Restoring Fiscal Sustainability in CESEE countries

Zsolt Darvas

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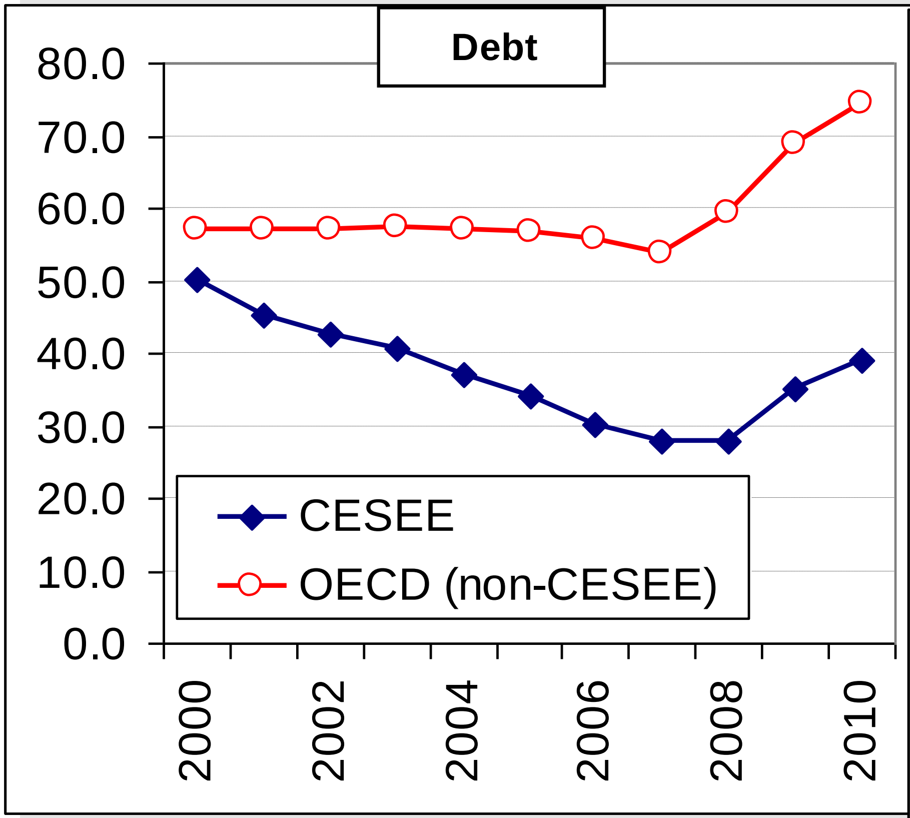
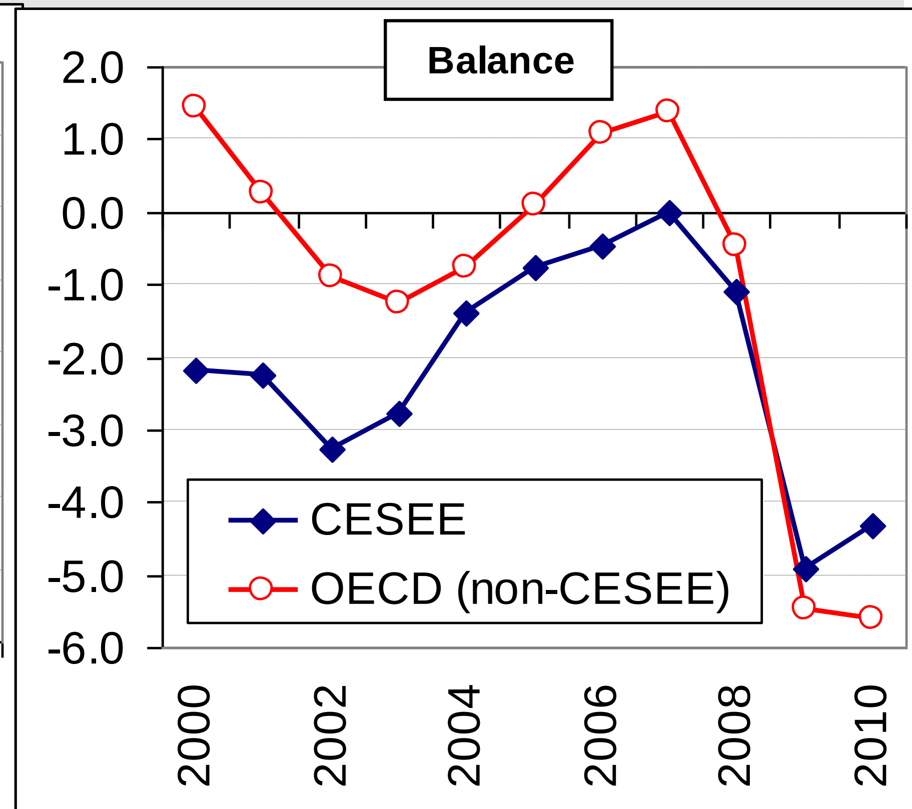
Is fiscal sustainability in danger?

General government balance and gross debt (% GDP), 2000-2010





CESEE: low debt (on average), even after the crisis

What is the alarming level of government debt?

- Government debt/GDP levels in 2007 in CESEE countries that turned to IMF in 2008/09

Armenia	16
Bosnia and Herzegovina	19
Georgia	22
Hungary	**66**
Latvia	**9**
Romania	13
Serbia	34
Ukraine	13

What is the alarming level of government debt? (2)

- Government debt/GDP levels in the year before some recent government defaults

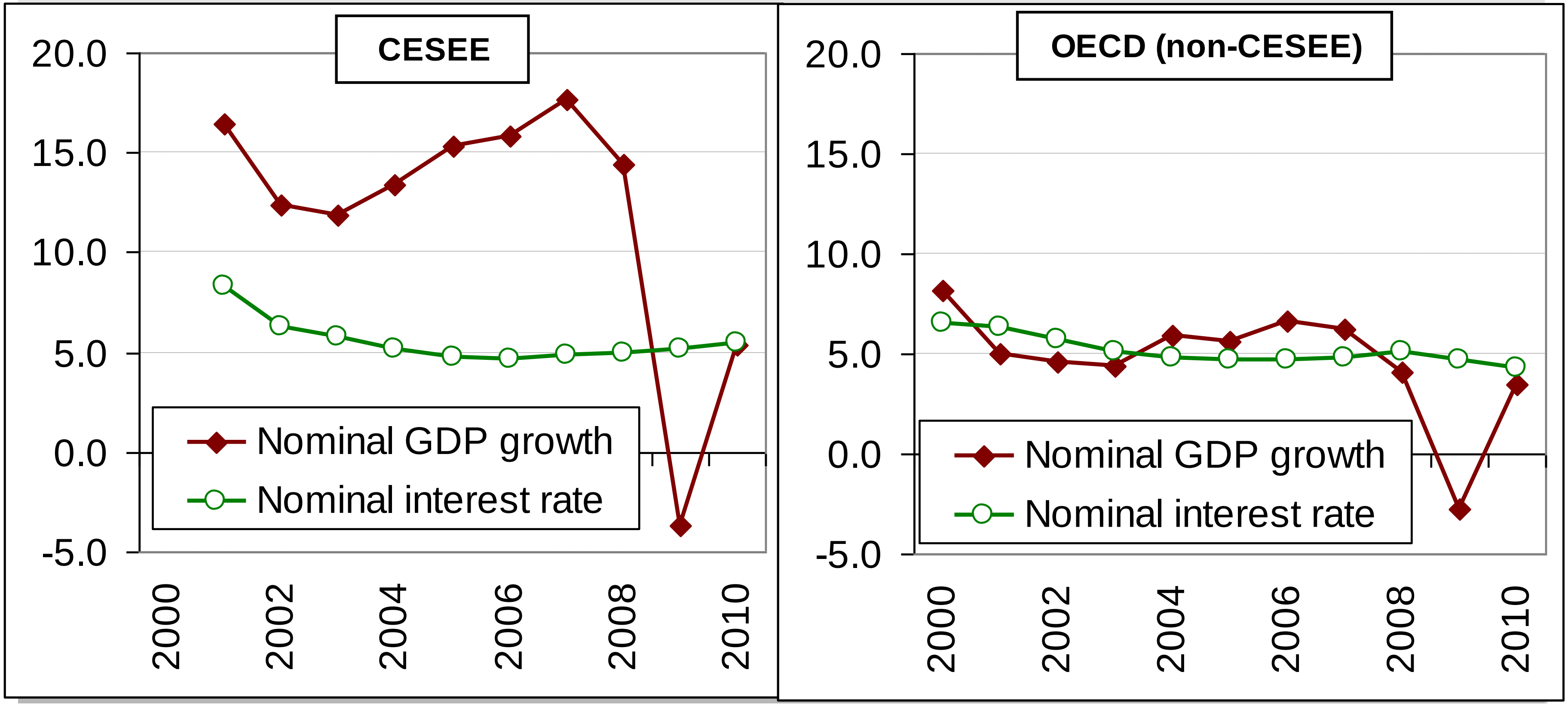
Argentina 2002	54
Russia 1998	66
Ukraine 1998	37

What is the 'optimal' level of government debt?

- Government debt/GDP levels in CESEE are quite low even after the crisis
- Yet some countries had to turn to the IMF when debt was very low, and there were also sovereign defaults at reasonably low levels of debt
- But other CESEEs have not defaulted/gone to the IMF
- Other factors than government debt were more important in CESEE: vulnerability of the private sector

The reason why government debt fell before the crisis in CESEE: GDP growth was well above the interest before the crisis

Implicit nominal interest rate on government debt and nominal GDP growth (%), 2000-2010



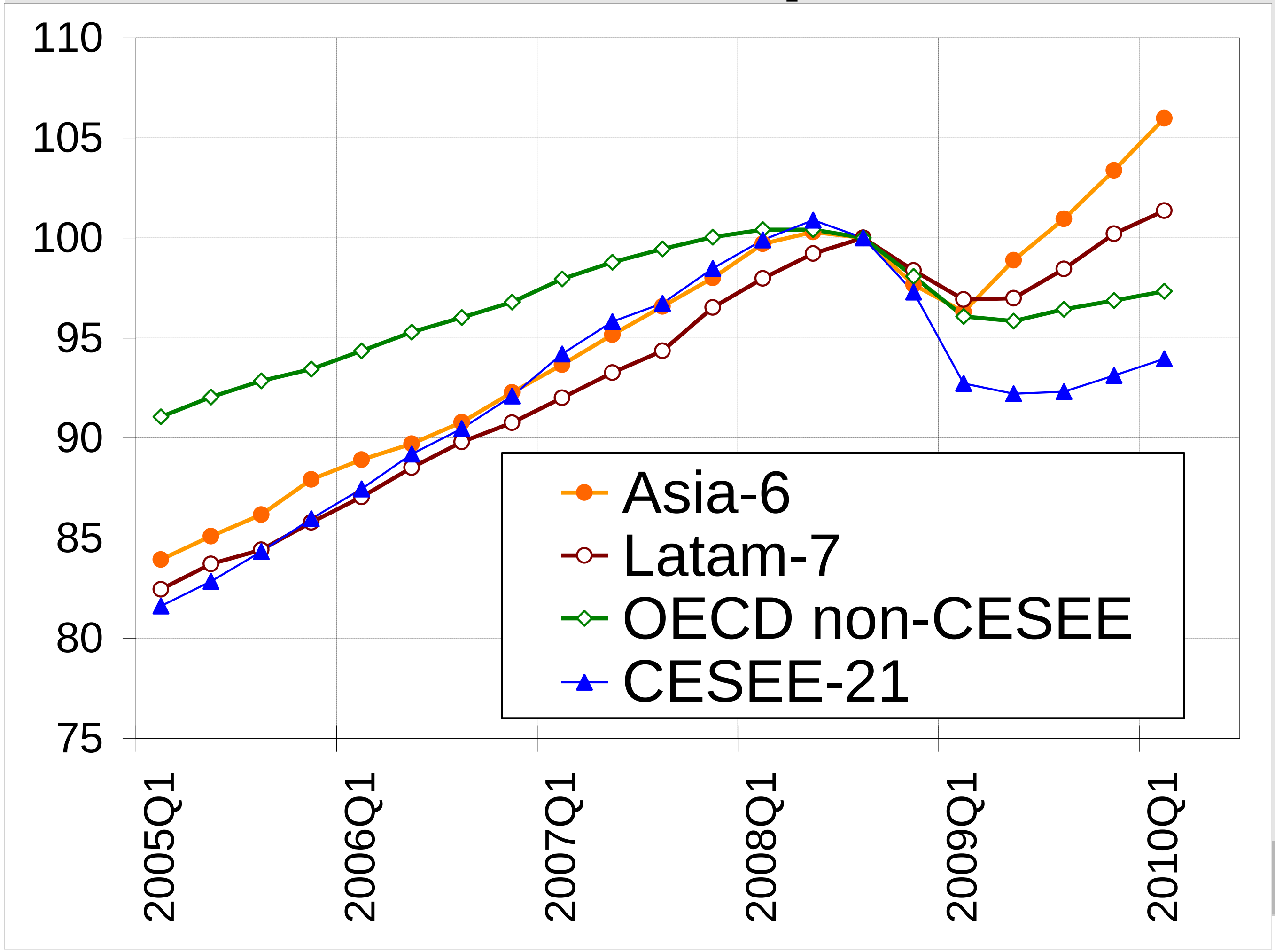
Note. Interest rate=government interest expenditures/previous year gross debt

Implications of the crisis

- GDP fell. Part of this fall is likely a permanent downward shift (the other part is a negative output gap that will correct)
- GDP growth will be less than it was before the crisis
- Interest rates may be higher
- Expenditure/GDP ratio have increased is several countries (even in the event of significant consolidation) $\rightarrow$ when output fall is permanent, this creates a structural deficit
- Revenues fell, but reasonable to assume that the revenue/GDP ratio is stable
- Markets became more sensitive

CESEE countries grew fast before the crisis, but have been hit hard, and recovery is slow

GDP, 2008 quarter 3 = 100

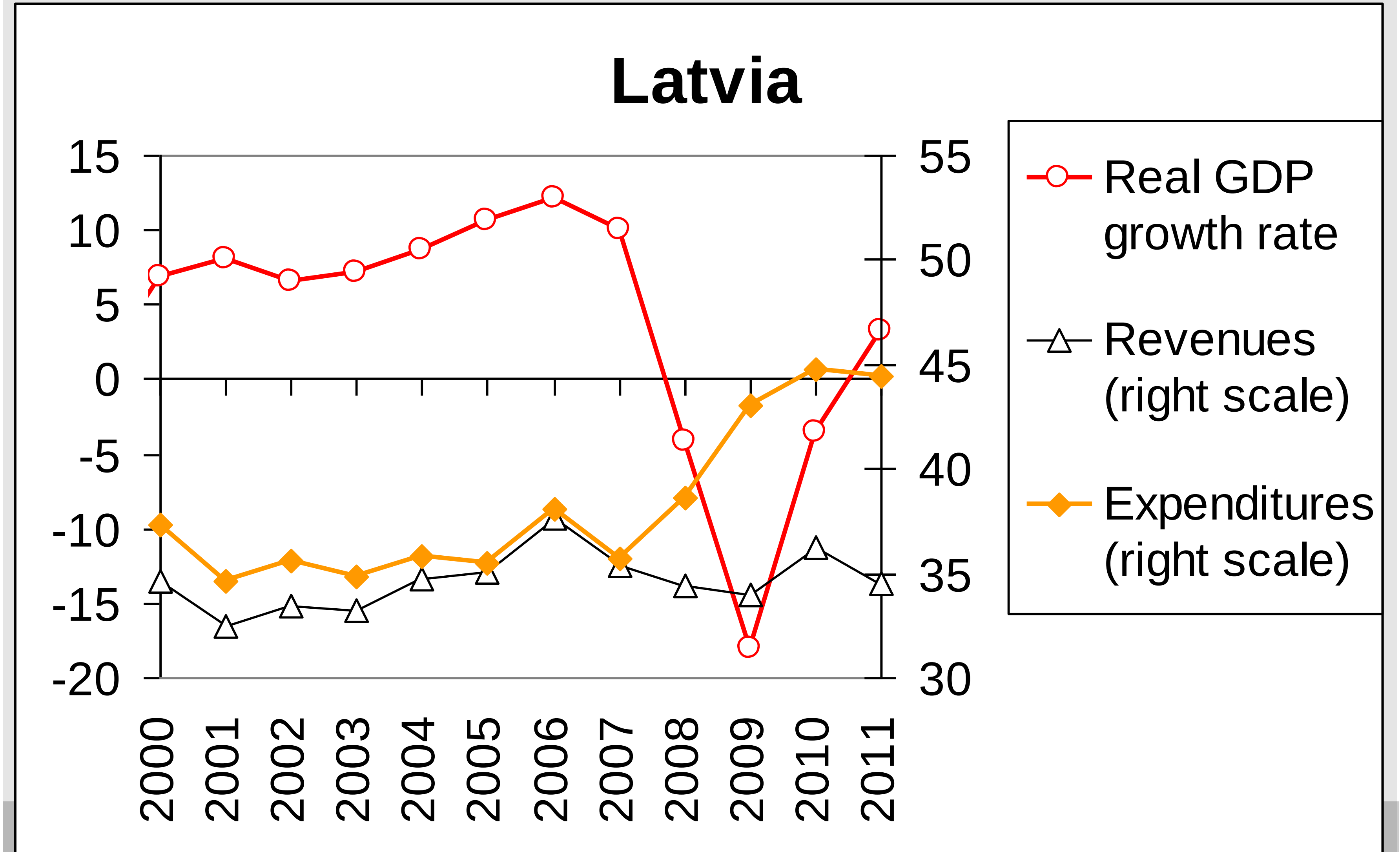


Asia-6: Indonesia, Korea, Malaysia, Philippines, Taiwan and Thailand

Latam-7: Argentina, Brazil, Chile, Columbia, Ecuador, Mexico and Peru

CESEE-21: Armenia, Belarus, Bulgaria, Croatia, Czech Republic, Cyprus, Estonia, Georgia, Hungary, Latvia, Lithuania, Malta, Moldova, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey and Ukraine

Some examples: expenditure and revenue ratios, GDP growth



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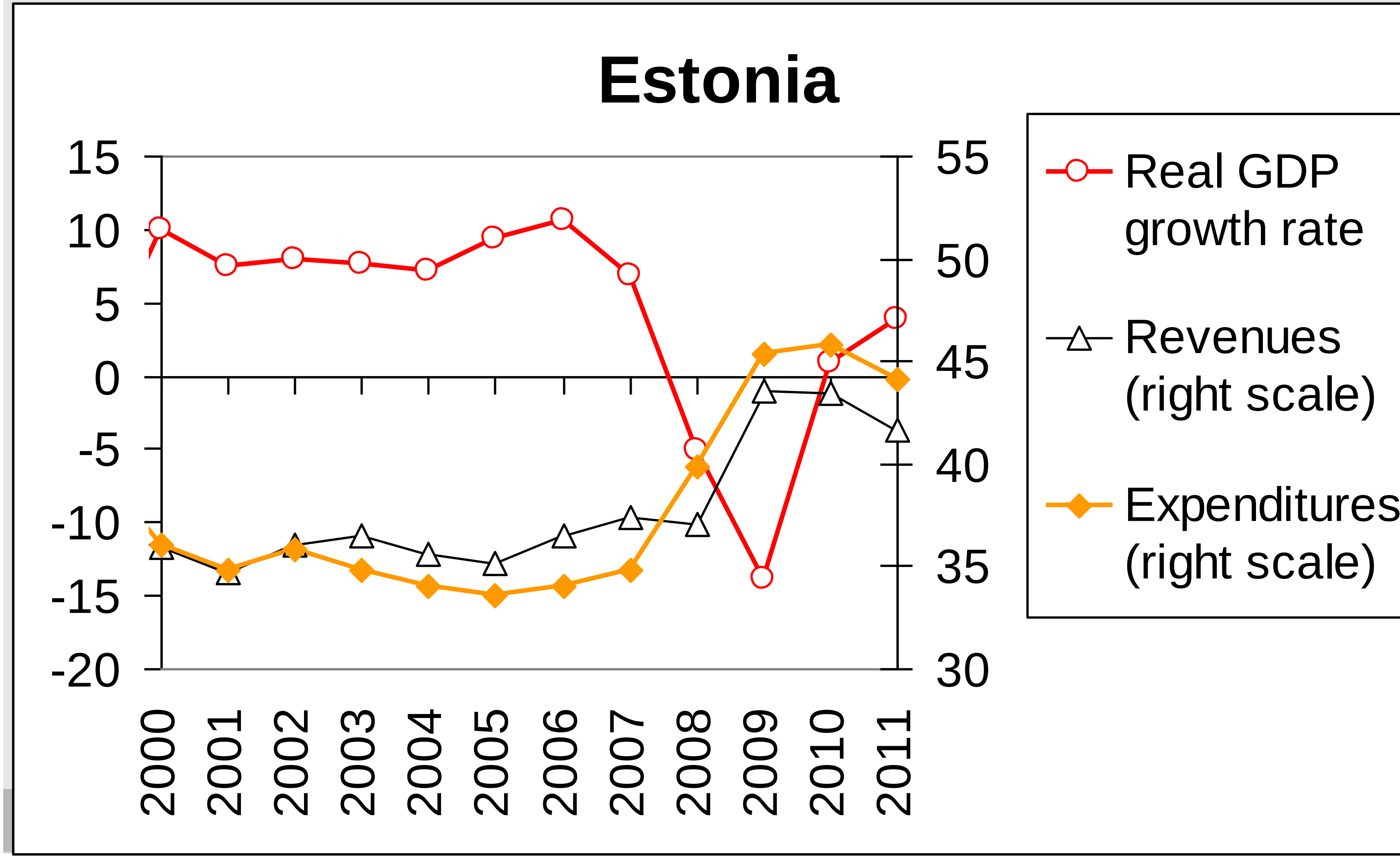

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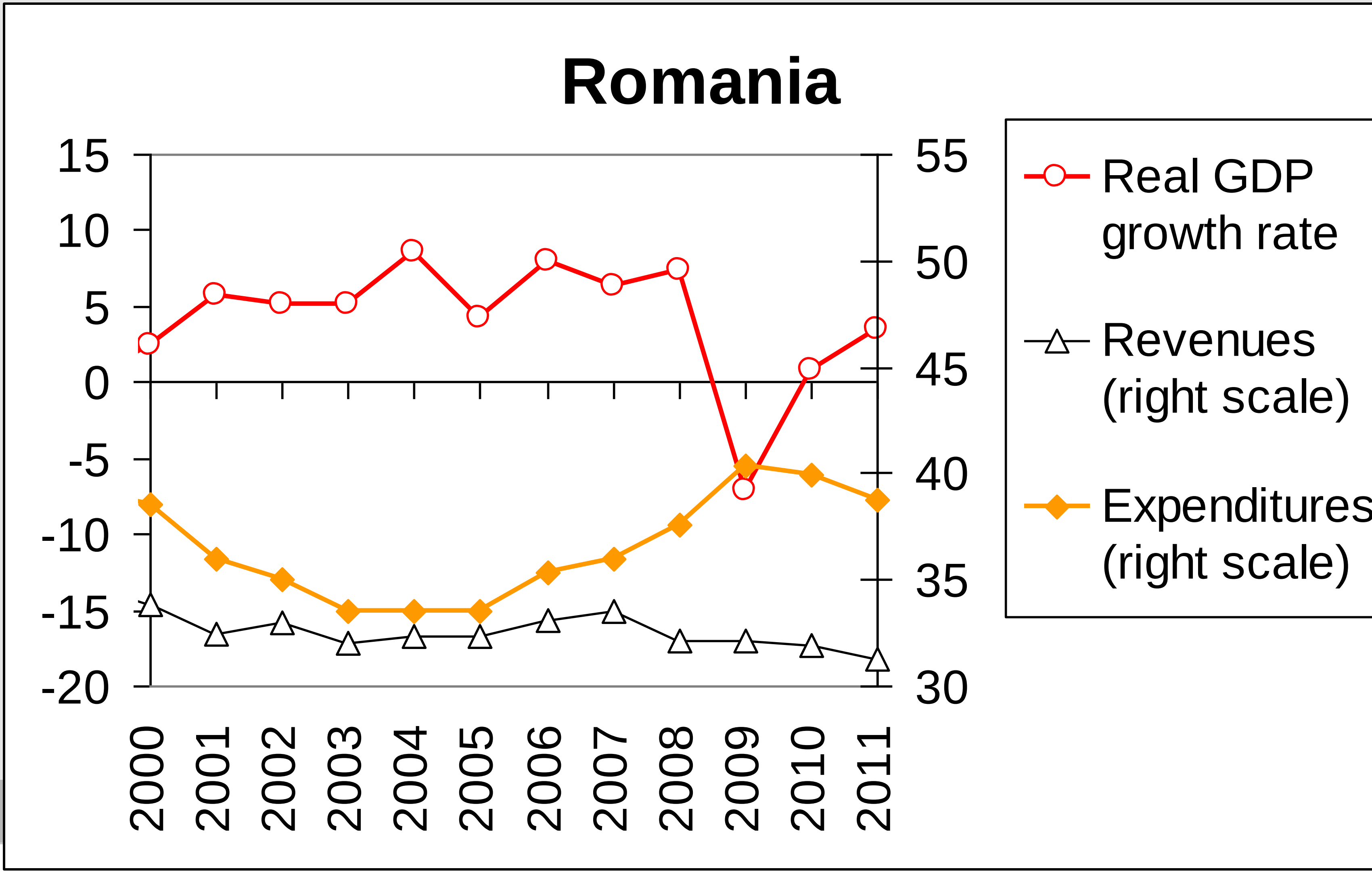

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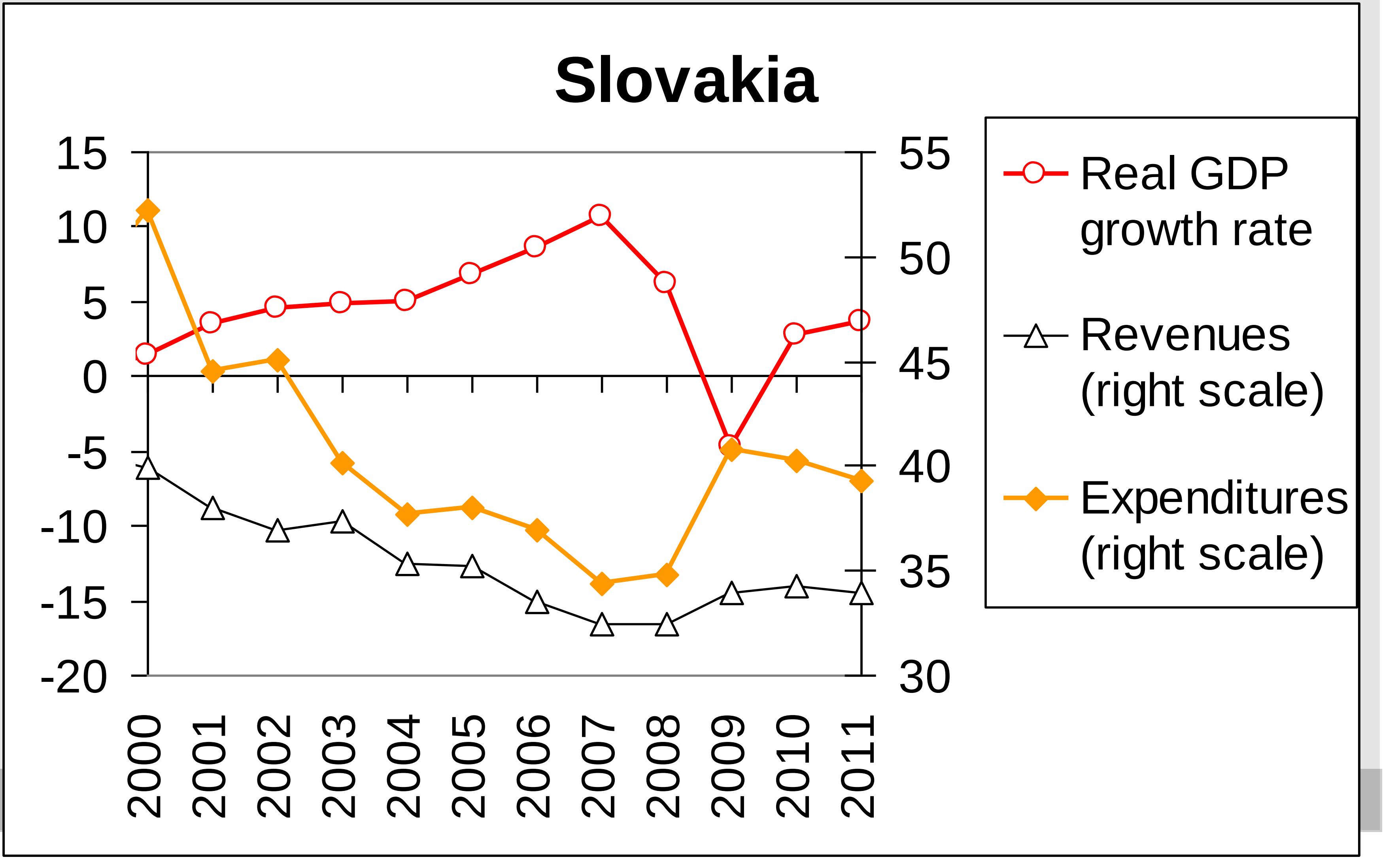

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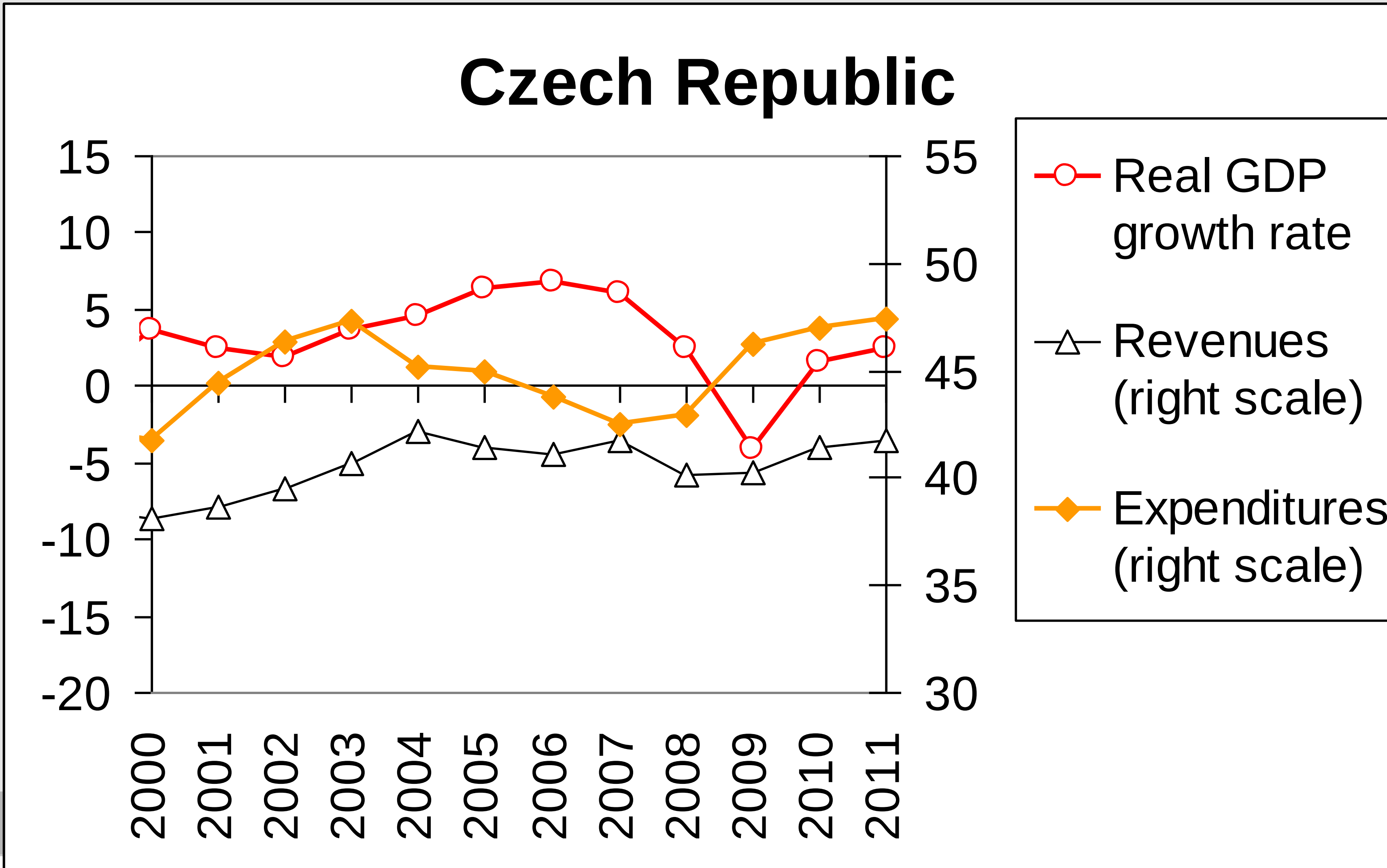

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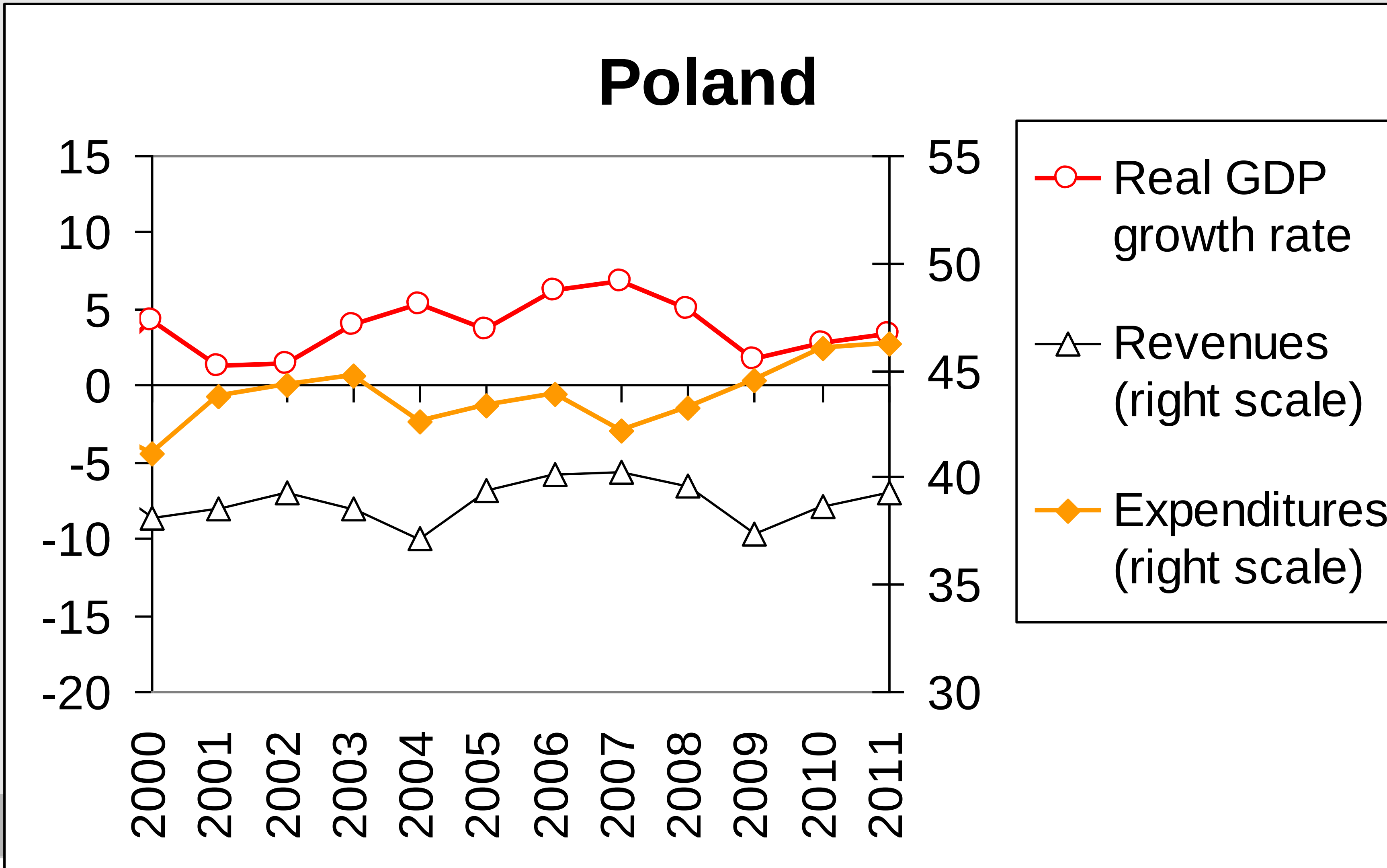

Key questions of fiscal sustainability

- Will GDP return to pre-crisis trendline? Or will there be the same growth after a downward level shift in GDP? Or will there be both slower growth and downward level shift?
- (related to the previous question:) Has the expenditure/GDP ratio risen permanently in a structural sense?
- Will the interest rate – GDP growth rate nexus change?
- Has debt levels reached alarming levels? Are there private sector vulnerabilities with potential fiscal consequences?
- (Plus standard long run factors, aging, contingent liabilities)