Twitter Thread by Michael Pettis



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While debt-to-GDP ratios already have a limited but very misunderstood use, it seems economists are finding bright new ways of misunderstanding them. Now we say that when nominal interest rates are lower than nominal growth rates, the

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downward pressure on the debt-to-GDP ratio makes rising government debt and larger government deficits more sustainable and more easily justified.

This is totally confused. When the nominal interest rate is lower than the nominal GDP growth rate, it only means that net...

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borrowers are getting a disproportionate share of growth relative to net lenders. This in and of itself changes the comparability of the debt-to-GDP ratio, so the fact that the ratio may decline tells us nothing about its sustainability which, I'm glad to say, isn't...

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a mistake Olivier Blanchard makes in this article.

At least three things matter. First, whether or not rising debt is sustainable depends almost wholly on underlying conditions in the real economy, and only trivially on the arithmetical relationship between...

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the interest rate and the growth rate. Second, this approach simply assumes away financial distress costs, in which case debt capacity is infinite anyway and the interest rate becomes irrelevant. And third, it assumes that the nominal debt level matters independently...

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of its structure, and while this assumption allows economists to write well-regarded academic papers, it would fail you in finance class.

In the end, if more fiscal spending results in an increase in the real value of goods and services produced domestically, the real...

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debt-servicing costs to the economy are self-liquidating. When government borrowing results instead mainly in income transfers, then it can be either positive or negative, depending on whether those transfers increase demand or overall welfare (e.g. transfers to the...

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poor) or reduce it (transfers to rich savers).

It should be obvious, for example, that in cases where financial repression leads to investment misallocation, debt becomes less sustainable, not more, even though the interest rate is lower than the growth rate. Drawing...

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conclusions about debt sustainability from the relationship between the nominal interest rate and the nominal expected growth rate may at first seem like a clever trick, but it is just bad bond math.