

CAN DEBT SUSTAINABILITY BE MADE OPERATIONAL?

Fifth Annual Conference of the European Fiscal Board

Giovanni Callegari – Head of Economic and Risk Analysis

11 May 2023



*The views expressed in this **presentation** are those of the author and do not necessarily reflect the views of the ESM*

STRUCTURE AND MAIN POINTS

SOME STRUCTURE:

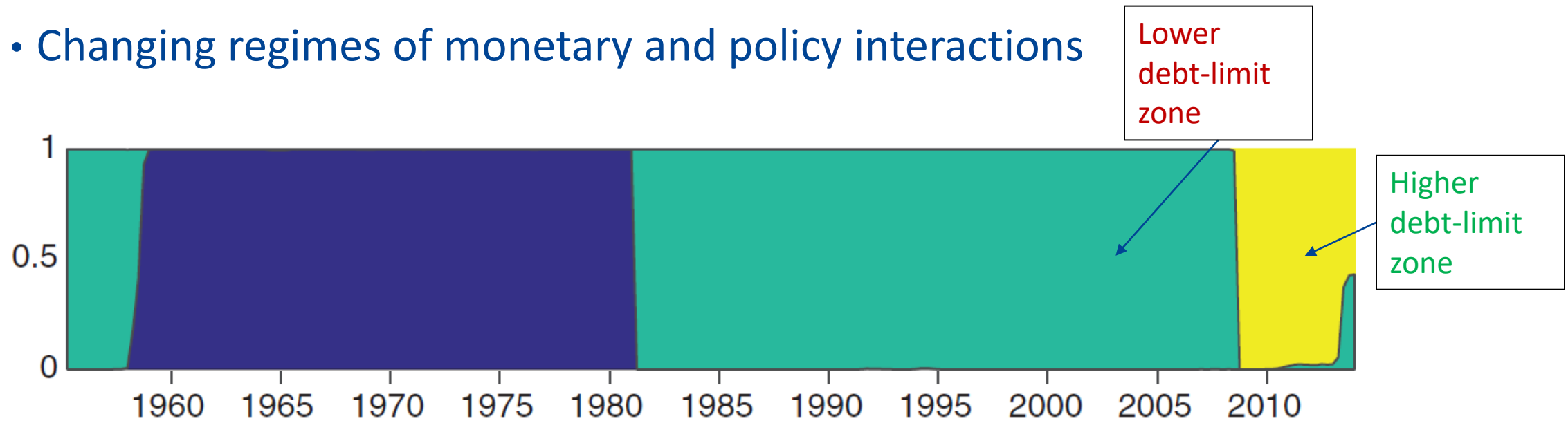
- Challenges in conducting DSA
- Possible ways to deal with them
- Implications for the use of DSA as a driver for policy-making

SOME POSSIBLE TAKE-OUTS:

- Focus on narrative rather than individual shocks
- Communication becomes even more important than in the past

POLICY RESPONSES

- Changing regimes of monetary and policy interactions



Blue regime: high fiscal deficits low and partially responsive real interest rates

Green regime: declining deficits, higher and more responsive interest rates

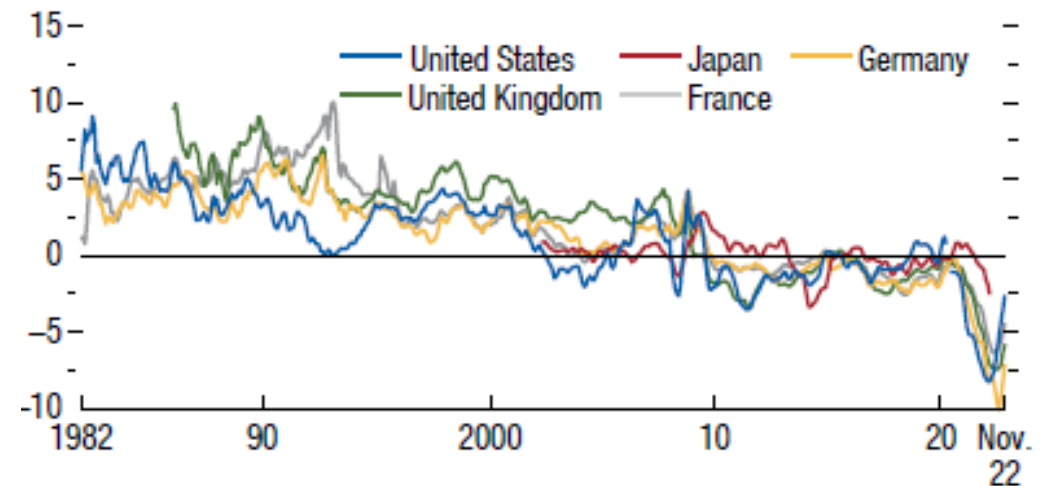
Yellow regime: high fiscal deficits, zero-lower bound

Source: Bianchi and Melosi (2017), data relative to the US up to 2014

UNCERTAINTY ON TRENDS

- Not clear view on where the post-pandemic and post-energy crisis steady state is
- This all reflected in the dynamics of Natural Interest Rate (NIR)
- IMF's WEO: NIR will go down, but the debate is still open
- Aging, inequality still at work, but what about int'l spillover and convenience yields? Climate?

Real short-term interest rates in advanced economies (ex-post measure)



Source: IMF WEO Spring 2023, Chapter 2, figure 2

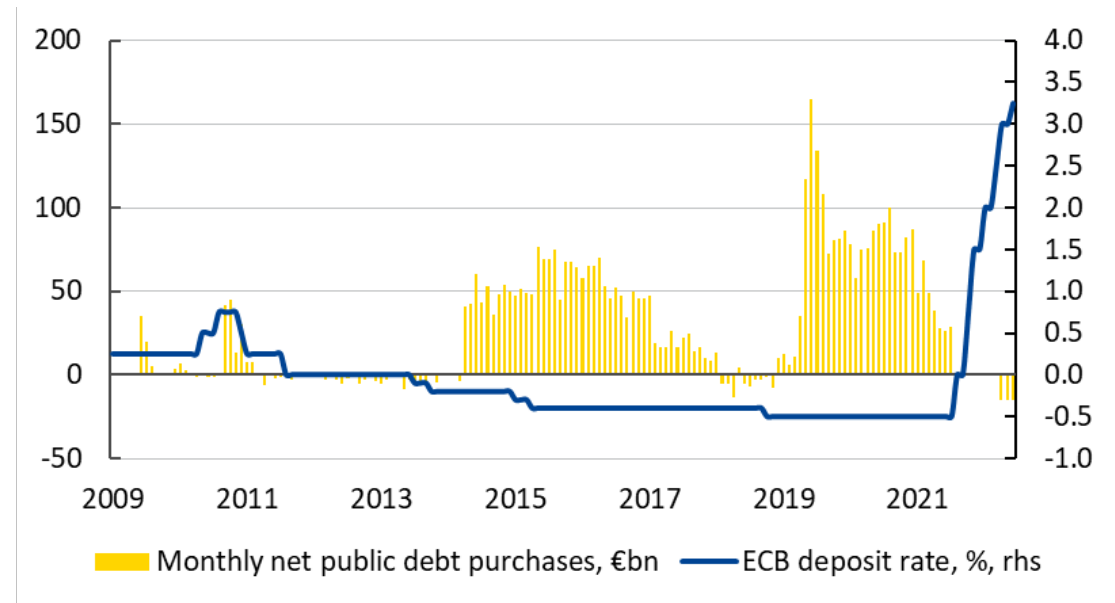
OUR APPROACH

- Endogenous monetary policy and forward looking approach
 - Moving to a more general equilibrium approach
 - Endogenous Fiscal/Monetary policy interaction
 - Probabilistic approach on transition between regimes
- Shock design and calibrations
 - Narratives (i.e., composition of different shocks, country- and time-specific) instead of standardised shocks
 - Trying to avoid momentum thinking...
 - Results casted in probabilistic terms

WHAT ABOUT COMMUNICATION?

- How to avoid un-communicable black boxes?
- Explain the concepts to the public (takes time)
- Focus on narratives also when presenting results
- Avoid momentum thinking

We cannot use the past to predict in the future in presence of regime shifts



Source: Bloomberg

DSA AS A BENCHMARK FOR POLICY-MAKING?

- All above ok for repayment capacity, more complex for policy-making
- Remember Goodhart's law

When a measure becomes a target, it ceases to be a good measure, as it becomes subject to manipulation

- Use DSA as a policy objective, not as a policy instrument
- Robust approach (taking into account outputs of different models from different stakeholders) might reduce risks



CONTACT

European Stability Mechanism
6a Circuit de la Foire Internationale
L-1347
Luxembourg

Follow the ESM on Twitter:
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STARTING POINTS

- Conducting DSA faces new and old challenges:
 - More uncertainty on both short-term (policy responses) and medium-term fundamentals
 - This makes communication harder than ever
 - We are likely going through a series of structural breaks