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Statement by Mr. Bevilaqua, Mr. Saraiva, Mr. Fuentes, Ms. Mohammed, Mr. Antunes, and Mr. Barroso on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
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We thank staff for the insightful reports and underscore the importance of these comprehensive analyses to help guide the policy discussion in such testing times.

World Economic Outlook

On the back of strong fiscal and monetary policy support, the global economy is leaving the great lockdown recession behind and heading for two quarters of synchronized growth - albeit at different paces and under heightened uncertainty given varied infection and lockdown risks. Growth forecasts for most economies in 2020 have been revised strongly upward since the WEO June update. This points to overreliance, in the previous forecasting exercise, on general assumptions, such as average lockdown elasticities or policy effectiveness, overlooking country specific evidence – as clearly highlighted by several Board members back in June, and as might still be the case for some jurisdictions. Looking ahead, we call on staff to reflect carefully on the methodological lessons offered by the substantial revisions with respect to the previous forecasting exercise, even when accounting for the pervasive uncertainty. Since the last update, fiscal policy support has been extended, and global monetary policy pledged for low rates for even longer. Still, the recovery has been uneven across countries and sectors, with the service sector being a persistent and unusual source of concern, whereas strong consumption and retail recovery point to a less somber outlook for global trade, industrial output and commodity prices. In this sense, we welcome the inclusion of both upside and downside scenarios to the baseline, capturing the high degree of uncertainty in projections.

While medium-term scarring is a common feature of deep recessions, the current recovery faces even greater challenges, given the disruption in the service sector, the

lingering health issues and the increasingly limited policy space. We agree with the WEO concerns related to the scale of sectoral reallocation, the large human capital losses and important slowdown in capital accumulation. We take note of Box 1.3 result that 10% of jobs could be at risk from SMEs liquidity or solvency problems. However, the scale of the necessary support – and the risk or incentive problems linked with debt overhang and equity stakes – must be carefully weighed against the benefits from fast resolution. Moreover, attempting to lock workers into unproductive jobs can have a negative medium-run impact on its own. A difficult balance needs to be struck in supporting affected sectors, especially SMEs, and letting the healthy process of resources reallocation take place. We are also intrigued with why just a handful of countries in Figure 1.12 have growth deteriorating or stagnating well into 2025. *We wonder if recent structural reforms in several economies – including to facilitate labor market reallocation, bankruptcy procedures and credit market allocation – where fully considered to properly anchor country specific medium-term forecasts, or if general assumptions were again imposed on groups of countries*.

Against the backdrop of continuing need for fiscal spending in order to smooth the downturn and protect the most vulnerable, it is time for policymakers to begin weighing in the risks to fiscal sustainability. We support the WEO call for reallocation from wasteful spending and inefficient subsidies, along with smarter taxation and greater debt transparency. Moreover, keeping in mind the uphill battle with medium-term scarring, we agree it is important to facilitate resource reallocation and to nurture investment in high-growth industries – particularly where scale, coordination and externalities are an issue – increasing resilience to health and environmental shocks.

However, we do not support the unconditional call for suspending fiscal rules at the significant risk of derailing expectations – particularly in jurisdictions with initial signs of fiscal stress and steeping risk premia. Of course, in countries that have sufficient fiscal space and supporting yield curves, the benefits from fiscal spending could very well outweigh its costs. However, we warn that when it comes to policy advice this is certainly an area in which one size clearly does not fit all. And, in any case, the Fund should strengthen and expedite its work program on sovereign debt and be ready to offer ample support, including capacity building, where warranted. *That said, we call on staff and management to consider appropriately stronger qualifications in communication efforts, including in reference to large emerging market economies, keeping in mind the important market reactions that could result from IMF statements on fiscal rules suspension, or circumvention, in the current juncture, especially as domestic political economy considerations are not properly taken into account on those statements.*

Increase poverty and inequality following the great lockdown and its medium-term scarring are pressing issues for the international community. We take note of Box 1.2. warning that inequality in EMDEs might go back to 2008 levels. However, one must also acknowledge that unprecedented generosity and reach of transfers programs in large emerging markets have at least in one case contributed to a marked reduction in poverty and inequality – actually triggering a discussion on how to lock in such gains in a sustainable way. We strongly support the WEO call for greater multilateral collaboration to deliver vaccines on a global scale, in the context of generally limited fiscal space and institutional capacity constraints in LICs. We are concerned with the impact of the slowdown in trade, tourism and remittances, particularly for small and fragile open economies, pointing to the continuing need of multilateral support, including in the context of IMF facilities.

Global Financial Stability Report

Unprecedented monetary and financial policy accommodation has reduced near-term financial risks from its pandemic peak, perhaps at the cost of higher vulnerabilities that require close monitoring. We take note of the GFSR assessment that monetary policy in major central banks has compressed non-financial corporation credit spreads and emerging market sovereign bond spreads. On the positive side, this helps corporations and sovereigns navigate through turbulent pandemic times. On the other side, it presses corporations against interest coverage ratios and governments against debt service to revenue ratios, particularly over the medium run (or as soon as 2021 according to GFSR simulations). Policymakers will have to carefully balance targeting support to solvent corporations and allowing banks absorb losses of insolvent ones (on top of embedded regulatory flexibility). In principle, financial markets will help separate sustainable from unsustainable sovereign debt – even though the risk of panic and massive overreaction must be closely monitored. Where debt is unsustainable, debt resolution will have to proceed with extreme caution to avoid holdouts and disproportionate global externalities, buttressed by strong and viable adjustment with appropriate multilateral support.

As policy support is phased-out and becomes more targeted, synchronized loan losses in the global banking system could be another source of vulnerability – albeit seemingly manageable in the baseline scenario, given the strong capital position of banking systems and global systemic banks. That is indeed the broad conclusion of the GFSR global bank stress testing and support the call for clear guidelines for banks' handling of loan losses and for international bank resolution. Under the most stressed global downside scenario, the tests show that a number of EM banks could see some stress in common equity ratios, with 40% of assets linked to ratios below the minimum. This seems at odds with the demonstrated resilience of EM banks in stressed macroeconomic conditions, especially given the revealed preference of EM policymakers to provide emergency support to firms and households under severe stressed conditions.

Fiscal Monitor

A crisis like no other required an unprecedented policy response. At a global scale, the massive deployment of fiscal resources has been introduced by advanced and large emerging market economies. The public health and social assistance policies implemented around the world have been paramount to mitigate the pervasive effects of the pandemic. That said, the scope, structure and evolution of fiscal support across countries is wide-ranging and deserves very careful assessment and monitoring. In this context, staff's appraisal and recommendations regarding the policy response and macroeconomic projections has markedly evolved since the April update, as more data have become available and uneven outcomes surfaced. For instance, in emerging market economies fiscal responses to the pandemic have been generally more moderate relative to advanced economies (with the notable exception of Brazil), and projected deficits reflect the compound effect of large revenue drops and heightened health and social spending. In the case of low-income developing economies, the spending constraint has been more severe and have required intense budget reassignments to face the pandemic, as external financial support becomes available. Against this background, multilateral financing and policy guidance will remain critical as LIDCs fight the pandemic and work to enter the recovery phase.

As fiscal policy gradually transitions towards supporting reopening under extreme uncertainty, country-specific conditions and post-crisis challenges should not be overlooked. We welcome staff's proposition of a fiscal roadmap for the recovery and see merit on the initiative to divide the crisis into phases to highlight the main challenges and provide suitable policy recommendations. However, the recommendation about gradually transitioning away from accommodating health expenditures and social protection measures should be very carefully modulated and tailored to country-specific circumstances, especially in cases where debt sustainability and the credibility of the fiscal framework are at stake. Indeed, in the post-pandemic global economy, most countries, particularly EMDEs, will emerge facing substantial fiscal risks and sustainability issues.

Brazil mobilized a wide range of fiscal instruments to protect lives and livelihoods during the pandemic. Subsidies, state-owned enterprises' loans, and, above all, unprecedentedly large targeted cash transfers were used to shield the poorest households from the effects of the pandemic, allowing a significant part of the population to stay at home and practice social distancing, while sustaining domestic demand. The net impact of these emergency measures was not only a significantly better economic performance than forecasted by staff in the last WEO update – broadly in line with what the authorities and local dedicated analysts were anticipating at that time – but also positive effects on protecting jobs and curbing income inequality. Furthermore, these essential support measures explain the short-term fiscal impact documented in the Fiscal Monitor. Brazil is already scaling back many of the fiscal support measures implemented in the first semester and will resume its fiscal consolidation path in 2021, ensuring the unconditional application of the spending ceiling – its main fiscal anchor. Strengthening fiscal sustainability will remain a key priority going forward, and spending plans will abide strictly to the budget.

WEO – Analytical Chapters

The analytical work on chapter 2 of the WEO is of extreme importance, but we should avoid hastened policy conclusions given the ongoing nature of the pandemic. Taking stock of the economic and public health effects of the lockdowns imposed by several governments earlier this year is a key research priority and certainly a suitable topic for a WEO analytical chapter. Staff makes a very convincing point that lockdowns should be studied side by side with voluntary social distancing. We second the assessment that simply lifting lockdowns is unlikely to rapidly bring economic activity back to potential if health risks remain high, particularly in places where a significant proportion of the populations have the means to self-isolate. We also agree that, considering the protracted economic effects of the pandemic even after the lifting of lockdowns, policy support should be scaled back as gradually as warranted by fiscal sustainability considerations. Still under assessment is the general claim that strict lockdowns tend to be less economically disruptive, since they would be more effective in containing the pandemic, allowing for a faster economic recovery on the back of reduced voluntary social distancing once the lockdown is lifted. We call on staff to closely monitor the developments in Europe, where lockdowns may have to be re-imposed. Overall, we believe that local authorities and health experts are generally much better placed to define the adequate public health responses to the pandemic, accounting for country specificities that cannot be overlooked.

WEO Chapter 3 offers solid new arguments in favor of combining carbon pricing with a green investment push in order to achieve the reduction in global carbon emissions consistent with a limited increase in global temperatures. Staff's analytical work builds on a large scientific and economic literature addressing the causes and consequences of climate change, a key global challenge of the twenty-first century. Although staff's engagement with this important issue is warranted, we missed more specific attention to the role of the IMF in helping the membership tackling climate change – both from the perspective of mitigation and adaptation. The green investment push proposed by staff is a welcome addition to more consolidated strategies such as carbon pricing. Nevertheless, important questions about the fiscal sustainability of that push in the delicate current global situation remain open – particularly regarding developing countries. Going forward, we call on staff to explore fiscal solutions to finance the suggested green investment push, including by devising ways to increase the flow of grants and concessional funding to developing economies.

GFSR – Analytical Chapters

Since the global financial crisis (GFC) in 2008, the case for central banks to resort to the use of unconventional monetary policy has been well documented. During the GFC, advanced economies utilized asset purchase programs (APPs) to reduce financial market stress and contain adverse effects on output. While the experience of those economies has guided the actions of central banks in EMDEs in the use of APP, it must be noted that policy rates were generally lower in advanced economies a decade ago and the programs were somewhat different in scope. It would be important to monitor the effectiveness of these APPs not only in the short term but also in the medium term when the beneficial effect tends to be overshadowed by costs. Moreover, research has shown that APPs may not be always successful at boosting credit creation and may even result in an increase in implicit firm default rates, thereby increasing risks to financial stability. We are particularly interested in future research work on APPs in EMDEs as it will add to the body of knowledge and assist countries to effectively employ this unconventional policy measure when circumstances require.

While the main text provides insightful and welcome inputs for central banks in considering benefits as well as monetary policy and financial stability costs of APPs, the related figure 2.9 is highly misleading. For instance, while the main text discusses the effect of institutional quality and credibility of central banks, the figure uses obscure, non-financial sector specific, mostly perception-based indicators of government effectiveness and regulatory quality. The graph cannot convey or illustrate the point made in the text. Moreover, a figure about regulatory quality in a financial stability report, when discussing unconventional monetary policy, is highly suggestive that the indicator refers to financial sector regulation, which is not the case. Finally, the source is also somewhat opaque, as the World Bank assembles those indicators based on indicators from numerous other sources of varied nature and we have already agreed on how to cite them in IMF papers. Panels 3 and 4 in that figure are also poor illustrations of the points that are made in the text. Hence, we urge staff to consider deleting this misleading figure in an otherwise very useful chapter.

The assessment of key policy announcements on corporate funding liquidity in chapter 3 of the GFSR suggests that policies that directly support firms with vulnerabilities were most effective in mitigating their financial strains. We agree that premature withdrawal of policy support could jeopardize the success achieved so far in meeting firm's liquidity and funding needs. While we appreciate the analysis provided, we know that the performance and financial position of firms vary widely, particularly across sectors. In this regard, we believe that a sectoral disaggregation of firms with vulnerabilities would provide greater insight into the analysis.

Chapter 4 of the GFSR provides a very useful analysis of the challenges the Covid-19 pandemic has posed on bank capital and policy response. It quantifies unprecedented measures undertaken by supervisory bodies, such as the capital adequacy policies and government loan guarantee programs and discusses the potential impact on the solvency of the banking system. We think that this line of research is very useful as it provides guidance on whether the measures have successfully eased the pressures facing the banking system amid the Covid-19 pandemic and we strongly encourage staff to continue with this informative work. We take positive note that the analysis shows that the global banking systems would remain solvent in the coming years, partly due to buffers accumulated after the GFC. While we are aware that some banks are unwilling to utilize their buffers, we hope that a stronger approach would be used to encourage banks to use their buffers effectively to ease capital and liquidity constraints during challenging times.