



Finding Yeti

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Motivation

- Fiscal compact: output gap (OG) and structural budget balances (SB) are key in **evaluating** fiscal policy in **real time**
- Numerical benchmark for deviation from targets
- **Correction mechanisms** are attached (with welfare implications)
- **Independent fiscal institutions** are important in **triggering** these mechanisms
- Comply or explain principle

The Problem (1)

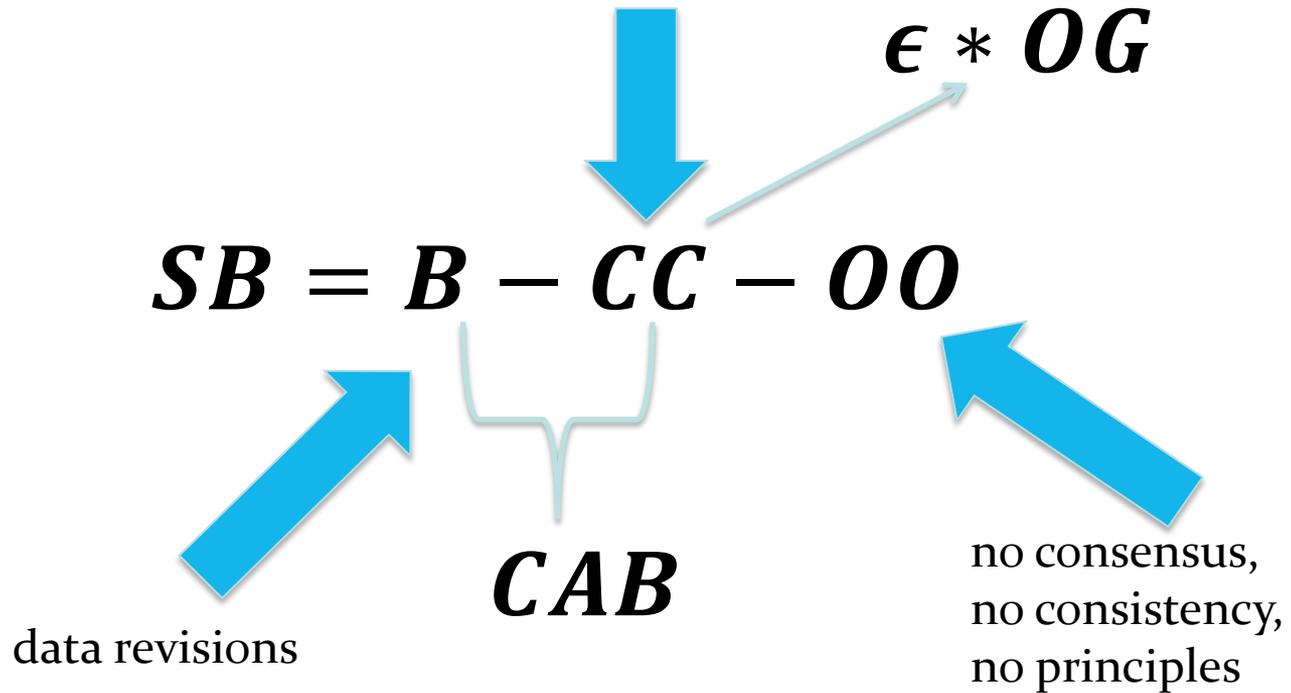
- Output gaps are unobservable and model dependent
- Huge uncertainty in real-time estimates even in developed countries
- In small and open economies the uncertainty is substantially bigger (short time series, structural breaks, frequent supply shocks, more important financial flows, etc.)
- Additional uncertainty is coming from budgetary elasticities and one-offs in calculating structural balances
- **It is more an art than a science**

The Problem (2)

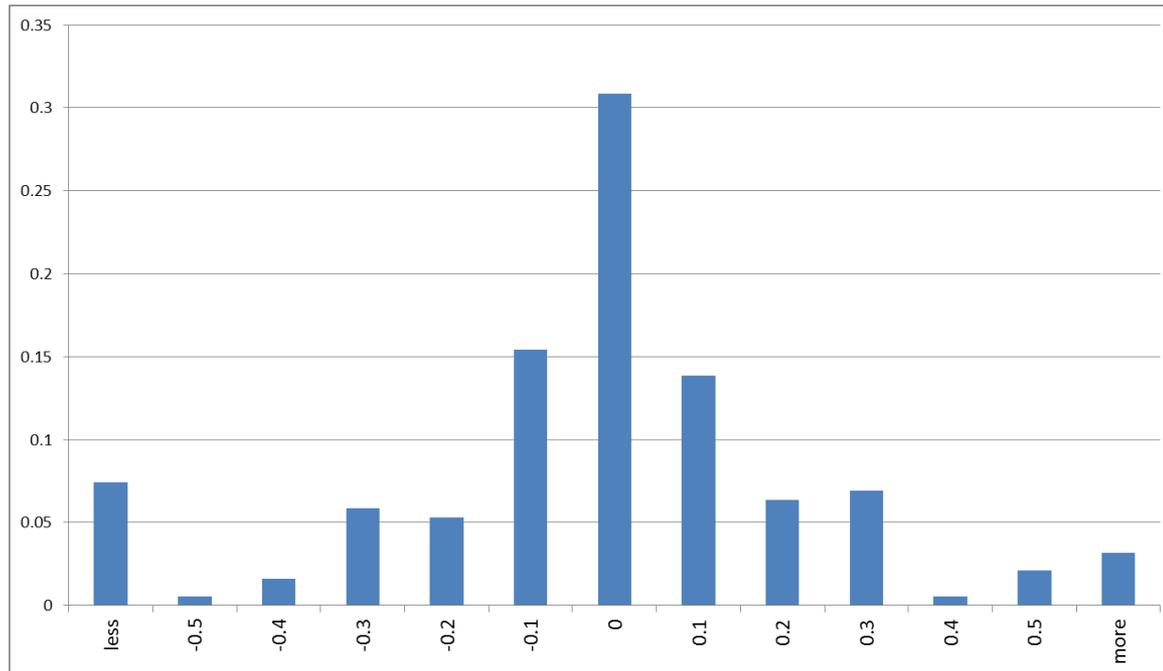
- Real-time CAB for 2009 increased by 4.3% of GDP on average in the euro area between spring 2008 versus spring 2013 (8.7% for IRL, PTL, ESP and GRE)
- **„near worthless indicator“** (Gilbert and Hessel, 2013)
- **Can we do better?**

The Problem (3)

different methods



The Trouble With B



- Although the average revision between the autumn and spring notification is -0.05% of GDP, the standard deviation is 0.44.

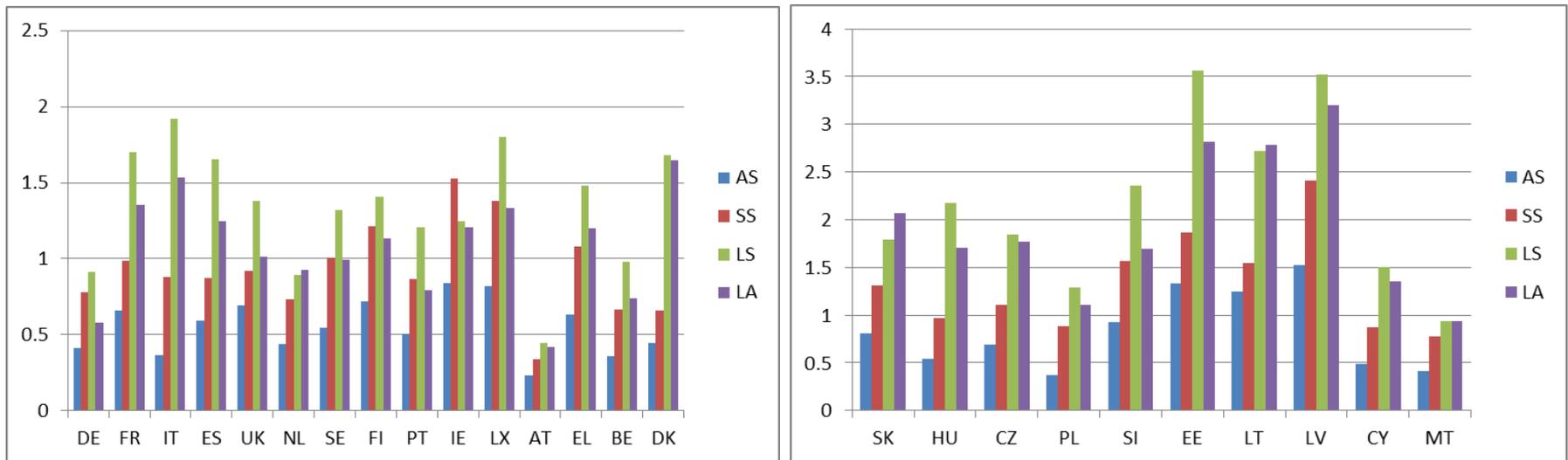
The Trouble With ε

- No time-varying elasticities
- Reflecting constant structure of revenues and expenditures
- No reaction to legislative changes
- No reaction to business or inventory cycles
- Only unemployment benefits on the expenditure side

The Trouble With the Output Gap (1)

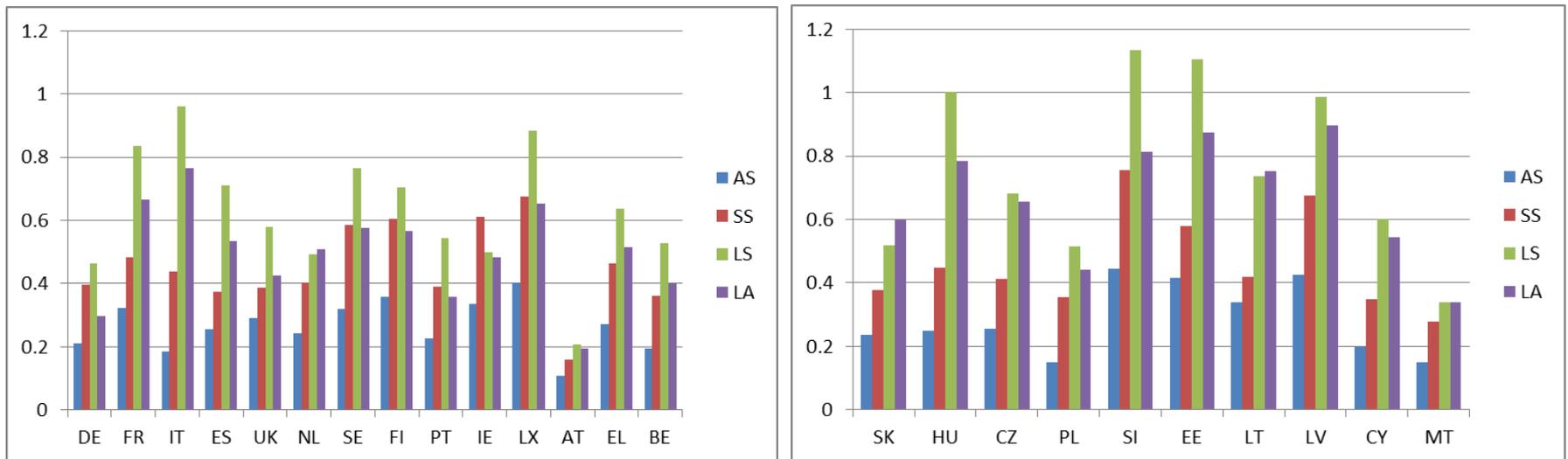
- Short time-series with many structural breaks
- High uncertainty around capital stock estimates
- No composition effects
- Downplaying international capital and labor mobility
- CA, financial cycles can be important in small and open economies
- Frequent supply-side shocks
- End point problem of the HP-filter

The Trouble With the Output Gap (2)



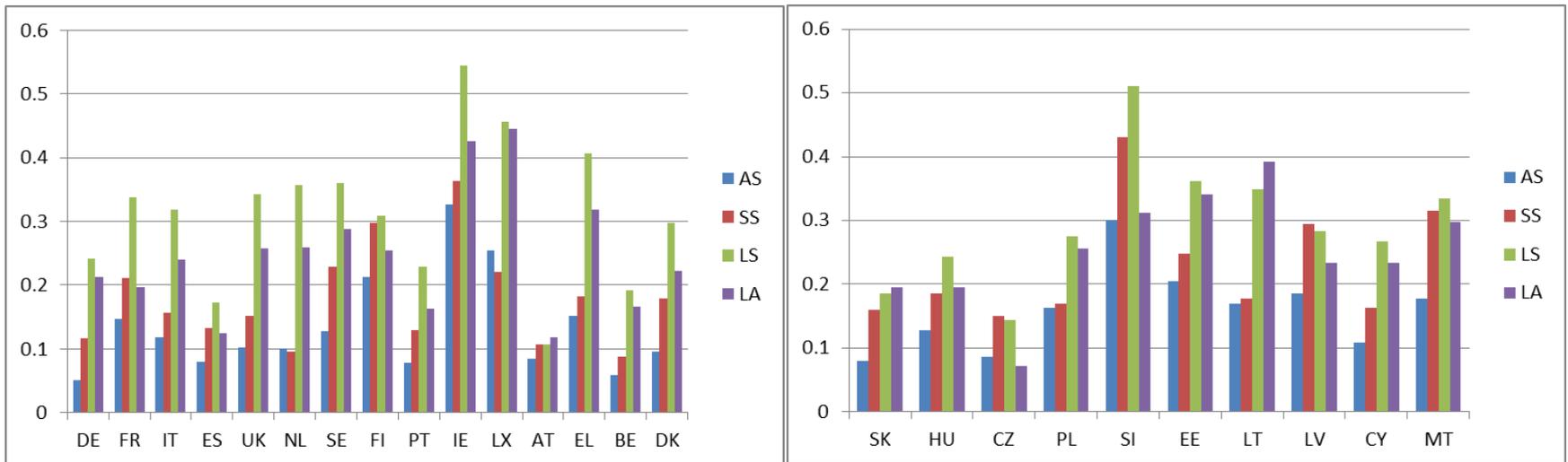
Average revisions to output gap between various EC forecast vintages

The Trouble With the Output Gap (3)



**Average revisions to cyclical component
between various EC forecast vintages**

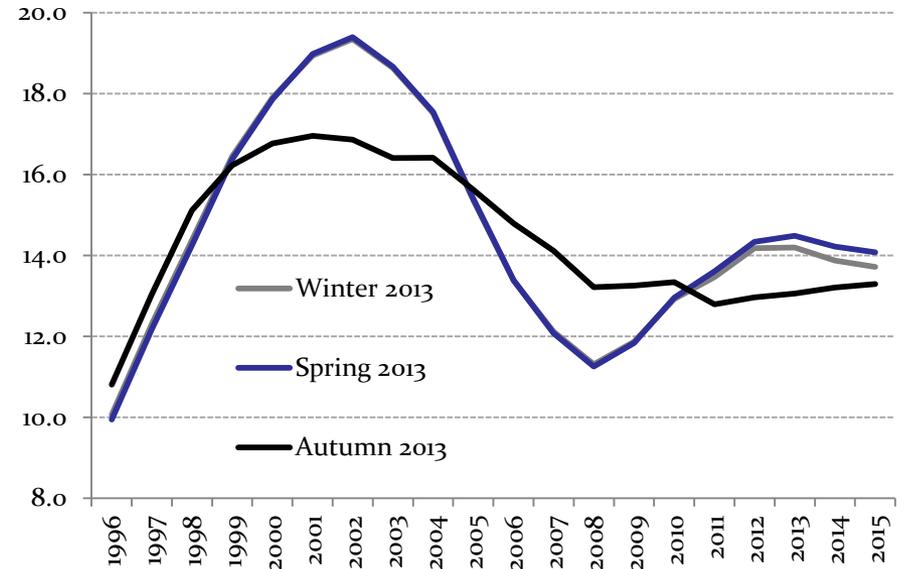
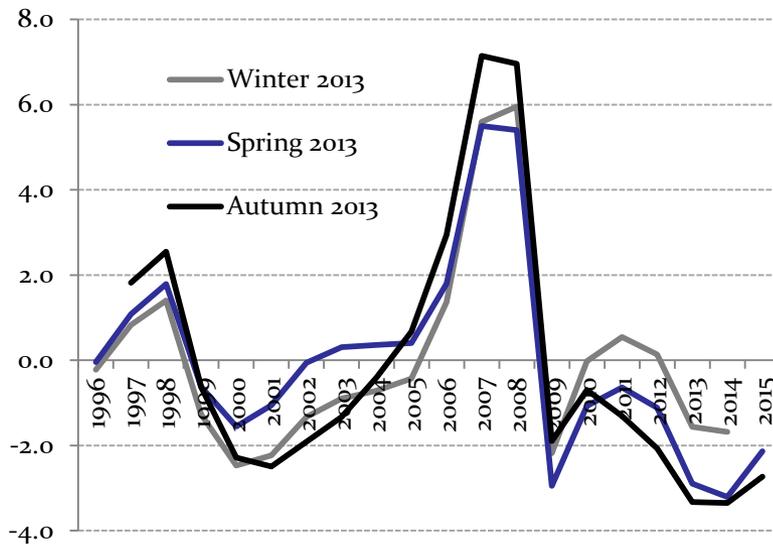
The Trouble With the Output Gap (4)



Average revisions to *changes* in cyclical component between various EC forecast vintages

Output gap estimates for SK

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Major revisions due to technical factors

The Trouble With One-offs

- No detailed data are available
- No consistency across time and countries
- Data transparency issues

Real-time Evaluation of changes to SB in Slovakia

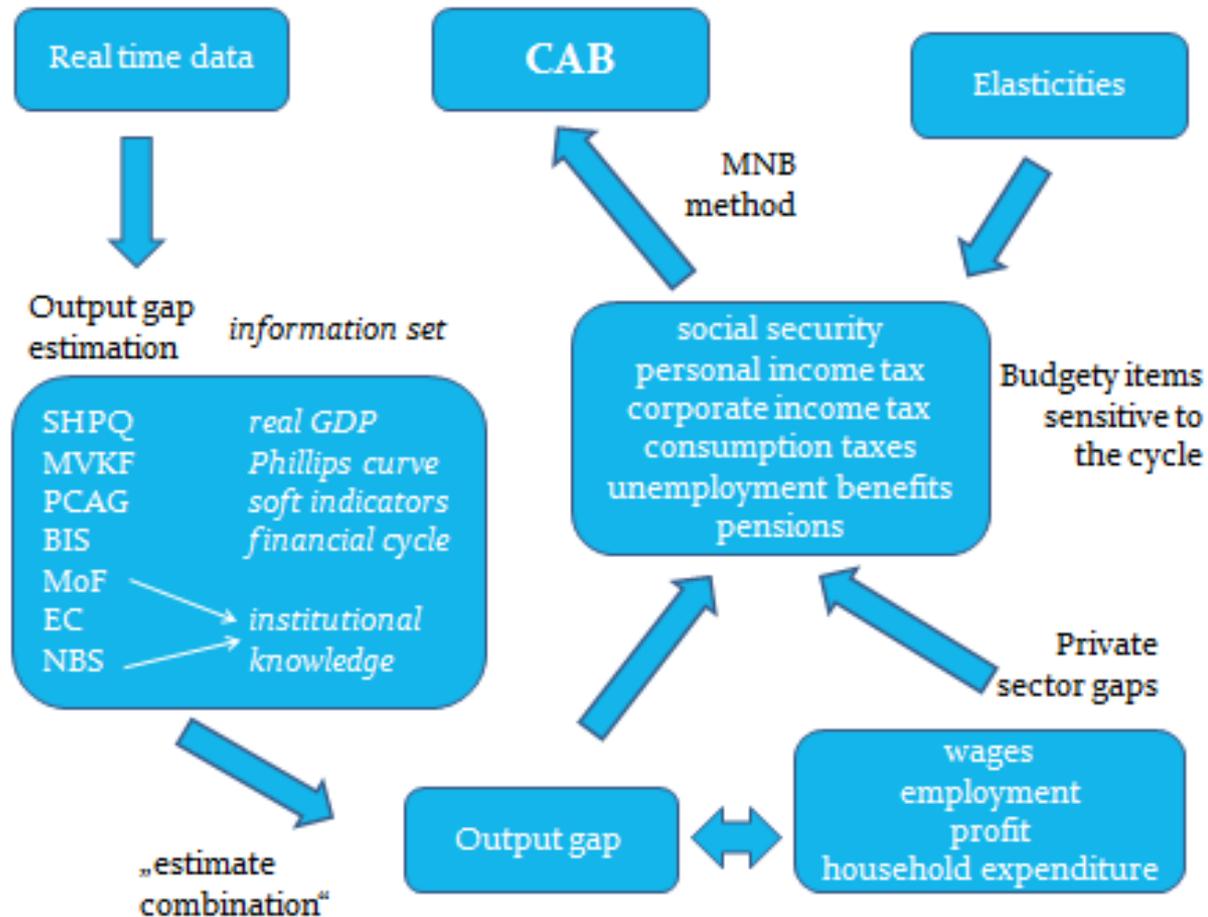
Table 4 – Average revisions to SB changes (EC methodology, % of GDP)

Changes	2006	2007	2008	2009	2010	2011	MIN	MAX
AS	-0.2	-0.2	-0.3	-1.4	0.2	-0.2	-1.4	0.2
SS	0.0	-0.6	-0.1	-1.4	0.2	-0.3	-1.4	0.2
LA	0.9	-0.4	0.8	0.2	-0.3	-0.1	-0.4	0.9
LS	0.7	-0.6	0.5	-1.2	-0.1	-0.3	-1.2	0.7
Absolute							AVG	MED
AS	0.2	0.2	0.3	1.4	0.2	0.2	0.42	0.20
SS	0.0	0.6	0.1	1.4	0.2	0.3	0.43	0.25
LA	0.9	0.4	0.8	0.2	0.3	0.1	0.45	0.37
LS	0.7	0.6	0.5	1.2	0.1	0.3	0.58	0.55

Source: CBR

CBR's Methodology for CAB

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Principles for Identifying One-Offs (1)

1. **Time horizon** – medium term measures; no exact number of years
2. **Transaction value** – at least in one year greater impact than 0.05% of GDP
3. **Type of transaction** – changes in the composition of the public sector balance sheet will be treated as one-offs (asset sales, revaluation gains, etc.)
4. **Sign of the budgetary impact** – more strict treatment of measures decreasing the deficit compared to transactions with negative impact
5. **Consistency** – same treatment across time

Principles for Identifying One-Offs (2)

6. **Legal power** – constitutional acts are more likely to be permanent
7. **Implicit and contingent liabilities** – transaction with no impact on the intertemporal budgetary position will be treated as one-offs
8. **Capital expenditures** – permanent measures as a rule
9. **Accrual treatment** – time of transaction is more important than the cash-flow
10. **Political risk** – careful examination of measures adopted at the end of the election cycle (transferring burden to the next government)

Conclusions

- Real-time numerical evaluation of structural balances is extremely difficult
- Policy makers need more robust estimates
- The current methodology is not ready for the new fiscal framework





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Thank you for Your attention!