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The $100 Trillion Global Debt Bomb and Financial Shock Risk

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Commentary

Last month, the International Monetary Fund (IMF) stated that "our forecasts point to an unforgiving combination of low growth and high debt, a difficult future," emphasizing that "governments must work to reduce debt and rebuild buffers for the next shock, which will surely come, and maybe sooner than we expect."

This advice comes with a warning. At the current rate of spending, the U.S. debt to GDP will reach 198 percent by 2050 even without expecting a recession. The G-7 public debt to GDP is expected to soar to 188 percent; the global figure would rise to 122 percent. Only one country will reduce debt. The IMF expects Germany to reduce its debt from 63.5 percent to 42 percent. In the case of Japan, the IMF expects public debt to reach a staggering 329 percent. The IMF's Fiscal Monitor informs that public debt levels will reach $100 trillion in 2024, driven by China and the United States.

Very rarely do governments follow the IMF's advice. Governments only listen when the advice is to spend more. However, when it comes to saving and cutting expenditures, governments quickly perceive the IMF as a malicious organization.

The IMF's 2020 messages bear some responsibility for this fiscal crisis. In its Annual Report 2020, "A Year Like No Other," they wrote: "Governments around the world have undertaken major fiscal and financial measures to provide lifelines to people and firms. Such rapid expansions in the role of the government, however, create opportunities for corruption, as past crises have shown. This means governments need to control and oversee emergency fiscal and financial measures. The IMF's advice has been to spend whatever it takes but keep the receipts." Which part of the IMF's advice did governments around the world adopt? Yes, the "spend whatever it takes." And they did. They still do. In fact, many governments have consolidated and increased the extraordinary expenditure programs of 2020, expanding their role in the economy and increasing deficit spending during a period of economic growth.

One of the fastest growing debt burdens is the United States one. Over the next five years, the IMF anticipates an annual increase in public debt to GDP of nearly three percentage points. It is important to note that the IMF does not foresee a crisis or recession, so this will happen in a growth and job-creation environment.

Governments will disregard any of these recommendations. As I said before, governments only listen to the IMF when it recommends increasing public expenditures and blame the organization when it comes to reducing debt.

No interventionist government will reduce spending, particularly when central banks are lowering interest rates. Even worse, many statistical bodies in the eurozone have massively upgraded the GDP of the past, and their policymakers have used this statistical revision to accommodate more spending, more debt, and more taxes.

The IMF explains in its blog entry, "How High Economic Uncertainty May Threaten Global Financial Stability," that the risks of a financial shock are rising, as complacency about debt meets the risk of a significant slump in economic growth. As usual, the tone of the article is diplomatic and assumes that governments are going to be fiscally prudent and build cushions to avoid a financial shock. Unfortunately, the IMF authors are too optimistic. The pandemic paved the way for record global fiscal irresponsibility. Every government believes that they will solve their problems by increasing taxes to the wealthy and to large corporations, the oldest and most ludicrous excuse in fiscal policy.

If you believe that the wealthy and large corporations are going to pay $100 trillion in higher additional taxes in the next ten years, you have a problem with mathematics and with history.

The idea that central banks will implement aggressive easing measures when things turn ugly is familiar to governments, and they will push the limits of fiscal policy. However, governments seem indifferent to the devastation this policy is causing the middle class.

The $100 trillion fiscal timebomb means lower growth, lower real wages, financial repression, and destruction of the currencies' purchasing power in the future. Governments will not pay attention to the IMF because they will use the next shock to increase the size of government in the economy even further under the excuse of another "emergency."

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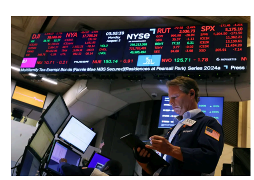

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