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July 29, 2020

Statement by Ms. Riach, Mr. Ronicle, Ms. Andreicut, and Ms. Campbell on United States (Preliminary)
Executive Board Meeting
July 31, 2020

We thank staff for the reports for the 2020 Article IV consultation and the Financial System Stability Assessment, and Mr. Rosen, Mr. Grohovsky, and Mr. Shenai for their insightful Buff statement. We welcome resumption of bilateral surveillance and we broadly agree with staff's assessment in both reports.

Article IV surveillance report

The US economy was in the midst of its longest expansion on record before the Covid-19 crisis shifted the economic outlook dramatically. We commend the authorities for their quick and assertive action to protect livelihoods and businesses to mitigate the lasting economic costs of the pandemic. We recognize the efforts of the authorities to restart the economy and note the positive impact this had on employment and output. However, we note the current worsening virus trajectory and apparent levelling-off of the economic recovery. We agree with staff that it is of particular concern that the number of Covid-19 cases in the US is still rising at pace. This presents significant downside risk to the economic outlook where recovery is contingent on effective containment of the virus.

- **Policy response to the crisis**

We broadly agree with staff's near-term projections on growth with a sharp fall in the second quarter and a rebound in the third quarter. We agree that there are significant risks and uncertainty around the shape and pace of the recovery given the further increases in infections since this report was drafted. This reinforces the need for the authorities to continue to act quickly and assertively to preserve lives and mitigate the long-term impacts on the economy. We note that the authorities saw little risk that the economy would be shut down again particularly given the improvements in public health preparadeness. Whilst acknowledging the complexity of policy making in a Federal system, we urge the authorities to continue to monitor the pandemic situation closely and take necessary steps to contain the virus given the economy cannot recover until the virus is contained.

Fiscal Policy

We commend the authorities for their swift and substantial fiscal policy response which provided substantial assistance to households, businesses and state and local governments. We agree with the authorities that the design of the fiscal support packages provided more resources to lower income groups. We note that data show that spending rebounded fastest for the bottom 25% of the income distribution and independent research concludes that this suggests that government stimulus programs so far have limited the effects of job losses.

We agree with staff's assessment that despite their large impact on the public finances, large fiscal stimulus was necessary to support the economy and virus containment efforts. The US has fiscal space so should use this space to provide the right support at the right time. This means providing support to households and businesses in the containment and stabilization phases and then carefully calibrated support to accelerate recovery. We agree that over the medium-term authorities will need to shift to put public debt to GDP onto a sustainable path but that this should only be once the recovery is well established. The appropriate timing and shape of the roll-back of fiscal support packages is a very significant challenge for the authorities in many countries – including the US and UK – and more detailed staff advice on factors to consider would be useful.

It is inevitable that the significant increase in debt levels gives rise to important vulnerabilities. The balanced budget requirement on all states bar one presents a significant and unique challenge. If unaddressed we agree that it will present significant macroeconomic risks and could exacerbate that the economic costs of the crisis being borne disproportionately on the poor and vulnerable.

Monetary Policy

We commend the Federal Reserve for the swift and forceful measures taken since the start of the Covid-19 crisis. These extraordinary actions supported the US economy, boosted demand and liquidity and ensured continued market functioning. We agree with staff that the extension of swap lines to a broader range of foreign central banks was effective in reducing strains in global dollar funding markets, which in turn supported the easing of global financial conditions.

We particularly welcomed the report's rich discussion of monetary policy options, against a backdrop of limited conventional policy space and the FOMC's wider framework review. This provided a comprehensive overview of potential options for further easing of monetary policy, to support the recovery from COVID-19 in the even that further stimulus is needed.

- **Trade**

We agree that the crisis has underscored the importance of open trade for the US and the global economy. We commend the authorities for avoiding the use of trade restrictions on critical health products and food which set a positive example to others. However, we note that the US still maintains the bulk of trade restrictions and tariffs that were imposed in 2018-19. We continue to believe that trade barriers are harmful for global trade and are unlikely to be effective in reducing bilateral trade imbalances.

We welcome the authorities' commitment to pursuing the benefits of open international trade and investment and the commitment to pursing a trade agreement with the UK. We recognize that there are shortcomings in the operation of the existing international trading system and believe that these are best addressed through reform of the World Trade Organisation rather than through tariffs.

- **Energy**

We agree with staff's assessment of the impact of the pandemic and the collapse of oil prices on the US oil sector. We note that the fall in prices has severely damaged the financial health of many US shale produces and oil field services companies and that this may leave long lasting scarring effects on the economy in the form of bankruptcies and permanent job losses if firms are not able to issue new debt.

We agree with staff's analysis that the US shale oil and gas industry will likely face difficulty adapting to the circumstances of the current crisis particularly if demand for oil and therefore prices stay low for a long time. The UK strongly advocates global policymakers using the recovery from Covid-19 to accelerate the shift to a lower carbon economy. As such we agree with staff that this presents a historic opportunity for the US to adopt fiscal policies that will facilitate a shift towards a more environmentally-sustainable economic growth model.

Financial Sector Assessment Program (FSAP)

The US FSAP is timely and valuable, given the size, complexity and importance of the US financial sector for global financial stability. We welcome the comprehensive report, including stress testing exercises, interconnectedness analysis and consideration of emerging risks. We also thank staff for the analysis of the effects of COVID-19 on the US financial sector. We agree that global post-crisis reforms have made banks more resilient and that capital losses in the stress test were manageable. We agree with staff that strong prudential rules contributed to a sound banking system.

While banks have weathered the COVID-19 storm well, we agree with staff that corporate leverage and the migration of risks to non-bank financial institutions (NBFIs) pose risks to financial stability. On this basis we think that staff are too sanguine on the overall resilience of the financial system. On corporate leverage, the results of the corporate sector stress tests are particularly sobering. We consider that the stresses witnessed globally in NBFIs in March were deeply troubling. We commend the Fed for their swift action to alleviate strains and restore market functioning in key US markets, but these actions have not resolved possible underlying vulnerabilities in NBFIs. There will need to be a collective effort in coming months to better understand how such strains emerged and to consider the appropriate policy response. To that end we welcome the authorities' participation in efforts at the FSB to better understand what happened in March. We also agree with staff that macroprudential tools for NBFIs are essential going forward, given the significant role played by US NBFIs in financial intermediation and the rapid expansion of non-bank mortgage lenders.

In the context of the ongoing FSAP review, we welcome staff's focus on emerging risks relevant to the US, including climate, fintech and cyber risk. We welcome the coverage of climate risks in the insurance sector and take note of staff views that carbon-intense assets do not represent a major asset class but that transition risks could nonetheless arise from transport or heavy industries which were not part of the analysis. But the insurance sector is not the only one subject to climate risks. Transition risks are also very relevant for the banking sector, particularly in the context of potential exposures to oil and gas companies. We consider that this FSAP is a missed opportunity for carrying out a banking climate stress test and for linking the challenges faced by the oil and gas industry outlined in the Article IV report to potential spillovers for the financial sector.

Turning to fintech, we welcome staff's analysis on the impact on banks of competition from fintech companies. We would also have welcomed a stand-alone analysis of the fintech sector and latest US developments. This could have included a positive focus on the benefits that fintech competition can bring. Finally, on cybersecurity, we take note of significant efforts made by the authorities to embed cyber risk preparedness into their oversight frameworks and agree with staff that cyber risk is even more relevant in the COVID-19 context.