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# Thinking beyond public debt

Savings, salaries and systemic stability

EU flags outside the European Parliament in Strasbourg © AFP via Getty Images

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Our readers largely know that Italy's public debt burden is very high, both in absolute terms and in its debt-to-GDP ratio.

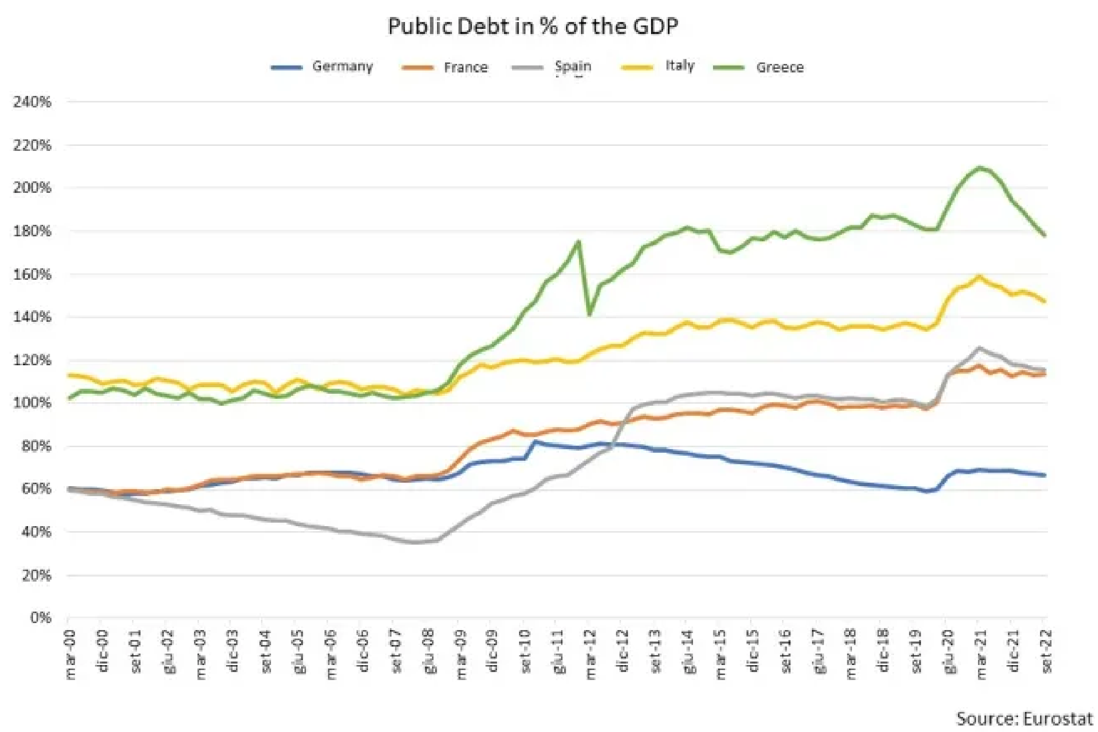
But this ignores a significant amount of the debt landscape: when private non-financial debt is included, Italy doesn't seem nearly as burdened.

To set the stage, we should first take a look at how public debt has evolved over time in the EU.

## Public and private debt

For our purposes today we will compare the four largest eurozone economies — and Greece, with its historically high debt burden and [recent signs of a turnround](#) — using BIS data on the market value of private and public debt.

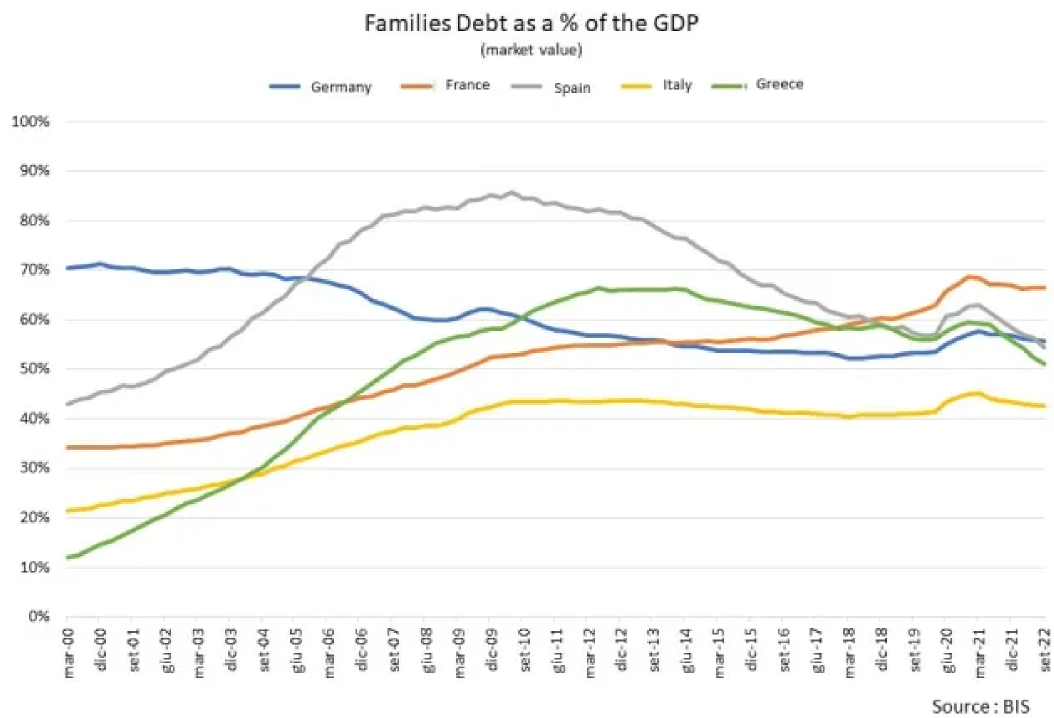
European countries' debt-to-GDP ratios mostly rose between 2008 and 2022, with Germany serving as an exception:



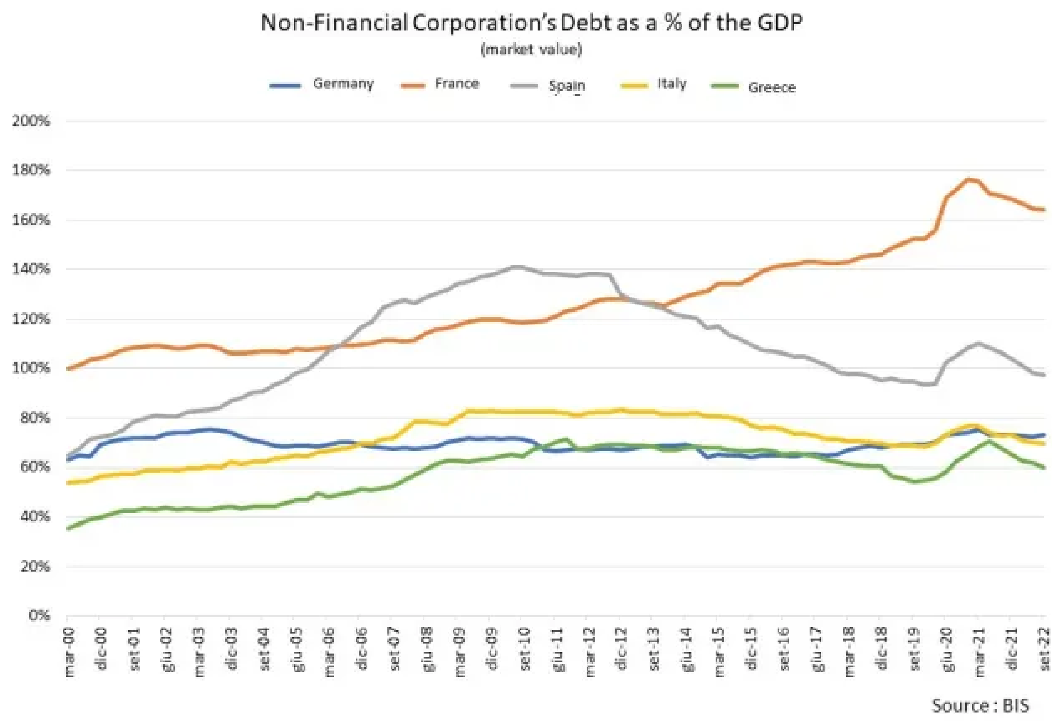
As shown above, debt-to-GDP ratios have decreased since February 2021. This decline has been global, as documented by the IFF, and is attributable to a couple of different factors. First, there's been an increase in GDP connected to the post-pandemic resumption of economic activities and international trade. Seconds, governments have relied less on debt issuance for funding since the end of the Covid-19 crisis.

And while the chart above shows that Italy's public debt level remains high relative to its peers, there are other ways to evaluate a country's indebtedness.

When private nonfinancial debt is taken into account, Italy's debt levels stands at considerably lower levels than many of its major European counterparts. Families in Italy, for example, have a lower debt burden than any of our comparison countries:

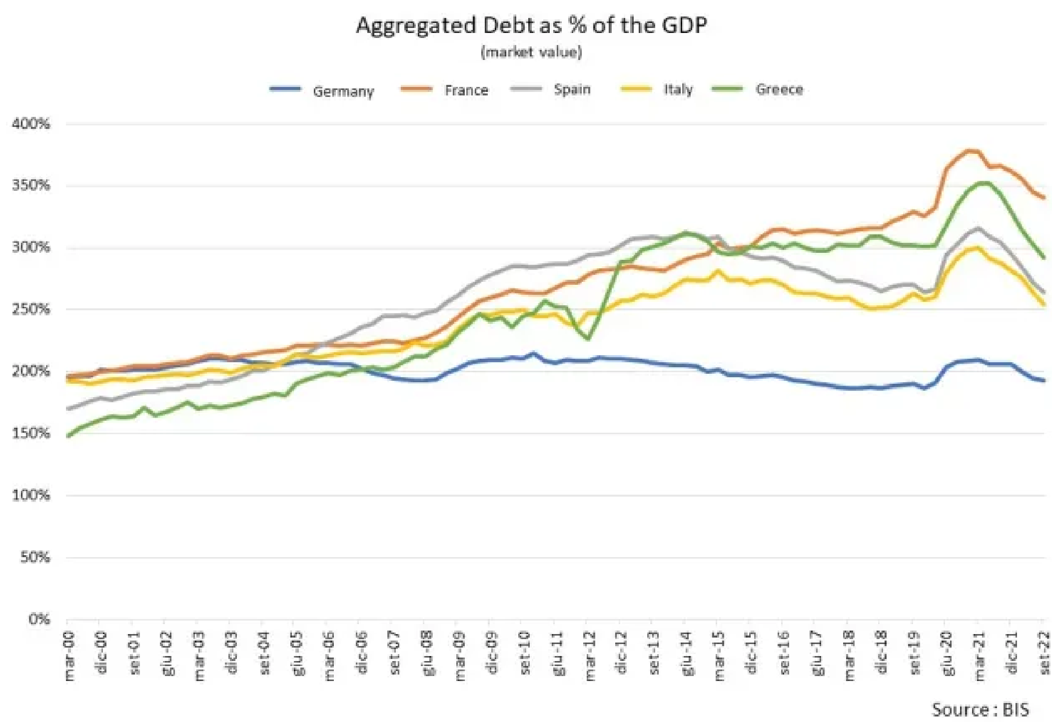



Italy also stands out for its relatively low levels of indebtedness among non-bank corporations:




## Low aggregate debt, high sovereign rates

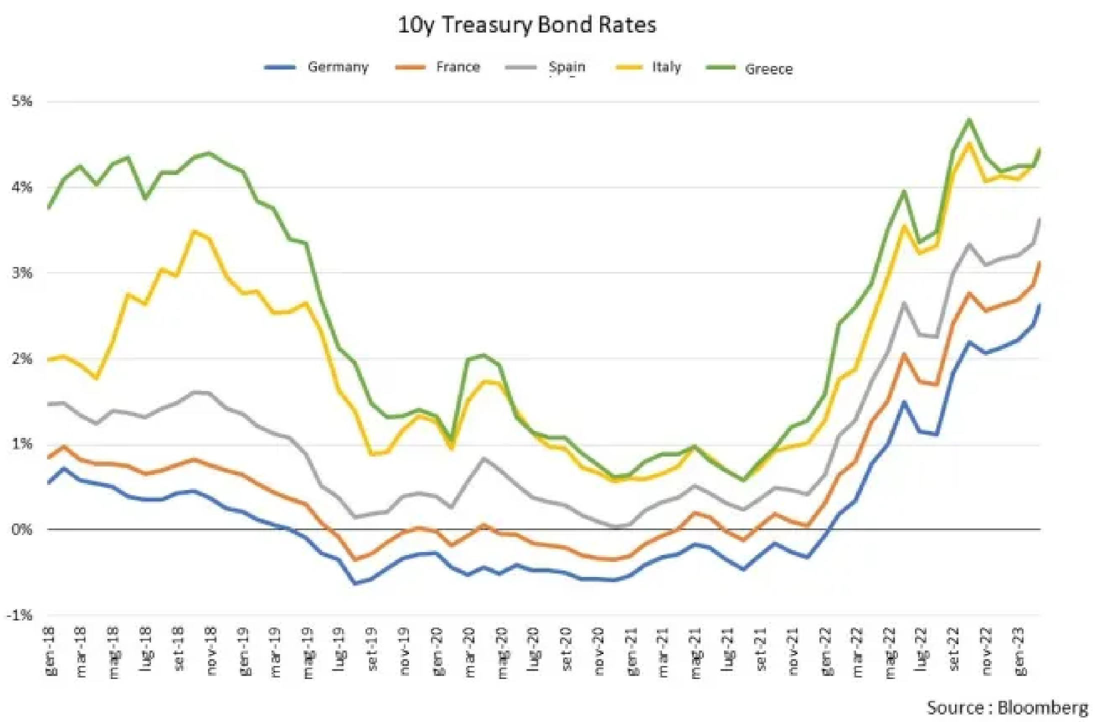
In fact, if we combine public debt and non-financial private sector debt and then compare them to GDP, Italy has the second-lowest debt burden of the group, right behind Germany:



That is something to take into consideration, since a high level of private debt might contribute to financial instability. This was the case for Iceland, where, just before the 2008 economic crisis, the private-debt-to-GDP ratio reached a ratio of 450 per cent.

The analogies do not end here, since that crisis hit hard when interest rates started to rise. (While Iceland's financial sector was the source of its problems, the 2008-09 crisis showed that many governments aren't willing to let their banks fail, giving them semi-public status.)

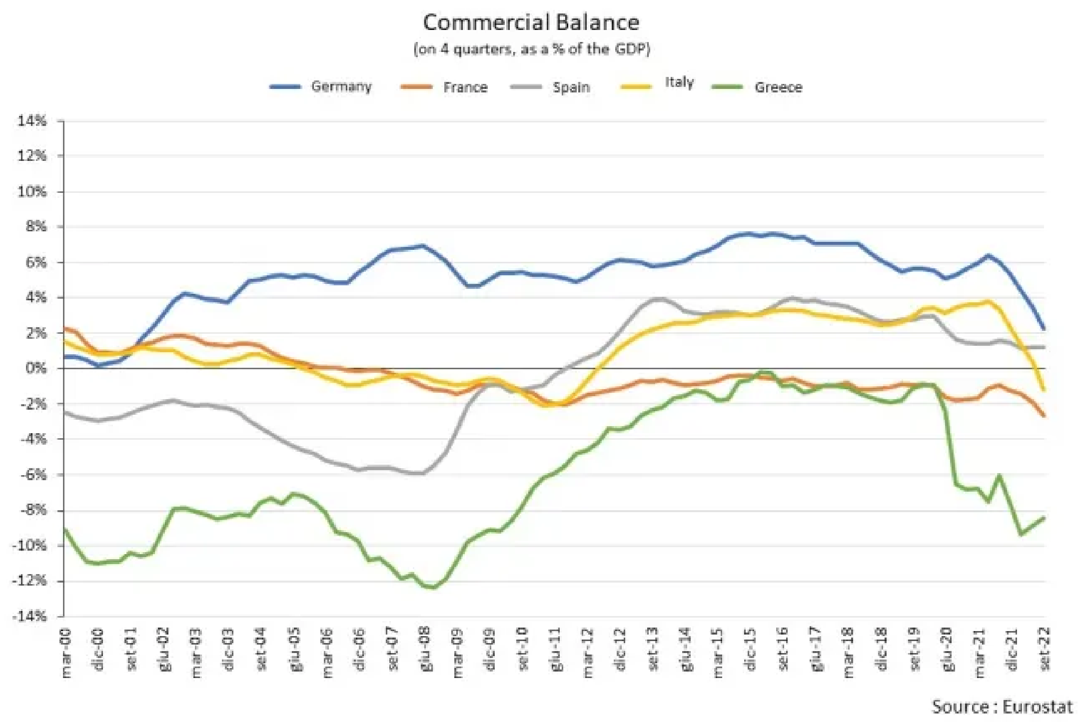
Yet even with its relatively low aggregate non-bank debt levels, Italy's sovereign yields remain high. Italy's average 10-year bond yield is the highest of the bunch, at 4.45 per cent to Greece's 4.42 per cent:




One could argue that investors' expectations are affected more by the EU's regulatory supervision than by macroeconomic conditions.

From this perspective, Italy appears to be disadvantaged by a regulatory system that has far too sharp a focus on public debt-to-GDP ratios, while underestimating or ignoring other parameters. One potential useful parameter neglected by EU regulatory supervision is the non-financial private sector debt-to-GDP ratio. Eurostat's monitor of macroeconomic imbalances prescribes that ratio remain below 133 per cent, while the comparable threshold for a country's public-debt-to-GDP ratio is 60 per cent.

Another parameter ignored by EU regulatory supervision is the measure of trade balances. Germany, for its part, spent years with a trade surplus greater than the 6-per-cent regulatory threshold set by Eurostat, and its trade surplus hovered above or right around that level from 2012 until 2021:




## Changing convergence criteria

One benefit of basing convergence rules on measurements of public debt is that EU member governments have direct control over their own borrowing. With private-debt monitoring, governments' relationships with borrowers and investors are subject to market rules, only mediated through government economic-policy actions.

Nevertheless, it might be necessary to reconsider and supplement the standard measurements in the review of the convergence criteria expected in the next few months. That review will take into account the exogenous variables that have affected the EU in the recent past (eg, the pandemic, war) or will affect it in the near future (climate change, immigration flows) and their consequences on the real economy (ie, inflationary pressures, levels of employment, and a need for structural investments). Officials may want to consider private debt levels as well.

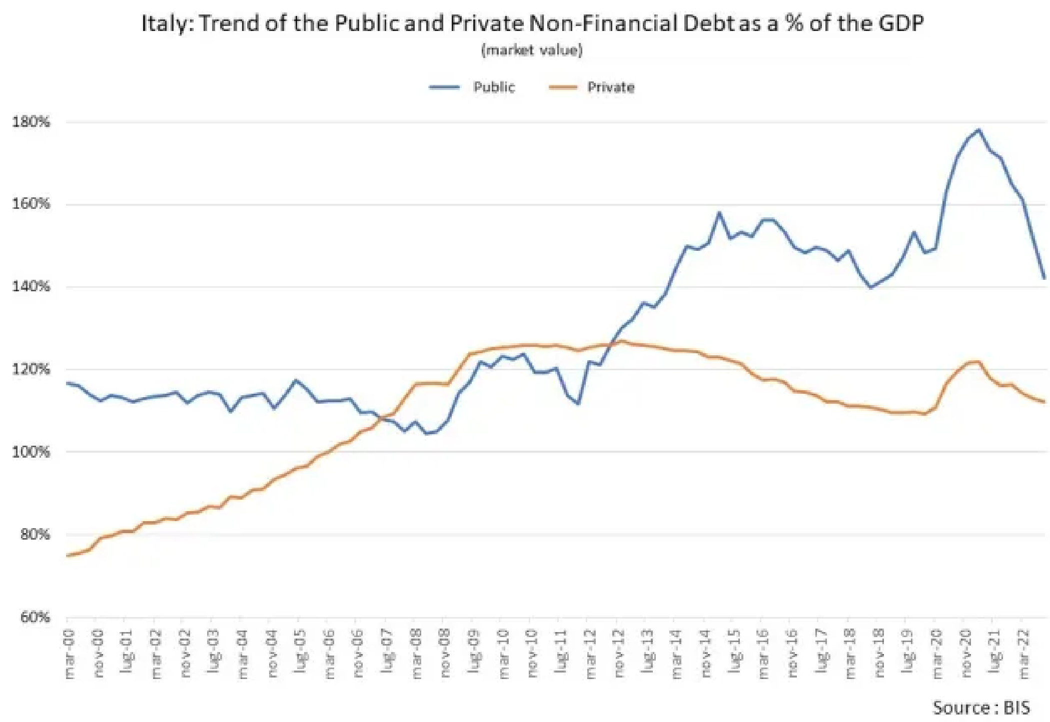
For example, we can expect that a low level of private-sector debt and/or a high level of private savings are likely to contribute to the system's stability, and, therefore, such phenomena must be considered by public debt management regulations.

A recent study shows that, since 1950, only on one occasion a reduction of public debt went hand in hand with a reduction of private sector debt.

These findings might be explained considering that a higher private debt exposure might have boosted the economy, consequently increased tax revenue and reducing the automatic stabilisers expenditure ratio. Alternatively, the stronger fiscal discipline directed to reduce public debt might have drained resources from the private sector and pushed companies and families to a higher debt exposure.

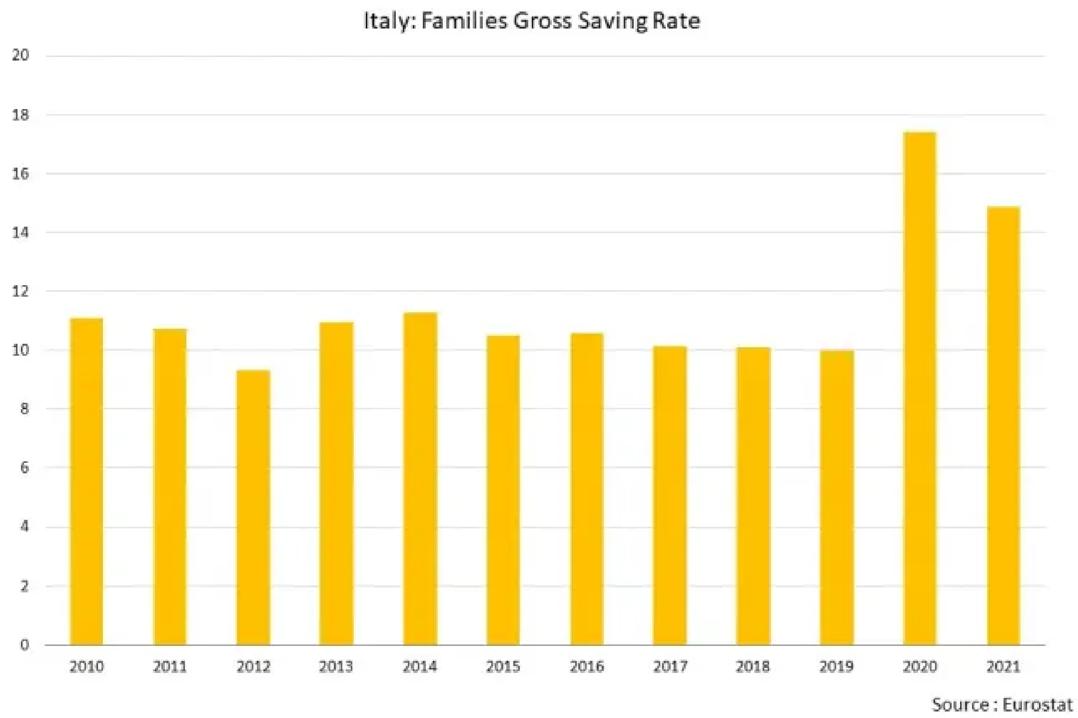
In any case, data collected over the past 70 years shows that if the private sector does not increase its debt exposure, it is unlikely that EU countries will be able to achieve a significant reduction of the public debt-to-GDP ratio.

In Italy, the public debt-to-GDP ratio has increased since 2008. This continued until the end of the pandemic. In contrast, private debt data shows a slowing growth since July 2009, followed by a less than proportional decline that started at the end of 2012, except for a temporary surge during the pandemic:




Italian families' total wealth (if we also consider real estate, net of liabilities) is over €10tn. During 2021, Italian families' net wealth was the highest in Europe, at 8.7 times their disposable income (France: 8.6; Germany: 8.8).

Nevertheless, the Italian savings rate, which has been the highest in the developed world for a long time, has been falling for at least two decades. But there has been a trend reversal with the start of the pandemic:




This is not surprising. In a climate of uncertainty, individuals are less likely to consume, and more likely to allocate a part of their income to savings. That's exactly what happened between January 2020 and September 2021, when families' financial wealth increased by €334bn, with the greater part of it deposited in bank accounts.

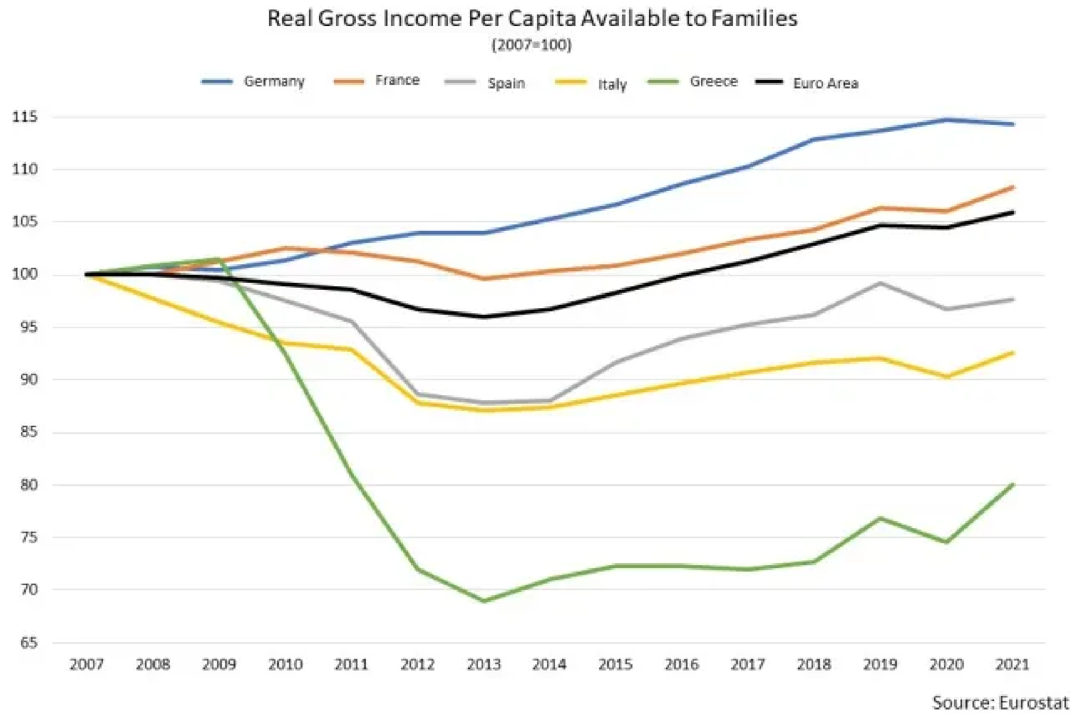
In 2004, Italians saved about 15 per cent of their yearly income, an average savings rate only surpassed by Germany and Belgium and higher than the broader eurozone's.

Today's situation is quite different. It is estimated that Italian families save on average just 10 per cent of their yearly income, the lowest in Italian history, while the eurozone averages 14 per cent. There is a widening gap between the savings rates of Italian families and German families.

After the pandemic, both private debt and families' savings rates increased in Italy: that's a clear indicator of an increase in social inequalities. In other words, the poorest individuals and those who suffered a decrease in income took debt to maintain their standard of living, while, the richest individuals invested even more.

## Savings, debt exposure, salaries and social inequalities

Italians' ongoing impoverishment is confirmed by the results of a study conducted by the International Labour Organization, or ILO: at purchasing power parity (PPP), the Germans and the French receive higher salaries today than they did in 2008, while Italians' salaries decreased by 12 per cent:




It is important to stay mindful of the challenges faced by Italy in its efforts to reduce the gap with the other Eurozone countries in terms of real income. The safest way to do that, and to strengthen the eurozone and EU in the process, is to review convergence policies that are far too focused on public debt alone.