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The World Economy Is Hooked On Government Debt for Growth

BY TOM FAIRLESS

FRANKFURT—This year, global growth is being brought to you by the government.

Rocked by an avalanche of growth-sapping shocks, countries are tearing up savings plans and rolling out large fiscal stimulus packages financed by bumper budget deficits.

From slow-growing Europe to the U.S. and parts of Asia, where multitrillion-dollar investments in artificial intelligence are fueling demand, the spending spree is expected to boost economic growth and jobs in the near term. Global growth could accelerate to a 3% annual rate over the next six months as a result, according to JPMorgan.

This could be a risky strategy at a time of low unemployment and higher interest rates, economists say.

In Japan, the yields on longterm government debt surged to records last week after Prime Minister Sanae Takaichi unveiled a plan to increase spending and cut consumption tax ahead of snap elections in February. The selloff spilled into global markets, pushing up U.S. Treasury yields.

"It's a red flag. It's another symptom of the vulnerabilities bubbling under the surface of advanced economies," said Neil Shearing, chief economist at Capital Economics in London. These vulnerabilities include weak private-sector demand and poor productivity growth, Shearing said.

As President Trump threatened a sharp escalation of the trade war over Greenland, Europe's economy looks particularly vulnerable, with few sources of growth outside government largess.

In the U.S. and Germany, the world's No. 1 and 3 economies, fiscal stimulus is set to boost economic growth by around one percentage point this year, according to calculations by Torsten Slok, chief economist at Apollo Global Management. In Japan—number four—the stimulus will boost growth by a half-percentage point. China is set to run a nearly 9% of GDP aggregate budget deficit for the second year in a row, roughly twice as large as its expected growth rate.

The wall of government money aims to address growing challenges. Politicians are seeking to support companies whose business models are threatened by AI, U.S. tariffs and China's subsidized exports. Many countries are also spending

heavily to rearm in a more uncertain world, to finance a transition to cleaner energy, or to care for rapidly aging populations.

In the past, this would have meant higher taxes, not just higher deficits. But today's leaders are reluctant to hand voters the bill. Government budget deficits averaged 4.6% across advanced economies and 6.3% in emerging markets last year, up from 2.6% and 4%, respectively, a decade earlier, according to IMF data.

In the U.S., this year's expected 6% of GDP budget deficit partly reflects efforts to keep tax rates low. Goldman Sachs expects the U.S. economy to grow by 2.5% this year, up from around 2% last year, as the drag from tariffs gives way to a boost from tax cuts, according to a Jan. 16 note.

In Germany, whose trillioneuro defense-and-infrastructure spending package is expected to support growth, taxes are among the highest in the developed world and raising them further could weaken growth prospects.

Germany's relatively low public debt is an exception, however. After exploding during the pandemic and shrinking somewhat as a share of economic output, global public debt is projected to exceed 100% of global GDP by 2029, its highest level since 1948, according to an October IMF report.

Bond markets seized up when former U.K. Prime Minister Liz Truss proposed unfunded tax cuts in late 2022, prompting her resignation. Interest rates have marched upward in France over the past two years as President Emmanuel Macron's governments struggled to pass a budget.

Yet there has been no repeat of the investor flight that sparked the eurozone's sovereign-debt crisis in 2010. In fact, governments learned during the pandemic that significant increases in public spending didn't come with immediate problems, said Ricardo Reis, economics professor at the London School of Economics.

The heavy spending represents a strategic shift. After the global financial crisis, many countries, especially in Europe, tightened their belts to reassure jittery investors. Today, leaders have learned that austerity isn't just unpopular but has also led to weak militaries and crumbling infrastructure.

As spending becomes harder to finance, some governments could eventually have to raise taxes or reduce expenditures, some economists say.

"I'm quite worried," Reis said. The interest bill "is getting to very high levels in any kind of historic comparison."

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