



Global Outlook. View on Hungary

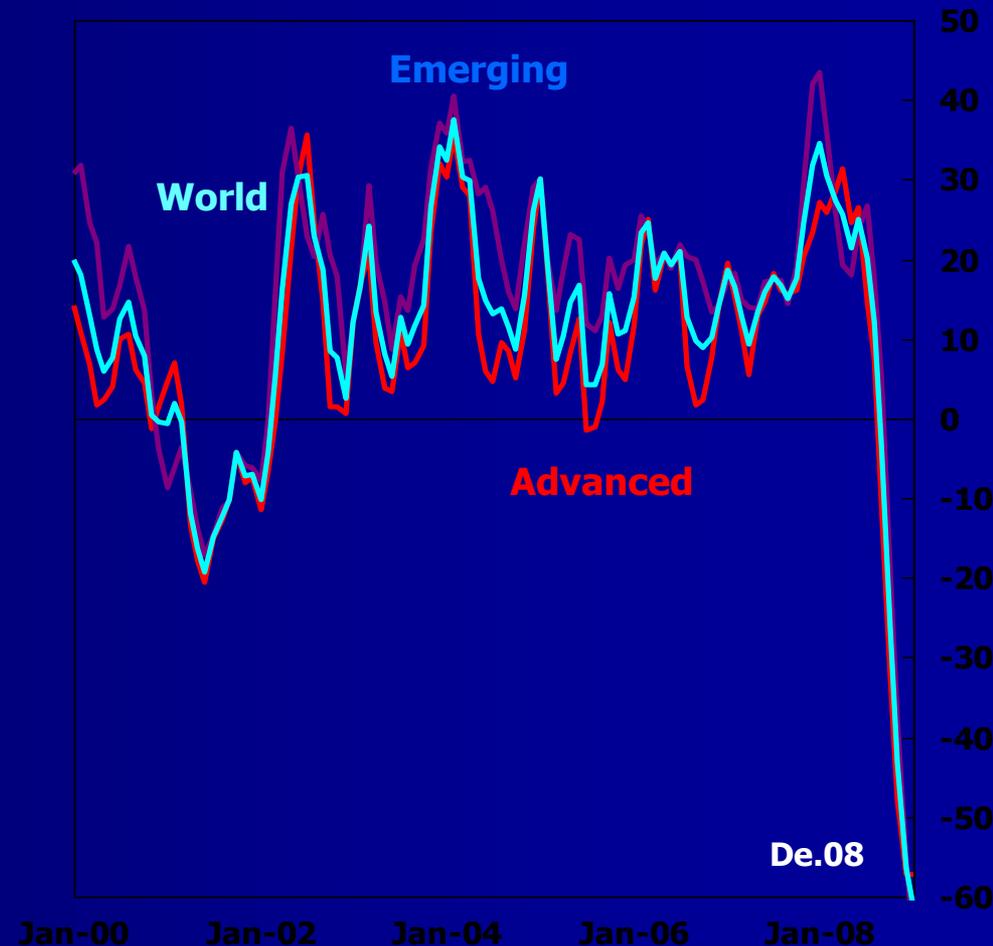
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IMF Resident Representative in Hungary

Presentation at the Széll Kálmán Foundation
October 14, 2011, Budapest

Crisis Backgrounder

- Financial crisis (August 2007)
 - ↳ "Growth crisis" (Fall 2008)

Merchandise Exports
(Annualized percent change of 3mma over previous 3mma)



Crisis Backgrounder: Emerging Europe Hard Hit

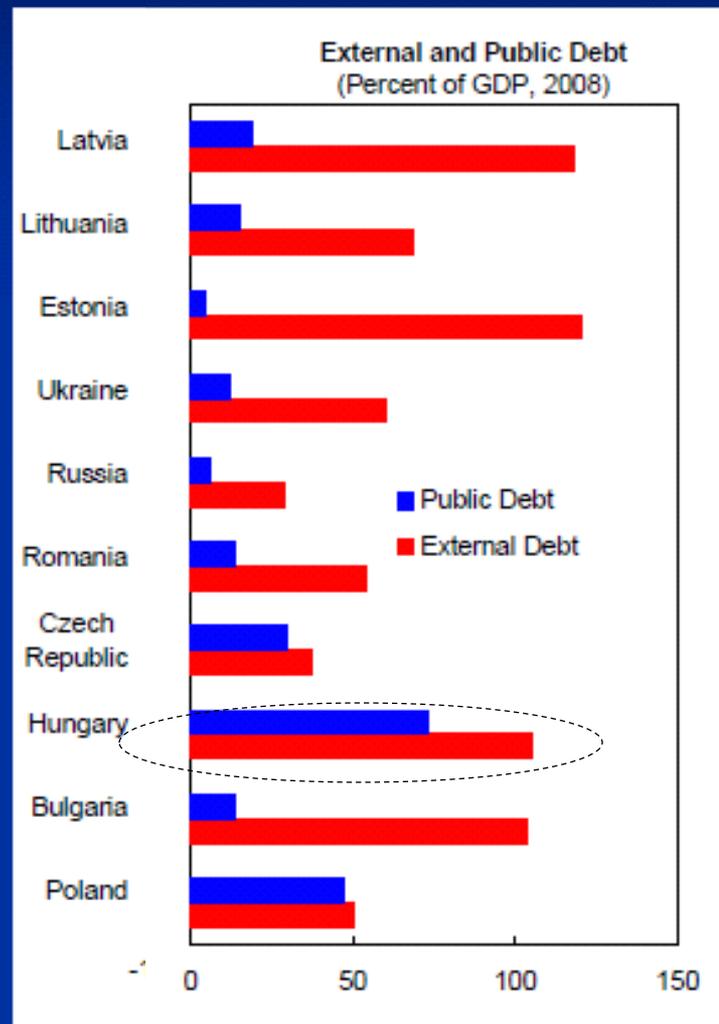
- Tight cross-European linkages, financial linkages
- Rapid demand-led growth in most countries, financed by capital inflows
- Sudden stop to capital inflows, trade linkages collapse:
 - No growth
 - Stresses the financial system; on balance sheets as currencies depreciate

Crisis Severity: Function of Vulnerabilities

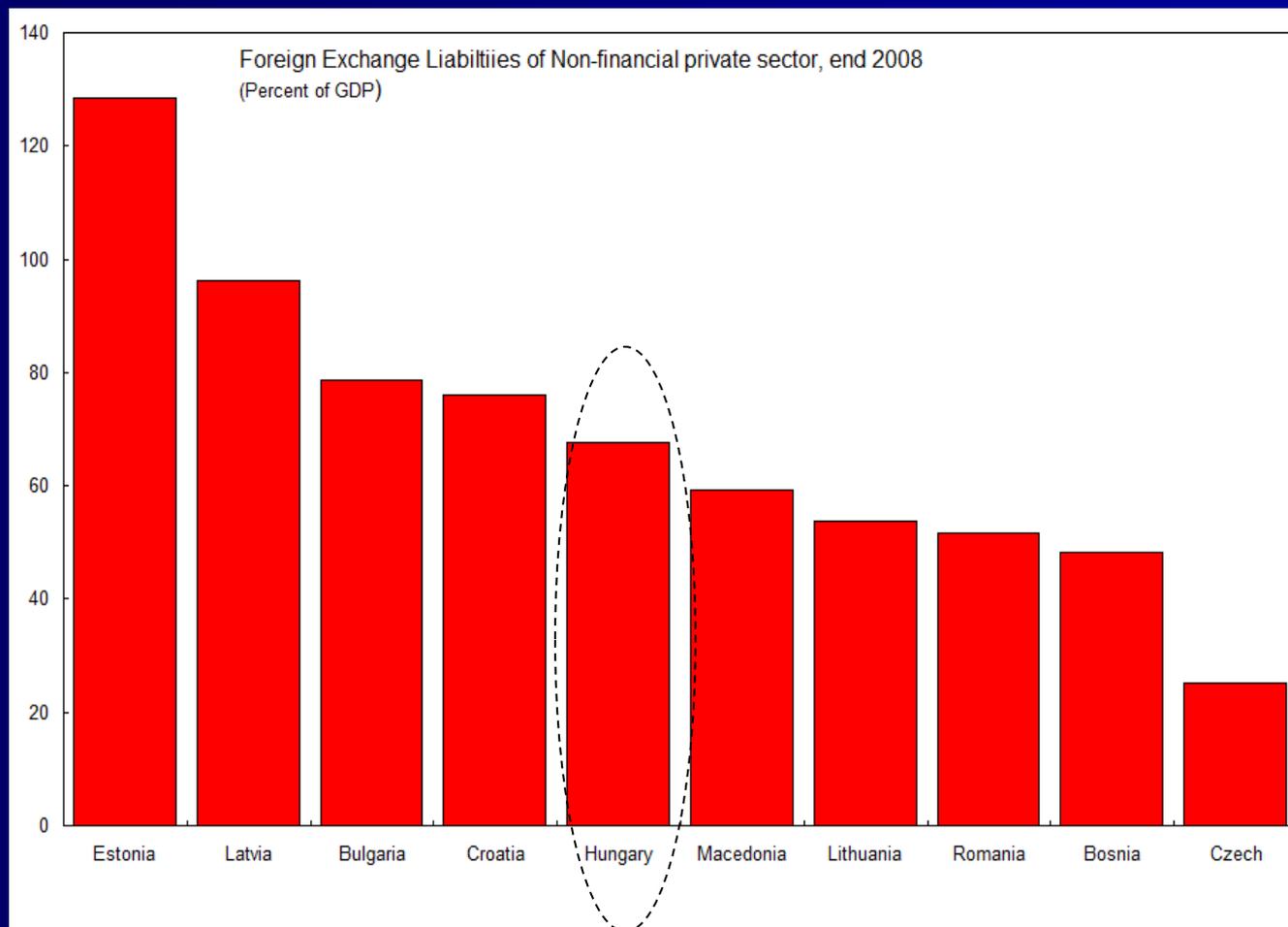
Vulnerabilities →

limited room for policy responses

Public finances, FX debts,
local asset price bubbles,
remittances



Emerging Europe Crisis Severity: Function of Vulnerabilities



Crisis Response: IMF Part

- About USD 75bn of total new programs in EME
- 250 bn SDR allocation to boost global liquidity:
 - SDR 100 billion to emerging markets, SDR 991 million to Hungary
- G-20 strengthen the IMF (London, April 2009)
 - Tripling recourse to \$750 billion
 - Additional concessional lending to low-income countries

Crisis-Response: IMF Part

Member	Type of Arrangement	Duration of Arrangement	Amount Agreed (SDR millions)	Amount Drawn (SDR millions)
Ukraine	SBA	11/05/08 - 07/27/10	11,000	7,000
	SBA	07/28/10 - 07/27/12	10,000	2,250
Hungary	SBA	11/06/08 - 10/05/10	10,538	7,637
Latvia	SBA	12/23/08 - 12/22/11	1,522	982
Belarus	SBA	01/12/09 - 03/30/10	2,270	2,270
Serbia	SBA	01/16/09 - 4/15/11	2,619	1,321
Romania	SBA	05/04/09 - 03/30/11	11,443	10,569
	SBA	03/31/11 - 03/30/13	3,091	0
Bosnia and Herzegovina	SBA	07/08/09 - 06/30/12	1,015	338
Poland	FCL	05/06/09 - 05/05/10	13,690	0
	FCL	07/02/10 - 01/20/11	13,690	0
	FCL	01/21/11 - 01/20/13	19,166	0
Moldova	ECF/EFF	01/29/10 - 01/28/13	370	120

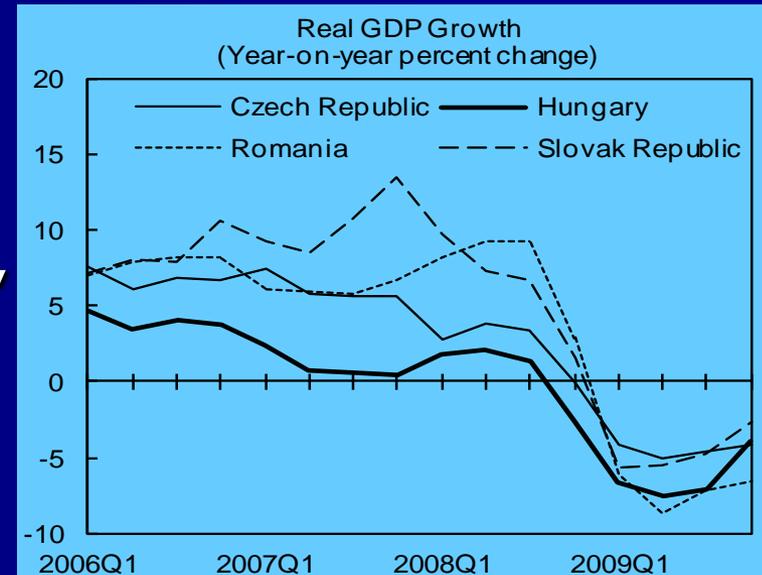
Hungary SBA: Taking Stock

- 1st -5th Reviews: completed by March 24, 2010:
 - Drawn app. EUR 9 bn (>70% of all SBA)
 - Did not draw EUR 1.7 bn at 4th and 5th reviews:
 - Re-gained market access: HUF and FX
 - better financing environment and consistent national policies
 - Structural fiscal adjustment 3% of GDP in 2009
 - Strengthening financial supervision
- SBA expired October 5, 2010
 - 6th & 7th Review: not completed. App. SDR 3bn of undrawn funds would have been an insurance against deterioration in global financial environment.

Hungary SBA: Crisis-Response

Not easy measures, but likely better than counterfactual:

- Smaller currency depreciation
- No large-scale defaults,
- No banking crisis: costly!
- Possibly better growth outcome, less adjustment



Source: Haver.

Overcoming Political Risks and Crisis Legacies

Confidence crisis

- Sources: weak growth, weak politics
- How different from Lehman?

Sovereign strains

- Becoming more widespread
- After U.S., who's next?

Spillovers to banks

- How strong?
- Will credit dry up?

The credit cycle

- Where are we? AE vs. EM
- The unpleasant side-effects of low rates. How serious?

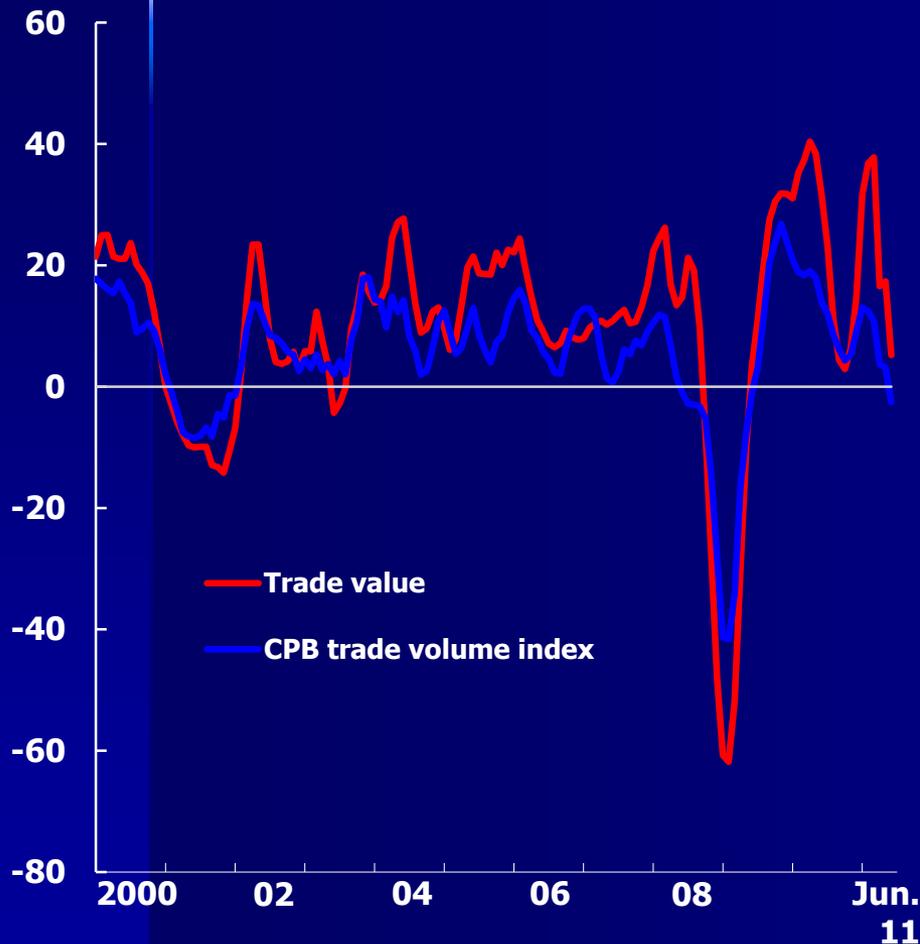
Policy priorities

- Time is running out... but not yet too late

Challenging Outlook: Slower Global Growth and Higher Financial Volatility

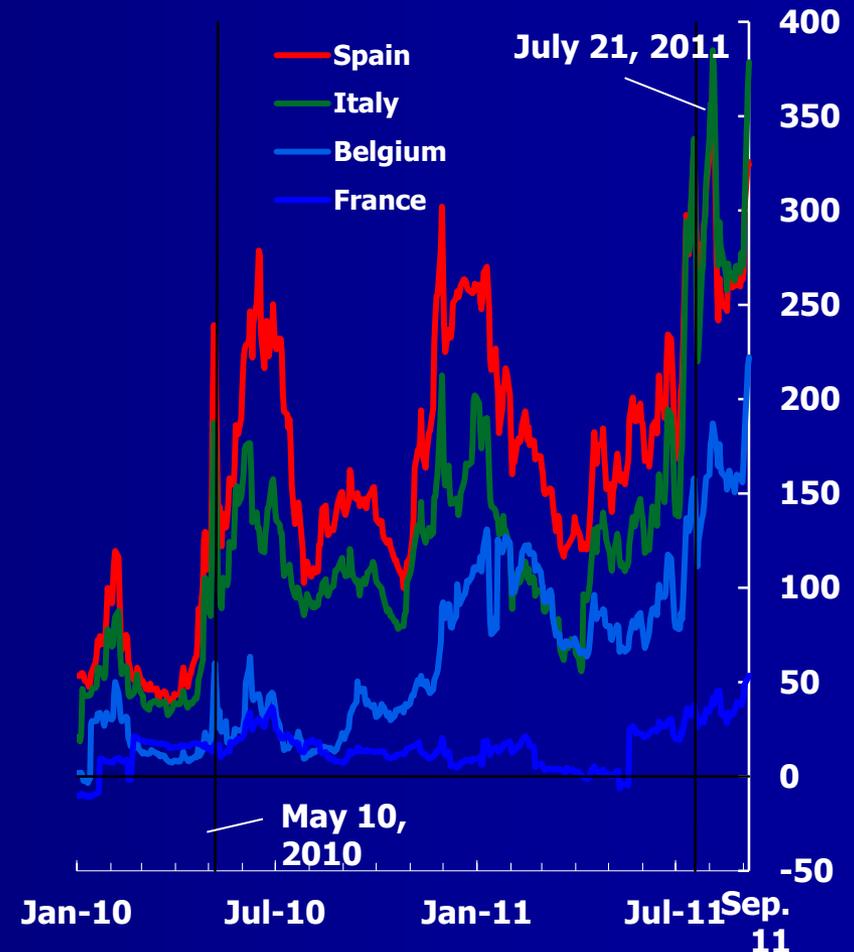
World Trade

(annualized %change of 3m ma over previous 3m ma)

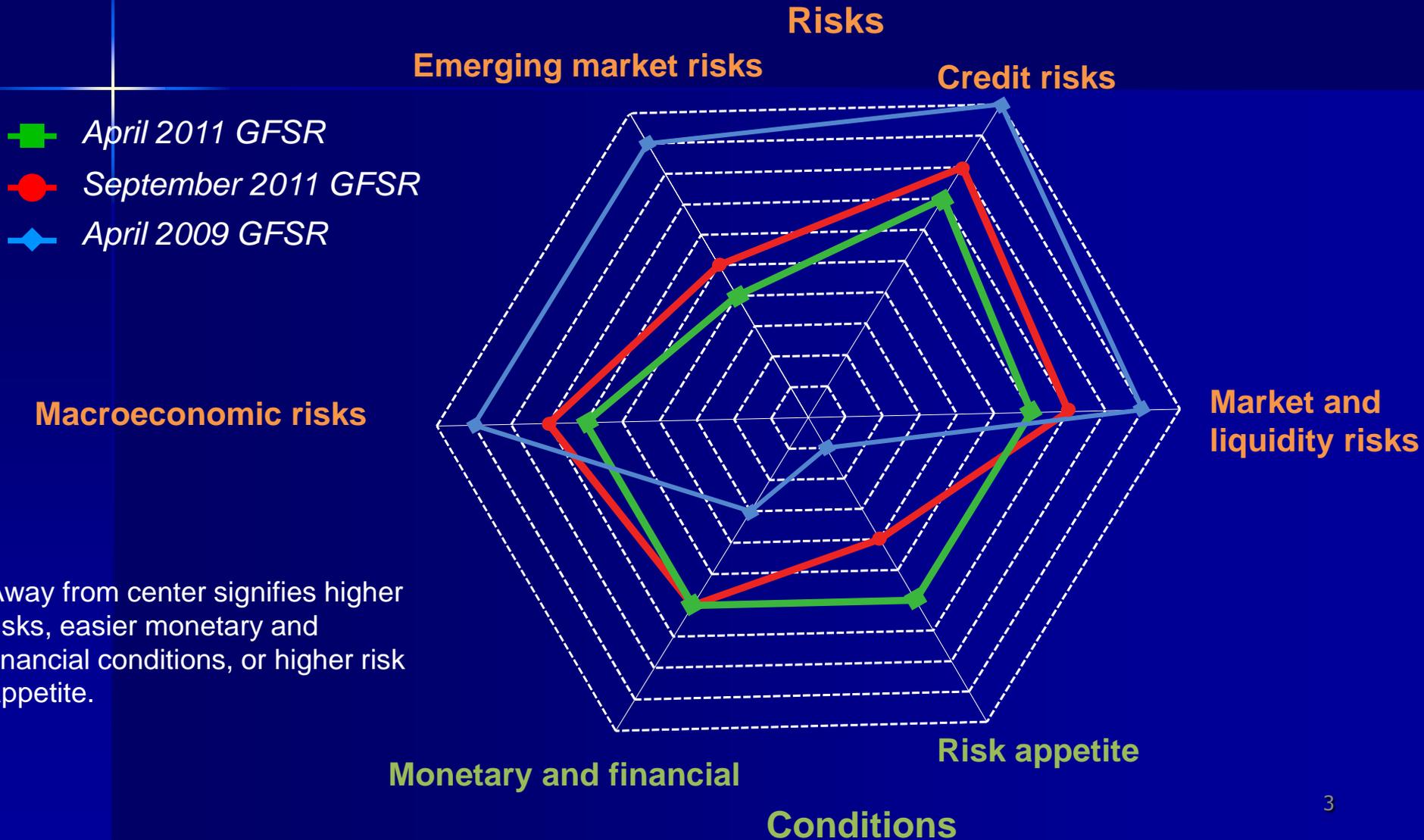


Government Bond Spreads

(2y yield spreads over German bunds; bpts)



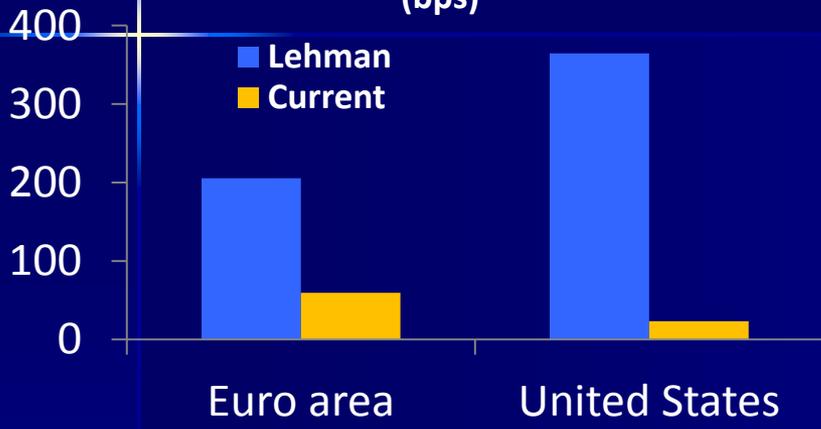
Stability Risks Increased Across all Risk Metrics



What's different from "Lehman"?

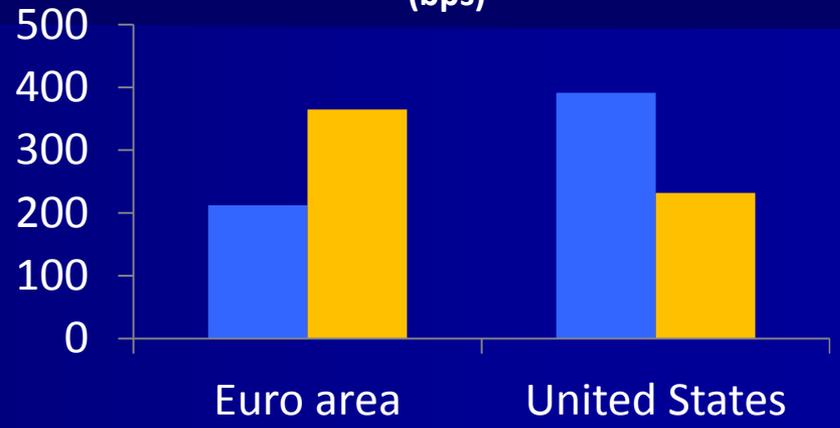
Interbank funding stress is less, while ...

Libor – OIS Spreads (bps)



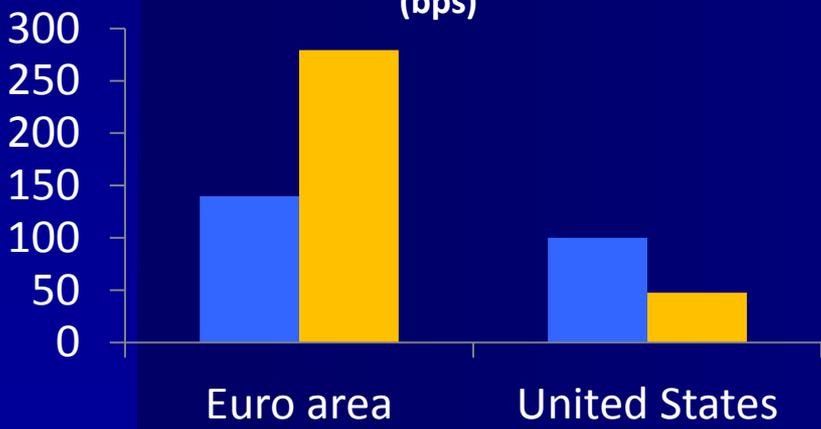
... risk perceptions are greater for European banks ...

Bank CDS Spreads (bps)



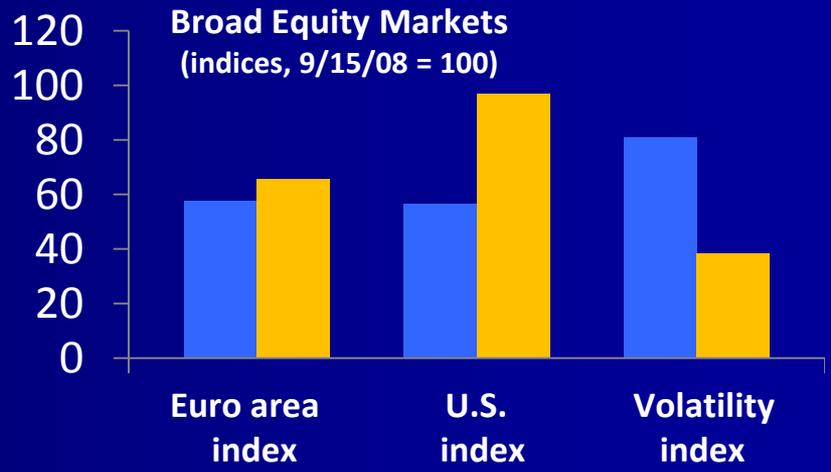
... partly due to sovereign strains ...

Sovereign CDS Spreads (bps)



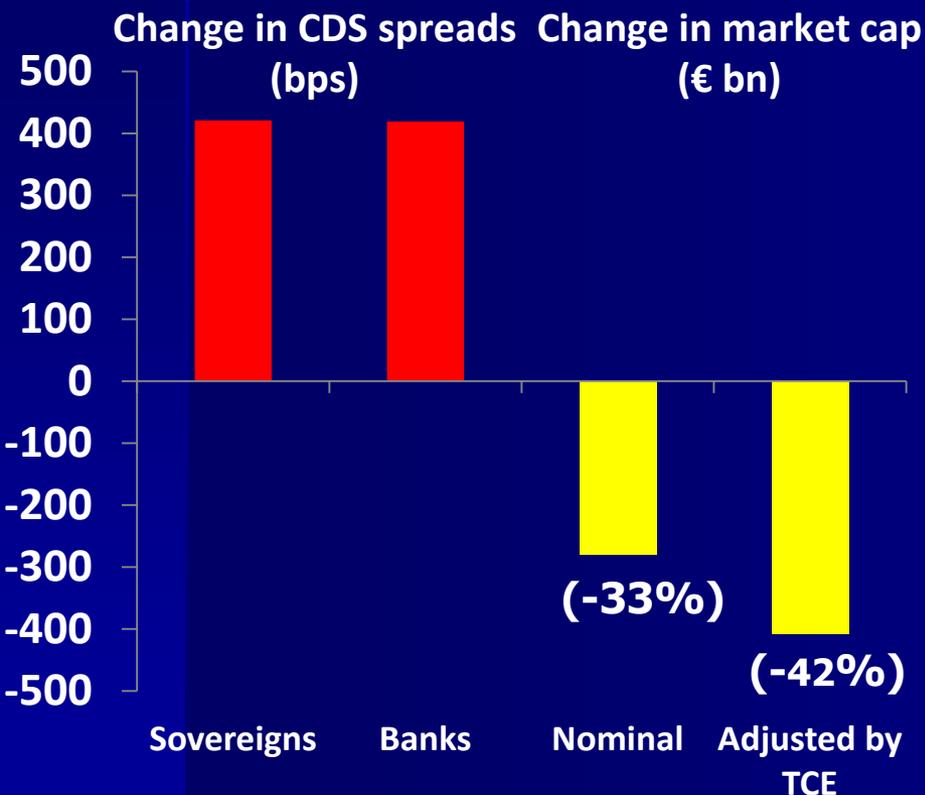
... with stress rising on broad markets ...

Broad Equity Markets (indices, 9/15/08 = 100)

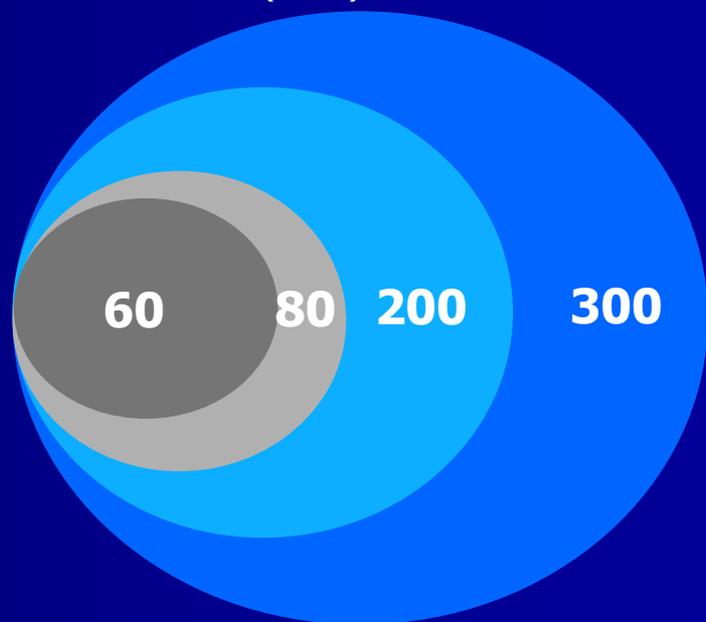


Euro area sovereign risks have spilled over to the EU banking system

Sovereign and Bank Credit Risks and Market Capitalization (changes since January 2010)



European Banking System Mark-to-market Impact from High-spread Euro Area Sovereign Spillovers (€ bn)



Spillovers from . . .

- Greek sovereign
- Irish & Portuguese sovereign
- Belgian, Spanish & Italian sovereign
- High-spread euro area banking sector

The baseline forecast: more uneven recovery:
 > 6 % in EM, < 2 % AE = 4 % global growth.

Real GDP Growth
 (percent change from a year earlier)

Advanced Economies

- United States
- Euro area
- Japan

Emerging Economies

Emerging Asia

MENA

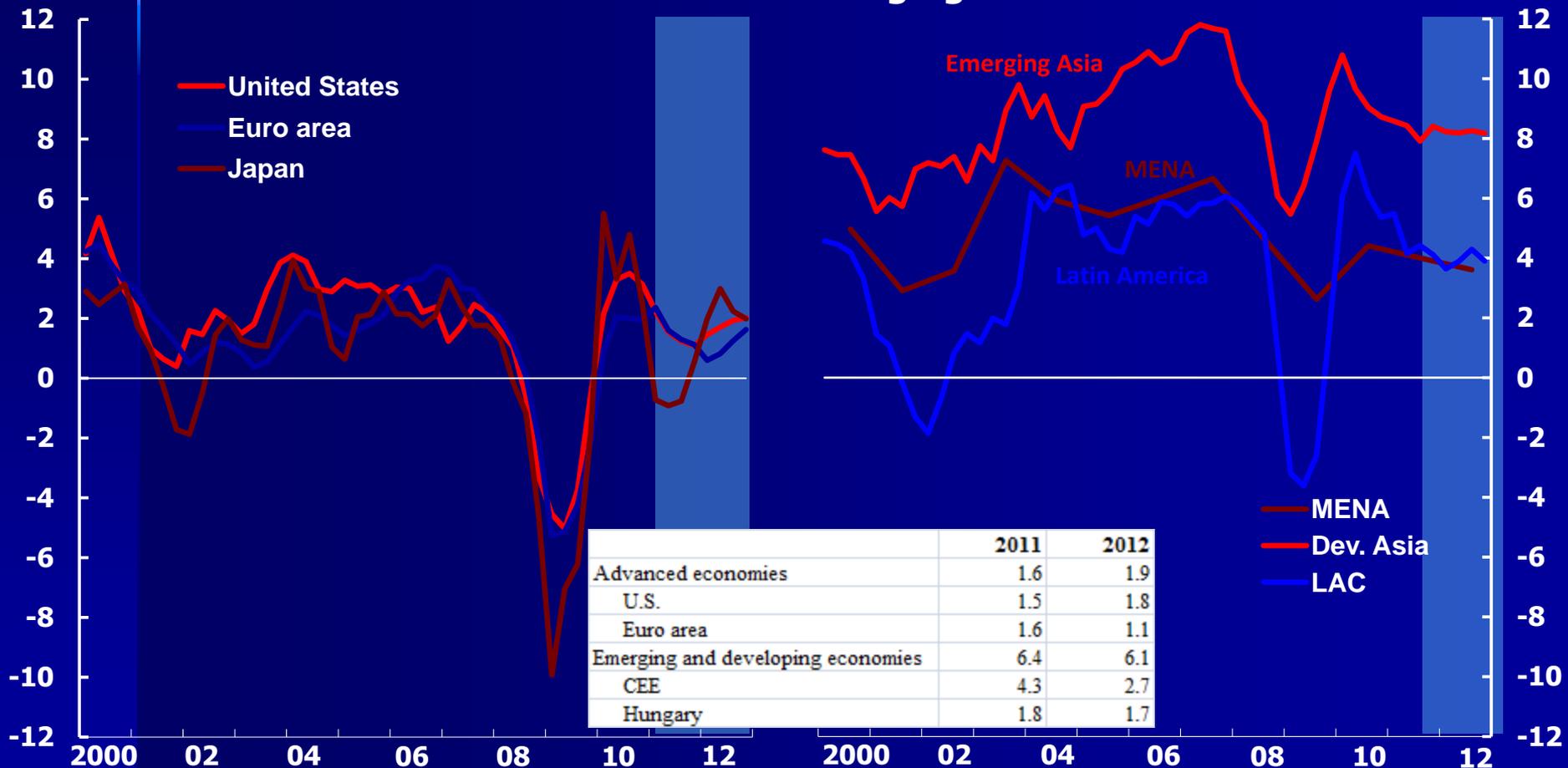
Latin America

MENA

Dev. Asia

LAC

	2011	2012
Advanced economies	1.6	1.9
U.S.	1.5	1.8
Euro area	1.6	1.1
Emerging and developing economies	6.4	6.1
CEE	4.3	2.7
Hungary	1.8	1.7



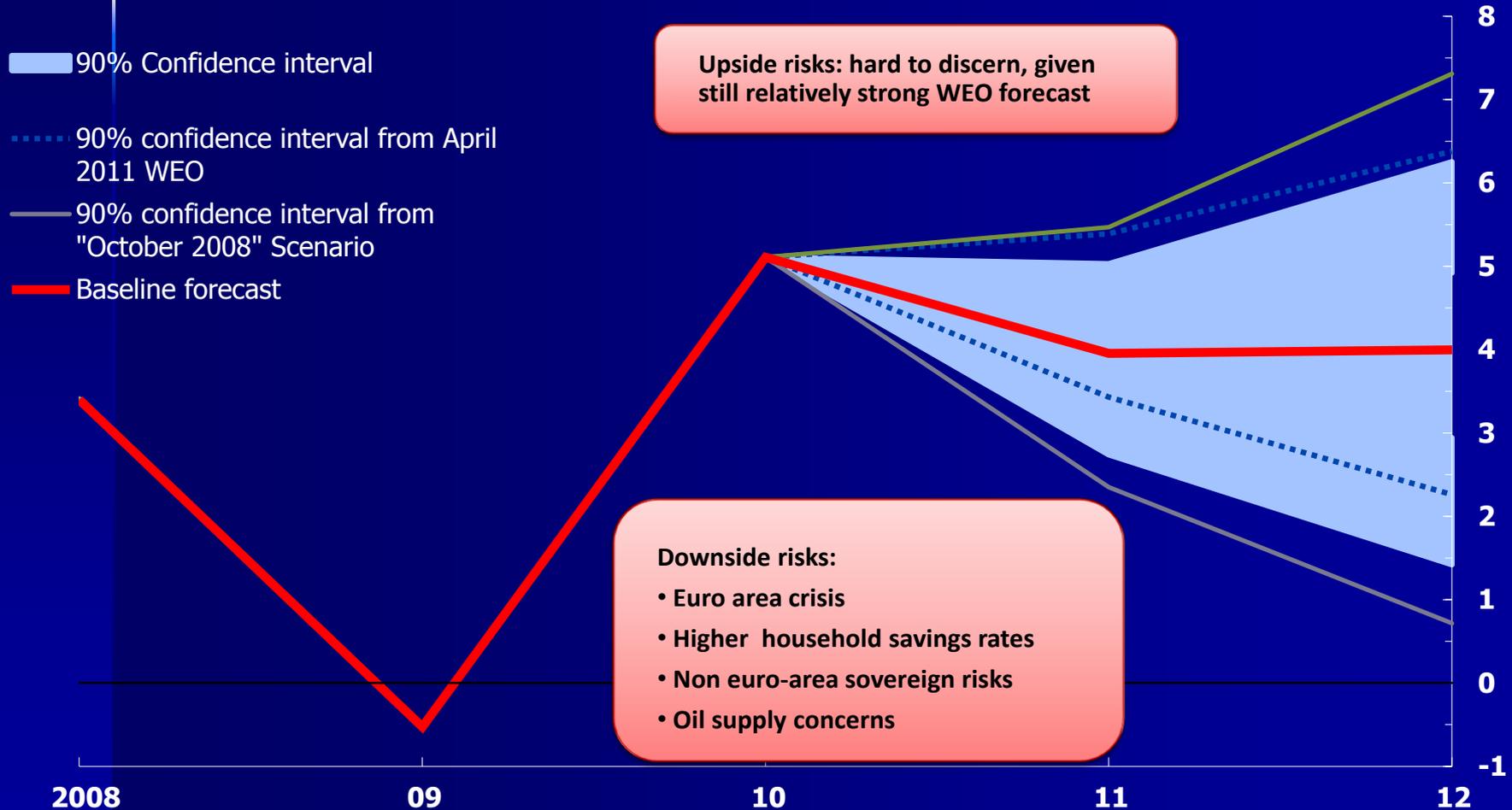
Baseline: no doomsday

- Key assumption underlying the WEO baseline: financial recovery delayed but not derailed.
-
- 1. Euro area crisis does not run out of control.
- 2. Global financial volatility does not escalate.
- 3. No major tightening of bank lending conditions.

Risks: Increased and on the Downside

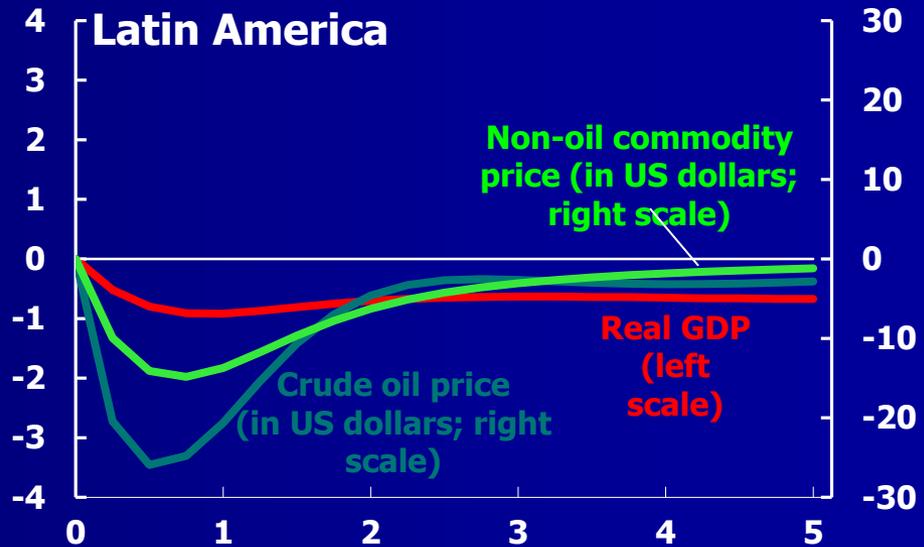
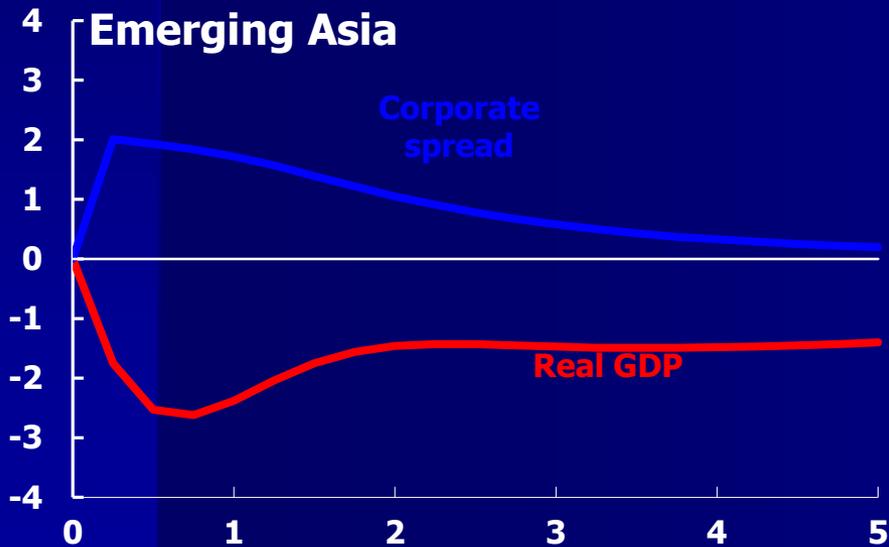
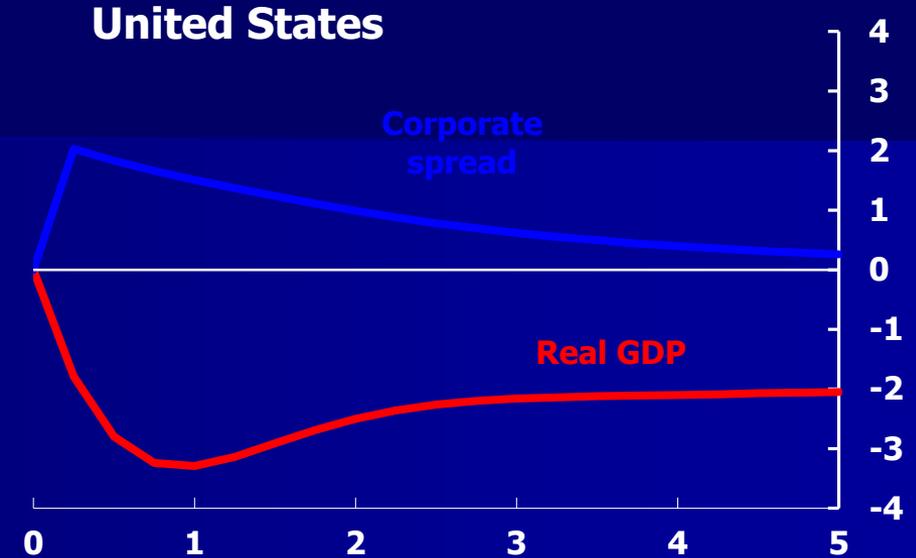
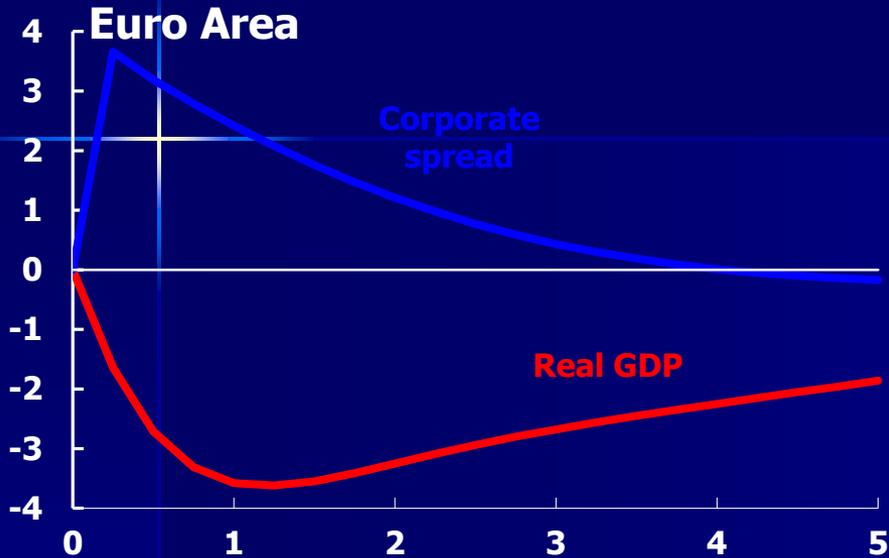
Risk (global growth < 2 percent)=10%!

Prospects for World GDP Growth (percent change)



Downside scenarios point to potentially large output losses.

Downside Scenario
(Deviation from control; years on x-axis)



Policy choices

Advanced economies—most urgent: strengthened euro area crisis management framework; raise capital buffers (incl. from EFSF); credible medium-term fiscal consolidation that helps avoid overly strong short-term adjustment; supportive monetary policy.

Emerging and developing economies: structural reforms and currency appreciation in key surplus economies; policies to avert build-up of financial vulnerabilities; social safety nets.

Other (regulatory, IMS, etc): Financial regulation, new macroprudential tools, enhance IMF surveillance and strengthen global financial safety net; reform global financial system; trade.

Advanced Economies

avoid *near-term* crisis

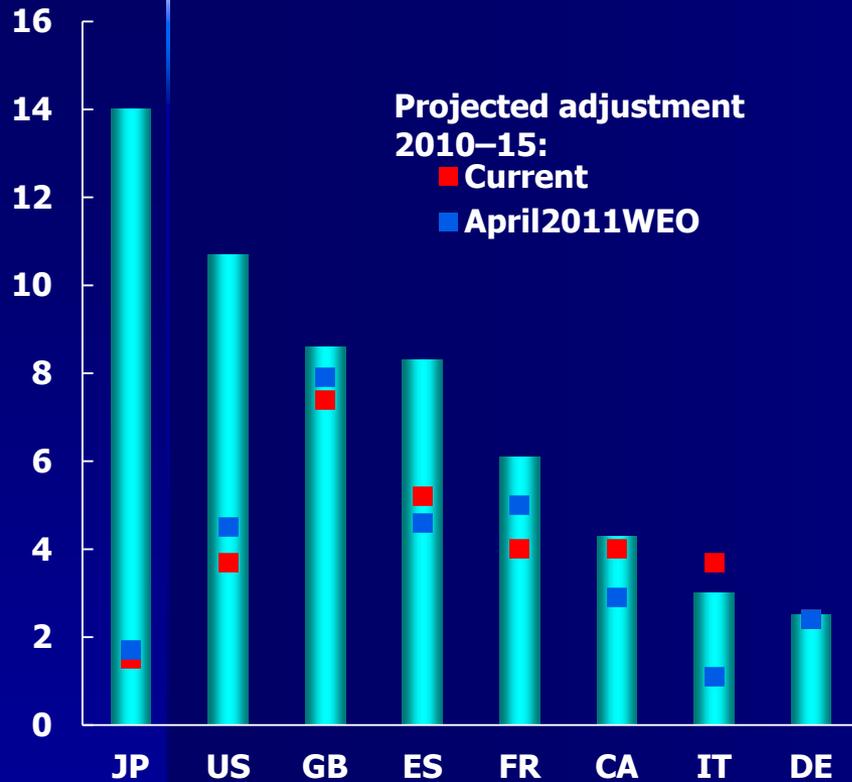
Sovereign risks	Balance sheet repair	Public (US, EU, Japan)	medium-term credible fiscal consolidation
		Private (Households, US)	mortgage debt - banks
		Banks (EU)	more capital (private, public, EFSF) funding structures

Complete financial reform agenda

Policy Room: Some AE have made good fiscal progress, EM are in a better position.

Required Adjustment^{1,2}

(percent of GDP)



Fiscal Balance

(percent of GDP)



Sources: IMF, *Fiscal Monitor*, and IMF staff calculations.

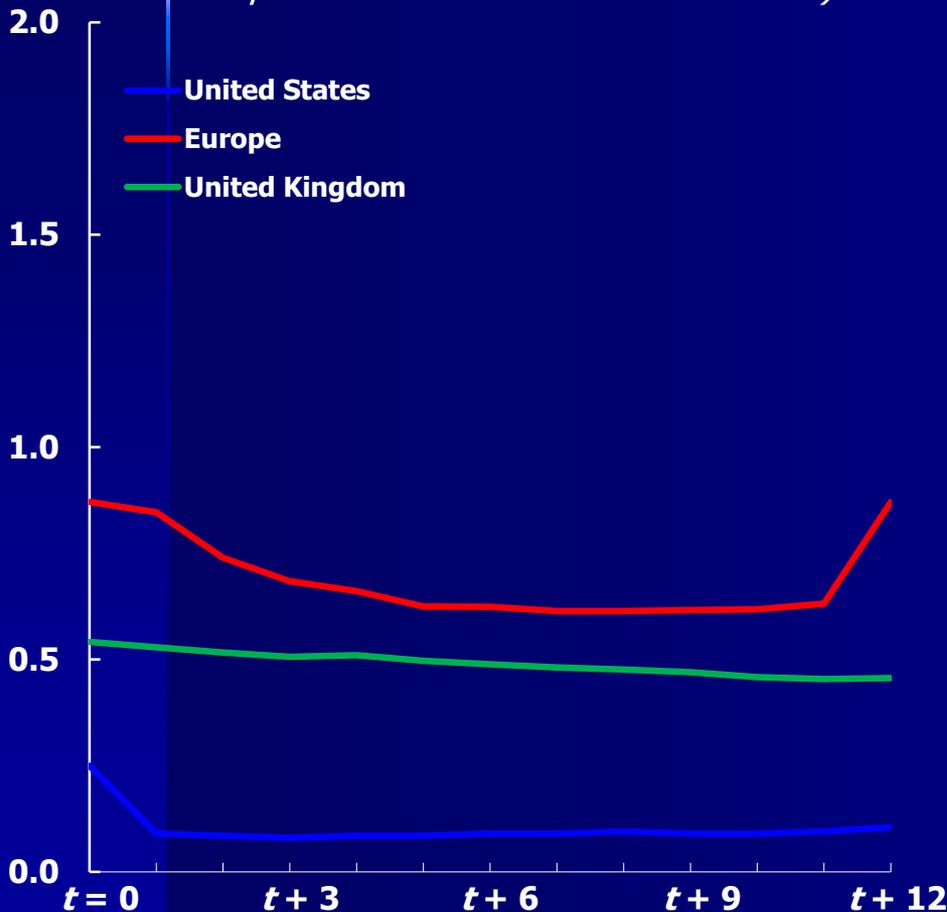
¹ CA: Canada, FR: France, DE: Germany, IT: Italy, JP: Japan, ES: Spain, GB: United Kingdom, US: United States.

² Cyclically adjusted primary balance adjustment needed to the debt ratio to 60 percent in 2030, except for Japan.

Monetary policy: AE must stay very accommodative. EM&DC requirements vary

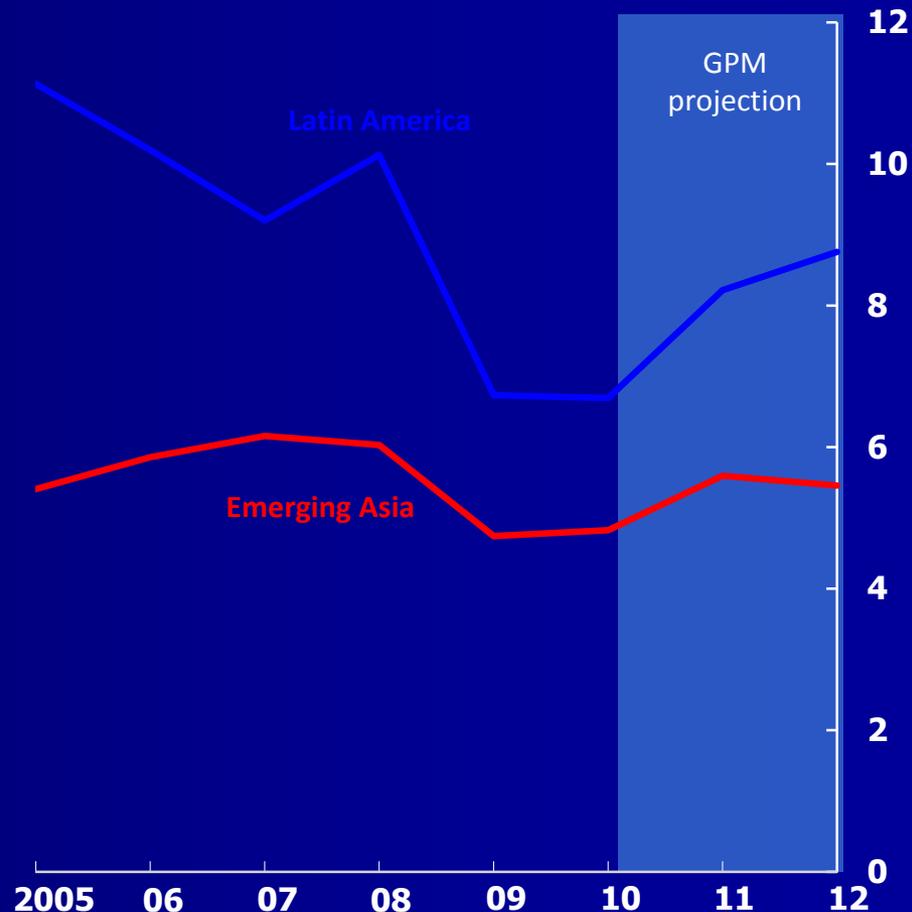
Policy Rate Expectations

(percent; months on x-axis; dashed lines are from the April 2011 World Economic Outlook.)



Policy Rates

(percent)



Real credit growth is still high in a number of EM—
need to continue to watch for prudential risks.

Real Credit Growth
(year-over-year percent change)



Emerging Economies

avoid *future* crisis

**Contain buildup of
macro- financial
vulnerabilities**

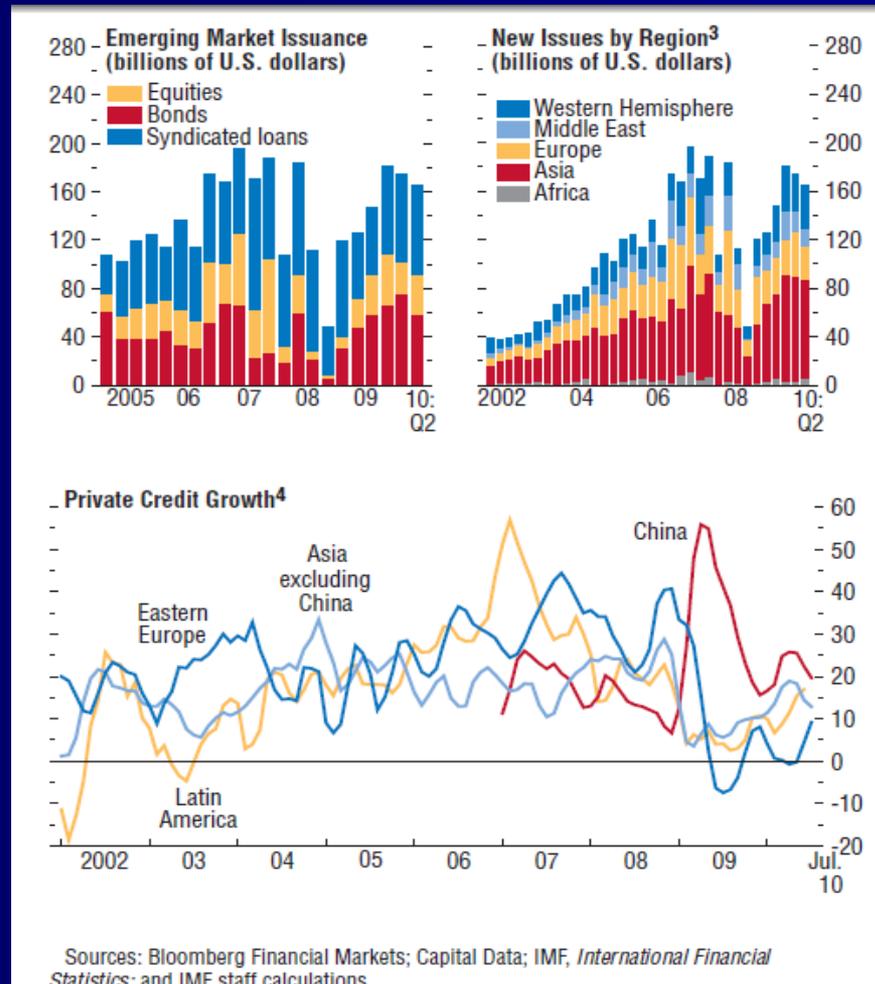
macro (monetary, fiscal)

**Enhance macro-financial
resilience to cope with
external shocks**

**macro-prudential and
CFM**

**structural financial
reform**

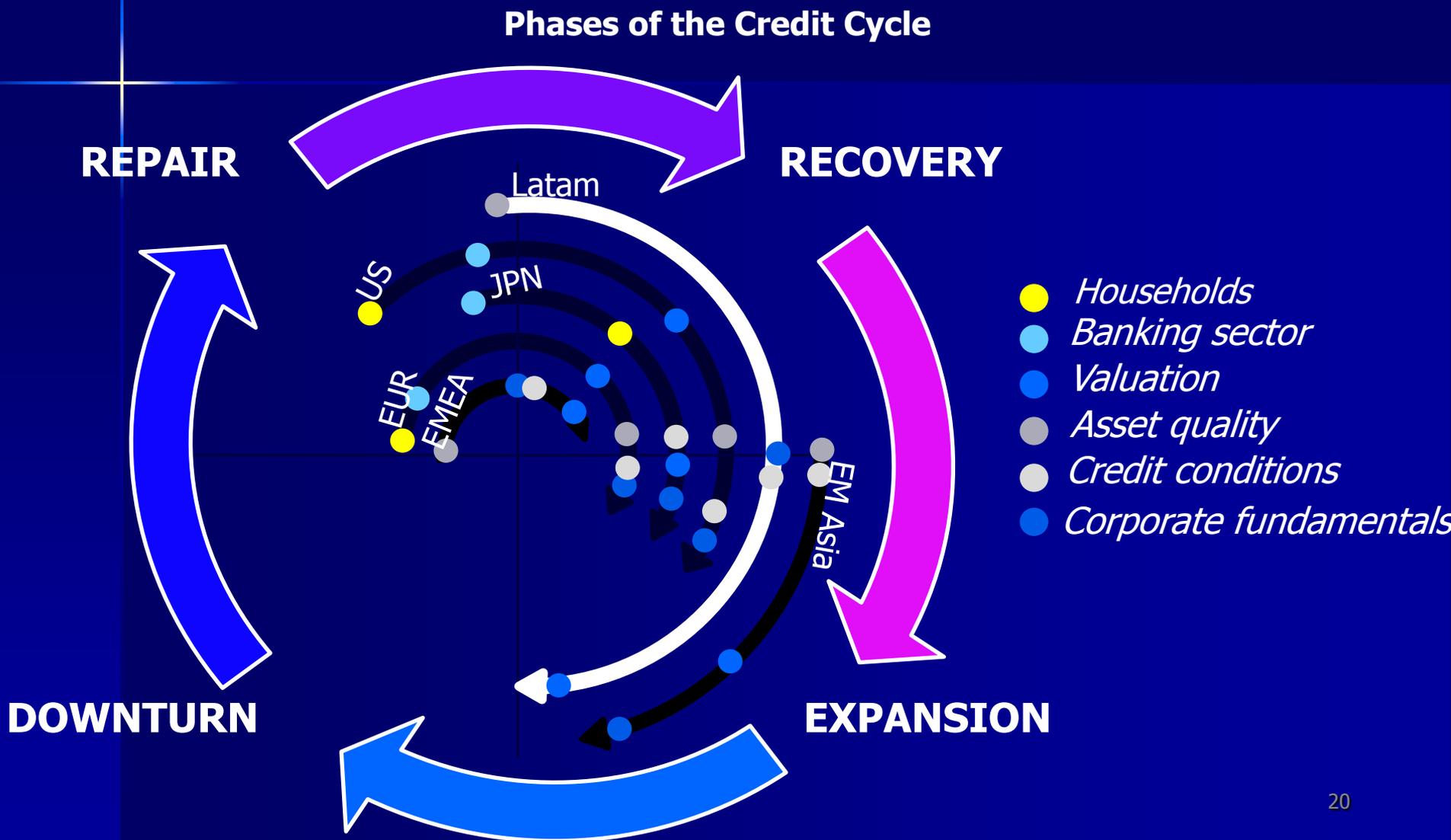
But EM Outlook is Uneven: Europe is Lagging



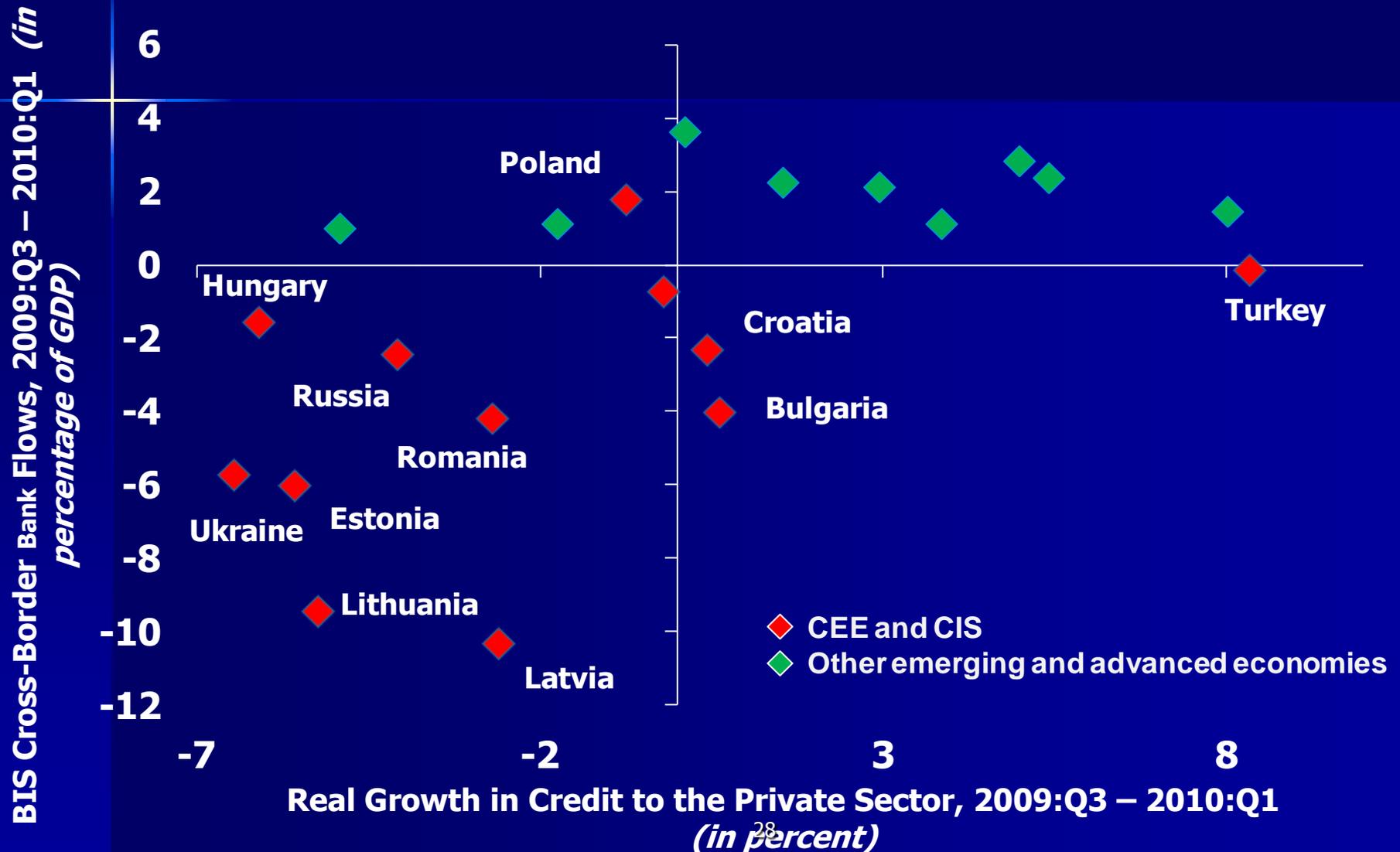
EM Europe Lagging

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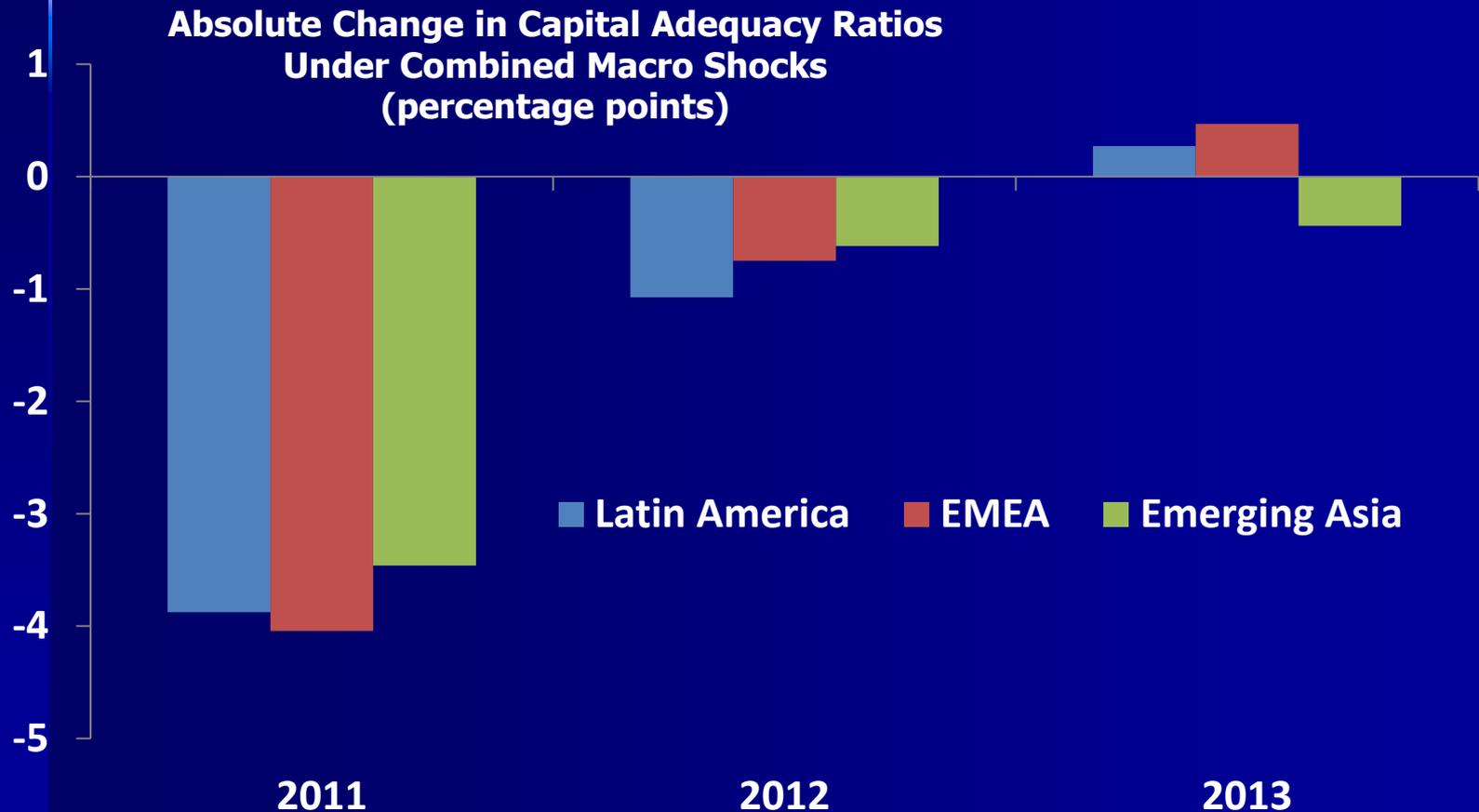
Emerging economies are further along in the credit cycle, EM Europe Lagging



CEE vulnerable to cross-border bank deleveraging



An external shock would test the resilience of emerging market banks



CEE-specific Challenges Ahead

- Complete started adjustment and reforms
- Navigate through:
 - weaker global growth outlook
 - higher financial volatility
- Find sustainable growth model for longer-term

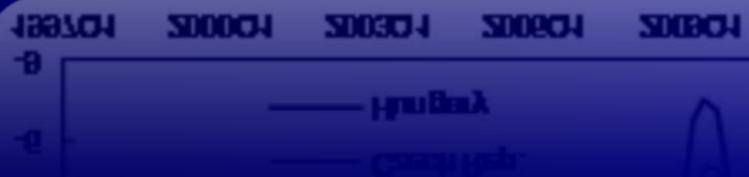
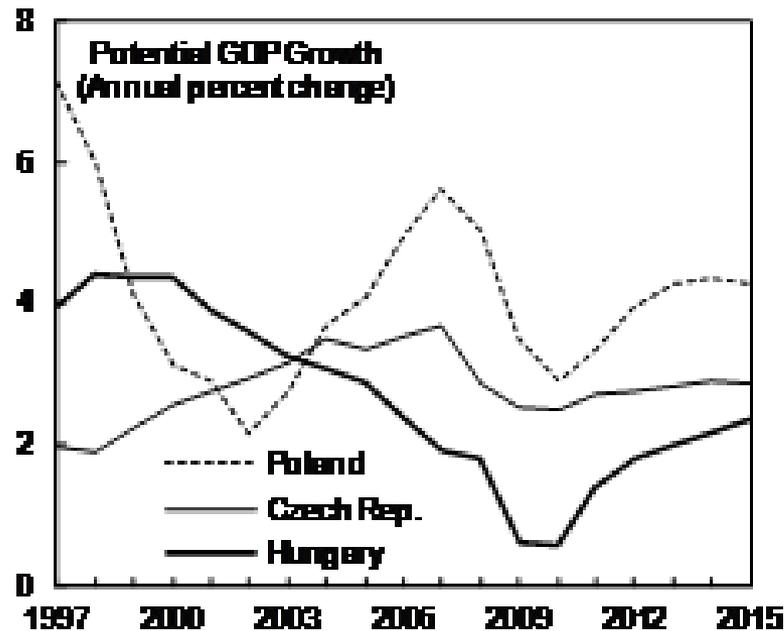
Hungary: Weak Short-Term Outlook

- Growth: weak and below CEE average,
- CA surplus
- Inflation manageable
- Fiscal: good headline, structural mixed
- Financial stability: economy, policies take toll
- Stock vulnerabilities: public and net external debt, FX debt
- Sizeable gross financing needs
- Muddling-through baseline, downside risks

Policies short-term: Stability vs Stimulus

- **Fiscal:** consolidation course helps stability, need to ensure good structure
 - structural adjustment on spending side-helpful for sustainability and growth
- **Monetary:** appropriately cautious
- **Financial:** keep up the reform for stronger forward-looking, crisis-resilient regulatory setup
- **Other:** need to shore up confidence, reduce policy unpredictability, take care of investment climate

Long-Term: Modest Growth



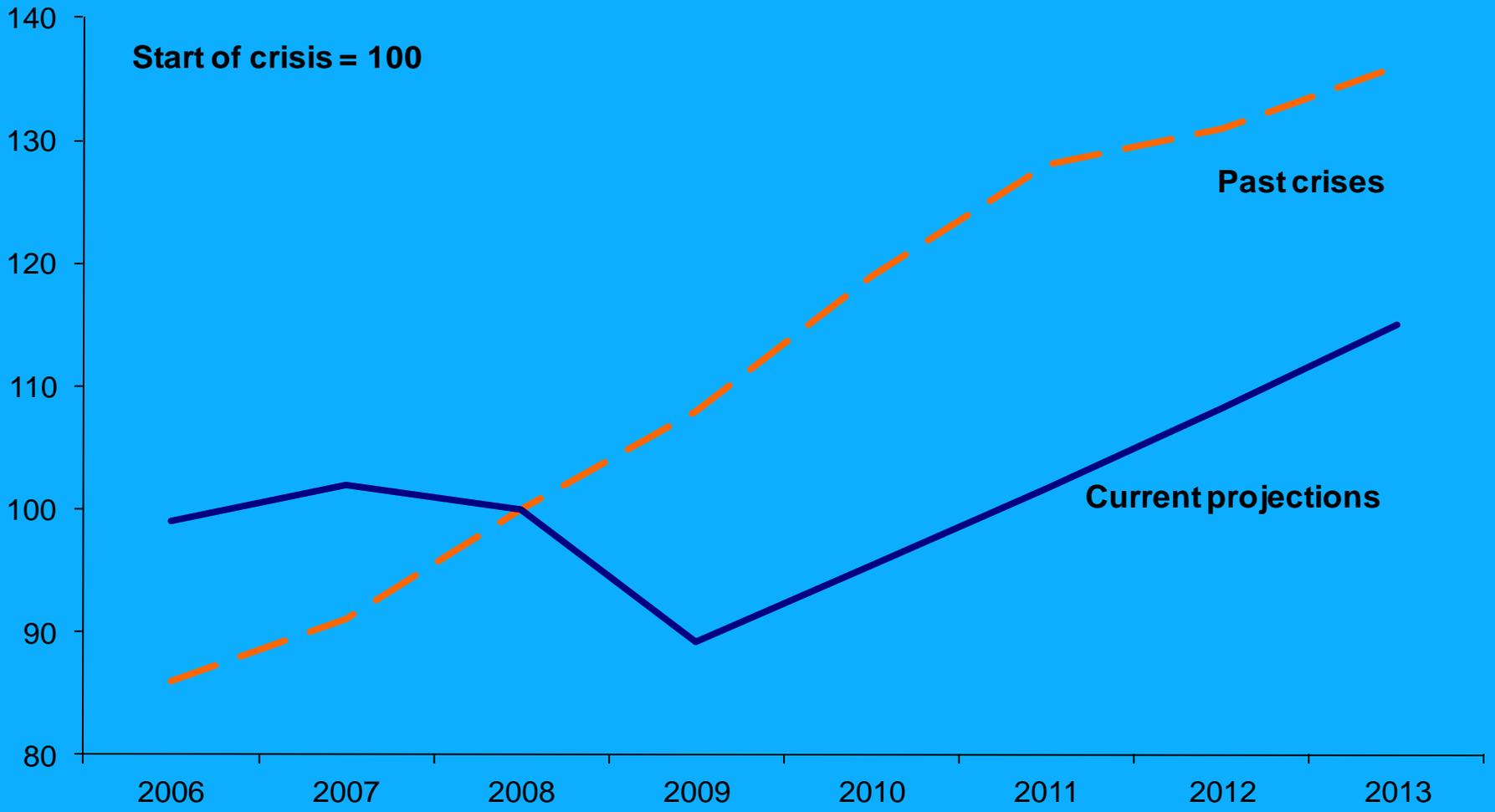
Policies Going Forward: Fiscal Prudence and Reforms

- **Continue fiscal discipline** to:
 - Reduce vulnerability
 - Create room for growth-boosting bold reforms
- Maintain financial stability: institutional quality, prevent vulnerabilities
- Structural reforms key for potential growth, which is relatively low in Hungary
 - No lack of good reform ideas in Hungary

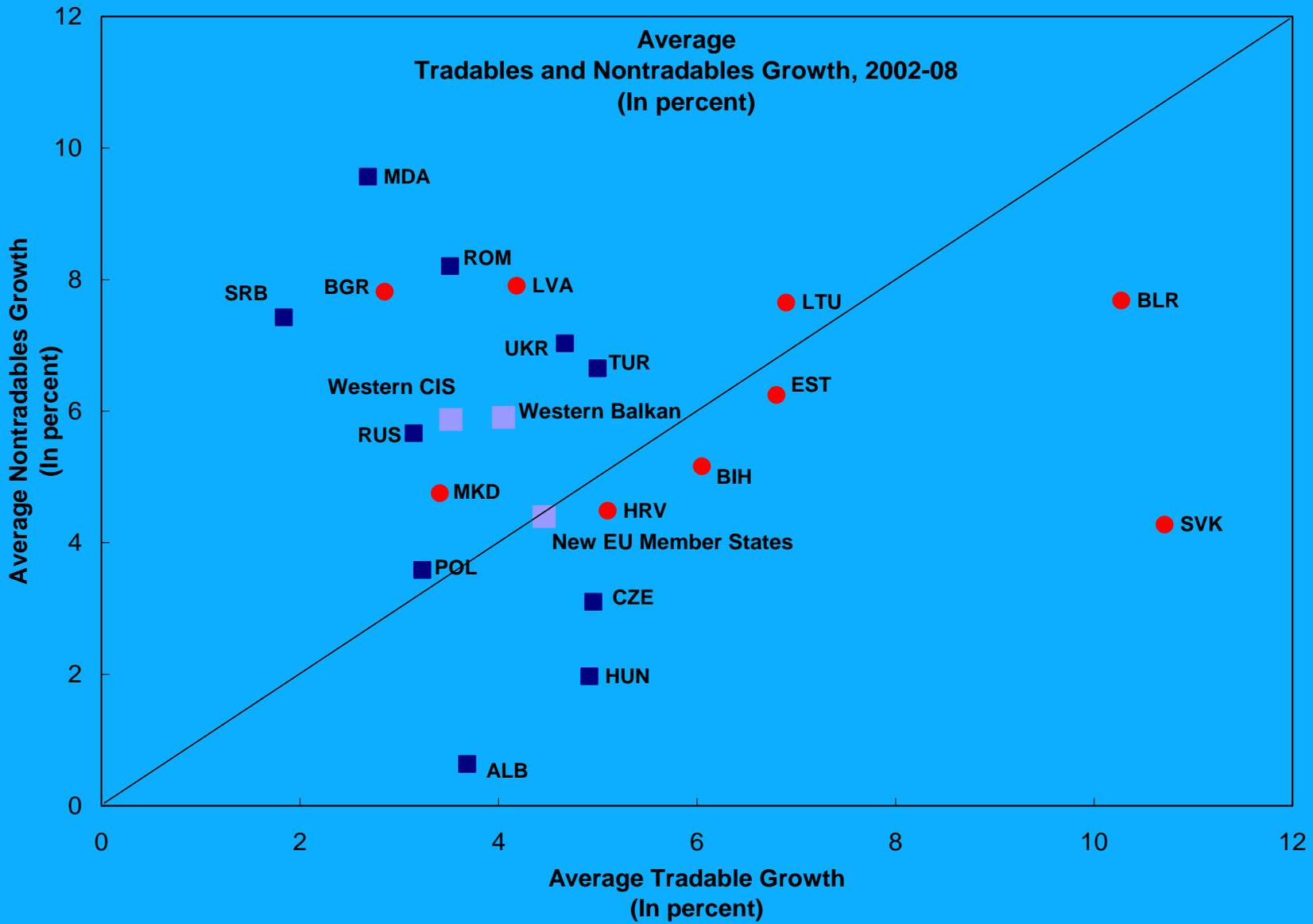
Useful Ideas for Reforms

- Public Administration: better budget and quality of public services, lower administrative burden, improved business climate
 - Local Governments: control over general budget, better quality of services (education, health, utilities)
- Welfare reform: higher labor participation
- Public Transport System (MAV, BKV): reduce subsidy need from the budget (i.e. room for tax cuts and costlier reforms), better quality of services
- Health care, education: can all be good for growth

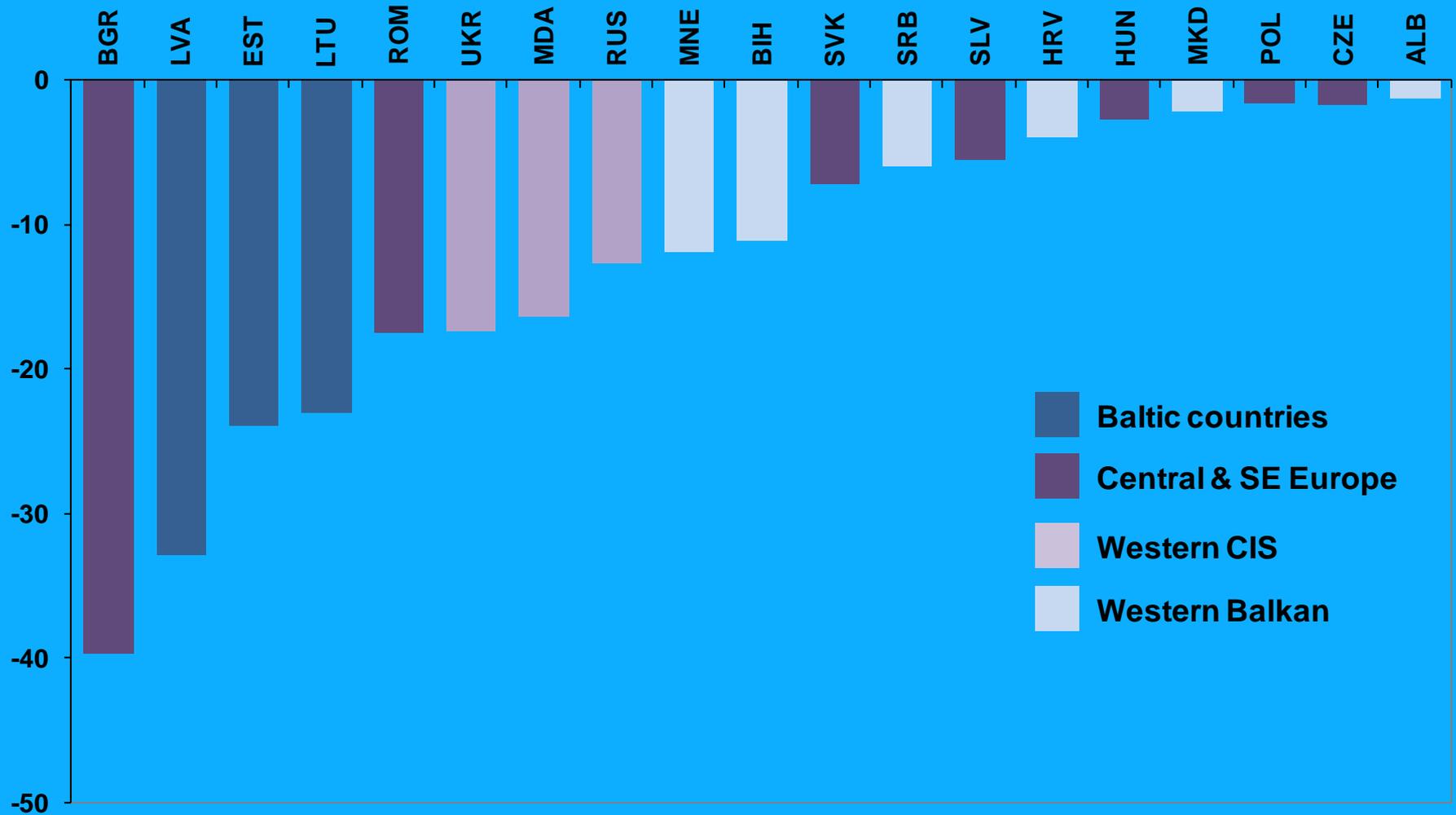
Trade Volumes: Imports by G3 countries



Source: WEO.

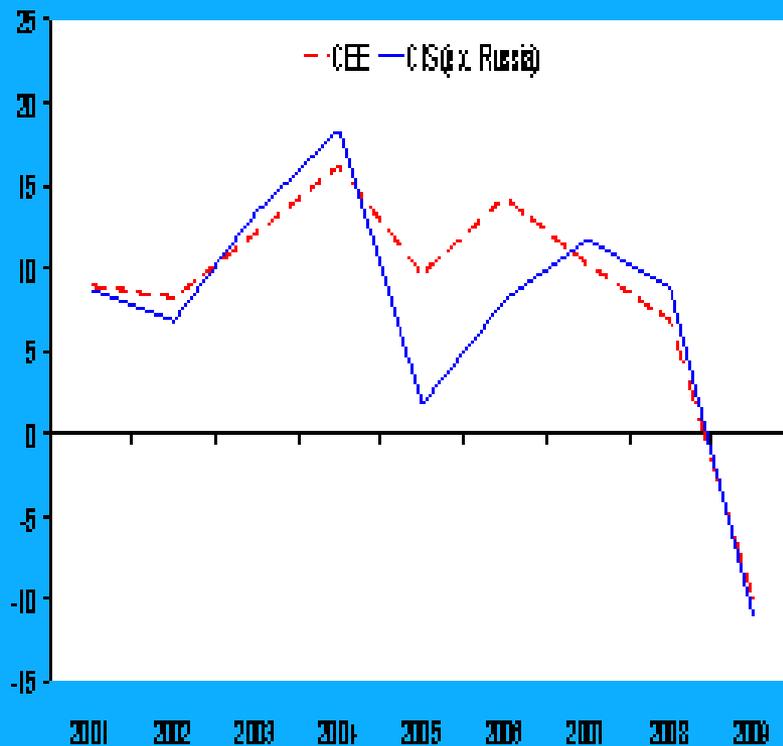


Decline of Capital Inflows (2007-2009, percent of GDP)



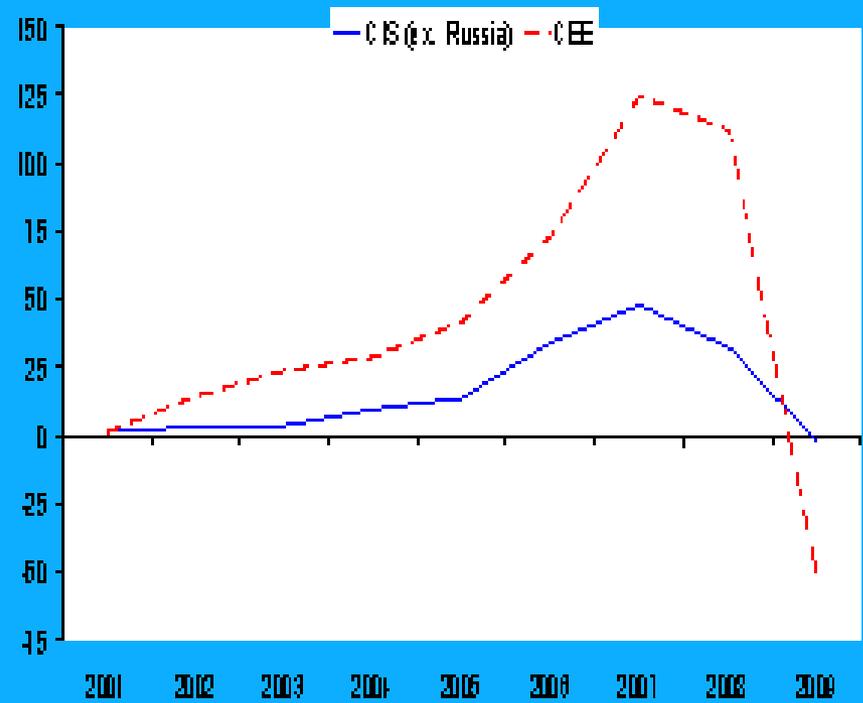
Crisis Backgrounder: Emerging Europe Hard Hit

Volume of exports (annual percentage change)



Source: WEO.

Other investments, liabilities (bn USD)

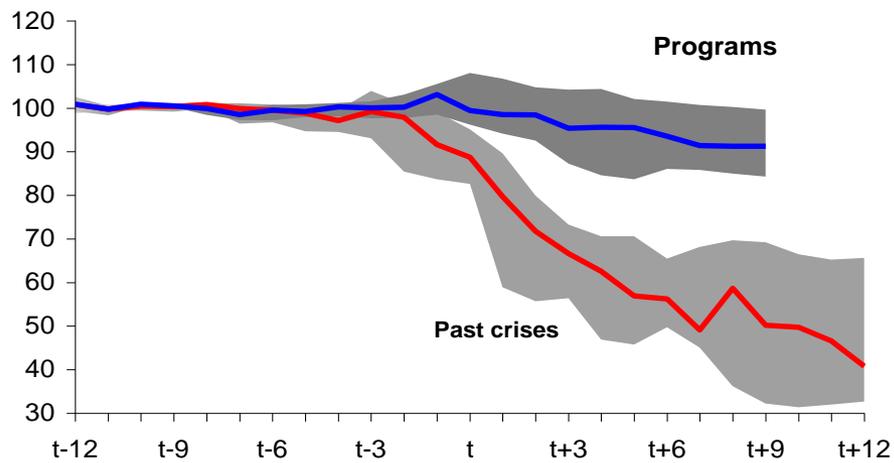


Source: WEO.



Nominal effective exchange rates

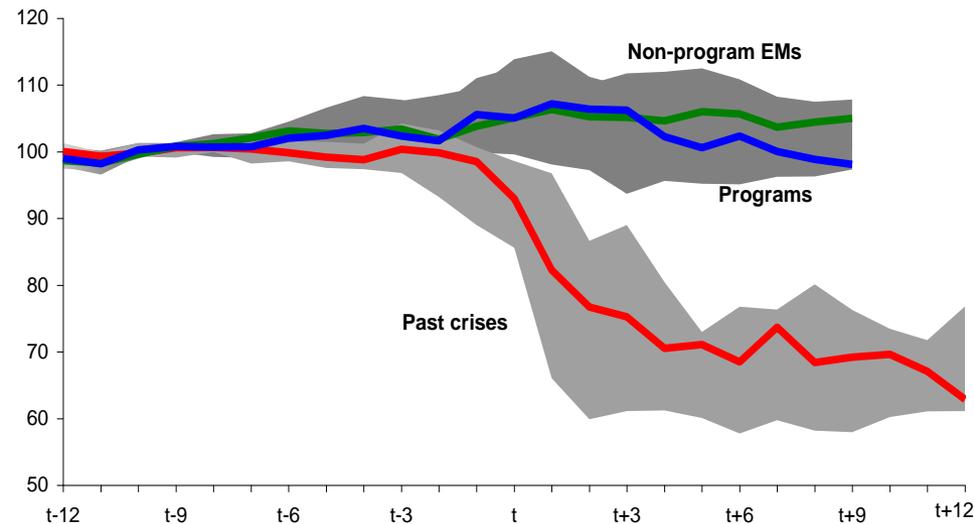
Median and interquartile ranges, average of t-12 to t-7 = 100, monthly 1/



Source: IMF, International Finance Statistics and Fund staff estimates.
1/ "t" represents Oct 2008 for current programs, and beginning of crisis for past crises.

Real effective exchange rates

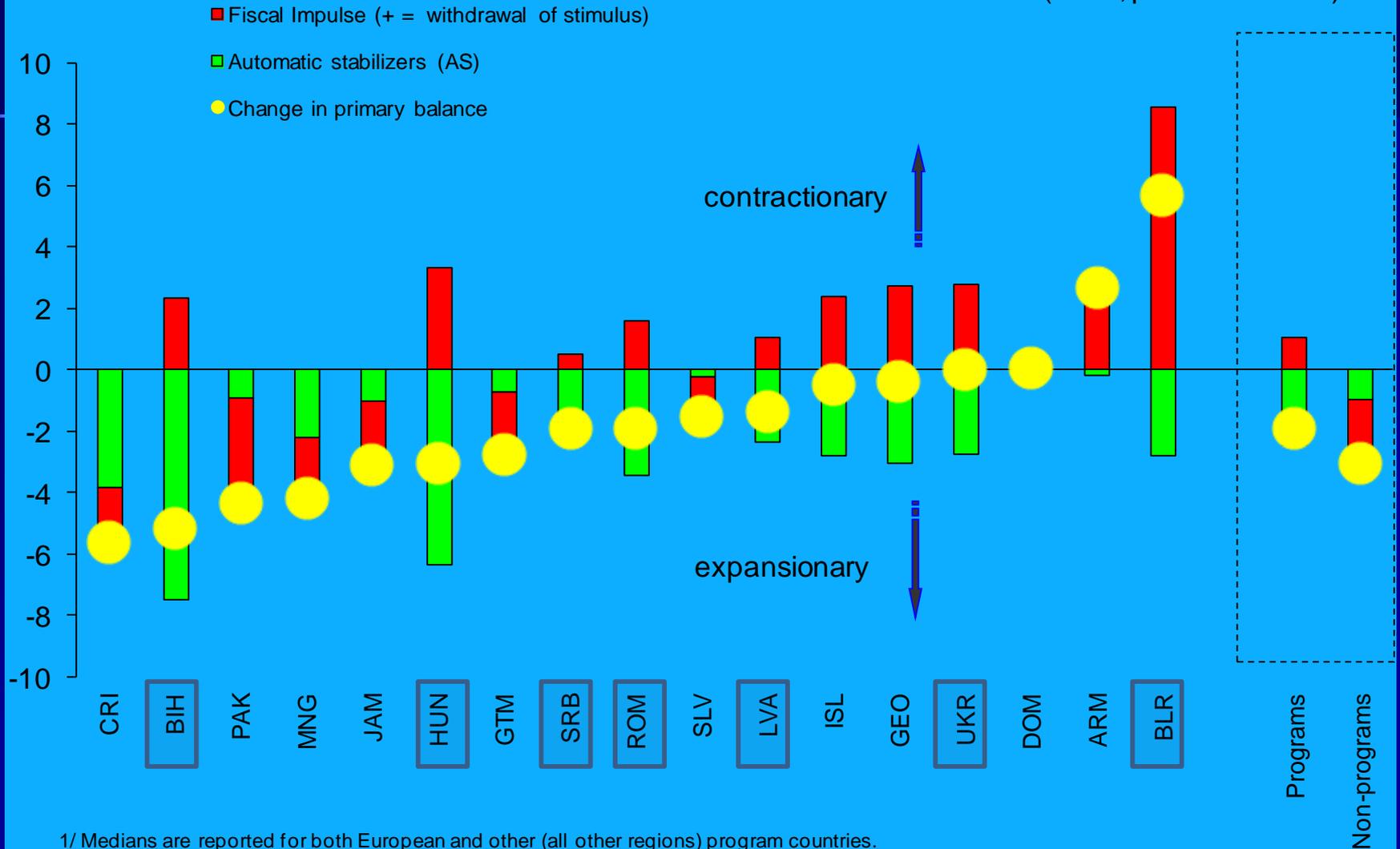
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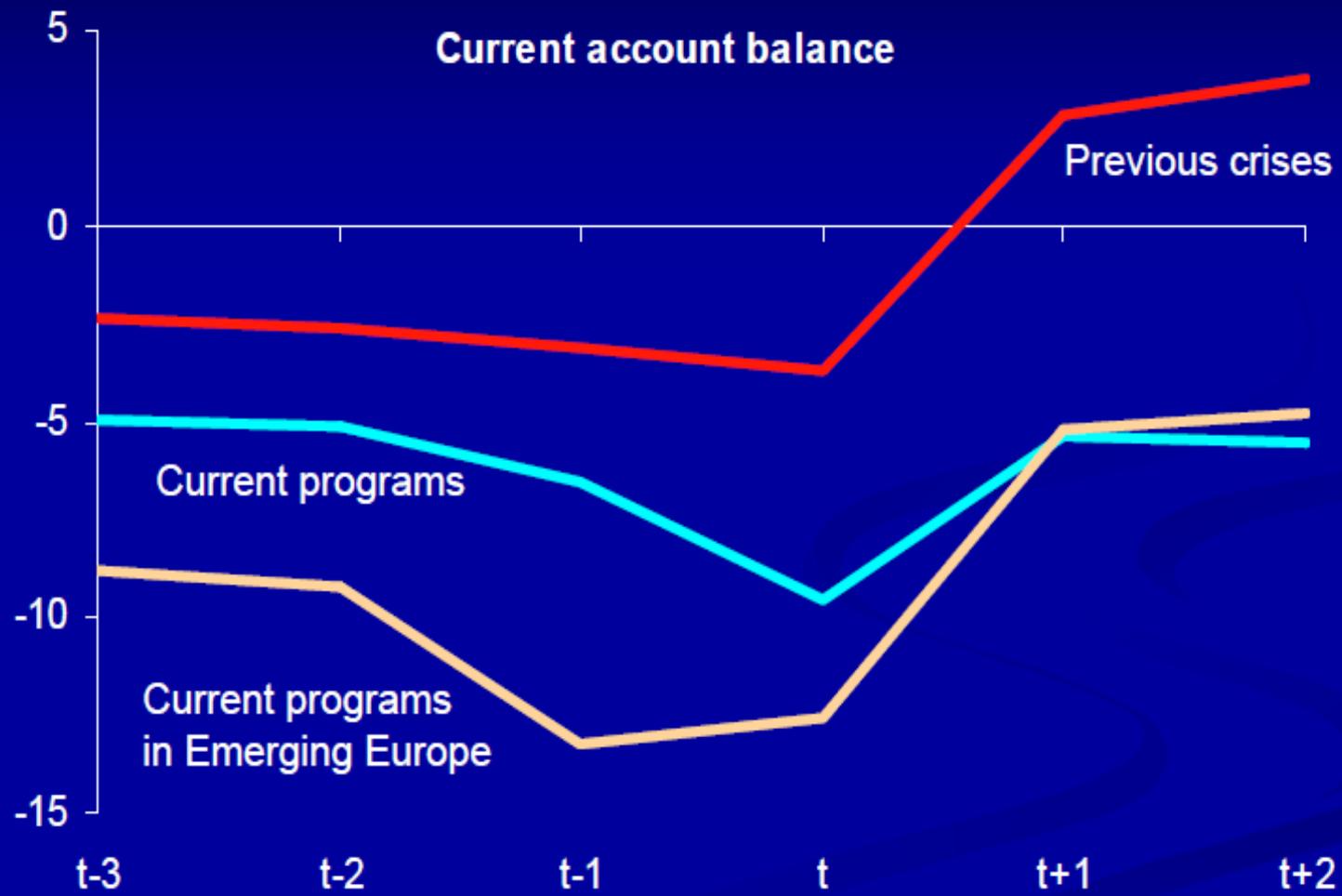
Source: IMF, Information Notice System and staff estimates.
1/ "t" represents Oct 2008 for current programs, and the beginning of the crisis for past crises.



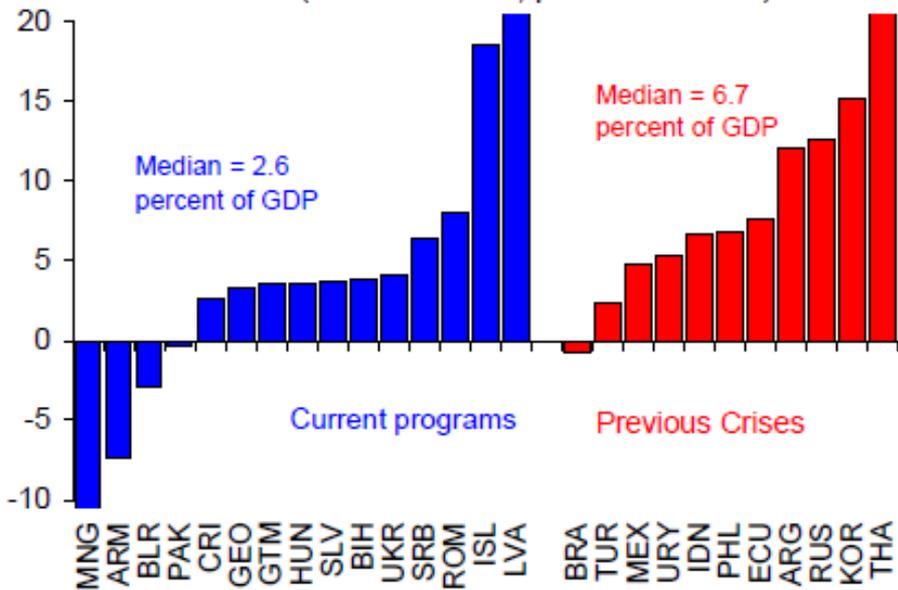
(2009, percent of GDP)



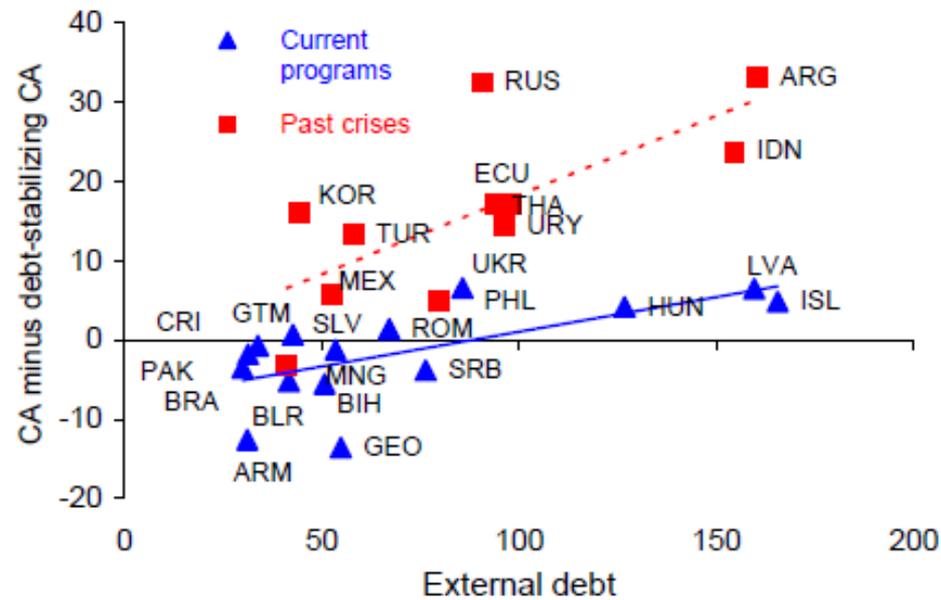
1/ Medians are reported for both European and other (all other regions) program countries.

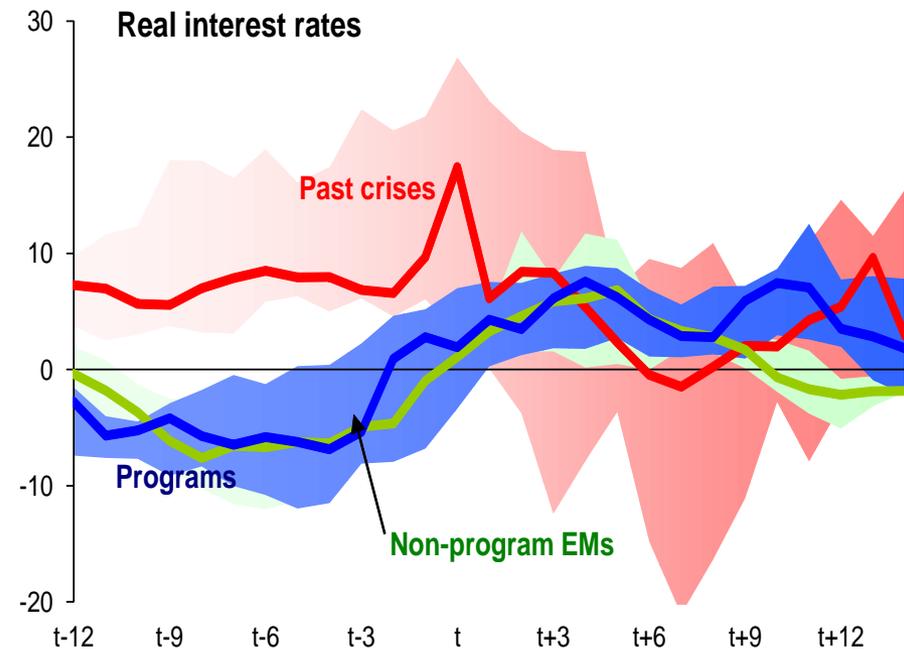
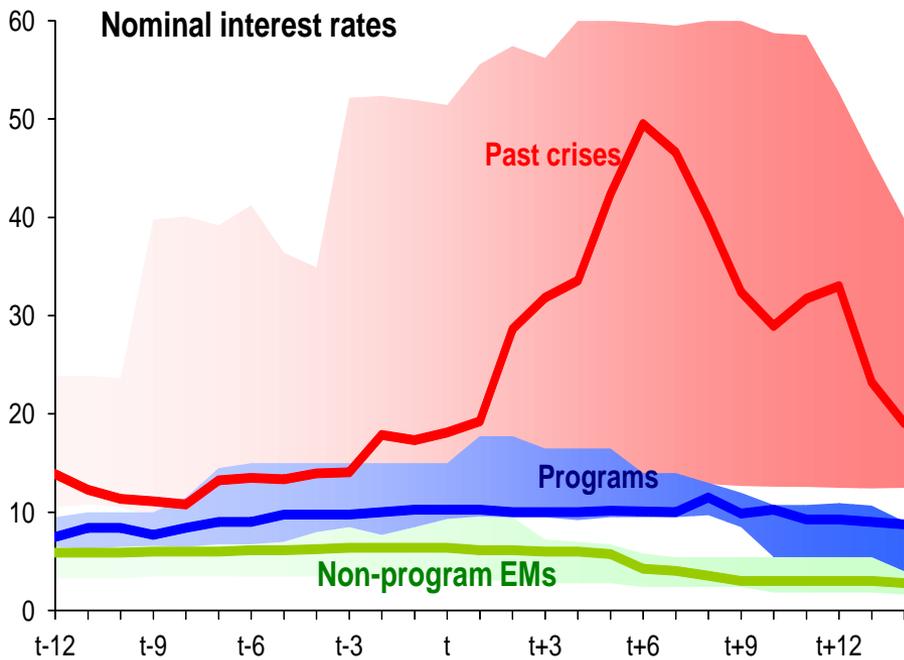


Current account adjustment
(from t-1 to t+1, percent of GDP)



External debt stabilization
(in percent of GDP, 2009)

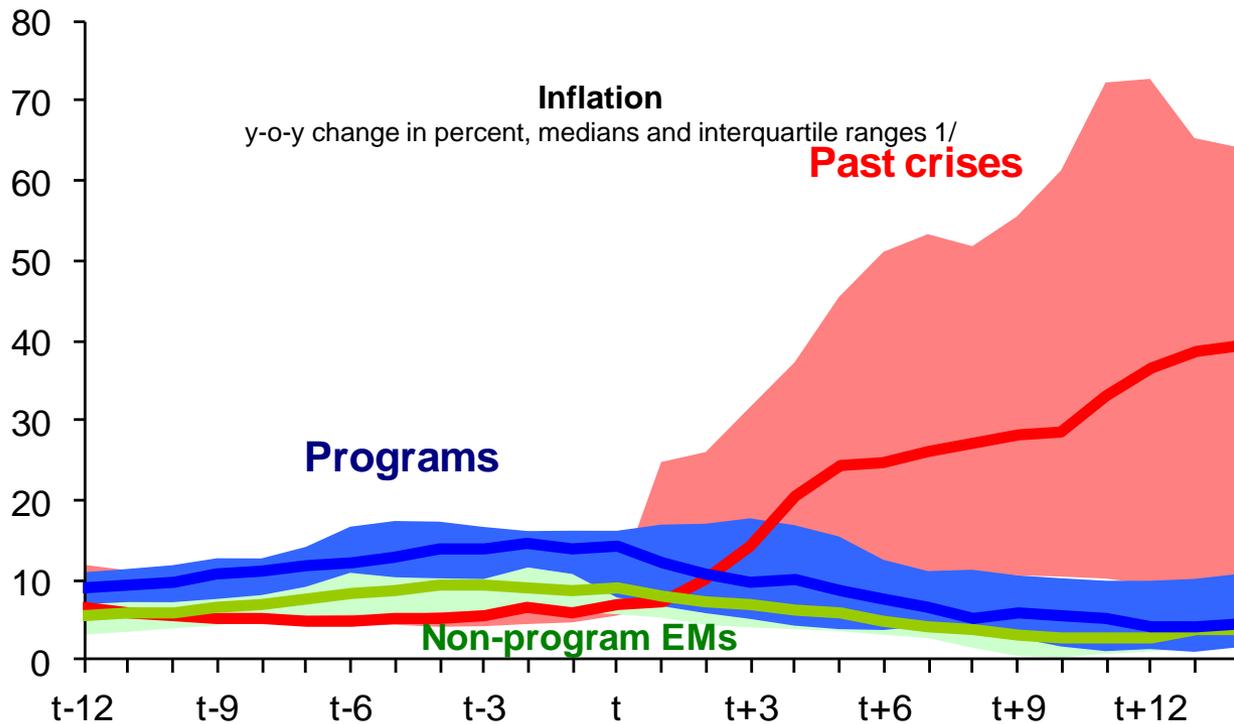




Source: IMF, International Finance Statistics and Fund staff estimates.

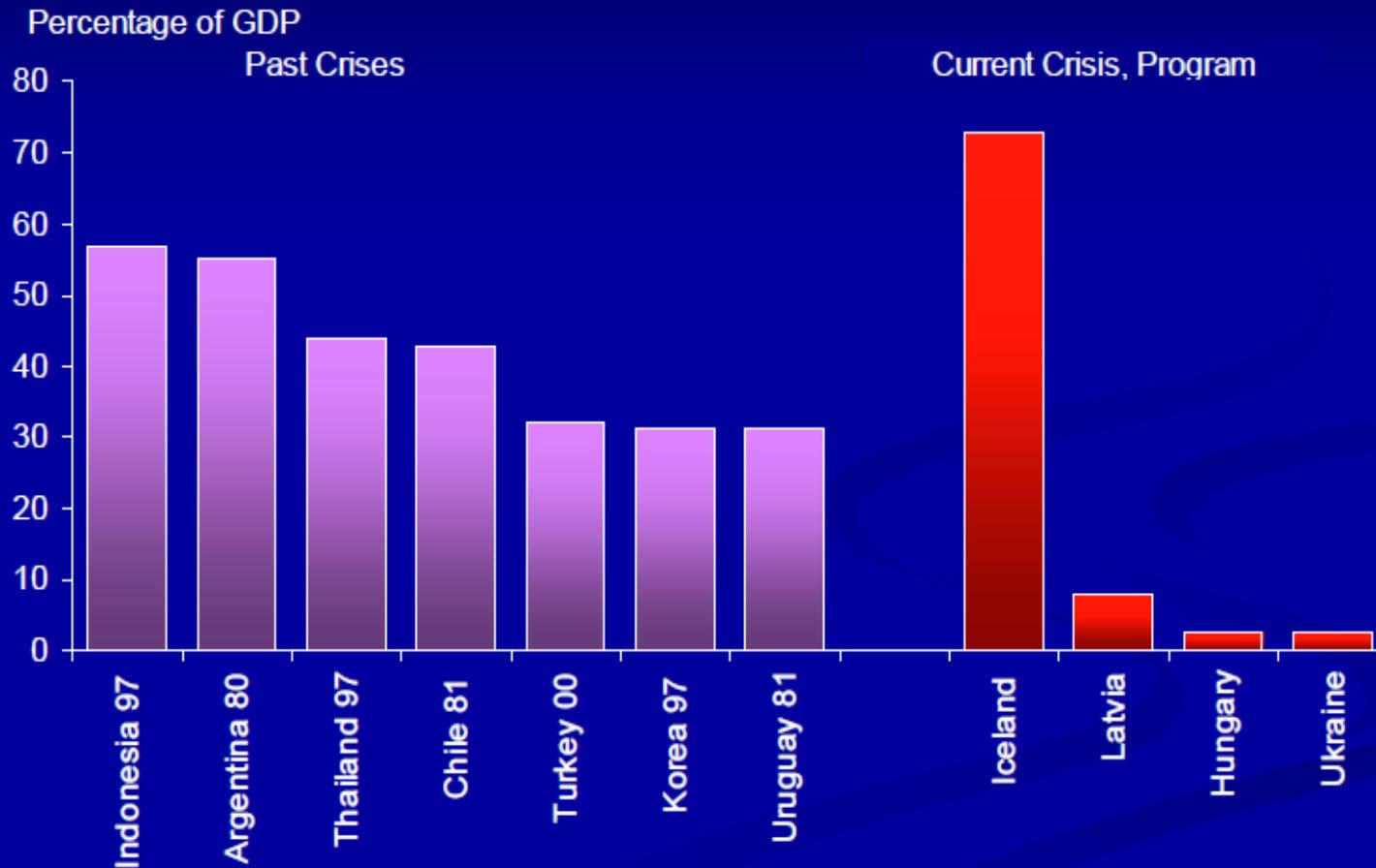
1/ "t" represents Oct 2008 for current programs, and the beginning of the crisis for past crises. EMs include Argentina, Brazil, Chile, China, Croatia, Czech Republic, Ecuador, India,

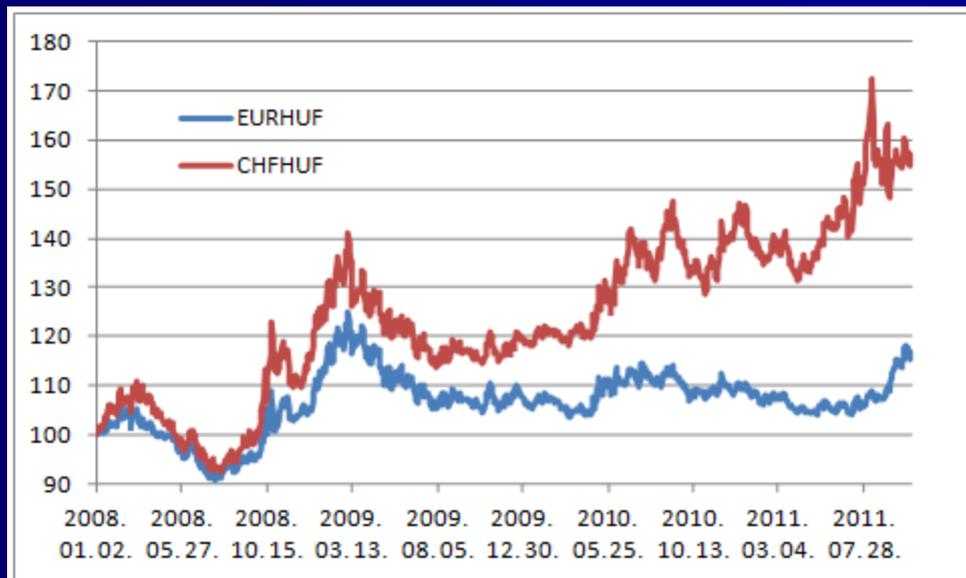
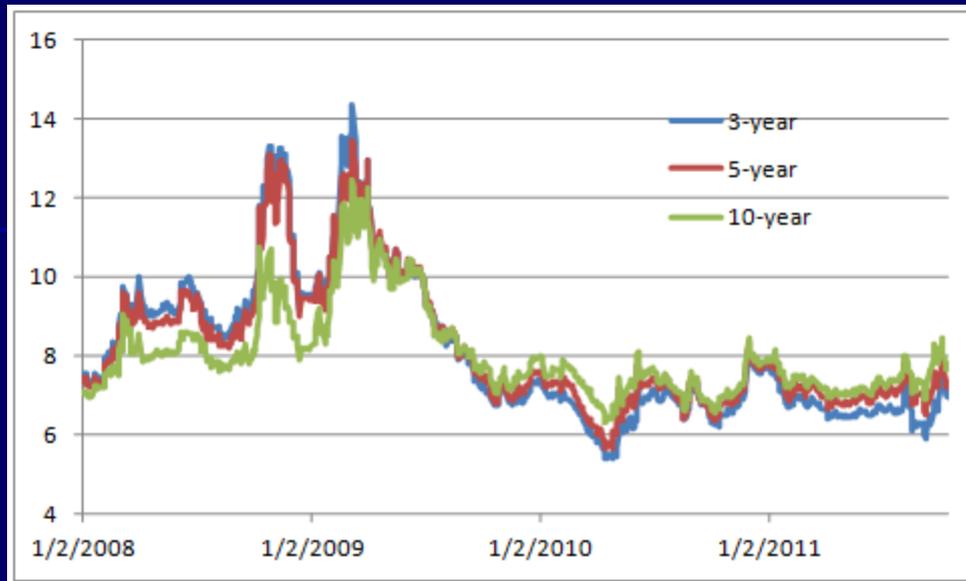




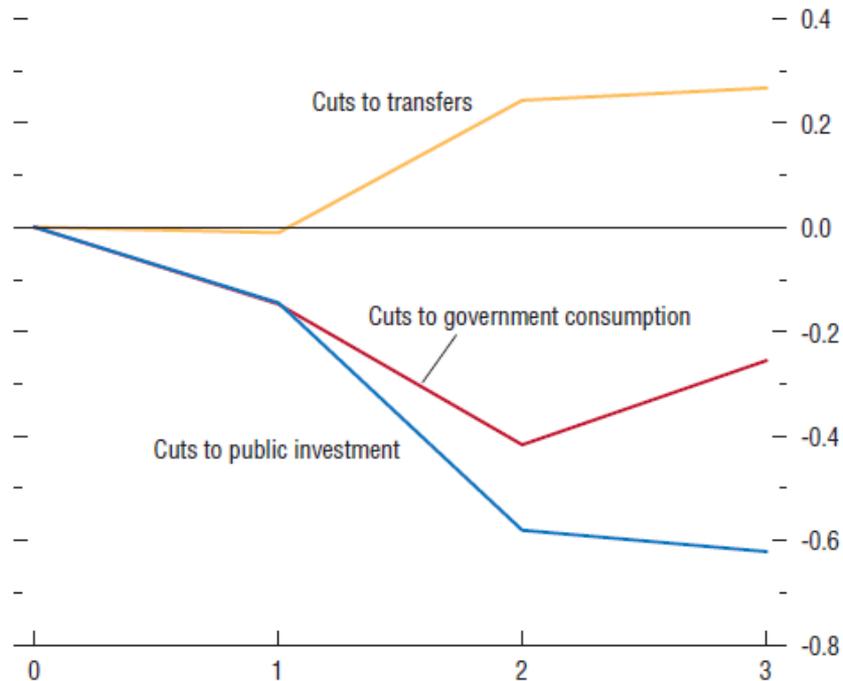
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Gross fiscal costs of banking crises





Impact on GDP of a 1 Percent of GDP Spending-Based Consolidation



Source: IMF staff calculations.

Note: The three lines indicate consolidation in which most of the spending cuts fell on government transfers, government consumption, and public investment, respectively. $t = 1$ denotes the year of consolidation.



