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Statement by Ms. Levonian, Ms. McKiernan, and Ms. Vasishtha on 2020 External Sector Report
(Preliminary)
Executive Board Meeting
July 24, 2020

We thank staff for the comprehensive and well-written 2020 External Sector Report (ESR). The report's rich discussion of the outlook for global external imbalances and assessment of the external positions and policies of a globally representative set of economies makes a strong contribution to the Fund's surveillance activities. The external balance assessment presented in Chapter 1 raises several important issues that are particularly relevant for the current economic conjuncture and as the COVID-19 pandemic unfolds. We also appreciate the detailed discussion of the significant uncertainty and risks surrounding the outlook for external positions for 2020. We broadly agree with staff's assessment as well as the key policy recommendations, which are aptly crisis-focused, and offer the following comments.

Protectionist trade policies pose significant risks to global economic growth and cross-border trade integration. The analysis in the April 2019 World Economic Outlook showed that the role of tariffs in driving bilateral trade imbalances is small relative to macroeconomic factors. We also reiterate that tariffs are a poor and ineffective tool at rebalancing trade, and sustained increases in tariffs can have significant long-term costs. We, therefore, welcome the emphasis in Chapter 1 on the importance of avoiding trade restrictions. We strongly support staff's call for countries to avoid using tariffs to target bilateral trade balances, since tariffs limit trade, investment, and growth and are generally not effective in reducing excess external imbalances. In particular, avoiding trade restrictions on medical supplies and equipment is essential to mitigate the effects of the pandemic.

With regard to policy priorities, we agree that near-term fiscal policies should remain focused on protecting lives and employment. As the pandemic subsides and economies gradually reopen, countries with fiscal space should boost public investment to support the recovery and the transition to a low-carbon economy. Expanding the social safety net to protect the most vulnerable should also be a priority, given that the pandemic has had a disproportionate impact on lower-skilled workers. Further, economies that are heavily reliant on tourism and remittances are likely to face long-lasting challenges. We would welcome more tailored policy advice for such countries with a view of avoiding the build-up of persistent imbalances.

Regarding medium-term policy priorities, we support the focus on encouraging investment and discouraging excessive private saving, where warranted, to support the recovery and help restore monetary policy space. As the pandemic is also likely to speed up certain structural changes, such as the expansion of digital services trade and automation, further analysis on the implications of these trends for both the neutral rate and the evolution of external balances would be informative.

Heightened global risk aversion could amplify the risk of an external stress episode for countries with preexisting vulnerabilities, such as large current account deficits, high share of foreign currency debt, and limited reserves. We welcome the focus in Chapter 2 on the relationship between the structure of external assets and liabilities and the risk of external stress episodes, especially for EMDEs. The analysis is very timely given the ongoing uncertainty around the global impacts of the pandemic and the vulnerabilities associated with the accumulation of debt in many EMDEs over the last decade. We agree with staff's conclusions on the importance of: (i) limiting a buildup of external vulnerabilities through monitoring various components of external flows and the IIP; and (ii) limiting the foreign-currency-denominated component and currency mismatches by maintaining adequate buffers.

We are concerned about staff's approach to include precautionary arrangements in the definition of an external stress event. While we recognize that countries tend to request precautionary arrangements, such as the FCL, in situations of heightened stress, we would caution staff in treating precautionary and non-disbursing arrangements in the same vein as sovereign debt default and restructurings. The approach risks undermining the Fund's overarching message on precautionary arrangements -- that precautionary facilities are a prudent response to a *potential* balance of payments need. *Staff comments are welcome*.

The analysis in Chapter 2 could consider additional important elements. First, the maturity of external liabilities seems to be a natural additional element to consider (besides equity versus debt and currency denomination.) *We welcome staff's comments on why this aspect was not considered, including on the role of data limitations*. Second, it would be very helpful to provide a list of the external stress episodes or indicate how many of these episodes occurred in advanced economies vs. EMEs. *Did all/most of the episodes in* *advanced economies occur during the eurozone debt crisis?* If so, this would be worth mentioning as it could explain the differential role of foreign vs. domestic currency assets/liabilities and of foreign reserves in EMEs only as opposed to the entire sample.

Third, future work could aim to further understand the relationship between private external debt assets denominated in foreign currency and the reduced probability of stress episodes in EMDEs. We also recommend further discussion on how the findings of this report can provide insights on strengthening the Global Financial Safety Net. *Also, we wonder whether there are any plans to develop country-specific numerical benchmarks for external stock imbalances, analogous to what is done for current account balances.*

We support the conclusion that monitoring currency mismatches appropriately requires timely data on the currency composition of external assets and liabilities. We welcome the cross-institutional effort to compile a new data set for this report and encourage staff to compile additional data sets on the currency composition of debt and foreign ownership of debt denominated in local currency, which would be useful for future analytical work.

We welcome the ongoing improvements to the ESR and would like to see this trend continued. We encourage staff to continue incorporating topical issues, such as the likelihood of external stress episodes in this edition, which help maintain the significance of the publication. We also welcome the progress in increasing transparency and comprehensiveness in external assessments, although more needs to be done. More details on certain aspects would be helpful, notably on the determination of current account norms, country-specific factors, and data gaps or inconsistencies. We note that data gaps are one of the main challenges for the quality of external sector assessments and would reiterate that members have a role to play by providing accurate and timely data, particularly in terms of foreign exchange interventions and reserves. We also see scope to enhance the consistency and evenhandedness of assessments and advice across members, notably by clearly articulating the use of staff judgement, where needed.

Finally, we reiterate that rigorous and candid assessment of members' external positions and policies is at the core of the Fund's surveillance mandate. Assessments of non-ESR countries in addition to the major economies help identify cross-cutting macro themes to inform surveillance. It is important to integrate the ESR's findings into bilateral and multilateral surveillance in a consistent manner. We encourage staff to address this in the Comprehensive Surveillance Review.