# On The Mark

HUNTINGTON ADVISORS

Special Edition - February 2023

# Dooming Debt or Déjà Vu?

## Key Takeaways

- The US debt ceiling is not about future spending but instead is about paying past due bills.
- The US has never defaulted on its debt.
- The odds of a default in the latest showdown remain low but odds of a full throttle drama as Congress works to raise the limit remains high.

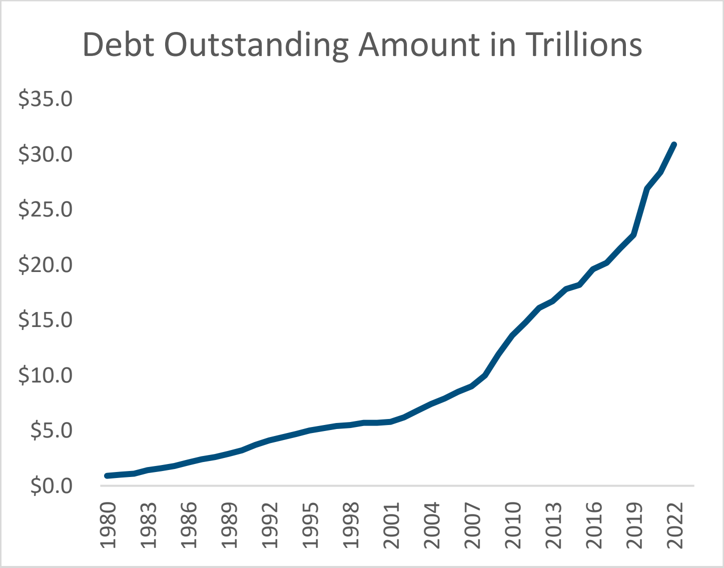
## What is The Debt Ceiling?

On January 19, the US government reached its legal $31.4 trillion (T) debt limit[1]. The debt ceiling is about paying the bill on purchases already made, just like paying your credit card bill. The difference, however, is when individuals reach their credit limit, they can no longer make new purchases on that credit card. In the case of Congress, when it reaches the debt ceiling or its credit limit, it can continue to spend. That is because Congress is not bound by the debt ceiling; instead, the Treasury department, which is responsible for the financing of or paying the government's bills, is bound by the debt ceiling. In short, the debt ceiling is often confused as a vehicle to control future spending, which it is not. Instead, it's simply the way to pay our past-due bills.

## History of US debt

The US has carried debt since its inception. The US national debt has increased from $908B in 1980 to nearly $31T in 2022[2]. Notable recent events triggering large spikes in the debt include the Afghanistan and Iraq Wars, the 2008 Great Recession, the 2017 Tax Cuts, and the COVID-19 pandemic.

The debt ceiling was put in place in 1917, allowing the government to issue bonds to finance participation in the First World War. Since WWII, the ceiling has been raised or suspended 102 times[3]. This has happened across both Republican and Democratic control of Congress, as the national debt has continued to rise as spending has exceeded revenues. Importantly, the US has never defaulted on its debt, thus retaining its stature within the global financial system.




Source: Treasury.gov

While the US has never defaulted on its debts, it did have a close call in 2011, when Congress increased the ceiling just two days before the Treasury would run out of the means to pay bills owed. Days later, the rating agency Standard & Poor's downgraded the US credit rating to

AA+[4] (from AAA), just like a knock on one's credit score after missing to pay one's bills.

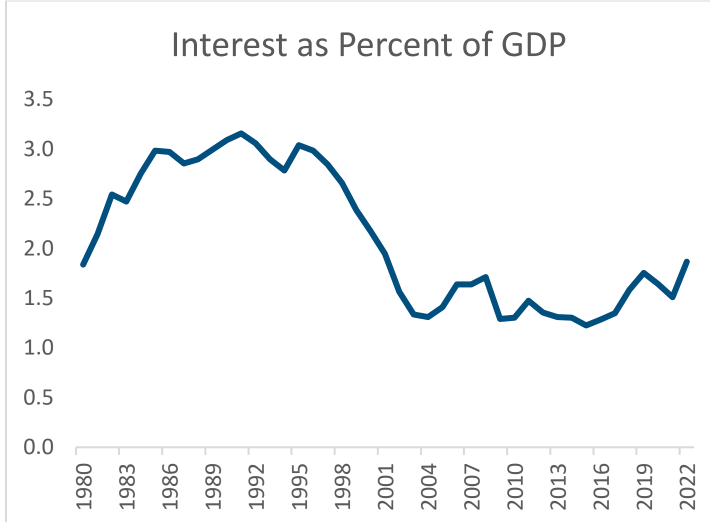
The result of the downgrade on the US dollar and stock markets was swift but short-lived. The dollar sold off, and stocks (S&P 500 Index) fell 6% on the day of the announcement[5]. However, a year later, the S&P 500 gained 20%[6]. Within the bond market, we saw a strong rally in Treasuries, which led bonds higher. This rally in bonds, while counterintuitive, was likely caused by simultaneous fears of a European sovereign debt crisis, which led investors to still lean on the US Treasury market despite the downgrade.

## How Much Debt is Too Much?

Undoubtedly, $31T in debt is a shockingly large number. Naturally, the question many investors have is how much debt is too much. Is there a tipping point at which it becomes a big problem for a country? The answer to that question requires understanding debt relative to the economy, as well as the interest cost on the debt.

While the debt has grown, so has the economy as measured by gross domestic product (GDP). US GDP has grown from $2.7T in 1980 to $26.1T in 2022, and the US remains the largest global economy[7]. Comparing a country's debt to its GDP is considered a better indicator of a country's fiscal situation than just the national debt number because it shows the burden of debt relative to the country's total economic output and, therefore, its ability to repay it. The US debt-to-GDP ratio surpassed 100% in 2013 when both debt and GDP were approximately $16.7T, and it now stands at 124% as of 2022[8]. For comparison, Japan's debt-to-GDP ratio has been over 200% since 2013[9]. Clearly, countries don't strive to have a greater than 100% debt-to-GDP ratio. However, if the economy can continue to grow, its large debt alone doesn't mean imminent doom.

Second, looking at the interest we pay on debt today shows that despite rising interest rates, the interest cost remains below the mid-1980s and 1990s when the total debt was smaller than today[10]. In other words, the US can still afford to pay its debts even though interest rates and the amount of debt have risen.




Source: FRED. OMB; St. Louis Fed

## What's Next?

Now that the debt ceiling limit has been reached, the Treasury will run down its cash balance and use "extraordinary measures" to keep paying the bills. It is estimated that the Treasury has enough funds to keep the US from defaulting until June 2023[11], but there is a lot of uncertainty around that date.

Congress is in charge of suspending or raising the debt limit, and a full-throttle drama will likely ensue as political parties demand concessions as they try to negotiate a deal. If Congress does not suspend or raise the debt ceiling before it reaches a critical point, it would raise the risk of a hit to the economy, similar to 2011, as well as the risk of default. That said, given the 102 times since WWII when policymakers have reached a consensus, we hope history is a guidepost that we will avoid a worst-case scenario of default, and any potential damage could be short-lived.

[1] https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/debt-limit
[2] https://fiscaldata.treasury.gov/datasets/historical-debt-outstanding/historical-debt-outstanding
[3] https://privatebank.jpmorgan.com/gl/en/insights/investing/tmt/debt-ceiling-drama-what-you-need-to-know
[4] https://www.atlantafed.org/cenfis/publications/notesfromthevault/1108
[5] FactSet
[6] FactSet
[7] https://fred.stlouisfed.org/series/GDP
[8] https://fiscaldata.treasury.gov/americas-finance-guide/national-debt/
[9] https://www.fitchratings.com/research/sovereigns/japan-debt-trajectory-at-risk-as-possibility-of-tightening-rises-18-01-2023
[10] https://fred.stlouisfed.org/series/FYOIGDA188S
[11] https://privatebank.jpmorgan.com/gl/en/insights/investing/tmt/debt-ceiling-drama-what-you-need-to-know



**AssetMark, Inc.**

1655 Grant Street
10th Floor
Concord, CA 94520-2445
800-664-5345



105311 | C23-19644 | 02/2023 | EXP 02/28/2025