Seed Weekly

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Global Debt Levels

Over many years now, especially following the global financial crisis some 10 years ago, when subprime mortgage markets in the US led to a global banking crisis, investors have become concerned about the ballooning levels of debt in the global system.

There are many investment commentators and researchers that have a very gloomy fascination with trying to anticipate the next economic crisis and downturn. Their arguments are always plausibly backed up by some very daunting economic data.

There is no doubt that we live in a world laden with increasing amount of debt. Debt levels owed by the financial sector, other non-financial companies, governments, and households has reached an **estimated $244 trillion** in the third quarter of 2018, according to the Institute of International Finance.

But the question is, "*Are we at the precipice of a melt down due to high debt levels?*"

Of the total debt levels, **governments the world over owe $65 trillion and corporates an estimated $73 trillion.** Ten years after the global financial crisis, aided by ultra-low interest rates and the ease of access to credit, more and more debt has piled up.

In addition to the debt owed by governments and corporates, **households owe an estimated $46 trillion and the financial sector some $60 trillion.**

This level of total debt is around three times the size of the global economy.

One of the biggest borrowers is the United States government. Like most governments, they spend more each year than they receive in taxes. They are able to do this by issuing bonds – i.e. borrowing money. The cumulative impact of this on the approximately **$20 trillion** economy, is a government that is indebted to an amount in excess of **$22 trillion.** This level of debt was approximately $10,6 trillion when President Obama started his presidency in January 2009 and is expected to reach an estimated $29 trillion by 2029.

The debt levels of G7 nations has risen by 27 percentage points since the global financial crisis, to around 117% of GDP. By way of comparison, South African gross government debt, before contingent liabilities is around R3 trillion ($211 billion) or 56% of GDP.

However, debt issued by developed sovereigns in their own currency, is probably less of a concern at this stage than the rising company debt levels over the past 10 years. Governments in general have the ability to print and to increase taxes and so pay down their debt.

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As household debt levels have stabilised following the financial crisis, since 2012 corporate debt has been ballooning.

The Dangers of Debt

Debt is a promise by a borrower to pay enough in future to allow the debt including all interest to be repaid within the agreed term. Debt becomes a problem –

- When the interest payments required to service the debt become more and more difficult to make;
- When the assets backing the debt do not perform as expected – making the servicing of the debt more onerous;
- When, at maturity of the debt, it is difficult or very expensive to roll over – i.e. difficult or impossible to source new borrowings in order to replace maturing debt;
- When currency movements make it difficult to meet the interest and capital commitments of foreign currency loans.

Is It Time to Panic?

Many individual economies, companies and individuals can find themselves in difficultly when in an over indebted situation and unable to service the interest and maturing capital. Historically major crashes have involved debt, but just because debt levels are at high levels, is not reason enough to panic.

Over the past years many large corporates have taken advantage of the cheaper debt for merger and acquisitions and in gearing their balance sheet to buy back equity. The chart below reflects US corporate debt levels rising over the years relative to GDP.

Global Debt Levels

Chart 1: U.S. Non-financial Corporate Debt as % of GDP*

Source: BCA Research (30 April 2019)

Conclusion

Individual companies that are overindebted will find it difficult to roll over their debt, resulting in a rise in defaults. At this stage however the default levels are very low relative to history even as corporates have boosted debt in a low interest rate environment.

While debt levels have increased across the various borrowers, they do not appear to be at excessively stretched levels. While economies are expanding and inflation, interest rates and default levels remain low, debt levels in general can be sustained. At the same time, this is one of the signs that we will continue to keep an eye on.

Kind regards,

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Director & CIO

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ADDITIONAL INFORMATION (where applicable)

Performance has been calculated using net NAV to NAV numbers with income reinvested. Full performance calculations are available from the manager on request.

DEFINITIONS (where applicable)

Annualised Return	Annualised return shows longer term performance rescaled to a 1-year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.
Highest and Lowest Annual Return	The highest and lowest returns, since launch, for any rolling 1-year period have been shown.