EIU Global Forecast - Sovereign debt crises are coming

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The coronavirus pandemic is a game-changer for the global economy; 2020 and 2021 will be lost years in terms of growth. We only expect the global economy to recover to pre-coronavirus levels in 2022. The effects of the pandemic will be felt beyond economic losses; sovereign debt crises are likely. Governments in many developed countries have concluded that increasing public expenses, and therefore public debt levels, is preferable to the widespread destruction of productive capacity during the epidemic. As a result, public debt levels will increase sharply this year. For the most reliable sovereigns, the cost of servicing these much higher levels of public debt will not be an immediate cause for concern.

Public debt is piling up

However, the debt pile-ups will eventually have to be confronted. To curb fiscal deficits, governments in most developed countries will not be able to pursue austerity strategies as many did after the global financial crisis. Austerity absorbs political capital, and there might not be enough left to pursue such a plan, especially given that for many countries the last period of belt-tightening was so recent. Governments are also unlikely to be able to make the sorts of savings that could meaningfully reduce debt stocks; in many economies the public sector is much smaller than before the 2008-09 financial crisis, and cuts to healthcare spending, for instance, are unlikely, as the epidemic has brought to light the stress that health systems are under as a result of recent austerity measures.

Governments have little fiscal room for manoeuvre

Rather than dramatically cutting spending, governments are likely to look at the other side of their balance sheets and consider raising fiscal revenue. Among advanced economies, the trend over the past 40 years has been one of lower corporate and personal income taxes. Demographic changes were going to force governments to reverse this eventually; the coronavirus crisis might mean that they will have to do it sooner. However, it is not clear whether governments will be able to raise taxes quickly enough for such measures to be sufficient. Investors' appetite for increased amounts of sovereign debt may also wane.

Sovereign debt crises will quickly spread across the world

As a result, some developed countries will, in the medium term, find themselves on the brink of a debt crisis. This is compounded by the fact that many of the European countries that are among the worst affected by the epidemic, such as Italy and Spain, already had weak fiscal positions before the coronavirus outbreak. South European states are still recovering from years of austerity, combined with high levels of public debt, an ageing population (which is more vulnerable to severe forms of the coronavirus) and persistent fiscal deficits. A debt crisis in any of these countries could quickly spread across the globe, sending the global economy into another economic crisis.

Multilateral assistance will give poor countries some breathing space

Poorer countries might be among the hardest hit in such a scenario. In an effort to mitigate the economic impact of the pandemic, multilateral financial institutions, together with the world's wealthiest countries, have now offered substantial financial support to help to ease the financial burden on low-income and emerging-market economies. The IMF, the World Bank and other multilateral development banks have ramped up their emergency funding support, debt relief is on the agenda, and the G20 is offering substantial financial support by temporarily suspending debt repayments. These efforts will give the world's poorer countries some short-term breathing space on their balance of payments and free up resources for them to beef up healthcare spending and implement economic stimulus and relief programmes.

Poorer countries will emerge from the coronavirus crisis even more indebted

However, most new funding (albeit on concessional terms) will be added to the balance sheets of emerging economies, and the debt-assistance package from the G20 is a delay rather than a write-off, so debt repayments will remain outstanding and continue to accrue interest. Many countries will emerge from the current virus-driven economic crisis even more indebted and financially stressed than before. This will raise concerns about their ability to repay external debt in the absence of more comprehensive debt-relief plans.

Are massive debt restructurings on the cards?

Attention could turn to more widespread debt restructuring and debt relief as the coronavirus crisis unfolds in the developing and emerging world. Steps in this direction would require the leadership of the G20, the backing of multilateral financial institutions and, crucially, the full engagement of China, the world's largest lender to low-income and emerging markets. Adding private creditors to the mix would provide a substantial boost, but this is unlikely. The current fractious nature of global geopolitics and historical precedents suggest that any debt restructuring or write-offs are more likely to occur on a case-by-case basis rather than as a broad-brush policy.

World economy: forecast summary

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real GDP growth (%)										
World (PPP[a] exchange rates)	3.4	3.3	3.8	3.5	2.7	-3.4	4.1	3.5	3.5	3.3
World (market exchange rates)	2.8	2.5	3.2	2.9	2.2	-4.2	3.7	2.9	2.8	2.7
US	2.9	1.6	2.4	2.9	2.3	-4.0	2.4	2.2	2.0	1.8

Euro area	2.0	1.9	2.7	1.9	1.2	-8.0	3.8	2.1	1.7	1.6
Europe	2.0	1.9	2.8	2.1	1.5	-7.1	3.4	2.2	1.9	1.7
China	6.9	6.7	6.8	6.6	6.1	1.0	8.0	5.3	5.1	4.7
Asia and Australasia	4.6	4.5	4.9	4.3	3.9	-1.6	5.1	4.0	4.1	3.8
Latin America[b]	0.1	-0.3	1.9	1.7	-0.3	-5.4	3.7	2.7	2.7	2.6
Middle East & Africa	2.3	4.9	1.3	1.0	0.2	-4.1	1.4	3.0	3.3	3.4
Sub-Saharan Africa	2.7	0.8	2.3	2.4	2.0	-3.5	1.7	3.7	3.9	4.3
World inflation (%; av)[b]	3.0	3.1	3.2	3.5	3.5	3.1	3.2	3.3	3.2	3.1
World trade growth (%)	2.2	2.1	5.8	3.7	0.9	-24.8	20.9	4.0	3.8	3.8
Commodities										
Oil (US$/barrel; Brent)	52.4	44.0	54.4	71.1	64.0	38.1	44.0	58.5	65.0	62.5
Industrial raw materials (US$; % change)	-15.2	-2.2	20.2	2.2	-8.6	-8.5	6.5	3.0	5.1	3.0
Food, feedstuffs & beverages (US$; % change)	-18.4	-3.5	-1.0	1.6	-4.3	0.9	2.0	1.6	1.8	1.5
Exchange rates (av)										
¥:US$	121.0	108.8	112.1	110.4	109.0	109.0	107.8	104.2	102.4	98.5

US$:€	1.11	1.11	1.13	1.18	1.12	1.10	1.12	1.17	1.21	1.24
[a] Purchasing power parity. [b] Excludes Venezuela.										

Source: The Economist Intelligence Unit.