

## CIO Flash Bulletin

## The indebted sword of Damocles?

### Investment Solutions

30 April 2018

Sovereign debt is at its highest level since the financial crisis, according to the International Monetary Fund<sup>1</sup>. After a long period of low interest rates, government debt has reached USD 164 trillion, equivalent to 225% of global GDP in 2016, making the world 12% deeper in debt compared with 2009.

#### Are record highs a cause for concern?

The latest of the IMF's twice-yearly Fiscal Monitor reports generated much noise, but gave little context to help investors who have experienced a decade of turmoil to understand whether the headlines are a new cause for concern.

Since the financial crisis, government spending rose to generate economic growth and central banks injected liquidity using unconventional tools such as bond buying to ease financing. Now monetary policies are on course to normalise, interest rates in the US are rising gradually and volatility has returned to the markets this year. Still, after the subprime crisis and the European debt crisis, do these vast debt levels constitute a sword of Damocles, the threat of a new crisis?

"Things are good, but they're getting risky," is how David Lipton, First Deputy Managing Director of the IMF, summarised the report in a recent Bloomberg interview. Some economies, including the US, Lipton said, will not have the fiscal space to manoeuvre should the global economy stall. The debt-to-GDP ratio needs to fall, concluded Lipton "because you never know what will happen tomorrow."

We should put this data into the context of a broader, global reallocation of debt between the emerging and middle-income economies on the one hand, and advanced economies on the other. More specifically, commodity producers such as Saudi Arabia, the United Arab Emirates or Bahrain, have now become borrowers, even if their debts remain a fraction of those in the advanced economies.

Compared with ten years ago, the difference is that the debt levels are now both self-financing and cheap. Take Japan, which with sovereign debt at 236.4% of GDP has never owed so much, yet never paid so little to finance that debt. That and other debt levels may be the consequence of artificial injections on the part of central banks, but we continue to see decent growth everywhere, and most of our cyclical indicators are in line with this scenario. None of them point to a recession or a serious slowdown in the US, China or the Eurozone.



**Stéphane Monier**  
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<sup>1</sup> Spring 2018 Fiscal Monitor, International Monetary Fund, 18 April 2018

Looking closer, the IMF’s own numbers show that debt-to-GDP ratios peaked in 2016. The sub-headline to the IMF’s story then should be that for the first time since the financial crisis, with the exception of the US and emerging economies, global debt is stabilising and is projected to decline.

**The US stands out**

The US is the only advanced economy bucking the trend, with an IMF forecast that debt-to-GDP will continue to widen to reach 116.9% by 2023, thanks to its recent tax cuts and rising spending. The US certainly seems unlikely to rebalance this deficit until it relearns that horses pull better when harnessed in front of carts, and spending cuts still come before tax cuts.

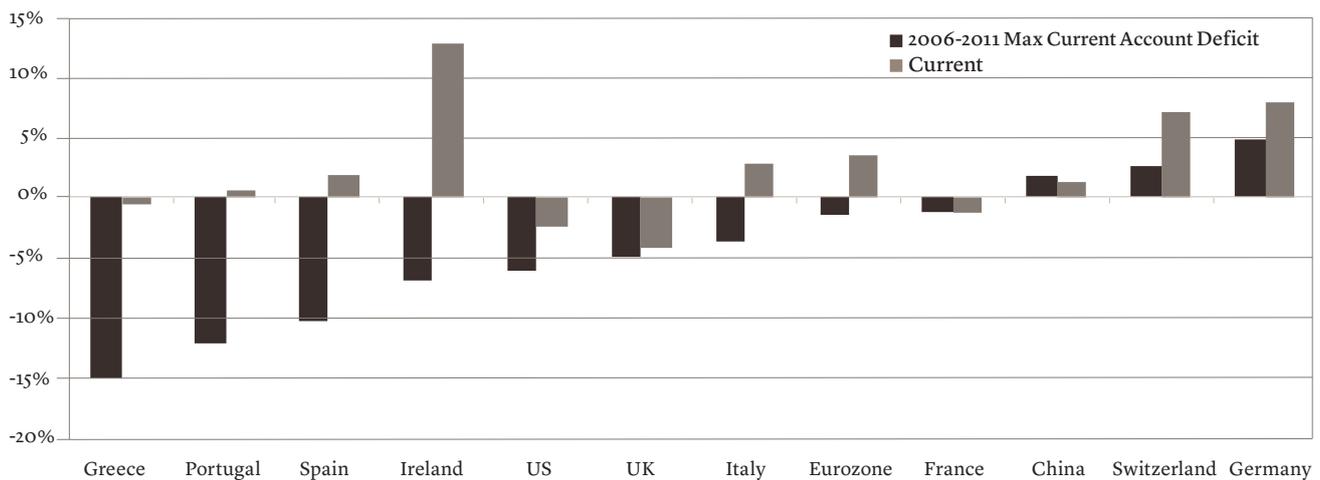
Still, let’s not forget that the US has a little more fiscal space than others. The country continues to enjoy the ‘exorbitant privilege’, in the words of Valéry Giscard d’Estaing, then French Minister of Finance, of printing its own reserve currency. The US can print a USD 100 bill for just a few cents, while “other countries had to pony up USD 100 of actual goods in order to obtain one,” as Berkeley economist Barry Eichengreen put it.

**Stronger than pre-crisis**

Elsewhere, if we look at a range of leading economies, including those that caused the greatest fallout in the wake of the financial crisis, most are in a much stronger position than pre-crisis. The current accounts of a range of economies, shown below, as a percentage of GDP, are relatively healthy and certainly far from their pre-crisis levels.

**Current accounts**

In % of GDP



Source: Bloomberg

<sup>2</sup> Published on 23 April 2018  
<https://www.lombardodier.com/contents/corporate-news/investment-insights/2018/april/china-bull-yet-to-show-cracks.html> investment-insights/2018/april/china-bull-yet-to-show-cracks.html

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