IMF Programs in Emerging Europe. View on Hungary

Iryna Ivaschenko
IMF Resident Representative in Hungary

Presentation at the Concorde investor conference
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

Foreign Exchange Liabilities of Non-financial private sector, end 2008 (Percent of GDP)

- Estonia
- Latvia
- Bulgaria
- Croatia
- Hungary
- Macedonia
- Lithuania
- Romania
- Bosnia
- Czech
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 recourses to $750 billion
  - Additional concessional lending to low-income countries
## Crisis-Response: IMF Part

<table>
<thead>
<tr>
<th>Member</th>
<th>Type of Arrangement</th>
<th>Duration of Arrangement</th>
<th>Amount Agreed (SDR millions)</th>
<th>Amount Drawn (SDR millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ukraine</td>
<td>SBA</td>
<td>11/05/08 - 07/27/10</td>
<td>11,000</td>
<td>7,000</td>
</tr>
<tr>
<td></td>
<td>SBA</td>
<td>07/28/10 – 07/27/12</td>
<td>10,000</td>
<td>2,250</td>
</tr>
<tr>
<td>Hungary</td>
<td>SBA</td>
<td>11/06/08 - 10/05/10</td>
<td>10,538</td>
<td>7,637</td>
</tr>
<tr>
<td>Latvia</td>
<td>SBA</td>
<td>12/23/08 - 12/22/11</td>
<td>1,522</td>
<td>982</td>
</tr>
<tr>
<td>Belarus</td>
<td>SBA</td>
<td>01/12/09 - 03/30/10</td>
<td>2,270</td>
<td>2,270</td>
</tr>
<tr>
<td>Serbia</td>
<td>SBA</td>
<td>01/16/09 - 4/15/11</td>
<td>2,619</td>
<td>1,321</td>
</tr>
<tr>
<td>Romania</td>
<td>SBA</td>
<td>05/04/09 - 03/30/11</td>
<td>11,443</td>
<td>10,569</td>
</tr>
<tr>
<td></td>
<td>SBA</td>
<td>03/31/11 – 03/30/13</td>
<td>3,091</td>
<td>0</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>SBA</td>
<td>07/08/09 - 06/30/12</td>
<td>1,015</td>
<td>338</td>
</tr>
<tr>
<td>Poland</td>
<td>FCL</td>
<td>05/06/09 - 05/05/10</td>
<td>13,690</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>FCL</td>
<td>07/02/10 – 01/20/11</td>
<td>13,690</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>FCL</td>
<td>01/21/11 – 01/20/13</td>
<td>19,166</td>
<td>0</td>
</tr>
<tr>
<td>Moldova</td>
<td>ECF/EFF</td>
<td>01/29/10 - 01/28/13</td>
<td>370</td>
<td>120</td>
</tr>
</tbody>
</table>
Crisis Response: IMF’s substantial co-financing for EU members

<table>
<thead>
<tr>
<th>Member</th>
<th>Total Financing</th>
<th>IMF</th>
<th>EU</th>
<th>World Bank, EBRD, and bilaterals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hungary</td>
<td>€ 20 billion</td>
<td>€ 12.3 billion (61 percent)</td>
<td>€ 6.5 billion (33 percent)</td>
<td>€ 1.2 billion (6 percent)</td>
</tr>
<tr>
<td>Latvia</td>
<td>€ 7.5 billion</td>
<td>€ 1.7 billion (23 percent)</td>
<td>€ 3.1 billion (41 percent)</td>
<td>€ 2.7 billion (36 percent)</td>
</tr>
<tr>
<td>Romania</td>
<td>€ 19.9 billion</td>
<td>€ 12.9 billion (65 percent)</td>
<td>€ 5 billion (25 percent)</td>
<td>€ 2 billion (10 percent)</td>
</tr>
</tbody>
</table>
Crisis Response: New Tools

- **FCL**: crisis-prevention and mitigation tool (introduced March 2009)
  - Unrestricted renewability
  - For countries with robust policy framework and strong track record in economic performance
  - No cap on access
  - Used, but not drawn, by Poland, Mexico, and Columbia

- **PCL**: an “FCL-lite”:
  - For countries with moderate remaining vulnerabilities
  - Strong policies to reduce vulnerabilities
Crisis Response: Program Design

**Objectives**: shore up confidence, reduce pain, smooth adjustment, ensure long-term sustainability, protect vulnerable,

- **Large**, front-loaded financing
- Financing to create policy space:
  - Facilitate deficit spending
  - Support currencies / avoid excessive depreciation
  - Support/restore financial stability
- Involve stakeholders: “Vienna Initiative”
Program Design: Tailored to Country-Specific Vulnerabilities

- Fiscal policy: public debt sustainability, ER policy, external adjustment need, financing constraints

- Monetary policy: risk premia, exchange rate pressure, inflation outlook
  - Currency depreciation: country preferences, competitiveness, balance sheets, income policies, economic flexibility

- Financial sector policy: degree of stability, confidence-building
Hungary SBA: Crisis-Response

**Objective:** put a floor for investor confidence, avoid more severe crisis, give room for policy:

- **Large:** EUR 12.5 bn from IMF (6.5 bn from EU)
- **Front-loaded:** first tranche EUR 4.9 bn
- **Targeted:** two goals
  - Achieving fiscal sustainability: deficit targets, quality structural measures
  - Maintaining financial stability: reserves, bank safety net, coordination initiative
- **Flexible:**
  - Deficit target revised up by 1.3% of GDP in 2009 in response to worse outlook
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.
Program Performance

- Exchange rate **overshooting avoided**:  
  - pegs preserved in Latvia, Bosnia and Herzegovina  
  - depreciation contained in Hungary, Romania, Serbia

- Smaller **external adjustment**

- Nominal interest **rate spikes avoided**

- Inflation **contained**

- Banking crises avoided: **these are costly!**
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
CEE: Challenges Ahead

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

Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Macroeconomic risks
Emerging market risks
Credit risks
Market and liquidity risks
Monetary and financial risks
Risk appetite

April 2011 GFSR
September 2011 GFSR
April 2009 GFSR
The baseline forecast: more uneven recovery: > 6 % in EM, < 2 % AE = 4 % global growth.
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)

- 90% Confidence interval
- 90% confidence interval from April 2011 WEO
- 90% confidence interval from "October 2008" Scenario
- Baseline forecast

Upside risks: hard to discern, given still relatively strong WEO forecast

Downside risks:
- Euro area crisis
- Higher household savings rates
- Non euro-area sovereign risks
- Oil supply concerns

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.
Some AE have made good fiscal progress (but not yet US, JP). EM are in a better position.

Sources: IMF, Fiscal Monitor; and IMF staff calculations.
2 Cyclically adjusted primary balance adjustment needed to the debt ratio to 60 percent in 2030, except for Japan.
AE monetary policy must stay very accommodative. EM&DC requirements vary: some can pause tightening.
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)
Uneven within EM: Europe Lagging
EM Europe Lagging

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advanced economies</td>
<td>1.6</td>
<td>1.9</td>
</tr>
<tr>
<td>U.S.</td>
<td>1.5</td>
<td>1.8</td>
</tr>
<tr>
<td>Euro area</td>
<td>1.6</td>
<td>1.1</td>
</tr>
<tr>
<td>Emerging and developing economies</td>
<td>6.4</td>
<td>6.1</td>
</tr>
<tr>
<td>CEE</td>
<td>4.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.8</td>
<td>1.7</td>
</tr>
</tbody>
</table>
Emerging economies are further along in the credit cycle, EM Europe Lagging.
CEE vulnerable to cross-border bank deleveraging


Real Growth in Credit to the Private Sector, 2009:Q3 – 2010:Q1 (in percent)

-12 -10 -8 -6 -4 -2 0 2 4 6 8

-12 -10 -8 -6 -4 -2 0 2 4 6 8

CEE and CIS
Other emerging and advanced economies
An external shock would test the resilience of emerging market banks

Absolute Change in Capital Adequacy Ratios
Under Combined Macro Shocks
(percentage points)

<table>
<thead>
<tr>
<th>Year</th>
<th>Latin America</th>
<th>EMEA</th>
<th>Emerging Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>-4 to -5</td>
<td></td>
<td>-3 to -4</td>
</tr>
<tr>
<td>2012</td>
<td>-2 to -3</td>
<td>-1</td>
<td>-1 to 0</td>
</tr>
<tr>
<td>2013</td>
<td>0 to 1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>
Advanced Economies avoid *near-term* crisis

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

**Complete financial reform agenda**
Emerging Economies               avoid *future* crisis

- **Contain buildup of macro-financial vulnerabilities**
- **Enhance macro-financial resilience to cope with external shocks**
- **macro (monetary, fiscal)**
- **macro-prudential and CFM**
- **structural financial reform**
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
- 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
Financial: Keeping up the Reform Momentum

- Strengthening regulatory setup makes it more forward-looking, crisis-resilient:
  - Consistent with European and global process
  - Confidence-boosting

- Continue work on:
  - Enhancing bank resolution regime
Trade Volumes: Imports by G3 countries

Start of crisis = 100

Past crises

Current projections

Source: WEO.
Decline of Capital Inflows
(2007-2009, percent of GDP)
Crisis Backgrounder: Emerging Europe Hard Hit

Volume of exports (annual percentage change)

Other investments, liabilities (bn USD)

Source: MNEO.
Fiscal Impulse (+ = withdrawal of stimulus)
Automatic stabilizers (AS)
Change in primary balance

1/ Medians are reported for both European and other (all other regions) program countries.
Nominal effective exchange rates
Median and interquartile ranges, average of t-12 to t-7 = 100, monthly 1/

1/ “t” represents Oct 2008 for current programs, and beginning of crisis for past crises.

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

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.
Nominal interest rates

Past crises

Programs

Non-program EMs

Real interest rates

Past crises

Programs

Non-program EMs


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,
Inflation
y-o-y change in percent, medians and interquartile ranges 1/

Past crises

Programs

Non-program EMs

1/ "t" represents Oct 2008 for current programs, and beginning of crisis for past crises. EMs include Argentina, Brazil, Chile, China, Croatia, Czech Republic, Ecuador, India, Indonesia, Jordan, Korea, Lithuania, Malaysia, Mexico, Morocco, Peru, Poland, Russia, Thailand, Turkey, Venezuela, Vietnam.
Gross fiscal costs of banking crises

Percentage of GDP
Past Crises

Current Crisis, Program

Indonesia 97
Argentina 80
Thailand 97
Chile 81
Turkey 00
Korea 97
Uruguay 81

Iceland
Latvia
Hungary
Ukraine
Access in Percent of GDP

Current
Median: 7.0

Previous Crises
Median: 4.0
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.