

Revisiting Fiscal Space

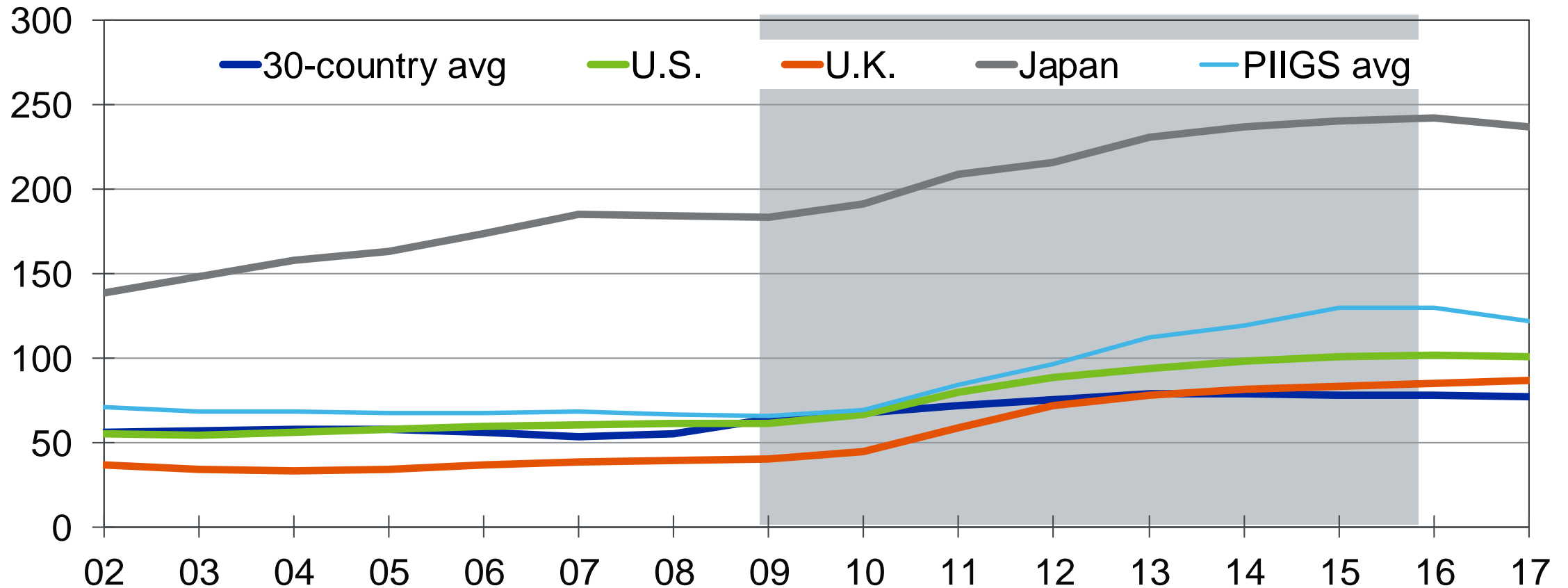
Ryan Sweet, Director – Real Time Economics

1

The Global Rise
of Government Debt

Debt Rising Sharply Since 2009...

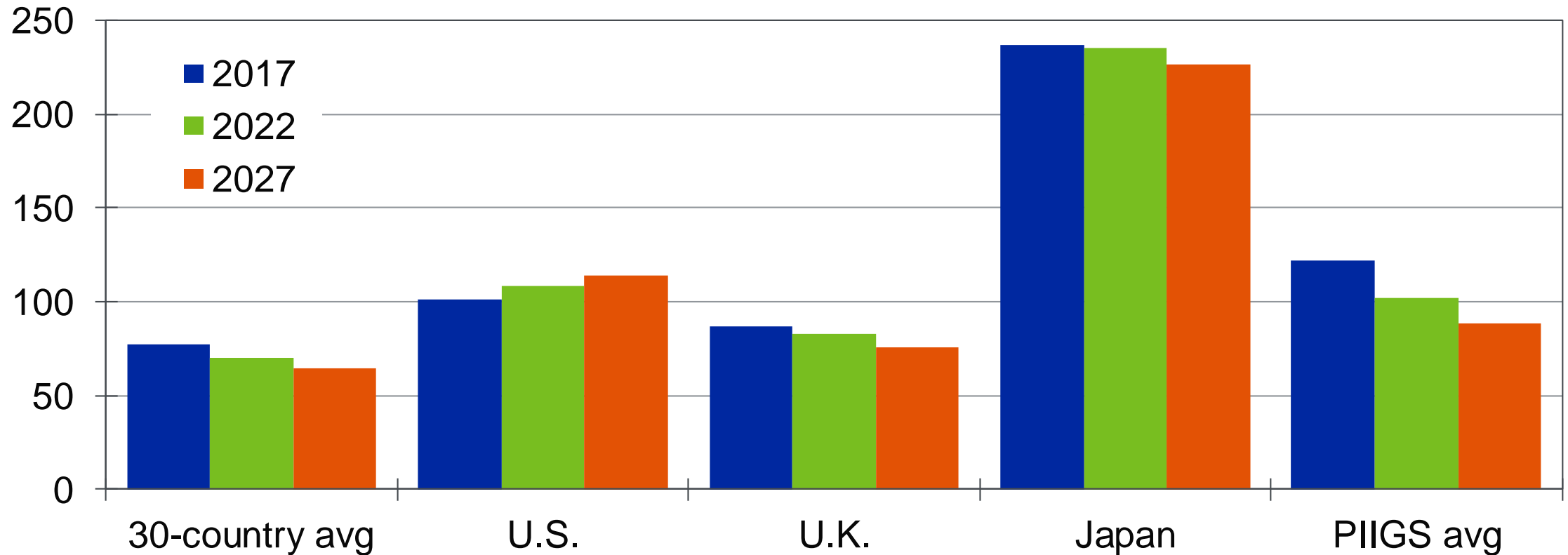
General government debt, % of GDP



Source: Moody's Analytics

...But It Should Stabilize

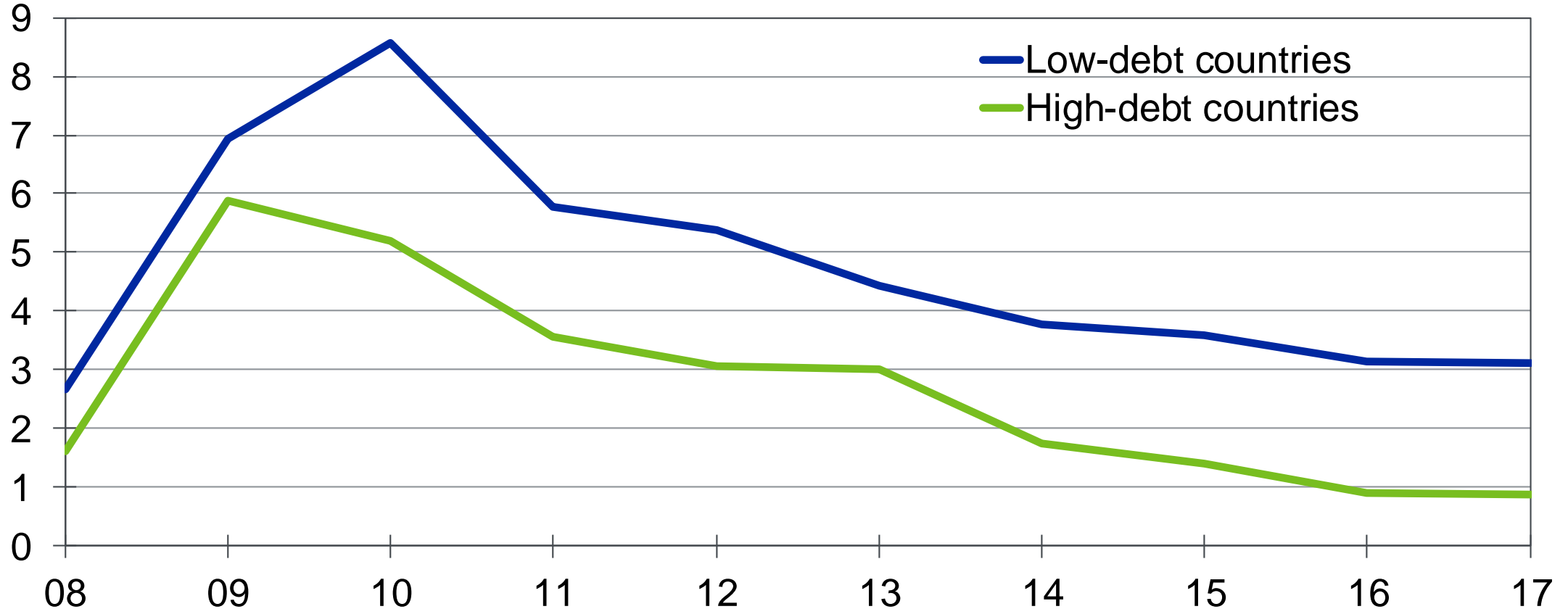
General government debt, % of GDP



Source: Moody's Analytics

More Debt Means Less Stimulus

Difference in spending less revenues from 2007, % of GDP



Source: Moody's Analytics

2

How Much Is Too Much?

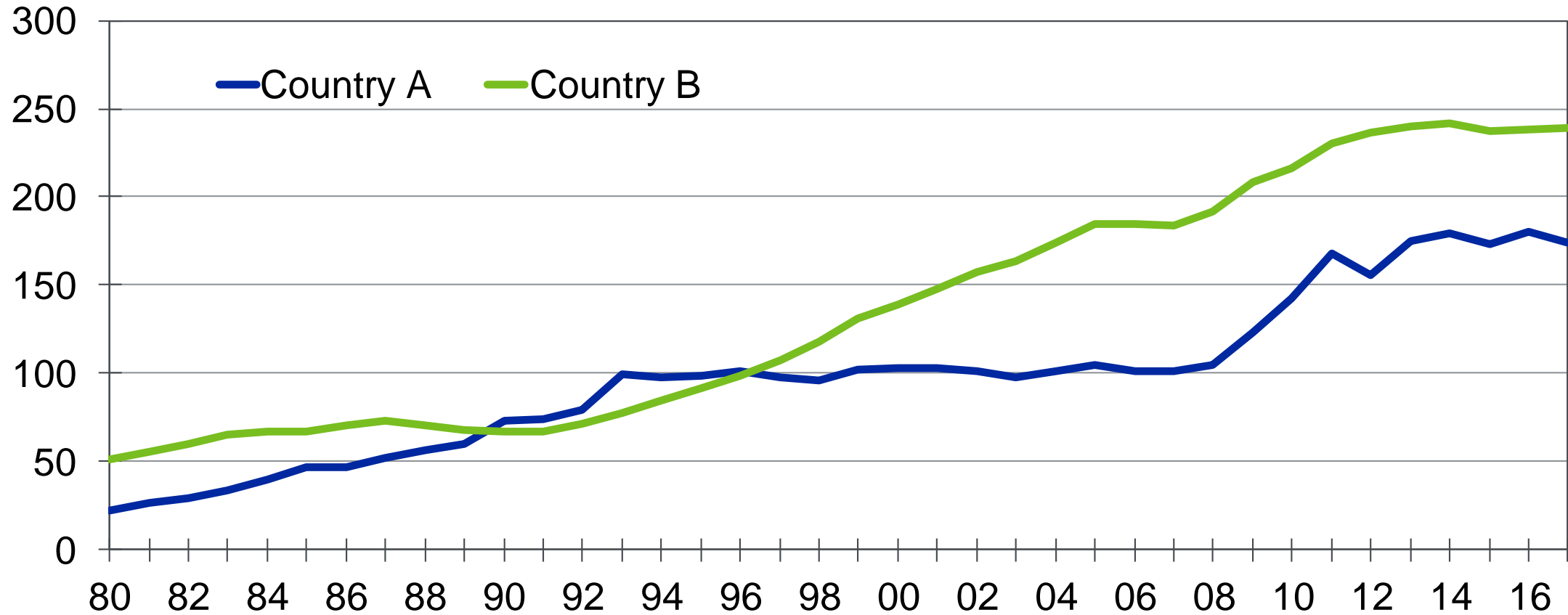
Key Factors

Country-specific, depends on many factors including...

- » Interest costs
- » Growth prospects
- » Fiscal prudence
- » Nature of debt (maturity, gross vs. net, internal vs. external holders)
- » Monetary regime and political climate

Spot the Fiscal Crisis...

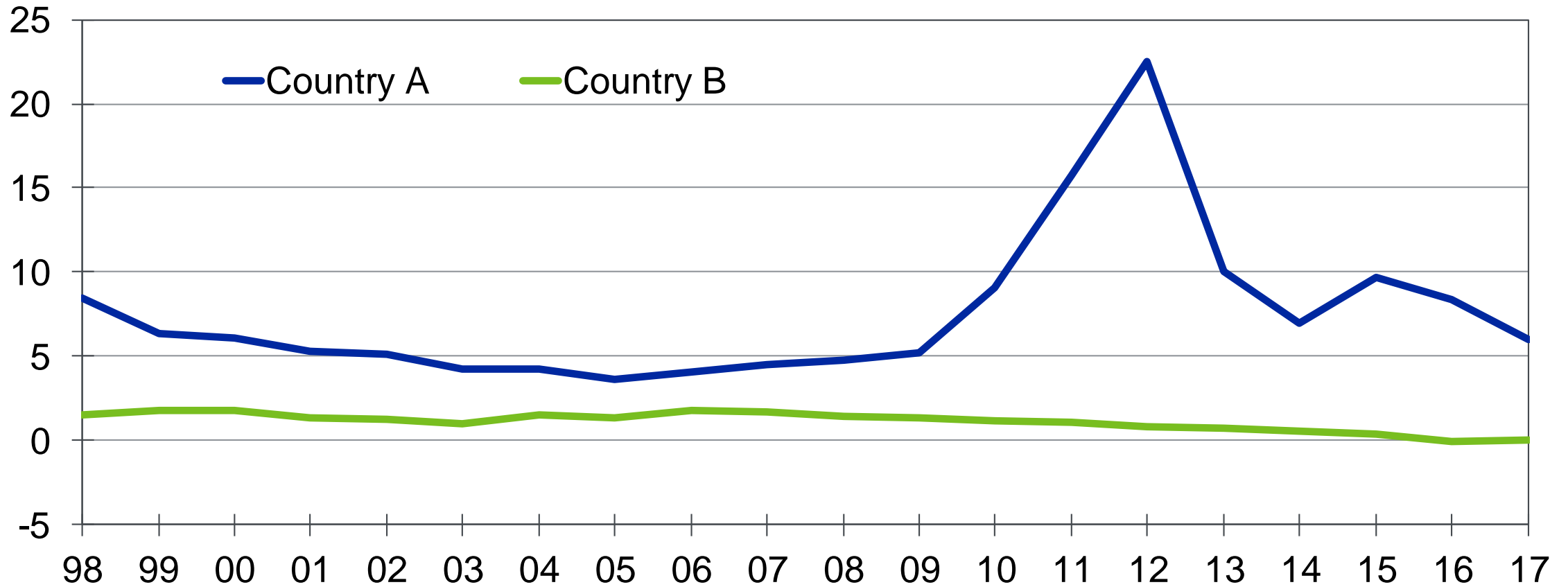
Debt-to-GDP ratio, %



Source: Moody's Analytics

...Or Is It More Clear Here?

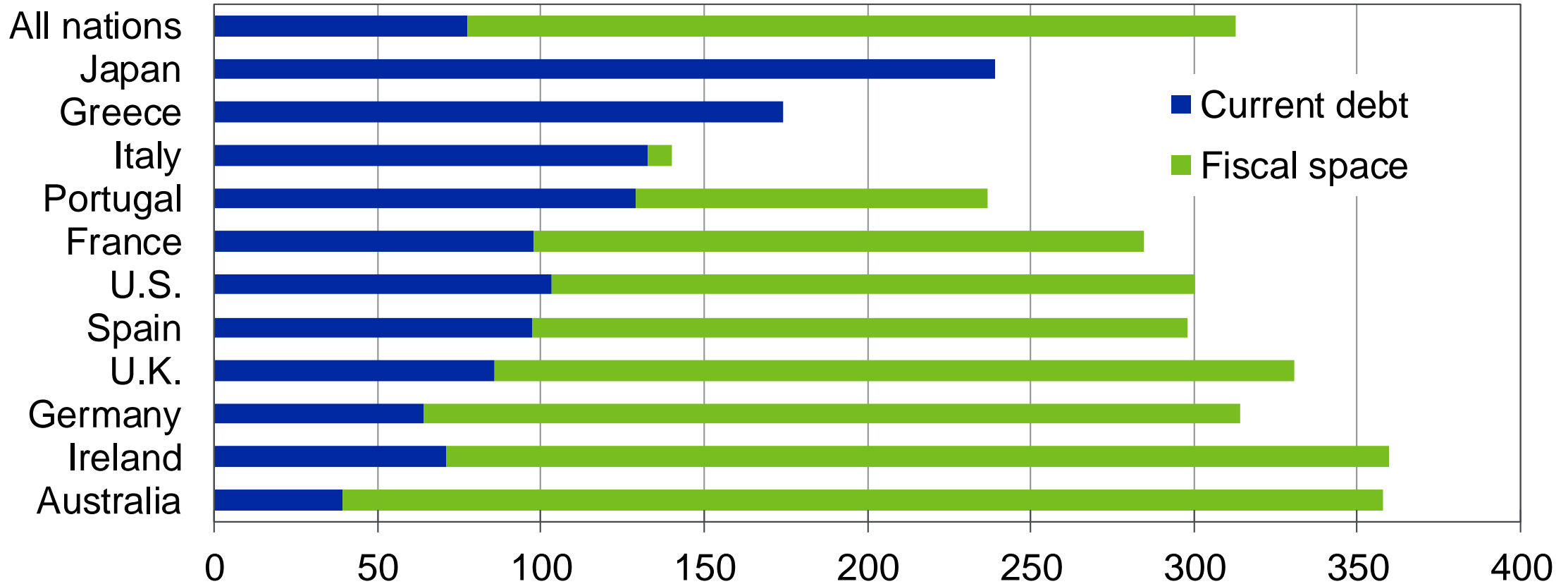
10-yr yield on government bond, %



Source: Moody's Analytics

Debt and Fiscal Space

% of GDP



Source: Moody's Analytics

3

Debt Sustainability Methodology

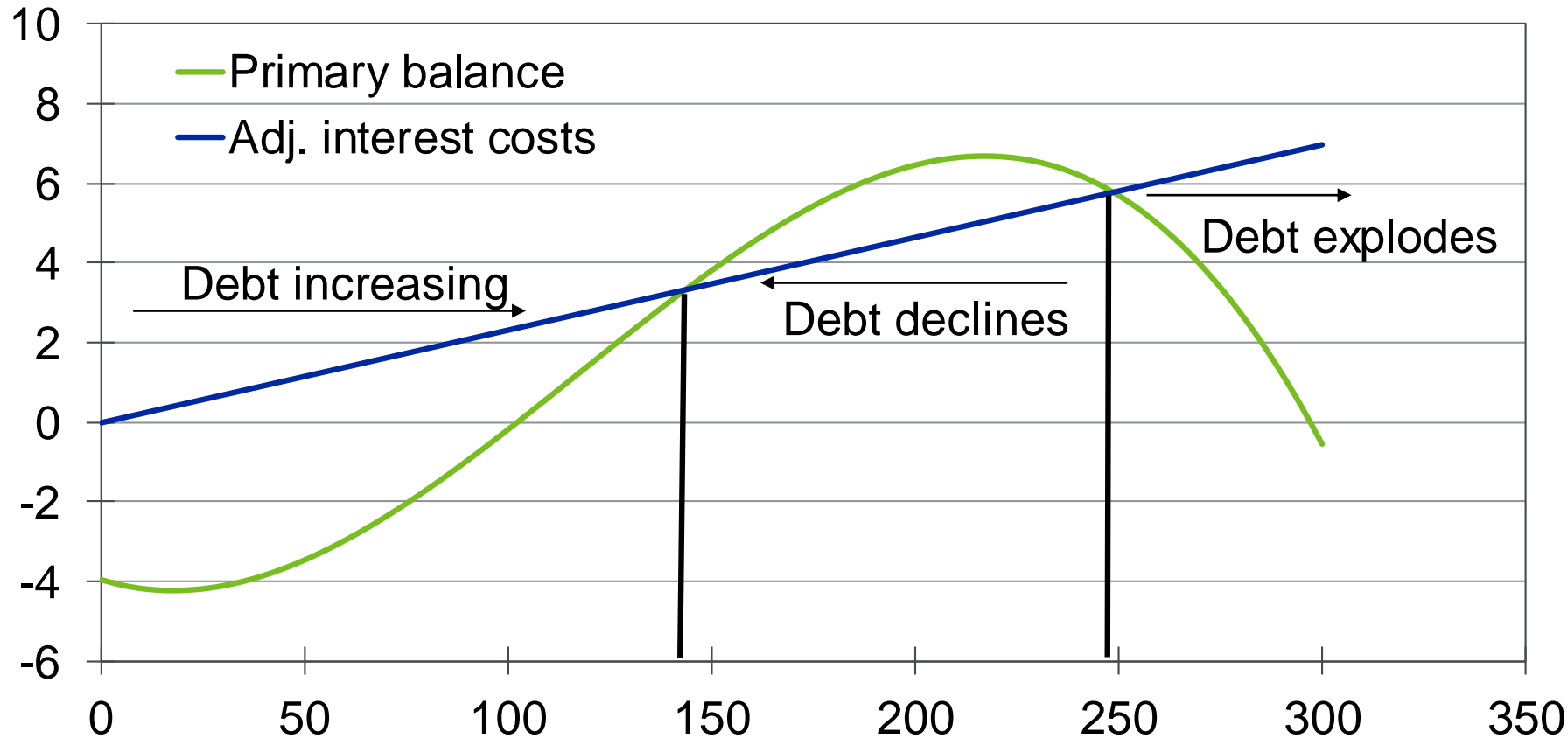
Estimating Primary Balance Reaction

Cross-country regression on 30 countries, 1985-2007

Variable	Coefficient
Debt-to-GDP ratio	0.09
Squared debt-to-GDP ratio	0.0001
Cubed debt-to-GDP ratio	-1.3E-06
Output gap	0.50
Expenditure gap	-0.29
Dependency ratio	-0.57
20-yr ahead dependency ratio	-.15
Trade openness	0.03
D(Major oil exporter) * Relative oil price	3.3
Regression R-squared	0.87

Debt Dynamics Differ

Y-axis: Interest costs adjusted for GDP growth, % of GDP

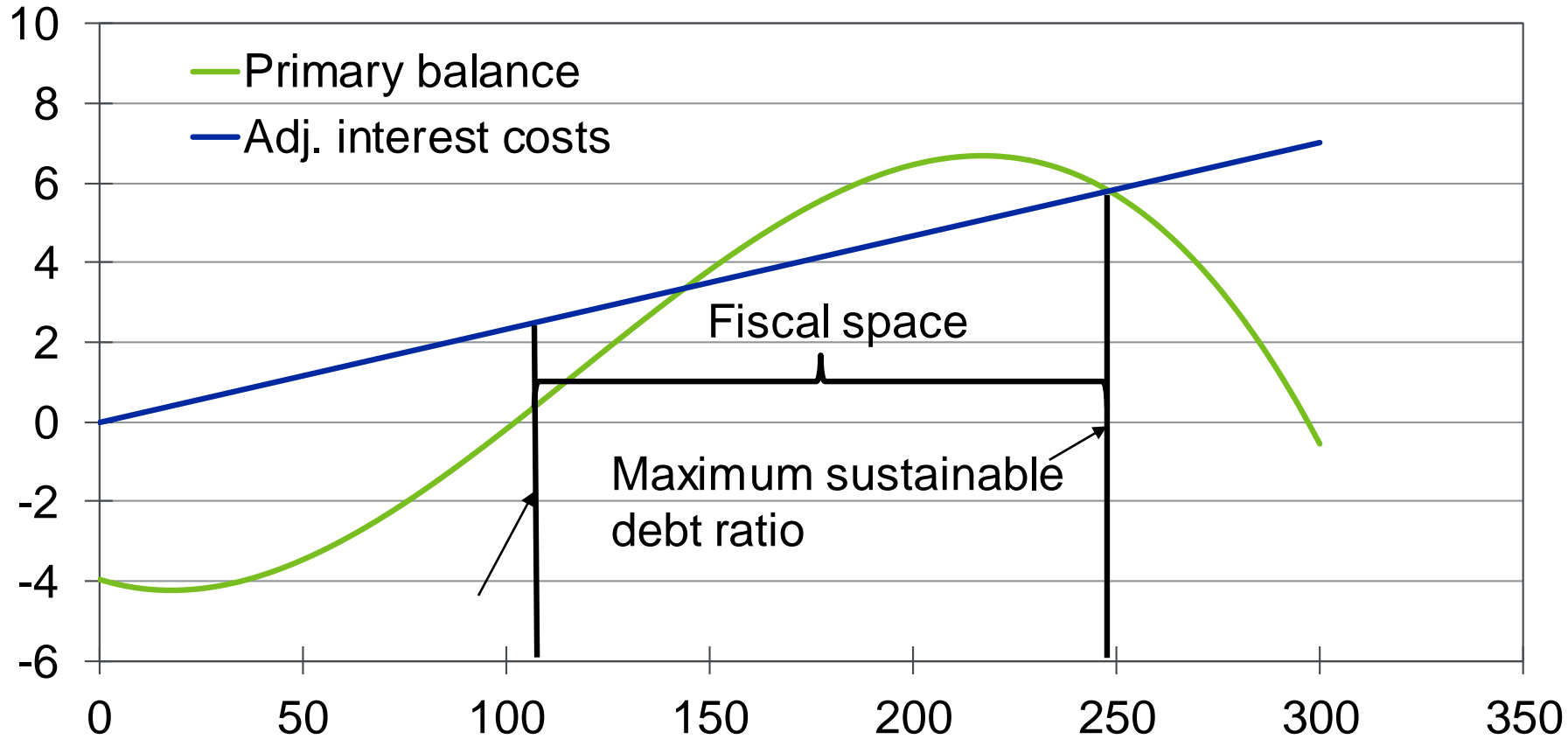


Sources: IMF, Moody's Analytics

X-axis: Current debt-to-GDP ratio, %

Fiscal Space Is Distance to Tipping Point

Y-axis: Interest costs adjusted for GDP growth, % of GDP

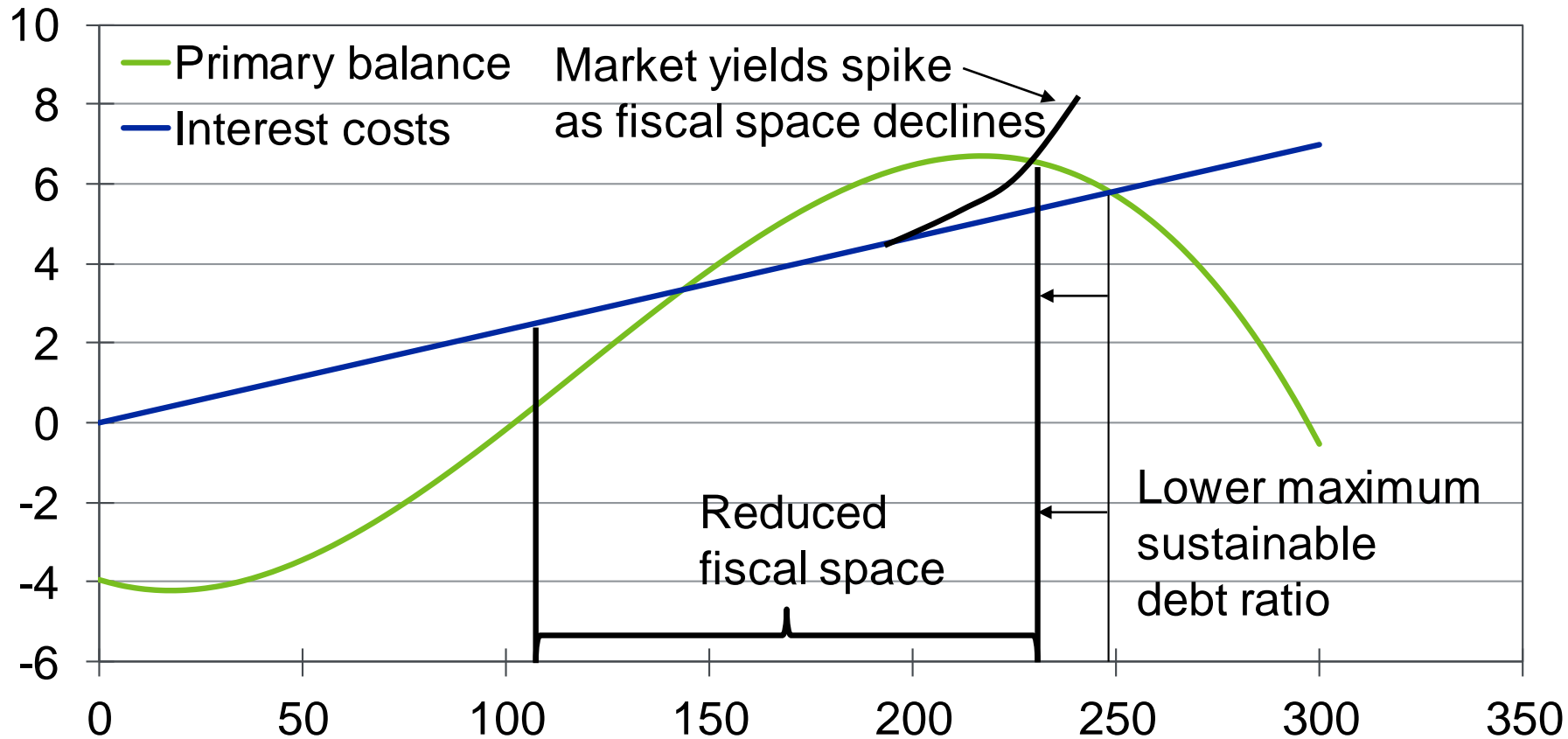


Source: Moody's Analytics

X-axis: Current debt-to-GDP ratio, %

Market Reaction Lowers Space

Y-axis is interest costs adjusted for GDP growth, % of GDP

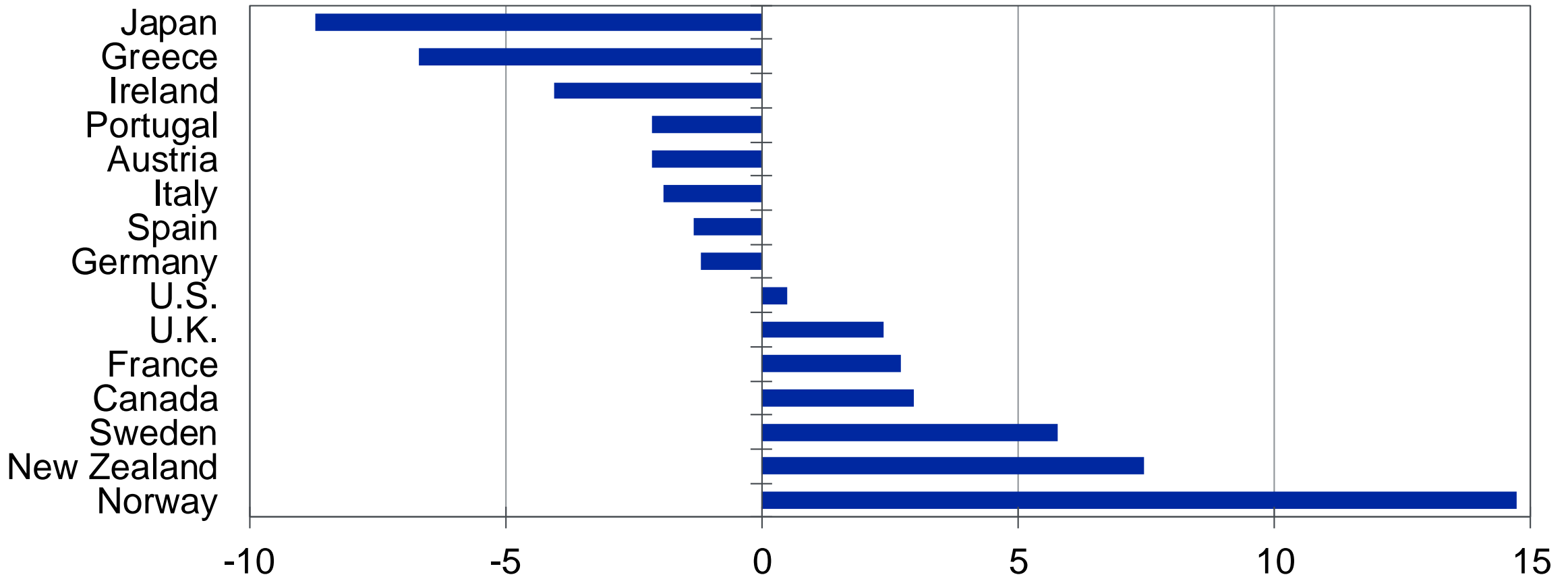


Source: Moody's Analytics

X-axis: Current debt-to-GDP ratio, %

Fiscal Prudence Varies Across Countries

Estimated fixed effect, deviation from cross-country mean, % GDP



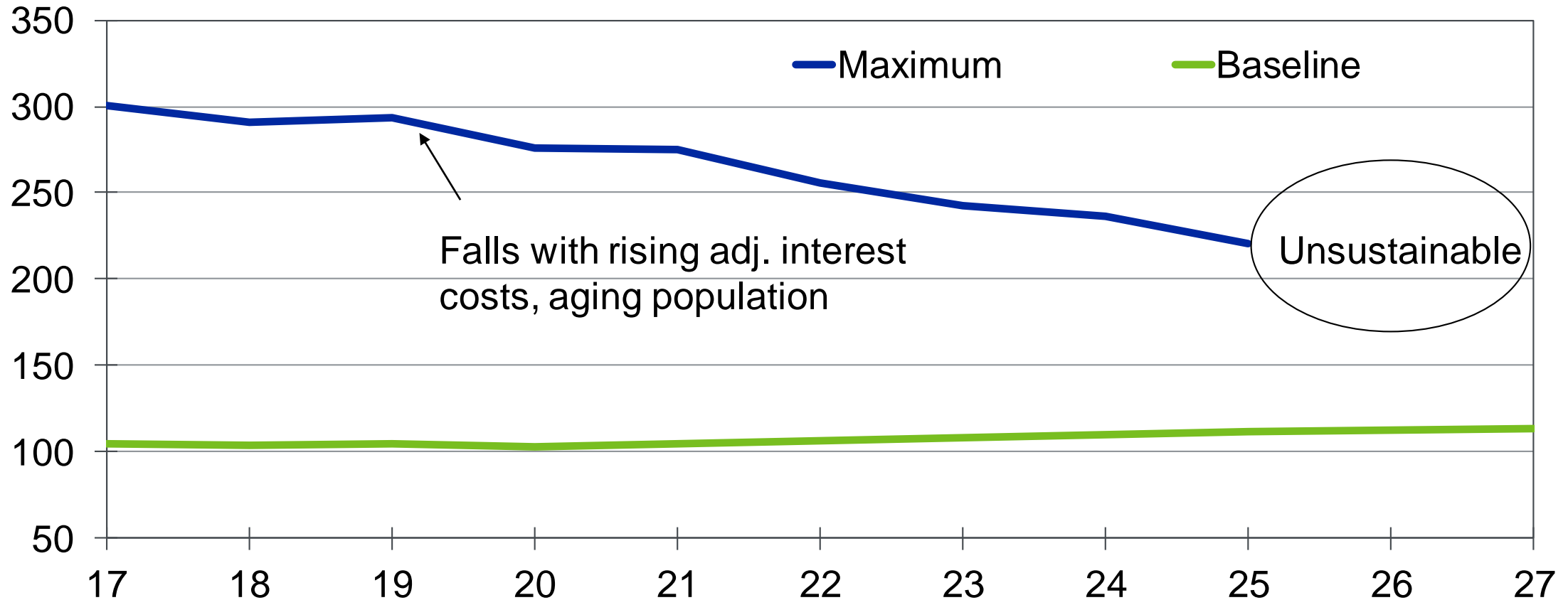
Source: Moody's Analytics

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Fiscal Space Under Different Scenarios

Fiscal Space Declines in U.S. Baseline

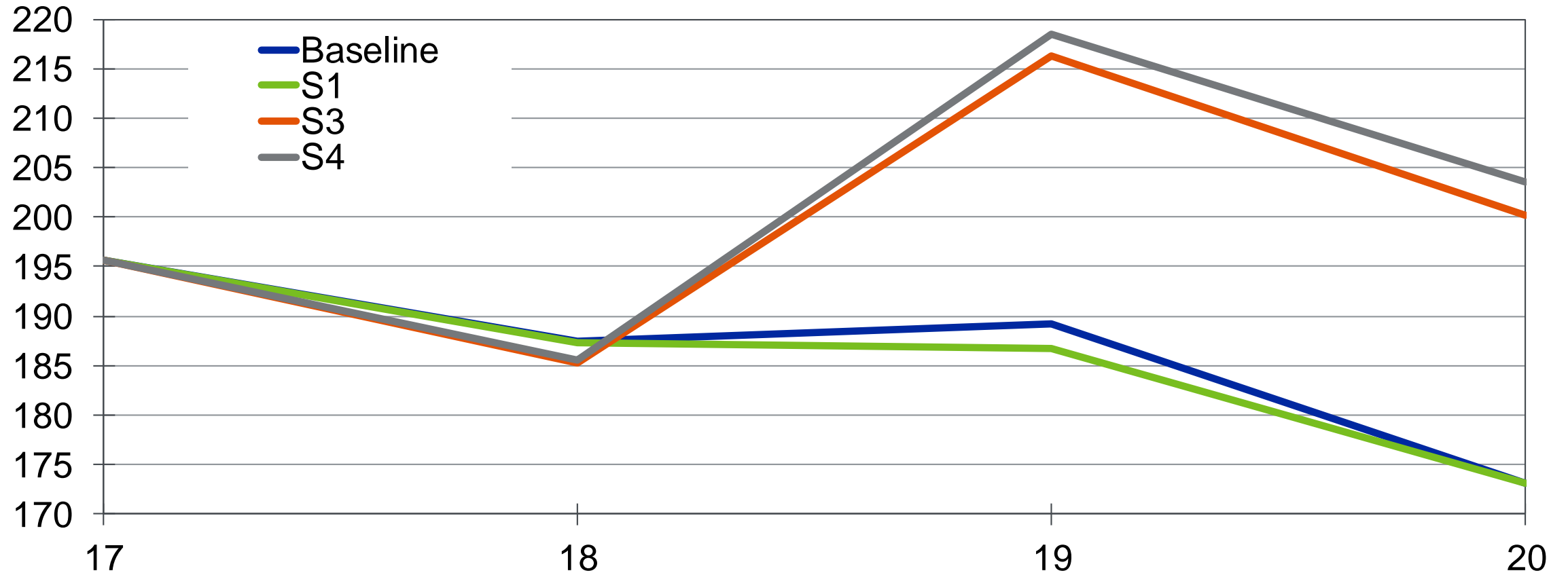
Debt-to-GDP ratio, % of GDP



Source: Moody's Analytics

U.S. Fiscal Space Varies by Scenario

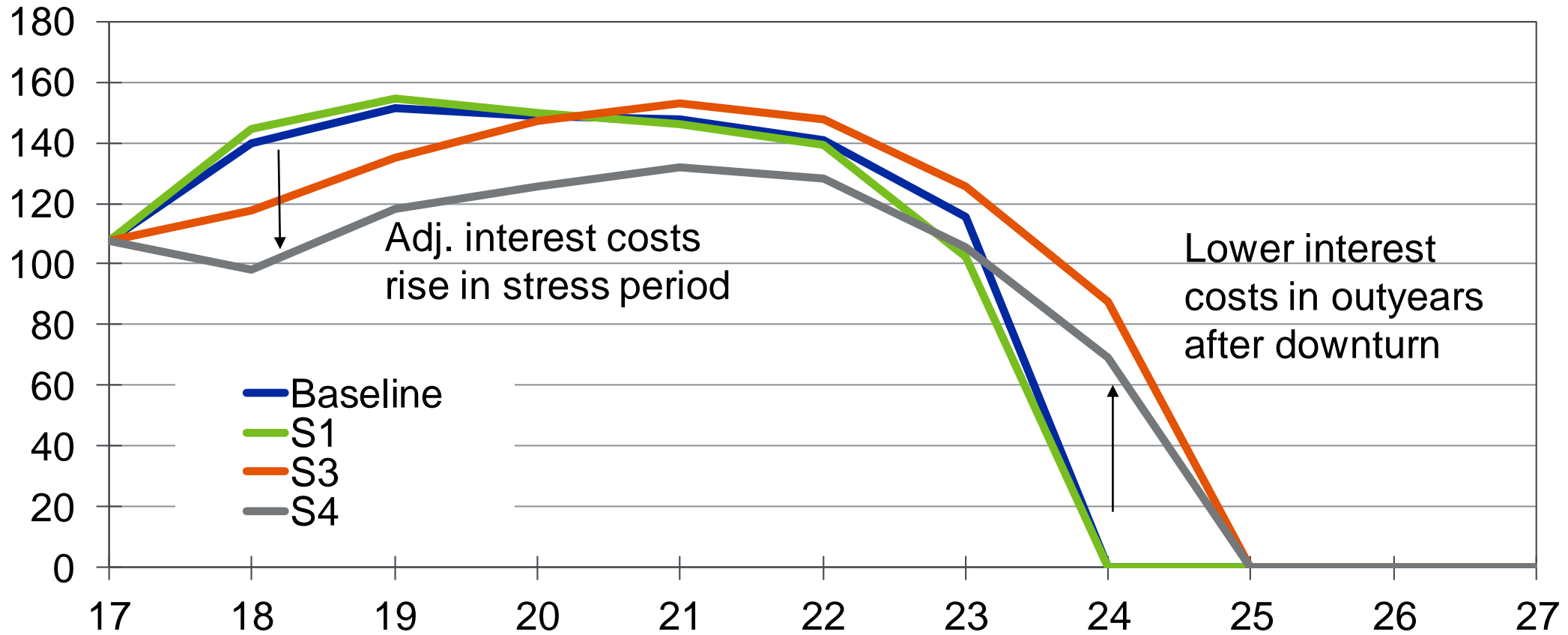
% of GDP



Source: Moody's Analytics

Portugal Fiscal Space

% of GDP

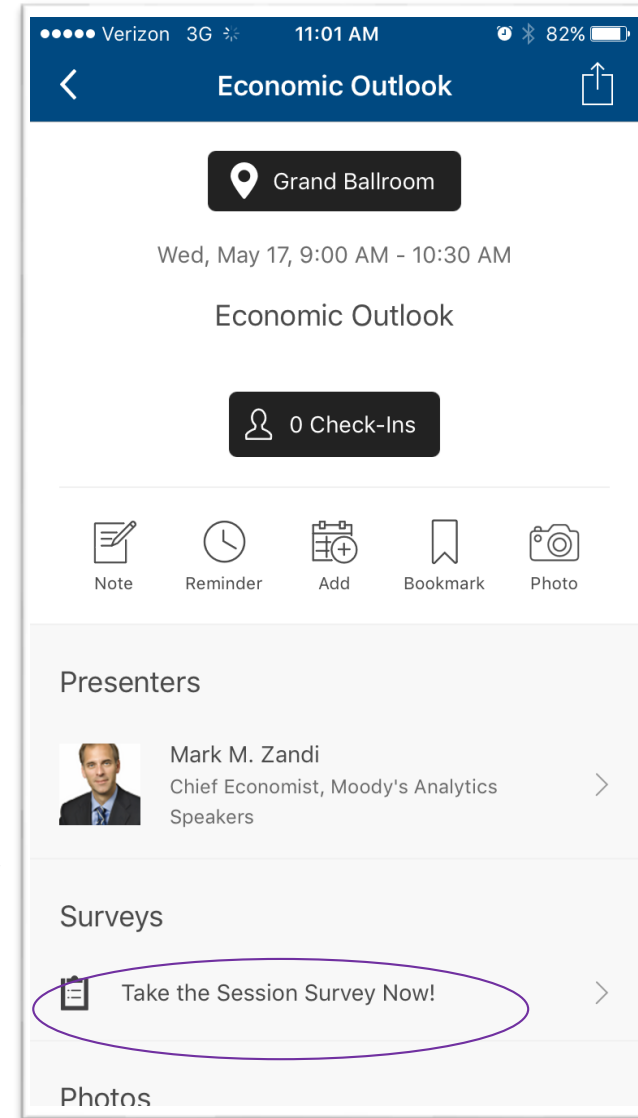


Source: Moody's Analytics

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