

Debt worries grow

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In the early part of 2010, the global economy is showing tentative signs of recovery. Most countries returned to positive growth in the third quarter of 2009. Mature economies have been slower to recover from the crisis while emerging economies have seen a more obvious recovery. However, government debt has risen to worrying levels, especially in the large mature economies.

The cost of the stimulus

The key factor leading to this stability and tentative recovery, especially in the developed economies, has been the massive and unprecedented monetary and fiscal stimulus provided by various governments and central banks. However, this improved economic outlook has come at an enormous cost that is now reflecting in a massive deterioration of government finances; especially within the large mature economies. A sharp rise in government spending during the credit crisis combined with a significant fall-off in tax revenues (due to a rise in unemployment and lower company earnings) has meant that the government budget deficits have ballooned to their highest level in decades.

Debts greater than the economy

In particular, government debt within the mature economies is expected to rise to over 100% of GDP in 2011. This means that a country's debt is equal to the entire economic output of the economy over one year. Budget deficits (the shortfall between what the government is spending and what it is receiving in tax revenues) has in many countries passed 10% of GDP,

The internationally accepted guidelines for these metrics are government debt of 60% or less of GDP and a budget deficit of no more than 3% of GDP. (South Africa in comparison has a budget deficit of 7.3% and government debt is expected to rise to 40%)

The problem with PIGS

In recent weeks the southern European countries of Portugal, Italy, Greece and Spain (PIGS) have attracted a great deal of media and financial market attention as a result of their lack of financial discipline. For example the budget deficit in Greece is currently well over 10% of GDP and government debt could exceed 130% of GDP by 2011. The United Kingdom is equally in financial difficulty as is the United States.

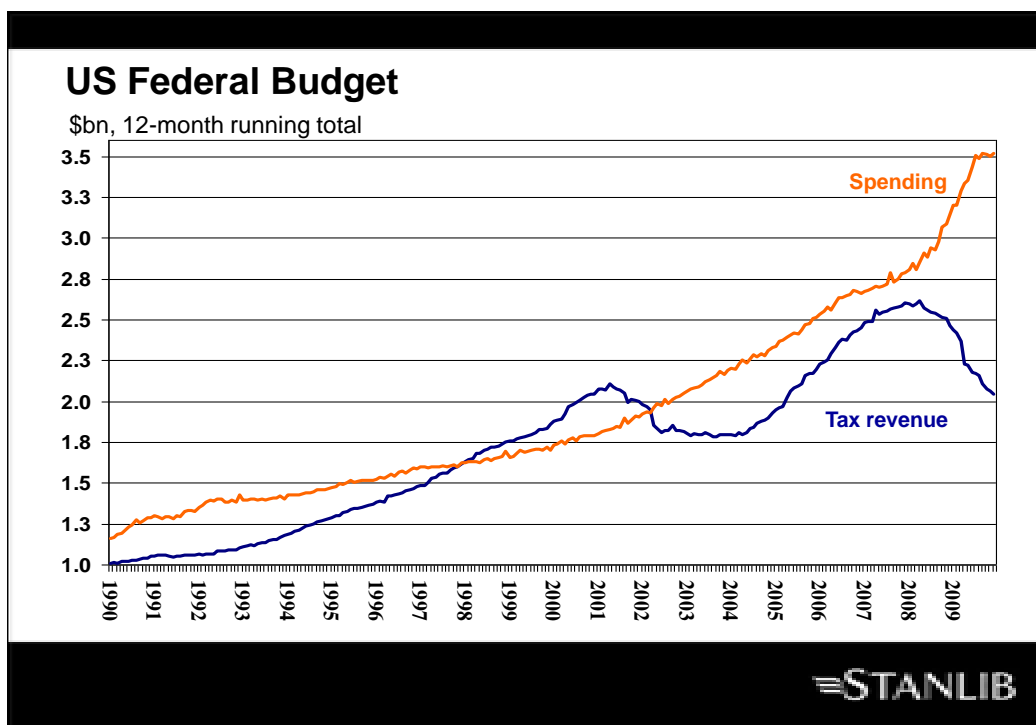
US debt largest since WWII

The US budget deficit amounted to a staggering \$1.4 trillion in 2009, which is equivalent to 9.9% of GDP, and the largest deficit since the Second World War. For 2010, the budget deficit is currently projected to increase to over 10% of GDP. The slump in revenue, (see blue line in graph below) which has been a consistent theme in most mature economies, is due to a collapse in tax earnings, especially corporate and individual income tax. In contrast, US government expenditure totaled \$3.5 trillion or 24.7% of GDP in 2009 (see orange line below). The ratio of expenditure to GDP is the highest the US has experienced since at

least 1970. There was an especially large increase in spending on unemployment insurance, as well as other relief programs that formed part of their efforts to stabilise and ultimately restore the economy.

Consumer recovery needed

The key risk facing the global economy now is how to remove the excess spending by governments, coupled with the historically low interest rates and increased liquidity; without derailing the recovery. Ultimately, consumer spending would need to take the place of all artificial stimuli; however recent data confirms that the consumer, although moving in the right direction, is not yet ready to take over that burden. We will continue monitoring all aspects of the consumer recovery very closely going forward.



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