World Economy

Global debt woes are building up to a tidal wave

Borrowing in the US is at record highs but the phenomenon is a far wider problem

The Exchange

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YESTERDAY by: **Dambisa Moyo**

Virtually every class of US debt — sovereign, corporate, unsecured household/personal, auto loans and student debt — is at record highs. Americans now owe $1tn in credit card debt, and a roughly equivalent amount of student loans and auto-loans which, like the subprime mortgage quality that set off the 2008 financial crisis, are of largely low credit quality (and therefore high risk).

US companies have added $7.8tn of debt since 2010 and their ability to cover interest payments is at its weakest since 2008, according to an April International Monetary Fund report. With total public and private debt obligations estimated at 350 per cent of gross domestic product, the US Congressional Budget Office has recently described the path of US debt (and deficits) as almost doubling over the next 30 years.

But this is not just a US phenomenon. Globally, the picture is similarly precarious, with debt stubbornly high in Europe, rising in Asia and surging across broader emerging markets. A decade on from the beginning of the financial crisis, the world has the makings of a fresh debt crisis.

In November last year, unsecured household debt in the UK passed pre-financial crisis highs in 2008. In the UK, debt excluding student loans crept up to £192bn, the highest figure since December 2008, and it continues to rise this year. Meanwhile, in the eurozone, debt-to-GDP ratios in Greece, Italy, Portugal and Belgium remain over 100 per cent. As of March there were more than $10tn negative yielding bonds in Europe and Japan.

There is also the perennial risk and market concern that debt levels in China will at some point bubble to the top of the country's economic woes in a very damaging way. Among the most risky are non-performing loans of state-owned enterprises, and mismarked and therefore not properly accounted for debt obligations in the overheated real estate market.

More broadly, emerging market borrowing is surging. Sales of EM corporate dollar-denominated notes have climbed to about $160bn this year, more than double offerings at this point in 2016 and the fastest annual start on record, according to data compiled by Bloomberg going back to 1999. The total stock of foreign currency EM debt stands at more than $15tn.

The threat of a looming crisis is not solely down to the absolute volume of debts. At least three things make the situation especially precarious.

First, debt — particularly dollar denominated — is becoming more expensive as market expectations are pricing at least three rate hikes by the US Fed this year, and a relatively strong dollar is putting pressure on borrowers to service foreign currency obligations. The recent downgrades of South Africa to junk status follow a year in which credit rating agencies cut EM borrowers' grades in record numbers. Moody's downgraded 24 sovereigns (including Brazil, Nigeria and Saudi Arabia) in the first half of 2016, adding to concerns as to whether borrowers will be able to service their obligations.

Second, the ability to repay debt is under strain in countries whose revenues stem disproportionately from commodities, whose prices have suffered. Furthermore, nations exposed to significant Chinese trade and investment face fiscal stress as China itself has a relatively soft economic outlook.

Finally, the prevailing mixed global economic growth picture — underscored by the forecasts in the recent IMF World Economic Outlook — prompts questions as to how (and indeed whether) outstanding debts will be paid or brought under control.

It is possible that US corporate debt repayment could be boosted by president Donald Trump's plans attract $2.6tn in corporate cash residing offshore back into the US. Barring any stipulations on its use, the prospect of a significantly low repatriation tax of just 10 per cent (compared with the 35 per cent current corporate tax rate) could help put a meaningful dent in outstanding corporate debt obligations.

Meanwhile, with crippling student debt now a political issue, there is scope for a resolution that could see significant writedowns and debt forgiveness with vast amounts potentially subsumed on to the government balance sheet.

But neither of these would help debt repayment outside the US. Of a shortlist of prescriptions to escape unsustainable debt — from outright default and austere fiscal policy to bailouts — only growth itself can lift countries out of high indebtedness in a non-disruptive way. Without it, we have the makings of a debt crisis that would reverberate around the world.

The writer is a global economist and the author most recently of 'Winner Take All'. She serves on the boards of Barclays Bank, Barrick Gold, Chevron and Seagate Technology

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