Commentary: US Fed rate hike, stronger dollar aggravate global debt risk
By Gao Haihong

Global debt ended the first quarter at a record $247.2 trillion, up 11.1 percent from the same period last year, where non-financial corporate debt ($74 trillion) held the largest amount, according to latest data released by the Institute of International Finance (IIF).

The heavy debt was accumulated in a loose financing environment for years. The ultra long-term policies of low interest rates adopted by many countries have substantially expanded their credit and lowered corporate borrowing costs.

Fiscal stimulus also encouraged governments and corporations to increase debt, making cheap loans enter the market and raising levers. The financial cycle signified by credit expansion and the rise in asset prices entered an upward period ahead of the business cycle, and asset bubbles were soon formed.

There will be a great deal of risks brought by the accumulated global debt.

High debt has restrained the adjustment room of fiscal policies. Experience suggests that economies bearing higher public debt and severe financial deficit will face a comparatively longer recession period. That's because a downward economy needs the support from fiscal policies but the heavy public debt would restrain the effectiveness of policies.

Heavy debt burden may lead to a financial crisis. Regarded as a main indicator of financial fragility, debt burden is closely related to the health of a country's banking system and has an impact on asset prices, investment and consumption.

For countries with greater openness of capital accounts, domestic financial fragility will soon send a warning to the financial market, causing capital outflow and currency devaluation. The capital outflow and currency depreciation in Argentina, Brazil, Turkey and other countries in recent years were all related to the above reason.

The interest rates hike announced by the US Federal Reserve and a stronger US dollar worsen the debt challenges. The rising interest rates would place a heavier burden on interest repayments, and enormously impact floating rate notes.

It's estimated that floating rate bonds account for more than 10 percent of corporate debenture in emerging markets. The appreciation of the US dollar has heightened the risk for emerging markets to repay the bonds in the dollar, as the dollar accounts for a dominant 80 percent of their foreign-currency funding.

Furthermore, a capital outflow will threaten emerging markets since their currencies would be weak against the dollar. Countries with current-account deficits and inadequate foreign exchange reserves will have to face the risk of dual crisis in currency and debt. Emerging markets debt has climbed to a record high of $58.5 trillion.

It’s hard to ease the global debt burden in a short term. The tax reform in the US will substantially reduce tax revenues of US federal government, thus adding pressure on the country’s finance in the long run.

The gross debt of emerging economies accounts for half of their total GDP figure. Latin American debt has been at a high point since the 1980s, with some low-income countries under heavy interest burden.

Various measures are needed to curb the breakout of a debt crisis, such as maintaining the robust economic growth. The global economy is currently in a rising period, creating a favorable condition to avoid a debt crisis.

Unnecessary fiscal stimulus should be avoided and a plan to pare debt and lower deficit should be mapped out. In addition, fiscal reforms should be carried out so as to optimize the tax system and improve productivity with human capital and physical capital.

Changing the currency structure of foreign debt is also effective to avoid too much exposure to the risks caused by relying on a single currency. Meanwhile, measures such as improving external balance, monitoring exchange rates and capital flows, and seeking bilateral cooperation or assistance from international financial institutions when necessary should also be taken to stop a debt crisis from breaking out and spreading.

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