ADVISORS & PARTNERS
Solid solutions. Long-term results.

MONTHLY MACRO ANALYSIS
JANUARY 2021
No 20
"Clarify economic and financial news to better anticipate and control risks"

Inherited debt?

With negative interest rates, debt is not a problem unless it causes a concentration of wealth.

As a result of the initiatives taken by governments and central banks to cope with the current pandemic, **public debt has soared** all over the world.

This debt is often described as the result of the systematic **trade-off between health and the economy**. It has triggered a number of debates, most very lively, the main theme of which being the question of what world we are going to leave to future generations.

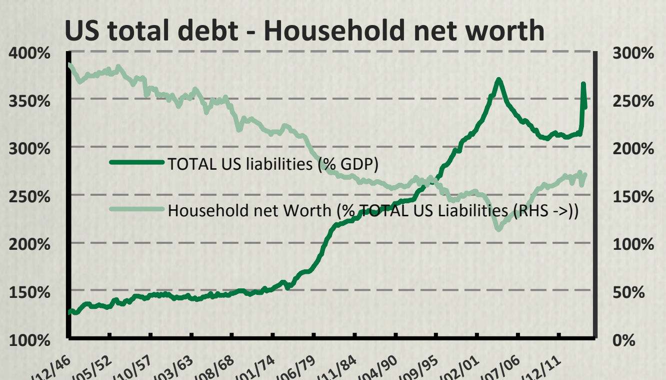
There are therefore many calls for the **cancellation of the portion of this debt** borne by central banks as part of their programmes to inject liquidity in order to lower interest rates and stimulate inflation.

Against the current backdrop of **financial assets' extremely high price**, which attests to an almost blind faith in the foresight of governments and central banks' actions, a default – even if organised – on government borrowings could be the last straw. A **major financial crisis** would become even more likely if the pandemic takes off again, and non-performing loans on banks' balance sheets could be expected to rise sharply.

In reality, **the question of debt is a concern** because it has been **put the wrong way**. Firstly, a traditional bank's aim is not to get its loans repaid and reduce its balance sheet. It is in the business of wanting debtors to pay interest. With **negative interest rates**, debtors can **pay off their debts' load eternally**.

Negative interest rates are of major significance, supporting in a certain way those who defend the theory of reasoned negative growth. They mean that **savers should expect to see their investments fall in value** in the medium term - in other words losing money on a recurring basis. **Getting into debt today in order to spend today** would therefore be the most rational decision to make under current circumstances.

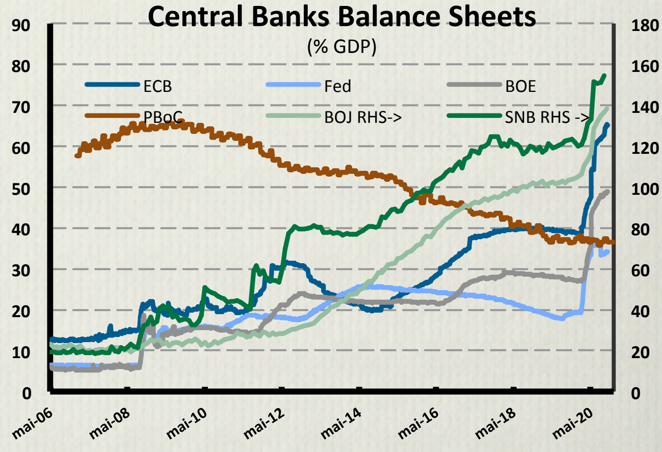
The third key observation is that government debt is not representative of the economy's general level of debt; it represents the level of concentration of this debt among certain debtors.



Source : -BEA - Agata Capital

The example of the United States shows that although government debt has risen sharply, the country's **overall debt** remains **below** the percentage of GDP reached in **March 2009**. As per the above chart, the latest available figures (September 2020) show that this debt is 334% of GDP, following a peak of 365% in March 2009. And it should also be stressed that at the same time US household saving rate has jumped precisely as a consequence of government transfers, resulting in an **increase in household wealth**, which has **at least equalled the increase in the country's total debt**.

Lastly, the central banks will continue to want to stimulate inflation and therefore inject liquidity on a massive scale: in Japan, the plan is to inject $700 billion, compared with around €2,000 billion in Europe, and $1,440 billion in the United States.



Source : ECB / Fed / BOE / SNB / BOJ / PBoC - Agata Capital

As the above chart shows, **buying up debt** has become **a norm** in terms of conducting **monetary policy**, just like the level of interest rates or money supply in the past. In the case of the **Fed**, **34%** of GDP will hence be frozen between now and end of 2021, compared with **50%** for the **Bank of England** and 65% for the **ECB**. At the other end of the spectrum, the **Bank of Japan**'s total balance sheet has reached **135%** of the country's GDP. This clearly also relates to government bonds, but the BoJ has also bought up a lot of other assets such as equities. Most unexpectedly, since the Swiss government is not in debt, is the **Banque Nationale Suisse** with a total balance sheet of **154%** of GDP in the third quarter of 2020. **The BNS** "only" **buys currencies** against the Swiss franc to counteract its rise. These currencies are then invested in government bonds – mainly US and European – but also, like the BoJ, in shares in various major listed companies. Lastly, the **People's Bank of China** is quite an unusual case insofar as its **total balance sheet** has remained more or less unchanged since 2006 and has therefore **decreased** significantly as a percentage of GDP. China is in debt (over 300% of its GDP) but the **government does not have very much debt (48% of GDP)** and the central bank is still steering its monetary policy mainly on the basis of a reserve requirement ratio equal today to 12% of Chinese banks' total balance sheets (vs almost zero elsewhere in the world).

This kind of statistics show is that our **world can survive** for a long time in this **configuration,** without the need to talk about defaults. However, governments will have to endeavour to deal with the highly toxic collateral effects of such developments, particularly with **the distribution of wealth**, a recognised driver of **populism and social instabilities**, as can be seen in Russia and Turkey, as well as in the United States, the UK and even in a largely redistributive country such as France.

Olivier Dyer

ADVISORS & PARTNERS

Solid solutions. Long-term results.

<u>About Advisors & Partners:</u>

Founded in 2011, Advisors & Partners LLP ("A&P") is an independent, privately held, London-based Company providing Business, Financial and Investment Management Advisory Services to institutional investors, asset managers, financial institutions and corporations globally. Its area of expertise spans investment opportunities sourcing, asset operators and managers selection, structuring capabilities, portfolio construction, capital raising and dedicated investment solutions in both financial and real assets with a focus on capital preservation and returns stability and repeatability. A&P thrives to provide solid solutions for long-term results.

A&P is a signatory of the UN-supported Principles for Responsible Investment (UNPRI) Signatory of: PRI Principles for Responsible Investment

For further information about Advisors & Partners and our services, please see our website at www.advisorsandpartners.co.uk