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Statement by Mr. Bevilaqua and Mr. Barroso on United States
(Preliminary)
Executive Board Meeting
July 31, 2020

We thank staff for the detailed and insightful reports. We also thank Messrs. Rosen, Grohovsky and Shenai for their candid statement. The United States economy faced an abrupt shift from its longest expansion to the sharpest deceleration since the great depression, a direct result of the COVID-19 outbreak and the necessary containment measures. Fiscal and monetary policies have been appropriately used to respond to the shock and remain central to secure a sustained and strong recovery. Once the health crisis is contained, the key concern moving forward is to minimize economic scarring and avoid downside risks still lingering in the horizon.

The authorities' policy response has been unprecedented and commensurate with the shock, protecting household incomes, shielding the most vulnerable segments of the population and ensuring positive global spillovers. Fiscal policy delivered extraordinary support to households, mostly through substantial unemployment benefits and paycheck protection, perhaps filling a gap in the social safety net by keeping employer provided health insurance and supporting higher expenditure in health programs for low income families. Monetary policy brought unparalleled easing not only with large asset purchase programs, lower policy rates and forward guidance, but also with direct lending and purchase of corporate debt. Swap lines minimized extreme flight to safety pressures on the dollar and preserved well-functioning global financial markets and payment systems, reducing capital outflows from emerging and developing economies and avoiding negative spillbacks.

The sheer level of uncertainty at this juncture points to a wide range of possible alternative medium-term scenarios. We agree with staff that the most important downside risk to the outlook is the resurgence of the number of COVID-19 cases, leading to cautious consumption and investment behavior on the back of partial state-level shutdowns. We take note that the baseline does not incorporate additional fiscal stimulus, even though some form of targeted support as currently being discussed in Congress seems highly likely despite the political impasse. We echo the concern with protracted unemployment. The risk of a deflationary spiral is arguably low given the likely strong policy reaction from the Federal Reserve. We wonder however if staff sees limited policy space to cope with an additional large shock—for instance, a second wave of COVID-19 in the Fall—particularly given high public debt levels, the already extensive use of unconventional monetary policy to cope with the zero nominal lower bound and the available buffers in the financial system. *Staff's comments would be welcome.*

Poverty and inequality were high in the US relative to other advanced economies before the COVID-19 crisis, and there are significant risks of further deterioration despite the largely progressive nature of the fiscal policy response. The ongoing and likely persistent adverse effects of the containment measures on the most vulnerable segments of the population underscores the importance of some form of continued income support. The fact that inequality has an important racial dimension and the forceful signs of social tension in the streets attest to the urgency of the matter. Better targeted stimulus measures could unleash higher consumption potential than initial rounds of stimulus, particularly in the context of higher level of economic activity as the economy gradually reopens.

While we agree that current policies would not stabilize public debt, the unconditional statement in the report that debt is on an unsustainable path seems too strong. This opinion appears at odds with staff's advice of maintaining further multi-year fiscal deficits to restore full employment. In such a scenario, general government debt is forecasted to grow to 160 percent of GDP by 2030. We take note of assumptions that additional fiscal response should be constrained by debt sustainability, in the case represented somewhat arbitrarily by a 200 percent of GDP debt limit. Simply put, governments are expected to scale back from fiscal activism and implement appropriate policies in the medium run. Indeed, we agree with authorities that the United States has more than ample fiscal space to respond as necessary to the downside pressures and still reach a sustainable general government debt position. We wonder if staff should consider improved language and methodology for the debt sustainability analysis based on the ongoing MAC DSA review. *Staff's comments would be appreciated.*

The report puts forward a heterogeneous set of fiscal measures to help the US economy weather the ongoing crisis, some of them requiring more thorough elaboration. We see some merit in the idea of targeting personal income tax credits to vulnerable households and allowing for full expensing of new investment, pointing to the similar precedents in the recent tax reform. We agree that infrastructure should be a high policy priority. Other specific measures suggested in the report such as consumption vouchers would require more maturing before actual consideration by authorities.

Monetary policy should continue to support the economy, mindful of the constraints imposed by the zero nominal lower bound. Staff's forecast of inflation around 2 percent in 2021 seems quite optimistic given the protracted convergence of inflation to that level in the wake of the global financial crisis. This seems related to the staff's assessment of low potential output in the aftermath of the pandemic, which contrasts with staff's new estimate of a very protracted recovery of the output gap in the previous decade. *Are the current estimates for output gap and inflation consistent with the recent experience in the United States economy?*

Asset purchases are one of the most effective monetary policy tools to deploy in the current juncture, along with forward guidance, which is currently the object of an ample and informed debate within the monetary authority. We are not convinced by staff's characterization of asset purchases as mildly effective in lowering yields on treasuries and mortgage-backed securities with the increasing limitations imposed by low yields. Indeed, given asset substitution effects, asset purchases can affect the prices of other assets, well beyond those originally targeted for intervention. Also, we are not persuaded by the appropriateness of overly detailed propositions on forward guidance, such as communication of internally consistent projections and yield control strategies. This discussion should first mature within the Federal Reserve System for a full appreciation of the relevant tradeoffs. Meanwhile, the Fund should continue to invest in capability to follow and contribute at the proper fora with the technical and policy debate within central banks.

The resilience of the United States financial system has been a reassuring factor during the pandemic, even more so given the pivotal role of the system in the previous crisis. We welcome the suggestions to bolster relevant regulatory and supervisory institutions, pointing that stronger regulation and higher capital standards were key for the resiliency of the financial system during the pandemic. That said, we cannot lose sight that monetary actions were still necessary to support the liquidity and well-functioning of key financial markets. We take note that high corporate debt has not yet translated into liquidity or solvency problems, but we share staff's concerns with the energy sector, including the possible negative feedback into aggregate investment.

We strongly support the call for a cooperative approach to external sector imbalances and international trade. While recognizing the unprecedented level of uncertainty in external assessments, we take note of staff's view that the increase in private savings and decrease in investment will be largely offset by increasing fiscal deficits, contributing to maintain a relatively constant current account deficit. International trade under a fair, stable and rules-based system, with amicable resolution of conflicts, is key to support global growth and stability. Accordingly, we welcome the call for the US to continue its engagement with key partners to address perceived distortions in international trade and investment, preempting the escalation of tensions.