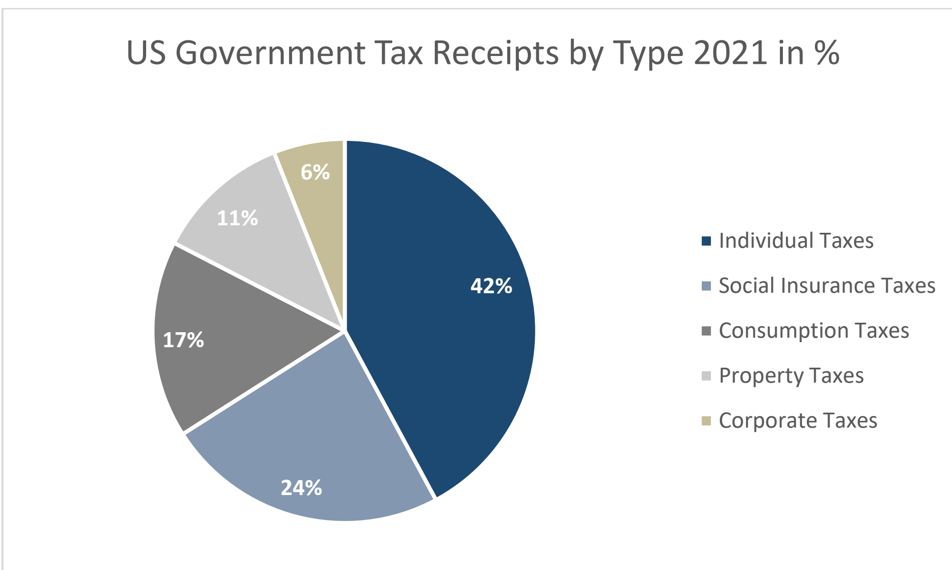
11th September 2023

# Is the current US fiscal path sustainable?

## US government fiscal deficit

The US government has received its 2nd AAA rating downgrade this year by Fitch after S&P downgraded the US debt in 2011. The key takeaway of the downgrade by Fitch this year is that the agency is expecting a worsening fiscal situation. The big problem about the US fiscal situation is that mandatory expenditures already exceed income by 20% (2021), and total expenditures exceed income by over 60%. Moreover, Federal income seems to be more and more closely correlated with the US stock market performance, and the deficit widens when expenditures rise to stimulate the economy during a downturn, while income declines. This phenomenon began in 2000 with the Dotcom crash and continued thereafter with subsequent market crashes.




Source: OECD



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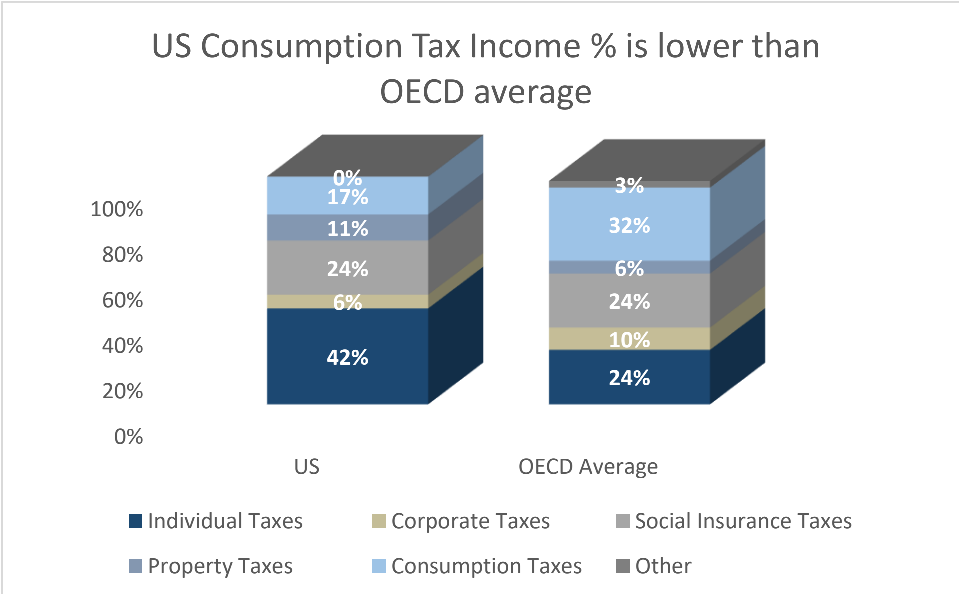


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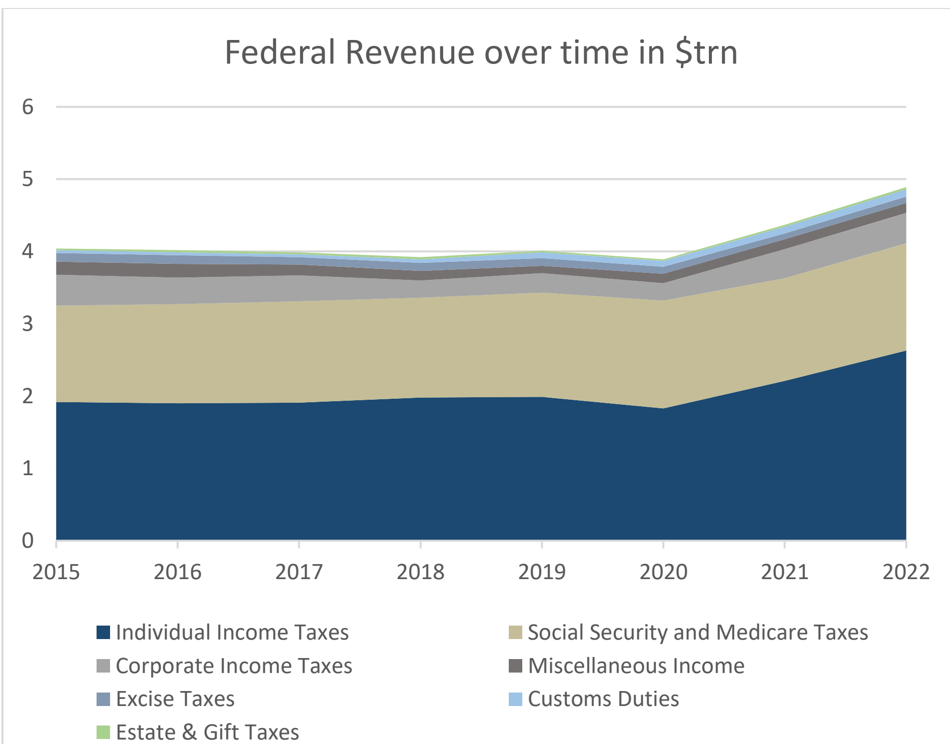


Source: Treasury.gov



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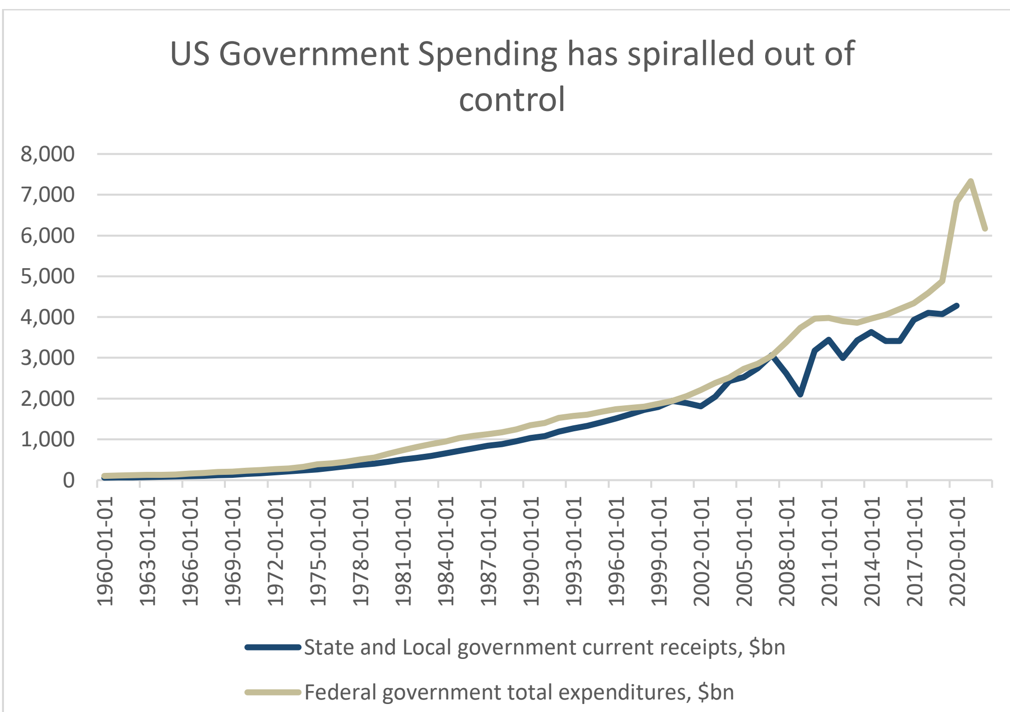
## US government income vs. expenditures in US$ trn

| Income Category | 2021 |
|---|---|
| Individual Income Taxes | 2.21 |
| Social Security and Medicare Taxes | 1.42 |
| Corporate Income Taxes | 0.4 |
| Miscellaneous Income | 0.14 |
| Excise Taxes | 0.08 |
| Customs Duties | 0.09 |
| Estate & Gift Taxes | 0.03 |
| **Total in $trn** | **4.37** |

| Expense Category | 2021 |
|---|---|
| Social Secuirty, Unemployment & Labour | 2.81 |
| Medicare & Health | 1.61 |
| Military | 0.77 |
| Education | 0.44 |
| Interest on Debt | 0.3 |
| Veterans' Benefits | 0.26 |
| Food & Agriculture | 0.24 |
| Housing & Community | 0.23 |
| Transportation | 0.21 |
| Government, International Affairs, Energy & Environment, Science | 0.23 |
| **Total in $trn** | **7.1** |

Source: Treasury.gov




Source: FRED St. Louis



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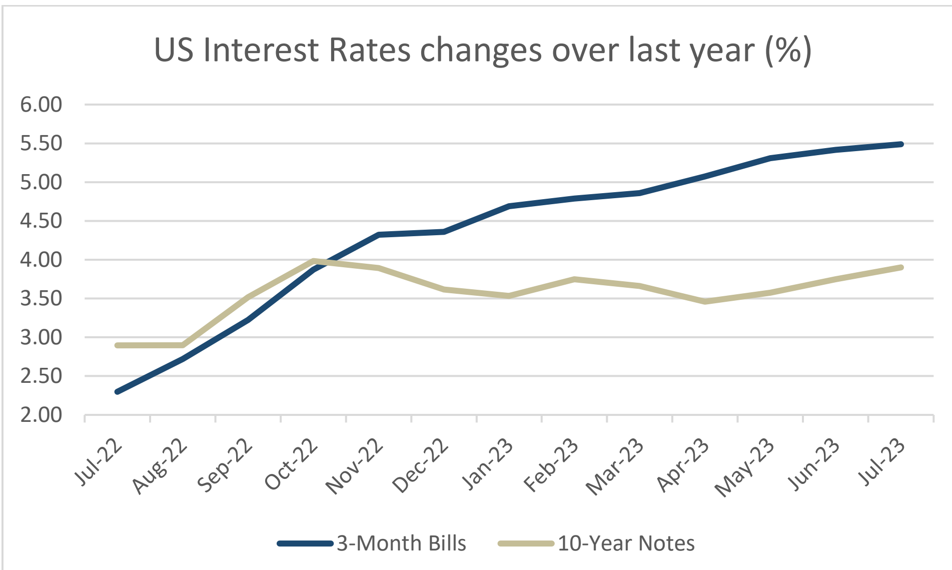
## US interest rate sustainability

The main problem is not only the fiscal deficit, but also a climbing US government debt mountain of 117% of GDP. Now, with interest rates moving to +5%, the interest expense on debt has reached $1trn, equivalent to ¼ of 2021 tax receipts. Furthermore, for every 1% change in the yield curve affects interest expense on the $25trn US debt, the interest expense rises by $250bn. If we now compare the current time with the 1980s, when last time the US interest expense on government debt/GDP reached nearly 5%, interest expense/government expenditures could reach once again 50%. Notably, US government debt/GDP doubled between 1981 and 1991 from 30% to 60%. If this would repeat itself again this time, US government debt/GDP would reach close to 240%.




Source: SIFMA

<u>US government debt outstanding in $bn</u>

| Date | Bills (<1 yr) | Notes (2-10yr) | Bonds (15-30yr) | TIPS (Linkers) | FRN (Floaters) |
|---|---|---|---|---|---|
| Jul-23 | 4,770.5 | 13,732.1 | 4,200.4 | 1,902.0 | 527.6 |

Source: SIFMA



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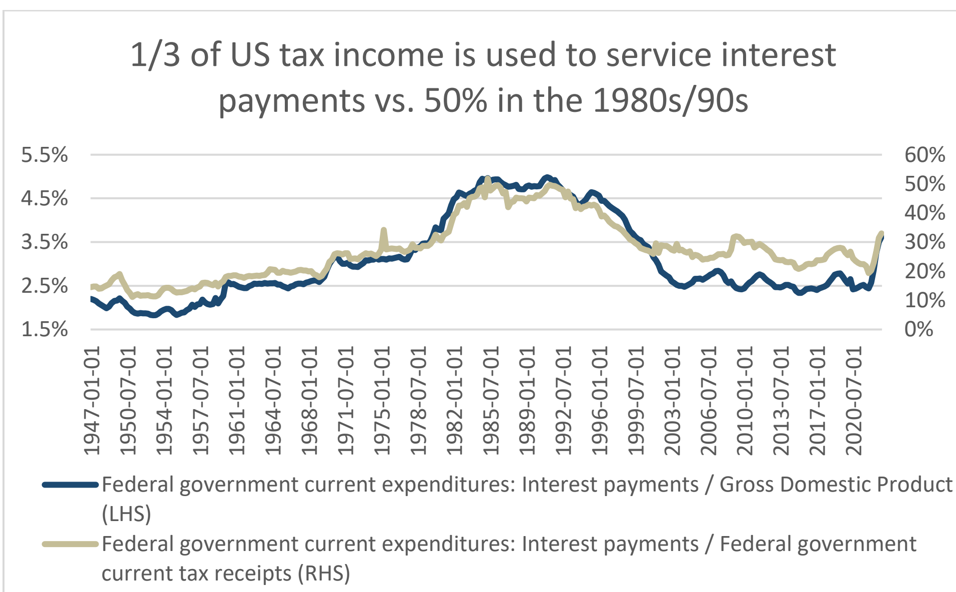
US government debt yield changes over the last year

| Date | 3-Month Bills | 10-Year Notes |
|---|---|---|
| Jul-22 | 2.30 | 2.90 |
| Aug-22 | 2.72 | 2.90 |
| Sep-22 | 3.22 | 3.52 |
| Oct-22 | 3.87 | 3.98 |
| Nov-22 | 4.32 | 3.89 |
| Dec-22 | 4.36 | 3.62 |
| Jan-23 | 4.69 | 3.53 |
| Feb-23 | 4.79 | 3.75 |
| Mar-23 | 4.86 | 3.66 |
| Apr-23 | 5.07 | 3.46 |
| May-23 | 5.31 | 3.57 |
| Jun-23 | 5.42 | 3.75 |
| Jul-23 | 5.49 | 3.90 |

Source: SIFMA




Source: FRED St. Louis



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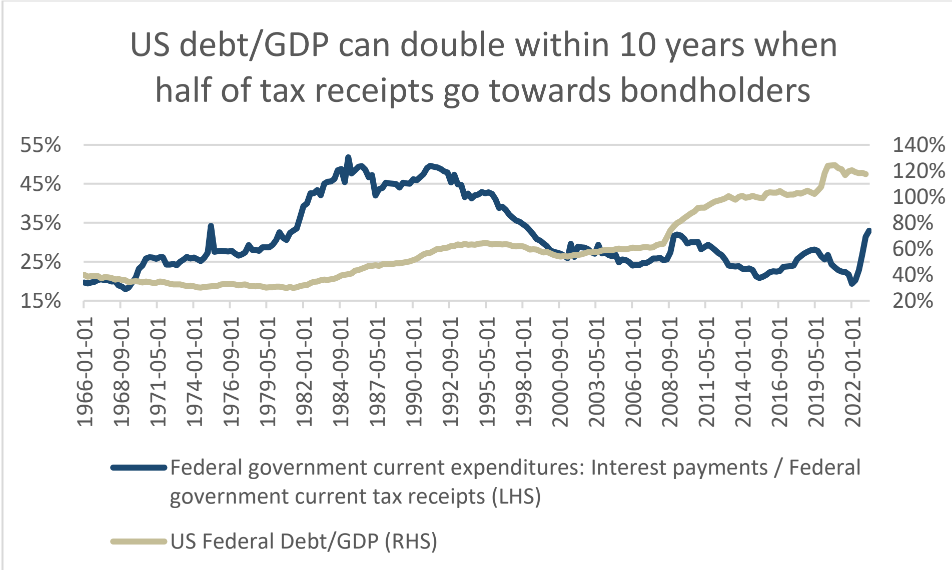


Source: FRED St. Louis

## US fiscal outlook

If interest rates were to stay here for longer, the US government would face rising debt/GDP, which could reach 240% within 10 years. At the same time, the Biden Administration began three major spending programmes, 1. The Inflation Reduction Act (IRA), 2. The Chips Act, 3. The Bi-partisan Infrastructure Act. While these programmes draw a significant amount of investment into the country, and hence increase GDP, the nature of some of the uncapped tax credits, especially in the Inflation Reduction Act, could make the initial estimates vastly different from reality. One example is that the IRA was depicted as generating +$300bn in net deficit reduction in August 2022[1], but recent estimate now show that the real cost of the IRA could amount to $1.2trn[2]. That's a $1.5trn swing! For instance, the Green Energy Tax Credits for 10 years were estimated at $270bn in August 2022, but now are expected to cost $663bn, with EV credit growing from $11bn to $69bn[3]. This massive variance suggests that the IRA will come in much more expensive than even currently estimated. In conclusion, the US fiscal situation is very shaky, and in light of the growing geopolitical tensions, any escalation in conflicts could quickly put the US on an unstable footing in terms of its financing of debt. Last but not least, I believe the similarities to the 1920s are

[1] https://www.democrats.senate.gov/imo/media/doc/inflation_reduction_act_one_page_summary.pdf
[2] https://www.wsj.com/articles/inflation-reduction-act-subsidies-cost-goldman-sachs-report-5623cd29
[3] https://taxfoundation.org/blog/inflation-reduction-act-green-energy-tax-credits-analysis/#:~:text=provided%20a%20%E2%80%9Cvery%20preliminary%E2%80%9D%20new,%24270%20billion%20over%2010%20years.



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significant and this is also true when comparing the debt/GDP of the British empire in 1920 (150%) compared to that of the US currently (117%). Therefore, interest rates have likely peaked now and will come down slowly, potentially paving the way for further commodity gains in US$, while US$ weakens.



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