Dealing with High Debt in an Era of Low Growth

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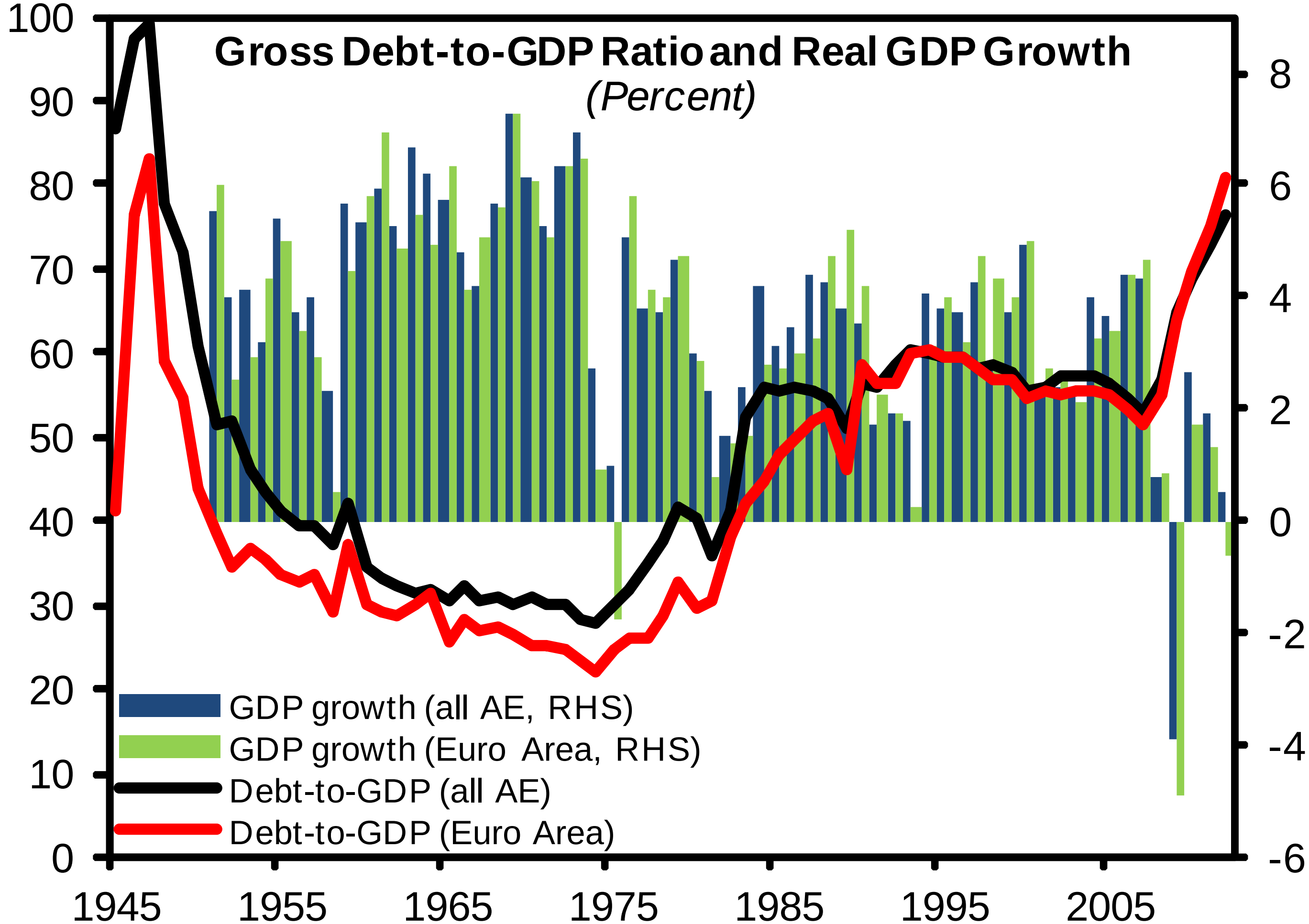
Scale of the Problem

Debt at historical highs amid modest growth



Sources: Historical Public Debt Database, IMF Fiscal Monitor, IMF World Economic Outlook, and IMF staff calculations.

A challenging macro-fiscal environment

Main Macroeconomic Indicators for Selected Advanced Economies

(Percent unless otherwise indicated)

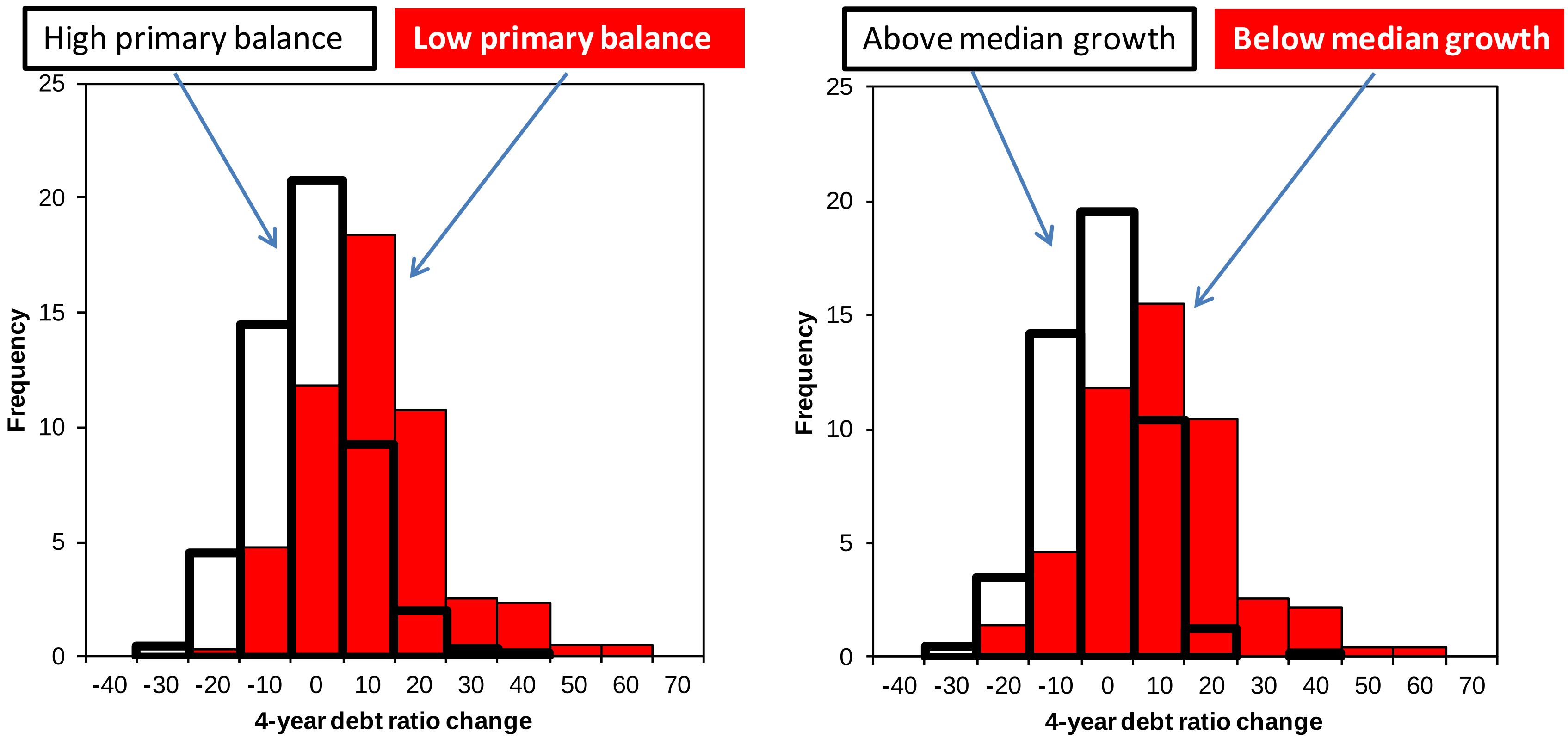
	2013	2014-19 Average			
	Debt ratio	Inflation Rate	Real Average Interest Rate	Real Growth Rate	r-g
Selected Euro					
France	93.9	1.4	0.8	1.7	-0.8
Germany	78.1	1.6	1.2	1.4	-0.2
Ireland	122.8	1.3	3.0	2.4	0.6
Italy	132.5	1.2	2.8	1.0	1.8
Portugal	128.8	1.3	2.1	1.6	0.5
Spain	93.9	0.9	2.8	1.1	1.7
Non-Euro G7					
Canada	89.1	1.9	1.7	2.2	-0.5
Japan	243.2	2.0	-0.1	1.0	-1.1
UK	90.1	2.0	1.9	2.5	-0.5
US	104.5	1.8	2.1	2.7	-0.6

Sources: IMF Fiscal Monitor, IMF World Economic Outlook, and Fund staff calaculations.

What Moves the Debt Ratio?

Debt falls with high growth and primary balances…

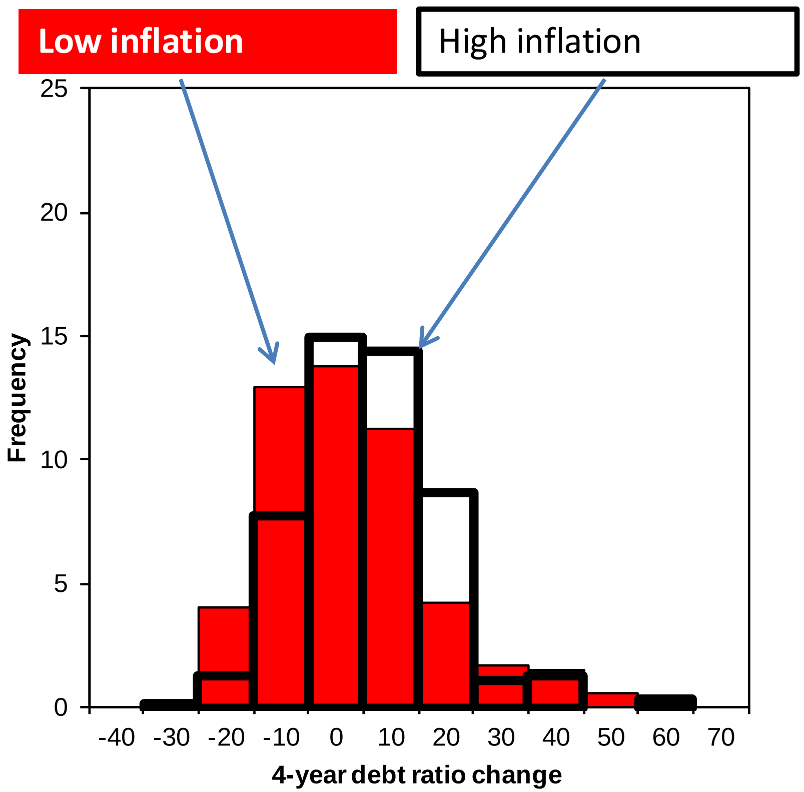
Distribution of Debt Ratio Changes (1)

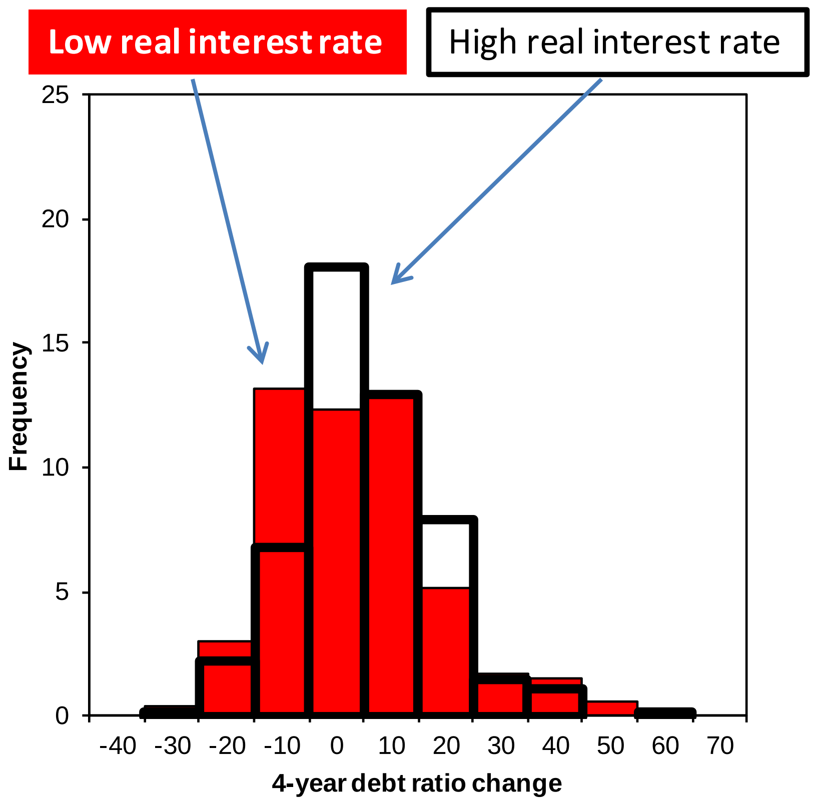


Sources: IMF WEO; and IMF Staff calculations and estimates.

…while inflation & interest rates have little impact

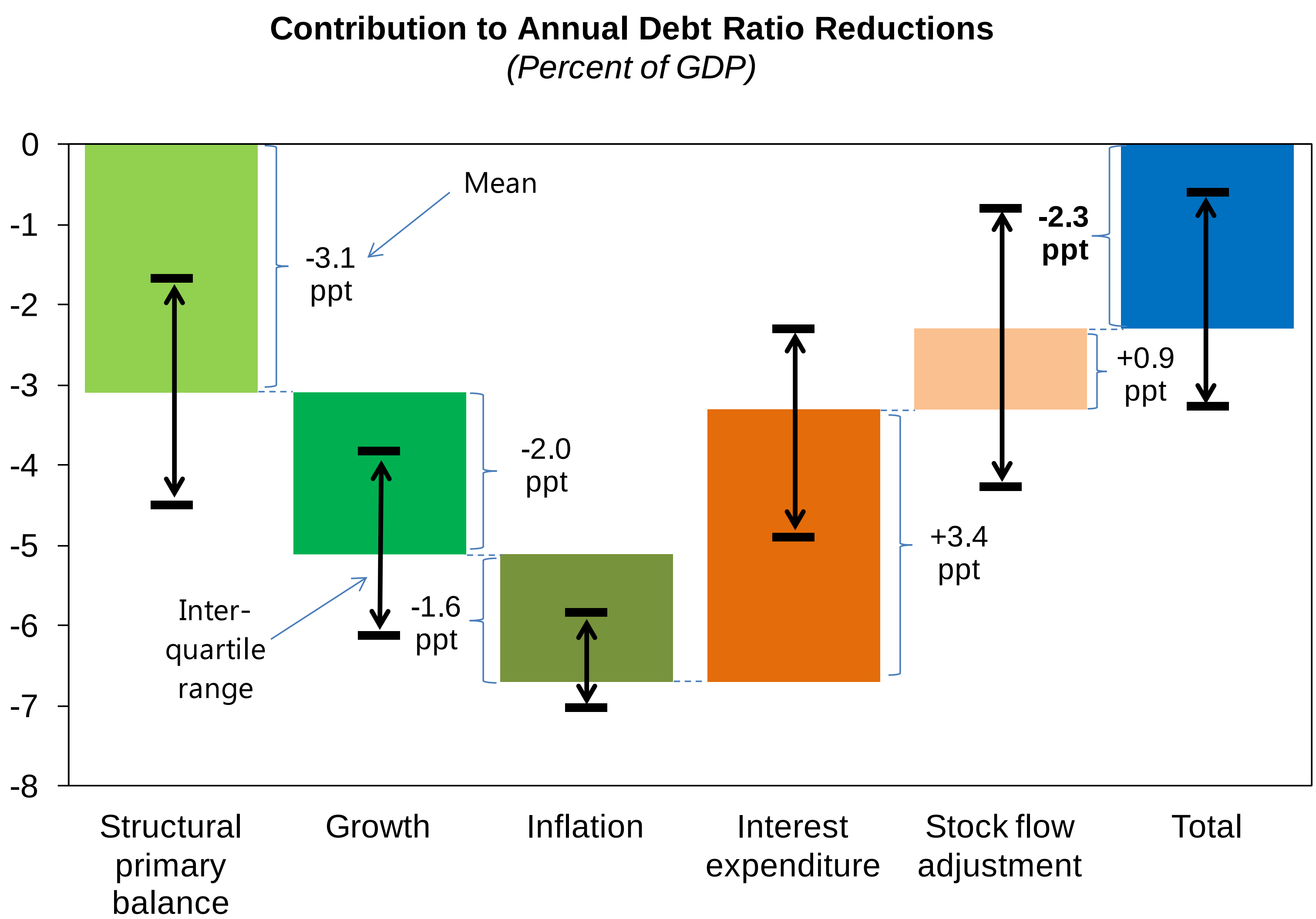
Density of Debt Ratio Changes (2)





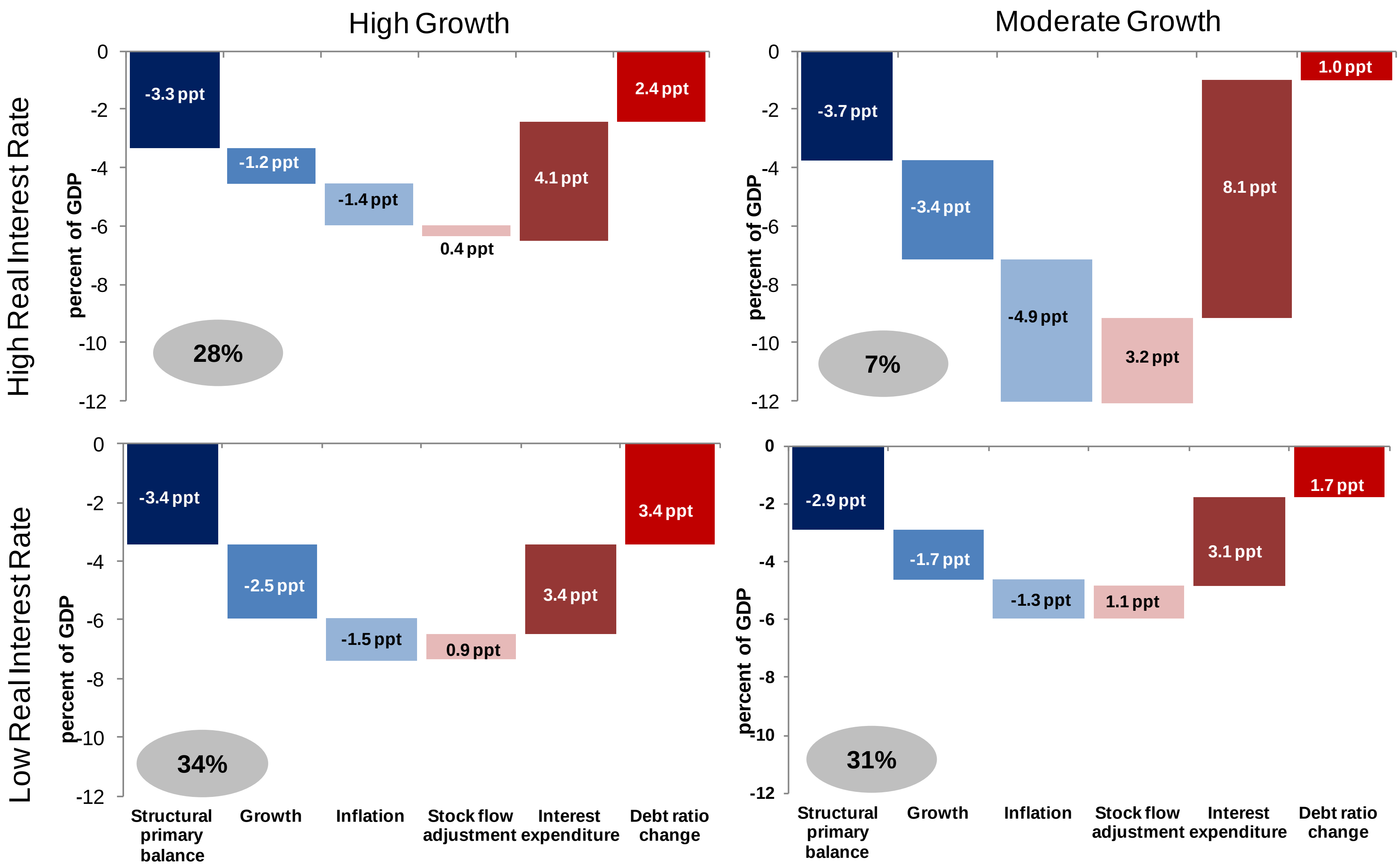
Sources: IMF WEO; and IMF Staff calculations and estimates.

Decomposition of debt changes points to fiscal effort



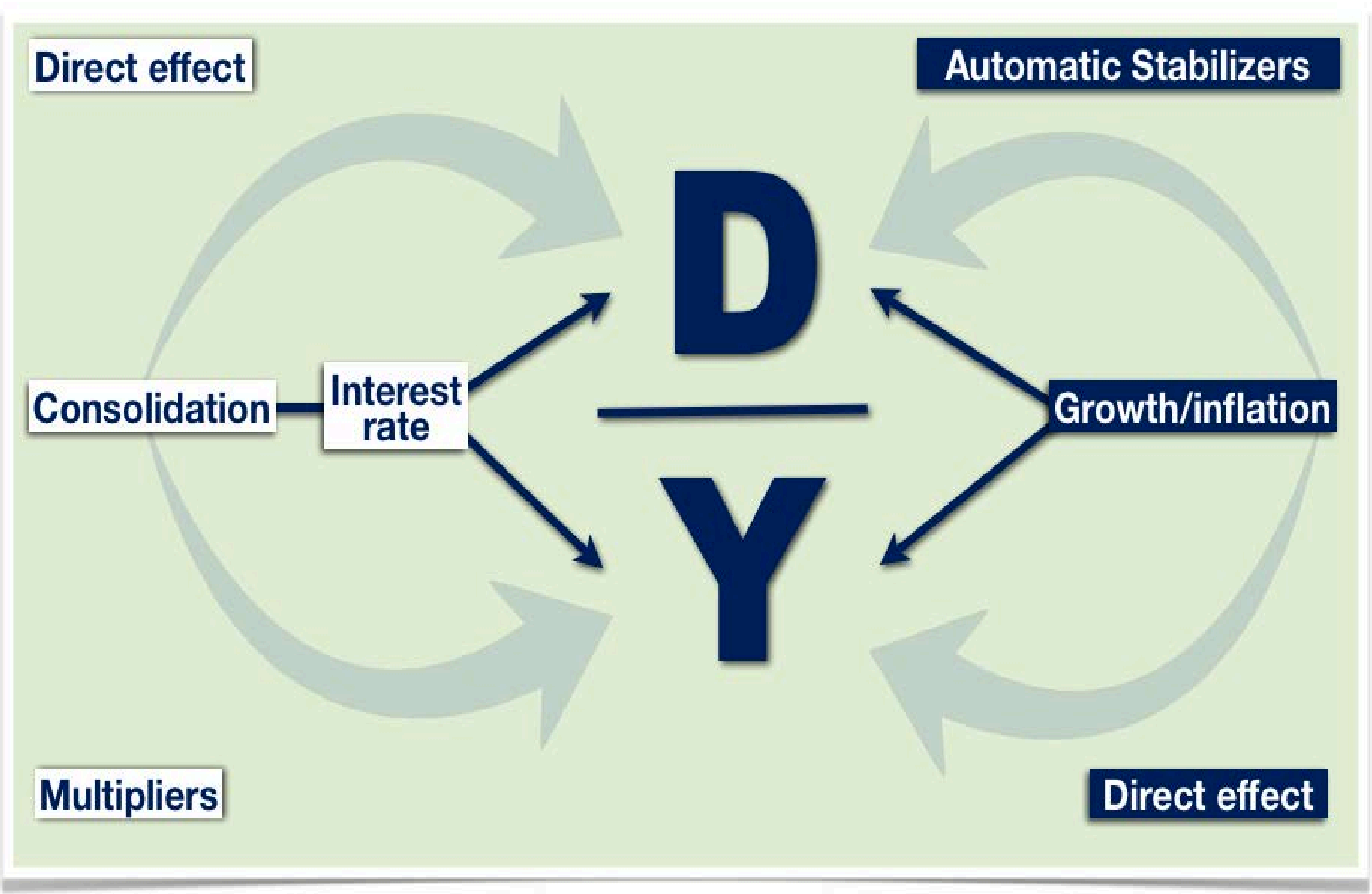
Sources: IMF World Economic Outlook; and IMF staff calculations.

…but success shaped by economic conditions

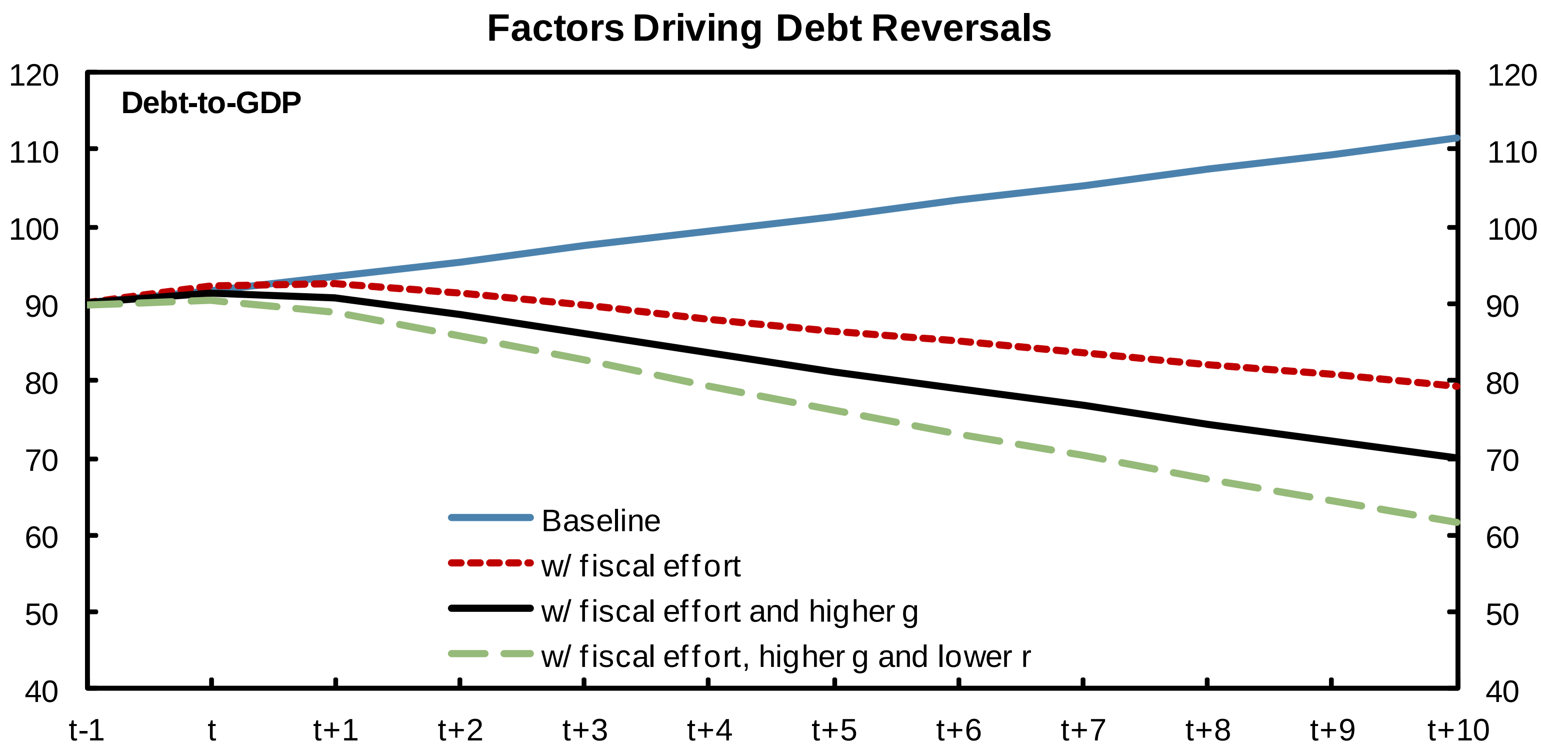


Consolidation and growth

Complicated interaction and trade-offs



Drivers of debt: fiscal effort, growth, interest rate



Assumptions:

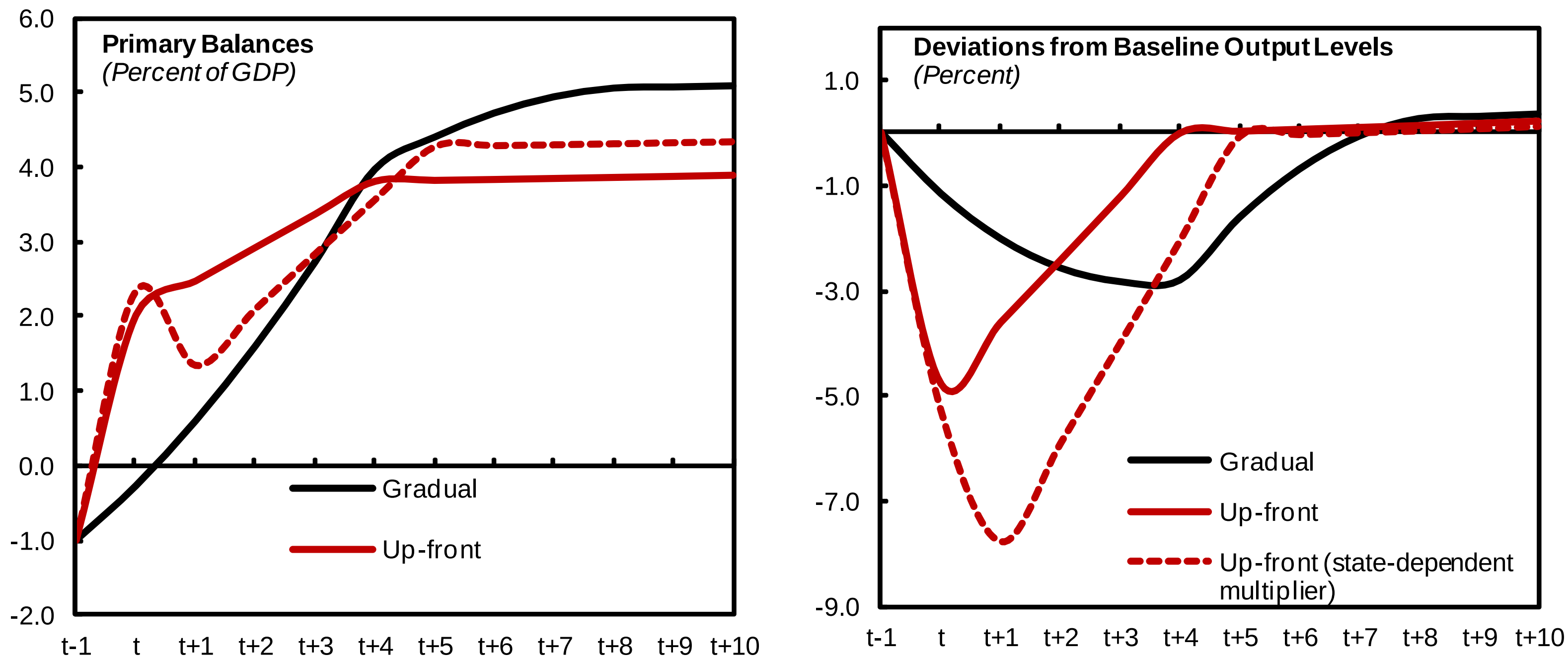
Baseline real growth: 1.2 percent (excluding drag from risk premium).
Starting debt-to-GDP ratio: 90 percent.
Fiscal multiplier: 1 and persists for 4 years.

Underlying interest rate: 2 percent.
Maturity (average): 7 years.
Credibility effect: 15 bps per 1 percent of GDP adjustment.

The structural primary balance is adjusted by 2 percent of GDP in t and 1 percent more in t+1. Higher growth and lower interest scenarios increase/decrease baseline rates by 1 percentage point respectively.

Consolidation: to frontload or not to frontload?

Growth and Primary Balance Paths for Achieving a Given Debt Reduction



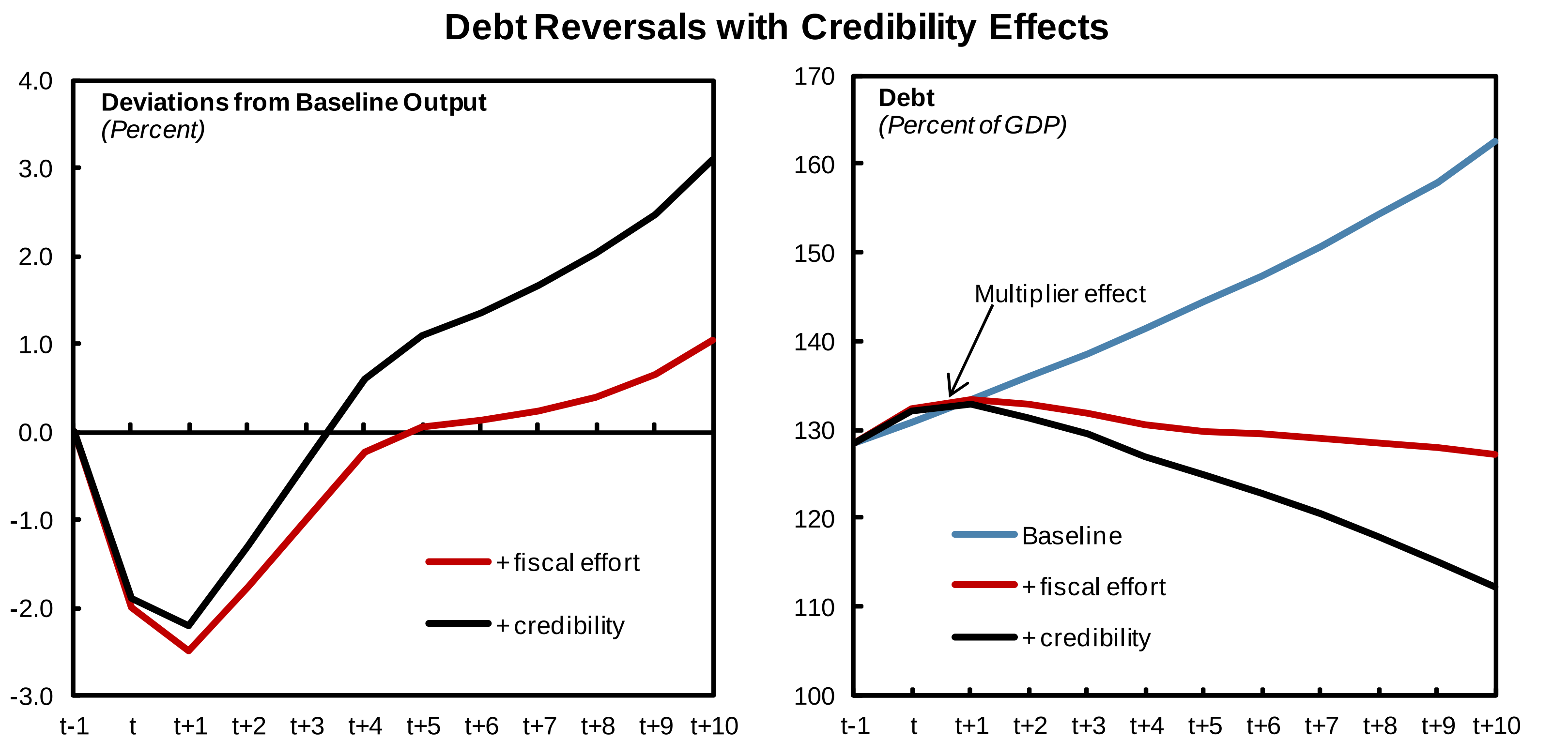
Assumptions:

Baseline real growth: 1.2 percent (excluding drag from risk premium).
Starting debt-to-GDP ratio: 90 percent.
Fiscal multiplier (regular) : 1 and persists for 4 years.
Fiscal multiplier (state-dependent): 1.5, peaks in t+1 and persists for 5 years.

Underlying interest rate: 2 percent.
Maturity (average): 7 years.
Credibility effect: 15 bps per 1 percent of GDP adjustment.

The structural primary balance is adjusted in order to meet a 60 percent of GDP target by t+10 under two strategies: gradual adjustment over 5 years (total adjustment needed is 6 percent of GDP) or up-front adjustment (total adjustment needed is 4.8 percent of GDP with regular multiplier and 5.3 percent of GDP with state-dependent multiplier).

Credibility effects: Relatively small?



Assumptions:
Baseline real growth: 1.2 percent (excl. drag from risk premium).
Starting debt-to-GDP ratio: 130 percent (closer to D_max of 170).
Fiscal multiplier: 1 and persists for 4 years.
Baseline primary balance: -1.

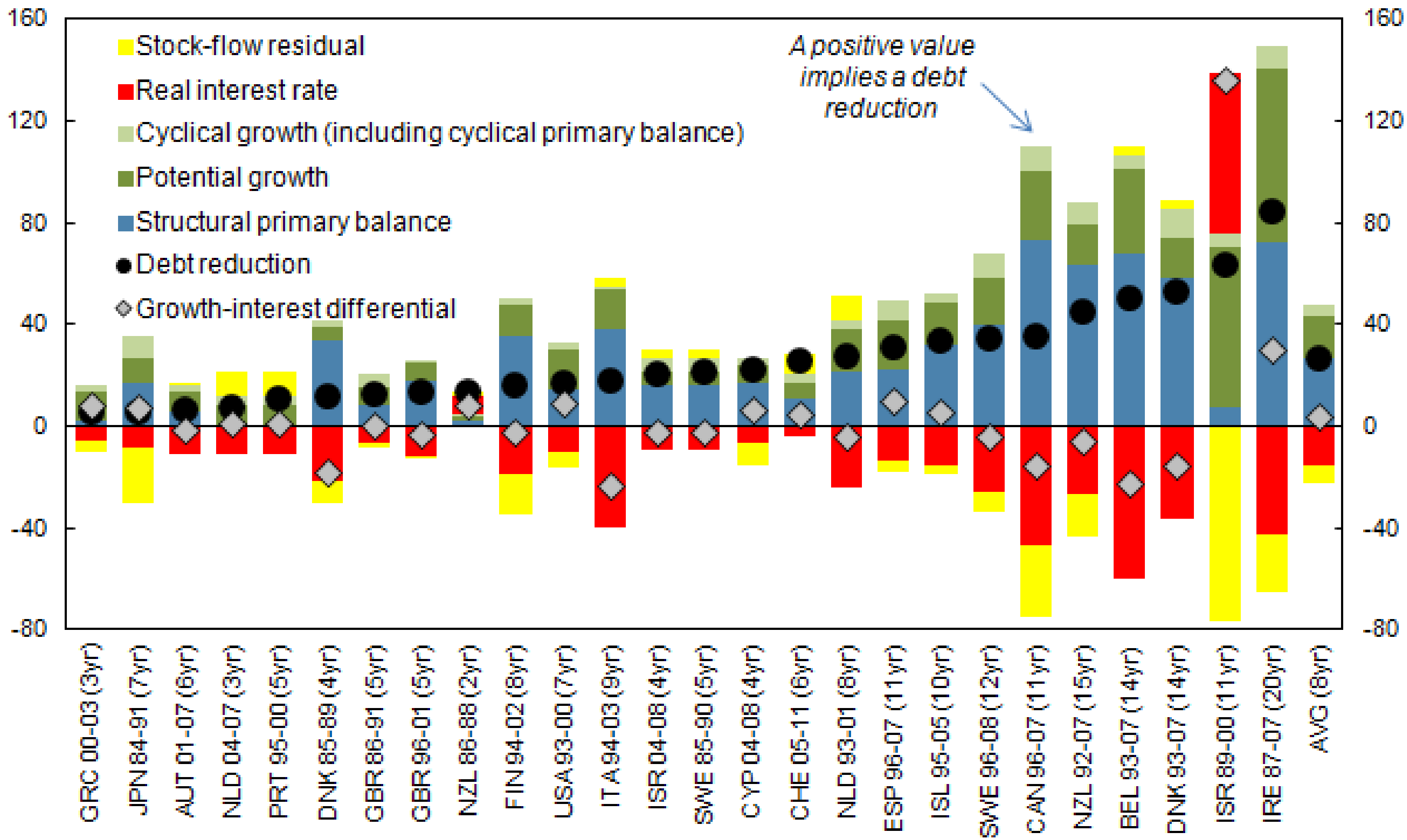
Underlying interest rate: 2 percent.
Maturity (average): 7 years.
Credibility effect: 30 bps per 1 percent of GDP adjustment.

The structural primary balance is adjusted by 2 percent of GDP in t and another 1 percent of GDP in t+1.

Understanding
Past Debt Reductions

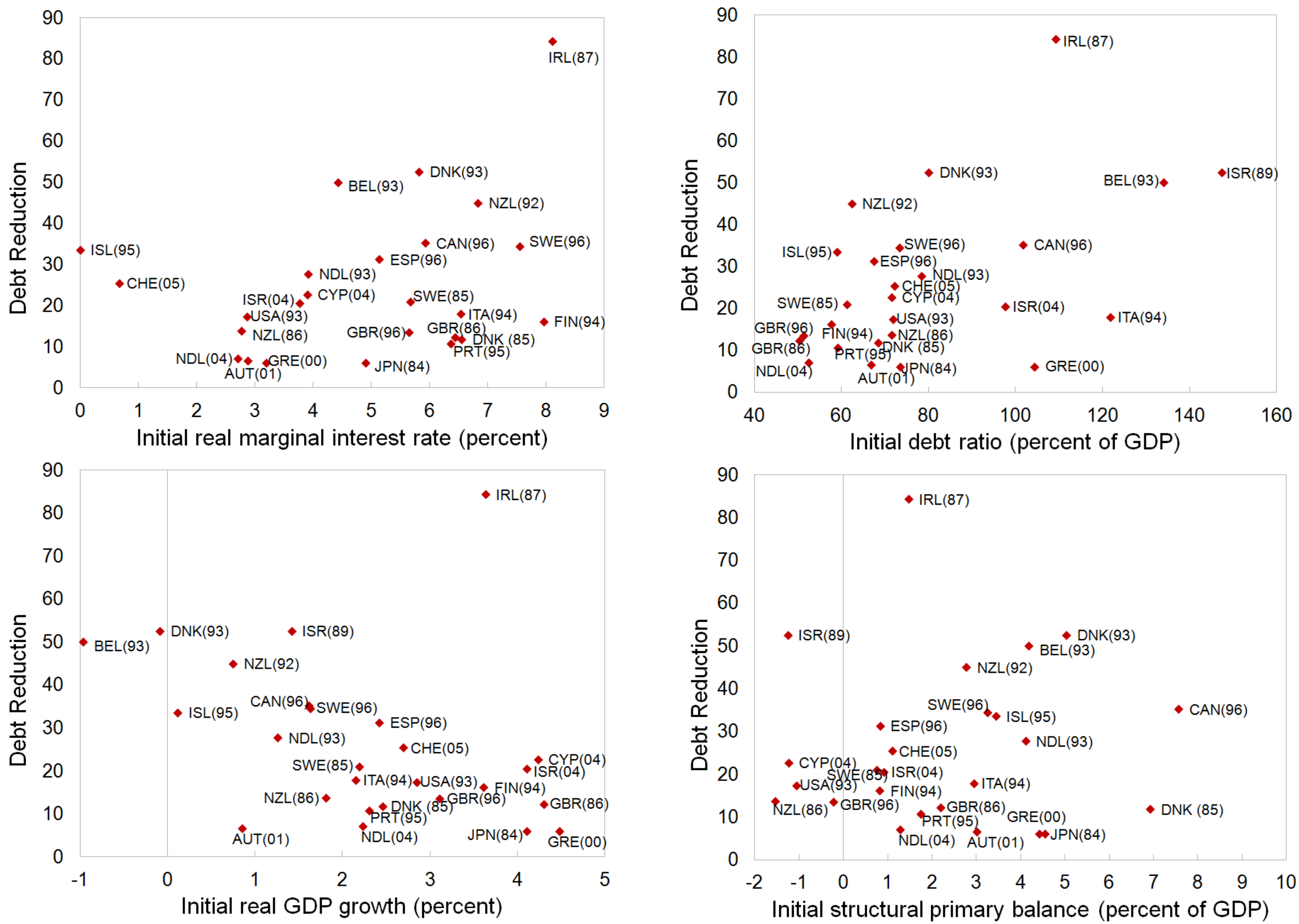
26 major debt reductions since 1980

Components of Major Debt-to-GDP Reductions *(percent of GDP)*



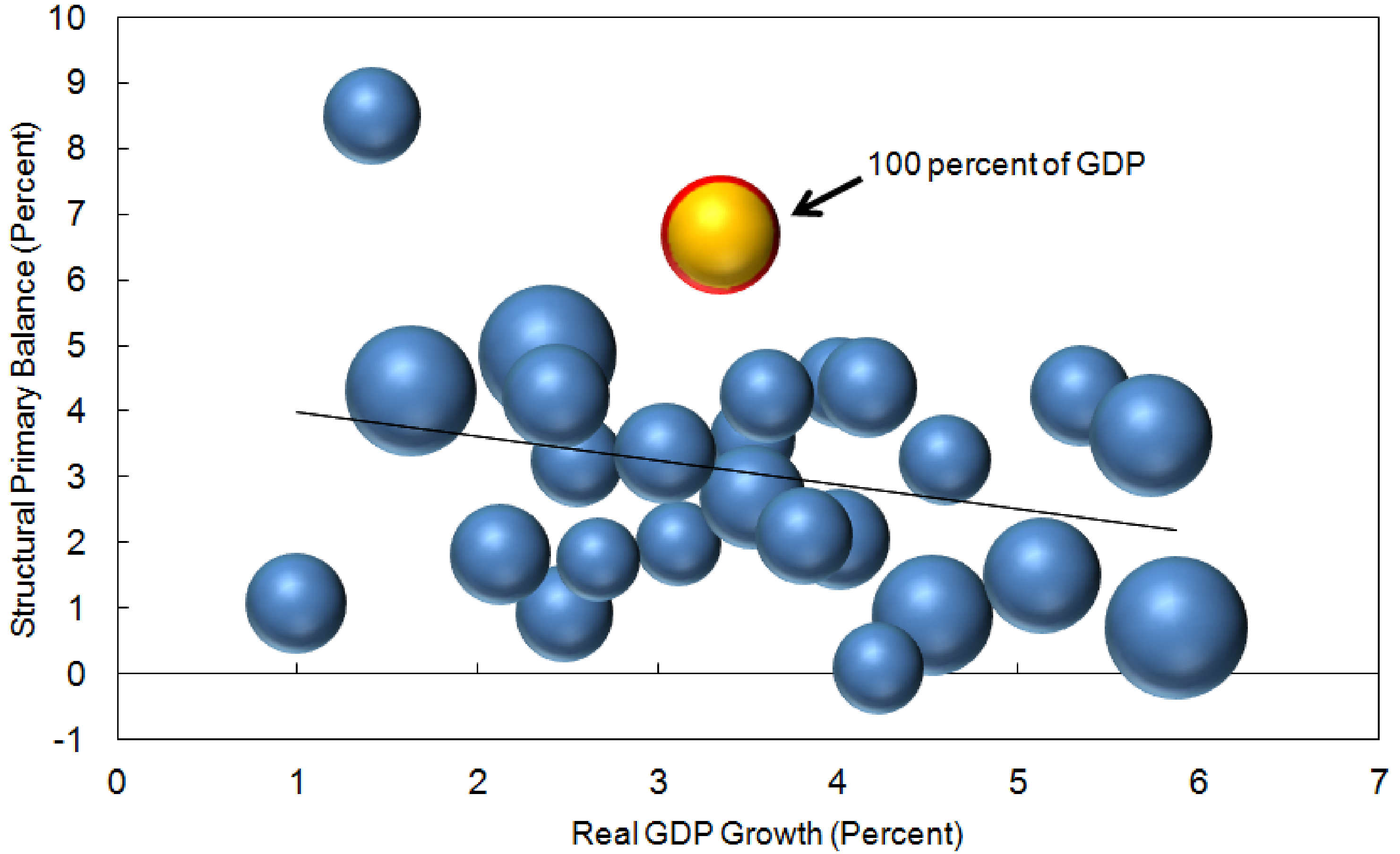
Sources: IMF World Economic Outlook ; and IMF staff calculations.
* Total contribution of components over entire debt reduction period (length of period in brackets).

Some starting in quite difficult conditions



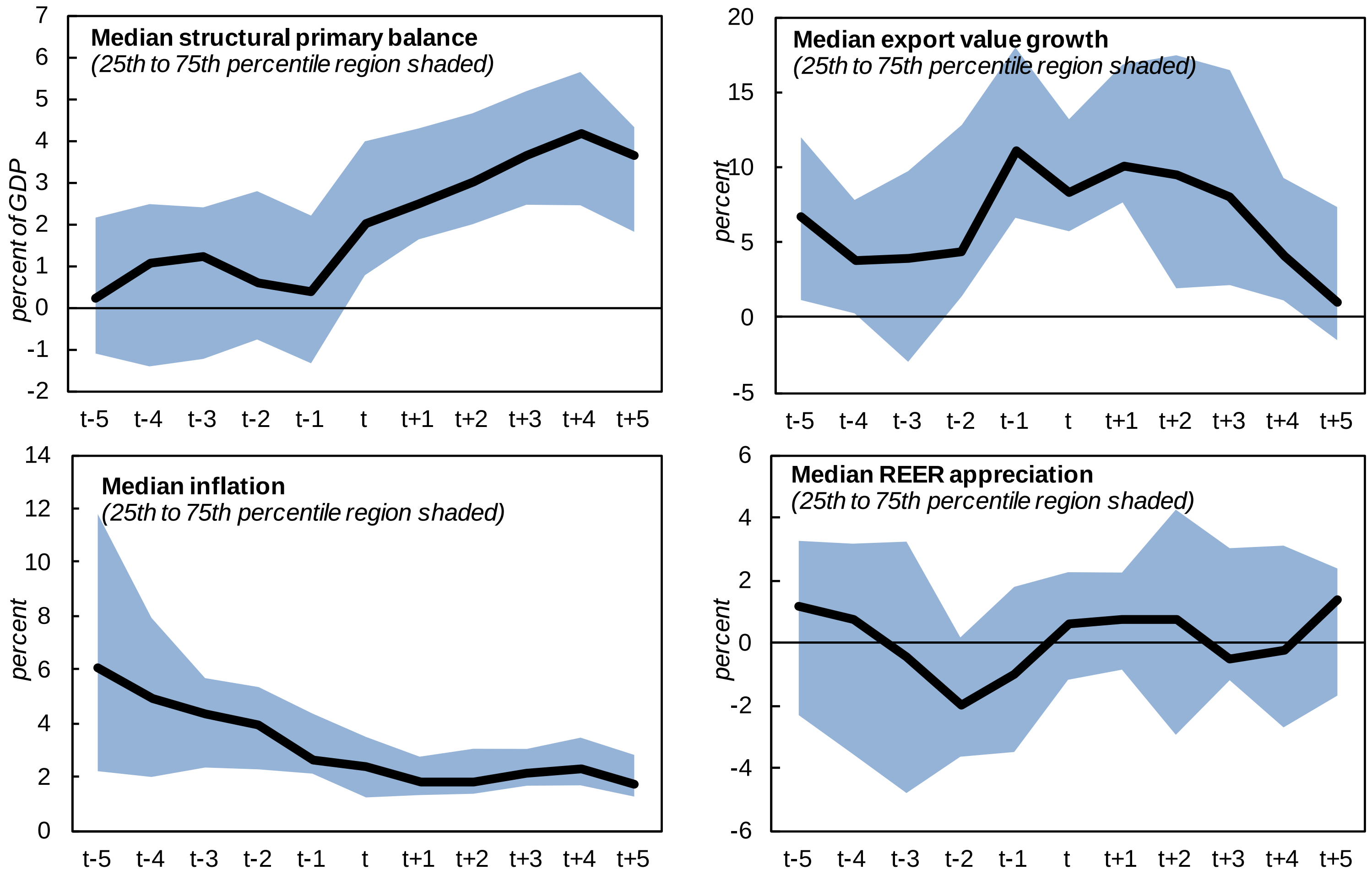
Did fiscal effort compensate for low growth?

Figure 10. Real GDP Growth, Structural Primary Balance, and Size of Initial Debt 1/
-- Advanced Economies Since 1980 --

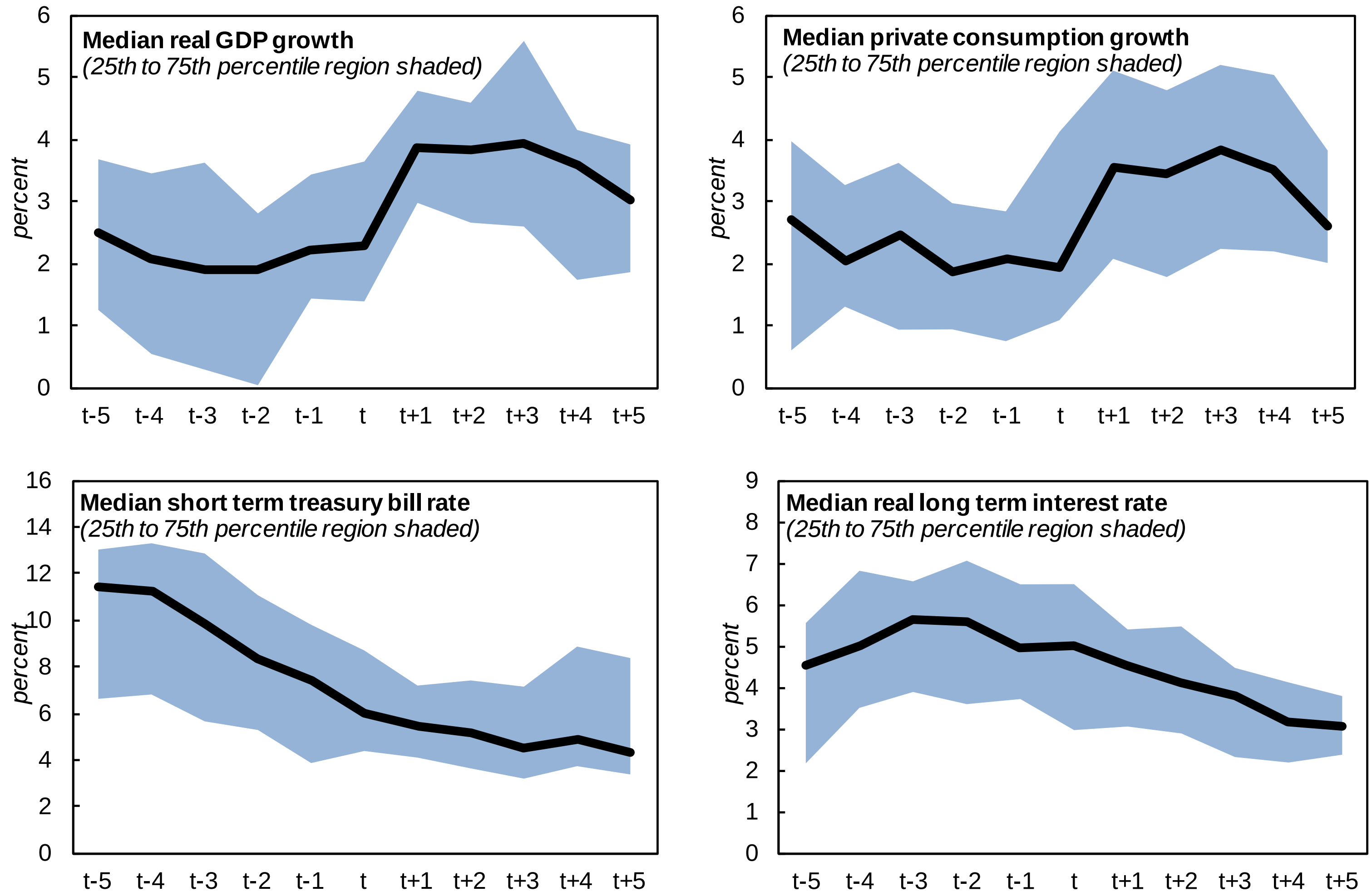


Source: IMF staff calculations.
1/ Real GDP growth and primary balance data are calculated as averages observed over the debt reduction period.

Sustained effort + supportive external demand



Accommodative monetary policy + credibility effects



POLICY LESSONS

Good news and bad news

- Examples of successful debt reductions, even under adverse circumstances
- Current environment shifts much of the burden to fiscal policy
- Trade-offs (where there is a choice)

Policies

- Well-designed consolidation: targeted, gradual, within good medium-term strategy—for those that can wait
- Monetary policy
- Structural reforms for growth