How Dangerous is Global Debt - speech by Kalin Anev Janse

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(Please check against delivery)

Dear ladies and gentlemen,

This session aims to answer a thought provoking question: **"How dangerous is swelling government debt to the global economy?"** If you look at the highest debt to Gross Domestic Product ratios in the largest economies in the world, Japan has the highest level of government debt, about 237% of GDP, followed by the US at 105%. Then the euro area with 85% and China with 50%.

Next to China, which has the lowest debt to GDP, there is one unexpected outperformer in this group. Often Europe is portrayed as the continent with problematic debt. Interestingly enough, it has done the most to handle its debt levels following the crisis. At an aggregate level, a lot has happened in the euro area. The overall debt to GDP ratio is decreasing at a solid pace. While over the last half-decade Japan, the US and China have increased debt levels, in the euro area as

a whole, government debt has gone down.

In the spirit of reducing debt in good time to be prepared for bad times, I would say Europe has done a good job. The difference between debt to GDP in the US and Europe was 10 percentage points in 2014, and has widened since, standing at 20 percentage points last year. An impressive achievement.

Also, the countries that were hit the most by the financial crisis and for which the European Stability Mechanism and the European Financial Stability Facility disbursed nearly €300 billion, are becoming reform champions with sustainable debt levels.

Portugal, Ireland, Spain and Cyprus are success stories as they are experiencing high growth and rapidly falling unemployment rates. And they can easily refinance themselves on the market again.

Greece left its programme last August. The extent and depth of Greek problems exceeded by far those of the other programme countries. But even Greece can be a success story, provided it continues its reform path.

Looking at the euro area as a whole, there is budgetary space, although there are large differences among countries. The fiscal deficit in Europe is smaller than in the US, Japan and China.

This provides Europe with a competitive edge. Given lower interest rates in Europe than in the US, European taxpayers can service their debt more cheaply and easily, and improvements in domestic economic fundamentals support the stability of the euro area. For the first time in 10 years, the euro zone will have moderate fiscal expansion. So, while the outlook isn’t as bright as it was last year, there is no immediate cause for concern and some structural strength.

I would also add that most countries have used this period of low interest rates to extend the maturity profile of their debt and created space to diversify their issuance across the yield curve. This mitigates interest rate volatility in sovereign funding and gives reassurance to investors.

And how does the general economic outlook for the euro area look like?

Manageable debt levels are also a result of good economic growth. The region has been growing above potential for some time now, and we are currently facing a cyclical slowdown, which is inevitable. Last year, the euro area grew by 1.9%. This year and beyond, growth will slow down to a more moderate pace. It is a normal phase in a maturing global economic cycle and not a prelude to a recession.

Some may raise questions about the robustness of the second-largest economy in the world, but I would argue that the euro area has hidden intrinsic strengths, which are sometimes overlooked. We have come a long way since the crisis. Macroeconomic imbalances that emerged in the years before the crisis have been removed. Budget deficits have narrowed, current account deficits have disappeared. The unemployment rate is at its lowest level since the end of 2008.

What does this all mean for the euro?

We already spot shifts in foreign exchange holdings of some major investors, with Russia moving into euros and some Asian investors reducing dollar holdings. We see these changes also in the European Stability Mechanism's (ESM) primary and secondary bond markets, where the Asian investments have been increasing for the first time since 2014.

Strengthening the role of the euro and European financial markets matters as the geopolitical, technological, and financial landscape are changing. And this means we must continue deepening Economic and Monetary Union.

So what does this mean for the future of our monetary system?

Our world is rapidly changing. According to most forecasts, China will become the largest economy in the world by 2030, followed by India. If history teaches us anything, the renminbi may be on track to replace the dollar as the world's reserve currency.

Can we learn from the past? Hardly anybody remembers that the Dutch guilder was the world's reserve currency for much of the 17th and 18th centuries. If you wanted to trade, you needed the guilder. By the 19th century, the pound had replaced the guilder because of Britain's rapid industrialisation and growing empire.

Several decades later, when Europe was devastated by two World Wars and the US became the world's biggest economy, the dollar quite naturally became the world's reserve currency and this is where we are.

But if we want to design a fairer, equal and more balanced global financial system, then a multicurrency world could be the right answer for the 21st century.

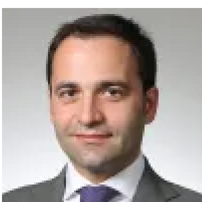
The goal should not be to replace the dollar, but rather establish a multipolar system, in which several currencies have a comparable role, including the dollar, renminbi and euro.

This means Europe and China have some homework to do to further strengthen their currency. Europe needs to deepen its monetary union by completing the banking union and introducing fiscal mechanisms for the euro area. More important, it must push for further integration of financial markets, with a capital markets union as a top priority after the European Parliament elections. A euro area safe asset would be crucial for integrating markets, as well as a European public debt distribution platform.

And not only Europe has to change; it would help China to make its renminbi convertible and open its capital markets.

The coming decade will be key in moving towards a multicurrency reserve world. If we want to do it, this is the right moment. It would be good not only for Europe, China and even the US, but also for emerging markets and the entire international monetary system.

Author



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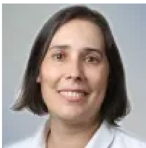

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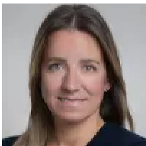

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