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Statement by Mr. Bhalla, Mr. Goyal, Mr. Natarajan, and Mr. Singh on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
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WORLD ECONOMIC OUTLOOK

1. We compliment the Staff for an excellent document. It analyses global prospects and risks and makes forecasts under these continued uncertain, and unknown, times. We broadly agree with the Staff's assessment of prospects, risks, and policy prescriptions, but would like to highlight a few points.

2. Although **revised growth estimates** continue to show a sharp slowdown during 2020 over the preceding year, they are **a shade better than the June forecast**. In the baseline scenario, global growth has been estimated to be at -4.5 percent compared with -5.2 percent projected in the June update. The improvement essentially reflects reopening by many economies though some are reintroducing partial lockdowns. Notably, the second quarter GDP outturns were generally above the June WEO forecasts, particularly for the advanced economies.

3. We note that the staff growth forecasts for global as well as individual countries are conditional upon assumptions regarding the speed and extent of pandemic spread and expected recovery path. Therefore, **it is critical that our assumptions and understanding of pandemic is consistent with the underlying reality.**

4. The Report makes two important conclusions regarding the **impact of lockdowns on the spread of pandemic**. The first important conclusion is that the imposition of a stringent lockdown when the number of cases is low is successful in containing the spread of the pandemic. This is a plausible hypothesis, but one that needs much more robust statistical evidence than that offered in Chapter 2. There

are many “outliers” to this hypothesis/conclusion, and outliers which are spread in number, and population, across all continents.

5. Second conclusion in WEO pertaining to lockdowns: lockdowns are endogenous *i.e.*, with rise in number of cases, governments responded with stricter lockdowns. These **conclusions appear to be inconsistent with the pattern of pandemic spread observed across many countries**. At least three of eight closure indices that form part of the stringency index used by WEO (e.g. closure of schools, cancellation of public events, closure of public transport, closure of borders etc.) were in effect for more than 90% of the world’s population, as early as March 20th. Further, by March 20th, the aggregate stringency index was at 68, a level which can be interpreted to mean the beginning of a strict lockdown (the maximum for the stringency index is 100).

6. The diffusion of COVID-19 in economies is *not* lower when stringent lockdowns are imposed at an early stage of the pandemic. As stated in the previous paragraph, more than 90 % of the world’s population was already in significant lockdown in late March. Number of Covid cases worldwide on March 20 – around 300,000. **Just three months later, (and with lockdowns intensifying), number of cases worldwide were more than thirty times higher.** There are several pieces of such heuristic (and rigorous) evidence to negate any strong claims about lockdowns and Covid diffusion. Indeed, it remains an open question whether the low stringency, herd immunity model of Sweden was better for the world than the lockdown model. And precisely because it is an open question that one should be cautious in over-stating, and over-interpreting, model-based results.

7. Regarding the impact of lockdowns on economic activity, distinguishing between the state-imposed lockdown and voluntary social distancing, the Report concludes that *tighter lockdowns appear to entail modest additional economic costs*. This is another important result running against the evidence. Two sets of regressions have been estimated to arrive at this conclusion. One relates GDP growth to lockdowns, the other relates mobility to lockdowns. An additional explanatory variable ‘voluntary social distancing’ in each case has been captured by ‘number of infections’.

8. We observe that coefficients for the ‘number of infections’ in all the alternative regressions in the first set are statistically *insignificant.* As regards the second set of regressions, only simulation results have been presented in the report. It would have been better to have statistical results indicating size and significance of coefficients to draw firm and definite conclusions.

9. Further, the report highlights the issue of debt sustainability. It has been projected that debt ratios may rise by more than 20 percent for advanced economies and about 10 percent for the emerging market economies. We believe these estimates are based on the baseline scenario about growth and global financial conditions. It would be helpful if the Staff could provide estimates of likely debt scenarios if

growth projections and global liquidity conditions embedded in the optimistic growth scenario are incorporated.

10. We fully **support staff recommendations that accommodative macro policies should continue** in the near term so that the growth process takes firm roots. There are at least two reasons why macro policies need to stay accommodative. First, as observed in April WEO as well, fiscal multipliers are much higher during an economic slowdown. Second, global financial conditions are likely to stay favorable for an extended period given the policy stance of all the major economies. This would certainly keep the debt dynamics more favorable, and debt ratios as a result may stay relatively moderate.

11. WEO deals with the topic of climate change at length. It undertakes a detailed analysis of the environmental policies needed to reach net zero emissions by 2050, emissions which are compatible with the objectives endorsed by world leaders in the Paris agreement. It argues that COVID-19 crisis has created an opportunity for pursuing environment friendly policies. It builds up a case that the fiscal stimulus now needed to revive the economies from the pandemic should boost green and resilient public infrastructure and make active use of carbon taxation to enable transition from high carbon to low carbon economic activity.

12. While we appreciate that it is an opportunity to move towards goals of climate change, the proposed **strategy which is completely devoid of any discussion on climate finance, is likely to be a non-starter**. It may be noted that efforts to move towards a low carbon economy face a major challenge in terms of access to adequate finance and technology.

13. It is important to note that neither UNFCCC nor the Paris Agreement talk about the term of “decarbonization”. Hence any advocacy for the term, which is not multilaterally agreed, especially in such a report, gives out a wrong signal. Further, the report talks about the Carbon pricing as a critical tool to mitigation because higher carbon prices incentivize energy efficiency besides reallocating resources from high- to low-carbon activities. However, the negotiations on market mechanisms under Article 6 of the Paris Agreement still remain unresolved in the UNFCCC negotiations as on date. In the pursuit of low carbon growth, the focus should be on technology that needs to be moved from lab to field and those that require targeted global research. One of the important areas of global collaborative research should be cleaner coal, clean energy management and storage systems for renewable energy, which we should push for inclusion in this track. In this regard it is also important to remember that Paris Agreement does not talk about low carbon growth as an exclusive effort. The Article 2 of the Paris agreement brings in sustainable development, poverty eradication and very basic tenet of Equity and ‘Common but Differentiated Responsibilities and Respective Capabilities’ (CBDR-RC) as the over-arching concepts for low GHG pathway.

14. The Report talks about concessional finance towards mitigation actions and though it is a considerable step, this should not undermine in any circumstances the effectiveness and importance of international public finance in climate finance, from developed to developing countries and the need for grant and grant equivalence. The availability of adequate, credible and predictable climate finance for the developing countries holds the key in the successful implementation of climate actions by the developing countries. the momentum in international climate finance arena and the scope, scale and speed of climate finance is lagging behind considerably. Any significant efforts on climate finance arena are yet to be seen in the mobilization and global action on climate change is contingent on the delivery of timely and adequate finance. Call for climate actions should set in motion a serious discourse on climate finance required to take climate actions effectively. However, the chapter is silent on this important aspect on climate action.

15. Just to place it on record, India's NDC (Nationally Determined Contribution) has already taken ambitious mitigation targets. As per some recent reports[1], **India is among very few countries in G20 economies whose actions are 2^0 C compatible** while most of the advanced economies are nowhere near this target. India had made a voluntary pledge in 2010 to reduce the emission intensity of its GDP by 20-25% from 2005 levels by 2020 (excluding emissions from agriculture). As a result of India's multiple mitigation actions, the emission intensity has already reduced by 21% between 2005 and 2014, thereby achieving its pre-2020 voluntary target.

16. Further, India has set itself an ambitious target to reduce the emissions intensity of its GDP by 33 to 35 per cent of the 2005 level by 2030; achieve about 40 per cent cumulative electric power installed capacity from non-fossil fuel- based energy resources by 2030 with the help of transfer of technology and low cost international finance including from the Green Climate Fund (GCF) by 2030.

Global Financial Stability Report

17. The GFSR underscores lower near-term global financial stability risks with rising vulnerabilities and intensifying financial stability concerns in some countries. In our view, at the global level, **despite several downside risks to the financial conditions, credit markets do not appear to be as dislocated during the Covid-19 crisis** as they were during the 2008 financial crisis and its aftermath. Even at the peak of Covid-19, the US high yield index option-adjusted spread rose to 8.8% as compared with 19.9% during November 2008 and has since fallen to the pre-Covid-19 level within a short span. The uncertainty reflected in a spike in the VIX during the Covid-19 reverted back much quicker than during the global financial crisis

1. Elzen, M. et al., 'Are the G20 economies making enough progress to meet their NDC targets?', *Energy Policy* 126 (2019) 238-250. Elsevier.

(GFC). Thus, going forward, once the pandemic subsides, global recovery may be better supported by a financial system in much better shape.

18. **Against the apprehensions, the moderation in risk aversion does not seem to be disconnected from the real economy**, indeed the financial markets seem to be picking up early signals from improving real activity in certain geographies. If the momentum is sustained, this may also have implications for the outlook for global growth as certain sectors and countries may exhibit a much steeper recovery path than assumed in the baseline of the WEO. Though we agree that there could be some pockets of localized insolvencies of non-financial corporates and banks/non-banks in certain geographies, particularly those with weaker initial conditions, we do not visualize the risk of a widespread scenario of insolvencies. Thus, from a policy perspective, an emphasis on micro-prudential measures may assume importance.

19. A related question to ask is **whether the global financial system has become more procyclical, less procyclical, or remains as cyclical as it was during the period leading to the 2008 GFC?** The financial stability concerns need to distill the nature of deterioration in the asset quality, *i.e*., cyclical versus structural deterioration. For instance, if a shock exposes the structural weakness in the banking system, it may have a durable impact on the capital of the banking system; while a shock which causes only cyclical deterioration in asset quality and profitability and hence the capital shortfall, may only have transitory effects, and such effects may wither away faster with the cyclical upturn in economic activity.

20. Surprisingly, the FSB in its 2019 review of Implementation and Effects of the G20 Financial Regulatory Reforms had observed that **those aspects of Non-bank financial institutions (NBFIs) that contributed to the financial crisis had declined significantly and generally no longer posed financial stability risks**. **In contrast, the GFSR highlights that NBFIs have entered the crisis with elevated vulnerabilities.** It argues that the increased links between NBFIs and banks imply that fragilities could spread through the financial system. We would like to understand as to **why shadow banking continues to remain a gray area in the perimeter of the global financial regulatory reforms.** We, thus, strongly support the call for strengthening the prudential regulation as well as broadening the regulatory perimeter of non-bank financial institutions.

21. The Report highlights the largely positive experience of asset purchase program so far by the emerging market central banks, though, it cautions against further expansion and motivation to use this unconventional tool by the emerging market central banks. Although, we agree with the views that the use of asset purchase program is constrained by the several factors, as indicated in the Report, we believe, there would be greater use of this tool by the emerging market central banks, going forward. Hence, **it would be helpful for policy makers if the Fund Staff could further expand this analysis to indicate its effectiveness, especially the trade-off between conventional and unconventional tools.**

22. The Report highlights the concern that new debt supply and weak domestic fundamentals may have curtailed demand for local currency bonds from foreign investors, especially where they hold large shares of debt and where the domestic investor base may not be deep. In our view, **this calls for increased attention to developing and deepening the local currency bond markets and fostering greater domestic investor participation,** particularly in the frontier markets, where the current crisis has exposed the local currency bond market illiquidity in the face of external shocks.

23. The report finds that a large decline in the output gap would lead to a decline in firms' environmental performance in the medium term, which also implies that sustaining economic growth will be the key to channelizing greater investment for environmental protection. We note with concern that the financial constraints imposed by the COVID-19 crisis could substantially reduce firms' capacity for green investments, we, thus, **underscore the need for reinforcing the efforts in technology transfer and scaling up of climate finance to help developing countries' transition to low-carbon economies.**

Fiscal Monitor

24. **Forceful fiscal response by the Governments has helped to save lives and mitigate the economic fallout of the pandemic.** These measures have also underscored the differences in capacity across countries in financing emergency support activities. In general, fiscal expansion in most of the advanced economies (AEs) and some emerging market (EM) economies was facilitated by providing massive liquidity and asset purchases whereas most of the LICs are constrained by weak financing. As a socio-economic consequence, a significant share of the world population is expected to enter extreme poverty, reversing the decade-long declining trend. With severe economic contraction combined with narrowing fiscal space, most of these countries require careful assessment of benefits, costs and risks of sustaining fiscal support measures.

25. **Fiscal measures undertaken are estimated to be 12 percent of global GDP – comprising additional spending, foregone revenue and liquidity support.** Sharp decline in output coupled with fall in revenues is expected to push up global public debt from about 83 percent in 2019 to about 100 percent in 2020. The increased risk of debt distress in about half of the LICs would severely limit the available fiscal room. We share the concern expressed in the Report that as bankruptcies rise, sizable private debt could migrate to the public sector through bailouts. *Can the Staff provide details regarding the scope of this problem in different categories of countries, and its fiscal policy implications?*

26. **Countries must design fiscal policy measures by adapting to the challenges in different phases of the pandemic. The Report rightly specifies reorienting the fiscal policy measures in three different phases of pandemic.** In the first phase of outbreak, lockdown measures were imposed, and the need was to respond to

immediate health and livelihood issues. Alluding to the fact that countries which responded to the pandemic with "smart" containment measures have lost fewer lives and are projected to better contain the adverse impact on economic activity reflects the nuancing of Fund's approach to containment measures.

27. Currently most of the countries are in phase two, characterized by reopening of economic activities and involve phased rolling back of temporary support measures. **For countries with fiscal space, it is advisable to accelerate job-intensive public investments such as maintenance or public works**. In the third phase, when the health crisis is contained, the government should shift focus to ensuring sustainability of public finances.

28. Fiscal deficit is expected to worsen to about 12.7 percent of global GDP in 2020 as compared with 3.9 percent in 2019. The fiscal deficit of the AEs, which have taken powerful and broad-based fiscal measures is expected to be more than 14 percent in 2020, about 4 times that of 2019 levels. In case of Emerging Market and Middle-Income economies, and oil-exporting countries, the increase in fiscal deficit is almost half of AEs at about 6 percent. **Fiscal deficit in LICs is expected to increase by 2 percent but is likely to exhibit heterogeneity across countries.** The rising debt servicing burden is being addressed by the debt service suspension initiative of the G20 but may eventually require debt restructuring in some cases.

29. **The Report refers to low appetite for borrowing in these countries despite record-low global interest rates.** *Could the staff comment on how emerging market and low-income countries with market access can factor the low interest environment in their fiscal policy roadmap? How can they balance the benefits of low interest cost and elevated risks, and expand their resource envelope in the medium to long-term?*

30. **We recognize the importance of targeted, temporary and timely fiscal support measures and the findings of the preliminary assessment of these measures in the report. We also agree that the outcomes could have been much worse without these measures to save lives, livelihoods and businesses.** The Report refers to the efficacy of cash transfer measures in India, which was achieved by expanding the existing cash benefits rapidly to provide support to the people. Linking of socio-economic databases, citizen identity and digital platforms ensured timely availability of benefits in a safe, efficient and transparent manner. The JAM trinity – the Jandhan Accounts, Aadhar Biometric Identification system and Mobile and efficient digital payment mechanisms ensured quick and transparent cash disbursement to the socially disadvantaged under the program – 'Garib Kalyan Yojana'.

31. **Ensuring sustainable reopening and recovery of the economy should be the aim of the fiscal road map ahead.** We agree that the policies need to be calibrated to ensure safe and sustained resumption of activities for workers, businesses and consumers. Reorienting fiscal measures, like support for SMEs

and low-income households and unwinding Government intervention in the corporate sector are some useful suggestions. Further, the matrix on fiscal strategies during different phases of pandemic provided in the Report is a useful guide to members.

32. The Report advocates the key role of public investment in fostering post-pandemic recovery. It provides a strong argument for additional investment to reach the sustainable development goals in roads, electricity, water, and sanitation in the EMs and LICs. **It is imperative that the nature of investment should make a strong impact on employment and crowd-in private investment – easy to start maintenance projects, job-intensive activities and activities with high fiscal multipliers.**

33. We take note of the analysis carried out by the staff in Chapter 2: *Online Annex 2.4. Public Investment Job Creation.* The results of the analysis show the employment impact of various activities – the highest is for water and sanitation at 15.2 jobs per US$ 1 million spending compared to 8 jobs in roads and 3.3 in electricity**. Pertinently, the Government of India had launched, "Jal Jeevan Mission" (Water for Life) in 2019, a national program, aimed at providing drinking water supply to every rural household which is currently under active implementation**. **The Government of India had also launched the Phase II of the "Swachh Bharat Mission - Grameen" (Clean India Mission-Rural) 2020-21 to 2024-25, which will *inter alia* focus on Solid and Liquid Waste Management (SLWM) across all the villages in India.**

34. Finally, we commend the Fund for **advocating strong fiscal policy measures and providing insights into the impact of various fiscal measures – cash and in-kind transfers, wage subsidies, loans and guarantees and tax measures**. May we suggest dissemination of this rich knowledge and experiences to help countries to design fiscal measures to enhance their benefits and make them cost-effective.