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September 28, 2020

Statement by Ms. Mahasandana, Mr. Tan, Mr. Anwar, Mr. Srisongkram, and Ms. Susiandri on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the well-written set of reports and high-quality analysis. We broadly agree with the assessment and recommendations and offer the following comments.

World Economic Outlook (WEO)

The global economic outlook has improved but the recovery ahead remains uneven and highly uncertain. While economic activities have started to recover with the gradual re-opening in many countries, the recent uptick in COVID-19 cases could prompt countries to re-think the pace of reopening. Staff has rightly noted that even the baseline projection remains highly uncertain. In this regard, we see that scenario analysis and appropriate policy advice to address challenges in each scenario would be useful to provide a more complete picture of the potential risks and uncertainties surrounding the forecast as well as help authorities calibrate their policy response to ensure resilient recovery.

- *We note that the upward revision of the 2020 growth forecast is mostly driven by AEs, while the outlook of EMDEs has been revised down, particularly for the ASEAN-5 economies. Could staff elaborate on the drivers of the downward revision for ASEAN-5 economies?*
- *We share the view that prolonged pandemic and possible resurgence in COVID-19 cases are key downside risks. This could also be exacerbated by shifts in financial market sentiment, especially as there remains a disconnect between financial market developments and real economic activities. Hence, we underscore the importance of policies that are well-tailored and prioritized to address the short-term pandemic risk and long-term challenges on potential growth from macroeconomic scars. We invite*

staff's comments on how to mitigate the risk of sharp market corrections due to a sudden shift in market sentiment.

The Fund should continue to tailor its policy advice especially as different countries are still in varying stages of the crisis.

- We share staff's view that policy priorities in the near term should focus on ensuring adequate resources for health care and limiting economic damage. This unprecedented crisis requires exceptional policy responses as reflected in the actions taken by country authorities, including asset purchases programs (APP), which is a new endeavor for many EM central banks. Country authorities will need to consider all available policy tools and the appropriate policy mix. In this regard, the Fund should provide tailored policy advice such as how monetary and fiscal policies, as well as other policy tools such as foreign exchange interventions (FXI), capital flow measures (CFM) and macroprudential measures (MPM), could complement each other to achieve optimal outcomes and address concerns, such as perceived fiscal dominance, etc.
- As economies reopens, policy goals should shift towards supporting the recovery process while minimizing the risk of scarring. Until recovery takes hold, we agree that premature withdrawal of policy support could be detrimental and the preparation for unwinding these policies will need to be carefully thought-out and well-planned. The Fund should stand ready to provide policy advice in better targeting the support measures as the membership navigates the recovery.
- The low-for-long environment will continue to pose challenges for EMDEs during the stabilization phase as well as in the post-pandemic world as they will once again be dealing with the adverse impact of cross border spillovers and capital flow volatility. It is therefore critical that EMDEs are well-equipped with all available policy tools. In some circumstances, FXI have been used and will continue to play a role in curbing excessive volatility. Recent research has also suggested that CFM may be a useful part of the financial stability framework, along with MPM. Thus, we welcome the IPF work and encourage staff to operationalize its finding into Fund advice expediently.

Beyond the pandemic, Fund policy advice should focus on helping member countries address medium-term challenges and secure resilient economic growth, including through boosting growth potential, resolving debt overhang, reducing inequality, and promoting a greener recovery.

- We encourage staff to conduct further study on issues such as the scarring effect and the corresponding policy response, and the impact on global value chains. Given the potential withdrawal of fiscal stimulus and future fiscal consolidation, the role of the private sector would be important to boost investment as potential output dwindles. In this regard, medium-term policy should prioritize enhancing business climate and facilitating private sector participation. Notwithstanding the need to pursue fiscal consolidation and enhance revenue mobilization, we view that the message on corporate taxation should be more nuanced given the need to maintain an investment-conducive environment. *Staff's comments are welcome.*
- The global pandemic may entail large structural changes in the drivers of growth, including a shift away from contact-intensive sectors. We appreciate staff's assessment

on the impact of the pandemic to tourism and remittances. Moving forward, the Fund should assist member countries that rely heavily on these sectors with in-depth analysis of their sectoral dynamics. Fund policy advice and technical assistance in these areas would help countries to reallocate resources towards more productive sectors.

- Attention should be given to elevated debt levels and rising debt vulnerabilities as they pose a major risk to achieving sustainable growth. We welcome the analysis on sovereign and corporate debt overhang, including the potential need for debt restructuring. Going forward, it will be important for the corporate sector to play a continuing role in supporting the recovery. *We invite staff's comments on how the corporate sector could meet their financing needs, considering different financing instruments (e.g. debt, equity, etc.).*
- We agree that policy should also be directed to promote more inclusive and greener growth. We share concerns that the pandemic has adversely affected the progress made in poverty reduction and addressing inequality. Fiscal policy will play an important role to address this issue, including by providing targeted stimulus to the most vulnerable segments. The crisis also provides an opportunity to pave the way for greener growth. We look forward to further work on these issues, particularly in the surveillance context.

We concur with the call to strengthen multilateral cooperation. This crisis is multifaceted and requires multilateral efforts to effectively tackle the health and economic challenges. Beyond the crisis, multilateral cooperation is needed to address public debt challenges faced by a large portion of the membership and also to defuse intensifying trade and technology tensions between countries as these could put additional pressures on global outlook. The WEO found that trade restriction played a limited role in subdued trade flows in 2020, but this should not undermine a call for resolving trade restrictions. Against this backdrop, we reiterate our view that the Fund should continue to advocate for a swift resolution.

More broadly, we underscore that the Fund still needs to do more to deliver policy advice that is better tailored to country-specific circumstances. We highly welcome the efforts so far with the assessment of policy actions taken by different groups of countries in this report. In this vein, we would encourage staff to deepen the analysis of small state issues in future editions, given that this is a critical group of countries that are severely affected by the pandemic and will benefit tremendously from Fund advice and support.

Global Financial Stability Report (GFSR)

We broadly agree with the monetary and financial policy roadmap. The 3-phased approach is appropriate and reflects the reality that countries are at different stages of the crisis and require tailored policy guidance. In the near-term, vulnerabilities among corporates and banks must be closely monitored as they can be important channels for shock transmission. The second phase will be crucial for policy makers to help banks to preserve their balance sheets and take account of the climate and digitalization agenda where possible. The Fund's work on digitalization will be particularly important given its potential in helping to secure an expedient recovery and its implications for monetary policy. In the post-pandemic phase, strengthening the regulatory framework, particularly with respect to risks

from the less regulated non-bank financial institutions will be critical especially as they can be a major source of financial stability risks. We also encourage the Fund to step up its work on cross border spillovers, especially from source countries, and to assess the wider implications of unconventional monetary policies on non-banks, household wealth, inequality, etc.

We would have preferred to see more discussion on the roles of FXI, CFM and MPM in the monetary and financial policy roadmap. While Chapter 2 of the GFSR recognizes the benefits that FXI and CFM could bring to the table, these tools are not mentioned in the roadmap that is integral to the Fund's policy advice. Similarly, MPM also have a role in helping to ease liquidity conditions and support market stability.

The Fund should engage and assist EMDEs on their APP. APP have been helpful in supporting the smooth functioning of markets, but also resulted in EM central banks taking up more credit risk and facing new challenges. APP remain a novelty for many EMDEs and thus the Fund advice and hands-on experience with similar tools used by AEs would be helpful for EMs in navigating the trade-offs (e.g. risk of fiscal dominance, impact on long-term market development), designing exit strategies once the tool has served its purpose, and managing excess liquidity in the aftermath. *Could staff elaborate on the lessons from exit strategies of AEs after the GFC that could be useful for EMs as mentioned in paragraph 32 of GFSR chapter 2?*

Greater use of flexibility inherent in the regulatory framework may be needed to support the economic recovery, while preserving financial system stability. Fund advice for authorities to encourage banks to use its buffers is sensible and is in line with the intended purpose of building up buffers over the years. Given the potential risk of negative market perceptions, standard-setting bodies have issued guidance to alleviate some of those concerns, and the Fund should provide further support with analysis and feedback from the membership. At the same time, the implementation of new regulations such as the IFRS9 would need to be pragmatic so that banks could continue to play their credit extension role in the recovery. We note that the key findings of chapter 4 regarding the weak tail of banks is based on the new global stress test tool. Here, we would encourage staff to engage country authorities on the findings and seek their feedback. This iterative process will make the analysis more rigorous going forward and ensure that important analytical findings are well understood by the membership.

Fiscal Monitor (FM)

We commend authorities around the globe for a timely response to this crisis through a proactive fiscal measure consisting of supplementary spending or forgoing revenue. *In this context, we invite staff to elaborate on the effectiveness of the fiscal measures as well as how well they have been implemented so far. What lessons, if any, could be drawn from the phase-1 of the recovery roadmap to be better prepared for the second wave of pandemic.* Fiscal support should continue to be well-targeted and carefully calibrated in the near-term as the risk of a pandemic resurgence remains.

We support staff recommendation for authorities to start considering revenue enhancing measures to help finance the significant spending needs arising from the ongoing crisis. Enhancing revenue collection from more affluent and less-affected groups can be appropriate to avoid excessive revenue losses. This must be carefully designed so as not to constrain consumption and investment spending given these groups' large contribution to the economy. When appropriate, lifting current temporary measures while maintaining enforcement measures to prevent increases in non-compliance and help rebuild the tax bases are also required. *On enhancing revenue, we would like to hear more from staff on further steps needed for EMDEs to adequately respond to the taxation challenges arising from the digital economy.*

We found staff analysis and recommendations in Chapter 1 on the choice of fiscal instruments helpful for member countries in assessing the impact of their fiscal measures on economic growth and job creation. We concur with staff that countries' level of financing access, debts, and economic scarring will shape their fiscal policies to help in promoting an inclusive economic recovery and a speedy structural economic transformation as soon as vaccines and therapies become widely accessible. We encourage staff to work closely with authorities and provide proper advice to help member countries restore credible fiscal discipline in line with their medium-term fiscal consolidation plans, when conditions permit.

The current crisis underscores the need for structural reforms, including on digital transformation. We agree with staff analysis in Chapter 2 that additional spending on digital infrastructure is critical in light of social distancing, shifts towards remote schooling and work, the importance of cash transfer in supporting the most vulnerable segment of the population, and gaps in access information and opportunities. Failure to address this issue will have wider consequences for both economic convergence across countries and inclusive growth within countries. In this context, we encourage the Fund to enhance its role to help member countries in accelerating the development of digital infrastructure to mitigate the effect of the crisis on the economy, human capital and reduction of poverty and inequality.