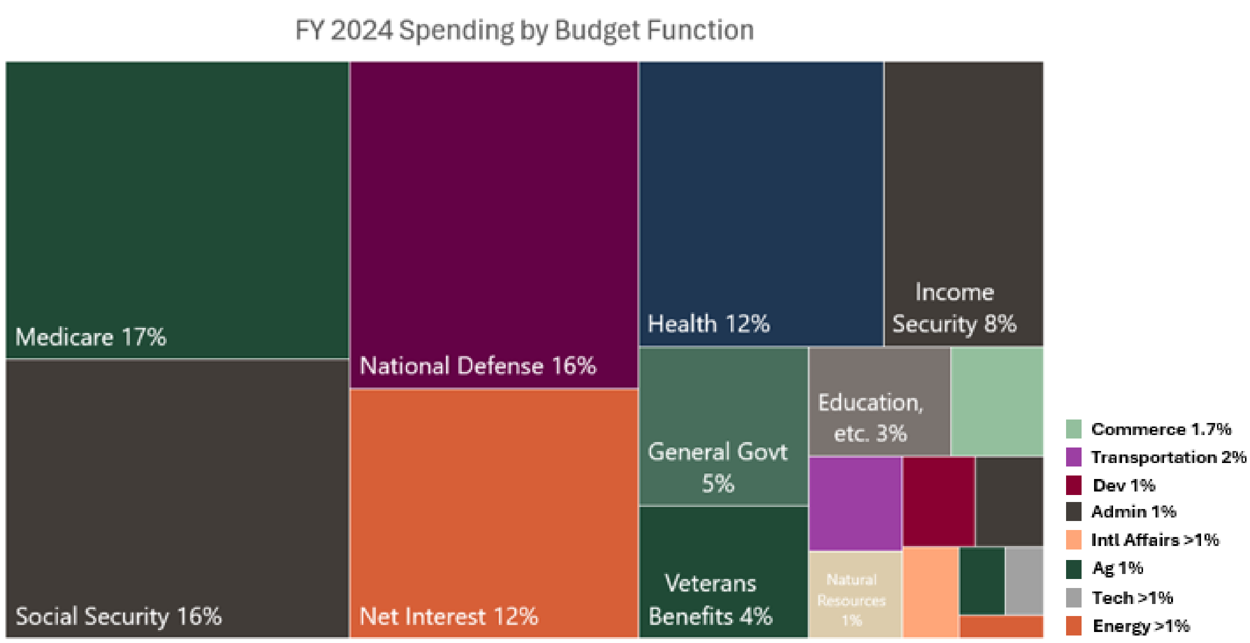
The US National Debt: History and Impact of Budget Deficits

The United States Census estimated the US population to 337,194,721 individuals as of September 30, 2024. Also as of September 30, 2024, the US National Debt was calculated to $35,296,367,284,952*, or, roughly, $104,676.51 per person. Now, if your local agency had to issue a $10 million par value 10-year bond at the same rate as a 10-Year US Treasury Bond, it would pay 3.781% in interest. This amounts to approximately $378,100 per year which would then need to be included in the local agency's fiscal budget.

This brings us to the Federal Budget. The federal budget is a plan for federal spending, revenues and borrowing for the fiscal year. The federal budget takes almost a full year to work through the process beginning with the President's proposal through funding assuming all information is submitted on time. A budget can have a surplus or deficit. A surplus occurs when more taxes or revenues are collected than are spent. The US last had a surplus in 2001, and only three other times since 1950. A budget deficit occurs when the money going out exceeds the money coming in for a given period.

To pay for federal government programs while operating under a deficit, the federal government borrows money by selling non-marketable and marketable securities. These marketable securities primarily exist of US Treasury bills, notes and bonds which are considered risk free as they are backed by the "full faith and credit" of the US government. This backing makes Treasury bonds the benchmark for many rates in the US and Global Markets.



Source: USA Spending website – US Treasury Fiscal Data

The national debt is the accumulation of this borrowing along with the associated interest owed to investors who purchased these securities. The more the government borrows, the more securities the government must issue and thus the more interest it must pay. In 2024, the Congressional Budget Office (CBO) reported federal spending will reach its highest level ever outside of a crisis. Most of the record spending growth is attributable to the rising cost of interest payments on the national debt as well as non-health, non-Social Security mandatory spending.

The above example illustrates how the growing United States Federal Debt has become an ever-increasing burden for policymakers and a reality the Bond Market can ill afford to ignore. By jumping back to the inception of the nation's debt, we can see how and why we arrived at the current national debt level, its impact on the bond market and the potential implications of growing national debt on local agencies.

The US government has carried debt since the inception of the country with most surges occurring due to crises like war and famine. National debt was first incurred during the Revolutionary War due to loans taken from France, the Netherlands and domestic investors amounting to $75 million once consolidated with state debts. Different administrations worked to reduce the national debt, but the War of 1812 caused it to begin to increase again. In 1835, the national debt was paid off for the first and only time under President Andrew Jackson following federal land sales and deep cuts to the federal budget. The fiscal budget surplus lasted for one year ending as the US fell into a deep depression with the Panic of 1819. The debt then grew throughout the course of the American Civil War, increasing from $65 million in 1860 to $1 billion in 1863.

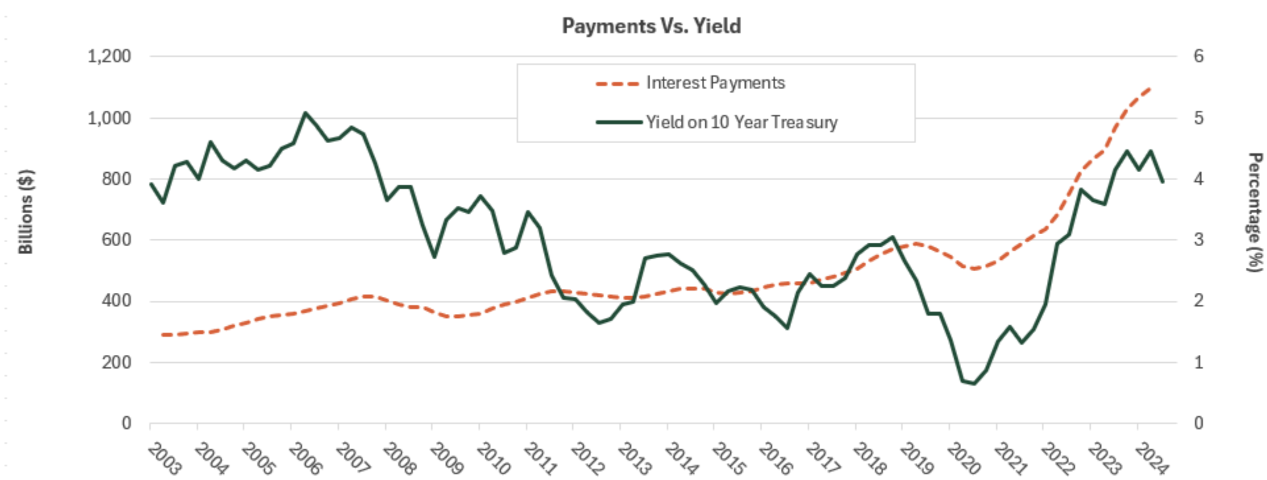
The Twentieth Century saw the federal debt rise through the years and by the end of World War I, it had accumulated to $22 billion. Black Tuesday in 1929 set off the Great Depression with unemployment rising above 20%. To provide aide to US citizens, President Herbert Hoover doubled federal spending and, along with Congress, focused on raising taxes in his last year in office attempting to balance the federal budget. When President Franklin Roosevelt came into office embracing Keynesian economics, the first 100 days of his presidency were focused on implementing the New Deal which required a substantial amount of government funding for grant and loan programs. The New Deal and the second New Deal created many programs with the aim of easing the burden on US Citizens from the Great Depression. Several of the programs continue to exist today including the Social Security Act and Civilian Conservation Corps.

The first half of the Twentieth Century culminated with the ending of World War II which increased the Federal debt to just under $260 billion due to loans to Allied Nations and the United States' own involvement in the war. In a major milestone, 1945 was the first year the national debt was 100% of US Gross Domestic Product (GDP). Debt-to-GDP is a highly watched metric as it is a key ratio that demonstrates a country's ability to repay its debts. The US successfully reduced its debt-to-GDP ratio after World War II through a combination of primary surpluses and rapid economic growth. The Nixon Shock, when President Richard Nixon removed the US Dollar from the gold standard (established through the Bretton Woods system after WWII) which led to the Great Inflation of the 1970s and culminated in the national debt crossing $1 trillion for the first time in 1981.

The Great Recession increased federal government spending, pushing the debt-to-GDP ratio back above 100% in 2013. To combat the challenges of 2008, the Federal Open Market Committee (FOMC) used quantitative easing (QE) which began to contribute to an already growing deficit. QE is a type of monetary policy involving the Federal Reserve purchasing securities to move money into circulation to encourage economic activity. The QE of the 2010's enabled a period of low interest rates with the Federal Funds Rate near 0% for most of the decade. This provided opportunities for the federal government to issue more debt ($174 billion per Fiscal Data of the US Treasury) with historically low costs of funding.

In response to the COVID pandemic and global shutdowns, US government spending increased 50% from 2019 to 2021, entering another round of QE. Under the current and previous presidential administrations, $12.7 trillion were added to the nation's debt with less than half of that attributable to Covid response programs such as the CARES Act, Coronavirus Relief Bill, Phase 4 Stimulus and the American Rescue Plan.** The QE enacted at the onset of the pandemic continued to stoke inflation which led to interest rates rising over 5% in a year and a half.

The cost of servicing the national debt continues to rise as more debt is issued and interest rates move off the historically low rates of the 2010s. The combination of the high debt and high interest rates means the federal government's cost to service the debt takes up an increasingly larger share of government spending. In the Monthly Treasury Statement issued by the US Department of the Treasury in August, the interest payments on the debt securities represent over $1 trillion for the full 2024 fiscal year, over 12% of the budget, and it is expected to continue to rise through the next decade.

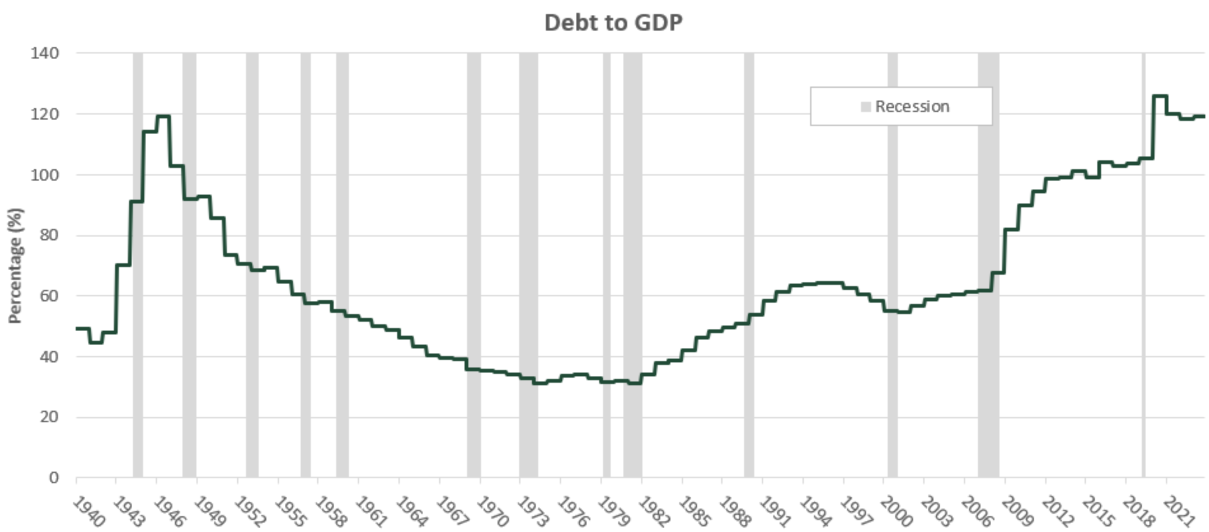


Source: Federal Reserve Bank of St. Louis

The CBO indicated in its June 2024 report that the US national debt is poised to top $56 trillion by 2034 as rising spending and interest expenses outpace tax revenues. The deficit in 2024 is now projected to be $1.9 trillion, up from $1.6 trillion previously forecasted and is projected to swell to $2.9 trillion annually over the next 10 years. The overall supply of US Treasury securities increases as the government continues to borrow to fund government expenditures and the deficit persists. With more bonds in the market, the prices of bonds decrease, and when bond prices decrease, yields increase. This is due to the inverse relationship between bond prices and yields. Higher yields are great from the investor's perspective, but not necessarily from that of an issuer.

Government borrowing can lead to higher interest rates as the government competes for capital with other borrowers, including businesses and consumers. This scenario can slow down economic growth as borrowing costs rise. Moreover, persistent deficits and increasing debt might lead to fears of inflation, which could further drive-up bond yields. Inflation reduces the value of existing debts which in turn transfers wealth from creditors (investors) to borrowers (US government), a process some describe in simple terms as "Inflating your way out of the debt".

Deficits might also affect how investors view the US economy. If deficits are funded by borrowing in a way that investors believe is unsustainable, it could decrease the attractiveness of US Treasuries. Furthermore, international investors, who hold significant portions of US Treasuries, watch deficit levels closely. A loss of confidence could lead to investors requiring a higher rate of return, thus higher yields, which again increase borrowing costs. According to the Bureau of Economic Analysis, the US is currently 124% of debt-to-GDP, the highest level ever. Many factors have contributed to the exponential growth of the deficit including increases in tax cuts, stimulus, and spending, and decreases in tax revenue.



Source: Bloomberg

The difficulty for the federal government to pay for the mounting national debt could potentially trickle-down to local agencies. Keeping a pulse on the national budget and debt is important for local agencies of all sizes who depend on the federal government in one way or another. There could be implications for local agencies as both an issuer and as an investor considering the federal government may need to either cut spending or increase taxes. As more federal funds are used on debt payments to the bearers of federal debt, multiple programs may eventually be affected. The strain could affect federal government grants to local municipalities. As a takeaway, it is prudent for all agencies to ensure they conduct regular cash flows to ensure appropriate budgets and liquidity through market cycles.

The US bond market is a critical component of the global financial system. However, government deficits, if not managed prudently, can lead to adverse effects on the bond market, influencing everything from bond yields to economic growth. Understanding these dynamics is crucial for policymakers, investors, and engaged citizens. As we move forward, balancing fiscal responsibility with economic growth will continue to be a delicate dance for the United States government.

*As of September 30, 2024: https://fiscaldata.treasury.gov/datasets/debt-to-the-penny/debt-to-the-penny

**https://www.crfb.org/papers/trump-and-biden-national-debt

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Questions?

Please contact Chandler at info@chandlerasset.com, or toll free at 800-317-4747 with any questions or to learn about investment management solutions for public entity investment programs.