

**FAZ**

27. April 2018

## **Debt warning!**

*by Michael Heise*

In its most recent publications, the International Monetary Fund has confirmed a concern that also worries many people in our country - the high level and the apparently relentless rise in debt in the global economy. At present, the sum of public and private debt (excluding banks) totals around 240% of global economic output. Before the financial crisis in 2008, the figure was 210%, at the beginning of this century it was 190%. In the industrialized countries, public debt in particular has risen sharply in the last ten years, while in the emerging countries it was mostly private debt.

With the growth in debt, ever greater risks are building up in the national economies. In good times this is hardly noticeable. However, when the economy weakens, it is the debt burden that pulls economies down further. Many companies and private households then have to make substantial savings in order to remain solvent. This exacerbates the downturn. Banks are burdened by rising bad loans and heavily indebted governments have little room to stimulate economic activity through tax cuts or additional spending without running into problems themselves.

All this we have experienced in previous debt crises. Three lessons should be learned. Firstly, that it is a still popular misconception that higher growth always presupposes higher debt. This does not apply to the private sector, nor is it true that governments must increase borrowing in order to keep the economy going when the private sector is saving. Such ideas are behind the frequent criticism of the European Stability and Growth Pact's supposedly anti-growth "austerity constraint". It is not higher debt that creates long-term growth. It is done by creating better growth conditions, for example in education and skills, by making markets competitive, by improving infrastructure and investment conditions. Secondly, monetary policy needs to be adjusted. There is no longer any need to stimulate the credit markets specifically by means of negative interest rates or conditional long-term liquidity programmes. The US Federal Reserve has already changed its policy and the ECB should follow suit soon. A third lesson is that credit quality deteriorates in the late stages of a financial cycle. During the boom, even less stable companies get credit and less valuable loan collateral is accepted. There are sufficient indications of this in the Monetary Fund's stability report. Regulators should look into this. Of course, a termination of an extremely expansionary monetary policy and stricter macro-prudential measures against market overheating will have dampening effects in the short-run. But for prosperity and jobs, a stabilisation of long-term growth is crucial. The build-up of financial market crises needs to be avoided.