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STRICTLY CONFIDENTIAL

September 28, 2020

Statement by Mr. Rosen, Ms. Shortino, Mr. Grohovsky, Ms. Lyngaas, and Ms. Robitaille on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020

The Fall 2020 WEO, GFSR, and Fiscal Monitor (FM) come at a pivotal moment in the crisis. On the positive side, the global economic contraction may be less severe than anticipated at 4.5 percent in 2019 vs. the 5.2 percent forecast made earlier this year, and there are nascent signs of economic recovery particularly in advanced economies. At the same time, uncertainty about the trajectory of the virus and the measures needed to contain it remains high, with lack of clarity around the timing and efficacy of new treatments and vaccines. Further, a number of large economies continue to face increases, or in some cases resurgences, in the number of confirmed COVID cases, and some countries are partially reinstating lockdown measures.

What is clearer is that the scale of the policy response in most countries, coupled with a range of innovative approaches, has greatly mitigated the severity of the economic crisis. In the absence of such policy support the outlook for the global economy would look far bleaker. Notably, the GFSR highlights that the impact on the financial sector has been buffered by policy measures to support market functioning and credit flows. **We stress that premature withdrawal of policy support poses risks for the global recovery. At the same time, with fiscal space declining and debt levels rising precipitously in many countries, future policy measures must be well-targeted.** Despite the economic rebounds projected by the WEO, GDP in many countries will remain below its 2019 level—well below in some countries. Amid this situation, policymakers need to begin tackling structural reforms in a prioritized manner so as to lay the groundwork for stronger, more sustainable growth. The journey through this crisis is far from over.

As we have stated in the past, we would have appreciated greater integration among the documents, particularly given the depth and breadth of the fiscal and monetary responses.

Indeed, now would have been an opportune time to produce a single overview document pulling in the messages from all three flagships, rather than delivering three separate executive summaries and chapter ones. We urge staff to consider this as a possible innovation for future WEO/GFSR/FM reports. We also would have welcomed more country-specific examples of policy measures, along with a forward-looking assessment of countries' investment plans.

Economic Performance and Outlook

While we welcome the upgrade relative to June's projections, the forecast remains subject to heightened uncertainty. The global economy remains in a deep hole, and while advanced economies have experienced some improvements in the trajectory for growth, some emerging markets face a worsened outlook. Even in the best-case scenario, where a health solution allows for widescale reopening and resumption of activity, the depth and persistent effects of higher unemployment and heavy debt are likely to cause long-term scarring that will require consistent attention by policymakers.

Though the Fund's forecast has improved, we note that its projections remain on the low end relative to those of other forecasters. Given the high uncertainty around the baseline, we do not doubt that a weaker forecast may well be more accurate. That said, we have reasons to believe there are opportunities for potential upside to future economic outturns. For example, the U.S. Article IV projected a real GDP contraction of 6.6 percent this year. Less than two months later the WEO has revised the contraction upward to 4.3 percent thanks to more positive outturns in the second quarter, and we continue to see additional positive data emerge. More broadly, consumers, businesses, and governments are finding ways to adapt to our new reality, and as noted in FM chapter 2, investments in digitalization may be paramount in allowing for further adaptation.

The FM documents the extensive actions to date taken by our authorities—estimated at nearly $12 trillion globally, and provides some detail on the depth and breadth of the different measures deployed. These actions have led government deficits to surge by an average of 9 percent of GDP in 2020, and public debt will approach an estimated 100 percent of world GDP, a record high. As countries move into the recovery, and particularly the post-pandemic phase, our focus should necessarily turn to addressing these risks—particularly for countries at high risk of debt distress.

Policy Recommendations

We generally agree with the WEO's recommendations for near-term policy responses, including continued fiscal support and monetary accommodation. We especially appreciate the reference that sovereign debt incurred to support the recovery, particularly for investment, can pay for itself down the road through a larger economy and tax base. Given the uncertainty, it is critical that policy makers maintain support and only scale back their response once they are certain the crisis is behind us. We must not make the mistakes of the Global Financial Crisis, in which fiscal support was withdrawn too quickly, stalling recoveries and sending some economies into another recession. This should be a key public message coming from the WEO's release.

Policy makers must also be careful not to backslide on efforts to reduce longstanding external imbalances. High current account surplus countries, particularly in Europe, must take steps to boost demand and contribute to European and global rebalancing. The Chinese authorities should not resort to a growth model that is heavily dependent on exports and unproductive investment, financed by off-balance-sheet borrowing, at the expense of stronger consumption. This message should also be more prominent in the Fund's public messaging about the recovery. Rectifying long-standing imbalances in the global economy remains a top priority and one that is squarely in the Fund's mandate. This recovery is a unique opportunity to tackle issues that have plagued the global economy for decades.

We agree with Chapter 1 of the FM that countries' fiscal responses should be tailored to each phase of the recovery. As many members are still cycling between the first and second phases, the situation will likely remain highly uncertain for some time. Based on country-specific circumstances, the move to the post-pandemic phase must involve a shift away from exclusively providing social insurance to producing jobs by taking actions that promote lasting growth. With regards to inequality, we would have liked to see the FM include policy recommendations to raise overall wages, which in turn should help improve living standards for all, rather than focusing so heavily on progressive income tax policies, which may not be appropriate for all country circumstances.

We welcome that Chapter 2 of the FM emphasizes the importance of scaled up investment in infrastructure as a way to boost future output, particularly in the context of limited fiscal space. As countries shift to the recovery phase, they should speed up projects in the pipeline and plan for new projects that are aligned with post-crisis priorities and health realities, but it remains important that they focus on project quality in addition to quantity. *In that regard, will staff be offering advice to EU member states on their recovery and resilience investment plans?*

The GFSR's recommendations on the need for considerable monetary policy accommodation are entirely sensible. The baseline forecast of 5.2 percent growth in 2021 on the heels of a decline of 4.5 percent this year assumes a continuation of unprecedented monetary accommodation, though downside risks remain sizeable. Once the pandemic is under control, we agree that liquidity support should be removed slowly. And, given the additional leverage taken on by already debt-laden corporates to deal with the effects of the pandemic, proactive efforts to deal with debt overhang will need to be considered.

Debt

A persistent theme in the WEO, GFSR, and FM is the issue of rising debt among sovereigns and corporates. In particular, sovereign vulnerabilities have grown as fiscal deficits have widened to support economic activity. While the near-term priority remains the fiscal response, for many countries unsustainable debt positions will serve as a binding constraint to further fiscal stimulus. Debt moratoria and early action on restructurings will be a necessity for some countries in the period before a recovery a can take hold. We should be cognizant that past economic recoveries have been hindered by impaired balance sheets and debt overhangs. As we move out of the crisis, addressing unsustainable debt levels must be a priority.

It will be critical that all major creditors take timely and transparent steps to support debt sustainability over the near and medium term, particularly for those low-income countries facing high risks of debt distress or unsustainable debt positions. Without such action, the IMF and other international financial institutions will continue to face constraints in the extent to which they can deploy much-needed financing. We welcome the references in the WEO to the importance of debt transparency, which is even more critical in the current context of rising debt challenges. We also emphasize that the Debt Service Suspension Initiative (DSSI) and the Fund's Catastrophe Containment and Relief Trust (CCRT) both play a key role in providing low-income countries with needed debt relief. We urge all creditors to participate in both initiatives. The United States has participated fully in the DSSI, and we continue to explore a contribution to the CCRT to support the Fund in this effort.

We share the concern of this and prior GFSRs with the increasing leverage in the non-financial corporate sector. We appreciate staff's adverse scenario analysis in Chapter 4, but given the far-reaching macroeconomic and financial implications of high and rising non-financial corporate debt, we feel additional analysis could be warranted beyond two scenarios of stress to the financial sector. There is scant research on the distribution of non-financial corporate debt within the financial sector, and aggregates mask jurisdictional and sectoral concentrations, where the largest vulnerabilities may lie. *Has staff considered extending its work to include a detailed mapping of non-financial corporate stress to the financial sector?* We also note that the GFSR sets out only briefly the huge increase in sovereign debt held by local banks in several emerging market economies; one interpretation is that local banks also serve as lenders of last resort to the sovereign in time of stress. *Do staff agree?* Our concern is that the rise in debt held by banks increases the potential for adverse feedback loops between sovereign and banking insolvency.

Other Topics

<u>Lockdowns</u>: While we acknowledge that the issue of lockdowns and their associated

economic effects is a critical topic in our current environment, we believe this chapter would have been more appropriate in next April's WEO, once the data become clearer and we have a better understanding of the impact of flare ups over the summer. It is clear that lockdowns can reduce infections substantially, and we agree with the need to maintain policy support after lockdowns end. But further research is required to substantiate conclusions that the pace of recovery depends on the severity of a lockdown. Further, the chapter fails to account for an evolving understanding of the effectiveness of different health measures in responding to the crisis. Whereas a broad lockdown may have been more appropriate in the early stages of the crisis, a more targeted approach incorporating new data on how the virus spreads may be more effective moving forward. It will be important for the Fund to be careful not to overstate its conclusions in its messaging around the findings of this chapter.

Green Recovery: Regarding the WEO chapter on mitigating climate change and the FM's references to green investments, we stress that, in a period where policymakers need to be focusing on stabilization and recovery, there should be a clear understanding of the extent to which scarce fiscal resources should be allocated towards a green recovery. For many countries, climate cannot be characterized as immediately "macro-critical" in this context, and the impact of mitigation and carbon emission reductions on longer-term growth remains fraught with uncertainty. We would also caution that the Fund should appropriately caveat conclusions around a "comprehensive package" in its public messaging, given the high uncertainty around the estimates. Finally, we had concerns with the chapter's approach of promoting green investment at the expense of other technologies.

We also find references in the FM to the job-creation potential of green investments to be lacking in solid empirical research. The data extrapolate estimates for advanced economies to low-income countries, where evidence appears to be weaker with respect to the labor intensity of some of these investments. We are concerned that extrapolating estimates to this degree will in effect downplay the economic trade-offs involved in promoting green investments. While we agree that these investments may make sense in some instances as part of a diverse suite of infrastructure and technology investments, it is important to accurately account for higher costs, particularly for those countries operating under significant budget constraints.

U.S. Lending: We share staff's interest in the U.S. commercial banks as uniquely experiencing tighter lending standards in Q2. At the same time, we feel that ascribing this development to differences in policy responses is premature. As staff are aware, commercial banks in the United States hold a much smaller share of corporate debt than banks do in other G7 countries. Corporate credit held by banks is less representative of the broader landscape of U.S. corporate credit, with sectoral and quality concentrations that can easily skew results. *Have staff considered these issues in their analysis?*

Conclusion

Looking ahead, the Fund will need to remain vigilant in this time of uncertainty, identifying potential risks and providing targeted policy advice to help countries transition from crisis to recovery. Baseline forecasts will remain subject to heightened uncertainty, particularly as the health situation evolves, and frequent updates on these forecasts will be material to inform our understanding of the global trajectory. We would also appreciate more clarity in future WEOs on the medium- and long-term policy measures, including how best to prioritize and sequence these measures and how best to apply these to individual country circumstances.