Economic Views Brief

Russell T. Price, CFA | Chief Economist
March 25, 2024

U.S. Debt and Deficit Outlook

Over the last 15 years, U.S. government debt has grown at an unprecedented peacetime pace. Debt levels had long been expected to rise during this period as a growing share of the U.S. population entered their retirement years and began taking Social Security and Medicare. However, the recent expansion of deficits has far exceeded those prior expectations primarily due to the fiscal measures employed to combat two crisis periods.

The Financial Crisis of 2008/09 and 2020's COVID-19 pandemic led to robust government policy responses. Government borrowing grew sharply during these periods to provide substantial economic stimulus at a time when tax revenues were down. A case could be made that the fiscal responses were more aggressive than necessary, even adding to the inflation problem of the last few years, but that evaluation is not the subject of this report.

Key Takeaways

- U.S. government debt is growing at an unprecedented pace, and forecasts look for it to expand at an accelerating rate in coming years and decades.
- The most significant considerations associated with higher debt **are** higher interest costs crowding out other spending needs and the possibility of higher market interest rates.
- Long-term government debt /deficit projections represent a serious problem that must be rectified sooner rather than later.

In our view, the government debt situation is not yet at a crisis point. However, there's little doubt that the situation is growing more concerning as it draws greater attention and the government budget faces increasing strain. Each of these factors is projected to grow even more challenging in the coming years. Fixing the situation will require a combination of higher taxes and lower spending. The longer elected officials wait to implement such changes, the more difficult the situation will become, requiring the eventual remedies to be more consequential.

Governments that print their own currency (such as the U.S.) cannot technically go bankrupt. However, history is littered with examples of counties that try "monetizing" their government debt (i.e., a central bank printing money to fund government deficits). At a minimum, such efforts typically result in a sharp decline in currency values.

Higher taxes and reduced government spending carry direct adverse economic consequences; but relatively modest changes, implemented over time, can have a material impact on long-term debt /deficit projections given the size of the economic base and current programs, in our view.

CBO Projection of Federal Debt Held by the Public

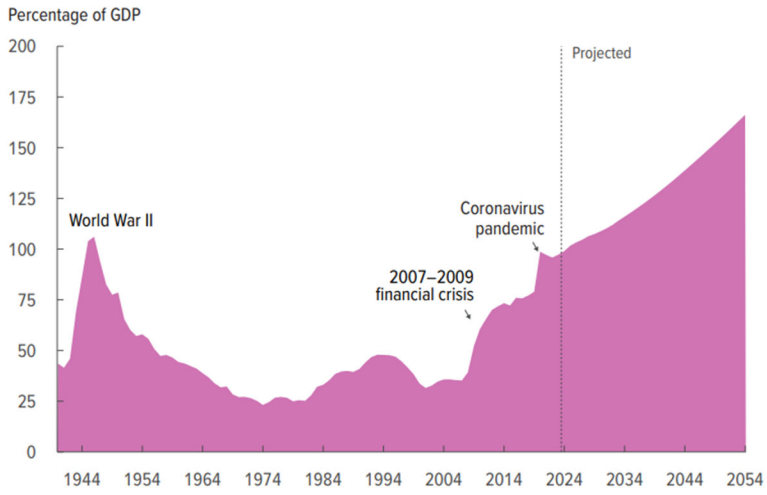


Chart source: CBO

The current status. The dollar value of U.S. government debt outstanding has grown more than six-fold over the last 20 years. In the country's first 228 years (1776 through 2004), the government accumulated total debt of $4.1 trillion (as of December 2004, per FactSet), equal to about 35% of U.S. Gross Domestic Product (GDP) at the time. By the end of 2023, federal government debt had grown to $26.9 trillion, representing a "debt to GDP" figure of 96% (*see Box 1 below for more).* In the current fiscal year 2024 (the federal fiscal year ends September 30), the Congressional Budget Office (CBO) projects the U.S. government to take in revenue of $4.9 trillion and spend approximately $6.4 trillion, leaving a deficit (i.e., need to borrow) of $1.5 trillion.

Clearly, this pattern is detrimental to the U.S. economy's long-term economic prospects, and potentially, global financial market operations. What's worse, government spending is currently projected to grow faster than either government revenue (i.e., taxes) or the underlying economy far into the future. As shown in the chart on page one of this report, the CBO currently projects the U.S. government debt-to-GDP ratio to steadily expand in the coming years, reaching an estimated 166% by 2054. Changes need to be implemented relative to government revenue and spending that over time enable the debt-to-GDP ratio to "roll over" at some point in the future and begin trending lower. We believe the goal should not be to balance the budget quickly, as abrupt changes could cause more problems than they would solve given what would likely be a material detrimental impact on the economy and tax revenue.

How much debt? We noted previously that U.S. government debt outstanding ended calendar 2023 at $26.9 trillion. However, other sources may quote a figure of $34.0 trillion (equating to a debt-to-GDP ratio of 124%). The difference between the two figures is the inclusion of Social Security Trust Fund "IOUs" and other inter-government obligations (largely related to health care and government pensions).

In this report we focus on the $26.9 trillion figure which is the most commonly used by forecasters and economists (including the CBO). It represents the total value of Treasury securities issued and outstanding (including what is held by the U.S. Federal Reserve). There is no publicly issued and outstanding debt associated with the Social Security Trust Fund IOUs.

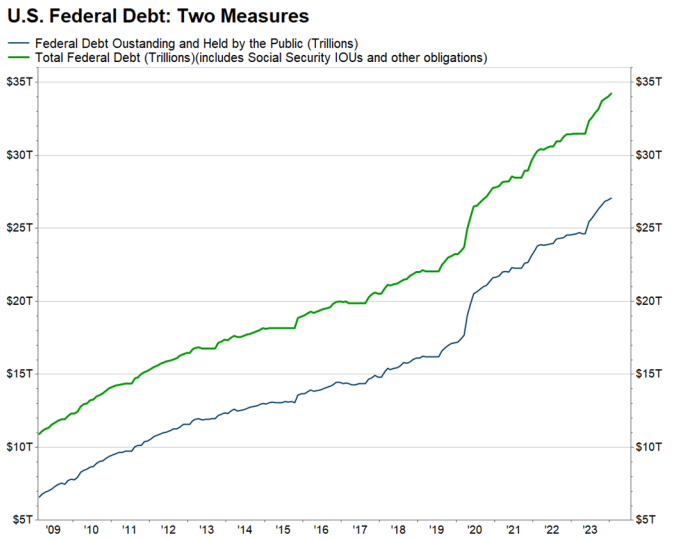


Chart source: FactSet.

"Debt-to-GDP." Around the world, government debt burdens are primarily evaluated by the level of government debt outstanding relative to the size of the underlying economy, a figure termed: "debt-to-GDP." This ratio puts country debt burdens on a comparable basis. For instance, in 2012, the Greek government was deemed insolvent as it could not pay the servicing costs on its outstanding debt, which totaled approximately €340 billion, according to the European Commission. Though this was excessive for a country like Greece, whose 2012 GDP totaled $188 billion, (equating to a debt-to-GDP ratio of about 181%) it would be negligible for a country the economic size of the U.S.

The table at the top of the next page shows that the U.S. is not alone in its current debt /deficit predicament. Most major countries have very high levels of debt with some being more burdensome than others. According to the International Monetary Fund's most recent *Global Debt Monitor*, government debt globally amounted to 92% of GDP in 2022 (most recent available data). The ratio was very high across Europe, though lower than the U.S. figure of 121% (for technical reasons, the IMF report includes the inter-governmental borrowings – as described above - for its estimate of U.S. debt levels). Japan, however, stands out as having the worst debt-to-GDP ratio amongst developed nations, with a figure of 261%. Under normal circumstances, such a level would likely result in sharply higher interest rates and a sharp devaluation of its currency, the Yen. What makes Japan somewhat different is that the vast majority of its debt is owned internally (just 6.8% was held by foreigners as of September 2023, according to Statista). With little foreign ownership, the currency impact has been manageable.

Global Public Debt, 1950-2022

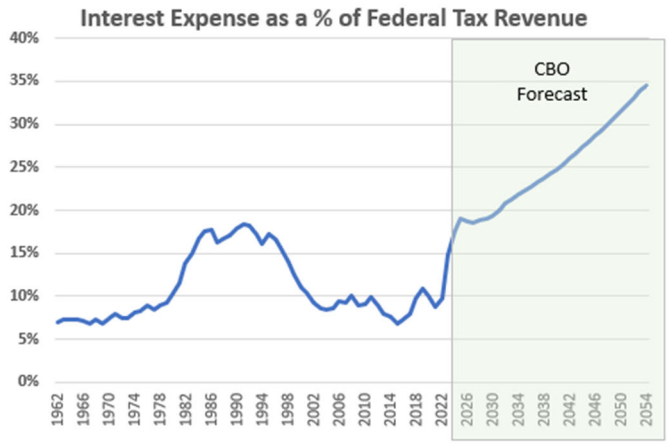
(Percent of GDP, weighted averages)

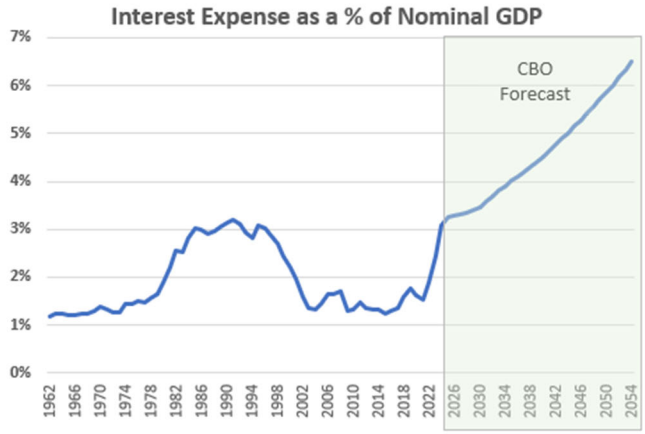
Source: IMF

	1950s	1960s	1968	1970s	1980s	1986	1990s	2000s	2004	2010s	2019	2020	2021	2022
World	**56.2**	**39.8**	**36.3**	**33.1**	**47.6**	**54.3**	**62.0**	**66.5**	**69.8**	**81.0**	**84.9**	**100.4**	**96.0**	**92.4**
Advanced Economies	**64.0**	**44.3**	**39.5**	**36.1**	**50.7**	**57.5**	**66.4**	**75.3**	**76.8**	**104.6**	**105.4**	**124.4**	**118.7**	**113.5**
Euro Area	32.5	24.7	25.0	27.7	47.0	52.1	67.0	69.9	69.7	90.9	85.9	99.2	97.3	93.2
Japan	13.1	10.1	11.8	23.4	64.3	74.0	89.0	166.6	169.5	227.5	236.4	258.7	255.4	261.3
United Kingdom	134.0	81.5	70.9	57.5	40.3	41.0	38.1	42.6	39.8	84.7	85.5	105.6	105.9	101.4
Unite States	69.7	54.4	48.7	43.6	51.6	57.7	66.3	64.1	66.1	104.1	108.7	133.5	126.4	121.4
Emerging Market Economies	**15.5**	**18.8**	**20.6**	**21.4**	**35.6**	**40.2**	**41.5**	**40.9**	**44.1**	**44.3**	**55.7**	**65.8**	**64.8**	**65.2**
China 1/							21.2	26.9	26.4	44.3	60.4	70.1	71.8	77.1
Others	15.5	18.8	20.6	21.4	38.6	45.8	46.3	44.7	49.0	44.0	52.0	61.9	58.4	55.3
Low-Income Developing Countries				**15.6**	**36.2**	**43.2**	**64.8**	**45.8**	**51.2**	**34.8**	**42.9**	**48.5**	**48.5**	**48.4**

How much is too much? There's no specific dollar value or debt-to-GDP ratio whereby a government's debt situation officially becomes "too much". Unlike human beings, governments are considered to live on in perpetuity. As such, they never have to fully pay off their debts. In fact, some debt is necessary to conduct monetary policy and efficient financial market functioning. Government debts become problematic when an increasing and material percentage of the annual budget needs to be allocated simply to finance the debt – i.e., the interest expense.

Annual interest expense is a function of the total dollar value of debt outstanding multiplied by prevailing interest rates. The charts below show the severity of the current problem. **The CBO projects interest expense alone will consume nearly 35% of all tax revenue by 2054 (based on current tax law), more than double 2023's 14.8% and more than three times the sub-10% percent rates seen from 2002 through 2022.**





Source: CBO and AEIS Inc.

Further, a consideration somewhat unique to U.S. government debt is the financial market's willingness or ability to absorb the massive dollar value of debt being issued without causing a material increase in market interest rates. Global debt markets are huge but so too is the U.S. government's borrowing needs. See the *"Recent experience a worrisome omen?"* section on the next page for more on this issue.

Long-term budget challenges and choices. The U.S. government budget math will become increasingly difficult in the years ahead, as revenue and spending projections are simply on an unsustainable path. As seen in the table below, U.S. government spending is projected to rise steadily over the next few decades, growing by nearly five percentage points as a percentage of GDP (based on current laws and programs), while revenue (i.e., tax collections) is expected to grow by less than one percentage point.

By category, interest on the debt, health care obligations, and higher required Social Security outlays (as the population ages) account for all the increase in spending as a percent of GDP. Meanwhile, projected spending on discretionary items is steadily crowded out, and it falls from 6.5% of GDP in 2023 to 5.4% in 2053. Additionally, in calculating its long-term interest expense estimates, the CBO currently assumes a long-term 10-year Treasury rate of 4.0% which may ultimately be too low. *(See page 6 of this report for a more comprehensive list of CBO revenue and spending projections.)*

CBO Budget Projections as issued March, 2024

(as a percentage of GDP)

	2023	2024	2034	2044	2054
(-) Spending /Outlays	22.7%	23.1%	24.1%	25.7%	27.3%
Social Security	5.0%	5.2%	5.9%	5.8%	5.9%
Health care	5.8%	5.6%	6.7%	7.8%	8.3%
Other Mandatory	3.1%	3.1%	2.5%	2.3%	2.0%
Discretionary	6.4%	6.2%	5.1%	4.9%	4.9%
Net Interest	2.4%	3.1%	3.9%	5.0%	6.3%
(+) Revenue	16.5%	17.5%	17.9%	18.4%	18.8%
(-/+) Deficit	6.2%	5.6%	6.1%	7.3%	8.5%

Source: CBO

Recent experience a worrisome omen? In our view, the ability of global financial markets to absorb much higher U.S. government debt issuance is also a concern worth watching. From the end of May 2023 to the end of October, the yield on the U.S. 10-year Treasury security jumped from 3.6% to 5.0% - a fairly rapid move for such rates. An improving inflation picture may have been a driver, but a sharp increase in new Treasury security issuance may have also played a prominent role. If that was the case, we believe it could suggest that global financial markets were unable to fully absorb the added issuance without higher interest rates as an enticement.

What happened? The U.S. Treasury Department could not issue any net new debt in the spring of last year as the federal government had reached its self-imposed debt limit on January 19, 2023. Negotiations between the President and Congress came down to the wire, but in early June, both sides agreed to suspend the limit until early 2025.

As the issue was negotiated for months ahead of the agreement, the amount of money held by the Treasury Department in its "checking account" (so to speak) dropped to a low of $22.9 billion on June 1st. Typically, we estimate the Treasury holds about $400 to $600 billion. Further, the yield on the 10-year Treasury closed June 1st at 3.61%. In the weeks and months following the debt ceiling agreement, the Treasury Department worked to replenish its coffers, while still needing to fund the government's ongoing deficit spending. From June 1st through October 31st, the Treasury Department sold $1.95 trillion in net new debt into the market. This represented an approximate 19% increase on an annualized growth basis. On a dollar basis, it was the largest period-defined issuance outside of the pandemic or Financial Crisis (2008-'09).

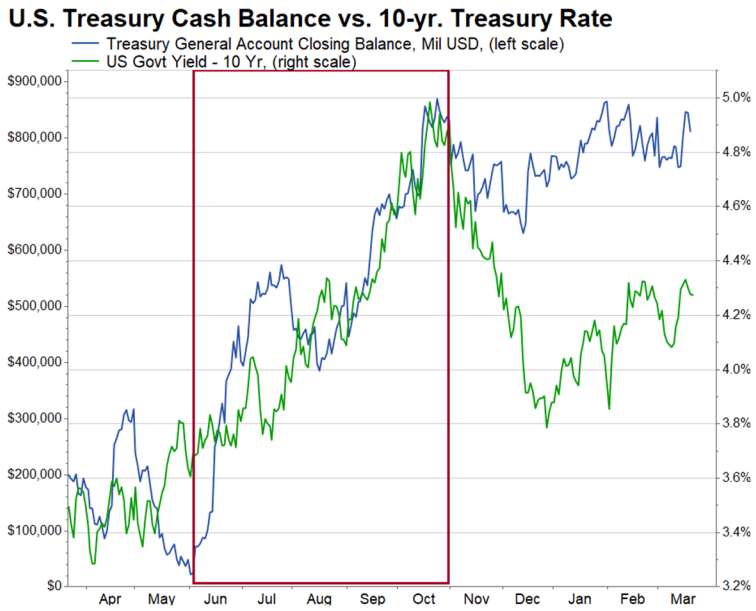


Chart source: FactSet

Possible solutions. There are no easy solutions. Getting long-term debt-to-GDP projections to eventually roll over and begin to decline in future periods will require a combination of higher taxes and reduced spending. Given the magnitude of the challenge, we believe neither lever could get the job done alone. Higher taxes and/or reduced spending will be a drag on economic activity when implemented, adding to the challenge given that economic growth, the denominator of the debt-to-GDP ratio, would also be pressured. In its long-term projections, the CBO assumes average annual U.S. real GDP growth through 2040 of 1.8%.

Total Outlays and Revenues

From 2024 to 2054, federal spending is larger and rising faster, on average, than revenues are. Spending and revenues each represent a larger percentage of GDP over that period than they did, on average, over the past 50 years.

See Figure 2-1 on page 18.

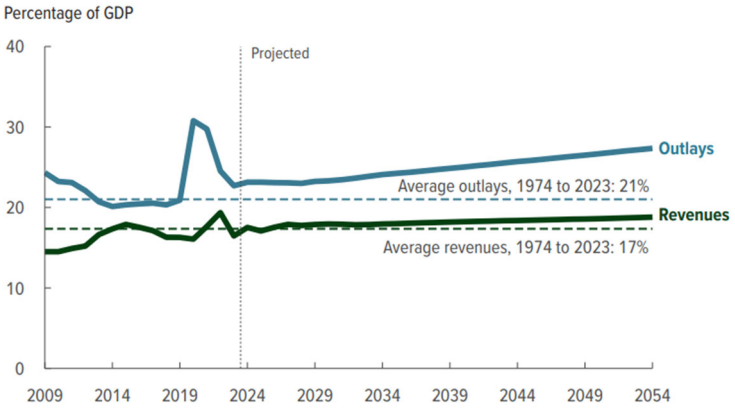


Chart source: CBO

Artificial Intelligence (AI) to the rescue? Possible, but not probable. A best-case scenario relative to the debt and deficit outlook would be stronger-than-expected economic growth. Stronger growth would lead to a higher dollar value of tax revenues, thus reducing annual deficits and reducing debt-to-GDP ratio projections.

Over the next few decades, the U.S. economy's sustainable growth rate is estimated to be about 2.0%. The number is calculated by taking growth in the workforce times their productivity. Workforce population is primarily a function of demographics, which typically do not vary much from projections. However, if advancements in AI can achieve a faster pace of labor productivity growth, which some forecasters believe is possible, it could have a meaningful impact. However, in our view, a meaningful impact is likely a long shot. Although labor productivity can be very volatile over short periods, it has been fairly static over the long term. The Internet revolution that began in the mid-1990s was also thought to likely boost productivity, which it did, for a period. Rates have since largely returned to historical norms, however.

Summary:

Elected officials need to enact budgetary changes over the coming years that put the government budget on a much more sustainable long-term path. This is not to say that the federal budget needs to be balanced immediately, as doing so during high deficit periods would likely cause more economic harm than good. Rather, officials need to enact changes that enable debt-to-GDP forecasts to head lower at some point in the future. In our view, realistic budgetary solutions will need to include adjustments on both sides of the equation, higher revenues (i.e., taxes) AND lower spending, to be effective.

We do not necessarily see the situation as becoming a crisis over the near term. Unfortunately, however, it may take a crisis to get movement on the issue, and it would likely be overly optimistic to believe Congress could pass dramatic long-term budgetary changes anytime soon, given today's sharp political divides. However, on a positive note, numerous media reports have indicated growing bipartisan support in Congress for establishing an independent fiscal commission that would be responsible for developing long-term solutions. Fiscal commissions have been effectively used in the past, but some have also received little response.

Higher debt levels should not be expected to directly cause a default. Governments that print their own currency (such as the U.S.) need not ever default as they can print more currency to pay the required principal and interest. Theoretically and logically, however, monetizing debt (printing money to pay the bills) never ends well and, at a minimum, would very likely lead to a sharply lower currency value (weaker U.S. dollar) amongst other significant economic / financial market consequences.

No doubt, the federal government debt/deficit picture is ominous. Nevertheless, there are solutions, in our view. None are socially, economically, or politically easy, but neither do they have to be economically calamitous. In our view, the sooner changes are implemented, the less severe the adjustments will ultimately need to be. In an extreme example, a national sales tax or a value-added tax could be considered.

The Long-Term Budget Outlook, by Fiscal Year

Percentage of GDP	Average, 1994–2023	Actual, 2023	2024	2034	2044	2054
Revenues	**17.2**	**16.5**	**17.5**	**17.9**	**18.4**	**18.8**
Individual income taxes	8.0	8.1	8.8	9.5	9.9	10.3
Payroll taxes	6.1	6.0	5.9	5.9	5.9	5.8
Corporate income taxes	1.7	1.6	2.0	1.3	1.4	1.4
Other	1.4	0.8	0.8	1.2	1.2	1.3
Outlays	**21.0**	**22.7**	**23.1**	**24.1**	**25.7**	**27.3**
Mandatory	12.1	13.9	13.9	15.1	15.8	16.2
Social Security	4.5	5.0	5.2	5.9	5.8	5.9
Major health care programs	4.3	5.8	5.6	6.7	7.8	8.3
Medicare	2.6	3.1	3.2	4.2	5.1	5.4
Medicaid, CHIP, and premium tax credits and related spending	1.7	2.7	2.4	2.5	2.7	2.8
Other mandatory	3.3	3.1	3.1	2.5	2.3	2.0
Discretionary	7.0	6.4	6.2	5.1	4.9	4.9
Net interest	1.8	2.4	3.1	3.9	5.0	6.3
Total deficit (-)	**-3.8**	**-6.2**	**-5.6**	**-6.1**	**-7.3**	**-8.5**
Primary deficit (-)	-2.0	-3.8	-2.5	-2.2	-2.4	-2.2
Debt held by the public at the end of each period	58	97	99	116	139	166

See Chapter 1 and Chapter 2. Deficits and outlays have been adjusted to exclude the effects of shifts in the timing of certain payments when October 1, the first day of the fiscal year, falls on a weekend.

The Long-Term Economic Outlook, by Calendar Year

Percent	Average, 1994–2023	Actual, 2023	2024	2034	2044	2054
Growth of real (inflation-adjusted) GDP	2.5	2.5	1.8	1.8	1.6	1.6
Inflation						
Growth of the PCE price index	2.1	3.7	2.2	1.9	1.9	1.9
Growth of the consumer price index for all urban consumers	2.5	4.1	2.6	2.3	2.2	2.2
Labor force participation rate	64.8	62.6	62.6	61.4	60.9	60.7
Unemployment rate	5.6	3.6	4.2	4.5	4.2	4.1
Interest rates						
On 10-year Treasury notes	3.8	4.0	4.6	4.1	4.2	4.4
On all federal debt held by the public (by fiscal year)	3.7	2.5	3.1	3.4	3.6	3.8

Source: CBO, The Long-Term Budget Outlook 2024 to 2054, as issued March 2024.

This space intentionally left blank.

Ameriprise Financial
1441 West Long Lake Road, Suite 250, Troy, MI 48098
Telephone: 248.205.5808
For additional information or to locate your nearest branch office, visit ameriprise.com.

The content in this report is authored by American Enterprise Investment Services Inc. ("AEIS") and distributed by Ameriprise Financial Services, LLC ("AFS") to financial advisors and clients of AFS. AEIS and AFS are affiliates and subsidiaries of Ameriprise Financial, Inc. Both AEIS and AFS are member firms registered with FINRA and are subject to the objectivity safeguards and disclosure requirements relating to research analysts and the publication and distribution of research reports. The "Important Disclosures" below relate to the AEIS research analyst(s) that prepared this publication. The "Disclosures of Possible Conflicts of Interest" section, where applicable, relates to the conflicts of interest of each of AEIS and AFS, their affiliates and their research analysts, as applicable, with respect to the subject companies mentioned in the report.

Each of AEIS and AFS have implemented policies and procedures reasonably designed to ensure that its employees involved in the preparation, content and distribution of research reports, including dually registered employees, do not influence the objectivity or timing of the publication of research report content. All research policies, coverage decisions, compensation, hiring and other personnel decisions with respect to research analysts are made by AEIS, which is operationally independent of AFS.

Important Disclosures

As of December 31, 2023
The views expressed regarding the company(ies) and sector(s) featured in this publication reflect the personal views of the research analyst(s) authoring the publication. Further, no part of research analyst compensation is directly or indirectly related to the specific recommendations or views contained in this publication.

Index definitions

An index is a statistical composite that is not managed. It is not possible to invest directly in an index.

Definitions of individual indices mentioned in this report are available on our website at ameriprise.com/legal/disclosures/ in the **Additional Ameriprise research disclosures** section, or through your Ameriprise financial advisor.

Disclaimer Section

Except for the historical information contained herein, certain matters in this report are forward-looking statements or projections that are dependent upon certain risks and uncertainties, including but not limited to, such factors and considerations as general market volatility, global economic and geopolitical impacts, fiscal and monetary policy, liquidity, the level of interest rates, historical sector performance relationships as they relate to the business and economic cycle, consumer preferences, foreign currency exchange rates, litigation risk, competitive positioning, the ability to successfully integrate acquisitions, the ability to develop and commercialize new products and services, legislative risks, the pricing environment for products and services, and compliance with various local, state, and federal health care laws. See latest third-party research reports and updates for risks pertaining to a particular security.

This summary is based upon financial information and statistical data obtained from sources deemed reliable, but in no way is warranted by Ameriprise Financial, Inc. as to accuracy or completeness. This is not a solicitation by Ameriprise Financial Services, LLC of any order to buy or sell securities. This summary is based exclusively on an analysis of general current market conditions, rather than the appropriateness of a specific proposed securities transaction. We will not advise you as to any change in figures or our views.

Past performance is not a guarantee of future results.

Investment products are not insured by the FDIC, NCUA or any federal agency, are not deposits or obligations of, or guaranteed by any financial institution, and involve investment risks including possible loss of principal and fluctuation in value.

Ameriprise Financial, Inc. and its affiliates do not offer tax or legal advice. Consumers should consult with their tax advisor or attorney regarding their specific situation.

Securities offered by Ameriprise Financial Services, LLC. Member FINRA and SIPC.