Private Sector Debt and the Global Recovery

APRIL 2022 WEO CHAPTER 2

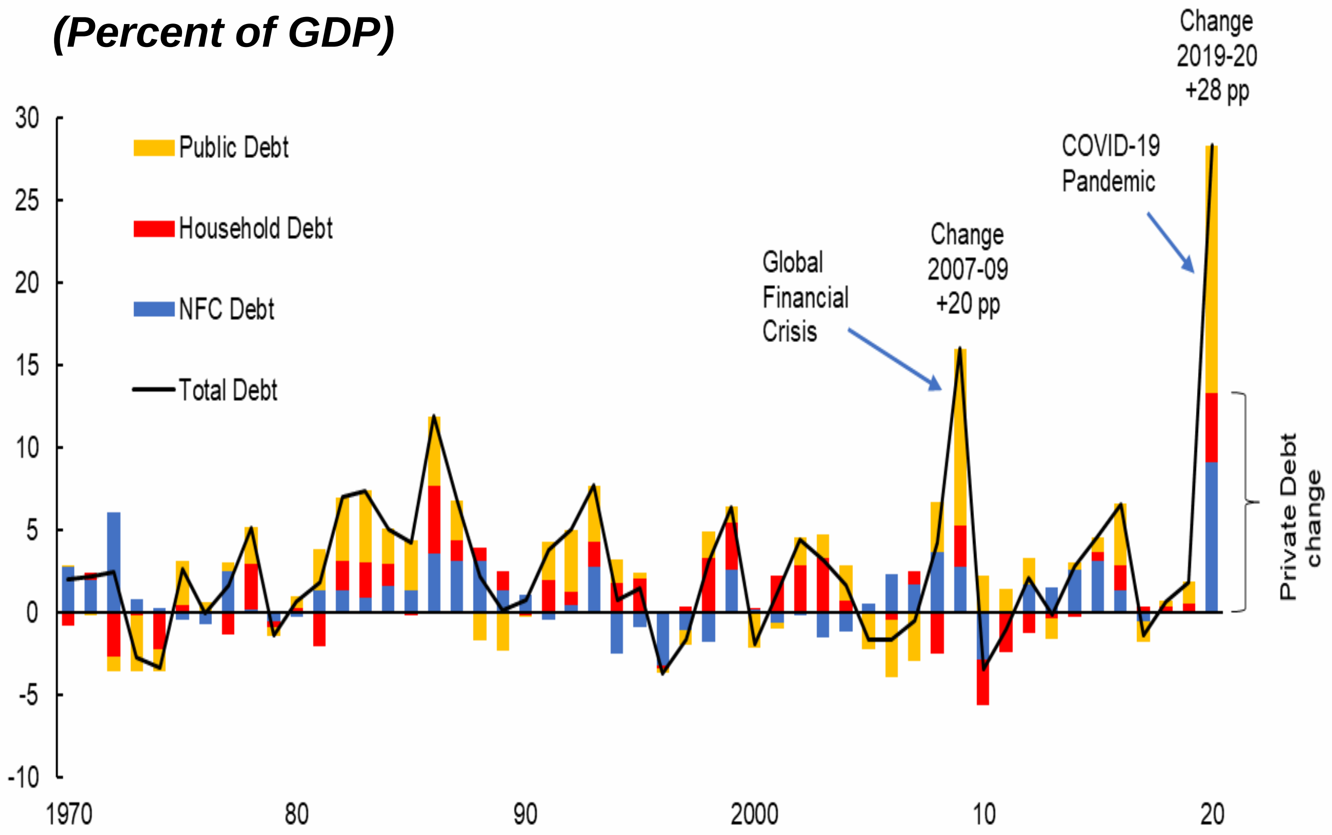
WEO OUTREACH

Silvia Albrizio, Sonali Das, Christoffer Koch
Jean-Marc Natal and Philippe Wingender, with support from Evgenia Pugacheva and Yarou Xu

WEO CHAPTER 2 : link to the original chapter and blog

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

Global Debt Stock: Annual Changes in Public and Private Debt 1970-2020
(Percent of GDP)



Source: Global Debt Database, 2021.

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

Key insight of the chapter: Aggregate debt does not tell the whole story

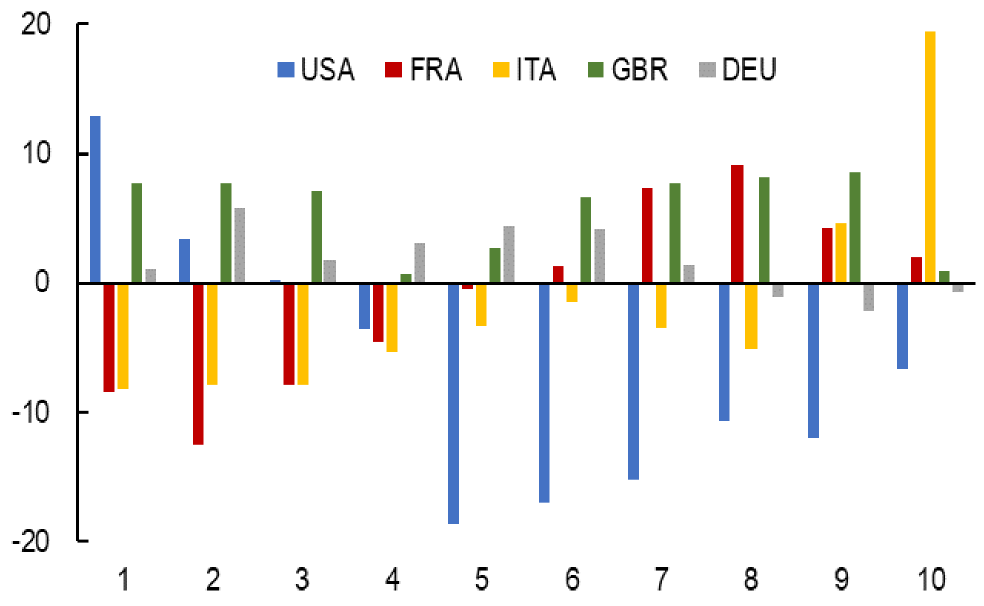
1. **Documents distribution of private debt buildup across households and firms**
   - Focus on financially constrained households and firms; more likely to feel deleveraging pressures in the future when policy support is withdrawn.
2. **Estimates impact of recent leverage buildup on future growth**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

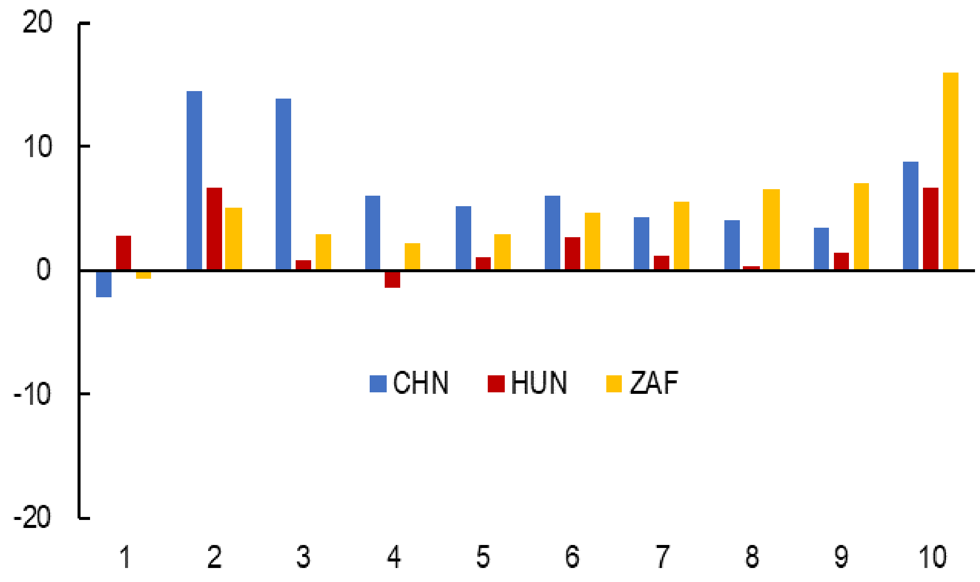
Households: Wide heterogeneity in distribution of debt buildup during the pandemic

Change in Debt-to-Income Ratio by Income Decile in 2020
(Percent of income)

Advanced Economies



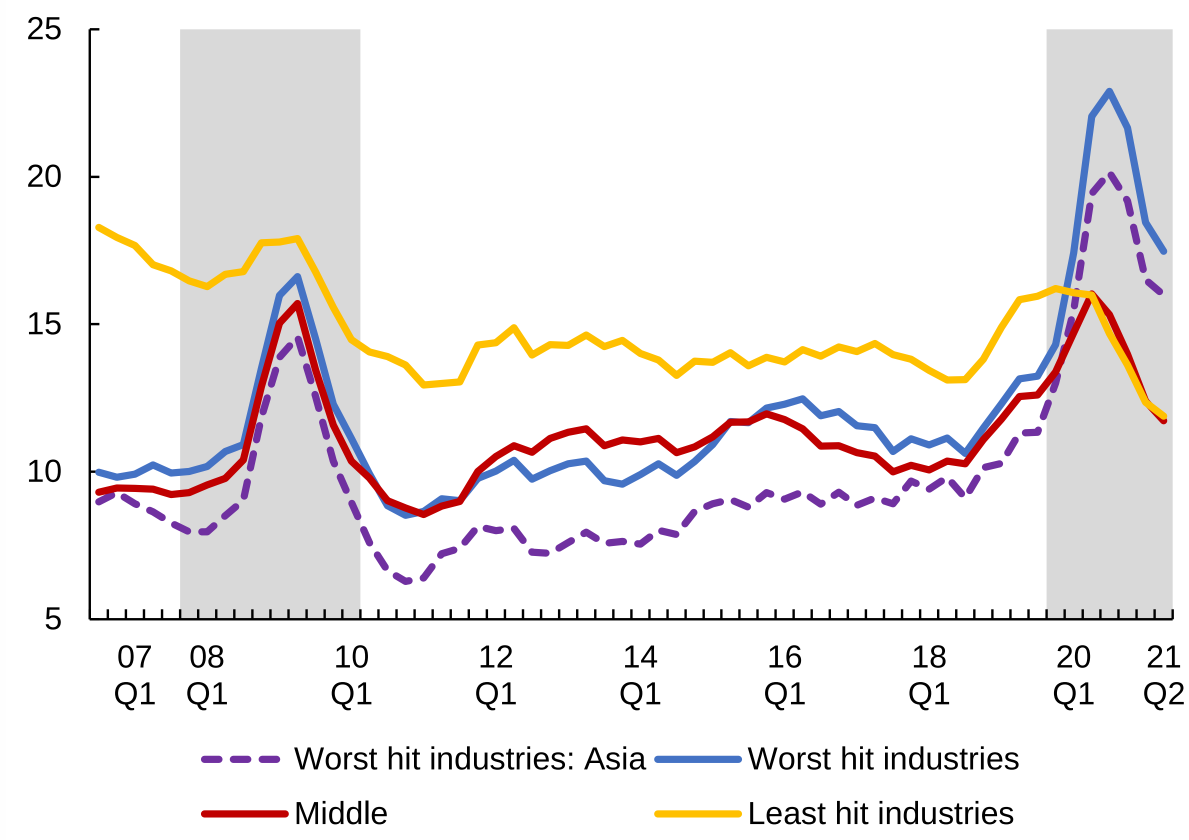
Emerging Market Economies



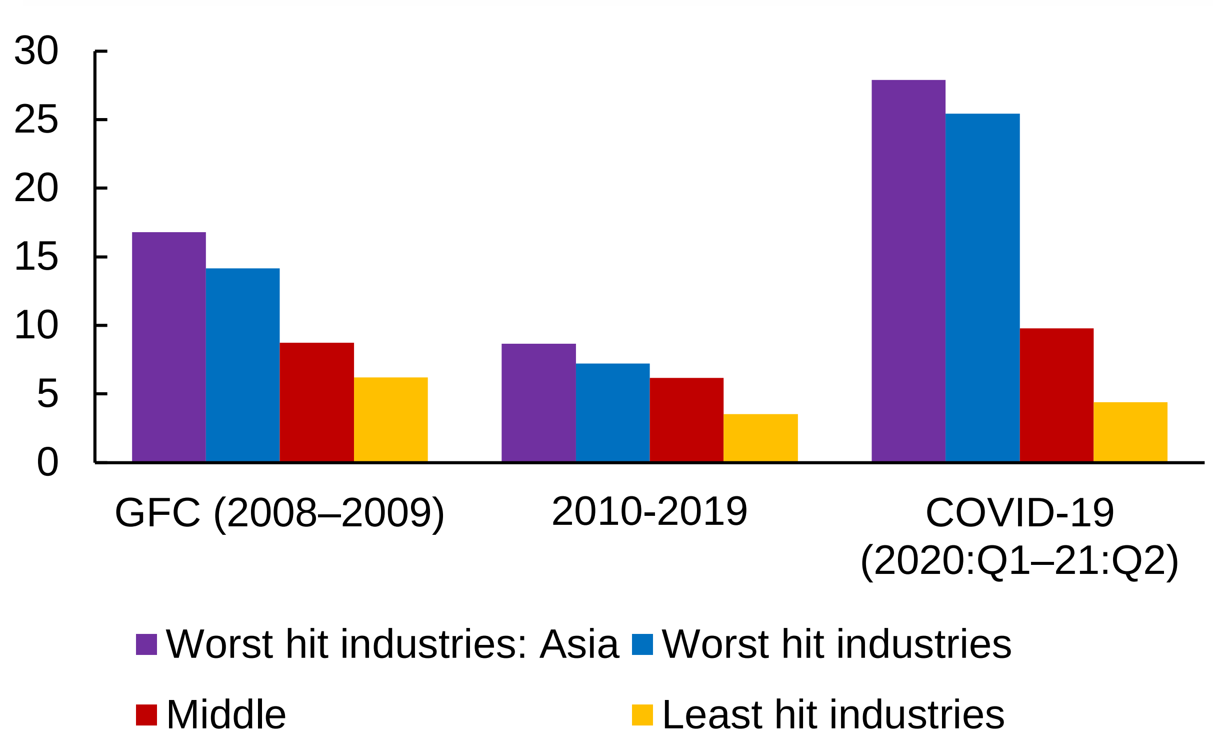
Source: IMF staff calculations – see online annex Chapter 2, April 2022 WEO for details

NFCs: increased leverage concentrated among vulnerable firms

Share of Vulnerable Firms
(Percent)



Share of Debt in Vulnerable Firms by Sector
(Percent)

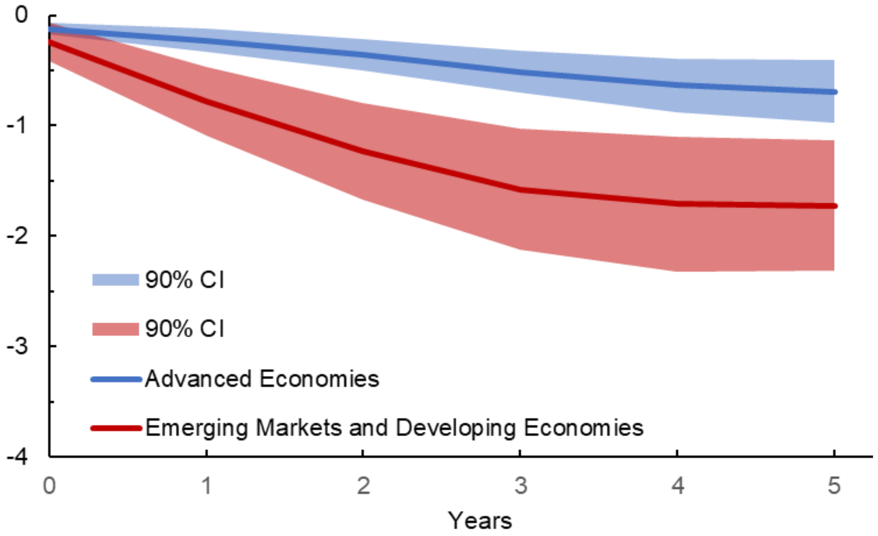


Sources: Standard & Poor's Capital IQ; and IMF staff calculations.
Note: Sample consists of 71 economies, including 15 economies from Asia. Vulnerable firms are defined as: top tercile of leverage, bottom tercile of the ROA and ICR < 1. ICR = interest coverage ratio.

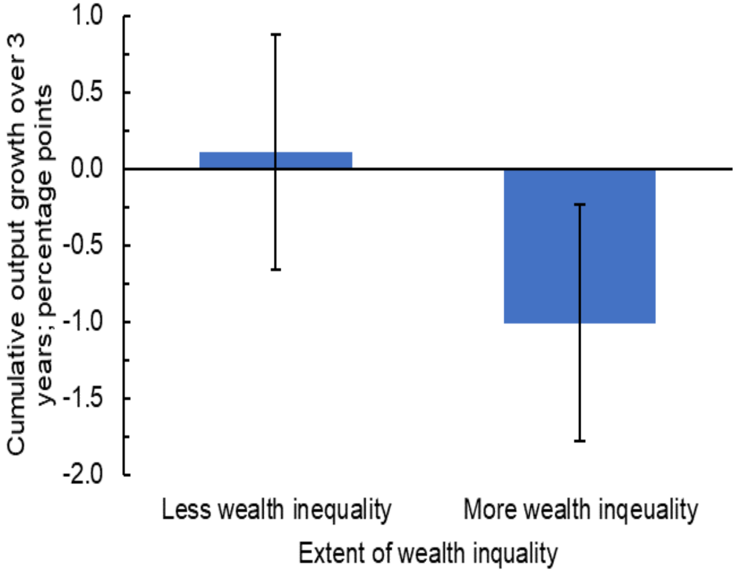
2. Drag on Growth

Households: Rapid leverage may impede future growth

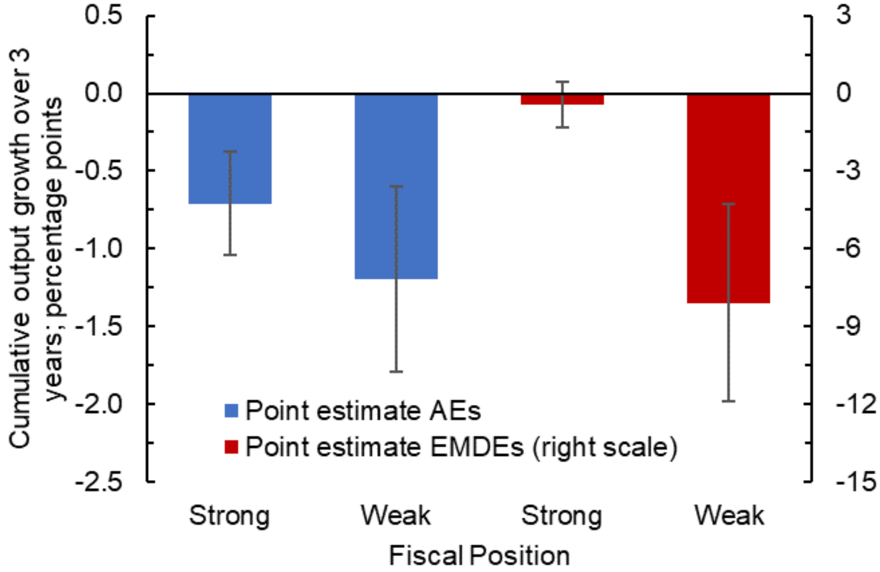
Stronger growth effect in EMDEs



… where wealth inequality is large …



… and fiscal space is limited.



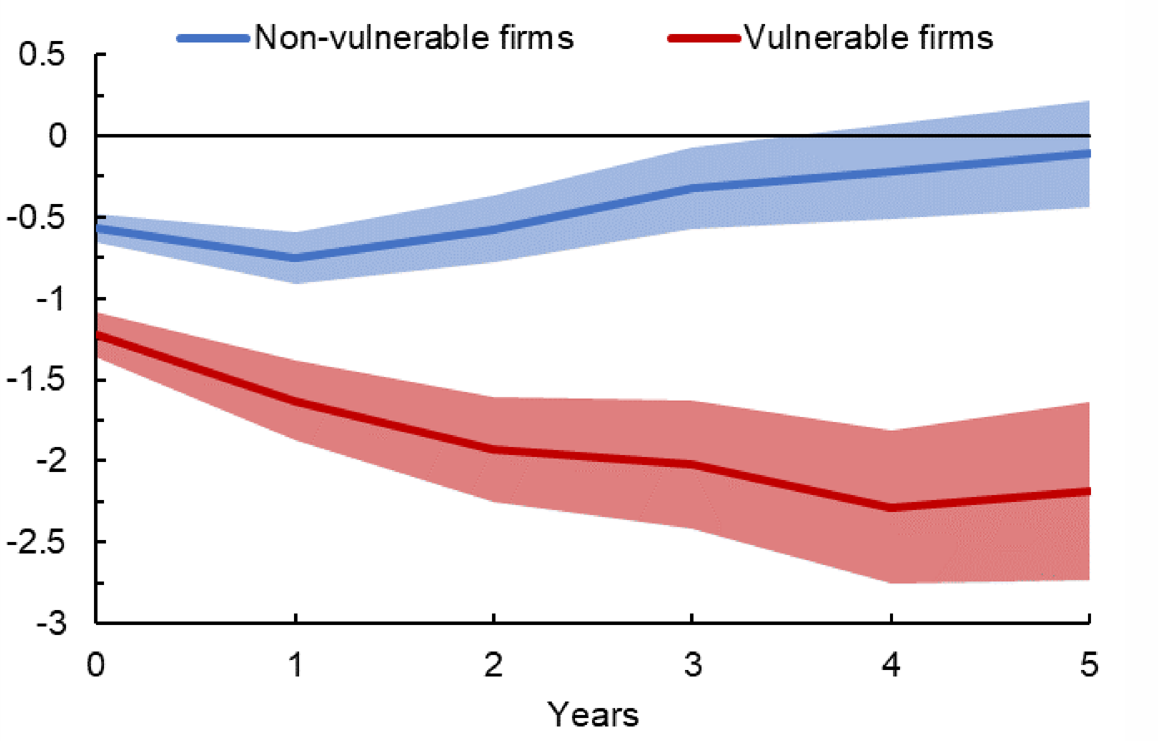
GDP Response to 1 pp Excess Household Credit
(Cumulative percentage points)

Source: IMF; BIS; IMF staff calculations.

NFCs: Debt overhang has persistent effect on capital formation …

… for vulnerable firms …

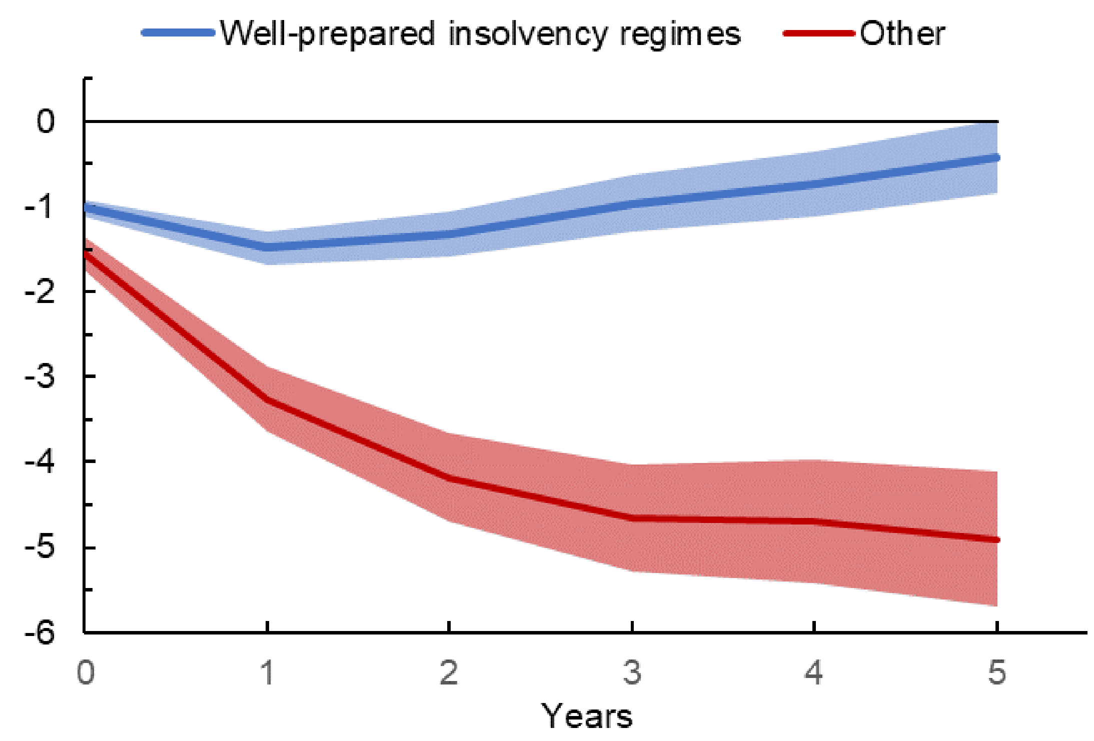
Cumulative investment loss
(Percentage points)



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.

… and where insolvency regimes are relatively inefficient.

Cumulative investment loss
(Percentage points)

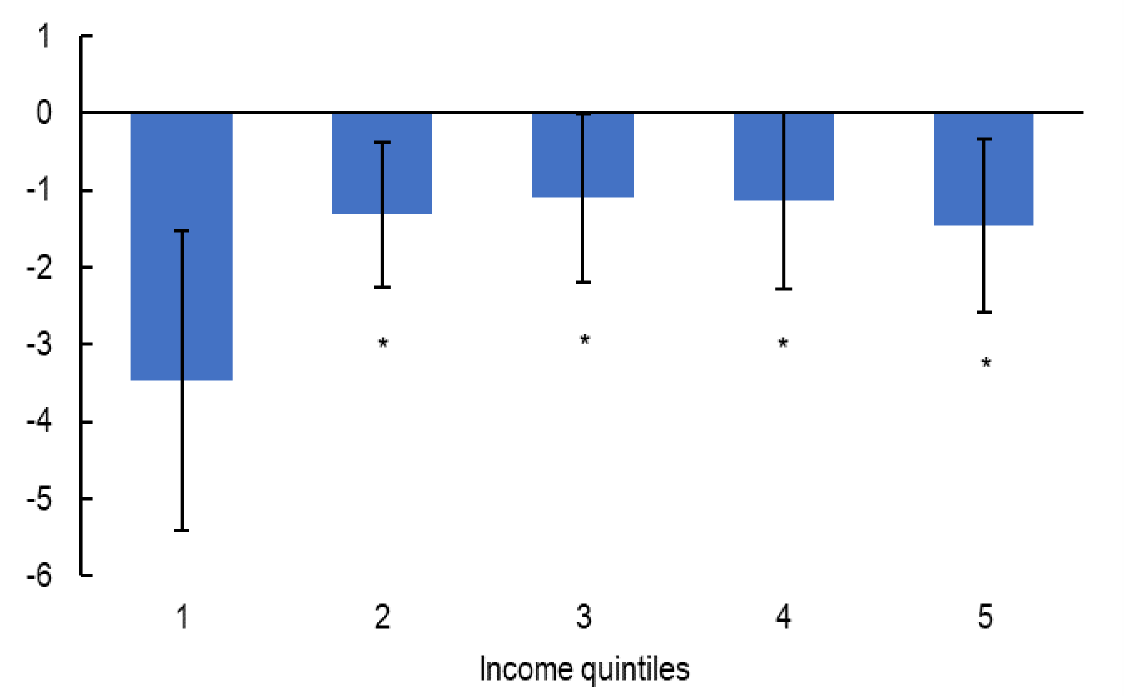


Sources: Bureau van Dijk Orbis; IMF, Crisis Preparedness Index; and IMF staff calculations.
Note: Cumulative effect of a 1 standard deviation increase in leverage on capital stock. Well-prepared insolvency regimes are defined as countries at the top quartile of the SPR-LEG indicator of crisis preparedness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

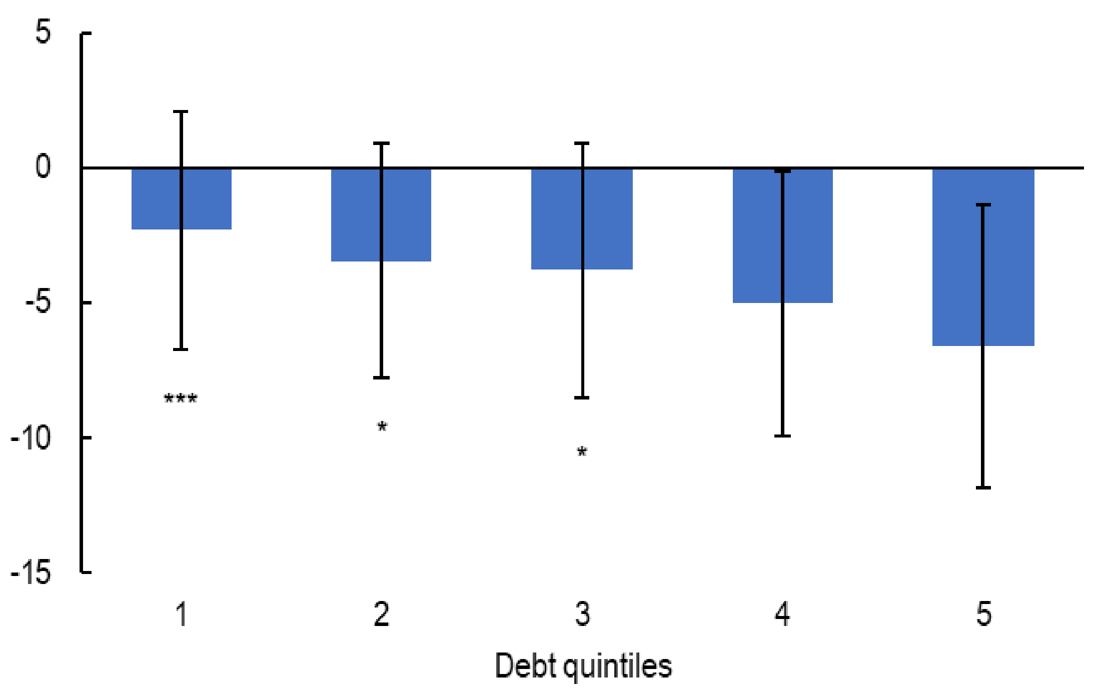
3. Distributional Effects of Countercyclical Policy

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

<u>**Cyclical:**</u> 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.
    - T**argeting 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

<u>**Structural:**</u>

- 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**.**

World Economic Outlook
APRIL 2022

THANK YOU!