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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 18/82-1

10:00 a.m., September 20, 2018

1. World Economic Outlook; Global Financial Stability Report; Fiscal Monitor

Documents: EBS/18/76 ; EBS/18/77; EBS/18/80, and Correction 1; and Supplement 1; EBS/18/81; SM/18/224; SM/18/225 ; SM/18/227

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

Length: 3 hours, 31 minutes

Executive Board Attendance

C. Lagarde, Chairman

Executive Directors	Alternate Executive Directors
M. Mkwezalamba (AE)	
D. Sembene (AF)	
A. Armas (AG)	
	C. Barron (AP)
A. Tombini (BR)	
Z. Jin (CC)	
	T. Gonzalez (CE)
N. Horsman (CO)	
M. Erbenova (EC)	
H. de Villeroché (FF)	
	K. Merk (GR)
S. Gokarn (IN)	
A. Leipold (IT)	
M. Kaizuka (JA)	
J. Mojarrad (MD)	
	S. Geadah (MI)
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
	R. Alkhareif (SA)
J. Agung (ST)	
M. Panek (SZ)	
S. Riach (UK)	
	S. Vitvitsky (US), Temporary

J. Lin, Secretary
J. Morco / O. Vongthieres, Summing Up Officers
A. Bala / L. Briamonte / M. Gislen, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: P. N'Diaye. Asia and Pacific Department: T. Helbling, K. Mathai. Communications Department: N. Ismail, C. Rosenberg, O. Stankova. Corporate Services and Facilities: N. Pambukhchyan. European Central Bank: I. Moder, R. Rueffer. European Department: B. Barkbu, P. Dohlman. Fiscal Affairs Department: J. Harris, V. Louca Rabaca Gaspar, P. Mauro, C. Pattillo, C. Renteria Rodriguez, A. Senhadji, A. Tieman. Finance

Department: T. Krueger, A. Tweedie. Independent Evaluation Office: C. Collyns. Legal Department: N. Rendak. Middle East and Central Asia Department: A. Holland. Monetary and Capital Markets Department: T. Adrian, S. Antoshin, A. Barajas, P. Breuer, D. Drako, M. Erbenova, A. Ilyina, W. Kerry, F. Natalucci, C. Raddatz Kiefer, J. Walsh. Office of Risk Management: V. Arora. Research Department: R. Bems, L. Buono, O. Celasun, E. Cerutti, G. Milesi-Ferretti, M. Nabar, P. Topalova. Strategy, Policy, and Review Department: T. Bayoumi, R. Duttagupta, P. Koeva Brooks, M. Muhleisen. Western Hemisphere Department: A. Spilimbergo. Executive Director: P. Inderbinen (SZ), G. Lopetegui (AG), D. Mahlinza (AE), M. Raghani (AF). Alternate Executive Director: A. Castets (FF), G. Johnston (AP), A. McKiernan (CO), K. Obiora (AE), Y. Saito (JA), B. Saraiva (BR). Senior Advisors to Executive Directors: W. Abdelati (MI), C. Collura (IT), A. Del Cid-Bonilla (CE), H. Etkes (NE), F. Fuentes (BR), N. Jost (NE), S. Keshava (SA), W. Kuhles (GR), Y.Liu (CC), T. Nguema-Affane (AF), S. Potapov (RU), G. Preston (AP), C. Sassanpour (MD), J. Shin (AP), T. Sitima-wina (AE), F. Spadafora (IT), O. Stradal (EC), A. Tolstikov (RU). Advisors to Executive Directors: F. Al-Kohlany (MI), O. Bayar (EC), P. Braeuer (GR), J. Corvalan (AG), D. Crane (US), P. Dhillon (IN), O. Diakite (AF), J. Hanson (NE), T. Hemingway (UK), M. Josic (NE), N. Komura (JA), I. Lopes (IT), T. Manchev (NE), M. Mehmedi (EC), M. Merhi (MI), C. Moreno (AG), M. Mulas (CE), A. Park (AP), B. Parkanyi (NE), F. Rawah (SA), F. Rivadeneira (BR), P. Snisorenko (RU), N. Vaikla (NO), D. Vogel (AG), K. Hennings (BR), K. Lok (CC), A. Sode (FF).

1. WORLD ECONOMIC OUTLOOK; GLOBAL FINANCIAL STABILITY REPORT; FISCAL MONITOR

Mr. Ostros and Ms. Sand submitted the following statement:

We thank staff for the comprehensive set of flagship reports and very good analytical work. We broadly share staff's assessment of the global economic situation and associated risks, and would like to offer the following comments for emphasis.

World Economic Outlook

We share staff's analysis that the global expansion is expected to continue, though with more mixed momentum and diverse prospects across countries and regions. We take note of staff's revised projections for 2018-19 that point towards a steady rate of global growth rather than a further pickup. We agree that risks to the downside have increased due to escalating trade tensions and a reversal of capital flows for emerging market economies with weaker fundamentals and higher political risk. With risks tilted to the downside, enhancing prospects for a strong and inclusive growth, building buffers, and monitoring the build-up of financial market risks have become more urgent.

We agree with staff that escalating trade tensions and a shift away from a multilateral, rules-based trading system are key threats to the global expansion. In this respect, we value staff's efforts to highlight the potential for a more positive and constructive multilateral policy agenda on trade, including the aim to reform the multilateral trade system to e.g. better address trade in services and e-commerce.

The Scenario Box in chapter 1 on Global Trade Tensions clearly shows the negative consequences for all countries, including the US itself, should the trade measures announced and considered by the US, and counter measures by other countries, materialize. We appreciate staff's analytical efforts to take into consideration not only the direct impact of increased tariffs, but also the potential confidence and financial market effects as well as implications for extended global value chains.

Accommodative monetary policy and, in some countries, more expansionary fiscal policy will continue to support growth in the short term. It is important to prepare for possible economic headwinds by boosting fiscal buffers and avoiding pro-cyclical fiscal policies. Building financial resilience and containing financial stability risks is essential. Appropriate structural policies should be undertaken to boost potential growth, reduce inequality and income polarization, and to foster sustainability. Low-income countries should take effective actions to reduce poverty, while taking appropriate measures to manage public debt, supported by development partners and IFIs.

We agree that productivity and broad-based gains can be ensured by encouraging technological innovation and diffusion, increasing labour force participation, especially for women and youth, assisting those displaced by structural change back into employment, and by investing in education and job training to enhance job opportunities.

While global GDP growth is relatively high and employment close to full capacity in many economies, core inflation and wage growth have remained low or are rising slowly. We welcome staff's recent analysis of this issue and note that in the Euro area this can be explained by backward-looking inflation expectations and remaining slack in the labour market. This has dampened underlying inflation in the Euro area so far, but these effects can be expected to eventually diminish going forward.

Staff's analysis of the global recovery a decade after the financial crisis (chapter 2) reinforces our view that strong macroeconomic policy frameworks, sustainable external positions, sound macroprudential policies and financial market regulation, and responsible fiscal policies with sufficient buffers, are necessary elements to mitigate the effects of economic and financial crises and to create policy space for subsequent recoveries.

The results show that, after fiscal and monetary policy buffers have been used, when conditions permit, the space for such actions should be rebuilt in order to prepare for future downturns. Accommodative monetary policy has been necessary for the recovery, but we should be aware that a prolonged period of unconventional policies and low interest rates could lead to a build-up of financial market vulnerabilities.

We also note the finding that flexible exchange rates were associated with better output and wealth performance during and after the crisis. It should be noted that the result is partly driven by the developments in some euro area countries during the sovereign debt crisis. Also, while controlling for pre-crisis public debt levels, the estimation leading to this conclusion does not seem to account for some country-specific factors that could explain the severe economic crises of some euro area countries, such as labour market structures, current account imbalances, and domestic credit growth (cf. Annex Table 2.2.5).

We concur with staff's conclusion that low growth in capital formation and total factor productivity appear to be key features of the post-crisis development in many countries, and that this suggests an important role for trade links in the international propagation of shocks. It is worth noting that non-crisis countries also see relatively persistent deviations in capital investment as a result of external factors. Policy recommendations for these countries to return to previous levels of investment would be worth exploring further.

Lasting consequences of the crisis on unemployment and inequality need to be addressed. It is vital to design policies that address inequality and support vulnerable groups to find employment and adapt to structural changes. Facilitating transitions between jobs, including reskilling and upskilling, is important to support both growth and equality.

Chapter 3 provides interesting insights about inflation performance in emerging market economies. We note that the moderate and stable inflation in many emerging economies is mainly attributed to lower long-term inflation expectations reflecting particularly improvements in institutional and policy frameworks. Staff's analysis shows that better-anchored inflation expectations reduce inflation persistence and limit pass-through of exchange rate movements to inflation. As a result, this allows monetary policy to focus more on smoothing output fluctuations.

It takes time to anchor inflation expectations, and they can become de-anchored quickly should domestic fiscal and monetary policy frameworks change for the worse. A combination of an independent and credible central bank, clear inflation target, and transparent central bank communication in an environment of sustainable public debt and fiscal policies seem to be common elements for countries with well-anchored inflation expectations. Recent turbulence in some countries underlines the need for sound and sustainable fiscal and monetary policies.

We take note of staff's conclusion that the role of global factors in emerging market inflation performance have been more limited. However, inflation expectations by forecasters may incorporate information from global inflation dynamics. Recent studies have found that global inflation is less helpful in explaining domestic inflation once survey inflation expectations are accounted for, mostly because of the high correlation between the two.

The output gap is a key variable for assessing inflationary pressures. However, we find no numbers or charts quantifying the output gap in the report and would suggest including a simple chart showing output gaps for some main economic areas.

Global Financial Stability Report

We share staff's assessment that short-term financial stability risks have increased modestly, and that they could rise sharply, as a consequence of mounting pressures in emerging market countries, escalating trade tensions, and enduring political and policy uncertainty. Medium-term risks continue to be elevated, as a number of vulnerabilities that have built up over the years could be exposed by a sudden and sharp tightening of financial conditions. The higher debt levels are a broad-based global concern, though the sector-specific vulnerabilities vary across countries and call for differing responses. Financial fragilities related to excessive risk-taking and mispricing of risks should continue to be closely monitored.

The focus on vulnerabilities in emerging market economies is welcome, particularly given the recent market pressures and the outlook of a challenging external environment for a number of EMEs and LICs. Countries with large foreign currency denominated external debt and/or large share of foreign investors in domestic capital markets are sensitive to quick changes in investor sentiment and monetary policy normalization in advanced economies. Strong economic fundamentals, sound policies, and stable institutions, as well as adequate buffers are important domestic safeguards to reduce vulnerability to external pressures. More can be done to improve resilience and reduce risks.

We take note of staff's analysis on capital flows and risks. While considerable capital outflows are to be expected in some cases, capital flow measures to avert a crisis should only be considered when other tools are exhausted. We welcome the section on policies to safeguard financial stability stressing the need to further develop and deploy macroprudential policy tools in a timely and effective manner, including in areas outside the banking sector.

International policy coordination remains critical to safeguarding global financial stability and facing common challenges. A more fragmented regulatory policy could lead to arbitrage and, eventually, a race to the bottom in regulation and supervision.

The banking sector overall has become more resilient since the global financial crisis, as noted in the GFSR. Banks now have higher capital levels and more liquidity on aggregate. This is important as banks in many countries are exposed to increasing credit risks related to borrowers with high debt-service burdens. Risks associated with interconnectedness between financial institutions are an important reason why banks should hold enough capital and liquidity to limit their vulnerability to external and internal shocks. In addition, the adoption of currency-differentiated LCRs could provide extra buffers to be used in the event of significant capital outflows. While particularly relevant in emerging market economies, such measures may be also prudent in advanced economies with large, internationally-active banks.

We share staff's views in chapter 2 that much progress has been made in reforming the global financial rulebook. The financial regulatory reform agenda should be completed and implemented, and a rollback of reforms must be avoided. The agreement on the finalisation of the Basel III framework is a central element in completing the regulatory response to the financial crisis.

We believe that the IMF should take a lead in assessing the benefits, challenges, and risks associated with fintech developments for all its members, including by streamlining the IMF surveillance framework in this area. In general, the activities of fintech firms should be covered by the existing regulatory framework in a way that is proportionate to the associated risks. The IMF could also raise awareness of the importance of sustainability as a horizontal issue in fintech developments and solutions, especially concerning crypto-assets.

Fiscal Monitor

An extended public-sector balance sheet can potentially improve the analysis of public finances and fiscal policy by giving a broader picture of public sector assets and liabilities. Such a database can be a useful tool for analysis and comparison between countries. It could also have the benefit of bringing more attention to the management of public assets and liabilities and risks relating to them.

Many private sector approaches to assets and liabilities are not applicable to the public sector. For example, it is difficult to assign a value to the right to tax citizens, but it is essential for understanding a country's ability to handle liabilities. On the liability side, a government can change legislation meaning that certain liabilities are not as certain as others.

At the same time, extending the scope of public sector assets and liabilities will inevitably raise issues on data availability and evaluation problems. It is not always clear what to include in the balance sheet, and how to make an appropriate evaluation of assets which may be illiquid and lack market values. Value estimation can be complicated, long term, and built on fragile assumptions implying large margins of uncertainty.

It is important that both assets and liabilities are included to an equal extent. For instance, public sector financial assets in pensions systems, the value of which may be relatively straight forward to assess, are often ear-marked for future obligations which may be more difficult to estimate.

However, difficulties in identifying and assessing all public-sector assets and liabilities does not mean that the balance sheet approach should be abandoned. There is a clear need to improve the reporting of public sector net wealth in many countries, so further work to develop techniques and concepts within this area are warranted.

Specific comments on the Finland and Norway financial net worth analysis

According to the analysis Finland has a positive net worth of 30 percent of GDP, mainly because of employment pension funds. Net worth of central government is negative. It should be noted that net worth stated in the report does not include pension liabilities of private sector pensions (but inconsistently includes financial assets relating to private sector pensions). If private sector pension liabilities were included, net worth of Finland would be -160 percent of GDP. This is clearly stated in the IMF report published in April 2018 (Working Paper No. 18/78). Hence the present FM does not give a correct picture of the situation.

The comparison of Finland and Norway highlight that, in the selected scenarios, Norway's future primary balances are negative, which implies that future services and benefits need to be financed by running down assets. Finland has more positive scenario, where reforms and prudential fiscal policy lead to positive future primary balances and increase in net worth. It should be noted that scenario selected for Finland is not the baseline scenario. The selected scenario assumes that social and health care reform is implemented, thereby decreasing costs of ageing. This could be mentioned in the report.

As regards Norway, the IMF's assessments correspond well with Norway's own views, for instance in the white paper on long term perspectives that was published in 2017. The baseline scenario in this white paper shows a financing gap of 5.3 percent of mainland GDP in 2060 and 9.5 percent in 2100.

Mr. Doornbosch, Mr. Etkes, Mr. Jost, Mr. Josic and Mr. Manchev submitted the following statement:

We support a strong call to the membership to reduce risks and urgently implement long-overdue structural reforms needed to boost global growth potential and build policy buffers against future shocks. The flagships rightly look back on the tenth anniversary of the global financial crisis, as it is important that the Fund continues to confront policymakers with a clear and strong picture of the implications of being complacent. The IMF is right in drawing attention to potential side effects of policy actions and challenges relating to long-lasting crisis legacies. The GFSR rightly points out that vulnerabilities continue to build up as financial conditions remain loose and market participants appear complacent about the risks. Private and public debt continue to rise, fiscal policy continues to remain procyclical in major advanced economies and more LIDCs are at risk of debt distress. This continuing buildup of risks instead of policy buffers makes a more dialed up tone of the Fund in its policy messages appropriate.

Trade tensions are a clear threat to economic growth, but also provide opportunities to deepen existing and finding new trade relations. They provide a wakeup call to urgently rethink and modernize the multilateral trade system. Staff rightly emphasizes the need to resist tendencies towards inward-looking policies given the scenario box on p. 41 of the WEO. Declining trade flows would certainly hurt growth by lowering corporate earnings and making consumer goods more expensive but may also have additional spillovers and confidence effects. In the longer term, lower trade would slow the spread of knowledge and new technologies, reducing global productivity and investment. The scenarios clearly show the self-inflicted effect of tariff measures. Economic growth in the US will be most negatively affected when it will impose tariffs on a broader range of products. However, aggregate economic growth is not the only outcome to analyze. The distributional effects between regions and sectors and concerns about the consequences of globalization on equality need to be recognized. Governments should increase their efforts to ensure that gains from free trade are more broadly shared. Integrated global production structures, for example, require more coherent rules across different policy areas. In addition, a further deregulation of services, trade or progress in new areas such as digital trade could provide a renewed boost to global trade and may reduce global imbalances.

World Economic Outlook

The window of opportunity is rapidly closing. We concur with staff that the expansion may have already peaked in some major economies, and that the macroeconomic policy mix should be aimed at building resilience for the possible downturn. The urgency for such policies is increasing. This is particularly important for fiscal policy, considering that the current level of gross public debt is significantly higher across all groups of countries compared with 2007. Against this background, we strongly agree with the notion that pro-cyclical fiscal stimulus in countries with full employment, an unsustainable upward dynamic in the public debt and a large current account deficit -like the USA- should be withdrawn. In the euro area, countries should prioritize rebuilding fiscal buffers, consistent with the Stability and Growth Pact. Widening debtor positions in key economies could constrain global growth and possibly result in sharp and disruptive currency and asset price adjustments. In this vein, we would have appreciated a stronger message and the inclusion of a shock scenario analysis in the case of slowdown or recession.

We agree that risks have become more clearly tilted to the downside, and some have already materialized. Escalating trade tensions which could disrupt global supply chains are a major risk to the global outlook. Protectionist measures put pressure on trade flows and seriously dent investor and business confidence, affecting both the AEs and EMDEs to a larger scale than some scenarios suggest. Therefore, we would like to reiterate and strongly encourage that any trade dispute should be resolved within the existing multilateral, rules-based trading system. Furthermore, any shift in market sentiment, which could easily result in a sudden and sharp tightening of global financial conditions and lead to a broader sell-off in financial markets, could have significant negative repercussion on EMDEs and LIDCs. Lastly, we welcome the inclusion of rising inequalities, cybersecurity and declining trust in mainstream economic policies as risk factors for global growth. We would add climate change as a macro critical risk for global economic growth that should remain firmly on the radar screen of the Fund.

We appreciate the analysis of drivers of the slow recovery after the 2008 meltdown in Chapter 2 but wonder whether the used methodology and time frame is sufficiently robust. Understanding the consequences of the crisis and the policy choices is very important in light of the persistence over time of the output and employment losses. Demonstrating the long run impact on demographic trends is also critical as these trends may aggravate the aging challenge. We encourage staff to continue working on this issue with fresh data that provide hints on the mid- and long-term implications of the global recession. It would be interesting if future analyses could include explicit measures of the pre-crisis macro-prudential policy. Could staff explain the 2011-2013 timeframe chosen for the regressions evaluating the impact of pre-crisis conditions? Does staff have concrete plans to conduct additional studies on the implications? What would be the focus of these studies?

We welcome the analysis in Chapter 3 and strongly agree on the importance of domestic factors for a country's inflation performance. Well-anchored inflation expectations strongly depend on the soundness and credibility of a country's monetary and fiscal frameworks. From a policy perspective, there is no alternative to having sound macroeconomic and policy fundamentals, as illustrated again by the events over the past months. Against this background, staff could have given more attention to the importance of central bank independency in anchoring inflation expectations, and the role of empirical measures of de jure and de facto central bank independence. Staff comments are welcome.

We also welcome the special feature part of the WEO on the relationship between energy demand and income, and support staff's future work on this topic. It rightly points out that increasing energy efficiency can play a significant role in supporting countries in achieving their developments goals, without constraining economic growth. Similarly, the Global Commission on the Economy and Climate highlighted in their recent report that transitioning to low-carbon, sustainable growth could deliver a direct economic gain of US$26 trillion through to 2030 compared to business-as-usual. All this sheds new light on the opportunities of the "green growth" which needs to be further analyzed.

Global Financial Stability Report

We broadly share staff's assessment that the near-term global financial stability risks have slightly increased since April, but could rise sharply, while medium-term risks remain elevated because of high debt and stretched asset valuations. The accommodative financial conditions continue to fuel leverage cycles both in advanced and emerging economies, and new risks emerge from the cyber and financial technology developments. The recent vulnerabilities build-up is furthermore worrying against monetary policy normalization, ongoing trade tension, and increased geo-political risks. The sensitivity of the financial system to these events has been well illustrated by the recent turmoil in some of the major EMEs.

The regulatory and supervisory frameworks have indeed been enhanced, both by deepening as well as by extending their reach. The consensus seems to be that the financial sector has become more resilient. As mentioned in the GFSR, however, the framework and the resilience of the financial sector have yet to be tested. The international standards of Basel III need to be incorporated into legislation as soon as possible. It also takes more time than initially envisaged in the BCBS standards to be implemented in a fully-fledged fashion. For instance, the TLAC eligible liabilities have not yet been built up in many cases and the resolution of many institutions still risks involving bail-outs rather than bail-ins. The increasing importance of non-bank lending shifts also risks outside the banking sector. We support efforts of the FSB and BCBS to evaluate the effectiveness of the reforms.

The financial regulatory reform agenda should be completed, and a rollback of reforms avoided. As the memory of the crisis fades, the "regulatory fatigue" reigns and regulators find it more and more difficult to convince legislators not to water-down the internationally agreed standards. We agree with the recommendation to proactively use macroprudential tools to address systemic risks. However, as the use of broad-based tools, like the countercyclical capital buffer rests on international agreements, including with regards to reciprocation, multilateral policy coordination remains critical. The sovereign-bank nexus remains an important vulnerability, especially in the EA, and further reforms should limit the preferential treatment of sovereign debt to reduce financial sector sensitiveness to problems faced by national governments. Thus, adequate monitoring and possibly new tools and regulation will be necessary going forward. Staff's comments are sought.

We endorse the call to supervisors and regulators to remain vigilant towards new risks and developments and to react proactively. The world is continuously evolving and the chances that the Fund will encounter the exact risks and problems are limited. We note that new risks stemming from technology development, like fintech and digitalization, have been recognized, but other risks like the climate-related risks on financial stability have not been discussed. We encourage further analyses on these new and emerging risks to achieve a better understanding of their implications for financial markets and global financial stability.

Fiscal Monitor

We fully share staff's assessment on the importance of balance sheet analysis (PSBS), which we consider most useful for achieving long-term fiscal policy objectives. A thorough understanding of a Government's assets and liabilities provides more flexibility to meet policy challenges, in both the short- and long-term. We therefore strongly support staff's efforts to develop tools to comprehensively analyze the resilience of public finances, among which intertemporal public sector balance sheets and fiscal stress testing. These tools help improve long-term fiscal projections and help reveal how well-placed Governments are to cope fiscally with, for example, building demographic pressures in the face of rapidly aging economies.

That said, we would like to caution against a simplistic application of the tools presented by staff. Indicators included in the paper should be used as one piece of information in any assessment of the state of public finances. They should, however, not give reason to defer necessary short-term fiscal consolidation, if indicators point to a possible, or likely, improvement of fiscal data in the long-term. For instance, a large gross net stock poses inherent fiscal risks on its own and independently of whether or not the net wealth position is strong, and/or outlook is positive.

In that sense, we welcome staff's emphasis on the need for Governments to strengthen balance sheets by reducing debt and investing in high quality assets. This holds in particular because public debt levels remain above pre-crisis levels in many countries. Staff's assessment complements our notion that fiscal buffers should be rebuilt while conditions are benign, in order to contribute to safeguarding the sustainability of public finances over the long-term and creating sufficient policy space in case of a downturn. In addition, we would like to underline the importance of the composition of public spending. In that light, we welcome staff's analysis in Box 1.2 (p. 36) that builds on earlier work of the Fund on the impact that private and public debt levels have on the pace of economic recovery after a financial crisis. The analysis shows that strong public sector balance sheets contribute significantly to a faster economic recovery after recessions due to a better ability to engage in countercyclical fiscal spending.

In order to overcome the availability of reliable data we believe that further efforts to improve public accounting systems should be sustained. In the meantime, the Fiscal Monitor could serve as a useful tool to present methodological work on how the balance sheet approach could be used in a data-constrained environment.

Mr. Beblawi, Mr. Geadah, Ms. Abdelati, Ms. Choueiri, Mr. Al-Kohlany and Ms. Merhi submitted the following statement:

World Economic Outlook

Global growth remains strong, but is moderating amid tightening financial conditions, rising policy uncertainty, and higher oil import bills. Risks that had been identified in the April WEO have partly materialized. Compared to our last meeting, trade tensions are more elevated, interest rates are higher, and financial conditions are tighter. The pick-up in U.S. growth, following the stimulus package, has been adjusted down, as well as the outlook for several advanced economies, while inflation remains below targets in Japan and the EU. In addition, global growth continues to be at risk from geopolitical tensions, in addition to unexpected market reactions to the normalization of monetary policies. Beyond the next two years, the report raises concern over the projected slowdown in global growth, reflecting low productivity, an aging workforce, and low labor market participation. Against this background, the WEO sees a pivotal role for domestic and multilateral policies to sustain the global expansion and enhance prospects for strong inclusive growth. We concur with this message and that strengthening resilience and tackling long-standing challenges have become more urgent.

We agree that advanced economies' macroeconomic policy stance should be tailored to their cyclical position, and that the major central banks should continue with data-dependent and well-communicated monetary normalization. Countries should continue with efforts to rebuild fiscal buffers, enhance inclusiveness, and accelerate structural reforms to increase productivity, including by raising investment in physical and digital infrastructure. We emphasize the need to fortify financial systems and to avoid a rollback of the post-crisis regulatory reforms.

Collective action is urgently needed to address rising trade tensions and other areas of multilateral policies. The IMF should continue to highlight the risks from further escalation of trade protectionism. We should continue to advocate for the benefits of open trade, while also recognizing the costs borne by some groups. In this regard, we welcome the simulations in the Box on Global Trade Tension that show that the impact of tariffs that have been imposed so far are small and limited to the United States and China. However, the costs would increase markedly should the United States proceed with imposing the 25 percent tariff on $200 billion in Chinese imports, as currently proposed. We broadly agree with the multilateral policy agenda outlined on pages 39-40 with respect to trade, global financial stability, migration, taxation, curbing corruption, and the sustainability and inclusiveness of global growth. Is there scope to raise the prominence of the need for collective actions and greater cooperation earlier in the report, including earlier in the Executive Summary?

Emerging market and developing economies (EMDEs) face a more challenging environment overall—while activity is strengthening for oil exporters, oil importers face higher import bills, and all countries face a stronger dollar and generally tighter global financial market conditions. A sub-group of EMDEs has also seen significant currency pressures, which have required adjusting policies. We agree that EMDEs need to be prepared to an environment of higher volatility. They need to apply monetary, fiscal and structural policies that enhance resilience and strengthen the credibility of their frameworks to maintain financial stability and debt sustainability, as market conditions tighten, and capital flows retreat. We agree that EMDEs need to keep inflation expectations anchored as commodity prices rise and, in some cases, currencies appreciate. The analysis in Chapter 3 demonstrates how credible fiscal and monetary policy frameworks could limit the passthrough of currency depreciations to domestic prices. The reference to subpar growth prospects for EMDEs and the low growth in per capita income is an important message that could motivate accelerated structural reforms.

Growth in our region remains subpar, due to structural constraints and continued fragility, partly due to political turmoil. Despite the sustained reform's efforts of many of our counties, including in creating a more enabling environment for the private sector, attracting investments and job creation remain a challenge. Nevertheless, many countries in our region continue to strengthen macroeconomic policy frameworks, address imbalances, build buffers, and implement policies to transform their economies. These reforms leave them better positioned to face increased volatility.

Box 1.1 provides timely and interesting analysis of increasing market power, especially in advanced economies, where it may have reached a strong level that negatively affects investment and innovation and is likely associated with lower labor shares and, therefore, increasing inequality. While staff considers it too soon to draw policy implications, it seems reasonable to consider the need to address gaps in anti-trust laws, and we would welcome staff elaboration of work in this area within or outside the Fund.

With oil prices at the highest level since 2014, we welcome the Special Feature on Energy Demand and the section on the demand and supply of renewable energy. Staff indicates that energy efficiency has raised the possibility of reaching a saturation point in the global demand for energy, which could leave producer countries with overcapacity and stranded assets. As demand has reached a zero elasticity to income in advanced economies, most of energy demand will come from emerging economies. The presence of an S-shaped relationship between energy and income would ultimately induce saturation in energy demand, but not for a long time. However, even as the total energy demand remains stable, the primary energy mix may shift and countries—especially those with higher income—are rapidly shifting to renewable energy technologies, notably solar panels and wind turbines that have become more affordable. This further underscore the need for countries that rely on export of coal, oil, and natural gas to accelerate structural reforms and diversification policies.

Global Financial Stability Report

Since our last discussion, near-term risks to global financial stability have increased. These risks could rise significantly with a sharper tightening of financial conditions in advanced economies and escalating trade tensions. Medium-term risks remain elevated because of persistent financial vulnerabilities related to high-debt levels and stretched asset valuations. Against this background, the October 2018 Global Financial Stability Report (GFSR) appropriately highlights the greater urgency for macro- and microprudential policies to build financial buffers, strengthen resilience, curtail rising leverage, and limit excessive risk taking, while containing financial stability risks, including new risks stemming from cybersecurity and financial technology. We concur with the main messages that advanced economies central banks should continue to gradually withdraw monetary accommodation, where appropriate, and countries with high public-sector debt burdens should aim to improve debt sustainability, and jurisdictions with high and rising financial and nonfinancial sector leverage should mitigate attendant vulnerabilities. It is critical that efforts to mitigate risks to global financial stability and to reform the global financial system continue to be coordinated internationally.

Since the April 2018 GFSR, market sentiment has deteriorated in some emerging markets and developing countries (EMDCs), driven by a combination of country-specific factors, worsening external financing conditions, and trade tensions. Staff notes that investors have been differentiating among emerging markets so far. Can staff provide an update on recent developments and the extent to which recent policy corrections have calmed markets? As advanced economies central banks proceed with monetary policy normalization, financial conditions will eventually tighten. This could reveal financial vulnerabilities that have built up over the years of accommodative policies and further reduce capital inflows to emerging markets. Aside from the idiosyncratic country-specific risks that have affected several countries' currencies, could staff comment on the evidence of reduced capital inflows or outflows related to the gradual normalization of interest rates and the dollar strengthening in other countries that don't have country specific risks?

Paragraph 36 in Chapter 1 shows that high levels of external debt and foreign currency debt are a source of vulnerability in some EMDCs. For completeness, and to avoid unnecessarily highlighting vulnerabilities in some countries, we suggest adding the following phrase at the end of line 7: "but these vulnerabilities are ameliorated by strong official reserve positions in some countries." Panel 4 of Figure 1.15 should also include foreign exchange reserve coverage.

We particularly appreciate Box 1.6 on Correspondent Banking Relationships (CBRs) and the recognition by staff that, although the global value of cross-border payments has not been affected by the withdrawal of CBRs so far, regional pockets of pressures remain. We concur with staff that concentration through fewer CBRs accentuates financial fragilities in some countries, which could affect these countries' long-term growth and financial inclusion. We fully support continued strong engagement by the Fund on ways to address the withdrawal of CBRs. Particularly, we support ongoing efforts to facilitate dialogue between regulators in home and host jurisdictions and among market participants, as well as capacity development programs to strengthen legal, regulatory, and supervisory frameworks, and assist supervisory agencies in the analysis of CBR trends.

Chapter 2 provides a useful stock-taking of the global regulatory reform agenda over the past decade. We welcome the finding that the regulatory agenda set by the international community helped to strengthen the global financial system, rendering it less leveraged, more liquid, and better supervised. We see merit in staff's advice to carefully monitor liquidity conditions, which is seen as fragmented. We also agree with staff that the regulatory reform agenda needs to be completed, the main priorities being the full implementation of the leverage ratio and of frameworks for the cross-border resolution of banks and for insurer solvency. Containing threats to financial stability stemming from new risks, including cybersecurity and financial technology, also warrant continued vigilance from regulators and supervisors. Can staff indicate what could be a potential role of the Fund in these areas?

Fiscal Monitor

We welcome staff analysis and policy recommendations in this Monitor, which focuses on managing public wealth and using the balance sheet approach to identify fiscal risks and evaluate fiscal policies. We certainly agree with staff that comprehensive balance sheets allow for better informed assessments of fiscal policies and risks. The added transparency would also enrich the policy debate about how public wealth can be better used to meet any society's economic and social goals. We concur with staff that including public corporations in fiscal analysis is necessary to assess and manage fiscal risk more effectively, especially given that considerable fiscal activity occurs outside the general government. However, and given that many entities can be involved, this exercise may be more complicated than it seems, and many countries will need capacity development in this regard.

Although we recognize that the balance sheet approach would help to identify mismatches and mitigate against different fragilities, we agree with staff that it cannot be interpreted in isolation of access to markets, institutional quality, and the monetary and exchange rate regime.

We note the lack of data availability and quality issues when looking at the broader public sector. We also note that efforts to incorporate the balance sheet approach into the Fund's work have been supported by many statistical and transparency initiatives introduced over the years to improve the availability of some key balance sheet stock data and the accuracy of these data. In particular, we can single out the SDDS requirements and the revised Government Finance Statistics Manual 2014, which support the balance sheet approach through a new statistical framework that systematically links flows and stocks. Given that the sample included in the Monitor only covered 31 countries, how would staff describe the current data issues? and how do they evaluate capacity development needs in this regard, especially in middle– and low-income countries?

Ms. Riach, Ms. White, Miss Chen and Mr. Hemingway submitted the following statement:

We thank staff for an informative and thought-provoking set of flagships. We appreciate that this was a challenging set of forecasts to produce. Since the Spring meetings, trade rhetoric in some regions has dialed up, financial conditions have tightened and several idiosyncratic events have occurred. Where risks have crystalised, the judgements are more straightforward. However, where uncertainty remains, such as due to ongoing and complex negotiations whose impact is not yet clear in the data, the judgements are necessarily more difficult. Since the impact from possible downside risks could be larger than modelled and the global growth peak appears to have passed, the Fund's message that policymakers must not be complacent - echoed with perhaps even more urgency in the Managing Director's Global Policy Agenda - is the right one. As ever, the challenge for the Fund is the speed with which domestic policymakers will build policy buffers and whether calls for enhanced economic resilience will be heeded.

We appreciate the work to streamline the reports. Striking the right balance between simplicity and depth, coverage and brevity is difficult and we think that reduction in chapters and greater use of special features and boxes goes some way to meeting that challenge. We would therefore encourage staff to build on these improvements and look for ways to further increase accessibility while still covering the key issues facing the membership. For example, summarizing some of the analysis and providing links to the underlying detail would have left room for some additional discussion of Low-Income and Developing Country issues including debt vulnerabilities.

World Economic Outlook

We broadly agree with the narrative that global growth remains strong and above potential, but less synchronized and balanced, with downward adjustments predominately driven by idiosyncratic events. In addition, global vulnerabilities remain material and the balance of risks has tilted further to the downside in the near term.

Forecasts for emerging markets are mixed. Many of those that have not experienced an idiosyncratic shock may continue to perform well despite policy normalization and trade tensions that will likely weigh on growth. Given the delicate environment, it is important for the Fund to be crystal clear in its policy advice. We think staff could delineate more with respect to which policies are helpful as preemptive measures and ones that should be used when closer to crisis, particularly in advice on reserve accumulations and capital flow measures to manage FX mismatches.

We welcome the chapter on spillovers from monetary policy normalization in advanced economies and note the complementary analysis in the GFSR that even under a relatively benign baseline scenario EMs will likely experience capital outflows. We agree clear and transparent communication from central banks in advanced economies is important to help manage spillovers. However, communication is just one component in managing risks from normalization and we would be interested in staff views as to what more the Fund can do to help to move the debate beyond transparency.

Uncertainty surrounding the future of the multilateral system continues to weigh on investment appetite. We found the global trade tensions scenario box helpful at drawing out the different potential channels for trade effects. However, we note that the range of possible outcomes is large and modelling the potential impacts is difficult. In particular it is generally difficult for macroeconomic models to fully capture disruption of complicated global value chains and trade diversion may not provide as much offset as staff's modelling suggest. We welcome the Fund's call for multilateral cooperation and note that it could be more explicit in promoting increased service trade liberalization (where there are broader growth grains to be made) as a way of resolving trade tensions. More generally, we continue to believe that the IMF has a critical role to play in making the case for adhering to the rules-based system, free trade and the multilateral order.

Fiscal Monitor

We welcome the analysis of public sector balance sheets in the October 2018 Fiscal Monitor and the development of the underlying methodology. Since first publishing Whole of Government Accounts in 2011, the UK has benefited from the complementary picture of the public finances a balance sheet approach provides. The Fiscal Monitor helps to strengthen the understanding and management of the public-sector balance sheets and the risks around them, as well as demonstrating the potential value of this approach regardless of specific country circumstances. We particularly welcome the examples highlighting the potential impact of non-economic shocks such as natural disasters on public balance sheets, given that such scenarios are becoming both more frequent and more severe, so must be considered more systematically going forward.

The Fiscal Monitor highlights the potential for useful assessments of the public-sector balance sheet across the whole membership and in a wide array of circumstances. However, we also note remaining methodological and data challenges associated with public sector balance sheets. It is therefore important these limitations are reflecting in analysis based on public sector balance sheets and these assessments are used as complements to – rather than replacements for – existing fiscal indicators and policy messages. We are aware of the challenge staff have in communicating clearly that their central message to rebuild fiscal buffers is not undermined by the finding that most of the 31 countries included in the Fiscal Monitor have a positive net wealth.

Global Financial Stability Report

We support the use of the 10th anniversary of the global financial crisis to remind policymakers of its substantial and long-lasting impact on virtually all countries and to reflect on the lessons learnt. Notwithstanding the fact that financial crises can be hard to predict, and the next crisis will likely look different to the last, we must guard against complacency, reiterate the importance of maintaining high regulatory standards and be vigilant in respect of emerging sources of risk.

Much progress has been made on the global financial regulatory architecture over the past 10 years. However, we note staff have observed a slowdown in implementation and urge policymakers to complete the regulatory reform agenda to ensure a strong foundation for an open and safe financial system. We agree with the overall conclusions in Chapter 1 that policymakers should consider developing new tools for use outside the banking sector, closely monitor the increase in corporate debt and pursue greater coordination of efforts across borders. In particular, we support implementing comprehensive and globally consistent standards for asset managers to allow regulators to identify and mitigate risks such as those from liquidity mismatches and leverage risks.

We welcome the box on the financial stability considerations pertaining to Brexit. Staff's baseline scenario assumes a broad trade pact with a relatively smooth exit process yielding the best outcome for both parties, and we note that a more disruptive departure from the EU would yield a significantly worse outcome. We broadly agree with staff's analysis and recommendations and would highlight that the UK authorities have, inter alia, committed to legislating for temporary permission and recognition regimes to minimize disruption to financial services in the event of a disorderly exit. We would disagree with the assertion that the "odds of a no deal Brexit appear to have increased". The UK government remains committed to agreeing a bold, ambitious new partnership with the EU.

We commend the further development of the growth-at-risk approach and the focus on the underlying vulnerabilities that skew real GDP growth distribution. And we concur with the overall narrative that global risk vulnerabilities remain material with some likely to crystallise in the near term. Further analysis and commentary on rising risks emanating from the corporate sector would be welcome in future updates and reports. Looking further ahead, we welcome the evolution of FSAP over the past decade and see next year's review as an important opportunity to maintain that progress. For example, as risks shifts towards the non-bank sector, staff need to complement existing tools with new ones targeted at emerging risks.

Mr. Sembene, Mr. Nguema-Affane, Mr. N'Sonde and Mr. Diakite submitted the following statement:

We welcome the set of flagships and the analytical chapters on the stocktaking of the global recovery and regulatory reform as well as policy challenges facing emerging economies confronted with tighter financial conditions. Against the backdrop of the current international conjuncture characterized by heightened risks and significant policy uncertainty, we endorse staff's call for urgent and coordinated policy actions.

World Economic Outlook

The report describes the current context as being a setback to the outlook that prevailed six months ago, with notably a less balanced global expansion, downward revisions of global growth projections; and short- and medium-term downside risks. In addition, trade tensions continue to weigh heavily on immediate and longer-term prospects through adverse effects on consumer and market sentiment, investment, and productivity. Alongside these tensions, tightening financial conditions pose a significant risk to macroeconomic and external stability in EMDCs especially those with weak fundamentals. We are of the view that the WEO and GFSR would gain from greater emphasis on the spillovers of financial conditions to EMDCs, including frontier economies. Staff's comments are welcome.

Furthermore, the assessment on demographic trends should be more differentiated. While working-age populations grow very slowly in advanced economies—dampening medium and long-term growth prospects—the fast-rising youth populations in developing countries, especially Africa, present risks but also opportunities as these countries could reap significant benefits from demographic dividend if they invest efficiently in education and healthcare systems to improve human capital and advance necessary labor market reforms.

Going forward, it is important to sustain the focus on noneconomic risks, notably those related to security challenges and geopolitical tensions, which often feed fragility and have considerable macroeconomic implications. In this connection, we would have expected more granular policy prescriptions for countries in fragile and conflict situations.

Regarding Sub-Saharan Africa (SSA), we are puzzled with the bleak picture presented in the report (e.g. "tepid growth", "subdued prospects"). In our view, the assessment of the region's prospects should be more nuanced and granular given the heterogeneity of situations. While we agree with the need for fiscal adjustment and economic diversification in many SSA countries, the fundamentals, growth performance and outlook remain robust in many others, notably non-commodity exporters and diversified economies. In this light, the tone of the flagship should be more balanced to avoid potential undesirable effects on market confidence

We call on the Fund to ensure that the issue of illicit financial flows is given more prominence and attention in policy discussions on international taxation and raising domestic revenue mobilization in LICs.

We believe that a holistic and evidence-based approach to addressing debt vulnerabilities is warranted. In this regard, the Fund flagships should explore ways to address vulnerabilities related to public and private debt in all segments of the membership level rather than just LICs. This would be consistent with recent staff's work that confirms that both types of debt are currently at a record high. It is also critical to recognize that improving debt dynamics is a shared responsibility of both debtors and creditors. For LICs, increased transparency and improved management of public debt will be important, and capacity building will continue to be critical. That said, preserving debt sustainability will also require overcoming the daunting challenges facing many countries in mobilizing resources needed to achieve SDGs, including through increased domestic resource mobilization efforts and private investment. Furthermore, the Fund should play a key role in helping establish effective debt restructuring mechanisms involving all creditors, particularly for the benefit of developing countries in debt distress.

Global Financial Stability Report

Global financial conditions deteriorated since April 2018 reflecting tighter financial conditions in the EMEs, with some of them experiencing particularly strong market pressures, including capital outflows. We take good note of the indication by the report of limited spillovers between emerging markets, and of an effective investor differentiation among emerging markets, as the countries most affected by market developments were those with weaker policy frameworks, who experienced idiosyncratic events, or who are more exposed to trade tensions. LICs are also among the most affected as evidenced by the sharp decline in international bond issuances. Could staff elaborate on whether any differentiation is perceptible within this group?

We welcome the GFSR's retrospective and prospective look at the strengthening of regulatory frameworks. Significant progress has been made since the global financial crisis, and recommendations to address remaining vulnerabilities in the global regulatory architecture are appropriate. The section on the main failings in the global financial framework prior to the GFC could have delved more into the extent to which failings were known, debated and addressed not only at the IMF but also by other stakeholders in the international financial system. Staff comments are welcome. We note that the overhaul of the global financial system has led to the emerging of new vulnerabilities, notably with respect to market liquidity, while financial technology has brought about new challenges for regulators. We agree that these new vulnerabilities should be closely monitored and dealt with to safeguard the global financial system.

Fiscal Monitor

We welcome the focus of the October 2018 Fiscal Monitor on highlighting some of the benefits and challenges of developing public sector balance sheets (PSBS) which are important telling indicators of public wealth. More than simply debt and deficits, the PSBS approach provides a broader picture of public assets and liabilities accumulated by countries, and therefore enables a more accurate analysis of fiscal sustainability.

We take note of the findings from the case studies and find helpful the conceptual framework and tools proposed to analyze the resilience of public finances and achieve the objectives of public policy. The increasing use of accrual accounting by governments around the world has led to an increase in the availability of balance sheet information.

We concur that PSBS analysis can provide a useful framework to identify and test resilience to risks that could result in significant fiscal and financial losses with important macroeconomic consequences. We find the inclusion of an intertemporal dimension in the balance sheet framework to be very relevant. The determination of the long term intertemporal net worth in the framework, combining discounted future flows of revenues and spending with the static balance sheet puts emphasis on the need to manage resources for the long term as well as the short term, to deliver sustainable economic growth. As future generations will bear the consequences of current policies, it is essential to have a proper understanding of how public assets and liabilities will change as a result.

Having that said, PSBS can only be useful if the information is of good quality and there is a strong commitment to effectively use them in a transparent manner. In this regard, there are important challenges associated with the estimation of public sector balance sheets, particularly in LIDCs not least the quality of data and standardization of various accounting systems. One point in case is the difficulty of assessing the economic value of some natural assets in LIDCs, or land, and incorporating them in a balance sheet.

There are also important challenges in terms of human resources and institutional quality in implementing PSBS. The level of policy coordination and institutional strength required may not exist in many countries. In this regard, we support a gradual process, starting with basic balance sheet estimates, and subsequently improving accounting and statistical collections over time to produce reliable PSPS. This requires developing capacities along the process.

Mr. Jin submitted the following statement:

The global economy has continued to recover as a whole, but the pace has further diverged and become less balanced. We concur with staff's view that the balance of risks is tilted to the downside, both in the short term and beyond. Recovery in advanced economies has become less synchronized with economic activity moderated in some large advanced economies. Growth in emerging markets and developing economies has also continued to diverge, albeit generally at a more rapid pace, with some emerging markets facing substantial pressures to achieve macroeconomic balance.

Trade frictions and monetary policy normalization in the major economies add uncertainties to the global economy and financial markets. We concur with staff's view that downside risks have accumulated, and some highlighted risks have partially materialized. Many people are now mainly focusing on and looking at countries directly involved in trade disputes as outsiders, observers and even potential beneficiaries. But history shows that a trade war will become a disaster for the world economy as a whole. The country that started the trade war will get backfired. Many medium and small-open economies will suffer the most, because world trade would shrink, while larger economies could adapt more easily and become more self-reliant than their smaller and more open counter-parties.

The IMF should support reforms to the existing multilateral trade system. It also needs to make it very clear that: shortcomings of the existing system should be resolved in an orderly and rules-based way and should not be used as an excuse for unilateral, coercive and destructive trade policies. History shows that when people are using a seemingly righteous goal or purpose to justify an illegal action they take, some tragedy will likely happen sooner or later. We should not forget that the IMF was established exactly for the purpose of preventing those historical mishaps from happening again.

Financial markets of some emerging market economies have come under pressure. Due to a stronger dollar, geopolitical tensions, growing risk aversion and lack of investor confidence, emerging market economies with weaker fundamentals and high external debt were the worst hit in the recent bouts of financial market turmoil in May and August. Even those emerging markets with stronger fundamentals and larger policy space can hardly escape. Worsening financial market conditions could increase debt vulnerabilities. Although emerging market economies have generally become more resilient than in 2013 and 2015, the possibility of a new crisis cannot be ruled out.

The recovery momentum should be sustained by an appropriate mix of multilateral and domestic policies. Escalating trade tensions and a damaged multilateral trade system pose key threats to economic growth. First and foremost, trade tensions need to be resolved in an open, rules-based multilateral trade system and with a cooperative and constructive approach. Monetary policy normalization not only needs to be well communicated and data dependent, but also needs to be supported by the necessary measures taken by the IMF, such as possible liquidity support and even new issuance of SDR. Fiscal policy needs to focus on rebuilding buffers while calibrating with the growth needs. Procyclical fiscal stimulus, which would contribute to higher global imbalances and come at the cost of lower future growth, should be more loudly alerted. The window of opportunity of the recovery should be seized to implement broad-based structural reforms to lift long-term potentials and achieve inclusive growth. Multilateral cooperation is warranted in international taxation issues.

We share staff’s view that near-term risks to global financial stability have increased. Staff’s capital-flows-at-risk analysis reminds us that we cannot be complacent. Authorities therefore need to stay vigilant and remain mindful of potential spillover risks arising from their own policies. We also encourage staff to step up engagement with members economies across the board, advanced and emerging and developing economies alike, to help members to weather the turbulence ahead. For low-income countries, for example, the Fund's assistance in enhancing debt management capacity, policy frameworks, and governance would help reduce the vulnerability of these markets under tough external conditions.

We welcome the Fund's analysis on the public sector balance sheets (PSBS) of member countries and agree that better balance sheet management would help improve fiscal policymaking and reduce fiscal risks. The Chinese government is taking active steps to compile its balance sheet, which would provide a full picture of public wealth and increase international comparability. We note that the coverage varies in the PSBS dataset, understandably based on data availability. Nevertheless, mismatch between assets and liabilities should be avoided. For example, calculation of the financial liabilities of China's general government adopts the "augmented" concept by including local government off-budget borrowings, whereas the infrastructure in the asset side that has been financed by such borrowings is not included. We call on staff to properly address the debt incurred to finance infrastructure, which will generate income in longer run. When bringing onto the balance sheet the liabilities (whose perimeter is also subject to debate), the assets—in the form of work-in-progress as well as future prospective returns—should also be included, to analyze the net debt of infrastructure investment.

Discretionary fiscal policy could be used as a tool for countercyclical demand management. We appreciate the deep analysis presented in the WEO Analytical Chapter 2 on the global recovery 10 years after the crisis, which uses a sample of 180 countries to quantify the output losses and examine the related actions. Among the main findings, sluggish investment appears to be a key channel through which losses were registered. In this regard, appropriate fiscal stimulus could offset weak demand by stimulating infrastructure development and social housing construction, which in turn could ultimately promote economic growth and generate favorable spillovers to its trading partners, as evidenced by China's 4 trillion yuan stimulus during 2008-11.

The Chinese economy has performed well. In the first half of 2018, GDP grew by 6.8 percent. Inflation went up modestly with CPI increasing by 2.3 percent in August. Employment has continued to improve with the surveyed urban unemployment rate at 5.0 percent in August. Industrial growth began to rebound, and corporate profits increased 17.1 percent in the first seven months. The consumption's contribution to growth has increased to

78.5 percent in the first half of this year. In the first seven months, the trade surplus narrowed by 30.6 percent. With the support of strong economic fundamentals and a versatile policy toolkit, we are confident that the economy can withstand external shocks and avoid systemic risks. Going forward, the authorities will continue to open up and press ahead with financial regulatory reforms, while maintaining financial stability.

Mr. Leipold, Mr. Psalidopoulos, Ms. Collura, Mr. Spadafora, Ms. Cerami, Mr. Di Lorenzo and Ms. Lopes submitted the following statement:

We thank staff for a comprehensive set of reports. We broadly share the staff's assessment of the global outlook and related risks as well as the policy advice, notably the emphasis on multilateral cooperation. We also appreciate the thread running through the flagships, in terms of a stock-tacking of the lessons learned from the global financial crisis (GFC) ten years later, as a helpful guide for current policy actions.

Outlook

While the global economy continues to expand, the overall picture emerging from the WEO is qualitatively distinct – and more worrisome – than that prevailing six months ago. The global economy might be at (or approaching) an inflection point, is surely less synchronized, and downside risks have intensified, including in the short term. Among these, rising trade tensions and the reversal of capital flows to emerging market economies (EMEs) loom large. Indeed, these risks have essentially materialized since April 2018. In particular, trade tensions have escalated further since circulation of the WEO, following this week's tariff announcements by the US. We would be interested to hear to what extent these materially change staff's projections and risk assessment. At the same time, one is hard-put to identify any potential upside surprises.

Besides risks that have materialized, still-easy global financial conditions could tighten sharply – and already have for several EMEs. Tighter global financial conditions are in the making as a result of monetary policy normalization in the US on top of a contractionary fiscal policy in advanced economies (AEs) projected to start in 2020. Against this background, elevated policy uncertainty and doubts on the remaining longevity of the current recovery increase the risk of self-fulfilling shifts in expectations and market sentiment, which in turn could trigger a sudden correction in market valuations and an abrupt tightening of financial conditions, which has indeed already occurred in most EMEs since April. As noted in the GFSR, the magnitude of this tightening is, in the aggregate, comparable to that which occurred during the 2013 taper tantrum, potentially dampening growth prospects.

In an adverse scenario, EMEs face a risk of portfolio capital outflows of a magnitude similar to the one observed during the GFC, as well illustrated by the new capital flows-at-risk analysis in the GFSR. This concern is somewhat tempered by evidence of markets' capacity to discriminate among EMEs according to their fundamentals, with pressures focused on countries with an increasing share of external foreign currency debt. The flagships rightly highlight how EMEs' vulnerabilities are magnified by the large increase in debt recorded in recent years, notably in the corporate sector, and by the widespread exposure to exchange-rate risk (while at the same time exchange rate flexibility remains a key shock absorber, as evidenced in Chapter 2 of the WEO).

More worryingly, the number of low-income countries with debt-to-GDP ratios above critical levels has continued to increase, calling for a concerted policy response by both creditors and debtors. The increasing fragmentation of creditors and debt instruments is of concern. There is a pressing need for greater creditor-debtor engagement toward more sustainable lending practices and enhanced debt transparency. The pursuit of highly-needed investment must rest on resource mobilization and underlying fiscal soundness.

Trade Tariffs: A Self-Inflicted Wound

The WEO provides ample evidence of the negative impact of global trade tensions stoked by the imposition of tariffs. We particularly appreciated the compelling analysis presented by staff in Scenario Box 1 of the WEO. Its multi-layered approach is helpfully illustrative of the costs to the global economy in each step of an eventual escalation of trade restrictions. Slower export growth has already contributed notably to the euro area slowdown. As expected, protectionist policies are a negative-sum game or, more plainly, a self-inflicted wound to the global economy and its longer-term prospects. This at a time when output growth is already projected to decline toward its potential rate, below its pre-crisis pace (with the relevant exception of the US).

An escalation of trade tensions can generate negative spillovers beyond the current cycle, exerting a longer-term impact via its effects on confidence and investments, as well as on financial conditions. As well documented in Chapter 2 of the WEO, the fall in investment triggered by the GFC was the main driver of the permanent output losses suffered in the following years. Moreover, the GFSR (Box 1.2) underscores that mounting trade tensions can be a source not only of sharp increases in near-term risks to financial stability but also of shocks to financial conditions, leading to more persistent effects on future global growth.

Protectionist policies are destined to have a negligible impact on the external imbalances they purport to address. Excessive external imbalances remain a source of risk to global stability. We support the Fund's advice on the policy actions needed to address such imbalances, both in relevant debtor and creditor countries. At the same time, we would recall the last External Stability Report's (ESR) observation that "the persistence of external imbalances – especially on the surplus side (emphasis added) – continues to be a feature of the global landscape," reflecting the asymmetry inherent in the global payments imbalances adjustment process.

The Tightening of Financial Conditions: Still Marginal and Localized

While the tightening of financial conditions has so far been marginal and localized, a recurring question is what could trigger a sudden, more generalized shift. With output gaps closed or expected to close in most cases and inflation firming up, we concur that inflation surprises in the US (including from increases in import tariffs) remain the leading candidate to act as a trigger for a more rapid tightening of global financial conditions and the materialization of attendant risks. The recent uptick in wage growth for US non-farm payrolls lends concreteness to this risk. Policy mistakes should also be included in the list of potential triggers.

Evidence of some market complacency around the risk of a sharp tightening of financial conditions, as reported in the GFSR, is of concern. On market expectations of the future evolution of US interest rates, we wonder if there is a possible misalignment between the sentence in paragraph 13 of the GFSR ("near-term market-implied interest rate expectations have drifted higher, but still lag the median policy rate expectations of the FOMC") and that in paragraph 30 ("over the past year, market participants have substantially revised upward their expectations for the likely path of US interest rates"). Staff's comments are welcome.

Financial Regulatory Reforms: The Way Forward

A rollback of financial regulatory reforms and "competitive deregulations" must be avoided. The staff's analysis in Chapter 2 of the WEO illustrates the impact of banking crises on the persistence of output losses. A rollback of financial regulatory reforms, designed to avoid a repeat of this experience, would be clearly ill-advised.

Important financial reforms still need to be implemented. Going forward, as evidenced in Chapter 2 of the GFSR, authorities are well advised to focus on completing the resolution framework of systematically important institutions, intensifying the supervision of large banks, strengthening the macroprudential framework based on more comprehensive and timely data, and expanding the regulatory perimeter to prevent regulatory arbitrage and safeguard financial stability.

In contrast, we see less scope for further regulatory reforms in the near term on some widely debated issues, such as the treatment of banks' sovereign exposures, which have recently been thoroughly analyzed by the Basel Committee on Banking Supervision (BCBS) without reaching a consensus on the best way forward. We would therefore advise against raising expectations of potential changes of the current framework until consensus is reached on a more robust and holistic approach to address the sovereign-bank nexus, based on both micro and macroeconomic risk considerations.

On the sovereign-bank nexus, the staff's analysis should have taken a more holistic approach – as done in the recent Departmental Paper on Managing the Sovereign-Bank Nexus – by recognizing that a bank's holding of sovereign debt is only one of the channels through which sovereigns' conditions can affect banks. Banks and their sovereigns are everywhere strictly intertwined, independently of banks' holdings of sovereign bonds. The link between banks and their sovereign cannot thus be simply ascribed to the sovereign exposure of banks; it primarily depends on the link that both banks and sovereigns have with the real economy. A key conduit is the macroeconomic channel, as sovereign distress negatively impacts economic growth and ultimately increases the insolvency rate of domestic households and firms. Accordingly, the analysis should have recognized that the correlation between sovereign spreads and banks' credit default swap spreads can be accounted for by factors other than banks' holdings of sovereign bonds, such as macroeconomic variables and bank-specific factors (e.g., capitalization, profitability).

The Three-Pronged approach Is Valid

Against this background, we support the staff's overarching call for policies that reverse the risk of slowing momentum, strengthen resilience and raise medium-term growth and its degree of inclusiveness. The three-pronged approach still holds; in particular:

structural reforms are key to sustaining the recovery in investment and boosting productivity, including by increasing labor force participation;

fiscal policy should remain growth-friendly, as advised by staff. Countries with ample fiscal space should increase public investment, while those with limited fiscal space should re-think the composition of public expenditure and revenue to reduce resource misallocation, support public investment, and facilitate private investment, while rebuilding buffers as much as possible;

for monetary policy, the WEO sums up its guiding principles well: data-dependent, well-communicated, and country-specific. In essence, monetary accommodation needs to continue where inflation is weak (notably in the euro area, given also a strong backward-looking element in shaping inflation expectations), while cautious normalization will need to proceed where inflation is close to target.

The call for resuming public investments, especially where they have declined the most, while preserving debt sustainability, is also reinforced by the findings of Chapter 2 of the WEO which highlight the impact of a fall in investment on the persistence of output losses. We also welcome the staff's recognition of the countercyclical role of discretionary fiscal policy.

We also share the policy conclusions (WEO, Chapter 2) on the need to advance on euro area architecture. As noted by staff, output losses in the aftermath of the GFC could have been reduced with a more advanced integration in the monetary union's architecture. This lesson needs to be drawn, with progress in closing the remaining gaps, in particular with regard to area-wide banking and capital markets union and a central fiscal stabilization capacity.

Analytical Studies

Fiscal Monitor: The Public Sector Balance Sheet

We welcome the analysis of the Fiscal Monitor on the Public Sector Balance Sheet (PSBS) methodology. In terms of fiscal strategy, such a comprehensive approach reveals the importance of improving public sector balance sheets, not only by reducing debt but also through investment in high-quality assets.

Even more insightfully – and challenging – the inter-temporal balance sheet analysis helps analyze the consistency of policies over time, incorporating current wealth with future revenue and expenditure; in this regard, we found the case study on Norway especially telling.

Such an approach can usefully complement the traditional analysis of public deficits and debt. By bringing to the fore possible trade-offs between short-term and long-term policies, it might also give rise to divergent policy indications – as illustrated by the example of privatizations, which increase revenues and lower debt, but also reduce the government's asset holdings.

That said, one must remain mindful of the challenges of the PSBS methodology, such as the availability of the necessary data, the uncertainty intrinsically related to evaluations, extended time horizons, and the choice of discount rates. These challenges might prevent cross-country comparisons, unless the scope of the PSBS is limited to exclude those assets/liabilities where valuation uncertainties might be more prominent, such as infrastructure or natural resources. We encourage staff to conduct more analytical work to temper such uncertainty.

The Global Recovery 10 Years After the 2008 Financial Meltdown

The analysis of the output losses since the GFC, their drivers and consequences, is relevant ant timely. While differing in relation to starting points, structural characteristics, and policy frameworks, ten years after the 2008 meltdown GDP in a majority of the observed economies still lags behind the level that would have prevailed in the absence of the crisis. These results are consistent with the findings, reported in previous Fund research1, that in fifty percent of the cases a recession is followed not just by lower

[1] O. Blanchard, E. Cerutti, L. Summers, Inflation and Activity – Two Explorations and their Monetary Policy Implications. IMF WP/15/230.

output levels, but also by lower output growth relative to the pre-recession trend. It is particularly worrisome that in some countries, including in our constituency, income per capita ratios are still well below the pre-crisis levels. More generally, we note that there is no mention in the Chapter of the role of uncertainty and the sharp falls in confidence that presumably worked to prolong the crisis and, along with banking system shortcomings, go a long way to explain the investment gap.

Staff's empirical results indicate that countries with higher firing costs suffered large post-crisis losses in output as these costs thwarted job creation during the subsequent recovery. It would be interesting to understand if the analysis has taken into account channels through which employment protection legislation might have helped to contain job losses during the most acute phase of the crisis. Staff's comments are welcome.

Challenges for Monetary Policy in EMEs as Global Financial Conditions Normalize

The chapter focuses on whether recent improvements in inflation performance in many (but not all) emerging economies are mostly related to a benign global environment or to domestic factors. The findings of the chapter point to domestic – rather than external – factors as the major contributors to the positive performance and identify inflation expectations as the key driver. That said, it should be noted that inflation expectations are still higher than target inflation in these countries and also higher than inflation expectations in advanced economies. There is furthermore considerable heterogeneity across countries.

We welcome these findings and agree that strong institutional frameworks, both on the monetary and fiscal fronts, are fundamental to ensuring confidence and thus anchoring agents' expectations. We also note that economies with better anchored inflation expectations were able to keep monetary policy relatively more accommodative during the taper tantrum, thus exercising a lower drag on growth.

Staff also makes the case that if inflation expectations are better anchored, there can be a greater role for monetary policy to be used as a countercyclical tool. On this point, we tend to be more cautious as the paper does not seem to focus on possible reverse causality effects: is it possible that inflation expectations are better anchored exactly because monetary policy is not expected to be used, at least primarily, as a countercyclical tool? And if a country chooses to start using monetary policy in a countercyclical fashion, to what extent would the anchoring of inflation expectations be affected? Staff's comments would be appreciated.

Regulatory Reform 10 Years After the GFC: Looking Back, Looking Forward

We welcome the chapter on the review of the regulatory reform launched in response to the global financial crisis and agree with its main conclusions, namely that the financial system is more resilient today on the back of better capitalized, less leveraged, more liquid, and better supervised financial institutions.

Given this overall positive assessment, we also strongly support and emphasize the main message and policy recommendation that any fine-tuning of the post-crisis regulatory framework should not lead to a rollback of the its building blocks, nor should it encourage a race to the bottom in regulation and supervision.

At the same time, the report rightly highlights several remaining weaknesses, which require further progress to complete the reform agenda, as revealed by the findings of the FSAPs conducted in several member countries over the last years. This draws due attention to the important role of FSAPs in building a more resilient international financial system through the Fund's assessment of national frameworks and technical assistance in the implementation of international regulatory standards also in jurisdictions outside the Financial Stability Board.

Looking beyond the banking sector, the still infant but rapidly evolving fintech sector provides a good example of the challenging trade-offs faced by regulatory authorities in the treatment of alternative forms of financial intermediation; namely, promoting financial deepening, innovation, and greater competition on the one hand and mitigating risks to financial stability, integrity, consumer protection as well as cybersecurity on the other.

Ms. Pollard, Ms. Crane, Ms. Svenstrup and Mr. Vitvitsky submitted the following statement:

Introduction

Winter is coming. That appears to be the message from the Fall 2018 World Economic Outlook (WEO), Fiscal Monitor (FM), and Global Financial Stability Report (GFSR), replacing the more upbeat message from the Spring report: The Sun is Shining: Fix the Roof. While we recognize that global growth has become less synchronized and somewhat softer, and that several large emerging market economies have had recent growth downgrades, the tone of the report struck this chair as excessively dark. Global growth is projected to remain at its highest rate since 2011 in both 2018 and 2019. Moreover, for EMDCs, growth in 2019 is projected to remain at or above 2018 rates across all regions, except for Europe. We also disagree with the assessment of the main factors behind the view that downside risks are rising. Despite these differences in views we welcome the rich set of analytical products on public sector balance sheets, lessons learned from the 2008-09 global financial crisis, and monetary policy in emerging markets, provided by the WEO-FM-GFSR.

Economic Outlook and Policy Recommendations

We welcome the continued global economic expansion. We value the IMF's analysis of gathering risks to the global economic outlook but believe the WEO could strike a better balance between taking risks seriously while recognizing underlying strengths. As global financial conditions have tightened, key economies have continued to perform solidly. Strong U.S. growth has been positive for the global economy. We disagree with the IMF's persistent warnings that U.S. fiscal policy is leading toward a slowdown in U.S. growth in the coming years. We continue to expect our tax reforms to spur structural improvements in the U.S. capital stock, the labor force participation rate and productivity that will durably raise U.S. potential growth.

While we agree that monetary policy tightening has material effects on emerging market capital flows, to date, sharp financial turbulence in Argentina and Turkey are primarily because of their underlying vulnerabilities, and stresses in other emerging market economies appear in proportion to their macroeconomic and financial vulnerabilities. The Federal Reserve will continue to communicate its gradual policy tightening as clearly as possible and to analyze possible spillovers of its policies carefully.

The vulnerabilities identified in the WEO require proactive policy action, but they should not be overblown. While emerging markets need to be prepared for rougher seas ahead, we have not witnessed a wholesale pulling back from emerging markets. Instead, pressures have intensified for those economies with large vulnerabilities, suggesting that markets are continuing to differentiate based on fundamentals and policies. We concur with the findings in the WEO on the potentially destabilizing effects of rising public debt in a number of developing economies.

Regarding rising trade tensions, we see this through the lens of U.S. efforts to more directly address restrictive trade practices. Additional IMF analysis on tariff and non-tariff barriers, with a focus on less open trade regimes, would be constructive. While the Scenario Box highlights various ways that tensions and impacts could deepen, we would point to the possibility of an outcome in which we are able to resolve these issues in a positive way, which would lower global trade barriers. While there is some anecdotal evidence of possible broader impacts of trade uncertainty, we have not seen such impacts showing up in hard data. In examining the effects of trade uncertainty on investment, staff use the economic policy uncertainty rather than a more specific trade policy uncertainty index. Staff comments would be welcome.

We largely concur with the policy recommendations for advanced, emerging and low-income economies, aimed at extending the momentum of the current strong growth and raising medium-term prospects. Bringing inflation to target, building buffers, enhancing financial sector resilience and adopting structural reforms to boost growth potential comprise a sensible prescription. We would also stress the importance of action to reduce persistent current account surpluses.

Managing Public Wealth

We welcome the focus of the FM on Managing Public Wealth. Staff's analysis on public sector balance sheet assessments across advanced economies, emerging markets, and low-income countries is an excellent contribution to its membership. We appreciate that the report was, for the most part, not just an academic exercise but offered some tangible lessons for fiscal policy.

The report also fits very well with the Fund's increasing focus on public debt transparency, which this chair has strongly supported. The inclusion of The Gambia as a case study suggests that public sector balance sheets can be assembled even in constrained data environments. Can staff comment on whether building basic country balance sheets could address gaps in public debt transparency for economies with capacity constraints, particularly for large bilateral liabilities?

We appreciate the report's added time dimension to set up an intertemporal balance sheet framework, including in Figure 1.2. Amid demographic pressures in many advanced economies and emerging markets, the "Future Spending" line item is particularly relevant. In this context, the Finland and Indonesia case studies were insightful, pointing to the importance of pension and other reforms in Finland to improve intertemporal net worth, and demonstrating the positive impact of public investment in infrastructure on Indonesia's net worth, as well as its potential GDP. We hope that this latter case study could provide an impetus to countries with large current account surpluses, including those facing demographic challenges, to boost public investment.

Additionally, the FM appropriately discusses the importance of quality, liquidity, and marketability when assessing assets on a country's balance sheet. Still, it was unclear whether the report would suggest greater use of net versus gross debt for debt sustainability analyses across the Fund's membership. For example, staff utilize net debt for the UK in a case study, the main fiscal measure used in the UK. Staff comments would be welcome. Can staff also elaborate on why central bank foreign exchange reserves were excluded from the analysis?

Global Financial Conditions

We broadly agree with staff's assessment that global financial conditions have marginally tightened over the last six months, with a growing divergence between AEs and EMs. We continue to believe that the U.S. financial system is on strong footing, with moderate financial stability risks. We welcome continued analytical work and focus by staff on ongoing weaknesses in the banking and non-bank sectors, as well as on emerging risks, including on U.S. dollar funding risks in non-U.S. banks.

While we agree with staff's analysis of risks related to capital outflows from emerging markets, much of it is focused on U.S. monetary policy normalization, rather than on the underlying vulnerabilities in emerging markets themselves. As noted above, although we agree that monetary policy normalization can have effects on emerging market capital flows, we do not see normalization as a financial stability risk, as it is largely in the context of stronger growth and is being clearly communicated. Moreover, the United States is not the only advanced economy that is gradually unwinding accommodative monetary policy.

We appreciate staff's analysis of risks associated with Brexit. We are particularly concerned about contract continuity issues. Absent appropriate authorization, firms' ability to service certain long-dated contracts, such as derivative and insurance contracts, would be in question and cross-border capital flows could be disrupted. We urge staff to continue monitoring these two issues closely. We also agree with staff's analysis on the risks of high leverage in China. While leverage has plateaued, there are still significant risks related to highly leveraged corporates and the reliance of banks on riskier funding structures. Further, staff's analysis in Box 1.5 of the GFSR shows that trading activity in China's bond market is a significant and growing vulnerability.

Lessons of the Global Financial Crisis

We welcome the retrospective analysis of the global financial crisis and the post-crisis reform agenda in the WEO and GFSR. The speed, magnitude, and creativity of fiscal and monetary policy responses were key factors in determining the shape of the recovery. The post-crisis financial reform agenda has led to a stronger and more resilient financial system while we also recognize that there are remaining financial sector vulnerabilities. With the implementation of the major reforms now largely complete, we think that it is relevant and timely to examine and identify what is working well and what can be improved. We fully support the FSB's analytical work in this regard. On non-banks, the United States, as well as the FSB, IOSCO, and IAIS, have moved to an activities-based approach for addressing systemic risks instead of the entities-based approach that works well for banks. Further, we disagree with staff's focus on compensation as a focus of the international regulatory agenda, as we are not convinced of its link with financial stability.

In the United States, we have reviewed the status and impact of U.S. financial reforms through a series of Executive Order reports. Building on this analysis, recent U.S. legislation and rule changes aim to further tailor supervision and regulation of large banks, while keeping the United States compliant with Basel III standards. A complete rollback of reforms that have made the financial system more stable should be avoided. But we need to look at how we can achieve our regulatory objectives in ways that maintain the measures' effectiveness, while improving efficiency, transparency, and simplicity.

Finally, we wish to highlight the following specific comments on Chapter 2 of the GFSR:

Regarding macroprudential approaches to systemic risk, staff underappreciate the importance of "soft powers," such as the authority to make non-binding recommendations to regulators and the importance of interagency convening authority. Although staff state that "no preferred model has emerged for the structure of supervision," the implication is a bias towards those countries with more consolidated regulatory structures. Further, staff's description of FSOC's powers was incorrect. FSOC can designate nonbanks for Fed supervision, designate Financial Market Utilities for additional risk-management requirements (but generally not Fed supervision), and designate payment, clearing, and settlement activities for additional risk-management requirements. We would appreciate staff's clarification on this issue.

In paragraph 27, we were disappointed to see staff highlight examples of macroprudential measures without acknowledging that they are also capital flow measures, and thus underscoring the limitations and risks of MPM/CFMs, in line with the Institutional View.

Staff correctly note the importance of the Crisis Management Groups (CMGs) in developing resolution plans for G-SIBs. We think it is important to continue building international coordination channels in the event of a cross-border resolution. We also note staff's call for further resolution planning for CCPs and encourage the formation and/or continued work of CMGs for systemically-important CCPs.

We agree with staff that the bank-sovereign nexus can be a problem in some jurisdictions, but staff go too far by hinting that positive risk weights and limits for sovereign exposures is the answer. This is a determination best left to the BCBS.

Mr. Hurtado, Mr. Gonzalez, Mr. Moreno, Mrs. Del Cid-Bonilla, Mr. Rojas Ramirez, Ms. Arevalo Arroyo, Mr. Montero, Ms. Mulas and Mrs. Suazo submitted the following statement:

World Economic Outlook

We believe the shifting of risks to the downside is the main message of this WEO. The report rightly places emphasis on trade and financial tensions, as well as on policy uncertainty already materialized in some countries, underlining their potential escalation and a rapid international contagion. While the macroeconomic impact of the tariffs imposed to date has been small, it could sharply go up should trade tensions grow. The scenarios box on trade is very timely and, in our view, reflects the destructive effects of escalating trade wars. Financial tightening is already affecting some emerging economies with evident weaknesses. Even though markets are so far discriminating among economies, the risk of contagion to “innocent bystanders” could rise, particularly if there is a shift in market expectations on US interest rates hikes. Policy uncertainty is having an impact on specific countries prone to more doubt about their political agenda, but we should not rule out contagion, particularly if paired with trade and financial risks.

The report includes the United States among the countries with excess current account deficit and unsustainable fiscal position. We ask staff to expand on the possible consequences of this assessment in the short and medium term both in the US and globally when, among other things, future higher interest rates may increase debt service significantly.

We share the staff’s policy recommendations, which are consistent with the risk scenario. Among the recommendations, we would stress in the current juncture: (i) the need for caution in monetary policy normalization in advanced economies, which should be country-driven, gradual and well-communicated; (ii) the rebuilding of fiscal buffers everywhere; and (iii) international cooperation on trade, but also on the risk of scaling-back on the financial reform agenda and taxation. We also welcome signaling of the need for cooperation on migration and, importantly, on increasing market power, which can have significant implications on inclusive and equitable growth and on the effectiveness of monetary policy, as largely discussed at the last Jackson Hole Conference. We encourage the staff to further develop these lines of research.

Chapter 2 of the WEO takes a timely look at the global recovery a decade after the global financial crisis (GFC). Searching for the lessons that can help the world economy prepare for the next downturn, it puts the right focus on tracing the pre and post-crisis output trends to explain why the impact has been persistent and it determines the policy actions that helped or hindered recovery. Results appear strong and consistent, but we believe the methodological challenges of separating the GFC from other structural forces that could be at play should be thought out given the persistence of output deviations from pre-crisis trends still observed in so many countries today.

We acknowledge that the findings support the policy advice the Fund has been given in the past years. By showing the crisis had an impact well beyond the countries that experienced a banking crisis, it convincingly points to weak investment as the link for output losses via long-standing capital and

TFP falls—linked to slower R&D spending and technological adoption. Unsurprisingly, countries with larger financial and external vulnerabilities, including rapid credit growth, more rigid exchange rates, weaker fiscal positions and lax banking regulation were more vulnerable. Consistently, quasi-fiscal fast measures to support the financial system in crisis seem to have effectively limited output losses. We agree with the need of greater cooperation, rebuilt buffers, strong external positions and financial regulation and supervision. What additional actions does staff think the Fund should take given its warning that many economies are going in the opposite direction and could therefore be sowing the seeds of and limiting our defenses to the next global downturn? Furthermore, what are the implications of these vulnerabilities for the Fund's size and role in the GFSN?

Finally, we worry that the results showing that countries more integrated to global financial markets and with stronger trade links to advanced economies suffered larger output deviations could be understood as evidence against integration. We encourage the Fund to stress that causes and channels of a crisis must not be confused, and that the soundest policies remain within the realm of openness and integration.

We find the analysis of the challenges for monetary policies in emerging markets as global financial conditions normalize very relevant in the present context of tightening of financial external conditions as well as significant to understanding the causes that have contributed to, in average, to lower and more stable inflation in the last decade. Particularly, in the current juncture of increased volatility in emerging markets, it is relevant to note that evidence suggests that well-functioning monetary frameworks with anchored expectations help countries contain the impact of negative external financial conditions. Considering this and that anchoring inflation expectations take time, what further specific policy recommendations would staff provide to countries that have significantly increased their debt, reduced their fiscal space as well as maintained weak monetary frameworks?

As staff states, communication is increasingly important for central banks to be able to anchor expectations. However, in bad times, there could be a case made that too much transparency can generate self-fulfilling prophecies that could give rise to more volatility. Are there any specific suggestions for maintaining the right balance in central bank communication and avoid risk contributing to financial stress?

There is greater sensitivity to higher inflation and volatility in emerging and low-income countries that are vulnerable to commodity price swings. What kind of implications do the findings of this chapter have for monetary unions and other countries with relatively fixed exchange rate regimes, especially if some of them are commodity exporters with little export diversification?

Global Financial Stability Report

In the 10 years since the global financial crisis, regulatory and supervisory frameworks have been overhauled while the banking system has become stronger. Current developments in financial markets are to test this new framework, as near-term risks to global financial stability have increased ─reflecting (localized) strains in EMs and escalating trade tensions─ and could possibly rise sharply going forward due to high debt levels and stretched asset valuations. Furthermore, we observe a continuous disconnection between market expectations (still buoyant) and medium-term risks. This is evident in the atypical tightening cycle in the US where, despite increases in the policy rate, financial conditions have eased further as a result of continued strong risk appetite and rising asset valuations. Could staff provide any explanation for this puzzle? What would be the possibilities for the FED to address this decoupling between monetary policy stance and market conditions?

Over the past 6 months, global financial conditions remained accommodative, despite strains in some EMs. Although overall vulnerabilities in EMs, with some exceptions, remain moderate compared with historical standards, leverage has continued to rise across most countries and signs of vulnerabilities have appeared; Figures 1.10 and 1.15 are telling in that respect. In the event of a sharp deterioration in risk appetite, capital outflows could intensify thus exerting greater pressures on economies with higher vulnerabilities and weaker buffers. However, it would be desirable that the recommendation to EMs to implement capital flow management measures when needed should warn about higher danger of outflows measures. We welcome the new empirical approach to assess tail risks to portfolio debt flows, which points to severe outflows in a tail scenario. We therefore emphasize the need to accelerate the process of strengthening the prudential and regulatory financial frameworks in those countries that are lagging, as well as to build buffers.

We agree that exposure to foreign capital markets and deep local financial markets entails risks of volatility and capital outflows, but the benefits of EM openness to international financial markets should also be noted.

We would like to stress the key role of global policy coordination in the aftermath of the global financial crisis, which averts policy uncertainty and regulatory arbitrage. We are also wary about the implications of a potential rollback of financial regulations in a moment in which the banking industry is dealing with low profitability and increased competition from fintech.

We welcome the opportune evaluation of the effects of the regulatory agenda after the global financial crisis on financial stability in Chapter 2. It is especially relevant in the current context of increased volatility in global markets and of reform fatigue. A widespread rollback in financial regulation could endanger global financial stability.

The staff report mentions that considerable progress remains to be done on bank compensation practices and on the use of credit rating agencies. We would appreciate further details on how staff believes this problem can be tackled.

Liquidity buffers have increased over the last decade, while reliance on wholesale funding is diminishing. Part of this liquidity improvement has resulted from an increase in government bond holdings, large in some institutions. They play a crucial role as safe and liquid assets in new regulations and in markets. We caution against penalizing bank holdings of sovereign bonds, as they may trigger instability in the sovereign debt market, especially when there are no clear alternatives. Could staff comment on possible alternatives for safe and liquid assets?

We note that staff´s focus is mainly on advanced and large emerging market economies. However, we wonder how appropriate Basel III is for LIC's and other small emerging market economies lacking deep financial systems that have to apply, in principle, the same standardized approach. Staff comments are welcome. We encourage the IMF to work closely with other institutions to find creative solutions to protect correspondent banking in fragile states and other small countries.

Fiscal Monitor

We welcome the new framework for a comprehensive analysis of public wealth and public finances through the Public Sector Balance Sheet (PSBS) approach. This approach offers a broader fiscal perspective to analyze the evolution of public wealth and identify risks to assess fiscal policy beyond debt and deficits. An important finding, among others, is that public wealth in advanced economies (AEs) deteriorated in the aftermath of the global financial crisis and has not recovered to pre-crisis levels, even though the fiscal balance has improved, in general, in these countries. This highlights the need for AEs to continue policy efforts to restore adequate cushions.

The preliminary nature of the exercise calls for caution with the results; it could be the case, for instance, where the incorporation of assets that are difficult to value be misleading by reflecting a better fiscal position than when analyzing only deficits and debt; this could cause risky complaisance about relevant fiscal variables. While recognizing its attributes, at this early stage the framework and methodology presented should not supply traditional fiscal analysis.

The implementation of this approach is difficult, as rightly recognized in the report, not only because of data quality limitations but also because it is hard to correctly value many public assets. This challenge may be particularly important for LIDCs. As this is an ongoing research, it is important to know what next steps staff is considering to enhancing the PFBS approach, and if providing TA to interested countries is among them. We also believe the implementation of this new approach would require a well-designed communication strategy to avoid misinterpretations. Staff's views are welcome.

Finally, as monetary and exchange policy could also impact intertemporal public wealth, we would like to hear from staff to what extent this aspect has been incorporated in countries' different frameworks.

Ms. Barron, Mr. Johnston, Ms. Preston and Mr. Shin submitted the following statement:

We thank staff for a high-quality, relevant and interesting set of reports. We broadly agree with the assessment of the outlook and risks, including the judgement that downside risks have increased, and that some previously-identified risks have materialized. Ten years on from the global financial crisis is an appropriate time to reflect on the progress of the recovery and the continuing impact of policy choices. The WEO and GFSR chapters provide an excellent stock-take of the crisis, the responses to it, and some of the issues that remain to be addressed, for example in the regulatory reform agenda. The reports also set out the vulnerabilities generated by the crisis response highlighting that a fuller reckoning of the GFC's legacies is yet to come. We appreciate the streamlining of the flagship documents, which has made them more accessible to a general audience and encourage staff to continue to consider ways to increase their reach and accessibility.

The WEO makes clear that with increasing risks around monetary policy normalization – given a buildup of financial vulnerabilities – and a significant accumulation of public debt in many countries, important questions remain about the longer-term effectiveness of the policy tools deployed during the crisis. The reports discuss the vulnerabilities arising from the use of unconventional monetary policy and we look forward to the upcoming IEO review of IMF advice on non-conventional monetary policy advice.

We think similarly useful policy insights could be made clear through a discussion of the vulnerabilities that have arisen from the use of fiscal policy. The longer-term effectiveness of counter-cyclical fiscal policy depends on the stimulus being unwound at the right time. The inability of many countries, at least so far, to embark on the necessary fiscal consolidation is contributing to the vulnerabilities arising from high and rising public debt and external imbalances. We also note that the IMF's advice as recently as October 2016 encouraged the membership to take a three-pronged approach to stimulate growth which included using fiscal policy as a support for demand. Fiscal policy advice can change quickly – but we are skeptical about how quickly fiscal positions can be turned around. Given elevated levels of debt and the stickiness of fiscal policy, we consider that there is scope for more fine-tuning of the fiscal space framework.

We welcome the strong support for the multilateral, rules-based trade system in the reports, while acknowledging the calls for the system to be modernized so it can continue to play a pivotal role. The reports highlight the risks to world growth of ongoing trade tensions, and the scenarios are a useful illustration of the potential impact on growth through confidence, investment and financial market channels. Do staff consider that there will be price effects as well as growth effects from higher tariffs? The modelling assumes the tariffs to be permanent. We would appreciate any insights from staff on how global firms are viewing the tariffs. Are plans underway to re-structure production networks based on a business decision that tariffs are here to stay, or do a large number of firms hope to ride out what they believe to be temporarily high trade costs? And is it possible to assess how this uncertainty might be currently affecting business investment?

A number of downside risks identified in the reports center around US fiscal policy: that fiscal stimulus may lead to faster-than-expected interest rate normalization. The reports point out that markets continue to anticipate the path for interest rate increases that is less steep than that projected by the Federal Reserve. Do staff have a view on why this is the case, e.g. are markets more optimistic about the outlook, or are there challenges with the Federal Reserve Board's communication?

The reports find that countries with more flexible exchange rates experienced smaller losses as a result of the crisis. This is not surprising as floating exchange rates are an important buffer for an economy facing adverse external conditions. As part of the Fund's regular surveillance, we would like to see a more transparent assessment of the appropriateness of countries' exchange rate regimes, the necessary preconditions and capabilities required to transition towards greater flexibility, and the costs and benefits of doing so, while recognizing the need for care in presenting these issues publicly.

The GFSR makes a strong case for countries to act to address systemic risk, including though proactive use of financial regulation and prudential supervision, and – in some circumstances – carefully designed macroprudential tools. While financial regulatory frameworks have improved since the crisis, many risks to global financial stability have grown. We agree that the regulatory agenda needs to be completed, and that rollback pressures should be resisted. We also support an assessment of the efficiency costs of the post-crisis regulatory changes and look forward to the planned work of the FSB and the IMF in FSAPs. This should include an analysis of the potential macroeconomic implications, an assessment of the impacts on competition, particularly in the context of future work on market power, and on the potential fiscal impacts of 'too big to fail'. Can staff comment on what this work is expected to cover?

We appreciate the comments in the GFSR on correspondent banking relationships, and the work the Fund has been doing to support members in this area. Financial regulatory changes have contributed to the decline in CBRs over the past decade. While there does not appear to have been a fall in value of transactions, the concentration into fewer channels constitutes a major risk for some small economies. Do staff have any information on how the cost of cross-border transactions, such as remittances, has changed as the number of channels has decreased?

The Fiscal Monitor demonstrates the benefits of balance sheet analysis but also some of the difficulties, including the availability of data, valuation of assets and the scope of the public sector. Preparing a comprehensive balance sheet has the benefit, amongst others, of focusing policy-makers' attention on how assets are being used to deliver the government's commercial, risk management and public service goals. Also, while net worth typically doesn't drive annual fiscal objectives, it does illustrate longer-term dynamics. However, given currently elevated levels of debt and an increasing number of countries considered at high risk of debt distress, a more pressing issue for many countries will be to improve debt management practices and develop a better understanding of their fiscal risks.

With balance sheets only produced by a small segment of the membership, there is scope for the IMF to play a catalytic role, not just in capacity development but also in its own country surveillance, to demonstrate the usefulness of the balance sheet as an analytical tool. The global financial crisis highlighted the importance of high quality and transparent fiscal data to appropriately assess countries underlying fiscal position and potential fiscal risks. Yet as highlighted in the 'Second Review of the Implementation of the GFS Framework', balance sheet data in Article IV reports stood at only 15 percent of the membership in 2017, down from 27 percent in 2013. We encourage Fund staff to routinely assess balance sheets during surveillance and work with the membership to fully implement the Government Finance Statistics Framework. Aside from data limitations, is there a reason why balance sheets are not more widely used to shape fiscal policy recommendations in surveillance, and is there a case for balance sheet data to be subject to Article VIII, Section 5?

Mr. Mojarrad, Mr. Daïri, Mr. Sassanpour and Mr. Nadali submitted the following statement:

We thank staff for well-written flagship reports, including informative analytical background chapters. We are in broad agreement with staff analysis and policy recommendations.

World Economic Outlook (WEO)

The global economic recovery is continuing, but has lost some momentum and become uneven across and within regions and country groups. Moreover, risks to the outlook highlighted in the April 2018 WEO have become more pronounced. Risks arising from trade conflicts and retreat from globalization have in fact already materialized, and expectations of their further intensification have begun impacting trade and investment decisions, and eroding confidence in general. The imposition of tariff and non-tariff barriers, including outright economic sanctions, carries heavy economic costs and welfare losses extending well beyond the disputing parties by disrupting the supply chains on which a broader set of countries depend. Early indication of sluggish capital spending is particularly worrisome, given that investment is the main driver of WEO's baseline growth scenario. The prospects of tighter global financial conditions are also increasingly being reflected in sharp exchange rate depreciation, reversal of capital inflows, and market turmoil in some major emerging market and developing countries (EMDCs), with major spillover effects. The prospects for low-income developing countries (LIDCs)—and especially non-commodity exporters and those under a heavy debt burden—have not improved since the April 2018 WEO, as many of them continue to fall behind in income convergence and improvement in living standards. The window of opportunity for decisive action that has been open to all for an extended period may be closing soon, while many of the challenges—particularly in building adequate buffers and undertaking major structural reforms to guard against the next economic downturn—remain.

Over the next two years, the moderation of economic activity in a number of key advanced economies (AEs) is largely offset by a strong growth spurt in the United States on the back of its sizable pro-cyclical fiscal stimulus and economic deregulation. However, the growth prospects beyond next year are not particularly encouraging as the output growth for most AEs reverts to sub-par potential, which is low by historical standards. The US growth will also weaken markedly after 2020 as the fiscal stimulus unwinds, at a time when monetary normalization may be at its peak. The process could even accelerate if the strong above-potential growth and the full employment conditions in the US give rise to an upside inflation surprise and stronger monetary tightening. An accelerated tightening of financial conditions in the US could intensify pressure on those EMDCs with high debt and large foreign exchange exposure and currency mismatch, and would also delay global external rebalancing. In a way, growth moderation brings to surface the structural impediments that have in the past hindered productivity growth. The brewing trade conflict and policy uncertainty are adding to the current headwinds and are creating new ones. The output and employment losses arising from retaliatory trade barriers are also likely to strengthen the support for inward-looking policies in a race to the bottom.

WEO's emphasis on finding cooperative solutions to trade disputes to preserve and extend the global expansion cannot be overstated, as an open, fair, and rules-based multilateral trade system has been at the core of global economic expansion and prosperity of the past few decades. International financial organizations, and in particular the IMF and the World Bank, have a key role in highlighting the benefits of free trade and the adverse impact of protectionism on all countries, but especially on EMDCs.

EMDCs are a diverse group and their economic prospects vary considerably, but virtually all EMDCs stand to lose from intensification of trade disputes, with the poor losing the most. Welfare losses go beyond output losses and include losses from limitations on the flow of capital, labor and technology from which the EMDCs benefitted significantly in recent decades, including by lifting hundreds of millions of their population out of poverty. Many EMDCs, particularly primary commodity exporters benefiting from favorable terms of trade, took advantage of the current prolonged recovery to address their financial imbalances and structural shortcomings, but others fell short in policy implementation and income convergence. The window of opportunity is narrowing, but is still open, and a supportive environment still exists for EMDCs to enhance resilience, rebuild fiscal buffers, and strengthen their policy framework.

The situation of many LIDCs—particularly those in Sub-Saharan Africa burdened by widespread poverty and high unemployment—remains precarious, and their longer-term prospects are uncertain, as their rapidly growing debt service costs limit their policy maneuverability. These countries are also vulnerable to climate change and large-scale migration. The policy imperatives are clearly identified by staff; what is less clear is the availability of concessional financing. A recent staff presentation to the Board concluded that large efforts will be needed for LIDCs to meet their 2030 UN Sustainable Development Goals. It also concluded that domestic revenue mobilization will not be sufficient and the remaining financing gap for LIDCs will be a staggering 18 percent of their respective GDP. We were expecting the WEO to address this issue, including the need for higher official development assistance. Staff comments are welcome.

For oil exporting countries in the MENA region, the strength of the oil market—reflecting both the buoyant global demand and, on the supply side, capacity constraint and production disruptions and uncertainties—offers a favorable environment to rebuild fiscal and external buffers and support inclusive, job-rich growth, and promote economic diversification. In the case of MENA oil importers, the increase in international oil prices has pressured the internal and external positions, creating a challenge to meet price stability without hampering output growth. The MENA region has its share of fragile and conflict-affected states. Humanitarian relief, including for countries hosting refugees, along with economic and institutional reconstruction, when the situation permits, is a global responsibility.

Global Financial Stability Report (GFSR)

We agree with the GFSR's main finding that the financial system is now stronger than it was at the outset of the global financial crisis (GFC), given the significant advances made over the last decade in strengthening financial sector regulation and supervision through coordinated efforts at the national and international levels, with the Fund playing a key role in the context of bilateral and multilateral surveillance. That said, it is also important to remember that crises are often difficult to predict, can take different forms, and evolve in different ways and at different speeds. A key lesson is to avoid complacency while recognizing financial sector vulnerabilities and addressing them in a timely manner.

The GFSR stresses that, despite the progress made in the last decade, not all vulnerabilities that contributed to the GFC have been eliminated: specifically, many banks' balance sheets are still saddled with opaque and illiquid assets; banks in several countries lack adequate capital to absorb major shocks; and unregulated financial activities are still endangering financial stability. Moreover, asset valuations are high and rising in major countries, with high sovereign, corporate, and household debt—under the still accommodative monetary policy—posing risks to financial stability in both AEs and EMDCs. More recently, non-synchronized monetary policy normalization—spearheaded by the US—has contributed to an appreciation of the US dollar, and more costly and difficult access to finance, as well as reversal of capital flows for several EMDCs, in particular. The rising trade tensions and policy uncertainties are also exacerbating financial stability risks.

We agree with staff that policymakers should continue to closely monitor developments and remain vigilant to financial sector risks, build adequate buffers, complete the cleanup of balance sheets, curtail banks' excessive risk taking, and reduce exposure to highly indebted corporates and households and to currency and maturity mismatches, including through enhanced macro-prudential tools and stronger prudential regulatory regime for nonbanks. Fiscal consolidation in high debt countries would reduce the financial system's exposure to the sovereign. Emerging market economies should strengthen their resilience to potential capital outflows by maintaining sound policies, strengthening reserve buffers, and developing local bond markets. Greater efforts are also needed to address increased withdrawal of correspondent banking relationships for a number of developing countries, including by strengthening the AML/CFT framework and improving communication between origin and destination institutions and with their respective regulators.

While fintech holds significant opportunities for greater financial sector efficiency and inclusion, it can also create significant financial stability risks if left unchecked. We welcome the Bali fintech agenda which, if implemented in close partnership with Fund members and other international organizations and stakeholders, with due attention to countries' capacity and needs, could help reap the benefits of fintech while identifying and mitigating potential risks.

Increased global policy coordination and better communication and data availability are essential for decisive progress in reducing vulnerabilities and maintaining financial sector stability and integrity. It is important that the Fund continue to play a leading role in these efforts, given its mandate and expertise, and its significant leverage with members and other international and regional financial institutions.

Fiscal Monitor (FM)

We welcome the new broader framework for assessing public sector finances. The Fiscal Monitor provides estimates of public sector assets and liabilities for a sample country group and presents tools to analyze and manage public wealth through case studies, including by identifying imbalances or mismatches on both sides of the balance sheet, and by using fiscal stress tests to gauge the resilience of public finances against tail-end shocks. By taking a more comprehensive view of public wealth, and going beyond the traditional focus of fiscal analysis on debt and deficits, the public sector balance sheet (PSBS) approach enables countries to improve revenue, risk management, and fiscal policy formulation, adopt countercyclical fiscal measures to mitigate the impact of economic downturn, and lower financing costs. However, given that many nonfinancial assets are illiquid, and their valuations are very volatile and highly correlated with the economic cycle, we agree that the assessments of deficits, gross debt, and financing should continue to remain at the core of fiscal policy analysis and formulation.

Despite considerable challenges in compiling reliable balance sheets, FM claims that developing balance sheet estimates and basic balance sheet analysis are within the reach of even low capacity countries, although caution is warranted in using the estimates in view of the wide variation in accounting and statistical standards. Of the 31 countries in the sample, only 17 have PSBS time series and 14 have public sector estimates drawn from the fiscal transparency evaluations that only cover a single year. Could staff indicate which of these countries currently undertake a PSBS approach in fiscal policy analysis? Are there plans to reflect on this point in the relevant Article IV consultation reports? Do countries that subscribe to the SDDS have the data needed to apply the balance sheet approach to fiscal policy? Is Fund technical assistance being offered to capacity-constrained countries that might have expressed an interest in the PSBS methodology?

The erosion of public wealth in the aftermath of the global financial crisis—even as fiscal deficits have been reigned in—and population aging in many countries support a balance sheet approach to public finances as well as a long-term view of net worth. While the static balance sheet extends the coverage of fiscal analysis from general government to the entire public sector, it needs to be combined with the discounted future revenue and expenditure flows to provide for a more comprehensive intertemporal balance sheet analysis. We agree, however, that balance sheet strength is not an end per se, but rather a tool to support the objectives of fiscal policy, including improving service delivery.

Important lessons are distilled from the case studies, including the effect of policies on assets and nondebt liabilities; large wealth effects of valuation changes; the importance of assessing and managing fiscal risks stemming from public corporations; the need to compare current levels of public wealth with long-term fiscal projections; and benefits from broadening the policy debate. We understand that in some cases, lack of reliable data has prompted staff to draw on third party sources and use assumptions for estimation. Natural resources form the largest nonfinancial asset in many oil producers, and the ultimate impact of natural resource extraction on net worth is determined by what the government does with its cash receipts. Could staff elaborate on the source of information and assumptions made in determining the value of subsoil natural resources, in particular crude oil?

Mr. Panek, Mr. Inderbinen and Mr. Waelti submitted the following statement:

The global expansion continues but it is losing speed and becoming less balanced. Downside risks are increasing. The window of opportunity to implement policies and reforms that foster strong, sustainable and inclusive growth is narrowing. We fully share the greater sense of urgency to rebuild policy space, enhance resilience, and advance reforms that raise potential growth to the benefit of all. Policies should be designed with a long-term perspective and be geared towards sustainability.

Trade tensions should be tackled collectively within the rules-based, multilateral framework, thus helping to strengthen the confidence in multilateral solutions and institutions. Trade costs should be reduced further and trade disputes should be resolved without resorting to tariff and non-tariff barriers. Openness and global economic integration have played a critical role in raising global welfare through diffusing innovation, lifting productivity, and expanding the variety of goods and services available globally. Relying on protectionist measures would open a vicious cycle of measures and counter-measures, harming everyone and shaking investor confidence.

Global Outlook and Risks

We broadly share staff's assessment of recent developments and the outlook for the global economy. While global growth remains solid, it is decelerating and it has become less synchronized. Risks are tilted to the downside. Rising trade tensions resulting from either actions or threats of actions are fueling policy uncertainty, with the potential to slow down investment and economy activity. Meanwhile, after years of very low interest rates, the global economy has become increasingly vulnerable to a tightening of global financial conditions, especially as public and private debt levels remain very high in many countries. More fundamentally, the global economy is facing the more insidious risk of declining trust in mainstream policies, which may further increase the appeal of politically popular yet unsustainable policy measures. The mere fact that policy buffers are yet to be rebuilt to an adequate level casts doubts about policymakers' ability to deal with the next downturn.

Monetary Policy

Monetary policy normalization should be data dependent, well communicated and tailored to the macroeconomic environment of individual economies. It remains essential for central banks not to fall behind the curve. Central bank independence plays a crucial role in allowing central banks to pursue a monetary policy aimed at ensuring price stability and creating a supportive environment for economic growth.

Fiscal Policy

Rebuilding fiscal buffers is essential in light of the heightened vulnerabilities arising from the very high debt levels that expose many economies to shocks and economic downturns. At the very least, fiscal policies should not be procyclical, including to avoid increasing global imbalances further. Robust medium-term fiscal frameworks with clear and credible debt and fiscal strategies, complemented with fiscal rules, should thus be a central pillar of the Fund's work and advice.

We welcome the comprehensive analysis of public wealth and finances. Taking into account accrued assets and liabilities can provide a clearer picture of fiscal policy issues. This being said, data constraints and uncertainties related to methodology should be kept in mind when interpreting the results. To ensure a dynamic, long-term and hence comprehensive analysis, challenges such as those posed by demographic trends also need to be captured. One way of doing this would be to calculate fiscal gaps.

Structural Policies

Structural reforms remain a high priority and should be implemented vigorously to raise productivity, increase labor supply and lift potential growth. While priorities may differ across countries, reforms should in particular aim at ensuring broad-based access to high quality education, skills building, and retraining—including vocational education and training—which would promote greater equality of opportunities over the long term, and raise the adaptability of the workforce to structural change.

Financial Sector Issues

The recently finalized international banking reforms must be implemented in a consistent and comprehensive manner, and a rollback of reforms must be avoided. Important steps have been taken to address the risks stemming from large and highly interconnected financial institutions. The banking system has become more resilient. Looking ahead, it remains crucial that, amidst favorable market conditions, we do not turn a blind eye to the risks that could prompt a new crisis. The channels of risk transmission have evolved since the global financial crisis and stress could be amplified through new avenues. Continuous monitoring as well as strong regulatory and supervisory practices are necessary to identify and address financial stability risks effectively.

Banks should continue strengthening their balance sheets, especially by reducing NPLs, to play their role in supporting economic activity through the provision of credit to the private sector. Banks should continue to increase their capital ratios, and they should be discouraged from holding an excessive amount of sovereign bonds. The calibration of capital requirements should be applied consistently across jurisdictions to ensure a level playing field.

Emerging Market Economies

Emerging market economies with weak fundamentals and heightened domestic policy uncertainties are now especially vulnerable to trade tensions and tightening global financial conditions. The optimal policy response lies in a combination of sound macroeconomic policy adjustment and robust financial supervision and regulation. A strong and independent central bank is a prerequisite. While capital flow management measures can be a last line of defense under certain circumstances, they should not substitute for necessary macroeconomic adjustment.

Debt Vulnerabilities in Low-Income Countries

We recognize the significant investment needs of many low-income countries and the key role that public spending on infrastructure, health and education—to mention just a few—play in achieving higher and more inclusive growth. It is absolutely critical that limited resources be used for high-quality projects. Domestic resource mobilization continues to be a key priority to reduce dependence on external financing. Creditors and borrowers have a shared responsibility in ensuring sustainable and transparent lending practices.

Process

The late circulation of some chapters of the flagship reports is highly regrettable. We urge staff to adhere to the rules in this regard. We understand that the production of these reports requires a substantial amount of coordination and time. That said, the two-week circulation period is essential for Directors to effectively engage with their authorities on the many important issues raised in the reports.

Mr. Agung, Ms. Villa, Mr. Sumawong, Mr. Alias and Ms. Rauqeuqe submitted the following statement:

We note that this is the first set of multilateral flagship reports issued under the modernizing and streamlining effort of the Fund. As such, we commend staff for maintaining a high quality, frank and candid assessment, with clear and consistent messages across the reports. In this regard, we offer the following comments.

The current global expansion continues to proceed, however, the uncertainty in the growth outlook has increased. This WEO represents the first downgrade to global growth forecasts since October 2016, reflecting the more challenging near-term environment. In addition, growth is expected to slow over the medium term as most advanced economies (AEs) converge to well below their pre-crisis growth potential, reflecting structural drags. The expansionary impact on global growth from the US fiscal stimulus will also dissipate beginning 2020, potentially leaving behind wider global imbalances. This underscores the Fund's strong call for the membership to rebuild buffers, enhance inclusiveness and resilience, and implement growth-friendly structural reforms against the backdrop of heightened uncertainty and the narrowing window of opportunity.

Several downside risks highlighted in April 2018 have intensified or have partially materialized. Notable among these is the dynamic of retaliatory trade measures, which continues to escalate with potentially deleterious effects on the global economy.

A trade war as illustrated in the WEO's Scenario Box 1, if it materialized, could lower global growth to below 3 percent in 2019, the weakest growth since the Global Financial Crisis (GFC). We are wary that the slowdown impact could be even more severe than projected as pointed out in Box 1.6 of the WEO. Staff comments are welcome. In addition, the impact of protectionist measures tends to linger long after a trade conflict with a resultant slowing down in overall long-term growth as confirmed by staff's analysis.

We reiterate our view that protectionism could worsen economic outcomes for all and appreciate the Fund's continued exhortations for the membership to resist inward-looking policies. We therefore strongly support the sustained call for trade openness under a rules-based, multilateral trading system.

Financial conditions in AEs and emerging market and developing economies (EMDEs) are diverging and risks arising from the sharp tightening of financial conditions have become more worrisome. Indeed, some EMDEs are already experiencing markedly tighter financial conditions. Staff suggest in Chapter 1 of the GFSR that EMDEs with weaker fundamentals appear to have been mostly affected thus far. As such, we note with concern that the magnitude of capital reversals from EMDEs (excluding China) under a severely adverse scenario; subject to risk appetite, the US market interest rate and the US dollar, could be similar to outflows during the GFC.

We continue to emphasize that a gradual and well-calibrated monetary tightening in the US and other AEs is essential to normalize financial conditions and curb further buildup of debt vulnerabilities across all country groups. Nonetheless, as recent events have shown, even a careful and well-communicated normalization could entail volatility in EMDEs. Moreover, procyclical stimulus in the US may put upward pressure on inflation and trigger faster-than-expected interest rate increases, which could amplify capital outflows from EMDEs. Hence, we underscore the need for fiscal policy to be cyclically appropriate.

We note staff's finding from Chapter 3 of the WEO that domestic factors are the main contributors to recent inflation outcomes in EMDEs. We ask staff to elaborate on whether those domestic factors are attributable to demand-pull or cost-push pressures, which have different policy implications. In addition, while the pass-through to inflation is lower in economies with better anchored inflation expectations, we are of the view that the impact of normalization on inflation could vary significantly across EMDEs with the same degree of anchoring of inflation expectations. Staff comments are welcome. Nevertheless, we agree that strengthening the credibility of monetary policy frameworks and clearer communication would help better anchor inflation expectations.

As shown in staff's analysis, certain types of investors could introduce further volatility to capital flows, which remains a key source of concern for EMDEs. We agree that EMDEs should continue to increase resilience to external shocks including developing deeper and more liquid domestic markets. Our experience shows that while sound macroeconomic management is the first line of defense, policymakers must be prepared to deploy the full range of policy instruments, including macroprudential and capital flow measures, sometimes pre-emptively, to safeguard financial and macroeconomic stability against the often-severe impact of volatile capital flows.

Continued efforts to address vulnerabilities while boosting productivity remain essential in ensuring sustained growth.

Significant progress has been made on the global financial regulatory reform. While there remain legacy issues, backtracking on the regulatory agenda should be resisted. We highlight the importance of regulatory consistency as deviations may lead to unwanted consequences arising from regulatory competition, arbitrage, gaps and overlaps from a cross-border perspective. Moreover, ten years since the GFC, we now face new challenges, among others, related to fintech and cybersecurity risks, which are uncharted territory. Therefore, the regulatory community should continue the crucial work to tackle financial stability challenges with cooperative solutions. Any competitive deregulation could reverse past gains and lead to a race to the bottom in regulation and supervision and weaken the policy response to future crisis.

We agree on the need for members to rebuild fiscal buffers. In this regard, the public-sector balance sheet approach presented in the Fiscal Monitor illustrates a more comprehensive approach to help policy makers better analyze fiscal positions and risks beyond the standard measures of debt and deficits, which will be essential for policy makers to effectively deal with high public debt in some EMDEs and mounting pressure on age-related spending in AEs.

A decade after the GFC, output remains below pre-crisis levels in most countries. Over the medium term, growth is expected to decline in AEs while stabilizing at current levels in many EMDEs. This highlights that the long-standing advice on structural reforms aimed at boosting productivity and lifting growth potential remains relevant for both AEs and EMDEs alike. In addition, staff's analysis in Chapter 2 of the WEO points out that technology adoption has slowed following the GFC which partly explains sluggish productivity growth. Could staff elaborate as to what extent technology adoption could help offset the impact of aging population on productivity growth?

Finally, although global risks are adequately analyzed in the flagship reports, selecting and deploying the right policy tools has become a much more complex exercise given the interconnectedness of risks, as well as uncertainty surrounding their transmission and the speed at which these risks could materialize. While staff´s recommendations on economic policies are suited to the risks facing global growth, it is also important to continuously upgrade the Fund´s analytical toolkit to continue to deliver high-quality analysis and policy recommendations. With this latest downgrade in global growth projections, we recognize that forecasting macro variables is not an exact science. Nevertheless, in the current context of heightened policy and political uncertainty, the Fund's roles as a trusted advisor on both bilateral and multilateral levels and being a strong advocate for collaborative efforts will become even more important and require responsive and timely communication.

Mr. Tombini submitted the following statement:

We thank staff for the excellent work in putting together the new editions of the World Economic Outlook (WEO), Global Financial Stability Report (GFSR) and Fiscal Monitor. While global growth was revised down, it is still expected to remain relatively robust in 2018 and 2019 by post-crisis standards. However, the strong momentum experienced in the second half of 2017 seems to be dissipating. Additionally, with monetary policy normalization proceeding in major advanced economies, tighter financial conditions can expose structural gaps and crisis legacies that have not been fully addressed. Reassessing the balance of risks in the short term as tilted to the downside seems warranted, as suggested by recent events. The Fund's message over the past few years – that is, the need to rebuild buffers and fiscal space, strengthen financial sector resilience, and implement key structural reforms – has become more urgent as the facilitating environment for advancing such reforms may be coming to an end.

Against the backdrop of trade tensions and tightening financial conditions, the general optimism with the global economy seems to be waning. Although growth in the US has been quite robust, the performance in several other large advanced economies (AEs) during the first half of 2018 has not been as buoyant as initially expected. Facing tightening financial conditions and as idiosyncratic factors surface, many emerging markets and developing economies (EMDEs) are experiencing increased market pressures that could ultimately lead to slower growth. Meanwhile, the recovery in energy prices has provided some relief to many energy exporters, but at the same time, has put additional strain on importers and led to a pick-up in global headline inflation. While core inflation in general has been contained, we take note of the recent strong wage growth in the US and possible implications for US inflation and monetary policy if this momentum continues.

The downward revision in the global growth outlook for 2018 and 2019 is disappointing, but not necessarily surprising. Trade and investment – the drivers of the strong global performance in the second half of 2017 – have come under pressure thus far in 2018. We take note of the significant downward revision to the near-term outlook in several regions including Latin America and the Caribbean, the Middle East and emerging and developing Europe. Growth could additionally be affected by rising headline inflation which would erode purchasing power and limit the space for monetary policy to support economic activity, despite the progress made by several EMDEs in anchoring inflation expectations. As such, growth is now expected to be relatively modest in many EMDEs, which is deeply concerning since staff's analysis suggests that many will fall further behind advanced economies in living standards.

We agree with staff that the global environment is becoming more challenging for policy makers. Since the Spring of 2018, trade tensions have escalated and financial conditions have tightened, especially for EMDEs. With global liquidity now slowly drying up, investors' risk appetite towards developing economies, particularly those with higher external financing needs and policy consistency issues is waning. Experience shows that shifts in market sentiment frequently takes place in discrete steps, even when the underlying factors shaping the new environment evolve in a gradual manner. In such a context, episodes in individual countries can trigger a wider retreat from EMDEs as an asset class.

Bouts of volatility would gain in intensity and extent in the case of a sudden correction in the market's expected path for the US Federal Reserve's (Fed) policy rate. In this respect, the outstanding discrepancy between the Fed dots plot and market median projections does not necessarily bode well. Having said that, risk appetite and asset valuations remain buoyant in the US – favored by the considerable fiscal stimulus – causing the Treasury yield curve to flatten to a degree not seen since before the global financial crisis, in what staff called an atypical tightening cycle. Given this behavior, including the recent inversion of the TIPS yield curve, we welcome the analysis put forth in Box 1.1 of the GFSR but would appreciate it if staff could elaborate more on the ambiguity of the signal under current conditions. We also note that the Cboe's volatility index for emerging markets (VXEEM) has fallen since Spring and remain within acceptable thresholds – suggesting that investors' risk appetite remains relatively bullish.

Noting that financial conditions and investor sentiment can quickly change, staff's policy advice that EMDEs should prepare for an environment of higher volatility is appropriate. Many EMDEs have undertaken key reforms over the last decade, such as introducing greater exchange rate flexibility, strengthening their financial sectors, and instituting credible monetary policy frameworks as highlighted in WEO, Chapter 3. However, with public debt levels on the rise, there is the need to rebuild buffers and fiscal space in many EMDEs. For countries under strain, adjustment may have to happen under difficult circumstances, requiring a proper balance between deliverables in the short and longer run, with the margin for maneuver narrowing if action is delayed. The same is applicable to small developing states, who face the unenviable trade-off between fiscal consolidation on one hand, and the need to invest in infrastructure, provide social services and build climate resilience on the other.

We might have an extended global adjustment process ahead and stresses on EMDEs could be larger than currently anticipated by markets. Capital outflows so far have been mostly concentrated in countries with larger external financing needs. Anchoring expectations, in a more difficult international environment, should be addressed with a focus on implementing sound macroeconomic policies while improving resilience to adverse shocks. We particularly concur with staff's caution on the need to use reserves judiciously, given the outlook for a prolonged challenging period. Rebuilding buffers and adopting prudential measures should continue to be encouraged, even though the timing for such steps to be taken with higher chances of success is becoming increasingly less favorable.

Under such circumstances, the Fund may be called to play a more prominent role, both directly as an emergency finance provider and policy adviser, and indirectly as a global sponsor of dialogue and cooperation. The increasingly overcast scenario underlines the importance of reassuring the membership and market participants that the Fund is ready and will have sufficient resources to support members' adjustment efforts whenever requested. Among the issues requiring multilateral cooperation, we highlight the importance of resolving trade tensions, strengthening the global financial safety net, enhancing tax cooperation, and preserving correspondent banking relationships.

The GFSR clearly depicts the main features of the current financial context, namely: divergence between AEs and EMDEs; high debt and vulnerabilities; potential for sudden adjustments; and a more resilient but untested financial stability framework. Within such a trying setting, the message that near-term risks, despite a modest increase, are still regarded as subdued could sound as somewhat out of sync with the overall more guarded tone of the report, which cautions against market complacency on the face of the risk of a sharp tightening on financial conditions. Moreover, as argued in the report, the still relatively benign global financial conditions are hinging on the lingering sanguine risk appetite – a factor that is less closely related to fundamentals and more prone to sudden shifts. While there is no gain in instilling more doubts in the markets, the potential for disruptive episodes in the forthcoming months calls for a prudent stance.

Ten years after the global financial crisis, progress in the regulatory environment and supervisory practices have led to a strengthened financial sector, but the new framework has yet to be tested. Missing pieces of the comprehensive global reform agenda must be finalized and rollbacks avoided. While agreeing that no cost-effective financial regulatory framework could reduce the probability of a crisis to zero, record debt levels across the board and still opaque and possibly illiquid assets in some banks expose known pockets of vulnerability. All in all, bank's balance sheets are indeed much more robust than in the running up to the GFC, but the fact that aggregate price-to-book ratios remain below one in several systemic economies suggests that individual financial soundness indicators could shift abruptly.

The global context for this Fiscal Monitor is still dominated by the declining trend in corporate tax rates among some advanced and emerging market economies, headlined by the US and France. Reforms have positioned these economies closer to the OECD average corporate rate. However, the potential of tax competition is still a concern, as other countries ponder their response to this new environment. In any case, we reiterate our support to continued international cooperation on tax issues.

Rebuilding fiscal buffers remain a pending task in most economies. Staff's medium-term projections suggest a gradual reduction in the average fiscal deficit driven primarily by GDP growth. Fiscal consolidation should be resolute, while avoiding excessive pro-cyclicality, especially in countries where growth remains fragile. In Latin America, the fiscal consolidation process continues with a growing number of countries moving towards a tighter fiscal stance. Nonetheless, average public debt in the region is projected to increase further in the medium term, even as the economic recovery picks up steam and primary balances gradually turn positive. Which additional fiscal reforms staff considers necessary to stabilize and reduce debt-to-GDP ratios in the region?

We welcome the focus of the Fiscal Monitor on discussing the use of the public-sector balance sheet (PSBS) approach as a valuable tool to complement fiscal policy analysis. Analyzing public wealth *would* allow the government to acquire a comprehensive view of its financial situation and to conduct a more effective intertemporal management of all assets and liabilities. However, it should not weaken the resolve to undertake needed difficult fiscal consolidation. Furthermore, we suspect that the challenges arising from data quality, valuation difficulties and the complexities inherent to public sector financial management could turn out to be unsurmountable for many countries. In any case, further assistance and guidance to countries will be warranted to bear the fruits of the PSBS approach.

Mr. Gokarn, Mr. Joshi, Mrs. Dhillon and Mrs. Roy submitted the following statement:

We thank staff for the comprehensive flagship reports with analytically rich and informative content.

World Economic Outlook – October 2018

Lower projected growth rates in this WEO draft reflect a correction of the over-optimism in the April WEO that expected monetary policy normalization in AEs to proceed without triggering large and protracted increases in financial market volatility. The current draft states that the US economy is above full employment, yet the path of interest rate increases that markets anticipate is less steep than that projected by the Federal Reserve. Unexpectedly high inflation readings in the US could, therefore, lead investors abruptly to reassess risks leading to a possible sharp tightening of financial conditions in the US which would have spillovers to other economies. What are the reasons behind the markets anticipating a less steep tightening than that projected by the Federal Reserve? How could the same be rectified so as not to engender greater market volatility going ahead?

It is a matter of concern that despite the current growth rate being the highest since 2010-11, over 45 EMDEs — accounting for 10 percent of world GDP —are projected to grow by less than the AEs in per capita terms over the period 2018-2023, failing to narrow income gaps and improve convergence prospects. The record of income convergence between AEs and EMDEs has not been favorable over the past five decades. Given this, continued progress toward the 2030 United Nations Sustainable Development Goals could pose a challenge for low-income developing countries. In the context of the recent discussions on fragile states (IEO evaluation) and Fund facilities for low-income countries, it has become critical for the Fund to overcome the identified inadequacies and provide advice on country-focused and measurable macro-economic and structural reforms, along with appropriate lending, while keeping in view the required strengthening of capacity in such countries for greater traction and effectiveness. Staff may indicate the manner in which these critical issues may be incorporated in the WEO.

The draft WEO warns that an intensification of trade tensions, and the associated rise in policy uncertainty, could dent business and financial market sentiment, trigger financial market volatility, and slow investment and trade, and advises members to avoid protectionist measures and find a cooperative solution that promotes continued growth in goods and services trade which remain essential to preserve the global expansion. The proposed conference on How Global Trade Can Promote Growth for All during the annual meetings in Bali organized jointly by the IMF, World Bank, WTO, and OECD is welcome in this regard. However, we have seen the way in which unfettered trade can adversely affect the population even in AEs. EMDE populations are even more vulnerable given the absolute number of affected people and the lack of safety nets and necessary institutions in many of them. If trade rules and instruments are not appropriate for a country's level of development, then trade could be detrimental to its population. Discussions in the forthcoming conference, especially on gaps in the trading system, should recognize this aspect of global trade and focus on complementary domestic policies to help share the gains from trade more broadly which will ensure that the global playing field is level for the entire membership of these IFIs. Staff comments on creating a global level playing field in trade is welcome.

Chapter 2 takes stock of the global recovery a decade after the 2008 financial crisis. Output losses after the crisis appear to be persistent, irrespective of whether a country suffered a banking crisis in 2007–08. Sluggish investment was a key channel through which these losses registered, accompanied by long-lasting capital and total factor productivity shortfalls relative to pre-crisis trends. Countries with stronger pre-crisis fiscal positions, those with more flexible exchange rate regimes and lesser financial vulnerabilities in the pre-crisis years experienced smaller losses. With reference to investment shortfalls after the crisis, chart 2.5 on p.6 shows a greater deviation from pre-crisis trend in the more recent years (2014-17) than in the years immediately after the crisis when the lack of access to credit after the crisis or from weak expectations of future growth and profitability would have been greater. This also appears to run counter to the chapter 1 discussion which states that the 2017 upsurge in global growth and trade was led by a pickup in investment in AEs and an end to fixed investment contractions in some large, stressed commodity exporters and were the highest since the 2010-11 rebound from the global financial crisis (p.16). Staff may clarify.

We agree that unprecedented and exceptional policy actions taken after the crisis helped mitigate countries' post-crisis output losses. However, we also share the concern stated in the chapter that the extended period of ultra-low interest rates in AEs has contributed to the buildup of financial vulnerabilities including large accumulation of public debt and the erosion of fiscal buffers in many economies. Staff may please clarify why some of the crisis management tools deployed in 2008-09 are no longer available including the Federal Reserve's bailouts of individual institutions. Also, would the currently emerging risks to global financial stability have been lower if the unconventional monetary policy measures and the period of ultra-low interest rates had been ended earlier?

The chapter has discussed the effect of robot diffusion on employment since the GFC. WEO should also elaborate on the role that robots will be playing in the years to come as the anticipated loss in employment opportunities on account of robots will require development of new avenues and means of employment.

Chapter 3 analyses the dynamics of inflation in EMDEs since the mid-2000s and concludes that it has, on average, been low and stable. Regarding the sustainability of the inflation performance as global financial conditions normalize, the chapter finds that there is sizable heterogeneity in inflation performance and in variability of longer-term inflation expectations among EMDEs with the latter being the main determinant of inflation rather than global factors. Anchoring of inflation expectations, by enhancing fiscal discipline and monetary policy credibility, can significantly improve economic resilience to adverse external shocks in EMDEs. Anchoring reduces inflation persistence and limits the pass-through of currency depreciations to domestic prices, allowing monetary policy to focus more on smoothing fluctuations in output. We agree with the findings of the chapter. Regarding policy implications, however, while we recognize the necessity of strengthening domestic policy to enhance resilience to global shocks, we emphasize the need for multilateral coordination to ensure financial stability and global growth.

The chapter reports a baseline specification that is estimated for a panel of sample emerging economies using core inflation for 2004-2018. Given that a higher share of consumption in EMDEs is devoted to food and other commodities, whose prices tend to be more volatile and which the chapter indicates raises the volatility and persistence of inflation in EMDEs, it would have been more appropriate to report the results of a baseline specification that is estimated using headline inflation in the chapter and center the discussion around these results rather than those related to core inflation. Staff comments are welcome.

With regard to India, the draft chapter states that “Elsewhere in emerging Asia, core inflation in India has risen close to 6 percent as a result of a narrowing output gap and pass-through effects from higher energy prices and exchange rate depreciation.” (p.11) It may be noted that India’s CPI inflation in fiscal year 2018-19 is likely to be lower than the current forecast of 5.1 percent in the WEO. CPI headline inflation has been slowing since

July 2018 (down from 4.9 percent in June 2018 to 4.2 percent in July 2018 and 3.7 percent in August 2018) and is expected to remain low in the next few months owing to favorable base effects.

In p. 36, the draft chapter mentions that a high interest burden and risks from rising yields require debt reduction, further reductions in subsidies and enhancing compliance with the GST. In this regard, it may be noted that though sovereign debt of India is at elevated level, the country still maintains a low level of foreign currency debt. Besides, India has explicitly made its commitment towards fiscal prudence in its Medium Term Fiscal Policy Statement 2018-19, including reduction in both fiscal deficit and public debt.

Global Financial Stability Report

The GFSR offers a balanced and informative review of global financial developments and a comprehensive evaluation of the ongoing progress of regulatory reforms agreed by G-20 leaders after the GFC. We broadly agree with the main thrust of assessment but have important points to emphasize.

The global financial system at present has marginally tightened though the divergence between AEs and EMEs has increased. We note that while financial conditions in AEs and China remain easy, those in EMEs in general have worsened because of rising financing costs, trade tensions and capital flows. The report hints that capital outflows from EMEs excluding China could intensify further under severely adverse scenarios with run-off of up to US $ 100 billion from debt portfolios. Under these challenging circumstances preserving resilience and policy credibility by EMEs would be imperative for mitigating risks of capital outflows. India's low level of foreign currency debt and abiding commitment to fiscal prudence reflected by Medium Term Fiscal Policy Statement, 2018-19 on the reduction of fiscal deficit to 3.3 percent of GPD in budget estimate of 2018-19 and public debt to 48.8 percent of GDP in 2018-19 underscores strong policy credibility and resilience. Both these positive aspects about India ought to be appropriately highlighted in para 18 in chapter 1 of the GFSR. At the same time medium-term risks to financial stability remain elevated due to persisting financial vulnerabilities rooted in high debt levels and exuberant asset valuations amid risks of rising trade and geopolitical tensions and tightening of global financial conditions. The report cautions that vulnerable EMEs with weak buffers and policy frameworks including those facing trade shocks and external financing risks ought to remain vigilant to the likelihood of further intensification of capital outflows.

We note that several reforms have been adapted although others have either progressed or lagged in implementation. We compliment IMF experts for facilitating the implementation of the regulatory agenda by way of TA and CD. Compliance with Basel III capital regulations, reduction in leverage, enhanced liquidity buffers, better regulation and supervision including system-wide risk monitoring and macroprudential oversight underpin the success of the agenda. The material non-compliance by nine EU states and insufficient macroprudential mandates in many jurisdictions is however a matter of concern. Although efforts to curtail shadow banking activities and the introduction of bank resolution powers for G-SIBs in sync with FSB Key Attributes is welcome yet more is needed to be done to contain systemic risks. At the same time, even as procyclicality of bank credit has declined, the implementation of leverage ratio has progressed slowly while cross-border bank resolution and non-bank/insurer insolvency frameworks have lagged. We invite staff to comment on the implications of Basel III leverage ratio on the risk-taking capacity of banks in EMDEs and implications for credit growth. The report notes that while regulatory ring- fencing of liquidity on individual entity basis may be desirable, it could result in fragmentation in funding and market liquidity and cause unintended effects on market functioning Would staff comment on changes that they would advise on the extant regulatory approach regarding liquidity ring-fencing?

The GFSR has made a useful foray into the global financial regulatory reforms undertaken in the 10 years since crisis. It is helpful to know how much more resilient the banking system has become. Capital buffers have increased notably and liquidity buffers also have improved while efforts have been made to address procyclicality of rules. However, the GFSR while discussing these reforms has termed the regulatory treatment of sovereign debt as a “remaining issue”. This an issue that lies in the domain of the Basel Committee on Banking Supervision (BCBS) and the fact of the matter is that it had completed the review of regulatory treatment of sovereign exposures and decided not to pursue risk weights on sovereign assets. While the member jurisdictions like ours are keen to complete the agreed reforms, it is important at this juncture not to re-open issues that can be disruptive. It is not correct to describe the issue of regulatory treatment of sovereign debt as a remaining issue. Also, it is neither necessary nor opportune to make a reference to proposals for positive risk weights and exposure limits that have been dropped from the reform agenda. Such references can be highly market sensitive at the present juncture and can confuse markets at a point when EMEs are already facing challenges from selling of the sovereign bonds and resultant capital outflows. As such, the observations GFSR in Chapter 2 in paras 12, 25 and 48, where the issue is mentioned, must be dropped altogether.

We welcome the Fund's call for reforms in banks' operational and risks management policies for overhauling governance and compensation rules well as review of use of credit rating agencies to ensure prudence in risk taking. We support coordinated international regulatory reforms including the post-facto assessment of unintended consequences of reforms. The initiative of the FSB to assess regulatory impact on the broader economy is welcome. We also support IMFs advocacy of regulatory and supervisory scrutiny that is proportional to institutional complexity and systemic importance which will reduce the burden of compliance. The caution on new risks to financial stability such as from Fintech and cybersecurity is opportune and would require renewed oversight framework. We welcome the Bali Fintech Agenda, but would like the Fund to also offer positive guidance on how fintech could be used to expand financial inclusion of productive but financially under-served sections of the society. We believe that a careful re-assessment of the benefits of financial inclusion against excessiveness of regulatory burden is warranted to enable under-served segments in LICs and developing countries to reap its full benefit. Could staff comment?

Fiscal Monitor

Fiscal Monitor delivers a captivating message for governments to manage public wealth and their balance sheets wisely for enriching policy making. In doing so it does provide a momentary shift away from the traditional preoccupation of debt and deficits, even as it goes on to advocate a comprehensive approach. We agree that a complete picture of a government's asset and liability position, including nonfinancial assets acquire wider importance post the Global financial crisis, especially in the context of providing support to the financial system during crisis episodes. Further, synergies for fiscal policy with a wider framework of balance sheets could also lessen the informational asymmetry. Beyond the challenges of compiling balance sheets, the FMs emphasis on the public sector balance sheet approach being an important instrument in surveillance of financial stability and deeper analysis of overall economic risks is pertinent and a laudable goal.

We agree that better accounting might lead to better policy and improved management of assets and liabilities. But the extent to which net worth alone can serve as a simple guide to managing the public sector is debatable. The public sector is not a business and the goals are far wider and more aligned to achieving balanced socio-economic growth. And, not all assets can, or should, be sold. Notably, only a few Countries have made some progress on public sector balance sheet approach. Staff analysis in Box 1.2

indicates that governments with stronger balance sheets are better able to engage in countercyclical fiscal policy during recessions and financial markets take account of assets and balance sheet strength? Could staff offer empirical evidence to support this? Further, could staff elaborate on the progress on the adoption of balance sheet approach in countries most impacted by the crisis.

The case studies identify valuable policy options even as the acknowledged caveats on the data quality, valuations, diversity of public sector entities constrain cross country comparisons and wider application. The FM gives a new database that shows comprehensive estimates of public sector assets and liabilities for a broad sample of 31 countries, covering 61 percent of the global economy. This, along with the practical experiences of relating the budgetary positions to evaluation of fiscal policies, natural resource exploitation, unfavorable demographics and public investment, provide substantial insights. More significantly, the case studies do carry a lesson that a balance-sheet approach, may alter the results from traditional sustainability evaluations and more generally, the perception of a country's fiscal vulnerability. We encourage this research and look forward to more analysis and best practices, including through Funds ongoing surveillance.

To conclude, the future generations will bear the consequences of the decisions of today and therefore it is vital to understand how assets and liabilities will change as a result of policy making. So, focusing on the entire range of public wealth for policy, service delivery and resource use are well accepted.

Mr. de Villeroché, Mr. Castets, Ms. Sanchez, Mr. Rozan and Mr. Sode submitted the following statement:

We thank staff for an excellent and comprehensive set of "flagship" reports. While global growth is projected to remain at a relatively high level in 2018 and 2019, the outlook has deteriorated during the last six months. The escalation of trade tensions and financial turbulences in some emerging markets have contributed to create an environment of higher risks. These vulnerabilities are accentuated by a weakening of international cooperation and inward-looking policies in some countries. In parallel, financial stability risks have evolved worldwide since the last April assessment. While, in aggregate, risks remain constant in the medium run and are mildly rising in the short run, at the individual level (for some countries or markets' segments), they are growing or even materializing.

Against this background, the IMF – both through its surveillance and financial assistance activities – has a central role to play to ensure the stability of the world economy. Relying on an adequate level of resources is therefore key at a time of mounting uncertainties. Moreover, the 10th anniversary of the global financial crisis (GFC) is a useful reminder that financial excesses, external imbalances, procyclical policies and insufficient macroeconomic buffers can be extremely costly when the cycle turns down. Though major progress has been made during the last decade to enhance the resilience of our economies, international cooperation as well as domestic efforts remain paramount to strengthen the sustainability and inclusiveness of our growth models.

World Economic Outlook

Advanced Economies

While the global economy still benefits from cyclical tailwinds, we are increasingly worried that rising trade and geopolitical tensions could undermine confidence and take a toll on growth. Even if the impact of trade tensions has probably not fully materialized yet, we fear that it could derail the growth momentum through confidence effects. Adding to this risk, procyclical policies will exacerbate domestic and global imbalances and should not then be used as a pretext for protectionist policies. This is particularly true in the United States, where rapidly rising public deficit and debt could imply a more rapid monetary tightening and a contractionary fiscal stance from 2020 onwards. We therefore fully concur with staff recommendations to reverse the current policy course and to increase the revenue-to-GDP ratio to put the public debt on a declining path going forward.

We support staff's recommendation to further adapt the policy mix to domestic conditions. We agree with staff that monetary policy should remain accommodative as long as inflation does not sustainably come back to its target, notably in the Euro Area and Japan. We also encourage the new Italian authorities to maintain a prudent fiscal strategy going forward.

On the structural front, public policies should aim at creating more job opportunities, raising growth potential and protecting the most vulnerable against the adverse impact of trade and technological change. Increased investment in education and lifelong training, universal access to efficient health care system or policies fostering labor mobility are crucial in this perspective. France is committed to pursue such an agenda through a comprehensive set of reforms with the aim to foster our competitiveness while ensuring equal opportunities for all. Furthermore, as shown in last year Fiscal Monitor, there is room in most countries to increase the progressivity of taxation and to mobilize such public resources to strengthen the social safety net. To ensure that each and every household and firm contribute to a fair share of the welfare's funding, international cooperation in the domain of taxation should also be reinforced. In this domain, we reiterate our call for an increased role of the Fund to promote fairer international taxation and curtail the risk of a general race to the bottom as regards corporate taxation. Looking forward, we expect this analytical work to feed into bilateral surveillance recommendations. We also encourage staff to further investigate questions related to the rise of corporate market power (particularly significant in advanced economies according to the Box 1.1 of the chapter 1 of the WEO) and its potential impact on falling labor income shares in some advanced economies. Could staff indicate if and how the Research Department intends to pursue its work on this major issue? We appreciate the Special feature on Commodity market developments and forecasts and wonder whether staff considered integrating climate-related issues in the WEO report, notably by looking at the impact of the economic outlook on climate change (ie. assessing the progress made towards a low-carbon growth model).

Persistent external imbalances remain a source of concern. Ensuring a global rebalancing, with a correction in both deficit and surplus countries, was a major focus of the international community in the aftermath of the global financial crisis. However, the rebalancing effort has been asymmetric so far, notably in advanced Europe where it was mostly undertaken by debtor countries through internal devaluation with a depressing impact on aggregate demand. Going forward, we are puzzled by staff's projection of a widening of creditors and debtors positions as a share of world GDP over the next five years. Such a trend questions the traction of staff's advice on external sector imbalances and call for a reinforced effort to convey the Fund's recommendations in that field. We notably concur with staff's recommendation to countries with fiscal space and excess external surpluses, such as Germany, to boost domestic growth potential and address external imbalances. Beyond encouraging additional public investment, wage dynamics and corporate savings trends should not be overlooked. Could staff comment on its projections of wage dynamics in the Euro Area?

Emerging Markets and Low-Income Countries

Several emerging markets and developing economies experienced tensions in a more volatile financial environment. Staff's assessment that markets are currently discriminating across countries depending on domestic fundamentals (as shown by the heterogenous evolution of sovereign spreads) is somewhat reassuring. Nonetheless, the tightening of financial conditions is broad and affects all emerging economies (as displayed by the EMBIG spread change – fig 1.12 of GFSR) in the context of ongoing monetary policy normalization in the United States. Going forward, the communication around this issue should be well-calibrated to convey staff's assessment that the contagion risk is limited while encouraging countries with less solid fundamentals to take resolute actions. In addition, we take note that capital flows reversal will be significantly driven by the Fed policy in the staff baseline scenario (fig 1.14 of GFSR). To avoid an abrupt adjustment and contagion effects, monetary tightening in the US needs to proceed gradually and be well-communicated, something crucial in the context of the current procyclical fiscal stance. In the meantime, emerging markets should prepare for further volatility, using exchange rate flexibility and existing buffers when available to smooth the impact of capital flows reversal. Developing domestic funding markets and a stable local investor base is also desirable although it can prove challenging in the current unstable markets' environment. In this context, staff analysis of the challenges of monetary policy in emerging economies (chapter 3 of the WEO) is particularly timely. We concur with its conclusion on the dominance of domestic factors over external factors in the shaping of inflation. We also welcome the GFSR analysis of the changing landscape of debt and equity investors in emerging markets. Did staff also assess the portfolio rebalancing effects within the EME asset group? In China specifically, we encourage the authorities to remain prudent regarding their answer to current tensions, notably by remaining committed to financial deleveraging.

The progressive growth recovery in Low Income Countries masks highly heterogeneous situations. Within the Sub-Saharan African region, commodity-exporting economies still face a difficult and protracted adjustment. Alongside a rationalization of spending that protects priority capital expenditures and social spending, continuous efforts to improve domestic revenue mobilization over the medium term will be crucial to undertake less regressive and more sustainable adjustments. Against such a backdrop, ambitious reforms of the LIC facilities should be targeted to ensure a sustainable adjustment while tackling macrostructural weaknesses in these countries. Additionally, the change in the composition of investors, including commercial and non-Paris Club creditors, as well as the recourse to complex financing schemes (use of collateralized debt) create new and in some cases challenging conditions for debt restructuring where warranted to restore debt sustainability. Debtors and creditors share the responsibility for promoting sustainable lending practices, and the G20 principles on sustainable lending should guide lending practices going forward. In cases where debt levels prove unsustainable, we reiterate our call for non-traditional lenders to consider joining or working with existing international fora such as the Paris Club to ensure orderly restructuring and fair burden-sharing.

Global Financial Stability Report

Globally, while banks have increased their resilience since the GFC, risks stemming from highly-leveraged exposures (corporate, household and sovereign borrowers) cannot be eliminated. However, they can be monitored more finely, through an improved reporting framework, and prudential measures can help mitigate them. Macroprudential tools have been developed and authorities should use them proactively. In front of the high level of debt of the non-financial sector, the French macroprudential authority implemented two measures to tackle this issue, a concentration ratio and the activation of the CCB. Going forward, we don’t see a need to add new requirements to tackle sovereign and liquidity risks as they can be covered by the existing toolkit, including Pillar 2 requirements. In addition, like staff, we consider that international cooperation, in terms of monetary policy, regulation and supervision, remains key to safeguard global financial stability. In this respect, the special features on international banking group models is insightful and shows that cooperation between authorities should be pursued. Nonetheless, it could have differentiated between jurisdictions. Within the Euro Area, since the supervision and resolution of banks are now centralized, there is no justification for ring fencing policies.

We thank staff for their box on financial stability considerations related to Brexit. Initiatives taken by the EU and UK financial institutions to accompany banks and insurers should be fully acknowledged. We welcome the report’s conclusion that adaptation will above all fall to market participants and will unavoidably incur costs for them. These costs should not equate automatically financial stability concerns. In particular, the impact of a forced relocation of central clearing activities appear overestimated by the industry whereas it is critical for financial stability purpose, monetary policy and the functioning of the payment systems that European authorities maintain control over systemic activities.

10 Years After the Global Financial Crisis a Stock-Taking

The answer to the global financial crisis has been unprecedented in its magnitude as well as in its modalities beyond the financial regulatory reforms agenda. As recalled by staff in the second chapter of the WEO, the international community's answer has been instrumental in curtailing the impact of the financial meltdown on the wider economy. The G20 fora allowed to coordinate at the highest level a vast fiscal stimulus undertaken to offset falling global private demand. It also recalled its attachment to open trade in an effort to prevent the repetition of past experiences of protectionist policies aggravating a global recession. Effective in fulfilling its mandate of the global lender of last resort, the IMF managed to mobilize its resources to the benefit of its whole membership through a general allocation of SDRs and, more specifically, of its members facing BOP needs through dedicated IMF-supported programs. This internationally coordinated response was dictated by the very nature of the crisis, in particular the magnitude of the spillovers and rapid contagion to financial markets worldwide. In this regard, the Integrated Surveillance Decision of 2012 constitutes a key milestone of the after-crisis overhaul as it placed international spillovers and the potential impact of domestic policies on global financial stability at the core of the bilateral and multilateral surveillance of the Fund. More than six years after its adoption, we still see the need to remain vigilant to fully embed in both bilateral and multilateral surveillance an in-depth analysis of international spillovers, in particular for systemic economies.

The policy response from national authorities and international standard-setters has also led to an overhaul of the financial sector regulation. The coordinated action of regulators and supervisors enhanced the requirements for banks and intensified the supervision of "shadow-banking" activities. Admittedly, we have to avoid repeating the same mistakes: the remaining elements of the reform agenda should be completed and a rollback should be avoided. Limited and uneven progress has been made in addressing the role of compensation practices in excessive risk taking. But we should also exercise modesty and accept that new trigger points will emerge. This means assessing the unintended consequences of the new regulatory environment, monitoring the migration of risks and tracking financial innovation, that can have huge positive impacts but also disastrous consequences, as was the case ten year ago. In this regard, while the regulation effort has been focused on enhancing the resilience of globally systemic banks, less has been done on domestically systemic institutions raising the risk of "too many to fail" in some jurisdictions. Looking forward, we concur with staff on the fact that enhancing the resilience of CCPs and the challenges posed by new financial technologies are major priorities.

Beyond the financial channels of the crisis and the excessive leverage that sparked off the crisis, the root causes of the recession should not be overshadowed. While staff usefully recalls that countries entering the crisis with stronger fiscal and financial buffers withstood better the shock, financial imbalances originated mainly from private sector misbehavior and excessive indebtedness. The main driver of these imbalances was therefore not fiscal, apart from one Euro Area country. It is notably worth recalling that, in 2007, the public debt to GDP ratios of Portugal, Spain and Ireland were respectively 65 percent, 36 percent and 25 percent. While encouraging members to rebuild their fiscal buffers and avoid pro-cyclical stances, it is therefore paramount to collectively keep private indebtedness developments well in sight. Additionally, evidences of a link between unsustainable private indebtedness developments and rising inequalities and distorted added value sharing in advanced economies should be further investigate.

The European Union and the Eurozone have undertaken major reforms to enhance crisis-management tools and deepen the integration of the EMU, even if further progress is warranted. Staff's analysis underlines the fact that output losses could have been reduced with a more advanced integration in the architecture of the monetary union. The Euro Area is now better prepared to resist external shocks in the immediate future. Crisis management mechanisms, that were non-existents when the crisis sparked-off, have been created such as the European Stability Mechanism (ESM) and the Single Resolution Fund (SRF). As regards crisis prevention, fiscal rules have been strengthened and the banking sector has been submitted to a single supervision body. Importantly, the ECB took steps to put a stop to the sovereign debt liquidity crisis and stem the risk of contagion within the Euro Area. Nonetheless, the deepening of the EMU to ensure its ability to withstand external shocks remains incomplete. We notably share the view of Messrs. Berger, Dell'Ariccia and Obstfeld that "without decisive progress to foster fiscal risk sharing, EMU will continue to face existential risks"[1]. Beyond the design of crisis-management mechanisms, creating the conditions for convergence in real terms within the Euro Area remains a major challenge.

Managing Public Wealth

We commend the Fiscal Monitor team for their insightful thematic chapter on public sector balance sheets. This work sheds light on a topic that has long been overlooked but that is important both in terms of public finance analysis and policy guidance. Having a comprehensive and accurate picture of public wealth and integrating this metric in the public policy debate would be highly beneficial in our view. Nonetheless, the low availability of statistics on public assets and non-government liabilities appears as a major impediment to

[1] Berger, Dell'Ariccia and Obstfeld (2018), "Revisiting the economic case for fiscal union in the euro area", IMF Departmental Paper No.18/03.

comparability and the Fiscal Monitor usefully calls for wider and better public finance statistical collection. Could staff indicate what concrete steps could be taken to improve data availability and to incentivize countries to collect and publish more data? Are the current methodological guidelines of the Government Financial Statistic Manual sufficiently fleshed out for government to collect such data? Absent wider availability of good and reliable data on public wealth, the analysis of public sector balance sheets of countries which already publish these data should be done and communicated with the greatest care. Disparities in statistical methodologies could entail a penalty for countries who are the most rigorous. International comparisons such as the one presented in Figure 1.1. should notably be communicated with a disclaimer. Such caution should be even greater when dealing with the intertemporal public sector balance sheet as it relies on several assumptions that are particularly uncertain but that can strongly influence projection outcomes (productivity, demography, interest rates notably). Furthermore, age-related expenditures are particularly difficult to forecast and highly volatile. These forecasts do not only rely on demographic trajectory but also on policy parameters that are bound to evolve over time and whose evolution is very often already fully embedded by past reforms (notably regarding pensions). Could staff also elaborate on whether its assessment methodology ensures neutrality between the different types of pension systems (publicly-run pay-as-you-go versus privately-run funded)? With these questions in mind, we encourage the IMF to further work on the development of such analytical tools, notably to study the impact of ageing.

Mr. Alogeel submitted the following statement:

The global economic expansion is continuing, but the momentum is appearing to peak with increasing evidence of uneven growth among countries and plateauing of the expansion in some major economies. This softening is occurring against the background of partial materialization of previously identified risks, including rising trade tensions, tightening of global financial conditions in most emerging market economies, and reversal of capital flows in emerging markets with weaker fundamentals. These risks could rise further because of policy uncertainty, and high public and corporate debt levels in many countries. Cybersecurity breaches and cyberattacks on critical financial infrastructure represent an additional source of risk to the outlook.

The emphasis in the WEO and the GFSR on the need for vigilance is therefore timely and appropriate. Notably, countries should be prepared to respond to mounting vulnerabilities and changes in market sentiments and act rapidly to minimize risks to financial stability and sustain the economic recovery. At the same time, efforts should continue to rebuild policy buffers and improve resilience relying on monetary and fiscal policies, together with structural reforms, tailored to individual country circumstances.

We welcome staff analysis on trade tensions, including the simulations of the economic impact of tariffs. Still, the WEO's baseline scenario assumes healthy trade growth this year and in 2019. While the focus on trade tensions is appropriate and timely, care should also be taken to account for the impact on global GDP of the more structural changes affecting the world economy, including the rebalancing of the Chinese economy and the reduced pace of trade liberalization. Could staff clarify if forecasts for trade take into account these structural changes?

In the face of escalating trade tensions and their impact on global growth, it is critical for policymakers to use every opportunity to foster cooperation to safeguard, and if needed, further enhance the gains achieved in the global trading system. Experience has shown that pursuing global cooperation and maintaining an open and fair-trading system benefits all countries.

Ten years after the global financial crisis, one of the main lessons is that collective and timely actions taken during and in the immediate aftermath of the crisis were critical in averting major dislocations to markets and a repeat of the great depression. Even so, and as documented in the analytical chapter 2 of the WEO, collective actions, although with unprecedented and exceptional nature, were not enough, as output losses seem to be persistent and not limited to countries that suffered banking crisis in 2007-08. The analytical chapter 2 of the GFSR is also timely as it provides a thorough account of the progress made in implementing regulatory reform since the global financial crisis that has contributed to a more resilient financial system. In addition, we appreciate the identification of areas in which consolidation or further progress is needed.

Completing the financial regulatory reform agenda is important to further improve the resilience of the global financial system for which continued multilateral policy coordination will be crucial. In this connection, we are encouraged to note that the Fund is leveraging the FSAP to conduct the assessments in some countries of the effect of financial regulations on the broader economy. We would welcome staff comments on the work plan to contribute to the FSB-led evaluation of regulatory reforms to help identify and address any material unintended consequences and ensure that the reforms accomplish their objectives.

In Advanced Economies (AEs), and apart from the United States, growth is slowing in many countries suggesting the need for maintaining accommodative monetary policy, while a gradual, well communicated, and data-dependent tightening should continue to contain inflation expectations where inflation is close to or above target. As the experience of the global financial crisis has shown, countries with strong fiscal position managed well the crisis and suffered smaller losses. Therefore, countries should use the narrowing window of opportunity to rebuild fiscal buffers while avoiding sharp drags on demand and protecting vulnerable people. Countries with fiscal space need to spend in projects to improve potential output and productivity. It is also essential to accelerate structural reforms to address the challenges of low productivity and aging workforce to boost potential growth.

Growth in Emerging Market and Developing Countries (EMDCs) is moderating but is projected to remain robust over the medium-term. Despite corrections to the forecasts, it is important to note that these markdowns to GDP growth were limited to countries with weak fundamentals and specific risks. As also noted in the GFSR, recent market pressures have to date been concentrated in countries with large external imbalances and weak frameworks. Against this background, we note a slight difference in the tone between the WEO and the GFSR. The GFSR notes in ¶26 that “while global factors affected all countries, the overall spillovers between emerging markets have so far been relatively contained and idiosyncratic factors explained much of the outsized asset price moves”. The WEO, on the other hand, concludes in Page 29 that “in an environment of gradually tightening global interest rates and rising uncertainty, the likelihood of contagion from such episode to other economies has also risen”. We would appreciate staff comments, including on the relevance of the reference to “contagion” instead of “spillover”.

As the external environment will remain challenging with the normalization of monetary policy and the risk of reduced capital inflows, EMDCs should take advantage of the still current favorable external conditions to build buffers, strengthen financial resilience, and promote inclusive growth. This is all the more important since for many EMDCs, prospects to close income gaps relative to AEs appear weaker than in the past with 45 EMDCs projected to grow in per capita terms between 2018 and 2023 by less than AEs and therefore fall further behind in living standards. Call for more inclusive growth is important; however, more efforts need to be made to identify the drivers of growth and share the experience of successful countries. Interestingly, a recent report by McKinsey & Company, Outperformers: High-growth emerging economies and the companies that propel them, identifies 18 EMDCS out of 71 who are outperformers in achieving rapid and sustained high GDP per capita growth because they have a pro-growth agenda that support capital accumulation and, more importantly, have large and highly competitive public companies. While for many EMDCs restructuring and privatization of many public companies remain a desirable solution, could a case be made for a more effective contribution to growth by public companies in EMDCs?

Despite healthy growth, many low-income countries (LICs) remain confronted with several risks, including vulnerabilities to external shocks, trade tensions, and rising debt levels. These countries need to promote policies that strengthen resilience, fiscal prudence, and improve debt management to ensure macroeconomic stability. Particular emphasis should be devoted by the international community, including the IMF, to fragile and conflict-affected states to help these countries restore macroeconomic stability, build institutions, and catalyze donor support.

In the MENA region, growth is projected to increase to around 3 percent in the medium-term. Such level remains insufficient, however, to accommodate the growing labor force and reduce unemployment. Therefore, more efforts are needed to enhance inclusiveness and strengthen the role of the private sector. In Saudi Arabia, growth has been revised upward for 2018 and 2019 from the July 2018 WEO Update. The authorities consider that maintaining gradual fiscal consolidation, supported by ambitious and all-encompassing reforms, is necessary to diversify the economy and further promote the contribution of the private sector to growth and job creation.

Finally, we take note of staff analysis in the WEO's Special Feature on Commodity Market Developments and Forecasts that tight supply conditions and sustained economic activity in the first half of 2018 explain recent increases in oil prices. Saudi Arabia will continue to focus on supporting the stability of oil markets for the benefit of both producers and consumers, including through the implementation of the OPEC+ agreement to increase oil production and to support global economic growth. On the section on the long-term determinants of energy demand, the conclusion that saturation is probably much closer for some energy sources such as oil does not seem to be supported by data. We think that oil demand is expected to continue to increase over the long term driven in part by an expanding middle class, high population growth rates, and expectations of stronger economic growth in EMDCs. Staff comments would be appreciated. Here, we would like to underscore that expectations of rapid switching from oil could be counterproductive as massive investment, including in aging infrastructure, is needed over the next quarter of century to meet rising demand for oil.

Ms. Erbenova, Mr. Bayar, Mr. Just, Mr. Hagara and Mr. Stradal submitted the following statement:

We thank staff for a comprehensive and informative set of reports, including the timely thematic chapters. We broadly concur with the main tenets characterizing the conjuncture, as well as the policy advice. Global growth seems to have peaked and is becoming increasingly uneven, while the downside risks have risen in the last six months and partially materialized in a context of elevated policy uncertainty.

World Economic Outlook

We share the view that escalating trade tensions and the potential shift away from a multilateral, rules-based trading system are key threats to the global outlook. We appreciate the box which attempts to quantify the economic impacts of several scenarios. It is a welcome contribution to the policy debate and clearly shows that there can be only losers and no winners from trade conflicts. We also acknowledge that staff clearly spells out the caveats and limitations of the model results. The confidence channel is inherently difficult to model and the potential value-chain disruptions, which are not captured in the model, may have an outsized effect on the corporate sector and hence on business investments.

We fully endorse the recommendations to urgently build fiscal buffers as the window of opportunity to do so is narrowing. The public debt levels are very high in many countries, while debt projections worsened compared to April. In this vein, we fully subscribe to the recommendation to roll back the procyclical fiscal stimulus in the United States. In contrast, although staff's projection already assumes some fiscal easing in Germany, policy advice continues to ask for further steps to boost domestic demand on the back of estimated fiscal space to help address global external imbalances. Echoing Mr. Ostros, we suggest including staff's assessment of cyclical positions underlying the projections given their importance for assessment of fiscal positions and inflationary pressures.

The pace of economic growth in Europe has slightly slowed down this year relative to 2017, mostly due to slower export growth, and a moderate decline in confidence in the context of rising trade tensions. Some EU countries outside of the euro area are already bouncing against their capacity boundaries as unemployment has reached historical lows. We concur with staff's expectations for the moderately above-trend growth to continue in the next two years, subject to more severe trade shocks not materializing.

Inflation in the euro area is expected to remain stable at 1.7 percent in 2018 and 2019. The sustained pick-up in core inflation will compensate for the decline of more volatile parts of the consumer basket as the effects of energy price spikes dissipate. Monetary policy is expected to remain highly accommodative well into 2020. We take note of the hypothesis of strong backward-looking tendencies in the formation of inflation expectations in the euro area. Nevertheless, we are still puzzled by the projected path of core inflation, which is expected to rise sharply to 1.6 percent in 2019 from 1.2 percent in 2018, but to only grow slowly thereafter to 2 percent in 2022. Could staff elaborate on the causes of this markedly slower acceleration in the outer years of the forecast?

We share staff's assessment that recent exchange rate movements in emerging and advanced economies largely reflect their fundamentals, domestic factors and perceptions about future monetary policy developments. Nonetheless, a fair share of influence on a shift of portfolio flows away from emerging market economies should also be attributed to the role of sentiment shocks and geopolitical factors.

We take note of the difficult long-term trade-offs in China in rebalancing the economy, against the background of tariff shocks, a significantly stronger USD and addressing the formidable financial vulnerabilities, while preserving economic growth. We welcome the progress achieved so far in slowing the build-up of leverage in the shadow banking sector, as well as the growing role of bankruptcy proceedings in resolving the non-viable corporations. However, we are concerned by repeated bouts of monetary easing and backtracking on implementation of regulatory measures in response to signs of slowing growth, despite the authorities deemphasizing growth targets.

Global Financial Stability Report

We agree with the main conclusion that near-term risks to global financial stability have increased somewhat and could rise sharply, while the medium-term risks remain elevated. We acknowledge the divergence between advanced economies and emerging markets, where some of the risks highlighted in the last GFSR have already materialized over the past six months.

In the advanced economies, financial conditions remain easy creating incentives for continued leverage build-up. In the United States, despite the continuing but slow tightening of the monetary policy, the financial conditions have eased further. The core personal consumption deflator, the Fed's preferred measure of inflation, has already exceeded the 2 percent implicit target and is forecast to climb further. The unemployment rate is at a multi-decade low but does not seem to pose a threat to the Fed's dual mandate of price stability and maximum sustainable employment. At the same time, the procyclical fiscal stimulus risks overheating the economy which is already operating above its potential. We thus find it somewhat surprising, that staff reiterates the recommendation of gradual, data-dependent monetary tightening in the US. We have serious doubts about the effectiveness of macroprudential policy alone to contain the vulnerabilities building up in the financial assets markets, housing markets, and non-financial corporate sector. Monetary policy can contribute to this end once the inflation and inflation expectations rise sufficiently far from the deflation danger territory. Noting that staff's assessment of risks has changed, we would appreciate staff's comment on the appropriateness of keeping the monetary policy advice for the US unchanged from previous flagships.

We appreciate the focus on fragilities in emerging and frontier markets in the current conjuncture. We take note of the staff's assessment pointing to investors' differentiation among sovereign borrowers and the lack of generalized contagion so far. The final verdict is still out on the respective weights of the idiosyncratic factors and the global factors, such as financial conditions and removal of monetary stimulus in the major advanced economies. Regardless, the foreign currency sovereign debt as well as open FX positions of financial and non-financial corporates are vulnerabilities that are increasingly getting exposed by the continued US monetary tightening, even though it has not come as a surprise. We concur with the importance of flexible exchange rates in cushioning the external shocks, accompanied by timely adjustments in fiscal and monetary policies. However, more granular and differentiated policy advice would be welcome for the countries where the existing FX exposures already cause tensions. For instance, the somewhat philosophical discussion on the importance of deeper capital markets is inconclusive with arguments both pro and con without relative weights assigned. Further staff comments are welcome.

We share the view that banks on aggregate have strengthened their balance sheets – both in terms of capital and liquidity – but pockets of weakness remain. Concerns relate to exposures to highly indebted household and corporate sectors in some EU member states. At the same time, important structural challenges continue to weigh on banks' long-term profitability prospects in a number of countries. Macroprudential policies should primarily be implemented in a preventive fashion at times when risks start to gradually accumulate. As the risky exposures reach excessive levels, policy options are limited largely to building capital buffers to address the effects of accumulated risks in case of an adverse scenario.

Chapter 2 is a useful overview of the regulatory changes that have been designed and largely implemented in response to the Global Financial Crisis. We acknowledge the difficulty of assessing the overall impact of a wide array of reforms with complex interconnections. We agree that backtracking on the regulatory reform would be very risky at this phase of the financial cycle and that vigilance is needed in monitoring the new sources of risk.

Staff mentions a number of newly emerging risks which should be addressed, such as cybersecurity risks. In this regard, we would like to highlight that the Basel Committee on Banking Supervision has announced limited number of new policy-related initiatives in its 2018-2019 work program—cyber risk, operational resilience and proportionality—which may usefully be acknowledged in the document. In our view, particularly the need for proportionality deserves to be mentioned as an important theme for the Fund's global membership. We would also appreciate a recognition of the increased complexity of regulation, supervision and decision making resulting from the global regulatory reforms.

Fiscal Monitor

We support the increased focus on public-sector balance sheet assessment in staff's fiscal analysis, particularly in view of its ability to cover risks and long-term challenges that are outside of scope of traditional fiscal indicators such as government balance and public debt. The comparison of Finland/Norway long-term net worth outlooks is instrumental, highlighting the large aging challenge faced by many countries. Similarly, the intertemporal net worth concept can be used to assess long-term sustainability of underlying fiscal positions of commodity exporters in view of finite nature of the natural resources.

Nevertheless, the balance sheet analyses have also limitations, mainly due to large uncertainties surrounding the valuation estimates. The uncertainties stem from comparing various asset classes and liabilities with differing liquidity, marketability, volatility of valuation as well as probability of realization. As such, the use of public-sector balance sheets indicators cannot replace the standard fiscal analysis based on government balance and public debt and should rather be seen as a complement to it. Indeed, staff analysis shows that net worth is well below the pre-crisis level, thus reinforcing the call to rebuild fiscal buffers. This message should have been propagated more prominently in the Fiscal Monitor as well as in the main chapter of the WEO.

We agree that large public assets deserve more transparency and increased scrutiny, which can lead to their improved management. Having said that, the illustrative estimate of potential revenue gains from improved asset management (Box 1.1) should be presented with more caution. As rightly pointed out in the report, the low rate of return of public assets can also reflect their different operational objectives or pervasive governance shortcomings leading to structurally low rate of return, in which case a sale of assets can be more appropriate policy response. Further analysis of public sector balance sheets is definitely warranted. However, additional fiscal indicators and improved analyses may themselves not be sufficient to spur the policy action. In that vein, we appreciate the case studies of the UK and New Zealand, showing increased attention to balance sheet management. We wonder what factors galvanized the positive policy response.

While public sector balance sheet analysis can improve fiscal risks monitoring, its compilation requires significant resources and efforts and is heavily dependent on the quality of data, which needs to be ensured by independence and sufficient resources to statistics' bodies as well as use of accounting standards that are up-to-date with the government's accounting practices. Staff argues that the basic balance sheet estimates can be compiled even in LICs. We note however that many LICs and emerging market economies still record fiscal data on a cash basis and many cover only the central government. As such, fiscal analysis of emerging markets and LICs net worth is more prone to miss risks related to fiscal illusion. We thus believe that the approach is well-suited to play a complementary role in surveillance and sustainability analysis rather than serving as a more operational policy making input in most country cases. We wonder whether there is progress with subscription to SDDS Plus and GDI standards.

Mr. Mozhin, Mr. Palei, Mr. Tolstikov, Mr. Potapov, Ms. Smirnova and Mr. Snisorenko submitted the following statement:

While the global expansion continues at its strongest pace since 2011, concerns are mounting about its sustainability, accumulation of vulnerabilities, and the rise of international tensions. Global growth is becoming less synchronized and in many advanced economies (AEs) output gap has closed. Expansionary fiscal policy in the United States has provided temporary stimulus to global growth, but it also increased the risks of abrupt changes going forward. Growth in AEs is expected to slow down in 2019-20, as capacity constraints will become more binding. The emerging market economies (EMEs) continue to drive global growth, but they face a more challenging market environment, and some are struggling with capital outflows and large currency depreciations.

Several risks have become more pronounced since April 2018, and the balance of risks in the near term is increasingly shifting to the downside. The main risks include the continuing build-up of financial vulnerabilities, the appreciating U.S. dollar, higher energy prices, unsustainable macroeconomic policies in some large economies, growing trade disputes, declining trust in the mainstream policies, and rising income inequality. Increasing geopolitical tensions lead to reassessment of the benefits and costs of close economic integration and interdependence.

We note, however, that despite repeated calls to fix the roofs during sunny days, too many roofs still need substantial repair. As the clouds are gathering over the horizon, the global economy is approaching the next downturn with weaker buffers and narrower room for policy maneuver than ten years ago. The special chapters in the WEO and the GFSR with the analysis of the post-crisis developments highlighted the achievements and the remaining reform agenda. Public and corporate debts remain at a record level in many AEs, and the recovery of balance sheets is still work in progress. As highlighted in the FM, the G7 net worth is well in the negative territory. Persistently low productivity suggests that in many areas of structural reforms progress remains insufficient. Due to the prolonged period of low interest rates and unconventional monetary policies, in most AEs current capacity of central banks to support growth is weak. Significant progress has been made in strengthening the financial systems, but important gaps remain, and the implementation of the new rules and standards is uneven across jurisdictions.

Notwithstanding evolving circumstances, policy recommendations remain largely the same. To sustain growth momentum and avert the looming risks, AEs should continue gradual monetary normalization. Accommodative monetary policy remains, however, appropriate for AEs where inflation remains below target. The task of rebuilding fiscal buffers remains of utmost importance, but one can argue that momentum has already been lost. EMEs need to be better prepared for the more volatile and unstable times. They should adopt policies, which enhance their resilience to the tightening of global financial conditions and reversals in capital flows. Continued efforts are needed to boost growth potential through structural reforms and growth-enhancing public investments in both AEs and EMEs. It is also paramount to avoid reform fatigue in the global financial regulation agenda, and the IMF should play a critical role here, especially through its FSAP surveillance and Article IV consultations.

We welcome staff evaluation of the possible impact of higher tariffs on the global economy, which provides the quantitative assessment of GDP losses under various scenarios and outlines possible effects on economies from trade disruptions. We find this analysis very useful for further policy discussions. However, we should keep in mind that the introduction of higher tariffs is not the only way in which global integration is being undermined. The United States increasingly use their dominant position in the global financial system to disrupt trade and capital flows between third countries. Such actions present a similar, if not a bigger threat to the normal functioning of the global trade and finance. They have already triggered a search for counterbalancing measures by other major economies, which can eventually change the landscape of the global financial system. We encourage the Fund to monitor and analyze these developments.

We agree with staff that the procyclical fiscal stimulus in the United States should be avoided. However, it was already implemented, boosting the U.S. growth above potential, and bringing unemployment to the record low. Inflation is slowly picking up. In the environment of low unemployment inflation may eventually surprise on the upside, triggering faster monetary tightening and further U.S. dollar appreciation. On the backdrop of stronger currency and fiscal stimulus, the U.S. current account deficit would widen further, adding to protectionist impulses. These developments could be exacerbated by a reappraisal of asset valuations that remain stretched, as the cyclically adjusted price/earnings ratio has exceeded its post-1990 average.

We agree that the global economy is now more vulnerable to a sudden tightening of global financial conditions, which could be triggered by various factors, not just the unsustainable policy mix in the United States. Such tightening may materialize even if there is no inflation or monetary policy surprise in the major AEs. Concerns about fiscal and debt sustainability, the continuous deterioration of non-financial corporate balance sheets, the sovereign-bank nexus, high housing and commercial real estate prices, as well as political developments may become triggers of destabilizing events in financial markets.

Against the background of elevated risks in the global economy, both AEs and EMEs may face difficult times ahead, and the IMF’s flagship reports should keep a balanced focus on the key developments and fundamentals in these countries, not under- or overestimating their resilience. It is essential to maintain proper differentiation within the groups of countries.

Considering financial conditions in AEs, the GFSR seems to downplay the challenges associated with the Brexit and the euro area, including Italy and other vulnerable members of the currency union. We have some doubts about staff’s conclusion that financial conditions remain easy in the euro area. We note that over the past six months the economic outlook for all major countries in the euro area has significantly deteriorated, while higher credit spreads and lower equity prices are observed in some euro area countries. In this context, we would ask staff to present the evolution of spreads within the euro area and provide a stand-alone figure with the Financial Conditions Index for the euro area.

The GFSR could have better distinguished the evolution of financial conditions within the group of the EMEs. While a few countries have clearly stood out as the extreme cases affected by large external debt, elevated inflation, and other policy challenges, other EMEs have broadly demonstrated their resilience (WEO Chapter 1 Figure 1.6 (page 14)). The balance of payments pressures in Argentina and Turkey were largely driven by idiosyncratic factors. Could staff provide the Financial Conditions Index for EMEs excluding these economies?

The fact is that many EMEs now have well-tested macroeconomic frameworks and accumulated greater buffers than during the previous episodes of market turbulence. Stronger fundamentals in many EMEs should have been better articulated in the main messages of the GFSR. In this regard, we would prefer staff’s conclusion that overall vulnerabilities in EMEs are moderate compared to historical norms (page 21, GFSR) to be included in the Executive Summary of the report.

The point in the GFSR that financial stability risks in EMEs could be mitigated through building and maintaining adequate international reserves is well taken. Since the initial stages of the global financial crisis the authorities in many countries consistently emphasized the benefits of having large reserves. At the same time, this call in the report may create an impression of the failure to address remaining substantial gaps in the global financial safety net. With respect to the IMF, the reluctance among many AEs to strengthen the IMF quota resources and its governance is regrettable. We also continue to view the resistance to creation of the new liquidity instrument as a mistake.

The call for self-reliance in the face of possible financial turmoil in the near term may also be misunderstood due to remaining fragmentation of the GFSN, with the Fund's role in it being increasingly questioned. In our opinion, one of the stark examples of the latter was the decision by the European regional financing mechanism (ESM) to essentially disregard the IMF/WB DSA for Greece. In the future this precedent may have uncertain repercussions for global financial stability.

In the Fiscal Monitor, we support staff's call to expand the use of the Public Sector Balance Sheet (PSBS) framework as it provides a crucial additional tool for the fiscal analysis. The insightful case studies demonstrate how balance sheet analysis can be used as an additional tool to evaluate fiscal health, as well as to identify and assess fiscal risks.

Evidence suggests that countries with stronger balance sheets face lower financing costs and are better able to engage in countercyclical fiscal policy during recessions. In that context, several conclusions in the FM are especially notable. The PSBS presented by staff shows that most of the G7 countries have negative net wealth. The net worth across the available sample remains 28 percentage points of GDP below the pre-crisis levels. Moreover, the stress tests of fiscal positions in some AEs show the risk of additional deterioration of a similar scale. At the same time, many EMEs included in the sample show healthy fiscal positions. Indonesia was a particularly interesting example as the analysis pointed to strong and improving public sector balance sheet.

At this stage, however, we should probably take the estimates provided by the PSBS analysis with a grain of salt due to data availability and quality, volatile valuations, and the choice of assumptions. Staff appropriately emphasized the key limitation of the PSBS estimates. Broader coverage of countries and more regular analysis of PSBSs would make the estimates more reliable and lead to better informed assessments of fiscal policies and risks.

Mr. Armas, Mr. Lischinsky, Mr. Vogel, Mr. Corvalan Mendoza, Ms. Moreno and Mr. Rojas Ulo submitted the following statement:

We thank staff for the flagship reports and insightful analytical work in the context of the 10th anniversary of the Global Financial Crisis (GFC). We have the following comments:

World Economic Outlook

The current report rightly underscores that “the balance of risks to the global growth forecast is tilted to the downside, both in the short term and beyond”. By definition, sooner or later medium-term perspectives end up affecting short-term facts. In the last World Economic Outlook (WEO) issued in April 2018, it was underlined that “upside and downside risks are broadly balanced over the last several quarters but risks farther down the road are skewed to the downside”. Unfortunately, this is no longer the case as trade tensions have materialized in recent months. Against this backdrop, we support a strong Fund message to build buffers and implement deep structural reforms to achieve higher and inclusive potential economic growth.

The 2008 GFC had many long-lasting consequences worldwide, not only in the economic area but in others that directly affect it. Chapter 2 of the WEO mentions that “societal support for openness and global economic integration appears to have weakened in many countries after the crisis”. Political uncertainty continues to increase in many parts of the world and, of course, Europe is one of these places: in some parts of the continent, nationalism and Euroscepticism are gaining ground. Perspectives in the United Kingdom are clouded by Brexit; sovereign spreads have sharply increased in Italy amidst political tensions that surrounded the 2019 budget; and, as was the case with Brexit, recent elections, facts, and trends in some European countries are questioning one of the most relevant political, social and economic developments of past centuries, that is, the European Union.

Global trade tensions have the potential of exacerbating current trends and volatility. We note from the WEO’s Scenario Box the damage that trade tensions, which include a chain of measures and retaliations, may impose on the world economy. It is noted, on page 9 of the report, that “the macroeconomic projections discussed below assume still-healthy trade growth this year and in 2019”. In this regard, we wonder whether, by making this assumption, the WEO’s projections could be tilted to the optimistic side. It is likely that all the negative spillovers from an escalation of trade conflict have not yet been fully estimated given the complexity of the world economy and the multiple dimensions of input-output relationships across each chain of production. The relevant consequences that an intensification of these disputes may have, not only for the parties directly involved but for the global economy, require that the Fund continue to warn of these consequences and urge all parties to act in good faith. One of the key structural reforms should be to achieve a more open rules-based international trade system with domestic mechanisms to mobilize labor forces according to the changes in the economic structure (i.e. permanent training programs and a suitable social safety net system).

What is happening in emerging economies is not only due to idiosyncratic factors. Although it is clear that volatility is more pronounced in countries which are perceived as more vulnerable, it is also affecting a number of emerging economies around the world. As underlined in Chapter 2, "the extraordinary policy actions to prevent a second Great Depression have had important side effects". Emerging markets have had some benefits from a period of low interest rates, but at the same time, it has created macroeconomic and financial vulnerabilities, some of which had been mitigated in many emerging economies through sound policies. Chile is one example where the recent volatility has not affected the outlook, and in fact, growth projections for 2018 have been revised upwards from 2.5 percent in the October 2017 WEO, to 3.4 percent in April, and 4.0 percent in the October 2018 WEO. In the case of Peru, 2018 GDP growth projections have also been revised upward from 3.7 percent in April 2018 to 4.1 percent in the October 2018 WEO. We agree with Ms. Roach, Ms. White, Miss Chen, and Mr. Hemingway that the Fund should make policy recommendations according to the specific situation of each country whether it is necessary to keep building buffers or start deploying them. We also share Mr. Sembene, Mr. Nguema-Affane, and Mr. Diakite's view that flagships should put more emphasis on the spillover of financial conditions to EMDCs.

Migration constitutes a relevant factor to understand developments and perspectives from economic, political, and social points of view. Addressing social and economic conditions in source (emigration) countries is critical and should be a global concern. The WEO report provides two important facts: "over forty-five emerging market and developing economies—accounting for 10 percent of world GDP in purchasing-power-parity terms—are projected to grow by less than advanced economies in per capita terms over the period 2018-2023, and hence to fall further behind in living standards"; and Chapter 2 appropriately warns about trends related to the declining share of labor income, subdued wage growth, and the rise of part-time work, which, although a global issue, especially affects emerging economies and low-income countries. These trends aggravate another important problem, that of the growing concentration of income and wealth on a global scale.

We find Box 1.5, “Sharp GDP Declines: some stylized facts” interesting, with the list of episodes of declines in GDP per capita exceeding 20 percent. As the report notes, these episodes are unfortunate but not rare, even though the results would be less extreme if instead of considering GDP per capita at dollar market prices the list considered GDP PPP per capita. Otherwise in the table, it looks like exchange rate changes have more influence in GDP per capita than real GDP per capita changes. In general, these episodes start with a very revalued local currency and end with a highly devalued local currency.

Chapter 2 of the WEO brings lessons from the global economic recovery ten years after the 2008 financial crisis. In a nutshell, deviations of domestic credit growth (one key macroeconomic imbalance) played a role, as did the nature of the shock and the policy choices once the crisis hit. The ability to build fiscal, financial and external buffers has shown to be effective. We share Mr. Ostros and Ms. Sand’s view that “strong macroeconomic policy frameworks, sustainable external positions, sound macroprudential policies and financial market regulation, and responsible fiscal policies with sufficient buffers are necessary elements to mitigate the effects of economic and financial crises and to create policy space for subsequent recoveries.”

Chapter 3 of the WEO focuses on inflation and what the challenges are for monetary policy in emerging markets with the normalization of financial conditions. It shows that heterogeneity remains among emerging markets with regards to inflation performance and long-term inflation expectations. It also confirms that internal factors are more important than external ones in recent improvements in inflation performance and that the main determinants of inflation are the changes to long-term inflation expectations, without explaining what the determinants are in changes in long-term inflation expectations. Furthermore, the report states that anchoring inflation expectations can improve resilience to negative external shocks by limiting pass-through of devaluations to internal prices shocks and, in this way, monetary policy can center more on reducing fluctuations in output. In this regard, a clear communication from monetary authorities is an important element to anchor expectations, but for most developing economies the issue of central bank independence (as pointed out by Mr. Doornbosch) and fiscal dominance or the reputation of the central bank as inflation fighter are probably more relevant ones.

Global Financial Stability Report

We welcome the appropriate selection of themes a decade after the GFC, asking if we are safer, and analyzing regulations that foster a stronger financial system while flagging some of the new emerging vulnerabilities. We note a much more somber tone in the report compared to the previous one, with a clearer sign of alert to global financial stability. According to the growth-at-risk (GaR) approach, a modest increase of risks for the near term has been detected, whereas the medium-term risks remain elevated compared to what was seen in the Global Financial Stability Report (GFSR) of April 2018.

The report highlights new elements that are compounding financial risks. Particularly monetary normalization in the US—which started in mid-April—plus trade tensions between the US and China that flared up in June. These new elements are particularly affecting emerging and frontier markets, as described in Figure 1.10., where capital outflows are happening due to the stronger US dollar, and significant changes in debt and equity markets are tightening financial conditions. Under this scenario, it caught our attention that the FED's latest raise in its policy rate in April did not tighten the financial conditions in the US economy, as was the case in emerging and frontier economies. This situation is puzzling for us and we would appreciate further clarification from staff on monetary policy traction in the US.

Investors' capacity to differentiate among emerging markets is a good sign of a better communication strategy and transparent information. This is especially true in times of uncertainties and looming financial risks. Timely and transparent information that helps differentiate specific situations by region and by country are critically needed, and the IMF is doing its part to solve the potential risk of asymmetric information. We would suggest to explicitly incorporate in Chapter 1, under "Policies to safeguard financial stability", a few paragraphs explaining that stronger collaboration and multilateral coordination on the communication strategy arena are needed. On the other hand, we agree with Mr. Ostros and Ms. Sand that currency-differentiated LCRs could provide additional buffers to face capital outflows and liquidity risk in foreign currency.

We praise staff for Chapter 2 of the report, which takes stock of regulatory reforms that were introduced right after the GFC, particularly on "Regulatory efforts going forward: Where to focus?". The content in this chapter reaches a very good balance between detail/comprehensiveness and expositional clarity and rightly points out the necessity to avoid, at all costs, the pressures to roll back the agenda that was put into motion immediately following the GFC. The role of the Fund on this task is not only limited to surveillance through both FSAP and Article IV Consultations for each member country and providing technical assistance, which of course are of utmost importance, but, contributing to the debate at all levels. In terms of classification of different tools implemented by countries, we believe that regulations to limit foreign exchange risk like the ones mentioned in paragraph 18 footnote 22 in the case of Argentina is better understood as a macro-prudential measure to contain foreign exchange risk, such as those mentioned in paragraph 27.

We support the message that improvements in oversight and regulation of shadow banking should continue (paragraph 47). This risk factor to global financial stability has been repeatedly singled out by international organizations and regulatory/supervisory bodies. The recent Argentine experience of fire-sales of central bank bills (LEBACs) by foreign funds could be a showcase, on a very small scale, of disruptions neither generated nor transmitted by banking intermediaries.

Fiscal Monitor

We support staff's efforts in analyzing public sector balance sheets in illustrative case studies in several countries that show important lessons. The Fiscal Monitor (FM) report explains a conceptual framework about public sector balance sheets, with important financial and macroeconomic topics and empirical evidence on potential gains for improved public-sector management due to allowing increased revenues, reduced risks, and improved fiscal policymaking. The report also explores different topics on balance sheets such as the evolution of public wealth, identifying fiscal risks, and evaluating fiscal policies and balance sheets in a range of countries that distill some lessons for the policy debate. We are encouraged by the inclusion of Uruguay's interesting case (together with those of Australia, New Zealand, and the United Kingdom) in this section. The report shows that governments should consider different effects on assets and liabilities and evaluate changes in public wealth. This aspect involves various data quality and transparency issues and calls for improved public-sector accounting and statistical collection standards in different countries.

We welcome the focus of the FM on managing public wealth which exposes a conceptual framework and a range of tools to analyze the resilience of public finances. The report shows the importance of public sector balance sheets as the evaluation of accumulated assets and liabilities which, by using a new database, provides a representation of the changes of public wealth against external and internal shocks for a broad sample of countries of the global economy. At present we believe that the estimation of PSBS is subject to a high level of uncertainty for several reasons pointed out by Ms. Roach, Mr. Ostros, and Mr. Sembene. At this stage we call for a prudent use of this new tool for policy advisory purposes. As improvement of methodology and quality data will occur in the future, the evaluation of the public sector through public balance sheets will suitably complement the standard fiscal evaluation, for instance, debt sustainability analysis, and will be incorporated in Article IV staff reports. Staff's comments are welcome.

Mr. Mkwezalamba, Mr. Mahlinza, Mr. Obiora, Mr. Sitima-wina, Mr. Tivane and Mr. Nakunyada submitted the following statement:

World Economic Outlook

We thank staff for an excellent set of reports and broadly concur with their assessment of the global outlook and policy priorities. Although the pace of global recovery seems to have gained slight momentum, we are concerned with the wide spectrum of associated downside risks, including escalating trade tensions, financial vulnerabilities, geopolitical and policy uncertainties, high and rising global debt levels, as well as concerns related to climate change. While welcoming the renewed emphasis on rebuilding fiscal buffers, strengthening financial sector resilience, and advancing structural reforms to support sustained and inclusive growth, we believe that the myriad of risks associated with the global outlook merits a more urgent call for remedial measures, should these risks crystalize. This is especially important given that the uncertainty around the pace and consistency of monetary policy normalization in advanced economies (AEs) will have a substantial impact across emerging markets and developing economies (EMDEs).

The divergence in growth prospects among different geographic regions is an important aspect of the latest flagship reports. For instance, the report notes that the renewed growth momentum in EMDEs has not translated into significant improvements in per capita incomes over the past several years, compared to AEs. Further, over 45 EMDEs, accounting for 10 percent of global GDP in purchasing power parity (PPP) terms, are projected to grow less than AEs in per capita terms over the period 2018–2023, and hence fall further behind in living standards. While supporting efforts by the Fund to include macro-financial issues in Fund surveillance, we believe it is worthwhile for the Fund to provide more detailed analysis of the reasons behind the contrasting fortunes and policy settings of EMDEs. We agree with staff that policy priorities should be geared towards advancing growth-friendly fiscal adjustments coupled with other reforms to diversify the sources of growth away from hydrocarbons and improve non-oil revenues.

The uptick in growth witnessed in sub-Saharan Africa, over the recent years, is projected to continue in the near term, supported by benign external conditions, a recovery in commodity prices, and improved access to international finance. While these developments are encouraging, we reiterate the call for policymakers to pursue actions to accelerate economic diversification; reinvigorate structural reforms to increase fiscal space, support climate-resilient infrastructure and social outlays; and boost productivity growth, and leverage opportunities from digital technologies.

We welcome the fresh perspectives on the global recovery ten years after the Global Financial Crisis (GFC), and the challenges to monetary policy in EMDEs as global conditions normalize, as discussed in the analytical chapters of the WEO. We are encouraged by the renewed body of evidence that seems to suggest that policy choices in the run-up and the immediate aftermath of the GFC have significantly shaped the economic outcomes for the better. For instance, countries that had robust policy frameworks coped better with the post-crisis economic conditions and recovered output losses. Similarly, we share staff's views that building sound and credible policy frameworks could yield substantial gains in anchoring inflation expectations. However, we are surprised with staff's conclusion that domestic factors play a more dominant role than foreign ones in driving inflation dynamics. To the extent that exchange rate movements are dominated by foreign developments, one would have expected these developments to be more dominant than domestic factors in determining inflation dynamics in EMDEs. Staff's comments are welcome.

Finally, we support the Fund's call for strengthening multilateral cooperation, including adherence to a rules-based multilateral trade system. At this juncture, we strongly encourage countries to give prominence to messages underscoring the adverse impact of inward- looking policies. In this vein, we strongly support multilateral cooperation as an important vehicle to achieve global economic integration, address cross-border taxation challenges, promote a more stable and resilient financial system, and address economic imbalances, while at the same time tackling non-economic risks, including climate change and cybersecurity threats.

Global Financial Stability Report

We are encouraged by the significant strides made within the regulatory reform agenda and support the Fund's continued role in the resolution of pre-crisis shortfalls. We note that new standards, tools, and practices have been adopted, culminating in improvements to the global financial system's resilience, leverage, systemic risk monitoring, and supervision, including the shadow banking sector. This notwithstanding, sustained efforts are required to complete the remaining elements of regulatory reforms to further strengthen the stability of the global financial system, guard against complacency, and resist rollback pressures as the effects of GFC fade.

Considering the progress made in strengthening the regulatory toolkit for systemic banks, we emphasize the need for similar efforts towards the regulation of systemic non-bank financial institutions and continued reforms in the corporate governance to contain excessive risk-taking and impose self-discipline. In this context, we agree that increased focus on the regulation of the systemic non-banking sector remains important to reduce regulatory arbitrage and address the migration of risks between banks and non-banks. To this end, we support the call to extend the perimeter of prudential regulations to areas such as asset management and emphasize the need to tailor these regulations to country circumstances. Similarly, further work is required to support the strengthening of the insurer solvency framework, and completion of capital standards for globally systemic insurers.

We positively note the Fund's critical role through surveillance, TA and the FSAPs to help design macroprudential policies and develop systemic risk monitoring capacity in many countries. That said, macroprudential authorities should be equipped with adequate toolkits to effectively monitor and contain systemic risks. In view of the different institutional setups among macroprudential authorities with varying degrees of autonomy and powers, we encourage further work to guide member states on the most effective institutional set-ups.

The complexity of some financial products and systems in many AEs have been determined to be at the root of regulatory problems. To the extent that products and systems in many EMDEs are less complex, we wonder if there are lessons to be gleaned from them. More broadly, it could be worthwhile to investigate whether there is an optimal level of complexity for these products and systems that ensure the most effective and efficient financial regulatory frameworks.

The on-going fintech revolution has amplified the need to monitor related risks as they currently evolve. Accordingly, we support the timely development of a global response to strengthening of regulatory and technological systems, to counter emerging fintech and cyber security risks.

Against the background of the significant loss of correspondent banking relationships (CBRs) in an increasing number of countries in the post-GFC era, we call on the Fund to continue supporting the affected countries through capacity development and technical assistance, while leveraging its convening powers to facilitate global dialogue on these matters. Additional focus on practical and country-specific remedial measures would be important to help restore the critical correspondent accounts. Relatedly, the assessment should focus on key tradeoffs, including bank profitability, financial inclusion and intermediation, remittance flows, and finance costs. Going forward, a detailed assessment of progress made in addressing previous deficiencies related to the fragmentation and complexity of the global financial architecture, and inadequate early warning system would be important in the development of preventive measures.

Fiscal Monitor

We welcome the focus on the public-sector balance sheet (PSBS) approach in measuring the net wealth of governments. Having a comprehensive picture of the government's assets and liabilities beyond debt and deficits is very useful in informing fiscal policy formulation, particularly in setting fiscal policy objectives. We note that net worth does not account for the state's ability to tax in the future, thereby underscoring the importance of intertemporal balance sheet analysis. Given that long-run development objectives of governments are generally to provide goods and services to its citizens and build fiscal buffers to mitigate future shocks, the strength of the balance sheet should indeed be regarded as a tool to support development objectives.

We appreciate staff's effort to estimate the PSBSs for The Gambia, notwithstanding a very data constrained environment—a feature common to most countries in our constituency. Our Gambian authorities should find the information useful and integrate the analysis in their economic workstream. Given the complexity in measuring and valuing assets, particularly non-financial assets and liabilities and the various data quality issues involved in producing balance sheet estimates, we urge the Fund to strengthen engagement with countries through enhanced capacity building initiatives to improve public sector accounting standards. We concur that balance sheet estimates should be treated with some caution, as the application of accounting and statistical standards varies widely among countries.

Given that the benefits of balance sheet analysis are within reach in many countries, we welcome the important lessons from countries that produce PSBSs. In particular, this tool has the capacity to facilitate improvement in asset management through maximizing efficient utilization of and returns on public assets. In addition, it is useful in identifying, analyzing, and managing fiscal risks emanating from within the balance sheet and from external shocks. More broadly, we would welcome broader coverage in this report on countries grappling with rising debt vulnerabilities, especially those in fragile and conflict affected situations.

Mr. Kaizuka, Mr. Saito, Mr. Ozaki, Mr. Komura and Mr. Minoura submitted the following statement:

World Economic Outlook (WEO)

The Global Economy, Chapter 1

According to the WEO, the global economy is expected to expand at 3.7 percent in 2018 and 2019 while the growth rates are revised down by 0.2 percent from this July. Many AEs are projected to grow at their potential growth rate afterwards which population ageing and subdued productivity growth continue to weigh on. In EMs and developing countries, growth outlook is also revised down, reflecting rapid slowdown in Turkey and Argentina and effects of the US sanctions on Iran.

We share the staff’s view that the balance of risks to global growth has shifted to the downside, both in the near-term and beyond, while several downside risks, such as an escalation of trade tensions and a reversal of capital flows, have been partially materialized. Escalating trade tensions is especially a matter of concern for the global economy. As the Scenario Box illustrates, negative impacts on the global economy would deepen and expand if tariffs on cars and car parts are imposed and if trade tensions have confidence effect and trigger market reaction, including tighter financial condition. Among emerging economies, developments in emerging economies, including Argentina, Turkey, India, and Indonesia, should be closely monitored at this current juncture.

Against this backdrop, we broadly agree with staff's policy recommendations that each country should aim to build policy buffers and raise potential growth and that multilateral cooperative actions are necessary, especially to preserve and promote open and rule-based global trade system and to promote sustainable lending practices.

Lessons from the Global Financial Crisis, Chapter 2

We welcome that the Chapter 2 takes stock of the global recovery 10 years after the GFC, which illustrates the necessity of urgent actions to enhance economic resilience. The analysis shows that economies with greater financial vulnerabilities in precrisis years suffered larger output losses after crisis and that economies with stronger fiscal position and more flexible exchange rate regimes experienced smaller output losses. This result offers a compelling reason why "fix the roof while the sun is shining" is critical (although preventing economic crisis is important in the first place). We encourage staff to underscore urgency of reforms, including building policy buffers and reducing debt vulnerabilities in LICs, by using the result of this analysis. While the analysis tells the importance of financial soundness, strong fiscal position, and flexible exchange arrangement, how does staff assess current situations in terms of those factors in comparison with the precrisis situation?

Inflation in Emerging Market, Chapter 3

Emerging economies can benefit from strengthening macroeconomic policy framework. As it is expected that global financial conditions normalize, the Chapter 3 implies that emerging economies can enhance economic resilience to economic shocks by improving the extent of anchoring of inflation expectations. As it would take time to anchor inflation expectations well, we encourage emerging economies to take actions to improve fiscal and monetary policy framework as soon as possible, including building fiscal buffers, enhancing independence of central banks, and improving their communications. Furthermore, as concerns about a reversal of capital flows grow in these economies, measures to limit capital flow might be a policy option. We urge staff to make policy advice for such measures to be consistent with the Institutional View. For example, outflows should usually be handled primarily with macroeconomic, structural, and financial policies. Related to this point, we commend staff's recent works on stocktaking from its application. We encourage staff to continue to improve consistency of its application across members.

In the following, we would like to make some comments on specific issues:

International Trade and Global Imbalances

Escalating trade tensions and potential move away from a multilateral, rule-based trade system are key concerns for the global economy. It is extremely important to reaffirm benefits of such a trade system and costs of protectionist measures in the global economy.

We welcome the work on the Scenario Box. The result indicates that no country can benefit from raising tariffs. In addition, the analysis illustrates that the US suffers more damages than other economies, including China, if tariffs on cars and car parts are imposed and trade tensions have confidence effect and trigger market reaction. The Fund should emphasize these important messages, with detailed explanations about the assumptions as the analysis entails uncertainties.

The WEO should explicitly mention the premise that current account imbalances can be entirely appropriate because of optimal resource allocations as the 2018 ESR. In addition, all countries need to keep in mind that global imbalances reflect domestic IS balance, in addressing excess global imbalances. We encourage staff to repeatedly emphasize these points to promote constructive discussions on global imbalances. In this regard, as the recent reports, including the 2018 ESR, describe clearly, the Fund should deliver messages such that protectionist measures reduce trade volume while give no impact on reducing global imbalances. We commend that the WEO mentions this point.

According to the staff's projection, global imbalances are expected to decrease, reflecting the rise in oil prices. It should be noted that the US expansionary fiscal policy would expand current account deficits further. Could staff share the latest estimates of the impact of the US expansionary fiscal policy on its current account deficits? Also, such a fiscal policy, together with regressive aspects of this policy, may add protectionist pressures in the US. In the euro area where adjustment mechanism through exchange rate are limited, some countries, including Germany, have persistent excess current account surplus. We encourage staff to provide more granular policy advice, taking specific features of each euro area country, such as needs from population aging and potential growth, into account.

Japanese Economy

The Japanese economy grows at 3.0 percent (on an annual basis) in the second quarter 2018, driven by private demand, such as private consumption and private non-residential investment, after contracting -0.9 percent in the first quarter. We consider that the economy is moderately recovering. Although it is expected that the economy keeps recovering as labor market condition has improved, we recognize it important to closely monitor impacts of escalating trade tensions on the global economy and those of the successive natural disasters on the economy.

As gross public debt to GDP has exceeded 200 percent, we need to deal with several challenges in the fiscal area, especially pressure on social spending from population ageing. In June 2018, we have set the new fiscal consolidation target aiming to achieve primary balance surplus by 2025 in the "Basic Policy on Economic and Fiscal Management and Reform 2018." We plan to raise consumption tax rate from 8 to 10 percent in October 2019. Note that we are going to raise consumption tax rate by smaller amount, 2 percent, than the last one, 3 percent, and changed the use of revenue from the hike to strike a balance between fiscal consolidation and strengthening social security, including investment in the future generation, which would alleviate macroeconomic impacts compared to its hike in 2014. We will carefully calibrate our economic policies to deal with effects of the consumption tax hike in any case, which will be further discussed in the upcoming Article IV consultation.

US Economy and Chinese Economy

The US economy is expected to grow at around 2.7-2.9 percent in the coming years, supported by its expansionary fiscal policy. It should be noted that this policy could entail costs and risks, such as rising public debt, inflation surprise, and expanding current account deficits.

The Chinese economy should keep aiming at the shift from the speed to the quality of growth, moving away from numerical growth target. In this regard, China needs to shift away from the growth model relying on excessive leverage and debt to make its economy sustainable in the longer time horizon. As to deleverage, the authorities have recently shifted to a more accommodative macro policy stance, while fine-tuning the pace of deleveraging. We urge staff to monitor the impacts of the policy shift on the macroeconomic stability and the consistency with the goal to further improve the overall efficiency of credit allocation in the economy so that growth sectors can receive necessary financing.

Regarding “Made in China 2025” formulated by the State Council in 2015 and was reaffirmed by the last National People’s Congress, it is welcoming that China is aiming at upgrading its industrial capacity and quality which may contribute to the economic growth. However, at the same time, there are concerns prevailing about market distortion through subsidies and intellectual property rights infringement, which may undermine the positive fruit of the initiative. Therefore, we would like to encourage the IMF to monitor them so that the initiative should be beneficial both to China and the global economy.

International Taxation

We agree with staff that further multilateral cooperation on taxation is needed to continue existing efforts aimed at fighting profit shifting. It is important to reach an agreement to a long-run solution as digitalization as well as globalization affect international taxation system. The Fund is not a standard setter, but it can make contribution to analytical work and capacity development.

Market Power

We encourage staff to further analyze market power issues, especially from the perspective of competition policies. Previous literature implies the relevance between market power issues and important challenges in the AEs, including decrease in business dynamism, subdued potential growth, and lower labor share. Could staff comment on why emerging economies and specific industries (auto parts, PC hardware, and electronic components) have experienced smaller increase in market power? Also, what does staff consider as possible reasons/backgrounds behind the emergence of superstar firms, such as developments of financial market, management method, like franchise, and information technology?

Global Financial Stability Report (GFSR)

While financial conditions in advanced economies have remained accommodative, market sentiment has worsened in some emerging markets, driven by a political and policy uncertainty and trade tensions. This leads to larger divergence between advanced and emerging market economies and increases near-term risks compared to the April 2018 GFSR. We take note of the staff's analysis that the overall spillovers between emerging markets have so far been relatively contained and idiosyncratic factors explained much of the outsized asset price moves. Nevertheless, given the increased correlations among emerging markets recently, risks of spillover and contagions should be monitored continuously and carefully.

In response to market pressures and currency depreciation, central banks in several emerging market economies responded with interest rate hikes and interventions in currency markets. On the other hand, Chinese authorities have eased monetary policy and reintroduced a 20 percent reserve requirement for foreign exchange forwards. Staff's evaluation on these policy measures is welcome.

As staff rightly pointed out, sharp tightening of global financial conditions could be trigged by a further escalation of trade tensions or rising geopolitical risks and policy uncertainty in major economies. In this regard, we encourage the Fund to provide continued advices on appropriate policy measures through multilateral surveillance and the Article IV discussions as we mentioned in the WEO part.

We take note that faster-than-anticipated monetary policy tightening in advanced economies could lead to sudden tightening of global financial conditions, especially in emerging markets. In this light, central banks are encouraged to keep close and clear communication with market to avoid disruptive volatility in financial markets. As views have diverged on termination timing of the Fed's current tightening cycle, we appreciate it if staff could share the view regarding this issue. Moreover, given the secular decline in neutral real interest rates and limited policy buffers for future economic downturns, discussions on potential alternative policy strategies in addition to forward guidance and balance sheet actions have become vigorous. Could staff share the view on possible options?

Medium-term risks remain elevated because of persistent financial vulnerabilities related to high debt levels, stretched asset valuations and external debt buildup in emerging economies. Against these vulnerabilities, we encourage policymakers to pay close attention to further buildup of financial vulnerabilities and increase the resilience of financial systems by using the micro- and macroprudential tools.

At the same time, we share the staff's concern on high levels of external and foreign currency debt in low-income countries. As many low-income countries have faced debt distress, misallocation and debt transparency problems, it is important for creditor countries to engage in recognizing debt situations of partners, analyzing viability of investment projects and appropriate asset management, as ‘responsible creditors’. We expect further contributions of the Fund on this issue.

As for the special feature on international banking groups, we concur with the staff’s concern that regulatory inconsistency or overlap, extraterritorial application of national regulations and gaps of details and schedules in international standards have caused fragmentation of the international banking system and unintended consequences that make market function less effective in many fields. We encourage staff’s further analysis on this issue to address market fragmentation.

We welcome that much progress has been made in regulatory and supervisory framework during a decade after the global financial crisis to increase a resilience of financial systems, as staff summarize in the Analytical Chapter 2. As it is important to analyze and explain benefits of these reforms to ensure credibility of the reforms, we appreciate the staff’s timely and useful analysis.

However, we should bear in mind that the Fund is not a standard setter. It should be strictly avoided to re-open discussions that have been already completed by standard setters, especially those regarding the regulatory treatment of sovereign exposures, in order to prevent regulatory uncertainty from re-emerging.

Fiscal Monitor (FM)

The FM introduces Public Sector Balance Sheets (PSBS) as a tool to comprehensively analyze the resilience of public finances. The PSBS extends the scope of fiscal analysis in terms of assets and coverage (from general government to the entire public sector, including central banks).

We see some merits of the PSBS. For example, the PSBS emphasizes the importance of asset management. In this regard, as both debtors and creditors should tackle to reduce rising debt vulnerabilities in LICs, the PSBS illustrates that debtors need to have quality infrastructure. Going forward, we encourage staff to assess quality of assets, including infrastructure in LICs.

However, the PSBS entails limitations and caveats as well. Such limitations and caveats include, but not limited to, the followings. In the first place, staff should be extremely cautious not to deliver inconsistent messages with DSA regarding fiscal risks. In particular, looking at the asset side would tend to send more optimistic messages. Related to this point, we are also concerned that a simple figure or measure, such as net worth to GDP, is taken out of context by public. Because the PSBS inevitably involves complex analysis, we are anxious that discussions of fiscal risks trivialize to such a simple “summary” figure or measure paradoxically. To avoid such risks, the Fund always needs to show other figures or measures altogether, such as net financial worth, in addition to net worth as well as to clarify its inherit difficulties, including statistical challenges, evaluation of marketability and liquidity, and pension assets earmarked for the future payment. Second, the PSBS extends the coverage to the entire public sector, including central banks. Needless to say, central banks should determine their monetary policy, including balance-sheet policy, in line with their mandate independent from the governments. The Fund should not make any discussions to be against this essential principle, of course.

In this regard, we highly welcome staff’s effort in the FM. For example, the FM mentions limitations and caveats in page 8 and clarifies that “recognizing these assets does not negate the vulnerabilities associated with the standard measure of general government public debt.” We believe that the FM can further clarify the latter point by adding descriptions such that analyzing fiscal risks by closely examining general government public debt is critical and essential for considering fiscal policies in countries where public debt vulnerabilities are particular concern. Going forward, while the Fund may use the PSBS to analyze fiscal risks, we urge staff to keep these limitations and caveats in mind.

In summary, we consider that closely analyzing general government public debt in gross term or excluding non-financial asset as in the DSA remains critically important. When the Fund uses the PSBS as a complementary tool to analyze fiscal risks, we encourage staff to continue to clarify the limitations and caveats. Otherwise, disadvantages of the PSBS would outweigh its advantages. In this regard, we appreciate that the FM deals with these points well. Having said that, we suggest two things. First, to avoid the risks that discussions about fiscal risks trivialize to a simple “summary” figure or measure, like net worth to GDP, the FM should include net financial worth or others in figures showing net worth, like the Figure 1.1 in the FM, to encourage readers to focus on wide and detailed measures. Second, the FM can add descriptions such that analyzing fiscal risks by closely examining general government public debt is critical and essential for considering fiscal policies in countries where public debt vulnerabilities are particular concern. Staff’s comments are welcome.

Ms. Horsman, Ms. McKiernan, Mr. Weil and Ms. Zorn submitted the following statement:

We thank staff for a concise set of reports that focus on the key issues requiring urgent attention by international leaders and policy makers. We welcome the clear and more urgent messages as trade tensions escalate, some economies move past the peak of their cyclical expansion, and as the balance of risks overall tilts towards the downside. Against this backdrop, we agree with the Fund's call for more timely policy action to protect and enhance sustainable growth prospects, to bolster resilience against shocks, and defend the multilateral system.

Outlook and Risks

Global economic growth has become less balanced and less synchronized, and the forecast has been downgraded for both 2018 and 2019. Output in many advanced economies (AEs) is slowly diminishing towards a rather subdued rate of potential growth, owing to lingering effects from the global financial crisis (GFC) and structural headwinds. The prospects for income convergence are declining for most emerging market and developing countries (EMDCs). Trade and export-linked production can no longer be counted on to drive global growth. Indeed, trade disputes are becoming a key constraint to global growth, and large markdowns in growth in a handful of countries seem to be mainly related to trade and capital investment. While US fiscal stimulus is currently providing a large boost to US output, and hence the overall global tally, the eventual unwinding of US fiscal stimulus will contribute to a softening in global growth beyond the medium term. In the meantime, financial vulnerabilities continue to increase, as still relatively easy financial conditions exacerbate the trade-off between higher short-term growth versus greater risks to longer-term growth.

Although the same threats to global economic growth and financial stability identified in earlier WEO reports have persisted, trade tensions and policy uncertainty are becoming more predominant. Potential financial stability issues related to Brexit, including transitional challenges and medium-term issues, are also looming. In addition, regionally-based non-economic risks – natural disasters, geopolitical tensions – have not dissipated. Their materialization alongside shared risks could be devasting for certain member countries. More generally, the interaction of risks, plus spillovers and spillbacks, through multiple channels deserves greater attention.

Widespread and Escalating Trade Tensions

One of the most significant shifts in the outlook since the April 2018 WEO report is the materializing of a key downside risk flagged in the spring – rising trade tensions – following the announcement of tariffs on a variety of imports along with retaliatory actions.

We welcome the extensive coverage of this issue in this WEO, including the assessment of the breadth of potential impacts of the current prevailing trade policy uncertainty. The projected broad-based contributions to growth from trade have been unwound with the global economic outlook now reflecting a significant slowdown in world trade volumes through 2019 and the related reduction of capital investment. Depending on the intensification of trade actions, the pervasiveness of trade-related uncertainty could trigger financial market risks along with a disruption in global supply chains and reduced global productivity and welfare. Uneven global growth forecasts would be accompanied by a higher burden on low income households via higher costs for tradable consumer goods.

Staff comprehensively assess the magnitude of the growth impacts from such an intensification scenario in Box 1 of the 2018 WEO. This box clearly illustrates how the narrow impact of previously-announced tariff actions can spillover into widespread, and in some cases sharp, global output declines. Trade uncertainty feeds an erosion of market sentiment, causing reduced investment and a tightening of financial conditions for corporates. The bottom line is that all economies are made worse off in a climate of escalating trade actions.

We agree with the policy prescription that countries should strive for global cooperation, pursue regional trade agreements, avoid protectionist reactions, and pursue trade under a rules-based multilateral system. Domestic policy adjustments that reduce external imbalances could also help to lessen anxiety about globalization and calm mounting trade unrest.

While the policy prescription for greater global cooperation is indisputable in the long-run, it may lack pragmatism in the near to medium term given the current environment. We would welcome further thinking on achievable near and medium-term multilateral policies to help mitigate the risks to global growth of rising global trade tensions.

Lessons from the GFC

Financial Sector Outcomes

We agree with staff's overall view that banks are more sound, their business models less risky, and their regulation and supervision much stronger since the GFC. Banking sector reform was perhaps an obvious place to focus initially, given its size and dominance in the financial system and the already well-established global standard-setting framework. Yet, a decade has passed, and banking sector reforms are not fully completed, with uneven progress among BCBS countries and across banks. In some cases, banking sector vulnerabilities have persisted or worsened. There may also have been unintended consequences to these reforms, including reinforcing the trend towards a migration of activity to non-bank financial entities, negative spillovers to non-AE countries (for example, adding to economic considerations prompting a withdrawal of correspondent banking relationships in small state economies), and potentially sub-optimal implementation where cross-border cooperation and consistency is weak. Less progress has been made in advancing other items on the global financial regulatory reform agenda, such as increasing the resilience of market-based finance and OTC derivatives markets, and advancing macroprudential policy tools. More concerning is the increasing presence of reform fatigue, regulatory complacency, and threats of a regulatory rollback.

The odds are that there will be another financial crisis at some point, but its materialization, channels of contagion, and effects cannot be fully predicted. Ongoing assessment of regulatory progress and reform outcomes are critical to fully reap the lessons from the GFC, adjust regulatory responses, and ultimately mitigate the breadth and depth of the impacts of the next financial stress event. We fully support this undertaking by the international community, led by the FSB. We urge all members to continue enhancing financial regulation and supervision, to remain vigilant in monitoring emerging threats, and to uphold global cooperation on both these fronts.

Macroeconomic Outcomes

While a well-functioning and resilient financial sector is important for economic growth, staff's analysis of post-GFC economic performance illustrates the criticality not only of swift and decisive ex post policy responses, but also strong ex ante policy frameworks and buffers. More importantly, countercyclical implementation of policies – characterized by better targeted, or productivity enhancing, fiscal policies and macroprudential policies in "good times", and more expansionary policies in "crisis times" – yields the strongest economic performance in the long run. Taking this further, it would be helpful to quantify the trade-offs so that policy makers could better determine the optimal level and mix of policies at each stage of the cycle. The analysis would also benefit from examining the role of international spillovers through financial and trade channels before, during, and after the GFC.

Individual country efforts to build buffers and strengthen resilience will help attenuate enduring output losses that will follow the next global crisis. Time is of the essence to improve macroeconomic fundamentals, including the resilience of public finances, given growing financial vulnerabilities.

Enhancing the Resilience of Public Finances

With global financial conditions expected to tighten, and interest rates expected to rise, the current growth outlook provides a narrow opportunity for many countries to rebuild fiscal buffers. Fiscal consolidation is especially relevant in many large emerging market economies where public debt is projected to continue increasing, as well as in developing countries that have been rapidly re-accumulating debt in an increasingly complex and opaque creditor landscape.

In this context, the Fund's research on innovative tools to enhance the resilience of public finances, such as the Public-Sector Balance Sheet Analysis (PSBA), is welcome.

We see three benefits of PSBA. First, it provides a snapshot of the inter-temporal impacts of changes in revenues and expenditures that can uncover previously obscured challenges to the sustainability of a country's public finances. Second, by consolidating assets and liabilities, PSBA enables countries to perform comprehensive balance sheet optimization, for example by assessing the marginal return on national assets. Third, PSBA increases transparency and accountability by providing greater information to taxpayers who can hold governments accountable for fiscal management.

The Fund acknowledges the challenges of PSBA, such as applying it to balance sheet items that serve a pure public policy objective, the volatility caused by assets that are susceptible to large valuation swings, and significant data limitations given the varying capacity of member countries. These factors may act as barriers to the widespread take-up of PSBA in the near-term, but even incremental movement towards a PBSA standard could be beneficial in terms of promoting enhanced accounting standards and greater fiscal transparency at a time when many counties need to pay close attention to the resilience of public finances.

Mr. Merk, Ms. Kuhles, Mr. Braeuer and Ms. Fritsch submitted the following statement:

We thank staff for a set of well-written and insightful reports. We broadly share staff's appraisal of a continued marked expansion of the global economy and of increasing risks to the outlook. Notwithstanding the recent slight moderation of momentum in some advanced economies and episodes of increased volatility in a few vulnerable emerging markets, global growth remains above trend. Economic activity is projected to stay robust over the medium term, when structural factors encompassing demographic trends and moderate productivity developments would curb growth towards potential. Staff's risk assessment is largely in line with our own views. Risks to the outlook have intensified, notably including an increased reliance on protectionist policies, the realization of mounting financial vulnerabilities, debt sustainability concerns, other policy uncertainty, and the implementation of pro-cyclical and ultimately unsustainable policies. Against this background, we join staff in its call to use the "narrowing window of opportunity" to bolster economic resilience by rebuilding fiscal buffers and curtailing excessive debt levels, while promoting bold structural reforms to ensure strong, sustainable and inclusive growth going forward.

Policy priorities rightly focus on strengthening structural growth factors while reinforcing overall macroeconomic and financial stability. Tightening fiscal policies and refraining from pro-cyclical fiscal stimuli appears most relevant in the current global upswing that is characterized by closing or even positive output gaps combined with high public indebtedness in many countries. We would caution against overemphasizing the need for gradualism in this regard, given the considerable downside risks and staff's view that the "expansion […] may have peaked in some major economies", and "emerging market and developing economies need to be prepared for an environment of higher volatility". Other than in a severe crisis, fiscal consolidation should not be fine-tuned to economic conditions. Structural reforms that boost productivity and participation on labor markets combined with measures that strengthen education and health care should be promoted to alleviate demographic pressures, support potential growth, support adjustment to technological change, and counter high levels of inequality and poverty in many jurisdictions. We welcome staff's call to complete the necessary cleanup of balance sheets and avoid rolling back hard-won regulatory advances in the financial sector.

We broadly agree with staff's assessment of financial vulnerabilities, especially for emerging market economies, as laid out in more detail in the GFSR. So far, the impact of US monetary policy on financial conditions in emerging market economies seems to have been rather moderate. There are, however, pronounced adverse effects of domestic factors like political tensions and macroeconomic instability in some emerging economies, where growth prospects have clearly deteriorated. Not least with a view to recent bouts of financial volatility in these countries, we see a strong case for exchange rate flexibility and for conducting monetary policy independently and with a pronounced focus on the price stability objective. As regards low-income developing countries, staff rightly accentuates the crucial role of policies that facilitate private sector development and contain debt sustainability risks.

World Economic Outlook

Staff Projections

We agree with the staff's growth projection for the euro area, which is broadly in line with the ECB staff projection of September, forseeing the euro area economy to expand by 2.0 percent this year and by 1.8 percent in 2019. We also agree on the low potential growth path.

Staff's GDP growth forecast for Germany is broadly in line with our own assessment. With respect to 2019, we expect a slightly different growth composition, more specifically weaker dynamics of exports and investment and stronger growth of private consumption – presumably caused by additional fiscal stimuli.

The inflation projection for the euro area in 2018 and 2019 is in line with our own assessment. We expect that inflation in the euro area will converge to about 2 percent in the long term. The long-term forecast of German inflation standing at 2.6 percent in 2023 seems quite high.

We notice that staff's "assumptions regarding the Brexit outcome remain broadly unchanged relative to the April 2018 and October 2017 WEOs. Tariffs on trade with the European Union are expected to remain at zero, and nontariff costs will likely increase moderately".

Region-specific Policy Recommendations

We agree with staff that Germany has a strong fiscal position. Against this background and given the external surplus, staff advises to increase public investment. In addition to the fact that administrative restraints limit the possibility for a swift increase, we would argue that it is important to take into account the current state of the German economy in the cycle when discussing these issues.

We appreciate staff's outspoken discussion of risks arising from recent US economic policy decisions for both the domestic and the global economy. We share staff's view that the highly pro-cyclical fiscal stance in the US intensifies risks of overheating, adds to debt sustainability concerns and will likely increase the country's current account deficit further, each with potentially worldwide repercussions. Staff's advice to dampen fiscal expenditure and lastingly strengthen revenues thus appears appropriate. Indeed, continuous vigilance during the Federal Reserve's data-dependent and clearly communicated normalization will remain critical going forward.

Trade tariffs imposed over the last months are not only mutually harmful for the parties involved, but could also depress global growth more broadly, should deteriorating confidence lastingly affect investment and trade. Against this backdrop, staff's plea to "avoid protectionist reactions to structural change and find cooperative solutions" is highly welcome.

We welcome China's rebalancing towards a more sustainable and inclusive growth model, which should be accompanied by measures to reinforce the country's fiscal position, curtail excessive private sector leverage and strengthen financial stability. Ambitious structural reforms are key to achieve more self-sustaining economic growth in Japan.

The Global Recovery 10 Years after the 2008 Financial Meltdown

On a general note, we regard the comparison of recent GDP levels with historical trends as highly problematic. As staff acknowledges, many developments, such as China's rebalancing process, population aging in advanced economies and the slowdown of TFP in the aftermath of the ICT revolution, were set to lower output growth. At the same time, output levels before the crises were arguably elevated by potentially unsustainable dynamics. Furthermore, several countries faced additional crises during the last decade, due to sovereign debt problems or plunging commodity prices.

Staff's analysis could thus overestimate scars caused by the 2008 financial meltdown.

We agree to the conclusion that fiscal space is important and needs to be built up with the help of fiscal frameworks, i. e. fiscal rules. Yet, the reasoning should not only be based on the argument that active countervailing policy may have made the difference. Also, confidence effects play an important role. In countries with more solid pre-crisis positions, market reactions were less pronounced. Moreover, taking into account moral hazard, the long-term effect of fiscal policy is far from clear. Once having learned that support will be provided, the willingness to take risk may increase and thus future crises may be more likely.

In general, we agree that taking swift and decisive actions is beneficial after a financial crisis and that the severe crisis of 2008 was mitigated by fiscal policy action. However, fiscal demand management should be restricted to severe crises only. The case should not be made for fine-tuning fiscal policy, as risks to sustainability outweigh potential stabilization gains. Moreover, in particular recapitalizations in the US involved massive public support, which in our view bears the risk of distorting incentives and of moral hazard.

Challenges for Monetary Policy in Emerging Economies as Global Financial Conditions Normalize

We agree with the general thrust of the chapter and staff's assessment of emerging economies' inflation developments. Staff's findings also have important policy implications, namely that the anchoring of inflation expectations, in particular by improving the credibility of monetary policy and the sustainability of public finances, is key to ensure a smooth functioning of the monetary policy transmission process.

Global Financial Stability Report

We broadly agree with staff's view on short- and medium-term risks to global financial stability. Near-term risks to global financial stability have increased, with most of these risks affecting emerging market economies, although unevenly due to country-specific vulnerabilities. Medium-term risks remain elevated. Rising or high debt levels in many countries pose a significant challenge for financial stability, as they increase sensitivity to changes in interest rates. Also, political and policy uncertainty is an actual concern for the near-term global financial stability. Waning confidence could sharply affect market sentiment adversely, lead to a spike in risk aversion and spillovers to other countries, particularly to those with high public debt.

Emerging market economies (EMEs) face the challenge of tighter financial conditions against the backdrop of higher US interest rates and a stronger US dollar. Normalization of monetary policy in advanced economies makes EMEs vulnerable to further capital flow reversals. In particular, if the pace of monetary policy normalization occurs faster than expected, implications might be severe. Nevertheless, monetary policy in advanced economies should not account for those vulnerabilities with regard to the pace of monetary policy normalization or the unwinding of unconventional measures. We welcome staff's new empirical approach to assess the tail risks to capital flows. Capital flows to EMEs have already slowed down, with a reversal of portfolio flows. We agree with staff that a rise in global risk aversion, triggered e.g. by a further escalation of trade tensions or policy uncertainty, could further deteriorate these developments.

We share staff's assessment that the overall spillovers between emerging markets have so far been relatively contained. We also agree with staff that emerging market exchange rates have become, on average, more correlated in the past few weeks. Our analyses also suggest increased spillovers from the Turkish lira to other EME currencies. However, our estimates obtained from methods similar to those employed in the GFSR indicate that volatility spillovers between the Turkish Lira and other EME currencies spiked in mid-August 2018. This might be interpreted as suggesting that contagion risks have increased in emerging foreign exchange markets during the August 2018 market turmoil.

We welcome that staff emphasizes high valuations in several market segments as a significant risk to financial stability. Valuations in US equity markets and in high-yield corporate bond markets appear stretched on many metrics while market implied equity volatility and term premiums in US government bond markets are unusually low. Risks of a sudden repricing in financial markets are elevated as a consequence of these high valuations, increasing indebtedness and a high degree of political uncertainty.

We share staff's assessment that there is a greater urgency for policymakers to strengthen resilience in the financial sector. Banks' balance sheets are stronger, but vulnerabilities remain. We agree with the staff's view on risks stemming from a highly indebted nonfinancial private sector as well as from the sovereign-bank nexus in certain countries.

We appreciate staff's proposals on a proactive deployment of broad-based macroprudential tools in a timely and effective manner to address systemic risks. Financial conditions are still accommodative and credit growth is picking up in Germany while we observe stretched housing market valuations in major German cities. We share the staff's assessment that financial conditions might tighten, which should be addressed ex-ante by imposing appropriate tools. These could include capital buffers to strengthen bank resilience ahead of potential future adjustments.

We agree with staff's recommendations to closely analyze foreign currency liquidity risks in the banking system. Monitoring and evaluating intra-group transactions and carrying out stress-tests specifically designed to deal with foreign currency funding risk can be helpful tools in this regard. However, we are not yet convinced of the advantages of developing standardized currency-specific liquidity risk frameworks.

We share staff's view that branches of global banking groups can benefit more from internal capital markets to efficiently allocate funds. The flow of funds can be used by international banking groups to allocate liquidity to branches having liquidity shortages. However, the free flow of funds can also have contagion effects. We therefore do not necessarily share the view that a fragmentation of the banking structure is leading to higher systemic risk. Shielding the rest of a banking group from branches in trouble may also reduce systemic risk. We ask staff to provide more evidence on the trade-off between liquidity and the provision of credit. The arguments on the trade-off primarily rest on a few country observations/correlations. These can hardly be interpreted as causal. There may exist several other unobserved drivers, as the staff points out correctly. We highly appreciate staff's policy recommendations, esp. regarding enhanced resolution. Having full information about branches and their exposures is key to conducting frictionless cross-border resolution.

10 years after the global financial crisis (GFC) the post crisis reform agenda is not yet completed and there are that still unfinished issues such as the leverage ratio framework or the link between banks and sovereigns. The report urges regulators to avoid complacency and regulatory fatigue and while the ability to reduce crisis probabilities should not be overestimated, economic conditions where risks are perceived to be low ("good times") can be the footing for rising risks. Regulators should be mindful of potential blind spots. Risks that have not been on the agenda or were not relevant during the GFC could gain importance. New financial technology (fintech) or cybersecurity risks are examples in this respect.

Weakening the link between banks and sovereigns would be important for a stable financial architecture. We strongly support the view that policies to discourage banks from holding excessive domestic sovereign bonds would improve financial stability. Adequate risk weights for sovereign bonds would be an effective tool in this regard. This would also contribute to the adequate risk pricing of sovereign bonds.

In general, we agree with staff's view that the enhanced regulation of large and interconnected institutions is an important piece of post-crisis reform. We share the assessment that cooperation among authorities and communication with banks are necessary. We also support the view that access to good data is crucial for the achievement of the mandate of macroprudential supervision. However, the trend of less concentration and decreasing competition is not observable for the German banking system for this period of time and the indicators used. We would thus argue that heterogeneities across national banking systems should be considered in the discussion.

In general, we agree that corporate governance should contribute to limit cultures of excessive risk taking and that boards play have a role here. However, the corporate governance arrangements for each jurisdiction should take into consideration the peculiar characteristics of the national company law.

We welcome the results of the brief cross-country comparison on the advancement of resolution frameworks. We fully support the proposed way forward to further strengthen their functionality and effectiveness. Even though the enhancement of bank resolution regimes has progressed, further reforms still need to be brought forward to address remaining impediments to resolvability. Greater coordination and planning in preparing for cross-border resolution cases is needed, as are improvements in information sharing that is as of now often insufficient due to confidentiality issues.

Reform evaluation could be an important area for future assessments. The more widespread use of macroprudential instruments such as capital buffers as well as country specific experiences offer opportunities for reform evaluation. Evaluation of the effectiveness of macroprudential instruments can give a hint at how successful policy responses to the GFC were.

Fiscal Monitor

We broadly appreciate staff's initiative to comprehensively analyze public sector balance sheets in the Fiscal Monitor, with a view to enhancing the depth of fiscal analysis. A proper understanding of assets and liabilities of the wider public sector could be beneficial to interpreting public finance trends and for mapping risks and opportunities associated with such assets and liabilities. Moreover, a thorough understanding of what the government owns could improve management of these assets. Staff could have put more emphasis on the latter issue.

We share staff's view that decisive action is needed to strengthen fiscal buffers and anchor public debt, taking advantage of the ongoing expansion of the global economy. The fact that net financial worth deteriorated substantially during the financial crisis and that a third of the countries in the analysis currently face negative net worth only reinforces staff's advice for further fiscal consolidation. Moreover, sustained structural reform is key for improving the fiscal position and for raising intertemporal public wealth, as set out in the FM.

This said, we caution, however, against relying predominantly on the analysis of net public worth for assessing resilience and fiscal sustainability risks and for deriving fiscal policy recommendations due to several caveats of the analysis. The net worth of public corporations and other financial and non-financial assets of general government are only to a very limited extent available to meet governments' financial needs in general, particularly in times of financial distress, as staff itself acknowledges.

As staff rightly points out, the main impediment to wider use of the balance sheet approach lies in the lack of comparable and reliable data. Going forward, first improving public national accounts and ensuring better data availability, quality and comparability could increase transparency and encourage better management of public assets.

The representative from the European Central Bank submitted the following statement:

We thank Staff for their substantial set of flagship publications that in our view captures well recent key economic and financial developments and the policy challenges at the current juncture. We broadly agree with the policy recommendations made in the report. More specifically, we would like to make the following observations:

World Economic Outlook and Fiscal Monitor

We largely share Staff's assessment that the expansion of the global economy is expected to continue, albeit at an increasingly uneven pace, and to gradually decelerate over the medium term. In advanced economies, accommodative monetary policy, along with the pro-cyclical fiscal stimulus in the US, supports economic growth, while the recovery in commodity prices sustains activity among commodity exporters. Yet, the combination of uncertainty about trade relations and the gradual normalization of monetary policies in advanced economies have led to a tightening of global financial conditions in recent months, particularly for some emerging market economies. In the medium term, as policy support diminishes, global activity is expected to expand at a pace close to potential growth. In our assessment, the pace of global expansion will remain below pre-crisis levels, as growth potential has declined across most advanced and emerging economies in recent years. On global imbalances, we note that Staff projects creditor and debtor positions to continue to widen slightly, and we agree that in the long run excessive global imbalances may pose financial stability risks and constrain the well-functioning of the global economy. Like Staff, we emphasize that protectionist measures are not the appropriate answer since they would hurt the global economy and yet not support the narrowing of global imbalances. Thus, we support the view on the need to find co-operative solutions to achieve strong, sustainable and inclusive growth and preserve a well-functioning multilateral framework.

Growth in the euro area is expected to remain broad-based in the near term, slowing moderately towards potential over the coming years. Compared to 2017, the pace of economic growth in the euro area has slightly slowed down, notably on the external side. In addition, a number of temporary factors during the first quarter combined with a slight decline in confidence in a context of rising trade tensions have also contributed to the downshift in the economic momentum. Looking ahead, we share Staff's view that the fundamentals for sustained growth in the euro area in 2018/19 remain in place with supportive monetary conditions, brightening labor markets and still elevated levels of consumer confidence. In addition, the expansion in global activity is expected to continue, supporting euro area exports. The most recent September ECB staff projections, which see growth in 2018 and 2019 at 2.0 percent and 1.8 percent, respectively, are broadly in line with those of IMF staff. The risks surrounding the euro area growth outlook can still be assessed as broadly balanced. At the same time, risks relating to rising protectionism, vulnerabilities in emerging markets and financial market volatility have gained more prominence recently.

While headline inflation in the euro area is currently being pushed up by developments in energy prices, underlying inflation is expected to pick up towards the end of the year and to increase gradually over the medium term. Headline inflation has been hovering around 2.0 percent recently, while measures of underlying inflation have remained muted, although increasing from earlier lows. Latest incoming data has supported our view that domestic cost pressures are strengthening and broadening amid high levels of capacity utilization and tightening labor markets, which are pushing up wage growth. In addition, uncertainty around the inflation outlook is receding. Like Staff, we thus expect underlying inflation to pick up towards the end of the year and thereafter to increase gradually over the medium term. Together with a declining contribution from energy prices this is expected to result, according to the ECB Staff projections, in headline inflation rates of 1.7 percent in 2018 and 2019, again broadly in line with IMF staff.

As regards euro area monetary policy, we note that Staff agrees with our assessment that an ample degree of monetary policy accommodation is still necessary in order to secure a sustained return of inflation in the euro area towards levels that are below, but close to 2 percent over the medium term. The underlying strength of the euro area economy supports our confidence that the sustained convergence of inflation to our aim will proceed and will be maintained also after the gradual winding-down of our net asset purchases. At the same time, underlying price pressures are expected to increase only gradually. Therefore, we agree with Staff that the provision of ample monetary policy accommodation needs to continue. In this regard, the ECB Governing Council decided in mid-September to keep policy interest rates unchanged and expressed the expectation that they will remain at their present levels at least through the summer of 2019. As to non-standard monetary policy measures, it decided to reduce the monthly pace of net asset purchases to €15 billion beginning in October and anticipates that, subject to incoming data confirming the medium-term inflation outlook, net purchases will stop at the end of 2018. In that respect it is important to highlight that monetary policy will remain to be very accommodative also thereafter, not only through the forward guidance on policy rates but also through the sizeable stock of acquired assets and the associated reinvestment, which is expected to be maintained for an extended period of time after the end of net asset purchases.

Given the continuing euro area economic expansion, we welcome the emphasis by Staff on the need to rebuild fiscal buffers and to avoid pro-cyclical fiscal stimulus. The importance of building buffers in good times is essential as this will allow economies to build policy space which is crucial for pursuing counter-cyclical fiscal policies when the next downturn occurs. In the euro area, the aggregate fiscal stance has been broadly neutral over the past four years, thus not affecting economic activity. However, given the continuing euro area economic expansion, more efforts towards rebuilding fiscal buffers is certainly needed. We welcome that Staff's fiscal policy messages for euro area countries are generally in the spirit of the Stability and Growth Pact (SGP). However, it would have been helpful if the reports had explicitly called for the need for euro area countries to comply with the SGP, as full compliance with the SGP would allow countries to rebuild the necessary buffers and ensure the credibility and confidence in the EU fiscal framework. Furthermore, compliance with the SGP would help build the necessary trust among Member States to pursue the necessary further deepening of the Economic and Monetary Union (EMU). In this regard we take note of the analysis in the second chapter that underlines the fact that during the post-crisis recovery, output losses could have been reduced with a more advanced integration in the architecture of the EMU. Pursuing prudent policies in full respect of the commitments of the SGP is particularly important in countries with high government debt, which should use the current favorable economic environment for faster debt reduction. Buoyant tax revenues – which reflect notably the strength of the cycle – should be saved or, in countries already at their fiscal objectives under the SGP, channeled towards fiscal-structural reforms that boost potential growth. All countries would benefit from intensifying efforts towards achieving a more growth-friendly composition of public finances. We appreciate Staff's work in the Fiscal Monitor on developing the Balance Sheet Framework to further improve the depth of fiscal analysis. While many statistical and methodological challenges remain, this work, which is also undertaken in the EU by European and national authorities, should help to improve policy making by enhancing the understanding of assets and liabilities of the wider public sector as well as their associated risks and opportunities.

We fully support the recommendations for financial sector policies made by Staff. Specifically, we agree that completing all pillars of the banking union is a priority. On balance sheet clean-up, we see continuous progress with respect to the reduction in the stock of non-performing loans (NPLs). Moreover, the ECB Banking Supervision closely follows and challenges the banks' NPL reduction strategies, and engages with each bank to ensure continuous progress to reduce legacy risks. We also agree that further improvement in euro area banks' profitability is needed, where some progress could recently been observed. We take note of the renewed sovereign-bank concerns in some euro area countries. However, while many banks hold a significant amount of sovereign bonds as part of their total assets, such market movements did not seem correlated with actual sovereign bond holdings of banks. Moreover, we would like to stress that potential spillovers from banking sector distress to sovereigns have been significantly reduced by regulatory reforms. In particular, state aid and resolution frameworks lay down clear restrictions on the use of public money to support the financial sector.

Global Financial Stability Report

Staff's analysis and assessment of global financial stability issues provides a good overview of the current risks and vulnerabilities and the chapter on regulatory reform is a timely overview of the accomplishments achieved since the Global Financial Crisis and challenges remaining. Like Staff, we see some increase in the near-term financial stability risks - in particular reflecting pressures in Emerging Market Economies (EMEs) and political and trade policy tensions. While markets have so far distinguished among EMEs on the basis of their fundamentals, it is important not to underestimate the risk that initially idiosyncratic, country-level events turn into more broad-based risk aversion vis-à-vis EMEs, notably in the context of a global confidence shock. In general, we consider that global medium-term risks remain elevated and, against the background of high asset price valuations and still high debt levels globally, agree that a sudden sharper than expected tightening of financial conditions is a significant risk. In the euro area, ongoing and broad-based economic growth and improved banking sector resilience serve to attenuate risks. Euro area banks have, on aggregate, strengthened their balance sheets in terms of capital and liquidity and bank profitability has improved. However, some pockets of weakness remain and structural challenges such as long-term profitability are pertinent. In real estate, developments such as housing market valuations, mortgage lending and household leverage warrant ongoing active monitoring.

On policies, we continue to share the view that coordination, both globally and within the European Union, is important for the regulatory reform agenda going forward. On the sovereign-bank nexus, we share Staff's view that this is an important issue remaining to be addressed but consider this should be done at the global level in a careful and gradual manner and should come about through price mechanisms rather than quantitative restrictions. In particular, we would caution against using piecemeal national macro-prudential measures to address this issue. As to macroprudential policies in general, the EU is well advanced in their use, especially with regard to tools, cross-border reciprocation and communication. An analysis of the relative effectiveness of macroprudential tools and the interaction between micro- and macroprudential tools would be interesting. As to developments in the G-SIB sector, it is noteworthy that there are important differences in the evolution of their systemic importance, with euro area and UK G-SIBs having reduced their importance, while G-SIBs in other jurisdictions have increased their size and/or complexity. In addition, the fact that G-SIBs' market valuation has declined and market-based measures of risk have increased despite strengthened capital/liquidity buffers and enhanced supervision deserves some attention. As regards the Special Feature analysis of centralized versus decentralized business models of international banking groups, we agree that foreign bank offices are an important element of the international financial system as they play an important role in foreign currency intermediation of both assets and liabilities and provide a sizeable volume of foreign lending. However, a complete analysis needs to take into account the impact of both the intended (e.g. improving the resolvability of complex banking groups and avoiding liquidity outflows prior to resolution) and the unintended consequences (e.g. the creation of a more decentralized and fragmented banking system and a reduction of intermediation by branches) and should attempt to quantify both.

We agree that Brexit has potential financial stability implications in both the United-Kingdom and the European Union in a limited number of areas. However, the final nature, scope and scale of these challenges remain to be determined as they depend not only on ongoing political discussions but also on preparations by policy makers and, importantly, market participants. Policy making should be based on a factual assessment of the nature and magnitude of the various potential channels through which financial stability could be affected. An ECB-Bank of England working group is currently assessing some of the technical aspects of the complex issues involved. We appreciate the intention of the GFSR to provide an overview of the potential sources of financial stability risks, but we do not fully share their assessment of some of the financial stability issues including with regard to uncleared OTC derivatives, legacy insurance contracts and the setting up of subsidiaries. Nonetheless, we fully agree with Staff that, even though its final shape is not yet known, market participants should step up their preparations to adapt to the new situation. The European Union will continue to monitor market developments ahead of Brexit and ECB Banking Supervision is well-prepared to deal with any Brexit-related issues.

The Chairman noted that the current meeting would be Mr. Obstfeld's last WEO presentation before his retirement. She paid tribute to his intellect and team spirit.

The Director of the Research Department (Mr. Obstfeld), in response to questions and comments from Executive Directors, made the following statement:[2]

I thank the Chairman for those kind words. I want to convey how much I have enjoyed these meetings, the back and forth and the intellectual and policy discourse that we have had here. It has been a rich discourse over the three years that I have been at the Fund. I will certainly take the ideas I have gotten here with me into my afterlife from the Fund. Hopefully there will be an afterlife.

The global expansion has plateaued in our estimation, as one can see in our revised numbers. (Slide 1) It is still solid, in fact, at a level better than what we had been seeing since very early in the decade, but it is certainly less balanced. There are downward revisions. I will go over them in detail. These are concentrated in emerging markets, although there was a weaker 2018 in several advanced economies, which also contribute to downgrades.

Mr. Adrian will talk in great detail about financial conditions, but they have tightened, in general, for emerging and developing economies. Around the time of our Spring Meetings, the dollar began to strengthen markedly, and that was also a signal that these conditions were tightening. But as the Financial Counsellor's presentation will also indicate, markets are differentiating strongly.

Generally, we see falling investment globally, falling industrial production, falling trade growth, and these are signs that make us worried. As before, medium-term global growth is also depressed due to secular forces, also due to the prospective unwinding of U.S. fiscal stimulus.

In our view, the risks are now definitely tilted to the downside, including in the near term. The pressures on emerging markets could intensify. There are ongoing trade disputes, which are escalating and could have further spillovers in financial markets. This takes place in a context where many years of easy financial conditions have led to increased private and public debt burdens. This is something Mr. Gaspar will discuss in detail. Emerging markets, in general, are more vulnerable to global shocks that may come along, whether from trade disputes, geopolitics, or financial conditions.

[2] Prior to the Board meeting, SEC circulated the staff's additional response by email. For information, these are included in an annex to these minutes.

Action is needed. There will be a set of joint recommendations at the end that Mr. Gaspar will go through, but I would just emphasize, as we do in the World Economic Outlook (WEO), the need for multilateral cooperation to be enhanced, rather than downgraded.

In these data (Slide 2), one can see the growing unevenness of growth in quarterly data, although China, with a steady growth rate, is something of an exception. Headline inflation has been rising, particularly as oil prices rise; whereas, core inflation is generally more muted and has not risen as strongly with the recovery of recent quarters. (Slide 3)

As I indicated, commodity prices are playing a role, particularly oil. (Slide 4) The price of oil is playing a big role in driving headline inflation and activity in some countries. More generally, non-oil commodity prices have tended to fall in 2018, having risen sharply since the middle of 2016.

Trade frictions are likely having important effects. (Slide 5) These effects are hard to see yet in aggregate data, though I will provide some model simulations. But there is a significant amount of anecdotal evidence at the micro level that firms are encountering disruptions in supply chains. We can see evidence of trade distortions in pricing data for commodities like soybeans or steel, where the United States imposed tariffs earlier in the year.

The behavior of the dollar is a key factor. (Slide 6) This chart shows the strong appreciation that began last spring. It is notable that this depreciation has been much more an emerging market phenomenon than an advanced country phenomenon, with several emerging markets' currencies having depreciated extremely strongly against the dollar.

I should note that there has been some weakening of the dollar since mid-August. The reasons for this are not totally clear, but observers seem to think that this is associated with some easing of financial pressures on emerging markets. However, our view of the fiscal fundamentals, the continuing pro-cyclical fiscal stimulus in the United States and the path of monetary policy suggests that dollar weakening would not be a continuing feature.

Mr. Adrian's report will go into much greater detail on emerging market vulnerabilities. One indication is spreads. (Slide 7) As one can see from this chart, there is differentiation across regions, with Asia much less affected recently. There is also a differentiation within regions. In Latin

America, Argentina stands out, with an upward spike. In Europe, Turkey stands out. This is one sign that emerging markets are in for a rockier time.

I mentioned the vulnerability caused by higher debt levels, but I wanted to focus a bit on low-income countries (LICs). (Slide 8) These charts indicate that, starting with the left-hand chart, government debt has risen since 2012 in a range of countries that were involved in the Heavily Indebted Poor Countries HIPC exercise. One can see these dots clustered above the X axis. There is some very weak relationship with terms of trade, with countries that have experienced improvements in the terms of trade, accumulating less debt; but it is not strong. Similarly, private debts have risen substantially as well.

One reason for the weak correlation with terms of trade is the diverse behavior of governments. This is illustrated by a chart about African countries' fiscal policy, courtesy of the African Department (AFR). What one can see from this slide is that less than half of African economies in sub-Saharan Africa actually pursue countercyclical fiscal policies. A good number are pro-cyclical, about 10 percent. Some of them expand at the top of the cycle. Some of them contract at the bottom of the cycle, but we do not see the countercyclical policies we would like in most of them.

Turning to the projections, we only learned that the latest round of U.S. tariffs would be implemented and what their level would be a few days ago. (Slide 9) I have to congratulate not only the WEO team but also country teams, particularly in the Asia and Pacific Department (APD) and the Western Hemisphere Department (WHD), who helped revise our projections to take account of the tariff actions and retaliation.

So where are we? Global growth, which we had hoped in July, as well as in April, would be 3.9 percent in 2018 and 2019, has been downgraded by 0.2 percentage points in both cases. As one can see from the chart, the advanced economies on the whole are seeing no downgrade, no change for 2018, and a 0.1 percentage point downgrade for next year—driven to some degree by the new round of tariffs.

There is heterogeneity among the advanced economies. For the United States, with its pro-cyclical stimulus, we still peg growth for this year at 2.9 percent. We have, however, downgraded somewhat next year's projection in light of the effects of tariffs and retaliation against those tariffs. For 2018, we see bad news for the euro area, as well as for Korea; but there are spots of good news, particularly Australia, New Zealand, Taiwan. On the whole, these effects balance out.

It is the emerging economies for which the outlook is significantly bleaker. (Slide 10) This is driven in large part by tighter financial conditions and reflects uncertainty over trade policy. Although not all emerging market economies are suffering severe stress—far from it—there are a number that are, which affects growth. There are particularly large downgrades for Argentina, Turkey, Iran, South Africa. In fact, Argentina Q2 data just came out this morning, and it is a very bad outcome. This is where the downgrades are concentrated.

What can we say about trade tensions? (Slide 11) We did a number of much more detailed simulations to indicate what we think could happen and what has happened. This blue line is the effect of the existing steel, aluminum tariffs of the United States—its 25 percent tariff on US$50 billion in Chinese goods and then this week's additional tariffs on US$200 billion of Chinese exports.

I will not go into detail through every country, but looking at the world, one can see that these are pretty consistent with a roughly 0.1 percentage point fall in global growth. To this, we can add on various other possible actions. I like to call this the hamburger chart because, as in most burger places, one can add various ingredients—cheese, onions, bacon, guacamole. We can add other actions. The 25 percent tariff on US$267 billion of U.S. imports from China, which have been threatened in case China retaliates, which they have promised to do, clearly is a big deal, particularly for Chinese growth.

If tariffs on vehicles and auto parts come into play, this is a major factor, particularly for the North American Free Trade Agreement (NAFTA). One can also think about effects on confidence through the rise in policy uncertainty and how that affects investment empirically. That makes things worse.

Finally, if markets react negatively, which they have not yet, there is the prospect of very big output losses that start to approach 1 percent for the world.

Let me quickly comment on the WEO chapters. (Slide 12) Chapter 2 looks at the legacy of the crisis. One point it makes is that the output levels, both in emerging and advanced economies, have not approached pre-crisis trends. In most cases, they remain significantly below. This is also true for low-income commodity exporters. It is also true that the countries that have had worse output performance in terms of returning to trend have seen bigger increases in their Gini coefficients, as one would expect worse performance in terms of inclusiveness.

One interesting consequence of the crisis that does not get talked about much but we have discussed in a box in the WEO is that there was actually a market effect on fertility rates. For emerging markets in the OECD, there had been a downward trend, which was starting to moderate up until the crisis and then turns down again. For other countries, in many cases, there was an upward trend in fertility leading up to the crisis and then a sharp reversal. It is striking that fertility is quite cyclical. However, it has not really recovered broadly, even as we have recovered over the past 10 years. This will have long-term effects on labor markets.

The next chapter looks at inflation in emerging markets. (Slide 13) The left-hand chart tracks the remarkable fall in inflation as emerging markets—following the Asian crisis, especially—moved to more exchange rate flexibility in many cases, and took inflation-targeting-type regimes seriously.

The second panel indicates that measures of credibility of monetary targets in terms of variability of inflation forecasts improved as inflation expectations became better anchored.

Finally, we do a controlled experiment because we want to look at the effects of being more anchored or less anchored. One problem with that is that these are endogenous circumstances, but we looked at the response to the taper tantrum. What one can see is that countries with more anchored frameworks allowed more short-term exchange rate volatility, but they had a payoff in terms of inflation performance, in terms of consumer prices not rising as much long term.

There is some correlation, and this is not shown in the chapter, but I present it as possible future work. (Slide 14) Between the anchoring of inflation expectations and pass-through, less anchoring means a faster pass-through of exchange rates. Furthermore, there seems to be some relationship. Neither of these is necessarily extremely powerful or causal between the variability of intervention and the anchoring of expectations. It is an interesting question to ask, whether fear of floating due to high pass-through may be self-sustaining in some sense.

The Director of the Monetary and Capital Markets Department (Mr. Adrian), in response to questions and comments from Executive Directors, made the following statement:

Let me turn to the global financial stability assessment. (Introductory Slide) Since the last Global Financial Stability Report (GFSR), near-term risks to financial stability have increased somewhat, and medium-term risks remain elevated. Global financial conditions have tightened somewhat. There are several shocks that could increase short-term risks significantly—broader pressures on emerging markets, an escalation of trade tensions, political risks, faster-than-expected monetary policy normalization.

These shocks, in turn, would be exacerbated by vulnerabilities in the financial system. Those include: high non-financial sector leverage, stretched asset valuations, external borrowing by emerging markets, and bank exposures and foreign exchange funding.

Let me start my financial stability assessment with an overview of market developments. (Slide 1) Since the last GFSR, financial conditions have diverged between advanced economies and emerging markets, in particular, as shown in the left chart. Financial conditions have tightened sharply in emerging markets due to rising external borrowing costs. Financial conditions have eased in the United States despite monetary policy tightening. That is illustrated in the middle chart. What is unusual in the U.S. case is that, despite having tight monetary policy for two years, financial conditions keep getting easier.

In other countries, such as China, financial conditions have been broadly stable. From a global point of view, our message is mixed. In the short term, our estimated distribution for future growth, for global growth is skewed to the right in the short term; but in the medium term, we have a very strong left skewness. We worry that these easy financial conditions are associated with the buildup of risks that lead to downside risks in the medium term.

Let me focus a bit more on emerging markets. (Slide 2) Portfolio flows to emerging markets have fallen sharply but remain positive year to date, as shown in the left chart. This has been driven mainly by retail flows, which have turned negative.

Going forward, emerging markets will likely be facing reduced portfolio flows, given the ongoing U.S. monetary policy normalization. The chart on the right shows the estimated cumulative impact of the U.S. monetary policy normalization on portfolio flows to emerging markets. The estimated cumulative decline in net flows through the end of 2019 is about US$80 billion.

Investors have continued to differentiate across emerging markets based on fundamentals and policy frameworks. (Slide 3) This is illustrated with charts that order a country according to the credit ratings. Countries with lower credit ratings, riskier countries, have faced much larger pressures in bond and currency markets. This differentiation is also reflected in greater dispersion and exchange rate volatility, as shown in the red line on the right chart. There is limited evidence of contagion so far, given strong global risk appetite. However, if global risk appetite were to weaken, the risk of contagion could rise.

Let me turn to the policy responses in emerging markets. (Slide 4) Policy responses have varied. Several emerging markets have hiked rates and are expected to continue tightening monetary policy, as illustrated in the left chart. Some emerging market central banks have intervened in the foreign exchange market, as shown in the right chart. Our main policy advice remains that exchange rate flexibility should be used as a key shock-absorber. Policy rate hikes should count inflationary pressure from currency depreciation and market pressures from outflows.

Foreign exchange interventions can be used to prevent disorderly market conditions if reserves are adequate. Capital flow management measures (CFMs) can be implemented in near crisis situations, should not substitute for needed macroeconomic adjustments, but should be temporary, transparent, and part of a broader policy response.

Many LICs have rapidly increased their debt in recent years and are now facing challenging external borrowing conditions. (Slide 5) Over 40 percent of them are in or close to debt distress, as shown by the two shaded areas on the left. The middle chart shows that for frontier market issuers, threats have widened sharply, and external debt issuance has dropped since May. The right chart illustrates that challenging external conditions may pose risks for frontier borrowers whose rollover needs rise considerably by 2021.

Turning to financial vulnerabilities, non-financial sector debt has continued to rise since the global financial crisis and now stands at 2.5 times aggregate GDP in all countries with systemically important financial sectors. (Slide 6) The heat map on the right presents an aggregate leverage matrix for different sectors in the rows and countries or regions in columns. These leverage matrixes are based on several key indicators for each sector. The colors are based on percentile rank within the pooled sample. The heat map shows that vulnerabilities vary across countries and sectors. Corporate leverage is elevated in the euro area and high in China. Household debt is at high levels in several advanced economies experiencing housing booms, as well as in China. Sovereign debt is high in the United States, as well as in some European economies. In contrast, banking sector leverage is relatively low, reflecting the post-crisis regulatory reforms.

High public and external debt are key vulnerabilities for emerging markets. (Slide 7) The chart shows the median values for each vulnerability indicator in black lines based on a large sample of emerging markets, as well as the weakest tails in red going all the way back to the Asian financial crisis.

The first two charts show that government and external debt vulnerabilities have been rising since the global financial crisis. The last two charts show that the foreign exchange debt and reserves have remained broadly similar to the global financial crisis levels. We worry more about the debt than about the foreign exchange positions.

Banking systems have more buffers than before the crisis. (Slide 8) Banks have built more capital, as shown in the left chart, but remaining issues include large holdings of level two and three assets by some banks, as the right chart shows. These are opaque, illiquid, and risky assets that can put bank capital at risk.

Stretched asset valuations are another potential vulnerability. (Slide 9) The left chart shows that U.S. equity markets continue to rise, boosted by strong growth and fiscal stimulus. The middle chart shows that U.S. equity valuations appear stretched relative to underlying fundamentals. Furthermore, U.S. market volatility appears compressed relative to model-based estimates.

Turning to the risks, in this GFSR, we introduce a new capital flow at risk analysis. (Slide 10) The chart shows an adverse scenario in which investor risk appetite deteriorates by a magnitude that is similar to the 2015 episode. Corporate bond spreads widen by 100 basis points. The U.S. 10-year yield falls by 30 basis points, and the U.S. dollar rises by 5 percent. This leads to a leftward shift of the distribution of portfolio flows in the near term. With a 5 percent probability, outflows could exceed 0.7 percent of emerging market GDP, which is a magnitude similar to outflows during the global financial crisis.

An escalation of trade tensions could also lead to a sharp tightening of global financial conditions, which would put financial stability and growth at risk. (Slide 11) This slide relies on the growth-at-risk approach. Financial conditions are modeled as being subject to an adverse shock, with wider corporate spreads reflecting market participants' estimated impact of an escalation of trade tensions. This scenario is aligned with the simulations in the WEO that Mr. Obstfeld presented.

In the near term, the range of several adverse growth outcomes shifts leftward the distribution of future growth as a function of financial variables by around 1.5 percentage points. Under the assumption that the shock is persistent so that trade tensions lead to a persistent adverse development in financial conditions, the downside risk to growth would increase in the medium term as well, as shown in the right chart.

Increased political risks and policy uncertainty could trigger a risk-off sentiment. (Slide 12) For example, increased uncertainty about fiscal policy in Italy has led to a widening of sovereign spreads and reduced valuations of Italian banks, shown in the left chart. This highlights the risk of a re-emergence of the sovereign-bank nexus.

In addition, Brexit uncertainties have started to weigh on market prices. Foreign exchange volatility has picked up, and the spread between the U.K. and the U.S. term premium has risen.

A decade after the crisis, it is fair to ask: Are we safer? (Slide 13) Significant progress has been made in terms of regulatory reforms, as shown by the dominance of green colors on the left slide. However, the reform agenda is not completed. Financial Sector Assessment Programs (FSAPs) show that a significant portion of jurisdictions are still working to full compliance, as shown in red and yellow in the left chart. There are also some jurisdictions where policymakers do not have adequate macroprudential powers, as shown in the right chart. Significant progress has been made in developing macroprudential tools, but gaps remain.

This slide shows the availability of macroprudential tools to address specific types of vulnerabilities in different sectors. (Slide 14) The columns represent the different sectors in advanced economies and emerging markets, while the rows are the different types of financial vulnerabilities.

Policymakers have made significant progress in terms of dealing with banking sector vulnerabilities. That is indicated by the dark blue shaded area in the banking column. In contrast, relatively few macroprudential tools are available to address vulnerabilities outside the banking sector. In particular, in the non-bank financial sector, the blues are very light or there are lots of white columns, white entries as well. In general, more tools are available in advanced economies than in emerging markets.

To end this discussion of financial stability, I will turn to fintech. (Slide 15) While fintech is still small, it has grown rapidly, with cumulative investments above US$100 billion by end-2016 across almost 9,000 entities, as is shown in this chart. Fintech could potentially support the creation of new services, improve financial efficiency, and foster inclusion. However, some new banking models introduce new systemic risks, including operational, cyber, money laundering, and terrorist financing, privacy, data security, and liquidity risks.

Over time, fintech innovations may have the potential to introduce macro-financial risks that could amplify shocks, so we are watching developments closely.

The Director of the Fiscal Affairs Department (Mr. Gaspar), in response to questions and comments from Executive Directors, made the following statement:

There are two issues that I want to flag before I start. One is that the fiscal policy recommendations that we emphasized in the spring continue to be valid; with a few exceptions, I will not be emphasizing those today, although I am available to elaborate and discuss, as appropriate.

Second, in terms of the emphasis on fiscal policy, I will continue emphasizing the role of fiscal policy as a structural policy when it comes to developing countries, fiscal policy as part of the development toolkit. I will be emphasizing stability instead of stabilization, and sustainable inclusive growth much more than economic activity.

Roughly 20 years after the Asian financial crisis and 10 years after the beginning of the global financial crisis, it makes sense to have a long-term perspective both from the viewpoint of evaluating policies looking backward but also thinking about policy recommendations looking forward. in that sense, I am following the footsteps of Mr. Obstfeld and Mr. Adrian.

We have new preliminary estimates from the global debt database, and that means that we do have figures for 2017. (Slide 1) Global debt is at a new record level of US$182 trillion. Going back 20 years, we see that, between the Asian financial crisis and the beginning of the global financial crisis, global debt more than doubled from US$55 trillion to US$116 trillion, and then it increased, albeit at a slower rate from the beginning of the global financial crisis until 2017 to this new record level of US$182 trillion.

If we look across the world and focus on the last 10 years, we see that the country that most contributed to the accumulation of global debt was China, with roughly 40 percent of the US$66 trillion increase in global debt. (Slide 2) But there is a sharp contrast between public and private debt. For the accumulation of public debt, the trend is dominated by advanced economies, with the United States accounting more than half of contribution to the increase in advanced economies, and China in the accumulation of private debt, with almost 60 percent of the total.

Looking at advanced economies, what we see is that before the global financial crisis, on the top left-hand side, there is a sharp increase in private debt. On the right-hand side, one can see that after the beginning of the global financial crisis, it is changes in public debt that dominate. (Slide 3)

Turning to the bottom of the slide, one sees that in quite a few advanced economies, policies are pro-cyclical in the upswing, which is something that contradicts our policy advice.

Moving to the Fiscal Monitor, this fall, we emphasize that there is much more to long-term fiscal policy than levels of debt. The balance sheet of the public sector is extremely important and the Fiscal Monitor includes data for the public sector balance sheet for 31 countries.

In the next slide, I focus on advanced economies. (Slide 4) These 31 countries cover 61 percent of global GDP. For these 31 countries, assets controlled by the public sector represent US$101 trillion, and that corresponds to 219 percent of the GDP of these 31 countries. A very large number. We also see from the chart that the net worth position of countries varies significantly, with Portugal and the United Kingdom on the left-hand side with significant negative net worth, and Norway on the right-hand side with a net worth which is a large multiple of the country's GDP.

Perhaps interestingly, we can go back to the beginning of the global financial crisis and see what happened to the balance sheet of the subset of countries for which we have a time series. (Slide 5) What we see, not surprisingly, is that both assets and liabilities increased sharply. The balance sheet of the public sector increased substantially. On the right-hand side, one sees that the net financial worth of these countries did deteriorate, but by much less than the increase in liabilities. The deterioration of net financial net worth has been US$11 trillion for this group of countries.

Why should we care about the balance sheet? (Slide 6) For many reasons. One of them is because countries that have a more comfortable net worth position are better at tackling shocks coming from economic recessions or financial crises, in the sense that they have shorter and shallower recessions.

Turning to emerging market economies, this slide does emphasize the accumulation of private debt. (Slide 7) The slide shows the cumulated growth in private debt in emerging markets since the end of the 1980s, but what one sees is that private debt has increased sharply, mostly after the beginning of the global financial crisis. At the same time, at the bottom, one sees that public debt is basically stationary. The levels of private debt and public debt as a percentage of GDP are on the right-hand side. This pattern of a sharp accumulation of public debt and an almost stationary public debt as a percentage of GDP was exactly the pattern of advanced economies before the global financial crisis.

Looking at the composition, what we see is that China dominates this trend. (Slide 8) The vertical axis on the left-hand side shows the accumulation of debt as a percentage of GDP over this decade, and the width of the bars is the GDP weight. The trends on the left-hand side are dominated by China.

On the right-hand side, one sees the importance of the analysis of the government balance sheet. The country on the right-hand side is also China. The little horizontal black line shows that the net worth of China, in terms of the general government balance sheet, is more than 100 percent of GDP. That is an important qualification that allows us to understand the macro and financial implications of the left-hand side specifically.

We should care about these developments in China because we use a number of alternative concepts of public debt for China. The official number, a concept which is reported in the WEO, and these various concepts do not change total debt in China, but they do change the borderline between the public and the private sector. We would like to know more about this borderline, and that is something that the Chinese authorities are working on. There is a balance sheet work that promises results by 2020.

Second, we also care about these developments because the empirical evidence does suggest that leveraging in a country and a subsequent deleveraging process will have costs for growth irrespective of whether a financial crisis materializes or not. But what the comfortable net worth position of the general government of China does emphasize is that our traditional view—according to which the Chinese authorities do have the instruments which are necessary to engineer a smooth landing in these circumstances—is present. A difficulty that is also clear from this chart is that the net financial worth in the yellow dot is substantially less, which illustrates that it may be challenging to mobilize all these assets in case it is necessary to manage them under stress.

Continuing to emphasize the importance of public sector balance sheets for fiscal policy management, what we see in this slide is that various balance sheet variables have a significant impact on financing costs. (Slide 9) For example, on the rightmost side, we see that an increase in net worth by 10 percentage points of GDP has an impact of reducing the sovereign yield by seven basis points.

This slide illustrates another dimension, which is the importance of a sound management of the assets of the public sector. (Slide 10) On the left-hand side, we see that most countries do not yield much from the management of their public assets, and the right-hand side estimates that the average gains may total 3 percentage points of GDP, 2 percentage points from better management of financial assets, and 1 additional percentage point from better management of state-owned enterprises (SOEs).

I will conclude with low-income developing countries and with the results from an impressive process of coordination and cooperation inside the Fund involving functional departments, the Research Department (RES) and the Strategy, Policy and Review Department (SPR), but also all area departments, particularly the area departments of countries where we had case studies—for this presentation, AFR and APD. (Slide 12)

What we have looked at is: How necessary is it to ramp up spending in five areas—education, health, investment in transport infrastructure, water and sanitation, and energy—to attain SDGs by 2030? We did a benchmarking exercise including 155 countries. That includes all advanced economies, more than 70 emerging market economies, but also more than 50 low-income developing countries, and some are portrayed in this chart. In red, we have Benin, Rwanda, and Vietnam, countries for which we did detailed country studies. What we found is that a representative LIC would have to increase its spending in these areas by about 14 percentage points of GDP, which is a very high number.

Where can this financing come from? First and foremost, the SDGs require countries to develop their own national programs, where they will articulate their priorities. We believe that health, education, water and sanitation, energy, and transport infrastructure, are important priorities because they represent investments in social, human, and physical capital. In the context of those programs, countries should also articulate how they are going to mobilize resources for these ends.

One important source comes from tax capacity. (Slide 12) In most of these countries, tax capacity is relatively low. In the context of our collaboration with the OECD, the World Bank, and the United Nations on the Platform for Collaboration on Tax, we advocate medium-term revenue strategies that suggest that these countries can mobilize about five additional percentage points of GDP over five years. But still, there is some gap to bridge. That may come from other partners or sources of financing, the private sector, international donors, bilateral donors, philanthropists, civil society.

In this slide, we look at this gap from different viewpoints. We are talking about 9 percent of these countries' GDP, but that will represent 0.6 percentage points of developed countries' GNI and 0.3 percent of world GDP. (Slide 13) The assumption that is underlying the SDGs, that the world as a whole has the means to attain SDGs by 2030 seems vindicated, but bear in mind that this challenge is not mostly about financing. It is mostly about state capacity and governance at all levels.

I will conclude now with the policy recommendations from the three presentations. (Slide 14)

The first does emphasize the need to build buffers and tackle medium-term challenges in order to boost resilience and potential growth. In this context, it is crucial to implement country-specific policies that include structural and fiscal reforms to enhance growth and inclusion. Fiscal policies should avoid pro-cyclicality, anchor public debt, improve government balances, and enhance transparency. Advanced economies should cautiously steer inflation to target, should rebuild fiscal buffers for the next downturn or financial crisis, and anchor excess imbalances.

In emerging markets and developing economies, we should see the development of sound macroeconomic frameworks, the reduction of vulnerabilities, the enhancement of financial resilience, and the management of public finance risks.

It is also central to enhance fiscal and financial stability by reducing vulnerabilities. Investors and policymakers must remain attuned to risks stemming from sudden tightening of financial conditions. Broad-based macroprudential tools, including countercyclical capital buffers, should be used more actively in countries where financial conditions remain accommodative and where vulnerabilities are high. Financial stability requires new macroprudential tools for addressing vulnerabilities outside the banking sector. In the event of external pressures, flexible exchange rates can serve as key buffers. If disorderly market conditions emerge, foreign exchange interventions may be appropriate, as long as reserves remain adequate.

Last but not least, it is crucial to avoid protectionist reactions and seek globally cooperative multilateral solutions. In that context, it is key to preserve and modernize an open, rules-based multilateral trading system, complete and implement the financial regulatory reform agenda while avoiding backtracking, and finally, cooperate on global public good problems; and this includes, among others: climate, refugees, international tax, and excess external imbalances.

The Executive Board recessed at 11:04 a.m. and reconvened at 11:14 a.m.

Ms. Barron made the following statement:

I thank the staff for the three excellent presentations that represented the well-targeted reports that we had the opportunity to read.

We set out in our gray statement a more detailed and technical view, so today we would like to focus on what we believe are the critical messages for the Fund to pursue at the upcoming Annual Meetings in Bali.

Trade will clearly be at the forefront of Governors’ minds. We welcome the clear and urgent messages in the flagship reports that highlight the risks to growth of ongoing trade tensions. On trade, there are three separate strands and each need to be strongly advocated.

First, more liberal trade generates stronger economic growth, whether liberalization is achieved unilaterally or multilaterally, and the costs of protectionism are high. As Ms. Horsman put it in her gray statement, the bottom line is that all economies are made worse off in a climate of escalating trade actions.

Second, a multilateral and rules-based trading system lays the foundations for strong growth, and the current system needs to be reformed to regain the trust of all members in the rules.

Third, domestic policy settings are crucial to regain the trust of populations in the benefits of trade. Domestic policies help individuals and communities adjust to trade-induced structural shifts in the economy and are necessary to share the benefits of higher economic growth.

The flagships also highlight key learnings from the global financial crisis, and the policy prescription set out in the documents appropriately reflects those lessons. But one key takeaway is that the longer-term effectiveness of countercyclical fiscal policy depends not only on the stimulus being provided at the right time, as it was in many countries at the onset of the global financial crisis, but just as importantly, on it being unwound at the right time and with the realization that it takes time to turn fiscal policy around.

Putting debt back on a sustainable path requires growth that is faster than the accumulation of debt and/or consistent and sustained budget surpluses. This is clearly difficult for policymakers to achieve. Messages on fiscal policy need to recognize that it cannot turn on a dime.

Another key takeaway from the flagships is the importance of a flexible exchange rate as an important buffer for an economy facing adverse external conditions. We look forward to the active dissemination of the staff's analysis, that countries with more flexible exchange rates experienced smaller losses during the crisis.

Finally, like Ms. Riach and others in gray statements, we appreciated the staff's work to streamline the reports, and we encourage the staff to further build on these improvements to increase the accessibility and, more importantly, the traction of Fund advice going forward.

Mr. Merk made the following statement:

We thank the staff for the excellent set of reports and presentations. We agree that the current expansion of the global economy continues but has become more uneven. Downside risks to global growth and financial stability have increased and partially materialized.

First, rising trade tensions and an increased shift toward protectionist policies remain key downside risks. Trade tariffs imposed over the last months could have lasting negative confidence effects on investment and trade more broadly; thereby, depressing global growth, as Mr. Obstfeld and Mr. Adrian's presentations both illustrate clearly. We highly welcome the staff's plea to avoid protectionist reactions to structural change and to find cooperative solutions.

Second, we are increasingly worried about the high and rising public debt levels in many countries, which raise debt sustainability concerns. Furthermore, we are concerned about risks stemming from a highly indebted, non-financial private sector in many countries. All of the reports provide highly valuable insights on debt and its many dimensions.

Third, high valuations in several market segments, and political and policy uncertainty continue to pose risks to financial stability. Waning confidence could sharply affect market sentiment adversely. The slide on potential triggers for risk in Mr. Adrian's presentation makes the point, and I will refrain from adding to that.

Overall, we can subscribe to many of the flagships' key messages and the policy recommendations.

First, rebuild fiscal buffers and curtail excessive debt levels to enhance macroeconomic and financial resilience. In that regard, we caution against overemphasizing an alleged need for a gradual approach.

Second, bold structural reforms that ensure strong, sustainable, and inclusive growth should be on the top of the list. The staff rightly accentuates the crucial role of policies that facilitate private sector development, not least for low-income and developing countries (LIDCs). In that context, I would like to highlight the Compact with Africa initiative, addressing reform-minded African countries.

Third, we strongly support the view that policies to discourage banks from holding excessive domestic sovereign bonds would improve financial stability.

Fourth, we need to continue with the post-global financial crisis reform agenda and avoid complacency and regulatory fatigue.

Finally, I will end with some remarks on the Fiscal Monitor. We welcome the staff's novel and insightful analysis on public sector balance sheets. That being said, the limitations of the balance sheet approach for assessing resilience and fiscal sustainability and for deriving policy recommendations need to be kept in mind.

Mr. Gokarn made the following statement:

We would like to begin by appreciating and thanking Mr. Obstfeld for his contributions over the last few years, and we wish him all the best in his next avatar.

We thank all the presenters for their excellent insights into the current situation. We are broadly in agreement with the change in tone in the WEO, highlighting the risks of a slowdown and the emergence or the dominance of downside risks.

I would like to make two broad points. One is in the context of the forecasts and the policy recommendations. The other is in the context of a specific issue that has arisen in the GFSR.

We see no reason to challenge the thrust of the policy recommendations, but I want to pick up on two points. One is that financial stability requires new macroprudential tools for addressing vulnerabilities. The second is the flexibility of the exchange rate and how to respond if disorderly market conditions emerge.

A bit more granularity is warranted. Many countries are dealing with these situations in real time, and some sense of what else can be done and in what sequence, with what risks in a situation where foreign exchange movements are extremely disruptive, would help member countries that are in that situation deal with it better. I would ask, perhaps in this framework or separately, for some greater input into the nitty-gritty of managing this extremely volatile situation.

Coming to the issue in the GFSR, this is about the treatment or the reference to sovereign exposures. In responding to the draft document, we had made some fairly strong points in our gray statement about the need to delete three references—paragraphs 12, 25, and 48—for two reasons.

One is, we believe that this issue has been resolved at the Basel Committee on Banking Supervision level and that the standard-setter should have the final word. We did not want the Fund to be appearing to reopen the debate in a situation of some stress in many of these countries.

Second, from our own perspective, the treatment of sovereign exposures in the way the Basel Committee on Banking Supervision has finalized it is one source of stability in an otherwise volatile situation. We felt that the Fund reopening this debate would add to the uncertainty about which way it was going, so we asked for these references to be deleted. We understand that there is some consideration of a change in tone in all of these paragraphs. To the extent that that change addresses our concerns, we would be happy to go along with those. We look forward to seeing the revised version, and we can engage with the teams offline once we see that.

Mr. de Villeroché made the following statement:

We concur with the staff appraisal and these excellent presentations.

We have strong, solid growth, but it goes with the buildup of high risks. I would like to insist on four recent developments and challenges, and some of the risks are already materializing.

The first one is, as international liquidity starts to be tightened, some emerging economies are now experiencing heightened volatility and a loss of investor confidence. One important message from the flagship reports is that the normalization of the U.S. monetary policy triggers confidence shocks where fundamentals are weak or perceived as such. This is somehow reassuring, since it means that the risk of contagion could be limited. Nonetheless, there should be no complacency, since the effect of a normalization of U.S. monetary policy will keep materializing over the coming months and the perception of a fundamental weakness is highly dependent on the degree of investors' trust and is so highly volatile. Therefore, we share the flagships' message on the need to strengthen the buffers, where needed, to prevent new disruptions. In terms of risks, we see the inflation surprise as a possible aggravation to the situation, something which could happen in a very pro-cyclical U.S. fiscal policy context.

Second, regarding ongoing trade tensions, we reiterate our call to avoid protectionist measures and to remain committed to cooperation and an open and rules-based international trade system. We welcome the WEO's scenarios, also the hamburger charts. It will remain one of the most striking charts that we will get for the Annual Meetings in Bali. I am sure of the success of it.

Turning to excess global imbalances. This is one of the areas of the post-crisis agenda where progress has been limited. The rebalancing effort has been asymmetric so far; notably, on debtor countries in Europe. I would like to strongly encourage management and the staff to persist in conveying their message on the need for further progress on that front.

Surplus countries with fiscal space should do more to boost domestic growth and give more explicit support to more sustained wage dynamics. Additionally, pro-cyclical policies that will widen external imbalances should be avoided, and this is true for the United States.

On the financial regulation agenda, we still need to address gaps in the implementation of the reforms. Strong progress took place, but we still have issues on compensation practices. We have issues on the regulation of non-banks' activities. The Fund's should continue to send the message on the need to have full coverage of the prudential and regulation agenda.

I will conclude by saying that in this context of a build up of risks and vulnerabilities, we see a strong case for the Managing Director's Global Policy Agenda (GPA) and for a well-resourced and well-equipped Fund to potentially face more difficult times.

Mr. Kaizuka made the following statement:

I thank the three eminent department directors for the excellent presentations. I also thank them for our communications and conversations throughout the process of formulating these reports.

I greatly appreciate the streamlining effort of the flagship reports, which makes them more reader-friendly and more punchy in their message; but by contrast, I have to apologize for our lengthy gray statement, which is much longer than usual. To compensate, I will make only two points.

First, on trade, it is reasonable and timely that the WEO and the GFSR shed light on the trade tensions, with quantitative and objective analyses. The famous hamburger chart in Indonesia may be known as the nasi goreng chart. The message that there are no winners in a series of tit-for-tat protectionist measures is critically important, as indicated on page 11. It is worth noting that in terms of the long-run impacts, the United States would be the most severely negatively affected country in the world. This is a very important message.

On the other hand, there is room to reduce the barriers to trade and enhance the protection of intellectual property rights, which would positively impact the global economy and economic order. The Fund could advocate on this particular front in the meetings and the conference.

On the Fiscal Monitor and the public sector balance sheet, this is an interesting perspective. I appreciated that message. The accumulating debt in the developing countries should be matched by the productive and high-quality assets, which is summarized in Slide 11. Having said this, I fully agree with the other many Directors that the balance sheet approach should not contradict the long-lasting message of the Debt Sustainability Analysis (DSA), and the necessity of the fiscal consolidation should not be compromised. The Fund should continuously take a long-lasting analysis on gross government debt, using the PSBS as complementary information.

Ms. Riach made the following statement:

I join others in thanking the staff for their thought-provoking set of flagship documents but also for this morning's excellent presentations.

We broadly agree with the assessment that global growth remains strong and above potential; but it is increasingly unbalanced, and the global vulnerabilities remain material, with the balance of risks further tilted to the downside in the near term.

Since the Spring Meetings, things have changed. Trade tensions have increased. Financial conditions have tightened sharply in emerging markets. Some emerging markets have seen an extremely sharp currency depreciation. It is right that these developments should be reflected both in the forecasts and in the tone of the flagship documents. In that light, we are grateful to the staff for their efforts to respond quickly to the latest round of trade tariffs and to update the forecasts ahead of today's meeting. Having the most up-to-date forecast as possible is incredibly important at the current juncture.

It is important that the Fund strikes the right balance between avoiding appearing complacent while not being alarmist about the risks. I believe these documents set the right tone.

Like others, we welcome the focus on trade tensions and, in particular, the hamburger chart. The scenario box is helpful at drawing out the different channels for trade effects, and we appreciate the staff's efforts to take into account not only the direct impacts of increased tariffs but also the potential confidence and financial market effects.

We welcome the Fund's call for multilateral cooperation and believe that it could be even more explicit in promoting increased service trade liberalization as a way of resolving trade tensions. In that context, we welcome the focus provided in the WEO, but also the Fund's efforts highlighted in yesterday's Board discussion, to move the debate to a more positive focus on the benefits of multilateral trade cooperation.

As we said in our gray statement, we appreciate the work done to streamline the reports. Striking the right balance between simplicity and depth of coverage is difficult. But the reduction in chapters and greater use of special features in boxes goes some way to meet that challenge. We urge the staff to continue to build on these improvements, with a focus on the accessibility of the documents.

In these efforts to streamline, we ask the staff to avoid excluding certain sections of the membership from coverage in the flagships. In that context, I note that in this morning's presentations, there seemed to be much more focus on some of the issues pertaining to LICs, the debt levels, and also the spending pressures that they face than what we saw in the documents themselves. Going forward, it might be helpful to make sure that those important issues are fully reflected in the documents.

Turning to the United Kingdom, we note that there is an increased focus in these documents on the potential risks and impacts of Brexit. Given that we are getting closer to the United Kingdom's exit from the EU, this seems appropriate. We broadly agree with the staff's baseline scenario, which assumes a broad trade pact with a relatively smooth exit process yielding the best outcome for both parties, but we note that a more disruptive departure from the EU would yield a significantly worse outcome for both sides.

We welcome the box in the GFSR on the financial stability considerations relating to Brexit. This is an issue which featured in the recent euro area Article IV consultation and will feature in the forthcoming U.K. Article IV consultation. We welcome the Fund's assessment of the potential risks and the call for action from both the private sector and from U.K. and EU authorities working together.

To conclude, in this time of increased uncertainty and heightened risks, the challenge for the Fund and for us all is how to highlight familiar risks, the dangers of protectionism, rebuilding buffers, and fully implementing the regulatory reforms agreed after the financial crisis in a way that is proportionate and impactful. This set of flagship documents made some good steps to achieve this. The focus in the Fiscal Monitor on public sector balance sheets is an alternative and novel way to highlight fiscal risks, and we appreciate the focus on the tenth anniversary of the global financial crisis. We look forward to continuing this discussion in next week's Board discussion of the Managing Director's GPA.

Ms. Erbenova made the following statement:

We thank the three counsellors for their insightful presentations and their respective teams for the high-quality flagship publications.

We broadly concur with the overall tone and messages. The flagships appropriately do not shy away from identifying countries and regions with vulnerabilities. Against the backdrop of moderately slowing global growth momentum, rebuilding policy space and strengthening resilience have become even more urgent. At the same time, advancing structural reforms to raise potential growth in the longer term should not be postponed any further. Escalating trade tensions pose major threats to economic growth. We welcome Fund's continuing vocal advocacy of free trade and multilateralism, including the analytical work aimed at estimating the potential damage from further trade tariff escalations.

We appreciate the strong focus on the emerging markets, both in the WEO and in the GFSR. Chapter 3 of the WEO understandably struggles to generalize the experience and policy implications in a diverse set of countries. It seems that the divergence is further deepening between those economies which ex post react to external shocks, such as the current monetary tightening in the United States, and those which strive to address their vulnerabilities ex ante and are now reacting to the same real economy and price pressures as the originator of the shock.

The notion of contagion is, thus, increasingly becoming irrelevant for the latter group, and we may need to rethink the traditional, broad-based advanced versus emerging categorization to better reflect this dichotomy in the emerging market universe.

Noting the attention given to the developments in Turkey, we would like to underscore that the Central Bank of Turkey significantly tightened monetary policy last week. Today, the Ministry of Treasury and Finance unveiled a new economic program, envisaging a fiscal consolidation path. We are cognizant of the cutoff date of the flagship publications, yet would appreciate if some way was found for these major policy steps to be reflected in the flagships.

We agree with the main messages of the GFSR, which point to still loose financial conditions in the advanced economies, despite some risks materializing in some emerging market countries. We are concerned that, despite the well-communicated interest rate hikes in the United States, the buildup of leverage continues, which further increases the medium-term risks and vulnerabilities.

We share the staff's assessment of the growing urgency for policymakers to strengthen the resilience of the financial sector, including through the completion of the agreed reforms.

We welcome the box on Brexit-related financial stability risks, as March 2019 is approaching fast. We see the staff's focus on possible transitional risks as fully in line with our multilateral surveillance mandate. It goes without saying, however, that those risks need to be communicated in a balanced manner without presupposing any outcome of the ongoing negotiations about the future end state between the two jurisdictions involved.

We appreciate the special feature on international banking groups. The staff is right to point to the risk of fragmentation while also acknowledging the legitimate financial stability concerns by host supervisors. Close supervisory cooperation is needed to address the complex tradeoffs. We support a more nuanced analysis in this direction, but our concern is that sometimes the concepts of segmentation and fragmentation are considered mutually interchangeable, as are concepts of individual bank treasury liquidity and market liquidity. We would think that the executive summary should better reflect these nuances, which are well treated in the main text.

We support the staff's view on the risks stemming from the sovereign-bank nexus in many countries but would strongly caution against explicitly promoting ad hoc proposals lifted from one FSAP exercise. I concur with Mr. Gokarn's remarks on this matter.

Finally, we regret that the regulatory reform chapter is focused on systemic countries only. While recognizing the space limitations of one chapter and welcoming the streamlined format, we would see considerable value in analyzing the impacts and the appropriateness of these regulatory reforms for our broader membership that is not represented in the standard-setting bodies.

Mr. Alkhareif made the following statement:

We thank the staff for the excellent set of flagship reports and the informative presentations. As this is the last WEO under the leadership of Mr. Obstfeld, we take this opportunity to thank him for his excellent contributions, advancing research in the Fund, and promoting policy advice that was helpful in supporting the global economic recovery and enhancing countries' resilience.

On the flagship reports, many Directors referred in their grays to the staff's findings that 45 emerging market and developing countries are projected to grow in per capita terms by less than advanced economies, and therefore, fall further behind in living standards. In this context, we encourage the staff to continue to focus on identifying the drivers of growth and share the experience of successful countries.

Finally, we appreciate the staff's response to our question on the long-term determinants of energy demand. We have to be careful in using terms like "stranded assets," as we consider that oil and gas will continue to play a major role in the global economy, where all energy sources will be required for the foreseeable future. Underscoring peak oil demand or stranded resources is a risk to an orderly energy transition and energy security, as massive investments, including in ageing infrastructure, are needed over the foreseeable future to meet the rising oil demand.

Mr. Panek made the following statement:

I would like to thank our three speakers for their excellent presentations. Let me make four points.

First, we can discuss whether winter is coming, but which season is coming is beside the point. The point is that we must be prepared for all seasons. In this regard, we share the greater sense of urgency to rebuild buffers, enhance resilience, and advance reforms that foster high, sustainable, and inclusive growth. There is no time to waste.

Second, we urge the Fund to use every opportunity to continue making the case for the rules-based multilateral framework. Common challenges need collective solutions. Unilateral tit-for-tat policy measures will only shake confidence and have an adverse impact on global prosperity. Disagreements need to be resolved in a predictable and orderly fashion. This is what the multilateral framework was created for.

Third, some but not all emerging market economies have faced renewed capital flow volatility in recent months. The flagship reports rightly show that the effects of tighter global financial conditions have been differentiated according to country-specific vulnerabilities. I would like to emphasize the key role that robust policy frameworks can play in enhancing the resilience of countries to external shocks. This is something that the Fund should emphasize, perhaps more forcefully, in its various activities.

Fourth, many LICs have large investment needs, be it for infrastructure, health, or education. At the same time, public debt ratios in many of these countries have been rising fast and are now at dangerously high levels. It is essential to make ends meet. Domestic resource mobilization remains a key priority in this regard. Moreover, we would like to underscore the shared responsibility of creditors and borrowers in ensuring sustainable and transparent lending practices. When debt must be restructured, we need an orderly and predictable approach based on a commonly accepted set of rules.

Mr. Tombini made the following statement:

I thank counsellors for their excellent presentations. I believe there is broad agreement that the global economy lost its steam since our Spring Meetings, and the downside risks are becoming more pronounced, even in the short term. We are now entering a period of rebalancing global portfolios on the back of a strong dollar and tighter financial conditions and in the context of increased uncertainty and softening growth.

Emerging market and developing economies, as a group, are being affected, and countries with high external financing needs and policy inconsistencies are particularly exposed to the changing environment.

Episodes of volatility will gain in intensity and extend in the case of a sudden correction of markets' expected path for monetary policy normalization or of a further escalation of trade tensions. To my mind, the policy implications of this new global environment for emerging markets are clear.

First, adjustment needs to proceed with monetary policy focusing on controlling inflation and keeping expectations well anchored, while fiscal consolidation should ensure debt sustainability over the medium term.

Second, exchange rate flexibility will help those economies with a floating regime, contributing to absorb the shock and facilitating the adjustment.

Third, financing may be required for countries that do not have sufficient buffers to restore market confidence and smooth out the adjustment, making the whole process socially viable and economically affordable.

Therefore, I believe that, at this juncture, it is important for the Fund to convey a clear and reassuring message, balancing a candid assessment of the outlook with an encouraging communication. We want to underscore the Fund's readiness to act in a timely and effective way to support the membership, as requested.

Having said that, I have three specific points for the counsellors.

First, related to our message on commodities, it has been called to my attention that in the past six months, while energy prices went up, food prices and metals went down. The message today by Mr. Obstfeld was much more precise than reading the WEO. I have the impression that commodity prices are going up. I think the staff should focus on energy prices, rather than the broader index.

Second, the GFSR highlights the three factors supporting portfolio flows to emerging markets; namely, the U.S. interest rate, the U.S. dollar, and risk appetite. Risk appetite is still considered to be strong, while the other two factors are unfavorable for emerging markets. Mr. Adrian's presentation brought up the risk factors that could trigger a more abrupt change. I ask the staff what factors suggest that risk appetite may be still favorable for the time being, whether there are any aspects to be considered in that regard.

Finally, I would like to join several Directors—Mr. Leipold, Mr. Hurtado, Mr. Kaizuka, Ms. Pollard, and Mr. Gokarn—who questioned the approach to the sovereign-bank nexus. We had discussed this substance in the past, and this is an issue that is relevant in certain jurisdictions, under certain circumstances, but cannot be generalized. These subjects are better dealt with by the Basel Committee for Baking Supervision, as Mr. Gokarn mentioned, and to my knowledge, this is an issue that has already been settled in that environment, so we should not reopen it here at the Fund.

Mr. Ostros made the following statement:

I thank the staff for the excellent presentations. I agree with the overall tone and messages that they have conveyed both in the papers and in the Board.

It is clear from their presentations that risks and vulnerabilities have steadily been built up since the global financial crisis. I especially appreciate the deep analysis of vulnerabilities in emerging markets. There is a variety of developments that are worth noting, but there are also some pointed vulnerabilities that can be problematic to deal with going forward.

The staff has been more spot-on when it comes to risk developments in recent years than any other analysis in this field. It is hard to make point estimates for GDP in different countries or globally, but to be broadly right in the buildup of risks and seeing that some of this has played out is worth our praise. This has been important for all member countries, and the staff takes another step with these reports.

Added to the risk scenarios that we have been discussing for a few years is also the unfortunate pro-cyclical fiscal policy from the United States and the increased trade tensions that we see. That is playing with fire in a situation where we have risk built up because of other fundamental reasons.

I would like to ask staff, when they look at what has happened in the recent six to eight months, with rising tensions also in the financial markets, it looks like countries that have strong policy frameworks, strong fundamentals, have fared fairly well. But if we connect that to the discussion that we had last year about the possible need for liquidity instruments to support countries that are generally well managed, does the staff see tendencies for that need? Or is it the case that the staff sees this as an experiment? Has the sustainability of these countries been stronger than expected? It would be interesting to hear the staff's evaluation of that.

There is an urgency with the policy message on building buffers. That is important. I hope that the staff keeps that urgent tone also when they present this to the outside world. We would also like to complement that with the urgency to fulfill the global regulatory reform agenda. We see some slowdown in implementation. We would highlight the importance of addressing the persistent bank-sovereign nexus. This is sometimes a politically contentious issue, but it is important to point it out. We would like to see further discussions on policies discouraging banks from holding excessive bond issued by their home sovereign. We need to improve the resilience of the financial system by looking for solutions to that.

We are very happy with the Fiscal Monitor and the focus on the public sector balance sheet framework. Three of my countries have been involved in this. It has been a valuable contribution to the domestic debate.

I saw in one of the slides that China has a relatively comfortable position when it comes to net worth—not all of that liquid. But at the same time, we know from experience that a financial crisis in a country with high private debt quickly can transform into very high public debt in that situation. I would urge the staff to be clear on the message that that relatively comfortable position might not be sustainable if there is a sudden downturn in the financial markets.

Mr. Palei made the following statement:

I thank the counsellors for the interesting presentations and the staff for its work on the flagship reports.

We are concerned about the headline messages from the reports. The one that worries us is in formulating the Main Themes in Grays. It says: "Financial conditions in most EMDCs have tightened but have remained accommodative in advanced economies."

We are afraid that the media may misinterpret this message as a different one. For example, they may think that in the face of growing risks, everything is fine in advanced economies, and the emerging market economies are in trouble already. We are afraid that if we do not communicate carefully, then some of the messages from the reports could be misinterpreted outside the Fund, and they may get unfortunate attention.

For example, for the advanced economies, we would like greater differentiation. We know that Italy was one of the countries that was mentioned frequently in flagship reports. In the presentation, there is a special slide devoted to Italian spreads and bank equities. The story is that the markets are concerned about the budget policy in Italy. However, when we look at the spreads for other countries in the south of the euro area—for Portugal and Spain—we see a similar jump in spreads that we see in Italy. The question is whether it is an idiosyncratic situation for Italy, or something broader that is related to the more generalized risks.

For emerging market economies, in the report, it is highlighted that investors are still differentiating between different economies based on fundamentals. But in the headline messages, it is not as clear as it is from the main body of the report. We believe that it is important to differentiate for both groups of countries: advanced economies and emerging market economies. Russia is a good example. When we look at the studies, the one devoted to inflation expectations—volatilities, foreign exchange yields, and so on—we see averages for a long period of time—2004 to 2017. However, over the past several years, Russia has strengthened its policy framework, including fiscal framework, and we made the successful transition to inflation targeting. We have heard of a recent lecture by our central bank chair. For us, it is important to better highlight the strong fundamentals and strong macroeconomic frameworks that emerging markets worked on.

To conclude, I would like to join the Chairman's call to become a little more cheerful, though maybe not in the sense suggested by Ms. Pollard and her colleagues. But for many emerging market economies, it is good news that investors are still differentiating based on fundamentals. It is also good news for those of them who worked hard to prepare for the winter that is coming.

Mr. Mojarrad made the following statement:

I join other Directors in thanking the staff for the high quality flagship reports.

The narrative in the October 2018 WEO is dominated by the risk to the outlook related to the escalating trade conflict. Many of the risks flagged by staff in the October 2017 exercise have materialized, and in many cases even intensified—notably, the trade frictions. In the past six months, we have moved from shots across the bow to something close to a trade war which could expand and from which nobody will benefit and many will lose. The losses will clearly go beyond the immediate disputing parties and will include virtually all regions and country groups through multiple direct and indirect links that have been established over the years. Most countries will lose to varying degrees, but the losses will probably be the most acute for the poor in the poorer countries.

It is not common for the economic developments in Iran to be highlighted in a global context. But in this WEO, references to Iran appear in a number of places; unfortunately, mostly in a negative light. We broadly agree with the staff's assessment of the difficult economic conditions in Iran, which find their root cause in U.S. sanctions. The unilateral U.S. action this time goes beyond direct restrictions on trade and finance and includes extraterritorial threats of retaliation against third countries and entities trading with Iran, which is against all international norms. Its impacts are similar to the trade risks mentioned before.

On the oil market, Iran is a stronger believer that the stability of the oil market benefits producers and consumers alike. The current strength of the international oil market reflects a number of factors. On the demand side, there is still robust global economic growth, and on the supply side, there are capacity constraints facing large producers, production disruptions due to conflict and trade strife, and supply uncertainties due to sanctions and other geopolitical factors. Iran probably falls in the last category. Any significant reduction in Iranian oil output and exports will surely be felt in international prices, to the detriment of consumers, at a time when the prospects for global trade are uncertain due to the trade conflict, and the global cyclical economic recovery is approaching maturity.

Finally, I congratulate the Chairman for her elegant and succinct speech in London a few days ago on the challenges and ultimate rewards in meeting the 2030 Sustainable Development Goals (SDGs). She rightly pointed out that the meeting the SDGs not only benefits the developing countries themselves in so many different ways but also the global community at large through many positive externalities. Meeting the development objectives probably would not be possible without the strong partnership of all stakeholders, a core responsibility for the common good, as she put it. A key issue is financing, with some 50 percent of low-income and developing countries in debt distress, at high risk of debt distress, or having difficulty in meeting their debt obligations. The availability of grants and concessional assistance is critical.

Mr. Gaspar indicated that even after credible revenue mobilization, the low-income and developing countries in debt distress will still need additional resources equal to 10 percent of the GDP if they were to meet their SDG objective. I urge the next Fiscal Monitor to devote a background chapter to this issue.

Mr. Doornbosch made the following statement:

I thank the staff for the comprehensive set of reports and the rich and focused presentations.

In the outline for the GPA, the Chairman focused on policy cooperation and building buffers. Both teams captured the essence of these flagship reports.

Like other Directors, I would like to start with a comment on the hamburger chart that was presented. This is a powerful graph, but it might be interesting to see whether the staff can complement this graph with a graph with positive scenarios, what would happen if there was increased trade between the EU and Japan, what would happen when there is a more comprehensive agreement on services, because hamburgers normally get better when one adds ingredients, but I guess that is a subjective opinion.

I have four points. My first point is that there is a high premium on countercyclical policies. The WEO shows that the output losses after the global financial crisis are persistent. Recent IMF working papers by Cerra and Saxena and Comdelon and others have clearly demonstrated that the output loss after recessions and crises is often permanent. The policy implication is that there is a high premium on countercyclical policies. In other words, we need to take away the punch bowl before the party gets too crazy, because if it does, it will result in a painful hangover.

I am happy to see that this need to rebuild buffers resonates in the Fund's policy advice. This brings me to my second point, because it might be useful to look back. I think the Fund has been a bit behind the curve on this need to build buffers. On the fiscal side, the importance of building buffers was only really stressed in the last WEO in April. It was already carefully addressed in the WEO last year, but that was in an almost casual way. For example, the advice was that for some countries, when output gaps close, they need to start thinking about a gradual fiscal consolidation.

I applaud that this message has been sharpened over the past year; but if one looks back at the world economy, it has seen a steady growth of about 3.5 percent since 2012. The euro area now has seen 20 quarters of growth; and with this also holds for the United States, though with a few more bumps.

Also, on the monetary side, one could ask the same question, whether we take away the monetary punch bowl in time. If one looks at the GFSR, it suggests that global financial conditions depend critically on risk aversion. There is substantial evidence that expansionary monetary policy increases risk-taking and fuels the financial cycle. The recent work by our Financial Counsellor, Mr. Adrian, indicates that optimal monetary policy should take financial conditions into account, so any remarks on that would also be appreciated.

Third, I would like to strongly support Mr. Ostros on the need to complete the financial regulatory reform agenda, and not reverse it. I do believe there is one thing that is missing in the box on this in the WEO, and that is the sovereign-bank nexus. That is one of the uncompleted reforms that we still have to face, in one direction, in the sense of the strong resolution regimes that are needed. If one looks in the box, bail-in is mentioned zero times. But in the other direction, in the strong home buyers of sovereign bonds on banks' balance sheets.

Mr. Agung made the following statement:

I appreciate the staff for the high-quality flagship reports. The basic assumptions, driving forces underlying the outlook are clearly presented in the report. This would make the WEO even more readable for the public.

The key message from the flagship reports is clear: that the landscape of the global economy has changed, and the downside risks that we identified in April have materialized. The outlook is more uncertain, as the global financial conditions could tighten rapidly and trade tensions have increasingly been quite dynamic. In this context, we agree with the key message to the policymakers, to reduce vulnerabilities and to strengthen policy buffers.

Many emerging market economies have proven resilient to the recent financial market volatilities. Countries in my constituency have strengthened policy buffers and have implemented macroprudential policies to safeguard financial and macroeconomic stability. Our authorities are addressing vulnerabilities in the financial system and are pursuing fiscal and structural reforms to further enhance resilience and guard against vulnerabilities that could arise from a capital reversal. However, a sudden shift in investor sentiment could trigger a sharp reversal of capital flows that potentially would disrupt and derail economic activities in emerging market economies.

In this context, we join Ms. Riach, Mr. Tombini, Mr. Jin, and Mr. Gokarn in calling for the Fund to support the membership, to provide policy recommendations on how to manage this turbulence and capital reversal in a more detailed manner. We are also looking forward to the forthcoming Early Warning Exercise, which should focus on the possible tail risks as a result of a dynamic interaction between the further tightening financial conditions and heightened trade tensions in the global economy.

This brings me to the last point on the trade tensions, which is a key threat to the global economy. The recent unilateral tariffs pose a further concern in this regard. A trade war, in the end, comes at a great cost to everyone, including economies in my constituency. As such, we appreciate the staff's efforts to highlight the damaging impact of the trade war in the flagship reports. We also encourage the Fund to continue to promote greater trade openness under a rules-based multilateral trading system.

Finally, as this is the last WEO for Mr. Obstfeld, let me appreciate his contributions to the Fund and the membership. Our authorities enjoyed a very good relationship with Mr. Obstfeld.

Mr. Leipold made the following statement:

I thank staff for what I can only describe as a heroic effort to integrate the latest U.S. tariff announcements into the projections and presentations. Rerunning the whole exercise is a huge task, and it is a good example of why this institution is effective and efficient and why we say that its staff are its greatest asset.

This gratitude is, unfortunately, tinged by a heightened sense of concern about the prospects and, more generally, the current state of international cooperation. We would have been a lot more cheery if, in fact, this scramble to update had not been necessary at all.

We are moving to a world where strained relationships between key players are casting a heavy cloud on our ability to respond in a globally coordinated manner if we were to face another major crisis. Maybe it is not winter, but there is not much sun either.

This strained relationships is also conveyed by reading through the gray statements for today's meeting, where at times, one senses a sharper rhetorical edge in some of the language, which is unusual for exchanges in this institution. It is against this background that the one thing that has to be unequivocal—as it is embedded in the institution's origins, its charter, its history—and that is that trade tariffs are no way to address global imbalances. Never in all our many initiatives over the years to address such imbalances have tariffs even remotely appeared on the radar screen as a plausible response. Not in the 2007 Multilateral Consultation on Global Imbalances; not in any of the External Sector Reports we have issued since 2012; and for good reason, they represent a lose-lose outcome.

The fact that tariffs are now invoked as a solution must be seen as a departure from established economic thought, hopefully of a short duration, or else the hamburger that we are having to eat will be very difficult to digest.

This is not to say that there is not scope to modernize the present trade system. Just yesterday, we had an interesting illustration of ongoing work in this area by the Fund, the World Bank, and WTO staff. Today, the European Commission is presenting a set of ideas for the modernization of the WTO in a meeting in Geneva, convened by Canada. That is the way forward, not an escalation.

Let me add two further points. First, we found the GFSR's analysis of stretched asset valuations on pages 18 to 20 to be interesting, particularly its examination of cases where it finds notable evidence of deviations of market prices from estimated fundamental values. In particular, we were struck—though not surprised—by the analysis of term premiums, which is on panel four on the figure on page 20, used as a proxy for credit risk. The analysis clearly shows that the risk applied by markets to Italy is not justified by the economic fundamentals taken into consideration in the Fund's model and has notably overshot these fundamentals.

My second point concerns the treatment in paragraph 52 of the GFSR of the sovereign-bank nexus. It is a vulnerability. As we noted in our gray statement, the staff's analysis is too narrowly focused and it fails to recognize that the link, which is recognized in the departmental paper on managing the sovereign-bank nexus, is really a macroeconomic one. It is not simply the exposure to sovereigns that is the link. We have given the staff a number of comments conveyed from that paper and we look forward to these comments being reflected in the published version.

I fully share the points made in several gray statements, and made forcefully by Mr. Gokarn and Mr. Tombini about leaving the determination of the regular treatment of sovereign exposures to the Basel Committee and not overreaching on our side on that.

Ms. Horsman made the following statement:

We join others in thanking the presenters. We want to commend the staff for providing a more streamlined set of reports while maintaining their high quality and relevance.

The global economic outlook has worsened since April, resulting in a more downbeat tone in the reports. This is appropriate, and it comes across clearly. Given the downward revision to growth projections for both 2018 and 2019 and the further tilting of risks to the downside, we agree with the central message, that urgent policy action is needed to protect and enhance sustainable growth prospects.

With this backdrop, I would like to emphasize only a few points today.

First, we welcome the breadth and depth of the staff's analysis of the risks posed by trade tensions. The Fund is playing a necessary role by highlighting the macro-critical risks of trade tensions as well as the benefits of multilateralism and cooperation. The staff's assessment of the impacts of escalating trade tensions illustrates just how quickly a narrow set of trade measures can lead to global output declines and systemic risk. The question that lingers is what countries should do in the face of these risks? The trade policy prescription to pursue global cooperation, regional trade agreements, and generally pursue trade under a rule-based multilateral system is welcome. At the same time, where there are obstacles to pursuing these outcomes, countries are faced with a complex landscape.

Yesterday's discussion on plurilateral solutions made me wonder whether the Fund's policy advice on trade is fully integrated in terms of pragmatic ways that countries could move forward in the current environment. As Directors pointed out in the discussion yesterday, some of the possible policy prescriptions may include unilateral actions to reduce trade barriers and help promote market access. I would add that in many countries, policy actions have fallen short of addressing persistent, excessive, external imbalances, which may be feeding protectionist sentiments and undermining cooperative solutions.

Turning to my second point, many countries, particularly small island states, remain vulnerable to the economic impacts of climate change and natural disasters, which calls for a greater policy focus toward ex ante resilience-building. While the flagship reports acknowledge this, more advice could be provided in this area. As an addendum to this point, I note the finding that countries with flexible exchange rates experience smaller losses as a result of the crisis, which is certainly an important message. Having said this, I, along with many other Directors, represent countries for which fixed exchange rates provide needed stability. We agree with Ms. Barron and her colleagues that a more transparent analysis of the costs and benefits of fixed exchange rates would be useful, particularly in the context of small tourism-dependent states.

Third, on financial stability risks, we are concerned about the increased vulnerabilities, particularly from rising indebtedness across many sectors. While we share the view that banking is now more resilient after significant reforms, we urge the Fund to intensify analysis of other potential systemic areas, especially market-based finance, both for increased risks and macroprudential tools to mitigate them, yet another area where cross-border cooperation will be key.

My final comment is a question and builds on what some other Directors have said about the communication of the key messages in Bali—that is: How can the Fund leverage the flagship reports as a call to action, particularly since the window for action has narrowed substantially since April and the trend away from multilateral cooperation seems to be continuing?

Mr. Armas made the following statement:

I thank the counsellors and their teams for the well-done work. I have four specific comments.

First, regarding the Research Department's (RES) estimation of natural interest rate, we are living in a world with an almost zero interest rate. Short term is 2 percent. Long term is about 3 percent. We will probably need a rapid update of this estimation; in particular, because there are sometimes policy recommendations based on old estimations. In that regard, in our gray statement, we mentioned that for most developed economies, the message of communication is important. We were talking about communication of monetary policy but it is probably more important for issues such as central bank independence, lack of fiscal dominance, and the reputation of the central bank as an inflation factor.

Regarding total debt, the level that we were mentioning here is worrying. But in terms of communication, I recommend that we not speak in terms of nominal numbers, the US$182 trillion. A more technical way to put it is in terms of GDP, just to avoid some bias in the comments.

Second, in terms of private debt in emerging markets, we welcome the analysis, but I want to mention some points. I believe it was Ricardo Hausmann in a recent sovereign bond seminar, where Mr. Lipton was the chair. He mentioned that the original thing, which is the fact that emerging markets were not able to issue their debt in their own currency, has shifted from public debt to private debt. It is quite difficult for the corporate sector to issue debt in foreign markets.

We believe that the comparison in terms of the size should be complemented with other ones: maturity of debt, a currency mismatch analysis, whether the borrower belongs to the tradable sector, whether the borrower has asked for a financial hedge, et cetera. In my constituency, we have sometimes FDI projects, where there is a debt, but the debt is between the subsidiary and the headquarters.

On the fintech agenda, I have the following comment. Maybe it would be useful to break up the analysis in terms of which type of fintech we are talking about. For instance, there are some related to payments service, payments systems, crypto assets, financing of households, financing of small- and medium-sized enterprises (SMEs), for which the impact is different and the risks are different. We need to focus more on that. There are some concerns about risks, but we have to realize that there is a balance. The problem comes when someone tries to kill some sector there.

I wanted to mention that in terms of communication, Mr. Obstfeld's articles in the *Financial Times*, explaining the trade tensions, explaining basic concerns of the current account were very useful.

Mr. Mkwezalamba made the following statement:

We join other Directors in thanking the staff for their excellent work, as well as the lucid presentation. In addition to the points that we raised in our gray statement, we need to highlight a few points.

First, although the WEO appropriately identifies several downside risks to the global outlook, it is important to highlight the uneven effects of some of these risks, were they to materialize. For example, if the ongoing trade tensions were to escalate and truly depress global trade, the analysis presented at yesterday's Board briefing on reinvigorating trade and inclusive growth suggests that the poor and vulnerable would suffer much more from trade losses. Therefore, we believe that this is an area that the Fund should also be thinking more about.

Second, we note the increasing number of LIDCs facing rising debt vulnerabilities, which could undermine growth prospects and the achievement of the SDGs. In this regard, we share the concerns of other Directors that the flagship reports are needed to provide sufficient coverage on these issues. Going forward, we encourage the staff to explore ways to address these rising vulnerabilities through a holistic and evidence-based approach.

Third, we have, in the past, underscored the importance of a more visible analysis of LIDC issues in the flagship reports. While we very much appreciate the decision taken to retain the report on macroeconomic developments and prospects in LIDCs, as well as the coverage of LIDC issues in these flagships, we call on the Fund to continue exploring ways to enhance the coverage of macroeconomic developments in LIDCs in the flagship reports. That being said, we appreciate the profiling of one of our countries in the constituency, and that is the Gambia in the Fiscal Monitor.

Finally, we also welcome the slide on additional spending needs in LIDCs required to meet SDGs in education, health, electricity, roads, water, and sanitation. We also take note of the observations about addressing issues related to weak tax and state capacity. But as we have said in the past, also in support of Mr. Sembene's comments in his gray statement, we still believe that the issue of illicit financial flows needs to be looked at within the context of the attainment of the SDGs.

Mr. Jin made the following statement:

We first thank the staff for the comprehensive reports. We found the tone of the reports to be quite optimistic. The discussion on the risks facing the global outlook in the WEO, in the hamburger chart is interesting and welcome. But the effect of a broken WTO and the spread of multilateral protectionism in a no-rules environment has not been fully estimated. Facing these uncertainties, multilateral mechanisms should play a more important role.

The Fund can contribute to the reform of the existing trade system, and strengthen and reform the role of the WTO. But before any new rules of the WTO can be established, the existing rules must be respected. The plurilateralism approach could be an option, but we should make sure that this plurilateralism would not cause segmentation of the international trade system.

We encourage the Fund to stand ready to provide needed financial support. A timely completion of the Fifteenth General Review of Quotas, with a strengthened lending capacity and improved governance and representation, will be important to shore up the confidence of the international community.

Regarding the Chinese economy, I would like to focus on one major issue. Regarding the leveraging efforts, our approach is to stabilize total leverage and then gradually reduce it, rather than reducing it in a dramatic way.

The graph presented by Mr. Gaspar on China's high net worth illustrated an important point, that a large chunk of the debt in China is borrowed to finance infrastructure investment, which is productive, which has already generated and will continue to generate economic returns and boost economic growth in the future.

Regarding the private debt, when one compares China with emerging market economies and developing countries of a much smaller size, it is clearly higher; but if one compares China with other major economies, it is quite normal. We are confident that the total leveraged ratio, which includes private and public debt, has been stabilized. A more general perspective is to look at China's total financing ratio, which is the combination of debt financing and equity financing. That ratio is also more normal compared with major economies. It is more an issue of structural financing, rather than a level of financing.

Mr. Geadah remarked that the reports had made it clear that downside risks had increased for emerging markets. He noted that these markets needed to increase their buffers, and that there was an increasing likelihood that they might need balance of payments support. He supported the point made by Mr. de Villeroché, Mr. Tombini, and Mr. Jin on the importance of having a well-resourced Fund and the need for a strong lender of last resort. He suggested adding that point to the reports' policy recommendations.

Mr. Gonzalez made the following statement:

We thank the presenters for the very good and thought-provoking presentations. We wish Mr. Obstfeld well in his new endeavors and thank him for his contributions.

We believe that the shifting of risks to the downside is the main message of this WEO. It rightly places emphasis on trade and financial tensions, as well as on policy uncertainty, highlighting the dangers of escalation and rapid international contagion.

Financial tightening is already affecting emerging economies, with evident weaknesses. Although markets are so far discriminating—and we echo Mr. Palei's point that many emerging markets have done their work in building the right defenses for this current situation—the risk of contagion could rise, particularly with a shift in market expectations on U.S. interest rate hikes.

We share most of the policy recommendations and would like to stress the need for caution in monetary policy normalization in advanced economies, the call for rebuilding fiscal buffers, and the need to find ways to advance cooperation, especially with the risk of scaling back the financial reforms and increased trade restrictions.

The flagship reports take a timely look at the global recovery a decade after the global financial crisis. Despite the methodological challenges of separating the global financial crisis from other structural forces at play, we find that the way it shows weak investment to be the link for output losses in so many countries beyond those that experience a banking crisis should be powerful evidence for taking faster action in dealing with credit growth, exchange rate rigidities, weaker fiscal positions, and lax banking regulations. Unfortunately, now that risks are shifting to the downside, many countries seem to be going in the opposite direction, potentially sowing the seeds of and limiting our defenses to the next global downturn.

In the 10 years since the global financial crisis, regulatory and supervisory frameworks have been overhauled, making banking systems stronger; yet we see current developments in financial markets. We will test this improved framework, as near-term risks have increased and could rise sharply in line with the evidence presented today. The continuous disconnection between markets' still buoyant expectations and medium-term risks should be a cause for remaining particularly vigilant.

We welcome the new framework for a comprehensive analysis of public wealth and public finances through a public sector balance sheet approach. Although its implementation has the challenges outlined in the Fiscal Monitor, we believe it has an important potential for policy and want to encourage continued work in this area, especially with an emphasis on its application to emerging markets and LIDCs.

Finally, let me make two points on the communications of the September flagship reports.

First, we should be vigilant in the current environment that the results showing countries more integrated to global financial markets and with stronger trade links to advanced economies suffered larger output deviations is not used as evidence against integration. We encourage the Fund to stress that causes and channels of a crisis must not be confused and that the best policies continue to be openness, cooperation, and strong domestic policies to share more widely the benefits of trade.

Finally, in describing the role of the Fund in the global financial crisis, the WEO seems to focus on the provision of resources. We believe this does not do justice to all the work that has been done in other areas, like surveillance or macroprudential policy, and would, therefore, encourage a broader message when communicating the flagships to a broader audience.

Mr. Sembene made the following statement:

I thank the three counsellors for their insightful presentations. I also join colleagues in thanking Mr. Obstfeld for his service to the Fund and wish him well in his future endeavors. I have three areas where I would like to comment.

First, on trade, arguably this is an area with the most stringent risks to the economic outlook. Certainly, the recent trade tensions will potentially weigh heavily on the global economic prospects, as well as through their potential effect on market sentiment, investment, and productivity. I echo the staff's call for the need to avoid protectionist reactions and to favor cooperative multilateral solutions.

The staff is estimating the effects of trade tensions as being temporary in some way. Because when one looks at the graph that the staff has circulated, it looks like the effects are subsiding within three, four years. I am a little puzzled by that because I would think that these trade tensions have the potential to have a self-sustaining damaging impact. I would like additional insight from the staff on why they estimate these effects would be temporary.

At the same time, trade tensions are high on the agenda right now, but there are many other risks to the global economic outlook that needs to be emphasized. The Fund would need to sustain its focus on those risks. I am thinking particularly of risks related to fragility and also geopolitical tensions. We need to sustain the focus there.

I am also thinking about risks related to inequality. At the end of the day, it is fair to say that inequality has been also feeding that protectionist sentiment in some economies. We need to keep the focus on those issues to make sure that they are appropriately flagged in the flagship reports.

Most importantly, the debt buildup at the global level also needs to have the same sense of urgency that we have been putting on debt in LICs, because at the end of the day, when we look at Mr. Gaspar's presentation, it is clear that the record-breaking level of global debt is worrisome. We need to make sure that, as an institution, the emphasis is put on the vulnerabilities that are related to global debt as a whole and not necessarily only in some segment of the membership, particularly when it comes to private debt. In this regard, I fully agree with Mr. Merk's comments.

Finally, on LIC issues, I commend the staff and thank them for the increased coverage of these issues in the flagship reports. This is in response to the call that some of us have been making in the past. That being said, with the increased coverage of LIC issues comes high expectations about the tone and granularity of the messaging. If one looks at the WEO, it is talking about sub-Saharan Africa as facing a tepid outlook. The example that is given is the commodity exporters. While commodity exporters are important in Africa, they are not the only countries on the continent. If one removes commodity exporters from the picture, there is a very good and strong outlook. In future flagship reports, we would appreciate that level of granularity that would show that not everything is bad in Africa. As Mr. Palei would say, we need to have a more cheerful tone when we discuss these LIDC issues.

Mr. Vitvitsky made the following statement:

We thank the staff for an interesting set of reports, including the chapter on managing public wealth and on the lessons from the global financial crisis. I will just make a few points for emphasis.

First, we were surprised by the large shift in tone from the spring reports. We recognize that there has been softer recent economic data, that global growth has become less synchronized, and that a few large emerging markets are facing considerable challenges. Still, Fund staff project what we would consider to be strong global growth rates for 2018 and 2019. Bank balance sheets and capital levels remain healthy in most advanced and emerging market economies, and labor market conditions across many countries have improved in recent years. In this context, we think the appropriate message remains: The sun is shining, fix the roof. On trade, this chair has been very clear on our authorities' views, particularly the need to address restrictive trade practices. The ultimate goal of U.S. actions is to reduce trade restrictions globally. We could also support Mr. Doornbosch on the usefulness of adding positive trade scenarios to Fund forecasts.

Second, we enjoyed reading the chapter on managing public wealth. The chapter demonstrates the importance of greater transparency and analysis of the liabilities and assets of a country's balance sheets and the lessons they may offer for fiscal policy. We encourage Fund management and the staff to continue pushing for comprehensive public debt data for both debtors and creditors. At the same time, we recognize, as other chairs have pointed out in their gray statements, that balance sheet analysis have its difficulties, such as the valuation of natural resources, and agree that it should be seen as more of a complement to the traditional analysis of deficits and debt. Still, we would appreciate the staff's views if country balance sheets could be used more widely across surveillance or even in programs to identify risks and recommend policies.

Third, regarding monetary policy normalization. We understand that the U.S. monetary policy path can have large effects on emerging market capital flows. We recognize Mr. Tombini's point in his gray statement that normalization will result in a global adjustment process. However, the Fed has clearly communicated a gradual policy path, and we do not consider monetary policy normalization itself a financial stability risk. Most of the emerging market financial stresses today appear to be the result of homegrown vulnerabilities. We agree with the staff that markets appear to be differentiating based on fundamentals and policies, and would have preferred a greater emphasis in the WEO and GFSR on the need for emerging economies to improve policies and strengthen buffers.

Finally, on lessons learned from the global financial crisis on regulatory reform, notwithstanding the comments in our gray statement, we thought this was a useful chapter. In the United States, a complete rollback of reforms that have made our financial system more stable is not on the table. Recent legislation and proposed rule changes by the Federal Reserve keep the United States in compliance with Basel III; keep us super compliant with

Basel III capital rules. Further, we are committed to remaining engaged in international fora, and to supporting Basel III finalization and the implementation of remaining banking standards. My authorities are looking at how we can achieve our regulatory objectives in ways that maintain the measures' effectiveness while improving efficiency, transparency, and simplicity.

The Fed's Vice Chair for Supervision, Randal Quarles, gave a speech in Washington in March, and there was one excerpt that reflects this sentiment quite well. He said: If there was still work to be done after Hammurabi, who developed one of the earliest comprehensive legal codes in history, there is probably still some work to be done now after Dodd-Frank.

The Director of the Research Department (Mr. Obstfeld), in response to further questions and comments from Executive Directors, made the following additional statement:

On the general outlook, it has been a challenge in our discussions to ask: Is it still a time to fix the roof, even if we are less optimistic than we were in April? I believe the answer is definitely yes. It is very much still time to fix the roof, but the growth experience among countries is becoming more uneven. While there are countries that are doing quite well—and I take Mr. Sembene's point about Africa, there is always great heterogeneity there in performance—there are others, where risks are even now emerging. In an interdependent world economy, this is of concern to all. we need to take the risks seriously, and they should make us even more willing to fix the roof.

I broadly grouped the comments under two rubrics. One is general policy frameworks, and one is more trade-related issues. A number of chairs, including Ms. Erbenova and Mr. Panek, raised the issue of ex ante policy frameworks and their importance in creating stability. We strongly support that. One of the strong messages of Chapter 3, as Ms. Erbenova pointed out, is that there is a payoff to investing in policy frameworks when troubled times arrive.

That being said, a number of chairs also asked what is our advice for the ex post situation when a country is hit by shocks? We cannot really say that a country should have invested in a better policy framework, and go home. We do have to think carefully about that. It is even an issue for countries that do have strong policy frameworks because if ex post responses are inconsistent with ex ante commitments, that is a problem for credibility. I hope the staff will keep working on these issues, which are at the heart of policymaking.

Mr. Ostros raised the important point about the liquidity need for countries that do have strong frameworks. It was important during the global crisis, and we are seeing now that the countries that have invested in strong frameworks actually can weather shocks more effectively. We are seeing this even now, where we see that the better-rated sovereigns seem to be doing better in weathering the current tightening and liquidity conditions. But I believe that this still does not remove the possible need for some sort of extended liquidity framework, such as we have discussed here, and certainly not, as many of Directors have mentioned, for a better-resourced Fund.

During the global financial crisis, the Federal Reserve extended swap lines to a small number of emerging markets. It generally chose emerging markets that were not only systemic but were quite well managed. In many cases, this was critical. Clearly, in the case of Korea, it was very important. I would view these types of facilities as important for situations where systemic shocks arise, shocks that overwhelm everyone. Even before those shocks arrive, these can be important for expectations.

Mr. Doornbosch raised the issue about our advice on fiscal buffers and monetary policy. Did we recommend building buffers too late? Are we too late on our monetary policy advice? This is always debatable. I would think we got it about right. The reason is because, for much of my early tenure here, we were quite worried about the de-anchoring of inflation expectations. Countries were at the zero lower bound. In those circumstances, one of the more robust results of recent research is that fiscal multipliers are quite large. It would have been more risky to try to rebuild fiscal buffers much earlier than we recommended. Having said that, it does loom as an important task in this upturn because we do have to worry about the next recession.

As far as monetary policy goes, monetary policy has to look at price stability. There could be side effects, which we would ideally like to manage with macroprudential policies. It is still a tricky tradeoff, and there is a significant amount of debate that will continue.

The last point I would make about the framework for resilience relates to Ms. Horsman’s important point about climate resilience. I believe it is worth thinking more at the Fund about the areas where that is a matter for economic policy, where private action is insufficient to generate the optimal degree of resilience.

I will not take enough measures on my own to fireproof my house because I do not internalize the damage that will happen to all those around me. We should all be looking at the real collective action problems.

One of the big risks of climate change is in terms of fluctuations in crop yields and whether futures markets could be used more effectively. This is an economic issue that we could be looking at.

Let me make a few remarks about trade. Directors made some very important points. Ms. Barron listed three reasons why it is important to think about trade issues and areas for action. Her third point was particularly important and it is often missed, although some other Directors such as Mr. Sembene brought this up, which is the importance of good domestic policies, inclusive domestic policies to build a constituency for trade and for international cooperation. Too often, foreigners' trade deficits are used as the excuse for dislocations when, in reality, domestic policies have fallen down on the job. Conversely, there will be distrust of trade liberalization as long as those policies are not in place. This is an important point to keep in mind.

That being said, the point about reforming the WTO is critical or strengthening the rules-based system more broadly. Mr. Kaizuka pointed out that in our simulations, the long-term damage of far-reaching trade wars is most severe for the United States. These simulations assume that the trade war is permanent and that the negative effects on the United States are because it is the focus of retaliation in these simulations. We should be worried that this is the kind of world we end up in.

The U.S. position, as I understand it, is that these actions are intended to bring others to the negotiating table and that ultimately we get to a world in which a level playing field, however defined, is achieved. I would just question the damage done along the way and whether we do not have frameworks within which multilateral negotiations can work. Of course, there is a significant amount of work to be done improving those.

To give an example of the collateral damage from the process, the analysis from our China team on the impact of this week's U.S. actions on China is that it will lower its growth in 2019 by a full 0.7 percentage points. Now, we assume that China undertakes stimulus actions equal to 0.5 percentage points, so the net loss, the net downgrade for 2019 is 0.2. But this is significant. One can see the spillover effects, and the effects on advanced economies in East Asia. In truth, this is really a lose-lose situation.

It was mentioned that it would be good to show positive effects from trade liberalization. In fact, we will have in a number of venues, including at the Annual Meetings, some simulations on the liberalization of services trade, which present a much more pleasant picture.

The Director of the Monetary and Capital Markets Department (Mr. Adrian), in response to further questions and comments from Executive Directors, made the following additional statement:

Let me start by addressing some of the policy issues that were raised. Our first order policy advice from a financial stability point of view is to reduce vulnerabilities. If I could turn Directors’ attention back to Slide 14, that is a framework for thinking about the range of vulnerabilities that can give rise to financial stability problems.

The way that we are thinking about the issue is that there are different types of frictions in different sectors. The frictions are in the rows—so this is leverage, liquidity mismatches, maturity transformation, foreign exchange mismatches. Some Directors mentioned that just looking at that is not enough. Of course, we have to look at the liquidity mismatches and maturity transformation as well. We look at valuations and interconnectedness and other vulnerabilities, and then these vulnerabilities are taking place in a variety of sectors. In the GFSR, we focus mainly on the banks and the corporates and the households and the non-bank financial institutions; but there are also these vulnerabilities in the sovereign sector.

What this chart is illustrating nicely—and this is based on our new macroprudential database that was put out publicly in April—is the macroprudential policy tools that are available to address these different vulnerabilities.

I would like to make two points. First, authorities might have the tools, but they have to be deployed appropriately. Second, there are many wide spaces here, where necessary tools are not available. So our first order policy advice is to reduce vulnerabilities by building buffers. This gives provides framework to guide policymakers to think about the variety of vulnerabilities and, hence, the variety of buffers that need to be built.

I fully agree with the point that globally, we are still in an upswing. These are the good times, and this is the time to build buffers. For example, for a number of jurisdictions, this might be a good time to think about building the countercyclical capital buffer. This is a tool that was phased in after the global financial crisis. Some jurisdictions have activated it, but perhaps it is something that should be considered more broadly. Some countries have also deployed other tools, such as tightening debt-to-income (DTI) and loan-to-value (LTV) ratios. But I would just urge Directors to think about using all of those tools more actively.

Of course, not all countries that are represented in our membership are in the upswing. A number have come under pressure, and we have revised downward forecasts for some countries quite dramatically. In the GFSR, we have an extensive policy discussion that covers monetary policy, exchange rate policies, and CFMs. What we have seen around the world is a number of those emerging markets that have come under pressure have typically increased interest rates. Turkey was named in particular, but there are other countries. That is the right response if pressures persist.

There has been a significant amount of analytical work by staff on exchange rate interventions. There is some evidence that exchange rate interventions can cushion exchange rate volatility when there are temporary distortions. I would like to point out that our baseline forecast is that capital flow reversals will continue for many months or even for many years. One does not want to use something that works on a temporary basis to address a flow that is a very permanent pressure.

Capital flow measures also have been shown by Fund staff to be useful in some situations; but it depends on how they are used and under what circumstances. Our Article IV consultations give granular advice on these issues, subject to the Institutional View.

Global financial conditions are easy, and that is supportive of growth. Global growth has plateaued, but it is at a very high level, and incomes are rising around the world. The short-term outlook is a positive one. What we worry about is the buildup of vulnerabilities in the medium term.

We have already seen that financial conditions have tightened for some countries around the world. We are clearly seeing that countries that have not built those buffers are hit hardest. Unfortunately, that is our expectation as well. If financial conditions were to tighten sharply, then countries that do not have buffers will be hit harder.

Risk factors that can trigger an abrupt change in global financial conditions are a sudden increase in inflation. At the moment, the United States is at target in the dual mandate. Unemployment is at or perhaps even below the natural rate, and inflation is roughly at target. But there could be an inflation surge that might lead to an abrupt tightening of monetary policy and could be associated with a reversal of financial conditions. There are policy risks around the world. We have seen that in elections, and there are the trade tensions that generate uncertainty and downside risks.

Turning to monetary policy, the stance of monetary policy aims primarily at price stability. Financial stability concerns should be addressed primarily with macroprudential tools. But when it comes to macroprudential tools, the toolkit is not complete, and there is a potential for risks building up outside of the regulated sector. Monetary policy does also face some intertemporal tradeoffs within an inflation targeting framework. Inflation-targeting central banks do have to consider intertemporal tradeoffs in terms of the buildup of risk over time.

In terms of regulation, we clearly demonstrate that the banking system is much safer. There is much more capital in the banking system, much more liquidity. But at the same time, there are some outstanding issues. Just last week, in Sweden, the Nordic market for Nasdaq Commodities had an incident where a trader had such a large loss that the central counterparties' (CCPs) waterfalls were insufficient, and the default contributions of members had to be triggered. This was the particular case of a Norwegian trader who made a bad bet, went the wrong way; and Nasdaq Clearing, which is located in the region, had to put in additional capital and so did other members in this exchange.

This is a vulnerability that we pointed out in the FSAP in Sweden at the time and something that we point to repeatedly, which is that CCPs have become much more important. There is much more central clearing. But the CCPs also have to be regulated conservatively. The Financial Stability Board (FSB) is working on that, and we are seeing that in the FSAPs that we are doing.

In terms of trade, our financial stability growth-at-risk analysis is closely linked to the WEO scenarios, but it is translating the WEO scenarios into downside risks from a macro-financial stability perspective. We have updated that calculation after Friday's actions, so we are distinguishing between temporary and permanent effects. One can see the shift in the distributions on Slide 11 with respect to both a temporary and a permanent shock.

We fully hear Directors that the communication in Bali will be extremely important. The message about the differentiation is extremely important. There has been a sharp widening of spreads in Italy. This has not had any significant spillovers to Spain or Portugal. We have a chart on that in the GFSR. There is a lot of differentiation, and we will be very careful in terms of our communications around that. We will also be extremely careful in terms of our policy recommendations.

Concerning the sovereign-bank nexus. I have the press release from the Basel Committee from last December. It states that the committee has not reached consensus on the sovereign-bank nexus and that it could benefit from broader discussions. The comments around the table have shown that this is a sensitive discussion, but there are clearly different views in the Board. We are reflecting those different views. When we go around the world and we assess financial stability issues, the sovereign-bank nexus comes up as an important financial stability problem. We are not trying to be standard-setters. The Fund is not a standard-setter. We are not making policy proposals, but we do have a seat at the Basel Committee. One of the goals of that is to represent the broader membership that are not members of the Basel Committee. In the broad membership, we see many of these sovereign bank nexus problems, where banking systems are undercapitalized relative to risky sovereigns.

In terms of streamlining, a number of Directors have pointed out that they are happy to see the streamlining, so we have cut the number of analytical chapters from two to one. We have cut the number of staff doing financial stability analyses. We now have less staff doing global financial stability analyses in accordance with the streamlining excersise. I do want to point out that the growth-at-risk analysis, which has been adopted by a number of central banks, and which was in Chapter 3 of the GFSR, will no longer be there.

The Director of the Fiscal Affairs Department (Mr. Gaspar), in response to further questions and comments from Executive Directors, made the following additional statement:

I want to cover communication policy advice, then analyses and information based on public sector balance sheets, then next steps, China, and finally development.

On communication, the message is the same. What the public sector balance sheet does is it allows us to be more structured and more granular in the policy recommendation. For example, the analysis about evolution of balance sheets after the global financial crisis in advanced economies clearly shows the importance of governments rebuilding and strengthening their balance sheets, and they can do that by at the same time reducing debt levels and improving the quality of the asset side. We have often emphasized, including in his Fiscal Monitor, the importance of public investment in infrastructure. I am completely at ease with the continuation of our policy message.

In terms of this work on information to build balance sheets, we have worked hand-in-hand with the Statistics Department (STA). We did the best that we could based on mostly publicly available information. That shows that one can build public sector balance sheets for advanced economies, emerging market economies, and LICs using available information. That is not an easy exercise. As many Directors emphasize, there is an issue of valuation of non-financial assets, which is difficult and makes the comparability across countries particularly difficult. But all of that is transparently acknowledged in the Fiscal Monitor itself.

Mr. Ostros was particularly emphatic in putting forward the idea that we have to manage risks. That is one of the exercises illustrated in the Fiscal Monitor, where the benefits from managing assets and liabilities together in the public sector balance sheet, plus the importance of identifying risks to public sector balance sheets by doing, for example, stress tests is illustrated.

Going forward, I know that the Monetary and Capital Markets Department (MCM) is looking at how debt factors can be approached from a probabilistic point of view, exactly as it has already done in other dimensions. We look forward to learning and collaborating with MCM in that important exercise.

Our representative from the United States asked about next steps, and we do have plans to publicly release the public sector balance sheet database as soon as we can; but we would like to make sure that we have a chance to incorporate the comments from the national authorities before doing so.

The database of 69 countries is already available to area departments. In many cases, it has become standard in Article IV analyses. It is systematically used in surveillance. In this discussion, the examples of Norway, Finland, and the Gambia were mentioned. It would probably make sense to refer to the example of Indonesia as well to see that this analysis is relevant to all country groups.

We were also asked about the relations between the balance sheet approach and the DSA. The staff is examining how to further incorporate a balance sheet approach in the standardized Article IV analyses, and we will take into account the balance sheet analyses as part of the DSA for market access economies (MAC-DSA) analysis, and that update of the MAC-DSA is scheduled to be presented to the Board in the spring of 2019. I could give further details on future steps, and I am happy to do that bilaterally.

On China, the staff looks forward to working together with the Chinese authorities to better understand the dynamics of public and private debt in China and to fine-tune the dividing line between public and private and also to assess risks for the public sector associated with the accumulation of private debt.

Mr. Jin made a remark about debt and other forms of financing; namely, equity. One aspect that we have discussed at length at this Board is that debt instruments are different from other assets from the viewpoint of macro systemic risks. That is a point that MCM regularly emphasizes. In a sense, it is not the overall financing of the economy that we are concerned with. We are concerned with the particular type of financing in the economy.

Mr. Jin asked about the comparisons between China and advanced economies, rather than other emerging market economies, making the reasonable point that China is absolutely one of a kind. I can give the full picture, but focusing only on one indicator: private debt.

In 2017, private debt in China has gone above 200 percent of GDP, and that compares with an average for advanced economies of 163 percent. If we would aggregate public and private debt, China would be below the average of advanced economies because China has a relatively low public debt-to-GDP ratio.

On development, we have been insisting that it is very important to look at fiscal policy as one of the tools in the toolkit for development policy. That is particularly important for developing economies. I want to draw Directors' attention to a very good book on Indonesia, published by the Asia and Pacific Department (APD), where there is a focus on SDGs, a quantification of spending needs for Indonesia, how that fits into a macroeconomic framework which is coherent for Indonesia, and how Indonesia will finance these spending needs. Indonesia will be able—according to its program—to meet its financing needs totally on the basis of their national capacity to generate revenue. That book is one of the sources where one can get a complete picture of what a development strategy may look like and the role of fiscal policy in that context.

The Chairman read the draft summing up.

Mr. Jin made the following statement:

I want to respond to Mr. Gaspar regarding private debt in China. My argument regarding China's private debt, the level compared to the other countries, is based on our discussion with APD during the Article IV consultation. Based on that discussion, some of the private sector debt has been classified as public sector debt because of the existence of a local government financing vehicle.

I discovered that the approach used by Mr. Gaspar is different from the definition of public sector debt. He refused to use the concept that has been used by APD. The Fiscal Affairs Department's definition of private sector debt is broader than the definition used by APD. This is why we have different understandings. In FAD's approach, they overestimated private sector debt in China and underestimated public sector debt in China.

The following summing up was issued:

Executive Directors broadly shared the assessment of global economic prospects and risks. They observed that the global expansion, while remaining strong, has lost some momentum and growth may have plateaued in some major economies. Prospects increasingly diverge among countries, reflecting differences in policy stances and the combined impact of tighter financial conditions, rising trade barriers, higher oil prices, and increased geopolitical tensions. Beyond 2019, growth in most advanced economies is expected to be held back by slow labor force growth and weak labor productivity. In emerging market and developing economies, growth is projected to remain relatively robust, although income convergence toward advanced economy levels would likely be less favorable for countries undergoing substantial fiscal adjustment, economic transformation, or conflicts.

Directors generally agreed that near-term risks to the global outlook have recently shifted to the downside and some have partially materialized. Trade barriers have risen, with adverse consequences for investment and growth. Financial conditions in most emerging market and developing countries have tightened since mid-April. Capital flows to some of these countries have declined, reflecting weak fundamentals, higher political risks, and/or U.S. monetary policy normalization. While financial conditions in advanced economies remain broadly accommodative, an inflation surprise could lead to an abrupt tightening of monetary policy and to an intensification of market pressures across a broader range of countries. In addition, most Directors saw as key risks a further escalation of trade tensions, a rise in political and policy uncertainties, and growing inequality. Meanwhile, high debt levels limit the room for maneuver in many countries.

Most Directors considered that the recent intensification of trade tensions and the potential for further escalation pose a substantial risk to global growth and welfare. They noted that unilateral trade actions and retaliatory measures could disrupt global supply chains, weaken investor confidence, and undermine broader multilateral cooperation at a time when it is urgently needed to address shared challenges. They therefore urged all countries to adopt a cooperative approach to promote growth in goods and services trade, reduce trade costs, resolve disagreements without raising tariff and nontariff barriers, and modernize the rules-based multilateral trading system. The possibility of an outcome in which trade issues could be resolved in a positive way was also pointed out. Directors noted that persistent large external imbalances continue to call for sustained efforts, mindful of countries' cyclical positions, to increase domestic growth potential in surplus countries and to raise supply or rein in demand in deficit countries.

Given a narrowing window of opportunity, Directors underscored the urgency of policy measures to sustain the expansion, strengthen resilience, and raise medium-term growth prospects. They encouraged countries to rebuild fiscal buffers where needed, and implement growth-friendly measures calibrated to avoid procyclicality and the risk of sharp drags on activity. Directors agreed that, where inflation is below target, continued monetary accommodation remains appropriate. Where inflation is close to or above target, monetary support should be withdrawn in a gradual, data-dependent, and well-communicated manner. Directors emphasized the critical role of structural reforms in boosting potential output, ensuring that gains are widely shared, and improving safety nets—including to protect those vulnerable to structural change.

Most Directors shared the assessment that near-term risks to financial stability have increased while medium-term risks remain elevated. They highlighted, in particular, the build-up of financial vulnerabilities over the past few years of very accommodative financial conditions, including high and rising public and corporate debt, and stretched asset valuations in some major markets. Addressing these vulnerabilities remains an important priority for many countries. For some countries, priorities include cleaning up bank balance sheets, improving corporate governance, and addressing risks from the sovereign-bank nexus, although a number of Directors felt that regulatory issues pertaining to sovereign exposures would best be left to the remit of the Basel Committee on Banking Supervision, which is the standard-setting body on the matter for a number of member countries. Directors also stressed the importance of completing and fully implementing the regulatory reform agenda, and of avoiding a rollback of reforms that have contributed to a more resilient financial system ten years after the global financial crisis.

Directors agreed that financial regulators and supervisors should remain vigilant about potential threats to financial stability and stand ready to act. They called for special attention to liquidity conditions and new risks, including those related to cybersecurity, financial technology, and other institutions or activities outside the perimeter of prudential regulation. These require policymakers to further develop policy tools, including macroprudential policies, and deploy them proactively as needed, as well as enhance coordination across borders.

Directors stressed that, as monetary policy normalization proceeds in advanced economies, emerging market and developing economies need to prepare for an environment of tighter financial conditions and higher volatility. Countries need to tackle their vulnerabilities and enhance resilience with an appropriate mix of fiscal, monetary, exchange rate, and prudential policies. In certain circumstances, capital flow management measures may be appropriate but not as a substitute for macroeconomic adjustment. Directors observed that markets have so far differentiated among emerging market and developing economies based on their fundamentals and idiosyncratic factors. In this context, they underlined the importance of maintaining credible policy and institutional frameworks, strengthening governance, and improving human and physical capital. Directors noted that the current environment highlights the need for the Fund to offer granular, tailored policy advice and stand ready to provide financial support to its members as needed.

Directors underscored that priorities for low-income developing countries include building resilience, lifting potential growth, improving inclusiveness, and making progress toward the 2030 Sustainable Development Goals, while commodity exporters should also prioritize economic diversification. Stronger efforts are needed to create room for development expenditure, through broadening the tax base, improving revenue administration, and prioritizing spending on health, education, and infrastructure, while cutting wasteful subsidies. Directors also called for urgent action to contain debt vulnerabilities, which are rising in many countries. They stressed that both debtors and creditors share a responsibility for ensuring sustainable financing practices and enhancing debt transparency.

Directors agreed that public sector balance sheet analysis provides a useful tool to analyze public finances. By revealing the full scale of public assets in addition to debt and nondebt liabilities, it helps governments identify risks and manage both assets and liabilities, potentially reducing borrowing costs and raising returns on assets. Directors noted that the long-term intertemporal analysis is particularly relevant in aging societies. They also saw the benefits of the added transparency in enriching the policy debate. At the same time, Directors acknowledged that the balance sheet approach still has limitations, notably data quality and differences in accounting practices hindering cross-country comparisons, and thus it should be used with caveats to complement traditional fiscal analysis.

APPROVAL: February 5, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

World Economic Outlook, Chapter 1

1. ***While the focus on trade tensions is appropriate and timely, care should also be taken to account for the impact on global GDP of the more structural changes affecting the world economy, including the rebalancing of the Chinese economy and the reduced pace of trade liberalization. Could staff clarify if forecasts for trade take into account these structural changes?***

- Yes, the forecasts take these structural changes into account.

2. ***Is there scope to raise the prominence of the need for collective actions and greater cooperation earlier in the report, including earlier in the Executive Summary?***

- Thank you, we have moved the text up in the Executive Summary.

3. ***We are of the view that the WEO and GFSR would gain from greater emphasis on the spillovers of financial conditions to EMDCs, including frontier economies. Staff's comments are welcome.***

- The Counsellors' WEMD presentations will address this issue.

4. ***Trade tensions have escalated further since circulation of the WEO, following this week's tariff announcements by the US. We would be interested to hear to what extent these materially change staff's projections and risk assessment.***

- The Counsellors' WEMD presentations will address these issues.

5. ***A trade war as illustrated in the WEO's Scenario Box 1, if it materialized, could lower global growth to below 3 percent in 2019, the weakest growth since the Global Financial Crisis (GFC). We are wary that the slowdown impact could be even more severe than projected as pointed out in Box 1.6 of the WEO. Could the staff comment?***

- Please note that the Scenario Box presents simulation results of illustrative downside scenarios based on the Global Integrated Monetary and Fiscal Model (rather than forecasts). By contrast, box 1.6 is on the past performance of WEO and private sector forecasts during severe growth declines and recessions.

6. ***Staff comments on creating a global level playing field in trade is welcome.***

- The Counsellors' WEMD presentations will address this issue.

7. ***Do staff consider that there will be price effects as well as growth effects from higher tariffs?***

- The direct price increase effects from the tariffs are temporary and small. Generally, the impact of the broad weakening in demand in the scenario more than offsets the direct impact of tariffs on overall CPI.

8. ***In examining the effects of trade uncertainty on investment, staff use the economic policy uncertainty rather than a more specific trade policy uncertainty index. Staff comments would be welcome.***

- The most robust empirical work for estimating the potential impact on investment is based on broad policy uncertainty, which would encompass trade policy uncertainty.

9. ***Are plans underway to re-structure production networks based on a business decision that tariffs are here to stay, or do a large number of firms hope to ride out what they believe to be temporarily high trade costs? And is it possible to assess how this uncertainty might be currently affecting business investment?***

- Staff will follow this issue closely, as data permit.

10. ***Could staff share the latest estimates of the impact of the US expansionary fiscal policy on its current account deficits?***

- The fiscal boost to demand in the U.S. is expected to translate into higher import growth, stronger U.S. dollar, and an increased current account deficit (to nearly 3½ percent of GDP by 2019–20).

11. ***The report includes the United States among the countries with excess current account deficit and unsustainable fiscal position. We ask staff to expand on the possible consequences of this assessment in the short and medium term both in the US and globally when, among other things, future higher interest rates may increase debt service significantly.***

- The higher U.S. current account and fiscal deficits will contribute to the rise in global imbalances. Domestically, the increase in the fiscal deficit over the next few years will add to an already-unsustainable public debt. The expansion in the deficit and the increasing amount of debt service leave few budget resources available to invest in a range of urgently needed supply-side reforms that could boost medium-term growth and raise living standards and reduces the fiscal buffer in the event of a downturn. Higher borrowing needs, stronger domestic demand, and higher inflation in the United States as a result of expansionary fiscal policy could also put upward pressure on interest rates globally, while larger US current account deficits could lead to higher trade barriers in the United States, which in turn would weigh on global trade and activity.

12. ***It seems reasonable to consider the need to address gaps in anti-trust laws, and we would welcome staff elaboration of work in this area within or outside the Fund.***

- Staff is conducting preliminary research on the macroeconomic effects of market power. The analysis would touch on the policy implications of rising market power, including as regards competition policy insofar as relevant. Additionally, there is a significant amount of current work being done on this topic outside the Fund, including several academics, many of whom presented at the Fed's recent Jackson Hole Economic Policy Symposium; among IOs, the OECD has work done on market power focusing in particular on its relation to the digital economy.

13. ***Could the staff explain the 2011-2013 timeframe chosen for the regressions evaluating the impact of pre-crisis conditions? Does staff have concrete plans to conduct additional studies on the implications? What would be the focus of these studies?***

- The timeframe covers the period 3-5 years after the most intense period of the global financial crisis, representing a 'medium-term' horizon that abstracts from the years of deep output decline (2009) and sharp rebound (2010). Staff plan to continue investigating implications such as technology adoption after the crisis, its employment impact, and labor market policies that can help absorb the labor displacement effect of new technologies.

14. ***We also encourage staff to further investigate questions related to the rise of corporate market power (particularly significant in advanced economies according to the Box 1.1 of the chapter 1 of the WEO) and its potential impact on falling labor income shares in some advanced economies. Could staff indicate if and how the Research Department intends to pursue its work on this major issue?***

- RES is indeed working on this issue, building on the research that underpins Box 1.1.

15. ***Could staff comment on why emerging economies and specific industries (auto parts, PC hardware, and electronic components) have experienced smaller increase***

in market power? Also, what does staff consider as possible reasons/backgrounds behind the emergence of superstar firms, such as developments of financial market, management method, like franchise, and information technology?

- The possible drivers of the rise in market power include the ones mentioned in the question, as well as further ones, such as outsourcing to cut labor and other costs, lax or outdated anti-trust enforcement, network effects and the rise of the digital economy. Ascertaining the relative roles of these individual drivers is difficult and there is so far no consensus. Further analysis is needed to distinguish between them and to determine how they have affected different sectors and countries.

16. ***In the context of the recent discussions on fragile states (IEO evaluation) and Fund facilities for low-income countries, it has become critical for the Fund to overcome the identified inadequacies and provide advice on country-focused and measurable macro-economic and structural reforms, along with appropriate lending, while keeping in view the required strengthening of capacity in such countries for greater traction and effectiveness. Staff may indicate the manner in which these critical issues may be incorporated in the WEO.***

- In recent WEOs, staff has expanded its analysis of low-income country and fragile state issues—including, among others, a chapter on climate change; boxes on growth collapses and the growth impact of conflict; chapters on drivers of emerging market and developing economy growth; more emphasis on LIC policy challenges in Chapter 1; increased discussion of multilateral policy priorities to address shared challenges that affect LICs. The WEO will continue to build on these areas in future cycles.

17. ***We appreciate the Special feature on Commodity market developments and forecasts and wonder whether staff considered integrating climate-related issues in the WEO report, notably by looking at the impact of the economic outlook on climate change (ie. assessing the progress made towards a low-carbon growth model).***

- The Counsellors' WEMD presentations will address this issue.

18. ***A recent staff presentation to the Board concluded that large efforts will be needed for LIDCs to meet their 2030 UN Sustainable Development Goals. It also concluded that domestic revenue mobilization will not be sufficient and the remaining financing gap for LIDCs will be a staggering 18 percent of their respective GDP. We were expecting the WEO to address this issue, including the need for higher official development assistance. Staff comments are welcome.***

- The Counsellors' WEMD presentations will address this issue.

19. ***Beyond encouraging additional public investment, wage dynamics and corporate savings trends should not be overlooked. Could staff comment on its projections of wage dynamics in the Euro Area?***

- Wage growth in the euro area has been subdued over the past years. Recent data show that wages in the euro area increased by 1.9 percent (on a year ago) in Q2, up from 1.8 percent on average in 2017 and 1.4 percent in 2016. Going forward, we expect a gradual increase in wage growth, reflecting tighter labor markets and continued reductions in unemployment. There will be some heterogeneity across countries, as they will be in different stages of their business cycles. In the WEO, we project that the euro area average growth rate of hourly compensation in manufacturing will increase from 1.5 percent in 2017 to a little over 2 percent over 2018-20.

20. ***While for many EMDCs restructuring and privatization of many public companies remain a desirable solution, could a case be made for a more effective contribution to growth by public companies in EMDCs?***

- The Counsellors' WEMD presentations will address this issue.

21. ***On the section on the long-term determinants of energy demand, the conclusion that saturation is probably much closer for some energy sources such as oil does not seem to be supported by data. We think that oil demand is expected to continue to increase over the long term driven in part by an expanding middle class, high population growth rates, and expectations of stronger economic growth in EMDCs. Staff comments would be appreciated.***

- Under the baseline estimates, even for a typical advanced economy reaching saturation would take about 13 years (see footnote 19). For world energy demand, saturation is, thus, further away. This means that at a certain point, global oil demand will stop increasing (probably before the slowdown in global demand for other energy sources such as natural gas and renewables). Since this is in the future, however, the *level* of global oil consumption will be substantially higher than the one today, still requiring massive investment in the oil extraction sector, including the replacement or upgrade of aging infrastructure.

22. ***We note a slight difference in the tone between the WEO and the GFSR. The GFSR notes in ¶26 that "while global factors affected all countries, the overall spillovers between emerging markets have so far been relatively contained and idiosyncratic factors explained much of the outsized asset price moves". The WEO, on the other hand, concludes in Page 29 that "in an environment of gradually tightening global interest rates and rising uncertainty, the likelihood of contagion***

from such episode to other economies has also risen". We would appreciate staff comments, including on the relevance of the reference to "contagion" instead of "spillover".

- The first statement is an assessment of recent developments, while the second is a statement of risks going forward. As such, they are consistent.

23. ***Could the staff elaborate as to what extent technology adoption could help offset the impact of aging population on productivity growth?***

- As documented in Adler and others (*"Gone with the Headwinds: Global Productivity." IMF Staff Discussion Note 17/04*, 2017), many factors have contributed to a decline in productivity growth, which notably began before the global financial crisis. The acceleration in population aging in almost all advanced economies (also see April 2018 WEO chapter 2) has led to significant decreases in labor force participation as well as decreasing productivity growth. At the same time, this demographic trend has been accompanied by weak investment in physical capital, which further resulted in subdued labor productivity growth not only by weakening the contribution of capital deepening, but also by affecting TFP growth itself through a slower adoption of capital-embodied technology. Technology adoption can however mitigate some of these effects. For example, in the late 1990s and early 2000s technological change embodied in increasingly powerful computers and enhanced communications platforms, raised labor productivity (see further discussions in Adler and other, 2017).

World Economic Outlook, Analytical Chapter 2

24. ***We agree with the need of greater cooperation, rebuilt buffers, strong external positions and financial regulation and supervision. What additional actions does staff think the Fund should take given its warning that many economies are going in the opposite direction and could therefore be sowing the seeds of and limiting our defenses to the next global downturn? Furthermore, what are the implications of these vulnerabilities for the Fund's size and role in the GFSN?***

- The Counsellors' WEMD presentations will address these issues.

25. ***While the analysis tells the importance of financial soundness, strong fiscal position, and flexible exchange arrangement, how does staff assess current situations in terms of those factors in comparison with the precrisis situation?***

- The global financial crisis has left many countries with indebtedness at record levels. Median general government debt-GDP ratio has risen from 36 to 52 percent of GDP during 2008-17. Central bank balance sheets, particularly in advanced economies, are several multiples of what they were before the crisis. And monetary policy rates remain close to record lows. Current conditions hinder the ability to respond to recessions in the future. Regarding flexible exchange arrangements, they continue to play an important role as dampers of external shocks.

26. ***With reference to investment shortfalls after the crisis, chart 2.5 on p.6 shows a greater deviation from pre-crisis trend in the more recent years (2014-17) than in the years immediately after the crisis when the lack of access to credit after the crisis or from weak expectations of future growth and profitability would have been greater. This also appears to run counter to the chapter 1 discussion which states that the 2017 upsurge in global growth and trade was led by a pickup in investment in AEs and an end to fixed investment contractions in some large, stressed commodity exporters and were the highest since the 2010-11 rebound from the global financial crisis (p.16). Could the staff clarify?***

- Figure 2.5 shows a significant increase in investment (blue line) in 2016-17, which is consistent with the Chapter 1 discussion on the pickup in investment in advanced economies and an end to fixed investment contractions in some large, stressed commodity exporters.

27. ***Staff may please clarify why some of the crisis management tools deployed in 2008-09 are no longer available including the Federal Reserve's bailouts of individual institutions. Also, would the currently emerging risks to global financial stability have been lower if the unconventional monetary policy measures and the period of ultra-low interest rates had been ended earlier?***

- Reforms after the crisis have altered the tools available to regulators to manage financial rescue operations. As such, some of the crisis management tools used in 2008-09 are no longer available. Regarding the current risks to global financial stability, as described in the April 2018 and October 2018 GFSRs and Chapter 2 of the WEO, the period of ultra-low interest rates—while it has supported activity at a time when output gaps have been negative and inflation has been below target—has had the side effect of contributing to the buildup of financial vulnerabilities.

28. ***It would be interesting to understand if the analysis has taken into account channels through which employment protection legislation might have helped to contain job losses during the most acute phase of the crisis. Could the staff comment?***

- While the immediate and/or short-run impact of employment protection (or, more specifically, the angle studied in the chapter—restrictions on dismissal) on household income may have been positive, the analysis shows that during 2011-13, the effects of more difficult dismissal procedures on GDP were negative.

World Economic Outlook, Analytical Chapter 3

29. ***We are still puzzled by the projected path of core inflation, which is expected to rise sharply to 1.6 percent in 2019 from 1.2 percent in 2018, but to only grow slowly thereafter to 2 percent in 2022. Could the staff elaborate on the causes of this markedly slower acceleration in the outer years of the forecast?***

- The output gap is just turning positive in 2018, which is expected to lead to some upward pressure on core inflation in the near term. However, growth is slowing and the output gap is expected to peak in 2020, then gradually move toward zero, implying less upward pressure on inflation over time. Moreover, staff's work on the Phillips curve suggests that inflation is quite persistent, hence the movement toward the ECB's inflation target is expected to be gradual.

30. ***We note staff's finding from Chapter 3 of the WEO that domestic factors are the main contributors to recent inflation outcomes in EMDEs. We ask staff to elaborate on whether those domestic factors are attributable to demand-pull or cost-push pressures, which have different policy implications.***

- The focus of the analysis on drivers of recent inflation is to assess whether global factors played an important role in keeping inflation low and stable since mid-2000s. We find that domestic factors played a dominant role. Among these, the main explanatory factor is longer-term inflation expectations. The analysis did not attempt to disentangle the remaining contribution of demand and supply shocks.

31. ***We are surprised with staff's conclusion that domestic factors play a more dominant role than foreign ones in driving inflation dynamics. To the extent that exchange rate movements are dominated by foreign developments, one would have expected these developments to be more dominant than domestic factors in determining inflation dynamics in EMDEs. Staff's comments are welcome.***

- We agree that exchange rate movements reflect both domestic and foreign developments and in principle can be an important driver of inflation dynamics (as it was the case during large devaluations in the 1990s). However, the contribution of exchange rate movements to domestic inflation in our sample starting in 2004 is rather limited. Moreover, by embedding the entirety of exchange rate movements in the external price pressure variable, the decomposition analysis could, if anything, overstate the contribution of foreign factors to inflation dynamics (as also discussed in footnote 18 of the chapter).

32. ***We agree that clear and transparent communication from central banks in advanced economies is important to help manage spillovers. However, communication is just one component in managing risks from normalization and we would be interested in staff views as to what more the Fund can do to help to move the debate beyond transparency.***

- The Counsellors' WEMD presentations will address this issue.

33. ***Communication is increasingly important for central banks to be able to anchor expectations. However, in bad times, there could be a case made that too much transparency can generate self-fulfilling prophecies that could give rise to more volatility. Are there any specific suggestions for maintaining the right balance in central bank communication and avoid risk contributing to financial stress?***

- The measure of central bank transparency used in the chapter is a comprehensive index proposed by Dinçer and Eichengreen. It covers five categories that measure political, economic, procedural, policy, and operational aspects of central bank transparency—including, among other things, whether central banks give a comprehensive account of policy deliberations. While policy deliberations at times of high uncertainty and market pressure may indeed be sensitive, details of such discussion under transparent frameworks are typically released with a reasonable lag.

34. ***It is relevant to note that evidence suggests that well-functioning monetary frameworks with anchored expectations help countries contain the impact of negative external financial conditions. Considering this and that anchoring inflation expectations take time, what further specific policy recommendations would staff provide to countries that have significantly increased their debt, reduced their fiscal space as well as maintained weak monetary frameworks?***

- Sound and sustainable fiscal policy is essential for the credibility of monetary policy. When starting from a situation of high debt and low fiscal space, providing a credible plan to achieve fiscal sustainability is key. Moreover, in countries where the credibility of monetary frameworks is relatively low, the emphasis should be on communicating clearly the reasons for policy actions taken in response to global developments.

35. ***The staff could have given more attention to the importance of central bank independency in anchoring inflation expectations, and the role of empirical measures of de jure and de facto central bank independence. Could the staff comment?***

- We agree that central bank independence is key for monetary policy credibility (as stressed in the concluding section). If public debt is perceived to be unsustainable and limited independence raises concerns of fiscal dominance, this will likely result in less-anchored inflation expectations—as suggested by the negative relationship between spreads of sovereign debt and the extent of anchoring shown in the chapter. While we find a clear correlation between central bank transparency and the extent of anchoring, the relationship with central bank independence, for the period under analysis, is not significant. However, this may reflect the fact that most of the gains in terms of central bank independence in EMDEs in the sample took place prior to the timeframe of our investigation. It could also reflect difficulties in measuring central bank independence as acknowledged in the literature.

36. ***While the pass-through to inflation is lower in economies with better anchored inflation expectations, we are of the view that the impact of normalization on inflation could vary significantly across EMDEs with the same degree of anchoring of inflation expectations. Could the staff comment?***

- We agree that the impact of normalization of monetary conditions in advanced economies on domestic inflation in EMDEs could differ even among countries in which expectations are similarly anchored. The main reason is that normalization may have a differential effect on capital flows to EMDEs, depending, e.g., on the degree of financial openness or because liquidity can differ across EMDEs with the same degree of anchoring.

37. ***We tend to be more cautious as the paper does not seem to focus on possible reverse causality effects: is it possible that inflation expectations are better anchored exactly because monetary policy is not expected to be used, at least primarily, as a countercyclical tool? And if a country chooses to start using monetary policy in a countercyclical fashion, to what extent would the anchoring of inflation expectations be affected? Could the staff comment?***

- It is true that central banks can face a dilemma when the economy is hit by shocks that, for instance, raise inflation but deteriorate output prospects. However, to the extent that the monetary framework is credible, actions to support activity that are adequately communicated need not affect the anchoring of inflation expectations.

38. ***There is greater sensitivity to higher inflation and volatility in emerging and low-income countries that are vulnerable to commodity price swings. What kind of implications do the findings of this chapter have for monetary unions and other countries with relatively fixed exchange rate regimes, especially if some of them are commodity exporters with little export diversification?***

- The chapter highlights the benefits of anchoring inflation expectations, regardless of the exchange rate regime. When inflation expectations are well anchored, the effect of inflationary shocks are less persistent.

39. ***Given that a higher share of consumption in EMDEs is devoted to food and other commodities, whose prices tend to be more volatile and which the chapter indicates raises the volatility and persistence of inflation in EMDEs, it would have been more appropriate to report the results of a baseline specification that is estimated using headline inflation in the chapter and center the discussion around these results rather than those related to core inflation. Could the staff comment?***

- The analysis in the chapter was conducted using both headline and core CPI. The description of the results focuses on the specifications using core CPI with the aim of better capturing underlying inflationary pressures. But, as noted in footnote 13 and Annex section 3.2.A, the main findings are unchanged when using headline CPI.

40. ***We concur with its conclusion on the dominance of domestic factors over external factors in the shaping of inflation. We also welcome the GFSR analysis of the changing landscape of debt and equity investors in emerging markets. Did staff also assess the portfolio rebalancing effects within the EME asset group?***

- Staff has not done a quantitative assessment of the portfolio rebalancing effects within the EME asset group. Market contacts suggest that funds tended to be underweight Turkish assets ahead of the April sell-off and that this has not changed significantly. While weights of Argentine assets in EM investors' portfolios have fallen, this has reflected the decline in asset prices and weights relative to the index have not changed substantially. Asset returns suggest that there may have been some rebalancing from fixed income markets to equity markets, but its significance is hard to assess without additional analysis of disaggregated fund flow data.

41. ***The reports point out that markets continue to anticipate the path for interest rate increases that is less steep than that projected by the Federal Reserve. Do staff have a view on why this is the case, e.g. are markets more optimistic about the outlook, or are there challenges with the Federal Reserve Board's communication?***

- Some degree of divergence between the dots and market interests is to be expected, as they are differing concepts – the dots represent the modal outcome path of rates while the market-implied path is a probability-weighted outcome. Since bond traders are concerned more about the full range of possible outcomes, the mode-mean distinction can partly explain some of the discrepancy. Aside from this distinction, various other hypotheses have been advanced for the divergence. For instance: markets may be less sanguine in the future as the probability of a recession in the future has increased given the length of the current expansion. Markets may also have a similar view on growth prospects but be more pessimistic than the Fed about future inflationary pressures. Finally, it could be that term premiums at the front end of the term structure are very negative, as some arbitrage-free models now suggests. This implies that raw futures quotes understate the market-implied path (as one needs to “add back” the negative term premium).

42. ***What are the reasons behind the markets anticipating a less steep tightening than that projected by the Federal Reserve? How could the same be rectified so as not to engender greater market volatility going ahead?***

- Please see the answer to Q40 above.

Global Financial Stability Report

42. ***Noting that staff's assessment of risks has changed, we would appreciate staff's comment on the appropriateness of keeping the monetary policy advice for the US unchanged from previous flagships.***

- Our message on monetary policy is unchanged and remains consistent with the 2018 US Article IV – namely that the Federal Reserve should continue to pursue monetary policy normalization in a gradual, data-dependent, and well-communicated manner. But we also stress the need for policymakers to be mindful of potential global spillovers as monetary policy tightens. Specifically, given the sizable fiscal stimulus, achieving the dual mandate of maximum employment and price stability could require a faster pace of policy rate increases. With inflation firming, central banks may step up the pace of monetary policy normalization, and so there is a risk that there could be a sudden tightening of global financial conditions.

43. ***It is evident in the atypical tightening cycle in the US where, despite increases in the policy rate, financial conditions have eased further as a result of continued strong risk appetite and rising asset valuations. Could the staff provide any explanation for this puzzle? What would be the possibilities for the FED to address this decoupling between monetary policy stance and market conditions?***

- Indeed, despite the ongoing US monetary policy normalization, US financial conditions have eased further, supported by continued strong risk appetite and rising asset valuations. US equity market performance has been boosted by strong corporate profitability and payouts to shareholders, which, in turn, have been partly propelled by fiscal stimulus. US corporate spreads are relatively tight and the VIX index of equity market implied volatility remains low. Together this now means that asset valuations appear stretched in some major markets and that there is a risk of a sharp tightening in financial conditions. As discussed above, the Federal Reserve should continue to pursue monetary policy normalization in a gradual, data-dependent, and well-communicated manner.

44. ***It caught our attention that the FED's latest raise in its policy rate in April did not tighten the financial conditions in the US economy, as was the case in emerging and frontier economies. This situation is puzzling for us and we would appreciate further clarification from staff on monetary policy traction in the US.***

- Please see the response to Q43 above.

45. ***As views have diverged on termination timing of the Fed's current tightening cycle, we appreciate it if staff could share the view regarding this issue. Moreover, given the secular decline in neutral real interest rates and limited policy buffers for future economic downturns, discussions on potential alternative policy strategies in addition to forward guidance and balance sheet actions have become vigorous. Could staff share the view on possible options?***

- IMF staff policy rate forecasts suggest a steeper path than both market-implied rates and the Fed's median projections, though they are consistent with the Fed's long run equilibrium. Regarding potential alternative policy strategies in the event of lower long-run equilibrium interest rates and limited policy buffers, a few points are worth noting. There is a good deal of uncertainty about both the current and future evolution of the neutral rate of interest, with empirical estimates sensitive to methodological differences. In the event the lower bound becomes a constraint, there is a wider set of tools that now exists, including asset purchases, interventions to directly target longer-term yields, negative nominal interest rates, maintaining an explicit lower-for-longer strategy. But policymakers need to acknowledge trade-offs (e.g., market functioning, bank profitability, financial stability risks) and limits (e.g., diminishing effectiveness, implementation hurdles), while policies need to be appropriately tailored to circumstances and achieving clearly stated objectives, and not replace any fiscal, structural, and financial sector reforms that may be needed.

46. ***Risk appetite and asset valuations remain buoyant in the US – favored by the considerable fiscal stimulus – causing the Treasury yield curve to flatten to a degree not seen since before the global financial crisis, in what staff called an atypical tightening cycle. Given this behavior, including the recent inversion of the TIPS yield curve, we welcome the analysis put forth in Box 1.1 of the GFSR but would appreciate it if staff could elaborate more on the ambiguity of the signal under current conditions.***

- The flattening of the UST term structure, insofar as such a development portends slower growth or an outright recession, could be seen as an offset to otherwise accommodative financial conditions in the current environment. Indeed, as noted in Box 1.1, on its own the narrowing slope seems to not only worsen mean expected growth, but also to widen and tilt the growth forecast distribution toward the downside.

- However, there are a number of caveats to consider. First, as noted in Box 1.1, to the extent that flatter curves owe to lower longer-term rates, and possibly to lower term premiums, the overall signal may be more benign than malignant, as several studies document a countercyclical relation between term premiums and recessions. Also, the portion of the yield curve that may be most relevant for nearer-term forecasts today is, in fact, upward rather than downward sloping. Indeed, shorter-dated futures still price further policy rate increase in the US, whereas the flatter lower longer-horizon rates map less cleanly the economic cycle over the next couple years. Along these lines, note that the FOMC has already inverted its expected policy path, albeit only between the 2020 “dot” and the “long-run” projection. At the same time, the Committee hardly forecasts a contraction in output over the full horizon.

47. ***The sovereign-bank nexus remains an important vulnerability, especially in the EA, and further reforms should limit the preferential treatment of sovereign debt to reduce financial sector sensitiveness to problems faced by national governments. Thus, adequate monitoring and possibly new tools and regulation will be necessary going forward. Could the staff comment?***

- As discussed in the GFSR, we agree that the sovereign-bank nexus remains an important vulnerability. This is most pressing in economies where the government is highly indebted. In such cases, bank supervisors should continue to monitor bank lending to sovereign borrowers and could require additional capital buffers to increase banking system resilience, preferably in a consistent manner across jurisdictions.

48. ***Since the April 2018 GFSR, market sentiment has deteriorated in some emerging markets and developing countries (EMDCs), driven by a combination of country-specific factors, worsening external financing conditions, and trade tensions. Staff notes that investors have been differentiating among emerging markets so far. Can the staff provide an update on recent developments and the extent to which recent policy corrections have calmed markets?***

- Looking at the major economies that have felt the most market pressure (Argentina and Turkey), external funding costs have declined substantially since early September, while exchange rates remain under pressure. In Argentina the exchange rate has reached new lows, though external credit spreads have narrowed substantially. Recent policy measures taken by the Turkish authorities have stemmed further depreciation of the lira so far and have supported a sizable decline in external credit spreads.

49. ***In response to market pressures and currency depreciation, central banks in several emerging market economies responded with interest rate hikes and interventions in currency markets. On the other hand, Chinese authorities have eased monetary policy and reintroduced a 20 percent reserve requirement for foreign exchange forwards. Staff's evaluation on these policy measures is welcome.***

- As discussed in the GFSR, there are a number of factors that policymakers should consider when deciding on how to respond to an increase in market pressure. One option is to increase policy rates. This decision should be taken in the context of the overall macroeconomic, structural, financial and macroprudential policy mix in a country and also take into account the economy's cyclical position, balance sheet vulnerabilities and policy space. During periods of stress, exchange rate flexibility can often serve as a key shock absorber, but central bank interventions could also be used to prevent disorderly market conditions. When deciding on whether to intervene, policymakers should consider banks' and corporations' balance sheet exposures in foreign currencies, how the exchange rate is valued relative to fundamentals, the level of foreign exchange reserves, and whether alternative policy measures are desirable. An assessment of individual country responses to recent market pressures will be conducted in the context of bilateral surveillance.

50. ***More granular and differentiated policy advice would be welcome for the countries where the existing FX exposures already cause tensions. For instance, the somewhat philosophical discussion on the importance of deeper capital markets is inconclusive with arguments both pro and con without relative weights assigned. Further staff comments are welcome.***

- The discussion in the GFSR highlights that the right mix of policies should take into account an economy's cyclical position, balance sheet vulnerabilities, and policy space available. An assessment of individual country responses to recent market pressures will be conducted in the context of bilateral surveillance. On the discussion of a deepening in financial markets, even though potential downsides of a further (or too fast) deepening are mentioned in the text, the overall policy message is that emerging market economies should continue developing domestic financial markets given their economic and financial stability benefits.

51. ***We invite staff to comment on the implications of Basel III leverage ratio on the risk-taking capacity of banks in EMDEs and implications for credit growth.***

- The impact of the introduction of the leverage ratio and credit growth depends on a number of factors. First, there is a question of whether the impact comes primarily from international banks providing credit to EMDEs on a cross-border basis, or whether there is an impact on local banks. The impact on overall credit growth will depend on the importance of international and local banks in lending to the economy in question. Secondly, the impact on credit will depend on whether the leverage ratio or the Tier 1 capital ratio is binding for banks. Some banks may find that by meeting the Tier 1 capital ratio, they also meet the leverage ratio and so the leverage ratio has little impact. Other banks may need to adjust balance sheets to meet the leverage ratio. Thirdly, if banks do take action to meet the leverage ratio, the impact on credit will depend on whether banks increase capital or reduce assets. If banks increase the level of capital, then this should support a higher level of bank lending. However, if banks choose to meet the leverage ratio threshold by cutting back assets, this could affect credit growth in the short-term.

52. ***Aside from the idiosyncratic country-specific risks that have affected several countries' currencies, could staff comment on the evidence of reduced capital inflows or outflows related to the gradual normalization of interest rates and the dollar strengthening in other countries that don't have country specific risks?***

- In the GFSR, we provide estimates for the adverse impact of US monetary policy normalization on portfolio flows to emerging markets (Figure 1.14, panel 2). We estimate that over the past 12 months, the drag from Fed policy normalization has reduced portfolio flows by $32 billion, of which $17 billion is due to financial markets pricing in higher policy rates and $15 billion is due to Fed balance sheet contraction. The model does not capture the impact of dollar appreciation, but it includes the impact of investor risk appetite (proxied by US corporate credit spreads), which is estimated to have had a more limited adverse impact over the past 12 months.

53. ***We take good note of the indication by the report of limited spillovers between emerging markets, and of an effective investor differentiation among emerging markets, as the countries most affected by market developments were those with weaker policy frameworks, who experienced idiosyncratic events, or who are more exposed to trade tensions. LICs are also among the most affected as evidenced by the sharp decline in international bond issuances. Could staff elaborate on whether any differentiation is perceptible within this group?***

- Looking at the performance of frontier markets, apart from idiosyncratic events in some countries, the report highlights that one perceptible difference has been the underperformance of those issuers that increased their Eurobond issuance substantially in recent years; or where investors have built large overweight positions (e.g., based on investor surveys by investment banks) that had to adjust as outflows intensified.

54. ***The section on the main failings in the global financial framework prior to the GFC could have delved more into the extent to which failings were known, debated and addressed not only at the IMF but also by other stakeholders in the international financial system. Staff comments are welcome.***

- Given the space constraints, the focus of the discussion was put on the different vulnerabilities that accumulated before the crisis, that turned it into a global phenomenon, and that the reform agenda aimed to address. Thus, many important issues, such as this one, could not be adequately covered. Nonetheless, the chapter notices that the prevailing regulatory environment reflected a more benign view of the overall financial landscape, including the reliance on wholesale funding, the securitization process behind the originate to distribute model, and the containment role of market discipline, which were re-assessed only with hindsight.

55. ***On market expectations of the future evolution of US interest rates, we wonder if there is a possible misalignment between the sentence in paragraph 13 of the GFSR ("near-term market-implied interest rate expectations have drifted higher, but still lag the median policy rate expectations of the FOMC") and that in paragraph 30 ("over the past year, market participants have substantially revised upward their expectations for the likely path of US interest rates"). Could the staff comment?***

- We do not believe that the two statements are inconsistent. Both market-implied and FOMC projections have drifted higher and the gap between near-dated market-implied OIS and interest rate futures and the FOMC's dot plot has narrowed, but as Figure 1.2, panel 1 in the GFSR shows, there is still a significant divergence in 2019-20. Based on the June 2018 dot plot (which is the latest available), markets are implying 33 bps less tightening by the end of 2019 and 72 bps less tightening by the end of 2020 than the FOMC members' median projection.

56. ***We also support an assessment of the efficiency costs of the post-crisis regulatory changes and look forward to the planned work of the FSB and the IMF in FSAPs. This should include an analysis of the potential macroeconomic implications, an assessment of the impacts on competition, particularly in the context of future work on market power, and on the potential fiscal impacts of 'too big to fail'. Can staff comment on what this work is expected to cover?***

- The chapter mentions that the advanced implementation of some of the core measures of the regulatory reform agenda offers an opportunity to have a broad assessment of their consequences that was not possible ex-ante or during their phase in period. Staff supports the efforts led by the FSB in evaluating the impact of the regulatory reform in different aspects of credit provision, such as infrastructure financing and on SMEs. Other dimensions can certainly be considered in the future. Furthermore, MCM aims to leverage the FSAP process to assess the impact of specific reforms in jurisdictions with adequate data through technical notes and background papers, as it was done in the recent Peru FSAP where micro data was analyzed to assess the impact of higher capital requirements on lending.

57. ***We would welcome staff comments on the work plan to contribute to the FSB-led evaluation of regulatory reforms to help identify and address any material unintended consequences and ensure that the reforms accomplish their objectives.***

- Fund staff participates and collaborates with different FSB working groups and initiatives in representation of the IMF. Furthermore, MCM aims to leverage the FSAP process to assess the impact of specific reforms in jurisdictions with adequate data through technical notes and background papers, as it was done in the recent Peru FSAP where micro data was analyzed to assess the impact of higher capital requirements on lending.

58. ***Financial regulatory changes have contributed to the decline in CBRs over the past decade. While there does not appear to have been a fall in value of transactions, the concentration into fewer channels constitutes a major risk for some small economies. Do staff have any information on how the cost of cross-border transactions, such as remittances, has changed as the number of channels has decreased?***

- According to the March 2018 FSB report on correspondent banking and remittances (where IMF was a member), changes in the structure of correspondent banking relationships have in some cases put pressure on remittance service providers' (RSPs) ability to access banking services. Remittances costs have declined over the past decade. However, as of the third quarter of 2017, the cost of sending $200 was 7.2 percent, well above the United Nations' Sustainable Development Goal target of 3 percent. Furthermore, World Bank research suggests that despite a significant reduction over the last decade in the cost of sending remittances, there remain several factors that challenge further reductions. Among these are the de-risking behavior of commercial banks and the exclusive partnerships between some RSPs and a large number of agents, keeping fees high. An IMF paper on recent Trends in Correspondent Banking Relationships (discussed at the Board on April 21, 2017) also contains some analysis on remittances costs, which are broadly in line with the finding of the March 2018 FSB report and the research undertaken by the World Bank.

59. ***Would the staff comment on changes that they would advise on the extant regulatory approach regarding liquidity ring-fencing?***

- As discussed in the Special Feature in the GFSR, there are benefits to a ring-fencing of liquidity from a host regulator's perspective, but this could have unintended consequences for global banking groups. We advise that better home-host collaboration could help mitigate branch risks and reduce the need for ring-fencing. Where home-host collaboration does not currently take place, regulators should more actively coordinate. Where home-host agreements already exist, regulators should assess whether changes are needed to make them more effective. Recent work by the BIS suggests that while there has been progress in the sharing of information between home and host regulators, more work is needed to improve the flow of information. In addition, regulatory coordination is needed to ensure that measures adopted in individual countries do not impose significant costs on the financial system.

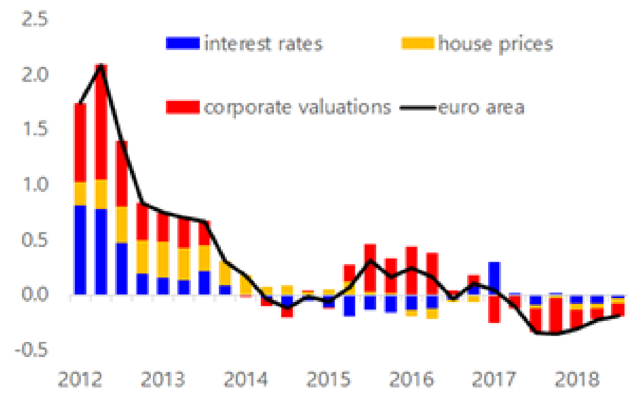
60. ***Against this background, we note a slight difference in the tone between the WEO and the GFSR. The GFSR notes in ¶26 that "while global factors affected all countries, the overall spillovers between emerging markets have so far been relatively contained and idiosyncratic factors explained much of the outsized asset price moves". The WEO, on the other hand, concludes in Page 29 that "in an environment of gradually tightening global interest rates and rising uncertainty, the likelihood of contagion from such episode to other economies has also risen". We would appreciate staff comments, including on the relevance of the reference to "contagion" instead of "spillover".***

- It is not clear that there is a difference in tone between the WEO and the GFSR. The GFSR paragraph cited above is discussing what has happened in markets so far, while the WEO paragraph is discussing what could happen going forward. Indeed, the GFSR also notes that an intensification of concerns about the resilience and policy credibility in emerging markets may lead to further capital outflows and possibly rising global risk aversion. In such a scenario, countries with high external debt, substantial financing or rollover needs, limited policy space, and weak reserve buffers would be particularly vulnerable. GFSR also mentions contagion as one of the risks facing EMs.

61. ***We would ask staff to present the evolution of spreads within the euro area and provide a stand-alone figure with the Financial Conditions Index for the euro area.***

- Figure 1.20, panel 3 in the GFSR shows sovereign spreads for selected euro-area countries. A chart on the euro area financial conditions index is shown below.

Euro area financial conditions index



Source: IMF staff calculations.

62. ***Could staff provide the Financial Conditions Index for EMEs excluding these economies?***

- Please note that the group of systemically important emerging markets economies (other than China) in Figure 1.2.6 does not include Argentina. We do not have the FCI index for emerging markets excluding Turkey readily available, but based on country specific FCIs, financial conditions are likely to have also tightened in other large EMs ex Turkey since the first quarter.

GFSR Analytical Chapter

63. ***Containing threats to financial stability stemming from new risks, including cybersecurity and financial technology, also warrant continued vigilance from regulators and supervisors. Can the staff indicate what could be a potential role of the Fund in these areas?***

- The Fund is playing and can further play an important role in these areas. For instance, by providing guidance and technical assistance to countries on regulation and supervision in these areas, especially in low income countries. The Bali fintech agenda provides a framework for national authorities to develop comprehensive policy approaches to fintech so they can better realize the opportunities and mitigating the associated risks. The Fund is also cooperating with the FSB in providing qualitative assessments of crypto assets developments outside FSB countries.

64. ***It would be interesting to understand if the analysis has taken into account channels through which employment protection legislation might have helped to***

contain job losses during the most acute phase of the crisis. Could the staff comment?

- RES will answer this question.

65. ***The staff report mentions that considerable progress remains to be done on bank compensation practices and on the use of credit rating agencies. We would appreciate further details on how staff believes this problem can be tackled.***

- Both of these are thorny issues, and the fact that they remain outstanding shows how difficult it has been to find practical and effective solutions. On compensation, a mechanism that does less to encourage excessive risk-taking could improve stability, though drawing the line of excessive will be challenging. Despite its complexity, the recent FSB review on compensation practices offers some guidance. For example, countries should consider adopting the FSB principles and standards on compensation practices, especially FSB jurisdictions. Furthermore, bank boards and supervisors should pay more attention to the link between compensation decisions and risk taking. Finally, the application of multi-year adjustments to compensation, such as malus and clawback, could be further considered and its legal enforceability clarified across jurisdictions. On credit ratings agencies, reforms to their fee structure is a potential partial solution, but it raises its own concerns.

66. ***We caution against penalizing bank holdings of sovereign bonds, as they may trigger instability in the sovereign debt market, especially when there are no clear alternatives. Could the staff comment on possible alternatives for safe and liquid assets?***

- The chapter recognizes that sovereign debt will remain at the center of holdings of safe and liquid assets. Other options to maintain adequate liquidity ratios is to increase the use of funding sources with low runoff factors, such as retail deposits and longer-term liabilities

- Additional question from Hurtado not included in Questions: We note that staff´s focus is mainly on advanced and large emerging market economies. However, we wonder how appropriate Basel III is for LIC's and other small emerging market economies lacking deep financial systems that have to apply, in principle, the same standardized approach. Staff comments are welcome.

- Across FSAPs and TA, the Fund has taken a proportionate and tailored approach in providing advice on banking supervision to LICs and other economies. Based on a country's own financial system conditions and implementation capacity, we may recommend some components from the Basel III package, typically definition of capital, but in many cases we actively advise against adoption of the more advanced options within Basel III.

67. ***Regarding macroprudential approaches to systemic risk/… Although staff state that "no preferred model has emerged for the structure of supervision," the implication is a bias towards those countries with more consolidated regulatory structures. Further, staff's description of FSOC's powers was incorrect. FSOC can designate nonbanks for Fed supervision, designate Financial Market Utilities for additional risk-management requirements (but generally not Fed supervision), and designate payment, clearing, and settlement activities for additional risk-management requirements. We would appreciate staff's clarification on this issue.***

- The use of broad language in the chapter to make the discussion more accessible and concise may have led to some ambiguity in this case. We have changed the language to clarify this point.

68. ***We would like the Fund to offer guidance on how fintech could be used to expand financial inclusion of productive but financially under-served sections of the society. We believe that a careful re-assessment of the benefits of financial inclusion against excessiveness of regulatory burden is warranted to enable under-served segments in LICs and developing countries to reap its full benefit. Could staff comment?***

- The Staff Discussion Notes "Fintech and Financial Services: Initial Considerations" (SDN/17/05) and "Financial Inclusion: Can it Meet Multiple Macroeconomic Goals?," (SDN/15/17) offer some valuable guidance on this regard. The chapter also acknowledges the opportunities offered by fintech on several dimensions, including inclusion, but emphasizes that these opportunities should be reaped in an environment that adequately protects the safety of the financial system and its participants. Considering that in most jurisdictions fintech is either unregulated or lightly regulated, we see little ground for concerns of excessive regulation at the moment.

Fiscal Monitor

69. ***As improvement of methodology and quality data will occur in the future, the evaluation of the public sector through public balance sheets will suitably complement the standard fiscal evaluation, for instance, debt sustainability analysis, and will be incorporated in Article IV staff reports. Could the staff comment?***

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

70. ***Staff analysis in Box 1.2 indicates that governments with stronger balance sheets are better able to engage in countercyclical fiscal policy during recessions and financial markets take account of assets and balance sheet strength? Could staff offer empirical evidence to support this? Further, could staff elaborate on the progress on the adoption of balance sheet approach in countries most impacted by the crisis.***

- Annex 1.4 of the Fiscal Monitor: Balance Sheet Strength and the Macro Economy presents the empirical results underlying the message in Box 1.2. An accompanying working paper providing more detailed analysis will be published in coming months. Although the balance sheet approach is still in its early days, a number of countries impacted by the global financial crisis have gone some way to developing it. The United Kingdom is at the forefront and is discussed in Section VI: Balance Sheet Analysis in Practice. More broadly, a number of other countries impacted by the crisis (e.g., Ireland, the United Kingdom, Portugal, and Finland) have now undertaken Fiscal Transparency Evaluations, which estimate and highlight the risks around public sector balance sheets.

71. ***Of the 31 countries in the sample, only 17 have PSBS time series and 14 have public sector estimates drawn from the fiscal transparency evaluations that only cover a single year. Could staff indicate which of these countries currently undertake a PSBS approach in fiscal policy analysis? Are there plans to reflect on this point in the relevant Article IV consultation reports? Do countries that subscribe to the SDDS have the data needed to apply the balance sheet approach to fiscal policy? Is Fund technical assistance being offered to capacity-constrained countries that might have expressed an interest in the PSBS methodology?***

- The number of countries already applying the balance sheet approach is relatively limited: The Fiscal Monitor draws attention to Australia, New Zealand, the United Kingdom, and Uruguay, for which the balance sheet approach has also informed past Article IV consultations.

- SDDS only require the disclosure of central government gross debt, which is not enough to apply the balance sheet approach. Nevertheless, the SDDS Guide encourages the disclosure of a full financial government balance sheet. An increasing number of countries are producing the data required to undertake a balance sheet approach at the general government level.
- Staff will respond to the question on technical assistance during the Board meeting.

72. ***Given that the sample included in the Monitor only covered 31 countries, how would the staff describe the current data issues? and how do they evaluate capacity development needs in this regard, especially in middle– and low-income countries?***

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

73. ***It is important to know what next steps staff is considering to enhancing the PFBS approach, and if providing TA to interested countries is among them. We also believe the implementation of this new approach would require a well-designed communication strategy to avoid misinterpretations. Could the staff comment?***

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

74. ***As monetary and exchange policy could also impact intertemporal public wealth, we would like to hear from staff to what extent this aspect has been incorporated in countries' different frameworks.***

- Monetary and exchange rate policies are both important for public wealth. Examples of analysis in the Fiscal Monitor looking at such policies include the discussion on the impact of quantitative easing in section II and VI and the role of exchange rate effects in the case study on Kazakhstan.

75. ***Can staff comment on whether building basic country balance sheets could address gaps in public debt transparency for economies with capacity constraints, particularly for large bilateral liabilities?***

- Building basic country balance sheets could expand the coverage of public debt, thereby improving its transparency. In particular, it could bring to light debts owed by public sector entities that sit outside the general government perimeter. As evidenced in The Gambia, as well as a number of advanced economies (including Portugal and Greece, see IMF policy paper "Fiscal Transparency, Accountability and Risk" 2012), debt owed by public corporations is often brought onto the government's balance sheet during crises.

76. ***Could staff indicate what concrete steps could be taken to improve data availability and to incentivize countries to collect and publish more data? Are the current methodological guidelines of the Government Financial Statistic Manual sufficiently fleshed out for government to collect such data?***

- The GFSM 2014 expanded considerably the practical guidance for compilation of government finance statistics, including those related to balance sheet positions. These guidelines are complemented by a number of compilation guides produced by the STA and FAD, most notably: the Public Sector Debt Statistics - Guide for Compilers and Users, the Government Finance Statistics: Compilation Guide for Developing Countries, and the Quarterly Government Finance Statistics - Guide for

Compilers and Users and the Fiscal Transparency Handbook. The IMF staff stands ready to assist member countries in the application of these methodological guidelines.

77. ***It was unclear whether the report would suggest greater use of net versus gross debt for debt sustainability analyses across the Fund's membership. Staff comments would be welcome. Can staff also elaborate on why central bank foreign exchange reserves were excluded from the analysis?***

- Staff are examining how to incorporate balance sheet analysis in a broader context, including possibly in surveillance across broad swaths of the membership. Net debt is already used to varying extent in a number of cases in the Article IV (e.g., in Australia, Canada, Japan, Singapore and the UK), in order to align with the authorities' preferred measure.

- Central bank reserves are included in the public sector balance sheet estimates. However, they are excluded from the analysis presented at general government level in Section III.A to improve cross-country comparability: in most countries, foreign exchange reserves are held by the central bank (i.e., outside of the general government). However, in some countries (most notably Japan) they are included within the general government. Not excluding these reserves from general government for these countries would affect cross-country comparability.

- Staff will respond on debt sustainability analysis during the Board meeting.

78. ***Aside from data limitations, is there a reason why balance sheets are not more widely used to shape fiscal policy recommendations in surveillance, and is there a case for balance sheet data to be subject to Article VIII, Section 5?***

- The largest limitation to date has been data availability. Staff hope that the expanded coverage included within the public sector balance sheet database, combined with the conceptual framework laid out in the FM will increase the use of balance sheet analysis, both in fund surveillance and by the authorities themselves. Going forward, collection of GFS data needed for the balance sheet analysis should improve owing to changes made in the GFS questionnaire, which now requests additional details, including the maturity structure, currency composition, and counterparty details. But the narrow coverage continues to hamper the use of balance sheets in surveillance. A concentrated effort by countries enhanced by technical assistance and training would accelerate progress in closing these data gaps. More generally, with respect to Article VIII, section 5 and data that staff uses for surveillance and requirements under the Articles, a Board session to engage is planned for November. Staff will look forward to engaging with directors on those issues in that context.

79. ***Could staff also elaborate on whether its assessment methodology ensures neutrality between the different types of pension systems (publicly-run pay-as-you-go versus privately-run funded)?***

- The intertemporal balance sheet incorporates all future revenues and payments associated with pension systems and can therefore accommodate different forms of pension systems.

80. ***Average public debt in the [Latin American] region is projected to increase further in the medium term, even as the economic recovery picks up steam and primary balances gradually turn positive. Which additional fiscal reforms staff considers necessary to stabilize and reduce debt-to-GDP ratios in the region?***

- Our general policy advice is to avoid pro-cyclical policies in good times in order build buffers, to raise potential growth through structural reform, and to improve fiscal frameworks. Detailed policy recommendations would be country-specific hence are within the realm of bilateral surveillance.

81. ***We wonder whether there is progress with subscription to SDDS Plus and GDI standards.***

- As of end August 2018, two thirds of the 17 countries that have adhered to the SDDS Plus are subscribers with systemically important financial sectors (SIFs). Austria, Canada and Denmark have adhered in 2017, while Finland, Latvia and Lithuania have adhered in 2018. Looking forward, an additional 12 countries have expressed interest in adhering to the SDDS Plus.

- On the data gaps initiative, as per the Third Progress Report of the DGI-2 (to be posted shortly by the FSB and IMF), four G20 economies and one FSB member jurisdiction have already achieved the 2021 targets related to the compilation of financial accounts and balance sheets and another eight G20 economies and one FSB jurisdiction made good progress in this respect.

82. ***We suggest two things. First, to avoid the risks that discussions about fiscal risks trivialize to a simple "summary" figure or measure, like net worth to GDP, the FM should include net financial worth or others in figures showing net worth, like the Figure 1.1 in the FM, to encourage readers to focus on wide and detailed measures. Second, the FM can add descriptions such that analyzing fiscal risks by closely examining general government public debt is critical and essential for considering fiscal policies in countries where public debt vulnerabilities are particular concern. Staff's comments are welcome.***

- Staff agree with the importance of not focusing on a single measure but rather presenting a dashboard of measures, as in figure 1.4. More generally, the FM presents data that allow the differentiation between financial and non-financial assets. While the fiscal risk case studies in the fiscal monitor focus on balance sheet measures, the impact on public debt, and its corollary, gross financing needs, remains a key part of the analysis. This can be seen in, e.g., the discussion of shocks in the case studies on Finland and The Gambia. The accompanying working and selected issues papers go into more detail on the impact of debt.

83. ***Could the staff elaborate on the source of information and assumptions made in determining the value of subsoil natural resources, in particular crude oil?***

- Annex 1.2 provides a detailed description of the sources and methods for valuing sub-soil natural resources — which follow GFSM 2014 valuation guidelines.

84. ***We appreciate the case studies of the UK and New Zealand, showing increased attention to balance sheet management. We wonder what factors galvanized the positive policy response.***

- The positive policy response in the countries at the frontier of balance sheet analysis have been the result of long-term improvements and fiscal reforms: the data underlying the balance sheet approach in Australia and New Zealand have been compiled since the 1990s. The United Kingdom's recent strengthening of their approach reflects their interaction with the New Zealand and Australia in particular, and an internal push to develop balance sheet data, as well as a recognition that the impact of the crisis came largely through balance sheet effects (see Section III.B.), and that managing fiscal policy requires sound balance sheet management.