IMF issues debt warning

Nick Beams
4 October 2020

The International Monetary Fund has warned that the COVID-19 pandemic has pushed international debt levels, already at record highs in 2019, to heights that could trigger a crisis.

The warning is contained in a blog post last week co-authored, among others, by IMF managing director Kristalina Georgieva. It noted that, compared to the end of 2019, average debt ratios "are projected to rise by about 20 percent of GDP in advanced economies, 10 percent of GDP in emerging economies, and about 7 percent in low-income countries."

These increases are on top of debt levels that were already historically high. While "many advanced economies still have the capacity to borrow, emerging markets and low-income countries face much tighter limits on their ability to carry additional debt," it stated.

It warned that before the pandemic struck about half of low-income countries and "several emerging market economies were already in or at high risk of a debt crisis, and the further rise in debt is alarming." It said that just as these countries were starting to recover from the pandemic many of them "could suffer a second wave of economic distress triggered by defaults, capital flight, and fiscal austerity."

The IMF said that while no debt crisis had so far emerged because of the action taken by central banks—the pumping of trillions of dollars into the financial system—these actions were "fast becoming insufficient." The suspension of debt service initiated by the G20 expires at the end of the year and developing countries would need additional low-cost financing in 2021 and beyond.

Most of the measures so far had focused on liquidity to maintain countries' access to finance both from official and market sources. "But as the crisis continues, solvency problems—the inability to repay debts—will increasingly come to the fore."

The IMF said it was "working hard to prevent a debt crisis" and that the world was at a "critical juncture and should not sit idle waiting for a crisis." It needed to "review its arsenal of weapons" and "do the utmost to prevent, and if necessary, pre-empt, another sovereign debt quagmire." The alternative was "large-scale debt defaults" that would "severely damage economies and set back their recoveries for years" with low-income countries especially at risk.

Very little action, however, was proposed that in any way matches the seriousness of the crisis to which the IMF is pointing. The only concrete measures were calls to extend the present debt service suspension initiative, the building of a more "more robust debt architecture" and for "all stakeholders to do their part to reduce the risk of a catastrophe and pave the way for a safer financial system."

An IMF analysis published last month on the "international architecture" of sovereign debt noted that while measures on debt restructuring since 2014 had largely been successful there were gaps in the system that "could pose challenges in future restructurings."

These arise from the development of new methods in the way debt is funded and this diversity in the credit base meant it had become more "diverse and fragmented" that had already "raised challenges."

It said that "should a COVID-related systemic sovereign debt crisis requiring multiple deep restructurings materialize, the current resolution toolkit may not be adequate to address the crisis effectively and additional instruments may need to be activated at short notice."

While the IMF always tries to present an image of being in control, the actual picture it presents is one of a deepening crisis that could rapidly escalate.

The issue of debt is by no means confined to the sovereign debt of emerging market economies and low-income countries. It lies at the heart of all the major economies, above all the US.

© World Socialist Web Site

A report published in the *Wall Street Journal* last week noted that the US has been plunged into the deepest slump since the Great Depression with the highest levels of debt in its history.

All told US consumer, government and business debt, fuelled by years of ultra-low interest rates now totals $64 trillion, more than triple the American GDP.

It noted that even before the pandemic the percentage of delinquent auto-loan debts had almost reached levels seen in the wake of the financial crisis of 2008.

Low interest rates have also led to a record level of corporate debt triggering concerns that "high levels of corporate debt during a recession could force companies to slow spending and hiring to repay what they owe—or get simply overwhelmed by their repayments."

The debt problem has been exacerbated by the use of borrowed funds to finance share buybacks that reached a record high of $806 billion in 2018. This is amechanism by which companies are loaded up with debt not for financial investment but to boost the incomes of executives, rewarded for lifting share prices, and hedge funds.

The quality of debt has declined significantly with the amount of triple-B rated corporate bonds—the lowest quality investment-grade debt—doubling over the past decade. So far the corporate bond market has been propped by government bailouts, the reduction of the Fed's interest rate to near-zero and the intervention of the central bank to buy up corporate bonds.

The *Wall Street Journal* report also noted that state and local governments had not been setting aside money to cover the cost of pensions and their problems were now compounding because of reduced revenues from income and sales taxes, with the result that they were cutting services and laying off workers.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site