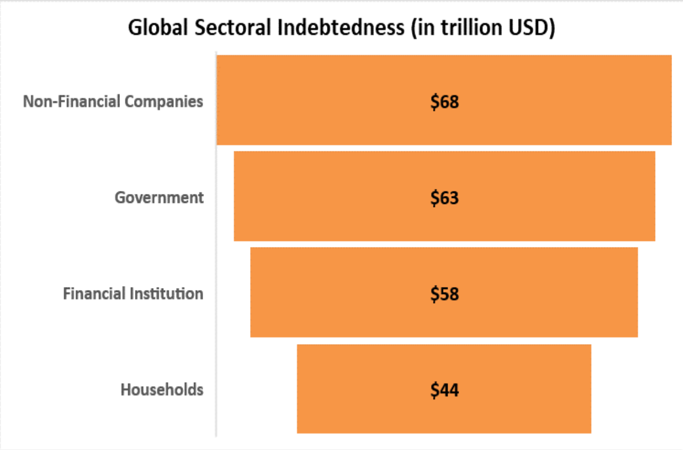
The Roving Scout

DEFICIT + DEBT = DEATH

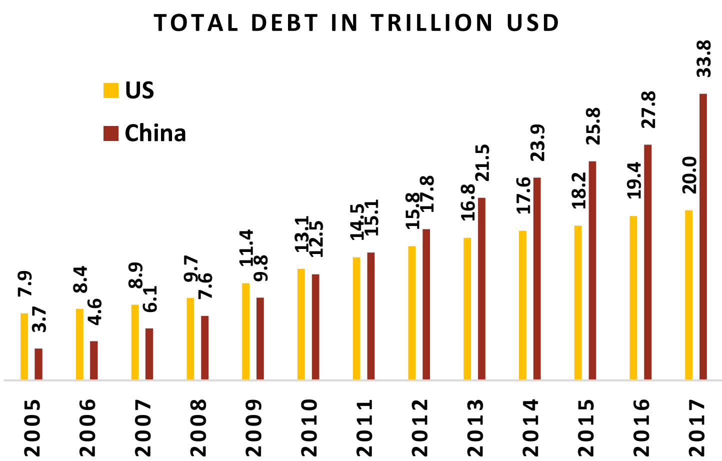
"You Can't Be in Debt and Win. It Doesn't Work" – By Dave Ramsey

Humans by nature are progressive and so are the Economies who desire for uninterrupted growth. The so-called pioneers of global economic growth – the US, China and India – who brag about the strength of their economies have daunting task staring at them the **'DEBT BOMB'.** While, debt-laden economies till date have successfully managed to dose-off the ever-ticking debt bomb but the economies scheduling to cut taxes, increase fiscal spending and curtail deficit all with an uncertain future economic growth outlook seems to be unachievable goal. We in this note try to decipher whether these so-called growth leading economies have true potential to be called leaders of growth and its likely impact on global growth.

BORROWED GROWTH:

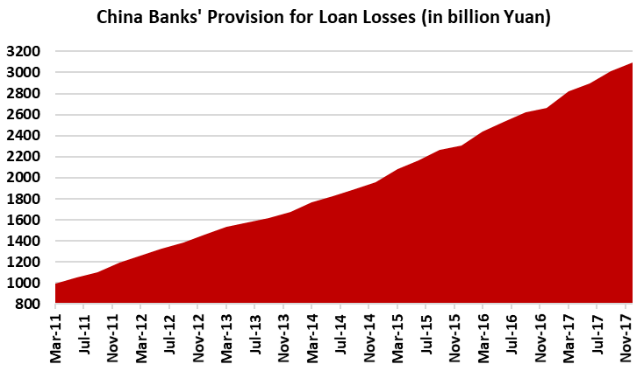


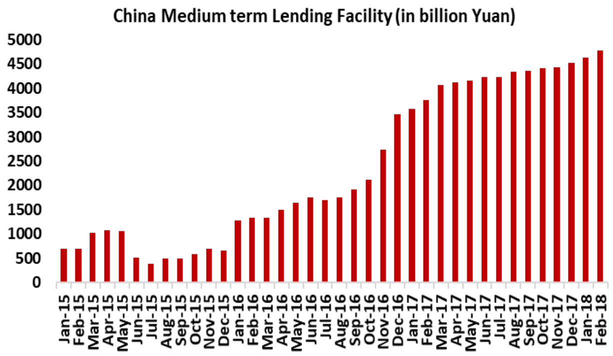
A deficit occurs when expenditure is greater than revenue and accumulation of each year deficit results in national debt. The pioneers of global growth are only amassing further debt and their respective country's trade & economic policies are only going to make the problem worse with the passage of time. The global debt rose to record $233 trillion in Q3'2017, $16 trillion more than year-end 2016. While the debt is on rising trajectory, the worrisome part is the largest chunk of the debt is held by Non-financial companies. Most of the liquidity flushed into the market post US financial crisis was to bailout the large corporations and financial institutions. If the debt was wisely invested servicing the debt wouldn't have been a problem, but with the rising interest rates globally, debt burden will be harder to service especially for the Corporate sector given the largest exposure to overall debt. So, the benefit of corporate tax rate cut which is expected to generate employment and thereby support growth looks dismal.



Next in line are the governments who have guarded their economies by borrowing heavily with every passing year to stay afloat. While, govt.'s has advantage to raise money through increasing the taxation and can often print money by over borrowing themselves and avoid running funding crisis. But currently govt.'s are reducing taxes (US & China) or have undergone drastic change in tax regime (India) which should upshot revenue deficit. Also increase in fiscal spending will result in ballooning deficit. Since govt.'s does not have any fix lifespan it ideally allows them to rollover their debts indefinitely. In 2017, US federal budget deficit was $665 billion and is expected to touch $1 trillion in 2019. This has resulted in high US debt and has already crossed $20 trillion-mark last year. Rising deficit is a big concern for treasuries as they must sell more treasury bonds to raise money and cover their deficit. Add to it the interest govt.'s has to pay to service these debts. All seems very patchy and will have negative impact on US GDP growth.

China on other hand has bad track record for debt. While, its Govt. debt as percentage of GDP (36%) has been constant, its accumulation of debt by Corporate (160%) and Consumer sector (49%) has risen sharply in past decade. Non-financial sector which is the backbone of generating employment holding such huge debt is big concern from economic stability point of view. China's total debt as percentage of GDP has increased to 266% in 2017 and is expected to increase further as it attempts to cut tax of 800 Billion Yuan ($126 billion) for companies and individuals. China debt has jumped to $33.8 trillion in 2017. While China has been making efforts to deleverage its economy, the signs of liquidity stress among banking sector are clearly visible with its provision for loan losses has increased substantially. This has also led to increase in money being pumped by Chinese Central bank into the system in form of short & medium-term lending facility. With trade war expected to cause major havoc, China's growth outlook looks bleak.





India's fiscal discipline has always been topic of contention for ages now. The chest-thumping Demonetization and GST reforms are yet to bear concrete fruits. Govt.'s revenue generation via tax and non-tax avenues depends on many factors which are beyond the govt.'s control like healthy economic growth; lower inflation etc. If the revenues fall short of the targets, govt. shall try to achieve deficit targets by reducing expenditure. While, this may not be right solution, given the rising concerns of unemployment already putting pressure on govt. to increase capex. The overall Capex as a percentage of GDP is falling to 5.2% in FY19 from 5.6% in the previous year is major cause of concern going ahead. There could be additional pressure on food subsidy given the higher MSP announced by govt. in recent budget. This should also lead to rise in inflation in medium-term providing no respite from lower interest rates by India's Reserve Bank. Farm loan waivers and cuts in value-added tax on petrol and diesel by many states would further add to state's fiscal deficit problem. Patchy revenue receipts and compulsion on govt. to not to cut the fiscal spending should increase deficit in medium-term. India's fiscal deficit (Apr.17 – Nov.17) has already reached 112% of the targeted deficit and will only increase govt. debt in near future.

TWIN DEFICIT: Means situation where economy is running both fiscal deficit and current account deficit. Now except China, both US and India run twin deficits. China which is known for being currency manipulator has never run current account deficit (imports more than exports) except few instances. But with rising trade protectionism among economies especially from US which is putting trade sanctions on some commodities and renegotiating trade agreements with economies who are running trade surplus against US are likely to retaliate strongly by putting befitting trade sanctions against US. China which is major consumer of global commodities is likely to face more trade sanctions from US. The Trump administration could slap tariffs on China on technology, apparel and other imports. Under consideration are also investment and visa restrictions. If implemented, China could run twin deficit in years to come which could also have negative impact on China's GDP and even worst impact on global commodity prices. While the extent of slump in commodity prices depends on the destruction the trade war could create across the global markets. But nevertheless, GDP slowdown seems to be unavoidable.

<u>CONCLUSION:</u> Governments across globe are fueling up the economy with tax cuts and higher fiscal spending at the same time are increasing interest rates to slow it down – HOW IRONIC!!! Someone somewhere has to give up we believe following things could happen:

- Slowdown in raising US Federal interest rates from 4 times to 3 times if not 2 times in 2018 – as raising interest rates could trigger fear of recession if it tightens credit too much

- Dollar to remain weak given the rise in US debt and trade war to impact the currency movement too and should keep commodity prices volatile

- Trade protectionism to keep commodity prices volatile and could see decline in seaborne import demand for commodities

- China likely to run twin deficit in medium-term. Rising debt to further weaken the GDP growth even below 6% against Chinese govt. target of 6.5% if not in 2018 then next year

- Trade war to have impact on global trade and could negatively impact shipping industry in lower charter rates