RESILIENCE IN A TIME OF HIGH DEBT

PRE-RELEASE OF THE SPECIAL CHAPTER OF THE OECD ECONOMIC OUTLOOK

(To Be Released on 28th November at 11.00am CET)

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www.oecd.org/economy/economicoutlook.htm
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BETTER POLICIES FOR BETTER LIVES

Key messages

Private sector indebtedness is at historically high levels

- Private debt has remained high since the crisis in advanced economies (AEs), it increased in emerging market economies (EMEs)
- Bond markets expanded, international debt issuance rose, credit quality decreased
- Household debt is linked to an upsurge in house prices in some AEs and EMEs

High debt can entail financial risks and erode medium-term growth

- As financial conditions tighten, rollover and debt service risk are high
- Highly indebted households and lenders are vulnerable to real estate price reversals
- Heavily indebted firms can become “zombies”, lowering productivity

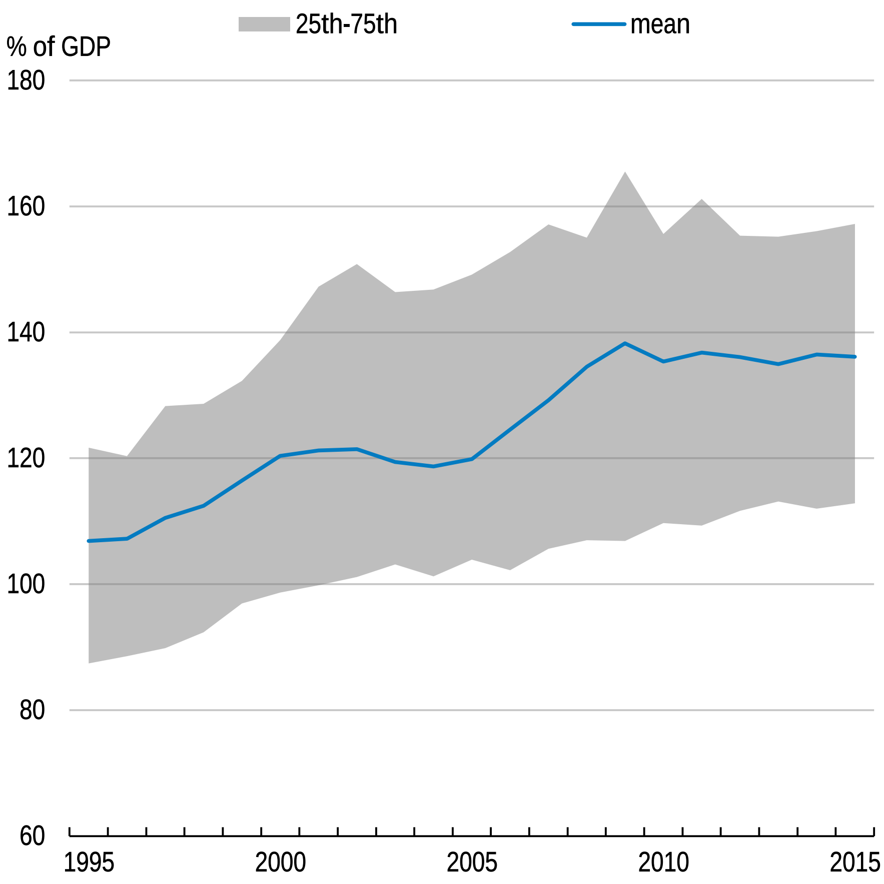
Policies to enhance resilience and to improve growth are needed

- Address macroprudential policies to financial risk, but without penalising growth
- Focus policies to reduce bias toward home ownership and to increase housing supply
- Reduce debt bias in corporate taxation and help development of equity markets
- Improve insolvency regimes to promote dynamism and bank health

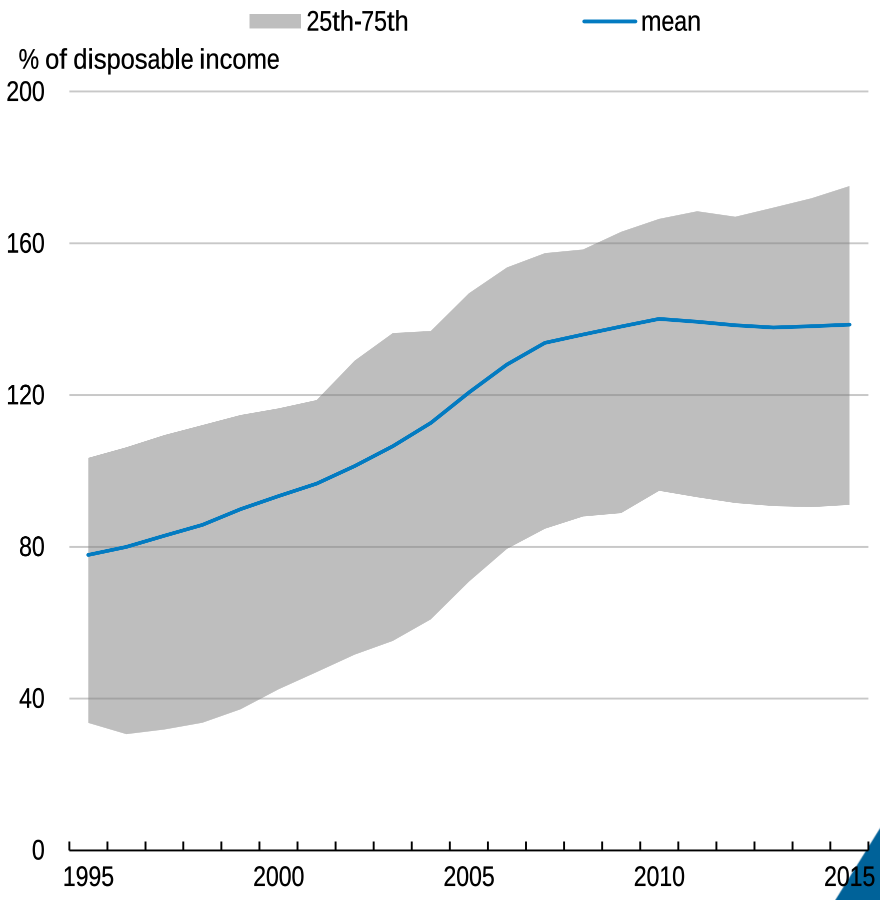
HIGH PRIVATE SECTOR DEBT AND CHANGES IN THE STRUCTURE OF FINANCE RAISE CONCERN

Private debt ratios have been trending since the 1990's

Non-financial corporate debt
OECD countries



Household debt
OECD countries

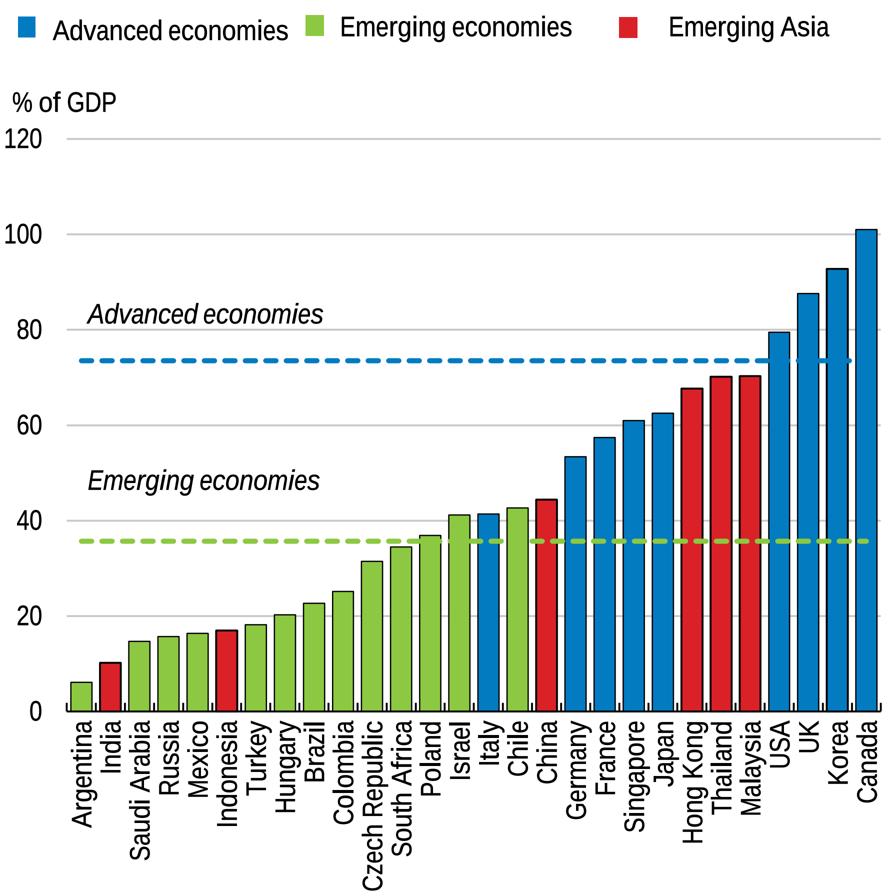


Note: Simple average of OECD members for which data are available through the entire time sample: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, the Netherlands, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, the United Kingdom, the United States, Chile, Estonia, Israel, Slovenia and Latvia. Shades show country distribution between the 25th and 75th percentiles.

Source: OECD.

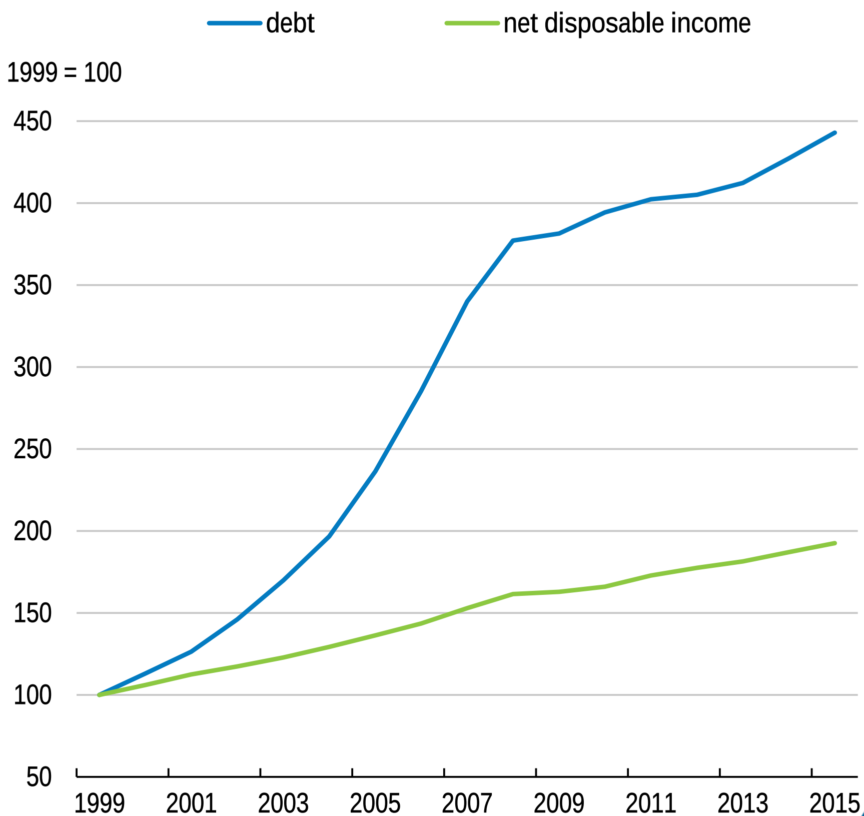
Household debt is high in many advanced and rising in some emerging economies

Credit to households
2016Q4



Source: Bank of International Settlements.

Evolution of household debt and disposable income

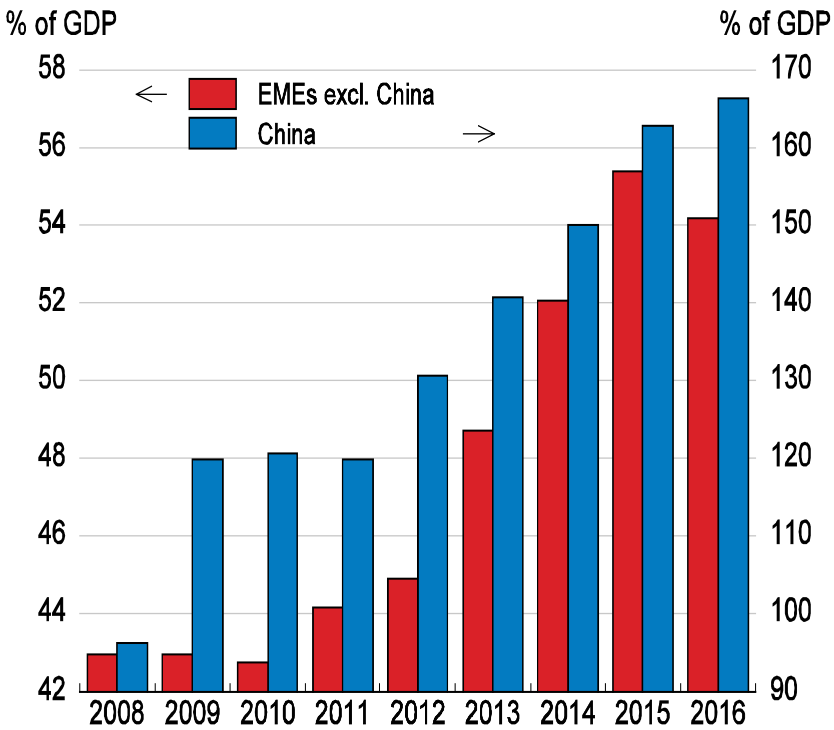


Note: Simple average of Australia, Austria, Belgium, Canada, the Czech Republic, Germany, Denmark, Estonia, Finland, Hungary, Italy, Japan, Netherlands, Norway, Slovak Republic, Spain, Sweden, Switzerland and the United States.

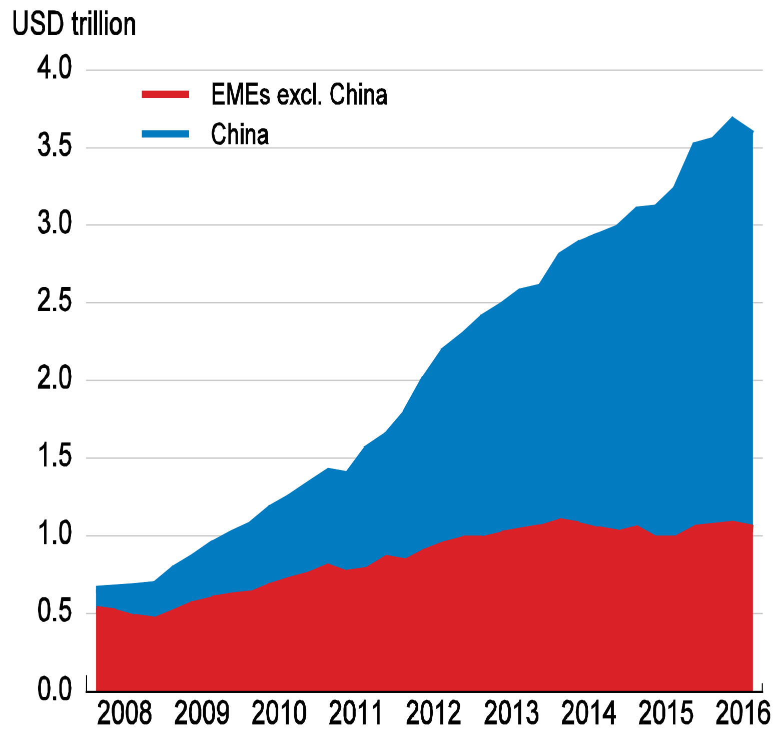
Source: OECD and OECD calculations.

Corporate indebtedness is rising in EMEs, especially in China

Corporates in EMEs accumulated significant debt



China was the main driver of the expansion in EMEs non-financial corporations' debt market

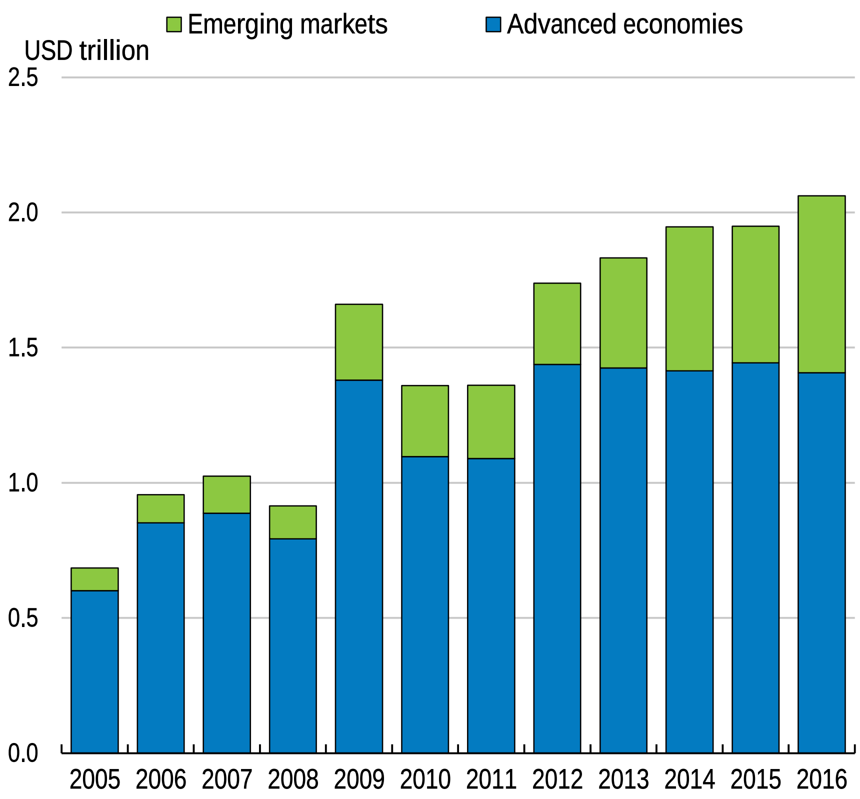


Note: Corporate debt for major EMEs. Countries included are Brazil, Chile, China, Colombia, Hong-Kong – China, Hungary, Indonesia, India, Mexico, Malaysia, Poland, Russia, Singapore, Thailand, Turkey and South Africa. Debt includes total credit to non-financial corporations issued by all sectors and outstanding debt securities.

Source: Bank for International Settlements.

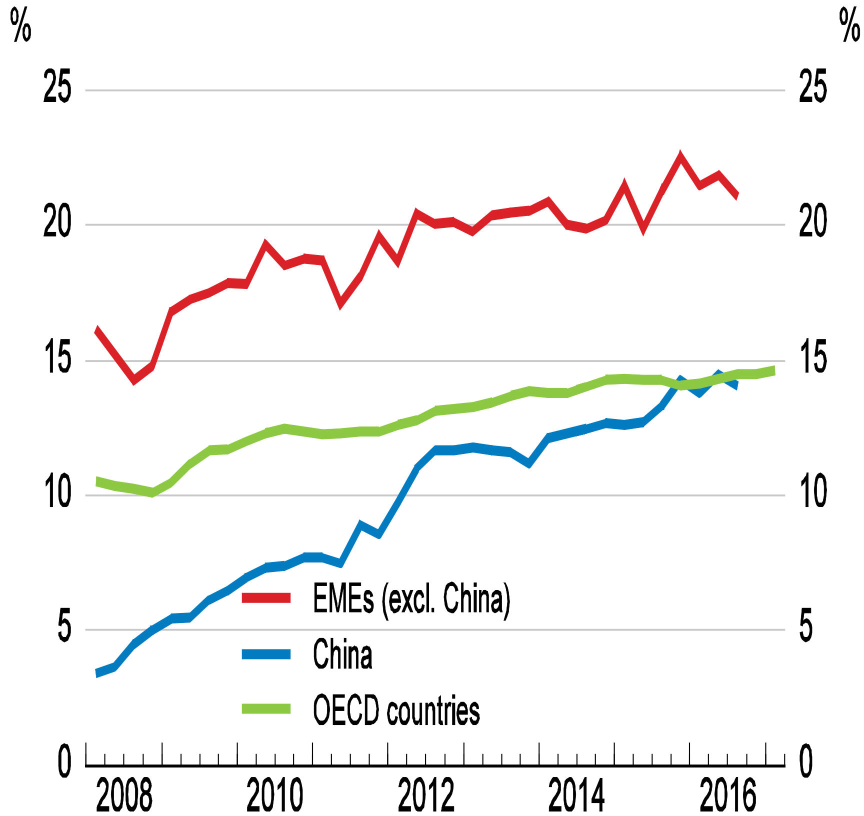
Risks have shifted from banks to bond markets

Gross bond emissions of NFCs



Source: OECD Business and Finance Scoreboard 2017.

Share of debt securities on core debt

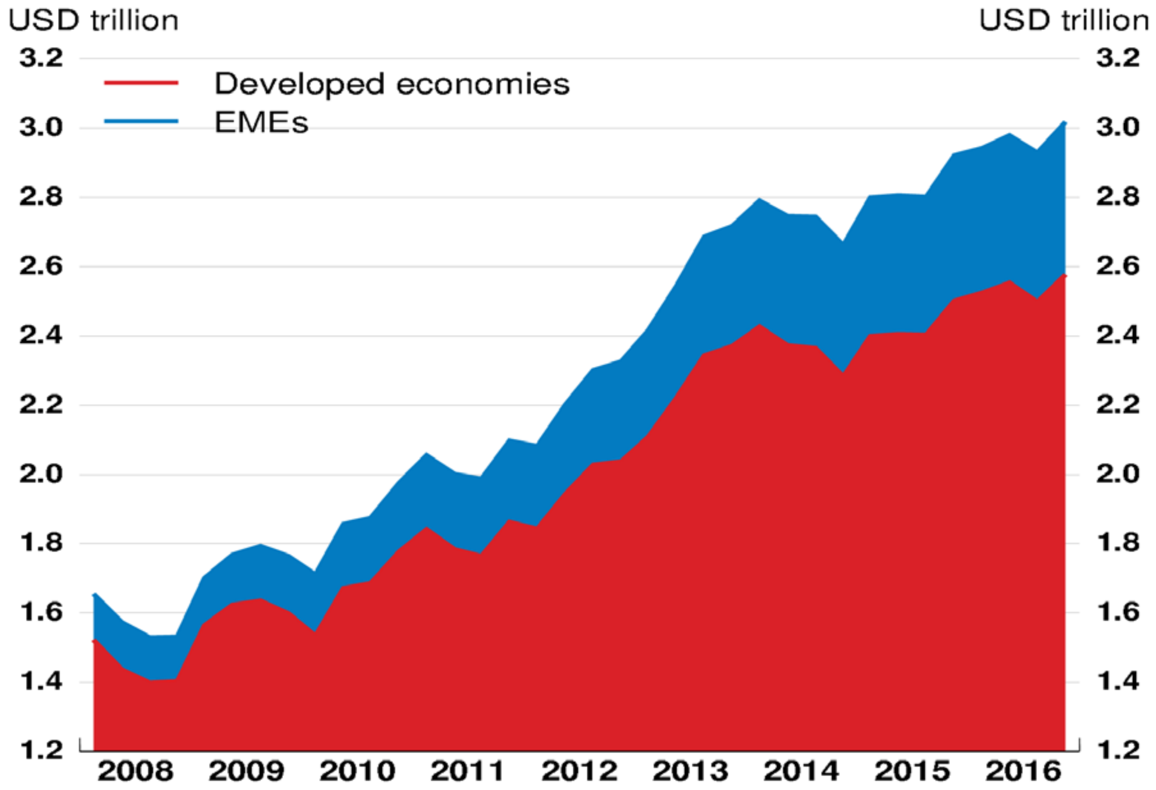


Note: Core debt comprises loans, debt securities, and currency and deposits.

Source: OECD Business and Finance Scoreboard; and OECD calculations.

International bond issuance has increased

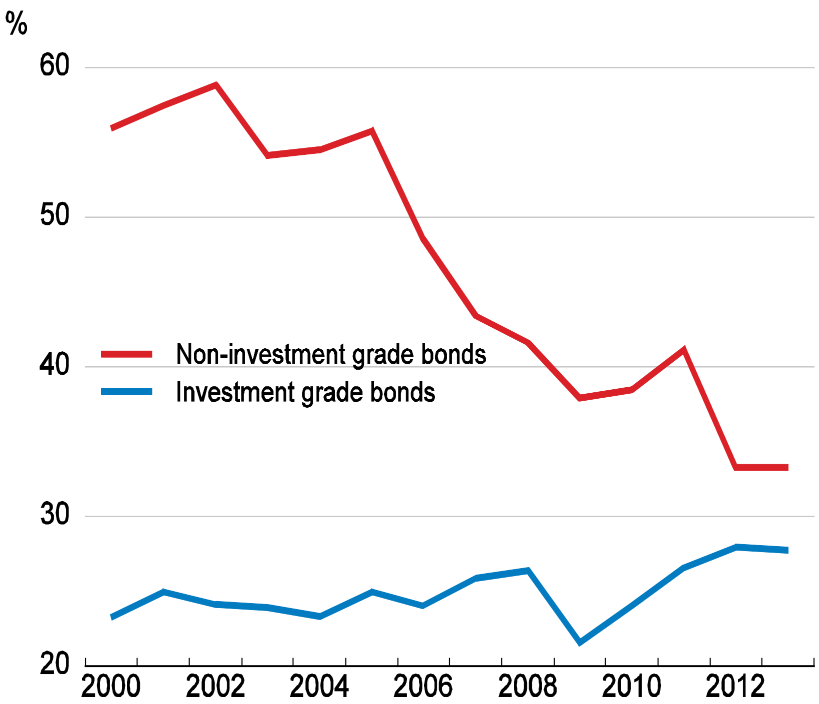
Corporate bond issuance outside domestic markets



Source: Bank for International Settlements; and OECD calculations.

Credit quality of corporate debt has declined in a context of favorable financial conditions

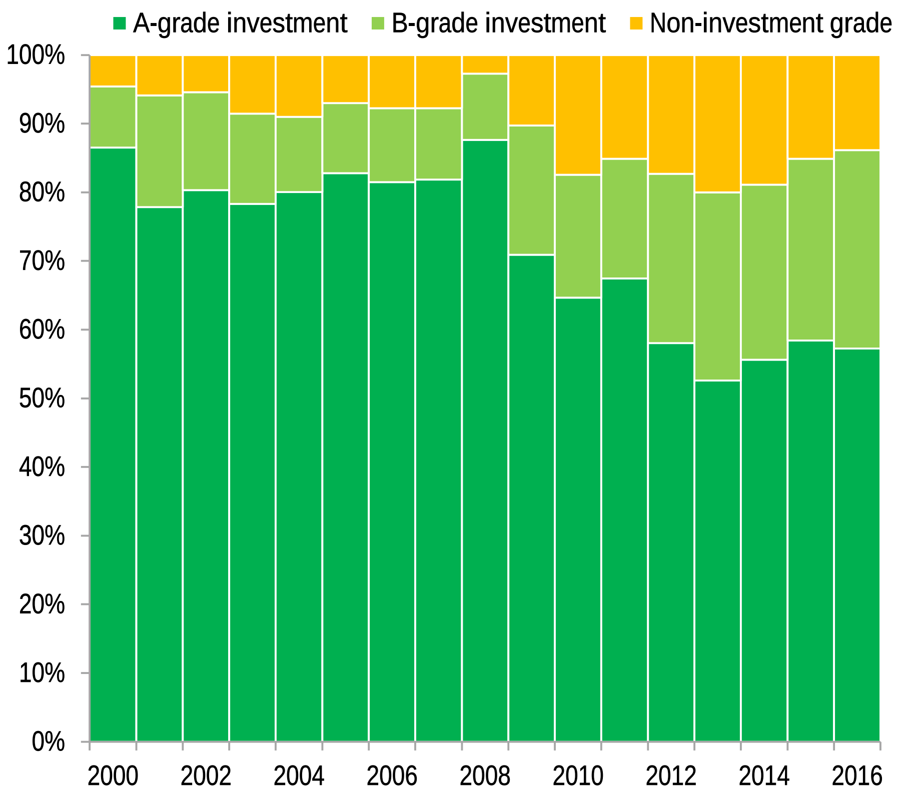
Covenant protection has decreased
Advanced and EMEs



Note: The covenant index is constructed considering a list of 15 covenants which are coded in a binary variable reporting 1 if the covenant type is available in the bond indenture. The sum of the binary variables, divide by 15 and multiplied by 100 generate an index that ranges from 0 to 100, with 100 denoting the highest possible protection for bondholders. It should be noted that this index provides only a rough measure of covenant quality, since the measure changes based only on the existence or non-existence of a given covenant.

Source: OECD Business and Finance Scoreboard, Çelik et al., 2015.

Credit quality has deteriorated
Share of bonds, Advanced and EMEs

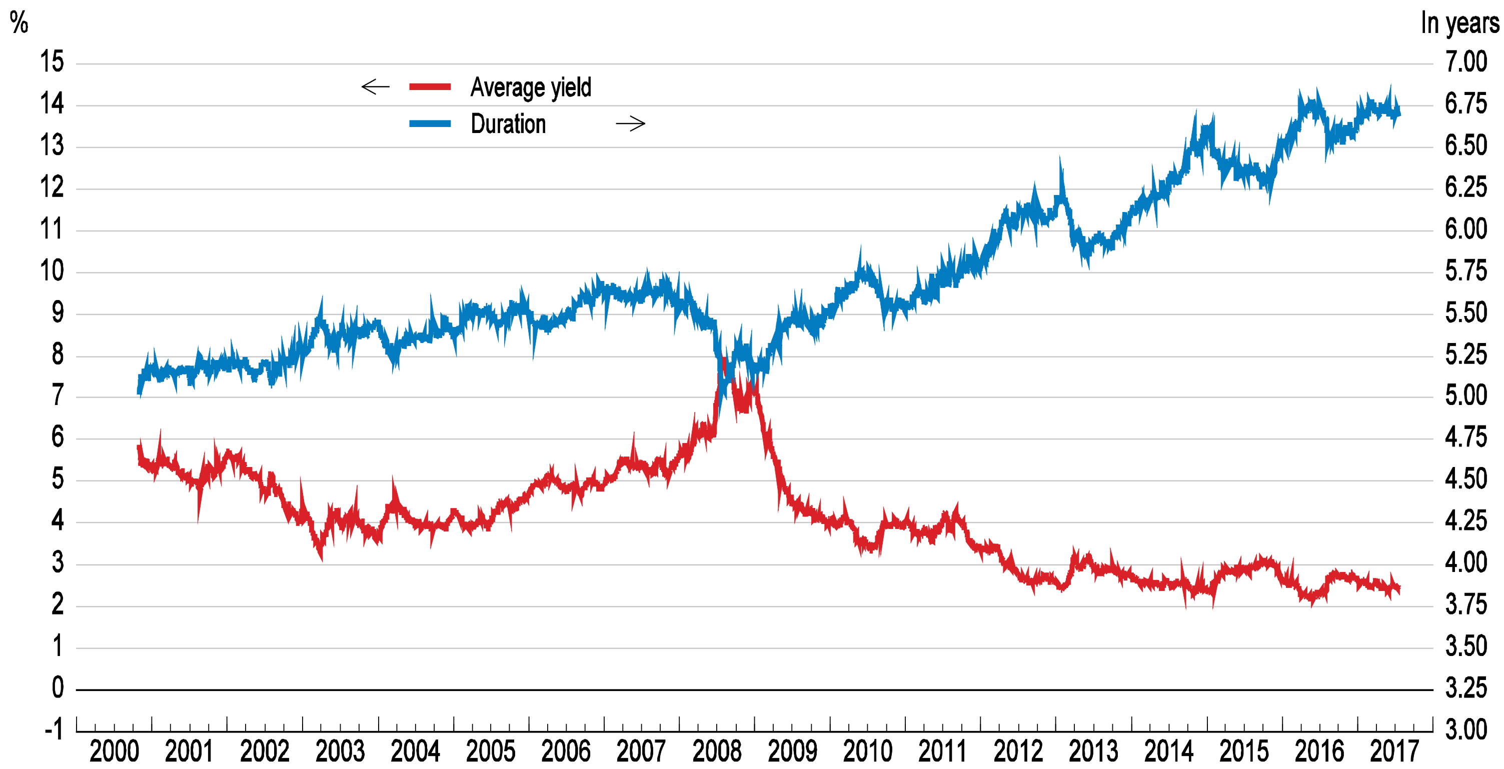


Note: A bond is considered investment grade if its credit rating is from AAA to BBB- (Standard & Poor's and Fitch) or from Aaa to Baa3 (Moody's). Non-investment grade bond are all other bonds with credit rating BB+ or lower (Standard & Poor's and Fitch) or Ba1 or lower (Moody's).The chart shows in different shadows of green, investment grade bond, in yellow and red non-investment grade bonds.

Source: OECD Business and Finance Scoreboard.

Duration risk has never been higher

Corporate bonds duration and average yield



Note: Duration and average yield refer to the Bloomberg Barclays Global Aggregate Corporate Index. This is a flagship measure of global investment grade, fixed-rate corporate debt. This multi-currency benchmark includes bonds from developed and emerging markets issuers within the industrial, utility and financial sectors.

Source: Bloomberg; and Barclays.

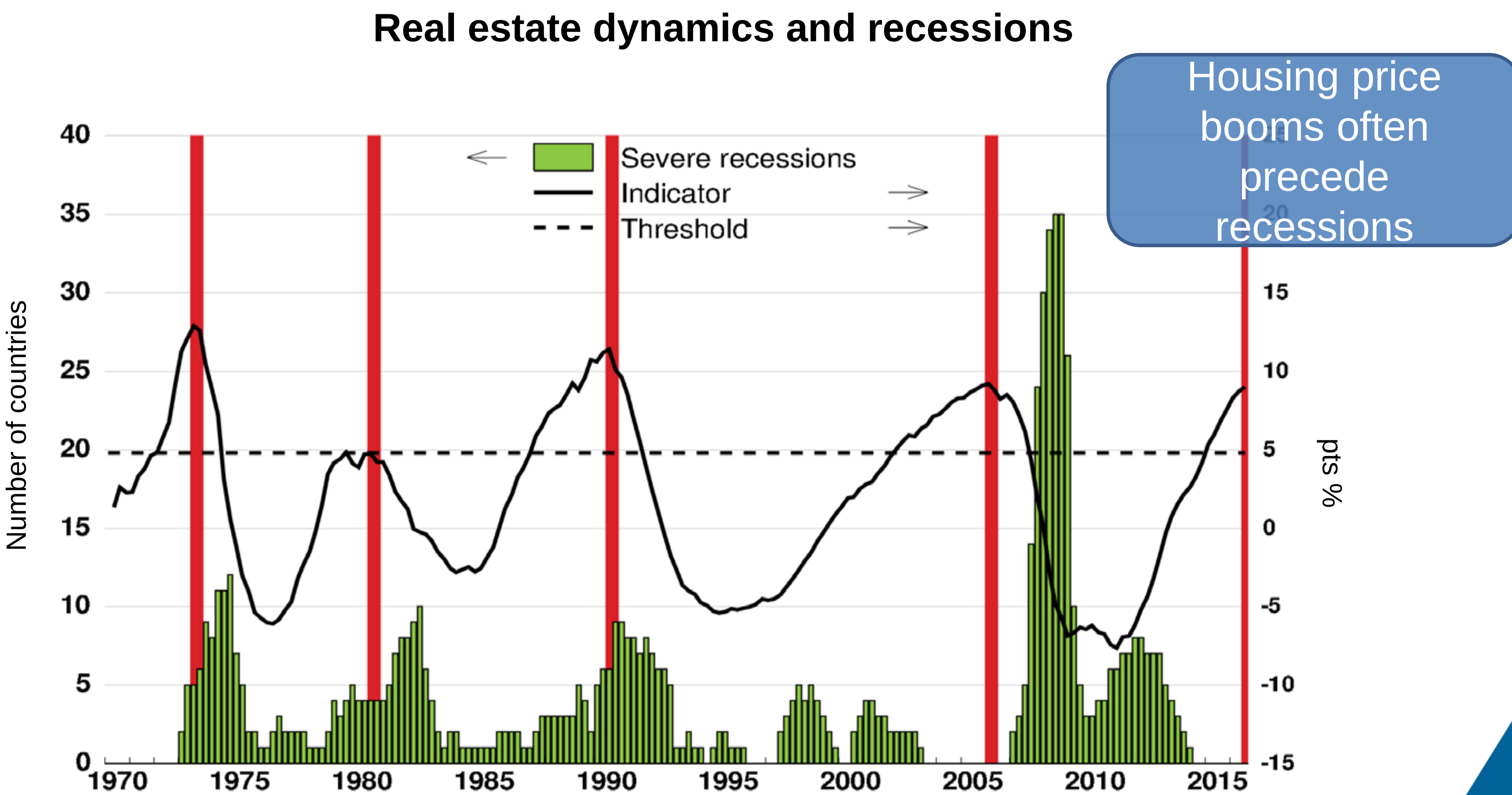
FINANCIAL VULNERABILITIES AND CONCERNS FOR MEDIUM TERM GROWTH

High indebtedness rises financial vulnerabilities

Financial vulnerabilities

- High debt increases ***rollover*** and ***credit risk***, especially as financial condition tighten
- The expansion of international bond markets and foreign-currency borrowing exposes borrowers to more ***foreign exchange risk*** and increases the ***risk of international spillovers***
- On the asset side, bond holders are now exposed to record levels of ***duration risk***, implying that bond value are very sensitive interest rate changes
- Indebted Households are exposed to higher ***debt servicing risk***

Household debt and housing cycles can lead to prolonged recessions

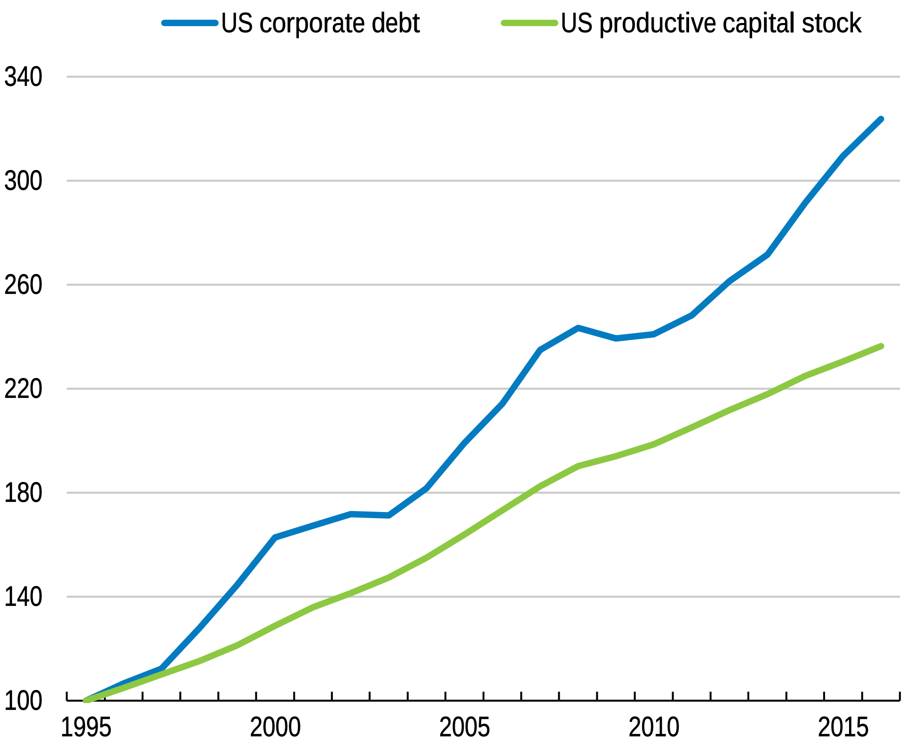


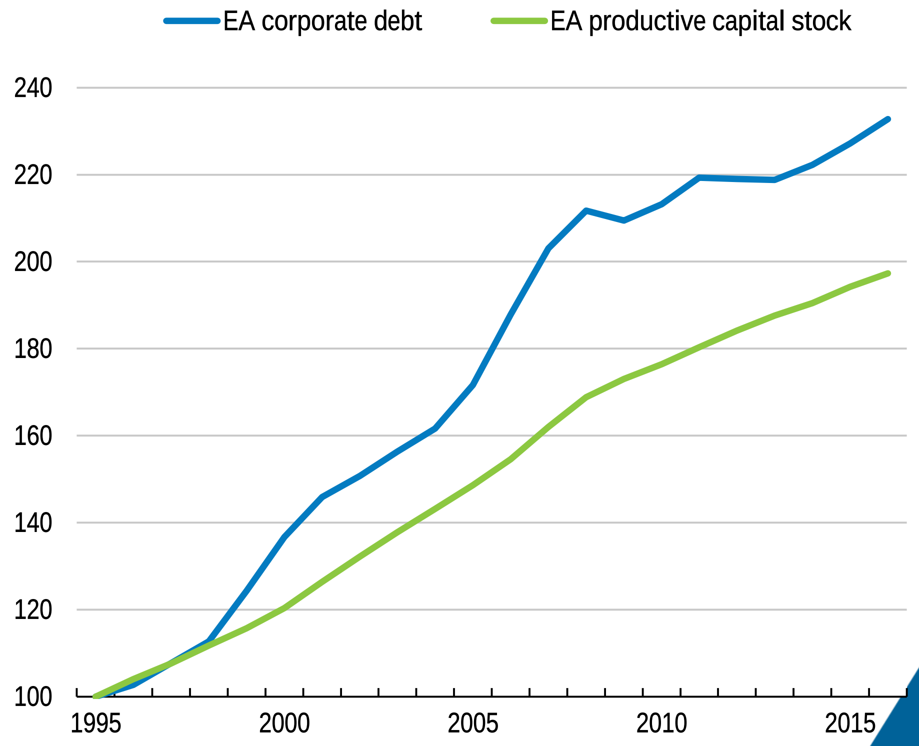
Note: Grey areas represent the number of countries identified as being in a severe recession. The global real house price index is constructed as a GDP-weighted average across OECD countries and is measured as deviation from trend.

Source: Hermansen and Röhn (2017).

The allocation of capital is critical to medium term growth sustainability

The expansion in corporate debt has far outpaced investment



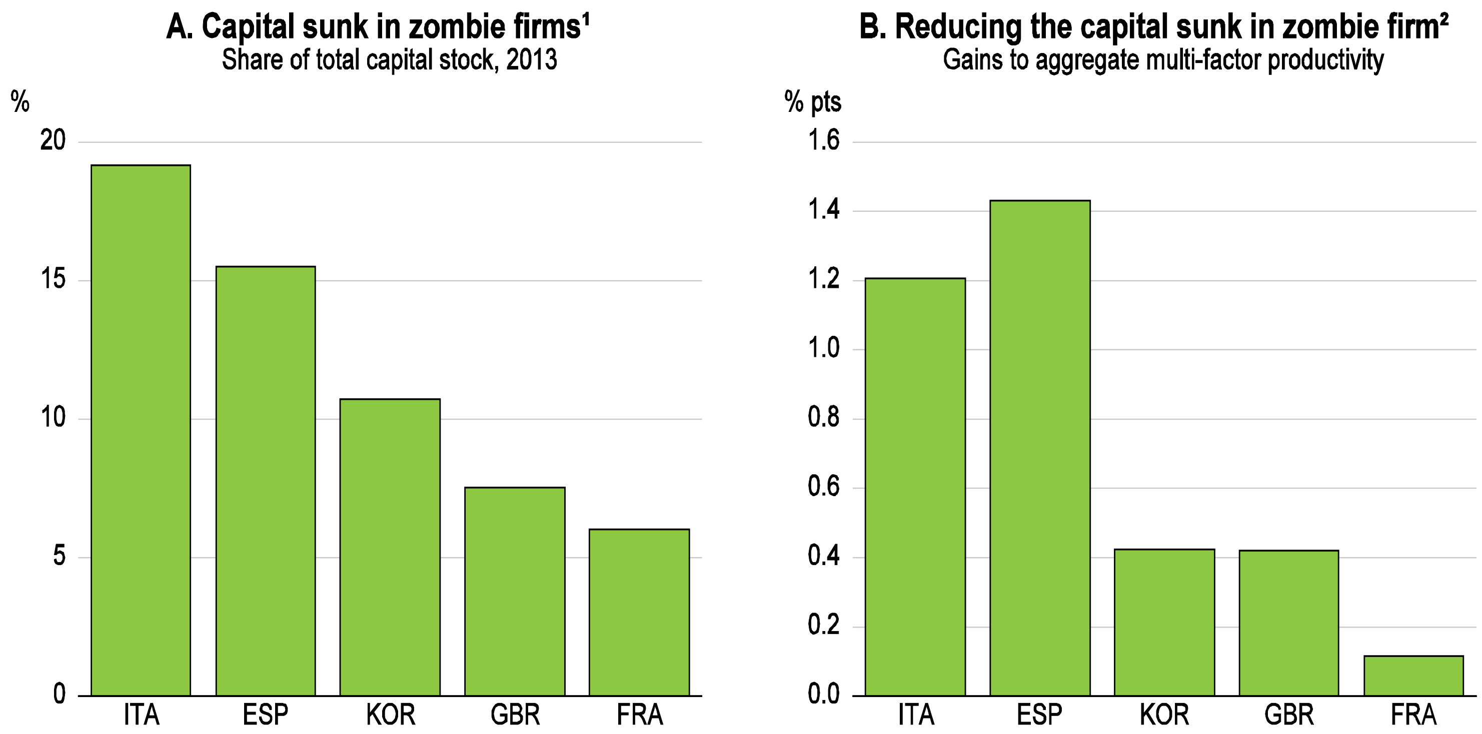


Note: Euro area based on countries for which data are available through the entire time sample: Austria, Belgium, Germany, Spain, Estonia, Finland, France, Greece, Italy, the Netherlands, Portugal and the Slovak Republic.

Source: OECD and OECD calculations.

Heavily indebted firms can become "zombies" lowering productivity for the economy

The zombie congestion effect

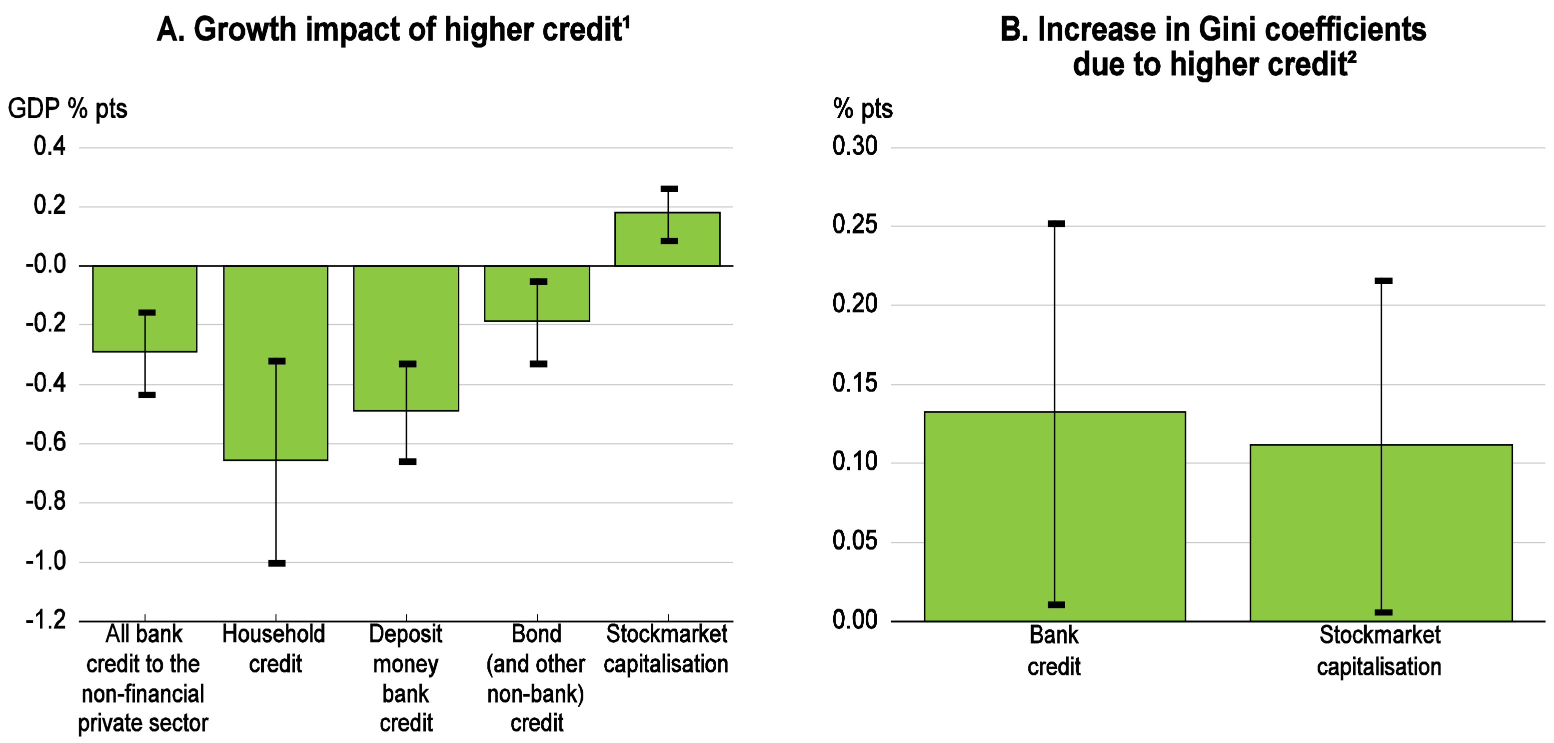


Note: Zombie firms are aged 10 years or more and with profits not covering interest payments over three consecutive years. The sample excludes firms that are larger than 100 times the 99th percentile of the size distribution in terms of capital stock or number of employees.
Counterfactual gains to aggregate MFP from reducing zombie capital shares to industry best practice level.

Source: Adalet McGowan, Andrews and Millot (2017); and OECD calculations.

Too much, or the wrong kind, of finance reduces medium-run growth and equality

Finance and inclusive growth in the medium-run



Note: The error bars show 90% confidence intervals.
1. For an increase in credit or stock market capitalisation equivalent to 10% of GDP.
2. Impact on the Gini coefficient, for an increase equivalent to 10% of GDP.

Source: Cournède and Denk (2015).

INTEGRATED POLICIES TO ENHANCE RESILIENCE AND FOSTER MEDIUM TERM GROWTH

Policies to increase resilience and foster medium-term growth

Reduce the debt bias in corporate taxation

Use prudential policies to prevent unsustainable credit dynamics, without penalising growth

Strengthen the incentives to develop equity finance by reducing the debt bias in corporate taxation

Enhance the efficiency of capital re-allocation by improving insolvency regimes

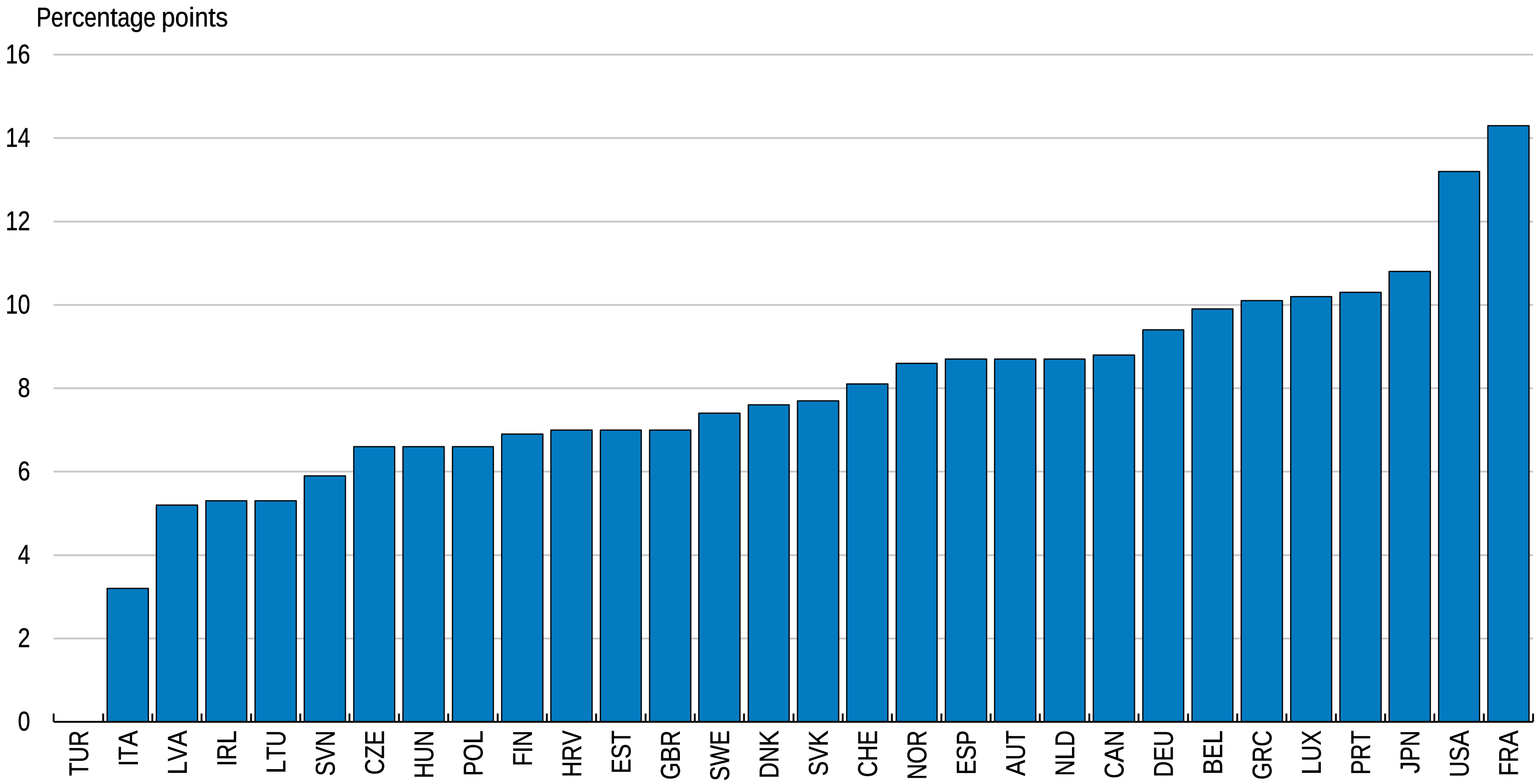
Step up coordinated monitoring and supervision of non-bank activities

Reduce implicit home ownership subsidies and mortgage interest deductibility. Consider expanding housing supply

Reduce the tax bias towards debt to mitigate risks and boost productivity

Debt-equity bias

Effective average tax rates on new equity minus debt, 2016



Source: Center of European Economic Research (ZEW, 2016).

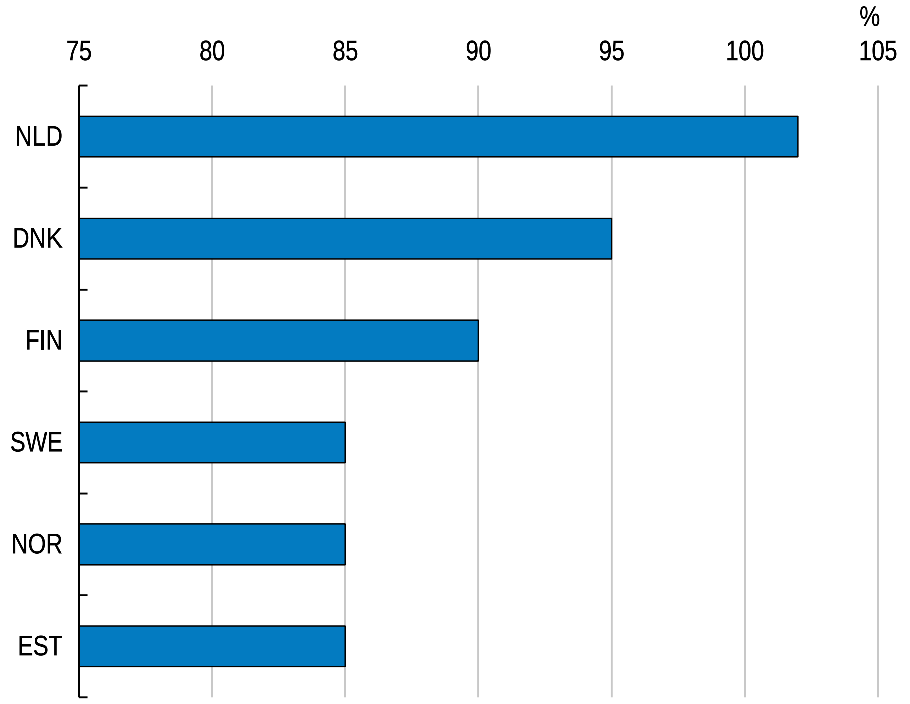
Address vulnerabilities arising from household debt

Recent OECD recommendations

Policy area	Countries
Macro- and micro-prudential measures	AUS, CAN, CHE, DNK, GBR, ISR, LUX, NZL, NOR, SVK, SWE, CHN, RUS.
Housing policies	AUS, CHE, FIN, DNK, GBR IRL, LUX, NLD, POL, SVK, SWE.
Tax policies	CHE, DNK, LUX, SWE.

Source: OECD Economic Surveys and Going for Growth 2017.

Loan-to-Values limits recently adopted



Sources OECD Economic Surveys.

Resources

[Economic Outlook](#) [ECOSCOPE blog](#) [Economic Resilience](#)

OECD
Economic Outlook 102

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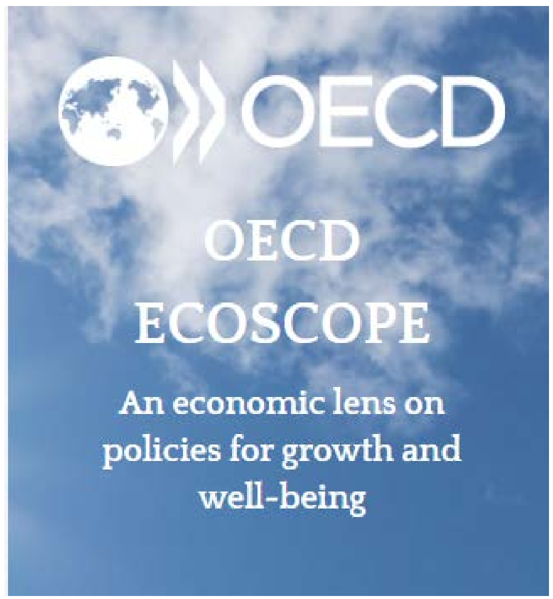

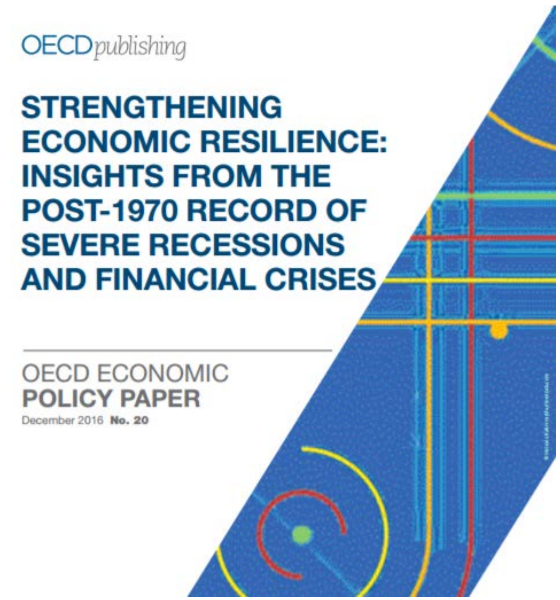

Other information

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