GRAY/20/3013

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September 28, 2020

Statement by Mr. Fanizza, Mr. Massourakis, Ms. Quaglierini, Mr. Spadafora, Ms. Cerami, Ms. Korinthios, and Ms. Mateus on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for a set of very informative reports. We broadly share the staff's overall assessment of the global macro-financial outlook and related vulnerabilities and risks magnified by the COVID-19 crisis; we also broadly support the reports' recommended policy priorities differentiated according to the evolution of the pandemic in each country. We welcome the additional emphasis on the difficult policy tradeoffs and the need for more effective policy design to improve them and create room for crisis countermeasures to foster a durable recovery. We would have appreciated more emphasis on how policies could defuse deflation risks that constitute a threat to both financial stability and public debt sustainability. We would like to offer the following comments on the main messages of each of the three flagships.

World Economic Outlook

- **We agree with staff that monetary, fiscal and financial policies should aim at escaping more adverse scenarios by supporting the recovery and limiting the longer-term scarring from the pandemic**. While the global growth outlook has improved since the June WEO Update, the pandemic keeps ravaging economic activity and new outbreaks prevent fundamental uncertainty from declining; setbacks in reopening the economies remain a concrete threat to a robust and sustained recovery. These conditions call for a risk management approach to economic policy, whereby a relatively more aggressive response is justified by the need to provide insurance against the worst possible macroeconomic outcomes.
- **We fully share the staff's well-documented view that liquidity pressures in the corporate sector could morph into solvency problems in the event the nascent recovery fails to build momentum**. A sharp rise of insolvencies in the corporate sector –

notably for small and medium enterprises (SMEs) – would be accompanied by higher NPLs and a repricing of risk, ultimately testing the resilience of the financial system with potential second-round negative effects on the real economy. Given the so far fundamental role played by the policy response to the pandemic in stabilizing financial markets, prematurely withdrawing policy support would be an indefensible policy mistake, one that could "solve" in the most disastrous way the apparent disconnect between financial markets and the real economy. Thus, we believe there is a need to continue maintaining – if not reinforcing – a supportive macro-financial policy stance to contain still dominant and substantial downside risks. In particular, an abrupt deterioration in investor sentiments and attendant sharp adjustments in asset prices – triggered by doubts on either continued policy support or the timing of the recovery – could endanger the stability of financial markets.

- **However, we also believe that at this juncture the main threat to financial stability is macroeconomic risk – namely a failed recovery and deflationary pressures – rather than excessive risk taking**. The pandemic has already resulted in a broad-based decline in actual and expected inflation and a combination of forces may exert further downward pressure on aggregate demand. Considering that substantial economic slack is projected to persist well into 2022, staff's projections that headline inflation in advanced economies will double between 2020 and 2021 (to 1.6 percent) may turn out to be overoptimistic. *Staff's comments are welcome.* We appreciate the WEO's recognition (p. 23) of the risk of disinflation in advanced economies, although we believe that the circumstances under which this risk may materialize are broader than the ones envisaged by staff (i.e., concerns on the limits of monetary policy). Against this background, monetary policy should remain firmly accommodative well into the foreseeable future to pursue medium-term price stability.

Fiscal Monitor

- **We appreciate the focus of the Fiscal Monitor**, with its preliminary assessment of the fiscal response to the pandemic and a categorization of desirable fiscal policy responses moving forward. This insight is useful for countries still facing hard policy choices. We broadly agree with the policy advice, tailored to the three identified phases of the pandemic. As health measures are scaled back, fiscal support can be better targeted to the most affected companies, sectors and workers, while fully taking advantage of existing automatic stabilizers.
- However, like staff, **we believe that government support should not be unwound too fast, being preferable to err on the cautious side**, to avoid further scarring of the economy and a worsening of poverty and inequality The pandemic has already had adverse effects on the most vulnerable categories of the population, particularly younger people and women, as recognized in Chapter 1 and Chapter 2 of the WEO. It will be of utmost importance that the policy response involve targeted measures to support youth and women in order to avoid long-lasting effects on their employment opportunities, a further widening of intergenerational and gender inequality, and ultimately a decline in labor force participation and growth prospects.

- **We agree that the policy response – including the mix between broad-based versus targeted measures – needs to be flexibly adapted in the face of accumulating evidence on the pace of the recovery and the actual impact of the pandemic across sectors and firms**. A shifting of fiscal resources to enhancing social safety net – given the disproportionate impact of the pandemic on low-wage earners – and boosting public investment should be an integral part of the policy adaptation process, along the lines of the comprehensive staff's analysis in Chapter 2 of the Fiscal Monitor.
- **Fiscal policy should create the incentives to foster a more balanced growth model, in terms of intertemporal, intergenerational and social equity in a third phase of the pandemic**. In this regard, we welcome the interesting analysis of the necessary policies to reduce carbon emissions. We agree with staff that, given the magnitude of the risks from climate change, the COVID-19 crisis provides an opportunity to promote the transition to a low carbon economy by implementing ambitious policy actions to reduce emissions. Undoubtedly, this requires a global effort. We are strongly committed to decarbonizing the economy and adhering to the Paris Agreement; countries should find the right policy mix to attain those goals. Such mix should also encompass appropriate financial policies aimed at fostering sustainable finance and support private investments in the green economy. Finally, while we broadly share the policy advice, we acknowledge that reality is more complex and **would welcome that future Fiscal Monitors also consider actual hurdles to policy implementation and practical solutions**.

Global Financial Stability Report

- **We concur with staff that the banking sector has proved to be broadly resilient so far, thanks to the post-GFC strengthening of capital, liquidity and leverage requirements**; further substantial support has come from the array of policies adopted by national authorities to shore up the economy and preserve banks' ability to lend. In this regard, we share the staff's view that financial supervisors and regulators have appropriately undertaken to allow full use of the flexibility embedded in the regulatory framework. We also welcome the staff's recognition that the guidance on regulatory loan classification standards and provisioning requirements has effectively complemented liquidity support and lending facilities by central banks in facilitating banks' provision of credit to the economy.
- **We welcome the GFSR's roadmap for monetary and financial sector policies at different stages of the crisis and the emphasis on the need to maintain policy support**. We also agree that policymakers may need to shift their focus to ensure well-targeted solvency support of viable firms while developing effective strategies to deal with the private sector debt overhang, particularly in the corporate sector, as well documented in Chapter 3 of the GFSR. The potential impact of liquidity strains in the corporate sector on banks and nonbank financial institutions should also receive greater emphasis in the post-pandemic regulatory reform agenda, which we believe could be best framed as a continuation or resumption of the unfinished post-GFC reform.
- Indeed, **lessons from the GFC are being reinforced by the COVID-19 pandemic**, as evidenced by the still elevated fragilities in nonbank financial institutions, which remain

largely outside the radar screen of financial authorities in many jurisdictions. Even within the banking sector, progress toward greater resilience in small local banks has been much slower compared to GSIBs; as smaller banks are generally more exposed to the sectors most affected by the pandemic, they now face more challenges. We, thus, agree with staff that a well-sequenced financial regulatory agenda that preserves the vital intermediation function and the stability of the financial sector is essential.