

## HIGHLIGHTS from Chapter 4:

### The Fourth Wave: Rapid Debt Buildup

#### Key Points

- *The global economy has seen four waves of broad-based debt accumulation over the past 50 years. The first three ended with financial crises in many emerging and developing economies (EMDEs). The current wave, which began in 2010, has already seen the largest, fastest, and most broad-based increase in EMDE debt than any of the previous waves.*
- *Current low interest rates—which markets expect to be sustained into the medium term—appear to mitigate some of the risks associated with high debt. However, EMDEs are also confronted by weak growth prospects, mounting vulnerabilities, and elevated global risks.*
- *A menu of policy options is available to reduce the likelihood of the current debt wave ending in crises and, if crises were to take place, to alleviate their impact.*

**Global waves of debt.** Waves of broad-based debt accumulation have been a recurrent feature of the global economy over the past 50 years. There were three historical waves of debt accumulation: 1970-89, 1990-2001, and 2002-09. Since 2010, another wave has been building. In 2018, global debt reached a record high of about 230 percent of global GDP in 2018 and total EMDE debt reached an all-time high of almost 170 percent of GDP, an increase of 54 percentage points of GDP since 2010 (Figure 1A). The debt buildup in EMDEs in the fourth wave has already been larger, faster, and broader-based than in any of the previous three waves (Figure 1B, C).

**Commonalities and differences among the waves.** The previous three waves of debt began during periods of low real interest rates, and were facilitated by financial innovations and/or changes in financial markets that encouraged borrowing. The waves ended with widespread financial crises that coincided with global recessions or downturns. These crises were usually followed by reforms designed to lower vulnerabilities and strengthen policy frameworks.

**Debt and crises.** Global waves of debt occurred when many countries experienced national episodes of rapid debt accumulation at the same time. About half of these episodes were associated with crises (Figure 1D). Crises were more likely, or the economic distress they caused was more severe, in countries with faster debt buildup, higher external debt and lower reserves. Many EMDEs also had combinations of unsustainable macroeconomic policies and structural and institutional weaknesses.

**Will history repeat itself?** In addition to elevated debt, EMDEs have accumulated other vulnerabilities, such as growing fiscal and current account deficits and a shift toward a riskier composition of debt. They also face challenging growth prospects (Figure 1E). Thus, exceptionally low interest rates, and prospects for their continuation, offer at best precarious protection against history repeating itself and the current wave ending in widespread crises (Figure 1F).

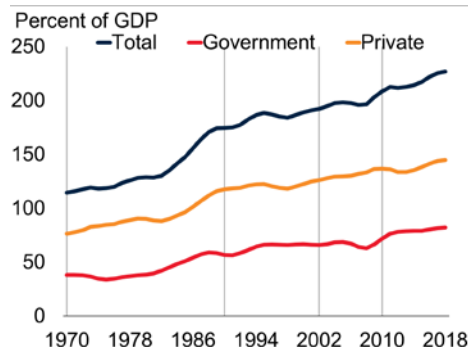
**Policy implications.** Specific policy priorities ultimately depend on country circumstances but there are four broad strands that can help reduce the likelihood of future crises occurring, and to alleviate their impact if they do take place. *First*, sound debt management and debt transparency can help reduce borrowing costs, enhance debt sustainability, and contain fiscal risks. *Second*, strong monetary, exchange rate, and fiscal policy frameworks can safeguard EMDEs' resilience in a fragile global economic environment. *Third*, robust financial sector regulation and supervision can help recognize and act on emerging risks. *Fourth*, effective public finance management and policies that promote good corporate governance can help ensure that debt is used productively.

# Global Economic Prospects

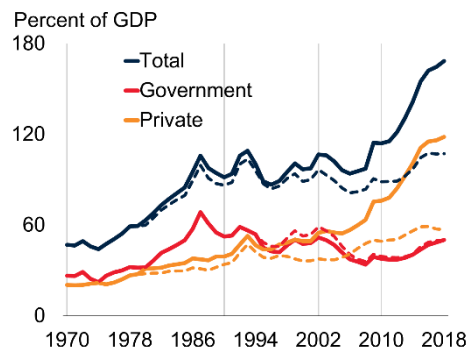
## Figure 1. Debt in EMDEs

Periodic waves of debt accumulation have been a common feature of emerging and developing economies (EMDEs) since 1970. Since the global financial crisis, another wave has been building, with both global debt and debt in EMDEs reaching all-time highs. The latest wave has also seen the largest, fastest and most broad-based increase in debt in EMDEs. Historically, episodes of rapid debt accumulation have often been associated with financial crises. While the current environment of very low interest rates mitigates some of the risks associated with elevated debt, EMDEs also face a number of other vulnerabilities, including repeated growth disappointments and challenging growth prospects.

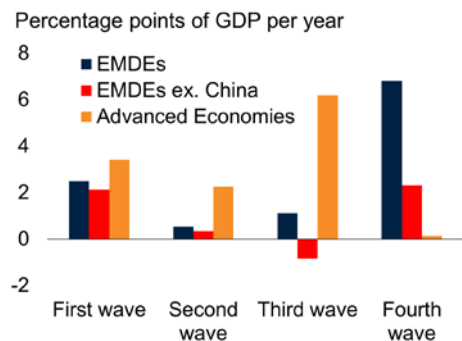
### A. Global debt



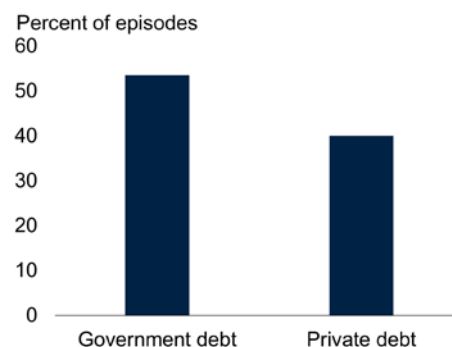
### B. EMDE debt



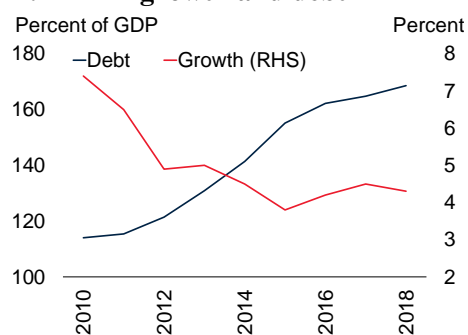
### C. Average annual change in total debt



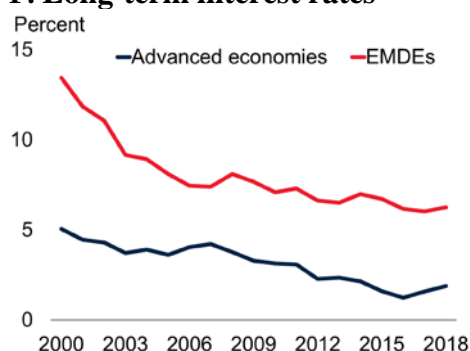
### D. Share of national debt accumulation episodes associated with financial crises



### E. EMDE growth and debt



### F. Long-term interest rates



Source: Haver Analytics; International Monetary Fund; Laeven and Valencia (2018); World Bank.

A.B. Aggregates calculated using current U.S. dollar GDP weight and shown as a 3-year moving average. Gray vertical lines represent start of debt waves in 1970, 1990, 2002, and 2010.

B. Dashed lines refer to EMDEs excluding China.

C. Annual average change calculated as total increase in debt-to-GDP ratios over the duration of a wave, divided by the number of years in a wave.

D. Crisis dates from Laeven and Valencia (2018) and include currency crises, sovereign debt crises and systemic banking crises. Sample period covers 1970-2018.

E. Total EMDE debt (in percent of GDP) and real GDP growth (GDP-weighted at 2010 prices and exchange rates).

F. Average long-term nominal government bond yields (with maturity of 10 years or close) computed with current U.S. dollar GDP as a weight, based on up to 36 advanced economies and 84 EMDEs.