PRIVATE DEBT IN EMERGING COUNTRIES: AVERAGES ARE MISLEADING

Since 2019, private sector debt in emerging countries as a whole has risen as a percentage of GDP, while at the same time private sector debt in advanced countries has fallen. However, a country-by-country analysis shows that China alone is responsible for this increase and that, even excluding China, debt ratios show positive aggregation effects. In fact, on the basis of median ratios and credit gaps, excluding China, the private sector has develeraged in a large number of countries, until the third quarter of 2024. Current and future economic and financial conditions point more to a continuation of the decline than to a rebound.

Last week, the IMF and the Institute of International Finance (IIF) published almost jointly an update of their estimates of public and private debt[1]. Usually, information and analyses relating to debt issues focus on government debt, as and when sovereign debt defaults/restructurings are announced or bond yields come under pressure. The IMF and IIF estimates, which cover not only governments but also businesses and households, provide an opportunity to take stock of private debt in emerging countries[2].

Compared with its level at the end of 2019, despite the health (COVID), financial (US monetary tightening) and geopolitical (war in Ukraine, Israeli-Palestinian/Lebanese conflict) shocks, the private debt of all the emerging countries has risen by only 6.5 percentage points (pp) of GDP to reach 128% of GDP at the end of 2023, according to the IMF. However, according to the IIF and based on a smaller but representative sample, the increase is 10.3 pp of GDP to 140.5% of GDP in Q3 2024. This is admittedly less than the rise in public debt (+13.6% for the IMF sample, +16.6 pp for the IIF sample). But it contrasts with the rise in private sector debt in advanced countries, which fell by 5.4 pp for the IMF and by 2.5 pp for the IIF. Should we be concerned about this overall worsening?

The answer is rather no. Unlike advanced countries, where developments by country and by agent are relatively homogeneous, the overall average (weighted by GDP) gives a misleading view of the dynamics since the end of 2019. The increase is largely attributable to the sharp rise in private debt in China, both corporate and household. Excluding China, private sector debt fell by 3.2 pp and stood at 69% of GDP according to the IMF. According to the IIF, the ratio in Q3 2024 was practically the same as at the end of 2019 (78% in a field most comparable with the IMF statistics - *see note on page 1*) and very stable since Q1 2022.

What's more, even excluding China, these average ratios show positive aggregation effects. For example, the median of the differences in debt ratios between the end of 2019 and Q3 2024 is slightly negative for households (-0.7 pp) and very negative for non-financial companies (-1.5 pp for total debt and -3.4 pp for domestic debt[3]). The same is true of the deviations of debt ratios from their trend (credit gap), measured using an HP (filter, indicators commonly used in applied economic research to assess credit excesses/overhangs (notably by the Bank for International Settlements). Also on a median basis and still excluding China, the credit gap is still negative (it already was at the end of 2019) for both households and non-financial companies.

To sum up, if we disregard the temporary impact of the COVID crisis on debt ratios between the beginning of 2020 and the end of 2021, it is more accurate to say that, excluding China, the private sector has deleveraged in a large number of EM.

What are the factors behind this debt reduction? IMF economists identify three main factors: recent growth and growth expectations, unanticipated inflation (surprise inflation) and uncertainty. For 2023, the contribution of recent growth to debt has been negative since 2021, although it is eroding. The contribution of expected growth, on the other hand, is still positive but is also eroding, in line with the downward revisions to growth forecasts over this period and to potential growth since the COVID crisis. The two contributions offset each other in 2022 and 2023. The contributions of unanticipated inflation (rigidity of disinflation linked to the effects of the spread of prices from goods to services and of wage catch-up) and uncertainty (multiplication of sources of geopolitical tension) have been negative, even if they have reduced slightly. The IMF economists do not mention the effect of the tightening of monetary policy in 2022-2023, which has probably contributed to the moderation in domestic credit to the private sector.

1 2024 Global Debt Monitor - IMF Foreign & fiscal affairs department - December 2024. "Winds of Change - Prospects for Debt markets in 2025" - IIF Global debt monitor - December 3, 2024.

2 IMF data is annual and covers a very large sample of countries (181 for governments and 81 for private non-financial agents, i.e. households and non-financial companies) up to 2023. The IIF's country coverage is more limited (31 developed countries and 30 emerging countries) but the data is quarterly and available until Q3 2024. In addition, the IIF also provides estimates for financial companies (which the IMF does not). As far as emerging countries are concerned, in order to make the best possible comparison between the two sources, we have not included the countries in the IIF's sample of emerging countries which, for the IMF, are classified as advanced (Czech Republic, Hong Kong, South Korea, Israel, Singapore, Slovak Republic) or as low-income developing countries (Ghana, Nigeria). Due to a lack of available statistics, those for Lebanon and Ukraine have not been updated by the IIF since 2022.

3 BNP Paribas estimates applying the same methodology as the IIF.

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For emerging countries, how will these different factors affect the dynamics of private debt in the years ahead? If Donald Trump carries out his protectionist threats, leading to equivalent retaliatory measures from the countries concerned, the recessionary impact on the global economy will be significant.[4] The effect will not only be cyclical but could also be structural if the increase in tariff barriers proves to be permanent. Under these conditions, the combined contribution of short-term growth and growth potential will become negative. What's more, tougher protectionism will be accompanied by increased uncertainty for all economic agents, and especially for companies in their investment decisions. Indeed, even if the easing of monetary policy in the United States and Europe continues, long-term interest rates will remain higher for longer, at least in the United States, which should support the dollar. Emerging countries would obviously be the first to suffer from this tightening of their external financing conditions. Finally, the contribution of unanticipated inflation will most likely be zero, with inflation rates stabilising from next year onwards.

The decline in private sector debt ratios in emerging countries is likely to continue. It could even worsen if the deterioration in external financial conditions, and in particular foreign portfolio investments repatriation to the US (a sharp slowdown of capital flows to EM has already been observed since October), lead to a further weakening of exchange rates against the dollar and spread to domestic interest rates, which have been spared for the time being. In such a scenario, there is no doubt that the central banks of emerging countries would delay and limit the easing of domestic monetary policies despite disinflation.

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4 -3.3% on global exports, -0.5% on global GDP, including -1.3% for China and the United States by 2030 according to the CEPII (Antoine Bouët & alii "The price of Donald Trump's protectionism" - The letter from the CEPII - November 2024). Between -0.9% and -1.3% for the United States and -1.2% for China by 2026 according to the Peterson Institute for International Economics (McKibbin & alii: "The international economic implications of a second Trump presidency" - PIIE working paper - September 2024).

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