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Deleveraging: Now the hard part

The challenge of managing the enormous debt burden weighing on global recovery is only just beginning.

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Even as signals multiply that a global economic recovery is underway, government and business leaders face uncertainty over its durability and how to manage the lengthy process of debt reduction—or deleveraging—that will weigh on growth after the bursting of the great global credit bubble.

New McKinsey research shows that the challenge of reducing total debt levels relative to GDP is a global problem that is only just getting started. Leverage is still very high in some sectors of several countries, including the United States. History also shows that deleveraging episodes are painful—on average lasting six to seven years—and exert a significant drag on GDP growth in the early stages.

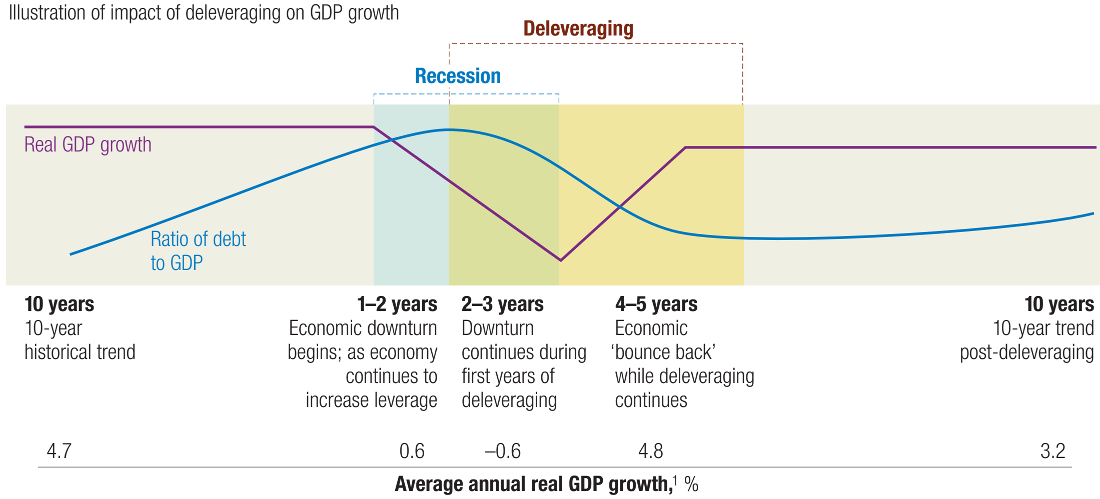
Several elements in today's environment—including the global nature of the crisis and sharply increasing government debt levels—suggest that deleveraging may start later and take longer this time around. These are among the findings of the recent McKinsey Global Institute (MGI) report *Debt and deleveraging: The global credit bubble and its economic consequences*. The report also assesses the implications for business executives, who will likely face more expensive and less available credit; regulators, who must increase the stability of the financial system going forward; and policy makers, who face a delicate balancing act in choosing between approaches to stimulate GDP growth to gently "grow" into current debt levels or to spend in ways that add to debt without significantly boosting growth, prolonging the deleveraging process and its harsh effects.

To read an executive summary or download the full report, visit mckinsey.com/mgi.

Exhibit

A slow start

Illustration of impact of deleveraging on GDP growth



[1] For "belt tightening" scenario (historically, the most common path). This scenario involves a prolonged period of austerity during which most countries experience some growth in credit, but at a pace that is far below pre-crisis rates of growth and slower than nominal GDP growth.

Source: International Monetary Fund (IMF); McKinsey Global Institute analysis

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