Fiscal Trends in Central and Eastern Europe

CEO for CEOs

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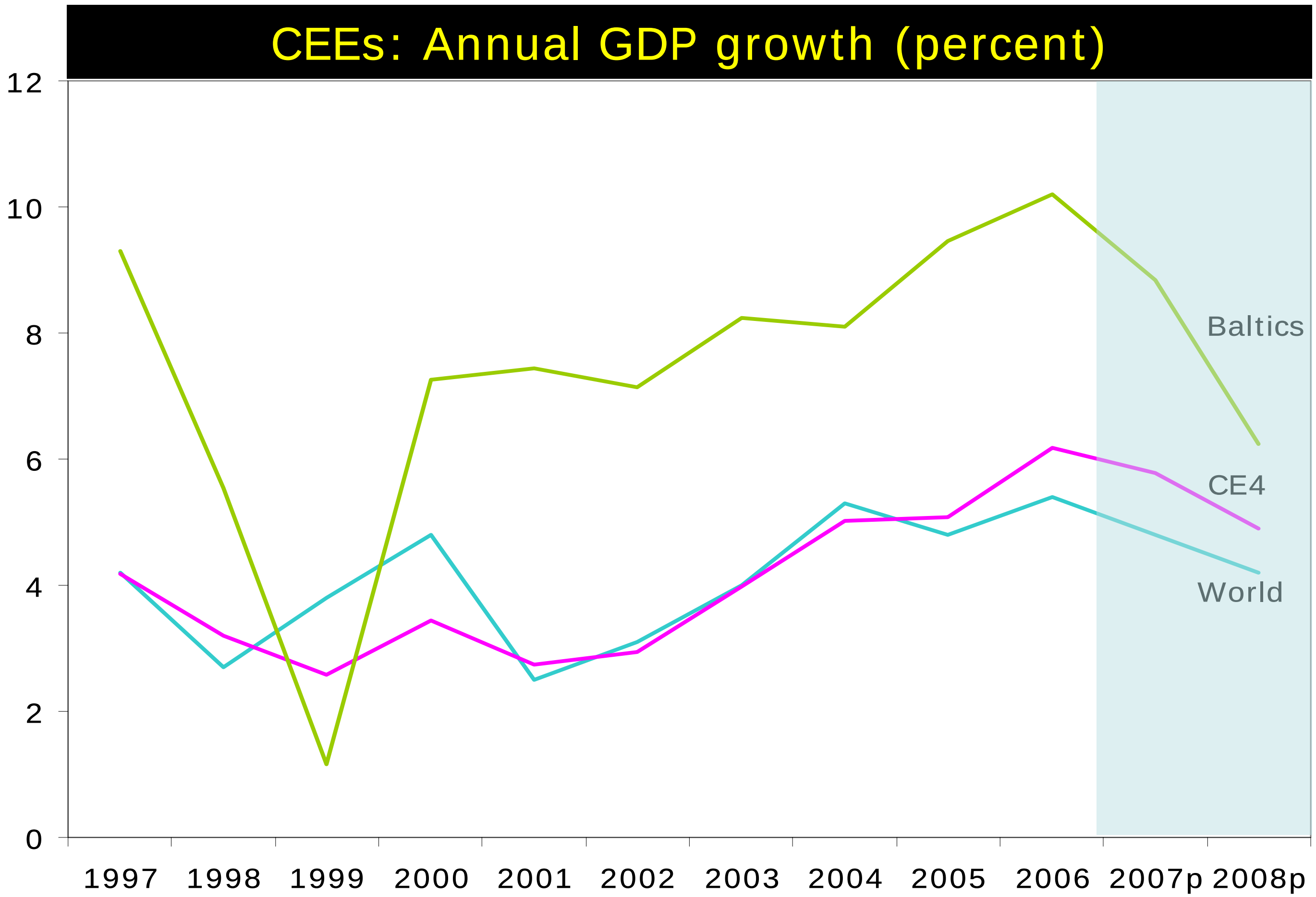
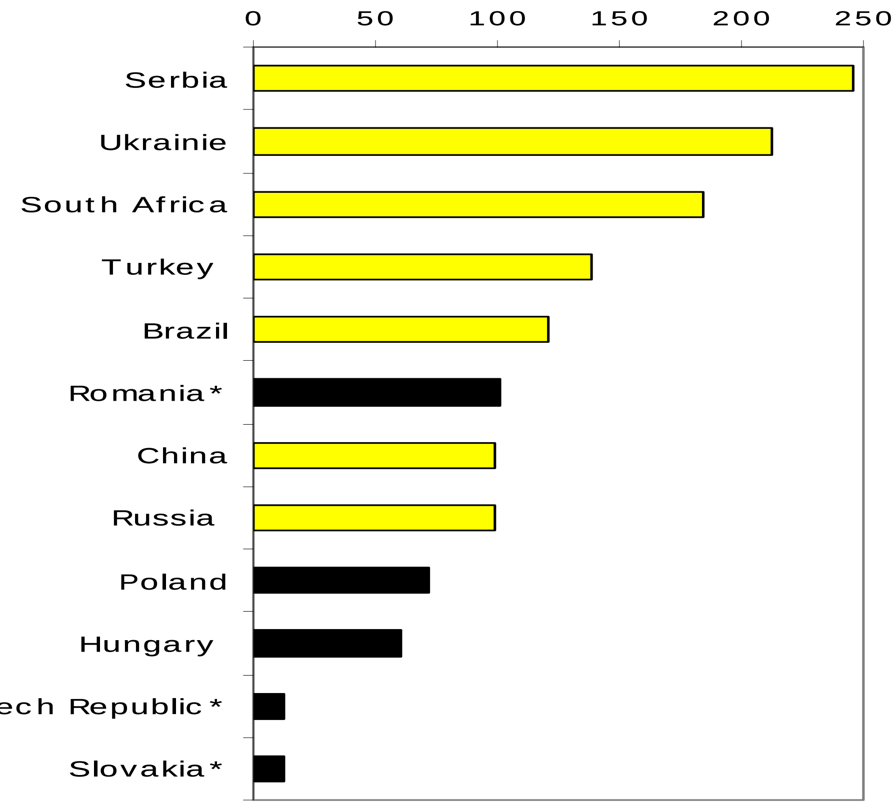
Growth in CEEs has been high, but is expected to slow in the near term



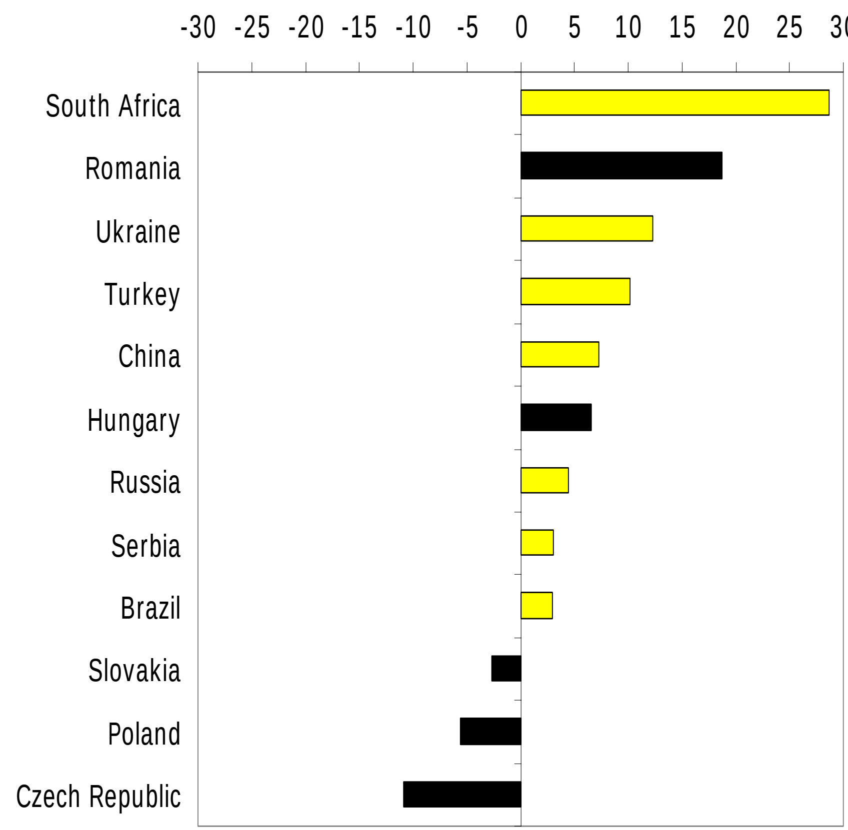
Source: WEO update Jan 2008.

Since the outset of the global credit crunch, markets have started to distinguish between EMs

Change in EMBI
July 16 – March 13 (bps)



Change in the EURO exchange rate July 16 – March 13
(+= depreciation, percent)



Source: Bloomberg, national statistics.

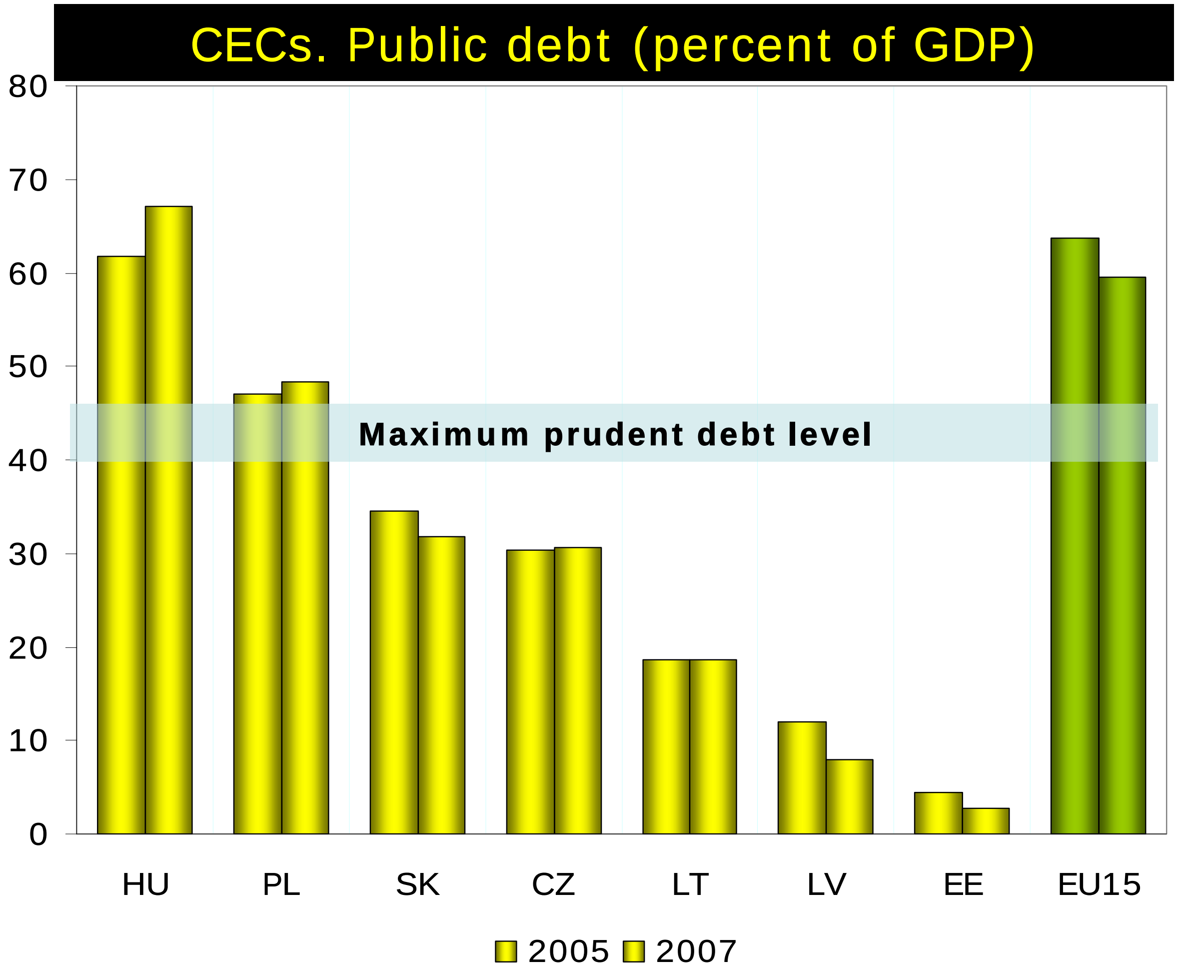
In the CE4 countries this likely reflects relatively poor fiscal fundamentals

Key Macro Indicators 2006 (in percent of GDP)

	CE4	Baltics	SEE	other EM countries *
General government deficit	-4.9	0.9	0.9	2.0
C/A balance	-5.2	-15.6	-13.0	2.7
External debt	57.7	89.8	60.4	22.0
Public debt	43.4	10.9	21.6	31.2
Reserves/ST debt	115.1	54.8	105.4	353.0
Credit growth (in percent)	8.4	37.6	54.2	11.4

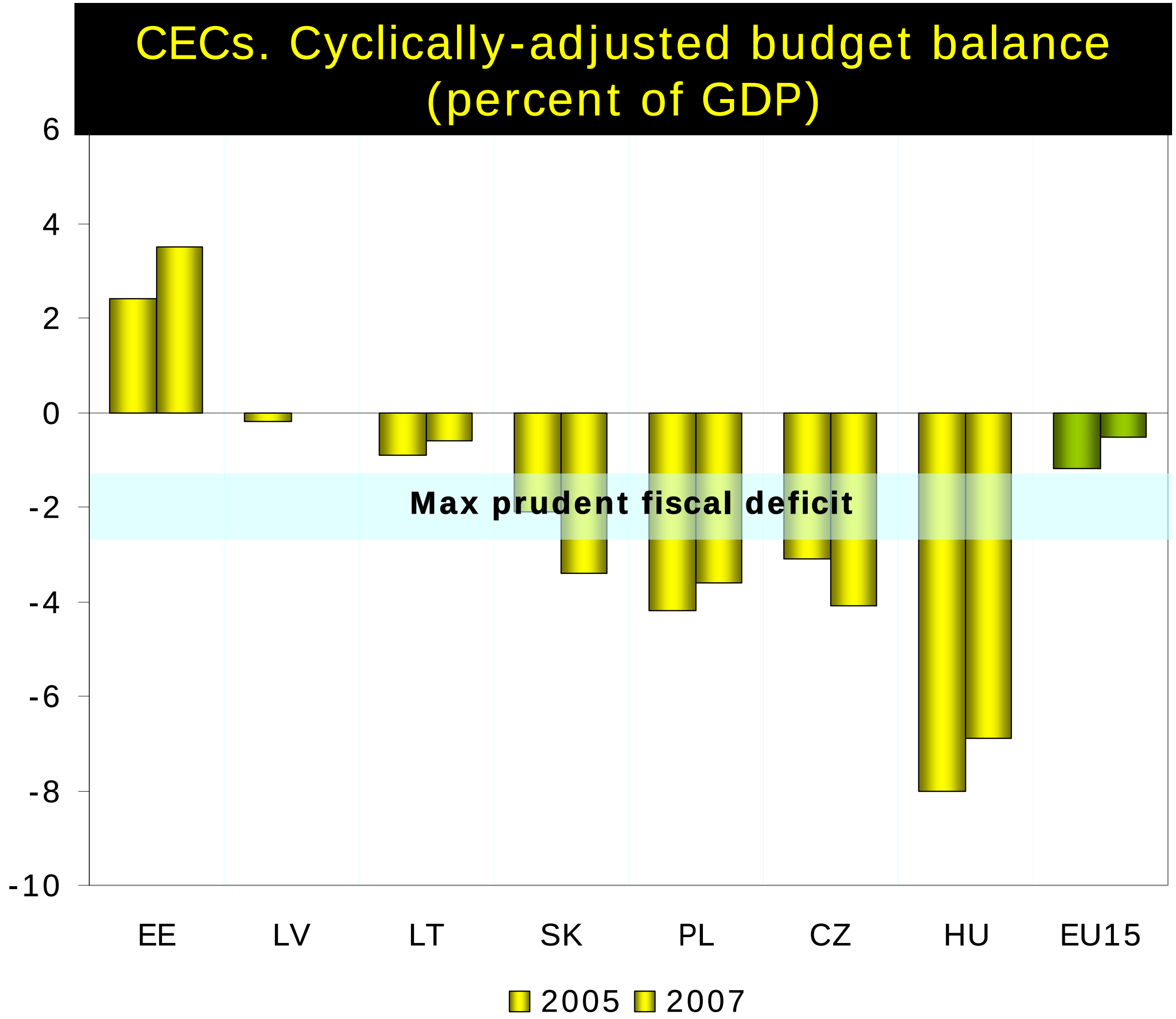
* EM countries - Brazil, Chile, China, Colombia, Indonesia, Peru, Russia, Thailand.
** Korea, Indonesia, Thailand.
Source: IMF GFS, IMF IFS, IMF Article IV Consultations

Despite buoyant growth, public debt has not been declining much…



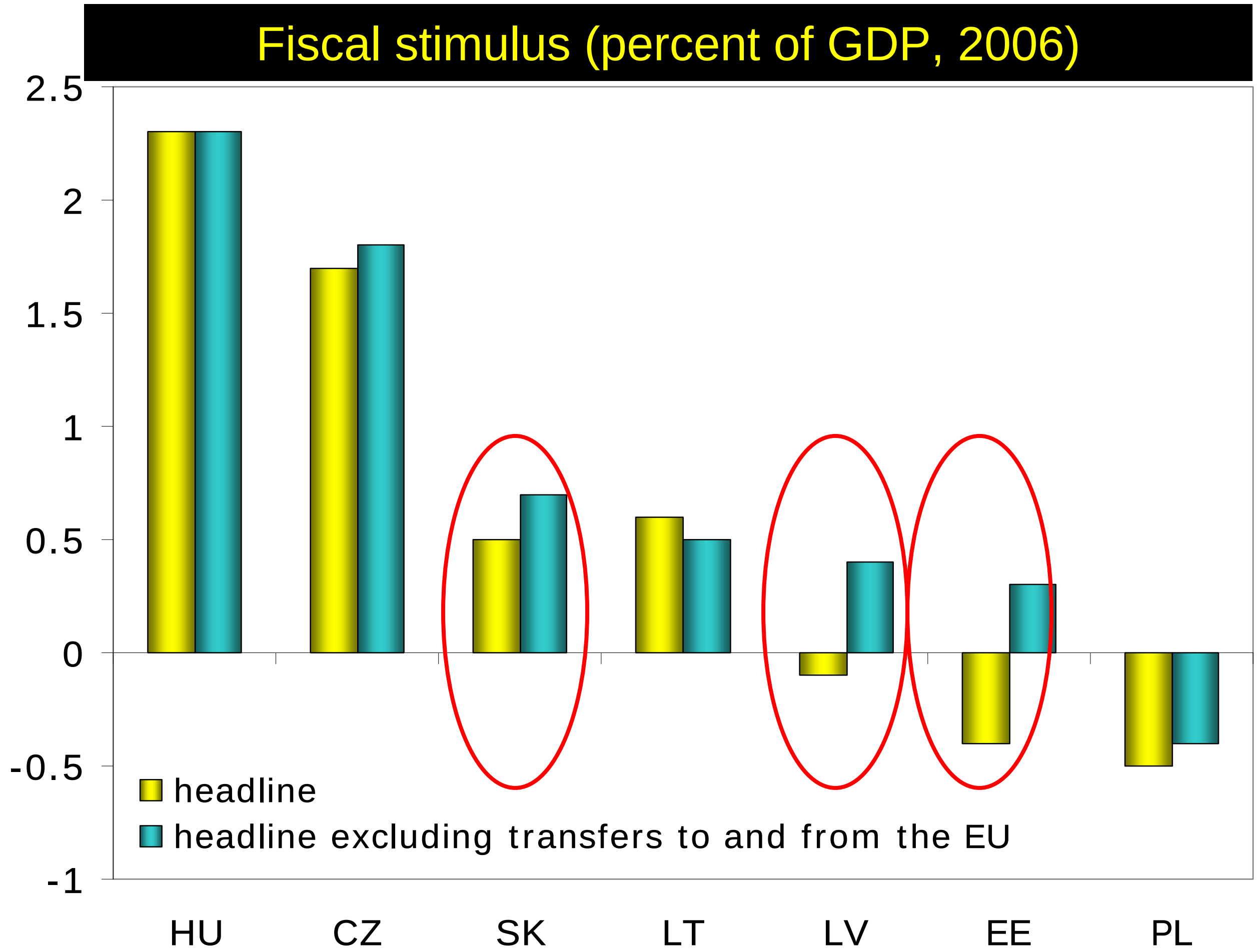
Source: EC, 'Public finance in EMU', 2007; IMF

…and structural fiscal balances do not show strong improvements



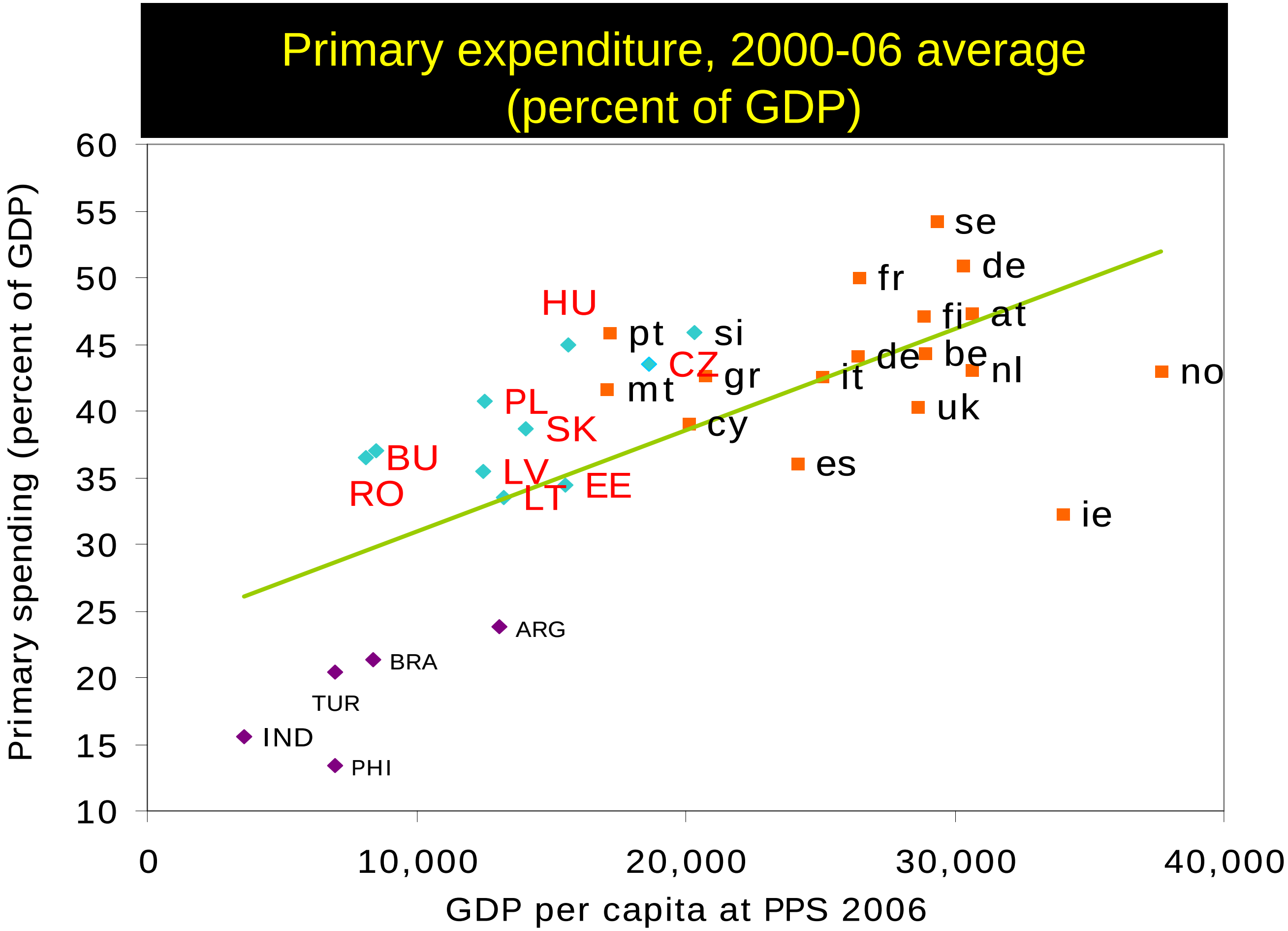
Source: EC Spring Forecast 2007

Fiscal policy is even more pro-cyclical if one accounts for the effect of EU funds



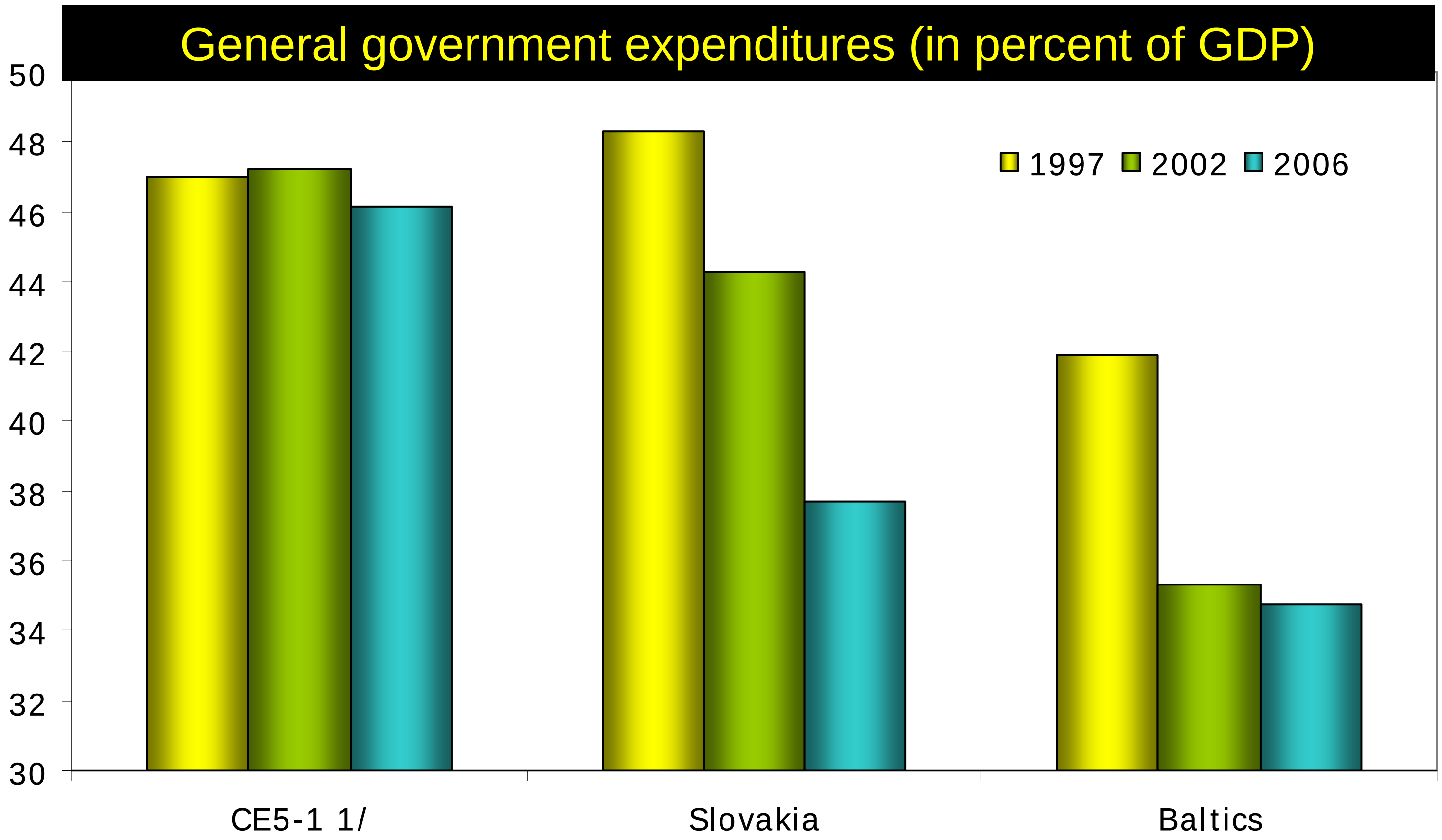
Source: Christoph B. Rosenberg and Robert Sierhej, Interpreting EU Funds Data for Macro Analysis in the New Member States, IMF Working Paper 07/77.

Primary spending in CEE is relatively high suggesting that fiscal adjustments should start on the expenditure side



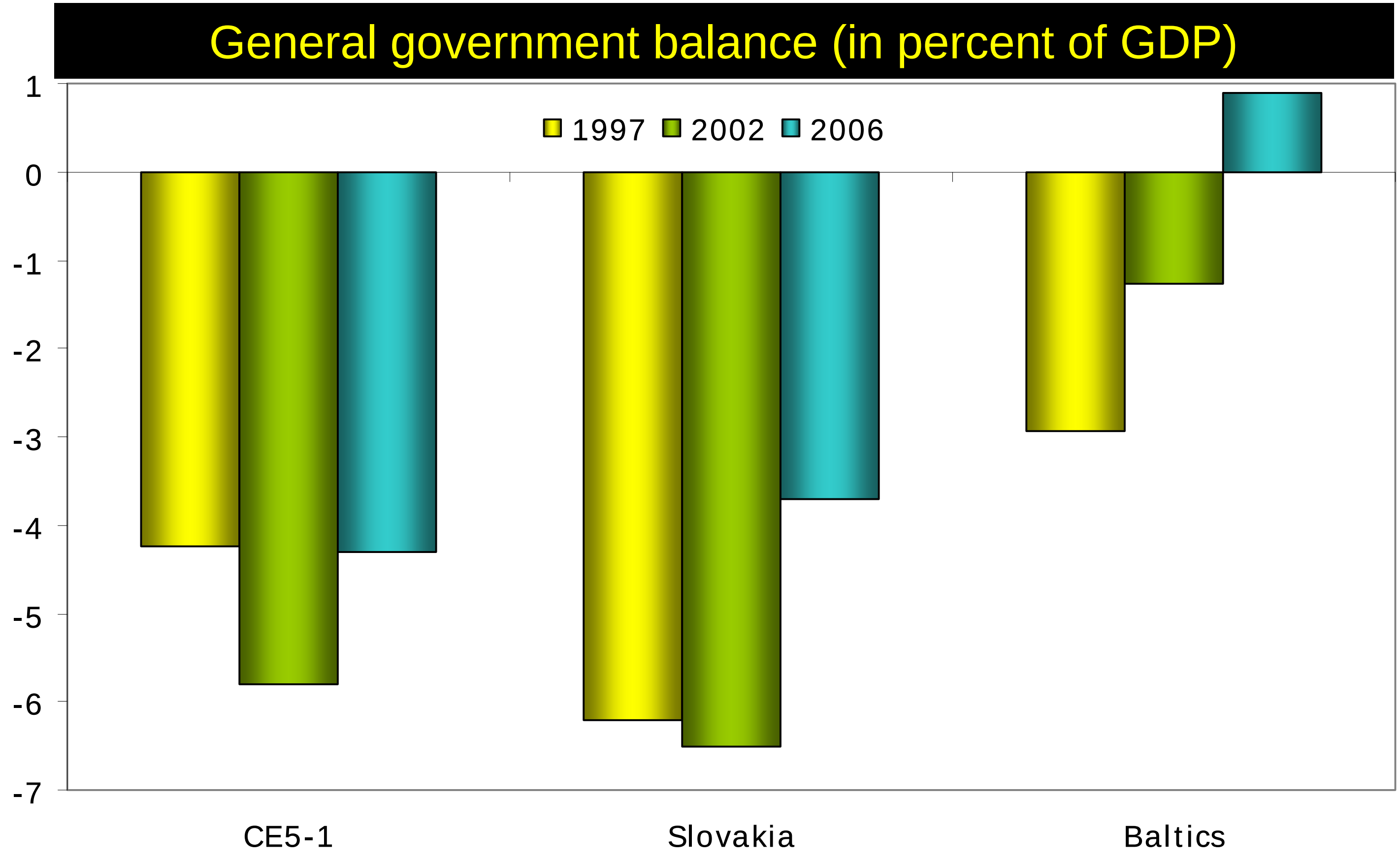
Source: AMECO.

Some CEEs implemented deep spending cuts in the last decade…



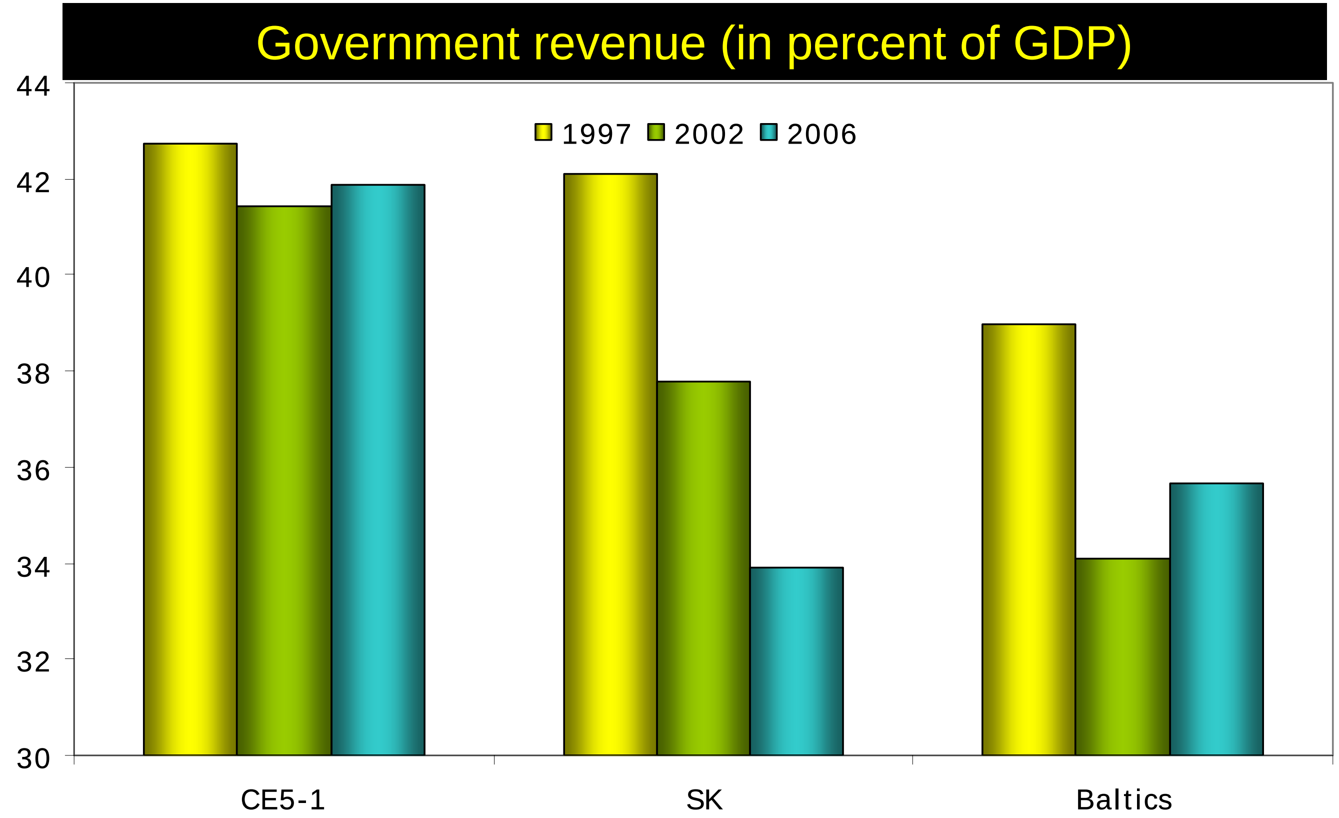
1/ Czech Republic, Hungary, Poland, and Slovenia.
Source: Eurostat

…achieving fiscal consolidation…



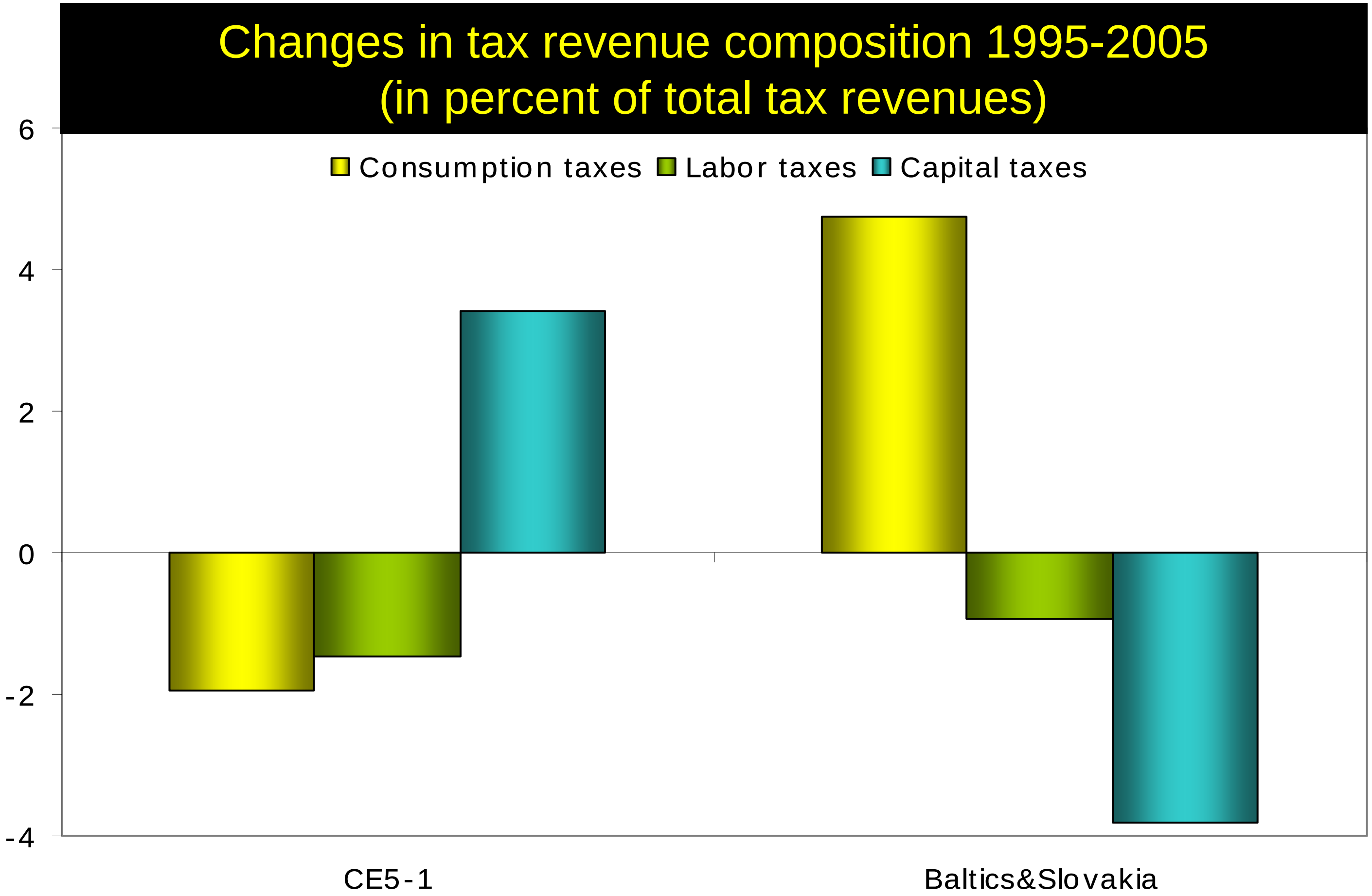
Source: Eurostat

…while at the same time lowering the tax burden



Source: Eurostat

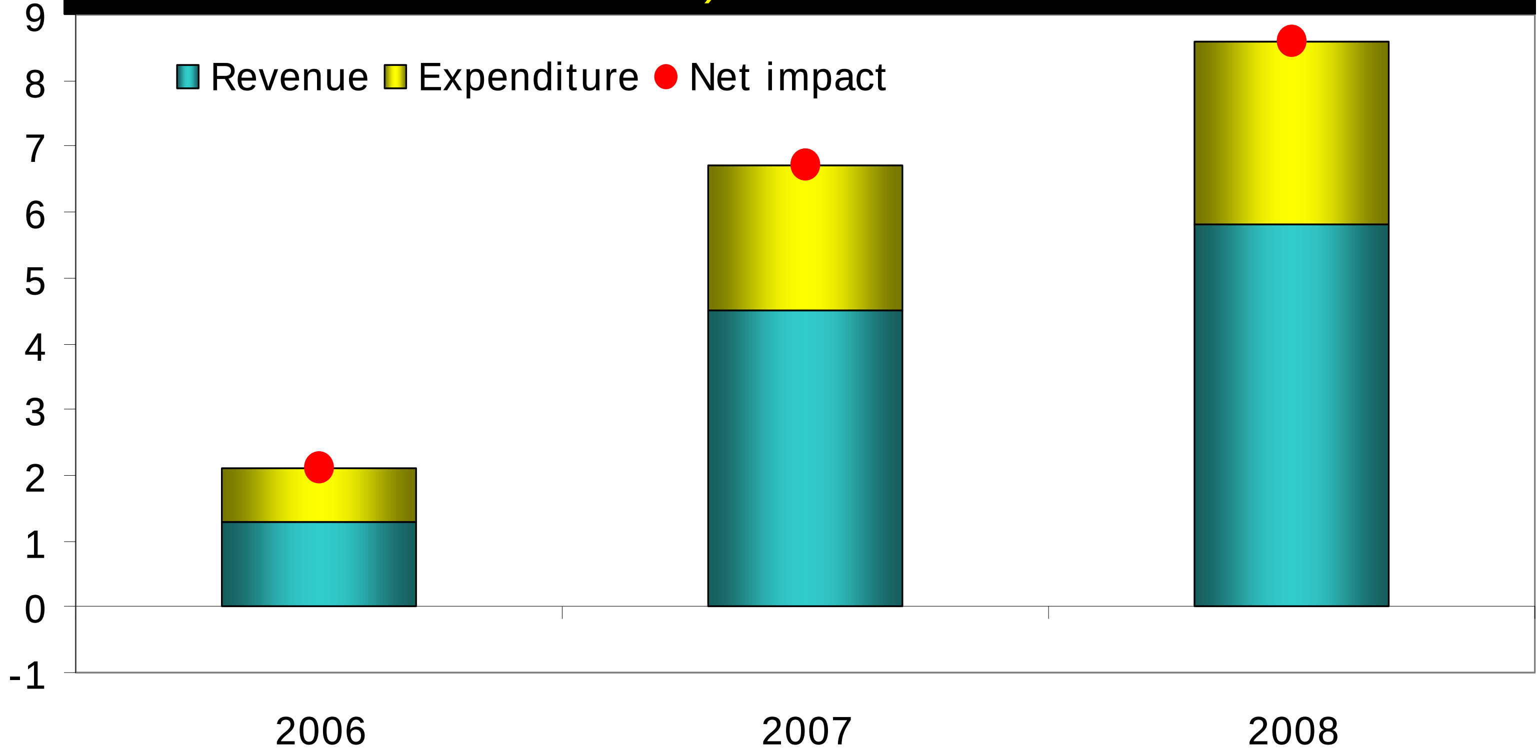
In the “reform countries” the tax structure has moved towards consumption



Source: EC, ‘Taxation trends in the EU’, 2007

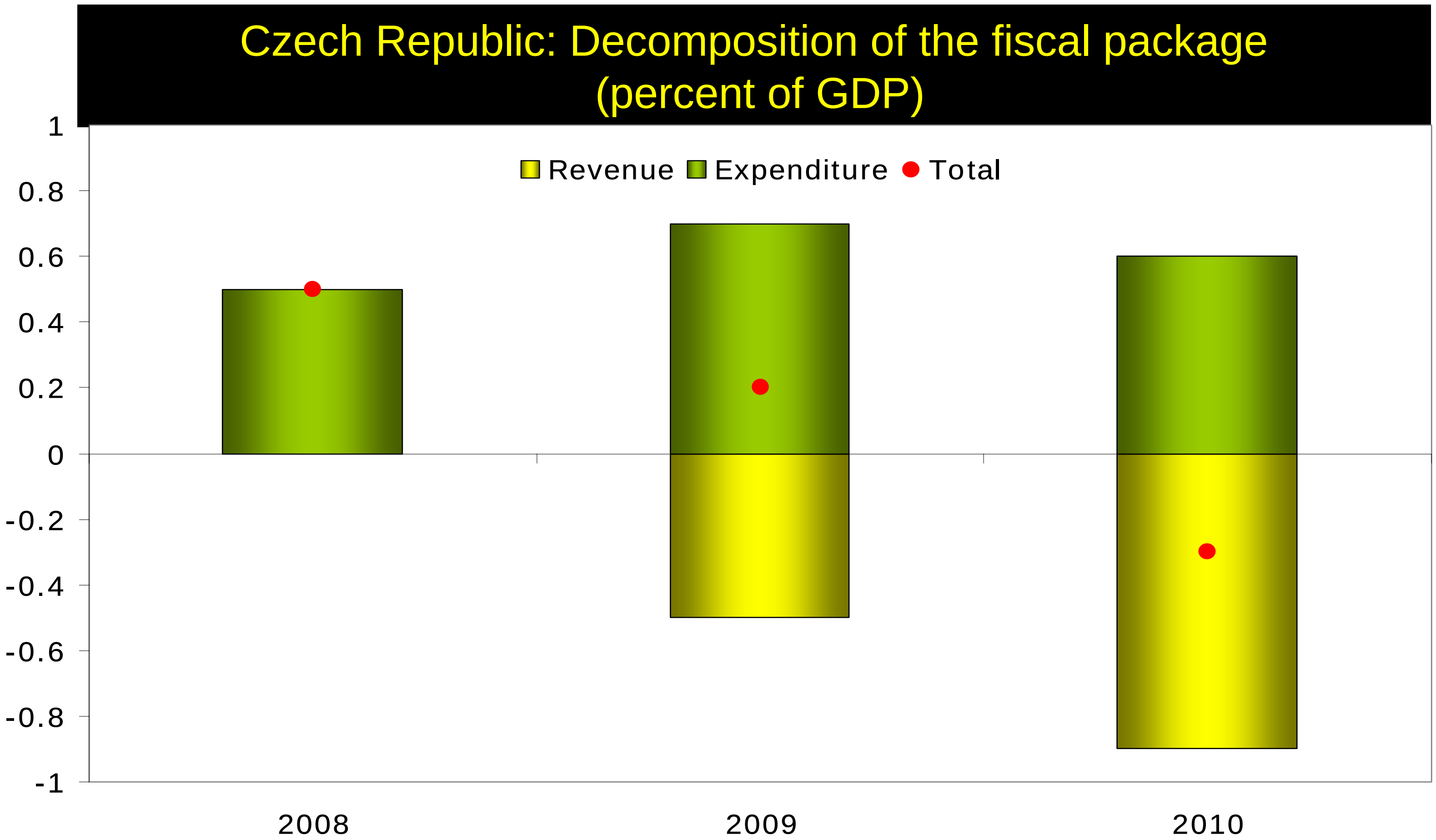
The Hungarian reform effort is sizeable, but in large part based on revenue increases…

Hungary: Decomposition of the fiscal package (in percent of GDP, relative to no reform scenario)



Source: National authorities, Barclays, IMF

…while the recent fiscal package in the Czech Republic has only a modest fiscal impact



Source: IMF Country Report 08/39.

Fiscal Rules can Enhance the Credibility of Fiscal Policy--Poland

Public finance act of 1998

- Debt/GDP levels at 50%, 55%, 60% (constitutional) trigger remedial action
- “PAYGO” rules, revenue overruns are usually saved
- Rules on debt issuance by subnational governments

=>Plans by the new government to strengthen the medium-term fiscal framework, limit annual expenditure increases to inflation

Fiscal Rules can Enhance the Credibility of Fiscal Policy--Hungary

Draft law to introduce fiscal rules and establish a parliamentary budget office (now with parliament)

- Public debt frozen in real terms, primary balance must be in surplus
- “PAYGO” rules
- Now: 3 year expenditure ceiling (should be anchored in debt sustainability objective)
- Independent office to critically appraise the budget

=>Welcome steps to strengthen fiscal institutions against the background of market turmoil and forthcoming elections, some details need to be clarified

Does the global slowdown call for a fiscal stimulus?

The IMF has supported anticyclical easing in US and some other countries

Considerations in Central and Eastern Europe:

- Relatively little fiscal space (deficits are close to EDP / Maastricht limits, public debt is relatively high)
- Growth is not expected to slow down by much (no recession)
- Monetary policy is tightening

=> Letting automatic stabilizers work is for the time being the best course of action

Key messages

- The macroeconomic environment is still good, but the outlook is increasingly uncertain.
- ‘Reform fatigue’: an opportunity to reduce structural deficits and make budgets more flexible has been missed.
- Fiscal adjustment should start on the expenditure side, contrary to recent fiscal reforms in CECs.
- Fiscal rules, like those considered in Hungary now, can increase credibility in turbulent times.
- The global slowdown: let automatic stabilizers work

Thank you!

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