

Post-COVID Economy and Society

Post-Pandemic Fiscal Policy

ESRI International Conference

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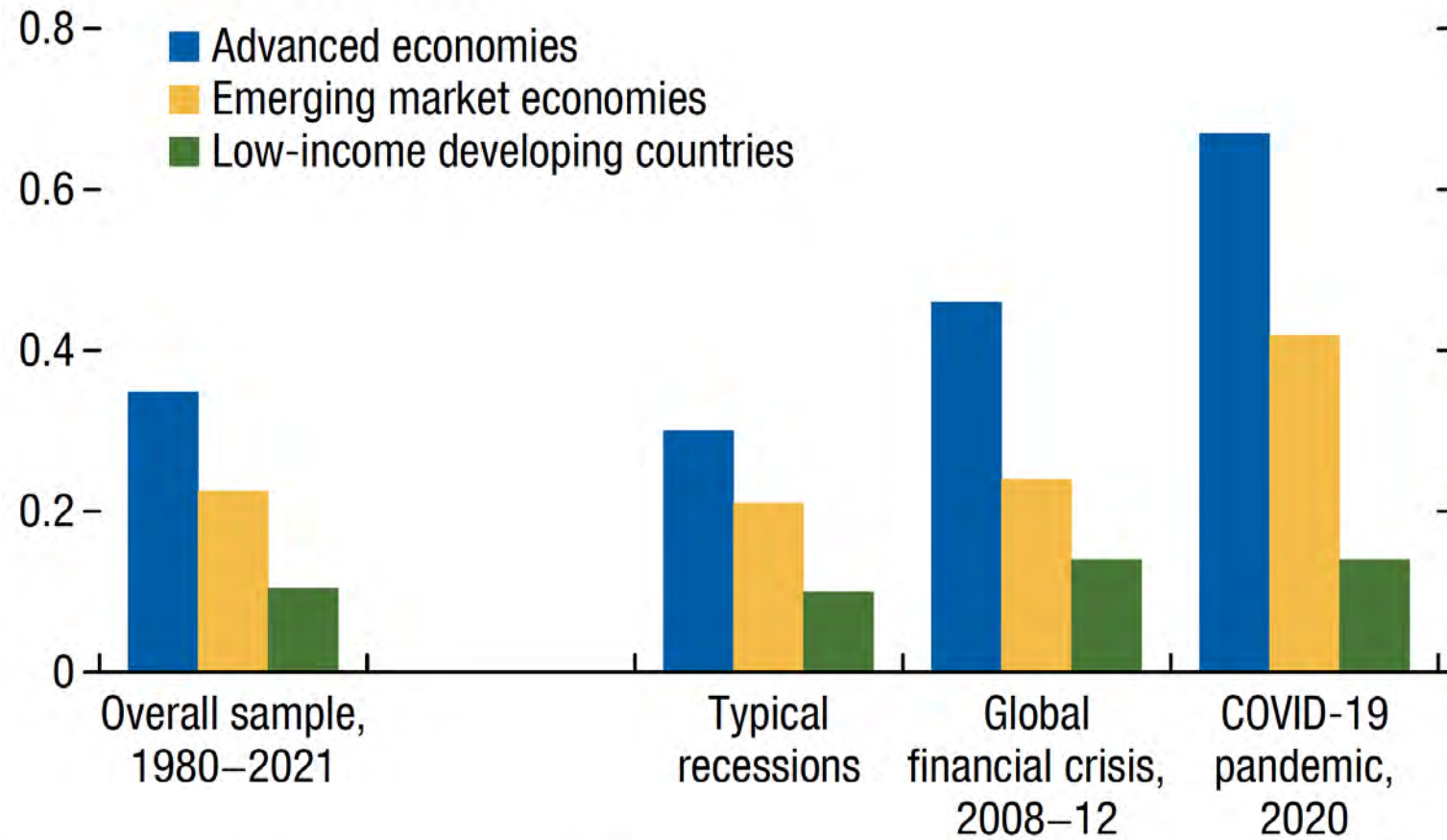
Questions for this session

Government debts around the world have notably increased during the pandemic

- *What should each government do to restore the fiscal health?*
- *How fast should they deal with this?*

Figure 1.2. Fiscal Responses in Large Crises

(Estimated coefficients)



Source: IMF staff estimates (see Online Annex 1.1).

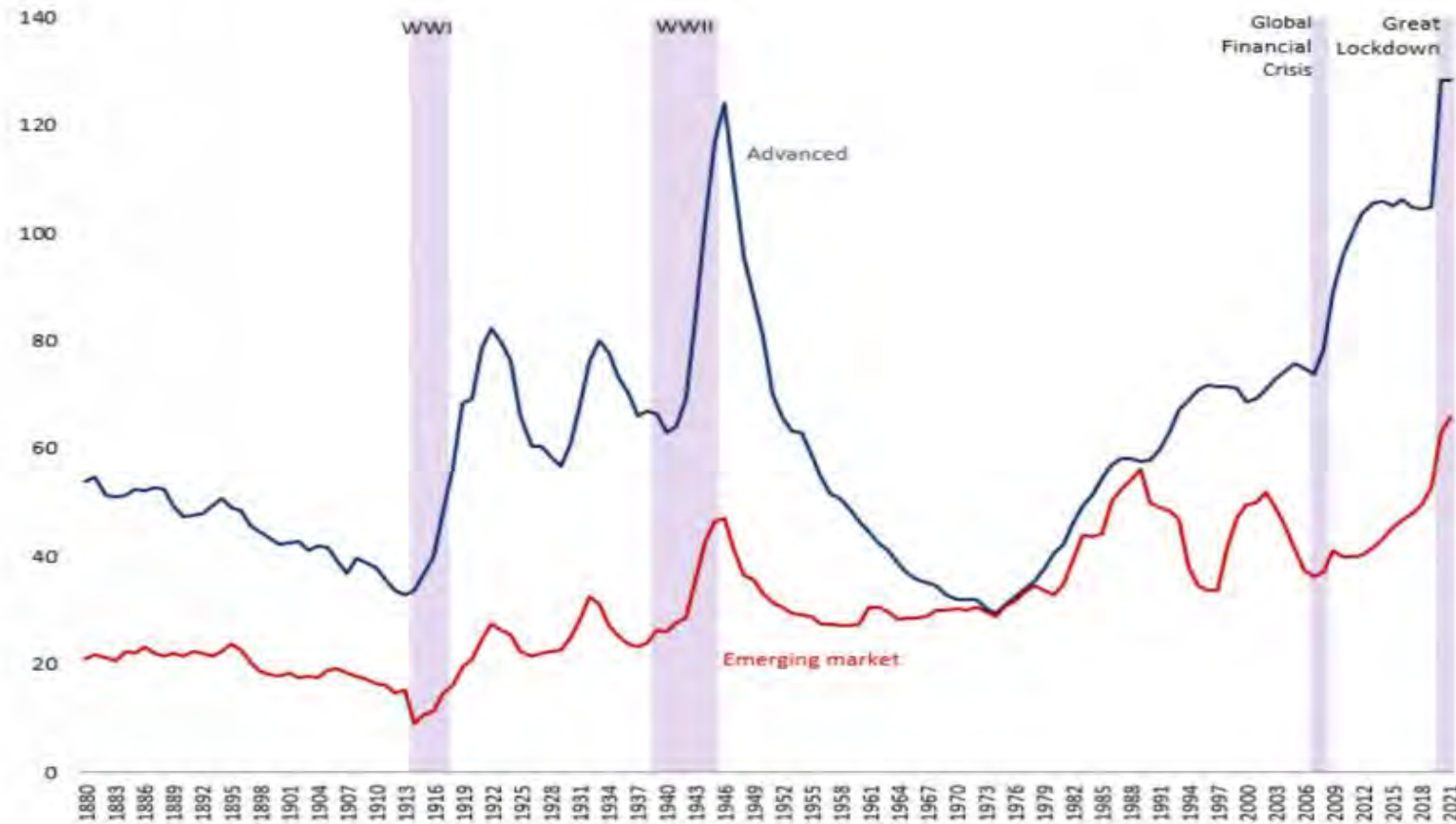
This figure is taken from IMF Fiscal Monitor Oct. 2022

Note: The figure shows the average of time-varying coefficients by country income groups, based on panel regressions estimated on the sensitivity to GDP growth of the deficit-to-GDP ratio from 1980 to 2021. Typical recessions are defined as periods when individual countries' growth rates are below their own average levels over the previous three years.

Soaring public debt

Global public debt is projected to reach 101.5 percent of global GDP in 2020 – the highest level ever.

(percent of GDP)

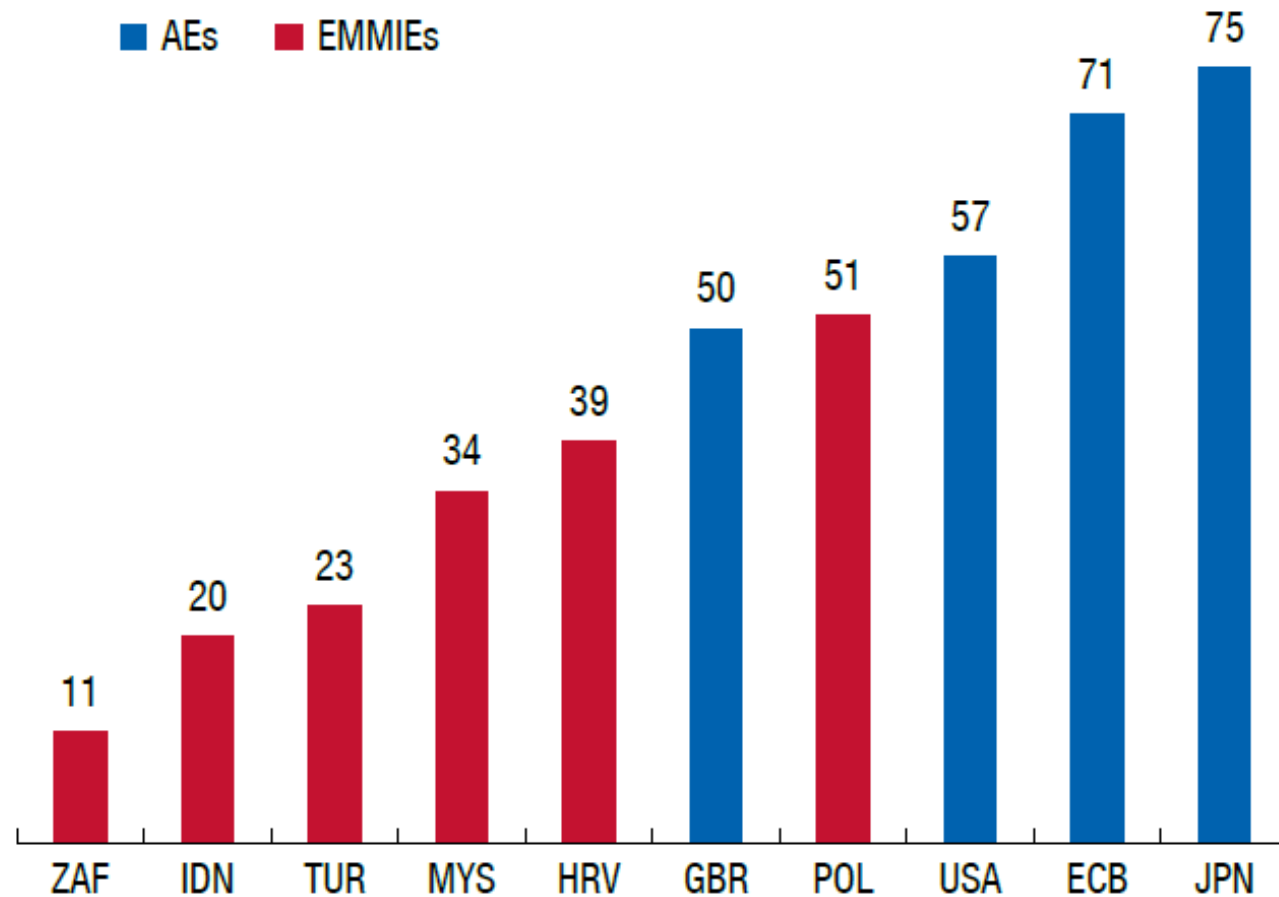


Sources: Historical Public Debt Database, IMF WEO, Maddison Database Project; and IMF staff calculations.

Note: The aggregate public debt-to-GDP series for advanced and emerging market economies is based on debt-to-GDP data for a constant sample of 25 countries and 27 countries, respectively. The averages are calculated using weights derived from GDP in PPP terms.

This figure is taken from the IMF blog

Figure 1.3. Central Bank Purchases of Government Debt
(Percent of central government marketable securities or debt issued since February 2020)



Government bonds that financed large fiscal supports were purchased by the central banks

Sources: Country authorities; US Federal Reserve Economic Data; Haver Analytics; and IMF staff calculations.

Note: Data labels use International Organization for Standardization country codes.

AEs = advanced economies; EMMIEs = emerging market and middle-income economies.

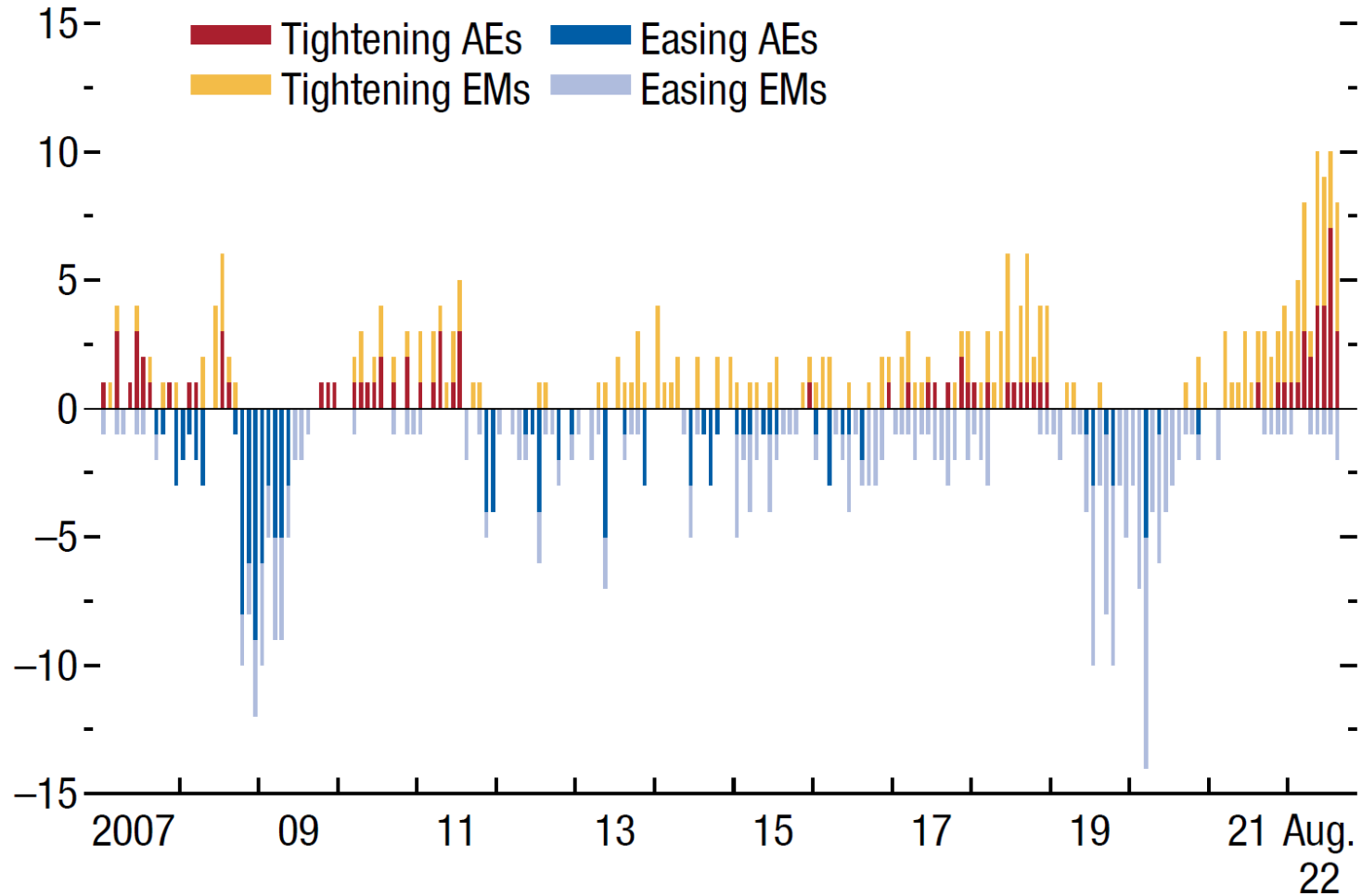
This figure is taken from IMF Fiscal Monitor Oct. 2020

Figure 1.2. Change in Monetary Policy Cycle among G20 Economies

Economies

This figure is taken from IMF WEO Oct. 2022

(Number of increases and cuts in policy rates)



This figure is taken from IMF WEO Oct. 2022

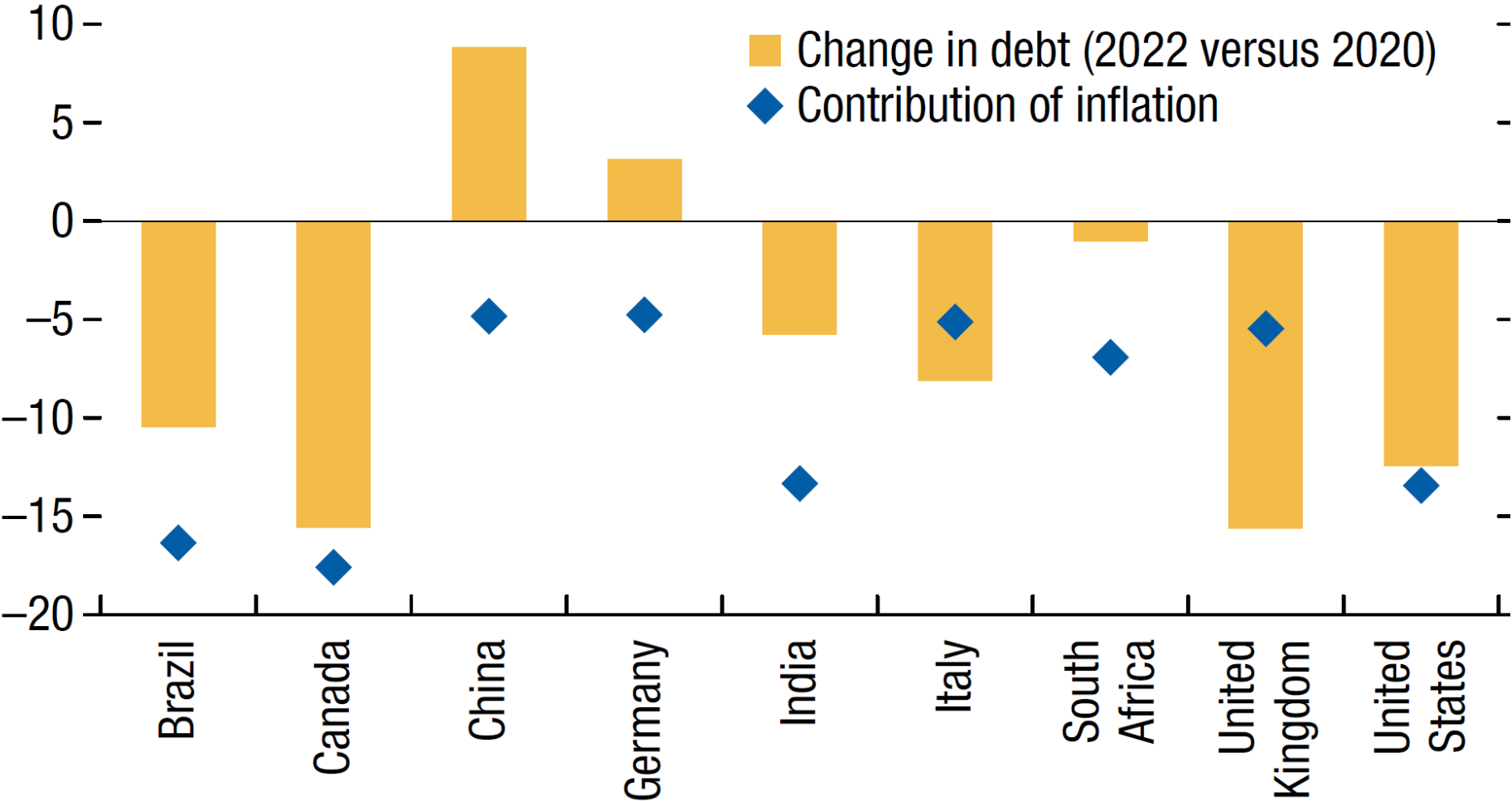
Sources: Bloomberg Finance L.P.; and IMF staff calculations.

Note: AEs = advanced economies; EMs = emerging market economies.

Figure ES.3. Effect of Inflation Shock on the Debt Ratio, Selected Countries, 2022 versus 2020

(Percent of GDP)

This figure is taken from IMF WEO Oct. 2022

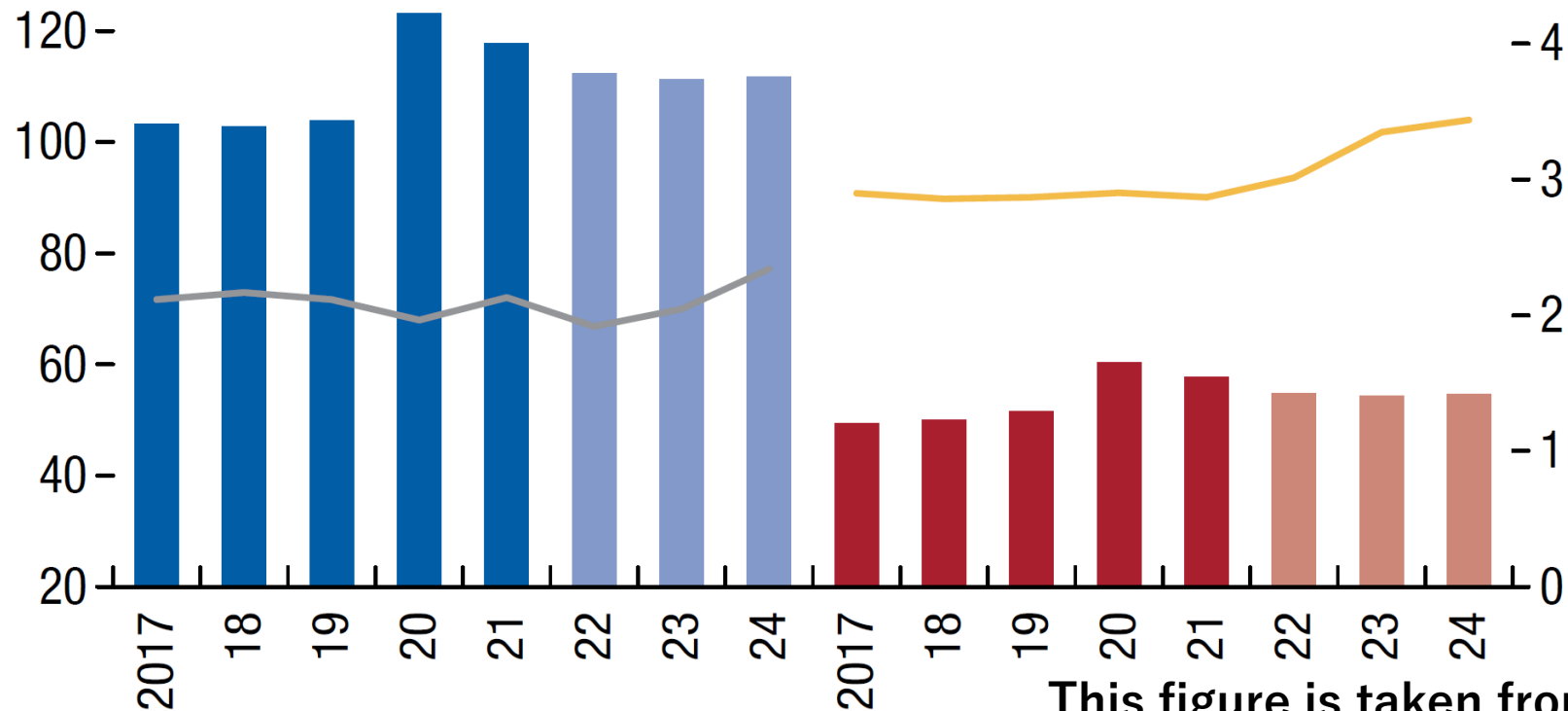


This figure is taken from IMF Fiscal Monitor Oct. 2022

Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Figure ES.2. National Gross Debt and Interest Expense, by Income Group, 2014–24
(Percent of GDP, weighted averages)

- Debt-to-GDP ratio, advanced economies (left scale)
- Debt-to-GDP ratio, emerging market and developing economies (left scale)
- Interest expense, advanced economies (right scale)
- Interest expense, emerging market and developing economies (right scale)



This figure is taken from IMF Fiscal Monitor Oct. 2022

Sources: IMF, World Economic Outlook; and IMF staff calculations.

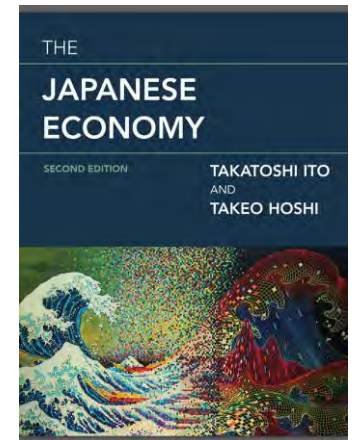
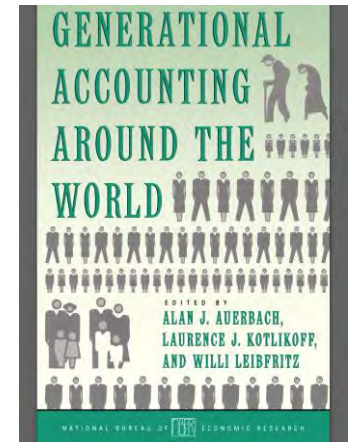
Note: China is excluded. Bars for 2022–24 are projected data.

Fiscal health in the post-COVID era

- Inequality
 - Globally important problem
- Debt sustainability
 - Higher borrowing cost in developing countries
 - Challenges in debt restructuring in low-income countries
- Fiscal-monetary interactions
 - Weakened interactions with recent policy rate hikes
- Japanese current situation is very different from the rest of the world
 - The above two issues
 - Intergenerational inequality

Existing Japanese studies

- Prominent scholars have already analyzed fiscal health and debt sustainability
- For example,
 - Auerbach's fiscal-gap and generational accounting
 - Takayama, Kitamura, and Yoshida (1999) pointed out that already a lot of burden had shifted to the young in the 90s.
 - Broda and Weinstein (2005), Doi, Hoshi, and Okimoto (JJIE, 2011), Hoshi and Ito's Japanese economy book and paper (Economic Policy, 2014) etc.
 - Japanese government debt is not sustainable unless the tax rate is very high (30-more than 40%)
- My discussion focuses on debt sustainability in a prolonged low interest rate environments

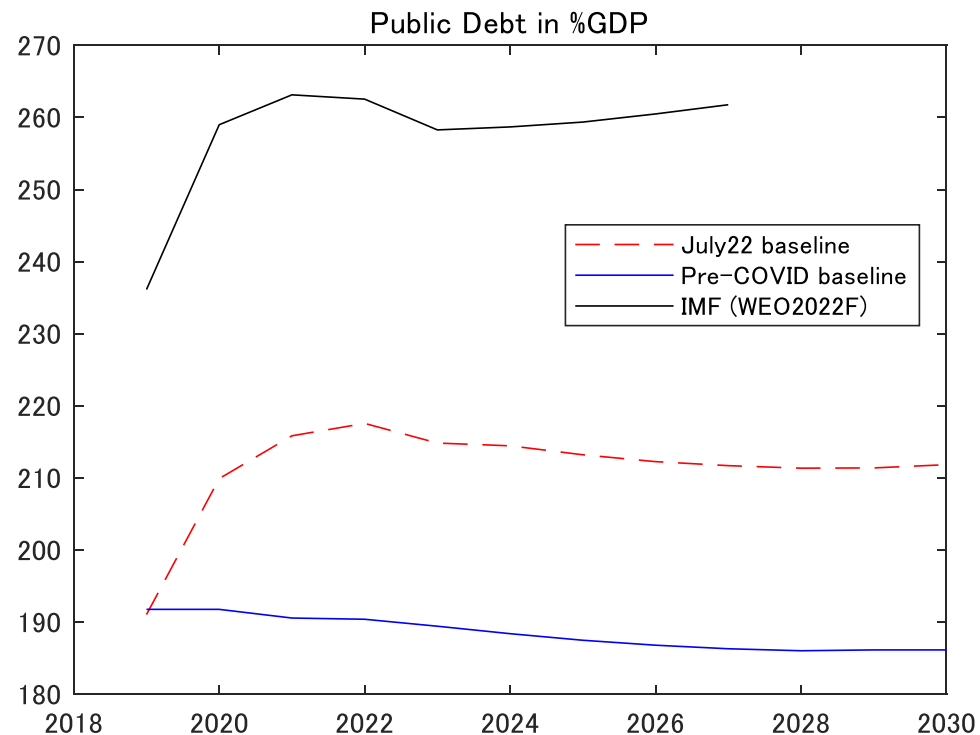


*What should each government do to
restore the fiscal health?*

*Fiscal consolidations are unavoidable for
low growth aging economies like Japan*

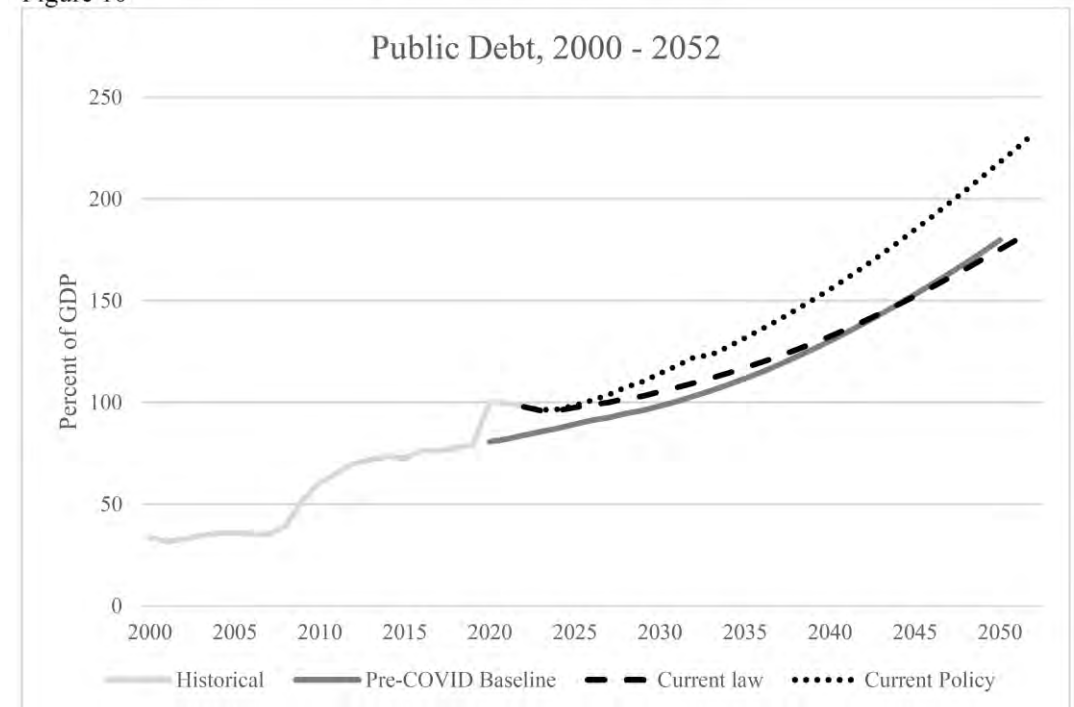
*Can an independent fiscal institution help
to restore fiscal health?*

Managing exceptionally large debt is a heavy burden



JPN: Cabinet office of Japan (CAO) or IMF projections

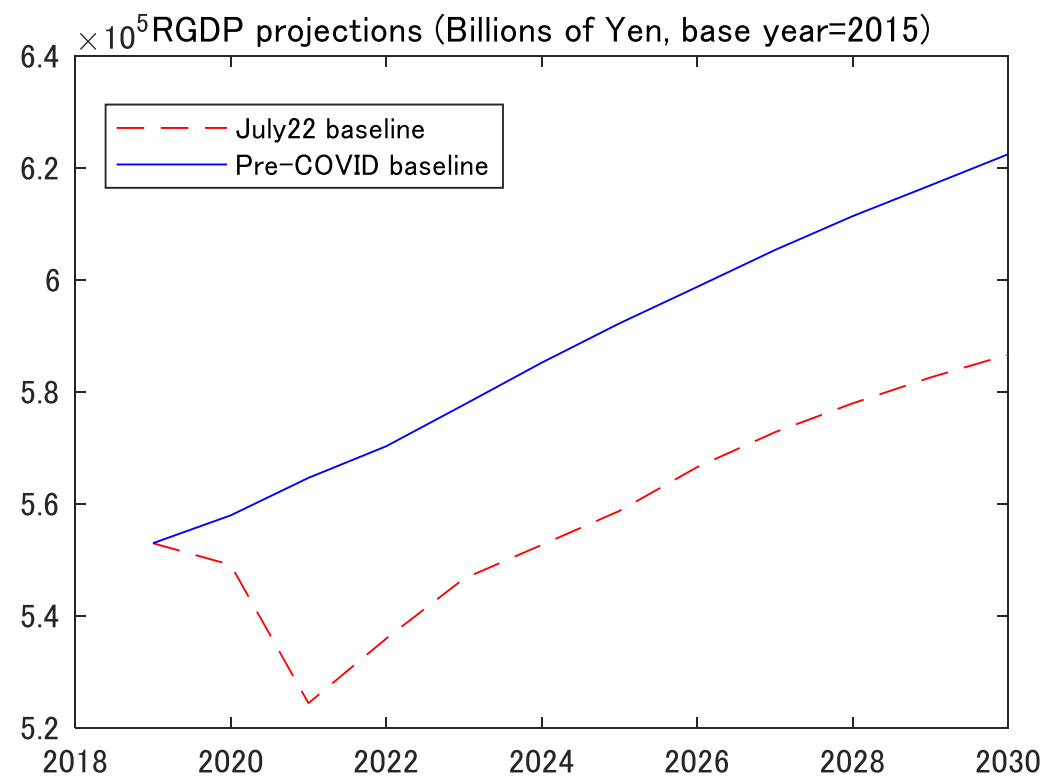
Figure 10



Source: CBO (2020a, 2022) and authors' calculations

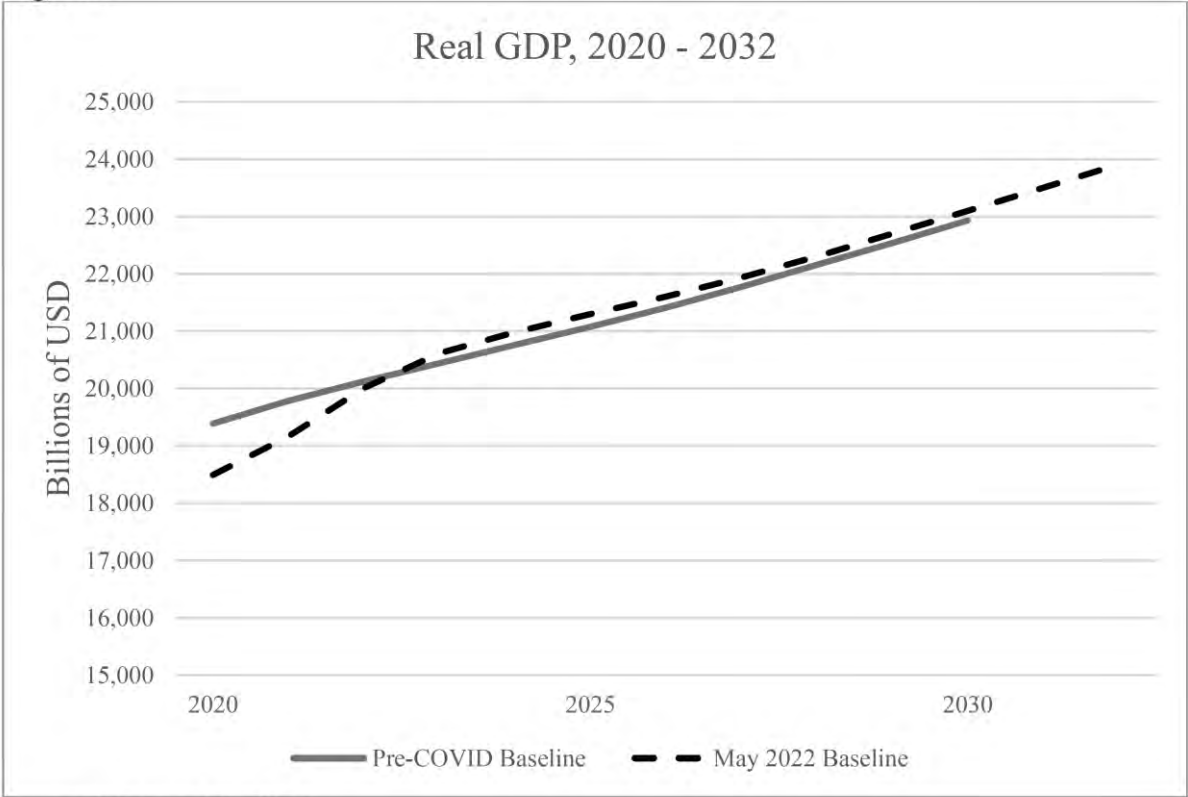
US: Auerback and Gale (2022)

Japan cannot count on strong economic growth to improve fiscal health



JPN: CAO projections

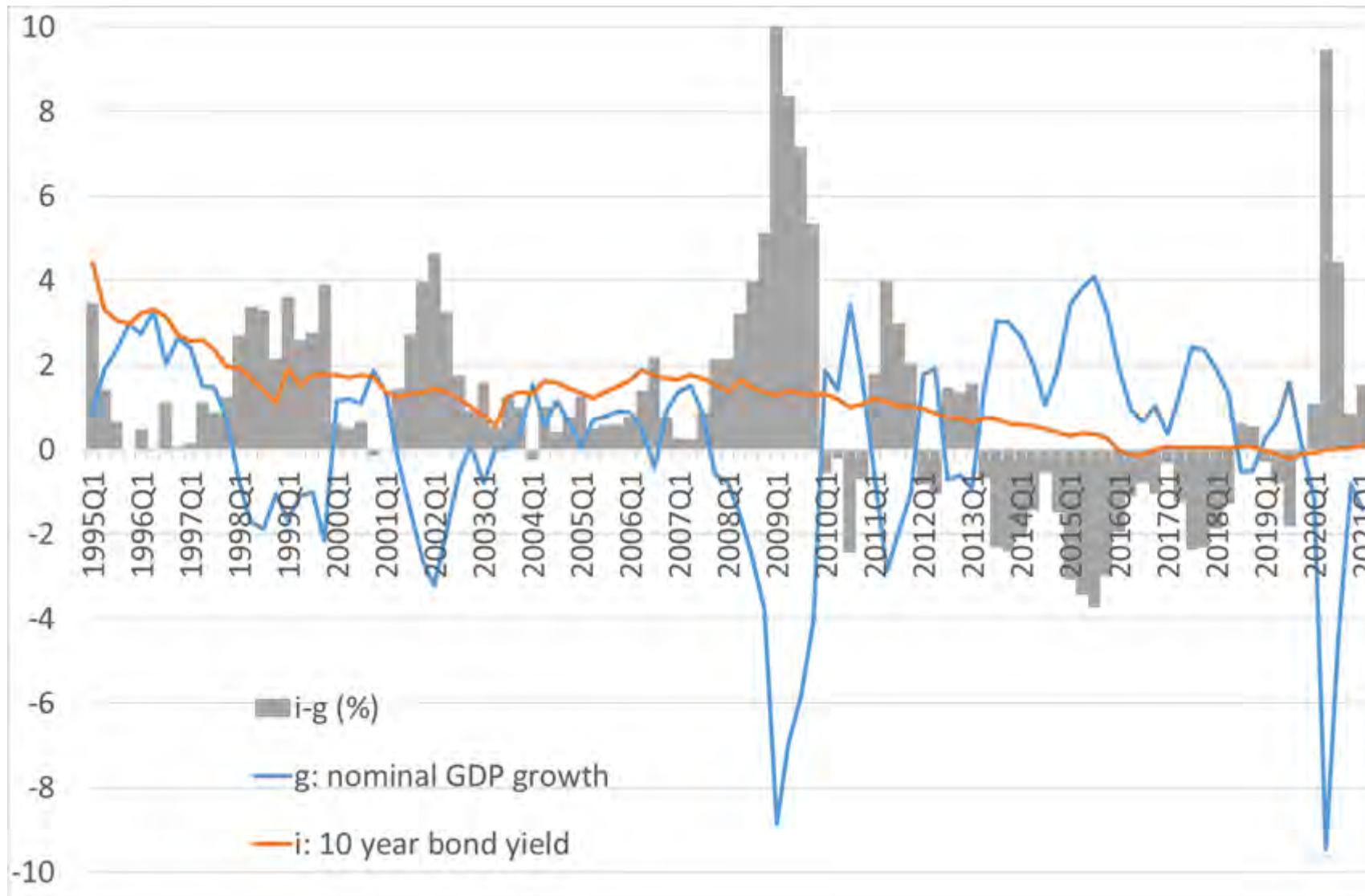
Figure 1



Source: CBO (2020a, 2022)

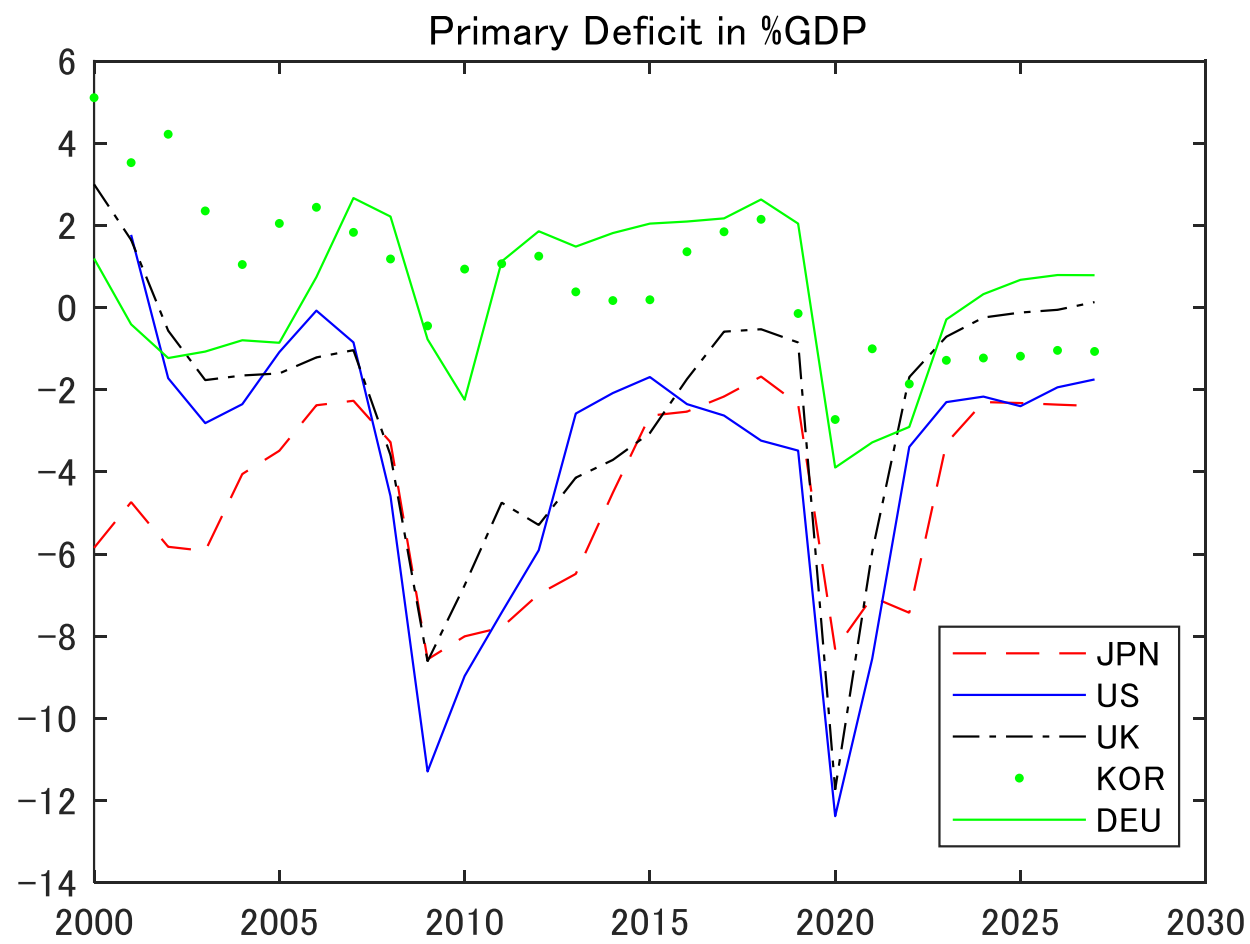
US: Auerback and Gale (2022)

“i-g” is not stably negative with weak output growth in Japan



Prepared using the following data sources: Cabinet office Japan, OECD

Large discretionary expenditures followed by delayed fiscal contractions in Japan

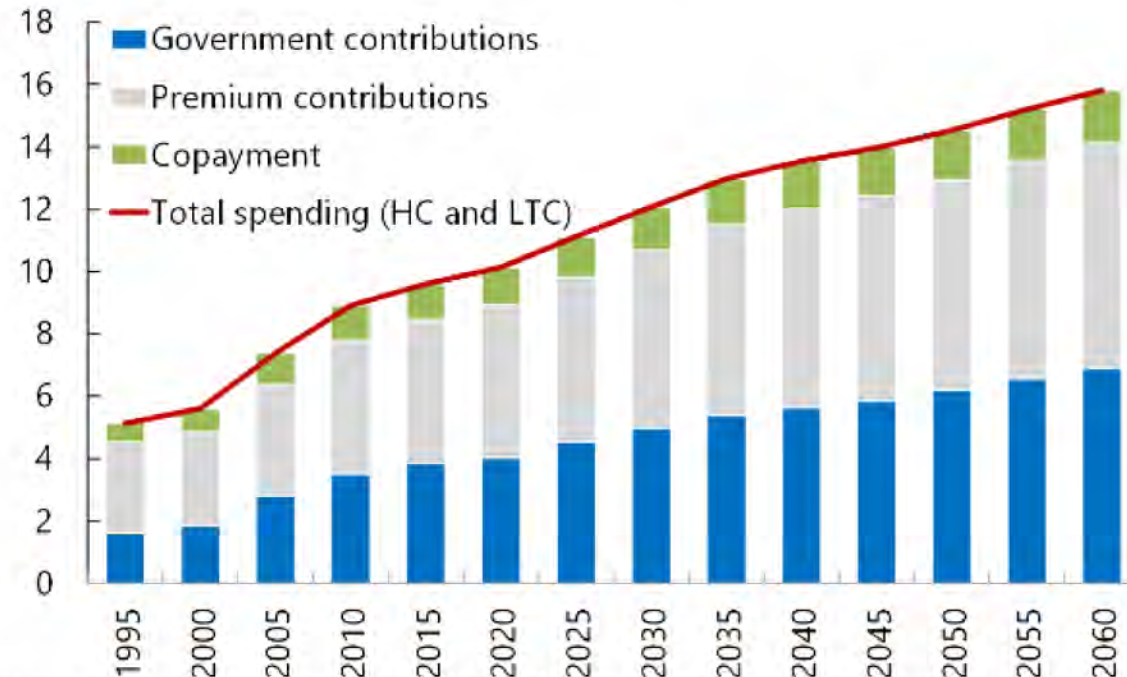


Source: IMF WEO Oct. 2022 database

Aging continues to put upward pressure on social security spending

Financing of Health Care and Long-Term Care

(In percent of GDP)



Sources: Ministry of Health, Labor, and Welfare; IMF World Economic Outlook database; and IMF staff estimates.

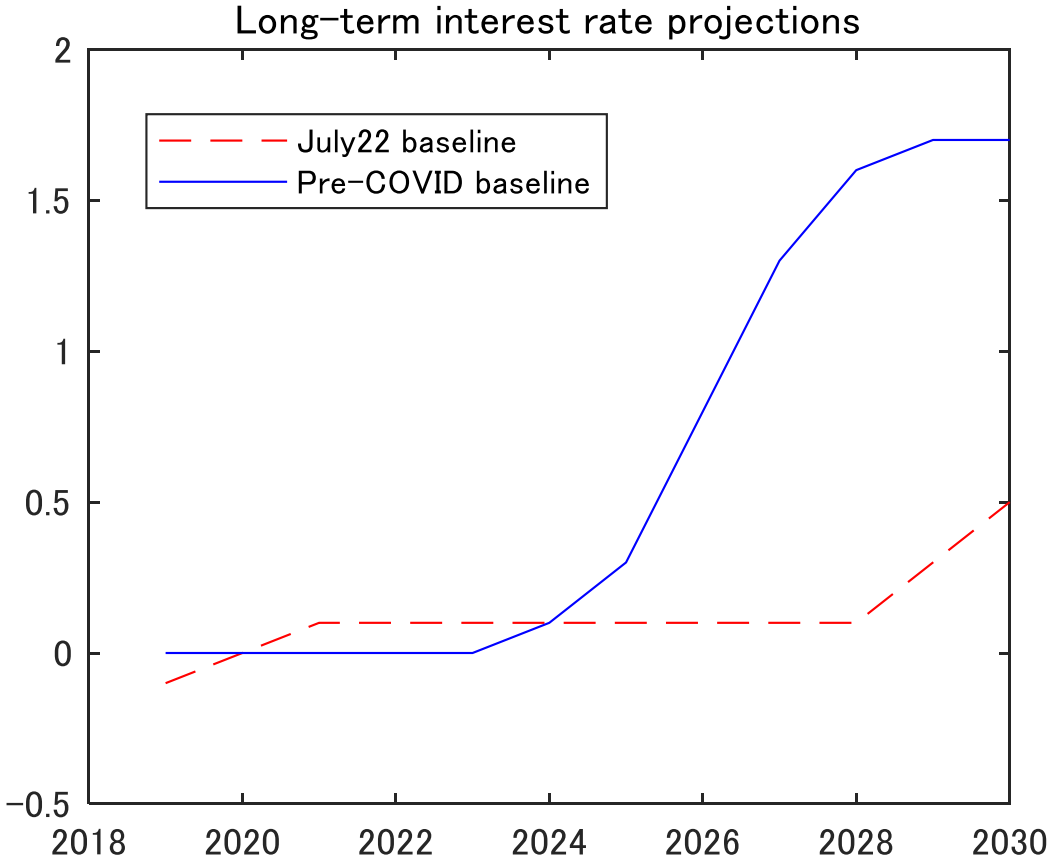
This figure is taken from IMF 2020 Art4 report on Japan

How fast should governments deal with restoring fiscal health?

It depends on the path of interest rates but too low for too long can have unintended consequences

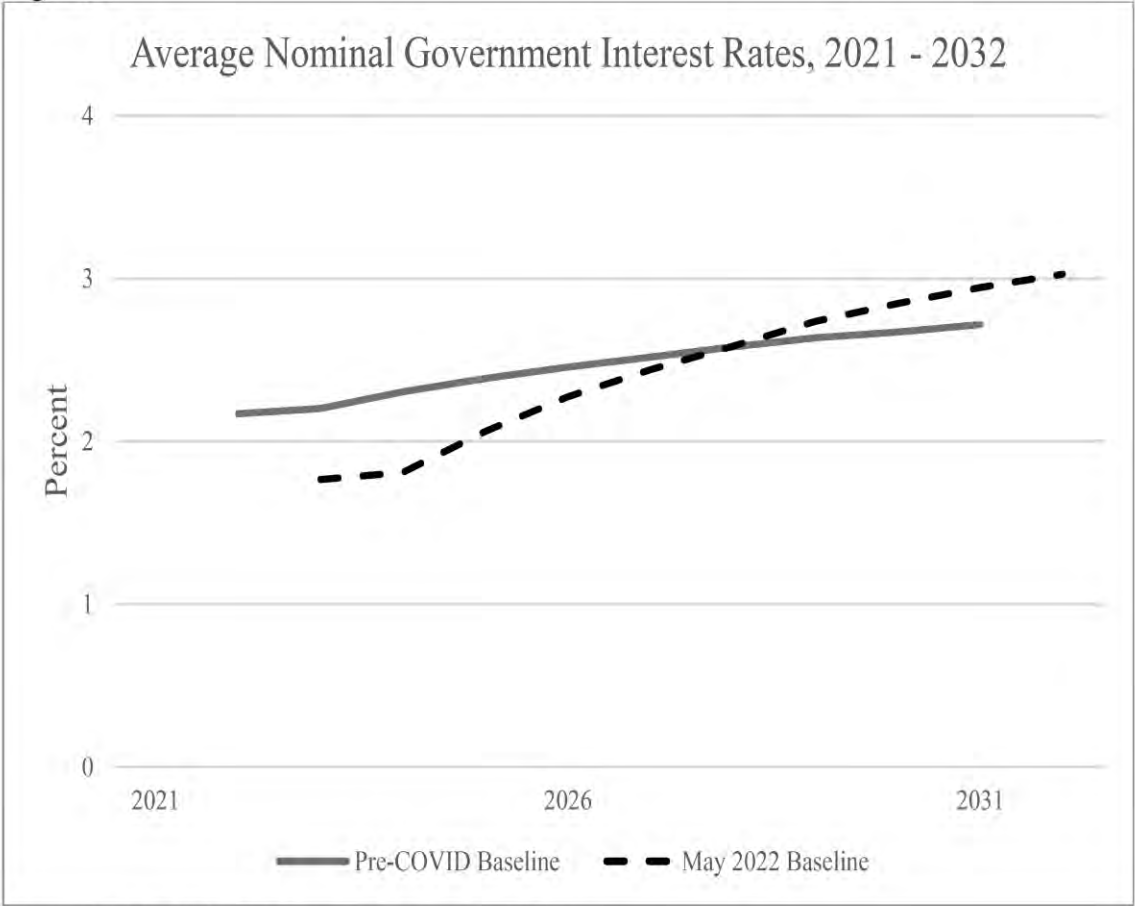
Need to watch out for signals from the government bond data

Nominal long-term nominal interest rate is a policy variable in Japan



JPN: CAO projections

Figure 2

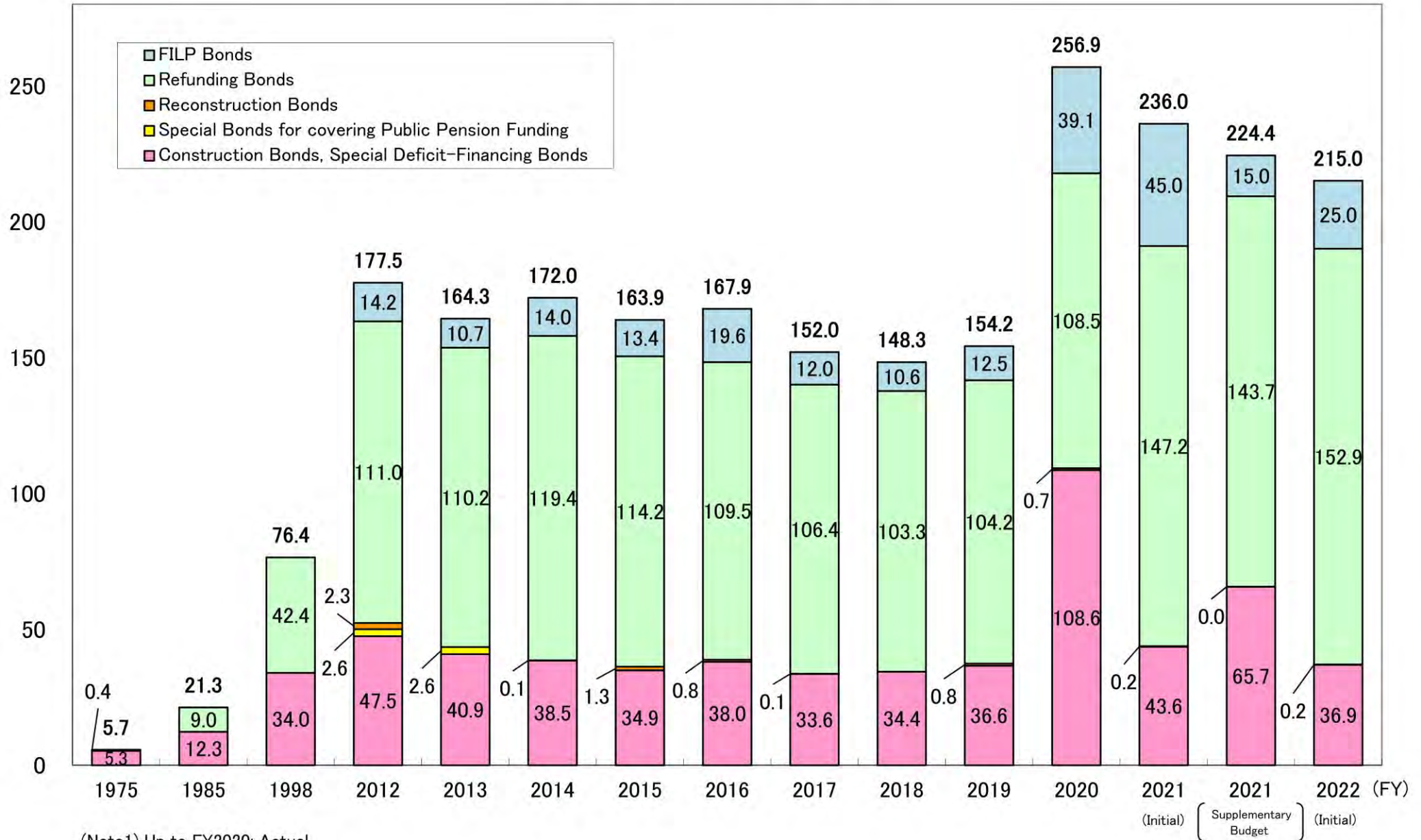


Source: CBO (2020a, 2022) and authors' calculations

US: Auerback and Gale (2022)

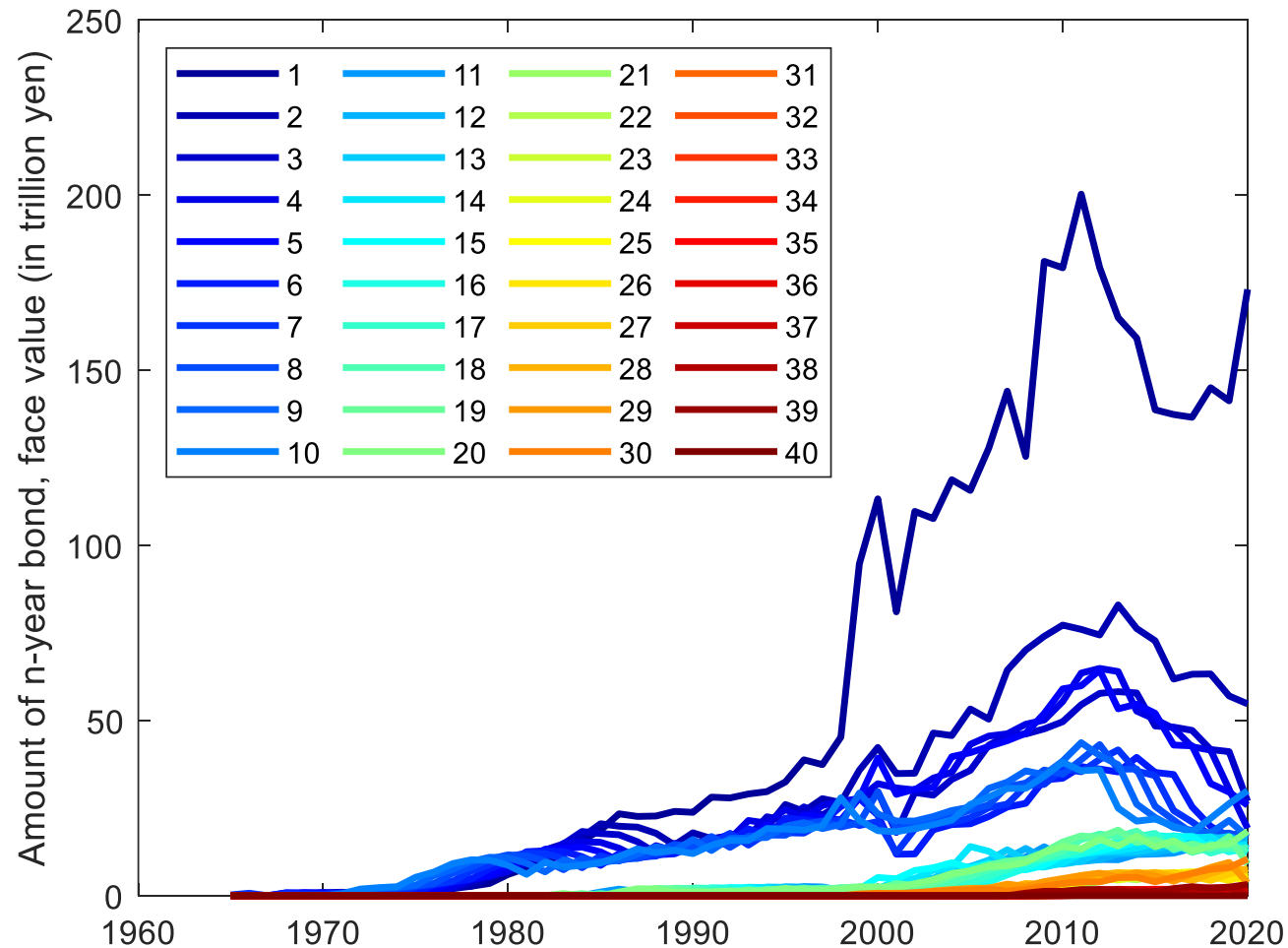
JGB Issuance Plan

(trillion yen)



Source: MOF, Japan

Managing large rollovers can be a challenging task going forward



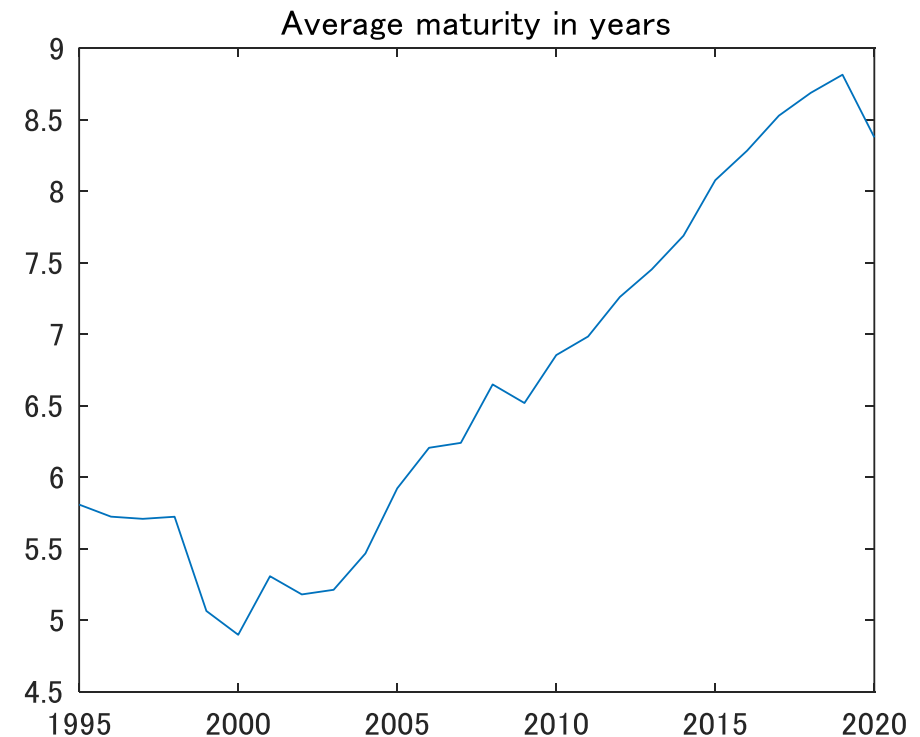
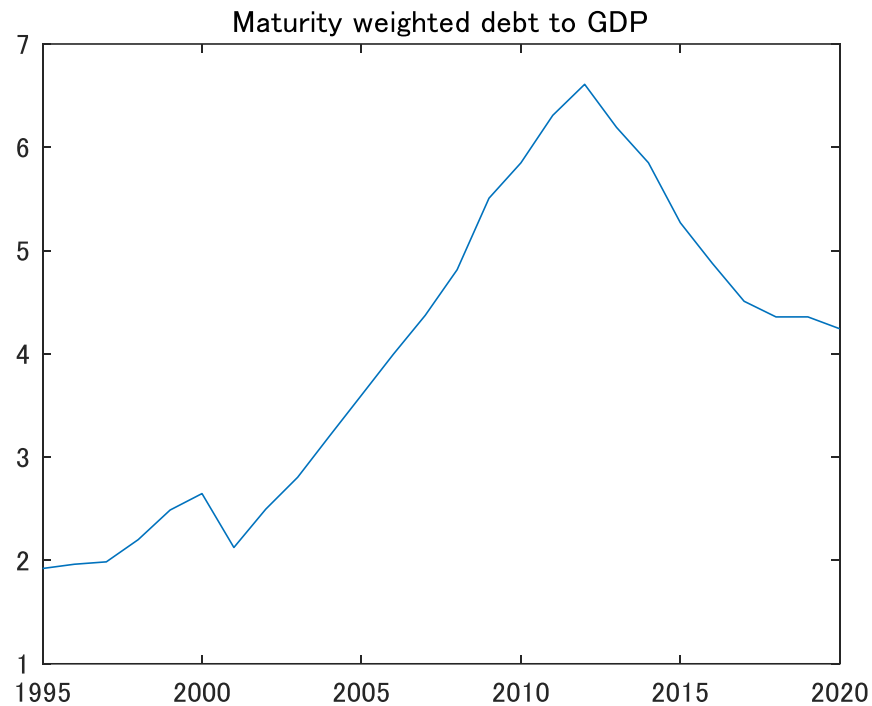
Numbers in the legend are remaining maturity in years

End of fiscal year (end-March) values

Figure 4. Marketable bond outstanding excluding BOJ holdings by maturity.

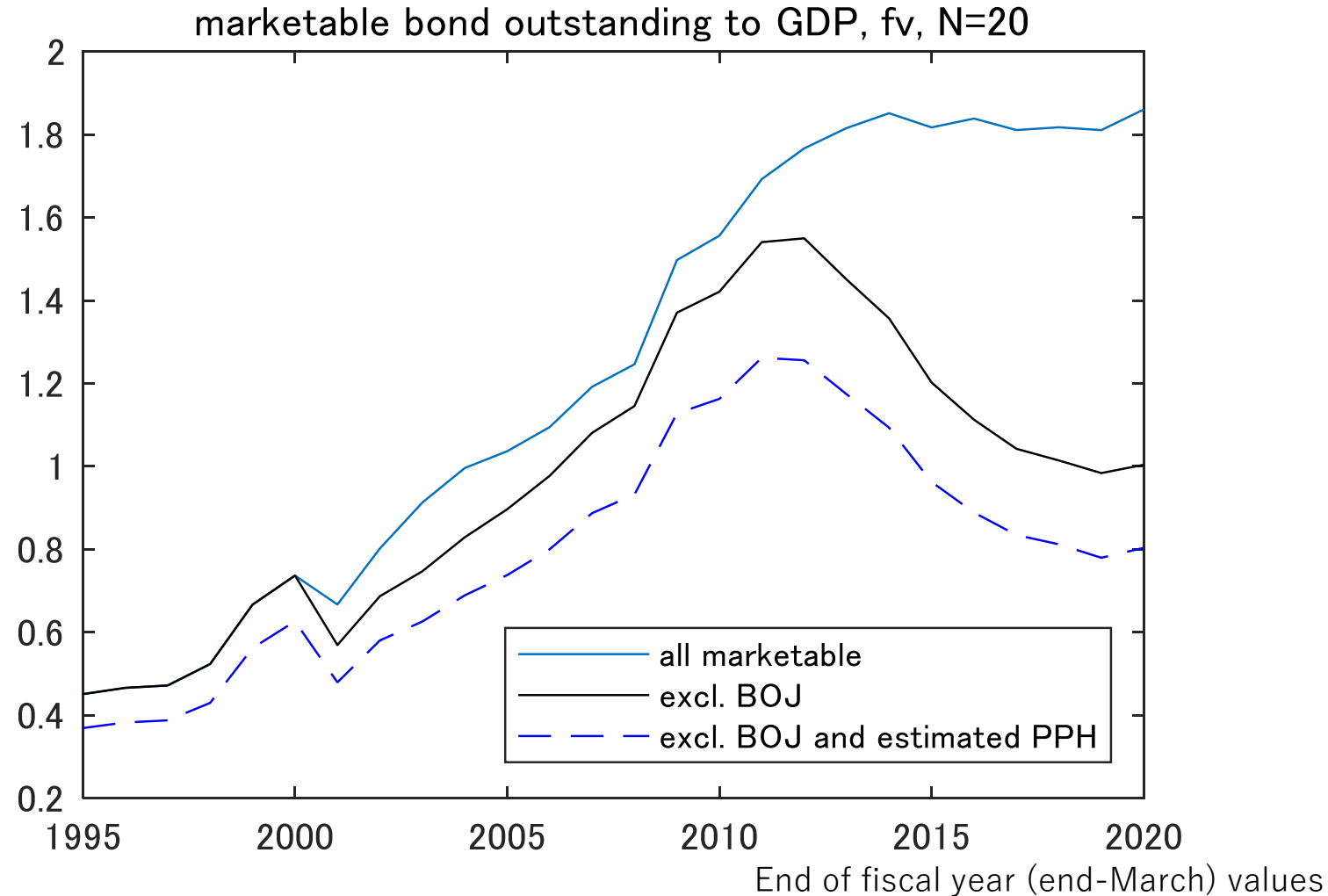
Source: Koeda and Kimura (2022) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4015576

A net bond supply factor (maturity weighted debt to GDP) has declined in the past decade despite the increase in the average maturity



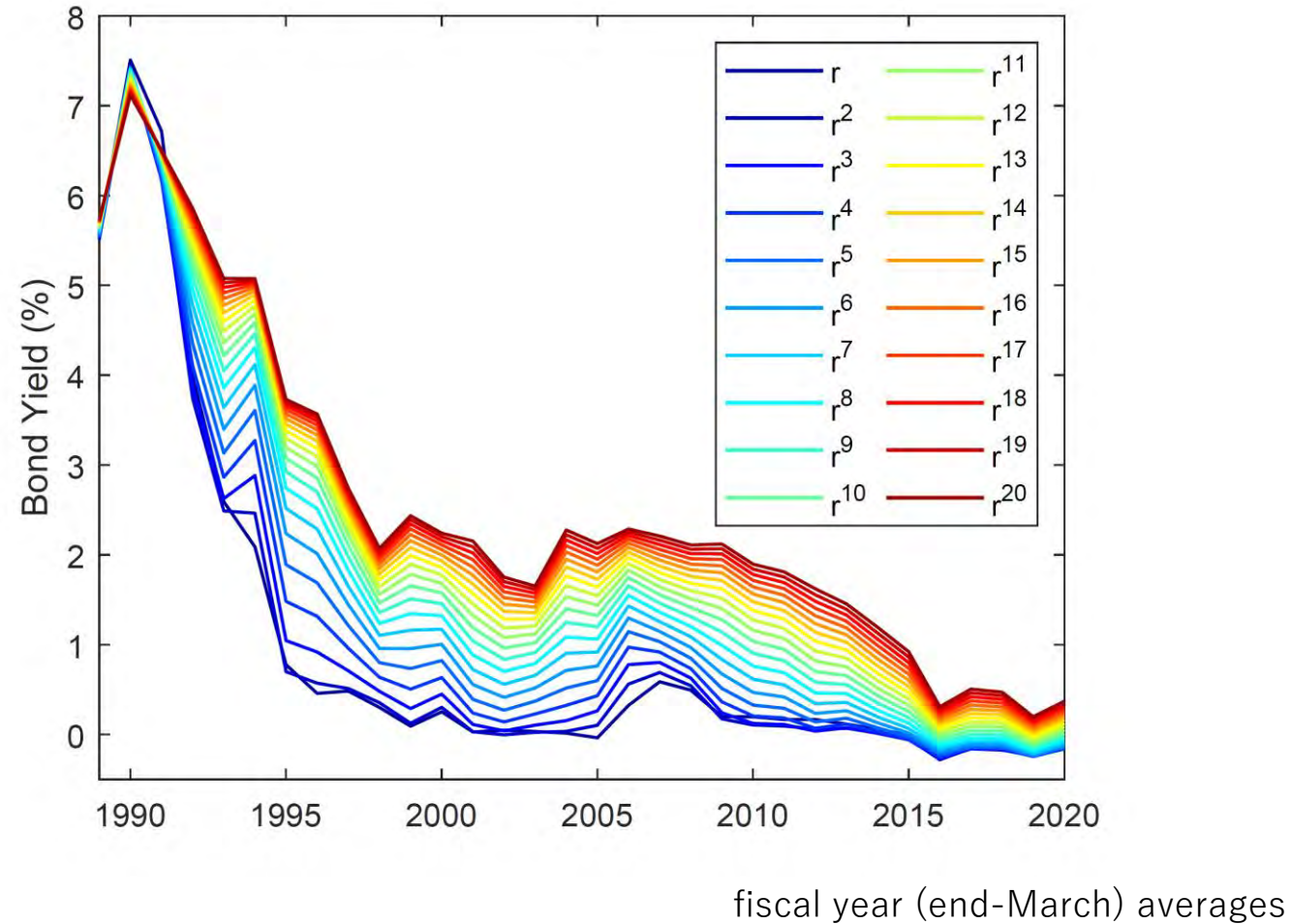
End of fiscal year (end-March) values
Data source: Koeda and Kimura (2022)

With the BOJ's large bond purchases



PPH: Private preferred habitat investors, N: max maturity in years, fv: face value
Data source: Koeda and Kimura (2022)

As a result, long-term interest rates have declined in the past decade



Source: Bloomberg

A preferred habitat view of Japanese government bond markets

Government

Koeda and Ueno (2022)—an extension of Vayanos and Vila (2021, Econometrica)
https://www.boj.or.jp/en/research/wps_rev/wps_2022/wp22e07.htm/

Bond supply



Arbitrageurs

Bond demand

Long rate

Short rate

Central bank

Private
preferred-habitat
investors

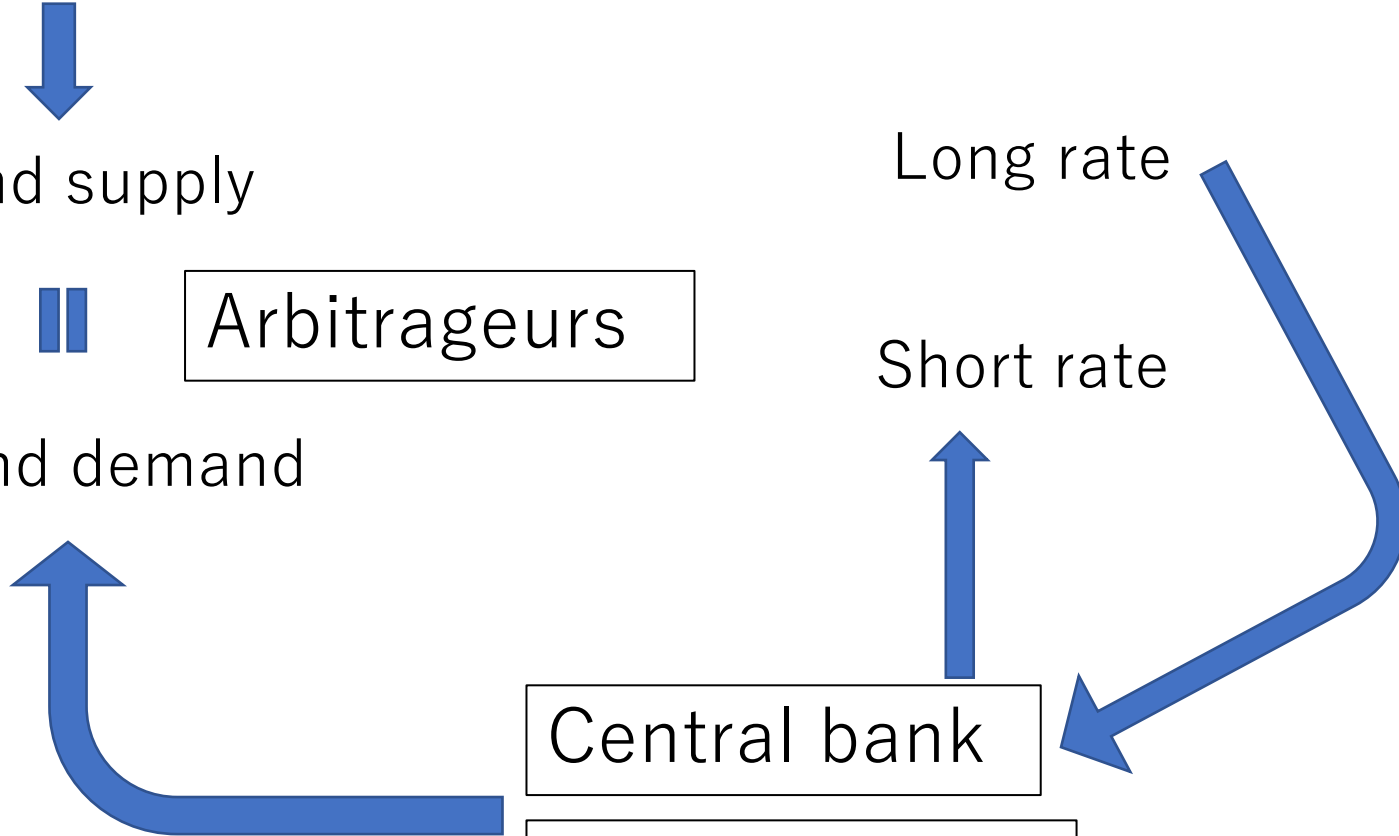
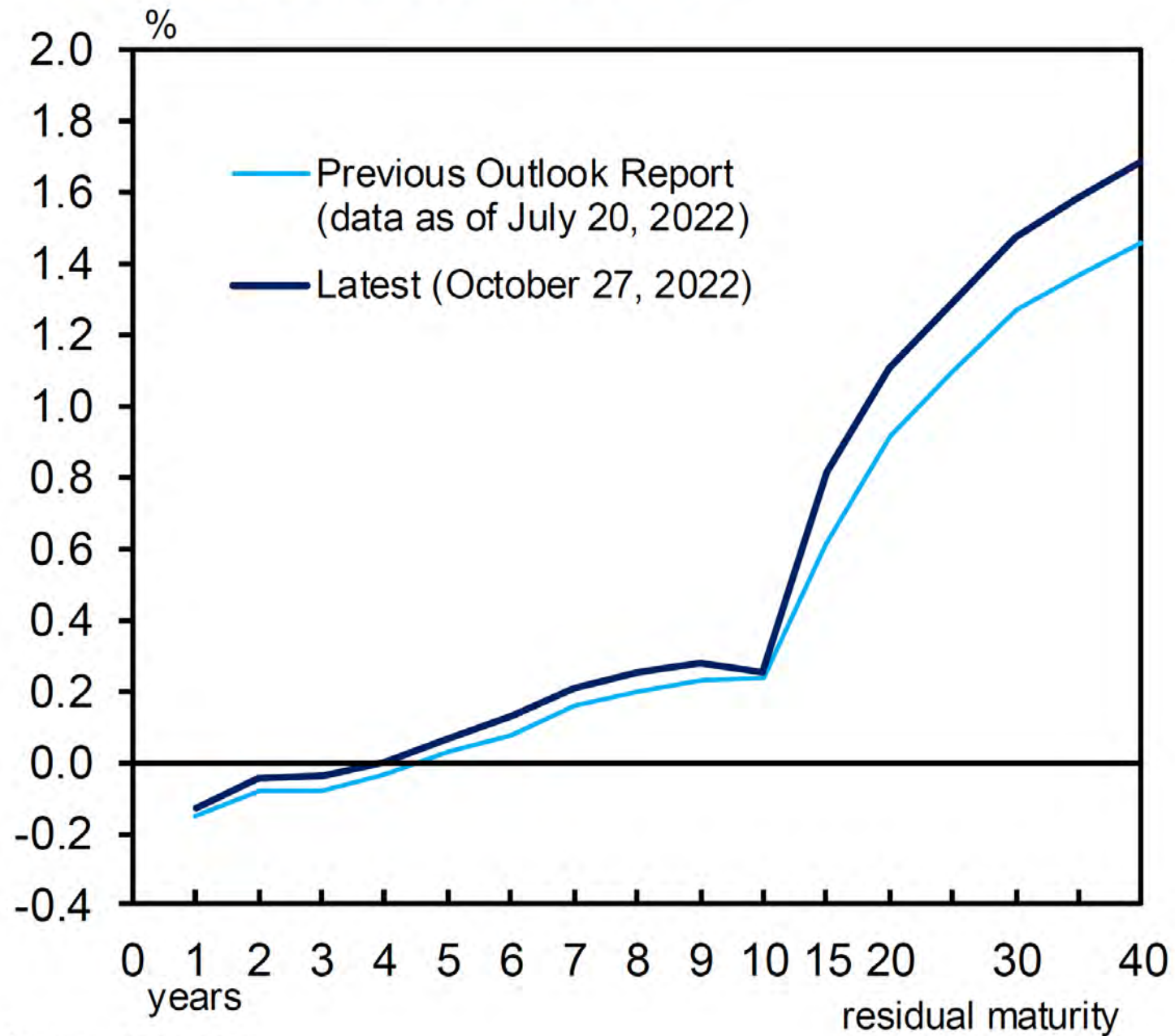


Chart 49: Yield Curves



BOJ 2022
Outlook for Economic
Activity and Prices

The trade-offs in optimal debt management

- Very large volume of short-term remaining maturity may
 - Imply large rollover risks
 - Economize term premia
- Keeping the interest rates too low for too long may
 - Accompany high rollover risks
 - Undermine the fiscal discipline
 - Amplify intergenerational inequality