GRAY/20/2793

July 29, 2020

Statement by Mr. Kaya, Mr. Just, and Mr. Harvan on United States
(Preliminary)
Executive Board Meeting
July 31, 2020

We thank staff for their reports, and Mr. Rosen, Mr. Grohovsky, and Mr. Shenai for their Buff statement. Prior to the COVID-19 shock, the US economy experienced the longest expansion in its history creating space to address long-term structural challenges and build buffers. The early and forceful policy response to the shock helped mitigate the impact on households and businesses and maintain the smooth functioning of financial markets. As the crisis drags on, the economic burden of the pandemic is disproportionately borne by the poor and vulnerable. We welcome the continued focus of this year's Article IV consultation on the long-standing problems of inequality and poverty and, in the context of financial sector surveillance, on the impact of emerging challenges including from climate change.

We broadly share the **assessment of the risks** including from Covid-19 dynamics and policy (in)actions. The economic recovery is subject to important downside risks related to the resurgent number of infections and an uneven public health response to the pandemic across states. Restrictive trade policies, including countervailing duties on imports, have negative consequences both for the US and global activity and remain an important downside risk. We positively note the progress on trade deals with Mexico and Canada as highlighted in the Buff statement. *We would welcome staff's update on the size of possible spillovers from a weaker US recovery and policy action to other regions.*

Fiscal policy helped cushion the initial adverse impact of the pandemic on economic activity with additional action being discussed, but medium-term structural challenges and accumulating debt dynamics remain unaddressed. We agree that policy interventions should continue to target firms and households that are most in need of support given the higher propensity to consume of low-income brackets and should serve as a stimulus to activity and job creation. We note the procyclical tightening at the local government level which is shouldering the public health response.

We agree with staff on the medium-term **structural fiscal challenges** that need to be addressed. The challenges include making the tax system more progressive and growth friendly while supporting the transition to a more carbon neutral growth model. Some of the upgrades of the social safety net should become permanent and reforms of the financing of health care should aim to deliver better health outcomes and lower costs. At the same time, a counter-cyclical fiscal stimulus can revive long-term growth with investment in infrastructure and human capital. *We note the revised potential output estimates and wonder whether staff has any estimates of how the 2017 Tax Cuts and Jobs Act has affected long-term growth.* A medium-term strategy to tackle debt sustainability should be formulated well before market pricing of sovereign risk becomes an issue and once the recovery takes hold. We note that needed reforms of the federal budget process leading to uncertainty in federal funding continuity remain unaddressed.

The **monetary policy** response to the pandemic has been forceful and timely and the Fed still has a range of options should the economy deteriorate further, or if financial markets optimism reverses abruptly. Medium-term consequences of the very accommodative stance need to be carefully monitored alongside incentives for financial risk taking and greater leverage. *Could staff provide an update on the monetary policy strategy review?*

We agree with staff that the US **financial sector** appears to be resilient not least due to the forceful actions by the Fed, but heightened vigilance continues to be of paramount importance as is the deployment of all tools at their disposal in case of a more prolonged economic dislocation. Given the globally systemic importance of the US financial sector, its innovative and technological leadership, US supervisory practices should continue to be at the global frontier both for areas were standards have been formulated but also beyond.

In this regard we appreciate that the FSAP goes beyond the standard exercise and sheds light also on those areas where the innovative capacity of the US financial industry has outpaced the development of regulatory best practice as this gives us a better understanding of the overall financial stability. More generally, we would see a more forward-looking approach to FSAPs that also discusses emerging policy challenges without being overly prescriptive as an important enhancement of the standard FSAP.

We note that progress on implementing certain aspects of the global regulatory reform agenda has been slower than desirable, which in conduct with some easing of regulatory burden may undermine the shock absorptive capacity of the financial system as a whole, especially during times of severe and prolonged stress. Given the impact of Covid-19 and notwithstanding continued or possibly additional policy support, credit quality of both households and corporates is likely to deteriorate further. It may therefore be prudent to strengthen regulatory tools in particular of Category III and IV banks with a regionally systemic footprint. This may help the authorities in addressing vulnerabilities heads on in a timely and forceful manner and would help to preserve their strength so that those banks can withstand the pandemic shock and support the economic recovery once the pandemic is more contained.

Likewise, SEC-led liquidity stress tests would in our view appear appropriate given the critical role of mutual and money market funds but also given global systemic liquidity interconnections. An added value of broadening the stress testing perimeter to the different segments of the financial sector would be the likely identification of regulatory blind spots that may need to be addressed by developing for example targeted macroprudential tools. *Staff's comments on whether a CCyb for category II to IV banks would be useful to mitigate* *risks would be welcome; equally, whether CCyBs for (systemic) nonbanks would be desirable and practically feasible or whether other tools could be considered.*

The deteriorating economic landscape may also pose mounting challenges for the insurance sector given its sizable interlinkages with the corporate sector. The valuation and capital framework for insurance companies may, at the current juncture, require some flexibility to cope with undue valuation volatility, but care needs to be taken not to undermine trust in the solvency of the sector overall.

In order to fulfill their complex tasks, the supervisory authorities should be adequately resourced and be budgetary independent with commensurate publicly accountability. An explicit financial stability mandate for the different agencies as recommended by staff could help in connecting interagency dots and overcome todays fragmented supervisory landscape.