Ninety One

The great shutdown - dealing with the debt burden

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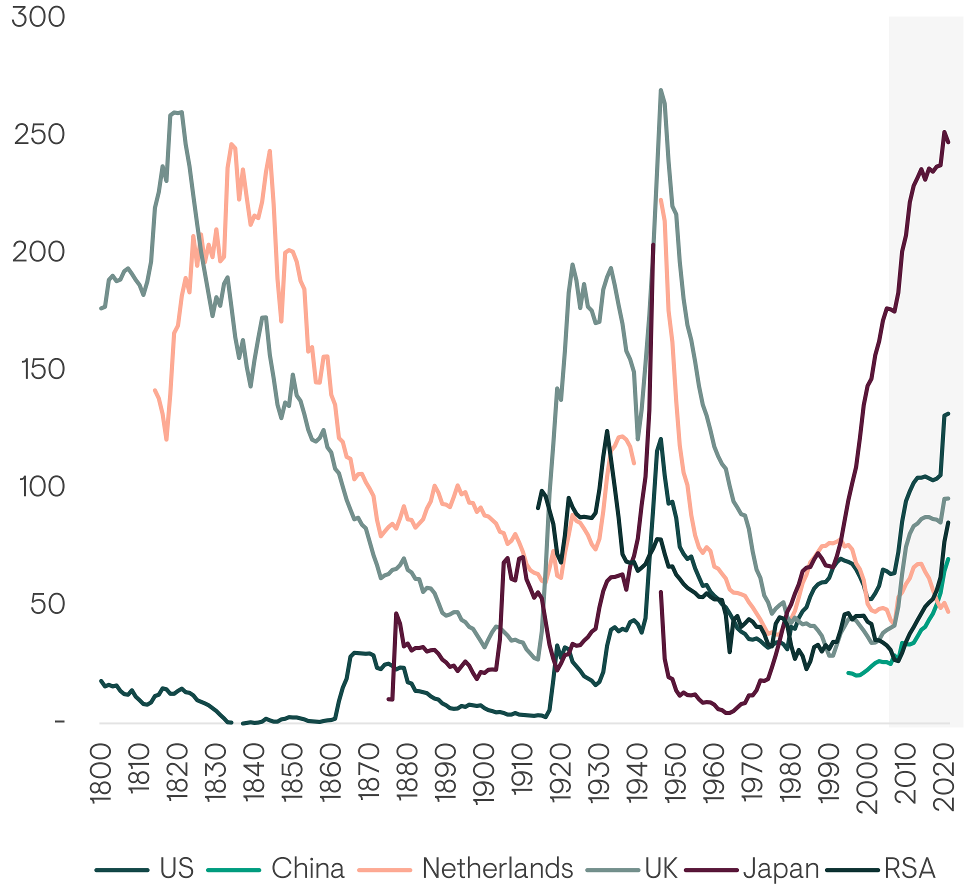
TAX-FREE DEBT

The long term view of government debt

Outside of war, it has never been higher

- **Post GFC** - government debt has been rising rapidly
- **Covid-19 pandemic** - governments stepped in to protect jobs and the economy
- **Exactly the right thing to do!**
- **Legacy for future generations** - to deal with
- **Huge debt burden** – what are the options for dealing with it?

Gross government debt to GDP %



Source: IMF & Ninety One calculations

It's not just government debt

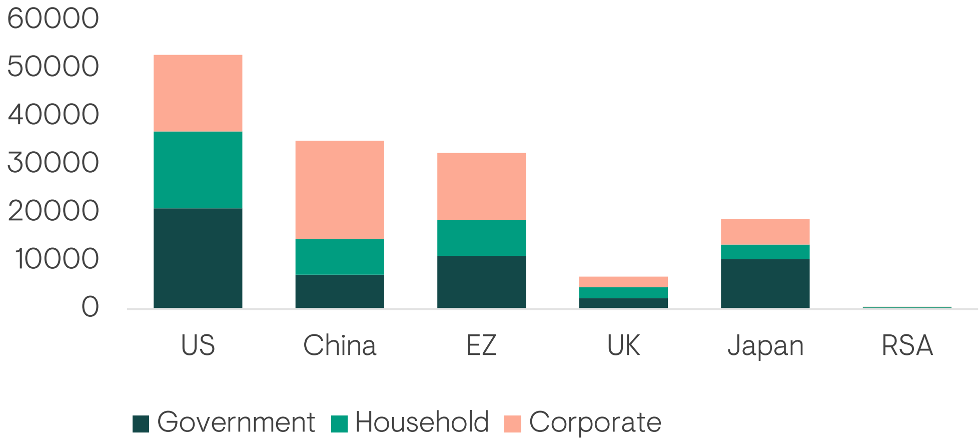
We need to consider households and companies

Major economy debt (Sep-19) - Across all sectors (US$):

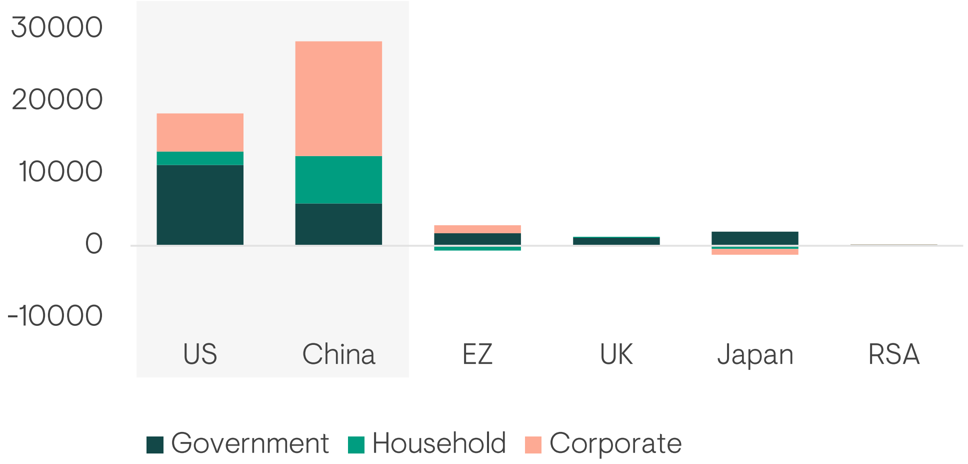
– United States	$52.8 trillion
– China	$35.0 trillion
– Eurozone	$32.5 trillion
– United Kingdom	$6.7 trillion
– Japan	$18.7 trillion
– South Africa	$0.46 trillion

Post GFC, it is only **US** and **China** that have seen any notable increase in debt, with the latter accounting for the bulk of the growth

All sector debt, $bn as at Sep19



Change since Dec-08, $bn



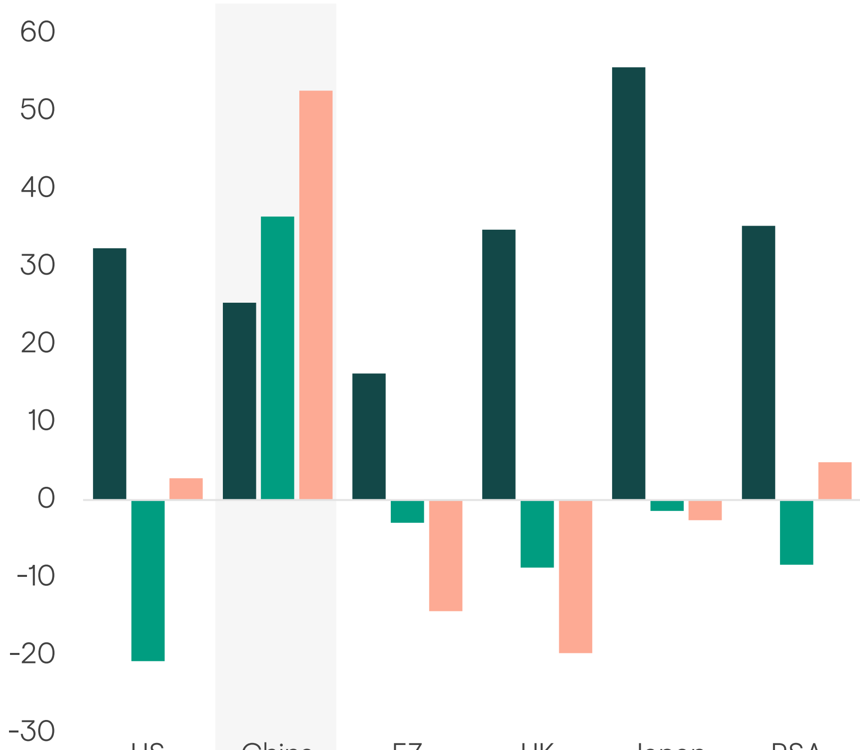
Source: BIS & Ninety One calculations

Post global financial crisis sectoral changes

The paradox of thrift

- **GFC** - A turning point for many western economies
- **Households** - have paid down debt
- **Corporates in EZ & UK** - have done the same
- **Interest rates pushed down** – as both sectors are saving - this lowers growth and increases demand for savings
- **China -** Opposite has happened with huge increases in household and corporate borrowing

Change in debt since Dec08, % of GDP



	US	China	EZ	UK	Japan	RSA
Government	32.4	25.4	16.3	34.8	55.7	35.3
Households	-20.7	36.5	-2.9	-8.7	-1.4	-8.3
Corporates	2.8	52.7	-14.3	-19.7	-2.6	4.9

Source: BIS & Ninety One calculations

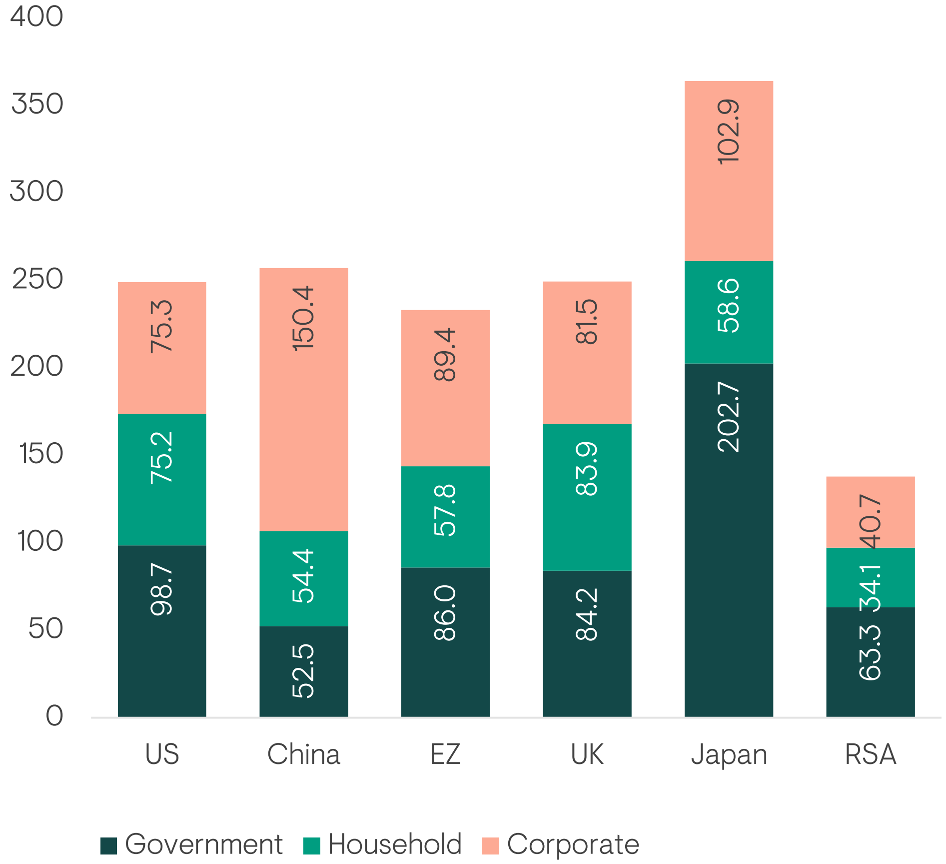
Does the debt burden actually matter?

How long does the music play?

- **Chinese debt** – Now more debt as a % of GDP than the US does
- **Paradox of Thrift** - Post Covid19, the risk is it reasserts itself more forcefully
- **Japanese style debt deflation** – Becomes a possible scenario if there a reassessment of the assets sitting behind the liabilities that have been taken on
- **Governments -** left to take up the economic slack
- **Historically low funding costs** – may not help
- **Debt service costs** - diverts resources from other needs

And we are burdening our children and their children with a liability

All sector debt to GDP, % as at Sep19



Source: IMF & Ninety One calculations

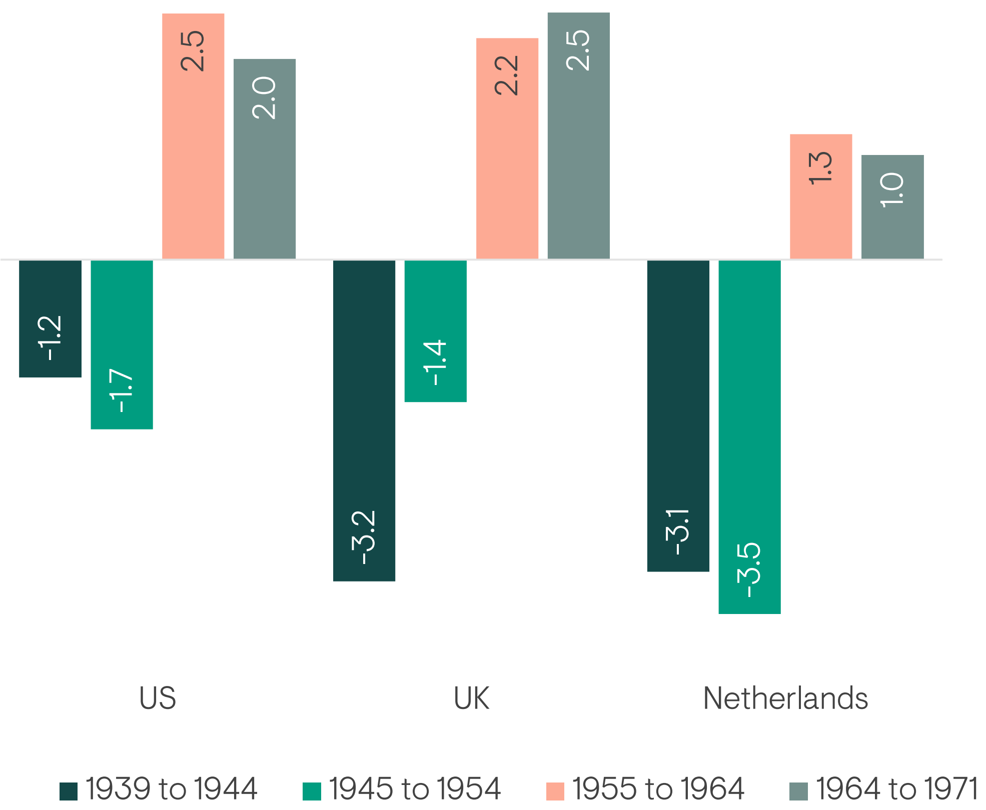
What then, are the options for dealing with the huge debt burden?

1. Financial repression

Dealing with the debt burden

- **Financial repression -** government policies that channel funds to themselves at below market yielding rates that, in a deregulated market environment, would go elsewhere.
- Historically been **very successful at reducing debt burdens** when accompanied by **inflation**
- **Post WWII -** governments kept real interest artificially low with strict capital controls - investors had little choice other than lending to government
- **Politically -** repression is least painful way to reduce debt
- **Post GFC** - was also widely practised

Real yield, %



Source: IMF & Ninety One calculations

2. Inflation

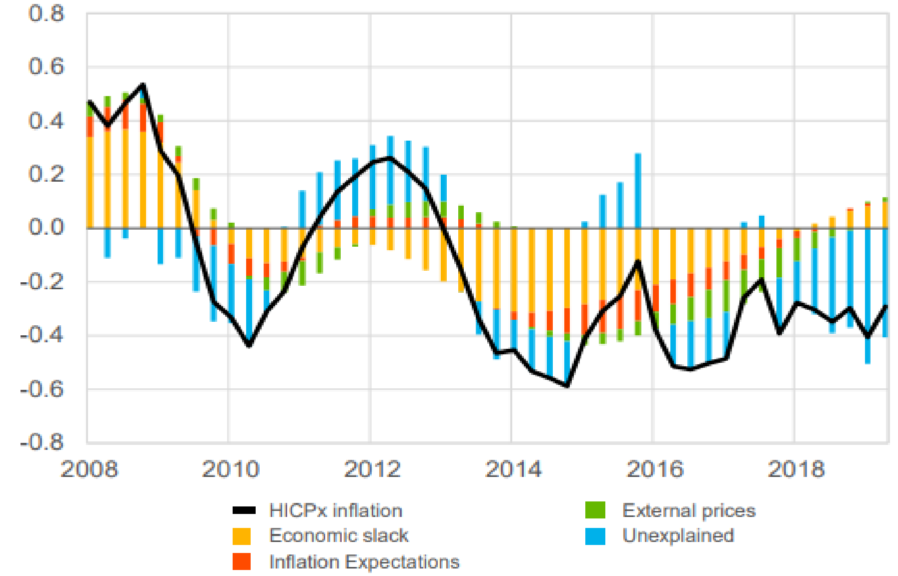
Dealing with the debt burden

- Debasing the value of debt through **inflation** can be traced back 1000s of years
- **Increasing inflation** - to erode the real value of debt is much more difficult in practice
- **Covid19 will decrease inflation**
- ECB Chief Economist – models (600) with different permutations of external price, economic slack and expectations measure - the dominant factor by a significant margin was "unexplained."
- **Inflation is appealing in theory** - outside of taking radical political steps central bankers have struggled to understand how inflation is created in a globalised world

Sicily, Syracuse. Dionysios I. 405-367 BC. Æ Drachm 29 mm, 31.8 gm. Struck circa 400-380 BC. Obv: Head of Athena left, wearing Corinthian helmet decorated with wreath Rev: Sea-star between two dolphins
Source: Google & European Central Bank

Thick modelling: Phillips Curve-based decomposition of core inflation

(percentage per annum & pp contributions: all values in terms of deviations from their averages since 1999)

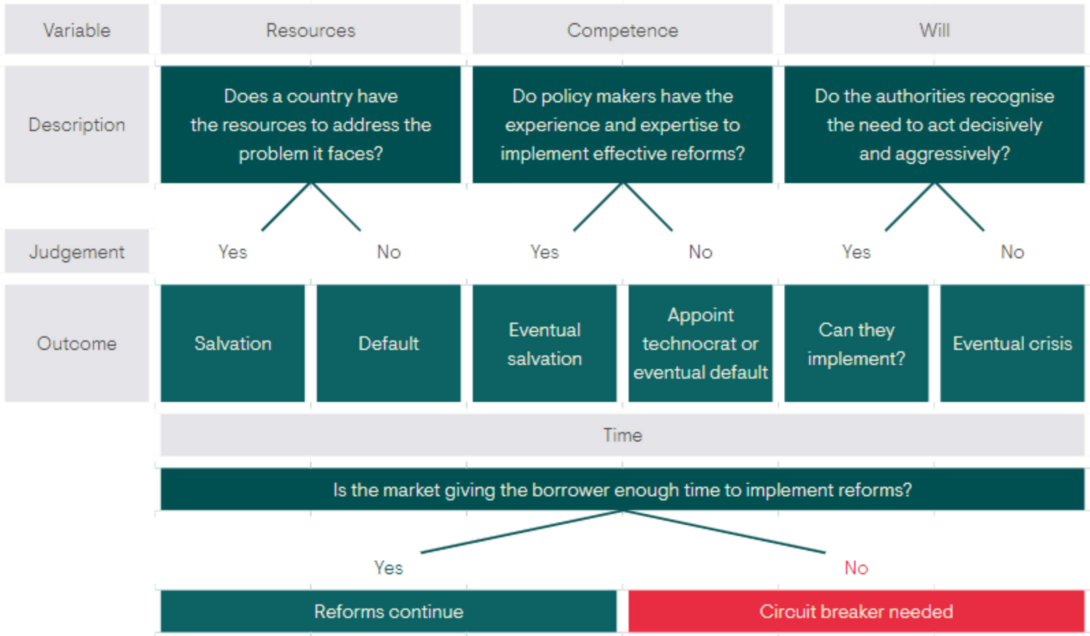


Source: ECB calculations
Notes: The bars show average contributions across 600 models with different permutations of external price, economic slack and expectations measures. Contributions are derived as in Yellen, J.L. "Inflation Dynamics and Monetary Policy" speech at the Philip Gamble Memorial Lecture, University of Massachusetts, Amherst, 24 September 2015. Latest observation: 2019Q2

3. Default

Dealing with the debt burden

- Default has long been a method of dealing with debt
- For governments, it is a political choice
- Can a government that prints its own money default?
- Technically, a debt will be repaid, but in worthless currency
- In 1923 the German Rentenmark was worth a billionth of the Reichsmark
- A keen eye for economic history reminds us that default is common
- Reinhart & Rogoff showed us that since its foundation in 1828, modern **Greece** has been in default for **53%** of the time
- We view the risk of default through the framework of **Resources, Competence & Will**



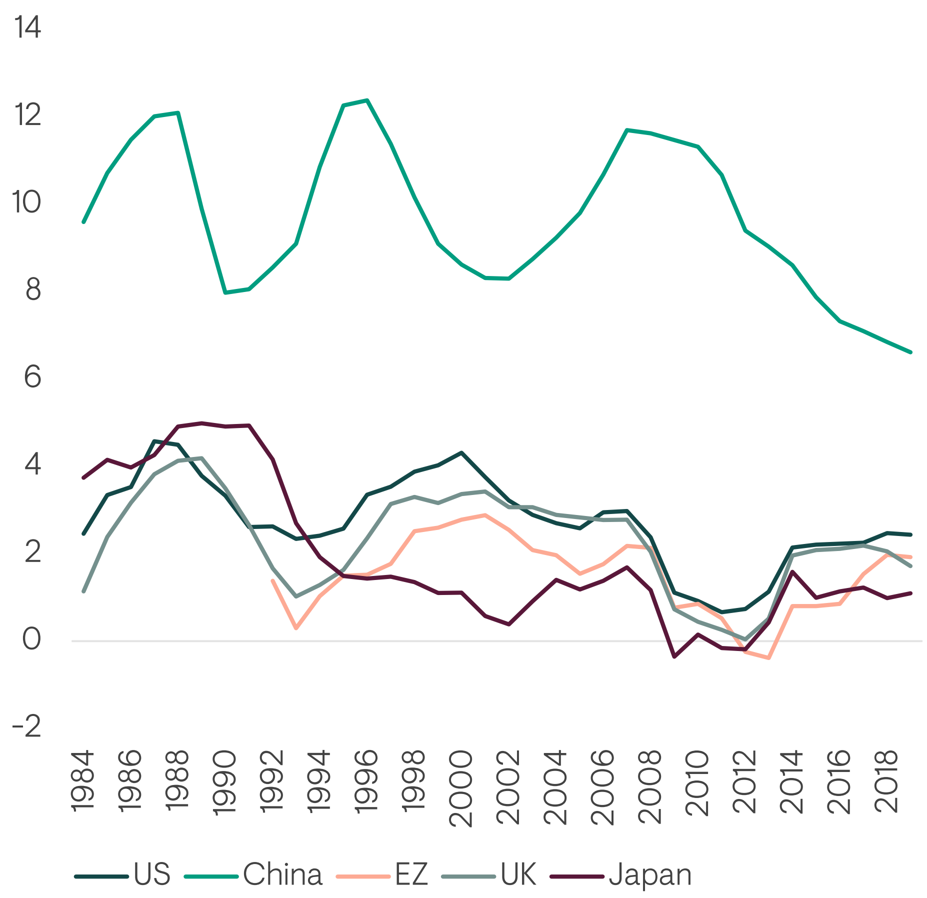
Source: www.project-syndicate.org/commentary/spence29/English & Ninety One

4. Growth

Dealing with the debt burden

- **For all sectors** - inclusive and sustainable growth is the way to ease a debt burden
- **Economic growth** - driven by working age population and productivity
- **Major economic blocs** - underlying rate of economic growth has been falling for several years
- **Covid-19** - will see an unprecedented fall in economic growth
- **We expect it to bounce** - but worry about the long term scarring

YoY real GDP growth – 5 year rolling average %



Unless the virus response unleashes a surge in productivity and business investment, strong growth looks like an unlikely solution to the debt burden

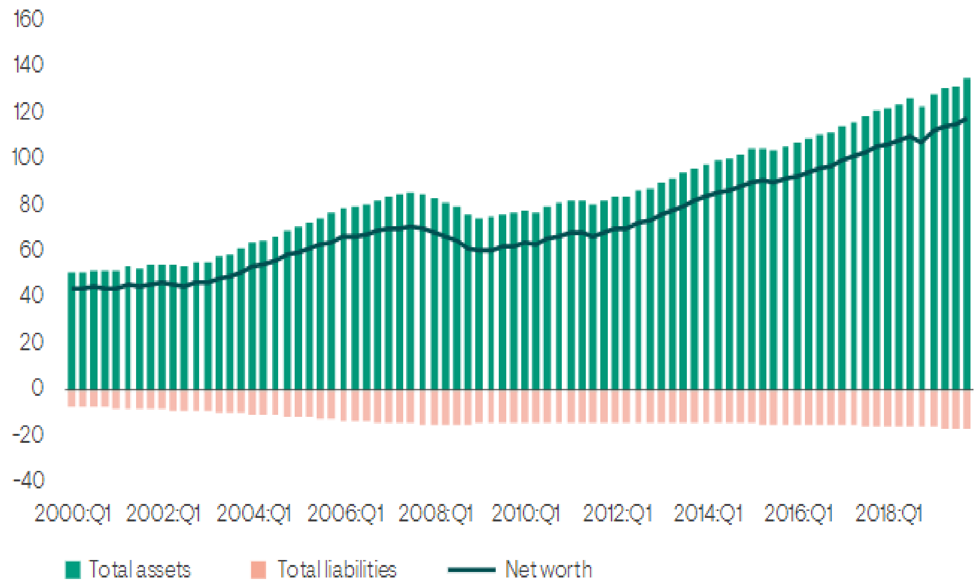
Source: IMF & Ninety One calculations

5. Taxation

Dealing with the debt burden

- Increasing a government's income by raising tax would clearly shift the burden of debt
- Government debt is 'secured' against future tax streams from households and corporations but the level at which this is imposed is a political choice
- In the aftermath of Covid19, **widespread rises in taxes seem unlikely**
- Rather there are two possible sources that could be tapped
  - Government's might choose to raise **corporate taxes**
  - Or they could tap the wealthiest in society via **wealth taxes**
- Relative to household liabilities, the level of assets is massive
- Is this a politically easy way to raise revenue?

US household assets and liabilities, U$ tn Dec19



Source: US Federal Reserve

6. Reduce spending

Dealing with the debt burden

- Reductions in government spending are not on the immediate horizon
- The appetite for austerity has a mixed record
- Arguably, Northern Europe has been able to unleash a massive stimulus to fight Covid as ‘they fixed the roof whilst the sun was shining’
- But the US, who has already cut taxes in 2016, have spent even more
- And there is an argument that public sector efficiency has been a false economy as many health systems have been seen to be too fragile to cope
- In the medium term, the emergency spending measures put in place by governments will be reined in
- But for now, there is **no political appetite at all to reduce government spending markedly**

7. 'Funny money'

Dealing with the debt burden

- Drastic times call for drastic measures
- Long list of possible routes that policy makers can make
- But they have one main feature, which is **monetary and fiscal policy become merged**
- And again, these are political choices
- They would be inflationary
- But they would increase growth, even if that growth is an illusion – **nominal versus real**

What?	Why?	How?
Modern Monetary Theory	The only constraint on government spending is inflation and whilst bond yields are below growth, there are no limits to borrowing	Government spending is the accelerator, taxation the brake
Monetary Financing	Stops crowding out of private investment	Central bank prints money and buys it directly form treasury
Deeply negative rates	Reduces cost of debt service	Do away with notes and coins and adopt digital only currency
Helicopter money	Guaranteed to increase spending in the economy	Government issues 'zero coupon perpetual bond' that central bank buys with printed money

Source: IMF & Ninety One calculations

Dealing with the debt burden

Conclusion: no easy choices

Dealing with the debt burden

1 Financial repression
Highly likely

2 Inflation
Can't see how

3 Default
Very unlikely

4 Growth
Difficult to see

5 Taxes
Few will dare

6 Reduce spending
Not much appetite

7 Funny Money
Requires political will

Source: IMF & Ninety One calculations

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Thank you

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