Remarks by Secretary of the Treasury Janet L. Yellen at G20 High Level Seminar on Macroeconomic Policy Mix for Stability and Economic Recovery

July 15, 2022

As Prepared for Delivery

Thank you, Minister Sri Mulyani, and thanks to your team for the tireless work you've undertaken to host the G20 in a year where we are facing an extremely challenging environment.

Just as the recovery from COVID-19 was taking hold, Russia's unjustified war against Ukraine sent a shockwave through the global economy. Indeed, the fallout from this shockwave is an overarching focus of our discussions in Bali. Russia's war has propagated a commodity price shock as prices of food, fertilizer, and energy remain high, resulting in more people going hungry. This shock has required us to take action to help mitigate food insecurity, including through our call-to-action for International Financial Institutions to redouble their work, and through our leading role with the Global Agriculture and Food Security Program – to which the United States is donating an additional $155 million.

The economic impact of the war is further exacerbating inflation, harming government fiscal positions, and exacerbating volatility in capital flows while many countries are still recovering from COVID-19. Accordingly, we all have to revisit our approach to macroeconomic policy. Like many of you here today, I'm no stranger to macroeconomic policy making, having spent three decades in various policy roles. Over this period, the global economy has faced many challenges – including balance of payments crises, debt crises, financial crises, and a global pandemic.

In my remarks today, I will share reflections and three lessons learned from my experience. I will also reflect on the challenges policymakers, particularly those in emerging and developing countries, face from external shocks. And I will share my view that, as we look ahead, the IMF's Integrated Policy Framework – or IPF – is a step forward in our understanding and consideration of a broader range of macroeconomic policy tools.

What are some lessons we've learned? First, it is critical to establish, maintain, and update a playbook of policy responses that aims to minimize the duration and severity of recessions and mitigate adverse economic consequences on firms and individuals. In both the global financial crisis and the COVID-19 pandemic, many countries implemented large fiscal responses, serving both the "macro" objective of reducing the severity of the shocks economy-wide, along with the "micro" objective of supporting the individuals, families, and firms most impacted by these crises. During the global financial crisis, many advanced economies pushed monetary policy into new territory, adopting negative policy rates and implementing quantitative easing. Targeted liquidity support was provided to certain asset markets that began to seize up. A similar monetary response occurred around the world during the pandemic, with more emerging market economies aggressively cutting rates than was the case after previous global shocks.

These macroeconomic policies served as the "first responders" to the economic fallout of the pandemic, and the lessons learned from past shocks enabled us to respond quickly and aggressively. The impact on the global economy was severe, but less severe than it otherwise would have been. In June 2020, the IMF projected a 5 percent contraction in global economic activity for that year, but the actual decline was just over 3 percent. I feel confident that the global macroeconomic response played a role in lessening the size of the contraction.

A second lesson is that sound fundamentals, strong institutions, and policy credibility underpinned by clear communication remain important foundations for any policy mix. Fiscal responses are only as effective as their implementation. The public sector must be able to efficiently raise funds and deliver them to the targeted recipients. Institutional transparency is also important for reducing corruption in both the revenue and expenditure sides of fiscal policy. Monetary policy effectiveness relies on the credibility of the central bank. As the United States learned in the 1980s if inflation expectations become de-anchored, lowering inflation is far more difficult and costly to the economy. Liquidity support is also more effective where markets are sufficiently developed to respond to it. For some of the United States' liquidity facilities, the announcement effect was enough to calm markets and restore their functioning.

Third, even with sound fundamentals and strong institutions, financial flows can be volatile. The flow of capital benefits source and recipient economies alike through a more efficient global allocation of resources and by allowing countries to smooth consumption. Foreign capital can increase productivity and wages, transfer know-how, raise GDP growth, and

increase the supply of credit. Yet, countries experiencing large capital flow surges or sharp swings can experience greater macroeconomic volatility and are vulnerable to crises. Strong domestic policy frameworks can help attract flows that are less volatile or less sensitive to external shocks, such as local currency debt flows and direct investment. Macroprudential measures can help achieve more stable cross-border lending and attenuate financial cycles that undermine overall financial stability. But, while robust macroeconomic and financial sector policies can help manage these risks, they cannot eliminate them.

This is particularly relevant for emerging markets in the context of the current global economic environment. Financial conditions have tightened due to rising, broad based inflationary pressures, geopolitical uncertainty brought on by Russia's war against Ukraine, and a slowdown in global growth. Now, portfolio investment is beginning to flow out of emerging markets. Maintaining or bolstering policy frameworks and institutional credibility remains an essential backstop for managing the risks of volatile capital flows.

Countries are responding to these developments from different starting positions. This underscores the clear need for policy makers to understand what course of action is most effective and what is appropriate, taking these three lessons learned into account. Furthermore, factors like external borrowing constraints, export price stickiness, shallow markets, and other economic characteristics matter for how effective policies can be, particularly in the short-term. The field of economics has made great strides in understanding open economies, global capital flows, and the role of policies. From Mundell-Fleming through to the work under the IMF's new Integrated Policy Framework, we have broadened our knowledge of the complexities of the international financial system. These advances help refine our understanding of how policies interact and can respond jointly in the face of pandemics, financial crises, and other local and global shocks.

The IPF recognizes that country-specific characteristics can lead to externalities in economic decisions, and that it can be beneficial to add to the playbook a wider set of policy tools to optimally meet domestic objectives. Emerging markets and low-income countries may, in some circumstances, benefit from capital flow management, and foreign exchange intervention alongside monetary, fiscal, and macroprudential policies. However, a remaining key challenge is to identify in real time when these circumstances arise or when, instead, more structural policies should be prioritized. We now better understand the case in support of using exchange rate and capital flow management policies. But that does not mean we have forgotten the case against them. For example, it remains important that foreign exchange

intervention not be used to create an unfair competitive advantage or delay needed balance of payments adjustments.

With its core mandate to maintain the stability of the international monetary system and the surveillance of exchange rate policies, the IMF has a clear role in ensuring these countries apply complementary policy tools responsibly. Country-specific circumstances help shine a light on the proper underlying macroeconomic policies and the appropriate complementary policy tools. But clear guidance on when these policies are not appropriate remains equally important. As is the case for all the tools we use as policymakers, these new frameworks should provide a strong basis for consistent advice as we face what comes next.

Thank you.

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