

Alþingi

Erindi nr. P 137/556

komudagur 8.7.2009

From: Rozwadowski, Franek J. [mailto:FROZWADOWSKI@imf.org]
Sent: 8. júlí 2009 09:40
To: Eiríkur Áki Eggertsson
Cc: Karlsdóttir, Edda Ros; Flanagan, Mark Joseph
Subject: Follow-up answers to questions

UNCLASSIFIED

Dear Eiríkur Áki,

Here, as promised are my follow-up answers to questions posed by members of the Tax and Economy committee yesterday, July 7th.. I would be grateful if you would forward them to all the committee members. Many thanks, and best regards to the committee members, Franek

Lilja Mósesdóttir

Municipal debt figures were not behind the increase in estimated external debt. The main factor was a the recognition that a large amount of bank liabilities were to nonresidents rather than to residents as originally thought.

Pétur Blöndal

I ran out of time before being able to answer fully your question on whether there is a threshold debt ratio beyond which debt is clearly unsustainable.

In fact there is no such number. One cannot make an assessment of sustainability based on the debt ratio alone—this is why we use the framework that I described today. Some things that make a difference (and which are taken into account by the framework) are:

1. The amount of external assets. A gross debt of, say, 200 percent of GDP might be unsustainable if the country had no external assets but sustainable if the country had external assets of, say, 100 percent of GDP. Although these numbers are just illustrative, this point is relevant for Iceland because the gross external debt is largely counterbalanced by external assets including pension fund assets, central bank reserves etc. Iceland's net debt is much smaller than its gross debt and this has a positive impact on sustainability.
2. A higher real growth rate or lower real interest rate allow a country to sustain a higher debt ratio than otherwise.

As I emphasized, our analysis of sustainability is still being refined and will not be final until it is discussed and assessed by the IMF's Executive Board. The staff's preliminary work suggests that Iceland's external debt should be sustainable assuming that the government's program is implemented vigorously.

More directly relevant to your present discussion, the impact of the Icesave loan (which is already included in the analysis) is smaller than what is suggested by the *gross* debt taken on (about 50 percent of GDP). This is because that impact is expected to be largely offset by an increase in assets corresponding to Iceland's share of the recovered assets of Landsbanki. The value of those assets is uncertain but if the range of estimates (75-90 percent recovery for

Iceland) is right this would imply a smaller impact on Iceland's *net* external debt (5 to 12.5 percent of GDP) and thus on sustainability.

Tryggvi Þór Herbertsson

I attach a copy of a recent IMF staff position note on the fiscal implications of the global crisis and draw your attention to Table 6.1 (page 35) on government debt. Also note the chapter on the dynamics of government debt.

Þór Saari

Our medium term growth projections do take into account the demographic implications of emigration. We assume a substantial emigration in 2009-11 followed by a stabilization of population growth thereafter.

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