Flash Economics

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Who is in the stronger position: lenders or borrowers?

When we look at the current account balances of major countries or geographical regions, we see:

- An external deficit in the United States and India;
- An external surplus in the euro zone, Japan, China and the oil-producing countries.

The net external debt of the United States and India is growing; the net external assets of Japan, China, the euro zone and oil-producing countries are increasing.

The question we ask ourselves is: "Who is in the stronger position: the lending countries or the borrowing countries?" Borrowing countries can threaten to default, which would only temporarily deprive them of access to financial markets. Lender countries can threaten to stop lending to borrower countries; but if they do in fact stop lending, they will face default by the borrower countries and a contraction in their exports to those countries, which would be difficult for lenders to bear if the borrowers are large. In reality, the threat to stop lending is not very credible. For example, China stopped buying US Treasury bonds, but continued to lend heavily to the United States (as shown by the AidData database at the University of William and Mary).

Clearly it is primarily the borrowers who are in a position of strength.

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Current account balances and external debt or assets

We examine the situations in the United States, India, the euro zone, Japan, China and oil-producing countries (Saudi Arabia, Qatar, the United Arab Emirates and Kuwait). **The United States and India have current account deficits, whilst the euro zone, Japan, China and oil-producing countries have current account surpluses** (**Charts 1A/B/C**).

Chart 1A
Current account balance (as % of nominal GDP)

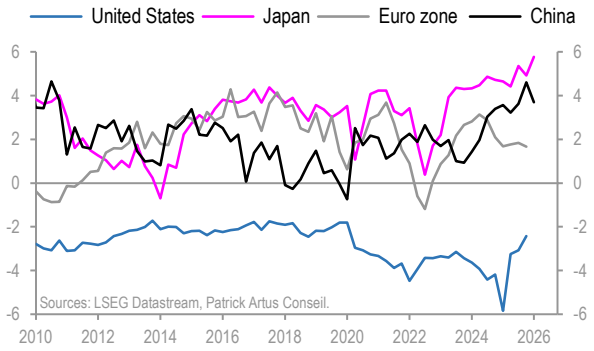


Chart 1B
India: Current account balance (as % of nominal GDP)

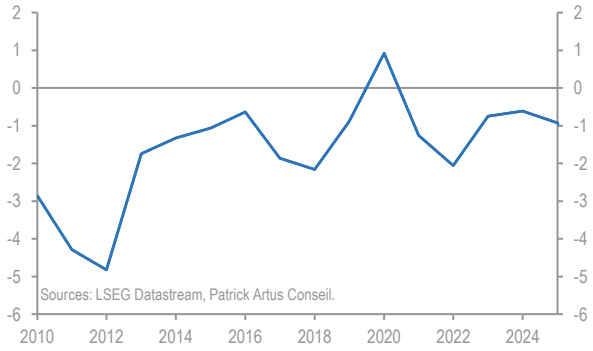
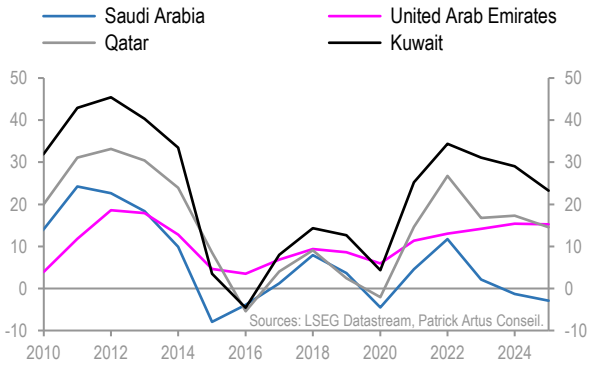


Chart 1C
Current account balance (as % of nominal GDP)



The United States and India **have a negative net external position** (external debt exceeds external assets), whereas the euro zone, Japan, China and oil-producing countries have a **positive net external position** (external assets exceed external debt; Charts **2A/B/C**). Data covering all oil-producing countries is not available with regard to external assets.

Chart 2A
Net foreign assets or liabilities (as % of nominal GDP)

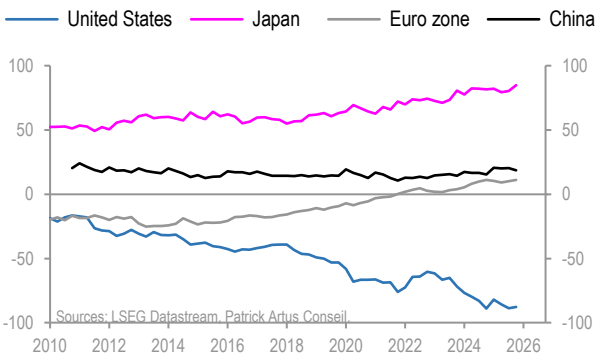


Chart 2B
India: Net foreign assets or liabilities (as % of nominal GDP)

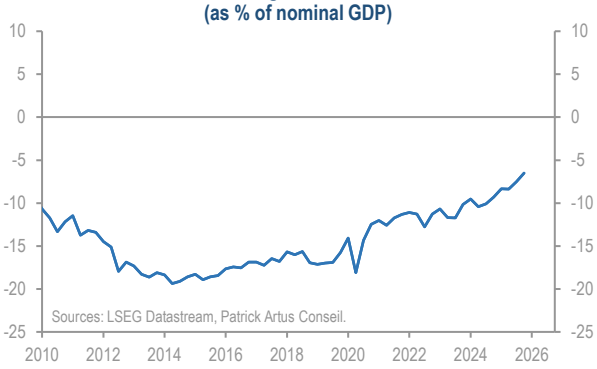
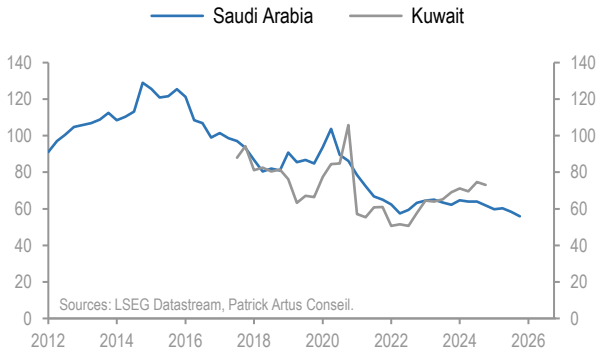


Chart 2C
Net foreign assets or liabilities (as % of nominal GDP)



The question we are asking is this: "**Who holds the upper hand: the creditor countries or the debtor countries**?"

Debtor countries can threaten to default, as default would only temporarily deprive them of access to the markets.

The threat available to borrowing countries is default, the total or partial cancellation of debt. This threat would not be credible if a default led to a permanent loss of access to financial markets. But a default does not permanently exclude a country from access to financial markets. In Europe, we see the example of Greece.

In 2011–2012, Greece and its creditors reached an agreement under which private banks would write off 53% of the Greek public debt they held. By 2014, Greece was able to borrow again on the financial markets, and today there is no trace of lenders' mistrust towards Greece.

Chart 3A shows Greece's public debt ratio, whilst **Chart 3B** shows the 10-year interest rate on Greek debt. We can see the decline in the public debt ratio in 2012 following the write-off of part of the debt, and the return to normal long-term interest rates from 2014 onwards.

Chart 3A
Greece: Public debt (as % of nominal GDP)

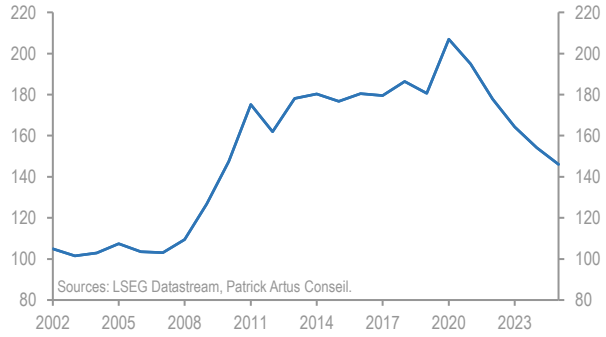
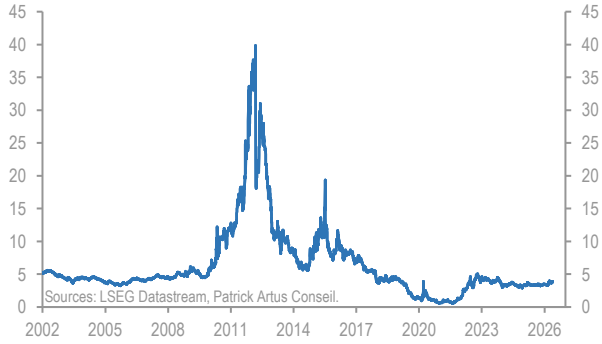


Chart 3B
Greece: Interest rate on 10-year government bonds (as %)



In reality, the threat of stopping lending is not very credible if the borrowers are large

The threat that creditor countries have at their disposal is to stop lending. But we believe that **this threat is not very credible**. Indeed, if creditor countries stop lending, they run the risk of:

- Facing a default by the borrowing country;
- A contraction in their exports, due to weaker demand in the borrowing countries.

One can see, for example, that China:

- **Has stopped buying US Treasury securities**, and has even become a seller of these securities (**Chart 4**);
- **But has replaced purchases of Treasury securities with loans**. AidData (William and Mary University) data show that between 2002 and 2023, China lent $2,002 billion to the United States to finance 2,500 projects, mainly in infrastructure, technology, ports, energy and electricity.

Chart 4
United States: Holdings of Treasuries by China (USD bn)



Summary: Overall, borrowers are in a position of strength

Lenders cannot stop lending, due to the risk of borrower default and the risk of a decline in exports that a halt to lending would expose them to. Furthermore, stopping lending leads to reduced investment in the economies of countries that may be attractive in terms of technological level and growth prospects.

Past experience shows that when borrowers default, they regain access to international financial markets fairly quickly. This demonstrates that the threat of default is credible, whereas the threat of a halt to lending is not. **Consequently, we believe that it is the borrowers (for example, the United States or India) and not the lenders (for example, the euro zone, Japan, China and the oil-producing countries) who are in a position of strength**.

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