

*Opinion***The ticking time bomb in the financial markets**

Pirmin Hotz

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Anyone following daily headlines will inevitably conclude that the war in Ukraine, the Gaza conflict and the tariff policy of the United States of America are the biggest problems affecting the world. Despite the human suffering, the impact of these trouble spots on the financial markets seems surprisingly modest.

Investors have long since grown used to the warfare, and the initial panic exhibited by investors at the announcement of the erratic tariff regime by US President Donald Trump has subsided as well. One might even contend that investors are no longer inclined to take the would-be dictator seriously.

**Government debt soars**

A telling indication of this was Friday, 1 August, when the Swiss stock exchanges were closed for the holiday. When Trump signed an executive order with sweeping tariff increases on imports from 68 countries and the EU, many analysts predicted that the Swiss stock market would plummet by 10 to 15% on the following Monday.

But this collapse in prices did not occur. Swiss equities closed at around the previous day's level, despite the imposition of punitive 39% tariffs. Investors evidently believe that dealing with irrational politicians is a waste of time.

Global government debt is a potentially far greater burden that is likely to weigh heavily on the financial markets. As if tomorrow would indeed never come, politicians of all persuasions are outdoing one another with their reckless spending policies.

Japan leads the world in spending, and its debt has now reached an astronomical level at 240% of gross domestic product (GDP). Europe has become accustomed to breaching the Maastricht criteria, which stipulate a maximum deficit of 3% and a debt ceiling of 60% of GDP. French debt is currently at 116% and Italy's at 135%.

The USA – whose debt stands at 120% and continues its steep upward trajectory – is increasingly becoming the chief source of concern. The fact that the Americans are running alarming annual deficits of 7% during a period of economic boom makes matters even worse.

Americans experienced their own version of a 'Liz Truss shock' when Trump announced his tariff plans in April. The prices of credit default swaps on treasury bonds shot up, prompting the president to shelve his plans.

Interest rates on long-term bonds have risen significantly in recent years, not just in the USA, but also in Japan, the UK and France, indicating shaken investor confidence.

As the European sovereign debt crisis aptly demonstrated over ten years ago, the unholy union between states, banks and insurance companies has become a ticking time bomb.

**“A sustained period of loose monetary policy leads to asset bubbles and irrational excesses in the financial markets.”**

The financial institutions have immense holdings of 'risk-free' government bonds on their books. But when rating agencies downgrade the creditworthiness of securities, their equity evaporates rapidly.

**Independence of central banks at risk**

Japan is a prime example of how states with excessive debt simply cannot afford high interest rates. The country has been keeping interest rates artificially low

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for many years. This has led to a massive devaluation of the yen and to risky, speculative transactions with cheap money (carry trades).

For his part, Trump is doing everything he can to force the Fed into cutting interest rates sharply in order to devalue the dollar and ease the burden on the national budget.

So far, Fed Chair Jerome Powell has stood his ground in the face of this pressure. However, it is foreseeable that his successor in May 2026 will seek to win Trump's approval, which might lead to accelerated cuts in interest rates.

Under pressure from governments, the central banks of highly indebted countries quite simply have no choice but to rely on financial repression to keep interest rates down and to push them below inflation – to the detriment of savers who, in real terms, experience gradual expropriation.

Central banks increasingly face the dilemma of mounting government debt and the need to maintain low interest rates. The independence of central banks from politics is at risk.

A protracted period of loose monetary policy leads to asset bubbles and irrational excesses on the financial markets. It is fuelling a boom in assets such as Bitcoin – which is not actually productive capital, has no intrinsic value and yields neither dividends nor interest.

Other speculative trends include meme coins such as Dogecoin or Shiba Inu, whose existence is based solely on the speculative frenzy of avaricious investors. Social media communities use cheap money to drive up the prices of investments that are often illiquid and easy to manipulate.

Excesses are also evident in the booming AI sector and certain tech stocks. The boom in gold, silver and platinum prices would barely have been possible without a loose monetary policy, nor would the boom in risky private market bonds (private debt).

This is reminiscent of the “junk bond king” Michael Milken, who rose to Wall Street fame during the 1980s with high-yield bonds – before the entire structure collapsed.

There are again signs from the United States that another crisis may be brewing, where the regional

banks Zions and Western Alliance and the bankruptcy of two billion-euro suppliers to the automotive industry, First Brands and Tricolor, are causing uncertainty.

### The moment of truth

Property prices are also soaring in many countries around the world. The Swiss mortgage volume of over 130% relative to GDP is a world record.

A significant rise in interest rates and, as a result, a property crisis like the one in the early 1990s, when residential and commercial properties in Switzerland lost between 30 and 50% of their value, would likely cause trouble for many lending banks and not just for numerous homeowners.

The moment of truth will come when the economy experiences a downturn, companies' earnings fall and businesses therefore owe less tax. When this moment comes, interest rates will already be too low to permit further cuts.

Similarly, governments will hardly be able to launch additional stimulus programmes due to the perilous state of the public coffers and the gradual erosion of investor confidence in government bonds.

The symbiosis of irresponsible fiscal policy and notoriously loose monetary policy is the mother of all bubbles and crises. It is a balancing act on a razor's edge.

“Despite numerous bear phases, Swiss equities delivered an attractive annual return of 7.7% over the past hundred years.”

Investors are faced with the question of whether to sell their equities for fear of a crisis and a stock market crash. This is not advisable for two reasons.

Firstly, equities offer better protection against crises than deposits with governments and banks, which have often collapsed in major crises. Despite numerous bear markets, Swiss equities have generated

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attractive annual returns of 7.7% in nominal terms and 5.6% in real terms over the last hundred years.

Secondly, the timing of crises cannot be predicted. The downfall of CS was triggered by a “harmless” tweet posted by an Australian journalist, while Greece – a country of no global significance – lit the fire that led to the eurozone crisis.

Not even the gods – at best perhaps the notorious prophets of doom – know which spark will trigger the next crisis and when it will happen.

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