

US debt dynamics look scary. Effective policy is critical

The problem for Treasuries is a 3% primary deficit plus 3% interest rate costs exceeds the typical 4.5% GDP expansion. That broadly equates to an ongoing 1.5% increase in the debt/GDP ratio. And this continues forever unless the primary deficit is cut. If not, our 5% + call for the 10yr yield can become a threat for 6%...



US Secretary of the Treasury Janet Yellen

The primary deficit is the swing factor that dominates worsening debt dynamics

We're at a key juncture when it comes to US debt dynamics. Government debt is approximately equal to the value of GDP. In other words, there's a c.100% debt/GDP ratio. This makes the mathematics relatively easy. Basically, when debt is the same size as GDP, debt dynamics are broadly determined by whether the growth in nominal GDP is above or below the average coupon print on the debt. Provided the former is higher than the latter, then the debt/GDP ratio can trend lower.

That is the case where the primary deficit is in balance, which is not the case for the US. The primary deficit is the fiscal deficit excluding interest payments. In the US, the primary deficit ran at

around 4% of GDP in 2024 and is projected at around 3% of GDP in 2025. If we assume a 3% primary deficit, for the debt/GDP ratio to fall, then the value of GDP must grow by more than the average coupon print plus 3%. That's a tough circle to square. For 2024, the value of GDP likely rose by almost 4.5% (not enough).

The weighted average fixed coupon print right now is around 2.85%. Bills then tend to account for around 20% of total debt and are rolling over at a cost of around 4.25%. That comes to an average interest rate cost of a little over 3%. The risk case is a trend towards 4% over time, as the yield on the weighted average 7yr maturity is over 4%, and the funds rate is not projected to get too far below 4% through 2025/26. Conservatively we should assume at least a 3% interest rate cost.

Here's how US debt dynamics continue to worsen, driven by the primary deficit...

$$\frac{d}{dt} \left(\frac{D}{Y} \right) = \frac{D}{Y} (r - g) + \frac{PD}{Y}$$

$1.5\% = 3\% - 4.5\% + 3\%$

D = fiscal deficit
Y = nominal GDP (value)
r = rate of interest paid on debt
g = change in value of GDP
PD = primary deficit (deficit less interest)

Debt/GDP ratio = c.100%

Change in nominal GDP is around 4.5%

Interest rate cost is around 3%

US runs a primary deficit of around 3% of debt



US debt/GDP rises by 1.5% pa ...

(Until or unless something changes)

Source: Macrobond, ING estimates

If the primary deficit is not cut, there is an accelerated worsening to come

The final mathematics is as shown above. We have a primary deficit of some 3% of GDP and interest rate costs of some 3% on total debt. With the debt/GDP ratio at around 100%, that means the value of nominal GDP needs to rise by some 6% for the debt/GDP ratio to stabilise. A repeat of 2024's c.4.5% value increase risks adding 1.5% to the debt/GDP ratio on an annual basis. Something similar for 2025, and over subsequent years would continue to build the debt/GDP ratio.

Moreover, as the debt/GDP ratio rises above 100%, the problem is amplified. Take an extreme – a 200% debt/GDP ratio would require the growth in the value of GDP to be double that of the annual coupon cost (plus half of the primary deficit ratio). This is a nightmare scenario we don't want to see, but it's one we trend towards on CBO estimates if nothing changes on the various components as described above. And so far, there is little in the works to divert us from this path.

Typically, what happens in crises seen elsewhere is the market begins to believe the negative spiral well ahead of it occurring. We saw this for example when the Greek debt dynamics began to gap in the wrong direction. Once the debt/GDP ratio hit 130%, the markets quickly saw 150% and beyond coming, and jumped to price a default scenario.

The US is no Greece, but yield concessional risk is very elevated

The US is not Greece. And we don't at all anticipate a spiralling out of control. But at the same time, the markets will absolutely look for and require some comfort that we should not even be talking this way. If the markets do not get that, we run the risk that on any given day, the Treasury market could decide that now's the time to price in a material concession. And that's how a 5% 10yr yield can threaten to hit 6%+.

Author

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.