Public Debt & Economic Growth

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Let's turn to Keynesian

- **AD = C + I + G + (X –M)**
- To boost AD/GDP during a slowdown or recession – spur AD components
- So "G" comes into the picture to compensate for any shortfalls from AD
- Typically "G" finance such stimulus with Public Debt (PD)
- Increasing PD to finance "G" – increase AD and GDP improves

Link between Public Debt (PD) & GDP

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A. Relationship is "Non- Linear"

- For a given level of PD – can have different levels of GDP growth
- If the PD is sustainable – have positive impact on GDP
- Sudden worsening of PD – hurt financial market (immediately) & housing (lag)

If PD exceeds its threshold

- Shock therapy – rapid consolidation – cut spending & raise taxes & revenue
- Fiscal consolidation can be offset by accommodative monetary policy
- But it risk falling into liquidity trap – so raise rates. Why?
- Break expectations that leads to the formation of bubbles on asset markets
- Alternative ways: (1) Default : Russia (1998) & Argentina (2002); (2) Outgrow debt through higher GDP; (3) Ignore the problem (Japan)

Will PD correct to its historical debt level?

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- Pace of PD's reduction depends on private expectations
- Are they forming a "rational" or adaptive expectation?
- If adaptive, PD's sustainable level will depend on past levels
- If rational, PD's sustainable level may move to a new level
- Possibilities for the correction to be "trend" or "difference" stationary

Risk of Debt Crisis

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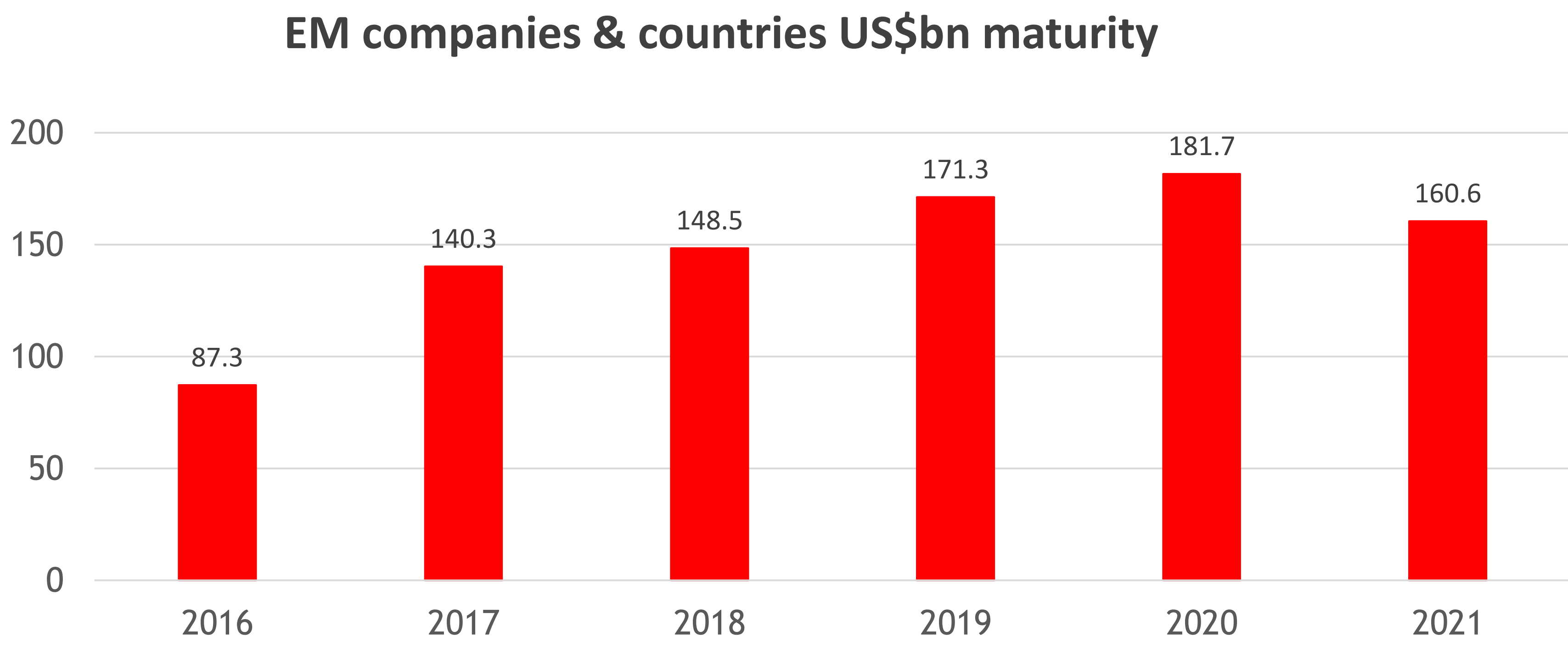
- Global debt in 2016 = 225% of world GDP versus 213% of world GDP in 2009

- EM's foreign currency debt: US$8.3trn in 2017 versus US$4.5trn in 2008



EM countries include China, Brazil, Mexico, Argentina, Korea, Russia, Indonesia, Colombia, India, Turkey, Philippines, Malaysia, Chile, South Africa, Saudi Arabia, Egypt, Thailand, Nigeria

Emerging Market Debt Crisis

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	Foreign Debt/GDP	US$ maturities	GFN % GDP	ERMPI	CABOP % GDP	FB % GDP
Argentina	33.4*	26.2	14.5	>2 SD	-4.8	-6.4
Brazil	3.2	17.7	15.0	>2 SD	-0.5	-7.8
India	-	12.8	10.6	>2 SD	-2.0	-6.9
Indonesia	11.4	11.4	4.5	<1 SD	-1.7	-2.5**
Malaysia	1.6	8.2	10.4	1-2 SD	3.0	-3.0
Mexico	16.9	8.6	7.1	>2 SD	-1.6	-1.1
Philippines	11.1*	4.1	4.6	>2 SD	-0.4	-0.3
S. Africa	5.3*	1.8	12.7	<1 SD	-2.3	-4.1**
Thailand	1.1	4.3	6.5	1-2 SD	10.8	-0.6
Turkey	11.2	22.0	6.5	1-2 SD	-5.5	-2.3**

Thank You