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Sovereign Nations' Debt to GDP Ratios: The Impact on Global Economic Growth

The Eurozone economic crisis has become the main global focus of many investors as the various Eurozone countries attempt to resolve how to re-structure their debt, address national economic agreements, and confront the reality of their plight. The higher productivity, lower debt to GDP ratio, and high national employment countries, like Germany, remain at odds with their Mediterranean neighbors' lower productivity, high government debt to GDP ratios, high unemployment, and seemingly less urgent attitudes towards resolving a number of critical issues.

The Eurodollar crisis is the direct consequence of the massive level of debt that several of the member nations have accumulated. As a whole, Europe is slipping into a recession. Individually, unemployment levels in Spain and Greece are in excess of 20%, and in Italy unemployment is above 8% and rising. As one European summit after another fails to act decisively, the banking and debt crises continue to worsen.

The **ratio of government debt to GDP** is an important economic measure. Reinhart and Rogoff[2] posit that as government debt to GDP reaches 90%, economic growth becomes curtailed. At the 100% level of debt to GDP, they estimate a reduction in economic growth of approximately 1% annually, meaning that a high enough level of debt will create its own recession. Japan and the United States already have current debt to GDP ratios above 100%, with larger Eurozone countries not far behind. (See Figure 1-- *2010 year end*)

FIGURE 1: GOVERNMENT DEBT TO GDP

Country	2010	2017*
Greece	142.8	136.8
Portugal	93.4	109.2
Ireland	92.5	109.2
Spain	61.2	91.9
Italy	118.7	118.9
France	82.4	84.6
Germany	83.2	71.1
United Kingdom	75.1	86.8
USA	98.5	113
Japan	215.3	256.6
China	33.5	10.1

**As estimated by the IMF[1]*

Total debt to GDP is of even greater concern. Japan's total debt to GDP **(Government, Nonfinancial Business, Households and Financial Institutions)** is estimated at **471%.** France, Italy and Spain's total debt to GDP each averages in excess of **300%.** The United States has total debt to GDP approaching **250%.** (U.S. off balance sheet accounting debt is very significant; however, it is not included.) Empirical evidence is unavailable regarding the impact of debt to GDP economic growth with regard to Non-financial Businesses, Households and Financial Institutions; though the author observes that aggregate demand is reduced as household debt significantly increases, and high levels of debt likely results in similar spending behavior for businesses as well. (See Figure 2—*2011 year end*)

The United States has seen an unusually slow recovery from the 2008-2009 economic recession. The anemic post recession economic recovery is at risk, which, in large part, is due to our high debt to GDP level. Our economy could soon fall back into another recession, should aggregate exports to European countries decline meaningfully over the next few months. Additionally, U.S. unemployment, a further concern, continues to be in excess of 8.2%, and the economic growth indicators remain mixed.

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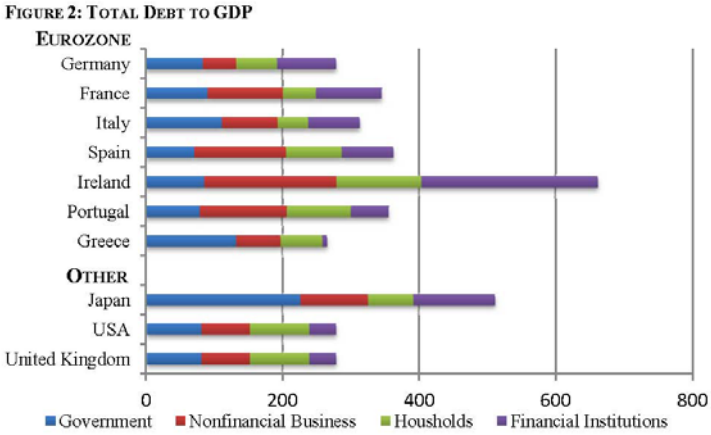
[1] http://www.imf.org/

[2] Reinhart, Carmine M, and Kenneth S Rogoff. *This Time is Different: A panoramic View of Eight Centuries of Financial Crisis.* Princeton, NJ: Princeton U.P., 2011.



How the European Union resolves its various economic crises is a concern to all investors. The United States ($14.8+ Trillion GDP) and Western Europe together account for 52% of the world's Gross Domestic Product. China's current GDP is approximately ½ of that of the United States and is rapidly growing. The Chinese economy, as a growing export-based economy, is uniquely sensitive to fluctuations in the purchasing power of Europe as well as the United States. Should the European recession continue to worsen, the volume of Chinese exports to Europe will also continue to fall, directly impacting Chinese demand for resources. Should Chinese demand fall, aggregate demand worldwide would be significantly impacted. The result would be a sudden glut in the natural resource markets that could bankrupt some raw material exporting companies and negatively impact natural resource producing countries like Canada, Australia, and Brazil.

Should the current Eurozone economic and political trends continue, the global stock markets will likely be more volatile in the next two years. The interconnectivity of our global economy directly impacts all of the participants. Each country's balance sheet is of concern to their neighbors and trading partners. Europe, China and the United States are the primary economic powers in this world economy. It is imperative that each of these nations' leaders act responsibly in order to maintain global economic stability.

- *Roger L. Johnson*