Box 2.1

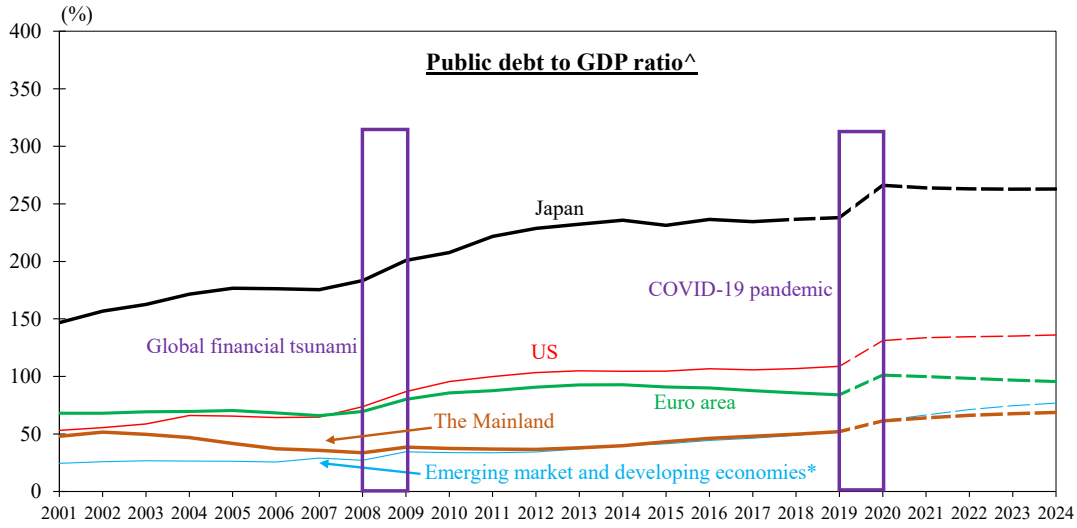
Potential implications of elevated public debt around the globe

To counter the impact of the COVID-19 pandemic, many governments have borrowed huge amounts to finance large-scale relief packages, leading to a surge in public debt around the globe. This has fuelled concerns about global financial stability and whether certain highly-indebted governments would have sufficient fiscal space to ensure macroeconomic stability in case of any future economic crisis. This box article looks into the latest surge in public debt worldwide and examines the potential implications for global financial markets and economic growth, both globally and in Hong Kong.

Overview of the global public debt situation since 2000

Except for Japan, public debt levels in other major economies generally remained relatively stable in the early years of the 2000s. Yet following the onset of the 2008-09 global financial tsunami, public debt levels around the globe rose visibly as many governments implemented huge counter-cyclical measures to support the economy. The public debt to GDP ratio(1) in the US increased from 74% in 2008 to 87% in 2009, and continued to trend upwards in the subsequent years amid persistent fiscal deficits to support the post-crisis economic recovery, reaching 109% in 2019 ***(Chart 1)***. Meanwhile, those in the euro area and Japan increased from 70% and 183% respectively in 2008 to 84% and 238% respectively in 2019. In the Mainland, the ratio rose from 27% in 2008 to 53% in 2019, but remained much lower than other major economies. The average ratio in emerging market and developing economies (weighted by purchasing power parity) increased from 34% to 52% over the same period.

Chart 1: Public debt to GDP ratios rose significantly after the global financial tsunami and the COVID-19 pandemic



Notes: (^) Dashed lines indicate projections.
(*) The ratio from 2015 to 2020 is an average of actual and projected data of individual economies within the group.

(1) Data on gross public debt to GDP ratios are sourced from the IMF World Economic Outlook database (October 2020).

Box 2.1 (Cont'd)

Entering 2020, the outbreak of COVID-19 dealt a severe blow to the global economy. To help both businesses and individuals endure the crisis, governments around the world swiftly stepped up their policy support. As of end-2020, the US rolled out two major rounds of relief packages amounting to over US$3 trillion, equivalent to around 15% of GDP[(2)]. Meanwhile, a number of European countries, Japan, the Mainland and many emerging market and developing economies also implemented massive relief measures, with the scale of measures in many places exceeding 10% of their GDPs.

Against this backdrop, fiscal deficits in many economies soared in 2020, resulting in a further surge of public debts. The degree of increase in different economies however varied, depending on their epidemic situations and the scale of the support measures implemented. In particular, as shown in ***Chart 1***, the International Monetary Fund (IMF) projected that the public debt to GDP ratio in the US would increase notably to 131% in 2020 (2019: 109%), while those in the euro area and Japan would reach 101% and 266% respectively (2019: 84% and 238%). The projected increase for the Mainland from 53% to 62% was relatively moderate, thanks to the early containment of the disease in March 2020 and the strong economic recovery in the rest of the year. In emerging market and developing economies, due to financial constraints, the ratio was also expected to increase by a relatively lesser extent, to 61% in 2020 (2019: 52%). From 2021 to 2024, the ratios in the US, the euro area and Japan were expected to stay largely stable. For the Mainland and emerging market and developing economies, the IMF projected that the ratios would increase gradually to 77% and 69% respectively by 2024, still lower than other major economies.

Potential implications of surging public debt

Surging public debt would trigger concerns about a government's creditworthiness, which could in turn drive up interest rates to compensate for the risk. Higher interest rates, together with the possibility of higher tax rates to sustain debt service payments, may discourage investment and have negative consequences for economic growth in the medium term. Meanwhile, concerns about governments' ability to repay debt might create turbulence in the financial markets, particularly if emergence of inflationary pressures after a long period of loose monetary policy prompt central banks to start raising interest rates. This is particularly so for those emerging market economies with weaker economic fundamentals and with more debt held by foreign investors, as higher debt service payments may erode investor confidence, which could lead to potential fund outflows amid normalisation of monetary policy in major economies, further increasing their financial vulnerabilities and undermining their economic growth. Moreover, high public debt levels would limit the room for further fiscal support down the road in case there is another major crisis or economic downturn.

Nonetheless, as noted in the IMF's *Fiscal Monitor*, high levels of public debt are not the most immediate risk to the global economy which is still weighed by the pandemic. In fact, the IMF called on governments to avoid premature withdrawal of fiscal support, with the health and education sectors having higher priority. Fiscally constrained economies were encouraged to prioritize their most vulnerable sectors. The World Bank and the IMF also urged creditor governments to suspend debt service payments for the poorest countries to allow them to focus resources on fighting the pandemic.

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(2) In addition to the two major rounds of relief measures rolled out in 2020, on 14 January 2021, US President Biden unveiled a US$1.9 trillion stimulus plan a few days before he was sworn in, which included a substantial increase in direct payments to individuals.

Box 2.1 (Cont'd)

Future trajectory of the global and Hong Kong economies

While global public debt will likely remain elevated in the foreseeable future, the near-term global economic outlook should largely depend on progress in containing the pandemic and vaccinating the population. As long as effective vaccines can be steadily and extensively applied as expected, the global economy should show a more visible recovery in the second half of 2021. Yet, in the subsequent years, global economic growth may increasingly be constrained by high public debt. Meanwhile, financial risks associated with elevated public debt may turn more apparent, adding uncertainties to the global business environment and potentially weighing on investment sentiment. On the other hand, other developments such as continued productivity enhancement stemming from technological advancement may add impetus to the global economy.

Hong Kong's near-term economic outlook also hinges on the epidemic. In the medium term, as a small and open economy, the Hong Kong economy will inevitably be influenced by global economic trends, including the potential repercussions of elevated public debt in many major economies which may surface via both trade and financial channels. We need to stay alert to these possible developments. Yet, with our sound fundamentals and resilient financial system, including a sustained current account surplus and abundant foreign exchange reserves, Hong Kong will be able to cope with the challenges.