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Executive Board Minutes 20/97-2

September 30, 2020–2:00 p.m.

World Economic Outlook; Global Financial Stability Report; Fiscal Monitor

Documents:	EBS/20/139; EBS/20/141; EBS/20/142; EBS/20/143; SM/20/148;SM/20/149; SM/20/150; SM/20/151 and Cor. 1; SM/20/152 and Cor. 1; SM/20/153 and Cor. 1; SM/20/154; SM/20/156
Staff:	Gaspar, FAD; Adrian and Natalucci, MCM; Gopinath, RES
Length:	3 hours, 5 minutes

ISSUED: October 21, 2022
APPROVAL: October 28, 2022

CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Transparency Policy and Open Archives Policy.

THE CHAIR'S SUMMING UP

Executive Directors broadly concurred with the assessment of the global economic outlook, risks, and policy priorities. While noticing the stronger than expected economic activity in the second quarter, especially in advanced economies, they agreed that the path to pre-pandemic activity will be long and precarious with persistent scarring effects on output and employment. They noted that the projections assume that social distancing will continue into 2021 and then fade over time as therapies improve and vaccines become more broadly available. Directors noted with concern that the pandemic is having dramatic effects on vulnerable people, leading to higher inequality, and a sharp increase in the number of people living in extreme poverty.

Directors agreed that the uncertainty surrounding the baseline projections remains exceptionally large as the economic recovery will be shaped primarily by the path of the pandemic, the efficacy of containment measures, and pharmaceutical innovations. More rapid development of new therapeutics and wide distribution of effective vaccines could accelerate the economic recovery, while medical setbacks and new waves of infections could require new lockdowns. Other important sources of uncertainty include the extent of global spillovers, the damage to supply potential, the efficacy and duration of policy support, and potential shifts in financial market sentiment. Directors also noted pre-pandemic risks stemming from trade and technology tensions, geopolitical challenges and climate change.

Directors agreed that effective and decisive policy support is needed to ensure stronger, more equitable, and resilient growth. Key near-term priorities include supporting the economic recovery, protecting vulnerable people, and strengthening health care systems. They stressed the need to reduce the scarring effects of the crisis on potential output and employment and to reverse the development toward greater inequality and setbacks to human capital accumulation. Most Directors also saw the crisis as an opportunity to stimulate innovation, develop the digital infrastructure, and to transition to lower carbon emissions using different climate tools, such as green investment and a gradual increase of the carbon price, with due consideration to offsetting negative social impact.

Directors welcomed the unprecedented fiscal actions in response to the pandemic. Directors emphasized that, as economies tentatively reopen, governments should ensure that lifelines are not withdrawn prematurely. Support should gradually shift from protecting jobs to helping displaced workers find new jobs through retraining and reskilling. Directors noted that when the pandemic is under control, governments will need to address the legacies of the crisis, including record deficits and public debt levels, elevated unemployment, and increased poverty. Directors agreed that public investment should play a crucial role in supporting the post-pandemic recovery, noted its sizable job creation potential, and underlined that good governance, budget execution, and communication, remain crucial to reap the full benefits of fiscal support and maintain public trust.

Directors emphasized that governments will need to do more with less and prepare credible and equitable measures to reduce fiscal deficits and debts over the medium term. Countries with limited fiscal space should protect public investment and support lower-income households that have been disproportionately hit by the pandemic. Governments could consider increasing progressive taxation as well as reforms to modernize business taxation, including multilateral cooperation on the design of international corporate taxation to respond to the challenges of the digital economy. LICs in particular are faced with significant financing constraints and many countries will require external support, including in the form of debt relief, grants, and concessional financing.

Directors agreed that bold policy actions taken by central banks to ease monetary policy, provide ample liquidity, and maintain the flow of credit have helped contain the near-term risks to global financial stability. They noted, however, that vulnerabilities are rising, most notably in the nonfinancial corporate sector as liquidity pressures may morph into insolvencies, especially for small and medium-sized enterprises. The credit outlook will ultimately be shaped by the extent of continued policy support and the pace of the recovery, which is expected to be uneven across sectors and countries. Rising defaults could lead to significant losses at banks and nonbank financial institutions. While the global banking system is overall well-capitalized, some banks and banking systems may experience aggregate capital shortfalls in the WEO adverse scenario. Directors also highlighted the importance of improving access of emerging markets and frontier economies to capital markets.

Directors emphasized that as economies reopen, accommodative policies and the continued flow of credit to borrowers will be essential to sustaining the recovery. Once the pandemic is under control, policy support can be gradually withdrawn. The post-pandemic financial reform agenda should focus on strengthening the regulatory framework to address vulnerabilities in the nonbank financial sector exposed by the crisis and stepping up prudential supervision to contain excessive risk taking in the lower-for-longer interest-rate environment.

Directors underscored the importance of international cooperation in the fight against the global health and economic crisis. A key priority is to scale up production capacity and develop distribution channels to ensure that all countries have access to an effective, affordable, and safe vaccine. Directors noted that several emerging market and developing countries require international assistance through debt relief, grants, and concessional financing. They pointed out that the IMF has rapidly scaled up its lending facilities since the onset of the pandemic, providing swift financial assistance to more than 80 countries. Directors discussed opportunities for multilateral cooperation to alleviate trade and technology tensions between countries and to collectively implement climate change mitigation policies.

EXECUTIVE BOARD ATTENDANCE[2]

K. Georgieva, Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
	A. Andrianarivelo (AF)
	B. Lischinsky (AG)
	C. White (AP)
A. Bevilaqua (BR)	
Z. Jin (CC)	
L. Villar (CE)	
L. Levonian (CO)	
D. Palotai (EC)	
A. Buisse (FF)	
	K. Merk (GR)
S. Bhalla (IN)	
D. Fanizza (IT)	
T. Tanaka (JA)	
	M. El Qorchi (MD)
	S. Geadah (MI)
A. De Lannoy (NE)	
M. Poso (NO)	
A. Mozhin (RU)	
M. Mouminah (SA)	
A. Mahasandana (ST)	
P. Inderbinen (SZ)	
S. Riach (UK)	
M. Rosen (US)	

C. Ogada, Acting Secretary
K. Hviding, Summing Up Officer
A. Lalor / E. Mannefred / R. Smith Yee, Board Operations Officers
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department**:** V. Kramarenko, P. N'Diaye, C. Purfield. Asia and Pacific Department: A. Gulde, J. Ostry, A. Stuart. Communications Department: R. Anspach, J. Lundgren, C. Rosenberg. Corporate Services and Facilities: C. Calhoun. European Central Bank:

[2] For countries in each constituency, please see the Constituency Codes in the annex.

D. Rakitzis, R. Rueffer. European Department: R. Balakrishnan, E. Detragiache. Fiscal Affairs Department: R. Espinoza, F. Gonguet, V. Louca Rabaca Gaspar, P. Mauro, P. Medas, C. Pattillo, A. Peralta Alva, J. Ralyea. Finance Department: T. Krueger, Z. Murgasova, A. Tweedie, O. Unteroberdoerster. Human Resources Department: K. Kochhar**.** Institute for Capacity Development: S. Coorey, M. Erbenova, R. Nord. Independent Evaluation Office: C. Collyns. Information Technology Department: C. Andersen. Legal Department: K. Christopherson Puh, B. Steinki. Middle East and Central Asia Department: Y. Abdih, O. Bayar, C. Serra Ronceros, H. Ture. Monetary and Capital Markets Department: N. Abbas, T. Adrian, J. Caparusso, F. Cortes De Miguel, A. Deghi, D. Drakopoulos, A. Garcia Pascual, R. Goel, A. Ilyina, F. Natalucci, E. Papageorgiou, M. Qureshi, F. Suntheim, J. Vandenbussche. Office of Budget and Planning: A. Schimmelpfennig. Research Department: E. Bang, O. Celasun, M. Chivakul, A. Dua, G. Gopinath, J. Hu, F. Jaumotte, G. Milesi-Ferretti, M. Nabar, R. Piazza, C. Sandoz-dit-Bragard, D. Sandri. Strategy, Policy, and Review Department: J. Dutra Pessoa de Araujo, R. Duttagupta, P. Garcia Martinez, A. Iancu, N. Meads, C. Pazarbasioglu Dutz, N. Suryakumar, H. Ward. Statistics Department: L. Lusinyan. World Bank Group: F. Ohnsorge. Western Hemisphere Department: N. Chalk, J. Roldos. Office of Executive Directors: T. Abalala, C. Cruz, K. Lok. Office of Risk Management: V. Arora. Executive Directors: S. Chodos (AG), P. Moreno (CE), D. Palotai (EC), E. Shortino (US), R. von Kleist (GR). Alternate Executive Directors: K. Chikada (JA), F. Fuentes (BR), A. Guerra (CE), Y. Indraratna (IN), C. Just (EC), M. Massourakis (IT), W. Nakunyada (AE), R. N'Sonde (AF), F. O'Brolchain (CO), O. Odonye (AE), L. Palei (RU), M. Peter (SZ), V. Rashkovan (NE), D. Ronicle (UK), P. Rozan (FF), B. Saraiva (BR), J. Sigurgeirsson (NO), Z. Zhang (CC). Senior Advisors to Executive Directors: W. Abdelati (MI), S. Ahmed (MD), K. Badsi (MD), M. Choueiri (MI), J. Damgaard (NO), A. Ekelund (NO), R. Farber (US), I. Fragin (GR), M. Gilliot (FF), R. Goyal (IN), L. Johnson (AP), S. Keshava (SA), Y. Liu (CC), M. Maidi (AE), L. Marek (EC), T. Nguema-Affane (AF), C. Quaglierini (IT), T. Sitima-wina (AE), L. Smith (CO), F. Spadafora (IT), N. Thiruvenkadam (IN), A. Tolstikov (RU), G. Vasishtha (CO), L. Voinea (NE), J. Weil (CO), B. Yoo (AP), M. Zhunusbekova (SZ). Advisors to Executive Directors: M. Albert (FF), F. Al-Kohlany (MI), D. Andreicut (UK), A. Arevalo Arroyo (CE), S. Belhaj (MD), A. Biriukv (RU), Campbell (UK), E. Cartagena Guardado (CE), K. Carvalho da Silveira (AF), L. Cerami (IT), T. Chrimes (UK), O. Diakite (AF), R. Edwards (CO), K. Florestal (BR), Rachel Lyngaas (US), J. Hanson (NE), T. Iona (AP), H. Koh (GR), A. Korinthios (IT), T. Krahnke (GR), T. Manchev (NE), M. Merhi (MI), P. Mooney (CO), R. Moral Betere (CE), T. Nagase (JA), A. Ribeiro Mateus (IT), S. Senich (US), M. Shimada (JA), B. Singh (IN), D. Susiandri (ST), D. Tevdovski (NE), A. Tola (SZ), Y. Zhao (CC), J. Barroso (BR), F. Lopez (CE), P. Robitaille (US).

DISCUSSION RECORD[3]

The Chair:

I want to welcome all to the session to discuss our flagship reports: the World Economic Outlook, the Global Financial Stability Report, and the Fiscal Monitor.

We are in a very intense moment in terms of Board engagement. We are also still in this unusual environment of working from home. The departments have prepared videos of their presentations, which allows us to reduce the overall screen time but, more importantly, allows the Board to prepare for the discussion today.

We are in a crisis that has severely affected everybody, everywhere. While, as seen from the WEO, the situation is less bleak today than it was a couple of months ago, we still ought to qualify that the recovery that has started is partial, uneven, and uncertain. We are hoping for the best, but we are also projecting a worse-than-baseline scenario. If we do see vaccines and treatments accelerating and confidence being rebuilt, we might be, at the Spring Meetings, recognizing that the conditions have become better what they are today, but there is also a risk of negative surprises.

In the gray statements, Directors reflected objectively on the uncertainties, and their views very much reinforce ours. Until there is a durable exit from the health crisis, support needs to continue, but it has to be better targeted. It puts a very high burden of responsibility on the Fund to make sure that not only do we provide good, credible forward guidance on what this more targeted support should look like, but that we are also capable of offering financial support to those who are faced with very constrained capabilities of their own.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath):

Directors have seen the video recording of my presentation. The global economy has somewhat rebounded from the depth of its pandemic-driven recession in the first half of this year. In the second quarter, growth outcomes were severely negative, but they were somewhat less dire than we expected. That said, the ascent back to pre-pandemic levels of activity will likely be long, uneven, and highly uncertain.

[3] Edited for clarity.

This is, of course, a pandemic crisis, so we look at what is happening with the pandemic. The pandemic continues to spread in emerging markets. We are seeing second and further waves in advanced economies. At the same time, new deaths remain well below their peak. The cause of this resurgence in the spread of the virus. What we see in the right graph, is that re-openings have stalled and, with it, the improvements in mobility.

We have global growth projected to be negative 4.4 percent for 2020. That is a 0.8 percent upgrade since June. It basically reflects better second quarter outcomes than we had projected, especially for advanced economies. We have a rebound in 2021, with growth at 5.2 percent. This is, again, a partial rebound. For advanced economies, growth is projected at negative 5.8 percent, a significant upgrade of 2.3 percent. This is owing to significant upgrades in the United States, in the euro area, and a few other countries. However, let us not forget that if one looks at the absolute numbers, we are still staring at severe recessions across the board in 2020. Again, we have projected bounce-backs in 2021, but these are partial recoveries.

Here are the numbers for emerging market and developing economies, which are projected to shrink at 3.3 percent and then recover; growth recovers to 6 percent in 2021. These numbers have not changed much since June, but it does mask significant heterogeneity. We have upward revisions for countries like China, Brazil, and Russia since June, but we also have a significant downward rescission for India. Again, we have a return to positive growth in 2021, but the amount by which that happens is actually quite heterogenous across the different countries and regions.

What one sees here is the path of activity projected out to the end of 2021. The first thing to note is that China, which is the red line, is quite the outlier, returning to the pre-pandemic-projected path relatively quickly. On the other hand, advanced economies, which is the blue solid line, and emerging and developing economies, excluding China, which is the green line, have a much slower recovery. Even by the end of 2021, they are below the 2019 level.

The other thing one notices here is, if one looks at the gap that we have in terms of lost output for emerging markets and developing economies, excluding China, relative to what we had projected pre-COVID, that is just much higher than that gap for advanced economies, which means that we are staring at a significant divergence in global outcomes.

For the first time, we also have medium-term growth projections out until 2025. If one looks at the cumulative growth from 2019 to 2025, as one can see from the red bars, we are projecting slower cumulative growth, as compared to pre-COVID, which are the blue bars, which means that the improvements in the living standards that we were expecting pre-COVID is just going to be much lower now post-COVID and pretty much in all regions of the world.

I cannot emphasize enough the tremendous uncertainty, as long as this pandemic is with us. We have upside and downside scenarios. The baseline is the black line. One could have an upside scenario, which is the green line, where one has better news all around in terms of health solutions, including mobile spreads and a quicker availability of vaccines and treatments. It can improve outcomes, especially as you go into 2022 and 2023 because one has less scarring. On the other hand, if we just have setbacks or there is just worse news on the health front and the health crisis is stronger than we expect, even in 2021, then one could have significant downward revisions of, for instance, 3 percentage points additional in negative growth in 2021. So, again, there is tremendous uncertainty. We expect the ascent back for most countries in the world will be long, uneven, and uncertain.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian):

Let me turn to a very brief overview of the financial stability assessment.

I will just go over asset valuations, corporates, banks, and emerging markets to root the discussion going forward.

What we have seen in equity markets around the world, as well as in corporate bond markets, is a very sharp rebound from the sell-offs in March.

The left chart shows equity market performance. These are cumulative returns since the beginning of the year. The very sharp sell-off in March was driven by two main factors: On the one hand, a very sharp increase in risk premia. So, market sentiment turned very negative, of course, in the face of the pandemic. But there was also a sharp downward revision in earnings expectations, which is in blue. As one can see from the presentation, the risk premia have reverted. In fact, we estimate stretched valuations in many segments of equity markets today; but, of course, earnings have not fully rebounded and continue to be a drag on valuations.

The right chart shows that the run-up in valuations has been particularly pronounced for the largest tech stocks. Here, I am showing in blue, on the right chart, the five top U.S. stocks, which are all tech stocks. They rebounded extremely sharply. They have sold off to some degree but are still up very sharply during the year.

On the other hand, when one looks at the S&P 500, excluding those five stocks, there was some rebound, but it is much less pronounced. In fact, the equity market, without those top five stocks, has underperformed the global equity index, excluding the United States. And that, in turn, is underperforming, relative to the Emerging Markets Index. Therefore, emerging markets, from the equity point of view, have done fairly well. Of course, a lot of this rebound in risk sentiment has come from the tremendous support of central banks, and we have discussed that in many earlier sessions.

Turning to the corporate sector, the left chart shows that in most countries, corporate leverage is at historically high levels. The presentation shows the range of corporate debt over the past 10 years. One can see that either it is close to the top of the range or at the top of the range in most advanced economies and emerging market countries. The right chart shows the default rates. Defaults are certainly expected to rise to the level seen in previous recessions, including the global financial crisis (GFC) of 2008. There is corporate distress priced in; and that, of course, leads to the scarring that Ms. Gopinath mentioned.

For the first time, we publish the global bank stress test that we briefed the Board on earlier and that is part of the Global Financial Stability Report (GFSR). The banks are much better capitalized than in the 2008 crisis. As a result, most banks are resilient, relative to even very adverse scenarios going forward. Having said that, in many countries, there is a weak tail of banks that could face severe trouble if the pandemic continues; and, of course, the weak tail is concentrated in some countries. Those stress charts will be updated with the latest WEO numbers in the GFSR.

In terms of magnitude, the aggregate capital losses are substantial; globally, over $600 billion. Of course, the policy support helps tremendously; and with the policy support, those losses are only about $400 billion.

Turning to emerging markets and frontier markets. The investment grade subsegment of emerging markets has recovered, as shown in the yellow on the left. The yield for investment grade emerging market debt is actually lower than it was at the beginning of the year, so funding conditions have eased for a few emerging markets segments. But in the riskier segments, such as frontier markets or emerging markets in Africa, the level of yields is quite a bit higher than at the beginning of the year. So, there is some improvement relative to March but not a total reversal of funding conditions. And, of course, the right chart is just zooming in on a few of the countries that we are working with particularly closely that have a major debt service coming due over the next year and that certainly have debt sustainability challenges to a certain degree, more or less some of those countries on the chart here.

In aggregate, the picture is very differentiated across countries. Here, each dot is a country, and red dots are those countries with medium-term high or high sovereign vulnerabilities. The x-axis shows high corporate vulnerabilities, and the y-axis shows high bank vulnerabilities. The upper right charts are those countries that have vulnerabilities on all three dimensions. Of course, there are a few other countries that have only vulnerabilities in a few dimensions. As a result, any policy considerations have to be highly differentiated across countries, and the intertemporal trade-offs in between supporting the economy in the near-term through monetary policy and liquidity policies or bank policies, how that is traded off with a medium-term objective really depends on country circumstances.

The Director of the Fiscal Affairs Department (Mr. Gaspar):

I want to highlight a number of calls for policy action with an emphasis on fiscal and then spend a few seconds emphasizing the importance of institution building in the context of COVID-19.

The first aspect of policy action is that, even though public debt is at a record high, the near-term priority is to avoid a premature withdrawal of fiscal support. It should persist at least into 2021 so that lifelines are preserved and long-term scarring is avoided.

Second, we emphasize in the Fiscal Monitor that public investment has an acute role to play in the recovery. In the chapter, we show that, in a period of uncertainty, as the one we are living in, the multiplier effects of public investment are particularly strong and complementarities with private investment are particularly important. Going forward, public investment can facilitate the transition to a smarter, greener, more resilient growth. Later, I will mention briefly the importance of public investment governance.

Third, countries that are facing the most severe fiscal constraints will have to prioritize their efforts on key spending areas. Those include health and education; but, of course, it is crucial to ensure that the most vulnerable are protected.

Fourth, further international support, debt relief, access to grants, and concessional financing will be needed now and going forward to help the poorest countries tackle the urgent and painful trade-offs that I have mentioned in the video received by the Board earlier. More broadly, the stability of the global financial system requires that international financing be available for all countries facing temporary financing challenges. For countries with unsustainable debt, options for an orderly debt restructuring should be considered.

Back in April, a key message on fiscal policy was to do whatever it takes to contain the pandemic but to make sure to keep the receipts, which is our prompt to institutional building. To be able to keep the receipts, countries need strong public financial management (PFM) practices and institutions. To establish these practices, institutional capacity building is needed in many countries. This makes capacity development critical at the current juncture. And this is true beyond public financial management. Efficient revenue mobilization also requires strong revenue administration capacity, and that is an important example.

I will conclude by highlighting one area of capacity development which connects naturally to this fall's Fiscal Monitor: infrastructure governance. By developing sound public investment management institutions, countries can improve public investment efficiency and avoid waste. The very favorable results that I quoted for public investment assume that waste has been at least put under control.

Let me mention that FAD has just published a book on infrastructure governance, elaborating on successful reform strategies and practices. A public online launch of the event is hosted by the London School of Economics and the Centre for Economic Policy Research (CEPR) and is scheduled for October 2.

Mr. Rosen:

All three reports include very valuable analyses that will help contribute to future policy decisions.

We welcome the improvements to the 2020 outlook, particularly for advanced economies. In particular, the U.S. economy is showing encouraging signs of recovery, including increases in consumer confidence, a substantial decline in unemployment from the peak levels we reached during the shutdown, increases in retail sales, and a housing market that has nearly returned to pre-pandemic levels. We believe the U.S. is now on a path of sustainable recovery.

However, both upside and downside risks to the global outlook remain predominantly due, in large part, to the considerable uncertainty we are facing, as rightly pointed out by Managing Director. Pandemic risks are well documented in the WEO and GFSR. Upside risks relate mainly to the rapid global deployment of a COVID vaccine which, given the recent news on this, to us, looks increasingly likely. But as Ms. Levonian noted in her gray statement, downside risks go beyond the pandemic. The potential for no agreement on Brexit and increased geopolitical risks are a concern.

We support the bulk of the policy recommendations and reiterate the need to ensure that policy support is not withdrawn prematurely. That said, we would encourage more country-specific analyses in the advice.

As Ms. Gopinath highlighted in the presentation, China’s V-shaped recovery looks quite different from much of the rest of the world, and some emerging markets face a worse outlook than others. Therefore, we support Mr. Ray’s call for practical advice and Ms. Levonian’s request for more cross-country analyses and the identification of best practices in policy responses to facilitate tailored advice to member countries.

We welcome the extensive coverage of debt vulnerabilities in all three flagships. Providing debt relief in the near term and addressing debt sustainability must remain a priority for all of us, alongside efforts to improve debt transparency. Both private and official creditors need to move quickly in providing debt relief to those countries that are facing unsustainable debt or high risks to debt sustainability, to give space to the IMF and other international financial institutions (IFIs) to lend.

While we appreciate the staff’s analysis on lockdowns in Chapter 2 of the WEO, we echo the comments made by Mr. Merk and others, that the research presented is in its initial stages, and more work will be needed to be done before any concrete conclusions can be drawn.

On the issue of climate change, we agree with Mr. Mouminah, Mr. Bhalla, and Mr. Ray, that the timing for the proposals outlined in the WEO, Chapter 3, may not be optimal. Access to adequate finance and technology may be difficult for many countries, and the bandwidth for dealing with reforms beyond the immediate challenges of the pandemic could prove highly limited.

We support the policy proposals in the Fiscal Monitor, particularly with regard to infrastructure investments, but we do not agree that in all cases, with a focus on the need for progressive taxes, as we believe the staff should identify more general policies that can increase median incomes and reduce poverty through increases in wages to the poorest in the economy.

Finally, I would like to emphasize our point that the three flagships would benefit from greater integration and a single opening chapter. In addition, given the ongoing uncertainty, we welcome regular updates to the global outlook.

Mr. De Lannoy:

I fully support Managing Director's introduction. We issued an extensive gray statement, so let me focus on a few short points.

First of all, we agree that the global economy has gradually bottomed out since the Great Lockdown in April. The recession is milder than initially predicted, but large uncertainty and downside risks remain. A counterfactual quantitative analysis could also have helped us to better understand the positive effects of the massive policy interventions so far. The post-pandemic recovery increasingly looks K-shaped; and as Ms. Mahasandana, Mr. Ray, and others well underscored, the asynchronous trajectory of both pandemic control and global recovery makes some segments even more vulnerable, and intertemporal policy trade-offs are exceptionally important in maintaining long-term financial stability and macroeconomic sustainability.

Second, we admire the staff's approach, especially in the GFSR and the Fiscal Monitor, to outline specific fiscal policies for different phases of the pandemic and economic recovery. We agree with colleagues on the need to start implementing well-sequenced structural reforms to lay the groundwork for a strong recovery and to build a greener, more inclusive, more digital, and more resilient economy. Investments in education will also be a key precondition for productivity growth in the long run. We also agree with

Ms. Levonian that we cannot afford waiting for a postmortem assessment of the relative effectiveness of policy responses.

Third, one cannot neglect the need for fiscal consolidation and the restoration of public finance sustainability more broadly in the medium and long term, given the already record high public debt levels in many countries. The Fund's role is vital in providing well-tailored advice to countries on how to best to tackle debt burdens in a growth-friendly manner. Addressing debt vulnerabilities also requires full transparency from both creditor and borrower countries. I fully support Mr. Tanaka's point oven how to evenhandedly address these issues going forward.

Fourth, on monetary policy, we agree in principle that there is no urgent need to exit from crisis-related measures. It should remain supportive, given the subdued inflation outlook. However, the unorthodox measures taken during the pandemic should not become a new normal. The strong and prolonged policy response can have important negative side effects, which may contribute to building up systemic risks. This should have been emphasized more thoroughly in the GFSR, and more analysis of their long-term externalities and unintended consequences would be welcome.

Finally, looking ahead, policies should mitigate the emerging financial stability and debt sustainability risks. Ideally, the benefits of policies that temporarily loosen banks' capital constraints to maintain the flow of credit to the real economy should continuously be balanced against their potential risks to financial stability.

Like Mr. Fanizza, we are concerned that the gains in terms of capital buffers built during a decade of regulatory reforms may have been undone in the last six months during the pandemic. Further Fund research on the growing nonperforming loans and the role of the non-bank financial institutions in today's credit market would be welcome. In the meantime, the Fund should push financial regulators to provide adequate guidance to banks to maintain sufficiently high levels of equity and capacity to absorb shocks in the current uncertain environment.

Mr. Tanaka:

We thank staff for the set of comprehensive flagship publications, which are well focused on the analysis of the COVID-19 crisis and shed light on the over-the-medium-term global challenges, including debt issues and climate change. As we issued a detailed gray statement, I will focus my comments on the following points.

As to the economic outlook, we appreciate the comprehensive analysis. We agree with the staff's view that the global economy has started the recovery slowly. However, we found the recovery is partial and uneven, and uncertainty is exceptionally high. We appreciate the staff for answering the questions on the big difference or degree of unevenness of the recovery among countries.

According to the answers, it might be due to second quarter economic indicators, the situation of the pandemic, the impact of the following lockdown, the structure of affected industries, and the policy responses. We expect the staff to continue to analyze and monitor the underlying causes.

We welcome that the staff reemphasized the importance of multilateral cooperation, including a rules-based trading system and equitable access for affordable vaccines. We expect the Fund to closely cooperate with other organizations to contribute to multifaceted agendas.

As to the Global Financial Stability Report, we appreciate the timely topics selected. We agree with staff, that the near-term global financial stability risks have been contained for now, thanks to the unprecedented and timely implementation of fiscal, monetary, and financial sector policies, including the IMF's financing role to maintain the flow of credit to the economy. However, we took note with concern that the financial vulnerabilities and risks have increased further, stemming from the disconnects and the intertemporal risk trade-offs, which we pointed out in our gray statement. We expect the staff to continue to monitor those risks rigorously and to provide an objective analysis in a timely manner.

As to the Fiscal Monitor, we appreciate the staff's analysis on debt issues, as well as policy tracks, and necessary fiscal policies. We have a concern on the rise of the public debt level in many countries, and especially the increase in the debt payment burden of low-income countries (LICs), where fiscal space to tackle the crisis will be limited. Now it is necessary to consider the next steps of the Debt Service Suspension Initiative (DSSI). In the next step, we should take a case-by-case approach based upon Debt Sustainability Analyses (DSAs), and all creditors, both official and private, should participate in this initiative. We request staff in the World Bank to conduct robust DSAs as early as possible to enable us to initiate the next steps.

Lastly, looking back this half year, we could acknowledge the great achievements of the IMF and should also acknowledge the further sense of responsibility of the Fund based upon the precise surveillance of the flagship reports.

Mr. Bevilaqua:

The staff, once again, presents us with an outstanding set of flagship reports. The comprehensive analysis is very insightful, and the focus on the COVID-19 fallout is most welcome and is definitely appropriate. We issued a comprehensive gray statement, and I will focus here on three main issues.

First, I believe the tone from the WEO is generally adequate, underscoring the improvement in the baseline scenario, with the recession less severe than what was expected at the time of the last WEO update. At the same time, as noted in Managing Director's introduction, the recovery is immersed in uncertainty, will leave deep scars, and will take a long time to close the huge output gap that was formed this year. Upside and perhaps predominantly downside risks remain substantial. Overall, it is a well-rounded, cautiously positive tone, especially when compared to the staff's June update. However, I believe that the role of the policy response appears somewhat downplayed. The policy response is acknowledged, but it does not get the prominence that perhaps it deserves.

It is clear that loosening the more stringent lockdowns opened space for resuming activity. However, the less severe economic performance would not have taken place if it were not for the swift and remarkable fiscal, monetary, and financial policy support provided in most economies. I believe the staff's narrative here should be clear. And that takes me to my second point.

Perhaps the under-appreciation at the June WEO update of the extent and effectiveness of the policy response may have contributed to the substantial generally upward revisions of growth projections the staff is doing now. In June, we warned that IMF growth projections were being revised down by much more than the consensus view in many countries. Brazil's projections, for example, was a noticeable case, with growth in 2020 being revised by almost 4 percentage points, to a negative 9.1 percent, an enormous drop that had no comparison with what independent local analysts were forecasting and with what the leading indicators were then suggesting. I have the impression that here, the staff may have overlooked country specificities, favoring maybe a questionable top-down approach.

My third point follows from this. While it is evident that the recovery requires support, IMF advice on extending fiscal support until the recovery firms should not disregard country-specific constraints, a point more generally and properly emphasized by Mr. Rosen today. Again, the case of Brazil is illustrated. Brazil used a legal escape clause to the spending ceiling and provided fiscal support on par with advanced economies. This was vital to support companies, keep employment from collapsing further, save lives, and sustain livelihoods. But the price tag of this policy was almost 10 percent of GDP in 2020, and the public deficit went all the way this year to an estimated 18 percent of GDP, with public debt approaching 100 percent of GDP.

As the economy gradually bounces back, the right thing to do is to restore the fiscal anchor and resume consolidation, ensuring continuous confidence on debt sustainability in order to support the recovery through consistently lower interest rates across the entire yield curve.

At a moment when the economy is clearly starting to recover, my authorities firmly believe that trying to circumvent in any way the fiscal anchor--conducting extraordinary spending outside the regular budgets, for example--would have detrimental consequences and backfire in the form of a deeper and longer crisis.

I insist on this issue because we need not only to provide the right policy advice but to also get the communication right. The message coming from our flagships should be crystal clear on how to effectively support the recovery, without giving rise to any ambiguity or policy stances that may end up having results that are exactly the opposite of what will be desired.

The Chair:

I agree with Mr. Bevilaqua that we cannot get too far in emphasizing the decisiveness and the scale of action in a synchronized manner that has, relatively quickly, reversed the trend that we have seen at the start of the pandemic toward a very severe recession, possibly depression. It is important for the world to know that action has been taken decisively, and it matters. I thought we had been quite clear on that, but I am listening to Mr. Bevilaqua. Indeed, this is a message to be clearly communicated.

Secondly, on country specificity. It is not an easy task to get good, high-level advice, and then to make sure that it can be interpreted at the country level. We will work on that, obviously, by linking the flagships also to the regional updates and then to what we communicate at the country level. I am sure that we will have further deliberations in that direction.

We did say at the beginning: spend, but keep the receipts, as Mr. Gaspar repeated. Now we are saying, well, spend, but target better and think about medium-term fiscal consolidation. Therefore, the message is different now than it was just a couple of months ago.

Mr. Pösö:

We broadly agree with the WEO's assessment of the current situation and the outlook for the global economy. We have sizable forecast revisions; but this is hardly surprising, considering the extreme shock the global economy has faced, which I would compare to an earthquake of a magnitude 9. Revisions are a healthy sign that the staff is closely monitoring the pandemic and dynamically incorporating new information. With the current tremendous uncertainty, the assumptions of the trajectory of the virus and the pandemic are also susceptible to change.

The first chart in Mr. Gaspar's prerecorded presentation on the mounting debts are telling. Total global debt was at a very high, if not at the record level already before the pandemic, as both private and public debt have risen across regions. Much of the increase in public debt this year is a natural consequence of countries' much needed fiscal response to the pandemic. In addition, the Fiscal Monitor makes a convincing case for public investments, but the growing debt stocks are worrisome. We are putting a heavy burden on future generations; and the burden is likely to get heavier, as medium-term growth is projected lower and downward revisions to potential output imply a smaller tax base. I fully share Mr. Gaspar's emphasis on strong public financial management practices and institutions.

Potentially adding to the debt burden is the downward-trending inflation, an issue highlighted also by Mr. Fanizza in his gray statement. As shown in Ms. Gopinath's presentation, inflation has fallen both in advanced economies and the emerging market and developing economies, excluding LICs.

I note that advanced economies are in deflationary territory when we look at the headline inflation. There is a risk that the low demand pulls, like gravity, inflation further down. Lower inflation means higher real interest rates and a higher real value of debt. With limited monetary policy space, such a scenario is scary.

Speaking of policy space, the report notes that in the downside scenario, emerging market economies are more negatively impacted than advanced economies, given that limited fiscal space constrains their ability to support incomes. Many advanced economies are facing a zero lower bound and must resort to unconventional monetary policy measures or negative rates in order to ease further. I was wondering if differences in the policy space between emerging market economies and advanced economies are perhaps less clear-cut when it comes to monetary policy. Staff's comments are welcome.

Lastly, the developments in real interest rates and the real value of debt have implications also for financial stability. Mr. Adrian's presentation showed many interesting developments; one of them, that corporate debt and corporate defaults are expected to rise. As we also heard from Ms. Gopinath, so far, bankruptcies have not really gone up that much, owing to substantial policy support. If countries will have to cave in and scale back support due to approaching fiscal constraints, bankruptcy rates could rise rapidly. How much is this risk factored in in the staff's overall assessment of banks' vulnerabilities? Are the banks forced to considerably tighten their lending standards, soon? Recent data from the United States looks worrying in this respect.

Mr. Mouminah:

There are three points and key messages that we want to emphasize.

First, on debt, everyone who spoke before me spoke about debt. While fiscal policy has significantly been helpful in minimizing the COVID-19 impact on households and firms, debt levels have increased substantially. Many countries have used all their fiscal firepower during the first phase. Deficits are becoming larger but cannot be sustained for long at that level.

As we move forward, policymakers will face difficult trade-offs between supporting the recovery and pursuing procyclical consolidation to avoid excessive debt, especially as they unwind support, as mentioned by Mr. Gaspar in his presentation. In this regard, the IMF's analysis should provide practical recommendations that can help countries to better distinguish between a short-term liquidity issue and long-term solvency issues. The advice on the composition of the fiscal adjustment should also be granular, taking into account country-specific circumstances. We also need to ensure clear communication about our policy advice on fiscal policy, as it could have profound implications on countries' debt sustainability down the road.

That brings me to the second point, on the importance of looking at fiscal multipliers to help support the recovery. We very much welcome the Fiscal Monitor's work on the fiscal multipliers and take note that a number of factors, including high debt and continued uncertainty, could change the fiscal multipliers. We, therefore, encourage the staff to frequently update their analyses on this front, given its high relevance to promote stronger recoveries. This is also extremely important, given their impact on containment measures, on the labor market, and, specifically, on women and youth, as we heard. So, policymakers need to prioritize accordingly.

Finally, the G-20 energy ministers met virtually two days ago, where they reaffirmed their commitment to ensure that the energy sector continues to make full and effective contributions to overcoming COVID-19 and powering the subsequent global recovery. They endorsed the circular carbon economy platform and its four Rs framework, which is: reduce, reuse, recycle, and renew. In this context, we encourage the staff to take this into account prior to the publication of the flagship reports, given that it builds on the concept of using multiple tools to combat climate change, rather than focusing on one, which was highlighted in Chapter 3.

We also share the views expressed by Mr. Rosen, Mr. Bhalla, Mr. Tanaka, Mr. Ray, Mr. Bevilaqua, and others, on the need to consider the fiscal implications of the staff's recommendations on climate change. Here, we express the importance of taking into account countries' priorities and circumstances, especially the macro-criticality of climate change in the immediate future.

One issue that I want to highlight is on the overall communication of the IMF on the efforts of global cooperation. We should continue to advocate that we are in this together. We can only get out of this if we work together.

Ms. Levonian:

Let me start by saying that the timing and pace of the recovery do not seem much clearer to us today than they were in April, and Ms. Gopinath certainly mentioned that. In Canada, we are currently deciding whether or not we will need to impose a second lockdown, given a surge of infections and winter is coming.

For the foreseeable future, our policy actions are likely to continue to be dictated by the path of the virus and a "by any means necessary" approach to the policy response. But we should also be looking ahead, as has been said, to those policies that will support a green and sustainable recovery, and we very much appreciate the flagship's focus on this theme.

Since we issued a comprehensive gray statement, my comments are really going to rely mostly on the astute observations of my esteemed colleagues.

First, like Ms. Riach in her gray statement, we were somewhat taken aback by the assumption in the WEO that the acute phase of the pandemic will last until the end of 2022. To us, this formulation means that the pandemic could, in fact, peak at the end of 2022. We also wonder whether the wording needs to be revised here to avoid having this assumption steal the headlines.

Ms. Gopinath's presentation touched on a rise in new trade restrictions, which serves as a reminder that the Fund needs to stay vigilant in its call for free and fair trade. Like Mr. Inderbinen said in his gray statement, we need to resist the temptation of deglobalization.

Ms. Gopinath also highlighted the growth divergences between advanced, emerging, and developing economies, which will be a setback for income convergence and will exacerbate global inequalities. In that vein, Mr. Merk's gray statement reminded us that the impacts of this crisis are falling disproportionately on women. This is a theme that could have been more prominent.

The Fund's greatest comparative advantage in this crisis is multilateral surveillance and, in particular, the ability to provide analysis on cross-country policy experiences. We see this as the next incarnation of the COVID-19 policy tracker. This will be important to those members who do not have the fiscal space or market access to mount a decisive fiscal response and those who are forced to do more with less. We saw some of this analysis in the Fiscal Monitor, which we thought was an excellent start.

We welcome the assessment of trade-offs in Mr. Adrian's presentation, which was a pragmatic way to approach our advice to policymakers. It highlights, the decisions today will make for harder decisions potentially tomorrow; for example, when it comes to providing liquidity support or allowing banks to eat into their buffers. This theme of policy trade-offs could have been carried through the document.

The Fiscal Monitor highlighted the role of investment in a green and sustainable recovery. We agree with Mr. Gaspar that the macro conditions are ripe for such investments. Here, we would also echo Mr. Rosen on the importance of selecting high-quality projects in countries so that we could reap the expected returns.

Lastly, we welcome the emphasis on the role that a push toward net zero emissions by 2050 could play in the recovery. Like Ms. Riach, we see this as a win-win scenario.

Mr. Jin:

The flagship reports serve as timely and useful guidance to help policymakers navigate through these difficult times.

Let me first report, one month ago, I went back to China for about five weeks. I spent more than a week to travel to Shanghai first on the east coast and one of its neighboring towns and went to Chongqing in the southwest and one of its neighboring towns. I then sailed through the famous three gorges along the Yangtze River by taking an airplane, high-speed railway, buses, taxis, and cruise ships. I purposely arranged this travel, completely private, by using apps on my cellular phone to book the transportation and accommodations. Based on my firsthand experience, I would like to share some of my observations and thoughts with the Board.

First, strong efforts are needed for both containing the virus and supporting the economy simultaneously. The two fronts are equally important. Countries can draw experiences and lessons from each other. Due to diverse cultural and economic backgrounds, there may not be a one-size-fits-all best practice across countries. But a general observation is, countries could avoid a blanket nationwide lockdown based on scientifically stringent monitoring, tracking, and rapid response, with limited and well-targeted local lockdowns, if necessary.

The relationship between virus control and the economic recovery is not necessary a trade-off, especially in the medium- and long-term. In fact, the more effective in combatting the virus, the more likely the economy will recover smoothly. The Fund has a lot to contribute in this area through conducting topic surveillance, sharing and distributing useful practices through technical assistance and capacity development.

We are also facing a worldwide challenge, how to closely monitor the virus and other damaging elements and, at the same time, protecting individuals' privacy and national security. I believe multilateral institutions can play a key role in formulating international best practices and codes of conduct in this area. I believe we should strive to emerge from this crisis with more mutual understanding and unity than before.

I fully support the management and the staff's call for a green recovery and growth and support the Fund's work on climate change.

Currently, China's per capita carbon emissions remains significantly lower than many advanced economies, but we are fully aware of the fact that, due to our large population, the aggregate number of emissions is quite phenomenal. Our president announced recently in a U.N. conference that China would reach peak emissions by 2030 and achieve carbon neutrality before 2060. This was praised by a Financial Times article as a big leap forward.

In most cases, science and technological achievements or advancements are equivalent to green development because it can help to increase production efficiency and reduce input and waste emissions per unit, and that is the sense of green development. In this regard, the international community should encourage, facilitate, and protect a greater sharing of scientific knowledge, experience, and new technologies across countries.

Finally, we have a few specific comments on the GFSR's discussion on China, which we will raise bilaterally with the staff to provide a more accurate assessment of our situation and the pandemic response.

The Chair:

I also want to recognize that the net zero commitment announced brings a very welcome new direction for the Chinese economy and China's commitment to climate action.

Mr. Buissé:

I really deeply appreciated the attention to both short-term and longer-term issues, which raise very interesting points of policy trade-offs, as

Mr. Gaspar eloquently said. We published an extensive gray statement, so I would like to limit myself to a few comments.

First, regarding the global scenario, we really hope the worst is behind us, although we should not let our guard down, of course. A recovery will take time.

On the euro area, we welcome the upward revision for 2020, which is now more in line with our own forecast, already in June. However, my authorities do see also a higher rebound in 2021, in particular, thanks to the powerful stimulus plans. One question could be of interest; could the staff provide its analysis of the recent euro dollar movements and, going forward, the potential impact on the euro area's growth? We see a number of risks to the baseline, of course, like staff, and, in particular, significant risks associated with an early removal of support and with a disconnection between the financial markets and the real economy. There is a clear need to closely monitor financial stability, in particular, in the non-banking financial institutions.

Second, I think it is very important to continue to work on the hysteresis effects of the crisis, which remain unclear. I see two lines of work. First, the staff should develop more sectoral analyses and recommendations on the reallocation effects, both regarding jobs and companies. Second, we encourage the staff to dig deeper on the distributional impacts of the crisis, given the huge negative impact on poverty and inequality.

Third, there is no doubt on the need to continue for now our accommodative policies. Growth should remain our primary objective, as consolidation efforts will not be able to be sufficient alone to tackle the debt challenges in the long term. As fiscal space becomes more limited, however, we also need to better target our policies and ensure efficiency. What would be very helpful would be for the staff to develop a granular analysis, which would outline what would be the best type, calibration, and sequencing of policy support. It would be irrelevant, of course, to try to propose a calendar for the various phases of the policy support, but it would be useful to think hard about the preconditions needed to move from one type of support to another phase.

Fourth, while we are in the midst of the crisis, we need to remain alert on long-term challenges. Climate change is macro-critical, and the spillovers from domestic actions to fight or not to fight climate change are extremely large, simply because the molecule of CO2 travels everywhere.

To quote the MD: "If you don't like the pandemic, you are not going to like the climate crisis one iota." I could not have said it better.

Moreover, the sizable long-term GDP gains of decarbonization presented in the documents speak for themselves. Let us be clear: The reverse is also true. No decarbonization efforts mean major hits on the global GDP. I commend the staff for scaling up their work over the last years, and we encourage them to continue.

In the short-term, climate policies can also support the recovery with job opportunities. We also need to be conscious of the potential negative effects the reallocation costs of these policies can have. We would be interested to hear from staff on how to integrate the social support needed in the fiscal trajectories.

The Chair:

I want to recognize the efforts that have been made to look at the opportunities for a job-rich recovery, based on decarbonation, combined with, what are the distributional issues, and how to make it a just recovery. In that sense, Chapter 3 of the WEO, that is going to come to the public, is a very good, comprehensive approach to these trade-offs that have to be made and how to optimize the efforts.

Ms. Mahasandana:

Overall, we broadly agree with the staff's economic assessments and policy recommendations. We also want to underscore that, in the Fund's agenda to catalyze a resilient global economic recovery, it will be important to leave no one behind. Countries are in varying stages of crisis, and their roads to recovery will be different. As such, the Fund must continue to tailor its policy advice for each member country. In doing so, we view that two-stage policy recommendations--dealing with the lingering pandemic crisis in the near term, and promoting smart, green, inclusive, and resilient growth in the medium term--lay a good foundation for the Fund to further share its policy advice to country-specific circumstances and needs.

In our gray statement, we discussed in detail the various policy priorities in the near term and medium term. For this meeting, I want to bring up three areas of work where we view the Fund should prioritize in assisting its members.

The first is in navigating the low-for-long environment. The Fund must continue to sharpen its policy thinking to deliver actionable advice that can help member countries address the challenges arising from the capital flow volatilities and rising financial vulnerabilities from unprecedented monetary easing on a global scale. The Integrated Policy Framework (IPF) offers important lessons for the Institutional View. We encourage the staff to incorporate the recent findings of the IPF into the Fund's policy advice. Like Mr. Jin, we encourage the staff to closely monitor the spillover effects from advanced economies in their surveillance work.

With regard to emerging markets' recent ventures into the realm of unconventional monetary policy, the risk management of central banks' balance sheets and the strategy for pursuing measures like asset purchase programs will be crucial. In this regard, we encourage the Fund to engage and assist emerging market authorities with their asset purchase programs to improve policy outcomes and design appropriate implementations, as well as exit strategies, when conditions permit.

The second area is the elevated public and corporate debt levels. Sovereign debt management and restructurings, as well as debt transparency, prudent fiscal policy and fiscal reform are all crucial for medium-term debt sustainability. On corporate debt, as noted by many Directors, addressing corporate debt overhang will be particularly important for the recovery ahead. Here, we reiterate that the Fund can play a role in supporting members in dealing with debt overhang and facilitate a corporate debt restructuring, including through its policy advice and technical assistance. In this regard, we hope to see the staff's thoughts on the Fund's role during the informal Board briefing on corporate insolvency and debt restructuring later in October.

Finally, the third area is on the longer-term challenges, especially the potential scarring effects from the pandemic and the transformation of the economic structure that may entail. The Fund's policy advice on how member countries should address the long-term challenges in their country's context is something we hope to see further work on going forward.

Mr. Bhalla:

We broadly agree with the reports' assessments of prospects, risks, and policy advice. We have issued an extensive gray statement, so I will confine myself to only two points.

First, on the impact of lockdowns, we note that the staff's growth forecasts for global as well as individual countries are necessarily conditional upon assumptions for the speed and extent of the pandemic spread and the expected recovery path. Therefore, it is critical that our assumptions and understanding of the pandemic is consistent with the underlying reality.

The report makes two important conclusions regarding lockdowns.

First, the imposition of a stringent lockdown when the number of COVID infections is low is successful in containing the spread of the pandemic. We observe that this conclusion is not adequately supported by the data, nor by robust statistical evidence.

The second lockdown conclusion is that more stringent lockdowns entail only modest additional economic costs. This inference does not seem to be fully supported by the empirical estimates. The estimates indicating the size and significance of coefficients are not presented in the report. This would have been useful to support the controversial conclusion.

My second point relates to the observation that the pandemic has created an opportunity for employing greener technologies to achieve a decarbonization of the world by 2050. It is important to note that neither the United Nations nor the Paris Agreement talk about the term "decarbonization;" hence, any advocacy of a new term which is not multilaterally agreed upon sends a wrong signal.

While we appreciate that it is an opportunity to move toward the goal of climate change, any proposed strategy which is completely devoid of a discussion on climate finance is likely to be a nonstarter. Article 2 of the Paris Agreement brings in sustainable development, poverty eradication, and the very basic tenets of equity as the overarching pillars for low emission pathways. The availability of adequate and predictable climate finance for developing countries holds the key to the successful implementation of climate actions. The time has come. The call for climate actions should set in motion a serious discourse on climate finance required to take climate actions effectively. However, the report is silent on this important point.

Lastly, I would like to inform the Board that some recent research indicates that India is among the very few countries in the G-20 whose actions are 2° C compatible, while most others are nowhere near this target. As a result of India's multiple mitigation actions, the emission intensity declined by 21 percent between 2005 and 2014, much ahead of its voluntary target set for

2020. India has also set an ambitious target of reducing the emissions intensity of its GDP by a third by 2030, from its 2005 level.

Mr. Merk:

We share the staff's assessment of the near-term global economic outlook. That said, the IMF forecasts might even still be a bit on the cautious side, so I only refer to the first half of a sentence we often used in the past months: Let us hope for the best.

For Germany, the upward revisions to the economic outlook and the benign prospectus for the labor market are in accordance with the recent positive surprises of incoming data.

As other Directors, we agree that the extensive policy measures by monetary, fiscal, and prudential authorities have importantly helped to maintain the flow of credit to the real economy and avoid adverse macro-financial feedback loops. Similar to the analysis in the GFSR, we find that the German banking sector overall is resilient and should be able to cope, even with very adverse scenarios.

Fiscal policy will remain a crucial and powerful tool to foster and shape the economic recovery. To recover from the crisis, Germany will, in a sustainable manner, continue to provide all the fiscal support needed. Once the recovery is firmly on track, governments should gradually shift from crisis management to high-quality fiscal consolidation, considering often high levels of debt. The pandemic has, once again, proven the importance of building up sufficient buffers in good times to increase resilience.

Lastly, the crisis provides an opportunity for transformative measures to foster growth and sustainability. Public investment programs in infrastructure, green mobility, energy transition, and digitization should set incentives for and crowd in private investment.

Ms. Riach:

As we said in our gray statement, this is a moment in time when making sense of the global outlook and providing pertinent policy advice is both more challenging and more important than ever. These reports do a good job of interpreting a complex and increasingly divergent global picture.

As others have said, the outlook remains daunting, and enormous uncertainty prevails. Many countries have made progress from the containment phase of the pandemic toward stabilization, but resurgences in the pandemic are unpredictable and are likely to warrant a future tightening of public health interventions, with economic consequences. I, therefore, join Mr. Bevilaqua in emphasizing the absolutely crucial role that the extraordinary policy response has played so far in mitigating the economic consequences of the crisis.

As we move into the next stage, policymaking will need to be nimble, and policies will need to be fine-tuned as the challenges evolve.

Fund advice has a crucial role to play in sharing best practice and supporting authorities in considering how to calibrate and sequence their policy response. I very much support Mr. Buissé's comments here.

Like other Directors, we welcome the emphasis in the flagships on the importance of tackling debt challenges. I agree with Mr. De Lannoy, that addressing debt vulnerabilities requires full transparency from both debtors and creditors.

We welcome the emphasis throughout the reports on the scale of the challenges faced by low-income countries. The projections on the number of people falling into extreme poverty are both striking and saddening. And even above the extreme poverty threshold of a $1.90 a day, populations are experiencing falling incomes and precarious circumstances. We, therefore, believe that tracking data on income impacts more broadly than the extreme poverty line will be important.

Turning to the United Kingdom, we broadly share the staff's assessment of the situation. The necessary introduction of public health measures in the first half of the year led to the largest fall in U.K. GDP on record. While the impact was not as severe as the initial forecasts suggested, the latest data points to a recovery having taken place in the third quarter. The recent uptick in infections and the associated tightening of restrictions means that there is considerable uncertainty over prospects for growth in the rest of the year. On that basis, we agree that the hit to U.K. GDP continues to look severe, as it does for other advanced economies. We note that the forecast for the U.K. is broadly in line with the consensus of independent forecasts.

Last week, the U.K. government set out a new fiscal package to support the economy in the next stage of the crisis. The targeted package of measures is designed to support jobs and business through the winter months and includes a new job support scheme, continued VAT reduction for the retail, hospitality, and ledger sectors, and a further £23.4 billion investment in public services.

In response to the pandemic, the Bank of England has taken a number of actions to ensure that the financial system can safely continue to serve the U.K. economy and provide credit, including supporting market functioning. It has released the countercyclical capital buffer and encouraged banks to use their capital buffers, which exists precisely to allow banks to absorb losses in periods of stress and continue lending. A desktop stress test exercise in May illustrated that banks were more than adequately capitalized to absorb the pandemic shock.

I recognize comments from a few Directors on the risks associated with the potential for no agreement on Brexit. The United Kingdom continues to seek a relationship with the European Union, which is based on friendly cooperation between sovereign equals and centered on free trade. But on 31st of December, the transition period will end, and there will be a guaranteed series of changes to the U.K.'s relationship with the EU. Many of these changes will be required, regardless of the agreement reached with the European Union on the future trade relationship because the United Kingdom will be leaving the single market and the customs union.

Authorities in the U.K. and the EU are making preparations to ensure that businesses and individuals are fully prepared for the end of the transition. I hope that the Board will have the opportunity to discuss the United Kingdom Article IV report before the end of the year. I am sure that we will have the opportunity to return to this issue then.

Like Mr. Rosen, we would have appreciated greater integration among the flagship documents, and we continue to favor a single overview summary document for the flagships. I very much welcome the Managing Director's remarks today, recognizing the importance of more frequent updates in a period of such enormous uncertainty. As mentioned by Ms. Levonian, we remain concerned that the language on the acute stage of the crisis risks generating unwelcome headlines. We ask that staff consider the presentation at this point.

Mr. Beblawi:

We broadly share the staff's outlook on the risks. We welcome the upward revision, which reflects the effectiveness of the bold actions taken. We hope for a more optimistic scenario than the baseline, with good news on a vaccine or treatment.

We welcome more specificity in a few areas of Fund advice, like Mr. Ray and Mr. Buissé. Given the high uncertainty and the possible setbacks, the flagships provide the right overall message.

Well-targeted support should continue in the near-term and should aim to build more resilient inclusive economies. Building resilience calls for continuity in strengthening the healthcare system to protect the vulnerable sectors, prevent a larger rise in poverty, while limiting rising debt vulnerabilities, a difficult trade-off, especially for developing countries, as noted by Mr. Chodos.

Fiscal policy will need to do more with less. The Fund will need to continue to support the membership in achieving debt sustainability and reducing inequality.

Monetary accommodation and liquidity support need to continue, while closely monitoring the rising risks to financial stability and banks' use of available buffers. Like Mr. Rosen, we see a premature withdrawal of support as a risk to the global recovery. The risk of rising insolvency and an increase in corporate bond defaults need to be carefully monitored. The global bank stress test was a useful exercise and should continue.

We jointly call for stronger multilateral cooperation to deliver an affordable vaccine worldwide and to support open trade.

Much more is needed to provide adequate financial support to low-income countries at this critical time. Emerging and frontier markets also face acute financial constraints, and nearly half of emerging economies and low-income countries face debt distress and may require official support.

The Fund's toolkit will also need to adapt to meet these challenges, including the allowance for an augmentation of access. Developing countries should also provide adequate financial resources to assist the developing countries to meet the cost of climate change adaptation, as noted by Mr. Mouminah.

It is generally too early to prescribe post-pandemic policies and to know what makes sense for each country; but we agree that for some countries, a reallocation of resources may well be needed, which would entail a retraining and reskilling of workers. We support the call for investing in a green economy.

Mr. Kaya:

On the World Economic Outlook, we broadly share the thrust of the staff's assessment of the outlook and support the policy recommendations. Key to the relevance of the fall WEO forecast is to adequately capture the strength and durability of the initial recovery momentum we have observed in the third quarter. We concur that a potential resurgence of the pandemic in many countries constitutes a major risk, particularly in case of a delayed launch of an effective vaccine and/or treatment, as the economic prospects are intertwined with the prospects of a medical breakthrough. Therefore, we cannot emphasize enough the importance of multilateral cooperation in the healthcare area. No one will be safe unless everyone is.

On the balance of risks, the staff's scenario-based approach continues to be adequate, vis-à-vis the degree of uncertainty facing the global economy. Inevitably, the attention of the markets will be on the downside scenario, which is, indeed, quite a possibility. Here, we are worried that the adverse market reaction could be more severe than implied in the WEO, reflecting the persistent disconnect between market valuations and the underlying economic fundamentals.

Beyond the immediate forecast horizon, we are also concerned about the risk that the pandemic will leave protracted scars on the growth potential. Particularly worrisome is the trend in productivity growth, which has already been sluggish since the global financial crisis.

On the policy responses, we broadly agree that fiscal policy should remain supportive and flexible, where fiscal space exists, and that countries should use their fiscal space efficiently to support health-related priorities, mitigate the effects of the pandemic on supply and demand, boost confidence, and support a more broad-based, inclusive, and greener recovery.

The proposed fiscal road map for the recovery rightly attunes the use of all available fiscal tools to the three phases of the pandemic. Going forward, it is essential that countries slowly unwind the untargeted measures and channel those resources into more productive and growth-inducing areas.

Finally, on the financial markets' risks, we note that the downside is largely contained by the regulatory macroprudential and fiscal policy responses. However, these massive policy stimuli cannot be the new normal. The financial sector's regulatory overhaul after the GFC is now being put to the test, and we should allow the buffers and business continuity plans to take effect, further mitigate the adverse feedback loop between the corporate and financial sectors. It will be critical to monitor the corporate sector's recovery and strengthen the insolvency frameworks, which would help banks to recover their distressed loan portfolios. Structural changes in the banking sector, owing to lower-for-longer market conditions, digitalization, and competition pressures from non-banks will require continued supervisory vigilance going forward.

Mr. Mahlinza:

We thank staff for the comprehensive set of reports, the succinct presentations, and the detailed responses to the questions raised by Directors. We found the reports and the Analytical Chapters very informative. We would concur with Mr. Rosen and Ms. Riach, that a single overview report, pulling together the messaging from the three flagships, could have been more beneficial. This would have been more important under the current circumstances as we deal with the COVID-19 pandemic.

We also appreciate the spotlight on poverty and inequality issues in the reports. Like other Directors, we are concerned that the crisis threatens the progress made in reducing global poverty and inequality in the past decades. We see this issue taking center stage in international development discourse going forward and would urge the Fund to continue to pay close attention. For us, this crisis has also underscored the need to carefully balance and sequence targeted policies at the national level. At the same time, we concur that a carefully calibrated withdrawal of policy support to foster a sustained recovery is warranted.

We also welcome the focus on public debt developments, particularly the elevated vulnerabilities among low-income developing countries (LIDCs). We are concerned that the pandemic has resulted in a sharp rise in financing needs for emerging and frontier markets, which may tip a few into debt distress. In this context, we agree with staff that debt restructuring may be necessary to place debt dynamics on a sustainable trajectory, including in the post-pandemic period. We would also emphasize the need for enhanced creditor coordination, together with the gradual implementation of structural reforms necessary to anchor a sustainable recovery.

We broadly welcome the staff's analysis on the near-term global financial stability risks and concur with the proposed policy priorities to support countries in the subsequent phases of the crisis. We share the concerns by Directors on the erosion of bank capital buffers and the elevated vulnerabilities in the non-bank financial sector. We believe this is a real and important challenge for LIDCs, given the increased government borrowing in this sector. In this context, we underscore the importance of strengthening the regulatory framework for non-banks and intensifying prudential supervision to moderate excessive risk taking.

On the Fiscal Monitor, we welcome the recognition of the differences in the ability of countries to respond to the crisis. For many LIDCs, financing has been a binding constraint, while domestic revenue mobilization efforts have been compromised by the disruption in economic activity. Nonetheless, countries have implemented bold fiscal responses to protect lives and limit scarring. Like Mr. Raghani and Mr. Bevilaqua, we agree on the need to assess the benefits, costs, and risks of measures to address the crisis. Looking ahead, we also agree that fiscal policy will be important in fostering recovery and, therefore, support the use of flexible fiscal measures to navigate through the different pandemic phases.

Finally, in view of the increased financing constraints in our region and the need for increased post-pandemic public investment to support the recovery, we want to underscore the importance of an international response to support the recovery. Here, we also want to emphasize the need to enhance capacity development efforts, not only to ensure the efficiency of investment projects but to foster fiscal sustainability and facilitate the achievement of the Sustainable Development Goals (SDGs).

Mr. Ray:

I would like to acknowledge the 189 country teams that actually build the forecasts from the bottom up. I think sometimes we forget that it is a very broad exercise.

Whenever I come to the flagships, I keep asking myself and staff: who is the intended audience? I would argue that, particularly in a time like this, we should be aiming to inform and influence policymakers, preferably directly, but if not, then at least through the most senior officials and advise them. These documents are simply too dense, complex, repetitive, wonky, and wordy to do that. No minister that I have worked with has the time to wade through this amount of material and neither do senior officials. I certainly did not when I was working as a deputy secretary. In this regard, like Ms. Riach and Mr. Mahlinza, I strongly support Mr. Rosen in his call for a single overview document and greater integration among the documents.

I really like the shorter chapeau focus of the WEO update in the middle of the year. It is a document that I could take to a senior official and ask them to read. And it was an excellent document.

That said, on the GFSR, because central banks are so well resourced, there is probably a more ready readership for the GFSR.

I think the area that is particularly valued by the membership is the forecasts. They are a global public good. As we have discussed before, given the significant uncertainty, they are bound to be out of date before they are published. And we should not be shy about that, and we should not have any real concerns. But it does mean, as Mr. Kaya said in his gray statement, that we should stand ready to update the forecast as new information comes to hand. Indeed, there might even be a case to move to live forecasts, particularly for those members who are likely to be coming to the Fund for UCT programs. We really need to have those programs based on the most up-to-date view.

On a parochial thing, many of the smaller members of this constituency value the focus of their own countries because they use those forecasts directly in their budgets because the Fund has the resources to do the forecasting for them, which is very valuable.

Turning to the policy advice, we are at a critical juncture of the crisis. As several colleagues have stressed, the outlook, while it is less daunting than it might have been a few months ago, it is still incredibly daunting. And that is despite the extraordinary policy support that has been put in.

Looking ahead, I very much agreed with Ms. Mahasandana's emphasis on the low-for-long interest rates.

On monetary policy, we would welcome more analysis on the use and implications of unconventional monetary policies, particularly where these are being used much more widely. Mr. Mozhin, in his gray statement, set out a few good issues worthy of consideration. Mr. Adrian glossed over, in his opening remarks, the intertemporal trade-offs here. Those are going to be very challenging.

On fiscal policy, most of the authorities in this chair are really wrestling with this at the moment, both on strategy and measures. On the one hand, we need to urge members to stay the course on fiscal support, but we also need to assist them to transition to supporting a reallocation of capital and labor. As I said in my gray statement, this is really tricky, even if we knew where we were going; and we do not actually know where we are going. So it is hard. And it is an area where Fund staff can really provide some value-added.

On debt burdens, I am probably in a camp which says that a lot of the rise in the debt burden has been in advanced economies, where we might not need to worry about it just at the moment. The focus should be on dealing with the crisis at hand, and then we might have to come back to debt later, because the cost of not protecting our people is going to fall on the young as well. And one can think about the impact that that is already possibly having.

As we move forward, it does start to look as if we might be moving into a more standard, if very deep recession. And here, I think the questions that a number of colleagues have asked around scarring are really pertinent. I support the idea that we need to do a bit more work on that.

In this chair, many members are facing the prospect of a lengthy period of having their borders closed to protect their people and their health systems. Those that are tourist-dependent are going to probably require a few more innovative and practical policy solutions. We asked a question on this and the staff answered it; but the answer was a bit standard.

The challenge is: if one is aid-dependent, then infrastructure is not the answer, and so on. This is an area where many countries in this chair and elsewhere are going to need help, and I would encourage further work on that.

The Chair:

I want to start from the innovation of presenting the substance in the prerecorded messages, which is here to stay.

When we come to the tightness of the report, we had a very extensive debate with very different views. In the end, what prevailed was the understanding that, while the policymakers want it dense and short, those who are working, wrestling with these issues want to not only know what but also how we got to it. Therefore, we leaned back to a more comprehensive report. It is an open question though, so we still need to think how to come to a better place. In the Global Financial Stability Report, we are trying to find a middle ground by having a tight, illustrative, and rich summary, and then having a lengthier report. Maybe this is the path to follow.

There is a lot of merit in having one integrated summary. To be fair to the teams, it is a very pressing moment. We are asking not only to do that work but also to provide support to countries. This crisis is demanding a lot from us. It is not an excuse for why there is not one integrated summary of the three reports, but it is an explanation as to why this time we are not doing it. Again, keep pushing us. We want to be as useful to the membership as possible.

I could not agree with you more on the small tourism-dependent island states. We do need to think about the way in which we can financially support highly vulnerable countries that are not low-income countries but are extremely severely affected by this particular shock.

Mr. Inderbinen:

We broadly share their assessment. I would just like to add a couple of points at this stage.

I would first underscore that striking the right balance between lessening the immediate impact of the COVID-19 shock, on the one hand, and addressing medium-term challenges on the other remains the key challenge for policymakers at this juncture. We note that several of staff's recommendations, such as the call to repair balance sheets and to eliminate labor market rigidities, target issues that are being exacerbated by the crisis but predate the pandemic. And policy interventions now should support the transition to more competitive and productive economies over the medium-term. In this sense, the crisis can be seen as an opportunity for a more effective resource allocation and for increased growth going forward.

Relatedly, looking at the high public debt levels and the worries about debt sustainability that many others have commented on, fiscal support measures should best be accompanied by a clear communication on medium-term strategies to put public finances on a sound footing. And I would like to add that credible medium-term consolidation strategies do not in any way speak against the need to avoid an earlier withdrawal of stimulus in the short term that was emphasized by Mr. Gaspar in his opening remarks and also alluded to by Mr. Ray; but it does speak to the argument that Mr. Bevilaqua was making earlier, on getting communication right, as well as to Mr. Merk's point on the importance of having buffers.

We agree that monetary policy should remain accommodative in the short run but would also stress that we do not lose sight of possible side effects. I do agree with Mr. De Lannoy, that the risks associated with such side effects could have been brought out a little bit more forcefully in the GFSR.

Normalizing monetary conditions in the medium-term without causing severe market disruptions will, in any case, be a challenging task going forward.

Lastly, like Mr. Tanaka, Mr. Mouminah, and others, we would like to emphasize that dealing with a global shock calls for global cooperation, in which the Fund has a central role.

Mr. Lischinsky:

A modest improvement in the outlook justifies cautious optimism about the room for policy options that the reports analyzed in depth. However, we should expect a prolonged uncertain environment because of the unpredictable path of the pandemic, undetermined adjustment costs of the economy, and the unknown effectiveness of policy responses. As we have said before, the Fund is to be commended for its rapid response to emergency requests, flexibility to adapt its toolkit, and the continuous provision of advice in different formats. The Fund's advice will be fundamental to guide difficult decisions by policymakers facing complex dilemmas.

We would like to highlight the policy issues that were raised in our gray statement for emphasis.

First, all countries have a collective responsibility to prevent a dramatic setback of potential output, including efforts to avoid a dramatic erosion of human capital that may compromise the standards of living for generations, setting back the progress made in reducing global poverty and lowering inequality.

With regard to the erosion of human capital, I should mention that visas to highly qualified Argentinean professionals are being offered in local newspapers by some advanced countries, repeating what they have made during the 2001-2002 crisis in Argentina.

Second, a strategy to expand the social safety net is more urgent than ever to preserve employment and protect the vulnerable.

Third, countries should adapt policy frameworks to support the economy, keeping a focus on how to return to a path of stronger, equitable, and resilient growth, avoiding the premature withdrawal of supportive measures. In all these areas, the Fund's advice will be needed.

On fiscal policy, we fully concur with the near-term priorities raised by Mr. Gaspar in his presentation and with the need for institution building. It is imperative to create room to meet crisis spending needs; namely, health and education spending, as well as supporting the most vulnerable sectors of society. Avoiding a premature withdrawal of the stimulus that we support will be particularly challenging for emerging markets, for which fiscal space is rapidly narrowing. Public debt has significantly increased this year, complicating the margin for maneuver, especially for countries with significant debt legacies. Rising private sector debt entails additional concerns, including the risk of the migration of debt from the private to the public sector. A continuous assessment of fiscal instruments and policies by the Fund will contribute to timely decisions before fiscal sustainability is significantly compromised.

On monetary and fiscal policy, the trade-off between accommodative monetary policy and the buildup of risks has led to the accumulation of vulnerabilities. However, there is no alternative than maintaining an accommodative stance, given the urgent need for stimulus during the recovery, as highlighted in the GFSR. On the positive side, market stress has been contained, thanks to central bank programs to support liquidity and Fund-Bank lending complemented by government guarantees and the implementation for the first time of asset purchase programs by some emerging economies.

In addition, many market economies maintain the stock of reserves without resorting to the disruptive use of capital controls, instilling confidence in financial markets. These measures have prevented the procyclical behavior of credit and liquidity shortages, helping to contain solvency risks, particularly in small and medium-sized enterprises. However, defaults are likely to increase as non-performing loans materialize, coupled with a reduction in banks' capital buffers. We agree with the staff that regulators should use their room for flexibility while maintaining best standards in transparency and supervisory practices.

For the medium-term, we count on the Fund continuing to provide high-quality analyses to understand the gravity of the crisis as it evolves, making sensible and timely recommendations, including through capacity development and providing the needed financial resources to countries that request it.

As underlined in our gray statement, medium-term policies should include sustainable and growth-supportive fiscal policy, raising public investment efficiency, removing lingering trade policy uncertainty harmful to growth, and ensuring multilateral support in main areas. In this regard, fighting the health crisis should continue being the first priority. Efforts to manage debt sustainability in a comparative environment, as currently under the DSSI, should continue with the involvement of all relevant parties.

Finally, countries should aim at planning for a post-pandemic future of high-quality growth, promoting inclusion, enhancing employment opportunities, and encouraging green investments with multilateral involvement.

Mr. Mojarrad:

We have issued a detailed gray statement, so I will confine myself to a few brief remarks for emphasis.

Thanks to a timely, strong, and synchronized policy response, the near-term global economic outlook in the October 2020 WEO is somewhat more promising than three months ago, but the progress has come at a great cost in terms of a tragic loss of lives and significant economic dislocations. Priorities, however, have changed little since then. Containing and mitigating the impact of the pandemic continues to be the highest global priority. Lockdowns and safety measures have been most effective, as shown by the staff analysis; and until there is a major breakthrough in a vaccine development, reopening economies should be carefully calibrated and safety measures strictly enforced. Likewise, the withdrawal of emergency economic support should be closely synchronized with the economic recovery.

We are still in the first phase of the pandemic. There are significant uncertainties and downside risks, to be sure, especially, as pointed out by Ms. Levonian, considering the prospect for a possible serious second wave during the upcoming cold season, at a time when returning to another full lockdown would not be politically, socially, or economically feasible.

The health crisis and unprecedented near-term recession have had a significant impact on livelihoods worldwide, especially on the vulnerable populations. Upwards of 70 million more people have fallen into extreme poverty. Youth and women have been hit the hardest, and income and gender inequalities have widened significantly in most countries, including in some advanced economies.

The race for developing a safe and effective vaccine is at the full pace. An equally important challenge for the international community is to ensure that the vaccine is accessible everywhere and is affordable for everyone. Large-scale international financial support will also be needed to help low-income countries to build up their health infrastructure and put their economies back on track and address the deep-rooted poverty and inequality.

We are in broad agreement with the GFSR's assessment of the global financial conditions, outlook, risks, and policy priorities as we emerge from the Great Lockdown. The near-term global financial stability risks have receded somewhat, thanks to the extraordinary policy response of leading central banks to ease monetary conditions and ensure adequate market liquidity, including through unconventional monetary policy, where appropriate. Countries that have pre-existing financial fragilities, however, will continue to face strong headwinds, with about half of emerging markets continuing to experience capital outflows. The vulnerabilities of the nonfinancial corporate sector aggravated by the crisis are also a cause for concern.

The Fiscal Monitor paints a grim picture of elevated public debt and binding financing constraints in LIDCs, where almost half of them are in or at a high risk of debt distress. There is insufficient external financial support on concessionary terms at a time when their debt service capacity is heavily constrained by weak economic revenue mobilization due to administrative challenges and large informal sectors that are mostly outside the tax net.

Reprioritizations of spending due to the crisis have already forced many countries to abandon their 2030 SDGs. Their development and poverty alleviation goals will remain beyond reach, unless the international donor community steps in with significant increases in grants, concessional assistance, and debt relief.

Mr. Fanizza:

I agree with Mr. Rosen and many other colleagues who pointed to the need for a paper that brings —the messages together. We have discussed it a number of times already. But I think we should try to avoid doing a new flagship. I would like to propose a chapeau within the World Economic Outlook.

Let me say, I have basically three things to say because we have issued a gray statement, which is very supportive, and we like the basic policy message.

We do not understand how deflation risks have not been highlighted in the message at this juncture. Let me say, it is not only that the headline inflation is in negative territory in Europe but, actually, as well illustrated in today's Global Markets Monitor, market-based indicators of inflation expectations have quickly slid since July. And that is the real issue. That is what bold monetary policy is about at this moment, the discussion. This is what the European Central Bank is trying to undo with its statement today, of considering inflation above 2 percent. This is essential because, otherwise, on monetary policy, we say, it only should stay accommodative. It has been accommodative for 12 years. So we should say: How can monetary policy anchor inflation expectations better? Because right now, there is a real risk that things worsen.

What I mean is that the risk of deflation is a major threat to the stability of the fiscal sector. I beg to disagree with a few of my colleagues, that I worry about too much money chasing yields and the undesired consequences of unconventional monetary policy. It is not that. Banks are full of money that does not go anywhere because there are huge uncertainties. And if it continues like that, expectations of low or negative inflation will get entrenched, and that would be a real issue. It would be a problem for the stability of the financial market because then we will have huge bankruptcies, and it will also be a problem for the fiscal sustainability. That is the real issue, and we would like to pay more attention on that issue.

On fiscal policy, we support the message of the Fiscal Monitor. But fiscal support to households and firms has been essential. And this has explained why budget pressures have not been an issue in the short term but also because the actions of central banks have de facto removed the budget constraints. But now is the time to move to policy actions that use the room given by these exceptional actions to address the long-term vulnerabilities and improve productivity over the long term.

Look, I buy the arguments that the short-term multipliers for investments are higher. It is true and important. But the real things that are important, that we need to take this as an opportunity to favor the structural transformation of our economies in the direction of higher productivity, the adoption of new technology and green, climate-friendly technology, is very important. If we don't do it, we are doomed because sustainability problems will harm us.

Finally, education is a top priority at the moment. Investments in human capital need to be preserved. People have to come back to school. We cannot afford another year in which we let our human capital and the future of our youth to get worse.

Mr. Raghani:

I will limit myself to a few policy priorities.

With the uncertainty, we believe that maintaining policy support should be the highest priority now. This also includes providing adequate resources to countries where there is little policy space or financing. As stressed by Mr. Buissé, Mr. Beblawi, Ms. Riach, Mr. Mahlinza, Mr. Mojarrad, and others, many LICs are in dire situations. This includes many African countries. Addressing vulnerabilities when the situation allows will comes in due time, as assessed by Mr. Ray, and requires actions at a country level but also multilateral solutions to foster capital flows, address debt issues, and ensure a strong global financial safety net. The latter needs to be addressed now.

The positive experience with the use of asset purchase programs in emerging and frontier markets is a welcome development. These programs have expanded room for maneuver to address a shock of this magnitude, yet the Fund should encourage vigilance on financial stability risks from the protracted use of such unconventional tools. These measures should come out more strongly.

We appreciate the focus of the Fiscal Monitor on public investment to boost long-term growth. We welcome the push on scaling up public investments in the highly uncertain environment, based on fiscal multipliers, the crowding-in of private investment, and financial conditions. That said, this message should be nuanced, as this could hardly apply to frontier and low-income countries that are facing greater financial challenges in these uncertain times. To leverage the opportunity for transformation, these countries would need access to long-term financing–to support building functional capacity investment projects to produce high rates of return.

Finally, regarding scarring, like Mr. Buissé, Ms. Riach, Mr. Beblawi, Mr. Mojarrad, and others, we are particularly concerned with the prospects of income divergence, rising extreme poverty, and human capital loss. We encourage the staff to further analyze human capital issues and expect these policy areas to be taken up in an upcoming WEO report.

Mr. Villar:

We issued a comprehensive gray statement, so I will focus on a few points for emphasis.

We broadly concur with the staff assessment of the global outlook. While the outlook for 2020 is slightly more positive than the June update, we would note that such outlook improvements is mostly restricted to advanced economies and China, so it does not refer in general to the developing world. Also, we highlight that prospects for global growth in 2021 have not improved and that the uncertainty remains very high.

We note with concern that the effects of the pandemic are raising inequality and decreasing economic well-being and opportunities, especially for women and youth cohorts. In this regard, we highlight the importance of the Fund's larger engagement and policy recommendations, mainly for the low- and middle-income countries where weaker social security institutions could imply more difficult challenges in trying to avoid the long-term negative impacts on poverty and inequality.

We believe that addressing the impacts of global warming, as proposed in Chapter 3 of the WEO, are paramount to put the global economy on a sustainable growth path. Governments play a key role in this process, implementing policies to promote green investment and low carbon activities but also in encouraging international cooperation to take advantage of the positive spillovers. More broadly, the Fund should continue to be a strong voice regarding the need for increasing international cooperation and multilateralism, including on other fronts, for instance, to defuse trade and technological tensions.

On the GFSR, we commend the staff for the detailed policy priorities and road map, as well as for the insightful work presented in the Analytical Chapters. It is clear that the unprecedented monetary and financial policies in advanced economies have helped to mitigate the near-term negative impacts of the crisis; but close monitoring is required, as high vulnerabilities may be building up in the financial sector and in the international bond market. The banking sector has been so far part of the solution to the crisis, and we must avoid it becoming part of the problem.

Also, the emerging markets have been able to finance their larger deficits in bond markets that have worked well after some stress in the initial path of the crisis, but sovereign bond markets are quite vulnerable to risk perceptions and to monetary policy in advanced economies.

On the Fiscal Monitor, we acknowledge that countries' fiscal response has been heterogenous, depending on pre-existing financing conditions and debt levels and the timely adoption of containment measures. As a result, the pandemic will leave uneven scars on countries in terms of indebtedness and inequality, and those scars may be deeper in middle-income and low-income developing countries, where it is required to do more with less due to the fiscal space constraints.

As stressed by Mr. Bevilaqua and colleagues in their gray statement, we are entering a new phase of the crisis, in which authorities should begin weighing the risks to fiscal sustainability. In this context, tailored and timely technical and financial support from the IMF is critical to enable a more inclusive and green recovery, especially for developing economies which face stronger financial restrictions. The IMF has been upgrading its efforts to provide timely policy advice and capacity development support, and has provided very important financial support to the developing world. But we cannot be complacent. We should continue adjusting our lending toolkit and the financial tools, including through a much-needed new Special Drawing Right (SDR) allocation.

Mr. Mozhin:

I also welcome the kind of modified approach to the consideration of these flagship reports, meaning the prerecorded video presentations, then the very much streamlined oral presentations, and then, as far as I understand, we will have another opportunity to discuss the Analytical Chapters after we get to the more tranquil times, after the Annual Meetings. I think this is another welcome innovation. This gradually modified approach may address some of the concerns raised by Mr. Ray and several others. Of course, the flagship reports are intended to address many different audiences, not only the senior public officials but also the academic community, the markets, and the rest. We are moving in the right direction with this modified approach.

Regarding the projections, of course, I welcome that they have improved in comparison to June. Obviously, they will continue to be reviewed and revised. What we have seen today already have some differences with the projections in the reports originally circulated to us, so these revisions will certainly continue. At the current stage, on the pandemic side, the circumstances are deteriorating, rather than improving. And we are only at the very beginning of the fall and winter season, which are expected to be challenging and difficult times. Nonetheless, the improvements in the projections are very welcome.

Regarding the projections themselves, it is impossible not to single out the striking projected performance of China, especially, I would say, on the pandemic side. When I look at daily reports from the Johns Hopkins University on the daily infections and see the numbers for China at like 12, 15 people in a day, this is very striking. For that reason, I was, of course, very interested to hear from Mr. Jin about his recent trip around China.

Now, the unconventional policies, both fiscal and monetary, especially in the advanced world, have certainly played a crucial role in addressing the economic consequences of the pandemic. However, we all know that the collateral damage, the medium-term effects of this policy will at some stage also need to be addressed. In that connection, I would once again repeat my request for providing data, such data as the evolution of central banks' balance sheets, major central banks' balance sheets, and also such data as the share of government bonds held by major central banks. I am specifically asking to provide not spot numbers but the evolution. I hope that these data are available, that the major central banks are sufficiently transparent in their operations. Given their crucial role in addressing the pandemic, it is very important for us to understand the magnitude of the measures they have taken.

I was glad to hear from Mr. Adrian that the banking sectors have become more resilient. This is perhaps reflecting the major efforts made in the last decade to strengthen their balance sheets and the regulatory framework. However, we learned from various reports that major risks have moved from the regulated commercial banks to the shadow banking sectors. And here, my question is: What do we really know about these shadow banking sectors? How can we at least try to monitor the developments in this area? I suspect we do not know much, but I would be interested to hear from Mr. Adrian on this subject.

Lastly, I would ask a question. When should we begin to think more specifically about the period after the end of the pandemic? We have heard many Board members speaking about the collateral damage, the medium-term risks. We were talking about the need for a fiscal consolidation at some stage. Certainly, I fully agree that it would be premature at this stage to unwind the accommodative measures, both fiscal and monetary; but at some stage, this will need to be addressed. In particular, in order to achieve fiscal consolidation or achieve improvements in productivity growth and the overall growth rates, the authorities in many countries will need to address the nonviable companies which are subtracting value. This will be very painful, of course. This will lead to a few temporary spikes in unemployment. And there will need to be strategies to address these medium-term challenges. Without addressing nonviable companies, the share of which must have grown significantly--and that is what we learn from many reports--without addressing this, there can be no fiscal consolidation, no improvements in growth, of productivity and overall growth, no improvement in deflationary pressures.

When will it be the right time for us to start thinking--even if preliminarily--about developing strategies to address the medium-term consequences of this crisis? Because it will take many years, as we all know, to get away from these consequences.

The Economic Counsellor and Director of the Research Department (Ms. Gopinath):

I will just make a few points.

One, about the outlook. The uncertainty here was not just about the length of the pandemic, about the amount of policy support that would be available, but also about how people will adapt to live with the virus. What we have learned is that people have learned to do it better than we might have expected. And that was not known. That was an unknown, about how exactly the behavior has changed.

Now, of course, in a few places they did better, whereas in few others it was worse; it was harder to adapt to living with the virus. So I hope we learned that the world is finding even better ways to live with the virus and policies are more supportive and we can upgrade further. It would be a good outcome.

In this third quarter, we are going to start seeing numbers which will be quite the opposite of what we saw in the second quarter. We are going to see big, positive growth numbers coming out, after the first half of this year's very big negative numbers. The question is: How will that hold up? These next three months are quite crucial. After seven months of just heightened uncertainty, in the next three months maybe we will really figure out, where are we headed. We hope the fog will clear because we certainly know that there are many things coming out on the medical front that will provide us greater foresight.

On the language of the acute phase of the pandemic ending by 2022, that came from conversations with public health officials and epidemiologists. They meant that local transmissions will come down to a very low level everywhere in the world. Now, of course, there are countries where that phase is going to end sooner than in other parts. It depends upon how quickly we can scale up the production of treatments and even vaccines maybe.

On the issues on the policy front, I completely agree that we don't really want to get into questions about what works and what does not work. The data comes in with a lag, and we need very rich data to be able to tell this. But just some very simple takeaways that we already have is that we know that income support measures seem to be working very well. They have helped hold up consumption, especially at the lower end, and aid the recovery.

On the other hand, in a few countries, measures that have worked in the form of more loan guarantees, which is basically more of the firms taking on more loans and carrying more debt have not worked that well because of the problem that this is a crisis that is more a solvency problem than a liquidity problem for many firms, which is why we support measures that take the form of equity-like support or just grants have been working better. Then we have the short-time work schemes, where employers and employees match. And they work well now; but as one starts to reallocating workers, they can become more of a constraint. But, we will continue to examine this more carefully and improve the granularity of the advice.

On the two Analytical Chapters in the WEO, one on lockdowns, Mr. Bhalla raised a few important points, and we responded in our technical responses. There is no smoking-gun evidence at this point because it is just a hard problem to solve, but I think this is the best data we have in terms of trying to tease out the effect of lockdowns on economies and of social distancing, too.

On the climate chapter, a question came up about, how do you finance all of this? How does climate financing happen? The chapter argues that this comes about automatically when we have carbon pricing; because when we have carbon pricing, it incentivizes the private sector to invest in the right kinds of technology. That is where the financing comes from. And for emerging markets, it comes not just from domestic financing but also from financing from international sources.

In terms of the fiscal deficit spending that is required, the number in terms of infrastructure spending--public infrastructure spending would increase, at the global level, the fiscal deficit by 5 to 6 percent of GDP cumulative over seven years; but, importantly, as we start getting revenues back from the carbon taxes in the future and as we get the higher GDP outcomes in the future, it becomes neutral.

I would also like to take a minute to share with you that Mr. Gian Maria Milesi-Ferretti, who is our Deputy Director in the Research Department and has led the WEO division for many years, is retiring at the end of the Annual Meetings, after a very long tenure at the IMF. Many of Directors have seen him and have gotten to know him quite well. He did his first WEO in 2014, a total of 13 WEOs. That is excluding the updates. He covered everything from the 2014 oil price collapse to the COVID-19 crisis. Certainly, these have been interesting times.

I just wanted to recognize that it is thanks to Mr. Milesi-Ferretti that we have had, over the last seven years, such incredibly high-quality WEOs. It is because of his careful attention to detail in terms of the numbers and his incredible clarity of mind, and also just being a phenomenally great person to interact with at all levels. We have all been very fortunate to have him at the helm here, with respect to the WEO.

The Deputy Director of the Research Department (Mr. Milesi-Ferretti):

It has been a privilege to work on the WEO. I think it is the best job I could imagine. I have just done it for seven years, and it is time for me to do a different job now. And I will leave it in supergood hands.

Again, it has been a privilege to work with marvelous Economic Counsellors on this, from Olivier to Maury and to Gita.

The Financial Counsellor and Director of the Monetary and Capital Markets Department (Mr. Adrian):

Let me also thank Mr. Milesi-Ferretti for his incredible contributions to this institution and for his amazing work across departments, which is extremely important in terms of getting the flagship messages aligned and getting our thinking across these quite diverse policy areas.

I would like to take this time to just expand a little bit more on the policy front, which is certainly challenging at this point. I agree with what many Directors pointed out, which is that the policy responses have been impressively good so far. Monetary policy has been very aggressive. We calculate that the G-10 economies alone expanded their balance sheets by over $7.5 trillion in the last six months, and that has helped in easing global financial conditions and has helped both corporates and countries keep access to markets.

Financial sector policies are put to the test for the first time since the 2008 crisis. And I think we can call ourselves very lucky that the banks entered with so much more capital into this crisis than the 2008 crisis, so we do not have a systemic banking crisis yet.

And, of course, there were massive fiscal transfers, many to households but also to corporates. As a result, while certainly defaults are increasing, and are expected to be in the order of magnitude of previous recessions, perhaps given the magnitude of the economic decline, this is fairly well contained.

Going forward, uncertainty remains very large, so policy trade-offs continue to be difficult to navigate. I structured my presentation around intertemporal policy trade-offs. There are trade-offs for monetary policy, for financial sector policies; in particular, for banks, for borrower support, and for sovereign debt issuers. And there is no simple answer because countries really face very differing circumstances at this point. As Mr. Jin pointed out, China is in incredibly good shape already, while a few of the frontier markets in a few of the poorest countries in the world have lost market access and struggle with tremendous debt issues. Of course, it was pointed out that poverty rates are going up in many countries.

A few emerging markets and developing economies also face tremendous pressure from banks. Even though globally, the banking system is in good shape, that does not mean that it is in good shape in every country, and we certainly have some countries with acute banking pressures that might morph into a banking crisis at some point.

As I showed, vulnerabilities are very different and policy space is very different across countries, so the trade-offs are going to be very different for different countries. We hope that the GFSR, along with the other flagships, allow policymakers to think through the trade-offs and then make their own choices in a systematic and well-informed manner.

Let me turn to monetary policy, in particular. We have seen many emerging markets conduct asset purchase programs for the first time. That is certainly venturing into new territory, and it has gone very well so far. Of course, it is very important to have a clear communication framework and a clear governance framework around those asset purchase programs.

We do not want asset purchase programs to morph into monetary financing. We are actually working on an analytical piece that is making a very clear distinction between asset purchases that are well governed for specific monetary policy purposes and monetary financing that can be associated with fiscal dominance and how to distinguish between those things.

We also have a very thick program on advanced economy unconventional monetary policies going forward, including a very concrete framework for trading off the benefits of low-for-long against the increased risk taking, as well as additional analytical work on the impacts of savers and borrowers and distributional impacts. Over the coming month, we will be coming to the Board with more work along these lines. And, of course, we discuss all of these issues in the GFSR.

Liquidity support is easier because the liquidity support by central banks is typically structured in a way that is self-liquidating. We have already seen that many of the facilities that were introduced in March in the acute crisis have at least partially self-liquidated.

We are also very present in the monetary policy framework debates. President Lagarde from the ECB put forth her broad thinking around the ECB's monetary policy framework. And, of course, we are working very closely with the staff of the ECB on these issues. We have been in close touch with the Fed. And their new framework was, of course, announced at the

Jackson Hole conference, and many other central banks are engaging on that as well.

In terms of the question on central bank balance sheets, we do have a lot of the numbers in the GFSR. These numbers are publicly available for the major central banks and, for a few of them, even on a weekly basis and at a very granular level. I am very happy to follow up and give more details, but there is already a lot in the GFSR.

In terms of the corporate sector, on the one hand, policy support is very important in terms of making sure that there are no inefficient liquidations that could cause scarring and a persistent impact of the crisis. On the other hand, there is also a need for adjustment at some point. Of course, the point that structural adjustments across industries have been triggered or accelerated by the crisis--to some degree, for example, the move toward new technologies--that might need support and, of course, adjustments. The support should not inhibit the needed adjustments. An analytical framework is needed there, and we asked staff to do corporate stress testing. We work very closely with Research as well on these issues to basically allow policymakers a framework for deciding when to restructure, when to resolve, and when to recapitalize corporations. That is going to be a critical policy question with many trade-offs, again, going forward.

On the banks, we are publishing this global stress test for the first time. That also allows policymakers to think about the intertemporal trade-offs, relative to the banking system, where, on the one hand, policymakers want banks to lend and to use the capital but, on the other hand, want to make sure that there is enough capital against future shocks as well.

We are certainly still of the opinion that restricting payouts, as Managing Director has argued in a recent op-ed in the FT, continues to be adequate for most countries. Indeed, I saw today that the Fed, in the United States, is extending its restrictions through the end of 2021, and most countries around the world have similar policies as well.

Of course, we are helping not just through multilateral surveillance but also through bilateral surveillance, through Financial Sector Assessment Programs that are restarting slowly, and through technical assistance on banking sector issues, both within programs and outside of programs. And there is more to come. We are still in the early days in this crisis. A few countries might recover quickly, but there will be countries that will be hit hard and where, unfortunately, lots of work on banks will need to be done.

On the shadow banking system and the non-bank financial sector, we did have a chapter on sort of like the shadow credit markets in April. We work very closely with the Financial Stability Board and the International Organization of Securities Commissions on mapping the whole non-bank financial system and on regulations that are necessary now that we have seen what went wrong in March. Certainly, money market fund reforms, swing pricing for asset managers, some degree of prudential regulation for asset managers is high on the agenda; and we are working very closely with the standard setters and with the relevant authorities from your countries on pushing that agenda.

Finally, let me just end by saying something about the frequency of updates. We publish the GFSR twice a year. We have the updates twice a year, in January and July, and we have market updates in May and November. We basically brief the Board every two months on markets. In the midst of the crisis, we went to a monthly frequency, which we would certainly consider if there was a reacceleration of market sell-offs.

We are happy that a few Directors appreciated the new Executive Summary, which really aims at the finance ministers. In some sense, the GFSR, like other flagships, tries to cater to three different audiences. The Executive Summary is for the ministers. Chapter 1 can be thought of as for the vice ministers. And then all the lengthy, thick stuff is more for staff. I remain convinced that it is a very important leadership role for the Fund to also have the difficult stuff to read because it really impacts what is done in capitals, in the central banks and the finance ministries.

The Director of the Fiscal Affairs Department (Mr. Gaspar):

I want to start by paying tribute to Gian Maria, who is a fabulous colleague and an example of excellent cooperation across departments in the Fund and a very open-minded individual.

I would really love to engage on this policy dialogue for long; but I think at this point of the proceedings, I should be telegraphic.

The first remark I want to make is that many Directors pointed to the importance of differentiation across countries and to the importance of policy trade-offs, and that is exactly a message that we have in common across the three flagships. We believe that is absolutely spot-on.

There are a number of interesting trade-offs having to do with fiscal policy. Directors very much highlighted that, when one needs to continue fiscal support in the short run, one is helped if one has a good anchor in a medium- and long-term fiscal framework. And that is something that one has to reconcile, and that is precisely one of the trade-offs that we discuss.

An interesting point has to do with public investment. We do qualify that public investment, in order to be effective at the current juncture, would be the most helped by strong public financial management procedures, by ample financial capacity, and by timely action. We also show that public financial management procedures are crucial to avoid that a ramp-up in investment be accompanied by cost overruns or delays in project execution.

So, we have all these granular qualifications in the chapter itself; but we do argue that, under the current circumstances, the public investment is a great bargain for those who can afford it without hitting financing constraints because it helps transformation and because, given the large multipliers, it helps current and future generations. It is not frequent that, in terms of our policy options, we have such a strong case.

When we go to broader issues and look at the world, indeed, the increase in inequality and, in particular, the increase in extreme poverty or other measures of poverty and the increase in risks of malnutrition put in sharp relief very painful and urgent policy trade-offs that play out right now. In that context, one does need--as we have many times emphasized and many Directors repeated--the engagement from the international community and, from the viewpoint of the country concerns, we need the approach to be long-term oriented and in the context for low-income countries, in particular, of the Sustainable Development Goals 2030. I would definitely not give up on the Sustainable Development Goals. One needs to emphasize the importance of a long-term engagement.

I tried to emphasize in the joint policy conclusions at the end of my video that we tried to put together a number of sound policy principles for policymakers but that the policy advice had to be country-specific and granular. We do that, clearly, in the context of bilateral surveillance; but as Tobias emphasized, we do that also in the context of capacity development. FAD has been conducting capacity development missions on tax, PFM, also infrastructure, governance. These activities are extremely important, I believe, for country-specific engagement at this juncture.

We are very much open to continue this dialogue. And, for example, in the context of the Annual Meetings, we are open to meet jointly with area departments, with any country delegation that would be so interested.

The Chair adjourned the discussion.

ANNEX

- Gray Statements
- Staff's Responses to Executive Director's Technical Questions
- Presentations
- Constituency Codes

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GRAY/20/3008

September 27, 2020

Statement by Mr. Bevilaqua, Mr. Saraiva, Mr. Fuentes, Ms. Mohammed, Mr. Antunes, and Mr. Barroso on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the insightful reports and underscore the importance of these comprehensive analyses to help guide the policy discussion in such testing times.

World Economic Outlook

On the back of strong fiscal and monetary policy support, the global economy is leaving the great lockdown recession behind and heading for two quarters of synchronized growth - albeit at different paces and under heightened uncertainty given varied infection and lockdown risks. Growth forecasts for most economies in 2020 have been revised strongly upward since the WEO June update. This points to overreliance, in the previous forecasting exercise, on general assumptions, such as average lockdown elasticities or policy effectiveness, overlooking country specific evidence – as clearly highlighted by several Board members back in June, and as might still be the case for some jurisdictions. Looking ahead, we call on staff to reflect carefully on the methodological lessons offered by the substantial revisions with respect to the previous forecasting exercise, even when accounting for the pervasive uncertainty. Since the last update, fiscal policy support has been extended, and global monetary policy pledged for low rates for even longer. Still, the recovery has been uneven across countries and sectors, with the service sector being a persistent and unusual source of concern, whereas strong consumption and retail recovery point to a less somber outlook for global trade, industrial output and commodity prices. In this sense, we welcome the inclusion of both upside and downside scenarios to the baseline, capturing the high degree of uncertainty in projections.

While medium-term scarring is a common feature of deep recessions, the current recovery faces even greater challenges, given the disruption in the service sector, the lingering health issues and the increasingly limited policy space. We agree with the WEO concerns related to the scale of sectoral reallocation, the large human capital losses and important slowdown in capital accumulation. We take note of Box 1.3 result that 10% of jobs could be at risk from SMEs liquidity or solvency problems. However, the scale of the necessary support – and the risk or incentive problems linked with debt overhang and equity stakes – must be carefully weighed against the benefits from fast resolution. Moreover, attempting to lock workers into unproductive jobs can have a negative medium-run impact on its own. A difficult balance needs to be struck in supporting affected sectors, especially SMEs, and letting the healthy process of resources reallocation take place. We are also intrigued with why just a handful of countries in Figure 1.12 have growth deteriorating or stagnating well into 2025. *We wonder if recent structural reforms in several economies – including to facilitate labor market reallocation, bankruptcy procedures and credit market allocation – where fully considered to properly anchor country specific medium-term forecasts, or if general assumptions were again imposed on groups of countries*.

Against the backdrop of continuing need for fiscal spending in order to smooth the downturn and protect the most vulnerable, it is time for policymakers to begin weighing in the risks to fiscal sustainability. We support the WEO call for reallocation from wasteful spending and inefficient subsidies, along with smarter taxation and greater debt transparency. Moreover, keeping in mind the uphill battle with medium-term scarring, we agree it is important to facilitate resource reallocation and to nurture investment in high-growth industries – particularly where scale, coordination and externalities are an issue – increasing resilience to health and environmental shocks.

However, we do not support the unconditional call for suspending fiscal rules at the significant risk of derailing expectations – particularly in jurisdictions with initial signs of fiscal stress and steeping risk premia. Of course, in countries that have sufficient fiscal space and supporting yield curves, the benefits from fiscal spending could very well outweigh its costs. However, we warn that when it comes to policy advice this is certainly an area in which one size clearly does not fit all. And, in any case, the Fund should strengthen and expedite its work program on sovereign debt and be ready to offer ample support, including capacity building, where warranted. *That said, we call on staff and management to consider appropriately stronger qualifications in communication efforts, including in reference to large emerging market economies, keeping in mind the important market reactions that could result from IMF statements on fiscal rules suspension, or circumvention, in the current juncture, especially as domestic political economy considerations are not properly taken into account on those statements.*

Increase poverty and inequality following the great lockdown and its medium-term scarring are pressing issues for the international community. We take note of Box 1.2. warning that inequality in EMDEs might go back to 2008 levels. However, one must also acknowledge that unprecedented generosity and reach of transfers programs in large emerging markets have at least in one case contributed to a marked reduction in poverty and inequality – actually triggering a discussion on how to lock in such gains in a sustainable way. We strongly support the WEO call for greater multilateral collaboration to deliver vaccines on a global scale, in the context of generally limited fiscal space and institutional capacity constraints in LICs. We are concerned with the impact of the slowdown in trade, tourism and remittances, particularly for small and fragile open economies, pointing to the continuing need of multilateral support, including in the context of IMF facilities.

Global Financial Stability Report

Unprecedented monetary and financial policy accommodation has reduced near-term financial risks from its pandemic peak, perhaps at the cost of higher vulnerabilities that require close monitoring. We take note of the GFSR assessment that monetary policy in major central banks has compressed non-financial corporation credit spreads and emerging market sovereign bond spreads. On the positive side, this helps corporations and sovereigns navigate through turbulent pandemic times. On the other side, it presses corporations against interest coverage ratios and governments against debt service to revenue ratios, particularly over the medium run (or as soon as 2021 according to GFSR simulations). Policymakers will have to carefully balance targeting support to solvent corporations and allowing banks absorb losses of insolvent ones (on top of embedded regulatory flexibility). In principle, financial markets will help separate sustainable from unsustainable sovereign debt – even though the risk of panic and massive overreaction must be closely monitored. Where debt is unsustainable, debt resolution will have to proceed with extreme caution to avoid holdouts and disproportionate global externalities, buttressed by strong and viable adjustment with appropriate multilateral support.

As policy support is phased-out and becomes more targeted, synchronized loan losses in the global banking system could be another source of vulnerability – albeit seemingly manageable in the baseline scenario, given the strong capital position of banking systems and global systemic banks. That is indeed the broad conclusion of the GFSR global bank stress testing and support the call for clear guidelines for banks' handling of loan losses and for international bank resolution. Under the most stressed global downside scenario, the tests show that a number of EM banks could see some stress in common equity ratios, with 40% of assets linked to ratios below the minimum. This seems at odds with the demonstrated resilience of EM banks in stressed macroeconomic conditions, especially given the revealed preference of EM policymakers to provide emergency support to firms and households under severe stressed conditions.

Fiscal Monitor

A crisis like no other required an unprecedented policy response. At a global scale, the massive deployment of fiscal resources has been introduced by advanced and large emerging market economies. The public health and social assistance policies implemented around the world have been paramount to mitigate the pervasive effects of the pandemic. That said, the scope, structure and evolution of fiscal support across countries is wide-ranging and deserves very careful assessment and monitoring. In this context, staff's appraisal and recommendations regarding the policy response and macroeconomic projections has markedly evolved since the April update, as more data have become available and uneven outcomes surfaced. For instance, in emerging market economies fiscal responses to the pandemic have been generally more moderate relative to advanced economies (with the notable exception of Brazil), and projected deficits reflect the compound effect of large revenue drops and heightened health and social spending. In the case of low-income developing economies, the spending constraint has been more severe and have required intense budget reassignments to face the pandemic, as external financial support becomes available. Against this background, multilateral financing and policy guidance will remain critical as LIDCs fight the pandemic and work to enter the recovery phase.

As fiscal policy gradually transitions towards supporting reopening under extreme uncertainty, country-specific conditions and post-crisis challenges should not be overlooked. We welcome staff's proposition of a fiscal roadmap for the recovery and see merit on the initiative to divide the crisis into phases to highlight the main challenges and provide suitable policy recommendations. However, the recommendation about gradually transitioning away from accommodating health expenditures and social protection measures should be very carefully modulated and tailored to country-specific circumstances, especially in cases where debt sustainability and the credibility of the fiscal framework are at stake. Indeed, in the post-pandemic global economy, most countries, particularly EMDEs, will emerge facing substantial fiscal risks and sustainability issues.

Brazil mobilized a wide range of fiscal instruments to protect lives and livelihoods during the pandemic. Subsidies, state-owned enterprises' loans, and, above all, unprecedentedly large targeted cash transfers were used to shield the poorest households from the effects of the pandemic, allowing a significant part of the population to stay at home and practice social distancing, while sustaining domestic demand. The net impact of these emergency measures was not only a significantly better economic performance than forecasted by staff in the last WEO update – broadly in line with what the authorities and local dedicated analysts were anticipating at that time – but also positive effects on protecting jobs and curbing income inequality. Furthermore, these essential support measures explain the short-term fiscal impact documented in the Fiscal Monitor. Brazil is already scaling back many of the fiscal support measures implemented in the first semester and will resume its fiscal consolidation path in 2021, ensuring the unconditional application of the spending ceiling – its main fiscal anchor. Strengthening fiscal sustainability will remain a key priority going forward, and spending plans will abide strictly to the budget.

WEO – Analytical Chapters

The analytical work on chapter 2 of the WEO is of extreme importance, but we should avoid hastened policy conclusions given the ongoing nature of the pandemic. Taking stock of the economic and public health effects of the lockdowns imposed by several governments earlier this year is a key research priority and certainly a suitable topic for a WEO analytical chapter. Staff makes a very convincing point that lockdowns should be studied side by side with voluntary social distancing. We second the assessment that simply lifting lockdowns is unlikely to rapidly bring economic activity back to potential if health risks remain high, particularly in places where a significant proportion of the populations have the means to self-isolate. We also agree that, considering the protracted economic effects of the pandemic even after the lifting of lockdowns, policy support should be scaled back as gradually as warranted by fiscal sustainability considerations. Still under assessment is the general claim that strict lockdowns tend to be less economically disruptive, since they would be more effective in containing the pandemic, allowing for a faster economic recovery on the back of reduced voluntary social distancing once the lockdown is lifted. We call on staff to closely monitor the developments in Europe, where lockdowns may have to be re-imposed. Overall, we believe that local authorities and health experts are generally much better placed to define the adequate public health responses to the pandemic, accounting for country specificities that cannot be overlooked.

WEO Chapter 3 offers solid new arguments in favor of combining carbon pricing with a green investment push in order to achieve the reduction in global carbon emissions consistent with a limited increase in global temperatures. Staff's analytical work builds on a large scientific and economic literature addressing the causes and consequences of climate change, a key global challenge of the twenty-first century. Although staff's engagement with this important issue is warranted, we missed more specific attention to the role of the IMF in helping the membership tackling climate change – both from the perspective of mitigation and adaptation. The green investment push proposed by staff is a welcome addition to more consolidated strategies such as carbon pricing. Nevertheless, important questions about the fiscal sustainability of that push in the delicate current global situation remain open – particularly regarding developing countries. Going forward, we call on staff to explore fiscal solutions to finance the suggested green investment push, including by devising ways to increase the flow of grants and concessional funding to developing economies.

GFSR – Analytical Chapters

Since the global financial crisis (GFC) in 2008, the case for central banks to resort to the use of unconventional monetary policy has been well documented. During the GFC, advanced economies utilized asset purchase programs (APPs) to reduce financial market stress and contain adverse effects on output. While the experience of those economies has guided the actions of central banks in EMDEs in the use of APP, it must be noted that policy rates were generally lower in advanced economies a decade ago and the programs were somewhat different in scope. It would be important to monitor the effectiveness of these APPs not only in the short term but also in the medium term when the beneficial effect tends to be overshadowed by costs. Moreover, research has shown that APPs may not be always successful at boosting credit creation and may even result in an increase in implicit firm default rates, thereby increasing risks to financial stability. We are particularly interested in future research work on APPs in EMDEs as it will add to the body of knowledge and assist countries to effectively employ this unconventional policy measure when circumstances require.

While the main text provides insightful and welcome inputs for central banks in considering benefits as well as monetary policy and financial stability costs of APPs, the related figure 2.9 is highly misleading. For instance, while the main text discusses the effect of institutional quality and credibility of central banks, the figure uses obscure, non-financial sector specific, mostly perception-based indicators of government effectiveness and regulatory quality. The graph cannot convey or illustrate the point made in the text. Moreover, a figure about regulatory quality in a financial stability report, when discussing unconventional monetary policy, is highly suggestive that the indicator refers to financial sector regulation, which is not the case. Finally, the source is also somewhat opaque, as the World Bank assembles those indicators based on indicators from numerous other sources of varied nature and we have already agreed on how to cite them in IMF papers. Panels 3 and 4 in that figure are also poor illustrations of the points that are made in the text. Hence, we urge staff to consider deleting this misleading figure in an otherwise very useful chapter.

The assessment of key policy announcements on corporate funding liquidity in chapter 3 of the GFSR suggests that policies that directly support firms with vulnerabilities were most effective in mitigating their financial strains. We agree that premature withdrawal of policy support could jeopardize the success achieved so far in meeting firm's liquidity and funding needs. While we appreciate the analysis provided, we know that the performance and financial position of firms vary widely, particularly across sectors. In this regard, we believe that a sectoral disaggregation of firms with vulnerabilities would provide greater insight into the analysis.

Chapter 4 of the GFSR provides a very useful analysis of the challenges the Covid-19 pandemic has posed on bank capital and policy response. It quantifies unprecedented measures undertaken by supervisory bodies, such as the capital adequacy policies and government loan guarantee programs and discusses the potential impact on the solvency of the banking system. We think that this line of research is very useful as it provides guidance on whether the measures have successfully eased the pressures facing the banking system amid the Covid-19 pandemic and we strongly encourage staff to continue with this informative work. We take positive note that the analysis shows that the global banking systems would remain solvent in the coming years, partly due to buffers accumulated after the GFC. While we are aware that some banks are unwilling to utilize their buffers, we hope that a stronger approach would be used to encourage banks to use their buffers effectively to ease capital and liquidity constraints during challenging times.

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Statement by Mr. Mahlinza, Ms. Mannathoko, Mr. Odonye, Ms. Maidi, Mr. Nakunyada, and Mr. Sitima-wina on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

1. We thank staff for the comprehensive set of reports, which provide a detailed assessment of the state of the global economy as well as the setbacks occasioned by the COVID-19 pandemic. Notwithstanding the nascent signs of recovery, the severe impact on the global economy and scaring suggest a longer path to the pre-pandemic growth levels.

World Economic Outlook (WEO):

2. **We positively note a slight upward revision of the 2020 growth forecast from -4.9 percent in June 2020 to -4.5 percent, reflecting signs of a partial global recovery**. Nonetheless, we recognize that the outlook is subject to significant downside risks. The WEO notes that infection rates remain high, especially in emerging and developing economies (EMDEs) and rightly acknowledges numerous risks including, the possibility of a resurgence of the virus, uncertainty regarding the length of the pandemic, the extent of global spillovers from soft demand and possible changes in financial market sentiment. Given this uncertainty, we remain cautious about the outlook as the crisis in some advanced economies (AEs) and parts of the EMDEs is still unfolding. Further, international travel, which is an important indicator of consumer confidence, remains subdued, including under the upside scenario. The report also paints a bleak picture characterized by rising unemployment and sharp increases in global poverty and inequality. While we welcome the balanced view of forecasts provided under the two scenarios, *staff comments on a possible optimism bias are nevertheless welcome.*

3. **We agree with the near-term policy actions needed to boost productivity growth to support recovery and build economic resilience.** In this regard, we welcome the robust policy responses implemented by the authorities to contain the socio-economic fallout from the pandemic. Further, we concur with the report on the need to strike the right balance between health and economic policies. We caution against the premature withdrawal of policy support which could undermine recovery and growth. At the same

time, we welcome the emphasis on the need to address elevated debt levels and restore debt sustainability, while safeguarding critical social spending to avoid further erosion of gains made on poverty, inequality, and human capital development. Looking ahead, we underscore the importance of striking an appropriate balance between policies that cushion the impact of the pandemic on the economy, while supporting the gradual implementation of structural reforms necessary to anchor a sustainable and green recovery and ensuring financial stability.

4. **We welcome the detailed analysis of the economic effects of the lockdown and the findings of a disproportionate impact on vulnerable households and economies with high levels of informality**. Due to weaker social safety net programs in developing countries, the vulnerable population tends to ignore social distancing rules as they strive to survive, which exposes them to additional health risks. In contrast, AEs have more robust health infrastructure and more policy space to provide social benefits and support teleworking. Moreover, residents in these societies can tap into personal savings to help address constraints during the early stages of the pandemic. These differences have important implications for the design of policy responses in developing and advanced economies. The report also notes the uneven effects of the lockdown across population groups, including lower income households, minorities, immigrants, women, and youths. We, therefore, support the call for targeted policy interventions, in particular to support women, and young workers who rely on informal or temporary jobs, to moderate the widening of the income inequality gap.

5. **We broadly agree on the need for multilateral cooperation, particularly in global trade and access to the vaccine to boost recovery.** In this regard, we underscore the importance of the IMF's continued support to promoting free trade. We also concur on the need for multilateral cooperation to support health care systems, development of a vaccine as well as assistance to financially constrained countries, in particular the low-income countries (LICs). Further, we agree with the sentiment that multilateral cooperation is needed to defuse trade and technology tensions between countries and address gaps in services trade rules once the crisis abates.

Global Financial Stability Report:

6. **We broadly share the thrust of staff's analysis on the near term global financial stability risks and policy priorities for subsequent phases of the COVID-19 crisis.** We note that the decisive and swift actions by major central banks have eased global financial conditions and stabilized key markets. Reflecting the impact of the policy actions taken to sustain the flow of credit to the economy, near-term global financial stability risks remain contained, while risky assets have rebounded owing to improved investor sentiment. Nevertheless, we remain concerned that global financial vulnerabilities stemming from rising corporate and household indebtedness could morph into insolvencies and undermine market stability. Considering the widespread defaults and bankruptcies, we call for vigilant monitoring of corporate debt and related financial vulnerabilities. Relatedly, we impress on the need to restructure debt to non-viable firms, as well as credible plans to reduce problem assets. To mitigate financial vulnerabilities, policy efforts should also be directed towards maintaining accommodative monetary

policy to support economic activity until the monetary objectives are achieved while keeping inflation in check.

7. **We commend banks for building strong capital buffers that have helped weather the impact of the COVID-19 shock**. Nonetheless, we observe the tail risks that could lead to sizeable capital erosion in several economies. As such, we call for decisive measures to support bank capital and prevent further widening of capital shortfalls. We are also concerned that the risks from fragilities in the non-bank financial sector (NBFS) may further accentuate capital erosion. High leverage and the growing reach of non-banks, including in riskier segments of credit markets, should be carefully monitored, as it has the potential to transmit risks to the entire financial system. Against this backdrop, we call for efforts to strengthen the regulatory framework for non-banks and intensify prudential supervision to moderate excessive risk taking particularly in a low interest rate environment.

8. **The rise in global public debt to historic levels, on the back of fiscal stimulus packages adopted to tackle the COVID-19 pandemic, also carries financial stability risks.** We note that EMDEs are likely to face greater debt challenges with feedback loops on the risk premium and financing costs. Given the sizeable bank holdings of sovereign debt in some systemically important jurisdictions, the nascent recovery in portfolio flows to some EMDEs with strong fundamentals may unravel. Further, we note that most emerging market and frontier economies have experienced capital outflows over the past three months and may face external financing challenges and high rollover risks going forward. *Could staff elaborate on the key drivers of the continued portfolio outflows?*

Fiscal Monitor:

9. **The Fiscal Monitor notes that the pandemic has exposed major differences in the ability of countries to finance the emergency spending needed to protect lives and livelihoods.** In this context, we broadly welcome the fiscal policies outlined in the report that recognize the varied challenges in different country groupings. For many low-income and developing countries including those at high risk or in debt distress, financing constraints have been binding; and while countries received emergency support, financing gaps remained. At the same time, efforts to enhance domestic revenue mobilization have been compromised by the disruption in economic activity.

10. **Given limited fiscal space, we see merit in countries assessing the benefits, costs, and risks of different policy support measures, before deployment.** At the same time, we underscore the need to ensure full transparency and good governance before deployment of scarce fiscal resources. For LICs with little or no fiscal space, whilst the primary focus is on preserving lives and livelihoods, we encourage the efficient and accountable use of resources – including those from the international community. In this context, meaningful investment in infrastructure to support growth and Sustainable Development Goals (SDGs) can be made with scaled up support from the international community.

11. **We are in strong support of a toolkit of flexible fiscal measures to navigate lockdowns and tentative reopening, and to facilitate a post pandemic transformative recovery.** In this context, we welcome the roadmap of fiscal policies for different phases of the crisis. In particular, we underscore the importance of universal access to affordable and effective vaccines and treatment. Concerted global efforts are therefore required, to avoid further marginalization of poorer regions and a worsening of the human and economic costs of the pandemic.

12. **We concur that the pace of adjustment should be informed by country specifics in view of the varying depths of recession, poverty, unemployment and access to finance.** In this context, we encourage further analysis to inform policy advice and the sequencing of interventions. Once the pandemic is brought under control, countries with limited fiscal space would need additional official financial support and debt relief. To enable growth, countries need to protect public investment as well as transfers to lower income households, while ensuring that highly profitable firms are appropriately taxed and base erosion and phantom FDI challenges are addressed. *In this regard, could staff comment on progress with the international corporate taxation agenda including work on measures to limit impacts on low-income developing countries?*

13. **On public investment and growth, the fundamental issue for our region will be the sources and options for financing to support the recovery and related infrastructure development projects.** As the report notes, in most developing countries infrastructure investments have not kept up with needs, and public investment-to-GDP ratios were already declining before the pandemic. We, therefore, strongly support the need for a global response to this investment need, in order to avert a sustained decline in the wake of the pandemic and to help regenerate growth, reverse scarring and avoid significant reversal of progress under SDGs. We welcome the conditions presented for investment scaling up, especially the need to have a pipeline of carefully appraised projects which could be selected for financing and implemented within 24 months. We see merit in continued capacity building, including on the Fund's public investment management assessment (PIMA) framework.

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Statement by Mr. Ray on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff and management for a set of flagship documents that have been prepared at a critical juncture for our membership. The focus, in the main, on the COVID-19 pandemic, the risks it poses and the policy challenges faced by the membership is welcome. It is the correct focus as the world grapples with this unprecedented crisis, though we would have preferred a shorter, sharper set of flagships that honed in on practical macroeconomic policy advice for the membership.

IMPACT, OUTLOOK AND RISKS

We hope we're through the worst, but there is still a long road to travel. As we noted in April, forecasting is a thankless task especially in a crisis where uncertainty is the defining feature clouding so much – the course of the pandemic, the shape of the recovery, the extent of scarring, the path of commodity prices, the stability of global financial conditions and the extent of contingent liabilities. The WEO forecasts that the global recession has bottomed out and we hope this is the case. While the recession seems to be shallower than forecast in advanced economies, emerging market and developing economies face a deeper contraction in 2020 than expected; their prospects remain precarious. And the virus is still spreading – global infections have more than tripled and deaths more than doubled since June – with partial lockdowns being re-imposed in some places. Unfortunately, the risk of setbacks remains high.

Even with the massive policy support around the world, the downside scenario is plausible. The baseline scenario relies on a readily available vaccine in 2021 and assumes that the acute phase of the virus will be over by the end of 2022. Again, we hope this will be the outcome. But nothing is assured. The baseline does not grapple with how to handle a much longer period of containment or social distancing (either voluntary or enforced), which is a real possibility.

The pandemic has touched nearly everyone; but the impact is uneven across countries, sectors and cohorts. The pandemic is a shock to both supply and demand. Industrial production in many countries is still below pre-pandemic levels. Global trade is expected to contract by over 10 percent this year. Employment has fallen with a global loss in work hours equivalent to 400 million fulltime jobs in Q2. Distinct features of the crisis are the severe hit to the services sector and to economies heavily dependent on tourism and external remittances. Women and informal sector workers, particularly the young, have also been disproportionately affected, and the disruption to education could impact a generation.

Unprecedented and aggressive policy measures by major central banks have been 'game changers' – stabilizing key funding markets, maintaining the flow of credit to the economy (or keeping business afloat), calming abrupt and volatile capital flows, and laying the foundation for central banks in emerging market economies to adopt unconventional policies for the first time on a broad basis. We note staff's assessment that near-term global financial stability risks have been contained for now.

The fiscal response has also been unprecedented. Measures have been diverse, state-dependent and significant, including additional spending measures to support households and firms, expenditure to strengthen the public health response, as well as providing sizeable liquidity support. The forceful response by governments has saved lives and helped to cushion the blow from the economic fallout. But the fiscal response has not been without costs; public debt is at record levels and vulnerabilities have intensified.

Many downside risks remain. While some of them cannot be mitigated, we should try to avoid 'own goals', including for example on public health or trade policy. Many low-income countries that are in debt distress or at high risk of it and some emerging market economies have limited scope to respond to further adverse shocks. More broadly, a widely held perception that central banks will continue to intervene to calm down markets may incentivize investors to take on more risk, deepening the disconnect between financial markets and the real economy.

POLICY ADVICE

It's mostly fiscal: for many, the appropriate macroeconomic policy mix has changed. Given limited conventional monetary policy space, continued accommodative fiscal policy will be necessary to ensure investment in health systems, support for households and firms, and funding for active labor market policies to support displaced workers. We agree with the broad thrust of the policy advice in the WEO, GFSR and FM. But we would have welcomed more practical advice on the choices policymakers face. For example, is it just the case that fiscal rules should be suspended temporarily or will they need to be revised? How should low income countries with relatively high debt burdens react to sustained losses of revenue? How do governments actually distinguish between short-term liquidity issues and longer-term solvency issues? These are difficult issues that may require innovation in the Fund's advice.

Economic policy support must not be withdrawn prematurely. Unwinding the extraordinary measures taken by central banks will require fine judgments, especially to avoid negative spillovers. Equally, keeping them in place too long would be risky. We recognize that fiscal support cannot be sustained indefinitely, so hard choices will likely be required at some point. But timing is everything – withdrawal of support too early would be a big set-back. Fiscal authorities will also need to make difficult judgments about when to stop cushioning the impact on individual firms and switch instead to facilitating the reallocation of capital and labor to permanently changed circumstances.

For low income countries, rising debt vulnerabilities will be an ongoing significant macroeconomic challenge and dealing with the buildup of debt should be a core focus for the Fund. As members look to continue to contain the virus and transition their economies, many will face debt challenges that limit policy space and make continued support for economic recovery challenging. Solvency issues are likely to intensify. Grants and access to concessional financing will remain critical and the Fund should stand ready to support its members through tailored arrangements as they move through the crisis. *As members are taking on higher debt to respond to the crisis, are staff building in flexibility around augmentation of programs in the DSA framework?*

Economic disruptions may lead to lasting effects. For example, patterns of work, reshoring of supply chains, higher household saving, changed consumption patterns, as well as reduced travel and tourism, could all have enduring impacts. The potential for longer-than-expected international border closures will impact potential growth opportunities. Partial reopening will be challenging, especially for those members with fragile health systems and limited resources to acquire medical equipment/facilities required for COVID testing and preventative measures. *If international borders remain closed, and the downside scenario materializes, how would Fund advice change for tourism dependent countries?*

While we note that public investment can play a significant role in fostering the recovery, widespread infrastructure spending is not a universal panacea. Public investment can create jobs, facilitate private investment and absorb excess capacity. But fiscal multipliers vary across countries and many countries import the machinery, materials and labor required for infrastructure projects. Many infrastructure projects have long planning and contracting lead times that makes them hard to accelerate, particularly if capacity is low.

Low for long interest rates will require continued refinements to financial sector regulation. Since interest rates are expected to remain very low for the foreseeable future, as the pandemic subsides stronger prudential measures may be needed to constrain excessive risk taking. Strengthening the regulatory framework for the non-banks sector to address vulnerabilities identified by the COVID-19 crisis will also be a priority. On inflation dynamics, inflation in the noncyclical sectors in advanced economies seems to have shifted downward from around 2012 as shown in Figure 1.16 of Chapter 1 of the WEO. *We welcome staff comments on the main causes of these downward movements and implications for monetary policy.*

The pandemic is accelerating some economic transitions. The accelerated shift towards e-commerce and innovations in data-based services will promote digitalization of the economy, which has both positive (jobs) and negative (higher concentration) effects. E-learning could help minimize the quality education gap and bring realistic opportunities to fast-track the attainment of education related SDG goals. In respect of climate change, we see a role for the Fund in considering the global growth implications of moving to net zero emissions over time and in understanding the macro-criticality of climate for economies. But while we note that green public investment could provide short-term stimulus, the proposed comprehensive mitigation policy package including tax base broadening would be difficult for some members given limited bandwidth for reforms beyond dealing with the immediate challenges of the pandemic.

Continued multilateral cooperation, particularly with respect to open trade and access to a vaccine, will be essential to support recovery efforts.

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GRAY/20/3013

September 28, 2020

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

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

<u>**World Economic Outlook**</u>

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

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

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

<u>**Fiscal Monitor**</u>

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

sectors and firms. A shifting of fiscal resources to enhancing social safety net – given the disproportionate impact of the pandemic on low-wage earners – and boosting public investment should be an integral part of the policy adaptation process, along the lines of the comprehensive staff's analysis in Chapter 2 of the Fiscal Monitor.

- **Fiscal policy should create the incentives to foster a more balanced growth model, in terms of intertemporal, intergenerational and social equity in a third phase of the pandemic**. In this regard, we welcome the interesting analysis of the necessary policies to reduce carbon emissions. We agree with staff that, given the magnitude of the risks from climate change, the COVID-19 crisis provides an opportunity to promote the transition to a low carbon economy by implementing ambitious policy actions to reduce emissions. Undoubtedly, this requires a global effort. We are strongly committed to decarbonizing the economy and adhering to the Paris Agreement; countries should find the right policy mix to attain those goals. Such mix should also encompass appropriate financial policies aimed at fostering sustainable finance and support private investments in the green economy. Finally, while we broadly share the policy advice, we acknowledge that reality is more complex and **would welcome that future Fiscal Monitors also consider actual hurdles to policy implementation and practical solutions**.

<u>**Global Financial Stability Report**</u>

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

most affected by the pandemic, they now face more challenges. We, thus, agree with staff that a well-sequenced financial regulatory agenda that preserves the vital intermediation function and the stability of the financial sector is essential.

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Statement by Mr. Mouminah, Mr. Alkhareif, Mr. Keshava, Mr. Abalala, Mr. Rawah, and Ms. Alzamel on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the comprehensive set of flagship reports, and we reiterate our call to maintain the focus of Fund work on the most pressing issues pertaining to the COVID-19 crisis. We would like to raise the following points.

World Economic Outlook

1. **We welcome the upward revision of the global growth projection for 2020, mainly reflecting better-than-anticipated Q2 GDP outturns.** However, uncertainty remains high and growth across countries remains uneven given the wide differences in the pace of recovery. Using scenario analysis is particularly useful in this uncertain global environment, and we thank staff for the analysis in Box 1. *Since COVID-19 shock has adversely impacted economic activity and labor-force participation across economies, could staff comment on the structural impact of the crisis, including on consumer behavior as well as de-urbanization trends driven by many firms' decision to move away from commercial properties in large urban centers?* Separately, we take note of the PPP revision in Box 1.1, which has impacted the calculation of aggregate growth rates. Notably, global growth is expected to be slightly lower because of the reduction in the relative weight of the fastest-growing regions. *Can staff comment on their communication plan about the updated PPP weights and its global growth implications?*

2. **It is concerning that the crisis has reversed the progress in alleviating global poverty in the past few decades and will increase inequality.** Unlike the GFC, the job losses during COVID-19 crisis have been concentrated among low-skilled labor. As rightly

pointed out in Chapter 2 of the WEO, the effects of lockdowns have been uneven, with larger impact on the mobility of women and younger cohorts. With the expected income losses, poverty is projected to rise significantly. Moreover, the high informality in the labor market and low coverage of social protection programs remain a key policy challenge in many countries especially LICs. Under the Saudi G20 Presidency, a strong focus has been put on policies that enhance access to opportunities for all, especially for women and youth. Particularly, the Saudi G20 Presidency aims at enhancing efforts to create high quality jobs and adapt to the changing patterns of work resulting from this crisis and technological progress while ensuring adaptability of social protection schemes to these changes. To this end, the G20 has recently developed a **Menu of Policy Options** that countries can draw from to enhance access to opportunities for all. We encourage staff to reference this menu in the flagship reports given its high relevance to the Fund work and its importance to other members during this crisis.

3. **We cannot overemphasize the need to pay closer attention to the mounting debt vulnerabilities.** The COVID-19 crisis has significantly worsened fiscal positions and public debt is expected to increase significantly in many countries, including LICs. In this connection, the G20 under the Saudi Presidency has launched its Debt Service Suspension initiative (DSSI) to free up fiscal resources for the poorest countries during this crisis. A time-bound extension is under consideration to ensure that the countries continue to receive the needed liquidity support. The Fund has a key role to play in this area by catalyzing global cooperation and providing the necessary support to foster greater private sector participation in the DSSI. We urge the Fund to focus its efforts on fostering debt sustainability, including by expediting its work on the multi-pronged approach in collaboration with the World Bank. as increasing number of countries will face daunting debt-sustainability challenges. In particular, the Fund should step up its support by providing more tailored-policy advice and capacity development particularly in debt management. We also look forward to timely completion of the ongoing reviews of the Debt Sustainability Analysis for Market Access Countries and the Debt Limits Policy.

4. **We broadly share staff's views on the policy priorities.** We concur that the immediate dual priority is to ensure adequate resources for healthcare systems and to limit the economic damage. At the same time, fiscal space is limited in many countries and policymakers are faced with difficult tradeoffs. Here, we agree that fiscal rules should be relaxed where they may constrain action to achieve a more inclusive and durable recovery. As economies recover, public and private investments should be geared toward boosting productivity and inclusiveness, including of women and youth .

5. **Strong multilateral cooperation is paramount to resolve the health crisis and ensure lasting economic recovery.** Indeed, further global cooperation is needed to develop affordable treatments and vaccines that can be distributed worldwide. The Saudi G20 Presidency is determined to support the global efforts to fight the health and economic crisis. More recently, the G20 Finance and Health Ministers issued a joint statement on the COVID-19 response, in which they emphasized the importance of taking forward their collective action to accelerate the research, development, manufacturing and distribution of COVID-19 diagnostics, therapeutics and vaccines, including through the Access to COVID-19 Tools Accelerator (ACT-A) initiative and its COVAX facility and voluntary licensing of intellectual property. The aim is to support equitable and affordable access for all, which is key to overcoming the pandemic and supporting global economic recovery.

6. **We encourage the Fund to pursue a more balanced approach on climate change, both in terms of the timing and coverage, as well as to enhance collaboration with other international organizations (IOs) that have the right expertise in this area.** Here, we would like to stress the following points:

- **Timing:** While we strongly support the global efforts on climate change, including through the Saudi G20 Presidency which puts climate change on top of its agenda, we feel that the timing in terms of Fund priorities is not right. Almost all countries are grappling with the COVID-19 crisis and rightly focused on fighting the crisis to protect human lives and restore macroeconomic stability. The Fund should spare no efforts to help its members during this crisis by devoting all of its resources (financial and human capital) towards accelerating global recovery and safeguarding financial stability by providing technical analysis and advice in its core areas of expertise that also takes into account country-specific circumstances given the wide differences in countries' responses to the crisis. In this context, we hoped that the Flagship reports, including analytical chapters, would focus only on the COVID-19 crisis rather than on the long-term goal of reducing emissions. This would have given a strong signal that the Fund is fully focused on fighting this crisis to benefit the membership.

- **Coverage:** Given its near-universal membership, we believe that the Fund should take a more holistic approach that takes into account the alternative policy options available on climate change. In this context, we positively note staff's efforts in covering different options beyond carbon taxation. Indeed, it is important that the Fund explores all possible options that include both market and non-market measures. Given the wide differences across countries with regard to their stage of development, we encourage the Fund to carefully examine the implications of its climate-related work and policy advice on its members, especially EMs & LICs. In particular, mitigation is not costless and can prove unaffordable, especially for LIDCs facing resource constraints. The Saudi G20 Presidency is working toward developing comprehensive approaches to manage emissions in all sectors and improving synergies between adoption and mitigation actions.

- **Carbon (taxation) pricing:** We disagree with the call to increase carbon pricing. Carbon pricing is stacked against resource-rich countries, and all negative spillovers from such distortive policy tool should be internalized in our analysis. It is also regressive since the burden falls disproportionately more on LICs and poorer segments of the population, raising serious political economy issues. We encourage staff to further acknowledge the shortcomings of carbon pricing. Instead of carbon taxes, we suggest the Fund to focus on countries' pledges under their "Nationally Determined Contributions (NDCs)" which should be the basis for any action to mitigate climate change. Hence, we ask staff to make the necessary changes in the flagship reports prior to publications (particularly in Chapter 3 of the WEO), to ensure a well-balanced approach toward climate change.

- **Relatedly, we caution the Fund against suggesting "joint action" on a carbon pricing floor among major emitting countries.** We do not see the merit of a carbon price floor at the international level. We believe that it is up to each country to determine how it pursues domestic public policy to meet mitigation pledges considering the short and long-term trade-offs they perceive between alternative national development priorities and budget constraints. In practice, there are many problems in internationalizing national carbon prices, let alone the difficulties in harmonizing national with regional prices.

- **Negative emission technologies** are very important in achieving emission reduction. Regardless of the source (agriculture, livestock, energy, among all other sectors and gases), they transform the emission challenges into vast opportunities that help create jobs, spur innovation, advance growth, and address climate change. We very much welcome staff's reference to the carbon capture and storage. We believe that carbon capture, use and storage (CCUS) can play a key role in achieving prosperity and sustainable development. In particular, CCUS is a central part of efforts to achieve net zero emissions while reliably meeting the energy needs of billions of people for decades to come. Achieving climate goals by closing the loop in a circular carbon economy is an innovative concept that can be explored, and the Kingdom has taken key steps in this area. We recommend staff to take into account the role of technologies in addressing climate change.

- **Diversification:** Relatedly, we encourage staff to reflect in their analyses the diversification efforts by some commodity exporters, including Saudi Arabia, which should help strengthen economic resilience more than envisaged in the report (i.e., Fig. 3.9 in Chapter 3).

- **Collaboration with other IOs:** We strongly encourage the Fund to ensure closer cooperation and coordination with other international organizations that have the right expertise in climate change. For example, we note from Chapter 3 of the WEO that the Fund's estimate of global energy subsidies in 2015 was $5.3 trillion, based on Coady & others (2015). However, in the same year the World Bank, which has much greater expertise on climate change issues, estimated that the global cost of energy subsidies was $500 billion (Kojima and Koplow (2015)). According to the IEO, the presentation of different numbers created confusion among stakeholders, reducing the joint impact of the two products. We therefore ask staff to report the World Bank estimate in Chapter 3 as well. In addition, many countries have implemented bold energy price reforms since 2015, we see merit in acknowledging such efforts and drawing on the key lessons learned in Chapter 3.

Global Financial Stability Report

7. **We are reassured that near-term global financial stability risks have been contained.** We also take positive note that the global banking system is well capitalized. However, vulnerabilities are rising as the economic impact of the COVID-19 shock is still unfolding, especially in the nonfinancial corporate sector where firms have been accumulating higher debt. In particular, we agree that corporate liquidity pressures can morph into insolvencies, especially if the recovery is delayed. Hence, policymakers should remain vigilant and put in place adequate safeguards to preserve financial stability. We note staff's work on the near-term growth forecast densities, which shows that the deterioration of the global economic outlook has shifted the expected 2020 distribution of global growth deeply into negative territory. In addition, the impact of the crisis has disproportionately burdened the contact-intensive sectors, especially SMEs. Therefore, we encourage staff to

deepen our research in this area, especially given the importance of these sectors for job creation and economic growth. We welcome staff analysis in Table 1.1 on the monetary and financial policy roadmap throughout the pandemic's different phases. It is also encouraging to note that capital flows to emerging markets have resumed.

8. **We welcome the detailed analysis in Chapter 2 on the Asset purchase programs (APPs) and the local stress index.** We take positive note of the findings that APPs have been effective in reducing bond yields and have not contributed to currency depreciation or immediate financial stability risks. *Here, could staff elaborate on the reasons why APPs have been relatively slow in reducing broader domestic bond market stress?* We encourage further research in this area, including by conducting detailed cost-benefit analysis that countries can utilize when considering the application of unconventional monetary policies. Separately, we are encouraged by the finding that markets are not pricing in a significant risk from DSSI participation, despite concerns about possible negative actions by the credit rating agencies. As rightly pointed out by staff, the initiative is helpful in allowing countries to better weather the outcome of the pandemic, including by freeing up scarce resources to mitigate the human and economic impact of COVID-19. The potential DSSI extension should have positive impact on investors' confidence and economic activity.

Fiscal Monitor

9. **We are encouraged by the swift and sizable fiscal actions taken to address the COVID-19 pandemic**. We concur that fiscal policy should be used flexibly to provide the needed support for health-related priorities and provide lifelines for households and firms during this challenging period. We underscore the critical role that fiscal measures can play to support the recovery, and we caution against premature withdrawal of fiscal support, especially for the most-affected households and firms. Particularly, sufficient resources should be devoted to the healthcare systems and social safety nets throughout the recovery phase. We note staff's analysis in Table 1.3 about the roadmap for fiscal policies during the different phases of the pandemic. Public investment should focus on enhancing inclusiveness and increasing productivity, with more emphasis on job creation. Investment in digital infrastructure is critical in this regard, where it can help improve connectivity and digitalization of economic activity, including among SMEs.

10. **We welcome the analysis on fiscal multipliers in the COVID-19 crisis and recovery.** We take note of staff's finding that fiscal multipliers tend to be higher during recessions and in countries with fixed exchange rate regimes. *While we understand that in normal times public investment has larger short-term multipliers than public consumption,*

taxes, or transfers, we wonder if this finding will hold during this health crisis. One would expect that in the short-term cash transfers or wage subsidy programs would lead to higher multipliers given the immediate boost to spending power. The sizable upward revision in the WEO forecasts for a number of AEs probably indicate that the multipliers from such programs are very high. Staff comments are welcome. We agree with staff that initial conditions and the unique nature of the COVID-19 crisis should be taken into account, especially the level of public debt. Staff pointed out that fiscal multipliers will be lower in phase 2 of the pandemic than in phase 3 due to supply constraints associated with social distancing policies. In this context, we see merit in providing more granular analysis about fiscal multipliers in phase 2, particularly on which policy levers would lead to the highest positive impact on economic activity. *Does FAD envisage providing such analysis in the near future given its high relevance to many countries? It could be part of the IMF Special Notes on the COVID-19. We invite staff to comment.*

11. **Finally, we take note of staff's estimates for public investment for climate change adaptation.** We agree with staff that building protection and strengthening physical assets are key to address the natural disasters and climate change risks, thereby making progress toward the Sustainability Development Goals (SDGs). We note the increase in estimated costs of adaptation, particularly for LICs and small states. It is therefore important that developed countries provide adequate financial resources to assist developing countries given their significant financial constraints. The Fund's analysis on LICs could take this issue into consideration going forward.

GRAY/20/3015
Revised

September 28, 2020

Statement by Ms. Levonian and Mr. Weil on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for a well-written set of reports, which come at a time when the membership is in great need of advice to combat the crisis and transition to a sustainable and inclusive recovery.

While we are seeing some positive signs as economies reopen and activity begins to normalize, the Fund's upgraded forecast for 2020 does not reflect a broad-based improvement to the near-term outlook, confidence that the pandemic is firmly under control, or certainty around the near-term availability of a safe and widely available vaccine. Thus, we see risks to the outlook as tilted to the downside. Those risks include the resurgence of pre-pandemic concerns, such as worsening trade tensions and rising social unrest. Financial conditions have eased in response to unprecedented policy measures, but vulnerabilities continue to rise and the disconnect between markets and the global economy persists. Policymakers will need to avoid withdrawing policy support for households and firms too early, implement measures to support near-term growth, strengthen social safety nets, boost human capital, and invest in green growth. Policy space is limited in many cases by significant debt burdens, which will require more targeted spending and consolidation efforts in the medium term. Debt issues will require treatments beyond the G20's Debt Service Suspension Initiative (DSSI). The shared challenges of this global crisis will require enhanced multilateral cooperation to overcome.

Below we offer detailed comments on each Flagship publication.

We are in general agreement with the revised outlook, acknowledging that the trajectory of the pandemic is highly unpredictable and an effective vaccination or herd immunity in the global population is unlikely to materialize over the very near term. We would underscore that the improved outlook for 2020 is driven by a stronger-than-expected second quarter outturn in a handful of major economies. This masks continued weak demand in many markets. We note the assumption in the baseline that the acute phase of the pandemic is assumed to be over by end-2022, which is quite sobering and, in a way, seems at odds with the projected pace of the global recovery. *Can staff clarify how this assumption has evolved since the April WEO?* We welcome the presentation of both upside and downside scenarios given the tremendous uncertainty surrounding the baseline. In the medium term, all economies will progress only modestly toward the pre-crisis path of economic activity and will be affected by significant scarring. We would have welcomed a description of how behavioral changes, such as social distancing and increased tolerance for government intervention, might play into the medium-term outlook. The WEO appropriately emphasizes the bleak outlook for tourism-dependent economies, including those in the Caribbean, where the recovery will depend on the resumption of international travel.

The balance of risks is strongly tilted to the downside, which makes the projected recovery in 2021 highly uncertain. We see advances in therapies and the accelerated production of a safe vaccine with broad distribution as the only credible upside risk to the outlook. Conversely, there are myriad downside risks, some of which are already beginning to materialize, such as a resurgence of infections in many countries thought to be past their peak infection rate. Other downside risks include outbreaks, premature withdrawal of support, tightening financial conditions, trade frictions, and social unrest. The risk of a disorderly Brexit appears to have increased in recent weeks, and we would have expected deeper analysis of this issue given its wide-ranging impacts on the economies of Europe and the United Kingdom. We would note that whereas social unrest is clearly a downside risk to the outlook, in the medium term it could serve as a catalyst for more inclusive domestic policies and more sustainable growth.

The membership cannot afford to wait for a post-mortem assessment of the relative effectiveness of policy responses. With many countries on the precipice of a second wave of infections, the membership is looking to the Fund to draw out cross-country experiences and advise on those measures that have been the most (and least) effective. This is especially important for emerging and developing economies who are going to have to do more with less. The Fiscal Monitor provides a welcome preliminary assessment of the fiscal response to the pandemic, but regrettably this analysis was not aggregated-up into the WEO or broadened- out to include monetary and financial sector policy interventions. Presentationally, the WEO would have benefitted from adopting the trifurcated approach to policy advice used in the GFSR and Fiscal Monitor based on the various stages of the pandemic.

We welcome staff's focus on advice to support a green recovery. We were encouraged by staff's assessment that the goal of bringing net carbon emissions to zero by 2050 is still within reach. As economies decarbonize and undergo major structural transformations, it will be critical to support displaced workers. Policymakers will need to manage this reallocation of jobs from high to low carbon sectors alongside pandemic-driven structural changes in contact-intensive sectors. Pricing carbon pollution is the most economically efficient way to change behavior and incentivize economic actors to make more environmentally sustainable choices. It is reasonable to expect that domestic climate change strategies should differ depending on income level, emissions profile, sectoral mix, and the political economy. In many cases, the road to decarbonization will start with the phasing-out of distortionary and wasteful fuel subsidies and the tightening of environmental regulations. We would underscore that small states face an existential threat despite little contribution to the climate crisis.

Global Financial Stability Report

Unprecedented and wide-ranging policy actions taken in response to the pandemic have helped calm markets, boost investor sentiment, and maintain the flow of credit to the economy. Nevertheless, vulnerabilities are rising in the non-financial corporate sector and in the sovereign sector in many countries. While the global banking system is generally well-capitalized, a weak tail of banks exists. The pandemic has also resulted in a sharp rise in financing needs for emerging and frontier markets, which may tip some into debt distress.

Policy action has bought time but may also be fueling financial vulnerabilities. We remain concerned about the continued disconnect between equity markets and the global economy. Weak earnings outlooks are being offset by policy support, which has driven down risk-free rates and compressed the equity risk premium. A similar trend is being observed in credit markets where easy financial conditions have compressed spreads below values estimated to be consistent with fundamentals. This raises the risk of a sharp correction in the event of a change in investor sentiment or expectations regarding continued policy support.

Growing corporate debt vulnerabilities pose significant challenges. While solvency risks in the nonfinancial sector have been mitigated by policy support so far, the immediate liquidity phase of the crisis is giving way to a solvency phase as the crisis unfolds. If this develops into a significant solvency issue, default rates could be much higher than in previous crises, which could have implications for the global financial system. We agree that SMEs are much more vulnerable to shocks compared to large firms with access to capital markets. Further, since SMEs rely heavily on bank financing, this could have adverse implications for the banking sector.

NBFIs have entered the crisis with elevated vulnerabilities. These institutions have been playing an increasingly important role in riskier segments of the credit market, such as leveraged loans and private debt. In the event of increasing defaults and insolvencies, these entities could face sizeable credit losses. In addition, growing cross-border linkages between banks and NBFIs can exacerbate vulnerabilities, as was evident from the market turmoil unleashed by the COVID-19 shock. These interlinkages warrant ongoing monitoring. We agree with staff that the post-pandemic financial reform agenda should focus on strengthening the regulatory framework for NBFIs and enhancing prudential supervision to contain excessive risk taking.

Unlike the Global Financial Crisis (GFC), which had the banking sector at its epicenter, banks have been at the receiving end of stress in the current crisis. Wide-ranging reforms undertaken since the GFC have helped strengthen banks' capital and liquidity positions. This has meant that financial stress from the crisis has been felt mostly by market-based financial intermediaries and in money and bond markets. However, liquidity pressures may transform into solvency issues if the crisis deepens or a recovery is delayed. The banking sector would then bear the brunt of insolvencies affecting weaker businesses.

We welcome the analysis on risks in the commercial real estate market. The outlook for commercial real estate is uncertain, and assessment of vulnerabilities arising from changing business models and associated changes in demand for urban vs. suburban real estate should be a medium-term research project. *Are staff seeing evidence of accelerated suburbanization and associated pressures on urban real estate valuations as a result of prolonged (and in some cases permanent) shifts to work-from-home arrangements?*

Fiscal Monitor

The widespread economic fallout from the pandemic necessitated a forceful fiscal response. This has caused an unavoidable deterioration in public finances. Nonetheless, we support the unprecedented fiscal actions taken and believe that fiscal policy will have to remain well-designed, flexible, and tailored to the specific needs of the different phases of the crisis. A significant challenge will be ensuring that fiscal tools are not withdrawn in a premature manner.

Low rates and negative interest-growth differentials have enabled advanced economies to take on much heavier debt loads in the crisis. Conversely, economies that face high borrowing costs or constraints in their access to financing will need to do more with less by focusing on careful design and the selection of high-quality investments. This puts a premium on the resumption of bilateral surveillance to advise the membership on the calibration of fiscal measures, as well as on cooperation with the World Bank to improve the reach and targeting of social safety nets.

The fiscal response has pushed public debt levels to record highs, exacerbating pre-existing debt vulnerabilities. Tackling these vulnerabilities will require the establishment of sound medium-term fiscal frameworks, and in emerging and low-income countries will also necessitate improvements in domestic revenue mobilization, spending efficiency, and public financial management. The DSSI is providing valuable liquidity support to low-income countries, but with 47 percent of these members deemed to be in debt distress or at high risk of debt distress as of mid-August, solvency issues loom large and localized sovereign debt crises seem inevitable. Addressing debt vulnerabilities also requires full transparency by both creditor and borrower countries. We strongly support the Fund and World Bank's efforts to support transparency practices, including through technical assistance, lending policies, and enhanced public reporting of debt data.

We welcome the Fiscal Monitor's deep dive on issues of poverty and inequality which have been exacerbated by the crisis. As the Flagship reports note, the COVID-19 pandemic is expected to push millions of people into extreme poverty and could reverse years of progress on poverty reduction as the costs are borne disproportionately by the poor. The pandemic also threatens decades of women's labor force participation gains, effects could have been better emphasized in the Fiscal Monitor or the WEO. For example, in Canada, in April, women's participation dipped to 55 percent for the first time since the mid-80s as they bore the brunt of childcare and education needs due to school closures and also make up a greater share of employment in those sectors hardest hit by the recession. Scarring effects could worsen if lockdowns or voluntary social distancing persist and women permanently detach from the labor market to assume childcare or education responsibilities. It will be critical to enhance social protection systems to protect the vulnerable, but also to ensure that policies during the reopening and recovery phases promote gender equality, for example through investments in affordable childcare.

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GRAY/20/3016

September 28, 2020

Statement by Mr. Tanaka, Mr. Chikada, Mr. Naka, Mr. Nagase, and Mr. Shimada on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the set of comprehensive October 2020 Flagship Publications, which are well focused on the analysis of the COVID-19 crisis, while paying necessary attention to the medium- to long-term global challenges, including debt, trading and climate change issues. We commend staff for their hard efforts to make the fulfilling Flagship Publications despite the current exceptional and uncertain circumstance.

We agree with staff's view that the global economy has started climbing out from the depths and slowly recovering, while the recovery is partial and uneven, and uncertainty is exceptionally high. We recognize that the Fund's efforts, including the financing supports and policy recommendations to the member countries, combined with the bold policy responses by each authority have greatly contributed to mitigate the current crisis.

However, the COVID-19 pandemic continues to spread and has negatively affected the real economy by causing restrictions on mobility and supply chain disruptions. The end of the pandemic remains uncertain, and the authorities of the member countries are facing very difficult situation to recover the economy, while preventing the spread of the coronavirus. Under this situation, it is paramount to continue close monitoring of the situation and the impact of the authorities' policy responses on their fiscal situation, financial systems and financial markets. For example, while the pandemic has forced economic activities to be restrained, increase of both sovereign and corporate debts is inevitable and can be a huge future risk. **Under this difficult circumstance, we believe that the Fund should continue to conduct comprehensive and cross-cutting analysis on the impact of the pandemic on the member countries and provide objective policy advice and strong message based on the collective wisdom to the world to help them combat the crisis and to give them confidence.** Because accurate understanding of the latest situation and the impact of the COVID-19 pandemic on the global economy and individual countries, which is rapidly changing day by day, is basis of the decision of the member countries' policy responses and the Fund's supports for them, we would like to emphasize the importance of frequent information update to the Board and objective and careful external communications on this matter.

World Economic Outlook

Global economy has started a slow recovery, but still due attention is needed. We note that the growth projection of the global economy was revised upward to minus 4.5 percent in 2020 due to the better-than-anticipated second quarter GDP outturns, mostly in advanced economies. However, the impact of the COVID-19 crisis and the outlook for economic recovery after 2021 remain uncertain and uneven. The member countries need to continue to make great efforts to contain the pandemic and support most vulnerable people and businesses, while building the solid path for the economic recovery and sustainable growth. As we believe the Fund is expected to provide seamless support for the member countries by the surveillance, lending and CD, we strongly encourage staff to continue to make further efforts through utilizing its macroeconomics expertise.

Regarding the WEO projections, we would like to ask three points to staff. *Firstly, we noted that the size of the revision of the growth rate varies from country to country. For example, among the advanced countries, the growth rate of U.S. was revised upward by 3.7percentage points from June WEO update in 2020, but the size of the revision of the part of the EU countries seem relatively small; the rate of India in 2020 was revised downward by minus 5.8 percentage points, while those of Brazil and Russia were revised upward by more than 2.5percentage points. We would like to ask staff to elaborate on the factors behind these differences. Secondly, we noted that the growth rate of China is forecasted to be 8.2% in 2021, while the negative impact of the pandemic is expected to remain globally. What is the cause of the difference between China and other countries? In addition, how does staff evaluate the positive spillover of the high growth rate of China to the global economy? Thirdly, we note that the growth rate of the world economy in 2025 is expected to be 3.5percentage points in which we understand, would be the average growth rate of the world economy in the last 40 years or so. Does staff expect that the world economy will be able to go back to the trend growth rate in 2025, although they pointed out the lingering risks of the reduction of the productivity caused by the scarring of the pandemic?*

The Japanese economy has also started recovering. Although Japan is still facing difficult circumstances due to the pandemic, we recognize the consumption and export are improving these days, thanks to the resumption of economic and social activities and gradual improvement of the global economy. Japanese authorities have been making great efforts to revitalize the economy from the crisis by deciding and implementing two supplementary budgets which have over 230trillion yen ($2.2 trillion) scale, while preventing the spread of the coronavirus. We would like to continue our efforts to tackle the pandemic and recover the economy to get back to the growth path as soon as possible and to realize the economy and society with high-quality, including the better use of IT, by providing necessary supports to the people and businesses and implementing necessary structural reforms.

Multilateral cooperation is necessary for recovery for the global economy and to realize its sustainable growth. We welcome that staff reemphasized this point in the WEO report. Especially, we agree with the staff's view that it is indispensable for us to achieve rules-based multilateral trading system to recover the global economy. Based on this understanding, Japan has been making great efforts to expand the free trade, including the conclusion of the Japan-UK Comprehensive Economic Partnership Agreement this month. We would like the Fund to continue to contribute to the area from the macroeconomics point of views by closely cooperating with other relevant institutions, including the WTO. In relation to this matter, we would like to point out again that the restrictions on the flow of technology are different in that there is an acceptable type of restriction such as one for national security purposes, while trade tensions are by nature negative and should be minimized as possible.

Equitable and affordable access for safe vaccines and effective therapies to combat the coronavirus is key to overcoming the pandemic and supporting global economic recovery as emphasized in the report. On this point, we would like to point out that the G20 Joint Finance and Health Ministers Meeting, which was held on September 17th, agreed the need for a global response and the importance of taking forward collective action to accelerate the research, development, manufacturing, and distribution of COVID-19 diagnostics, therapeutics and, vaccines, including through the Access to COVID-19 Tools Accelerator (ACT-A) initiative and its COVAX facility and voluntary licensing of intellectual property. We would like to emphasize the importance to make steady efforts to realize these actions for the recovery of the global economy by enhancing the international cooperation.

We welcome the analysis on the impact of the lockdowns and social distancing on the economic activities and spread of coronavirus in the member countries in the Chapter 2 of the WEO report. We would like to commend the staff's efforts to analyze the impact of the unprecedented and ongoing crisis, which would be very difficult. We believe this kind of analysis will contribute to the timely and accurate policy decisions by the member countries to tackle the pandemic, and thus encourage the staff to deepen their works. We note the lockdowns have made severe negative impact especially on women and younger workers. In the Finance Ministers and Central Bank Governors' Meeting last year, we agreed to the importance of encouraging the labor market participation of women and well-functioning and fiscally sustainable social safety net with due consideration to intra- and inter-generational equity in the context of the response to the demographic changes. We would like to ask staff to enhance their analysis and policy advice to the member countries on this policy area through the surveillance. In addition, we found it very interesting that the analysis on the role of IT adoption during the Pandemic in the U.S., and we encourage staff to expand this analysis to the other member countries' cases.

We appreciate the staff's analytical works on the climate change mitigation policies in the Chapter 3 of the WEO report. We recognize this kind of research would be useful for the member countries to tackle the climate change issues and the Fund to discuss the engagement on this area. However, we would like to point out that not only the discussion of mitigation policies but also that of adaptation policies is important to address this issue, and we encourage staff to further deepen and diversify their analysis. In addition, we emphasize the importance of the CD of the Fund to support the countries especially where climate change is becoming a macro-critical problem based on these analytical works.

Global Financial Stability Report

We agree with staff that near-term global financial stability risks have been contained for now. Unprecedented and timely implementation of fiscal, monetary and financial sector policies by membership countries, especially by advanced economies, has helped maintain the flow of credit to the economy and avoided adverse macro-financial feedback loops, even though the pandemic has led to the worst global recession since the Great Depression. We see it particularly important amid the crisis that the accommodative financial conditions have been warranted mainly in advanced economies by the decisive policy actions.

We, however, take note with concern that the financial vulnerabilities have increased further against the background of forcefully maintaining accommodative financial conditions, while the global financial system have had some weak spots before the COVID-19 crisis, as mentioned in the past GFSRs. Specifically, we note of the increased financial stability risks stemming from the following 4 "disconnects" or "tradeoffs" between; i) rising market valuations and the evolution of the real economy (cf. Chapter 1) , ii) the short-term merits to maintain financial markets function by unconventional monetary policies such as asset purchases in emerging economies and the risk of fiscal dominance by prolonged or recklessly expanded use of such policies (cf. Chapter 2), iii) the essential liquidity support for the corporate sector and the risk of capital misallocation and increased public debt if those measures are prolonged used (cf. Chapter 3), and iv)the merits to maintain bank lending and the risk of the bank capitals' adequacy by easing financial sector policies (cf. Chapter 4). The aforementioned points clearly show the intertemporal policy difficulties due to high "uncertainty" of the COVID-19 crisis, which force the authorities to make difficult decisions on policy choices, including how to coordinate these policies and when and how to exit them. We expect staff to continue to monitor those risks rigorously and provide objective analyses.

Against these backdrops, we welcome that the current issue of GFSR will give the authorities the roadmap of policies at each stage of the crisis. Going forward, we expect that the Fund would provide policy advices tailored to country specific circumstances, through bilateral surveillances.

We will provide the following comments on specific chapters.

- On Chapter 2, we welcome the analysis on unconventional monetary policies such as asset purchases in emerging economies. We encourage staff to strengthen the Fund's policy advice on monetary policies through the stock taking by leveraging the Fund's comparative advantage, namely its wider membership covering almost every country in the world, while actively cooperating with the BIS and national central banks.
- On Chapter 3, we welcome the analysis on the corporate financing environment in the G7 economies. We encourage staff to further analyze the heterogeneity on the bonds market and the bank lending among G7 countries amid the current crisis. In addition to that, while we understand that the analysis focused on the listed companies due to data constraints, we would appreciate if the analysis could expand its coverage on small and medium-sized enterprises which the current crisis has hit harder. We also would like to see the similar analysis on the corporate sector in major emerging economies.
- On Chapter 4, we welcome that banking sector have shown resilience to the COVID-19 crisis thanks to the financial regulatory reforms after the Global Financial Crisis and the accumulation of capital and liquidity buffers by each bank. It is beneficial to forecast the bank capitals based on the global stress test with the consideration on bank specific policy responses in order to judge whether banking sector would need additional capitals. We expect that bilateral surveillance would complement some shortcomings of the analysis, such as the lack of coverage on some systemic important economics (e.g. China) in the global stress test, and less granular data sets on bank assets due to public data constraints. In relation to that, we commend staff for stocktaking the membership countries' policy responses to the COVID-19 crisis. We encourage staff to cooperate with national authorities continuously to gather and analyze more granular data, given its difficulty to gain some data such as the accurate capital ratio.

Fiscal Monitor

We appreciate the staff's analysis on the policy responses of the member countries against the COVID-19 crisis and the necessary fiscal policies to realize the economic recovery after the pandemic. We welcome the staff's views that the bold fiscal and monetary policy responses in the beginning of the crisis have supported the most vulnerable people and businesses and prevented the fallout of the economic activities in member countries.

Debt issues are the critical challenge for the global economy. Due to the crisis, fiscal situation of the member countries has worsened sharply, and the level of the public debt has risen higher than that of the after WWII. In order to stop the situation getting worse, the authorities of the member countries should pay due attention to benefits, costs and risks when they implement the supporting measures to address the crisis as staff pointed out in the report. In addition, as discussed in the April 2020 Fiscal Monitor, those measures should be implemented in targeted, timely, and temporary manners. In this regard, we would like staff to closely monitor the policy responses of the member countries, especially those who have been approved of the emergency financing by the Fund, and to provide necessary policy recommendations to them as appropriate.

In the same context, **we have concerns that the rise of the public debt level and increase in the debt payment burden of the LICs has been limiting the fiscal space of those countries to tackle the crisis.** To effectively support them, it is important for all the bilateral public creditors to implement the DSSI and secure the liquidity for those countries. In addition, as pointed out in the staff report, debt vulnerability has further increased in recent years due to the increasing reliance on non-concessional borrowing by the LICs. To restore debt sustainability and ensure sustainable growth of those countries, it is necessary to consider the next steps of the DSSI. In the next stage, we should take a case-by-case approach depending on different situations of each country based on the DSAs, and all creditors, both official and private, should participate in this initiative. We request staff and World Bank to conduct robust DSAs as early as possible which will enable us to initiate the next steps.

We take note the Table 2.1. of the Chapter 2 of the Fiscal Monitor in which summarized the role of the public investment in each stage from the great lockdown to the post-pandemic. Regarding this point, we have no objection on the idea that the investment related to the policies such as health, digital infrastructure, and climate change adaptation and mitigation should be prioritized in the post-pandemic phase; however, it is important to decide the priorities depending on the situation of each country. Furthermore, in order to establish the well-resourced and better-prepared healthcare systems, it would be necessary for the member countries to steadily implement reforms step by step from various aspects, and thus we would like staff to provide more concrete policy advices to effectively support them. In relation to this matter, we would like to point out the fact that the G20 Joint Finance and Health Ministers Meeting agreed the importance to promote the UHC in the context of well-balancing the containment of the pandemic and the economic recovery. We would like staff to have deep discussions with both finance authority and health authority of the member countries on the matter of the appropriate resource allocation in the health sector based on this idea.

In order to achieve both improvement of the fiscal situations and implementation of the necessary public investment, discussion to secure the public revenue would be warranted. On this point, as we found staff touched the discussion of the policies to increase the revenue by enhancing the tax compliance and strengthening the design of the progressive tax policies in the report, we would like them to further deepen their analysis on this matter and provide concrete policy recommendations. In addition, we understand not only the tax reforms, but also the enhancement of the tax administration is necessary, especially for the developing countries, and we encourage staff to prove necessary support by conducting the CD on national mobilization to them. *Staff's current views and plans on the discussion over these matters are welcome.*

GRAY/20/3017

September 28, 2020

Statement by Mr. Poso, Mr. Damgaard, and Mr. Evjen on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the comprehensive and well-written set of flagship reports and highly appreciate the effort to analyze the global economic, financial, and fiscal outlook in a challenging environment.

World Economic Outlook

We broadly agree with the WEO's assessment of the current situation and outlook for the global economy. After sharply contracting during the first half of the year, economic activity rebounded during the summer as economies reopened and constraints were increasingly lifted. Unprecedented policy measures have supported households, businesses, and the functioning of the financial system, preventing worse outcomes. However, the resumption of economic activity has been only partial and very uneven across countries, sectors, and population cohorts. We are particularly concerned about the ability of countries with weak economic fundamentals and limited policy space to weather the difficult environment.

The path to full recovery will likely be long and uneven, depending on the development of the pandemic and its cure. We note the projected global economy rebound in 2021, starting in the second half of this year. In view of unprecedented uncertainty, we appreciate the consideration of both positive and negative scenarios. While the evolution of the pandemic remains a key risk, there are also significant concerns regarding financial conditions, geopolitical and trade tensions, and political uncertainties. *We would welcome staff's elaboration on their view on the balance of risks to the outlook.*

We welcome that the WEO discusses the importance of scarring effects and the negative effects on potential output. These effects may operate through, for example, agents' beliefs about the future and their assessment of tail-risks leading to permanently lower investment and growth in the long run. At this point, however, it is unclear which of the currently observed shifts are temporary and which prove permanent. In addition, these developments depend on the length of the pandemic. How to detect true structural change thus warrants further analysis.

We agree with staff on the necessity of the current sizable policy response to continue, concentrating on limiting damages, securing resources to health care, and supporting recovery where reopening is underway. Furthermore, we highlight the challenges related to identifying the correct timing and approach to unwind support measures. This could have warranted further analysis in the WEO as member states need to rely more on multilateral surveillance until the resumption of the Fund's bilateral surveillance and policy advice.

The sequencing of withdrawing policy support is of particular importance. If measures are maintained for too long, they do not only accumulate debt, but may also prevent efficient resource allocation, delay necessary reforms, and maintain inefficient structures (such as zombie firms) that weaken growth potential. On the other hand, withdrawing support too quickly could generate cliff effects for corporates and households as regards the availability of finance and income support when measures are removed.

Fiscal policy will remain a critical tool to foster economic recovery. We support the recommendation of gradually unwinding the immediate crisis support measures as economies reopen and recover, together with supporting recovery through targeted growth-enhancing public investment, which could advance important priorities, including green transition and digitalization. We agree that tax and spending measures should prioritize initiatives that can help lift potential output, ensure inclusive growth, and protect the most vulnerable.

We agree with staff that maintaining an accommodative monetary policy stance is essential. The role of monetary and structural policies is, however, scarcely discussed in the report. *Could staff elaborate on how they see the role of monetary policy and its interaction with fiscal and macroprudential policies in the recovery?*

We call for more weight to be put on the need for structural reforms to improve growth prospects when entering the recovery phase. The crisis has revealed and heightened structural weaknesses in many countries, which may hamper the recovery. These weaknesses should be addressed from the onset of recovery, consistent with the objectives of supporting growth and equity, for example through labor market policies, reforms in social safety nets, and digitalization.

The large fiscal stimulus combined with the contraction in output has further exacerbated the trend of debt accumulation. Elevated debt levels highlight the importance of finding the right balance between short-term support for growth and longer-term sustainability. When economic conditions allow, policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability should be pursued, while enhancing investment to increase productivity and potential output. This is particularly challenging for many EMDEs, where debt service is absorbing an increasingly large share of tax revenues. Hence, improving the efficiency and transparency of public financial and debt management will be important. Where other measures prove inadequate, we agree with staff's view that debt restructuring may be necessary to restore debt sustainability.

The effects of the COVID-19 shock on poverty and equality are devastating. We thank staff for the thorough analysis on the topic and concur with the policy advice. We underline the importance of implementing measures to maintain human capital and support the recommendation of increasing investment in education, both to mitigate the effects on learning from school closures as well as to break the pre-existing trend of increased inequality in opportunities which is exacerbated by the pandemic. A crisis-induced disruption in education can have long-lasting consequences for individuals' lifetime learning potential, thus increasing inequality, as well as for economy-wide productivity growth. Furthermore, many low-income countries will require support from the international community to address their complex health, poverty, and economic challenges. Increasing inequality could hold implications for monetary policy as there is some evidence that it may be one of the driving factors behind the low natural interest rate.

In Chapter 2, analysis with high-frequency real-time data provides further insights to understanding the current economic situation. Our key takeaways from the analysis are that the decrease in mobility and its effects on economic activity has been driven both by administrative lockdown measures and self-imposed social distancing due to health risks and risks to society. Thus, easing of lockdowns tends to have mild effects on mobility and economic activity as long as health risks persist. Hence, a further rebound of economic activity depends strongly on the health situation. Furthermore, the analysis confirms the unequal effects of the pandemic with lower-income families, women, and younger cohorts disproportionately impacted. We agree with staff that more research is warranted to examine the effects of more targeted instruments to help these groups as well as to examine the balance between the benefits and costs of lockdowns.

We agree with staff on the critical importance of addressing climate change and the need for increased policy ambition regarding emission reduction. Chapter 3 of the WEO provides valuable analysis and policy advice toward attaining global zero net CO_2 emissions by 2050. We support staff's call for a green investment push during the recovery by setting a carbon price and other financial incentives to direct private capital spending towards decarbonization in combination with targeted fiscal stimulus to boost green and resilient public infrastructure. This will strengthen growth and mitigate the costs of transitioning to a low-carbon economy. Yet, it is important to keep in mind the risks related to green investments such as the risk of novel technologies and the risk of over-pricing green assets due to the lack of sustainable/green projects available. Gradual increases in the price of carbon to incentivize the needed emission reductions is one of the most efficient ways to reach a low-carbon economy. The actual crisis measures taken, broadly continuing to support existing fossil-based industries, is an unfortunate evidence to the contrary.

We agree with staff that international policy coordination on climate change deserves further attention and support staff's call for the five largest emitters to join forces in ambitious action to meet the 2015 Paris Agreement targets. Finally, we encourage staff to examine the best practices and policy responses to mitigate the impact of physical and transition risks on financial stability as well as to study the scope and transmission channels of second-order effects.

Global Financial Stability Report

We agree that the unprecedented and broad-based policy response to the COVID-19 crisis has been a key factor in averting adverse macro-financial feedback loops and a full-fledged financial crisis. Moreover, the regulatory improvements initiated after the Global Financial Crisis (GFC) have played their part and proved to be efficient in making the financial and banking sectors more resilient. In AEs, banks are better capitalized than at the onset of the GFC, and extensive policy support has kept financial markets afloat so far. A number of EMEs had strengthened their monetary policy frameworks in recent years, anchored inflation expectations, and further developed local currency sovereign debt markets, which allowed them to use quantitative easing without triggering adverse market reactions.

The crisis is far from over, and the recovery will continue to be fragile and uneven. Vulnerabilities are increasing, and downside risks to global financial stability are plentiful. Specifically, we emphasize the following potential sources of risk:

- As the stabilisation is extensively a result of massive policy support, **authorities will face the challenge of striking the right balance between continuing and withdrawing support.** Central banks will need to be careful in withdrawing their policy actions without causing market disruptions. For prudential authorities, a key challenge is the appropriate timing for changing their advice on bank capital and liquidity buffers and encouraging banks to start rebuilding the releasable buffers again.

- **Policy actions should continue to support bank lending to aid the recovery while also ensuring the resilience of the financial sector to meet future shocks**. The current temporary state guarantee measures and debt moratoria will eventually end, leading to potential cliff effects that will reduce the capability of banks to extend credit. *Is staff planning to further analyze the timing and consequences of such cliff effects?* Further, the banking sector should begin preparations for dealing with non-performing loans now, rather than wait until the pandemic is under control, as this could take time.

- **We agree that the misalignment between stock market values and the real economy is worrisome and the risks of adverse market reactions are growing**. We note that the stock market recovery and the misalignment are largely driven by technology shares. Combined with exceptional trading volumes in equity derivatives – in particular the call options of tech firms – this creates a sector-specific vulnerability in addition to broader concern of elevated asset values.

We emphasize the need for an ambitious regulatory drive to address the vulnerabilities exposed and amplified by the crisis, specifically to address regulatory gaps related to the non-bank financial sector. We agree with staff that addressing excessive risk-taking in the low-for-longer interest rate environment is a priority going forward. Furthermore, we note that managing the quickly rising debt levels will be challenging in the coming years, and it will require careful attention and decisive actions, such as debt restructurings, to reduce the risk of a debt crisis.

Fiscal Monitor

Massive and decisive fiscal policy action has been instrumental in curbing the most adverse scenarios of the Covid-19 crisis. We agree that the crisis has revealed gaping differences in countries' ability to finance emergency spending and that fiscal constraints have been binding in many EMDEs.

We agree with the main messages from the analysis on public investments boosting recovery. However, it would be interesting to see more analysis of risks related to public sector projects crowding out (or in) private sector projects. Moreover, multipliers vary a lot depending on the timing, macroeconomic situation, project quality, and degree of uncertainty. We also note recent meta-analysis that finds that public investment has larger short-term multipliers than public consumption, taxes, or transfers. Thus, as noted in the report, **it is important that countries commit to efficient investment projects that enhance the productive capacity of the economy**. At the same time, the possible negative fiscal effects arising e.g. from permanent increases in current spending should be taken into account. *Could staff elaborate on their views on how public investment can affect fiscal space in the longer run?*

GRAY/20/3018

September 28, 2020

Statement by Mr. Raghani, Mr. Nguema-Affane, Mr. N'Sonde, Mr. Carvalho da Silveira, and Mr. Diakite on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

1. We thank staff for the flagship reports and appreciate the focus on the continued fallout of the Covid-19 crisis and the policy priorities to contain its impact while sustaining the recovery. We also welcome the discussions on key medium to long-term challenges that must be tackled beyond the pandemic.

WORLD ECONOMIC OUTLOOK

2. **We broadly share the analysis of the conjuncture and outlook which provides reasons for less pessimism than a few months ago while remaining subject to great uncertainty.** We note the projection of a less severe global contraction in 2020 than anticipated at the time of the June 2020 WEO Update, mainly due to the reopening of some economies. Nevertheless, output gaps are still significant and uncertainty around the pandemic persists. We also note that the forecast of a strong rebound next year is predicated on the effectiveness of social distancing into 2021. Low-income countries are disproportionately affected as their economies structurally rely on contact-based and informal activities. Among those are commodity exporters which face the concomitant fall in commodity prices and production due to the sharp decline in global demand. In addition, we agree that this pandemic will have a durable impact on economies—for instance, raising debt levels, further exacerbating the pre-crisis productivity slowdown and causing a setback to human capital accumulation—and on living standards, Particularly worrisome is the threat to the gains achieved by low-income countries in poverty reduction over the past two decades.

3. **It seems to us that the balance of risks remains tilted to the downside given the preponderance of negative risks over upside risks.** The report could have provided a clearer direction of the balance of risks around the baseline despite the primary uncertainty regarding the evolution of the pandemic. We recognize the difficulty of

quantifying the risks directly related to the pandemic, notably those surrounding the developments in rates of infection; the pursuit or withdrawal of policy support, the availability of data-enabled services and remote working; the advances in therapies; and the provision of a safe and effective vaccine. However, whereas each of these risks carries a symmetrical probability distribution, there is a significant number of other risks that are mostly skewed to the downside. These include risks stemming from social strife, geopolitical tensions, trade and technology frictions, and climate change. In addition, the materialization of upside risks associated with the evolution of the pandemic may well lead to a stop in social distancing and trigger the realization of those latter downside risks. Thus, we *would appreciate further elaboration on the balance of risks.*

4. **Against the background of high uncertainty and negative risks, we appreciate the WEO's continued emphasis on priorities to provide adequate resources for health care systems and contain the economic fallout of the pandemic.** The pre-requisite for achieving the objectives of overcoming the health crisis, restoring confidence and ensuring a resilient and inclusive recovery is to curb the infection rates and strengthen all public health systems, as no economy will be safe in this environment unless all countries can cope with the pandemic. As rightly underscored by the report, meeting these priorities will require a great sense of multilateral cooperation, notably in supporting developing countries, most acutely in Africa. The bulk of these countries may not have reached their infection pikes yet. Therefore, we endorse the message on strong multilateral solutions and open trade to allow all countries' access to protective supplies, medical equipment, treatments and vaccines.

5. **We are in broad agreement with the prescription that near-term policy support should be calibrated in such a way as not to undermine the medium-term objectives of stronger, resilient and inclusive growth which depends, among others, on tackling debt vulnerabilities.** Prioritization of spending towards health and education—to boost long-term productivity—as well as investments in infrastructure to support post-Covid-19, digital-based and greener economies is of the essence to preserve favorable longer-term prospects. At the same time, the tradeoffs between the necessary immediate policy support and preventing further buildup of debt burdens must be addressed also through multilateral initiatives aiming at debt restructuring and relief. Those initiatives should be extended as needed, benefit all developing countries in dire need and be attentive to avoiding a mere postponement of debt service peaks. In particular, regarding the G-20 initiative, we would welcome a clearer call for a comprehensive participation of creditors, including private creditors (page 31 in Chapter 1). *It would also be desirable to deliver a message on the need to provide adequate support to countries in debt distress along with promoting debt transparency and good borrowing and lending practices.*

6. **While objectives at the national level are shared across countries, specific policy actions should vary depending on national income level, pre-existing vulnerabilities, policy space, informality and the phase of the pandemic in each country.** We welcome the recognition of these differences for policy recommendations and broadly agree with the set of policies in the various country circumstances presented. Even within each situation, agility in economic policy response is needed to quickly adjust towards

the most efficient and cost-effective policy actions, including possible unwinding of supportive measures. That said, a key common concern is to avoid premature withdrawal of policy support.

7. **Measures to tackle pre-Covid 19 challenges and the pandemic's scarring are properly detailed and remain fundamental.** It is important to keep an eye on those challenges as they can only be exacerbated if action is not taken. These include debt vulnerabilities, productivity slowdown, inequality and climate change, all challenges that are macro-critical and that the Fund should continue to help address. There is now also the concern of learning loss caused by long closing of education institutions and by virtual learning, which will impact human capital, further slow down productivity and affect incomes going forward. Resolving this loss will require significant resources. We welcome that the report attempts to provide avenues for closing the gap—including solutions related to the duration of school years, teaching methods, outside-class programs and vocational training—but more extensive analysis is required given the novelty in the nature of this challenge. *We urge staff to reflect more deeply on options to minimize the human capital loss in an upcoming WEO report.*

8. **On the analytical Chapter 3 regarding climate change, while we are pleased to note that reaching net zero pollution emissions by 2050 is still attainable, global coordination and significant funding are needed and attention should be paid to the impact of climate policies on vulnerable groups**. We see merit in setting policies that promote private green investments and, combined with green fiscal stimulus, can help alleviate adjustment costs to carbon pricing, boost aggregate demand and support employment in low-carbon sectors and the overall economy. That said, *emerging and developing economies are likely to encounter challenges in financing their low-carbon future as they are faced with limited fiscal space, high debt burdens and potentially reduced access to capital markets. Staff's elaboration will be appreciated.* We also share the view that meeting climate objectives while preventing spillovers from related economic disruptions will require governments, businesses and individuals to work together on international policy coordination and burden sharing. This joint effort should also take into account the potential role of private sector, technology and financial systems in helping mobilize finance for low-carbon solutions, as well as the situation of oil-producing countries. Moreover, work on the distributional impact of climate policies should be deepened further, even though measures such as targeted cash transfers to the most vulnerable could be attractive to mitigate the impact of difficult transitions and reskilling on those populations.

GLOBAL FINANCIAL STABILITY REPORT

9. **Ensuring stable capital flows and closing the disconnect between financial and economic developments are essential to sustaining the recovery.** Notwithstanding recent easing of global financial conditions and alleviation of near-term financial stability risks—thanks to timely and strong policy response to the pandemic—financial vulnerabilities are rising across segments (asset management companies, nonfinancial corporate and sovereign), and in emerging and frontier market economies due to the worsening of fiscal positions. Given the protracted nature of the pandemic, financing needs to keep economies afloat are likely to remain substantial and could further increase these vulnerabilities. This highlights the importance of maintaining stable capital flows to help support the recovery while giving room to address vulnerabilities. Moreover, we agree that the dichotomy between financial and economic developments, amplified by policy support, raises concerns, especially given IMF's finding that overvaluations are at historically high levels in some countries. *We encourage staff to closely monitor the evolution of this disconnect while assessing the risk of another financial crisis occurring down the road as policy support subsides.* We appreciate the road map for monetary and financial policies at different stages of the crisis. *We wonder whether we could have a map showing the stage at which each country stands.*

10. **We welcome Chapter 2 on emerging and frontier markets' policy response to the pandemic, which draws some interesting lessons for policymakers in these countries**. While domestic policy rate cuts and FX interventions on domestic currency markets have had limited impact, the unprecedented adoption of asset purchase programs (APPs) by central banks in some of those countries has been effective in reducing domestic market stress. The positive experience with APPs is likely to encourage policymakers in emerging countries to use more often this unconventional monetary policy tool to reduce market pressures and preserve financial stability. We look forward to staff finetuning their analysis of APPs in emerging and frontier economies to identify conditions for their effectiveness in reducing domestic market stress, beside the position of interest rates relative to their effective lower bound. In addition to alleviating fiscal burdens, debt reduction initiatives involving both official and private creditors are also essential to mitigate financial stress. In the meantime, and in parallel, international financial institutions, including the Fund, have an important role to play in providing support to countries facing financial challenges.

11. **We appreciate the analytical Chapters 3 and 4 which underline the importance of specific measures in the nonfinancial corporate and banking sectors respectively to contain financial stability risks.** We note that non-compliance with bank capital requirements may increase under the WEO's adverse scenario and welcome the insight provided in Chapter 4 on policies to cope with such event, including bank-specific mitigation measures to adjust capital requirements and limit capital distribution.

FISCAL MONITOR

12. **As acknowledged earlier, responding forcefully to the crisis while preserving buffers to the extent possible and strengthening medium-term growth prospects raises daunting challenges that call for policymakers' attention.** Difficult tradeoffs are confronting countries as they continue to struggle with the fallout of the pandemic, especially those that did not have adequate fiscal space and/or had significant debt vulnerabilities before the crisis. We appreciate the Fiscal Monitor's work on this issue

and the roadmap proposed to help countries at various stages of the pandemic navigate through these trying times while preserving the future.

13. **Fiscal policy remains a prime tool in support of short-term macroeconomic and equity objectives, and necessitates careful calibration to country circumstances, notably as it relates to low-income countries.** Going forward, monetary policy is likely to be constrained by persistent low interest rates and asset purchase programs cannot be extended too long out of concern for central bank balance sheets. Therefore, we agree that fiscal policy will continue to be relied upon to enhance social programs in protection of the most vulnerable and stimulate economic recovery. However, as also noted in the WEO, the policy space in many low-income countries, notably in sub-Saharan Africa, remains extremely challenging, not least because of a significant risk of reduction in the financing available to this region, both private and official development assistance. Associated with difficulty to enhance domestic resource mobilization significantly at this juncture, this could reverse decades of progress in social and economic development. It is therefore critical that the development efforts of countries to improve human capital, enhance productivity and promote jobs continue to be supported by multilateral backing, including through grants, concessional financing and debt relief.

14. **We recognize the importance of evaluating the costs and benefits of fiscal measures put in place during the pandemic.** These measures have often been implemented under circumstances of urgency, and a proper assessment of their effectiveness and risks to the long-term sustainability of public finances is necessary. However, to be valid, this assessment requires full transparency, good governance, and proper costing of those measures. We encourage the Fund to focus on these aspects in its policy dialogue with members.

15. **Finally, we welcome the emphasis on fostering post-pandemic recovery and enhancing resilience to future pandemics and other shocks and recognize the centrality of public investment in this regard.** We share the view that priority should be given to upgrading infrastructures in a variety of areas to boost long-term economic growth, including health systems, digital groundwork, and infrastructures needed to enhance resilience to climate change. In this connection, the use of public investment for fiscal stimulus should target projects that are well designed, rigorously selected and well implemented to produce high rates of return. That said, in this area too, many low-income countries should be supported by multilateral development partners to prevent them from having to resort to cuts or postponements in public investment deemed critical for economic growth.

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September 28, 2020

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

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

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

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

Economic Performance and Outlook

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

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

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

Policy Recommendations

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

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

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

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

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

Debt

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

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

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

Other Topics

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

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

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

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

Conclusion

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

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September 28, 2020

**Statement by Mr. Buisse, Mr. Rozan, Ms. Gilliot, Ms. Albert, and Ms. de Waziers on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020**

We thank staff for their very well-crafted and insightful reports. The pandemic has generated a unique crisis that calls for a unique response. And as this crisis spares no country, strengthened multilateral cooperation and solidarity are more important than ever. Faced with a context of low visibility on the evolution of the pandemic and the uncertainty on a possible vaccine, policymakers need to continue to apply strong, well-articulated and well-designed emergency policy support to deal with the unprecedented recession this year, while ensuring that current measures also pave the road for a resilient, sustainable and inclusive growth in the longer term to counteract the social and economic scarring of the crisis. The features of the policy support (type, calibration and sequencing) will be the key determinants of the recovery, and should be carefully designed, while keeping the financial stability risks under close watch. It will also be important not to lose sight of our vital climate objectives. In this context, the set of reports is very useful, and we strongly believe that their value-added will contribute to improve the soundness of policy-making decisions both at the domestic and international levels.

1) **An expansive policy-mix is warranted in the short term to face the unprecedented recession this year and strong uncertainty ahead.**

We broadly share staff's analysis regarding the depth of the recession this year and the rebound in 2021, as well as the extensive list of risks, and welcome the useful scenario analysis presented. Though activity continues to be heavily impacted, positive surprises in recent months and the upward revision for 2020 are good news. However, regarding the advanced economies, we do find the euro area's growth projection, and in particular France, as slightly too pessimistic: we expect a more dynamic growth in 2021, in light of short-term indicators and the impact of the stimulus package. *We would be interested to have more details regarding the incorporation of the national stimulus plans in the countries' forecasts and the impact of the 750 Bns EUR package on the euro area's growth*. Uncertainty surrounding the risk of a no-deal Brexit could have been more highlighted in the report. We also note that there is significant uncertainty on the US policy support in 2021, pending the outcome of the elections, which will most likely have impact on the policy-mix and thus growth in 2021. We take note of the more differentiated situation in emerging economies, with some countries being limited by their health capacity. While the resilience of China's growth has been impressive, India and Latin America are paying a heavy toll. It is clear that countries relying more extensively on informal markets have more difficulty to respect social distancing. We agree that inflation should stay low for a while due to the importance of demand effects. However, we are wondering in which extent the downward trend of non-cyclical effects could last and recognize also the existence of several upside risks. More broadly on the scenarios presented, we encourage staff to develop a more sectorial approach, which will be key to better understand the evolution of the economic situation. *Could staff give more details on (i) how they determined the calibration of the recovery in the baseline and the loss of GDP level by end 2021 compared to 2019, and (ii) the underlying quantitative assumptions (variables and shocks) of the alternative scenarios?*

Financial easing has contributed to the mitigation of tail-risks, and we agree with staff's overall diagnostic in terms of financial system stability. The disconnect between financial markets and the real economy has heightened the risk of a sharp asset price adjustment, though part of overvalued equity reflects outperforming technology and long-term profits unaffected by the crisis. Fragilities in Non-Bank Financial Institutions (NBFI) remain among the main concerns that should be primarily addressed and warrant a full-fledged assessment of interconnections and risks (including moral hazard) in this sector. **The assessment of the global banking sector's resilience is very useful in helping to figure out the effects of both the Covid-19 crisis and of the supporting measures. It is clear that the banking sector is much better prepared to the crisis compared to the GFC.** Still, this exercise deserves additional clarity on the reasons why the solvency ratio of the advanced economies in the baseline scenario records a stronger deterioration compared to emerging economies while the situation reverses in the adverse scenario. Expanding the pool of banks in this Stress Test to large emerging economies like China and Russia would make the results more representative. We encourage staff to better take into account the geographical diversification of the large international banks when assessing their sensitivity to the macroeconomic shocks as well as the impact of additional support measures that could not be quantified at this juncture, like those of sectoral policies As previously underscored, we warn against not accounting for the neutralization of the impact of expected loss provisions (when booked in compliance with IFRS9) in CET1 ratios until 2025 as recommended by the Basel Committee.

Exceptional monetary and fiscal support has cushioned the impact of the pandemic. However, policymakers should avoid removing policy support too quickly, and should continue to fine-tune their approach to better target policies.

We share the idea that the long-term positive effects of controlling the pandemic will offset the short-term costs associated with the lockdown. As demonstrated by the interesting preliminary results (WEO chapter 2), a tighter lockdown implemented at an early stage could be more efficient than implementing a mild lockdown at an advanced stage of the epidemic. In coordination with relevant health organizations, we would encourage further work to develop more granular analysis on the differentiated impact of government's measures (school closures, work from home, ban on gatherings…) as well as precise circumstances where a localized lockdown and targeted instruments are more efficient, to help further assist policy-makers in their choices. We also encourage staff to integrate in their lockdown analysis the impact of variables such as social capital, trust in health system or urbanization rates which could affect the efficiency of lockdown measures.

We strongly support the Fiscal Monitor's roadmap for fiscal policies, which underscores the need to avoid premature fiscal tightening to protect economic recovery. Strong growth friendly spending measures are warranted in the current exceptional circumstances. Moreover, international coordination also matters to maximize the impact of recovery plans. In the case of the Euro Area, the effectiveness of the recovery plan will also depend on the ability to use funds efficiently, quickly and in a targeted way. First and more specifically, we agree with staff on the need for ambitious public investment policies in order to support the recovery, which could also respond to the chronic investment deficit in some countries. It is important to ensure the effectiveness through productive projects in the priority sectors identified by staff (energy transition, digital, health). Second, as fiscal resources are limited, we support the message of flagships calling for more redistribution, with progressive taxation schemes, as well as the changes to corporate taxation to ensure that firms pay their fair share. We also strongly support the need for strengthening social safety nets, as the most vulnerable, in particular women and young people, have been disproportionately affected by the crisis. With worrying poverty and inequality trends highlighted in the reports we encourage staff to continue to pay a specific attention to these topics.

Maintaining accommodative monetary policies, including through unconventional measures, and monitoring the effects associated with these policies, remains important. Overall, we fully support the policy priorities proposed in the GFSR, including the need to closely monitor potential unintended consequences of ultra-accommodative measures. Sequencing of policy actions distinguishing short- from long-term objectives remains a key success factor, along the different phases of the crisis. Potential adverse effects of low interest rates in an already low inflation environment should be closely monitored while adequate policy-mix should be supported by consistent structural reforms to boost potential growth and anchor inflation expectations. We particularly share staff's assessment of policy response in EMDEs where monetary policy has generally lived up to expectations so far. Although in several cases, Central Bank Asset Purchases (APP) were sterilized, alleviating downward pressure on exchange rates, we agree that expectations of larger-scale APP could reverse this trend and result in significant investors' portfolio shifts. We will welcome further work on this issue. In China, monetary policy response, though supportive of the economy, has nonetheless added to financial vulnerabilities underlining the need to improve the effectiveness of interest rates transmission channel. More emphasis could have been put on consequences on banks' balance sheets of the PBoC's incentive measures to relax lending practices.

The challenge related to the policy mix and fiscal space is even more pressing for LICs, which are also faced with considerable setbacks in their development objectives. Expenditure should be reoriented to health and adequate relief to vulnerable populations. Efforts to mobilize domestic revenues, notably through the enhancement of the tax collection in low income countries will contribute over the medium term to meet development financing needs and anchor fiscal sustainability. However, in the short run, one of the biggest challenges of the most vulnerable countries is their ability to deal with their large financing gaps, and their high level of external debt service, in particular if they are characterized by a pre-existing vulnerability. While the DSSI and an unprecedent amount of emergency Fund financing have provided liquidity bridges, tackling structural issues will require moving towards longer-term IMF engagement. In some cases, this will also require rescheduling or restructuring of sovereign debt. A common international approach to debt treatments will be needed, based on an IMF program, full debt transparency, sound macroeconomic and governance, coordination and burden sharing between creditors, and comparability of treatment, including private ones. This is key to recreate the necessary fiscal space for long term growth.

2) **Short and medium-term measures should be well articulated and designed to ensure a resilient, sustainable and inclusive long-term growth.**

We welcome the attention dedicated to potential growth and long-term challenges in the WEO. Hysteresis effects will significantly hamper activity, and global growth will slow to 3.5 percent in the medium term. As the crisis represents a highly persistent reallocation shock, we see many challenges ahead, but also opportunities:

First, more work is needed to have a better understanding on the trade-off between favoring reallocation of resources versus preserving existing jobs and sectors. In addition, tackling unemployment with appropriate labor market policies is a top priority. Labor markets will clearly be characterized by mismatch issues, and permanent loss of labor supply, affecting notably low skilled workers, and countries with large informal labor market. Detailed recommendations on how to better protect (social safety nets) and help them in the reallocation process (training, length of unemployment benefits…) would be useful, and contribute also to limit the risk of increasing intergenerational inequality, especially in a context of higher dependency ratio in many advanced economies. We thank staff for their focus on this topic through several notes (special series to respond to Covid-19). The exploration of the indirect effects of the job multipliers (chapter 2 of the Fiscal Monitor) could also provide guidance to maximize the job intensity of various investment projects. *Could staff detail its recommendations to promote a more job-intensive recovery?* We also thanks staff for focus about social unrest (box 1.4 in the chapter 1 WEO), as it remains a key risk to monitor especially when elaborating a reform agenda.

Second, productivity losses are highly likely, but reallocation effects could give a bigger role to more productive firms (through creative destruction), which calls for appropriate competition policy. We encourage staff to have more granularity in its policy advice regarding how to manage sectoral reallocation, and more particularly, the trade-offs associated with phasing out policy support to firms, to find the right balance between economic efficiency, socials costs and scarring effects. While it is impossible to plan a precise timetable for phasing out supportive measures, it would be key to outline the main preconditions for doing so. We found interesting the mention of the market concentration risk in chapter 1 of the WEO: indeed, concentration could exacerbate an already pre-existing pattern of increasing market power, as discussed in the April 2019 WEO chapter 3. The reduction in the number of firms could limit innovation and investment as well as reduce labor income share. Against this background, we strongly encourage the reinforcement of competition policies as well as a stronger international cooperation on corporate taxation to ensure a level playing field between compagnies, and we encourage staff to continue to work on these topics.

Third, the policy response to the crisis is an opportunity to tackle climate change and maintain a high degree of ambition. Ensuring alignment of the policy response to COVID with long term sustainability goals is key. As shown in Box 1.3 in the Fiscal Monitor, France has taken significant steps in greening its fiscal response to the COVID-19 crisis. The September stimulus plan, which is not included in the Box, contains nearly €30 billion of environmentally friendly spending and includes important adaptation measures. We strongly welcome the thorough work on this topic throughout the three reports. <u>First, we welcome the discussion on the ways to reach the carbon neutrality in 2050</u>, which this chair as called for repeatedly in the past. We fully agree that dealing with climate change is a global effort and each country should contribute to this effort in line with its NDC, to reduce emission, consistent with the 2015 Paris Agreement. We broadly share the recommendations and would like to commend staff for emphasizing the importance of a gradual carbon price increase as a key component of the toolkit to advance mitigation, which should be associated with measures to offset potential negative impacts. *We would like however to better understand how the large ranges of carbon prices are declined by country and why these ranges are significantly lower than the ones presented by Stiglitz-Stern commission in 2017 and in the April 2019 Fiscal Monitor.* Moreover, we would like to highlight the mention in the report that renewable energy and energy efficiency can be more job-intensive than fossil fuels sectors, which is a key advantage in the present circumstances. In addition, the report could have emphasized more that OPEP countries could also participate to the global efforts, through diversification policies, as well as energy efficiencies. We also encourage staff to continue to develop their modelling work to further integrate the interaction between finance and the economy and to take into account this systemic risk. <u>Second, the launch of long-term projects to transition towards a low carbon economy highlights the need of mechanisms to ensure the credibility of long-term goals</u>. A gradual and clear trajectory of carbon price increases will help maintain confidence of private actors, which is key to stimulate investment. More broadly, a green strategy must also duly incorporate adaptation dimensions and enhance resilience of our systems, while being associated with the appropriate social support.

Fourth, we underline the importance of global cooperation to support the recovery, especially in the trade area. While the size of the global trade shock should be limited this year due to the nature of the Covid crisis, with a bigger impact on services-oriented sectors, we continue to be concerned by the fact that protectionist measures weigh on growth. We would be interested to better understand to what extent the reconfiguration of the global value chains, and in particular the re-shoring effects as well as other structural trends (for example new technologies), contribute to explaining the 4 percent global trade growth forecast in the long term. Moreover, we encourage staff to pay a specific attention to policies to mitigate the effects of GVCs (more redistributive policies, level playing field regarding capital taxation, strong environmental policies). On global imbalances, while they should reach the lowest level since 2005, we should not be complacent and relax our efforts and keep in mind the ESR recommendations while elaborating our long-term policies. The crisis will cause a large decrease in public saving, while in the short run (i) an increase in household saving and (ii) a fall in corporate savings (which play a major role in explaining imbalances), are expected. *What is staff's view regarding the evolution of disaggregated saving in the future?*

Fifth, dealing with the massive debt increase will be one of the biggest challenges going forward. We agree with staff that regarding the high levels of public debt, policies to encourage growth are the best way to deal with the issue in the long term. We share staff's view on the importance of credible medium consolidation plan when the recovery is be firmly entrenched, with a clear communication. *Could staff provide more analysis on the calibration and the sequencing of the fiscal measures, including (i) additional measures (more supply or demand oriented?) and (ii) the removal of existing measures.* Given the difficulty of this exercise, we strongly encourage staff to develop a detailed analytical framework to better specify the conditions of government action. Moreover, as also demonstrated with this crisis, automatic stabilizers play a key role in mitigating its impact, and we encourage countries, like the United States, to ensure the availability of these tools in the future.

GRAY/20/3021

September 28, 2020

Statement by Mr. Merk, Mr. Fragin, Ms. Koh, and Mr. Krahnke on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the informative set of reports illustrating the state of the global economy at this difficult juncture, describing the policy challenges ahead and trade-offs involved. While the global economy is still confronted with an unprecedented shock since the onset of the global pandemic, the latest data indicate that the drop in economic activity was probably less severe than previously expected a few months ago. Swift and considerable policy support has prevented even greater income losses and an amplification of the crisis through the financial system.

Still, it is without doubt that the crisis will leave considerable scars on the global economy, and the repercussions of this crisis will be harshly felt for an extended period of time. Subdued medium-term economic prospects imply permanent welfare losses which will likely be unevenly distributed among different income groups, age cohorts and gender and a serious setback to the global fight against poverty. With this in mind, we wholeheartedly subscribe to staff's plea for enhanced multilateral cooperation to ensure a sustained global recovery.

Fiscal policy will remain a crucial and powerful tool to foster and shape the economic recovery. Recent economic data for Germany suggests that the comprehensive measures taken to combat the Covid-19-crisis prove to be effective. To recover from the crisis, Germany will, in a sustainable manner, continue to provide all the fiscal support needed. A supportive and balanced policy mix, cushioning people and firms against pandemic-induced income losses, should be maintained as long as necessary to avoid scarring and reinforce confidence in the recovery. Governments should ensure that policy responses remain sufficiently flexible. In this context, it is also important to ensure that measures are well-targeted and **seize the opportunity to build a greener, more inclusive, more digital and more resilient economy.**

With regards to **monetary policy**, we agree in principle that given the subdued inflation outlook, there is no urgent need to exit from crisis-related measures.

The fundamental uncertainty with respect to the evolution of the pandemic complicates a quantitative assessment of the balance of risks around the baseline. Accordingly, we advocate the final assessment of the balance of risks to remain open. For the time being, downside risks are significant and include among other things, new lockdowns, premature withdrawal of policy support, tightening of financial conditions and a surge of insolvencies. Geopolitical tensions and trade policy uncertainty such as a hard Brexit represent further risks. Many of these adverse risks could coincide, thereby leading to a possible mutual amplification of shocks. On the upside, the recovery already taken place and the health system gaining experience with handling new virus outbreaks indicate that the economic normalization could also proceed faster than expected.

World Economic Outlook

We share staff's assessment of the near-term global economic outlook. Compared to the most recent ECB projections for the world economy (September MPE), the current IMF forecast (still) appears a bit on the cautious side. Considering the high uncertainty surrounding the baseline forecast, both projections are, nevertheless, not too far apart.

We broadly agree with the macroeconomic outlook for Germany. The upward revisions to the economic outlook and the benign perspectives for the labor market are broadly in line with recent positive surprises of incoming data. Against the background of favorable corporate profitability and financing conditions as well as ample government support, we assess the overall risk of broad-based business insolvencies in the current year with severe damages to supply capacities to be comparatively low. With regard to staff's inflation projections, the projected recovery for the German rate in 2021 seems to somewhat underestimate the positive base effect from the temporary VAT cut in 2020. *Staff's comments would be welcome*.

The long-term pandemic's economic consequences resulting from the unprecedented economic shock to the world economy are becoming increasingly apparent. A rising number of private insolvencies, a considerable drop in labor force participation, and, in particular, resource re-allocation across sectors including the reconfiguration of global value chains, will cause high adjustment costs to firms and households. Against this backdrop, staff's estimates of the medium-term potential output losses appear high, but not unrealistic. For advanced economies, the magnitude of the medium-term potential output losses is, for example, quite comparable to that attributed to the Global Financial Crisis of 2008-09.

Moreover, the pandemic will also act as a catalyst for structural change, partly also reflecting pre-existing trends, with digitization receiving a strong boost, shifting sectoral demand and changing the way we work. Accordingly, support to firms should, as far as possible, be based on a critical assessment whether the respective business model will likely continue to bear fruit in the future. We generally concur with staff on the notion of "triaging business cases" to preserve the economic substance of firms considered to be of strategic importance. However, risks for misallocation and distortion of competition could intensify with enduring government support measures. Accordingly, the focus should shift towards policies promoting a primarily market-led re-allocation of resources and the gradual withdrawal of crisis-related suspension of regulatory rules, supported by efficient corporate debt restructuring and bankruptcy frameworks and robust competition policies.

GFSR

Overall, we concur with the GFSR's analysis of the impact of the Covid-19 shock on the real economy and its effects on financial stability. We agree that extensive policy measures by monetary, fiscal and prudential authorities have helped maintain the flow of credit to the real economy and avoid adverse macro-financial feedback loops. The pandemic has also once again proven the importance of building up sufficient buffers in good times to increase resilience. In the first phase of the crisis, there was a looming illiquidity-insolvency spiral, which could have resulted in a liquidity crunch in the corporate sector. **Meanwhile, the situation has stabilized but risks remain high.** While on an aggregate level banks are better capitalised than they were before the global financial crisis and are likely to withstand expected losses, the future course and length of the pandemic and the economic recovery remain highly uncertain. **We fully agree that banks should be encouraged to use available capital buffers to support the flow of credit to the real economy.**

Staff rightly accentuates that policy makers need to make sure that structural changes and sustainability considerations are taken into account appropriately. Here we face a trade-off between the short-term stabilization of the economy and potential negative effects of prolonged policy support, with consequences for medium-term financial stability.

We welcome staff's efforts to conduct a stress-test exercise, which covers a broad range of banks from several regions and models the effect of policy measures on bank capitalization. One worrisome result of the stress test is a significant tail of G-SIBs whose capital levels could fall close to or even below minimum capital requirements. **However, we would read the results with a bit of caution**. The analysis comprises a very heterogeneous sample, whereas the econometric models employed may provide a better fit for some banks' business models than for others. Moreover, the model assumes that support measures are kept in place throughout the three-year horizon, and that announced guarantee programs apply to all, not only to new loans. In addition, it is assumed that the full amount of announced guarantees is used (full uptake). This may overstate the mitigating effects of support measures.

As in other countries, German banks today are much better capitalised to weather potential losses than at the outset of the global financial crisis. Similar to the analysis in the GFSR, we find that the German banking sector overall should be able to cope even with a very adverse scenario including a large drop in housing prices. Yet, in such an adverse scenario, some individual banks could get into difficulties.

Support measures are important in mitigating the fallout of the crisis. However, banks could use capital related relief for other purposes than lending, such as to distribute profits – if only to avoid an assumed stigma effect. For this reason, the ECB recommended that banks refrain from distributing profits or buying back shares. Although this recommendation is not legally binding and may weigh on investors' willingness to provide funds to banks, it is likely to have an impact, being a public communication from banking supervisors.

We agree that support measures should not become a "new normal". They should be carefully withdrawn when the crisis recedes. Structural adaptations and losses cannot be kept in check over the long run. Moreover, we should make sure not to impede the information content of balance sheets and benchmark quotas by regulatory exceptions.

Regarding the position of EMEs, we agree that economies with an insufficient domestic investor base may be particularly vulnerable. Portfolio outflows have never been as extreme and broad-based as in early March – not only for EMEs but also for AEs. While this trend has partially been reversed, the increase in non-financial corporate bond issuance in hard currency and increased sovereign reliance on foreign currency debt may put an additional burden on EMEs in case of a re-evaluation of risk.

We support the efforts of staff to introduce the local stress index (LSI) to summarize local bond and currency market conditions. The index only includes measures of local market liquidity and stress, without controlling for external factors, like policy rates or external conditions. This offers the advantage of reflecting the immediate conditions faced by market participants. Going forward, it would be helpful to assess the sensitivity of these conditions to external factors, to gauge to which extent they are under the influence of central bank policy instruments.

As asset purchase programs (APP) are a novel policy instrument in many EMEs, we welcome staff's investigation of their impact on local market stress levels. At the same time, with a single shock driving the introductions of APPs into countries' intervention toolset and the pandemic still ongoing, it is difficult to draw firm conclusions at this point. We would therefore encourage a cautious interpretation of the results. At this stage of the analysis, it might be useful to supplement the cross-country analysis with more detailed analyses of the differences between APP and non-APP countries that could have contributed to the results. The empirical analysis shows that APPs had an immediate impact on sovereign bond yields while the effect on exchange rates was limited. It is noteworthy that the effect of domestic policy rate cuts is insignificant, leading to additional support to the use of novel APPs. However, given the statistical uncertainty of these estimates, **conclusions should be made with the appropriate caution and considered provisional.** Moreover, we agree with staff's view that APPs can be helpful, but that they should not be regarded as a panacea to improve market conditions. As a consequence, in our view, the benefits of asset purchases must be carefully weighed against the risks resulting from an APP-driven increase in market valuations.

Fiscal Monitor

We welcome staff's analysis of the fiscal responses to the crisis. We agree with staff that **comprehensive fiscal responses were and continue to be essential to effectively contain the COVID19-crisis – by stabilizing the economy in the short term but also by avoiding high social and economic adjustment costs in the longer term. In that regard the crisis provides an opportunity for transformative measures to foster resilience and sustainability through investment and innovation.** Public investment programmes notably in infrastructure, green mobility, energy transition and digitization set incentives for and can crowd in additional private investment, thereby increasing future growth. That said, **to ensure that public investment is efficient and effective,** identifying projects and overcoming planning capacity limitations are a challenge to be met.

We appreciate the idea to outline fiscal policies separately for different phases of the pandemic. Generally speaking, while countercyclical fiscal policy stances are needed to counter pandemic-induced recessions, thereafter, prudent fiscal courses will be necessary with a view to reducing high public debt ratios. We acknowledge staff's word of caution that temporary policies - which provided essential support in the short-term - may have detrimental effects if they become permanent.

While not pertinent at present, governments should gradually shift from crisis management to high-quality fiscal consolidation once the recovery is firmly on track especially when debt levels are high, often resulting in higher borrowing costs. There will be more clarity on which post-crisis growth path our economies will take and how extensive the country-specific need for consolidation will be in structural terms. Well-designed fiscal rules and budgetary frameworks should promote the pursuit of credible fiscal policies aimed at achieving prudent medium-term fiscal positions and ensuring debt sustainability, while allowing for budgets better geared to investment, esp. green and digital, growth and resilience. Further consideration could also be attached to strengthening automatic stabilizers and conducting spending reviews to identify opportunities to reprioritize spending towards policy areas with maximum transformational impact. Fully restoring sound public finances would in turn also relieve monetary policy.

On a final note, we welcome staff's thorough and insightful analyses on the economic effects of the Great Lockdown and climate change mitigation strategies would highlight a few comments:

WEO Analytical Chapter 2: The great lockdown: dissecting economic effects

Given the rapidly evolving situation, some results, however, already appear refuted by actual developments. This particularly applies to the economic outlook. Some global mobility indicators have almost returned to pre-crisis levels, contradicting staff's assessment that the recovery will be slow. Furthermore, the evidence on the strong effect of voluntary social distancing is not as clear-cut as suggested. Covid-19 infections – the preferred indicator – is not a significant predictor of any traditional macroeconomic indicator scrutinized. Staff also emphasizes the finding that lifting lockdowns tends to have a more modest impact on mobility compared with the impact of a lockdown tightening. While this is true statistically, lifting restrictions still boosts mobility by close to 20 % over one week. We are also not convinced by the observation that job postings (a lagging indicator) did not pick up immediately after lockdowns were eased. The sample mostly consists of countries that relied on short-time work schemes to adjust labor input. In the US (not in the sample), by contrast, which adopted a different policy approach and initially experienced a large decline in employment, job openings have surged again during the past months.

We concur with staff that the distributional consequences of lockdowns are an important field of research. Differentiating economic effects by gender and age groups is an interesting starting point. A growing body of scientific evidence supports the conclusion of the negative impact of the crisis to fall disproportionally on women and young people. This special chapter makes a further contribution to this research strand by using novel mobility data. At the same time, we feel that some caution is still warranted in interpreting staff's results, which show economically modest differences for a very specific and small sample of countries (Italy, Spain, and Portugal). Accordingly, further analytical work, as well with a view to the digital divide, is needed to better inform policymakers' response to arising distributional effects.

Finally, we appreciate the IMF's call for additional research on the effects of contact tracing and more targeted containment measures. Tentative evidence from recent months seems to suggest that those might also be successful in limiting the spread of COVID-19, probably at much lower economic costs. We would therefore welcome further research in this field to elaborate alternative ways to strict lockdowns to deal with increasing numbers of new infections.

<u>WEO Analytical Chapter 3: Mitigating climate change – growth and distribution-friendly strategies</u>

While we agree that the transition to a low-carbon economy will benefit from a combination of higher carbon prices with green investment policies, the conclusions regarding necessary policy measures and their effectiveness appear too optimistic to us. For example, the carbon price path considered necessary to reach net zero carbon emissions in 2050 is rather at the low end compared to those used in large-scale integrated assessment models (IAMs), as outlined in other similar studies (see e.g. NGFS, 2020, NGFS Climate Scenarios for central banks and supervisors).[1] This implies high confidence on the extent to which green investment policies will reduce emissions. Staff's analysis would further benefit from a more open discussion of the manifold and vast uncertainties surrounding long-run climate (policy) simulations and their implications for climate policy. This includes uncertainties on the regional distribution of economic damages, on the risk of catastrophic outcomes, on the feasibility of climate policies due to free-riding, and on substitution elasticities.

[1] Moreover, the assumption of an annual carbon price growth as low as 7% contrasts with the outcome of initially much higher growth rates in other IAMs required to maintain the temperature increase at safe levels.

We agree with staff's assessment on the important impact of climate change mitigation policies in directing innovation to climate mitigating technologies, shifting electricity generation to renewables, and reallocating employment toward low-carbon activities. The conclusion that such mitigation measures did not harm activity in a broader sense, however, is a bit too general given that the empirical analysis just covers employment effects but not GDP effects. *Staff comments would be appreciated*.

We agree with the interpretation that green investment can act as a buffer against the large economic cost of carbon pricing. However, the outlined structural shifts in employment and private investment may potentially entail some unexamined downside risks to the simulated path of economic growth.

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The contents of this document are preliminary and subject to change.

GRAY/20/3023

September 28, 2020

Statement by Ms. Riach, Mr. Ronicle, Ms. Andreicut, Ms. Campbell, Mr. Chrimes, and Ms. Nelson on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the excellent and comprehensive papers; making sense of the global outlook and providing pertinent policy advice has rarely been so challenging – this World Economic Outlook, Global Financial Stability Report and Fiscal Monitor do so admirably.

The outlook remains daunting. Many countries have made progress from the containment phase of the pandemic towards stabilisation. But resurgences in the pandemic are unpredictable and are likely to warrant future tightening of public health interventions, with economic consequences. Few countries will travel in a straight line. Policy-making will need to be nimble and policies will need to be fine-tuned as challenges evolve. Withdrawing near-term accommodation now would only undermine the recovery, so we will need to anchor extraordinary support in credible medium-term frameworks. Some members face severe challenges and have struggled to make progress – a point compellingly made in the WEO; these countries will need further support and we should be ready to adjust our toolkit as needed and make sure we are resourced to help the most vulnerable. At the same time, we need to take action now to build the recovery we want – acting to mitigate climate change remains an imperative we cannot ignore.

THE OUTLOOK

Staff's headline projections for 2020 output are not as dire as in June, but the falls in output are nevertheless unprecedented in modern times. The main driver for the slightly improved picture is recent data, with Q2 GDP figures generally not as bad as expected, particularly in advanced economies. However, there are some signs that this nascent recovery may be slowing, and it is increasingly clear that the path out of the pandemic will not run in a straight line. While countries so far seem to be favouring more targeted public health responses to resurgent infections, further general lockdowns cannot be ruled out, and the baseline assumption of more persistent social distancing feels highly probable. Close tracking and reporting of high frequency data is vital for navigating a rapidly evolving outlook, so we welcome the increased coverage in the WEO.

The projections on the number of people falling into extreme poverty is both striking and saddening and, even above the extreme poverty threshold of $1.90 a day, populations are experiencing falling incomes and precarious circumstances. Tracking data on income impacts more broadly than the extreme poverty line would therefore be valuable.

Considerable uncertainty is an inevitable feature of this forecast, with both upside and downside risks evident. Two key judgments underpin the forecast and narrative:

- **First, around vaccines.** We agree that "no country is safe until all countries are safe" – something that will depend on vaccine research, production, efficacy, distribution and take-up, none of which can be taken for granted, despite positive progress. But while staff are right to be cautious about when the pandemic will end, *we wonder whether the term "acute phase", lasting until end-22, might sound more dramatic than staff intend, potentially generating unintended headlines?*
- **Second, on scarring.** Staff continue to assume fairly extensive long-term economic damage in the baseline. This may well be right, but the reasoning could be set out in more detail to help policymakers judge what actions they should be taking to mitigate this, particularly as this WEO helpfully includes point estimate projections out to 2025.

ACHIEVING CONTAINMENT

The flagships again highlight the precarious prospects for some members, particularly where: health systems are weaker; policy space is more limited, and; shocks are larger (especially where tourism, commodities and remittances are material). That is further compounded for low income states by constrained institutional capacity. For emerging and developing economies, rising poverty and inequality and the set-back to human capital accumulation risk significantly de-railing convergence and long-term sustainable & inclusive growth objectives.

Financing constraints are particularly acute for countries at a high risk of, or in, debt distress, who account for almost half of emerging markets and low-income countries. For these countries, financing constraints have been binding; it is notable that staff forecast that almost half of low-income developing countries are projected to cut total spending, and two thirds capital spending, in 2020. Protecting social safety nets will be critical. This underscores the challenge to the IMF and the wider international community. The IMF toolkit will need additional flexibility to match the complexities of the challenges these countries face, many of which will require financing, including concessional and grant financing. Adequately resourcing the PRGT will be critical.

Weather related natural disasters and intensifying social unrest pose a clear downside risk to many members, potentially undermining or reversing containment efforts. However, such risks should not be viewed in isolation from each other. Some countries this year have already felt the impact of negative risks materializing in a compounding manner – for example COVID-19, natural disaster and ongoing fragility and conflict risks coinciding. Greater consideration needs to be given to multiple and synchronised risks emerging, and how the pandemic might play out in such contexts. This could be a topic to explore in detail in the upcoming Macroeconomic Prospects in LIDCs Report.

THE CHALLENGE OF STABILISATION

The progress of the pandemic – and the recovery – will not be a straight line, but many countries are now at the stage of knowing which tools are effective and recalibrating the policy mix, both public health and economic, to their changing circumstances. The core challenge in transitioning to this stabilization phase is finding complementary near- and medium-term settings for key policies, to preserve confidence and policy space in the event of a downturn while not impeding necessary structural adjustment. We would not characterize this as a trade-off, which risks justifying the premature withdrawal of support – pulling back too sharply on accommodative polices now will deepen contractions and slow recoveries, undermining the objective of reducing vulnerabilities.

The Covid-19 pandemic has prompted an unprecedented fiscal response worldwide to support health systems and provide lifelines to vulnerable households and firms. These measures have been necessary and costly. Although public debt is at record highs, further support is necessary to protect people who cannot make a living under the current circumstances and to promote a stronger recovery; a focus on social spending will be key.

But as the pandemic evolves, the form of support needs to adjust, not least to facilitate any necessary structural change. To that end, the United Kingdom has just announced that its pandemic furlough scheme will end in November and be replaced with a wage subsidy scheme. This shifts support from all jobs to only those that employers expect to be viable.

Support for the unemployed is provided by the wider social safety net. Similarly, assessing which firms remain viable ongoing concerns is key to designing efficient and targeted support measures for businesses, but is fraught with difficulties; reallocation will need to be facilitated by efficient bankruptcy frameworks and active labor market policies, amongst other tools.

Monetary policy needs to remain accommodative. As many economies are nearing their effective lower bounds, central banks are re-examining their toolkits; these adjustments demonstrate the extent of policy space still available to accommodate downside surprises within well-established frameworks. Many emerging markets have launched programs of unconventional monetary policy in response to the pandemic, providing important support. Transparency and clear communication will be essential and Fund advice could be valuable in supporting the appropriate sequencing of instruments.

The financial system has weathered the COVID-19 storm well – a testament to the international standards adopted in the aftermath of the Global Financial Crisis and to unprecedented policy support. The global banking stress test shows that banks are largely-well capitalized and that most could withstand a more adverse stress scenario. Making use of the flexibility built into the post-crisis reforms, banks have been able to absorb the pandemic shock and continue lending to the economy. We stress that capital buffers have been built up to be used precisely in such circumstances – to that end, we think the GFSR should emphasise the $200bn barebones capital shortfall (i.e. excluding buffers) in an adverse scenario, rather than the $400bn broad capital shortfall. For banks to take defensive actions now would be counter-productive; collectively restricting lending at a critical time would ultimately result in bigger losses for banks themselves, through a feedback loop of company failures and unemployment.

PREPARING FOR THE RECOVERY PHASE NOW

Countries will have to grapple now with how to make progress on the long-term challenges that await us in the recovery phase, against a backdrop of constrained resources, limited bandwidth for policymakers and huge uncertainties. In all countries, structural reform remains key to unlocking long-run potential growth. Competing pressures and political economy realities may limit room for manoeuvre on deeper long-term issues; the pandemic will necessitate action in some of these areas, and creates opportunities in others. Policymakers will need to strike the right balance. The flagships make some helpful contributions here.

We strongly welcome the coverage of climate change in these flagships. Chapter 3 of the WEO sets out a compelling case for concerted, considered, and ideally coordinated near-term action to avoid devastating macroeconomic impacts over the coming generations. COVID-19 squeezes policymakers' and economic actors' attention, but at the same time, the disruption caused by the pandemic opens up a window for positive structural change. The GFSR provides a further compelling reason to act. Past crisis experience suggests that firms' environmental performance deteriorates during a downturn. This makes the case for comprehensive public policies and green recovery packages, particularly against the background of a severe and persistent shock such as COVID-19.

If green considerations can be effectively promoted as part of the COVID-19 recovery package, there is rare win-win potential here: job-rich green investment supporting both near-term demand *and* the transition to a more sustainable economy, and, similarly, fiscal measures to rebuild revenue bases *and* promote growth incentivising cleaner development. The financial sector needs to take an active part in the transition to a green economy. Regulators, supervisors and firms must push for a consistent identification, disclosure and monitoring of climate-related risks, as well as for regular stress testing of both physical and transition risks. As Sir David Attenborough said in his record-breaking Instagram post last week, "as we all know, the world is in trouble… But we know what to do about it." High-level talk of a green recovery will need to translate into meaningful engagement and action tailored to country circumstances. We encourage staff country teams to proactively pursue climate-related discussions with country authorities, not to defer them, given the closing window identified in the WEO for averting deep global macroeconomic damage.

The COVID-19 crisis has demonstrated the robustness of post-GFC financial sector reforms. Like any test, however, it has also highlighted areas which require further regulatory attention. The large-scale interventions taken by central banks in March to restore market functioning revealed significant shortcomings in the non-bank financial sector. We strongly support the comprehensive review being carried out by the FSB and the coverage of these issues in the GFSR. The GFSR highlights asset management in particular, but other sectors also require attention, such as prime money market funds. And while we agree that the pro-cyclicality of CCP margin calls is an issue that warrants review, the drafting of this recommendation in the GFSR could be read as calling into question the role of CCPs more broadly – to avoid being misconstrued, we would encourage staff to review the precise wording.

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Statement by Mr. Beblawi, Mr. Geadah, Ms. Abdelati, Ms. Choueiri, and Ms. Merhi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
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World Economic Outlook

1. We thank staff for an insightful set of reports that will guide the discussions on the global outlook and key messages on policies in the upcoming Annual Meetings. The membership is facing an exceptional crisis not seen in nearly a century. Bold fiscal, monetary and other policy measures were undertaken to mitigate the impact of the pandemic and have yielded positive results, reflected in the upward revisions to the forecast. Nevertheless, the outlook remains uncertain, although many countries have relaxed the more stringent containment measures, and it is likely to be an uneven and slow recovery path for many countries, with possible setbacks. While the significant upward revision, compared to the WEO's June update, is a welcome development, it suggests that we had not sufficiently taken into account country specific circumstances, and there was too much emphasis on projecting recessions of similar magnitude across country groups.

2. We recognize the heightened uncertainty surrounding the baseline projection and appreciate staff providing the additional upside and downside scenarios. We agree that social distancing will need to continue into 2021, and at least until a vaccine is widely available. The WEO assumes that the acute stage of the pandemic would not end before end-2022, and that there will be only limited progress toward catching up to the pre-pandemic path of economic activity for 2020-25 for advanced economies, as well as EMDCs. In this regard, *we would welcome staff comments on the extent of differentiation between countries, and what are the characteristics of countries that are more likely to return to that path?*

3. The impact on productivity and the adjustment costs can be significant. Sectoral reallocations may be necessary as health issues are not yet resolved, and some sectors are more severely impacted, notably the tourism, entertainment, and other service sectors.

Meanwhile, sustaining lifelines remains a necessary interim step to limit economic scarring, workers' exit from the labor force, and bankruptcies of viable firms. We agree with staff that the pandemic will compound forces that have earlier dragged productivity growth in some economies.

4. We broadly support staff's outlined policy priorities for the near- and medium-term, and the inherent challenges. Supportive monetary and fiscal policies must continue to limit economic scarring. However, many countries will be facing difficult tradeoffs between implementing measures to support growth and the further buildup of debt. We agree that the focus should be on tax and spending measures that are more likely to lift potential growth, and to the extent possible on infrastructure projects that also help move the economy to lower carbon dependence. Social spending will also need to be sustained or increased to ensure the health system can cope with the demand and to protect the most vulnerable.

5. The setback to poverty reduction and rising inequalities are of special concern, and that the progress made since 1990s might be reversed. The impact on human capital accumulation would also have important repercussions for future productivity and growth. This could be a good topic for the next WEO, to look at how countries have responded by expanding their social safety net, with durable productivity-enhancing reforms.

6. Multilateral cooperation is key to safeguard the road to recovery of the global economy. It is particularly important to maintain trade channels, diffuse trade and technology tensions, and to address rising debt vulnerabilities. Many LICs will need additional support from the international community through debt relief. We also support the WEO/GPA call for greater multilateral collaboration to deliver vaccines on a global scale, particularly to LICs with limited financial and institutional capacities. The idea of advance purchase commitments at the global level to incentivize the scaling up of productions is a welcome one, and *we would be interested to hear if this is taking place.*

World Economic Outlook Analytical Chapters

7. Drawing lessons from the pandemic response is a useful research avenue, it is timely and relevant, and we trust these will continue for some time. Staff makes a convincing case that lockdowns should be considered alongside with voluntary social distance practices. Until the infections are brought down, countries will need to continue to cushion losses for people and firms. Where sectoral reallocations seem necessary, retraining and reskilling will need to be pursued as targeted support is withdrawn.

8. In line with the call for a greener recovery, staff's analysis in Chapter 3 reviews a key global challenge to reduce carbon emissions. In addition to previous proposals for carbon pricing, we welcome the proposal to increase green investments and know these are being

pursued in some countries even as they face fiscal constraints in this environment. This is an area where joint action by the largest carbon emitters is of the highest importance.

Global Financial Stability Report

9. We appreciate the rich work presented in the *October* 2020 *Global Financial Stability Report*. We note the report's finding that short-term global financial stability risks have been contained on account of unprecedented policy responses in advanced and emerging markets economies. Nonetheless, vulnerabilities have increased; in some sectors—asset management, non-financial firms and sovereigns—representing potential headwinds for the recovery. The monetary and financial policy roadmap presented in the report is reasonable, and we support staff's view that as economies reopen, accommodative policies will be essential to sustaining the recovery. Chapter 5 appropriately stresses the need for climate policies and green investment packages to support a green recovery and the transition to a low-carbon economy.

10. Chapter 2 notes that many emerging markets used foreign exchange intervention effectively as a short-term shock absorber. The chapter introduces a new *local stress index* and suggests that unconventional monetary policy measures that were adopted in many emerging market countries in response to the crisis were effective. Particularly, asset purchase programs, adopted in eighteen central banks, were successful in helping lower government bond yields and eventually reduce market stress. The sterilization of the purchases in many cases also prevented an exchange rate depreciation. Going forward, we see scope for asset purchase programs to become part of the policy toolkit of emerging markets central banks, as needed. Staff outlines a series of potential risks associated with asset purchase programs, should they be used beyond the current pandemic situation (¶21). We look forward to further assessment of lessons from experience with asset purchase programs, including country authorities' feedback, in the context of bilateral IV consultations. Emerging and frontier markets face financing challenges that may lead them into debt distress or financial instability and may require official support.

11. The deterioration in economic conditions during the crisis has already led to the highest pace of corporate bond defaults, since the global financial crisis, and there is a risk of a broader impact on the solvency of companies and households. SMEs are more vulnerable than large firms in terms of access to capital markets. Against this background, supervisors and regulators face a delicate balance between contributing to support firms and individuals that are temporarily affected by the pandemic and ensuring that financial stability is maintained. While maintaining financial stability will be challenging as the crisis unfolds, it is essential to sustain a sound and healthy financial system, and, thus, to preserve internationally agreed standards. We support the Fund's continued active engagement in the Standard Setting Bodies' work, notably through monitoring and assessing risks to financial stability and supporting policy implementation through FSAPs and technical assistance. We agree with staff that the post-pandemic financial reform agenda needs to focus on

strengthening the regulatory framework for the nonbank financial sector and stepping up prudential supervision to contain excessive risk taking in a lower for longer interest rate environment.

Fiscal Monitor

12. **We welcome staff's analysis and policy recommendations in this Monitor, which reviews the effectiveness of fiscal responses and offers a recovery roadmap from the COVID-19 crisis that has prompted an unprecedented fiscal stimulus amounting to 12 percent of global GDP.** Governments are doing "whatever it takes" to mitigate the impact of this crisis and protect lives and livelihoods. We appreciate the note that fiscal policy should be tailored to different phases of the pandemic. Countries in our constituency have been severely impacted by the COVID-19 pandemic, and the fiscal response has been swift and focused on mitigating the economic and social impact of the crisis.

13. **We acknowledge that the unprecedented fiscal response to the pandemic has led to a surge in public deficits and are not surprised that global public debt is now projected to approach 100 percent of GDP**. While some advanced economies have substantial fiscal space for the necessary fiscal stimulus, many emerging markets and developing countries are experiencing financing constraints and were already struggling before the COVID-19 crisis. We recognize the need to resume fiscal adjustment and return to a prudent trajectory for debt sustainability once the crisis abates, while continuing to support the recovery.

14. **Many low-income and fragile countries are in a very difficult position. They do not have the fiscal space to address the added challenges created by the pandemic and will need financing help from bilateral and multilateral donors**. In this context, we welcome the G20 Debt Service Suspension Initiative (DSSI) and its aim to allow IDA countries to concentrate their resources on weathering the impact of COVID-19. We also welcome the effort by the IMF and WBG in supporting the implementation of the DSSI. The debt relief, being provided by the IMF through the Catastrophe Containment and Relief Trust, is very important in order to meet increased financing needs associated with the pandemic. However, more needs to be done to prevent a large rise in poverty and income inequality, and as the paper rightly mentions "fiscal policy will have to deliver more with less." Moreover, we should also be mindful of the countries that continue to host refugees and displaced populations, and that are witnessing mounting fiscal pressures on their already strained budgets and facing financing constraints. In these countries, the international community should continue its efforts to scale-up concessional financing to strengthen host countries economic and social resilience and help meet immediate needs and access to basic rights.

15. **After the crisis is contained, we agree with staff that governments will need to foster the recovery while addressing the legacies of the crisis, including elevated private and public debt levels, high unemployment, and rising poverty**. We welcome the discussion in Chapter 2 on the appropriate role of public investment in fostering the post-pandemic recovery, creating jobs, and increasing productivity. We are of the view that post-pandemic policies should focus on tackling poverty, ensuring sustainable growth, and building resilience against future shocks. We concur with staff that spending on digital infrastructure would be essential to narrow the disparities to access information, education, and job opportunities. Finally, new investments in healthcare, social housing, and environmental protection would lay the foundation for a more resilient and inclusive economy.

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GRAY/20/3025

September 28, 2020

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

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

World Economic Outlook (WEO)

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

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

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

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

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

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

of their sectoral dynamics. Fund policy advice and technical assistance in these areas would help countries to reallocate resources towards more productive sectors.

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

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

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

Global Financial Stability Report (GFSR)

We broadly agree with the monetary and financial policy roadmap. The 3-phased approach is appropriate and reflects the reality that countries are at different stages of the crisis and require tailored policy guidance. In the near-term, vulnerabilities among corporates and banks must be closely monitored as they can be important channels for shock transmission. The second phase will be crucial for policy makers to help banks to preserve their balance sheets and take account of the climate and digitalization agenda where possible. The Fund's work on digitalization will be particularly important given its potential in helping to secure an expedient recovery and its implications for monetary policy. In the post-pandemic phase, strengthening the regulatory framework, particularly with respect to risks from the less regulated non-bank financial institutions will be critical especially as they can be a major source of financial stability risks. We also encourage the Fund to step up its work on cross border spillovers, especially from source countries, and to assess the wider implications of unconventional monetary policies on non-banks, household wealth, inequality, etc.

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

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

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

Fiscal Monitor (FM)

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

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

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

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

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Statement by Mr. Chodos, Mr. Lischinsky, Mr. Dips, Mr. Morales, Mr. Corvalan Mendoza, Ms. Moreno, and Mr. Vogel on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary) Executive Board Meeting September 30, 2020

The global outlook recovers amidst high uncertainty and risks tilted to the downside

The global economy has rebounded from a deep slump in the second quarter in a highly uncertain environment, still under the threat of new waves of the COVID-19 pandemic as countries try to reopen. The outlook for 2020 has improved because of a lower-than-anticipated but still severe contraction in the second quarter, mainly resulting from a pick-up in demand from China and a faster resumption of seasonal activities in advanced economies, partly offset by weaker activity in some Asian countries. The October 2020 World Economic Outlook (WEO) provides a sobering but invaluable analysis of the risks ahead, weighing available policy options with cautious optimism. The baseline assumption of a gradual expansion of vaccine coverage and the adoption of improved therapies appears reasonable at this stage. However, the unpredictable path of the pandemic, undetermined adjustment costs to the economy, and the unknown effectiveness of policy responses make for a prolonged uncertain environment. In these difficult circumstances, the Fund has risen to the immediate challenge, responding rapidly to requests of emergency financing and adapting its toolkit to the pandemic realities, including for the delivery of capacity development, while widening its analytical coverage and disseminating its advice in friendly formats to guide policy decisions by its membership.

The prospects of a lasting erosion of human capital are a major concern. Global GDP in 2021 is expected to rise above 2019 levels by a meagre 0.5 percent, precipitating a significant reversal of progress made in the last three decades in reducing global poverty and lowering inequality. In the meantime, school closures and problems in introducing digital alternatives constrain access to quality education preventing children from access to nutrition and a safe environment in many cases. The prospects for preventing human capital erosion turn dramatic in an adverse scenario where the spread of the virus remains difficult to control, and fiscal and financial frictions are larger than envisaged in the baseline. In this adverse scenario, global growth would be 3 percentage points weaker in 2021, and global GDP would remain 1.5 percent below the baseline by 2025. The materialization of such scenario would create persistent damage to the world's supply capacity, including a persistent rise in the natural rate of unemployment and weaker productivity growth, with a disastrous loss in the standard of living of vulnerable workers, including informal laborers, providers of personal services, and migrant employees. More broadly, structural adjustments in the workplace, lower participation in the labor market and emerging financial dislocations are likely to give rise to scarring effects affecting potential output. Avoiding a dramatic setback in potential output is a collective responsibility which more than ever requires concerted efforts by advanced, emerging, and developing economies alike, as well as multilateral organizations.

Unfortunately, new waves of COVID-19 infection cannot yet be ruled out. As illustrated in Chapter 2 of the WEO, lockdowns have been effective in slowing contagion and countries are already partially reversing reopening plans. Countries may still need to resort to mitigation measures selectively down the road, with economic policy focusing on cushioning income losses and facilitating some reallocation away from contact-intensive sectors. The reallocation of resources and labor is likely to undergo a prolonged transition, for which a strategy to expand the social safety net should be put in place particularly in low-income countries (LICs) but also in emerging market and developing economies (EMDEs), including transfers that prioritize employment protection, such as family and sick leave, and expanding unemployment insurance for displaced workers. On a related point, we agree with staff's recommendation in the WEO that policy makers should continue to support the economy while keeping a focus on how to return to a path of stronger, equitable, and resilient growth. However, the precarious outlook for EMDEs portrayed in the WEO is a cause for concern, especially for those still facing suboptimal healthcare services, high informality, and a decline in remittances. Estimates of potential GDP for the 10 largest emerging market economies (EMEs) already show a larger decline than for advanced economies (AEs) relative to the January 2020 WEO. As the Fund resumes its regular surveillance work, it could help country authorities monitor the emergence of macroeconomic imbalances and deviations from a sustainable growth path, and to identify the most suitable corrective policies.

Spend, keep the receipt, and keep an eye on debt burden

A signature development since the start of the COVID-19 crisis has been the massive fiscal support deployed by governments worldwide. It is heartening to note that the October 2020 Fiscal Monitor (FM) states in no uncertain terms that the bold fiscal efforts have been successful in saving lives and livelihoods, even considering the heterogeneity of programs design, implementation, and effectiveness. We would like to underscore the Fund´s critical role during the pandemic, from helping its member countries to understand the gravity of the global crisis and its risks to recommending decisive action to meet health and social needs. Against this backdrop, the unprecedented fiscal responses around the world are translating into critical increases in public debt levels, some of which were already at high levels when the crisis hit. While in some economies further fiscal efforts might still be needed, countries face disparate fiscal outlooks: AEs would be able to increase debt-to-GDP ratios by 20 percentage points on average, twice as much as EMDEs, while a number of EMDEs may still experience downgrades to their debt sustainability outlook. Thus, EMDEs may soon face a difficult trade-off between policies supporting growth and policies to preserve fiscal sustainability.

Some EMDEs are likely to face a sizable increase in sovereign debt in parallel with rising corporate bankruptcies which may discourage new lending as financial sentiment eventually deteriorates. A larger-than-expected continuation of the pandemic and the associated economic contraction may rapidly generate unsustainable debt dynamics in countries with high fiscal vulnerabilities. Furthermore, private debt levels have also increased rapidly over the past lustrum and, as the FM report timely warns, bankruptcies could result in private debt/risk migrating to the public sector through bailouts. We welcome the WEO's statement that additional debt to help lift potential output, ensure participatory growth, and protect the vulnerable, would ultimately pay for itself if managed responsibly. The Fund should continue encouraging transparency in the availability of debt information and providing technical assistance to help countries improve public finance management, and debt management frameworks that would help them achieve a more efficient use of fiscal resources. The international community should support these efforts building on the Group of Twenty initiative for a temporary standstill on official debt service payments by LICs, and aim for a rapid agreement on debt restructuring when needed, as well as the provision of debt relief, grants, and concessional assistance for LICs. In this regard, the Fund is to be commended for expanding its lending toolkit, increasing access to emergency financing facilities, and expanding the scope for providing debt service relief through grants.

Many countries have appropriately taken advantage of easing financial conditions (see below) to upgrade their debt management frameworks, extending the maturity of government bonds and making cost-saving reprofiling operations. However, the likelihood of financial tightening will rise over time, raising further concerns on the sustainability of public and corporate actual and contingent debt levels in the absence of proactive policies. Resuming resource mobilization efforts would be unavoidable as the pandemic recedes, as countries aim at ensuring sufficient resources to sustain adequate health, education, social and infrastructure spending, desirably on lowering carbon dependence. We take note of the emphasis placed in the reports on considering additional taxation of high-brackets income, high-end property, capital gains, and wealth.

Financial markets bolstered by massive monetary easing across the board

Financial markets rebounded concurrently with the bottoming up of the global economy, already highlighted in the June WEO update. This is more evident in the evolution of the stock market, despite the recent correction, while the sharp decline in long-term real yields points to increasing concerns about a deterioration in growth prospects over the next 10 years, as analyzed in the October 2020 Global Financial Stability Report (GFSR). Near-term vulnerabilities appear to be contained, thanks to unprecedented and timely policy responses across the board, which helped boost market confidence, liquidity, and ensured that the credit provision channel remained open and flowing. It is remarkable how good practices shared during the last decades and particularly after the global financial crisis (GFC) allowed many countries to build precautionary buffers and face this unique crisis on better footing.

The interaction between AEs' policies and the behavior of EMEs' financial markets during the ongoing crisis shows interesting contrasts with respect to the GFC. In both events, AEs' central banks deployed large asset purchase programs (APPs), but the synchronicity of the current economic downturns across the world did not translate into capital flow volatility as during the GFC. Instead, accommodative monetary policies in AEs have contributed to support economic activity in EMEs, helping them cushion against sizable risks and prevent an abrupt deterioration of investor sentiment. EMEs' policy response has also been remarkable. Some countries effectively introduced APPs for the first time in significant amounts (Chile, Indonesia, Philippines, and Poland). As highlighted in Chapter

2 of the GFSR, EMEs' policies did help reduce market stress, with APPs reducing long-end bond yields in a significant and persistent way after they were announced.

EMEs resorted to FXI to mitigate excessive exchange rate volatility, but not to capital control measures during the COVID-19 sell-off. Staff estimates that many EMEs did intervene, but unlike the 2015 sell-off event, FXI were relatively insignificant in explaining currency surprises relative to global factors, defining currency surprises as the gain in the currency over the forward value from a month ago. This is consistent with the lower degree of capital flow volatility just mentioned, which is also consistent with a modest use of reserves. Also, as staff suggests, this may be related to the short duration of the stress period. Many FXI were carried out through forward contracts, which could signal that foreign exchange markets have become deeper in these countries. The low use of capital controls is also consistent with the Institutional View's advice of only resorting to these measures in the absence of alternatives, which adds to the difficulty of firmly establishing "the effectiveness of implementing capital controls to increase inflows or reduce outflows during crises", as staff mentions in the GFSR Online Annex, Box 2.2. In addition, considerations of negative effects on reputation and market confidence could be playing a role. In this context, we commend staff's addition of the Local Stress Index (LSI) to the risk monitoring toolkit, to assess conditions in local bond and currency markets by means of a simple summary statistic. In its first application, it is encouraging to learn that the COVID-19 sell-off being generally comparable to that of the GFC has been normalizing at a faster pace.

Vulnerabilities in the corporate sector have been building up, as they face liquidity constraints and increasing solvency risk. The COVID-19 crisis erupted while risks in the credit markets were already expanding rapidly, supported by favorable borrowing terms. Nevertheless, since June corporate liquidity pressures subsided, partly helped by a massive support from governments, central banks, and proactive policies by financial regulators. As a result, credit to the private sector has not followed its usual procyclical behavior in many countries. This was particularly the case in the G7, as highlighted in Chapter 3 of the GFSR, with the main tools being government guarantees, macroprudential measures, and changes in financial sector regulation, among others. Several EMEs also implemented broadly similar policies with similar results, with special central bank lines leading to double digit credit growth up to July (Brazil, China, Korea, and Peru; Central Bank of Peru Inflation Report, September 2020, Chapter V), and reaching a large share of firms hit the hardest by the pandemic (Chile; Central Bank of Chile Monetary Policy Report, September 2020, Box II.2). A note of caution is warranted regarding the difficult differentiation of viable and nonviable companies, given the strongest scarring effects of the crisis in some sectors. Ensuring financial stability while compensating for the withdrawal of support to some borrowers will constitute a difficult balancing act.

On average banks were on a better footing now than during the GFC, with higher capital buffers to absorb rising credit risks. Nevertheless, the analysis in Chapter 4 of the GFSR warns that the COVID-19 crisis still poses risks that may rise significantly if the crisis takes longer to recede. Under an estimated adverse scenario, a weak tail of banks would fail to meet minimum regulatory requirements, experiencing a shortfall relative to broad regulatory thresholds of close to $400 billion. This finding comes from the new global stress test showing how different components of the banking sector financial statements (73 percent of global banking assets), would respond to macroeconomic variables. We welcome this important step towards improving the analytical tools to assess risks to the global financial sector. We find that its forward-looking framework sheds light on likely scenarios in a useful format and would help regulators and financial supervisors in their regulatory design to help them respond proactively to emerging challenges. We are aware that this line of research is a work in progress, and as such, we would be interested to learn from future analysis how these results feed into other sectors highly interconnected with banks like nonbank financial institutions. We believe that as banks in AEs were in a process of deleveraging since the GFC, shadow banking was becoming the "spare tire" on the vehicle to finance the real economy.

During the recovery and beyond

The outlook is likely to remain uncertain for some time. We are encouraged by the rapid response of policy makers and multilateral institutions to minimize the damage being caused by the pandemic. We should reiterate our appreciation of the leadership of the Fund in helping shape the global agenda in balanced manner, which should help redouble the concerted effort to anticipate challenges down the road, keeping in mind the priority to restore growth and to make it more inclusive and sustainable than before the arrival of the pandemic. As countries monitor closely the evolution of the pandemic, they should avoid complacency with partial progress and maintain a vigilant approach especially on the possible damage to productive capacity and on the protection of the most vulnerable in the transition.

Monetary policy

We agree on the recommendation that under high levels of uncertainty monetary accommodation should be maintained, combining conventional and unconventional measures as needed, topping up communication efforts. However, the risk of premature withdrawal should be contained. For example, extending APPs carries risks, as they may weaken institutional and central bank credibility. It is imperative that authorities continue to closely monitor economic and financial developments. While saving lives should continue to be the priority, countries should continue implementing effective strategies to face household and corporate solvency pressures, while supervising the quality of bank portfolios and their capitalization levels.

Fiscal policy

The fiscal roadmap for recovery in the FM is especially welcome, including its strong emphasis on the need for multilateral coordination. As we indicated earlier, we fully agree with the position expressed in the WEO that one of the beacons of fiscal policy should be reviving growth and creating jobs. Online Annex 2.4 shows a gloomy outlook, with 305 million full-time job losses caused by the global recession, according to the International Labor Organization. Although economic activity worldwide may partially recover next year, uncertainty surrounding the velocity and sustainability of the recovery, and the rise of poverty and inequality generated by the pandemic, will not be easily reversed. The FM shows that phase 3 (Pandemic Under Control stage), would still require appropriate revenue and expenditure policies, which would be challenging for many EMDEs with less-developed safety nets, for which intense technical cooperation from the Fund and other multilateral organization will be required.

Public investment

Raising public investment efficiency is especially relevant at this time as financing restrictions for some EMEs and LICs are likely to rise. Therefore, ensuring that public investment effectively aims at boosting potential growth and creating jobs would be of the essence, not only through direct job creation but through indirect channels, subject to uncertainties regarding the size of multipliers. Chapter 2 of the FM identifies the main conditions that need to be met in order to achieve this goal, and we consider that the Fund should play an important role in helping countries meeting these conditions for an optimal public investment policy, namely setting up a credible strategy to build assets of quality, and commit efforts for a sustained and well communicated investment plan, so as to mitigate financing costs. In the near term, reviewing and restarting promising projects, and speeding up projects in the pipeline so as to benefit from them within two years, are a few of the priorities on which we concur with staff.

Trade

The expected decline in global trade does not appear to give rise to new imbalances. However, lower trade volumes may also result from possible inward shifts in the supply chains that would also bring foreign direct investment flows as a share of GDP below pre-pandemic levels. In this regard, it is concerning that the bulk of distortionary tariff and nontariff barriers instituted over the past two years remains in place. Lingering trade policy uncertainty in a fragile global outlook is harmful to global growth and the Fund should maintain its policy to predicate a rule-based multilateral trading system that would eventually be beneficial for global economic welfare.

Multilateral support

Strong multilateral efforts to fight the health crisis will be of the essence. Initiatives such as the European Union pandemic recovery package fund are a step in the right direction. In the coming year, funding purchase commitments for a vaccine at the global level would be crucial to prepare for a balanced and sustained recovery. A green investment push to reduce emissions in line with the 2015 Paris Agreement would facilitate desirable investment in green infrastructure. In this regard, we welcome the report's detailed analysis and policy recommendations on mitigating climate change. It is imperative that the Fund continues to send clear messages about the need to take urgent actions to reduce carbon emissions and avoid irreversible climate-change related damages, including lower productivity; deterioration of health and possible losses of life due to natural disasters and more frequent disruption of economic activity; and greater physical destruction of productive capital, infrastructure, and buildings. We recognize the great difficulties of undergoing transformations in this time of global recession, given the current constraints in fiscal space and elevated risks of debt distress. However, we recognize the Fund's important participation as an active promoter of mitigating climate change policies, and we ask staff to continue with the useful analysis and development of policy proposals. The whole world, and especially the largest economies around the world, should commit to undertake the necessary steps towards imperative progress in this critical area.

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GRAY/20/3029

September 28, 2020

Statement by Mr. De Lannoy, Mr. Voinea, Mr. Manchev, and Mr. Tevdovski on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary) Executive Board Meeting September 30, 2020

We welcome staff's thorough analyses in the Flagship reports and broadly agree with the policy messages. The Fund's research, policy recommendations, and communication remain crucial in dealing with the economic and social fallout of the health crisis and recession in the ongoing three parallel phases – gradual reopening, pandemic control and formulation of the post-pandemic reform agenda.

The global economy has gradually bottomed out since the Great Lockdown in April, but uncertainty and downside risks largely remain. Six months after the pandemic erupted, there is no silver bullet for policymakers and markets, and no vaccine for the sanitary crisis. While growth projections have been revised upwards, in light of the better than initially anticipated Q2 data and the present financial market conditions - following the massive policy support to global liquidity - the world economy is still set to experience a very deep recession in 2020. We agree with staff that a rapid recovery of the economic activity back to potential is unlikely in the MT, given that health risks and voluntary social distancing are likely to remain in place.

The post pandemic recovery is increasingly looking K-shaped: most AEs and large EMEs, most globally systemic banks, and part of the corporate sector will recover faster while some sovereigns, banks and firms that were vulnerable before the pandemic, including due to high indebtedness, are even more vulnerable now. The unprecedented policy measures have helped all of them to withstand the crisis so far. Yet, the unwinding of these policies will still leave those worse off, as the adjustment of spreads and valuations will follow the path to normalization. Thus, it is important that the policy unwinding will be prudent enough to avoid affecting the financial stability of the whole system, while being fast enough to prevent a further accumulation of debt, which would jeopardize the recovery process.

We particularly support the focus of all three reports on tackling inequality and moving towards a green recovery. We agree with staff that the policies to navigate the post-crisis recovery should explore the unique window of opportunity to ensure a green, prosperous, and equitable global economy for the generation to come, and this should be properly communicated. A resilient recovery, however, also requires addressing pre-crisis structural weaknesses and we believe that the reports could be further sharpened in this regard.

Going forward, policymakers face difficult trade-offs on which more granular advice by the Fund would be welcome:

- First, we see a trade-off between **protecting employment and allowing for the necessary reallocation**. In the current phase of the crisis policies should move away from blanket guarantees to adversely affected sectors to more targeted support. Fund advice on policies that facilitate reallocation may also help to accelerate the ongoing digital and green transformations. This includes advice on climate mitigation strategies capable of achieving the net zero emissions goal by 2050.
- Second, there is a trade-off between the fact that large-scale public investment may be needed to address longer-run challenges and to rekindle potential growth, but that **public investment is not the optimal tool to deliver timely, targeted and temporary macroeconomic stabilization**. In this context we see an important role for strong and sustainable automatic stabilizers.
- Finally, a delicate balance is needed between **supportive policies that bolster the recovery on the one hand and maintain sustainable debt burdens on the other**. We therefore strongly support further work on debt sustainability, especially on insolvency frameworks and private sector participation in sovereign debt restructuring.

Strong multilateral cooperation will be critical during and beyond the pandemic. Given the global nature of the Covid-19 shock and the common challenges across countries, multilateral efforts can achieve better results in fighting both the health and economic crisis. This should not be limited to trade, technology and climate, as well underscored in all three reports. The global community should assist countries with limited resources and health care capacity in dealing with the ongoing crisis. The worldwide availability of Covid-19 vaccines and/or treatments is a necessary condition for a robust recovery. Priority should be given to keeping borders open for trade in essential goods and avoiding export restrictions or other protectionist tendencies. Building strategic stockpiles is a better option than invoking trade restrictions.

WEO Chapter 1

Although still subject to substantial downside risks, staff's baseline scenario looks plausible, especially for the euro area. Despite the upward revisions for Europe, however, staff remains less optimistic on the regional developments in the euro area, compared to other IFIs. We also observe further downward revisions of the 2020 growth forecast in the EMDEs, where the containment of the virus has proven to be more difficult. China is a notable exception, but for a solid anchoring of its recovery, it would also need an extra growth impulse from external demand. Undoubtedly, the initially envisaged V-shape recovery scenario, presented in April, is not feasible anymore, given the need for voluntary social distancing to be further exercised as a major pandemic control factor.

Staff's alternative scenarios box is particularly relevant to the WEO as an important illustration of the uncertainty surrounding the baseline. The decomposition of the impact on GDP and the various layers of the scenarios are very much appreciated. *We would welcome further details on the magnitude and form of the assumed additional discretionary stabilization in AEs in the downside scenario.* Under this scenario, the relative impact of a net tightening of financial conditions also appears rather small considering the implied loss in confidence and increased risk aversion that such an event would trigger. We are not surprised that uncertainty in the projected outcomes is much higher for EMDEs than for AEs but remain very concerned about the impact of the downside scenario on LICs, which are simultaneously facing important challenges from climate change. These trends could be exacerbated by some of the pre-existing risks, such as the trade tensions between the US and China and the intensity of social unrest. Regarding social unrest, we share the conclusion in Box 1.4 that the threats may be bigger in cases where the crisis exposes or exacerbates problems like trust in the government, poor governance, gender issues, poverty and inequality. The analysis could be more specific on the impact of potential constraints in EMDEs regarding access to Covid-19 vaccines and/or new medical treatments. *Staff comments are welcome.*

The exceptionally large uncertainty in the current juncture requires flexible policy responses going forward. We concur with staff that broad-based accommodative monetary and fiscal responses have helped prevent a deeper and longer-lasting down-turn. Moreover, central bank actions have been successful in containing financial amplification of the shock by preventing undue procyclical tightening of financial conditions during market volatility. However, as the pandemic persists, additional fiscal policy should gradually become more targeted and more conducive to reallocation. We also believe that national authorities can raise confidence by stabilizing economies and use this opportunity to address common long-term structural challenges, including the need to ensure a green and digital transition, and therefore solidifying a sustainable recovery. In approaching the recovery phase, policies should focus on increasing productivity growth. Thus, we agree with staff that policies aimed at repairing balance sheets and freeing capital for new projects can stimulate productive private investment. Effective competition policy frameworks can reduce market power and protect market entry for small firms to prevent an increase of market concentration after Covid-19.

WEO Chapter 2

We welcome a very clear and concise analysis of the relative effects of lockdowns and voluntary distancing on economic activity. The chapter also demonstrates the potential of employing alternative sources of data to analyze fast-developing trends in real-time and to inform policymakers. Based on that, strong empirical evidence shows the disproportionate impact of the Covid-19 crisis on women, youth and workers. We share staff's view that a robust, broad-based economic recovery remains elusive as long as serious health risks persist. We also concur that voluntary social distancing in response to rising infections contributed significantly to the economic decline, above and beyond the impact of lockdowns and other official restrictions on contact-intensive activities. *Can staff elaborate on the potential LT behavioral consequences of the pandemic (if any) once the virus recedes, and the implications for particular sectors?*

WEO Chapter 3

Building on last year's FM, staff's analysis provides strong arguments for policymakers to commit to ambitious climate policies towards the recovery phase. It is essential to put sequenced and coordinated policies in place and to ensure the political acceptability and sustainability of mitigation strategies. Postponing necessary climate measures will increase the risk of an abrupt transition, resulting in further damage to the economy and the financial sector. We agree with staff that pricing carbon emissions remains the most effective way of reducing emissions and enable a green recovery. In addition, it is important to explore which investments in sustainability can be pushed forward. Such investments can both stimulate the economy in the short term and help achieve an efficient climate transition. Current low financing costs would also raise the net social benefits of these investments going forward.

GFSR

The GFSR messages should be more balanced from the perspective of the LT sustainability of the support measures. Decisive actions of central banks towards the provision of liquidity can positively influence markets. We agree that the sharp restoration of trust in the credit markets has proven the efficacy of unorthodox measures by Central Banks. The unprecedented policy response, however, has important negative side-effects like a rise in zombie firms and the search for yield. This could be emphasized more in the GFSR. These side-effects contribute to the further buildup of systemic risks in the medium- and longer term and should be taken into account when it comes to decisions on the extension of supportive measures. As many unorthodox policies may last for a while, there is a need for a thorough analysis of their LT externalities and unintended consequences. The role and timing of adequate communication in central banking has also become more critical, as the GFSR shows that policy announcements themselves have a quantifiable and significant impact on markets, different from the direct impact of policy measures.

We are concerned that the capital gains built during a decade long of regulatory reforms after the GFC have vanished in less than a year. If the crisis is protracted, the financial stability implications will not be shy. Should the crisis have been of a financial nature, the losses would probably have been even higher. An important point refers to the structure of these losses. If new NPLs stem from “zombie” loans, which are not viable and kept alive after the GFC due to the low interest rates, then a cleaning up of the banking system is beneficial as it creates the foundation of a healthy recovery. However, if the new flow of NPLs comes from loans granted in recent years, under favorable market conditions, this should be particularly concerning for regulators. The Fund should therefore push financial regulators to provide adequate guidance to banks. Transparency, disclosure and provisioning of loans to non-viable borrowers and flexibility under non-discretionary criteria for viable borrowers are quintessential for maintaining financial stability, and for avoiding the transformation of this sanitary and real economy crisis into a financial one. Looking ahead, the benefits of policies that temporarily loosen banks’ capital constraints in order to maintain the flow of credit to the real economy should at each point in time continue to be carefully balanced against their potential risks to financial stability. Going forward, in the post-Covid-19 period the debt moratoria and government guarantees should be more targeted, and a higher equity capital base would be needed for a greater shock absorption. *Staff comments are welcome.*

Fiscal Monitor

Fiscal policy will remain a crucial tool to foster the post-Covid-19 economic recovery. It should deliver “more with less”, thus putting a large premium on careful prioritization, design and implementation. While large-scale public investment may be needed to address longer-run challenges and to rekindle potential growth, it is not the optimal tool to deliver macroeconomic stabilization. We must strive to pursue fiscal policies aimed at achieving prudent MT fiscal positions, including through reprioritization of expenditures.

We agree with staff that policymakers need to avoid a premature withdrawal of policy support and keep a supportive, targeted and balanced policy-mix to foster the recovery. While avoiding costly consolidation measures in the short run, we should pursue fiscal policies aimed at achieving prudent medium-term fiscal positions. This can be achieved, depending on country circumstances, by introducing reforms to pension systems but also through credible fiscal frameworks that safeguard sound public finances. Given the already record-high public debt levels in many countries, the room for further fiscal support appears to be limited. One cannot neglect the need for fiscal consolidation and the restoration of public finance sustainability more broadly in the medium- and long term. Therefore, the Fund's role is vital in advising countries how to best build-down debt burdens in a growth-friendly manner. *Staff's further elaboration would be much appreciated.*

The Fund's advice on fiscal policy should be well-tailored and remain country- and state-dependent. We agree with staff that developing countries with a large share of government debt denominated in foreign currency will need a more cautious fiscal stance because of the possible effects of a currency depreciation. We agree that emerging markets and developing economies with limited fiscal space will need to boost revenue capacity and seek sustainable financing. At the same time, many low-income developing countries will need to combine this with fiscal adjustments as they are in or at a high risk of debt distress. We believe that ensuring debt transparency will help facilitate targeted solutions for these countries.

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September 28, 2020

Statement by Mr. Inderbinen and Mr. Tola on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
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The global economy is starting to recover from one of the biggest economic shocks in recent history, thanks to an unprecedented policy response that cushioned the impact on households and firms. Notwithstanding the policy support, some sectors of the economy will be permanently affected, leading to structural change. Some of these changes may enhance productivity, but others will weigh on medium-term prospects and inclusiveness. While the near-term management of the crisis remains the main policy priority, we should not lose sight of the need to work toward laying the foundations for more robust, inclusive, and sustainable growth in the future.

Global outlook and risks

We broadly share staff's outlook for the global economy, including that the worst may be over for now, and that the economic recovery in 2020 may be faster than expected a few months ago. However, social distancing will persist in most places, weighing on economic activity. The uncertainty remains unusually high and setbacks linked to a resurgence of the virus cannot be excluded.

Policy Priorities

The immediate policy priorities are to contain the health crisis and support the economy during the pandemic. We welcome the more detailed than usual policy recommendations in the three flagship publications. Going forward it will be essential to strike the right balance between premature removal of policy support and a protracted protection of existing structures. This will be a key challenge for policymakers. The IMF's surveillance and policy advice is more important than ever:

- **Policies need to support the necessary structural transformation, as well as competition and innovation.** The negative effects of scarring on potential output make a quick return to the pre-crisis growth path unlikely. There will likely be large differences in the speed and scope of the recovery across sectors and countries. This points to the need to quickly adjust skills and productive capital to a new situation. In this sense, the crisis should be used as an opportunity for a more efficient allocation of resources that increases medium-growth prospects.

- **It is crucial that policies to bridge income shortfalls do not prevent reforms and the necessary structural transformation.** There is a need to offset human capital setbacks by retraining and reskilling the labor force. In addition, policies should tackle excessive market concentration and encourage more research and innovation through improved incentives and more generous public financial support.

- **We agree that policy needs to focus on growth-enhancing structural adjustments and productive public investments to avoid negative long-run implications of short-term fiscal measures.** In the face of rising fiscal risks and record high public debt, fiscal policy needs to be crafted carefully to contribute to higher productivity. Smart structural adjustments could credibly increase revenues and reduce spending as the situation normalizes. We commend staff's work on public investment, which can support the transition to a more resilient and inclusive economy, adapted to the evolving structural challenges. In this context, we miss a stronger call to take advantage of the current low commodity prices to further eliminate energy subsidies. We also agree that it is crucial to ensure full transparency and good governance as a condition for effective investments.

- **Monetary policy needs to remain accommodative in the short run, but getting the financial sector off policy support will be challenging in the medium term.** Widespread cuts in interest rates and asset purchases by central banks have stabilized markets and lifted investors' risk appetite. As investors incorporate yet more policy support in case the situation deteriorates further, Wall Street and Main Street continue to diverge. This causes concern, as excessive risk taking creates systemic instability and increases the likelihood that more support will in fact be needed. Normalizing monetary conditions and reducing markets' reliance on policy support without substantial disruptions will be a key challenge in the medium term.

- **We need to resist temptation of deglobalization.** As the pandemic disrupted supply chains and, in some cases, exhausted the supply of critical medical goods, globalization has become vulnerable to political exploitation. Some restrictions on investment and trade may be legitimate, but that does not make them economically feasible, neither for the world nor for a specific country. We would like the IMF to continue to be beacon for a rules-based, transparent international system and the generally free movement of capital and goods.

- **We see a good opportunity to learn useful lessons from the Covid-19 crisis to address global challenges.** Dealing with global shocks requires a combination of national and international cooperation. An example is this year's WEO chapter on climate change policies. We note the important role that market-based mechanisms have in energy transition.

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September 28, 2020

Statement by Mr. Kaya, Mr. Benk, Mr. Just, Mr. Marek, Mr. Bayar, and Mr. Mehmedi on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the comprehensive set of reports. The Covid-19 pandemic is a truly transformational event, whose short- and long-term ramifications are defining the entire global economic system. As the human toll from the pandemic continues to mount and the concomitant economic fallout – despite a gradual reopening of economies – persists, authorities across the membership are facing binding policy constraints and difficult trade-offs. Against this backdrop, the flagship reports provide an accurate account of the global economic outlook as well as risks and offer an appropriate set of policy recommendations. Going forward, we would appreciate even more frequent updates, including in an informal format, to help the authorities stay abreast of the developments amidst an exceptional time of stress.

World Economic Outlook

We broadly concur with staff's assessment of the current economic developments and agree with the baseline scenario for the global economic outlook. We take positive note of the signs of recovery as most economies have started to gradually reopen. Nonetheless, resurgence of the pandemic in different parts of the world jeopardizes this nascent recovery as administrative containment measures appear to be reinstated in many economies while individuals continue to avoid contact-intensive economic activity. Therefore, the WEO baseline, which assumes a weakening of growth momentum in the second half of the year, appears sensible. In the absence of a vaccine and/or an effective treatment, social distancing and localized lockdowns will likely continue through and beyond 2021, undermining short-term economic outcomes as well as the longer-term potential through scarring effects. Therefore, the eventual recovery of the world economy hinges critically on the development of clinically proven vaccine(s) and treatments as well as on ensuring their broad-based coverage. The emphasis on multilateral cooperation in this regard is well placed.

We underscore that uncertainty remains a defining feature of the Fall WEO forecasts. In that regard, we see staff's scenario-based approach as quite pertinent. We agree that due to the exceptionally high degree of uncertainty, putting a quantitative assessment on the balance of risks is neither an analytically sound approach nor a useful one, for practical purposes. We therefore welcome the WEO presentation of both positive and negative scenarios as well as the breakdown of the impact of the pandemic on the global GDP. *We wonder whether and how staff in their projections about the impact of a downside scenario, have factored in the effect of a possible discretional policy response, where policy space exists.* Further, as also elaborated in the GFSR, the disconnect between market valuations and underlying economic fundamentals persist, which could amplify the potential adverse market reaction in case of a downside scenario. Thus, we are more concerned about a severe financial tightening – beyond the level implied by staff's scenario analysis - should there be a pronounced loss in confidence and risk appetite.

On the policy responses, we concur that fiscal policy has played a critical role in buttressing the economic recovery, preserving employment, and cushioning vulnerable segments of the population as well as firms from the adverse effects of the crisis. Going forward, as economies reopen, fiscal policy needs to be gradually unwound while retaining targeted social support programs and policies to foster reallocation of resources in the economy. We caution against a premature scaling back of crisis-related measures. We acknowledge the growing trade-off between the need to provide continued support to foster economic activity and the significant build-up of debt across all country groups. Reflecting this, anchoring fiscal policies to credible medium-term programs that would safeguard debt sustainability is crucial. In the interim, we underscore the importance of ensuring the quality of spending, including through prioritizing productivity enhancing, inclusive spending programs rather than wasteful subsidies and expenditures.

Monetary policy stimulus by the major central banks remains necessary to underpin economic activity and financial market sentiment, while safeguarding medium-term price stability. Introducing swap lines within a broad group of central banks, including from major emerging market economies, helped countering earlier bouts of tightening in financial market conditions. We encourage advanced economy central banks to consider widening these swap networks to cover remaining systemic gaps in the international monetary system. Similarly, we appreciate the ECB's targeted longer-term refinancing operations which have eased lending conditions in the euro area and also created some positive spillovers to the periphery. Given the prevailing uncertainty about the course of inflation, central banks need to remain vigilant against incipient inflationary/deflationary pressures to adjust all available tools, as appropriate, to ensure that inflation expectations are well anchored.

We are deeply concerned about the possibility of the pandemic leaving longer-term scars on potential growth. While the precise effect will vary across economies and sectors, it will reflect a variety of factors, particularly the pressures on sectoral balance sheets, labor market frictions, and the inherent flexibility of countries to undertake a swift and efficient resource reallocation within their economies. Global productivity gains were already sluggish since the Global Financial Crisis and the pandemic is posing renewed pressures in this regard. To that effect, we support staff's emphasis on the policy initiatives that could counteract the drags on productivity growth – including, repairing balance sheets and resolving distressed debt, addressing labor market rigidities and investing in human capital, expediting product market reforms to remove barriers to entry and facilitate resource reallocation, countering undue concentration of market power through effective use of competition policy. We also agree that the crisis presents an opportunity to prioritize new avenues of growth such as information technologies, data-enabled services, medicine and biotechnology, and green investments.

Finally, on a very specific point, we find the wording of a sentence (on page 22, paragraph 3) somewhat disturbing as it suggests that the children schooling from home are more likely to be exposed to violence and exploitation. While recognizing some unfortunate incidents in various parts of the world, we believe that the WEO should refrain from presenting such contentious and categorical propositions - which also do not add much value in terms of advancing the argument.

Global Financial Stability Report

We thank staff for the comprehensive GFSR which provides an in-depth analysis of risks across the main financial market segments and their interconnection with the real economy. The fallout of the COVID-19 pandemic on the financial sector has been largely mitigated by coordinated fiscal, monetary and regulatory response. Depending on the recovery path, it is critical to avoid early policy reversal, and differentiated policy response across jurisdictions is the right way forward. Downside risks in the financial sector were contained owing to massive easing of financial conditions and extensive public policy support. While gradual phasing out of the public and private supporting measures, including loan moratoria, should be pursued in the recovery phase, some jurisdictions facing a more prolonged duration of the pandemic, might need to continue using monetary, regulatory and macroprudential policies to avoid sudden cliff edge effects.

While supervisory authorities should use existing flexibility in financial sector regulation, it is critical to ensure that the gains in the post-GFC regulatory agenda are preserved and in line with the agreed international standards. The relaxation of macroprudential buffers can be encouraged, in line with their regulatory purpose, but their complete depletion must be avoided as the fallout of the pandemic might further weigh on the banking sector's capital position. Jurisdictions in the recovery phase should take gradual steps to withdraw contingency measures and move ahead with regulatory measures distinguishing between liquidity and solvency issues of individual borrowers, to avoid zombification of banks' balance sheets and a rapid increase in non-performing loans. Supervisors should be vigilant regarding the structural transformation in the banking sector and keep abreast of the emerging risks stemming in particular from the ongoing digitalization of banking services as well as risk management and compliance processes. Prudent risk management practices have to be promoted as the low interest rate environment may fuel excessive risk taking. Conducting well-designed stress testing exercises will also be pivotal to monitor banks' resilience to potentially distressed borrowers going forward.

We note that the non-financial corporate sector benefited from substantial public sector measures aiming to relive pressures on their cash-flow, including through commercial loans secured by state guarantees and public sector financial support schemes. Access to capital markets at more favorable terms was facilitated by asset purchase programs deployed by central banks on a large scale, which helped maintain corporate spreads compressed. While this immediate support was warranted to avoid corporate bankruptcies resulting from government-imposed business restrictions, a prolonged pandemic might weigh on the corporates' liquidity position and increase solvency issues. We are concerned that corporate credit quality has already shown signs of deterioration. Solvency developments in the SME sector should also be closely monitored, as their funding conditions are even more constrained compared to large firms, including in terms of access to capital markets funding, lower liquidity buffers and non-diversified revenues. The approach to addressing corporate SME loans should therefore be based on a careful assessment of the SMEs' capacity to repay and customized restructuring.

The disconnect between rising market valuations and economic developments identified in the April 2020 GFSR continues, which might weigh on capital and liquidity position of non-banks. Despite the sharp sell-off at the onset of the pandemic, equity markets have recovered owing to the substantial policy support. We are concerned that equity valuations seem to be at historically high levels in some jurisdictions and a potential abrupt reversal of investor sentiment has therefore been a persisting risk. While asset management funds might increasingly face sudden redemptions resulting in fire sales, insurance companies and pension funds might be incentivized by the extensive central bank capital market purchases to increase their leverage and expand their balance sheets with risky assets. Continued supervisory vigilance is therefore critical to reduce non-banks' asset-liability mismatches and ensure that they can meet their long-term liabilities.

Emerging markets' (EMs) central banks have for the first time engaged in quantitative easing, which helped keep their bond spreads compressed. However, the risk of stretched valuations, and debt distress might become pressing, in particular in those countries already making use of emergency Fund-supported financing and program arrangements, should their public expenditures soar on the back of the prolonged crisis. While the risk of portfolio outflows from the EMs has gradually decreased, rising external debt levels coupled with large rollover needs might further elevate their debt vulnerabilities. Finding the right balance between providing official support and implementing debt restructuring solutions with private creditors will be critical.

The expected rise in global public debt above 100 percent is worrying. We note that advanced economies (AEs) will experience larger increases in debt in 2020 than EMs due to their funding constraints. However, in the recovery phase both AEs and EMs will need to adopt medium-term consolidation strategies and address the issue of contingent liabilities, resulting from the extensive support programs for the corporate, banking and household sectors. Declining fiscal space also weighs on the sovereigns' capacity to engage in the potential recapitalization of distressed banks, therefore sound recovery and resolution plans are instrumental to avoid disorderly bank failures.

Fiscal Monitor

Staff appropriately analyses how fiscal policies have played a key role, as part of swift and concerted government responses across the membership, to mitigate the health and economic impact of the coronavirus crisis. We also appreciate the roadmap for fiscal policies during the different phases of the pandemic to better navigate lockdowns and reopening and to facilitate structural transformation to adjust to the new post-pandemic economy.

The massive and unprecedented fiscal policy support undertaken since the start of the COVID-19 crisis, with AEs and large EMs accounting for the bulk of the global fiscal policy response, has saved lives and livelihoods, supported vulnerable people and firms, and mitigated the fallout on economic activity. We take note of staff's conclusion that the outcomes would have been much worse without the public health and fiscal measures put in place. However, while the measures have been large and timely, they were also taken at the expense of targeting and governments should be fully cognizant of the unintended consequences of some of the implemented fiscal measures which could delay the necessary labor and sectorial reallocation, which in turn are critical for the recovery.

While fiscal support has been necessary to contain the spread of the disease and restore confidence, the fiscal response coupled with the sharp contraction in output and government revenues has pushed public debt levels close to 100 percent of GDP in 2020 globally, the highest ever. As policies that address health risks contribute to the restoration of confidence and trust, fiscal policy should therefore remain supportive and flexible where fiscal space exists, and countries should use their fiscal spaces efficiently. With 47 percent of low-income countries deemed at high risk of debt distress or already in debt distress and with debt vulnerabilities remaining elevated in many EMEs, fiscal risks should be properly contained, and debt sustainability ensured. To this end, it is critical that fiscal costs are properly assessed, disclosed, mitigated, and embedded in the budget processes and medium-term fiscal frameworks. At the same time, it is essential that countries carefully monitor and mitigate the sizable fiscal risks stemming from a potential protracted economic downturn, volatile financing conditions, commodity price movements, and contingent liabilities. With the COVID-19 pandemic inflicting a huge economic toll on LICs and overwhelming their weak health systems, we underscore that ramping up public health expenditures is the number one priority despite the limited fiscal space and vulnerable debt positions. Aid, grants, and concessional emergency financing by development partners and multilateral financial institutions for the health sector and other priority spending is essential, also with a view to ensure that fiscal positions do not deteriorate to unsustainable levels. Concurrently, ensuring that LICs have access to vaccines and treatments as soon as they become available is critical.

We welcome and agree with the proposed fiscal roadmap for the recovery, attuning fiscal measures and strategies to the three phases of the pandemic and ensuring that fiscal policy remains flexible. As most countries have partly or fully reopened, we concur that fiscal measures should remain targeted and countries with fiscal space could undertake job-intensive public investment while ensuring proper public investment management. Once the pandemic is under control, supporting the recovery will entail rebuilding fiscal buffers and strengthening debt sustainability while implementing measures which ensure a more inclusive and greener growth, including through investments in health, education, digital transformation and green projects while increasing income taxation, and strengthening social protection.

We appreciate the focus of the FM's Chapter 2 on the appropriate role of public investment in fostering the post-pandemic recovery, including the assessment on the fiscal multipliers in the COVID-19 crisis and recovery. We take note of the four steps needed to be taken immediately by countries, (i) the focus on capital maintenance of existing infrastructure; (ii) reviewing and reprioritizing active projects, (iii) creating a pipeline of projects, and (iv) starting planning for the development priorities stemming from the crisis. To this end, we underscore the importance of strengthening public investment management practices and governance, including through addressing shortcomings in the selection and appraisal process. We concur that investment priorities should include improving healthcare systems, addressing climate change risks and facilitating the transition to a low-carbon economy, and expanding digital infrastructure. In addition, training and re-skilling of displaced workers to support resource reallocation should be pursued.

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Revised

September 28, 2020

Statement by Mr. Villar, Mr. Guerra, Mr. Moreno, Mr. Rojas Ramirez, Mr. Tabora Munoz, Ms. Arevalo Arroyo, Mr. Cartagena Guardado, Mr. Lopez, and Ms. Moral Betere on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the informative set of flagship documents. The analysis presented by the Fund, focused mainly in the impact of the COVID-19 pandemic, is of crucial importance to the membership in order to successfully navigate a highly uncertain global context. Moreover, we welcome that key policy priorities and medium to long-term challenges are also considered to produce useful advice to secure a sustainable and inclusive recovery. We thank and commend staff for their hard work in a very complex context.

World Economic Outlook

We broadly concur with the staff's assessment of the global outlook. We notice that the outlook for 2020 is slightly more positive than that expected in June but mainly because of the anticipated recovery in China and in advanced economies. Prospects for global growth in 2021 have not improved and downside risks remain high. We believe that currently the most pressing challenge for member countries is to maintain their policy support to sustain the health system and mitigate the economic effects of the pandemic on businesses, employment, and social inclusion. Given the very high uncertainty, countries should put in place a policy strategy that is robust and consistent with medium-term financial restrictions, but flexible enough to extend the fiscal and monetary stimulus and reintroduce programs in case the pandemic worsens, while addressing the immediate urgent needs of aiding the more vulnerable population.

Looking ahead, policy design will have to manage the tradeoffs of supporting growth in the short-term while dealing with the pandemic and of confronting the depth of the likely economic scarring, especially in terms of increased inequality and debt buildup, with possible long-term implications for potential growth and financial stability. First, higher in our policy agenda should be a way to enhance the availability of resources for social spending and safety nets. Second, EMEs and developing economies, in particular low-income countries, will have to deal with a higher debt burden; the IMF should upgrade its efforts with adjustments to its lending and financial tools, timely policy advice and CD support where needed. Third, the financial implications of the link between higher fiscal pressures on the availability of resources for the private sector should be more broadly analyzed.

Finally, we agree with staff on the need to look beyond the pandemic for increased international cooperation to defuse trade and technological tensions and to advance in a recovery that is socially and environmentally responsible, while considering a comprehensive climate change agenda. The IMF should continue to be a strong voice in this regard.

Global Financial Stability Report

We broadly agree with the GFSR's Chapter I. We commend staff for the detailed policy priorities and road map recommended for the different stages (great lockdown, reopening, pandemic under control), as well as for adverse scenarios and post pandemic reforms; they constitute a useful toolkit for policymakers. We concur that the pandemic has become an important resilience test for the global financial system. We note with concern the rise of vulnerabilities highlighted in the report, particularly for countries with a narrow fiscal, monetary and financial space as they reach later stages and exit the pandemic. We want to underscore the importance of providing larger attention to the most vulnerable countries of our membership, for which the sharp deterioration of economic conditions and increased risks may have caused large distress in the banking and nonbanking financial systems in terms of liquidity, solvency, and asset quality. Also, we highlight the significance for the Fund to develop further research on the likely spillovers that may arise from countries facing a weakening of their financial systems and provide them with timely support and advice. The Fund will have a large role to play in closely assessing the soundness of the financial system and as a trusted advisor before crisis signals reappear. Capacity development and a close and integrated surveillance will be instrumental.

Fiscal Monitor

We welcome the analysis in Ch. 1 of the Fiscal Monitor of fiscal policies to address the pandemic. Globally, fiscal policy reaction has been swift and timely. Governments have approved fiscal support at an unprecedented level, including off-budget items and automatic stabilizers. However, country fiscal response has been heterogeneous depending on income per capita, pre-existing financing conditions and debt levels, as well as timely adoption of containment measures. As a result, the pandemic will leave uneven scars on countries in terms of indebtedness and inequality. In the future, those aspects should be considered when designing fiscal policy.

We concur that fiscal policy should initially respond to the immediate health crisis but overtime it should foster economic recovery and address the long-term post pandemic challenges, ensuring the sustainability of public finances while building resilience against future shocks. We believe that strong containment measures and limited mobility are required to bring the pandemic under control and to set the underpinnings for a smart and responsible re-opening of the economies, until universal and low-cost access to vaccines and effective treatments are available. We acknowledge that particularly in emerging middle-income countries, and low-income developing countries—due to their fiscal space constraints—it is required to do more with less. We welcome large, timely, temporary and targeted support for the people and viable firms most affected by the COVID-19 pandemic, including credit support, direct cash, in-kind transfers and wage subsidies to protect employment particularly for SMEs. However, tailoring these measures to country-specific conditions is crucial to warrant its effectiveness and ensure full transparency and good governance, especially given their size, exceptional nature and speed of deployment. As the economic effects of the pandemic seem to be more protracted than previously thought, temporary public measures should be appropriately calibrated to avoid possible cliff effects while ensuring financial stability and fiscal capacity of countries to help with economic recovery. Strong and timely technical and financial support from the IMF is critical to support and enable a more inclusive and green recovery.

World Economic Outlook – Analytical Chapters

Chapter II – "The Great Lockdown: Dissecting the Economic Effects"

We broadly agree with the content of the WEO's Ch. 2 on the economic effects of the great lockdown. The early measures that Governments around the world adopted to contain the spread of COVID-19 and the subsequent campaigns of social distancing have been instrumental to protect human lifes but have also meant a tradeoff with economic growth and development. We note with concern the effects of the pandemic in rising inequality and decreasing economic well-being and opportunities, especially for women and youth cohorts, as highlighted in the report. We also note that low-and-middle income countries have shared as well a larger burden of the cost of the pandemic than most developed countries given their lower human capital base, more labor-intensive sectors, and their lower preparedness for the work-at-home mode. Further research should be done by the Fund on the cost increase in the informal sectors derived from this crisis in some low and middle-income countries, which is affecting once again women, youth and elderly population. Following the main findings of this chapter, further IMF research will be instrumental to address the concerns related to the increase in poverty and inequality, as well as to draw policy recommendations to help the most impacted countries catch-up faster with financial inclusion and human capital, considering that the effects of the pandemic in economies and vulnerable populations may last for some time. In this vein, the report could have benefited from a deeper analysis on how the COVID-19 crisis has affected the middle class, the largest population cohort in many economies, as its loss of purchasing power could have amplified consequences on growth, fiscal vulnerabilities, financial stability and social unrest.

Chapter III – "Mitigating Climate Change—Growth and Distribution-Friendly Strategies"

We strongly believe that addressing the impact of global warming and keeping global temperatures to safe levels are paramount to put the global economy on a sustainable growth path. Governments play a key role in this process not only by developing market and non-market policies to promote green investments and low-carbon activities, but also by encouraging international cooperation, especially to take advantage of the positive spillovers created by research and innovations in green technologies developed in more industrialized economies. Moreover, countries that have contributed to the bulk of the stock of global carbon emissions should bear a greater part of the mitigation burden. Since reducing greenhouse gas emissions entails an important fiscal cost and economies transformation, particularly for low-income countries and fossil fuel exporters, measures to prevent and reduce inequality caused by the decarbonization of the global economy are critical. We acknowledge that the COVID-19 pandemic is a great opportunity to spur the global decarbonization process; however, it will only be successful if a proper and optimal set of mitigation policies—including technological and behavioral incentives—are in place to ensure their social and political feasibility.

Global Financial Stability Report – Analytical Chapters

Chapter II – "Emerging and Frontier Markets"

We welcome staff's analysis of the energetic response to the pandemic by frontier and emerging market countries, including the use of Asset Purchase Programs (APPs) by central banks. We appreciate staff´s recently created new gauge, the Local Stress Index (LSI), which has allowed to extract conclusions on the main impact APPs' use. We agree with staff that, although the recent experience has proven very positive and APPs can be a useful addition to central banks' toolkits with credible monetary policy frameworks and good governance, the associated risks are high and policy makers should be vigilant on the potential costs, especially for open-ended programs. In this regard, we fully agree with Mr. Bevilacqua and colleagues that the chapter provides useful insights for central banks in order to consider the benefits and costs of the use of APPs, but the inclusion of Figure 2.9 is highly misleading, and it should be deleted. We also consider that perception-based indicators could be problematic given their composition and the heterogeneity of the indicators in which they are based. Moreover, the conclusions extracted from the figure are deceptive. The assessment of central banks credibility and their ability to fulfill their mandates goes beyond, and it is more complex, than the proxies used in these panels.

Chapter III - "Corporate Funding: Liquidity Strains Cushioned by a Powerful Set of Policies"

We commend staff for the rich analysis on corporate funding in Ch. 3 of the GFSR. During the crisis, the financial sector—aided by massive public support—has been able to keep credit flowing to cover liquidity needs and avoid an even bigger economic crunch. This time around, banks have not been part of the problem, but part of the solution—acting as intermediaries in many public programs. However, the pandemic is not fading away. The success of policy interventions calls for their extension as needed, although authorities must be vigilant of the trade-offs between the benefits of policy support and the growing vulnerabilities due to over indebtedness and the deterioration of the solvency of corporates.

Chapter IV – "Bank Capital: COVID-19 Challenge and Policy Responses"

The COVID-19 crisis shock severely stressed the banking system with liquidity and solvency challenges. Policymakers around the world have responded to the COVID-19 crisis thru unprecedented policies, trying to maintain the credit flow to the real economy, while safeguarding the soundness of the banking system. We commend staff for the enlightening findings in Ch. IV of the GFSR. We see that the banking system entered the COVID-19 crisis with a strong initial position and recognize that policies aiming at maintaining the flow of credit to the real economy—such as Government loan guarantee programs, while giving banks flexibility to preserve capital adequacy, have been effective in keeping banks' capital ratios above regulatory minimums at the global level. Restrictions on dividend payments have also been instrumental to help banks build buffers and increase provisions. *Could staff elaborate on the robustness of the results and what to expect should the COVID-19 pandemic linger?* Simulations show a set of weak tail banks within regions that could see their solvency challenged, including some systemically important banks. *To what extent could this impact financial stability should the adverse scenario materialize*? *Could staff comment on the sample covered in the simulation exercise, and on the inclusion and validity of results for emerging and low-income economies?*

Chapter V – "Climate Change: The COVID-19 and Transition to a Low-Carbon Economy"

We greatly value staff's analysis on the impact of the crisis on corporate sustainability. We notice the reduction of carbon emissions since the beginning of the crisis, particularly during the sterner part of the lockdowns, as well as the sustained level of green bond issuance for supporting green investments. We agree that during the COVID-19 crisis, the concern of all actors for our vulnerability to global crises increased, and with it the pressure to improve corporations' environmental performance. We do acknowledge, however, that as the crisis continues to hit hard, priorities will likely lie elsewhere, not on improving environmentally friendly performance, as is evidenced in staff's detailed studies. Therefore, it is necessary that Governments act to protect and promote green investments and help develop the incipient sustainable finance sector.

Fiscal Monitor

Chapter II – "Investing in the Post-Pandemic Recovery"

Public Investment proved to be a powerful resource to cope with the consequences and uncertainties of the COVID-19 crisis. We value the theoretical and econometric results presented in Ch. II of the Fiscal Monitor regarding the impact that public spending in sectors like health and social welfare, schools, digital infrastructure, clean energy and green economy can have on GDP growth and employment as response to the COVID-19 pandemics crisis. We agree that the success of a public Investment strategy relies on timely action with quality projects and strong public investment management practices and governance. The current condition of historic low-interest rates in advanced and some emerging countries are favorable for improving employment, crowding in private investment and absorbing private savings without causing a rise in borrowing cost. We broadly agree that public investment during the pandemic, together with a well-focused structural reform agenda, is essential to raise long-term economic growth and strengthen economies' resilience to crisis. We note that for many low-income countries, and some emerging economies constrained by financing conditions, public investment needs to be safeguarded to meet efficient policy standards for successful results.

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September 28, 2020

Statement by Mr. Mojarrad, Mr. El Qorchi, Mr. Ahmed, Mr. Badsi, and Mr. Nadali on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor (Preliminary)
Executive Board Meeting
September 30, 2020

World Economic Outlook

The COVID-19 pandemic will leave deep economic and social scars. The economic and social divides that existed before the crisis—particularly income and gender inequality—have been compounded by the crisis. The crisis would have been much deeper had it not been for the preemptive, aggressive and synchronized policy response, mainly by the leading economies with the support of international institutions including the Fund.

While signs of optimism are emerging, it is important to bear in mind that the pandemic is still evolving, and its path is still uncertain and depends on the prospects of developing a safe and effective vaccine. The possibility of a strong second wave of the pandemic should not be underestimated, and complete lockdown may not be politically feasible. Considering these uncertainties, staff's "upside" and "downside" scenarios are reasonable. *Has staff considered an even worse scenario consistent with a serious second wave and all out lockdowns?*

Containing the pandemic is still of a highest priority. While the focus has been on developing and manufacturing a safe vaccine, less attention has been paid to its global distribution, accessibility, and affordability. Since no country is safe if the virus is spreading, external financial and logistical support will be critical to ensure that the vaccine is available widely, including for poorest countries. In this context, restrictions on trade and payments related to essential medical supplies are incomprehensible. We believe that multilateral cooperation is the most effective way to prepare for the next global health crisis.

Mitigating the economic and financial fallout entailed a large fiscal cost and a significant rise in indebtedness. The lockdowns and safety measures have been instrumental in the fight against the virus (Chapter 2), but it is important that reopening of the economies is carefully planned. Fund staff is expected to play an important role in advising members on unwinding the emergency measures and putting in place policies consistent with long-term growth, and fiscal and debt sustainability.

Moving beyond the immediate crisis, we agree with staff on policy priorities: putting back the economy on a durable growth track, protecting the vulnerable, addressing economic and social inequalities, and building up human capital. In AEs, the challenge is to enhance potential growth, reallocate resources efficiently, and ensure that future economic gains are shared evenly.

The challenges faced by EMs and DCs vary considerably across countries. Ensuring market access is one of the key priorities for EMs. DCs, and especially LIDCs many already burdened by high debt, are facing formidable challenges that they cannot overcome on their own. The pandemic has particularly hit hard countries highly dependent on tourism and inward remittances, and has created a new wave of economic migrants. In addition, the high level of informality in some countries has increased poverty as large segments of the population are outside the coverage of government support. Debt relief, timely and adequate provision of grants, and concessional financing are the lifeline of these countries' recovery, poverty alleviation, and economic development. The Fund has also an important role to play by providing financial support and policy advice.

The pandemic and the sharp collapse of international oil prices sent a double-shock wave through oil exporting countries, causing significant economic downturn and a sharp rise in their twin deficits. They interrupted their diversification efforts, with ripple effects on countries reliant on them for trade, tourism, and remittances. The strong collective response of OPEC+ countries in the early stages of the crisis helped to stabilize the oil market and sustain its partial recovery. *In Chapters 1 and 3, OPEC and OPEC+ have been used interchangeably with "fossil fuel producers". We request staff to make this distinction clear.*

Global cooperation in trade and technology has lifted hundreds of millions out of poverty in the past few decades. We urge all members to support a rules-based multilateral trading system, and the leading economies to resolve their bilateral trade and technology frictions, for the good of the world economy and of all its citizens.

Global Financial Stability Report

We are broadly in agreement with the GFSR assessment of the global financial conditions, outlook, risks, and policy priorities as well as the suggested monetary and financial policies roadmap after the Great Lockdown. We concur that countries suffering from pre-existing financial fragilities will face headwinds for recovery.

We note positively that the near-term global financial stability risks have presently receded. We welcome the extraordinary actions taken by many central banks to ease monetary policy, and provide ample liquidity to financial institutions and markets. We also welcome the flow of credit to households and firms by setting up emergency facilities. The considerable easing of financial conditions since late March has prevented a financial crisis and cushioned the economic impact of the pandemic. However, while aggregate portfolios have recovered from their March lows, about half of EMs continue to experience capital outflows.

Increased vulnerabilities in the nonfinancial corporate sector, due to rising firms' indebtedness, have intensified financial stability concerns in many countries. Premature withdrawal of policy support could jeopardize the success achieved so far in broadly meeting the nonfinancial corporate sector's liquidity and funding needs.

As noted in the GFSR (Chapter 3), the pace of recovery is likely to be uneven across sectors and countries. As the crisis unfolds, particularly if the recovery is delayed, corporate liquidity pressures may lead to insolvencies and SMEs will be more vulnerable than large corporates with access to capital markets. Banks now generally have larger capital and liquidity buffers relative to the Global Financial Crisis. We would therefore argue that they should be encouraged to use the existing buffers to absorb losses and accept to prudently re-negotiate loan terms for firms and individuals, using the flexibility within regulatory frameworks. Any regulatory relief would need to be reassessed once conditions permit. We agree that bank-specific mitigation policies will help reduce financial stability risks.

The GFSR has noted that many emerging and frontier market central banks used for the first time Assets Purchase Programs (APPs) to ensure the smooth functioning of bond markets and implement accommodative policies in a very low policy rates environment. The apparent success in helping reduce bond yields without risking financial stability—so far—raises a pertinent question of whether APPs should be part of emerging and frontier markets policy toolkit in future as well. *Staff views are welcome.*

We note that the pandemic also triggered a record portfolio outflows from emerging and frontier markets. *In this environment, would staff recommend that central banks allow exchange rate to act as a shock absorber and limit intervention in foreign exchange markets to reduce excessive volatility and ease liquidity constraints? What would be the appropriate timing to phase out macroprudential measures taken during the crisis?*

Fiscal Monitor

Large and timely fiscal actions deployed by many governments, as called for by the April 2020 Fiscal Monitor (FM), have helped save lives and livelihoods, and avert much worse health and economic outcomes in the membership. However, these unprecedented spending and liquidity support measures, amounting to 12 percent of global GDP, combined with a sharp output contraction and ensuing fall in revenues, have exacted a heavy toll on public finances in 2020, as reflected in the 9 percent of GDP surge in average government deficits and a record high global public debt of almost 100 percent of GDP. Fiscal deficit-to-GDP ratio in AEs is over four times higher this year and government debt-to-GDP is projected to reach 125 percent. Fiscal measures and output losses will also give rise to sizable widening of fiscal deficit and increase in public debt in both EMs and LIDCs, many of which face binding financing constraints, with almost half of LIDCs deemed to be in, or at a high risk of, debt distress.

The FM preliminary assessment of the fiscal response to the pandemic reveals that country-specific circumstances have played a key role in the vast variation in size, composition, and scope of discretionary and automatic fiscal support across countries. While fiscal policy actions have been massive in AEs, they have been constrained by financing in many EMs and, especially, LIDCs, which must also deal with large informal sectors. An important lesson learnt is that countries that put in place strong containment measures at an early stage, managed to mitigate overall negative social and economic consequences and ultimately deployed smaller fiscal packages.

We note that health and non-health measures, including cash and in-kind transfers, wage subsidies, unemployment benefits, loans and guarantees, equity injections, tax deferrals, and payment moratoria have served varying objectives and faced different trade-offs. While we agree that overextended job retention schemes and overly generous unemployment benefits could both delay the necessary job reallocations, we wonder which of these two schemes is preferable, including in terms of the eventual smaller adverse impact on the unemployment rate, if country circumstances allow for a choice to be made between the two. *Staff comments are appreciated*.

A toolkit of flexible fiscal measures to navigate through containment, stabilization, and recovery phases of the pandemic is needed, while ensuring that all pandemic-related fiscal measures are transparently deployed, adhere to good governance standards, and are fully costed. We agree that the scope for stimulus or the appropriate pace of fiscal consolidation depends on country-specific circumstances. Fiscal roadmap for the recovery rightly prescribes the use of all available tools during the containment phase, a more selective government support for viable or strategic firms during the stabilization phase, and supporting growth while ensuring debt sustainability, including by unwinding government interventions in the corporate sector, during the recovery phase.

We note with concern the setback imposed by the pandemic in the LIDCs' plans to achieve the 2030 SDGs and call on the international community to provide increased development aid and debt relief to help LIDCs achieve their adjustment and growth objectives and alleviate hunger and poverty.

Regarding climate change challenges, we support continued staff research on their economic costs. We also encourage staff to assist member countries in designing policies that mitigate their impact as part of bilateral surveillance. While little of the response to the COVID-19 shock to date has been *green*, we agree that the recovery from the current pandemic provides an opportunity to move away from the pre-crisis growth model regarding climate change and invest in a green and sustainable future. We welcome the EU's announcement of a 30 percent green spending target for its 5.5 percent of GDP stimulus package and *appreciate staff indication of the extent to which green budgeting has been introduced by the membership.*

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September 28, 2020

Statement by Mr. Jin, Mr. Zhang, Ms. Liu, Ms. Zhao, and Ms. Lok on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

We thank staff for the set of well-written flagship reports and broadly agree with staff's assessment of the global economy and risks. The extraordinary and decisive policy response by member countries has supported the global economy through the unprecedented shock brought on by the pandemic so far, and the global economy is starting to see emerging signs of recovery. Nevertheless, the recovery ahead is slow, uneven, and subject to many uncertainties, including a potential resurgence of infections. Downside risks surrounding the outlook also remains significant, including a further building up of debt, increasing volatility in financial markets, and intensifying trade and technology tensions.

This challenging time offers a valuable opportunity for countries to help each other, share experiences, and build trust to foster a more open, inclusive, and resilient global economy going forward. The global community should work together in solidarity and defuse tensions, while the Fund should continue to be a strong advocate of multilateral cooperation on key policy fronts. The Fund should also draw on positive experiences from across the membership and step up collaboration with other international organizations to provide its members with sound and targeted policy advice.

World Economic Outlook (WEO)

We welcome the upward revision to WEO projections for 2020, which is mainly driven by the better-than-expected second quarter GDP outturns. Economic activity has been bolstered by strengthening industrial production and retail sales, increasing public investment, and slowly recovering global trade. We take positive note that capital inflows to some emerging market economies (EMEs) have resumed after the sharp reversal in March. The pace of recovery hinges crucially on policies undertaken. In the near-term, given the pandemic is still affecting many countries, policy priorities should ensure adequate resources for health care and limit economic damage. Policy makers should strike an appropriate balance between containing the spread of the virus while also preventing scarring and facilitating reopening and recovery. Strong efforts on both fronts would be necessary to climb out of this crisis. As the crisis evolves, policies should continue to adapt nimbly to sustain a resilient and sustainable recovery. With the global situation evolving rapidly, we encourage staff to closely monitor developments and update growth forecasts as necessary.

An open and rules-based international trade and investment system is still the best way to serve everyone's interest. Decoupling or total self-reliance could risk exacerbating the current crisis. We should strive to restore basic trust in international trade and investment. The international community also needs to come together to support the most vulnerable. We note with concern that the pandemic is reversing the hard-earned progress made in global poverty reduction and worsening income inequality. Adequate attention should be paid to the social consequences of the unprecedented pandemic.

In China, COVID-19 has been largely contained thanks to stringent, scientific, and comprehensive measures, and people's lives have basically returned to normal. The economy continues to experience a steady and broad-based recovery, with second quarter GDP posting 3.2 percent positive growth. Production and investment continued to rebound, consumption is gradually recovering, exports picked up significantly, and employment and prices remained generally stable. The PMI has moved into the expansionary territory since March. Monetary policy has been supportive so far, resulting on lowered bank lending rate and market financing rate. The exchange rate of RMB has remained flexible and strengthened significantly against the US dollar in recent months. Fiscal support has also been increased, with budget deficit reaching over 3.6 percent of GDP this year, while tax and fee cuts will amount to 2.5 trillion yuan (USD 360 billion). However, with the global economy experiencing a deep contraction and high uncertainties, there will be headwinds ahead. The authorities will remain vigilant and continue to deepen reform, generate new driving forces by technological innovation, and pursue greater opening-up in the financial sector. We are confident that the Chinese economy will continue to recover in the second half of this year.

Global Financial Stability Report (GFSR)

Risks in the global financial system seem contained for now, at least in the near-term. Financial market sentiment continues to be supported by the large-scale policy response to the pandemic. As observed by staff, despite the recent repricing in equity markets, the disconnect between market valuations and the economy seems to persist. However, should downside risks to the economy (e.g. a resurgence of the virus) materialize, and/or market expectations of policy support change, market sentiment can reverse, leading to sharp adjustments in markets. Policymakers should stay vigilant and act accordingly to safeguard financial stability. *In staff's view, is there a risk of "disconnect" between market expectations of what policymakers will do in the event of further economic deterioration, and what policymakers can do given existing policy space and potential unintended consequences?*

For EMEs, there has been a resumption of capital inflows and the outlook for portfolio flows in the coming quarters has also improved. But underlying this overall improvement is an uneven distribution of flows, with a sizeable portion of EMEs still experiencing outflows, while frontier market economies continue to face considerable financing challenges. This suggests a differentiation across economies based on economic fundamentals, which could persist under the current uncertain environment. We encourage staff to continue to monitor developments closely, paying close attention to the cross-border spillover effects of developed countries' policies on the exchange rate and capital flows of EMEs in their surveillance work. Building on the analysis in Chapter 2 on EME responses to the pandemic, we look forward to further analysis on EME use of unconventional monetary policy tools as more experience is garnered.

Financial conditions in China have remained basically stable despite the impact of the epidemic. Since the COVID-19 outbreak, the People's Bank of China (PBC) has introduced a series of measures to provide effective support for the economy. These measures have played a critical role in mitigating the adverse impact of the pandemic and preventing large-scale bankruptcies in China. Staff pointed out in Chapter 1 and Online Annex Box 2.1 that, while measures taken by PBC have helped direct credit to vulnerable borrowers and support the economy, these measures may increase the vulnerabilities in the nonfinancial sector. This is not a unique challenge for China. The pandemic has caused an unprecedented shock to economies around the world, causing significant disruptions to economic activity particularly in contact-intensive sectors. Meanwhile, widespread job losses have placed significant burden on households. During this difficult time, vulnerabilities will inevitably increase. The priority of all policymakers is to provide adequate assistance to affected firms and families to stabilize the economy, while ensuring financial stability and resilience are maintained and avoiding moral hazard. As measures to support immediate needs of the economy may entail costs, it is critical to have effective exit strategies in place to withdraw from exceptional support measures in a well-paced manner as the economy begins to stabilize.

As for the potential financial stability risks associated with local governments in China discussed in Box 1.3 in Chapter 1, it is important to note that, in recent years, the Chinese authorities have made notable progress in regulating local government debt financing and containing associated risks. On the potential risks stemming from the debt of local government financing vehicles and local state-owned enterprises, the authorities will closely monitor developments and their potential impact on the banking sector, and take measures as necessary to safeguard financial stability.

Overall, while we appreciate staff's discussion on potential risks and vulnerabilities facing the global financial system, we wonder whether, at this juncture, China is a representative example of staff's concerns given our current stage in economic recovery and the relatively stable financial conditions so far. That said, our authorities will stay vigilant and continue to strengthen our financial regulatory and supervisory framework going forward.

Fiscal Monitor (FM)

We agree that the consequences of the pandemic on public finances have been massive and fiscal risks are also unprecedented. Fiscal policies should be adopted in line with fiscal space, and large amounts of fiscal deficits financed by excessive external debt in a low interest rate environment should be avoided to improve resilience to an inevitable capital flow reversal in the future.

We are concerned that financing constraints are binding for many emerging market and developing countries, and official support to alleviate such constraints has been overwhelmed by financing needs. For emerging markets, public debt owed to multilateral creditors are about one and a half times of those owed to official bilateral creditors. Therefore, all stakeholders including MDBs and private creditors should be included on board to ensure an even-handed solution. In addition, it is important to recognize that the current crisis caused by the pandemic is two-fold, a liquidity crisis in the first place, and then a possible solvency crisis. The Fund should find ways that can provide both liquidity and equity in its program. A general allocation of the SDR is an appropriate choice.

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Statement by Mr. Mozhin, Mr. Palei, Mr. Potapov, Mr. Tolstikov, Mr. Biriukov, and Mr. Shestakov on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
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The initial confusion and scare from the COVID-19 pandemic has been gradually replaced by a more sober and informed evaluation of the scale of the threat and its possible economic consequences. With a better understanding of the risks and a gradual return of confidence in the ability to arrest the pandemic through a mass vaccination and herd immunity, public officials can now move from indiscriminate lockdowns to much better targeted measures. According to the new WEO projections, economic activity is recovering in many countries amidst partial re-opening of the economies.

Against this background, compared to the June WEO update the baseline growth projections for 2020 have improved substantially for many major economies and, thus, for the global economy. China is once again projected to lead the way and play the role of an engine of global recovery. We also note that the projection for the U.S. GDP contraction has improved from -8.0 percent to -4.3 percent. In the euro area the contraction will remain very large, with stark differences between the North and the South, but the projections are also somewhat better. Unfortunately, in India -- one of the largest economies -- growth prospects have deteriorated sharply, while the authorities are gradually regaining control of the spread in infections. The uncertainty surrounding the 2020 projections remains large, but much less so than in April and June. For 2021, a lot will depend on the progress in development and mass production of vaccines, which looks more and more promising. The health officials' baseline scenario assumes mass availability of vaccine by the middle of next year, if not earlier. The rapid growth of technology sectors is also a silver lining on the overall dark horizon.

Despite somewhat more positive updated outlook, the overall impact of the Great Lockdown on the world economy is still devastating. This situation still calls for the continuation of proactive policy stance relying on fiscal and monetary stimulation measures as well as the regulatory forbearance. At the same time, these unprecedented policy measures aimed at mitigating the economic contraction come at a very high price. Public debts will rise to unprecedented levels, especially in advanced economies (AEs). In many countries public debts will achieve the levels that the Fund considered unsustainable only a few years ago. As a result of the pandemic and the associated policy response, public debts will jump in AEs by about 20 percent of GDP and reach about 125 percent of GDP, on average. However, it is also true that for many AEs unconventional monetary policies and expected low interest rates provide room for the increase in their public debts. During this crisis, up to 75 percent of the new public debt in major AEs was purchased by their central banks.

In this connection, it is regrettable that the comprehensive data on the evolution of the major central banks' holdings of government bonds is once again missing in the new set of the Fund's trademark reports.

We note that the current staff views on the risks associated with high public debts differ from their views taken at the height of the Global Financial Crisis. Ten years ago, the Fiscal Monitor focused on the need to bring the levels of public debts in AEs down to about 60 percent of GDP. The Fund members agreed that all the required reforms had to be completed by 2020, setting public debt levels firmly on the way to reaching the target by 2030. In the second half of the past decade the emphasis shifted to the concept of fiscal space, and the Board held many heated debates about the meaning of the concept and the reasoning behind it. The COVID-19 crisis led the world into a new reality. Today, it seems that concerns about possible consequences of high public debs for future growth, the role of the state, and many other issues are downplayed. The dominant view is that policy actions, including structural reforms and public investments in human capital and infrastructure will be effective and ensure public debt sustainability. We believe that the Fund must revisit its past logic more explicitly and, if warranted, to articulate the modified views without delays.

The Fund should also revisit its views on the unconventional monetary policies. After such policies have been actively used for more than a decade, they now seem to become the permanent policy tool for the foreseeable future. The unconventional monetary policies, including asset purchases, forward guidance, and negative interest rates, will continue to be necessary for most AEs for a long time. As we have discussed in the past, re-anchoring of inflation expectations at a level much lower than the target, in combination with prolonged reliance on UMPs, may well elevate risks to growth and debt sustainability for many years to come. The experience of Abenomics and the developments over the past decade in the euro area, unfortunately, point to the major challenges in this area.

Financial stability risks are likely to intensify going forward. Many countries have entered the crisis with elevated vulnerabilities in many sectors, including already mentioned high public and private debt, mounting pressures in the corporate sector, and suppressed risk premia. While the massive use of unconventional monetary policy tools has prevented sharp tightening of financial conditions so far, these vulnerabilities will remain a constant threat and may well increase. Chapter 4 of the GFSR offered a timely estimate of the likely effects of the deep and prolonged contraction on the banks' capital. We are encouraged that the global stress test shows that most banks will be able to withstand a combination of severe shocks.

However, it is also true that, in response to the GFC, the focus in regulatory reforms was on the banks, while more risky activities ended up in the shadow financial sector. The international community faces the challenge of expanding the perimeter of supervision and regulation without excessively harming the flexibility and innovation in the financial markets. In addition, we believe that the Fund should revive its attention to the offshore financial centers and other underregulated jurisdictions.

In the emerging market economies (EMEs) economic developments and outlook differ in terms of their ability to control the spread of infection, the scale of the economic damage from the crisis, and the availability of policy levers. We feel that the flagship reports insufficiently highlighted the differences in this group of countries. Moreover, in many parts of the reports the EMEs are lumped together with vulnerable low-income countries (LICs).

Despite the varying success in controlling the spread of the virus, many EMEs demonstrated enviable economic and financial resilience in the face of the shocks. In contrast to prior crises episodes, the authorities in many EMEs were able to embark on countercyclical monetary and fiscal policies. As it was highlighted in Chapter 2 of the GFSR, some central banks successfully employed asset purchases facilitating financial market stabilization. From this point of view, we would like to underscore that policy analyses and recommendations should be clearly differentiated in accordance with the country-specific circumstances, including the stage of the pandemic response. While most of the world economies are in the partial reopening stage, with some risks of falling back to Phase 1 if infection intensifies, a few countries have contained the pandemic and are successfully recovering for some time now -- China is the most obvious example. Countries with even lower income levels, such as Vietnam and Rwanda, also offer good lessons in how good institutions and coherent national strategies can contain the damage to the population and the economies.

Many low-income countries (LICs) do not have the capacity to offset the economic damage of COVID-19. Economic activity in the poorest countries is expected to drop by about 2.5 percent in 2020. Those countries that rely on commodity exports, tourism, and remittances face the strongest economic headwinds. Even before the pandemic, many of these countries were dealing with significant development pressures and rising fiscal risks and debt vulnerabilities. The crisis is expected to reverse the progress in poverty reduction and undermine their prospects to reach the sustainable development goals. Amid worsening solvency concerns, more countries may face unsustainable debt burdens and, therefore, debt distress.

With respect to all economies, we are concerned about vocal calls for delaying pro-growth structural reforms, including policies designed to nudge faster reallocation of resources. Permanent changes to the economy are not limited only to negative ones. In addition to lower growth potential, possible bankruptcies, and scarring, the crisis also has a silver lining. The latter part seems to attract little attention in the flagship publications. The crisis accelerated many changes that were expected to take 5-10 years and occurred in a matter of months. The move in favor of digital economy was extremely strong, as evidenced by the technology part of the S&P 500, and the experience of quite a few countries, both AEs and EMDCs. Distance learning, telehealth, digital financial services, online shopping, and all kinds of communications saw a tremendous expansion. Even if our lives normalize due to mass availability of vaccines soon, these changes are here to stay. The only question is what will be the scale of the effect from these permanent positive changes. These structural shifts already feature prominently in adjustments in many IMF members, so the discussion should not be limited to the likely policy responses in the future, but also pay attention to what has already worked in many countries. The upgraded knowledge exchange in the Fund with a broader access should play a prominent role in dissemination of best practices.

The pandemic will force us to reevaluate once again the role the state in the economy. In many countries, large-scale fiscal support, including direct subsidies, loans, guarantees, equity injections, as well as widespread regulatory forbearance, have weakened market mechanisms and substantially increased the role of the government and regulatory bodies. The effectiveness and speed of reallocation of resources, and even the future of certain sectors of the economy, may now depend on discretionary government decisions. Chapter 2 in the Fiscal Monitor touched on just one of such areas -- public investments -- where the role of the state might be more pronounced than it was before the COVID-19 crisis. In the long run public investments in pandemic preparedness, digital infrastructure, and climate change adaptation should help to build resilience. Another example of the possibly stronger role of the state could be in facilitating exit of unviable entities when market mechanisms play a weaker role. In order to reignite growth, it would be essential to gradually reduce the number of “zombie companies”.

We note the WEO emphasis on the social aspects of policy response. It is entirely appropriate, since the achievements in poverty reduction and income distribution made since the Global Financial Crisis have been mostly wiped away. Tax and spending measures should ensure fair and participatory growth that protect the vulnerable. We note that the WEO urges raising progressive taxes on more affluent individuals and profitable corporates. Also, fiscal instruments could be useful in stimulating investments, including green investments, encouraging redistribution of resources towards less carbon-intensive activities. Similarly, digital infrastructure and access to financing could contribute to rebalancing opportunities in the economies, while alleviating social tensions.

The flagship reports paid scant attention to the huge health and economic costs primarily affecting older people and to the related challenges facing the ageing societies.

Staff claimed that the COVID-19 crisis most severely affected younger people, as they were the first to lose jobs and face potential life-long decline in their incomes. We believe, however, that the focus of this analysis was too narrow. The mortality rate of older people from the COVID-19 infections has been much higher than for the young. Older people constitute an overwhelming majority of one million victims of COVID-19. Given the much higher health risks, this part of the population is also facing more isolation. Moreover, the security of their pension savings may be under threat. We call on staff to rebalance somewhat the text in Chapter 2 of the WEO report.

The issue of trust in the authorities is not a new one, as it was so prominent during the policy debates at the time of the GFC. Subsequent years were marred by increasing political polarizations in many countries, both AEs and EMDEs, and the declining trust in the authorities' willingness or ability to address deeply entrenched socio-economic fault lines. We believe that the COVID-19 crisis led to further deepening of social conflicts and, in some countries, is clearly associated with the reduced trust in the authorities and doubts that the key institutions can function properly. These are very disturbing trends, as they may complicate the implementation of anti-crisis measures and subsequent reforms.

We support the Fund's call for international cooperation. Yet, it would be more powerful in light of a more comprehensive and prominent description of current challenges. The increase in international hostility, deepening of the trade, technology, and information wars, unilateral versus multilateral approaches to addressing global challenges, unfortunately, distinguish the current crisis response from the GFC. At the time of the GFC, we witnessed not just coordinated policy responses among Fund members, but also a major improvement in the international cooperation. The strengthening of the G-20, and the agreement on governance reforms at the IMF illustrated the willingness to cooperate. Today, the implementation of tax and climate initiatives depends a lot on the degree of multilateral cooperation and the ability to agree on common approaches.

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GRAY/20/3038

September 28, 2020

Statement by Mr. Bhalla, Mr. Goyal, Mr. Natarajan, and Mr. Singh on World Economic Outlook; Global Financial Stability Report; Fiscal Monitor
(Preliminary)
Executive Board Meeting
September 30, 2020

WORLD ECONOMIC OUTLOOK

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

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

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

4. The Report makes two important conclusions regarding the **impact of lockdowns on the spread of pandemic**. The first important conclusion is that the imposition of a stringent lockdown when the number of cases is low is successful in containing the spread of the pandemic. This is a plausible hypothesis, but one that needs much more robust statistical evidence than that offered in Chapter 2. There are many "outliers" to this hypothesis/conclusion, and outliers which are spread in number, and population, across all continents.

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

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

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

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

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

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

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

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

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

14. The Report talks about concessional finance towards mitigation actions and though it is a considerable step, this should not undermine in any circumstances the effectiveness and importance of international public finance in climate

finance, from developed to developing countries and the need for grant and grant equivalence. The availability of adequate, credible and predictable climate finance for the developing countries holds the key in the successful implementation of climate actions by the developing countries. the momentum in international climate finance arena and the scope, scale and speed of climate finance is lagging behind considerably. Any significant efforts on climate finance arena are yet to be seen in the mobilization and global action on climate change is contingent on the delivery of timely and adequate finance. Call for climate actions should set in motion a serious discourse on climate finance required to take climate actions effectively. However, the chapter is silent on this important aspect on climate action.

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

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

Global Financial Stability Report

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

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

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

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

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

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

22. The Report highlights the concern that new debt supply and weak domestic fundamentals may have curtailed demand for local currency bonds from foreign investors, especially where they hold large shares of debt and where the domestic

investor base may not be deep. In our view, **this calls for increased attention to developing and deepening the local currency bond markets and fostering greater domestic investor participation,** particularly in the frontier markets, where the current crisis has exposed the local currency bond market illiquidity in the face of external shocks.

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

Fiscal Monitor

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

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

26. **Countries must design fiscal policy measures by adapting to the challenges in different phases of the pandemic. The Report rightly specifies reorienting the fiscal policy measures in three different phases of pandemic.** In the first phase of outbreak, lockdown measures were imposed, and the need was to respond to immediate health and livelihood issues. Alluding to the fact that countries which responded to the pandemic with "smart" containment measures have lost fewer

lives and are projected to better contain the adverse impact on economic activity reflects the nuancing of Fund's approach to containment measures.

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

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

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

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

31. **Ensuring sustainable reopening and recovery of the economy should be the aim of the fiscal road map ahead.** We agree that the policies need to be calibrated to ensure safe and sustained resumption of activities for workers, businesses and consumers. Reorienting fiscal measures, like support for SMEs and low-income households and unwinding Government intervention in the corporate sector are some useful suggestions. Further, the matrix on fiscal

strategies during different phases of pandemic provided in the Report is a useful guide to members.

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

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

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

Staff's Responses to Executive Directors' Technical Questions

World Economic Outlook

EBM/20/ 97, September 30, 2020

Staff's responses to technical and factual questions are below. Broader policy questions in the areas of tax reforms, pace of monetary policy, and challenges to the structural reform agenda will be addressed in staff's oral intervention at the Board meeting.

Outlook/Risks

1. We note the assumption in the baseline that the acute phase of the pandemic is assumed to be over by end-2022, which is quite sobering and, in a way, seems at odds with the projected pace of the global recovery. Can staff clarify how this assumption has evolved since the April WEO?

- In the April WEO we assumed the pandemic will "… fade in the second half of 2020, allowing for a gradual lifting of containment measures". The assumption was based on our understanding of the likely path of the pandemic after conversations with epidemiologists, public health experts, and those involved in vaccine development. The assumption was about the intensity of transmission and the speed at which caseloads would evolve. With more information available at the time of the June WEO Update, the assumption was updated to "persistent social distancing into the second half of 2020" and "countries where infections have declined will not reinstate stringent lockdowns of the kind seen in the first half of the year, instead relying on alternative methods if needed to contain transmission (for instance, ramped-up testing, contact tracing, and isolation)". Following further conversations with the specialists in July and August, our current understanding is that local transmission is likely to be brought down to low levels everywhere by the end of 2022 from a combination of precautions (testing, tracing, isolation; limiting numbers in indoor spaces), improved therapies, and growing vaccine coverage. Some regions will bring it down sooner than others over this interval. As all three WEOs (April, June, and this current one) have emphasized, there is still considerable uncertainty about the path of the pandemic. We have therefore presented alternative scenarios based on different sets of assumptions about the evolution of the pandemic.

2. While we welcome the balanced view of forecasts provided under the two scenarios, staff comments on a possible optimism bias are nevertheless welcome.

- As the report discusses, there is still considerable uncertainty around the forecast related to the path of the pandemic, the extent of domestic disruptions, the global spillovers, the amplification via financial sector strains, and the effectiveness of policy support. As we have seen in the revisions going from the June forecast to this current October forecast, activity could begin normalizing faster than anticipated in places that are reopening. Moreover, extension of fiscal policy support into 2021 represents an upside risk to the current forecast. We therefore do not think the baseline is overly optimistic. Nonetheless, there are still significant risks of worse outcomes than projected (as discussed at length in the risks section of the chapter).

3. ***While the evolution of the pandemic remains a key risk, there are also significant concerns regarding financial conditions, geopolitical and trade tensions, and political uncertainties. We would welcome staff's elaboration on their view on the balance of risks to the outlook.***

- The chapter notes there are significant downside risks, including from: outbreaks, premature withdrawal of policy support, tightening financial conditions, liquidity shortfalls and insolvencies, social unrest and geopolitical tensions, trade policy uncertainty and technology frictions, as well as weather-related natural disasters. Given the unprecedented nature of this shock, growth density forecast models estimated on historical data are limited in their ability to quantify risks. The chapter thus discusses the various risk factors, on both the upside and downside, and complements this with scenario analysis, as in the April and June WEOs.

4. ***We would appreciate further elaboration on the balance of risks.***

- The chapter notes there are significant downside risks, including from: outbreaks, premature withdrawal of policy support, tightening financial conditions, liquidity shortfalls and insolvencies, social unrest and geopolitical tensions, trade policy uncertainty and technology frictions, as well as weather-related natural disasters. Given the unprecedented nature of this shock, growth density forecast models estimated on historical data are limited in their ability to quantify risks. The chapter thus discusses the various risk factors, on both the upside and downside, and complements this with scenario analysis, as in the April and June WEOs.

5. ***Could staff give more details on (i) how they determined the calibration of the recovery in the baseline and the loss of GDP level by end 2021 compared to 2019, and (ii) the underlying quantitative assumptions (variables and shocks) of the alternative scenarios?***

- The sectoral pandemic framework developed by Research and shared throughout the Fund has been used to estimate the main shock that is driving the baseline and the alterative scenarios. The speed of recovery in the high-contact sectors from mandatory and voluntary social distancing measures and the associated knock-on effects to other sectors drives the baseline and the alternative scenarios. The information in incoming data has been used along with judgment to project the speed of recovery in high-contact sectors. However, there is considerable uncertainty about these baseline projections and the alternative scenarios explore the implications of either a slower near-term recovery in those sectors (downside) or a faster medium-term recovery in those sectors (upside). Other associated assumptions regarding fiscal policy, financial conditions, and scaring are also adjusted accordingly in the alternative scenarios.

6. ***We wonder whether and how staff in their projections about the impact of a downside scenario, have factored in the effect of a possible discretional policy response, where policy space exists.***

- In the downside scenario it is assumed that advanced economies have sufficient fiscal space to implement discretionary measures. This is implemented by doubling the typical response of automatic stabilizers on the expenditure side. On the revenue side there is no change to automatic stabilizers. For emerging market economies automatic stabilizers are allowed to operate fully, but no additional discretionary measures were assumed.

7. ***We would welcome further details on the magnitude and form of the assumed additional discretionary stabilization in AEs in the downside scenario.***

- The precise numbers on the increase in discretionary spending in AEs in the downside scenario are in the table below.

	2020	**2021**	**2022**
Advanced Economies: Discretionary spending (share of GDP, percentage point difference)	0.2	3.2	1.3

8. ***Has staff considered an even worse scenario consistent with a serious second wave and all out lockdowns?***

- The implications of such a scenario for financial conditions would clearly be more dire than presented in the downside scenario. Significantly tighter financial conditions could result in a second wave, tipping vulnerable borrowers into debt crises and significantly denting sentiment. With policy space likely to be more limited after the sizable response to limit damages from the first wave, the overall implications for growth would be much more severe than considered in the downside scenario.

9. ***The analysis could be more specific on the impact of potential constraints in EMDEs regarding access to Covid-19 vaccines and/or new medical treatments. Staff comments are welcome.***

- The box aims to draw lessons from past pandemics for their likely impact on social unrest. The somewhat surprising result from recent history is that activity-suppressing effects of pandemics seem to dominate the expression of popular dissatisfaction, but turns out to be consistent with the COVID experience. Given the unique nature of the current shock (most notably the novelty and spread of the disease), it is important to take care not to over-interpret the data. Comparisons to historical experience at a broad level are valid, but at a more detailed level are likely not. In particular, it is not obvious that there are sufficient historical precedents to draw general conclusions on an issue as specific as access to novel vaccines or treatments to a wholly novel disease, and so not clear what data could be applied to address this issue.

10. The WEO assumes that the acute stage of the pandemic would not end before end-2022, and that there will be only limited progress toward catching up to the pre-pandemic path of economic activity for 2020-25 for advanced economies, as well as EMDCs. In this regard, we would welcome staff comments on the extent of differentiation between countries, and what are the characteristics of countries that are more likely to return to that path?

- As seen in Figure 1.12, there is significant variation across countries in terms of medium-term losses relative to pre-COVID projections. The differentiation across countries in medium-term paths and their likelihood of returning to paths that reduce medium-term losses depend on a variety of factors: the structure of the economy (e.g. share of contact intensive sectors in accounting for GDP value added and employment); the damage caused by the pandemic, associated domestic disruptions, global spillovers; the scarring from the recession; pre-existing vulnerabilities entering the crisis and legacies likely to be left by the crisis; the impact of these factors on private activity and the space for policy to respond.

11. But while staff are right to be cautious about when the pandemic will end, we wonder whether the term "acute phase", lasting until end-22, might sound more dramatic than staff intend, potentially generating unintended headlines?

- This assumption is about the acute phase lasting no longer than the end of 2022, based on conversations with leading epidemiologists and senior staff at the World Health Organization. The report clarifies this means local transmission is assumed to be brought down to low levels everywhere by then through a combination of precautions, therapies, and growing vaccine coverage. Some regions will get there sooner than others. Clearly if all goes well on all fronts of the fight against the pandemic, this would represent an upside to the baseline growth projection.

12. We wonder if recent structural reforms in several economies – including to facilitate labor market reallocation, bankruptcy procedures and credit market allocation – where fully considered to properly anchor country specific medium-term forecasts, or if general assumptions were again imposed on groups of countries.

- Staff forecasts are based on announced and implemented policy measures. The medium-term forecasts depend on country-specific factors and assumptions: the structure of the economy (e.g. share of employment in contact-intensive sectors); the disruption caused by the pandemic; scarring likely to result from the recession; pre-existing vulnerabilities entering the crisis and likely legacies coming out of the crisis; and their impact on private activity as well as space for policy to respond.

13. We would be interested to have more details regarding the incorporation of the national stimulus plans in the countries' forecasts and the impact of the 750 Bns EUR package on the euro area's growth.

- As usual, euro area country teams incorporate national stimulus measures into their forecasts. However, the pandemic crisis is unusual in nature, which increases uncertainty in the forecast generally and the multipliers on fiscal measures in particular. One aspect of this is that saving rates have risen considerably due to pandemic containment measures, social distancing, fears of contracting COVID-19, and general uncertainty, which fiscal stimulus measures can counter only partially. We expect high uncertainty related to the resurgence in infections, availability of vaccines, and limitations on production and consumption from physical distancing will continue to weigh on consumer spending and firms' investment decisions into 2021.

- All euro area country teams have also taken into account the EU recovery funds in their forecasts, in particular the grants from the Recovery and Resilience Facility (RRF) and other parts of the Next Generation EU package. However, in many cases, teams had relatively little information from the authorities on how these funds would be spent and how quickly they would be deployed, leaving teams to rely on their own judgment and estimates for this WEO round. Hopefully, more information will be available on how EU recovery funds will be used after countries release their draft budgetary plans in October.

- For France, whose government has already announced the details of its recovery plan, staff projections incorporate that plan, which will be partly financed with grants from the EU recovery funds. The new measures, to be voted in the context of the 2021 budget, are expected to support growth primarily in 2021-22. But the factors weighing on consumption and investment mentioned above hold for France as well. In this context, taking into account the sharp contraction in 2020H1 and the sizable fiscal response, staff expects the extent of recovery of the French economy by end 2021 to be broadly in line with the EA average.

14. We note that the upward revision of the 2020 growth forecast is mostly driven by AEs, while the outlook of EMDEs has been revised down, particularly for the ASEAN-5 economies. Could staff elaborate on the drivers of the downward revision for ASEAN-5 economies?

- The downward revision in 2020 growth for ASEAN 5 is driven by downward revisions in growth for Indonesia, Malaysia, and the Philippines. The revisions can be explained, when compared to the June WEO forecasts, by stronger than anticipated impact of lockdowns and/or containment measures on economic activity, highlighting in some cases the large challenges of reconciling the reopening of the economy with managing the pandemic.

15. We noted that the size of the revision of the growth rate varies from country to country. For example, among the advanced countries, the growth rate of U.S. was

revised upward by 3.7percentage points from June WEO update in 2020, but the size of the revision of the part of the EU countries seem relatively small; the rate of India in 2020 was revised downward by minus 5.8 percentage points, while those of Brazil and Russia were revised upward by more than 2.5percentage points. We would like to ask staff to elaborate on the factors behind these differences.

- As the Chapter 1 section on recent developments notes, Q2 outturns varied across countries. In many advanced economies, Q2 GDP contractions were not as severe as anticipated and activity in the third quarter has rebounded strongly (even though the pace of recovery appears to be slowing in recent weeks). In China, the economy returned to stronger-than-forecast growth in the 2nd quarter on the back of strong public and property investment as well as a recovery in exports. In Brazil and Russia, activity also began normalizing at a stronger pace than anticipated. In other EMs however, notably India, the pandemic continued to surge, consumption and investment plunged in the second quarter (first quarter of India's fiscal year), and domestic activity disruptions were stronger than projected. These developments are important contributors to the forecast revisions. In addition, updated policy announcements since the June WEO were also taken into account in forecasting the path going forward, also contributing to forecast differences.

16. Secondly, we noted that the growth rate of China is forecasted to be 8.2% in 2021, while the negative impact of the pandemic is expected to remain globally. What is the cause of the difference between China and other countries? In addition, how does staff evaluate the positive spillover of the high growth rate of China to the global economy?

- China's strong projected recovery reflects (1) an early suppression of the pandemic and continued strong monitoring that is expected to keep the pandemic under control domestically; (2) continued use of available policy space to support the economy and a smooth handoff to private activity-led growth (signs of which are emerging now with the recovery in private fixed asset investment and industrial production); (3) reversion to pre-crisis growth trends that were considerably stronger than those of many other economies. The spillovers will help economies in the regional supply chain and commodities exporters, but these favorable external spillovers will in some cases co-exist with subdued domestic demand prospects where the pandemic continues to pose a serious challenge.

17. Thirdly, we note that the growth rate of the world economy in 2025 is expected to be 3.5 percentage points in which we understand, would be the average growth rate of the world economy in the last 40 years or so. Does staff expect that the world economy will be able to go back to the trend growth rate in 2025, although they pointed out the lingering risks of the reduction of the productivity caused by the scarring of the pandemic?

- There is considerable uncertainty around the medium-term forecasts, as discussed in the report, and the baseline projection comes with downside risk if scarring proves more damaging than currently assumed. Even with growth projected to return close to the long-term global growth average, regional differences will likely persist into the medium-term.

18. Can staff comment on their communication plan about the updated PPP weights and its global growth implications?

- We will highlight the discussion in Box 1.1 in our outreach and remind interlocutors that this is a standard update of the benchmark reference year. The last time this was done was in 2014 upon the release of ICP 2011.

19. The crisis will cause a large decrease in public saving, while in the short run (i) an increase in household saving and (ii) a fall in corporate savings (which play a major role in explaining imbalances), are expected. What is staff's view regarding the evolution of disaggregated saving in the future?

- Regarding public saving, the sharp fall in 2020 reflects relief and recovery efforts and is expected to partly unwind across major economies over the medium term. The sharp rise in private saving in 2020 mainly reflects higher household saving associated with falling consumption and higher precautionary saving, with a partially offsetting fall in corporate saving with lower profits. Staff projections foresee a gradual unwinding in the overall jump in private saving over the medium term as consumption moves toward recovery.

- Much uncertainty surrounds the outlook for household and corporate saving, which will also depend on how the crisis affects income and wealth inequality. A sustained decline in corporate saving could narrow current account balances among surplus economies, although needs for corporate deleveraging and more saving after the crisis are also possible. A persistent rise in precautionary household saving, especially in economies where the pandemic has revealed the limitations of existing social safety nets, could contribute to a decrease in global equilibrium interest rates, which have already declined in recent decades. At the same time, the large and necessary fiscal expansions, especially in advanced economies with greater access to financing, could, if not withdrawn at an appropriate pace, contribute to persistently higher debt and lower current account balances in these economies.

- Staff will continue assessing the impact of the crisis on saving and investment balances as well as on global imbalances in the future.

20. We share the view that prolonged pandemic and possible resurgence in COVID-19 cases are key downside risks. This could also be exacerbated by shifts in financial market sentiment, especially as there remains a disconnect between financial market developments and real economic activities. Hence, we underscore the importance of policies that are well-tailored and prioritized to

address the short-term pandemic risk and long-term challenges on potential growth from macroeconomic scars. We invite staff's comments on how to mitigate the risk of sharp market corrections due to a sudden shift in market sentiment.

- Recent IMF research (link below) suggests that the apparent disconnect between financial markets and real activity is most likhely driven by unprecedented monetary actions. This has lowered discount rates (mostly by compressing risk premia, rather than via risk-free rates), leading to asset price gains in excess of indicators of real activity. Any unwinding of these gains is terefore most likely to come from actual or perceived changes in Central Bank support. One source of such risk is the possibility that populist political developments which pit financial elites against the broader public ("Wall street versus Main Street" in the U.S.) could undermine the viability of continued market support. In the current environment, therefore, central bank independence as well as a clear communication of both policy objectives and a willingness to do what is required to achieve them, all remain essential tools for guarding against this risk.

  Link to paper: https://www.imf.org/~/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-the-disconnect-between-financial-markets-and-the-real-economy.ashx

Fiscal Policy and Debt

21. We share staff's view on the importance of credible medium consolidation plan when the recovery is be firmly entrenched, with a clear communication. Could staff provide more analysis on the calibration and the sequencing of the fiscal measures, including (i) additional measures (more supply or demand oriented?) and (ii) the removal of existing measures.

- This question will be addressed by staff during the meeting.

22. Notwithstanding the need to pursue fiscal consolidation and enhance revenue mobilization, we view that the message on corporate taxation should be more nuanced given the need to maintain an investment-conducive environment. Staff's comments are welcome.

- This question will be addressed by staff during the meeting.

23. We call on staff and management to consider appropriately stronger qualifications in communication efforts, including in reference to large emerging market economies, keeping in mind the important market reactions that could result from IMF statements on fiscal rules suspension, or circumvention, in the current juncture, especially as domestic political economy considerations are not properly taken into account on those statements.

- For discussion during the meeting.

24. It would also be desirable to deliver a message on the need to provide adequate support to countries in debt distress along with promoting debt transparency and good borrowing and lending practices.

- We agree. The WEO discusses adherence to highest standards of debt transparency as essential for containing risk premiums and minimizing future rollover risks.

25. As members are taking on higher debt to respond to the crisis, are staff building in flexibility around augmentation of programs in the DSA framework?

- The Fund has provided increased flexibility in the use of Fund resources in Fund policies, for instance by temporarily increasing access limits. A number of countries have availed themselves of this option, including through augmenting existing access. Of course, the Fund may only lend if debt is assessed to be sustainable in the medium term under the GRA and PRGT. If debt is not sustainable, the Fund is precluded from lending unless the member takes steps to restore debt sustainability, including through either debt restructuring or the provision of concessional financing. As the 2018 Review of Conditionality shows, public debt operations tended to be associated with greater program success, at least in small and non-systemic program cases.

26. Going forward, it will be important for the corporate sector to play a continuing role in supporting the recovery. We invite staff's comments on how the corporate sector could meet their financing needs, considering different financing instruments (e.g. debt, equity, etc.).

- The key to restoring the financial health of the corporate sector will be working off debt overhangs, sorting through the backlog of deferred loan payments to come to a solution acceptable to both firms and creditors. This will likely require some policy innovation, including: reforms to make bankruptcies more efficient and equitable, encouraging markets for distressed debt, rewriting tax codes to eliminate rules which deter restructurings, and improving regulatory oversight to manage increases in nonperforming loans. Looking forward, the possibility of larger spillovers from corporate bankruptcies to the broader financial sector may also impede corporates' access to finance more generally. This risk can be mitigated at least in part by continued loose monetary policy stances where inflation expectations are well anchored.

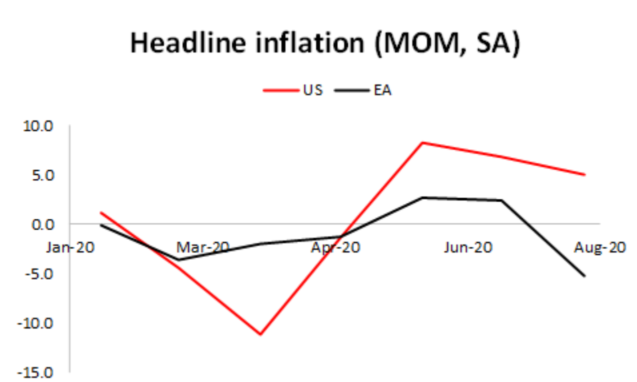
Monetary Policy

27. Could staff elaborate on how they see the role of monetary policy and its interaction with fiscal and macroprudential policies in the recovery?

- As discussed in the report, where inflation expectations are well anchored accommodative monetary policy should support the economy until the recovery is on a durable footing. Where central banks have embarked on asset purchase programs (including in emerging market economies that have introduced them for the first time), clear communication on the objectives and the consistency of the policy strategy with price stability goals will be important to avoid creating perceptions of fiscal dominance. Similarly, where an aggressive fiscal policy response is underway clear communication on a medium-term fiscal strategy to place public finances on a sustainable footing would help create space for supporting crisis mitigation measures in the near term. Macroprudential policies will need to balance the goals of supporting credit provision to the economy while containing any side effects that accommodative monetary policy may have (for instance excessive risk taking).

28. Considering that substantial economic slack is projected to persist well into 2022, staff's projections that headline inflation in advanced economies will double between 2020 and 2021 (to 1.6 percent) may turn out to be overoptimistic. Staff's comments are welcome.

- The latest projection is that headline inflation in advanced economies would recover to 1.4 percent (1.5 percent) by end-2021 in QoQ (YoY) terms. It assumes that the rebound of headline inflation in the US that has occurred since the lockdown was lifted will persist. Beyond 2021, there is significant amount of uncertainty regarding inflation developments in the medium term.



29. On inflation dynamics, inflation in the noncyclical sectors in advanced economies seems to have shifted downward from around 2012 as shown in Figure 1.16 of Chapter 1 of the WEO. We welcome staff comments on the main causes of these downward movements and implications for monetary policy.

- The downward trend of non-cyclical components is likely driven to an important extent by technological innovation. Further research is needed to substantiate this claim, and to ascertain whether it is seen more in goods or services. The implication for monetary policy is that if this downward trend of non-cyclical components persists, monetary policy needs to be accommodative for a longer period than otherwise would be the case to ensure that inflation comes back to the central bank target.

30. With regard to staff's inflation projections, the projected recovery for the German rate in 2021 seems to somewhat underestimate the positive base effect from the temporary VAT cut in 2020. Staff's comments would be welcome.

- The temporary VAT cuts—which came in effect on July 1—are projected to reduce core CPI inflation (i.e., HICP excluding energy and unprocessed food) by 0.6 percentage points in the second half of 2020. We are assuming a stronger rebound of core CPI inflation by 0.8 percentage points in Q1 2021, when the VAT cuts expire, as underlying inflationary pressures gradually increase on the back of the narrowing negative output gap. Also, note that our projections on headline inflation of 0.5 percent in 2020 and 1.1 percent in 2021—which reflect core inflation projections as well as energy and food inflation projections driven by global commodity price assumptions—are comparable to the official forecast published by the German Federal Ministry for Economic Affairs and Energy in September (0.5 percent in 2020 and 1.2 percent in 2021).

Structural Issues

31. We urge staff to reflect more deeply on options to minimize the human capital loss in an upcoming WEO report.

- We will indeed follow this key policy area closely, building on the messages introduced in this report.

32. If international borders remain closed, and the downside scenario materializes, how would Fund advice change for tourism dependent countries?

- Should borders remain closed and the downside materializes, the policy strategy would need to place more emphasis on facilitating reallocation to other sectors to the extent possible. Diversification is clearly not an easy process, as commodity-dependent economies have seen over past several years. Priorities will vary based on factors specific to the economy. However, the broad policy areas that can support diversification include: closing infrastructure gaps, reducing administrative burdens and regulatory barriers (all of which can incentivize private investment); investing in education and vocational training (to build human capital); and resolving and restructuring unviable firms in the tourism sectors (to facilitate redeployment of resources to other sectors); enhancing access to credit and financial inclusion. Where domestic revenue sources and administrative capacity are limited, countries may need help through the transition with financial support, technical assistance and capacity development from the international community.

33. Since COVID-19 shock has adversely impacted economic activity and labor-force participation across economies, could staff comment on the structural impact of the crisis, including on consumer behavior as well as de-urbanization trends driven by many firms' decision to move away from commercial properties in large urban centers?

- It seems likely that there will be persistent effects from the pandemic recession, leading to structural changes in the composition of the economy. Contact-intensive sectors (such as hospitality and tourism-related businesses) may be on a permanently lower demand trajectory as consumer behavior and tastes change, with lower contact sectors and technologies that facilitate lower contacts benefiting. Firms may aim to adapt and reshape their business models to reduce workplace contacts and make them more resilient to epidemics (through greater automation and telework), with attendant consequences on supporting sectors (such as commercial real estate). Workers and the unemployed may require reskilling to better match the new demands of the labor market. As detailed in the WEO, signs of these changes are visible in many data series. However, the ultimate magnitudes and persistence of these shifts are highly uncertain and depend upon the depth and duration of the pandemic and associated downturn.

34. Can staff elaborate on the potential LT behavioral consequences of the pandemic (if any) once the virus recedes, and the implications for particular sectors?

- Until effective and safe medical treatments or vaccines for COVID-19 are broadly available, social distancing will persist through a combination of government restrictions and behavioral changes. This will continue to depress economic activity especially in contact-intensive sectors that are likely to suffer a significant contraction. In the LT once the pandemic is resolved, these sectors are likely to recover but the process could be quite gradual due to the scarring effects of bankruptcies and prolonged unemployment.

35. Could staff detail its recommendations to promote a more job-intensive recovery?

- The policy strategy will vary across countries depending on the structure of the economy (which will determine the need for reallocation). In general, there are four broad areas of policy focus. First, efforts will need to be made to incentivize private investment and job creation. This includes, as needed, closing infrastructure gaps, reducing administrative burdens, ensuring a level playing field between private and state-owned entities, and lowering barriers to entry. Second, efforts will need to be directed toward ensuring workers have the right skills to be gainfully employed in the high growth areas. This means investing in education, retraining, and reskilling as needed. Third, efforts will need to focus on reducing labor market rigidities that may deter firms from hiring. Fourth, supportive macro policies (accommodative fiscal where space exists and monetary where inflation expectations are well anchored) can help stimulate activity and promote job creation.

36. Emerging and developing economies are likely to encounter challenges in financing their low-carbon future as they are faced with limited fiscal space, high debt burdens and potentially reduced access to capital markets. Staff's elaboration will be appreciated.

- Fiscal space is indeed an important issue for EMDEs with respect to climate policies. However it is useful to distinguish between the largest EMs and the low-income countries in this regard. Mitigation efforts are unlikely to succeed without the participation of the largest EMs—in particular China and India. Low-income countries would however play a smaller role in climate mitigation on account of lower aggregate and per-capita emissions.

- The policy package combining green investment and carbon pricing would add about 6 percentage points to debt globally, and more so in countries with large transitional output losses. That said, there are attenuating factors—interest rates are low—and significant gains. The investment strategy would both boost the global recovery in the short run, and pay for itself over the long run by increasing output very significantly.

37. We would like however to better understand how the large ranges of carbon prices are declined by country and why these ranges are significantly lower than the ones presented by Stiglitz-Stern commission in 2017 and in the April 2019 Fiscal Monitor.

- The path of carbon prices in this chapter's simulations reflect (1) the combination of carbon prices with other instruments (green infrastructure investment and subsidies for renewables production), which achieve part of the emission reduction; (2) the high assumed growth rate of carbon prices, which back-loads their increases. Furthermore, green R&D subsidies would likely help reduce emissions over the long term, slowing the required rate of increase of the carbon tax.

- Country-specific carbon tax rates are calculated to achieve the emissions targets by 2050 in the policy package—after accounting for emissions reductions from other layers of the policy package and assuming a constant growth rate of 7 percent for carbon taxes over the period of 2021-2050. Differences in carbon tax rates across countries reflect multiple factors, including projected emissions growth under unchanged policies, which, in turn, depend on projected economic and population growth, as well as energy and carbon-intensity of the economy.

38. We agree with staff's assessment on the important impact of climate change mitigation policies in directing innovation to climate mitigating technologies, shifting electricity generation to renewables, and reallocating employment toward low-carbon activities. The conclusion that such mitigation measures did not harm activity in a broader sense, however, is a bit too general given that the empirical analysis just covers employment effects but not GDP effects. Staff comments would be appreciated.

- In the policy simulations, the chapter notes that there would indeed be net output losses for a period from the policy package featuring carbon pricing, averaging 0.6 percent of GDP between 2036 and 2050. The effects for different countries vary around this level.

Multilateral cooperation

39. We also support the WEO/GPA call for greater multilateral collaboration to deliver vaccines on a global scale, particularly to LICs with limited financial and institutional capacities. The idea of advance purchase commitments at the global level to incentivize the scaling up of productions is a welcome one, and we would be interested to hear if this is taking place.

- CEPI (Centre for Epidemic Preparedness and Innovation), Gavi (originally the Global Alliance for Vaccines and Immunization), and the WHO are co-leading a global initiative for rapid vaccine development, production, and distribution known as COVAX. All participating countries (self-financing or donor-supported) will have equal access to the vaccines in the COVAX portfolio once they are developed. The initial aim is to have 2 billion doses of an effective vaccine by the end of 2021, distributed to protect healthcare and essential workers, as well as those at high risk of serious illness.

Other issues

40. The strong collective response of OPEC+ countries in the early stages of the crisis helped to stabilize the oil market and sustain its partial recovery. In Chapters 1 and 3, OPEC and OPEC+ have been used interchangeably with "fossil fuel producers". We request staff to make this distinction clear.

- The simulations include a country group called "Oil-Exporting and the Middle East", which includes: Ecuador, Nigeria, Angola, Congo, Iran, Venezuela, Algeria, Libya, Bahrain, Iraq, Israel, Jordan, Kuwait, Lebanon, Palestinian Territory, Oman, Qatar, Saudi Arabia, Syrian Arab Republic, United Arab Emirates, Yemen.

- We will clarify and change the labeling from "OPEC" when referring to this group in the chapter.

- Fossil fuel producers is a broader group which would refer to all countries who rely heavily on production and export of fossil fuels (including coal and natural gas).

Global Financial Stability Report

Staff's responses to technical and factual questions are below. Broader policy questions (including on policy trade-offs and risks associated with the real-financial disconnect) will be addressed in staff's oral intervention at the Board meeting.

Please note that panels 2 and 4 of Figure 2.9 of GFSR Chapter 2 on emerging market economies will be removed before publication. The removal of these charts does not change the main messages presented in paragraph 21.

1. Could staff elaborate on the robustness of the results and what to expect should the COVID-19 pandemic linger?

- Directionally, a longer period of low or negative growth would increase bank losses. Without running additional stress tests, it is difficult to describe quantitatively the degree of capital loss sensitivity to pandemic duration. For a sense of the relationship between the shape of recovery and through-the-cycle, you might refer to the Federal Reserve's report titled 'Assessment of Bank Capital During the Recent Coronavirus Event', dated June 2020. This report presents three scenarios (V-, U- and W-shaped) and the associated bank losses.

- Further on the robustness of the results, please note that the methodology that has been employed for estimating the banks' relationship to macro-financial conditions has as its very foundation the quest for robustness (a model averaging method). That said, it is indeed a challenge to conduct this type of analysis using only publicly available data, implying a notable margin of uncertainty around the results.

2. Simulations show a set of weak tail banks within regions that could see their solvency challenged, including some systemically important banks. To what extent could this impact financial stability should the adverse scenario materialize? Could staff comment on the sample covered in the simulation exercise, and on the inclusion and validity of results for emerging and low-income economies?

- Clearly, a capital shortfall in a systemically important bank is a significant risk event with potentially significant adverse implications for system stability. The actual repercussions from an event like this would depend on which G-SIB has a problem (some are more interconnected than others); how significant the financial problem is; and how vigorously the bank, its investors, and supervisors respond to the event.

- The stress test analyses in this Chapter include about 350 banks from 29 jurisdictions (24 advanced economies, 5 emerging markets), accounting for 73 percent of global banking system assets. At the individual country level, the bank sample was chosen so as to cover more than 80 percent of the individual banking systems' total assets as of 2019. The 29 jurisdictions are a subset of the 32 country-list for which the IMF considers mandatory FSAPs in its ongoing FSAP Review (plus South Africa in the GST exercise). Some of these countries' banks and banking systems (e.g. for China and Russia), had to be dropped due to difficulties in obtaining empirically robust relationships between bank balance sheet items and the macro-financial scenarios that were considered in the exercise. The work continues in order for the GST to include such countries in the near future.

3. ***The current temporary state guarantee measures and debt moratoria will eventually end, leading to potential cliff effects that will reduce the capability of banks to extend credit. Is staff planning to further analyze the timing and consequences of such cliff effects?***

- We believe that the duration of support policies in many countries remains highly uncertain. It will be difficult to assess potential cliff effects without better understanding of the likely timing of countries' exit from major mitigation policies.

4. ***In staff's view, is there a risk of "disconnect" between market expectations of what policymakers will do in the event of further economic deterioration, and what policymakers can do given existing policy space and potential unintended consequences?***

- The prompt and large-scale actions from policymakers in March and April had an immediate and decisive impact on restoring market functioning and containing near-term risks to financial stability. Many market participants expect more such actions if the need arises (what is sometimes referred to as "pandemic put"). However, policymakers may have already expended much of their ammunition, e.g., fiscal space has become more limited, and rising infection counts are putting increasing strains on some countries. A virus surge over the winter that necessitates more lockdowns with more adverse implications for economic activity could test the ability of policymakers in some countries to contain the economic and financial fallout.

5. ***We agree that the dichotomy between financial and economic developments, amplified by policy support, raises concerns, especially given IMF's finding that overvaluations are at historically high levels in some countries. We encourage staff to closely monitor the evolution of this disconnect while assessing the risk of another financial crisis occurring down the road as policy support subsides.***

- To be addressed in staff's oral intervention

6. ***We appreciate the road map for monetary and financial policies at different stages of the crisis. We wonder whether we could have a map showing the stage at which each country stands.***

- Staff conceptually characterizes the crisis in three stages—the Great Lockdown, the gradual reopening under uncertainty, and the pandemic under control. The characterization is largely based on the COVID-19 situation. Broadly speaking, most countries are at the gradual reopening as restrictive containment measures have been gradually eased. In the recent months, some major economies (e.g., Australia, Indonesia, and New Zealand) have tightened containment measures to curb the contagion; the measures seem to be more localized rather than nationwide. It is also important to note that even though country authorities may not impose containment measures, people may voluntarily opt for social distancing, which would in turn have similar, albeit less severe, effects on businesses. Among major economies, China may be closer towards the third stage (i.e., the pandemic under control), as the domestic transmission has been largely under control. That's said, globally, the pandemic will likely be fully under control only when effective vaccines or treatments become available. Hence, policy support remains essential. However, as policy space becomes more limited, country authorities may need to be more strategic, for example by directing support to the most needed group of businesses and individuals.

7. ***Has staff considered extending its work to include a detailed mapping of non-financial corporate stress to the financial sector?***

- Chapter 2 in the April 2020 GFSR provided a mapping of bank and non-bank lenders' exposures to risky credit markets by segment and assessed potential losses by lender type in a severe downside scenario.

- A more detailed multi-country assessment of differences in loan mix and implications for bank credit losses would be a non-trivial exercise. A major difficulty is the dearth of granular, homogeneous information on loans (and total credit) by borrower sector (households, corporates, other) and, within the corporate sector, by industry. Data on loans by sector and industry are in many countries entirely absent, available only for excessively broad categories, or available only for brief historical time series. While publicly available data in the US and some other OECD jurisdictions are of good quality, they are not necessarily comparable across countries.

8. ***We also note that the GFSR sets out only briefly the huge increase in sovereign debt held by local banks in several emerging market economies; one interpretation is that local banks also serve as lenders of last resort to the sovereign in time of stress. Do staff agree?***

- Yes, we have seen a similar situation in the latest crisis episode with domestic institutions (primarily local banks) stepping in to absorb the increased local currency sovereign bond supply. This is especially important, as foreigner inflows have not recovered in earnest. However, while this is definitely helpful in the near term and at the time of crisis, there are some caveats: (1) Higher holdings of sovereign bonds by banks strengthen the sovereign-financial nexus, which can prove to be a vulnerability to bank balance sheets during sovereign stress; we have discussed this in detail in previous GFSRs; (2) While holding more sovereign bonds improves banks' liquidity positions, it may potentially affect their lending decisions, reducing the flow of credit to the economy.

9. Could staff elaborate on the reasons why asset purchase programs (APPs) have been relatively slow in reducing broader domestic bond market stress?

- As we highlight in the GFSR the announcement of asset purchase programs in the second half of March did not have an immediate ameliorating impact on their local stress index (LSI), given that global financial conditions were very tight and market conditions were hampered by illiquidity, strong risk aversion, and fiscal concerns. However as external conditions started to improve in April and countries stepped up implementation of asset purchase programs, country-level local stress indices showed some improvement and differentiation. A large part of the improvement was seen in market liquidity measures, such as bid-offer spreads and a reduction in intraday volatility where we believe APPs had been a positive contributing factor. Indeed, countries with APPs showed a faster reduction in their LSIs than non-APP emerging market economies as we also show in the report and in the Financial Counsellor's WEMD presentation.

- In terms of the experience since March-April, term premia in some local bond markets remain elevated as investors are facing bond supply risks over a longer horizon given the uncertainty of pandemic-related government financing requirements. In some cases, this higher bond supply has already started to materialize which has created more pressure on LSIs. Additionally, even though market conditions improved notably by late April, the lack of local currency bond inflows continued for longer (e.g. some inflows returned in June while in some cases it took until August). APPs have not been big enough to restore market depth that has been lost due to exit of non-resident investors. This had negative impact on market liquidity, especially in markets with large foreign presence before the COVID outbreak.

10. As staff are aware, commercial banks in the United States hold a much smaller share of corporate debt than banks do in other G7 countries. Corporate credit held by banks is less representative of the broader landscape of U.S. corporate credit, with sectoral and quality concentrations that can easily skew results. Have staff considered these issues in their analysis?

- We are aware of cross-country differences in bank loans' share of total corporate borrowing. Presumably, this has the effect of shifting bank loans toward smaller borrowers with less access to capital markets. It is legitimate to point out that cross-country comparisons may be skewed by these differences.

- We did not intend to ascribe changes in reported bank lending standards to differences in policy responses. Rather, our use of the loan officer data was intended simply to underscore that banks have become much more cautious about macroeconomic prospects and borrowers' creditworthiness.

- We also do not intend to argue that the US is unique in this respect. Note that European banks also experienced some tightening of lending standards in Q2.

11. While we appreciate staff's discussion on potential risks and vulnerabilities facing the global financial system, we wonder whether, at this juncture, China is a representative example of staff's concerns given our current stage in economic recovery and the relatively stable financial conditions so far.

- China has emerged from the COVID crisis ahead of most countries with the recovery well on the way and financial conditions relatively stable. Financial vulnerabilities in China were nevertheless elevated prior to the crisis, and, as in many countries, those vulnerabilities have only risen further during the COVID crisis.

- In China as elsewhere, policy support has supported economic activity in the current period at the cost of accumulating more debt and financial vulnerabilities that may weaken growth and narrow policy flexibility in the future. China's experience is therefore a particularly helpful case for discussing the forward-looking implications of the crisis for financial vulnerabilities.

12. Could staff elaborate on the lessons from exit strategies of AEs after the GFC that could be useful for EMs as mentioned in paragraph 32 of GFSR chapter 2?

- While the generally positive experience of AEs with APPs is encouraging for emerging markets, we would stress the differences with and across EMs, making direct analogies less applicable. First, we do not have many examples of AE central banks exiting UMP. The only example of an exit strategy so far has been the US and that has been interrupted by the crisis. Second, the lack of reserve currency status, lower market depth, higher inflation and nominal policy rates, limited duration and different APP objective in many cases complicates the comparison.

- Nonetheless, there are some lessons that could be usefully derived from the AE experiences:

    - **Clear communication and transparency:** Predictable, well-communicated, gradual unwinding of balance sheets can help to mitigate market concerns about the impact of the APP unwind will have on the bond market and overall liquidity in the system.

    - **Passive runoffs can work for EMs as well:** Allowing holdings to passively run off, rather than selling assets back into the market has been utilized with mostly positive results, while being transparent but flexible about the level of net reinvestment to deal with any disruptions.

    - **EM CBs might have to pay closer attention to:**

        a. **Market depth:** Although EM programs are smaller as a share of GDP compared to AEs EM central banks should be careful when the size of the programs is large as a share of the market outstanding. Additionally, for EMs, seasonal factors might be more important (e.g. tax or dividend payment periods or large bond maturities) therefore exit strategies should avoid exacerbating liquidity pressures during certain periods. Finally given that local repo markets lack alternative good quality liquid collateral and thereby rely heavily on government securities the impact on interbank funding market should be monitored with extra care.

b. **External environment:** For EMs, investors facing larger supply of local currency bond during the unwind might choose to convert to USD, especially during periods when USD is strong and/or portfolio flows to EMs are weak. Central banks may wish to take into account the level and speed of outflows that has typically resulted in excessive bond market volatility and compare that to the level of their own purchases. For instance, unwinding bond positions to the order of 2-3% of GDP is commensurate to a 6-9 months of average nonresident portfolio inflows (over the past 10 years) for most EMs.

13. We note that the pandemic also triggered a record portfolio outflows from emerging and frontier markets. In this environment, would staff recommend that central banks allow exchange rate to act as a shock absorber and limit intervention in foreign exchange markets to reduce excessive volatility and ease liquidity constraints? What would be the appropriate timing to phase out macroprudential measures taken during the crisis?

- Emerging market economies with flexible exchange rates, deep markets, and credible policy frameworks should continue to use the exchange rate as a shock absorber, especially when other vulnerabilities (such as balance sheet mismatches) are in check. FX intervention has a place in the policy toolkit but it would in most case be used to lean against market illiquidity to mute excessive volatility. This is especially relevant for countries with relatively shallow FX markets. FX intervention should not be used as a substitute for needed macro-economic adjustments, especially when the shocks are expected to be prolonged in nature. Furthermore, as the GFSR analysis shows, the use and effectiveness of FX intervention can also be influenced by the nature of the shock.

- As emphasized in a recent MCM COVID-19 note on operational aspects of macroprudential policy relaxation, where adopted, a relaxation will typically need to remain in place for an extended period. A return to steady state levels should generally be gradual and begin only after the economy has returned to health. Such communication is important to make the relaxation effective and more likely to achieve its objectives. Accompanying restrictions on dividend payouts should remain in place.

14. We note that most emerging market and frontier economies have experienced capital outflows over the past three months and may face external financing challenges and high rollover risks going forward. Could staff elaborate on the key drivers of the continued portfolio outflows?

- The April 2020 GFSR presented analysis on the drivers of capital flows and the funding costs – and drew the difference between local currency assets (local currency and equities) vs hard currency assets. Our analysis highlighted that local currency assets are generally more sensitive to domestic fundamentals, while foreign currency assets are more sensitive to external financial conditions. The same results were corroborated by the analysis of funding costs b/w local currency and hard currency debt. This partially explains the portfolio trends observed since the COVID-19 sell-off.

- Hard currency flows have improved significantly, driven by the very strong hard-currency bond issuance (at a YTD record high for 2020 with almost $150bn in EM sovereign issuance), partly driven by the fact that external risk sentiment has rebounded materially. However, as we highlight in the latest GFSR, increased fiscal deficits and external funding needs have made some emerging markets even more vulnerable to shifts in external financing conditions. Local currency flows to EMs on the other hand have remained weak. This is partly due to the deterioration in domestic fundamentals since the crisis hit. Another key factor weighing on the local currency flows are concerns about future debt supply given the elevated financing needs.

15. We welcome the analysis on risks in the commercial real estate market. The outlook for commercial real estate is uncertain, and assessment of vulnerabilities arising from changing business models and associated changes in demand for urban vs. suburban real estate should be a medium-term research project. Are staff seeing evidence of accelerated suburbanization and associated pressures on urban real estate valuations as a result of prolonged (and in some cases permanent) shifts to work-from-home arrangements?

- The impact of the COVID-19 pandemic crisis on the housing market in urban areas relative to suburban areas appears to have been mixed so far. Recent data from Zillow, for example, show that in terms of housing market activity and annual home value growth in the United States, in all but a few cases (e.g., New York City and San Francisco), suburban markets and urban markets have seen similar changes in recent months. In terms of rents, however, urban ZIP codes in the United States have experienced larger declines (relative to their pre-pandemic trend) than the suburban areas, indicating that urban areas have been disproportionately affected in the rental market. While no comparable information is yet available for the commercial property market, looking forward, any divergence in housing market trends in urban relative to suburban areas could potentially have implications for the commercial property market as well. The commercial real estate market seems to have already been hit particularly hard, especially in the retail and hospitality segments. New market appraisals reported by the Financial Times suggest that the value of the collateral backing commercial mortgage might have lost, on average, one quarter of its value relative to the pre-pandemic level. Since the economic outlook is tightly connected to how the pandemic evolves, the future of the commercial property market remains highly uncertain. In the longer-term, any shifts in lifestyle choices and demand for office space will determine the persistence of the impact of the pandemic on commercial real estate markets.

16. Still, this exercise deserves additional clarity on the reasons why the solvency ratio of the advanced economies in the baseline scenario records a stronger deterioration compared to emerging economies while the situation reverses in the adverse scenario.

- The differences in the path of the banks' capital ratios between the advanced economies (AEs) and emerging market economies (EMEs) are in principle driven by differences in both the underlying macro-financial scenarios as well as the estimated model sensitivities relating bank risk parameters to macro-financial conditions. In this case it is primarily driven by the former. The baseline scenario corresponds to the August WEO baseline projection and features a sharper output contraction for AEs than for EMEs (in particular in the first year), whereas the adverse scenarios (designed based on IMF in-house structural macro-financial models) led to a more severe capital depletion for EMEs than for AEs. Please note that the macroeconomic scenario does not only comprise GDP growth but includes a range of macro-financial variables (GDP, unemployment rates, short- and long-term interest rates, corporate bond spreads, etc.) which jointly influence the path of the banking risk indicators and thus banks' capital ratios. Please also note that the scenario has been recently updated to produce a more severe cumulative capital impact for the EME banking systems both under the baseline and the adverse scenario.

17. Going forward, it will be important for the corporate sector to play a continuing role in supporting the recovery. We invite staff's comments on how the corporate sector could meet their financing needs, considering different financing instruments (e.g. debt, equity, etc.).

- Global borrowing in debt markets boomed amid the height of the COVID crisis and has remained strong for most of the year. Yet the boom was mainly led by bond markets, while the syndicated loan market trailed. This decoupling between bond and syndicated loan markets recalls a similar divergence observed during the GFC when market and bank-based finance parted ways. This underscores the resilience of market-based finance in supporting firms when other forms of finance are strained. As a result of this divergence, larger firms have been able to capitalize on easier access to bonds markets and have outpaced borrowing by mid-sized/SME firms. The preponderance of large firms in new borrowing reflects their better access to the booming bond market and the lesser reliance on the strained syndicated loan market. More than 70% of the large borrowers had outstanding bonds at the onset of the pandemic or have issued bonds in the past. By contrast, two thirds of mid-sized borrowers have never issued a bond. In addition, elevated equity valuations also provide larger firms with favorable market conditions for financing via equity issuance. Going forward, and as Chapter 1 in the GFSR highlights, larger firms with easier access to bond markets should continue to have access to financing via market-based finance. Mid-sized/SME firms could still face bottlenecks due to reliance on a slow to recover syndicated loan market and hurdles in switching to bond markets, and will continue to depend on policy support measures as these firms maintain considerable solvency issues.

18. Looking ahead, the benefits of policies that temporarily loosen banks' capital constraints in order to maintain the flow of credit to the real economy should at each point in time continue to be carefully balanced against their potential risks to financial stability. Going forward, in the post-Covid-19 period the debt moratoria and government guarantees should be more targeted, and a higher equity capital base would be needed for a greater shock absorption. Staff comments are welcome.

- Distinguishing between borrowers that are 'non-viable' and those which are experiencing temporary distress is an important challenge. Ultimately, this is a task for bank management. However, as you suggest, strong supervisors may be able to nudge banks toward an appropriate balance between prudence and excessive tightening.

- We agree with the need to manage 'intertemporal tradeoffs' and in particular to avoid excessive or protracted policy loosening which sows the seeds of future asset quality deterioration. We intended to communicate this message in Chapter 4

- We have highlighted the need to exit from extraordinary government support in a carefully phased manner that balances between the risk of destabilizing premature tightening and the risk that support measures will permit excessive buildup of weak credit leading to eventual losses.

- We also agree that prudence requires that banks maintain strong equity capital buffers to absorb potential losses. This is the motivation for supporting policies that restrict bank capital distributions during a period when future credit losses are particularly uncertain.

19. The apparent success in helping reduce bond yields without risking financial stability—so far—raises a pertinent question of whether APPs should be part of emerging and frontier markets policy toolkit in future as well. Staff views are welcome.

- As the GFSR mentions, there may indeed be scope for asset purchase programs (APPs) to become part of a central bank's unconventional monetary policy toolkit, especially for those central banks that have limited conventional monetary policy space. Other preconditions for the suitability of asset purchase programs (APPs) include: well-anchored inflation expectations, limited concerns over capital outflows and FX depreciation, and the potential for a temporary intermediary of bond flows, where the domestic absorption capacity of new bond supply is limited.

This inclusion of APPs in the policy toolkit, however, comes with important caveats. Policymakers should consider both the benefits and costs of APPs with respect to monetary policy and financial stability as is discussed in the chapter. Focused use of APPs as part of the toolkit of emerging and frontier market economy central banks with credible monetary policy frameworks and good governance has a role to play. But continuing evaluation is needed as more data on the effectiveness of unconventional monetary policy in emerging markets become available, especially for open-ended programs.

Fiscal Monitor

Staff's responses to technical and factual questions are below. Broader fiscal policy questions will be addressed in staff's oral intervention at the Board meeting.

1. Could staff provide more analysis on the calibration and the sequencing of the fiscal measures, including (i) additional measures (more supply or demand oriented?) and (ii) the removal of existing measures.

- The speed and composition of the fiscal package and consolidation efforts will have to be country specific. However, the Fiscal Monitor provides some discussion in the main text and annexes 1.4 and 1.5 with some model-based illustrations of the trade-offs. We highlight that for countries with some fiscal space and significant scarring, the fiscal adjustment should be more gradual—and there could be some further fiscal stimulus in the first years to support the recovery. Countries with limited fiscal space and significant FX debt face other constraints and may have to undertake earlier fiscal adjustments (see annex 1.4).

- Staff has also undertaken model-based simulations to illustrate the effects of different types of spending and revenue measures, which would have implications on the sequencing of additional fiscal measures and the unwinding of current lifelines. Results show that among typical fiscal stimulus measures, those that target liquidity constrained households, in particular targeted cash transfers , are the most effective ones to boost output in the short run because these measures are aimed to raise income of liquidity-constrained households, who have higher propensity to consume. Untargeted transfers and labor income tax cuts, on the other hand, have much smaller multipliers of around 0.2 to 0.3, as a large part of additional income is saved, rather than spent, by the higher-income households. Capital income tax cuts are less effective under a prolonged recession because firms are less likely to invest with suppressed demand.

- These results would imply that unwinding the current lifelines would need to be gradual and sequenced. Low-impact measures such as untargeted broad-based transfers could be withdrawn earlier as the recovery takes hold.

2. Notwithstanding the need to pursue fiscal consolidation and enhance revenue mobilization, we view that the message on corporate taxation should be more nuanced given the need to maintain an investment-conducive environment. Staff's comments are welcome.

- We agree policies need to pay attention to create an environment that is conducive to investment. In many countries, following decades of corporate income tax cuts, the key issues for fostering the investment climate will be nontax aspects, such as regulation, the legal system. Where taxes are a problem, it is often the result of high compliance costs, inconsistent administration and enforcement, or other governance problems. Following the pandemic, the risks of intensifying tax competition as a result of tax rate cuts or the introduction of new special regimes appears to be the greater risk. In this respect, the international efforts at coordinating action on fighting base erosion and profit shifting, and on taxing the digital economy, remain of utmost importance.

3. Could staff detail its recommendations to promote a more job-intensive recovery?

- With respect to public investment, standard building construction (education, health, water & sanitation) has a larger local unskilled labor component than engineering-driven construction (i.e., electricity and roads). Investing in maintenance can also have an immediate effect on employment, since projects are relatively easy to deploy and can be construction-job-intensive. Maintenance can be scaled up promptly without affecting the quality of investment, and there are large needs even in advanced economies.

- Green investment is often found to have a high job content, although this depends on the specifics of the project. While investment for isolation or retrofitting has a high job content, complex projects are often capital intensive and may take too long to plan to deliver jobs during the recovery.

- An additional issue is the permanence and the quality of jobs created. Generating high-quality formal jobs is difficult. R&D spending stands out in that regard, as it was found to have a high job content, especially in higher education.

- Sound public investment management institutions are important to ensure the effectiveness of a recovery strategy geared towards employment. Job content could explicitly be set as one of the key criteria for selection of projects, alongside feasibility, affordability and implementation readiness.

4. We invite staff to elaborate on the effectiveness of the fiscal measures as well as how well they have been implemented so far. What lessons, if any, could be drawn from the phase-1 of the recovery roadmap to be better prepared for the second wave of pandemic. ***We invite staff to elaborate on the effectiveness of the fiscal measures as well as how well they have been implemented so far. What lessons, if any, could be drawn from the phase-1 of the recovery roadmap to be better prepared for the second wave of pandemic.***

- Chapter 1 of the Fiscal Monitor discusses early insights from the use of lifeline measures to address the phase 1 of the pandemic. On the whole, these measures have saved lives, protected vulnerable people and firms, and mitigated the output loss. For instance, we show that additional social assistance have modestly alleviated the projected increase in extreme poverty. Early and localized mobility restrictions as well as smart health measures (testing, tracing, public outreach) have helped mitigate the output and fiscal costs. Digital solutions have helped target and reach the most affected and vulnerable, including in the informal sector. Loan and guarantee schemes have faced low take-up, in some cases due to poor design; but more targeted conditionality (for instance smaller loans to SMEs with a larger guarantee component) has helped improve take-up. Besides their many benefits, some of these measures carry risks: overly generous unemployment benefits, overextended wage subsidies, and equity injections into hard hit strategic firms could delay labor and sectoral reallocation that is necessary for the recovery.

5. Given the already record-high public debt levels in many countries, the room for further fiscal support appears to be limited. One cannot neglect the need for fiscal consolidation and the restoration of public finance sustainability more broadly in the medium- and long term. Therefore, the Fund's role is vital in advising countries how to best build-down debt burdens in a growth-friendly manner. Staff's further elaboration would be much appreciated.

- The speed of the fiscal adjustment will depend on country circumstances, including fiscal space (especially borrowing conditions) and the depth of the impact of the crisis (growth, unemployment). Countries with fiscal space and significant scarring from the crisis (e.g. high and persistent unemployment) should have a very gradual fiscal adjustment over the medium term and consider some additional stimulus initially to support the recovery. This will allow to ensure the economy will be in a stronger footing before putting more emphasis on reducing debt. Countries with larger vulnerabilities, including those with high risk of debt distress, will have to start the fiscal adjustment earlier to prevent debt distress or sizable increases in borrowing costs that would derail the recovery.

- The composition of the fiscal adjustment will also be critical. The strategy will have to be country-specific given different circumstances and needs. However, in general, countries should protect or increase transfers to the lower income households as these will have a large multiplier and help reduce poverty and inequality as they are the group most affected by the crisis financed by progressive income taxes. In addition, it would be important to protect public investment in priority areas to promote long-term growth.

- More generally, the fiscal adjustment over the medium-term should also be accompanied by structural reforms (country-specific) to raise productivity and higher-quality jobs.

6. The increased risk of debt distress in about half of the LICs would severely limit the available fiscal room. We share the concern expressed in the Report that as bankruptcies rise, sizable private debt could migrate to the public sector through

bailouts. Can the Staff provide details regarding the scope of this problem in different categories of countries, and its fiscal policy implications?

- Private sector debt was elevated before the pandemic. In 2019, non-financial sector corporate debt in advanced economies and emerging markets is about 90 percent of their respective GDPs and 14 percent of GDP in low-income countries. The potential for bailouts will be country specific. It will depend crucially on developments with corporate bankruptcies, the perceived need to help the private sector and the willingness and financial ability of governments to do so. Elevated pre-crisis debt levels, a longer pandemic, slower recovery, weaker banks, inefficient bankruptcy procedures, a higher concentration of firms in sector adversely affected by the pandemic are among the factors that could contribute to higher bailout costs.

7. Could the staff comment on how emerging market and low-income countries with market access can factor the low interest environment in their fiscal policy roadmap? How can they balance the benefits of low interest cost and elevated risks, and expand their resource envelope in the medium to long-term?

- Countries with fiscal space (especially benefiting from favorable borrowing conditions) should focus on supporting a sustainable recovery. This is especially important for countries where the pandemic leads to significant scarring. The low interest rates allows for a more gradual fiscal adjustment over the medium term as the recovery is in a stronger footing.

- However, countries with high debt should manage carefully the associated risks and develop a sound and credible fiscal adjustment plan to reduce vulnerabilities over time. If debt continues to rise to high levels it could lead to sharp rises in borrowing costs, loss of market access, and a debt crisis which would disrupt the recovery. In cases of highly indebted countries there may be a need for further official financial support and debt relief.

8. Could staff elaborate on their views on how public investment can affect fiscal space in the longer run?

- For economies that are able to maintain low borrowing costs – economies where the Treasury can count with the support of a central bank whose credibility ensures that inflation, exchange rates and interest rates are stable (mostly advanced economies and some emerging markets) – borrowing to invest is expected to expand fiscal space. Indeed, if projects are well selected and have high economic returns, investment should enhance the productive capacity of the economy, allowing the government to obtain higher tax revenues and to reduce the debt burden. The October 2018 Fiscal Monitor on public sector balance sheets also noted that market spreads tend to recognize the value of assets owned by governments.

- For economies that need to borrow in a foreign currency and for which the stability of their exchange rate, inflation and sovereign spreads are sensitive to market sentiment (many emerging markets and frontier low-income countries), the strategy of scaling up investment by borrowing is also sustainable but should be designed carefully. It should build sufficient buffers so that investment is protected during downturns, otherwise it will not result in a long-term buildup of productive assets.

- For economies whose fiscal space is currently compromised or which do not have access to financing at good terms, investment should be financed either by reprioritization of expenditure or by increasing revenue mobilization. Improving the efficiency of public investment management might also allow an opportunity to scale up public capital stocks without an increase in the budget envelope. International aid will also be important and will be a good use of public money in sectors with high rates of return, such as healthcare and climate change adaptation.

9. While we understand that in normal times public investment has larger short-term multipliers than public consumption, taxes, or transfers, we wonder if this finding will hold during this health crisis. One would expect that in the short-term cash transfers or wage subsidy programs would lead to higher multipliers given the immediate boost to spending power. The sizable upward revision in the WEO forecasts for a number of AEs probably indicate that the multipliers from such programs are very high. Staff comments are welcome.

- It is too early to ascertain whether investment will turn out to have higher or lower short-term multipliers compared to other fiscal instruments in the current crisis. Cash transfers or wage subsidy programs are essential in the short-term, especially during the first phase of the crisis, to save lives, avoid skills and technology losses and maintain firm-employer relationships, which should mitigate the medium to long run negative effects of the crisis. Cash transfers can also be expected to have larger short-run multipliers than public investment if cash transfers are targeted, although in many countries, targeting is imperfect.

- There are however specificities in this crisis that make it difficult to anticipate the short-term effect of public investment. Keynesian mechanisms behind the fiscal multiplier are weaker during phase 1, when lockdown and social distancing limit the circulation of money in the economy, but they should be larger in phase 2 and phase 3. Uncertainty is driving spikes in savings rates and private investment is falling. Public investment can be geared to certain sectors most in needed. Investments in healthcare, in digitalization, upgrading of buildings and transportation to facilitate social distancing, are critical in this phase of the crisis to limit the effects of the pandemics and to prepare for a gradual reopening of the economy.

10. As countries shift to the recovery phase, they should speed up projects in the pipeline and plan for new projects that are aligned with post-crisis priorities and health realities, but it remains important that they focus on project quality in addition

to quantity. In that regard, will staff be offering advice to EU member states on their recovery and resilience investment plans?

- To ensure success of the investment plans, it will be important for countries to rely on strong and effective institutional practices, such as realistic planning, in-depth appraisal, transparent selection, competitive procurement and timely monitoring of projects. Sound infrastructure governance is critical to ensure public investment efficiency and to avoid waste – as explained in the Fiscal Monitor, one third of resources spent on public infrastructure have been lost due to inefficiencies.

- FAD stands ready to provide advice to its membership on how to strengthen infrastructure governance. FAD has applied its Public Investment Management Assessment (PIMA) framework to more than 60 countries since 2016, including in Ireland and Estonia and with several more assessments to come in some EU countries (Greece, Lithuania, Slovenia). The PIMA provides a comprehensive diagnostic of the strengths and weaknesses of a country's public investment management system, as well as a set of country-tailored recommendations for priority infrastructure governance reforms.

- The Fiscal Monitor also highlights a few priority areas for investment. Healthcare investment is necessary, and it has a high multiplier. Digital infrastructure needs to be improved to facilitate social distancing. Global warming is the crisis that is looming, and investments are needed in climate change mitigation and adaptation.

11. We see merit in providing more granular analysis about fiscal multipliers in phase 2, particularly on which policy levers would lead to the highest positive impact on economic activity. Does FAD envisage providing such analysis in the near future given its high relevance to many countries? It could be part of the IMF Special Notes on the COVID-19. We invite staff to comment.

- Based on macroeconomic theory, fiscal multipliers could be lower in phase 2 of the pandemic than in phase 3 because the second-round effect is likely absent when supply is still constrained by social distancing policies. For instance, the impacts of tax cuts or government spending, including public investment, transfers, and other social assistance schemes, primarily intended to stimulate demand will be attenuated due to insufficient demand and supply response. Likewise, fiscal policies aimed at reducing production costs and hence promoting aggregate supply are likely to have limited effects as workers are still fearing the virus and social distancing is still in place, preventing businesses to operate at full capacity.

- This Fiscal Monitor has discussed other factors that could change fiscal multipliers, in particular high debt, acute uncertainty on the path of the pandemic and the economy, and corporate sector weakness. FAD will continue assessing the impact of the different types of fiscal measures in forthcoming analyses.

12. While we agree that overextended job retention schemes and overly generous unemployment benefits could both delay the necessary job reallocations, we wonder which of these two schemes is preferable, including in terms of the eventual smaller adverse impact on the unemployment rate, if country circumstances allow for a choice to be made between the two. Staff comments are appreciated.

- Unemployment benefits are a key component of automatic stabilizers, which should be a first line of defense against any downturn. But design matters to make the most out of any measure. Over-generosity and lax access could disincentivize work, whereas under-generosity and strict access could undermine its protection. Job retention schemes, on the other hand, are usually exceptional measures. They could be used to address the emergency, along with unemployment benefits, but should not be kept for long to facilitate the reallocation of labor that is crucial for the recovery.

13. To enable growth, countries need to protect public investment as well as transfers to lower income households, while ensuring that highly profitable firms are appropriately taxed and base erosion and phantom FDI challenges are addressed. In this regard, could staff comment on progress with the international corporate taxation agenda including work on measures to limit impacts on low-income developing countries?

- The most relevant related initiative is the work under the Inclusive Framework at the OECD, notably the so-called Pillar 2, which foresees minimum taxes on outbound and inbound investment. The minimum tax on inbound investment would help developing countries directly, by allowing them to enforce a taxing right even if faced by aggressive profit shifting. The minimum tax on outbound investment can also be expected to help them: provided most important capital flow exporters adopt such a tax, the pressure to reduce taxes below the minimum tax levels will be greatly reduced.

14. On enhancing revenue, we would like to hear more from staff on further steps needed for EMDEs to adequately respond to the taxation challenges arising from the digital economy.

- Regarding the taxation of the digital economy, for EMDEs the first priority is ensuring an adequate framework for value-added tax, where the solutions are well known and possibly the most revenue is at stake. Specifically, EMDEs need to ensure that all imports are effectively covered by VAT, even small-scale imports by individuals and imports of digital services (such as video or music streaming etc.). Regarding corporate income taxes, work is ongoing at the Inclusive Framework at the OECD (the so-called Pillar 1) but no decision has yet been taken. A multilateral solution would be preferable to uncoordinated country-specific taxes.

15. As we found staff touched the discussion of the policies to increase the revenue by enhancing the tax compliance and strengthening the design of the progressive tax policies in the report, we would like them to further deepen their analysis on this matter and provide concrete policy recommendations. In addition, we understand not only the tax reforms, but also the enhancement of the tax administration is necessary, especially for the developing countries, and we encourage staff to prove necessary support by conducting the CD on national mobilization to them. Staff's current views and plans on the discussion over these matters are welcome.

- Revenue mobilization has been and continues to be an important component of CD on tax policy. Regarding more concrete advice, it should be noted that this is necessarily specific to a country's circumstances, but a few general points can be made: (i) countries with low maximum or even flat personal income tax rates can add additional higher rates; (ii) countries with preferential treatment for some types of incomes (e.g., capital gains) accruing especially to better-off individuals can close them; (iii) equally, loopholes in estate or inheritance taxes should be closed; (iv) VAT exemptions and reduced rates—especially those benefiting more the well off—can be abolished and poverty can be effectively addressed through targeted transfers or tax credits, (v) property taxes can be made progressive by abolishing any upper limits, updating values and offering a tax free amount, (vi) international tax avoidance should be lowered through measures against base erosion and profit shifting.

- Revenue administration options to support compliance improvement in the short-term include: monitoring of taxpayers' compliance behavior to identify emerging trends and new risks (such as taxpayers exploiting crisis relief/stimulus measures); monitoring taxpayers and traders in specific business sectors that are highly affected, both positively and detrimentally, by the crisis; and digitalizing revenue administration compliance processes. They should also establish business continuity plans to be ready for future crises. In the medium to longer term, countries should consider more comprehensive medium-term revenue strategies (MTRS), ensuring whole-of-government support for the timely passage of tax policy reforms that are appropriately aligned with revenue agencies' implementation capacity. FAD stands ready to provide CD to support compliance improvements and medium-term strategies, as country requests are received.

16. We welcome the EU's announcement of a 30 percent green spending target for its 5.5 percent of GDP stimulus package and appreciate staff indication of the extent to which green budgeting has been introduced by the membership.

- We do not have comprehensive data on green budgeting in the EU at the current time. We are currently working on green budgeting at the IMF, however at this stage we do not have comprehensive data on the application of it across the IMF membership. While some countries have introduced some elements of green budgeting practices, green budgeting is comparatively new and we would not anticipate its application at this stage to be widespread among the membership.

International Monetary Fund

September 30, 2020

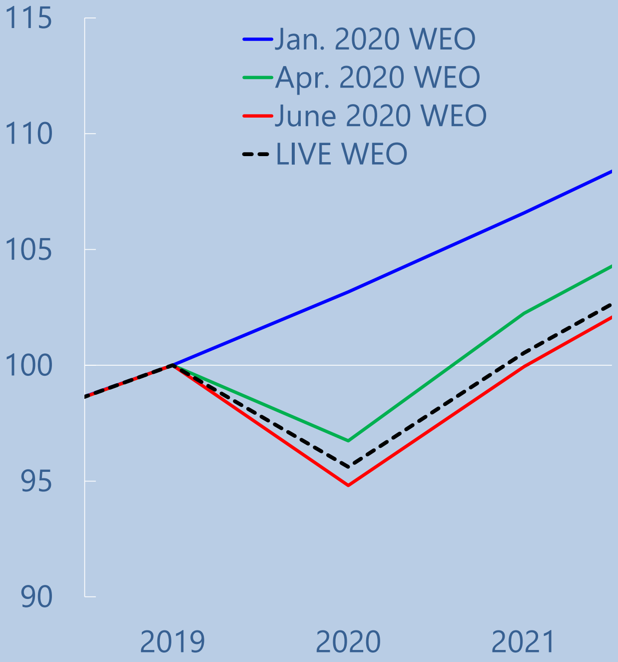
World Economic and Market Development

Gita Gopinath
Economic Counsellor

Outcomes less dire but long, uneven and uncertain ascent ahead

Output

Smaller contraction in 2020, partial recovery in 2021



Risks

Pervasive Uncertainty

- Further severe waves of pandemic
- Financial conditions could tighten e.g. if medical solutions are delayed
- Trade, technology, geopolitical tensions could escalate
- Prolonged decline in activity leads to scarring
- Upside risk in more advanced therapies, faster vaccine production, greater policy support

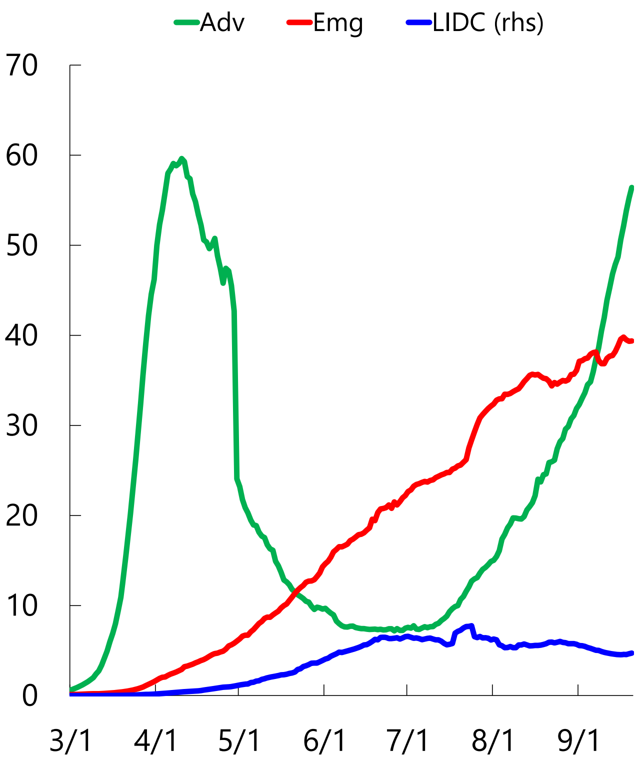
Policies

Ensure a sustained recovery

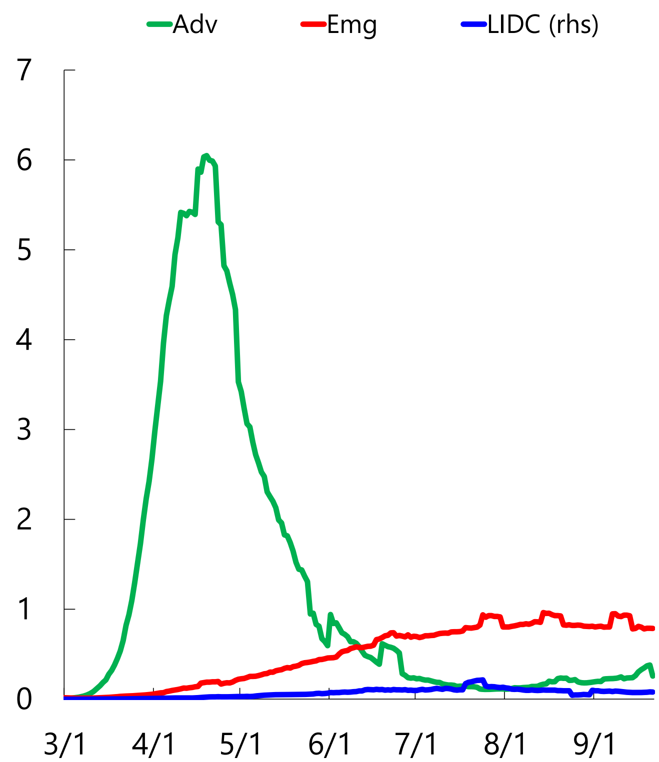
- Support health systems
- Unwind support only after activity picks up durably. Gradually shift to support reallocation of resources.
- Ensure soundness of financial system
- Foster inclusive, green recovery
- Plan for medium term debt sustainability
- International support needed for vulnerable countries. Defuse trade and technology tensions.

Rising COVID-19 cases in EMs, Second Waves, Reopening stalls

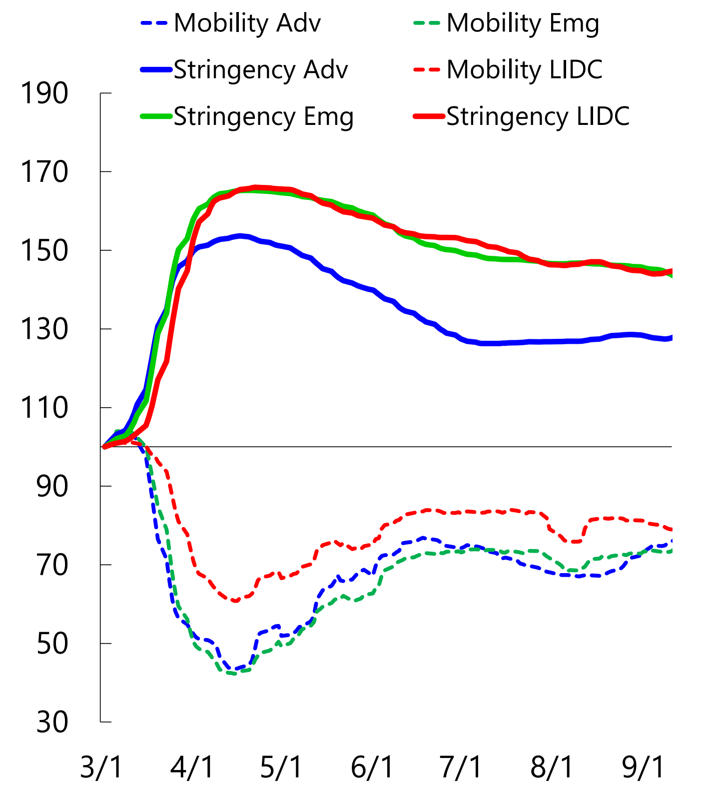
New cases
(per million population)



New deaths
(per million population)



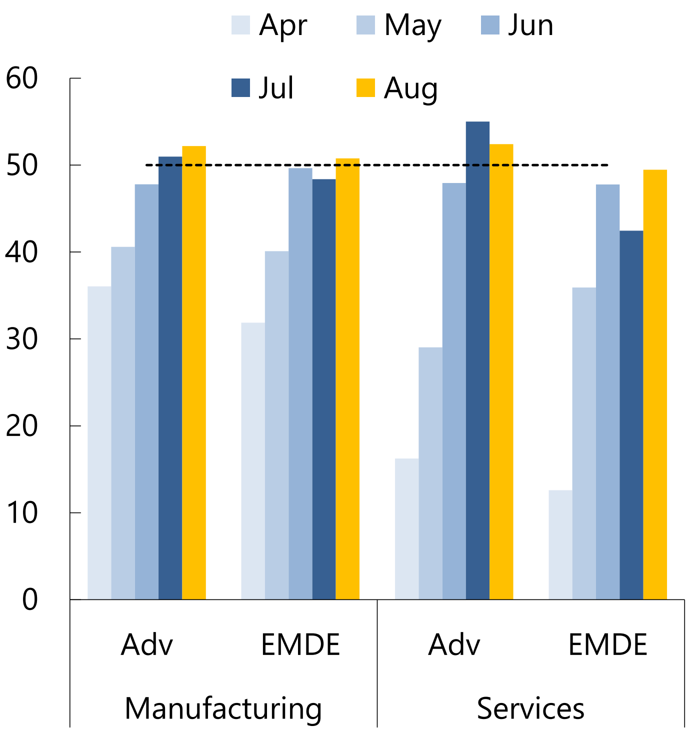
Strictness of containment policy and mobility
(index; March 1 =100; 7 day moving average)



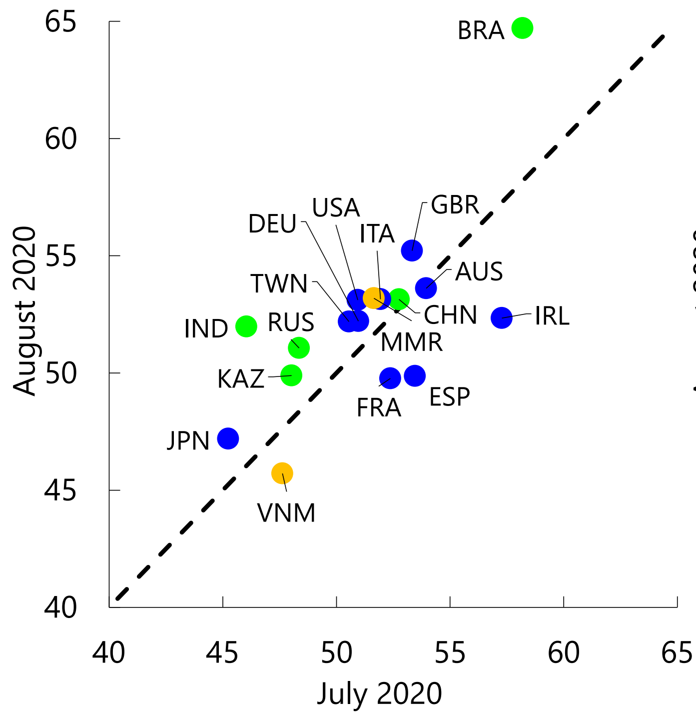
Sources: Ourworldindata Organization; OxCGRT; and IMF staff calculations.

Recovery underway but signs of setbacks

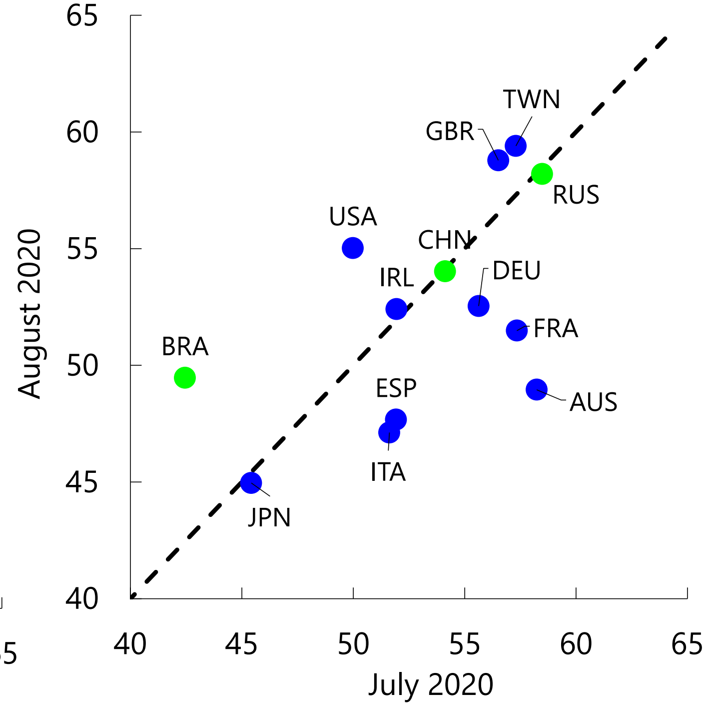
PMIs
(median; index; >50 = expansion; sa)



PMI manufacturing
(index; >50 = expansion; sa)



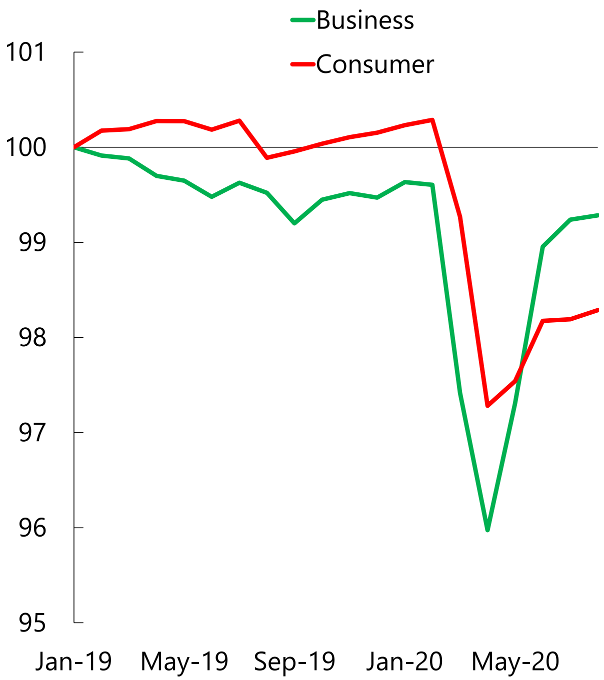
PMI service
(index; >50 = expansion; sa)



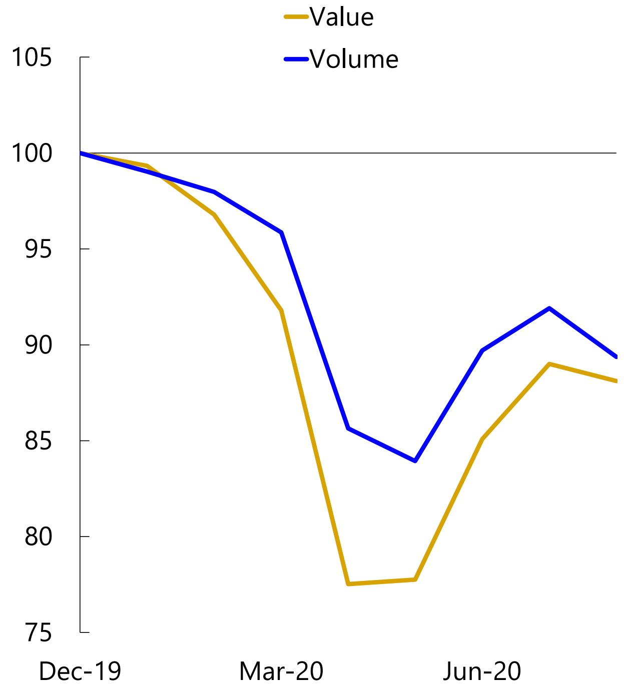
Sources: IMF, *World Economic Outlook*; IMF, *Global Data Source;* Haver Analytics; and IMF staff calculations.

Uneven recovery of sentiments and trade

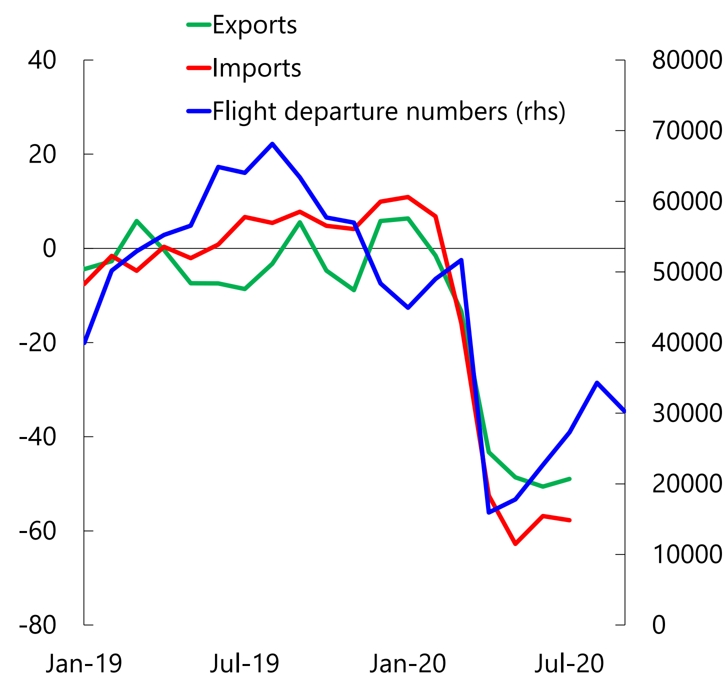
Global business and consumer sentiments 1/
(index; Jan 2019 = 100)



World: Merchandise imports 2/
(index; Dec 2019 = 100)



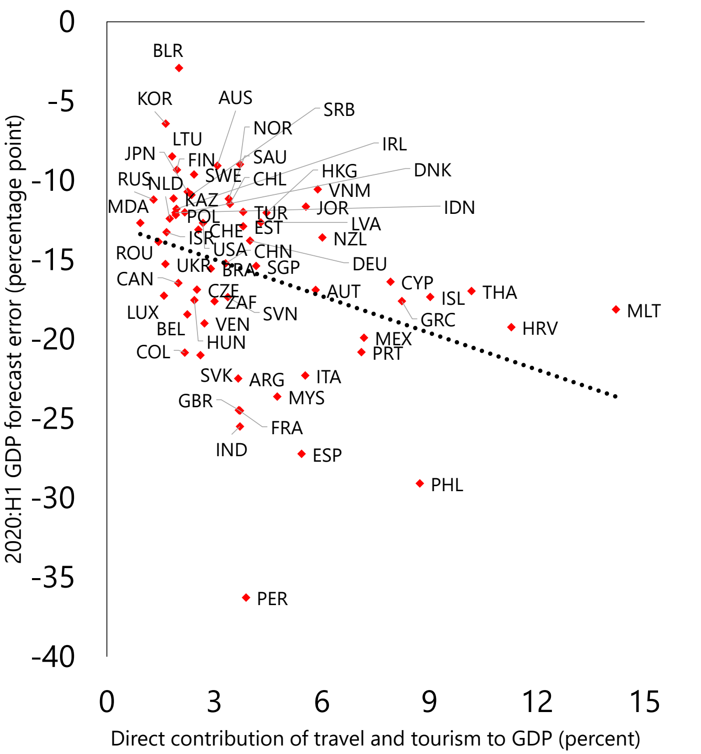
World: Service trade and international flight departure
(y/y; unless otherwise noted)



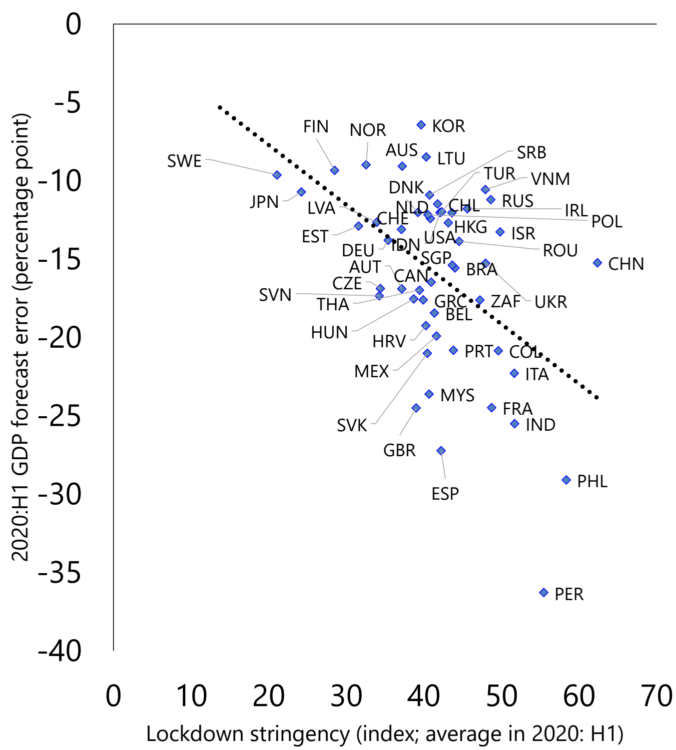
Sources: CPB World Trade Monitor; national authorities; Flightradar24; Haver Analytics; IMF, *World Economic Outlook*; IMF staff calculations.
1/ Business sentiment in manufacturing consist of AUS, CAN, EUR, GBR, KOR, JPN, SWE, USA, BRA, CHN, CZE, MEX, RUS, POL, THA, TUR, ZAF. Consumer sentiment consist of AUS, EUR, GBR, JPN, NZL, SWE, USA, ARG, BRA, CHN,CZE, IDN, KOR, MEX, POL, THA, TUR, TWN.
2/ June 2020 data based on CPB; July and August data in value based on national sources (customs) from reporting countries (respectively 95% and 33% of world trade).

Growth outturn affected by lockdown, social distancing and size of tourism sector

GDP forecast errors in 2020H1 and tourism contribution 1/

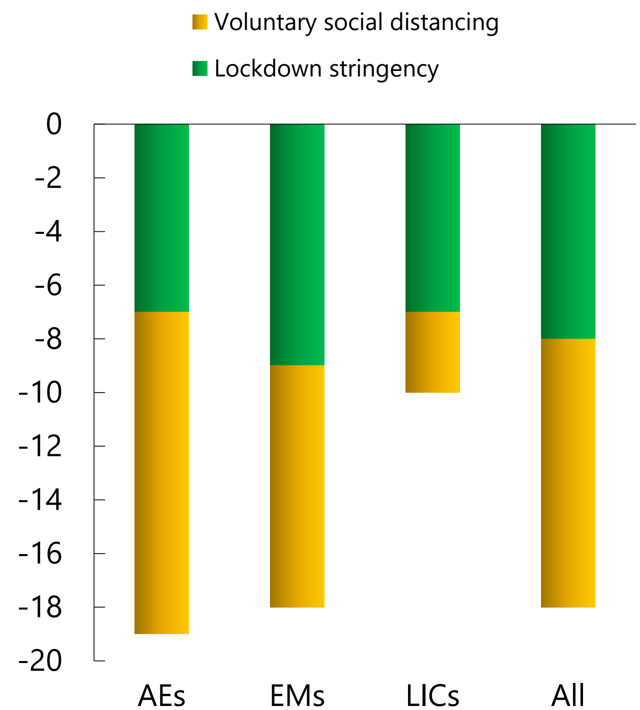


GDP forecast errors in 2020H1 and lockdown stringency 1/



Impact on mobility during 90 days after 1st case

(percent)

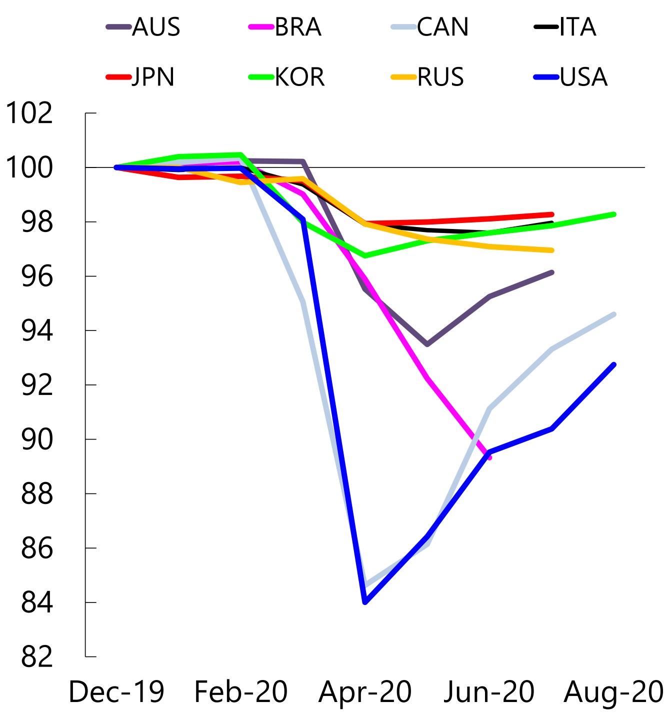


Sources: IMF, *World Economic Outlook*; UNESCO; IMF staff calculations.

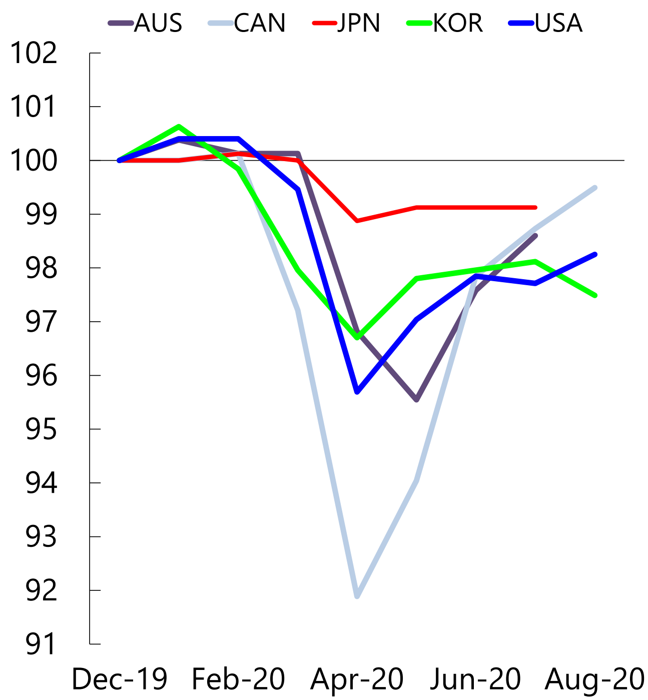
1/ GDP forecast errors are defined as the deviations from January *WEO* projections for the first half of 2020 (2020:H1).

Labor market conditions remain weak

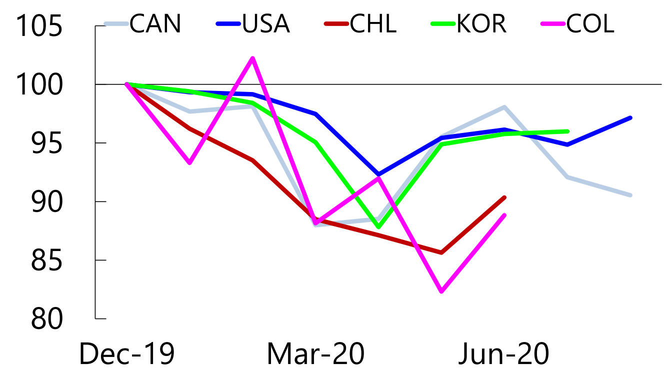
Total employment
(index; Dec. 2019=100)



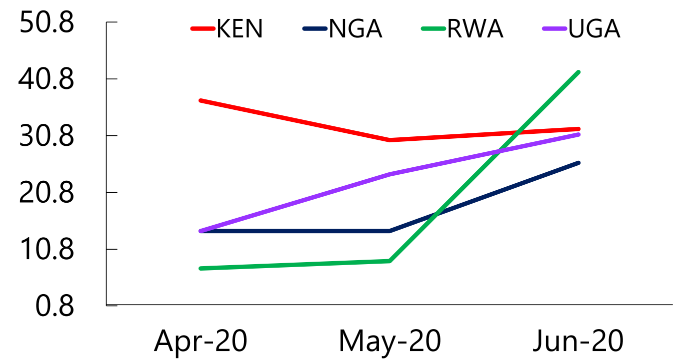
Labor force participation
(index; Dec. 2019=100; 15 to 64 Years; sa)



Mean weekly hours worked per employee
(index; Dec. 2019=100)



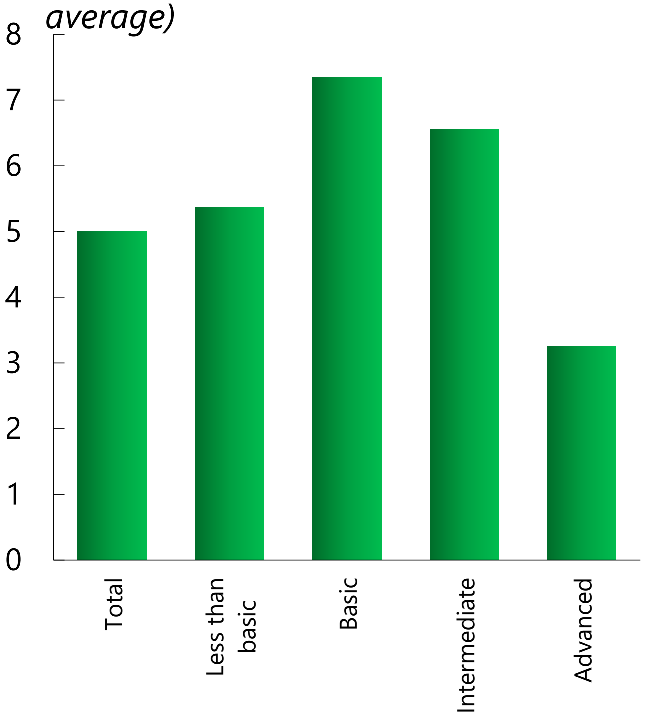
AFR: weekly hours worked per employee
(average hours)



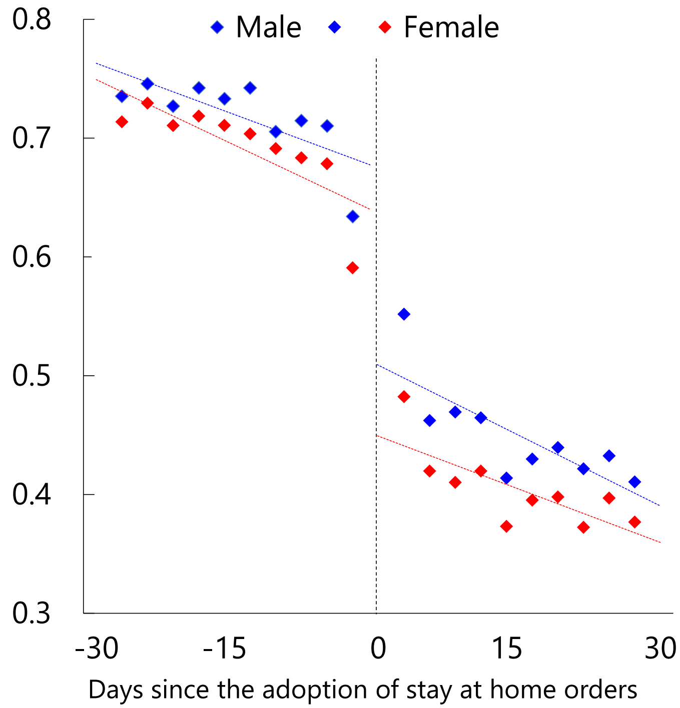
Sources: IMF, *Global Data Source;* ILO; https://covid19tracker.Africa; Haver Analytics; and IMF staff calculations.

Low and middle-skilled, and women, more adversely impacted

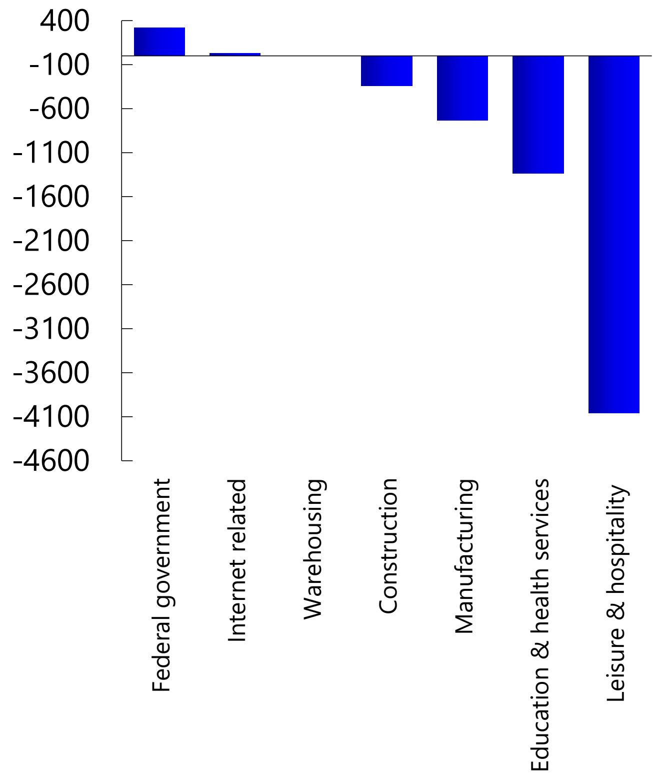
Change in unemployment rate by education 1/
(percentage points, 2020Q2 vs 2019Q4; average)



Impact of stay at home orders 2/
(percent of people moving age 25-44; estimates based on a linear interacted model)



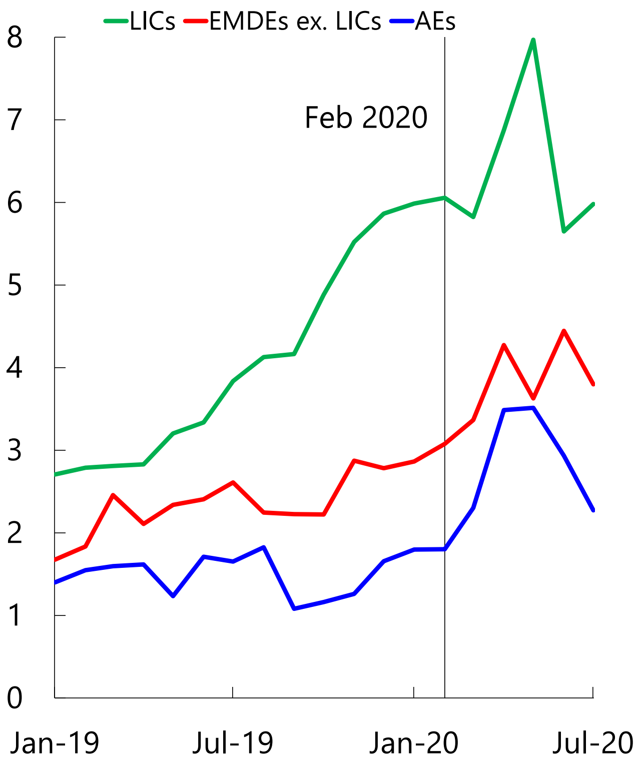
US: Sectoral employment change
(change in thousands; Aug 2020 vs Dec 2019)



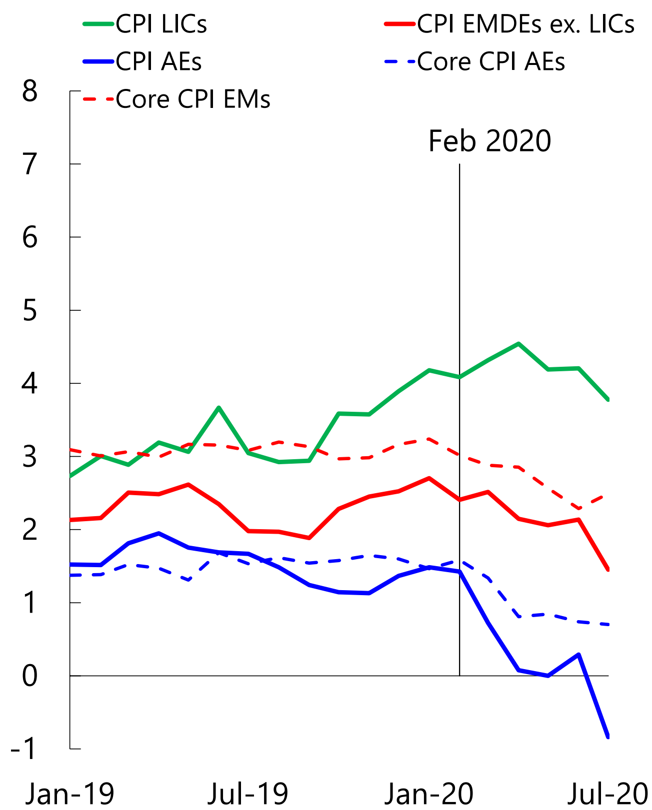
Sources: ILO; Vodafone; WEO 2020 Chapter 2 and IMF staff calculations.
1/ Consist of Canada, Korea, Mexico and United States.
2/ Based on Vodafone data for Italy, Portugal and Spain. Binned scatter plots around the time of stay-at-home orders introduction. The series are residualized with respect to province and day-of-the-week fixed effects.

Inflation continues to fall in most countries

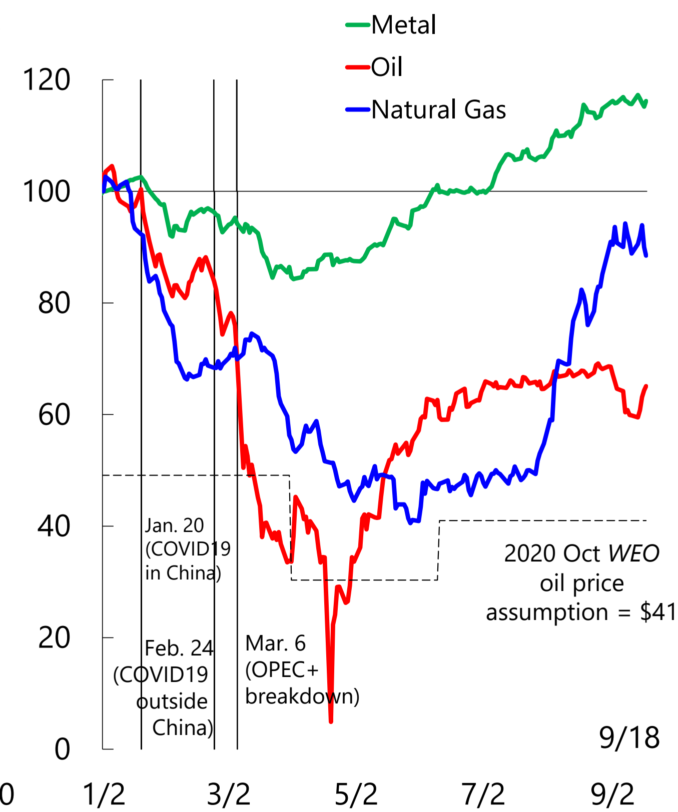
Food price inflation
(percent; yoy; median)



Consumer price inflation
(percent; yoy; median)



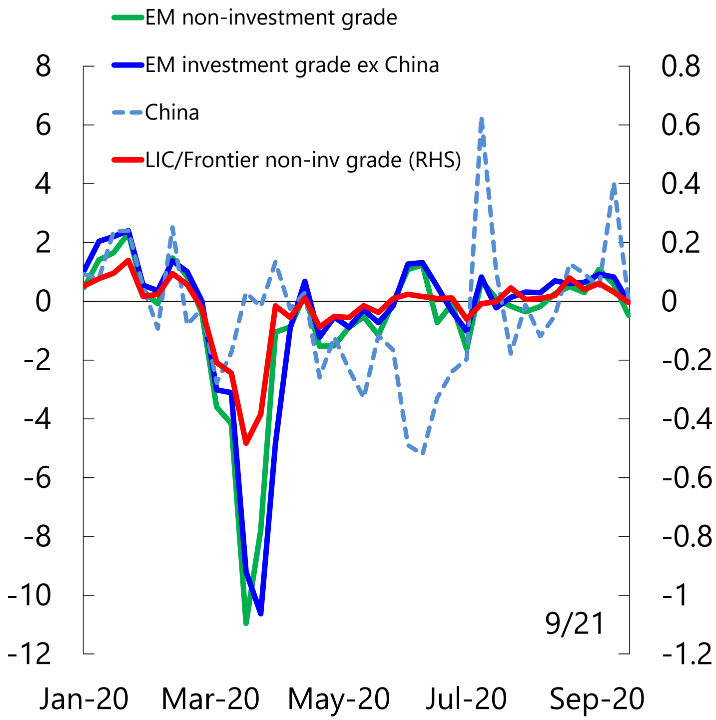
Commodity prices
(Jan 2, 2020 = 100)



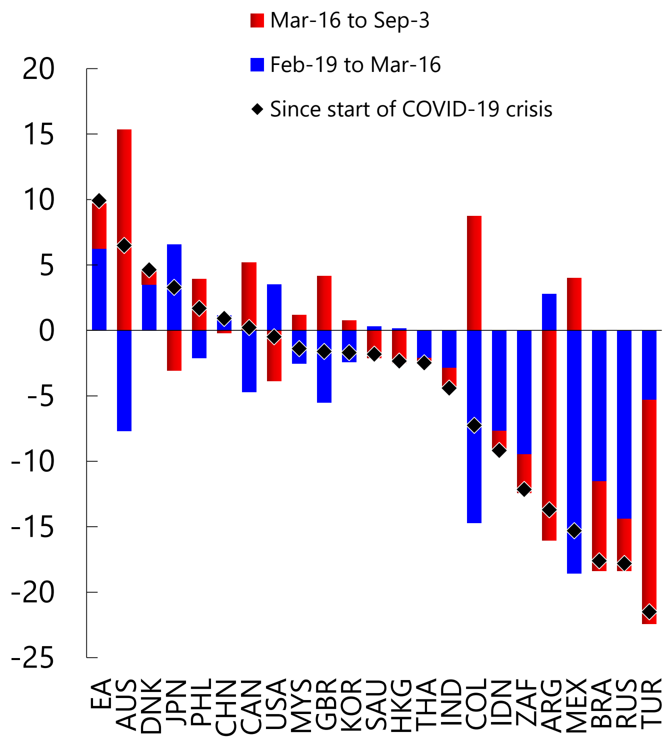
Sources: IMF, *Global Data Source*; IMF *STA CPI Database*; IMF, *Commodity database*; and IMF staff calculations.

Policies eased overall financial conditions with country differentiation

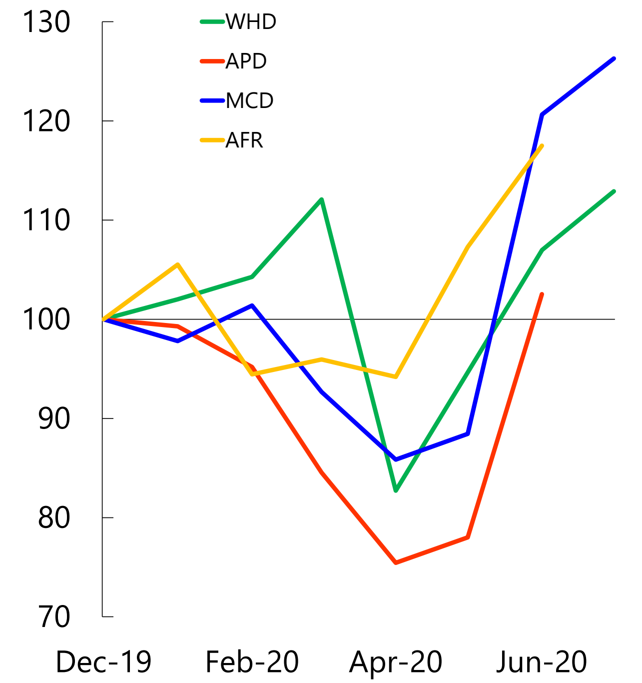
Emerging Markets: Portfolio flows 1/
(US$ billions; EPFR)



Currency movements
(cumulative NEER in percent)



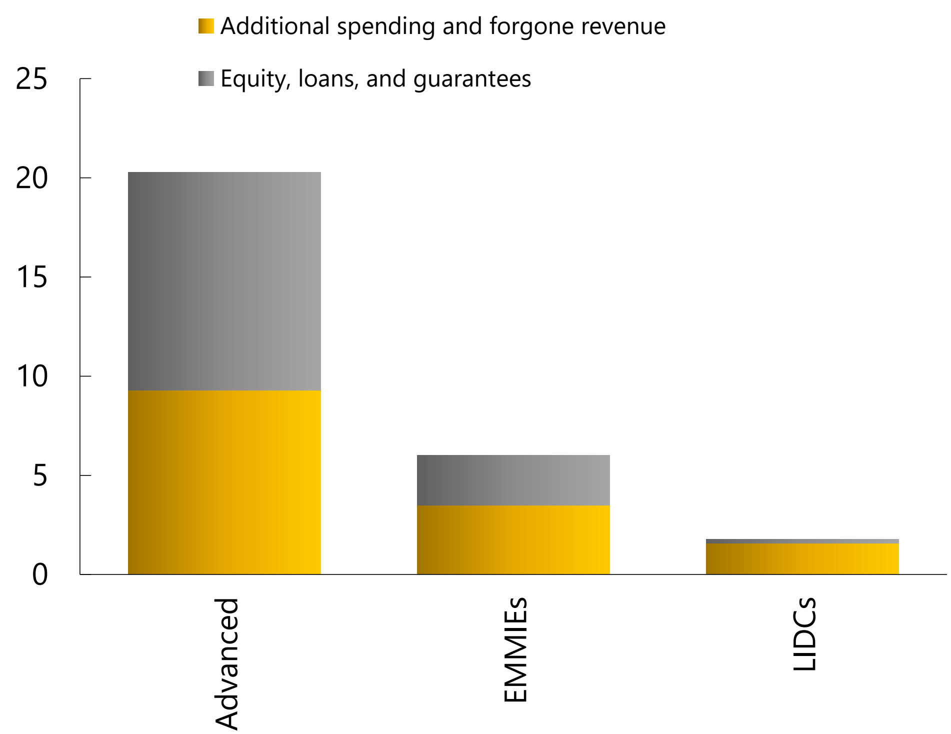
Remittances of selected regions 2/
(index; USD; Dec 2019=100)



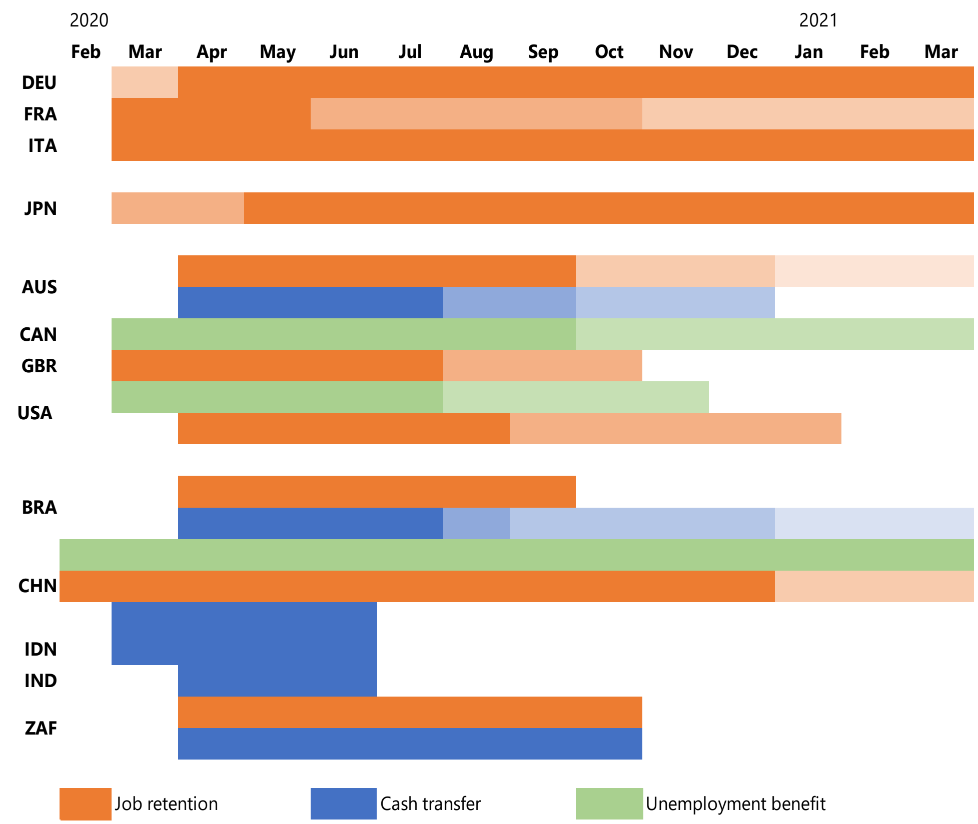
Sources: EPFR; IMF, *Global Data Source;* and IMF staff calculations.
1/ All available emerging and LIC countries in EPFR.
2/ WHD: Mexico, Colombia, Guatemala, El Salvador, Dominican Rep, Paraguay (up to July), APD: Thailand, Philippines, Bangladesh, Sri Lanka (up to June), MCD: Pakistan, Morocco, Georgia (up to July) AFR: Kenya, Gambia, Cabo Verde (up to June)

Fiscal support put a floor on contraction but in some countries fading out of income support could halt the nascent recovery

Announced fiscal measures
(percent of GDP)



Duration of income support measures by country 1/
(months)



Sources: IMF, *Fiscal Monitor*; and IMF staff calculations.

1/ Cash transfer includes economic support payment, income supplement, food and electricity subsidies, social and distress grants, and emergency aid programs to households.

WEO baseline assumptions

Disruptions to activity

- Social distancing will persist into 2021, but will then decline over time as therapies and vaccine coverage improve, with the acute phase of the pandemic over by end-2022

Financial conditions and policy support

- Financial conditions to remain approximately at current levels for both AEs and EMs
- The projection factors in the impact of the sizable fiscal countermeasures implemented so far and anticipated for the rest of the year

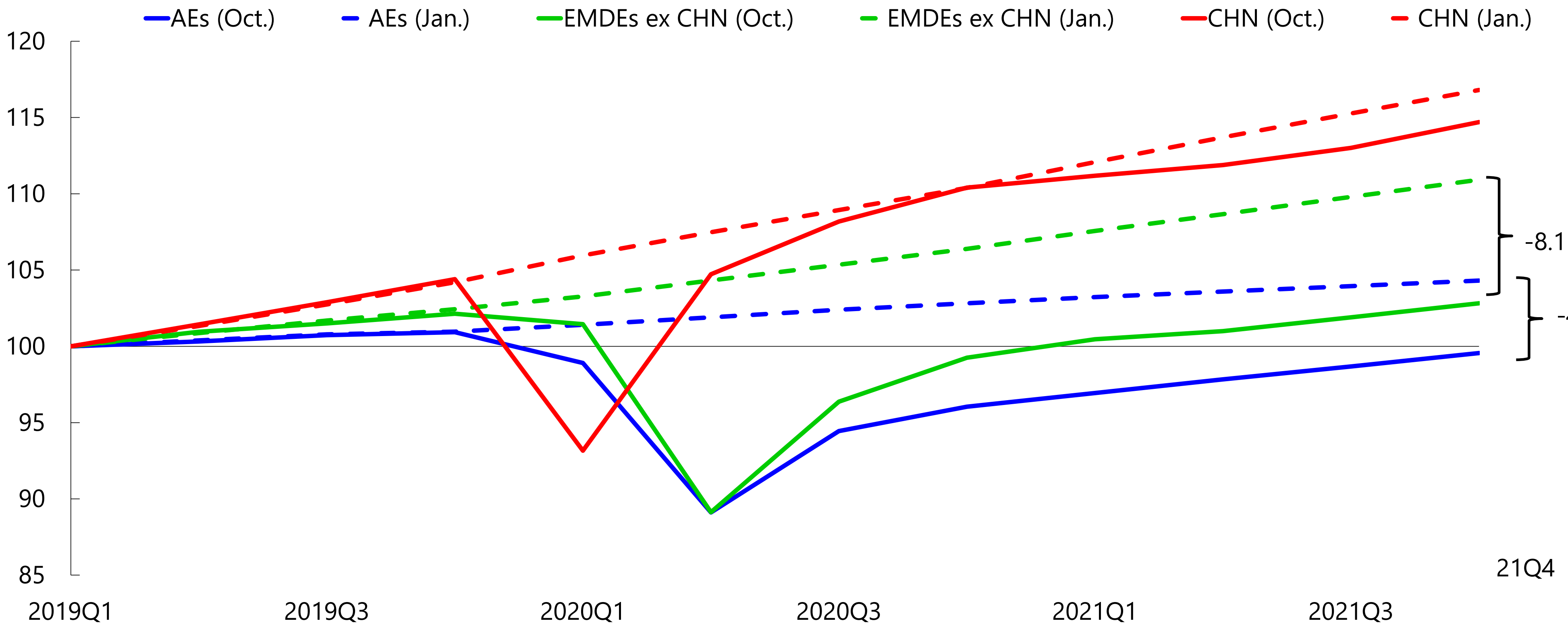
Commodity prices

- Higher than April and June 2020
- Average petroleum spot prices (APSP) per barrel: $41 in 2020 and $43.8 in 2021. For the years thereafter, prices expected to increase toward $48
- Non-fuel commodity prices are expected to rise faster than assumed in the April and June 2020

WEO Projections

Partial recovery, Growing Divergence

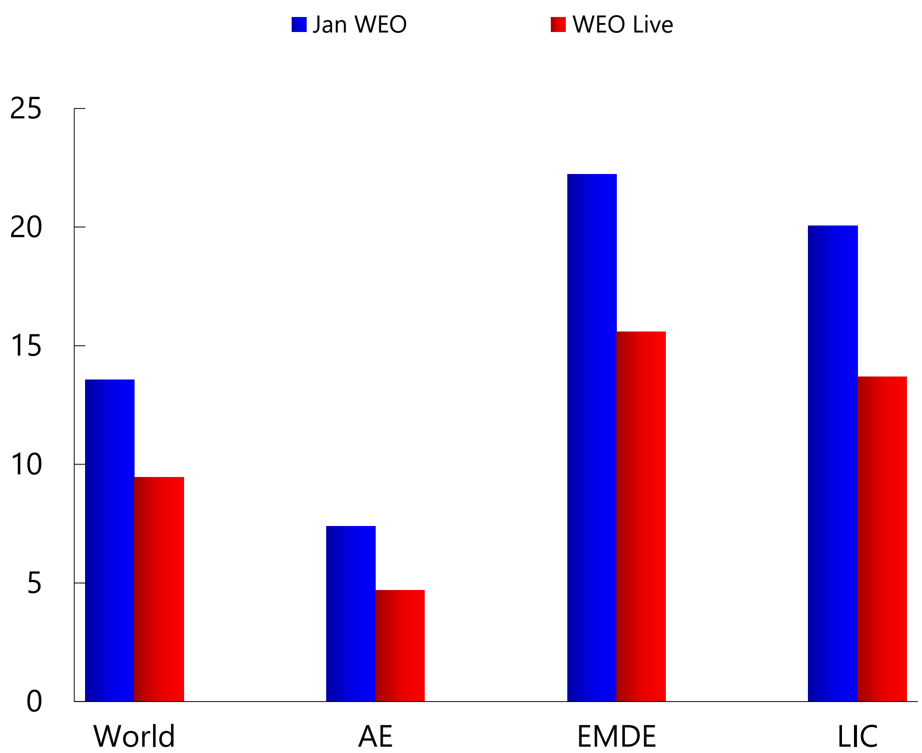
Real GDP forecast, 2019-2021
(index; 2019Q1=100)



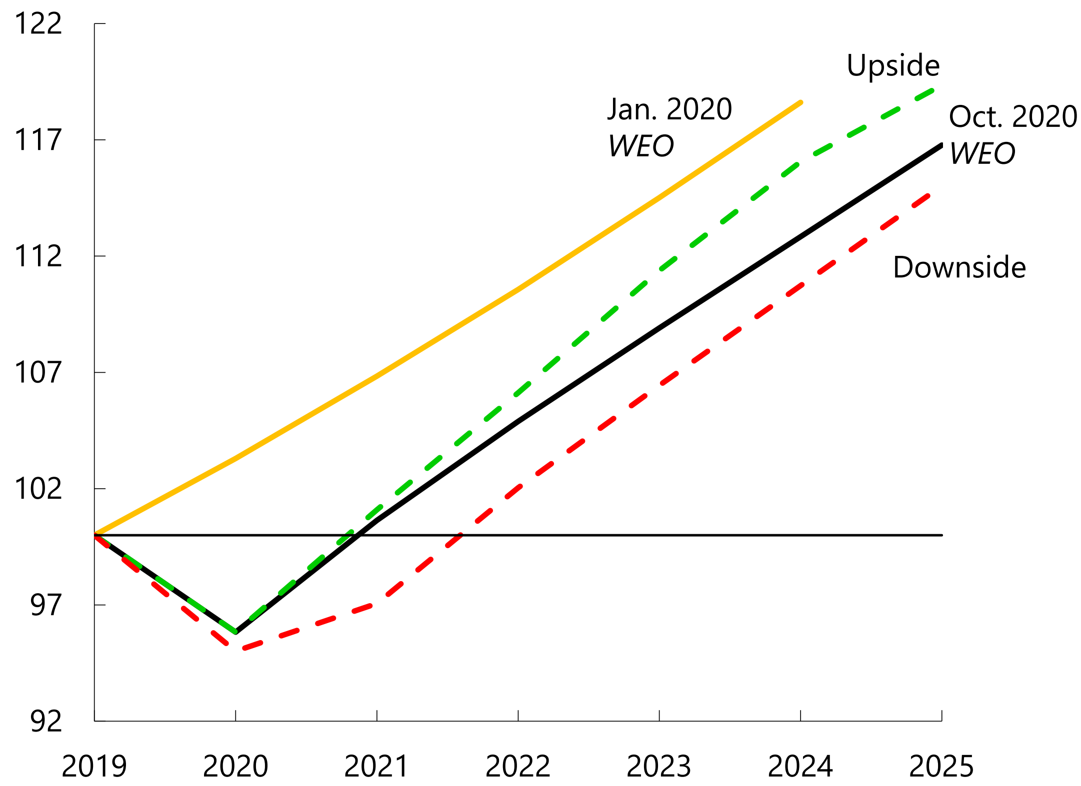
Sources: IMF, *World Economic Outlook*; and IMF staff calculations.

Medium-term growth and alternative scenarios

Per capita GDP, cumulative growth 2019-24
(percent)



Global: Real GDP path, 2019-2021
(index; 2019 Real GDP normalized to 0)

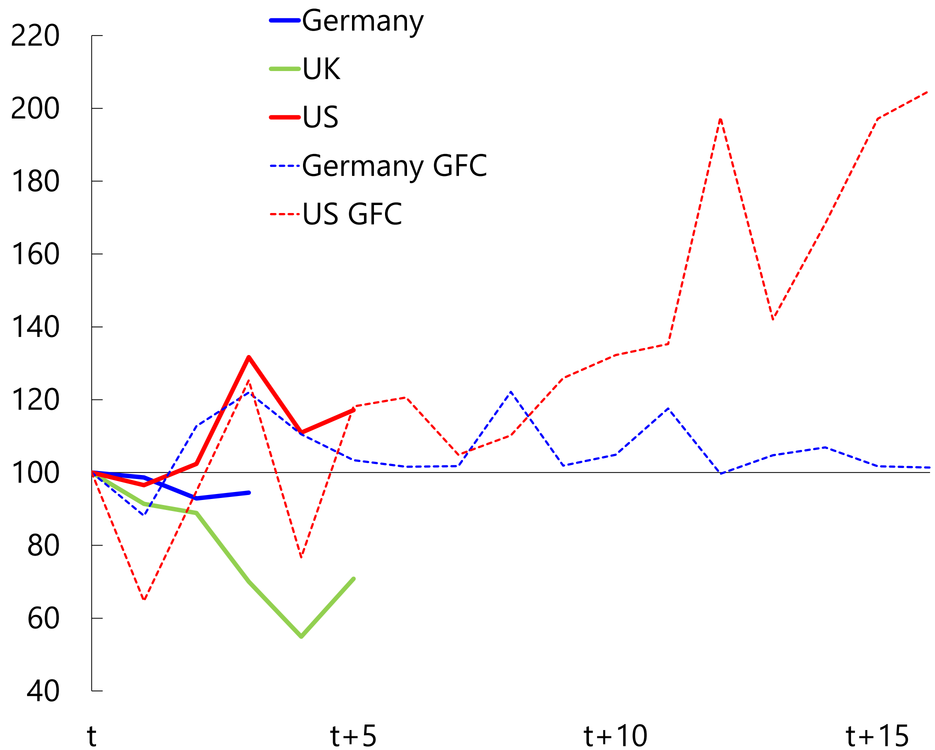


Sources: IMF, *World Economic Outlook*; and IMF staff estimates.

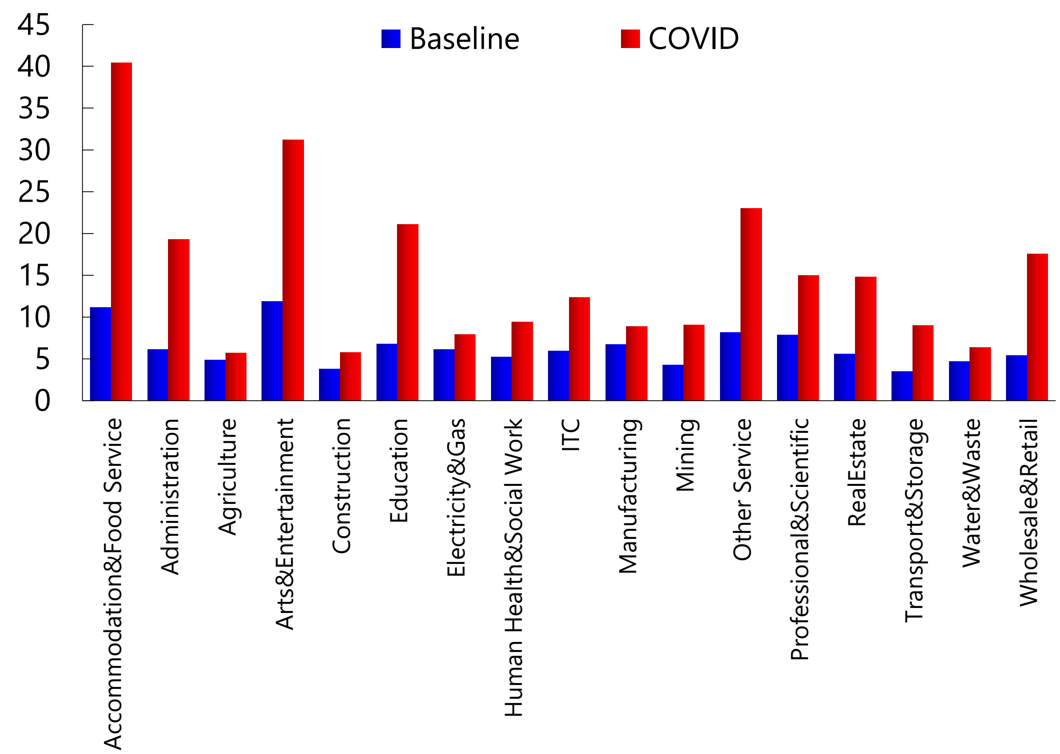
Risks

Risk of bankruptcies and jobs-at-risk

Bankruptcy filing 1/
(index; total commercial filings)



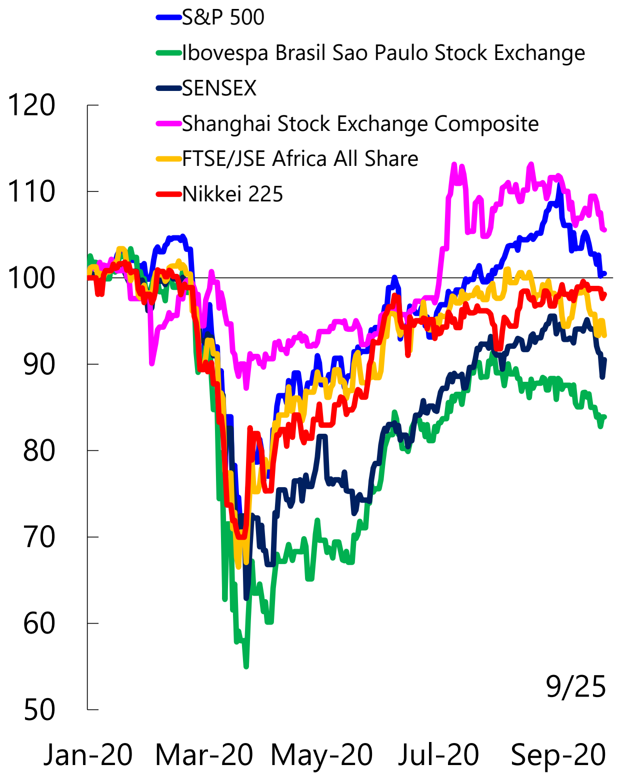
SME Job at risk 2/
(percent of private SME)



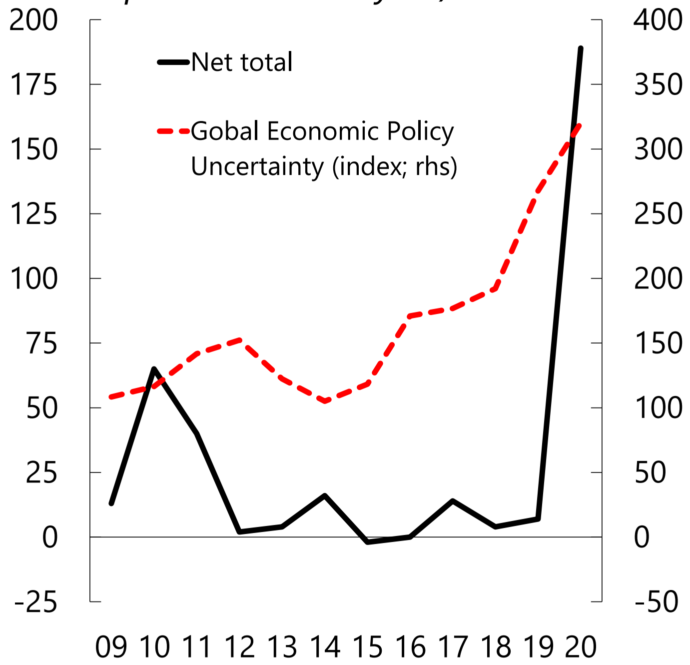
Sources: American Bankruptcy Institute; United Kingdom Insolvency Service; Germany Federal Statistics Office; CEIC; IMF VE database; and IMF staff calculations.
1/ US data only covers Chapter 11 filings.
2/ The share of SME jobs-at-risk are computed using the employment information firms with less than 250 employees from ORBIS database which covers 21 countries that are projected to face negative cash or negative equity at the end of 2020. The projections use the methodology developed by Gourinchas et al (2020).

Risk of financial market reversal, geopolitical tension and debt distress

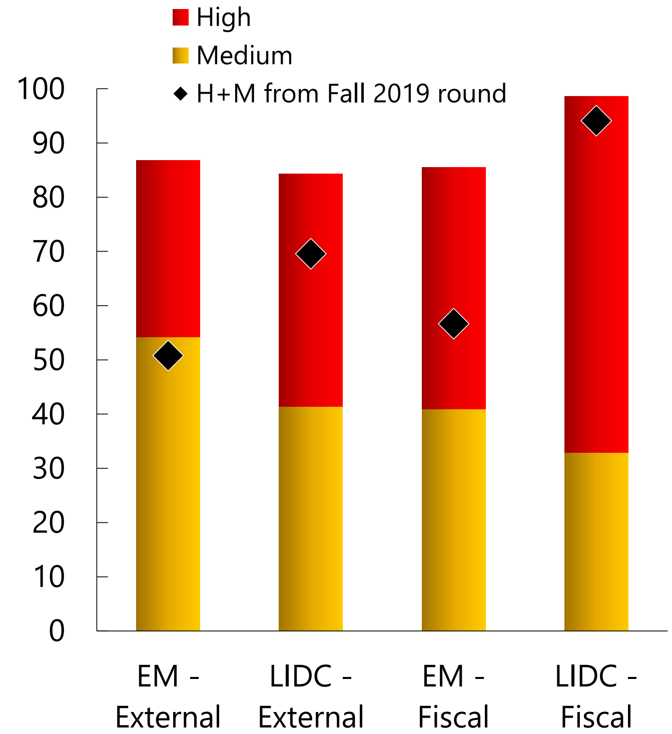
Equity market index
(Jan. 1, 2020=100)



Trade restriction and policy uncertainty
(net; difference between the number of harmful and liberalizing interventions implemented each year)



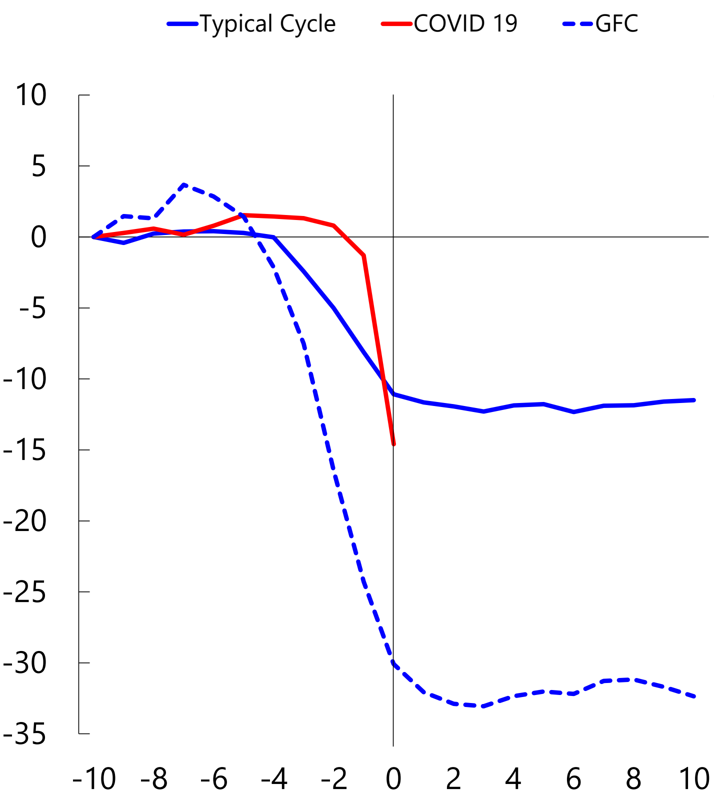
EM and LIDC: External and fiscal vulnerabilities
(percent of total countries)



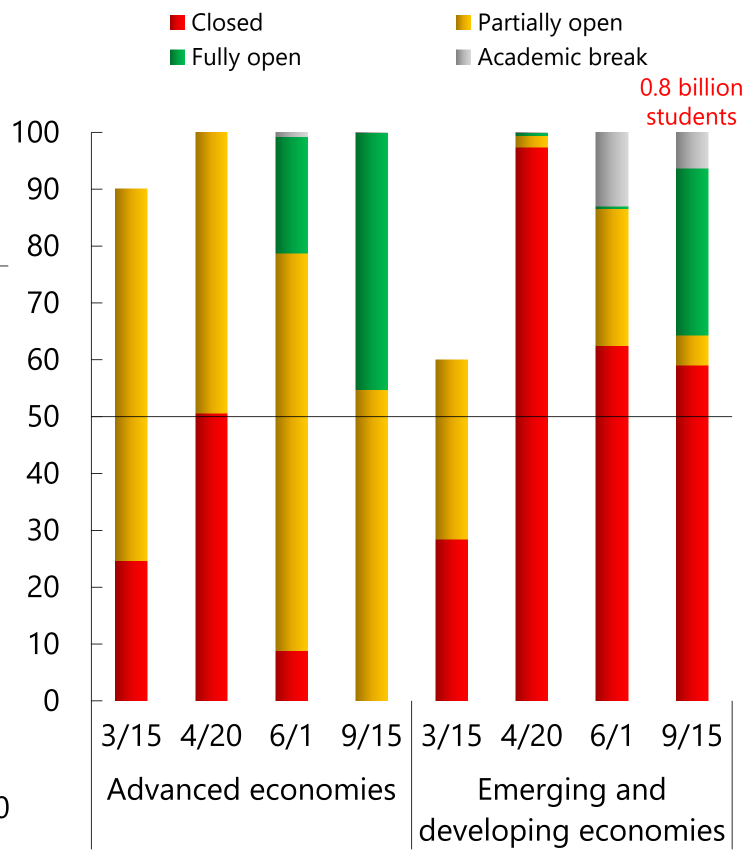
Sources: Bloomberg, L.P.; Global Trade Alert; IMF VE database and IMF staff calculations.

And prolonged weakness in investment and loss of human capital

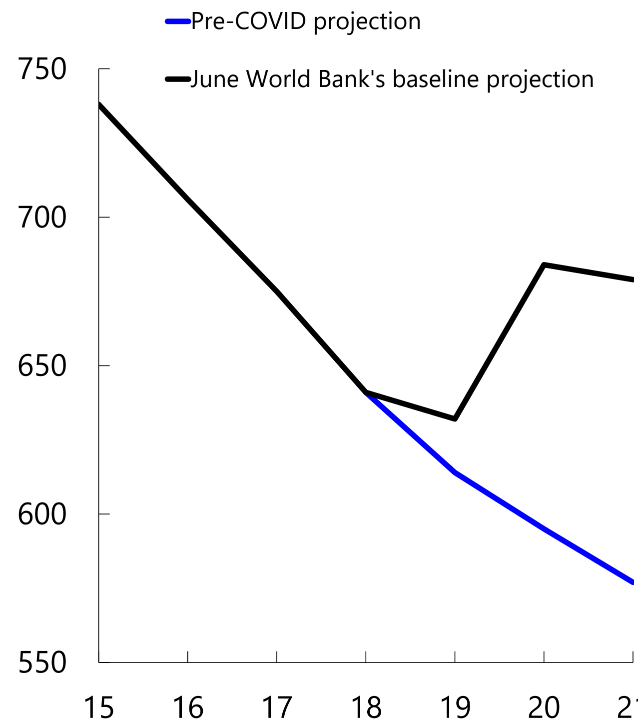
Gross fixed capital formation 1/
(percent deviation from pre-crisis trend)



School closures and enrollment
(percent of students)



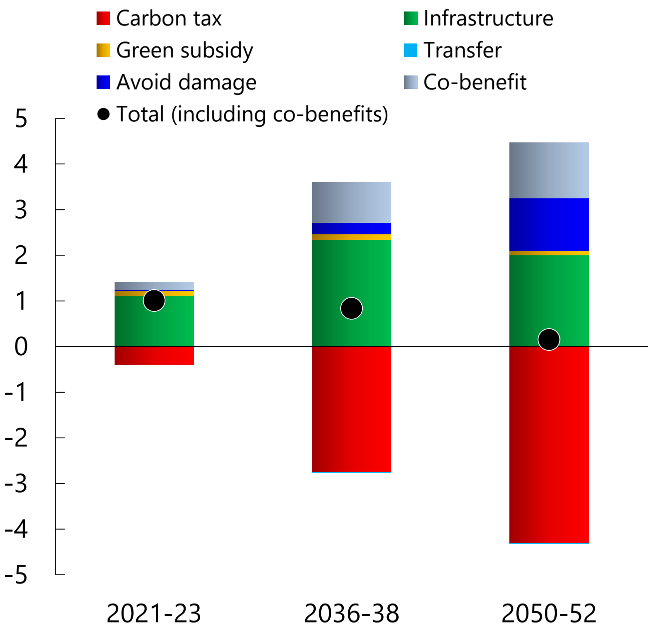
The impact of COVID-19 on global extreme poverty 2/
(millions of people in extreme poverty)



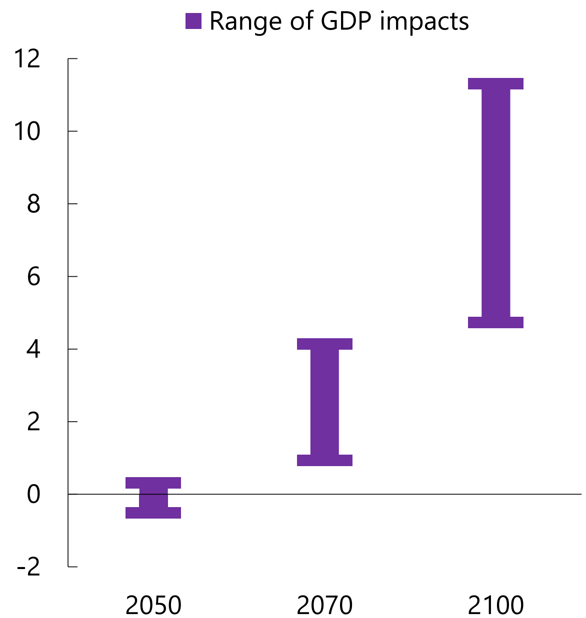
Sources: IMF, *World Economic Outlook*; UNESCO; World Bank; IMF staff calculations.
1/ The typical cycle is based on 170 recession episodes from 1960s to 2006.
2/ Extreme poverty is measured as the number people living on less than $1.9 per day.

A comprehensive decarbonization strategy can lift output in the near and long term

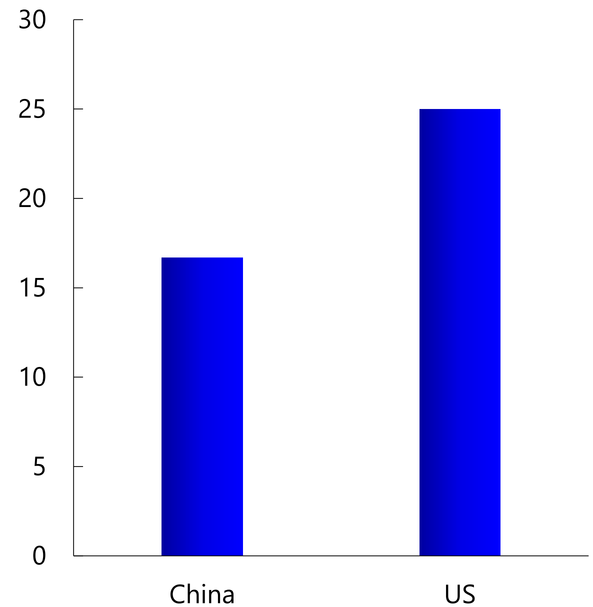
Impacts on real GDP 1/
(deviation from baseline, percent)



Long-term real GDP gains 2/
(deviation from baseline, percent)



Compensation for poorer households 3/
(percent of carbon pricing revenues)



Source: IMF staff calculations for Chapter 3 of the October 2020 *World Economic Outlook*.
1/ Three-year averages, based on simulations using the G-cubed Model of McKibbin and Wilcoxen (1999, 2013) and Liu and others (2020). The policy package aims to reduce emissions by 80 percent in every country/region by 2050 and includes: (1) gradually rising carbon taxes, (2) green infrastructure investment (over the first decade) and a subsidy to renewables production, and (3) compensatory transfers to households.
2/ Range of net global output gains using estimated sensitivities of output to temperature from Nordhaus 2010 and Burke, Hsiang, and Miguel 2015, assuming that global temperatures rise in the long run by 3C in response to a doubling of atmospheric CO_2 (Heal, 2017).
3/ The transfer needed to protect the poorest 20 percent of households' purchasing power against a hike of carbon prices to $50 per ton of CO_2.

Policy recommendations

FAD/MCM/RES joint slide

Near-term policy priorities

Monetary, fiscal and liquidity support measures are needed at least into 2021. Premature withdrawal would be a major risk to the recovery.

- Everywhere, ensure health care systems adequately resourced
- Where pandemic is not under control: limit persistent economic damage as needed with measures such as cash transfers, wage subsidies, expanded criteria for UI benefits
- Where countries are reopening: unwind lifelines gradually after activity picks up durably, policy focus should shift to facilitating reallocation
- Limit amplification of the shock:
    - support viable but still vulnerable firms with moratoria on debt service, equity-like support, debt restructuring and efficient out-of-court workouts;
    - retraining and reskilling where feasible to allow sectoral reallocation;
    - banks to continue using capital and liquidity buffers to support credit provision;
    - maintain accommodative monetary policy support where inflation expectations are anchored and provide broad fiscal stimulus where space permits

In fiscally constrained economies, the priority is to create room to meet crisis spending needs:

- prioritize health and education spending, income support to the poor;
- reduce wasteful spending and poorly targeted subsidies.
- extend maturities on public debt and lock in low interest rates to the extent possible to reduce debt service expenses
- revenue measures: raise progressive taxes, adjust corporate taxation to ensure firms pay taxes commensurate with profitability

Policy recommendations

FAD/MCM/RES joint slide

Enhance international cooperation

- **Health.** Fund vaccines through advance purchase commitments, plan for delivery to LICs, and support countries with limited health care capacity.
- **Financial support for countries facing high borrowing costs and rollover risks** to help close the financing gap and catalyze additional resources.
- **Debt relief, grants and access to concessional financing** for the most vulnerable countries.
- **Defuse trade, technology, geopolitical tensions.**

Policies to address medium and long-term challenges

In the medium to long-term, national policies need to address legacies and facilitate the transition to a smart, green, inclusive, and resilient growth path.

- **Address debt overhangs**
  - Recapitalize, restructure or resolve nonviable firms as needed.
  - Adopt a realistic medium-term fiscal strategy which supports development priorities and adequate fiscal risk management. In some cases, orderly sovereign debt restructuring may be needed.
  - Enhance debt transparency.
- **Counteract slowing productivity growth and supply-side damage.** Repair balance sheets, address labor market rigidities, and ensure that increasing corporate concentration does not lead to abuses of market power.
- **Facilitate new growth opportunities**
  - Encourage pro-active management of climate-related risks and green investments. Gradually increase carbon prices to reduce emissions, stave off physical risks, and strengthen fiscal finances.
  - Increase digital investment to improve productivity growth, bridge the digital divide.
  - Remedy the crisis-induced setback to human capital accumulation.
  - Enhance financial sector efficiency.
- **Pursue further financial reforms**
  - Banks: gradually rebuild buffers and reduce problem assets.
  - NBFIs: enhance the regulatory framework to address vulnerabilities exposed during COVID-19.
  - Macro- and micro-prudential policies should deal with “lower for longer” and contain risk taking.
- **Address income inequality.** Close health and education gaps, enhance social safety nets and progressive income taxation.

International Monetary Fund

September 30, 2020

World Economic and Market Developments

Tobias Adrian

Financial Counsellor and Director

Monetary and Capital Markets Department

A Bridge to Recovery

Unprecedented policy support has:

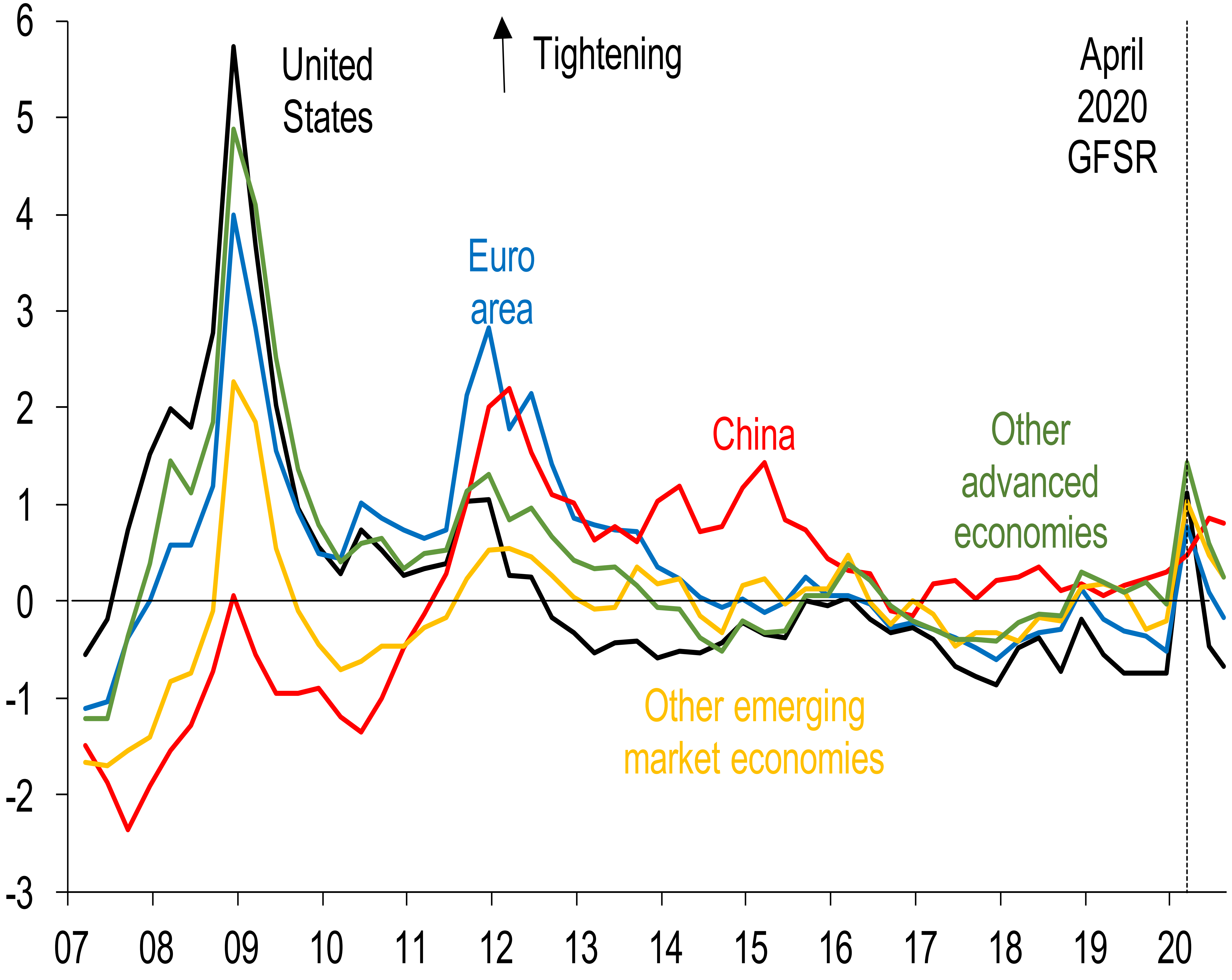
- Kept markets functioning
- Maintained the flow of credit
- Avoided adverse macro-financial feedback loops…
- …and widespread bankruptcies

… but may exacerbate future vulnerabilities:

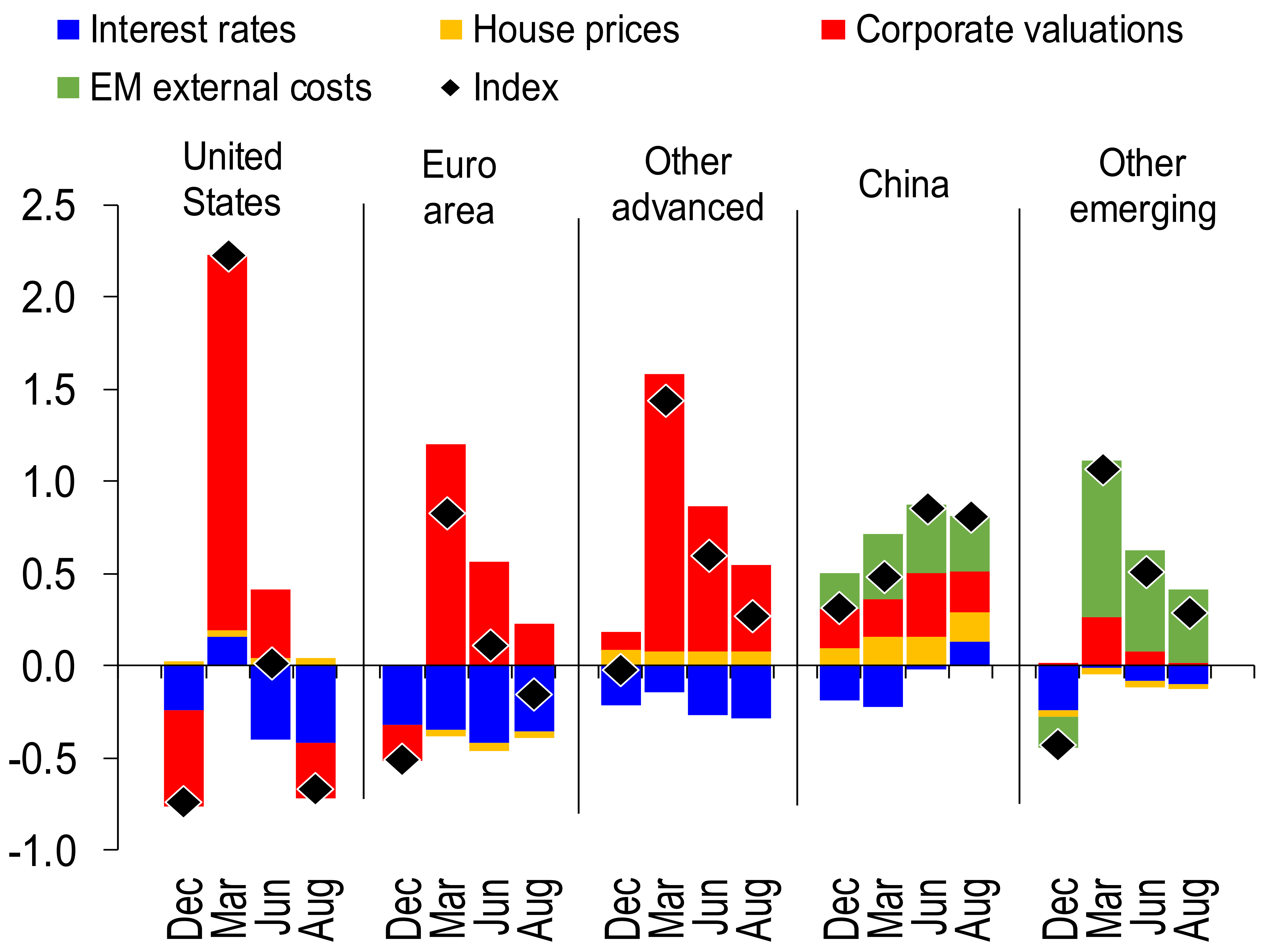
- Real-financial disconnect
- Rising debt and insolvencies
- Depletion of bank buffers
- Excessive risk-taking

Financial Conditions Have Remained Accommodative

Global Financial Conditions Indices
(Standard deviations from mean)

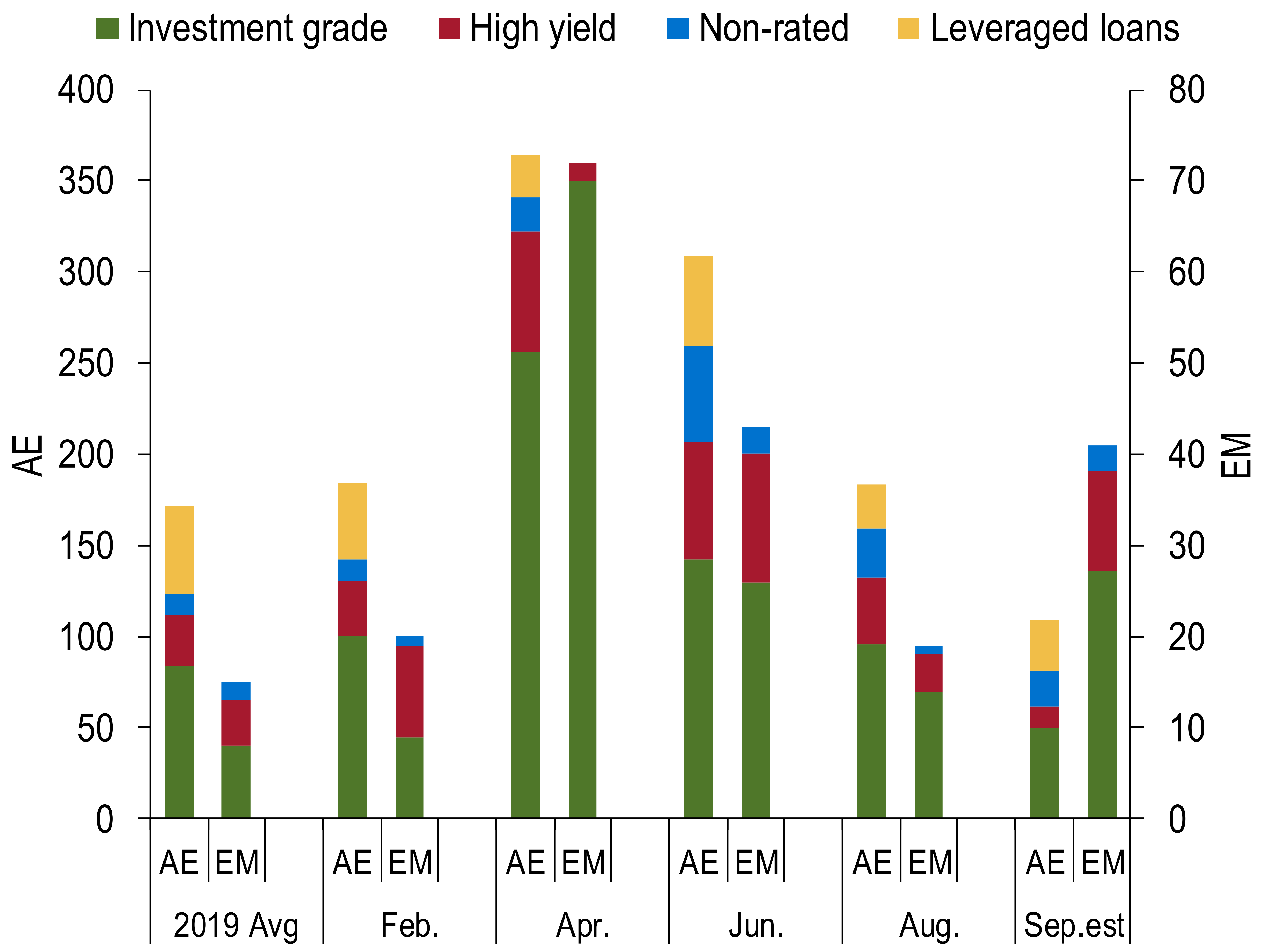


Key Drivers of Global Financial Conditions Indices
(Standard deviations from mean)

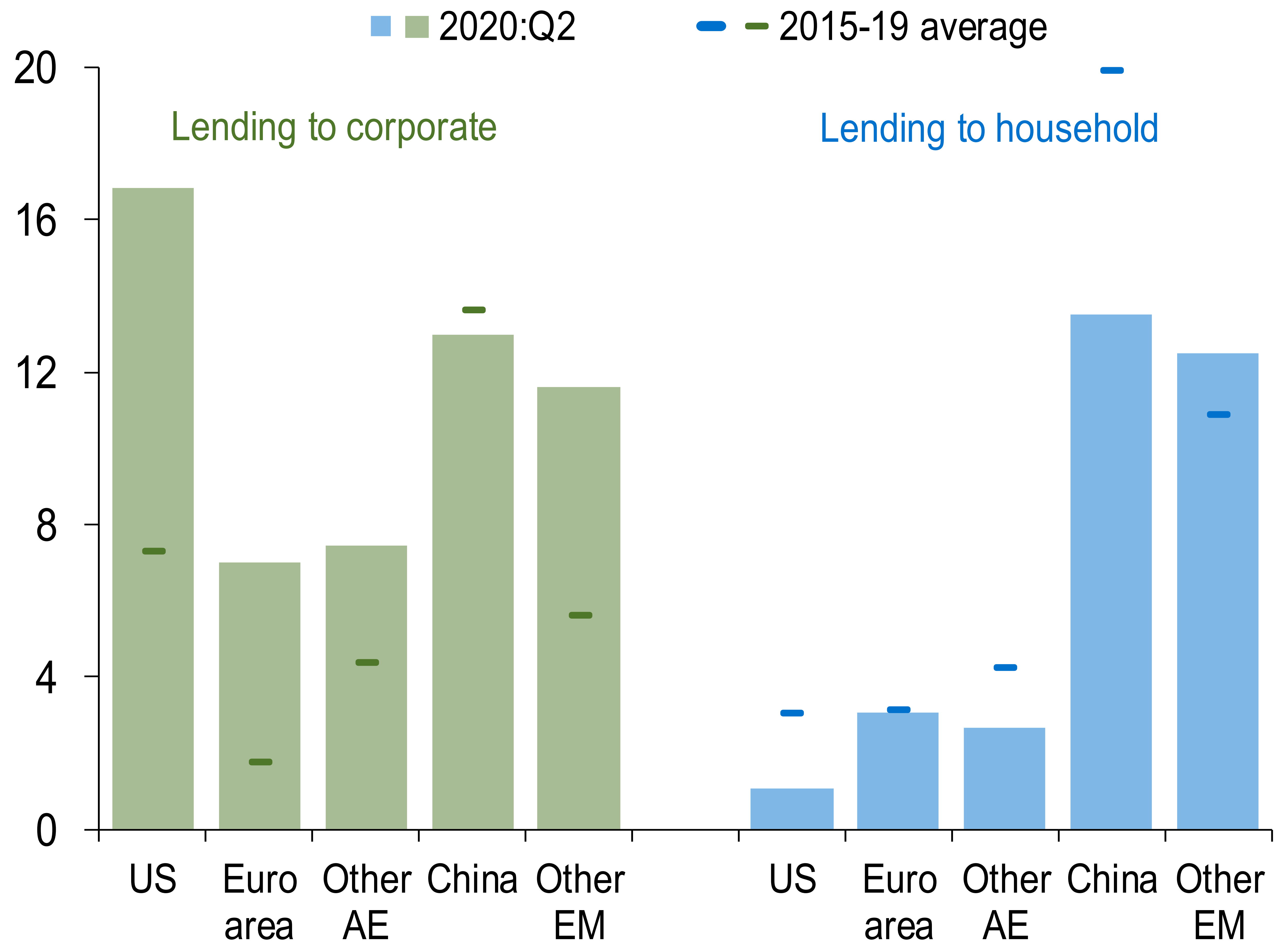


The Flow of Credit To the Economy Has Been Maintained

AE Corporate Bond and Leverage Loan Issuance
EM Corporate and Sovereign Bond Issuance
(Billions of US dollars)

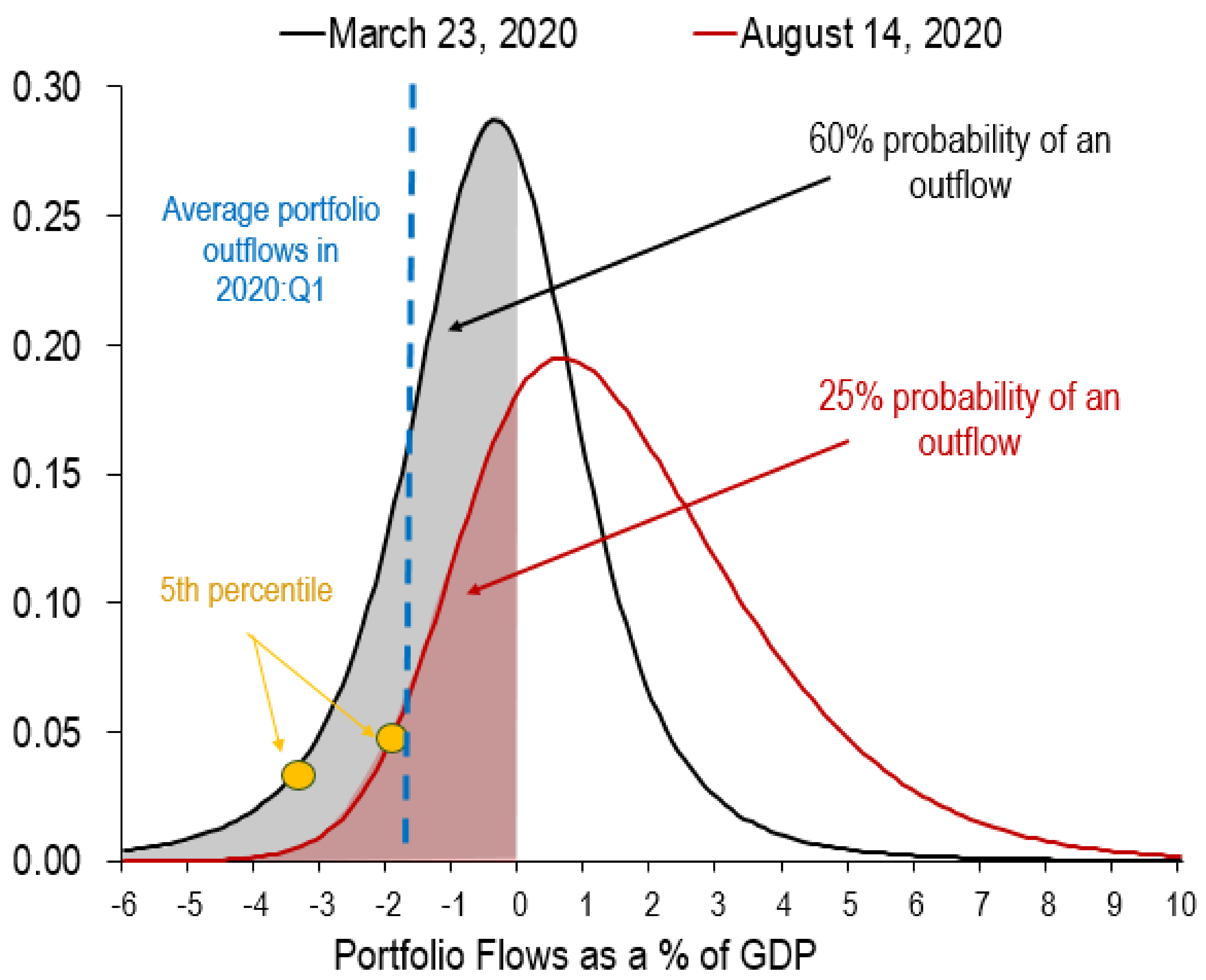


Bank Credit Growth in AEs and EMs, 2020:Q2
(Percent)

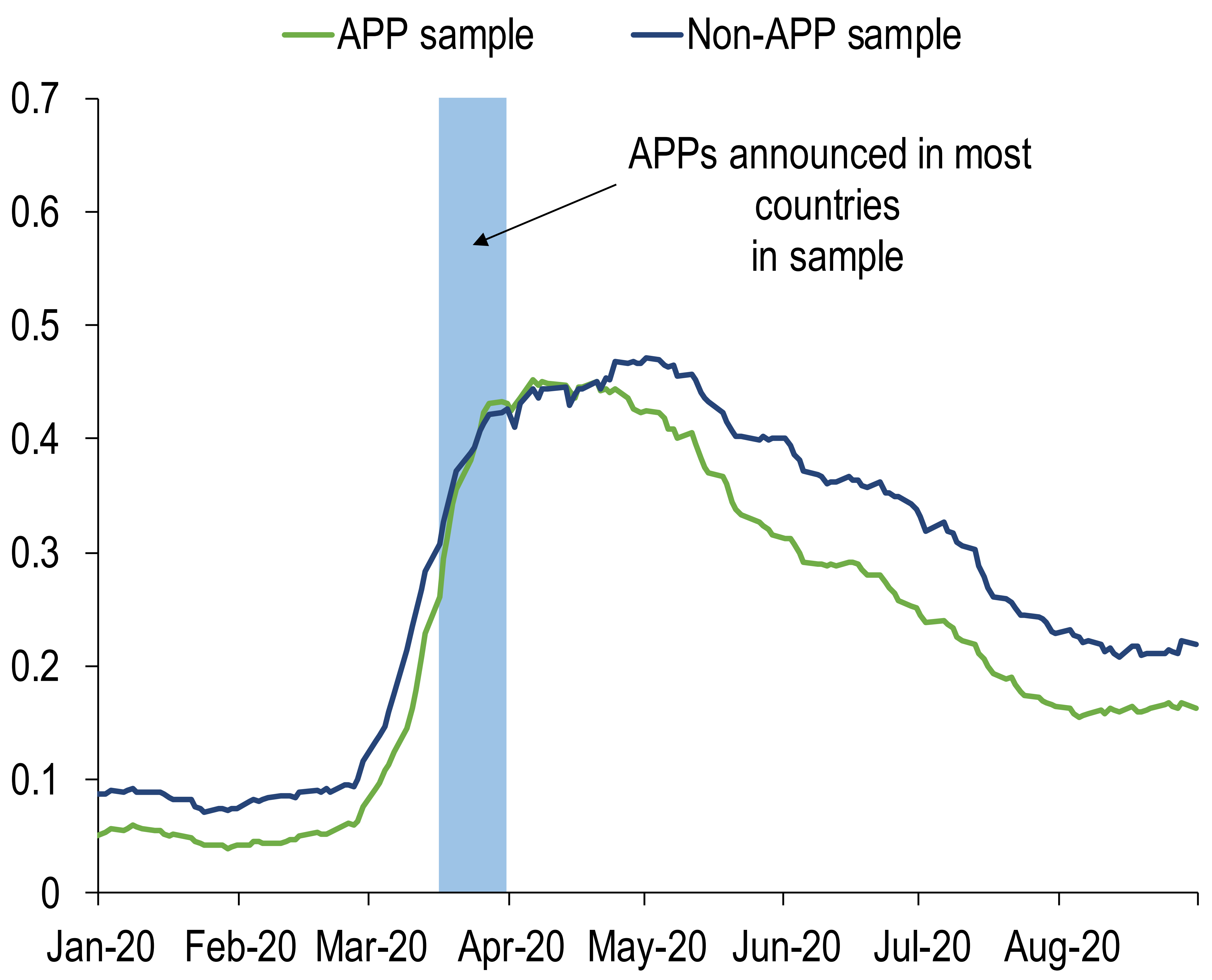


Risk of EM Outflows Has Declined; EM Local Markets Have Stabilized

EM Capital Flows at Risk
(Probability density function)



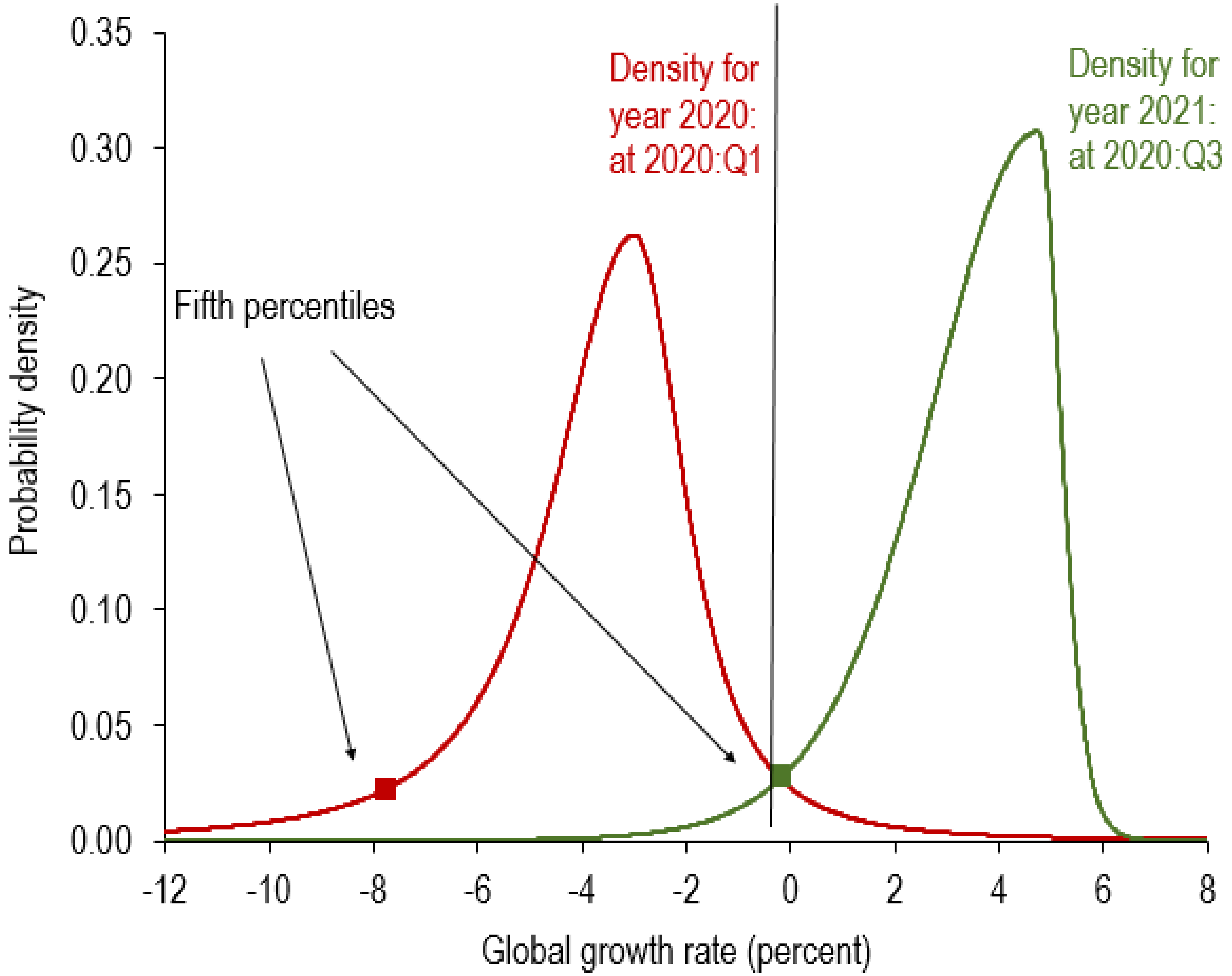
EM Local Stress Indices
(Index)



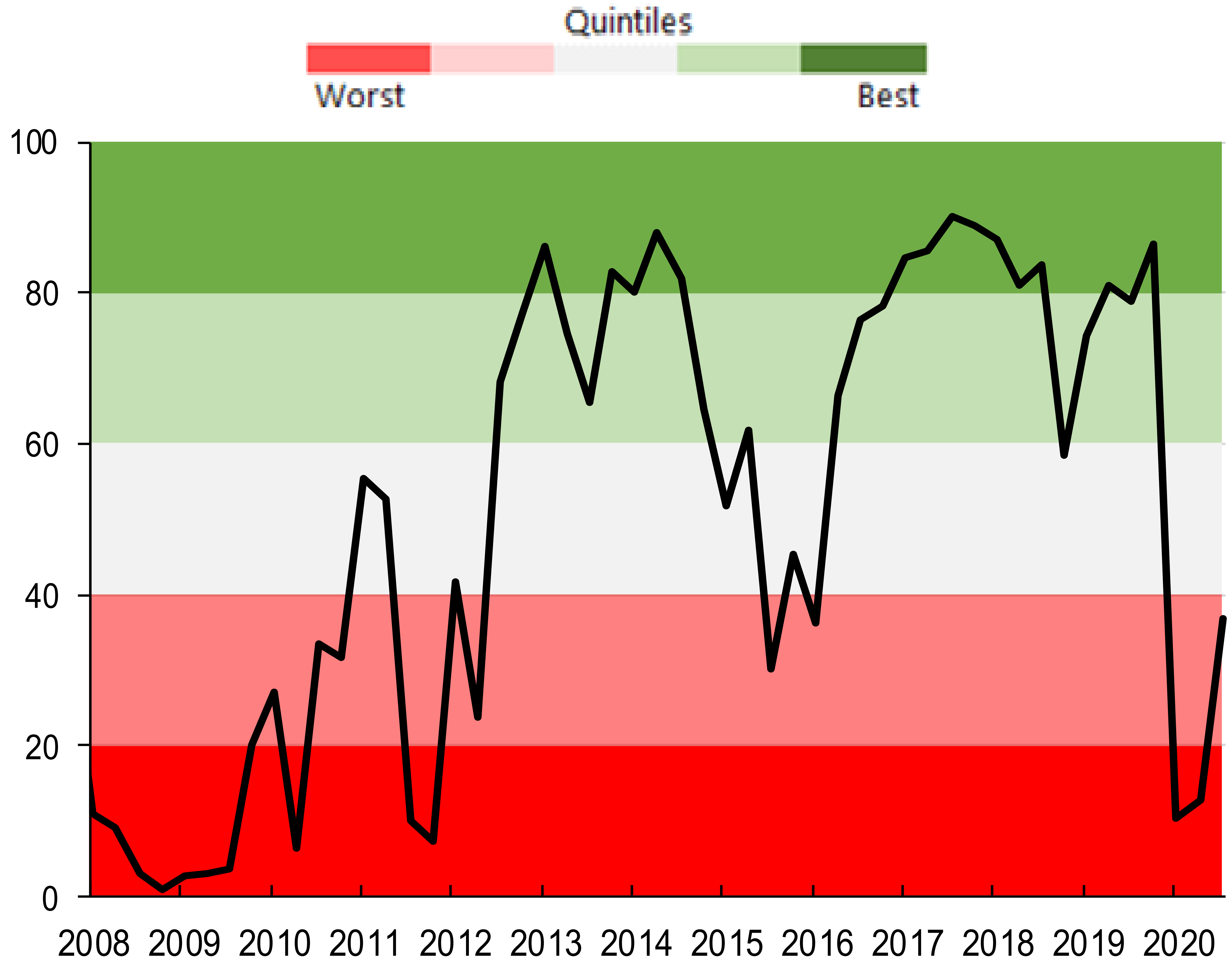
Note: "**APP economies**" refer to countries where the central bank deployed asset purchase programs

Global Financial Stability Risks Have been Contained

Near-Term Growth Forecast Densities
(Probability Densities)



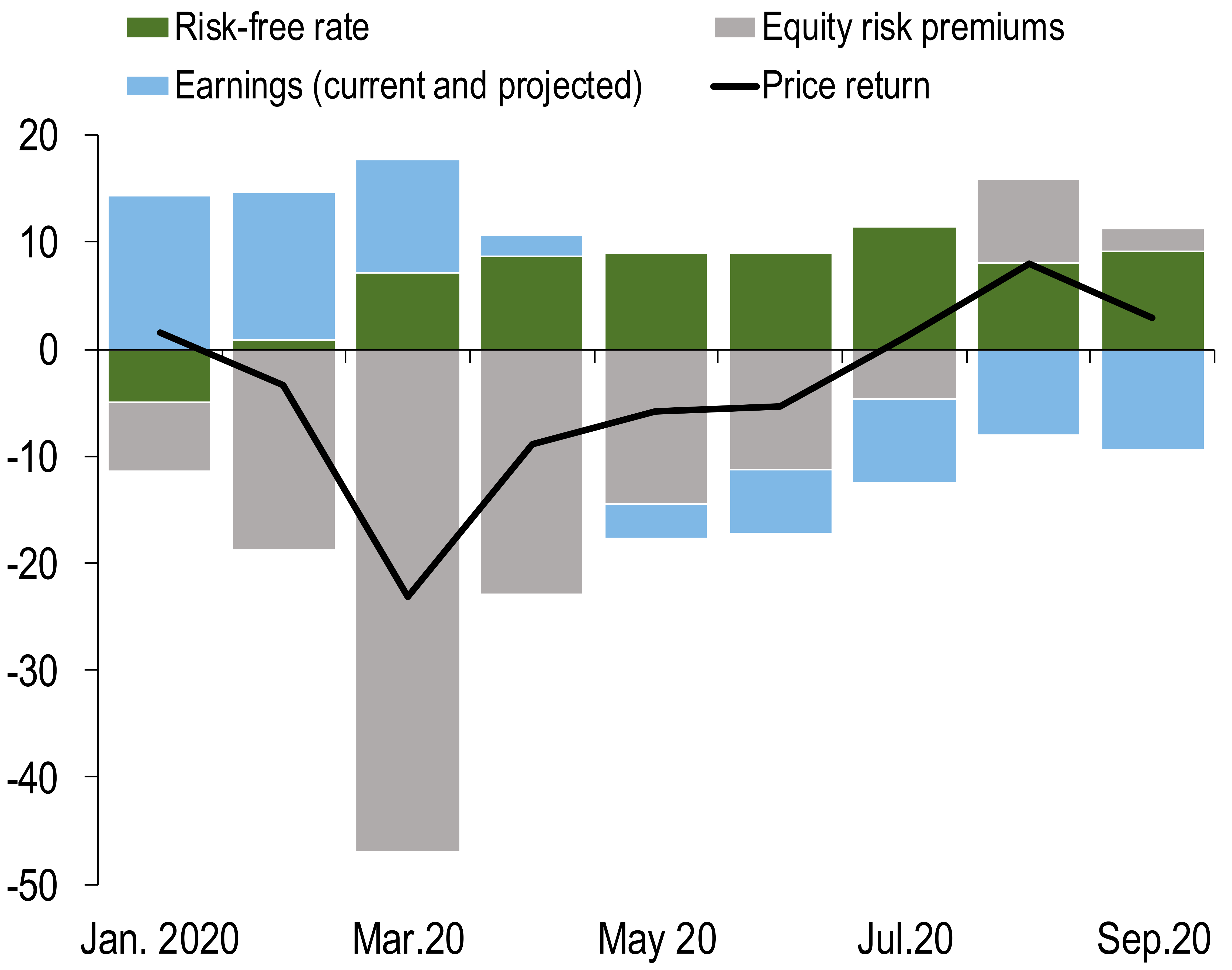
Near-Term Growth-at-Risk Forecasts
(Percentile rank)



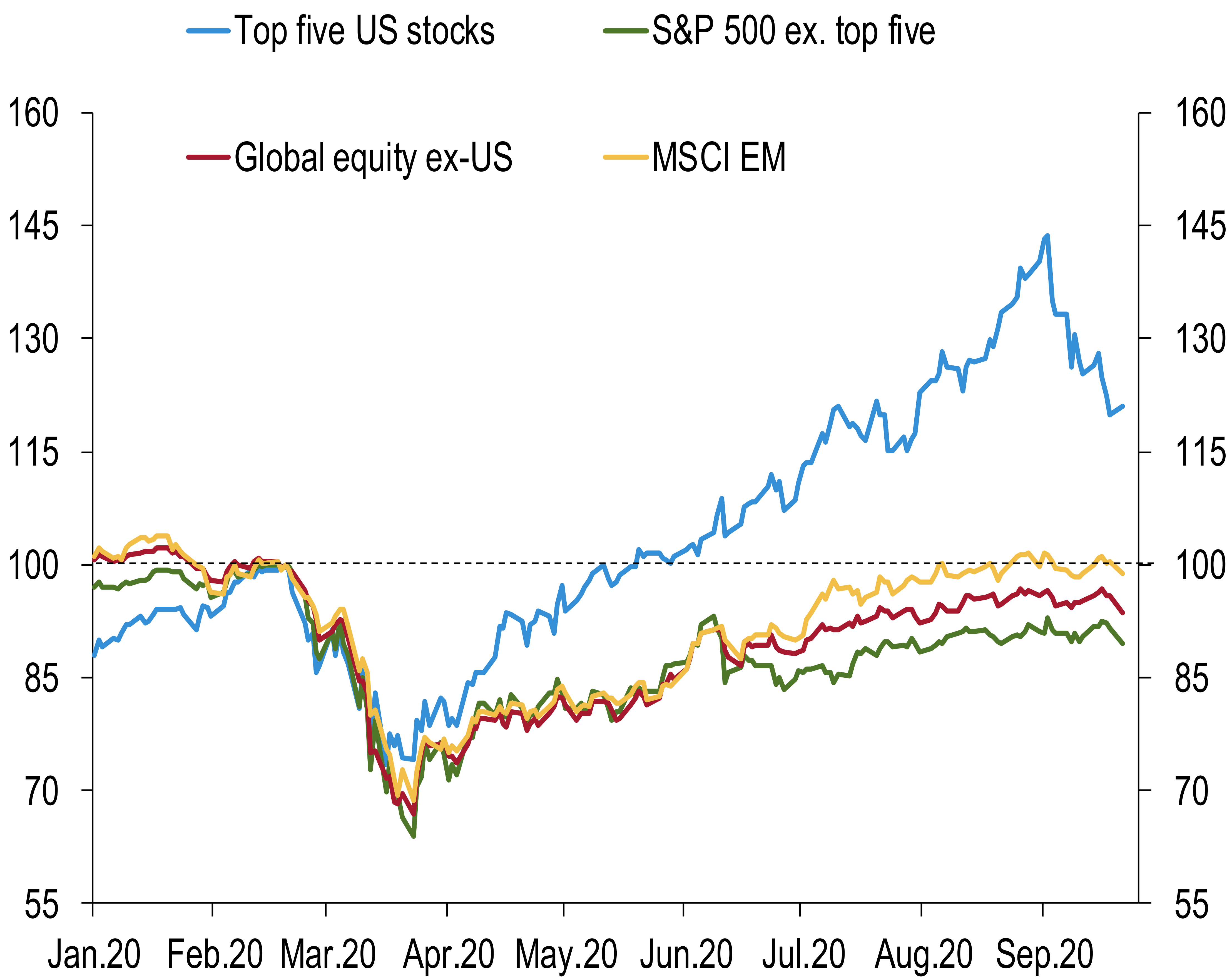
The Real-Financial Disconnect Persists

Strong Rebound Led to Stretched Valuations in Equity Markets…

S&P500: Decomposition of Equity Market Performance
(Percent contribution to cumulative returns)

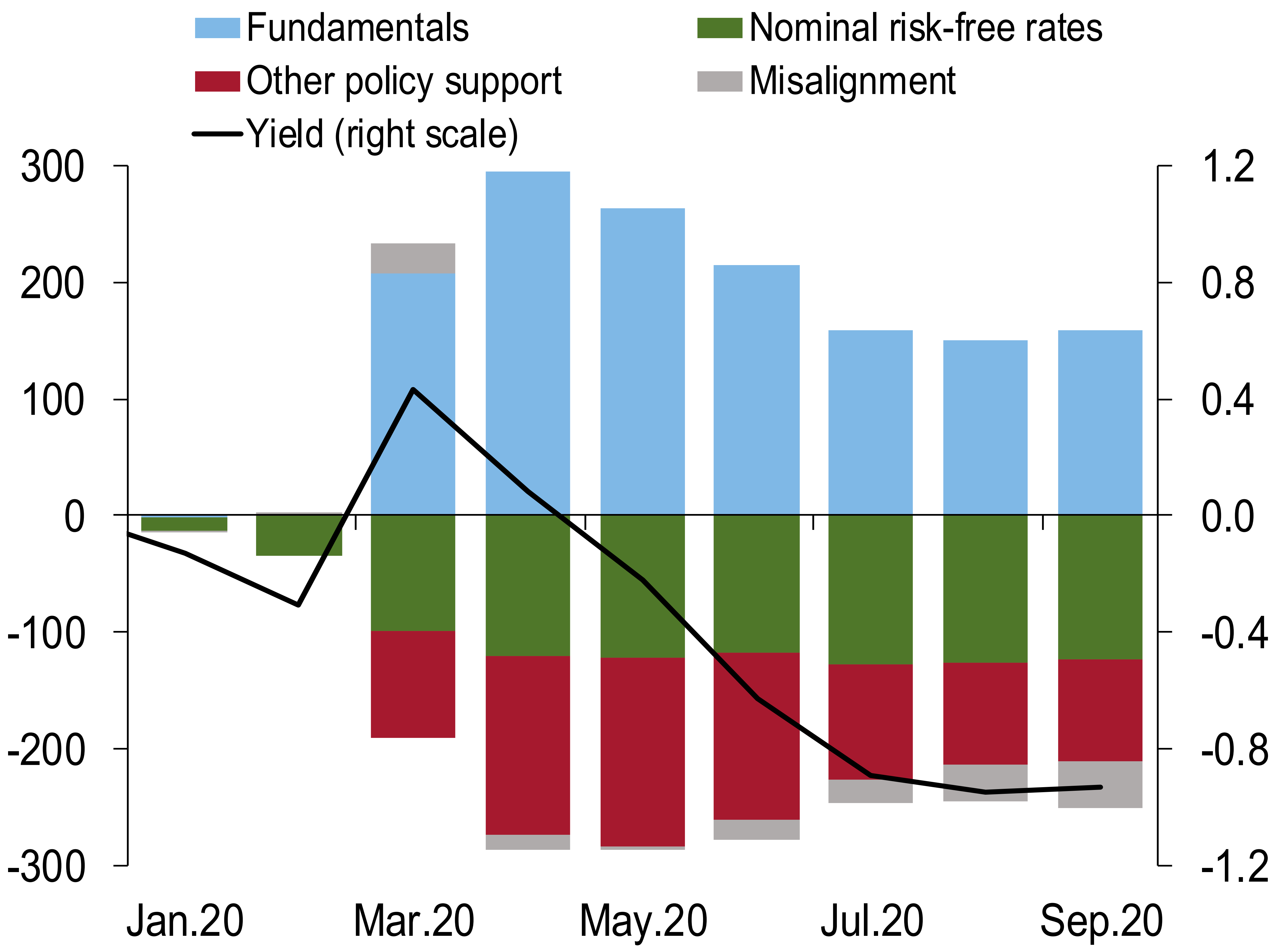


Global Stock Markets Performance
(Indices; 2/19/20=100)

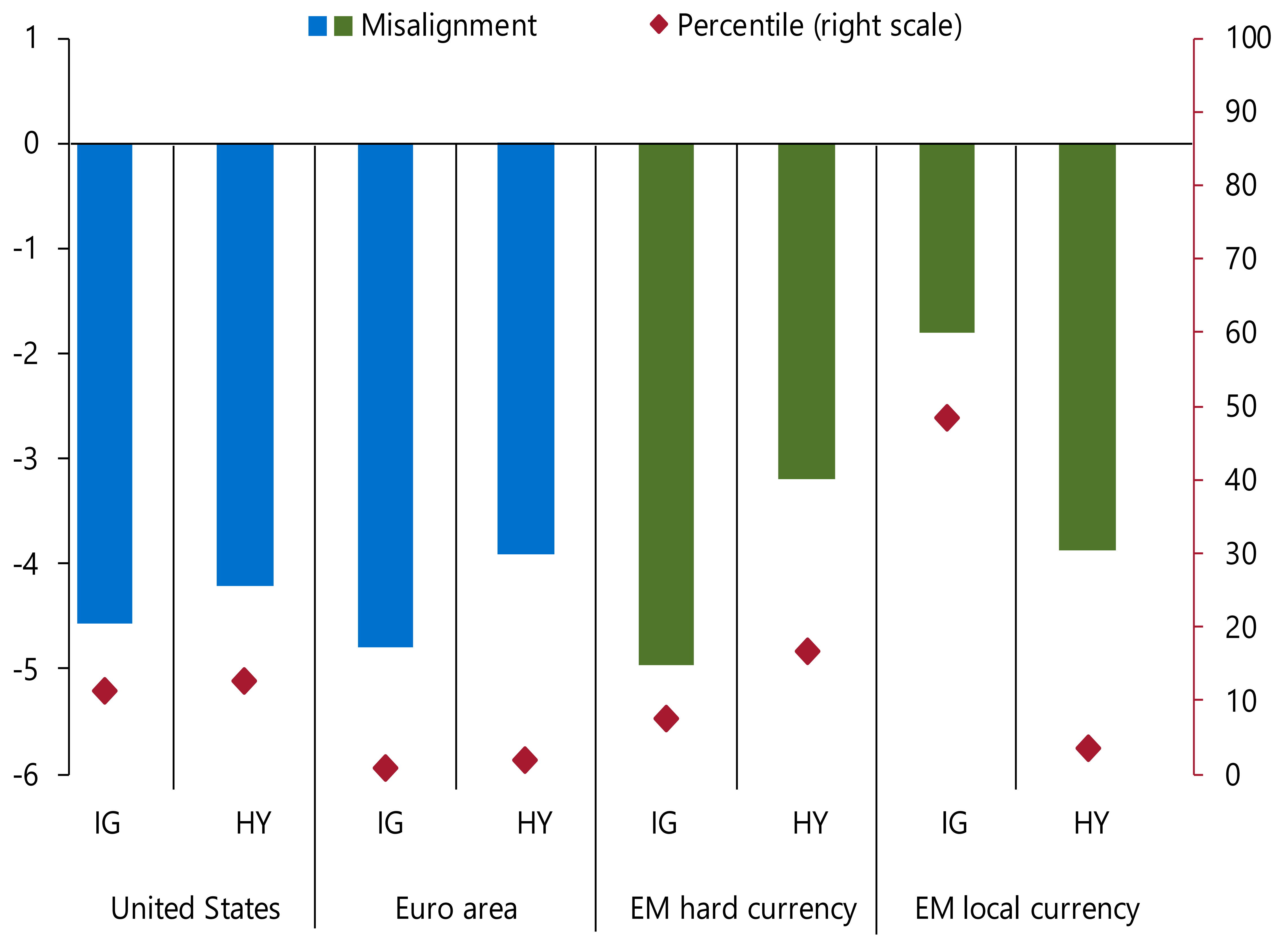


…and in Fixed Income Markets, Driven by Policy Support

Decomposition of Changes in US Investment-Grade Corporate Bond Yields
(Basis points, left scale; percentage points, right scale)



Bond Spread Misalignments, Q3 to date
(Deviation from fair value per unit of risk, left scale; percentile based on 1995–2020, right scale)

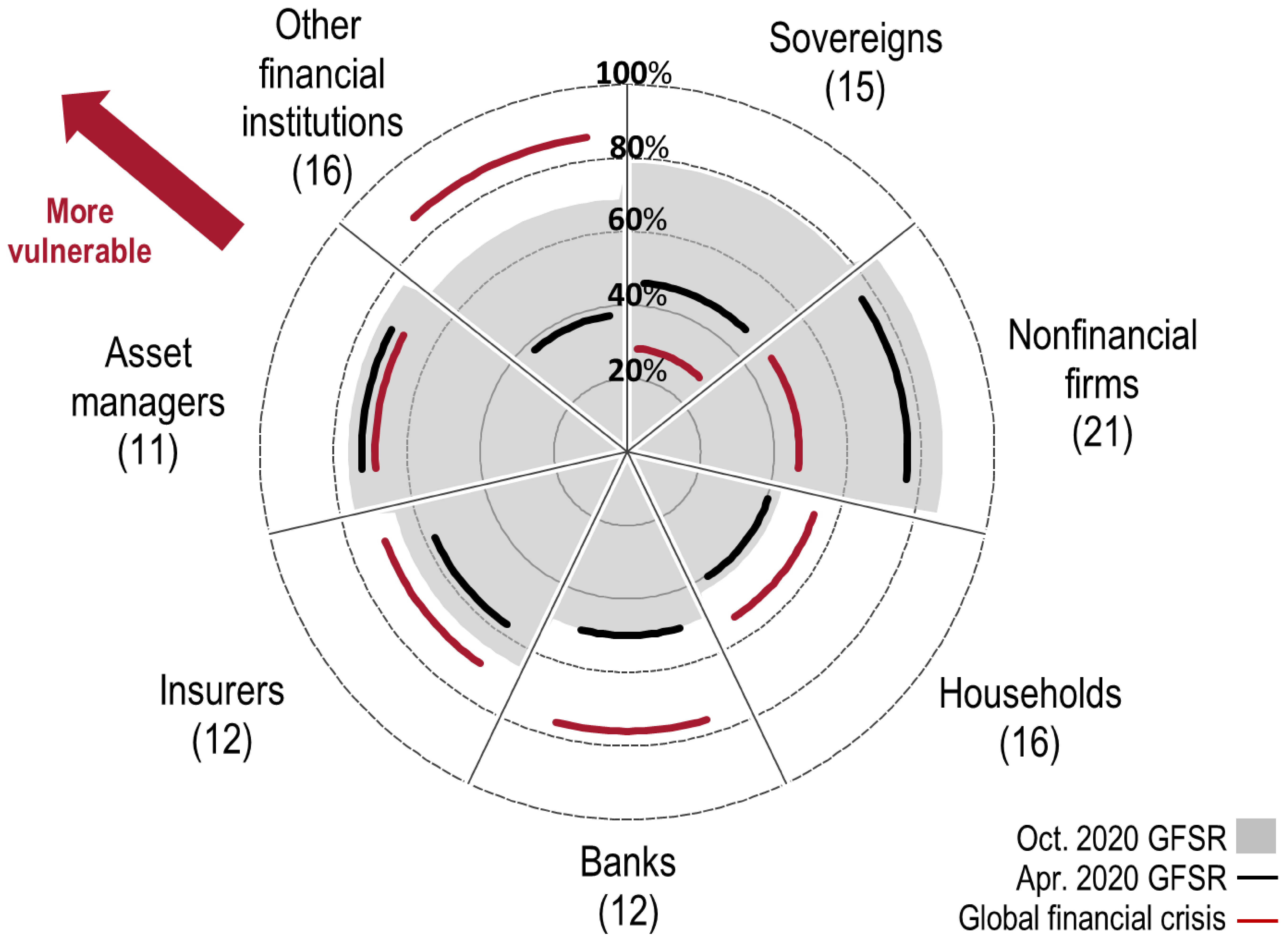


Note: For the LHS chart, the explanatory variables are economic (firm value) factors, uncertainty measures, leverage metrics and policy support factors. The policy support factors includes five variables: the size of the Federal Reserve's balance sheet, the number of announced policy measures, a dummy (0 before March 2020 and 1 thereafter), the amount of the Federal Reserve US dollar swap lines used (flow), and the outstanding amount of the Federal Reserve US dollar swap lines (stock). RHS chart is based on the 3-factor model (without "other policy support").

Vulnerabilities are rising…

Many Countries Entered the Pandemic with Pre-existing Vulnerabilities

Proportion of Systemically Important Countries with Elevated Vulnerabilities, by Sector
(Percent of countries with high and medium-high vulnerabilities, by GDP [assets for banks, asset managers, other financial institutions and insurers]; number of vulnerable countries in parentheses)



Corporate Sector: Policy Trade offs

From "whatever it takes" today…

More liquidity support today…

- Collapse in revenues led firms to increase borrowing
- Liquidity support kept bankruptcies at bay
- Impact uneven across countries and sectors

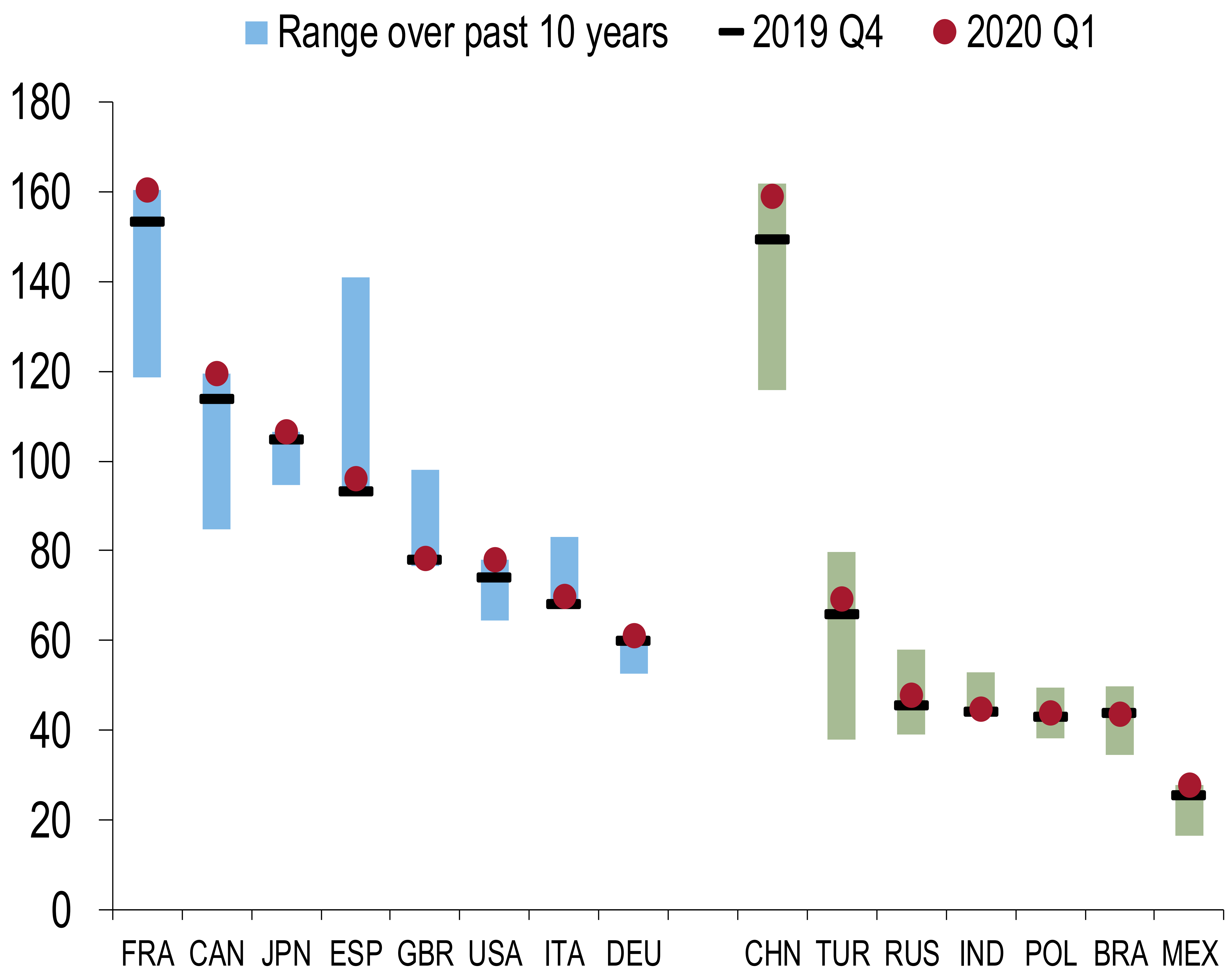
…to phasing out extraordinary policy support

… solvency risks shift into the future

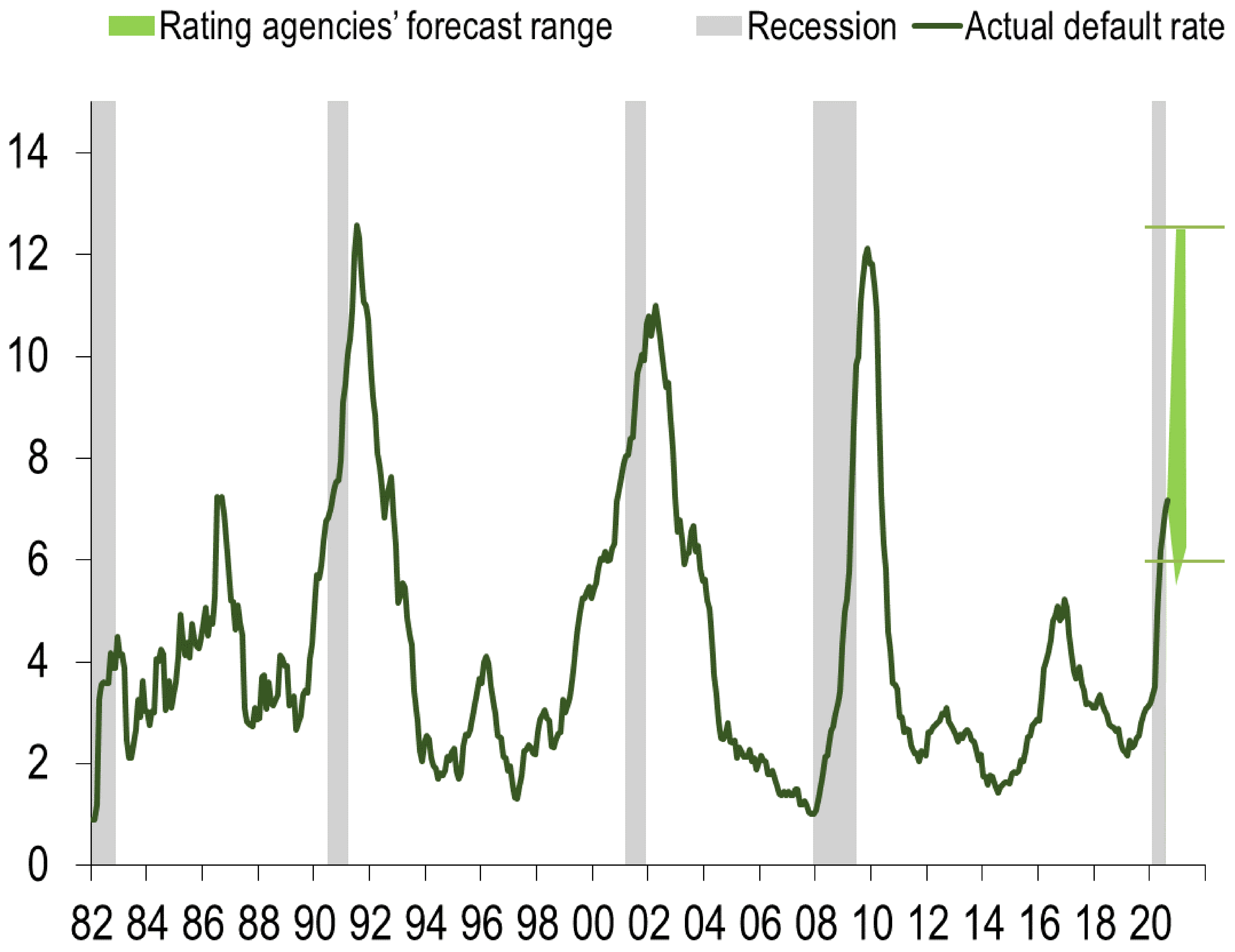
- Liquidity extended to nonviable firms
- Debt overhang
- Misallocation of resources

Corporate Debt and Expected Defaults Are Rising

Aggregate Corporate Debt
(Percent of GDP)

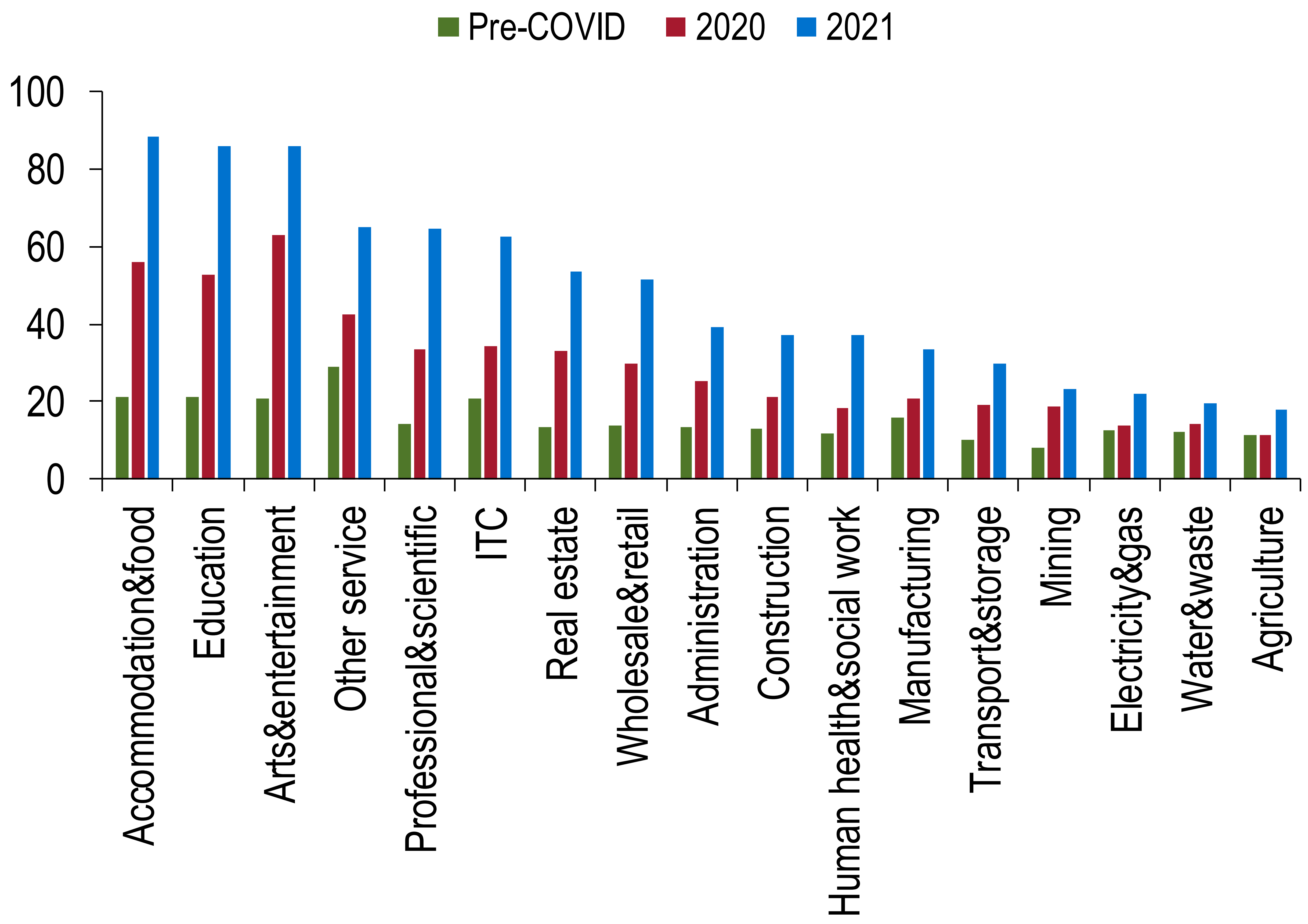


US Speculative-Grade Default Rate: Actual and Forecasts by Credit Rating Agencies
(Trailing 12-month rate, percent)

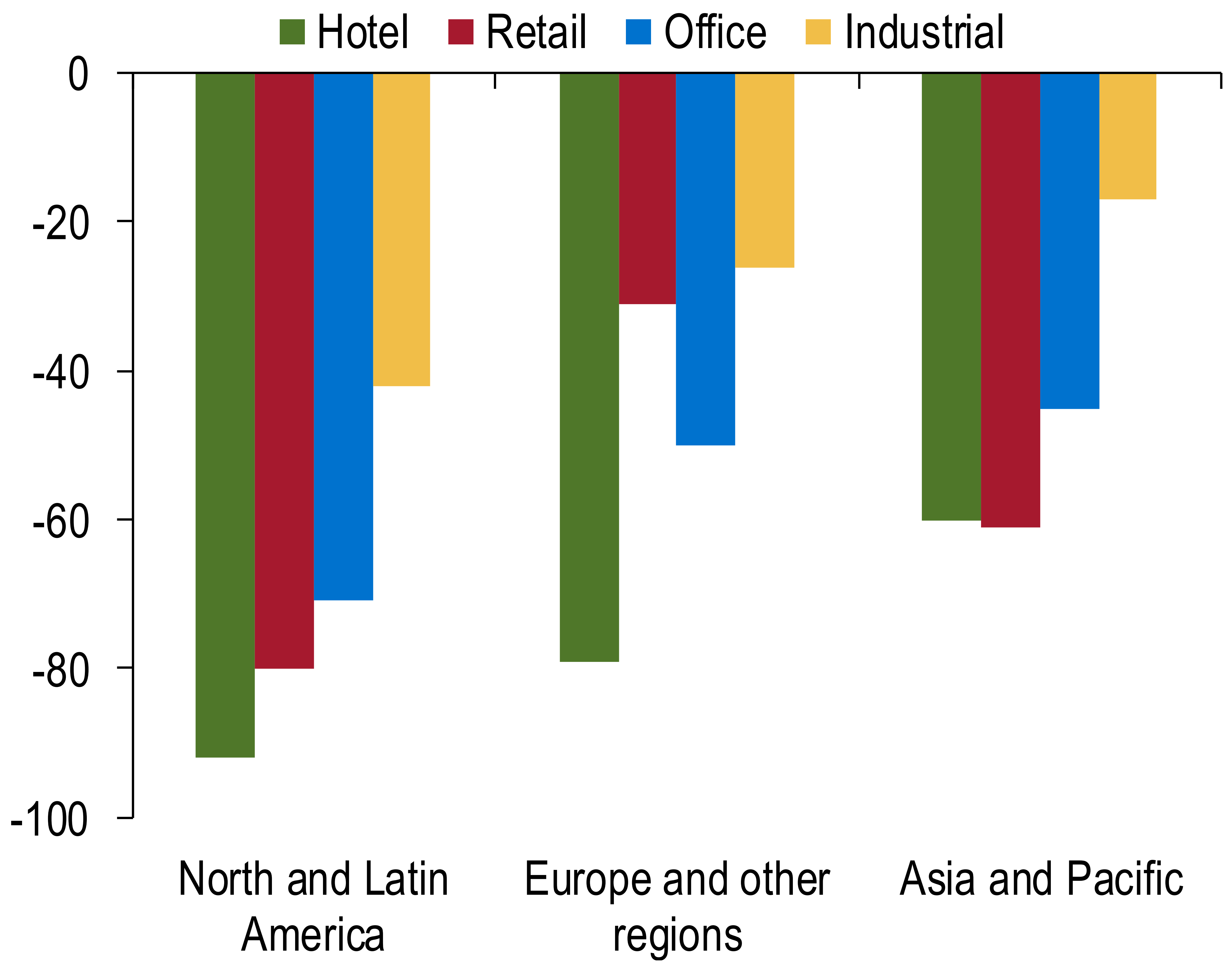


Notably in Vulnerable Sectors: SMEs and Commercial Real Estate

SMEs' Solvency Risk under Baseline Model-Based Scenario: Share of Debt with "Interest Coverage Ratio" ICR< 1 by Sector
(Percent of total debt)



Change in Commercial Real Estate, Transaction Volumes
(Percent, 2020:Q2 versus 2019Q2)



Note: The LHS charts shows the results of the scenario analysis based on the methodology of Gourinchas et al (forthcoming), which allows firms to optimize choices of labor and other inputs in response to economy-wide and sector-specific shocks. The debt projections assume that firms are able to meet their liquidity shortfalls in 2020 by issuing new debt and interest payments are deferred to 2021".

Banks: Policy Trade offs

From "whatever it takes" today…

Greater use of buffers by banks today…

- Banks entered the crisis with strong capital & liquidity
- Borrower support policies and flexibility in regulatory frameworks have further supported bank lending

…to phasing out extraordinary policy support

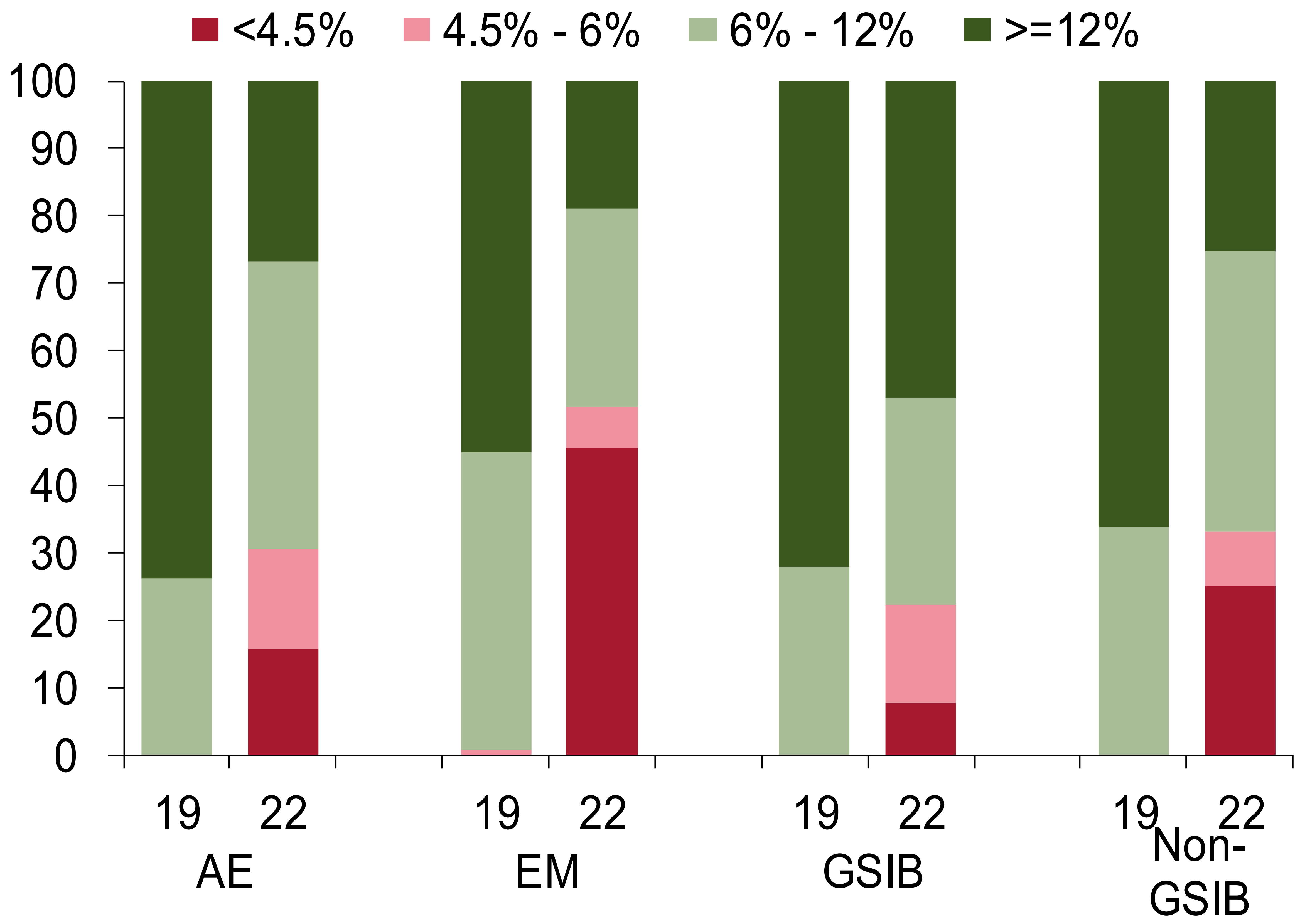
… less capacity to lend tomorrow

With low profitability & rising NPLs ahead, depletion of capital & liquidity buffers may

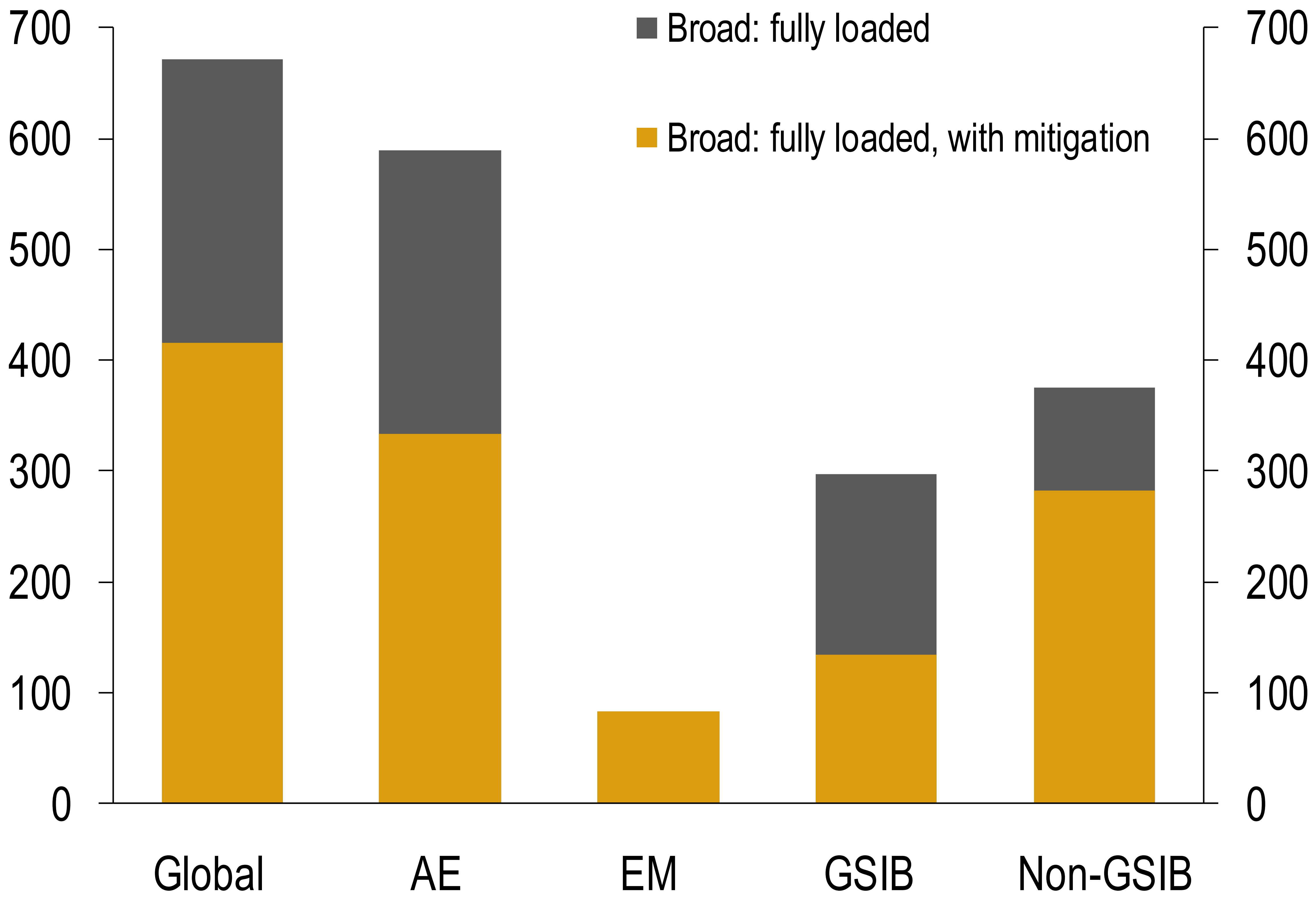
- leave banks vulnerable
- and force them to scale back lending

Banks May Face Sizable Losses in the WEO Adverse Scenario

Distribution of Bank Assets by Capital Ratio under Adverse Scenario, with Policy Mitigation:
(CET 1 ratio, percent)



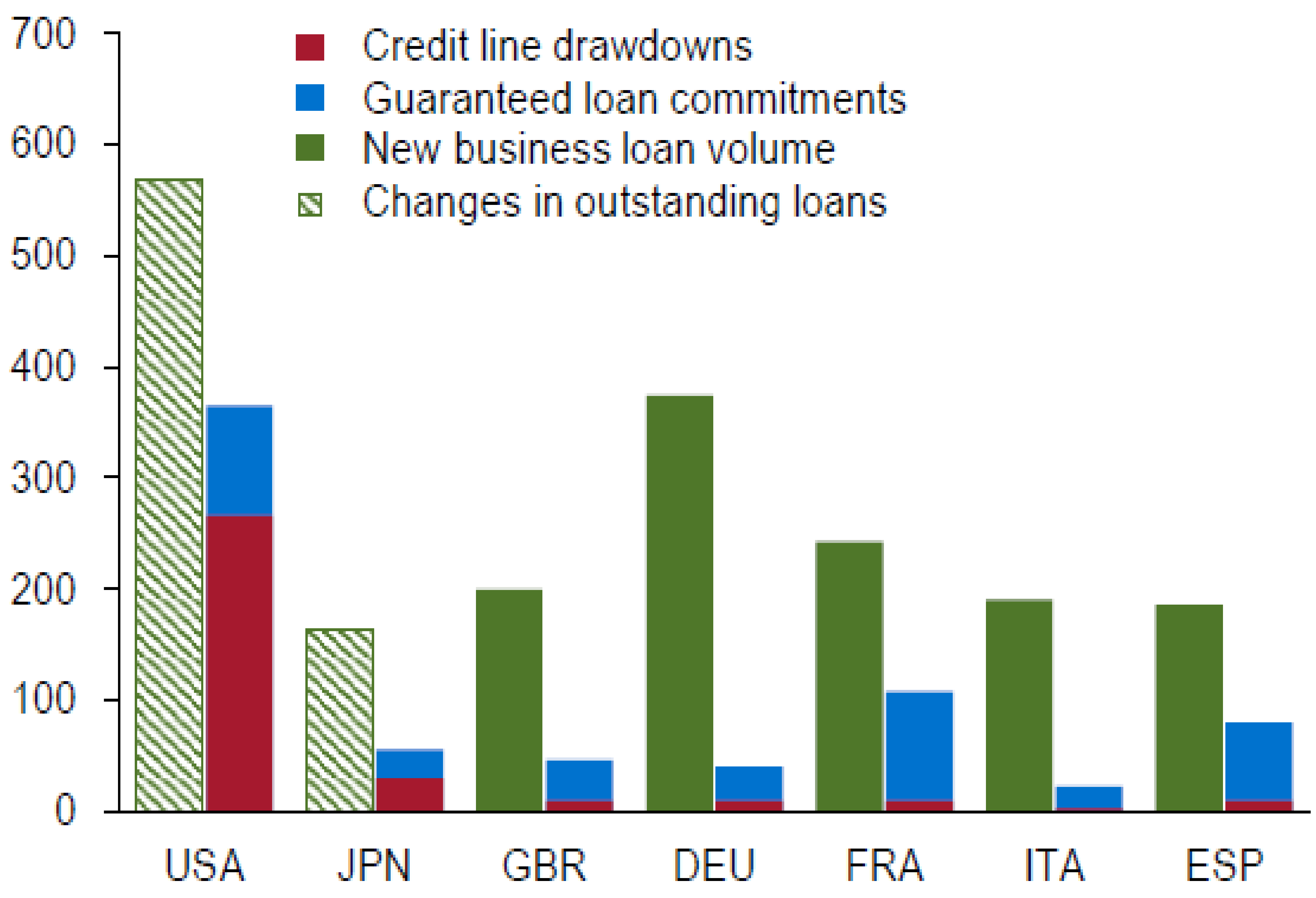
Broad Capital Shortfall under Adverse Scenario
(Billions of US dollars)



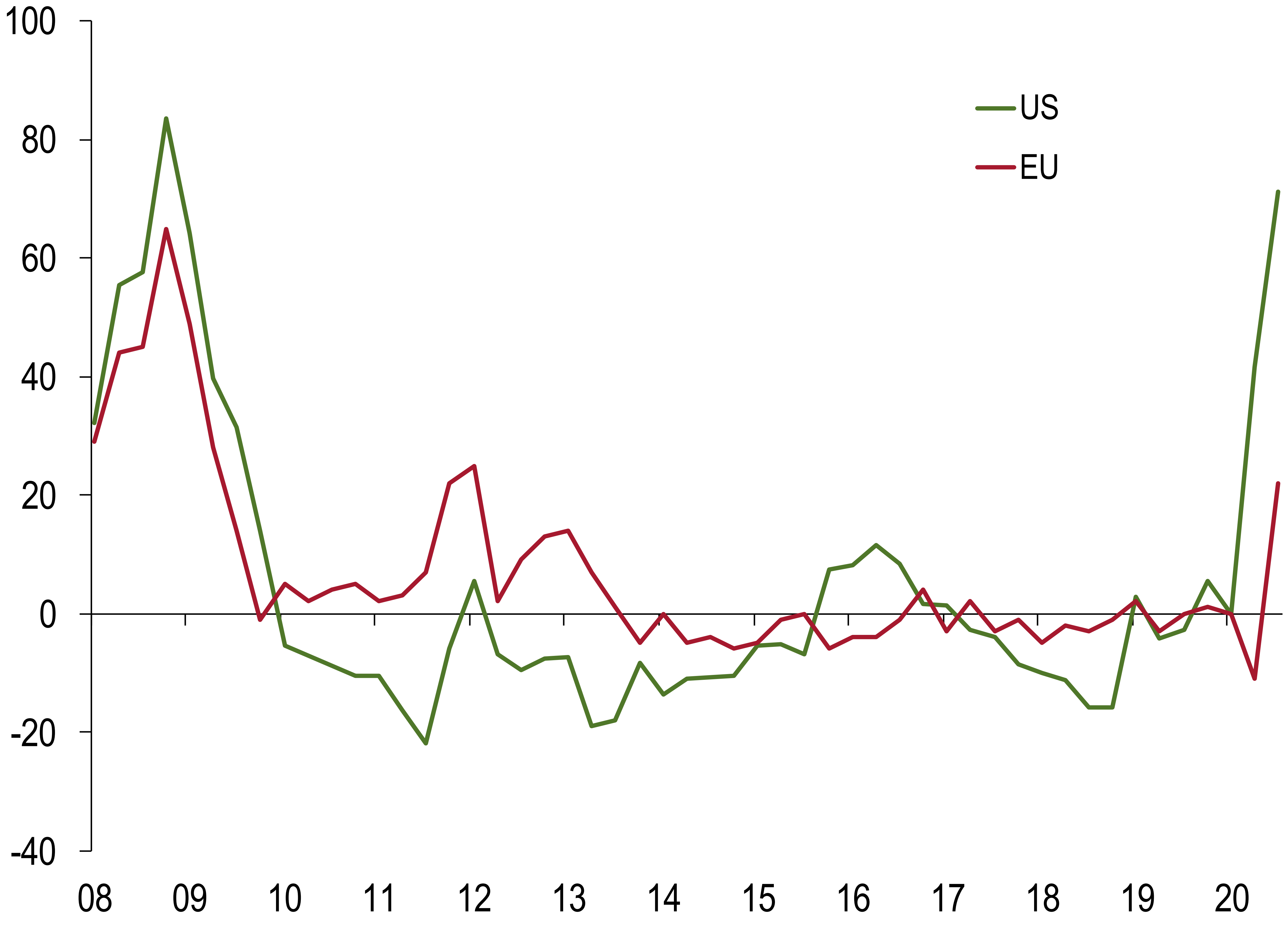
Sample: ~350 banks in 29 systemically important jurisdictions.
Note: The shortfall (RHS chart) is measured against bank-specific and fully loaded capital requirements, including a minimum CET1 of 4.5%, a GSIB buffer, a systemic risk buffer, a stress capital buffer, a conservation capital buffer, and a countercyclical capital buffer.

Banks Begin to Prepare for Tough Times Ahead

New Loans, Credit Lines, and Government Guarantees, in Major Advanced Economies, 2020
(Billions of USD)



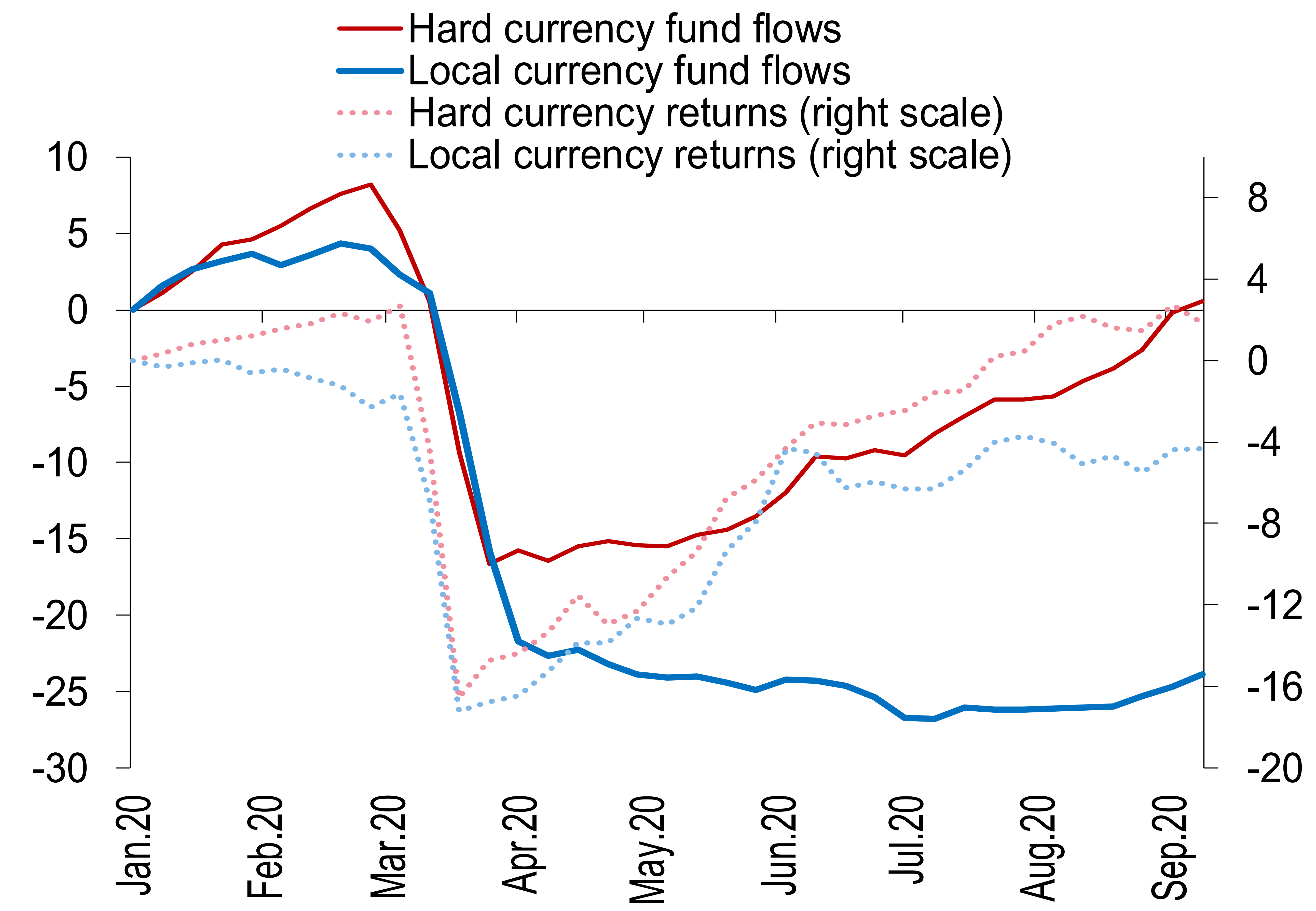
Bank Lending Standards
(Net percentage of banks reporting tighter lending standards)



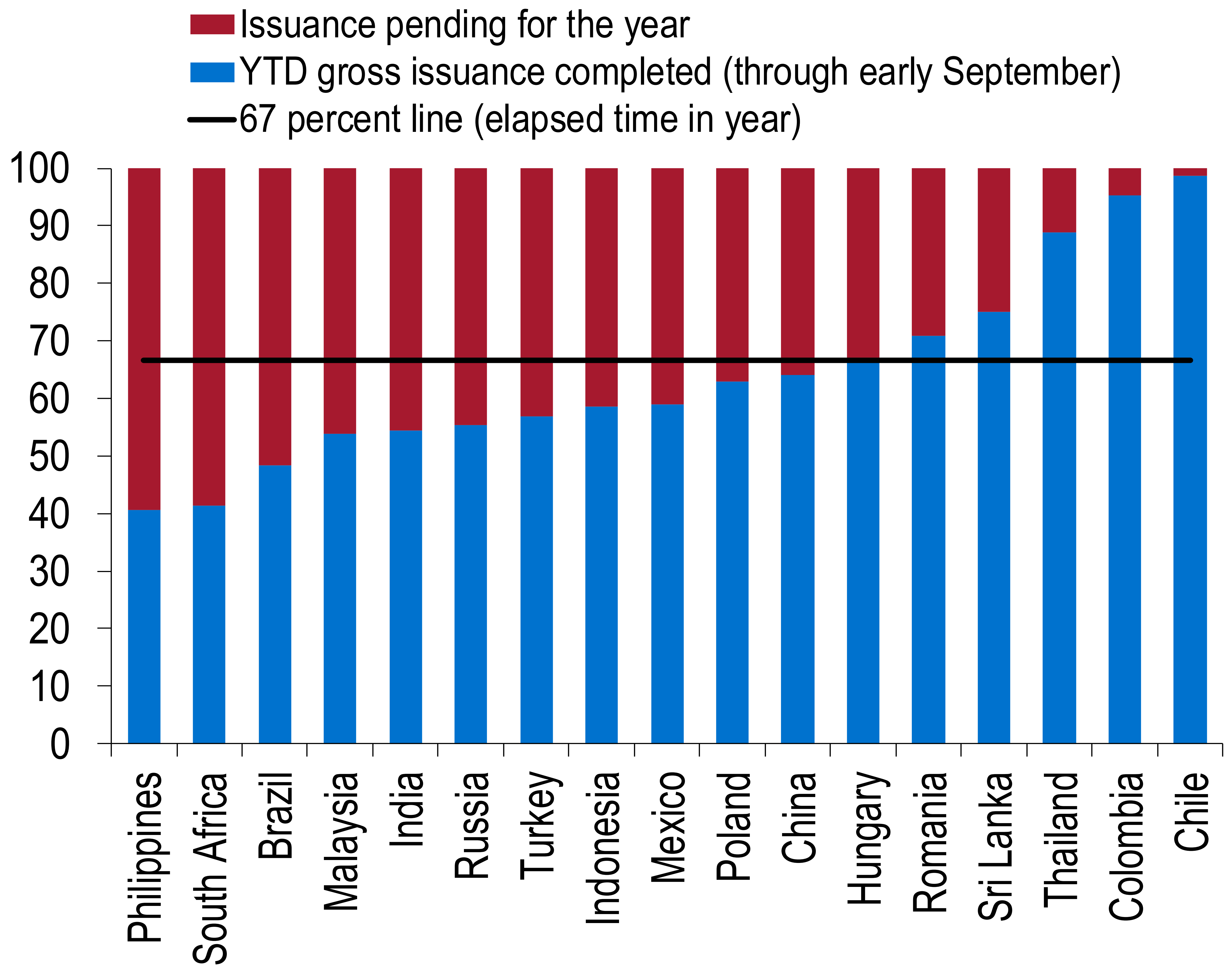
Emerging and Frontier Markets Face Financing Challenges

Some Emerging Markets Face Financing Challenges

EPFR Global Emerging Market Debt Dedicated Fund Flows and Returns (Cumulative, year to date, billions of US dollars, left scale; percent, right scale)

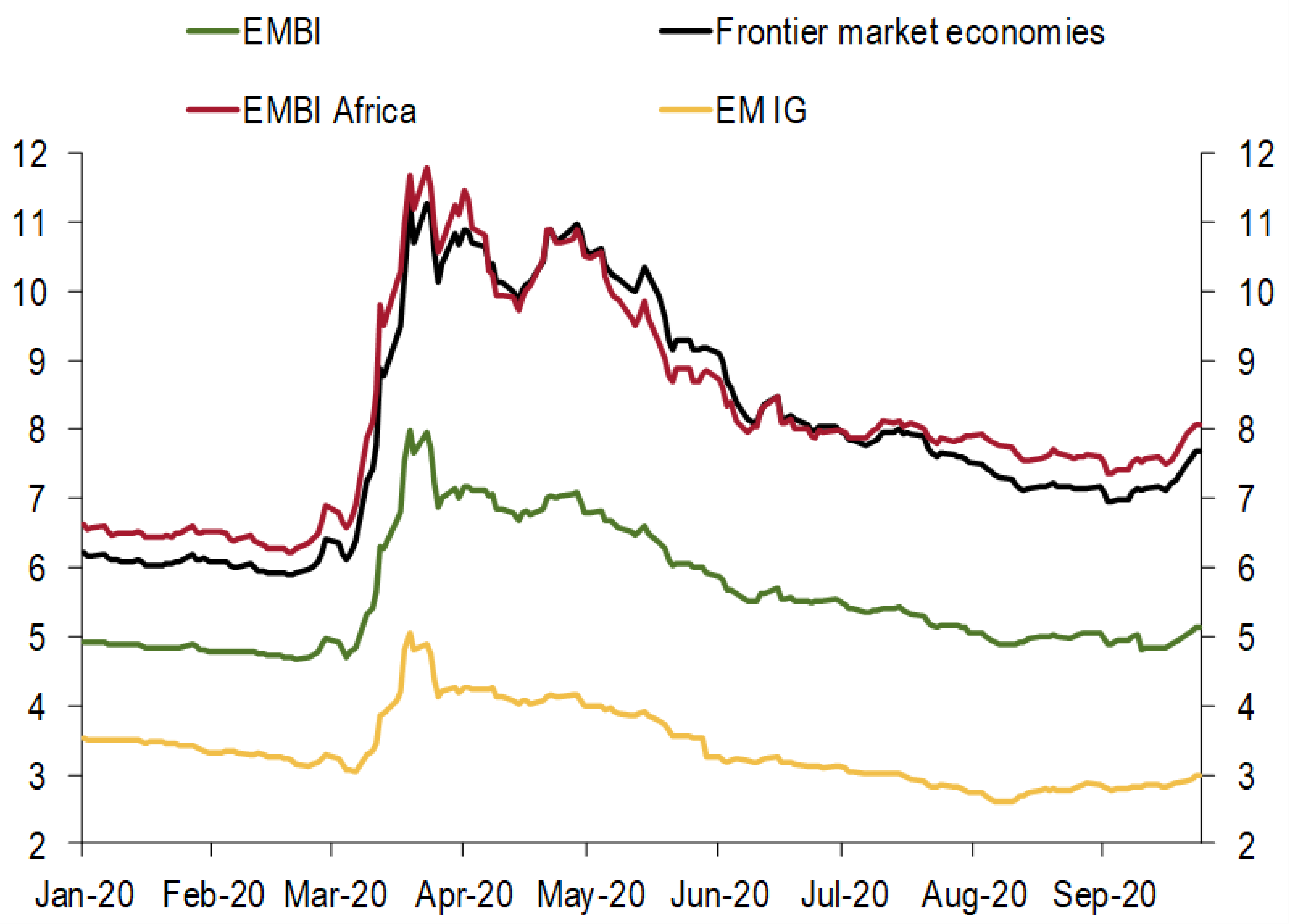


Local Currency Government Bond Gross Issuance Completed Relative to Estimated Total Issuance (Percent of total)

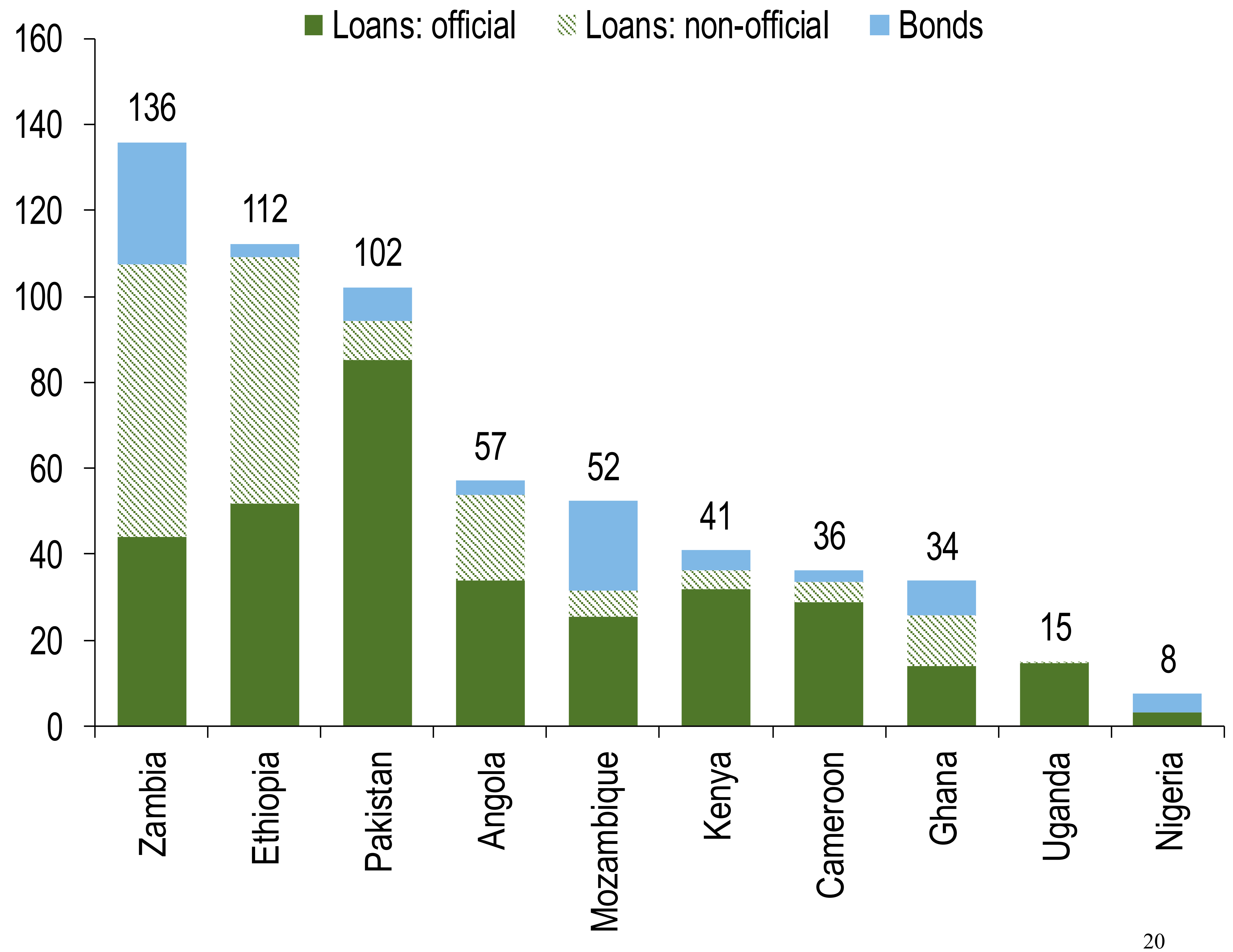


Funding Costs for Frontier Markets Are High; Some Lost Market Access

Hard Currency Bond Yields in EMs and FMs
(Percent)



External Debt-Service, through the End of 2021
(Share of foreign reserves, percent, as of July 2020)

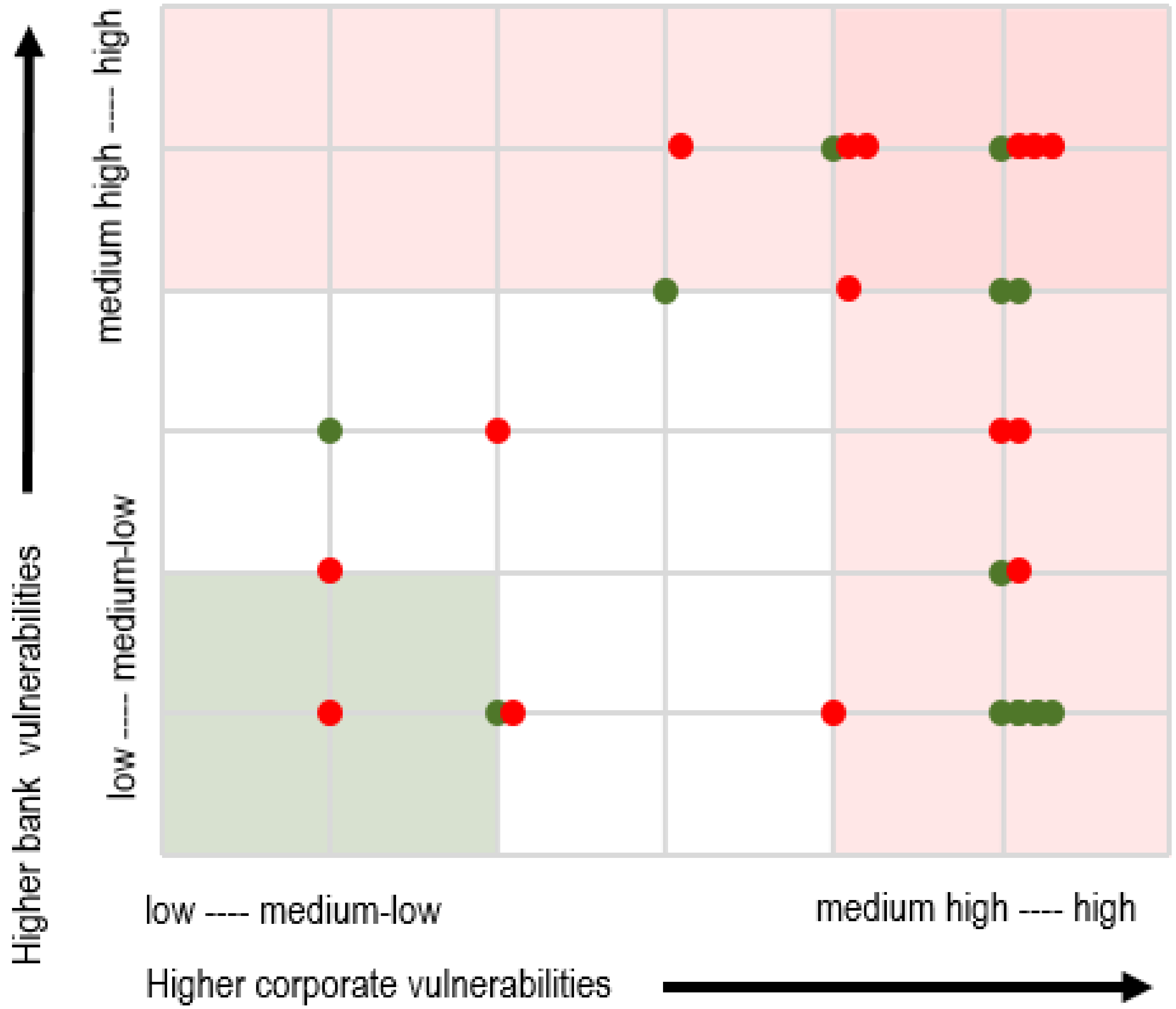


Policy Priorities

Vulnerabilities in Multiple Sectors; Policy Space Shrinking

Corporate, Bank, and Sovereign Vulnerabilities in the S29 Economies

Red dots denote countries with medium-high or high sovereign vulnerabilities



A Bridge to Recovery: Policy Trade offs

Unprecedented policy support has:

- Kept markets functioning
- Maintained the flow of credit
- Avoided adverse macro-financial feedback loops…
- …and widespread bankruptcies

Near-Term Policies

- **Monetary policy**: maintain accommodation
- **Liquidity support**: continue but adjust pricing to incentivize exit
- **Banks**: encourage the use of capital and liquidity buffers
- **Borrower support**: extend moratoria (if needed); facilitate debt restructuring; efficient out-of-court workouts
- **Sovereigns**: support EMEs and LIDCs with financing difficulties

… **but may exacerbate future vulnerabilities:**

- Real-financial disconnect
- Rising debt and insolvencies
- Depletion of bank buffers
- Excessive risk-taking

Medium- and Longer-term Policies

- **Monetary** accommodation until objectives achieved
- **Liquidity support:** withdraw gradually once pandemic under control
- **Banks:** rebuild buffers & reduce problem assets over time
- **NBIFs**: enhance the regulatory framework
- **Debt overhang**: recapitalize/restructure/resolve nonviable firms
- **Lower for longer:** contain excessive risk-taking via prudential policies

A Bridge to Recovery

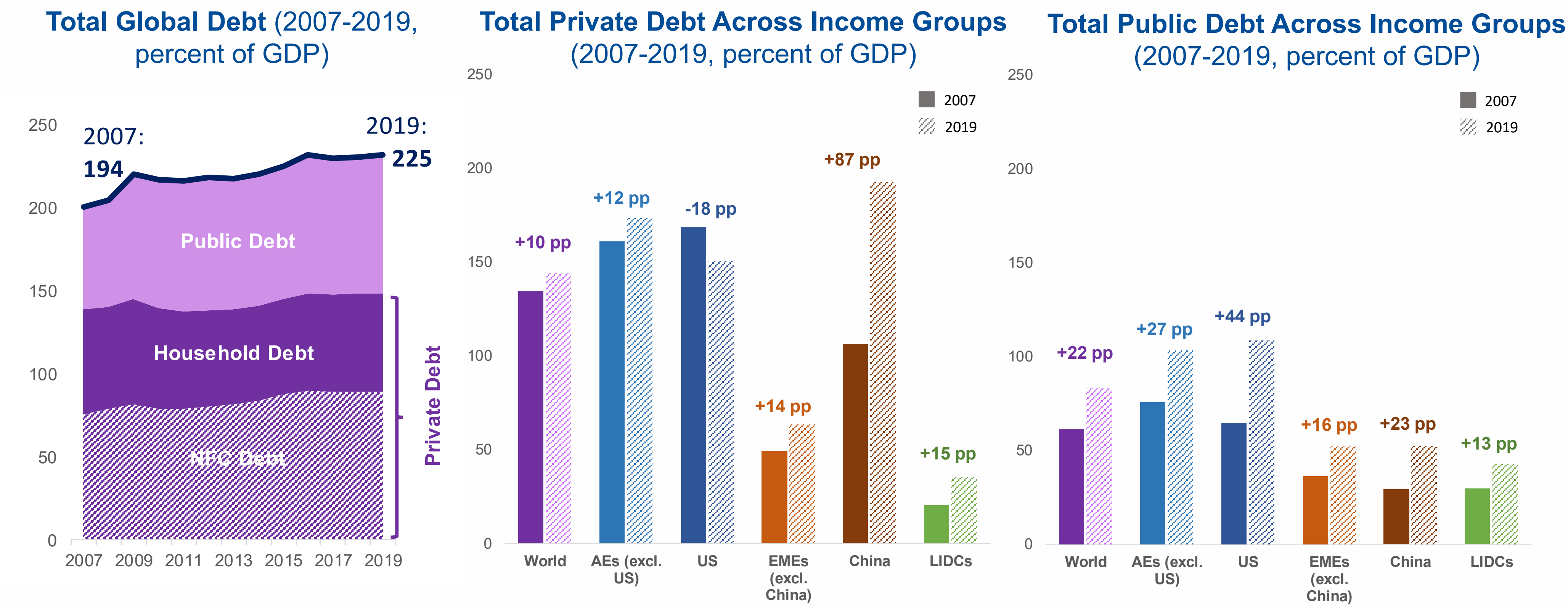
FISCAL AFFAIRS

World Economic and Market Developments

SEPTEMBER 30, 2020

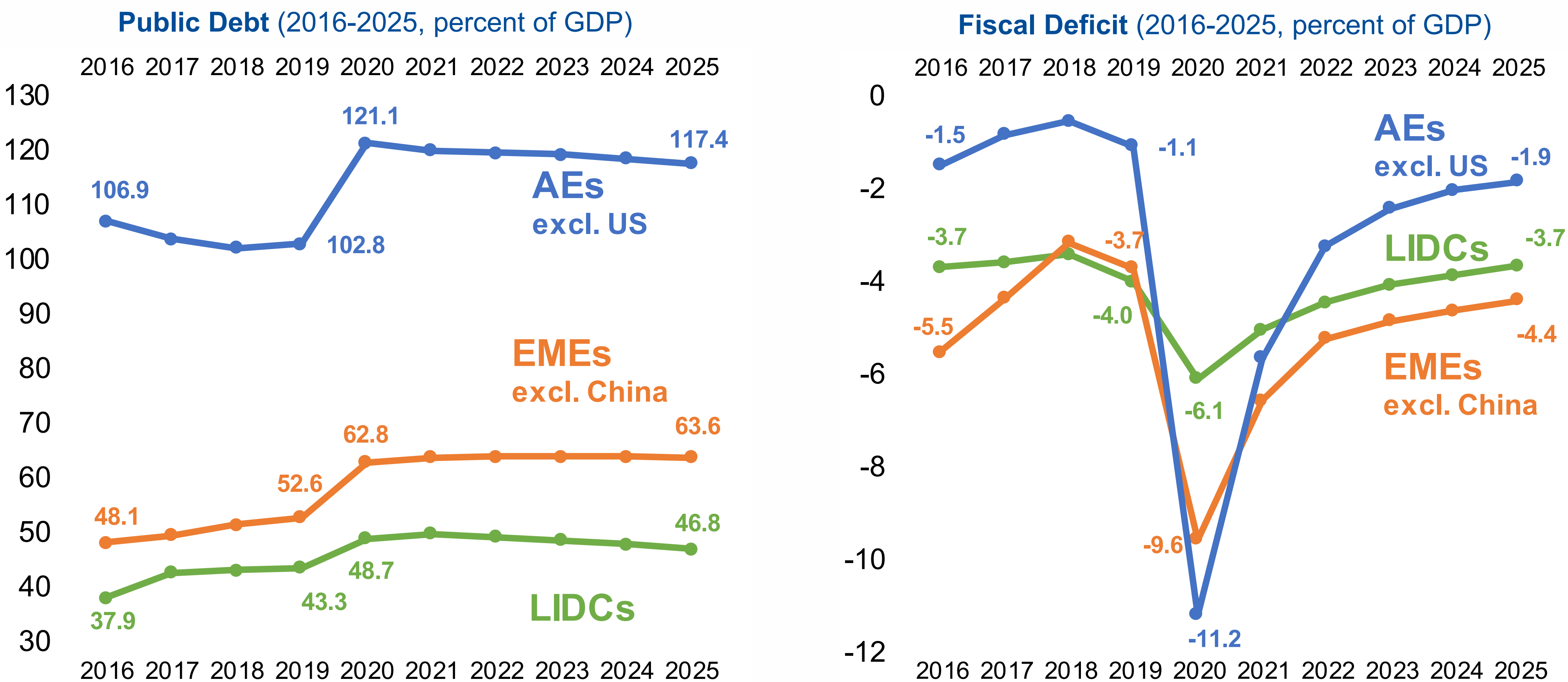
Vitor Gaspar
Director
Fiscal Affairs Department

Debt Legacies



Source: Global Debt Database (September, preliminary estimates)
Note: Public Debt refers to the largest category of debt available (Non-Financial Public Sector, General Government and Central government, in decreasing order). Private debt includes only loans and securities. All income and regional groups follow WEO's methodology. Total Debt (as a percent of GDP) will be close but not exactly equal to the sum of the public and private debt. This is because of the difference in country coverage for the corresponding variables - which causes the corresponding country weights to differ.
NFC = nonfinancial corporations.

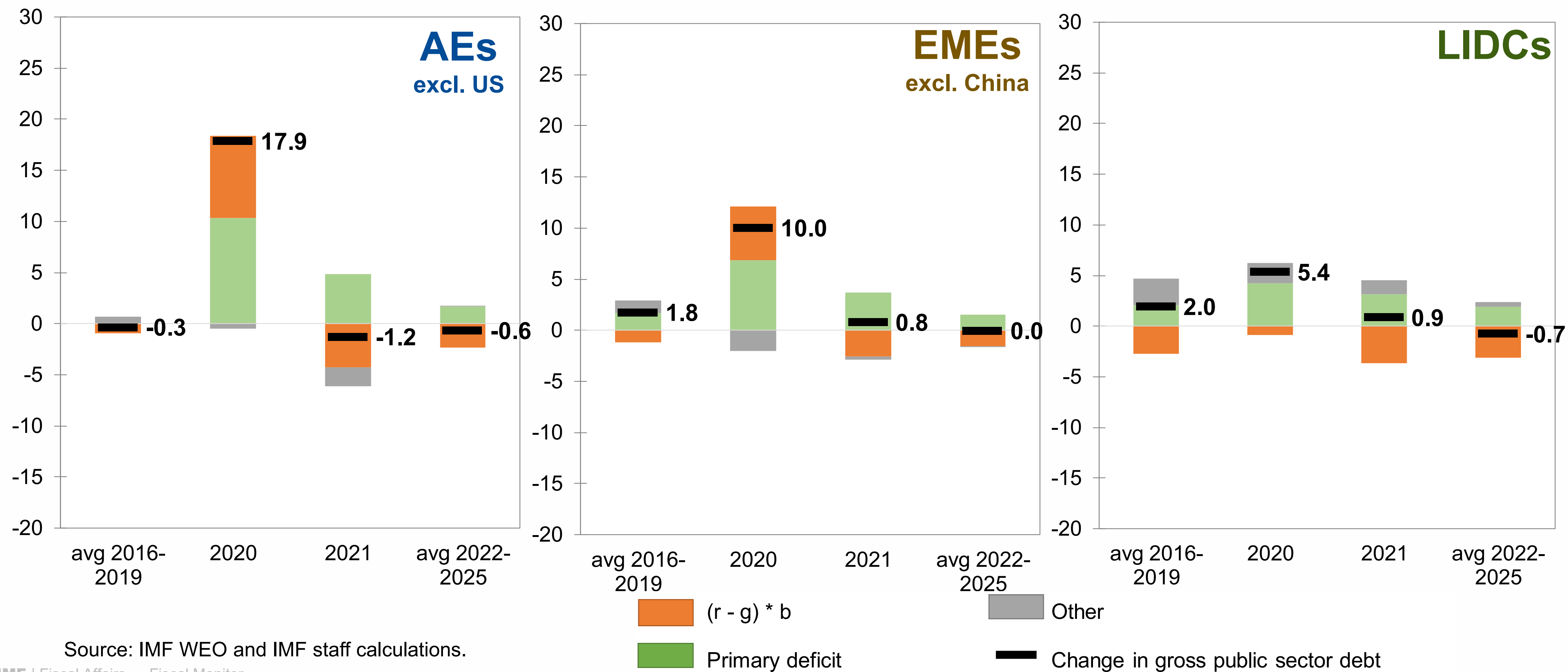
Debt and Deficits, 2016-2025



Source: IMF Fiscal Monitor and IMF staff calculations.
Global public debt (in percent of GDP) 2016: 82.7 / 2019: 83.0 / 2020: 98.6 / 2025: 100.0
Global fiscal deficit (in percent of GDP) 2016: -3.5 / 2019: -3.9 / 2020: -12.7 / 2025: -4.5

Drivers Of Debt Dynamics

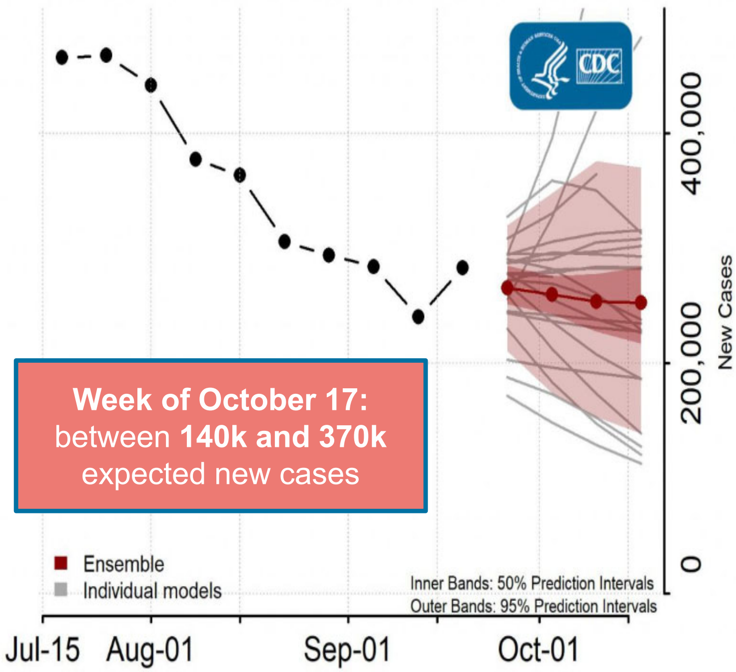
Decomposition of the Change in Public Debt
(percent of GDP)



Source: IMF WEO and IMF staff calculations.

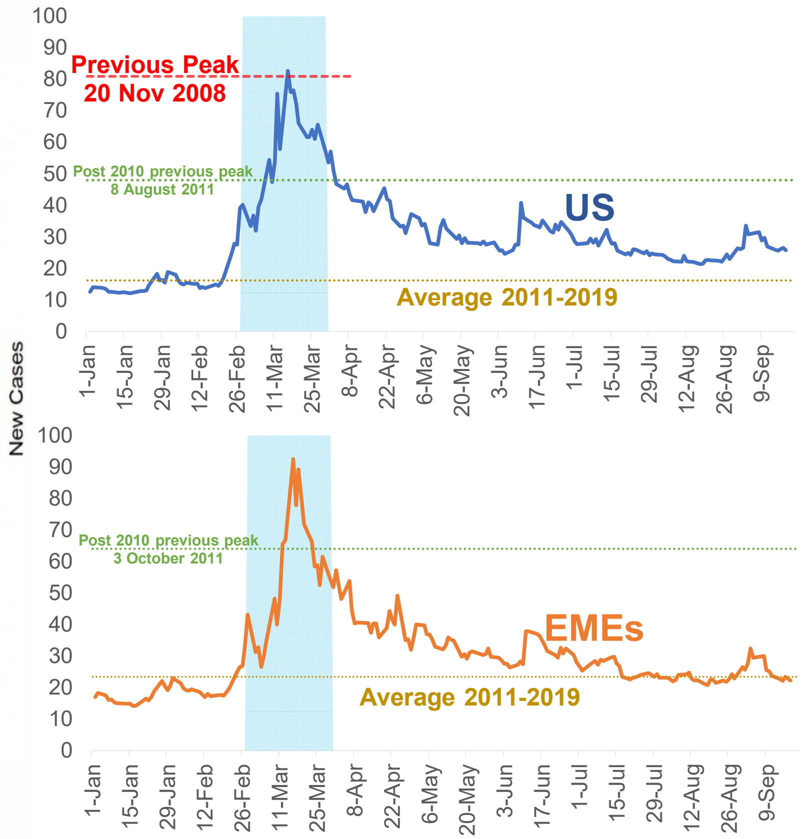
Uncertainty Is Still High

US: Ensemble National Forecast for New Weekly COVID-19 Cases



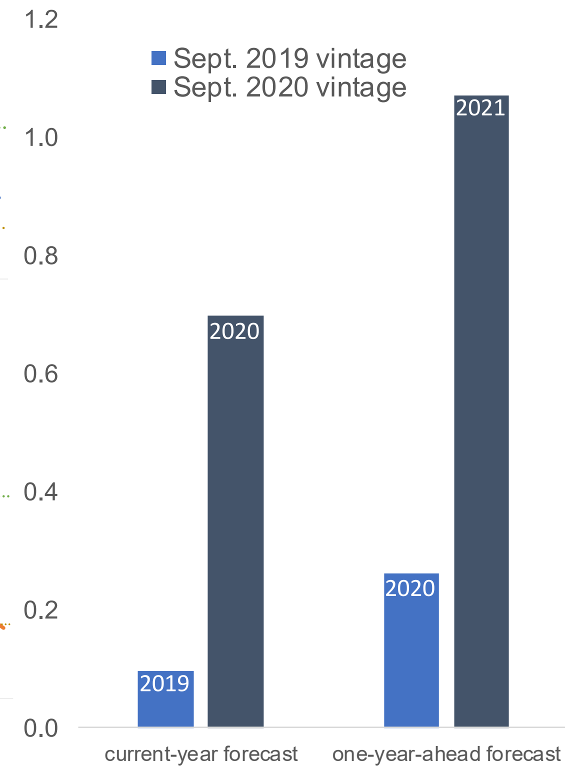
Source: CDC.

Market Volatility Indices in the US and EMEs



Sources: CBOE, Haver Analytics, IMF Staff calculations.

Standard Deviation of Real GDP Growth Forecasts (median among G7 countries)

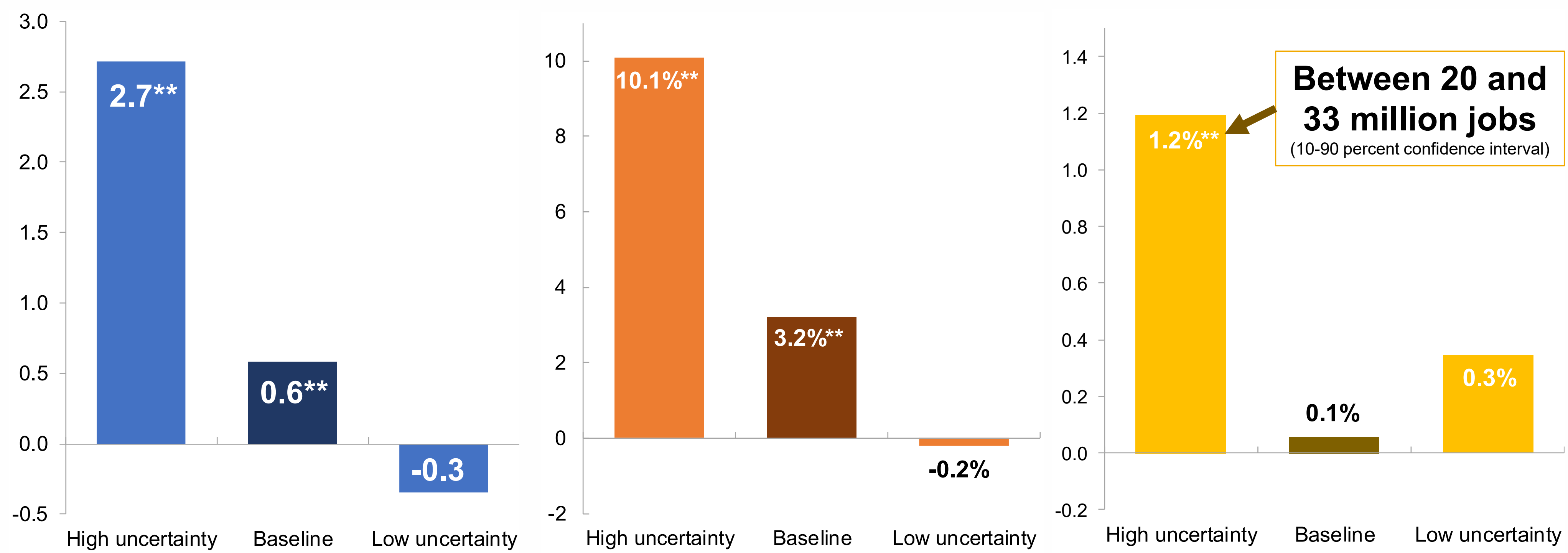


Sources: Consensus Economics, IMF Staff calculations.

In Uncertain Times, Public Investment Brings Significant Macroeconomic Benefits in the Short To Medium Term

Two-year-ahead macroeconomic effects of a one-percent-of-GDP unexpected increase of public investment (AEs and EMEs)

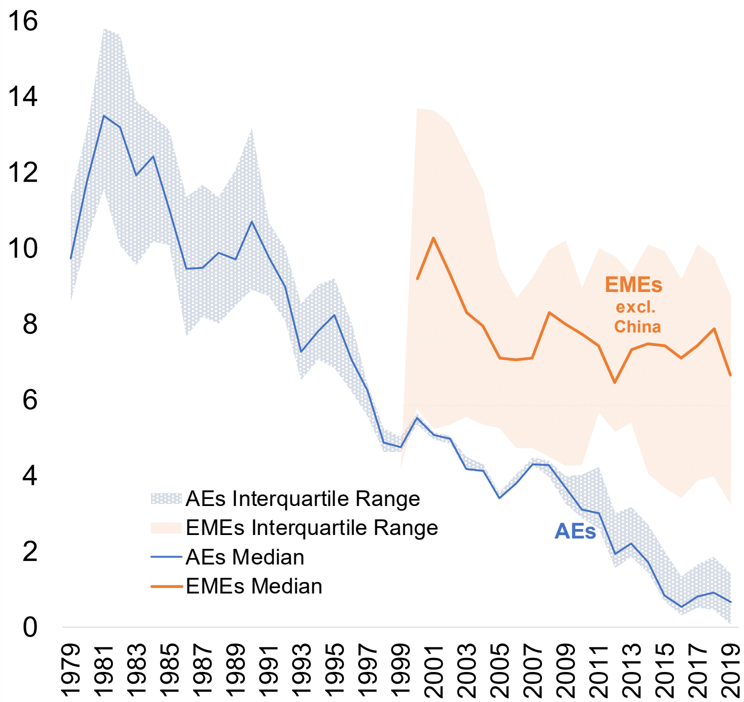
1. Fiscal Multiplier **2. Private Investment** **3. Employment**



Source: IMF staff estimates. Note: Panel 1: two-year fiscal multipliers of public investment; Panel 2: semi-elasticity of private investment to public investment; Panel 3: semi-elasticity of employment to public investment. ** stands for a statistically significant coefficient at two standard deviation confidence interval.

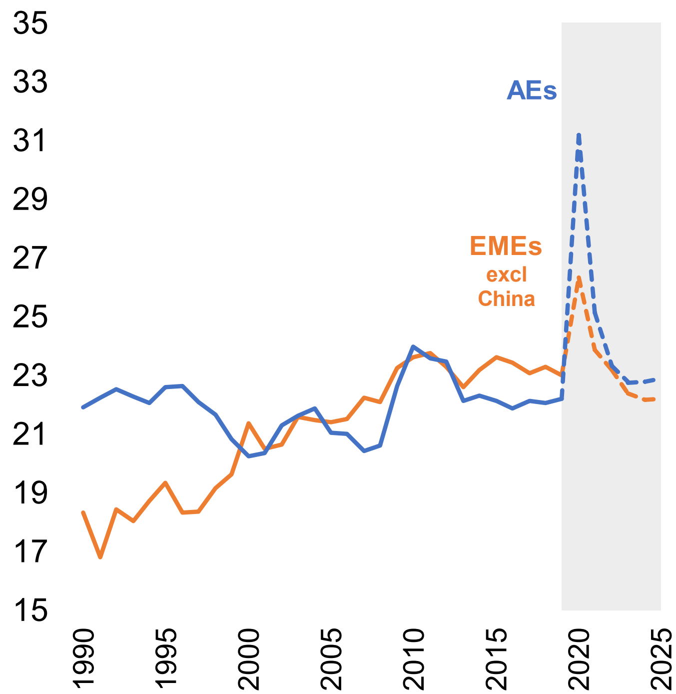
The Macroeconomic Environment Is Favorable To a Ramp-Up Of Public Investment

Nominal Ten-Year Bond Yields
(1979-2019, percent)



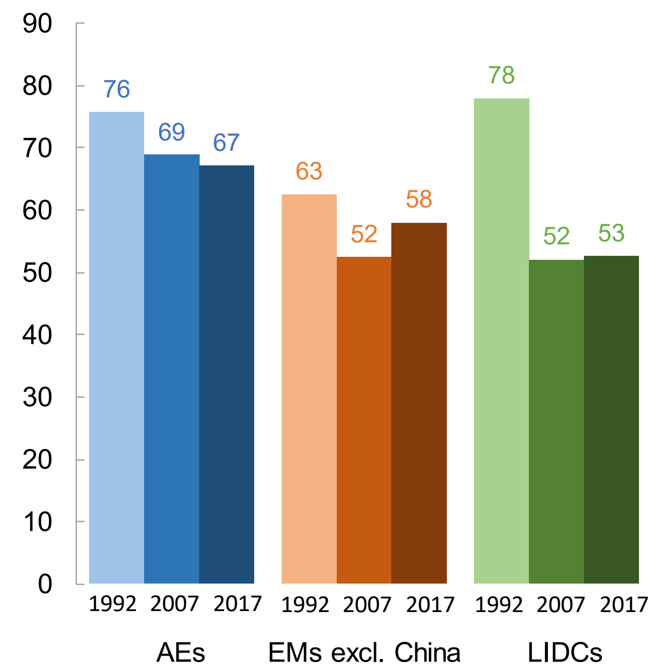
Source: JST Macro-History Database; World Economic Outlook (WEO) and IMF staff estimates. The AEs and EMEs sample are 85% of the respective AEs and EMEs aggregate GDPs.

Gross Private National Savings
(percent of GDP, 1990-2025)



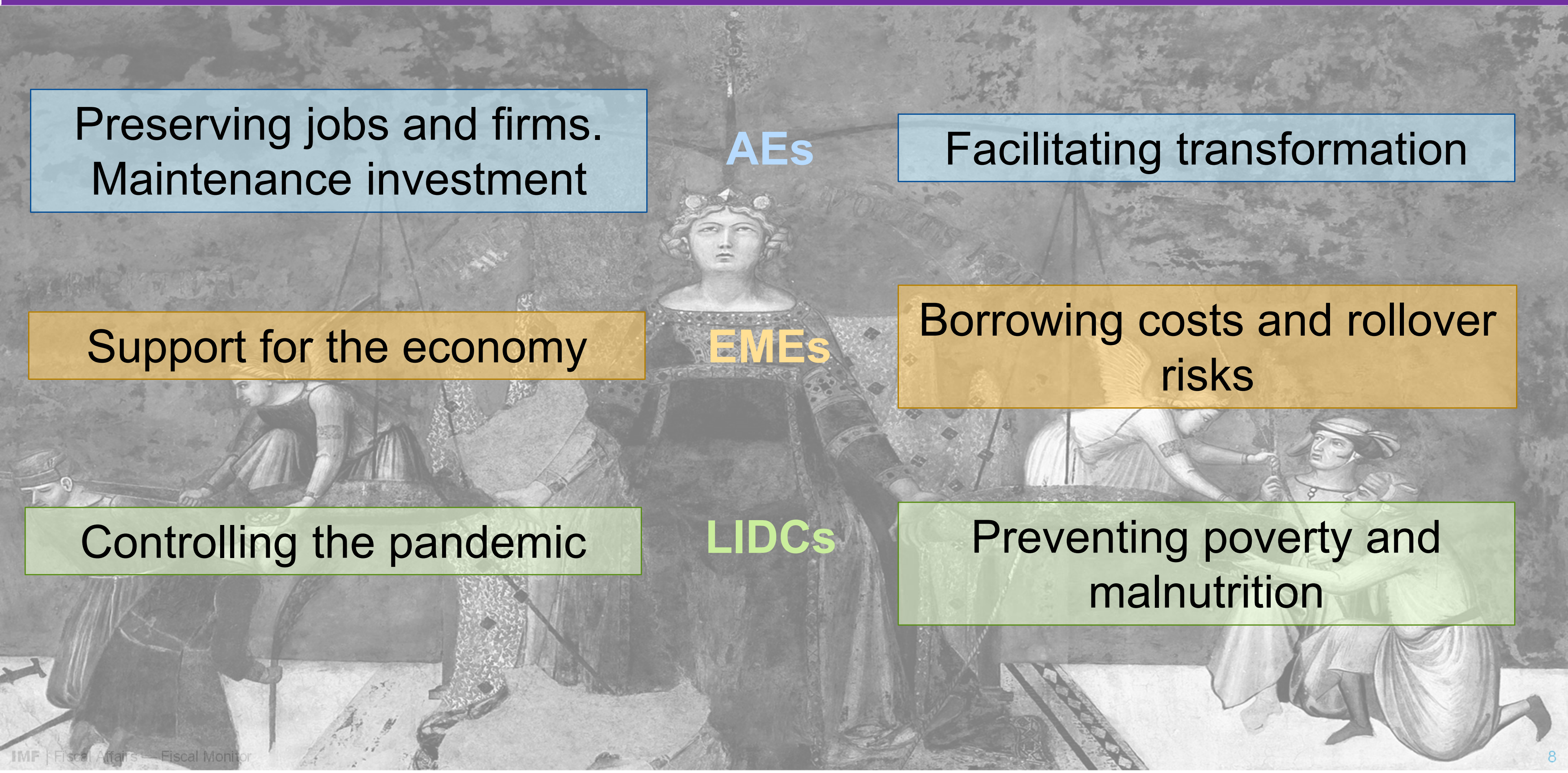
Source: IMF World Economic Outlook and IMF staff estimates .

Public Capital Stock
(percent of GDP, 1992-2017)



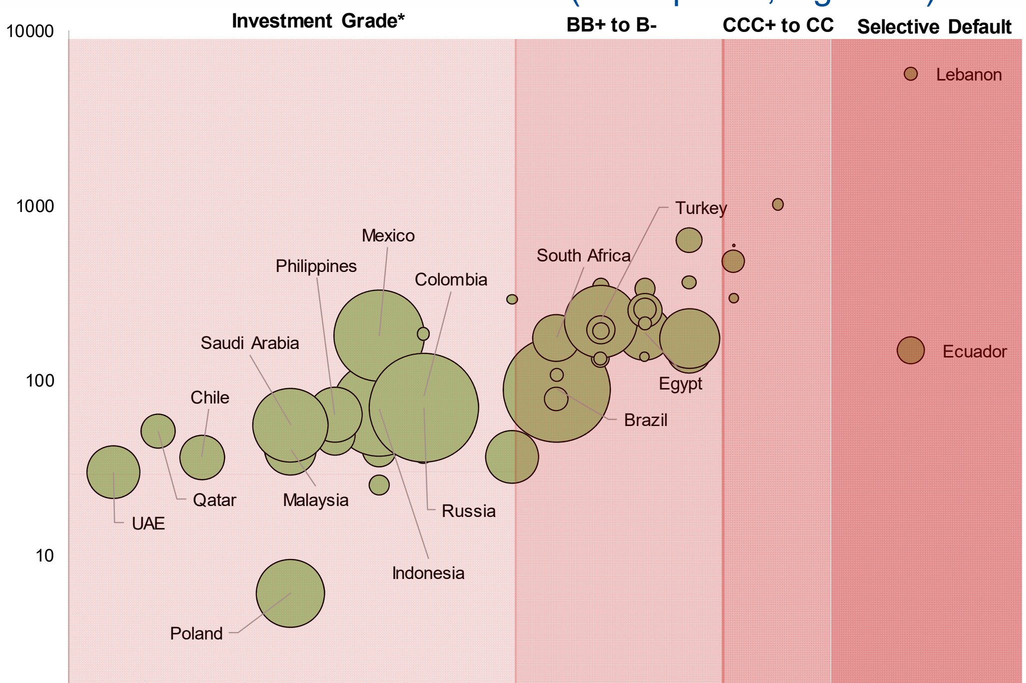
Source: IMF Investment and Capital Stock Dataset. General government coverage. The high ratio in low-income countries could hide statistical issues with the construction of a stock variable by cumulating flows, especially where there are inefficiencies in public investment management systems.

Painful and Urgent Tradeoffs



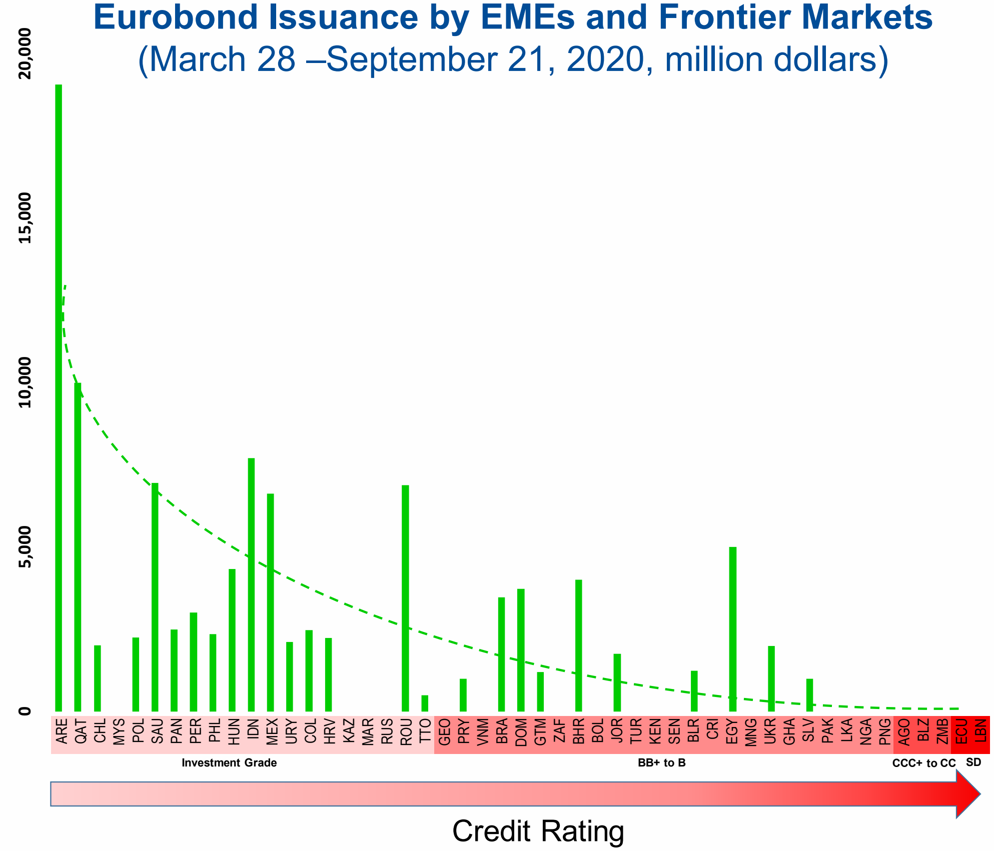
A Pecking Order of EMEs in Rollover Costs

Change in EMBI Spreads (EMEs and Frontier Markets) Over the Course of 2020 (basis points, log scale)



Sources: Bloomberg, S&P Sovereign Credit Ratings and WEO.
Note: The chart depicts 45 EMEs and 10 frontier markets. Logarithmic scale is used on the vertical axis, representing EMBI Global Sovereign Spreads. Bubble size represents the country's gross domestic product, in USD, current prices (latest WEO vintage). The changes in EMBI spreads indicate the difference between the beginning of January and as of Sept 17,2020. * Considered Investment grade when the sovereign is issued a credit rating of BBB- and above.

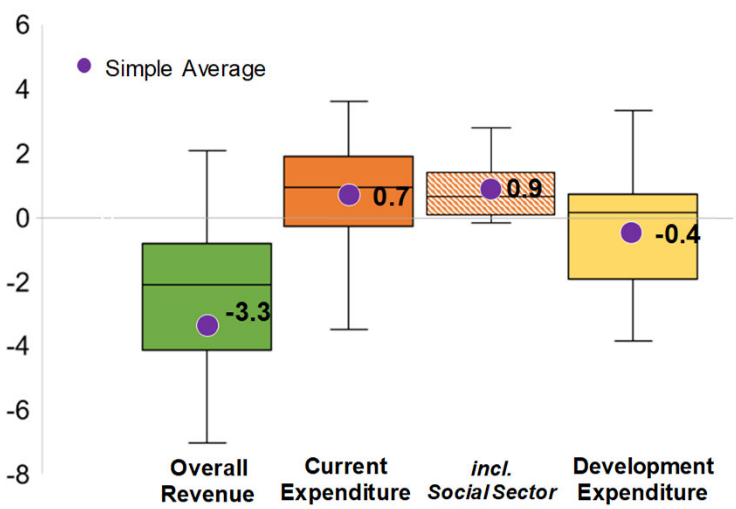
Eurobond Issuance by EMEs and Frontier Markets (March 28 –September 21, 2020, million dollars)



Sources: Bondradar, S&P Ratings, Fitch Ratings & Moody's & IMF Staff estimates.
Note: Hard currency Eurobonds. All ratings have been standardized to S&P's rating nomenclature. The chart depicts the same 45 EMEs and 10 frontier markets as on the right hand side.

Further Social Protection and Assistance Are Needed in LIDCs

Budget Revisions in DSSI Recipients (in percent of 2020 GDP)

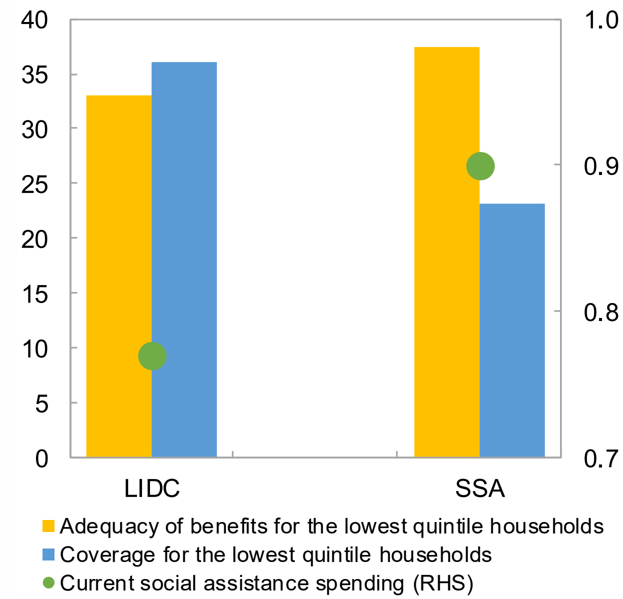


Sources: IMF staff estimates based on national authorities' data. The sample covers 28 countries which have requested debt service suspension under the DSSI and for which budget data has been collected. 2020 GDP is the forecast of the Jan 2020 WEO vintage.

Decomposition of the Increase in Extreme Poverty in 2020 relative to 2018 (million people)

Sources: IMF World Economic Outlook, Gentilini and others (2020); World Bank PovcalNet database; and IMF staff estimates.

Adequacy and Coverage of Social Protection Programs (percent LHS, Percent of GDP RHS)



Sources: World Bank PovcalNet database; IMF World Economic Outlook and IMF staff estimates.
Note: Adequacy is the total transfers received by beneficiaries as a share of the pre-transfer total income in the lowest income quintile of individuals. Coverage is the share of the lowest-quintile individuals who receive social protection benefits.

Policy recommendations

FAD/MCM/RES joint slide

Near-term policy priorities

Monetary, fiscal and liquidity support measures are needed at least into 2021. Premature withdrawal would be a major risk to the recovery.

- Everywhere, ensure health care systems adequately resourced
- Where pandemic is not under control: limit persistent economic damage as needed with measures such as cash transfers, wage subsidies, expanded criteria for UI benefits
- Where countries are reopening: unwind lifelines gradually after activity picks up durably, policy focus should shift to facilitating reallocation
- Limit amplification of the shock:
    - support viable but still vulnerable firms with moratoria on debt service, equity-like support, debt restructuring and efficient out-of-court workouts;
    - retraining and reskilling where feasible to allow sectoral reallocation;
    - banks to continue using capital and liquidity buffers to support credit provision;
    - maintain accommodative monetary policy support where inflation expectations are anchored and provide broader fiscal stimulus where space permits

In fiscally constrained economies, the priority is to create room to meet crisis spending needs.

- prioritize health and education spending, income support to the poor;
- reduce wasteful spending and poorly targeted subsidies.
- extend maturities on public debt and lock in low interest rates to the extent possible to reduce debt service expenses
- revenue measures: raise progressive taxes, adjust corporate taxation to ensure firms pay taxes commensurate with profitability

Policy recommendations

FAD/MCM/RES joint slide

Enhance international cooperation

- **Health.** Fund vaccines through advance purchase commitments, plan for delivery to LICs, and support countries with limited health care capacity.
- **Financial support for countries facing high borrowing costs and rollover risks** to help close the financing gap and catalyze additional resources.
- **Debt relief, grants and access to concessional financing** for the most vulnerable countries.
- **Defuse trade, technology, geopolitical tensions.**

Policies to address medium and long-term challenges

In the medium to long-term, national policies need to address legacies and facilitate the transition to a smart, green, inclusive, and resilient growth path.

- **Address debt overhangs**
  - Recapitalize, restructure or resolve nonviable firms as needed.
  - Adopt a realistic medium-term fiscal strategy which supports development priorities and adequate fiscal risk management. In some cases, orderly sovereign debt restructuring may be needed.
  - Enhance debt transparency.
- **Counteract slowing productivity growth and supply-side damage.** Repair balance sheets, address labor market rigidities, and ensure that increasing corporate concentration does not lead to abuses of market power.
- **Facilitate new growth opportunities**
  - Encourage pro-active management of climate-related risks and green investments. Gradually increase carbon prices to reduce emissions, stave off physical risks, and strengthen fiscal finances.
  - Increase digital investment to improve productivity growth, bridge the digital divide.
  - Remedy the crisis-induced setback to human capital accumulation.
  - Enhance financial sector efficiency.
- **Pursue further financial reforms**
  - Banks: gradually rebuild buffers and reduce problem assets.
  - NBFIs: enhance the regulatory framework to address vulnerabilities exposed during COVID-19.
  - Macro- and micro-prudential policies should deal with “lower for longer” and contain risk taking.
- **Address income inequality.** Close health and education gaps, enhance social safety nets and progressive income taxation.

Constituency Codes

OEDAE
Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, Somalia, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF
Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP
Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR
Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC
China

OEDCE
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Spain, and República Bolivariana de Venezuela

OEDCO
Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC
Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF
France

OEDGR
Germany

OEDIN
Bangladesh, Bhutan, India, and Sri Lanka

OEDIT
Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA
Japan

OEDMD
Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, United Arab Emirates, and Yemen

OEDNE
Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO
Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU
Russian Federation and Syrian Arab Republic

OEDSA
Saudi Arabia

OEDST
Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ
Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK
United Kingdom

OEDUS
United States