Private Sector Debt and the Global Recovery

APRIL 2022 WEO CHAPTER 2

WEO OUTREACH

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Needed support policies during the crisis led to unprecedented increase in public and private debt

(Percent of GDP)

- Will the pandemic’s private debt legacy affect the pace of the recovery?
- What are the implications for policy?

Source: Global Debt Database, 2021.
Key insight of the chapter: Aggregate debt does not tell the whole story

1. **Documents distribution** of private debt buildup across households and firms
   - Focus on financially constrained households and firms; more likely to feel deleveraging pressures in the future when policy support is withdrawn.

2. **Estimates impact of recent leverage buildup on future growth**
   - Importance of low-income households and vulnerable firms
   - Importance of public debt burden
   - Importance of insolvency regime

3. **Analyzes role of balance sheets for transmission of countercyclical policies**
   - Important to calibrate fiscal and monetary normalization post-pandemic
1. Private Leverage in the Pandemic
Households: Wide heterogeneity in distribution of debt buildup during the pandemic

Change in Debt-to-Income Ratio by Income Decile in 2020

(Percent of income)

Source: IMF staff calculations – see online annex Chapter 2, April 2022 WEO for details
NFCs: increased leverage concentrated among vulnerable firms

Share of Vulnerable Firms (Percent)

Share of Debt in Vulnerable Firms by Sector (Percent)

Sources: Standard & Poor's Capital IQ; and IMF staff calculations.
Note: Sample consists of 71 economies, including 15 economies from Asia. Vulnerable firms are defined as: top tercile of leverage, bottom tercile of the ROA and ICR < 1. ICR = interest coverage ratio.
2. Drag on Growth
Households: Rapid leverage may impede future growth

Stronger growth effect in EMDEs

... where wealth inequality is large ...

... and fiscal space is limited.

GDP Response to 1 pp Excess Household Credit
(Cumulative percentage points)

Source: IMF; BIS; IMF staff calculations.
NFCs: Debt overhang has persistent effect on capital formation …

... for vulnerable firms ...
Cumulative investment loss (Percentage points)

... and where insolvency regimes are relatively inefficient.
Cumulative investment loss (Percentage points)

Sources: Bureau van Dijk Orbis; and IMF staff calculations.
Note: Cumulative effect of a 1 standard deviation increase in leverage on capital stock. Vulnerable firms are defined as: top tercile of leverage, bottom tercile of the ROA and ICR < 1. ICR = interest coverage ratio.

Sources: Bureau van Dijk Orbis; IMF, Crisis Preparedness Index; and IMF staff calculations.
Note: Cumulative effect of a 1 standard deviation increase in leverage on capital stock. Well-prepared insolvency regimes are defined as countries at the top quartile of the SPR-LEG indicator of crisis preparedness 2020 (insolvency regimes).
3. Distributional Effects of Countercyclical Policy
Countercyclical policies have larger effect on financially-constrained households and firms

Response of Consumption by Income Quintile to Fiscal Consolidation Shock (1 percent of GDP)

Response of Investment by Leverage Quintile to Monetary Shock (100 basis point)

Sources: Allen, Kolerus, and Xu (2022); Bureau van Dijk Orbis; and IMF staff calculations.
Note: Sample consists of 13 economies for consumption and 24 countries for investment.
Key takeaways

- Empirical analysis based on aggregate data suggests some drag on growth from pandemic-driven debt increase:
  - AEs: -0.9%; EMs:-1.3% (GDP cumulative over 3 years)

- But pandemic had very unequal effects across households and firms so aggregate debt buildup is only part of the story.

- As monetary and fiscal policies are normalized, drag on growth will be larger where:
  - Debt increase has been concentrated among financially constrained households and firms in hard hit sectors
  - Private leverage buildup happened against backdrop of limited fiscal space
  - Insolvency regime is inefficient
Main policy messages

**Cyclical:** on a “country-by-country” basis

- Where recovery is well underway and balance sheets are in good shape, fiscal support can be reduced faster to assist central banks in their efforts to rein in inflationary pressures.

- Elsewhere, exit from accommodative policies could be more **gradual**
  - **Fiscal sustainability:** limited fiscal space, support should be **temporary**, and **targeted** to financially constrained households and viable firms.
  - **Targeting is difficult:** government should partake in upside
    - Improve revenue mobilization through e.g., temporary higher taxes on excess profit or quasi-equity participation instead of outright credit guarantee

**Structural:**

- Enhance **real-time measurement** of households’ and firms’ **balance sheets** for better targeting.

- Improve **insolvency regimes** to allow rapid reallocation of resources to most productive use through restructuring or liquidation.

- Address **debt bias in taxation** to avoid excessive debt buildup in the future.
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THANK YOU!