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July 22, 2020

Statement by Mr. Kaya, Mr. Benk, Mr. Just, and Mr. Bayar on 2020 External Sector Report
(Preliminary)
Executive Board Meeting
July 24, 2020

We thank staff for the comprehensive set of reports. We appreciate that this year's External Sector Report (ESR) was prepared against a peculiar backdrop as the pandemic has altered the underlying economic fundamentals abruptly and materially across all the economies. Staff appropriately balanced the traditional, model-based, and backward-looking assessment of external balances with a forward-looking perspective reflecting the fast-evolving dynamics and inherent uncertainties of the post-COVID world. Preserving this balance in the future surveillance operations remains crucial, which calls for continued use of staff judgment in a judicious and transparent manner. On that note, we broadly agree with staff's assessments and policy recommendations, and would like to offer the following comments for emphasis.

Outlook and Policies

We take note of the modest reduction in the overall imbalances in 2019 and 2020, while excessive imbalances continue to be large, reflecting structural dynamics. We also recognize that this improvement has come mainly on the back of adjustment in deficit economies. For economies dependent on commodities, tourism, and remittances, the COVID-19 crisis has further complicated the domestic adjustment efforts and aggravated the costs in terms of output and employment losses. In this regard, we welcome the large policy packages recently announced by major surplus countries and regions, which should not only help contain the economic fallout of the pandemic in these economies, but also help narrow the persistent current account imbalances at the global scale.

We broadly agree with the staff assessment that the impact of the pandemic has varied across countries, reflecting underlying economic fundamentals and institutional settings. We note

that swift and decisive actions by major central banks have been critical to ease the market conditions and help reverse the capital outflows from emerging and developing countries. In this regard, we note that the ECB has concluded several bilateral swap and repo line arrangements with central banks within and outside the EU in response to the COVID-19 crisis. These steps also helped safeguard the smooth transmission of monetary policy in the euro area.

On a similar note, we concur with staff that the fiscal response has played a critical role in underpinning global economic activity. Many of the countries in our constituency have taken significant fiscal measures to cushion the pandemic shock on incomes and the real economy. We acknowledge that the Fund's encouragement in this regard, including with the careful tone of the ESR, has been very instrumental in persuading a broader set of countries to embrace a *`whatever it takes`* mode at a very critical point in time. If it weren't for this massive policy effort, achieving the recent turnaround in global market sentiment would not have been possible. Notwithstanding, we agree that in the medium term, the fiscal stimulus should be gradually withdrawn as the recovery takes hold, to safeguard debt sustainability. We are deeply concerned about the risk of resurgence of protectionist tendencies in the post-COVID world. We support staff's emphasis on eliminating the underlying macro-structural distortions as the means to effectively and durably address excessive external imbalances. We also support the ESR's call to modernize the rules-based multilateral trading system, including through a well-functioning WTO dispute settlement system.

Notwithstanding the modest improvement of excessive current account positions, we note with concern that the stock asset and liability positions are at their historical highs, aggravating sustainability risks. Furthermore, the persistence of current account positions and excessive imbalances of many economies would imply a further rise in these stock positions in the years to come. We agree that the attendant risks from growing International Investment Positions would not only impact debtor countries, but also will have significant implications on creditor countries, including through valuation losses.

<u>Methodology</u>

The COVID-19 crisis, among others, has led to a sharp contraction in global trade. We note that staff explains the decline in trade of goods and services fully with the historical relationship between trade and components of GDP. At the same time, staff also highlights that the services trade has deviated from its historical trend as well as its historical relationship with activity-based variables. While we agree with these observations, we note that the rather idiosyncratic development of services trade, in the post-COVID world, tends to also weaken the methodological link between the current account balances and REER positions. *We would appreciate if staff could elaborate more on how the EBA model accommodates this exogeneous and large shock?*

We welcome the analysis in Chapter 2 of the ESR, which broadly confirms the earlier observations that the external debt tolerance potentially varies across countries, reflecting *inter alia* the respective composition of their International Investment Positions. We acknowledge that the level and composition of stock imbalances are likely to explain the external debt tolerance of countries not only between advanced and emerging market economies, but also within these heterogeneous categories. *Building on the findings of this chapter, we wonder whether staff is planning to devise quantitative benchmarks for external stock imbalances, similar to the methodology used for assessing flow variables.*

Finally, we note that in the ESR Chapter 2, staff defines `external stress episode` as an event that involves either a sovereign external debt default, debt restructuring, or recourse to an IMF arrangement. We understand that the `IMF arrangement` in this definition also comprises non-disbursing and precautionary arrangements. While the Annex 2.1 of the Chapter extends the robustness checks to alternative definitions (e.g. the exclusion of Flexible Credit Line arrangements from the definition), extreme caution is warranted in the communication of these results as they may aggravate the inherent stigma about Fund arrangements, including the Precautionary and Liquidity Line and Short-term Liquidity Line.