CAN DEBT SUSTAINABILITY BE MADE OPERATIONAL?

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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
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• 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