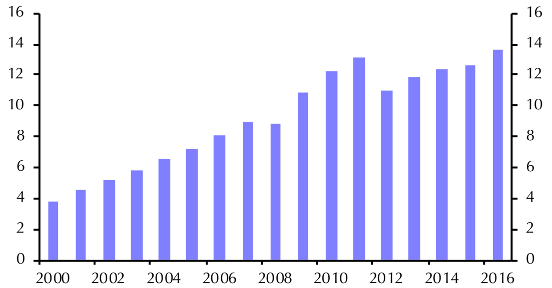
EMERGING MARKETS ECONOMICS UPDATE

Time to worry about rising EM sovereign debt?

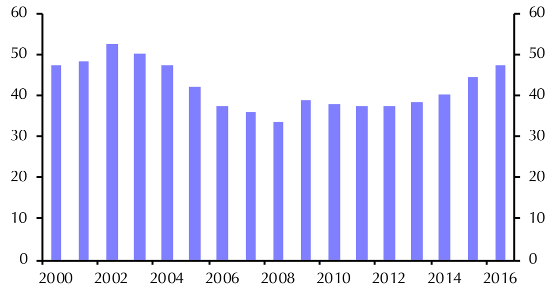
- **The fact that aggregate EM sovereign debt has now surpassed $11.7trn has grabbed a few headlines but several factors – notably the increase in EM GDP over the past decade – mean that fiscal risks are lower than the dollar numbers on sovereign debt otherwise suggest. Looking ahead, three things are worth watching for over the next couple of years.**
- According to a new report by the Bank for International Settlements, EM sovereign debt is now running at $11.7trn. Defining what counts as sovereign debt is ultimately subjective – for example, how should the liabilities of state companies be accounted for? **But for what it's worth our own analysis puts aggregate EM sovereign debt at $13.6trn. This is up from $3.8trn in 2000**. (See Chart 1.)
- The key point however is that the ability of EMs to service higher debt loads has improved. Around 75% of EM government debt is now issued in local currency, up from 69% in 2000. Average maturities have lengthened. For example, the average maturity of Brazilian government debt in 2002 was 3½ years but it has now risen to 6½ years.
- Most importantly, EM GDP has grown significantly over the past 15 years – meaning the flow of income available to service government debt has also increased. As a share of aggregate GDP, EM government debt was actually lower last year than it was in 2000, albeit only marginally (47.3% of GDP compared with 47.5% of GDP). (See Chart 2.)
- That being said, while immediate fiscal risks are low, three things are worth watching over the coming years. **First, while the burden of foreign currency debt has fallen in most EMs, this is not true across the board**. Argentina stands out in this regard following a recent jump in the issuance of dollar-denominated debt. This leaves the government balance sheet vulnerable to further falls in the peso, and means the risks of another fiscal crisis over a three-to-five-year horizon have increased.
- **The second thing to watch for is how EMs tackle large budget deficits.** The stock of existing debt is manageable in most EMs, but the flow added by substantial deficits is worrying in several cases. A related problem here is that EM GDP growth is likely to be structurally weaker over the coming decade, meaning the size of deficits that are 'sustainable' has potentially fallen. This is not yet an issue given the low level of global bond yields. But a global bond sell-off would start to present problems for several EMs, notably Brazil and Egypt.
- **The final thing to keep an eye on is the evolution of private debt.** The experience of developed markets over the past decade shows how private liabilities can transfer to the public sector as credit bubbles unwind. China is the obvious concern here, but we also think that private debt risks in Turkey are being underplayed. (See our *Emerging Europe* service for more details.)

Chart 1: EM Sovereign Debt (US$trn)



Sources: IMF, Capital Economics – This estimate is based upon a sample of 66 Emerging Market economies.

Chart 2: EM Sovereign Debt (As a % of GDP)



Sources: IMF, Capital Economics – This estimate is based upon a sample of 66 Emerging Market economies.

Neil Shearing, Chief Emerging Markets Economist, +1 646 934 6162, neil.shearing@capitaleconomics.com


TORONTO
NEW YORK
LONDON
SINGAPORE
SYDNEY