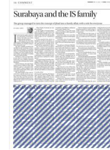

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# The debt shackles return with the acceleration of global growth

BY MICHAEL HEISE

GLOBAL growth is accelerating. But before we break out the champagne, we should acknowledge the long-term risks to sustained expansion posed by rising private and public debt.

Market analysts view the uptick in private lending in most emerging and some developed economies as a sign of higher demand and a precursor of faster growth.

But, while this is true in the short run, the relentless rise of overall debt remains among the most serious problems burdening the global economy.

Despite years of deleveraging after the 2008 global financial crisis, debt remains very high — and yet we have now returned to an expansionary credit cycle.

### Total debt up almost 245%

According to the Bank for International Settlements, total non-financial private and public debt amounts to almost 245% of global gross domestic product (GDP), having risen from 210% before the financial crisis and around 190% at the end of 2001.

General government borrowing in the US may reach 5% of GDP this year, pushing total public debt to about 108% of GDP.

In the eurozone, public debt stands at about 85% of GDP; in Japan, the debt-to-GDP ratio registers close to an eye-popping 240%. Globally, private non-financial debt is growing faster than nominal GDP.

These trends are set to continue, as many major central banks — including the European Central Bank and the Bank of Japan — have not just welcomed the recovery in lending, but are even aiming to stimulate more credit-financed growth.

Only the US Federal Reserve (Fed) and the People's Bank of China are taking steps to rein in bank lending.

The world has endured enough economic crises to know that high debts create serious risks. Nominal debt is fixed, but asset prices can collapse, generating huge balance-sheet losses and causing risk premia — and thus borrowing costs — to rise.

The only sustainable debt burden is one that can be managed even during cyclical downturns.

Yet governments continue to repeat the same mistakes, treating debt as a boon for long-term growth, rather than what it is: a heavy burden and a source of massive long-term risks.

It is time for policymakers and their economic advisers to recognise this, and abandon the assumption that more debt always leads to more growth.

### Deficit spending unadvisable

Though there are times when governments need to borrow to stimulate the economy, deficit spending cannot lift growth in the long term.

And at times when growth rates and private-sector borrowing are rising — times like now — governments should be working to reduce their own deficits.

This is relevant for the US and Japan, but also for European Union countries.

Governments should seek to prevent the build-up of unsustainable debt by stimulating long-term, non-debt-financed growth, using a combination of regulation, trade agreements, investment incentives, and educational and labour-market reforms.

### Central banks

In a low-inflation environment like the one prevailing today, central banks can cushion the impact of such reforms through expansionary monetary policies.

But central banks must calibrate their interventions carefully, to ensure that monetary expansion does not encourage the build-up of even more private-sector leverage. This means thinking twice before enforcing negative deposit rates, designed to pressure banks to lend more, or liquidity operations conditioned on bank lending.

A better approach would emphasise the use of forward guidance to influence interest-rate expectations and bond yields.

With asset prices already high and economies growing at a healthy pace, central banks should follow the Fed's lead in gradually unwinding the stimulus programmes they initiated after the 2008 crisis.

Moreover, regulators should do more to ensure that private debt is channelled toward productive uses offering decent longer-term returns.

### Lesson learnt

This is the lesson from previous debt crises, including the subprime mortgage bubble that triggered the meltdown a decade ago, with devastating consequences for growth and employment.

For example, regulatory authorities can employ macro prudential policies to impose limits on segments of financial markets that are overheating, thereby improving the allocation of capital and stabilising investment returns.

They should take particular care to prevent real-estate bubbles, because real estate constitutes a huge share of overall wealth and a key source of collateral in finance.

But the strong rise of low quality leveraged loans should also be a concern.

None of this will be easy for governments, regulators, or central banks.

### Devastating consequences

Today's febrile political environment certainly will not simplify matters.

But the consequences of shying away from such choices could be devastating.

The financial cycle will continue to gain momentum, eventually causing asset prices to overshoot fundamentals by a wide margin; leverage ratios will rise even further, and demand will outstrip capacity, spurring inflation.

At that point, an external shock or a decision by central banks to apply the monetary brakes — an inevitable response to mounting exuberance and rising inflation — will lead to a

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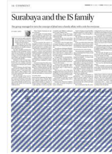
Surabaya and the IS family

potentially ruinous crash.

Financial markets, hopped up on low interest rates and ample liquidity, would take a major hit. Private leverage and public debt levels would suddenly look a lot less sustainable.

Times may be good, but good times are precisely when risks build up. Policymakers cannot say they have not been warned. — *Project Syndicate*

*Michael Heise is chief economist of Allianz SE.*

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