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Keynote Speech: Fiscal sustainability and frameworks
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Lúcio Vinhas de Souza: Ladies and gentlemen, if I can call your attention, please. I am extremely sorry for interrupting what I am sure is a very interesting lunch, but allow me to welcome the current head of the Fiscal Department of the IMF, Vitor Gaspar.

Vitor and me, we have known each other forever since for over 20 years now. Vitor actually is one of my former professors in my alma mater in Portugal that was only the beginning of this long and distinguished career. Vitor as most of you know is the former Minister of Finance of the Portuguese Republic, a period of his life during which he took painful but extremely necessary and deeply appreciated decisions for the good of the Portuguese people.

Before that, Vitor was the head of the one of the advisory services to the president of the European Commission, the outgoing one, President Barroso. He is an economist that I have used always as one of the references in my professional life. I don't want to over-extend the introduction, but I would like to welcome Vitor into the podium and personally deeply thank for accepting the invitation.

Vitor Gaspar: Thank you, Lúcio, for your extremely kind words of introduction and thanks also to Adam for the invitation to come and give the presentation on the global fiscal outlook at the Peterson Institute. You will have to be very indulgent with me today because it's the first time that I present the Fiscal Monitor to an external audience. So I'm extremely anxious and nervous about it, and I will try to keep this under control.

So this is the material which has been released yesterday with the Fiscal Monitor. But this presentation is completely different from the one that I gave at the press conference. It's … I would say, much more complete, and it focuses more on the current fiscal situation and prospects because I thought that that would be of more interest to this particular group of people.

So what about the global fiscal outlook? We believe deeply in the Fiscal Affairs Department of the IMF that one should look at the world using an extremely well-reputed model that we call the model from Clint Eastwood. So we look at the good, the bad, and the ugly.

So we start with the good, and what you see there in the map is that you have lots of green around the world which is good. You have some red which is not so good, but you have lots of green. And so what we see in the map is that bond yields have behaved extremely benignly in the last six months and all areas in green have experienced decreasing borrowing costs.

Now that basically means that immediate pressures on public finances have eased. So things look good from the viewpoint of the short-run market conditions. If you would use other financial indicators and you can look at the global financial stability report for many such indicators, you will see that the other indicators would confirm this assessment.

Then we see something that here we look at which is the bad. And the bad is an overall theme of the Fiscal Monitor, and we basically say that underlying fiscal risks and underlying vulnerabilities have continued to accumulate. So immediate pressures have eased, but risks and vulnerabilities have continued to accumulate.

So what you have in this map is one of such risks, and it comes from high debt-to-GDP ratios. And what you see is that you have quite a lot of red around the world, which means that, in our view, the countries that are in red have levels of debt-to-GDP which are higher than a safe level given the country group that they belong to.

Now, the ugly is the weakening recovery. If we look at what happened when we compare the current real forecast with the forecast from six months ago is that almost everywhere around the world the revision has been down sometimes by a lot, sometimes by a little. And the aspect which is most misleading from this chart is that if you focus on low income developing countries, most of them have seen the forecast revised down, but the average growth is very high. It has been revised down to 6.1 percent. So perhaps we should have had that country group in green rather than red.

But the ugly has a repeat in my presentation which is very low inflation in Europe. And you do see that there are quite a substantial number of countries that actually have negative inflation. In this group of European countries that is portrayed here we have 8 countries with negative inflation rates. Then we have 17 countries that have inflation rates between 0 and 1. And only 2 countries, Iceland and Turkey, have inflation above 2 percent, so clearly a very low inflation and downside risks to price stability.

Now what you see in this chart is actually, I believe, quite interesting. You see that measured by the overall fiscal balance, we have a situation where the effort of a fiscal adjustment or fiscal consolidation is basically stabilizing. So fiscal policy is broadly approaching neutral, and we believe that that is appropriate, having a fiscal drag of close to 0 is appropriate given the macroeconomic situation. More broadly, our view is that under baseline, assuming that the baseline scenario materializes monetary and fiscal policies are broadly appropriate.

According to the way these presentations are normally structured when presenting the Fiscal Monitor, we will go now by country group. We will do advanced economies. We will do emerging markets. And we will do low income developing countries.

So here what you do see is that for the group "advanced countries" as a whole, there was quite a substantial effort at the fiscal adjustment. And in red, you do see in the top left side panel you have cyclically adjusted primary balance. And you see that the adjustment has actually been quite pronounced.

If you move to right, still on the top panel, you see that that has been sufficient to moderate the pace and basically lead to government debt stabilization as a percentage of GDP. But if you compare the red and the yellow, you see that the current level of public debt is substantially higher than what was recorded in the past episodes.

You also see in the bottom two charts that both real GDP and the deflator are substantially below, in advanced economies, what has been on average the record of past historical episodes. Now, low real GDP growth and low inflation make the reduction of public debt-to-GDP ratios particularly challenging. And that's one of the features of the current situation, it's one in which bringing down public debt-to-GDP ratios to safer levels is a challenge.

Now, the topic that we picked for the Fiscal Monitor was, "What can fiscal policy do for jobs?" And this particular plot highlights one of the possible roles which is the following: What we have here in this chart is a situation where we consider a labor market structural reform. This is something which is based on empirical evidence, basically the simulation around a growth equation.

If we look at the dataset that was used for this empirical research, you see that the type of structural reforms we're talking about is easing of employment protection. And what you do see is that, in accordance with the empirical evidence, an easing of the employment protection legislation leads to a fall in output and to a fall in employment.

Here in the chart on the left side you have output. Now, there what fiscal policy can do, in case there is sufficient fiscal space, is to ease the adjustment process and limit and even eliminate the negative impact on output associated with this type of a structural reform. That is something which is important because it may be essential for the structural reform to be politically viable. The same applies in cases where the structural reform has very positive aggregate effect, but may be detrimental to some specific groups in society that can block reform. Fiscal policy can also help in that regard.

If you move to the right hand side panel, what you do see is that there is some short run costs in terms of public debt-to-GDP accumulation. You have the baseline in red and then you have the two scenarios of structural reform with stimulus and without stimulus. And what you do see is that, indeed, when the positive effects of structural reforms on GDP dominate the path, the public debt-to-GDP ratio declines below baseline and the cost of having the stimulus becomes irrelevant after a while, but it does persist in the plot and it never goes away.

Now that suggests, indeed, that structural reform can help—sorry—fiscal policy can help in the context of structural reform, but that's something which is not easily done. From the viewpoint of say a Ministry of Finance, deciding whether fiscal policy can be deployed to support structural reform, I would say that four conditions at least have to be met.

The first is that there should be no risks to market confidence and fiscal sustainability associated with the fiscal expansion. Secondly, the costs and benefits, the economic cost and benefits of structural reforms should be quantified and well identified. The fiscal costs have to be constrained in size and time so that one actually has the intertemporal budget constraint and the control. And finally, last but definitely not least, the Finance Ministry must be persuaded that structural reform will be delivered up to the end, that is, there would be no backtracking in the structural reform process.

Now, it is the case that these type of considerations may be particularly relevant in Europe. But in Europe, the context is substantially different and I'm very happy that Alessandro Leipold who has written about these type of issues recently is here and can of course clarify a number of these for you. And Servaas Deroose who is one of the architects of the system which is applied in Europe can of course clarify all institutional issues which make my position very comfortable. Concepts and institutions are all under control in this room.

Now, I will pace up because I would like to—well, this I have to show, I'm afraid. This is second role that fiscal policy can play in the context of structural reform which is the use of fiscal instrument as an essential element of structural reform. I will focus just on the left side of the picture.

This is an example from Sweden 2004, a program to foster the employment of young people which is the most pressing problem associated with labor markets in most countries. And what was done in Sweden was to reduce the employer's social security contribution.

And what we see there is, in blue, workers between 15 and 34, those are the young, and in yellow the remainder. And what you see is that the impact is actually quite substantial. And what we conclude from this experience and others that we have in the Fiscal Monitor is that indeed targeted fiscal measures to specific groups can be very effective while containing the fiscal cost. So if you think about bang for buck, you may get a very good ratio with these type of measures.

If you look at the group of emerging market economies, what you do see is that the fiscal adjustment has been basically postponed. And that debt-to-GDP ratio instead of declining as we were expecting two years ago is actually virtually constant. Now, that is something which basically has to do with the way the economy behaved during this period, that is, the driver is mostly the expenditure-to-GDP ratio and debt was, in most cases, driven by GDP. So GDP came lower than expected. There are some exceptions to this rule especially in Latin America. But by and large, this is how it worked.

Another general topic that we insist on at the Fiscal Affairs Department is the importance of contingent liabilities. And we do believe that contingent liabilities have continued to accumulate during this period, not only in emerging markets but I give an example with emerging markets. But it's very important to understand this is not a phenomenon which is specific of emerging markets.

And what you have there is that, indeed, if you look at the historical episodes, you have examples in which the materialization of contingent liabilities had a very significant impact on the budget and the debt. And on the left side, you have the examples of Belarus and Argentina. And in both cases, you have cost that the exceeded the percent of GDP. So we're talking really about very important values.

If you look at the activities of FAD, we're now conducting what we call fiscal transparency evaluations. And in the context of fiscal transparency evaluations, we look at how countries deal with fiscal risks and contingent liabilities. And what we have found is that it is often the case that the public debt-to-GDP dynamics are dominated by these type of effects, right? So there is ample information that does show that risks and vulnerabilities are high that they should be controlled and they should be reported transparently.

If you go to low income developing countries, I want basically to give two examples of important issues. One is the fiscal impact of Ebola. This is our estimate at the time we produced the Fiscal Monitor. What you do see here as a percentage of GDPs that we have values which are macroeconomically significant.

And at the time—the situation is obviously evolving every day—But at the time of the production of the Fiscal Monitor, what we had was that the fiscal impact on the left side was finance on the right side basically through additional financing. The adjustment in spending is in yellow. The adjustment in other spending is in yellow. And as you can see, it's always a relatively small proportion which basically means that the social expenditures, the health expenditures which are necessary, have been basically accommodated in fiscal policy—were accommodated by fiscal policy and that additional financing was forthcoming.

One point which is important to realize is that the share of sub-Saharan GDP which is covered by these three countries most affected is a very small share. And as a matter of fact, it is true that, in general, this region is performing very strongly macroeconomically.

What you see in this slide is the shifting structure of external financing in low income developing countries. What you see is that concessional financing has been trending down. And at the same time, you have a situation where the importance of market financing has increased for a number of countries.

And that is something that FAD has looked at. And you do see that international bond issuance by low income developing countries poses—well creates a number of opportunities, but creates a number of risks. The risks have to do with the sizable refinancing and exchange rate risks, but those are well known. But there is something else which is worth looking at, which is, the international bond issues are very large frequently compared to the size of the country.

So the stress which is put on budgetary institutions, budgetary procedures, is quite substantial. It's very important that this type of financing does not go into current expenditure. That, of course, is something that depends on the strength of the institution; and when it goes to investment, it's crucial that it goes to efficient investment, which again, depends on the project management procedures and tools which are used by these countries.

And let me conclude. So I've tried to persuade you that immediate pressures on public finances around the world have eased, but underlying fiscal vulnerabilities and risks remain high. In advanced economies, the main challenges come from a weak recovery, a low estimate of potential output growth going forward, low inflation in some countries. And so the challenge is to reconcile support for employment and growth with debt sustainability.

For emerging market economies, we have a situation where, as you've seen, debt levels remained high relative to the historical standard of that group of countries. And it's important that the relatively favorable position in many of these countries is used to rebuild fiscal buffers. It's also important to put in place procedures that control contingencies and risks.

Now for low income developing countries, the key aspect that I would underline is the importance again of budget institutions and project management procedures in order to strengthen the fiscal governance in these countries and make sure that, when they become frontier economies and access international bond markets, that is actually something that helps the development of the country in a sustainable way.

Then when it comes to this question of what fiscal policy can do to support jobs, we outlined three roles. First, debt reduction and fiscal consolidation can be timed in order to minimize effects which are adverse on economic activity and employment. Then, under certain conditions—and you remember the four conditions that I listed—budget resources can use to facilitate a structural reform. And finally, last but not least, fiscal or quasi-fiscal instruments can be used as an intrinsic part of the structural reform process.

And this is all I want to tell you today. I'm ready to answer your questions and hear your comments or to pass the difficult questions to Alessandro or Servaas.

Lúcio Vinhas de Souza: Thank you. Vitor, let me just start by thanking you for a remarkable presentation, as usual. I will take questions from the audience in a moment. But unfortunately, I will start by taking you back to your European Union or Euro area experiences given that is the overall theme of these discussions.

One question that you mentioned in brief during our presentation was related to the importance of fiscal frameworks and fiscal rules. Now, we seemed to be in the middle of a discussion in the Euro area concerning the degree of implementation of the existing fiscal frameworks. I, unfortunately, will not transfer the question to Servaas. It will be you that would have to address that.

Looking not only from your current position but from your previous one, how would you approach the result of the discussion and perhaps talk to us about the effectiveness of the result of fiscal frameworks in the euro area space?

Vitor Gaspar: Okay. Now, the answer to that question is relatively easy from my viewpoint because it does happen that the institution that is generous enough to employ me does have an official view on that issue.

So what we do say as I said during my presentation is that if we look at fiscal and monetary policy under the baseline scenario, the position is broadly appropriate. Moreover, if you look at the last few years, it is remarkable the degree of adjustment that took place across Europe. In many countries, the adjustment, the size of the adjustment is truly unprecedented by international standards.

If you look at the average adjustment for the Euro area, it does exceed 3 percentage points of GDP which for an average across a very diverse group of countries is again truly remarkable. Basically, the public debt-to-GDP ratio has been stabilized, albeit at very high levels. In many countries, either public debt-to-GDP ratios have stabilized or they're actually declining.

So it's very important not to deny the achievement of the set of rules and procedures which is in place in Europe. Moreover, the framework of budgetary rules and procedures is a fundamental element, not only of the current and past governance structure of the Euro area which aims at stability-oriented macroeconomic policies, but it's also a crucial element of the political deal that in the summer of 2012 made it possible for the ECB to act decisively to eliminate the catastrophic risks associated with the fragmentation of the Euro area.

So clearly, it would be incomprehensible if one would let all this progress and all the credibility that was gained during the process to go to waste. You just have to look at the current level of bond yields across the Euro area to have a measure of the degree of progress that has been achieved in the last two or three years according to your taste in terms of mind frame.

However, given the weakness of the current macroeconomics situation, the IMF does encourage the Europeans to look for flexibility within the rules. And here it's very important to underline the <u>within the rules</u> because as you have seen for the case of structural reform, a very important condition for fiscal policy to be of help is that fiscal policy actions continues to be compatible with fiscal sustainability and continued and smooth market access. And for that, again, the framework of rules and procedures is absolutely key. And I believe this is all I would like to say about this issue.

Lúcio Vinhas de Souza: Thanks for that, Vitor, a very clear answer. We've grasped the implications in terms of the expected behavior of European Union authorities. I would like to start by taking questions now. And I obviously will start by my dear colleague, Adam over there.

Adam Posen: Thank you, Lúcio. Thank you so much, Vitor, for gracing us with your first run through of the Fiscal Monitor here at Peterson Institute with Moody's. It was great to have you here a few months ago for your first appearance from the Fund and we look forward to ongoing exchange.

Vitor Gaspar: Thank you.

Adam Posen: I do want to push you a little more on just your reply to Lúcio. You had a sentence in there that sounded something like "because there was such a large fiscal adjustment on the part of the member countries that the ECB had room to deal with the fragmentation risk of the Euro" or you said something to that effect.

Vitor Gaspar: No, actually, I did not.

Adam Posen: Yes, you did, but okay, correct me.

Vitor Gaspar: What I intended to say—

Lúcio Vinhas de Souza: You finish the question—

Adam Posen: No, no, no. He should correct me and then we'll go on.

Vitor Gaspar: What I intended to say is that Mario Draghi was able to do his dramatic, whatever it takes announcement in London after the heads of state and government agreed on what was then called Genuine Economic and Monetary Union that did include a number of elements. And one of them was fiscal union that basically emphasized very much the type of rules and procedures that we are talking about here.

Adam Posen: Okay. So I just have a quick empirical question then. Why was it that the interest rates responded when Draghi said whatever it took, but the interest rates did not respond to the various fiscal measures undertaken by these countries?

Lúcio Vinhas de Souza: And that will be Adam's last question.

Adam Posen: Yeah. That's it.

Vitor Gaspar: Actually, they did. The evolution of bond yields has always responded to policy actions taken by these countries and to the overall environment. The relative importance of these factors has varied over time. And clearly in the summer of 2012, the effect of Mario Draghi's announcement and then the followup by the ECB in September had, quantitatively, a very large impact on bond yields because I believe it was clear that the ECB had the control over tools that were effective in the prevention of fragmentation of the Euro area.

Lúcio Vinhas de Souza: Okay. Please, Alessandro, here. You please introduce yourself to those who do not know you.

Alessandro Leipold: Hi, I'm Alessandro Leipold from the Lisbon Council. First of all, Vitor, thank you very much for your plug of my piece on using the flexibility within the rules. If I may just finish the plug, you can find it on the site of the Lisbon Council website.

It is in that context though that I'd like to ask you. How do you view and also your four sort of rules about using fiscal policy to support employment? How do you view the recent agreement [inaudible 00:32:48] in Milan where the ministers agreed that a reduction in the fiscal wedge was a political priority? They'd look at the country-specific recommendations, which is a good approach and so that actually it was recommended for 11 out of the other countries in the Euro area including, incidentally, Germany. And so they said it needs to be done.

I think that was a good step. It was in the direction of coordination of structural reforms like Draghi and others have been asking for, but then they went on. They didn't actually taken concrete steps or say we were all going to be doing it together or anything like that. They then went on to announce a number of principles. And one of these said that the finance reform you'd have to find corresponding cuts and other expenditure or shifts in taxes so basically a very orthodox approach on that.

And one wonders then, "What is the meaning of the structural reform flexibility clause under the pact?", which states that some deviations from adjusted path are permitted in the case of structural reforms that are seen at payoffs in the long-term but some short-term costs, the sort of short-term cost for long-term gains.

So the question to me is how does the Fund or how do you view and perhaps have [inaudible 00:34:12] the fact that no appeal was made to the structural reform clause even for a reform that is viewed as a priority? When will it then ever be used?

Vitor Gaspar: There are many more than one question in what you said. I think there are a number of elements with which I fully agreed. That is, when you think about these elements, monetary policy, fiscal policy, structural policy, they are areas like the coordination of structural reforms where it does make sense to use more intensely the coordination at the European level.

My understanding, but Servaas will correct me if I'm wrong, is that in terms of institutional setup, everything which needs to promote that correction is actually in place. It's an issue of using it in practice, right? And I do think that there are important advantages associated with this type of coordination given the degree of integration of Euro area and the very clear identification of spillovers that were made evident by the crisis.

Servaas was actually associated, many years ago, with the drafting of a report about the experience of the Euro area in the first 10 years. And one of the things that we discussed was that, for many years, the story about international spillovers was something which was mentioned in academic conferences, but it was very hard to document them. But back then—so we're talking about 2009—one could actually be run over by a spillover. Spillovers became big bits and they're still big bits. So these spillovers can only be controlled through appropriate coordination and that seems to be a very important issue in Europe.

Now concerning the issue of the structural reform clause that you do discuss in your paper, very carefully, again my understanding is that the clause is in the framework. It has been used in the past. It was used for pension systems reform when you make the transition to a capitalization system and so you have these fiscal cost up front. And if you think that that is the only precedent that exists, you actually get the answer to your question.

When it is something like pension system reform, the quantification clauses that I listed in the four conditions are easily met. We know how to quantify those things. For other structural reforms, it's much harder. So the question is: Can the Commission that basically controls the agenda on these issues put together a set of procedures which is sufficiently robust that we can be comfortable, that the Commission can be comfortable, that something like the four conditions that I listed are met?

Now, I don't know what is the state of preparedness of the Commission in this particular dimension, but it's not an easy issue, right? It's definitely not an easy issue. But as you say, it is an issue of very great policy relevance at this point in time, right? You asked or I believed you asked something like, "If not now, when?" and I tend to share your sense of urgency.

Lúcio Vinhas de Souza: Thanks. I have been bravely trying to resist Vitor's attempt to transfer responsibility to Servaas. But you put me in a position which I have to ask if Servaas would like to make a brief statement [inaudible 38:24].

Servaas Deroose: I have nothing to add on this about Vitor had said today. I could go on on the four conditions in that Vitor has enacted or has put forward. These are not the four conditions that we would look into, so I can't say really. The last one, for instance, is problematic from our view the commitment for the future in this kind of issues.

So in our provisions, it is clearly stated that reforms has to be enacted so that's an issue that which we differ from that, at least institutionally, that's different from what you have. And for many of the other issues that is work in progress. And within the next couple of weeks, we will get clearance on all of this but it's not today that I will give you the answer on that.

Lúcio Vinhas de Souza: Thanks, Servaas, for being the unofficial member of the panel. Other questions, please. I believe that the gentleman there on the back. Please introduce yourself.

Angel Ubide: Yeah, it's Angel Ubide from D.E. Shaw and Peterson Institute. Vitor, first of all, I want to thank you for having said in public that the structural reform sometimes have negative effects on demand in the near term. I think it's an important statement to make and it's important that that is clarified. But now I want to put you on the spot a little bit in the following sense.

There is a debate about what fiscal policy should be in each individual country of the Euro area, but also President Draghi said in Jackson Hole about the overall stance of fiscal policy in the Euro area. So if you could decide, what do you think the stance of fiscal policy in the Euro area next year should be? How do you think that would be achieved? Thank you.

Vitor Gaspar: Okay. Before I go to your question, Angel, allow me to make just one side remark to Servaas. Considering the fourth question, when you emphasized that you only take into account structural reforms that are enacted, you're basically saying that your view about the commitment is very extreme. If it is enacted, then there is no risk of just announcing it and then not delivering.

But of course, you still have an issue of commitment associated with the possibility of backtracking, that is, enacting a structural reform, getting a deal out of it, and then undo the reform. And if you look around Europe, you can actually find some examples of backtracking in this particular sense.

So I would say I would not expect us to have any particular difficulty in kind of agreeing a framework. The issue is not so much agreeing the framework. It's actually being able to do something that matters in practice, how to do it. It's a very, very difficult challenge. Well, I wish you all the luck in the world because I believe it's very important.

Now concerning the overall stance of fiscal policy in Euro area, Angel, you're going to be disappointed because I'm not going to elaborate on that question because the IMF has a very clear official view which is: The monetary fiscal policy stance in advanced economies including the Euro area is appropriate on the baseline.

Lúcio Vinhas de Souza: Thanks, Vitor. Servaas, I will not allow you a rebut on that. I'm sorry for this. Additional questions, please. You made an argument [inaudible 42:14] so please then you just raised your hand—okay. Do we have additional questions from the audience?

Okay. Allow me to then ask you one question before I return to Adam for his final question of the session then. This is the question of contingent liabilities which you rightly pointed out are significant, not only for developing or advanced economies but also for emerging ones, right, anyway, two very good examples there namely Belarus and Argentina.

However, on average, I think that we can assume that the relative importance of those contingent liabilities for advanced market economies is considerably larger, right? That's the way that we would interpret it.

Now if this is not the case, please clarify. And now also I would find [inaudible 00:43:11] to understand what you are putting there in terms of contingent liabilities. If we are talking immediate questions like banking systems et cetera, then it's understandable how you can get two different values. But if we start talking about medium to long-term contingent liabilities, pension systems, the saturation of populations, then the results can be quite different so a little more color on that, please.

Vitor Gaspar: No. Thank you for the question. What I showed you is not contingent liabilities. What I showed you is implicit and contingent liabilities that actually materialized as actual impacts on the budget, right? So we're not quantifying in that chart what could have been. In the chart, what you have is the accident that actually took place.

Now, when we conduct fiscal transparency evaluations, we go very systematically through the various assets and liabilities of the general government and the exposure of the general government, for example, to the wider public sector. And we go on quantifying the implicit liabilities associated with pension systems, the contingent liabilities associated with the structure of the financial sector and so on and so forth.

So if you go to our website and look at the fiscal transparency evaluations, at this point now, I believe we have six evaluations that have already been published. And you have examples of how those liabilities are actually quantified and reported. And you can also see, for the examples, how the public debt-to-GDP ratio of those countries has been affected in the period recovered by the realization of liabilities that were not necessarily explicitly accounted for.

Lúcio Vinhas de Souza: Okay. Thanks for that reply to my question. I should also point out that on the next panel we're going to have a discussion that we'll talk about Asian issues that are an important component in terms of contingent liabilities. It should be realized, of course. Now as indicated, we have time for one last question. We will give to Adam there.

Adam Posen: This, of course, reflects the failure of the audience to step into the breach and I try—

Lúcio Vinhas de Souza: I implicitly conveyed the message but—

Adam Posen: Yeah, yeah, I'm more explicit. Now, Vitor, one of the many interesting things in charts you presented was a very striking chart about bond issue, international bond issuance with some particularly large spikes from Africa, some particularly low numbers seeming to come out of Asia. I realized this wasn't the main thrust of this particular Fiscal Monitor, there will be other ones in the future many under your leadership.

But I was wondering if you could say a word or two about how you see global bond markets developing the ability of sovereigns to issue debt. I mean this is obviously important for today's discussion, but just as we get out from the sort of bust/boom cycle in emerging market bond issues, where do you see the future there? Does structural reform or integration of say Asian or Latin American bond markets matter for fiscal space or is that just a side issue? How do you think about that?

Lúcio Vinhas de Souza: Just one little color on what Adam was saying. From the graph, one would imagine that Africa, a region of the world that famously has a relatively limited degree of financial integration to global markets, had significantly more global issuances in terms of bonds than Asia and Lat Am combined that would strike one as counterintuitive.

Vitor Gaspar: It is so counterintuitive that it would be even wrong. So what we have in the chart—and I thank you for the opportunity to clarify—is what we call "frontier economies". So we're talking about the subset of low income developing countries. And among those, there are few, there are not many, there are few that have made issuances in international bond markets.

So it's a very imbalanced sample. And most low income developing countries happened to be in Africa, right? So it has to do with the sample, not with international bond issuance. Most of the countries that you are thinking about issuing in Asia or Latin America are emerging market economies. And clearly, there's no comparison whatsoever.

The reason why you have those spikes in the chart is actually very important. That's because the size which is necessary to issue a bond in international markets is very large relative to the size of those economies, which is where the budgetary procedural challenges come from. Since you have something which is very large compared to the economy, you need to have sound budget institutions and very solid procedures to identify real productive use of those financial resources is absolutely key.

I think I have three observations on your question, Adam. The first one is that clearly global bond markets have been behaving very strongly; bond yields are at record lows and volatility is extremely reduced. Now, there is a situation which is amply analyzed in the global financial stability report. And José Viñals has elaborated on that quite a lot.

One issue which is very much discussed in [inaudible 00:49:04] is what to expect from a possible—actually in the JFSR is what—and the [inaudible 49:13] and the JRSR is what we expect in the case of a normalization of monetary policy in the United States. And there the conclusion is that it depends a lot on basically two factors. One is, "What is the driver force of normalization in the United States?" If it is better prospect for growth there are a number of compensating factors that do help the adjustment. But clearly, given the empirical experience recently and historically patterns, one has to look at that development as a possible risk. It is a possible risk, something which is of concern.

Which leads to my third remark which is: one has seen that in many countries around the world, the frameworks which can be used to macroeconomic stability have been improved and at this point in time, consideration has been given in how to make these countries robust to shocks to disturbances coming from the rest of the world.

There are some reasons to be optimistic that the degree of domestic resilience in many countries has significantly improved. But our view is that, for many of these international spillovers, regional and global cooperation are going to continue being necessary, which means that the very important line of research that is making the Peterson Institute famous is going to continue alive and kicking.

Lúcio Vinhas de Souza: I would like to thank Vitor for this wonderful and kind ending for his remarkable presentation with this. Please a round of applause if you are.