A SYMPOSIUM OF VIEWS

Is a Serious Global Debt Crisis Possible?

Are economic forecasters about to miss another big call?

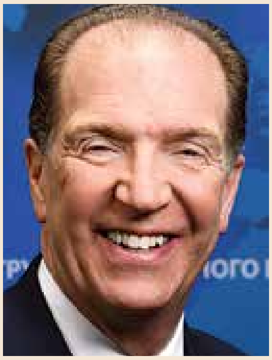
Economic forecasting can be a frustrating profession. In early 2007, for example, American banks hid mortgage risk in a set of off-balance-sheet vehicles initially worth only roughly $200 billion. Yet by 2008, the erosion of the value of these vehicles led incredibly to the collapse of the entire global financial system. The surprise was that the vast majority of the economics forecasting profession missed the call.

Could a similar thing be happening on the issue of today's soaring global debt and steep rise in debt servicing costs? Another missed call?

On the one hand, for decades debt worriers have been predicting—inaccurately—the demise of the world financial system, even as global equity markets soared. On the other hand, the notion that the level of global debt doesn't matter because of the limitless ability of the world's central banks to come to the rescue seems a risky assumption.

On a scale of one to ten (with one indicating very low probability and ten the opposite), what are the chances the global economy experiences a serious debt crisis in the next three years? Put another way, if the word "confidence" is the ultimate definition of the word "liquidity," what are the chances today's growing economic and geopolitical uncertainties at a time of rising debt servicing costs lead to a serious shrinking of liquidity throughout the global system?

On a scale of one to ten, more than two dozen noted observers rate the risks.



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A ten out of ten.

DAVID R. MALPASS
Former President, World Bank

The world is already in a serious debt crisis. Make it a ten out of ten on your rating scale. The evidence is slow global growth and the distortion of capital flows that subtract from future growth.

The most credit-worthy governments and private borrowers are taking most of the world's capital. Much of the proceeds go into wasteful spending and subsidies, ineffective contracting, and debt service. The cost falls on less credit-worthy businesses and weaker sovereigns.

As the largest borrower, the U.S. government has contributed the most to the crisis by failing to lengthen its debt maturity in anticipation of debt increases and allowing its central bank to maintain an historically large maturity mismatch, borrowing in short-term markets to buy government bonds. One measure of the depth of the hole that is being dug is the devastating forecast for rapid further growth in the U.S. government's debt-to-GDP ratio, which already exceeds 100 percent. The Federal Reserve's losses have already topped $200 billion with much more to come, taking capital away from more deserving businesses and countries. Japan and Europe are doing the same, adding to the debt crisis.

Liquidity is skewed in favor of those who are already liquid. Small businesses pay the price. This is creating a debt-related liquidity crisis in many financial markets and parts of the world. The parts of the world with growing populations are getting less capital while narrow groups are soaking up most of the capital and liquidity.

For the world's one hundred poorest countries, there is no mechanism to exit the debt crisis caused by excessive floating-rate debt. Rather than narrowing the income gap with developed nations, the gap is widening. The G20 controls the failed Common Framework for Debt Reduction, leaving many hundreds of millions of people in deepening poverty due in part to the existing debt crisis and the risk that it will worsen.

The problem is not only the debt service costs. Those are high, but the bigger problem is the shift of principal from the future into the present. A trillion dollars borrowed now by the U.S. government takes resources from the future. If the principal were invested well, the debt might be useful, but no one can defend the U.S. 6 percent of GDP fiscal deficit at this point in the expansion. Examples of the debt crisis abound. The ineffectiveness of past defense spending means that future governments in the United States and Europe will have to rebuild their defenses after already using up their borrowing power to fund waste. The premature drawdown of the Social Security and Medicare trust funds signals the government's lack of preparation for an aging society.

Rather than judging the debt crisis by the ability of the strongest borrowers to issue debt, we should judge the crisis by the crowding out of small businesses worldwide.

No immediate danger.

OLIVIER BLANCHARD
Robert Solow Professor of Economics Emeritus, Massachusetts Institute of Technology, and Senior Fellow, Peterson Institute for International Economics

I shall limit myself to discussing what may happen in advanced economies.

In those economies, if safe interest rates remain close to growth rates, which I see as likely, the existing levels of public debt, although high, should be manageable. What is more worrisome, however, are the large primary deficits, most notably the United States, but in some others as well, such as my native country, France. To stabilize the ratios of debt to GDP, primary deficits must go back roughly to zero.

Given the need to spend more on defense and on the green transformation, this is a substantial challenge. And the politics stand in the way of sufficient action, whether in the United States or in France. Indeed, the risk is that primary deficits continue, that debt ratios steadily increase, that investors worry, and that spreads increase, leading to a budget crisis.

Central banks can and should intervene when investors panic for no good reason, but not when they panic for good reasons. They should, however, have the tools to limit contagion and induced financial crises.

Bottom line: I do not see a global public debt crisis in the works. But I do not exclude seeing it in some advanced economies. So, on a scale of one to ten, I would put a the risk at a three—something to keep in mind and be ready for, but not an immediate major danger.

A debt crisis is not imminent.

ÁLVARO S. PEREIRA
Chief Economist, OECD

Indeed, attempting to predict the future can be a task. Let's take a moment to consider how we got to where we are. Average total debt, that is the sum of outstanding credit of households, non-financial corporations, and general governments, across OECD economies stood at around 240 percent of GDP at the end of 2023—around 26 percentage points higher than shortly before the global financial crisis at the end of 2006, and around 50 percentage points higher than at the beginning of the century.

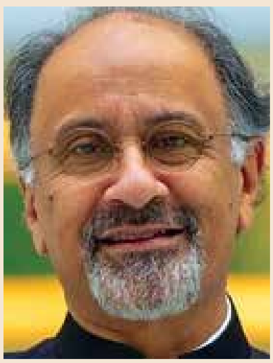
For most OECD economies, much of the increase in total debt stems from higher government debt. This is not surprising given where we are coming from. First, we had the global financial crisis. More recently, people around the world have experienced two "once-in-a-lifetime" events in the last four years—the pandemic, and a cost-of-living crisis fueled by Russia's war of aggression against Ukraine.

Both events were catastrophic from a humanitarian point of view, but swift and decisive policy action has prevented a much worse economic outcome. This came at a cost—a sizable increase in government debt. In OECD economies, public debt currently stands at around 115 percent of GDP, more than 40 percentage points higher than at the beginning of this century. At the same time, future fiscal pressures are mounting—aging, the climate transition, industrial policies, defense, in addition to much-needed public infrastructure investments—and all will likely be putting increasing claims on public funds.

The combination of historically high public debt ratios, rising interest rates after a long period of very low rates, and acute spending pressures makes us concerned about public debt.

I do not believe that a global sovereign debt crisis is around the corner. Governments still have ample opportunity to bring public debt ratios down, or at least stabilize them. But this does not mean governments can or should relax and postpone tough decisions. Doing so would simply mean that debt rises further. Recent OECD work looking at successful past efforts to rein in public debt ratios since the late 1970s in OECD economies casts some light on how this was achieved in the past. There is no magical solution—the recipe hinges on a combination of boosting growth and concerted efforts to achieve and sustain primary surpluses over several years. Put simply, a good dose of structural reforms and fiscal discipline would take us a long way. Such decisions require political courage. In successful debt reductions, primary surpluses were usually achieved through cutting expenditures related to pensions, subsidies, unemployment benefits, and public consumption, while preserving health and education spending. In the past, the role of tax increases was relatively minor, except for corporate tax increases. Either way, tough political choices will need to be made.

What about households and corporate debt? Sure, there are pockets of high household and non-financial corporate debt in some OECD economies. But collectively, the banking system appears more resilient than before the global financial crisis and should be able to cope with defaulting private borrowers—as long as a deep and prolonged recession does not generate a wave of defaults. And, as set out in our September Interim Economic Outlook, this is not something we currently project.



The world today is experiencing the largest, fastest, and most broad-based wave of debt in fifty years.

INDERMIT GILL
Chief Economist, World Bank

We are already in the midst of a serious global debt crisis—quite possibly the gravest since the 1980s. Let me admit my prejudice: I work at the World Bank, so I come at this question a bit differently than most.

I think a global debt crisis is "serious" when it inflicts pain on countless millions of poor people across the world—not just when it gums up the banking systems of advanced economies or lengthens the unemployment lines there.

We ought to be alarmed any time debt-service burdens reach a point where a large swath of developing economies must consider spending even less on health and education than the puny sums they usually do. That is exactly where we are today—and it has serious implications for global economic growth, peace, and prosperity in the coming decades. In short, a "serious shrinking of liquidity" in the next three years is not all that global policymakers need to worry about.

Here's what the data tell us. The world today is experiencing the largest, fastest, and most broad-based wave of debt in fifty years. This wave crested with Covid-19, but the numbers are down only slightly since then. Total debt as a share of GDP exceeds 245 percent, down about 20 percentage points from 2020, but still higher than it was before the pandemic. The interest-rate environment, meanwhile, suddenly became much more inhospitable for developing economies. After 2022, their borrowing costs spiked amid the fastest rise in global interest rates in decades.

Against this backdrop, the recent monetary easing will not be a magic bullet. In the next few years, interest rates are likely to remain well above their 2010s levels, and above growth rates in many developing economies. Already, nearly 40 percent of all developing economies face some form of debt stress. Developing economies with weak credit ratings—middle-income economies in many instances—face interest rates almost 10 percentage points above the global benchmark rate. That effectively locks them out of commercial markets and leaves many of them vulnerable to debt crises. Bond issuances in economies with weak credit ratings have all but ground to a halt—a dry spell of the kind not seen since the global financial crisis. Not surprisingly, eleven of them have defaulted since 2020. In short: in the last four years alone, more defaults on their debt have been recorded than in the previous two decades.

A lot of this—too much in my view—is playing out silently. The global system for debt restructuring simply hasn't caught up with the times. It is so agonizingly slow that even countries with paralyzing debt burdens are choosing to muddle through rather than default, restructure, and establish a decent footing for future growth. Between December 2020 and February 2021, four countries applied for relief under the G20's Common Framework for debt restructuring. So far, only one—Chad—has completed the process.

The problem isn't a shortage of policy solutions. It's a problem of will. Countries with the power to make a difference today are paying little attention, just as they did during the Latin American debt crisis of the 1980s.

Yet, now as then, delays in resolving the problem of debt result only in increasing the costs—to governments and citizens. This is because sovereign-debt build-ups, as the debt expert Lee Buchheit once noted, involve a problem akin to "soiled diapers and nuclear waste": Disposal is an enormous headache, but it cannot be postponed indefinitely.

A serious debt crisis? An eight out of ten.

DESMOND LACHMAN
Senior Fellow, American Enterprise Institute

I put the probability of a serious debt crisis in the next three years at an eight.

The exceedingly high debt levels across the world's major economies heighten the chances of not one but a multiple set of debt crises over the next three years.

Take the United States. It has both a public debt and a commercial real estate debt problem of epic proportions. With a 7 percent of GDP budget deficit at a time of close to full employment and a public debt-to-GDP ratio of 100 percent, the United States is clearly on an unsustainable debt path. The Congressional Budget Office forecasts that by 2034, the U.S. public debt-to-GDP ratio will exceed its level at the end of the World War II. That is before either of this year's presidential candidates exacerbates the country's debt problem by implementing the irresponsible public spending or tax cut proposals that they are making on the campaign trail. The lack of political will to deal with this country's public debt problem would seem to be setting the United States up for a dollar crisis and the return of the bond vigilantes.

At the same time, the United States is experiencing a slow-motion commercial property loan train wreck as a result of record-high office vacancies as more work is done from home. This makes it all too likely that we will see a wave of defaults on the $1 trillion in commercial property loans that fall due over the next year—and heightens the chances that we will soon experience another round of U.S. regional bank crises.

Over the next three years, Europe is likely to be another source of debt crises that could shake the world financial system. France and Italy, the eurozone's second- and third-largest economies, both now have higher debt-to-GDP ratios than they had at the time of the 2010 eurozone debt crisis. Both those countries appear to lack the political will to address their debt problem. And even if they did have the political will, stuck within a euro straitjacket, it is difficult to see how they could engage in serious budget belt tightening without precipitating a recession.

Meanwhile in Asia, China is already struggling with the bursting of its epic housing and credit market bubble, while a highly indebted Japan is struggling to exit from its experiment with yield control. China's debt problem is setting it up for a Japanese-style lost economic decade, while Japan's attempt to normalize interest rate policy risks another bout of extreme Japanese yen weakness.

Needless to add, we would have a series of debt crises sooner rather than later should the world drift to an economically destructive international trade war as appears all too likely should Donald Trump win the election. It would also occur sooner rather than later should the current Middle East crisis result in a major international oil supply disruption.

A seven-in-ten chance.

DAVID M. WALKER
Former U.S. Comptroller General

I would assign a seven to the likelihood that we will face a global debt crisis within the next three years. Country sovereign debt levels as a percentage of GDP in many of the largest economies—such as the United States, Japan, the United Kingdom, France, and Italy—are at or near an all-time high and are rising. In addition, total debt levels in these countries are high and rising. At the same time, little to no meaningful action is being taken by political leaders to defuse these ticking debt bombs.

The U.S. dollar is still the world's largest reserve currency. However, the United States has been abusing its position and is clearly on an unsustainable fiscal path with projected deficits of over 6 percent of GDP for the next ten years absent action. Interest is the fastest-growing expense for the U.S. federal government and has already passed spending on defense. China, Japan, and other historical buyers of U.S. debt have already curbed their appetite for Treasury securities, putting more pressure on the Fed to make up the difference. In addition, a number of major banks have significant exposure to losses on their commercial real estate loans.

The international situation has also changed considerably in recent years. Saudi Arabia is accepting currencies other than the dollar for its oil. More importantly, the BRICs group is expanding and working to create a new reserve currency that will be backed partially by gold and a basket of other currencies. The result will be a dilution in the dollar's dominance which will result in higher borrowing costs, more inflation in the United States, and less of an ability for the United States to impose economic sanctions over time.

All of the above factors serve to increase the risk of a debt crisis in the United States. I have advocated for a fiscal responsibility constitutional amendment, a statutory Fiscal Sustainability Commission, and a Government Transformation Commission to restore fiscal sanity and sustainability, and improve government efficiency and effectiveness. Adopting these can defuse the U.S. debt bomb.

As the saying goes, if the United States catches a cold, the world gets the flu. However, a crisis of confidence in the United States would result in something far worse than the flu both domestically and internationally. No country is exempt from the law of prudent finance, including the United States.

We will get by, even this time.

LORENZO CODOGNO
Visiting Professor in Practice, London School of Economics and Political Science, and Founder and Chief Economist, Lorenzo Codogno Macro Advisors Ltd.

Another missed call? If economic forecasting does not work, let's try weather forecasting. Many people smell the rain even before it arrives, especially in summer, because ozone can be carried by winds over great distances and precedes the arrival of the storm. The human nose can easily distinguish the presence of ozone in the air. How can we "smell" a debt crisis?

Debt becomes unsustainable if economic growth sharply weakens relative to the cost of servicing the debt, and there are no savings that can be put aside for that. Many countries around the world would not pass the smell test, even if we make optimistic assumptions about future growth and interest rates. Growing economic and geopolitical uncertainties at a time of rising debt servicing costs might lead to a severe liquidity crisis that could shake the global system to its core. In wartime—which may be trade or cyber wars instead of the kind of horror we see in the Middle East and Ukraine—the option of monetization or financial repression, which in normal times would be considered anathema, may well become feasible and acceptable.

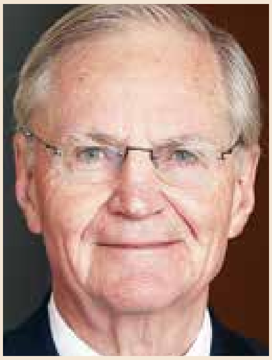
Indeed, the world has been inundated by liquidity for many reasons, including the desperate attempt to lift inflation. It is still not clear where the cost of borrowing will settle in equilibrium relative to economic growth, and that's why establishing a credible downward trend in the debt ratio is tantamount to boosting credibility, thereby reducing the risk of a sudden disappearance of liquidity.

Credibility is key, as misguided announcements of reckless fiscal policy may bring forward a crisis that otherwise would have more time to unfold and thus be prevented. And there are many ways this could happen. Even in the United States, the unthinkable could occur if policies are not credible and responsible. The situation in Japan is tricky, to say the least, and in China, the potential disruption from the housing bubble is a looming threat.

Even in Europe, despite earnest attempts to introduce a medium-term fiscal framework, economic growth looks feeble, and there are many long-term structural challenges that financial markets may suddenly bring forward.

On the private side, many situations look fragile. For example, consumer credit in the United States is a case in point. Consumer debt has ballooned over the past few years, and the capacity to service rising interest rates due to growing risk premiums asked by the banks appears at risk. Delinquencies are rising from low levels, but things may develop non-linearly should unemployment rise and income decline. Can U.S. consumer credit become the new subprime?

Yet despite all these potential risks, global economic growth appears to be very resilient to the many past and possible future shocks and the rising geopolitical uncertainty. Moreover, a debt crisis rarely happens when policy rates start to decrease, easing some of the earlier pressures. Thus, despite the smell of ozone, we will get by even this time.



A 1.5-in-ten chance. But U.S. federal debt is on an unsustainable long-term path.

WILLIAM R. CLINE

President, Economics International Inc., and Senior Fellow Emeritus, Peterson Institute for International Economics

The chances of a serious global debt crisis in the next three years are low, say 1.5 on a scale of one to ten. Such a crisis would require disruption of sovereign debt servicing in major economies. IMF projections over three years show little increase in net government debt as a percent of GDP for G7 economies from their recent peaks in 2020. Five-year credit default swap rates are low, ranging from 10–25 basis points for Germany, the United Kingdom, and Japan, and 30–40 basis points for France, the United States, and Spain, to 65 for Italy. In contrast, in the European debt crisis, Italy's CDS rate reached 400 basis points in 2011, and Greece had to impose a 50 percent haircut on debt held by private creditors—eroding the precedent that advanced economies do not default.

Nonetheless, over the medium- and especially longer-term horizons, debt trajectories are toward excessive levels for some major economies, most importantly for the United States. The International Monetary Fund projects that from 2023 to 2033, government debt will rise from 110 percent of GDP to 122 percent in France, 100 percent to 112 percent in the United Kingdom, and 137 percent to 144 percent in Italy.

U.S. federal debt is on an unsustainable long-term path. Federal debt held by the public was already 74 percent of GDP in 2015 and 79 percent in 2019. Following the pandemic recession and massive relief spending, the debt ratio surged to 97 percent by 2023. The Congressional Budget Office projects that under current policies, the ratio will reach 116 percent by 2034 and 166 percent by 2054. Net interest payments are projected to rise from 3.1 percent of GDP in 2024 to 6.1 percent by 2054. At some point along this path, investors could begin to doubt that federal debt is a safe asset.

If the 2017 Trump tax package scheduled to expire at end-2025 is made permanent, the projected 2034 debt ratio would add about another 10 percent of GDP. And the main proposals for additional spending and tax relief in the presidential campaign have ten-year costs of $1 trillion to $2 trillion (Harris) to $4 trillion to $6 trillion (Trump), adding another 4 to 12 percent of 2034 GDP to debt, even before counting late-campaign proposals for additional tax relief on social security income and overtime (Trump) and tips (both candidates).

Some have argued that countries that borrow in their own currency do not face debt crisis risks. But the implication of this premise is that these economies can deal with excessive public debt by printing money to inflate it away. A major lesson of the pandemic shock was that it is politically costly to permit a surge in the price level, even if the subsequent plateau of inflation can be brought back to target levels. The corollary is that the imposition of debt restructuring with haircuts should not be assumed to be ruled out for advanced economies. A correction in fiscal policy is necessary sooner rather than later for the United States and some other key economies.

A three-out-of-ten chance.

JOSEPH E. GAGNON
Senior Fellow, Peterson Institute for International Economics

It would be foolish, of course, to assume that a debt crisis cannot happen at any time. However, with interest rates falling around the world as inflation recedes, the risks of a debt crisis are probably declining now. On a scale of one to ten, I rate the chance of a serious global debt crisis in the next three years to be a three.

It is intrinsically difficult to predict crises. If it were otherwise, markets would act to prevent them. Usually, crises happen after an unexpected economic, political, or military shock worsens the prospects for servicing a stock of debt. Sometimes a fundamental change in financial institutions creates a new risk that market participants are slow to understand, as was the case for structured finance prior to 2008.

The biggest apparent sources of future debt risks are the governments of China and the United States. In China, the risk is that the central government will have to borrow extensively to support distressed property developers, households, and local governments in the context of a housing slump, declining labor force, and slowing productivity growth. In the United States, the risk is that the federal government will continue unprecedented peacetime deficits in the context of a historically high national debt. In either country, investors may come to doubt the ability or willingness of the government to service the debt without an explicit or implicit (via inflation) restructuring.

Because China and the United States borrow in local currencies managed by local central banks, they are not prone to a Greek-style debt strike. Instead, central banks may be forced to buy government debt while raising interest rates to stabilize inflation. The result would be growing malaise, as higher real interest rates crowd out productive investment and dampen growth. This process can unfold over years and even decades. Eventually, the economic pain captures enough attention from the public that politicians feel obliged to do something. We can only hope that "something" is a helpful rebalancing of taxes and spending and not a harmful default or inflation.

An important financial risk is a sharp currency depreciation, forcing the central bank to raise rates even more to contain inflation. History shows that currency crashes are not harmful in countries without foreign currency debt as long as inflation is under control before and after the crash. In the United States, depreciation would have the beneficial side effect of shrinking the trade deficit. In China, however, it would widen a trade surplus that is already growing too large.

A four-in-ten chance.

ROBERT E. LITAN
Non-Resident Senior Fellow and former Director in Economic Studies, Brookings Institution

I estimate the probability of a serious debt crisis over the next three years at four out of ten.

The fact that global public debt in 2023 hit $97 trillion, almost equivalent to global GDP of $105 trillion, looks scary. But a closer look is required into which countries' public debt is rising most rapidly, the currencies in which that debt is denominated, and the maturity of that debt, in order to assess the likelihood of debt crises in any one or more of them.

From the Asian financial crisis of 1997–1998, we know that when countries borrow too much in foreign currency on a short-term basis, they expose themselves, and their trading and investment partners, to both currency and refinancing risk. Today, the largest risk of another Asian-type crisis lies in Africa and Latin America, where according to UNCTAD, public debt has grown twice as rapidly since 2010 as in developed economies. Most of that debt, including corporate debt, is denominated in foreign currency, primarily U.S. dollars, and a large share (about a one-third) appears to have a short maturity. In other words, a crisis of confidence awaits a spark to set off a debt financing crisis in the most highly indebted African and Latin American economies.

What about the United States? Mounting government debt-to-GDP ratios here have prompted observers to worry we face the same risk. While I have long been a deficit hawk along with many colleagues at Brookings, the fears that domestic and/or foreign investors will run from the dollar any time are overblown. Unlike in less-developed countries, the United States borrows in its own currency, the dollar, which has long been viewed as a safe haven. A disruption to the peaceful of transfer of power following this year's election could upset that status—and it may by the time this is in print—but absent that, I don't see a "dollar strike" as being in the cards. Instead, as my mentor and colleague, economist Charlie Schultze, observed years ago, the rising debt service share of GDP is like having termites in our economic woodwork, eating away at future growth in living standards through gradually higher interest rates, which dampen investment, and thus productivity growth.

The European Union is different, because its member countries borrow in a common currency, but not their own. Accordingly, if investors refuse to buy the debt of countries with the highest debt-to-GDP ratios (Greece, Italy, and more recently France), the entire EU bloc is exposed to a currency run. It is for that reason that the European Union joined with the International Monetary Fund to bail out Greece last decade. That same dynamic should be enough to keep an EU debt crisis from getting out of hand for the foreseeable future, even though the EU debt-to-GDP ratio as a whole is nearing the U.S. level (at close to 90 percent).

Like the United States, China has the luxury of borrowing in its own currency, but China also has $3 trillion in huge foreign currency reserves and its capital controls largely insulate the country against a run on the yuan. So, with its mounting debt, China's real problem is that it too has "termites in its woodwork."

Averaged across all these parts of the world, my debt worry rating is a four. But that gets us only to 2027, the year China has vowed to be ready to take over Taiwan. If that happens, debt crises won't be the biggest world problem.

A two-out-of-ten chance.

JEFFREY R. SHAFER
Chairman of the Board of Trustees, National Committee on American Foreign Policy, and former Undersecretary for International Affairs, U.S. Treasury

Debt crises are always surprises, so one cannot exclude a global-scale crisis in the coming three years, and there is one reason to be concerned. But I put the probability as modest for two other reasons—a likelihood of two out of ten.

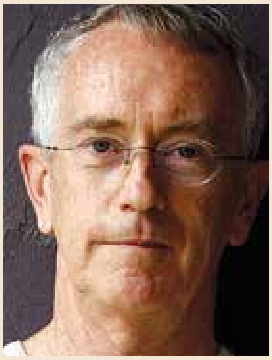
One reason for concern is that systemic crises occur at intervals of ten to fifteen years, and we are seventeen years beyond the onset of the last one. More controlled crises occur much more frequently—I count a dozen in the fifty-five years that I have been monitoring markets. But there have been only three global systemic crises—the Latin American debt crisis beginning in 1982, the Asia debt crisis beginning in 1997, and the great financial crisis beginning in 2007.

It takes time for the lessons learned in one crisis to be forgotten and for imbalances to build up to a scale that requires large losses to be allocated when the inevitable repricing occurs. The time until the next crisis may have been extended by the extreme response of regulators and market participants to the greatest crisis in seventy-five years. We did go more than forty years after the previous great crisis until the Latin American debt crisis in 1982. But the regulatory response to this crisis and the Asian debt crisis was modest. We only got deep reform after the great crisis of 1997. Watering down is starting, but it has not gone far yet.

One reason not to be concerned is that large imbalances are not evident. Careful analysts saw problems building up when previous crises were developing, even if the market seemed oblivious. Yes, there is a repricing taking place in commercial real estate in both the United States and Europe, but it is not of systemic scale. There is also a debt problem in a number of emerging markets. But this is a problem of excessive lending by China, not by global financial institutions or bond markets. China and the international financial institutions will have large losses to eat. One hopes the costs to the borrowers can be contained. But the problem will not be systemic. Other debts seem manageable on an aggregate basis.

A second reason not to be too concerned is that we are in a monetary policy easing phase. Systemic crises occur in the tightening phase of the monetary policy cycle. We are two or three years away from this.

Problems remain hidden and build up in the easing phase. They will again, so we will have another systemic crisis. But it is unlikely in the next three years.



There will be a "Climate Minsky Moment"—most likely when the refusal of insurance companies to underwrite businesses or insure houses becomes too widespread to ignore.

STEVE KEEN
Distinguished Research Fellow, University College London

As the brief for this forum noted, the vast majority of economists did not foresee the 2007 global financial crisis. I was not one of them. In fact, readers of the non-mainstream *Real-World Economics Review* chose me (ahead of Nouriel Roubini and Dean Baker) as the economist who "first and most clearly anticipated and gave public warning of the Global Financial Collapse and whose work is most likely to prevent another GFC in the future."

The basis for my accurate warning was Hyman Minsky's "Financial Instability Hypothesis" (1982). This asserted—contrary to conventional neoclassical economics—that private debt and its annual rate of change—"credit"—were the main causes of financial crises. A period of tranquil growth after a preceding crisis would lead to investor and banker expectations transitioning from cautious to "euphoric," resulting in a credit-fueled boom that would lead to a bust as the boom altered the distribution of income and thereby the serviceability of debt. A crisis would occur when private debt reached extreme levels relative to GDP, and credit then turned from positive to negative.

That is clearly what happened in 2007: a series of credit booms and busts caused private debt to more than triple from 50 percent of GDP in the early 1950s to 170 percent by 2007. Credit—which, contrary to conventional economic theory, adds to both aggregate demand and income, and inflates asset prices—reached a peak of 15 percent of GDP in the United States in 2007, then plunged to minus-5 percent of GDP in 2009.

This was the first time in post-World War II economic history that credit had been negative in the United States—the last times this had occurred were during the Great Depression.

Though there is still far too much private debt today, the booming levels of credit that are also required for a crisis are not present in 2024. Credit peaked at 12 percent of GDP in the first quarter of 2022, and has fallen to 3 percent in the first quarter of 2024, largely in response to excessive increases in official interest rates. But I don't expect this negative trend to continue, especially once central banks realize they've overdone rate rises and shift into cutting them. The high level of government deficits—running at 10 percent of GDP in the United States and 6 percent globally—are also a support for economic activity that was noticeably absent during the global financial crisis. In answer to this forum's probability poll, I'd put the odds at two in ten.

That's the good news. The bad news is that mainstream economists have dismissed the possibility of a climate crisis for reasons that are even more stupid than the reasons why they didn't see the global financial crisis coming. Financial markets, which don't realize how appallingly bad the work of economists has been on climate change (see my 2020 paper), have accepted at face value claims by economists that global warming will only slightly reduce the rate of economic growth. For example, William Nordhaus's latest paper (2024, with Lint Barrage) claims that 3°C of warming by 2100 will reduce GDP in 2100 by 3 percent. This is a claim that global warming will reduce the annual rate of economic growth between now and 2100 by a mere 0.03 percent.

These claims are delusional, and based on ignorance of what global warming actually entails. The result is that current stock market valuations are based on wildly optimistic expectations about how the economy and financial markets will cope with climate change.

Since the climate doesn't care about the opinions of economists, at some point in the near future, the gap between the severe damage that climate change will do to the economy and the trivial predictions made by economists will become evident. There will then be what has been termed a "Climate Minsky Moment"—most likely when the refusal of insurance companies to underwrite businesses or insure houses becomes too widespread to ignore.

The odds of this happening are ten out of ten—though timing when tipping points and climate volatility will cause sufficient catastrophes to cause financial markets to flip from optimism to terror is far harder than timing the global financial crisis.

I will stick with a two-out-of-ten chance of this in the next three years, but I feel the odds of this happening are even by 2030 and almost certain by 2035.

Only a two.

THOMAS MAYER
Founding Director, Flossbach von Storch Research Institute, and former Chief Economist, Deutsche Bank Group

On a scale of one to ten, I would choose only two as the probability for a serious global debt crisis. The reason is not that excessive debt would pose no threat, but that central banks are determined to nip any debt crisis in the bud before it has the slightest chance to unfold.

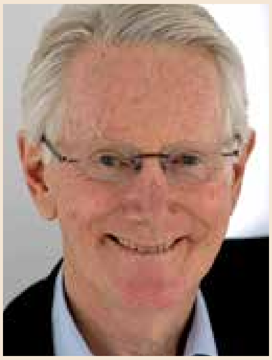
According to Bank for International Settlements statistics, total global credit was up by 25.2 percentage points of world GDP in the first quarter of 2024 from the first quarter of 2008, driven by an increase in credit to governments of 24.2 percentage points. Credit to non-financial corporations rose by only 7.6 percentage points while credit to private households fell by 6.6 percentage points. At 242 percent of GDP, total debt is worryingly high by historical standards.

In the Great Financial Crisis of 2007–2008, defaults of sub-standard ("sub-prime") mortgages of U.S. private households triggered a banking crisis in the western industrial world. Central banks and governments were initially slow to react when the defaults began to show in early 2007, taking the view that it was a private sector problem to be solved by the private sector itself. The initial belief was that public sector intervention would create moral hazard and should hence be avoided. Only when the default of Lehman Brothers in September 2008 threatened a meltdown of the global financial system did central banks and governments step in decisively.

From this near-death experience, central banks drew the lesson that they had better intervene early rather than late when defaults loom in the financial sector. Thus, when Silicon Valley Bank, a relatively unimportant regional institution in California, was hit by a bank run in March 2023, the U.S. Federal Reserve immediately injected large amounts of liquidity into the banking sector. And U.S. Secretary of the Treasury Janet Yellen, Federal Reserve Chairman Jerome Powell, and FDIC Chairman Martin Gruenberg assured that all depositors would be fully protected, including those with deposits above the statutory limit of U.S. $250,000. A similar swift and powerful reaction can be expected to any similar event in the future. Central banks will be ready to step in immediately, especially since highly indebted governments—which are after all their masters—have become much more exposed to liquidity or even default risks. Hence, only the possibility of central bankers sleeping at the wheel creates the risk for another full-blown debt crisis.

However, suppression of a debt crisis by central banks shifts the problem of excessive debt from the financial to the monetary system. Monetary financing of struggling private or public debtors by central banks could destroy confidence in the fiat credit money system. This system was created by chance when U.S. President Richard Nixon in 1971 broke the link of the U.S. dollar to gold—the backbone of the Bretton Woods exchange rate system created in 1944—in order to stem the outflow of gold reserves. Probably without understanding the full consequences, Nixon thus eliminated the material anchor of money and left it to commercial banks under the guidance of central banks to create money through credit extension.

More and less prudent monetary policies by the central banks over the past decades have allowed this system to survive for more than fifty years. But the fiat credit money system has also fostered a huge build-up of debt in both the private and public sectors, the financialization of the economy, and the recurrence of credit boom-bust cycles. Although Bitcoin was created as an alternative to it during the Great Financial Crisis, the fiat credit money system has survived and still stands firm. Another round of big money creation to avoid another financial crisis, however, may eventually lead to its demise.



A serious global crisis is likely.

WILLIAM R. WHITE
Former Economic Adviser, Bank for International Settlements

The global economy is a complex, adaptive system like many others in nature and society. Like them, it is prone to crises both big and small that are often preceded by long periods of stability. Sadly, most macroeconomists have failed to grasp this reality. Accordingly, their economic forecasts have remained little more than simple extrapolations of past trends. Official bodies have failed to predict most post-war recessions, and their performance has worsened as financial developments have increasingly dominated the real economy. The three recessions preceding the pandemic were all triggered by financial disturbances, each following a long period when debt was rising faster than GDP and asset prices were also rising rapidly. To slightly alter an old joke: "Even economists, when they see something happen, should admit that it is possible."

Complex, adaptive systems are also path dependent, and past fiscal and monetary policies have put us on a bad path. In recessions, both have always eased more than they tightened during successive upturns. This succeeded in mitigating each pre-pandemic downturn, but only at the expense of policy rates ratcheting down to the zero lower bound and debt levels ratcheting successively higher. In effect, past policy choices had to be repeated and even strengthened to avoid triggering the underlying risks to both financial and economic stability that the past policies had created. This process is unsustainable and, in economist Herb Stein's famous words: "It will stop."

Today, global debt ratios are at record levels in both emerging markets and advanced economies. Both private sector debt and public sector debt ratios are worryingly high, with the former raising fears of debt-deflation and the latter raising fears of fiscal dominance and inflation. Ancillary fears affecting private sector debt have been increases in leveraged debt, sharp declines in credit quality, and the migration of debt from regulated banks to opaque shadow banking systems. Ancillary fears affecting public sector debt are massive off-balance sheet government spending obligations and rising levels of contingent liabilities. Both public and private sector debt markets have seen an uptick in liquidity incidents in recent years. Could more "Truss moments" be in the offing?

Debt increases risk exposure in all states of nature. In bad times, revenues fall as does the capacity to service existing debt. In good times, interest rates rise as does the cost of debt service. Looking forward, there seems a reasonable chance of "stagflation" and the worst of both worlds. Worsening demographics, deglobalization, and climate change all constitute negative supply shocks. At the same time, they also signal the need for sharp increases in investment. Government budgets will be under still further pressure to support health spending for an aging population, to meet defense requirements, and to mitigate growing social tensions. This combination of circumstances suggests continuing inflationary pressures and higher real interest rates over a much longer time period than is currently envisaged. Could this lead to a serious global debt crisis? It seems more than possible. It seems likely.

Another serious debt crisis is virtually certain.

JIM O'NEILL
Former Commercial Secretary to the Treasury, United Kingdom, and former Chairman, Asset Management, Goldman Sachs International

The likelihood of another serious debt crisis is virtually certain. Just as night follows day, debt crises follow booms and bubbles. The dilemma is trying to identify them correctly, predict when a crisis unfolds, understand how bad the pain will be, and decide how policymakers will respond.

As for it being in the next three years, that is distinctly possible, but my hunch is maybe not. Given the geographic uncertainties which seem to be growing both in terms of seriousness and distribution, and the woeful state of global governance, perhaps the bigger concern might be, when it happens, whether it has truly global dimensions like the 2008 crisis, and whether policymakers can rise above their differences and respond appropriately and quickly enough. An optimistic view is that such a crisis might be among the few things that will bring the unlikely set of actors together. At the moment, too many seem to be focused on blaming the world and other countries and people for their own woes.

Without contradicting myself, hopefully, despite the obvious numerical scariness of so much debt, I have become quite passionate in favor of a more imaginative approach. Instead of focusing on the numerator in the debt-to-GDP ratio, we might try something different about the denominator, and be more serious about investment spending to boost productivity and hence trend growth. After all, surely that is the real crisis of the post-2008 environment, especially in western economies? Most advanced countries have very disappointing investment performance and evidentially, weak productivity.

I think the time has come for deep economic thinkers to persuade the International Monetary Fund to adopt a different framework, and its members should be encouraged to introduce and develop their own national independent fiscal body, a version of the U.K. Office for Budget Responsibility. But unlike how the OBR is encouraged to opine on U.K. fiscal finances and to be geared greatly towards short-term GDP forecasting, this body should undertake much more transparent and accountable work on the benefits of various forms of public investment and their positive multipliers, whether they be health, education, roads, railways, and more. Without this, I am not sure how we can really develop the degree of non-inflationary growth required to help boost real wages, curtail gaping inequalities, and reduce long term debt.

One side note. It is quite remarkable how the U.S. public debt situation is developing, and given the election ideas of each side, how it seems set to continue. Without the remarkable ongoing privileged role of the U.S. dollar, it is likely the United States might not get away with as much as it does. In this regard, at least for the next few years, it is perhaps a nice coincidence for the United States that China, India, the euro area, and others never really do the things necessary to truly develop their own financial systems sufficiently to compete. Otherwise, things could look very different.

Zero chance of a crisis.

KEVIN P. GALLAGHER
Professor, Boston University Pardee School of Global Studies, and Director, Boston University Global Development Policy Center

On a scale one to ten, the chances of a global debt crisis are zero. Yet the majority of developing countries are already in a debt crisis. They get a ten.

The World Bank, United Nations, and many experts have been sounding the alarm about what the World Bank calls the "silent debt crisis"—silent because no one is listening or doing much about it.

The United Nations reckons that the number of countries paying more than 20 percent of government revenue on external debt service has reached the same level as in 2000—the height of the last developing country debt crisis. The United Nations further calculates that there are now 3.3 billion people that are living in a country that is paying more on debt service than on health or education investments.

At this year's United Nations General Assembly, Rebeca Grynspan of the United Nations Conference on Trade and Development reminded world leaders that the West agreed that Germany's post-World War II debts should not exceed 5 percent of export earnings. Otherwise, Germany might never recover and the drums of authoritarianism would start to bang again.

Grynspan noted that 90 percent of all developing countries now have debt service that exceeds 5 percent of their export earnings.

For all but a few developing countries, this crisis was not of their making. Covid-19, war and sanctions, climate change, and advanced economy interest rate hikes have had a piercing effect on developing country debt levels and fiscal balances.

Many of these developing countries are at or near debt distress and/or face borrowing costs that will far exceed their potential growth rates and thus push them into distress in the future. The rest simply don't have the fiscal space or access to affordable and counter-cyclical financing to recover from these external shocks and put themselves on new growth paths.

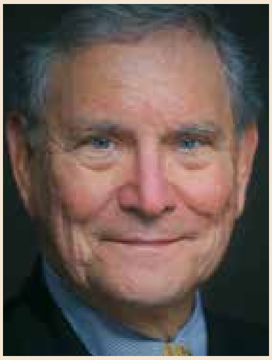
To its credit, the G20 enacted two mechanisms in anticipation of the impacts of these shocks, the Common Framework (for countries facing solvency issues) and the Debt Service Suspension Initiative (that suspended debt payments for countries with liquidity problems). The DSSI exempted two-thirds of developing country debt (private bondholders and multilateral development banks) and was sunsetted after a short time.

The United States thought the DSSI could be substituted with the "Nairobi-Washington Vision"—a bridge of International Monetary Fund and World Bank financing that could kickstart recoveries and bring market confidence. Well, markets came back to Kenya at a staggering 10.35 interest rate. The IMF's (austerity) program triggered mass protests in Kenya and close to forty citizens were killed by the Kenyan government.

The Common Framework is in paralysis for plummeting participating country credit ratings and granting inadequate levels of debt relief. In the one case with real debt reduction, private bondholders had to cancel the least amount of debt despite reaping higher interest rates going into the restructuring—and MDBs remain exempt altogether.

This is supposed to be an era where developing countries are mobilizing upwards of $3 trillion annually for investments in development and climate resilience that will avoid further social and environmental risk across the world.

So there may not be a chance of a systemic global debt crisis. Yet the drag on global growth due to retreating investment in countries that house over 3.3 billion of the world's people may lead to alarmingly higher social, economic, and environmental costs. Sound the alarm.



An eight-in-ten chance.

ROBERT DUGGER
Retired Partner, Tudor Investment Corporation, and Co-founder, ReadyNation

Over the next three years, a global debt crisis is very likely—I rate the possibility at eight out of ten.

A nation has a debt problem when its government needs to issue more debt than markets can absorb at "affordable" interest rates. It is a crisis when the problem threatens global markets, debt restructuring is not feasible, and the domestic central bank must buy (as in quantitative easing) enough of the debt to keep domestic interest rates affordable. Japan has been in a national debt crisis since the 1990s.

A global crisis occurs when the governments of many economies, including several major ones, need to sell more debt than world markets can buy. How much debt can the world buy? In a given time period, the limit is the amount of available world net savings.

In the near term, the supply and demand curves of net savings are nearly vertical—their intersections set the world savings market clearing rates for given maturities and risks. Savings supply is always slow moving, but demand can increase suddenly, say, from a large, legislated deficit increase. Because of curve inelasticity, the rightward movement of demand drives the intersection up rapidly. To prevent economy-crushing interest rate increases in a global crisis, each national central bank must buy what the market cannot. Seen this way, the 2020–2021 covid pandemic was a global debt crisis.

World net savings peaked around 2017 and moved sideways thereafter, exposing the world to more frequent crises. A mini-global debt crisis was signaled when the Fed had to buy Treasury bills to quell the 2019 "corporate debt problem."

During the years of Ben Bernanke's "savings glut," the "excess savings" he referred to were allocated by savings market clearing rates. Because the net savings supply curve was moving rightward more than the demand curve, clearing rates were falling, putting downward pressure on U.S. rates. After covid, net savings demand retreated but not enough to enable central banks to meaningfully reverse their covid quantitative easing buying. Net savings supply, most likely, has trended further leftward as China contracted. Currently, clearing rates are no doubt rising.

Former ECB President Mario Draghi and others say spending must increase to accommodate deglobalization, climate change, national security, and demographics, and tax and spending policies must change enough to keep debt costs (*r*), below economic growth (*g*).

Past policies systematically allocated resources to the already well-to-do, deepened inequalities that politically gridlocked societies, and slowed growth. In a recent Brookings paper, Alan Auerbach and Danny Yagan show that, in the United States, it was politically possible to enact fiscal reforms in the 1980s but not now.

In future years, there will be many leadership changes around the world. Most likely, deficits will continue upward because voters and politicians oppose spending cuts and tax increases, and the Draghi imperatives will deepen. We can hope advances such as quantum computing and clean nuclear reactors will yield massive productivity enhancements and free us from debt trap dynamics. However, it may be that only a global debt crisis will be sufficient to shock the public and political leaders into enacting successful fiscal reforms.

My worry is not a debt crisis, but global stagnation.

EWALD NOWOTNY
Former Governor, Oesterreichische Nationalbank, and University Professor, Vienna University of Economics

As Professor Barry Eichengreen from the University of California at Berkeley argued convincingly in his book *In Defense of Public Debt* (2022), it is essential to distinguish between "good" debt for macroeconomic stabilization and productive investments and "bad" debt for public or private consumption (including military expenditures). In both cases, debt sustainability has to be seen in the context of economic variables, though. To be sustainable, the interest rate on debt has to be lower than the nominal growth rate of the economy.

The sharp interest rate hikes after a period of ultra-low interest rates have come to an end, but some important fundamentals have changed for the foreseeable future. In many regions of the world, medium-term growth rates are expected to decline for a variety of reasons. Owing to higher perceived risk of inflation and the dynamics of public debt, long-term real interest rates will remain at an elevated level. Term risk premia will rise. While this may certainly lead to debt sustainability issues in some cases, it has to be seen as a new normal, which a capitalist market economy can deal with.

An important element of the global debt crisis of 2008–2009 was the bank-sovereign nexus. Issues with private debt led to massive problems for some banks, which then led to a crisis of confidence in the banking industry in general. A great number of banks considered too big to fail had to be bailed out with public funds. This, in turn, caused concerns about the stability of public finances in several countries.

Over the past two decades, economic policymakers have learned many lessons on this nexus problem. Bank capitalization has increased substantially, new banking regulations have—hopefully—resulted in more prudent lending practices, and awareness of the crucial role of liquidity has been on the rise. Overall, private debt does not seem to pose an imminent threat to global debt sustainability.

Today, attention is mainly centered on public debt. And indeed, as studies by the International Monetary Fund and OECD show, public debt has climbed to record levels. A look at debt-to-GDP ratios, however, reveals a wide range across countries. On a global scale, it is primarily the evolution of public debt in the United States and Japan that matters most. In both cases, public debt is in domestic currency and thus not subject to international liquidity constraints that affect other countries. In the United States and Japan, however, central banks may respond to sharp increases in public debt to avoid financial repression.

What is of crucial importance for the world economy is not the amount of public debt as such, but the dynamics of interest rates and thus debt service and the effects on exchange rates. For instance, in light of the sheer scale of U.S. dollar holdings by foreign central banks, life insurers, and other investors, uncoordinated interest rate and exchange rate movements may indeed cause massive tensions on international capital markets. Eventually, this might lead not to a global debt crisis but to global stagflation. One unintended result of this scenario could be a reduction of the public debt burden—but at the cost of investor and, maybe, overall confidence in the Western economic system.

Not an event worth losing sleep over.

STEVEN B. KAMIN
Senior Fellow, American Enterprise Institute, and former Director, International Finance, Federal Reserve Board of Governors

It is easy to come up with a lengthy laundry list of reasons why a global debt crisis is imminent. First, debt levels have risen substantially over the past decade, both for the public sector and private corporate sector, and for advanced, emerging market, and developing economies. Second, real interest rates the world over remain elevated, even as the battle to vanquish inflation draws to an end, and they are likely to remain well above pre-pandemic levels in the future. Third, with the U.S. economy slowing, China grappling with its on-going property crisis, and Europe struggling to gain traction, there are scant prospects for the most highly indebted borrowers to grow their way out of their problems. And, finally, despite these concerns, bond-market credit spreads for risky borrowers are surprisingly narrow, suggesting that lenders are overly optimistic and due for a disruptive reappraisal.

But all that said, I'm skeptical that a global debt crisis is an event worth losing sleep over—if the normal probability of such a crisis merits a ranking of two, I'll give it a three or at most a four at the current juncture. Underpinning my seeming insouciance is the fact that the global financial system has already weathered three major shocks—the pandemic, the surge in inflation and interest rates that followed it, and Russia's invasion of Ukraine—without breaking. To be sure, forceful government intervention and an expansion of the financial safety net was required to ward off financial panic and depression in 2020, to avoid a meltdown in the U.K. bond market in 2022, and to prevent a run on regional banks after Silicon Valley Bank's collapse in 2023. But the success of these policies also speaks to underlying strengths in the global financial system, which is at least somewhat more prudently managed and better capitalized than it was in 2007.

Going forward, the strains induced by the shocks of the past few years will continue to pose challenges.

Many corporate borrowers refinanced at very low rates in 2020–2021, and as their debts mature and are refinanced at higher rates, their debt service burdens will rise. The hole in commercial real estate caused by remote office work will mean further losses for U.S. regional banks. Italy's dismal growth prospects raise concerns about its ability to sustain a government debt load exceeding 130 percent of GDP. And some of the world's poorest economies are already in debt distress. But absent new shocks, which by definition are difficult to predict, these strains should play out gradually, allowing corporations, banks, and public policymakers time to manage the risks and contain contagion. Central banks retain the ability to boost liquidity and backstop financial markets. And although many believe that governments exhausted their fiscal capacity supporting their economies during the pandemic recession, debt-to-GDP ratios have now fallen much of the way back to 2019 levels as economies have recovered and prices have risen, suggesting there is still scope for fiscal stimulus.

The question may be less what central banks are able to do in response to a banking crisis, and more what they are willing to do.

J. W. MASON
Associate Professor of Economics, John Jay College of the City University of New York, and Fellow, Roosevelt Institute

As Hyman Minsky famously described, when market participants believe that crises are possible, they behave in ways that make the system relatively robust. Only when the chance of a crisis is deemed very low, or forgotten entirely, do financial markets accept the degree of leverage and illiquid commitments that make a crisis possible.

This means, among other things, that crises are inherently difficult if not impossible to predict. A predicted crisis is a crisis that does not occur.

So to the question of whether a serious crisis is likely in the near future, the sensible answers range from "maybe" to "I don't know."

There are other questions we have a better chance of answering. First, are the authorities able to handle a crisis if one does occur? And second, what kind of spillovers will a financial crisis have for the rest of the economy?

On both questions, the answers would seem to be reasonably encouraging for the rich countries, less so for the developing world.

The 2007–2009 financial crisis and the 2020 pandemic were very different events in many ways. But one thing they had in common is that both demonstrated the awesome power of a committed central bank to overcome almost any kind of disruption to the financial system. The Fed, in particular, was willing to buy a much wider range of assets, and intervene in a wider range of markets, than almost anyone would have previously predicted. Today there can be little doubt that the Fed can stem the contagion from even the biggest bank failure or sovereign default, if it wishes to.

That last caveat is worth emphasizing. The decade after 2007 saw a sharp divergence between the United States and Europe. While the Fed moved aggressively to repair the financial system, the European Central Bank moved more slowly—in part because of tighter institutional constraints, but also, it's now clear, because decision makers at the ECB saw the crisis as a chance to push through a broader set of policy changes. Not only Greece but also Spain, Italy, and Ireland were in effect held hostage by the ECB, which refused to restore liquidity to their banking systems until they accepted various structural reforms.

This divergence suggests that, in the rich countries, the question may be less what central banks are able to do in response to a banking crisis, and more what they are willing to do.

As for the second question, it's worth maintaining a bit of skepticism that finance is as important to the rest of us as it appears in its own eyes. In retrospect, it seems clear that the long-term damage to the U.S. economy after the 2007 crash had more to do with the collapse of housing market—a pillar of the real economy—than with the financial aftershocks that got so much attention at the time. When we think about the dangers of a financial crisis today, we should ask not only what are the chances of bank failures and asset market disruptions, but how important those markets are for real activity. Mortgages and cryptocurrencies are very different in this respect.

For the developing world, unfortunately, such a relatively sanguine view is harder to sustain. Central banks are much less powerful in countries where a large fraction of domestic obligations involve foreign currencies, and where financial conditions are largely determined beyond the borders. Serious spillovers to the real economy are more likely in this case. If there is a crisis in the near future, it may finally teach the lesson that the world has been slowly learning: Outside the core of the world economy, an essential requirement for any kind of macroeconomic management is a degree of financial delinking.

A five in the next three years, an eight in the next decade.

MORITZ KRAEMER
Chief Economist and Head of Research, LBBW Bank

A new debt crisis is an accident waiting to happen. I rate the probability of one happening in next three years at a five on a scale of one to ten, and at an eight in the next decade.

Unless there is a notable change of course, and soon, the world is racing towards yet another debt crisis. And this is not only because there is now more of the stuff than ever before: the Institute of International Finance estimates that the total amount of debt outstanding has hit $312 trillion in mid-2024. While the ratio at around 330 percent of world GDP is lower than it has been, this is an only superficially positive development. It has been driven by the inflation spike, which lies now behind us. No relief from that front should be expected going forward.

The epicenter of future debt risks lies with governments. Governments seem to perennially believe that their economies are in a bad spot and need propping up through fiscal stimulus. China is only the latest example. Before the financial crisis, advanced economies' public debt was close to an already-respectable 70 percent of GDP. Today it is nearer to 110 percent and rising. As the era of close-to-zero interest rates gradually disappears in the rearview mirror, the debt service burden will inexorably rise. This will come on top of a secular deceleration of the world economy and thus tax receipts, higher public spending on aging populations, and rising defense outlays. As populations age in the rich world, but also in China, savings will decline, throwing another spanner in the wheel of fiscal sustainability. At the same time, political dysfunction is on the rise, rendering fiscal consolidation an ever-remoter prospect.

No country epitomizes this worrying trend better than the world's largest debtor, by far: the U.S. federal government. Despite full employment and no wars to be fought, the budget deficit has hovered near 8 percent of GDP. We are lurching from one debt-ceiling cliff to another. If Capitol Hill pushes the Treasuries over the political cliff, a trigger for much higher risk premia could be pulled, making fiscal sustainability even more elusive. And if Donald Trump returns to the White House and meddles, as he said he would, with the Federal Reserve, the ultimate guardian of global financial stability, this could make investors also nervous and prone to rapidly reducing their exposures of the asset that for decades served as a safe haven.

Governments, from Beijing to Washington and from Paris to London, let alone Tokyo, appear not to have the will, let alone a credible plan, to effectively address the rising fiscal imbalances. True, investors are more tolerant with governments than they are with corporates. If push comes to shove, the former can raise taxes, the latter can't. But if government debt is a rubber band that can be pulled much harder and wider than other debt instruments, even the strongest rubber band will snap at some point. We cannot know when this point comes. But leaders in the advanced economies seem to want to find out. They shouldn't.

A three-out-of-ten chance.

HOLGER SCHMIEDING
Chief Economist, Berenberg

I rate the probability of a serious global debt crisis in the next three years at three on a scale of one to ten.

The global economy dodged a major risk in the last two years. After public debt had soared skywards in the wake of the Covid-19 pandemic, the drastic hikes in central bank rates to combat the post-pandemic surge in inflation could have easily spooked bond markets. But except for a few isolated instances in some emerging markets and a brief bout of turmoil in post-Brexit Britain, investors kept buying record amounts of bonds throughout this period. As central banks are now cutting rates again, we have moved beyond peak risk. A debt crisis does not seem imminent.

Of course, serious risks remain. Debt has reached eye-watering levels in many countries. With total public and private debt at 290 percent of GDP, China is carrying an outsized burden for a country that is still half poor. But its debt is almost exclusively domestic, held at home and in the home currency. With inflation under control, the central bank could use its balance sheet to buy bonds and prevent a debt crisis if need be.

U.S. fiscal policy is unsustainable. Running deficits of 7 percent of GDP while the economy is growing nicely, as the United States did in the last three years, is storing up major trouble for the future. However, the U.S. bond market remains the safe haven of choice for global investors. In times of elevated geopolitical risks, safe-haven inflows allow the United States to get away with its fiscal follies for longer than almost all other countries. Unless the United States engages in a new tax-cutting (or spending) orgy after its election, the bond vigilantes will probably still spare it for the next three years. But the calm may not last for much longer if dysfunctional U.S. politics offer no hope of a return to prudence in the foreseeable future. At some point in time, markets will likely force the United States the hard way to adjust its fiscal stance. Almost by definition, policy cannot stay unsustainable forever.

As usual, some emerging markets will probably default on their debt in the next few years. In addition, serious trouble may be lurking in the less-transparent corners of global markets for debt and derivatives. But policymakers across much of the globe have learned a key lesson from the catastrophic way in which the United States mishandled the Lehman crisis in September 2008. They are aware of contagion risks. And they know how to contain such risks. It thus seems unlikely that the current generation of policymakers would allow any of the isolated debt crises that seem likely in the next few years to spiral out of control and trigger a major global calamity.

A three out of ten. I do not currently see the kind of global lending craze that was triggered before 2008 or prior to 1982.

RICHARD C. KOO

Chief Economist, Nomura Research Institute, and author,* Pursued Economy: Understanding and Overcoming the Challenging New Realities for Advanced Economies *(2022)

The global financial crisis in 2008 was so severe not because Lehman Brothers was too big to fail, but because such a large number of financial institutions faced the same problem at the same time. They had all eagerly bought collateralized debt obligations that were marketed with egregiously high credit ratings assigned by corrupt rating agencies despite having risk characteristics decipherable only by "rocket scientists." When the value of those CDOs not only collapsed but became impossible to determine because the market for them disappeared, many banks could no longer tell if they were still solvent. That created widespread mutual distrust among financial institutions and led to a dysfunctional interbank market, which in turn sparked the global financial crisis.

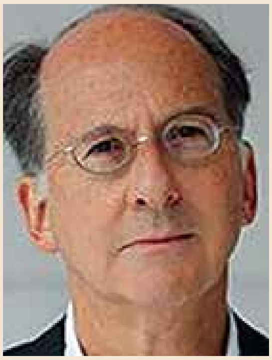
The only other global debt crisis comparable in size was the 1982 Latin American debt crisis, where seven out of eight U.S. money center banks were left insolvent when all sovereign borrowers south of the U.S.-Mexico border defaulted on their syndicated Eurodollar loans. That crisis was also preceded by a lending craze—this one spearheaded by Citibank CEO Walter Wriston, who famously argued that companies may go bankrupt, but not countries. His words convinced many lenders in North America, Europe, the Middle East, and Japan to join loan syndicates led mostly by large American banks.

These two examples suggest that a global debt crisis requires both a lending boom and a large number of financial institutions experiencing the same problem at the same time. I may be wrong, but I do not currently see the kind of global lending craze that was triggered by CDOs in the years before 2008 or by Eurodollar syndicated loans to Latin America prior to 1982.

I was worried about the sharp fall in the price of long-term, fixed-coupon bonds when central banks shifted from quantitative easing to quantitative tightening and raised interest rates to fight inflation starting in 2021. Those bonds were held by virtually all financial institutions around the world, and sharp declines in prices from the inflated levels of the QE era led to large unrealized capital losses. Luckily, problems surfaced only for Silicon Valley Bank and a few other lenders. For the rest—including central banks—the problems apparently remained manageable. Although we cannot be complacent, the fact that central banks are loosening monetary policy means related capital losses are now less likely to morph into a global crisis.

It is extremely concerning, however, that house prices have been setting record highs almost everywhere except Germany, even though central banks were tightening monetary policy until recently. Now that they are loosening policy, the bubble could get worse. The massive accumulation of excess reserves at so many banks could also lead to a lending boom if it has not done so already. As a result of QE, the U.S. banks have 1,614 times as many excess reserves as they did when Lehman collapsed in the third quarter of 2008. The corresponding multiples for Japan and the eurozone are 1,947 and 2,990, respectively. If lower interest rates and excessive liquidity cause a further acceleration of the housing bubble, we may face another global debt crisis when this boom finally bursts.

I rate the probability of that happening in the next three years at maybe three out of ten.



In the U.S. presidential campaign, there was scant mention of the elephant in the room—U.S. debt and deficits.

MARK SOBEL
U.S. Chair, Official Monetary and Financial Institutions Forum, and former Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Treasury

High public debt levels are not just a U.S. problem. They are also elevated in Japan, China, and many European nations. Given aging, slowing global potential growth, climate and defense spending needs, and a general lack of political discipline, maintaining and tackling public debt sustainability is an enormous—and increasingly threatening—challenge. It is not, however, a systemic challenge that will likely disrupt the global economic and financial system in the next few years. But acting sooner may lessen the inevitable costs and disruptions from waiting.

In the U.S. presidential campaign, there was scant mention of the elephant in the room—U.S. debt and deficits. Instead, the campaign focused on increased budget-busting tax cuts and spending. In Congressional Budget Office baseline estimates, U.S. fiscal deficits will exceed 6 percent per year over the next decade, with net debt held by the public rising from nearly 100 percent today toward optimistically 125 percent. Debt then explodes, fueled by entitlement spending, rising toward 180 percent by the early 2050s.

The composition of the U.S. budget doesn't easily lend itself toward repair. Some two-thirds of spending is mandatory—mainly entitlements which Republicans and Democrats are loath to touch—and the remaining one-third consists heavily of sacrosanct military spending. America's interest bill is soaring, squeezing funds for programs.

A U.S. debt-to-GDP ratio a decade from now of roughly 125 percent of GDP seems readily finance-able, especially looking at other advanced economy ratios and given the attractiveness of U.S. capital markets and the dollar's global role.

Deficits of greater than 6 percent of GDP annually, however, point to massive Treasury issuance that global markets will have to absorb. Could they get a serious bout of indigestion?

The Treasury market functions smoothly in normal times, but is not as robust as in the past. Funds have become major players but are less sticky holders of Treasuries than banks. If the United States is hit by another shock, akin to the global financial crisis or the pandemic, it may lack fiscal space to respond. Bouts of stress and illiquidity may arise with growing frequency, even if the Fed has the tools to respond. The term premium may rise, crimping U.S. investment and growth. Questions may arise about fiscal dominance and Fed independence.

The United States must face the music, finding a path to begin gradually and predictably arresting and lowering the rise in the debt-to-GDP ratio without harming activity. Our political class will need to raise revenue and slow spending growth, yet polarization is high, Republicans shout no new taxes and demand tax cuts, and Democrats focus on middle class cuts and higher taxes on the wealthy. The arithmetic isn't adding up.

It would be nice if Congress and the executive branch could come together and forge a responsible fiscal strategy. But given our dysfunctional politics, nobody wants to eat their spinach! Disruptive market turbulence may ultimately force fiscal prudence upon America with attendant turmoil and damage to the United States and the world.

A one-in-ten chance.

CHEN ZHAO
Chief Global Strategist, Alpine Macro

It is unlikely that a serious global debt crisis will erupt in the next few years. The U.S. household sector balance sheet is in great shape, with the debt-to-disposable income ratio having fallen to its lowest levels in more than two decades. U.S. small businesses have also ratcheted down their borrowing sharply since 2008. The Chinese business sector is going through a painful deleveraging process that has sharply reduced the economy's growth rate, but it is unlikely that a debt crisis will happen inside the Chinese economy.

Some people have expressed the serious concern that the U.S. budget deficit and public sector debt have been running out of control, raising the specter of a potential public sector debt crisis. I believe that such a concern is groundless and misplaced. In a fiat monetary system, if a nation does not borrow in foreign currency, the risk of a sovereign debt crisis is next to zero. The reason is that the central bank can always act as the "buyer of last resort" to ensure the solvency of a government and its debt obligations. The Bank of England could have quickly clamped down the "Liz Truss Moment" in October 2022 by promising a renewed gilt purchase program. Similarly, then-ECB President Mario Draghi's "whatever it takes" statement effectively ended the eurozone debt crisis.

Finally, there is a paradox for public sector debt: For example, the U.S. public sector debt-to-GDP ratio has increased more than four times since the 1970s, but bond yields, both nominal and in real terms, have melted for the same time, suggesting that the so-called fiscal risk premium does not exist. Similarly, if one looks around the world, a similar paradox also exists: the countries that barely have any debt (both public and private) usually have much higher interest rates than those that have much bigger debt loads. For example, Brazil, Mexico, and South Africa do not have much debt (both private and public) at all but have very high rates of interest. Japan, Singapore, China, or Korea have much higher total debt loads but extremely low interest rates. Why so? I have my explanations but that is beyond this topic.

On a scale of one to ten for a serious debt crisis in the next three years, my rating is a one.

The next global debt crisis is hiding in plain sight.

RICHARD JERRAM
Chief Economist, Top Down Macro

The next global debt crisis is hiding in plain sight. In many developed economies, public finances were fragile even before the global pandemic that hit in 2020. Now, they are far worse, with debt levels rising by 20–30 percent of GDP, and in many cases exceeding annual output. Individual countries have their own specific pockets of private sector debt problems, but the weakness of government finances is commonplace.

Of course, it takes time for the central bank policies of the recent tightening cycle to feed through to higher debt service costs—a slow-motion train wreck, if you like. But interest costs on the stock of public debt are already rising and it would take something remarkable to prevent this from continuing, even with short-term interest rates now heading down. Higher debt levels and higher neutral short-term interest rates unavoidably lead to higher debt service costs. This is just math.

Perhaps a greater concern is the lack of fiscal discipline. With one eye on left- or right-wing demagogues, centrist governments are shying away from austerity out of fear it will drive voters towards populists. That is understandable in the short run, but they are closing their eyes to the longer-term risks. When combined with poor demographics and low productivity growth, it is hard to see a path toward stable public finances. Faster economic growth would help, although policy innovations that could make a material difference are elusive.

So, on a scale of one to ten, what are the chances of a serious debt crisis in the next three years? Three years isn't long, so I would say four, as the situation seems unsustainable but stable. However, as British Prime Minister Liz Truss showed in September 2022, it doesn't take much to lose the confidence of the financial markets and, if that happens, all sorts of vulnerabilities will soon float to the surface.

A distinct possibility, based on a reversal in the real interest rate trend and a rising U.S. fiscal risk.

CHARLES W. CALOMIRIS
Co-Director, Institute for Research in Economics

A debt crisis begins when many borrowers (sovereigns, households, or firms) find themselves unable to make good on their promised debt service payments in the future. In some cases, the large systemic accumulation of debt that precedes a crisis is the result of government subsidies for taking on more leverage—for example, in the lead-up to the subprime crisis of 2008–2009. Typically, excessively loose U.S. monetary policy followed by monetary tightening in response to rising inflation also plays a key role in encouraging the buildup of debts that turn out to be unpayable when monetary policy tightens.

The empirical financial economics literature has shown that when the Fed lowers interest rates, there is an accompanying decline in market risk premia on bank loans, bonds, and equities, which encourages risk taking, especially in the form of increased borrowing. That was true about the petrodollar recycling of the 1970s that produced the less-developed-country debt crisis, and there was a similar U.S. interest rate-driven emerging markets debt boom-and-bust in the 1990s. Economist John Taylor and many others have also shown that the unusually loose monetary policy of 2002–2005 also contributed to the subprime crisis.

In the wake of that crisis, from 2008 to 2021, the U.S. Federal Reserve kept short-term interest rates near zero, and also used quantitative easing and forward guidance to keep long-term interest rates low. This protracted extremely loose monetary policy regime produced a remarkable increase in indebtedness of both sovereigns and corporate borrowers around the world. In my own work with Mauricio Larrain, Sergio Schmukler, and Tomas Williams, we find that the boom in emerging market debts partly reflects the behavior of developed-country institutional investors (including mutual funds with little experience investing in emerging markets) that reacted to the low U.S. Treasury rates and risk premia from 2008–2020 by "searching for yield," which led them to buy risky foreign dollar-denominated debts.

From 2008 to 2020, a large amount of debt was built up. The Fed's recent contractionary policy, by itself, has not created a debt crisis because borrowings are mainly medium- and long-term. The crisis will come if interest rates remain high for a protracted period, which will make it difficult for sovereign and corporate borrowers to roll over maturing debts. The crucial question, therefore, is whether dollar interest rates are likely to be high for the next several years. That uncertainty is driven by two unknowns: global trends in the real supply and demand for funds, and U.S. fiscal policy.

With regard to the first of these, some observers believe that the Fed's current response to declining inflation and labor market cooling will persist, taking us back to low interest rates over the next year or two, reducing the risk of any rollover problems. That view is probably too optimistic. Over the period from the 1990s to 2020, short-term real dollar interest rates appear to have trended downward from their historical average of 2 percent to somewhere around 0.5 percent. Economists don't know why that happened—the possibilities include demographic shifts and reduced demand for tangible investment capital—but there is some evidence that this trend has reversed. The Fed, academics, and market participants all face huge uncertainty about the trend in dollar real interest rates, which are market determined. It is possible that the average short-term real interest rate will be 1.5 percent going forward, implying a substantial escalation of dollar-denominated debt service payments as debts are rolled over.

U.S. fiscal policy poses a separate risk that could be even greater. The United States clearly faces its own debt crisis as the result of unsustainable cumulative deficits. It is possible, I would even say likely, that in anticipation of a "fiscal dominance" problem, U.S. Treasury interest rates could see a major increase in their inflation risk premia, which would boost real interest rates. No one knows exactly when the "bond vigilantes" will awaken from their slumbers and start to become worried about the prospect of a major increase in U.S. inflation, but I would not be surprised if that occurred within the next five years.

The combination of a reversal in the real interest rate trend and a rising U.S. fiscal risk make me believe that a global debt crisis for sovereigns and corporations is a distinct possibility over the next several years. ◆