Accuracy

GOING BEYOND GROWTH FORECASTS

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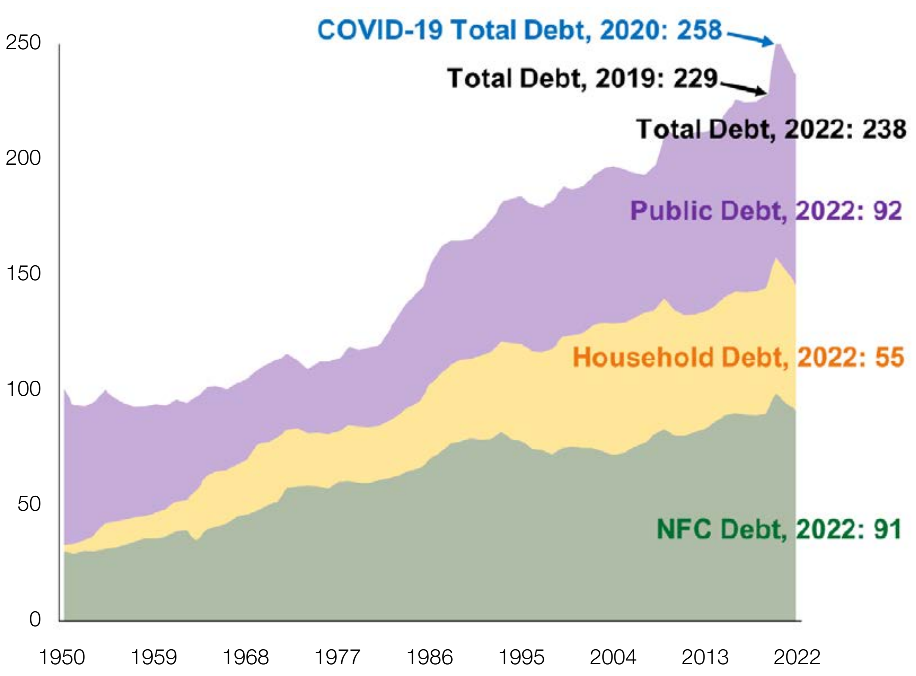
In today's edition of the Economic Brief, we touch on three separate, albeit interrelated, topics: we will take a bird's eye view of global debt and its development over the past few years; we will investigate the trends in US long-term rates to understand what is driving them; and we will examine what a soft landing is in relation to monetary tightening and how likely it is to occur.

Global Public and Private debt, 1950–2022 (Percent of GDP)



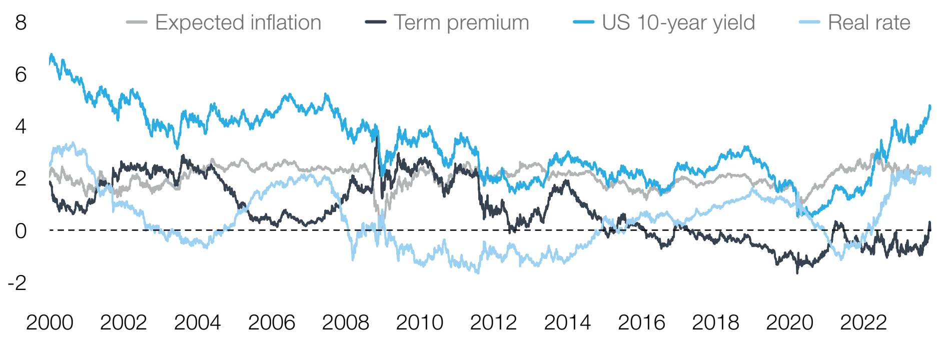
Source: IMF

Though global debt stands at approximately USD 235 trillion in 2022, representing 238% of world GDP, it has been falling over the past two years. The graph opposite shows the evolution of non-financial corporation debt, household debt and public debt for the past several decades. We can observe that public debt, after peaking during the pandemic, decreases to 92% of GDP in 2022, a fall of 3.6 percentage points from the previous year. This reduction represents the reversal of approximately half of the increase incurred during the pandemic.

Private debt, whether household or held by non-financial corporations, contributed further to the general downward trend. Together, they fell by 6.4 percentage points from the previous year to reach 146% of world GDP. Indeed, in numerous developed economies and emerging markets (with the exception of China), debt has returned to below its pre-pandemic level.

In spite of these decreases over the past two years, which total 20 percentage points of global GDP, the impact of the Covid-19 pandemic lingers, with global debt in 2022 remaining nine percentage points above the pre-pandemic level. Now, it appears to have resumed its historical upward trend; managing debt vulnerabilities will be essential.

Drivers of US 10-year government yield



Sources: Accuracy & Bloomberg

When looking at the US 10-year Treasury rates, as shown in the graph opposite, we can observe several points of note. Rates are now above 4.70%, compared with below 2% early last year and even lower in 2020 and 2021. Initially, inflation expectations were the main engine of the rise. However, for the past couple of quarters, a sort of rotation has taken place. While inflation expectations have stabilised a little above 2%, both the term premium (the premium required to invest in longer maturity bonds and not in an overnight money market asset) and real rates generate the surge. Two main reasons explain this upward inflexion: volatility and uncertainty on the one hand in relation to recent developments, whether it be inflation, monetary policy or geopolitics, and a growing concern around indebtedness on the other hand, whether governmental, corporate or household, in an environment of higher interest rates.

You may recall that during 2023 economic growth forecasts for the year were revised upwards for almost all the G20 economies. For example, US forecast growth for 2023 increased from 0.3% estimated at year-end 2022 to 2.1% in early October; over the same period, eurozone forecast growth increased by circa 0.7 points to reach 0.6% (from a negative -0.1% starting point). Of all the G20 economies, only China bucked this trend: its forecast growth rose from 4.8% at year-end 2022 to 5.7% mid-year, only to fall again to 5.0% in early October. Forecasts for 2024 are now in the spotlight, but this time, all the G20 economies have seen their prospects revised downwards (e.g. an 8-point reduction for the US, from 1.3% initially to 0.5%, and a 6-point reduction for the eurozone, from 1.4% to 0.8%). However, a note of hope remains: recession does not appear to be on the cards… just yet.

In such cases, economists often talk of a 'soft landing', where monetary tightening succeeds in countering inflationary pressures sufficiently and convincingly, but it does not go so far as to break growth. Then, once the inflationary environment is past, monetary policy can be loosened. However, instances of soft landings remain rare. Alan Binder, the former vice-chair of the board of the Federal Reserve, studied the 11 episodes of monetary tightening undertaken by the Fed since 1965; he found that only one concluded with a soft landing.

Though institutions and general consensus forecast continuing growth in 2024 and therefore what appears to be a successful soft landing, the probability of a recession remains high (over 50% for the US and for the eurozone). It remains to be seen how soft – or hard – the landing will be.

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