The Global Recession and its Implications for the Slovak Economy

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Abstact: The global financial crisis caused the world recession. The global economic slowdown increased fiscal deficits and government debt, mainly in developed economies. The main challenge for policymakers is to bring the public finance to a sustainable level from the long-term perspective. To do so, adopting measures on both revenue and expenditures sides is needed.

Since the fiscal stimulus has played a very important role in supporting recovery, in particular, in the developed countries, their withdrawal should be considered on a case by case basis, which depends on the country circumstances. Prematurely withdrawing fiscal and monetary stimulus will complicate the whole process of recovery in the world economy.

Slovak economy with a very high degree of openness was significantly hit by the external shocks. Based on the latest economic outlook for Slovakia and in line with the continuing process of recovery in the world economy and in the eurozone, the Slovak economy will grow much faster than other economies in the eurozone. Economic growth will be driven mainly by foreign demand and domestic demand, including infrastructure projects.

To bring the world economy to a sustainable and balanced path, cooperative and collective actions in this regard are essential.

Key words: Global recovery, fiscal sustainability, multi-speed of recovery, exit strategy, domestic demand, foreign demand.

1 Introduction

The global economic recession is the worst one after the Great economic crisis in the late 30s. This recession was a result of global financial crisis that resulted from the mortgage crisis in the USA. In comparison with the crisis in the late 30s, the present crisis is much more complex and has a strong impact on the entire world economy. Although there are some similarities between both crises, the present crisis has its own specifics.

To compare with the crisis in the late 30s, the present crisis is much more vulnerable in terms of growing public debt and still pending agenda that related to the regulatory framework for the global financial system. Furthermore, there is instability of the international monetary system, continuing disparity between the rich and the poor, growing protectionism, increased financing of the climate change, and global imbalances. Although the world economy is on the growing trajectory, those are the main challenges which the work economy is facing at the moment. All these negative factors have a strong impact on the future development of the Slovak economy.

In order to support global economic growth, the developed countries should adopt all necessary measures in this regard. Based on the present experience, it might be noted that the globally adopted harmonized monetary policy was less successful than it was expected[1].

Supporting global economic growth leads to fiscal deterioration. Both fiscal deficits and public debt are not sustainable, in particular, for the developed countries. Therefore, the main goal for policymakers is to bring the fiscal side to a sustainable level.

2 Fiscal sustainability

The global economic slowdown and increasing fiscal stimulus created an unprecedentedly high level of deficit and public debt in most industrial countries. In addition, unfavorable demographic development together with medical care reforms in most developed countries will even more complicate the present, already difficult, situation in public finance. If this trend continues without adopting any changes in budget policies, individual countries will cause a major problem for sustainable and balanced economic growth[2].

Therefore, a stable debt-to-GDP ratio should be the goal for achieving fiscal stability. To fulfill the fiscal gap, adopting necessary measures on both revenue and expenditure sides will be needed.

Based on the latest IMF projection for G20, the gross general government debt in the industrial economies will rise from an average of about 75 percent of GDP at end-2007 to about 110 percent of GDP by the end of 2014[3]. The biggest economy in the euro area, Germany, will have debt-to-GDP ratios close or exceeding 100 percent by 2014. This year, the average debt-to-GDP ratio in most industrial economies is projected to reach the level prevailing at the end of World War II.

The global recession strongly influenced the level of the overall fiscal balance (see Table on page 4). The deficit has increased mainly in most developed economies, e.g. the United States from -2,9 to -13,5 percent of GDP from 2007 to 2009, respectively; in the United Kingdom from -2,6 to -11,6 percent of GDP from 2007 to 2009, respectively and in Japan from -2.5 to -10.3 percent of GDP from 2007 to 2009, respectively.

In comparison with the industrial economies, the fiscal stance in most emerging market economies is much more favorable. Based on projections, although the average debt-to-GDP in some new industrial economies has reached a worrisome level, it is expected to decline in most of these countries in 2011, after rising in both 2009 and 2010[4]. Therefore, since the

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[1] The central banks of the USA, Canada, Australia, Switzerland, Sweden, Japan, including ECB, etc. have implemented broadly based harmonized monetary policy by significantly reducing the interest rates.

[2] According to the Report of the Center on Budget and Policy Priorities in the USA, deficits and public debt are headed to dangerously high levels. If the current policies continue, the federal debt will increase from 53 percent of GDP in 2009 to more than 300 percent of GDP in 2050. That would be three times as much as when the debt reached 110 percent of GDP at the end of World War II. In addition, interest payments on the national debt will increase from 19.2 percent of GDP in 2008 to 24.5 percent in 2050.

[3] This assumption takes into consideration temporary fiscal stimulus measures, which will most likely be withdrawn next year. Bringing the general government debt ratios in advanced economies to the pre-crisis average of 60 percent by 2030 will definitely require permanently raising the structural primary balance.

[4] Leading emerging economy - China introduced a big fiscal stimulus package. This fiscal package is oriented on not only on physical infrastructure, i.e., improvements in education, health and social security, but also on improving human capital and boosting consumption.

majority of industrial countries is facing big challenges regarding the pension and health reforms, adopting additional measures would be needed[5].

General Government Debt (Gross)				
Country	**2007 (pre-crisis)**	**2009**	**2010**	**2014**
Argentina	67,9	50,4	50,6	48,4
Australia	8,5	13,7	19,1	25,9
Brazil	67,7	70,1	68,5	62,2
Canada	64,2	75,6	76,6	65,4
China	20,2	20,9	23,4	21,3
France	63,8	77,4	83,8	95,5
Germany	63,6	79,8	86,8	91,4
India	80,5	83,7	85	73,4
Indonesia	35,1	31,1	31	28,4
Italy	103,5	117,3	123,2	132,2
Japan 3/	187,7	217,4	226,2	239,2
Korea	29,6	35,8	42	39,4
Mexico	38,2	49,2	50,3	44,5
Russia	7,4	7,3	7,8	7,3
Saudi Arabia	18,5	14,6	12,6	9,4
South Africa	28,5	29	30,5	29,5
Turkey 4/	39,4	46,9	50,7	58,1
United Kingdom	44,1	68,6	82,2	99,7
United States 5/	63,1	88,6	99,8	112
G-20	62,4	76,1	82,1	86,6
Advanced G-20 Countries	78,8	100,6	109,7	119,7
Emerging Market G-20 Countries	37,5	38,8	40,2	36,4

Source: IMF. *World Economic Outlook*. July 2009 Update.
1/Data are on calendar year basis for the general government if available (otherwise central governments). Debt is on gross basis for general governments.
2/Averages based on 2008 PPP GDP weights.
3/Includes financial sector related measure of 0.5% of GDP in 2009 and 0.9% of GDP in 2010.
These measures cover both subsidies to and capital injections in public financial institutions.
4/ Fiscal projections reflect staff estimates.
5/Includes financial sector support, 5% of GDP in 2009 and 0.2% of GDP in 2010.

Preparing all necessary measures for bringing the public finance to a manageable and sustainable path is critical. Currently, policymakers are facing the main challenges to introducing the broad based fiscal adjustment. Implementing fiscal adjustment should follow all necessary preconditions for supporting the economic growth. In this regard, strengthening fiscal institutions, improving tax administration and reinforcing legislation for fiscal responsibility would be needed.

[5] Since the economic growth is very moderate, revenue will be at a relatively low level; therefore, a possible solution will be the combination of both an increase in revenue and a reduction in expenditure. One of the possible ways to achieving this would be through the implementation of a tax policy. However, this action depends on country specific circumstances, which might by influenced by the pace of recovery and the fiscal position itself.

Therefore, the main priority for policymakers is to bring the fiscal side to a sustainable level. If fiscal side stays on an unsustainable path, this might undermine confidence in the economic recovery. Currently, several industrial economies with particularly high debt-to-GDP ratios and deficits lead to an increase in sovereign risk premia[6].

Overall Fiscal Balances				
Country	**2007 (pre-crisis)**	**2009**	**2010**	**2014**
Argentina	-2,2	-3,3	-1,5	-0,4
Australia	1,5	-4,3	-5,3	-1,3
Brazil	-2,5	-3,2	-1,3	-1,3
Canada	1,6	-4,2	-3,7	0,5
China	0,9	-4,3	-4,3	-1
France	-2,7	-7,4	-7,5	-5,2
Germany	-0,5	-4,6	-5,4	-0,5
India	-5,2	-9,8	-8,4	-4,6
Indonesia	-1,2	-2,6	-2,1	-1,7
Italy	-1,5	-5,9	-6,3	-4,8
Japan 3/	-2,5	-10,3	-10,3	-7,6
Korea	3,5	-3,2	-4,3	2,1
Mexico	-1,4	-3,9	-4	-2,9
Russia	6,8	-5,5	-5	2
Saudi Arabia	15,7	4,2	8,8	13,4
South Africa	1,2	-2,8	-3	-2,3
Turkey 4/	-2,1	-5,8	-5,4	-5
United Kingdom	-2,6	-11,6	-13,3	-6,9
United States 5/	-2,9	-13,5	-9,7	-4,7
G-20	-1,1	-8,1	-6,9	-3,1
Advanced G-20 Countries	-1,9	-10,2	-8,7	-4,3
Emerging Market G-20 Countries	0,2	-4,9	-4,2	-1,2

Source: IMF. *World Economic Outlook*. July 2009 Update.
1/Data are on calendar year basis for the general government if available (otherwise central governments). Debt is on gross basis for general governments.
2/Averages based on 2008 PPP GDP weights.
3/Includes financial sector related measure of 0.5% of GDP in 2009 and 0.9% of GDP in 2010.
These measures cover both subsidies to and capital injections in public financial institutions.
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From a historic point of view, it is more probable that over the medium-term, large public debt could lead to high real interest rates and slower growth[7]. The question is, how should fiscal adjustment be made? This is the ongoing discussion between researchers, academia and policy makers. An IMF study has been published in this regard. There is no doubt that increasing inflation will reduce public debt. However, increasing inflation will have a negative effect on sustainable and balanced economic growth[8].

[6] In PIIGS countries, the sovereign risk premia has increased, in particular, in Greece.
[7] Maintaining public debt at its post-crisis levels could reduce potential growth in industrial economies.
[8] On contrary, high economic and balanced growth in combination with necessary control of public spending could contribute to reducing public debt.

Rebalancing fiscal policy between the big economies is crucial. On the USA side and other industrial economies, it is important to bring in the fiscal side to a more sustainable level. This should be supported by increasing public and household saving. Higher saving will create more favorable conditions for reducing the current account deficit. On the emerging market side, with the current account surpluses, boosting consumption, lowering domestic saving, both household and public, will create better conditions for rebalancing the global economy.

3 Multi-speed of recovery

The global recovery is stronger than it was projected in fall last year. Recovery is different, in the industrial economies, which was mostly supported by the fiscal stimulus and there is robust growth in the emerging market economies, in particular, in China and India. After significantly contracting to 0.8 percent in 2009, global output is expected to be around 4 percent in 2010 and 4.3 percent in 2011. In comparison with the beginning of this year, risks to the outlook of the global economy are balanced moderately to the downside.

In 2009, the emerging market economies significantly contributed to economic growth[9].

The main risks that are facing individual countries on the way towards to the global recovery[10]:

- (i) Fiscal vulnerabilities e.g., Greece, Portugal, Ireland, Italy, Spain, etc.
- (ii) Premature withdrawal of fiscal and monetary stimulus by individual countries.
- (iii) So far, slow progress in cleaning the bad assets in some banks in the US and in Europe.
- (iv) Slow progress has been made in the reform of regulatory and supervisory reform.
- (v) Increasing the commodity prices which could constrain the recovery in advanced economies.

Multi-speed of recovery, as policymakers during the G-20 underscored, depends on country specific circumstances. Furthermore, there will be differences between the industrial economies, which are facing very many challenges on the way towards fiscal sustainability, and emerging markets, which are growing much faster than it was expected, in particular, China and India (see table on the next page).

[9] In 2009, the emerging market contributed around 80 percent to global growth. Only China itself contributed with around 50 percent to the global GDP. There is expectation that China's share on the global GDP in 2010 will be around 30 percent.

[10] Meetings of G-20 Deputies: *Global Economic Prospects and Policy Challenges*. February 27, 2010, Seoul, Korea.

Gross Domestic Product				
Country	**2008**	**2009 estimate**	**2010 projections**	**2011 projections**
World output 3/	3	-0,8	3,9	4,3
Advanced economies	0,5	-3,2	2,1	2,4
Euro area	0,6	-3,9	1	1,6
Emerging and developing economies 4/	6,1	2,1	6	6,3
Argentina	6,8	-2,5	3,5	3
Australia	2,2	0,8	2,5	3
Brazil	5,1	-0,4	4,7	3,7
Canada	0,4	-2,6	2,6	3,6
China	9,6	8,7	10	9,7
France	0,3	-2,3	1,4	1,7
Germany	1,2	-4,8	1,5	1,9
India	7,3	5,6	7,7	7,8
Indonesia	6,1	4,3	5,5	6
Italy	-1	-4,8	1	1,3
Japan	-1,2	-5,3	1,7	2,2
Korea	2,2	0,2	4,5	5
Mexico	1,3	-6,8	4	4,7
Russia	5,6	-9	3,6	3,4
Saudi Arabia	4,4	0,1	3,9	4,1
South Africa	3,7	-1,9	2	3,3
Turkey	0,9	-6	3,5	4
United Kingdom	0,5	-4,8	1,3	2,7
United States	0,4	-2,5	2,7	2,4
European Union	1	-4	1	1,9
G-20 2/	2,9	-0,7	4,3	4,4

Source: Meetings of G-20 Deputies: *Global Economic Prospects and Policy Challenges*. February 27, 2010, Seoul, Korea.
Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during November 19 – December 17, 2009. Country weights used to construct aggregate growth rates for groups of countries were revised.
1/IMF, January 2010 World Economic Outlook Updates as of January 28, 2010.
2/G-20 yearly projections exclude European Union and quarterly projections exclude Saudi Arabia and European Union.
3/The quarterly estimates and projections account for 90 percent of the world purchasing-power-parity weights.
4/The quarterly estimates and projections account for approximately 77 percent of the emerging and developing economies.

Bringing the global economy to strong, sustainable and balanced economic growth will need additional efforts in this respect. Implementing institutional and legislative framework for regulatory and supervisory reform is urgent. In addition, continuation of present global imbalances would deteriorate the potential global growth. To solve these problems, cooperation between individual countries is essential. In this regard, G-20 together with the international financial institutions will play an important role.

4 Economic Outlook in Slovakia

Slovakia with a high degree of openness of its economy has been strongly hit by the global recession[11]. However, in comparison with other eurozone countries, the financial sector in Slovakia is relatively sound and stable. The reason is simple. The foreign branches in the banking industry in Slovakia have not been active in the highly risky financial products, like derivatives, in particular, credit-default-swaps. In addition, the financial sector in Slovakia was completely restructured at the beginning of this decade.

In 2009, Slovak real economy has significantly deteriorated. The real external shocks which were a result of a decline in foreign and domestic demand were the main factors, which significantly deteriorated the real economy in Slovakia. The real GDP in the second quarter in 2009 significantly declined to the highest level among EU countries. However, in the third and the fourth quarter in 2009, moderate economic growth occurred. GDP growth was supported by the acceleration of export as well as an increase in consumer demand.

In 2010, there is an expectation that domestic demand will grow moderately. This demand will be driven by the final consumption and the formation of fixed capital. The pace of growing consumption in the public sector will be slower. The economic growth will be driven by foreign demand, which will be the main contributor to real GDP growth.

Over the medium-term, there is expectation that the Slovak economy will growth faster. This growth will be supported by the potential recovery of the world economy. Higher foreign demand could create conditions for an increase in Slovakia in 2011 and an even more pronounced increase in 2012. This positive development will create favorable conditions for increasing domestic demand. In addition, the export driven economy will be supported by opening a new assembly line in automotive industry in Slovakia.

In 2010, the expectation is that household consumption will grow faster than in 2009. This will be driven by growing disposable income. This trend could lead to a decline in saving. However, this trend might be influenced by the development of the labor market.

Fixed investment will increase over the medium-term. Growing of investment activity in infrastructure projects, in particular, Public Private Partnership will create additional space for decreasing unemployment.

Economic development in Slovakia will depend on the recovery of the global economy. Although there are some positive signs of this recovery, it is needless say that still this recovery is very weak and uncertain. This uncertainty could be overcome once all countries cooperate and adopt collective actions on the way towards strong, sustainable and balanced economic growth.

[11] In 2007, the openness of the Slovak economy was the highest between Vyshehrad 4 countries. Slovakia experienced 170 percent of GDP in comparison with Poland, which only had 80 percent.

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