

# Can deficits be self-financing?

Comments and a view from the tropics

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# Motivation

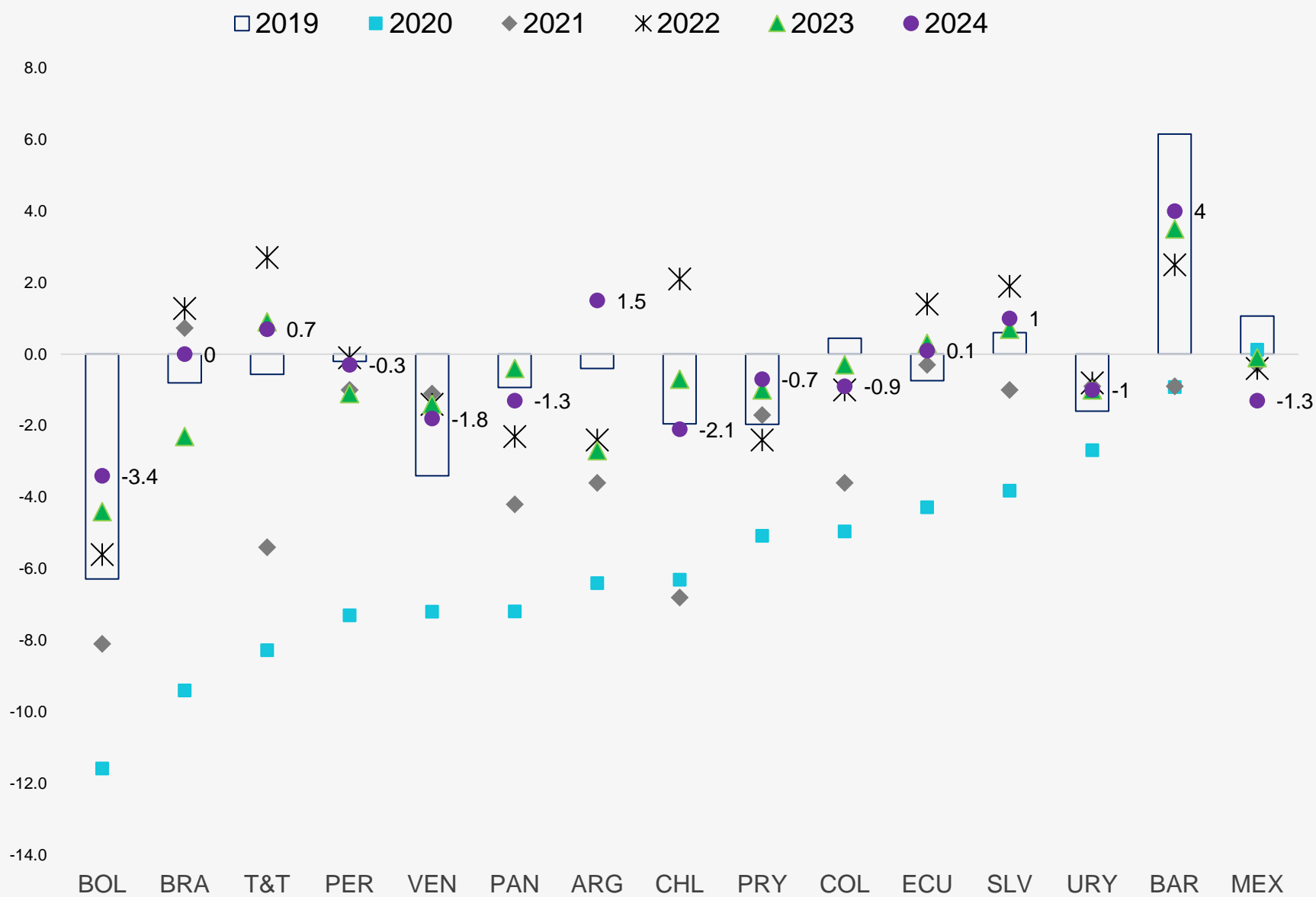
# Motivation

- The region is prone to significant shocks
- Fiscal policy is the preferred macro instrument for aggregate demand management
- Lack of fiscal space is a severe limitation
- Cost of financing makes fiscal policy pro-cyclical
- **...so, the self financing deficit idea is certainly an attractive proposition in the region...**

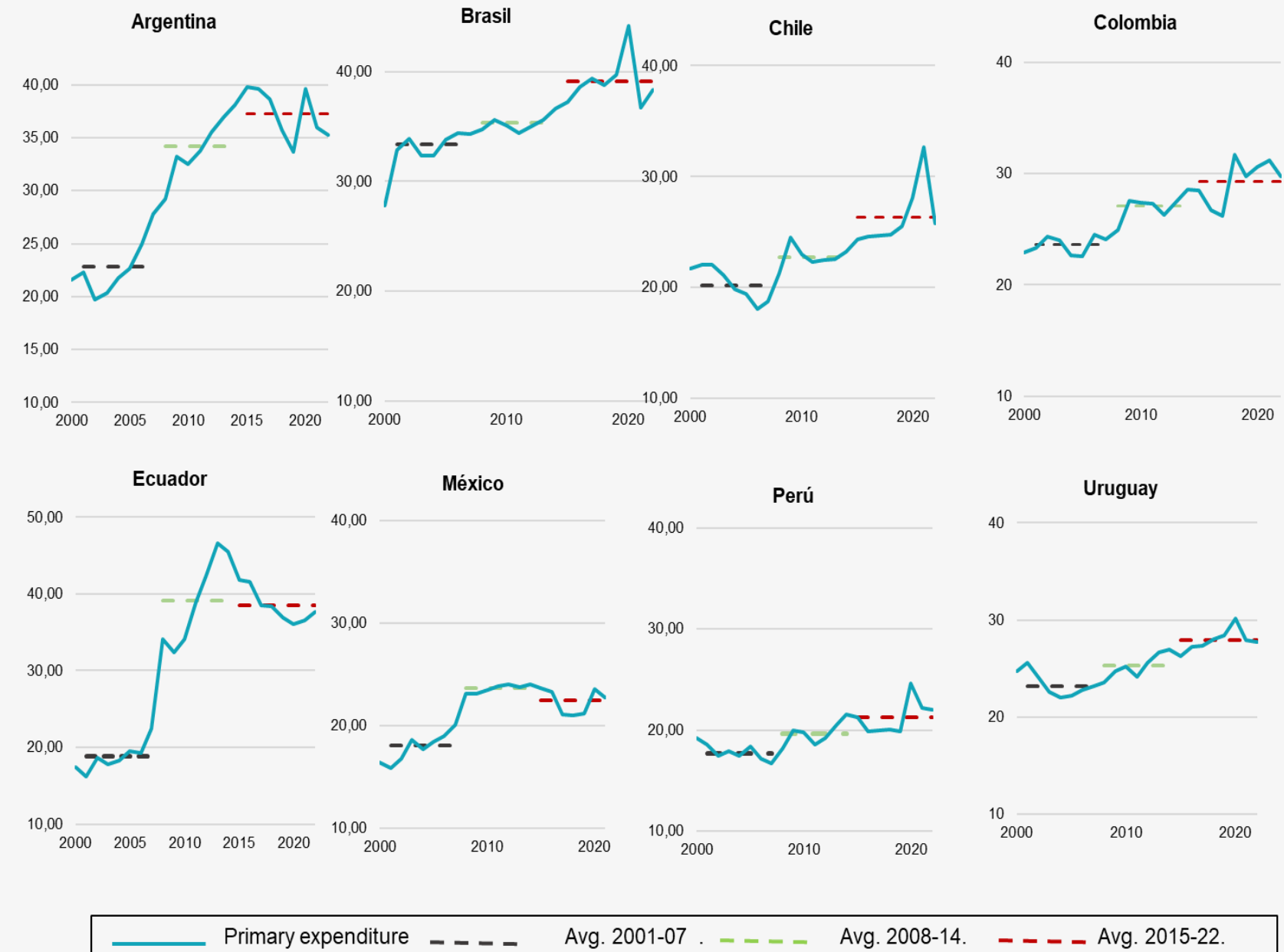
**Is it happening?**

# The COVID-19 fiscal expansion

**Latin America: Primary fiscal balance**  
(% of GDP)

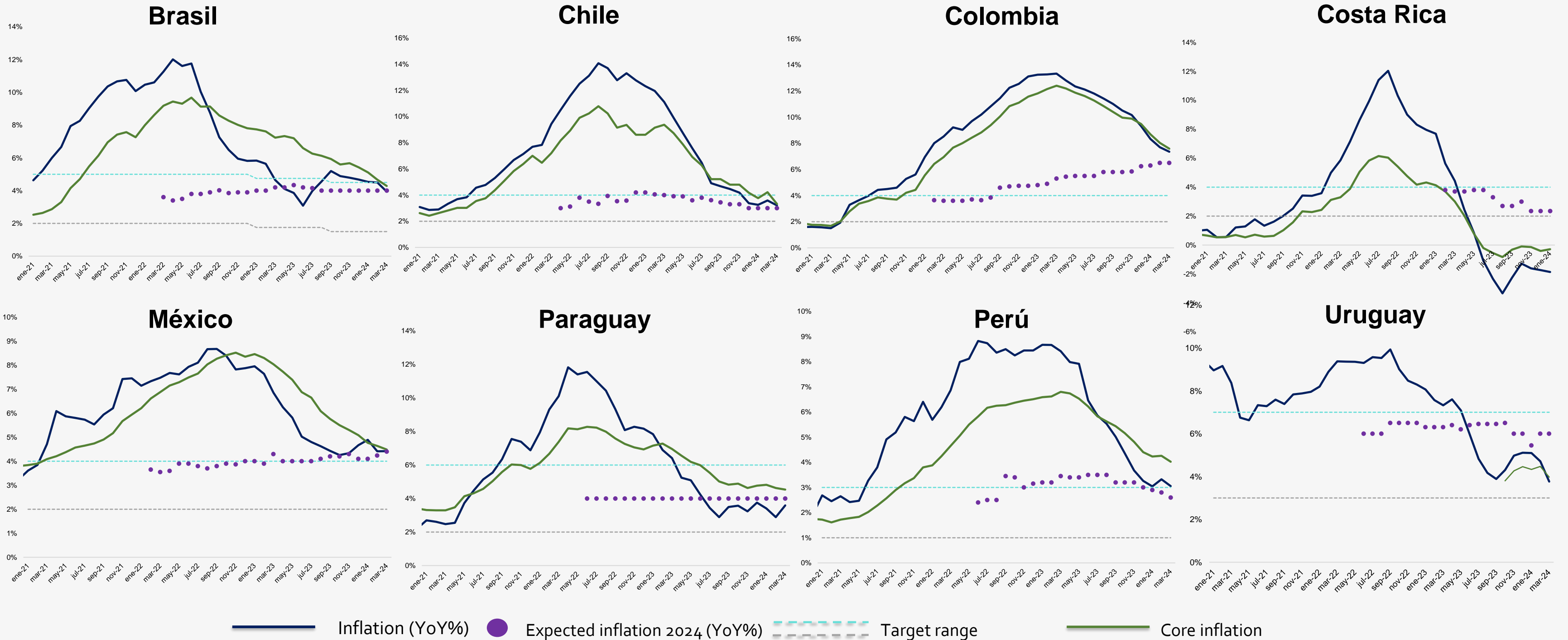


**Primary expenditure**  
(% of GDP)

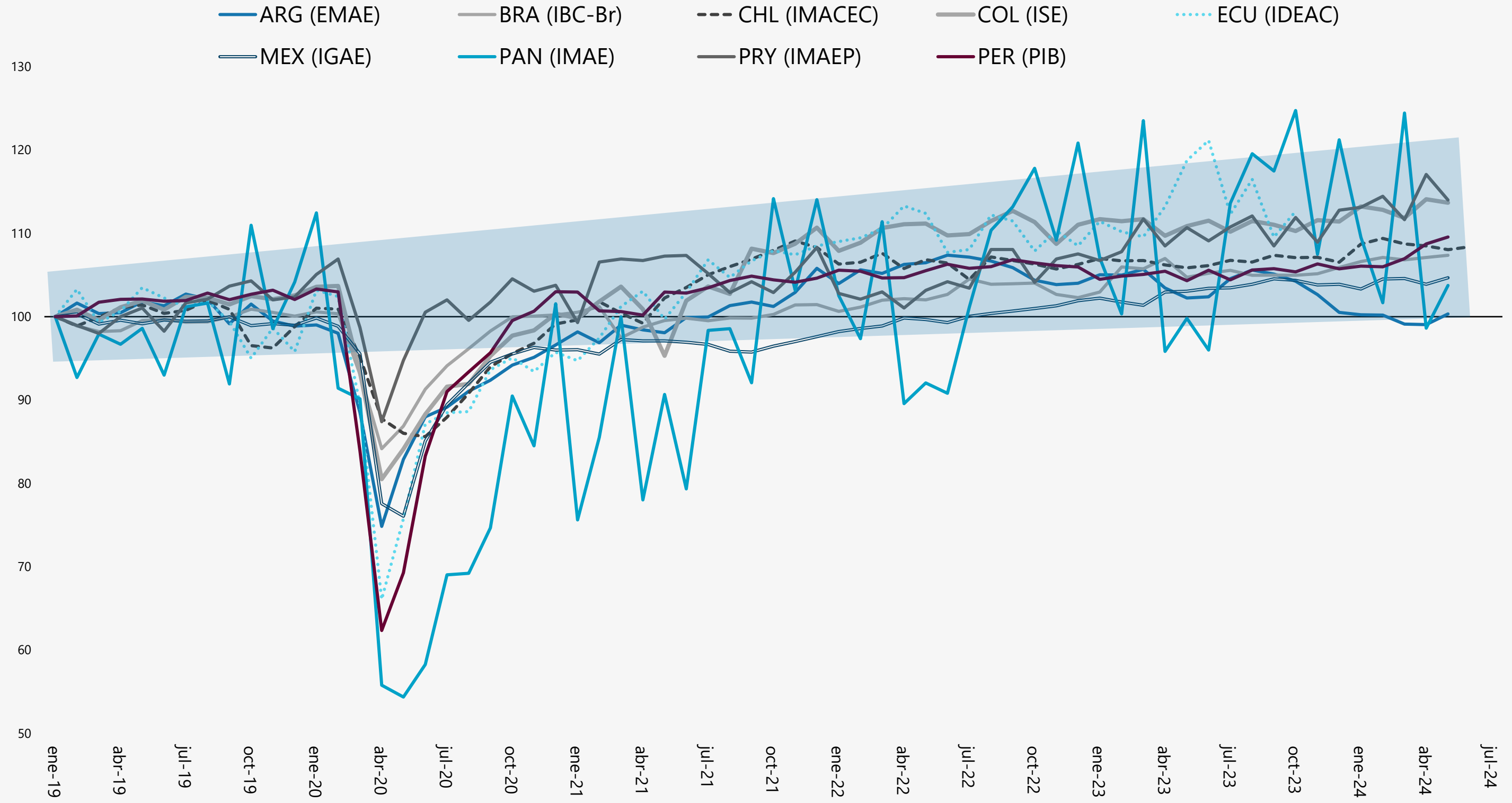


# Inflation...

Annual inflation and expectations for 2024 (%)



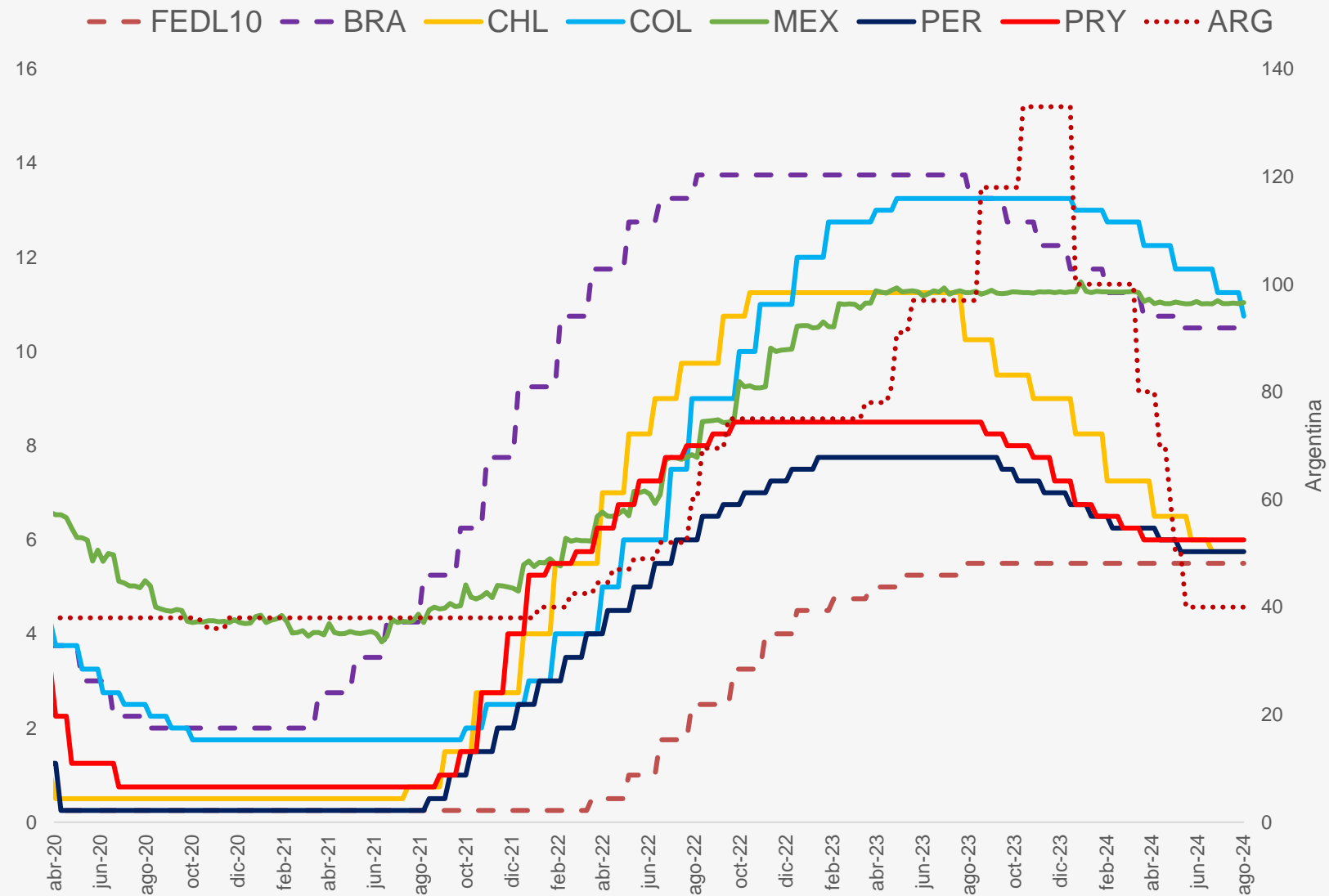
# ...and economic activity



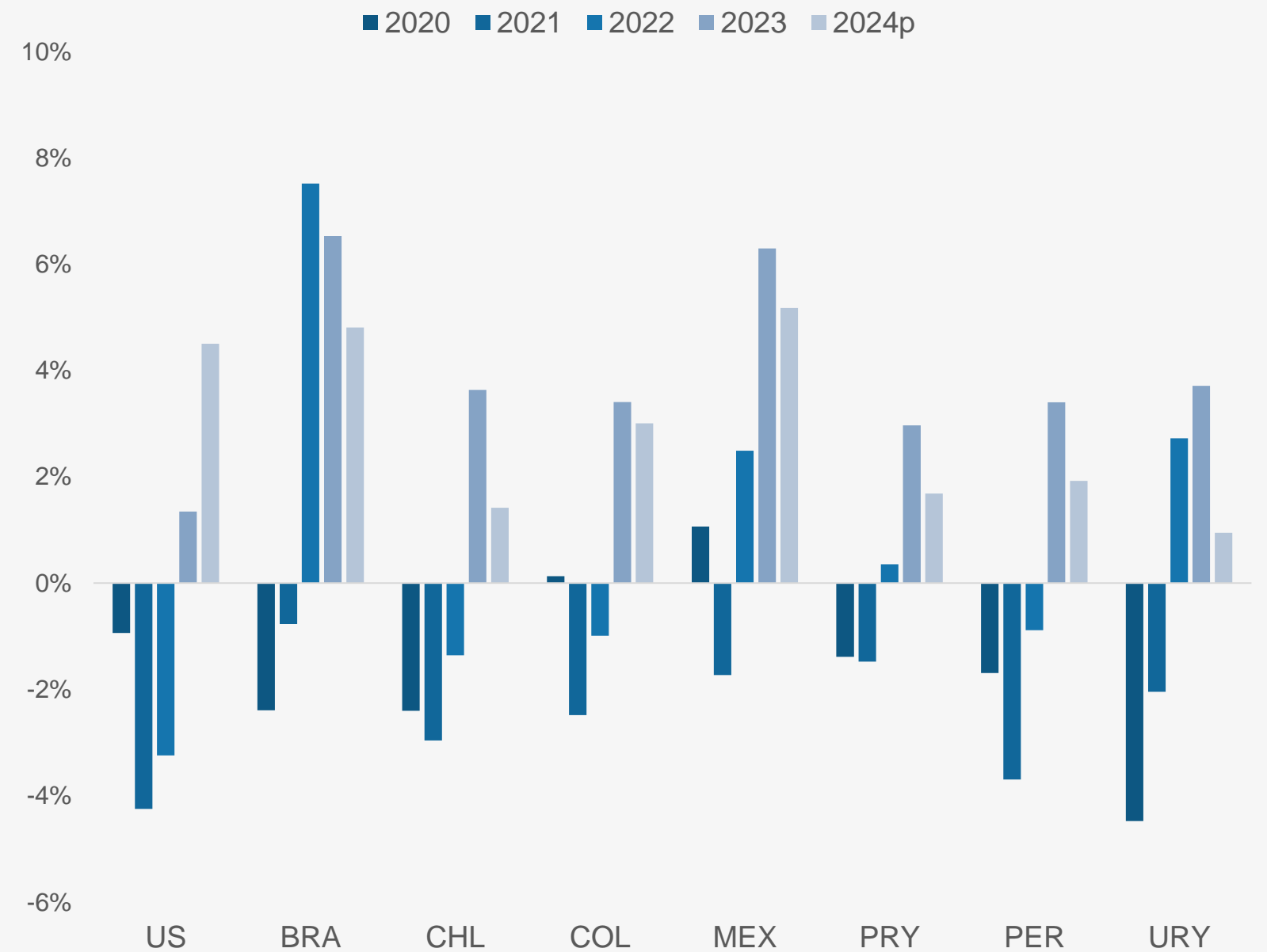


# Monetary policy response

**Policy interest rates**  
(%)

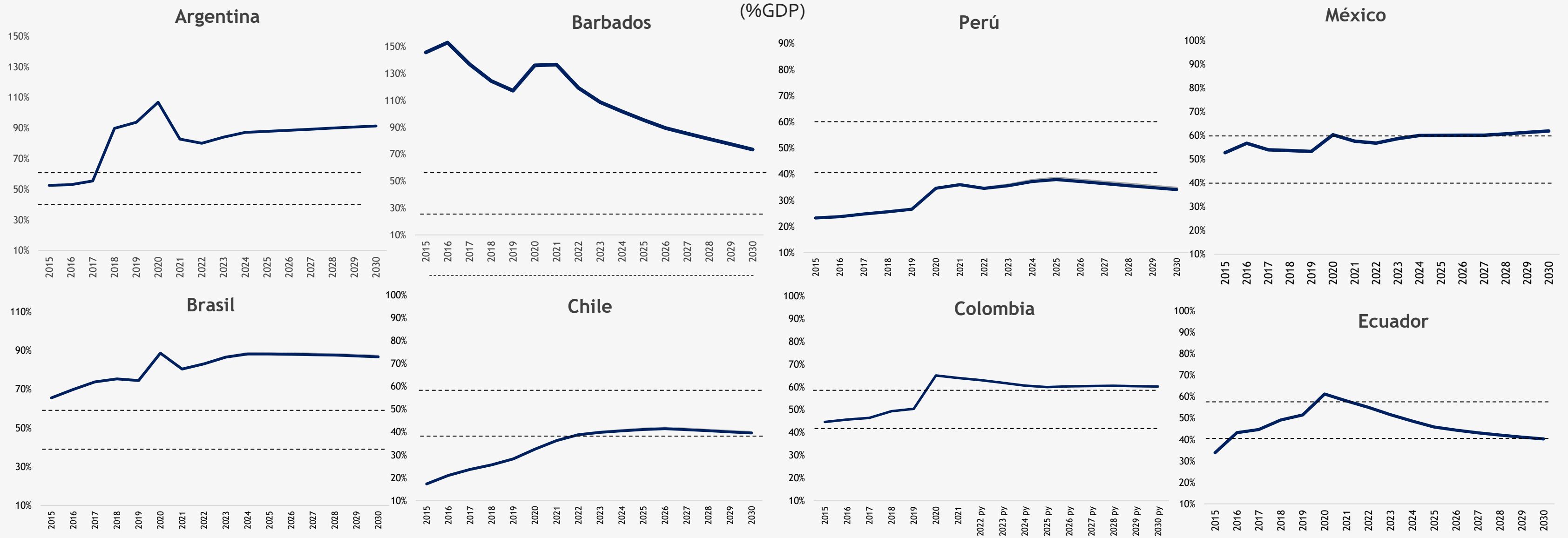


**Real interest rates (%)**



# Debt trajectory

## Latin America: debt forecast



Source: CAF (2022).

## ...in summary...

- We saw a significant fiscal expansion as a reaction to the Covid-19 crises, and a significant part was associated with higher primary spending.
- Inflation did go up significantly, opening the door for liquefying part of the debt
- Economic activity recovered but no evidence of a fiscally generated boom that would allow to pay for the expansion.
- Monetary response was quite active with real interest rates becoming (significantly) positive relatively soon, reducing the space for the two channels to operate.
- **...debt to GDP after the shock stabilized in most economies, but at higher levels...**

**...lets take a closer look**

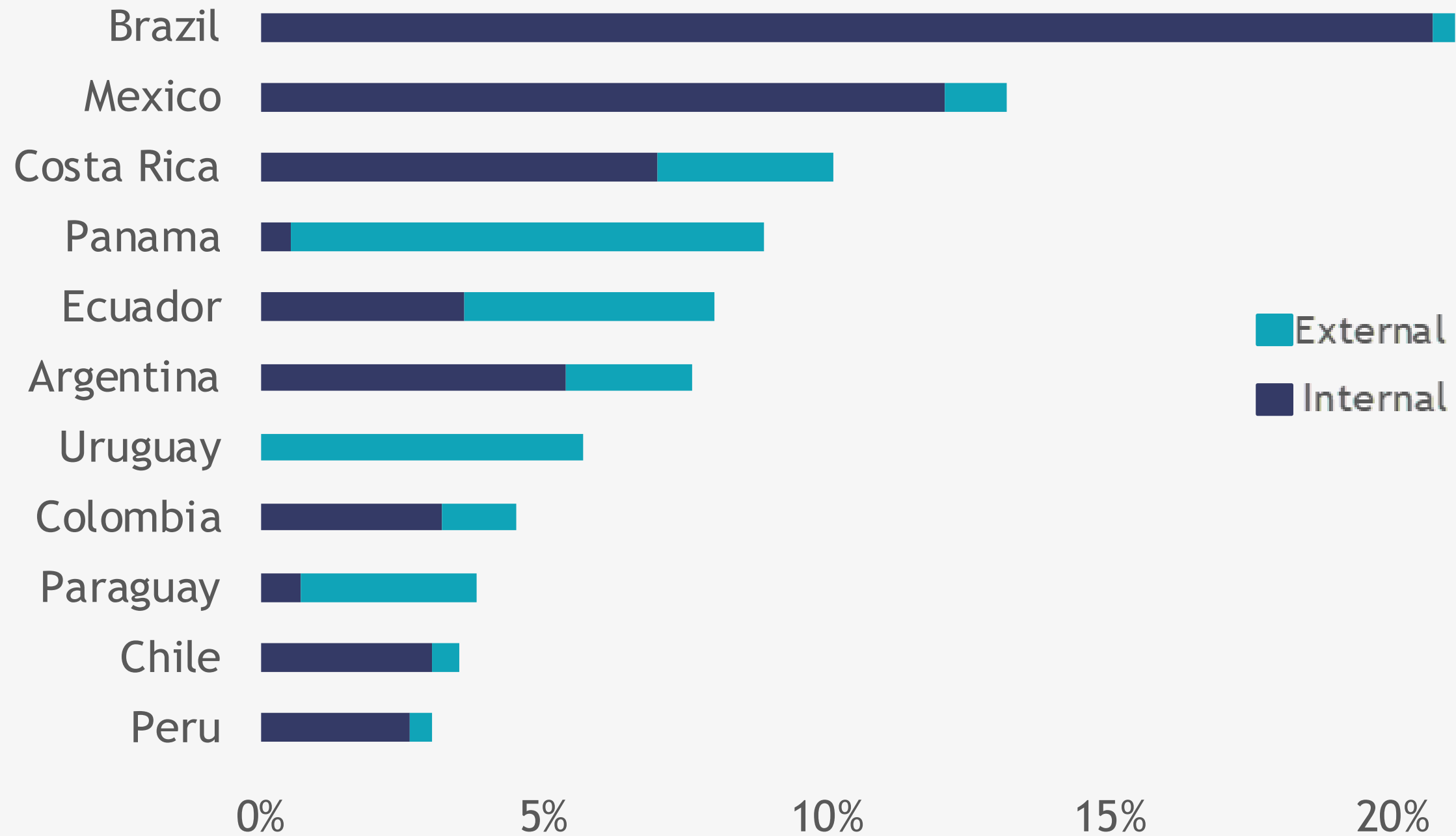
# Challenges

**Challenge to channel 1:  
liquify the debt**

# Type of financing

## Sources of funding

(Domestic and external sources, % of GDP)

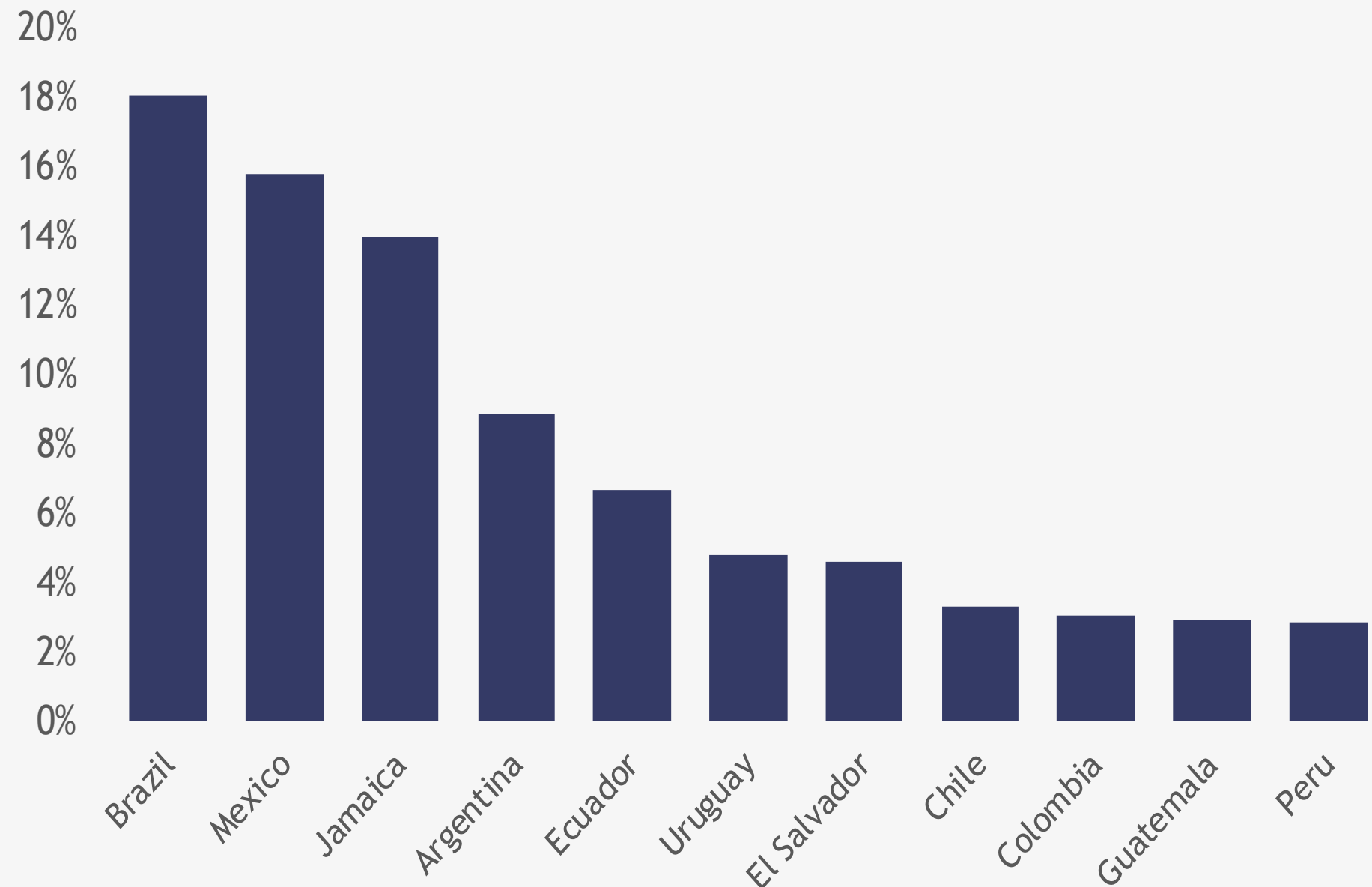


Source: National Budget Laws and National Financing Plans.

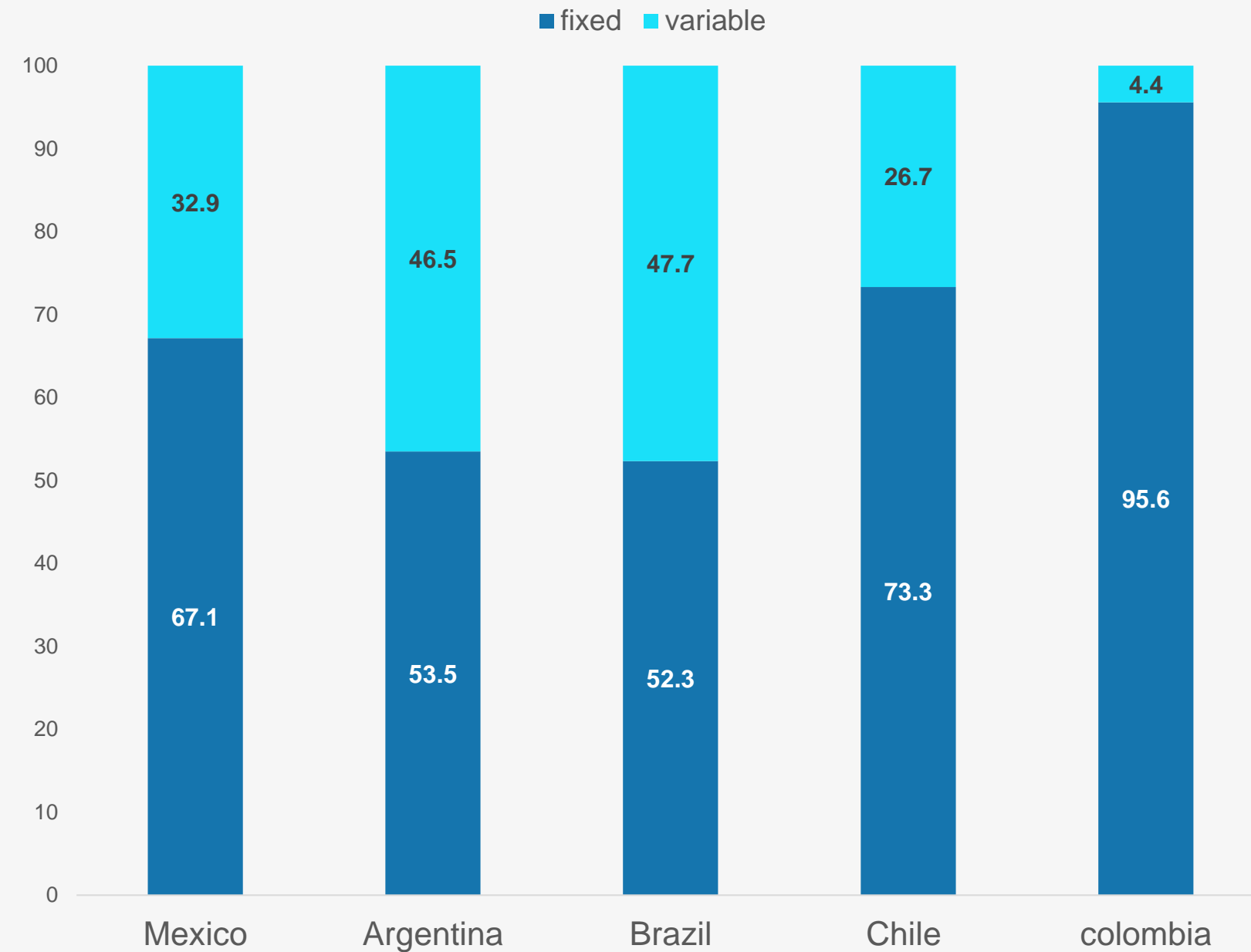
# Debt structure

## Debt amortization over total debt

(2024 Budget Estimates, %)



## Debt's Coupon type



# Central Banking: independence and mandate

## Central Bank Independence Index (CBI)

(Legislative framework and reforms, from least to most legally independent)



## Inflation targeting in the region

(From 1999)

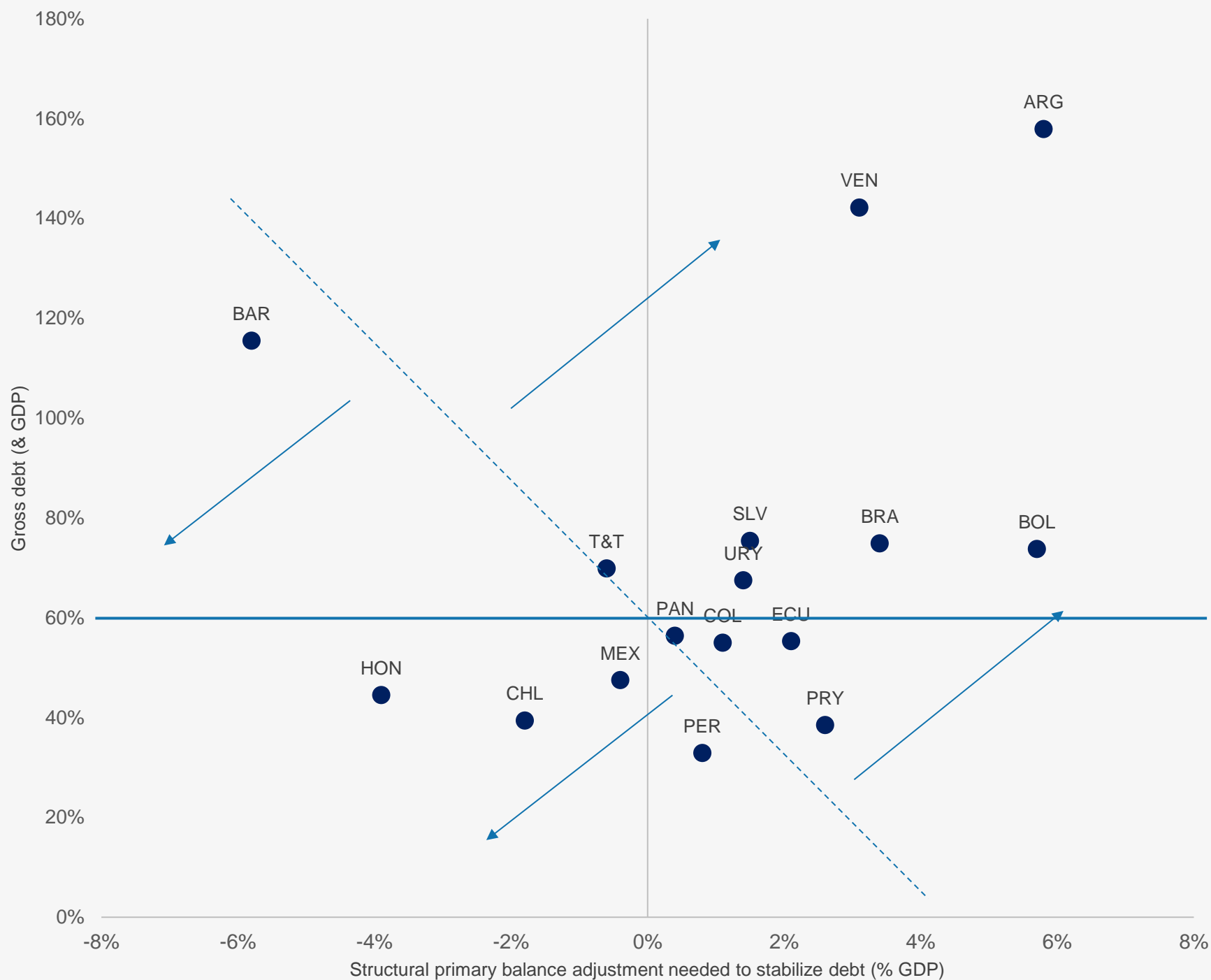




# Fiscal space

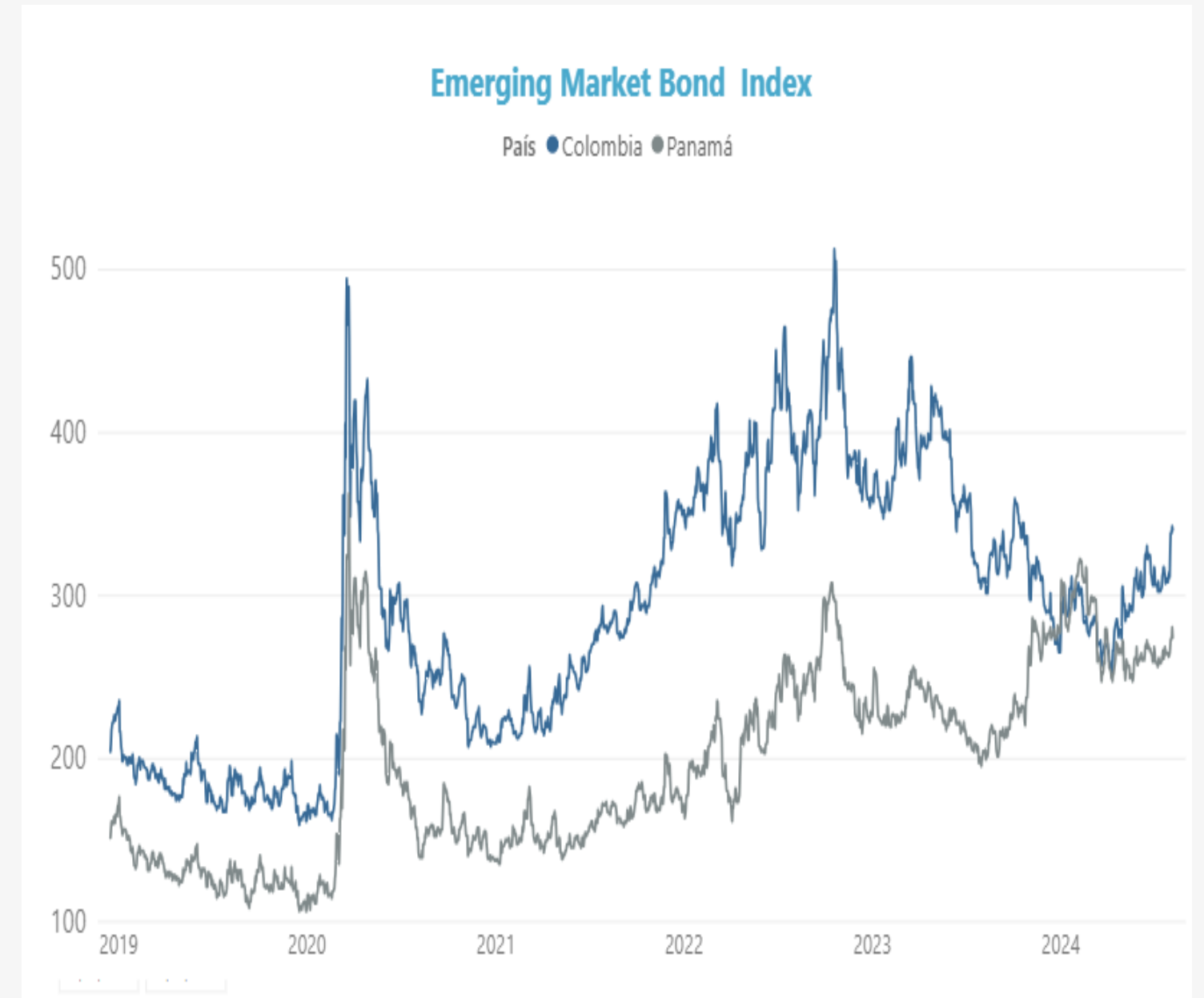
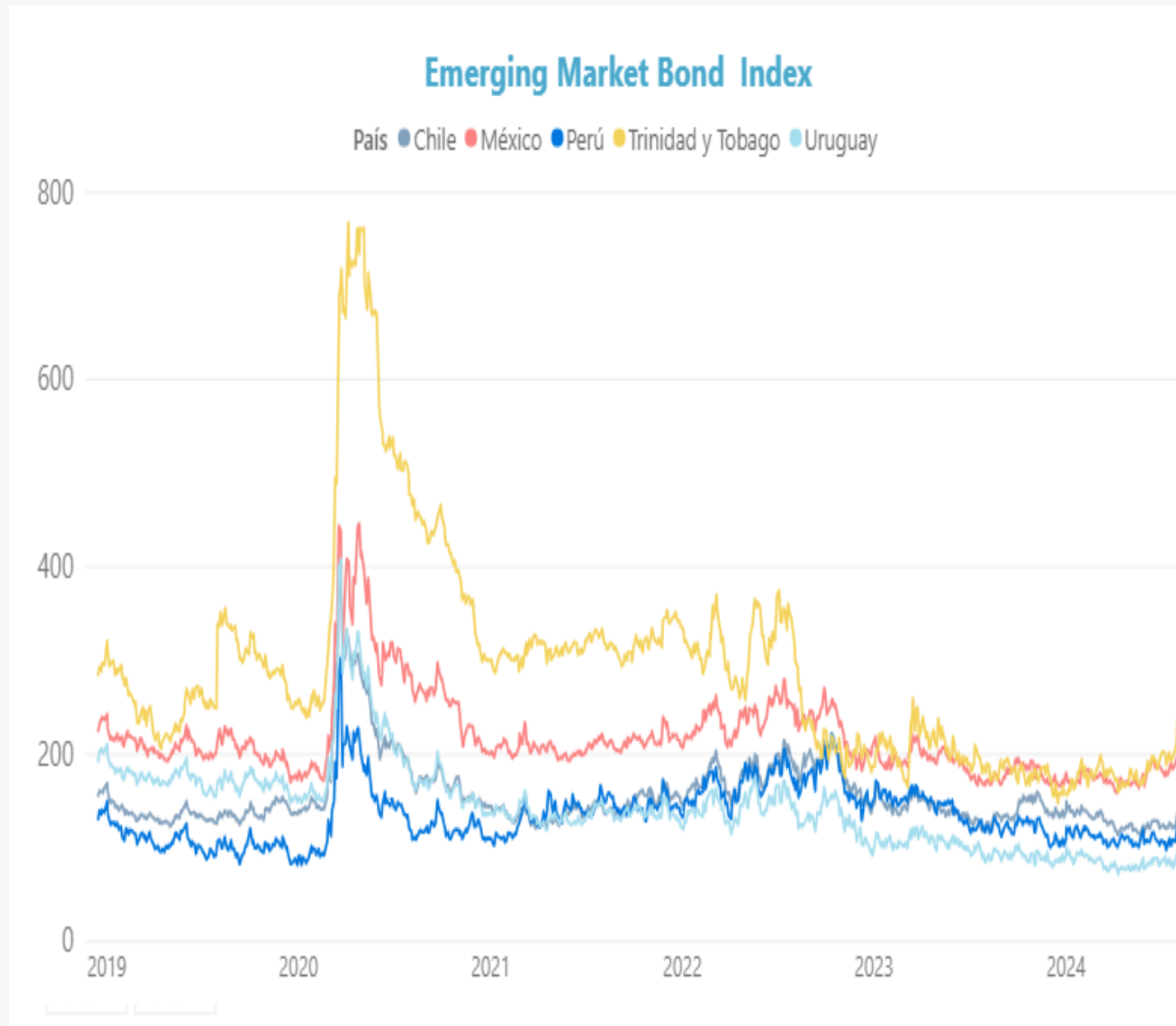
## Latin America: Debt-stabilizing primary adjustment and gross debt

(General government, 2023 % of GDP)



ISO	Public Debt% GDP (2023)*	Primary adjustment to stabilize debt % (2023)	Financing needs % GDP (2023)	Public Debt Held by Nonresidents % of Total (2023)*	Public debt foreign currency % of Total (2023)*
ARG	157,90	5,80	10,00	37,70	72,00
VEN	142,20	3,20	//	70,00	100,00
BAR	115,50	-5,80	3,40	N.A.	37,45
SLV	75,40	1,50	12,20	53,24	//
BRA	74,40	3,30	21,30	9,50	3,80
BOL	73,8	5,70	10,70	37,80	40,50
TYT	69,90	-0,68	3,30	21,40	31,37
URU	67,50	1,40	6,90	57,40	48,30
PAN	56,40	-0,40	6,70	85,30	//
ECU	55,30	2,10	8,30	73,24	//
COL	53,80	1,10	7,60	47,90	34,70
MEX	47,49	-0,36	4,70	24,41	24,13
CHL	39,40	-1,8	7,2	37,6	35,8
PAR	38,2	2,6	3,9	86,6	86,7
PER	32,90	0,8	5,30	46,51	48,1

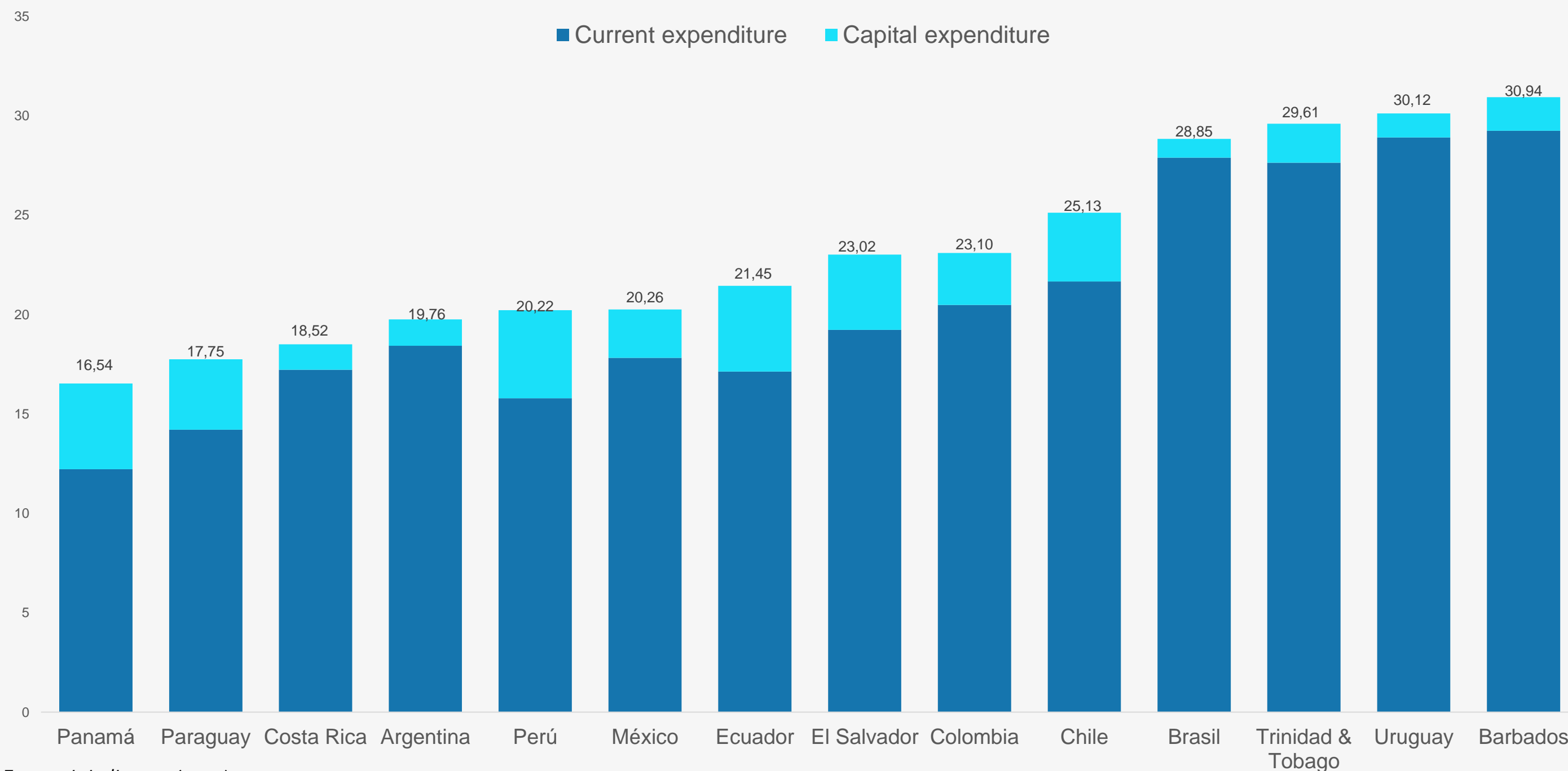
# Country risk limits degrees of freedom



**Challenge to channel 2:  
expand fiscal base**

# Effectivity of fiscal policy I: Spending structure

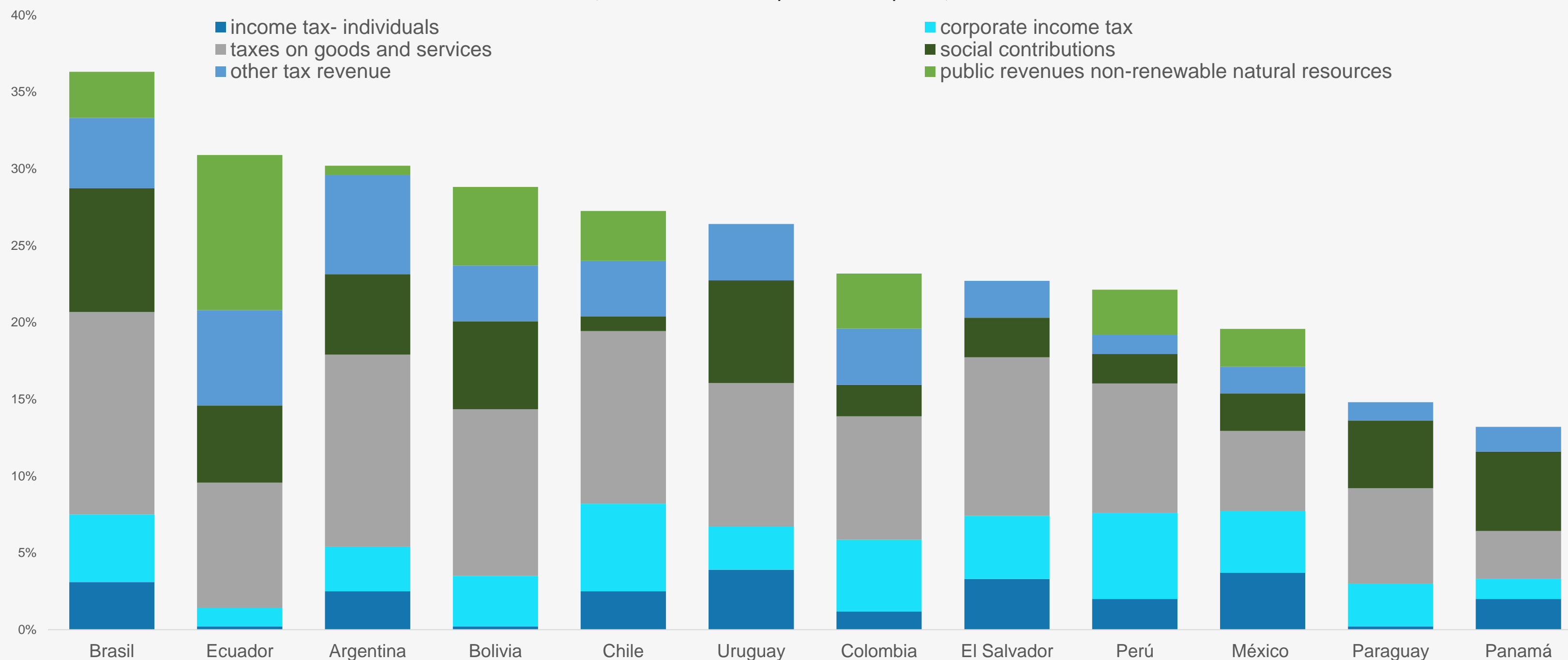
Composition: Expenditure in Latin America and the Caribbean  
(Central Government, as % of GDP, 2023)



# Effectivity of fiscal policy II: Taxation structure

## Composition: Tax revenues in Latin America and the Caribbean

(General Government, as % of GDP, 2022)



Source: CEPALSTAT Economic Indicators (2024), OECD et al. (2024), Revenue Statistics in Latin America and the Caribbean 2024. 2/ Public revenues from non-renewable natural resources include tax and non-tax revenues from the extraction of hydrocarbons (up-stream), marketing and sale of hydrocarbons (down-stream), and mining.

# Final remarks

## **A fiscal deficit is more likely to be self-financed if:**

- Expansion comes as a surprise (to deal with an exogenous/non anticipated shock)
- Financing is mostly domestic and with own currency
- The debt structure is favorable (long maturing profile, fixed interest rates)
- Central bank is not independent or has a loose mandate
- There is ample fiscal space (in which case it is less needed)

## ...but in Latin America:

- Fiscal perturbances sometimes follow a political cycle and are correctly anticipated.
- Foreign debt is an important source of financing (particularly in smaller economies, countries with credibility issues and dollarized jurisdictions).
- In countries with predominance of domestic debt, structure is biased towards short term and variable interest rates.
- Many central banks are independent (following reforms in the 90s) and follow inflation targeting.
- Fiscal space is very limited and country risk tends to discipline governments.

**...no free lunch**





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