor runs, and that it is important for the authorities to ensure appropriate implementation of such mechanisms by OEFs. We are of the view that the appropriate policy response would vary depending on the legal and institutional framework of each jurisdiction and the nature of each OEF's asset holding. On the other hand, such potential diversion should also be accommodated by balancing the need for international consistency of regulatory and supervisory frameworks. We expect the Fund to closely coordinate with the FSB, which has rich expertise in this area, to make concrete policy advice going forward.

We agree with staff's analysis in Chapter 2 that one of the key issues for achieving the goals of the Paris Agreement is how EMs can mobilize climate financing in parallel with implementation of mitigation measures. With limited fiscal capacity after the pandemic, and fossil fuel investments attracting attention due to the current energy crisis, green funding is facing significant challenges. Global concerted efforts are essential in terms of fund mobilization measures (e.g., establishment of green projects), enhancement of financial intermediary schemes, and securing funds. We expect the Fund to do its part to serve a catalytic role through the soon-to-be operationalized RST and tangible policy advice.

Fiscal Monitor

Amid growing concerns of a global slowdown and geopolitical tensions, surging inflation and interest rates exert substantial fiscal pressure on both revenues and expenditures. The government must provide temporary and well-targeted support to people who are most vulnerable to increasing energy and food expenses and a coordinated fiscal and monetary policy stance would also send a powerful market signal. We concur with staff that the decline in the debt-to-GDP ratio due to inflation will be limited, and that increasing borrowing costs, external debt risks, and spending pressures warrant additional attention. As fiscal space of many countries is limited, it is essential to rebuild the medium-term fiscal framework, pursue fiscal consolidation, and prioritize policies. Also essential are efforts to build economic and social resilience, and in this context, we agree with staff that it is crucial to build fiscal buffers to absorb future shocks, in addition to addressing climate change, food and energy security, and the global debt crisis.

In order to draw lessons in designing fiscal policy for crisis response, it would be beneficial to evaluate the cost-effectiveness and policy trade-offs of government

supports for households and firms during the COVID-19 pandemic. Prolonged policy support could weaken the fiscal capacity to deal with future crises, and could have a detrimental effect on productivity by impeding labor mobility and the restructuring of nonviable companies. In this respect, we welcome staff's insightful analysis on the policy effects of support measures, such as an efficient policy design for timely job retention schemes and unemployment income assistance, as well as the significance of digitalization and appropriate communication in providing well-targeted support programs. Also, there can be fiscal risks associated with government loans and guarantees, and as staff rightly noted, it could be difficult to quantify the associated fiscal burden and prospective expenses.

Statement by Mr. Hilbers, Mr. Tsur, Mr. Voinea, Mr. Ghalanos, Mr. Manchev, Mr. Verhelst, and Ms. Volociuc on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for their hard and high-quality work to analyze the global economy and we appreciate the timely circulation of the documents, which allows for a deep discussion and engagement. Staff's task was especially difficult following the consecutive shocks that set complex policy dilemmas. Multilateral cooperation is needed to rise to the challenge: ***policymakers should coordinate to fight inflation, reduce trade fragmentation, agree on debt resolutions, and mitigate climate change.***

Russia's unjustified war against Ukraine is the root cause of many turbulent challenges the world and its economy face. First and foremost, the war has been causing tragic loss of human life and extensive damage to the physical capital in Ukraine. Adjoining economies feel the large impact and uncertainty, despite the somewhat mild impact of Russia's war on the Caucasus and Central Asia until now. An in-depth analysis of how a protracted war in Ukraine and/or eventual deglobalization may affect the growth-at-risk and financial vulnerability indicators is therefore required. We commend staff for clarifying that the sanctions are the result of Russia's invasion and that they are aimed at pressuring Russia to end all hostilities. At the same time, it is disappointing that the language used is not always consistent. Instead of using the term 'Russia's war against Ukraine', different terminologies are used, e.g., the term 'war in Ukraine' which reflects indifference over Russia's aggression. We urge staff to correct this.

WEO and Policy Mix

The mix between monetary, financial, and fiscal policies should prioritize reducing inflation, especially in economies showing signs of labor market tightness, while coordinating policies that minimize the welfare burden and financial risks.

We agree that the priority for central banks must be to tame inflation and maintain well-anchored expectations by normalizing policy rates and balance sheets and raising real policy rates above their neutral level where warranted. This should be done even at a cost of slowing activity to avoid higher costs for longer. A risk for CB independence will develop if the high expectations are not met. Healthy communication between policymakers, clear forward guidance, and analytical efforts should identify the optimal path to recover price stability with minimal damage to growth. While we agree with staff that the appropriate path of anti-inflation policies is country-specific, coordination between central banks can prevent excessive monetary tightening due to miscalculation of other central banks' movements and their restraining effect on the global economy. Relatedly, the ECB faces more uncertainty from policy normalization and the new Anti-Fragmentation Tool is welcomed, while its effectiveness should be assessed.

A policy mix of combined fiscal consolidation and monetary tightening is warranted in many countries, but open discussion and analysis regarding the right balance are critical. Lowering aggregate demand too much could risk a global recession. We call for a decisive message from the

Fund that coordination between monetary and fiscal policy should not jeopardize central bank independence, which is crucial for the ability of central banks to reduce inflation.

The combination of shocks and historically high debt levels increased the risk of a disorderly tightening of global financial conditions and pose global financial stability challenges going forward. The GFSR could have benefited from an analysis of the role of macro-prudential policy (especially, the counter-cyclical capital buffers) to mitigate financial risks at the current juncture. The near-term growth-at-risk forecast enters red territory and the Fund's policy advice should be further streamlined to emphasize the role of the financial sector and regulation to alleviate pressures from high energy prices. Banks should be encouraged to proactively engage with vulnerable debtors to see whether debt payment holidays or debt restructuring operations could help avoid vicious cycles of payment defaults. Payment defaults could trigger losses related to other vulnerabilities, such as in the residential real estate market.

<u>Fiscal Monitor</u>

As a principle limiting energy price increases should be avoided, but a better distinction is needed between short-and longer-term policy priorities.

Price signals would help the structural shift towards the green transition, but at the same time immediate elimination of price caps would make fighting inflation, the main policy priority of the WEO, harder to achieve. Furthermore, the energy market is fragmented, often populated with natural monopolies or restricted oligopolies; our knowledge of the energy market, as macroeconomists, should be enhanced to make appropriate recommendations. C*ould staff calculate what the current inflation rate in Europe would have been in the absence of energy price caps?*

While in principle targeted fiscal support to the most vulnerable groups is sound advice, governments may struggle to put this into practice. Even middle-income households are extremely vulnerable to large energy price shocks. It is therefore questionable if governments can develop tools to define and identify the "most vulnerable" in a fair and precise way. *What is staff's assessment of the share of vulnerable households in the total population and which criteria do they use for such classification?*

<u>GFSR</u>

We suggest strengthening the GFSR policy massages against the backdrop of extreme volatile asset prices, including crypto assets, worsening market liquidity, and widening spreads.

We welcome the analytical use of the Integrated Policy Framework (IPF), whose tools can be useful when experiencing a sharp tightening of global financial conditions and fear of a global recession. Monetary policy tightening in advanced economies needs to take into account an increasing number of factors, such as the diverging cycle of the People's Bank of China, specificities of the regional energy markets, and house prices. As a result of the Fed's policy tightening cycle, conditions in the local currency bond markets have materially worsened in EMEs, and especially in CEE term premiums sharply increased. These tensions are likely to persist, and we encourage thorough policy advice on how CEE can best respond to the portfolio outflows. Given the volatile environment we also welcome the global bank stress test conducted by the IMF. However, the exercise does not specify the exact assumptions regarding interest rate normalization and the transmission of shocks to bank balance sheets is not fully clear. It is therefore hard to assess the outcomes of the stress test. *More details from staff about the stress test are welcomed.*

The GFSR should highlight the need for policymakers to accelerate governance and regulatory reforms. AML/CFT measures, public finance management, and corporate governance reforms are needed to strengthen the functioning of financial markets and payment infrastructure. (The words governance and AML/CFT are not present in the executive summary and chapter 1 of the GFSR).

The recommendation to consider revisiting borrower-based measures to contain risks in the housing market is premature. The section "Housing Markets: At a Tipping Point?" provides valuable analytical insights into the rising risk of housing market declines in many economies following aggressive monetary policy tightening. However, at this stage, house price increases are still significant in many countries and the financial stability risks posed by the housing market are sizable, which underlines the continuous need for buffers.

The provided Conceptual Framework to understand the financial stability risks of Open-End Investment Funds (OEFs) is a helpful addition to the Fund analytical toolkit (chapter 3 of the GFSR). While investments by advanced economies in OEFs in emerging markets are generally positive, they have adverse effects on emerging market asset prices during the ongoing tightening of the monetary policy cycle. If not managed properly, it could lead to an excessive and unnecessary tightening of domestic financial conditions, thus reinforcing the vicious cycle between investor runs and asset market volatility. Further development of both micro-and macro-prudential toolkits would be needed to adequately respond to these challenges. Such an alignment could be coordinated by supervisors to ensure a consistent approach across the asset management sector. *Staff comments are welcome.*

Pre-existing vulnerabilities and policies with longer-term benefits

Many vulnerabilities that existed before the spike in inflation require just as much – if not more – attention today.

We share the view that climate change is an immediate concern that cannot be relegated to the medium-term. We welcome the IMF's empirical work which shows that policies to fast-track the green energy transition can be designed over the coming 8 years at manageable macroeconomic costs. Estimates of co-benefits of air pollution mitigation would reinforce this point. We join staff in welcoming the climate change policies incorporated in the US Inflation Reduction Act – even if it does not include a carbon tax – but question linking tax credits for electric vehicle production to stringent local content requirements. Europe's search for a new, more secure energy mix in response to the sanctions from Russia's war against Ukraine and Russia's countermeasures should accelerate rather than hamper the necessary climate transition. The IMF advice and the new RTS instrument should play a catalytic role to address the "triple challenge" the EMEs and LICs face when designing and implementing their climate mitigation and adaptation strategies. IFIs should help strengthen the climate information architecture, develop transition taxonomies, and facilitate the development of payment and market infrastructure to incentivize private investment and create new international carbon markets for EMDEs.

Structural reforms could facilitate short and long-term goals. Addressing supply-side problems that cannot be solved through monetary policy can contribute to reducing inflation. While the WEO acknowledges this opportunity, it misses some long-term structural reforms when discussing "policies with longer-term benefits". Particularly, while specific policy advice on education reforms is not the expertise of the IMF, it should convey the message that stable investment in human capital should be maintained even in periods of fiscal consolidation.

Low-income countries and some highly indebted emerging market economies are impacted the most by the successive shocks, including by the pandemic-related responses in China. Tighter financial conditions and the impact of the strong dollar on their FX-denominated debt risk pushing more of these countries into (or to the edge of) sovereign default. Figure 2 (Fiscal Monitor, page 2) shows that 60% of them are already in or at high risk of debt distress, which is striking. The IMF should stand ready to provide temporary emergency finance to countries hit by severe food price shocks while helping countries with structural vulnerabilities to design and implement realistic full-fledged reform programs. Where debt is considered unsustainable, the IMF should push for sufficiently deep debt treatments by all relevant official and private creditors. *Additional suggestions on how to speed up the progress under the Common Framework, e.g., to make it more attractive to prospective debtor country participants and ensure comparable private creditor participation, would be very welcome.*

Statement by Mr. Mozhin, Mr. Potapov, Mr. Shestakov, Mr. Tolstikov, Mr. Biriukov, and Ms. Zubareva on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

WEO, GFSR, Fiscal Monitor

We thank staff for a set of the well-written flagship reports. The global economy is entering a new phase, which is fraught with numerous risks. As inflation in advanced and developing economies alike has reached the levels unseen in decades, some major central banks have embarked on the most aggressive monetary policy tightening since the 1980s. This may push some advanced economies into recession, with serious repercussions for the global economy. China is experiencing slowdown due to COVID-19 containment policies and mounting challenges in its property sector. Other emerging markets and developing economies are facing strong headwinds from rising food and energy prices, depreciation of their currencies against the rising US dollar, tighter global financial conditions, and capital outflows. Many low-income countries are dealing with acute fiscal and debt problems. Continued escalation of the sanctions war against Russia disrupts global food, energy, and commodities markets, destroying supply channels that were built over decades, and supplementing them with new and much less efficient ones. The COVID-19 pandemic is not going away and continues to depress economic activity. In such a challenging environment, there is a strong need for coordinated actions in order to mitigate risks, improve resilience, and slow down the ongoing fragmentation of the global economy.

We broadly share the WEO overall assessment of the global outlook and risks as well as the policy recommendations. The reports appropriately focus on the urgent need to address high inflation and prevent it from becoming entrenched. This has become the overarching objective of macroeconomic policies around the globe, as price stability is a key precondition for sustainable growth and social stability. It is also important to underscore that without monetary and fiscal policies coordination the disinflation process would be more protracted. Staff rightly emphasize that despite diminishing space for supportive fiscal policy, protecting the vulnerable population is paramount. Fiscal and debt problems in many countries would be difficult to solve without improving the framework for debt resolution. We also fully support the call for strengthening multilateral cooperation and avoiding fragmentation.

We note that the updated WEO growth forecast for 2022 is only 0.4 percent lower than in the April WEO, despite materialization of many downside risks during the past six months. Such resilience of the global economy, or optimism of the forecasts, is encouraging, but certain doubts remain. We note that after remaining behind the curve in fighting inflation the monetary policy tightening by the Fed and some other central banks was unexpectedly aggressive and that several EMDE central banks have followed suit immediately. Many other central banks are preparing similar actions. Moreover, the signal they sent to the markets was that they would do "whatever it takes" to stop inflation and meet their price stability mandates. Market expectations about a future policy rates path have surged upward. Such decisiveness is in line with the advice of the flagship reports, but it was probably not fully assumed in the forecast. *Could staff comment if the recent hardening of policy stance of the major central banks makes a difference for the growth outlook?*

We support the policy advice on resolute monetary tightening. We welcome staff analysis in the WEO of why high inflation surprised macroeconomic forecasters. It concludes that excess demand has been a dominant factor, particularly in 2021. Thus, we can conclude that the monetary tightening in many countries started too late and proceeded too slow to prevent inflation from becoming entrenched. Now we strongly support the emphasis on frontloaded and aggressive monetary tightening to limit second-round effects on inflation and prevent inflation expectations from de-anchoring. We agree that clear communication about the monetary authorities' policy actions and their commitment to achieve disinflation is crucial to avoid unwarranted market volatility and mitigate risks to financial stability.

Tightening global financial conditions and a surge in the US dollar are expected to cause flight to safety and the reintroduction of capital controls in some member countries. The flagship reports rightly highlight the various options recommended by the Integrated Policy Framework to address rising external risks. These options, depending on the situation, may include foreign exchange interventions or various capital flow measures. We also note that in some circumstances even preemptive CFMs could be appropriate. Recognition of appropriateness of these options may mitigate the risk that the monetary and macroprudential authorities will find themselves behind the curve in CFMs, as they did in fighting inflation.

As central banks around the globe accelerate monetary tightening, the actions of the fiscal authorities should be determined by country-specific situations. Late exit from the emergency pandemic support has left many countries without fiscal space to address the upcoming recession. Others may still have some fiscal space, but accelerating inflation leaves them with no room for fiscal easing, as containment of aggregate demand becomes a priority. We note that staff emphasize the need for fiscal consolidation to support disinflationary efforts, while providing only targeted support to the most vulnerable. Such advice, while broadly correct, should not be regarded as universally applicable. Countries with still relatively low inflation, such as some in East Asia, may be less constrained in providing fiscal support in case of shocks. Fiscal consolidation during crisis may be politically challenging. We note that even some high-inflation G7 economies are loosening fiscal policy to boost the economy.

The flagship reports should provide continued analysis of the interaction between high inflation and the public debt. Elevated inflation in many advanced economies is successfully eroding the stock of the public debt. We note that, according to the April WEO data, the public debt in the United States was expected to decline by 7.1 percent of GDP in 2022, in the UK by 7.5 percent of GDP, in Canada by 10.2 percent of GDP, etc. We assume that this could be mostly explained by high GDP deflator and strongly negative real interest rates. The high level of accumulated debt may create an incentive problem for policy makers, as they may become less inclined to address the inflationary shock. This may become an issue for countries with weaker central bank independence. *What are the estimated improvements in the debt sustainability for the most indebted advanced economies due to prolongation of elevated inflation?* We note also that high inflation in the US, UK, and the euro area erodes the value of their currencies and, therefore, the value of international reserves held by the Fund members.

Monetary tightening in advanced economies substantially increases sovereign debt distress in EMDEs. These countries are facing capital outflows and currency depreciation, as investors reassess sovereign risks. External financing conditions have already become extremely difficult for many emerging market issuers. We note staff's estimate that, should global financial conditions tighten further, the number of distressed sovereigns could rise from 17 to 31, with potential contagion to other countries. Therefore, timely financial assistance to vulnerable countries by international community is critical for maintaining global financial stability.

Deteriorating debt burdens in developing economies also highlight the need to further strengthen the current framework for sovereign debt restructuring. The G20 Common Framework can be improved, enabling countries to resolve debt crises more swiftly and without extended economic pain. Involvement of the private sector creditors should be enhanced, given their increased share in public debt holdings. Preemptive discussions with creditors should become more common.

We appreciate a thorough analysis of risks to the financial system in the Global Financial Stability Report. We agree that financial stability risks have increased sharply amidst high inflation and extreme uncertainty about the global outlook. Financial conditions have tightened in most regions and continue to tighten. Against the background of preexisting vulnerabilities, accumulated during the period of very low interest rates, this uncertainty elevates the risk of rapid and disorderly repricing of all assets and distress in the financial system.

The prospect of the sequential forced interest rates increases by central banks is a substantial risk for the global economy. Aggressive monetary policy tightening by the Federal Reserve compels other central banks to raise interest rates more than they otherwise would have done. In many economies that peg their currencies to the US dollar, interest rates have to increase almost automatically, even when higher rates are harmful to their economic prospects. We note that China and Japan remain among a few countries that have not embarked on the competitive monetary tightening yet. *Could staff comment on the risks of desynchronized policy stance for the major Asian economies?*

Widening interest rate differentials can also put pressure on the exchange rates and ignite the so called "reverse currency wars". Many governments and central banks are rethinking their exchange rate policies in an attempt to strengthen their own currencies. Local currencies' weakness makes dollar-priced imports costlier, aggravating high domestic inflation. The first move has been recently made by Japan, which intervened in the foreign exchange market for the first time since 1998. As other currencies are depreciating against the US dollar, we may see more of this in the near future. Such moves could become self-reinforcing, resulting in even more global tightening than is warranted.

We note that, as the euro area economic conditions are deteriorating, the fragmentation risks are growing. Investors may become more sensitive to fiscal vulnerabilities in some member states amidst rising energy prices, supply disruptions, and increasing interest rates. The recent announcement by the ECB of the new Transmission Protection Instrument (TPI) has reduced spreads of vulnerable countries' bond yields so far. However, the TPI is an untested instrument and risks for financial stability of Southern Europe remain elevated.

We are concerned that property sector downturn in China may become a major challenge for economic stability and growth, as housing risks may spread to the banking sector and undermine financial positions of local governments. It is, however, encouraging that China's globally systemically important banks appear to be resilient. The authorities are well aware of the need to take a proactive approach to restructuring troubled construction companies and prepare for resolving the banking sector vulnerabilities.

We welcome the well-written analytical chapters and would like to provide a few comments on them.

The WEO Chapter 2 analysis may understate the risks of inflation expectations de-anchoring. We broadly support the increased realism of the adaptive learning assumption in the expectation formation process outlined in the end of the WEO Chapter 2. However, adaptive learning [concept] might still overstate rationality of inflation expectations formation: the assumption that economic agent acts like an econometrician estimating the unknown parameters of the economy seems to be a poor description of firms and households. The latter, in turn, might be attuned to the message of professional forecasters with attention varying to the degree of perceived importance of inflation and subject to behavioral biases. The unfortunate side effect of modelling all agents as adaptive learners is that Chapter 2 understates the role of central bank communication in formation of inflation expectations.

High producer prices inflation in some advanced economies may be a harbinger of the forthcoming CPI acceleration. We take note that the analysis of wage-price spiral episodes leads to the conclusion that supply-side shock predominantly drove wages, while pent-up demand was important for inflation. However, even supply-driven nominal wage growth will still be reflected in prices, but maybe with a longer lag. It is also unfortunate that the rich multi-sector structure of the Chapter 2 model was not used to explore the implications of elevated producer price inflation on consumer price inflation. While we understand that there is a lag for a passthrough from producer to consumer prices, the lag is not constant and might turn shorter if accompanied by growing nominal wages. *Do staff consider that the high levels of producer prices increase the risk of more protracted CPI inflation in major economies?*

Global green transition should proceed in an evenhanded and coordinated manner to avoid risk to macroeconomic stability. We welcome the analysis of the near-term macroeconomic consequences of climate change policies presented in the WEO Chapter 3. High energy prices amid geopolitical tensions highlight an urgent need to restore international cooperation and ensure that global green transition will not threaten macroeconomic stability. In this uncertain environment each country faces unique trade-offs, and there could be no one-size-fits-all approach. An even-handed approach should ensure that advanced countries, which have benefited from centuries of industrial pollution, move faster toward carbon neutrality, while emerging economies might phase out fossil fuels more slowly to cushion economic risks and take advantage of the decreasing costs of green technologies. Such an approach will be more consistent with the UNFCCC principle of common but differentiated responsibilities and respective capabilities. *Can staff comment on the welfare consequences of the policy packages from the WEO Chapter 3 for the different income groups within the countries?*

Statement by Mr. Trabinski, Mr. Peter, and Mr. Tola on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

The WEO paints a gloomy picture of the global outlook, owing to a confluence of factors. We remain deeply concerned by Russia's war against Ukraine. In addition to the human toll, the war has caused significant economic disruptions, including in food and energy markets, leading to human suffering and lasting economic scarring in low-income economies but not only. In Europe, disruptions in the near-term energy supply are threatening industrial activity and household income. In the medium term, the hostilities may lead to a reversal of global integration, making the world poorer and the international community less able to address global challenges.

Risks remain tilted to the downside, while many have already materialized. We agree that properly calibrating policy responses has become more challenging for most countries, given the historically unusual context and the various shocks affecting economic activity. Further, the persistence of high inflation would accentuate the tightening of financial conditions. The relevance of other risks varies across regions. In Europe, a further worsening of the energy crisis is a prominent risk, while a significant economic slowdown in China, due to continued Covid-lockdowns and/or a worsening of the housing crisis, would have important global implications, particularly for Asia.

The key challenge facing policymakers is to bring inflation back to target and to restore fiscal buffers, while protecting the most vulnerable from the dramatic loss in real income due to high energy and food prices.

- **Monetary policy needs to tighten fast to avoid inflation de-anchoring.** Inflation has kept surprising on the upside. As a result, many central banks had to accelerate the tightening of their policy stance. This trajectory needs to continue because the risks of tightening too little currently outweigh the risks of tightening too much. Yet, central banks also need to be aware that the contractionary effects of higher policy rates on the real economy may materialize more quickly than disinflation. Careful calibration is thus key, particularly as models developed during the Great Moderation have uncertain predictive power in today's extreme circumstances.

- **Policymakers should stand ready to adjust macroprudential tools according to country-specific circumstances and the evolving challenges to contain the buildup of financial vulnerabilities.** Financial stability risks stemming from tighter financial conditions have increased. The primary responsibility to address financial risks at the firm level lies with the firms' own risk management. Ensuring greater market transparency can also help improve the effectiveness of risk management strategies. On a country level, policymakers should adjust macroprudential tools to counter disorderly tightening of financial conditions. Central banks' communication about the outlook and what it implies for monetary and fiscal policy can help manage investors' expectations and risk management without constraining monetary policy adjustments.

- **Fiscal policy must be targeted and focused on consolidation to avoid accentuating inflationary pressures.** In view of high food and energy prices as well as lingering effects of the COVID-19 pandemic, it may be necessary to maintain a targeted fiscal support, as the supply of food and energy is inelastic in the short to medium term. Cash transfers can be targeted more easily than price controls or tax cuts and do not distort price signals that are needed to guide consumption. This said, on aggregate, fiscal policy should focus on restoring and preserving fiscal buffers and take immediate steps toward consolidation given high public debt levels, tighter financing conditions, and rising inflation. Increased spending and tax cuts in some regions will render this objective more difficult to achieve. Credible medium-term fiscal frameworks remain important to lock-in consolidation efforts beyond the short term and underpin market confidence. We also see merit in well-designed fiscal rules.

- **Structural policies can help reduce inflationary pressures, with the added benefit of increasing growth potential.** The structural reform agenda remains key and has the potential to expand supply, boost economic activity and productivity, and, hence, help reduce inflation in the medium term. More ambitious structural policies would make our economies more dynamic and thus improve medium-term growth prospects.

- **Large negative shifts in the commodity terms of trade and rapidly tightening financial conditions have brought many low-income economies close to debt distress.** Multilateral support tailored to country circumstances may be needed. The IMF should be part of such solutions, by lending through existing instruments and by supporting the authorities' efforts to mobilize other sources of financing. A greater push towards debt transparency and efficient debt restructuring frameworks should also remain a key objective.

- **We must ensure the resilience of global value chains and support a solid, open, rules-based, and transparent international trade system through well-functioning markets.** The pandemic, recent geopolitical tensions, and the surge in food and energy prices have led to an increase of protectionist measures. This trend undermines global economic integration and important achievements in reducing poverty and should be reversed. Efforts should also involve reforming the World Trade Organization and the dispute settlement system.

- **Climate policies must be credible, timely, and predictable to support the transition.** The quantification of the costs of various climate policy scenarios and of delayed de-carbonization shows the need for robust climate policy and for bolstering resilience to climate-related shocks. The current energy crisis has halted efforts to move away from carbon-intensive sources of energy. Such efforts need to resume and accelerate once the immediate challenges to energy security are overcome. Countries should not postpone measures until a binding international agreement is in place.

Fund policy advice and surveillance remain as important as ever. We fully support and encourage the Fund's high-caliber economic analysis, policy advice, and knowledge sharing. These activities remain crucial to assist member countries in shaping their domestic policies, particularly in times of high uncertainty.

Statement by Mr. Palotai, Mr. Azal, Mr. Just, Mr. Hagara, Mr. Marek, and Mr. Meizer on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor Executive Board Meeting 22/82 September 29, 2022

We thank staff for the comprehensive set of flagship documents. Amid the current geopolitical and economic maelstroms, policymakers are increasingly confronting challenging trade-offs, calling for well-calibrated responses at all levels. While staff have made good progress in capturing key challenges facing the global economy, as well as the optimal policy mixes, we still see scope for sharpening certain recommendations, especially those for adverse scenarios, and giving even higher priority to safeguarding stability and building resilience to shocks. We offer the following remarks for emphasis.

World Economic Outlook (WEO)

The consequences of Russia's war in Ukraine and the growing geo-economic fragmentation are reverberating globally, weighing heavily on the outlook. There is an urgent need to find a way out of the conflict, otherwise, the aggravation of risks further adds to strains. The membership faces multifaceted challenges associated with the deteriorating external environment, multi-decade-high inflation, rising food and energy insecurity, as well as growing debt burden and climate threats, while policy buffers are largely depleted.

In this environment, where downside risks dominate the outlook, the close examination of risk scenarios is critical. We note that staff cut the growth outlook and revised up inflation projections for the fourth time in a row. While we understand the difficulties of economic forecasting at the current juncture and appreciate the special boxes in the WEO on the inflation forecast errors and uncertainties around baseline projections, the threats stemming from the confluence of risks could also be featured more prominently. *In this context, we would also appreciate staff's elaboration on the calibration of adverse scenarios. Even if a widespread recession is not currently in the baseline, recession fears are already squeezing many sectors. In this context, we also wonder how staff assess the new macro data released after the first draft of the WEO, as well as stagflation risks on the horizon.* In the main chapter, we would also place higher emphasis on the need to enhance contingency planning.

The detailed analysis of inflation dynamics remains essential to develop adequate policies. We appreciate staff's analytical work in Chapter 2 on the risks associated with de-anchoring inflation expectations and wage-price spirals. Sustained periods of high inflation warrant close attention to these areas. We also encourage staff to take a closer look at the patterns of the commodity prices pass through, the persistence of second-round effects, as well as the historically high profit margins in some sectors. The latter suggests that regulation should also play a more active role in taming price pressures.

Restoring price stability is of utmost importance. The effective use of monetary policies remains essential to curb stubbornly high inflation and keep inflation expectations under control. Since inflation has become increasingly broad-based in the past few months, decisive measures are needed to prevent inflation from becoming systematically entrenched. While we also agree with staff's assessment that central banks must stay the course, staff's general recommendations for more aggressive monetary tightening, in particular by AEs, do not fit for all and could easily lead to undesired outcomes, given that monetary policy decisions work with a lag. In case of a more rapid contraction in economic activities, inflation can also peak sooner; therefore, output-inflation trade-offs would also require closer monitoring. Further, to prevent higher volatility in financial markets, we also underscore the importance of clearly communicating the drivers of central bank decisions both domestically and internationally.

Fiscal policies should also avoid adding upward pressures on inflation. The judicious use of fiscal policies is key to both providing further support for those most in need and safeguarding fiscal and external stability. To this end, budgets need rationalizing and reprioritizing. The dynamics of external imbalances also require close monitoring, since rapidly tightening global financial conditions, the soaring US dollar, and changing patterns of capital flows can spell trouble for emerging markets and developing countries via multiple channels. Thus, we understand the necessity of FXI in some countries to address disorderly market conditions and safeguard financial stability. Amid growing debt sustainability concerns, the importance of pursuing prudent policies, as well as of improving debt resolution mechanisms, are also growing.

We agree on the urgent need for putting energy sectors on a more sustainable footing. However, we also ask for staff to give greater scope for energy security considerations and green incentives when calibrating climate recommendations in Chapter 3. The current energy market turmoil is dealing a significant blow to a range of countries, particularly in Europe. Soaring energy prices are sharply increasing living costs, costs for industry and businesses and putting a significant burden on budgets, there is also great uncertainty over energy supplies going forward. Consequently, a multi-pronged approach is needed to simultaneously maintain energy security, increase energy efficiency, and advance the green transition by investing in alternative energy sources. Beyond that, we agree that countries' collective failure to honor their climate pledges results in the need to drive the green transition forward in a shorter period of time, while stop-and-go policies also lead to unfavorable outcomes. We found staff's assessment of enhancing credibility of climate policies particularly valuable. To advance climate action and sustainable development, we also see a strong need for establishing credible frameworks and stronger public-private partnerships. Going forward, it would be useful if staff could also closely examine policies along which governments can best catalyze private financing for climate action.

Global Financial Stability Report (GFSR)

We share staff's assessment that financial stability risks have substantially increased in some sectors since the April GFSR. **The GFSR's focus on selected issues, which are critical for monitoring financial stability risks, is well-thought through.** While it is challenging to strike the right balance between presenting clear messages and not losing track of certain country-specific developments, **we would have welcomed a more nuanced presentation of risks across countries and greater use of specific country examples.** We welcome the two analytical chapters on scaling up private finance in emerging markets, as well as the role of open-end funds, and offer the following comments on the GFSR's main chapter.

Corporate sector vulnerabilities have come to materialize. The corporate sector has been under strain since the pandemic-induced lockdowns and supply-chain disruptions. While the prolonged government-provided support schemes kept the corporate sector protected, tightening funding conditions, coupled with rising input costs, inflate borrowing costs and weigh on profitability. Against this backdrop, it is critical to keep the corporate sector under scrutiny, considering its potential debt distress and spillovers to both banks and nonbank financial institutions. We see a need for a nuanced view on government support for corporates. High energy costs are wiping out otherwise healthy businesses. Government support for fundamentally sound corporates may thus be warranted to prevent premature stranded assets. Any potential rise in nonperforming loans requires an upfront prudent loan portfolio management and provisioning practices.

Supervisory authorities need to duly monitor developments in the housing market. The price reversal in the housing market in several jurisdictions following a period of rapid boom poses risks to financial stability. We are concerned by staff's estimates that in the adverse scenario, the real house price declines over the next three years in emerging markets and advanced economies could be nearly 25 percent and 10 percent, respectively. In this context, we see merit in conducting stress tests, particularly related to the diminishing value of banks' mortgage collateral and households' income strained by rising price levels.

We positively note that the banking sector has thus far demonstrated resilience amid the double crisis. The post-GFC regulatory overhaul in the banking sector supported its overall sound standing. At the same time, we note that staff's stress testing exercise exposing global banks to a stagflation shock reveals vulnerabilities in some segments of banks, particularly in emerging market economies. In this context, we stress the need to keep financial sector regulation in line with global standards, including practices for bank recovery and resolution.

Fiscal Report (FM)

We thank staff for the informative and well-written FM, focusing on policies protecting households and firms against large losses of real income or employment. The Executive Summary provides a useful background for Chapter 1 and is well-reflected in the discussions of tradeoffs that policymakers face, even recently. **We broadly concur with staff's appraisal and offer our comments on several issues.**

In face of elevated debts, the gradual reduction of fiscal deficits is necessary to help tackle inflation, while protecting the most vulnerable through targeted measures. Low interest rates helped finance fiscal expansion in the response to the COVID-19 pandemic, despite elevated public debts. With ongoing monetary policy normalization, debt service costs are rising and further reduce fiscal space, thus add to the pressure to prioritize spending and mobilize revenues. In this vein, responses to high energy prices also need to be well-targeted, avoiding costly across-the-board subsidies and tax cuts.

We concur with staff that preparation can help governments better protect households and firms during crises. Drawing from and reflecting on lessons learned in both the existing and new tools and strategies can help ease the difficult tradeoffs that policymakers will face in response to future crises. However, to **make most effective use of the tools and strategies, they should be underpinned by the fiscal space created in normal times.** The response to the COVID-19 crisis showed that the social safety nets are useful in providing targeted support and can be eventually expanded quickly. We see value in preparing strategies on how to respond to different types of crises but are less convinced by the idea of "semi-automatic" stabilizers which would be activated in harsher crises. A pre-committed response would reduce flexibility and precious fiscal room that may be needed elsewhere.

Analyses of the various approaches to income and employment stabilization and support to firms during the COVID-19 pandemic, and the responses to surging food and energy prices are useful and timely. Examples from the EU, the US, and Brazil illustrate well the impacts of automatic stabilizers, the expansion of existing schemes, and discretionary measures on the income and employment of different segments of the population. While acknowledging the possible limitations of microsimulation tools, *we wonder whether staff also considered the impacts of loan deferrals for different types of households that were used in many countries, and how helpful these measures are, in staff's view.*

Statement by Mr. Buissé, Mr. Roman, Mr. Grossmann-Wirth, Ms. Morfouace De Broucker, Ms. Albert, and Ms. de Waziers on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We commend staff for their clear and thoughtful reports. The world continues to suffer from the negative impacts of the pandemic and Russia's invasion of Ukraine, highlighting the need for international cooperation. Policymakers are seeing increasingly difficult trade-offs, in a context of rising inflation which requires decisive action by monetary policy in most countries. While we agree that fighting inflation is a top priority and fiscal and monetary policies should walk hand in hand, we also strongly emphasize the need to carefully calibrating and sequencing policies according to country specificities. It is key to avoid an unnecessary recession, in particular if the compounding effects of the current synchronous tightening become more important than expected. Moreover, the current energy security crisis, which has exacerbated the food insecurity crisis, combined with the urgent necessity to fight climate change, are a clear call to take prompt action now to accelerate the green transition. The IMF has a key role to play by helping policymakers to design the best policies to deal with these turbulent times, in particular to protect the most vulnerable and to ensure a green, inclusive and sustainable future growth, and we very much welcome the dedicated chapters of the flagships

1) **As uncertainty is surrounding the outlook, the potential materialization of downside risks needs to be monitored closely, and inflation could surprise again.**

We broadly share staff's view on the global economic slowdown, with the risk of a sharper slowdown in case of a materialization of several downside risks. The lack of momentum of the recovery post pandemic is a concern, in the context of Russia's invasion of Ukraine. Nevertheless, we note the upward revisions for the euro area this year compared to July's forecasts. We are also a bit more optimistic regarding France's rebound for 2022-2023, due to a more robust investment and public demand. We fully share staff's view regarding downside risks, and the evolution of the war and the pandemic will remain key drivers affecting the global economy. We are interested in further work about scarring effects of these two external shocks. Among the downside risks, we interestingly note the risk of further dollar appreciation. It could have a negative impact on global trade, reinforce imported inflation in EMDEs, and have consequences on debt distress when combined with the increasing tightening of monetary policies. *More specifically, regarding global imbalances and international investment position, the report mentions the valuation losses associated to the decline in asset prices and the valuation gains associated to the USD appreciation. Could staff elaborate on the relative importance of each factor for 2022?* An extreme scenario with a global recession cannot be excluded, and we thank staff for their useful analysis regarding the confidence bands around the baseline. We would be interested to see more disentangled results for advanced and emerging economies.

Inflation is a key concern, as it has been more persistent than expected and its evolution is uncertain. Higher prices negatively affect growth, the most vulnerable and could lead to social tensions. Sizeable inflation forecasts errors have been made, and we welcome the analysis in the WEO Box 1.1, noting the underestimation in the impact of fiscal packages. We also appreciate the work on market power (WEO Box 1.2), while noting that the sample excludes some large firms which have seen a significant increase in their market power[4]. While markups growth didn't seem to have contributed to inflation, it could be interesting to take a closer look at the role of the average level of the markups. Regarding the outlook, the volatility of commodities prices could continue to significantly impact the forecasts. Moreover, we would be interested also to understand better how staff see the normalization of supply chain disruptions. Monitoring the evolution of the risk of wage-price spiral will be critical and we thank staff for their analysis in the WEO chapter 2. Backward-looking expectations will be an important indicator to follow. *We are also wondering to what extent the pandemic and the war could have structurally affected the wage formation mechanism. Could staff provide some insights?* In addition, we encourage staff to continue to work on the structural impact of the pandemic on the labor markets.

2) **We broadly agree on the merit of a consistent policy-mix to fight inflation, while underlying the necessity of fine-tuned policies to limit as much as possible the impact on growth and employment.**

Fighting inflation is a top priority, in particular through monetary policy. While we agree that it is necessary to avoid a more costly adjustment later (in case of insufficient monetary tightening), we also would like to insist on the need to limit as much as possible the impact on growth and employment thanks to a careful calibration and sequencing of policies, according to country circumstances. More attention should be paid in our views to the negative compounding effects associated to the synchronous tightening of the policy-mix which could also raise financial stability risks in the longer run. *Could staff elaborate on those risks and explain how policymakers could take them into consideration in their decisions?*

That's being said, regarding monetary policy, we fully agree that central banks should act resolutely to fulfill their mandate and bring inflation back to target. In the euro area, the ECB has taken decisive steps to monetary policy normalization with a 75bp increase in September, following a 50 bp increase in July. In addition, as noted in the GFSR, the Transmission Protection Instrument (TPI) has been approved in July this year to ensure, together with flexible PEPP reinvestment, that the monetary policy stance is transmitted smoothly across all euro area countries. The ECB will still be in a normalization phase until probably the end of the year, and any "tightening" (beyond neutral rate) will then be assessed. **However, staff's analysis could have further highlighted the differences in inflation dynamics (drivers and regions) which call also for differentiated policies.** The share of "supply-side" factors in the inflation dynamics is higher in Europe than in the US and should be further analyzed (product and labor markets, energy security, trade and investment). While we recognize that the impact of supply-side policies could take more time to materialize than the impact of monetary policy on demand, they deserve more attention,

[4] *De Loecker, Eeckhout, and Unger (2020)*

especially in a context of persistent inflation and limits of monetary policy to address the supply part of inflation issues. **Furthermore, we fully share staff's concerns about the risks of further tightening of financing conditions, and in particular for frontier markets characterized by a high risk of debt distress.** The heterogenous situation of EMDEs calls for differentiated policies, but the risk of capital outflows is increasing, in particular with the Fed's tightening, and we encourage the authorities to reinforce their resilience to the extent possible in case of future shocks. We also recall our strong commitment to the ongoing implementation of the Common framework for debt treatment to provide debt relief for low-income countries facing risk of debt distress. We encourage LICs and EMDEs countries at high risk not to delay structural adjustment and to engage early with their creditors and the IMF.

Regarding financial stability risks and macroprudential policies, we broadly agree with the assessment of the GFSR. Further work could be devoted to spillovers between regions and to volatility risks in some key segments (e.g., US Treasuries market, FX), in case monetary policy become less synchronized. We strongly agree with the need to develop instruments for NBFI, also in relation to the market liquidity risks highlighted in the report. We agree with the need to avoid pro-cyclicality but do not support relaxing existing borrower-based measures to cushion a (potential) downturn in the housing market: we see these as structural features that need to be retained to ensure resilience. **As regards open-ended investment funds, we broadly concur with staff's analysis**. Given the vulnerabilities identified in March 2020, we strongly agree on the need to enhance monitoring of fund managers' liquidity risk management practices, increase use of liquidity management tools (LMTs), and broaden data coverage both on the use of LMTs and leverage. Based on post-mortem exercises of the previous crisis, we also observe that one of the main issues to address is the reluctancy of managers to provide for the possibility of activating LMTs in the legal documentation of their funds as they expect it could reduce the marketing prospects of their products. It is therefore critical to make the selection of certain LMTs mandatory to overcome this market stigma and ensure they will be effectively available once a crisis occurs. The incorporation of such provisions is currently being considered in the ongoing review of the EU fund legislation. This idea is only briefly mentioned in the GFSR. *Could staff elaborate on its recommendation to consider mandating the adoption of LMTs and the kind of tools that would be covered by such requirement?*

Policymakers continue to face difficult fiscal policy tradeoffs. They are still struggling with surging prices, rising borrowing costs, risks of social unrest and sharper economic downturn while dealing with exhausted fiscal space and high legacy debt from the Covid crisis, despite the recent reduction in debt ratios for many countries. As already highlighted at the time of the April flagships, we fully agree with the recommendation not to rely on repeated inflation surprises to improve the sustainability of public debts. We recall that an asymmetric shock on inflation (where consumption prices are more impacted than the GDP deflator) is likely to impact the numerator of the debt-to-GDP ratio more than the nominal GDP. Budgetary support to fight against the impact of inflation on the poorest, coupled with the fact that some countries issued debt partially indexed to inflation, only reinforces this argument. *We would be interested on further analysis regarding the complexity of the interactions between debt management and high inflation.*

We agree that in general and to the extent possible, fiscal support should focus on protecting households and firms most vulnerable to food and energy prices hikes, with temporary and targeted support, such as exceptional cash transfers. Nevertheless, it should be noted that the level of prices is exceptional and that cross-cutting measures contribute to limit losses in purchasing power and to contain inflation and the risk of a wage price spiral, as shown by a recent study in France[5]. While being gradually phased out, these measures should also be complemented by incentives to save energy to balance energy demand and supply, and increase decarbonization.

Beyond managing the war impact, unwinding untargeted pandemic-related measures and improving structural reforms are needed to rebuild buffers. To avoid the cost of a too late and abrupt consolidation, fiscal adjustment should be gradual, differentiated according to country circumstances and anchored in a credible medium-term policy framework. Fiscal policies should maintain the agility and flexibility to adjust, if needed, and calibrate the targeting not to endanger the economic recovery. We thank staff for the lessons of the pandemic. We share staff's assessment on the effectiveness of income stabilization and job-retention schemes combined with unemployment support schemes and their role in preserving the poverty rate and income inequality from the adverse consequences of the crisis. We agree on the opportunity to consolidate social safety nets, fiscal and financial toolboxes, taking advantages of new technologies, and more broadly to reduce informality and develop financial insurances. *We would appreciate more operational advice in the future to help policymakers improve targeting (which socio-economic and geographic criteria and conditions to take into account, etc). Could staff comment?* **Rising energy prices should not distract governments from the long-term fiscal challenges:** raising growth potential in a sustainable and equitable manner through prioritization of spending and a focus on productive spending such as education, health, and public investment, funding the transition to low-carbon economies and tackling aging, inequalities, and gender gaps.

3) International cooperation is more critical than ever, in particular to answer the energy security and climate change challenges.

Energy security issues have been exacerbated by Russia's aggression against Ukraine and countries should not wait to act decisively. The current context is a clear call for accelerating the green transition. Increasing the role of renewables energies, prioritizing investments with high growth and climate yields to diversify energy supplies and reducing energy dependency and working on appropriate carbon pricing systems would help. And beyond those supply policies, we also highlight that energy sobriety is a necessity and should be strongly encouraged at each and every level (firms, households, etc).

We commend staff for their work in the report highlighting once again the urgency of the fight against climate change. The WEO chapter 3 rightly emphasizes the high cost of climate inaction and makes clear that implementing credible and gradual decarbonization policies as soon as possible to avoid more costly adjustments later is critical to meet Paris agreement goals. We strongly welcome the GMMET new model to help to assess the macroeconomic evaluation of ecological transition and we are looking forward to the

[5] « La flambée des prix de l'énergie : un effet sur l'inflation réduit de moitié par le « bouclier tarifaire » », Insee analyses n°75, septembre 2022.

publication of the detailed report. Macroeconomic costs remain small in the short term with negligible impact on monetary policy, and carbon pricing remains the most cost-efficient instrument to trigger the necessary investments for decarbonization. *Could staff elaborate (i) on the comparability of the three packages and in particular how environmental norms have been integrated: (ii) the impact of coordinated policies on developing economies in the short term, in particular according to their energy-mix?* We note that climate policies are budget neutral in the model, which makes sense in the current context, but we also highlight the potential benefits from mitigation measures, and in particular the return on green investments, which can be partially financed by debt. Moreover, it will be also interesting to explore the emission reduction paths of individual countries, as the exercise currently sets relative targets (25 percent of emission reduction) which implicitly maintain the hierarchy of polluters. It would also be informative to use the model with NGFS current policies scenarios and compare the results obtained under the different policy alternatives as well as with the countries' climate goals as defined in their NDCs.

In a context of low fiscal space and significant needs to finance the fight against climate change, we fully agree on the need to foster both accessibility and affordability of private green finance to emerging markets (GFSR chap 2). In this regard, international cooperation and coordination are crucial, and we very much welcome that the chapter is looking at a various set of tools. We particularly welcome the ongoing work of the IMF for ensuring interoperable sustainable finance taxonomies and climate disclosures. This will be key for scaling up financial flows towards projects that support the transition and avoid regulatory fragmentation. Public finance, including through MDBs, is of course also crucial to support the implementation of policies and leverage private finance. The operationalization of the RST by the end of the year will in addition help finance climate-related investment. As mentioned by staff, the adoption of appropriate levels of carbon pricing without delay is another key step. Finally, we share staff's questions on the link between ESG flows and climate finance/benefits and encourage further research on this topic.

Finally, multilateral cooperation remains imperative in all areas to foster global resilience to current and future shocks. On the food crisis, the IMF will continue to play a key role to protect the poorest with the new Food Shock Window, if adopted by the Board. As the tensions in fertilizers access in vulnerable countries could lead to significant harvest losses, the "Save Crops Operation"[6], will promote access to fertilizers and other critical inputs in vulnerable countries. We also want to emphasize that, for every IMF member, protectionism is particularly harmful, especially regarding food exports bans, in the current fragile economic context. Lastly, we reiterate our call to the IMF for close cooperation with partners - including but not limited to MDBs, UN agencies, etc - to avoid counterproductive duplication and ensure the best use of each organization comparative advantage on climate, energy, humanitarian crisis, food security, debt crisis, pandemic preparedness and tax revenues mobilization among others.

[6] https://www.elysee.fr/en/emmanuel-macron/2022/09/23/launch-of-the-save-crops-operation-initiative

Statement by Mr. Zhang, Mr. Bai, Ms. Qi, and Mr. Law on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
Executive Board Meeting 22/82
September 29, 2022

We thank staff for the set of flagship reports and agree with many of staff's assessment of the global economy and risks. Since the July WEO Update, the world economy and global financial markets have been facing increased challenges. These flagship reports should focus on the right and urgent issues in accordance with their risks of global importance and give tailored advice to members, in order to maintain the evenhandedness and reputation of the Fund's multilateral surveillance.

World Economic Outlook (WEO)
The COVID-19 pandemic remains a key risk in the current juncture, noting that on September 27, the worldwide new cases was 588,962 with 1,547 deaths. Safeguarding people's health and lives should remain a priority, and enhancing international cooperation in accelerating vaccination would be key to ensure a safe and orderly reopening of the economies.

Since the July WEO Update, the high inflation situation in many countries has further worsened, although monetary policies in these countries have been tightening further in a faster-than-expected pace. We welcome staff's analysis of global inflation trends and advice on how to bring inflation back to target. We encourage staff to carefully study all the factors driving up the current inflation when assessing the future inflation path, and earnestly draw lessons from last year when the Fund asserted that inflation would be transitory. We agree that monetary policy should play a major role in containing inflation. But as always, the monetary tightening can bring a higher burden on the middle- and lower-income households domestically and cause negative spillovers externally. We reiterate that many inflation drivers this time are from supply-side structural issues, and supply side policies are more effective in these areas with positive spillovers. Therefore, monetary policy is better to be accompanied by appropriate fiscal and supply side policies. We encourage staff to provide more targeted advice on how to use fiscal policy and structural policy to address supply bottle necks. This is an urgent issue when we see recently some major countries' fiscal policies are in contrast to what staff recommended in their most recent staff reports. We hope the WEO can have more discussion on this front, such as by adding a box.

We note staff's warning that monetary policy could miscalculate the right stance to reduce inflation. The faster-than-expected monetary tightening in some advanced economies (AEs) has already caused visible negative spillovers, with many developing and low-income countries at risks of volatile FX markets and disorderly capital outflow. Staff mention that divergent policy paths may lead to further US dollar appreciation and cross-border tensions. It is worth noting that not only the emerging markets and developing economies (EMDEs) currencies, but also the currencies of advanced countries are facing depreciation pressures. *We notice the exchange rates of some major AEs currencies are reaching their multi-decades low recently and accompanied by oral interventions by the relevant authorities, could staff elaborate more on their potential impact on the global financial markets and capital flow in EMDEs? What is the appropriate policy sequencing for these advanced countries when coping with the exchange rate depreciation among macroeconomic adjustment, macroprudential policy, and FX intervention, etc.? We urge staff to study this globally important issue in the WEO, to ensure its surveillance and policy advice is being evenhanded across member countries and topics.*

Geopolitical conflict and related sanctions are also important sources of downside risks and partial drivers of the food and energy crisis. We concur with staff that supply disruptions as a result of sanctions and conflicts are introducing upside risks to the global oil prices which has a big impact on oil importers. The world economy has suffered and will continue to suffer from the possible worsening of the conflicts and sanctions through the 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.

On addressing the energy and food insecurity, we notice that since the agreement to resume grain shipments was reached in end-July, the Food and Agriculture Organization of the United Nations (FAO) Food Price Index has decreased. This assuring development indicates that first, the food crisis can be solved to some extent by international cooperation; and second, supply side measures are able to take effect to solve food insecurity. Therefore, we cannot only rely on financial support to fight the energy food crisis. Supply side measures and multilateral cooperation are crucial to end the energy and food insecurity.

We concur with staff that risks of further fragmentation and supply-chain disruptions are rising. To this end, we support the Fund to continue its constructive role, deepen the analysis on trade policy, and help member countries refrain from protectionism measures. In addition to closely monitoring potential implications of these risks, more importantly, the Fund should increase its voice and decisively reduce these risks. We strongly encourage the Fund to continue its constructive role in enhancing solidarity and a rules-based multilateral trading system. Rolling back artificial trade restrictions and supply restrictions are in the interest of all countries.

On China's economic outlook, we notice that the report mentions that "the world's three largest economies – China, the euro area, and the US – will slow significantly in 2022 and 2023." This is a little bit surprising, because China's growth differences in 2022 and 2023 from the Fund's July WEO projections are relatively moderate among countries. Since the July WEO Update, many of the recent economic indicators in China have beaten market expectations, showing the resilience and steady improvement of the Chinese economy. In

August, the value-added of large industrial companies increased by 4.2 percent year on year, an acceleration of 0.4 percentage points than that in July, and total retail sales of consumer goods increased by 5.4 percent year on year, 2.7 percentage points faster than that in July. In the first eight months, investment in fixed assets increased by 5.8 percent year on year, an acceleration of 0.1 percentage points compared with January-July 2022.

Most importantly, for the first eight months, China's foreign trade increased by 10.1 percent, and the FDI inflows increased by 16.4 percent, showing that China's economic ties with the world further strengthened. China is one of the reliable pillars of a stable global supply chain. This has been proved once again by the August trade data. Therefore, the risk of potential "pandemic-related supply-side disruptions" from China should not be overemphasized. In the longer term, what we are really concerned about is the artificial trade and supply restrictions over parts and components in some key sectors, including the semiconductor sector. We call for the Fund to play its constructive role in reducing these restrictions and have a more balanced assessment on supply chain disruption.

We note with regret that too many places in the WEO mentioned the COVID-19 lockdowns in China. We call for staff to be more evenhanded in the surveillance of pandemic policy, as China is the only country with the pandemic policy discussed in the WEO and there is no even mention of the economic impact of massive human lives losses in some countries in the WEO. What's more, the WEO only mentioned the lockdowns, which is just an element of China's pandemic policies, and focused on the negative impact of lockdowns, which does not comprehensively nor accurately reflect the holistic picture of China's pandemic policy. The Chinese government always put people and their lives as the priority. China's dynamic zero-COVID policy is very comprehensive, including broad vaccination, regular masking and testing, fast tracing, targeted quarantine, and regional lockdown as needed. Regional lockdown is only an exceptional measure, and its economic cost is much less than that of the broad spread of COVID cases resulting from no lockdown. Given China's large population and huge density, the current pandemic policy is the best option, which effectively avoids severe COVID-19 outbreak, huge hospitalization, and massive loss of human lives. In fact, just because of the dynamic zero-COVID policy, China's economy recovered quickly and maintained a stable supply chain such that China exported hundreds of billions of masks and other protective garments which contributed to the global response to COVID. China has been working hard to minimize the economic impact of the pandemic and will continue to find the optimal balance between pandemic control and economic growth. Staff should avoid inappropriately and partially reflecting and stigmatizing the efforts of the Chinese government, health system, and people to contain the pandemic in the WEO.

On China's real estate sector, risks stemming from some individual firms in the short term will not undermine the effective operation of the overall market now and in the medium- and long- run. Housing sales, land purchases, and financing are gradually stabilizing. China is also implementing its policy toolbox in a timely manner, to support the construction and delivery of presold projects through special loans from policy banks to safeguard the legitimate rights of house buyers. In this context, we think it is not convincing to label the current Chinese property sector risks as a "crisis," as these risks are well managed and gradually decreasing, and the global economy is facing many other risks with more urgency to be focused.

Global Financial Stability Report (GFSR)

We are surprised that the GFSR was almost silent on the risks of deep currency depreciations in some AEs which were unseen for decades. We expect staff to provide more updates and professional analyses in the GFSR after the Board meeting. We also suggest staff to analyze the potential tail risk of currency crisis in one or more AEs in the upcoming EWE.

We feel that the Fund is once again behind the curve—this time in warning against the risks in the rapid increase in interest rates in the AEs, particularly the US. While we broadly agree that central banks should continue to tighten monetary policy to anchor inflation expectation, 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. Many economists are already asking whether monetary tightening is going too far and whether the major central banks are ignoring the cumulative impact of their simultaneous shift towards tightening. Such analyses were regrettably missing, and we urge staff to provide more analyses in this area in the GFSR. There should be better choices of policy mix for the world. Major central banks should also more proactively consider the spillover effects of their monetary policies, as well as the interaction between fiscal and monetary and supply side policies.

To mitigate spillovers of global tightening of financial conditions to EMDEs, solely relying on central bank communication in AEs is not enough. International monetary policy coordination would be essential to avoid negative spillovers. The Fund needs to provide pragmatic policy advice to country authorities where appropriate, including on the use of capital flow management measures on outflows and temporary foreign exchange intervention as part of the policy toolkit, in accordance with the revised Institutional View on Liberalization and Management of Capital Flows.

We are also somewhat surprised that the risk of fragmentation of the international monetary system was no longer mentioned in the GFSR. This risk has been mentioned in the April 2022 GFSR and, in our view, has only become more prominent in the past six months as many sanctions implemented by AEs are becoming permanent fixtures. We urge staff to more clearly articulate and prominently highlight such risks in the GFSR as well as in external communications.

With recession risk increasing, the risk assets and housing market will likely become even more volatile. Central banks are now committed to bring down the multi-decade-high inflation, and this would increase the risk of a downward spiral in many of the risk assets. *Staff's views are welcome.* Staff's analysis showed that in a "severely adverse" scenario, real house prices could fall more than 10 percent in AEs. This seems a tiny decrease by historical standards and do not tally with the recent fall in other types of risk assets, such as equities. *Could staff elaborate on their assumptions?*

We feel that the risk of China's property market remains overstated in the WEO and GFSR compared to other major markets. Compared with other more prominent risks, such as the overly tight monetary policy in AEs (as mentioned above), the coverage on China's property market is disproportionate. Financial conditions in China have remained basically stable and eased somewhat in the past six months. On a yearly basis, new home prices in the four first-tier cities in China rose 2.8 percent in August, while resale home prices in these cities climbed 0.8 percent, whereas the property markets in many major cities in AEs are already rapidly cooling. Moreover, with a relatively low inflation in China (2.5 percent year-on-year in August 2022), our authorities have a larger policy headroom to address any potential downturn in the property sector. Our authorities have consistently urged upholding the principle that "housing is for living in, not for speculation," making full and good use of the policy toolkit by adopting city-specific policies, and supporting people's essential housing needs as well as their needs for better housing.

Our authorities have coordinated efforts from both the supply and demand sides to promote the smooth operation of the property market in China. On the demand side, our authorities support people's essential housing needs as well as their needs for better housing. Our authorities have reduced the lower limit of interest rates on home loans for first-time home buyers to loan prime rate (LPR) minus 20 bps. Currently, the lowest interest rate is at 4.1 percent, a historically low level. Our authorities have also prudently lowered the down payment requirement on a city-by-city basis. On the supply side, our authorities will adhere to the market economy and the rule of law to resolve the risks arising from distressed property developers on a prudent manner. Through setting up special loan accounts in the policy banks, our authorities will strive to ensure that the construction and delivery of overdue residential projects. Going forward, we will continue to uphold the principle of "housing is for living in, not for speculation," making full and good use of the policy toolkit by adopting city-specific policies.

Fiscal Monitor

We welcome the Fiscal Monitor report to help policymakers balance the short-term needs and mid-term agenda against the shifting landscape. As the report rightly highlights, the surfacing recession concerns further accentuate tradeoffs among competing priorities of debt stabilization, protection of vulnerable populations, and investment for the future. Drawing lessons from the pandemic, automatic stabilizers and discretionary spending could be deployed to soften the downturn and boost activity. We commend the report focusing on the narrower aspect of how to help people and firms bounce back from the widespread real income losses and broadly agree with the costs and effectiveness analysis on fiscal policy options

The size, timing, composition, and duration of the policy matters, especially when budget constraints are tightening. We agree that the responsiveness and scope of the discretionary spendings can be enhanced through the existing social programs to cushion the shocks from soaring food and energy prices on the vulnerable households. The periodic review or expiration mechanisms for policy responses could help ensure that new initiatives are on track and do not outlive their initial purpose. We stress that fiscal choices ultimately depend on the available fiscal space. *We appreciate that staff share more specific guidance on domestic revenue mobilization and credible medium-term fiscal framework for countries with limited fiscal space in such a difficult juncture.*

Statement by Rasmus Rüffer (ECB Representative), Dimitrios Rakitzis and Sander Tordoir (Advisors) on the September 2022 World Economic Outlook, Fiscal Monitor and Global Financial Stability Report

IMF Executive Board Meeting

29 September 2022

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

World Economic Outlook / Fiscal Monitor

We broadly share the IMF staff assessment of the global economic outlook. Real GDP growth continued to slow in the first half of 2022 amid contraction in the US and China and the impact of the Russian war of aggression in Ukraine. Going forward, global growth is expected to remain subdued in the second half of 2022 and in 2023. The near-term outlook will indeed be shaped by three main drivers: the successful calibration of monetary policy; the course of the war in Ukraine and the possibility of further pandemic-related supply-side disruptions, for example in China. In addition, we view the ongoing slowdown of China's real estate sector and potential negative spill-overs as an additional factor shaping the global outlook. Like Staff, we see a sharp slowdown in global trade stemming primarily from more subdued global economic activity. The balance of global risks is to the downside for growth and the upside for inflation.

We broadly concur with the WEO assessment of the growth and inflation outlook for the euro area. The Russian invasion of Ukraine exacerbated pre-existing headwinds to growth, leading to further surges in commodity prices, renewed supply disruptions, mounting inflationary pressures and heightened uncertainty. Nonetheless, growth in the second quarter surprised to the upside, with euro area GDP expanding by 0.8% over the previous quarter. Growth was not only driven by tourism: while private consumption was the main driver of growth, investment also played a role, and growth surprised on the upside also in areas less dependent on tourism. Since the summer, adverse developments have started to prevail, weighing on the growth outlook. We concur with the IMF assessment about the key driving factors weighing on euro area GDP growth, which are related to the high inflation, the gas shock, and the elevated uncertainty. The natural gas supply disruptions are expected to be very heterogeneous across countries. At same time, it is important to note a number of factors which can be expected to cushion the deterioration in economic conditions, including a resilient labour market, high levels of accumulated savings and fiscal support measures, not least the deployment of the EU Recovery and Resilience Facility (RFF). The overall risk assessment rightly emphasises downside risks to GDP growth and upside risks to the inflation outlook.

Staff's assessment of inflation developments resonates with ours. We agree that global inflationary pressures are likely to peak in 2022, although inflation is likely to remain higher than previously expected throughout the forecast horizon. As noted by Staff, the increase in headline inflation in the global economy is not only due to volatile items such as food and energy, but increasingly also due to core inflation. In the euro area, energy and food inflation remain the dominant drivers of overall inflation. Whilst indicators of underlying inflation have increased in the euro area, recent month-on-month rates have been moving broadly sideways, albeit at still elevated levels. Like in the latest ECB Staff projections, projections for inflation in 2022 and 2023 have also been revised up in the WEO. We concur that upside risks to inflation require careful monitoring. One of the main risks is the complete halting of gas supplies to Europe.

Staff's analysis of inflation forecasting errors is timely and welcome. Whilst Staff see a strong role for excess demand in explaining forecasting errors, particularly for 2021, our assessment for the euro area is that errors have been mostly driven by supply factors, in particular the unprecedented energy price dynamics and supply bottlenecks. Other factors include lower-than-expected slack in the labour market and the rise in energy prices possibly being transmitted more strongly than usual.

As inflation in the euro area is far too high and expected to stay above target for an extended period, the ECB continues on its normalisation path. The ECB has been on a monetary policy normalisation path since December last year. We have terminated net asset purchases under the Pandemic Emergency Purchase Programme (PEPP, end-March) and the Asset Purchase Programme (APP, end-June) and raised our key interest rates by 50 basis points in July, and by 75 basis points in September. With these steps, we frontloaded the transition from the prevailing highly accommodative level of policy rates towards levels that will ensure the timely return of inflation to our two per cent medium-term target. Based on our current assessment, we expect to raise interest rates further over the next several meetings, to dampen demand and guard against the risk of a persistent upward shift in inflation expectations. The future policy rate decisions will continue to be data-dependent and follow a meeting-by-meeting approach. To support the policy normalisation process, we have announced the creation of a Transmission Protection Instrument to counter unwarranted, disorderly market dynamics that pose a serious threat to the effective transmission of monetary policy across the euro area. Moreover, we apply flexibility in reinvesting redemptions coming due in the PEPP portfolio, to counter risks to the transmission mechanism related to the pandemic. Sustained periods of high inflation – especially when coming together with labour shortages – may increase the risks of excessive second-round effects, which may lead to more persistent elevated inflation. We closely monitor wage dynamics and long-term inflation expectations to assess such risks. At the current juncture, while wage growth has increased, it remains still contained, although this comes with the caveat of a time lag. Going forward, resilient labour markets and some catch-up to compensate for higher inflation are likely to support growth in wages. With this in mind, we are focused on keeping long-term inflation expectations anchored. Policy makers across the EU are determined to avoid policies that could trigger a wage-price spiral and for now the risks look limited for the euro area as a whole. In this context, we welcome Staff's analysis on the risks of a wage price-spiral and observe that their narrative for wage dynamics in advanced economies corresponds to our assessment for the euro area.

We concur with Staff's call not to delay the green transition any further and agree that central banks should be able to adequately address inflation-output trade-offs arising from decarbonisation policies. Delaying the green transition further would only exacerbate transition costs, worsening the inflation-output trade-off and possibly creating a greater risk of inflation expectations de-anchoring. Within the chapter, the focus on the need to take system-wide action and to foster renewable energy is welcome. We also agree with the central tenet of the chapter; that as central banks continue to maintain their credibility in attaining their inflation mandates, they should be able to adequately address inflation-output trade-offs arising from decarbonisation policies. While the decarbonisation policies currently in place have only had a limited impact on output and inflation, maintaining well anchored inflation expectations will be crucial as the necessary decarbonisation policies are fully rolled out.

Turning to fiscal policies, we agree with the main messages of the Fiscal Monitor. The fiscal stance in the euro area, taking into account national budgets and the funding provided by the RRF, will remain supportive in 2022. However, supporting overall demand through fiscal policies in 2023 is unwarranted. Regarding fiscal-monetary interactions, we hold for the euro area the view that fiscal policy can complement monetary policy in fighting price pressures and supporting households and firms, as fiscal measures are partly buffering the shock from the war. Temporary and targeted transfers to vulnerable households may help contain second-round effects to inflation and limit the impact on public finances over the medium term. The focus should thus be on protecting households and firms most vulnerable to energy prices hikes with temporary and targeted support, including to avoid further fuelling inflation. We agree that targeted cash transfers are a better option than blanket price subsidies on fuel because they allow the rise in fuel costs to pass on to end users to facilitate energy saving and switching out of fossil fuels. Fiscal policies should maintain the agility and flexibility to adjust, if needed.

Defining a consistent medium-term fiscal policy framework for the post-pandemic world to help reduce deficits is indeed crucial. In particular, we believe that the focus of fiscal policy will need to shift progressively towards measures that ensure fiscal sustainability without endangering the recovery in the medium run and boost potential growth in the long term, thereby also facilitating the task of monetary policy to ensure price stability by not adding inflationary pressures. The European Commission will provide orientations for the reform of EU economic governance framework soon. The implementation of structural reforms and supporting investment for structurally diversifying energy supplies and reducing energy dependencies, as well as the green transition more broadly, remain priorities. Finally, we welcome the Fund's analysis on automatic stabilisers, which have served Europe well in absorbing the income shock during the pandemic, and the call for advance preparation of strategies to deploy fiscal tools, thereby improving their stabilisation effectiveness. As regards job retention schemes and government to support to firms, it is important that these are well-designed to avoid hampering the reallocation of resources.

Global Financial Stability Report

We broadly concur with Staff's general messages regarding financial stability in the current high inflation environment. Despite accelerated monetary tightening, inflationary pressures, supply and price strains in particular in the energy sector, and still lingering effects of the Covid-19 pandemic, the EU financial sector has remained resilient. It has been benefitting from solid bank capital positions, robust asset quality, high bank liquidity buffers, and well-functioning market infrastructures that have withstood market volatility shocks and declines in asset valuations.

The GFSR rightly emphasizes significant short-term risk, including the risk of a sudden, disorderly tightening in financial conditions, and the further repercussions of such a tightening. This would also affect sovereign refinancing conditions, though not uniformly. The economic situation and rising debt-servicing costs also create financial strains for some households and non-financial corporates, which may lead to rising non-performing loans. Some financial market segments show higher volatility and lower liquidity, which warrants close monitoring. Recent developments point to a moderation of the residential real estate cycle, but accumulated vulnerabilities in some markets increase the potential of house price corrections in some Member States. While high buffers in EU banks should limit potential ramifications for the financial sector, developments in some markets may warrant considering adjusting certain macroprudential policies.

The euro area banking sector remains highly capitalized and holds robust liquidity buffers. The sector benefits in particular from a continuous decrease in the levels of NPLs since 2014. Higher interest margins and the low cost of risk have supported banks' profitability, although the outlook is subject to elevated uncertainty regarding the impact of the slowdown in the European economy on banks' asset quality. In spite of analyst expectations that bank earnings would remain strong, bank valuations have fallen, reflecting the uncertain outlook. Early signs of higher credit risk have become visible with the share of stage two loans increasing, and default probabilities in the energy-intensive sectors. Euro area bank bond funding costs increased significantly during 2022. However, there are no clear signs of fragmentation in the bank bond market across euro area countries, and primary markets remain active.

We broadly share the conclusions of Staff's global bank stress test analysis. We overall agree with Staff's findings that there could be risks for banks related to a stagflation scenario and share the need to monitor them closely. Like Staff, we also consider stress tests to be a useful tool to assess such risks and conducted a top-down vulnerability analysis on the euro area banking sector in April. Similar to Staff's findings, our exercise showed that euro area banks are resilient to the macroeconomic ramifications of the war in Ukraine, which included rising inflation and weakening growth. Furthermore, based on ECB Staff analysis banks seem to be overall well-equipped to cope with a normalisation of interest rates.

We agree with Staff that macroprudential tools should strike a balance between containing the build-up of vulnerabilities and a disorderly tightening of financial conditions but would like to caution against loosening of borrower-based measures. The outbreak of the war in Ukraine has compounded the existing macro-financial vulnerabilities and increased the likelihood of risk materialisation in the near term. In this challenging environment, macroprudential capital buffers consistent with the prevailing level of risk preserve and strengthen banking sector resilience and increase room for manoeuvre, if and when adverse developments materialise. At the same time, the macroprudential response should consider current headwinds to economic growth and avoid undue tightening of credit conditions. As regards the appropriate macroprudential tools for preventing severe macroeconomic implications in the event of a sharp repricing in housing markets, we would advocate for not loosening borrower-based measures (BBM) in a downturn of the real estate cycle. In our view, BBM are a tool contributing to increase resilience of households and lenders over the medium term. Given longer time needed for the BBMs to decrease the riskiness of the stock of lending and given that BBMs are often introduced as a backstop, we consider that BBMs should not be loosened in a downturn. Some fine-tuning over the different phases of the real estate cycle may be possible via the use of selected exemptions to the policy limits.

We also welcome the analysis on risks and vulnerabilities in open-ended investment funds and support the policy conclusions, but also see scope for some additional considerations. Staff's analysis of the role of open-ended funds in potentially amplifying asset price volatility is timely and relevant. The ECB has also repeatedly warned about structural vulnerabilities in the asset management potentially amplifying market-wide stress (e.g. ECB Financial Stability Review, May 2022). It is indeed important to reduce the potential liquidity mismatch in this sector via enhanced anti-dilution measures, but also by aligning redemption terms with asset liquidity via more structural liquidity management tools. Such an alignment should be coordinated by supervisors and, at global level, by the FSB, to ensure a consistent approach across the asset management sector, and the FSB could also assess the effectiveness of such measures. We would like to offer a few additional considerations. As asset purchases by major central banks might have contributed to a shortage of high-quality collateral, it might be worth highlighting that a reduction of central banks' footprint in the future can have also positive impact on liquidity in some market segments. Moreover, it is worth noting that: (1) while banks have reduced the capital allocated to market making, regulatory reforms following the GFC have also made banks, and by extension their market making activities, more resilient; (2) algorithmic trading is believed to on average improve market liquidity in times of low volatility; (3) increase in trading automation can also make market liquidity assessment more challenging and traditional liquidity measures less reliable.

The GFSR analysis on scaling up private climate finance in EMDEs is timely as many EMDEs are highly vulnerable to climate hazards and they already account for a large share of global carbon emissions. Whilst private finance is key, it indeed does not substitute for other policies, most notably carbon pricing, which remains a cornerstone of credible signals for investors. We share Staff's analysis on the obstacles EMDEs are facing in scaling up green finance. We would emphasize the complementary need for international coordination to facilitate the development of a truly global green finance markets and avoid regional regulatory fragmentation. As approximately 80% of catastrophe losses are uninsured in EMDEs, we would also appreciate a deeper exploration on the role and potential of private (re)insurance sector in mitigating the macroeconomic losses of climate catastrophes and reducing the climate insurance protection gap. As we explore these topics in the EU context, we would welcome further work from the IMF on a global scale.

Responses to Technical Questions Posed by Executive Directors in Advance of EBM/22/82—September 29, 2022

World Economic Outlook

Staff's responses to technical questions are below. Broader policy questions will be addressed in staff's intervention at the Board meeting.

Outlook/Risks

1. **Unlike previous reports, the latest WEO offer no alternative scenarios to baseline projections. A plausible adverse alternative to baseline projections would have been useful, especially considering that the balance of risks are still heavily tilted downward. The fan charts of risk assessment around the baseline projections are very useful, but are no substitute to articulating an alternative scenario. *We would welcome staff comments*.**

- An adverse scenario has been circulated to the Board.

2. **On the outlook, we have seen a pattern this year of baseline WEO forecasts being presented together with warnings about substantial downside risks. Then the next WEO revises down the baseline, and again warns of substantial downside risks. We wonder if it would be more realistic and credible if the baseline forecast was revised down to a level where staff believe the distribution of risks to the outlook is more balanced. *Staff comments are welcome, including on how they would characterize the level of risks now compared to the April 2022 WEO*.**

- The risks section of the WEO report discusses the different risks to the outlook, and compared to the April 2022 WEO, we see the risks of monetary policy mistakes, dollar strength and sovereign debt stress as particularly noteworthy. To further quantify the impact of some of those risks, should they materialize, an adverse scenario has been prepared and presented separately to the Board.

3. **Staff emphasize the longer-term impact of scarring from the pandemic, but also expect the Chinese economy to slow in the medium term as the country deemphasizes growth targets and as its infrastructure-led development model fades. *We welcome staff comment on the external spillover impacts associated with the medium-term slowdown in Chinese growth*.**

- As noted in the report, the slowdown in China is expected to lower demand for the exports for foreign suppliers to China, which may contribute to a slowdown in regional trade (for Asia) and also globally. It also may intensify capacity constraints in production and logistics, and thus delay the relief global supply pressures. This may entail some inflationary pressures globally, but it will also be countered by a moderation in commodity prices for which China's demand is a main driver.

4. **Looking to Europe, we note that staff's forecast for growth in the euro area reflects a wide divergence in member state growth rates, with Germany and Italy facing a particularly weak 2023. *We welcome staff comment on the likely uneven impact of energy supply disruptions on European economies, and staff views on what role the IMF and other IFIs can play to support countries that may face macroeconomic instability as a result in the near term*.**

- There is considerable uncertainty around the macroeconomic impact of energy supply disruptions on European economies. Recent staff analysis focuses on the impact of a complete halt to Russian natural gas supplies to Europe and concludes that it could be especially large in countries in central and eastern Europe, where imports of Russian gas account for a significant share of energy consumption and where infrastructure constraints would prevent sufficient non-Russian (mainly liquefied natural gas) imports in the near term. Policies that substantially delay or prevent the pass-through from gas prices to household retail prices would concentrate the demand adjustment on industry, amplifying the output impact. (See Flanagan, M., Kammer A., Pescatori A., and Stuermer, M., 2022. How a Russian Natural Gas Cutoff Could Weigh on Europe's Economies.)

- Prompt and reliable access to liquidity—including through IMF and other IFI emergency lending instruments—can give countries breathing room to adjust to external shocks in an orderly manner.

5. **We strongly concur that downside risks dominate, and uncertainty continues to cloud the outlook and complicate forecasting. *We would, however, be interested in staff's assessment of potential upside risks to growth in the baseline, including from measures to stabilize global energy supply like the proposed oil price cap that could allow for Russian oil flows to remain on the market after European restrictions take effect*.**

- Growth could be higher than expected for a number of reasons. Factors that could boost growth include: a faster removal of recent cross-border restrictions to essential food, fertilizer and energy supplies, which would also mitigate food insecurity in lower-income economies; an intensified implementation of policies that expand the workforce (childcare subsidies, earned income tax credits); better access to COVID-19 vaccinations and treatment; and reforms related to enhancing education, business climates, and digital infrastructure.

6. ***Can staff comment on implications for unemployment and participation in the countries projected to experience an output contraction given recent labor market tightness in many countries?***

- The projected global slowdown is expected to slow growth and, with a lag, increase unemployment and ease labor market tightness. The cost-of-living squeeze may also incentivize some workers to return to the job market. Future labor market conditions critically hinge on incentives to increase participation as the labor market recovers from the pandemic shock.

7. ***Can staff comment on the global implications of the risks to China's real estate sector, with consideration of channels, timing, and other countries most likely to be affected?***

- The downside scenario circulated to the Board addresses this risk, including spillovers to the global economy. Issues in China's real estate sector reduce global output by –0.3 percentage points in 2023. The effects amplify over time as China's investment continues to decline relative to baseline in 2024. The associated slowdown in China is disinflationary, including via reduced demand for commodities.

8. ***We note the sharper decline in US growth compared to the EU while the latter is experiencing the direct effects of the war, including energy supply constraints. Could staff elaborate on the contrasting growth contraction?***

- The EA has seen upward revision for 2022H1, reflecting in particular better-than-expected growth in a number of service sectors (including tourism), but a downward revision for 2022H2. The US has seen a downward revision for 2022 as a whole. The difference in part reflects the unexpected weakness in US GDP in 2022H1 as well as the faster pace of US monetary policy tightening.

9. **We note the three assumptions underlying the baseline forecasts, namely no further reduction in natural gas flows to Europe in 2022, long-term inflation expectations remaining stable, and monetary policy tightening not inducing widespread recession. *Could staff comment more on the probability of the inflation expectations assumption given recent trends? We further note that policy actions will play a significant role in determining the two latter assumptions. Could staff also clarify why, in Table 1.1 on page 10 of the WEO, PPP GDP growth data for sub-Saharan Africa and LICs is missing? Is the data not available? Including an explanation in the Table notes would be helpful*.**

- The probability of these particular assumptions holding is difficult to ascertain.

- There is insufficient quarterly data for SSA and LIDCs to calculate the aggregates.

10. **As supply chain disruption has also been contributing to the slowdown in global trade growth with China being a critical node, in Spring we asked staff if it was possible to share effective third country approaches and work with the Chinese authorities to seek a solution to the supply chain disruptions linked to Chinese supply. *Could staff comment on progress in this regard?***

- Measures that the Chinese authorities have taken to address the supply chain disruptions linked to Chinese supply include: (i) expediting production resumption of key enterprises in the industrial and supply chains in areas affected by the pandemic; encouraging qualified enterprises to carry out " closed-loop production" to ensure stable operation; supporting logistics companies and seeding up construction of commodity storage and transportation bases; and improving cargo distribution, warehousing, transit transportation, and emergency support capabilities in key hub cities and ports; supporting the aviation industry, including expanding emergency loans and extending assistances to aviation enterprises and addressing aviation infrastructure construction needs.

- Together with 2022 G20 Chair, Indonesia, China and a few countries jointly proposed the Initiative of International Cooperation on Resilient and Stable Industrial and Supply Chains, calling for global partnership for the resilience and stability of the global industrial and supply chain.

11. **Some commentators have highlighted the parallels between the current situation and the early 1980s, when rising global interest rates, the strengthening of the US dollar, and the decline in global trade triggered a widespread debt crisis in EMDEs. So far, the increase in sovereign spreads in major emerging economies has been moderate. We highlight that current policy frameworks in EMDEs are much stronger than in the early 1980s, but debt levels are higher. *We would appreciate if staff would elaborate on the possibility of another debt crisis in EMDEs and the ability of the global financial safety net to meet this challenge*.**

- The WEO report notes the recent surge in sovereign spreads for many EMDEs and emphasizes that sovereign debt distress is a key risk to the outlook. Many vulnerable emerging market and developing economies, particularly those hit hardest by energy and food price shocks, may face debt sustainability risks. This is further amplified by the dollar strength and a potential intensification in capital outflows which may cause distress for economies with large external financing needs. However, a generalized debt crisis remains a low probability outcome as debt distress is currently confined to countries that are not systemically significant at this point (see Figure 1.27).

12. ***Could staff also provide their view on the size of the global output gap and its role in driving global inflation currently?***

- The output gap is currently estimated to be modestly negative for the world economy (about –0.7 percent in 2022 and –0.9 percent in 2023). Estimates of the output gap are not available for all economies and so this (unpublished) estimate is approximate. It nevertheless reflects the incomplete recovery from the pandemic and the ongoing slowdown. As Chapter 1 explains, the unexpected rise in inflation is better explained by other measure of economic slack, such as the ratio of vacancies to unemployed workers. Adverse shocks from the disruption of supply chains, the rise in food and energy prices, and their passthrough into underlying inflation have also driven the rise in inflation.

13. ***Regarding the global economic growth forecast, we seek staff's clarification on the difference in projection in WEO (3.2%) and GFSR (3% in Chap 1 para 16)*.**

- The GFSR text is now aligned with the WEO forecast (3.2 percent global growth in 2022).

14. **Both the WEO and GFSR strike an appropriate balance in highlighting the risks to EMEs posed by tightening global financial conditions, without sounding alarmist. … *We would, though, welcome elaboration for the Board as to how much comfort or concern staff have drawn from recent events, relative to what one might have expected based on historical relationships, such as those embodied in their capital flows at risk model.***

- Acknowledging that the balance of risk is firmly tilted to the downside, an adverse scenario has been circulated to the Board.

15. ***Could staff comment if the recent hardening of policy stance of the major central banks makes a difference for the growth outlook?***

- Yes, the latest forecasts incorporate the recent tightening in central banks' policies, which is contributing to the projected slowing in the global economy from 6.0 percent in 2021 to 2.7 percent by 2023—an usually weak growth profile. At the same time, the overall pattern of forecast revisions across economies reflects multiple other factors, including, for example, better-than-expected outcomes in the first half of 2022 in the services industries of a number of European economies. Furthered tightening of financial conditions is assumed under the adverse scenario, separately circulated to the Board, with a discussion of its impact on the growth outlook.

16. In this environment, where downside risks dominate the outlook, the close examination of risk scenarios is critical. We note that staff cut the growth outlook and revised up inflation projections for the fourth time in a row. While we understand the difficulties of economic forecasting at the current juncture and appreciate the special boxes in the WEO on the inflation forecast errors and uncertainties around baseline projections, the threats stemming from the confluence of risks could also be featured more prominently. ***In this context, we would also appreciate staff's elaboration on the calibration of adverse scenarios. Even if a widespread recession is not currently in the baseline, recession fears are already squeezing many sectors. In this context, we also wonder how staff assess the new macro data released after the first draft of the WEO, as well as stagflation risks on the horizon.***

- An adverse scenario has been circulated to the Board.

17. ***More specifically, regarding global imbalances and international investment position, the report mentions the valuation losses associated to the decline in asset prices and the valuation gains associated to the USD appreciation. Could staff elaborate on the relative importance of each factor for 2022?***

- A quantification of the magnitude of relative gains and losses in 2022 would require further work and has not been conducted at this time.

Wage and Price Dynamics

18. ***Do staff consider that the high levels of producer prices increase the risk of more protracted CPI inflation in major economies?***

- Chapter 2's multi-economy, multi-sector model was calibrated to reflect the impacts of the largest and most important sources of underlying variation for prices, which affect both producer (wholesale) and consumer prices. In the context of the model, whether CPI inflation will be more protracted depends critically on whether there are new shocks (such as commodity price and supply chain shocks) that hit the system. The baseline presented in Chapter 2's forward-looking analysis assumes that there are no new shocks and the effects of the underlying cost-push shocks as of mid-2022 gradually decay (similar to previous experience). On the narrow question of the pass-through from producer to consumer price inflation (which Chapter 2 did not examine), we note that PPI inflation has been elevated but also volatile since the onset of the pandemic, making an assessment of potential pass-through to CPI inflation challenging.

19. **Monitoring the evolution of the risk of wage-price spiral will be critical and we thank staff for their analysis in the WEO chapter 2. Backward-looking expectations will be an important indicator to follow. We are also wondering to what extent the pandemic and the war could have structurally affected the wage formation mechanism. *Could staff provide some insights?***

- Discerning whether there has been a large structural change in wage-setting processes is difficult, as there are so far few data points to assess. Over the past several decades, there has been a secular decline in worker bargaining power (as captured by union coverage rates) in many economies, which has likely dampened second round effects on wages (see Baba and Lee 2022 for discussion on this). If there have been structural breaks (such as large changes in unionization or wage indexation impacting wage-setting), then historical analyses would be less informative about prospects. As noted in Chapter 2, the forward-looking model-based analysis with expectations provides some insurance against structural breaks, since it implicitly incorporates a limited type of regime change through the time-varying impact of adaptive learning on wage- and price-setting processes.

20. **On monetary-fiscal policy coordination, we note the importance of efficient fiscal spending and well targeted measures to cushion the impact on the vulnerable, given the simultaneous need to reduce fiscal deficits and debt vulnerabilities. *Staff note that the cost-of-living crisis may put pressure on governments to give in to above inflation wage demands, generating second round effects. As this is already the case in various countries in our region, staff insights on how to stem this and disincentivize labor unions from going this route, would be valuable.***

- Based on the analysis in the *World Economic Outlook*'s Chapter 2, the risk that sustained wage-price spirals emerge appears limited for the average economy, given that the underlying inflationary shocks are not coming from the labor market, the fall in real wages helps slow inflation, and monetary policy is tightening aggressively. Importantly, actions to bring inflation down help real wages to recover over the medium term. If such conditions change (such as a sharp uptick in wage indexation), risks could rise. Where inflationary pressures are high, fiscal authorities will need to ensure that deficits do not rise, while buffering vulnerable populations through targeted support. In this context, the need to maintain fiscal prudence and the beneficial effects for workers from lowering inflation back to target could be emphasized in interactions with unions.

21. **Food inflation has eroded global living standards, and in SSA, the situation has been exacerbated by high energy costs, which show up both directly and indirectly through higher transportation and cooking costs, highlighting the need to cushion vulnerable households. Manifold challenges underscore the centrality of collective action needed to address such global challenges and avoid reverse**

spillovers down the road. *Could staff elaborate on the differential effects of commodity price trends on SSA and LAC?*

- The share of food in the consumption basket of the average SSA household is larger than that of the average LAC household and both groups differ in their income level and policy capacity to offset external shocks.

22. The narrative on pages 4-8 provides helpful guidance especially in the context of large central banks that are coming out of unconventional monetary policy and monitoring the evolution of the natural rate of interest and the implications for monetary policy transmission. We also welcome the ECB's recently introduced Transmission Protection Instrument to improve monetary transmission and tackle fragmentation risks in the Euro-Area. *Could staff also offer analytical guidance on policy intervention and limits to avoid recession, for those developing countries that have higher inflation and high unemployment in regions such as SSA, and most of which did not face deflation during the great moderation. Did they have a similar evolution in their natural rate of interest due to the pandemic's impact on potential output, or were there other factors of note?*

- The natural rate of interest is driven by many factors such as demographics, productivity, wealth inequality and, importantly, is unobservable. Globally, financial flows and the associated global natural rate of interest is likely drive by the volume of excess savings that accrue naturally in the wealthier economies. In so far, SSA countries take the evolution of the natural rate of interest as given, and risk-adjusted capital flows will result from any perceived return differentials. The Integrated Policy Framework (IPF) offers concrete policy guidance for optimal reaction to external shocks under different policy calibrations.

23. *On terminology used in the WEO, we observe that the WEO refers to China's "property sector crisis", whereas the GFSR, which analyses China's housing market in greater detail, avoids the use of the term "crisis" and instead refers to China's "property sector downturn" or "housing market risks". In addition, the title of Figure 1.18 reads "Inflation Likely to Stabilize Next Year", an observation that is not supported by the WEO analysis, where inflation in AEs and EMDEs is projected at 4.3 percent and 7.8 percent, respectively, in 2023. Staff may comment.*

- The reference to a crisis is consistent with the assessment in the July WEO Update. Regarding inflation, it is expected to *decline* in 2023 and we will look into the specific wording.

Monetary Policy

24. *As we noted before, with central banks around the world all currently raising key interest rates in widespread tightening of monetary policy, this could end in recession if the collective impact on global demand is not factored into policy guidance. Have IMF models mapped out how impacts from this simultaneous tightening will play out across the globe? Could staff comment further on this?*

- Yes, IMF staff forecasts are based on a shared set of assumptions that include the anticipated tightening in global monetary conditions and the implications for global demand.

- In addition, the different layers of the adverse scenario in the 2022 July WEO *Update* and the Downside Scenario in the 2022 October WEO are based on multi-country models where policymakers incorporate the cross-border impacts of other countries' policies.

25. ***The current context of synchronized monetary tightening at the global level calls for caution when calibrating the adequate policy stance. Disregarding the spillover effects from other central banks' actions could lead to a policy overshooting, increasing the risks of a global recession. Staff´s comments are welcome.***

- Please refer to the answer to the preceding question.

26. ***What is staff's assessment of the timeliness and appropriateness of monetary policy normalization to date compared to the Fund's past advice to members, and are there lessons for how the Fund's advice can be improved?***

- The Fund's policy recommendation on monetary policy is to normalize and tighten monetary policy to restore price stability. We also caution against premature easing to avoid the risk of under-tightening and to ensure inflation expectations remain anchored.

- We also note that inflationary dynamics have been underestimated by most forecasters, including those at the Fund, and assess which factors, including the Covid-19 fiscal stimulus, contributed to this issue (WEO Chapter1, Box 1.1).

27. ***We would appreciate staff's elaboration on the assumed monetary policy path in the advanced economies in the WEO baseline and whether this is still realistic given the latest round of policy tightening and guidance from central banks. We would also have welcomed further analysis and guidance in the WEO and GFSR on the desired monetary stance relative to the neutral rate for countries to achieve timely disinflation. Staff comments are welcome*****.**

- The forecasts incorporate implemented and announced tightening in central bank policies. Restoring price stability will require raising real policy rates above their neutral level fast enough and for long enough to keep inflation and inflation expectations under control. Uncertainty about the level of the neutral rate of interest makes means that there are risks of under- and overtightening.

28. ***Can staff comment on what additional measures could be considered by individual authorities or through international cooperation?*** **We see merit in refining the policy toolkits under the IPF taking account of the current economic situation and FX market developments.**

- In the current context, the IPF generally recommends that exchange rate flexibility is desirable to facilitate adjustment to shocks to fundamentals, e.g., US interest rate hikes and commodity price shocks. If frictions arise related to shallow FX markets, FX mismatches, and/or de-anchoring of inflation expectations, the use of FX intervention may help smooth market functioning or replace missing markets, provided that the intervention is targeted to the market with the frictions, rather than trying to prevent the exchange rate from adjusting at all. There may be limits to the effectiveness of FX intervention. FX intervention may not be effective if FX markets are deep or if the frictions are arising owing to a lack of macroeconomic adjustment; in these cases, macro policy settings should be adjusted. FX intervention may also be ineffective if there are insufficient FX reserves, in which case access to FX swap lines and IMF facilities may be useful. Finally, for FX intervention to be effective, there needs to be effective communication and governance whereby central banks explain how the intervention fits into the envisaged monetary and fiscal policy mix for adjustment during the upcoming turn in the global financial cycle.

29. *We would appreciate if staff would elaborate on avenues to enhance international policy cooperation among major players, including monetary policy and foreign exchange interventions in key currencies*.

- Please see the response to the preceding question.

30. Countries that are barely starting to recover from the pandemic and the deepest global recession since 1945, and have yet to reverse scarring, must now raise interest rates even more aggressively than most to curb inflation, further constraining their growth. *Robust analysis and policy advice to central banks on managing these tradeoffs is therefore essential for developing countries at this juncture. Could staff brief us on plans in this regard?*

- Policy analysis and advice to support central banks in assessing these tradeoffs will come both through multilateral surveillance (the flagships and REOs) and—to provide more tailored advice—through bilateral engagement under the surveillance umbrella.

- The IMF has pivoted with its new Surveillance guidance note (effective this year) to specifically address these questions with its focus on scenarios, contingent policy plans, and policy advice for environments in high uncertainty.

- Separately, work on the IPF is proceeding: the IPF in a nutshell aims to deliver policy advice that takes country specific circumstances and frictions into account. The recent Thailand Staff Report is one recent example. The PHL team-currently in the field- has followed a similar approach, and further IPF implementation pilots are in train.

31. *Could staff comment on conditions pertaining in 1994, the one time that [US] inflation came down without recession? Were there factors other than monetary policy at play (such as oil prices peaking then falling), and if so, might this be replicated this time around since futures markets point to a fall in oil prices starting next year? If so, this would be good news for the global economy, helping*

to avert recession and reducing current BoP and inflationary pressures (including in developing countries), from elevated energy prices. Perhaps outreach messaging could also highlight the positive / optimistic scenarios that countries can aspire to (beyond the baseline), so that we are constantly communicating a way out of both inflation and recession?

- Please refer to the GFSR Box 1.3 on "Financial Markets and US Monetary Policy Tightening Cycles: A Historical Perspective," which discusses the 1994 cycle.

32. ***Could staff elaborate on how monetary policy can best affect expectations formation and the best strategies to balance the inflation-output trade-off while prioritizing price stability? When should central banks with relatively strong credibility pause, and how should that be communicated to minimize the impact on output? How are staff estimates of the neutral rate arrived at for most countries? Have neutral rates changed materially since the pandemic?***

- The history of monetary policy that led to the "Great Moderation" (Bernanke, 2004) suggests that monetary policy tames inflation best if it leans against inflation and increases real interest rates appropriately to moderate excess demand, while communicating clearly about goals and policies.

- Assessing how neutral rates have evolved is an area of ongoing research. Figure 1.24 in WEO Chapter 1 provides a preliminary estimate of how the neutral rate has evolved for the US, although the estimation is subject to large uncertainty.

33. ***Taking into account elevated borrowing costs and deteriorated market access in EMDEs stemming from the spillovers effect of AEs' aggressive monetary policy tightening, we would appreciate staff's views on policy trade-offs faced by EMDEs*****.**

- It is difficult to generalize across the EMDE's as policy advice needs to be tailored to individual circumstances such as exposure to shocks, realization of shocks, resilience through institutions, automatic stabilizers, and measures policy space. However, in this environment, spillover effects are more adverse for economies with greater shares of external dollar denominated debt and short debt maturities. The policy section on "International capital flows" provides specific policy guidance based on the IMF's Integrated Policy Framework (IPF).

34. ***While we share the view that monetary policy tightening should be sufficiently aggressive, the current labor market dynamics, with decelerating real wages as discussed in Chapter 2, requires that monetary policy tightening be carefully calibrated and should not "overkill", and also be accompanied by clear communication to anchor expectations. Staff comments are welcome*****.**

- We share this concern and highlight the danger of policy mistakes in the risks to the outlook section on "Policy mistakes: under- or over-tightening monetary policy", while giving due weight to the asymmetry in policy errors (also highlighted in the GFSR): Policy under-tightening may increase the risk of de-anchoring of inflation expectations and require a more abrupt tightening with larger economic losses later on. Central banks should avoid a stop-go policy approach as in the early 1980s in the US where premature policy easing was followed by recession.

35. The prospect of the sequential forced interest rates increases by central banks is a substantial risk for the global economy. Aggressive monetary policy tightening by the Federal Reserve compels other central banks to raise interest rates more than they otherwise would have done. In many economies that peg their currencies to the US dollar, interest rates have to increase almost automatically, even when higher rates are harmful to their economic prospects. We note that China and Japan remain among a few countries that have not embarked on the competitive monetary tightening yet. ***Could staff comment on the risks of desynchronized policy stance for the major Asian economies?***

- The policy divergence between, for example, policy rates increases in the US and lower rates in Japan and China and the consequences for currency movements is addressed in the paragraph on “Divergent policy paths and dollar strength.”

36. Fighting inflation is a top priority, in particular through monetary policy. While we agree that it is necessary to avoid a more costly adjustment later (in case of insufficient monetary tightening), we also would like to insist on the need to limit as much as possible the impact on growth and employment thanks to a careful calibration and sequencing of policies, according to country circumstances. More attention should be paid in our views to the negative compounding effects associated to the synchronous tightening of the policy-mix which could also raise financial stability risks in the longer run. ***Could staff elaborate on those risks and explain how policymakers could take them into consideration in their decisions?***

- Chapter 1 of the WEO calls for monetary policy to commit to the fight against inflation and for fiscal policy to align to the stance of monetary policy. In the section on “Monetary and fiscal policy coordination”, we emphasize that fiscal policy should be used when needed to soften the cost-of-living squeeze for households but should be targeted and accompanying by saving/contraction elsewhere in the budget. This helps in ensuring aggregate demand is cooling down and avoids a hike in already elevated debt levels. For EMDEs, further advice is given in the policies section on “International capital flows” where policy guidance from the IPF is given on the appropriate use of exchange rate policy and capital flow management measures (CFMs), as part of a coherent policy mix.

Fiscal Policy

37. Staff comments are welcome, including on the recently announced plans and proposals in the UK and EU to mitigate the impact of higher energy prices. Support for the most vulnerable needs to be well-targeted through carefully designed redistributive measures. Even here, there may be macroeconomic consequences given different marginal propensities to consume across income levels. ***We would welcome staff comments on whether policies to strengthen the***

safety net may add to excess demand pressures in current circumstances even if fiscally neutral.

- Although targeted redistributive policies may be appropriate, deficits should be reduced to help tackle inflation and address debt vulnerabilities. Fiscal consolidation can also send a powerful signal that policymakers are aligned in their fight against inflation. Countries will need to make difficult choices in the composition of spending, given the need to keep a tight fiscal stance. For example, the cost-of-living crisis may put pressure on governments to approve above-inflation public sector pay deals.

- Without fiscal contraction elsewhere, and with tight supply, unfunded government spending increases or tax cuts will only push inflation up further and make monetary policymakers' jobs harder.

Climate Policies

38. The Fund's policy advice must be only guided by macroeconomic considerations that serve the broad interest of the membership in line with the Fund mandate. *Hence, we request a revision of the relevant text accordingly so that the climate agenda is only guided by climate objectives in line with the Paris agreement*.

- We are looking into the specific wording.

39. We would request staff to include in future reports analysis of the macroeconomic impact of global de-carbonization on fossil fuel producing countries, which are going through transitions of their own. *Could staff comment on any progress on this front?*

- Staff will work actively on developing a version of the model with a region representing fossil fuel producing countries in the coming months.

40. How does staff see Russia's invasion of Ukraine affecting assessments of climate transition risks?

- Russia's invasion of Ukraine has large implications on the outlook (economic growth, fossil fuel trade and availability at the regional level, and GHG emissions), and adds a new layer of risks. A main concern for the transition is the availability and price of fossil gas in Europe over the next couple of years, as gas availability has been a centerpiece of the transition in the electricity sector (to backup, together with hydropower plants, growing shares of intermittent renewable sources). As fossil gas is an infrastructure commodity (it requires pipelines or liquefaction/regasification utilities), it takes a couple of years to rebalance each regional market towards alternative sources of fossil gas. At the same time, there is an opportunity for implementing policies that (i) save energy in the short run, (ii) revive or accelerate other types of electricity generation (nuclear power plants, renewables), (iii) foster financing of R&D in green technologies. Also note that a greater availability of Russian gas in Asia could facilitate a swift crowding-out of high-emission coal and provide a greener bridge technology towards renewables.

41. **We share the staff's recognition that the first-best option of establishing an institutional arrangement – an analogy with independent central banks – to achieve the credibility of climate policies is too ambitious; however, the focus of future research should be on whether there is a case for devising alternative "*disciplining devices*" – notably for (automatic) redistribution – that can provide second-best solutions by fostering the adjustment of investment in the electricity sector. *Staff's comments are welcome*.**

- Given that credibility is a key prerequisite for mitigation policies to affect forward-looking investment and R&D decisions, we agree that research on credibility-enhancing tools is highly relevant. Nemet and others (2017) provide a more detailed discussion on aspects of mitigation policies that work to some extent as a "disciplining device" while falling short of a full, central bank-like delegation of policy. One example is the periodic review of the success for mitigation policies carried out by an independent institution. Rogge and others (2018) draw on the case of the German *Energiewende* to investigate what policies are perceived as credible by the electricity sector, which is helpful in the design of second-best policies. While studies like these constitute a first step, additional research would be helpful to provide effective advice to the IMF's membership.

[1] Nemet, Gregory F., Michael Jakob, Jan Christoph Steckel, and Ottmar Edenhofer. "Addressing policy credibility problems for low-carbon investment." Global Environmental Change 42 (2017): 47-57.

[2] Rogge, Karoline S., and Elisabeth Dütschke. "What makes them believe in the low-carbon energy transition? Exploring corporate perceptions of the credibility of climate policy mixes." Environmental Science & Policy 87 (2018): 74-84.

42. ***Can staff comment on the welfare consequences of the policy packages from the WEO Chapter 3 for the different income groups within the countries?***

- Staff has not investigated this. The focus is on macroeconomic implication of mitigation, particularly for the three largest emitters. Note that the online annex looks at alternative mitigation strategies to achieve a 25 percent decline in global emission while allowing the "rest of the world" block to delay any climate action until the end of the decade. This is a polar case but allows to gauge the range of possible outcomes without taking a stand on the actual speed of transition in these countries. Also, note that the impact of mitigation policies on a larger set of countries and different income groups within countries, has been estimated in Fall 2020 WEO Chapter 3.

43. ***Could staff elaborate on the comparability of the three packages and in particular how environmental norms have been integrated?***

- The three illustrative policy packages are comparable in that they all induce the same reduction in greenhouse gas emissions by 25 percent. They differ on how revenue is used (to compensate households with labor tax cuts and transfers and to subsidize low-emitting sectors). Package 3 proxies for sector-specific regulations as it contains measures that bring about the same adjustment of the supply side as a tax, but without generating government revenues. However, norms with a broader environmental objective (pollution, biodiversity, etc.) are not considered in the model.

44. ***Could staff elaborate on the impact of coordinated policies on developing economies in the short term, in particular according to their energy-mix?***

- The model's regions are chosen to represent the three largest emitters, where immediate emission reduction is required to keep alive the goals of the Paris Agreement. An analysis of emission mitigation in specific developing economies requires additional work. Note that the rest of the world block is mainly composed of EMDEs and is on balance a fossil fuel exporter. It is only indicative given the large variety of countries with different characteristics. Unfortunately, the mapping to individual countries is currently beyond the scope of the model. Staff will work actively on developing a version of the model with a region representing fossil fuel producing countries in the coming months. Some insight can be gleaned from the Fall 2020 WEO chapter 3 that has a more granular analysis of climate policies by country groups.

45. **We have several objections to the characterization of Uruguay's climate policies in Box 3.2. We have sent technical comments to staff which we appreciate will be considered for the publication of the document**

- Staff is in contact with the authorities to address any factual error regarding Uruguay climate policy.

Other Policies

46. ***Could staff comment on whether the sharp jump in yield spreads for SSA sovereign bonds in 2022 has been influenced by the ongoing reporting on common framework delays and expectations of private creditors regarding their required participation in SSA debt restructurings? We would also be interested to hear more on outreach plans for the IPF guidance note including to SSA, and how this can be folded into contingency planning. Could staff also comment on whether there is scope to coordinate normalization and the messaging that goes with it in major economies, to help contain inflation expectations globally, and further negative spillovers to developing countries from an extended normalization?***

- The contribution of this factor is difficult to ascertain. As in other regions, economies initially perceived as riskier have faced a proportionately larger increase in spreads.

- With policy space tightening for highly indebted countries, the Common Framework can and must deliver more quickly. IMF and WBG staff have identified a number of improvements to speed up progress under the Common Framework.

- The interdepartmental IPF group is working on a revised guidance note for FX intervention, a cross-country dataset of IPF-relevant metrics, and diagrams of the IPF conceptual model. These outputs will be feed into IPF pilot cases, and the experiences will be summarized in a Board meeting at the end of the fiscal year. Overall, IPF operationalization will help in the formulation of contingent policy plans and policy advice for environments in high uncertainty.

47. ***Additional suggestions on how to speed up the progress under the Common Framework, e.g., to make it more attractive to prospective debtor country participants and ensure comparable private creditor participation, would be very welcome*****.**

- With policy space tightening for highly indebted countries, the Common Framework can and must deliver more quickly. IMF and WBG staff have identified a number of improvements to speed up progress under the Common Framework: (i) greater clarity and agreement from official bilateral creditors on the different steps and timelines in the CF process (e.g., official bilateral creditors should aim to provide financing assurances within three months of reaching a staff-level agreement (SLA) with the IMF staff. This would enable the early resumption of essential financing and support the implementation of a reform program); (ii) early engagement of official creditors with the debtor and with private creditors would help accelerate decision making; (iii) a debt service payment standstill for debt to official bilateral creditors for the duration of the negotiation would provide relief to the debtor at a time when it is under stress; and (iv) official creditors should clarify further how comparability of treatment will be determined and effectively enforced under the CF; and (v) expanding coordinated debt treatments to highly indebted non-DSSI eligible countries.

Commodity Special Feature

48. We would have welcomed an update of staff's projections of prices of "energy transition metals" in the Special Feature or in Chapter 3 on climate change; prices of these metals (e.g., copper) seem to be more responsive to cyclical factors than to structural greening factors.

- While metals and oil prices have declined substantially, natural gas prices remain extremely elevated as they are about 50 percent higher than before Russia's invasion of Ukraine. The decline in metals and oil prices can be attributed mostly to factors related to higher interest rates and a slowdown in global economic activity as mentioned in the CSF—indeed, base metals prices are about 25 percent lower than pre-invasion while oil prices are only 10 percent lower which suggests that demand factors and higher interest rates rather than supply have played a more relevant role. Tight space constraints have prevented us from adding projections for the new green metals index; however, staff welcome the suggestion for future work. Except lithium and other minor metals, industrial metals such as copper or nickel are still used in a broad set of applications, and their use in green technologies is expected to increase but as of today traditional sectors are still predominant.

49. The WEO special feature on "Market Developments and Food Price Inflation Drivers" provides additional insights on the spillover effects of the war in Ukraine

across the globe, although it may have been appropriate to point out that upward movements in commodity prices commenced before February 2022.

- We agree that there were upward movements in commodity prices before Russia's invasion of Ukraine. Due to space considerations, we mention this briefly here: "Global food commodity prices entered an expansionary phase in 2020, increasing by 54 percent, from trough to peak, with the prices of food that make up large parts of diets increasing by 107 percent."

Global Financial Stability Report

Staff's responses to technical questions are below. Broader policy questions will be addressed in staff's intervention at the Board meeting.

Chapter 1

Market Liquidity

1. Could staff elaborate further on the best policies to mitigate market liquidity risks, and their views on increasing calls to review regulatory capital regulations adopted after the GFC?

- The recent market developments show how the deterioration in market liquidity can amplify price moves and exacerbate volatility. So, it's critical for policymakers to mitigate liquidity risks and safeguard financial stability. The Chapter 1 of the GFSR provides a specific policy recommendation to mitigate market liquidity risks. Also, further policies to address market liquid challenges discussed in previous IMF publications including (i) Improving the availability of trade level data, which would help the private and public sectors with timely assessment of liquidity risks in markets ; (ii) For US Treasuries specifically, the publication of trade level data has many benefits in terms of increasing transparency and counterparty risk management (see US FSAP, 2020); the broadening of the Fed Standing Repo Facility; and (iii) In our view, recent episodes of market stress underscore the need to strengthen NBFI resilience. In this context, strengthening NBFIs' liquidity risk management tools and practices and potentially, by directly addressing key structural liquidity mismatches can play a significant role in reducing the imbalance between liquidity demand and supply in core financial markets under stressed conditions.

- On post-GFC regulatory reform. Regulatory reforms to increase banks' resilience tightened capital regulations and increased the costs of and decreased the returns to dealer banks' market-making activities. In this regard, it is important to note that better recognition of the costs involved in providing liquidity to markets and the reduction of dealer banks' leverage are intended and expected outcomes of these reforms. Overall, the experience during the COVID-19 and subsequent shocks has reinforced the importance of completing and implementing the remaining elements of the post-crisis reform agenda—those parts of the financial system where implementation of post-crisis reforms was most advanced displayed greater resilience as evidenced by banks displaying much greater resilience during these episodes relative to their experience during the GFC. When assessing banks' ability and willingness to make markets during recent stress events, it is important to note that available evidence points to such market intermediation not increasing at the same pace and by the same magnitude as the demand for liquidity in markets rather than to reduced market making by dealer banks.

Consequently, the fact that large orders may be more difficult to execute under stressed market conditions today may owe more to the very significant increase in debt issuance and volume of bonds outstanding in global financial markets than to reduction in banks' market making per se.

<u>**Monetary Policy**</u>

2. **We would also have welcomed further analysis and guidance in the WEO and GFSR on the desired monetary stance relative to the neutral rate for countries to achieve timely disinflation. Staff comments are welcome.**

- The Financial Counsellor will address this question verbally at the Board meeting.

3. **Could staff provide further details, and their views, on the decision of many central banks in AE to abandon forward guidance (FG).**

- The Financial Counsellor will address this question verbally at the Board meeting.

4. **It cannot be ignored that monetary policy tightening has significant spillover effects on all aspects of the economy, including sovereign, corporate and household debt as well as on the financial sector. Therefore, we are of the view that it is appropriate to maintain language consistency between the GFSR and the WEO, where the latter also includes warnings on possible policy miscalculations in taming inflation. Staff may comment.**

- The monetary policy recommendations have been closely aligned across the three flagships. The key message is that central banks must act resolutely to bring inflation back to target, keeping inflationary pressures from becoming entrenched and avoiding de-anchoring of inflation expectations that would damage credibility. Therefore, the tightening of financial conditions that we are witnessing is partly an intended objective of tighter monetary policy. However, we agree that that there is a risk of a disorderly tightening of global financial conditions that may be amplified by vulnerabilities built over the years. There is also a risk that authorities may not do enough and inflation expectations de-anchor. We believe these risks are not symmetric; at the current macroeconomic juncture, the latter risk is more prominent than the former.

5. **We also appreciate staff comments on the applicability of FG by other central banks in the current environment.**

- FG could be readopted by central banks that are confident about where they are in the cycle. However, few central are in this situation at present.

6. **More attention should be paid in our views to the negative compounding effects associated with the synchronous tightening of the policy mix which could also raise financial stability risks in the longer run. Could staff elaborate on those risks and explain how policymakers could take them into consideration in their decisions?**

- International cooperation is always the most effective course of action for policymakers. Given the key situation of the Fed, its actions will have implications for other countries around the world. Central bank officials should remain in close contact and be as transparent as possible about future plans. However, as inflation remains well above target globally, price stability should remain the overriding objective. The concern raised about excessive monetary tightening could indeed be a future risk, but the greater one at this juncture is that central banks do not do enough, with large potential costs in terms of higher inflation expectations and a dent to central bank credibility.

7. **We note that China and Japan remain among a few countries that have not embarked on the competitive monetary tightening yet. Could staff comment on the risks of desynchronized policy stance for the major Asian economies?**

- As the gap with US rates widen, there is a risk of depreciation for these currencies. This may lead to higher inflation and capital outflows.

<u>China's Property Market Problems</u>

8. **We would appreciate insights from staff regarding the risks to the G-SIBs' balance sheets from potentially absorbing the domestic-systemically important banks (D-SIBs) and other smaller banks during this housing market downturn**

- The risks to G-SIBs to absorb the vulnerable D-SIBs is likely to be low. The staff view is that these D-SIBs could still raise capital at reasonable market rates. The smaller banks however are facing increasingly tight financing conditions and many small banks do not have market access at all. As a result, solvency risks are much higher. That said, given their limited size, the G-SIBs have the capacity to absorb them if needed. Though this would create additional strains on the G-SIB balance sheet capacity to provide credit when profitability pressure has already started to erode capital base.

9. **Could staff also elaborate on the linkages between banks and non-bank financial institutions (e.g., trusts) with respect to property exposure?**

- The linkages could come from bond holdings, contingent liabilities, guarantees etc. The exact amount is unknown given limited disclosure. Though interlinkages should be lower than before given tightened regulations.

10. Going forward, we would encourage staff to undertake deeper analysis of financial stability risks associated with local government financing vehicles and risks that these entities pose to the broader Chinese economy.

- The current GFSR attempted to highlight the Macrofinancial spillover from fiscally weak local governments. This topic will be explored in the next GFSR.

11. Can staff comment on the global implications of the risks to China's real estate sector, with consideration of channels, timing, and other countries most likely to be affected?

- The financial spillover is limited. Foreign financing for the real estate sector is less than 5% of the total, and mostly consists of holdings of offshore bonds by the developers. The main channel of spillover remains growth.

<u>Central Bank FX Policy</u>

12. Can staff comment on what additional measures could be considered by individual authorities or through international cooperation?

- As is discussed in "Toward an Integrated Policy Framework", for countries with flexible exchange rates and very liquid FX markets, allowing the exchange rate to adjust to economic and financial shocks is often the optimal policy. However, in countries with significant vulnerabilities—and in cases with severe market frictions—other tools may be appropriate, such as direct FX intervention. Macroprudential measures and capital flow management tools can also be considered. In many cases, intervention alone can greatly mitigate financial market stress. Swap line arrangements, either directly through other central banks, or through multilateral institutions such as the IMF, can help reduce the pressure on FX reserves should intervention be deemed appropriate. Such swap lines can also often serve as a useful signaling tool to support the currency in times of market stress.

<u>Corporate Credit Risk</u>

13. Corporate credit is also under pressure of default and several sub-investment grade firms exposed. Box 3 and Fig 1.11 shows the relationship between monetary policy tightening and recessions in the last 60 years. At this point in time, and given available information, we would like to ask staff about their views on the likelihood of a recession taking place in the United States and how soon could the economy return to positive growth.

- Concerns that central banks may be raising policy rates well above neutral levels, particularly in the US, to tackle inflationary pressures have raised investor concerns about a recession. In the United States, at the September 2022 Federal Open Market Committee meeting, participants anticipated the federal funds rate to exceed the Federal

Open Market Committee's projection of the nominal neutral rate over the forecast period. In real terms, the federal funds rate is expected to climb from deeply negative levels in 2022 to about 100 basis points in 2023 and 2024, well above the neutral real rate—roughly 300 basis points of policy tightening. Recession fears may well be justified based on historical evidence. Every time the Federal Reserve has raised the federal funds rate close to, or above, measures of the neutral nominal rate, the US economy has entered a recession soon thereafter (with the exception of the 1994 tightening cycle). Alongside commentary from FOMC officials noting tighter policy for longer may be needed to bring inflation back to target, evidence would point towards an increasing likelihood of recession taking place in the US, on balance. That said, the timing and/or severity of a US recession, if it were to materialize, is not an aspect that has been formally assessed or quantified in the current GFSR. In particular, analysis provided in Box 3 essentially serves to document market trends over previous tightening cycles, without attempting to forecast recession.

14. We note staff's recommendation that restructuring, and insolvency tools should help ensure efficient and orderly exit of non-viable firms facing structural challenges and that some firms and sectors facing credit constraints may still need short-term fiscal support to prevent market access failure. In this regard, we would appreciate staff's elaboration on qualifications for such support against the backdrop of high inflation and the ongoing fiscal consolidation efforts across the globe.

- The April 2021 GFSR provides a framework for policymakers to identify viable firms. The framework assesses current and near-term liquidity and solvency risks through a wide range of indicators. Once liquidity or solvency risks have been deemed high, the second step is an assessment of medium-term viability to determine whether a firm will be profitable within a three-year horizon. Viability is expressed as the ability of a business to generate future positive profits—that is, whether the benefits of continuing a business exceed the costs or, conceptually, whether future profits exceed the liquidation value of viable firms. In the current GFSR, we run a more simplified scenario of firm liquidity risks by estimating the increase in at-risk debt in response to a combined shock to revenues (earnings), cost of goods sold (inflation), and interest expense (tighter financial conditions). A further analysis into the viability of the most vulnerable firms could be incorporated in future reports using the proposed April 2021 GFSR framework. Despite the ongoing fiscal consolidation across the globe, temporary and targeted government support may be needed to prevent the risk of a wave of bankruptcies at small firms and avoid spillovers to the financial system.

<u>EM Issues: Sovereign Risk, Capital Flows and Policy Risks</u>

15. Could staff comment on whether the sharp jump in yield spreads for Sub-Saharan-African sovereign bonds in 2022 has been influenced by the ongoing

reporting on common framework delays and expectations of private creditors regarding their required participation in SSA debt restructurings?

16. **Additional suggestions on how to speed up the progress under the Common Framework, e.g., to make it more attractive to prospective debtor country participants and ensure comparable private creditor participation, would be very welcome.**

- Sovereign debt restructurings are complicated and require time and difficult negotiations to reach an agreement between country authorities and a multiplicity of creditors whose incentives likely differ, to overcome collective action challenges and ensure fair burden sharing. The Common Framework is designed to facilitate this process, The requirement of comparability of treatment by other creditors, including private creditors is a long-standing principle of the Paris Club – it is not new to the Common Framework. More complex debt stocks are likely intensifying these issues.

- There was a sharp jump in yield spreads for most Frontier markets in 2022, not only for countries eligible to the Common Framework. 78 countries defined as all IDA-countries that are current on any debt service to the IMF and World Bank, and all least developed countries as defined by the United Nations, that are current on any debt service to the IMF and World Bank are eligible to the Common Framework – but not required to use it when considering a debt restructuring. Note that yields on international bonds issued by Argentina, Egypt, Ecuador, El Salvador, Suriname and Tunisia all surpassed 1000 basis points at some point in 2022, even though these countries are not eligible to the Common Framework.

- So far only Chad, Ethiopia and Zambia have sought a debt treatment under the Common Framework. Some of the delays are not related to the Common Framework. To restore debt sustainability, Chad must restructure a large, collateralized obligation held by a private company, which is partly syndicated to a large number of banks and funds. This complicates the decision-making process. Domestic challenges slowed progress in Ethiopia and initially in Zambia. To speed up progress under the Common Framework, the Managing Director has suggested the following in a recent blog:

  - First, greater clarity on the different steps and timelines in the Common Framework process is vital. Alongside earlier engagement of official creditors with the debtor and with private creditors, this would help accelerate decision making.
  - Second, a comprehensive and sustained debt service payment standstill for the duration of the negotiation would provide relief to the debtor at a time when it is under stress, as well as incentivize faster procedures to get to the actual debt restructuring.
  - Third, the Common Framework should clarify further how the comparability of treatment will be effectively enforced, including as needed through implementation of the IMF arrears policies, so as to give greater comfort to creditors and debtors.
  - Last but not least, the Common Framework should be expanded to other highly-indebted countries that can benefit from creditor coordination. Timely and orderly debt resolution is in the interest of both debtors and creditors.

17. For EMs, A more positive perspective might emphasize how progress in deepening domestic financial markets has helped countries to weather a challenging period, as almost fifteen years of unprecedented monetary stimulus starts to unwind. We would, though, welcome elaboration for the Board as to how much comfort or concern staff have drawn from recent events, relative to what one might have expected based on historical relationships, such as those embodied in their capital flows at risk model.

- The past year in markets has demonstrated that emerging markets are not a monolith, with differing policy responses, macro vulnerabilities, and financial market performance. Portfolio outflows from EMs have been sizeable in aggregate but not out of line with past experiences, and for several countries, fairly benign. Compared to previous episodes of distress, the buildup of foreign reserves over the last decade in many EMs has provided a useful buffer to mitigate short term financing needs, ease exchange rate volatility, and support investor sentiment.

- IMF Staff also has long advocated for developing local capital markets, which Staff believes has provided an additional layer of resilience to external shocks. Indeed, in local currency debt markets, the foreign share of debt has declined markedly in recent years, a process that accelerated post-Covid. While the recent resilience is encouraging overall, Staff cautions that there are trade-offs involved, and EMs are not immune to global financial conditions. Foreign investment can be a valuable source of financing, and the lack of foreign inflows (broadly considered) in recent years has at times strained domestic debt markets. The heavy absorption of debt by the domestic financial sector has also contributed to a growing sovereign-financial sector nexus, as discussed extensively in the April 2022 GFSR.

- With regards to capital flows at risk, the deterioration in the forward-looking metric compared to earlier in the year has largely been driven by the rapid and persistent appreciation of the dollar since the second quarter, and in September specifically. This stands in contrast to recent years, where rallies in the dollar were relatively short lived and occurred primarily during the peak of market distress. The selloff in global bond yields has also played a supporting role, with financial conditions showing signs of tightening in a more disorderly fashion.

<u>**Household Indebtedness**</u>

18. We would welcome more discussion of vulnerabilities from household indebtedness. We are particularly concerned that a reversal of excessive risk taking and further abrupt tightening in global financial conditions could lead to a sharp decline in household income and house prices.

- Since the onset of the pandemic, house prices soared in some economies by more than 20 percent. As central banks around the globe rapidly increase interest rates to tackle broader price pressures, soaring borrowing costs coupled with stretched house valuations could in turn adversely affect housing markets, especially in countries with higher exposure to rising interest rates via variable rate mortgage debt. However, there are some key mitigating factors such as the stronger capital position of banks and more conservative loan underwriting standards since the global financial crisis. As a result, the potential contagion effect through the banking sector in the event of a large house price correction and income decline is likely to be more limited than in previous recessions. That said, risks may be emerging elsewhere in the housing sector, especially in the United States, where the nonbank financial institution sector has started to play a larger role in the securitized mortgage market.

Banks

19. Given the volatile environment we also welcome the global bank stress test conducted by the IMF. However, the exercise does not specify the exact assumptions regarding interest rate normalization and the transmission of shocks to bank balance sheets is not fully clear. It is therefore hard to assess the outcomes of the stress test. More details from staff about the stress test are welcomed.

- The stress scenario entails a severe stagflationary shock, with high policy rates in 2022-23. The benefit from higher short-term interest rates is offset by larger credit, marked-to-market, and net interest income losses. For net interest income, the increase in interest income from performing loans is offset by the negative impact of growth and unemployment shocks on credit losses. The methods of shock transmission to bank balance sheets are explained in the MCM Departmental Paper on GST, which is now cited in the section in the GFSR.

20. We generally agree with staff's recommendations for financial authorities and regulators to limit the build-up of financial sector and debt vulnerabilities going forward. We note with concern staff's conclusion that in a large global slowdown 29 percent of emerging market banks may broach minimum capital standards. We would welcome additional insights from staff regarding how to balance this risk while avoiding potentially pro-cyclical regulatory responses. We encourage staff to examine and provide recommendations regarding the efficient allocation of losses during a potential downturn, as this topic is likely a comparative advantage of Fund staff. We also agree that sovereign borrowers in developing economies and frontier markets should work to contain risks associated with high debt vulnerabilities

- Banks should have adequate risk management practices and systems to identify, measure, report, and manage risks. Risk management practices and systems should be commensurate with the bank's size, complexity, and risk profile. In addition, banks should conduct internal stress tests to identify potential weaknesses that could negatively impact capital and liquidity positions. Adequate risk management measurement and reporting will enable bank management to develop risk management strategies to minimize losses during business as usual and stress scenarios.

CBDCs

21. Policy makers should reinforce data collection and financial regulation to mitigate financial stability risks, including in the Fintech world. Having sufficient and reliable data to analyze financial vulnerabilities is essential for horizon scanning and supervision by prudential authorities. This includes the collection of data on cross-borders exposures of private debt markets and nonbank financial institutions. Furthermore, policymakers need to address Fintech risks to users and investors, to market and financial integrity and to macrofinancial stability not only in crypto asset markets but within digital financial instruments in the overall. Can staff elaborate on the risks' related to the use of central bank digital currencies, in particular in developing economies? What role could CBDCs have in financial deepening?

- Risks related to use of CBDC:

  i. Disintermediation risks. For developing economies where payment systems may not be well developed, a prominent risk is of a structural shift away from commercial bank deposits and towards CBDC (so-called disintermediation), if CBDC is well designed. This shift could potentially stifle credit to the real economy with adverse economic effect. However, commercial banks may have leeway to increase interest rates on deposits, and to improve services. Also, CBDC can be designed to cap holdings, or tax these beyond a threshold.
  ii. Run risks. A similar risk exists of runs from bank deposits to CBDC during periods of financial turmoil, if CBDC is deemed safer. However, for developing economies where deposit insurance exists, this should contain this risk. In addition, CBDC may facilitate the central bank's role of providing liquidity during crises.
  iii. Political and operational risks. A very large balance sheet could expose the central bank to political interference, whilst technical glitches, cyber-attacks, and breaches of financial integrity could damage the central bank's reputation.
  iv. Crowding out risks. Finally, a successful CBDC may crowd out private sector innovation. In contrast, low or no adoption may involve high costs and no returns.

- Specific CBDC design choices that may help in financial deepening include:

  i. Innovative new functions. Financial assets will increasingly be tokenized, and money will be needed to pay for those assets—CBDC is the safest and most reliable to do so. As such, CBDC will also spur the development of tokenized assets that will lower transaction costs, require new risk management tools, and open the door to the automation of trading through smart contracts instead of through intermediaries. CDBC may also offer programmable functions (e.g., social grant payouts) and may target spend at only merchants who are in the program, thus protecting consumers from being exploited by unscrupulous providers. Programmability may also offer the potential for offline transactions especially useful in circumstances where there may be no electricity or connectivity. Through programmability other features such as autopay for taxes may be set up, benefiting merchants form cumbersome tax submission processes.
  ii. Wide set of providers (not just financial institutions). CBDC designs may include a wider set of providers, broader than current financial institutions, at the second tier.

Such a design may thus attract a range of new providers such as mobile network operators and micro-finance institutions, who may target the onboarding of micro and informal businesses, thus widening the net for acceptance of CBDC.

iii. Incentives for users. To deepen financial inclusion, CBDC must provide incentives for users to accept CBDC. One of the most important incentives could be the low cost to use CBDC. This may be achieved with a no fee model on the consumer side, with a low merchant fee on the other. To keep costs low, acceptance infrastructure may include standardized QR codes and mobile point of sale devices (e.g., the recently launched e-Naira includes an "e-Naira Speed Merchant App" that may be downloaded from app stores). In addition, convenient and free cash-in model, easy onboarding processes, no minimum balance requirements, and intuitive user interfaces could all encourage CBDC adoption.

iv. Data usage (incentive). A potential advantage of CBDC service providers is their ability to provide more targeted financial services (such as lending without collateral) based on payments transaction data. Providers can analyze this data to view income patterns and expenses. Therefore, to promote this data usage, the central bank should include the payments data architecture and economic model as an important part of the CDBC platform design. The central bank could openly share data with all institutions to give full play to the value of data.

Chapter 2

22. Can staff comment on the success and challenges of small developing countries in utilizing appropriate instruments to support adaptation?

- Adaptation financing needs for small developing countries are difficult to discern, as the estimates are ultimately based on the IPCC scenarios for which such a breakdown is not directly available. Nevertheless, we believe the financing needs and the associated challenges faced by smaller developing economies are even greater than those for other emerging and developing markets. Adaptation investment needs (relative to GDP) tend to be higher in smaller and less developed countries (transition financing needs tend to be higher in major emerging markets). Exposure to physical risks for small island states is particularly high. As argued in the chapter, adaptation finance will require substantial public support, as it often cannot generate private returns. Drawing in private sector money will therefore be challenging. The financing instrument we describe in the chapter (environmental impact bonds) is complex and more suited for larger emerging markets. The chapter argues that the UNFCCC carbon markets as well as specialized funds, such as the Green Climate Fund, are best placed to deliver the necessary financing. The chapter calls for complete and swift implementation of the UNFCCC carbon markets and sufficient financial resources for the GCF.

Chapter 3

23. We would appreciate if staff would further elaborate on the reasons behind the low use of price-based tools and advice on how jurisdictions could overcome obstacles.

- In some jurisdictions the implementation of price-based liquidity management tools has been challenging for operational reasons. With respect to swing pricing, to determine the appropriate price adjustment open-end funds need to receive information about inflows and outflows before setting the daily net asset value. However, in at least one major jurisdiction, information on flows only becomes fully available after the net asset value is determined. Antidilution levies—which are fees imposed on redeeming investors—may be an alternative price-based liquidity management tool that can help mitigate vulnerabilities from open-end funds that may require less detailed information on flows. Jurisdictions where price-based tools cannot be implemented should consider other liquidity management tools, such as linking the frequency of redemptions to the liquidity of funds' portfolios.

24. We would also appreciate if staff would elaborate on the potential impact of the proposed measures on investor participation, financial intermediation competition, and the cost of capital for those companies that rely more heavily on OEFs as a source of financing.

- Chapter 3 of the GFSR notes that price-based liquidity management tools are desirable not only to mitigate vulnerabilities from open-end funds, but also from an investor protection perspective as they prevent the dilution of those investors that remain in a fund when others withdraw. Consequently, price-based liquidity management tools should not reduce the demand for open-end funds by such patient investors. However, even in jurisdictions where swing-pricing is widely used, caps on swing factors appear too low to be fully effective in periods of stress (Figure 3.16, panel 2). This may point to competitive pressures that constrain funds in their ability to calibrate liquidity management tools effectively. As noted in the chapter, policymakers could consider mandating the adoption of liquidity management tools and greater international regulatory coordination is warranted so that liquidity management practices are deployed consistently, and to maintain a level playing field across jurisdictions.

25. The provided Conceptual Framework to understand the financial stability risks of Open-End Investment Funds (OEFs) is a helpful addition to the Fund analytical toolkit (chapter 3 of the GFSR). While investments by advanced economies in OEFs in emerging markets are generally positive, they have adverse effects on emerging market asset prices during the ongoing tightening of the monetary policy cycle. If not managed properly, it could lead to an excessive and unnecessary tightening of domestic financial conditions, thus reinforcing the vicious cycle between investor runs and asset market volatility. Further development of both micro-and macro-prudential toolkits would be needed to adequately respond to these challenges. Such an alignment could be coordinated by supervisors to ensure a consistent approach across the asset management sector. Staff comments are welcome.

- We agree that vulnerabilities in the open-end fund sector, combined with an adverse shock that causes a sudden repricing of risk, could have significant ramifications for emerging market economies. For example, Chapter 3 finds that a plausible drop in the liquidity of funds domiciled in advanced economies could result in an increase of emerging market bond return volatility by more than 20%. This transmission of open-end fund vulnerabilities to asset prices is caused by the liquidity mismatch inherent in open-end funds offering daily redemptions but holding illiquid assets. Policymakers should therefore ensure the availability and implementation of liquidity management tools that address this vulnerability.

26. Could staff elaborate further on best policies to mitigate market liquidity risks, and their views on increasing calls to review regulatory capital regulations adopted after the GFC?

- In relation to the non-bank financial sector, Chapter 3 of the GFSR shows that vulnerabilities of open-end funds that hold relatively illiquid assets can amplify the effects of adverse shocks by raising the likelihood of investor runs and asset fire sales. To mitigate the asset price fragilities that result from these vulnerabilities, policymakers should ensure the availability of adequate liquidity management tools and their implementation by funds.

27. Could staff elaborate on its recommendation to consider mandating the adoption of LMTs and the kind of tools that would be covered by such requirement?

- We agree that competitive pressure and concerns about stigma may prevent funds from voluntarily implementing adequately calibrated liquidity management tools. For example, caps on swing factors that appear too low to be fully effective in periods of stress may be the result of such competitive pressure. Tighter monitoring of liquidity risk management tools by supervisors and regulators is thus necessary and making their adoption mandatory could be considered.

- As outlined in the chapter, price-based liquidity management tools can be effective in reducing investors incentives to run on funds that hold illiquid assets. Alternative tools that link the frequency of redemptions to the liquidity of funds' portfolios may be more suitable for funds holding very illiquid assets or for funds domiciled in jurisdiction that cannot implement price-based liquidity management tools. Therefore, the kind of liquidity management tools covered by such a requirement would have to vary by fund and by fund domicile.

Fiscal Monitor

Staff's responses to technical questions are below. Broader policy questions in the areas of recently announced policies to mitigate the impact of high food and energy prices will be addressed in staff's intervention at the Board meeting.

Response to High Energy Prices

1. ***What is staff's assessment of the share of vulnerable households in the total population and which criteria do they use for such classification.***

- The share of vulnerable households varies across country depending on the severity of shocks, the share of food and energy in household consumption, and the risks of the household suffering large real income losses as a result of the shocks. For example, many low-income and middle-income households who are outside the pre-existing social protection system could struggle given food and energy prices have been volatile and risen sharply in many countries. Household-level data, such as on income distribution and consumption spending by category, including on staple food and energy, would allow for an estimation of the share of the population exposed to food and energy price shocks. At the same time, building a strong social safety net that has up to date information and is readily scalable would help tailor the coverage of vulnerable households to the specificity of shocks.

Social Protection Systems

2. ***We would welcome staff comments on whether policies to strengthen the safety net may add to excess demand pressures in current circumstances even if fiscally neutral.***

- Strengthening social safety nets involves many dimensions, such as targeting right beneficiaries and ensuring timely and adequate disbursements of benefits. Preparing a system that is readily scalable to adverse shocks can support vulnerable households in difficult times. The Fiscal Monitor discusses some policy options, such as leveraging digital technology and semi-automatic stabilizers, to ensure fiscal support is timely, temporary, and targeted. However, if social spending is overly generous and untargeted (partly because of the lack of a strong safety net to target well and assess the adequacy of benefits), it could push up aggregate demand and entail large fiscal costs, which could overburden central banks in maintaining price stability. In the current environment of high inflation, the Fiscal Monitor thus emphasizes that maintaining a sufficiently tight fiscal stance is critical when providing targeted relief to vulnerable households. These require prioritizing spending among competing needs and mobilizing domestic revenues to finance the additional fiscal support.

3. ***We would appreciate more operational advice in the future to help policymakers improve targeting (which socio-economic and geographic criteria and conditions to take into account, etc). Could staff comment?***

- Programs that use a combination of criteria, such as geographical, categorical, community, and means-testing, can achieve better accuracy in targeting the beneficiaries truly in need. In selecting the targeting approach, policymakers need to balance the costs and benefits of various options, which are specific to country circumstances. There are different types of costs involved. For example, targeting based on a means test can involve efficiency costs (for example, reducing work incentives), administrative costs associated with collecting and verifying information on household income or assets, and socio-economic characteristics. At the same time, being identified as a welfare recipient could have some social costs to individual households. To achieve better targeting, policymakers can leverage the use of digital tools, such as big data and machine learning, to reduce the above-mentioned costs. This is particularly applicable in low-income countries where social protection system is weaker, and alternative sources of information and the ability to deliver assistance are limited.

Macro-Fiscal

4. ***We appreciate the analysis made by staff of the fiscal responses to protect households during the pandemic, and the reassessment of policy tools based on the lessons learnt. ... However, the analysis is mainly backward-looking, and it does not consider how these actions might have helped to fuel current inflationary pressures, which is a key question when designing future interventions in times of crisis. Staff's comments are welcome.***

- Drawing lessons from previous crises such as the COVID-19 pandemic is important for policymakers in preparing for the current challenges and cope with future adversities. Policymakers faced difficult trade-offs when designing policy support under great uncertainty and had limited capacity to target recipients in real time. At hindsight, some measures could have adjusted and targeted better to reduce fiscal cost. The current high inflation observed globally is related to a combination of factors including supply-side constraints, pent-up demand owing to lock-down restrictions, policy responses, and more recently intensified by the war in Ukraine. In response to the current cost-of-living crisis, the Fiscal Monitor suggests that policies should protect the vulnerable groups through targeted relief while keeping a tightening stance to facilitate monetary policy in fighting inflation. A lesson from the pandemic is that fiscal responses can be swift and impactful, especially if monetary policy is constrained. This would require preparing in advance with deployable tools and strengthening social protection systems to foster economic resilience.

5. ***Could staff calculate what the current inflation rate in Europe would have been in the absence of energy price caps?***

- Countries are exposed to different degrees of energy price surges, depending on the differences in wholesale markets, behavioral responses, regulations and contracting practices, and the availability of alternative energy supply. The design of policy measures also differs across countries (for instance, limits on the unit wholesale price or end-user price), making it difficult to quantify the counter-factual inflation rate in the absence of policy support. Given the weight of energy goods and services in the CPI varies between 5 and 15 percent in Europe, the sharp rise in energy prices directly accounted for about half of the annual headline inflation rates in May 2022, according to an IMF working paper (Ari and others 2022). Restricting the price signals through energy price caps or subsidies may dampen the pass-through to domestic prices in the near term but could increase the persistence of inflation, lead to inefficient rationing and discourage energy efficiency. It will also entail large fiscal cost if the energy shocks become more protracted.

6. ***We would be interested on further analysis regarding the complexity of the interactions between debt management and high inflation.***

- Inflation has important implications for debt management, which depend on how persistent high inflation is and how monetary policy responds. Initial inflation surprises contributed to an average decline in the debt ratio to GDP of 3 percentage points in 2021 for advanced economies. The magnitudes vary across countries, depending on the debt profile (for example, maturity, currency denomination, and inflation indexation). It is also important to consider the broader public sector (including central banks) because a sizeable portion of long-term government debt in some advanced economies is mirrored by larger short-term public sector liabilities owing to quantitative easing.

- Although inflation surprises can improve debt dynamics in the near term, unexpected inflation cannot last. If investors are concerned of inflation risks, they will require higher risk premium in holding government debt, which would reduce fiscal space. Cross country analysis suggests that higher inflation volatility is associated with a rise of long-term bond yields, particularly for countries with high public debt. As inflationary pressures are high, preserving the special status of government debt as the safe asset of reference requires maintaining price stability. Fiscal policy should pursue a tightening stance to keep monetary policy on target to fight inflation, which, in turn, would reduce the size of required policy rate increases and lower the cost of borrowing. This will also help anchor households' expectations of a prudent fiscal policy path, which is key in containing inflation, particularly for highly-indebted countries (Bianchi and Melosi 2022).

7. ***We wonder whether staff also considered the impacts of loan deferrals for different types of households that were used in many countries, and how helpful these measures are, in staff's view.***

- Temporary loan deferrals (such as deferral of mortgages or rental payments for households) can alleviate cashflow difficulties for households. They can have merits in supporting households, particularly if the adverse shocks are severe but short-lived or other credit programs takes time to introduce (Coelho and Zamil 2020). During the COVID-19 pandemic, loan deferral programs were often accompanied by other support measures to stabilize income and consumption. As mentioned in the Fiscal Monitor, it is important to ensure that different types of instruments have exit strategies and proper risk management—in the case of loan deferrals, loans are to be repaid in the near future without principal haircuts or large reduction in the net present value.

8. ***We appreciate that staff share more specific guidance on domestic revenue mobilization and credible medium-term fiscal framework for countries with limited fiscal space in such a difficult juncture.***

- Governments face difficult policy trade-offs with record debt levels, tightening monetary policies, and urgent demands to address cost of living crisis. Developing a credible medium-term fiscal framework will help guide fiscal policy and anchor investors' expectations. Governments need to communicate fiscal plans to reduce debt sustainability risks and promote consistent macroeconomic policies. Staff proposes enhancing medium-term fiscal frameworks that combine more flexible rules with stronger institutions to promote sound public finances, while striking better balance between flexibility and credibility. A forthcoming Staff Discussion Note was circulated to the Board which outlines the details and policy options to strengthen fiscal framework.

- Given high debt vulnerabilities, governments will need to rebuild buffers over time so that they can respond flexibly to shocks. Developing countries will also need additional revenues to finance their development needs to meet sustainable development goals. These require prioritizing spending among competing needs and raising domestic revenue over the medium term. This requires broadening the tax bases, raising gradually VAT rates, strengthening revenue administration in many emerging market and developing economies. The Fund is providing capacity development to countries to develop Medium-term Revenue Strategy (MTRS), which provides a road map covering tax policy, revenue administration, and the legal framework to improve revenue performance in countries.

Debt Statistics and Debt Relief

9. ***Fiscal Monitor continues to exclude unfunded pension liabilities of government employees' defined-benefit pension plans from reported debt statistics. This exclusion understates the true extent of public liabilities and undermines cross-economy comparability. Staff comments welcome.***

- The international fiscal statistical standards (i.e., the GFSM 2001 and 2014) require that unfunded pension liabilities of government employees' defined-benefit pension plans to be recorded as liabilities. The Public Sector Debt Statistics Guide in 2011 also recommended that these unfunded pension liabilities be included in government gross debt. Notwithstanding this guidance, very few countries currently compile these data and include it in national debt data. The institutional aspects of pension schemes differ widely across countries. Therefore, it remains difficult to present cross-country comparable data on gross debt that includes unfunded pension liabilities. Continued IMF capacity development would help to improve data availability in this area.

- The Fiscal Monitor Methodological and Statistical Appendix (MSA) indicates that for cross-economy comparability, gross and net debt levels reported by national statistical agencies for economies that have adopted the 2008 System of National Accounts (SNA) (Australia, Canada, Hong Kong SAR, and the United States) are adjusted to exclude the unfunded pension liabilities of government employees defined-benefit pension plans.

The MSA publishes the projections on the public pension spending increases (and their present discounted value), including government employees' defined-benefit plans, as a measure of the impact of pension liabilities on long-term public finances.

International Monetary Fund

September 29, 2022

World Economic and Market Developments

Pierre-Olivier Gourinchas
Economic Counsellor

Global outlook continues to worsen, inflation squeezes real incomes

Deepening global slowdown, persistent inflation

Risks to the downside

- **Risk of policy miscalibration.**
- **More Dollar strength causes cross-border tensions, further inflation and more monetary tightening.**
- **Tighter financial conditions trigger wide-spread debt distress, worsen food insecurity, and cause social unrest.**
- **China slowdown deeper and longer.**
- **War in Ukraine further escalates energy crisis.**

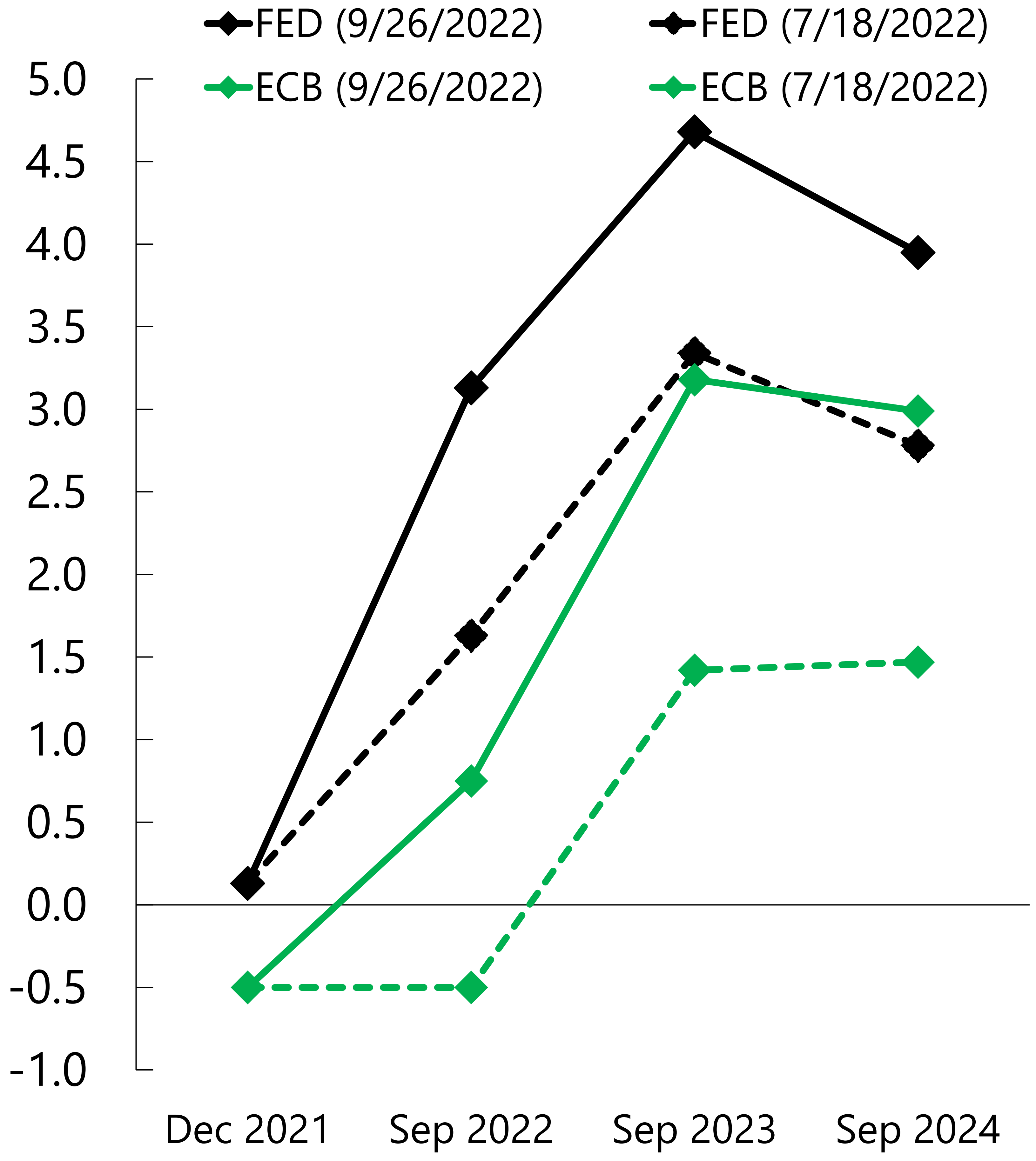
Policies

- **Monetary policy must stay the course until inflation is back to target.**
- **Fiscal policy should not work at cross purpose with monetary policy. Relief for vulnerable needs to be targeted.**
- **Debt resolution frameworks must be improved.**
- **Accelerate the green transition through carbon pricing, subsidies and investment.**
- **Strengthen multilateral co-operation to counter fragmentation.**

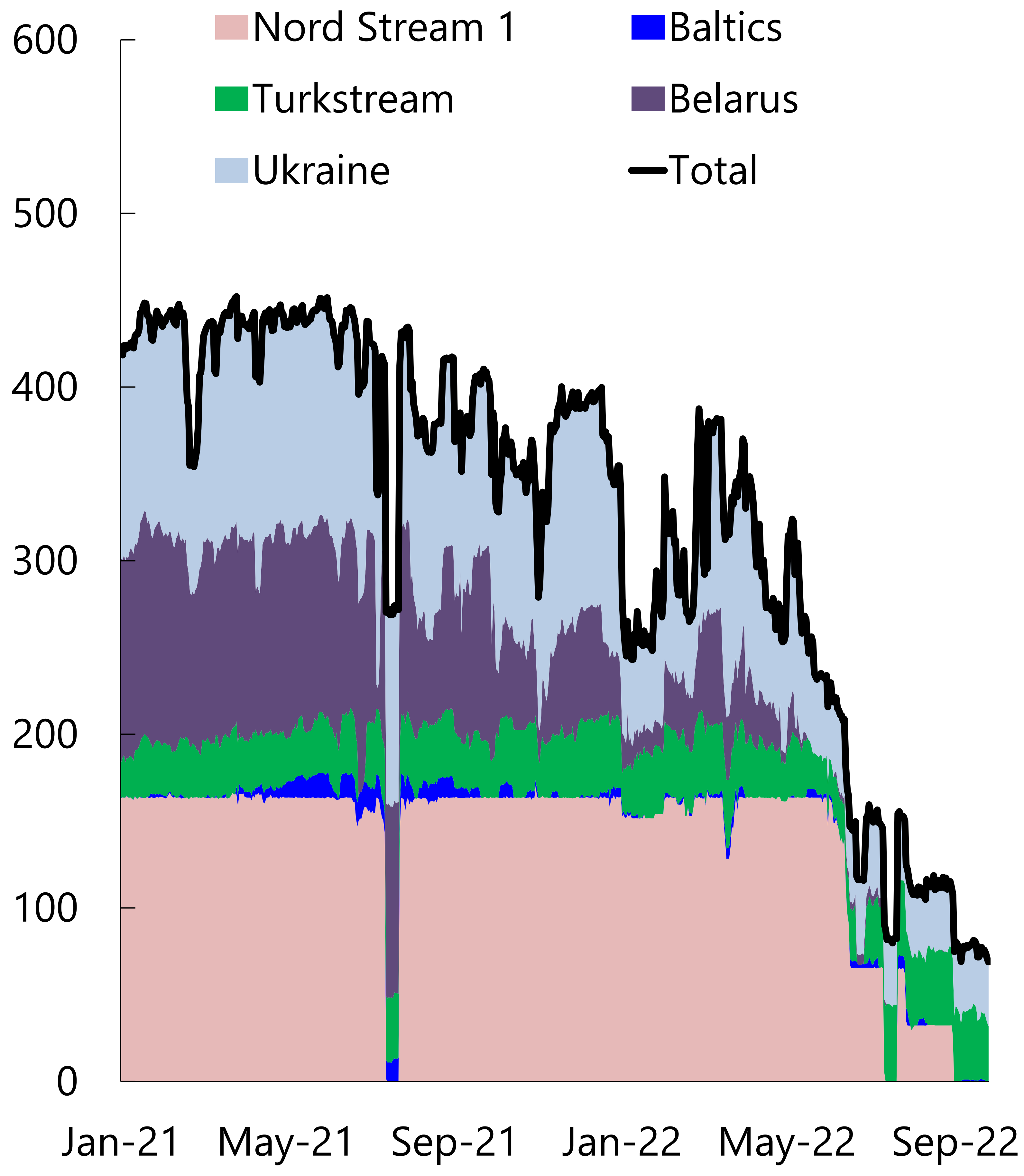
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.
1/ Relative to July 2022 WEO Update 2/ Fan shades denote 5-95 percentile; 5 centiles for each shade change.

Downside risks materializing

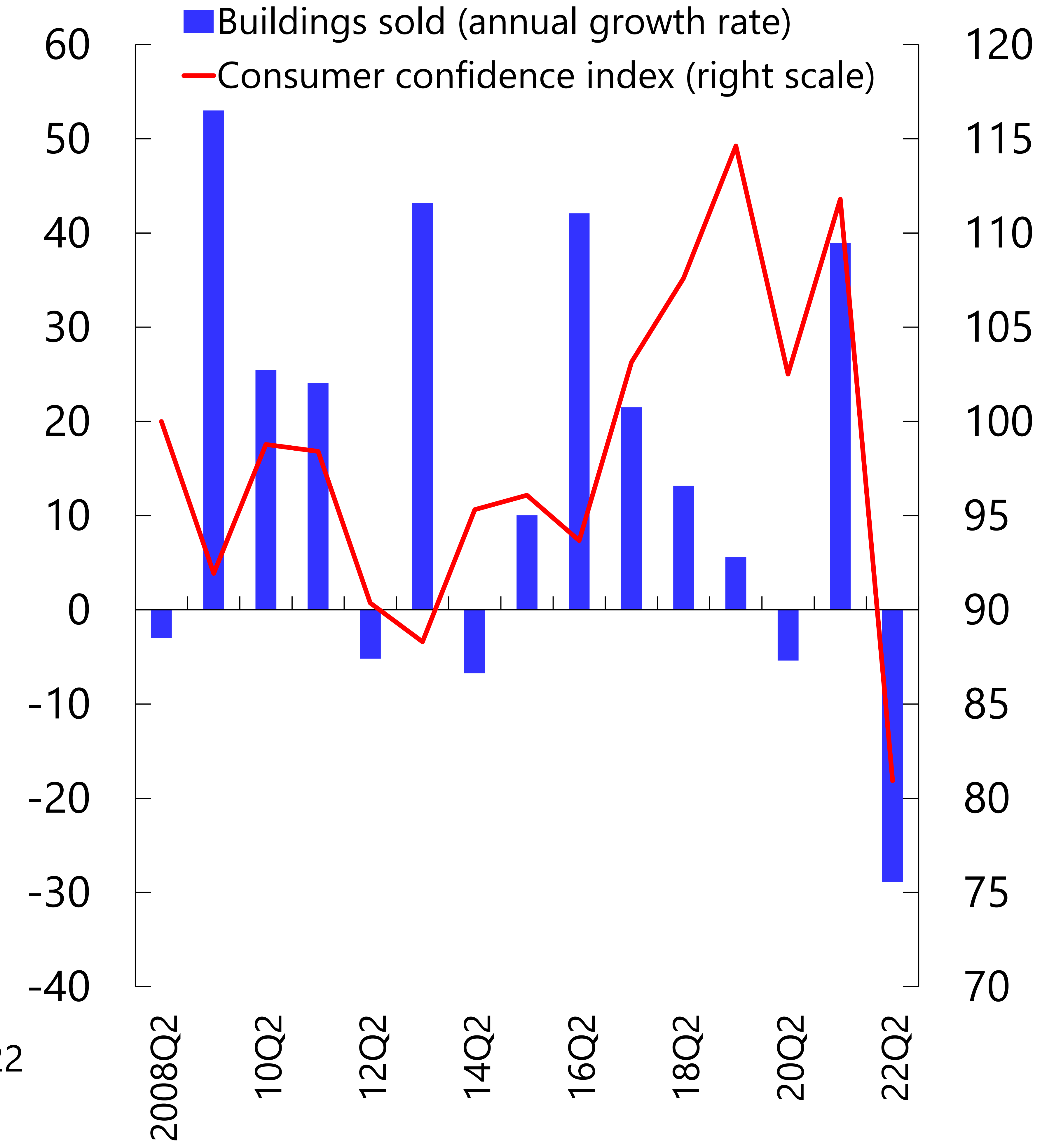
Fed Funds Futures and ECB Policy Rate Paths
(market-implied; percent)



Russian Pipeline Gas Supplies to EU by Route
(million cubic meters per day)



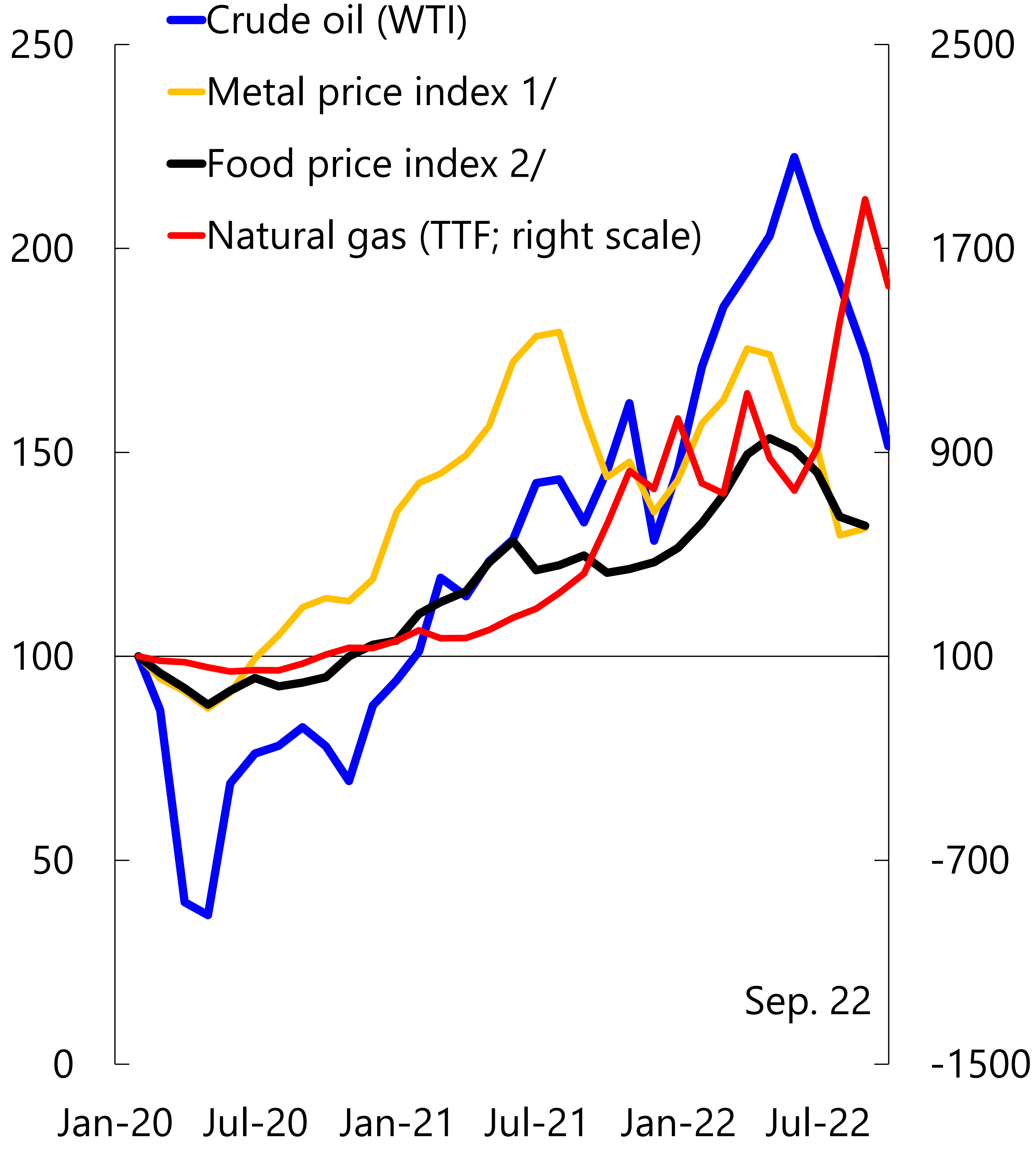
China's Slowdown
(index; annual growth rates)



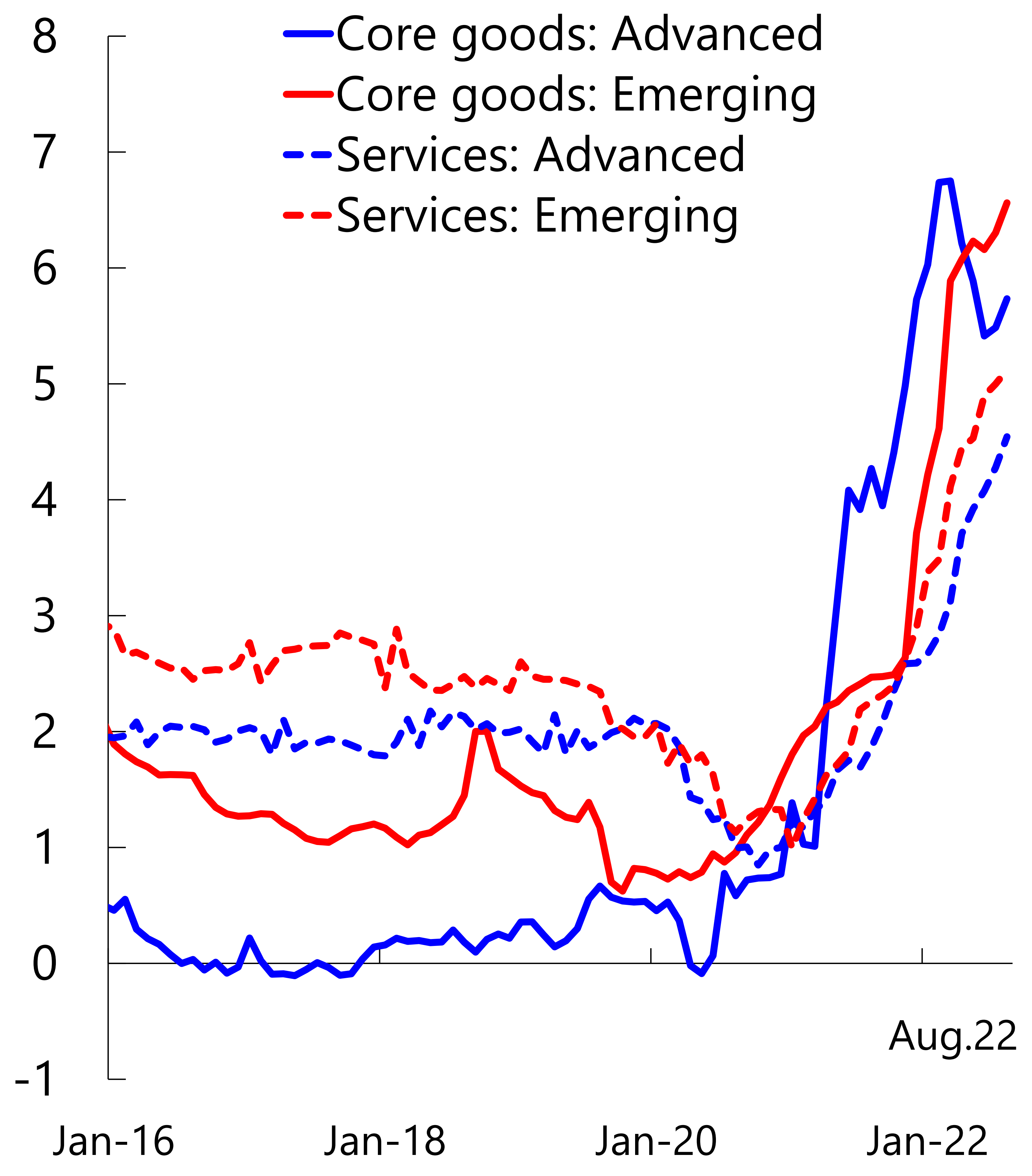
Sources: Bloomberg Finance L.P.; CEIC; European Network of Transmission System Operators for Gas; Gas Transmission System Operator of Ukraine; and IMF staff calculations.

Persistent inflation worsens cost of living crisis

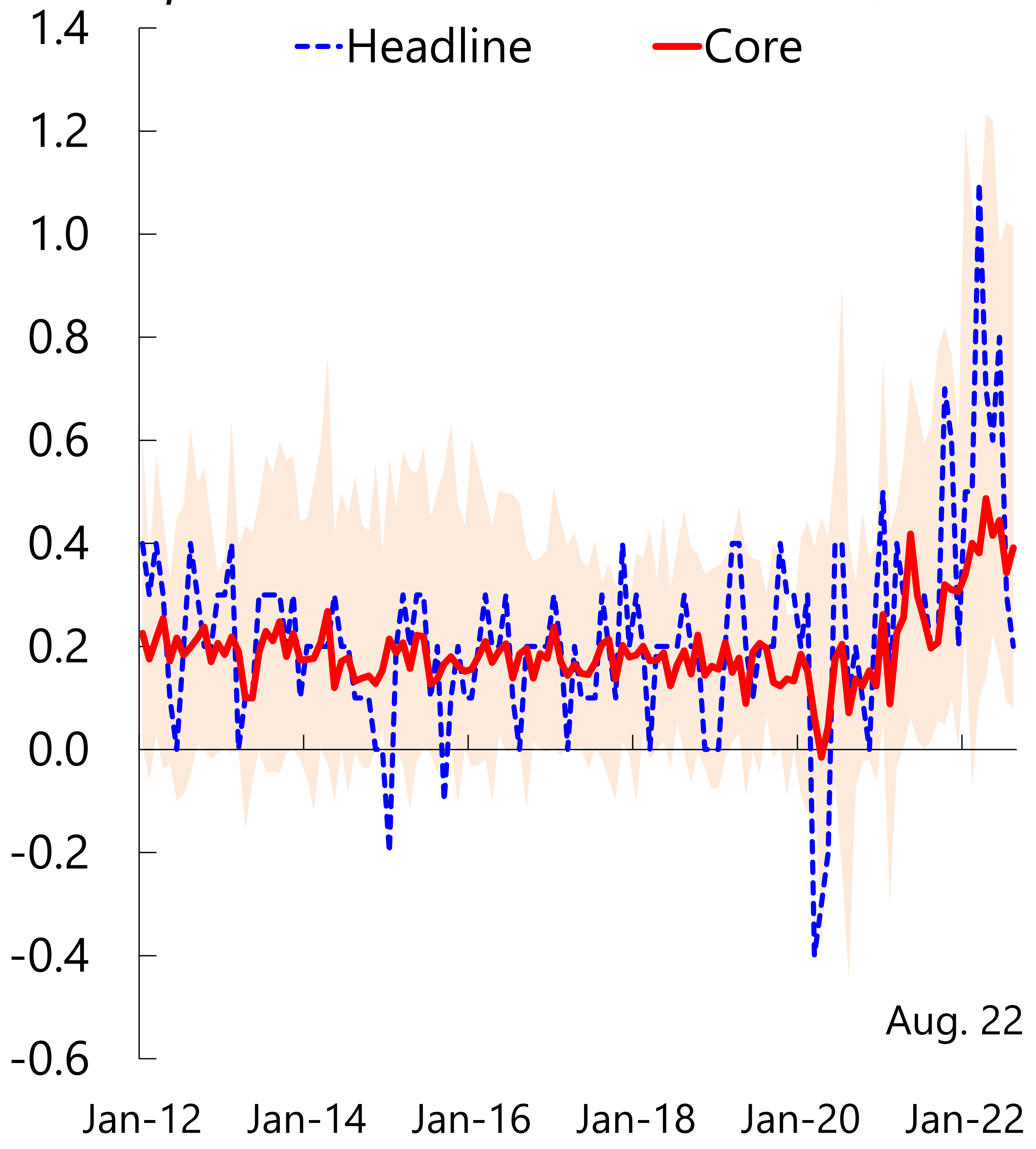
Commodity Prices
(Jan 2020=100)



Inflation: Core Goods and Services 3/
(percent; year on year)



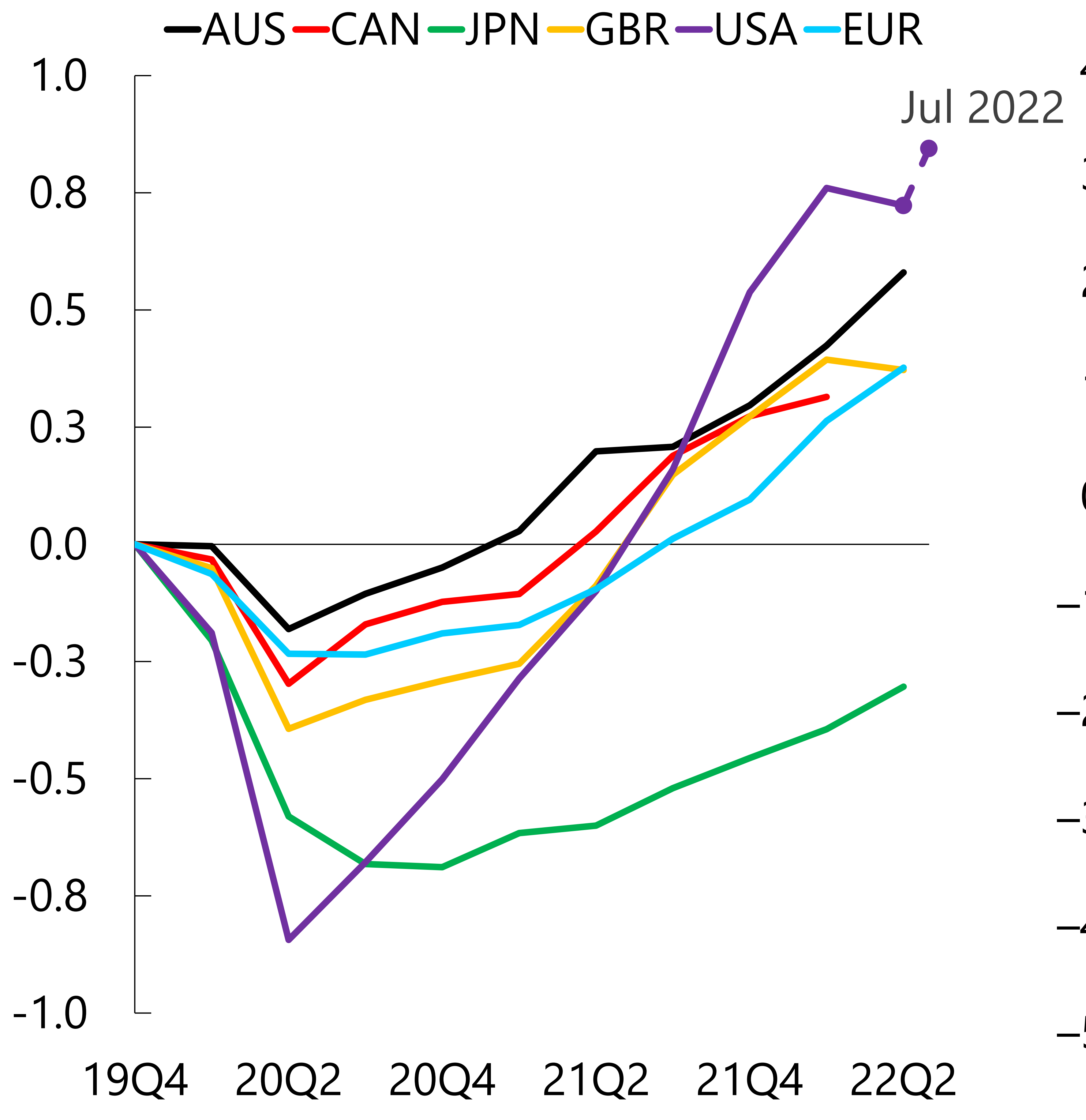
World Headline and Core Inflation 4/
(percent; month-on-month; SA)



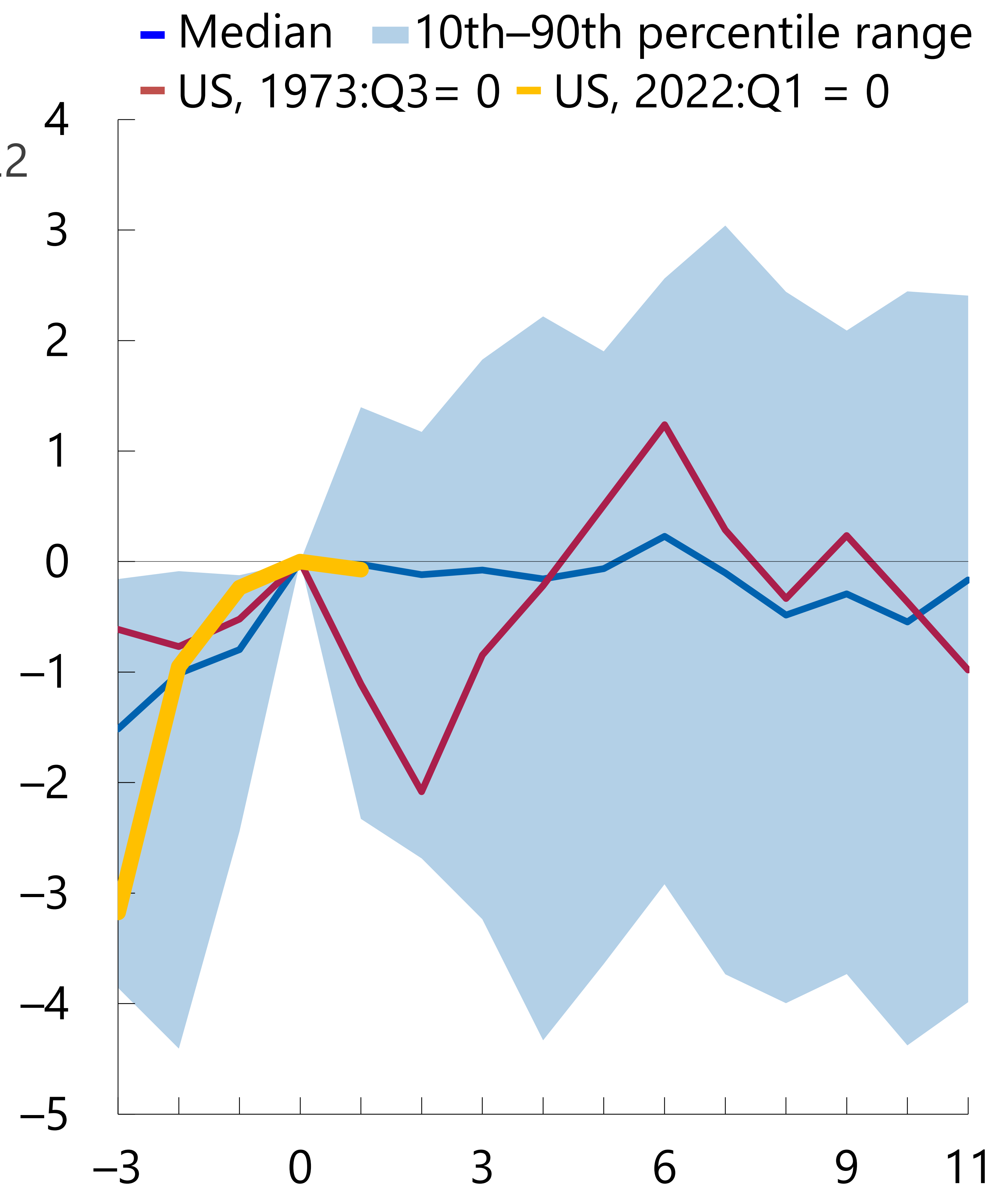
Sources: Argus Direct; Bloomberg Finance L.P.; Organisation for Economic Co-operation; Haver Analytics; IMF Primary Commodity Price System; and IMF staff calculations.
1/ Includes Aluminum, Cobalt, Copper, Iron Ore, Lead,. Molybdenum, Nickel, Tin, Uranium, and Zinc Price Indices.
2/ Includes Cereal, Vegetable Oils, Meat, Seafood, Sugar, and Other Food (Apple (non-citrus fruit), Bananas, Chana (legumes), Fishmeal, Groundnuts, Milk (dairy), Tomato (veg)) price indices.
3/ PPP-weighted averages. Advanced includes USA, Euro Area, GBR, JPN, KOR, TWN, CAN, AUS, SWE, NOR, and CZE. Emerging includes: MYS, BRA, MEX, COL, CHL, RUS, ZAF, TUR, HUN, and POL.
4/ Excludes ARG, RUS, and TUR. The band indicates 10-90 percentile for core inflation.

Labor Market Developments in Advanced Economies

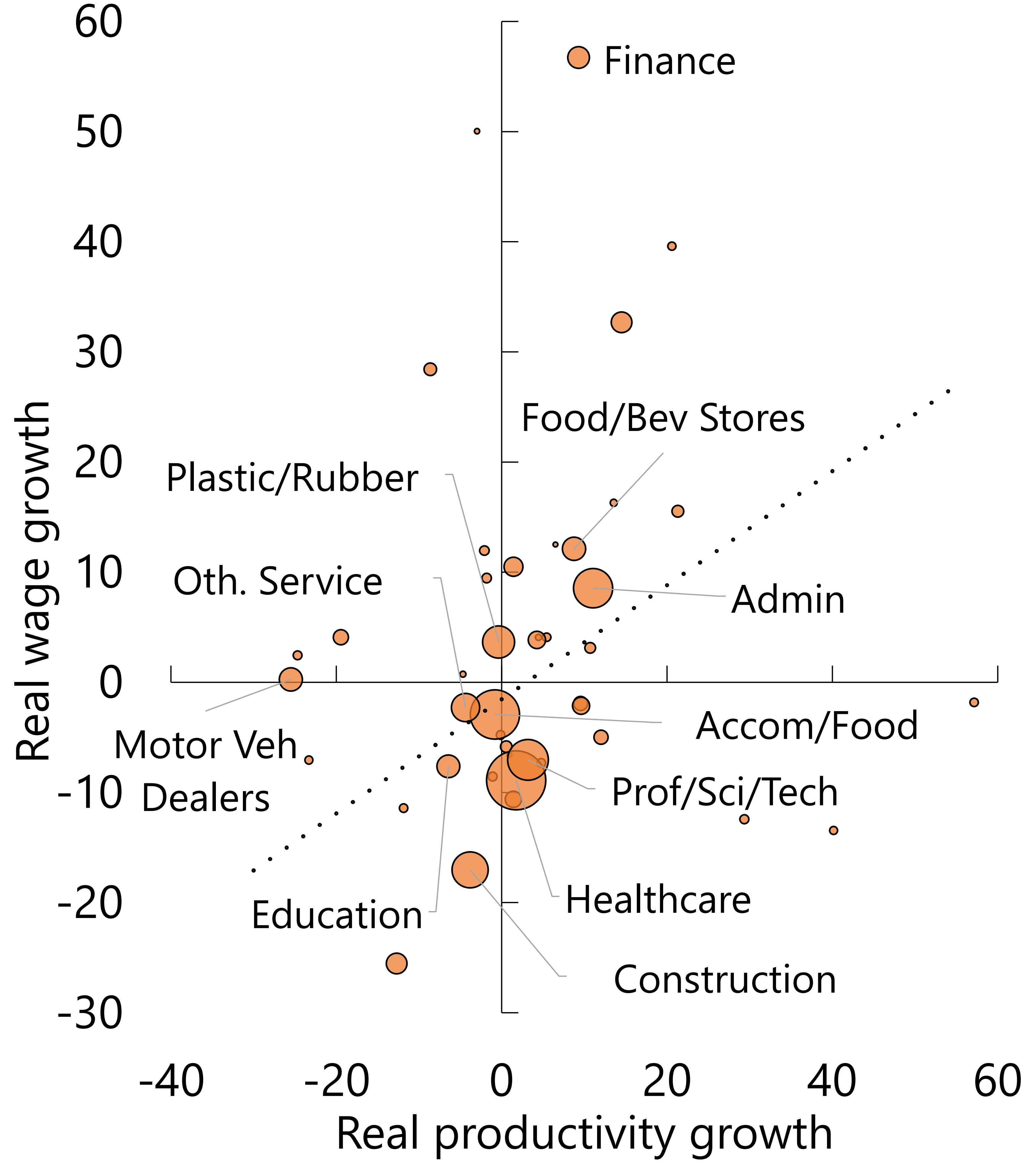
Vacancy-to-unemployment Ratios
(change in vacancy per unemployed relative to 2019Q4)



Nominal Wage Growth 1/
(deviation from t=0; percentage points; year-on-year)



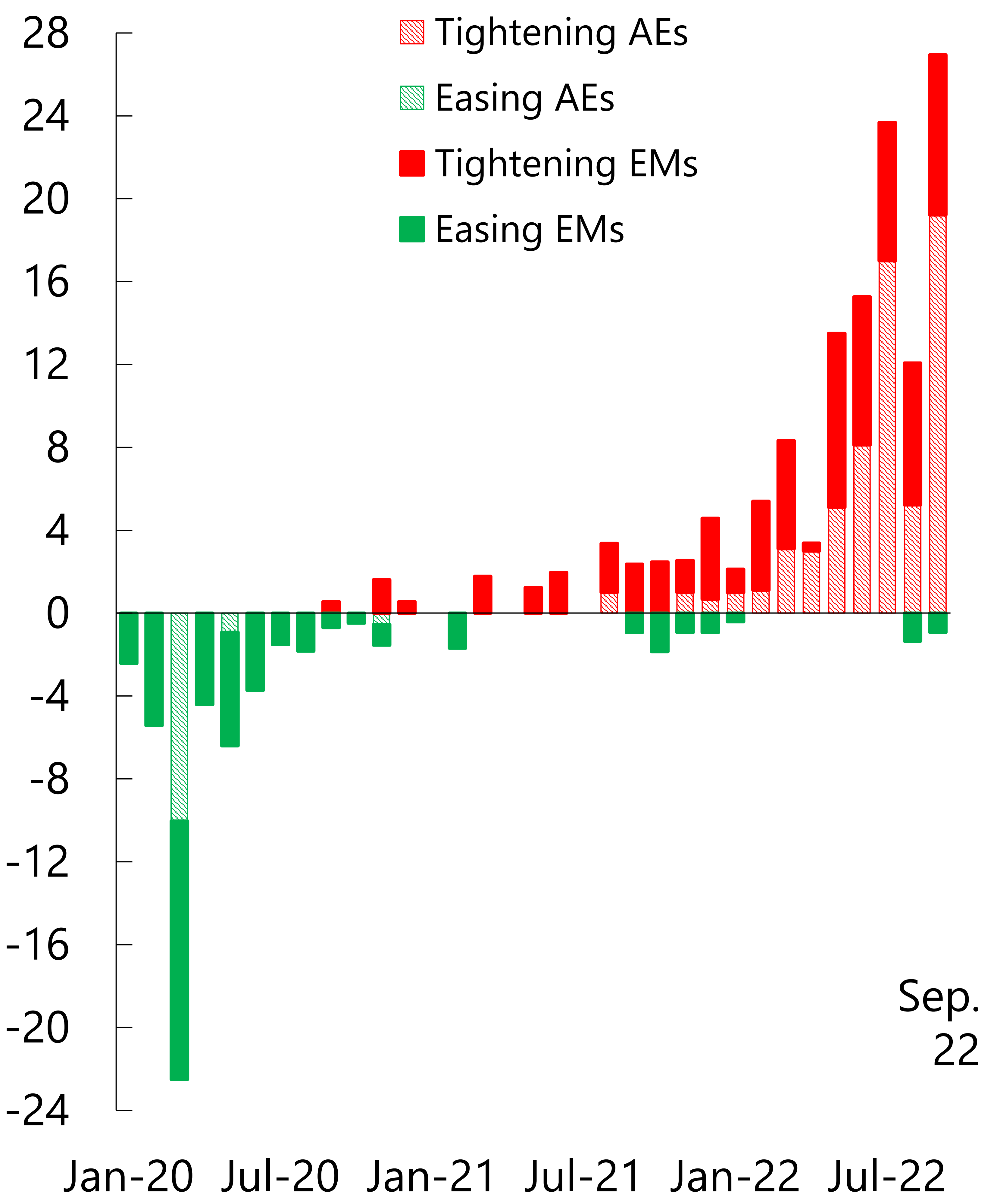
USA: Productivity and Wage Growth 2/
(percent, from 2019Q4 to 2022Q1)



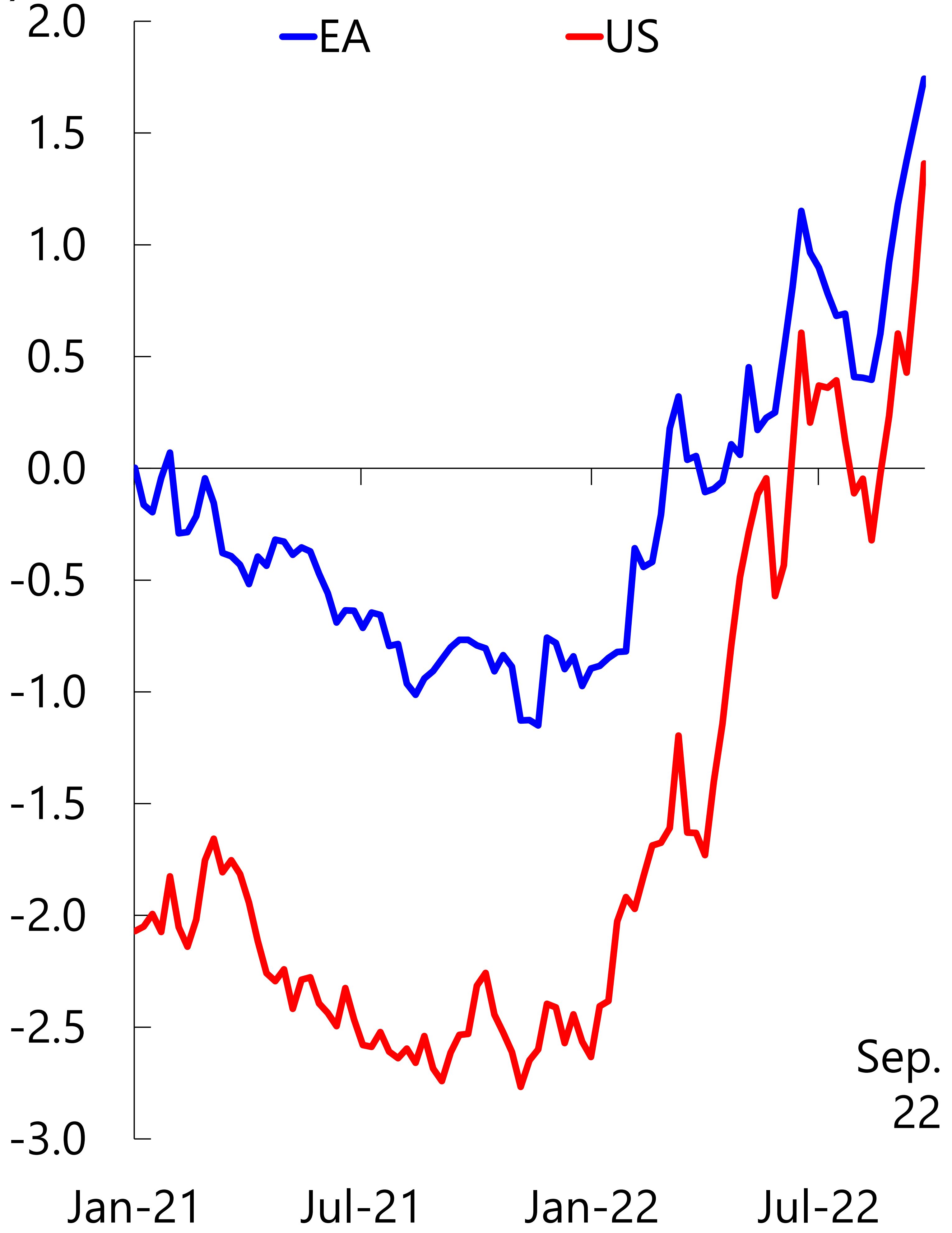
Sources: Haver Analytics; OECD; Bureau of Labor Statistics; Eurostat; Federal Reserve Economic Data; Fernald and Li (2022); and IMF staff calculations.
1/From WEO Chapter 2, October 2022. The figure shows the developments following episodes in which at least three of the preceding four quarters have: (1) accelerating prices/rising price inflation and (2) accelerating nominal wages/rising nominal wage growth. Seventy-nine such episodes are identified within a sample of 30 advanced economies going back to at the earliest 1960. The bands indicate the 10th–90th percentile of the outcomes in the identified episodes. 2/ Bubble size proportional to 2019 sectoral average monthly employment.

Pace of monetary tightening quickens, fiscal under pressure

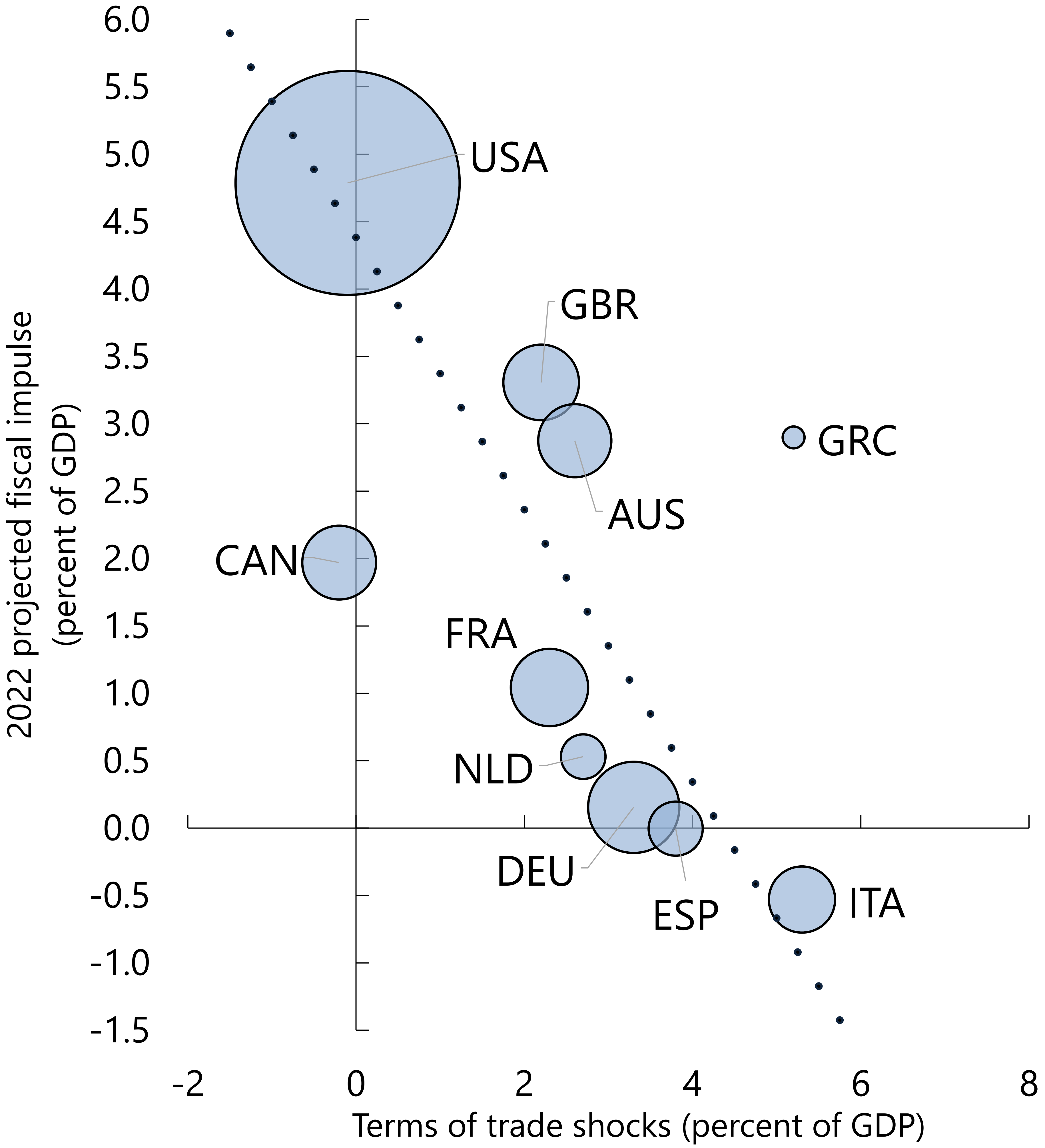
Change in Monetary Policy Cycle among G-20 Economies ex RUS
(number of increases/cuts normalized 1/)



Financial Conditions 2/
(standard deviations from mean)



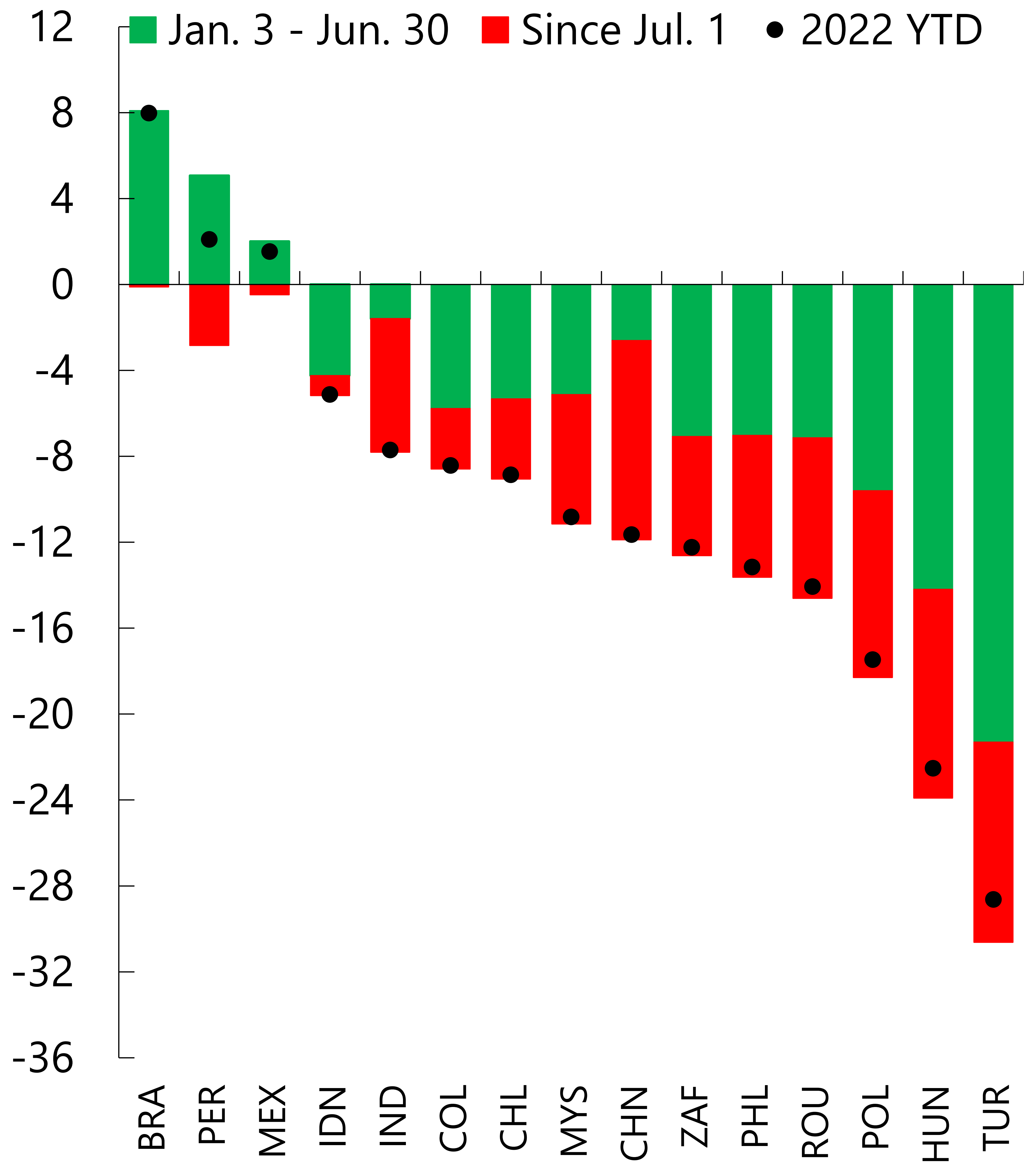
Terms of Trade Shocks and Projected Fiscal Stance 3/



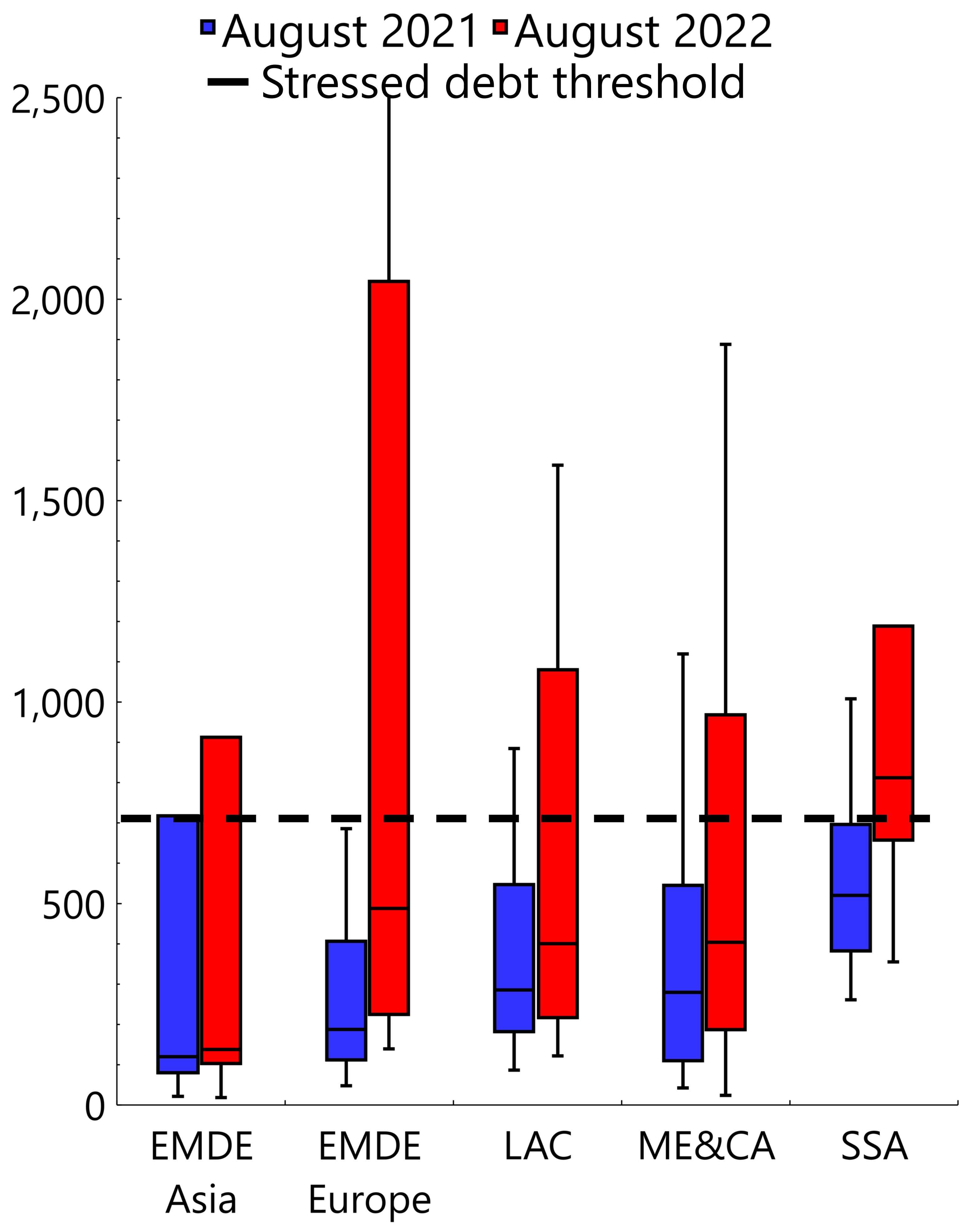
Sources: Bloomberg Finance L.P.; Goldman Sachs Research; Capital Economics; IMF, *World Economic Outlook*; and IMF staff calculations. 1/ normalized by size of average hike/cut. 2/ Mean and standard deviation are computed based on the sample starting January 2010. 3/ ToT shock calculated as the change in costs for net energy imports. Fiscal impulse is change in cyclically-adjusted primary balance. Bubble size proportional to real GDP.

EM vulnerabilities rising unevenly

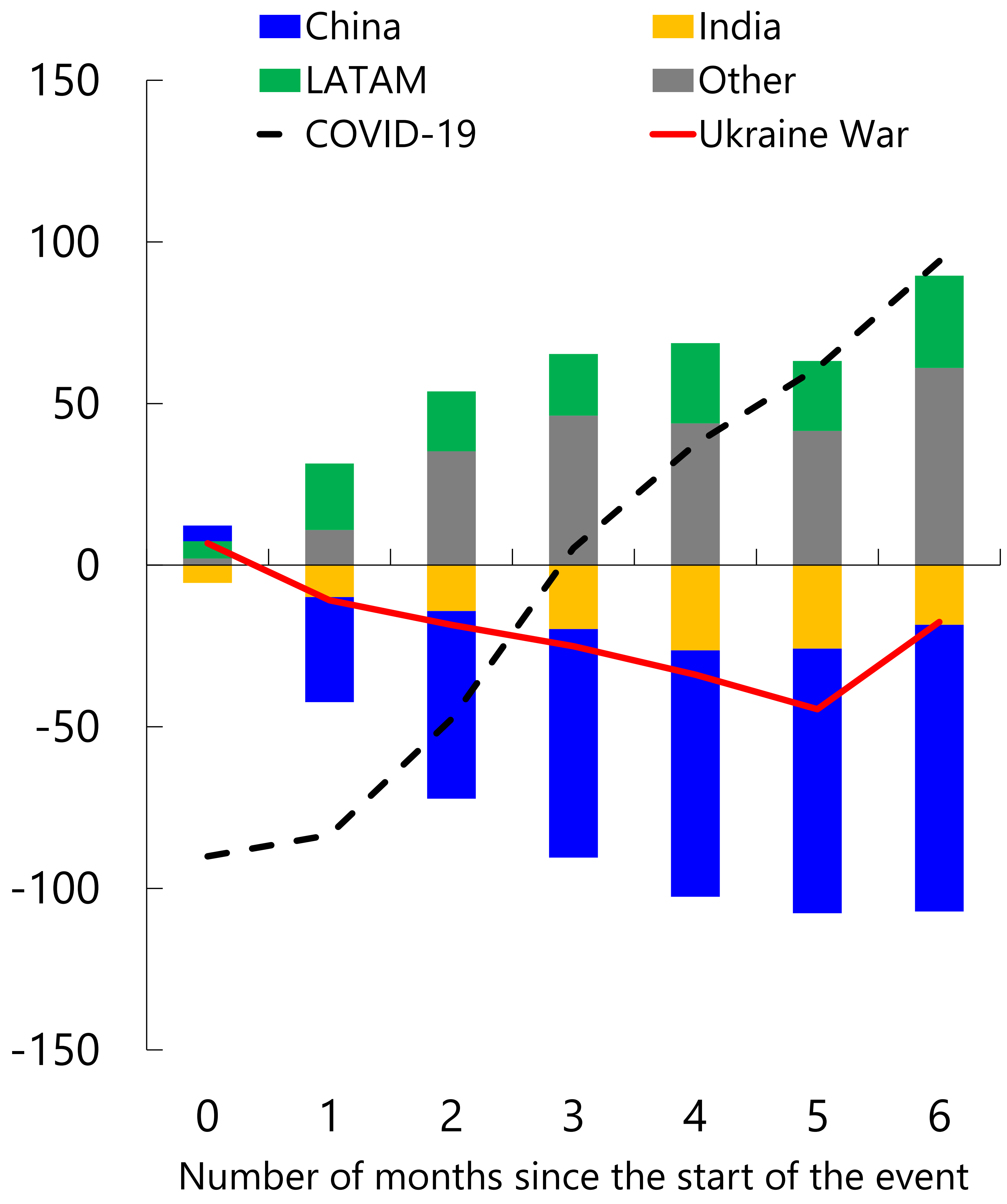
Exchange Rates vis-à-vis US Dollar
(% change; as of Sep 23, 2022; ex RUS)



EMDE Sovereign Spreads Rise Sharply
(basis points)



Capital Flows to EMs
(cumulative, US billion, as of August 2022)



Sources: Bloomberg Finance L.P.; IIF; Haver Analytics; IMF, *World Economic Outlook;* and IMF staff calculations.

October *WEO* assumptions

The war in Ukraine and sanctions

- Pipeline gas flow from Russia to Europe remains at 20 pct of pre-war level; full shutdown of NS1.
- Russian gas flow declines to negligible level by mid-2024 as announced by Europe.
- Financial and energy import sanctions from the West tighten as announced.

Policy support

- The Fed expected to frontload interest rate hikes and raise rates by a total of 425 bps in 2022 and further 25 bps through 2023.
- The ECB is expected to withdraw monetary accommodation faster in 2022 and 2023.
- Long-term inflation expectations remain stable, financial conditions tighten but markets remain orderly.

China slowdown and COVID

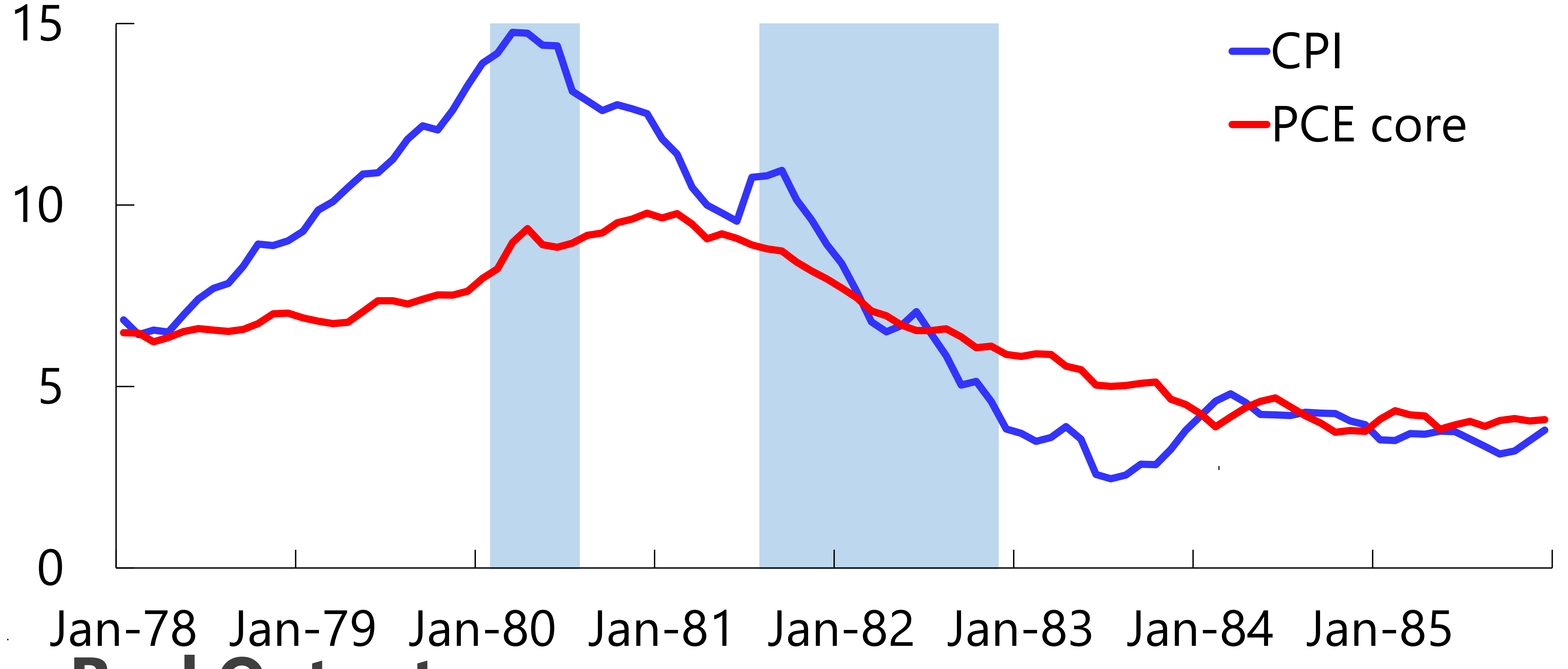
- Deeper slowdown in China from property sector crisis, lingering COVID outbreaks and weaker external demand.
- Hospitalization and deaths brought to low levels in most countries by end-2022.
- Possible renewed outbreaks less severe than previous waves thanks to improved adaptation.

Adverse scenario

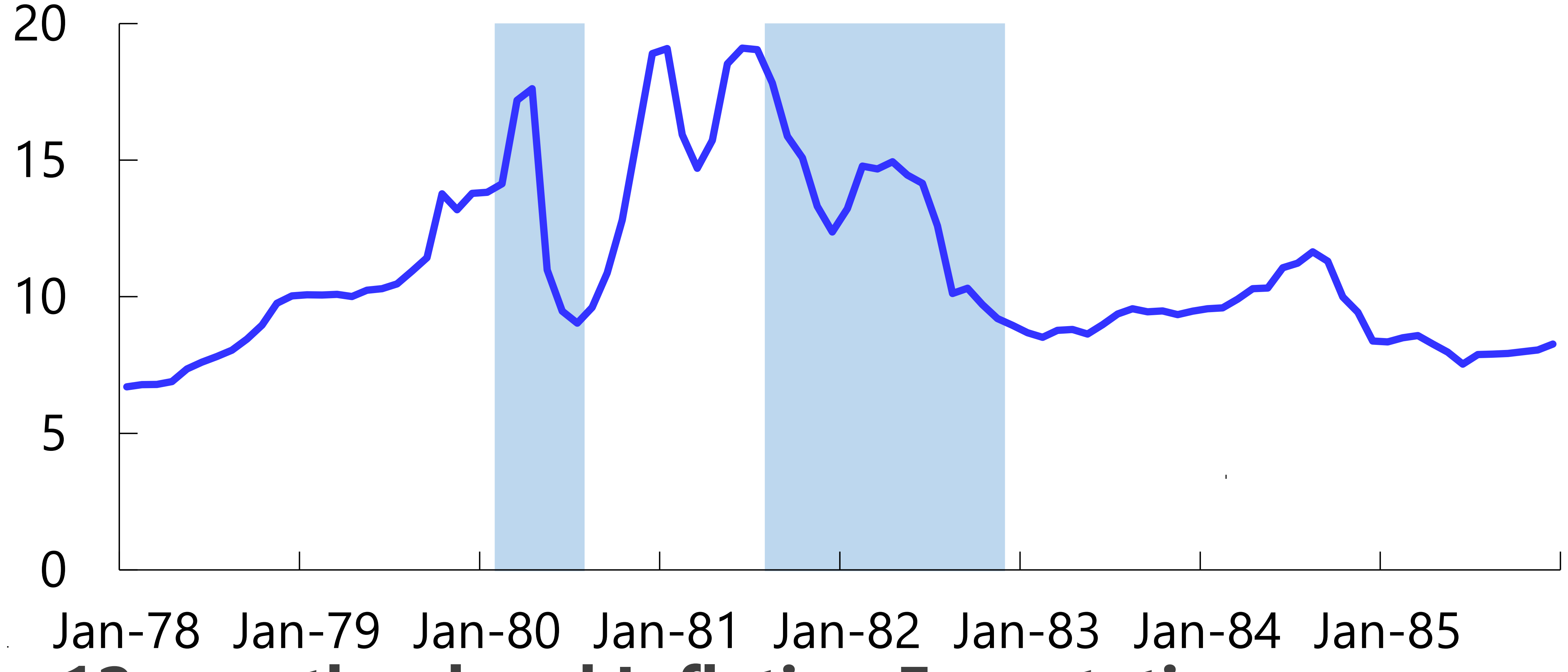
- Increasingly tight sanctions in response to Russia’s invasion of Ukraine (price cap, insurance ban) cause oil prices to rise by a further 30 percent relative to the baseline in 2023 and 15 percent in 2024.
- China’s property sector shrinks significantly over next 2 years.
- Persistent labor market disruptions raise NAIRU and lower potential output.
- A stronger dollar and tighter financial conditions push up sovereign and corporate spreads

Policy challenge: Risk of easing too early

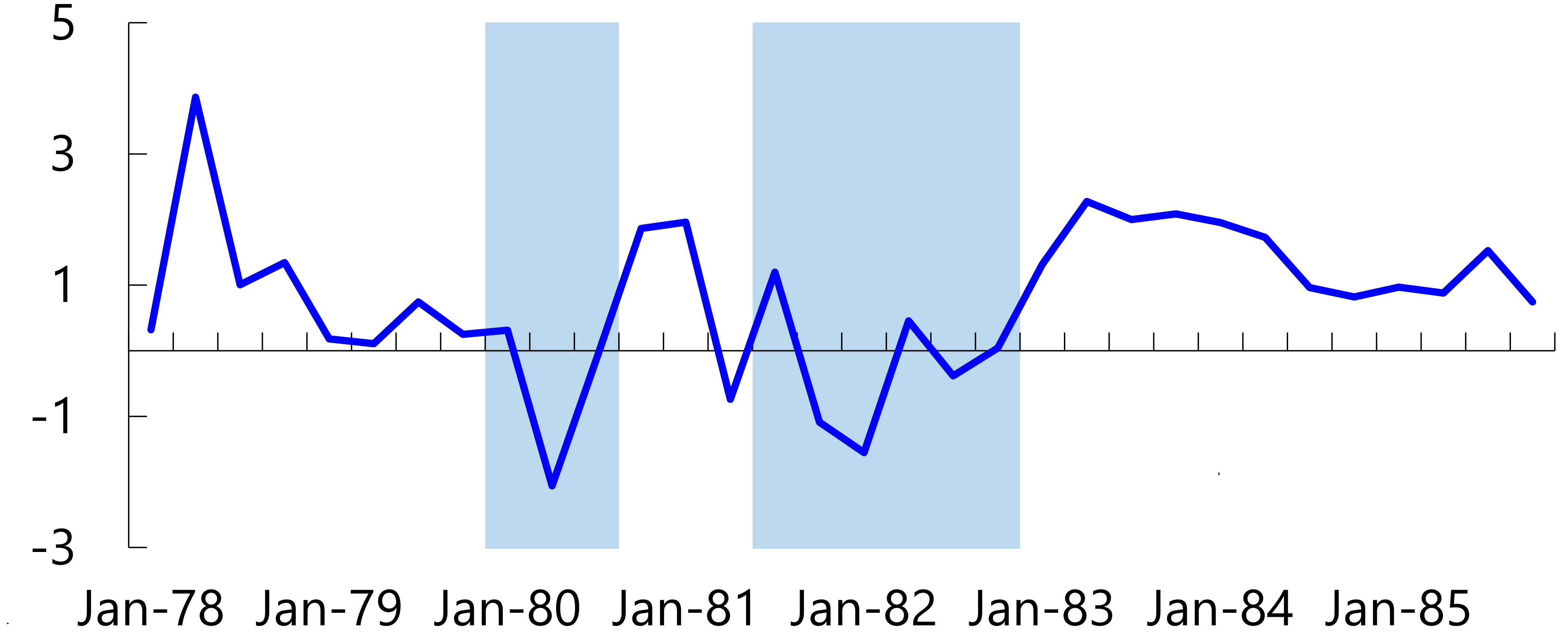
US Inflation
(percent; *yoy*)



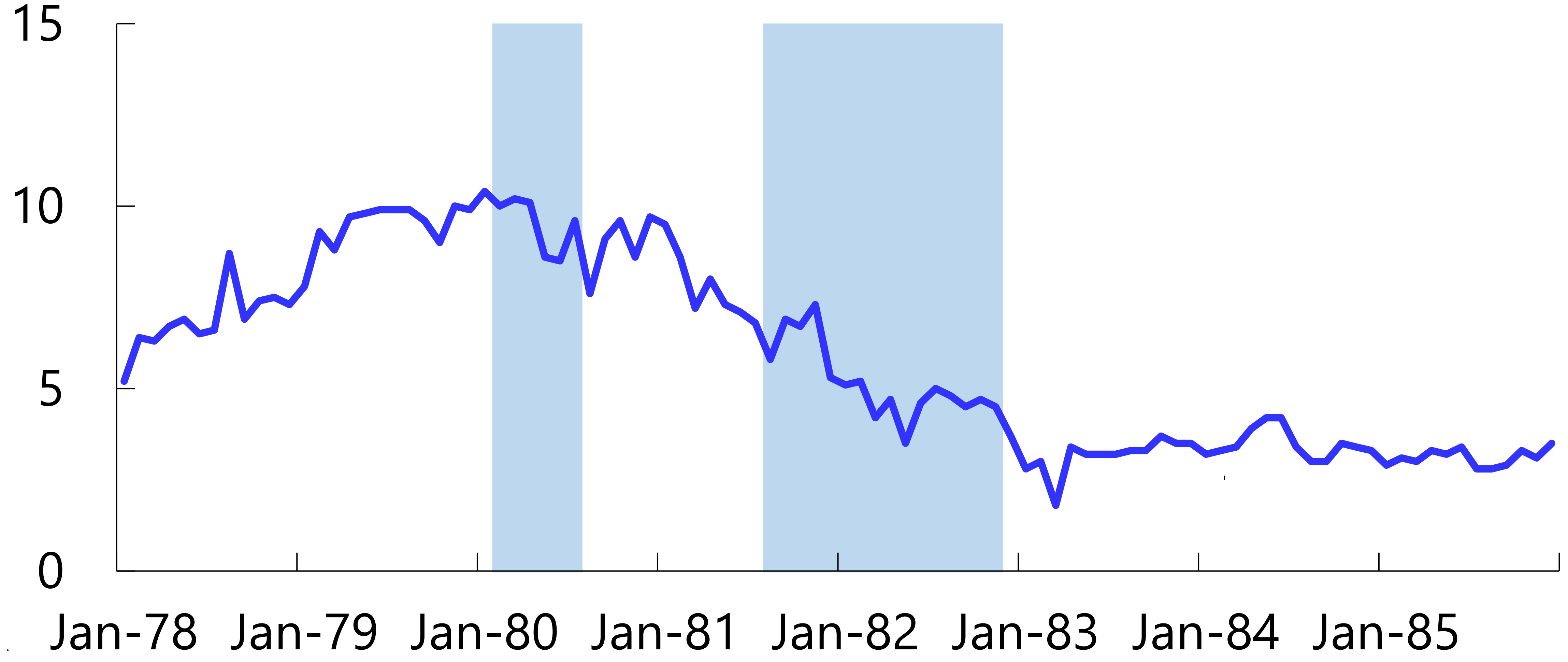
Federal Funds Rate
(percent)



Real Output
(*percent*; *qoq)*



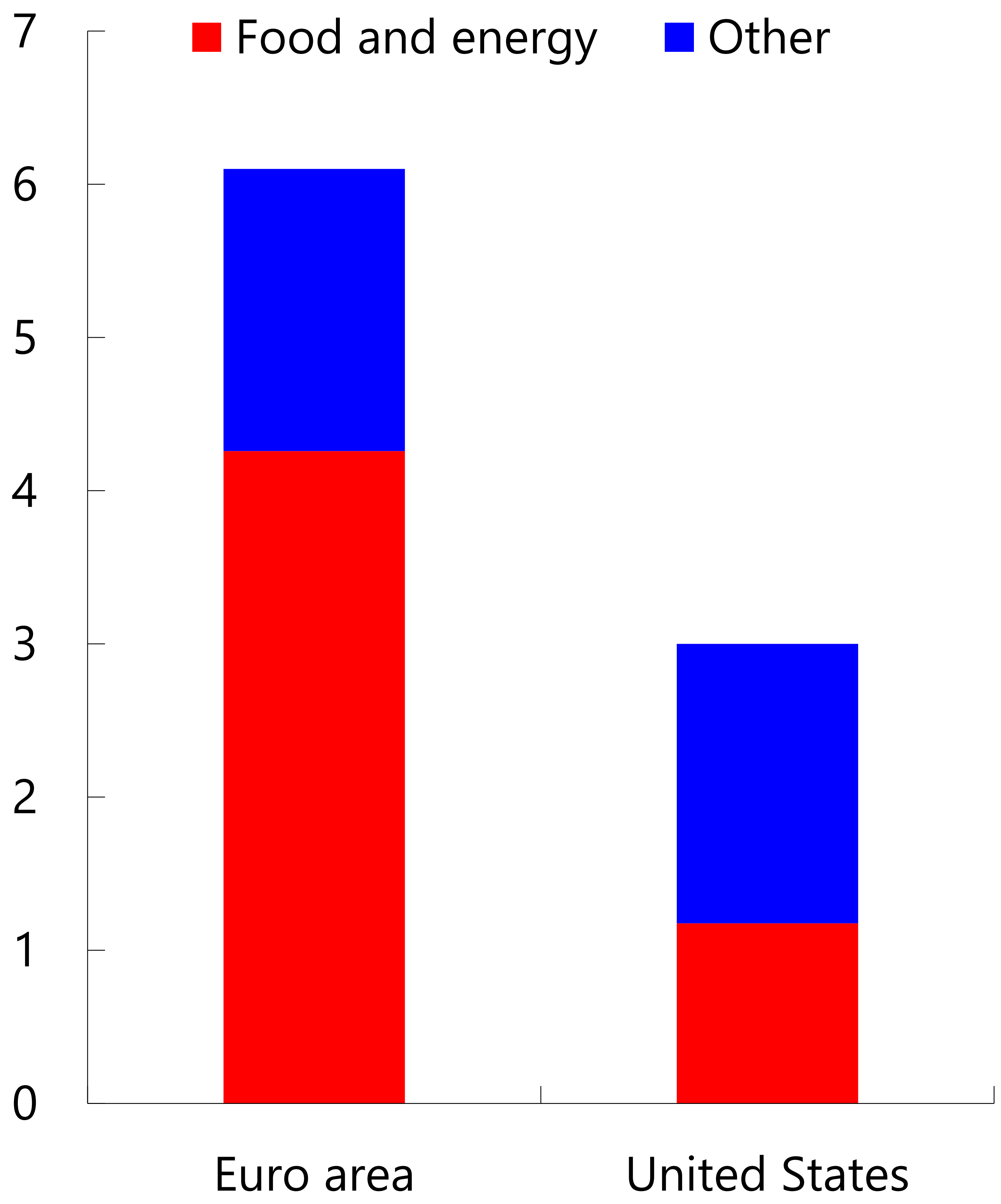
12-months ahead Inflation Expectation
(*percent)*



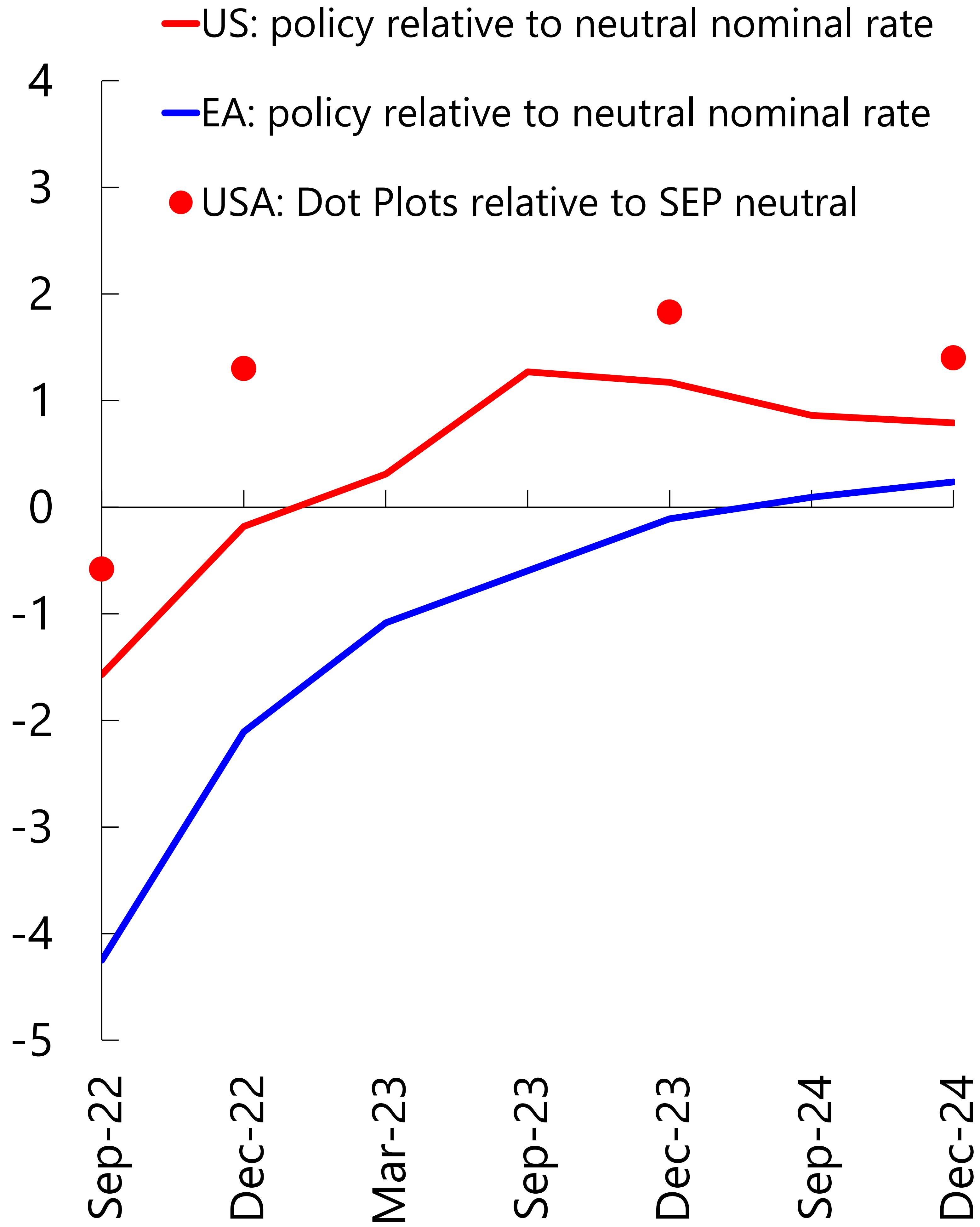
Sources: Federal Reserve Economic Data; University of Michigan (Survey of Consumers).

Policy challenge: Manage the monetary tightening cycle

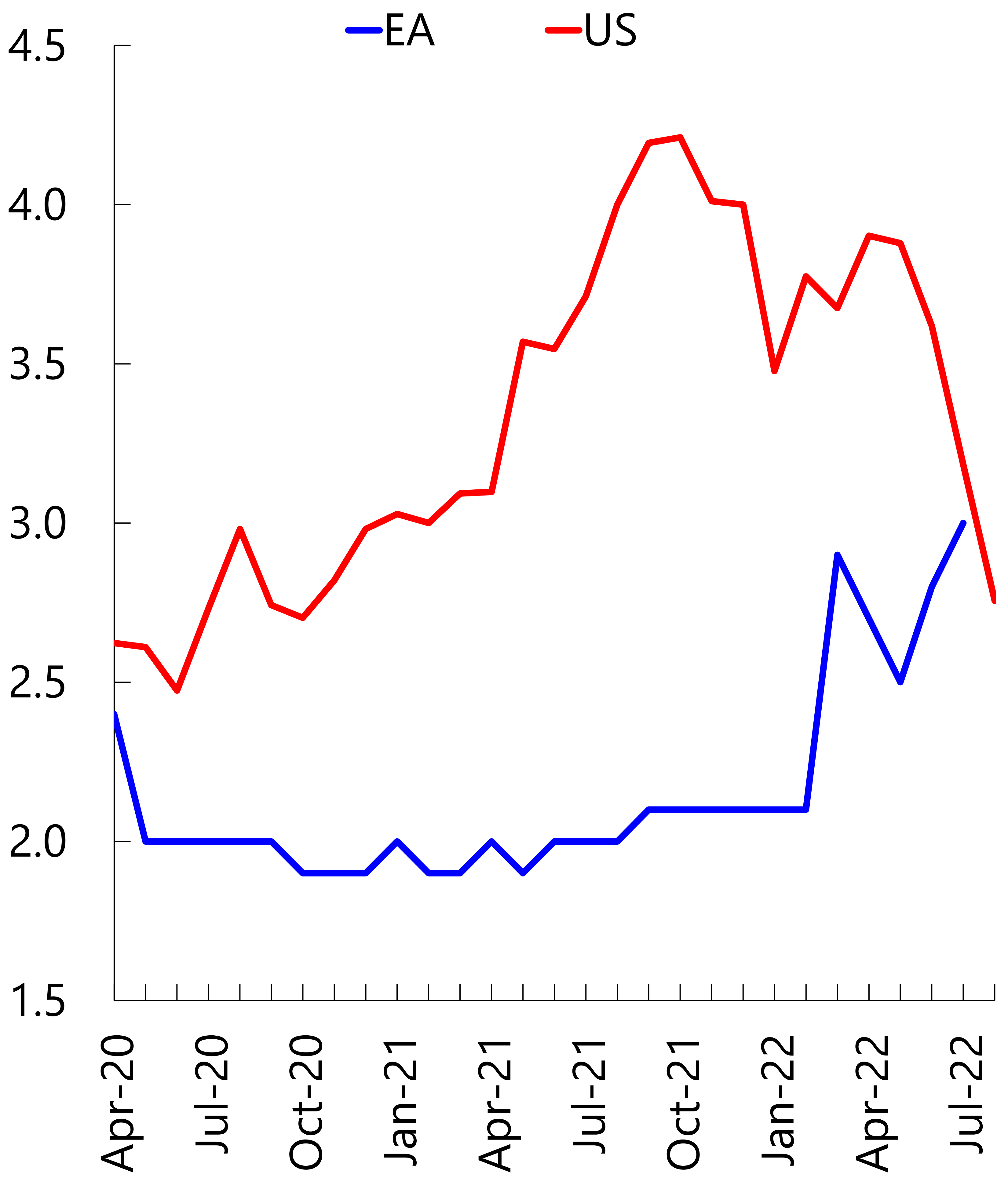
EA and US: Change in Inflation August 2021 – August 2022
(percentage points)



Monetary Policy Stance 1/
(percent)



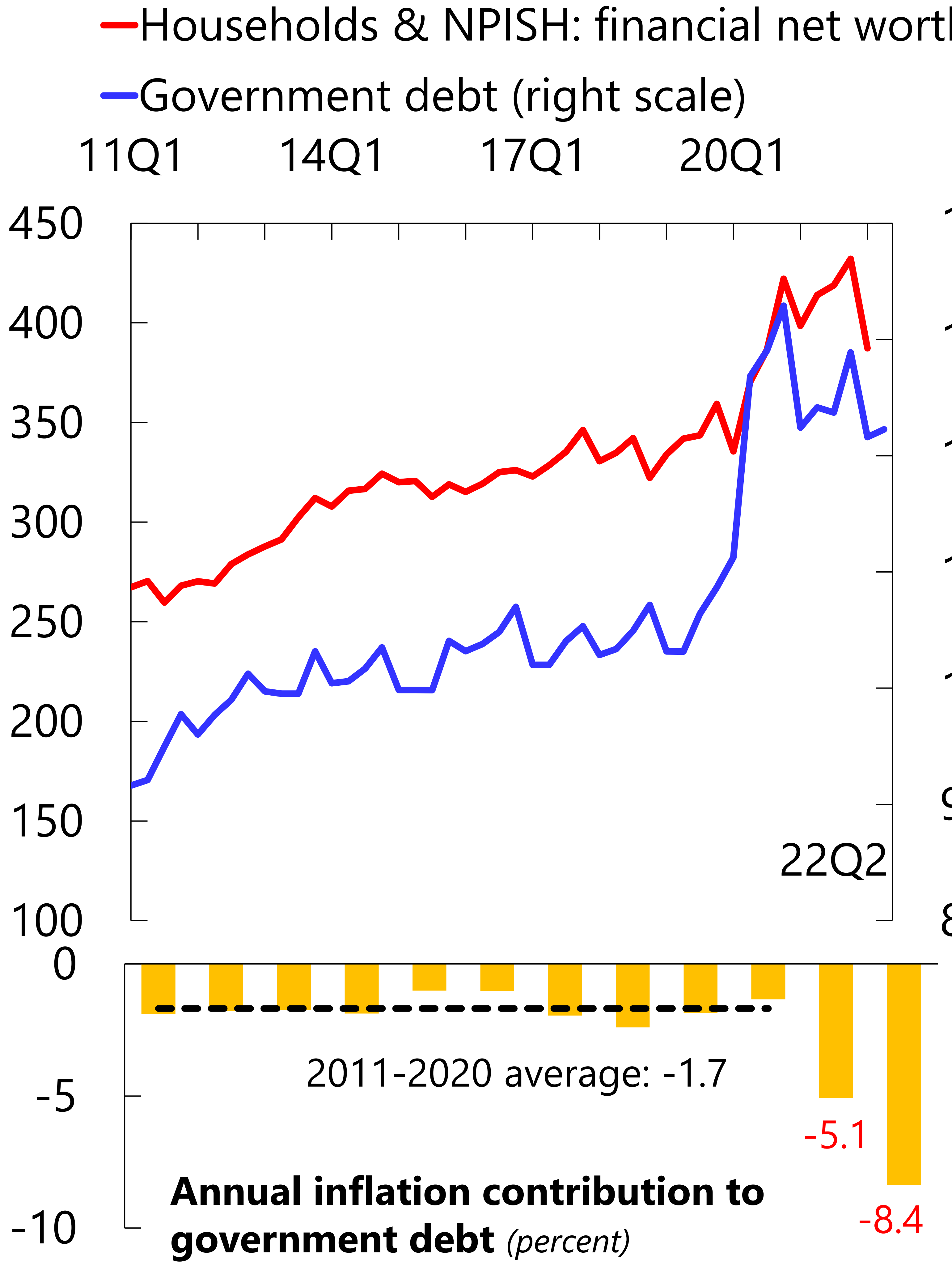
3-year Ahead Consumer Inflation Expectations
(percent)



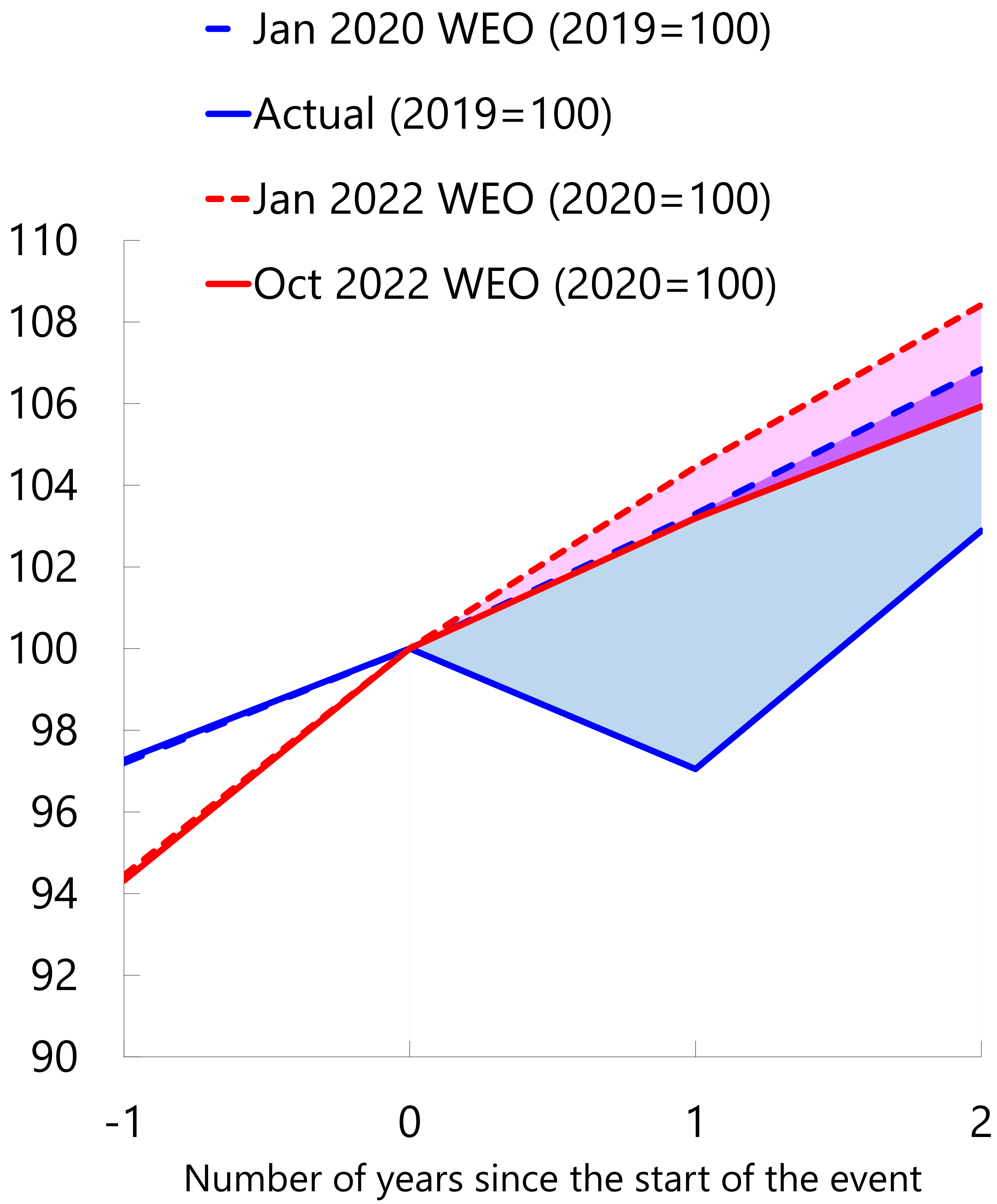
Sources: Bloomberg Finance L.P; IMF Yield Curve Manager; FRB of Cleveland, ECB, and IMF staff calculations.
1/ USA lines are based on market data as of September 26, EA line as of September 15, 2022. EA real neutral rate r* assumed equal -0.5 pct, US r*=0.5 pct. Expected inflation retrieved from US/EA inflation-linked bonds and survey expectations.

Policy challenge: Protect vulnerable households yet preserve price signals

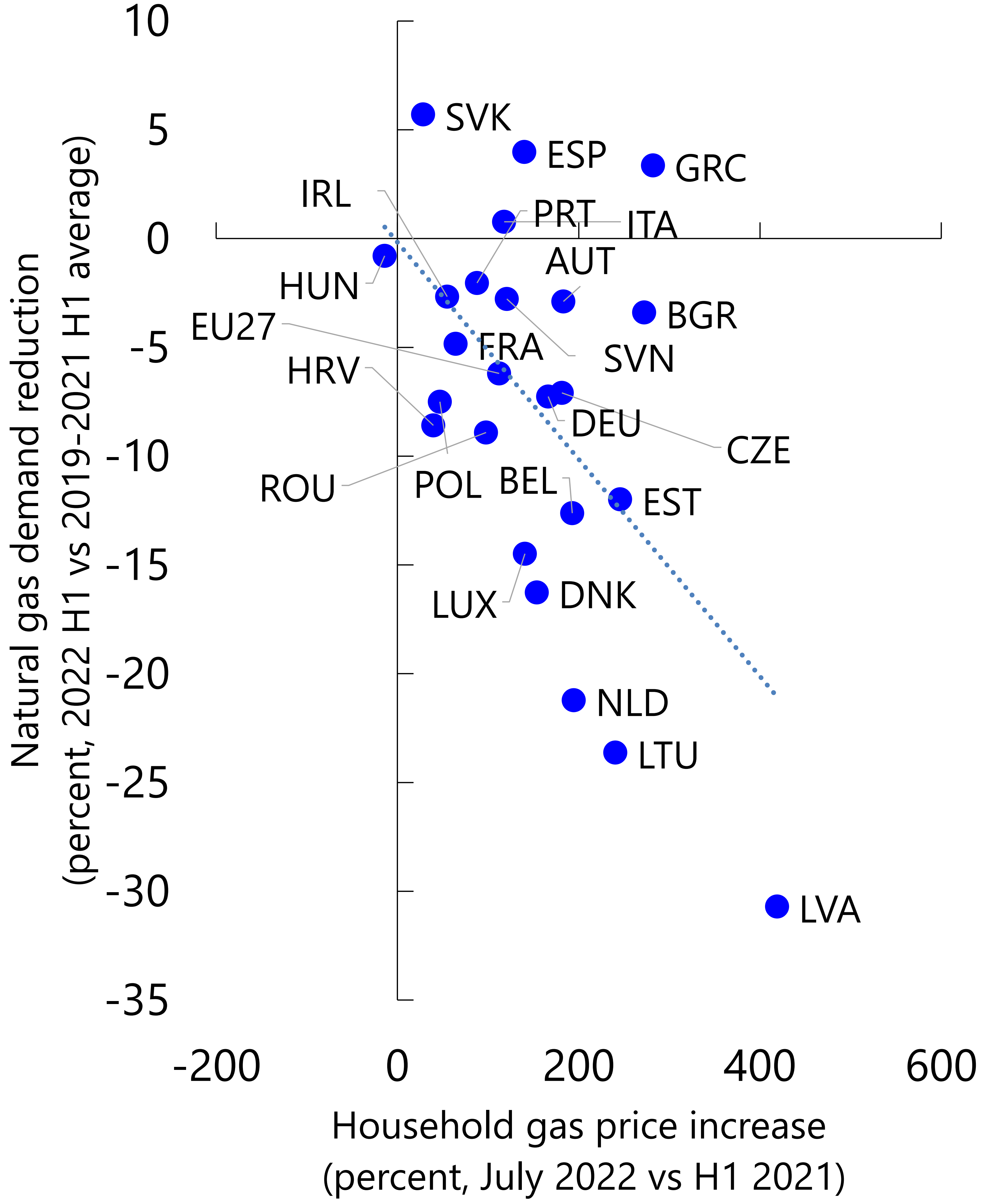
USA: Government Debt vs. Household Net Worth
(percent of GDP)



COVID vs. Ukraine War Shock
(indexed world GDP)



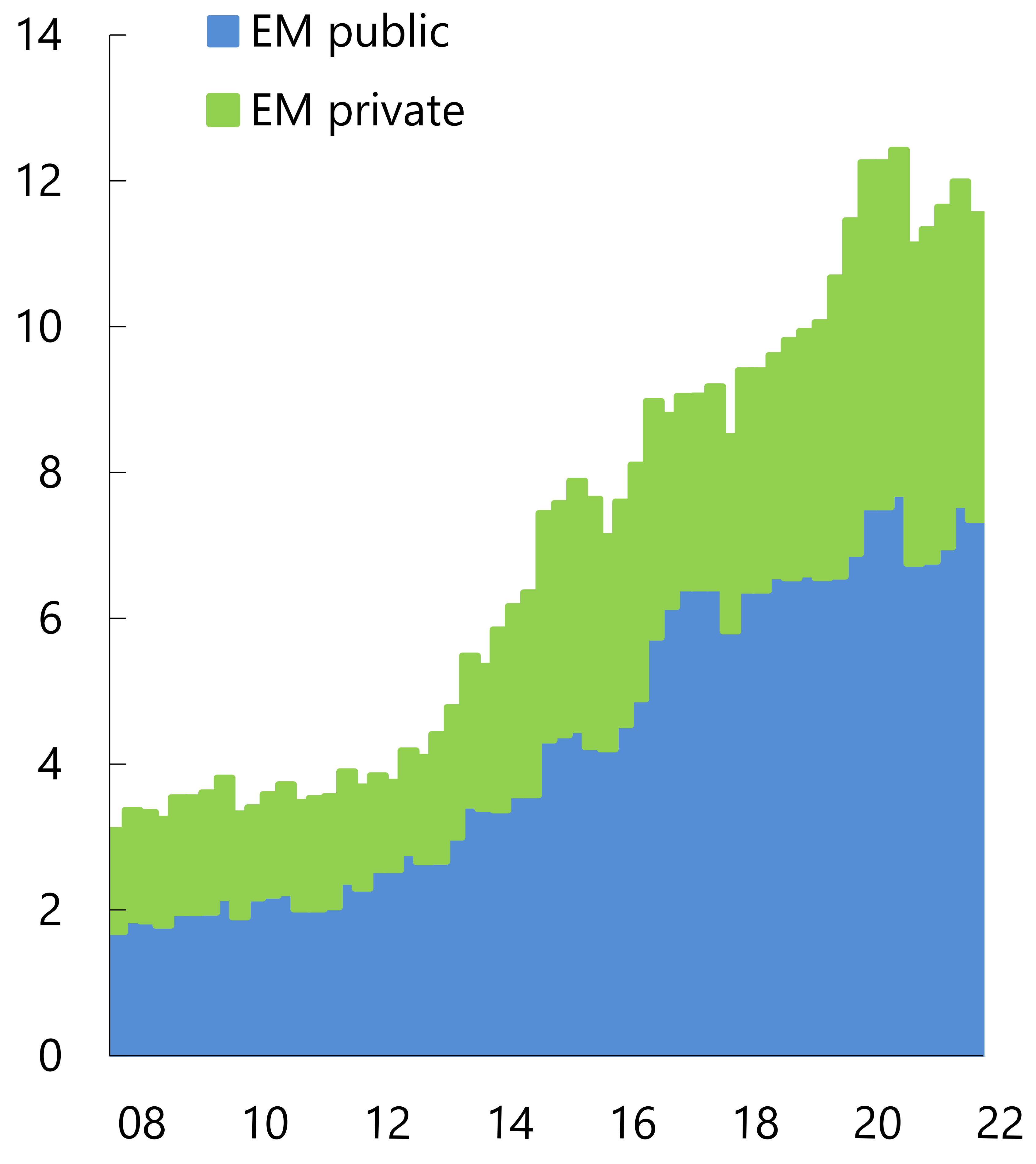
Change in Price for Households and Gas Demand in EU Countries



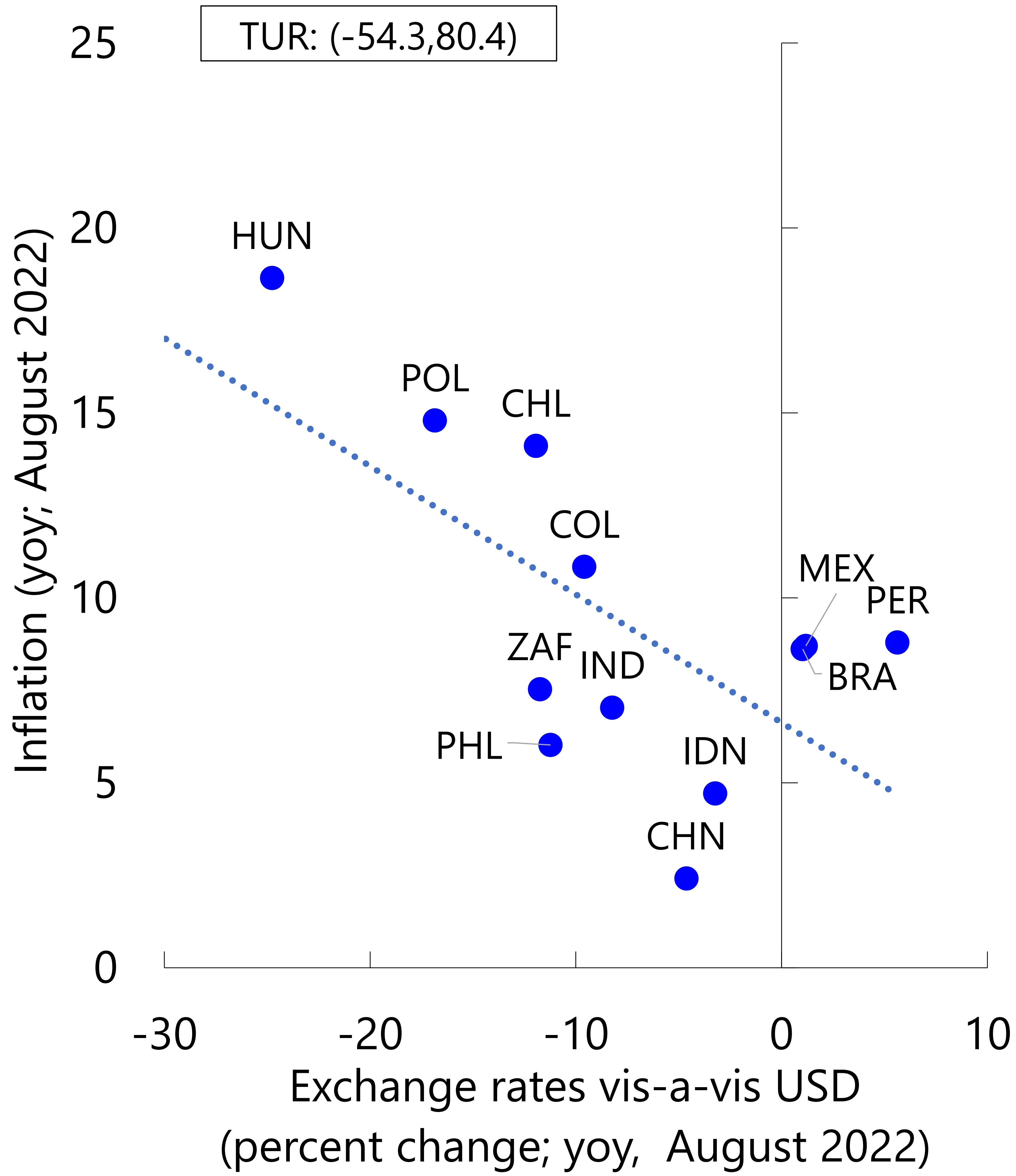
Sources: Haver Analytics; McWilliams et al (2022); IMF, World Economic Outlook; and IMF staff calculations.

Policy challenge: Manage dollar pressures in EMDEs using IPF

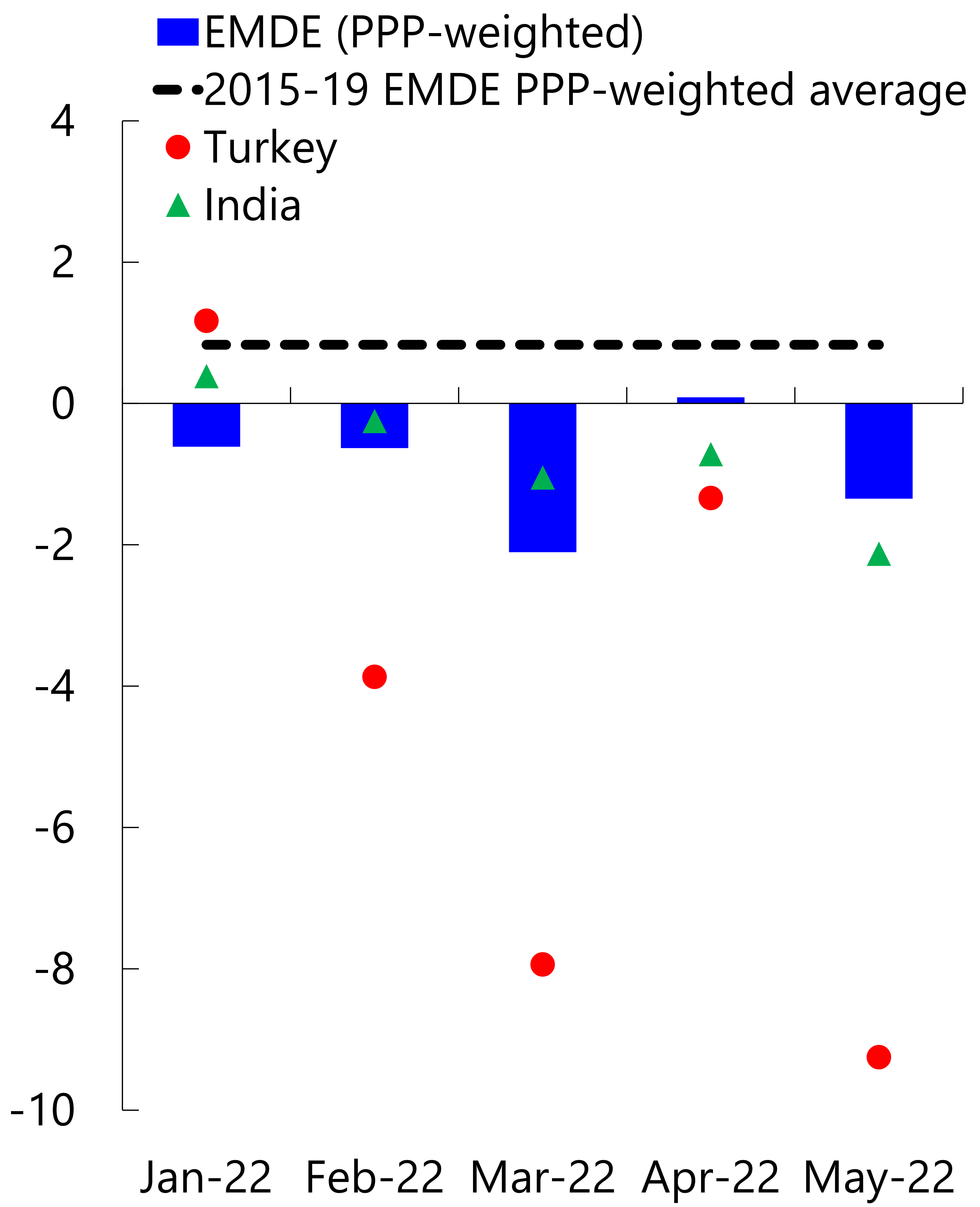
USD-denominated Debt
(percent of GDP)



EM: Headline Inflation and Exchange Rate vis-a-vis USD
(percent)



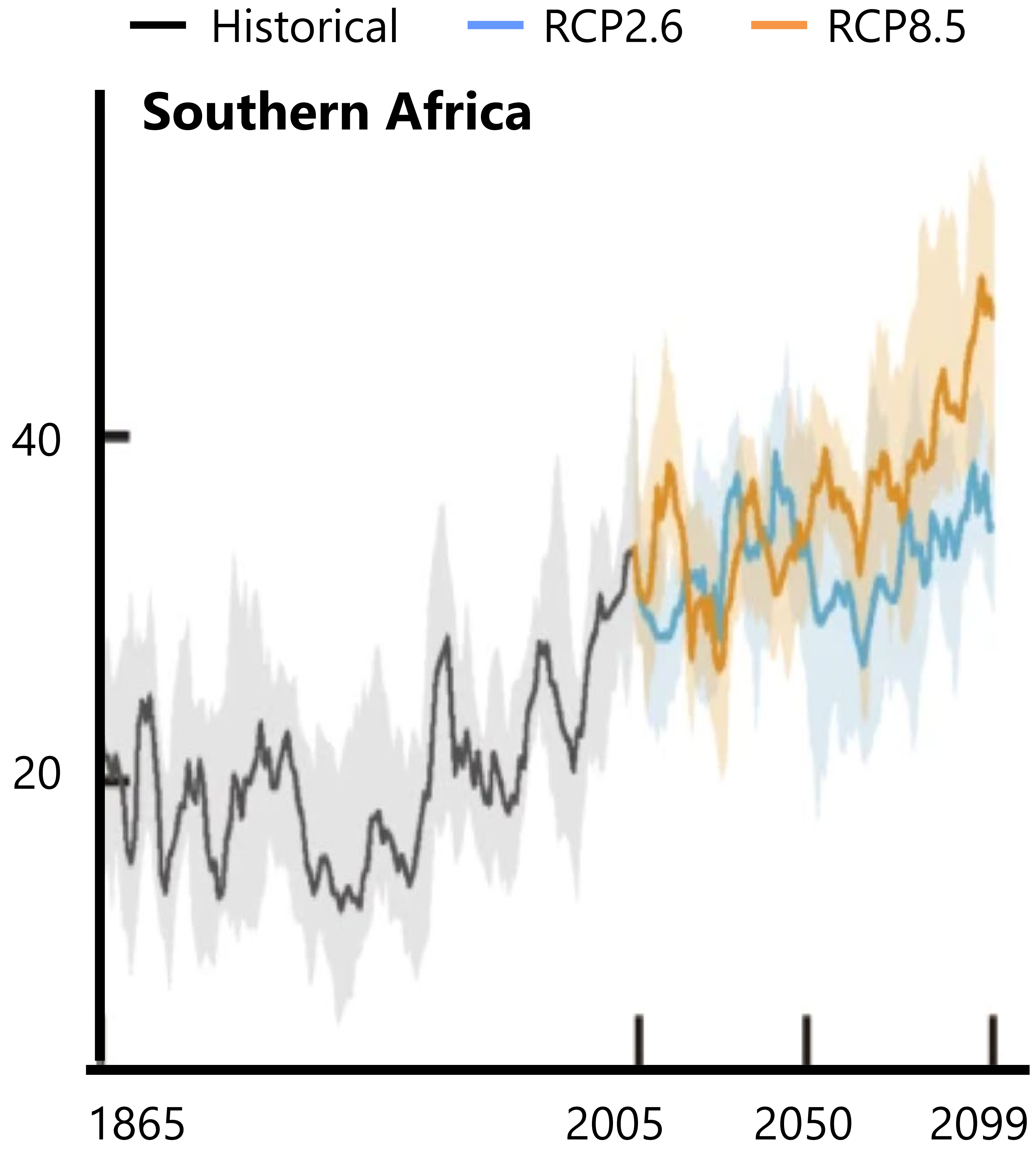
Foreign Exchange Intervention
(percent of FX reserves)



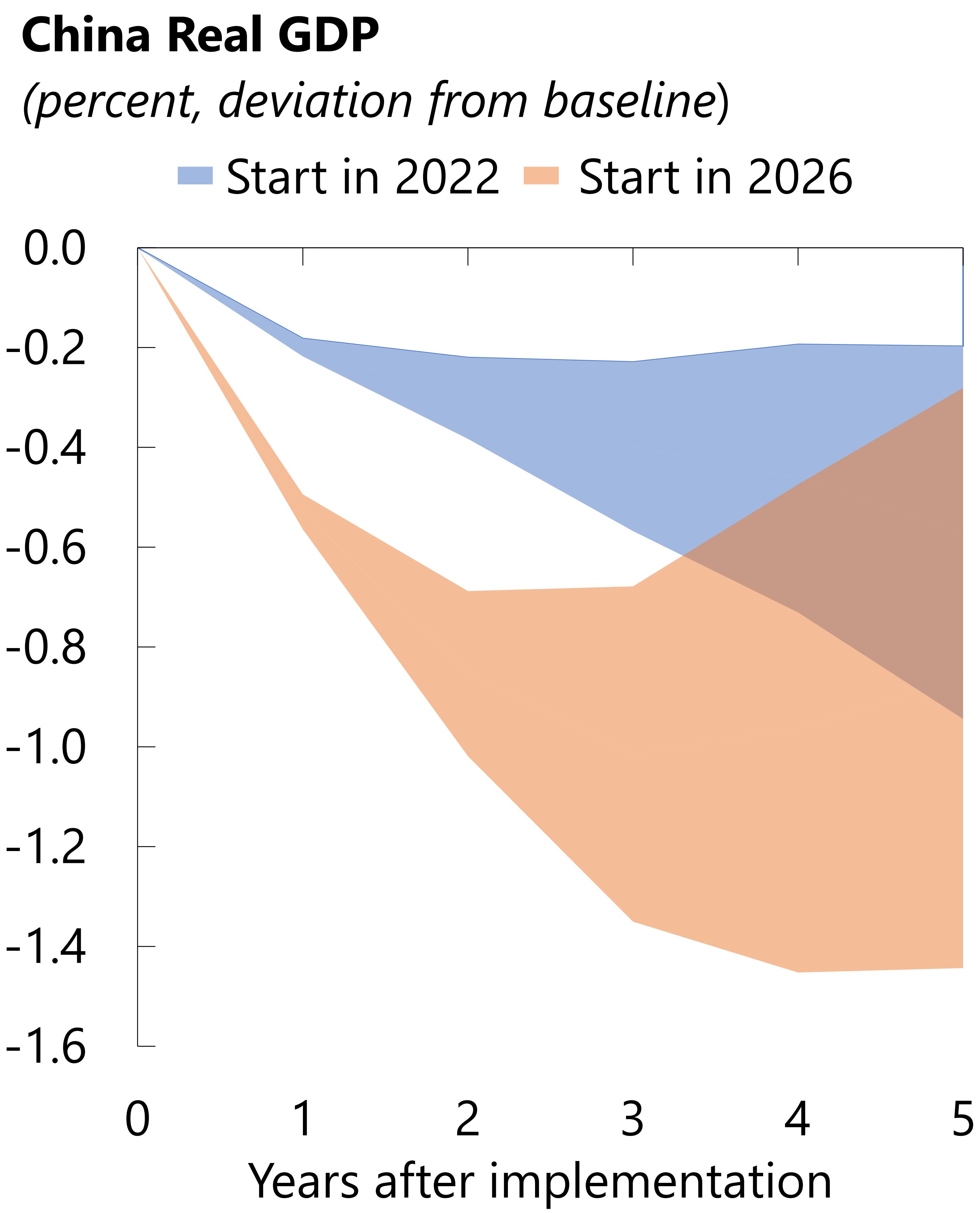
Sources: Bank for International Settlements; Adler et al. (2021); Haver Analytics; IMF, World Economic Outlook, October 2022; IMF, International Financial Statistics; and IMF staff calculations.

Climate change looms larger – timely transition critical

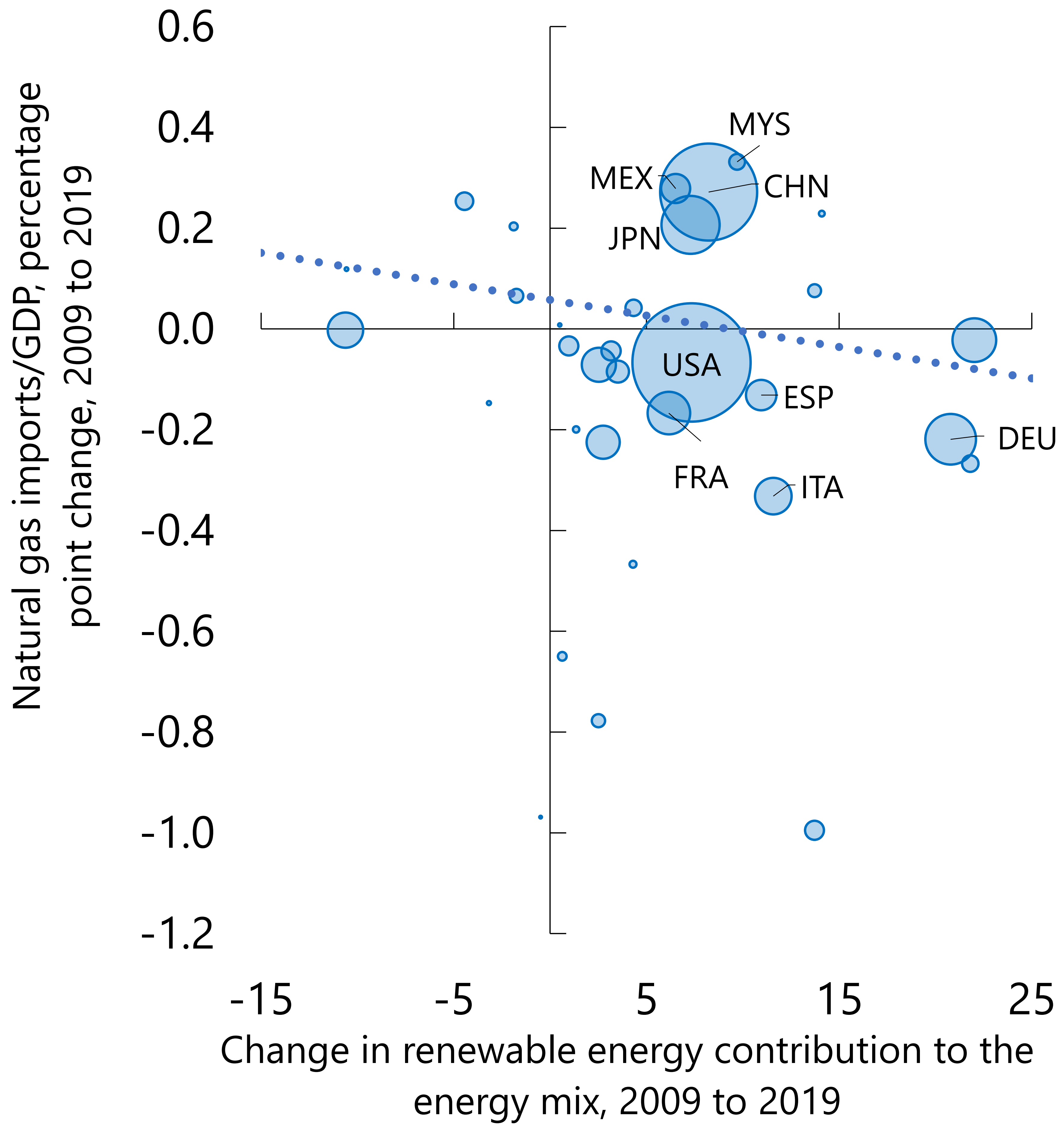
Frequency of Drought Days 1/



Cost of Delay on Climate Action 2/



Climate Policy and Energy Independence 3/



Sources: IEA World Energy Statistics and Balances; IMF, World Economic Outlook Chapter 3, October 2022; Satoh et al. (2022), The timing of unprecedented hydrological drought under climate change; World Integrated Trade Solution (WITS) and IMF staff calculations.

1/ Hydrological drought is defined as the condition when the daily river discharge is lower than or equal to a daily variable threshold for which seasonality is considered. The chart to the right shows all countries with available data but excludes those countries with a ratio of natural gas import expenditure to GDP of less than 0.02 in both 2009 and 2019. RCP refers to "Representative Concentration Pathway". RCP2.6 is a scenario with very strong climate policy, RCP8.5 a scenario with no climate policy. Southern Africa includes Botswana, Eswatini, Lesotho, Namibia, South Africa and Zimbabwe. 2/ Range of cost reflects variation in key elasticities of substitution. 3/ Bubble size proportional to GDP.

Policy recommendations

Main policy priority: fight inflation, mitigate financial distortions

- Act resolutely to bring inflation credibly back to target in a timely way and avoid a de-anchoring of inflation expectations.
- Do not yield to pressure to ease monetary tightening, this will necessitate more painful policy actions in the future.
- Use Integrated Policy Framework to help avert crises, combining targeted foreign exchange interventions, capital flow measures, and other actions as needed to smooth exchange rate moves and reduce financial stability risks.
- In some cases, macroprudential policy adjustments and regulatory actions may be needed to avoid risks materializing.

Fiscal policy should protect the vulnerable while aiding the tightening monetary stance

- Targeted, temporary measures, should be deployed to cushion the impact of economic slowdown on the most vulnerable.
- Fiscal policy should tighten to support monetary policy where there is excess demand or inflation expectations are at risk of de-anchoring.
- For most countries, deficit reduction is appropriate, anchored in medium-term fiscal framework, esp. if there is little fiscal space or debt concerns are pressing.
- Policies should preserve price signals; attempts to control prices directly are fiscally costly and ultimately ineffective.
- Complement with structural policies to boost supply capacity in the long-term: education, childcare access, digitalization, infrastructure investment, pension reforms, supply chain resilience & pandemic preparedness.

Multilateral cooperation is urgently needed for crisis prevention and investment in the future

- More sovereigns in debt distress will require restructuring: urgently implement and broaden G-20 Common Framework.
- Ensure resilience of market functioning and maintain global liquidity amid tightening financial conditions. For many EMDEs, now is the time to apply for precautionary credit lines with the Fund.
- Prevent catastrophic climate change impact by accelerating green transition. Delays will magnify transition costs.
- Strengthen cooperation on common goods (e.g. climate policies, debt) to mitigate fragmentation risks. The Fund stands ready to deliver with existing and new tools: incl. SDR channeling, RST, RFI Food Shock Window.

International Monetary Fund

September 29, 2022

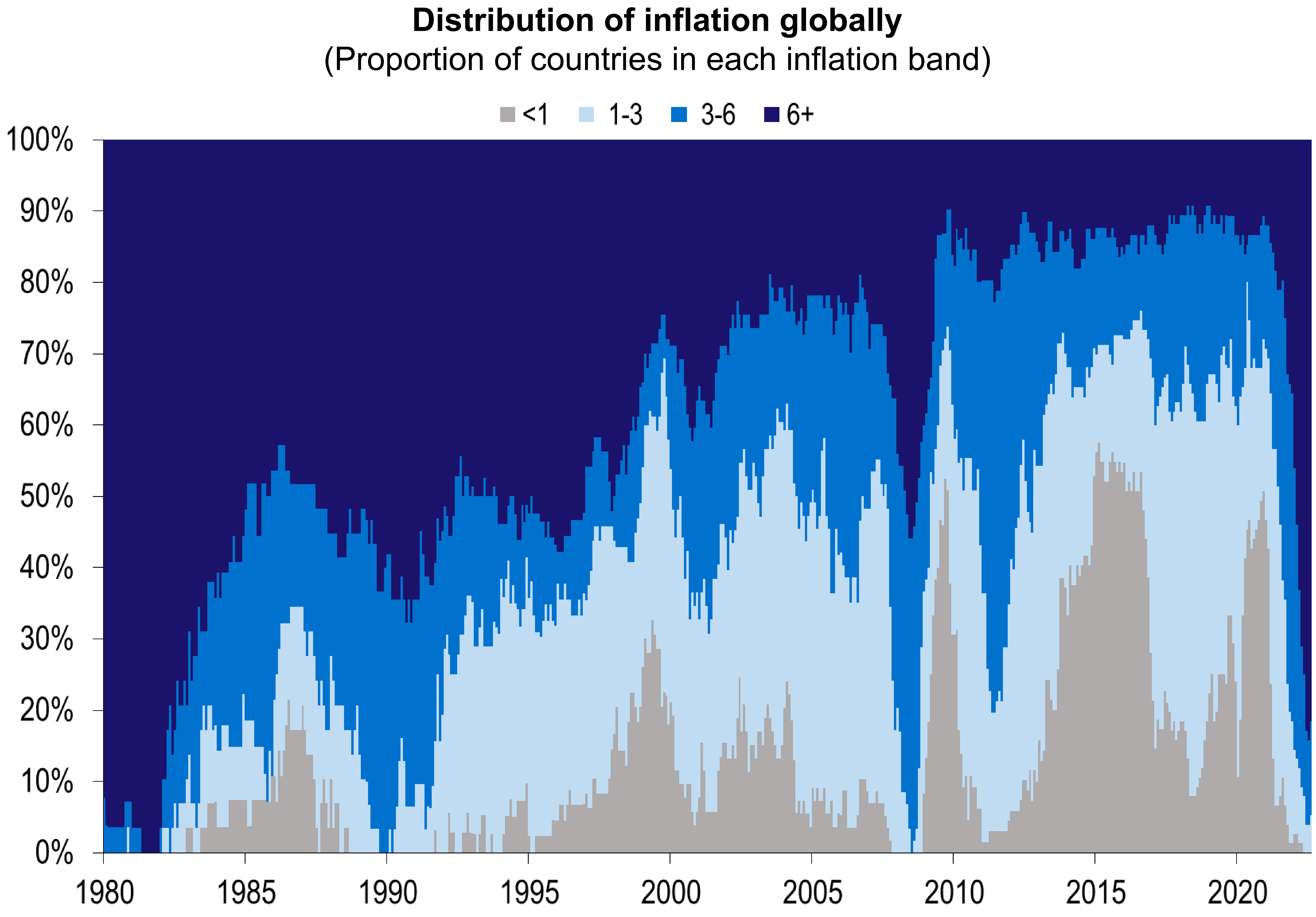
World Economic and Market Developments

Tobias Adrian

Financial Counsellor and Director

Monetary and Capital Markets Department

Worldwide Inflation Has Reached Multidecade Highs



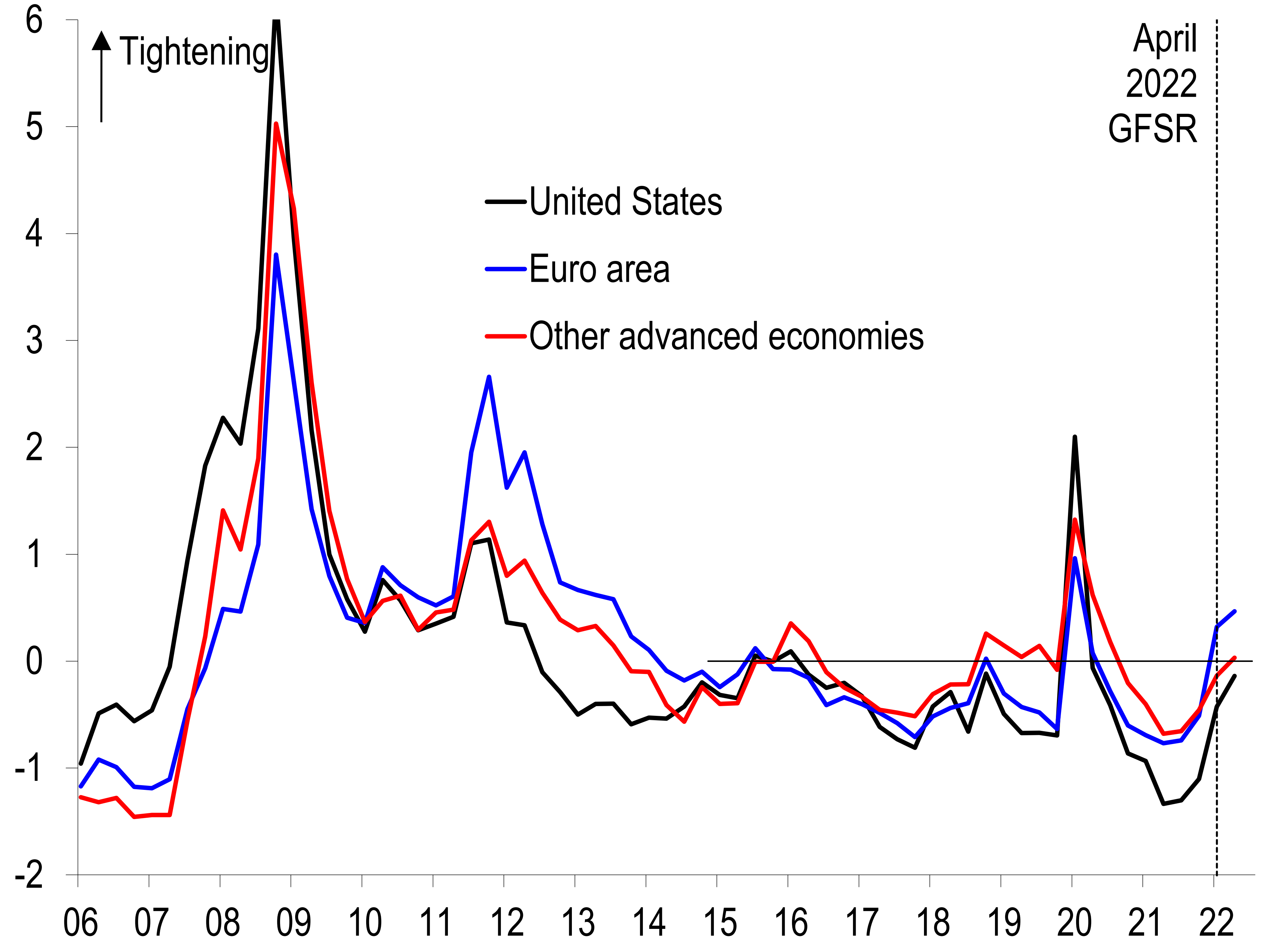
Note: Based on realized y/y headline inflation in 76 countries

Financial Conditions Have Tightened

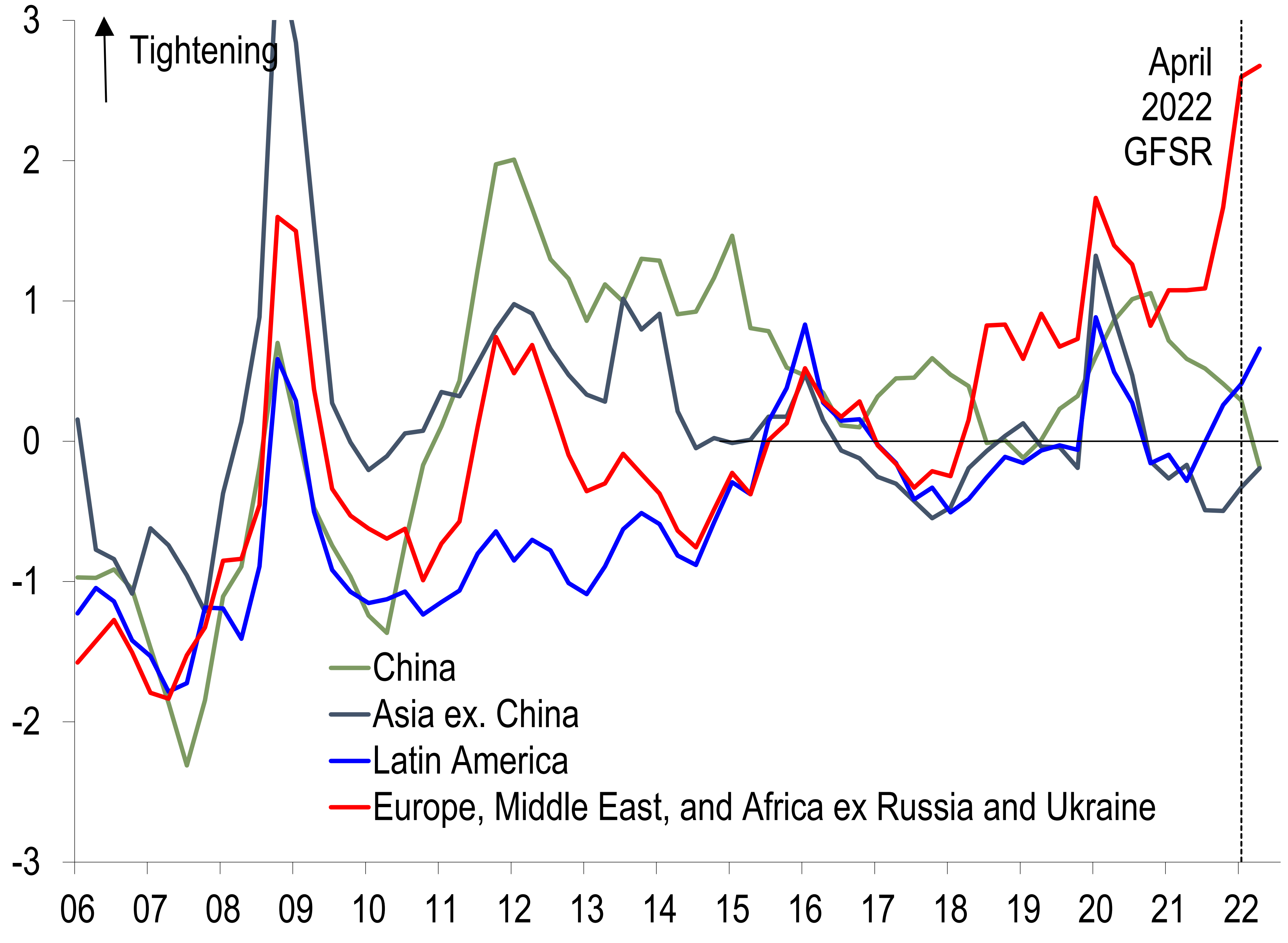
In AEs, FCIs have only risen to historical averages…

… While in some EMs, they have reached March 2020 levels

Financial Conditions: Advanced Economies
(Standard deviations from the mean)



Financial Conditions: Emerging Markets
(Standard deviations from the mean)



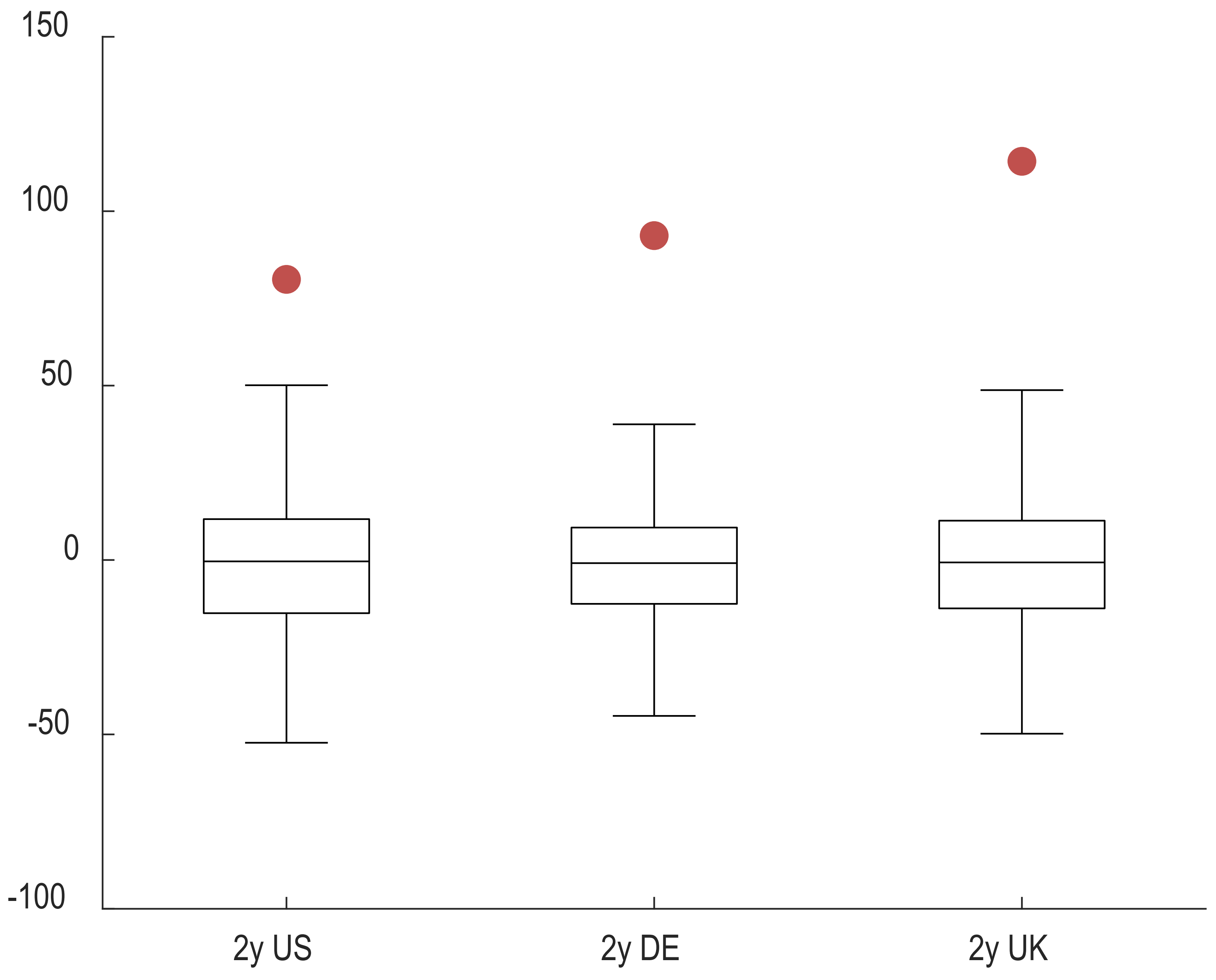
With Accelerating Market Moves in Last Month

Since August Jackson Hole Meeting, Short-Term Yields Sharply Corrected…

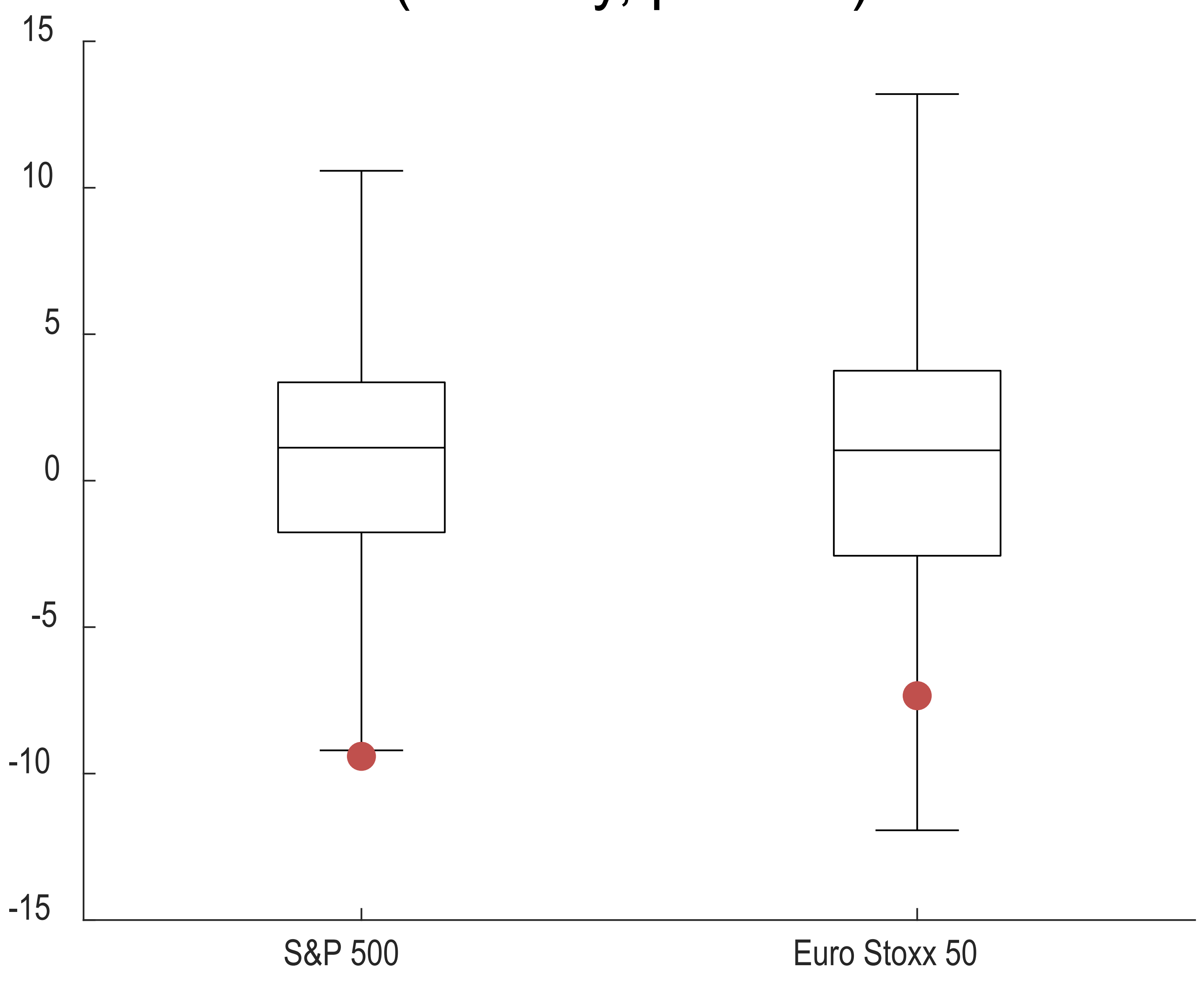
… Prompting Equity Markets in the US and in Europe to Selloff…

… Amid a Continuation of Dollar Dominance.

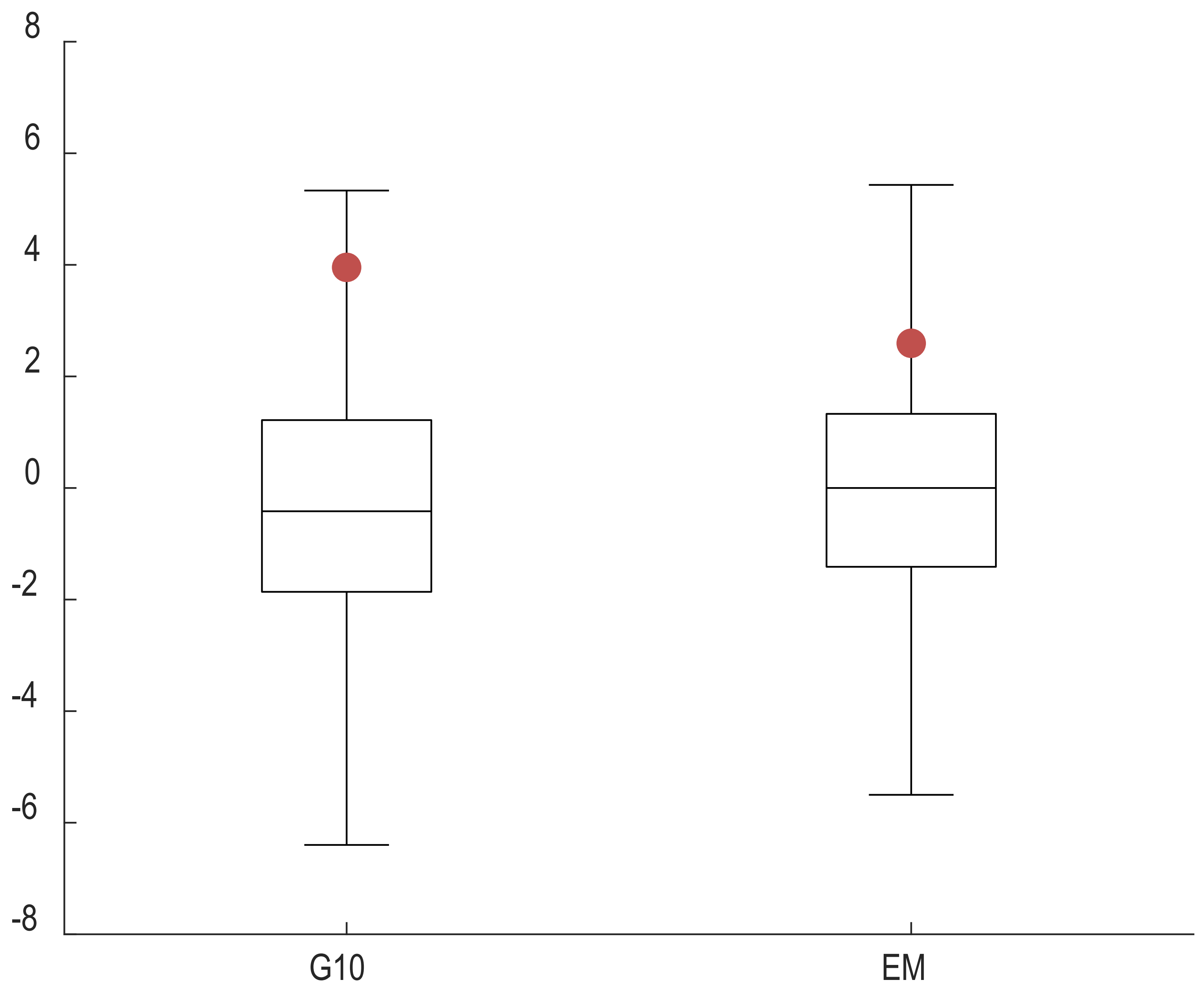
Yield changes in the US, Germany & UK
(monthly, basis points)



US and Euro Area Equity Returns
(monthly, percent)



G10 and Emerging Market Currencies
(monthly, percent)



Note: The black dots denote changes from August 26, 2022, to September 23, 2022. The Boxplots reflect monthly data since January 1990. On each box, the central mark indicates the median, and the bottom and top edges of the box indicate the 25th and 75th percentiles, respectively. The whiskers extend to the most extreme data points not considered outliers. Given limited availability the EM currency index only starts in July 2010. Currency indices are shown as direct quotes, so that a positive return reflects US dollar appreciation.

Main Financial Stability Themes Since Last GFSR

1) More tightening expected in many countries

2) Stagflation threats loom globally; energy crisis intensifies in Europe

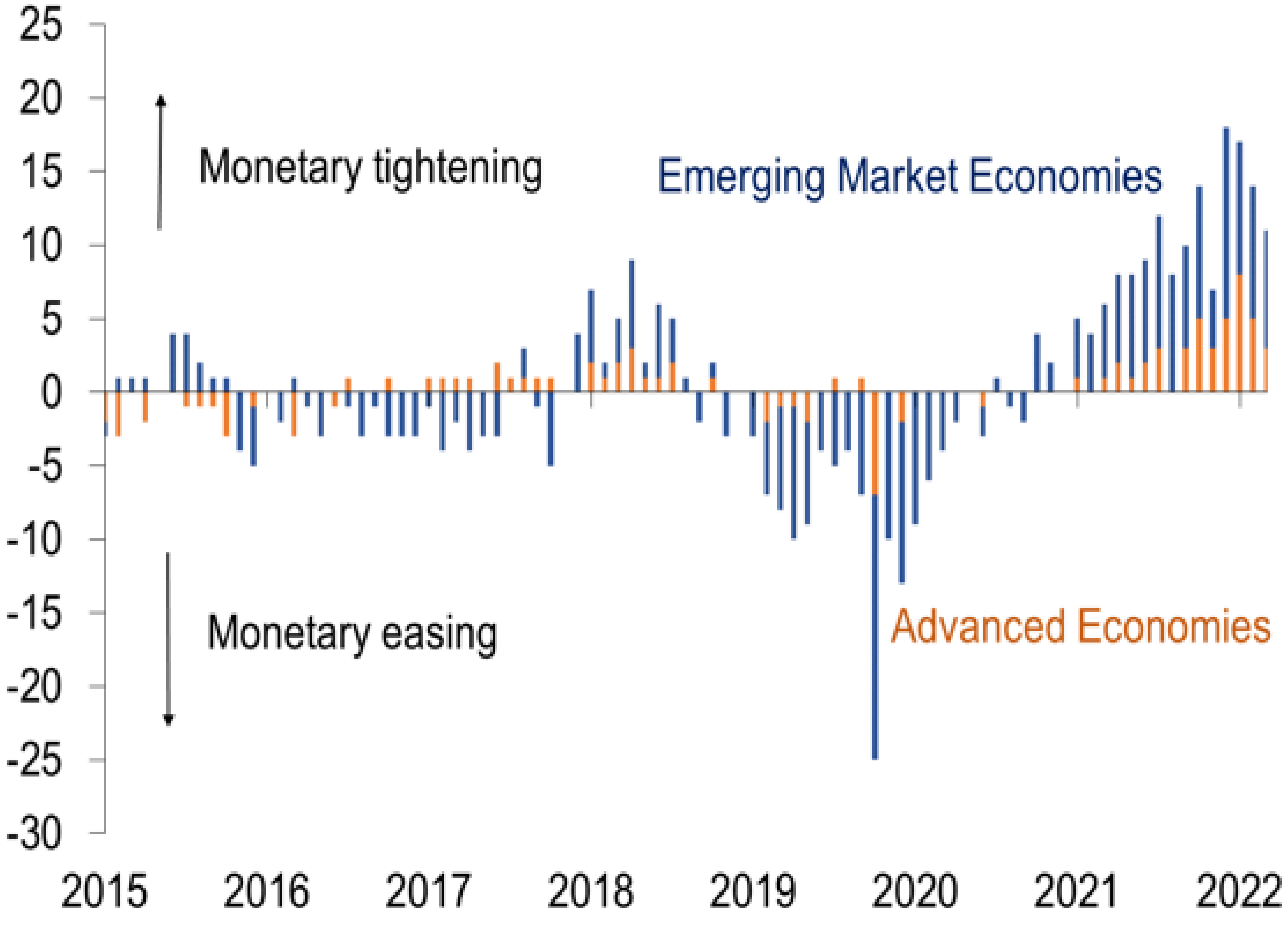
3) Vulnerable EMDEs could face defaults and difficult restructurings

4) Global housing risks intensifying; China property market near crisis

Persistent Inflation Prompted Central Banks to Act More Aggressively

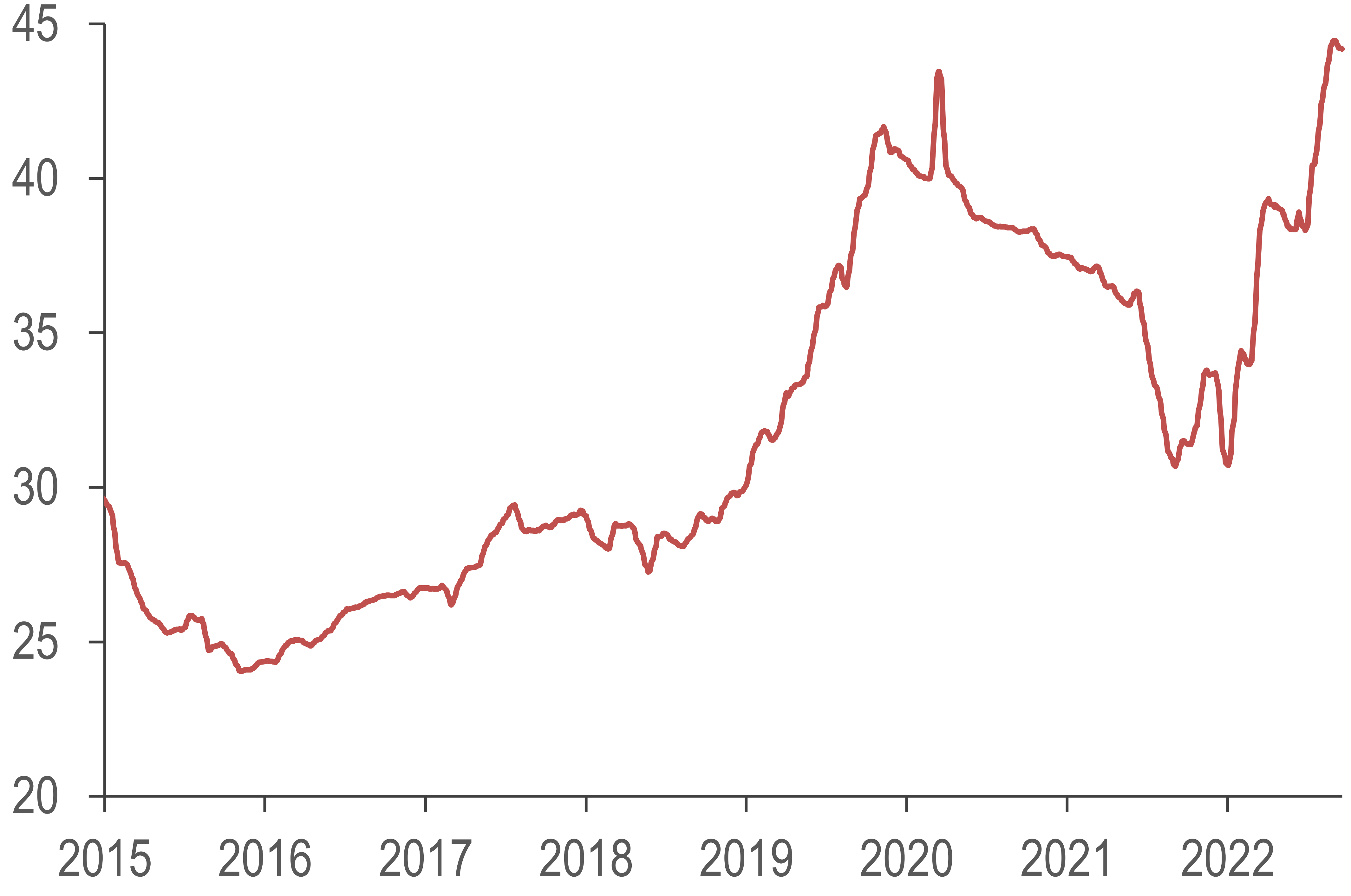
AE and EM central banks have dramatically synchronized monetary tightening…

Number of Central Banks changing policy rates
(net)



… so that correlation among global interest rates has been increasing.

Co-movement of G10 yield changes at select maturities
(Proportion of variance explained by common factor)

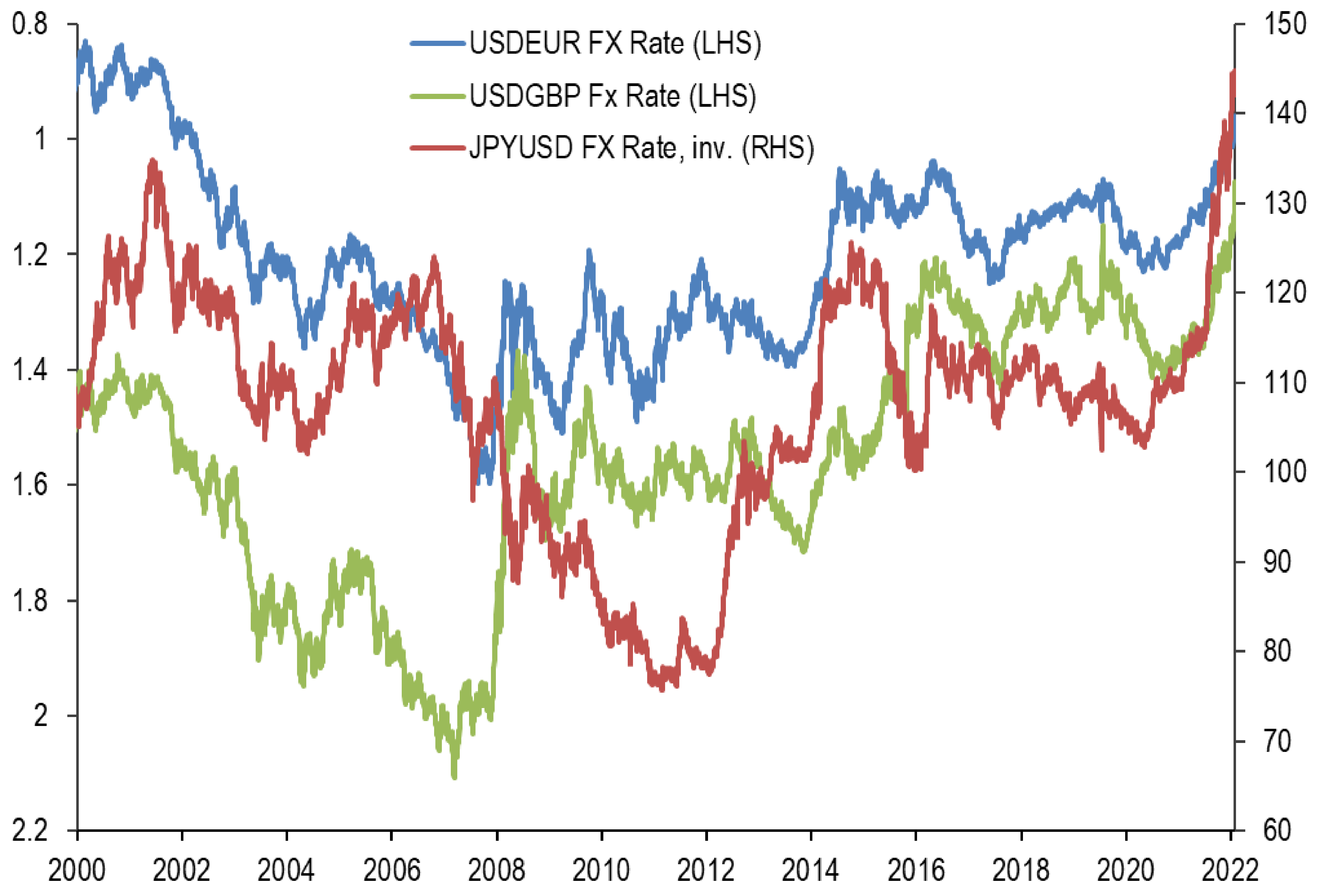


Note: Rolling proportion of G10 interest rate changes excluding Japan explain by a common factor, based on rolling 1-year principal component analysis.

Dollar has Strengthened on the Back of Fed Tightening

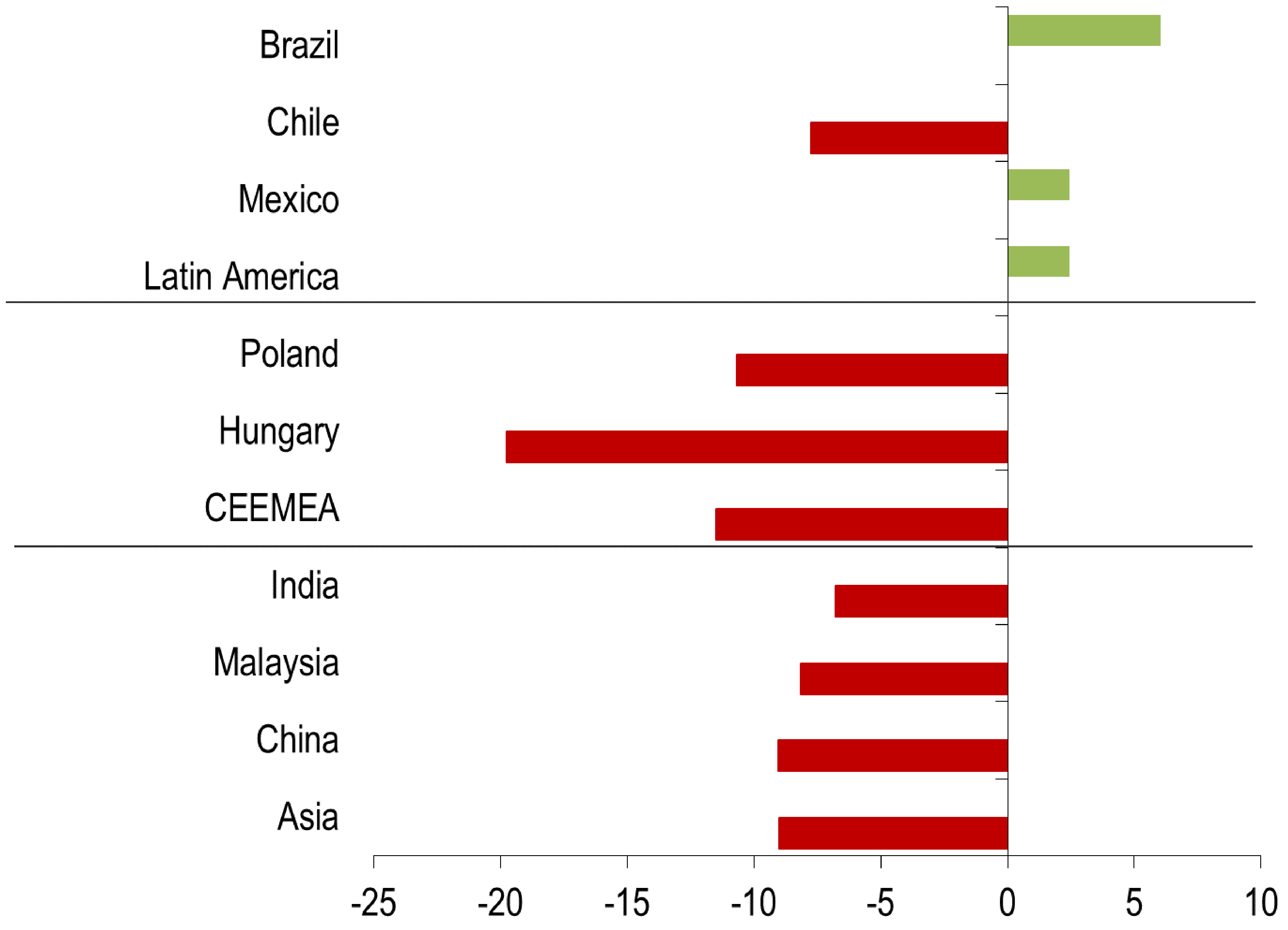
Interest rate differentials have driven USD to historic highs

Euro and Yen Exchange Rates vs Dollar since 2020
(EUR and GBP left scale, JPY right scale)



EM currencies have also depreciated, but with marked regional differences

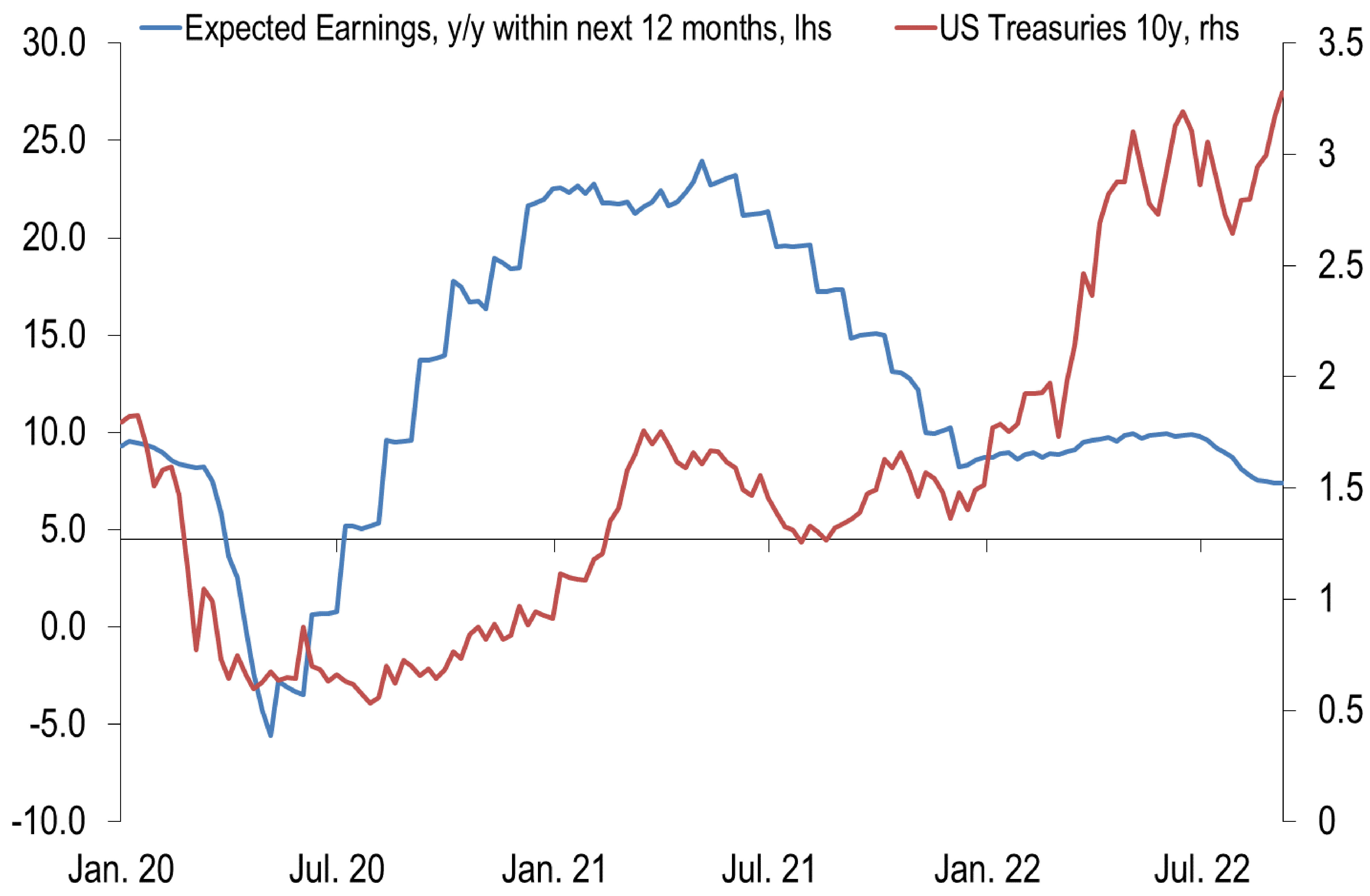
Emerging Market Regional Currencies
(2022 percent return versus US dollar)



Spectre of Stagflation Has Repriced Markets, But More Downside Risk Remains

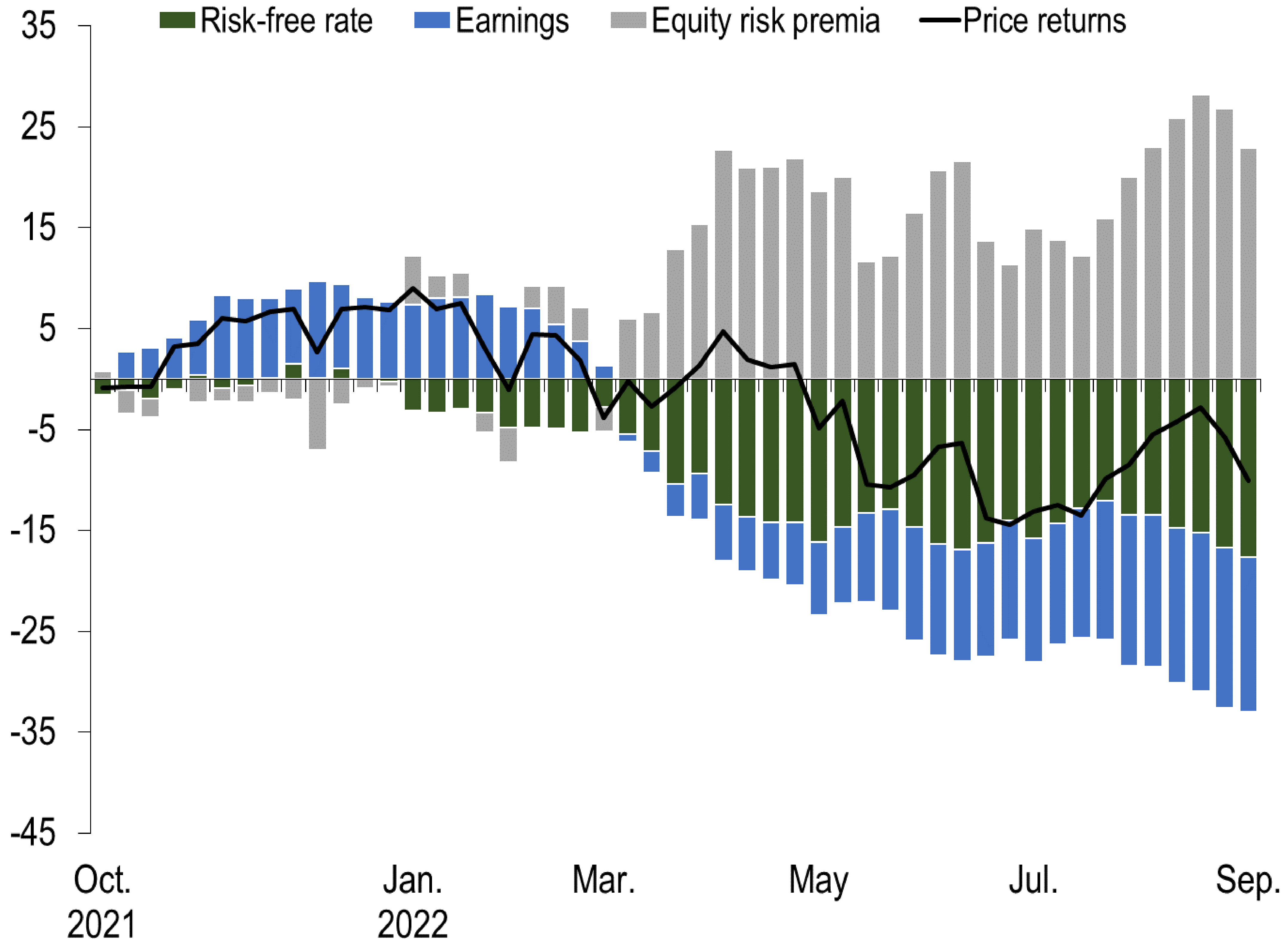
Rising rates and earnings downgrades have driven markets down…

Components of S&P 500 valuation
(y/y percent growth, left scale; percent)



…but a falling risk premium has blunted the selloff

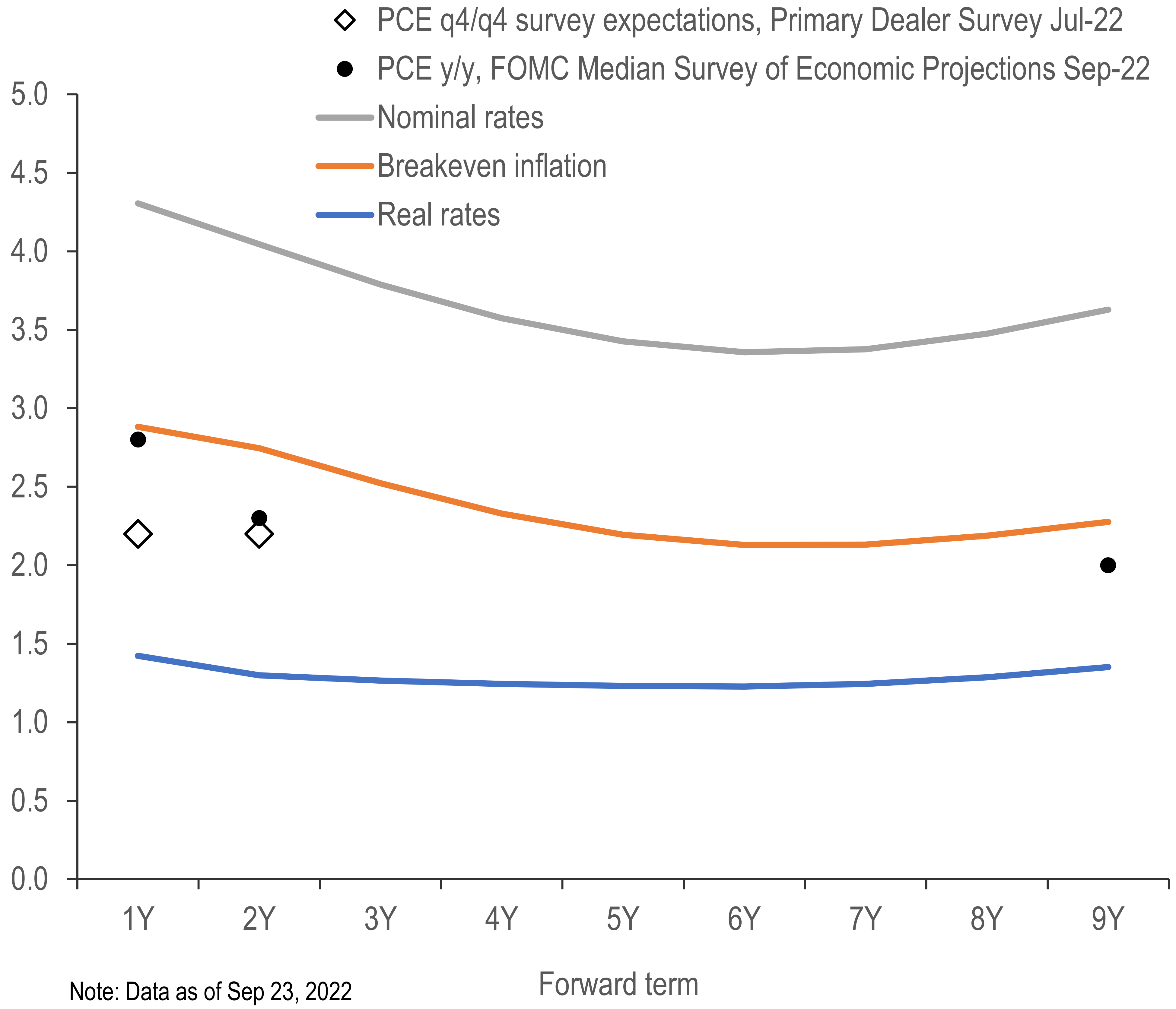
S&P 500 Equity Index Returns Decomposition
(percent)



Real Yield Curves Are Still Fairly Flat

The market expects the Fed to begin cutting rates next year

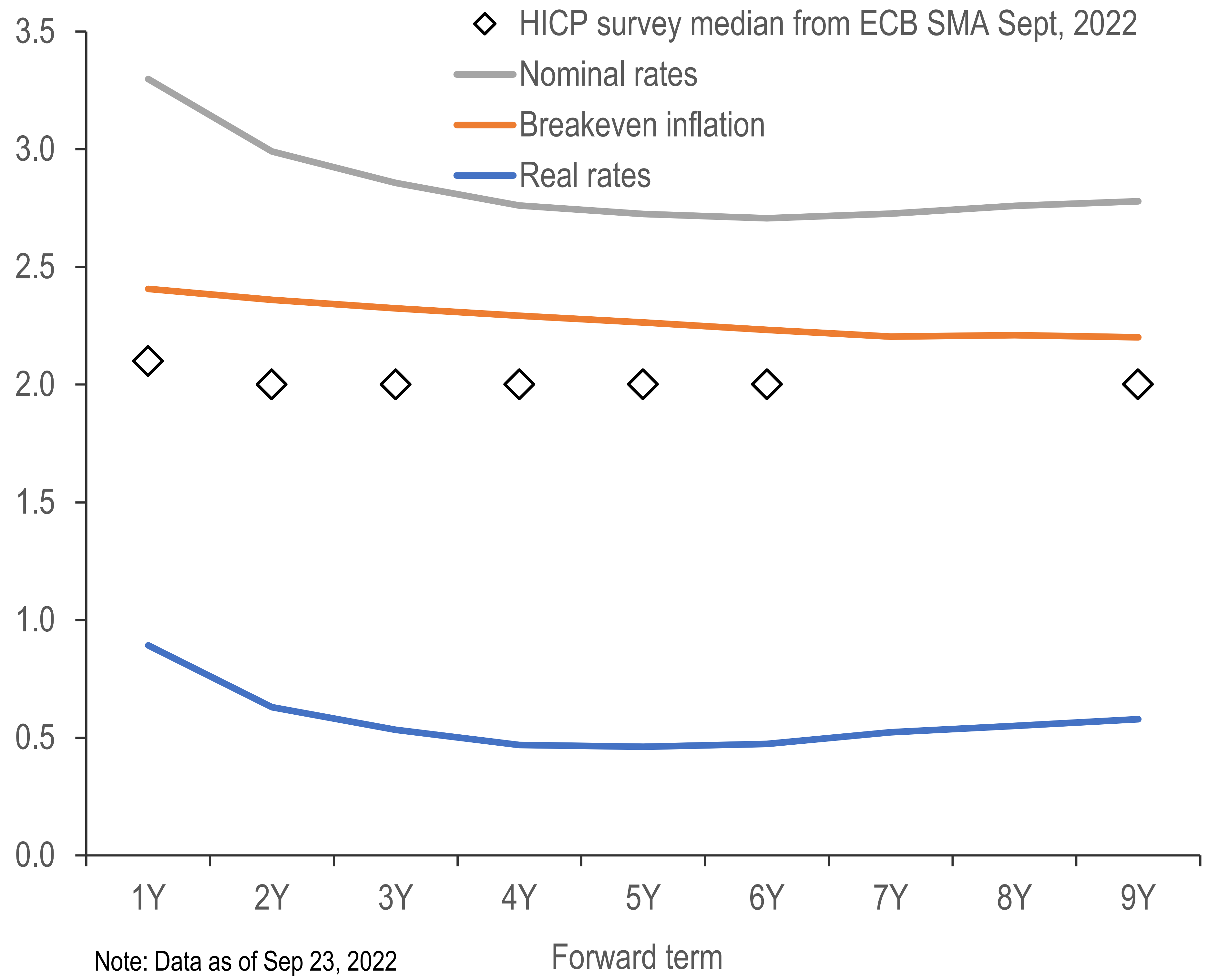
US Term Structure of 1y Forward Rates
(Percent, based on government bonds)



Note: Data as of Sep 23, 2022

In Europe, nominal yields expected to plateau at ~2%

Euro Area Term Structure of 1y Forward Rates
(Percent, based on swaps)



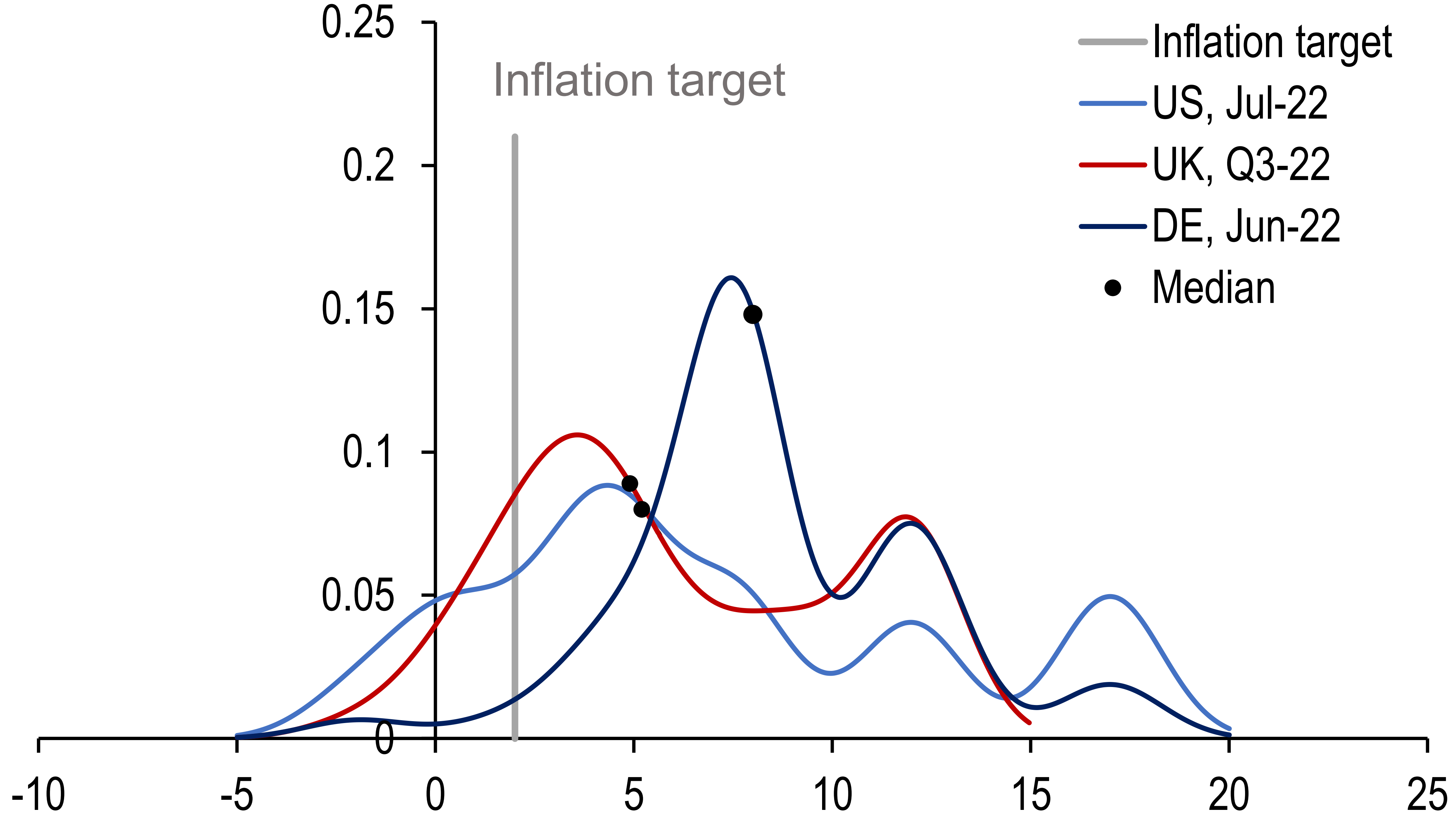
Note: Data as of Sep 23, 2022

Real rates remain very low in US and in Europe

Investors Expect Inflation to Remain Elevated

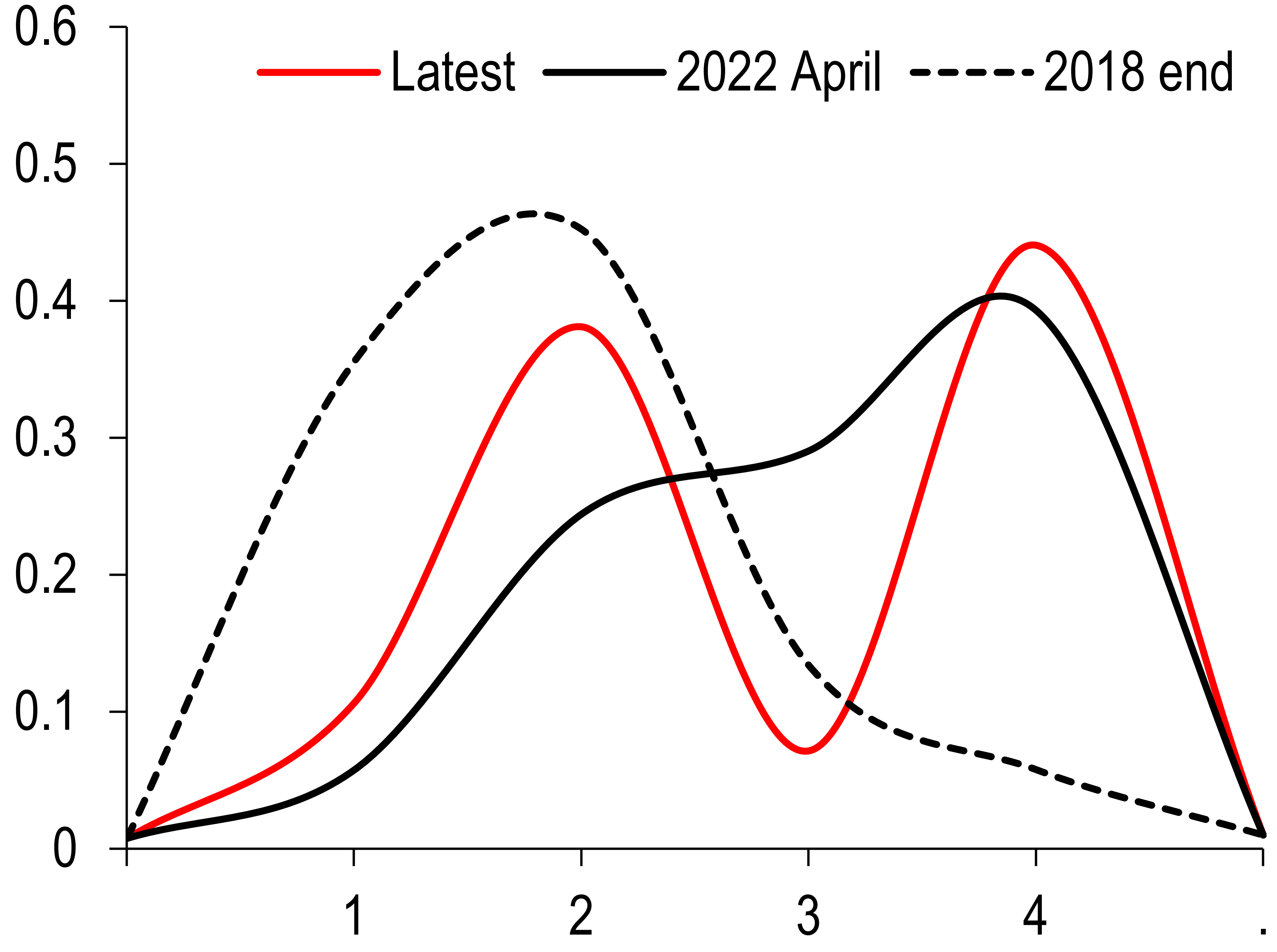
In AEs, household inflation expectations remain high

Household Expectations, 1 year horizon
(Latest, Share Of Respondents, Percent)



While in Euro Area, inflation options point to bi-modal inflation expectations

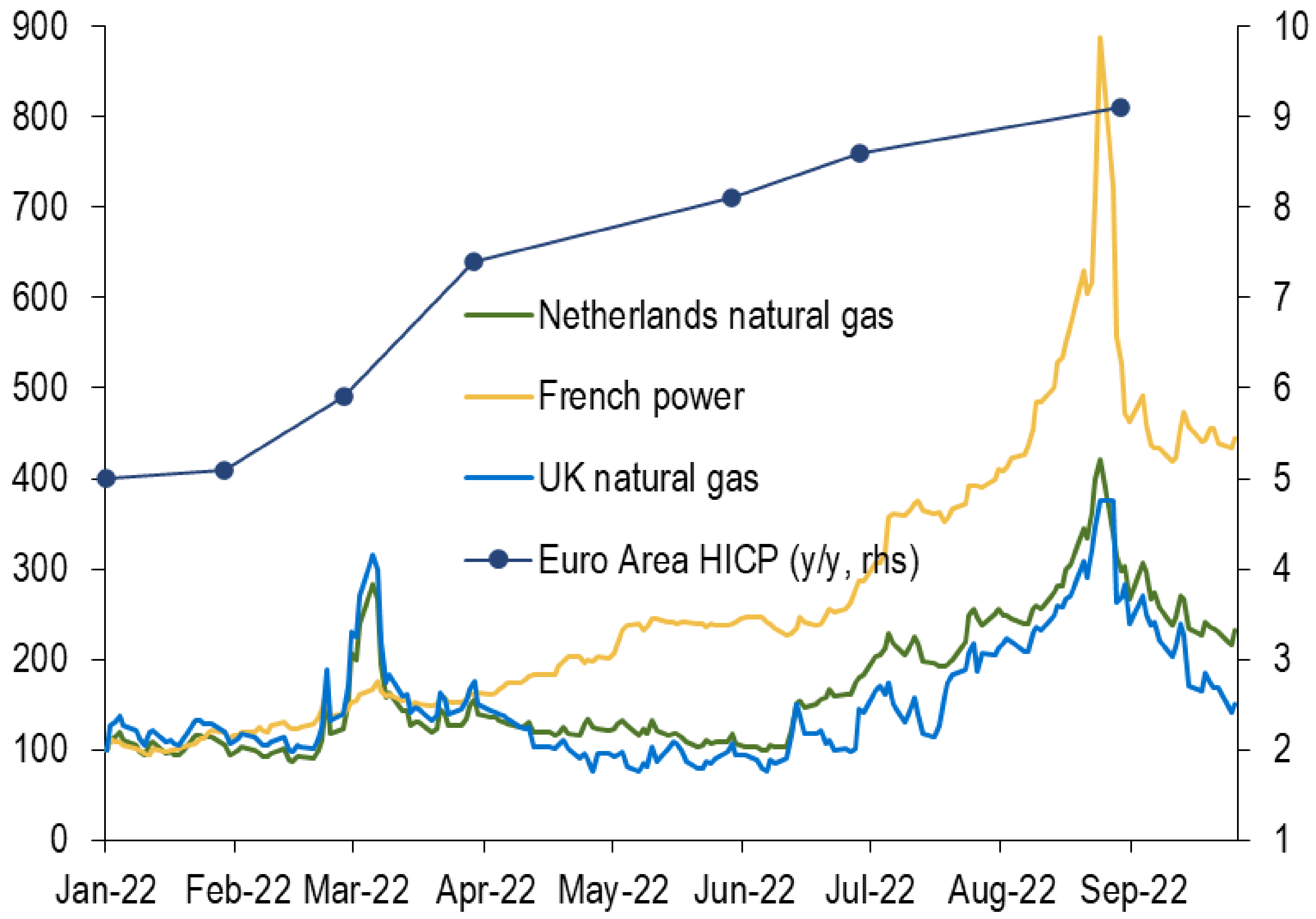
Option-Implied Distributions of Various Inflation Outcomes in the Euro Area, 1 year horizon
(Probability density)



Euro Area and United Kingdom Under Pressure

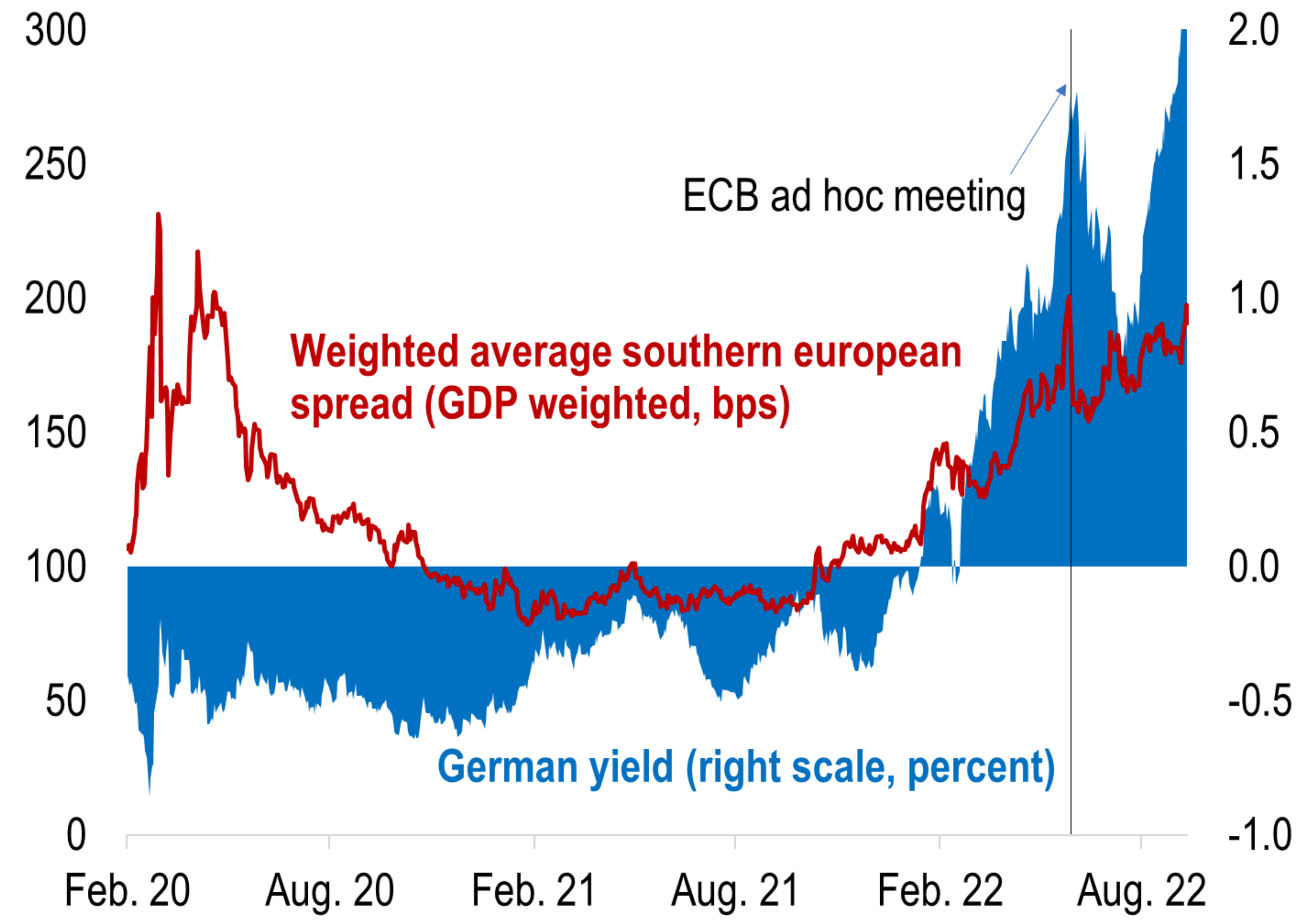
Rising energy prices threaten to tip the continent into recession

European Energy Prices and Headline Inflation
(Prices in Euro, left scale; percent, right scale)



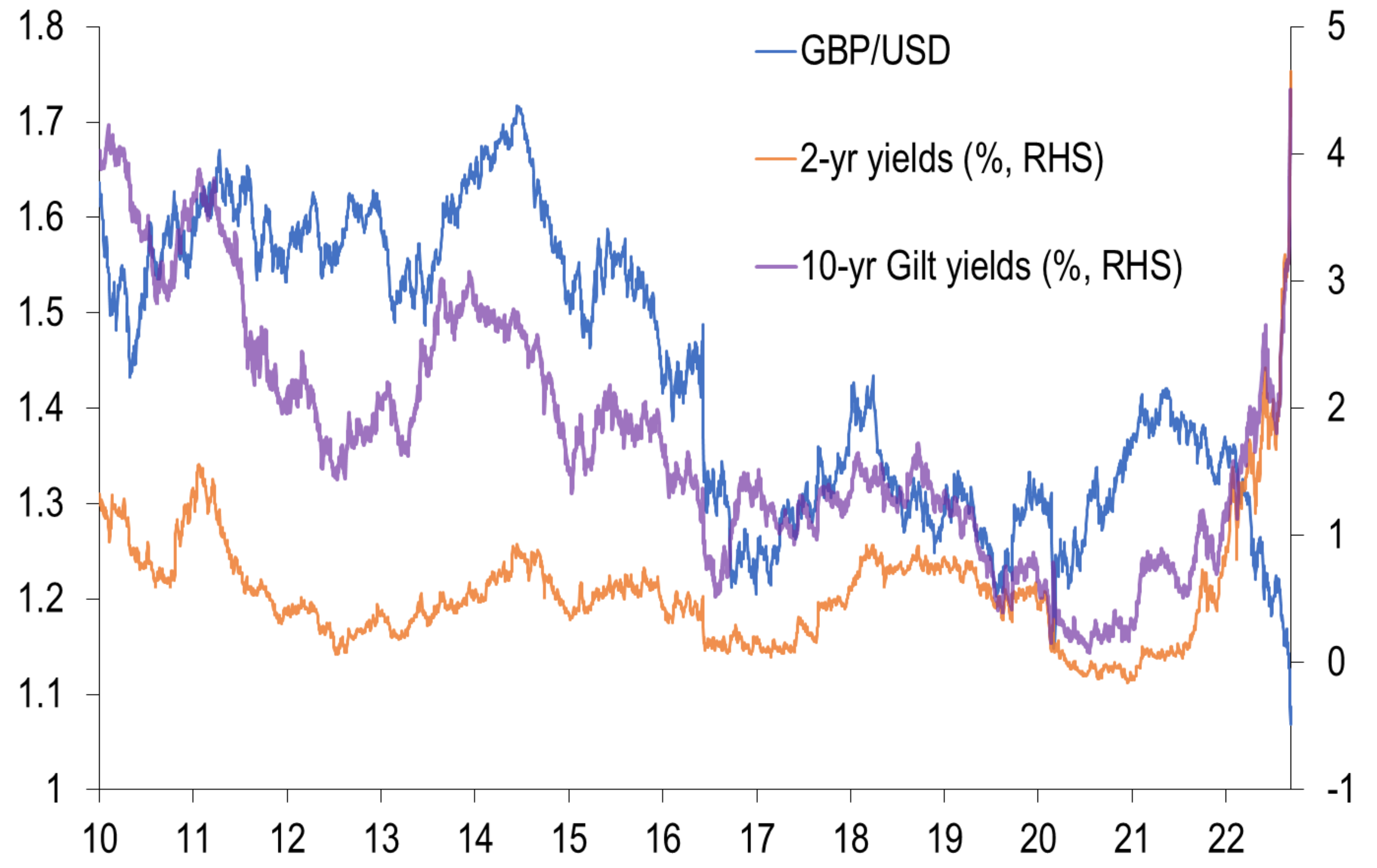
Peripheral euro area sovereign yields have surged

German 10-Year Yields and Sovereign Spread
(Basis points, left scale; percent, right scale)



UK Pound is falling rapidly even while interest rates rise sharply

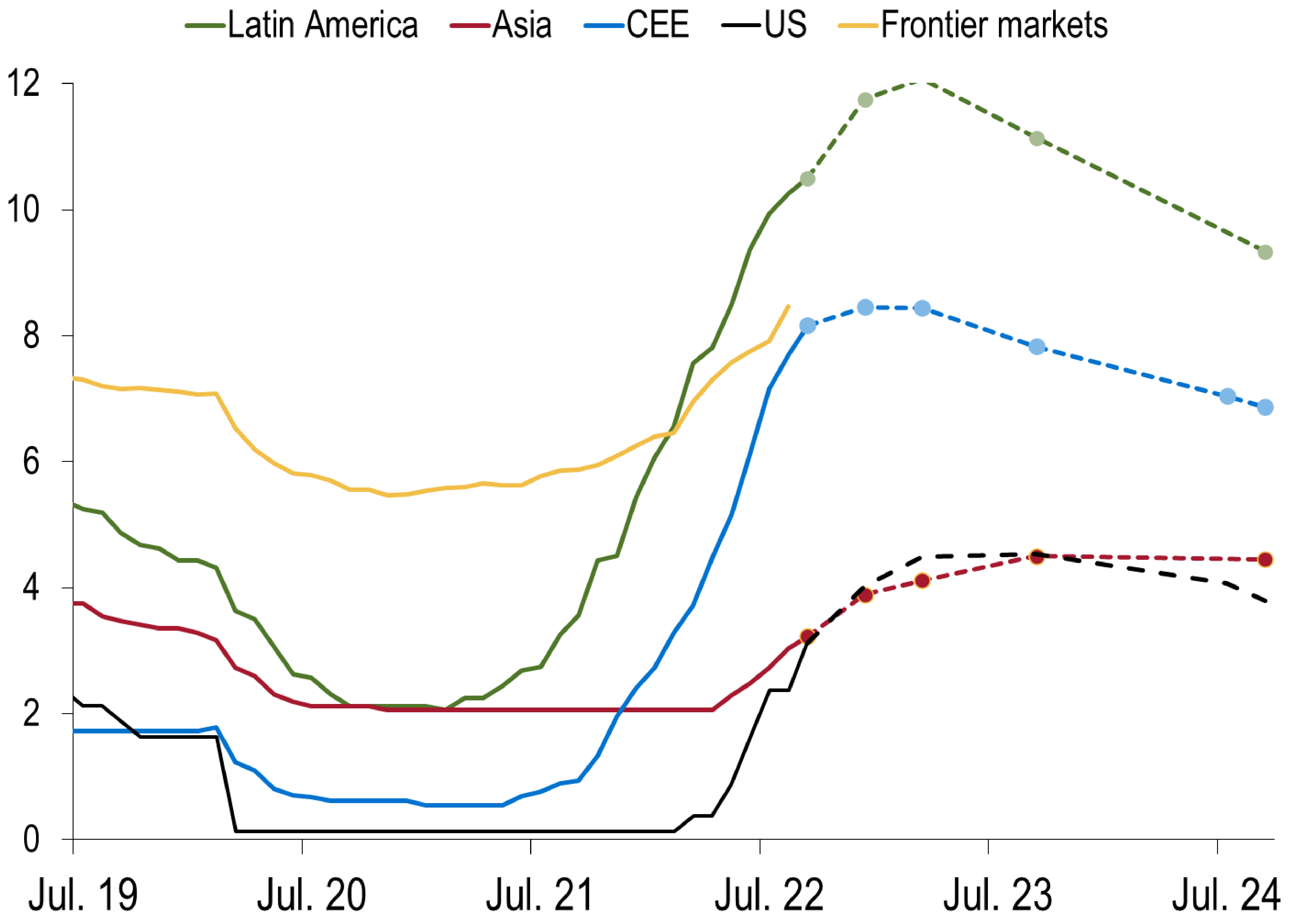
Pound Sterling and Yields
(GBP left scale; Gilt yields percent, right scale)



EMs Appear Close to Easing, But Face Global Pressures

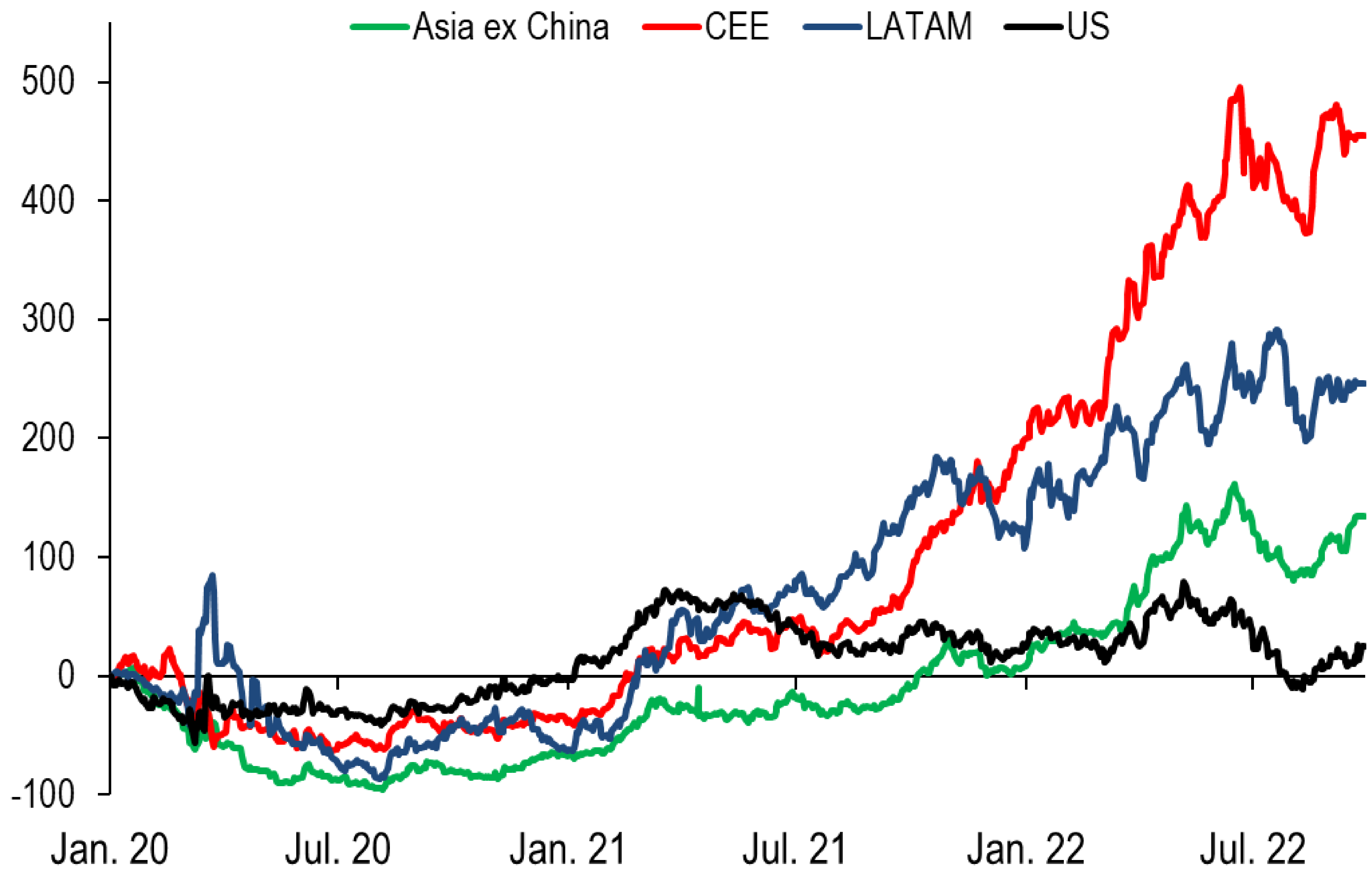
EMs are expected to begin easing in 2023…

Historical and Market-Implied Policy Rates across Regions
(Percent)



…but term premia remain elevated due to global uncertainty

Change in Five-year Term Premia since January 2020
(Basis points)

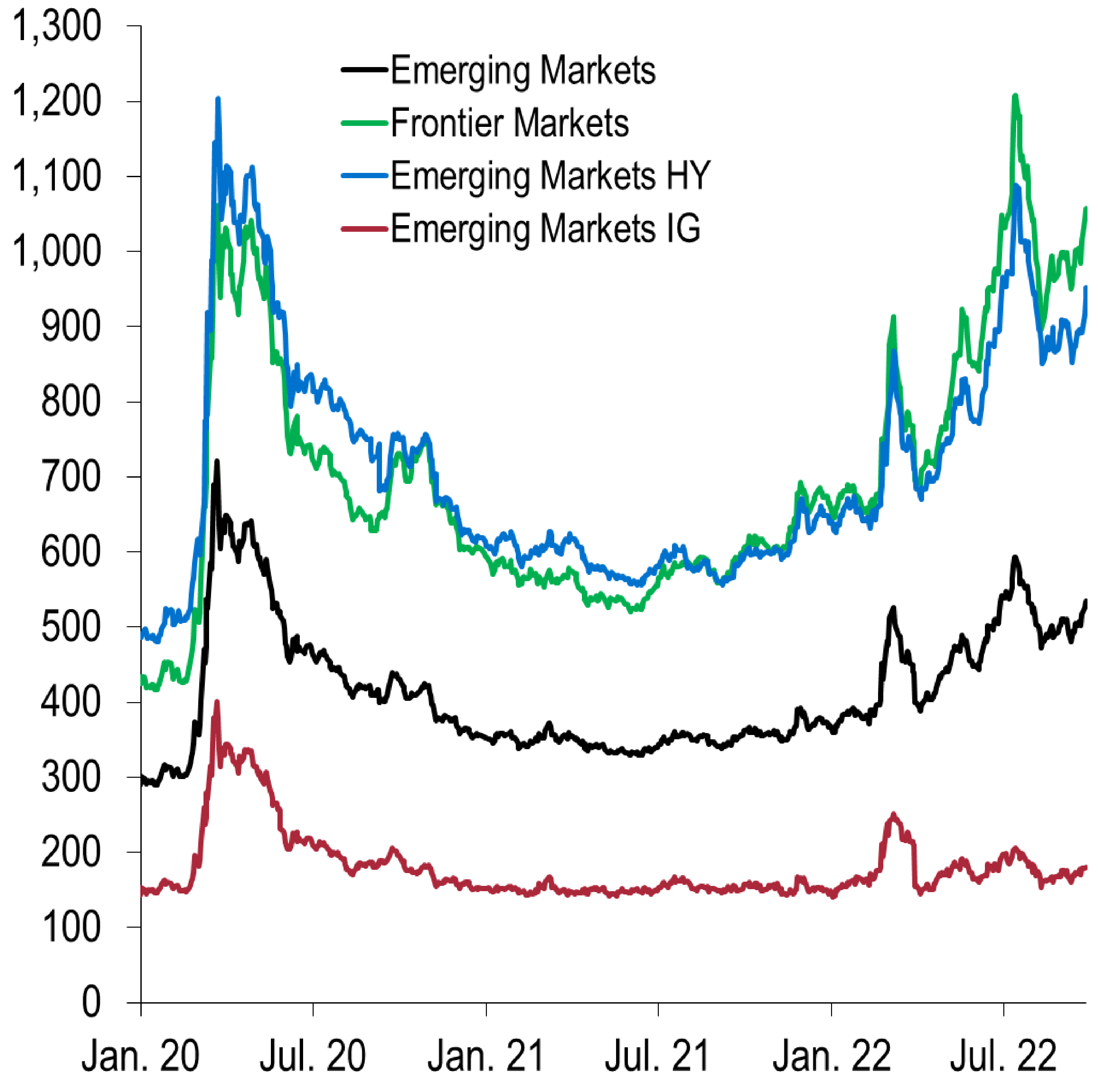


Note: CEE reflecting the average of Poland, Czech Republic and Hungary.

Serious Sovereign Debt Risks In Many Vulnerable EMDEs

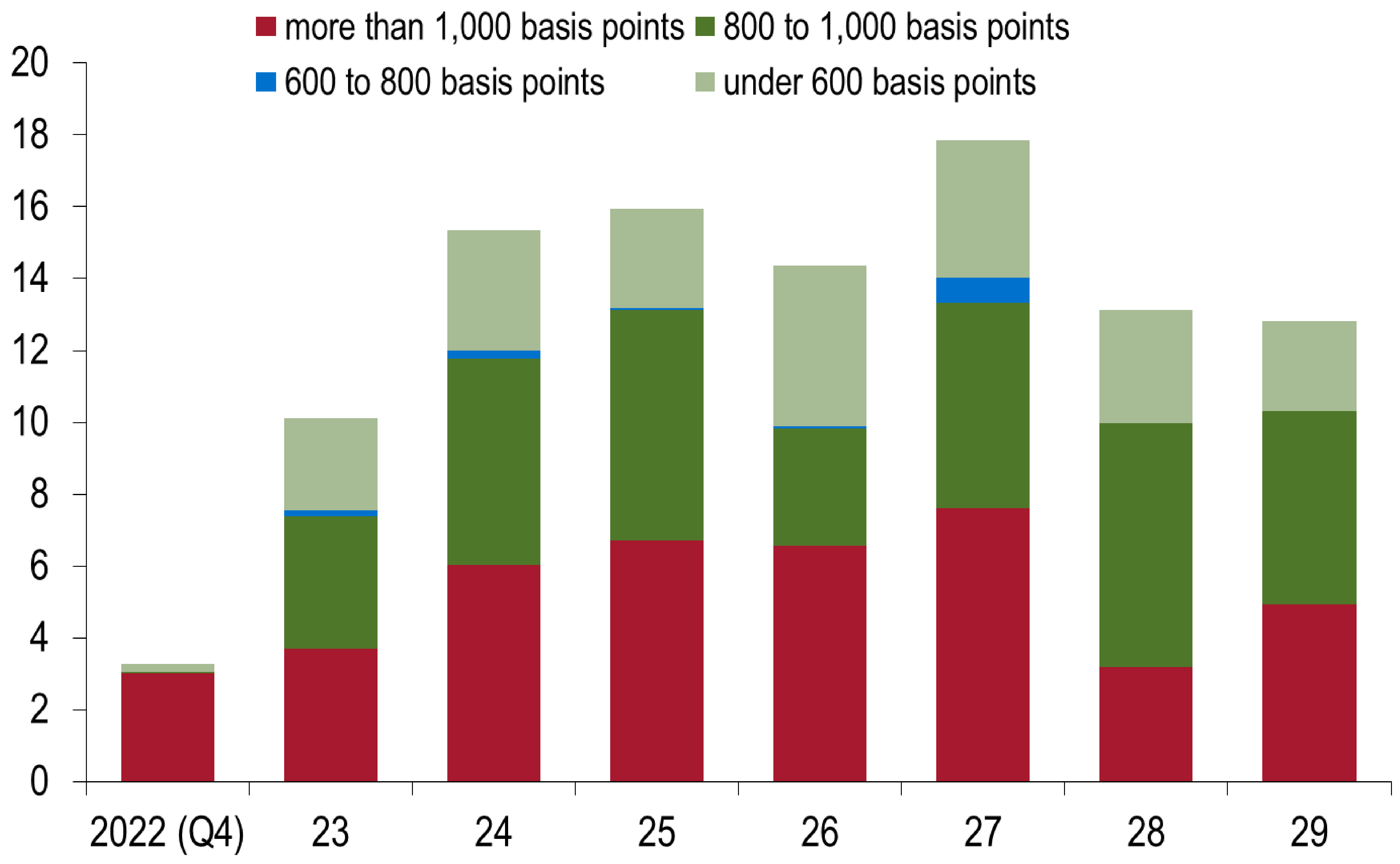
While large issuers have shown resilience, many lower-rated issuers now trade at distressed levels

Emerging market Sovereign Spreads
(Basis points)



Frontier markets face challenging re-financings, with ~20 names at high risk of (or already in) default

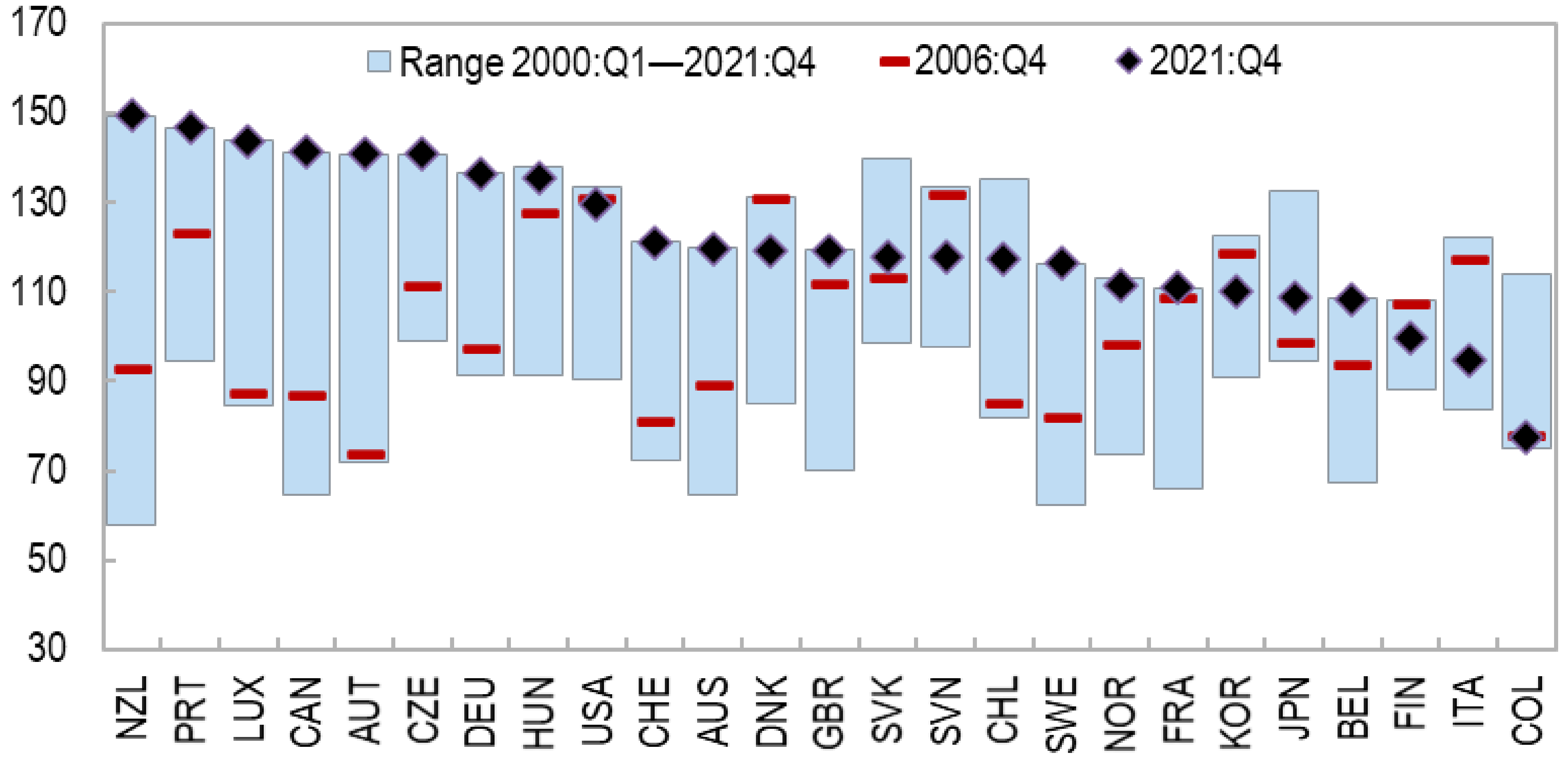
Hard- Currency Bond Maturities and Spreads
(Billions of US dollars)



Global Housing Markets May Come Under Pressure

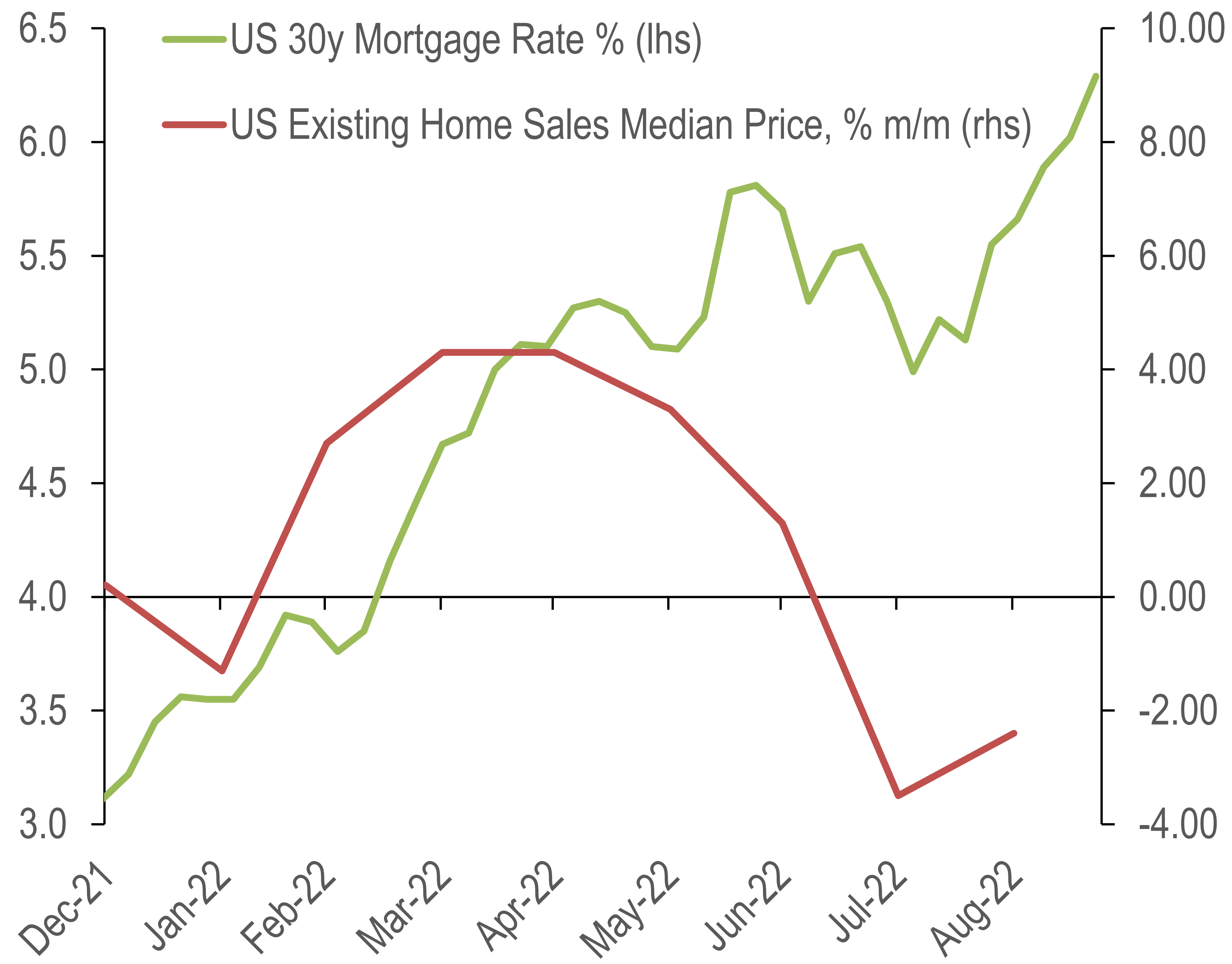
Stretched housing valuations relied on low rates to maintain affordability

Price-to-Income Ratio, 2000:Q1–21:Q4
(Index, 2015 = 100)



Prices are beginning to turn as mortgage rates back up dramatically

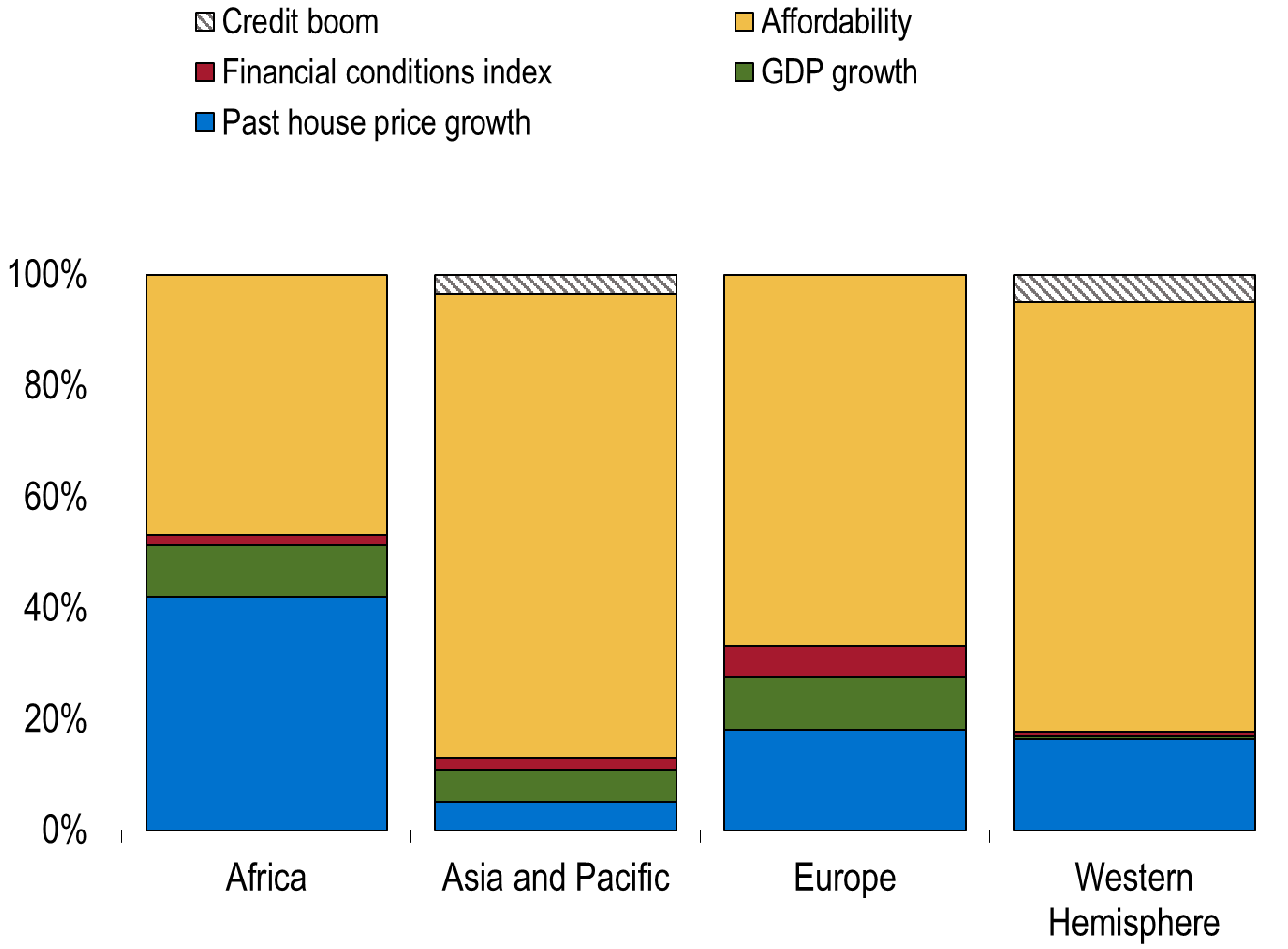
US 30y Mortgage rates and Home prices
(Percent)



House Price at Risk is Substantial, Especially for EMs

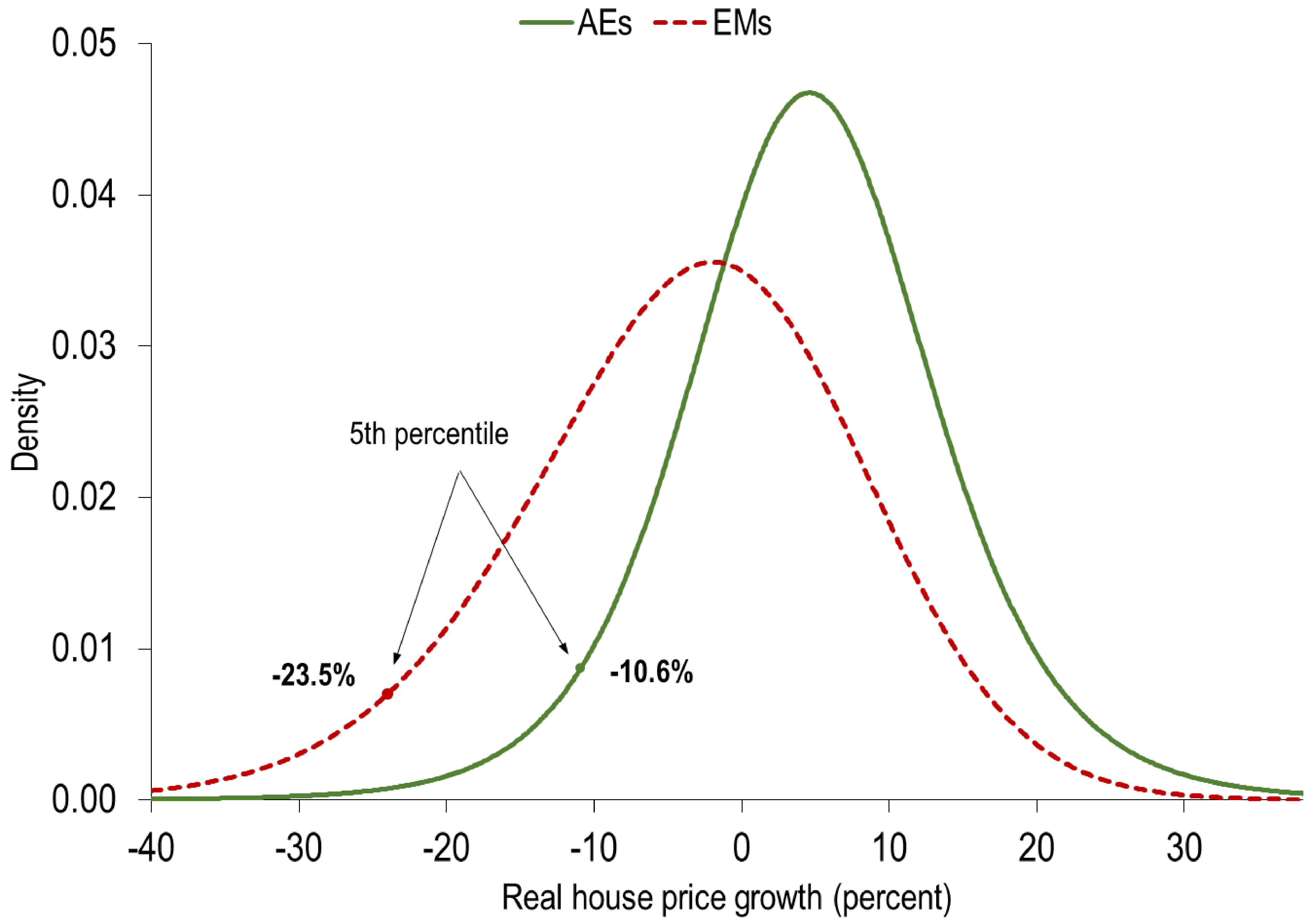
Affordability weighing on house prices

House Price at Risk Decomposition
(Percent, projected contribution, latest)



EM downside risks are elevated

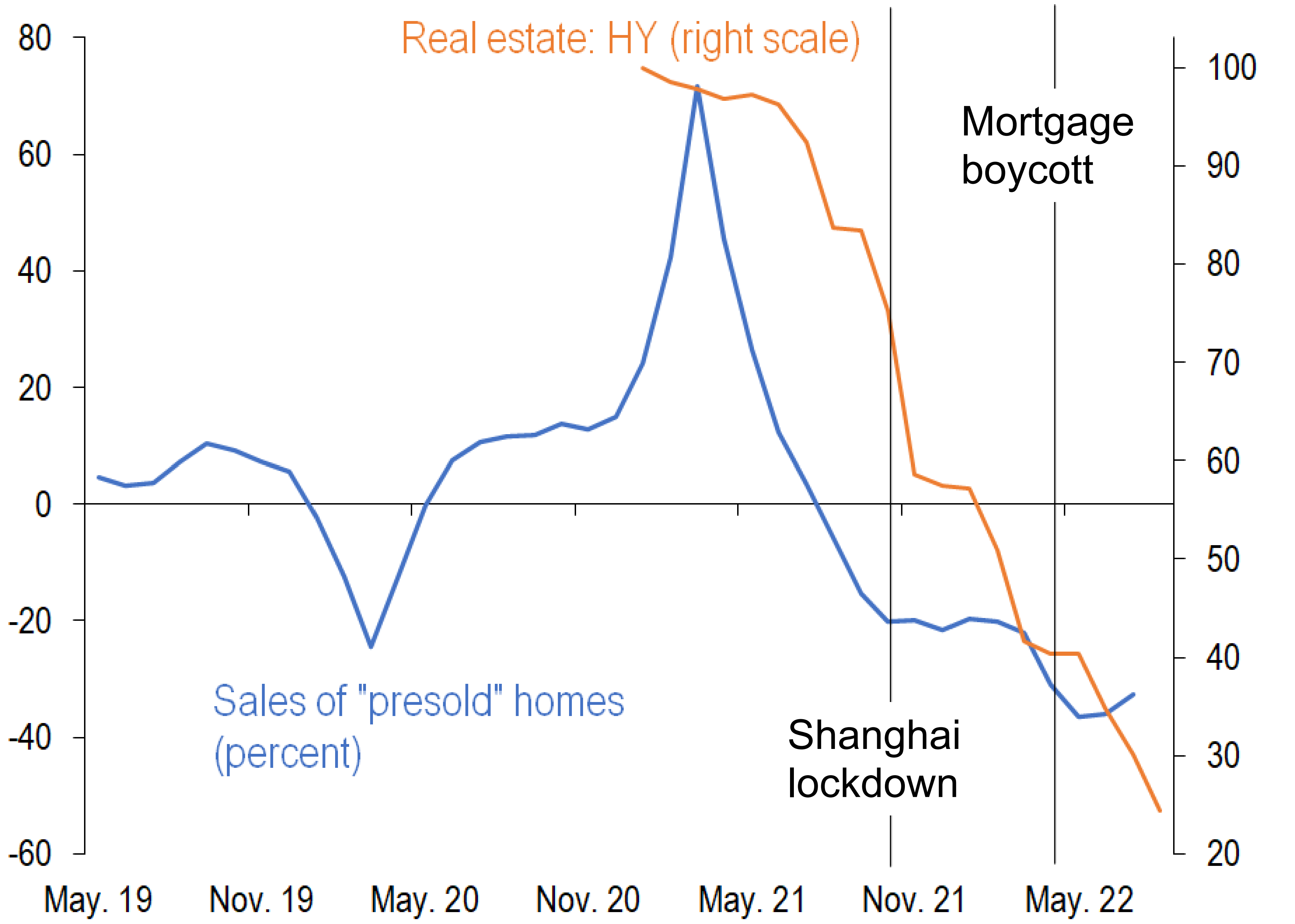
House- Price-at-Risk, Advanced Economies and Emerging Markets, Three Years Ahead
(Density; cumulative growth in percent)



In China, Housing Risks May Spread Far Beyond Property Developers

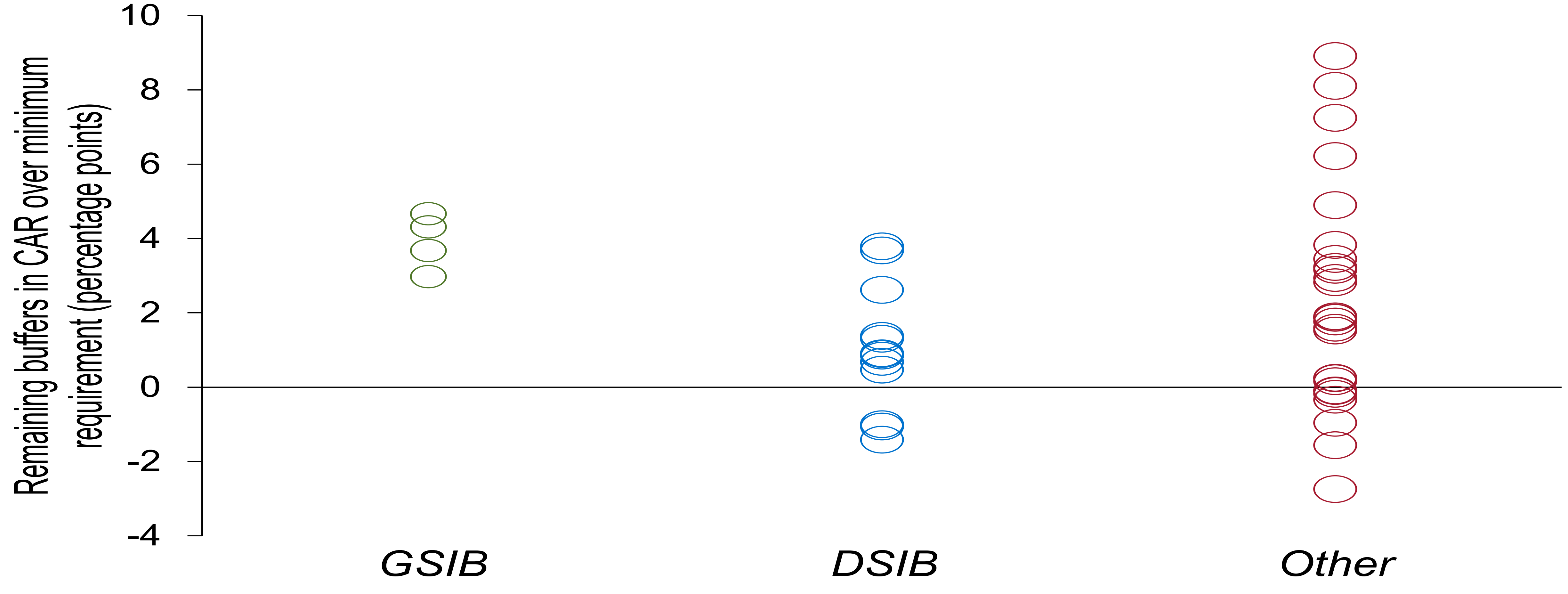
A stalled housing market has put developers into distress, threatening home completions

Residential Real Estate Sales and Property Developer Bonds
(Index, May 2021 = 100)



If pre-sold mortgages end up in default, many banks could face large losses

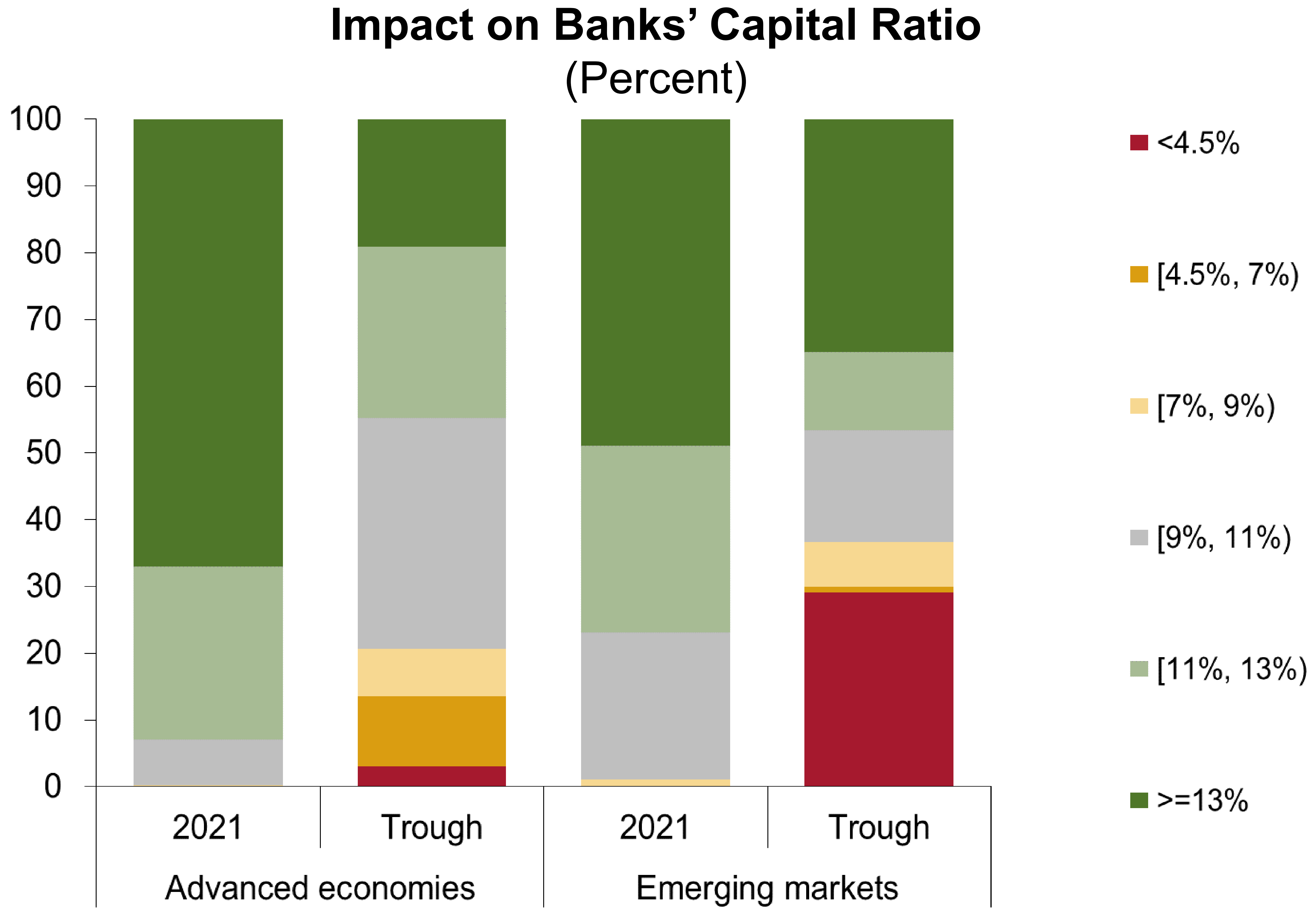
Banks: Potential Credit Losses Related to Real Estate Exposure
(Percent of total risk-weighted assets)

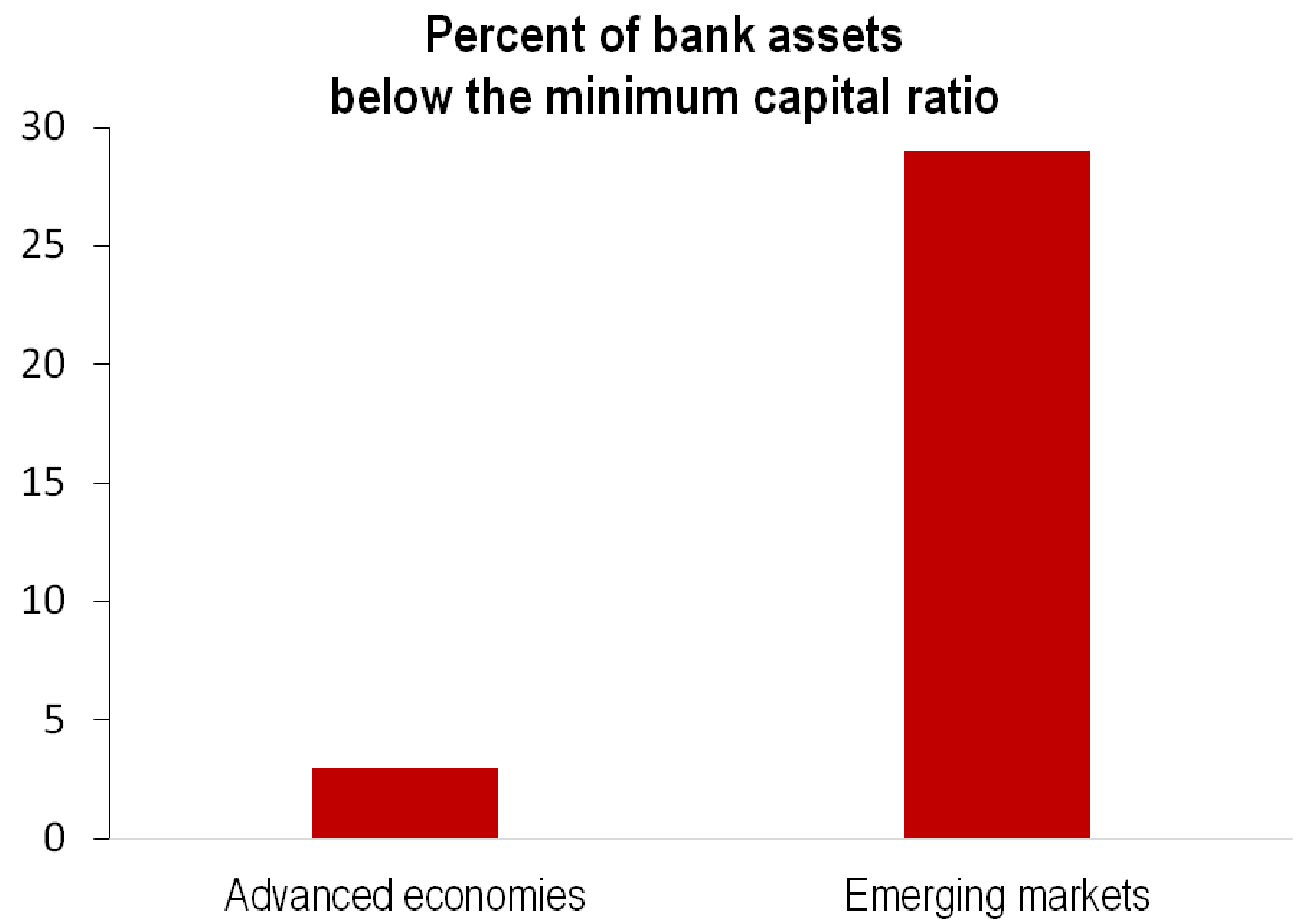


Global Banking Stress Tests Shows Some Weaknesses in EMs

Globally systemic banks and those in advanced economies seem largely resilient to adverse scenarios…

…but many EM banks face significant recapitalization needs under a stress test



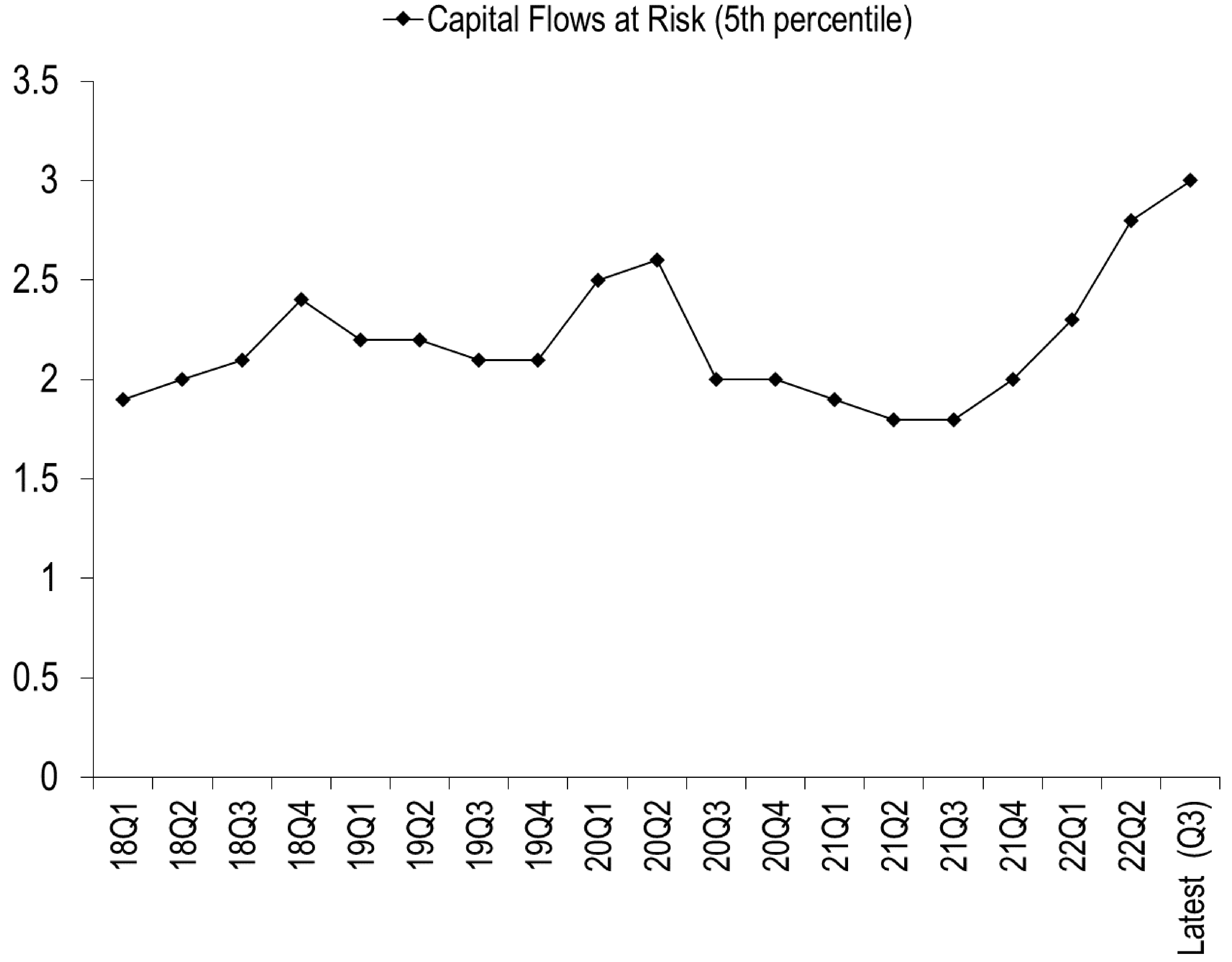


Capital Flows at Risk and Growth at Risk Reach Multi Year Highs

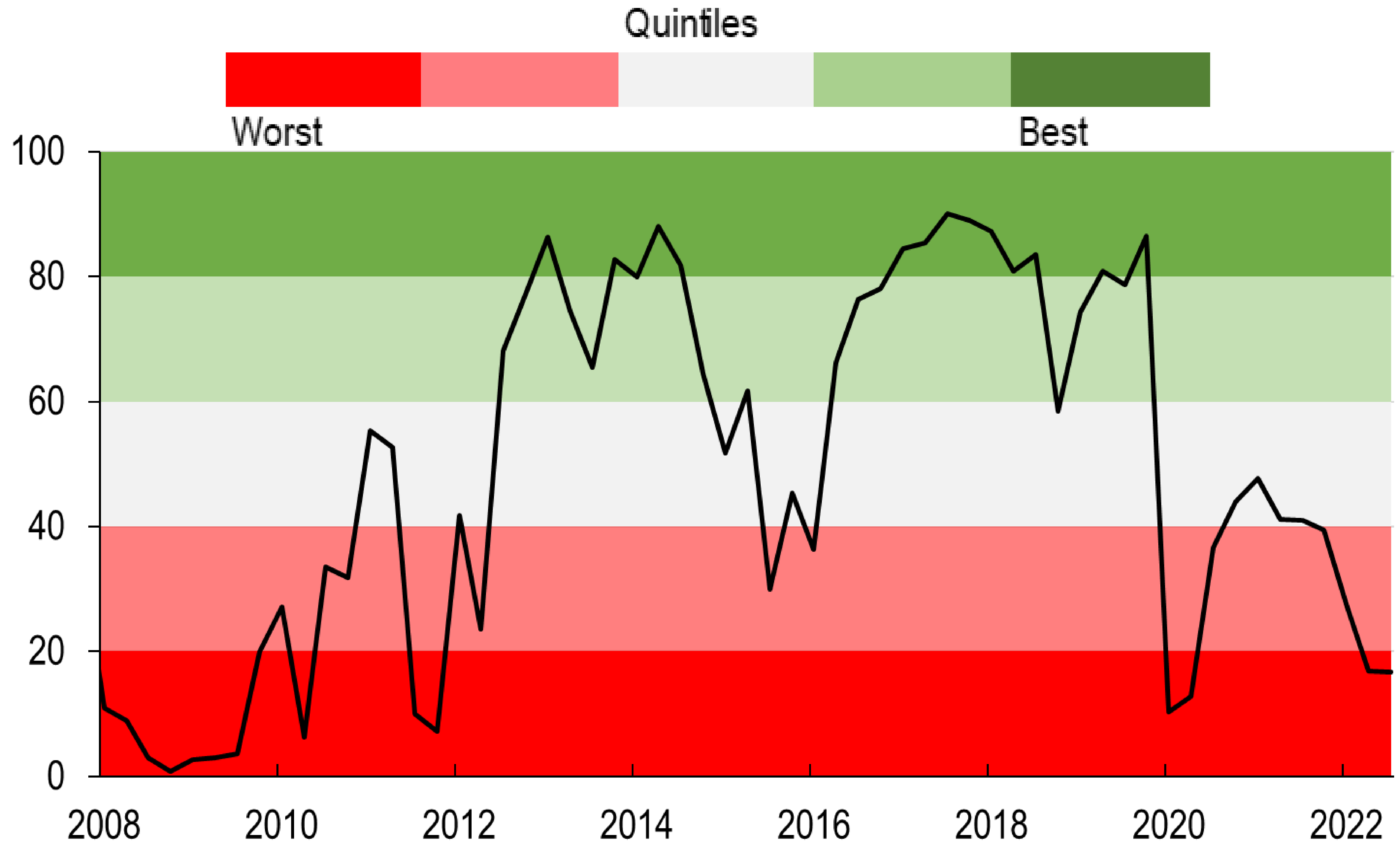
With high global rates and volatile capital markets, EMs face a risk of large outflows…

…and growth downside risk is nearing peak 2020 levels

Capital Flows at Risk
(Probability density, percent, left scale; 5th percentile, percent of GDP)



Near-Term Growth at Risk Forecasts
(Percentile rank)



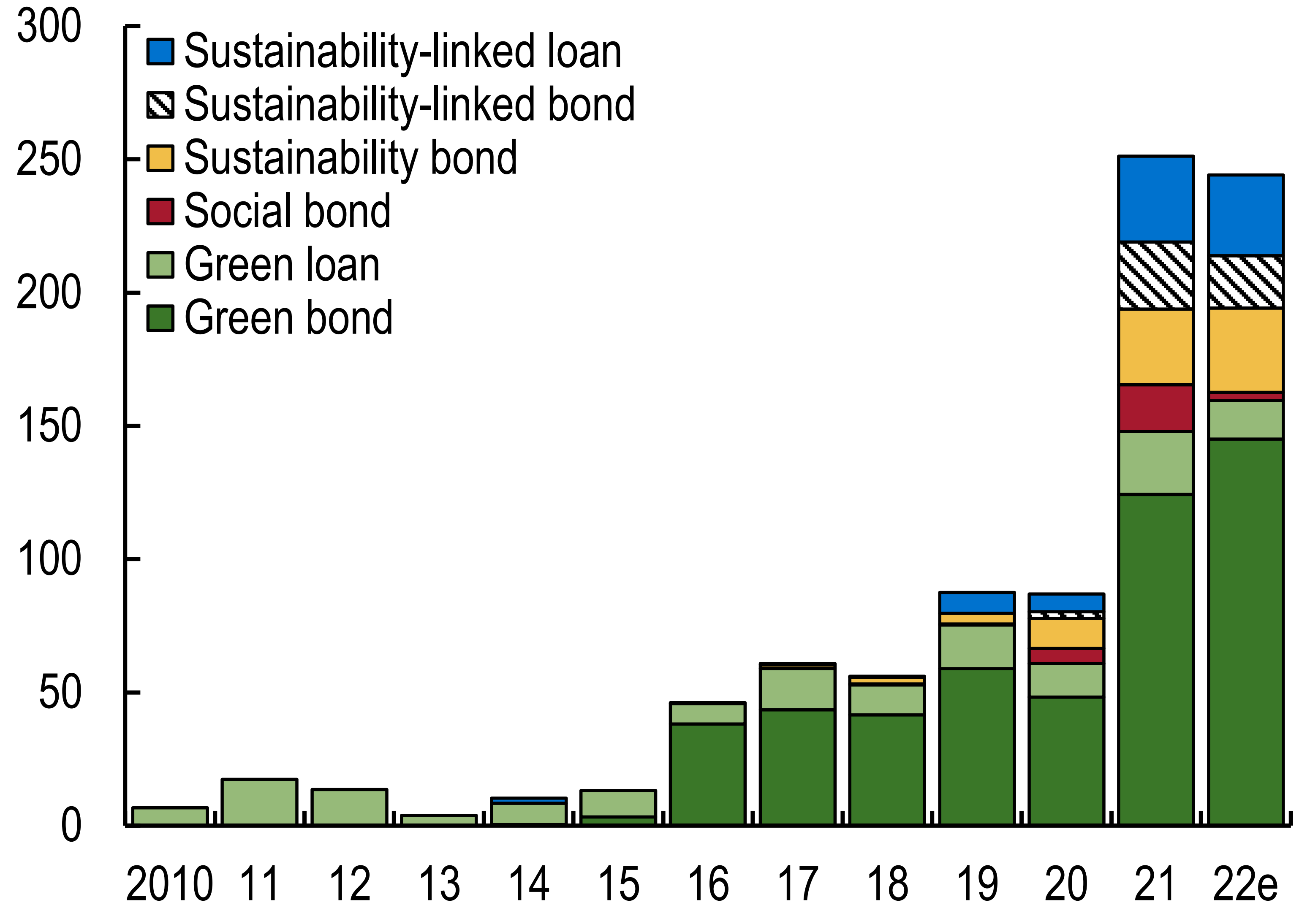
The Market for Sustainable Finance in EMDEs is Growing

There has been a strong momentum in sustainable debt issuance in EMDEs…

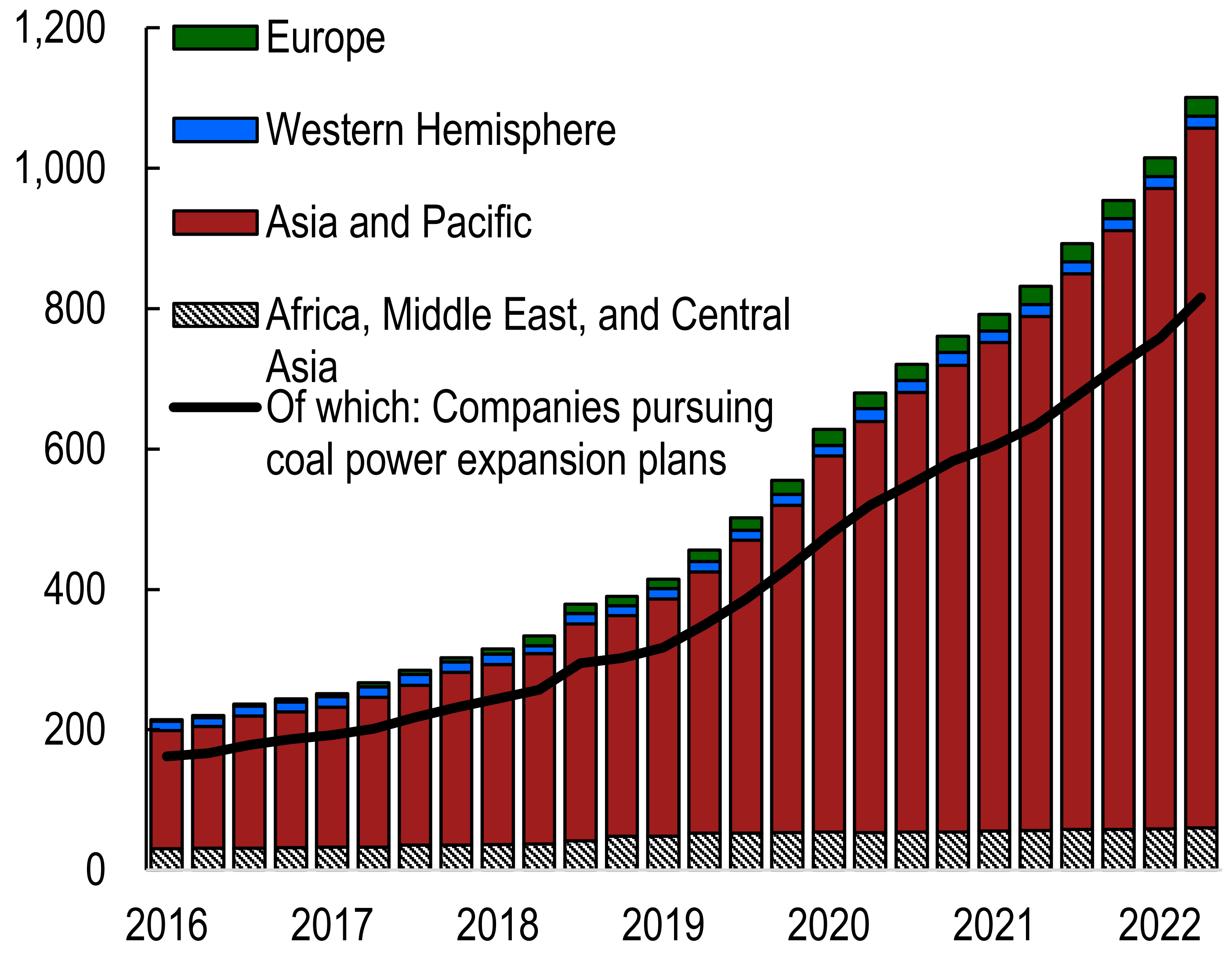
…while financing for fossil fuel firms in EMDEs is still rising rapidly.

MDBs have to play a key role in crowding in private finance.

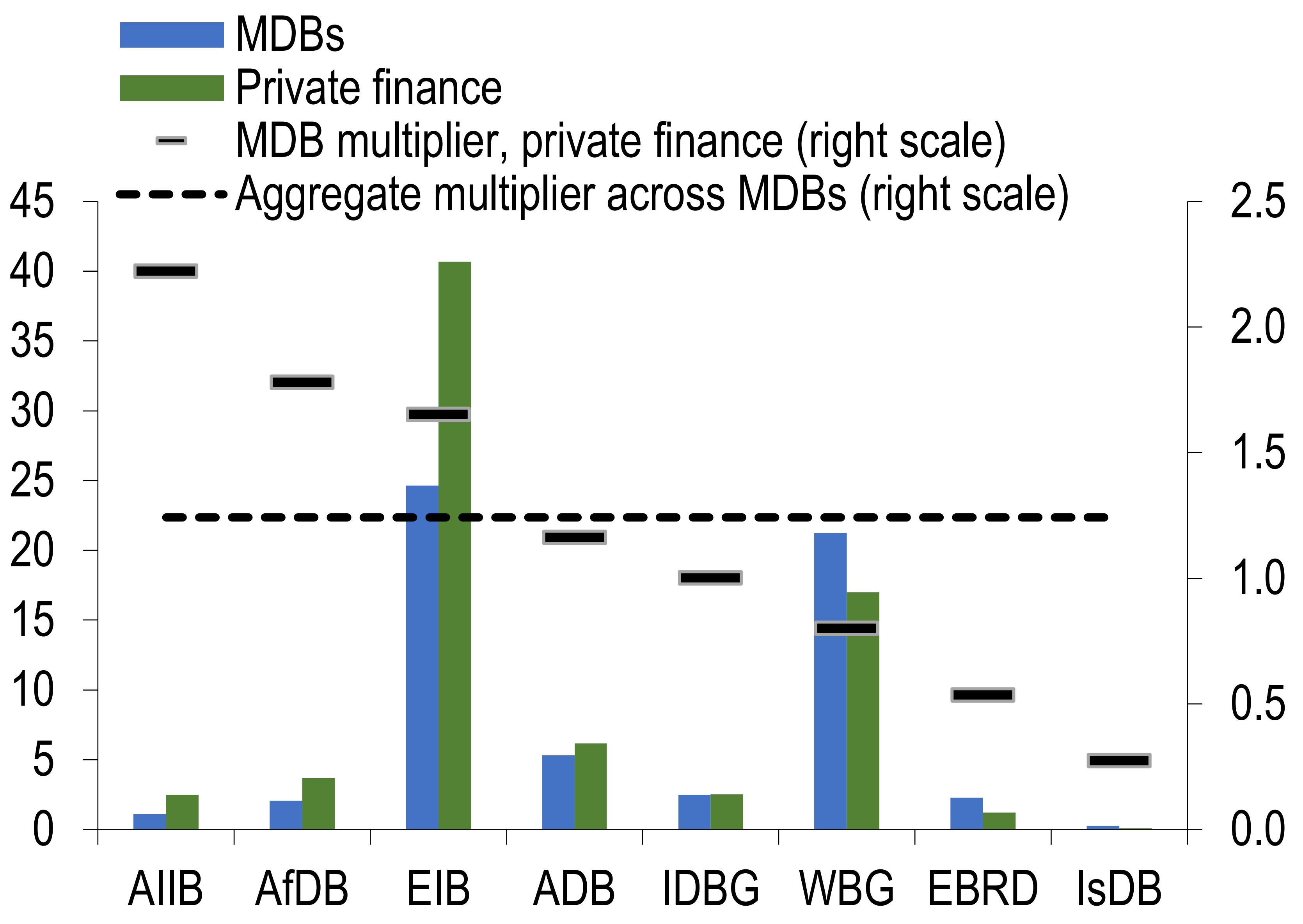
Sustainable Instruments by Issuance Type
(Billions of US dollars; as of mid-2022)



EMDE-Domiciled Debt of Companies with Significant Role in Thermal Coal Value Chain
(Billions of US dollars)



MDB Climate Finance from Own Resources & Private Investors (private finance), 2020
(Billions of US dollars, left scale; ratio, right scale)



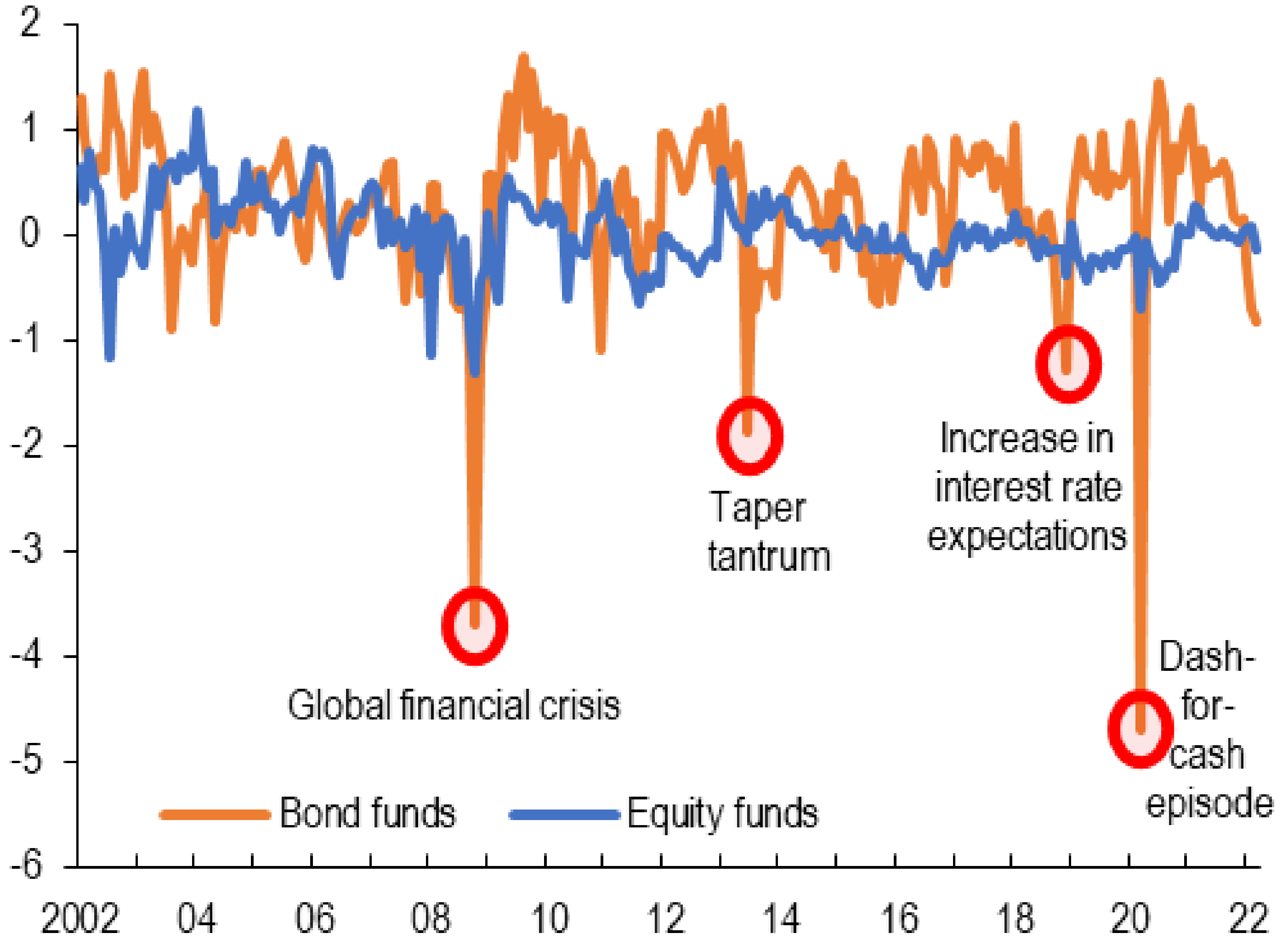
Note: ADB = Asian Development Bank; AfDB = African Development Bank; AIIB = Asian Infrastructure Development Bank; EBRD = European Bank for Reconstruction and Development; EIB = European Investment Bank; IDBG = Inter-American Development Bank Group; IsDB = Islamic Development Bank; MDB = multilateral development bank; WBG = World Bank Group.

But Several Challenges Will Need to be Overcome

Resilience of Open-End Investment Funds May Be Tested Again

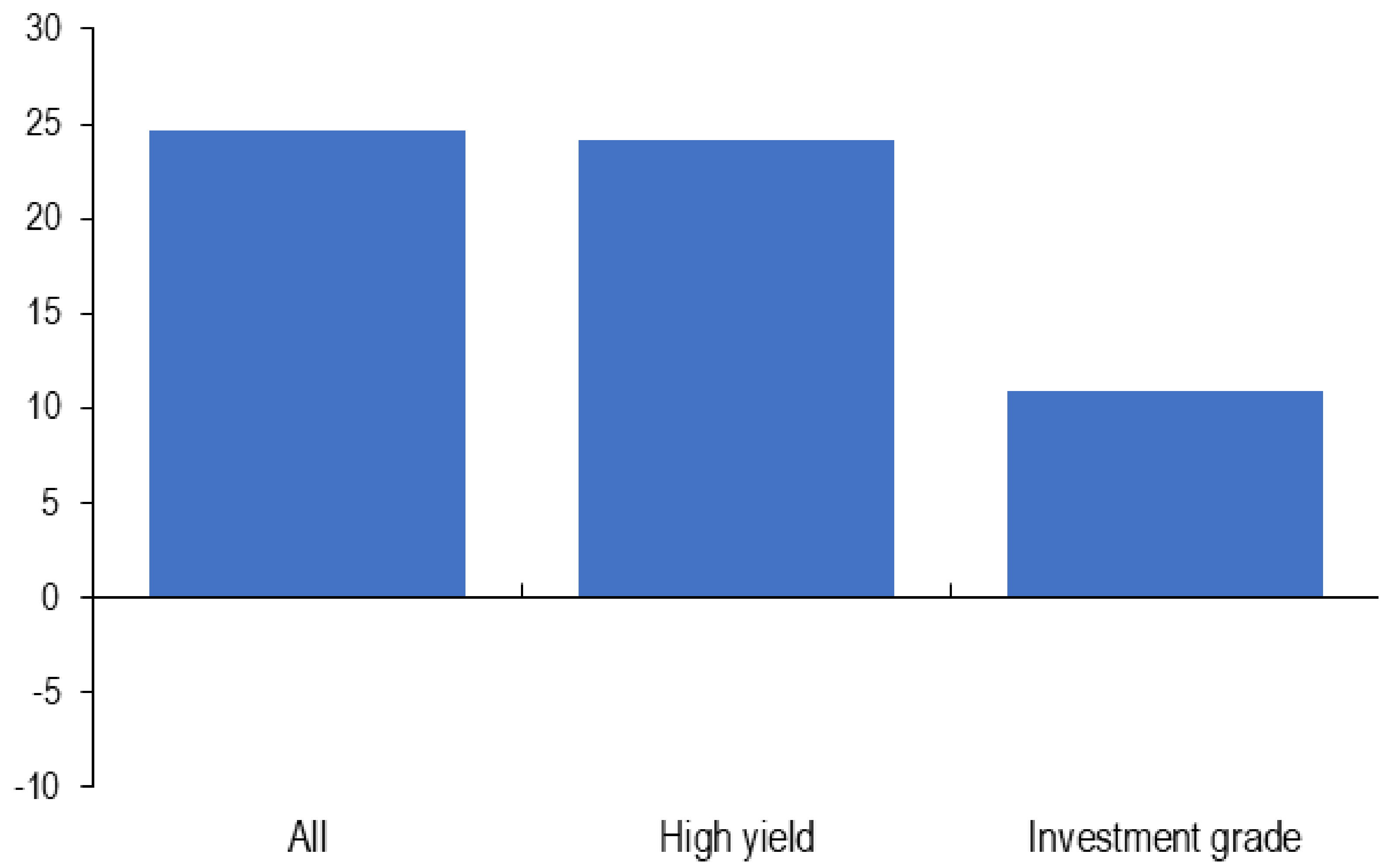
The March 20 market turmoil revealed vulnerabilities of open-end funds.

Monthly Net Flows
(Percent of lagged total net assets)



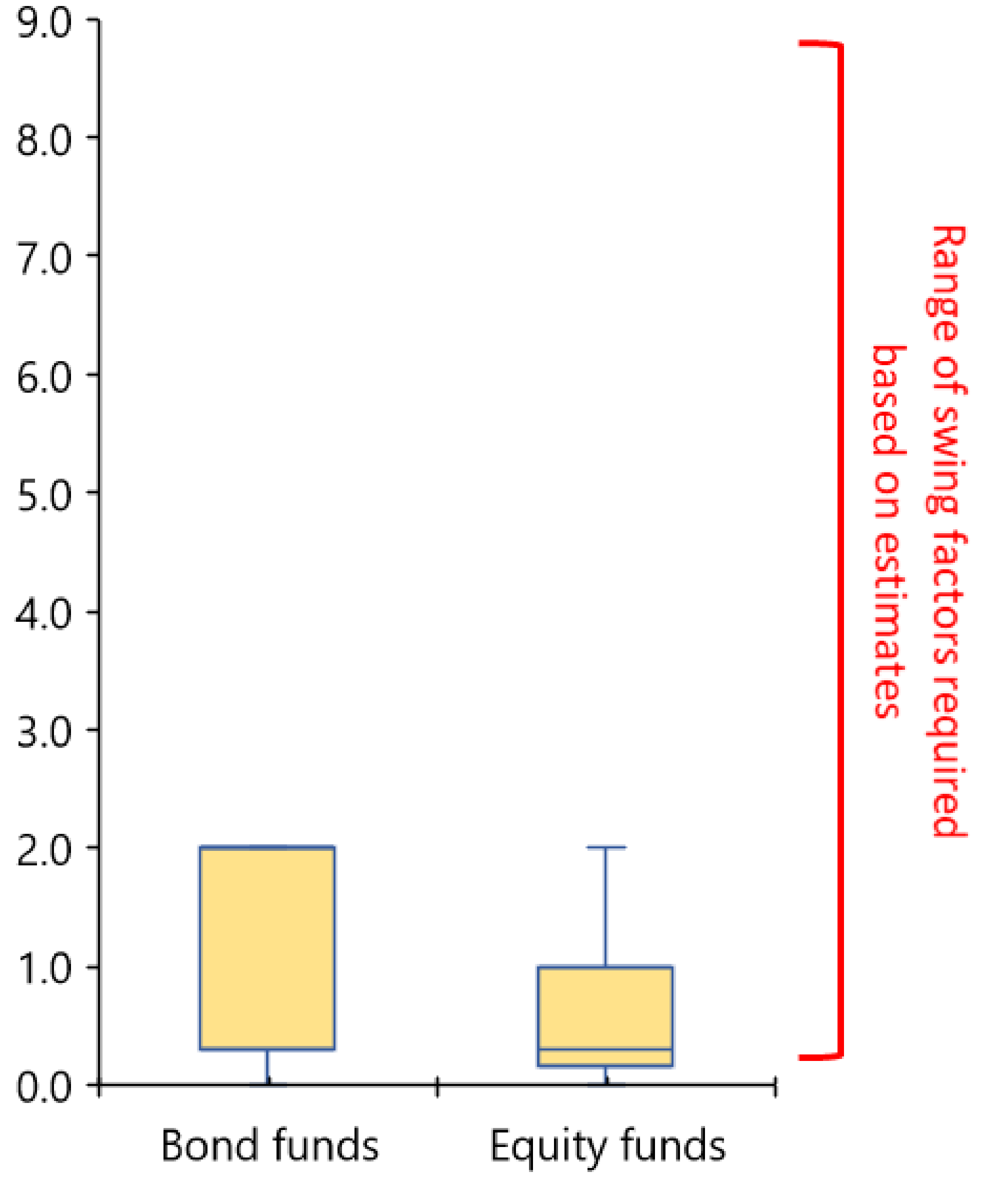
Corporate bonds held by less liquid funds have higher return volatility.

Effect of Vulnerability on Corporate Bond Return Volatility
(Percent of median volatility)



Swing pricing can mitigate fragilities, albeit often capped at levels that appear too low.

Maximum Downward Swing Factor among 200 Sample Funds
(Boxes cover the 25th–75th percentiles)



Effective liquidity management tools are key

Policy recommendations

Main policy priority: fight inflation, mitigate financial distortions

- Act resolutely to bring inflation credibly back to target in a timely way and avoid a de-anchoring of inflation expectations.
- Do not yield to pressure to ease monetary tightening, this will necessitate more painful policy actions in the future.
- Use Integrated Policy Framework to help avert crises, combining targeted foreign exchange interventions, capital flow measures, and other actions as needed to smooth exchange rate moves and reduce financial stability risks.
- In some cases, macroprudential policy adjustments and regulatory actions may be needed to avoid risks materializing.

Fiscal policy should protect the vulnerable while aiding the tightening monetary stance

- Targeted, temporary measures, should be deployed to cushion the impact of economic slowdown on the most vulnerable.
- Fiscal policy should tighten to support monetary policy where there is excess demand or inflation expectations are at risk of de-anchoring.
- For most countries, deficit reduction is appropriate, anchored in medium-term fiscal framework, esp. if there is little fiscal space or debt concerns are pressing.
- Policies should preserve price signals; attempts to control prices directly are fiscally costly and ultimately ineffective.
- Complement with structural policies to boost supply capacity in the long-term: education, childcare access, digitalization, infrastructure investment, pension reforms, supply chain resilience & pandemic preparedness.

Multilateral cooperation is urgently needed for crisis prevention and investment in the future

- More sovereigns in debt distress will require restructuring: urgently implement and broaden G-20 Common Framework.
- Ensure resilience of market functioning and maintain global liquidity amid tightening financial conditions. For many EMDEs, now is the time to apply for precautionary credit lines with the Fund.
- Prevent catastrophic climate change impact by accelerating green transition. Delays will magnify transition costs.
- Strengthen cooperation on common goods (e.g. climate policies, debt) to mitigate fragmentation risks. The Fund stands ready to deliver with existing and new tools: incl. SDR channeling, RST, RFI Food Shock Window.

FISCAL AFFAIRS

World Economic and Market Developments

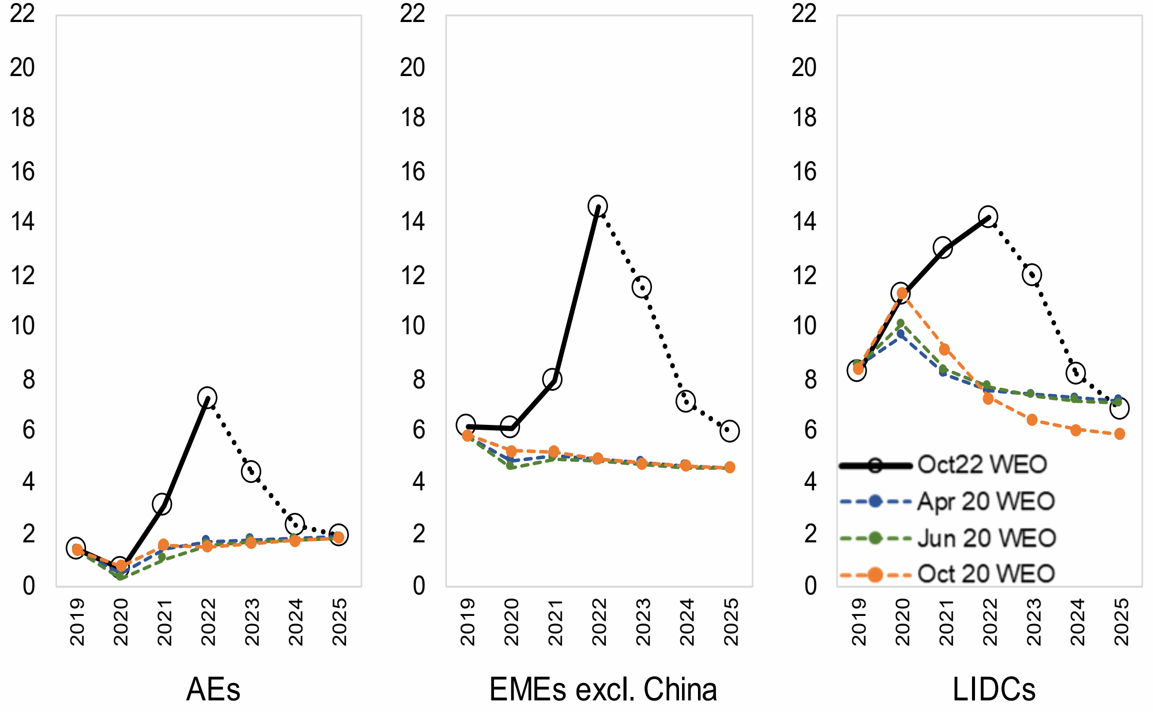
SEPTEMBER 2022

Vitor Gaspar
Director
Fiscal Affairs Department

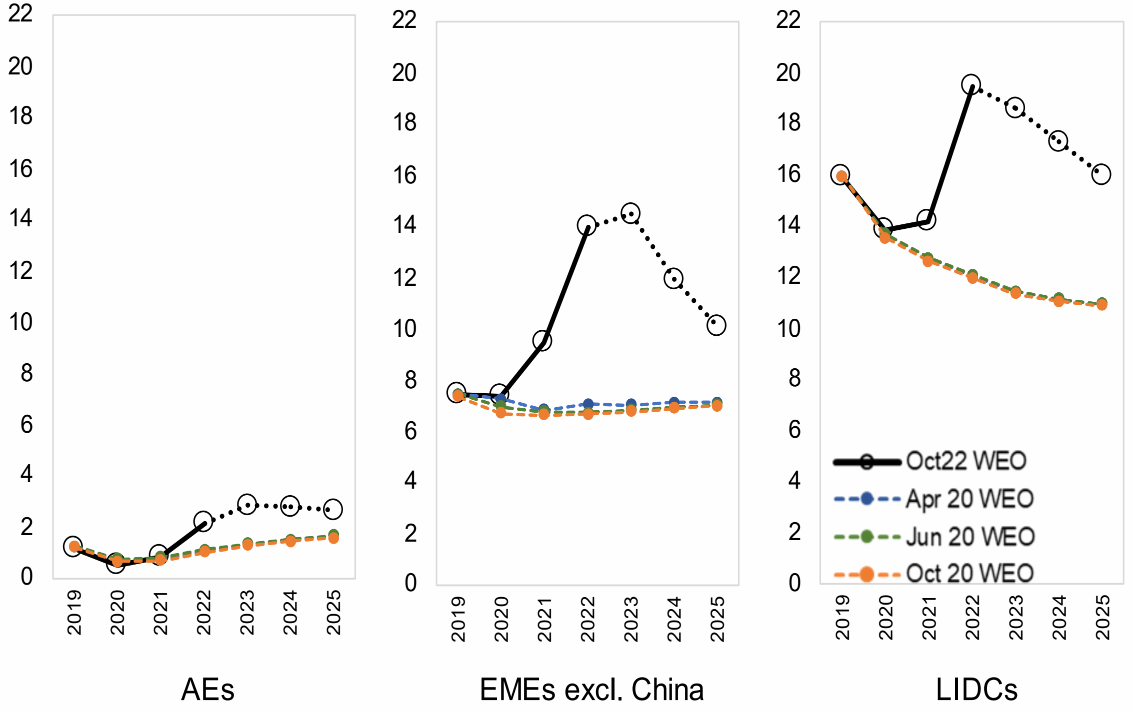
Data in the presentation uses the WEO October 2022 vintage as of September 27, 2022. Data for the Global Debt Database is preliminary and under review till the update is launched in December 2022. Dates for high-frequency data are listed in the notes under the figure.

From Low For Long To Very High

Inflation



Bond Yields

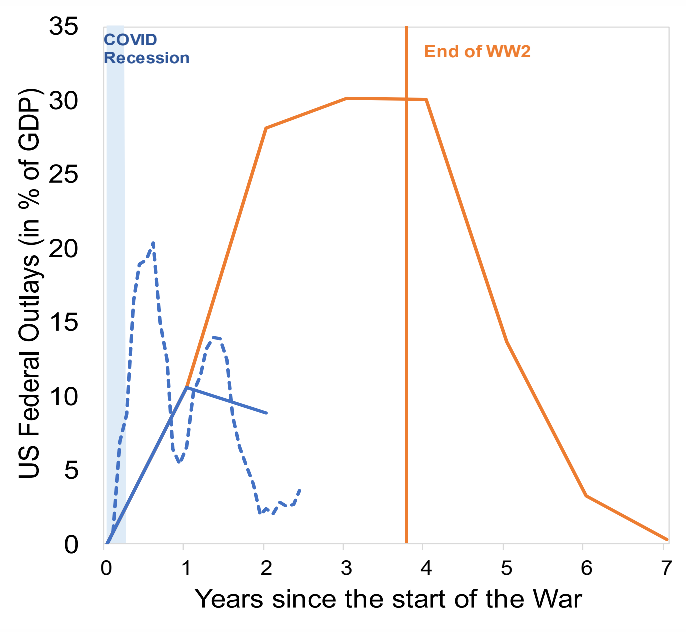


Source: IMF WEO (Various Vintages).

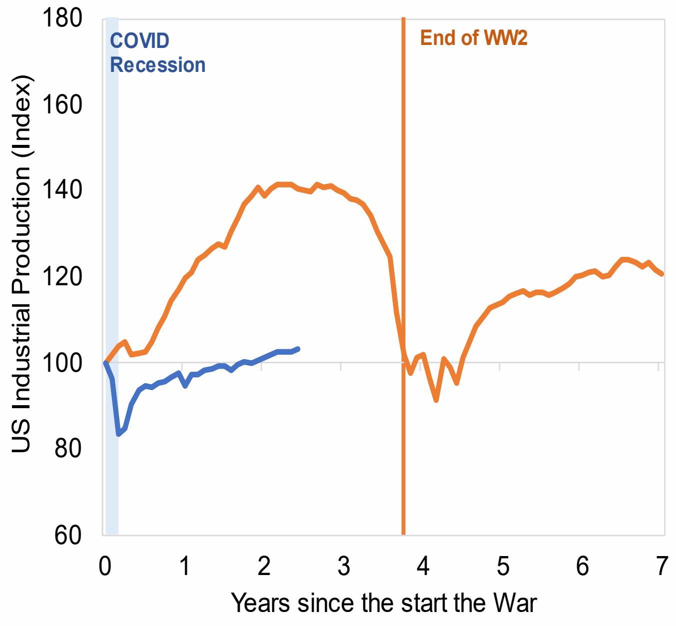
Note: The figure compares the projected average annual inflation (CPI) & long-term local-currency bond yields for aggregates, across World Economic Outlook (WEO) vintages. The April 2020, June 2020 and October 2020 WEO vintage projections provide the prevailing sentiment and economic projections during 2020. The October 2022 WEO vintage provides the realized values for 2019, 2020 and 2021 and the latest projections for 2022, 2023, 2024 & 2025. All income groups follow WEO's methodology.

The War on COVID

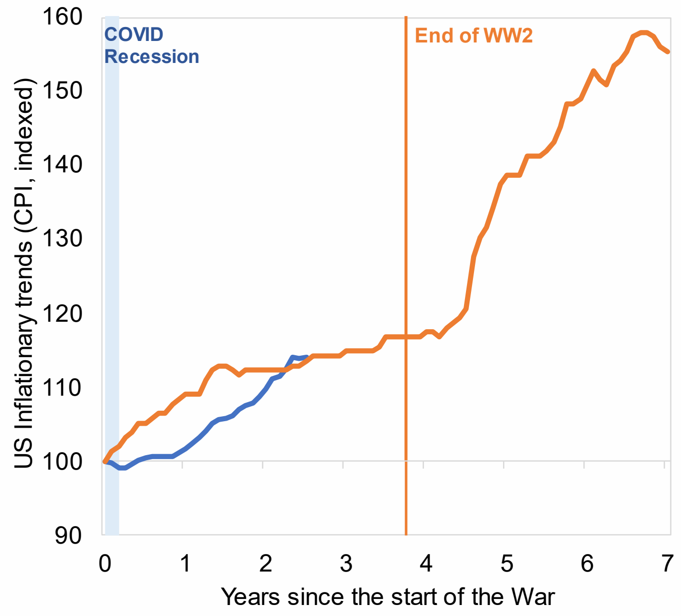
US Federal Government Spending



US Industrial Production



US Inflation (CPI)



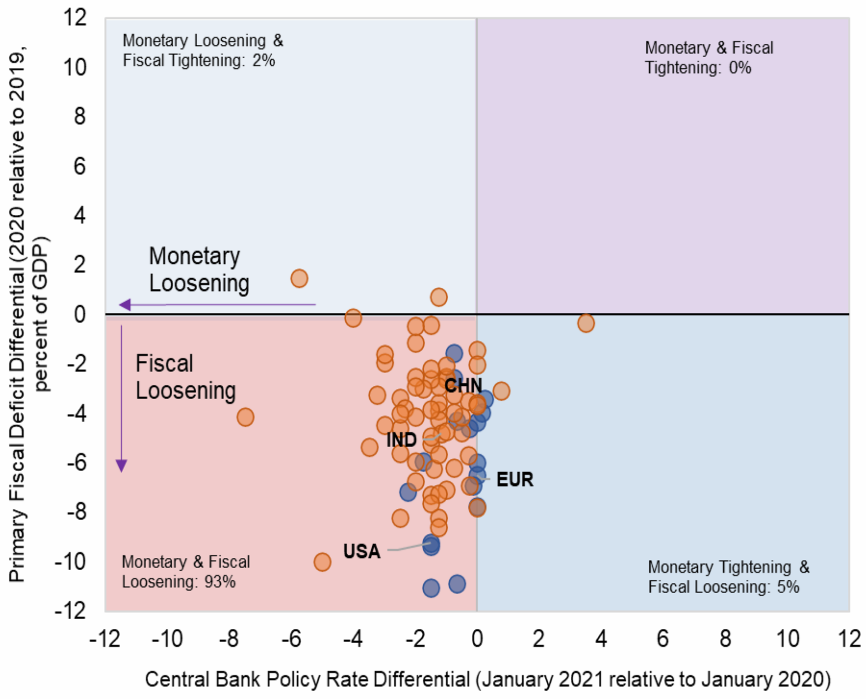
World War II (Dec 1941=100) COVID (Feb 2020=100)

Source: Hall, G. J., & Sargent, T. J. (2022). '*Three world wars: Fiscal–Monetary Consequences*'; Federal Reserve (FRED); Bureau of Labor Statistics (BLS); Global Financial Database (GFD); Office of Management & Budget (OMB)/Haver Analytics; NBER & IMF Staff Calculations

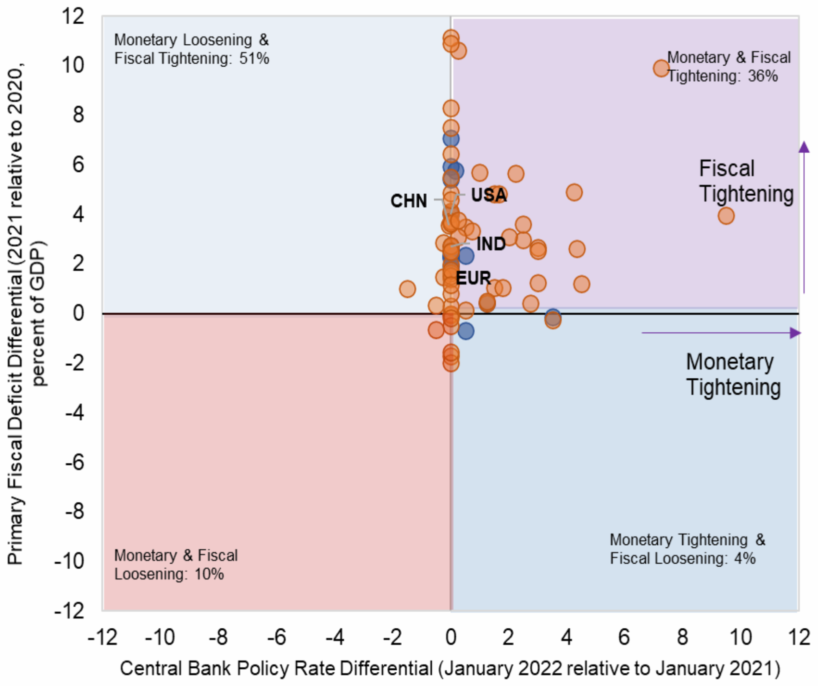
Note: Figures represent trends in the United States. In the middle and right figure, data is in monthly frequency. In the left chart, data is in annual frequency, with the dashed line being federal government spending for COVID in monthly frequency. Federal Net Outlays (Spending) is shown as the difference relative to federal spending at the start (point 0). The COVID Recession, classified based on NBER's definition of recessions, is shaded in light blue, and includes the months of February, March and April 2020. The last date for Federal spending is the month of July 2022, for inflation and industrial production is the month of August 2022.

Policy Mix

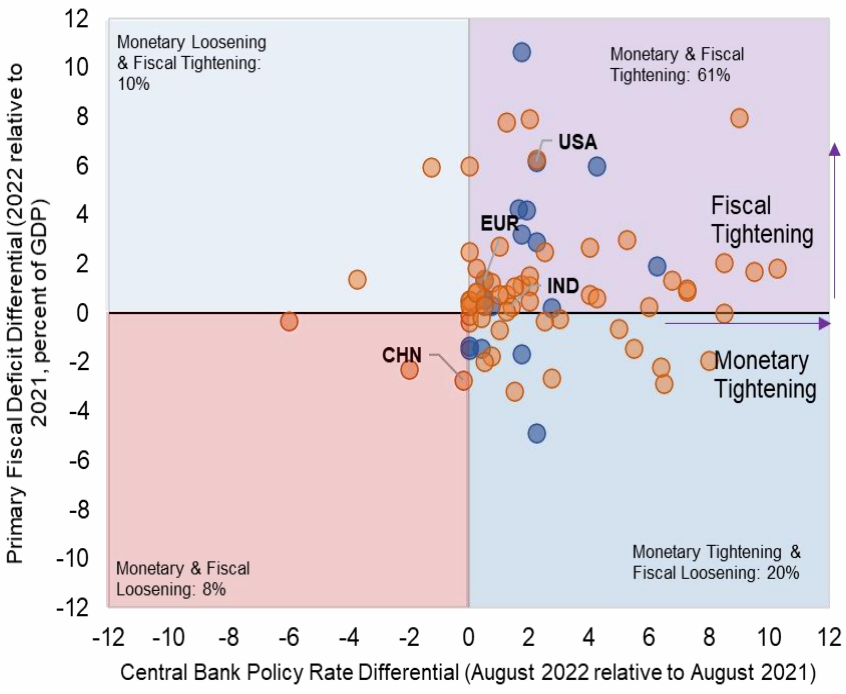
Fiscal-Monetary Interaction in 2020



Fiscal-Monetary Interaction in 2021



Fiscal-Monetary Interaction in 2022

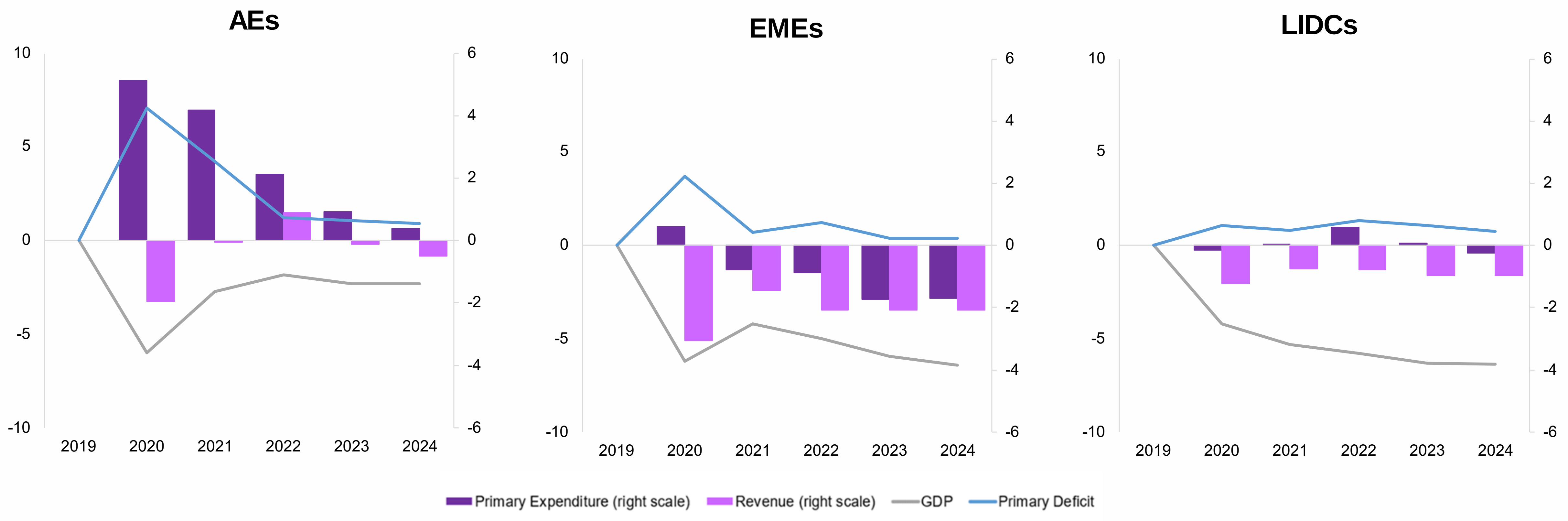


Source: IMF Fiscal Monitor (October 2022); National Sources/ Haver Analytics

Note: Countries in blue represent Advanced Economies and orange represent Emerging Market & Developing Economies (EMDEs). The Euro Area is shown as a singular entity. Around 60% of the Sample is Tightening Monetary and Fiscal Conditions.

Fiscal Deficits Down But Lasting Scarring

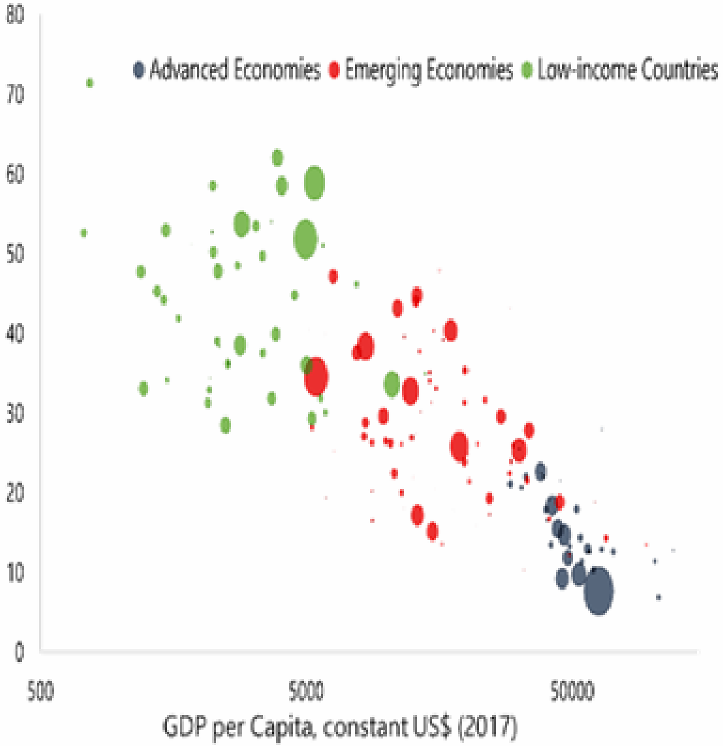
Effect of the Pandemic on Revenue, Spending, Primary Deficit and GDP



Source: IMF WEO; Fiscal Monitor (October 2019 and October 2022)
Note: All variables are weighted average real values, deviations from pre-pandemic projections as a percentage of WEO October 2019 vintage projected GDP.

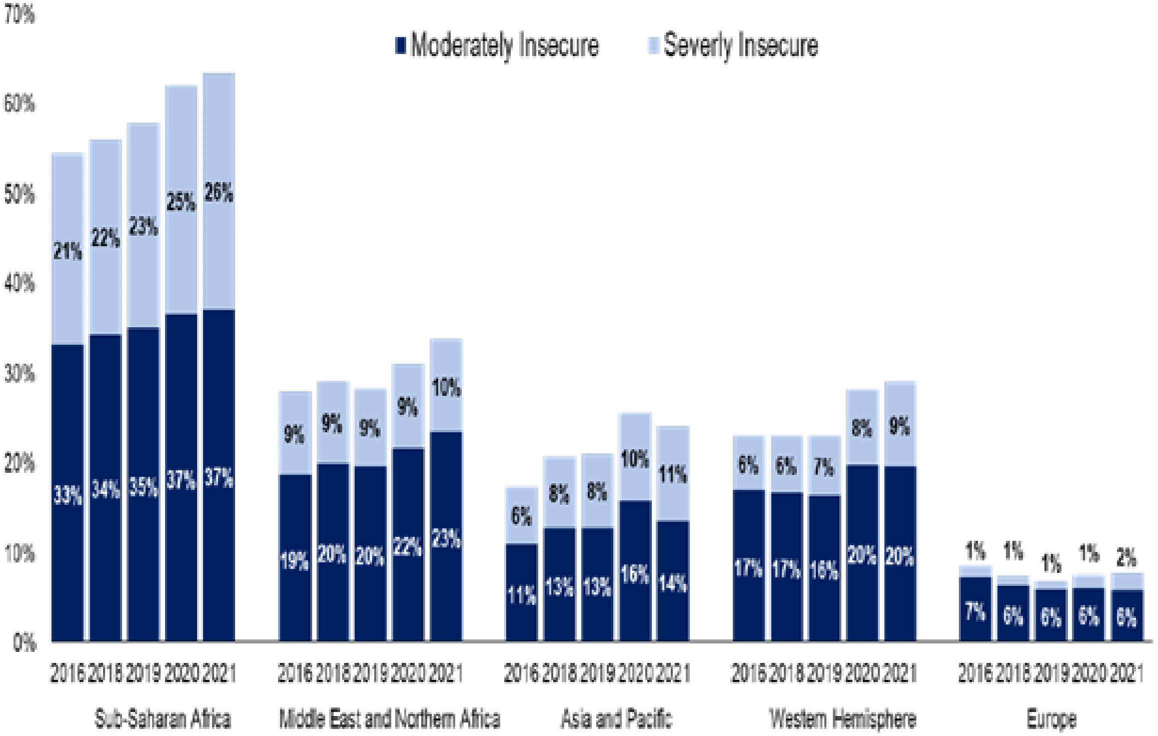
Support for LIDCs Is Critical

Share of Food in Consumer Basket (Percent, Averages by Country)



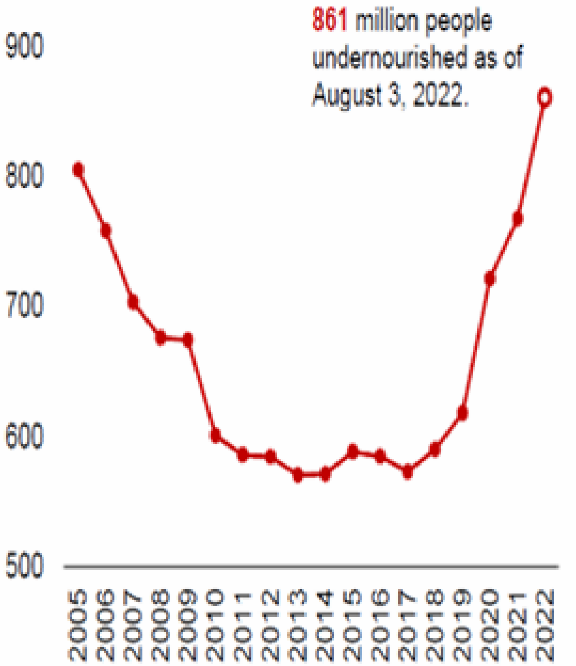
Sources: IMF CPI database and IMF WEO
Note: Dot sizes represent approximate percentage of population in each household income group within country groupings

Prevalence of Moderate and Severe Food Insecurity (Percent of Population)



Sources: FAOSTAT
Note: Middle-East countries are those labelled in FAOSTAT as Western Asia. Western Hemisphere is North America and Latin America and Caribbean groupings from FAOSTAT

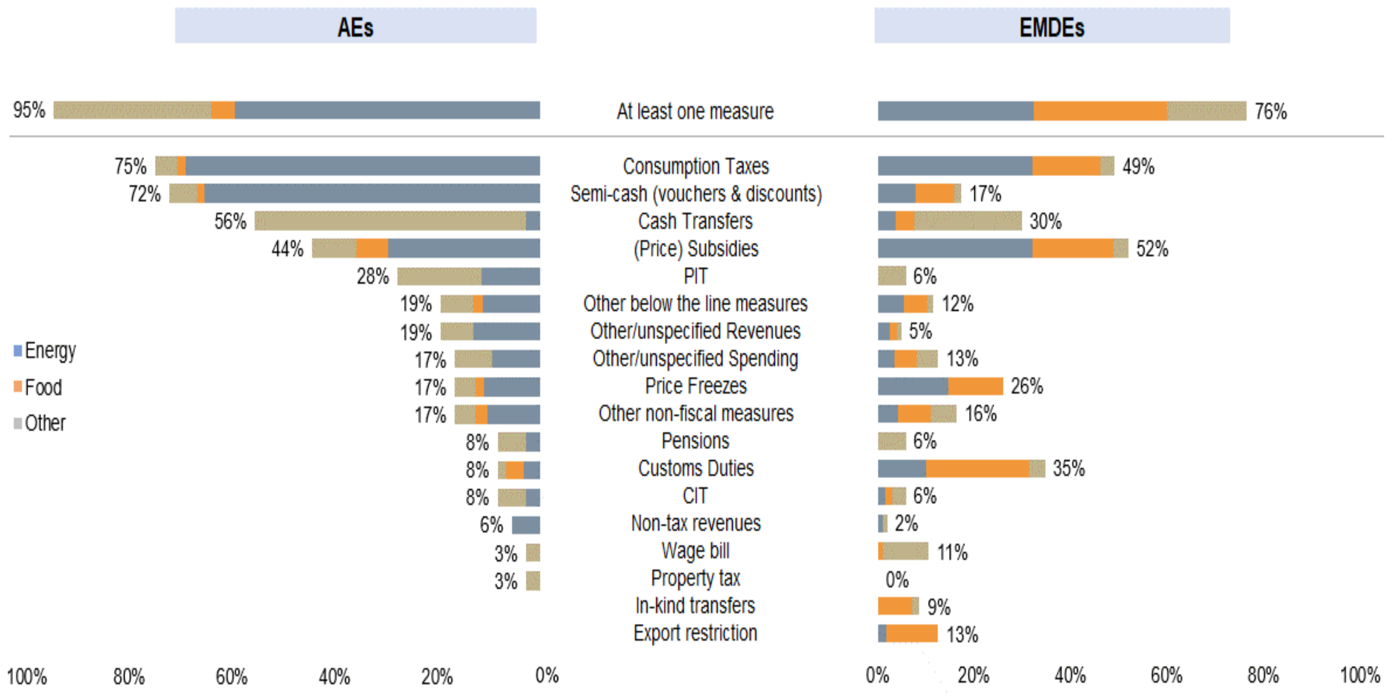
Global Undernourished Population (in millions)



Sources: FAOSTAT and World Food Program (WFP)
Note: The last point for 2022 is an estimate from WFP's HungerMap liv e as of August 3, 2022

Higher Prices and Subsidies for Food and Energy

Recently Announced Measures in Response to Higher Energy and Food Prices



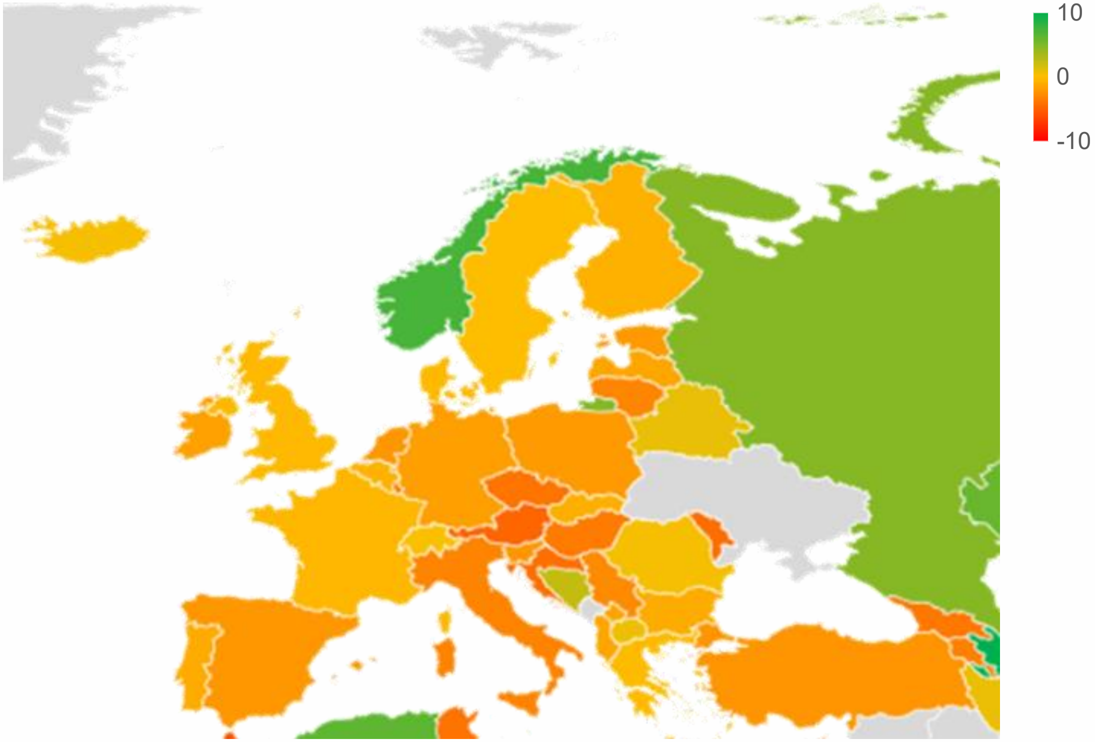
- The energy crisis is likely to be protracted. Large and persistent shocks cannot be smoothed, they require adjustment.
- Measures in response to the cost-of-living crisis need to cognizant of the fiscal cost, and should not lead to expansionary fiscal policies.
- Policies responses need to ensure the right incentives for the energy sector. They should promote increasing energy supply, decrease energy demand and protecting renewable investments.

Sources: FAD staff survey of IMF country teams on policy responses to high energy and food prices.

Note: The survey was conducted in June and covered 174 countries (38 advanced economies and 136 emerging and developing economies). The survey includes measures that were announced in 2022 as of June. At least one measure represents the ratio of countries taking at least one measure relative to the total number of countries that were covered in the survey. The remaining bars represent the share of countries that announced at least one measure in each category relative to countries taking at least one measure. The stacked bar shows the breakdown of total measures in each category in terms of food, energy and other. ‘Other’ indicates the measure is either targeted at both food and energy or is unspecified

From Energy Crisis to Climate Change

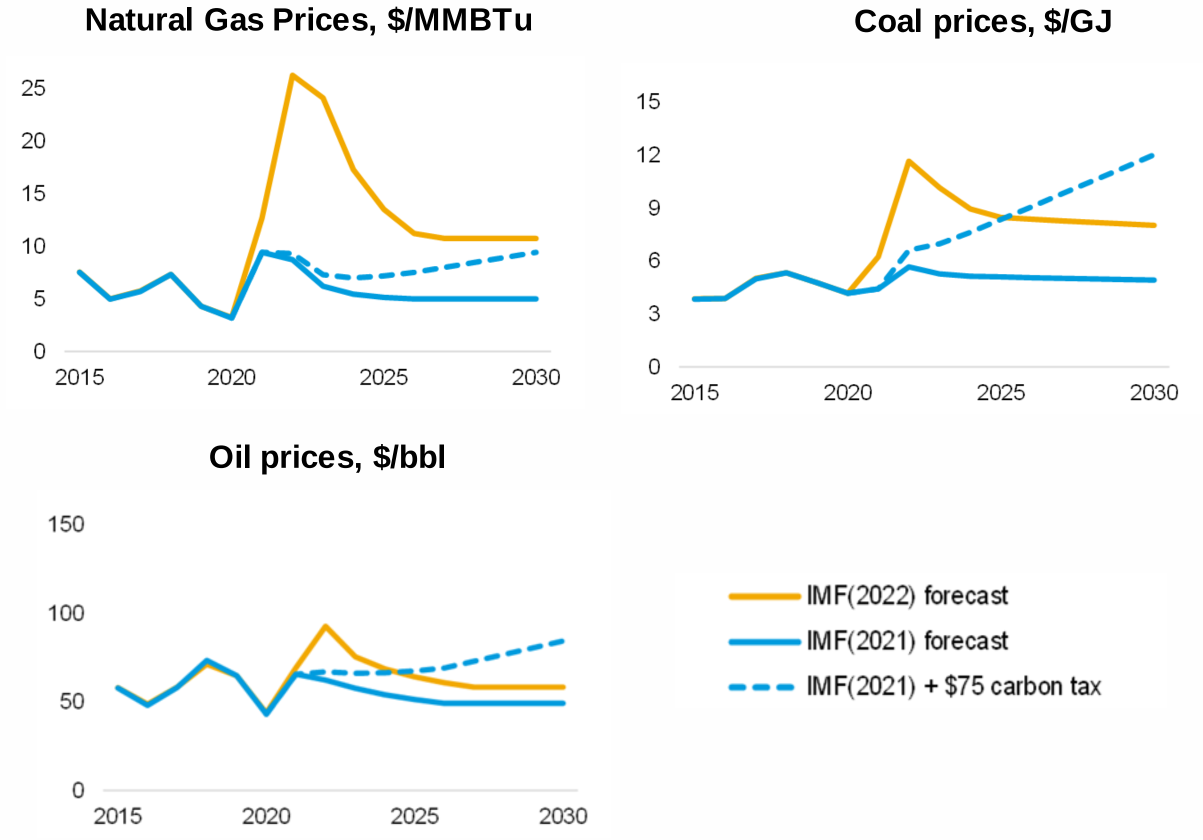
Impact of Terms of Trade Shock on Nominal GDP in Europe (percent, 2022)



Source: IMF WEO (January & October 2022 Vintages)

Note: The impact of terms of trade changes on nominal GDP is expressed as the share of the value of net exports changes due to price changes in percent of 2022 nominal GDP. The effect of price changes on export (import) is calculated by multiplying the volume of exports (imports) in 2022 by the exports (imports) deflator differential (Oct 22 WEO relative to Jan 22 WEO). The deflators in Jan 22 WEO have been adjusted based on the realized 2021 values in WEO Oct 2022.

Surge in Energy Prices

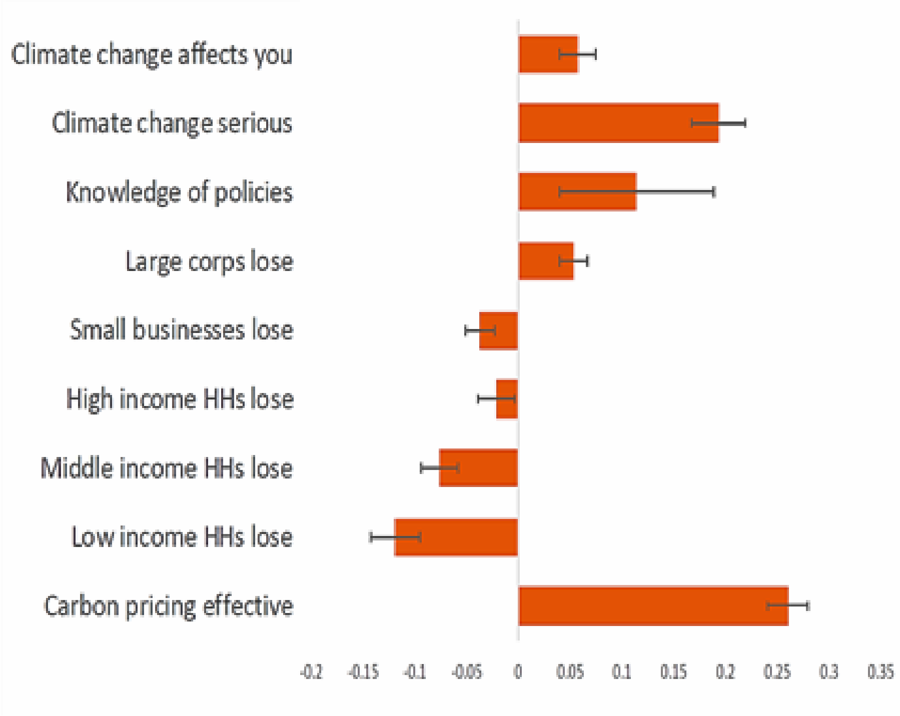


Source: IMF staff estimates

Notes. Prices in real 2021 US$, deflated by respective IMF projections. Carbon tax starting at $10 in 2022 and rising to $75 in 2030 is assumed on top of IMF (2022) baseline assuming elastic supply (this assumption is likely reasonable for coal and gas, although possibly less so for oil). Natural gas prices are a weighted average of natural gas in Europe, North America (Henry Hub) and LNG market (Japan). Coal prices are a weighted average of domestic sectoral coal prices in China, India, and the US. Oil prices are an average of Brent, Dubai Fateh, and West Texas Intermediate.

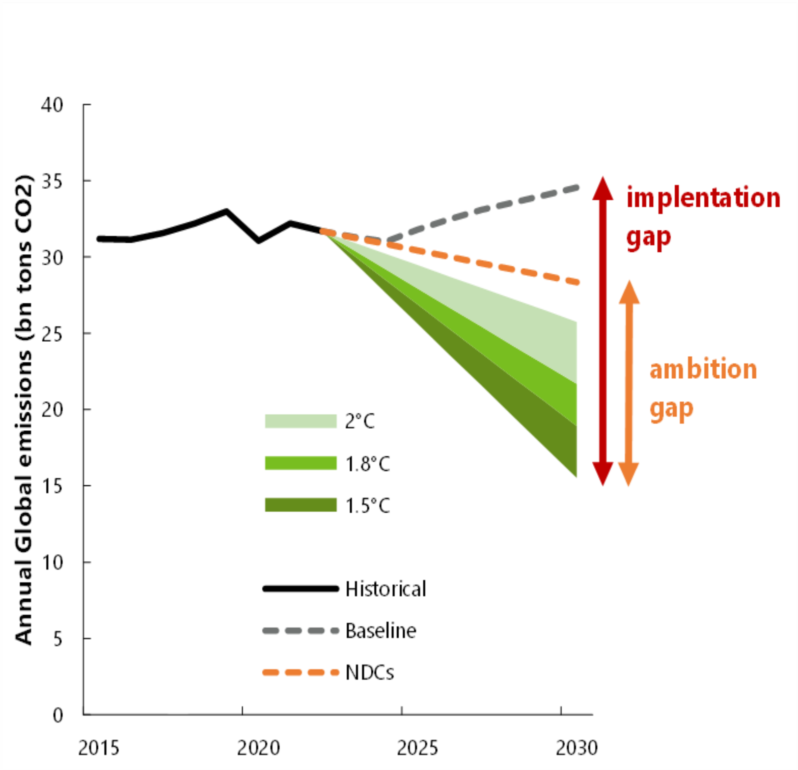
Urgency of Climate Action Continues to Increase

Drivers of Support for Carbon Pricing:
Regression Coefficients & 95% Confidence Intervals
(Question: Would you support a carbon pricing policy in your country?)



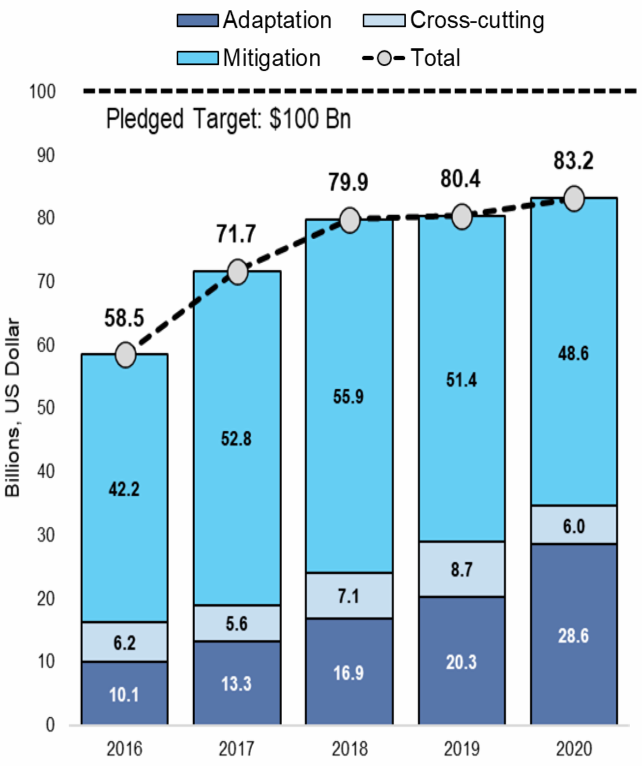
Sources: Dabla-Norris et al. (Forthcoming), "*Public Perceptions of Climate Change Mitigation Policies: Evidence from across-Country Surveys*"

CO_2 Emissions, Mitigation Ambition and policy gaps to 2030



Sources: IMF staff estimates

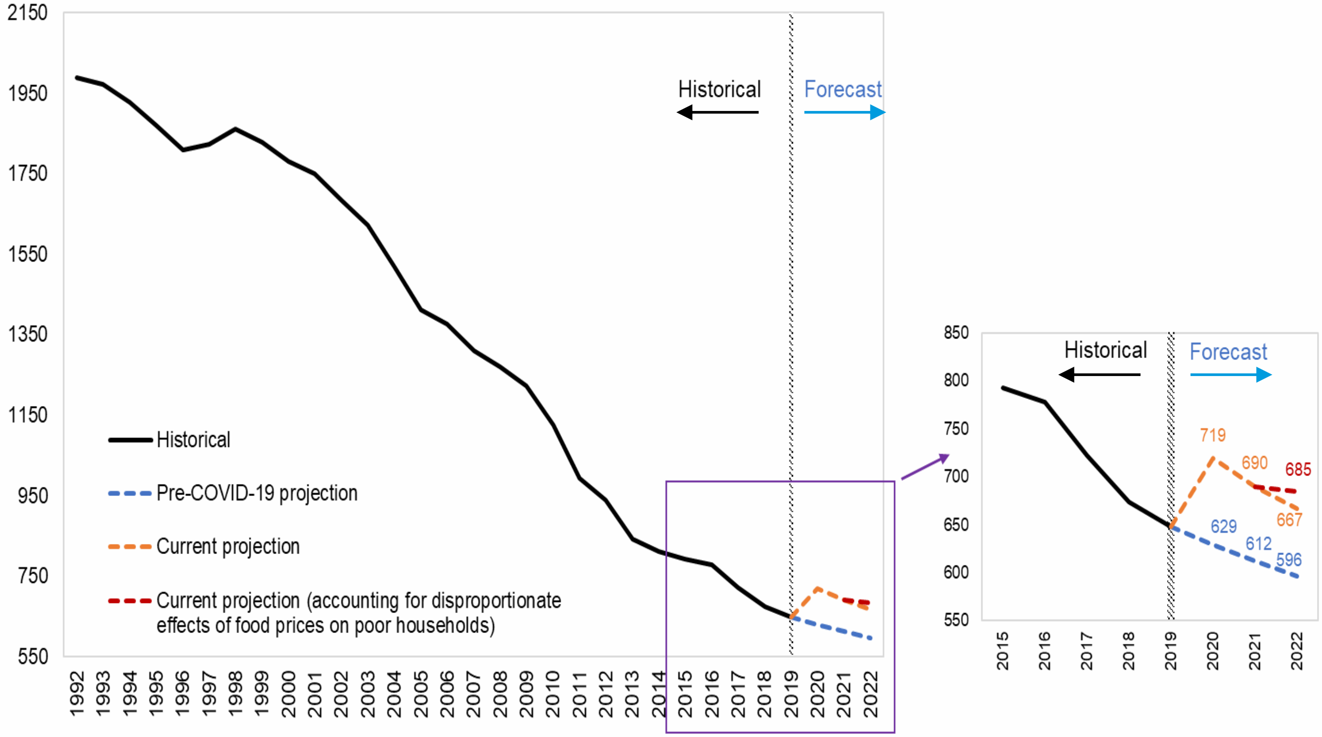
Developed Countries Climate Finance Provided & Mobilized Relative to $100 Bn Pledged



Sources: OECD "*Aggregate Trends of Climate Finance Provided and Mobilized by Developed Countries, 2013-2020*".

Global Poverty Reduction Experienced a Setback

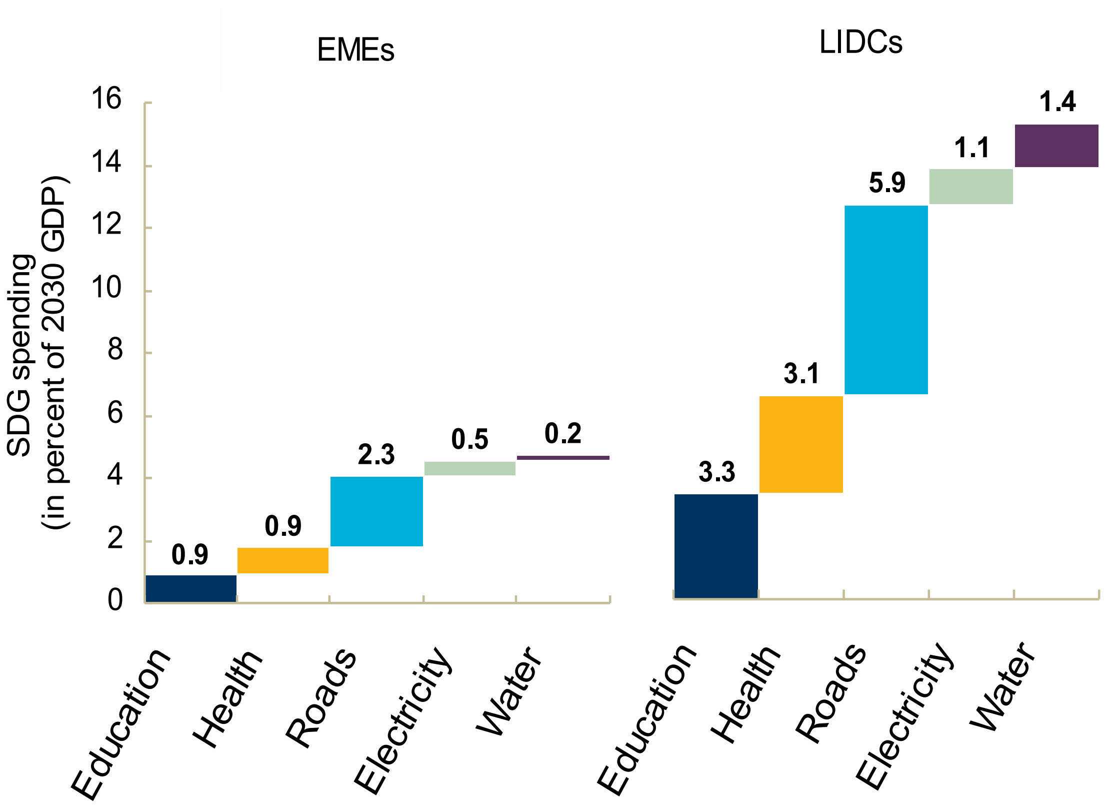
Estimates of Extreme Poverty, (Millions of People, 1992-2022)



Sources: World Bank, Lakner et al (2022) (forthcoming), Poverty & Inequality Platform (PIP), Macro and Poverty Outlook.

Note: Extreme poverty is measured as the number of people living on less $2.15 based on 2017 PPPs (previously $1.9 based on 2011 PPP) 2018 is the last year with official global poverty estimates. 'No pandemic projection' utilizes Global Economic Prospects growth forecasts from before the COVID-19 pandemic. Baseline scenario distributes the impacts of the COVID-19 pandemic, rising inflation, and the conflict in Ukraine equally to all households. Pessimistic scenario includes the disproportionate impact of rising food prices on the bottom 40% compared to the top 60% over the baseline scenario. Official poverty estimates are available for East Asia & Pacific, Europe & Central Asia, Latin America & Caribbean, Sub-Saharan Africa, and rest of the world for up to 2019, and for Middle East & North Africa up to 2018. Official South Asia estimates are only available up to 2014. Regions are categorized using PIP definition.

SDG Financing Gap (in percent of 2030 GDP)

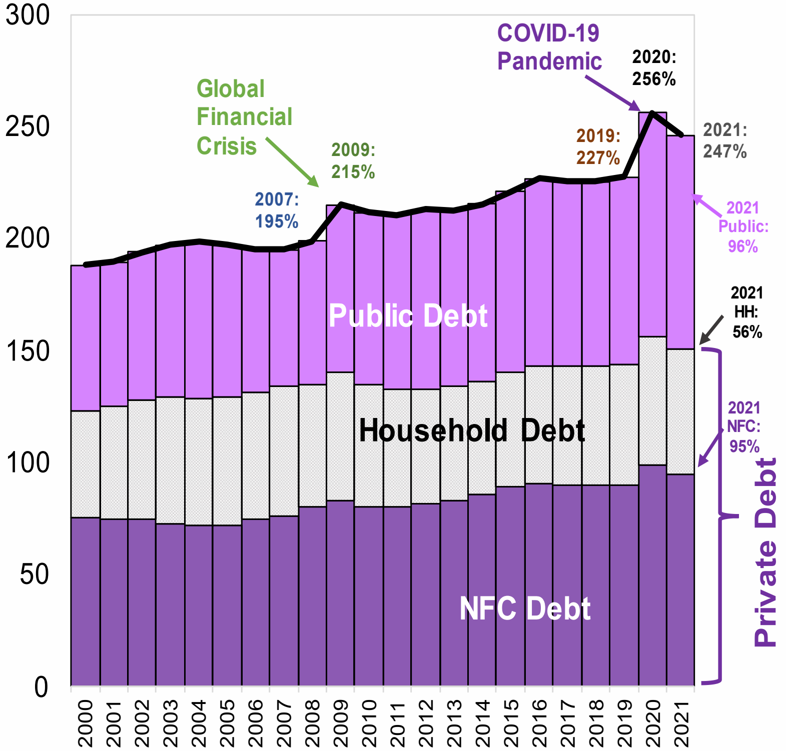


Sources: IMF Fiscal Monitor (April 2021)

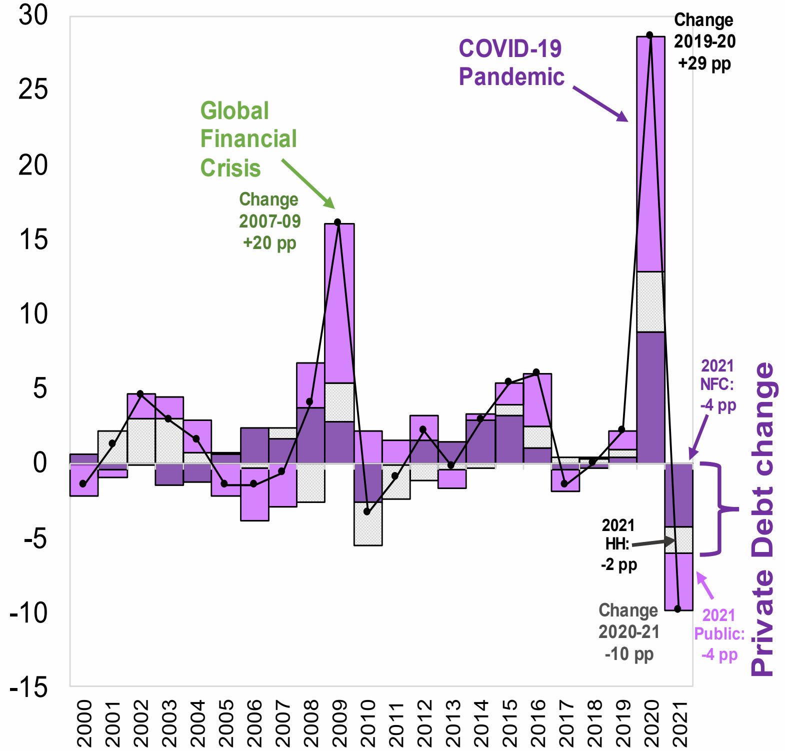
Note: Updated estimates of Gaspar and others (2019). Apart from updating the key input variables with more recent data, some methodological refinements were made including the development of a new education SDG performance index with recently developed education quality indicators, incorporating newly available rural access index, and systematical treatment of infrastructure depreciation and maintenance.

Global Debt Edged Down after Record High

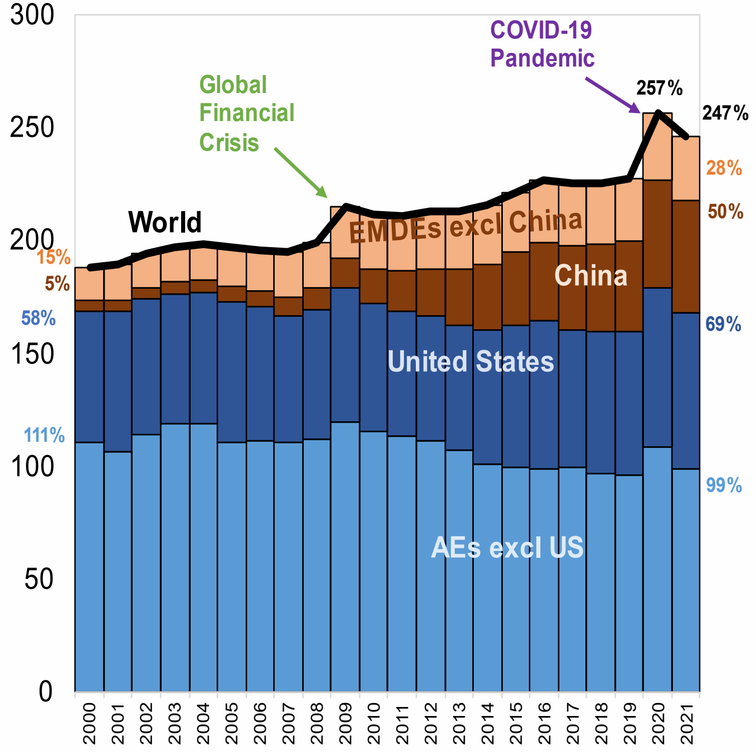
Global Debt Stock: Levels of Total Public and Private Debt 2000-2021 (in percent of GDP)



Global Debt Stock: Annual Changes of Public and Private Debt 2000-2021 (in percent of GDP)



Contribution to Total Debt in percent of Global GDP (in percent of GDP)



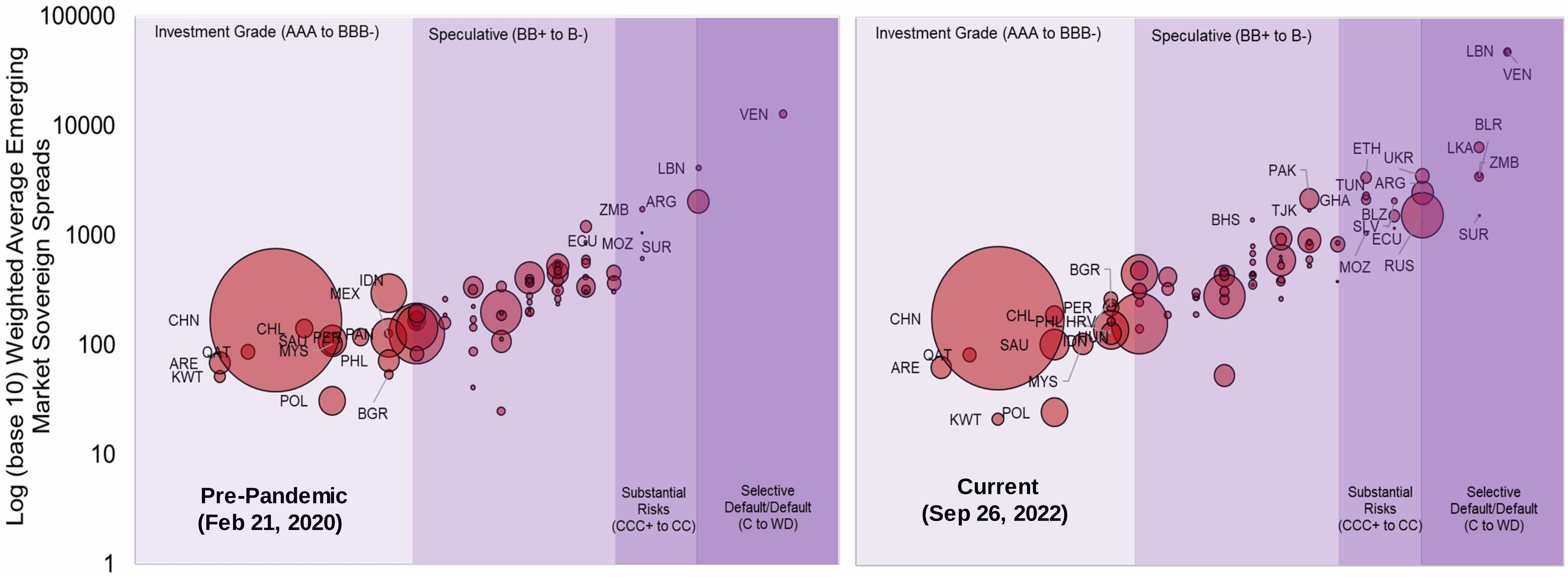
Source: International Monetary Fund (IMF) Global Debt Database (GDD) & IMF Staff Calculations

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.

NFC = Non-financial corporations; HH = Households

Debt Vulnerabilities on the Rise

Comparison of Debt Vulnerabilities:
EMDEs Spreads & Ratings (Pre-Pandemic and Current)

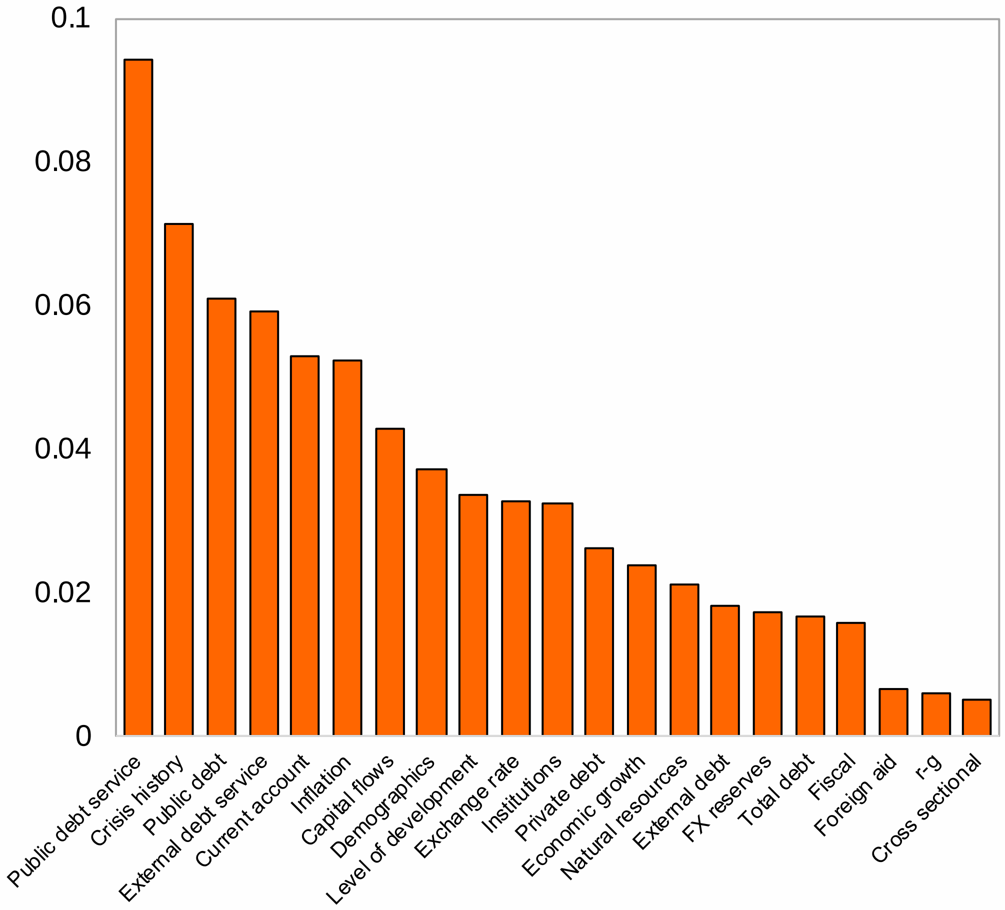


Source: JP Morgan EMBI Sovereign Spreads, Bloomberg Finance, Moody's Ratings, S&P Sovereign Ratings, Fitch Ratings & IMF Staff analysis

Note: The figures use the JP Morgan EMBI Sovereign Spreads and supplements with the MCM dataset prepared using Bloomberg. 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 across all three major credit agencies (S&P, Moody's & Fitch). The Ratings classification are standardized to the Fitch Rating hierarchy nomenclature. The figure here includes 79 EMDEs of which: 16 are low-credit risk (20% of sample, 64% of the EMDEs GDP); 35 are performing (44% of sample, 16% of the EMDEs sample GDP); 9 are stressed (11% of sample, 3% of the EMDEs GDP) and 19 are distressed (24% of sample, 9% of the EMDEs sample GDP). In cumulative, 28 EMDEs (35% of sample, 11% of the EMDEs GDP) are considered stressed or distressed. The figure uses the JP Morgan EMBIG Sovereign index for classification to allow for the inclusion of India and Venezuela.

Fiscal Crises and Exchange Rate Vulnerabilities

Main Predictors of Fiscal Crises in Emerging Markets (Mean Difference of Shapley Values)



Source: Moreno Badia et al. (2022).

Note: Predictor importance using Random Forest. The charts show the mean difference of Shapley values (crisis versus non-crisis observations) by income groups. The Shapley value represents the contribution of each respective variable towards the predicted valued compared to the average prediction for the data set.

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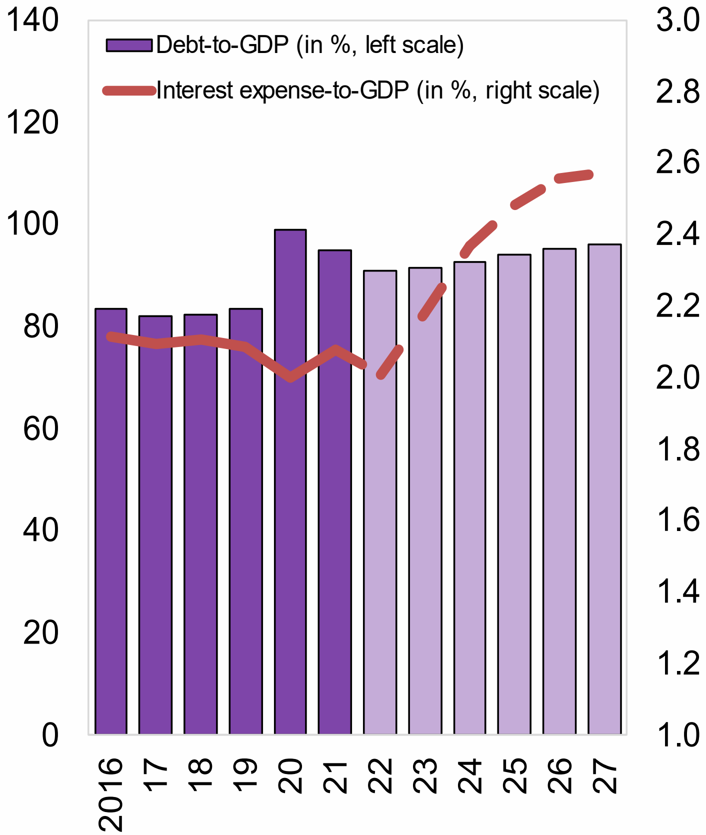
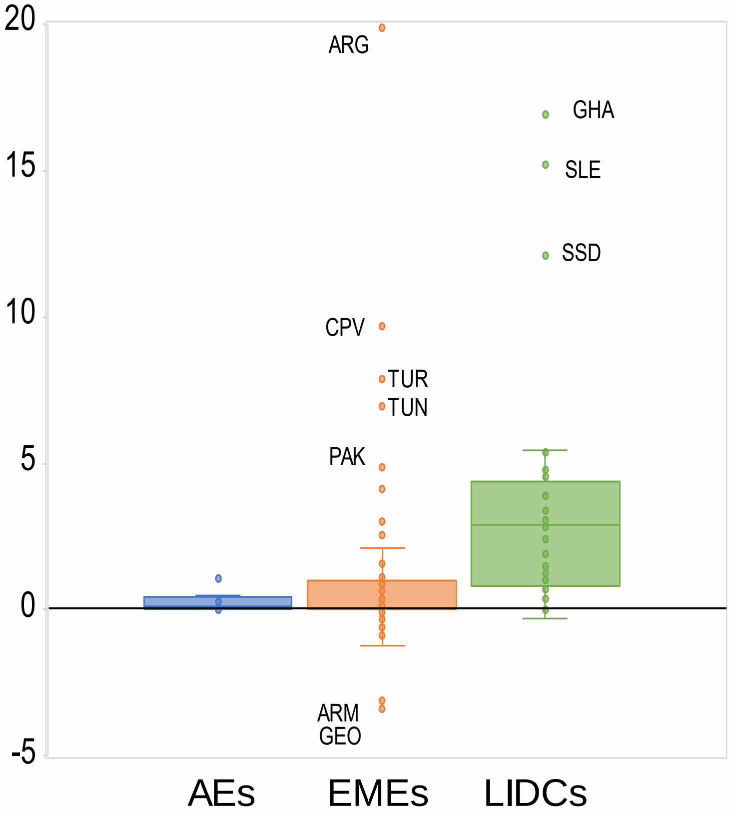
Global Public Debt and Interest Payments (in percent of GDP)



Source: IMF Fiscal Monitor.

Change in Foreign Currency Denominated Debt Stock in 2022 (in percent of GDP) Attributed Only to Exchange Rate Changes



Source: IMF WEO & IMF Staff Calculations.

Note: The figure only shows the effect of the increase in exchange rate on the valuations of foreign-currency denominated stock of debt. It does not take into account the change in net issuances (securities issued and matured) or the overall foreign currency public debt-to-GDP ratio.

Policy recommendations

Main policy priority: fight inflation, mitigate financial distortions

- Act resolutely to bring inflation credibly back to target in a timely way and avoid a de-anchoring of inflation expectations.
- Do not yield to pressure to ease monetary tightening, this will necessitate more painful policy actions in the future.
- Use Integrated Policy Framework to help avert crises, combining targeted foreign exchange interventions, capital flow measures, and other actions as needed to smooth exchange rate moves and reduce financial stability risks.
- In some cases, macroprudential policy adjustments and regulatory actions may be needed to avoid risks materializing.

Fiscal policy should protect the vulnerable while aiding the tightening monetary stance

- Targeted, temporary measures, should be deployed to cushion the impact of economic slowdown on the most vulnerable.
- Fiscal policy should tighten to support monetary policy where there is excess demand or inflation expectations are at risk of de-anchoring.
- For most countries, deficit reduction is appropriate, anchored in medium-term fiscal framework, esp. if there is little fiscal space or debt concerns are pressing.
- Policies should preserve price signals; attempts to control prices directly are fiscally costly and ultimately ineffective.
- Complement with structural policies to boost supply capacity in the long-term: education, childcare access, digitalization, infrastructure investment, pension reforms, supply chain resilience & pandemic preparedness.

Multilateral cooperation is urgently needed for crisis prevention and investment in the future

- More sovereigns in debt distress will require restructuring: urgently implement and broaden G-20 Common Framework.
- Ensure resilience of market functioning and maintain global liquidity amid tightening financial conditions. For many EMDEs, now is the time to apply for precautionary credit lines with the Fund.
- Prevent catastrophic climate change impact by accelerating green transition. Delays will magnify transition costs.
- Strengthen cooperation on common goods (e.g. climate policies, debt) to mitigate fragmentation risks. The Fund stands ready to deliver with existing and new tools: incl. SDR channeling, RST, RFI Food Shock Window.

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