NATIXIS

FLASH ECONOMICS
ECONOMIC RESEARCH

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What will be the long-term consequences of the excessive global indebtedness?

The world - and even more OECD countries as a whole - is characterised by significant excessive indebtedness (public debt is higher than in 1945, and the private debt burden is the highest ever observed), the long-term consequences of which are quite clear:

- ***growth is going to be sluggish and savings will be high, due to the need for public and private sector deleveraging;***
- ***monetary policies will remain highly expansionary in terms of interest rates and liquidity, either to try to reduce debt ratios via inflation, or to boost growth, or to help governments raise financing by monetising public debt;***
- ***inflation will remain low despite the expansionary monetary policies, due to weak growth, high unemployment and lower commodity prices than expected, which will obviously complicate deleveraging;***
- ***asset prices will stay low despite the expansionary monetary policies, due to deleveraging, sluggish growth and low inflation.***

The world in the 2010s will therefore be very different from the world in the 2000s, when borrowing had driven up growth and asset prices.

ECONOMIC RESEARCH
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The global legacy of high indebtedness

We will look at the **situation of the world** and of **OECD countries as a whole** (United States + Canada + Europe + Japan).

Currently, the world and the OECD are facing the legacy of a very high debt ratio (public, private, total) **(Charts 1A** and **B).**

Chart 1A
World: Indebtedness (as % of nominal GDP)

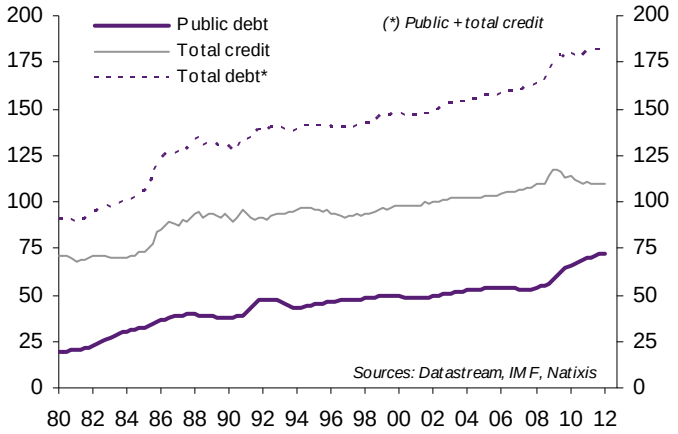
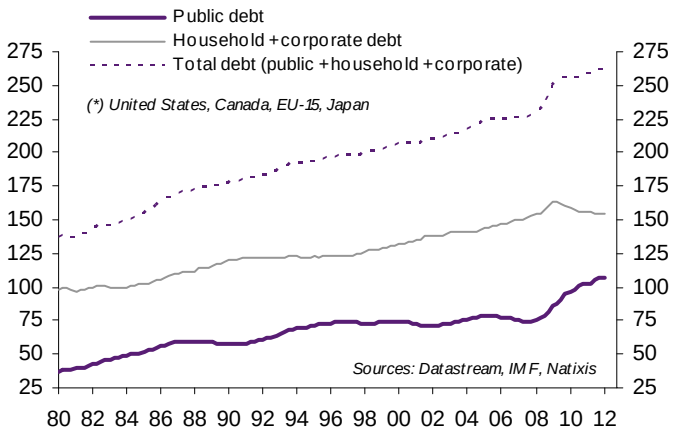


Chart 1B
OECD*: Indebtedness (as % of GDP)



The public debt ratio has reached levels not seen since the end of the Second World War (Chart 1C), and the private debt ratio has reached levels never seen in the past (Chart 1D).

Chart 1C
Public debt (as % of GDP)

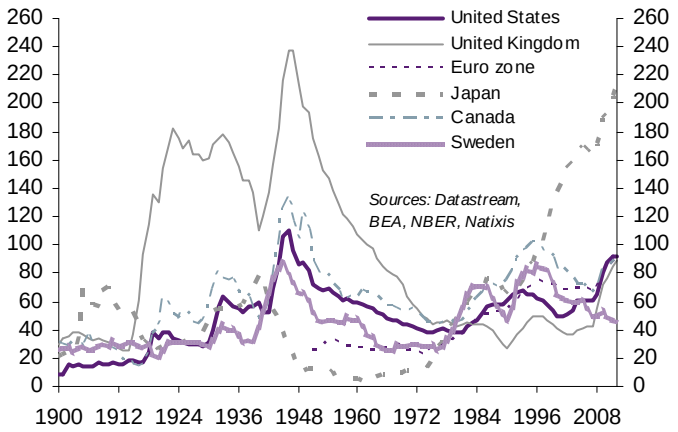
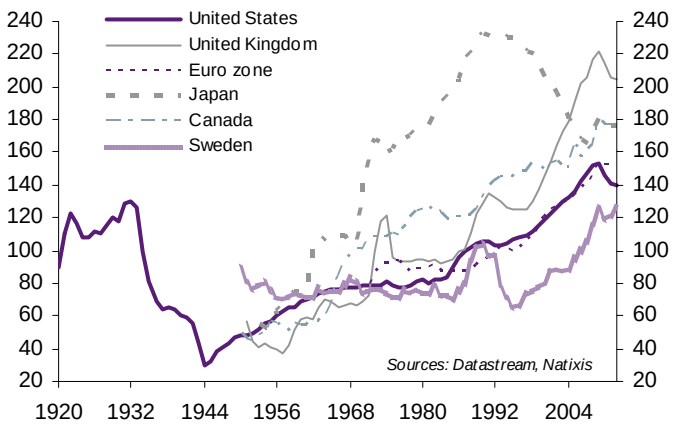


Chart 1D
Household + corporate debt (as % of GDP)



We seek to determine the **structural consequences of this very high level of indebtedness.**

Structural consequences of the very high level of indebtedness

These structural consequences of the very high level of indebtedness concern:

- **growth;**
- **monetary policies;**
- **inflation;**
- **asset prices.**

1. Weakened growth, rise in savings

The very high level of the debt ratios (Charts 1A and **B) is forcing economic agents to deleverage,** leading to:

- **a reduction in the fiscal deficits** (rise in public savings, **Chart 2**);
- **a rise in savings and a slowdown in private sector credit (Charts 3A, B** and **C).**

Chart 2
Fiscal deficit (as % of GDP)

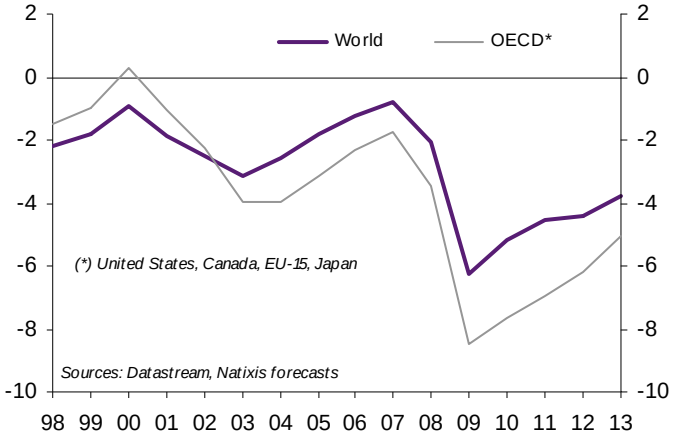


Chart 3A
Private savings rate* (as %)

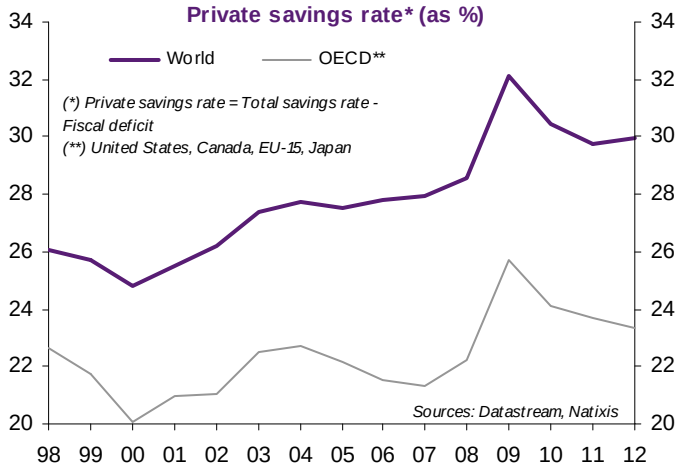


Chart 3B
OECD*: Household savings rate and profits

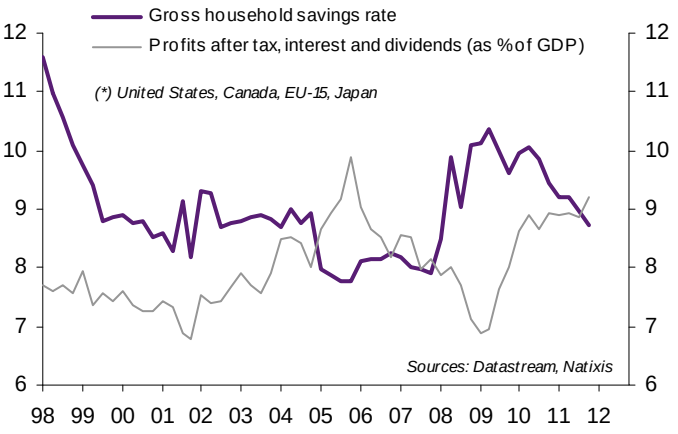
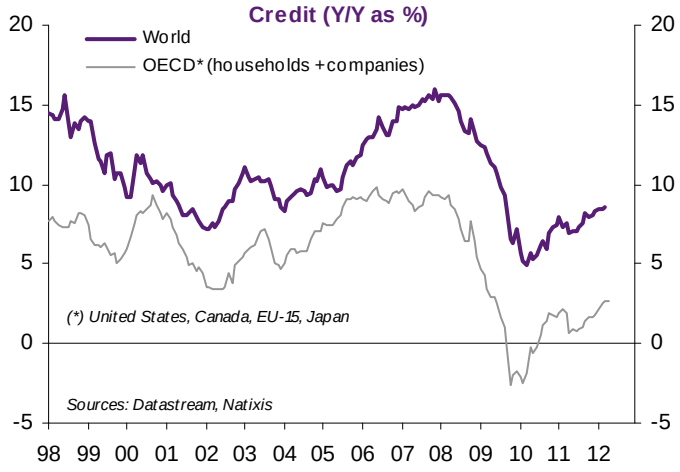


Chart 3C
Credit (Y/Y as %)



If there is a reduction in fiscal deficits, deleveraging and a rise in private sector savings, **demand and growth** will necessarily be **weak (Chart 4A) and unemployment will remain at a high level (Chart 4B).**

Chart 4A
Real GDP growth (Y/Y as %)

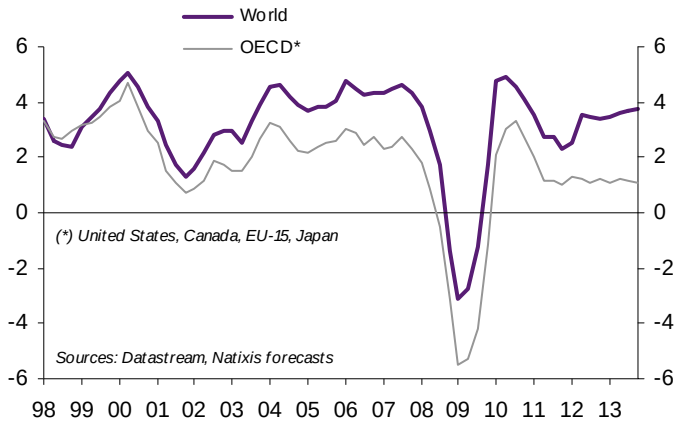
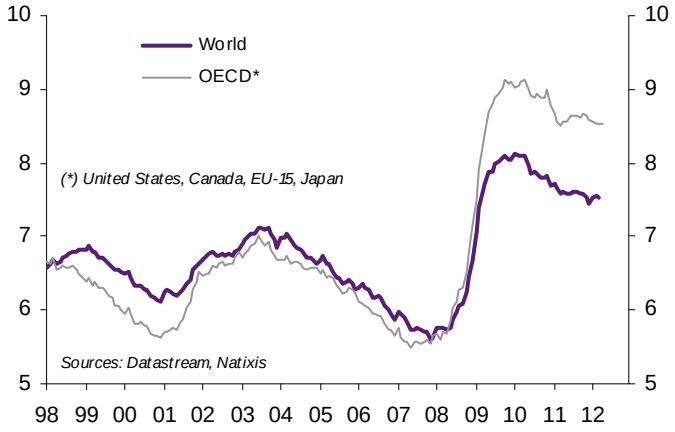


Chart 4B
Unemployment rate (as %)



2. Monetary policies remaining expansionary

In this environment, **central banks are faced with**:

- **the need to facilitate deleveraging, which necessarily means they have to keep short-term interest rates very low (Chart 5A);**
- **the need to help governments raise financing** by monetising part of the public debt, which means liquidity will remain abundant **(Chart 5B);**
- in certain cases, a desire to **facilitate deleveraging via inflation if possible,** also leading to rapid monetary creation;
- **the need to boost growth** through an expansionary monetary policy.

Chart 5A
World: Nominal 3-month interest rate

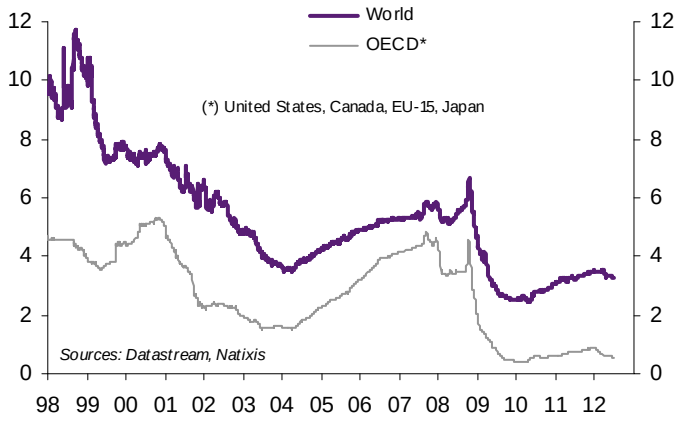
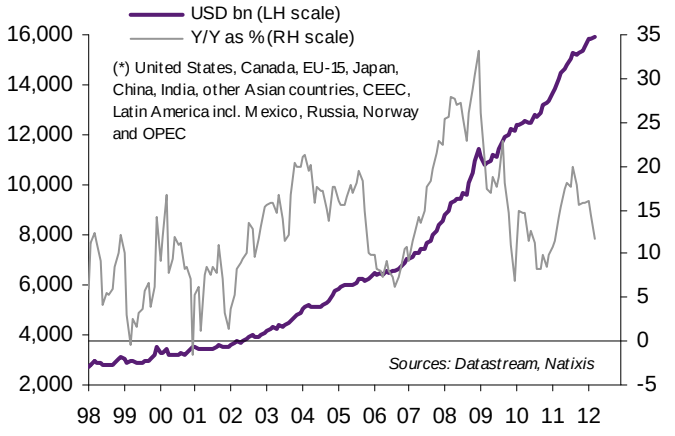


Chart 5B
Global monetary base (in dollars) (*)



The global monetary policy will therefore definitely remain very expansionary.

3. Inflation remaining low

Some analysts believe inflation will return since monetary creation will remain rapid. But we should not forget that monetary creation generates inflation only if the economy is at full employment and if this monetary creation leads to additional demand for goods and services. As long as there is a situation of:

- lacklustre growth and under-employment (**Charts 4A** and **B** above);
- deleveraging (**Charts 1A** and **B, 2** and **3C** above);

the creation of monetary base (central bank money, **Chart 5B** above) will not trigger a rise in credit or pressure on the goods and services market, **and there cannot be any inflation (Charts 6A** and **B).**

Chart 6A
Inflation (Y/Y as %)

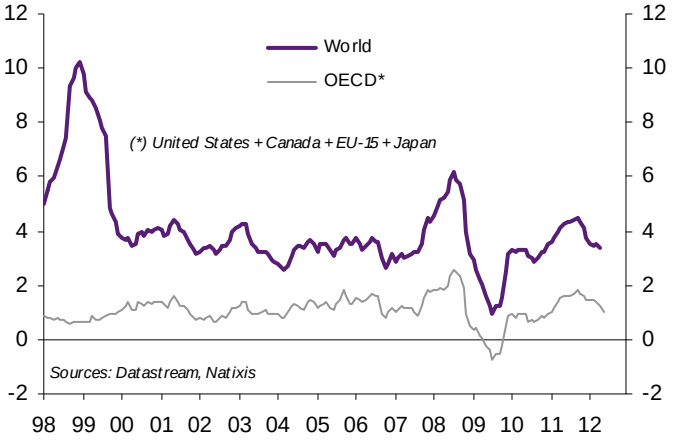
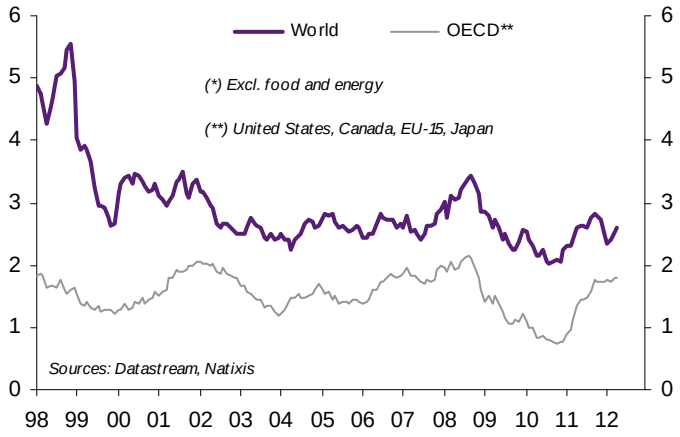
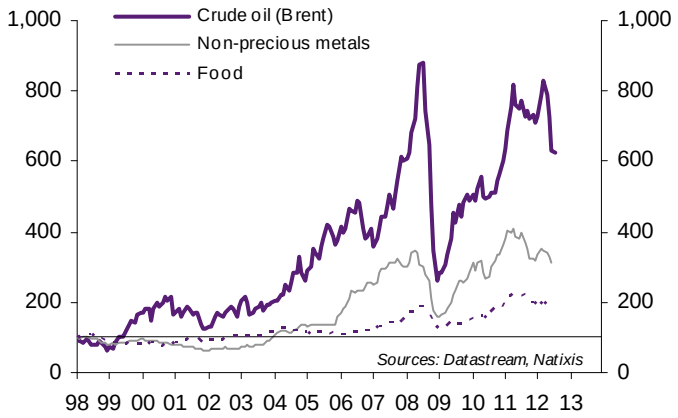


Chart 6B
Underlying inflation (core CPI*, Y/Y as %)



This is all the more the case as **the weakness of global growth is reducing commodity prices below expected levels (Chart 6C).**

Chart 6C
Commodity prices (in USD, 1998:1 = 100)



Low inflation makes it difficult to reduce debt ratios since it limits the ability to switch to very negative real interest rates **(Charts 6D** and **E).**

Chart 6D
World: Real interest rate (deflated by CPI, as %)

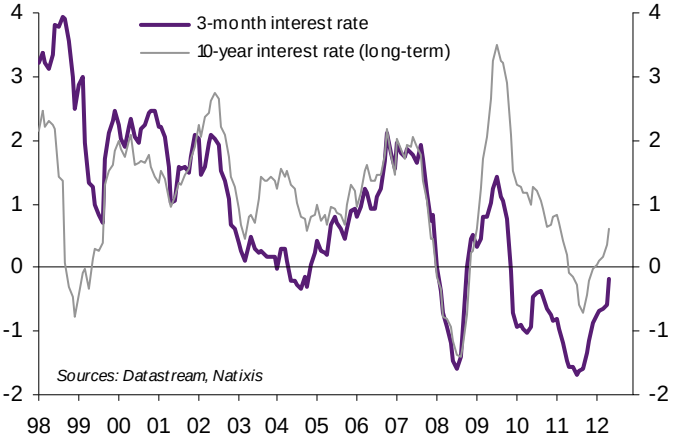
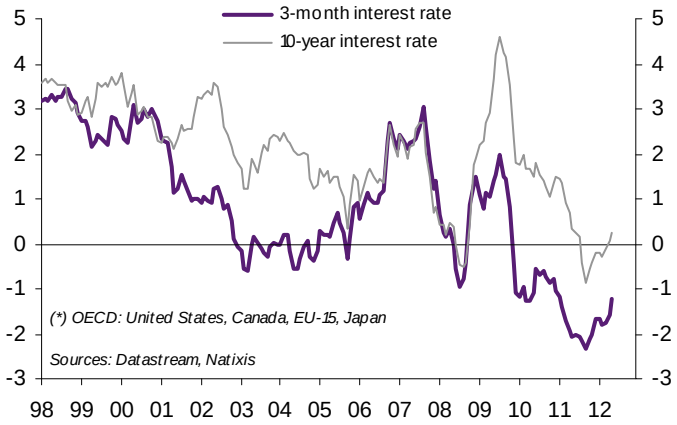


Chart 6E
OECD*: Real interest rate (deflated by CPI, as %)



4. Depression of asset prices

Due to weak growth and deleveraging, and the tame inflation limiting the fall in real interest rates, **asset prices remain depressed (Charts 7A, B, C** and **D).**

Chart 7A
World: House prices

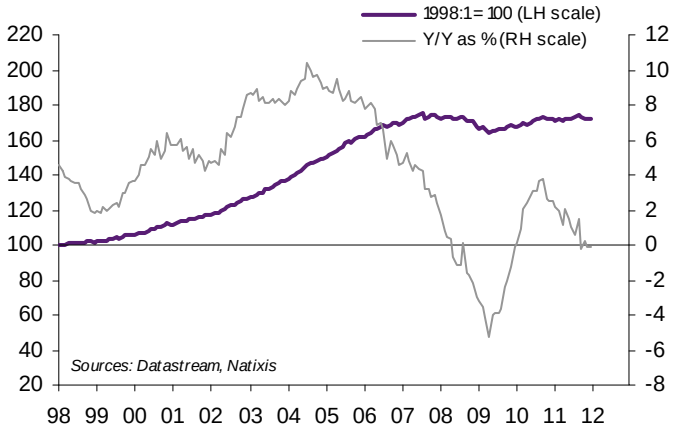


Chart 7B
World: Stock market index

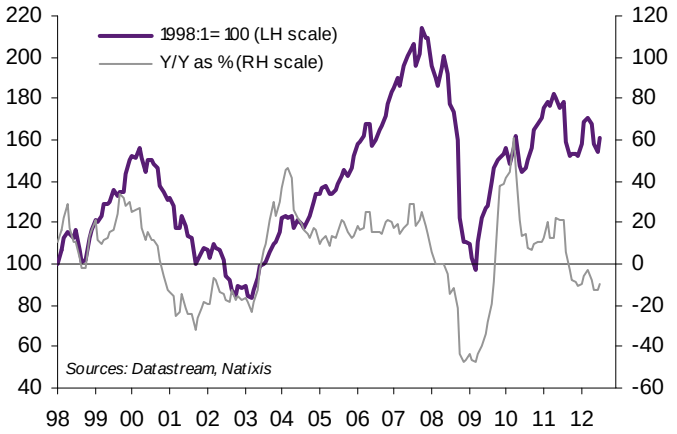


Chart 7C
OECD*: House prices

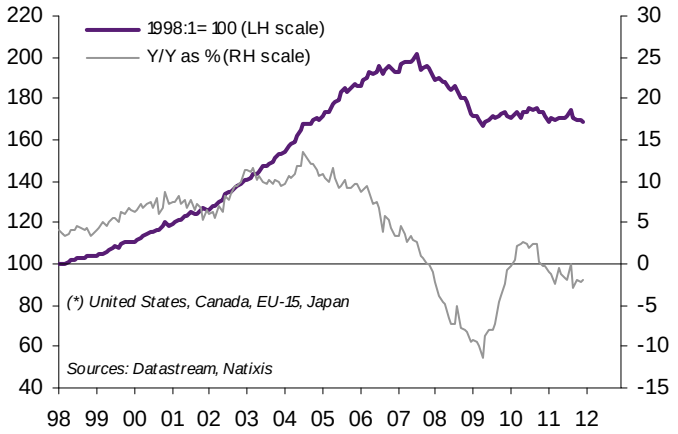
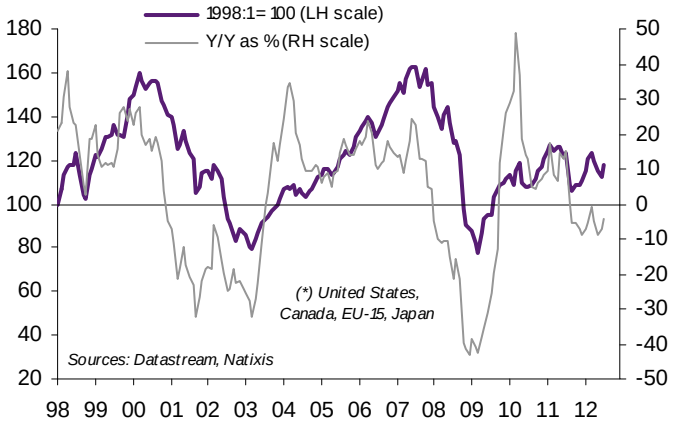


Chart 7D
OECD*: Stock market index



Conclusion: The world in the 2010s will be very different from the world in the 2000s (and the second half of the 1990s)

From the second half of the 1990s until the subprime crisis (2008), the world was characterised by vigorous growth (**Chart 4A** above) driven by borrowing (**Charts 1A** and **B** above) and by the rise in asset prices (**Charts 7A** to **D** above).

This dynamics of the global economy is currently being reversed: due to the required deleveraging, the global economy is being slowed down, global inflation remains low and asset prices remain depressed, despite the expansionary monetary policy.

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