Economic Perspectives

Who will save the world from 2020 peril?

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Assisted by Yvan Berthoux, Liseth Galvis-Corfe and Tom Traill

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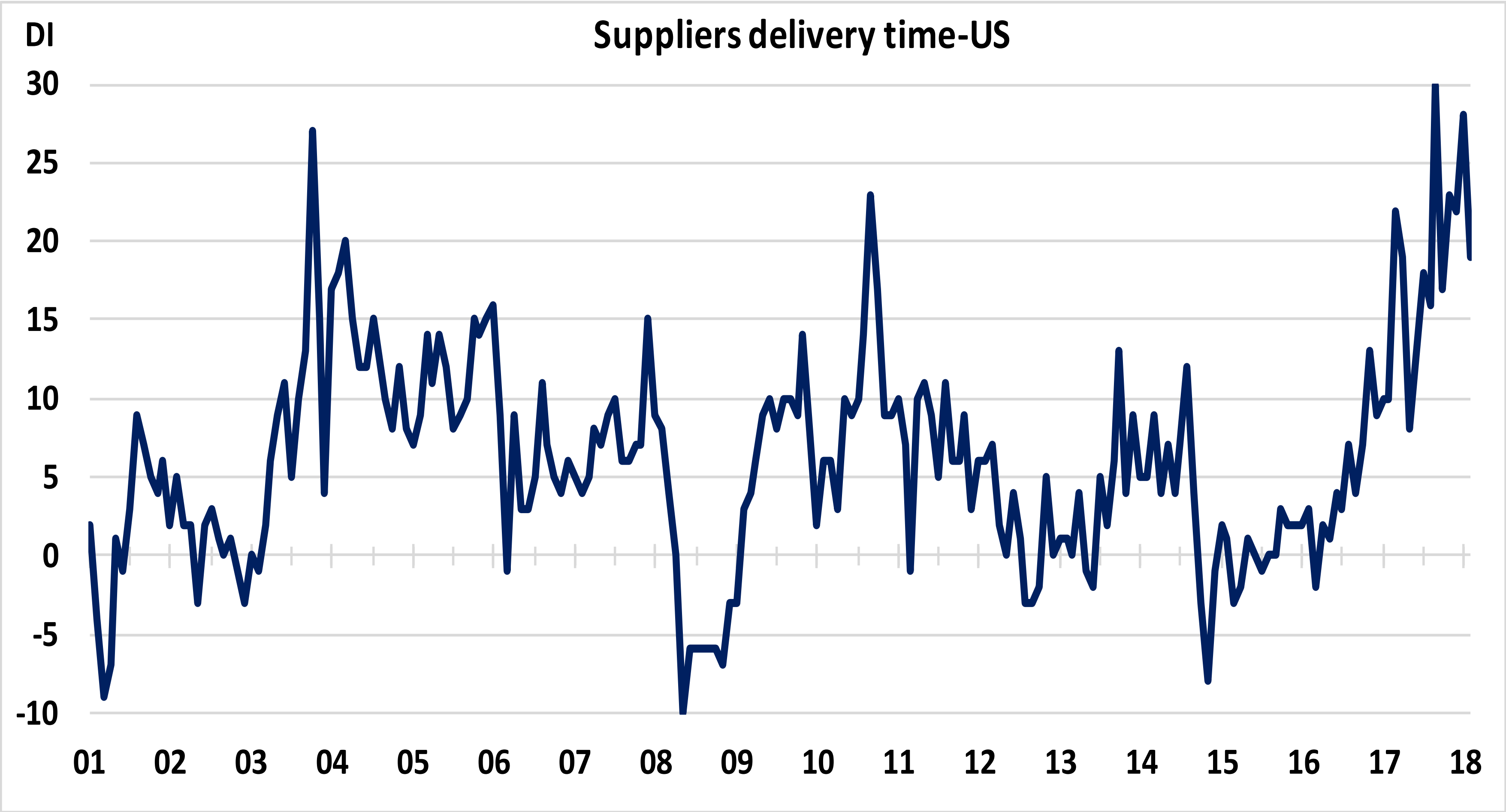
Ingredients of the 2020 peril

- Overheating and growing inflation pressures
- Approaching corporate debt refinancing challenge
- Approaching public debt refinancing challenge
- Continuing lurch towards higher policy rates
- Adjustment of global bond yields to faster nominal GDP growth
- Approaching quantitative tightening
- Approaching tariff and trade restrictions

Overheating and increasing inflation pressure

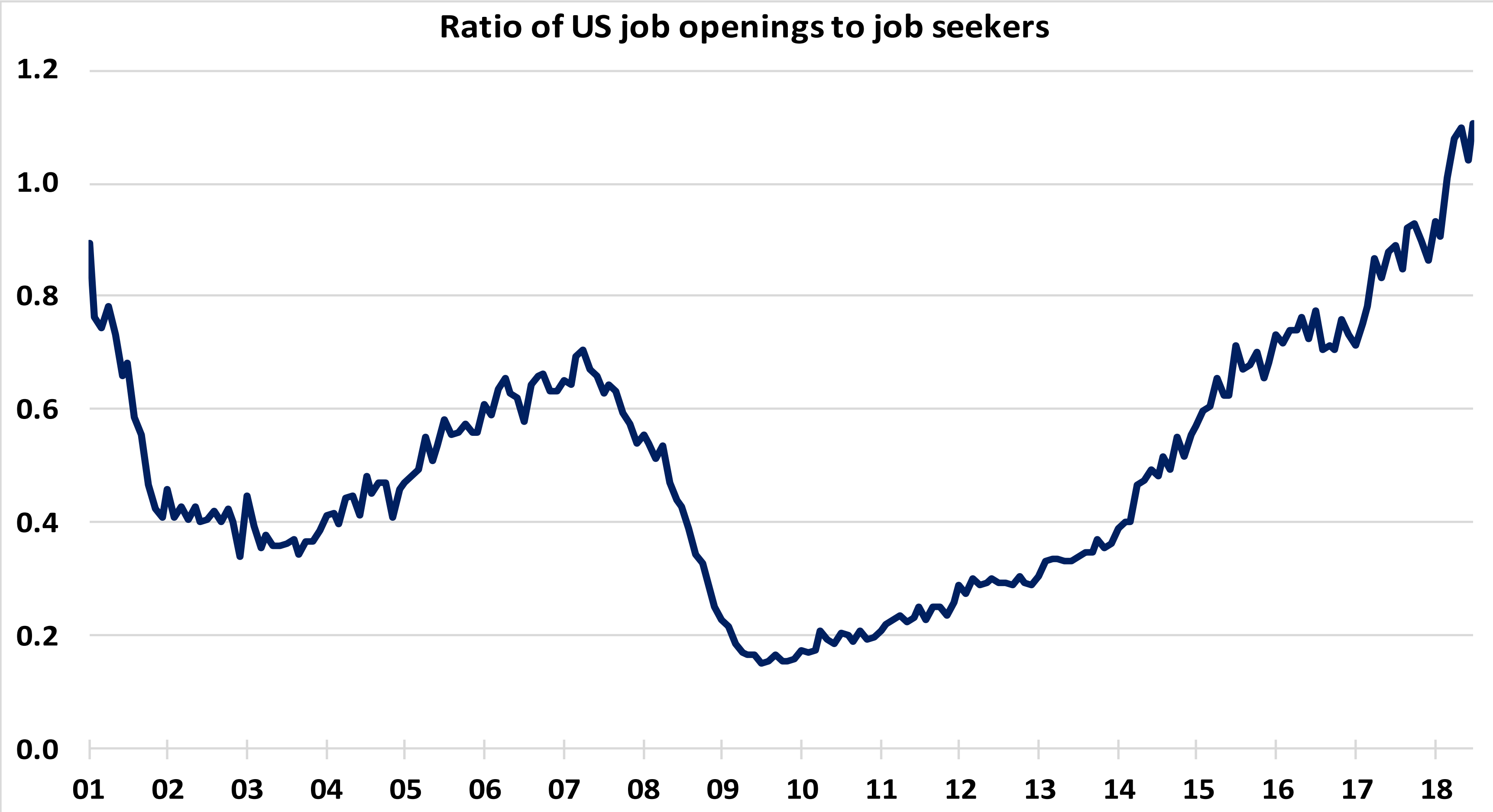
- Extreme tightness in US supply chains



Data source: CEIC

Overheating and increasing inflation pressure

- Extraordinary degree of staffing and skill shortages



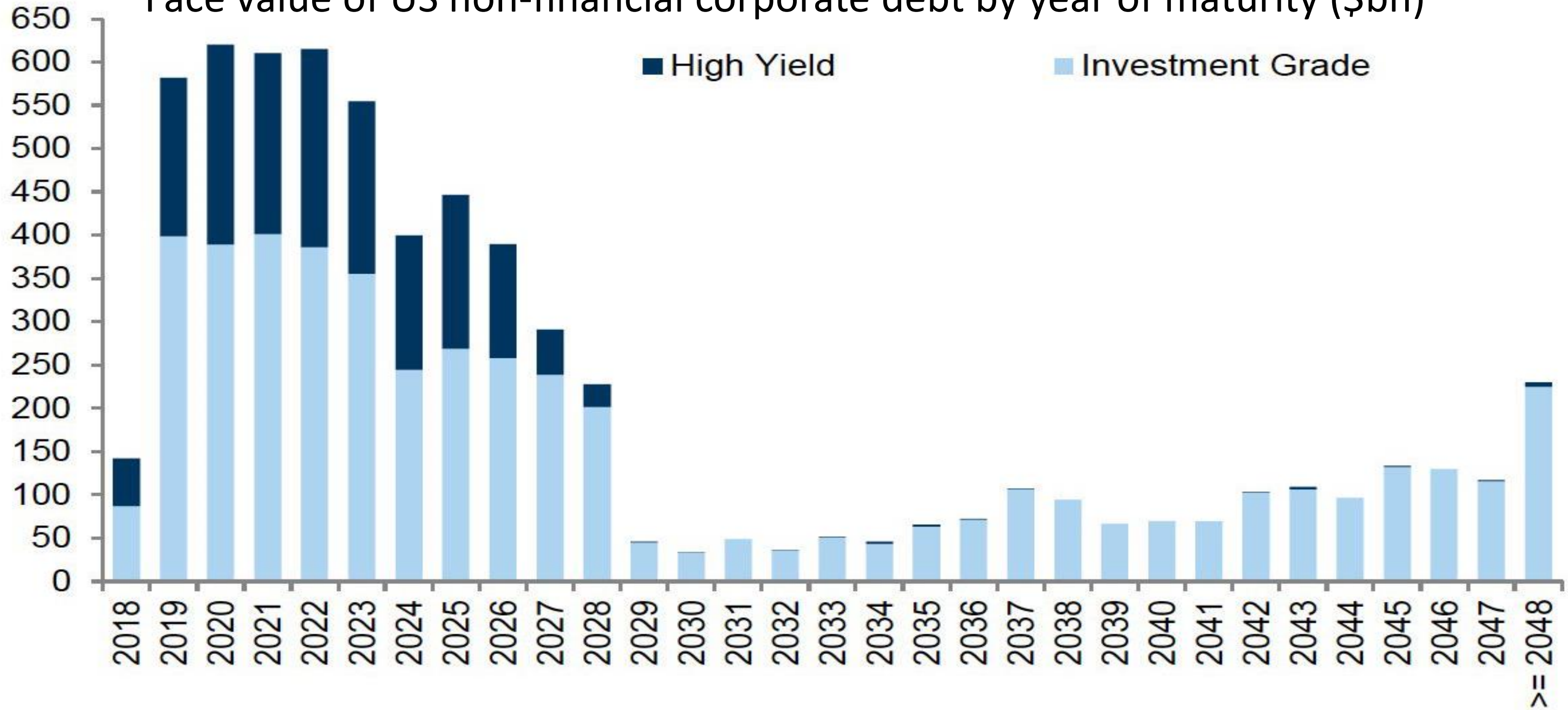
Data source: St Louis Federal Reserve

Approaching corporate debt refinancing challenge

- A forbidding mountain to climb

Over $1.3tr (20%) and $3 tr (47%) of total debt outstanding is set to mature through 2020 and 2023, respectively.

Face value of US non-financial corporate debt by year of maturity ($bn)



Source: Dealogic and Goldman Sachs Global Investment Research

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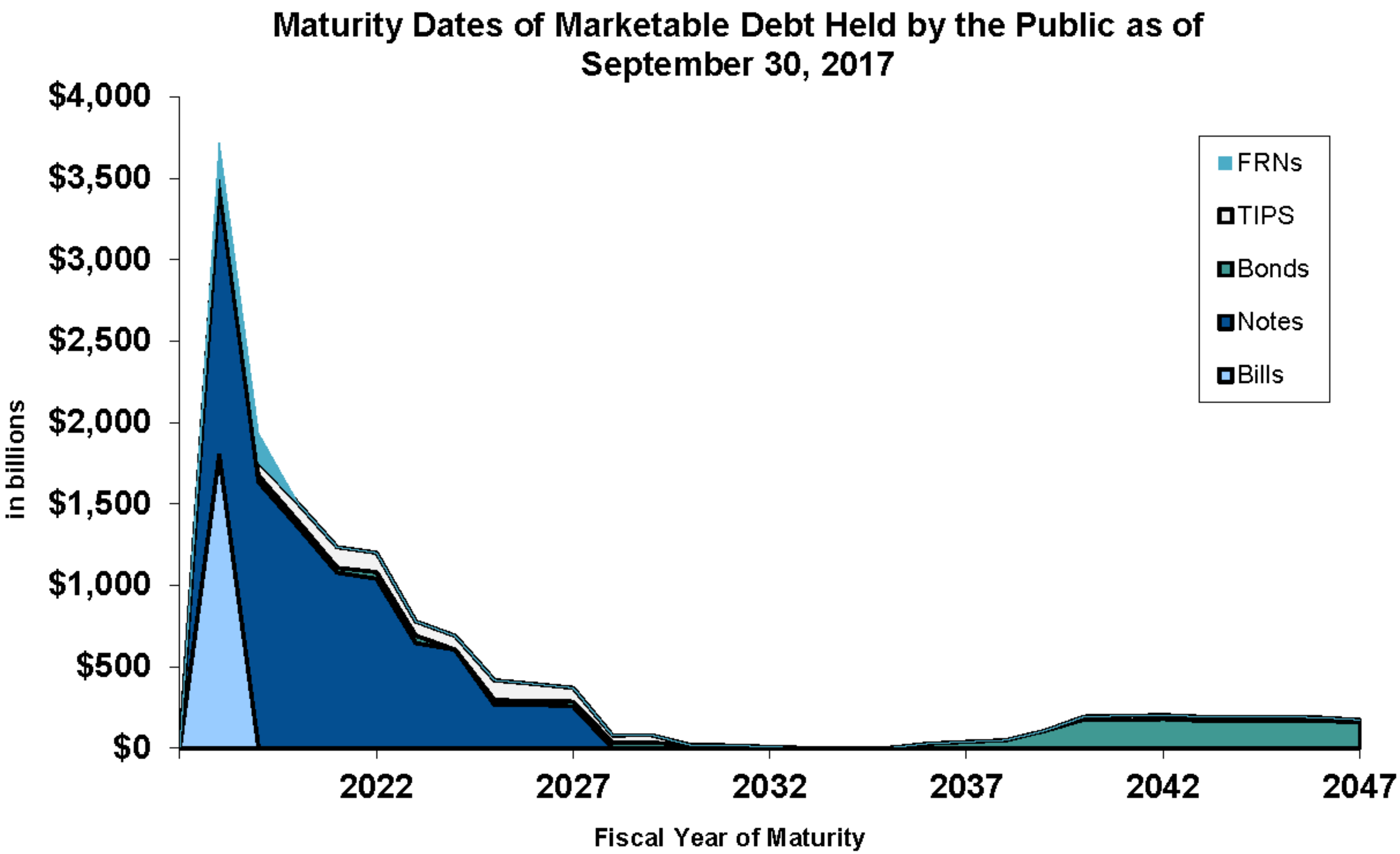
Approaching public debt refinancing (US)

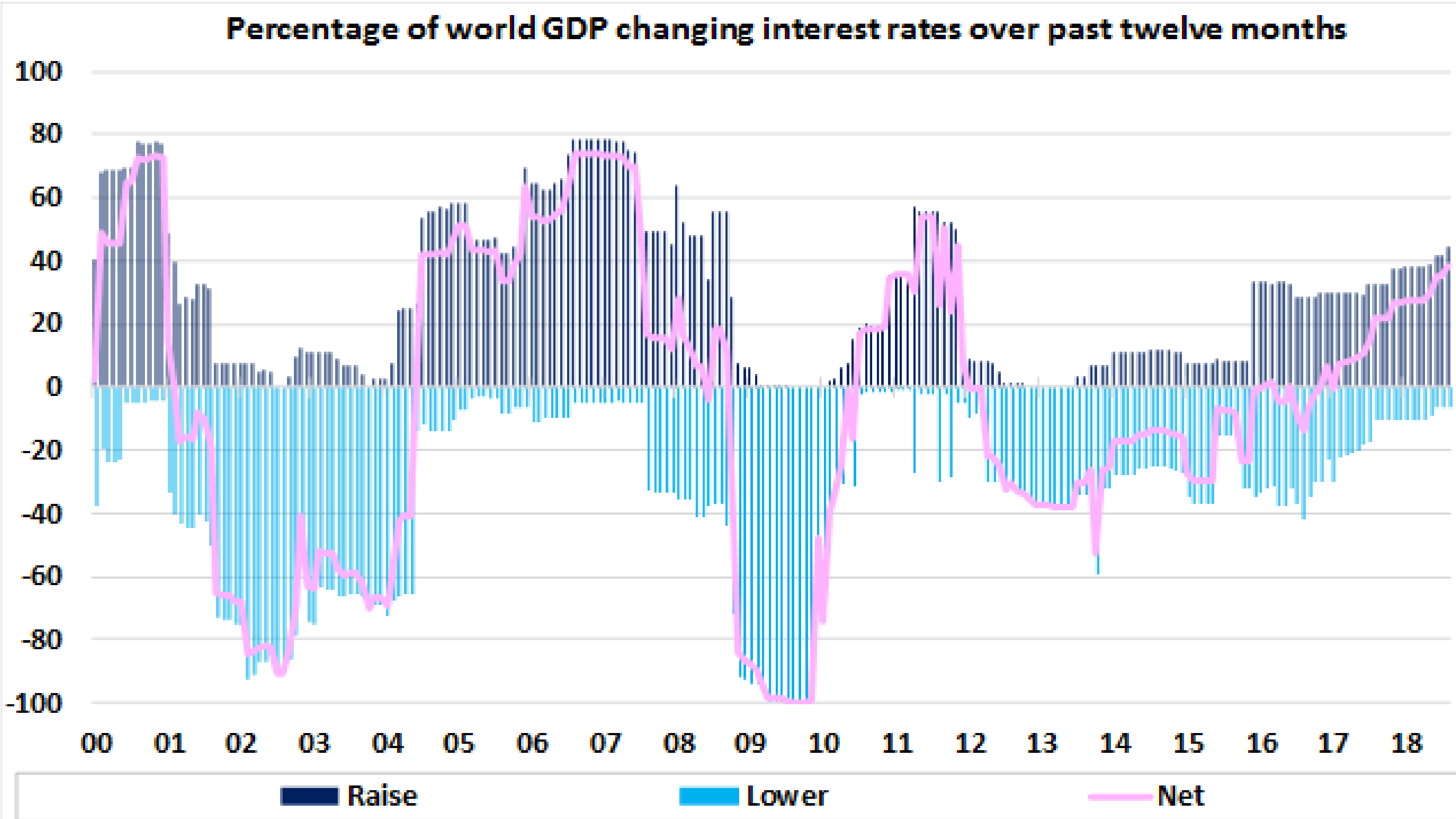
- Bill finance must be replaced by notes and bonds



Source: US Treasury

Continuing lurch towards higher policy rates

- Held back by Bank of Japan and ECB



Data source: CEIC

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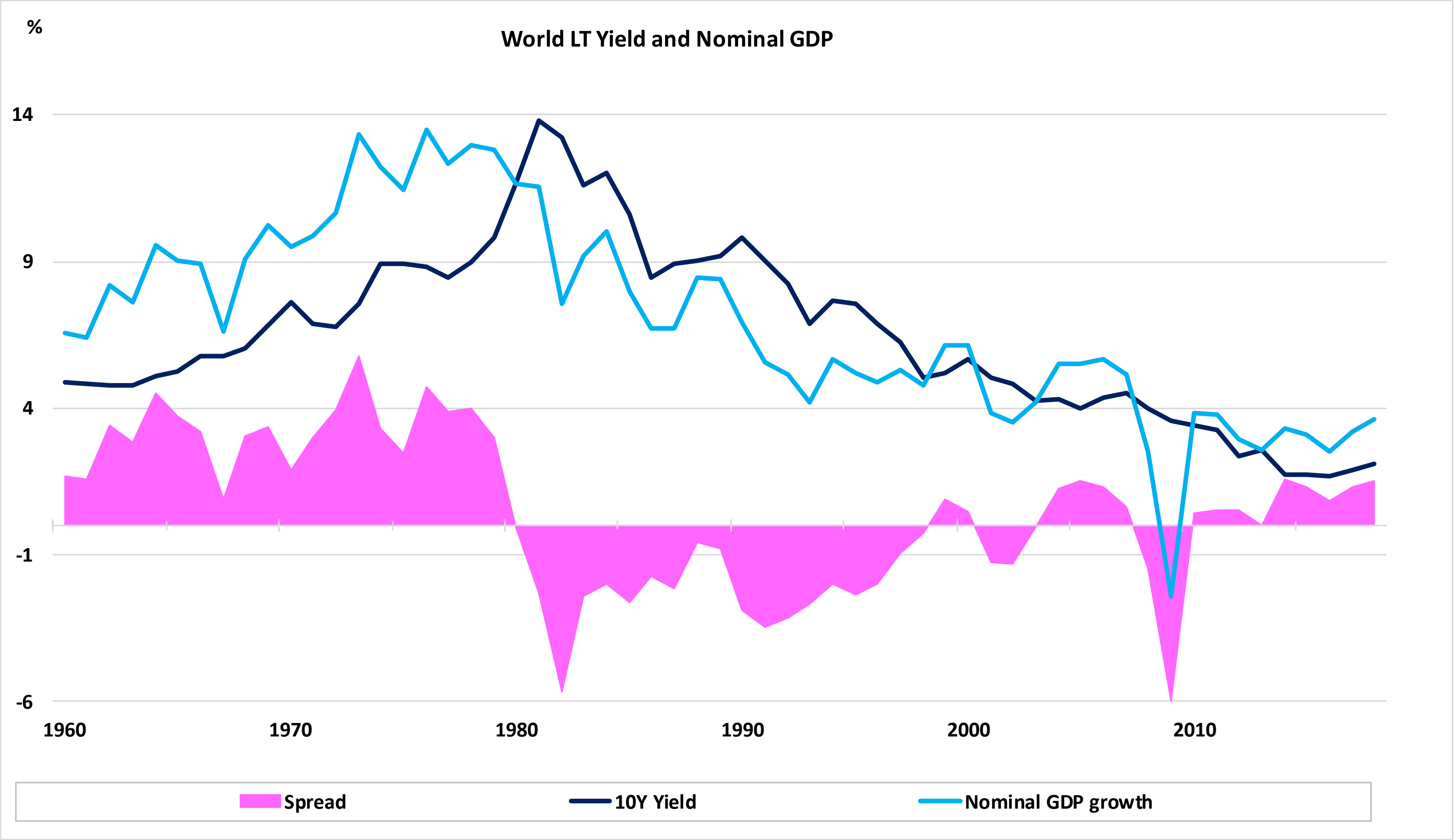
Adjustment of govt yields to global nominal GDP growth

- Nominal GDP growth leading bond yields higher



Data source: Eikon Reuters and Jorda et al. (2017)

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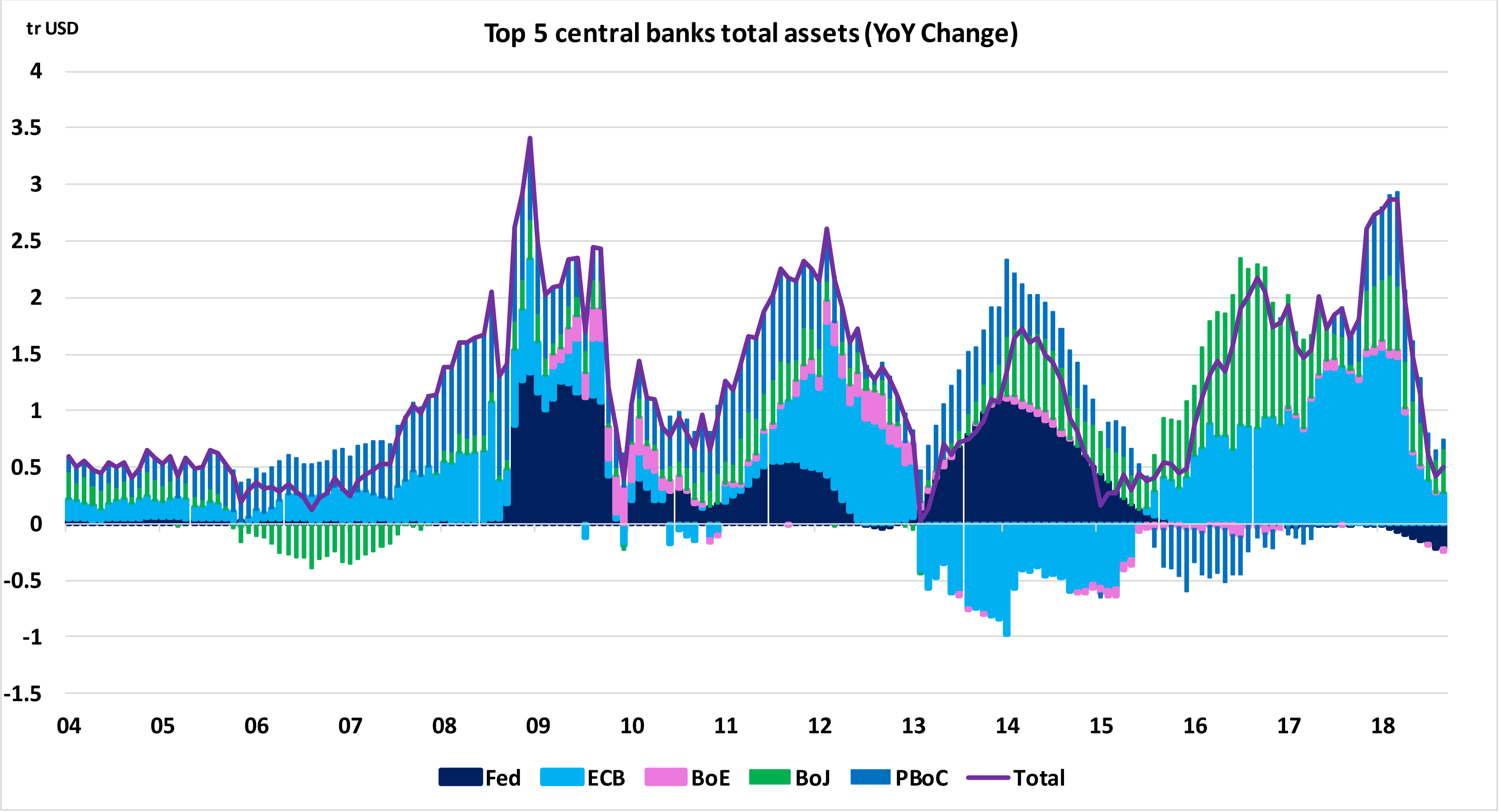
Approaching quantitative tightening

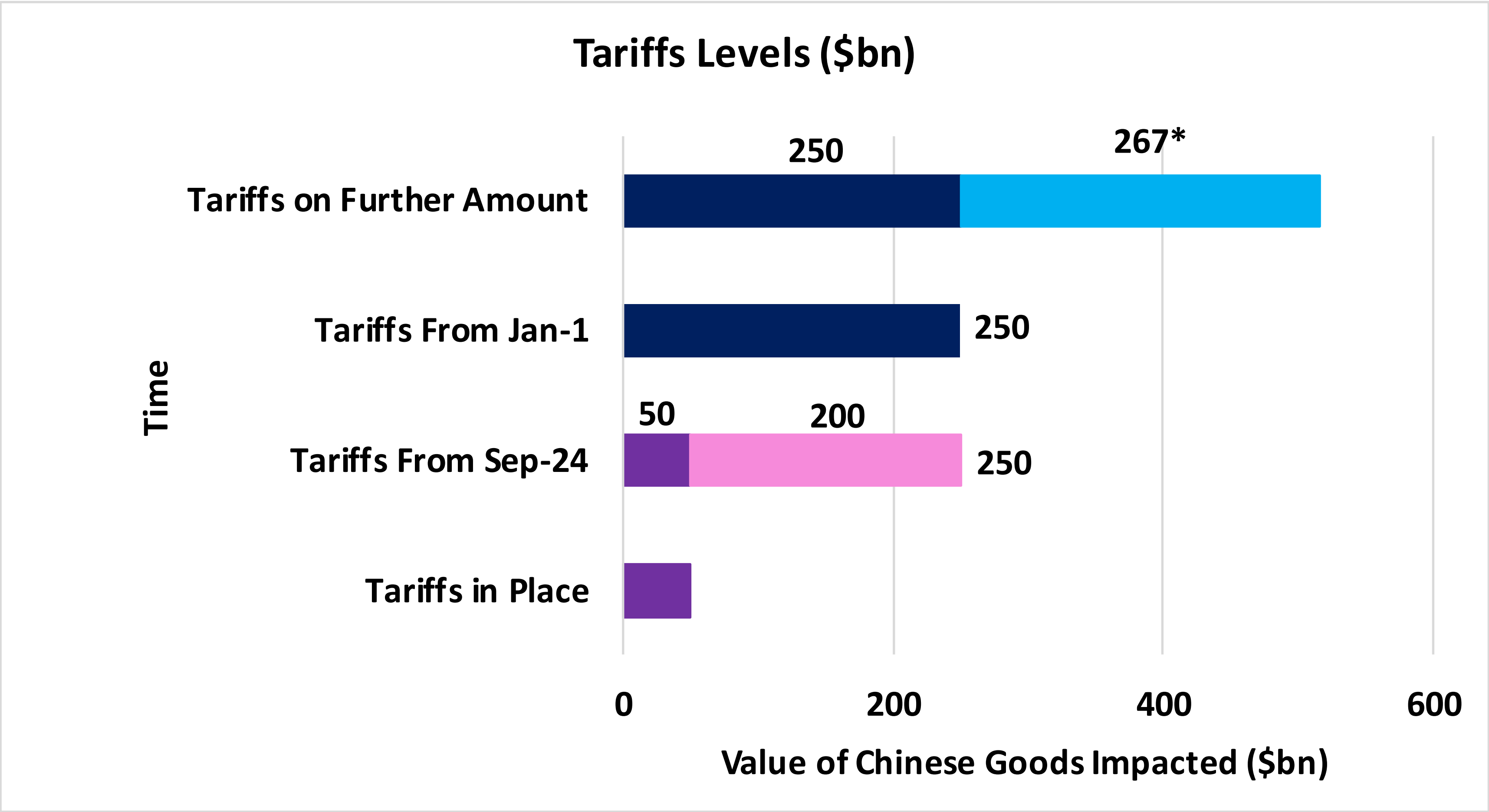
- The purchasing party is over



Data source: Eikon Reuters

Approaching tariff and trade restrictions

- The rubber is about to hit the road …



Data source: Bloomberg

Contexts of the 2020 peril

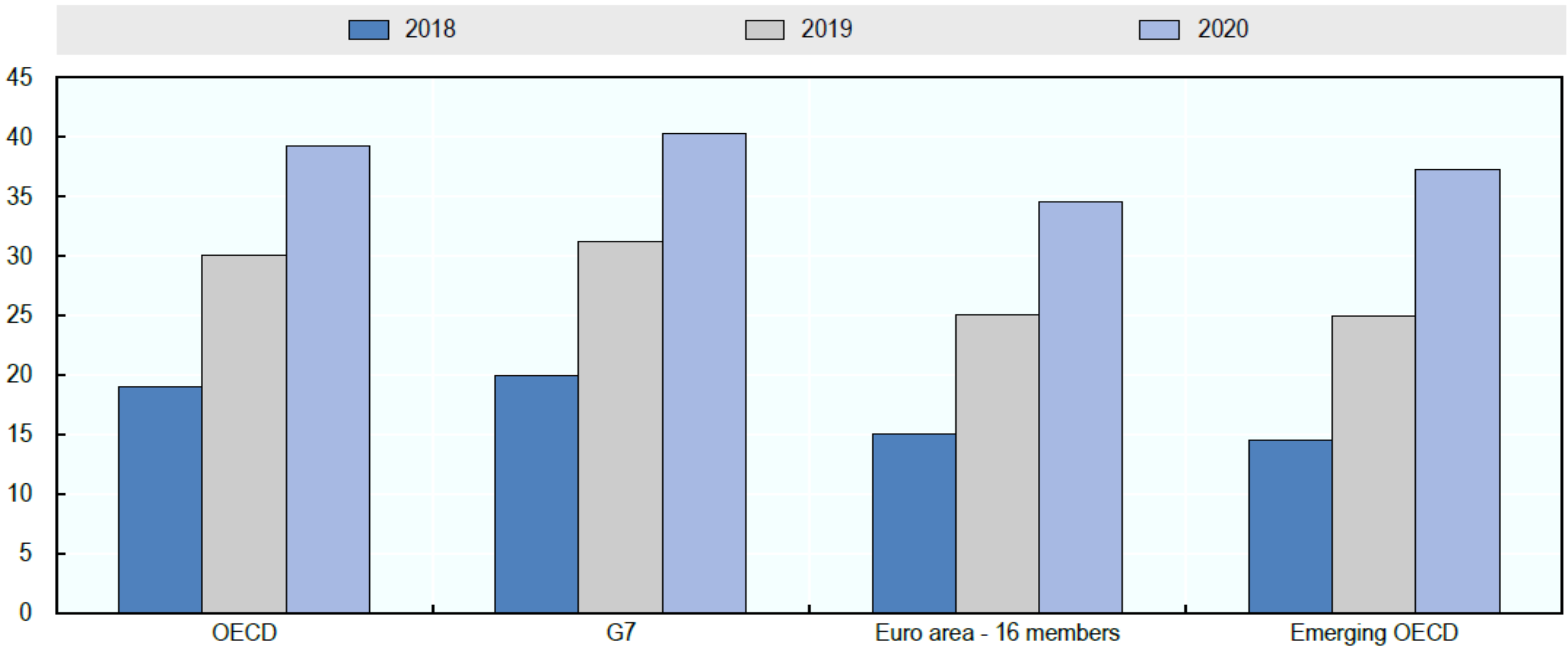
- Developed market government bond markets
- Developed market corporate bond markets
- Developed market sub-prime corporate debt (credit spreads)
- Emerging market debt securities
- Global equities
- Bond and equity market volatility
- Global economy

DM government bonds

- The presumption of limitless demand

Cumulative percentage of debt maturing in the next 12,24 and 36 months

As a percentage of total marketable debt in 2017



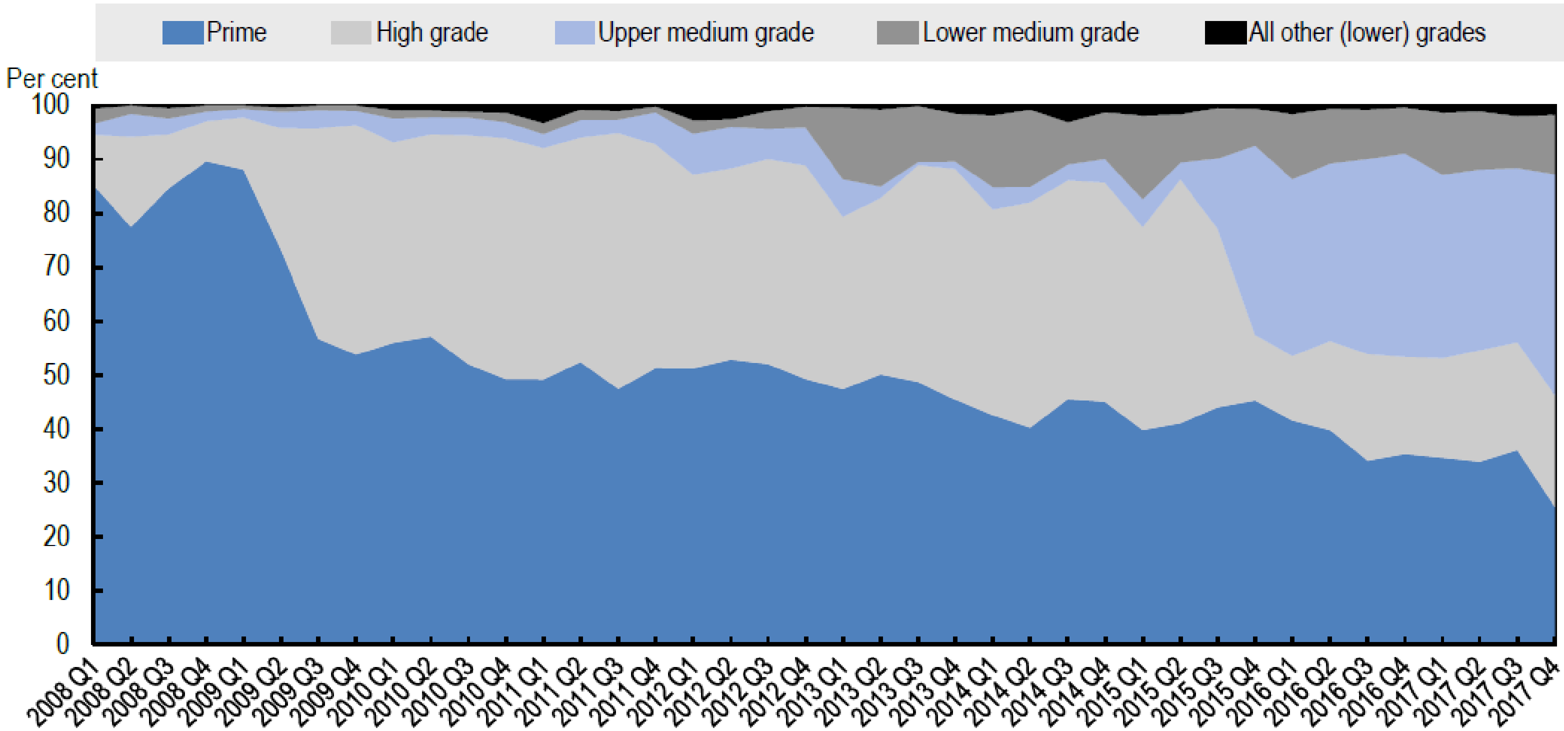
Notes: Cumulative percentage of debt maturing in the next 12, 24 and 36 months (i.e. in 2018, 2019 and 2020), as a percentage of total marketable debt stock (without cash) in 2017. Values of principal payments and marketable debt have been aggregated into a single currency by using fixed exchange rates, as of 1st December 2009, for all years.

Source: OECD Sovereign borrowing outlook 2018

DM government bonds

- Yet the median sovereign rating is declining

Distribution of sovereign bond issuance among rating categories, as a percentage of total, 2008-17

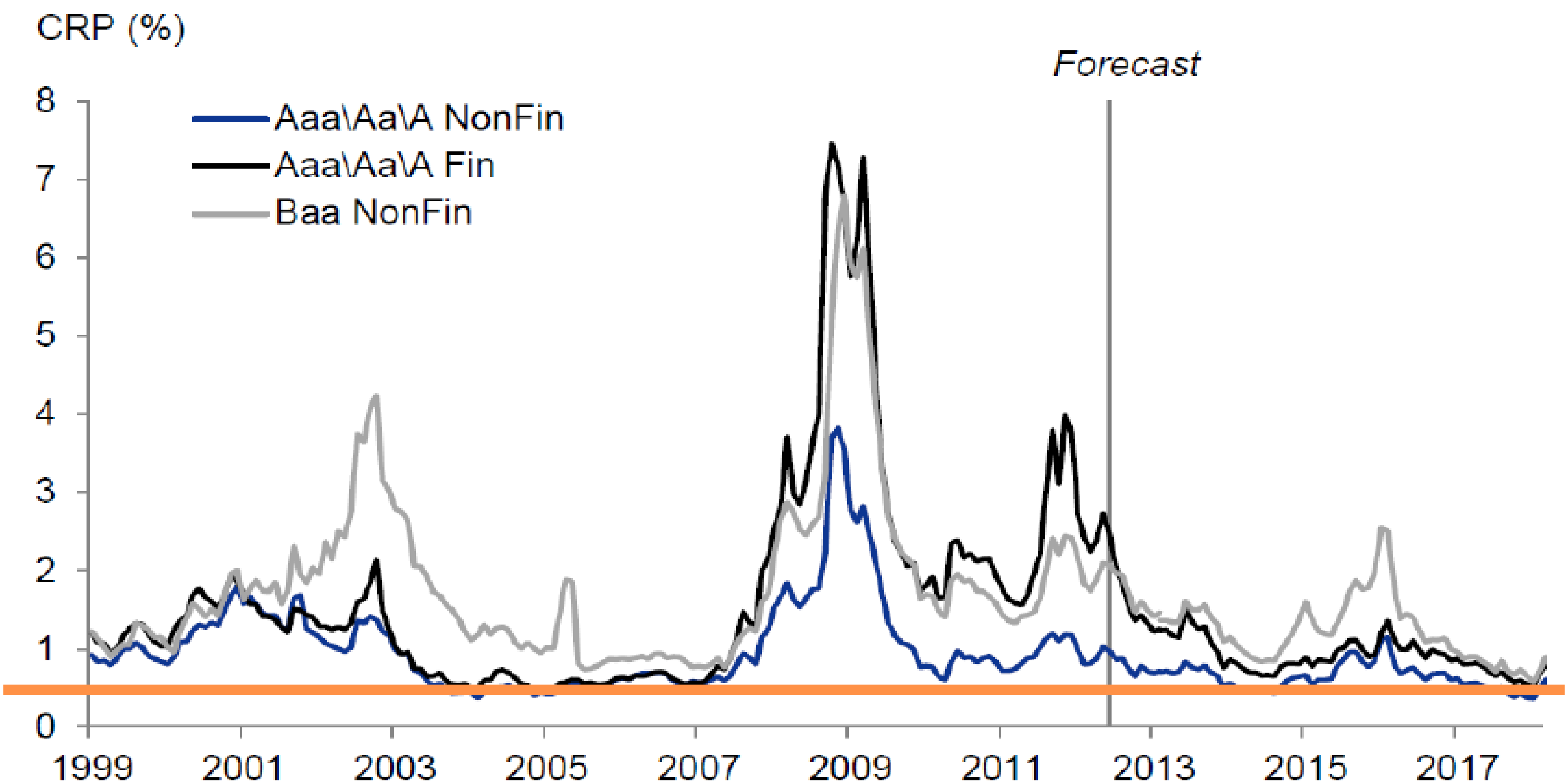


Notes: Weighted by amounts issued and based on the maximum issuance rating from three rating agencies: Fitch, Moody's and Standard and Poor's.

Source: OECD Sovereign borrowing outlook 2018

DM corporate bond markets

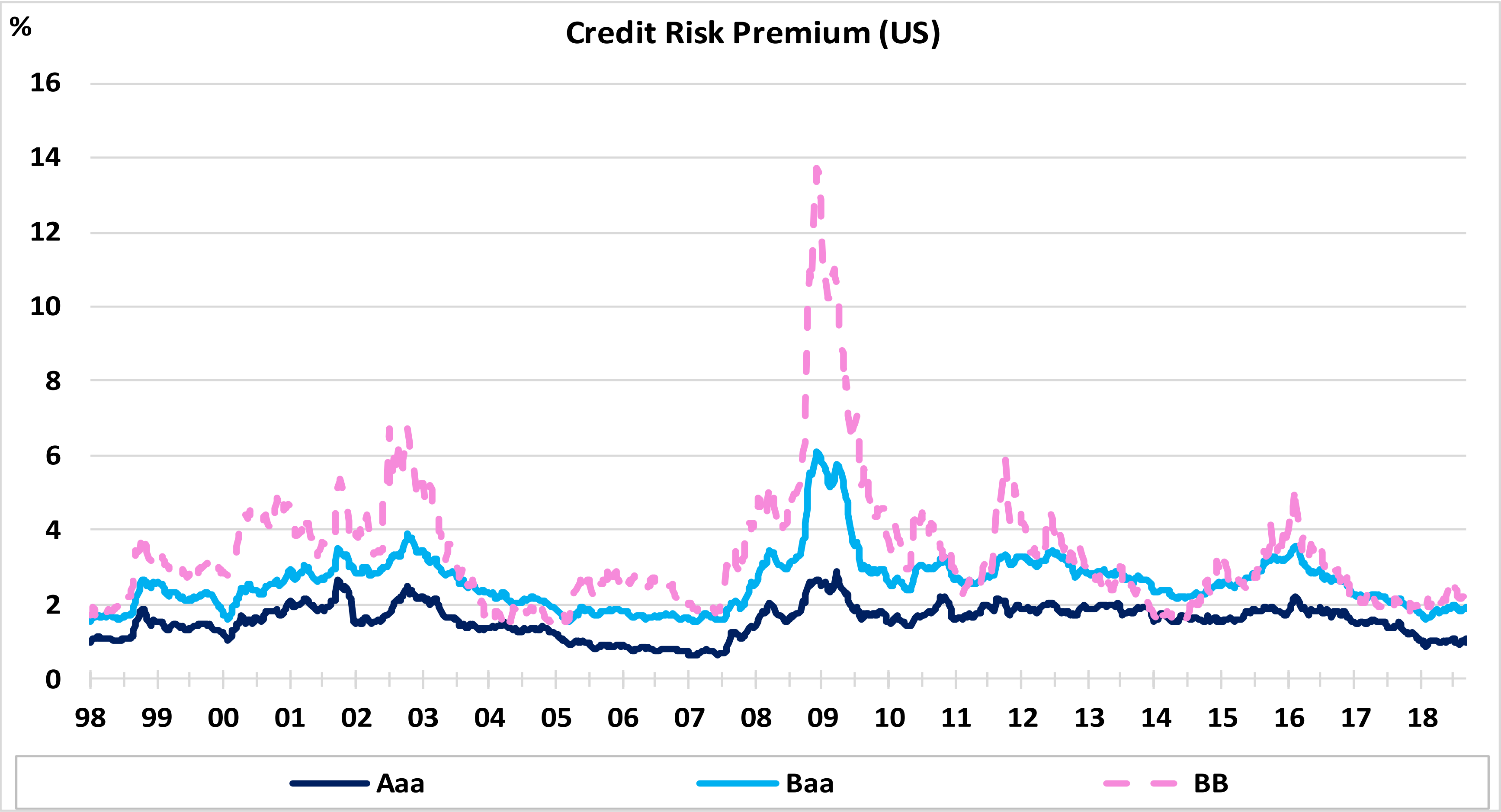
- Historical and forecast IG Credit Risk Premium



Source: iBoxx, Moody's, Goldman Sachs Global Investment Research

US corporate credit risk premiums (Aaa to BB)

- High yield is outperforming high grade!



Data source: St Louis Federal Reserve

DM sub-prime corporate debt

- Recovery rates are favourable now, but later?

			Implied 5Y Cum. Default Rate			Actual Average 5Y Cum. Default Rates	
		5Y Spread	0% Recovery	20% Recovery	40% Recovery	Worst	Average
EUR	**HY All**	397	18.2%	22.2%	28.4%	39%	12%
	BB	317	15.0%	18.3%	23.7%	27%	5%
	B	519	22.7%	27.5%	34.9%	48%	14%
	CCC	989	35.3%	41.9%	51.5%	75%	40%
US	**HY All**	349	16.0%	19.5%	25.2%	31%	17%
	BB	215	10.2%	12.6%	16.4%	17%	8%
	B	367	16.6%	20.3%	26.1%	38%	20%
	CCC	744	31.1%	37.2%	46.2%	73%	51%

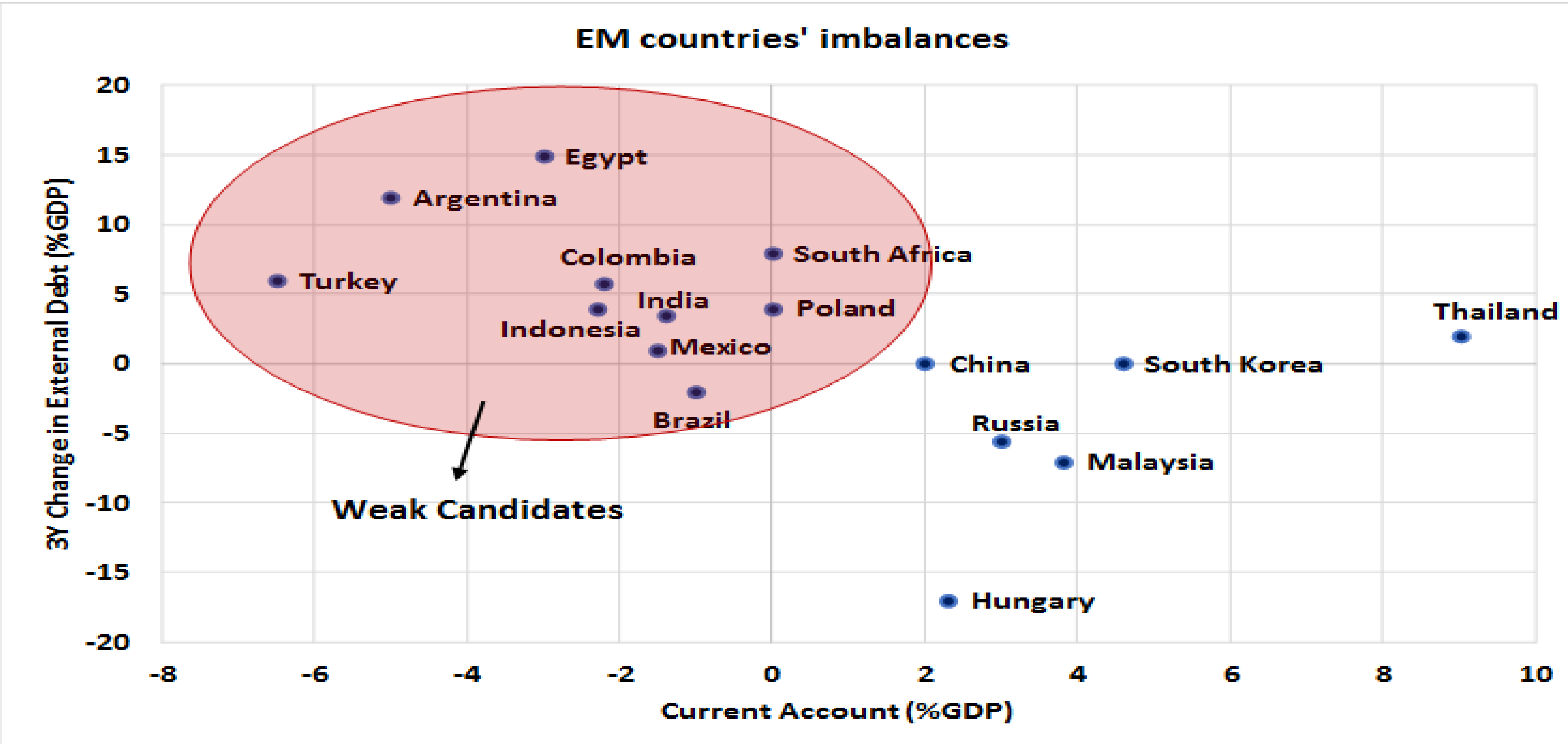
Implied default rate lower than LT average

Implied default rate lower than worst historic rate

Data source: Deutsche Bank

Emerging market debt securities

- Beware adverse debt and deficit dynamics

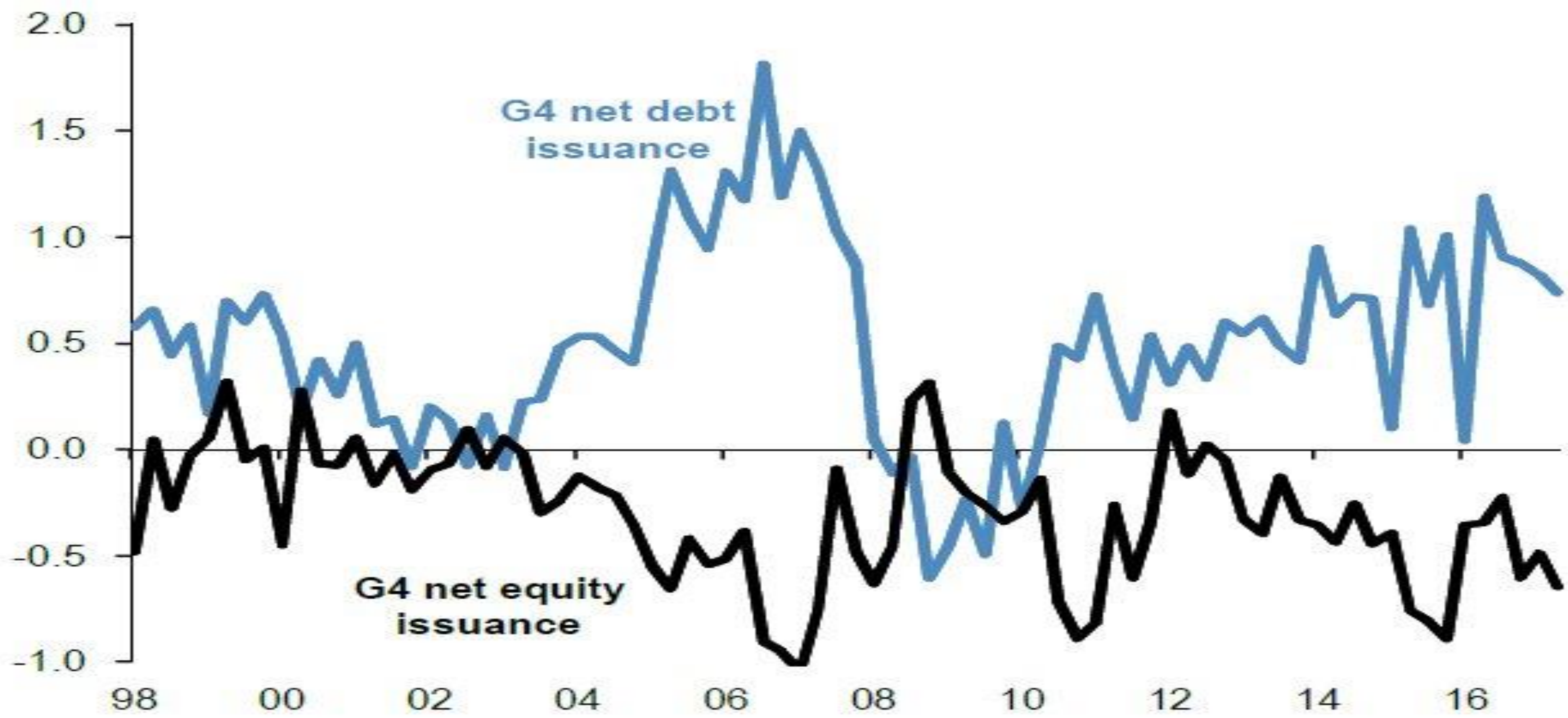


Data source: Eikon Reuters and JPMorgan

Global equities: the threat from reduced net debt issuance

- Lax credit conditions are protecting equity prices

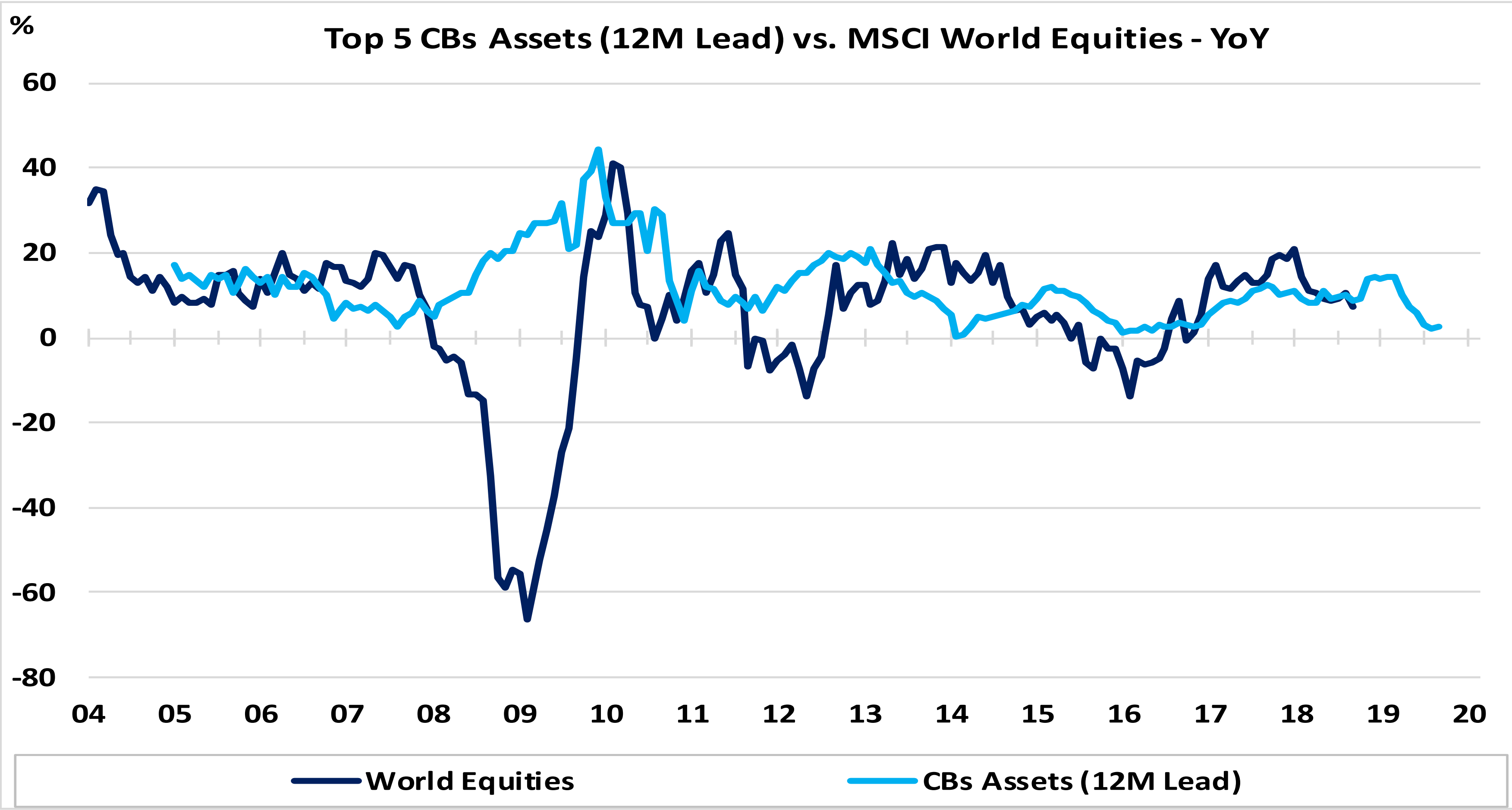
$tr per quarter, G4 includes the US, the UK, the Euro area and Japan. Last observation as of Q1 2018.



Source: JPMorgan

Global equities: the threat from Quantitative Tightening

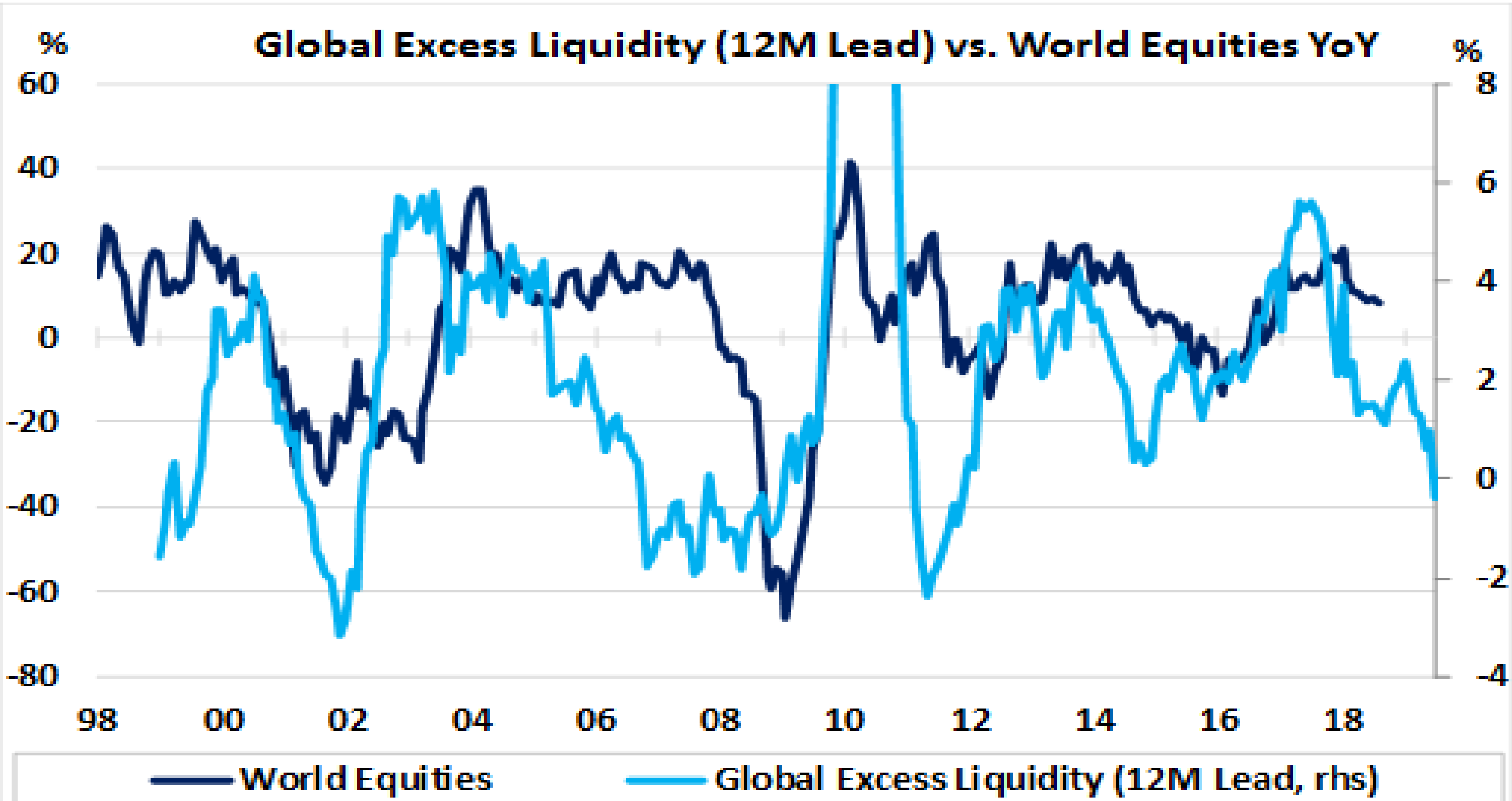
- QT will ultimately deliver a powerful blow



Data source: Eikon Reuters

Global equities: the threat from shrinking liquidity

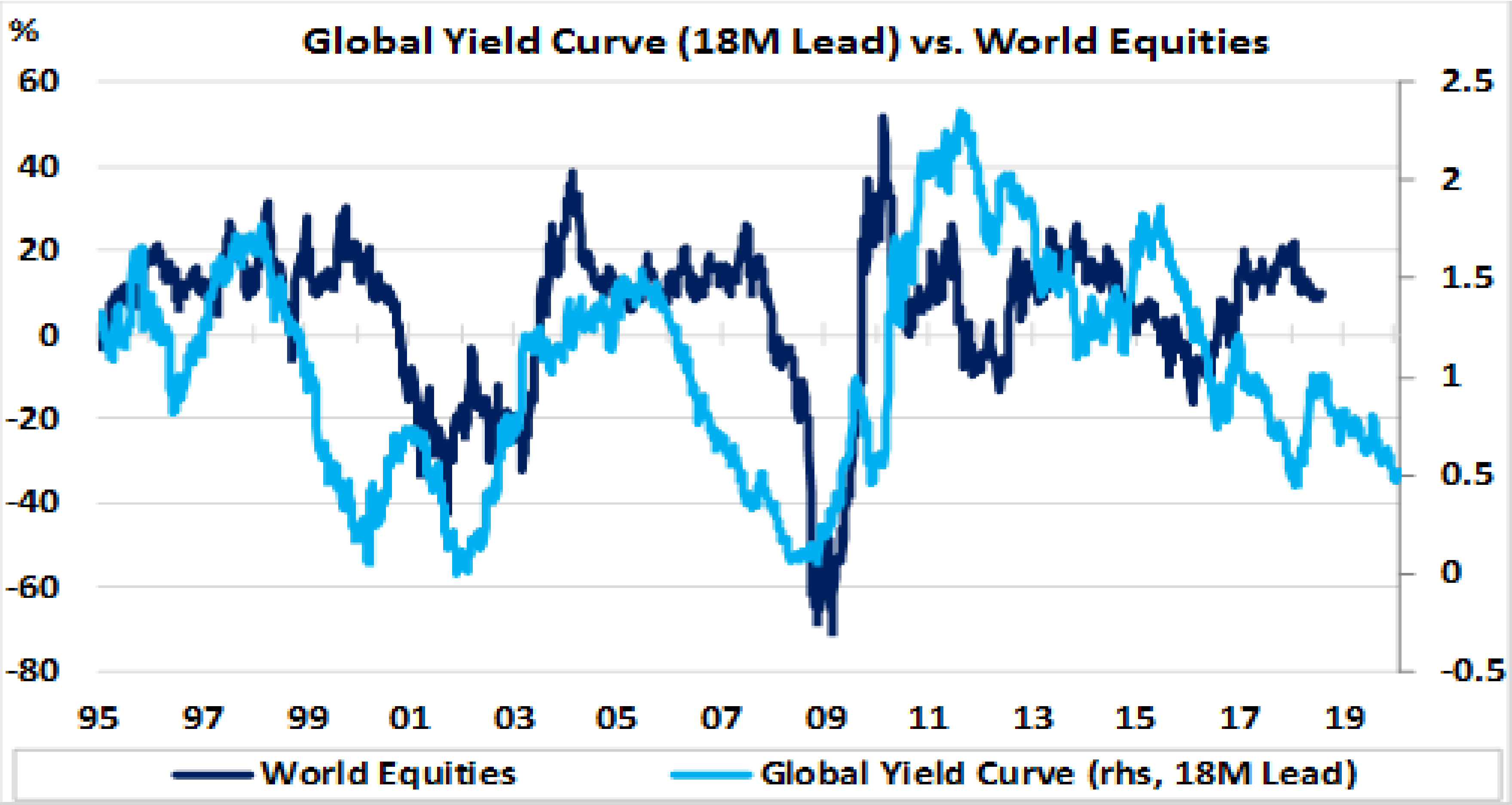
- When credit withdraws support, watch liquidity



Data source: Eikon Reuters and Economic Perspectives

Global equities: the threat from yield curve inversion

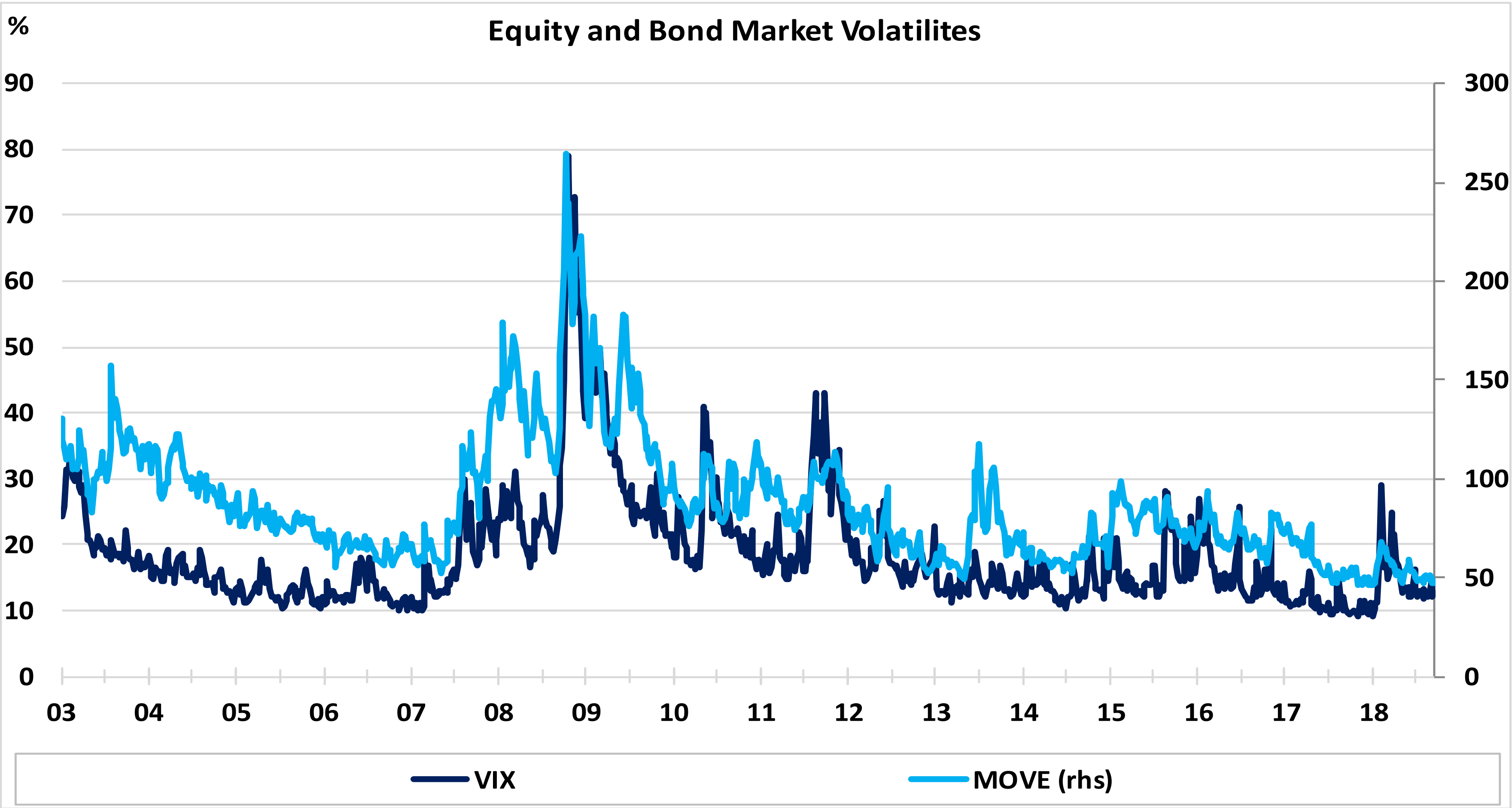
- A flattening curve is not a flattering development



Data source: Eikon Reuters and Economic Perspectives

Bond and equity market volatility

- The eruption of volatility will one day wreak havoc



Data source: Eikon Reuters

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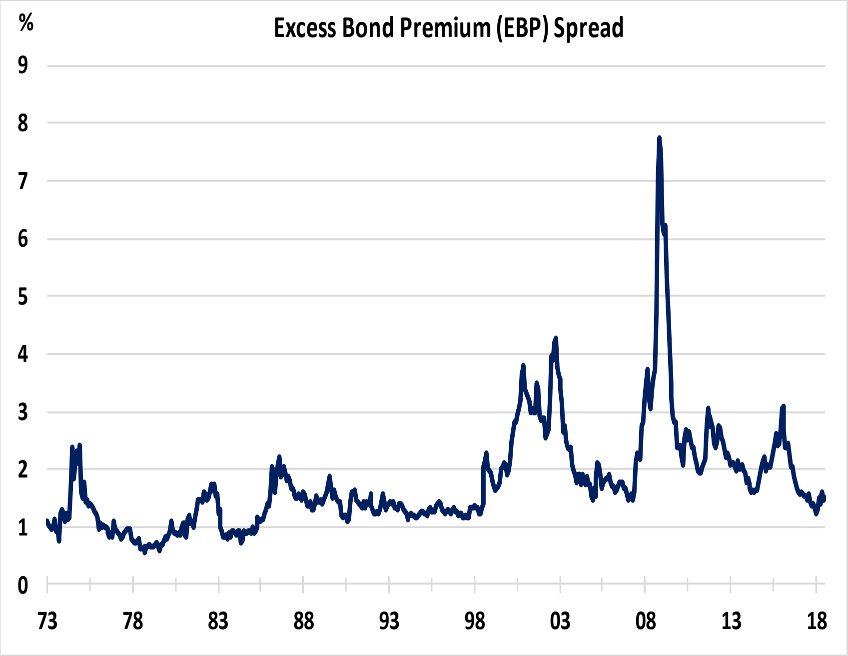
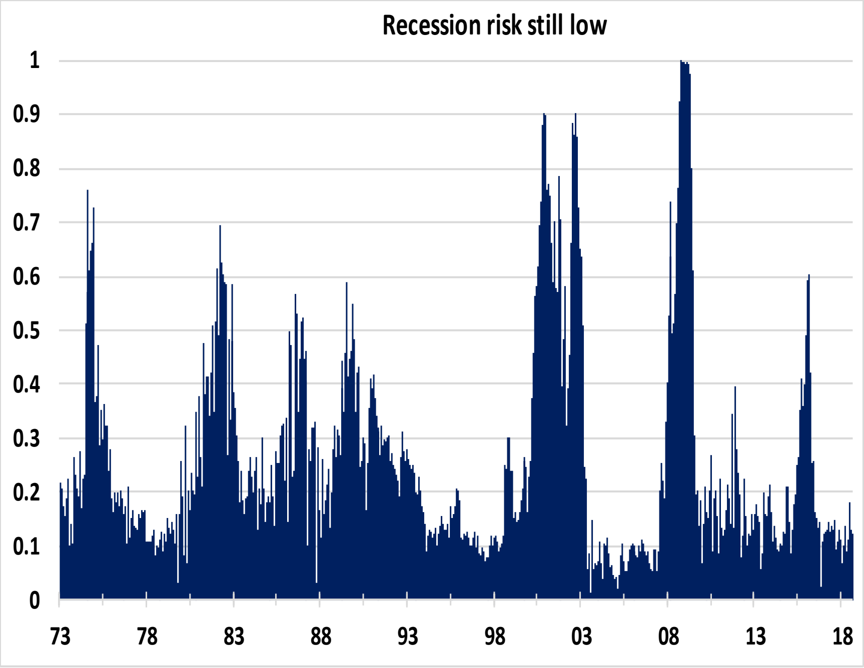
Excess bond premium spread and implied recession risk

- Widening spreads foreshadow economic weakness





Data source: Favara et al. (2016)

The Great Dichotomy: path A or path B?

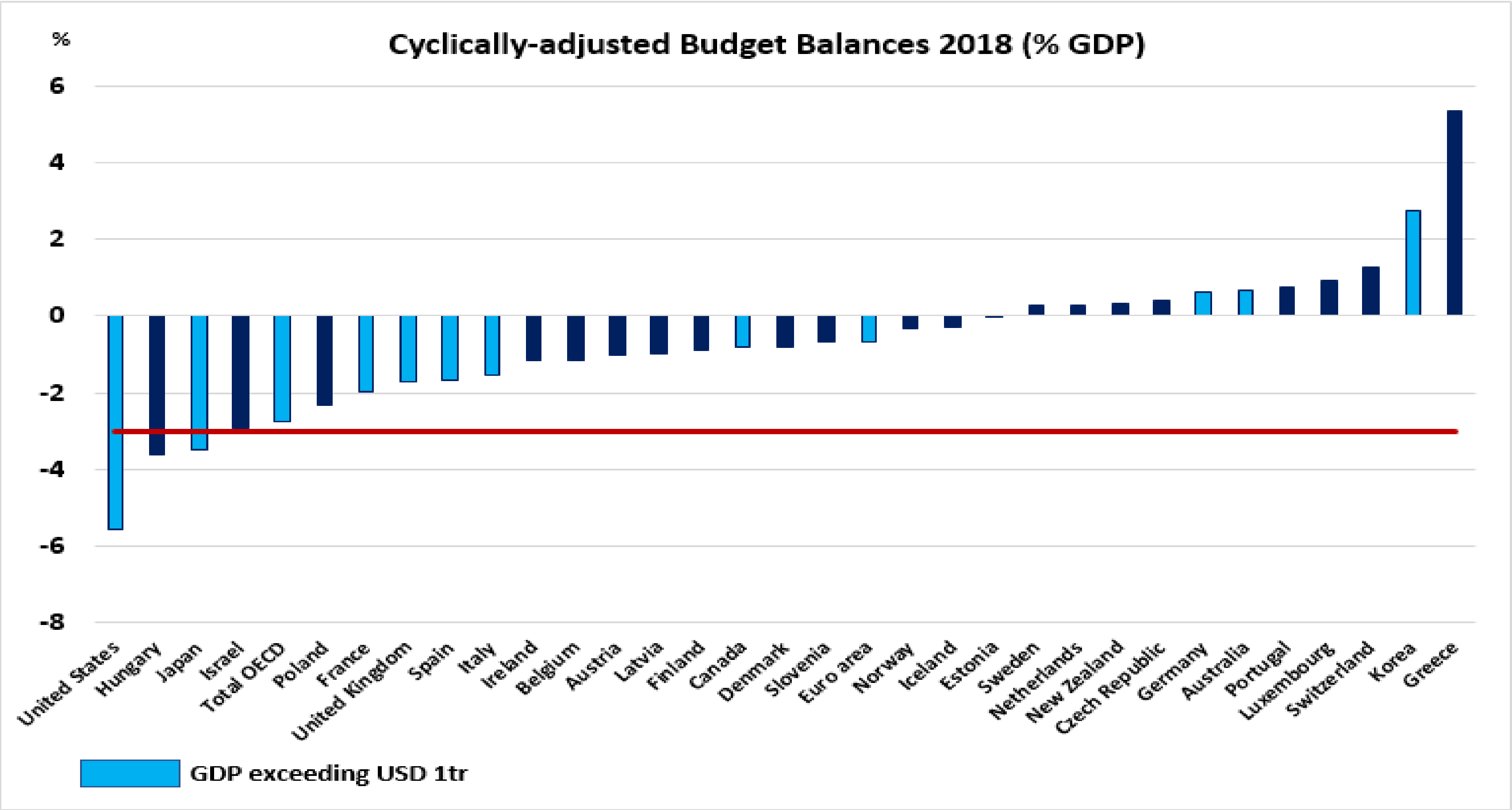
- Can the existing policy framework hold together?
- Path A: institutional and policy frameworks remain intact
  - central bank inflation targets
  - central bank operational independence
  - budget deficit ratio limits
  - public debt ratio limits
  - central bank balance sheet limits
  - bail-ins not bail-outs for future financial crisis
- Path B: institutional and policy frameworks bend or break
  - fiscal dominance
  - helicopter money/ people's QE
  - nationalisation of the financial sector
  - outright debt repudiation

Calibrating the scope for crisis response

- Fiscal capacity
- Overall debt capacity
- Scope for reducing policy interest rates
- Scope for further expansion of QE

Fiscal capacity is lacking in large economies

- Germany, Canada, Australia and Korea



Data source: OECD

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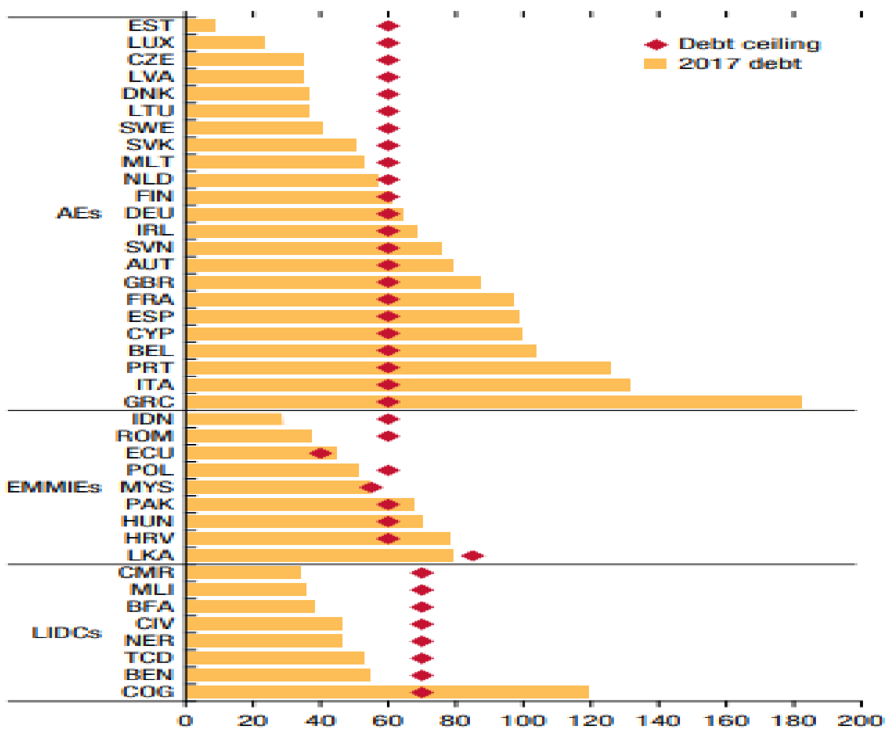
Who has fiscal debt capacity ?

- Can the conservatives hold the line in 2020?

Figure 1.4. General Government Debt Levels in 2017 and Debt Ceilings under Fiscal Rules
(Percent of GDP)

In several countries, debt is close to or above debt ceilings defined under the fiscal rule.

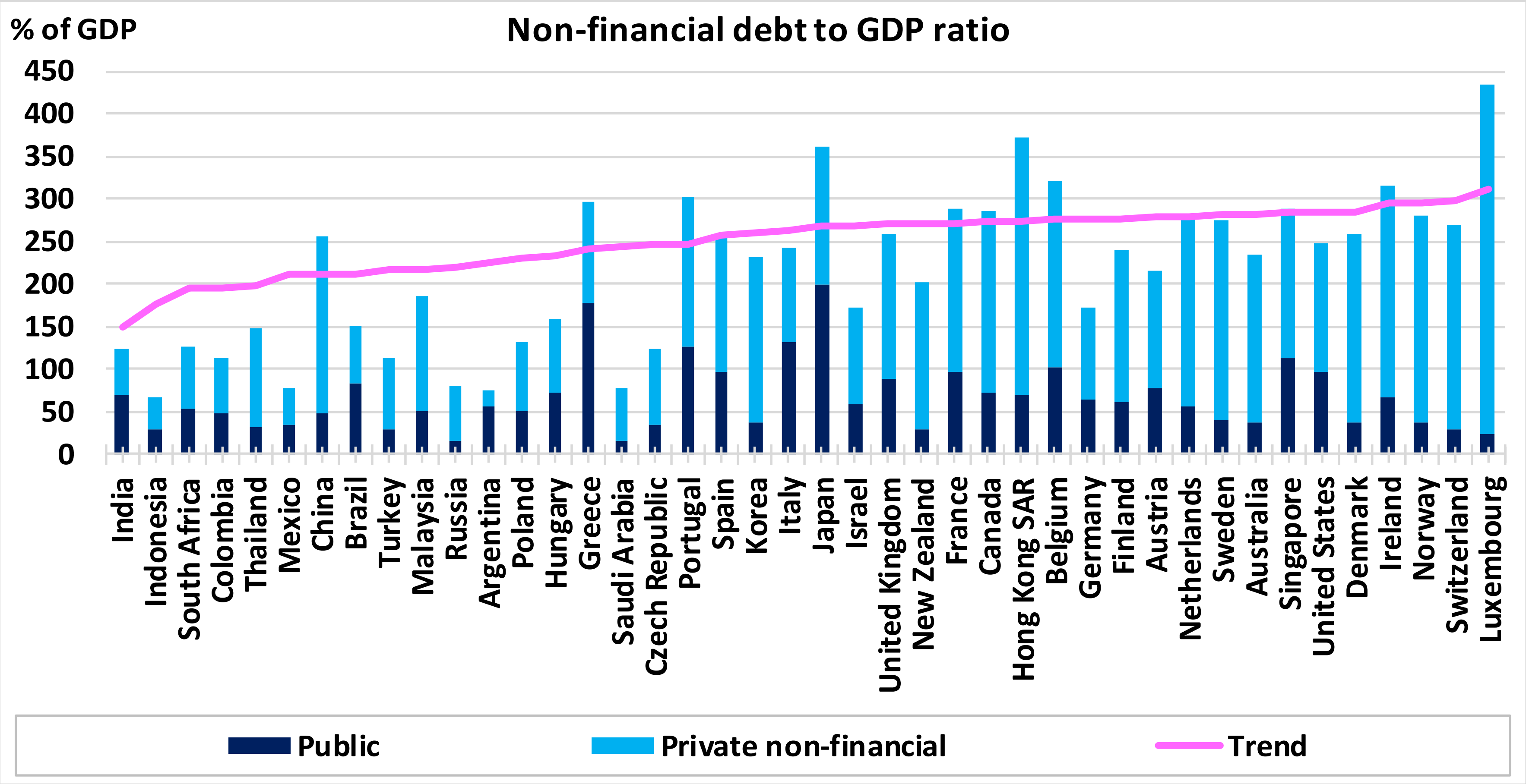


Sources: IMF, fiscal rules database; and IMF staff estimates.
Note: Data labels in the figure use International Organization for Standardization (ISO) country codes. AEs = advanced economies; EMMIEs = emerging market and middle-income economies; LIDCs = low-income developing countries.

Source: IMF

Who has overall debt capacity?

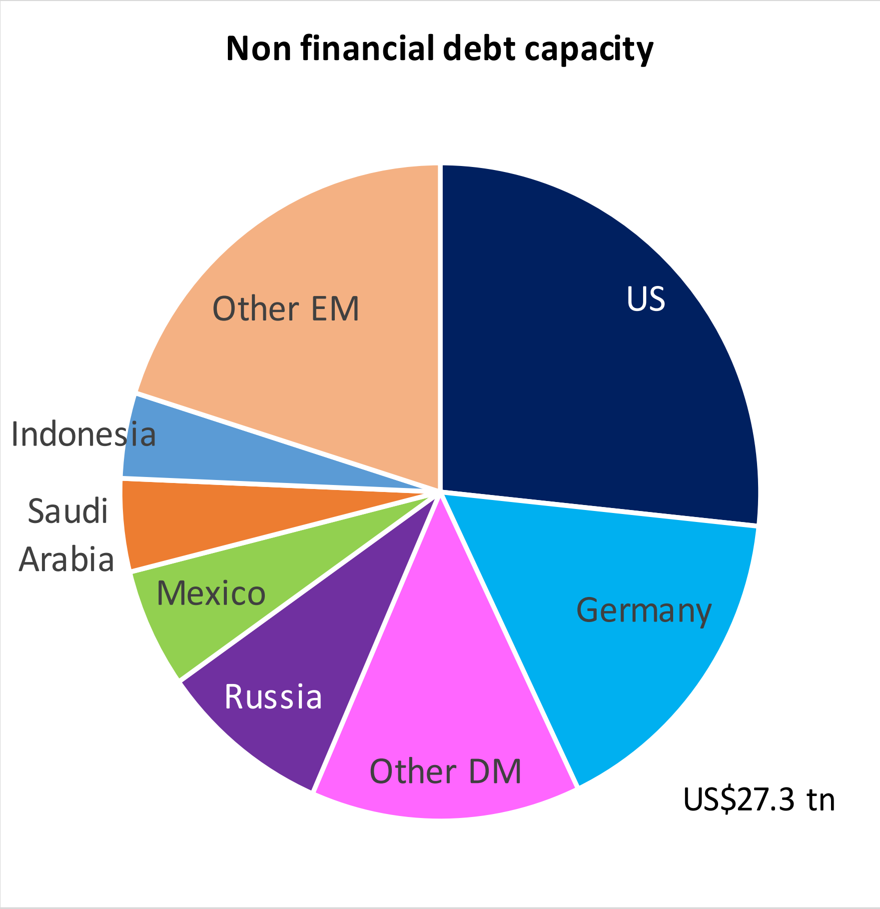
- Most countries are already saturated with debt

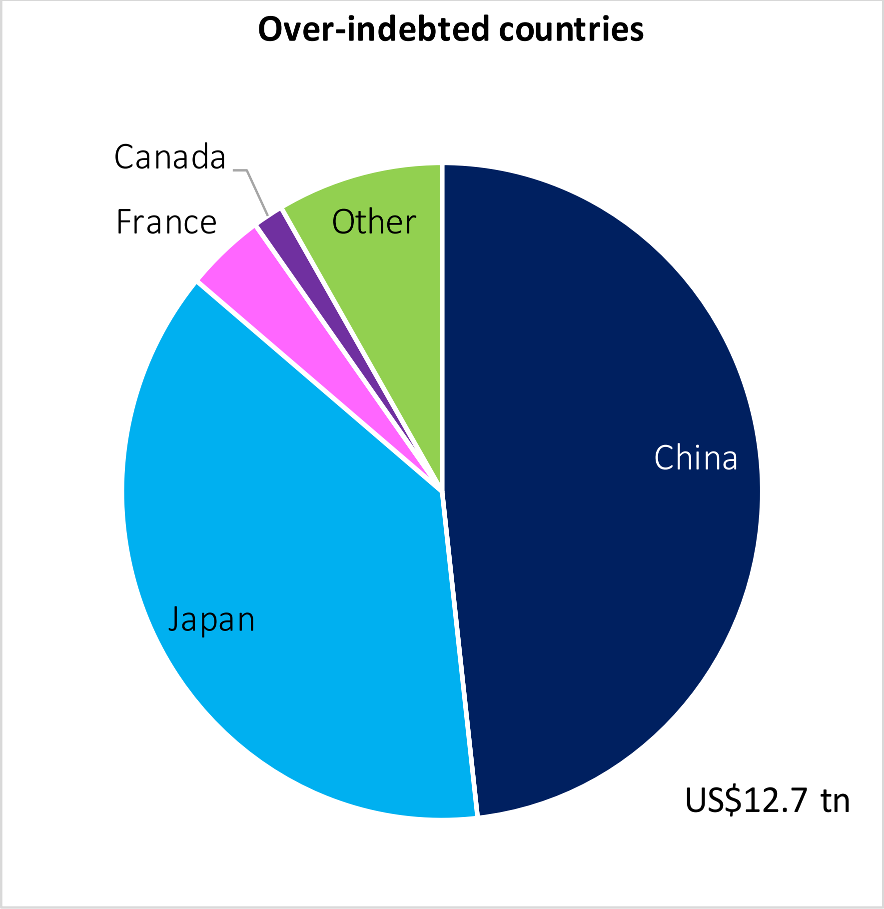


Data source: IMF and Economic Perspectives

Where does non-financial debt capacity reside?

- Still looking to US and Germany for a lift

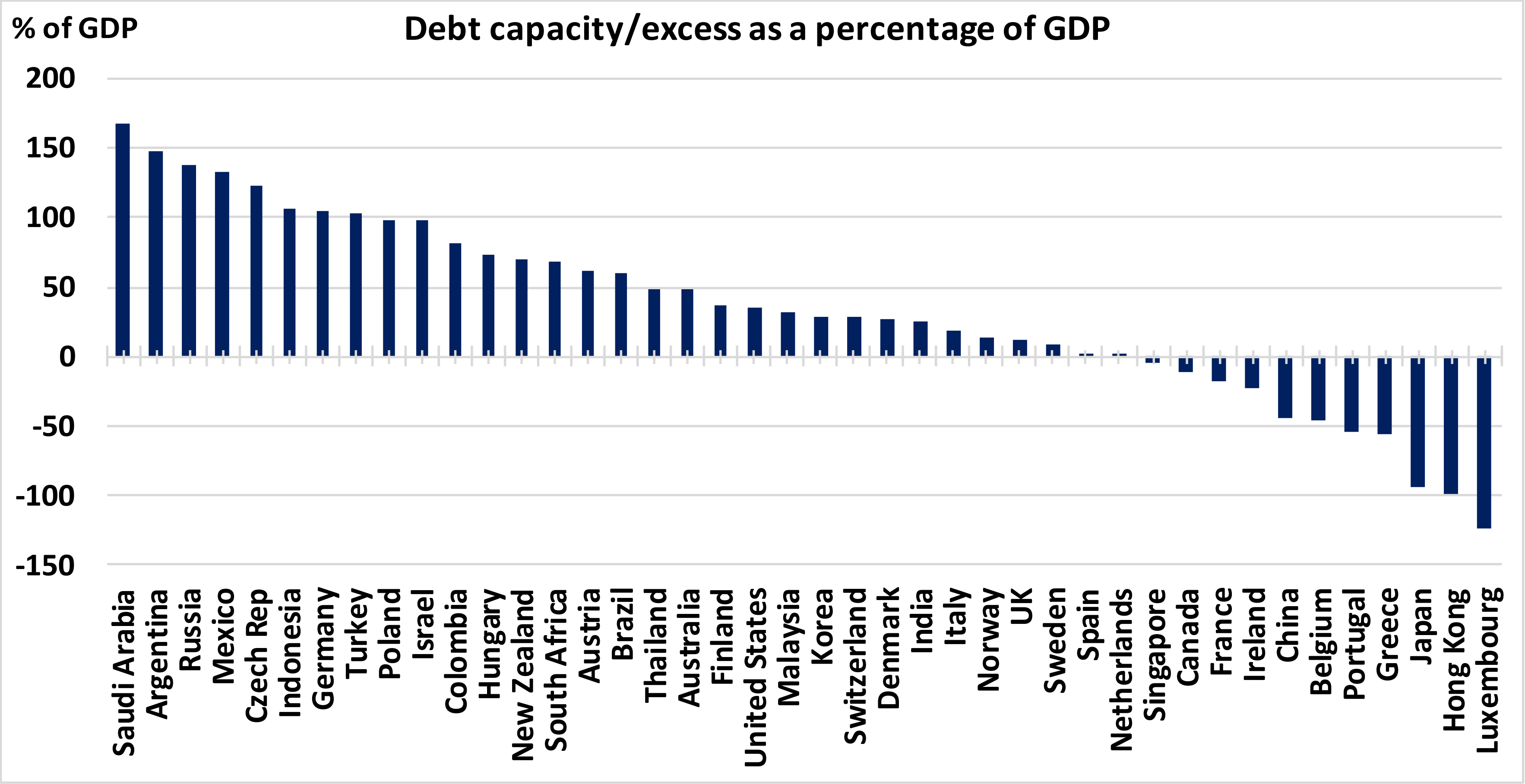




Data source: IMF and Economic Perspectives

Where does non-financial debt capacity reside?

- Proportionately, only Germany has the clout



Data source: IMF and Economic Perspectives

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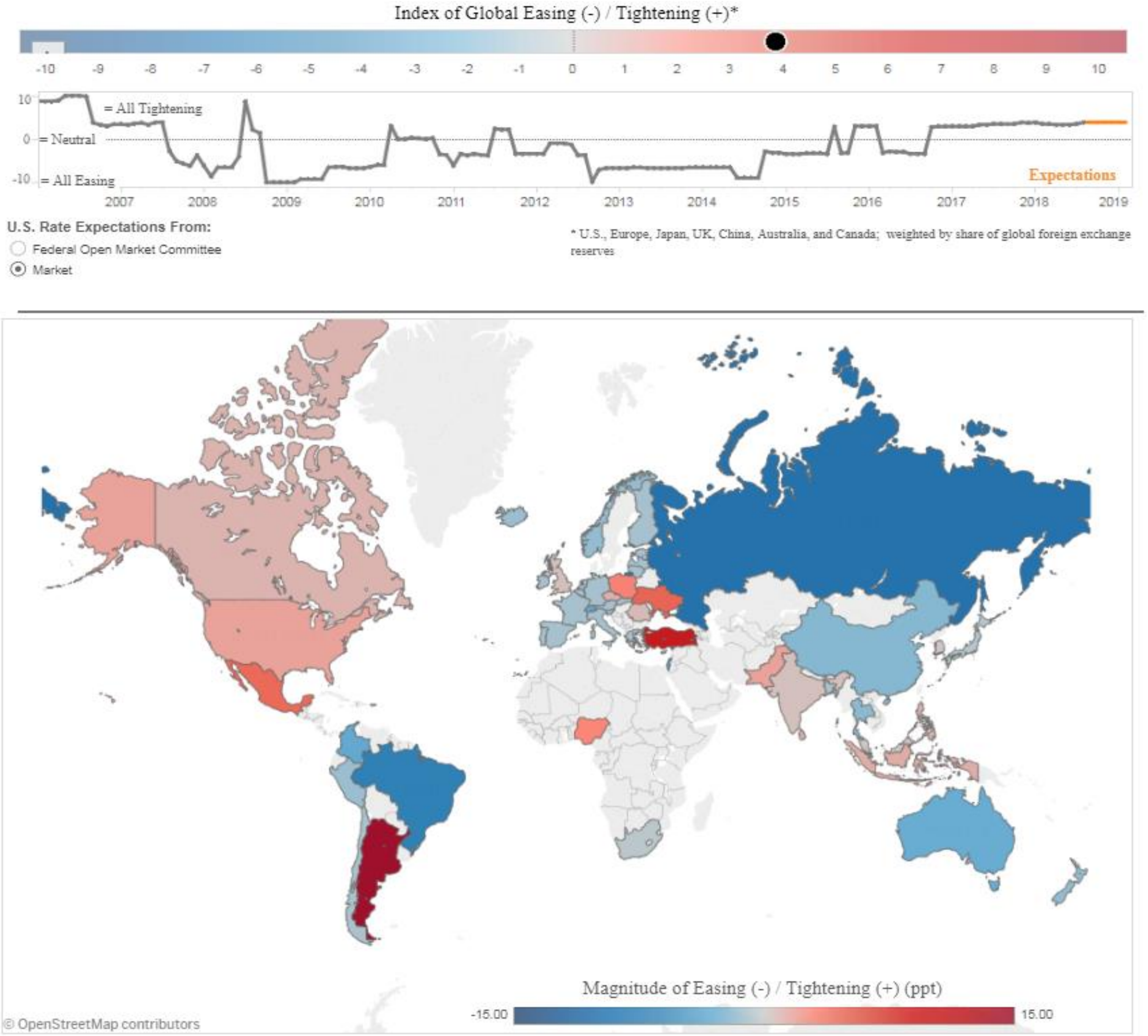
Who has scope to reduce policy rates?

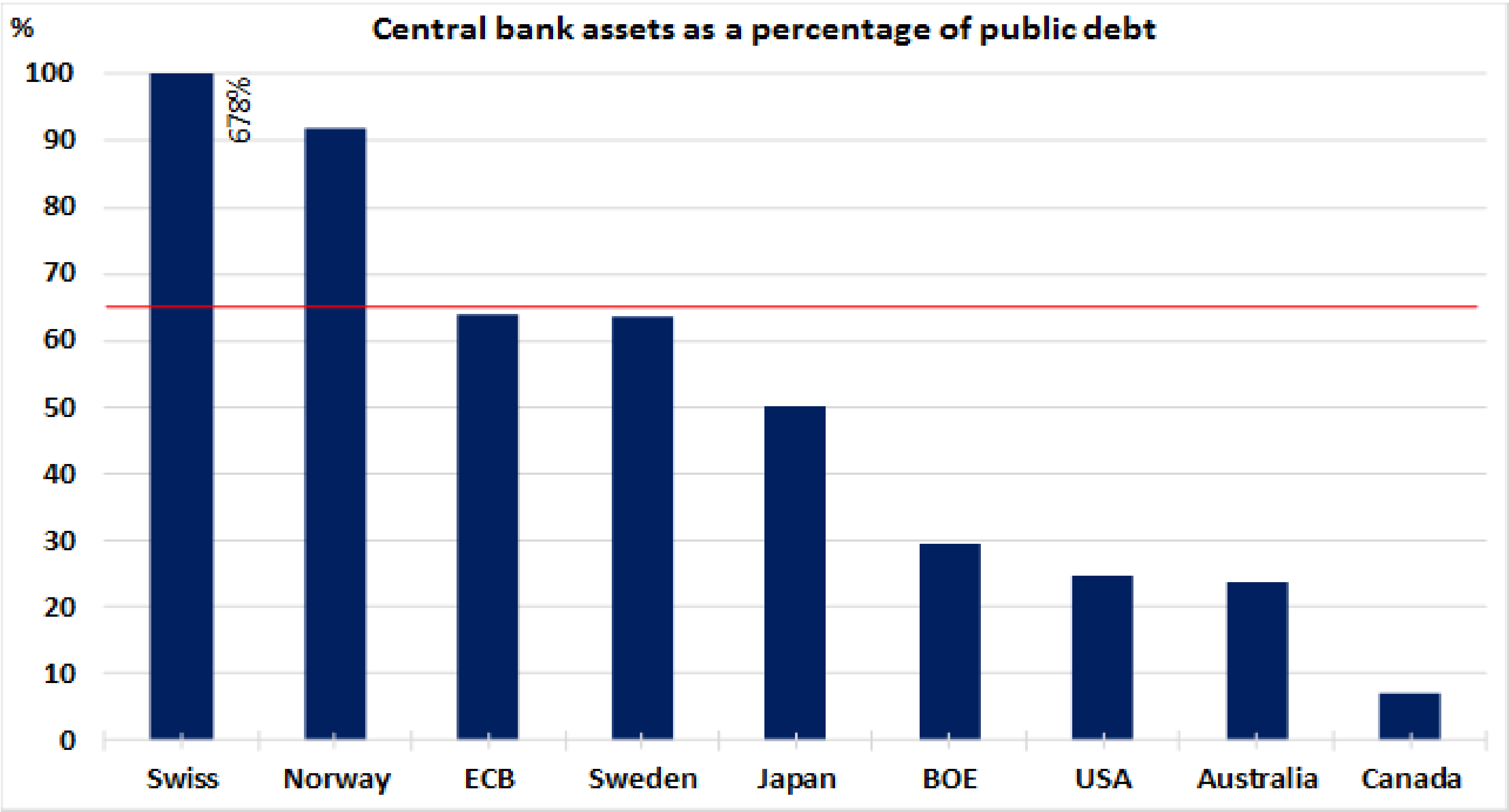
- Not China



Source: CFR

Who has scope to expand QE?

- Anglo-Saxon countries are the better-placed



Data source: IMF and Economic Perspectives

Who (or what) saves the world in 2020?

- US debt-financed stimulus (private or public)?
- German debt-financed stimulus (private or public)?
- Emerging market debt-financed stimulus (private or public)?
- Chinese QE /emerging market QE?
- Revolutionary monetary change, resulting in an inter-generational inflationary reset?

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Global Inflation Update	✓	✓	
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North America Economic Perspective	✓	✓	
Eurozone Economic Perspective	✓	✓	
Research Digest	✓	✓	✓
Global Inflation Heatmaps	✓	✓	
GDP Heatmaps	✓	✓	
Research publication archive access	✓	✓	
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Research Insight presentations	2 per year	1 per year	1 per year
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Economic Perspectives – Partnership selections

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