



This is an excerpt of [Long-Term Asset Return Study: The History and Future of Debt](#), published on September 23, 2019.

# The History and Future of Debt

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Jim Reid, Global Head of Thematic Research & Credit Research, Deutsche Bank Research has just published his annual Long-Term Asset Return Study. This year's focus is on the History and Future of Debt. The report also have all the usual long-term returns data for dozens of countries across different asset classes tracked back over more than a century for many series.

Common wisdom suggests that the prudent upper threshold for government debt/GDP is in the range of 70-90% for high-income countries, 50-70% for euro area countries and 30-50% for the EM complex. Evidence has suggested that growth slows past these thresholds and thus risks creating an unsustainable and negative debt/GDP cycle.

Today many countries are above these levels, with the globe seeing the highest peacetime debt in history, and yet until recently hardly a week went by without fresh record lows in bond yields. The other unusual part of this cycle is that although aggregate government debt/GDP has soared since the GFC, if you assume that the post-GFC accumulated central bank holdings never get repaid, then most governments have actually de-levered over the last decade. Do we have to rethink our view on debt sustainability or is this a big bubble?

Much depends on the future interaction between governments and central banks. In a world of stubbornly low growth and low inflation, and with populist governments increasingly looking at reversing prior fiscal consolidation/austerity, eventually the temptation to use negative/ultra-low rates to borrow to spend will prove too tempting. Indeed, at current yields, Germany could move from a surplus of c1.5-2% to a deficit of roughly the same magnitude and still keep debt/GDP constant over the next several years. This won't be easy in reality, and it's worth remembering that the German word for debt is "Schuld", the same as the word for guilt.

The multi-trillion dollar question is whether governments can successfully and consistently issue the holy grail of funding – zero-coupon perpetual bonds. If they can do that, spend the money, and central banks buy the bonds, then that is pure helicopter money. We're actually not a million miles away from this. It feels like central banks have given governments the keys to the helicopter in helping yields fall to current levels, but governments have yet to fully embrace the spending power that this may offer them. It may take the next recession to encourage the move.



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Ironically, the biggest risk to a plan to borrow at low/negative rates to facilitate fiscal spending might be that it is actually successful. If inflation is generated (as it should be with such policies), then the bonds that are still 'free float' may be much more vulnerable than they are today, when markets don't believe inflation is possible and total returns are still being made by buying negative-yielding bonds. At this point, if such policies are to be maintained, we may need even more central bank buying of government bonds to keep yields down.

The key to a sustainable debt environment over the next decade(s) will be about keeping nominal yields well below nominal GDP. As such, financial repression and aggressive central bank purchases might still be in the early stages. The big difference – relative to the last decade – will likely be that governments start spending the "free" money that central banks have served up. Infrastructure (tech led) and green investment may give even the most prudent of countries the political cover to spend.

So higher debt, higher inflation, higher nominal GDP, higher yields, and higher central bank balance sheets.

To read the full report click [here](#). If you don't have access please contact a Deutsche Bank Sales representative.

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