Weekly Market Insights

December 2, 2019

$21.6 trillion and counting. Debt, the budget and the dollar.

Although Friday markets closed with minor losses, it was a good week with all indexes closing at or near record levels: DJIA 0.63%, S&P 500 1.04%, NASDAQ 1.72%.

As the year closes and primaries heat up with spending proposals, it makes sense to examine debt, budgets and the dollar and how they interact.

Debt

It is always interesting to start with U.S. government and due to its staggering size, it gets people's attention. Debt is an interesting financial instrument. It can be very helpful or a ruinous waste. It is used by governments, businesses and families. The use of credit by any one of the above, or all three, has a dramatic effect on the economy. Debt is very useful for purchasing things needed now, which we can pay for when expected income arrives. Businesses can use it for investing in capital equipment, which will create opportunities to earn more money. Governments use deficit spending to fund now and repay in future tax returns. These, of course, are only a few of the reasons debt is used. The use of debt can easily be overdone. Economists constantly look at debt to see how it is used and if it is growing to a dangerous level. The United States government's total debt as of 2018 was $21.6 trillion, a staggering amount when we first see it. Direct debt held by government accounts is $5.8 trillion,[1] reducing debt owed to others to $15.8 trillion. Interestingly, 40% is owned by International investors, with China and Japan being the largest by far. Much of the debt has been used for very good purposes, but there are concerns. People presume that government debt has the same life cycle as family debt. This huge amount of debt would be a disaster if we were talking about a family budget. Individuals retire and, presumably, their cash flow stops, so their debt must be paid in full at some point. Upon retirement, they must use their savings to live on. Since governments are presumed not to die, their cash flow in the form of taxes continue. Governments never need to pay off their debts entirely.[2] Therefore, government debt is not the same as family debt, so it must be viewed in a different light. Still, $15.8 trillion is a lot of debt.

How much is too much?

Not an easy question to answer. But, there is a limit. If we use GDP as a proxy for national income, we can get some idea. Since current debt is a given, it is a good way to look to the future. A country's GDP or national income is presumed to grow over time. The U.S. government's debt is quite high and assumed to be growing. "Deficit spending has become the norm. In the past 90 years it has run 76 annual deficits and only 14 surpluses."[3] What can be done?

The Budget

Since the National Debt already exists, investors must look to the future for solutions. This, of course, leads us to the national budget and the budget is all about priorities. As a general rule, the growth of the deficit should be lower than the growth of GDP. If this is adhered to, the deficit as a percent of GDP should be reduced.

[1] St. Louis Federal Reserve 2019.
[2] Ibid.
[3] Making Sense of the National Debt, Federal Reserve Bank.

Weekly Market Insights (cont'd)

There are many expenditures that grow national income over time: education, research and development, and infrastructure immediately come to mind. They increase the productive capacity of the country.

There are, of course, vital spending projects that do not necessarily add to the productive capacity of the nation. Much of the spending such as military and social issues (Medicaid, disability and automatic stabilizers) fall into this category. It is very clear the government has to set priorities.

Of course, there is another side of the creation of a deficit, and that is tax policy. That is the subject for another paper. It is always easy and popular with the voting public to increase spending and benefits at the expense of future generations. Public spending is not a campaign tool. If used properly, it can create great good, and if not, the opposite.

Where are we now?

The obvious question is where do we stand now? Is the United States on the precipice of a financial disaster? The answer is no. A primary thermometer is the value the international community places on the U.S. dollar. No one, of course, expects the United States to default on its debts or devalue the dollar, but what is possible is a serious bout of inflation. The international community clearly does not believe this.

Thanks!

Many thanks to the scholars at both the New York and St. Louis Federal Reserve!

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