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BUFF/ED/13/109

July 18, 2013

**Statement by Ms. Lundsager and Mr. Weiss on United States**
**Executive Board Meeting**
**July 24, 2013**

The United States continues a steady recovery from its worst downturn since the Great Depression. Underlying private demand has supported economic expansion for 15 straight quarters while labor market conditions have continued to improve. This reflects a combination of very supportive monetary policy; fiscal policy that has been calibrated to the pace of private demand growth, including initial stimulus to sustain the recovery in the face of strong headwinds and, more recently, strong deficit reduction measures; and early and decisive action on banking sector repair.

We thank the staff for its dialogue with our authorities and broadly agree with the primary messages of the report. We also appreciate the set of interesting and in-depth Selected Issues Papers. The staff's policy recommendations are broadly in line with our authorities' goals.

**Economic Outlook**

Recovery in the United States has been supported by private domestic demand, which has proved resilient despite headwinds from a larger-than-expected fiscal adjustment this year. Solid fundamentals have underpinned this demand, including a housing sector that is gradually coming back, further progress on household balance sheet repair, an uptick in investment by firms, and steadily improving labor market conditions.

Growth accelerated to an annual pace of 1.8 percent in Q1 2013, from 0.4 percent in Q4 2012, reflecting stronger growth of consumer spending, a large buildup in private inventories, and a smaller drag on growth from declining federal defense spending. Federal fiscal policy should exert somewhat less drag over time as the effects of the sequester diminish. In fact, our authorities and a consensus of private forecasters expect the pace of expansion to pick up in the second half of the year and to accelerate through 2014 on the continued easing of headwinds from the financial crisis; gradual improvements in the strength of European economies as policymakers continue to resolve their debt crisis; and continued labor market healing in the United States, boosting household wealth and demand. We are encouraged that the Fund staff projects U.S. growth in line with consensus for 2014, at 2.7 percent, although still slightly below our authorities' Mid-Session Review forecast of 3.1 percent.

U.S. labor markets are gradually improving. Non-farm payrolls rose by 195,000 in June, with total non-farm payrolls up nearly 6.6 million since February 2010, and private non-farm payrolls up 7.2 million. The percentage of long-term unemployed declined to its lowest level since October 2009. However, both headline and long-term unemployment rates remain too high.

The U.S. current account has been stable on increased services exports and reduced oil imports. Lower oil imports reflect higher domestic energy output and greater energy efficiency, which, as outlined in staff's Selected Issues Paper, significantly narrowed the energy deficit to 1.9 percent of GDP in 2012. However, foreign demand remains weak and the non-oil trade deficit will increase as the U.S. output gap closes. As such, greater progress on global rebalancing is required.

**Fiscal Policy**

Policy measures taken earlier this year avoided the fiscal cliff, supporting a still-moderate pace of growth despite significant adjustment. At the same time, our authorities remain committed to ensuring that the U.S. fiscal balance and debt trajectories remain on sustainable paths. The President's proposed fiscal approach would allow growth to continue in the long term while producing less fiscal drag in the near term.

While the pace of fiscal consolidation has been faster than expected this year, expiration of the payroll tax cut and higher taxes on the wealthy were necessary to ensure medium-term fiscal sustainability. The United States has now achieved significant adjustment while still maintaining growth: our authorities' Mid-Session Review lowered its estimate of the U.S. FY 13 federal deficit from a budgeted 6.0 percent of GDP to 4.7 percent on higher-than-expected receipts, lower-than-expected outlays in discretionary programs as a result of the sequester, increased dividend payments to the Treasury from Fannie Mae and Freddie Mac, and updated economic assumptions. Our federal deficit as a share of GDP will be less than half as large this year as in 2009.

We agree with the staff that entitlement spending containment and higher revenues are necessary for long-term sustainability. Our authorities' plan would reduce the deficit by $4.3 trillion over 10 years, putting U.S. debt on a declining path by mid-decade. The federal primary deficit would be eliminated by 2019 and would become a primary surplus of 0.9 percent of GDP by 2023, with a net debt-to-GDP ratio of 66 percent.

More than $2.5 trillion in long-term deficit reduction measures have already been put in place over the past two years. In addition, President Obama's FY 14 budget proposal would replace $1.2 trillion in automatic, across-the-board spending cuts from the sequester with $1.4 trillion in targeted cuts and program savings, leading to less fiscal drag than under current law. President Obama has also proposed a detailed set of reforms to the U.S. tax code that would broaden the tax base, close loopholes, and eliminate inefficient tax breaks to finance the reduction of marginal rates.

Indeed, our authorities' long-term budget forecast projects the overall federal deficit to peak at 2.8 percent of GDP in 2033 and begin falling thereafter as a result of rising revenue, controlled spending, and stabilized entitlement growth. These savings will be driven by structural changes to the U.S. health care system, driven by the Affordable Care Act (ACA). The CBO estimates that the ACA will save more than $100 billion in its first 10 years and more than $1 trillion over its second 10 years.

Subnational governments are also in much better fiscal condition this year on higher-than-expected revenues and conservative budgeting, in line with many states' balanced budget laws. The sequester has only brought limited fiscal drag for states, as the large majority of federal funding for states has been exempt from the sequester. Improved public finances at the state level will, in turn, allow for a more supportive growth environment and help to offset some of the necessary medium-term federal adjustment.

Mindful of the need to reduce excessively high long-term unemployment, our authorities continue to propose targeted measures to encourage job creation. President Obama's FY 14 budget includes maintaining job training and employment services programs; streamlining existing programs in order to better fund and organize them; $150 million to promote innovative new ways to train and help workers find jobs at the state and regional level; funding for an $8 billion Community College to Career Fund to support state and community college partnerships with businesses; and $1.8 billion for the Department of Labor's worker protection programs.

**Monetary Policy**

While our authorities take steps to ensure fiscal sustainability, monetary policy continues to support the recovery. At its June meeting, the Federal Open Market Committee (FOMC) noted still-elevated unemployment despite moderate growth. As such, it reiterated its plans for highly accommodative monetary policy, including the continuation of its asset purchase program – at a pace of $40 billion in agency mortgage-backed securities and $45 billion in longer-term Treasury securities per month – until the outlook for the labor market has improved substantially in the context of price stability. The FOMC reiterated that it expects highly accommodative monetary policy to remain appropriate for a considerable time after the asset purchase program ends and the recovery strengthens, with the policy rate at 0.0 to 0.25 percent at least as long as unemployment remains above 6.5 percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the FOMC's 2 percent longer-run goal, and longer-term inflation expectations remain well-anchored.

Our authorities are keenly aware of markets' interest in the future trajectory of monetary policy. The criteria noted above will continue to inform, though not necessarily dictate, the FOMC's policy decisions. With regard to asset purchases, if economic conditions were to improve faster than expected, the pace of purchases could be reduced somewhat more quickly. Alternatively, if the economy is, in fact, weaker than expected, the FOMC could delay moderating asset purchases or even increase them for a time. In addition, even after purchases end, the Federal Reserve will be holding a substantial stock of Treasury and agency securities, which will continue to put downward pressure on longer-term interest rates and help to make broader financial conditions more accommodative. With regard to the federal funds rate target, the Federal Reserve has emphasized that it intends to maintain a high degree of monetary accommodation for a considerable time after the asset purchase program ends and the economic recovery strengthens, and that its decisions regarding the appropriate setting of the federal funds rate will depend on incoming data on employment, inflation, and inflation expectations.

The Federal Reserve Board has made significant changes in communicating its policy intentions in recent years. This and the rest of the Fed's policy toolkit should allow it to successfully navigate a future transition to normalization.

At the same time, our authorities recognize potential medium-term risks that might come with an extended period of low interest rates. The Fed continues to monitor financial markets closely for signs of financial or price distortions, but these signs are not currently at worrying levels. If necessary, our authorities have macroprudential tools at their disposal to address potential emerging vulnerabilities.

**Financial Sector**

U.S. bank health continues to improve, with returning private-sector credit growth, better liquidity, and more and higher-quality bank capital. Financial vulnerabilities are easing in both cyclical and structural terms. Official bank stress tests in March 2013 showed that bank balance sheets had been substantially restructured, with only one firm falling below the minimum capital ratio threshold under stressed conditions. U.S. banks have raised over $440 billion in high-quality capital since the crisis and all internationally active U.S. banks already meet the 7 percent common equity tier 1 requirement applicable at the end of Basel III transition in 2019 (with the 18 largest banks above 11 percent).

U.S. regulators have made significant progress over the past year in implementing the Dodd-Frank Act and other key regulatory reforms, which will further shore up the stability of our financial institutions. This includes (1) a robust regulatory structure for over-the-counter derivatives and continued strong efforts on cross-border issues, most recently the significant July 11 announcement between the Commodity Futures Trading Commission (CFTC) and EU; (2) implementation of the Financial Stability Board Key Attributes for bank resolution; (3) policy measures to address risks in the shadow banking system, such as recent Securities and Exchange Commission (SEC)-proposed rules on money market mutual funds, as well as work on securitization activities and the tri-party repo market; and (4) designations of large, complex nonbank financial companies and systemically important financial market utilities.

Our authorities have also made significant progress on implementation of the Volcker Rule, which generally bars deposit-taking institutions and their affiliates from proprietary trading or owning, sponsoring, or having certain relationships with hedge funds or private equity funds. U.S. regulators have received thousands of public comments that will help them to achieve the rule's objectives and bolster the stability and safety of our financial system.

The Financial Stability Oversight Council (FSOC), established by the Dodd-Frank Act and charged with critical responsibilities for identifying and responding to threats to financial stability, has played a key role in the past year in monitoring the financial system. It has strengthened coordination and cooperation between regulators and holds frequent meetings to discuss current and potential future threats. The FSOC recently issued its third annual report, which has become a valuable tool in presenting a single, unified voice on financial market and regulatory developments in the United States.

Finally, our authorities remain highly committed to the Basel III process. In fact, they have gone beyond this by recently proposing a stronger-than-required leverage ratio for the largest U.S. banks. The recent approval of final rules on banks' capital positions will enable banks to continue lending to creditworthy households and businesses in the event of unforeseen loses or severe economic downturns.

The U.S. housing market is steadily recovering, although prices remain well below pre-crisis levels. Space remains to expand mortgage lending to creditworthy borrowers without generating distortions, despite recent price increases and continued accommodative monetary policy. Higher confidence and easier lending standards have spurred mortgage growth, as the gradual economic recovery continues. The Federal Housing Finance Administration's recent two-year extension of the Home Affordable Refinance Program should help with market repair, and modifications will become easier as prices continue to rise.

**International Outlook**

As noted above, the U.S. external position remains stable, but foreign demand is still weak. Moreover, the United States' shift to a more sustainable international position (relative to its large pre-crisis current account deficits) will challenge the world's exporters. A stronger effort is thus required to fully complete global rebalancing. Imbalances have fallen in recent years, but largely as a result of cyclical factors driven by demand compression in deficit countries. Asian and some European current account surpluses remain too high.

The structural rebalancing necessary to achieve strong and sustainable global growth requires policy measures to stimulate domestic demand in surplus countries; internal rebalancing within the euro area, which remains a significant risk to global stability; and greater exchange rate flexibility in some Asian economies. Continued foreign exchange intervention and excess reserve accumulation will inhibit this process.

It is also imperative to maintain open trade channels. In this regard, our authorities remain committed to the global trade agenda and continue to press ahead on high-standard bilateral and multilateral trade agreements.