How sustainable is public debt in CESEE?

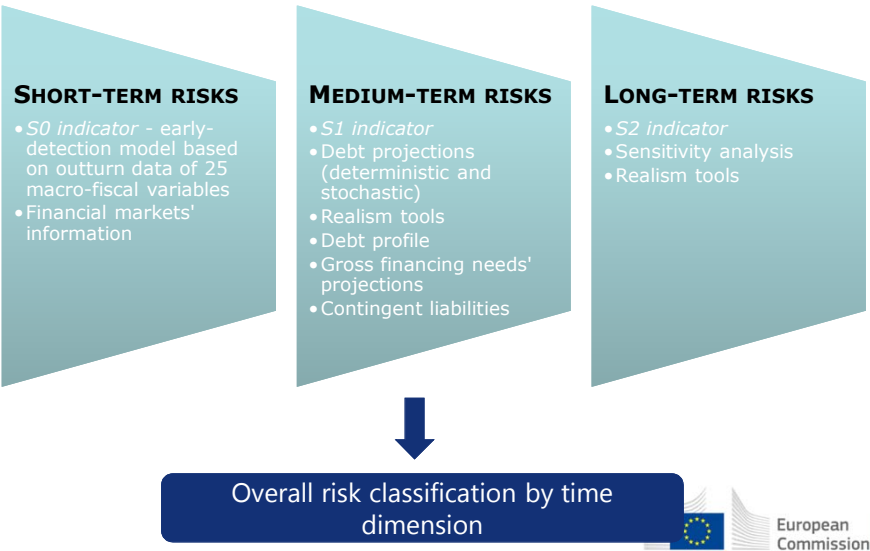## 82nd East Jour Fixe of Oesterreichische Nationalbank – 11 June 2018

S. Pamies Sumner
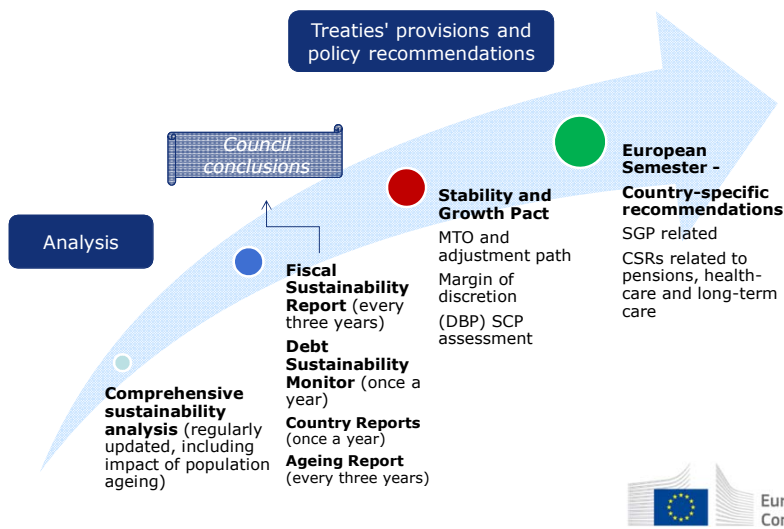*ECFIN – C2 – Sustainability of public finances*

Content

- Short introduction on the Commission framework to assess debt sustainability

- Debt sustainability assessment in CESEE from a EU perspective

- Challenges and policy implications
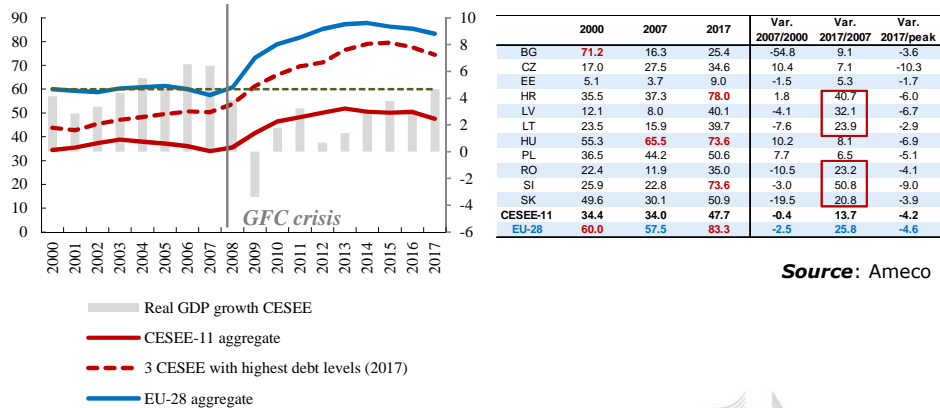
The current COM fiscal sustainability framework

SHORT-TERM RISKS
- *S0 indicator* - early-detection model based on outturn data of 25 macro-fiscal variables
- Financial markets' information

MEDIUM-TERM RISKS
- *S1 indicator*
- Debt projections (deterministic and stochastic)
- Realism tools
- Debt profile
- Gross financing needs' projections
- Contingent liabilities

LONG-TERM RISKS
- *S2 indicator*
- Sensitivity analysis
- Realism tools

Overall risk classification by time dimension

European Commission

COM fiscal sustainability analysis in the EU surveillance framework today

Treaties' provisions and policy recommendations

Council conclusions

Analysis

Fiscal Sustainability Report (every three years)

Debt Sustainability Monitor (once a year)

Country Reports (once a year)

Ageing Report (every three years)

Comprehensive sustainability analysis (regularly updated, including impact of population ageing)

Stability and Growth Pact
MTO and adjustment path
Margin of discretion
(DBP) SCP assessment

European Semester -
Country-specific recommendations
SGP related
CSRs related to pensions, health-care and long-term care

European Commission

A relatively more favourable situation compared to the EU aggregate but…

Government debt (% of GDP)

	2000	2007	2017	Var. 2007/2000	Var. 2017/2007	Var. 2017/peak
BG	71.2	16.3	25.4	-54.8	9.1	-3.6
CZ	17.0	27.5	34.6	10.4	7.1	-10.3
EE	5.1	3.7	9.0	-1.5	5.3	-1.7
HR	35.5	37.3	78.0	1.8	40.7	-6.0
LV	12.1	8.0	40.1	-4.1	32.1	-6.7
LT	23.5	15.9	39.7	-7.6	23.9	-2.9
HU	55.3	65.5	73.6	10.2	8.1	-6.9
PL	36.5	44.2	50.6	7.7	6.5	-5.1
RO	22.4	11.9	35.0	-10.5	23.2	-4.1
SI	25.9	22.8	73.6	-3.0	50.8	-9.0
SK	49.6	30.1	50.9	-19.5	20.8	-3.9
CESEE-11	34.4	34.0	47.7	-0.4	13.7	-4.2
EU-28	60.0	57.5	83.3	-2.5	25.8	-4.6

GFC crisis

- Real GDP growth CESEE
- CESEE-11 aggregate
- 3 CESEE with highest debt levels (2017)
- EU-28 aggregate

Source: Ameco

European Commission

Debt sustainability analysis point to risks in some countries

Overall DSA heat-map, based on Commission Spring forecast 2018

Sovereign-debt sustainability risks in CESEE countries

	BG	CZ	EE	HR	LV	LT	HU	PL	RO	SI	SK
Baseline no-policy change scenario	LOW	LOW	LOW	MEDIUM	LOW	LOW	MEDIUM	LOW	LOW	MEDIUM	LOW
Debt level (2028)	10.7	25.6	7.7	60.4	39.4	36.2	72.9	53.5	57.3	61.0	34.0
Debt peak year	2017	2017	2017	2017	2017	2017	2017	2028	2028	2017	2017
Average Structural Primary Balance (2019-2028) Percentile rank	36%	38%	70%	28%	73%	54%	68%	68%	86%	55%	49%
Historical SPB scenario	LOW	LOW	LOW	MEDIUM	LOW	LOW	MEDIUM	MEDIUM	LOW	MEDIUM	LOW
Debt level (2028)	14.1	42.3	5.4	84.3	39.4	45.8	70.9	60.4	52.3	66.4	49.5
Debt peak year	2017	2028	2017	2028	2017	2028	2017	2028	2028	2017	2017
Average Structural Primary Balance (2019-2028) Percentile rank	41%	64%	68%	64%	73%	67%	67%	75%	83%	62%	72%
Negative shock (-0.5p.p.) on nominal GDP growth	LOW	LOW	LOW	MEDIUM	LOW	LOW	HIGH	LOW	LOW	MEDIUM	LOW
Debt level (2028)	11.7	27.1	8.1	64.3	41.3	38.2	76.7	56.2	59.6	64.2	36.0
Debt peak year	2017	2017	2017	2017	2028	2017	2028	2028	2028	2017	2017
Positive shock (+1p.p.) to the short- and long-term interest rates on newly issued and rolled over debt	LOW	LOW	LOW	MEDIUM	LOW	LOW	HIGH	LOW	MEDIUM	MEDIUM	LOW
Debt level (2028)	11.2	27.3	8.0	65.2	41.5	38.4	77.5	56.3	60.6	64.4	35.6
Debt peak year	2017	2017	2017	2017	2028	2017	2028	2028	2028	2017	2017
Negative shock on the PB equal to 50% of the forecasted cumulative change over the two forecast years	LOW	LOW	LOW	MEDIUM	LOW	LOW	HIGH	LOW	MEDIUM	MEDIUM	LOW
Debt level (2028)	13.6	30.7	9.0	67.3	43.6	37.8	74.8	54.8	61.1	69.6	34.0
Debt peak year	2017	2017	2028	2017	2028	2017	2028	2028	2028	2017	2017
Stochastic projections	MEDIUM	LOW	LOW	MEDIUM	MEDIUM	MEDIUM	MEDIUM	LOW	MEDIUM	LOW	LOW
Probability of debt in 2022 greater than in 2017 (%)	23%	22%	6%	25%	39%	40%	44%	72%	12%	19%	
Difference of the 10th and 90th percentile in 2022 (p.p. of GDP)	33.4	22.1	3.2	40.5	39.5	32.9	39.7	21.3	35.5	25.9	28.9
Debt sustainability analysis - overall risk assessment	LOW	LOW	LOW	MEDIUM	LOW	LOW	HIGH	LOW	MEDIUM	MEDIUM	LOW

- 7 countries at low risk, 3 countries at medium risk (HR, RO and SI) and 1 country at high risk (HU)

A mix of situation

- In some countries, vulnerabilities linked to 'high' **debt levels** (HR, HU and SI)
- In others, current weak **fiscal performance** (PL, RO) and / or exposure to **shocks**
- Additional vulnerabilities in some countries due to the **debt profile** (creditors' structure, FX exposure, rollover risk)
- Relatively low **potential growth** in few countries
- **Implicit and / or contingent liabilities** can create additional risks (banking sector, population ageing)

Risks related to government debt profile

	Short-term public debt (original maturity)	Public debt in foreign currency	Public debt held by non-residents
	Shares of total debt (%):		
BG	0.3	82.1	48.7
CZ	0.9	44.8	42.2
EE	2.5	0.0	65.0
HR	6.5	76.5	37.5
LV	3.4	15.9	72.4
LT	1.0	27.4	69.3
HU	18.5	28.7	41.7
PL	0.8	35.1	54.5
RO	6.9	52.4	48.4
SI	4.8	0.1	67.1
SK	2.0	6.0	52.8

GDP per capita and potential growth (%)

- GDP per capita (1000 PPS)
- Potential growth (avg 2020-28, %) - RHS
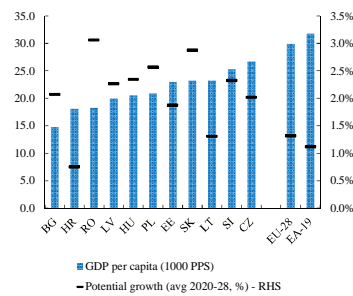
Over the long-term, fiscal challenges linked to population ageing in most countries

Long-term fiscal gap indicator and sub-components (pps. of GDP)

High risk

Medium risk

- Cost of ageing
- Gap to debt-stabilizing primary balance
- S2 indicator
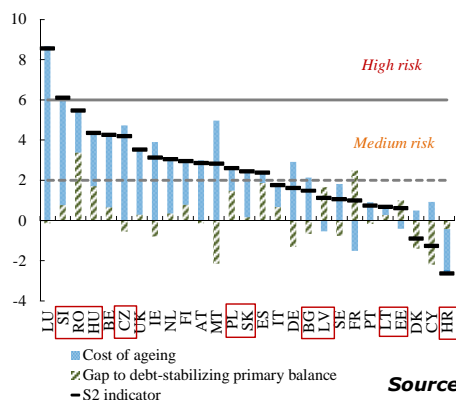
Public pension benefit ratio (%)

- 2016
- 2070
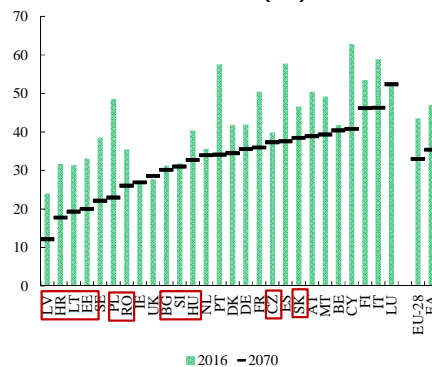
Source: DSM, Spring forecast 2018, Ageing Report 2018

European Commission

Adhering to fiscal rules is a key ingredient to support fiscal sustainability

- *Under no-fiscal policy change scenario*, debt is projected to remain above 60% of GDP in HR, HU and SI by 2028, and to increase in RO and PL
- *Compliance with the main provisions of the SGP* would bring debt ratios to safer levels in these countries

Government debt
(% of GDP)

■ 2017
■ 2028 (Baseline no-fiscal policy change)
■ 2028 (SGP scenario)
▬ Distance to MTO (2019) - RHS

Source: DSM, Spring forecast 2018

European Commission
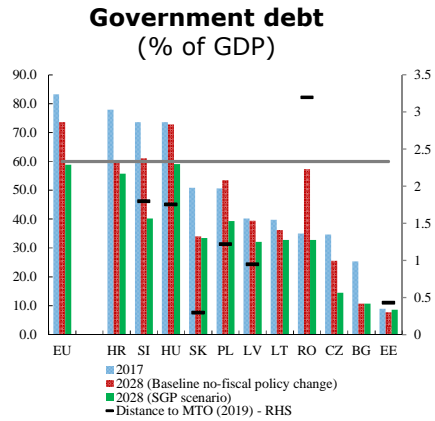
Evolution of 'compliance' with key SGP targets through time

Headline balance in CESEE
(% of GDP)
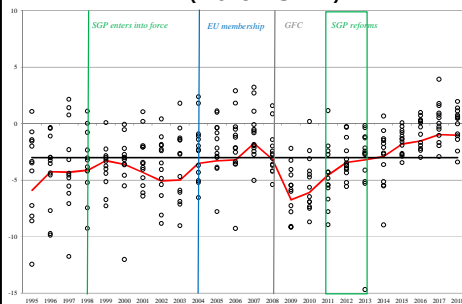
Structural balance in real-time in CESEE (% of GDP)
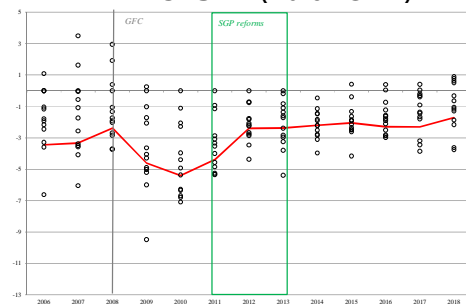
Source: Ameco, Commission services

European Commission

Far-reaching fiscal policies are necessary to ensure fiscal sustainability

- Rebuild **fiscal buffers** in high-debt countries
- Improve **fiscal frameworks** (e.g. HR, RO and PL)
- Reform **pension and health-care systems** (e.g. CZ, LT and SI)
- Make taxation and expenditure more **efficient**
- Improving tax rules and administration (e.g. HU, BG, LT and RO)
- *Strengthen the supervision of the financial sector and pursue efforts to **reduce NPLs** (e.g. BG)*

Country	SGP-related CSR	Long-term fiscal sust. CSR	Other fiscal-related CSR
BG			X
CZ		X	X
EE	X		
HR	X*	X	X
LV	X		X
LT		X	X
HU	X		X
PL	X	X	X
RO	X		X
SI	X	X	
SK	X		X

Structural reforms are also essential to support growth and sustainability

Overview of Country-specific recommendations in 2018-19 by policy area

Conclusion

- Compare to the EU average, debt burdens appear on average contained
- However, heterogeneity among countries
- Fast increases in some cases (past / foreseen under 'unchanged policies')
- Additional vulnerabilities due to debt profile, implicit / contingent liabilities, structural 'gaps', sensitivity to shocks
- Adherence to fiscal rules important, as well as structural reforms to boost potential growth and cater for uncertainties
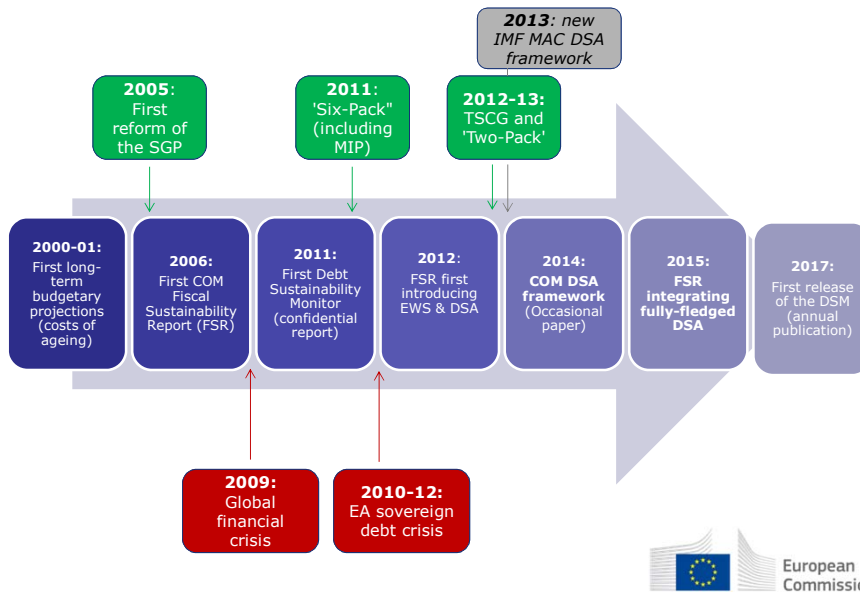
European Commission

Thank you for your attention!

https://ec.europa.eu/info/publications/debt-sustainability-monitor-2017_en

Extra slides

Background: fiscal sustainability in the EU, an evolving challenge

2013: *new IMF MAC DSA framework*

2005: First reform of the SGP

2011: 'Six-Pack" (including MIP)

2012-13: TSCG and 'Two-Pack'

2000-01: First long-term budgetary projections (costs of ageing)

2006: First COM Fiscal Sustainability Report (FSR)

2011: First Debt Sustainability Monitor (confidential report)

2012: FSR first introducing EWS & DSA

2014: COM DSA framework (Occasional paper)

2015: FSR integrating fully-fledged DSA

2017: First release of the DSM (annual publication)

2009: Global financial crisis

2010-12: EA sovereign debt crisis
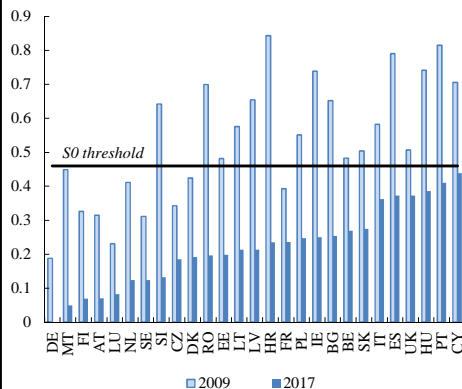
European Commission

Different definitions of fiscal sustainability...

- ***(IBC perspective)*** Ability for a government to ensure (based on economically and politically feasible budget) that debt in not on an increasing *path* in the long-term
- ***(Fiscal space perspective)*** Ability for a government to maintain the debt *level* at 'prudent' values in order to cope with adverse shocks and future (implicit / contingent) spending pressures
- ***(Financial markets' perspective)*** Ability for a government to maintain regular access to international markets at a reasonable cost
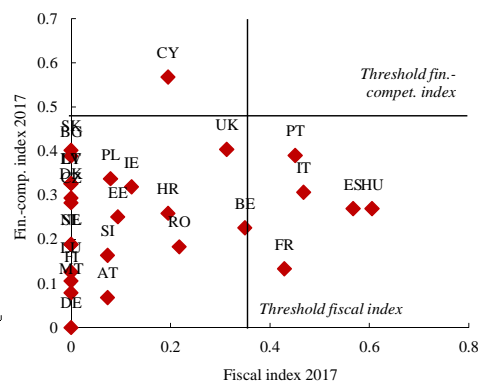
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No country at risk of fiscal distress in the short-term although some vulnerabilities exist

S0 overall indicator
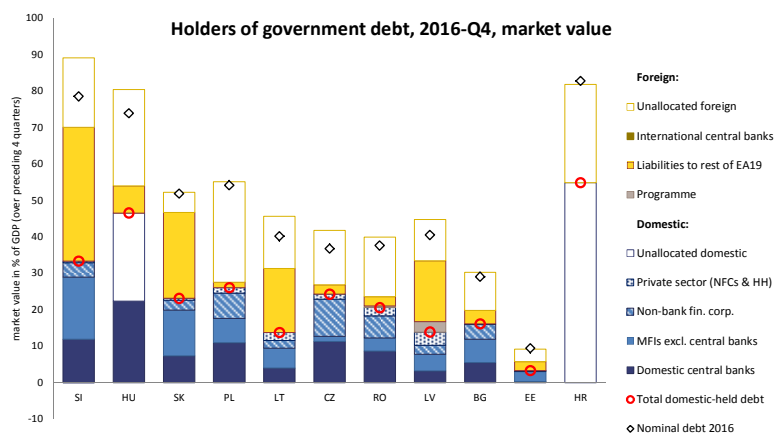
S0, sub-indexes

Source: DSM, Spring forecast 2018

European Commission

Risks related to government debt profile, by country (2016)

Source: DSM 2017

Holders of government debt, 2016-Q4, market value, % of GDP

Source: DSM 2017

Gross public debt projections in baseline versus exchange rate shock

	2018	2027			
		Baseline	Standardized (temporary) shock on nominal exchange rate (depreciation equivalent to the maximum historical depreciation over last 10 years)		
	Debt	Debt	Exchange rate change (per annum, '-' means depreciation)	Debt	Debt (difference with Baseline no-policy change scenario)
BG	25.9	21.1	0.0	21.2	0.0
CZ	38.5	41.9	-6.0	42.5	0.7
DK	38.2	28.9	-0.2	29.3	0.4
HR	82.8	87.8	-2.1	92.7	4.9
LV	36.0	33.6	-0.6	38.1	4.5
LT	40.2	54.1	0.0	58.9	4.8
HU	71.8	70.3	-11.5	80.7	10.5
PL	55.5	69.2	-23.2	78.2	9.0
PT	127.8	124.0	0.0	125.1	1.1
RO	41.5	55.7	-15.1	63.6	7.9
SK	51.5	40.3	0.0	40.8	0.5
FI	68.1	79.8	0.0	82.7	2.9
SE	38.2	28.8	-10.4	33.5	4.7
UK	87.5	89.9	-16.4	89.9	0.0
EU	83.9	81.2	-3.8	82.4	1.2
EA	89.4	85.3	0.0	86.0	0.6

Source: DSM 2016

Potential triggers for contingent liabilities from the banking sector, by country (2016)

	Private sector credit flow (% GDP)	House price nominal index change (%)	Bank loan-to deposit ratio (%)	NPL ratio (% of total gross loans)	NPL ratio change (pps 2016 v 2015)	NPL coverage ratio (%)
BE	13.3	2.6	105.0	3.2	-0.7	44.1
BG	4.0	7.0	71.7	12.5	-1.2	57.8
CZ	4.4	7.2	83.1	2.5	-0.8	62.5
DK	3.9	4.7	333.4	3.1	-0.6	30.0
DE	3.8	6.0	149.7	2.5	-0.5	37.4
EE	5.9	4.8	105.8	1.3	-0.6	31.7
IE	-19.0	7.5	115.2	13.6	-4.9	35.5
ES	-3.6	4.6	117.6	5.7	-0.7	43.7
FR	-6.2	1.0	112.3	3.7	-0.4	51.8
HR	-0.1	0.9	75.5	10.1	-2.4	63.3
IT	0.6	-0.8	126.9	15.3	-1.5	48.9
CY	10.2	0.3	83.9	44.8	-4.2	39.7
LV	0.3	8.5	74.9	3.2	-0.8	28.6
LT	4.3	5.4	97.4	3.8	-1.3	30.4
LU	1.5	6.0	130.1	1.1	0.0	44.7
HU	-3.6	13.4	77.7	11.5	-2.4	63.9
MT	11.1	5.6	56.0	4.4	-3.0	35.9
NL	1.5	5.3	127.1	2.5	-0.2	35.2
AT	3.2	8.5	104.5	5.3	-1.6	55.1
PL	4.7	1.9	95.7	6.1	-0.6	58.8
PT	-2.2	7.1	93.2	19.5	0.5	43.6
RO	0.6	6.0	67.4	10.1	-4.5	65.8
SI	-0.8	3.3	68.4	14.4	-7.1	63.9
SK	9.2	6.7	104.6	4.2	0.1	55.0
FI	2.2	0.6	148.0	1.6	0.0	29.5
SE	7.6	8.6	219.5	1.0	-0.2	28.8
UK	8.2	7.0	91.0	1.9	-0.5	30.5

Source: DSM 2017