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Joint Statement by Mr. Ray, Mr. Lischinsky, Mr. Corvalan Mendoza, Ms. Moreno, Ms. Park, and Mr. Yoo on 2020 External Sector Report
(Preliminary)
Executive Board Meeting
July 24, 2020

We welcome the opportunity to discuss the 2020 External Sector Report (ESR). Rigorous, evenhanded and multilaterally consistent analysis of external positions can foster useful conversations about policy settings that would be supportive of addressing excess global imbalances.

The report shows that global imbalances are rather modest overall and are likely to be reduced further. We welcome the focus on forward looking assessments of the impact of the pandemic on external positions, including via the contraction in tourism and decline in remittances and risks to cross-border trade integration. More work on the potential medium-term impact via these channels, including beyond the ESR sample of countries, would be welcome.

We strongly agree that policymakers' near-term focus should be on dealing with the current crisis. Specifically, key policy messages from the ESR include:

- **Avoiding protectionist measures** – Imbalances are not a valid reason for protectionism, but rather a strong case for reinforcing the multilateral rules-based trading system, including a well-functioning WTO dispute settlement system. We support staff's assessment that the adoption of currency-based countervailing duties (C-CVDs) do not only pose a significant risk to the multilateral trade and international monetary systems but would also be counterproductive to the country adopting such measures. Care must be taken to ensure that the Fund's valuable analysis is not misinterpreted or misused. We are concerned about the possibility that the Fund's external sector assessment could be used to make the case for countervailing actions during a trade dispute. *Staff comments are welcome.*

- **Managing capital outflows and currency pressures** – Exchange rate flexibility has an important role in facilitating responses to shocks and foreign exchange intervention and capital flow management measures can also be useful in some contexts. IMF policy advice should be tailored to country specific circumstances and characteristics and be guided by results from the Integrated Policy Framework and IEO evaluation of IMF advice on international capital flows. This advice also needs to be mindful of the medium-term impact of the different measures. We look forward to upcoming Board discussions in the Fall.

- **Addressing risks of external crisis** – We agree that the IMF plays an important role in the global financial safety net. The broader use of precautionary facilities for those with strong fundamentals, where needed, early enough and at a credible scale, should reduce the probability that a country needs to draw on IMF resources, through commitment to strong policies and associated signaling effects to financial markets, and have positive spillover effects.

We agree that in the medium term, carefully calibrated policies are needed to achieve domestic objectives while contributing to external rebalancing. Recommendations regarding the macroeconomic policy mix should also take into account the cyclical context and avoid premature fiscal consolidation until the economy firmly recovers. Structural reforms have a role in addressing external imbalances, but policy advice has most traction with policymakers when it is clearly centered on domestic objectives, as implementation challenges often stem from domestic political economy constraints. In an environment of elevated uncertainty, the bias should be toward enabling flexible economies to make the necessary adjustments occur as efficiently as possible.

We are deeply uncomfortable with the treatment of precautionary and non-disbursing arrangements in Chapter 2, which risks undermining the Fund's overarching message on precautionary arrangements. We therefore strongly urge staff and management to revise the chapter before publication. Specifically, we think it is problematic to describe application for a precautionary or non-disbursing arrangement as a "stress event". The Fund's positive message on these arrangements has been, and ought to remain, that precautionary facilities are a prudent response to a potential balance of payments need. They are an endorsement of strong policy frameworks, seeking to boost confidence – aiming to avoid a crisis, not representing one. For qualifying countries, they are often a more desirable, less costly and less distortionary policy response than other options. Furthermore, including non-disbursing arrangements in the stress sample feels methodologically questionable – not least as it distorts the sample by excluding countries which have chosen not to apply for a precautionary arrangement (instead pursuing less desirable and/or less proactive policies), as well as countries with weaker policy frameworks who do not meet the qualification criteria.

We welcome the examination of the relationship between external stress and international investment positions in Chapter 2 but have some concerns about the

strength of some of the conclusions drawn from this work and resulting policy implications. One omission from this chapter is analysis of the factors that can mitigate the vulnerabilities associated with larger net debtor positions, including the development of hedging markets and deep and liquid FX markets. Similarly, while the work finds that in aggregate gross private external debt assets do not play a mitigating role on average, it would be useful to examine the intuition behind this result as our experience is that considering assets can be important in specific country cases. We would caution against too strongly drawing the conclusion that sustained current account deficits are associated with higher external stress, without considering the openness of the capital account, the depth and liquidity of domestic FX markets, of hedging markets and domestic credit market dynamics, as well as the domestic macroeconomic framework and institutions.

Staff are encouraged to continue to improve the reliability and relevance of EBA methodologies and be candid about the limitations of models and their conclusions to ensure that external sector analysis remains credible and persuasive. We encourage staff to continue to review and evaluate the effectiveness of their suite of tools, while seeking more relevant factors to explain the current account dynamics. *What plans do staff have for further refinement of EBA models, including to take into account the impact on the current account of global value chains and dominant currencies highlighted in the 2019 ESR?*