Kryzys fiskalny w Europie – Strategie wyjścia

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BRE BANK SA

CASE
Centrum Analiz Społeczno-Ekonomicznych

Presentation based on:

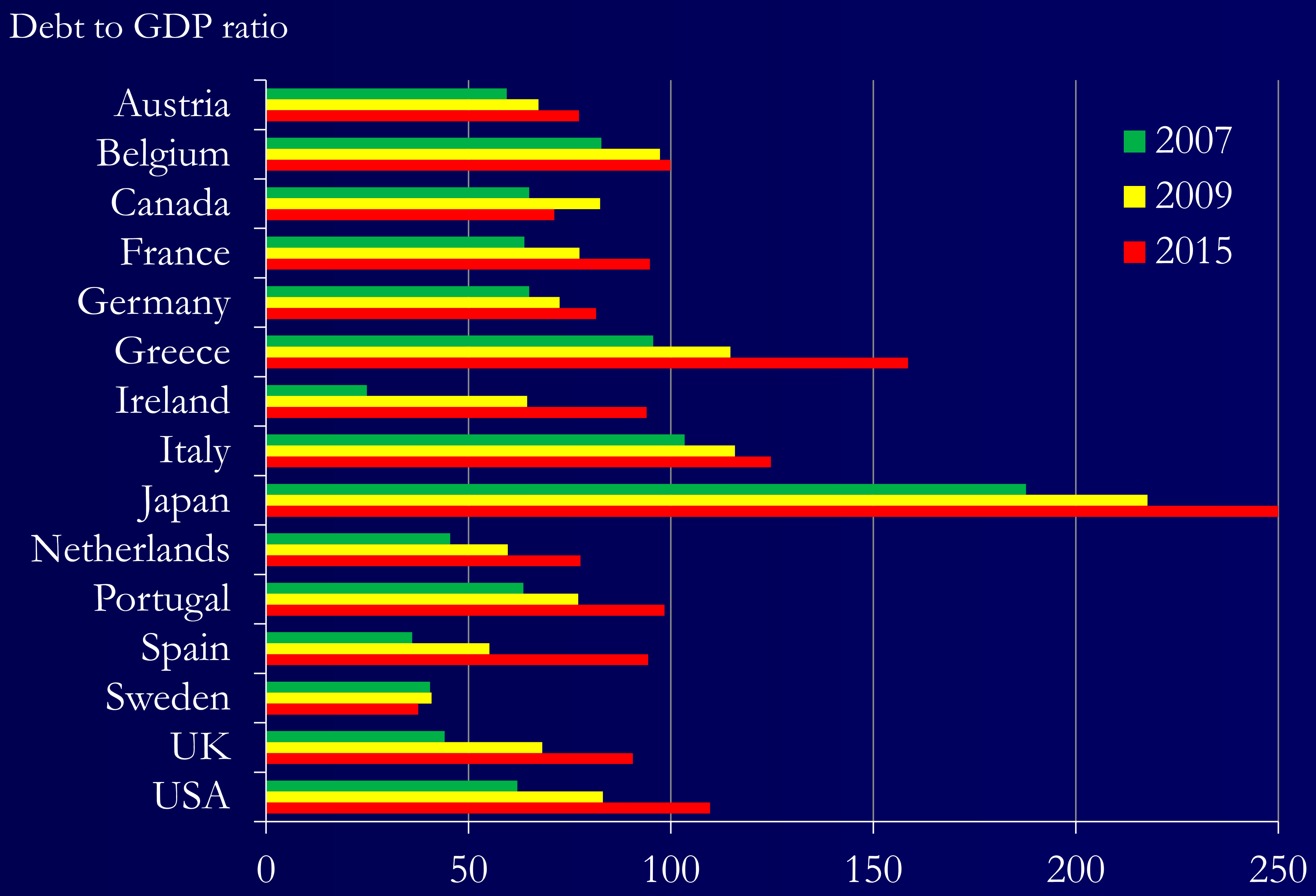
✓ Fiscal Space

- Ostry, Ghosh, Kim and Qureshi SPN/10/11 (September 1, 2010)

✓ Default in Today's Advanced Economies: Unnecessary, Undesirable, and Unlikely

- Cottarelli, Forni, Gottschalk and Mauro SPN/10/12 (September 1, 2010)

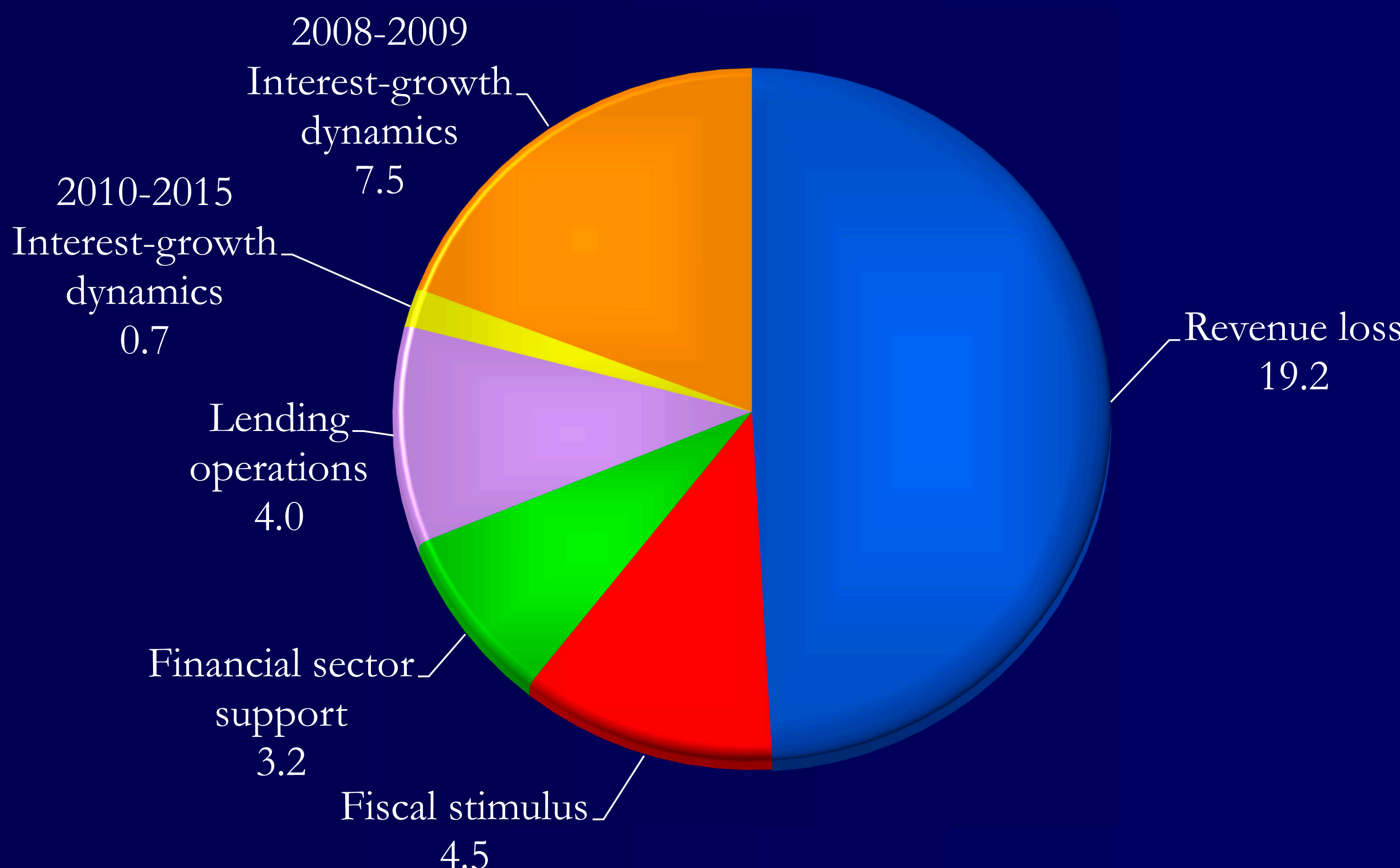
Growth of debt has been very rapid



Recession, not stimulus, is to blame.

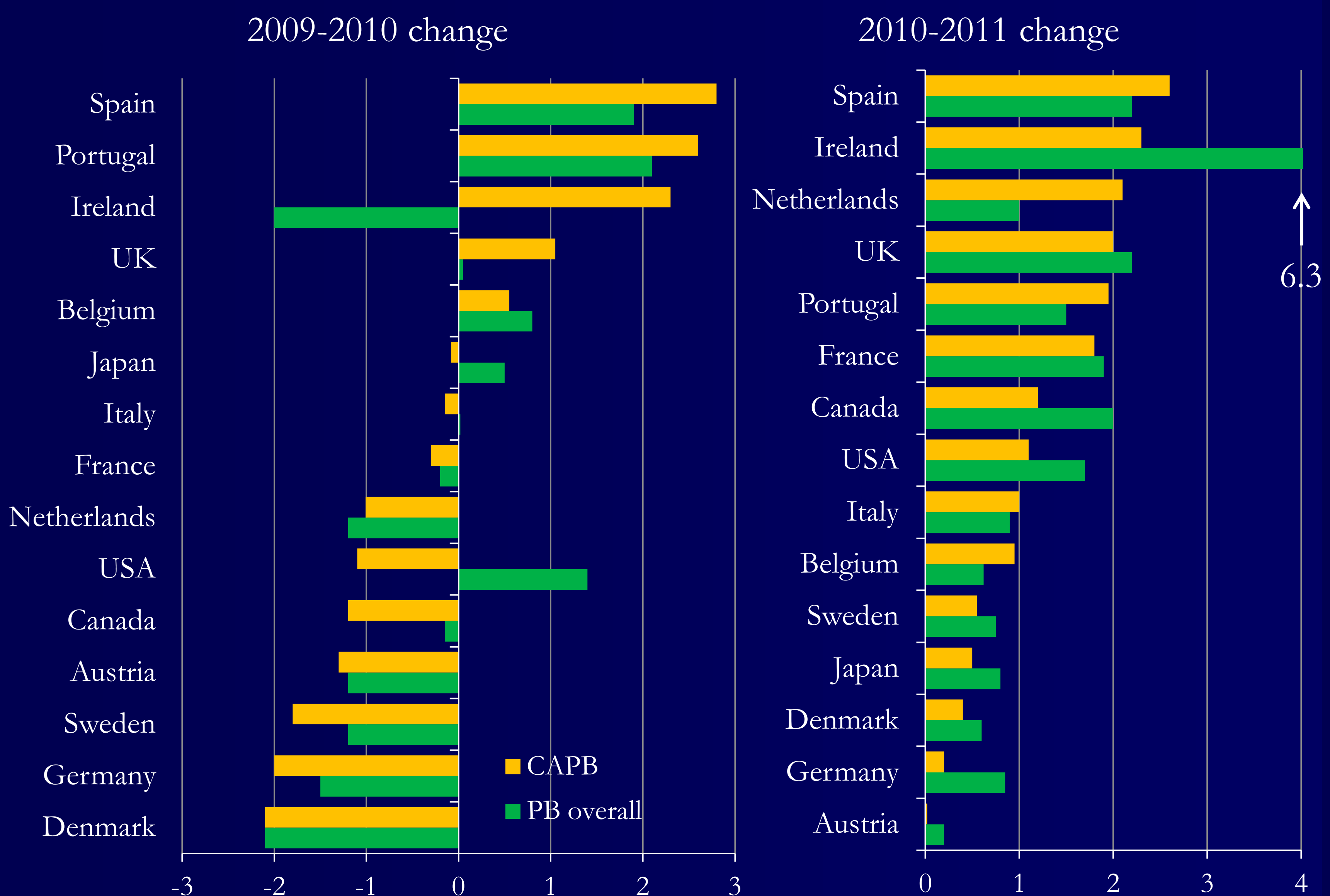
G-20 Advanced Economies: Increase in Public Debt, 2008-15

(Total increase: 39.1 percentage points of GDP; 2009 PPP weighted GDP)



Source: World Economic Outlook, April 2010; Staff estimates

Adjustment of primary balances starts in earnest in 2011

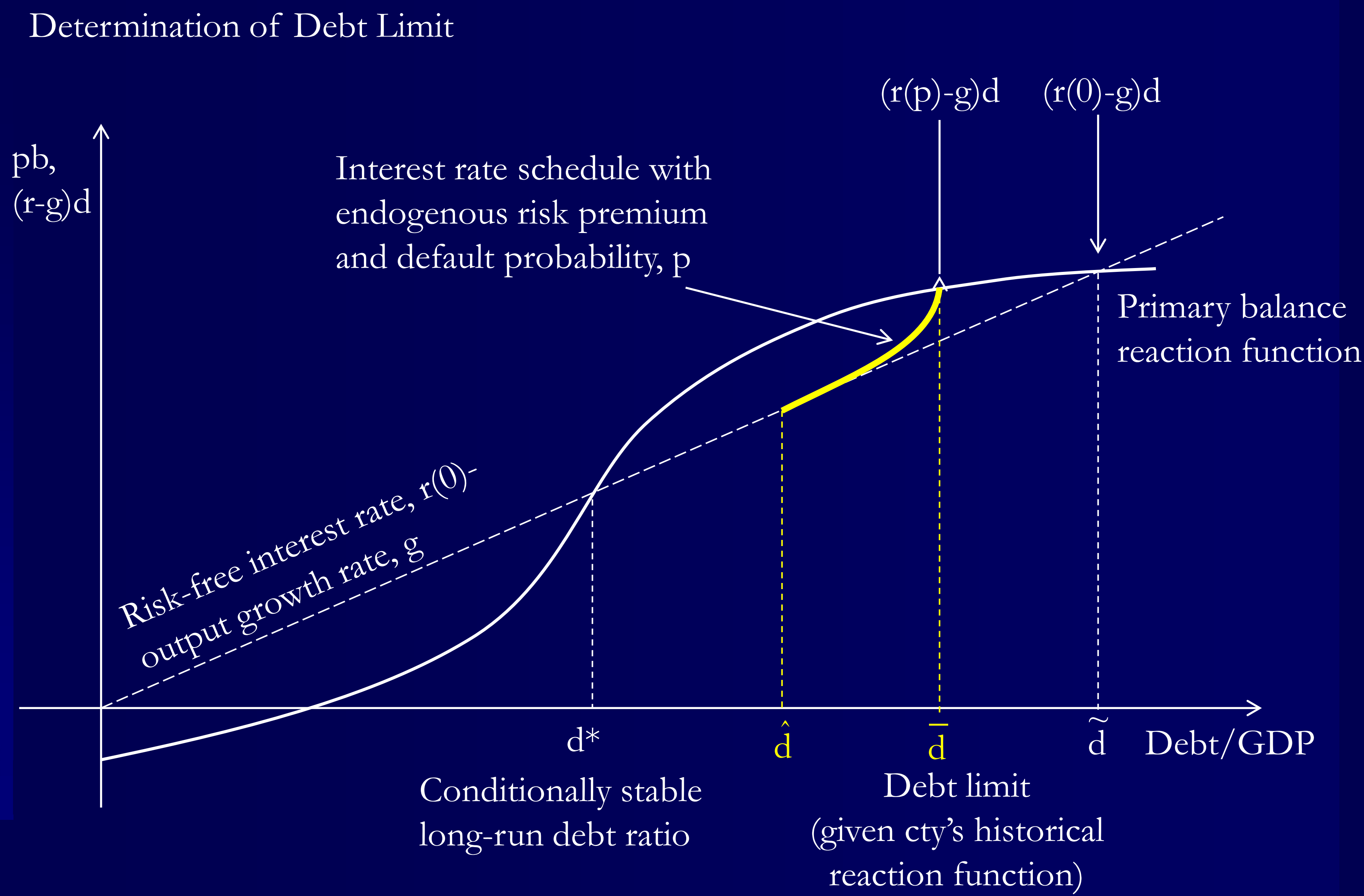


Some definitions

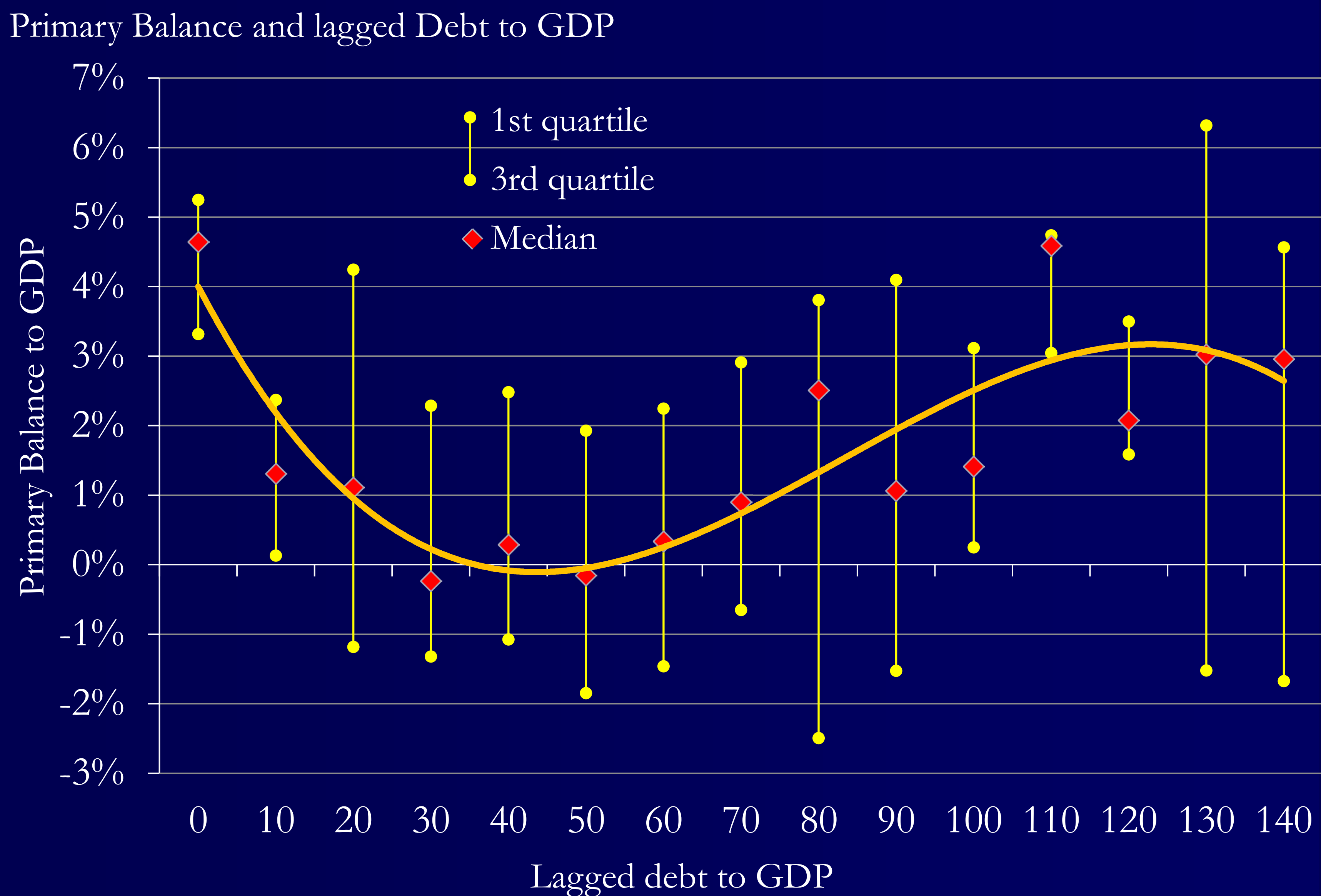
- ✓ Debt limit
  - Point at which debt dynamics become unstable without exceptional fiscal effort
- ✓ Fiscal space
  - Room to borrow before hitting debt limit

Paper makes definitions operational and estimates fiscal space in advanced economies

Simple dynamics of the debt limit



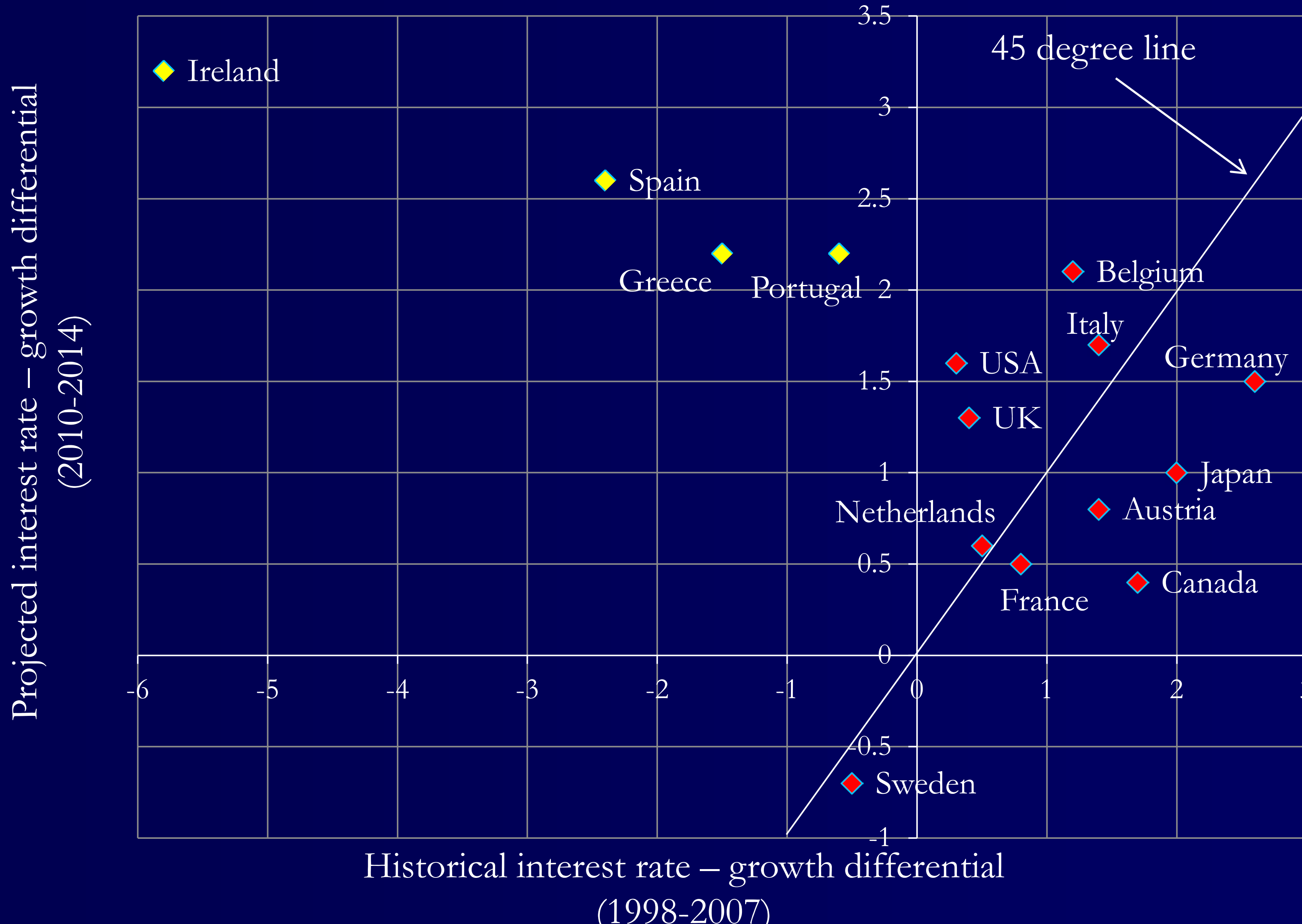
Reaction function looks plausible



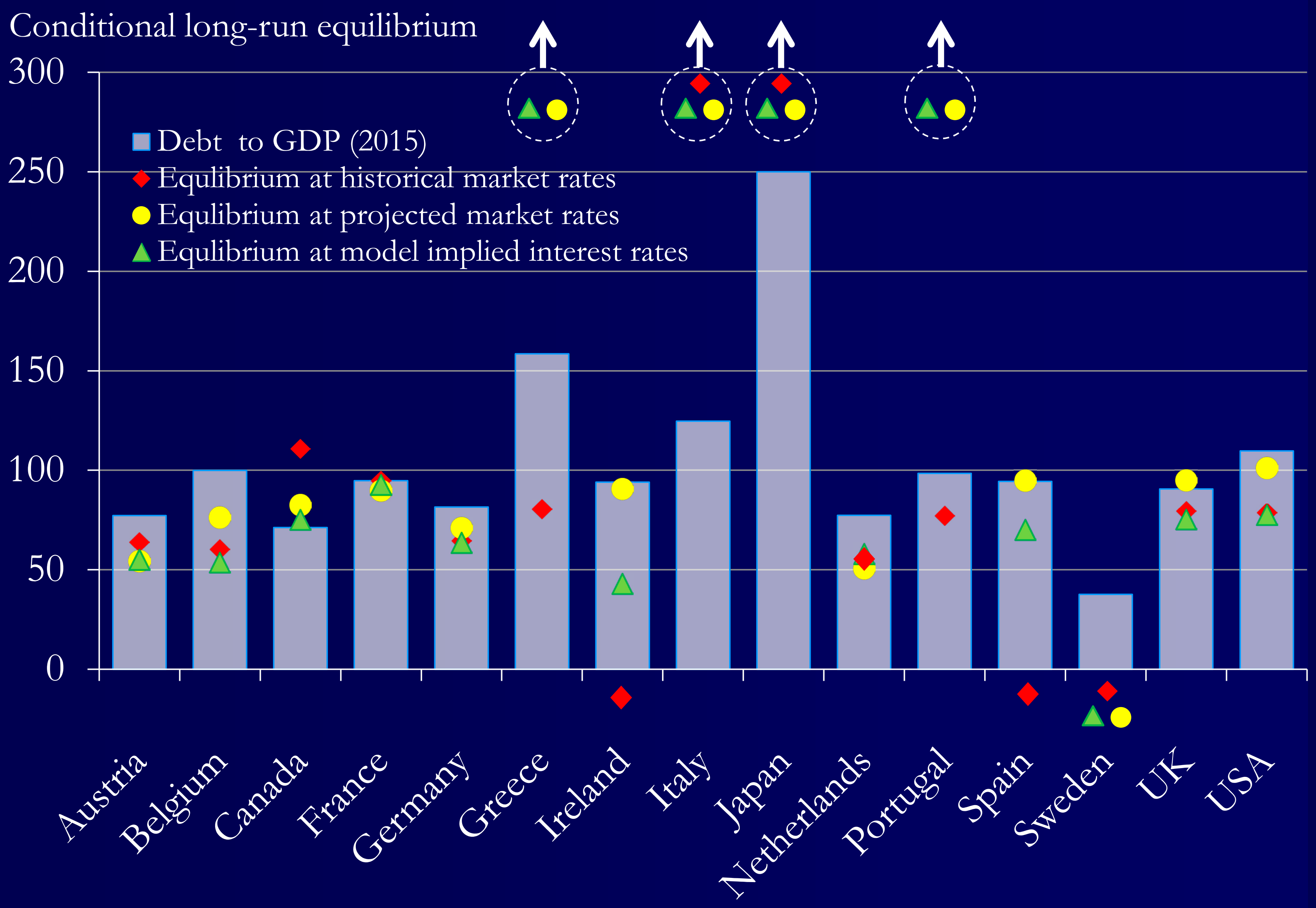
Elements in the regression

- ✓ Dependent variable
  - General government primary balance to GDP
- ✓ Independent variables
  - Lagged debt (cubic)**
  - Output gap***
  - Government expenditure gap***
  - Trade openness***
  - Inflation**
  - Age dependency (present and future)
  - Commodity prices
  - Political stability**
  - IMF arrangement
  - Fiscal rules

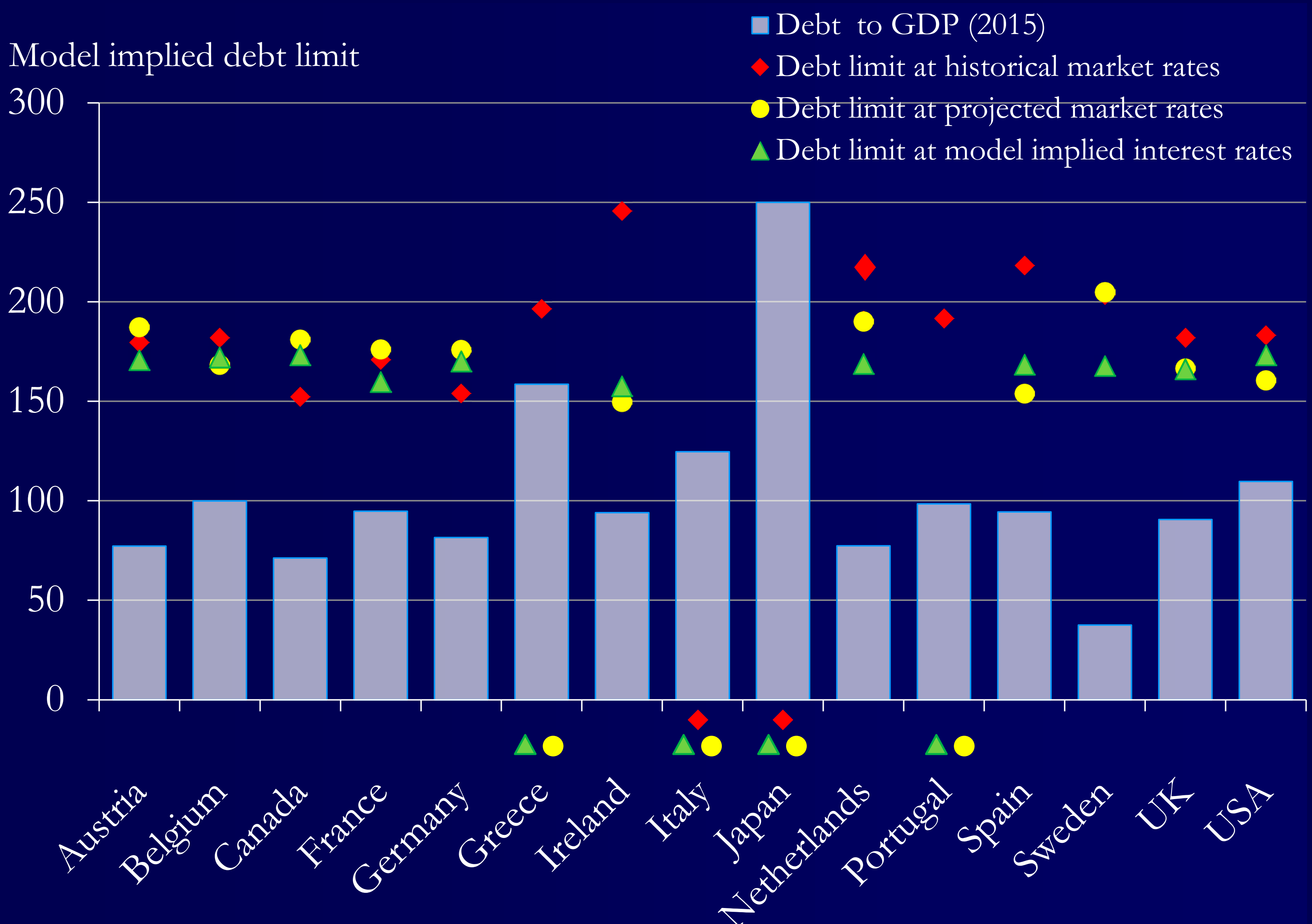
The interest-growth differential is deteriorating in some cases



2015 and stable debt levels (d*)



2015 debt and debt limit ($\bar{d}$)



Estimates of fiscal space

	Fiscal Space (percent of GDP)	p(FS>0)	p(FS>50)	p(FS>100)
Austria	93.4	0.81	0.81	0.38
Belgium	72.1	0.96	0.92	0.05
Canada	101.9	0.81	0.81	0.57
France	64.9	0.66	0.63	0.04
Germany	88.5	0.83	0.82	0.26
Greece	0	0.00	0.00	0.00
Ireland	63.6	0.61	0.59	0.04
Italy	0	0.00	0.00	0.00
Japan	0	0.00	0.00	0.00
Netherlands	91.3	0.81	0.81	0.35
Portugal	0	0.28	0.24	0.01
Spain	74	0.83	0.80	0.06
Sweden	130.2	0.71	0.71	0.71
UK	75.4	0.69	0.69	0.12
USA	63.4	0.82	0.71	0.03

Probability lower than 50%

Some points to note

- ✓ Estimates are based on historical patterns and do not exclude exceptional responses
- ✓ Shocks can push countries beyond their debt limit
- ✓ Having fiscal space and using it are different things

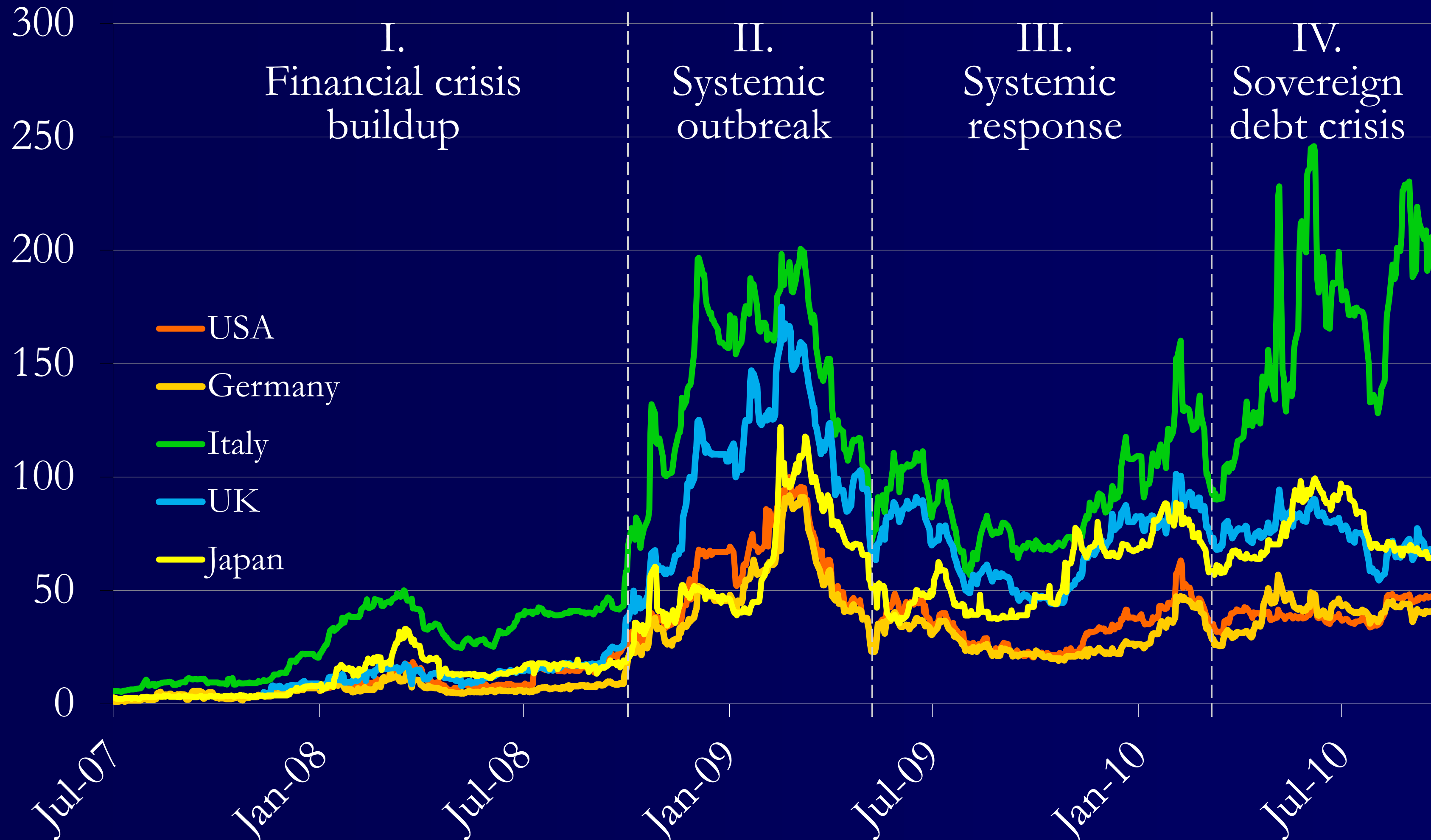
Why do some commentators think default is inevitable?

- ✓ Needed adjustment is too large
- ✓ Interest rates make debt burden unsustainable
- ✓ Fiscal adjustment will hurt growth and make debt unsustainable
- ✓ Once primary balance reaches balance it makes sense to default

Markets have become worried about possible defaults

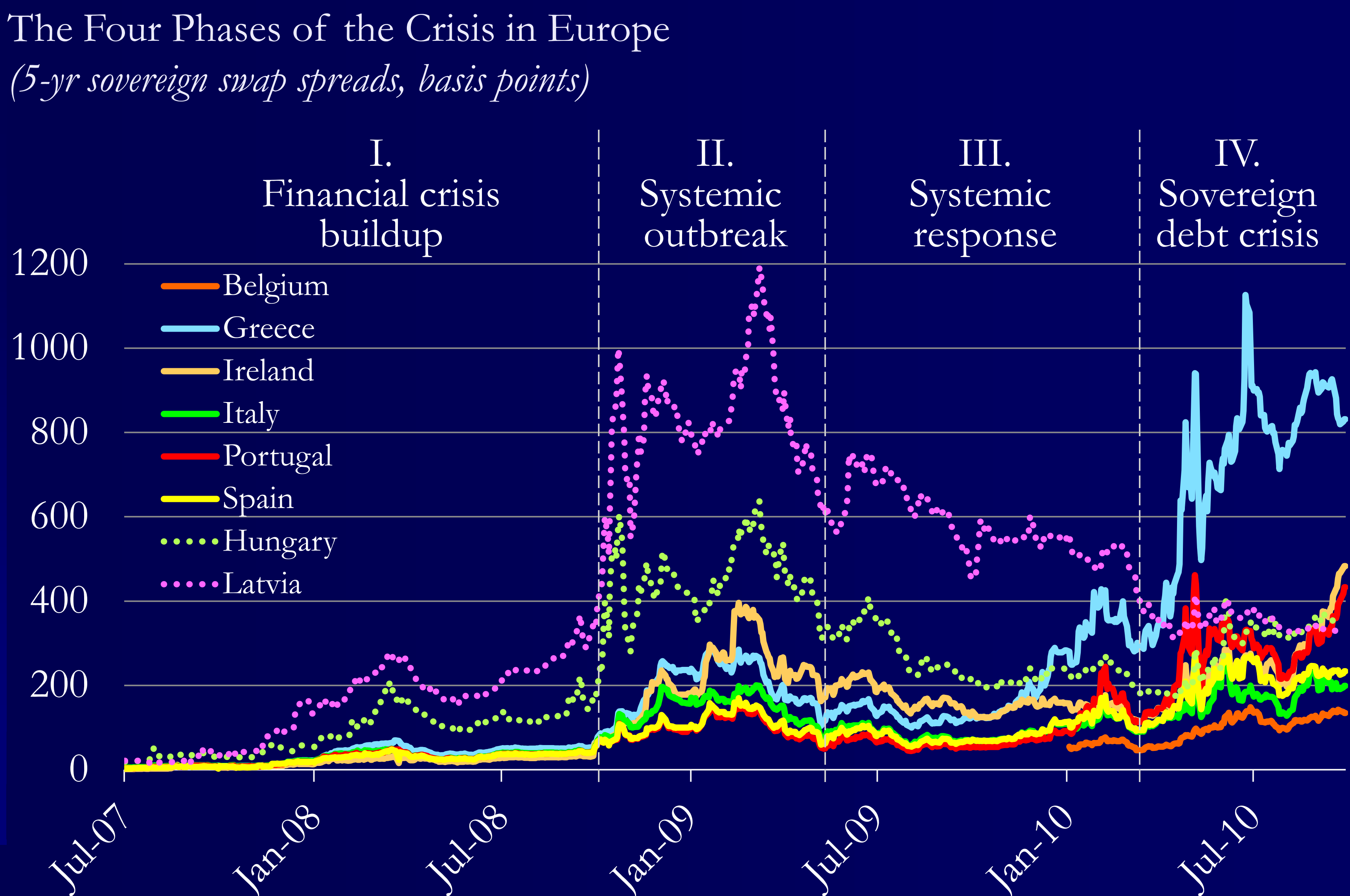
The Four Phases of the Crisis

(5-yr sovereign swap spreads, basis points)



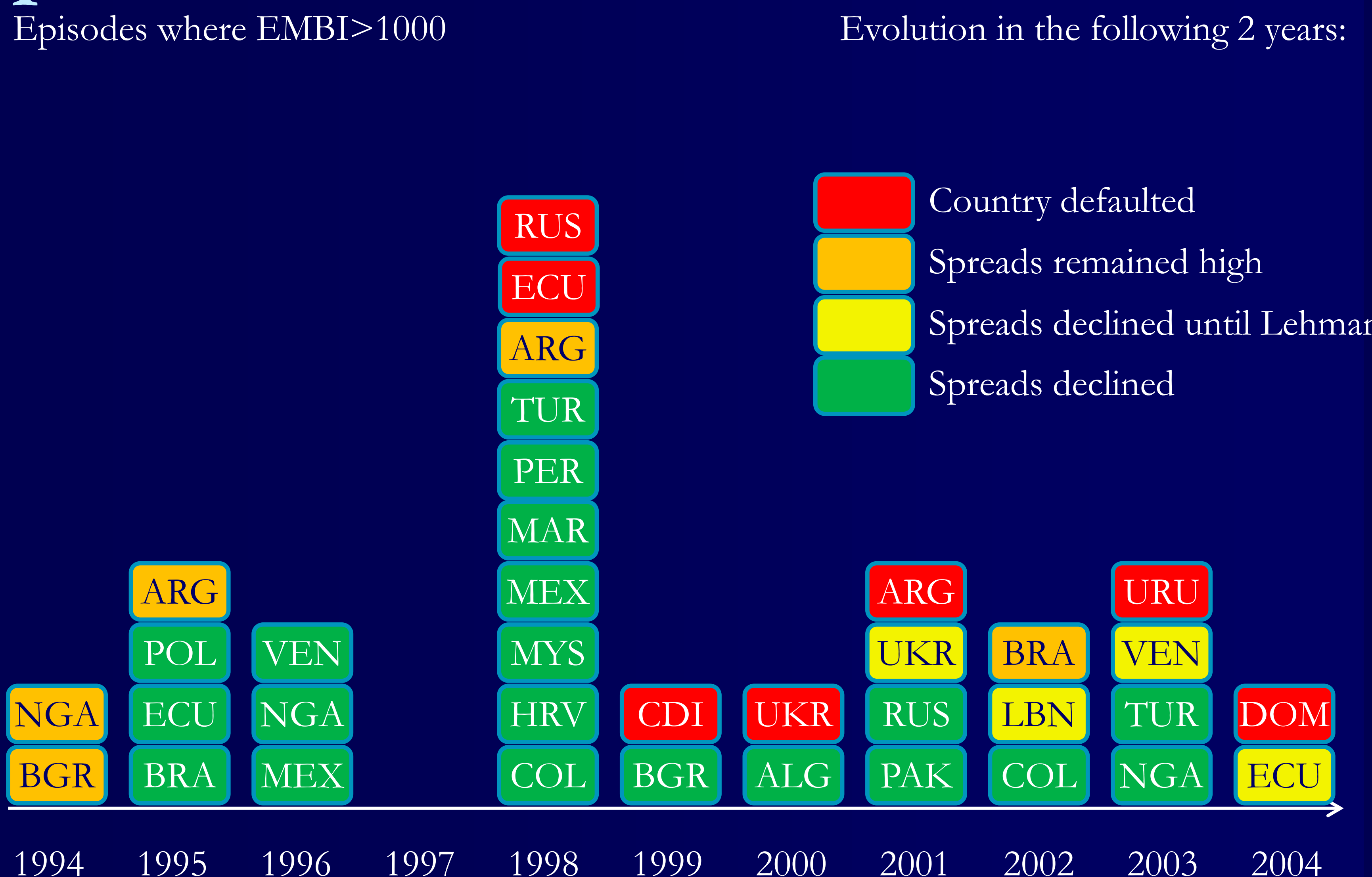
Source: Bloomberg

Particularly in some European countries

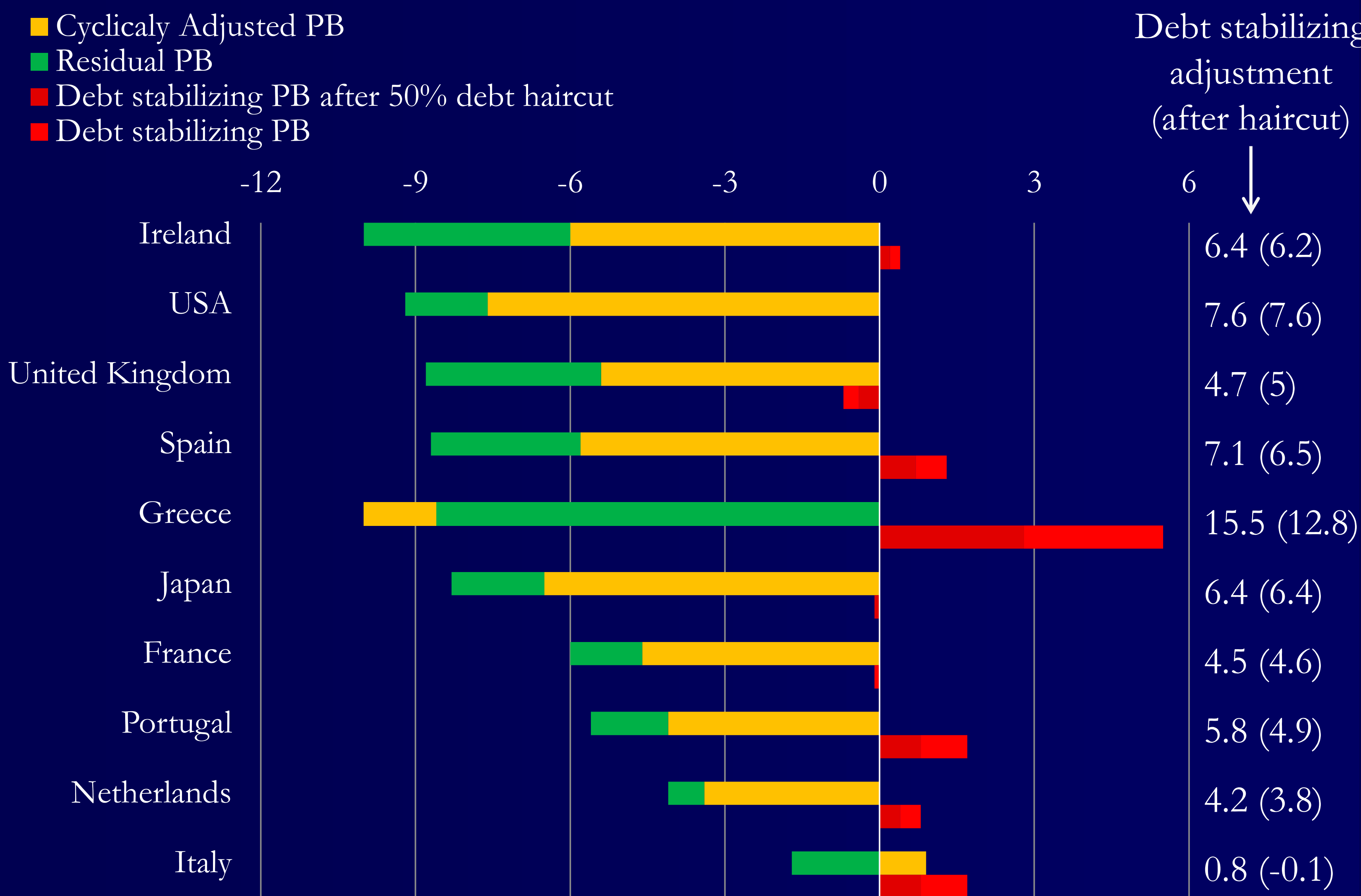


Source: Bloomberg

High spreads are not a very good predictor of default



Primary balance adjustment to stabilize debt



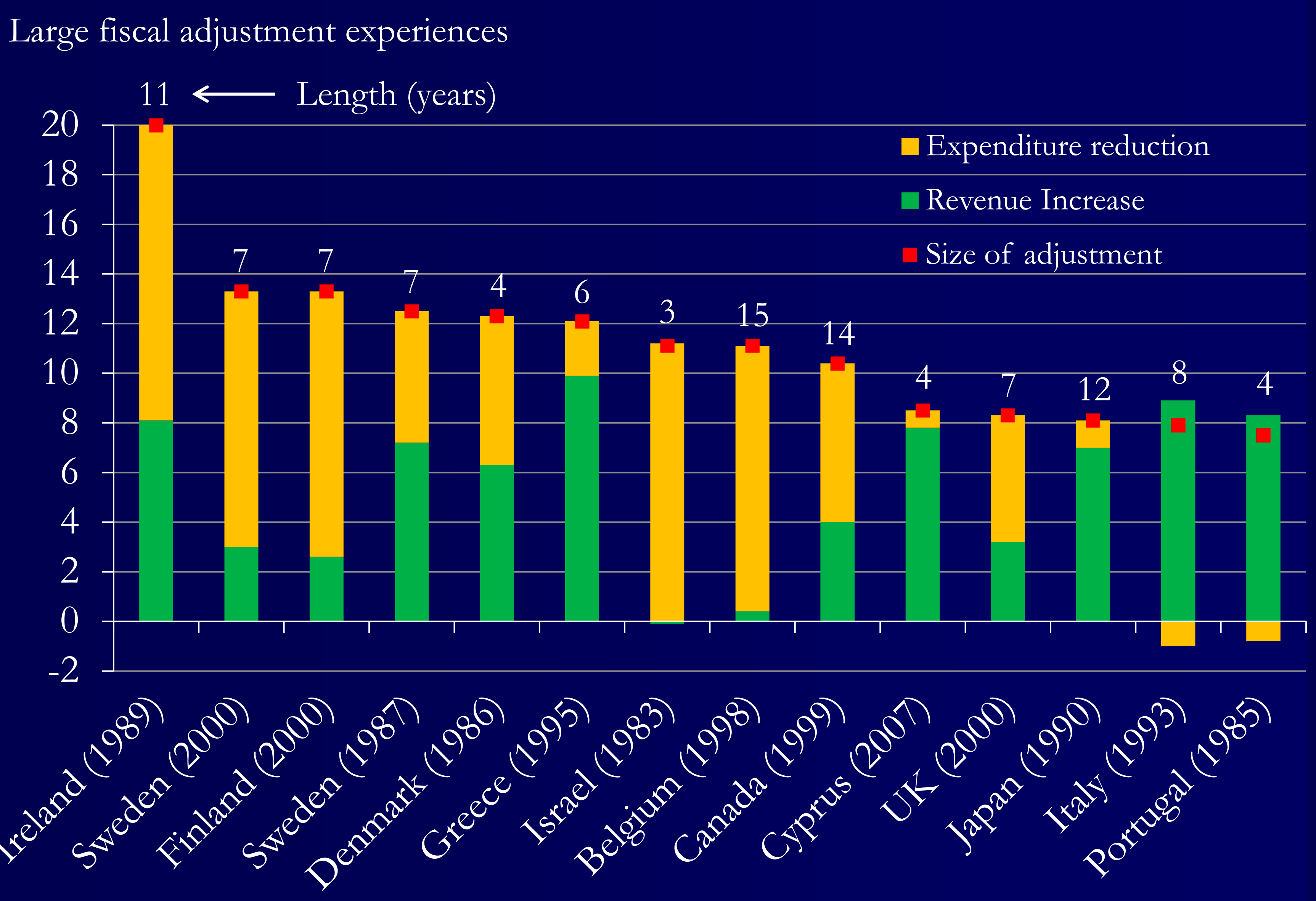
Other debt targets are important

- ✓ Stabilizing debt at the 2012 level may not be sufficiently ambitious
- ✓ In most cases further action would be needed to bring debt to 60 percent of GDP
- ✓ Aging and health-care costs will require further adjustments

Recent large adjustment episodes
Structural PB improved by more than 7 percent

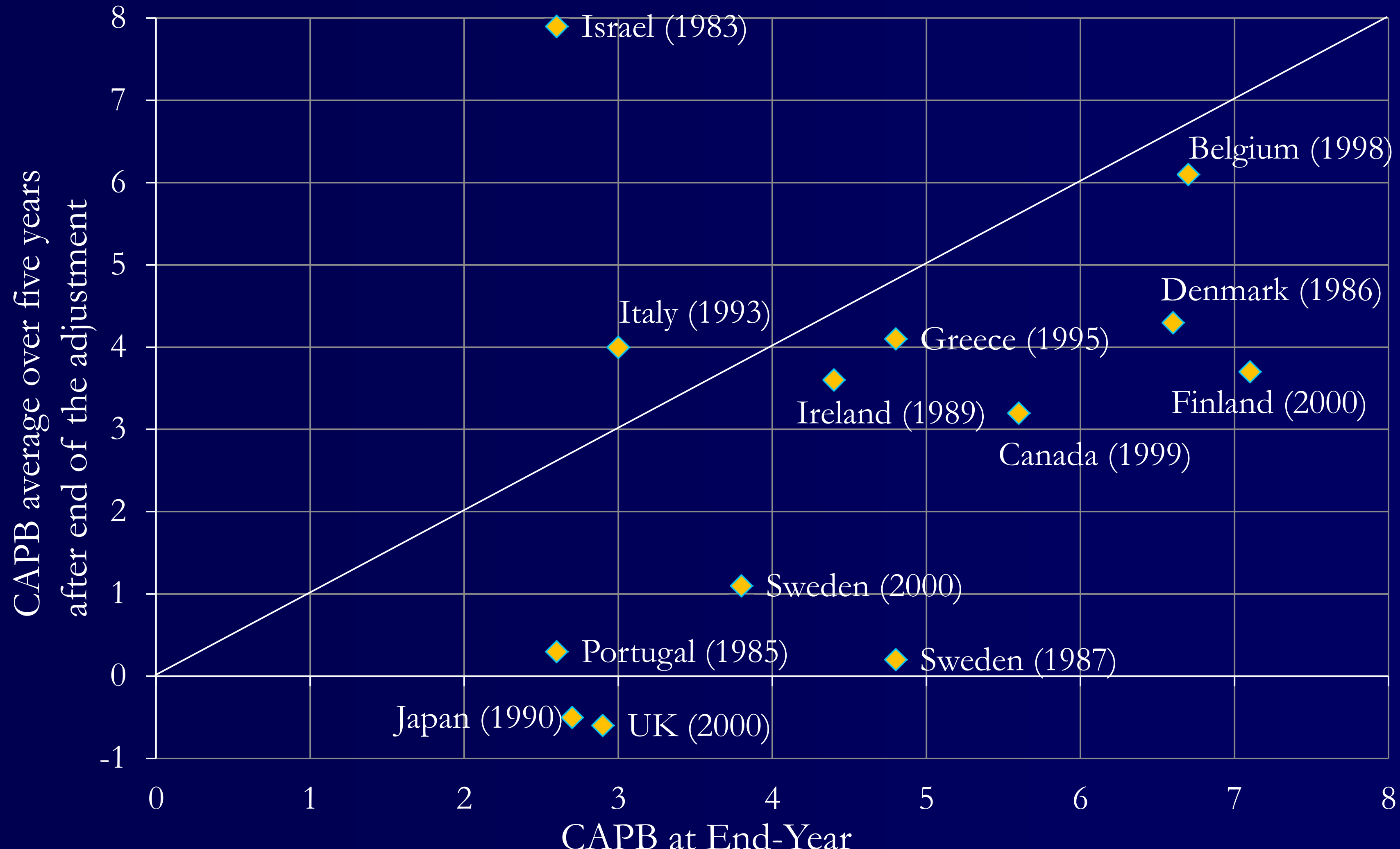
- ✓ Advanced (14)
  - Belgium (1998), Canada (1999), Cyprus (2007), Denmark (1986), Finland (2000), Greece (1995), Ireland (1989), Israel (1983), Italy (1993), Japan (1990), Portugal (1985), Sweden (1987), Sweden (2000), United Kingdom (2000)
- ✓ Emerging Economies (26)

Episodes of large fiscal adjustment

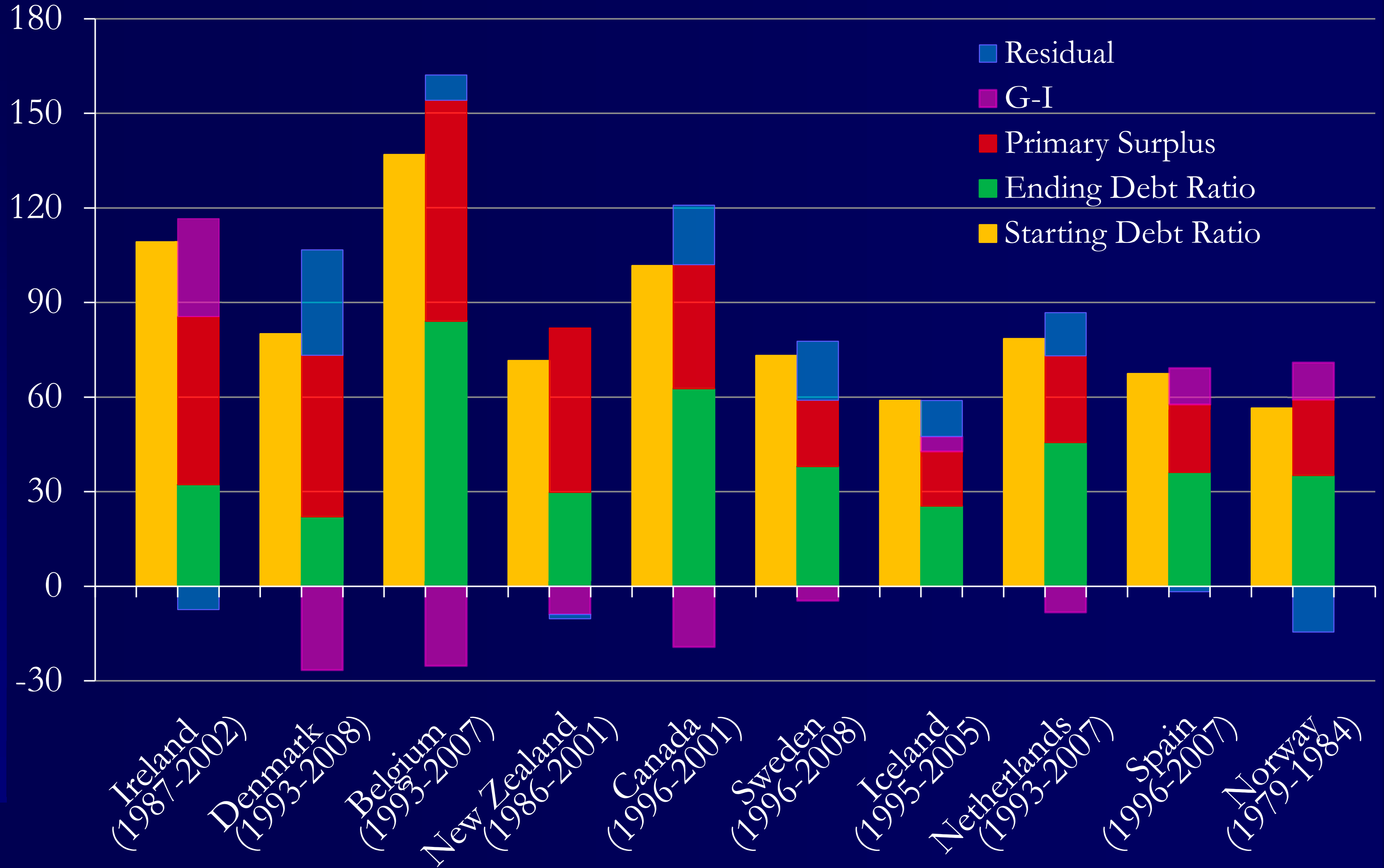


Primary balance surpluses in large fiscal adjustments

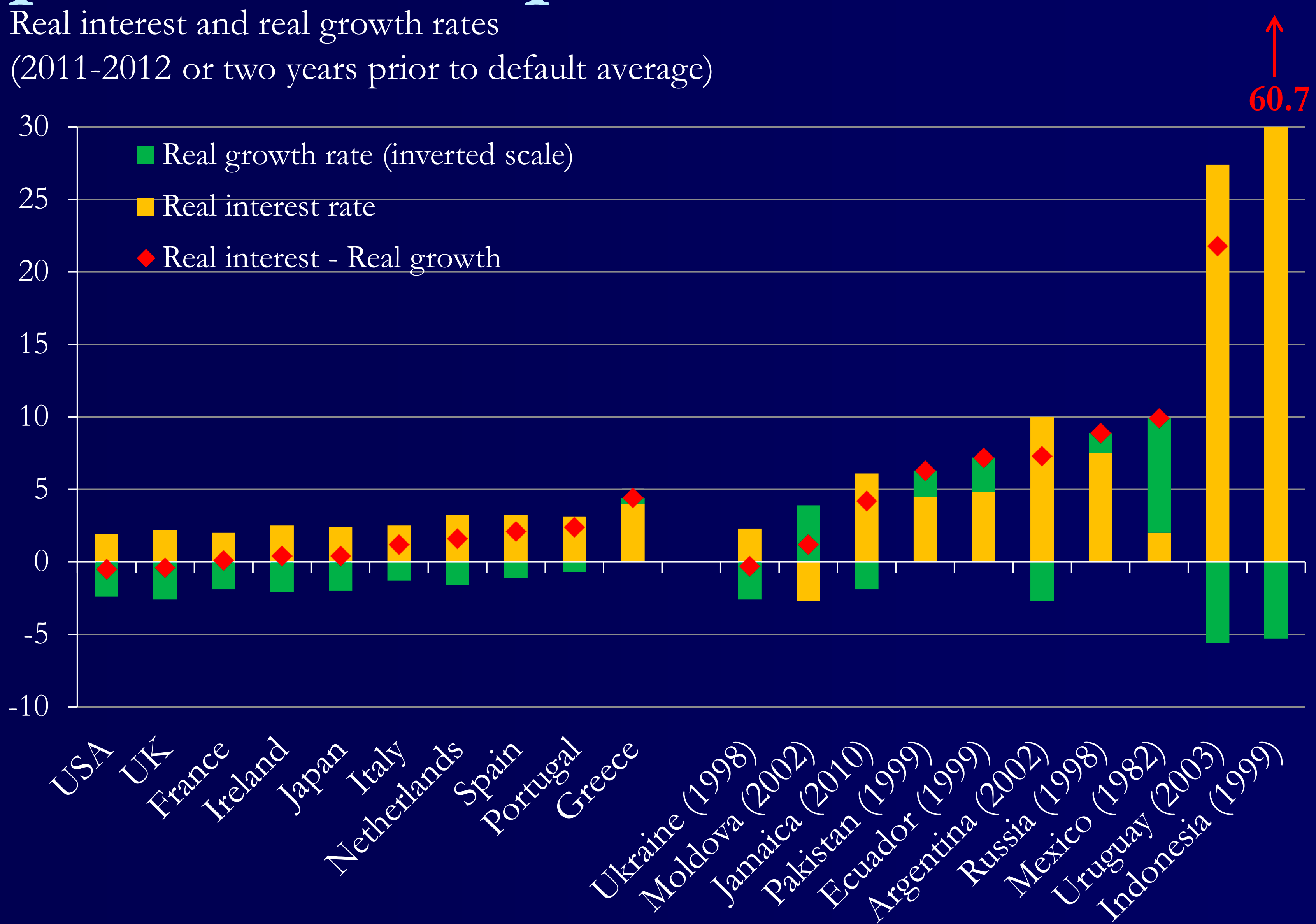
Large fiscal adjustment experiences



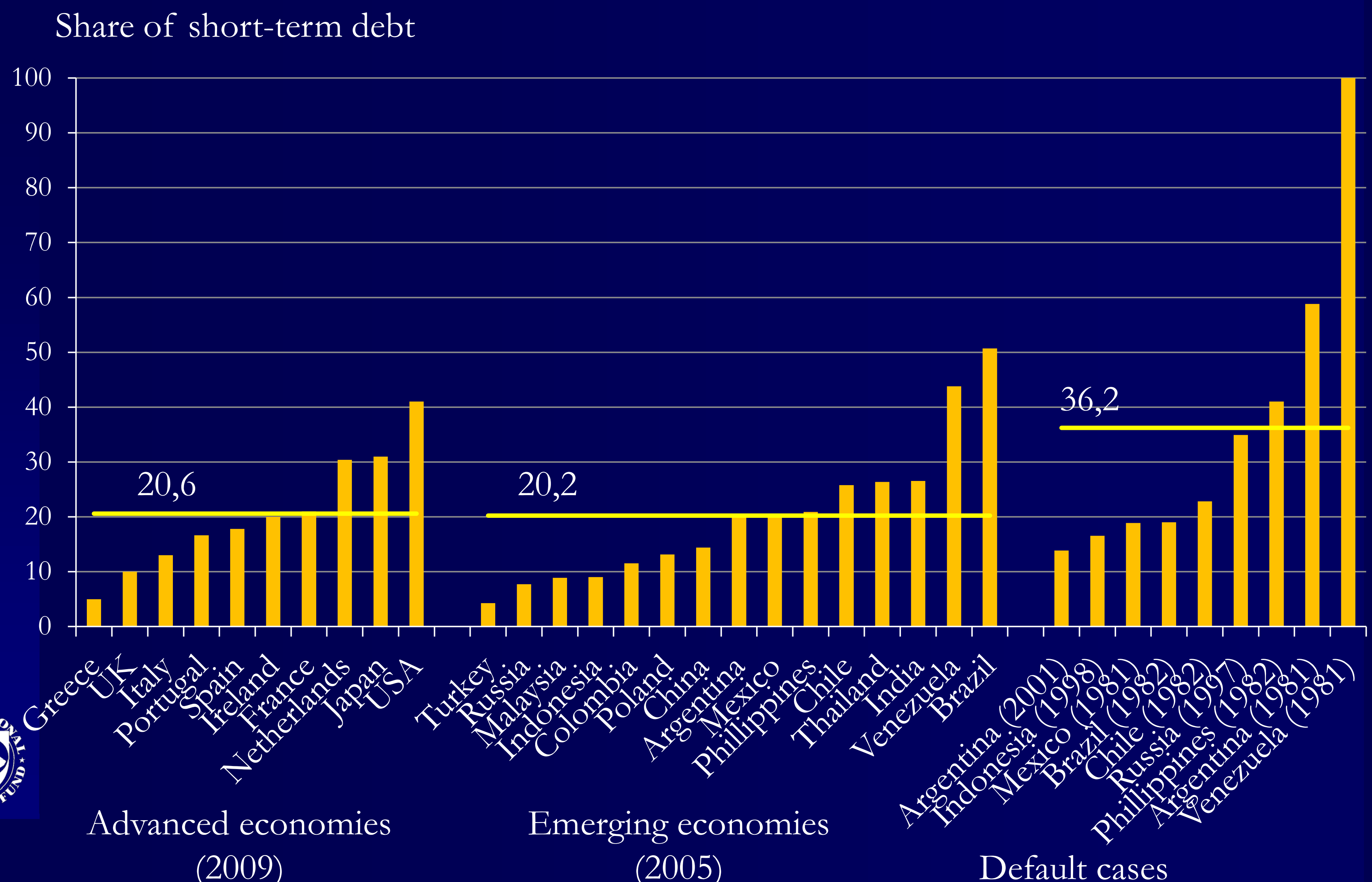
How high debt ratios were reduced



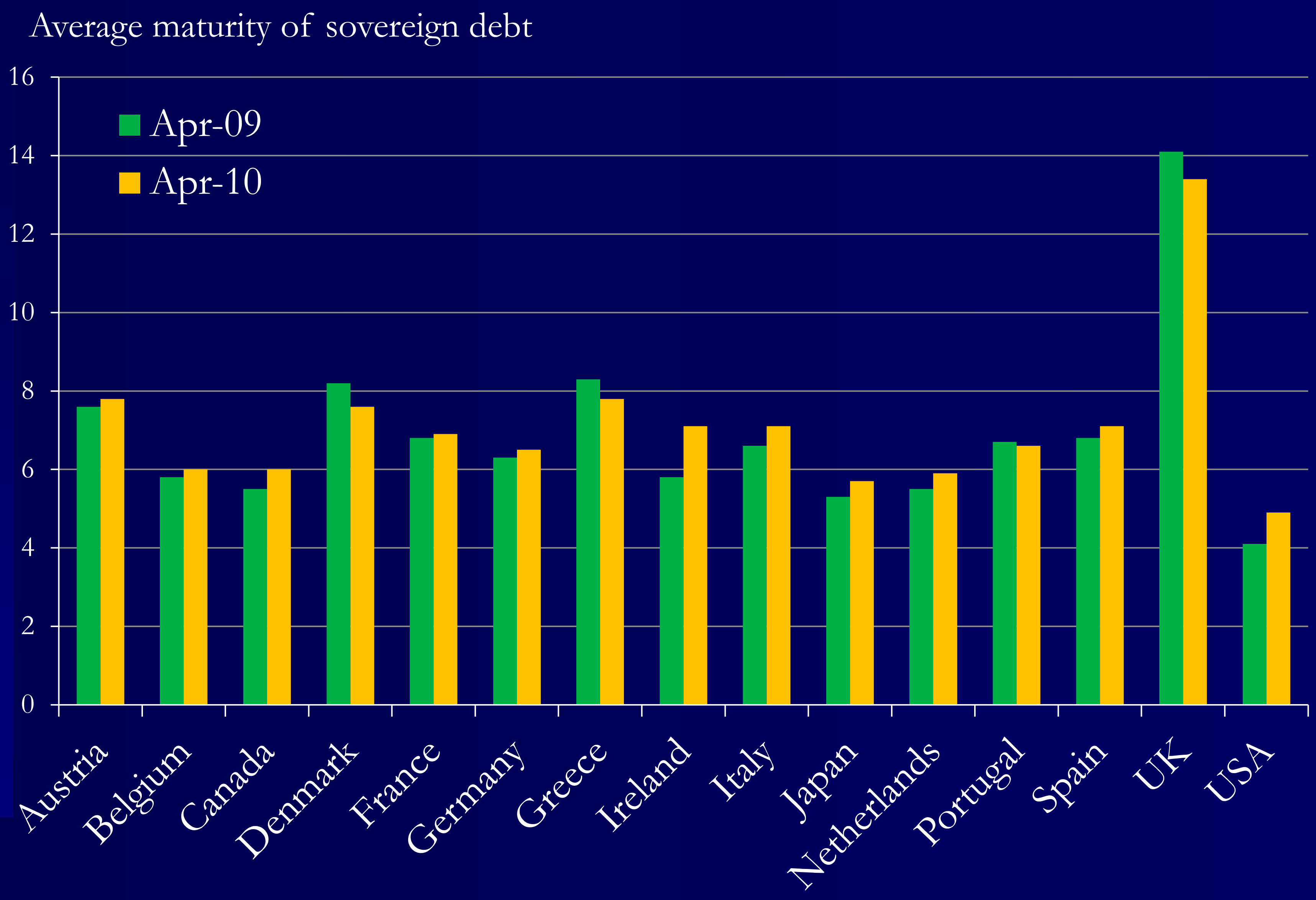
Interest-growth differential below past default episodes



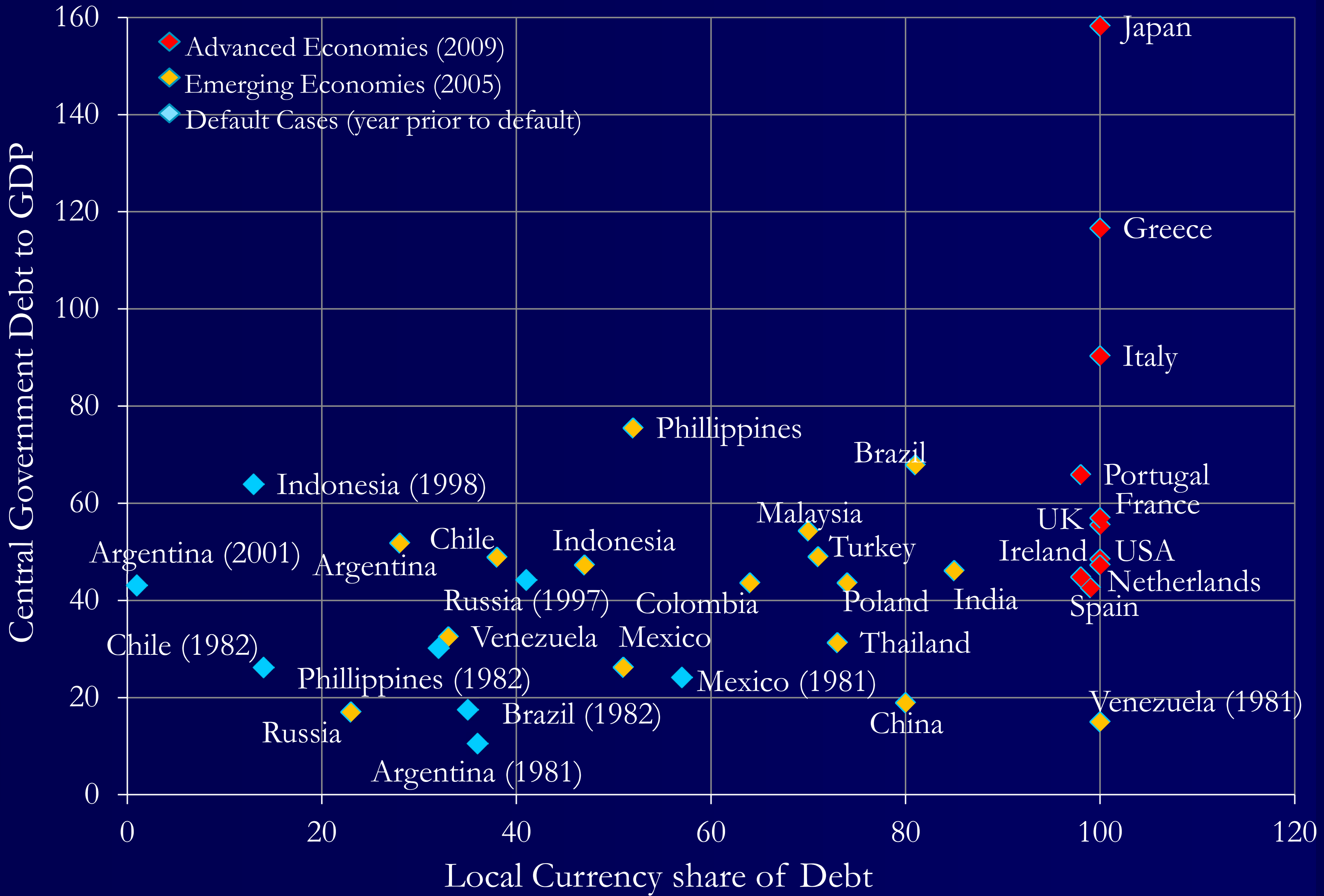
Maturities longer than in past defaults



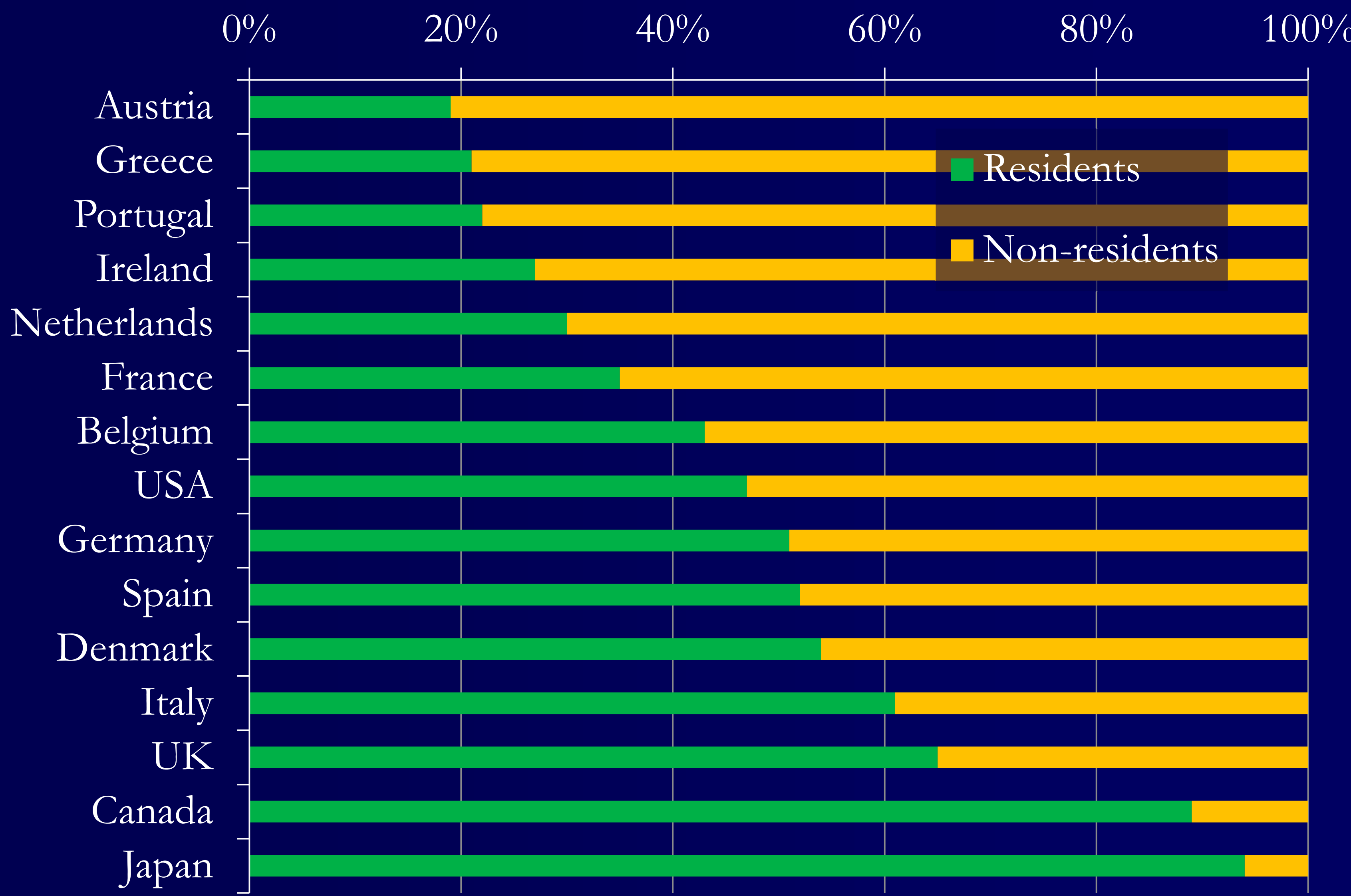
The average maturity of Government debt gives countries time to adjust



The structure of debt is more resilient



Residency of holders discourages default in some cases



Some observations (1)

- ✓ The primary balance surplus required to stabilize debt is not unprecedented.
- ✓ Large deficits in some cases reflect recent wrong policy decisions which could be more easily reversed.
- ✓ Once countries have incurred the initial pain of adjustment, they persevere and go to great lengths to avoid default.
- ✓ The problem today is the large primary deficit, not high interest rates and a high interest bill.

Some observations (2)

- ✓ Countries have time to convince the markets before their total government interest bill becomes too high.
- ✓ Many countries have faced serious market tensions and similarly high spreads but could stabilize the situation.
- ✓ Current market signals should not be interpreted as pointing to an inevitable negative outcome.

Main message of paper

- ✓ A large fiscal adjustment is unavoidable for today's advanced economies for a durable increase in economic growth.
- ✓ A restructuring would be no substitute for the needed fiscal and structural reforms, and would be a distraction.

Thank you