

“The role of the Independent Fiscal Institutions in assessing the sustainability of high public debt in the post-Covid era”

The Network of EU Independent Fiscal Institutions

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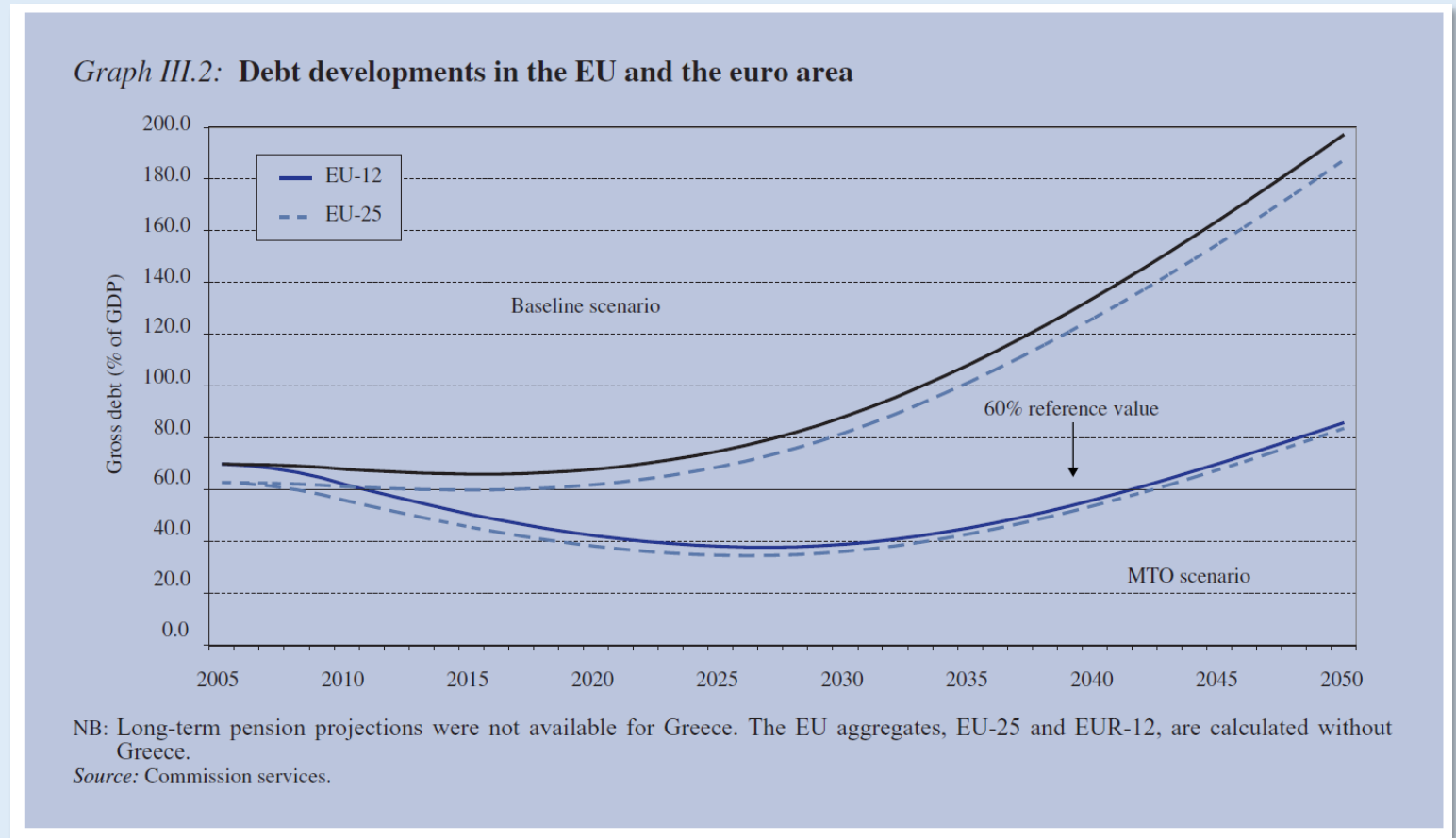
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* The views expressed here are my own and do not necessarily correspond to those of Banco de Portugal or the European System of Central Banks.

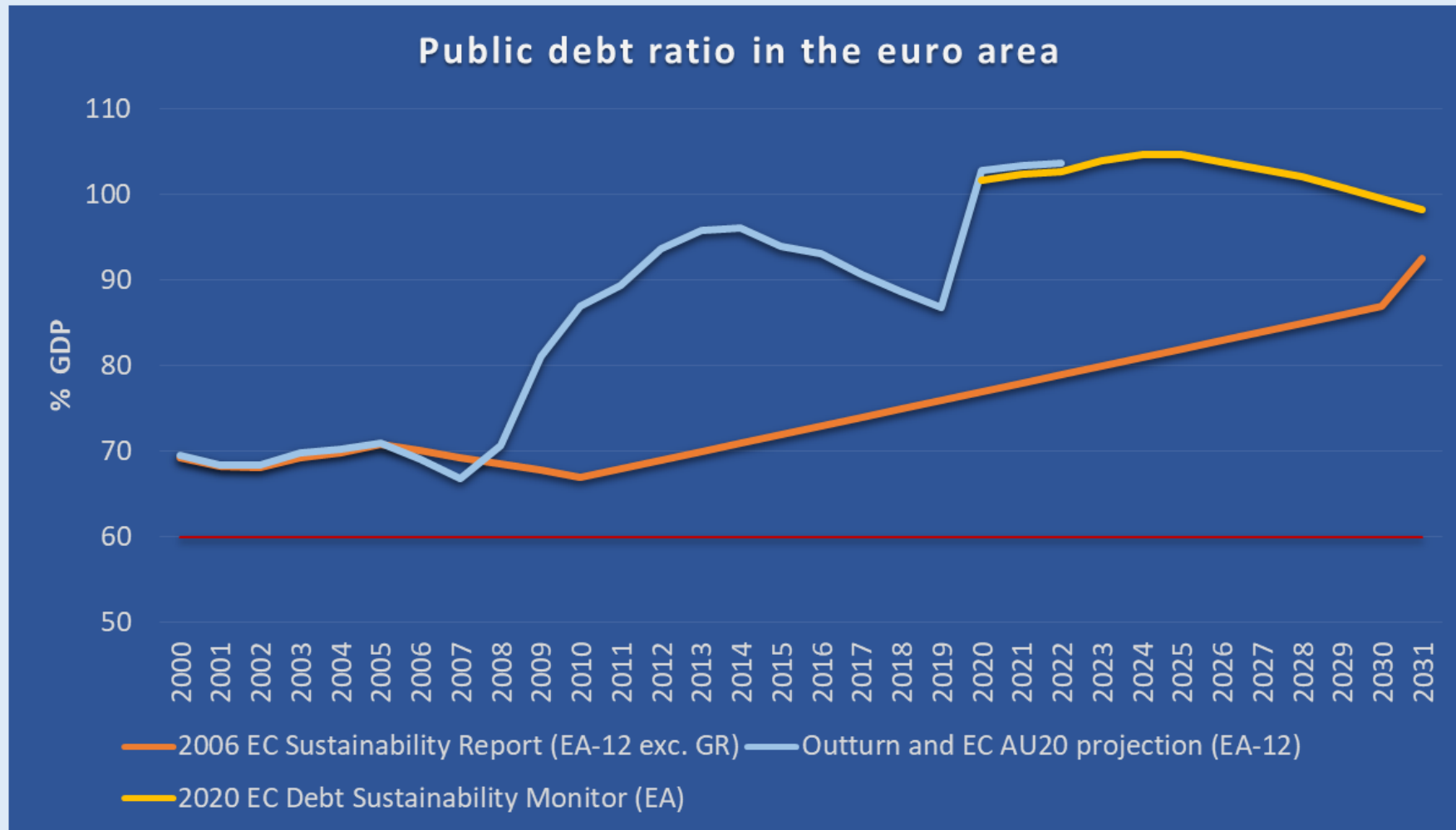
The challenges of projecting debt ratios over the long-term

➔ In 2006 the Commission published the first 'sustainability report'.



The challenges of projecting debt ratios over the long-term

➔ The '2006 debt projection' did not materialise... but that was not expected.



The usefulness of DSA methodologies

➔ A framework to assess risks to public debt sustainability

Sensitivity of results to assumptions
(primary balance, interest rate on public debt, economic growth and GDP deflator)

Need to better cater for other types of risks
(other macroeconomic and financial risks, contingent liabilities, governance and political risks,...)

Increasing complexity of DSA methodologies:

- Multiplicity of deterministic scenarios
- Stochastic DSA
- Short-term/financing needs analysis
- Introduction of many other indicators

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- Judgement

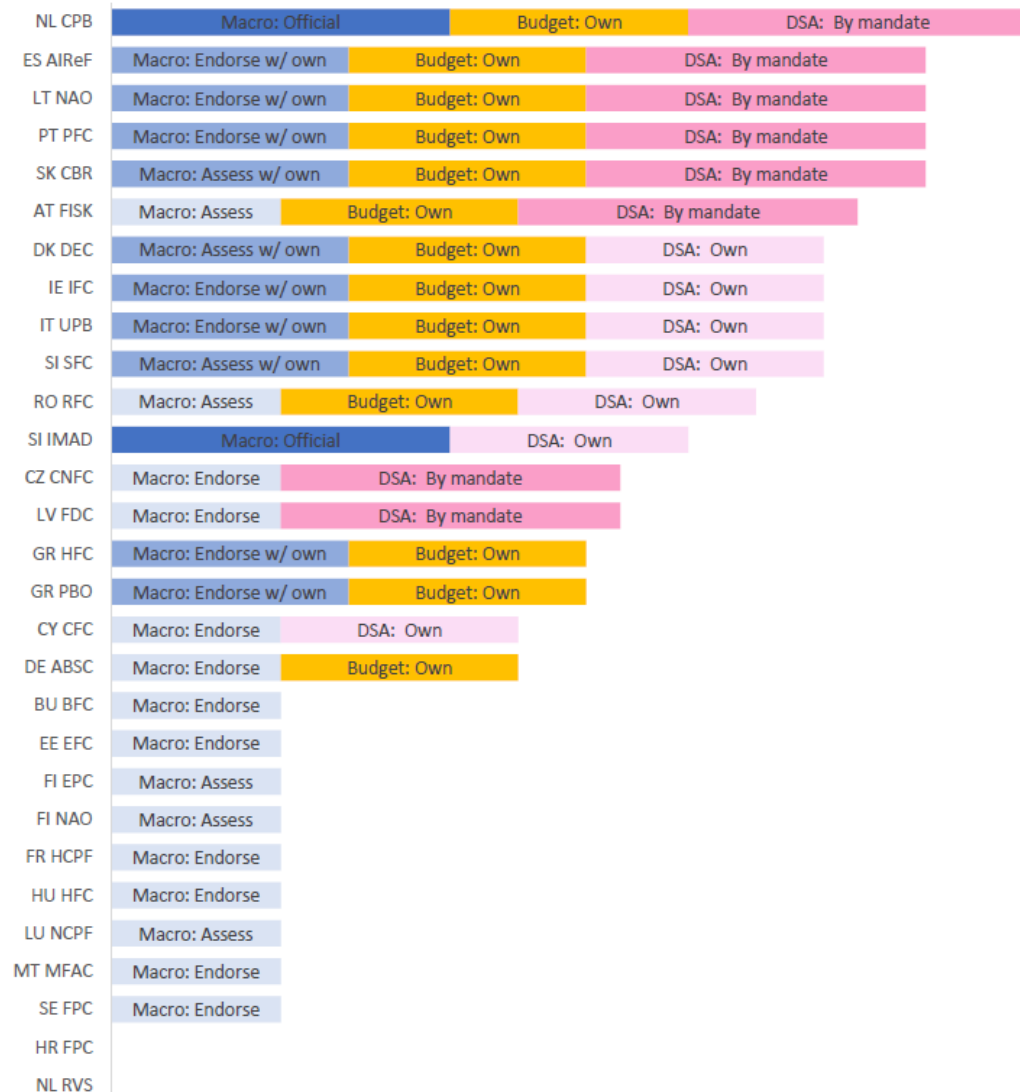
Need to define thresholds and scoring schemes, as well as aggregation criteria / rules

Communication difficulties
(in spite of the colour schemes / heatmap approaches)

So far, the role of DSA results to trigger policy actions in EU member states seems to have been limited... but performing this evaluation is not straightforward... and overall, awareness was raised.

The use of DSA by IFIs

Figure 3 IFI Mandates in terms of macroeconomic and budgetary forecasting



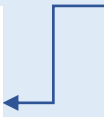
Around 1/3 of surveyed IFIs have an official mandate to produce DSAs, while another 1/3 are producing these more generally



Explained by the short sightedness of governments?

But they should care:

- Access to financial markets
- Fiscal rules (54 references to 'sustainability' in the Vade Mecum)



Is there advantage in a well-established methodology for DSA?

- ✓ Definitely yes
- ✓ Even more so if it is an harmonised methodology shared by the IFIs Network
- ✓ If not possible, to communicate on medium-term to long-term risks is already crucial
- ✓ Especially after the pandemic crisis (contingent liabilities...)

Additional challenges to DSA created by the pandemic crisis



Are the new debt levels sustainable?

- Financial market reactions are currently muted by the ECB asset purchase programme
 - The pandemic crisis was a symmetric global transitory shock
 - Existence of EU-level initiatives to support the recovery
 - Implementation of sound fiscal policies as soon as conditions allow
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- Make more likely a favourable reaction of financial markets thereafter



Without adjustment, DSA methodologies will inevitably point to higher sustainability risks

- Adjustment of assumptions, parameters, thresholds... (EC DSM example)
- Bigger role for judgement but caution is warranted to avoid a credibility loss
- Contingent liabilities risk-analysis goes far beyond the effects of ageing and climate change: the pandemic created significant amounts of government contingent liabilities plus the building up of risks in the financial sector
- The quality of public finances matters substantially

Thank you for your attention!