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July 29, 2020

Statement by Ms. Levonian, Ms. McKiernan, and Mr. Weil on United States (Preliminary)
Executive Board Meeting
July 31, 2020

We thank staff for their insightful Article IV and FSSA reports, and Mr. Rosen, Mr. Grohovsky and Mr. Shenai for their insightful and comprehensive Buff statement. We wish to extend our deepest sympathies to the American people for tremendous loss of life suffered at the hands of the COVID-19 pandemic.

We support the staff appraisal, and in particular support the view that, amid considerable uncertainty, the U.S. recovery is subject to important downside risks related to the path of the virus. The recent surge of infections illustrates the importance of continuing the focus on preserving lives as well as taking a data-driven approach to re-opening. The recovery is expected to be gradual, and staff are projecting a persistent widening of the output gap due to scarring effects. *Could staff comment on the relative contribution of unemployment, bankruptcies, and a reduction of capital formation to the widening of the output gap?*

We commend the authorities for their forceful policy response to the crisis, which has helped support households, businesses, and sub-national governments and has provided much needed liquidity to the financial system to help underpin proper market functioning. The U.S. has already mounted a very significant fiscal response to COVID-19, while the Federal Reserve's actions have supported activity and dollar funding markets, thereby contributing to the easing of global financial conditions. However, with critical income supports set to expire at the end of July, against a backdrop of rising infection rates and a slowing or reversal of re-opening plans in many states, it will be critical for the authorities to reach agreement on a renewed stimulus package to avoid a 'benefits cliff'. We took note of the recent proposal, under consideration by Congress, for further fiscal stimulus. *Can staff indicate how the recently unveiled proposal would (if adopted) impact the outlook and potentially mitigate near-term risks to the outlook?*

Issues of poverty and inequality have been exacerbated, as the most vulnerable groups have been disproportionally impacted by the crisis. The Fund's policy prescriptions to address the disproportionate impact of the crisis on vulnerable groups (via e.g. targeted tax credits, job training, and better access to education) are in line with the G20's plan to promote strong, sustainable, balanced and inclusive growth. We encourage the authorities to target the most vulnerable households as part of the next round of stimulus measures and to consider the Fund's advice for tackling poverty and inequality as part of a medium-term recovery plan.

The U.S. should work constructively with its trading partners to promote free and rules-based global trade. As staff point out, trade restrictions, rising tariffs and trade policy uncertainties have hampered global trade and investment and have triggered a cycle of retaliation. Failure to address policies that distort trade flows could potentially slow the crisis recovery. The U.S., Mexico and Canada Agreement, which came into effect on July 1, 2020, was a step in the right direction that has helped reduce uncertainty across a trading block representing over a trillion dollars in trilateral merchandise trade.

We commend the forceful measures taken by the Federal Reserve, which have included extraordinary actions to support the economy and maintain the smooth functioning of financial markets. We welcome the positive spillover effects on financial conditions globally and improved market access for other issuers as a result. We also agree with 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. We would welcome further analysis on the pros and cons of different monetary policy measures, as the inflation outlook continues to evolve.

We welcome the conclusion that the U.S. financial system appears resilient to an array of severe shocks, but there is scope to enhance oversight to further mitigate systemic risks. In particular, we welcome the stress tests results that support the conclusion that the banking sector, having improved liquidity and capital over recent years in response to myriad responses post-GFC, is resilient to a range of scenarios. But, with the pivot of some risks to the non-bank sector, we would highlight the importance of developing and deploying macroprudential tools to address vulnerabilities in that non-bank sector, a field which is at early stages of development internationally. *Could staff provide examples of macroprudential tools that were discussed with the authorities to address risks associated with rising corporate leverage?* The current conjuncture has illustrated the importance of crisis preparedness amongst financial sector regulators, and staff's recommendation - to provide explicit financial stability mandates to all federal FSOC members - would helpfully support that objective. We took note of the authorities' disagreement with staff's recommendation regarding the prudential standards that should apply to non-internationally active banks. *What is staff's response to this perspective?* One area potentially deserving of greater coverage in the FSAP concerns the role of ETFs in the corporate bond market. When liquidity in the underlying bond market became extremely poor in March, ETFs continued to function and became the main vehicles of price discovery.

We encourage the authorities to continue making progress against Fund FSAP recommendations, tailoring them where necessary. Against a backdrop of rising vulnerabilities amongst non-financial firms and non-bank financial institutions, we noted that three recommendations from the 2015 FSAP have been either fully or largely implemented.

We commend staff for making their reports relevant to the current crisis. Staff have gone to great lengths to tie their Article IV analysis and recommendations into the crisis, and the FSAP has been updated to incorporate crisis-related events. That said, the Article IV includes coverage of a range of structural issues that, while critical to long-term inclusive and sustainable growth, are not necessarily "crisis-related priorities" based on our understanding of the Fund's approach to Surveillance During the COVID-19 Crisis. *Staff comments are welcome, including on whether this Article IV consultation represents a model for Fund surveillance in the current stage of the pandemic?* The FSAP's recommendations on strengthening policy and institutional frameworks remain pertinent, but the analysis of vulnerabilities and risks may have been overtaken by events in some cases (e.g., the Financial Vulnerabilities Radar Chart was constructed using data from March 2020).