"How bad is this debt situation?"

By Tommy Williams, CFP®

The world is in debt. The April 2018 International Monetary Fund (IMF) Fiscal Monitor reported global debt has reached a historically high level. In 2016, debt peaked at 225 percent of global gross domestic product (GDP) (the value of all goods and services produced across the world). Public debt is a significant component of global debt. The IMF wrote:

"For advanced economies, debt-to-GDP ratios have plateaued since 2012 above 105 percent of GDP – levels not seen since World War II – and are expected to fall only marginally over the medium term…In emerging market and middle-income economies, debt-to-GDP ratios in 2017 reached almost 50 percent – a level seen only during the 1980s' debt crisis – and are expected to continue on an upward trend."

There are numerous reasons high levels of government debt (the amount a government owes) and significant deficits (the difference between how much a government takes in from taxes and other sources and how much it spends) are a cause for concern:

• Higher interest payments. Governments typically finance debt by issuing government bonds. When bonds mature, the government issues new debt. If interest rates have risen, the cost of that debt increases. As a result, high debt levels can make tax hikes and spending cuts a necessity, explained the Committee for a Responsible Federal Budget.
• Lower national savings and income. You may have heard the phrase, "Robbing Peter to pay Paul," which means taking money from one source to pay another. When a country runs a deficit, a similar thing happens. In The Long-Run Effects of Federal Budget Deficits on National Saving and Private Domestic Investment, the Congressional Budget Office explained, *"…a dollar's increase in the federal deficit results in…a 33 cent decline in domestic investment."*
• The tax lag. In his book, Do Deficits Matter? Daniel Shaviro suggests sustained deficit spending creates a 'tax lag' by shifting responsibility for current spending onto future generations. Obviously, "kicking the can down the road" is a popular method of handling such matters. Such irresponsibility is in direct conflict with what most of us express as the love we have for our grandchildren.


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The IMF Fiscal Monitor wrote, *"countries need to build fiscal buffers now by reducing government deficits and putting debt on a steady downward path."* Last week, the interest rate

on 10-year U.S. Treasuries rose above 2.9 percent, which raised concerns about inflation. Markets moved higher early in the week and tumbled later in the week. The major U.S. stock indices finished the week higher. Interest rates not only effect debt repayment, but obviously have a significant impact on market volatility.
To bring the issue of debt even closer to home, it's 2018 and American's are burdened by student loan debt more than ever. You may have heard that Americans owe over $1.48 trillion in student loan debt, spread out among 44 million borrowers. That's about $620 billion more than the total U.S. credit card debt. And, as if that weren't enough, in 2012, 71% of students graduating from four-year colleges had student loan debt. That number is increasing every year. Out state's debate about TOPS may be more important than you imagined. There can come a time when we all reach the end of the rope. I don't look forward to explaining that to my grandson.

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