GRAY/20/2774

July 29, 2020

Statement by Mr. Beblawi and Ms. Abdelati on United States
(Preliminary)
Executive Board Meeting
July 31, 2020

We thank staff for the rich set of staff reports and Mr. Rosen, Mr. Grohovsky and Mr. Shenai for their complementary Buff Statement. This is a particularly challenging time for staff assessments, but this consultation is also critical for the global outlook and we appreciate the priority it received. We firmly believe that staff assessments should not come as a surprise to the authorities. All analysis should be shared and the authorities must have a chance to respond—as a matter of good practice for all country teams.

We agree with the observation that prior to COVID-19, U.S. economic growth was strong and the economy was in its longest expansion. We also agree that the authorities' virus-response has been swift and appropriately forceful. The Federal Reserve acted swiftly to restore functioning of markets following a repricing of risk assets to avoid market turmoil. The Fed's easing by cutting rates and signaling they would remain near zero, and the broad-based support to stressed markets, including through emergency lending programs, helped preserve the flow of credit to the real economy.

We appreciate the Fed's readiness to support the economy for as long as needed. Options for further monetary stimulus are well laid out and still under consideration. We appreciate staff views on the potential to bolster the monetary support by scaling up asset purchases, and that the risk-reward tradeoff does not appear to favor resort to negative interest rates in the U.S. context. Staff also rightly raises the risk of low or even negative inflation, given the very large amount of slack in the economy.

The Fed's commitment to global stability is welcome. The dollar swap lines and the launch of a repo liquidity facility have helped to reduce strains in global funding markets. Indeed, these facilities have important positive spillovers and more countries wish they could have access to them.

The fiscal stimulus, close to 15 percent of GDP so far, has been broad based and multi-faceted, as required, to safeguard people and the economy from the pandemic, and consistent with the fiscal space available to the U.S. As in other countries, the authorities increased resources to healthcare providers, to state and local governments, assistance to small businesses, and to more affected sectors, such as airlines. In addition, the authorities provided cash transfers directly to households, more broadly than any other country, partly reflecting a smaller social safety net than other advanced economies. Indeed, large transfer payments have helped buoy household demand. As noted in the Buff statement, personal income grew by over 10 percent in April 2020, reflecting the large transfer payments, and the unemployment insurance payments provided funds in excess of their previous income for roughly two thirds of workers. *Could these payments have been better targeted or calibrated?*

It is clear that an ambitious fiscal package will be essential to accelerate the post-COVID recovery and in order not to place too much pressure on monetary policy. We agree with staff on the need to shift to more targeted support to incentivize new investments and not create disincentives for individuals to return to work. We also see a need to increase investment in infrastructure and to provide support to state and local government budgets to avoid countercyclical spending cuts to meet balanced budget rules. We see merit in staff's tax and social spending proposals. *What were the authorities' views on the potential size of the package, estimated around 10 percent of GDP over the three years, and on the use of vouchers to incentivize consumption?*

We support the pursuit of free and fair trade as a basis for U.S. and global prosperity. We support having a strong and effective multilateral trading system and see scope for some reforms to take account of new economic and technological developments. We are also concerned about the potential damage third party countries face from an escalation of trade tensions or continued trade policy uncertainties.

Looking beyond the pandemic, we agree that key longer-term challenges include implementing pro-growth policies, closing the infrastructure gap, and addressing the buildup of explicit and implicit fiscal liabilities. We also see a high priority to expand opportunities and to further build human capital with a focus on further strengthening coverage of the health system and narrowing quality variations in the education system, while making higher education more affordable. The concerns raised in this staff report also coincide with areas highlighted in the well-being indicators of the OECD Better Life Initiative.

Analysis from the FSAP confirms that the financial system is more resilient and flexible, having benefited from regulatory reforms, since the global financial crisis (GFC). We welcome the improvements made in several areas since the last FSAP.

- Regarding systemic risk oversight, we welcome staff's favorable findings. It will be important to continue to develop and refine macro prudential tools and to enhance data gathering and analysis to further improve systemic risk surveillance. The Chart on page 8 reflects the high exposure of nonbank investors to non-financial corporates—something that deserves careful monitoring. As noted in the AIV report, low inflation and a slow return of corporate earnings to pre-pandemic levels will combine to cause corporate failures to rise.

- Regarding the banking sector assessment, we note the overall positive assessment of strengthened regulations, improved quality and quantity of capital in internationally active banks, as well as higher liquidity and robust risk management practices. We also welcome the further enhancement of the recovery and resolution planning framework. *We note the disagreement with staff's views on the standards regarding not-internationally active banks and look forward to further staff clarification.*

- The FSAP confirms significant reforms in the supervisory and regulatory frameworks for securities markets, commodities markets, and financial market infrastructures. Important progress was made in implementing post-GFC reforms to OTC derivatives markets.
- We welcome the significant strengthening of supervision of the insurance sector, as a result of federal and state level efforts.

- Staff aptly recognizes the further strengthening of the AML/CFT regime, since the last FSAP with respect to identification of beneficial ownership and verification of customers. The framework was updated to be consistent with the FATF standards on virtual assets and their service providers.

- Continued communication with correspondent banks overseas about regulatory expectations and further guidance with respect to banks' remedial actions would help prevent unintended withdrawal of correspondent bank relationships in these jurisdictions.

- We support the authorities' call for alternative approaches, in the context of the FSAP Review, to assessing the quality of a country's stress testing in jurisdictions that have advanced practices, rather than conducting its own. We also look forward to proposals to streamline the exercise to be less burdensome on the authorities and to reduce intensive use of staff resources.