TYCHOS

Germany Commentary 2-1-20

Commentary:

As a very high net exporter, Germany would be expected to have low private debt growth to GDP, and indeed that has been the case. Surprisingly, the ratio has recently been rising, especially in the non-financial corporation category, which if it continues would portend potential future concern.

The only non-financial corporation sector showing particular concern is IT, with potential concern in construction and real estate, both commercial and residential. Although smaller in size, the hotel and restaurant sectors have seen moderate debt growth since the end of 2019.

Germany's extraordinary net export benefit is seemingly locked in due to its advantageous entry into the EU, to the disadvantage of its EU partners. Currently, Germany's high net export position is unique among major developed countries. This leaves it subject to greater risk than other EU countries if the EU were to lose members.

The German private debt lending categories with greatest risks are foreign loans, OFIs, and corporate bonds.

Germany has rapidly rising cross border lending levels to the US. This is smaller than, but similar to, its cross-border risk to the US in the Great Recession.

The lending institution that merits highest concern for risk is DZ bank.

Germany's government debt ratio has increased this year to 70% in the third quarter, from 60% at 2019-year end.

Country Net Worth

Because of its extraordinary current account surplus trends, Germany is challenging Japan for the best aggregate country financial net worth to GDP. Interestingly, this is in spite of the country having one of the lowest household financial net worth positions, a fact overcome by its non-financial corporations having one of the best financial net worth positions, and its government having an intermediate financial net worth position in comparison to others in the Big Seven.

Background:

Accelerating private debt for a country is normally a signal for some level of economic boom, which is then often followed by some type of economic reversal or calamity. The same is also true for rapid debt growth within an economic sector. At the point credit growth becomes excessive, the result is credit problems for that country or sector. The reason is this: rapid growth in credit, while usually favorable in the short run, if sustained can lead to oversupply or overcapacity—e.g. too many houses or too much oil extraction capacity—at the country level, or within a given industry or sector. In fact, overcapacity is only possible through rapid debt expansion. Significant overcapacity is generally followed by two events—a drop in sector activity and the necessity of sector layoffs during the period while demand catches up, along with high credit losses for lenders in that sector.

There is no hard and fast measure for the level of growth that leads to overcapacity, since the nature of policy responses and other qualitative variables have a significant influence on how events play out. Nevertheless, what has been a useful threshold measure is that if overall private debt to GDP increases by 20% in a five-year window, and reaches 150% in that time frame, credit problems are a likely result. Within a given sector, if sector debt to GDP increases over 40% within five years, credit problems of increased likelihood within that sector. If the sector is large enough, e.g. the real estate sector, that sectors problems can spill over into other sectors bringing systemic national risk.

Disclaimer:

All data in this report is as current as is readily available. Certain data is less timely than desirable, especially sector level data. However, most adverse volume trends must hold for more than a year or two to create significant credit concerns, so this lag in data, while unfortunate, does not preclude of significant trends.