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Global debt reaches record highs

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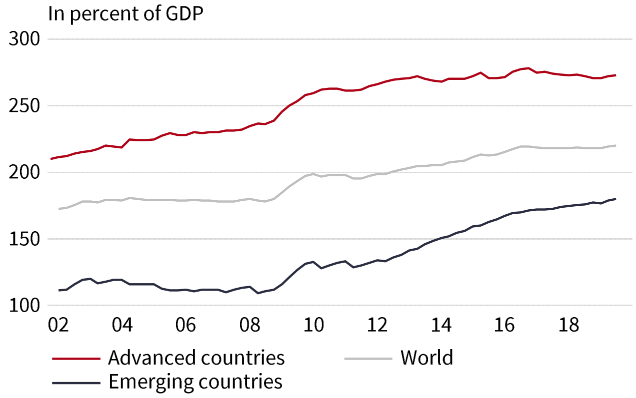
On the rise since the 2008 crisis, global debt has now reached levels not seen since the Second World War. The debt of Chinese state-owned enterprises and the government debt of developed economies were the biggest contributors to this increase. Another concerning trend includes a marked decline in the credit quality of corporate borrowers, notably in the US, along with a fall in covenant quality.

On the rise since the 2008 financial crisis, **global debt has now reached levels not seen since the Second World War**. Global debt, excluding the financial sector, reached $187,143 billion in the second quarter of 2019 – or 220% of global GDP, versus 178% of GDP in the second quarter of 2008 – according to the estimations of the Bank for International Settlements (BIS).

Debt of the non financial sector

In percent of GDP



The rise in debt since the 2007-2008 financial crisis has, however, been far from uniform from one country or sector to the next; it **is primarily a result of the debt owed by governments in advanced economies and by Chinese companies**:

- The gross debt-to-GDP ratio has remained globally constant in advanced economies since the financial crisis, but it has risen significantly in emerging markets, mainly due to the sharp increase in Chinese debt.

- In developed economies, household debt and financial sector debt have declined since the crisis, but government debt has risen considerably under the effect of various bank bailouts and the fall in tax revenues linked to the recession, while corporate debt has increased only slightly.

- After a period of post-crisis debt reduction, US corporate debt has nevertheless risen markedly, mainly due to the rise in the number of merger-acquisition transactions, and has now reached an all-time high.

- In emerging markets, the rise in indebtedness has mainly resulted from the increase in corporate sector debt, while public sector debt has risen only slightly.

- The rise in corporate indebtedness in emerging markets is primarily a result of Chinese corporate debt, which grew by two thirds between 2008 and 2016. Much of China's corporate debt must effectively be regarded as public sector debt as approximately 3/4 of this debt was issued by state-owned companies and local government entities.

- If the global banking sector's debt – which was at the centre of the 2008 financial crisis – has diminished since the outbreak of the crisis, with significant reductions in the US but a sharp increase in China, the level of indebtedness in the non-banking financial sector (also known as "shadow banking") has grown considerably, notably in the US and China.

The high level of public or quasi-public debt in advanced economies and in China is a source of concern, as it reduces states' budgetary room for manoeuvre. Moreover, a high level of public and private debt is likely to affect economic growth, notably by increasing the vulnerability of the economy to economic and financial shocks.

Another element of concern is the significant fall in the credit quality of corporate borrowers, notably in the US and Europe. It is the share of companies already deep in debt or with a weak credit profile that has seen the most dramatic increase over the past few years. Today, nearly a third of US corporate debt is comprised of leveraged bank loans and high-yield bonds.

This decline in credit quality can also be seen in the investment-grade corporate universe, with a significantly greater number of companies assigned the BBB rating (the lowest in the investment category, a notch above speculative-grade debt).

The risk is that in the event of a macroeconomic or financial shock, payment defaults increase dramatically in the risky corporate debt segments and that **BBB-ranked companies inflate the speculative category**. This would lead to **forced sales on the part of mutual bond funds**, which can have only a set proportion of risky securities in their portfolio.

Exiting the high yield market, typically marked by low liquidity or superficial liquidity, in a period of financial stress will be risky to say the least. The effect on valuations will no doubt be dramatic, all the more so as, with the easing of financial covenants (contractual clauses aimed at protecting investors), loans granted to riskier borrowers no longer offer lenders the same guarantees as ten years ago.

While investors' confidence in the sovereign debt of large advanced economies remains solid overall, and while global bank debt reduction has brought global systemic risk down, **new areas of risk have appeared, notably on the margins of the formal banking sector, which call for heightened vigilance**.

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