Ignazio Visco: The G20 under Italy's leadership in 2021

Keynote speech by Mr Ignazio Visco, Governor of the Bank of Italy, at The Global Foundation – Rome Roundtable 2020 "Which way the world after the pandemic? Our inclusive human future", Virtual meeting, 16-17 November 2020.

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Your Excellences, Ladies and Gentlemen, it is a great pleasure to join the 2020 virtual edition of the Rome Roundtable meeting. I would like to thank the Secretary General Steve Howard for giving me the opportunity to address such a distinguished group of guests and the Chairman Rob Knott for his kind introduction.

Next year Italy will chair the Group of Twenty (G20) for the first time since it started its gatherings in 1999. Our Presidency, not unlike the one that is about to conclude, takes hold under exceptional circumstances. The Covid-19 pandemic, a human tragedy, has triggered an economic collapse that is unprecedented in recent history. According to the latest IMF projections, global activity will contract by 4.4 per cent this year, the worst result since World War II.

At the time of the global financial crisis, in their Statement at the 2009 Pittsburgh Summit, G20 Leaders designated the Group to be the "premier forum for our international economic cooperation". Global financial stability was then in danger; that crisis had sizeable costs, but coordinated actions succeeded in halting a more costly spiral and, also through the work of the Financial Stability Board (FSB), making our financial systems more resilient.

Today's pandemic crisis brings to the fore another extremely dangerous challenge that must be addressed with ever closer cooperation across countries. We now realise that the risks of a global health crisis have been substantially underestimated. They are by no means the only ones: environmental sustainability, poverty eradication, trade openness, financial stability and knowledge transfer all contain elements of a global public good, whose provision may fall dangerously below desirable levels if national interests and market outcomes are not mediated through the balance of a truly multilateral, consensus-based and far-sighted approach.

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Three keywords embody the overarching priority themes of the Italian G20 Presidency: People, Planet, and Prosperity. The agenda of the Italian G20 Finance Track, the work stream led by Finance Ministers and Central Bank Governors, will then be inspired by those three words.

As a cross-cutting issue I want to emphasise inclusion, and remind you that three years ago, under the Italian Presidency, the G7 adopted the Bari Policy Agenda on Growth and Inequalities as a general framework intended to facilitate and promote "inclusive growth". In June 2018, at the Global Foundation's Rome Roundtable Meeting, I had the chance to discuss the extraordinary achievements made possible by the openness of the global economy and technological progress over the last decades. However, I stressed that these secular forces were unequal in their benefits: economic backwardness, extreme poverty and high mortality rates are still dramatic problems in many developing countries, especially in Sub-Saharan Africa, and too many people, even within our prosperous economies, have been left behind.

The Covid-19 pandemic comes as an abrupt shock that may erase years of progress in terms of poverty reduction and exacerbate inequalities and exclusion. The amount of people living in extreme poverty will increase for the first time in 25 years, by a number that the World Bank estimates could be above 100 million in 2020 and up to 150 million by next year. The impact of the pandemic has been uneven among workers, with job losses concentrated mainly in low-skilled and low-paid areas of the workforce; it is especially severe on women and the young.

Unequal access to health and education, and a consequent drop in human capital, may further worsen the impact on current and future generations.

The health crisis has therefore been at the core of this year's G20 meetings and will remain at the top of the agenda of the Italian Presidency. Indeed, it is no coincidence that our country will also host the 2021 Global Health Summit. G20 Finance and Health Ministers will continue to work together to ensure that research on vaccines and treatments and their production and distribution are adequately resourced and properly organised, with the common goal of reaching all parts of the world in the most effective way.

On the economic policy side, the response to the dramatic consequences of the pandemic has been prompt and massive on all fronts: fiscal, monetary and financial. Economic activity had come to an abrupt halt in several sectors, triggering sharp increases in (observed and disguised) unemployment, a collapse of business sales and severe liquidity strains, which disproportionately affected small and medium enterprises and brought important financial market segments to the verge of collapse.

Most governments introduced measures to relieve households' and firms' liquidity needs, such as debt moratoriums and temporary lay-off assistance, and to facilitate their access to new financing, such as loan guarantee programmes. Central banks deployed a wide array of emergency liquidity facilities and new asset purchase programmes, as well as funding facilities to support the essential role of banks in financing the real economy. With this objective in mind, bank supervisors used the flexibilities embedded in regulation and accounting standards so as to increase banks' headroom to absorb losses.

These actions have achieved their short-term objectives, setting the stage for the subsequent recovery. The multi-front policy response to the Covid-19 crisis has prevented the drying-up of liquidity and avoided an immediate credit crunch that could have led to a large wave of defaults, warding off a deflationary spiral with probable profound economic and financial stability consequences. Unlike other crisis episodes, in which credit crunches have been a problem, the policy mix has contributed to banks acting as part of the solution to the crisis, rather than as amplifiers of the initial shock.

Interventions have been devised in the spirit of close and constructive cooperation. G20 Finance Ministers and Central Bank Governors, together with the major international organisations, worked in close contact, participated in several scheduled and unscheduled (virtual) meetings and exchanged information on a continuous basis. As mandated by Leaders in March, a list of key principles and commitments for a coordinated response to the crisis was laid down under the Saudi Presidency. The Action Plan was endorsed in April and updated in October, coherent with the idea that – as a "living document" – it must regularly take into account ongoing developments and our progressive understanding of health and economic challenges.

A vital part of the plan is the support provided to low income countries in the form of free resources for addressing the health crisis. Through the Debt Service Suspension Initiative (DSSI), by mid-October official creditors suspended debt-service payments of about 5 billion dollars from 46 countries who requested it. Multilateral development banks committed additional resources to the value of 75 billion dollars to eligible countries. A Common Framework was endorsed last week to facilitate an orderly debt treatment of DSSI-eligible countries, and is now being submitted for the approval of Leaders. These initiatives will remain under the lens of the Italian Presidency, as part of a broader effort to deal with debt-related issues, enhance global financial safety nets, and improve mechanisms for financing development.

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The policy response to the global economic jolt caused by the pandemic will necessarily continue to be at the centre of our agenda. The recovery that took hold in the third quarter of the year, although vigorous, is partial and fragile.

The resurgence of infections and – sadly – deaths in many parts of the world will most likely cause a deceleration, and in many countries a reduction, of economic activity in the coming months. Uncertainty about epidemiological developments and economic prospects, feeding households' and firms' anxiety, reduces their propensity to consume and invest; there is a concrete risk that high precautionary savings will continue to weigh on aggregate demand. Recent news on vaccine development offer reason for cautious optimism; efforts must be further encouraged.

Fiscal and monetary authorities should continue to provide support, readily adapting their action to the evolving situation. Withdrawing support too early and failure to act timely, if needed, could jeopardise recovery, exacerbate social disruptions and, ultimately, prove self-defeating. In particular, the severity of the crisis requires that adequate protection reaches the households and firms that are most affected.

At the same time, in a context of rising firm debts, highly uncertain economic prospects and increasing risks in the post-pandemic world, we face the challenge of preserving the financial system's capacity to support the real economy without compromising its stability. The Covid-19 crisis will inevitably lead to a significant increase of non-financial firms' indebtedness and related debt overhang issues. Measures to support firms' recapitalisation might be necessary to avoid a generalised debt overhang problem.

It should also be considered that in the last ten years the financial system has become increasingly reliant on non-bank financial institutions for supporting economic growth. This has brought benefits but may also amplify some vulnerabilities, especially in short-term funding markets where these institutions obtain and supply liquidity to provide credit to the real economy. In March substantial stress was experienced, with large and persistent imbalances in the demand and supply of liquidity that was only eased by considerable public – mainly central bank – interventions.

In this field, as a starting point, our Presidency will promote a stocktaking analysis of the lessons learnt during the pandemic to understand which features of the existing regulatory framework for banks may need to be amended. One focus will be on the flexibility incorporated into the prudential standards (concerning for instance the use of bank capital and liquidity buffers); another will be on potential sources of pro-cyclicality, like those stemming from the way rating downgrades are dealt with under existing financial rules and from the accounting standards' approach to the quantification of expected credit losses. It will also be important to look at the adequacy of existing crisis management frameworks.

Coordination will be required on how to address the financial stability risks arising from a possible wave of corporate insolvencies, as well as on identifying the conditions that must eventually lead to the unwinding of current emergency measures, so as to avoid unintended effects across sectors and jurisdictions. And a spotlight will be turned on non-bank financial intermediation. As I already mentioned, the rapid expansion of this sector has widened financing options, but this year's crisis has shown that the non-banking sector can also be a source of systemic risk. The issue of a more effective regulation has gained due relevance only recently, and it is necessary to accelerate work to develop and adopt tools which improve our ability to monitor and prevent those risks.

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Engaging with a balanced and inclusive recovery requires long sightedness on the challenges and opportunities raised by pre-existing as well as newly emerging structural transformations. I would like to emphasise two of them in particular.

The first is the growing role of digitalisation in the economy, in finance and in society at large, which was certainly expected but is rapidly being accelerated by the pandemic.

We must avoid it resulting in new forms of exclusion and we must work to ensure that its benefits are widely shared. In particular, the shift towards digital financial services offers new opportunities but, if not effectively governed, also poses new challenges. Unequal access to finance may worsen the impact on current and future generations. The outcome crucially depends on the development and accessibility of digital infrastructures, the degree of financial and digital literacy and the adequacy of governance, including in the fields of regulation and supervision.

We should make the most of the lessons learned from the pandemic crisis and exploit them to "bounce forwards" towards a more inclusive and a more resilient post-pandemic world. The common goal is to make sure that no one is left behind, contrasting both the risk of exclusion and that of irresponsible financial behaviour, such as over-indebtedness, induced by disguised access to digital services.

We see two main, complementary areas of intervention. One is raising digital and financial awareness and competences of individuals and firms, delivering educational contents also through digital means. This is an essential tool for people's empowerment, active citizenship, financial inclusion, resilience and well-being. Households and businesses endowed with higher financial literacy will be better able to cope with the income strains they have to face during crises. Building up more substantial financial cushions in good times would make them better placed to cover living expenses in more difficult ones and avoid needing to resort to heavy borrowing. As co-chair of the G20 Global Partnership for Financial Inclusion, the Bank of Italy is fully committed to delivering on the thorough multi-annual agenda that was endorsed by the G20 last month.

This will also regard the other area of intervention that implies fostering more innovative regulatory and supervisory approaches so as to steer and encourage the development of inclusive and responsible digital financial services while granting an adequate protection to final customers, not least from cyber risk. This must be done as we adapt to an environment in which the use of digital channels for using payment, investment and lending services is steadily growing. Thus, under the Italian G20 Presidency we will continue to work on the cross-border dimension along the Roadmap that is being defined by the FSB.

The second structural challenge we should focus on is climate change. Absent more forceful measures to flatten the climate curve, global warming is expected to go far beyond the threshold of 1.5 Celsius degrees that, if surpassed, would bring about potentially catastrophic consequences for the planet, as is acknowledged by the United Nations Intergovernmental Panel on Climate Change.

Europe, China, Japan and South Korea have pledged to achieve carbon neutrality by 2050, an unprecedented transition in such a short time span. The temporary contraction of global energy demand induced by measures to contain the spread of Covid-19 reduced world emissions by 8 per cent in the first half of this year, a pace unparalleled in history and which cannot be maintained with the production technologies prevailing today. But urgency to restore pre-crisis output levels should not undermine our commitments.

It is necessary to make the growth and sustainability objectives complementary, in planning new infrastructures as well as in the maintenance of existing ones.

We should avoid, to any possible extent, using stimulus packages to finance technologies that lock our energy systems into a fossil fuel-dependent future. A lot can be achieved also in the financial sector, where mechanisms could be engineered to ensure that market allocation takes account of the environmental impact and climate-related risks. There is no lack of demand by investors: after the outbreak of Covid-19, amid market mayhem, we observed preferences skewed towards “sustainable assets”. This tendency must be encouraged through properly designed regulation and the adequate provision of information, and also by preventing the risk of “green washing” practices in the provision of sustainability scores by the rating industry.

There needs to be a coherent approach, activating all levers – incentives, taxes and regulation – to deliver on our goals. Italy, which will also co-host, along with the United Kingdom, next year’s Conference of the Parties (COP26) under the United Nations Framework Convention on Climate Change, will strive to bring “climate cooperation” to the centre of debate also within the G20. We are aware that there is some contention around how to deal with this issue, but we are also firmly convinced that there cannot be any more room for complacency.

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I discussed some of the issues that will be focused on by the Italian G20 Presidency in the coming year, in particular within the Finance Track, with no ambition to be either exhaustive or detailed. Our agenda will be kept flexible enough so as to adapt to the rapidly evolving health and economic situation.

Next year, the global economy is expected to advance along a slow and very uncertain path of recovery and so far we have merely succeeded in picking the proverbial low-hanging fruit; the end point will be a “new normality” that is hard to prefigure in sufficient detail at the moment. All policies must contribute to averting downside risks, by means of a far-sighted and cooperative approach.

Striving for the global common good, the signature byword of the Global Foundation, is also at the root of the G20 and must be its lighthouse. Multilateralism has suffered major setbacks in recent years, but in the current emergency the G20 has proven again that it can make a difference. With the 2021 Presidency of the Group, Italy now carries the full burden of responsibility for ensuring that it will live up to the expectations of all communities.