NATIXIS
BEYOND BANKING

Flash Economics

13 June 2018 - 684

High debt ratios: The crucial issue is the oil price

Should we be concerned about the fact that debt ratios are historically high in OECD countries? The level of debt ratios would become dangerous if interest rates became higher than the nominal growth rate, and therefore if inflation returned.

As long as interest rates remain lower than nominal growth, borrower solvency is easy to ensure even if debt ratios are high.

Could high inflation return, which would lead to a strong reaction by central banks and a sharp rise in interest rates?

- We cannot see any sign that wage inflation is rising in OECD countries;
- That leaves us with inflation generated by rises in commodity prices, and oil in particular;
- The current oil market equilibrium does not point to a sharp rise in the oil price; such a rise could therefore be triggered by a geopolitical crisis (even greater tensions or war in the Middle East).

Patrick Artus
Tel. (33 1) 58 55 15 00
patrick.artus@natixis.com

@PatrickArtus

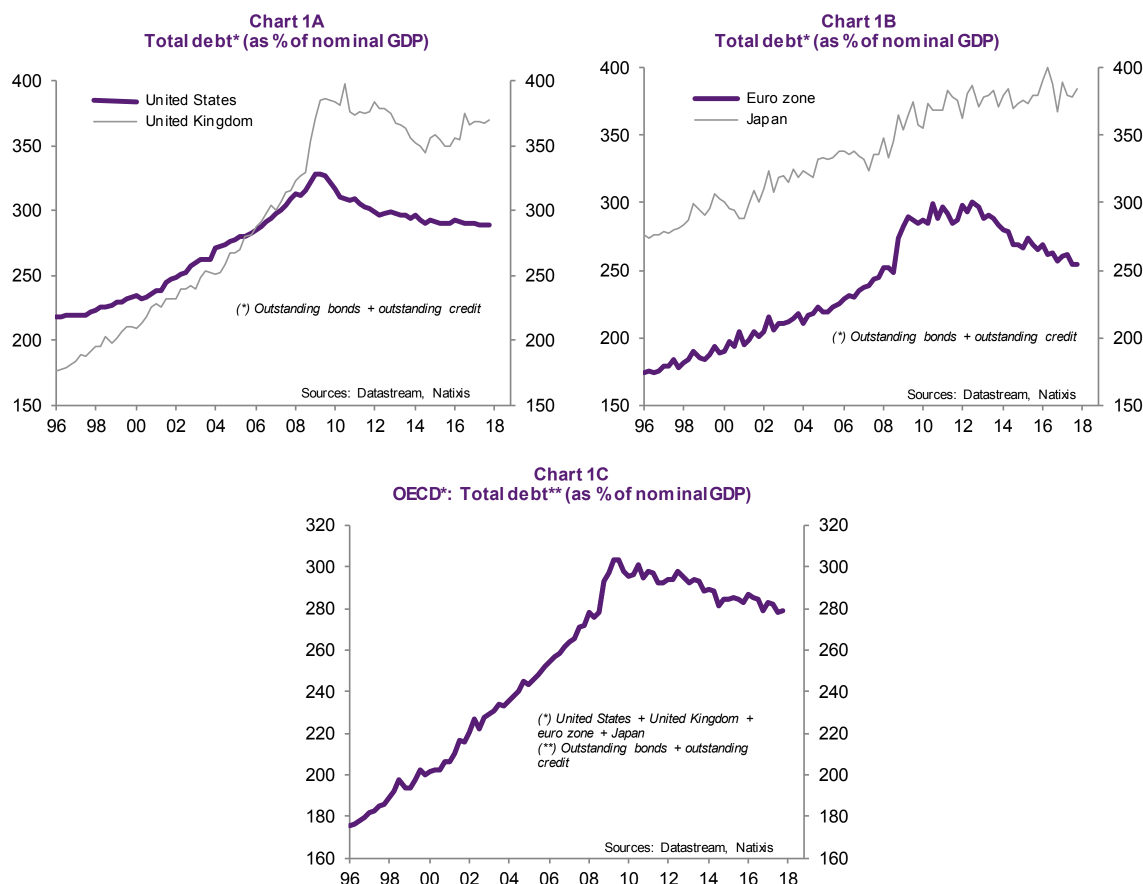
www.research.natixis.com

Ce document est distribué aux Etats-Unis. Merci de lire attentivement l'avertissement en fin de document..

ECONOMIC RESEARCH

Should we be concerned about the very high debt ratios in OECD countries?

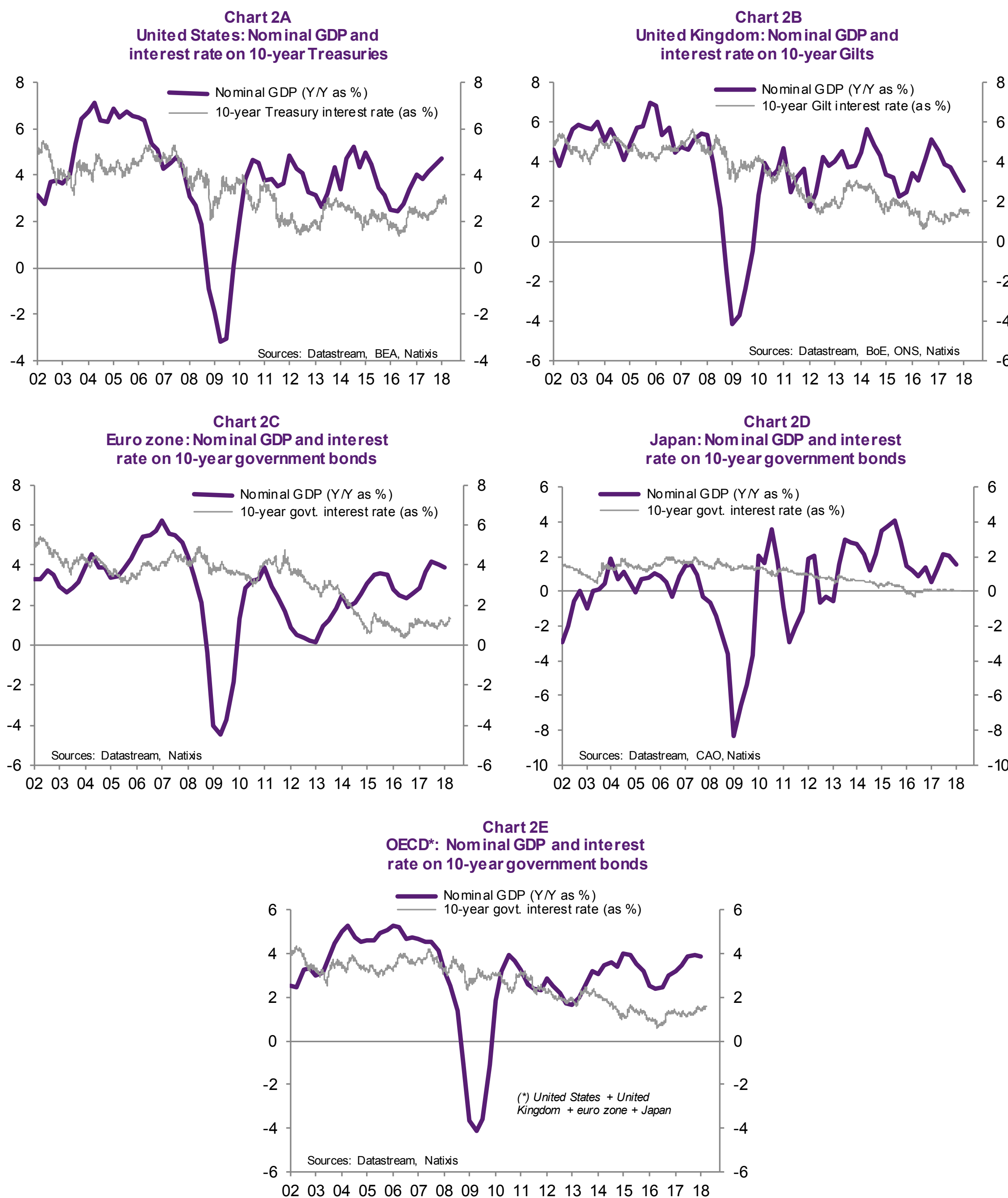
Debt ratios are now very high in OECD countries (Charts 1A, B and **C).**



Is this very high level of debt ratios dangerous? We know that the answer depends on the **relative level of long-term interest rates and nominal growth:**

- **As long as long-term interest rates remain lower than nominal growth,** the debt increases more slowly than incomes, and borrower solvency is easily ensured;
- **If long-term interest rates become higher than nominal growth,** the situation is different and far more dangerous since the debt ratio dynamics becomes divergent (the debt increases faster than incomes).

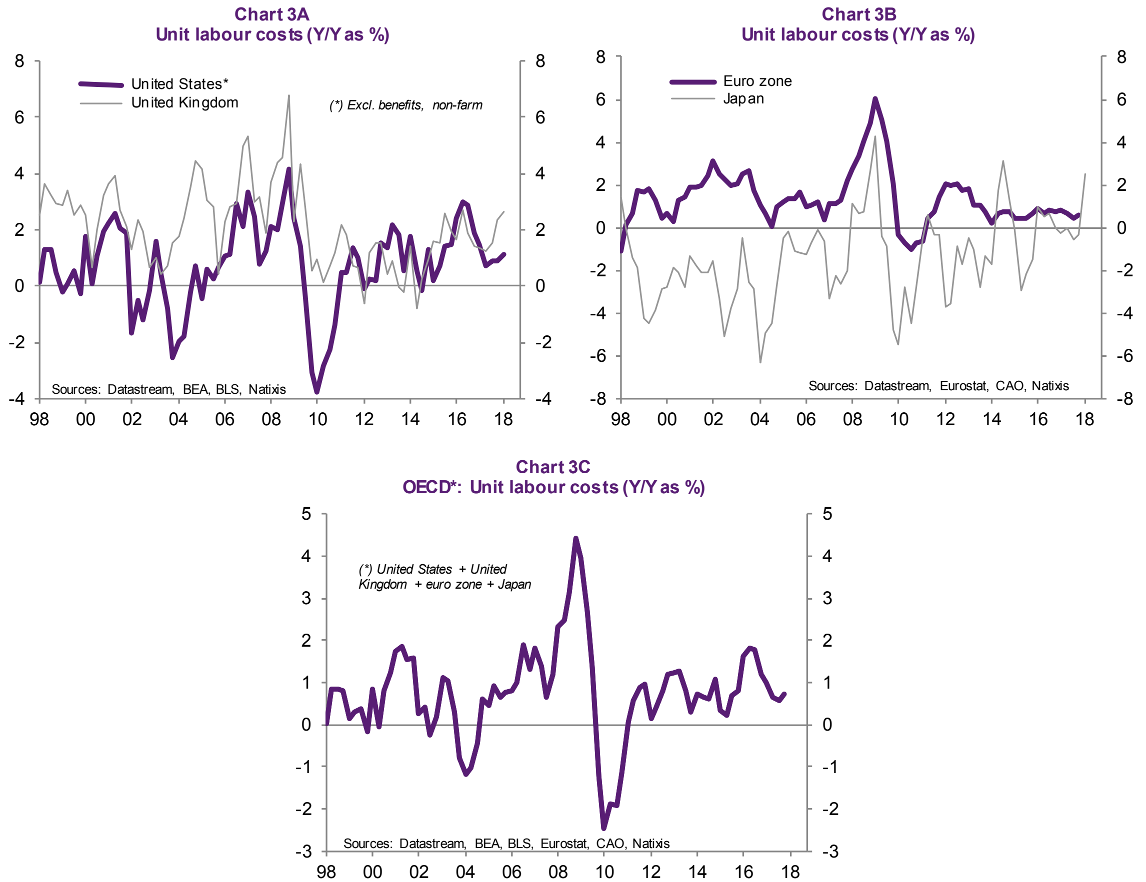
Currently, the long-term interest rate is lower than nominal growth everywhere (Charts 2A, B, C, D and **E).**



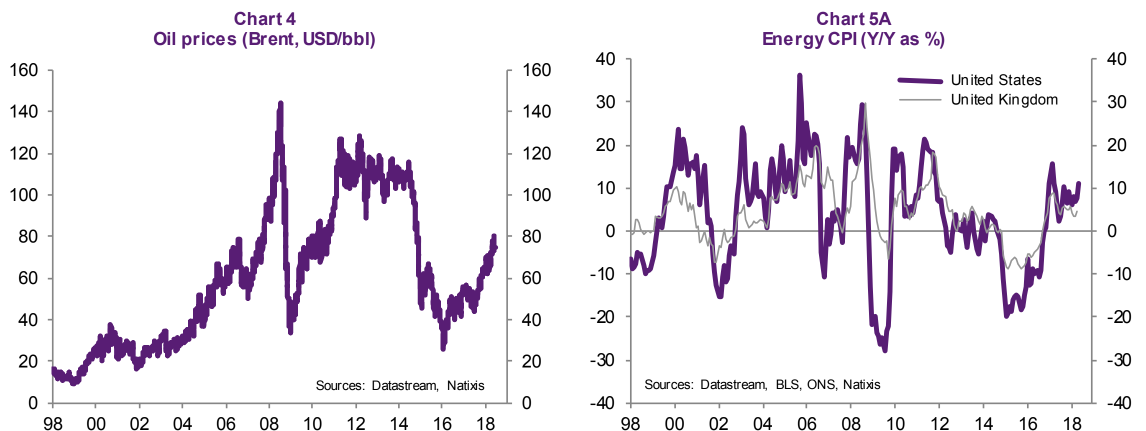
Could long-term interest rates become higher than growth in the future? **That could happen only if inflation returned and central banks reacted strongly to inflation.**

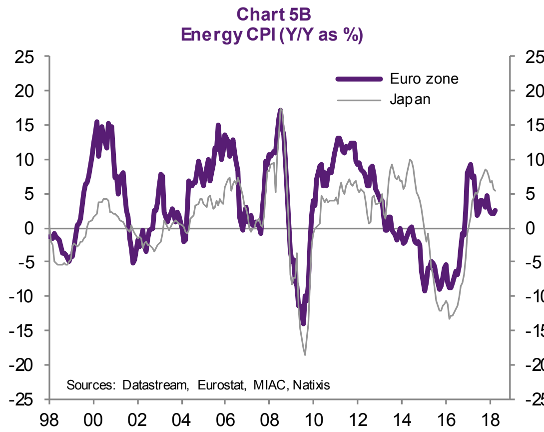
Could inflation return in OECD countries?

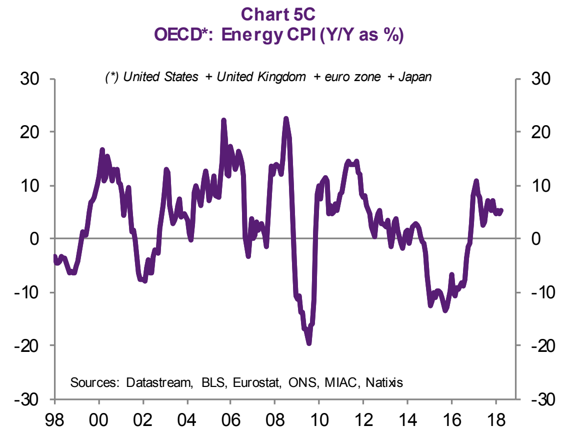
(1) The first possible cause of a return of inflation would be an acceleration in unit labour costs and a return of wage inflation. Given the greater labour market flexibility and the nature of job creation (in services companies, in the form of temporary jobs), **we cannot currently see any sign of an acceleration in unit labour costs (Charts 3A, B** and **C).**



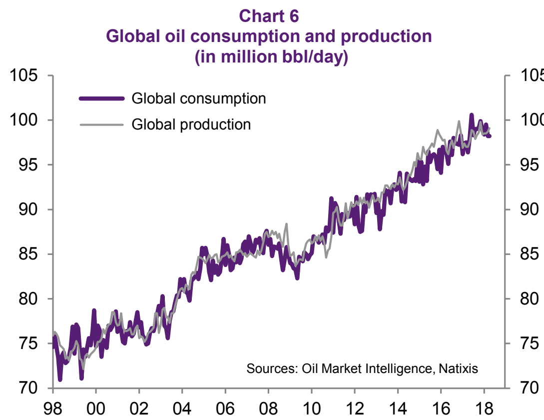
(2) The only cause of inflation would then be a rise in commodity prices, especially a rise in the oil price (Chart 4, Charts 5A, B and **C),** as in 1999-2000, 2007-2008, and 2010-2013.

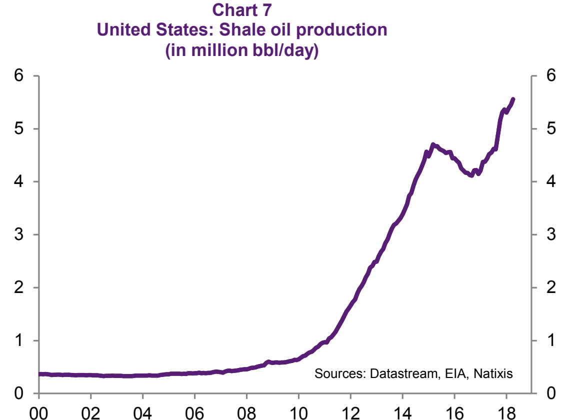


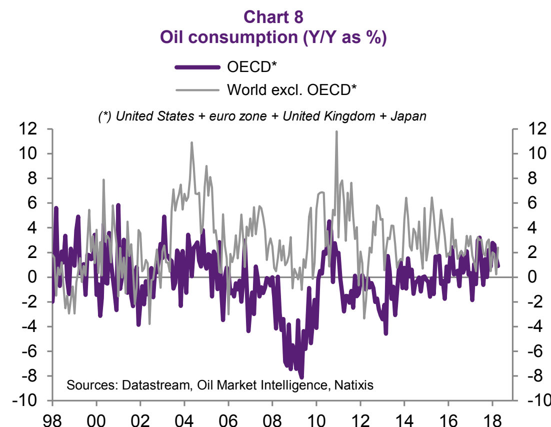




Currently, **the oil market is balanced (Chart 6),** with the increase in shale oil production in the United States **(Chart 7)** offsetting the increase in global oil consumption, especially in emerging countries **(Chart 8).**







In this configuration, a sharp rise in the oil price could therefore not stem from the spontaneous equilibrium of the oil price, but only from a geopolitical crisis (even greater political tension or war in the Middle East).

Conclusion: The key roles of geopolitics and oil prices

For the very high debt ratio in OECD countries to trigger a crisis, long-term interest rates would have to rise above the level of nominal growth, following a marked rise in inflation and the resulting reaction of central banks.

But:

- **Wage inflation is not reappearing;**
- **The oil market equilibrium is not giving rise to a very high oil price.**

So for inflation to return, there would have to be a serious geopolitical crisis pushing up the oil price sharply. In that case, the very high debt ratios would become a serious problem.

Disclaimer

The information contained in this publication and any attachment thereto is exclusively intended for a client base consisting of professionals and qualified investors. This document and any attachment thereto are strictly confidential and cannot be divulgated to a third party without the prior written consent of Natixis. If you are not the intended recipient of this document and/or the attachments, please delete them and immediately notify the sender. Distribution, possession or delivery of this document in, to or from certain jurisdictions may be restricted or prohibited by law. Recipients of this document are required to inform themselves of and comply with all such restrictions or prohibitions. Neither Natixis, nor any of its affiliates, directors, employees, agents or advisers or any other person accepts any liability to any person in relation to the distribution, possession or delivery of this document in, to or from any jurisdiction.

This document has been developed by our economists. It does not constitute a financial analysis and has not been developed in accordance with legal requirements designed to promote the independence of investment research. Accordingly, there are no prohibitions on dealing ahead of its dissemination.

This document and all attachments are communicated to each recipient for information purposes only and do not constitute a personalized investment recommendation. They are intended for general distribution and the products or services described herein do not take into account any specific investment objective, financial situation or particular need of any recipient. This document and any attachment thereto shall not be construed as an offer nor a solicitation for any purchase, sale or subscription. Under no circumstances should this document be considered as an official confirmation of a transaction to any person or entity and no undertaking is given that the transaction will be entered into under the terms and conditions set out herein or under any other terms and conditions. This document and any attachment thereto are based on public information and shall not be used nor considered as an undertaking from Natixis. All undertakings require the formal approval of Natixis according to its prevailing internal procedures.

Natixis has neither verified nor carried out independent analysis of the information contained in this document. Accordingly, no representation, warranty or undertaking, either express or implied, is made to the recipients of this document as to or in relation to the relevance, accuracy or completeness of this document or as to the reasonableness of any assumption contained in this document. Information does not take into account specific tax rules or accounting methods applicable to counterparties, clients or potential clients of Natixis. Therefore, Natixis shall not be liable for differences, if any, between its own valuations and those valuations provided by third parties; as such differences may arise as a result of the application and implementation of alternative accounting methods, tax rules or valuation models. The statements, assumptions and opinions contained in this document may be changed or may be withdrawn by Natixis at any time without notice.

Prices and margins are indicative only and are subject to change at any time without notice depending on, *inter alia*, market conditions. Past performances and simulations of past performances are not a reliable indicator and therefore do not anticipate any future results. The information contained in this document may include results of analyses from a quantitative model, which represent potential future events that may or may not be realised, and is not a complete analysis of every material fact representing any product. Information may be changed or may be withdrawn by Natixis at any time without notice. More generally, no responsibility is accepted by Natixis, nor any of its holding companies, subsidiaries, associated undertakings or controlling persons, nor any of their respective directors, officers, partners, employees, agents, representatives or advisers as to or in relation to the characteristics of this information. The statements, assumptions and forecasts contained in this document reflect the judgment of its author(s), unless otherwise specified, and do not reflect the judgment of any other person or of Natixis.

The information contained in this document should not be assumed to have been updated at any time subsequent to the date shown on the first page of this document and the delivery of this document does not constitute a representation by any person that such information will be updated at any time after the date of this document.

Natixis shall not be liable for any financial loss or any decision taken on the basis of the information disclosed in this presentation and Natixis does not provide any advice, including in case of investment services. In any event, you should request for any internal and/or external advice that you consider necessary or desirable to obtain, including from any financial, legal, tax or accounting adviser, or any other specialist, in order to verify in particular that the transaction described in this document complies with your objectives and constraints and to obtain an independent valuation of the transaction, its risk factors and rewards.

Natixis is supervised by the European Central bank (ECB).

Natixis is authorized in France by the *Autorité de Contrôle Prudentiel et de Régulation* (ACPR) as a Bank -Investment Services Provider and subject to its supervision.

Natixis is regulated by the *Autorité des Marchés Financiers* in respect of its investment services activities.

Natixis is authorized by the ACPR in France and regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority in the United Kingdom. Details on the extent of regulation by the FCA and the Prudential Regulation Authority are available from Natixis' branch in London upon request.

In Germany, NATIXIS is authorized by the ACPR as a bank – investment services provider and is subject to its supervision. NATIXIS Zweigniederlassung Deutschland is subject to a limited form of regulation by the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) with regards to the conduct of its business in Germany under the right of establishment there. The transfer / distribution of this document in Germany is performed by / under the responsibility of NATIXIS Zweigniederlassung Deutschland.

Natixis is authorized by the ACPR and regulated by Bank of Spain and the CNMV (*Comisión Nacional del Mercado de Valores*) for the conduct of its business under the right of establishment in Spain.

Natixis is authorized by the ACPR and regulated by Bank of Italy and the CONSOB (*Commissione Nazionale per le Società e la Borsa*) for the conduct of its business under the right of establishment in Italy.

Natixis is authorized by the ACPR and regulated by the Dubai Financial Services Authority (DFSA) for the conduct of its business in and from the Dubai International Financial Centre (DIFC). The document is being made available to the recipient with the understanding that it meets the DFSA definition of a Professional Client; the recipient is otherwise required to inform Natixis if this is not the case and return the document. The recipient also acknowledges and understands that neither the document nor its contents have been approved, licensed by or registered with any regulatory body or governmental agency in the GCC or Lebanon.

Canada: Natixis is not registered as a dealer under securities legislation in Canada and may only trade with investors that qualify as permitted clients as defined in section 8.18 of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations

Australia: In Australia, Natixis operates through a wholly owned subsidiary, Natixis Australia Pty Ltd ("NAPL"). NAPL is registered with the Australian Securities & Investments Commission and holds an Australia Financial Services License (No 317114) which enables NAPL to conduct its business in Australia with "wholesale" Clients. Details of this license are available upon request.

Hong-Kong: Notice to Residents in Hong Kong: In Hong Kong this document is for distribution to professional investors only (as defined in the Securities and Futures Ordinance (Cap.571) of Hong Kong and any rules made under that Ordinance).

All of the views expressed in this report accurately reflect the author's personal views regarding any and all of the subject securities or issuers. No part of author compensation was, is or will be, directly or indirectly related to the specific recommendations or views expressed in this report.

I(WE), AUTHOR(S), WHO WROTE THIS REPORT HEREBY CERTIFY THAT THE VIEWS EXPRESSED IN THIS REPORT ACCURATELY REFLECT OUR(MY) PERSONAL VIEWS ABOUT THE SUBJECT COMPANY OR COMPANIES AND ITS OR THEIR SECURITIES, AND THAT NO PART OF OUR COMPENSATION WAS, IS OR WILL BE, DIRECTLY OR INDIRECTLY, RELATED TO THE SPECIFIC RECOMMENDATIONS OR VIEWS EXPRESSED IN THIS REPORT.

The personal views of authors may differ from one another. Natixis, its subsidiaries and affiliates may have issued or may issue reports that are inconsistent with, and/or reach different conclusions from, the information presented herein.

Natixis, a foreign bank and broker-dealer, makes this report available solely for distribution in the United States to major U.S. institutional investors as defined in Rule 15a-6 under the U.S. securities Exchange Act of 1934. This document shall not be distributed to any other persons in the United States. All major U.S. institutional investors receiving this document shall not distribute the original nor a copy thereof to any other person in the United States. Natixis Securities Americas LLC, a U.S. registered broker-dealer and member of FINRA, is a subsidiary of Natixis. Natixis Securities Americas LLC did not participate in the preparation of this report and as such assumes no responsibility for its content. This report has been prepared and reviewed by authors employed by Natixis, who are not associated persons of Natixis Securities Americas LLC and are not registered or qualified as research analysts with FINRA, and are not subject to the rules of the FINRA. In order to receive any additional information about or to effect a transaction in any security or financial instrument mentioned herein, please contact your usual registered representative at Natixis Securities Americas LLC, by email or by mail at 1251 Avenue of the Americas, New York, NY 10020.

The stocks mentioned might be subject to specific disclaimers. Please click on the following link to consult them:

http://research.intranet/GlobalResearchWeb/main/globalresearch/DisclaimersSpecifiques