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Statement by Mr. Mozhin and Mr. Palei on 2020 External Sector Report (Preliminary)
Executive Board Meeting
July 24, 2020

We thank staff for the 2020 External Sector Report (ESR). The ESR is a useful, but rather technical exercise based on the previous year's data. Ideally, it should be a starting point for the in-depth discussions on the external sector developments intrinsically connected to fiscal policy, monetary policy, the health of the financial sector, and the prospects for structural reforms. Unfortunately, too often the ESR substitutes for such an analysis in bilateral surveillance, as country teams probably feel uncomfortable to question the results of the cumbersome Fund-wide exercise. We continue to question the value added by the ESR to the Fund's flagship reports, as it, at best, largely repeats key policy messages and, at worst, may even introduce unnecessary confusion and dilute the messages from the flagship reports.

In the new report the analysis of global imbalances and the relative role of current account surplus and deficit economies is similar to the observations made last year. China remains in a well-balanced position. The U.S., U.K., and Canada are among the economies with large current account deficits. Germany, the Netherlands, and a few other economies exhibit large, but poorly explained surpluses. Not surprisingly, the oil exporters and other commodity-dependent economies exhibited deteriorations in their current account balances.

The evidence on the developments during the COVID-19 outbreak provides interesting insights and, to a large extent, strengthens conclusions and recommendations offered by the Fund in the past. The COVID-19 shock was global and exogenous. Given the severe and simultaneous pressures, the crisis highlighted pre-existing vulnerabilities and/or the factors of resilience. Countries with limited foreign exchange reserves and without assured access to foreign exchange liquidity encountered difficulties. Economies with limited fiscal space, large public debts, lack of transparency with respect to contingent public sector liabilities experienced large swings in exchange rates. In addition, lack of clarity on the authorities' likely policy response arguably contributed to balance of payments pressures. Many economies have been downgraded by the credit rating agencies, closely reflecting the views of investors.

The risks to the outlook are familiar, as we have just had the discussions on the WEO and GFSR updates. One area which still needs deeper analysis and clear articulation is the so-called divergence between the developments in the real economy and the financial markets' exuberance. While the vigorous rebound in the financial market sentiment is interpreted as a disconnect between asset valuations and the underlying economic activity, and this disconnect is supposedly "raising the risk of another correction in risk asset prices", there is an issue of why asset prices should fall during the pandemic in the first place. According to the recent research by Nicholas Bloom from Stanford University, no other infectious disease outbreak in the past had more than a tiny effect on the U.S. stock market volatility, including the Spanish Flu as well as the influenza pandemics of 1957-58 and 1968, which resulted in the excess mortality rates in the U.S. roughly three times as high as the experience to date with COVID-19[1]. *Is it possible that the risks of financial market correction are lower than we think in the baseline?*

Chapter 2 addressed an important topic of the role of international investment positions in external sector behaviors. The analysis in this empirical study covering 73 economies offered additional arguments in favor of paying close attention to the structure of assets and liabilities, as different components have pronounced effects on vulnerabilities to the external stress. *In light of the findings in this chapter, would it be advisable for the Fund to reconsider its guidance on foreign exchange reserves within the 100-150 percent range of the ARA metric being an adequate buffer to protect members from the balance of payments crises*?

Finally, we believe that, in Chapter 3, the situation in Russia is described accurately. The Russian economy is resilient to a variety of external shocks, the current account surplus is aligned with the norm. NIIP is positive and close to 20 percent of GDP. Fiscal space is significant to accommodate gradual adjustment to external shocks. The Central Bank of Russia does not intervene in the foreign exchange market, while some transactions are carried out on behalf of the government guided by the transparent fiscal rule linked to the oil price. The inflation targeting framework proved its credibility, with inflation expectations

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[1] *The Unprecedented Stock Market Impact of COVID-19*. by Scott R. Baker, Nicholas Bloom, Steven J. Davis, Kyle J. Kost, Marco C. Sammon, Tasaneeya Viratyosin; NBER Working Paper No. 26945
Issued in April 2020, Revised in June 2020. https://www.nber.org/papers/w26945

being well anchored. It is gratifying to see that several years of difficult reforms did bear fruit.