Beneath the Surface

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SIGNET

US Public Debt Dynamics

- With its proverbial printing press and a current account deficit, the US is never about to default on its financial obligations. The alarmist narrative against excessive public debt has gained momentum in recent years, but that narrative is hardly new, as David Hume's essay from 1752 opines: *"It must, indeed, be one of these two events; either the nation must destroy public credit, or public credit will destroy the nation. It is impossible that they can both subsist."*

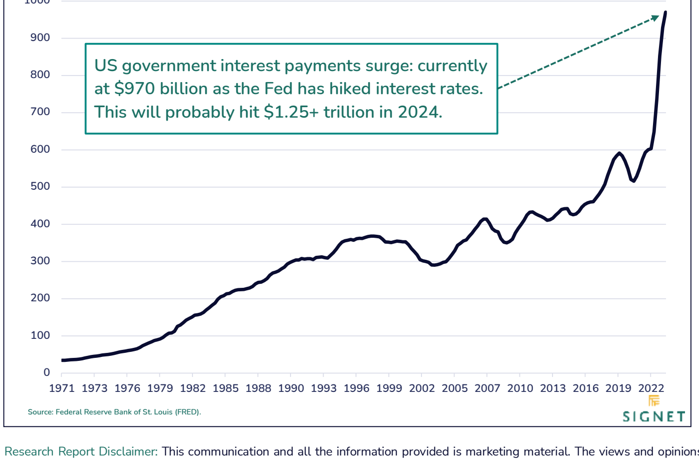
- However, it remains the case that US debt dynamics have become increasingly unanchored in recent years: routine public deficits, aggressive monetary policy and shifts in international demand have created pressures that are becoming more noticeable. US public debt exceeds $32 trillion, up from $23 trillion in Q1 2020. Public debt-to-GDP currently sits at 119% against 80% in 2009 and 106% at the end of WW2. This isn't meant to sound alarmist – Japan's public debt-to-GDP, for example, currently sits at a more eye-opening 218% – but the trend does present the US economy and its policy makers with several challenges.

- The federal government's current interest expense has exploded in the last year (chart, below left); it currently sits at $970 billion per annum – up from $520 billion in 2020. To put that into context, the US defense budget is $790 billion per annum. With an average duration of five years, that interest expense is due to increase rapidly in 2024, given the rate hikes and the deteriorating budget deficit. Federal spending has reached $4.81 trillion so far in the 2022 / 23 fiscal year, compared to $4.35 trillion for the same period last year (Oct 2021 - Jun 2022), an increase of $460 billion. This is deficit spending as well – the US budget deficit is expected to surpass $1.5 trillion in 2023, equal to 5.8% of GDP, which is unusually high during an economic expansion. For perspective, this exceeds the GFC deficit spending experienced in the calendar years 2007 to 2010, which averaged just 5.6% of GDP.

- The more pressing concern centers around exactly *who* will be holding all this US public debt. The share to major foreign holders has declined from 34% in 2014 to 23% now (chart, below right) and, within that, the share to foreign official holders has declined notably (China and Russia etc.) in the last two years. The 15th BRICS summit being held this month is unlikely to conclude with a reversal of this trend. The Fed is also reducing its allocation to public debt through quantitative tightening (QT). With the Fed and foreigners holding less, it falls on the private sector to hold a higher allocation of public debt; a dynamic that risks 'crowding out' productive investment elsewhere. The abrupt expansion in public debt means that the US economy is stifled with an increasing exposure to a low (negative?) government fiscal multiplier and less exposure to the high, positive economic multiplier of the private sector.

- Therefore, all other things being equal, the US economy may well continue its post-GFC stagnation. We expect a headwind for private asset classes, the possibility of renewed quantitative easing (QE) and yield curve control (YCC).

US Federal Government Current Interest Expense ($): 1971-2023



US Federal Debt held by Foreigners (%): 1971-2023