

# FOCUS: Fiscal Crises Head World Risk

## Issue in a Snapshot

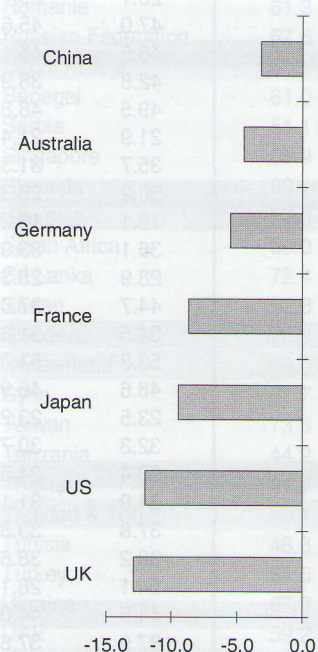
According to the World Economic Forum, major risks in 2010 include fiscal crises, asset price collapses and the impact of underinvestment in vital infrastructure.

Public debt in advanced G20 countries has grown markedly since the onset of the financial and economic crises. Fiscal consolidation will be crucial if investor confidence is to be maintained and sovereign debt crises avoided.

Asset price bubbles remain a risk but concern over Chinese growth is overdone.

Pressures on public finances will delay tackling infrastructure weakness, impeding business in the longer term.

**Government balance forecasts for selected countries in 2010**  
(% of GDP)



Source: D&B

*Fiscal crises, underinvestment in infrastructure and the impact of chronic diseases are the three key risks identified by the World Economic Forum (WEF) in its fifth annual Global Risks Report. Also highlighted are the risks of further asset price collapses, economic growth in China slowing to below 6% per annum and geopolitical risks associated with the political chaos in Afghanistan. The report, which will be discussed by global political and business leaders at the WEF's Annual Meeting in Davos, Switzerland, also highlights the significant degree of interconnectedness among all areas of risk, and the consequent need for decision-makers to co-ordinate governance and supervision on a global basis.*

## Unsustainable Public Debt Underpins Sovereign Debt Concerns

The financial and economic crises of the past two years have triggered a broader crisis of confidence among business, investors and consumers. The WEF notes that the public sector has assumed a far greater role in developed economies as a result, with central banks boosting liquidity and governments seeking to bolster demand with huge fiscal stimulus packages. As a consequence, public debt has reached record peacetime levels in many developed countries, with the average debt-to-GDP ratio of advanced economies within the G20 rising from 78.0% in 2007 to around 118.0% at the start of 2010. This level of debt is unsustainable and, as D&B has also argued, the timing and degree of fiscal adjustment will be a delicate judgement. Governments will need to strike a balance between managing the withdrawal of fiscal stimulus such that economic recovery is sustained, while preventing fiscal deficits from causing fears of sovereign debt deterioration and sustained capital flight. In this context, events in the United Arab Emirates, where government-owned conglomerate Dubai World had called for a standstill on its USD22bn of debt, and in Greece, where the fiscal deficit and public debt have been revealed to be far higher than admitted previously, serve as early warnings. The WEF report names the US and UK specifically, where D&B estimates that fiscal deficits reached 14.0% and 13.4% of GDP respectively in 2009. With public debt in the UK set to peak at around 105.0% of GDP in 2014 on current plans, and almost 110% in the US, the necessity for consolidation is clear. Meanwhile, the need to finance these high debt levels will exert upward pressure on real interest rates, dampening economic activity and potentially sapping job creation. However, at least for the US and UK, D&B believes that the risk of a sovereign default remains highly unlikely.

## Asset Bubbles and Slower Chinese Growth

The second main area of concern highlighted by the WEF is the possibility of further asset price collapses. In this, the WEF report echoes concerns raised by D&B over the emergence of a liquidity- (rather than debt-) driven asset price bubble (between March and December 2009, the Dow Jones Global Index of share prices rose more than 70% in US dollar terms). Question marks still hang over the resilience of the global economic recovery, with corporate bankruptcies (especially among small and medium-sized enterprises) still high and further shocks possible as refinancing needs arise (the WEF expects these to peak between 2011 and 2013). In particular, the WEF is concerned at the 'unbalanced growth trajectory' of the Chinese economy and the stock market and real estate bubbles that this is creating. However, D&B does not see any systemic threat in this. Rather, we take encouragement from the shift in policy focus towards inland provinces and increased urbanisation that China's leaders have signalled for 2010, especially with fiscal stimulus in heavy industry being geared towards infrastructure development in central and inland China. Warnings from the WEF that a sharp slowdown in Chinese economic growth could lead to mass unemployment and social unrest, with additional costs to the global economy of USD250bn-USD1trn, seem overdone. D&B expect China's real GDP to grow by 7.9% in 2010 and accelerate again in 2011.

## Poor Global Infrastructure Could Impede Business in the Longer Term

More generally, the WEF warns that large parts of the world's water, transport and (especially) energy infrastructure are structurally deficient or functionally obsolete, requiring considerable investment to avoid 'catastrophic failure'. With public finances in many countries under pressure, funding such expenditure will be hard, implying that ageing infrastructure could become a major impediment to businesses in the longer term.