



Debt and deleveraging: Uneven progress on the path to growth

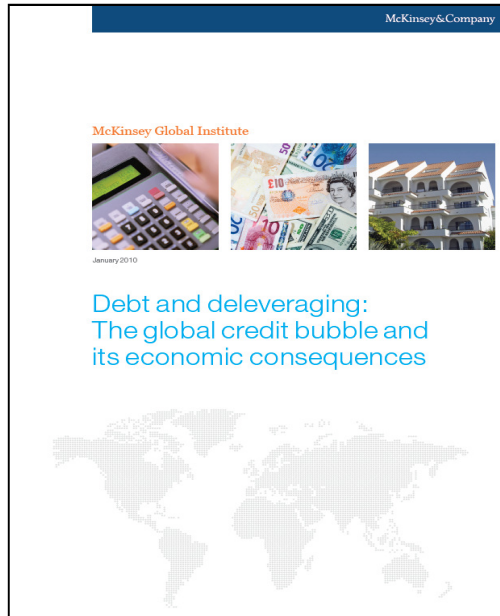
McKinsey Global Institute

January 2013

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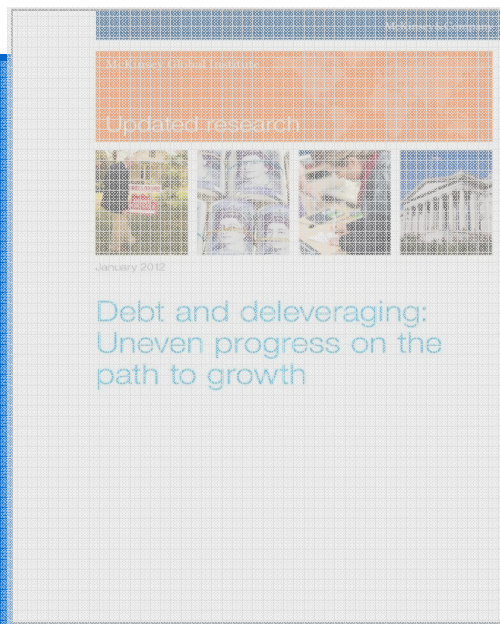
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We are suffering just now from a bad attack of economic pessimism. It is common to hear people say that the era of enormous economic progress which characterised the last century is over; that the rapid improvement in the standard of living is now going to slow down...; that a decline in prosperity is more likely than an improvement in the decade which lies ahead of us

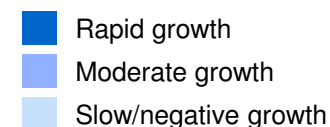


2010 report

- 1** Where did the debt build-up pre crisis?
- 2** What are the lessons to be learned from prior deleveraging episodes?
- 3** What are the implications for the current crisis?

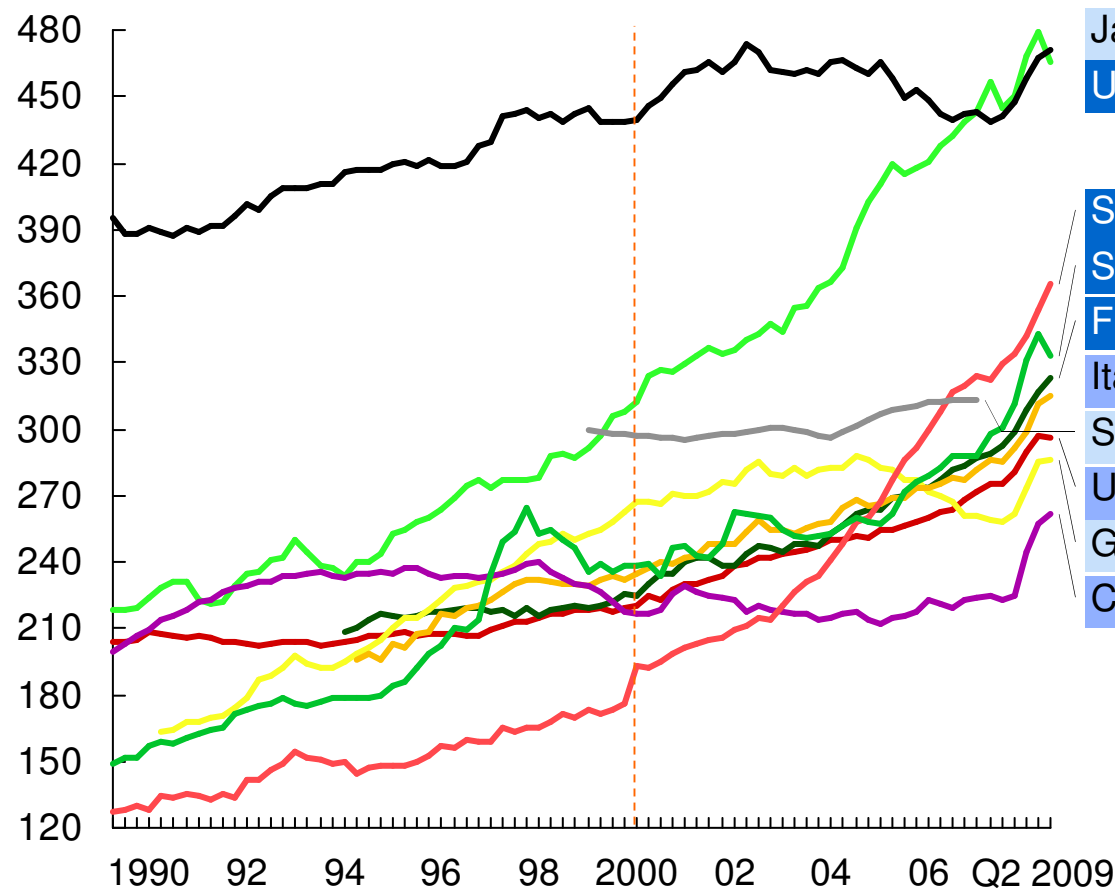


Debt grew in most mature economies



Domestic private and public sector debt¹ by country

% of GDP



	CAGR ² , %		Change, p.p.
	1990-00	2000-08	
Japan	1.2	0.5	19
UK ³	3.3	5.2	157
Spain	4.1	7.4	150
S. Korea	4.3	4.2	93
France	1.2	3.9	83
Italy	2.9	3.1	64
Switzerland	N/A	0.8	17
US	0.6	3.5	70
Germany	5.6	0.3	7
Canada	0.3	1.5	28

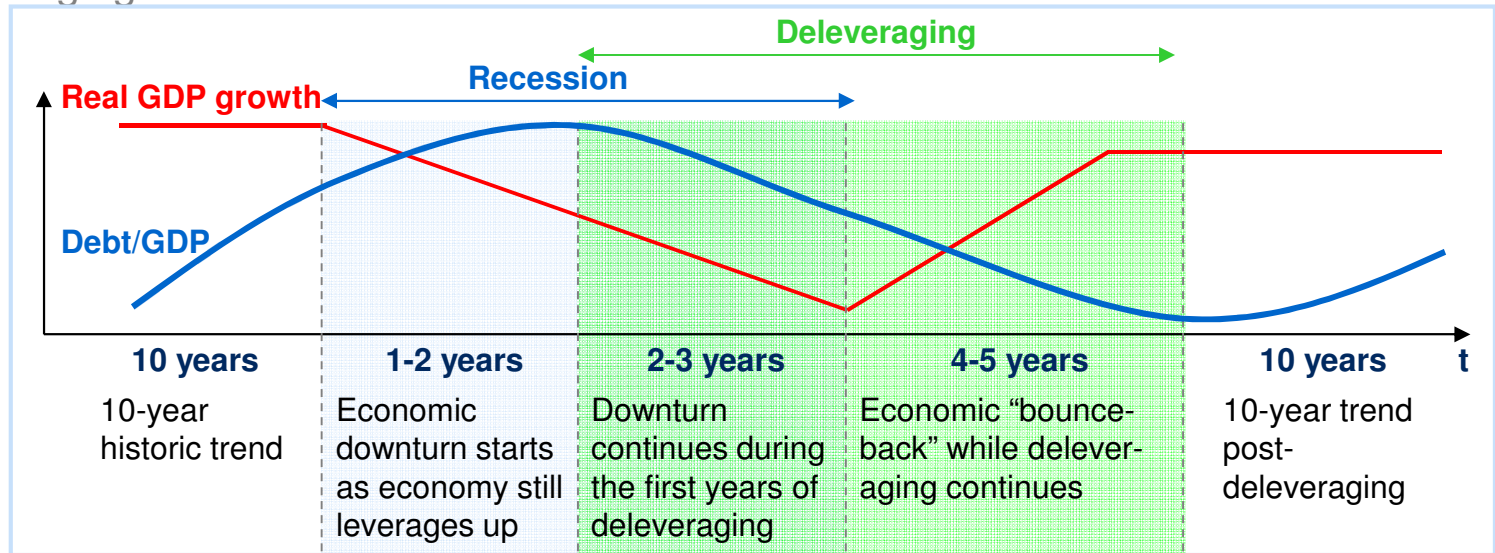
1 "Debt" is defined as all credit market borrowing including loans and fixed-income securities.

2 Compound annual growth rate. Where data are unavailable, the longest possible period is used.

3 Even after removing foreign lending by UK banks, UK debt/GDP remains higher than every country except Japan.

Real GDP growth is significantly slower in the first 2-3 years of deleveraging

Impact of deleveraging on GDP growth



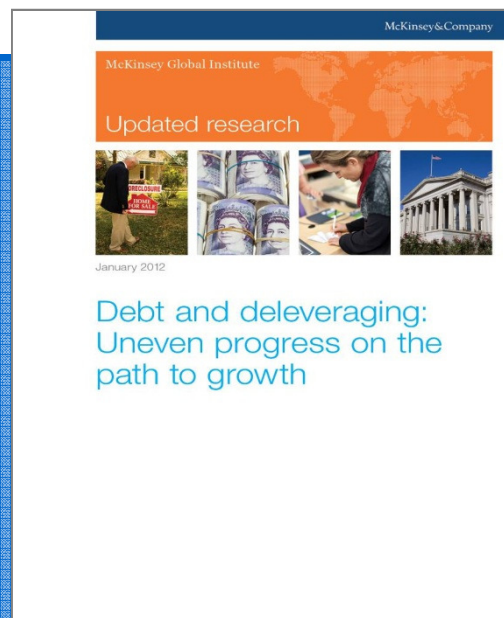
Average annual real GDP growth, %

	10 years	1-2 years	2-3 years	4-5 years	10 years
1 "Belt-tightening" n = 16	4.7	0.6	-0.6	4.8	3.2
2 "High inflation" n = 8	4.3	-	-1.4	4.1	4.2
3 "Massive default" n = 7	4.3	-	-3.0	5.7	4.8
4 "Growing out of debt" n = 1	7.9	0.8	← 12.8 ¹ →		2.3
Total n = 32	4.6	0.5	-1.3	5.1	3.8

1 Deleveraging driven by off-trend growth is not linked to a recession.



2012 update



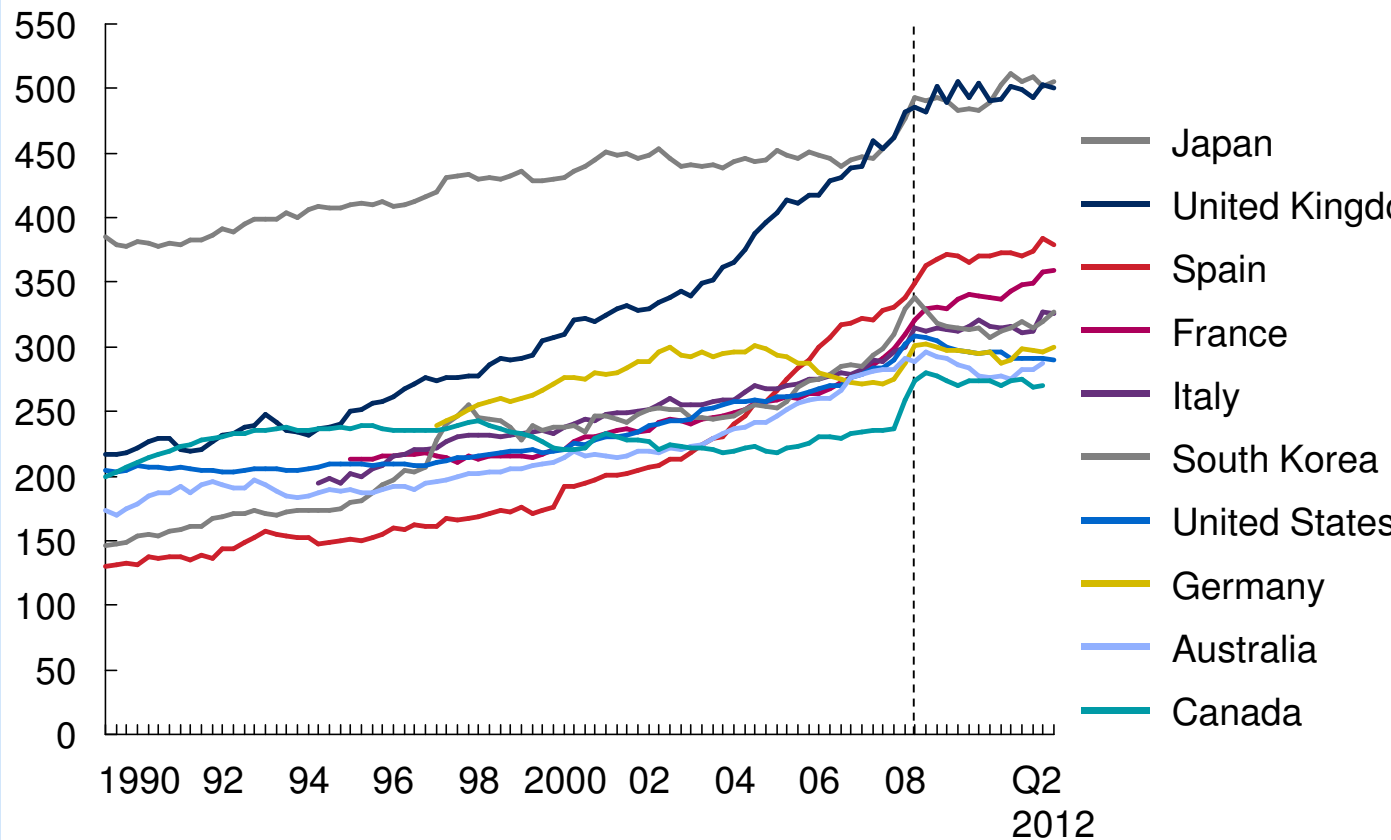
- 1 How much progress have mature economies made in reducing debt?
- 2 What are the conditions for full recovery and when will demand return?

Deleveraging has only just begun in the ten largest developed economies

- ▲ Significant increase in leverage²
- ▼ Deleveraging

Total debt,¹ 1990–2012Q2

% of GDP



Change		
Percentage points		
2000–08	2008–Q2 2012 ³	
46	28	▲
172	18	
146	41	▲
89	49	▲
62	27	▲
92	-2	▼
81	-12	▼
12	12	
77	-4	▼
39	11	

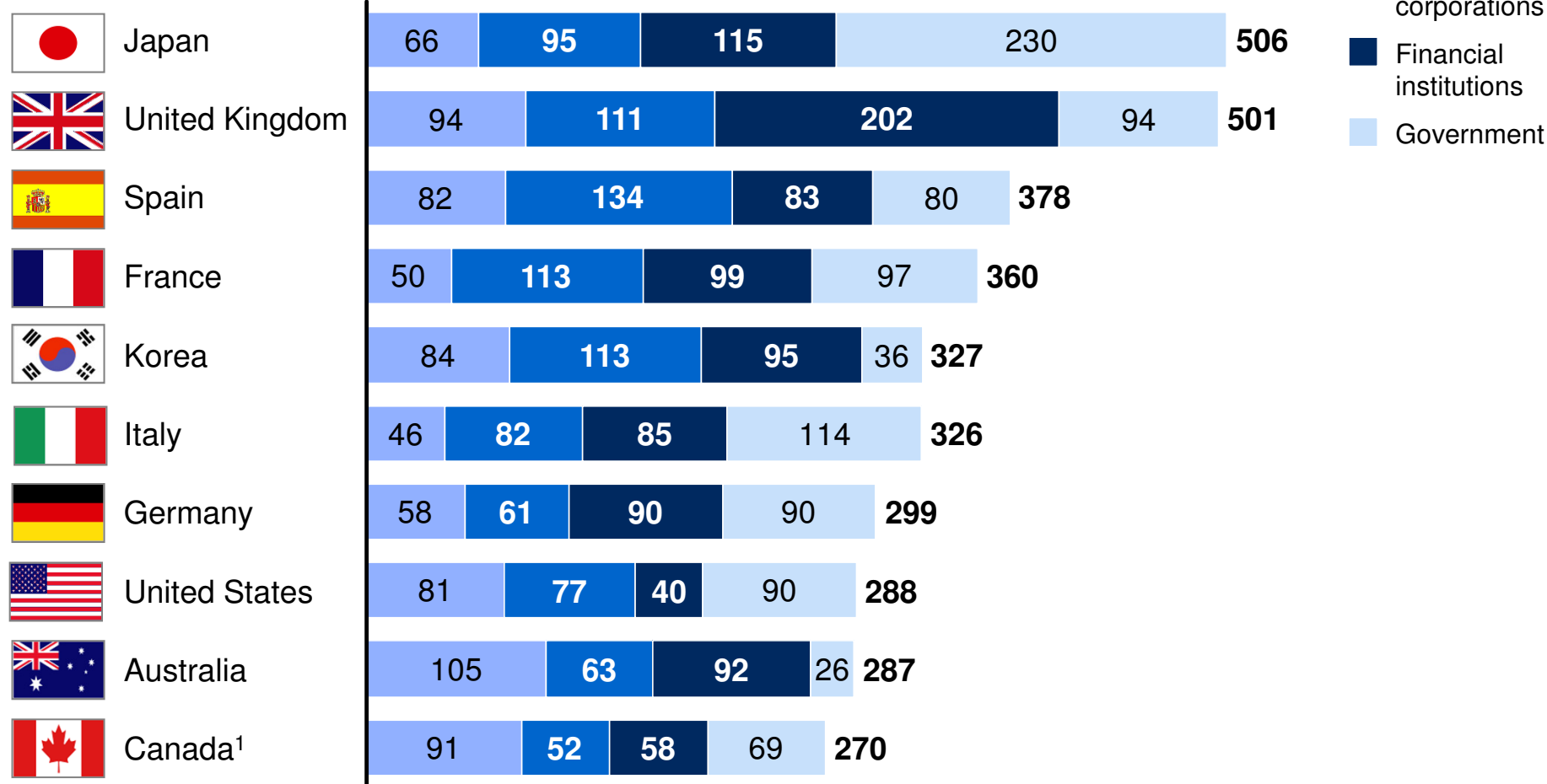
1 Includes all loans and fixed-income securities of households, corporations, financial institutions, and government.

2 Defined as an increase of 25 percentage points or more.

3 For the US, data is available up to 2012Q3

The composition of debt varies widely across countries, indicating different deleveraging challenges

Total debt of ten largest mature economies, Q2 2012 or latest
% of GDP

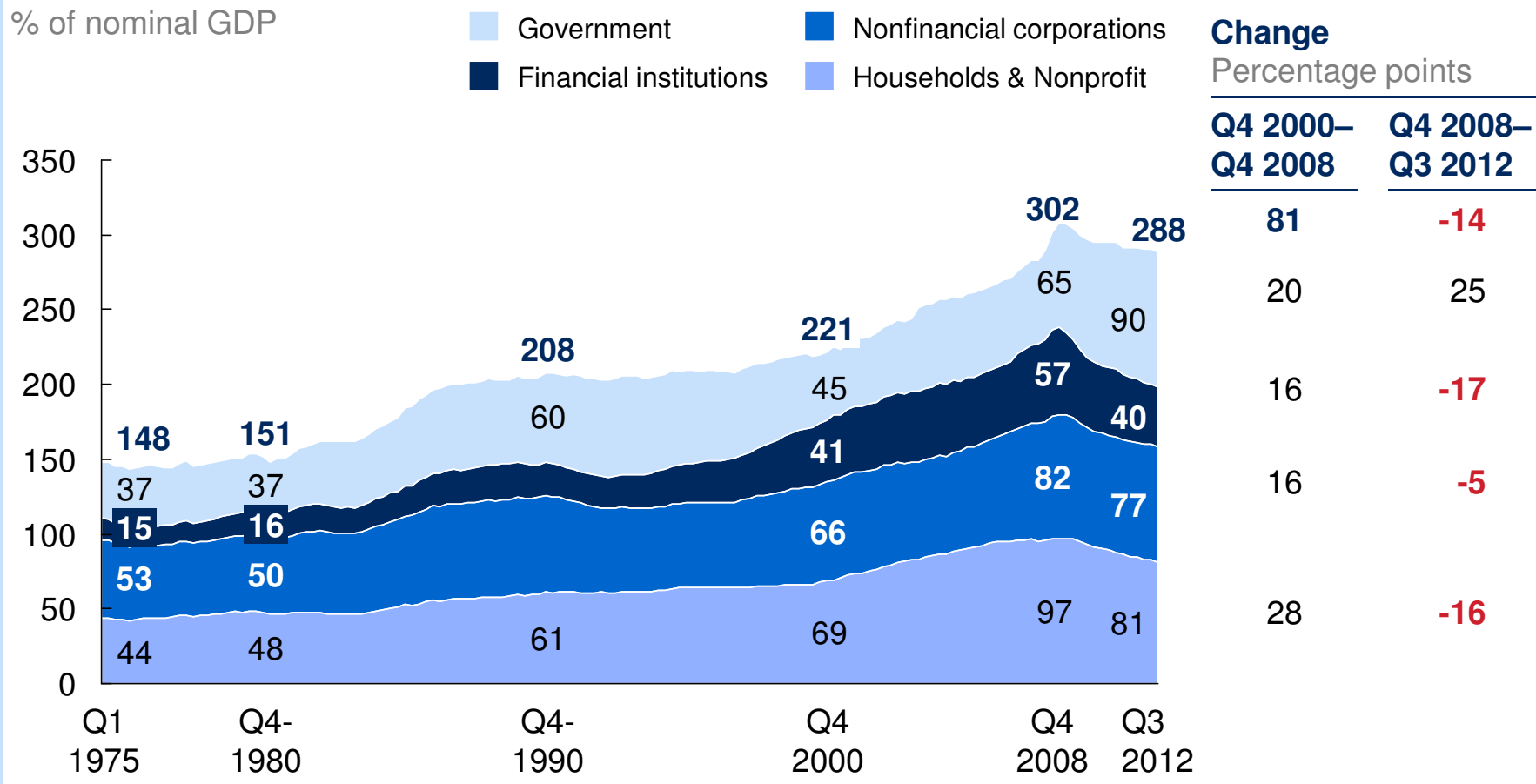


¹ According to Canada's national accounts, "household" sector includes nonfinancial, non-corporate business.
NOTE: Numbers may not sum due to rounding.

The United States has undergone rapid private-sector deleveraging since 2008



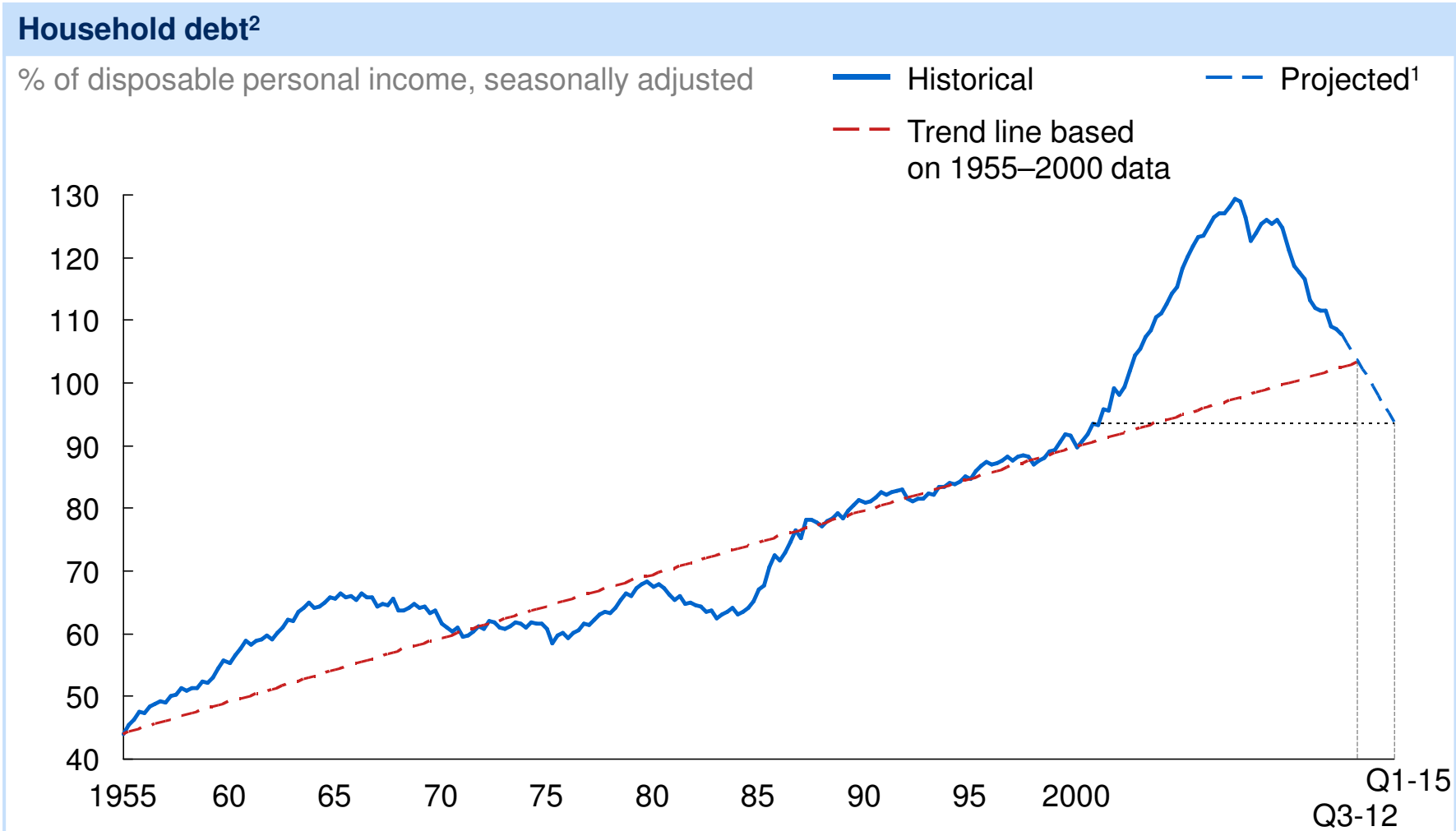
Debt¹ by sector, 1975–2012Q3



¹ Includes all loans and credit market borrowing (e.g., bonds, commercial paper); excludes asset-backed securities to avoid double counting of the underlying loan.

NOTE: Numbers may not sum due to rounding.

The US household debt ratio could return to its long-term trend in 2013 and be reduced to 2000 level by 2015



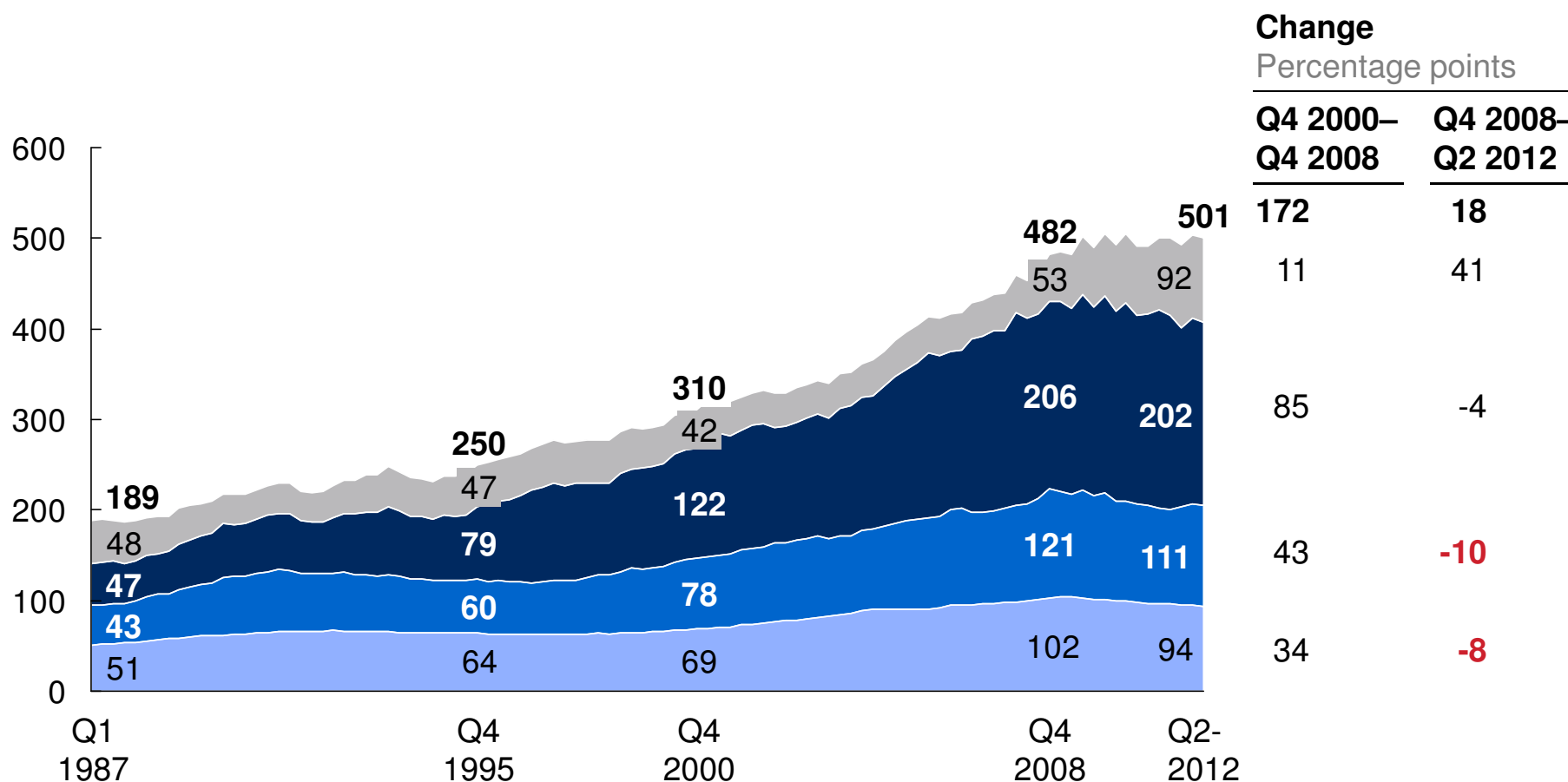
1 Based on household debt and disposable personal income trends from 2010 to 2012Q3

2 Includes debt of nonprofit organizations

UK financial sector and government borrowing has continued to grow since 2008

Debt¹ by sector, 1987–2012Q2
% of GDP

- Government
- Financial institutions
- Nonfinancial corporations
- Households



¹ Includes all loans and credit market borrowing (e.g., bonds, commercial paper); excludes asset-backed securities to avoid double-counting of the underlying loan.

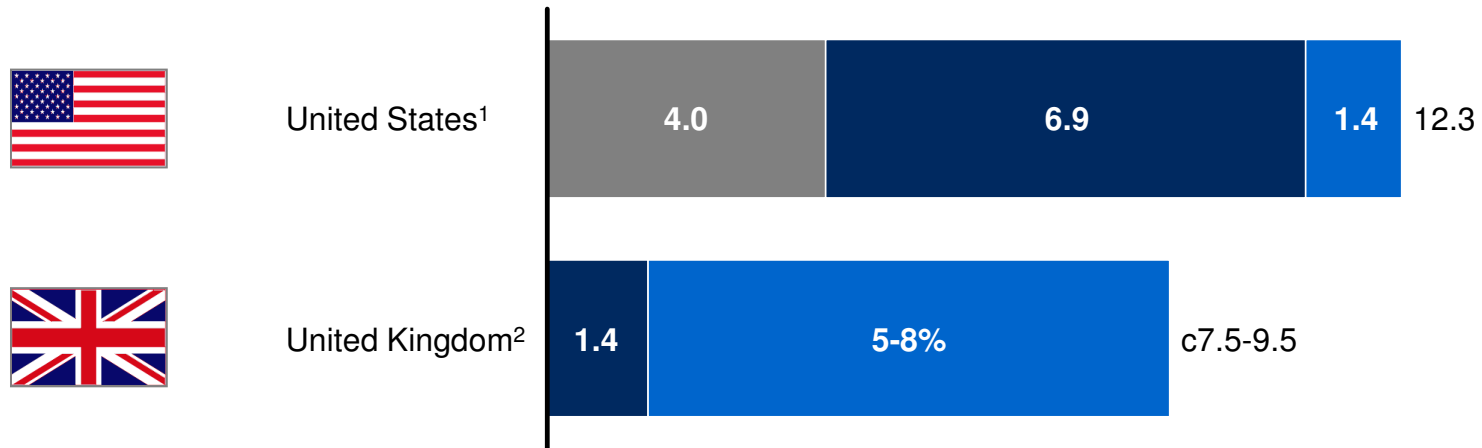
NOTE: Numbers may not sum due to rounding.

The share of UK mortgage holders in some difficulty is lower to that in the United States



Number of residential mortgages in difficulty
% of total residential mortgage loans

- In foreclosure
- Delinquent
- In forbearance



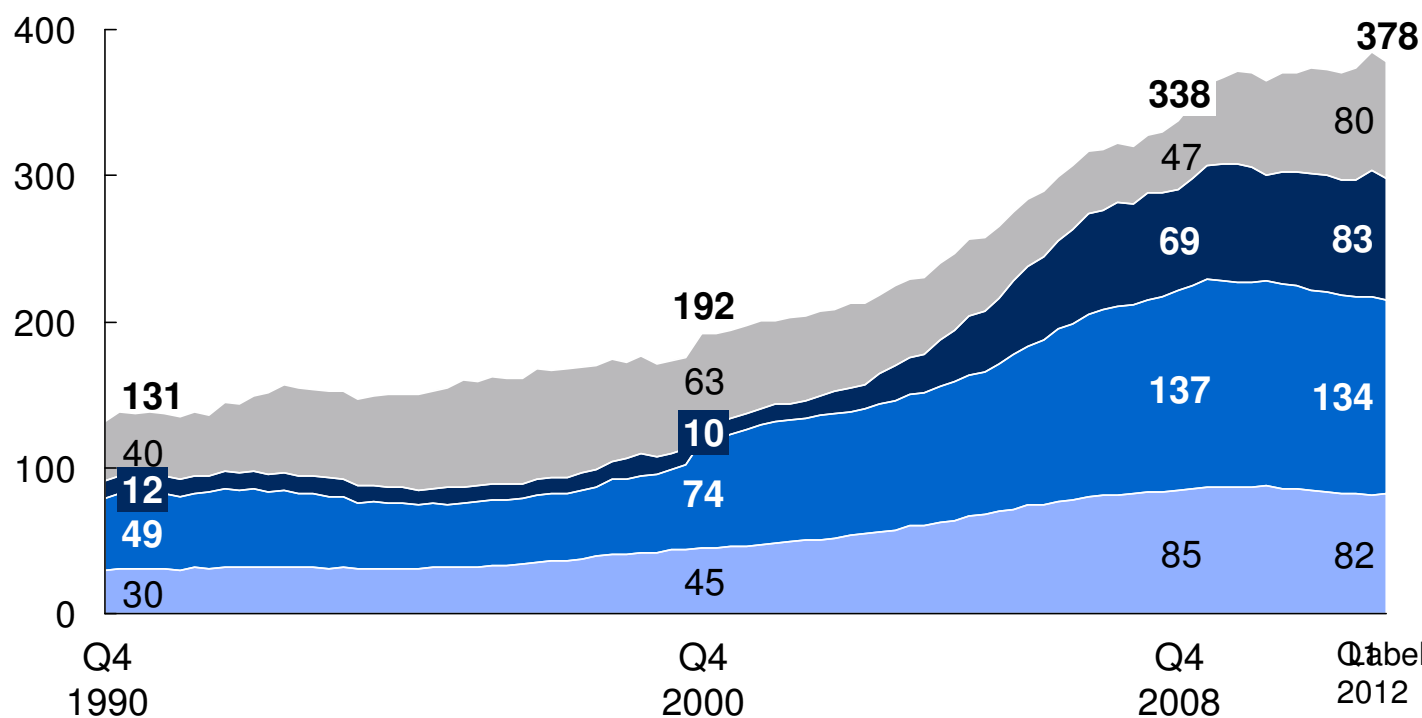
1 US delinquency and foreclosure data are as of Q2 2012. Delinquency data represent mortgages more than 30 days delinquent. Forbearance is estimated for August 2011 based on loan modifications under the US Home Affordable Modification Program (HAMP).

2 UK delinquency data are as of Q3 2012 and represent mortgage loans more than 1.5 percent in arrears. Estimates for forbearance are from the Financial Services Authority, Statistics on Mortgage Lending December 2012

Spain's private debt grew rapidly after 2000; public debt has grown faster since 2008

Debt¹ by sector, 1990–2012Q2
% of GDP

- Government
- Financial institutions
- Nonfinancial corporations
- Households



Change	
Percentage points	
Q4 2000– Q4 2008	Q4 2008– Q4 2012
146	41
-16	33
58	14
63	-3
40	-3

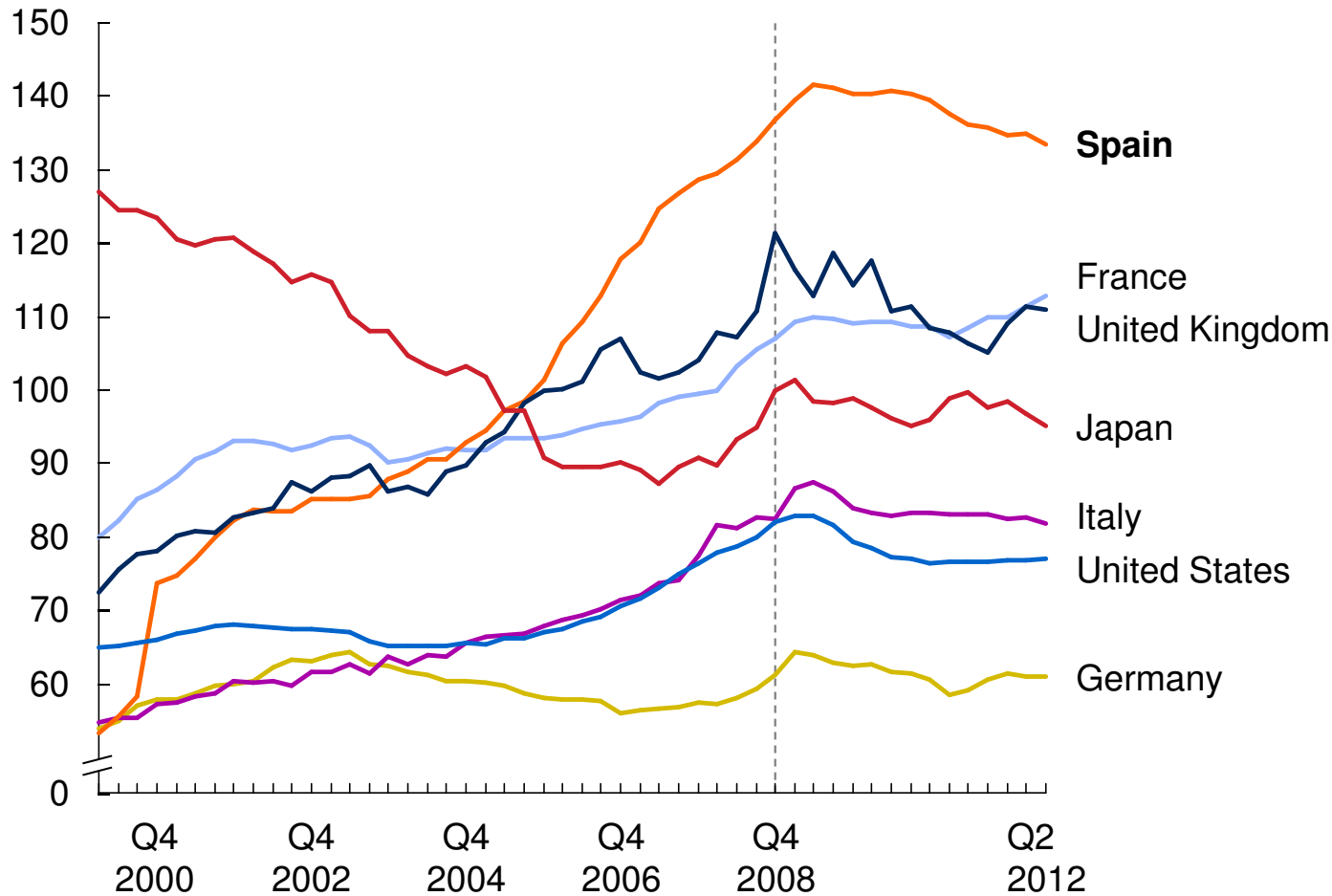
¹ Includes all loans and credit market borrowing (e.g., bonds, commercial paper); excludes asset-backed securities to avoid double counting of the underlying loan.

NOTE: Numbers may not sum due to rounding.

The debt levels of Spanish corporations grew dramatically from 2000 to 2008



Total debt of nonfinancial corporations, Q1 2000–Q2 2012
% of GDP



	Change	
	Percentage points	
	Q4 2000– Q4 2008	Q4 2008– Q2 2012
Spain	63	-3
France	21	6
United Kingdom	43	-10
Japan	-24	-5
Italy	25	-1
United States	16	-5
Germany	3	0

Six conditions for recovery and moving to the second phase of deleveraging



Banking sector is stabilized and lending resumes



Government enacts credible long-term plans for fiscal deficit reduction



Structural reforms unleash private-sector growth



Exports are rising



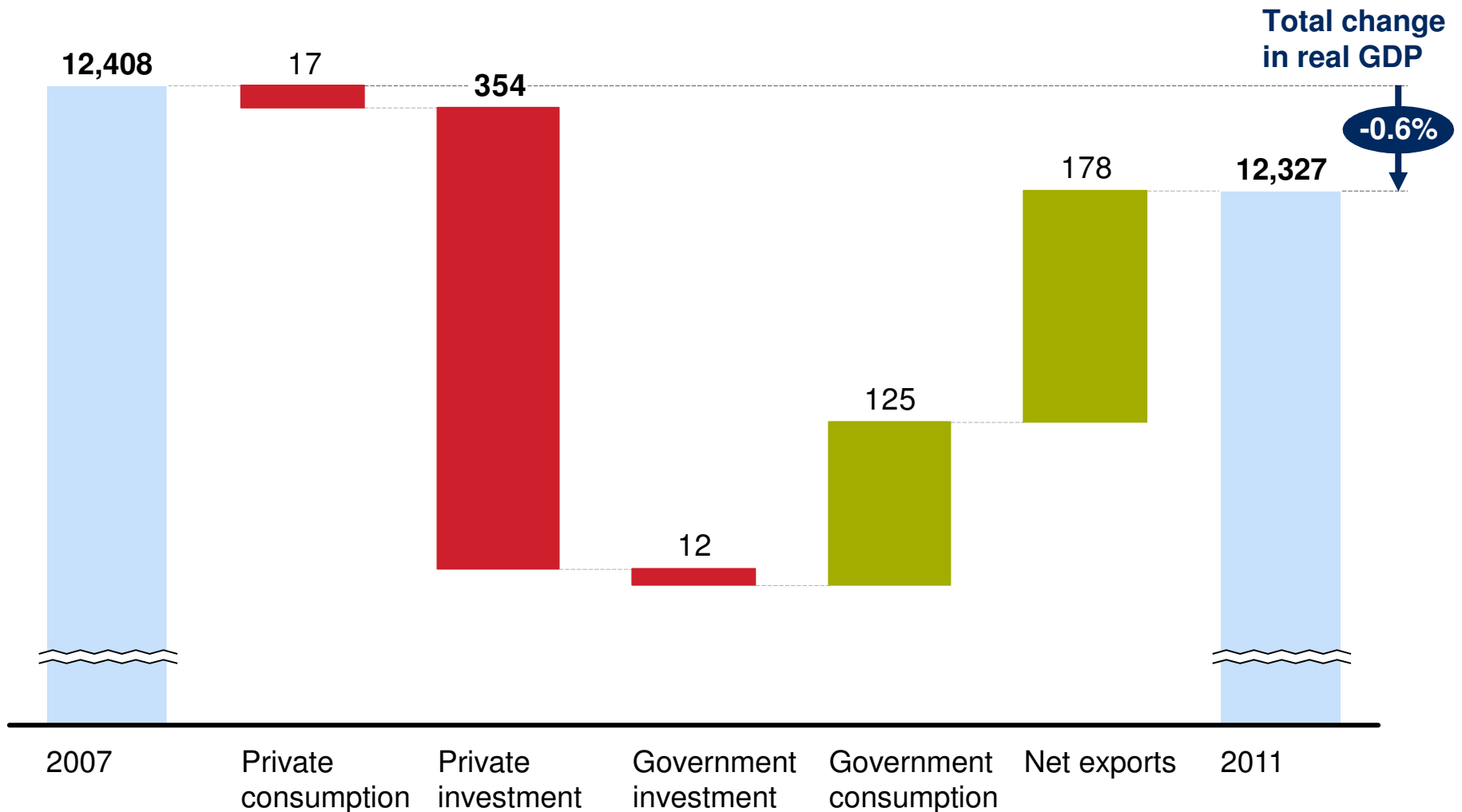
Private investment rebounds



House prices stabilize and new construction begins

Private investment has been the hardest-hit component of EU-27 GDP

Change in real GDP, EU-27 countries, 2007–11
2005 € billion



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“I believe that this is a wildly mistaken interpretation of what is happening to us”

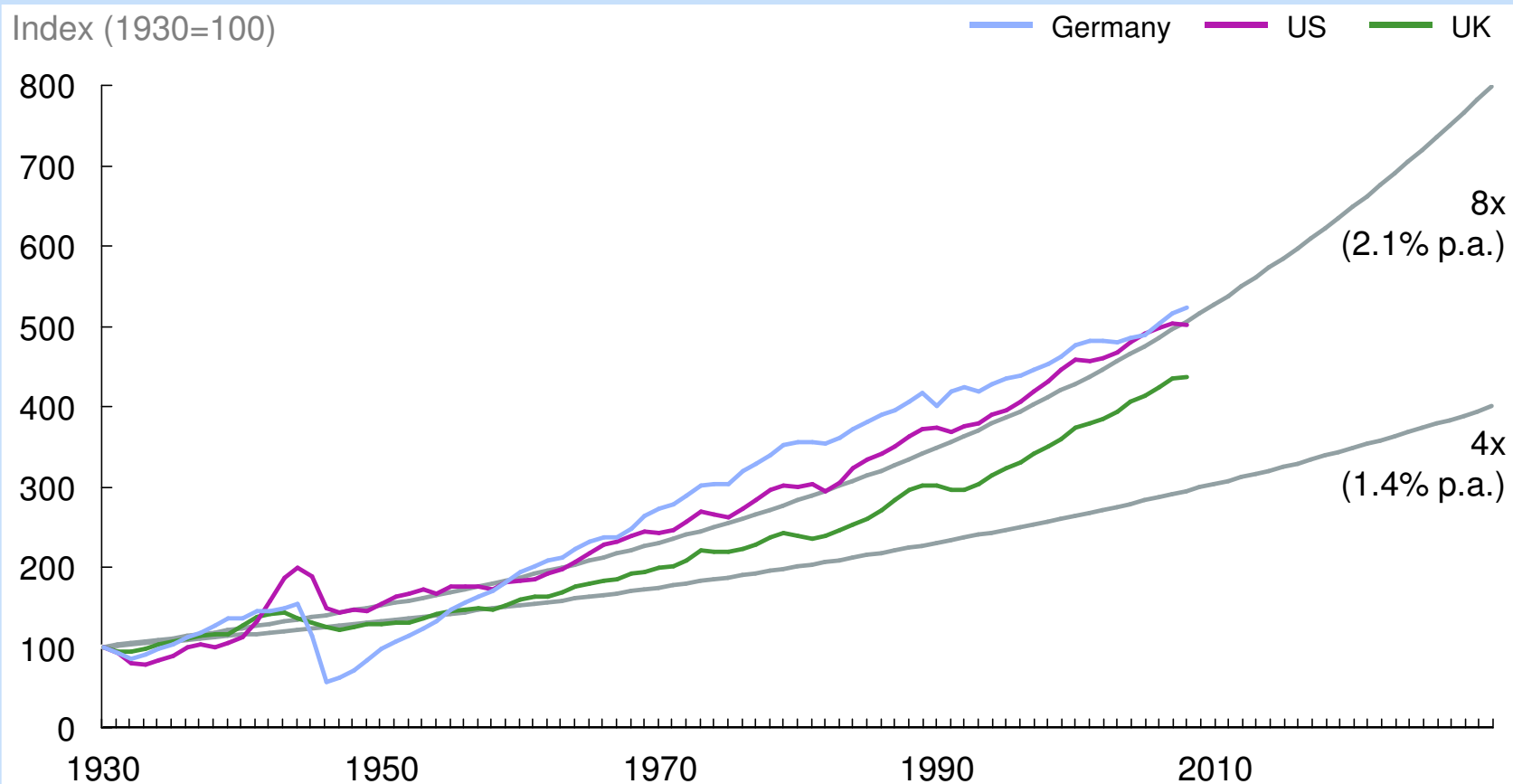
John Maynard Keynes
Economic Possibilities for our Grandchildren, 1930

Keynes's bold prediction:- “I would predict that the standard of life in progressive countries one hundred years hence will be between four and eight times as high as it is to-day”

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GDP per capita¹

Index (1930=100)



¹ GDP per capita in 1990 international Geary-Khamis dollars

SOURCE: Angus Maddison, IMF, McKinsey Global Institute analysis

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