IATA Economics' Chart of the Week

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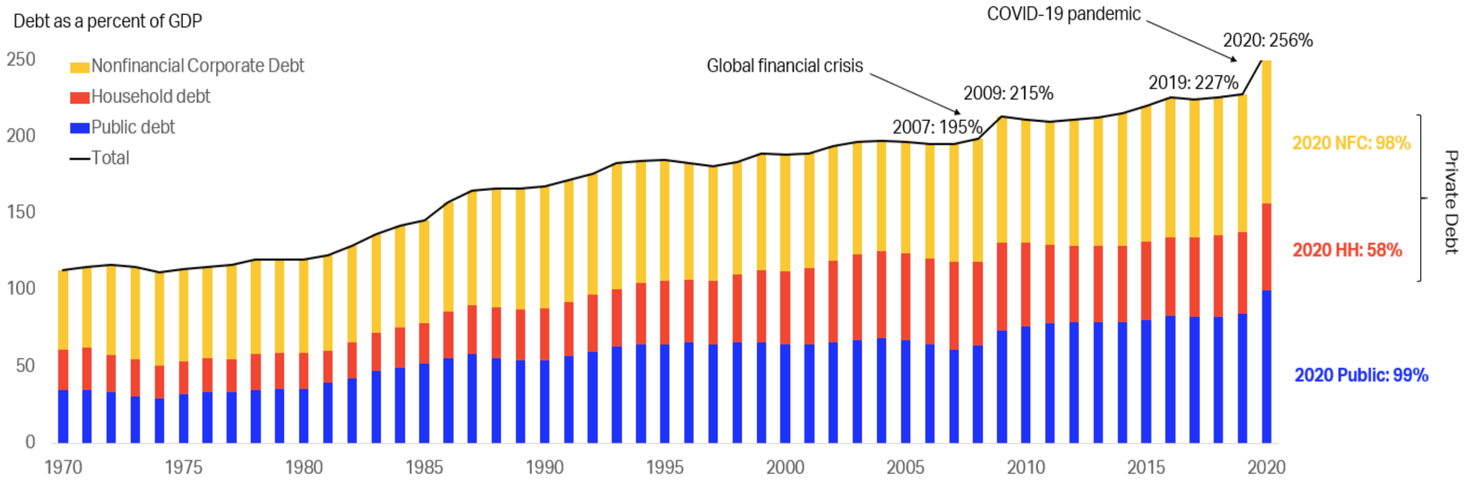
Record debt made more affordable by rising inflation



Source: IMF Global Debt Database

- Every economic crisis tends to push global debt to new highs, and the COVID-19 pandemic has set a new record in this respect. Total global debt reached 256% of world GDP in 2020. Of that total, 39% is public debt, very closely followed by non-financial corporate debt at 38%, and household debt represents 23%. The Institute of International Finance estimates that total global debt rose by another USD 10 trillion in 2021, significantly less than the USD 33 trillion added in 2020. Coupled with the global economy returning to positive GDP growth, the debt-to-GDP ratio might well have improved in 2021.
- The question of whether this debt burden is sustainable and affordable going forward is therefore a crucial one for all sectors of the global economy, including aviation.
- While it is difficult to characterize this kind of debt burden as sustainable, it is arguably affordable in the current macro-economic context. The global surge in inflation acts as a tax on economic activity and savings, though simultaneously as a subsidy of all indebted persons and organizations. This is because the real value of the debt to be repaid diminishes with inflation. Moreover, while many central banks have raised their policy rates and will continue to do so over the coming year, these nominal interest rates are still below the rate of inflation, generally speaking. Real interest rates are therefore low or negative. The St Louis Fed reports the 1-year real interest rate for the US in February 2022 at -2.9%, for instance, making it profitable to borrow money.
- A spanner in the works can be the currency in which the debt is incurred, if different from that in which the debtor earns income or revenue. Fluctuations in the exchange rate can rapidly outstrip any real interest rate advantage. Many have been caught out by the appreciating Swiss franc, for instance, while the central bank's policy rate of -0.75% clearly helps attract borrowers to this market.
- As long as airlines have the liquidity to service their debt in nominal terms, and as long as their debt is not in an appreciating foreign currency, they – and other debtors – will be greatly assisted by the higher rates of inflation as they seek to deleverage.

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