



# Global debt is a problem we can no longer ignore

By some estimates, it is now 286 per cent of GDP, and that means interest rate rises deliver much greater stakes than the market believes

**W**e have managed to get through the shark tank of October this year with nary a scratch – a month that often sees black days, as the markets sell off to excise the excesses of the past.

November is altogether a relaxed month, one in which markets traditionally settle; even recover, leading into the calmness of December and the closing of the books. November can provide news and entertainment but it does not normally provide market leadership.

This November it is different, in that the market has none of the typical excesses of September and October to correct. Remarkably, the MSCI World equity index is trading at almost exactly the same as it was when it began the year.

We have had some fun in the meantime. The index rose 6 per cent by May, only to fall 9 per cent by the end of September, and then to recover in just five weeks. Nevertheless, the record books show virtually no gain for equity investors this year.

It continues to be hair-pullingly frustrating for equity investors, unless you are a trader who can work out badly or well. Hedge funds who fancy themselves at the volatility game are actually down 2.5 per cent this year, below their stock market cousins. And for most investors, leaving cash in the bank is an admission of failure.

One mantra of investment is that there is always someone doing better than you are. Property has had a fine year with Centaline's Hong Kong house price index up the best part of 10 per cent. Greater London house prices are up 10 per cent this year and prices were up nearly 9



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per cent in Sydney in the second quarter alone.

Soaring property markets may be one inflating bubble but it is not the biggest or most worrying one. It is the bond market, generally regarded as one of the safest of the risk asset classes, which is well and truly at the top – even though predictions of its demise have confounded experts for half a decade.

It is at the top because interest rates can only really go to zero so the gains are constantly diminishing. Yes, semantics may say that interest rates can go negative, and indeed may be so in some parts of Europe, but gravity will eventually prevail. At the moment, 10-year Japanese bonds are yielding 0.3 per cent, German bonds 0.5 per cent – and unusually the UK is at 1.92 per cent, less than the US, which is at 2.14 per cent per annum.

Every time there was a little wobble in the economy, interest rates were cut by the Greenspan/Bernanke/Yellen clique, but never really raised. Each time rates are cut, the debt levels rise because low interest rates means cheap debt and more people use more of it.

Official figures on debt levels from the IMF make grim reading, with total global debt in the region of US\$100 trillion, compared to assets of US\$140 trillion. That is some 150 per cent of the world's annual economic output.

McKinsey, the strategy consulting company, calculate that the world's total debt is now 286 per cent of GDP by including hidden debt that officialdom chooses to ignore. For instance, China's debt has quadrupled since 2007 to 217 per cent GDP, with much of it lent by the unregulated shadow-banking sector on real estate, grandiose infrastructure projects and "wealth management" products.

Small rises in rates are mathematically insignificant. If interest rates encourage investors to deleverage, what's to say that the bond markets won't crash as investors all go for the door at the same time, driving market interest rates much higher than official ones. History tells us that rising interest rates are bad for assets, and crashes are worse.

The impending interest rate rise delivers much greater stakes than the market believes. We will probably survive the first few rounds of tightening – with markets pricing equities higher for a while; but the dirty secret is that the debt problem is like a great white shark lurking just under the water seeking the arms and legs of the unwary – and maybe even the shirt off your back.

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