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Statement by the Hon. **JIRI RUSNOK,**
Governor of the Fund for the **CZECH REPUBLIC**

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The Global Economy

This year, the global economy was hit by an unprecedented pandemic shock, unique in its nature and magnitude. Besides temporarily – although in many cases repeatedly – paralysing or crippling economic activity, COVID-19 has brought disorder and persistent uncertainty to the lives of billions of people. The pandemic has naturally also created a wholly novel situation for policymakers.

The vast majority of countries will see a sharp contraction in their GDP growth this year, often breaking historical records. The recovery is likely to be slow and uneven, not only across continents and countries, but also across sectors and industries. Several parts of the global economy, such as tourism and air transport, have been disproportionately damaged. The associated set of risks to future development is also unparalleled. There is an ongoing discussion about the composition of demand and supply shocks and the implications of the latter for the future path of the real economy. Most importantly, unlike several bigger and smaller crises we have experienced in the recent past, this crisis is first and foremost an international public health emergency, not an issue of destroyed physical assets. Therefore, the recovery is primarily dependent not on past or present economic fundamentals, but on an ongoing exogenous phenomenon, namely the epidemiological situation, which is inherently difficult to predict.

The COVID-19 shock has so far evoked a series of unprecedented responses from fiscal and monetary authorities alike, as well as from international institutions. Central banks have implemented unconventional monetary policy measures involving large-scale and diverse asset purchases and refinancing facilities, helping to secure credit for a wide range of borrowers. The policies of leading central banks, including the US Fed and the ECB, are evolving towards more temporally flexible inflation targets. These policy moves have significantly contributed to the prevention of possible further damage caused by the COVID-19 shock via the financial system. They have also supported economic sentiment. As a consequence of the budgetary measures, the fiscal position in a number of countries will deteriorate rapidly. This is particularly painful for emerging and developing countries, as they do not benefit from low interest rates as much as advanced economies do. The pandemic is expected to weaken productivity growth by worsening the already sluggish investment growth and through a loss of human capital and disrupted technological innovation processes in the most affected industries. Given the precarious global situation, policymakers face trade-offs between short-term and long-term policies under growing social constraints. Furthermore, trade policy uncertainty and technology disputes are threatening the prospects for the global recovery. Governments and policymakers should ensure that these tensions are contained and resolved sustainably and in a multilateral manner.

The Czech Economy and Authorities' Response to the Pandemic

Unsurprisingly, the Czech Republic has not emerged from the COVID-19 crisis unscathed. Various restrictions adopted by governments to combat the pandemic have seriously hit world trade. These restrictions on trade, combined with spontaneous adjustments to demand and supply frictions, have had a significant impact on the Czech economy. In addition, a part of the Czech economy itself was subject to a pandemic-related lockdown in the spring. An overwhelming increase in uncertainty adversely affected consumer and investment behaviour. Despite efforts by the Czech government and the Czech National Bank (CNB) to support recovery, the ongoing pandemic led to an unprecedented decline in economic activity. In the second quarter of 2020, when the first wave of the pandemic hit Europe with its full force, Czech GDP declined by 11% y-o-y.

To tackle the pandemic and limit its socio-economic impact, the Czech authorities adopted a wide set of measures. The government announced a fiscal package of CZK 245bn (€9.3bn, 4.4% of GDP) and adopted a number of fiscal and legislative measures. It lowered the VAT rate on selected services (accommodation, culture, sport) from 15% to 10% and introduced a loss carryback measure, bonuses for social services and healthcare workers, one-off benefits for pensioners and grants for the tourism sector. The government further pledged almost CZK 500bn (€18.9bn, 9% of GDP) with the potential to provide total guaranteed loans of up to CZK 862bn (€32.8bn, 15.5% of GDP). Advance payments on personal and corporate income tax were suspended for Q2 2020, and penalties for failing to pay property tax and file income tax returns on time were waived. The government also approved a moratorium on bank loans (subject to certain criteria and limitations) of up to six months.

The CNB responded to the pandemic with a massive easing of monetary policy. Measures were aimed at softening the impact of the pandemic on prices and financial stability. Among other things, they sought to create a financial market environment that should enable financial institutions and the entire economy to better deal with the current situation. The key monetary policy measure was a large policy interest rate cut, by 200 basis points in total. This took place in three steps between March and May. Further easing of monetary conditions occurred due to a market-driven weakening of the koruna exchange rate, which responded to the worsening global market sentiment and functioned as an automatic stabilizer.

Other CNB measures were of a preventive nature and aimed at supporting the Czech banking sector. Although the banking sector currently shows no liquidity shortage, the rules for monetary operations have been modified for pre-emptive reasons. Since March, liquidity-providing repo operations have been announced three times a week instead of the previous weekly frequency. In addition, liquidity-providing operations with three-month maturity were introduced, the list of counterparties was extended to include selected non-bank financial institutions, and the range of eligible collateral was broadened to include mortgage bonds.

Complementing these measures, a legislative amendment temporarily (until the end of 2021) granting the CNB a substantially wider range of competences to better influence the functioning of financial markets – specifically to stabilize the bond market in the event of major turbulence – was adopted.
The Czech banking sector as a whole is stable, profitable, well-capitalized and resilient and thus can cope with the consequences of adverse economic developments. Nevertheless, deteriorating economic activity is expected to exert downward pressure on the quality of banks' loan portfolios. Therefore, as another pre-emptive measure, the CNB has gradually lowered the countercyclical capital buffer rate to support banks' ability to finance the real economy without interruption and better provide for potential credit losses.
The government's anti-pandemic measures were almost completely lifted during the summer and the economy recovered robustly. However, since the end of August, the epidemiological situation has deteriorated dramatically, imposing a heavy burden on the economy. The currently raging second wave of the pandemic has given rise to a new set of lockdown measures. Although the latest measures are selective and intended to have a less adverse economic impact, the overall economic risks are tilted to the downside. It is now obvious that the fight against the pandemic will take longer and cost more than previously anticipated.

IMF Issues

In the midst of a crisis like no other, the IMF's pivotal role at the centre of the Global Financial Safety Net is evident. The Fund has moved quickly and decisively to diminish the impact of the COVID-19 pandemic on the global economy, channelling emergency financing to those most affected, providing debt relief to its poorest members and extending precautionary credit lines to countries with strong fundamentals. Beyond the immediate emergency response, the IMF is faced with the task of navigating and supporting its membership through the stabilization and recovery phases. Yet unprecedented levels of uncertainty and serious downside risks continue to cloud the outlook.
The deployment of large volumes of funding through the IMF's emergency financing facilities, characterized by the absence of ex post conditionality, has been warranted as the Fund has sought to contain the fallout from the crisis. Limited conditionality poses clear risks to the Fund's resources, however, and the disbursement of emergency financing must therefore be contingent upon the presence of an urgent balance of payments need, adequate governance safeguards and a credible assessment of a member's debt sustainability and capacity to repay. Where a balance of payments need stems from structural imbalances of a longer-term nature, members should be encouraged to request upper credit tranche quality programmes. Programme countries must commit to delivering macroeconomic adjustment and implementing necessary reforms, with the IMF assisting in charting their path to recovery. Close monitoring is key to ensuring that programme goals are met.

The Fund's agile response in the initial phase of the crisis is a testament to its well-calibrated lending toolkit, and it should continue to make full use of the ample flexibility embedded in its existing instruments in the period ahead. Alongside the IMF's lending activities, surveillance plays an essential role in building resilience and preserving economic and financial stability. The resumption of bilateral surveillance, albeit in limited and virtual form, is a welcome development. A focus on crisis-related priorities is both appropriate and in keeping with the IMF's core mandate. With the Fund's internal resources already stretched by the crisis, the integration of non-core areas into surveillance risks straining them further and should be approached with caution. Given that these issues lie outside the Fund's traditional mandate and field of expertise, other institutions are certainly better placed to tackle them and the IMF should only rely on close cooperation with them. Only if the issues are deemed macrocritical, an assessment that must be made on a case-by-case basis, should the Fund consider addressing topics such as climate change, corruption, gender, digitalization and governance.

As the crisis exacerbates global debt burdens, we encourage the Fund to continue to strengthen its focus on work in this area. This includes reviewing its own policies on debt limits and debt sustainability analysis for market-access countries, as well as collaborating with the World Bank on initiatives to increase debt transparency.

The Fund's engagement with its members should be conducted in such a manner as to minimize moral hazard, protect the Fund's resources and preserve its reputation. It is therefore essential that financial assistance is not provided on the basis of unrealistic programme assumptions. Continuing and stepping up the ongoing work to reduce forecast optimism and mitigate potential bias in judgement on debt sustainability is crucial in this light. The consistent application of the principle of uniformity of treatment also serves to contain moral hazard. Policy recommendations and programme design must be even-handed, ensuring that countries in similar circumstances are treated similarly, while also reflecting country specifics.

In these difficult times, we reiterate our support for the commitment by the IMFC and G20 leaders to a strong, quota-based and adequately resourced IMF. Of its $1trn lending capacity, the IMF has committed $260bn thus far. Given the significant uncertainty surrounding demand projections, the Fund must continue to monitor its resources closely. An assessment of resource adequacy must reflect the catalytic role of Fund lending, factoring in financing from other sources. Furthermore, the revolving nature of IMF resources is reinforced through the application of adequate conditionality and safeguards.

The 16th General Review of Quotas, to be concluded no later than December 15, 2023, represents the next opportunity to rebalance the structure of the Fund's resources towards quotas and to continue with governance reforms. Conditions allowing a reduction of reliance on temporary borrowed resources in favour of more stable sources is desirable.

We thank the IMF for its efforts to steer the global economy through this challenging period. The Czech Republic stands ready to continue to work in close cooperation with the Fund.