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

We thank staff for the report on the U.S economy and Mr. Rosen, Mr. Grohovsky, and Mr. Shenai for their informative Buff statement. We broadly agree with staff's appraisal and policy recommendations and would like to offer the following comments for emphasis.

The US economy entered the global COVID-19 crisis in a favorable economic situation with output close to potential, unemployment near the natural rate, and policy settings at neutral. The banking system left 2019 well-capitalized and with substantial liquidity buffers. However, a decade of low interest rates and steady economic expansion had led to a rise in balance sheet vulnerabilities. High levels of corporate leverage remain a main financial stability concern.

The US authorities have acted timely and forcefully to protect livelihoods and businesses and to mitigate the economic costs of the pandemic. The Federal Reserve has taken unprecedented steps to provide stimulus and liquidity. A range of fiscal measures are put in place. The pertinent question now is how much more fiscal and monetary stimulus is needed, and how much is feasible. Hence, we welcome the report's focus on the future direction of fiscal policy and options for additional monetary policy stimulus.

On fiscal policy, we agree with staff that more stimulus is needed, considering that the impact of further monetary policy easing is expected to be limited. We see merit in a stimulus package designed to address the deep-rooted social and economic challenges that the U.S. faces and environmental concerns, as staff suggests. We appreciate Box 7 on the potential size of the needed fiscal stimulus. The box is a good example of transparency regarding model calibration and the sensitivity of the results to the use of different assumptions, for instance on the output gap. The analysis demonstrates the difficulty of precisely assessing the right size of the stimulus package. *How does the fiscal package currently being discussed by Congress, compare with staff's recommended stimulus?*

Further fiscal stimulus should be targeted at the most vulnerable and help reduce the social challenges, including poverty. The relatively limited safety net and small automatic stabilizers compared to other advanced economies, and the severity of the COVID-19 crisis, suggest that the overall stimulus in the US should be large compared to other countries. Given the social challenges and the expected increase in already high poverty rates, we agree that it is appropriate to increase personal income tax credits and target them toward the most vulnerable. We see merit in staff's proposals to increase poor families' access to quality education.

Over the medium-term, measures to reverse the increase in public debt is warranted. The size of the fiscal packages, coupled with a lower level of nominal GDP, will cause a sizable jump in the U.S. debt-to-GDP ratio. We agree that the structural primary balance will, over time, need to be brought to a modest surplus in order to put the debt-GDP ratio on a downward path. This will also address the CA gap. We highly appreciate the discussion on medium term fiscal measures and Box 9 on transition to a low carbon-economy. We agree that low oil price provides an opportunity to significantly increase federal taxes on gasoline and diesel fuel. Moreover, a carbon tax and increased taxes on gasoline and diesel fuel would facilitate the transition to a lower carbon economy and potentially yield substantial fiscal revenues.

Ensuring transparency and accountability about the fiscal crisis measures is crucial. To this end, we agree with staff that federal and state governments should establish platforms to provide clear and timely information on the use of public monies. Given the size of the federal taxpayer-funded resources being deployed, it is particularly important that oversight bodies actively investigate potential fraud, waste or abuse and provide ongoing analysis and monitoring of COVID programs. We therefore welcome the three oversight bodies created by the CARES Act. *Staff's view on whether these new bodies have the necessary tools, access to information, and resources to fulfil their mandates and to coordinate with other oversight institutions would be welcome.*

We stress that trade barriers and tariffs are harmful for global trade and ineffective in reducing bilateral trade imbalances. Rolling back trade barriers as well as working with other countries to modernize and strengthen the rules-based multilateral trade system would be very beneficial to the global recovery and the US economy. We agree that potential countervailing duties represent a significant risk to the multilateral trade and international monetary system which could potentially escalate trade tensions, harming the U.S. economy and have negative spillovers.

On monetary policy, we commend the Fed for the swift and forceful measures that have taken place since the outbreak of the pandemic. Extraordinary actions to support the economy and maintain the smooth functioning of financial markets have been taken. This has had positive spillover effects on financial conditions globally and improved market access to new loans for a range of overseas sovereign and corporate borrowers.

Even with these strong measures, it is likely that both inflation and employment will remain below the Fed's medium-term goals for the next several years. We agree that this could exacerbate longer-term damage to the economy and create the risk of a de-anchoring of inflation expectations. A disinflationary path would be particularly problematic for the highly indebted households and enterprises. Hence, we positively note staff's assessment that, on balance, there is scope for more asset purchases to support a recovery. However, the side effects of a very accommodative stance should be monitored carefully and require further analysis.

We see merit in many of staff's suggestions on forward guidance, especially the idea to provide an internally-consistent projection with a set of alternative quantified scenarios that show the range of risks around the baseline. It is particularly in times like these, with tremendous uncertainty about the outlook resulting from COVID-19, that scenarios can give valuable guidance. The assumptions regarding key factors, such as the further evolvement of the pandemic (infection rates etc.), should be clearly communicated.

We agree that negative interest rates could represent risks to market functioning and financial stability that would be difficult to predict. We take note of staff's assessment that, on balance, the risk-reward trade-off for negative rates does not appear to favor the introduction of negative policy rates in the U.S at the current juncture. At the same time, other central banks have found negative interest rates to be very useful tools in avoiding deflationary pressures. This illustrates that continued analysis is needed to assess the pros and cons of different monetary policy measures to prepare for possible intensification of deflationary pressures.

On the financial sector, we positively note that the ongoing, real-time, economic and financial stress test experienced over the past few months has shown the U.S. financial system to be both resilient and flexible. Banks entered the current crisis with sizable capital and liquidity buffers. Nonbanks and capital markets have largely absorbed unprecedented shifts in portfolios, although distortions experienced in some key market segments need to be thoroughly examined. Moreover, as highlighted in the FSSA, the rise in corporate leverage and migration of risks to nonbank financial institutions compounded with ongoing economic disruption could result in a severe financial strain.

Institutional changes could further strengthen systemic oversight and reduce vulnerabilities. We see merit in the FSSA's proposal that an explicit financial stability mandate should be provided to all of the federal Financial Stability Oversight Council (FSOC) members and crisis preparedness efforts of the FSOC should be intensified. The development of macroprudential tools to manage systemic risks in the nonbanks remains an important priority.