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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/20-1

9:30 a.m., March 21, 2019

1. World Economic Outlook; Global Financial Stability Report; Fiscal Monitor

Documents: EBS/19/11 and EBS/19/12; and Supplement 1; EBS/19/14; EBS/19/7; EBS/19/8; SM/19/42; and Correction 1; and Supplement 1; SM/19/46; and Correction 1; SM/19/52; SM/19/53; and Supplement 1

Staff: Gopinath, RES; Adrian, MCM; Gaspar, FAD

Length: 3 hours, 56 minutes

Executive Board Attendance

C. Lagarde, Chairman

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
M. Raghani (AF)	
G. Lopetegui (AG)	
N. Ray (AP)	
	P. Fachada (BR)
	Y.Liu (CC), Temporary
L. Villar (CE)	
L. Levonian (CO)	
R. Kaya (EC)	
H. de Villeroché (FF)	
	K. Merk (GR)
	M. Siriwardana (IN)
D. Fanizza (IT)	
M. Kaizuka (JA)	
J. Mojarrad (MD)	
H. Beblawi (MI)	
A. De Lannoy (NE)	
T. Ostros (NO)	
	L. Palei (RU)
M. Mouminah (SA)	
	K.Tan (ST)
P. Inderbinen (SZ)	
S. Riach (UK)	
	P. Pollard (US), Temporary

J. Lin, Secretary
O. Vongthieres, Summing Up Officer
J. Acheson / L. Briamonte / M. Gislen, Board Operations Officers
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
African Department: P. N'Diaye. Asia and Pacific Department: H. Finger, A. Gulde. European Central Bank: K. Nikolaou, R. Rueffer. European Department: L. Papi, E. Stavrev. Fiscal Affairs Department: V. Louca Rabaca Gaspar, P. Mauro, P. Medas, C. Pattillo, J. Ralyea, H. Ture. Finance Department: T. Krueger. Legal Department: K. Christopherson

Puh, A. Gullo. Middle East and Central Asia Department: A. Al-Eyd. Monetary and Capital Markets Department: T. Adrian, P. Breuer, W. Kerry, F. Natalucci, C. Raddatz Kiefer, N. Valckx. Office of Budget and Planning: D. Citrin. Office of Executive Directors: M. Kaizuka. Office of Risk Management: V. Arora. Research Department: H. Berger, O. Celasun, R. Duval, G. Gopinath, G. Milesi-Ferretti, M. Nabar. Strategy, Policy, and Review Department: T. Bayoumi, R. Duttagupta, M. Muhleisen. Western Hemisphere Department: J. Roldos, K. Srinivasan. Executive Director: Z. Jin (CC), A. Mozhin (RU). Alternate Executive Director: R. Alkhareif (SA), S. Benk (EC), J. Di Tata (AG), S. Geadah (MI), A. Guerra (CE), I. Mannathoko (AE), A. McKiernan (CO), P. Moreno (CE), K. Obiora (AE), M. Psalidopoulos (IT), H. Razafindramanana (AF), D. Ronicle (UK), P. Rozan (FF), J. Sigurgeirsson (NO). Senior Advisors to Executive Directors: W. Abdelati (MI), B. Alhomaly (SA), A. Muslimin (ST), P. Braeuer (GR), M. Choueiri (MI), S. Evjen (NO), M.Gilliot (FF), N. Jost (NE), K. Karjanlahti (NO), W. Kuhles (GR), G. Gasasira-Manzi (AE), Z.Mohammed (BR), T. Nguema-Affane (AF), R. N'Sonde (AF), S. Potapov (RU), J. Shin (AP), T. Sitima-wina (AE), F. Spadafora (IT), G. Vasishtha (CO), J.Weil (CO), C. Williams (CO). Advisors to Executive Directors: M. Albert (FF), F. Al-Kohlany (MI), A. Arevalo Arroyo (CE), O. Bayar (EC), P. Braeuer (GR), X. Cai (CC), S. David (AP), A. Grohovsky (US), M. Josic (NE), G. Kim (AP), T. Manchev (NE), M. Mehmedi (EC), P. Mooney (CO), C. Moreno (AG), G. Nadali (MD), A. Park (AP), B. Parkanyi (NE), F. Rivadeneira (BR), P. Snisorenko (RU), M. Sylvester (CO), A. Urbanowska (SZ), D. Vogel (AG), Y. Zhao (CC), K. Hennings (BR), J. Montero (CE), A. Tola (SZ), A. Sode (FF).

1. WORLD ECONOMIC OUTLOOK; GLOBAL FINANCIAL STABILITY REPORT; FISCAL MONITOR

Mr. De Lannoy, Mr. Jost, Mr. Hanson, Mr. Josic and Mr. Manchev submitted the following statement:

> We broadly share staff's assessment of the global economy and the causes of the slowdown in growth momentum. We agree with staff that many of the identified risks would follow from policy missteps, such as a further escalation of trade tensions, which should be avoided. The policy stance should carefully weigh the desire for stabilization against concerns about sustainability, with debt levels still elevated in many countries, even when compared to pre-crises levels. In low-income countries, a more complex composition of debt calls for further efforts to improve debt transparency and increase debt management capacity.
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> Strengthening growth potential and building resilience remains crucial. We note that the downward revision to global growth for 2020 is negligible and that many economies are still converging to their long-term growth potential. Instead, the important challenge is to sustain potential growth rates beyond 2020. We should therefore embrace the still available window of opportunity to boost potential growth and build resilience. In this context, we reemphasize the need to focus on structural reforms that improve business dynamism (including measures to prevent market power), stimulate labor force participation in anticipation of population aging and boost potential output. This is needed, as high debt levels and low policy rates limit the policy space available in a next downturn, while new challenges such as demographic change, technological developments, cyber risks and climate change require policy responses that ensure sustainable and inclusive growth.
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> World Economic Outlook
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> We fully embrace staff's broad overall message of the short-term economic and long-term institutional harm of protectionist measures. Multilateral reductions in tariff and non-tariff trade barriers bring lasting net benefits and improved aggregate macro-economic conditions. We agree that they need to be accompanied by domestic policies that ensure that the net gains are widely shared and those bearing the brunt of adjustment costs receive the help they deserve. More generally, we strongly agree with staff's notion that the goal should remain to pursue the gains - for all parties - from strengthening the rules-based, multilateral trading system. Staff now assumes that trade tensions will not escalate further in the baseline, which is a significant relaxation from the previous outlook. What is the impact of this

relaxation on the outlook in the baseline, and what are the expectations in case an adverse scenario were to materialize?

We share staff's concern about the bleak convergence prospects for some emerging and developing economies. Staff mentions that countries with a population higher than 1 billion will grow by less than advanced economies in the next five years. We fully support the Fund's efforts through lending, surveillance and capacity development to improve the prospects of these countries.

We welcome the analysis in chapter 2 and find the conclusion that a further increase in market power could have significant negative macroeconomic implications worrisome. We take note that higher markups in firms have significantly contributed to innovation and that macroeconomic implications so far have been limited. However, the analysis provides some initial insights about the negative consequences of increasing market power on investment, productivity, output and income inequality. Against this background, we agree with staff that structural reforms to keep product market competition strong in the future are essential across the entire membership. We call on staff to continue their work on this topic. Lastly, we thought that the findings from this chapter could have featured more prominently in the summary and the first chapter of the WEO, where they were mentioned only once.

We welcome staff's analysis of bilateral trade balances in chapter 4 and would like to see more work on the effect of liberalizing export and production subsidies. We agree with staff's assessment that the targeting of bilateral trade balances through protective measures is unlikely to reduce a country's overall current account position, as this also leads to diversification and offsetting changes in trade balances with other partners. The recent experience of the U.S. is a case in point. Furthermore, we welcome the analysis on value-added in bilateral trade balances, which shows that bilateral trade balances are less sizeable when accounting for value-added as opposed to gross balances. In addition, we think that more attention could be paid to the widespread export or production subsidies that distort trade, and call on staff to push the analytical frontier in this area. Against this background, we reiterate our view that current account and trade imbalances are best addressed through adjustments to macroeconomic policies rather than distortionary trade policies and emphasize that protectionist policies have -on aggregate- negative consequences, especially in today's world of global value chains and strongly progressed globalization.

Global Financial Stability Report

We agree with staff's assessment of the global financial stability risks. The GFSR rightly points out that near term risks to the global financial stability have increased since the last update and vulnerabilities continue to build up as global financial conditions remain relatively accommodative. We agree that a sudden tightening of financial conditions, for example triggered by escalating trade tensions, poses a risk. The useful special feature on liquidity risk shows that such a shock can be amplified if liquidity is poor. In this regard, we would welcome further analysis on vulnerabilities stemming from low liquidity and we welcome efforts to improve data availability on the activities of nonbank market makers.

We welcome the analysis of late-cycle corporate sector risks in advanced economies. The increase in corporate debt coincided with a decrease in creditworthiness of debtors, weaker covenants and an increase in non-bank finance. The strong growth in the leveraged loan market, which is predominantly funded through collateralized loan obligations, is a case in point. Increasing data collection and understanding who holds the risks on this market remains an important challenge. We share the view that the macroprudential toolkit needs to be expanded and further developed, as its coverage is incomplete and it has been largely untested. At the same time, we agree with staff that a prolonged period of low rates will likely result in further rising debt levels, raising the risk of a sharper adjustment in the future. To us, this intertemporal trade-off warrants the integration of financial stability risks in staff's advice on monetary policy. Staff's comments are welcome.

More steps are needed to address the sovereign-financial sector nexus in the euro area. The euro area has taken important steps to reduce the contagion from banks to sovereigns through higher buffer requirements and the creation of a Banking Union with a resolution framework. To break this link, banks need to build adequate loss-absorbing capital and bail-in rules need to be fully applied. However, more steps are needed to address contagion from sovereigns to banks. Staff's analysis shows that repricing of sovereign bonds can generate significant losses for some euro area banks, due to their high exposure to the domestic sovereign. The risk of such a repricing can be reduced if indebted sovereigns prioritize debt reduction. Reforming the preferential treatment of sovereign debt would directly address the risks associated with high domestic sovereign exposures and strengthen cross-border risk sharing.

The chapter on housing market risks is highly relevant. Staff's methodology adds value to the analysis of housing market risks and early warning models. We encourage staff to use this methodology in surveillance and to continue their work on housing markets. We agree that house prices are relevant for macroeconomic performance, importantly through their effect on financial stability and household wealth, but also due to the impact of house prices on residential investment. We wonder whether the indicator of house prices at risk could be refined by including additional determinants such as disposable income growth and demographics in the model. We agree with staff that monetary policy is not well suited to target housing price risks. However, easy monetary policy may fuel house price increases and can counteract the effects of macroprudential policies. We would therefore welcome a more integrated analysis of the interaction between the effects of macroprudential and monetary policy. We invite staff to look into this question in the context of the integrated policy framework.

We see merit in presenting the growth-at-risk estimates with the WEO projections. The macroeconomic forecasts in the WEO and the growth-at-risk estimates in the GFSR provide complementary information but are presented separately. It would be interesting to integrate the presentation of the two frameworks, for example in a table with country-level growth projections and growth-at-risk estimates. This might also make the growth-at-risk framework easier to digest for policymakers. We strongly support the growth-at-risk framework, but we note that reading Figure 1.3 requires some effort, in particular for readers with no prior knowledge of the framework.

Fiscal Monitor

We welcome the focus in the Fiscal Monitor on the need to prepare for potential downturns and put more emphasis on reforms to foster long-term inclusive growth. Fiscal policy should be geared towards sustainability and stabilization, which are both affected by the fact that public debt is near historical peaks in many countries. From a sustainability perspective, we agree that fiscal adjustment is needed in high-debt advanced economies that will face risks when monetary policy normalizes. In addition, many economies need to prepare for the fiscal cost of ageing. From a stabilization perspective, we support staff's call to increase fiscal buffers to prepare for the next downturn. Indeed, little fiscal room exists in many countries to respond if risks materialize. We think that ensuring sufficient buffers is also relevant for countries with low debt levels. buffers and well-designed automatic stabilizers will enable much needed countercyclical policy in case risks materialize.

We agree on the need to improve the quality of public finance and domestic revenue mobilization to adapt to global trends. Emerging challenges, like demographic changes and digitalization, require that financial resources should be directed towards productive investment. We agree with staff that limited fiscal room for maneuver in large parts of the membership calls for reprioritization of budgetary resources and revenue mobilization. We fully agree with staff's assessment that inefficient spending should be cut and investment supporting adaptation to new challenges should be fostered.

We fully agree with staff that multilateral cooperation is crucial to successfully address many of the challenges faced by the membership, including reforming the international taxation framework, addressing climate change and achieving the SDGs. Regarding international corporate taxation, this chair agrees that the system is under stress and welcomes the recent technical analysis by staff. We fully agree with the message of the fiscal monitor that global cooperation remains of the essence, and that reform efforts should continue. Unlike some wording chosen by staff seems to suggest, we do believe that these efforts should be undertaken by all stakeholders, independently of geographical size. We also believe that the recent efforts at OECD level, such as the BEPS initiative, are a powerful example of a successful multilateral consensus-based approach, which we continue to fully support.

We welcome staff's analysis of the adverse economic effects of corruption. Sound institutions and continuous political determination are essential to successfully tackling corruption. We concur with the main recommendations put forth by staff, in particular the need for increased transparency, independent external scrutiny and sound public financial management. We wonder whether staff considered to include 'second-generation' or 'third-generation' corruption indicators, such as victimization surveys like the module in the World Bank's Enterprise Surveys, which asks whether participants have experienced corruption first-hand (e.g., paying bribes) and thus providing a more direct, objective measure of corruption.

Mr. de Villeroché, Mr. Castets, Ms. Gilliot, Mr. Rozan, Mr. Sode and Ms. Susbielle submitted the following statement:

We thank staff for the excellent set of "flagship" reports. Thanks to a judicious choice of topics of analytical chapters, staff provides a useful and relevant contribution to policy-makers at a time marked by rising uncertainty. Indeed, while global growth is expected to decline only moderately this year, projections have been revised downwards across the board, for most major advanced and emerging economies. The ongoing slowdown is more pronounced and widespread than anticipated. Under the current circumstances, the Fund's recommendations on the best policies to support growth while ensuring sustainability are particularly expected. In this regard, the "do no harm" message resonates strongly, notably as regards the exacerbation of trade tensions that are already taking a toll on global activity. We thank staff for further building a strong analytical case on the benefits of openness, with the WEO analytical chapters providing a consistent approach in this regard. Since the nature and the length of the ongoing slow-down remain debated, adapting the policy-mix might prove to be challenging. Nonetheless, we would see merit in pursuing the effort to craft more detailed policy recommendations on how to adapt to the rapidly changing environment, depending on domestic and regional conditions, beyond the insistence on the necessary rebuilding of resilience over the medium term.

As global expansion loses steam and risks are tilted to the downside, careful calibration of economic policies to support growth and enhance resilience over the medium-term is warranted.

The ongoing deceleration is affecting all country groups, with a combination of trade tensions, a broad-based weakness in manufacturing and tightening global financing conditions. The trade tensions are taking a growing toll on production and investment, with a sharp downward revision of trade growth for 2019. We note that staff took a more optimistic assumption of this downside risk than in October, with the assumption that trade tariffs between US and China would not be hiked as previously anticipated, and would welcome staff comments on what would have been the impact of maintaining the same assumption as last October on growth projections in 2019 for China, the United States and the world.

In such a context, we fully concur that avoiding policy missteps that could harm activity is the priority. This useful message should not prevent staff from precising its policy recommendations based on a detailed and country-by-country analysis of the policy space available to react to a protracted downturn. Indeed, while policy space appears limited in some economies, due to the combination of policy interest rates close to their lower bond and limited fiscal space, it is much larger in some others. If a sharp downturn were to materialize, and we agree with staff this is not the baseline scenario, an across-the-board emphasis on limited policy space might hamper efforts on a coordinated answer.

Activity is softening in the United States and the medium-term outlook appears quite difficult to predict. In the face of rapidly rising public deficit, indebtedness and external imbalances, we share staff's concerns regarding the sustainability of the current policy mix. The risks associated with such imbalances might be exacerbated in 2020 where, in a pre-electoral context, the planned unwinding of the fiscal stimulus could be contractionary. In this regard, recommendations to raise further the revenue to GDP ratio to ward off fiscal risks appear well targeted. While inflationary pressures have been contained so far, we wonder whether an upward and sudden inflation surprise is still considered by staff as one of the main risks for the American economy. In light of recent Federal Reserve signals, does staff still expect two rate hikes in 2019, as highlighted in box 1.2.? In the face of weaker underwriting standards and rising leverage, we encourage the authorities to preserve adequate financial sector policies and to develop adequate macroprudential tools.

In the euro area, the slowdown has been widespread under idiosyncratic factors and cyclical weakening. The puzzle of persisting low inflation and limited wage dynamics while the slack appears on the decline remains. Against this background and given the inherent difficulty to measure output gaps, we would call for caution in linking too mechanically the actual projections, the statistical assessment of output gaps and policy recommendations. During the last 10 years, the euro area has been through a double-dip recession, a process of financial deleveraging and significant internal adjustment for several of its members. Such a combination potentially had a recessive impact on actual GDP growth whose nature could be more cyclical than structural. Statistical filters used to estimate potential output can be particularly sensitive to the latest points of the sample from which they extract the cycle from the trend, implying a possible underestimation bias of potential growth estimation in real time when actual growth is underperforming. For this reason, the fact that euro area output gaps have retroactively been revised downward for the last ten years is not a definitive indication that current measures of output gaps are appropriate. In this regard, inflation dynamics is one of the tangible measure of real potential constraints. In relation to the uncertainty on the assessment of the cyclical position of the euro area and the persistent undershooting of inflation, we feel that recommendations on the optimal policy-mix in the euro area could be further refined. While we concur with staff's recommendation to pursue fiscal consolidation in a pro-growth manner in countries with elevated debt levels, this should be accompanied by further support to domestic demand in countries with ample fiscal space and excessive external current account surpluses, to allow for a rebalancing within the euro area. In this regard, we feel that staff's policy recommendations for this latter group of countries are less straightforward than in precedent WEOs, whereas the ongoing slowdown justifies enhanced support to domestic demand where possible. Further analysis of wage dynamics within the euro area also appears warranted, notably on how to better coordinate on that front, for example through European minimum wage standards – staff's comments are welcome. In parallel, we continue to believe that the Fund has a valuable role to play on the debate on the future of the EMU and on how to complete the monetary union.

Large emerging and developing economies continue to sustain global growth, yet with diverging trends. We welcome the current growth momentum in India that is projected to remain sustained over the coming years. In China, the gradual and limited slowdown of GDP growth appears coherent with the authorities' commitment to prioritize financial sector derisking and to shift towards a more sustainable growth model. The recently announced stimulus measures appear well-targeted and aim at responding to the impact of ongoing trade tensions, so as to ensure a smooth cooling down of the economy. Going forward, we would caution against any reversal of the ongoing rebalancing towards a more consumption-led economic model. In the current context, developing a stronger social safety net could serve both the short-term objective of cyclical stabilization and the medium-term goal of rebalancing the economy. On Turkey, we concur with staff's call for continuous monetary tightening in order to bring down inflation to its target. Given the existing fiscal space, we expect fiscal policy to be used to smooth the ongoing adjustment. Increasing fiscal transparency in parallel would help to reinforce investor confidence. In the same time, banking sector balance sheet should be closely monitored to fully assess the volume of non-performing assets and banks' capital should be reinforced where needed.

Growth patterns in Low Income Countries continue to appear very heterogeneous, with rapid growth in some countries while GDP per capita progression remains subdued in several others. Even though growth will be picking up at the aggregate level in sub-Saharan Africa, we note with concern that convergence prospects remain bleak, with income levels falling further behind advanced economies. Commodity exporting economies continue to face a difficult but necessary adjustment. We also note that staff projects slightly higher growth levels in South Africa as well as in Nigeria in 2019 than in 2018, but still far from levels that would allow income convergence with faster growing middle income economies. In the face of rising indebtedness, we continue to encourage close attention to public debt dynamics and to rapidly evolving financial conditions. Continued efforts to adjust in a growth friendly manner, notably by protecting social spending and investment, and mobilizing further domestic resources over the medium term remain warranted in several countries of the region. The ongoing work to strengthen the IMF lending toolkit for LICs as well as the ongoing review of conditionality are key to ensure the Fund's engagement encourages sustainable adjustment while tackling macrostructural weaknesses.

We have been particularly interested by staff's analysis of market powers trends in chapter 2 of the WEO. While market power has increased moderately in all advanced economies, we note that they are particularly prominent in the United States (twice as large as in the average advanced economy), in the non-manufacturing sector, and among the most dynamic firms. The possible factors underpinning these trends (and in particular, winner-takes-most nature of product market patterns, as well as possible change in the intensity of competition) warrant further examination, including to be better identify the specificities of the trend observed in the United-States. The analysis points to rising detrimental effects on innovation and investment if market power was to continue on its upward trend (the "hump-shaped relationship" displayed in figure 2.6). This is a source of concern given the high proportion of firms whose market powers assessed to be beyond the point where they have little incentive to invest in innovation. On the specific aspect of the intensity of competition policies, we note that staff indicated that "there is limited evidence that pro-competition policies have weakened across advanced economies so far" (p.17). Could staff elaborate on this assertion and whether it holds true for competition authorities' decisions on merging and trusts, notably in the US?

In the face of rising global vulnerabilities, global cooperation and multilateralism are key to progress towards more inclusive and sustainable growth patterns.

Rising income inequality and the feeling that tax systems are not putting each player on an equal footing are feeding resentment. Tackling tax evasion, profit shifting and harmful tax competition, which all hamper efforts to mobilize the revenues needed to finance domestic public goods, is a priority. The first steps taken by staff to support the ongoing reflection on how to improve international corporate taxation and to adapt to a rapidly changing environment are welcome in this regard. We encourage staff to further integrate the spillovers of tax competition in bilateral and multilateral surveillance, notably through regular follow-ups in the Fiscal monitor. Climate change also warrants close international cooperation to design and implement adequate adaptation and mitigation policies. This proves to be difficult and the Fund has already a strong track record in that regard, thanks to past analytical work, notably on carbon pricing, and Climate Change Policy Assessments that could also highly benefit low income countries, notably in Sub-Saharan Africa.

Persistent and still unresolved trade tensions should be resolved through multilateral and rules-based mechanisms, in an inclusive manner. While positive signs on ongoing bilateral negotiations are welcome, we could caution again bilateral agreements that could contribute to create distortions. To prevent such adverse developments, the European Union has made concrete proposals to modernize the WTO and strengthen the rules-based multilateral trading system. On the analytical side, staff once again provides a compelling analytical case on the benefits of openness through the WEO analytical chapters:

Chapter 3 provides a better understanding of the role of capital goods prices in the dynamics of investment. It highlights the sizable impetus coming from the decline in the relative price of tradable investment goods to the rise of real investment rates in machinery and equipment over the past three decades. We share the conclusions of this chapter highlighting the importance of supporting policies in favor of trade integration and innovation which have been instrumental to reduce the price of capital goods. We also share the concerns about the distributional consequences and potential job disruptions provoked by the economic benefits of declining capital good prices and emphasize the importance of investing in the long-term on education and reskilling programs to help workers better cope with disruptions caused by technological progress.

Chapter 4 of the WEO on the determinants of bilateral trade and spillovers from tariffs is a particularly timely. We fully share staff analysis about the predominant role of macroeconomic factors in explaining multilateral and bilateral trade balances. The IMF has a long experience in assessing external balance norms and has always highlighted the link between macroeconomic (Saving/Investment) and current account imbalances. This study confirms that this also applies to bilateral trade balances. Hence, we remain convinced that reducing trade imbalances – be it aggregate or bilateral ones – will be achieved first and foremost through coordinated macroeconomic policies adjustment both in surplus and deficit countries. Moreover, we also support staff's conclusions regarding the long-term cost of tariffs and the amplification mechanism created by global value chains. In this regard, we reiterate our call for stronger multilateral coordination on trade issues and to avoid unilateral and harmful tariff increases.

Chapter 2 of the Fiscal Monitor "Curbing corruption" is an excellent contribution to the critical challenge of improving governance. We fully concur with the recommendations highlighted in the report. Going forward, the chapter main conclusions should be integrated in bilateral surveillance and in the technical assistance delivered by the Fund. Moreover, we agree with staff that international cooperation is crucial to improve the fight against corruption, tax evasion and money laundering. In that regard, the voluntary assessment process of anticorruption legal and institutional framework in Article IV consultations – all G7 countries, Austria, Czech Republic and Switzerland have volunteered so far – is a welcome progress and we encourage other jurisdictions to volunteer as well.

Rapidly shifting market perceptions in a context of rising medium-term risks plead for a close monitoring and the mobilization of the macroprudential instruments where needed.

We thank staff for their comprehensive and detailed assessment of global financial stability. Since the precedent GFSR, financial conditions have evolved rapidly in a context of signals that monetary policy normalization might be more gradual than anticipated. Despite the observed rebound, we agree with staff that global financial vulnerabilities are elevated for several segments of the financial system as leverage has continued to build up and liquidity and maturity mismatches have widened in some advanced and emerging economies. In a context of growth slowdown and global uncertainty, monetary policy normalization should be carefully undertaken and well communicated to avoid any market disruptions or overreaction. Regarding rising liquidity risks, we appreciate the analysis made on capital markets' liquidity changes. A similar analysis of liquidity conditions on corporate bond markets would also be useful to fully understand the implications for demand and supply of market liquidity of tighter financial regulation or technological advances for instance.

The section on late-cycle corporate sector risks in advanced economies is timely and we share staff's concerns regarding rising corporate debt. In this regard, the role of macroprudential authorities in monitoring corporate debt dynamics is key. In France, the High Financial Stability Board (HCSF) has recently decided to limit national systemic banks' exposures to the most indebted national non-financial corporations to 5 percent of their eligible capital to preserve the resilience and the soundness of the banking sector. In the same vein, the contracyclical buffer has been increased to 0.5 percent, on a precautionary basis. These measures echo staff's recommendation to use proactively micro and macroprudential policies where vulnerabilities are elevated and rising. We also see merit in enriching the prudential and macroprudential toolkit to address risks related to the greater weight of nonbank lenders in financial intermediation – such as those operating on the leverage finance segment – and encourage staff to continue to work on the risks associated to these actors. On leverage loans specifically, we agree that risk retention rules applied to originating lenders should remain an important tool and associate ourselves to staff's recommendations to supervisors to enforce sound underwriting standards and risk management practices at banks and nonbank financial intermediaries.

We take note of staff's choice to put again a strong emphasis on the euro area sovereign-financial sector nexus. As this issue has already been covered extensively, we understand that recent developments justify in staff's eyes to dedicate a whole section to this issue. It might have been interesting to consider the sovereign-banking nexus for other geographies than the euro area, such as the United States, Japan or China since exposure of banks and financial players to the sovereign risk is hardly a European specificity. On the euro area, we would have expected a greater emphasis on policies the comprehensive set of reforms implemented to improve banks' resilience (through the creation of the SSM, higher capital buffers, resolution framework) and the fruitful efforts made to reduce the level of nonperforming loans. The NPLs ratio was indeed lowered from 8,1 percent by end-2014 to 4,1 percent of total loans by Q3 2018. While we concur on the need to continue to monitor developments carefully, including in Italy, we would be interested in having staff's view on the fact that the negative feedback loops seem quite limited so far (with spill over to companies and households) nor through contagion to other neighbor markets. European authorities remain deeply committed to strengthen the supervision and resolution framework as proved by the conclusions of the December Euro Summit.

The rise of financial downside risks should play as an incentive for emerging economies to keep strengthening the resilience of their financial system. In this respect, we fully share staff's recommendations to enhance the development of local currency bond markets given the growing weight of benchmark-driven investors and, in some emerging countries, the high share of foreign ownership of local currency bonds. Given the impact of recent outflow episodes, better preparedness is warranted through capital flow management measures on outflows in crisis or nearly-crisis situations, the reduction of external liabilities and reliance on short-term debt and the maintaining of adequate buffers (fiscal buffers, bank liquidity buffers and foreign exchange reserves as underlined in the chapter). We appreciate staff's analysis in Box 1.1 on China's stock collateralized loans (SCL) and its financial stability implications. In line with staff, we see as appropriate to encourage the authorities to further tighten SCL practices to avoid any disruption to market functioning and to reduce distortions detrimental to the private sector and favoring sate-owned enterprises. Reducing credit overhang at unviable borrowers will also contribute to strengthen the system's resilience.

We thank staff for Chapter 2's detailed and innovative analysis of the house price dynamics and its consequences, somewhat complex, on the real economy and financial stability. The chapter introduces a new methodology to estimate downside risk to house prices based on the growth-at-risk model of Adrian and others (2018) used by staff for growth but also for capital flows. Still, we feel that the global picture is incomplete, in particular on the causes of the rise in house prices and the discrimination among markets. First, the empirical analysis discusses the effects of fundamental factors such as a tightening in financial conditions, higher real GDP growth and house price misalignment which reflects an overvaluation. However, it falls short of explaining the causes of these endogenous variables such as supply-side constraints that features a large number of markets, in advanced economies as well as in emerging countries. The analysis could also have discriminated further among markets' specificities which are critical in the design of efficient policy measures, and namely macroprudential measures. Among those specificities, some are related to the coverage of the housing prices risk by households' financial wealth, the level of the credit-to-GDP ratio or the pattern of interest rates observed in each country. Moreover, the quantile regression succeeds in highlighting the behavior of house prices at risk, whereas the lessons that can be drawn in terms of policy recommendations remains to be substantiated. Indeed, the chapter concludes to an increase in downside risks to house prices over the next one to three years in some countries and to potential consequences on financial stability (based on the link between house prices at risk and growth at risk) but the transmission channel to the financial sector and thus the policy that should be conducted might more explicitly exposed. We concur with staff that, to some extent (to the extent that they do not target levels of asset prices) macroprudential policy measures are more effective in reducing house prices at risk and preserving financial stability that monetary policy may be. However, as pinpointed in the chapter, macroprudential policies should not target house prices, even less seek to be growth-enhancing as their main objective lies in preserving the resilience of the financial system. A separate analysis of the effects of macroprudential tools according to their nature (loan-to value and debt service-to-income ratios) would have been helpful to better understand the full scope of their impact. Moreover, shocks to house prices may translate into a slump in household consumption and investment through negative wealth effects without necessarily deteriorating banks' balance sheets. In these cases, financial stability might be of little help and monetary policy would be a first-best.

Ms. Levonian, Ms. McKiernan and Ms. Vasishtha submitted the following statement:

We thank staff for the comprehensive set of Flagship reports and welcome the timely and fresh analytical work on well-selected special topics. We broadly agree with the staff's assessment of the global economic outlook and risks, as well as the policy prescriptions.

In the wake of the further weakening of the global economic expansion, and confidence and uncertainty continuing to weigh on growth, we think the Flagships generally strike the right tone in raising significant concerns while acknowledging positives in the outlook. But, with limited policy space in many countries and risks to global growth skewed to the downside, we see urgency in the message regarding the need for multilateral and domestic policies to focus on preventing a further slowdown in growth and strengthening resilience. The current conjuncture also calls for strengthened international cooperation to address shared challenges. The Fund's communication should convey this sense of urgency and caution policymakers against complacency.

In what follows, we offer some specific comments on each of the three flagship reports.

World Economic Outlook (WEO)

While global growth is now expected to slow to a still-reasonable 3.3 percent in 2019, before returning to 3.6 percent in 2020, there is considerable heterogeneity in the growth outlook across countries. We note that the projected pick up is dependent on recent improvements in global financial market sentiment, policy stimulus in China, and a gradual stabilization of conditions in some large EMEs. Growth in advanced economies (AEs), in contrast, is expected to moderate towards potential growth which itself is being held back by tepid labor productivity growth, population aging, and slowing labor force growth.

We share staff's assessment that the balance of risks is tilted to the downside. A further escalation of trade tensions and the associated increases in policy uncertainty, rising geo-political risks, and a sudden sharp tightening of financial conditions would further weaken growth, in uneven ways, across economies and regions. Over the medium term, climate change and political discord against the backdrop of rising inequality remain key risks, with particularly severe implications for some vulnerable economies

Against this backdrop, the Fund's advice is rightly focused on avoiding policy missteps that could further weaken economic activity. At the same time, acting at a half-measured pace could entrench subdued growth over the long run. Raising medium-term growth prospects while enhancing resilience and economic inclusion is a shared responsibility requiring efforts at both the domestic and multilateral level.

The Fund also has a role to play in addressing medium-term global challenges, such as climate change. The Fund, together with other international institutions, can assist vulnerable members, especially small states, in reducing the adverse effects of natural disasters and climate change by helping them develop and implement appropriate macroeconomic policies and disaster management strategies, and access climate financing.

We welcome the special focus on corporate market power (WEO, Chapter 2). We think the discussion would also benefit from acknowledging the challenges posed to competition policies by new technologies, particularly the market power accorded to companies by access to user data. The conclusion that there is little direct evidence of pro-competition policies having weakened across advanced economies may not hold once the impact of technological change is considered; that is, while pro-competition policies may not have changed, the changes in technology could have made them effectively weaker. Further, we would welcome future work on the link between rising corporate market power and rising wage inequality.

Trade and tariffs

We appreciate the Fund being responsive to the IMFC's call for more trade-related macroeconomic analysis. We generally agree with the two main policy conclusions of the analytical chapter on trade and spillovers from tariffs. First, the discussion of external balances is rightly focused on macroeconomic determinants of trade and current account balances. Aggregate external imbalances are not a negative indicator per se, since they allow countries to borrow to finance investment and future growth, or to smooth consumption at times when income is temporarily lost. But policymakers should avoid distortive macroeconomic policies that create excessive—and possibly unsustainable—imbalances. Second, multilateral reductions in tariffs and other non-tariff barriers will benefit trade and, over the longer term, improve macroeconomic outcomes.

We consider the coverage of issues in staff's analysis to be generally appropriate, although we believe that some aspects could be adapted to help the communication of key messages. Notably, the empirical analysis covering the last two decades demonstrates that the role of tariffs in driving bilateral trade imbalances is small relative to macroeconomic factors. However, we note that the role of tariffs should not be underestimated since large, sustained increases in tariffs can have significant long-term costs. Also, it is important to demonstrate that tariffs are a poor and ineffective tool at rebalancing trade. We urge staff to ensure that these messages are appropriately nuanced.

With respect to the underlying analytical framework, the gravity model is an excellent tool to understand cross-country differences, but it abstracts from intertemporal considerations by assuming that the trade balance is exogenously given. Recent research has started to incorporate intertemporal decisions which would not only be a fruitful avenue to pursue for the Fund's future research on trade issues but also for the External Balance Assessment (EBA).

Staff note that "open and fair trade, with lower or no tariffs or other obstacles to trade, can bring lasting net benefits to all involved if the right policies are in place to ensure that the gains are widely shared and those bearing the brunt of adjustment receive the help they deserve." While this statement is demonstrably true in theory, there is little evidence (to our knowledge) of broad-based policies that have been effective in supporting those bearing the brunt of adjustment. We would welcome future work by the Fund on this topic.

Global Financial Stability Report (GFSR)

Global financial conditions have tightened since the October GFSR but remain relatively accommodative. With financial vulnerabilities remaining elevated in the sovereign, corporate, and nonbank financial sectors in several systemic countries, and near-term financial stability risks having risen, we remain concerned about the possibility of a substantial and/or abrupt tightening of financial conditions. The recent improvement in financial market sentiment – which reflects an optimistic view of the current growth, risks and uncertainty conjuncture – is vulnerable to a reversal in sentiment that could be triggered by from a variety of factors. Potential factors include policy and political uncertainty, weaker-than-expected growth outcomes, escalated trade tensions, and a no-deal Brexit, among others. In that context, the message for policymakers to sharpen their actions to safeguard the resilience of the financial system, was welcome and, indeed, could have conveyed a greater sense of urgency.

We welcome the GFSR's deeper analysis of risks that have pivoted from banking to market-based finance and the corporate sector; the analysis on late-cycle corporate sector risks in AEs was particularly useful in this regard. We especially welcome the expanded focus on the need to develop additional tools, including macroprudential, for dealing with vulnerabilities, particularly related to rising corporate debt funded by non-bank lenders, deteriorating credit quality and leveraged loans. Given the nascent development of many macroprudential tools beyond banking, we would have liked to see a greater emphasis on the need for action and internationally coordinated developments in this area.

Further, we acknowledge that the sovereign-bank nexus remains a source of vulnerability, not just in the euro area but also in other jurisdictions. Highly indebted sovereigns should take actions to place their debt-to-GDP ratios on a downward trajectory. As noted in the Fiscal Monitor, a gradual fiscal adjustment is needed to reduce fiscal risks while focusing on policies that will support medium-term growth.

The analytical piece on downside risks to house prices is very timely, given concerns about the possibility of a decline in house prices in many countries, and the associated consequences. The new 'house prices at risk' methodology helps forecast downside risks to GDP growth, and could thus be a useful addition to the set of early warning models for financial crisis, as noted by staff. We encourage the Fund to explore ways to incorporate the use of this methodology in financial surveillance, including integration with macro-financial analysis in Article IV consultations in relevant cases.

Fiscal Monitor

Public and private debt are near historical peaks in many countries. With slowing global growth and rising uncertainty and inequality, fiscal policy efforts should be focused on striking a balance between growth and debt sustainability objectives. At the same time, fostering higher and more inclusive growth will require fiscal policy to increasingly adapt to key global trends, namely demographic shifts, technological advances, and international economic integration. We, therefore, welcome the Fund's ongoing examination of longer-run and global trends, including how fiscal policy can support human capital development and facilitate equal opportunities for all with the aim of creating a workforce fit for the future.

International cooperation also has a critical role to play in ensuring that fiscal policy remains nimble in the face of the above-noted global trends. We welcome the report's focus on international coordination and sharing of best practices, particularly on product and labor market reforms, social safety nets, and tackling corruption through targeted fiscal reforms.

For EMEs and LICs, high public debt levels, financing needs, and contingent liabilities pose major risks for their development prospects. Limited fiscal resources in LICs are being increasingly devoted to interest payments, crowding out much-needed financing for SDGs. In this context, ongoing Fund efforts are needed to promote greater debt transparency, strengthen debt management capacity, collect better data, and design program conditionality to support sustainable development.

We welcome the increased focus on corruption and governance, more broadly, in the Fiscal Monitor, which signals the Fund's acknowledgement of the macro-criticality of these issues. Given the unambiguous correlation between corruption and economic growth, we see merit in greater focus on corruption in surveillance going forward.

The limited fiscal space in many LICs and EMDCs underscores the need for prioritization and proper sequencing of reforms to tackle corruption, based on a thorough assessment of the sources and costs of corruption. This is where the Fund and other development partners can best help these members in their pursuit to curb corruption.

Finally, regarding the international tax system, we were disappointed that the Fiscal Monitor (Box 1.3) did not seem to reflect the recent Board meeting on this topic. In our view, Box 1.3 does not do justice to the value of the BEPS project, takes too polemical a tone in framing the debate around international corporate taxation, and is too blunt in its treatment of tax competition issues. Further, references to "tax wars" and "multilateralism under threat" do not help advance the debate in a constructive manner. It behooves the Fund to be more measured in its engagement on these issues.

Mr. Raghani, Mr. Razafindramanana, Mr. Sylla, Mr. Nguema-Affane, Mr. N'Sonde and Mr. Diakite submitted the following statement:

We welcome the set of flagships, including their analytical chapters which address current and topical issues of interest to the membership. The global economy is showing signs of slowdown amid significant fiscal vulnerabilities and rising debt, policy uncertainties—notably related to monetary stance, financial conditions, and trade—and an incomplete financial regulatory agenda. Global prospects, while not negative yet, are filled with heightened downside risks. Many challenges facing the medium to long-term outlook—including demographic changes, migrations, technological progress, resistance to global integration, and climate change—are also global in nature or carry significant potential spillovers.

In this context, urgent and coordinated actions are needed on the part of policymakers and regulators to sustain activity, tackle vulnerabilities and build resilience, and raise potential output. The policy priorities have not changed much since last October, but the degree of urgency has increased, requiring swift action. The traction of the flagships with policymakers should be leveraged to stress the need to urgently prepare for more "rainy" times.

World Economic Outlook

We welcome the streamlined chapter on developments and policy priorities (Chapter 1). We regret however that the Executive Summary does not do justice to the important messages from the analytical chapters, notably the need to promote competition laws to prevent the adverse macroeconomic impact of corporate market power, and the beneficial effects of trade as it relates to capital deepening, financial conditions and confidence the Executive Summary also fails to stress again the importance of multilateralism in addressing global challenges which have not receded since last October.

The slowing global activity reflects a conjunction of factors affecting advanced economies as well as emerging market and developing countries. The report rightly highlights the sources of uncertainties, including the tightening financial conditions, trade tensions, Brexit developments, and natural disasters in some corners of the globe. We note that, over the last six months, financial markets have somewhat retreated or have become volatile; the Fund has revised down global growth for 2018; and forecasts for this and next years are marked down.

Against this background, policymakers should press ahead with macroeconomic policies to sustain activity and avoid precipitating a full-paced slowdown while addressing macroeconomic and financial vulnerabilities. Among shared vulnerabilities is rising public debt which needs to be tackled through fiscal consolidation and improved governance but also better lending practices, notably vis-à-vis low-income countries. Structural reforms should be implemented to build policy space, increase resilience, and raise potential output.

We generally agree with the outlook, risks and policy priorities laid out in the chapter. We also fully share the necessity to reiterate the importance of multilateral approaches to addressing global challenges, including risk to financial stability, and the need for global regulatory reforms; international taxation; and climate change. We wish to focus on two important risks:

Trade tensions and rising protectionism, if they persist, are a major roadblock to further progress in global integration and a serious threat to the already slowing global economy. Attention should be paid not only to removing recent distortionary barriers to trade but also collectively reflecting on the rules of the world trading system to further advance trade. Regional trade agreements are also means to further integration. The Fund should relentlessly promote free trade and support multilateral cooperation. We underscore the importance of Fund communication on trade issues. This communication should not only focus on the gains accrued from trade but should also emphasize the need to protect vulnerable groups who have not benefitted from trade so far.

Second, regarding the tightening financial conditions, as the GFSR underscores, market participants seem to reassess the prospects for monetary normalization. Nevertheless, vigilance is warranted, and monetary policy should continue to be data-based, attentive of potential spillovers, and carefully communicated. Emerging and frontier economies should continue to tackle their vulnerabilities through fiscal and macroprudential policies, and build buffers to prepare for an abrupt or sudden capital flow reversal if that occurs.

Regarding low-income countries, we agree that these countries need to address fiscal and debt sustainability issues while creating the fiscal space necessary to meet their infrastructure building objectives and broader development agendas, notably through domestic revenue mobilization. The latter should include broadening the tax base, strengthening tax administrations but also tackling illicit financial flows, which must be emphasized. In building resilience, they should also enhance their policy frameworks and, for commodity exporters, press on diversifying their economies.

The analytical Chapter 2 contributes to the ongoing debate on what is becoming a growing corporate market power in some countries and some industries, and its implications. We note that while apparent macroeconomic consequences of this phenomenon have been modest thus far, further market power among the larger, high-productivity firms in advanced economies could produce negative outcomes on investment, innovation, labor income shares and effectiveness of traditional monetary policy tools. We also retain from the empirical analysis—based on more direct measures of market power (e.g. price markups) than has been the traditional power concentration measure—that it covers a large number of firms (a million) in 27 countries. However, one would have expected that the sample include other countries where the dominance of firms in certain industries has been significant. These include Asian countries such as China, India and Singapore, and even some countries from the Gulf Cooperation Council (GCC).

The measures proposed to discourage the eventuality of adverse macroeconomic consequences of corporate market power are useful, and include stronger competition laws and regulations, reduction of barriers to entry, recalibration of intellectual property rights with a focus on incentivizing innovation but not at the detriment of technological propagation. Corporate tax reforms may also have a role to play. We are of the view that the Fund should continue to deepen its analysis in this area and further fine tune policy recommendations. Among avenues for improvement, it should extend its analysis to emerging markets by including Asian and Middle-East countries. Finally, the analysis may also benefit from developing regional perspectives in corporate market power.

Against the backdrop of trade tensions and rising protectionism, the analytical Chapter 3 focusing on the price of capital goods and investment is welcome from the perspective of promoting trade to enhance global growth while supporting technological progress. In the case of emerging market and developing countries (EMDCs), we agree that further efforts to reduce existing trade barriers are needed to improve capital deepening. This would also be helpful in offsetting external headwinds. That said, we would have expected the chapter to shed more lights on trade developments and present a deeper analysis on trade agreements.

The analytical Chapter 4 presents another perspective on the beneficial effects of trade. It highlights through stylized facts that macroeconomic factors and policies in two trading partners explain changes in their bilateral trade balances. Moreover, the quantitative analysis in the chapter shows that, in a world where international division of labor among countries is advanced, raising tariffs have disproportionately greater negative spillover and spillback effects. In fine, the escalation of trade tensions that ensue would adversely impact all countries, including by-standers, through confidence effects and tighter financial conditions. These findings as well as the policy implications laid out in the report—avoiding distortive policies that generate excessive imbalances and companying tariff reductions with policies that ensure that both the benefits and costs of trade are widely shared—are intuitive, consistent with recent trade literature and, nonetheless, very valuable at this juncture.

Global Financial Stability Report

Financial vulnerabilities have continued to build notably in advanced economies, despite some tightening since October 2018, as market participants are reassessing prospects for monetary normalization. Moreover, risks to financial stability have increased. The reassessment of the outlook for monetary normalization follows decisions taken in early 2019 by major central banks to revise their approach to monetary policy normalization. We would very much appreciate staff appraisal of those decisions. Do staff consider those decisions consistent with IMF policy recommendations made in October 2018? In addition, as indications point to stretched asset valuation and a maturing corporate credit cycle in addition to growing debt and protracted trade negotiations, major central banks may have missed the opportunity to firmly contain financial stability risks and put market participants and policymakers on a better position to face future shocks. Staff's comments are welcome.

The resilience of emerging markets against foreign portfolio outflows in 2018 and the resumption of net capital inflows in those countries earlier this year are particularly noteworthy. Nevertheless, the growing share of benchmark-driven capital flows to those markets and frontier economies and their high sensitivity to global factors increase the risk of capital flow reversal and propagation of vulnerabilities if monetary policy stance in the US and Europe came to change significantly or abruptly. In addition, the forthcoming inclusion of China in some benchmark indices could trigger a reallocation of portfolio flows and result in net capital outflows in other emerging markets. This further highlights the need for those countries to continue strengthening buffers. We note the Fund's call for a close dialogue between index providers, the investment community and regulators. The operationalization of this dialogue deserves further elaboration.

The improved risk sentiment that followed the financial market rally in early 2019 benefitted also frontier markets whose sovereign issuance jumped after being quasi flat in the second half of 2018. However, like emerging markets, the inclusion of frontier economies in benchmark indices exposes them to potential capital outflows with the increasing weight of China. While we agree that there is a strong rationale for strengthening debt transparency and management, the estimated potential spillovers to emerging markets from capital outflows in frontiers markets seem to be on the high side. This also seems at odd with the GFSR's message in October 2018 that there were limited spillovers between emerging markets. Staff's comments will be appreciated.

It would be desirable to reconcile the narrative on rising EM benchmark-driven portfolio flows contained in this report with the account of increased differentiation of emerging markets by investors in the October 2018 GFSR. Is differentiation solely a fact of unconstrained investors? We would also appreciate staff elaboration on the factors that could drive investors away from index-based allocation? In addition, we very much valued the capital-flows-at-risk analysis in the October 2018 GFSR and would have appreciated an update of that analysis in the current report, especially considering the recent reversal in capital flows to emerging markets. Staff's comments are welcome.

We find the analytical chapter on the downside risks to house prices (Chapter 2 of GFSR) very insightful. We welcome the development of the house-prices-at-risk measure to quantify those downside risks, which could help improve surveillance of the financial sector. Given that this measure is specific to the housing sector, it is not surprising that macroprudential policies targeting specifically the sector appear to be the most effective in reducing risks to house prices, compared to monetary policy and capital flow management measures, which have a broader reach. We therefore agree with the report on the need to further strengthen macroprudential framework where needed.

Fiscal Monitor

We concur that, in the current environment of global growth slowdown, rising risks stemming notably from trade tensions, policy uncertainty and financial market volatility, and the need to adapt to the underlying trends of a changing global economy, such as demographic changes, technological progress and deepening global integration, it is relevant to reflect on the role of fiscal policy in the pursuit of both long-term growth and sustainability objectives.

We continue to appreciate the corpus of fiscal policy prescriptions in the Fiscal Monitor report which is attentive of the large heterogeneity of circumstances among advanced economies experiencing large fiscal deficits. Countries with a positive output gap or facing heightened risks to financial stability, and lacking fiscal space, should undertake vigorous fiscal adjustment in a growth-friendly manner as possible, with the view to reduce public debt and build up adequate buffers that are critical to confronting downturns. On the other hand, countries that have fiscal space should not frontload their adjustment efforts but rather take an intertemporal perspective in ensuring fiscal sustainability through credible and gradual medium-term consolidation program.

In the case of low-income developing economies (LIDCs), fiscal policy should support development objectives as rightly mentioned in the report. These countries face the daunting challenge of increasing spending to address important infrastructure gaps and achieve the Sustainable Development Goals (SDGs) while at the same time striving to preserve debt sustainability. For some countries, these development efforts take place in a challenging environment of security threats which heavily weigh on their budgets This concern should be better integrated in policy recommendations. In this context of large financing needs, it is important that, on top of their own efforts to enhance domestic revenue mobilization and make public investment management more efficient, LIDCs be in position to tap concessional and non-concessional finance when their debt situation make it possible. There remains the case of LICs in debt distress or facing high risk of debt distress which require debt restructuring through a coordinated process involving all creditors. It is important that this message be re-emphasized in the report.

Part of the efforts to raise budget revenue should lie on countries fighting corruption, which is addressed in the analytical chapter (Chapter 2 of Fiscal Monitor). This can have broader macroeconomic and development implications, notably in terms of growth, per capita income, inequalities, and financial stability as the empirical literature makes amply evident. The Fund, consistent with its mandate of macro- and financial stability, can help member countries improve their institutional and policy frameworks to fight corruption. In this regard, Chapter 2 of this Fiscal Monitor is a valuable contribution to such efforts.

There are several analytical issues addressed in the report that deserve further discussion. One question is the existence of alternative definitions of corruption, various shades and different degrees of relevance based on country circumstances, which makes a one-size-fits-all analysis of this phenomenon challenging. Another issue relates to the analytical methodology. Caution is needed in interpreting indirect measures of corruption which are often based on perceptions as the report rightly states that corruption's hidden nature and diverse manifestations make it difficult to measure. Furthermore, the positive correlation between perceptions of control of corruption and GDP per capita does not imply a direction of causality between these two variables.

With these caveats in mind, we welcome the report's efforts to uncover some of the channels of corruption and associated fiscal costs. Country experiences and cross-country analyses presented in the report illustrate channels through which countries can tackle the areas of public finance vulnerabilities. These include putting in place strong fiscal governance frameworks, including proper procurement and revenue administrations, digitalization, internal controls, transparency and independent external scrutiny.

Even when confined to fiscal governance alone, reducing incentives for corrupt behavior can be challenging in the public sector. The challenges can often be at the implementation stage, especially when absorption capacity of reforms is limited. Therefore, it is important to sequence and prioritize reforms.

We agree with the message that international cooperation is indispensable as corruption has important transnational channels, facilitated by the actions of some multinational corporations or vested interests and the lack of transparency in certain international financial centers. In this regard, collective action at the global level is needed to design an international framework for information sharing on assets ownership abroad, recovering and returning stolen assets, and helping countries put in place appropriate legislations and enforcement mechanisms.

Ms. Riach submitted the following statement:

We thank staff for a detailed set of reports. Crafting an overall global narrative in the context of a maturing business cycle is challenging, and given this uncertainty, we welcome the state-contingent policy recommendations. In addition, the analytical chapters in this year's reports are highly topical, which should support an engaging set of Spring Meetings.

Global Outlook

As staff suggest, the current business cycle is maturing, and many countries are experiencing slowing growth, driven by a range of common and idiosyncratic factors. Failure to act could damage credibility, but we also agree that there is limited policy space in much of the membership to combat a sharp downturn. Setting policy appropriately depends on the underlying economic drivers; in this context, we would have welcomed a deeper discussion of the current conjuncture to inform those recommendations. Could staff elaborate on where the global economy is relative to potential? What share of global output is being generated in countries operating above or below potential? How will those metrics evolve over the forecast period?

We also note that risks continue to be skewed to the downside and the number of potential downside triggers remains high. For example, global asset valuations appear to rest on a relatively benign view of the potential for the global economy to continue to expand without generating inflation. A change in expectations or increase in inflation could result in increases in both the level and volatility of market interest rates. A substantial snapback in world interest rates would pose a significant risk to asset prices, economic activity, and hence monetary and financial stability. Staff's views on this risk would be appreciated. In addition, the risks posed by volatile capital flows remain a major source of concern for the global outlook, and one that the international community needs to focus on in its discussions, particularly against a backdrop of large structural shifts in the global economy. More cross-border capital, not less, is needed to finance development and infrastructure and tackle climate change. Therefore, safe-guarding and promoting cross-border private sector capital flows should be a priority.

Brexit

We note the analysis undertaken by staff on Brexit, including WEO scenario Box 1. We understand that the text of this box remains liable to change between now and publication, given that the circumstances remain fluid. While we consider that neither scenario A nor scenario B in themselves represent plausible outcomes for a no deal Brexit, the analysis in general illustrates the risks posed and the value of preparation by both sides.

Specifically, Scenario B does not reflect the temporary tariff regime for a no deal Brexit published by our authorities last week, which confirmed that in the event of the UK leaving without an agreement the UK would not apply our current external tariff regime to the EU. This would mitigate some of the negative effects on GDP in this scenario. We understand from staff that this scenario is designed to represent an upper bound estimate for the impact of a no deal Brexit on trade. As such, we request that this point is clarified in the final version of this box, and that it recognizes the announcement of the temporary tariff regime even if this is not explicitly modelled.

We also underline the extensive progress since the October 2018 Global Financial Stability Report on mitigating actions related to financial stability in preparation for Brexit. Such measures include the recent activation of currency swap arrangements between the Bank of England and the ECB, to underpin market liquidity, and mutual temporary recognition for central counterparties. These build on previous actions to strengthen the resilience of the UK financial sector; major UK bank's capital ratios are three times higher than prior to the global financial crisis and UK banks currently hold over £1 trillion in liquid assets. The Bank of England's Financial Policy Committee judge that the core of the UK financial system, including banks, dealers and insurance companies, is resilient to, and prepared for, the wide range of risks it could face, including a worst-case disorderly Brexit.

Corruption

We strongly welcome the analysis of the detrimental impact of corruption on the economy, fiscal balances and the core operations of the state. In many countries, corruption continues to be a macro-critical issue that can undermine inclusive and sustainable growth and poverty reduction. The analysis strengthens the case for the Fund to help broader efforts underway to root out corruption through the enhanced framework on governance agreed in April 2018.

The framework for the promotion of good governance in the public sector presented in the Fiscal Monitor usefully highlights the critical elements contributing to strong growth-enhancing institutions. Fiscal transparency evaluations are a useful diagnostic tool in highlighting areas that can be further strengthened and should be rolled out across the membership. However, as the excellent country examples in the monitor highlight, corruption is often a political problem that cannot be tackled with technocratic solutions alone. We therefore encourage staff to adopt a broader perspective and consider the political drivers of corruption in future analysis, alongside a consideration of incentives that can help promote the required political commitment. The adoption of new technologies can be very effective in increasing transparency and accountability, but we would caution against seeing them as a panacea.

The attention to the international aspects of corruption in the monitor is also highly welcome, and we would support further work in this area. Concerted action across the "supply chain" of corruption needs to take place - from where it takes place, to jurisdictions providing safe harbors for the proceeds of corruption to those permitting money laundering activities. To this end, the UK has taken tough action to tackle corruption at home and overseas. It has published an Anti-Corruption Strategy, introduced an Anti-Bribery Act, launched a Business Integrity initiative to support doing business with integrity overseas and take actions to render the UK even more hostile to storing, investing and laundering the proceeds of corruption.

Corporate market power and competition

We welcome the chapter on corporate market power, noting the macroeconomic consequences of the significant change in market power since 2000 in some countries. Technological progress has driven some of these changes, with rapid advances in the digital sector leading to the emergence of powerful new companies. That in turn has raised questions about how to guarantee a competitive economy that respects people's privacy and ensures the whole of society can benefit from technological progress. Noting these trends, the UK government commissioned an independent review, led by Professor Jason Furman, to consider the potential opportunities and challenges that the digital economy may pose for competition policy. The review drew many similar recommendations to this chapter, including on the need to reduce obstacles to entry, adapt competition policy and expand the powers of competition authorities. Given the likelihood of these trends to continue across the membership, we encourage staff to continue work in this area, reflecting on country experiences, such as those set out in the Furman Review.

Trade

It is important that staff continues to provide a drum beat of evidence to support the case for open international trade and we welcome the findings of the two trade-related chapters. We agree with staff's conclusion that targeting bilateral trade balances will likely only lead to trade diversion and offsetting changes in trade balances with other partners. We also emphasize that multilateral reductions in tariffs and other non-tariff barriers (NTBs) will benefit trade and, over the longer term, improve macroeconomic outcomes. In continuing their work on this issue, we feel staff could further explore the role of NTBs. Reducing NTBs further has more scope to affect macroeconomic outcomes than tariff barriers given their relative size, and we again highlight the potential contribution more open trade in services could make. Given data limitations, NTBs and services trade remain relatively under-explored analytical issues, meaning the value added of Fund work could be high.

Tax

Finally, we were disappointed that the Fiscal Monitor (Box 1.3) did not appear to reflect the recent Board meeting on this topic. In our view, the box takes too polemical a tone in framing the debate around international corporate taxation, dismisses the scope to make further progress within the BEPS framework too readily and is too blunt in its treatment of tax competition issues, issues many EDs were concerned about at that meeting. Further, references to "tax wars" and "multilateralism under threat" do not help advance the debate in a constructive manner. The Fund should be measured in its engagement on these issues, reflecting the range of views across its membership. We expect staff to present a redrafted box consistent with the views of the membership.

Mr. Ostros, Mr. Evjen, Ms. Karjanlahti and Mr. Gade submitted the following statement:

We thank staff for the comprehensive set of flagship reports and the very interesting analytical work. We broadly share staff's outlook of the global economy and the associated risks. Further, we would like to offer the following comments for emphasis.

World Economic Outlook

Following a period with strong growth above potential, global growth has slowed during the second half of last year. Trade tensions have contributed to the dampening of global trade and broad-based deceleration of industrial production. The underlying momentum in the world economy appears to have slowed in response to the softening of activity in China and some advanced economies, heightened policy and political uncertainties, and volatility in financial market sentiment. We expect global growth to stabilize this year and next as some of the current headwinds gradually fade out.

However, we note the heightened uncertainties related to the near-term outlook.

We agree with staff's assessment on the balance of risks remaining on the downside and that factors such as continued trade tensions and deterioration of market sentiment can affect the global outlook negatively. Additionally, the risk of a sharper than expected slowdown in the Chinese economy remains as financial vulnerabilities persist, and available policy space continues to diminish. We also note the continuing uncertainties related to Brexit and highlight the importance of preparedness to reduce risks of systemic disruptions in a case of a no deal outcome.

We recognize that the recent slowdown in growth in the euro area has been pronounced. However, it is mostly related to some temporary domestic factors and a disproportional hit from the slowdown in global trade. GDP projections by staff suggest that some large euro area countries will experience a more significant slowdown in 2019 than others. Overall, we expect the European economy to continue to grow this year and the next, though at a slower pace.

We agree with staff that avoiding policy missteps is important and that policies should aim to reduce unnecessary uncertainties and support growth, whilst ensuring debt sustainability and financial stability. Furthermore, in the coming years, economic policy should focus on enhancing resilience and raising potential growth. Structural policies aimed at lifting medium-term growth should be given central attention. This could be supported by fiscal policy measures that boost potential output, whilst reducing income inequality. We agree with staff that it is important that public investment aims to raise productivity growth and labor force participation. It is also important to improve financial resilience and contain financial stability risks, given higher debt levels among sovereigns, households, and firms in many countries. Macroprudential tools should be employed proactively to address financial vulnerabilities. We would also stress that addressing trade tensions and strengthening global cooperation are of the utmost importance.

Many economies have ageing demographics which will affect the supply of labor – unless counteracted by higher productivity growth – subsequently affect growth prospects. It will also affect public finances via age-related spending. We believe that this demographic challenge should have been mentioned in the main chapter.

We find the results from the IMF's investigation of the rise in corporate market power interesting and in line with our own observations. We note that the increase in mark-ups is concentrated to a smaller fraction of relatively more productive and innovative firms in non-manufacturing industries. At this stage, the macro-economic effects have been modest, but they may become more severe if the trend continues. We concur with the conclusions that strong competition law and policy is a key complement to product market deregulation.

We agree with the policy implications in chapter 3, which conclude that facilitating international trade and reducing trade costs are important to lower the relative price of machinery and equipment investments, which in turn fosters investment growth. Considering the slow productivity growth in advanced economies in recent years, it is important to identify measures to reverse this trend. Trade liberalization and lower tariffs can indeed be important factors for increasing productivity growth and their importance for emerging markets and developing economies is highlighted. There are also important lessons to draw for advanced economies. A lower relative price of capital goods could also spur innovation and productivity growth and thus increase GDP growth rates. However, in this context we highlight the importance of understanding the distributional consequences and the effect on the capital to labor income ratio when discussing the welfare effects of declining capital goods prices.

We fully subscribe to the two main policy conclusions from the analysis in chapter 4. First, that targeting particular bilateral trade balances is unproductive and that the aggregate trade balance is determined by macroeconomic fundamentals. Second, that there is a strong case for lowering tariffs and non-tariff trade barriers within a multilateral rules-based system. The results imply that lower tariffs will not only boost trade, but also allow adjustment in the international division of labor to more fully reflect the comparative advantage of each country. This in turn leads to output, employment, and productivity gains for the countries involved. We would, however, like to emphasize that further reduction of barriers to trade in services is equally important to reap the above gains. This would further support the growth of trade in service sectors, that has recorded strong growth in recent years.

Global Financial Stability Report

We share staff's assessment that financial conditions remain relatively accommodative but have tightened since the October 2018 GFSR. A dovish shift in the outlook for monetary policy in advanced economies and some optimism toward the US-China trade dispute have contributed to these conditions considering weakening global growth. We, however, consider market sentiment fragile to abrupt deterioration particularly given the uncertainties in the global economy and political landscape. Additionally, with financial conditions still accommodative, financial vulnerabilities continue to build and excessive risk-taking and mispricing of risks should continue to be closely monitored.

We welcome the attention to corporate sector risks in advanced economies and particularly to the rise in US corporate debt levels and increase in US leveraged loan markets. The new framework presented in the GSFR for analysing balance-sheet vulnerabilities across financial and non-financial sectors is welcome. While we take note of the assessment that balance sheets appear strong enough to sustain a moderate economic slowdown or a gradual tightening of financial conditions, unexpected sharp movements could strain the debt service capacity of indebted firms. In the absence of policy action, a future downturn could be deeper. More can be done to improve resilience and reduce risks, for example by taking measures to limit further leverage and strengthen private balance sheets. The idea of developing more macro-prudential tools toward the non-financial corporate sector is very interesting and seems timely.

With the challenges in the sovereign-financial sector in mind, we welcome the analysis of the different macro-financial contagion channels and the assessment of the resilience of euro area banks. We agree that euro area banks have built buffers since the crisis and are better prepared to face future shocks. However, we also acknowledge that nexus between banks and sovereigns remains a source of vulnerability, with other financial firms, such as insurance companies, exposed as well. We concur with staff that it is important for highly indebted sovereigns to take action to reduce debt levels and for banks to continue to repair their balance sheets. Further efforts are needed to reduce the stock of nonperforming loans. We also acknowledge the need of policies to address the bank-sovereign nexus and, in this context, consider the bail-in requirement in BRRD as an important measure to reduce contingent liabilities for the public sector.

The recent rebound in emerging market asset prices and portfolio flows is a welcome development. We would, however, caution against excessive optimism towards emerging market financial conditions as the risk of a renewed market turmoil remains pertinent. As staff’s analysis highlights, the increased share of benchmark-driven investors further increases the sensitivity of emerging market portfolio flows to global factors. Thus, it remains important that emerging market economies continue to improve resilience against volatile capital flows by reducing external vulnerabilities, strengthening buffers and building stronger foundations for robust growth.

We agree with staff that financial sector policies should tackle financial vulnerabilities in an environment where low yields and volatility are likely to persist and be proactive in deploying or expanding macroprudential tools in countries where vulnerabilities are elevated or rising. We also agree that it is important to use for example the countercyclical buffer when needed, and apply, when possible and relevant, loan-to-value, debt service ratios and debt to income ratios to mitigate financial stability risks. Yet, few macroprudential tools are available to address vulnerabilities in the nonbank financial sector.

We welcome staff's analysis on how the development in different variables relates to the probability of a large decline in house prices. As housing plays a key role in the economy, for investment and consumption as well as for lending decisions, it is important to enhance the analytical framework in which housing imbalances are identified. The house-price-at-risk measure makes it possible to quantify the downside risks related to house prices and therefore encourages the policymakers to be more proactive. It should however be noted that overvaluation is a key factor in the analysis, and the result most likely depend on the definition of this variable. More country-specific measures of the fundaments affecting house prices, such as demographic changes and user cost, should be included when assessing downside risks in individual countries.

Fiscal Monitor

We share the view that fiscal policy has focused more on macroeconomic stabilization than on strengthening long-term inclusive growth and on adaptation to the challenges of secular trends. It has brought along elevated public debt level that limits the fiscal policy room to maneuver in case of the next downturn. We therefore generally agree with the conclusion of the report, namely, that fiscal policy should be shaped both to prepare countries for the next downturn and to enable adaption to global trends and challenges such as shifting demographics, rapid technological progress, and rising global economic integration.

In the current context of high public debt levels and tapering of global economic expansion, countries need to pursue a careful balancing act in designing their fiscal policies by building adequate fiscal buffers and ensuring debt sustainability while at the same time pursuing well-designed reforms that support growth. As stated in the report, the changes brought on by technological advances and deeper trade and financial integration have implications for labor and product markets where social spending and tax policies must keep pace. Adaptation to global trends should be addressed by fostering sustainable long-term economic growth via openness and innovation, but it is equally important to ensure that the gains are broadly shared within societies.

The focus on curbing corruption is welcome. Our constituency has been a long-standing promoter of transparency and good governance, and has supported the Fund's work in this context, including the framework for enhanced IMF engagement in governance implemented in 2018. The importance of good governance, transparency, and solid institutions and frameworks to fight corruption and to achieve strong, sustainable, and inclusive economic development cannot be overstated.

The chapter provides a convincing overview of the detrimental toll of corruption in countries of all levels of development along with helpful country experience. Although we acknowledge that other institutions and state functions also have an important role to play, we agree that institutions responsible for core fiscal operations such as budget, tax, and procurement administration play a vital role in curbing corruption. This is particularly important as corruption has been found to affect fiscal revenues and growth to a significant degree i.e. through the effect on revenues and quality of spending. We find the elements of a fiscal governance framework outlined in the chapter to be an excellent basis for fighting corruption. It gives particular weight to transparency, external oversight, international cooperation, and the importance of political will. In our view, the section of the framework dedicated to international cooperation could stand to be developed further, as often corruption and the related flows can have an international affiliation

Mr. Kaizuka, Mr. Saito, Mr. Komura and Mr. Minoura submitted the following statement:

World Economic Outlook (WEO)

Global growth is now projected to slow to 3.3 percent in 2019 but pick up to 3.6 percent in 2020. Beyond 2020, the Fund expects robust growth at around 3.6 percent in the medium term. At the same time, we take note that this robust medium-term projection is based on the assumption that emerging market, including China and India, maintains its strong growth.

Risks are tilted to the downside. In particular, as the WEO points out, risks of a rapid slowdown of global growth, a further escalation of trade tensions, and a non-deal Brexit should be closely monitored.

Against this backdrop, we share the staff's view that a main policy priority should be to avoid policy missteps that could harm economic activities. On top of that, each country needs to take appropriate and timely actions, if necessary, based on its economic environment and policy spaces.

At the same time, all countries should work together for reducing downside risks and vulnerabilities. In this statement, we would like to especially highlight the following two points:

Reducing trade tensions and promoting open, rule-based global trade system are warranted. To this end, the Fund needs to keep emphasizing benefits of such global trade system and costs of protectionist measures. In this regard, we are of the view that this WEO, including its analytical chapters, is delivering appropriate messages. Specifically,

The chapter 1 well highlights trade tensions as main downside risks. In addition, we agree with staff that well-designed and ambitious regional arrangements, such as the CPTPP and the EU-Japan EPA, help to preserve and promote open, rule-based global trade system.

The chapter 3 shows that deeper trade integration and faster productivity growth in the capital goods producing sector have driven the broad-based decline in the relative price of machinery and equipment, explaining a non-trivial share of the rise in real investment rates over the past three decades. This result illustrates benefits of further reducing trade barriers and, in turn, substantial costs associated with protectionist measures. The chapter mentions that emerging market and developing economies still maintain higher trade barriers. We believe that the Fund should focus on trade barriers in bilateral surveillance for those countries, especially ones playing important roles as global production bases.

The chapter 4 finds that lower tariffs raise productivity through greater international division of labor and further specialization based on comparative advantages. Based on this finding, a following policy message should be emphasized. Namely, multilateral reductions in trade barriers, instead of bilateral tariff actions which would produce trade diversion effects, will benefit trade and, in the longer term, improve macroeconomic outcomes.

Reducing excess global imbalances is also critical agenda for the global economy. To this end, it is extremely important to reaffirm, in every opportunity, the basic principle that excess global imbalances should be dealt with adjustments of I-S balances by macroeconomic and structural policies, not with bilateral trade deals. Japan emphasizes this point under our G20 presidency. The Fund is also in an important position to underscore this principle. In this regard, we appreciate that the 2018 ESR delivered the message that protectionist measures, including tariff actions, will not help to reduce excess global imbalances while decreasing overall trade volume. In this WEO, we welcome that the chapter 4 underscores that discussions on excess external imbalances should focus on macroeconomic factors, instead of tariffs, based on empirical analysis on the determinants of trade balance. For instance, the chapter shows that a hypothetical large US-China trade disputes have no significant impacts on their aggregate trade balances, reflecting that macroeconomic factors, not tariffs, are main determinants, while the level of their bilateral trade is much reduced.

Furthermore, all countries, especially advanced economies, should keep pushing forward reforms to raise potential growth and to share gains from growth widely. Stagnated productivity growth, especially after the GFC, has not been reverted. In addition, enhancing inclusiveness plays a critical role in maintaining trust to nations and global economic system. We therefore look forward the Fund to further working on this area. In this context, we appreciate the analysis in the chapter 2 on the rise of corporate market power and its macroeconomic effects, including innovation and distributional effects.

Turning to the specific comments on individual economies, we would like to emphasize the followings:

On the Japanese economy, we take note that the chapter 1 assesses that the coupling of the planned October increase in the consumption tax rate with mitigating measures to support near-term activity is appropriate to ensure long-term fiscal sustainability while protecting growth. We are of the view that the Japanese economy is expected to be on a continuously recovering trend as employment and income environment improves, in part reflecting effects of mitigating measures for the consumption tax hike.

On the Chinese economy, policies should continue to focus on enhancing the quality of growth. In particular, a shift toward private consumption-driven growth by deleveraging and rebalancing is essential. Meanwhile, a rapid slowdown of growth, potentially by a further escalation of trade tensions, poses a downside risk on the global economy, through substantial spillover effects. In this context, while some stimulus measures may be needed if a larger-than-expected slowdown hit the Chinese economy, we encourage the Fund to closely monitor whether reforms toward the longer-term goal make progress steadily.

Global Financial Stability Report (GFSR)

While financial conditions have tightened since the October 2018 GFSR, they remain relatively accommodative. After sharp declines in the fourth quarter of 2018, markets rebounded with variations among countries in the first quarter 2019, reflecting a dovish shift of the outlook for monetary policies in advanced economies. On the other hand, financial vulnerabilities continue to build under the continued accommodative financial conditions.

As staff pointed out in the report, a sharp tightening of financial conditions could be triggered by a sharper-than-expected growth slowdown, an escalation of trade tensions, and political risks including a no-deal Brexit, which need to be cautioned by policymakers. Against this background, we encourage the Fund's continued advices on appropriate policy mix including macroprudential measures, to enhance financial resilience of member countries.

We also take note that an unexpected shift of an outlook for monetary policies in advanced economies could lead to a tightening of financial conditions. In this light, central banks are encouraged to keep close and clear communication with market to avoid disruptive volatility in financial markets.

As the credit cycle matures, we share the staff's concern of the increased corporate sector debt in advanced economies, and take note of risks regarding the deteriorated creditworthiness of borrowers and the increase in leveraged loan market. Against this backdrop, policy makers are required to proactive in deploying prudential tools or expanding their macroprudential toolkits as needed. In particular, given the inadequacy of prudential tools to address risks related to rising corporate debt funded by nonbank lenders, it is important to contain vulnerabilities in the nonbank financial sector. In this light, while staff mentioned as "few macroprudential tools are available to address risks related to rising corporate debt funded by nonbank lenders," we appreciate staff's more elaboration on possible policy measures and macroprudential tools to address vulnerabilities in the nonbank sector.

Increased sovereign spreads in Italy and possible spillovers to the banking sector and the real economy should be monitored carefully. We urge the authorities' and banks' continued efforts to implement rigorous risk management including further reduction of the level of nonperforming loans (NPLs). Moreover, in order to address the sovereign bank nexus ultimately, it is indispensable for highly indebted countries to lower their debt-to-GDP ratios through fiscal consolidation. We encourage the relevant authorities to take further actions on this front.

As financial vulnerabilities remain elevated, we understand that Chinese authorities have been facing a difficult trade-off between supporting near-term growth in the face of adverse external shocks and containing the buildup of financial imbalances. We welcome that strengthened macro- and micro-prudential regulation have contributed to containing bank asset growth, credit via on- and off-balance-sheet investment vehicles and shadow credits. Having said that, we share staff's concern that less progress has been made in reducing vulnerabilities related to the large stock of investment vehicle assets and the regulatory reforms for the asset management sector have been scaled back in recent months. In addition, weaknesses of profitability and capital ratios at small and medium-size banks need to be addressed not only to improving resilience, but also to ease financing conditions for smaller firms. At the same time, we encourage the authorities' implementation of deeper reforms to strengthen governance of SOEs including their budget constraints and reduce credit misallocation by eliminating the bias towards infrastructure and real estate sector, in order to contain credit risks and vulnerabilities.

We take note of the growing influence of benchmark-driven investors on portfolio flows to emerging markets. While it is expected to contribute to enhancing and diversifying opportunities of external financing for some emerging economies, a larger share of benchmark-driven investors could increase the sensitivity of portfolio flows to global financial conditions. Against this shift, authorities in emerging markets need to reduce excessive external liabilities and reliance on short-term debt, as well as to maintain adequate fiscal buffers, bank liquidity buffers, and foreign exchange reserves. We also note that the inclusion of China's local currency bonds in benchmark indices could bring $150 billion in additional inflows to China by 2020. We would appreciate it if staff could share more detailed explanations and views on estimated impacts of the inclusion on the financial systems in China and other economies whose weights would be reduced due to China's inclusion.

We appreciate the staff's detailed analysis in the analytical chapter 2 on downside risks to house prices by using a house prices-at-risk (HaR) framework. As increased downside risks to house prices over the next one to three years have been seen in some countries, authorities need to implement an appropriate policy mix to contain imbalances and risks of housing markets, given significant macroeconomic impacts of house prices and their asymmetricity, as well as the increase in synchronization of house prices among countries, suggested by the analytical chapter 3 of the April 2018 GFSR. At the same time, we encourage staff's continued efforts to accumulate stocktaking of member countries' experiences and make appropriate policy advices bearing in mind its operational feasibility.

Fiscal Monitor (FM)

Avoiding policy missteps that could harm economic activities, as the WEO mentions, should be a main policy priority in the near term. In this regard, we agree with staff that fiscal policies should carefully strike a balance between growth and sustainability objectives based on economic environment and policy spaces in each country. From a longer perspective, fiscal policies should adapt to key trends shaping the global economy, such as demographic changes, technological changes, and global economic integrations, to foster higher and more inclusive growth. The Fund needs to support members with more granular policy advice on their tax system, education and training system, and social security system. Because of large country specificities on those systems, we encourage the Fund to work on this issue by well integrating bilateral and multilateral surveillance.

We are concerned about rising public debt vulnerabilities. In particular, public debt has rapidly grown in developing countries. The share of LIDCs in debt distress or at high risk of debt distress had increased from a quarter in 2012 to half by early 2019. Furthermore, interest expenses in LIDCs have recently increased while public investment expenditures have decreased. In this context, we consider it important for those countries to enhance quality of investment, including infrastructure investment, to raise potential growth while ensuring public debt sustainability.

Against this backdrop, while the Fund and the Bank work together on the multi-pronged approach now, we consider that the FM illustrate the importance of the approach. We urge the Fund, together with Bank, to implement its agenda steadily and timely, showing specific achievements on this issue. In particular, Improving debt transparency and debt management are critical. The chapter 1 highlights risks associated with contingent liabilities from non-transparent financing. We encourage the Fund to keep supporting LIDCs to enhance the coverage of data on public debt and improve administrative capacity on debt management by technical assistance.

For reducing public debt vulnerabilities, developing countries need to improve public financial management (PFM) and to strengthen domestic revenue mobilization (DRM) to make their public finance less depending on borrowings from other countries. On PFM, the chapter 2 well illustrates how corruption brings fiscal costs, including lower revenues and inefficient budget allocations, illustrating the importance of better PFM. We encourage the Fund to keep supporting members to improve PFM by technical assistance. On DRM, we consider that medium term revenue strategy (MTRS) which covers a wide range of revenue-related areas, including tax system and tax administration, is a critical instrument. In this regard, we welcome that the chapter 1 describes recent progress of developing and implementing MTRS. To maximize effectiveness of supports on MTRS, it is important for technical assistance providers to coordinate at the Platform for Collaboration on Tax. The Fund holds rich experiences on supporting developing countries in this area, for example, through RMTF and TADAT. We encourage the Fund to actively collaborate on other institutions, including the Bank, based on these experiences.

Mr. Tombini submitted the following statement:

We thank staff for the comprehensive and insightful analytical work embedded in the IMF's flagship reports for the 2019 Spring Meetings.

World Economic Outlook

Despite being revised downwards, global growth remained robust at 3.6 percent in 2018, while decelerating to a more modest projection of 3.3 percent in 2019. Risks to the outlook continue to be tilted to the downside and have become more apparent due to self-inflicted circumstances, such as US-China trade dispute and Brexit negotiations, as well as to high policy uncertainty clouding the global outlook. The global economy may be facing a delicate balance, in which mounting challenges to policy makers leave very little space for mistakes.

The more pronounced and broad-based slowdown, in a context of intensifying structural headwinds, heightens the challenge of properly using limited policy space. The extent of growth deceleration in the second half of 2018 represented a negative surprise and the softened momentum continued as we entered 2019. Cyclical factors, magnified by policy issues, persistent uncertainty and structural drags, are driving the reduction in global economic speed. In most advanced economies, it is apparent that economic growth has already peaked and is now heading towards low rates of potential growth, mainly determined by demographics and slow progress in productivity growth.

Global trade growth has slowed sharply from its peak in late 2017 on the back of continuing trade tensions, which continue to present a significant downside risk to the global economy, with the potential of having negative effects going beyond the current cycle. The delicate rebalancing of the Chinese economy has been further complicated by the trade contentions with the US, which prompted an expansionary policy reaction. The US-China truce has raised the expectations of negotiated solution to the disagreements, but while some upside has been already incorporated in market perceptions, failure to resolve differences on trade, investment and property rights may have long-term impacts on business confidence, investment, financial market stability, supply chains and productivity growth. Against this background, we agree with the call for closer cooperation with a view to modernizing the WTO and resolving trade disputes within the existing multilateral, rules-based system.

The shift in the expected monetary policy normalization path in the US and, more recently, in Europe has provided a relief to markets, but also raises important questions. Policy uncertainty and rapid financial tightening in the second half of 2018 had waning effects on the global growth momentum. With the presumed interruption of the previous expected normalization path, improved sentiment has translated into a recovery in capital flows to Emerging Market Economies (EMEs) and, generally, currency appreciation in those economies. Looser financial conditions, however, hinge on the assumption that the monetary policy normalization in the US has come to an end, which in its turn depends on the tight labor market not leading to inflation acceleration. Even with the benign behavior of consumer prices so far, the fact that the US economy is expected to run above potential warrants a close monitoring of such developments and their far-reaching implications. A sharp tightening of the financial conditions could materially affect capital flows to EMEs and exacerbate debt vulnerabilities. Meanwhile, prospective growth and interest rate differential between the US and the euro area, as well as possible safe haven effects that might be unleashed by a surge in risk aversion or disappointing growth in EMEs, could yield scenarios that go beyond the trade-off between growth and financial conditions. Could staff elaborate on whether a low growth, strong dollar scenario arising from the current juncture is a reason for concern?

The marked slowdown in Europe has been mostly explained by idiosyncratic, temporary factors. We are wary, though, that the baseline may entail a more severe and pervasive softness, aggravated by the prevailing risks. A no-deal Brexit would disrupt supply chains and raise the cost of trade and not only have long lasting negative impacts on the UK, but also in some of its main partners. Moreover, renewed policy and political uncertainty in Europe could feed into sentiment, dragging domestic demand. Could staff elaborate on the likelihood of more underlying weaknesses being at play in Europe and what, in such a case, would be an adequate response, given the existing policy space?

Even with an expected lower growth in 2019, conditions in emerging market and developing economies (EMDEs) are projected to improve along the year. EMDEs' growth is expected to rebound in 2020 and would be the main factor behind the better performance of the global economy forecasted for that year. In Brazil, growth is projected to step up this year and continue moving upward next year, bolstered by higher consumer and investor confidence on the back of a bold structural reform agenda, which includes the social security reform, budget de-earmarking, tax reform, improvement in the business environment, privatization and trade liberalization. Well-anchored inflation expectations may provide further policy space to support growth, as the reform agenda moves forward.

Global Financial Stability Report

In line with the analysis in the WEO, the GFSR rightly calls for special attention to the fact that economic slowdown is taking place before most advanced economies resumed their previous path and policies normalized. In such circumstances, policy makers should continue to support growth, as appropriate, to avoid a sharper slowdown. However, in doing so, they should retain focus on enhancing resilience, while escaping the temptation of feeding into vulnerabilities to boost economic activity.

In spite of the recent easing of financial conditions in 2019, vulnerabilities remain high and have increased, hence financial stability could be derailed if markets expectations are frustrated by a shaper slowdown, a steeper normalization, or increased policy/political uncertainty. In fact, easier financial conditions contribute to stretch valuations and may result in sharper adjustments when the cycle turns down. Insufficient buffers and policy space may put vulnerable economies in a more difficult situation in case any of such risks materialize.

The main vulnerabilities identified in advanced economies are the excessive corporate indebtedness, especially in the US, as well as banks' exposure to public debt dynamics in the euro area. While maintaining monetary policy accommodation alleviates the pressure in both situations, it does not address the underlying vulnerabilities and may even aggravate them, particularly in the case of corporate indebtedness. We take note that rising corporate debt has been increasingly taken by non-bank creditors, for which there are insufficient prudential tools. Indeed, staff lists several macroprudential tools that could be used to address excessive credit expansion, while some non-bank lenders (i.e., insurers and asset managers) remain broadly outside the perimeter of such measures. Considering the late stage in the corporate credit cycle, prudential tools would help to avoid building further vulnerabilities, but are inadequate to address existing ones. Could staff elaborate more on how to mitigate existing vulnerabilities and on how effective the policies proposed in the report would be in case risks materialize?

While EMEs navigated well the selloff pressures in 2018, they should remain prepared for bouts of volatility. Capital flows to EMEs have been relatively resilient, but the more widespread incidence of benchmark-driven portfolio flows could increase contagion and disconnect such flows from country-specific fundamentals. Benchmark-driven portfolio investments are more sensitive to changes in global financial conditions and to changes in the composition of the index. This behavior tends to transmit external shocks throughout the asset classes faster than usual. On the positive side, taking part in the index could boost inflows and, by circumventing the need of deep country-specific analysis, may become the first step to invest in an unfamiliar economy.

Fiscal Monitor

We welcome FAD's assessment on the costs, country experiences and best practices to improve governance and fight corruption from the perspective of fiscal institutions. We strongly support the continuous analytical work on this issue to raise awareness and provide guidelines to mitigate its impact on public finances. While corruption remains difficult to measure, strengthening public financial management and governance in fiscal institutions can undoubtedly reduce its incidence. We associate ourselves with the promotion of ethical behavior among public officials. We also favor greater transparency and accountability, as key elements to fight corruption in the public sector. Furthermore, the rapid growth in digitalization in recent years provides an opportunity to use information and communications technology (ICTs) as a practical tool to promote transparency and accountability, as well as to identify and deter corruption. An increasing number of countries are using technology to combat corruption. Yet, available research on the impact of new technologies on the fight against corruption appears to be limited. Could staff provide further empirical evidence and case studies on how to leverage ICTs for anti-corruption efforts?

Global integration and technological progress have made corruption schemes more complex and sophisticated, warranting international cooperation to effectively tackle its causes and diminish its ominous repercussions. While international cooperation against corruption have made headways in recent years, there is still significant room for improvement in areas such as information exchange, legal arrangements and procedures, including for asset recovery, and capacity building. An issue that requires further action from the international community is the treatment of secrecy jurisdictions and tax havens. By providing opportunities for individuals and firms to evade national and international laws and regulations, these jurisdictions weaken fiscal institutions and lower the costs of criminal activities. They represent real obstacles in the international efforts to curb corruption. We believe all jurisdictions should establish mandatory, public registers that disclose the ownership of funds. Against this background, we would welcome staff elaboration on what else multilateral institutions like the Fund could do to promote high standards of transparency and accountability in global financial markets?

Mr. Beblawi, Mr. Geadah, Ms. Abdelati, Ms. Choueiri, Mr. Al-Kohlany and Ms. Merhi submitted the following statement:

World Economic Outlook

We thank staff for a detailed set of reports and for the topical analytical chapters.

Global growth has slowed in many countries and the global outlook has been revised down for 2019. The cyclical upswing decelerated in the latter half of 2018 reflecting a maturing business cycle in most advanced economies, as well as some common and some idiosyncratic factors. To some extent, the rising trade tensions between the U.S. and China have negatively affected business confidence and financial market sentiment. There is also the dampening effect of the necessary regulatory tightening in China and of the other country-specific factors in Germany, Italy, the U.K., and Japan. The projected pickup in 2020, driven mostly by the contribution of EMEs, depends on the recent improvements in global financial sentiment, following the shift in stance by the Federal Reserve as well as policy stimulus in China, and expected stabilization in a number of other large EMEs. However, it remains unclear whether the recent slowdown is part of a deeper and broader slowdown or a transitory path.

We hope that growth will surprise on the upside, but downside risks seem to have increased. Importantly, policy space remains limited amid high debt levels and elevated financial vulnerabilities. Countries need to be prepared for a less favorable scenario of a further escalation of trade tensions, and a possible no-deal Brexit, with a renewed rapid tightening of financial conditions. Over the longer term, key challenges to be tackled include climate change, shifting demographics, the impact of rapid digitalization, and political discord in the context of rising inequality.

We consider the Fund's advice to be appropriately focused on avoiding policy missteps that could further weaken growth. Macroeconomic policies need to be geared toward preventing further growth deceleration, while building resilience and economic inclusion. If the current slowdown proves to be more severe and protracted, more accommodative policies will be needed, particularly in countries where financial stability is not at risk. At the multilateral level, we agree that policy makers should cooperate to resolve disagreements to avoid injecting further destabilizing dynamics into a slowing global economy.

Volatile capital flows continue to represent a key source of risk especially for emerging market and developing economies who rely on external financing for critical development needs. A sudden tightening of financial conditions is a key risk, and the Fund should be prepared not only with advice but also potential financing in the case of a severe adverse scenario. Many countries are also grappling with creating enough jobs for a growing youth population. Therefore, it is important to advance initiatives to build human physical capital, advance structural reforms that remove obstacles to private investment and enhance labor participation, and to pursue pro-growth fiscal policies.

Middle East economies. With significantly lower oil prices compared to the last fall, and following agreed production cuts, the outlook for the group of MENA oil exporters is for slower growth in 2019 compared to last year. Nevertheless, a strong pickup is expected in specific countries, namely Iraq, Kuwait, U.A.E. and Qatar. For oil importers, the WEO is projecting growth to slow from 4.3 percent in 2018 to 3.7 percent in 2019 due in large part to a sharp slowdown in Pakistan and conflict-affected countries. However, the picture is differentiated and a pick up is expected in several oil-importing countries in both 2019 and 2020 including Tunisia, Morocco, Jordan, Lebanon, and Egypt. In the case of Egypt, economic activity is expected to grow by at least 5½ percent this year and approach 6 percent in 2020, which is allowing unemployment to decline markedly from previous levels. In terms of other good news for the region, the current account deficit of oil importers is expected to narrow in the coming two years, with Egypt having narrowed the deficit sharply from 2017 to under 2½ percent in 2018 and is expecting a further decline to below 2 percent in 2020. In the face of heightened global uncertainty, and persistent regional geopolitical tensions, sustained efforts to preserve macro stability and implement far-reaching structural reforms is key to unleash growth potential in the Middle East.

Staff's analysis in Box 1.3 provides useful insight on the widening income disparities between regions within advanced economies since the late 1980s. We agree that persistent income disparities have political economy implications, reduce trust, and increase political polarization. This regional aspect of disparities sheds a new perspective on regional divisions that may align with political and ethnic tensions. However, we would like to see more staff work on analysis of growing disparities and their potential economic consequences, not just on the regional level but also at the national levels.

The increase in corporate market power, which is mainly technology-driven, has important macroeconomic consequences. Staff's analysis finds little evidence of a weakening of pro-competition policies. This is a surprising view, however, given the greater access to individual user data and cross-border reach of digital technologies which inhibits sets up barriers to competition. We therefore agree that competition agencies should have enough resources to investigate mergers in detail and to examine the possible existence of barriers to entry when an industry's profits are larger and more persistent. A key policy challenge is how to maintain fair competition as digital technologies expand and what are the implications for adapting competition policies to a new landscape. We look forward to future research in this area.

We welcome staff's analytical work on the determinants of bilateral trade balances, and the view that external imbalances are not a problem per se since countries need to borrow to finance future growth, but policy makers should avoid distortive policies that lead to excessive imbalances. We also welcome the affirmation of the benefits of open and fair trade, if the gains are widely shared or those bearing the cost of adjustment are compensated or receive assistance. We would welcome staff's comment on successful examples of such compensation, and whether additional work is planned to highlight best practices?

Global Financial Stability Report

Since the October 2018 GFSR, near-term downside risks to global financial stability have increased. Against the background of relatively accommodative global financial conditions—despite the tightening late last year—and the US Federal Reserve's more gradual approach to monetary policy normalization, which supported a turnaround in market sentiment, financial vulnerabilities may continue to build. We share staff's view that medium-term financial stability risks remain elevated and could build further. The report highlights the risk that financial conditions remain susceptible to a renewed rapid tightening, which could expose existing vulnerabilities in sovereign, corporate, and nonbank financial sectors and raise near-term financial stability risks. Against this background, the report makes a series of well-targeted recommendations to preserve the resilience of the financial system, namely clearly communicating any change in the outlook of monetary policy normalization; using macro-prudential policies more proactively where vulnerabilities are elevated and rising, mitigating the sovereign-financial nexus, and bolstering resilience in emerging markets to be able to cope with capital flow volatility.

The sovereign-financial sector nexus remains an important source of vulnerability in the euro area. While bank capital buffers have improved in most jurisdictions, increased holdings of government debt have made some banks more vulnerable to a sovereign shock. We share staff's concern that this creates a risk that strains in the financial sector could be passed on to companies and households, with negative implications for economic growth. We would appreciate staff's comments on whether risks associated with the sovereign-financial sector nexus in some euro area countries could result in spillover to sovereign yields in other euro area countries?

We share the report's recommendations for emerging market economies to ensure resilience against portfolio outflows by reducing reliance on short-term debt and maintaining adequate fiscal and foreign-exchange reserve buffers. We also welcome the analysis on the rising importance of benchmark-driven portfolio flows in emerging markets. This development provides countries with access to a larger and more diverse pool of external financing. In this connection, we are pleased to note that staff expects the recent inclusion of Bahrain, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates in the EMBI Global Index—in addition to Oman, which was already part of the index—to boost flows to these GCC countries. However, a rising share of benchmark-driven investors also leads emerging markets to be treated as an asset class, shifting the focus from country-specific developments to factors that affect emerging markets as a group. The October 2018 GFSR signaled a different behavior by investors who had been differentiating among countries based on their fundamentals, against the background of a deteriorating market sentiment in some emerging markets last year. Could staff elaborate on country exceptions—cases of investor interest beyond the weight in the benchmark index—where investors are differentiating based on fundamentals? Given the importance of benchmark-driven portfolio flows in emerging markets, we agree with the need for a close dialogue between index providers, the investment community and regulators. In staff's view, what would be a good outcome of this dialogue?

The October 2018 GFSR included a useful box on correspondent banking relationships (CBRs) which highlighted the fact that concentration through fewer CBRs accentuates financial fragilities in some countries and could affect these countries' long-term growth and financial inclusion. We fully support continued strong engagement by the Fund on ways to address the withdrawal of CBRs. Particularly, we support ongoing efforts to facilitate dialogue between regulators in home and host jurisdictions and among market participants, as well as capacity development programs to strengthen legal, regulatory, and supervisory frameworks, and assist supervisory agencies in affected countries in the analysis of CBR trends.

In light of the recent rapid increase in house prices in many countries, and the associated concerns about the possibility of a price correction, Chapter 2 presents a useful house prices-at-risk framework and explores the relationship between policies and house prices at risk. We agree with staff that policymakers in charge of financial stability can use estimates of house prices-at-risk to complement other surveillance indicators of housing market vulnerabilities and guide macro-prudential policy actions aimed at building buffers and reducing vulnerabilities. We also agree that downside risks to house prices could also provide relevant information for monetary policymakers when forming their views on the downside risks to the economic and inflation outlook.

Fiscal Monitor

We welcome staff analysis and policy recommendations in this Monitor, which focus on how fiscal policy should adapt to global trends and prepare for the next downturn. Debt vulnerabilities, volatile oil prices, and tightening financial conditions call for fiscal restraint. We agree, however, with staff that limited fiscal support could be warranted in countries with some fiscal space and where growth is slowing. Fiscal policy should continue to balance growth, equity, and sustainability objectives, while adapting to the emerging global trends. Some countries can afford a gradual adjustment to support non-oil growth. It will be critical to boost revenues, improve spending quality, and better manage debt burdens, given that the estimated resources needed to achieve high performance on the Sustainable Development Goals by 2030 are immense.

In our region, fiscal consolidation efforts have continued to advance in both oil-exporters and oil-importers. In the Gulf countries, the introduction of the VAT constitutes a major milestone to diversify revenues. Other examples include Egypt, which has shifted to a primary fiscal surplus in a very short time and sharply reduced debt, and Jordan which has introduced a new income tax law, as well as other fiscal measures. Jordan and Lebanon continue to shoulder the burden of hosting large refugee populations. This is putting a significant strain on their fiscal balances and social services. Therefore, we concur with staff that coordinated international support and financing are also needed to confront broader challenges that no country alone can manage, such as tensions caused by conflict and migration.

Focusing on reprioritizing expenditures and increasing their efficiency is crucial to boost growth and support human capital development. Cutting unproductive spending, including untargeted subsidies, could also create room for public investment. These reforms should be accompanied by measures to protect vulnerable populations. We concur with staff that public financial management reforms could help expand the budget envelope through efficiency gains. The use of technology can also realize efficiency gains, by reducing, for example, cost of tax compliance or deliver a better targeted transfer mechanism. International cooperation is also essential to address crucial issues through a multilateral approach, such as corporate taxation of multinational companies, climate change, and corruption.

The discussion in chapter II draws a number of useful conclusions and recommendations on how to curb corruption, which distorts the use of public resources and impairs the effectiveness of government policies. We agree with staff that fighting corruption requires having strong institutions to promote integrity and accountability. In addition, designing appropriate incentives and controls can help reduce vulnerabilities to corruption. The key elements of a strong fiscal governance framework include a legal and regulatory framework, a professional civil service, and transparent information systems, and it is important to extend these practices to SOEs. Similarly, the governance challenges for resource-rich countries are greater and call for a higher degree of transparency and accountability in the exploration of these resources and the management of public assets. We recognize the important role of the Fund in many aspects of fiscal governance, including by promoting dissemination of good practices and peer learning. We are pleased to note the utilization of the Fund's comprehensive diagnostics tools and commend FAD for this great work. We would appreciate staff feedback on the level of expected demand from the membership for these tools going forward, and what would be the implications in terms of additional resources and budget for FAD.

Mr. Mojarrad, Mr. Sassanpour and Mr. Nadali submitted the following statement:

World Economic Outlook (WEO)

The growth momentum is weakening in major economies under a combination of factors, including trade tensions, efforts to rein in credit growth and debt accumulation in China, the diminishing effects of the fiscal stimulus in the United States, and the waning activity at this late stage of the credit cycle. The outlook is also fraught with risks, including an uncertain Brexit, country-specific financial and socio-political tensions in Europe, economic stress in some large emerging market economies (EMs), and the US policy on Iran and broader geopolitical risks (with their attendant impact on the oil market), which continue to weigh on the outlook.

The global trade tensions have extended beyond the parties involved and affected many emerging market and developing countries (EMDCs)– particularly those in developing Asia, both directly through the supply chains, as well as indirectly by threatening (or possibly reversing) the downward trend in the relative price of capital goods, and hence hampering investment (Chapter 3). Could staff comment on the extent to which these trade tensions have contributed to the WEO's trimming of global growth projections in 2019-2020? That said, we support staff in calling on major parties to the trade disputes to settle their differences within the existing rules-based system that has worked well and withstood the test of time. We also encourage staff to continue stressing the benefits of multilateralism in various forums and publications.

We agree that the cross-cutting policy priorities across the membership is to build (or reinforce) resilience in preparation for the next global downturn, which is virtually inevitable. There are other challenges, notably the aging issue in the AEs and the climate change, which require advance policy preparation. Immigration, which is not a new phenomenon, calls for effective absorption of immigrants, which should be viewed as an economic imperative as much as a humanitarian issue, as the fairly well-educated, younger and more mobile immigrants can contribute significantly to mitigating the host countries' adverse demographics.

In an environment of moderating growth, little or no nominal wage push, low unemployment, and subdued inflation, AEs should maintain an accommodative monetary policy, while at the same time building sufficient resilience and boosting potential output through major structural reforms. In cases where there is policy space (mostly on the fiscal front), we agree that policies should try to strike a balance between supporting demand and output, and assigning adequate resources for protecting the poor and vulnerable and meeting social objectives in health and education. Monetary policy in the euro area should remain accommodative for an extended period and the recent decision by the Federal Reserve to pause is welcome. But the side effects of prolonged monetary policy accommodation in building up financial sector vulnerabilities must be addressed. Investing in infrastructure and in human capital, facilitating greater labor force participation (particularly of women, older workers, and new immigrants), and supporting technological and digital advances should pay high dividends down the road, but well-sequenced plans must be formulated and put in motion well in advance.

Box 1.3 presents an interesting analysis of within-country income disparities and their impact on galvanizing discontent with globalization in the poorer regions of the AEs, with attendant political polarization. Although this trend started in the 1980s, its implications have become palpable in more recent years. This is an unexplored area that in our view deserves closer attention, with the recognition that market forces alone and country-wide policies may not be sufficient to eliminate the root causes of spatial income inequality and social discontent. We encourage further staff research in this area.

The low-income countries (LICs), many of which are already saddled with heavy debt, continue to suffer from the higher cost of borrowing, the lower availability of concessional finance, and fluctuations in commodity prices. The LICs and many small island states also bear the brunt of the adverse impact of climate change despite their own negligible carbon footprint. With external conditions stacked against them, their policies need to be focused domestically on revenue mobilization, enhancing resilience to shocks, curtailing unproductive spending while protecting the vulnerable groups, and creating an enabling environment for private sector growth and employment, including by tackling governance and corruption issues. However, as suggested by Fund staff studies, despite the LICs' best efforts in domestic revenue mobilization, the realization of their Sustainable Development Goals (SDGs) critically hinges on availability of concessional finance from the international community.

Oil producing countries, including in our region, continue to be exposed to disruptive boom-bust cycles and sharp relative price changes and, in response, have been pursuing–with varying degrees of success–policies to diversify their economy and revenue base, promote private sector-led growth and employment, and upgrade human capital and labor skills. We welcome the WEO's analytical special feature on extracting information from the commodity markets for forecasting purposes, but in the case of the oil market, we would like to underline the market's particular vulnerability to abrupt supply shocks (including unilateral sanctions) that cannot be modeled. As regards the oil importing developing countries in our region, the policy priorities are to build buffers during periods of growth and subdued oil prices, use monetary and exchange rate policies flexibly to that end, and ensure the protection of vulnerable groups.

Global Financial Stability Report (GFSR)

Against the background of the weakening global growth and increased uncertainty highlighted in the WEO, near-term global vulnerabilities and financial risks have increased moderately, while medium-term risks remain elevated. We share staff assessment of the relative country and sector exposures to these risks and note the renewed concern about sovereign-financial sector nexus in the euro area, increased corporate leverage in AEs, the growing housing price risks in several countries, and the growth slowdown in China in response to tightening of financial conditions. We welcome the indication that banks' vulnerabilities remain well contained and that EMs, other than China, have reduced financial vulnerabilities. With regard to a possible re-emergence of the sovereign-financial sector nexus in the euro area, which could be triggered by a sharp deterioration of financial conditions in countries with weak bank balance sheets and strong links between banks and sovereigns, we note from Figure 1.4 that financial sector vulnerabilities for banks, non-financial corporates, and insurers in the euro area are assessed to be low. Could staff comment on the likelihood of seeing another episode of sovereign-financial sector nexus? Is this scenario more akin to a tail risk?

The sharp equity market selloff in late 2018 may have reflected market perception that the pace of withdrawal of monetary policy accommodation in the United States was not in tune with the weakening growth in the US and around the world. Financial markets rebounded fairly quickly in early 2019 once the Federal Reserve signaled its "patience" with monetary policy normalization, also aided by market optimism over an expected US-China trade deal. With asset valuations still stretched and elevated vulnerabilities and downside risks, including from recent developments concerning Brexit, further financial market turbulence cannot be ruled out.

We welcome the indication that EMs were relatively resilient during the end-2018 market turmoil, and that portfolio outflows stabilized and rebounded in early 2019. While this reflects improved fundamentals and more attractive valuations in most EMs, the GFSR seems to suggest that the increase in the share of benchmark-driven investors may make capital flows to EMs more sensitive to global financial conditions than to country-specific developments. Could staff elaborate on the significance of this shift and whether the conventional understanding that investors discriminate among countries based on fundamentals is still valid?

We concur with the policy priorities and agree on the importance of strengthening resilience and addressing potential vulnerabilities and risks from various sources, including corporate debt, the housing market, and the non-banking sector. Both AEs and EMs, including China, need to tackle their country-specific vulnerabilities while containing negative spillovers. In addition to strengthening banks' balance sheets by reducing high NPLs, micro and macroprudential policies will be key to containing rising risks and addressing balance sheet vulnerabilities in the corporate and household sectors. Going forward, the limited room for policy maneuver, whether it is fiscal or monetary policy, will be quite challenging when the next economic downturn will happen. This underscores the importance of building resilience.

Fiscal Monitor (FM)

The FM depicts an overall environment in which public and private debt hover near historical peaks, with public debt ratios now significantly higher than those before the GFC in all country groups. Going forward, unwarranted easing of the fiscal stance in AEs and widening overall deficits in

EMs would further reduce the space to address fiscal risks and new challenges stemming from shifting demographics, rapid technological advances, and deepening global economic integration. We agree that fiscal policy should balance growth and sustainability objectives and benefit from international cooperation in addressing multilateral issues, including in corporate taxation, climate change, and corruption. Should downside risks materialize and necessitate back loading of adjustment, a clear and credible medium-term consolidation plan would help ensure debt sustainability.

While there is considerable divergence among countries within each group, fiscal restraint remains appropriate for AEs with high debt levels and facing expenditure pressures from an aging population, and EMs relying on external financing amidst tightening global financial conditions. Limited fiscal support, however, is warranted where demand is weak and there is some fiscal space. We see merit in better compliance with and enforcement of the EU fiscal rules to help reduce fiscal vulnerabilities and preserve the credibility of the common fiscal framework. Fiscal policy in low-income developing countries, focused on supporting long-term growth and development objectives, needs to be complemented by substantial concessional finance, even after assuming an increase of 5 percentage points in the tax-to-GDP ratio over the next decade to meet the SDGs.

We welcome staff analysis on corruption which reduces revenue collection, distorts spending choices, impairs the effectiveness of government policies, and undercuts efforts to promote sustainable and inclusive growth. We concur with the view that extractive industries and public procurement of goods and services, the granting of authorizations and licenses in a non-transparent way, as well as the activities of SOEs, are typically hotspots for corruption.

We agree that political commitment to comprehensive reforms, strong institutions and oversight, and greater international cooperation are essential to effectively combat corruption. Country experiences confirm that chances of successfully containing corruption are higher when mutually-supportive institutions are strong and credible. This involves a sound legal and regulatory framework, simplified tax code and modernized revenue administration, well-functioning budget and treasury systems, enhanced public financial and debt management, good corporate governance for SOEs, and effective system of incentives and disincentives. We concur with the view that a multipronged international cooperation to fight global corruption is critical and must involve, among others, improved international exchange of information, actions against bribery of foreign officials on the supply side, transparency in international transactions in extractive and natural resource sectors, as well as anti-money laundering activities and the fight against tax evasion through off-shore centers. The Fund and other multilateral institutions have an important role to play in disseminating best practices in this area.

Mr. Gokarn, Mr. Siriwardana and Ms. Dhillon submitted the following statement:

World Economic Outlook

We thank staff for an excellent document. While Chapter 1 effectively analyses global prospects and risks, the other three report on interesting findings on market power, the price dynamics of capital goods and factors affecting bilateral trade. These factors are directly related to many of the risk factors discussed in Chapter 1 and, therefore, provide substantial micro foundations to the macroeconomic outlook. We broadly agree with staff's assessment of prospects, risks and policy prescriptions, but would like to highlight a few points.

While the quantitative forecasts suggest a small blip in global growth during 2019 before it reverts to a stable trajectory in 2020 and beyond, the analysis of risk factors points to a somewhat more negative outcome. This is understandable, due to the difficulty in assessing the key risks identified – bilateral trade tensions, Brexit, etc. – and, consequently, the possibility that the assumptions underlying the forecasts may simply not pan out. The discussion of risks highlights this issue, but we feel that it is somewhat downplayed in the policy discussion. Since many of these risks are global in nature, i.e., external to many countries' policy, the importance of global policy responses should be given more prominence in the discussion. We suggest that, at the very least, it be placed before the country discussions in the chapter.

As regards the forecasts for Indian growth, we note that these have been lowered somewhat for both 2019 and 2020. We understand that these downgrades are explained by recent data revisions and not by any significant changes in the assessment of growth prospects. Could staff comment? Further, the key policy prescriptions laid out in the chapter – fiscal consolidation, infrastructure investment and strengthening of the financial sector – have already been prioritized by the authorities and are reflected in several policy measures that have been taken over the past few years. These are expected to yield significant long-term dividends in terms of both growth acceleration and macroeconomic stability. The forecasts suggest that the global risk factors can, to a significant extent, be offset by domestic policy actions.

Chapter 2 provides a very useful analysis of market power. Building on analysis presented in the EWE in October 2017, it quantifies increases in market power over a large cross-country sample of firms and discusses the potential costs that this imposes on the global economy. Global regulatory responses are implied. We think that this line of research is very important in the lager context of multilateral and collective solutions to global problems and encourage staff to continue with this work. In particular, strong market power in intellectual property, whether it is in IT, pharmaceuticals, renewable energy sources or other sectors which offer potential solutions to global challenges, could dilute the effectiveness of potential solutions.

Chapter 3 offers a new perspective on investment activity and the role that the prices of capital goods may be playing in its slowdown over the past few years. Intellectual property and economies of scale are both important factors in the competitiveness of manufacturers in this broad sector, resulting in significant international trading volumes. Reviving investment is a broad policy prescription emerging from Chapter 1; Chapter 3 highlights the potential for rising trade barriers to hinder this process. Of course, many other factors are also generating headwinds for investment, but this one has particular significance for EMDEs, as they are primarily importers of capital goods, broadly speaking.

Chapter 4 makes a very important point in the context of the assessment of key global risks; tariff increases do not provide a solution to bilateral trade imbalances. Increased protection, including higher tariffs, are clearly a causal factor in the recent slowdown in global trade. However, the implication that lowering tariffs can reverse the trend permanently needs to be seen in the light of zero lower bound considerations. Would reducing tariffs to zero across the board result in a significant and enduring increase in the growth rate of global trading volumes?

GFSR

The GFSR indicates that financial conditions have tightened since October 2018 report although they remain relatively accommodative. Financial markets turned around recently due to the more patient approach to monetary policy normalization in the United States, complemented by the renewed optimism about trade negotiations between the United States and China. Nevertheless, financial vulnerabilities continue to build up and medium-term risks to the global financial stability broadly unchanged amidst the growing signs of weakening economic growth. The present report focuses particularly on corporate sector vulnerabilities, which have already been elevated in some systematically important countries. That has created downside risks to growth as the credit cycle matures and eventually turns, especially in the United States. The current situation underscores that we cannot be complacent and need to be vigilant on unfolding developments while avoiding a rollback of regulatory reforms.

Against this backdrop, we welcome staff's recommendations to policy makers to address financial vulnerabilities. Given the uncertainty on the pace of monetary policy normalization, the importance of a well-communicated stance in the United States has been evident, particularly in the recent past, to avoid market overreaction and triggering sudden and undesirable volatilities. The effective usage of the present window of opportunity is important to reduce systemic risks by continued reforms in banks' operational and risk management policies to improve readiness of the players, i.e. financial intermediaries, markets and market infrastructures. In this context, we see the importance of deploying proactive prudential tools or expanding the macroprudential toolkits, while concentrating on sector specific tools where necessary, in a timely and effective manner with global cooperation and strong involvement of global standard setters. We very much value and echo staff's recommendation on the need for maintaining integrity of the institutional framework for macroprudential oversight.

At the same time, we note the emergence of different risks i.e. increased risks in two key segments in the credit market and the increased role of non-bank lenders, amidst historically high debt levels. Staff has highlighted the absence of prudential tools to address risks related to rising corporate debt funded by non-bank lenders. Staff also provide a summary on the available prudential tools for different types on vulnerabilities (Table 1.3) for a sample of 29 systematically important jurisdictions. Could staff comment on the potential for broader usage of these tools by other countries? The need for taking measures to repair public and private sector balance sheets, as well as gradual fiscal adjustment with growth friendly fiscal policies cannot be overemphasized.

The new framework for comprehensive assessment of balance sheet vulnerabilities across financial and non-financial sectors is a positive step forward. It would help identifying vulnerabilities and tracing the transmission of potential shocks and policies. Staff's comments are welcome on the key features of the new balance sheet approach and how it differs from the previous method(s).

The report rightly analyses several key aspects in the present global scenario, i.e. the sovereign-financial nexus in the euro area, vulnerabilities in China, emerging markets and frontier economies, and the implications on a no-deal Brexit. We agree with staff that addressing links between banks and sovereigns should be done with a holistic perspective and coordinated manner. China needs to address risks stemming from the interconnectedness of the banking and shadow banking system where vulnerabilities are entrenched. The message for the emerging economies to ensure their resilience against capital flow reversals in response to shifts in the global environment by reducing excessive liabilities and maintaining adequate fiscal and foreign exchange reserve buffers is clear. However, it should be complemented by orderly and timely communication of key policy moves by systematically important countries to avoid disruptive volatility in financial markets. In the context of the increasing importance of benchmark-driven portfolio flows, particularly by sovereign borrowers, staff recommends a close dialogue between index providers, the investment community and regulators. We would welcome a further elaboration on key policy directions expected through this proposed dialogue. Regarding the frontier and low-income countries' highly sensitive nature to changes in global risk sentiment and the high possibility of facing more market pressures due to weak debt management capacity, we believe that the Fund should play an important role by providing TA and CD to address these issues.

We see the analysis on the downside risks to house prices in chapter 2 of GFSR as informative. The new house-prices-at-risk (HaR) framework is expected to be a useful tool to predict downside risks to house prices, which is a key source of risk to the financial system and to the overall economy. It is also expected to help guide macroprudential policy actions going forward. We note staff's conclusion that some macroprudential policies appear to be effective in reducing house prices at risk over the more limited ability of the monetary policy on it. We also note staff's conclusion that 'capital flow measures might help when other policy options are limited, or timing is crucial'. Could staff comment on to what extent this conclusion is consistent with Fund's institutional view on capital flow measures?

Fiscal Monitor

An ever -changing global economy demands a fiscal policy which works in synchronization with the challenges of advancing technology, changing demographics and global developments. Pressures abound, from trade tensions, financial vulnerabilities, rising debt, Brexit and policy uncertainty. In this setting, the fiscal monitor presents a wide-ranging and timely analysis urging a balanced fiscal policy for inclusive growth and cautions on the downside risks. Amongst many solutions, the FM underscores greater international cooperation to address multilateral issues and to spread gains of reform globally, by addressing prime issues including corruption.

A universal approach to Fiscal policy is implausible. Pragmatically, theFM alludes to country tailored policy to match economic landscapes. Country cases present diverse scenarios and the related policy blends with rebalancing for checking debt vulnerabilities, fiscal consolidation and fiscal stimulus across three main country groups. When we talk of fiscal space, there is a premium on fiscal reforms through expenditure reprioritization, efficiency gains, public financial reforms, and revenue generation in the national fiscal policy implementation. It is also important to bear in mind that global factors do pose challenges, with demographics, technology and financing being key. FM has highlighted that fiscal policies need to adapt to these global trends by upgrading tax, active labor market policies, and a cut in wasteful subsidies and unsustainable social spending. We recognize that many of these reforms may involve tough tradeoffs and political complexities. Against the global backdrop of weaker nominal growth, rising debt, tighter financial conditions, commodity price volatility and the overhang of skepticism on benefits from globalization, could staff offer their views on the appetite of these measures?

Moreover,fiscal policy has its confines, especially in emerging markets and low-income countries. Here it faces the unenviable task of accelerating economic growth while balancing social spending, ensuring stability, reducing poverty amidst uncertain headwinds globally. The room for maneuver may be further constrained by the sectoral configuration of the economy. So, where agriculture continues to be the main driver of the rural economy, the exercise of fiscal policy is often circumscribed by the need to be supportive of this sector by way of social protection. Also, transmission lags need to be taken on board. In this context, with respect to India, we believe that staff comments on the recently announced farm-income-support program and revenues on goods and services tax (GST) revenues leading to deteriorations are not warranted.

Beyond this, international cooperation has a critical role for advancing fiscal efforts. In this direction, we welcome the focus on borderless areas cooperation including digitalization, taxation and the financial support to low income developing countries. Noting the annual spending gap to attain meaningful progress on the SDGs related to infrastructure alone in low-income developing countries amounts to US$358 billion, we would like to stress the importance of national polices to complement international support coming from the realistic standpoint of the needed levels of international support materializing fully and swiftly.

We welcome the focus on curbing corruption. Corruption can stifle a country's economic growth and damage the citizens' trust in institutions. Fiscal and social costs of corruption are well documented. The cases cited for country experiences offer an eclectic mix of choices which have succeeded, the complexity of the issue and the multipronged efforts needed. The lessons emerging in the FM to focus on good governance through strong political commitment, integrity of fiscal operations, transparency and external foresight are persuasive. Within the surveillance mandate, we welcome the continued deep engagement of the Fund on AML/CFT in cooperation with the World Bank, the Financial Action Task Force and other bodies. We see this as the right way for increasing transparency and reinforcing the strength, safety and integrity of the financial system. Therefore, incorporating AML/CFT and governance measures as a binding program conditionality should be an established pre-requisite in Fund programs and we hope to see progress on this.

In the same vein, we welcome the attention to international corruption and staff accentuating corruption as a global problem with transnational dimensions. Indisputably, it warrants enhanced international co-operation, both from the perspective of facilitators and enablers of corruption. Secrecy jurisdictions, tax havens remain loopholes and destinations for illicit flows. Exporting corruption, and cases of money laundering are another large piece. Therefore, we like the focus on combating bribery by companies, pursuit AML/CFT and the recognition these afore stated factors. Cooperation on the return of persons sought for offences and stolen assets, consistent with international obligations and domestic legal systems must also be included. Notably, FM mentions US$7 trillion in hidden wealth deposited by individuals—equivalent to 10 percent of world GDP. It would have useful to have a nuanced analysis of the flows, and more details on the composition and directions of these flows. Could staff elaborate?

Mr. Mozhin, Mr. Palei, Mr. Tolstikov, Mr. Potapov, Ms. Smirnova and Mr. Snisorenko submitted the following statement:

WEO

The global economy has slowed down in the second half of 2018, and the WEO growth forecast for 2019 is also substantially lowered. Although some slowdown has been already anticipated in the previous report, its magnitude appears to be higher now. Deteriorating market sentiments are frequently mentioned as one of the main factors driving growth down. Against the background of the accumulated vulnerabilities in the global economy, it seems that the ongoing unraveling of international cooperation is weighing heavily on investors' confidence.

Risks to the outlook remain substantial, and the balance of risks is again on the downside. Even relatively modest recent escalation of trade tensions has resulted in a noticeable decline in activity and sent shock waves across global production chains. A full-blown tariff war, which is still possible, could have a much deeper effect. Still growing financial vulnerabilities heighten the risk of a rapid market tightening and flight to safety. In the European Union the risk of disorderly Brexit is becoming more acute. In the United States, debt sustainability concerns in combination with pro-cyclical fiscal policy present formidable challenges. Unabating geopolitical tensions add even more uncertainty.

In such an environment avoiding policy missteps that could make the situation worse is the main priority, as staff appropriately suggested. We note that the focus of the current WEO has shifted from discussing how to use the favorable economic environment for strengthening the fundamentals to more immediate challenges and policy responses. We can conclude that the main priority now is to avoid a sharp slowdown of the global economy.

Market volatility has forced the central banks in advanced economies to largely postpone the normalization of monetary policy. In many economies, especially in the Euro Area, such an approach is driven by weaker growth and lingering financial stability risks. While additional policy easing helped to offset market pressures, these measures do not address the longstanding structural impediments and weak fundamentals. In the United States the revision of the pace of normalization occurred despite relatively strong economic activity, emerging wage pressures, and inflation close to its target. The central banks in advanced economies should aim to continue gradual data-driven and well-communicated monetary policy normalization. If monetary and financial conditions remain accommodating for a prolonged period, the authorities may face credibility issues, public and private debt will rise further, posing a threat of a deeper downturn in the future.

In the United States, procyclical macroeconomic policies boosted output above potential and brought unemployment to its lowest level in decades. It also led to the US dollar appreciation and a record trade deficit, fueling protectionist pressures. Pro-cyclical fiscal stance further increased fiscal deficit and aggravated debt sustainability concerns. Staff's advice to focus fiscal policy on raising revenue with greater emphasis on indirect taxes is, therefore, appropriate. We also agree that withdrawing monetary policy support in a well-communicated manner remains critical.

We note a substantial downgrade of growth prospects in the Euro Area, especially in Germany. We wonder, what are the main factors behind such a slowdown in Germany, in addition to "delays associated with introduction of new fuel emission standards for diesel-powered vehicles". We broadly support staff's advice on fiscal policies for the Euro Area, as well as staff's call for completion of the banking union, strengthening banks' balance sheets, and addressing the sovereign-financial sector nexus.

The prospect of the no-deal Brexit remains the major risk for the stability and growth in the UK and Europe, and its repercussions may also be felt worldwide through disruption of trade and rapid tightening of financial conditions. Protracted uncertainty weighs heavily on investment spending in Europe. Recent developments have only increased the risks to the baseline scenario.

We welcome China's continued rebalancing towards a more sustainable growth model, including the authorities' recent efforts to reduce reliance on credit and to rein in shadow banking. Reduced credit growth and trade tensions with the US have slowed down exports and economic growth. Under these circumstances, we agree with staff that the authorities can use some fiscal expansion to support growth. However, the large-scale infrastructure programs may not be the best way to implement fiscal stimulus in China.

We appreciate the analysis of corporate market power and its macroeconomic effects (Chapter 2). The rise of market power in the last 15-20 years has attracted considerable attention outside the Fund. Although macroeconomic implications of rising market power have been modest to date, they could be increasingly negative in the future, with slowing innovation depressing economic growth. The chapter also provides valuable insights for debates on the international corporate taxation issues.

GFSR

We broadly agree with staff's view on the risks to global financial stability. On a backdrop of accommodative monetary policies, financial vulnerabilities continue to build up, increasing the likelihood of a sudden tightening of financial conditions. The risk factors are numerous: a shift to less accommodative monetary policies, continuous deterioration of non-financial corporate balance sheets, the sovereign-bank nexus, elevated real estate prices, as well as the intensification of trade tensions, disorderly Brexit and adverse geopolitical developments. At this stage any of these factors may become a trigger for destabilization in the financial markets. At the same time, we would positively highlight the relative resilience of emerging market asset prices during the end-2018 financial markets turbulence.

The analysis of corporate sector risks in advanced economies once again points to a precarious and worrisome situation in this market segment. Staff highlighted that in the U.S. the corporate credit cycle appears to be at its highest point in recent history, while the situation in Europe is also a cause for concern. This late-cycle position is coupled with historically high levels of corporate debt and increased role of nonbank lenders, which create additional risks to stability. While in the aftermath of the crisis in the U.S. we witnessed improved corporate balance sheets and stronger debt servicing capacity, more recently the fiscal stimulus and persistently easy financial conditions led to deteriorating credit quality. As the effect of the fiscal stimulus is waning and financial conditions become less benign, the corporate sector may find itself in a more difficult position.

Against the background of elevated risks, we welcome the new analytical tools, which strengthen the Fund's capacity to understand and analyze the accumulation of vulnerabilities. We welcome the in-depth analysis of sovereign-financial sector nexus in the Euro Area. This framework allows to identify weak points and analyze interactions and channels of shock transmission in the financial systems, including not only sovereigns and banks, but also corporates and households, and the insurance sector.

We welcome the analysis of benchmark-driven portfolio flows. The volume of funds benchmarked against the emerging market bond indices is rapidly growing, and such investments become an increasingly important part of the EM-dedicated investment flows. We note the staff assessment that about 70 percent of country allocations of investment funds are influences by benchmark indices. As benchmark-driven flows are highly sensitive to external factors rather than country-specific factors, they may increase the volatility of capital flows, while the countries' fundamentals and quality of macroeconomic policies may become less important for investors. This is a somewhat disturbing conclusion, which may give additional arguments to the proponents of self-insurance and/or capital controls.

Fiscal Monitor

Slowing economic growth and significant downside risks pose new challenges for fiscal policies. Adaptation to new realities will require refocusing of expenditures towards investment in physical and human capital and improving expenditure efficiency. Fiscal policies should also contribute to reducing inequality and more equitable distribution of benefits from technological advances and global integration.

We support staff's call for greater international cooperation on critical fiscal issues, such as taxation of the multinational corporations. Given its universal membership, the Fund can play a more active role in international corporate taxation issues.

We appreciate staff's efforts in Chapter 2 of the Fiscal Monitor to assess the fiscal costs of corruption and to explore practical ways in the fiscal area to curb opportunities for corruption. Cross-country evidence, provided in the chapter, suggests that fiscal institutions can play a pivotal role in containing corruption. In particular, we note the importance of fiscal transparency, and we encourage the Fund to promote and widen its Fiscal Transparency Evaluations (FTEs) exercise. We also agree that digitalization could play an important role in promoting the integrity and transparency of the budget process and public finance at large.

In our view, improving the business regulation and environment is also critical to fighting corruption. In this context, staff's analysis could be strengthened by providing more information on the links with the World Bank Doing Business Indicators. Tackling corruption also requires greater international coordination in such areas, as information sharing, anti-money laundering activities, detection and prosecution of bribery by multinational enterprises, and regulation of offshore financial centers.

We are somewhat disappointed by the fact that staff do not examine the risks stemming from the lobbying activities and related regulatory capture. It is well-known that the lobbying activities in some advanced economies contributed heavily to excessive deregulation and lack of monitoring, and, thus, increased the costs of the global financial crisis. These governance-related deficiencies have a substantial impact on the budget process, as well as the legislative and regulatory environment. They also have major macroeconomic implications, as they affect tax systems, fiscal frameworks, and banking sector regulations. It is disappointing that the IMF continues to ignore these issues despite their significant macro-critical impact, as it is recognized by most informed observers.

Mr. Ray submitted the following statement:

We thank staff for a high-quality, relevant and interesting set of reports that provide a well-balanced picture of the outlook and risks facing the global economy. We broadly support the overall tone and main messages in the reports and appreciate that these have been derived from high-quality analysis.

On our read, the most important message from the flagships for Ministers and Governors at the Spring Meetings is that: open and free trade with lower, or no, tariffs can bring lasting benefits to all - if the right policies are in place to ensure that the gains are widely shared. This is reinforced by staff's finding that higher tariffs not only have a limited impact on bilateral trade balances, but they leave the global economy worse off. Indeed, this is not only proven in the Fund's analytical work but is already evident in the recent data and is currently weighing on global sentiment and growth forecasts. Specifically, we note staff's analysis that trade measures imposed by the United States and retaliatory actions by trading partners are expected to have limited impact on external imbalances.

We look forward to seeing these messages reflected in the high-level policy discussions during the Spring Meetings. In order to resonate, the Fund's key messages must be both well heard and understood. It would be an inordinate shame for key messages, underpinned by rigorous analytical work to be diluted, or even dismissed, because they are inaccessible to policy makers. In June 2018 the Board discussed a number of proposals to enhance the focus and effectiveness of messaging in flagships in order to achieve better traction across stakeholders. We understood that initiatives to streamline the documents included the development of reader friendly content, fewer analytical chapters, lower frequency of the fiscal monitor and a page cap. We very much support staff's initiative and management's agreement to streamline the flagships and believe that this will significantly increase the traction of the Fund's advice with the membership and make the Fund's analysis more accessible at all levels – technical and ministerial. Can Staff and Management comment on whether the take up of the streamlining efforts is as envisioned?

Outlook & Policy: 'Stay calm and do no harm'

We broadly agree with the assessment of the outlook and risks including the judgment that many of the factors currently impacting growth appear to be temporary and to a large degree are as a result of unfortunate policy choices. At the current juncture, the mantra 'stay calm and do no harm' is important. Risks associated with policy missteps, including a further escalation of trade tensions, should be avoided.

We broadly agree that policy priorities should be enhancing resilience and raising medium term growth prospects. While growth is slowing, the policy mix should carefully balance growth and stability objectives. We think that there could be greater clarity from the Fund over the appropriate role for fiscal policy. Debt levels are still elevated in many countries and policy space is limited. We caution against recommending significant additional discretionary fiscal policy to support growth in this period in the absence of a large shock. Rebuilding buffers and ensuring debt is sustainable must be a priority. In low-income countries, further efforts are needed to put debt on a sustainable path, improve debt transparency and increase debt management capacity.

We should continue to pursue structural reforms that will help lift potential output including reforms that improve business dynamism (including measures to balance competition and market power) and boost labor force participation, including through increasing migration and female labor, to help manage risks associated with population aging. New challenges such as adapting to technological developments, cyber risks and climate change require policy responses that ensure sustainable and inclusive growth.

Trade

We welcome the strong support for the multilateral, rules-based trading system in the reports, as well as modernization of the system so it can continue to play a pivotal role. To restore faith in the multilateral trading system, domestic policies need to play a stronger role, not only to share the gains but to help those directly impacted. When we look to liberalize services sector trade we need to take these lessons into account. We strongly welcome further staff work that demonstrates non-tariff barriers are just as ineffective at shifting trade balances as tariffs. Given the significant increase in non-tariff barriers relative to tariffs since 2008, we would like to see more work quantifying the positive impact that removing non-tariff barriers could have on economic growth, alongside policy options to assist those bearing the burden of domestic adjustment. We also found re-emphasizing old messages helpful, recalling that consumers directly benefit from trade by wider choice and lower price of goods and services.

Regional Disparities

We found the analysis presented in 'Box 1.3 Worlds Apart? Within-Country Regional Disparities' striking, raising some interesting questions about cases where regions fail to converge and instances of market failures. In our experience, flexible labor markets are key adjustment mechanisms. We agree that spatial and regional dimensions to income inequality could warrant further attention especially given the significantly large and persistent disparities in regional GDP per capita both in Advanced Economies and Emerging Markets. On a technical level, we would appreciate clarification from staff on the methodology for determining within-country regions.

Exchange Rate Flexibility

We welcome Fund advice about the important role that exchange rate flexibility can play as a buffer to external shocks. As part of the Fund's regular surveillance, we would like to see a deeper assessment of the appropriateness of countries' exchange rate regimes, the necessary preconditions and capabilities required to transition towards greater flexibility, and the costs and benefits of doing so, while recognizing the need for care in presenting these issues publicly. We hope that the Integrated Policy Framework offers helpful steps in this direction.

Financial Stability

The Global Financial Stability Report presents a sobering picture: near-term risks to global growth and financial stability have increased, and medium-term risks remain elevated. Low global policy rates have boosted a broad range of asset prices and encouraged financial risk-taking, resulting in high global debt levels that leave households, corporates and sovereigns in a range of countries vulnerable to adverse shocks. We agree that clear communication is necessary to avoid market overreaction to changes in the stance of monetary policy. Efforts should also focus on developing prudential tools to address corporate sector risks and address maturity and liquidity mismatches in nonbank financial intermediaries in the US and elsewhere.

House Prices

We appreciated the close look at drivers of downside risks to house prices, though would emphasize that it is important to take care in generalizing the chapter’s findings and policy recommendations. While the chapter concludes that some macroprudential policies appear to be effective in reducing house prices at risk, this is based on specific types of borrower-based, targeted macroprudential policies. Macroprudential policies have not been thoroughly tested through full cycles in many advanced economies and we see scope for further work to understand the speed and channels by which a range of macroprudential policies affect financial stability risks. We also note the finding that capital flow management measures have a role in mitigating downside risks to house prices associated with increased capital inflows. We see value in further Fund work on the influence of global investors on local house price dynamics, the range of policy tools available to respond and their pros and cons in different circumstances.

On the policy recommendations, as the chapter notes, house price levels should not be considered a direct target for monetary or macroprudential policies, or capital flow measures, and there is an important distinction between targeting downside risks and targeting levels of asset prices. It is also important to keep in mind that policy makers can have a range of objectives in responding to developments in the housing market, which includes preserving financial and economic stability but also social objectives like housing affordability. There are a range of tools that affect housing market conditions, and the appropriate policy response will depend on the specific situation.

Corruption

We welcome the discussion in Chapter 2 of the Fiscal Monitor on ‘Curbing Corruption’ that offers a sensible and practical stock take on how corruption can manifest in the public sector. We particularly welcome key messages that for fiscal policy less corruption means lower revenue leakage and less waste in expenditures, and potentially more investment in education and infrastructure that will help drive economic growth. In this respect we particularly appreciated ‘Figure 2.3: Corruption Leakages in the Public Sector’. We also strongly agree with the sentiment that fighting corruption is a global problem and that greater international cooperation is needed to tackle it. Given the importance of this issue we hope this message will be elevated during the Spring Meetings.

International Taxation

Like a number of other Chairs, we were disappointed that the Fiscal Monitor (Box 1.3) did not appear to reflect the recent Board meeting on this topic. Like others, we think the box takes too polemical a tone in framing the debate around international corporate taxation, too readily dismisses the scope to make further progress within the BEPS framework and is too blunt in its treatment of tax competition issues. Further, references to “tax wars” and “multilateralism under threat” do not help advance the debate in a constructive manner. The Fund should be measured in its engagement on these issues, reflecting the range of views across its membership. We expect staff to present a redrafted box consistent with the views of the membership.

Timeliness

The late circulation of some chapters of the flagship reports is highly regrettable. We urge staff to adhere to the agreed timetable. We understand that the production of these reports requires a substantial amount of coordination and time. That said the timetable is known well in advance and the two-week circulation period is essential for Directors to engage effectively with their authorities on the many important issues raised in the reports.

Mr. Mahlinza, Ms. Mannathoko, Mr. Obiora, Ms. Gasasira-Manzi, Mr. Abdullahi and Mr. Nakunyada submitted the following statement:

World Economic Outlook

We thank staff for the comprehensive set of reports and broadly share the assessment of the global outlook, risks and policy priorities. Although global growth is set to moderate in the near-term, before rebounding modestly thereafter, lingering policy uncertainty continues to pose downside risks to the outlook. This has affected sentiment in both advanced economies (AEs) and emerging market and developing economies (EMDEs), weakening global demand, impacting industrial production, and contributing to the sharp slowdown in global trade growth. Going forward, the balance of risks to the outlook remain tilted on the downside predominantly from policy uncertainty in systemic economies and the corresponding spillover effects. In this regard, broad policy actions are warranted to help reduce uncertainty including clear communication and cooperation efforts to quickly resolve contentious issues. Recovery in Sub-Saharan Africa is set to continue, with significant variation in performance within the region as growth prospects for some economies are weighed down by the subdued outlook for oil and commodity prices as well as the impact of the ongoing adjustment process to diversify away from commodity dependence. Growth in this region and other EMDEs continues to reflect varying impacts of challenging global developments and their interaction with domestic idiosyncratic factors. Nevertheless, conditions in EMDEs are expected to improve in 2019 and sustain global growth in the medium term.

We agree that policy efforts for economies, at both the domestic and global level, should be aimed at boosting potential output growth, improving inclusiveness and strengthening resilience, while avoiding policy missteps that could harm economic activity. In this regard, we would like to highlight two main items that should be at the top of the Fund's policy advice and on the multilateral cooperation agenda:

First, as discussed in the October 2017 WEO, extreme weather conditions would have devastating humanitarian effects with severe and persistent output losses on a broad range of economies, with disproportionate effects on Low Income Countries (LICs). In addition to adaptive strategies and well-targeted safety nets, effective mitigation of these threats, requires policy calibration on a global level and through multilateral cooperation.

Second, concerns relating to the 41 EMDEs whose per capita incomes are projected to fall further behind. This may exacerbate the risks arising from the increasing lack of trust in political institutions stemming from rising inequality. In this regard, we agree that EMDEs should strengthen their revenue base for social and infrastructure spending to sustain poverty reduction and inclusiveness, while maintaining debt sustainability. However, the critical consideration should be the attainment of convergence through high and sustainable growth. Therefore, country-specific policies for well-sequenced structural reforms, development of diverse and deep domestic markets, and access to global value chains, remain key policy measures, and we would advocate for a stronger focus on these issues going forward.

Furthermore, multilateral policies should focus on cooperative approaches to address the shortcomings of the rule-based trading system and resolve disagreements within a multilateral framework; safeguard global financial stability; and confront emerging financial vulnerabilities including close monitoring of cross-border payments and efforts to limit withdrawal of corresponding banking relations (CBRs). In addition, existing efforts in international taxation to tackle tax evasion, corruption and illicit financial flows should be reinforced. Further, LICs should be supported in making progress towards achieving the Sustainable Development Goals (SDGs).

We believe that the Fund, with its membership and through its mandate, remains at the center of the Global Financial Safety Net (GFSN), which must remain adequately resourced to support economies susceptible to cross-border spillover effects in the wake of elevated downside risks to the global outlook. Considering the changing global economic dynamics, we call for sufficient resources for the Fund, support for its mandate, and efforts to further strengthen the governance of the Fund.

We welcome the analysis of the trends in market power and the impact this may have on productivity growth and growing inequality, contained in Chapter 2 of the WEO. We note that higher markups may spillover from AEs through supply-links and that in some cases higher markups in AEs have been associated with slightly lower output among emerging market firms. We would be interested in seeing the extent to which multinational organizations contribute to market power in developing economies and how they affect growth and income distribution. Could staff comment on whether such an assessment has been done? That said, we note the increased case for corporate taxation reform, including the establishment of an efficient system that can prevent profit-shifting by multinational firms and provide a level playing field between large firms and their smaller competitors in various jurisdictions.

One of the main drivers of growth in EMDEs is the continued strong investment growth. In this regard, we are wary that the current trends in domestic protectionist policies could have an adverse impact on the relative price of capital goods and dampen the investment prospects of developing countries as described in Chapter 3. We recognize that EMDEs still face higher relative investment costs consistent with higher trade costs, emanating from tariffs and other trade barriers. In this regard, we support the call to fully implement commitments under the World Trade Organization's (WTO) Trade Facilitation Agreement, lowering tariffs and resolving disagreements without raising trade costs in order to prevent further weakening of investment growth. Further, as in outlined in Chapter 4, policymakers should avoid distortive macroeconomic policies that create excessive imbalances.

Global Financial Stability Report

Despite signs of a global economic slowdown, we positively note the rebound in market sentiment in early 2019, amid renewed optimism about the US-China trade negotiations, and flexible monetary policy normalization in major central banks. That said, the build-up of threats to global financial stability stemming from sovereign, corporate, and non-bank financial sector vulnerabilities in several systemic countries, remains concerning. To tackle these financial vulnerabilities, active policy actions remain important to dampen potentially adverse growth effects. In this vein, policymakers should sustain efforts to complete outstanding regulatory reforms, including by strengthening and tailoring macroprudential toolkits to address both bank and non-bank vulnerabilities. The October 2018 WEO highlighted concerns associated with growing cyber security and fintech risks. We would appreciate regular updates on these developments and progress in the adoption of mitigation measures. Staff comments are welcome.

We share concerns about the re-emergence of the sovereign-financial sector nexus, similar to the euro-area crisis of 2011-2012, and potential spillover effects including to frontier and low-income countries with market access, that remain sensitive to changes in global risk sentiment. Specifically, sharp increases in sovereign yields, expose banks and non-banks with large government security holdings to losses, raise funding costs, and erode corporate profits. Against this backdrop, we endorse the call for decisive policy actions through continued public and private balance sheet repairs, resolution of non-performing loans, mitigation of concentration risks in banks' sovereign exposures, and strengthening capital buffers. In parallel, policymakers in highly indebted countries should intensify efforts to place debt on a firm downward path. Furthermore, we note that although Brexit negotiations are still on-going, they remain a lingering risk to global financial stability. In this regard, we would appreciate more detailed and regular updates on associated near to medium term risks arising from Brexit.

We note the volatility of portfolio flows to emerging market economies (EMEs) and their potential spill-over effects to other developing countries. In view of the sensitivity of the benchmark-driven portfolio flows to external factors and their high correlation across countries, we underscore the need to build resilience to capital flow reversals in EMEs. In addition, we emphasize the need to reduce reliance on short-term debt instruments, as well as maintaining adequate fiscal and reserve buffers to cushion vulnerable economies from capital reversals. In this connection, we concur that capital flow management measures should be applied as needed, while exchange rate flexibility remains important to absorb related shocks.

Fiscal Monitor

Although favorable conditions existed in the recent past to implement the necessary fiscal reforms and rebuild buffers to withstand the slowdown of global economic activities, the window of opportunity for fiscal consolidation has narrowed for many countries. In this regard, preparing for the next global economic downturn will be difficult and will require differentiated policy responses in a context where many countries have limited room to maneuver. Recognizing these challenges, we are in broad agreement with staff's context-specific recommendations on the proposed course for fiscal policy going forward.

Adapting to global trends, including shifting demographics, technological advances and international economic integration, demands a strategy that relies on greater international cooperation. While the fiscal policy focus on economic stabilization was appropriate during the period following the financial crisis, the proposal for a renewed focus on growth friendly and inclusive growth reforms, is welcome. In this regard, we concur that fiscal policy in LICs should focus on supporting long term growth and development objectives, complemented by revenue mobilization, improvements in spending quality and better debt management.

The dual global demographic challenges relating to an aging population and the youth bulge, remain critical given their long run fiscal implications. While developed economies and some emerging economies should adjust to aging populations and an older workforce, developing economies including Sub-Saharan Africa countries, should contend with the associated fiscal demands from an increased number of youths entering the labor force as well as urbanization. These demands include the sizable human and capital investments needed to boost production and generate jobs to absorb significant shares of the youth population. In this regard, we support staff's emphasis on forward looking, quality human and capital investment.

We consider the attention given to the cost of corruption and how countries can address it, as appropriate, and timely given that corruption is a global problem. Widespread corruption represents a substantial cost to the public in lost revenues, undermines public confidence in government institutions, distorts the use of public resources, and reduces the effectiveness of public policies. Breaking the cycle of corruption is hard, however, Chapter 2 of the Fiscal Monitor succinctly lays out measures to curb corruption based on lessons from selected country case studies. The report also outlines the significant gains that accrue to breaking corruption cycles, as shown in the selected case studies. We agree that sustained efforts are required to limit corruption within and across different jurisdictions, including illicit flows. We, therefore, welcome the Fund's increased role on governance issues through surveillance and technical assistance, particularly with respect to improving the integrity of fiscal institutions.

Mr. Fanizza, Ms. Collura, Mr. Spadafora, Ms. Cerami, Ms. Lopes and Mr. Persico submitted the following statement:

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 risks as well as the policy advice. The key takeway from the staff's comprehensive analyses is the confirmation that trade tensions have turned into a global shock that lies at the hearth of the notable slowdown of the global economy in the second half of 2018; slower growth has also been reflected in a substantial decline in energy prices and downward revisions of growth in sub-Saharan Africa. Trade tensions also constitute the biggest downside risk to growth, via both direct and indirect effects.

Outlook

A resilient economy is first and foremost an economy that grows steadily. Growth sets the precondition for safeguarding financial stability, building buffers and implementing structural reforms to raise potential output and promote equality of opportunity.

Staff expect a firming up of global growth in the second half of this year, which would pave the way to a rebound in 2020 to a pace that would continue in the medium term (absent further trade restrictions). While acknowledging this baseline scenario as a clear possibility, we believe that the risks of a more protracted slowdown – if not a downturn – have gone up significantly. In fact, the April 2019 GFSR confirms that risks to growth have increased in the near-term and remain elevated in the medium-term. Furthermore, financial vulnerabilities continue to build up as financial conditions, after tightening at end-2018, have eased back and remain accommodative.

Against this background, we share the staff's view that avoiding policy missteps remain a priority to safeguard near-term growth; we also support the recommendation that authorities should stand ready to ease macroeconomic policies in case the current slowdown worsen or persist.

Recent decisions by central banks in advanced economies are more than appropriate in signaling that monetary policy will remain accommodative. As regards fiscal policy, since it remains uncertain whether the slowdown in global growth will be short-lived, we agree that fiscal policy should be agile, state-dependent and forward looking (given potential implementation lags). While fiscal prudence remains key in countries with limited fiscal space, pro-cyclical fiscal policies should be avoided in any event in order not to deteriorate further the growth prospects. We firmly concur with the emphasis on the importance of coordinating fiscal responses in the euro area. Besides, we encourage staff, in their surveillance activities, to continue making the case for a central fiscal capacity for the euro area.

One of the key questions is whether – and to what extent – the longest economic expansion in the US history can set new records. We share the staff's views on possible triggers of a renewed risk-off episode and sudden tightening of financial conditions. The recovery in financial market valuations since the beginning of 2019 rests on two critical expectations: a positive outcome from the trade negotiations between China and the US and a sustained patient attitude of the Federal Reserve. In this regard, the GFSR notes (paragraph 3) that markets do not anticipate any more policy rate hikes by the Federal Reserve – if anything, futures point to lower rates in 2020 – while the WEO acknowledges (p. 18) the possibility of further removal of monetary policy accommodation in the US. Changes in these expectations may trigger shifts in investor sentiment and financial conditions.

In particular, the likelihood of an inflation surprise may have risen in the US, where output is above potential, core inflation is close to 2 percent, unemployment is at record lows, latent slack is falling, and wage growth is on the rise. As a result, the potential for a reassessment of the expected monetary policy path – and ensuing swings in market sentiment and repricing of risky assets – may also have increased. In this regard, we wonder if, in the GFSR, the staff's characterization of the recent more accommodative monetary policy stance from the Federal Reserve as a "change in its approach" is somewhat overstated, as it may more quietly reflect only a shift in tone of communication (as recognized in the WEO itself). Staff's comments are welcome. Moreover, staff's openness to using monetary policy to "lean against the wind" (paragraph 71 of the GFSR) – by using the policy rate with a macroprudential orientation – seems a novelty. Staff's comments are welcome.

We support the staff's call for developing an adequate prudential toolkit for nonbank financial institutions, notably asset managers. It is also worrying that increased payouts to shareholders have at times been financed by increasing net debt. We welcome the staff's analysis of the potential risks posed by the elevated corporate sector indebtedness in some advanced economies. In particular, the impact of an unexpected tightening of financial conditions can be amplified by the fact that the credit cycle in the US displays increasing signs of approaching its peak, while financial vulnerabilities keep rising. Improved debt service capacity and (until 2018-Q3) profitability as well as stronger balance sheets confront increased debt levels and leverage, larger reliance on market-based finance, with a bigger role of investment funds in the investor base for corporate debt, and a higher share of risky borrowers (the cohort of BBB-rated bond issuers has quadrupled). The GFSR highlights that vulnerabilities in the corporate sector are elevated in systemically important countries (accounting for 70 percent of total GDP) and this can explain the heightened sensitivity of market valuations to changes in expectations on monetary policy.

The Euro Area Sovereign-Financial Sector Nexus

The staff's analysis, while warranted, should have been framed in a less alarming, more-forward-looking, geographically broader and holistic manner. The focus on Italy is inter alia backward-looking as the report admits that Italian spreads have halved since their Summer spikes. We have strong reservations about the robustness of the analyses carried out in this section, notably on the simulations in the paragraphs 30 through 34. The finding that Italian banks would today be more vulnerable to a sovereign shock than in 2010 is quite counterintuitive. Even if sovereign bonds holdings have increased, gross NPLs are broadly similar between 2010 and 2018-Q2, while capital and coverage ratios have substantially strengthened. Besides, the analysis in the section seems to be distorted by a number of methodological and data quality issues (which we have bilaterally shared with staff).

It is paramount to recognize that a bank's holding of sovereign debt is only one of the channels through which sovereigns' conditions can affect banks. The intertwined relationship between banks and their sovereigns holds true across countries regardless of banks' holdings of sovereign bonds. The section unwarrantedly overlooks the key role of the macroeconomic channel – much emphasized in a recent research by staff themselves[1] – which stresses the link that both banks and sovereigns have with the real economy. In the

[1] Managing the Sovereign-Bank Nexus by G. Dell'Ariccia, C. Ferreira, N. Jenkinson, L. Laeven, A. Martin, C. Minoiu and A. Popov, IMF Departmental Paper No. 18/16.

case of Italy, it is the macroeconomic channel that takes center stage – as in 2011-13 – in determining the risk of a negative spiral between the sovereign and domestic banks.

Moreover, the pattern of banks' holdings of government bonds deserves a deeper analysis. The section notes that banks' holdings of domestic government bonds, as a ratio to assets, have increased since 2010 in several countries (e.g., para. 29, Figure 1.17, Panel 1). However, the analysis is silent on any counterfactual scenario, i.e.: had banks in stressed countries disposed of their sovereign exposures at the height of the crisis, what would have been the consequences in terms of financial stability? Furthermore, it is critical to recognize that the rise in the above-mentioned ratio in periods of financial stress can be explained by a number of alternative factors: for example, banks can fly to safety when tensions arise; besides, leveraging on their deep knowledge of the domestic sovereign, banks can act as contrarian investors when volatile foreign investors are fleeing the market, ultimately playing a useful stabilizing role with possible benefits also on their profitability.

Fiscal Monitor

The Fiscal Monitor well identifies some key policy challenges. The reduction of high public debt should be pursued with determination; to this end, robust growth is necessary to complement fiscal consolidation, which would not be sufficient in itself, as extensively analyzed in literature and noted by staff. In this regard, we welcome the emphasis on fostering potential growth and public investment (including in countries operating above potential with ample fiscal space) as well as on upgrading fiscal policy to manage demographic challenges, technological progress and the global integration of production and distribution. However, domestic policies alone would have a limited impact on these phenomena, and only a renewed multilateralism can effectively tackle the unwanted effects of globalization – increased inequality, aggressive tax competition, massive migrations – and rebuild trust in institutions.

In the same vein, preventing and fighting corruption is also necessary for rebuilding trust. We welcome the Fiscal Monitor's focus on corruption; the analysis, that is based on extensive literature and heterogeneous country experiences, suggests concrete measures to promote a robust fiscal governance framework. Promoting traction of such advice across the staff will be important, and we wonder whether FAD intends to translate it into a standardized operational approach in the context of the 2018 Fund framework. Staff's comments would be welcome. We are mindful of the challenges in disentangling the links between corruption, institutions, and fiscal outcomes; it is an area where in-depth studies are welcome to continue upgrading policy responses. For instance, with reference to the empirical association between corruption and revenues, it would be interesting to analyze the impact of potentially common factors, such as the use of cash or informal economy.

Analytical Chapters

The rise of corporate market power and its macroeconomic effects

We appreciate the innovative analysis of the macroeconomic effects of corporate market power and broadly agree with its policy implications. In advanced economies, where potential growth is subdued amidst unfavorable demographic and productivity trends and monetary policy is constrained by interest rates close to their lower bound, competition policies could play an important role. By ensuring that product and services markets are contestable, these policies can prevent incumbent firms from gaining excessive market power, thereby loosing incentives to invest and innovate. The staff's analysis alarmingly documents an upward trend in market power across advanced economies and industries, which if sustained may ultimately lead to lower investments, slower productivity growth, and hence lower natural interest rates, which would further constrain monetary policy. Furthermore, as higher markups appear associated with lower labor income shares and greater wage inequality, a widespread increase in market power might also contribute to exacerbating income and wealth inequality.

The staff's analysis finds that markups remained broadly stable in emerging markets. These findings largely reflect the limited country coverage – mostly central and eastern European countries. In fact, a recent study by the McKinsey Global Institute[2], which covers a larger sample of emerging economies (including a subset of high-performers), finds that large competitive firms in these countries greatly contributed to their overall growth. These best-performing firms captured a larger share of profits compared to their peers in advanced economies but were also subject to stronger competition as measured by the lower share of firms in the top quintile of the profit distribution which managed to stay there for a decade. These findings provide further support to policies that foster market contestability both in emerging markets and even more so in advanced economies.

[2] Outperformers: High-Growth Emerging Economies and the Companies that Propel Them, McKinsey Global Institute, September 2018.

The determinants of bilateral trade and spillovers from tariffs

The chapter shows that the variations in a country's bilateral trade balance tends to be quickly offset by changes in the bilateral balances with other partners; for this reason, staff calls for a wider macroeconomic analysis of current balances. We broadly support staff's analysis, but we also believe that the generalization of the above-mentioned finding for countries with less diversified economic structures – notably commodity-exporter countries – should be treated with caution.

As the impact of trade is a central item in the political agenda, promoting adequate and focused policies to help groups and communities harmed by adjustments in the global supply chains is paramount both for national authorities and multilateral organizations. Such adjustments call for a greater attention on the role of social safety net and active labor market policies in order to fairly redistribute trade gains.

Downside risks to house prices

The chapter develops a methodology that can provide early warning signals to house prices, complementing other surveillance indicators. It also offers insights for policy makers in charge of financial stability and monetary policy. Overall, we consider it a very interesting paper and as a general remark, we wonder whether the house-prices-at-risk (HaR) measure significantly improve the risk analysis on the housing markets compared with signals coming from a model specification that includes controls for credit and financial conditions. Staff's comments are welcome.

The exercise provides some surprising results (e.g. a monetary easing shock would reduce the HaR in advanced countries only in the short run and would be virtually muted in emerging countries). Additional reflection on the transmission channels of the monetary versus the macroprudential shocks could have been helpful to shed some light on such findings. Also, a more detailed description on the channels through which macroprudential measures are so effective in reducing HaR would have been useful. Furthermore, the role of policies should be more clearly mapped against the distinction between the phase where vulnerabilities accumulate and the phase when shocks materialize.

The analysis could also have profited from a more in-depth discussion on some of its details. For example, we would have liked to have further information on the calculation of the 1-year and 3-year real house price changes or on the variable capturing the tightness of macroprudential policy.

Mr. Agung, Mr. Tan, Mr. Anwar, Ms. Ong and Mr. Srisongkram submitted the following statement:

We thank staff for a very rich set of reports. We broadly share Fund's assessment of the global outlook and risks, as well as the policy priorities going forward. We offer the following comments.

The near-term outlook has dimmed sharply from the last WEO. The global economy continues to expand, but momentum is softening more quickly than expected. We note that late-cycle dynamics are compounded by the "payback" of temporary growth drivers in 2018, as the procyclical fiscal impulse in the United States and the front-loading of imports ahead of expected tariffs has worn off. More concerning are the signs that trade tensions are taking a toll on business confidence and investment, as this can further affect already-tepid medium-term prospects. We note that the global growth forecast has been downgraded again despite more benign tariff assumptions under the baseline.

Meanwhile, there continues to be a divergence between macroeconomic and financial market developments. Despite the less sanguine growth outlook and a spate of turbulence in late 2018, financial conditions remain easy, underpinned by expectations of more accommodative monetary policy by major central banks. Financial system vulnerabilities remain elevated amid high leverage, deteriorating lending standards, and somewhat opaque risks in the growing leveraged loan market. Somewhat paradoxically, both stronger-than-expected macroeconomic outturns (which could change the trajectory of AE monetary policy) and a sharper-than-expected slowdown could precipitate a sudden repricing of risk. Against this backdrop, policymakers will have to find ways to ensure that measures to support growth do not compound financial excesses. We invite staff to elaborate on their baseline assumption of two more Fed rate hikes in 2019, given that this is substantially more hawkish than market expectations. Furthermore, should the Fed and other major central banks postpone, slow or pause monetary policy normalization as widely expected, what are the prospects for a gradual and orderly tightening of global financial conditions?

It is unfortunate that 'man-made' policy-related factors are the most prominent drivers of near-term risk. Do staff view that recent developments have changed the risk of a no-deal Brexit? We note that the potential for upside surprises has declined and the balance of risks has tilted to the downside. For a constituency of small and open economies anchored in global value chains, prolonged trade frictions are of particular concern. The sharp slowdown in global trade growth is already exerting a drag on economies in our region, although labor markets and domestic demand have proven relatively resilient thus far. Beyond the bilateral US-China dispute lie broader questions about countries' commitment to multilateral solutions, and the future of the international rules-based trading system. We support the Fund's efforts to continue to advocate for a swift resolution of trade tensions. We appreciate that WEO Chapter 3 supports continued trade liberalization, and that WEO Chapter 4 makes a compelling case to look beyond bilateral trade balances. We encourage further research in this vein. Could staff comment on what else is on the agenda?

Brewing headwinds add urgency to the call to strengthen resilience. The "window of opportunity" highlighted by the Fund last year is narrowing rapidly, but globally, progress on rebuilding buffers has been mixed. There is a need to enhance the traction of Fund advice on this issue, including by ensuring that advice is carefully attuned to country circumstances.

On the fiscal front, public debt levels are high in many countries. The challenge will be to enhance debt sustainability while creating space to address pressing infrastructure and human capital investment gaps, as well as long-term challenges such as demographic shifts and climate change. The Fiscal Monitor highlights the need to improve revenue mobilization, enhance public expenditure efficiency, cut wasteful spending and strengthen governance. We agree and emphasize that it will be important that bilateral advice on the magnitude, pace and composition of policy adjustment takes due account of country-specific growth prospects, policy priorities, structural challenges, implementation capacity – which could differ greatly between and within AEs and EMDCs.

On the financial sector, the house-prices-at-risk (HaR) model can usefully inform dialogue between staff and the authorities on housing market risks. We note that the impact of drivers of HaR can vary substantially across countries and over time. It is important at this stage to avoid drawing mechanistic conclusions about the appropriate policy responses to housing market developments within bilateral surveillance. We encourage further analytical work on this tool. More broadly, we appreciate the detailed discussion in the GFSR on country- and region-specific risks.

Policymakers will also have to respond flexibly to rapidly shifting conditions. Policymakers in our constituency have stepped up efforts to strengthen macroeconomic fundamentals since the 2013 taper tantrum. Fiscal buffers are generally adequate, and a tightening of monetary policy over the past year has yielded additional room to maneuver in the event that global momentum slows more sharply than expected. Nonetheless, adverse shocks can materialize rapidly. We are particularly wary of a sudden tightening in global financial conditions, which could trigger significant capital flow reversals. We note the GFSR's finding that the growing role of benchmark-driven investors could contribute further to capital flow surges to and from emerging markets which are decoupled from country fundamentals. Emerging market policymakers will need to continue to employ a mix of policy levers to cope with growing capital flow volatility. As such, we welcome the Fund's work to develop an integrated policy framework to better examine the roles and interactions of different policy tools. We call on the Fund to support members in managing short-term capital flow pressures.

We appreciate the focus on multilateral action to cope with shared challenges. The flagship reports appropriately highlight the cross-border nature of challenges facing the membership, including on trade, taxation, and climate change. With its universal membership and surveillance mandate, the Fund is in a privileged position to contribute to these debates. However, we are concerned that the Fiscal Monitor's discussion of corporate taxation and climate mitigation and adaptation strategies does not adequately reflect the nuance of Board discussions on these items. On climate change, the unequivocal recommendation of carbon pricing as the most efficient tool for mitigation does not capture the qualified nature of Directors' support, nor the potential role of other mitigation instruments. On corporate taxation, we share concerns by Ms. Riach, Ms. Levonian and Mr. Ray regarding the tone of Box 1.3 and its treatment of tax competition issues. We emphasize that the higher profile of the Fund's flagship reports calls for extra care to ensure that its messages are objective and well-balanced.

Mr. Kaya, Mr. Benk, Mr. Just, Mr. Stradal, Mr. Bayar and Mr. Mehmedi submitted the following statement:

We thank staff for the comprehensive set of reports as well as the special chapters which carry a wealth of analyses on very relevant themes. We share the thrust of staff's diagnosis of the current juncture and the assessment that the balance of risks remains on the downside, owing mainly to the continuing trade tensions, elevated levels of policy uncertainty, and geopolitical strains. We find the overarching policy message – "Do no harm!"

– a well-placed one. We also see it critical to strike a careful balance on our recommendations about promoting growth and strengthening resilience in view of the significant uncertainties about the extent of the current slowdown as well as the associated policy responses.

World Economic Outlook

We concur that global economic activity is on a weaker footing, reflecting a cyclical mean-reversion in a number of economies that were operating above their potential as well as a variety of structural and/or idiosyncratic factors affecting major economies. We agree that the current loss of momentum is larger than expected as trade tensions are already weighing on broad business confidence contributing inter alia to more uncertainty in financial markets. Trade disruptions and tightening in financial conditions affected the emerging market and developing economies (EMDCs) more directly, triggering an adjustment in many, albeit with varying pace and depth. We share staff's projections that the global growth should gradually recover later this year and next, reflecting recent more accommodative policy measures, the gradual resolution of trade disputes, waning of one-off factors dragging growth, as well as stabilization of conditions, particularly across stressed EMDCs.

We take note of the projected deceleration of advanced economies – mostly from above-trend levels – accounting for two-thirds of the expected moderation in global growth. The US economy continues to register robust growth rates, possibly above its potential, on the back of a strong labor market and continued impact of fiscal stimulus. While sharing directionally the staff's projection of a moderation in the US economy, we also see conflicting signals about the strength and durability of growth, which among other things triggered the Fed to take a more accommodative policy stance. Going forward, the uncertainty about where the US economy stands in the cycle poses significant challenges to both domestic authorities as well as global markets. Can staff elaborate more about the sensitivity of their growth forecasts should the course of the Fed policy rate deviate from the WEO assumptions.

The slowdown in Europe during the second half of 2018 was more pronounced than expected reflecting some – mostly temporary – domestic factors as well as the slowdown in global trade. Nevertheless, we believe that a deeper analysis of the factors driving euro area slowdown, including potential spill-overs is warranted. We concur that the euro area headline inflation is likely to be held back by the recent drop in energy prices, while core inflation is set to increase gradually on the back of higher wages. We also note that the more subdued pace of growth is likely to dampen inflationary pressures. In this regard, we take note of the ECB's recent decision to launch a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), which should help preserve favorable lending conditions and a smooth transmission of monetary policy in the euro area. In the UK we continue to follow the fast-evolving political agenda and note that uncertainties around Brexit poses challenges beyond the prospects of the UK economy.

Notwithstanding a notable variance across countries, the EMDCs continue to account for the majority of the global growth momentum. We agree that replenishing policy buffers and addressing vulnerabilities would help EMDCs to preserve their growth momentum and withstand future bouts of stress. We take note of the steady, but gradual progress in China in rebalancing toward a private consumption- and services- based economy, against a challenging backdrop epitomized by trade conflicts and frequent rounds of stress in financial markets. Going forward, we believe that the appropriate policy response would be to support growth with a well-calibrated policy mix, while continuing to enhance the regulatory framework to address complex financial vulnerabilities. On a more specific point, we would like to learn the reasons behind the staff's recommendation to avoid undertaking large scale infrastructure projects as a stimulus measure in China. In Turkey, since last August, the authorities have introduced a host of measures to stave off the pressures on the Turkish lira and financial markets, which have been successful to a significant extent. The authorities are taking steps to ensure a smooth rebalancing process through a correction in the current account and a rapid reversal of the inflation toward the targeted levels. They are also utilizing the fiscal room to introduce targeted incentives that should support growth and employment generation in 2019.

We note with concern the bleak prospects of income convergence for a sizable group of EMDCs, particularly in the Sub-Saharan Africa and broader MENA regions. This implies that for more than 1 billion people, the income levels are expected to fall further behind those of advanced economies. We wonder what the policy implications for the Fund would be with respect to the institutional policies governing our engagement with this country group.

We welcome the thematic focus on corporate market power and appreciate staff's careful analyses in this regard. We take note of the conclusion that the emerging concentration of corporate market power, particularly in advanced economies, has started to have a negative impact on growth, investment, monetary transmission as well as wage and wealth inequalities. While the robustness of these findings could be firmed by further empirical support, they still can provide crucial insights to the membership about the competition policy frameworks as well as the ongoing debate on international corporate taxation.

Finally, we reaffirm our strong commitment to an open and rules-based multilateral trading system and welcome the dedicated emphasis on the trade of capital goods, which provided additional arguments in support of policies aimed at reducing trade barriers.

Global Financial Stability Report

We broadly concur with staff's assessment of the financial stability risks. The last three months have been marked by diminished volatility in the financial asset prices and easing financial conditions in response to signals of more accommodative monetary policy than previously anticipated. In contrast, the preceding three months delivered a warning sign by sharply repricing equity markets and credit spreads. Despite net overall moderate tightening since the last GFSR, the financial conditions remain accommodative and conducive to continued build-up of financial vulnerabilities which already are elevated. We commend staff for selecting a relevant set of discussion topics and their well-documented and sound analysis. One issue which could have been added is the recent low currency volatility in advanced economies which is difficult to reconcile with the high political uncertainty including the Brexit. It also supports carry trade strategies which is another manifestation of the gradual increase in risk positioning.

We agree that many indicators are flashing late cycle warning signals, especially in the US. While the banking sector is significantly more resilient than before the Great Financial Crisis, the non-financial corporates are more leveraged as reflected in credit ratings distribution skewed to higher shares of sub investment grades and to BBB class within the investment grade bracket. The growing role of the leveraged loan market in financing the corporate borrowing is a source of concern as the credit risk assessment may be more remote and less transparent. In this regard, we were particularly struck by the 85 percent of covenant-lite share in the newly issued leveraged loans in 2018.

The financial cycle seems to be less advanced in the euro area, but the reemergence of the nexus between the sovereign and financial sectors in some member countries points to unresolved post-crisis legacies. The progress in completing the banking union has stalled and the cross-border risk sharing remains inadequate. Despite significantly stronger bank capital buffers, a reduction in the non-performing loan ratio, and the introduction of the bail-in regime, the very high public debt ratio in some countries continues to put pressure on banking sector funding rates at times of elevated risk. As staff rightly points out, the insurance sector is also at risk, with potential knock-on effects to the non-financial corporate sector more broadly through various channels.

We welcome the analysis of vulnerabilities in China's financial markets. We concur that the authorities face a difficult balancing act between sustaining the economic growth and regulatory tightening aimed at containing the build-up of imbalances. With the inclusion of Chinese equities and bonds in the respective benchmark indices, significant portfolio inflows are expected from passive investors and spillover risks will thus increase in the future. It will be important to increase transparency of the Chinese bond markets to be able to effectively monitor rollover, default, and liquidity risks.

We also welcome the special feature on liquidity risks in capital markets and support further analysis in this area. Several episodes of flash crashes in different markets generally considered as very liquid showed that the new regulatory frameworks in conjunction with the changing composition of trading and investment strategies may have changed the nature of market making. These episodes have so far not had a lasting impact, but it is important to better understand the main drivers and their mutual interplay to prevent major liquidity collapses from exacerbating asset price shocks by strengthening risk management frameworks and potentially rethinking some regulatory measures.

The thematic chapter on housing introduces a new early warning indicator, in line with the recent efforts to use traditional financial market tail risk methods in macroeconomic forecasting. We encourage the use of the models in bilateral surveillance where reliable data are available to improve the robustness of the findings. The empirical results show that macroprudential policies help reduce downside risks to future house prices, but the collective experience with the macroprudential toolkit has so far largely been limited to the expansion part of the financial cycle. While supporting the policy advice to employ macroprudential measures as a preventive measure, it is important to clearly communicate that the ultimate goal is broad and includes strengthening of the buffers as well as reducing vulnerabilities. We also underscore that in communicating the new analytical framework to policy makers and broader audience, a clear conceptual distinction should be made between a downside risk measure as an operational target, rather than targeting a certain level of house prices.

Fiscal Monitor

The FM's Chapter 1 appropriately focuses on how to balance growth and sustainability objectives, and how fiscal policy should adapt to key global trends, including shifting demographics, rapid technological progress, and rising global economic, and we agree with the main policy messages.

Public debt remains elevated in AEs and has grown in EMs to levels not seen since the early 1980s and gradual fiscal adjustment to put debt on a sustainable downward path therefore remains appropriate in many countries. In view of slowing global growth and substantial downside risks, fiscal policy will need to focus on revenue rationalization while at the same time creating more fiscal space for growth-friendly and inclusive reforms to foster robust economic growth. This, in turn, will require that fiscal policy adapts to global trends by reprioritizing spending toward physical and human capital which boost potential growth, increasing the efficiency of spending, phasing out subsidies and untargeted spending, and implementing public financial management (PFM) reforms. At the same time, there is scope to increase the efficiency and growth-friendliness of the tax system.

It is alarming that half of LIDCs are in debt distress or at high risk of debt distress. At this juncture, the reform agenda should include measures aimed at strengthening PFM and enhancing debt management, including by expanding debt coverage, and mobilizing domestic revenue. Shifting to a revenue-based debt stabilization will help LIDCs avoid a further buildup of debt vulnerabilities while creating fiscal space to fund priority expenditures and meet the sustainable development goals.

We appreciate the focus of the FM's Chapter 2 on assessing the fiscal costs of corruption while exploring the practices and institutions in the fiscal area that can help curb opportunities and incentives for bad governance. Weak governance and corruption are detrimental to sustainable and inclusive growth and we share staff's analysis on channels and fiscal costs of corruption which shows that corruption, among others, negatively impacts revenue collection, distorts the use of public resources, and impairs the effectiveness of government policies. Therefore, a multi-pronged approach, as well as strengthening fiscal institutions, and enhancing the functioning of the judicial system, are critical elements for increasing the integrity and accountability in the public sector. In this vein, strengthening the public procurement process through digitalization and introduction of e-procurement systems, enhancing public financial management, increasing public investment efficiency, and improving the internal and external oversight of public institutions, including of SOEs, are essential components for successfully curbing corruption.

This analytical work adds value to the Fund's work on economic governance and corruption and should feed into the implementation of the Framework for Enhanced IMF Engagement in Governance. We trust that going forward, the Fund's policy advice on reducing fiscal costs of corruption and strengthening of fiscal institutions will feature in all Fund's workstreams, including surveillance, program engagement, and technical assistance, and will take into consideration countries' -specific conditions.

We take note of staff's regression tree approach, which shows that for countries that start with a high level of corruption, fiscal transparency and digitalization stand out as key institutional features associated with better control of corruption. In this context, we are wondering about the robustness of the results and how these findings compare to other similar studies.

Ms. Pollard, Ms. Crane, Mr. Grohovsky, Ms. Svenstrup and Mr. Vitvitsky submitted the following statement:

The spring 2019 World Economic Outlook (WEO), Global Financial Stability Report (GFSR), and Fiscal Monitor (FM) reflect weakened prospects for the global economy, with a further mark down of the near-term growth outlook. We agree that the current global slowdown is due in part to temporary or idiosyncratic challenges, including China's necessary efforts to deleverage, Brexit negotiations, and emerging market vulnerabilities. But with growth slowing simultaneously across all regions, there is broader risk of the global economy getting stuck in a more prolonged stagnation than what is envisaged in the WEO-GFSR-FM. In this context, we think that staff's headline policy message—"avoid policy missteps that could harm growth"—reminds us of the advice by the American baseball great, Yogi Berra: "If you come to a fork in the road, take it." Given the uncertainty over the outlook, we think more analysis of trade-offs associated with various policy actions would have been helpful. Determining the appropriate mix between fiscal and monetary policy given limited space, as well as the sequencing of near-term and medium-term priorities, is a key challenge for all members. At the same time, pursuing ambitious structural reform agendas across the membership is needed to raise productivity.

Economic Outlook and Policy Recommendations

The WEO forecasts have been substantially marked down for both advanced and emerging economies, highlighting across-the-board weakness and recent disappointing data. Despite these downgrades, the outlook in the report still seems optimistic for some countries. In particular, the forecast for the euro area as a whole, at 1.3 percent in 2019, is more optimistic than the ECB's latest forecast and appears high given the Fund's forecast of German growth of just 0.8 percent. Additionally, while the report implies that the global slowdown is temporary, this is by no means guaranteed.

The FM appears to have dual messages: amid a projected global economic slowdown, countries should be ready to use fiscal policy to support economic activity, while elevated and rising public debt across most economies points to needed vigilance and fiscal consolidation over time. We broadly support these messages but thought the report could have had a clearer message on the balance of the fiscal and monetary policy mix, particularly where monetary policy has little room to ease further and in countries that have fiscal space, and better highlighted where structural fiscal reforms would durably raise growth prospects.

Robust country-level policy responses—greater than what is mentioned in the WEO and FM—are needed to ensure that growth returns to a healthy position. We are clearly no longer in a period of simply needing to build buffers, but instead need to calibrate policies and undertake growth-oriented structural reforms that boost actual and potential output. We question the assessment that many advanced economies are running at or above potential given that core inflation remains below targets even as unemployment trends downward. Instead, the risk of doing too little right now may be greater than doing too much. As the experience of Japan over the past 25 years exemplifies, the possibility of a permanent reduction in inflation expectations is a tangible risk for several advanced economies. Additionally, given the decline in productivity in advanced economies and that global growth is forecasted to plateau at a mere 3.6 percent in 2020, structural reforms are needed to boost potential output.

Uncertainty over output gap measurements and the causes of persistently weak inflation is particularly relevant for the euro area. The WEO could have focused more on the calibration of monetary and fiscal policies to support economic activity and the return to targeted inflation. We welcome staff's call for more forceful policy action in Germany, beyond the small fiscal expansion that is already planned (2/3 percentage point of GDP).

Staff also call for targeted, high-quality stimulus in China to facilitate rebalancing, which is welcome. This is particularly important given the need to address financial sector vulnerabilities, as discussed below. This message is consistent with other themes of the WEO and FM, which we support, including the need to rebalance the economy away from investment and exports towards household consumption and services, and the need to cut distortive subsidies and permit a greater role for market forces in the economy.

We continue to believe that staff's projections for U.S. growth are too low. We expect the structural elements of tax reform to durably strengthen growth and revenue prospects through the medium term. We welcome the upgrade to the U.S. fiscal outlook and agree with staff on the need for reducing the fiscal deficit. The Administration's focus will prioritize curtailing spending, particularly inefficient social expenditures. This is reflected in the Administration's recently released FY 2020 budget, which maintains funding for critical priorities while directing Federal agencies to curtail their top-line spending. Regarding monetary policy, the Federal Reserve will continue to communicate its policies as clearly as possible and analyze possible spillovers of its policies closely.

Fiscal and debt vulnerabilities in low income countries (LICs) remain concerning, with half of all LICs at high risk or in debt distress and interest-to-tax ratios rising sharply. Given the imperative of pursuing both growth and debt sustainability in LICs, domestic resource mobilization and improving the growth orientation of the fiscal effort are key. Without stronger policies, debt risks could become acute in more LICs and force a sharp adjustment. Enhancing the transparency of debt data would also help reduce harmful surprises. Further, the WEO notes that the convergence prospects for 41 emerging market economies and LICs are bleak, with expectations that they will fall further behind advanced economies over the next five years. Could staff comment on the policies that these countries could undertake to move them back to a path of convergence?

We found the discussion of medium-term risks in the WEO to be lacking, particularly compared to the GFSR. Near-term risks are indeed abundant, but there are also a number of vulnerabilities that could materialize over the horizon. Yet the report only recognizes two, neither of which are particularly macroeconomic in nature. We also found that staff's discussion of the implications of imbalances continues to be quite one-sided, with a strong focus on deficit country policies and a further widening in these deficits' effect on trade tensions, with a mere passing reference to the contribution to adjustment needed from surplus countries. Such asymmetric adjustment will undoubtedly fail to lift the economy out of its near-term malaise or improve trade tensions.

Financial Sector

We welcome the clear and candid analysis in the GFSR and broadly agree with staff's assessment. The GFSR notes three key financial risks that we agree warrant close monitoring going forward: high corporate debt in advanced economies, the sovereign-bank nexus in Europe, and Chinese financial sector vulnerabilities. We generally agree with staff's policy recommendations, although we would have preferred more nuance on recommendations to deploy macroprudential policies, which must be carefully tailored to country and sector circumstances. We support staff's new framework for analyzing financial stability vulnerabilities, as it is a simple but flexible tool to assess global financial stability risks across regions and time.

We agree with staff that the build-up of corporate debt and leveraged loans in the U.S. corporate sector are worth monitoring. However, we disagree with staff's recommendation to implement standardized prudential measures or stress tests, which would add little value across an enormously diversified fund sector. Further, we do not see the leveraged loan market as an imminent financial stability risk, as funds have successfully managed liquidity despite significant redemptions in the fourth quarter of 2018. We believe that staff did not give the long lock-up periods of Collateralized Loan Obligations (CLOs) enough coverage, particularly as CLOs are the largest investors in the institutional leveraged loan market.

Staff's thorough discussion of the sovereign-bank nexus in the euro area is welcome and timely given recent volatility in Italian sovereign bonds. Staff's stress test scenarios helpfully show heterogeneity of the impact of mark-to-market losses on bank portfolios across countries. In most countries, banks' capital buffers have increased enough that the severe scenario still leaves them better capitalized than they were in 2010; however, Italian, Portuguese, and Greek banks are worse off. We further welcome the analysis in the annex on the impact of addressing NPLs on euro-area banks. We urge the euro-area authorities to pursue policies that would strengthen the development of the banking union.

Financial sector risks in China remain considerable. Tackling the potentially dangerous levels of leverage in the Chinese financial and non-financial corporate sectors while still providing support for near-term growth will require the Chinese authorities to eschew credit-driven stimulus and shift towards well-targeted, transparent, on-budget fiscal support. We agree with staff that while credit has slowed, there are still significant vulnerabilities in the large stock investment vehicle assets. Like staff, we are concerned about the authorities weakening asset management regulations, which could lead to a return to excessive non-bank activity. Staff also highlight risks in the weakly capitalized small and medium-sized banks in China, and we support staff's recommendations to increase capital levels and shore up their funding structure.

Trade

The WEO contained considerable discussion of trade policy and developments. Under multilateral policies in Chapter 1, staff notes that countries should work together to address sources of dissatisfaction in the system. We would emphasize that existing long-standing trade barriers, more than any recent action, are the main "source of dissatisfaction" with the system. We therefore welcome the point in Chapter 3 that emerging markets have generally had higher barriers to trade and that removing these barriers would provide impetus for investment. In particular, further reforms are needed in large non-market economies, which have contributed to significant imbalances in global trade. We note the analysis of the link between bilateral tariffs and trade balances in Chapter 4. Staff's analysis indicates that broad-based reductions in trade barriers will improve long-term macroeconomic outcomes. Achieving this will require action on the part of all the world's largest economies. The unequal reduction in barriers (both tariff and nontariff) has resulted in the imbalances and dissatisfaction that we have today. While staff's analysis suggests that tariffs played a smaller role than macroeconomic factors in changing bilateral trade balances over the past 20 years, it does show tariffs affect both trade flows and trade balances, as well as productivity, output, and employment over the long term. The positive effect of a diversion tariff on employment raises the question of how countries should think about the feasibility of trade policies aimed at increasing employment, weighing such tariffs against policies needed to alleviate the distributional effects of lower tariffs. Staff comments would be welcome. We encourage staff to do more work in this area including looking at the economic impacts of non-tariff barriers. We would also welcome staff's views on how this analysis relates to the effects of regional trade arrangements on bilateral and aggregate balances.

Anti-Corruption

We strongly support the analysis and messages of the FM Chapter 2 on curbing corruption. The comprehensive analysis of the channels and costs of corruption demonstrates the tangible impact of corruption across a range of economic outcomes—from government revenues, to the quality of public investment to education outcomes. We encourage staff to do more to highlight the association of low perceptions of corruption with higher domestic revenues. We appreciated the focus on lessons from countries that have successfully enhanced governance and reduced corruption, as these could be useful for other members. We were encouraged by the ways in which new technology, such as e-procurement, can assist countries in reducing opportunities for corruption. While the causal links require further study, the associations shown in this chapter affirm that persistent efforts to root out corruption, build strong institutions and increase transparency play a key role in the broader economic development process.

Mr. Inderbinen, Mr. Trabinski and Mr. Tola submitted the following statement:

Global economic activity has slowed amidst ongoing trade tensions, heightened policy uncertainty, tighter financial conditions and some country-specific factors. Risks remain tilted to the downside. That said, the expansion of the global economy continues, while more subdued. Against this backdrop, the main priority is to avoid policy missteps. Tensions and disagreements need to be resolved in an orderly and predictable manner within a rules-based, multilateral framework that is fit for purpose. Policy buffers should be brought to adequate levels in preparation for a possible downturn. And the benefits of growth must be shared more widely. With these actions, the objective of strong, sustainable and inclusive growth would be within closer reach.

Global outlook and risks

We broadly share staff's assessment of recent developments and the outlook for the global economy. We note the downward revisions to global growth forecasts for 2019 and 2020.

Risks remain tilted to the downside. The acceleration of trade tensions beyond what is already incorporated in baseline projections could cause a deeper negative impact not only in those countries directly involved but also on global investment through negative business confidence effects. This in turn could lead to renewed deterioration of financial market sentiment and tighter financial conditions, with repercussions on real economic activity. Financial vulnerabilities continue to rise in several systemic economies on the back of still accommodative financial conditions. The limited policy space in an environment of high private and public debt levels casts doubts about the ability of policymakers to respond to the next downturn. The decline of public trust in established institutions and political parties is of strong concern with potentially serious implications, not only in the medium term but also in the short term.

Policy priorities

The main policy priorities remain broadly unchanged relative to six months ago. We welcome the greater differentiation of policy recommendations across countries.

Monetary policy

The stance of monetary policy should continue to be data dependent and well communicated, in line with central bank mandates. We stress the important role of sound monetary policy frameworks in anchoring inflation expectations and thus supporting macroeconomic stability. In particular, central bank independence is essential for central banks to fulfill their mandates.

Fiscal policy

Fiscal policy should preserve policy buffers and strengthen them where possible, thus reducing significant debt vulnerabilities. It should address the key structural trends and challenges to the global economic outlook by a budget recomposition that is growth friendly and support inclusiveness in all countries.

Major challenges around international tax issues have been addressed by the OECD and related institutions and work continues to modernize tax systems, e.g. in the area of corporate taxation. Related statements in the Fiscal Monitor, in particular in Box 1.3, lack precision and do not adequately reflect these ongoing efforts.

Structural policies

The role of structural reforms in enhancing resilience, lifting productivity and growth, and supporting the adaptability of the workforce to structural change cannot be overemphasized. We welcome the ongoing work on the political economy of structural reforms, which should help enhance the traction of the Fund's advice in this area. The macroeconomic impact of corporate market power is the subject of an intense debate and we appreciate the Fund's focus on its macroeconomic implications. The analysis of the impact that the rise in markups has on investment and the natural rate of interest in advanced economies is of particular interest. Fostering dynamism and having in place institutions and frameworks that promote innovation are crucial for enhancing long-term growth prospects.

Financial issues

Targeted macroprudential instruments are better suited to tackle the root causes of financial vulnerabilities, given that these vulnerabilities affect different sectors in different economies. Monetary policy is too blunt a tool for this purpose.

Balance sheet repair remains incomplete in some countries and further progress is needed, in particular to reduce the level of nonperforming loans. Moreover, banks should be discouraged from holding excessive amounts of sovereign bonds.

We welcome the work on house prices at risk and see merit in a broad dissemination to the membership of the tools used to assess the extent and the drivers of housing market risks.

Notwithstanding the increasing role of benchmark-driven investors in emerging market economies, country-specific factors continue to play an important role in driving capital flows. Thus, prudent macroeconomic policies and sound policy frameworks remain essential in enhancing resilience to capital flow volatility. While capital flow management measures can be a last line of defense under certain circumstances, they should not substitute for necessary macroeconomic adjustment.

We agree that broad-based macroprudential tools to mitigate rising corporate sector indebtedness are needed. The expected economic slowdown would expose highly leveraged firms to increased default risks. In this regard, we see a need to expand borrower-based tools to nonbank credit providers to contain the risk of regulatory arbitrage.

Multilateral level

We continue to stress the need for the Fund to remain a strong advocate of the benefits of trade integration and technological progress. Trade integration has been an engine of growth, including through its positive impact on real investment through lower prices of capital goods. That said, these benefits must be shared more widely. In this regard, domestic policies have a leading role to play, notably by ensuring broad access to high quality education, skills building, and retraining, including through vocational education and training.

Trade tensions should be addressed in a cooperative manner through a multilateral, rules-based approach. The multilateral framework should be adapted to new realities as needed. Unilateral measures and counter-measures will harm everyone and shatter confidence. Trade restrictions are no solution to address excessive global imbalances. We certainly share the notion that the discussion of external balances should focus on aggregate trade balances and current accounts.

We fully agree that a rollback of regulatory reforms must be avoided. The calibration of capital requirements should be applied consistently across jurisdictions to ensure a level playing field.

The determinants of bilateral trade and spillovers from tariffs

We broadly agree with the main policy conclusion of this chapter that macroeconomic determinants have been the main drivers of changes in bilateral balances. At the same time, we should not underestimate the negative impact of tariffs on gross value added and labor productivity in the long run, which are also factors shaping the sectoral composition of the economy.

Mr. Jin submitted the following statement:

We thank staff for the comprehensive set of flagship reports and broadly agree with staff's assessment of the global economy and risks.

World Economic Outlook (WEO)

The China-US trade talks have shown signs of positive progress, but retreat from multilateralism remains a key risk to the global economic outlook. We support staff's assumption of a truce in the China-US trade dispute without further tariff increases in the growth forecast. This helps to remind all member countries of the merits in resolving disputes in a cooperative manner. However, the final outcome remains uncertain. Even if the trade dispute between China and the US is resolved with a rollback on tariff increases, there is still no room for complacency. History shows that when countries are resorting to trade disputes and unilateral actions instead of multilateral rules-based resolution mechanisms, a depression will likely be around the corner.

The IMF should continue to support rules-based multilateralism. A seemingly righteous goal or purpose could not justify an illegal or rules-breaking action. The shortcomings of the existing multilateral system should not be used as an excuse for not obeying the existing rules. In this regard, policymakers should cooperate to address the shortcomings in a swift, orderly, and constructive way. Advanced economies and EMDCs should cooperate to establish a more dynamic and scientific method of classifying WTO member countries. Policymakers should make the regional free trade agreements (FTAs) more inclusive and avoid fragmentation of the multilateral trade system.

The trade balance should be considered from a macroeconomic and multilateral perspective. We concur with staff that macroeconomic factors are major determinants of bilateral trade balance. Targeting particular bilateral trade without adjusting one's own domestic macroeconomic policies will barely change a country's aggregate trade balance. Higher tariffs would have significant negative impacts on not only the countries involved but also other countries through the global value chain.

We welcome staff's analysis in the Analytical Chapter 2 of the WEO, particularly on the suggestion to ease obstacles to technological catch-up by lagging firms, including well-calibrated intellectual property rights that keep on incentivizing groundbreaking innovation and without undermining technological diffusion. The recent GPA rightly and properly connected the concept of a new multilateralism with "a level playing field." Excessive market power of multinational corporations is an important part of the "level playing field issue," which may deserve attention in future analysis. Large technology companies should also be given more attention to avoid giving rise to "winner takes all," which could hinder competition and eventually cause the effectiveness of the industry to decline. More market competition is needed to allow best technology to be benefit the whole mankind.

We welcome staff's analysis on the value-added trade balance, but more could be done. An over-estimated bilateral trade imbalance may result in excessive policy response. We note with concern that the data of this analysis comes from outside of the Fund. Despite much strength, the OECD is constrained by its limited membership. Non-OECD countries are not obligated to provide data to and verify the data of the OECD, which compromises the reliability and accuracy of the data. With the core mandate to facilitate the balanced growth of international trade and global membership, the Fund has both an advantage and obligation to address the data gap and broader use of the value-added trade data.

Chinese Economy

China's growth moderated steadily, but remains quite phenomenal and robust. Last year, China's GDP growth rate reached around 6.6 percent. The net export of goods and services in China turned negative and resulted in a negative contribution to growth of -8.6 percent last year. The total leverage ratio has been stabilized, though some short-term moderate rebound. The trough of this economic cycle may have already passed.

This year, China set its GDP growth target at between 6 percent and 6.5 percent. The fiscal deficit target will be raised from 2.6 percentage of GDP last year to 2.8 percentage this year, with a further tax cut and value-added tax reform to support industrial production and small and micro business growth. The monetary policy will continue to be prudent, with M2 and aggregate financing growth increase in pace with nominal GDP growth.

Global Financial Stability Report (GFSR)

We share staff's view that financial vulnerabilities continue to build, and take note that alleviating factors have been taken into account when analyzing advanced countries' vulnerabilities. We encourage staff to adopt the same practice for the analysis of EMDC's vulnerabilities to make a balanced assessment. We agree with staff that policymakers should clearly communicate their reassessment of the pace of monetary normalization, which is the dominating factor underlying capital flows to EMDCs.

We welcome staff's analysis on the impact of the inclusion of China's local currency bonds into benchmark indices. The inclusion is a milestone of China's financial integration into the global financial system and would be beneficial for global investors' asset diversification and facilitate risk management.

We associate ourselves with staff that macroprudential polices could play an active role in addressing house prices at risk, especially borrower-based measures such as loan-to-value and debt service-to-income ratios. That said, we believe more analysis is needed on the cross-border spillover impact of macroprudential policies, particularly in the context of currency unions. The fact that many countries in some currency union have experienced strong house price growth raises the question regarding the appropriateness of easy monetary policy. We encourage more research on how to enhance the coordination between monetary policy and macroprudential policy.

Fiscal Monitor (FM)

We welcome staff's proposal of three fiscal principles guiding the choice of China's fiscal measures. As for the evaluation of the investment-led stimulus undertaken during 2009-12, it should be noted that this investment had its specific historical context and was used as a crisis response measure. We are fully aware that the fiscal policy in that period might have some subsequent consequences, but those effects could gradually be digested and resolved. At the same time, the positive impact of infrastructure investment during that period should not be underestimated. The nationwide infrastructure network has greatly enhanced integration and deepening of the domestic market, increased effective labor supply by reducing people's travel time and allowing people to "work on the road" and therefore helped to alleviate the labor shortage problem caused by aging. Additionally, those investments played a significant role in boosting growth not only for China but also for many other countries. Therefore, the large-scale infrastructure investment in China has produced large positive externality for private sector, an important benefit that could not be fully reflected through the government's balance sheet. We call on staff to evaluate the effect of infrastructure investment in a broad and comprehensive way.

We continue to support deeper analysis on international tax issues from a broader macroeconomic perspective, taking into account the associated interactions with, and impact on, other aspects such as balance-of-payment adjustments. We also encourage looking at "tax" in a more comprehensive manner through an "effective tax rate" approach. Individual countries' tax schemes should be tailored to country-specific factors such as public debt management capacity, governance capability, and business environment. That said, any unilateral tax action should abide by existing rules that are agreed under the multilateral framework, especially those of organizations with universal membership such as the WTO. We encourage staff to continue more in-depth analysis on various alternative architectures of the international tax system and their associated distributive and economic implications. In doing so, it is important to remain objective and ensure a well-balanced analysis to facilitate constructive and cooperative discussions.

Mr. Villar, Mr. Guerra, Mr. Moreno, Mrs. Del Cid-Bonilla, Mr. Rojas Ramirez, Ms. Arevalo Arroyo, Mr. Montero, Ms. Mulas and Mrs. Suazo submitted the following statement:

We thank staff for its comprehensive set of reports and the relevant analytical work on stimulating topics in the current juncture. We broadly agree with staff's assessment and policy advice.

World Economic Outlook

We would highlight the increased uncertainty on the outlook. Notwithstanding the significant downward growth revision—particularly in the Euro area, the UK, Latin America and the Middle East—we note that the WEO projections assume a continuation of the global slowdown in the first half of 2019 and a pickup in the second half of the year as some of the 2018 weakening factors are mitigated, including through: policy stimulus in China, positive prospects about a US-China trade deal, improvements in financial markets as central banks have signaled a more accommodative monetary policy, waning drags on the euro area, and stabilization in stressed emerging markets.

We share the WEO's emphasis on downside risks to the outlook, such as a further escalation of trade tensions and policy uncertainty, geopolitical risks or a correction of financial conditions—with potential triggers, including a no-deal Brexit, fiscal problems in Italy, and reassessment of monetary policy normalization in the US. We also note that the outlook for China currently presents another important downside risk for the global economy: the upwards revision of GDP growth in 2019 to 6.3 percent is predicated on the offsetting effects of policy measures and the assumption that US tariffs on $200bn of imports from China stay at 10 percent. But if trade tensions exacerbate, China's GDP may decelerate more intensely despite policy stimulus with a potentially large global impact. Further, the WEO's outlook for the Euro area in 2019 (1.3 percent GDP growth) is relatively optimistic compared to the ECB (1.1 percent) and the OECD (1 percent).

In our view, this baseline scenario may be too optimistic as it assumes that the downward trend in global activity is mostly transitory and it will be reversed from mid-year. The current slowdown may be more persistent as the maturing cycle in some advanced economies and China's transition to a lower growth path proceed faster than expected, as this happens in a context of heightened uncertainty and important downside risks.

We thus support the general policy recommendations, including a growth and inclusive friendly fiscal policy design. We broadly agree with the main policy recommendations in the direction of avoiding a sharp slowdown in advanced economies and ease the negative spillovers on stressed emerging markets. Monetary policy should keep inflation near the target and support demand if the slowdown is more severe than expected. Fiscal policy should also stimulate demand if public debt is sustainable, particularly in economies with the larger fiscal spaces. On fiscal design, we would stress the importance of fiscal policies emphasizing measures that boost potential output and raise inclusiveness—even more so given the policy uncertainty risks in many economies, which include anti-globalization policies. On the financial sector, policies should strengthen balance sheets and address vulnerabilities through macroprudential tools. We would also highlight the need to boost medium-term growth through structural reforms with increased focus on technological innovation, market competition (we particularly welcome Ch. 2), education and worker skills, and green transition. We fully share the recommendations on strengthening multilateral policies and international coordination, and would highlight corporate taxation, climate change and migration policies among the areas where more stepping-up efforts are needed.

Regarding the second chapter, we very much welcome and strongly support the work on the rise of corporate market power and encourage staff to deepen its analysis. This is an area that is macro-critical with potential effects across many relevant dimensions, such as the evolution of investment, inflation dynamics, inequality, innovation and long-term growth. We note that although the overall macroeconomic effects seem to have been modest so far, further increases in the market power of the already powerful firms could weaken investment, deter innovation and reduce labor shares going forward. Thus, we support staff's comprehensive policy recommendations in the areas of corporate taxation and competition policy. Here, we would highlight the importance of deepening the Fund's analysis on the link between market power and the evolution of the labor share, in line with the recent literature[3] on firm's monopsony power and collusion in the labor market (evidence in Figure 2.10 would be consistent with this view). We sympathize with the

[3] Including: Azar, Marinescu and Steinbaum; or Naidu, Posner and Weyl; or Steinbaum and Stucke; or Marinescu and Hovenkamp.

growing view among academics to review antitrust policy in terms of expanding the current "consumer welfare standard" to encompass a broader notion of an "effective competition standard" that would push regulators to assess the health of competition in all markets. Staff's comments would be appreciated.

On a technical note, we observe the relatively modest average increase in price markups over the last 20 years and wonder whether this average is masking a high degree of heterogeneity in the distribution of markup increases across countries. Could staff elaborate on this point? The main data source of the paper is Orbis, which provides comprehensive balance sheet data for many firms across the globe but is weaker in terms of representativeness and coverage for some relevant variables. The staff is also applying some sensible filters further reducing the sample (countries with at least 40 percent of the total output reported in official statistics and firms with employment greater or equal to 20 employees). However, this is a restricted sample. We would welcome staff's comments on the robustness of these results and the direction of possible biases derived from the filters applied.

We find the analysis on Ch. 3 on the relative price of capital goods very interesting and timely. It provides a powerful argument in support of policies aimed at reducing trade barriers and strengthening global value chains. The chapter clearly shows the virtuous circles that have taken place during the last three decades between the consolidation of global value chains—which are particularly important in the production of machinery and equipment, the reduction in the prices of this type of goods, and the surge in investment—both in advanced and in developing economies. More worrisome, the chapter shows that such promising virtuous circles have started to stagnate in recent years and may even be reverted in the wave of protectionism that could arise if trade war is not averted.

We strongly welcome the chapter on bilateral trade and spillovers from tariffs. as it provides a timely and extremely relevant analysis. We broadly agree with the approach taken for the analysis and results. The emphasis on bilateral balances adds to the novelty of the study. The analysis lays on solid ground and is methodologically sound. We find highly valuable the finding that, under given macroeconomic conditions, changes in bilateral trade balances are unlikely to translate into sustained changes in the overall trade balances. The simulations of a bilateral trade war between China and the US run through different models highlight interesting additional findings, especially on spillovers at the sectorial level, with respect to similar simulations published in the January WEMD. A key message is that, against the backdrop of a trade war between China and the United States, most countries are likely to be worse off, even those that benefit from trade diversion, due to an increased uncertainty, negative confidence effects, and a tightening of global financial conditions.

We agree with the policy conclusion put forward in the chapter, particularly on the need to avoid distortive policies and on the benefits of promoting trade and globalization, either by lowering tariffs or by removing non-tariff barriers. We support the conclusion that current account positions are mainly determined by macroeconomic forces rather than by changes in bilateral trade policies.

Finally, we support the need to ensure that the benefits from trade are widely shared and that those left behind are adequately protected. As noted in the Fiscal Monitor, global integration of production and distribution has altered labor, capital, and goods market dynamics, creating a need to adjust tax and public spending policies to guarantee that the population at large shares its benefits.

Global Financial Stability Report

Over the last few months, near-term risks to global financial stability have risen somewhat, although they remain moderate by historical standards, in part supported by a (dovish) shift in the outlook for monetary policy in the USA and in the euro area. In this context, it is noteworthy the overall relative resilience displayed by EMs, which are benefiting from rising capital inflows after the turnaround in global risk sentiment. Regarding medium-term risks, they continue to be elevated, in line with the accumulation of financial imbalances caused by the prolonged period of easy financial conditions.

We appreciate the comprehensive analysis on the leveraged loan market, which has increased in size, complexity and riskiness over time. We take positive note of the fact that potential spillovers from distress in this market seem to be mitigated by several factors; above all, the fact that banks seem to have a low direct exposure through their balance sheets. As the investor base is mostly comprised of nonbank institutions, financial stability implications will ultimately depend on whether these institutions have tight links with banks that could amplify the impact of a shock in the leverage loan market on the broader financial system. Could staff comment on whether these links exist and how substantial they may be?

We take note of investors' concerns about the sovereign-financial sector nexus in the Euro area after the spike in Italian sovereign spreads in the second half of 2018. However, we would like to remark that so far there has been little, if any, spillovers to yields in other Euro area economies, reflecting the substantial strengthening of financial fundamentals in this region, which is not adequately recognized in the report. Moreover, the analysis in this section is overlooking a key driver of this nexus, which is fragmentation (see e.g. Lamas and Mencía, 2019, ESRB Working Paper). In this sense, it might be desirable to consider additional policy measures to tackle the root causes of fragmentation, such as creating a fully-fledged European Deposit Insurance Scheme or a Euro-wide safety asset. Staff's comments on the role of fragmentation would be appreciated.

Regarding policy priorities, there are a few novelties that are worth remarking. First, few macroprudential tools are available to contain vulnerabilities in the nonbank financial sector, especially in corporate debt funded by nonbank lenders. Thus, we agree with staff that countries should consider developing these prudential tools. However, given the limited knowledge we have on the effectiveness and side effects of the proposed tools, we would call on staff to work more on this interesting topic. Second, we take positive note of the recommendation that if prudential policies prove insufficient to mitigate risks to financial stability, consideration should be given to use monetary policy to lean against the wind in countries with strong cyclical positions and inflation at or above target. We share this view and would encourage staff to work more on this topic going forward. Thirdly, we see merit in the proposals for some EMs to address the financial stability challenges—in terms of increased sensitivity to global or EM factors—derived from rising membership in major benchmark indices, specifically a closer dialogue between index providers, the investment community, and regulators. Further, we share staff's view that highly indebted sovereigns should give priority to place their debt-to-GDP-ratios on a downward trajectory to reduce not only their own vulnerabilities but also potential spillovers to other EMs and frontier economies.

Finally, we concur with the importance to avoid a rollback of regulatory reforms and to maintain the integrity of the institutional framework for macroprudential oversight.

The second chapter of the GFSR on downside risks to house prices clearly shows that housing markets have macroeconomic relevance. Movements in house prices have important and long-lasting effects on private consumption and financial markets. The analysis presented in the chapter is an excellent example of how the IMF can help to identify preventively when imbalances are accumulating in housing markets. Subject to data availability, house price developments should be part of Art. IV consultations. In this regard, the analysis of house prices at risk is a welcomed addition to the IMF analytical toolkit, and a natural extension to the growth-at risk-analysis. On the policy side, we fully support the emphasis of the role that macro prudential policies has in reducing downside risks to future house prices. We have a more nuanced evaluation of the role that monetary policy can play in this regard. In particular, inflation and house prices, in general asset prices, do not behave in the same way. Central banks have an inflation target and not an asset price target. If monetary policy tries to stabilize the housing market, should it also stabilize the stock market? The other related issue is if central banks should lean against the credit cycle. These are some interesting policy issues that can be part of the focus of the new integrated policy framework research agenda. On the methodology, we would appreciate if staff could confirm that we can infer from figure 2.6 (panels 1 to 4) that EMs are still facing a high-risk scenario to a downturn in housing markets.

Fiscal Monitor

The report rightly stresses the need for fiscal policy not only to prepare for potential downturns but also to focus on measures to boost potential growth. We fully share staff's view that, considering the current trends and conjuncture, fiscal policy needs to place more attention to foster long-term inclusive growth-friendly and inclusive reforms by adapting to changing demographics, advancing technology, and deepening global integration. We agree that fiscal policy plays a major role by upgrading tax, social spending, and active labor market policies and by encouraging quality infrastructure. We concur with staff that international cooperation is crucial for advancing fiscal efforts to address issues related to global economic integration, particularly on taxation of multinational companies, including highly digitalized ones.

We note that public debt remains elevated in advanced economies and has grown in emerging and developing economies. Indeed, staff points out that little fiscal room exists in many countries to respond to fiscal risks. Against the backdrop of a weakening global growth momentum, the persistence of income inequalities and limited policy space, fiscal policy needs to manage trade-off between avoiding further deceleration, ensuring that public debt remains on a sustainable path, and better distributing the benefits of global economic integration. Therefore, fiscal policy needs to find the adequate balance between growth, debt sustainability and social objectives, tailored to country circumstances. Where fiscal consolidation is needed, we fully agree that fiscal policy should calibrate its pace to secure stability without suppressing near-term growth and harming programs that protect the vulnerable. Should downside risk materialize, fiscal response could complement monetary easing by countries that have appropriate space. Within the euro area, we share staff's view that coordination of policies with appropriately differentiated responsibilities across members strengthens their joint impact. Further, as noted by staff, a central fiscal capacity in the euro-area with a countercyclical function would reinforce its architecture.

On Ch. 2 of the Fiscal Monitor related to Curbing Corruption, we welcome the timeliness of the topic discussed, especially since the Board has stepped up its involvement in corruption and governance issues, with the approval of a New Framework for enhanced engagement on governance in April 2018 that supplemented the 1997 Governance Policy. As the paper noted, the Fund has been involved in fiscal governance for several years now, in cooperation with other financial institutions through PIMAs, the FTEs the TADAT, among other tools. It would have been valuable to see in this chapter the impact that these tools have had in the countries where they have been applied, for strengthening core institutional processes, promoting integrity in public administration and supporting fiscal transparency. This is in line with what this chair has been advocating for in that there must be measurable results in the capacity building work done by the Fund to better evaluate its efficiency. Staff's comments would be appreciated.

This chapter illustrates that corruption is a global problem affecting countries from all levels of development, involving multinational companies offering bribes, opaque international financial centers and major international players in the extractive industries. It is not a problem exclusive of countries with weak institutions as cases show up in advanced economies as well, and as such it should be confronted comprehensively. Another important lesson is that to be successful in reducing corruption and strengthening institutions, government authorities of the country in question need to be willing to fight it. All the above reiterates the importance of international cooperation in attacking corruption, and the Fund is well placed in acting as a catalyst for further actions through strategic alliances with other IFIs to promote incentives for countries to take a stand against corruption. Additionally, if surveillance or programs are taken at the national level (for example, aid and financing should support good governance), it is fundamental to have close engagement with country authorities and other actors, avoiding conclusions based solely on third-party perception indicators.

Mr. Merk, Ms. Kuhles, Mr. Braeuer and Ms. Lucas submitted the following statement:

We thank staff for their well-written and comprehensive set of reports. We broadly share staff's appraisal of global economic growth leveling off in the first half of 2019 and firming up thereafter. While the forecast is subject to heightened uncertainty, we share the staff assessment of the slowdown around the turn of the year being to a large extent influenced by idiosyncratic, transitory factors, with fundamentals remaining broadly intact. In our view, among these factors, supply-side aspects play an important role. Staff comments, including on the implications for their policy advice, would be welcome.

Output is projected to remain at or above potential in many economies until the medium term, when pro-cyclical stimuli in some large countries fade and growth returns to more sustainable levels. In fact, evidence suggests that activity in industrial production, trade and investment in advanced economies went through a phase of exceptionally strong growth in 2017 when compared with longer term averages. In this light, the loss of momentum since mid-2018 could be interpreted as normalization. Staff's comments would be appreciated. Going forward, the pace of economic expansion will likely remain subdued, owing not least to adverse demographic trends and modest productivity developments in many jurisdictions. We noted with interest staff's analyses in this context, suggesting only modest productivity gains from new technologies over the forecast horizon and potential headwinds for productivity from the retreat from global economic integration. This underscores the importance of ambitious growth-enhancing reforms.

Staff's risk assessment is largely in line with our own views, with the balance of risks tilted to the downside. We see risks and uncertainties surrounding the baseline as high at the current juncture, warranting a particularly cautious communication of the forecast. Besides prominent cases such as a possible further escalation of trade tensions, political and policy risks appear dominant for many economies, both as a source of shocks and a major detriment to sustainable growth over the longer term. Against this background, staff's call to resolve trade disagreements cooperatively, to avoid policy missteps and approach international issues in a multilateral, cooperative way is most welcome.

Prudent macroeconomic policies and bold structural reforms are crucial to reinforce resilience, sustainably raise global growth prospects and facilitate a swifter adjustment to shocks. Securing adequate fiscal, financial, and reserve buffers as well as reducing still elevated debt levels remain of the essence to sustain macroeconomic stability, unlock confidence and insure against external shocks. In the event of unexpected downturns and subject to fiscal space, the operation of automatic stabilizers should be the first line of defense. Reforms should aim at bolstering productivity and labor market participation, strengthening education, and setting the stage for much-needed research and development activity. Well-targeted, sustainable health care systems and social safety nets will be key to address demographic pressures and elevated inequality in many jurisdictions. As noted in the GFSR, safeguarding financial stability requires macroprudential vigilance and keeping vulnerabilities in check, including by conserving the valuable regulatory advances reached since the global financial crisis. The current episode underlines that authorities should act decisively and in a timely manner, as going too slowly risks that the overall still favorable economic circumstances could fade before a sound position would be reached.

World Economic Outlook

Staff Projections

We broadly share staff's projection baseline for the global economy. We would like to stress, however, that the projected rebound of global growth has yet to be confirmed by early indicators of economic activity. This also applies to the outlook for international trade, which still seems relatively optimistic despite the recent downgrade. Similarly, staff's growth projections for the euro area and for Germany are broadly in line with our own assessment. However, available short-term indicators suggest outcomes in 2019 might be even slightly weaker than expected by staff, in particular with regard to the euro area. Could staff provide an update on high-frequency indicators in major economies?

Region-specific Policy Recommendations

In Germany, general government and federal investment will increase significantly in 2019. While we take note of staff's advice on the use of fiscal space, we also see the need to deal with the costs of population ageing. On a more general note, we would like to stress that fiscal fine-tuning has significant shortcomings, such as real-time detection of cyclical position as well as implementation and impact lags. Furthermore, the EU's current fiscal framework allows automatic stabilizers to operate and provides enough flexibility to deal with exceptional challenges. While we broadly agree with the staff assessment of global external positions and implied risks, we would like to stress that the high net international investment position of Germany can be explained by the effects of an ageing population to a significant degree. Staff's position on monetary policy in the euro area is in line with monetary policy strategy and latest decisions taken by ECB Governing Council.

Economic policy moderation in the US would reinforce both, domestic and global stability. As staff points out, the US economy currently operates above potential. The authorities employ a substantial pro-cyclical fiscal stimulus, intensifying overheating risks, adding to the country's public debt burden and further contributing to global imbalances. Moreover, macroeconomic management could be further complicated, if resulting price pressures were to necessitate a comparatively stronger monetary contraction, leading to a potentially abrupt tightening of global financial conditions. Against this background, we echo staff's call for a more stability-oriented fiscal policy approach, including raising the revenue-to-GDP ratio.

We welcome staff's appeal for continued deleveraging and rebalancing in China. The authorities face difficult trade-offs balancing short-term growth and financial stability, but should continue to transform the economy towards a more sustainable and inclusive growth model, notwithstanding the recent softening in economic momentum. As some of the growth-moderating influences appear rather temporary in nature, we would caution against deferring the necessary regulatory tightening to stimulate short-term demand. We take positive note of recent achievements in curtailing shadow banking activity and containing the accumulation of debt. Going forward, measures aimed at reducing elevated leverage and preventing financial repression will be essential to further entrench financial stability. Strengthening the role of market forces in the economy should help bolster productivity growth and facilitate robust and sustainable growth going forward.

Chapter 2: The Rise of Corporate Market Power and its Macroeconomic Effects

We concur with staff that the evolution of market power is of high policy relevance. We appreciate this analysis as an important step to shed more light on the effects of mark-ups on price setting and inflation dynamics. We share staff's view on the importance of competitive product markets.

In general, we share staff's assessment on the impact of rising mark-ups on the natural interest rate. Recent Bundesbank (see Monthly Report, October 2017) as well as ECB research on the natural rate both highlight that the rise in mark-ups can help in explaining the increasing wedge between the estimated natural rate based on safe assets and the return on capital (in addition to the contribution of a high demand for safe assets in an environment of risk aversion and increasing risk premia on capital risk).

Chapter 3: The Price of Capital Goods: A Driver of Investment under Threat?

We share the assessment that protectionist measures and the attempt to resolve disagreements by raising trade costs pose a potential threat to investment and economic development. We also agree with staff's positive evaluation of competitive-enhancing structural policies targeted towards supporting technological progress and innovation.

However, some caveats are worth noting. Although the chapter recognizes that advances in information technology have played an important role in driving down the relative price of investment it leaves aside important implications following from this fact. For example, the complementary relationship between technologies and skilled labour has been frequently addressed in the literature. While this aspect is generally consistent with the chapter's recommendation of structural reforms, calling for policies that improve educational quality, skills, competences and job-matching, it provides an alternative explanation (not necessarily linked to productivity differences and trade barriers) for cross-country differences in relative prices of machinery and equipment. A similar argument may apply for the quality of the digital infrastructure.

Chapter 4: The Determinants of Bilateral Trade and Spillovers from Tariffs

We welcome this analysis of the determinants of bilateral trade and spillovers from tariffs as an important contribution to a highly relevant topic. We concur with staff's call for policies aimed at reducing trade barriers and reinvigorating international trade. We agree with the assessment that overall higher tariffs should have negative effects for output, employment and productivity in the long-run. The view that macroeconomic factors are key in explaining aggregate and, to a smaller extent, bilateral trade balances is in line with our own analysis of the US trade balance.

We want to emphasize, however, that findings from the EBA should be interpreted with great caution. The original EBA determines an equilibrium current account balance by explaining national saving and investment. Even if the trade balance is an important part of the current account, ignoring other components is disputable. Also, large residual components illustrate the uncertainties which come with this approach. In particular, for Germany, the residual component seems to explain significantly more than all other drivers jointly. In contrast to the original EBA and to our own estimates, the demographic situation of Germany does not seem to play an important role in the modified approach (all fundamental factors together even have a negative impact). Finally, as no attempt is undertaken to identify the causal effect of the drivers, the findings preclude a causal interpretation.

We are more sceptical with respect to the importance of trade diversion effects. Bundesbank simulations using NiGEM indicate that the trade conflict between the US and China tends to lower aggregate activity in third countries (see Deutsche Bundesbank, The potential global economic impact of the USA-China trade dispute, Monthly Report November 2018, pp. 11-13). Bilateral trade data for the second half of 2018 also indicate only very modest trade diversion so far.

Global Financial Stability Report

Global Financial Stability Assessment

We broadly agree with staff's view on near- and medium-term risks to global financial stability. Near-term risks to global financial stability have increased, as financial conditions tightened in both advanced economies and emerging market economies and global economic momentum has weakened. While asset valuations have declined at the end of 2018, investor optimism seems to have returned in the first quarter of 2019, especially due to the significant shift of major central banks to a more dovish stance. Nevertheless, medium-term risks remain elevated and financial vulnerabilities in different sectors of systemically important countries high. Furthermore, policymakers need to remain cognizant that still accommodative global financial conditions could result in further build-up of vulnerabilities.

We mostly concur with staff's policy recommendations. We generally echo the call for proactive efforts to strengthen financial resilience including through macroprudential policies. We particularly support work to address the sovereign-financial sector nexus, to improve minimum standards for insolvency and creditor rights regarding NPLs and to contain vulnerabilities in the nonbank financial sector, and we welcome the framework for comprehensive assessment of balance-sheet vulnerabilities across financial and non-financial sectors. It is important for central banks to communicate carefully any changes in their policy stance. For this, central bank independence remains essential. Finally, emerging markets should continue efforts to ensure resilience.

Late-Cycle Corporate Sector Risks in Advanced Economies

Debt service capacity in the corporate sector has improved during the recent cyclical upswing and corporates should probably sustain a moderate economic slowdown or a gradual tightening of financial conditions. On the other hand, debt levels have increased, and creditworthiness of borrowers has deteriorated. In a strong economic downturn or a sharp tightening of financial conditions, a significant repricing of credit risk, a deterioration of the debt service capacity of corporates and a significant increase of default rates can be expected.

Direct risks from distress in the leveraged loan market for banks are contained. Broader effects of decreasing leveraged loan prices triggered by fire sales from investment funds on the whole loan exposure of banks and the broader economy are rightly mentioned. Additionally, the links between banks and nonbank investors in corporate credit via loans, warehousing or liquidity lines merit closer analysis.

The Euro Area Sovereign-Financial Sector Nexus and Corresponding Policy Priorities

We share staff's assessment that there is still a risk that the euro area sovereign-financial sector nexus could be reinvigorated and we welcome staff's risk assessment considering different sectors and contagion channels. Increasing domestic government bond portfolios and a deterioration of sovereign credit ratings make banks and insurers in certain countries more vulnerable to sovereign shocks.

We appreciate the policy proposals to address the sovereign-financial sector nexus. We agree with staff's advice to sovereigns to put their debt-to-GDP ratios on a downward trajectory. This would be an important way to reduce risks in banks' balance sheets in the longer term. We strongly support the view that coordinated policies, in particular in Europe, should consider the mitigation of concentration risks in banks' sovereign portfolios. Capital requirements based on credit risk should be part of these considerations, bringing the regulatory treatment of sovereign debt more in line with that of private sector debt and with the underlying risk. Possible pro-cyclical effects and financial stability risks of such a reform could be minimized through an adequate transition period.

Effective resolution regimes are key to solve the sovereign-bank nexus. We are, however, critical with regard to the proposed financial stability exemption for bail-in. Concerns of financial stability risk due to possible spillovers from bail-in should not lead to avoidance of this tool but rather to its improvement through requirements of bail-in able liabilities.

Vulnerabilities in China, Emerging Markets, and Frontier Economies

We agree that benchmark driven portfolio flows to emerging markets are increasingly important and those investment decisions are to some extent based on group-specific rather than country-specific developments. Therefore, even countries with strong economic fundamentals could be affected by capital outflows.

The inclusion of China's markets in benchmark indices could boost capital flows to China. Since this could result in a more durable reduction of capital flows to other EMEs and thereby affect global financial stability. We welcome staff's focus on this important topic and support further monitoring.

Special Feature: Liquidity Risks in Capital Markets

Regulators should closely scrutinize market liquidity conditions, including the potentially large effects of increased electronic trading on the informative value of liquidity measures. They should assess the robustness of trade infrastructures and support transparency in the market place. There are concerns that, in stress periods, non-bank market makers can quickly retreat from market-making and thus exacerbate liquidity strains. We would like to point out, that the EU has already regulated market makers to mitigate this risk. We agree that data availability on activities of non-bank market makers should be improved. Another source of risk to be closely monitored is the liquidity mismatch in ETFs targeting less liquid assets, as passive investments through such vehicles have been growing.

Chapter 2: Downside Risks to House Prices

We broadly agree with most of the findings in chapter 2. The analysis regarding downside risks for house prices is welcome. We see it as an informative approach for macroprudential policy makers in order to estimate the actual prevailing "house prices at risk"-potential. We agree with the assessments that effects of the monetary policy stance and specific macroprudential policies on "house prices at risk" are evident and that capital inflows seem to increase downside risks to house prices. We support staff's view that house prices themselves should not be a direct target variable of macroprudential policy. Nevertheless, we welcome staff's analysis of the role of macroprudential policies with respect to the "house prices at risk"-concept as an additional perspective for macroprudential authorities, especially when set into the context of an overall decision framework of guided discretion. Having said that, we would like to point out that while we agree on most of the explaining variables, we see a more important role for residential construction activities in contrast to the broader view on GDP growth as currently proposed in staff's analysis. Finally, we would welcome a further improvement in the staff's assessment by an additional integration of data on debt service payments.

Fiscal Monitor

We broadly agree with many of staff's findings. As staff rightly points out, fiscal adjustment remains incomplete in many countries. Advanced economies, on average, have reverted to a neutral fiscal stance rather than restoring depleted fiscal buffers, and in emerging and developing economies deficits remain high or have further increased. Against this background, we agree that rebuilding fiscal buffers remains essential and, at the same time, fiscal policies should focus on strengthening the growth potential, e. g. by structural reforms and growth-friendly taxes.

We would be more cautious with policy advice on how to conduct fiscal policy over the cycle given the high uncertainty about the estimated potential output. Fiscal fine-tuning too often turns out to be rather pro-cyclical. As a result, attempts to stabilize the economy over the cycle might risk conflicts with fiscal sustainability. In particular in cases of normal cyclical downswings we would suggest to let automatic stabilizers work. Discretionary counter-cyclical fiscal policies should be reserved for severe recessions.

In the euro area, national governments are responsible for their fiscal policies, and budgets have to pass national parliaments. In addition, demand for public investment can best be judged on the national or local level and should be put on a steady path that is defined by economic necessities. We are sceptical about using public investment for conducting discretionary counter-cyclical policies.

The merits of coordinating fiscal policies in economic unions crucially depend on the size of fiscal spillovers. Our reading of the available studies is that we should not over-estimate these spillovers and thus the benefits of fiscal policy coordination in general. Furthermore, national responsibility for a sustainable fiscal policy should not be blurred.

Finally, we welcome staff's analysis of fiscal priorities in emerging and low-income countries. Enhancing public debt management and domestic revenue mobilization remains crucial, in particular for low-income countries, while strengthening external resilience remains essential for emerging countries to maintain investor confidence. In this context, we also welcome the special chapter on the economic and fiscal effects of corruption.

Mr. Mouminah submitted the following statement:

We note that the global economic expansion is slowing in 2019 but a modest pickup is expected in 2020 and then growth is projected to stabilize in the medium-term, as a result of myriad country-specific factors. As already anticipated in recent WEO vintages, global growth is receding following downward revisions for several advanced and emerging market economies and against the background of persistent trade and geopolitical tensions and increased policy uncertainty, including the Brexit outcome. At 3.6 percent for 2018, global growth is still strong, compared to recent years' average. Similarly, we take positive note of the projection that the trend increase in the share of emerging market and developing countries in global growth will continue and is expected to account for about 85 percent of global growth by 2024 against 76 percent in 2019. On global financial stability, we agree with staff's assessment that financial conditions, despite tightening since the October 2018 GFSR, remain broadly accommodative.

We need to remain vigilant as the global economy continues to be subject to a number of downside risks, as underlined in the WEO and the GFSR. Key sources of downside risks include potential escalation of trade tensions and policy uncertainties, including under a scenario of no-deal Brexit. Other important risks are the buildup of already elevated financial vulnerabilities in the sovereign, corporate, and nonbank financial sector of several systemic economies. Financial stability risks will further increase, as highlighted in the helpful special feature of the GFSR, due to the possibility of fire sales and significant movement in asset prices, contributing to a sudden and sharp tightening in financial conditions. In addition, cybersecurity breaches and cyberattacks on critical financial infrastructure remain ever-present sources of risk to the outlook.

Against this background, we support the Fund's main policy messages and note their consistency among the flagship publications. For the WEO, we echo the main priority "to avoid policy missteps that could harm economic activity". For the GFSR, we agree that "policymakers should aim to avoid a sharper economic slowdown, while keeping vulnerabilities in check". In this context, we concur that macroprudential policies should be deployed more proactively to affect financial conditions where vulnerabilities are elevated and rising. The emphasis on multilateralism by the Fund and on the need to upgrade global cooperation to address global challenges is also appropriate in the current environment of slower global growth and mounting risks. To this end, we agree that "at the multilateral level, the main priority is for countries to resolve trade disagreements cooperatively".

We agree that sustained excess external imbalances pose risks to global stability. While global current account deficits and surpluses have widened marginally in 2018, they are expected to decline gradually after 2020. In this context, we note from the WEO's Statistical Appendix that China's current account balance will move to a deficit by 2024. As Table A10 does not include the years 2021-2023, we would appreciate if staff could indicate in what year China's current account balance will move to a deficit for the first time? Could staff also offer some elaborations on the implications of this trend for China, in particular, and for the global adjustment process, more generally?

To mitigate the negative impact of globalization, policymakers should ensure that growth benefits all segments of the population. Despite encouraging improvement in social indicators, progress in reducing unemployment, particularly of youth and female, remains limited, compared with the important challenges being faced by many countries. It is therefore critical that policymakers commit more forcefully to ensure that growth dividends are well shared by all. In this context, the focus should be on implementing the right policy mix, including stronger safety net policies together with structural reforms to promote inclusive growth, while taking into account fiscal sustainability. Addressing poverty, unemployment, and inequality would also be appropriate.

We agree with staff on the benefit of developing prudential tools for highly leveraged firms similar to those applied to households. We also see merit in the need for more comprehensive stress tests for banks and nonbank financial intermediaries with significant corporate exposures. In this regard, we welcome the detailed analysis of late-cycle corporate sector risks in advanced economies and the recommended policies to address rising corporate sector vulnerabilities to mitigate financial stability risks.

The reemergence of investor concerns about the sovereign-financial sector nexus in the euro area underlines the need for proactive steps to mitigate risks. In this regard, it is important for highly indebted sovereigns to take measures to place their debt-to-GDP ratios on a downward trajectory through gradual but sustained growth-friendly consolidation. We also concur that euro area banks should continue to strengthen their balance sheets, including through steadfast efforts to address nonperforming loans. The GFSR also rightly underlines the benefit of introducing measures to alleviate concentration risk in banks' sovereign exposures.

In advanced economies, where the deceleration of growth is the more pronounced, macroeconomic policies should tilt towards accommodation, particularly if data confirm that the slowdown is more severe and protracted. In all cases, efforts should continue to strengthen financial systems and accelerate structural reforms to address the challenges of low productivity and aging workforce to boost potential growth.

In emerging market and developing economies, growth remains robust but not enough in many countries to address the pressing needs of job creation and poverty reduction. As noted in the WEO, 1 billion people living in 41 emerging market and developing economies, mostly in sub-Saharan Africa and the MENA+ region, will see their per capita income fall further behind those in advanced economies over the next five years. While policymakers should continue to promote inclusive growth, many of these countries will more than ever need the support of the international community to achieve the sustainable development goals (SDGs). In addition, and as the external environment is still characterized by important volatilities, many emerging market and developing economies, should promote policies that strengthen resilience, fiscal prudence, and improve debt management to ensure macroeconomic stability. Among emerging market and developing economies, the case of fragile states requires more attentiveness on the part of the international community, including the Fund, to help these countries restore macroeconomic stability, build institutions, and catalyze donor support. The GFSR rightly underlines the need for maintaining adequate fiscal buffers, bank liquidity buffers, and international reserves to build resilience. The report also brings attention to volatile capital flows to emerging markets, including increasing influence of benchmark-driven investors. In this regard, while we take note of the risk of reversal in countries with even strong fundamentals, inclusion in global indices brings substantial benefits.

In the MENA region, growth remains very low, less than two percent in recent years, but it is projected to exceed 3 percent by 2020, although such level remains insufficient to accommodate the growing labor force and reduce unemployment. Therefore, more efforts are needed to enhance inclusiveness and strengthen the role of the private sector. In Saudi Arabia, the authorities continue to implement their wide-ranging Vision 2030 reform agenda to modernize and diversify the economy and further promote the contribution of the private sector to growth and job creation. Indeed, such reforms would also have positive spillovers, especially for MENA region.

Regarding the oil markets, Saudi Arabia remains committed to support the stability of the oil markets for the benefit of both producers and consumers. We take note of the reference in the Special Feature of the WEO that supply shocks tend to cause spikes in oil prices when spare production capacity is low. In this context, we underline that Saudi Arabia maintains substantial spare capacity given the continued investment in energy infrastructure. This should help meet oil demand if there is any supply disruption.

We welcome the work presented in Chapter 2 of the GFSR to estimate downside risks to house prices, which could serve as a useful early warning indicator. Considering the role of large house price declines in adversely affecting macroeconomic outcomes and financial stability, the new methodology can supplement policymakers' existing tools for financial stability surveillance. We also concur with the conclusion that indicate a higher effectiveness of targeted and timely macroprudential policies than monetary policy in reducing downside risks.

We find the emphasis in the Fiscal Monitor on promoting sustainable inclusive growth to be appropriate. This is particularly important in a fast-changing global economy, with changing demographics, advancing technology, elevated debt levels, and more importantly persistent income inequality. Indeed, fiscal policy should strike the right balance between fostering growth and ensuring fiscal sustainability. Available fiscal space in countries facing sluggish growth and low inflation should be utilized to bolster growth and job creation. On the other hand, in countries where financial stability risks and debt vulnerabilities are high, priority should be given to rebuild buffers and strengthen resilience through a credible fiscal consolidation plan, which should be accompanied with growth-enhancing measures to boost productivity and potential growth. The situation in many developing countries are even more complicated where high financing needs are associated with inadequate buffers. These countries tend to be more vulnerable to volatility in capital flows and increasing public debt levels.

Therefore, efforts should focus on building adequate foreign reserves to provide self-insurance and protect against external shocks.

We agree with staff on the importance of greater international cooperation to achieve the 2030 SDGs. Corporate taxation is indeed an important area for cooperation to address the issues of profit shifting and tax competition while protecting the interests of developing countries. While we note staff's call for greater global cooperation on the issue of climate change, we would have expected more emphasis on country's specific circumstances rather than putting narrow focus on carbon taxation, without considering energy poverty in many developing countries. With regard to subsidies, we consider that the report focuses narrowly on eliminating energy subsidies, while we consider that all forms of subsidies, including agricultural and renewable energy subsidies, cause price distortions. Staff's comments would be welcome.

Mr. Lopetegui, Mr. Di Tata, Mr. Morales, Mr. Rojas Ulo, Mr. Corvalan Mendoza, Ms. Moreno and Mr. Vogel submitted the following statement:

We thank staff for the excellent set of reports and insightful analytical work. We have the following comments.

World Economic Outlook

For the third time in a row, the World Economic Outlook (WEO) has reduced its forecast for global economic growth, which has decreased from 3.9 percent expected in July 2018 to 3.3 percent in the current WEO. Beyond idiosyncratic factors, political developments and policy uncertainties appear to have an increasing relevance, while there is evidence that the credit cycle is maturing. While monetary policy adjustments and automatic fiscal stabilizers have a role to play in the current circumstances, the policy space to face a severe downturn is limited. Against this background, policy-makers should continue with their efforts on structural reform to address medium-term growth headwinds. In light of continued downside risk to the global outlook, upgraded global cooperation is needed.

Recently, positive market expectations about trade negotiations and signals of a slower pace of monetary policy normalization by the US Federal Reserve, led financial markets to exhibit an upturn from the past year's losses. Nonetheless, these developments are likely to be temporary, unless positive expectations are supported by further policy actions. Fiscal stimulus in the United States will diminish in 2019 and even further the following year, which will weigh on national and global growth. Meanwhile, in China, following a slowdown in growth during the second half of 2018 owing to regulatory tightening and the increasing trade tensions with the United States, policy stimulus through liquidity support and reduced reserve requirements is expected to keep the growth rate close to 6 percent in 2019, slowing to more sustainable levels over the medium term. Meanwhile, the uncertainties on Brexit—with increasing tensions that peaked a few days ago—are a source of risk to the economic outlook. Growth in the euro area posts a marked slowdown with very few exceptions at the country level. In this case, it seems that beyond cyclical explanations, structural factors have become more relevant recently, particularly in Italy and France, some of which are linked to political and social developments, as underscored in the report.

We agree with the WEO report that risks are tilted to the downside. Many of the potential triggers identified in the report appear to have an increasing likelihood of materializing compared to what was observed in previous years. Hence, an important question arises regarding countries' ability to react if these risks or others were to materialize. Monetary policies have been critical to successfully face the 2008 global financial crisis and its aftermath; however, since interest rates remain low, there is limited room for these policies to play an active role in the future. The fact that consumer price inflation remains muted across advanced economies, with a few exceptions, offers some relief in this regard. As highlighted in the WEO, the US Federal Reserve's signals on the trajectory of interest rates have contributed to a more optimistic mood of markets, but the continuation of this policy for a prolonged period of time is unlikely. The GFSR indicates that markets do not anticipate any more policy rate hikes by the Federal Reserve in the near term and expect the central bank balance sheet to stabilize slightly below the current level (Figure 1.1). Does staff have a view on the appropriate size of the Federal Reserve balance sheet? In the Euro area, interest rates have declined systematically since 2011 and the European Central Bank recently announced a further postponement of a rise in policy rates and a third targeted longer-term refinancing operation (TLTRO), which reflects its intention to maintain the policy of helping to reinvigorate the block's economic activity. Some analysts, however, have expressed doubts about the conditions of the TLTROIII when compared to TLTROII. Furthermore, as stressed in the Global Financial Stability Report "GFSR", in China "the authorities face a difficult trade-off between supporting near-term growth, countering adverse external shocks, and containing leverage through regulatory tightening".

Should fiscal policies increase their role to avoid a further slowdown? Is there scope to do more than what has been done since the crisis? The Fiscal

Monitor report clearly points out that the question should be answered on a case by case basis, considering fiscal space and the risks of a major downturn. Some creditor countries with enough policy space, such as Germany, could place stronger reliance on supporting demand growth. Other countries that have appealed to fiscal stimulus during the expansion phase of the cycle face a narrower fiscal policy scope, while a third group of countries must definitively undertake fiscal consolidation to restore sustainability. The report underlines that, in general, public and private debt are close to historical peaks, which requires fiscal policy to be extremely cautious when trying to stimulate economic activity by carefully balancing short-term effects with medium-term considerations. In this regard, we believe that the WEO presents policy priorities with great clarity.

Turning to Latin America and the Caribbean, we are encouraged that the WEO presents a positive view regarding growth rates, although it is disappointing that even their projected increases are still insufficient to meet the region's multiple and vast requirements in the economic and social areas. Considering that the region exhibits high levels of inequality, we would like to express our appreciation about the emphasis that the Fund's flagship reports place on distributional and poverty issues, which are regarded as one of the key sources of risk over the medium term.

We welcome Chapter 2 on The Rise of Corporate Market Power. This is a topic on which, at this stage, we have more questions than answers, but the chapter´s contribution is relevant because it sketches out several interesting policy issues, ranging from the adequacy of antitrust/competition policies to product market regulation and the need to reduce barriers to entry, to corporate taxation reform. We also appreciate the focus on macroeconomic and social effects, such as the distributional implications of market power on income and wealth, which could be investigated further in the future. We would welcome further elaboration from staff on two issues related to the rising market power of corporations. First, could staff comment on the suitability of existing anti-trust legislation to address the problem of rising market power? Second, the Chapter argues that "by reducing investment, rising markups can generate slack that may offset their immediate inflationary effect and may imply a trade-off for monetary policy". To what extent are these effects considered by staff to be sufficiently clear cut and relevant to be considered for operational purposes for conducting monetary policy in advanced economies, such as the United States and the euro area?

Chapter 3 on "The Price of Capital Goods: Key Patterns" finds that the decline in the relative price of capital goods has encouraged the rise in real investment rates in machinery and equipment over the past three decades, being driven by faster productivity growth in the capital goods-producing sector and rising trade integration. It also raises distributional concerns, especially those arising from the effect of the decline in the relative price of investment goods on the share of output captured by labor. The chapter gives a timely warning on the possible implications of a reversal of the process of trade liberalization on capital goods prices, and the associated impact on growth.

Along similar lines, Chapter 4 on "The Determinants of Bilateral Trade and Spillovers from Tariffs" highlights that the evolution of bilateral trade balances is determined by individual countries' macroeconomic dynamics. Targeting bilateral trade balances will mostly lead to offsetting changes in trade balances with other partners, assuming no significant changes in countries' savings-investment balance and national incomes, which determine the overall size of the current account. While multilateral reductions in tariffs and non-tariff barriers will benefit trade and global efficiency gains, it is worth emphasizing that non-tariff barriers to trade take different forms, ranging from regulatory barriers, to restrictions on services trade, to controls on foreign investment. We would encourage further work on these aspects of multilateral trade and would highlight that these diverse barriers cannot be analyzed in isolation. A more complete view on trade policy requires information on areas where there are important data constraints, including standards, subsidies, government procurement, and intellectual property. Last but not least, we believe that further gains are possible from reducing agricultural protectionism and encourage staff to further explore this issue.

Global Financial Stability Report

We concur with the GFSR that, compared to October 2018, global financial conditions are tighter but still accommodative. Financial vulnerabilities continue to build, with differences across regions. In the US, debt levels are high mostly in the sovereign sector and the nonfinancial corporate sector, while euro area risks are mostly concentrated in the sovereign sector. Other advanced economies' household debt is building up. In China, nonfinancial corporate, household, and banking sector indebtedness is high, as has been highlighted in previous reports.

One issue that comes out clearly from the report is the need to focus efforts on developing prudential tools to address rising corporate debt from nonbank financial intermediaries, as well as maturity and liquidity mismatches in the nonbank sector. The regulatory tightening in China has been successful in containing the build-up in risks, leading to a marked slowdown in bank credit growth, particularly by small and medium size banks, but there is a need to address vulnerabilities related to the large stock of investment vehicle assets, as regulatory reforms for the asset management sector have been scaled back recently.

The report highlights that portfolio flows to emerging markets are increasingly influenced by benchmark-driven investors, who are more sensitive to changes in global conditions than to country-specific developments. As a result, the benefits of index membership may be tempered by stability risks for some countries, which underscores the need to build stronger buffers in those cases. Portfolio flows to China are likely to increase by a large amount once the country is included in benchmark indices in global financial markets. At the same time, other emerging markets may see a significant reduction in benchmark-driven flows due to the rebalancing process. The Fund could help contain stability risks by communicating the strength of many emerging markets featuring lower vulnerabilities, stronger buffers, and larger policy space.

We agree with the staff's assessment about the possible triggers of a tightening of global financial conditions. These include a sharper-than-expected slowdown, an unexpected shift in the pace of monetary normalization in advanced economies, and political and policy risks. In this regard, we concur with the need to clearly communicate any reassessment of monetary policy decisions, expand the macroprudential toolkit in countries with rising financial vulnerabilities, and step up measures to repair private and public balance sheets. Emerging market economies should enhance resilience against portfolio outflows, including by improving debt management.

We welcome the new methodology to assess house prices at risk included in Analytical Chapter 2. The estimates are useful from a financial stability perspective as they prove to be an effective warning indicator. We agree with staff that macroprudential measures are better suited than monetary policy to address risks in the housing sector and that well-targeted capital flow management measures could reduce the downside risk of house prices when other policy options are limited but should be assessed on a case-by-case basis.

Fiscal Monitor

Chapter I of the Fiscal Monitor focuses on the role of fiscal policy in case of a possible downturn in the global economy. The Chapter notes that over the last decade fiscal policy dealt mainly with economic stabilization, paying less attention to reforms to foster inclusive long-term growth. We agree with staff that going forward fiscal policy should be prepared for possible downturns while also putting more emphasis on reforms to adapt to the changing global economy, including by upgrading tax, social spending, and investment in infrastructure in order to enhance public service delivery. We also concur with the report's emphasis on achieving greater international cooperation on corporate taxation, climate change, and the fight against corruption, as well as in attaining the SDGs.

The Chapter presents the main characteristics of new trends in the global economy, including shifting demographics, technological progress, and global integration. Each new key trend is evaluated considering the relevant challenges for fiscal policy according to the type of economy. This Chapter also describes recent fiscal developments sorted out by country groups, provides an overview of the fiscal outlook, and explains how key fiscal risks have evolved since the previous report. Staff includes policy recommendations in accordance with global trends. We agree with the analysis and considerations for each group of countries. An interesting general conclusion of the report is that removing fuel subsidies through efficient pricing could yield up to 4 percent of GDP in additional fiscal resources. Also, managing public sector assets more effectively could generate up to 3 percent of GDP a year in additional revenue. Could staff comment briefly on how fuel subsidies were calculated, including the assumptions used for oil prices and whether the fiscal cost associated with compensatory measures to mitigate the impact on the poor and vulnerable groups are included in the calculations? The report also notes that Sub-Saharan countries could raise, on average, 3 to 5 percent of GDP in additional revenue over the next five years through reforms to improve the efficiency of current tax systems. Unfortunately, the experience with increasing revenue mobilization in LICs has been disappointing, notwithstanding substantial Fund technical assistance in this area. Could staff elaborate on the main reasons behind this outcome?

We welcome the analysis of Chapter 2 on Curbing Corruption, which presents empirical evidence on the cost of corruption and suggests initiatives to reduce corruption at different levels, regardless of countries' development. The Chapter describes different channels causing leakages of resources in the public sector, their negative impact on the quality and effectiveness of public policies, and their effects on economic growth. It also shows diverse methodological approaches and country case studies and explores the potential role of fiscal institutions in fighting corruption. Regarding public investment, the Chapter shows that the losses due to corruption could range between 10 and 30 percent of construction value, which are striking figures.

Based on the analysis of new data, the report highlights how fiscal institutions can strengthen integrity and accountability in the public sector to build an effective fiscal governance framework. Reducing corruption in government operations and improving governance are linked to an overarching legal framework and information systems, strong institutions, independent external oversight, and a high level of transparency. Effective implementation requires the commitment of policymakers to design a comprehensive reform agenda to improve and solidify good governance. The Chapter also discusses the transnational dimensions of corruption and stresses the importance of international initiatives to combat them, which we support.

The representative from the European Central Bank submitted the following statement:

We thank Staff for their substantial set of flagship publications that in our view captures well recent key economic and financial developments and the policy challenges at the current juncture. We broadly agree with the policy recommendations made in the report. More specifically, we would like to make the following observations:

World Economic Outlook and Fiscal Monitor

We largely share Staff's assessment of the current global economic situation that growth is expected to pick up somewhat over the medium term, following the softening of the momentum in 2019. The current moderation in global growth reflects in addition to declining spare capacity and diminishing policy support in some economies also headwinds from trade tensions and geopolitical uncertainties. The dynamics of global trade have been adversely impacted by tariff measures amid weaker manufacturing activity. Looking forward, supported by favorable global financing conditions, like Staff, we also expect global growth to recover somewhat and stabilize in the medium term, particularly should the environment for trade improve. Nevertheless, like Staff, we see the risks to this narrative as being to the downside stemming from both external and domestic European factors. Continued uncertainties created by the ongoing trade tensions, or an escalation, could hold back the growth contribution from trade. In addition, a substantial reassessment of asset price valuations and/or tightening of global financing conditions constitute additional, and possibly related, downside risks. A 'no-deal' Brexit would also likely adversely affect the UK, and countries within the EU and elsewhere, with the largest impact likely on the UK economy in the near-, medium- and long-term. While the rest of the EU economy would also be negatively impacted, particularly those most closely linked to the UK economy, we consider that preparations taken by policy-makers, supervisors and market participants have attenuated the risk of systemic disruptions to the EU economy.

Economic growth in the euro area has moderated by more than expected, reflecting the slowdown in world trade and some, most likely temporary, domestic factors, but the underlying sound economic fundamentals should support the ongoing growth momentum. Reflecting geographic orientation and product specialization, euro area exports have been disproportionately impacted by the slowdown in global trade. In addition, some sector-specific developments, impacting car production in Germany in particular, and political uncertainties have weighed on economic activity and confidence. However, domestic demand more generally, supported by employment growth, accelerating wages and favorable financing conditions, provides resilient support to euro area economic growth. Looking forward, as the adverse impact of external and temporary factors wanes, like Staff, we expect growth to pick up in the course of 2019 and into 2020. This should underpin further increases in employment and wages, and lower unemployment rates.

While a weakening contribution from energy prices is likely to hold back headline inflation in the euro area, strengthening domestic costs pressures should support a gradual increase in underlying inflation. Following the fall in oil prices at the end of 2018, the contribution from energy to HICP inflation has fallen substantially and, on the basis of current futures prices for oil, can be expected to remain a drag on annual headline inflation over most of 2019. However, high levels of capacity utilization and tightening labor markets have been pushing up domestic cost pressures. With respect to Staff's analysis of labor market dynamics in selected advanced economies, we agree that weaker productivity growth since the global financial crisis has held back wage growth. However, more recently there has been a discernable uptick in various indicators of labor costs, such as negotiated wages and compensation per employee, and producer price inflation for (non-food) consumer goods has also been increasing. Staff note that the pass-through from rising wage growth to consumer price inflation has been limited thus far. Recent ECB studies suggest that this pass-through can be a function of the nature of the economic shocks impacting, with demand shocks more likely to be passed on, and can also be more attenuated after a period of low inflation, at least until inflation stably reaches a sustained path.

In this overall constellation, we welcome that Staff shares our assessment that an ample degree of monetary policy accommodation is still necessary for the continued sustained convergence of inflation to levels that are below, but close to, 2 percent over the medium term. In early-March, the ECB's Governing Council decided, against the background of the weaker economic momentum in the euro area, on a number of measures to ensure that inflation remains on a sustained path towards its inflation aim. Notably, it expects key ECB interest rates to remain at their present levels at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2 percent over the medium term. Moreover, a new series of targeted longer-term refinancing operations (TLTRO-III) was announced, starting in September 2019 and ending in March 2021, each with a maturity of two years, to help in preserving favorable bank lending conditions and the smooth transmission of monetary policy. Significant monetary policy stimulus will therefore continue to be provided by the forward guidance on the key ECB interest rates, reinforced by the reinvestments of the sizeable stock of acquired assets and the new series of TLTROs. In any event, the ECB's Governing Council has stated it stands ready to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

On fiscal policy, we consider Staff's call to prepare now for potential downturns very pertinent, and particularly support their emphases on rebuilding fiscal buffers in high debt countries and, more generally, on structural fiscal reforms to promote potential growth. The mildly expansionary aggregate euro area fiscal stance and the operation of automatic stabilizers are providing support to euro area economic activity at the current juncture. In view of the baseline economic projections, which are for continued economic growth, countries where government debt is high should work on building buffers so as to avoid pro-cyclical tightening in the event of a downturn. Given that the opportunity afforded by the recent favorable conditions has not been fully used to build buffers, it is all the more important that countries where public debt levels remain high avoid fiscal loosening and the back-loading of adjustment efforts. In countries where fiscal buffers have been built and fiscal space exists, the focus of fiscal-reform efforts should be to boost potential growth. All euro area countries would benefit from intensifying efforts towards achieving a more growth-friendly composition of public finances. For instance, Staff indicate a need to reorient expenditures towards infrastructure investment, education, health and R&D and revenues towards less distortive tax structures, in particular by reducing the burden on labor. Lastly, full compliance with the stability and growth pact (SGP) will not only allow countries to rebuild the necessary buffers, but would also increase confidence, support macroeconomic stabilization at the euro area wide and national levels and create the necessary trust among Member States to advance with EMU deepening.

On financial sector policies, we fully support Staff's recommendations on safeguarding global financial stability, preserving the achievements of the last decade of regulatory reforms and completing the remaining elements of reform agenda. We also agree with Staff that the persistence of global imbalances could pose some long-run financial stability risks in the global economy and share their view that protectionist measures would not help the adjustment process but risk to compromise the long-term prospects of the global economy. Instead, we re-emphasize the importance of appropriate macroeconomic policy settings. In this regard, Staff's analysis, in Chapter 4, of the determinants of bilateral trade and spill-overs from tariffs is salutary.

Global Financial Stability Report

We agree with the main thrust of the IMF's assessment of global financial stability risks and vulnerabilities. Financial vulnerabilities remain elevated, while financial conditions continue to be broadly accommodative, potentially leading to a further build-up of vulnerabilities. The widespread stock market correction in the last quarter of 2018 remains a testament of the potential risks of a sharp repricing which could expose existing vulnerabilities. Against this background, there is a premium on continued clear and careful communication by central banks. For this, central bank independence remains essential. In addition, the willingness and ability of macro-prudential authorities to act is essential to prevent the build-up of vulnerabilities.

The focus on risks to euro area financial stability stemming from the sovereign-bank nexus should not result in other, equally relevant risks, being overlooked and the coordinated efforts in the European Union to address this issue should be adequately acknowledged. With respect to the euro area, we continue to see three key medium-level systemic risks to financial stability: the risk of a disorderly increase in risk premia, which could be amplified by pockets of stretched asset price valuations and high correlations across global financial asset prices; increased debt sustainability concerns, amid slowing growth momentum, with a large public sector debt overhang or high private sector debt levels in several countries; and the risk of hampered bank intermediation capacity, with persistently weak bank profitability in spite of the cyclical tailwinds. The nexus between banks and sovereigns, which extends also to insurance companies and, in fact, the non-financial corporate sector more broadly through various channels, gives rise to financial stability risks related to debt sustainability which should not be downplayed. However, these risks are not specific to the euro area and have to be seen in proportion to the other sources of systemic risks. Moreover, important steps have been taken to strengthen banks' resilience and to severe the bank-sovereign nexus. In addition to good progress in reducing non-performing loans (NPLs) and achieving higher capital ratios, the shift from "bail-out" to "bail-in" enshrined in the Bank Recovery and Resolution Directive (BRRD) reduces contingent liabilities for the public sector, eventually buttressing fiscal sustainability ex-ante.

Significant efforts have been made by the private and public sector to reduce financial stability risks associated with a possible hard Brexit. A deterioration in political proceedings and a resultant hard Brexit could trigger a substantial market response. However, significant efforts have been made by various stakeholders, private and public, to reduce financial stability risks. The remaining issues related to contract continuity and data sharing pose, in our view, limited financial stability risk.

We agree with Staff that vulnerabilities in the sovereign, corporate, and nonbank financial sectors are elevated by historical standards in several systemically important countries across the world. Liquidity and maturity mismatches have been rising in the euro area investment fund sector amid concerns of increasing funds' holdings of risky assets amid declining cash buffers. We also concur that the leveraged loan market poses financial stability risks, both directly through the potential exposure of systematically important financial institutions and indirectly as a conduit for the propagation of a broader sell-off in credit markets. Regarding the exposure of US banks to the leveraged loan markets, there is a risk that, in case the US leveraged loan market performs worse than expected, markets may become concerned about the capacity of some of the larger or more exposed banks to manage their leveraged loan portfolio exposure effectively. As such, the bank contagion channel could still play some role in the transmission of systemic stress.

We agree with staff that more countries would benefit from actively using macroprudential policies to increase their financial system's resilience or to limit the accumulation of vulnerabilities at this stage of the cycle. In the banking sector, a further build-up of capital buffers to address cyclical systemic risks could be considered in some cases, with decision-making being based on a careful assessment of the costs and benefits. We concur that macroprudential policies could be used to address vulnerabilities in the corporate sector. Moreover, we also see that the macroprudential toolkit needs to be extended to cover the growing non-bank financial sector. In that respect, we would like to point to the fact that considerable progress has been made in strengthening the EU regulatory and supervisory framework for non-banks. In particular, the regulatory frameworks for securitization, money market funds and investment funds developed after the crisis represent a cornerstone to limit risks in the non-bank financial sector. At the same time, as the share of non-bank financial intermediation has been growing in the EU, the sector requires close monitoring, by, among others, developing comparable and meaningful leverage metrics.

Finally, as regards the analysis of risks emanating from house price developments (Chapter 2) we consider the house-prices-at-risk approach a useful complement to existing analytical frameworks. Notably, it complements the analysis of house prices performed by the European Commission as part of the Macroeconomic Imbalances Procedure, and to the macroprudential analysis of residential real estate markets by the ECB and ESRB. Nonetheless, moderate corrections in housing prices are not necessarily negative from a financial stability perspective, and therefore it is important that the results of the model are considered in conjunction with other vulnerabilities (e.g. stemming from household balance sheets and lending developments). On the policy responses, we agree that macroprudential policy seems to be the most targeted and timely tool. This is especially the case for monetary union where monetary policy and capital flow management cannot respond to country-specific vulnerabilities.

The Chairman made the following statement:

For those who thought there was a lot of material and maybe the streamlining should be a bit deeper, I want to address that, before I give the floor to much more competent and talented speakers. We have taken into account the recommendations of June, and as a result of that, we have reduced the number of special chapters. The Fiscal Monitor used to have two chapters in 2015, and it only has one now. We have reduced the number of words allowed for the three documents, and that has been respected. What is more important is the assessment that has been done by the Communications Department (COM), and Mr. Rice and his team reviewed the extent to which the documents could be streamlined, and there was a debate as to whether the

Fiscal Monitor should be produced once a year and not twice. The work that was done by Mr. Rice and his team identified different layers of audiences. There are the savvy experts who take great delight in dissecting the thorough work and research that has been done by the teams under the leadership of our three speakers, and clearly we have seen an increase because the Fiscal Monitor was particularly targeted at the time, and we have seen a definite increase in the readership, including the substantive and thorough material.

We have also identified people who are not interested in doing a deep dive into the work and the research that has been done, and COM has continued to try many different approaches for those audiences, using more common language that is easier to read and understand for the non-economist, as well as different media, from tweets to blogs to Instagram. All of it has been used to communicate the messages and to target those audiences. I am told our speakers will be communicating the messages from their respective chapters on Facebook Live in order to reach out to people who otherwise may never check the IMF website or take any interest in the research. We are trying. We are constantly checking, and that is the value of the measuring done by COM, to see whether it progresses, how broad the audiences are. But we would like it to be more streamlined, and the effort is underway.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath), in response to questions and comments from Executive Directors, made the following statement:

Global growth continues to weaken and to surprise on the downside. (Slide 1) Growth in the second half of 2018 disappointed broadly, owing to several factors including trade tensions, needed financial tightening in China, and country-sector-specific shocks like the auto sector in Germany, higher sovereign borrowing costs in Germany. This weakness is projected to carry over into the first half of 2019, and therefore weaken growth for 2019.

Several policy support measures have been put in place, including U.S. monetary policy shifting to a more accommodative stance, similarly for the European Central Bank (ECB). China has put in place several monetary policy and fiscal stimulus measures, and there has been some relaxation of the trade tensions. Owing to these measures, we expect the second half of 2019 to see some improvement, and then there will be a recovery in growth by 2020. To be clear, this recovery in 2020 is somewhat precarious because this would happen at the time when several major economies in the world, both advanced and emerging, are expected to continue to grow fairly modestly into the future.

The other important point to keep in mind is that risks remain skewed to the downside amid high policy uncertainty. For instance, trade tensions could escalate. They could enter into other areas like the auto sector, and that could affect investment and growth. Financial conditions could tighten suddenly, and this would be particularly problematic in a situation where there are high levels of private and public sector debt and bank and sovereign debt doom loops. Lastly, there is still the risk that growth in China will surprise on the downside and the ever-present risk of a no-deal Brexit.

While growth continues to be reasonable, and we are not in a recession, this is a delicate moment for the global economy, and therefore it is essential to avoid policy missteps, to build resilience, and undertake reforms. This will require multilateral cooperation on several fronts, including on the trade front. In the event of a more severe and protracted downturn, more policy measures will have to be put in place to ensure that demand is maintained. This will be country-specific and will depend upon the space that is available for countries. Lastly, a challenge that remains is that long-term growth has to be raised, for which we require structural and fiscal reforms.

Slide 2 basically points to the fact that though there has been a major improvement in financial conditions over the last few months following the policy measures, we have yet to see any major improvement on the real front. What we see is that there is a slowdown visible in manufacturing. Manufacturing PMIs that declined toward the end of last year remained weakened across the board for most countries. Services PMI, on the other hand, are mostly flat and less negative than manufacturing. Consumer confidence that came down toward the end of last year has mostly flat-lined and there is not much of a dramatic improvement.

Slide 3 again points to the broad-based nature of the decline that is being projected for 2019. The map shows what growth will be for 2019 relative to 2018, and the large areas of pink and red basically point to the fact that growth will be lower for most countries in the world, and this covers basically 70 percent of the world economy. The green regions point to an increase in growth. This weakness in growth comes along with fairly subdued inflation in most regions, including a concern about weak inflation expectations in some major economies of the world.

The graph on the right shows that 2019 will have a weak beginning but then some stabilization for advanced economies, and for emerging markets there will be some recovery into 2020.

Slide 4 points to global trade. We have seen global trade weaken toward the end of 2018, and the improvement in global trade is yet to come about. This weakness in global trade reflects the broad weakness in investment around the world, and in an environment with heightened policy uncertainty, we expect weakness in trade to continue into 2019.

We then want to present some facts on what is happening following the U.S.-China trade tensions. (Slide 5) The first graph shows that there is now a decline in imports coming into the United States from China, and one can see it strongly in some of the earlier categories in which tariffs were imposed.

The middle graph points to the fact that in some categories of imports, there has been trade diversion, which was basically the phenomenon where the United States instead of importing from China is importing the same good from another country in the world. The figure here refers specifically to the category of goods, the US$16 billion list. This was basically manufactured intermediate imports, and imports from China recently have declined, but we have seen an increase in imports from Mexico for a commensurate amount over this same period.

The last chart points to the fact that when one puts tariffs in place, one tends to have segmentation in markets, so this specifically refers to tariffs that China placed on soybean imports from the United States. That generated a wedge in soybean prices with U.S. producers getting lower prices for their output relative to soybean exposures from Brazil. That wedge disappeared once there was an improvement in trade talks.

A question that remains is about where the U.S.-China discussions are headed and what the agreement would look like. (Slide 6) What we have here is a pure hypothetical. The small short black bar is China’s imports from the United States, and the taller black bar is U.S. imports from China. The difference points to the deficit. What we try to simulate is whether there could be a shift in exports of goods going from the United States to other parts of the world toward China. There are certain sectors in which the United States imports to other parts of the world, and we could see a situation where China could buy more of those goods from the United States as opposed to buying it from other trading partners, so this would be a trade diversion story where China would buy more goods from the United States. This obviously has spillover effects to other countries in the world that export to China in these particular categories, and that is what the right chart shows. The right chart points to the fact that there are countries in the world, and some of these are low-income countries (LICs), that could be negatively impacted by such an agreement that takes the form of trade diversion, with some of these effects being quite substantial.

Slide 7 looks into the question of Brexit and what the cost will be of a hard Brexit. To be clear, this is hypothetical. The scenarios are ever changing, and we are paying close attention to this, so these numbers will change somewhat as we get more information about the specific nature of the exit, so this is a hypothetical outcome.

But we wanted to look into what the costs would be of a hard Brexit, and there are two possible scenarios for it. One is with major disruption to trade and major disruption to financial markets. That is the red line in the chart. The blue line represents a scenario with lesser trade and financial sector disruption, and so there is e a smaller, shorter, and negative impact. But in either scenario, the consequences are significant in terms of the loss of GDP to the U.K. economy.

There was also a significant negative effect of a smaller magnitude to the European Union (EU) as a whole, excluding the Untied Kingdom. For the world as a whole, the impact is smaller. But the important point that we wish to flag through exercises of this kind is that regardless of what we assume about the scenario, the impact is significantly negative, and in the long run we can see that the decline in the output for the United Kingdom relative to the baseline that is in the World Economic Outlook (WEO) is about 3 percentage points.

There has been one positive development following policy measures, especially on the monetary policy side from the U.S. Fed, and this is to the recovery in capital flows to emerging markets. (Slide 8) This is something that Mr. Adrian will go into in much greater detail, but I want to flag the fact that portfolio flows to emerging markets are recovering and the recent policy announcement made by the Fed yesterday will only further that. Emerging market spreads are declining. That is differentiated and not common across the board, but one sees an improvement there. In addition, several emerging market currencies have appreciated over the last few months.

Now we jump to the projections. (Slides 9-10) Global growth is projected to decline from 3.6 percent in 2018 to 3.3 percent in 2019 before recovering to 3.6 percent in 2020. But there are two important things to flag. The first is that the decline in growth for 2019 is broad-based. One sees that for the United States, the euro area, the United Kingdom, Canada, and if one looks at other advanced, Asia, which includes Australia and New Zealand, there actually have been sizeable downward revisions to growth. This is an important thing we pay attention to, the broad-based nature of this decline.

In terms of the recovery, it is important to note that the recovery does not come from advanced economies, because advanced economies as a whole are expected to decline further, from 1.8 to 1.7 percent, and this is a reflection of the fact that for most advanced economies they are either at close to their potential, and the potential in terms of the medium term is towards more weakness in growth given the demographics of aging and low productivity growth. The question then is where does this recovery come from? The recovery comes from emerging and developing economies, where growth again dips slightly from 4.5 to 4.4 percent, but then recovers to 4.8 percent. It is important to flag that this is quite heterogenous. This recovery relies on improvements in certain stressed economies like Argentina and Turkey, and therefore it is in this sense that the recovery is somewhat precarious.

If we look at low-income developing countries (LIDCs), while the average growth rate is around 5 percent, there is significant heterogeneity. There are commodity exporters like Nigeria whose growth rates are closer to 2 percent, while on the other hand there are countries like Vietnam where growth rates are closer to 7 percent.

Let me move on to the three analytical chapters. In the three analytical chapters, we have tried to address three important trends of our time. The first is about declining labor shares, the second about weak investment, and the third about rising protectionism and the consequences of that.

The first chapter, which is on the rise of corporate market power, looks into whether the phenomenon of rising concentration in markets is an important explanatory factor for declining labor shares and weak investment, and what that implies for policy going forward. (Slide 11)

The first fact is that there has been an increase in market power measured using markups, and this increase in market power is nevertheless fairly modest, so it is about 6 percentage points between 2000 and 2015. However, what underlies that is a great deal of heterogeneity. There is some heterogeneity across countries with the increase slightly higher in the United States relative to other parts of the world. It is more true for non-manufacturing sectors as opposed to manufacturing sectors. But more importantly, it is concentrated on a few firms with very large markups. These are the top decile of firms in terms of markups, and there we have seen an increase in markups of about 30 percent. These firms are also different in other ways. Not only do they have higher average profitability, but they also tend to be more productive and to invest more in intangibles. What they do less often is invest in terms of physical capital, so that can explain some of the decline in investment. But given that on the aggregate these are fairly modest, as of now it is not a major explanatory factor for the decline in investment. Nevertheless, it is important to be cautious and to pay attention to these trends because this market dominance could turn into greater rent seeking, and therefore it is important to reduce barriers to entry and keep working on competition policies.

The next chapter is about the relative price of capital goods and investment. (Slide 12) What we have seen is this extraordinary phenomenon of decline in the relative price of capital goods over the last 25 years, more in advanced economies than in emerging markets, and that has been an important factor for the increase in real investment over this 25-year period. In terms of policy recommendations, it is important that developing countries continue to reduce their trade costs with respect to capital goods, but even more, it is important for the world to stick the path with respect to trade integration, so we can get the gains in investment.

Slide 13 is on the last chapter, which concerns spillovers. We are looking into the relationship between bilateral trade imbalances and tariffs. This is very topical given that that is a major part of the ongoing U.S.-China discussion. The question is can one reduce bilateral trade balances dramatically by putting in tariffs. We do a historical exploration. That is what the first chart is about, and it indicates that historically bilateral tariffs have played a small role in explaining bilateral trade balances. The bigger factors have been more macro in nature in terms of supply and demand, and that also includes any generalized subsidies provided at the country level. Of course, this time could be different given that much larger tariffs are being put in place, but a second important point that the chapter flags is that in terms of explaining overall country balances, again the driving factor appears to be macro, and this is consistent with the recent trends we have seen with regard to the U.S. trade balance with China. The U.S. trade balance with China has not changed that much, and the U.S. trade balance as a whole is the largest it has been in the last 10 years.

We end by flagging that any kind of trade tariffs, trade tensions, are even more costly now than they would have been a few years ago because of the global value chains, global supply chains. This figure shows that the negative impact of putting a 1 percent tariff on all countries would reduce GDP now by far more than it would have done in 1995.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian), in response to questions and comments from Executive Directors, made the following statement:

Let me start with an overview of vulnerabilities and risks that we are particularly concerned about. (Slide 1) In the corporate sector, we do see a rise in corporate debt and the deterioration of underwriting standards. The sovereign-financial sector nexus is worrisome in countries with weak sovereigns. Liquidity and maturity mismatches are of concern in the non-bank financial sector, and vulnerabilities are emerging in some emerging markets, together with house price misalignments in other markets.

As usual, we will focus on vulnerabilities. Our philosophy is that there are many risk factors. There are many things in the world that can go wrong, and how bad that will be depends on the level of vulnerabilities, so these are the amplification mechanisms relative to any adverse shocks.

There are a number of risks that I do want to flag even though I am not going to discuss them in detail. There is a risk of a global growth slowdown. There is a risk of an unexpected monetary policy shift perhaps in response to a sudden unexpected rise of inflation, because that is certainly not priced in. There is always the risk of a deterioration of trade tensions, and there is the risk of disorderly Brexit. These are risks factors, but again our focus will be on the level of vulnerabilities.

Turning to market developments, the last six months since the last Global Financial Stability Report (GFSR) have been quite remarkable. (Slide 2) Take a step back and think about Q4 of 2018. Major equity markets, commodities declined by 15 to 20 percent, some more than 20 percent, within three months. Since the turn of the year, they have rebounded very strongly so there has been a sharp roller coaster of global financial conditions, as shown on the right side. Last year, we have seen not one, but two, major spikes in equity market volatility, first in February and then in December, and all of this reverted fairly quickly. In the meantime, financial conditions have tightened somewhat, so globally they are around neutral. They are a bit tighter in the emerging markets and advanced economies and the euro area, and they remain somewhat loose in the United States, but there have been large swings in financial conditions.

What is the story around that? (Slide 3) Monetary policy plays a major role, and many Directors have flagged that in the gray statements. My reading of the past six months is that financial conditions tightened substantially in Q4 as weak economic data came in, and downside risks to growth increased tremendously.

The chart in gives our estimate of downside risks to growth, and as financial conditions tighten, the short-term estimate of those downside risks increase tremendously. As a result, what we have seen is a concerted effort around the world to ease monetary policy. When one look at the left chart, the Fed dots in between last September, so just before the Annual Meetings in Bali, and yesterday after the Federal Open Market Committee (FOMC) meeting, the rates have come down 75 basis points this year, and next year and even the longer run dot has come down substantially. That is a major adjustment in the path of monetary policy. This is not only in the United States. This is also the case in Europe, where forward guidance was changed, where new targeted longer-term refinancing operations (TLTROs) were phased in, and where there is a perception that the stance of monetary policy has changed dramatically.

Even in emerging markets, shown in the right-hand chart, there on the X axis, we show the one year ahead market-implied policy rate and on the Y axis, the current implied policy rate one year ahead. What one can see is that with the exception of Mexico, all the other emerging markets are below the 45-degree line, indicating that the stance of policy as priced into the market today is easier and for some cases it is quite substantially easier by the magnitude of 100 or more basis points.

Easing of monetary policy around the world takes away downside risks. (Slide 4) Can I prove that? Yes, I do have suggestive evidence for that. The left-hand chart shows the global equity prices and the 12-month forward global earnings per share of growth. This is earnings per share for the whole world or the best proxy that we have for the whole world. Earnings per share of growth continues to slump down. A year ago it was above 10 percent. Now it is below 6 percent, so the one year ahead expectation of earnings per share is today nearly half of what it was a year ago.

Yet stock prices rebounded strongly, so how can it be that earnings per share expectations go down, yet stock prices suddenly rebound, and they rebound on the day of Federal Reserve chairman shares remarks at the American Economic Association on January 4? How is that possible? Well, one can overlay that with volatility. The VIX spiked to over 35 and then came down sharply, and with this market-implied measure of uncertainty, what is remarkable is that one can also see that the earnings per share standard deviation, the risks that analysts see about earnings per share based on their forecasts, came down dramatically. There is a dramatic quantitatively large reduction in the perception of uncertainty. That feeds back into this notion that monetary policy acted aggressively in the face of a sharp increase in downside risks to remove some of these downside risks. With a reduction in downside risks, equity prices go up, and financial conditions are easier because there is less uncertainty; there is less worry about a hard landing.

Basically, the market-implied likelihood of a soft landing is much more likely today than it was three months ago. We can look at that quantitatively when we look at our growth-at-risk forecast. This is the one year ahead estimated density centered around the WEO forecast. The mode of each of these three distributions are the realtime WEO forecast as we go through time. This is as of 2018 Q3, Q4, Q1, and then what we do as a notion of financial stability is to ask what is the spread around the WEO forecast? To what extent are the tails of the global growth distribution moving around as financial conditions are evolving, as financial vulnerabilities are evolving?

The one year ahead downside risk increased dramatically between Q3 and Q4. (Slide 5) The downside risk went from 2.8 percent to around 1.5 percent. That is a dramatic increase in downside risk. Then it moved back. For the last point, for 2019 Q1, we used the quarterly average. If we used the most recent update of financial conditions, this would be even, would indicate even less downside risks. These are large moves. When we had a discussion internally with management, we did feel that this move in monetary policy to contain downside risks was welcome.

One can ask if the easing of monetary policy increases medium-term risks because vulnerabilities are rising. We also have a quantitative assessment of our medium-term risks, and it turns out that while short-term risks fluctuated dramatically in the past six months, medium-term risks fluctuated very little. That is because medium-term risks depend more on the overall level of vulnerabilities. When financial conditions are easy and macroprudential policy is unchanged, then there is the worry that vulnerabilities are rising, and so in our policy recommendations, we are going to talk about that role of macroprudential policy in detail.

I am very excited about this new chart on Slide 6, which is our new vulnerability assessment. Into this chart feeds hundreds of indicators of vulnerabilities across sectors, across the world. Basically what we do is we look at leverage, maturity transformation, currency mismatches in all these different sectors in every single country of the 29 most systemically important countries (S29). Those are the countries where we do the Financial Sector Assessment Programs (FSAP) at five-year intervals. In every single country, we have hundreds of indicators, and then we aggregate them up across sectors. The current assessment is the gray bar, so in the non-bank sector, that is sometimes referred to as shadow banking, we see a deterioration of vulnerabilities. We see a deterioration in the non-financial corporates, and we also see that the sovereign sector is quite vulnerable.

Relative to the global financial crisis, the shadow bank system is much less vulnerable, but vulnerability is increasing. The banks are much less vulnerable because they are much better supervised, and the insurers are much less vulnerable because they are also much more tightly supervised. Furthermore, globally the household sector is not as vulnerable as it was 10 or 12 years ago, but in some countries, there are large vulnerabilities in any one of these sectors. In the GFSR, we also have a breakdown of these vulnerabilities by region or countries.

Let us turn to the credit cycle. (Slide 7) One of the worries in the marketplace, one of the triggers for the sharp tightening of financial conditions in Q4, was the worry of a hard landing, that the credit cycle would potentially have adverse implications for macro activity. and, indeed, one can see that in the euro area it looks like the credit cycle is moving sideways, while in the United States, it looks like it is peaking, and typically after a peak comes a downturn, but that is not necessarily the case. There could be a soft landing, and the shift of financial conditions did indicate that the market thinks a soft landing might be more likely than a hard landing, and so that might be like a smooth landing of this credit cycle. I do want to point out these indicators are also aggregating a very large number of credit cycle matrices, including underwriting standards, measures of risk-taking, credit conditions, profitability, and leverage, and the GFSR explains in detail how we construct that.

Part of the worry in the credit market is that firms realize that it makes sense to move down the credit spectrum, and one can see that dramatically both in the United States and in the euro area where investment grade corporates issue in much larger fraction at the BBB spectrum, and that is a bit of a vulnerability because it makes it easier for them to be downgraded to high yield. They are just one notch above high yield, and that is pretty much half of all issuance in both the United States and the euro area.

When we look at the overall level of leverage, the level of leverage in the corporate sector is comparable to what it was 10 years ago. (Slide 8) We used 2008 for the United States, 2009 for the euro area, because those were the worst in the corporate sector in these respective regions. Leverage is comparable, so it is not worse than 2008 or 2009, and actually interest rate coverage ratios look quite a bit better, but interest rate coverage ratios can deteriorate quickly if there was either sharp slowdown that drags down profitability or if interest rates were to rise unexpectedly because inflation comes back.

Another vulnerability that we point to in the report is the sovereign-financial nexus, and in the euro area, we do see that since 2010 there has been a sharp increase in the share of domestic sovereign bond holdings in some countries, and that can be a cause for concern if those countries also have weak public finances. (Slide 9) The combination of weak public finances and large banking sector exposures can trigger concern. In terms of NPLs, there has been a stark improvement in the euro area. They are roughly half from what they were on the peak. Nevertheless, when we look at balance sheets of banks today by country and we ask if there was an adverse scenario in the sovereign risk valuation—so here we use the 99th percentile of a shock to sovereign spreads, and if NPLs were mark-to-market using best proxies from market indicators of the real mark-to-market value of NPLs—so if we downgrade the both the sovereign exposure and the NPLs and then ask what would be the capital relative to that adjustment, there are some concerns in some countries. Those are the countries that tend to have weak sovereigns, where these sovereign shocks tend to be larger.

The ECB is aware of these weaknesses and has rolled out some fairly aggressive policy measures. (Slide 10) They did announce a week and a half ago the TLTRO-III program. To the best of our understanding, this will be of similar magnitude as TLTRO-II, and if we look at the pickup at the moment, at the outstanding amount of TLTRO-II, we can see that the countries that struggle more are expected to pick up more in these TLTROs. This is expected to lower the average cost of funding for the banks, which hopefully will translate into greater credit supply and support for aggregate demand.

We do have an analytical chapter on housing prices at risk, so this is something that some jurisdictions have already adopted and that some Article IV consultations and FSAPs have used already in the past three months. (Slide 11) Basically we asked what is downside risk to housing prices as a function of valuations in housing market, macro fundamentals, financial condition. The left-hand chart is a time series on the United States, which illustrates these downside risks. This is a three-year cumulative house prices risk, so that is like a variant risk of aggregate housing prices, and at the worst point in the crisis, this was -10 percent. We tested the model extensively out of sample, so this performs very well in the policy setting. The right-hand chart shows that there are a number of countries—among advanced economies, there are nearly 30 percent, and emerging markets there are over 30 percent—that have housing at risk at the -10 percent or worse than -10 percent level. There are a number of countries where housing prices are at risk.

Ms. Gopinath already mentioned that these capital flows to emerging markets are a good development, and I would add that when we think back the whole last year, what we pointed out repeatedly was that there was a lot of differentiation. (Slide 12) There was the retraction of capital flows early in the year. There remained a lot of differentiation. That was one piece of good news. The other piece of good news was when there was the large selloff of advanced economy risk assets in Q4, we did not actually see a collapse of capital flows in the emerging markets, and the emerging markets were pretty robust. Then, earlier this year, there was a sharp rebound of capital flows. The story is pretty hopeful.

We are breaking out China here because there has been a large amount of inflow into China, as China has been included in the major indices. For low-income and frontier markets, one can also see robust overall issuance in 2018. It is very comparable to 2017. The market expectation for 2019 is of similar magnitude as 2018. There is a risk that some countries cannot rollover, and Mr. Gaspar will discuss in detail the debt situation in countries and in particular in LICs.

In terms of portfolio flows, one channel of vulnerability that we discussed is that there is much more indexing today than there was 8 or 10 years ago. (Slide 13) Today, US$800 billion globally are benchmarked against the JPMorgan Emerging Market Index, and those benchmarked flows tend to be more sensitive to global financial conditions such as variations in VIX or the 10-year Treasury yield, so this is something to keep in mind when thinking about vulnerabilities of countries to capital flow shocks.

To finish, let me discuss China. (Slide 14) Along with other economies, China has taken aggressive steps to ease and to counteract downside risks. The reserve ratios were cut four times. Interest rates declined in the short term quite substantially, and this is partially offsetting the regulatory tightening in the non-bank sector and the shadow banking sector in particular. One can see that especially for the small banks, the shadow credit has declined dramatically, so there is definitely deleveraging.

The right chart does point out that if one were to hold those off-balance sheet assets on balance sheets and one were adequately capitalizing them, that would take quite a bit of time, in particular for those banks that have high asset growth in recent years.

The Director of the Fiscal Affairs Department (Mr. Gaspar), in response to questions and comments from Executive Directors, made the following statement:

Growth is slowing and risks are on the downside. That is something that Ms. Gopinath emphasized. Mr. Adrian spoke about risks again, but he focused on vulnerabilities, and he characterized the financial conditions recently as a roller coaster, and we will see that that has some implications on the fiscal side.

I will argue that fiscal policy has an important role to play, and in particular, I will try to persuade you that for fiscal policy, we should take a long-term view. That involves focusing on sound public finances as a cornerstone of stability, and that principle underlies our bilateral and multilateral advice on fiscal policy. Moreover, fiscal policies are increasingly and rightly seen as structural policies, and for developing countries, fiscal policies are a cornerstone of development policy.

Public debt levels are higher across all country groups, and they are at levels well above those that prevailed at the time of the global financial crisis. (Slide 2) In advanced economies, public debt stabilized in 2012, and then it has started to decline slightly. In emerging market economies and LIDCs the trend has been up.

If we look at interest rates, the picture is significantly different. Despite the fact that in advanced economies the public-debt-to-GDP ratio has increased quite substantially, the interest-to-tax ratio has actually declined. That is the red line in the chart.

In emerging market economies, the interest-to-tax ratio does not have a clear trend. For LIDCs, we see in red a doubling, but if we concentrate on the dashed red line, it basically only differs from the solid line by being an unweighted average compared with weighted, we see that the development is much less pronounced. The trend is still there but much less pronounced. That basically has to do with the fact that Nigeria, which has a very large GDP weight, has a very unfavorable indicator in this particular dimension.

There are many evolutionary trends with significant impacts on public finances. This is not only about public debt-to-GDP ratios or interest-service-to-tax ratios. Demographics are probably one of the strongest trends. (Slide 3) The trend is very pronounced in all country groups, but the trends are different. Advanced economies are dominated by aging, while in LIDCs the interaction of very young populations with development requirements puts pressure on public finances as well.

I will now go by country group, and I will start with advanced economies. (Slide 5) What one sees on the left-hand side is two things. One is that interest rates are volatile, and as one can see on the left-hand side of that chart, the volatility of interest rates is particularly pronounced in times of crisis. The highest line in the chart is Portugal in the left-hand side, and I was actually Minister of Finance at the time of the peak, so it is with a bit of embarrassment that I present this chart.

I want to call to your attention the amplification of the right-hand side where one does see that Japan and Germany are very close to zero. One does not see that in the chart itself, but it is quite an impressive development how much interest rates have declined, and in the case of countries like Japan and Germany, how close to zero it is.

On the right-hand side, we have the change in public debt and the change in the interest-to-tax ratio, and for most countries, the interest-to-tax ratio has declined. The size of the circles is the GDP weight.

Now let us look at the United States. (Slide 6) The United States is interesting because it is the biggest among the advanced economies. It has been discussed a lot recently. In our forecast, on the left-hand side, the differential between the interest rate and the growth is negative at -1.3. One sees from the chart that negatives, the difference between the real interest rate and the growth rate (R-G), are pervasive. There are only five advanced economies with positive R-Gs. The interesting aspect is that if one goes around the world and adds developing countries, the picture does not change. There are only a few countries with positive R-G. The vast majority of countries have negative R-Gs.

The United States is interesting also because it shows that having a negative R-G does not ensure a non-increasing public-debt-to-GDP ratio. The deficit of the United States is such, the primary deficit is such, that the public-debt-to-GDP ratio is forecast to increase, as shown on the right-hand side.

If one looks beyond the medium term for the United States, one sees that the spending which is projected under unchanged policies associated with pensions and health are quite sizeable. As a matter of fact, the United States has the highest estimate of increases in health spending in the world. When we think about long-run trends of public finances, that is important, but it is definitely not the only thing. In advanced economies, population aging matters greatly.

As a matter of logic, if public-debt-to-GDP increases, it cannot increase without limit. At some point R-G will turn positive. This is a matter of logic. But if we look at the real world, we do see that in most countries most of the time, R-G is negative, but we also see that there are many fiscal crises on record and even quite a substantial number of sovereign defaults. Why is that? Because when markets start having doubts about the ability of governments to roll over their debts, the interest rate can change suddenly and quite sharply exactly in line with the type of volatility that Mr. Adrian was talking about.

In emerging markets, debt levels vary greatly. (Slide 8) In some cases, we do have elevated debt levels, shown on the left-hand side. In almost all emerging markets, debt levels have increased, and the most frequent increase has been between 10 and 20 percent of GDP.

When the public-debt-to-GDP ratio increases by much, what are the main factors behind such a dynamic? (Slide 9) In this slide, we argue that interest rates and exchange rates play a big role. On the left-hand side, one sees that for Argentina and Angola, countries that are high on the attention of the Fund, the exchange rate depreciation did play quite a substantial role.

In the middle chart, we see that in the case of Brazil, the snowball effect caused by a positive R-G actually has a substantial role to play in terms of determining the debt dynamics. In our forecast, Brazil in 2024 will be at about 100 percent of GDP under the policies that we reflect in our baseline.

The right-hand chart reflects Mr. Adrian's roller coaster. Do not get misled by this chart. This chart is not a level of spreads. It is an index of spreads, so if we want to have an idea of the magnitude of the spreads, we have to look at the right-hand side, with the number of the latest observation of the spreads. What we see is that there was a sharp increase in the spreads at around the end of last year and then a sharp correction, so it looks like a roller coaster.

In the case of emerging markets, China is extremely important. (Slide 10) I want to focus on the announced fiscal stimulus, not so much to comment on the macro implications of the stimulus, but to comment on the composition. We would think that given the decline in the return on public investment on infrastructure, which is proxied on the right-hand side by the returns on local government financial vehicles, and the fact that these returns are below the interest cost on government liabilities, complemented by the fact that the public capital on infrastructure in China is already at the average level of the OECD, we would think that a composition of the stimulus that would not have emphasized public investment in infrastructure would be more appropriate for the case of China. There are many details about China that I am quite happy to discuss if there is interest.

Let us turn to LIDCs. (Slide 12) We have a situation where the number of countries that are at high-risk or in debt distress has increased from 2012 to 2019. That is shown on the left-hand side. At the same time, our work on Sustainable Development Goals (SDGs) estimates quite substantial spending requirements to attain the SDGs by 2030, and those are at about 15 percent for the set of LIDCs. They are about 20 percent of GDP for sub-Saharan Africa.

When we look at why sub-Saharan Africa is different and spending requirements are highest, they come from a younger population and more needs in the area of education but also some structural characteristics having to do with rural accessibility. That is also a driver.

How can we square the circle? The SDG strategy is based on full ownership of the development strategy by the country concerned, so strong sustainable inclusive growth has to be at the center of the process. It is necessary to mobilize public and private financing. Our estimates do not affect the breakdown between public and private. To make this complementarity between public and private happen, it is crucial to improve governance and the business environment, and I would like to quote the G20 Compact with Africa as a good example of a policy action that may act as a catalyst in this area. I have stressed many times that it is absolutely crucial to improve tax capacity as a way to enable state capacity and hence improve public financial management (PFM) and transparency and public spending efficiency. Strong cooperation and coordination among all stakeholders is also important.

Turning to the chapter on the Fiscal Monitor on combating corruption, (Slide 14) the left-hand side shows that in all country groups, there are opportunities to improve the tax-to-GDP ratio if countries would improve their combatting of corruption indicators from the 25th to the 75th percentile. We did do an exercise looking at what would happen if all countries in the world would improve their corruption scores, as the countries that are portrayed on the right-hand side as having improved their corruption scores in the last 20 years have achieved. The results are impressive. It would be a staggering US$1 trillion, or 125 percent, of GDP. That is quite substantial.

In Slide 15, we identify in the Fiscal Monitor chapter that fiscal institutions can do a lot in strengthening governance and combating corruption. I want to emphasize the improvement in the quality of tax administration and the simplification of tax laws, the fiscal transparency and independent external scrutiny. Technology through digitalization in areas like procurement makes a substantial contribution. Global cooperation is necessary to make sure that both the supply and the demand aspects of corruption are adequately covered.

I will conclude with the policy recommendations from the three departments based on the three flagship reports. (Slide 16) The first has to do with avoiding policy missteps, enhancing resilience, and raising sustainable and inclusive growth prospects. In advanced economies, there is a need for data-dependent and well-communicated monetary policy to avoid market overreactions, prevent further growth deceleration, or entrenchment of below-target inflation expectations. In a more severe and protracted downturn, more accommodative fiscal policies, where feasible, should complement monetary easing.

For emerging market and developing economies, it is important to reduce vulnerabilities, ensure strong policy frameworks to raise resilience, ensure central bank independence for effective monetary policy, implement structural and fiscal reforms to ensure sustainable and inclusive growth.

The second block has to do with the safeguarding of financial stability, and as Mr. Adrian has emphasized, macroprudential policies are at the center. We must deploy broad-based macroprudential tools, including countercyclical capital buffers, where financial vulnerabilities are building; develop macroprudential tools for addressing vulnerabilities outside the banking sector, including for rising corporate sector debt.

Emerging market developing economies should reduce financial and external vulnerabilities, including through prudent debt management. Flexible exchange rates can serve as buffers. In case disorderly market conditions emerge, foreign exchange interventions may be appropriate as long as reserves remain adequate.

Finally, we should seek globally cooperative solutions; preserve and modernize an open rule-based multilateral trading system; complete and implement the financial regulatory reform agenda while avoiding backtracking. Last but not least, we should cooperate on other public good problems; and our list of examples includes global imbalances, international taxation, climate, refugees, cybersecurity, and tackling corruption.

Mr. de Villeroché made the following statement:

We face uncertain weather, and it is hard to design policy recommendations in that context. However, it is our job to pass some messages, and there is one message that is simple. We discussed it when we had the Global Policy Agenda (GPA) discussion—the no harm message, and that one will remain. Beyond this, we see the need for further refined policy recommendations. Indeed, while policy space appears limited in some economies, we should avoid an overly general message in that regard since there is some room in other economies. We therefore encourage the staff to continue working on the right balance and sequencing between supported growth and enhanced resilience over the medium-term.

In terms of breaking down these recommendations to countries, we have some concern over the medium-term outlook of the U.S. economy since we had the procyclical stimulus, and the unwinding of this procyclical stimulus could have important impacts. I know it is priced into the forecast, but I am not sure it is completely understood by the rest of the world and I wonder what the consequences will be.

Of course, the latest decisions taken by the Federal Reserve have taken markets by surprise on the other side, and this is good news, and it is softening monetary policy, and it is a great message in this slowdown environment.

For the euro area, we remain puzzled by the persistent low inflation level while unemployment continues to decline. In this context, we need to remain cautious about relying mechanically on the economy being at full potential output but gaps are closed, especially if we use this assessment to design our policy recommendations. We also consider that the ongoing slowdown makes the case even stronger for adapting the fiscal stance in each country depending on their fiscal space so as to ensure an adequate aggregate fiscal stance. There is a case not only to work on fiscal policies, but we believe that wage dynamics merit more attention, and there could be some policy recommendations regarding wages in the euro area as well.

I want to signal that for the United Kingdom, the report details a no-deal Brexit scenario on which we have some issues. We will come back bilaterally on this. The way the scenario is designed does not seem realistic to us and not in line with EU decisions.

On sub-Saharan Africa, the situation is heterogenous and some economies are growing rapidly, but we note that the growth rate remains subdued in the continent's biggest economies and commodity exporters, and they still have to adjust, and it is a huge concern for us. We will reiterate our messages on domestic resource mobilization and avoid cutting spending too sharply.

I will just reiterate as a conclusion our important messages on cooperation on international issues like climate change and corporate taxation.

Mr. De Lannoy made the following statement:

I thank the staff for the excellent work behind this year's flagship reports and for the timely selection of relevant and pressing issues that are often discussed based on rhetoric rather than on analysis of facts. Given the number of key messages in the reports, it will be important to communicate them clearly in the next few weeks so that they do not get diluted and reach as many relevant stakeholders as possible. In that sense, I welcome the Chairman's remarks on the communication strategy. One of the key messages from this year's reports is that the majority of the near-term risks are driven by policy choices rather than by exogenous factors. Through our actions, we risk further income polarization, which is one of the main underlying causes for distrust in domestic and international institutions, a point also raised by Mr. Inderbinen, Mr. Mahlinza, Mr. Beblawi, and Mr. Kaizuka.

By opting for disruptive policy in social choices, we contribute to the rise in populist movements, as well as political and social instability. This is a message we hope the staff and management will voice clearly during the Spring Meetings and when presenting the flagship reports. Together we issued a total of over 120 pages of statement, so I will try to be disciplined and focus on four specific points.

First, on rising debt vulnerabilities, like many Directors, we are concerned about a continued rise in both public and private debt across most of the membership. The current slowdown is but a small wave compared to a much larger wave coming at us. The challenges stemming from climate change, demographic developments, digitalization, and new technologies, cyber risks, to name just a few, are likely to have a substantial impact on fiscal balances. It is important that the Fund repeats its messages that the window to build buffers is narrowing fast. In LICs, which continue to call for responsible equilibrium between addressing development needs and debt sustainability, like Ms. Levonian, we believe increasing debt transparency is key in addition to pursuing productive investments.

Contingent liabilities need to be addressed, and we caution against collateralizing loans with future fiscal revenues. We look forward to a new set of voluntary guidelines being developed by the private sector under the aegis of the Institute of International Finance.

Second, on rising market power, the analysis in Chapter 2 provides interesting insights about the negative consequences of increasing market power on investment, productivity, output, and income inequality. We see these conclusions as an excellent addition to the debate on the productivity slowdown and rising income inequality in advanced economies. We only regret that the key messages from this chapter are mentioned only once in the summary and the main WEO document. Like many other Directors, we call on the staff to continue its work on this topic and to develop clear policy recommendations. The role of strong competition policies and the effects of rising market power on income inequality deserve particular attention.

Third, on tax issues, as stated both in our gray statement and during the discussion on international corporate taxation last month, we agree with staff that the current Corporate Income Tax (CIT) system is under stress. Like the staff, we see a need for multilateral cooperation. However, and similar to some other Directors, we found that some choice of wording in the Fiscal Monitor is unfortunate. It is, for example, not constructive to explicitly distinguish between smaller and larger countries while at the same time advocating for a global cooperative approach which will need to include all stakeholders, both small and large.

Finally, like many other Directors, we welcome the staff's analysis on the adverse economic effects of corruption. We agree with the staff that robust institutions and political determinations are essential to successfully tackle corruption. We also concur with the main recommendations put forward by the staff, in particular the need for increased transparency, independent external scrutiny, and sound public financial management (PFM). In this context, we encourage the Fund to promote and widen its fiscal transparency evaluation exercise.

Ms. Levonian made the following statement:

I thank the staff for the presentations and the work. I very much enjoyed reading the flagships as this was my first time around and not only because Chapter 3 of the WEO taught me that I should be buying all of my family's Apple products in Australia, so, Mr. Ray, we can talk about that later. But having said that, you should also know that Canada comes in third, and so you should all come and buy them from Canada.

It would have been a bit more enjoyable to read the flagship products if we had had a bit more time, but that is fine. That being said, we felt that through the flagships, the Fund has really delivered on the mandate set out by the IMFC in Bali, and we would highlight the WEO Chapter 4 as an example of the Fund putting its analytical power behind the cause of free trade. Overall, the findings of this chapter confirm that while some countries may benefit from trade diversion, higher tariffs would leave the global economy worse off.

Box 1.3 of the WEO on within country regional disparities also spoke to this chair, and we believe there is space to carry that analysis over into bilateral surveillance and country-level policy advice to ensure that the growth that we promote is benefitting all.

I want to emphasize five key takeaways. Similar to the point just made by Mr. De Lannoy, first, it is worrying that most prominent drivers of near-term downside risks are person-made factors, and so we fully agree that the priority should be to avoid missteps that could do more harm. We see this as a core narrative.

Second, while the baseline global growth outlook still seems positive, it is masking significant divergence across regions and countries. There is a danger in focusing on the average, as Ms. Gopinath noted. The pickup in late 2019 and 2020 is subject to considerable uncertainty because it is premised on a sharp turnaround in several distressed economies as well as some unpredictable events such as trade dispute resolution and easing geopolitical tensions. Because of where we are in the cycle, and because of the greater divergence in outlook, we also see the narrative getting blurred, and the resulting policy prescriptions are no longer as clear cut. Which brings me to the third point, which is about communications. The current conjuncture puts more pressure on the Fund's communication team to grab the world's attention and deliver convincing key messages, but I am sure Mr. Rice and his team are up to that task.

Fourth, on the GFSR, we share the view that the macroprudential toolkit needs to be further expanded beyond the banking sector, particularly to address vulnerabilities related to rising corporate debt funded by non-bank entities. We see a clear need in this area, including an internationally coordinated response.

Finally, and importantly, as noted by Mr. De Lannoy, there is an obvious disconnect between Box 1.3 of the Fiscal Monitor and the outcome of the recent Board meeting on corporate taxation, and like Ms. Riach and others, we would like to see this box adjusted as well as a toning down of the kind of the corrosive rhetoric on corporate taxation. Finally, I do want to support the point made by Mr. de Villeroché on Brexit.

Mr. Ostros made the following statement:

I think we need the weekend to fully digest the richness of the figures presented, but it is really excellent. I will concentrate on the policy messages. It is for natural reasons a little more vague at this situation. I guess it is because we are in a bit more vague situation in the conjuncture cycle. What I extract from the messages that is most important is the "do no harm" message. That is quite a powerful message. It is mind-boggling that in this situation where we see also manufacturing being hurt relatively significantly, that we might be in a situation this year where further tariffs are imposed in the car industry, for example. That could push us into a situation we do not want to be in. That message is extremely important at this time.

The second message I would like to convey is to keep the powder dry when it comes to fiscal policy. We are not in a situation where we know exactly where we are heading, and the few advanced economies that still have fiscal space should wait and see, let automatic stabilizers function if possible, but many countries need also to continue to build buffers, and that should be clear. We have now a contingency message saying that if things go bad, maybe we should. I understand that, but it should not overshadow the need to continue to prepare for the downturn for many advanced economies.

We strongly support the message on relying on and reforming the rules-based and multilateral approach, and I appreciate Chapter 2 and Chapter 3 of the WEO adding new evidence. It is clearly a role we have to add evidence to the global discussion, and the staff does great work on that. If one or several of the significant risks materialize, the lack of general policy space in many countries will be a concern. I would encourage the staff to go further in thinking about how to act if we are in such a situation, not least the role of automatic stabilizers. Are there things we can do to make them more effective if we would be in a situation where we go into a deeper dip, not only a bit of a dip before coming back to potential again?

On the sharp reduction in manufacturing, that is a bit puzzling and what is behind it really? We have the idiosyncratic effects of the car industry and the German situation with emissions. We have less demand from China for obvious reasons, but is there something else that the staff sees signs of, a structural change in the car and automotive industry that could be playing in the background? That would be interesting to go deeper into. Also, if the Chinese rebalancing changes their demand for manufacturing products when it comes to capital goods and thereby affecting European countries, it would be interesting to go deeper into.

We are encouraged by China's regulatory efforts to rein in the debt increase in recent years. We agree with the staff's view on the importance of keeping the agenda of financial regulatory tightening despite the weakening in growth momentum. That is an important message to Chinese authorities.

On the GFSR, the attention to the corporate sector and the balance sheet approach is rich and important. We have these vulnerabilities that have been built up, and the discussion around using macroprudential tools directed to the corporate sector is a difficult one, but it is an important intellectual work that the staff can do that to stimulate the debate in member countries.

Mr. Merk made the following statement:

We share the global growth forecast, and the projections for growth in the euro area and Germany are broadly in line with our assessment.

We agree that the global forecast is subject to heightened uncertainty, and risks remain tilted to the downside with a further escalation of trade tensions and political and policy uncertainty as key risks. As short-term uncertainties around the baseline scenario seem particularly high, the cautious communication of the forecast seems to be warranted. As regards trade-related risks, we welcome this year's WEO analytical chapter on the determinants of bilateral trade and spillovers from tariffs as particularly topical. We share the staff's policy conclusion that multilateral reductions in tariffs and non-tariff barriers benefits trade and over the longer run have positive effects for output, employment, and productivity.

This leads me to the question of policy priorities. Against the background of the staff's forecast and risk assessment, sound macroeconomic policies and bold structural reforms remain crucial to strengthen resilience, sustainably increase global growth prospects, and ensure a swift adjustment to shocks. Member countries should take advantage of the still-favorable economic conditions and act swiftly and decisively.

Medium-term risks to global financial stability remain elevated, and still accommodative financial conditions could result in a buildup of further vulnerabilities. We generally echo the call for proactive efforts to strengthen financial resilience, including through macroprudential policies. In this regard, we support work to address the sovereign-financial sector nexus, particularly in the euro area, to improve minimum standards for insolvency and creditor rights regarding NPLs and to contain vulnerabilities in the non-bank financial sector.

We welcome the framework for a comprehensive assessment of balance sheet vulnerabilities across financial and non-financial sectors. We agree with the Fiscal Monitor's message that fiscal adjustment remains incomplete and that reducing elevated debt levels and rebuilding fiscal buffers is essential in many countries. On Germany, we would like to highlight that general government and federal investment will increase significantly in 2019. More generally, fiscal policies should further focus on strengthening the growth potential rather than trying to smooth the cycle. We would emphasize the role of automatic stabilizers as the first line of defense and reserve discretionary countercyclical policies for severe downturns, and that is how we understand the policy recommendations. We would also caution against blurring national responsibilities for sustainable fiscal policies.

Lastly, we support the point mentioned by Mr. de Villeroché on the WEO box regarding scenario A, where we have some criticism.

Ms. Pollard made the following statement:

I agree with Ms. Levonian and Mr. Ray that having some more time to digest the documents would be helpful, and I am sure the staff feels the same way when they have the 120 pages of our comments and have to answer the questions in about 24 hours. That being said, I agree with others that this spring's set of documents was excellent, and that extends to the presentations this morning, which I found incredibly helpful.

At the time of the Fall 2018 WEO, GFSR, Fiscal Monitor Board meeting, we noted that we thought the Fund's forecast seemed a bit too cautious, and now six months later, we are actually concerned that it may be too optimistic. Looking at the presentations this morning, Ms. Gopinath started by noting that growth has weakened and continues to surprise on the downside, and this fits with the message from Jerome Powell yesterday following the FOMC meeting, where he said growth is slowing somewhat more than expected in the United States and that the economies of Europe and China have slowed substantially. At that time, he indicated that the federal funds rate is in the neutral range, and that it would likely be some time before the outlook for jobs and inflation in the United States called clearly for a change in policy. Mr. Adrian's presentation was somewhat reassuring that markets expect at least a soft landing, and maybe that is based on projected changes in their views on monetary policy, so that gives me some hope. But I do believe that given the risks around a sharper slowdown in a number of countries, like Mr. de Villeroché and Mr. Ostros noted, that we should really consider looking at more detailed policy recommendations and even for ways to make policies more effective so that we do not end up trying to play catch up.

I also want to echo Mr. de Villeroché's statement on the possible underestimation of potential growth and thus the possibility that some countries may continue to be experiencing negative output gaps, and this is an important area to do some work on.

Mr. Ray's point on exchange rate flexibility was extremely important, and there is a need for a deeper assessment of the appropriateness of countries' exchange rate regimes, even recognizing that countries are free to choose whatever regime they want.

Turning to a few other issues, we agree with Mr. Inderbinen that in the context of potential capital flow volatility, countries are well served by making strong policy frameworks and robust financial supervision the frontline defense even if capital flow measures may be employed in a targeted and temporary manner in certain situations.

The Fiscal Monitor is often seen as the neglected younger sibling that is trying to play catch up with its older siblings, but this time the Fiscal Monitor really shines on its own. In particular, the chapter on corruption and governance was an excellent example of Fund analysis that can really help the membership, and I encourage the staff to do more of this work. As Mr. Kaya mentioned in his statement, it is important to incorporate the results of this study and analysis into bilateral surveillance.

On debt, Mr. Gaspar's presentation should give us all pause. Like Mr. Kaizuka, we believe that improving debt transparency is critical, particularly to manage risks from contingent liabilities and off-budget arrangements and avoid debt surprises. We agree with points made by Ms. Levonian that better data collection and program conditionality can play a role in supporting sustainability.

Finally, I want to echo Mr. Raghani's point that we need to think about this in the broader context that LICs face, and I do agree that there is this difficult balancing act of managing debt sustainability concerns while trying to increase growth and development and also addressing increasing security challenges. This is something that we should all try to do some more work on and think about.

Mr. Mahlinza made the following statement:

We broadly share the assessment that the balance of risks is tilted to the downside, and we agree with the messaging that policy missteps could further harm the global economic activity.

We concur with Mr. Raghani and others that the executive summary of the WEO should have brought forward important messages from the analytical chapters. Moreover, we feel that the risks to the outlook remain elevated and that the urgency to address them has increased since October 2018. In our view, this message has to continue to come out strong despite the assumptions of an extended trade truce. That being said, we welcome the analysis of trade-related issues in Chapter 3 and 4 and support the associated policy conclusions, including the need for countries to avoid distortive macroeconomic policies that create excessive and unsustainable imbalances.

We found Chapter 2 on the trends in corporate market power and the associated macroeconomic implications very insightful, and like other Directors, we encourage further work in this area with a closer look at inequality, including widening the sample of selected case studies. In addition, we commend the staff for developing the new house-at-risk framework as outlined in the GFSR, and we underscore the need to strengthen the macroprudential tools and appropriate monetary policy adjustments to counter the downside risks of rising house prices.

We welcome the discussion on corruption in the Fiscal Monitor, which we found very succinct. Corruption in all its forms continues to undermine the progress toward achieving sustainable economic growth in many countries. We support the messaging in this area, and we appreciate the Fund's continued work in this important area.

On sub-Saharan Africa's growth performance, we note that prospects vary, reflecting the heterogeneity of the economies. However, in the main, countries in this region continue to face risks of tightening financial conditions amidst elevated debt levels while growth prospects for oil and commodity exporters are weighed down by the softening outlook for commodity prices.

We see further risks emerging from the exposure to weather shocks such as the case of last week's cyclone that reached Mozambique, Malawi, and Zimbabwe and severely affected more than a million people in its path. In this regard, the Fund's role to help build resilience to natural disasters and provide the necessary support remains critical in addition to supporting the achievement of SDGs.

Finally, we continue to underscore the importance of strengthening multilateral cooperation. In this regard, we concur with the multilateral policies suggested in the report and continue to call for the Fund to play a central role in strengthening the achievement of these objectives.

Mr. Lopetegui made the following statement:

Beyond idiosyncratic factors that contribute to explain the downward revision to global growth, political developments and policy uncertainties appear to have an increasing relevance. On the other hand, there is evidence that the credit cycle is maturing. We take some comfort in the fact that the recovery in Latin America is expected over the next two years, but overall we see that risks to the global outlook are tilted to the downside, as does the WEO.

While monetary policy fine-tuning and automatic stabilizers on the fiscal side have a role to play in the current circumstances, we believe the policy space to face a severe downturn is limited. Against this background, policymakers should continue with their efforts on the structural reforms to address medium-term growth headwinds. In addition, upgraded cooperation on global issues is needed.

We like the WEO analytical chapters. Let me focus on trade. We support the conclusions of the paper, and we want to emphasize that a fuller view of trade policy requires assessing non-tariff barriers, including regulatory barriers and standards, control on FDI, domestic subsidies, government procurement, and intellectual property protection. We will encourage further work on these aspects of multilateral trade, including to address data gaps. We also believe that further gains are possible from expanding trading services and reducing agricultural protectionism, and we would encourage the staff to further explore these issues as well.

Turning to the GFSR, we concur with the big picture presented in the paper. Compared to October, global financial conditions are tighter but still accommodative. Financial vulnerabilities continue to build, and we share the staff's assessment about the possible triggers for a tightening of conditions.

One issue that comes out clearly from the report is the need to focus efforts to develop prudential tools to address rising corporate debt from non-bank financial institutions, intermediaries, as well as maturity and liquidity mismatches in the non-bank sector. The report also highlights that portfolio flows to emerging markets are increasingly influenced by benchmark-driven investors who are more sensitive to changes in global conditions than to country-specific developments. As a result, the benefits of index membership may be tempered by stability risks, which underscores the need to build stronger buffers in some cases.

The Fund could help contain stability risks by communicating the relative strengths of those emerging markets featuring lower vulnerabilities, stronger buffers, and larger policy space. We welcome the new methodology to assess house prices risks and agree with the staff that macroprudential measures are better suited than monetary policy to address them. We agree that well-targeted capital flow management measures (CFMs) could reduce risks when other policy options are limited.

Finally, on the Fiscal Monitor, we agree that going forward, fiscal policy should be prepared for possible downturns while also putting more emphasis on reforms to adapt to the changing global economy, including by upgrading tax, social spending, and investment in infrastructure to enhance public service delivery. We also concur with the report's emphasis on achieving greater international cooperation on corporate taxation, climate change, the fight against corruption, as well as attaining the SDGs.

Finally, let me congratulate the staff for the chapter on corruption. I would like to echo Ms. Pollard's words on that. It is a very good example of what can be done.

Mr. Agung made the following statement:

We agree with the characterization of the outlook, and today I have three comments.

First, on the growth outlook, this is the third downgrade to global growth forecast in the past years, and uncertainty and downside risks are high. This is clear from the fan chart in the WEO but not well reflected in the point estimate of growth. Given this, we wonder if presenting range instead of point forecasts would provide a more nuanced picture of the outlook while reducing the need for regular forecast revision.

My second point is on the risks ahead. We continue to see trade tensions as the key downside risk. The WEO notes that the global growth will increase above the baseline if a U.S.-China trade deal leads to a rollback of tariffs. But even if a trade deal is reached, we wonder if it will be enough to reignite business confidence and investment. This will depend on whether markets are confident that the deal will be durable and that bilateral tension will not erupt as well.

Hence, we see strong value in the Chapter 4 of the WEO, which highlights that tariffs are not a good response to bilateral trade imbalances. This should be among the Fund's headline message this spring. We remain strongly concerned about the financial sector risks. As the staff has pointed out, accommodative monetary policy may support growth, but the cost is continued buildup medium-term vulnerabilities. Like Mr. De Lannoy, we believe this calls for consideration of the financial stability perspective in monetary policy advice. We hope that the integrated policy framework will strengthen our understanding of the interaction and tradeoff between different policy tools.

Finally, on the policy priorities, we agree with the key message of avoiding policy missteps and rebuilding policy buffers, but we should also recognize the practical challenges. For instance, the Fiscal Monitor correctly outlined that fiscal policy will have to account for competing objectives of near- and medium-term growth, debt sustainability, distributional issues, and so on. We should not underplay the difficult choice and painful threat that will entail. While we can calibrate the pace, size, and composition of fiscal adjustment, country-specific considerations such as political economy and social preferences will be key in setting the policy stance.

Mr. Inderbinen made the following statement:

We take note that global activity is slowing down amid ongoing trade tensions, heightened policy uncertainty, and tighter financial conditions. At the same time, we also note the global expansion is continuing, albeit at a somewhat subdued rate. We emphasize the importance of resolving trade tensions in an orderly and predictable manner within the rules-based multilateral framework that we have. Like Mr. Ostros, we continue to stress the need for the Fund to remain a strong advocate for the benefits of trade integration and technological progress.

On the policy recommendations, we note that the policy priorities remain broadly unchanged relative to six months ago, but we welcome the greater differentiation that is being made of policy recommendations across countries.

Turning to fiscal policy, we appreciate the long-term view taken in the Fiscal Monitor and related in Mr. Gaspar's presentation. Like Ms. Pollard and Mr. Lopetegui, we also welcome the piece on the fiscal gains from combating corruption.

Turning to international tax, the challenges in this area continue to be addressed in the OECD and the related bodies, including on corporate tax. We do not take issue in principle on reporting on this work, but we believe it is important that it is done so faithfully, that gratuitous rhetoric is avoided, and that the staff's views are in line with those of the institution as a whole in accordance with the discussion that we had some weeks ago.

On the financial sector, we welcome the piece on the sovereign-bank nexus in the GFSR. It is important to note that vulnerabilities do remain despite improvement in capital ratios, and it does point to the need for further balance sheet repair and also to the overall need that banks should be discouraged from holding excessive amounts of sovereign bonds.

As a last point on the international regulatory reform, we continue to think that the Fund has an important voice and we fully agree that the rollback of regulatory reform should be avoided and that the calibration of capital requirements should be applied consistently across jurisdictions to avoid an unlevel playing field.

Mr. Kaizuka made the following statement:

I appreciate the voluminous work done by the staff. This is a very readable document which is concise and to the point on many of the implications in the paper, so I thank those persons who are working on this particular document.

Let me make one general remark. We completely agree with the main message of this flagship report that avoiding missteps is key at this particular juncture, but the more important thing is how we can avoid a misstep. Avoiding a misstep should be an overarching theme for any bilateral surveillance which we are engaging in from now on, since missteps vary from one country to another, and some of the countermeasures for any possible missteps also vary from one country to another, so we need a specific discussion about this key message in bilateral surveillance.

I have four points to make. First, on the trade and imbalances, we welcome the key message of the WEO Chapter 4 that to reduce the imbalances, there should be global macroeconomic adjustment to adjust the saving and investment pattern and not through bilateral tariff actions. This is a key message, and we appreciate that, and we are looking forward to our discussion on the External Sector Review (ESR) which is coming in June or July.

Having said so, I would like to suggest some positive progress out of bilateral trade negotiations, for example, the bilateral U.S.-China negotiation. There are some positive truths coming out of the negotiation. Looking at the situation in China, there has been positive progress in developing a framework for protecting the intellectual property rights (IPR) and banning the technology transfer, if I read the recent government activity report correctly, which was issued at the National People's Congress this month. My point is when we analyze trade, we should shed light onto the non-tariff aspect of the issues, so I am looking forward to further study on that.

On the GFSR, I have two comments to make. One of the warning messages are few macroprudential tools are available to address the rising corporate debt funded by non-bank lenders. I did see that the answer to the question that there are some trials to develop prudential tools that limit exposure of financial intermediary to highly leveraged firm or to make more comprehensive stress test. Furthermore, that includes some fiscal incentives. We need a Fund-wide approach to tackle these particular issues of the corporate debt program.

Mr. Adrian mentioned the inclusion of China to the global bond index which is the positive thing, or there should be some risk, but I have shed light on the positive side of this. Having that index, China can leverage China's development on the domestic bond market, and we would like to see the progress in the Article IV on that particular point.

Mr. Tombini made the following statement:

It is clear we are experiencing a quick change in the global baseline scenario, and some of the slides presented today, in particular the one on manufacturing PMI, are telling of the kind of deceleration risk we are facing. In this regard, the Fund has to remain vigilant and especially because the risks are tilted to the downside.

Importantly, the worsening of trade tensions beyond what is already incorporated in the baseline could trigger additional negative impacts on business and market sentiment and further exacerbate policy uncertainty. Like other Directors, I would like to encourage the Fund to continue to use the truth teller role during the Spring Meetings to warn the authorities about the potential disruptive effect of trade disputes.

On the issue of where we are now, the recommendation to not make policy missteps is an obvious one, but perhaps we are beyond that phase as of now. I want to call the attention to the communication of the major central banks, which has changed quite significantly, and we already see the possibility of monetary policy easing earlier than we suspected. If that is the case, we are at the end of the cycle, the end of the normalization process. We are in a tough spot because we have no policy space, certainly very little space in monetary policy, perhaps some more space on the other policies, and I want to associate myself with Mr. de Villeroché and Ms. Pollard about the use of policy space going forward.

With this scenario of no policy space in 2019, I want to hear from the counsellors what is the view toward emerging markets. We saw inflows increasing, and this scenario is supportive of flows in 2019 toward emerging markets. What is the recommendation? I saw in the recommendation to use buffers, including international reserves. Maybe we should advise countries to build buffers, including further accumulation of international reserves if market conditions allow in 2019.

The Phillips Curve may be out of fashion, but I still want to hear from Ms. Gopinath about the current view on this issue. We saw pressures from labor market to wages, but we have not seen pressures into inflation. What is the current view of the staff?

On the GFSR, we share the view that the financial vulnerabilities are continuing to increase. I wanted an update on where we are with respect to debt tracking in the international regulatory agenda, a point also made by Mr. Inderbinen.

On the Fiscal Monitor, I want to commend Mr. Gaspar for doing away with the modern monetary theory, so that is an important message to send in the Spring Meetings. With respect to Brazil, the projections are based on current policies; but there is an aggressive program to contain the wage bill to pass social security reform and to have an aggressive privatization program; therefore, the 100 percent 2024 is certainly in disagreement with the current policies.

I have another specific point on Ecuador, the color is red, meaning that it would contract more than 1 percent this year. We just approved a program March 11, and our forecast is 0.5, so we should change the color on that map.

Mr. Fanizza made the following statement:

I fully share this idea of do no harm, which is the right message, but we need to spell it out what it means. That is easy to say, but we may differ on what we mean. In my view, it means simply avoiding a procyclical stance for policies. That is important, and frankly I do not believe policy has a great power to do things. At least we should do no harm, meaning avoid making a situation worse. That is an important message.

The second thing we need to reflect on is what Mr. de Villeroché was hinting at, the issue with the measures that we have used to decide whether the stance is procyclical. We also are very dissatisfied with the use of measures which are highly questionable with regard to output gap and slack in the economy. This is a recurrent problem that needs to be addressed.

In addition, we need to be careful on communication. My authorities are concerned about some wording that is used in the document, and talking about the financing risks for the fiscal position in Italy seems quite extreme, quite dangerous in a situation which is difficult but in which no tension has been seen. The latest 30-year bonds were oversubscribed by a factor of five, and so I would appreciate work on that to avoid this miscommunication.

We welcome the analysis on the bank-sovereign link, but even then, the emphasis seems to be all on Italy, so please tone it down. Also, it is a bit strange, in the summary of the October GFSR, there was no mention of Italy when the spread was above 300. Now it is stabilized well below that, there is a mention of Italy. I do not want to sound too parochial, but I have to do that.

Finally, we welcome the idea that there should be caution in reducing NPLs. We hope that the European Department (EUR) takes note of that.

Mr. Villar made the following statement:

We congratulate the staff for the comprehensive set of flagship reports and the relevant analytical work on stimulating topics. We broadly agree with the staff's assessment and policy advice.

On the WEO, we share the staff's perception of increased uncertainty and the emphasis on downside risk to the baseline scenario. If trade tensions exacerbate, China's GDP may decelerate more intensely despite policy stimulus, with a potentially large global impact. Furthermore, the WEO's outlook for the euro area in 2019 is relatively optimistic compared to the ECB and the OECD. Following these considerations, the WEO baseline scenario may be too optimistic, as it assumes that the downward trend in global activity is mostly transitory and will be reversed from midyear onward.

Regarding the second chapter of the WEO, we strongly support the work on the rise of corporate market power. We note that the overall macroeconomic effect seems to have been modest so far. Further increases in the market power of the already powerful firms could weaken investment and deter innovation.

The analysis in Chapters 3 and 4 of the WEO are innovative and timely. They provide powerful arguments in support of policies aimed at reducing trade barriers. A key message is that against the backdrop of a trade war between China and the United States, most countries are likely to be worse off, even those that apparently benefit from trade diversion.

On the GFSR, over the last few months, near-term risk to global financial stability have risen somewhat, although they remain moderate by historical standards. In this context, we note the overall resilience displayed by emerging markets, which are benefitting from rising capital inflows after the turnaround in global risk sentiment. Regarding policy priorities, there are staff messages that we would like to highlight.

First, few macroprudential tools are available to contain vulnerabilities in the non-bank financial sector, especially in corporate debt funded by non-bank lenders. Thus, countries should consider developing these prudential tools.

Second, we see merit in the proposals for some emerging markets to address the financial stability challenges derived from portfolio flows increasingly influenced by benchmark-driven investors.

Third, we concur with the importance to avoid a rollback of regulatory reforms and to maintain the integrity of the institutional framework for macroprudential oversight. The chapter of the GFSR on downside risks to house prices clearly shows that housing markets have macroeconomic relevance and should be part of Article IV consultations.

On the policy side, we fully support the emphasis on the role that macroprudential policies play in reducing downside risks for future house prices. We have a more nuanced evaluation of the role that monetary policy can play in this regard. These are interesting policy issues that can be part of the focus of the new integrated policy framework research agenda.

On the Fiscal Monitor, we note that public debt remains elevated in advanced economies and has grown in emerging and developing economies. Against the backdrop of weakening global growth momentum, fiscal policy needs to manage difficult tradeoffs. Within the euro area, we share the staff's view that coordination of policies with appropriately differentiated responsibilities across members strengthens their joint impact. Furthermore, a central fiscal capacity in the euro area with a countercyclical function will reinforce its architecture.

On the chapter on corporate corruption, we welcome the timeliness of the topic discussed. Corruption is a global problem affecting countries from all levels of development, involving multinational companies offering bribes, opaque international financial centers, and other international players. It reiterates the importance of international cooperation in attacking it. The Fund is well placed to act as a catalyst for further actions through strategic alliances with other international organizations and national authorities.

Another important lesson from this chapter is about ownership. In national-level programs, it is fundamental to have close engagement with the authorities and other national actors and to avoid conclusions based solely on perception-based third-party indicators (TPIs).

Ms. Riach made the following statement:

Like others, we agree with the staff's assessment of the outlook and the balanced approach taken to uncertainties. In this context, we agree that state-contingent policy recommendations are the right approach. However, like Ms. Pollard and others, we would have welcomed a greater analysis of the tradeoff between different policy approaches. We appreciate the topical nature of the analytical chapters and in particular the significant focus on trade. As Mr. Ray said in his gray statement, we believe that the most important message for ministers and governors from this set of documents is that open and free trade with lower or no tariffs can bring lasting benefits to all. As Mr. Ostros said this morning, the Fund can play an important role in providing evidence to underpin these discussions, and the documents on the table today play an important role in achieving that.

In the Board discussion on the United Kingdom's Article IV consultation at the end of last year, I said that on some days I felt more optimistic than others that there would be an orderly resolution to the Brexit negotiations. Well, there is little that has happened in recent weeks to give me cause for optimism. There is a very real possibility that the United Kingdom will leave the EU without an agreement of any sort either at the end of next week or following a three-month delay.

In that context, I understand the decision to include a no-deal scenario box in the WEO, but I do share the concerns touched on by Mr. de Villeroché and Mr. Merk on the scenarios presented. My understanding is that the two scenarios are intended to represent the upper and lower bounds of what a no-deal exit would mean, the best possible no-deal—that is one with a two-year transition period, and the worst possible no-deal, where we leave at the end of next week and fully apply our external tariff regime to the EU.

I understand the attraction of simplifying the presentation in that way, but at this stage, I do not see a path where either of those scenarios would become a reality. The U.K. government announced last week a temporary tariff regime that would be applied in the event of a no-deal exit and which would avoid the default of application of external tariffs to EU trading partners; and as Mr. de Villeroché hinted, the scenario where we would have a no-deal exit but with a significant transitional period is also unlikely.

I understand why these scenarios are presented, and I do not dispute that, but in terms of the language around them, we need to be clear about what they are and what they are not.

On a more cheerful note, extensive progress has been made both by the U.K. and EU authorities since the October GFSR on mitigating actions related to financial stability in preparation for Brexit. The recent staff visit found that in terms of financial stability issues preparations were a good level, and the Bank of England's Financial Policy Committee judged that the U.K. financial system is resilient and well prepared for the range of risks it could face. We are having some bilateral discussions with the staff on the text in the GFSR just to make sure that this is fully reflected.

I also note that the scenario box assumes an easing of monetary policy following a no-deal exit. As discussed in the context of our Article IV consultation, the Bank of England's view remains that the appropriate path of monetary policy following Brexit will depend both on the form the withdrawal takes and on the balance of effects of demand, supply, and the exchange rate. Even in a no-deal scenario, the monetary policy response will not be automatic and could be in either direction.

On fiscal issues, we support Ms. Pollard's comments on the importance of debt transparency, and we welcome Mr. Gaspar's remarks on the challenges of the SDGs and the important role that domestic resource mobilization can play. As discussed yesterday, the Platform for Collaboration on Tax (PCT) has an important role to play in coordinating support across those efforts.

Finally, we welcome the commitment made in the staff responses to gray statements to make editorial changes to the chapter. We were disappointed that the first draft did not seem to reflect the recent Board discussions, and I strongly support Mr. Inderbinen's comments this morning.

Mr. Kaya made the following statement:

We broadly agree with the thrust of the reports, including the description of the conjuncture, the assessment of the risks, as well as the policy recommendations. We have issued a comprehensive gray statement and would like to follow-up with four remarks.

First, we believe that the defining feature of our debate on the WEO is the prevalence of uncertainties about the extent of the current slowdown, as well as the associated policy responses. The recent monetary policy decisions by major central banks, including the announcement by the U.S. Fed yesterday, is a testament to this. We wonder whether our headline message and forecast already captured that monetary policy normalization by major central banks has been put on hold.

Second, we note that the core narrative on financial stability has not changed much over the past several years. The financial conditions are set to remain accommodative and thus continue to incentivize financial market players to add to their risk positions. At some point, an event will trigger their wind-down, and the medium term will be upon us. In view of the monetary policy decisions, we would appreciate the staff's thoughts on whether it would be warranted to shift the emphasis from the risk of a renewed rapid tightening to stressing financial stability risks.

In addition, we reiterate our concern about the financial stability risks related to a no-deal Brexit. We recognize that a number of initiatives have mitigated the risks so far, but we are perhaps less sanguine than the staff on the remaining ones. Besides the potential spike in volatility, there are concerns about the longer-term impact on liquidity and contract continuity in the derivatives as well as other markets. The European Securities and Markets Authority's (ESMA) ruling just a few days ago on trading some 6,200 equities by EU investors is a case in point. Given the central role of the City of London in the global financial market architecture, the repercussions may be felt well beyond the United Kingdom and the EU.

Third, we note that the projected growth recovery in 2020 is predicated among other things on the resilience and growth momentum of emerging markets and developing economies. In that vein, we support our high-level policy recommendation to replenish policy buffers and address vulnerabilities.

Finally, the Turkish economy featured prominently throughout the flagship reports, and I would like to highlight a few points. The bottom line is that the authorities are closely monitoring developments and taking every measure to stave off the pressures on the markets. This includes persevering with a very tight monetary stance, preserving the fiscal anchor, and maintaining close scrutiny of the financial sector against possible stress points. The policy mix is delivering as the economy has now embarked on a rebalancing process exemplified by a rapid adjustment in external balances and a steep reversal in inflationary dynamics. The government also uses in a limited and well-targeted fashion the fiscal room Turkey has to support growth. All in all, we are encouraged by the emerging signs of recovery at the first quarter of this year.

Mr. Gokarn made the following statement:

We have a few points to make on each of the components, so let me start with the WEO.

As many Directors have said, the aggregate picture is quite reassuring, indicating a recovery of some sort in 2020, but this masks a wide range of possible outcomes across countries. Given the nature of risks—and this is a very good characterization of risks and the emphasis that many of these risks are external to most countries—obviously the implication is that the outcomes over the next two years will depend significantly on country exposures to the global environment. Countries that are more dependent on domestic demand are perhaps more likely to respond well to the policy recommendations in relation to domestic measures. The emphasis in the communication on multilateral actions, multilateral solutions, and responses to this set of risks is very critical, because for many countries, their outcomes will depend far more on what is happening outside than what they can do inside. The capacity to respond to this profile of shocks will be limited for many countries, and the smaller they are, the more important that becomes.

The second specific point I have is about oil prices. The forecast has a 30 percent decline in oil prices over 2019, which takes trend to about the low 60s or perhaps the high 50s. This is a significant benefit for energy importers. I just wanted to get a sense of how sensitive the overall forecast is to this particular projection.

Third, when I read Chapter 4—and I continue my practice reading from the back of the document to the front—and then I came to Chapter 1, and

I wondered why Chapter 4 was not Chapter 2, because it links so directly and concretely to the risk factors that Chapter 1 highlights. Be that as it may, in the communication, it is important to emphasize the messages in Chapter 4 because they absolutely and directly deal with the risk factors in Chapter 1. I hope that emphasis and that balance will be maintained.

With respect to the GFSR, I have two specific points. One is the risk diagram, a very interesting circle and a combination of spider web and other components. I found the characterization of households and insurance companies a little inconsistent with the larger picture that has been presented, so I wanted some elaboration on that.

The second is the BBB issuance. This can be interpreted in two ways. One way is because it is happening, because a number of smaller and newer companies are entering the market, that is a good thing because that suggests investment activity is increasing. Or it means that existing projects in the pipeline are actively becoming more risky, which is not a good thing. I am wondering what the interpretation is. I took a negative interpretation from the presentation, but it is amenable to the other interpretation as well.

Finally, on the Fiscal Monitor, we also appreciate the emphasis on corruption and its macroeconomic implications. It is important from the communication perspective to emphasize global cooperation on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), safe havens, and so on, all of which are instruments by which corruption is facilitated and allowed to entrench itself. That is an important messaging as well. We have had recent discussions on these issues, so this can add to the overall communication content.

Mr. Ray made the following statement:

This is my first taste of the flagship process from this side of the table, so I would like to start with a few observations. In my experience, the key thing ministers care about is the Fund's forecasts and how they compare to their own and the Fund's view on the direction of the global economy and risks.

Trying to get all these documents into a two-page brief is a challenging task for officials. There are some important messages in this set of documents, some of the most important of which are in Chapter 4 of the WEO, a place ministers will not get to. The key message is that open and free trade with low or no tariffs can bring lasting benefits to all. It needs the right policies to be in place to ensure that the gains are widely shared, and those policies, most importantly, are needed to regain the trust of our electorates. That is not new. We have been saying that to ministers for a long time, the key question is how do we get key policymakers to take notice?

I was struck in this morning's presentation by Ms. Gopinath in the last panel of her last slide, and that is the point that a small increase in tariffs today has a larger negative impact than a small increase in tariffs in 1995. That is an important finding. It is not what the WTO has been saying, and it is not what one would think from standard analysis relating to the square of the root. These products contain an incredibly important, robust and very high-quality work, but what if they do not resonate with the people who make the decisions? In a way, we relying on the Chairman and her messages to ministers, and my question is whether we cannot just do that but also better leverage the investment in these products to get some more traction and some appropriate action.

On the outlook and risks, we broadly agree with the picture the staff had presented. As a former forecaster, I was struck by Ms. Pollard's reference to Yogi Berra, and it prompted me to think of another Yogi Berra-ism, which is that "the future ain't what it used to be." In this sense, my worry with the forecast is that perhaps we have a bit of risk of falling into a forecaster's trap, keeping the outlook for the future the same while the data in front of us are telling us that the starting point for today is not what we thought it was going to be yesterday, and therefore we may not be going to get to where we thought we were going to go tomorrow.

In that vein, I was struck by Ms. Gopinath's emphasis on the precariousness of that forecast, and I do wonder how the staff will emphasize that publicly.

We broadly agree that the policy priorities are to avoid further missteps, and to enhance resilience while raising medium-term growth prospects. We particularly agree with those who have raised concerns around the role of fiscal policy in this period. In our view, we should be holding our fiscal fire to use it in the event of a large shock because otherwise, in a bit of Yogi Berra-ism, "there ain't much else in the future."

I have a note of concern around emphasizing house prices at risk. That is not necessarily a bad thing. It depends on the circumstances in particular markets. On Brexit, we all know the sign of the impact, but none of us have any idea of the magnitude; and as a non-European, I suggest a bit of caution.

Putting numbers out there has the potential to complicate what seems to be an already horrendously complex political situation, and as we saw in the United Kingdom, it can also damage the exports that are needed at this time.

My last point is that we echo the issues that others have raised on international taxation, particularly in regard to Box 1.3 of the Fiscal Monitor, and we look forward to seeing a redrafted box consistent with the views of the membership.

Mr. Mojarrad made the following statement:

In an environment of weakening growth and uncertainty, a major concern is the limited room for policy maneuver if a major downturn were to happen, which we believe is possible. At near zero bound interest rates, monetary policy in advanced economies is a constraint, and fiscal space exists only in a few countries. While the WEO calls for continued monetary policy accommodation, the GFSR rightly points to its effects on the buildup of risks. High debt and contingent fiscal risks in emerging markets also pose risks if growth stimulation were to continue or increase. We encourage the staff to explore such a scenario in future WEO rounds or in the Early Warning Exercise (EWE).

The escalation of trade conflicts between the United States and other countries, including China, has added to the global risk and uncertainty with adverse effects that go beyond the involved parties. While there are expectations that this trade dispute could be resolved shortly, it is not clear to us whether it would be the last one and whether the WTO framework for addressing these kinds of disputes will continue to be sidelined.

We are concerned that the corrosive effects of trade protections on investment and growth in a highly integrated global economy may be more significant than estimated and may have long lasting effects. Under the circumstances, the Fund, the World Bank, and the WTO have a global responsibility to more forcefully warn against the mounting risk of trade protection. We also urge the staff to continue stressing the benefits of multilateralism and the cost of protectionism in various forms and publication.

A related concern of prolonging trade restrictions in all its forms is the emergence of barter trade arrangements resulting from payment restrictions imposed by the United States on Iran’s trading partners in Europe and Asia importing oil from Iran. These countries and Iran now have to recourse to barter trade under special purpose vehicles, thereby undermining our key message of preserving the multilateral trade and payment systems.

Let me turn to the Fiscal Monitor and commend the staff on Chapter 2 on the fiscal cause of corruption. The rich analysis sheds light on a global problem that has no borders or limitations and must be addressed nationally and globally. We concur with the staff's policy recommendations and look forward to the Fund playing an important role in helping countries design well-calibrated strategies to fight corruption, putting emphasis on prevention incentives as well as on effective international cooperation.

Mr. Mouminah made the following statement:

Let me make a few general comments before I turn to some specific points. We take note of the staff revisions pointing to a lower global growth. Nonetheless, we consider that even 3.6 percent global growth for 2018 is still strong compared to the recent U.S. average. We are also comforted by the indication that the trend increase in the share of emerging market and developing countries in global growth will continue and is expected to count for about 85 percent of the global growth by 2024 against 76 percent in 2019. This is looking at the positive side. However, policymakers need to remain vigilant as the global economy continues to be subject to a number of downside risks, as underlined in the flagship report, and that is a message that we should continue to communicate, as highlighted by other Directors.

In that regard, we support the Fund's main policy of do no harm—this message to support growth momentum by avoiding policy missteps while keeping vulnerabilities in check. At the same time, countries should have the right balance between implementing necessary structural reforms while sequencing it to foster long-term sustainable and inclusive growth, as highlighted by Mr. de Villeroché and other Directors.

The second message is that to maintain the emphasis on multilateralism and the need to upgrade global cooperation to address global challenges in the current environment of slower global growth, mounting risks, and limited policy space. To this end we agree that at a multilateral level, the main priority is for countries to resolve trade disagreements cooperatively, especially in light of the consequences highlighted in the report. Equally important is the need for greater international cooperation to achieve the 2030 SDGs.

Let me turn to answers to the technical questions that we raised. Mr. Lopetegui raised a good question on how fuel subsidies were calculated. The staff indicated that the methodology used for calculating subsidy is based on the 2015 Fund working paper by Coady and others. I would like to point out that the authors of that working paper have acknowledged that estimates for each methodology must be viewed with caution as there are many uncertainties and controversies involved in measuring environmental damages in different countries. Therefore, I would like to ask the staff to put appropriate caveats in Figure 1.31, as these estimates must be interpreted with caution.

Finally, while we find the Fiscal Monitor's emphasis on promoting sustainable inclusive growth to be appropriate, the report focuses not only on eliminating energy subsidies, as noted in our question No. 65. We consider that all forms of subsidies cause price distortion and inefficiencies. The staff's answers refer to the global size of the energy subsidy compared to other sectors. In our view, the staff should address the issue in relative terms rather than in absolute terms. Moreover, subsidies vary across countries. For example, in Saudi Arabia, we are implementing important energy subsidies, among other subsidy reforms, that will continue over a seven-year period, again based on the balance of structural reforms and maintaining growth at the same time. Therefore, we encourage the staff to take into account countries' priorities and specific circumstances. As there is no-one-size-fits-all solution, it should be implemented with a sequenced approach to ensure long-term sustainable growth.

Mr. Raghani made the following statement:

We are in broad agreement with the main messages of the outlook, risks, and policy priorities. The traction of the flagship reports should be fully used to stress the need to prepare for more difficult times. Like others, we would highlight the importance of communication.

Let me focus on three risks or issues. First, trade tensions and rising protectionism, if they persist, are a major roadblock to global integration and a threat to the already slowing global economy. Attention must be paid not only to removing distortionary barriers to trade but also reflecting on the rules of the world trading system to further advance trade. The general trade agreements are also a means to advance integration, and further work on the recent arrangement can provide insightful analysis.

The topical Chapters 3 and 4 of the WEO report present different perspectives on the beneficial effects of trade. The findings and the policy implications laid out in those chapters can be intuitive to some and consistent with recent trade literature; nonetheless, they are very valuable, especially at this juncture.

Second, regarding financial conditions, as the GFSR underscores, market participants seem to raise the prospects for monetary policy normalization. Nevertheless, vigilance is warranted, and monetary policy should continue to be data-based, attentive of potential spillovers, and carefully communicated. Emerging and frontier economies must continue to tackle their vulnerabilities through fiscal and macroprudential policies and build buffers to prepare for an abrupt capital flow reversal if this occurs.

We appreciate the responses to our questions on the potential spillovers to emerging markets from capital outflows in frontier markets—a factor that could drive investors away from index-based allocation—and on the central banks' recent decisions.

Third, on LICs, we agree that these countries need to address fiscal and debt sustainability issues while creating the fiscal space necessary to meet their infrastructure and development needs, notably through domestic revenue mobilization. Like Mr. De Lannoy and others, we should stress the importance of striking the right balance between meeting these needs and preserving debt sustainability. Domestic resource mobilization efforts should include broadening the tax base, strengthening tax administration, but also tackling illicit financial flows and international taxation issues, and this must be emphasized. The base erosion and profit shifting (BEPS) minimum standards to combat tax evasion and advanced transparency are steps in the right direction, but more is needed.

We welcome the staff's correction of the wrong perception that efforts by LICs to increase domestic resource mobilization have been disappointing despite Fund TA in this area. As the staff highlighted, many LICs, including in Africa, have implemented reforms to their tax systems and certain fiscal measures which take time to fully bear fruit. Resolving illicit flows and international taxation problems should help make further inroads in scaling up budget revenues. In this regard, the Fund should be candid and factual in recognizing that the interests of LICs should be better taken into consideration in relevant international fora. Low-income countries should be at the table to ensure that solutions are inclusive.

Fourth, we share the view expressed by Ms. Pollard and others on debt issues.

Finally, on the issue of fighting corruption, which is the topic of the Fiscal Monitor analysis chapter, Mr. Gaspar's Slide 14, shows that curbing corruption will bring LICs' governance revenue-to-GDP ratios above the 20 percent mark they have been chasing. We agree with Mr. Mahlinza and many others on the criticality of this issue for the SDGs. The Fund now has a framework to assist members tackle corruption and promote sound governance. We agree with the message that international cooperation is indispensable as corruption has important transnational channels. We agree with those who favor collective action at the global level to design an international framework for information sharing on stolen or corrupt assets.

Mr. Mozhin made the following statement:

I would like to make two points. One is on this box in the main WEO report, the box on regional disparities, and I am glad that there is finally something about Russia here. It states that Russia stands out among emerging markets with a striking ratio of 44, in part driven by rich oil and gas intensive regions in the north.

There is nothing striking about it, and it is not in part but entirely driven by oil and gas production. The richest region in Russia is located in Western Siberia, close to the Arctic Circle. It is called Ugra. I have recently had a lengthy conversation with the governor of this region, and she was complaining to me that too little resources are left to her to address the local developmental and social objectives because everything is taxed. It is a major donor region, and these energy companies that are located there are paying huge taxes. It can be 44 times; it can be 77 times, depending on the year and the prevailing oil price. This is the single factor which is determining all this. The staff is talking about GDP per capita produced. If one looks at GDP per capita consumed, this would be a very different picture.

In fact, in this paper which is referred to in the report, the Growth in Regions report authored by Gennaioli, La Porta, Silanes, and Shleifer, they advise that in order to address regional disparities, it is much better to look at 75th percentile versus 25th percentile. They give these numbers, and according to their table, Russia is nothing spectacular, very average, nothing to talk about.

My second point concerns this whole topic of debt transparency, which is quite prominent in this report and also has become rather prominent in many other fora. This is an area where transparency is lacking. In fact, the Fund is proud about the progress we have made on transparency issues, but that is an area with an almost total lack of transparency, especially in the case of private sector creditors. We do not know who we are bailing out effectively. We can learn later on from other sources, but in the Fund's documents, there is a total lack of transparency. Was it the French banks followed by the German and Spanish banks as in the case of Greece? Was it companies like Franklin Templeton and others that specialize in milking the Fund, like in the case of Ukraine? Who are we bailing out in Argentina? We know nothing about it, and so I would strongly support dramatically increasing debt transparency in Fund documents.

Mr. Jin made the following statement:

We thank the staff for the comprehensive set of flagship reports, and I have issued a gray statement and want to make a few additional comments. First, regarding the Chinese economy, this year growth has been officially predicted to be in a range between 6 and 6.5 percent, so the market responded to this prediction positively, and the authorities emphasized that no big stimulus is necessary under this situation. The market analysts have also discovered that China's official intervention in the foreign exchange market has been greatly reduced during the past year, and the renminbi's forward premium or discount has become much smaller. This greater exchange rate flexibility in turn has contributed to much smaller estimated capital flight.

Regarding the house price in the GFSR, the staff mainly emphasized the demand-side factors, but supply-side factors such as common control on land sales or zoning policy in some countries have also played an important role.

We take note of the analysis on curbing corruption in the Fiscal Monitor. We encourage the staff to explore the various economic origins of corruption by analyzing the effect of market distortion, including some underpriced special labor force, such as civil servants in many countries. In the Fiscal Monitor presentation, the right chart on page 10 provided us some valuable information. I have two comments. The first comment is that that chart compared government's financial asset returns and the liability costs, and this proved our earlier argument that the augmented debt defined and measured by the staff has been issued for productive infrastructure investment purposes that generate positive returns. Therefore, the net public debt in China is much smaller than gross public debt. Therefore, a balance sheet approach is appropriate for analyzing infrastructure-related debt sustainability issues.

Second, the chart shows that the returns of local government financing vehicles are lower than interest costs on government liabilities, and these suggest the public-owned entities do not want to overcharge the use of infrastructure by the private sector. The private sector benefited greatly from the externality of infrastructure. Without a well-developed telecommunication and transportation network, we can never witness the emergence of some giant private companies in the field of e-commerce, fintech, and telecommunication equipment manufacturing, like Alibaba, which have paved the way. I strongly suggest to management, the staff, and Board members to pay more field visits to China, not merely visit Beijing and Shanghai, but travel to many inland cities unknown to many foreigners by using the high-speed railways and the express highway network and no-cash payment system. Then we will know the value of the government building this infrastructure with a higher but manageable public debt.

Finally, the authorities take the Fund's and the staff's warning and advice on debt-related issues very seriously and we highly appreciate that.

Mr. Kaizuka made the following statement:

I usually do not ask for the second-round intervention, but this time is a little bit different because I did not have enough time to touch upon Fiscal Monitor, and I cannot finish my intervention without indicating my respect for Mr. Gaspar and his team.

The Fiscal Monitor rightly focusing on debt issues, which is our favorite topic to discuss, and more importantly, it suggests a comprehensive approach to tackle the debt issues, not only the debt management policy, but also PFM reform, which is focusing on the asset side of the balance sheet, and also the domestic resource mobilization. Those comprehensive approaches are key to tackle the debt issues. The Fund has a multipronged approach, and FAD has some innovative tools, which we discussed intensively yesterday, and also the Public Investment Management Assessment (PIMA). These pieces should be integrated to tackle the debt issues within the Fund. We would like to see that integral or comprehensive approach to tackle the issue of debt here in this institution.

The Chairman made the following statement:

> I wanted to take the opportunity to inform Mr. Mahlinza that we have a team in the field in Maputo in Mozambique to assess how we can best help respond to the natural disaster. We will come back to the Board as soon as we have the diagnosis to see how we can help with the rapid financing.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath), in response to questions and comments from Executive Directors, made the following statement:

> I thank Directors for the many excellent comments. Given the time constraints, my plan is to aggregate a few themes and respond, and we will carefully consider all remarks.
>
> First, on the growth outlook, I am glad that Directors share the tone in the outlook. What is certainly true and important to communicate is that while it looks like there is a temporary dip and things come back up, there is considerable uncertainty around the recovery and that it is somewhat precarious. We certainly want to flag that. At the same time, we also note that growth is still at a reasonable pace, and as many Directors mentioned, there is still some scope for some countries to continue to prepare for if in the event of a more severe downturn.
>
> Just to emphasize again, what we will pay very close attention to is our point estimates versus the risks going forward.
>
> The second point is on policy recommendations. We are glad that "do no harm" seems like a message that resonates with the Board. It is, indeed, the case that there are too many policy risks on the near horizon, and addressing those are first order. There was an ask for more policy recommendations, more fine-tuned, more country-specific. I wanted to flag the fact that in terms of tuning it to circumstances, we have moved somewhat since the January update in the sense that we are actually considering recommendations in a scenario for a more severe, more protracted downturn which was not there in January.
>
> We recognize that policy measures that are undertaken will tend to be country-specific, and not all countries have the same space on the monetary side or the fiscal side, and so therefore that would be an important factor. We do also flag that if there is a very severe downturn, some synchronicity will help the global economy. We are doing a lot of work on the integrated global

policy framework, so that will become a more important part of our package as we go forward.

On Brexit, we want to thank everybody who brought up the uncertainty about the scenarios and the fact that Scenario B may not be exactly what happens. We completely see that, and this is something that we are working on, and we will be adjusting this in the next few days.

On the trade front, we are very glad that the Board liked the chapters on trade, and it is absolutely important for us to keep emphasizing the gains from trade integration and to deal not just with tariff barriers, but also non-tariff barriers.

A question came up about monetary policy in the United States and the spillovers to emerging markets, so what we have seen is that following the Fed pause earlier this year, there has been a resumption of portfolio flows to emerging markets. We still do not have data for other kinds of flows, and so we would also want to wait to see what that looks like, but that has helped ease financial conditions for these economies, and their exchange rates have appreciated some. But it is important to keep an eye on the kinds of capital flows in in terms of the maturity of the flow, in terms of the currency of denomination, and that could be a slag if this currency flow takes the form of foreign currency, borrowing by emerging markets and debt building vulnerabilities. Of course, different countries are going to be differentially exposed to these financial risks.

On the monetary policy side, there was also the question about the Phillips Curve. I just want to flag two points. First, the fact that the Phillips Curve right now suggests there is almost no passthrough of output gaps into inflation is actually not a new phenomenon. It is something that has been in place starting from the 1990s. That is how it has been, so there is not that much that is new about it. We had two chapters in previous WEOs in 2016 and 2017 that looked into the passthrough in output gaps, and it is positive there is some passthrough, but it remains weak. I am sure if you ask the U.S. Fed about what their view is and why the Phillips Curve is so flat, they will say it is because we do our job so well that we are able to get zero output gaps and no inflation. That would be one answer. Another possibility is that there is still scope for an increase in labor force participation, and so one could make an argument that there is continued slack going forward.

That would be a call for more work on both inflation and inflation expectations, and we will certainly explore that in the future.

A question was raised about our forecasts for oil. Our forecasts for oil are that they will stay in the average of US$60 per barrel benchmark for 2019 and 2020. We see the risks for oil as quite balanced. The risk for oil prices going up come from geopolitical tensions, developments in Venezuela, but the risk for downward movements come from U.S. supply-side policies and also what is happening with global growth. We see them as fairly balanced.

I will end with the question of what is happening with manufacturing. Certainly, one sees this decline toward the end of 2018 and not much of a recovery yet. That is a reflection of the fact that because of heightened policy uncertainty, there is weak investment in the world, and these tend to be capital goods, and so they show up in manufacturing. That is one broad phenomenon. There are some more idiosyncratic factors like the auto sector in Germany. The slowing of growth in China is another factor that contributes toward weak manufacturing, but there is a very tight link between the manufacturing cycle and global trade and investment, and all three are weak at this point.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian), in response to questions and comments from Executive Directors, made the following statement:

Let me elaborate on monetary policy. There were many questions in the gray statements, and we thank Directors for those thoughts and discussions. As Gita pointed out, downside risks increased tremendously in 2018 Q4, and monetary policymakers around the world reacted to that by easing policy. The reason that they had room to ease is that inflation was low in most countries, and if anything, core inflation has continued to decline. That allows the space to react to downside risks. A second factor is that financial vulnerabilities are judged by policymakers to be either low or neutral. Our own assessment is perhaps a bit more worried. Of course, we are not at the level of vulnerabilities we were 10 years ago, but we do worry a bit more about financial vulnerabilities in the corporate market among sovereigns and in some countries in households and housing sectors than perhaps the authorities do.

Many Directors asked the question of now that monetary tightening stopped at a level that is perhaps lower than was expected a year ago or two years ago, will financial vulnerabilities rise? That is a concern. It is a concern that asset valuations are going to rise. There is a concern that underwriting in corporate leverage loans, households, will deteriorate. Our policy line has always been that the first of the policy tools to address those vulnerabilities are macroprudential tools, and in the GFSR, we repeat the message many times that macroprudential tools should be developed in those areas where they are currently not available. That includes the corporate sector.

Then the question arises that there might be political reasons, institutional reasons, for why macroprudential tools are underdeveloped, and should that be taken into account at some point? I went back to the 2015 paper on monetary policy and financial stability this morning, and there is a discussion of this issue. When macroprudential policy tools are not well developed, at some point when vulnerabilities are rising, debt might become macrocritical and might have to be taken into account in a cost-benefit analysis fashion in monetary policy decisions. The integrated policy framework is one framework where some of our work is looking at the endogenous buildup of risk explicitly, so we can measure these tradeoffs quantitatively.

In terms of capital flows, the issues are similar. The three factors that we detect as major influencers of aggregate capital flows are the level of U.S. interest rates, credit spreads, and the level of the dollar. With monetary policy in the United States being on hold, the level of the ten-year is down to 250; the dollar, if anything, weakened, and credit spreads are expected to tighten because the stance does encourage risk-taking, so we would expect that capital flows will continue. Our first order policy advice is that prudential policies are the first tool against the buildup of leverage in recipient countries, such as emerging markets, against currency mismatches and against maturity transformation that might be excessive due to borrowing in international markets.

There again, it might be that we do FSAPs around the world. We see that not every country has a fully developed macroprudential tool, then our first order advice is to say that they should develop more macroprudential tools. If they are not there, then they are the second-best policies, and this is what the integrated policy framework is looking at, whether foreign exchange interventions or CFMs can be used as well, and the Institutional View is speaking to that issue, and we are fully committed to that.

One way to look at the past six months is that the market was concerned that there would be some overtightening that might trigger a hard landing, and then policy was eased so that those downside risks were taken away, and this is one illustration of how the "do no harm" could be translated explicitly.

I appreciate that many Directors are supportive of the sovereign-bank nexus. We are very careful about the communication, and the sovereign-bank nexus is an issue where there is a fiscal problem, so there are countries where there are sovereign exposures but there are not fiscal issues. It is a combination of the fiscal and the bank exposure that is the worry, and we will be very careful about wording around that.

In terms of the issuance of corporate debt, there are some new entrants in the marketplace, more in Europe than in the United States, so we have a chart in the GFSR that addresses whether this issuance at the BBB level is good or bad.

My last word is on the housing at risk. I believe there is broad support for looking at housing at risk. Of course, supply factors are important for house prices. We are excited about systematically assessing housing at risk because we have found and documented many times at the Fund that downturns, recessions that go hand in hand with a downturn in housing markets, tend to be more severe because amplification factors are strong in the housing market. This is one of the main forms of leverage for households. We have started to use the housing-at-risk framework in FSAPs as well as Article IV consultations, and I believe there is broad support among Directors but also among the staff for that thinking.

The Director of the Fiscal Affairs Department (Mr. Gaspar), in response to questions and comments from Executive Directors, made the following statement:

There were numerous remarks that are extremely relevant and important, including on communication. I will try to cover five topics.

On China, we can completely agree on the importance of a balance sheet approach taking into account assets and liabilities. Here we were focusing implicitly on the issue of valuation on the asset side. We were not passing judgment on the usefulness of infrastructure in the past. We were taking the current viewpoint of looking at the future. I do not see much of a gap between our views, but we can pursue that.

On international taxation, the intention is to align the box fully with the Board paper. There is no intention whatsoever of departing from the Board paper. We looked carefully at the box yesterday, and it does seem that it is a relatively straightforward drafting exercise that we will carry out willingly.

On the issue of governance, I thank Directors for their support on the chapter. In this particular case, it is not an innovative approach followed in the Fiscal Monitor that then has to be procedurally followed up. As a matter of fact, this process starts with Board approval of the framework for enhanced Fund engagement on governance. That was the result of the commitment of the Managing Director to this process. In my memory, the driving force of that process inside the Fund was Mr. Hagan from the Legal Department (LEG). But the point that I want to stress is that the progress is quite impressive, with the involvement of most functional departments, the Research Department (RES), LEG, but also area departments, and we have an internal procedure to make sure that this work is passed on systematically to surveillance and program work, and that is in train. We have the practice of sharing country experiences. We have produced how-to notes, and a knowledge-sharing website will be up shortly to make sure that mission chiefs and other staff can have access to the relevant information.

Some Directors asked about the effectiveness of tools in the area of capacity development and also our impact on the ground. We identified that as a priority some years ago. We have carried out a number of ad hoc evaluations. The process will become much more systematic as time goes by with the implementation of the results-based management and CDMAP. We have many examples of success on the ground. Let me just mention two.

The Medium-Term Revenue Strategies do look systematically at how one can design a strategy so that it can be evaluated ex post in the area of tax, and with micro data sets it is possible to conduct quasi-natural experiments. We have in the pipeline a study about the impact of e-invoicing in Peru in terms of raising tax compliance and tax revenues. The thing about this quasi-natural experiment is that it is a quasi-natural experiment by design. The Peruvians designed the policy so that the results could be measured. This is truly innovative, and it is truly exciting.

Many Directors did reflect on the fact that the current situation is particularly challenging in terms of the policy advice, in terms of fiscal policy. We have welcomed the easing of monetary policy in the context of the current slowdown. The advice on fiscal policy is much more subtle. It is much more country-specific. For most countries, we believe that building fiscal buffers is appropriate and following a strongly countercyclical policy in what is still an upswing—and at least one Director spoke about the narrowing of the opportunity window for building buffers—is absolutely appropriate. The advice is not universal, but country-specific, but there is a substantial amount of continuity relative to our past advice in Article IV consultations and in the Fiscal Monitor.

We are gradually looking at a longer-term perspective, structural policies, development policies, but please bear in mind that having stability associated with public finance resilience is one of the crucial aspects of a long-term perspective.

The Chairman asked Mr. Gaspar to clarify that the knowledge sharing website would only be used internally.

The Director of the Fiscal Affairs Department (Mr. Gaspar) confirmed that was the case.

The Chairman made the following concluding statement:

Before I move to the summing up, I just want to confirm to Mr. Ray, and to those who have expressed concern about communication, that we will do the best we can to focus on the messages and to clarify without being too nerdy. We will be specific and do justice to the papers and particularly the chapters which have been added to the flagships, which Directors have appreciated.

I have a question. Because Mr. Ray has the benefit of the first presentation and did raise the issue of streamlining and communication, do you believe that the three presentations that were given this morning by our three experts would be well received by ministers and governors, or is it too much?

Mr. Ray made the following statement:

In general, it would be well received, much better received than the documents. But the documents will not go to ministers, so that is the first point. The second point is that some of the charts are very complicated, and they are very complex for ministers to see, even with the special facilities that we use at Spring Meetings. If the staff can streamline the charts even more, that would be great.

To Ms. Gopinath, my advice would be not to leave one of the most powerful points to the very end. It is true that people remember the last thing that was said, but sometimes they may have drifted off by then. It is the last thing one says while they are still concentrating. That is a knack. I have been to many of these over the years, and these presentations are always excellent, but I do think that the presentations are very important to get the message across to ministers.

The following summing up was issued:

Executive Directors broadly shared the assessment of global economic prospects and risks. They observed that global economic activity had recently lost momentum, reflecting a confluence of factors in a number of large economies. Global trade had slowed sharply and concerns over trade tensions weakened business confidence. Directors noted that while growth is expected to level off in the first half of this year and firm up thereafter, this short-term outlook is subject to considerable uncertainty.

Directors noted that, over the medium term, growth is expected to moderate further in advanced economies, as population aging constrains the expansion of the labor force and labor productivity growth remains tepid. In emerging market and developing economies, growth is expected to increase modestly. Convergence toward advanced economy income levels, however, remains slow for many of these economies, due to structural bottlenecks and, in some cases, high debt, subdued commodity prices, and civil strife.

Directors agreed that risks to the global outlook remain skewed to the downside amid high policy uncertainty. These include a reescalation of trade tensions and disruptions from a no-deal Brexit. Given still-accommodative financial conditions, the global economy also remains susceptible to a sudden shift in market sentiment and associated tightening in financial conditions. Downside risks in systemic economies, if they were to materialize, also weigh on the outlook. On the upside, if recent tariff increases are rolled back and trade tensions resolved, rising business confidence could lift growth. Over the medium term, many Directors noted risks from rising inequality, climate change, cyber risks, political uncertainty, and declining trust in institutions.

Directors noted that the current conjuncture highlights the urgent need for strong global cooperation and coordination to tackle shared challenges. Many Directors attached priority to resolving trade disagreements cooperatively without raising further distortionary barriers, and reiterated the importance of strengthening the open, rules-based multilateral trading system. Directors stressed that broadening the gains from global economic integration would also require closer cooperation in the areas of financial regulatory reforms, the global financial safety net, international corporate taxation, and climate change. Progress on external rebalancing relies on macroeconomic and structural policies, mindful of countries' domestic conditions and objectives, to increase demand and growth potential in surplus countries, and initiatives to boost supply and potential output in deficit countries.

Against the backdrop of waning global growth momentum and limited policy space in many countries, Directors underscored the need to avoid policy missteps, contain risks, and enhance resilience while raising inclusive growth prospects. Macroeconomic policies should be carefully calibrated, aiming to support growth where output may fall below potential and policy space exists, and ensuring a soft landing where policy support needs to be withdrawn. In the event of a deeper or protracted downturn, policies should become more accommodative where feasible.

Directors stressed that fiscal policy should strike the right balance between growth and debt sustainability objectives as appropriate in individual countries. In countries with high debt, gradual fiscal adjustment is needed, particularly if financing risks are large. In countries with fiscal space, fiscal policy should boost aggregate demand where there is slack, and raise potential growth where the economy is operating above potential. In this regard, a few Directors noted the role of automatic stabilizers during cyclical downswings. In the event of a more protracted slowdown in growth, care should be taken to avoid a pro-cyclical fiscal stance. Directors concurred that fiscal policy should also adapt to shifting demographics, advancing technology, and deepening global integration. Where there is limited budgetary room, such a response will have to occur through budget recomposition and reprioritization.

Amid signs of weakening growth and muted inflation in most advanced economies, Directors welcomed the more gradual approach to monetary policy normalization by major central banks since the beginning of this year, which has helped boost positive market sentiment. They urged policymakers to clearly communicate any reassessment of the pace of monetary policy normalization that reflects either changes in the economic outlook or risks surrounding the outlook, to avoid excessive market swings or unduly compressed market volatility.

With financial conditions still accommodative as the credit cycle matures, Directors noted that financial vulnerabilities would likely continue to build in different parts of the global economy. These include rising corporate debt, sovereign-financial sector nexus, maturity and liquidity mismatches, house price misalignment, and sensitivity of portfolio flows and asset prices in emerging markets to changes in global financial conditions. The tightening in financial conditions late last year was too short-lived to meaningfully slow the buildup of vulnerabilities, leaving medium-term risks to global financial stability broadly unchanged. Where needed, policymakers should deploy prudential tools proactively, expand macroprudential toolkits, and continue to repair public and private balance sheets.

Across all economies, growth-enhancing structural reforms remain key to improving potential output, inclusiveness, and resilience. Directors emphasized that high debt levels in many countries require a multi-pronged approach, including to enhance debt transparency and management. Broader structural reforms should aim to lift productivity, encourage labor force participation, and upgrade skills. Further deregulation in product markets and services, supported by stronger competition law and policy, could help deter the rise in corporate market power in advanced economies.

Noting that corruption could undermine inclusive growth, public finances, and poverty reduction efforts, Directors highlighted the need to improve fiscal institutions, transparency, and governance in the public sector. Greater cooperation is also essential at the global level, including combating foreign bribery and money laundering of proceeds from corrupt activities, as well as improving the sharing of information to fight tax evasion and prosecute corrupt acts.

Directors stressed that, with external conditions remaining uncertain, emerging market and developing economies should focus monetary policy on anchoring inflation expectations where inflation remains high, and support domestic activity as needed where expectations are well anchored. Depending on country circumstances, efforts should continue to raise revenue, reduce debt-related vulnerabilities, and make steady progress on economic and financial rebalancing.

Directors underscored the need for low-income developing economies to adopt policies that focus on drivers of growth, raise resilience to volatile external conditions, durably reduce debt vulnerabilities, and advance toward the 2030 Sustainable Development Goals, with continued support from the international community. Priorities include improving macroeconomic and macroprudential policy frameworks, strengthening domestic resource mobilization, and gearing fiscal policy toward supporting growth and development objectives, including protection for social spending and carefully-selected capital projects. Commodity exporters need to continue diversifying their economies through policies that improve education quality, narrow infrastructure gaps, enhance financial inclusion, and boost private investment.

APPROVAL: August 26, 2021

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

World Economic Outlook, Chapter 1

1. ***While the forecast is subject to heightened uncertainty, we share the staff assessment of the slowdown around the turn of the year being to a large extent influenced by idiosyncratic, transitory factors, with fundamentals remaining broadly intact. In our view, among these factors, supply-side aspects play an important role. Staff comments, including on the implications for their policy advice, would be welcome.***

- Supply-side disruptions in the second half of 2018 did exert a drag on activity in several key economies (introduction of new emission standards and drought-related disruptions to river transport in Germany; natural disasters in Japan), but the slowdown reflects a broader set of influences.

- In the euro area, for instance, the growth slowdown reflects, to some extent, a slowdown in external trade. Domestic demand has also been lower than projected amid weakening economic sentiment, but remains solid. Temporary factors such as disruption in car production in Germany are being resolved. High-frequency indicators have pointed to continued weakness in early 2019, but there are some positive signs lately, including from PMIs. It is difficult to know at this juncture whether the weakness will continue, but the baseline forecast is for a rebound, with falling oil prices and a recovery in global trade. Risks are tilted to the downside.

2. ***In fact, evidence suggests that activity in industrial production, trade and investment in advanced economies went through a phase of exceptionally strong growth in 2017 when compared with longer term averages. In this light, the loss of momentum since mid-2018 could be interpreted as normalization. Staff's comments would be appreciated.***

- The loss of global activity momentum since mid-2018 in part reflects a moderation in advanced economy growth rates toward their modest potential, which appears to be occurring at a pace somewhat faster than anticipated last fall. However, business sentiment also weakened sharply in the second half of the year amid rising trade tensions—suggesting that the slowdown was more than just a maturing of the business cycle in context of narrowing output gaps.

- Among emerging market and developing economies, while some of the loss of momentum may be attributed to normalization related to needed regulatory and policy tightening in key economies (Argentina, China, and Turkey, for example), more broadly, trade tensions and relatively tight financial conditions since April increasingly took a toll on sentiment and activity.

3. ***Could staff elaborate on where the global economy is relative to potential? What share of global output is being generated in countries operating above or below potential? How will those metrics evolve over the forecast period?***

- Based on data for countries accounting for 91 percent of global PPP GDP, global output is estimated to have been roughly at potential in 2018.

4. ***We would welcome staff comments on what would have been the impact of maintaining the same assumption as last October on growth projections in 2019 for China, the United States and the world.***

- The current WEO baseline forecasts activity to stabilize in the first half of this year and firm up thereafter, in part reflecting revised assumptions on tariff increases. Specifically, the current baseline incorporates an extended trade truce between the United States and China (and a continuation of the relatively more accommodative financial conditions that have prevailed since the start of 2019, which in part reflects optimism that further tariff hikes between the US and China will be avoided).

- Instead, had the assumptions underpinning the October 2018 WEO been maintained (an increase in US-China tariffs on March 1), the baseline projection would have featured a more tepid pickup in global growth in the second half of this year.

5. ***Staff now assumes that trade tensions will not escalate further in the baseline, which is a significant relaxation from the previous outlook. What is the impact of this relaxation on the outlook in the baseline, and what are the expectations in case an adverse scenario was to materialize?***

- The current WEO baseline forecasts activity to stabilize in the first half of this year and firm up thereafter, in part reflecting revised assumptions on tariff increases. Specifically, the current baseline incorporates an extended trade truce between the United States and China (and a continuation of the relatively more accommodative financial conditions that have prevailed since the start of 2019, which in part reflects optimism that further tariff hikes between the US and China will be avoided).

- Instead, had the assumptions underpinning the October 2018 WEO been maintained (an increase in US-China tariffs on March 1), the baseline projection would have featured a more tepid pickup in global growth in the second half of this year, but the headline global, advanced economy, and emerging market and developing economy growth rates would have been little changed given the preponderance of weak data outturns that weigh on this year's growth rate.

- If trade tensions were to re-escalate, the adverse impact on business confidence and financial market sentiment would drag global growth below the baseline path (as discussed in the October 2018 WEO Scenario Box).

6. ***Could staff comment on the extent to which these trade tensions have contributed to the WEO's trimming of global growth projections in 2019-2020?***

- The anticipated effect of trade tensions were factored into the downward revisions at the time of the October 2018 WEO, when global growth for 2019 was revised down by 0.2 percentage point and for 2020 by 0.1 percentage point. These downward revisions were guided by the simulations presented in Scenario Box of Chapter 1 in the October 2018 WEO and incorporated a macroeconomic policy response in China to support demand.

7. ***In light of recent Federal Reserve signals, does staff still expect two rate hikes in 2019, as highlighted in box 1.2.?***

- Staff will discuss this issue at the Board Meeting.

8. ***We invite staff to elaborate on their baseline assumption of two more Fed rate hikes in 2019, given that this is substantially more hawkish than market expectations. Furthermore, should the Fed and other major central banks postpone, slow or pause monetary policy normalization as widely expected, what are the prospects for a gradual and orderly tightening of global financial conditions?***

- Staff will discuss this issue at the Board Meeting.

9. ***Can staff elaborate more about the sensitivity of their growth forecasts should the course of the Fed policy rate deviate from the WEO assumptions.***

- Staff will discuss this issue at the Board Meeting.

10. ***A substantial snapback in world interest rates would pose a significant risk to asset prices, economic activity, and hence monetary and financial stability. Staff's views on this risk would be appreciated.***

- Interest rates could rise either because of an inflation surprise or because of a change in risk appetite, as discussed in the Risks section of Chapter 1 of the WEO.

11. ***Could staff elaborate on whether a low growth, strong dollar scenario arising from the current juncture is a reason for concern?***

- As discussed in the Risks section of Chapter 1 of the WEO, downside risks to the outlook stem from a range of factors including the possibility of weaker-than-anticipated growth in key systemic economies such as the euro area. This scenario could lead to widening growth and interest rate differentials between the United States and euro area, and associated dollar appreciation.

12. ***On a technical level, we would appreciate clarification from staff on the methodology for determining within-country regions.***

- The specific definition of regions within a country differ according to the country's organization. Within-country "regions" are defined as the administrative unit one level below the federal or central government, for instance the US States or German Länder.

13. ***Could staff provide an update on high-frequency indicators in major economies?***

- High frequency data suggest that global growth momentum remains weak in early 2019, in line with the WEO forecast. This is primarily seen in subdued manufacturing activity and trade, while services activity has generally been resilient.

- In particular, this is reflected in subdued January-February industrial production in China (close to a decade low), United States, Japan, and Emerging Asia. While industrial production strengthened in the euro area in January, on a 3-month basis the sequential momentum still appears weak.

14. ***Further analysis of wage dynamics within the euro area also appears warranted, notably on how to better coordinate on that front, for example through European minimum wage standards – staff's comments are welcome.***

- Nominal wage growth in the euro area has picked up to 2.1 percent in 2018, thanks to the strong labor market. Wage growth in Germany and France continue to be robust, while in Italy and Spain have picked up significantly in the past year, reflecting higher negotiated wages and public sector wage hikes. Going forward, wage growth in the euro area is expected to increase modestly, consistent with the continued tightening of labor markets but somewhat lower inflation due to energy price developments. On minimum wages, it should be noted that these need to be country-specific, given the heterogeneity of labor markets in different economies. The details of President Macron's proposal to coordinate the setting of minimum wages across countries remain to be fleshed out. Staff will provide an assessment when there is more detail available.

15. ***Could staff elaborate on the likelihood of more underlying weaknesses being at play in Europe and what, in such a case, would be an adequate response, given the existing policy space?***

- The growth slowdown in Europe reflects, to some extent, a slowdown in external trade. Domestic demand has also been lower than projected amid weakening economic sentiment, but remains solid. Temporary factors such as disruption in car production in Germany are being resolved. High-frequency indicators have pointed to continued weakness in early 2019, but there are some positive signs lately, including from PMIs. It is difficult to know at this juncture whether the weakness will continue, but the baseline forecast is for a rebound, with falling oil prices and a recovery in global trade. Risks are tilted to the downside.

16. ***Do staff view that recent developments have changed the risk of a no-deal Brexit?***

- Staff will discuss this issue at the Board Meeting.

17. ***We wonder, what are the main factors behind such a slowdown in Germany, in addition to "delays associated with introduction of new fuel emission standards for diesel-powered vehicles".***

- Aside from temporary disruptions due to the introduction of new fuel emissions standards, German growth was lower in 2018 due to weak external demand, disruptions to river transport due to drought (affecting the chemical industry), and a drop in private consumption in Q3. For 2019, growth is projected to remain weak in Q1 and return to trend over the course of the year. However, due to the statistical impact of weak H2 2018 and Q1 2019, the annual growth figure for 2019 has been marked down significantly.

18. ***We note with concern the bleak prospects of income convergence for a sizable group of EMDCs, particularly in the Sub-Saharan Africa and broader MENA regions. This implies that for more than 1 billion people, the income levels are expected to fall further behind those of advanced economies. We wonder what the policy implications for the Fund would be with respect to the institutional policies governing our engagement with this country group.***

- Staff can address this at the Board Meeting.

19. ***Could staff comment on the policies that these countries could undertake to move them back to a path of convergence?***

- Staff can address this at the Board Meeting.

20. ***As regards the forecasts for Indian growth, we note that these have been lowered somewhat for both 2019 and 2020. We understand that these downgrades are explained by recent data revisions and not by any significant changes in the assessment of growth prospects. Could staff comment?***

- India's growth has been revised downward compared to the October 2018 WEO by 0.2 percentage points (ppt) to 7.3 percent in 2019 (FY2019/20) and 0.3 ppt to 7.5 percent in 2020 (FY2020/21). The revisions to the growth forecasts are largely driven by the recent revisions to the national account statistics which indicated somewhat softer underlying momentum particularly the deceleration of private consumption growth.

21. ***In this context, we note from the WEO's Statistical Appendix that China's current account balance will move to a deficit by 2024. As Table A10 does not include the years 2021-2023, we would appreciate if staff could indicate in what year China's current account balance will move to a deficit for the first time? Could staff also offer some elaborations on the implications of this trend for China, in particular, and for the global adjustment process, more generally?***

- China's current account balance is projected to move into deficit for the first time in 2022. This is consistent with an ongoing rebalancing toward a more consumption-based economy in China and gradual reduction in private saving rates. Staff will examine this issue further in the forthcoming China Article IV Consultation.

- Regarding the global adjustment process, excess current account balances in 2018 are estimated to have declined, supported in many cases by real exchange rate movements. As discussed in the section on external sector outlook in Chapter 1 of the WEO, medium-term projections suggest, on average, further movement of current account balances in the same direction.

22. ***On a more specific point, we would like to learn the reasons behind the staff's recommendation to avoid undertaking large scale infrastructure projects as a stimulus measure in China.***

- Staff will address this question at the Board Meeting.

WEO Analytical Chapter 2 (The Rise of Corporate Market Power)

23. ***On the specific aspect of the intensity of competition policies, we note that staff indicated that "there is limited evidence that pro-competition policies have weakened across advanced economies so far" (p.17). Could staff elaborate on this assertion and whether it holds true for competition authorities' decisions on merging and trusts, notably in the US?***

- The vast product market deregulation that took place over the past three decades across advanced economies (see, for example, Koske and others 2015 and Duval and others 2018), as well as trade and FDI liberalization until recently, indicate that pro-competition policies have been strengthened, rather than weakened. As regards competition law and policy, there is an ongoing debate regarding the extent to which rising market concentration, markups, and profits in the United States might reflect a weakening of antitrust enforcement, notably starting with the revision in 1982 of the 1968 merger guidelines that discouraged increases in concentration only in already highly concentrated markets. We provide more details and point to some of the existing literature in footnote 25. This literature is split regarding whether antitrust enforcement has materially weakened, and whether any weakening has had any material macroeconomic effects. Also, as pointed out in the chapter, while the aggregate increase in markups has been larger in the United States than in Europe, the difference appears to reflect primarily a much greater reallocation of resources away from low-markup firms to high-markup firms in the United States (which raises the aggregate markup through a composition effect) rather than larger markup increases within incumbent firms; if weaker competition law and policy had been playing a dominant role, one would have expected to see the opposite pattern—an aggregate markup increase driven predominantly by large markup increases within incumbents. That said, far more is needed in this area, which is left for possible future work.

24. ***We sympathize with the growing view among academics to review antitrust policy in terms of expanding the current "consumer welfare standard" to encompass a broader notion of an "effective competition standard" that would push regulators to assess the health of competition in all markets. Staff's comments would be appreciated.***

- There is indeed new research emerging on the link between market power and monopsony power in the labor market. In fact, this is an issue staff is considering for possible future work. As regards competition law and policy, there is an ongoing debate regarding the extent to which rising market concentration, markups, and profits in the United States might reflect a weakening of antitrust enforcement, notably starting with the revision in 1982 of the 1968 merger guidelines that discouraged increases in concentration only in already highly concentrated markets.

We provide more details and point to some of the existing literature in footnote 25. This literature is split regarding whether antitrust enforcement has materially weakened, and whether any weakening has had any material macroeconomic effects.

25. ***Could staff comment on the suitability of existing anti-trust legislation to address the problem of rising market power?***

- More than a policy-driven weakening of competition, several findings in the chapter suggest that changes in the structure of product markets have underpinned at least some of the overall rise in market power. One such change would be the winner-takes-most outcome achieved by the most productive and innovative firms, rooted in part in specific intangible assets (technological, managerial, or other), network effects, and economies of scale. The rather broad-based nature of increasing markups across countries and industries, and the role played by a small fraction of firms in most cases, also hint at common forces. At the same time, weak pro-competition policies and policies that fail to adapt can magnify winner-takes-most dynamics, and firms that have achieved market dominance primarily through innovative products and business practices may attempt to entrench their positions by erecting barriers to entry. Thus, policymakers should keep future market competition strong and the chapter offers several policy recommendations including cutting domestic barriers to entry in nonmanufacturing industries and liberalizing trade and foreign direct investment, adjusting competition policy frameworks to deal with emerging issues as needed, easing obstacles to technological catchup by lagging firms, and shifting the burden of corporate taxation onto economic rent.

26. ***On a technical note, we observe the relatively modest average increase in price markups over the last 20 years and wonder whether this average is masking a high degree of heterogeneity in the distribution of markup increases across countries. Could staff elaborate on this point?***

- There is large heterogeneity across countries; the United States, for example, experienced a rise in markups twice as large as the average advanced economy. By contrast, in some other advanced economies such as Japan and Korea, the rise in markups has been small.

27. ***However, this is a restricted sample. We would welcome staff's comments on the robustness of these results and the direction of possible biases derived from the filters applied.***

- The main filter applied to the data is to exclude smaller firms (less than 20 employees), but any effects of the cleaning procedure on aggregate markups is unclear a priori—bias, if any, could go either way. As regards robustness of the results, as will be shown in the underlying forthcoming IMF Working Paper, aggregate markup patterns are qualitatively, and most often quantitatively, robust to alternative methods for estimating the underlying production function, as well as alternative aggregation methods.

28. ***We would be interested in seeing the extent to which multinational organizations contribute to market power in developing economies and how they affect growth and income distribution. Could staff comment on whether such an assessment has been done?***

- To our knowledge, a study on multinational organizations' contribution to market power increases in developing economies has not been conducted yet. Given that this literature on market power in its current form is nascent in its use of detailed firm-level data, it has mostly covered advanced economies so far.

29. ***The Chapter argues that "by reducing investment, rising markups can generate slack that may offset their immediate inflationary effect and may imply a trade-off for monetary policy". To what extent are these effects considered by staff to be sufficiently clear cut and relevant to be considered for operational purposes for conducting monetary policy in advanced economies, such as the United States and the euro area?***

- Rising markups in our DSGE model generates two effects which are relevant for monetary policy and give rise to a policy trade-off: rising inflation, and increased slack through lower investment. We find, in our model-based quantitative exercise, that these two effects are quite small relative to other forces that affect the normal operation and conduct of monetary policy. Nonetheless, as indicated in the chapter, if markups continue to rise, then their consequences could become quantitatively more relevant. This is particularly the case when policy interest rates are near their effective lower bounds, as they are in the United States and euro area, in which case the consequences of rising markups for slack increase. More details about the model can be found in the technical annex, where we also conduct a Phillips curve exercise and show that the quantitative effects are modest for the tradeoff between inflation and unemployment, under a calibration that mimics the rise in markups in the United States and euro area between 2000 and 2015. \

WEO Analytical Chapter 4 (Bilateral Trade and Spillovers from Tariffs)

30. ***We appreciate that WEO Chapter 3 supports continued trade liberalization, and that WEO Chapter 4 makes a compelling case to look beyond bilateral trade***

balances. We encourage further research in this vein. Could staff comment on what else is on the agenda?

- This is an ongoing issue for staff. Current work includes simulations of additional scenarios, including a US-China agreement, US imposing tariffs on cars and auto parts, and short-term effects of Brexit; as well as further refinements of the financial effects triggered by trade policy uncertainty.

31. ***We encourage staff to do more work in this area including looking at the economic impacts of non-tariff barriers. We would also welcome staff's views on how this analysis relates to the effects of regional trade arrangements on bilateral and aggregate balances.***

- The impact of non-tariff barriers is less well understood than the effect of tariffs. The main reason is that non-tariff barriers data are difficult to collect and to quantify. In the chapter we run additional gravity regressions which include indicators of non-tariff measures (Table A1) and we confirm that the estimated coefficients are consistent with those in the baseline model. But the effect of non-tariff measures themselves lacks significance, possibly reflecting serious measurement problems and/or multicollinearity with other included regressors.

- The question of how regional trade agreements (RTAs) affect bilateral and aggregate trade balances is an interesting and increasingly important one with the number of RTAs continuing to grow globally. Indeed, our analysis controls for RTAs through our free trade agreement dummy variable which encompasses RTAs. This dummy variable captures the effect on trade that goes beyond that of bilateral tariffs—which are controlled for separately. For example, it includes the effect of reductions of non-tariff measures within a free trade agreement. We find that trade between countries that are part of a free trade agreement is amplified. In general, this leads to amplify the initial bilateral balances among the partner countries and, as a consequence of trade diversion effects, to lower trade with countries outside of the free trade agreement.

32. ***We also welcome the affirmation of the benefits of open and fair trade, if the gains are widely shared or those bearing the cost of adjustment are compensated or receive assistance. We would welcome staff's comment on successful examples of such compensation, and whether additional work is planned to highlight best practices? ***

- This is a complex question which is beyond the scope of the chapter.

33. ***The positive effect of a diversion tariff on employment raises the question of how countries should think about the feasibility of trade policies aimed at increasing employment, weighing such tariffs against policies needed to alleviate the distributional effects of lower tariffs. Staff comments would be welcome.***

- The "diversion tariff" captures the (weighted) average tariff imposed on competing countries; it is thus beyond the control of the country itself. Our results suggest that a tariff increase can benefit countries that are not directly targeted by the tariff. For example, the partial equilibrium effect of US tariffs on China may be to raise value-added and employment in countries such as Vietnam or Canada, to the extent that they are exporting similar goods. Similarly, if other countries lower tariffs among themselves, it is beneficial to participate in multilateral tariff reductions, as staying out would make the country less competitive (even though the tariff rates applied on its exports do not change). However, it critical to remember that the general equilibrium effects are not symmetrical—lowering tariffs unambiguously raises productivity and incomes in the longer term while higher tariffs ultimately lower welfare as it leads to a restructuring of previously optimal global value chains.

- At the highly aggregated sectoral classification used in the chapter, our results suggest that employment can be promoted through tariff reductions. This would benefit both the sector directly concerned (as indicated by the negative coefficient on domestic protection in Table 4.1) as well as other domestic sectors through their use of intermediate inputs (see the negative coefficient on upstream tariff in Table 4.1). However, despite the overall positive effect of tariff reductions, there will also be distributional effects, affecting negatively some groups of workers or communities. Two joint IMF-WB-WTO papers referenced in the chapter, namely "Making Trade an Engine of Growth for All—The Case for Trade and for Policies to Facilitate Adjustment" and "Reinvigorating Trade and Inclusive Growth" provide a detailed discussion of policy options to alleviate adjustment costs and distributional effects.

34. ***Would reducing tariffs to zero across the board result in a significant and enduring increase in the growth rate of global trading volumes?***

- In line with the literature, we find that the partial equilibrium effect of a 1 percent reduction in gross ad valorem tariffs is to increase gross bilateral exports by about 3 to 6 percent. In addition, in general equilibrium, output would also be positively affected by lower tariffs at the global level, leading to a positive level shift in output and thus in trade flows. Whether lower tariffs would also lead to a permanent positive growth effect is a more complicated question. The April 2018 WEO chapter 4 shows that global integration in the form of reductions in international barriers has positive effects on international knowledge diffusion and innovation. We would also note that, while tariffs may eventually be reduced to zero across the board, this would not necessarily imply frictionless trade. Indeed, as tariffs have been falling over time non-tariff barriers (particularly as they relate to services trade) have been falling much less quickly and in some instances may even be rising.

GFSR

35. ***The reassessment of the outlook for monetary normalization follows decisions taken in early 2019 by major central banks to revise their approach to monetary policy normalization. We would very much appreciate staff appraisal of those decisions. Do staff consider those decisions consistent with IMF policy recommendations made in October 2018?***

- To be discussed during oral intervention.

36. ***While we agree that there is a strong rationale for strengthening debt transparency and management, the estimated potential spillovers to emerging markets from capital outflows in frontiers markets seem to be on the high side. This also seems at odd with the GFSR's message in October 2018 that there were limited spillovers between emerging markets. Staff's comments will be appreciated.***

- The current and previous issues of the GFSR have highlighted the rapid increase of the share of high-yield first-time issuers in the key EM hard currency bond benchmark index (EMBIG). Most of these issuers can be classified as frontier markets given their irregular issuance patterns and low volume of issuance. The current GFSR highlights that frontier market issuers now account for close to 23 percent of EMBIG, which makes their performance a significant contributor to the performance of the overall EM asset class. Increased incidents of distress among frontier market issuers could lead to significant underperformance of the EM asset class relative to other credit markets (e.g., US HY) and could eventually lead to redemptions from passive and other benchmark-driven funds by end-investors, which could, in turn, result in benchmark investors scaling back their positions even vis-à-vis countries with strong fundamentals. The October 2018 GFSR highlights this as a risk but does not provide specific quantifications. Instead, it notes that this risk has likely increased over the recent years, given the increased weight of frontier market issuers in EMBIG, as well as the increased role of passive investors (such as ETFs).

37. ***To us, this intertemporal trade-off warrants the integration of financial stability risks in staff's advice on monetary policy. Staff's comments are welcome.***

- To be discussed during oral intervention.

38. ***Major central banks may have missed the opportunity to firmly contain financial stability risks and put market participants and policymakers on a better position to face future shocks. Staff's comments are welcome.***

- To be discussed during oral intervention.

39. ***While staff mentioned as "few macroprudential tools are available to address risks related to rising corporate debt funded by nonbank lenders," we appreciate staff's more elaboration on possible policy measures and macroprudential tools to address vulnerabilities in the nonbank sector.***

- As discussed in the GFSR, there are virtually no prudential tools to address risks related to rising corporate debt funded by nonbank lenders. Consideration could be given to developing prudential tools that limit exposures of financial intermediaries to highly leveraged firms (akin to those applied to households), which would help preserve the resilience of financial system and potentially slow the build-up of corporate debt. Such tools could be applied in cases where overall debt becomes systemically high and therefore, could have macro-financial implications. In the meantime, more comprehensive stress tests (that take into account macro-financial feedback effects) should be conducted by both bank and nonbank financial intermediaries with significant corporate exposures.

- More generally, few macroprudential tools are available to contain vulnerabilities in the nonbank financial sector. Further work is needed to develop additional policy options to mitigate or contain vulnerabilities in the non-bank financial sector related to corporate debt. Possible areas to explore could include fiscal incentives designed to moderate the risk appetite of investors in fixed-income funds and eligibility criteria for the inclusion of assets in investment fund portfolios that depend on the credit quality of underlying securities.

40. ***Staff also provide a summary on the available prudential tools for different types on vulnerabilities (Table 1.3) for a sample of 29 systematically important jurisdictions. Could staff comment on the potential for broader usage of these tools by other countries.***

- Similar tools are also used in other countries (other than the 29 systemically important countries). The macroprudential database attempts to cover all IMF member countries, though breadth of coverage and data quality vary (see https://www.elibrary-areaer.imf.org/Macroprudential/Pages/Home.aspx)

41. ***Considering the late stage in the corporate credit cycle, prudential tools would help to avoid building further vulnerabilities, but are inadequate to address existing***

ones. Could staff elaborate more on how to mitigate existing vulnerabilities and on how effective the policies proposed in the report would be in case risks materialize?

- Please see response to 44.

42. ***As the investor base is mostly comprised of nonbank institutions, financial stability implications will ultimately depend on whether these institutions have tight links with banks that could amplify the impact of a shock in the leverage loan market on the broader financial system. Could staff comment on whether these links exist and how substantial they may be?***

- CLOs remain the prominent nonbank investor in leveraged loans with estimates that over half of leveraged loans issued are packaged into securities and sold as CLOs. However, there remains limited data on the ultimate investors in CLOs, with the recent FSB announcement of its investigation into CLO investment holdings and investor base a testament to the current lack of information around these structured products. Estimates gathered from our market surveillance efforts show global banks hold about 33 percent (or $250 billion) of the total stock of CLO investments. That said, banks mostly hold the highest rated tranches (AAA) in CLOs and the structure of the new CLO 2.0 has improved and mitigated financial stability risks with more credit enhancements, longer lock-up periods, more restrictions on asset holdings, and better knowledge of the underlying investment. Further, funding provided by banks for CLO managers to source a portfolio of assets before pricing is estimated to be modest and banks have improved their risk management around unallocated leveraged loans in their pipeline. So while links do exist, they do not look to be substantial at this point in the cycle.

43. ***We would appreciate staff's comments on whether risks associated with the sovereign-financial sector nexus in some euro area countries could result in spillover to sovereign yields in other euro area countries?***

- While there was an increase in sovereign spreads in Italy in mid-2018 there was little spillover to other euro area countries. However, in a downside scenario there is still a risk that concerns about fiscal challenges in a weakening economy could lead to further rises in spreads that also impact other euro area countries.

44. ***Could staff comment on the likelihood of seeing another episode of sovereign-financial sector nexus? Is this scenario more akin to a tail risk?***

- The GFSR looks at vulnerabilities of the financial system to various types of shocks. The elevated level of debt in the sovereign sector suggests that in countries where financial sector has significant exposures to highly-indebted sovereigns there is a possibility of a reemergence of the sovereign-financial sector nexus in a downside scenario. The circumstances under which such scenario might materialize are not part of the baseline.

45. ***Staff's comments on the role of fragmentation would be appreciated.***

- The analysis of the sovereign-financial sector nexus does look at the fragmentation of borrowing costs. It notes that there has been an increase in the borrowing costs of the Italian sovereign, though this has partially retraced, and that this has spilled over to wholesale borrowing costs for banks. However, so far this has not led to a rise in interest rates that banks in countries with lower-rated sovereigns pay on deposits. There is also little evidence of a pass through to bank interest rates on loans to companies and households in these countries, perhaps because central bank liquidity support has lowered overall funding costs for banks. While there is a risk that bank funding costs could increase if sovereign and wholesale funding rates rise further, the recent announcement by the European Central Bank to launch a new longer-term refinancing operations will help to mitigate this.

46. ***We also note that the inclusion of China's local currency bonds in benchmark indices could bring $150 billion in additional inflows to China by 2020. We would appreciate it if staff could share more detailed explanations and views on estimated impacts of the inclusion on the financial systems in China and other economies whose weights would be reduced due to China's inclusion.***

- Chart 1.24, panel 4 illustrates the impact that China's inclusion in GBI-EM will have on the emerging markets. For the other bond indices, most of the impact will be for the key advanced economies (US, Euro Area, Japan, United Kingdom), but it is likely to be relatively small compared to their overall foreign holdings.

47. ***Is differentiation solely a fact of unconstrained investors? We would also appreciate staff elaboration on the factors that could drive investors away from index-based allocation?***

- As noted in the GFSR, purely passive benchmark-driven investors still account for a relatively small/modest share of foreign portfolio investors in EM hard currency debt, local currency debt and equities, and hence, a sizable share of EM investors are able to significantly deviate from the benchmark indices. There is also a number of unconstrained EM investors with large positions in certain countries that so far have not faced significant pressure from end-investors to unwind. If end-investors continue to prefer passive investment vehicles, the firepower (in terms of Assets Under Management) of active managers to benefit from arbitrage opportunities and/or differentiate based on fundamentals will be reduced.

- Factors that could reduce index-based allocation include:

1. A substantial and continued outperformance of non-indexed managers (e.g. absolute return/hedge funds) against the benchmarks.
2. Increased sensitivity of end-investors and asset managers to environmental, social and other governance (ESG) issues. Currently, most commonly used benchmarks don’t have such considerations and many investors end up being holders of bonds and stocks from issuers that score low on ESG criteria.

48. ***Could staff elaborate on country exceptions—cases of investor interest beyond the weight in the benchmark index—where investors are differentiating based on fundamentals?***

- The GFSR mentions that monthly surveys of investment funds still show a substantial capacity of managers to deviate from the benchmark allocations. In EM fixed-income markets, Argentina dollar bonds were a notable case of large “overweight” positions relative to the benchmark index. One possible driver of such allocation might have been market hopes for success of the new administration during 2016-17. The subsequent persistence of “overweight” positions may have been due to low market liquidity making it difficult to unwind these positions. An example “underweight” positions has been local currency Turkish sovereign bonds before the sell-off in early 2018. As Turkish yields rose and stabilized to above 20 percent, the underweight investor had to increase their allocations or risk significant underperformance against the index. Latest surveys show a slight overweight in local currency Turkish debt.

49. ***Could staff elaborate on the significance of this shift and whether the conventional understanding that investors discriminate among countries based on fundamentals is still valid?***

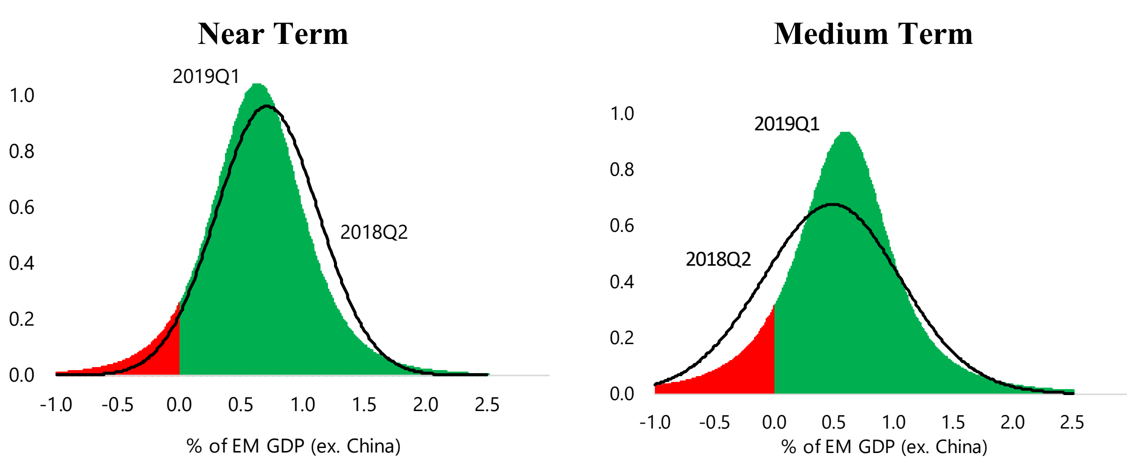
- The GFSR mentions that most investment funds especially in fixed income are actively managed and able to deviate significantly from their benchmarks. However, since the financial crisis there has been a secular trend of strong inflows into passive funds, especially ETFs, even while active (though still benchmark driven) funds have seen outflows. If this trend continues in the coming years, it could lead to the overall investor base in EM asset class becoming less discriminating among countries during times of stress.

50. ***In addition, we very much valued the capital-flows-at-risk analysis in the October 2018 GFSR and would have appreciated an update of that analysis in the***

current report, especially considering the recent reversal in capital flows to emerging markets. Staff's comments are welcome.

- Analysis based on partial data for 2019Q1 suggests that downside risks to capital flows have increased in the near term but have moderated somewhat over the medium term.[4] The small increase in near-term risks to portfolio debt inflows is explained by a stronger dollar and somewhat higher risk aversion in 2019Q1 compared to 2018Q2 (the quarter referenced in the October GFSR). The decline in US Treasury yields has mitigated this effect.[5] Tail risks to capital flows in the medium term are estimated to have diminished more substantially, reflecting the fact that some outflow risks have already materialized (captured in the model by the lagged dependent variable) and the positive impact on tail risks from somewhat higher risk aversion. Please note that as the analysis is performed on quarterly data, summary statistics for portfolio flows may not accurately reflect the significant intra-quarter volatility of portfolio flows. [Please also note that some updates of the past GFSR analyses, including capital-flows at risk, could not be included in the conjunctural chapter due to the tight word limits.]

Densities of EM Portfolio Debt Flows



51. ***Given the importance of benchmark-driven portfolio flows in emerging markets, we agree with the need for a close dialogue between index providers, the investment community and regulators. In staff's view, what would be a good outcome of this dialogue?***

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[4] Based on the methodology presented in the October 2018 GFSR and discussed in the online technical annex. Based on partial data for 2019Q1.

[5] The downside risks to capital flows in the near term had deteriorated more materially in 2018Q4, when US credit spreads and Treasury yields were higher and the dollar was stronger.

- Over the last few years there have been several changes to the regulatory landscape to require index providers to meet higher standards in governance, control and oversight. These include: (i) the EU benchmark regulation; and (ii) the IOSCO principles for financial benchmarks. Continued dialogue with regulators is warranted to ensure transparent, rules driven and robust design of benchmark indices. For example, one issue that could be discussed is a common transparent framework for inclusion or exclusion of countries in benchmark indices. Currently each index provider uses different processes to determine whether an issuer satisfies their index criteria.

52. ***In the context of the increasing importance of benchmark-driven portfolio flows, particularly by sovereign borrowers, staff recommends a close dialogue between index providers, the investment community and regulators. We would welcome a further elaboration on key policy directions expected through this proposed dialogue.***

- Please see answer to 56.

53. ***While we concur on the need to continue to monitor developments carefully, including in Italy, we would be interested in having staff's view on the fact that negative feedback loops seem quite limited so far (with spill over to companies and households) nor through contagion to other neighbor markets.***

- As is noted in the report, there has been little contagion from the increase in Italian sovereign yields to other euro area government bond yields to date. While we have seen an increase in wholesale funding rates for banks in countries with lower-rated sovereigns, there is little evidence so far of a pass through to the interest rates that banks in these countries charge on loans. This may be due to central bank liquidity support which has contained overall bank funding costs. However, as it is also illustrated in the report, a rise in government bond yields in a downside scenario could lead to significant mark-to-market losses for banks in some countries.

54. ***A substantial snapback in world interest rates would pose a significant risk to asset prices, economic activity, and hence monetary and financial stability. Staff's views on this risk would be appreciated.***

- To be discussed during oral intervention.

55. ***The October 2018 WEO highlighted concerns associated with growing cyber security and fintech risks. We would appreciate regular updates on these developments and progress in the adoption of mitigation measures. Staff comments are welcome.***

- MCM is following developments in the areas of fintech and cyber security. In response to calls from member countries, the IMF and the World Bank staff have developed the Bali Fintech Agenda. The Agenda offers a framework for the consideration of high-level issues by individual member countries, including in their own domestic policy discussions. The Agenda helps guide the focus of IMF and World Bank staff in their work on fintech issues within their expertise and mandate, inform their dialogue with national authorities, and help shape their contributions to the work of the standard-setting bodies and other relevant international institutions on fintech issues. Implications for the work programs of the IMF and World Bank will be developed and presented to their respective Executive Boards for guidance as the nature and scope of the membership's needs—in response to the Bali Fintech Agenda—become clearer. Regular updates on FinTech developments are provided as part of the Global Markets Monitor on a monthly basis. Fintech and cyber security related issues are also covered in selected FSAPs.

56. ***In particular, the likelihood of an inflation surprise may have risen in the US, where output is above potential, core inflation is close to 2 percent, unemployment is at record lows, latent slack is falling, and wage growth is on the rise. As a result, the potential for a reassessment of the expected monetary policy path – and ensuing swings in market sentiment and repricing of risky assets – may also have increased. In this regard, we wonder if, in the GFSR, the staff's characterization of the recent more accommodative monetary policy stance from the Federal Reserve as a "change in its approach" is somewhat overstated, as it may more quietly reflect only a shift in tone of communication (as recognized in the WEO itself). Staff's comments are welcome.***

- To be discussed during oral intervention.

57. ***Moreover, staff's openness to using monetary policy to "lean against the wind" (paragraph 71 of the GFSR) – by using the policy rate with a macroprudential orientation – seems a novelty. Staff's comments are welcome.***

- To be discussed during oral intervention.

58. ***Few macroprudential tools are available to contain vulnerabilities in the nonbank financial sector, especially in corporate debt funded by nonbank lenders. Thus, we agree with staff that countries should consider developing these prudential tools. However, given the limited knowledge we have on the effectiveness and side effects of the proposed tools, we would call on staff to work more on this interesting topic.***

- Please also see our response to 44.

GFSR Analytical Chapter (Downside Risks to House Prices)

59. ***We would therefore welcome a more integrated analysis of the interaction between the effects of macroprudential and monetary policy. We invite staff to look into this question in the context of the integrated policy framework.***

- The integrated policy framework is a work in progress and we concur that downside risks to house prices should be a part of that framework

60. ***We also note staff's conclusion that 'capital flow measures might help when other policy options are limited, or timing is crucial'. Could staff comment on to what extent this conclusion is consistent with Fund's institutional view on capital flow measures?***

- Footnote 33 summarizes the Institutional View on capital flows and this chapter's conclusion on capital flow measures (see para 32) is fully consistent with the Institutional View, i.e., using CFMs helps when other policy options are limited or timing is crucial.

61. ***On the methodology, we would appreciate if staff could confirm that we can infer from figure 2.6 (panels 1 to 4) that EMs are still facing a high-risk scenario to a downturn in housing markets.***

- The evolution of the interquartile dispersion in panel 4 of Figure 2.6 suggests a divergence of house prices at risk for the 3-year ahead horizon across EMs, with some showing less downside risks and others more, and the median EM country seems to have slightly higher downside risk toward the end of the sample period. In the short run, the 1-year ahead house price at risk in panel 2 estimates show a slight overall improvement as both the interquartile range and the median improve (i.e., become less negative). That said, individual EM countries appear to have above-median house prices at risk, looking at the observations in panels 5 and 6. It is important to notice, however, that because of data availability constraints our sample includes only 10 EMs.

62. ***As a general remark, we wonder whether the house-prices-at-risk (HaR) measure significantly improve the risk analysis on the housing markets compared with signals coming from a model specification that includes controls for credit and financial conditions. Staff's comments are welcome.***

- Additional findings (not reported in the chapter) showed that when the house price at risk measure is added to traditional early warning models with credit and financial conditions, it improves the prediction of financial crises. Also, in specific situations, when GDP growth tends to reach a turning point, such as in 2007, adding the house price at risk measure to the typical growth at-risk model results in stronger downside risk signals for GDP growth.

Fiscal Monitor

1. ***Against the global backdrop of weaker nominal growth, rising debt, tighter financial conditions, commodity price volatility and the overhang of skepticism on benefits from globalization, could staff offer their views on the appetite of these measures?***

- The skepticism on the benefits of globalization reinforces the need for reforms, in part to respond to growing inequalities. We acknowledge that in an environment of slowing growth and high public debt, upgrading tax, social spending, and active labor market policies, as well as public infrastructure to adapt to ongoing global trends entails difficult trade-offs. However, as noted in the Fiscal Monitor, a number of countries are under taking these reforms. For example, Mexico and Saudi Arabia recently reformed their fuel subsidies and importantly included measures to mitigate the impact on the poor. On the revenue side, Papua New Guinea has launched its medium-term revenue strategy, several other countries (Egypt, Lao P.D.R., Uganda) are working to develop theirs, and several others plan to do so (Indonesia, Senegal, Thailand).

2. ***Unfortunately, the experience with increasing revenue mobilization in LICs has been disappointing, notwithstanding substantial Fund technical assistance in this area. Could staff elaborate on the main reasons behind this outcome?***

- Many LICs including in Africa have been implementing reforms to their tax systems, but structural reforms often take time to be fully effective. Fund technical assistance has supported many of these reform efforts, including by capacity building with a medium-term orientation. However, other factors contribute to this revenue performance such as economic and commodity cycles. LICs are also affected by international tax challenges placing emphasis on ensuring that LIC interests are appropriately met in reforms to the international tax architecture.

3. ***With regard to subsidies, we consider that the report focuses narrowly on eliminating energy subsidies, while we consider that all forms of subsidies, including agricultural and renewable energy subsidies, cause price distortions. Staff’s comments would be welcome.***

- While these other subsidies may also be inefficient, they tend not to be large globally. For example, agricultural subsidies in the EU averaged about $100 billion a year, in 2014-16, or about 0.5 percent of GDP whereas energy subsidies are 6.5 percent of GDP (at the global level). Renewable energy subsidies are even smaller—around $70 billion worldwide in 2014. We note that renewable energy subsidies can help address the externalities that drive climate change. For example, some level of subsidy might be warranted if it addresses learning-by-doing spillovers associated with first use of a new technology.

4. ***Could staff comment briefly on how fuel subsidies were calculated, including the assumptions used for oil prices and whether the fiscal cost associated with compensatory measures to mitigate the impact on the poor and vulnerable groups are included in the calculations?***

- The methodology for calculating subsidies (i.e., the gap between actual consumer prices and international prices plus optimal revenue/environmental taxation) is explained in Coady and others 2015. It does not include compensatory measures. There are three basic components to the calculation:

- First, is the economic (or opportunity) cost of supplying fuel to consumers. For products traded across regions, such as gasoline and diesel, this can be measured by the international reference price as reflected in the cost faced by importers or the revenue foregone by domestically consuming rather than exporting the product. For non-traded energy, such as electricity, the supply cost is the domestic production cost or 'cost-recovery' price, with fuel inputs evaluated at international reference prices.

- Second, there are the environmental costs associated with fossil fuel use, the most quantitatively important of which includes global warming, local air pollution, and broader costs associated with the use of fuels in road vehicles.

- The third component of efficient fuel prices reflects general revenue-raising considerations and here IMF guidelines are to apply the same consumption taxes to fuels as applied to other consumption goods in general. Under the (near ubiquitous) value-added tax (VAT) this would apply the standard VAT rate to final fuel consumption—*based on prices reflecting supply and environmental costs*—but not to intermediate purchases.

Reference

Coady, D., I. Parry, L. Sears, and B. Shang. 2015. "How Large Are Global Energy Subsidies?" IMF Working Paper 15/105, International Monetary Fund, Washington, DC.

5. ***Like a number of other Chairs, we were disappointed that the Fiscal Monitor (Box 1.3) did not appear to reflect the recent Board meeting on this topic. Like others, we think the box takes too polemical a tone in framing the debate around international corporate taxation, too readily dismisses the scope to make further progress within the BEPS framework and is too blunt in its treatment of tax competition issues. Further, references to "tax wars" and "multilateralism under threat" do not help advance the debate in a constructive manner. The Fund should be measured in its engagement on these issues, reflecting the range of views across its membership. We expect staff to present a redrafted box consistent with the views of the membership.***

- Editorial revisions have been made to the box to adjust the tone, reflecting the recent Board meeting, and to highlight the scope for further progress within the OECD's Inclusive Framework.

Fiscal Monitor Analytical Chapter (Curbing Corruption)

6. ***We are pleased to note the utilization of the Fund's comprehensive diagnostics tools and commend FAD for this great work. We would appreciate staff feedback on the level of expected demand from the membership for these tools going forward, and what would be the implications in terms of additional resources and budget for FAD.***

- Staff will respond to this question during the Board meeting.

7. ***There must be measurable results in the capacity building work done by the Fund to better evaluate its efficiency. Staff's comments would be appreciated.***

- Staff will respond to this question during the Board meeting.

8. ***Promoting traction of such advice across the staff will be important, and we wonder whether FAD intends to translate it into a standardized operational approach in the context of the 2018 Fund framework. Staff's comments would be welcome.***

- Staff will respond to this question during the Board meeting.

9. ***We believe all jurisdictions should establish mandatory, public registers that disclose the ownership of funds. Against this background, we would welcome staff elaboration on what else multilateral institutions like the Fund could do to promote high standards of transparency and accountability in global financial markets?***

- Fund staff supports the progress made in the area of transparency and exchange of information, notably through the wide adoption of the new G20 standard of Automatic Exchange of Information, requiring that countries be given automatic access to information on their taxpayers' financial accounts abroad. This, and the BEPS minimum standard of "country by country reporting," are major steps in combatting tax evasion and furthering transparency, and Fund staff continues to stand ready to assist countries in implementing these standards. However, more must be done, including by implementation of stricter standards for disclosing "beneficial ownership" of assets and the reform of high-risk citizenship-by-investment schemes. In particular, Fund staff actively promotes and supports its members' implementation of the Financial Action Task Force (FATF) Standard, which includes the collection and exchange of information on the beneficial ownership of legal persons.

10. *Could staff provide further empirical evidence and case studies on how to leverage ICTs for anti-corruption efforts?*

- Technologies can help reduce corruption through automation and thus lower discretion, as well as greater fiscal transparency. Technology can apply to core functions of fiscal activities (tax administration, procurement, budget processes, information systems). Its effectiveness will vary depending on the different areas.

- It is also important to note that the impact of technologies will also depend on other factors, including the design and incentives structure. Technological advances also pose challenges as they can be used for corrupt activities. The Monitor includes evidence (both micro and macro) suggesting that technologies (digitalization) can be helpful. We provide some additional sources below as requested.

References:

Chene, M., 2016, "Literature review: The use of ICTs in the fight against corruption", U4 Anti-Corruption Resource Centre

Duflo, E., R. Hanna, and S. P. Ryan. 2012. "Incentives Work: Getting Teachers to Come to School." American Economic Review 102 (4): 1241–78.

Fan, H., Y. Liu, N. Qian, and J. Wen. 2017. "The Short and Medium-Run Effects of Computerized VAT Invoices on Tax Revenues in China." Unpublished report, Northwestern University, Chicago, IL.

Kim, S., Kim, H. J., and Lee, H. 2009. "An Institutional Analysis of an E-Government System for Anti-Corruption: The Case of OPEN," Government Information Quarterly (26:1), pp. 42-50.

Lund, S., O. White, and J. Lamb. 2017. "The Value of Digitalizing Government Payments in Developing Economies." In Digital Revolutions in Public Finance, edited by S. Gupta, M. Keen, A. Shah, and G. Verdier, 305–323. Washington, DC: International Monetary Fund.

Muralidharan, Karthik, Paul Niehaus, and Sandip Sukhtankar. 2016. "Building State Capacity: Evidence from Biometric Smartcards in India." American Economic Review 106 (10): 2895–929.

US Agency for International Development (USAID). 2014. Digital Finance for Development: A Handbook for USAID Staff. Washington, DC.

World Bank. 2016. *World Development Report 2016: Digital Dividends*. Washington, DC.

11. ***Notably, FM mentions US$7 trillion in hidden wealth deposited by individuals—equivalent to 10 percent of world GDP. It would have useful to have a nuanced analysis of the flows, and more details on the composition and directions of these flows. Could staff elaborate?***

- The source is the paper by Alstadsæter, Annette, Niels Johannesen, and Gabriel Zucman ("Who Owns the Wealth in Tax Havens? Macro Evidence and Implications for Global Inequality." *Journal of Public Economics*). It is also summarized in the *Finance and Development* 55 (2).in Damgaard, J., T. Elkjaer, and N. Johannesen. 2018. "Piercing the Veil."

- According to the authors, the equivalent of 10 percent of world GDP is held in "tax havens" globally, but this average masks a great deal of heterogeneity of the sources—from about 4 percent of GDP in Scandinavia, to about 15 percent in Continental Europe, and about 35-70 percent in some oil-producing countries and in countries that have suffered instances of major financial instability. The findings also suggest that individuals sometimes use offshore accounts for other reasons than tax evasion. For instance, tax haven banks may serve to circumvent capital controls during a currency crisis and to launder the proceeds from corruption in resource-extraction industries.

12. ***We wonder whether staff considered to include 'second-generation' or 'third-generation' corruption indicators, such as victimization surveys like the module in the World Bank's Enterprise Surveys, which asks whether participants have experienced corruption first-hand (e.g., paying bribes) and thus providing a more direct, objective measure of corruption.***

- Surveys on number of bribes, such as the Enterprise Surveys, while useful, are limited on the aspects of corruption covered (experience with bribes by some groups) and country coverage.

- We decided to mainly use the control of corruption from the Worldwide Governance Indicators because it has broad country coverage, time series, and measures corruption perceptions more broadly (not just specific elements of corruption). In addition, the Control of Corruption measure aggregates many indicators/surveys, including surveys on actual experience (paying bribes).

13. ***We take note of staff's regression tree approach, which shows that for countries that start with a high level of corruption, fiscal transparency and digitalization stand out as key institutional features associated with better control of corruption. In this context, we are wondering about the robustness of the results and how these findings compare to other similar studies.***

- One of the contributions of the Fiscal Monitor is assessing the impact of fiscal institutions depending on the initial level of corruption. The regression trees have the benefit of taking into account the interactions between different institutions when assessing the relative importance. The results suggest that countries that started with higher levels of corruption (in 1996) will see greater benefits (lower corruption today) from developing greater fiscal transparency and adopting digitalization. In countries that already start with a relatively low levels of corruption, transparency and digitalization still play a role, but seem relatively less important partly because corruption is already low (and tends to be persistent). One way to interpret this is that, in this latter group, the high degree of digitalization and transparency is already captured by the low initial level of corruption.

- Within the regression tree framework, we aimed to achieve greater robustness by using a bootstrapping technique which ensures that results are not driven by individual influential observations.

- We are not aware of other papers that have done this type of analysis. However, there is a literature on the importance of developing fiscal transparency and digitalization in fighting corruption (see chapter and additional references provided in the response above).