Global Outlook. View on Hungary

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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)
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>
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<tr>
<td></td>
<td>SBA</td>
<td>07/28/10 – 07/27/12</td>
<td>10,000</td>
<td>2,250</td>
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<tr>
<td>Hungary</td>
<td>SBA</td>
<td>11/06/08 - 10/05/10</td>
<td>10,538</td>
<td>7,637</td>
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<td>Latvia</td>
<td>SBA</td>
<td>12/23/08 - 12/22/11</td>
<td>1,522</td>
<td>982</td>
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<td>Belarus</td>
<td>SBA</td>
<td>01/12/09 - 03/30/10</td>
<td>2,270</td>
<td>2,270</td>
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<tr>
<td>Serbia</td>
<td>SBA</td>
<td>01/16/09 - 4/15/11</td>
<td>2,619</td>
<td>1,321</td>
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<td>Romania</td>
<td>SBA</td>
<td>05/04/09 - 03/30/11</td>
<td>11,443</td>
<td>10,569</td>
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<tr>
<td></td>
<td>SBA</td>
<td>03/31/11 – 03/30/13</td>
<td>3,091</td>
<td>0</td>
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<tr>
<td>Bosnia and Herzegovina</td>
<td>SBA</td>
<td>07/08/09 - 06/30/12</td>
<td>1,015</td>
<td>338</td>
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<tr>
<td>Poland</td>
<td>FCL</td>
<td>05/06/09 - 05/05/10</td>
<td>13,690</td>
<td>0</td>
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<td></td>
<td>FCL</td>
<td>07/02/10 – 01/20/11</td>
<td>13,690</td>
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<td></td>
<td>FCL</td>
<td>01/21/11 – 01/20/13</td>
<td>19,166</td>
<td>0</td>
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<tr>
<td>Moldova</td>
<td>ECF/EFF</td>
<td>01/29/10 - 01/28/13</td>
<td>370</td>
<td>120</td>
</tr>
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</table>
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**

![Real GDP Growth](chart.png)
### 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)

- Trade value
- CPB trade volume index

Spain
Italy
Belgium
France

July 21, 2011
May 10, 2010
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 conditions

Risk appetite
What’s different from “Lehman”?

Interbank funding stress is less, while ...
Libor – OIS Spreads (bps)

- Euro area
- United States

... partly due to sovereign strains ...
Sovereign CDS Spreads (bps)

- Euro area
- United States

... risk perceptions are greater for European banks ...
Bank CDS Spreads (bps)

- Euro area
- United States

... with stress rising on broad markets ...
Broad Equity Markets (indices, 9/15/08 = 100)

- Euro area index
- U.S. index
- Volatility index
Euro area sovereign risks have spilled over to the EU banking system

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

<table>
<thead>
<tr>
<th>Change in CDS spreads (bps)</th>
<th>Change in market cap (€ bn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereigns</td>
<td>Banks</td>
</tr>
<tr>
<td>(-33%)</td>
<td>(-42%)</td>
</tr>
</tbody>
</table>

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

- 60
- 80
- 200
- 300

**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.

Advanced Economies
- United States
- Euro area
- Japan

Emerging Economies
- Emerging Asia
- Latin America
- MENA

Real GDP Growth
(Percent change from a year earlier)
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
Downside scenarios point to potentially large output losses.

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

Euro Area

United States

Emerging Asia

Latin America

Real GDP

Corporate spread

Crude oil price (in US dollars; right scale)

Non-oil commodity price (in US dollars; right scale)
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**

<table>
<thead>
<tr>
<th>Sovereign risks</th>
<th>Balance sheet repair</th>
<th>Public (US, EU, Japan)</th>
<th>medium-term credible fiscal consolidation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private (Households, US)</td>
<td>mortgage debt - banks</td>
<td>Banks (EU)</td>
<td>more capital (private, public, EFSF) funding structures</td>
</tr>
</tbody>
</table>

**Complete financial reform agenda**
Policy Room: Some AE have made good fiscal progress, 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.
Monetary policy: AE must stay very accommodative. EM&DC requirements vary

Policy Rate Expectations  
(\textit{percent}; months on x-axis; dashed lines are from the April 2011 World Economic Outlook.)

Policy Rates  
(\textit{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
- Enhance macro-financial resilience to cope with external shocks
- macro (monetary, fiscal)
- macro-prudential and CFM
- structural financial reform
But EM Outlook is Uneven: Europe is 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

Phases of the Credit Cycle

- **EXPANSION**
  - Households
  - Banking sector
  - Valuation
  - Asset quality
  - Credit conditions
  - Corporate fundamentals

- **RECOVERY**
  - Latam

- **REPAIR**
  - US
  - JPN

- **DOWNTURN**
  - EUR
  - EMEA
  - EM Asia
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

Russia
Poland
Turkey
Hungary
Romania
Ukraine
Estonia
Bulgaria
Croatia
CEE and CIS
Other emerging and advanced economies

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

Lithuania
Latvia

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)

- 24 to 5
- 11 to 4
- 6 to 3
- 2 to 2
- 1 to 1

2011 2012 2013
Latin America EMEA Emerging Asia

Emerging Asia
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 cautiously
- **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

Start of crisis = 100

Past crises

Current projections

Source: WEO.
Average Tradables and Nontradables Growth, 2002-08
(In percent)

- ALB
- BGR
- BHC
- BIH
- BLR
- CZE
- EST
- HUN
- HRV
- MDA
- MKD
- POL
- RUS
- SRB
- SVK
- TUR
- UKR
- LVA
- LTU
- Western Balkan
- Western CIS
- New EU Member States

Average Tradable Growth
(In percent)

Average Nontradables Growth
(In percent)
Decline of Capital Inflows
(2007-2009, percent of GDP)
Crisis Backgrounder: Emerging Europe Hard Hit

Volume of exports (annual percentage change)

- CEE
- CIS (ex Russia)

Other investments, liabilities (bn USD)

- CIS (ex Russia)
- CEE

Source: MNEO.
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.
1/ Medians are reported for both European and other (all other regions) program countries.
Nominal interest rates

Real interest rates


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

- Cuts to transfers
- Cuts to government consumption
- Cuts to public investment

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.
Access in Percent of GDP

Current
Median: 7.0

Previous Crises
Median: 4.0