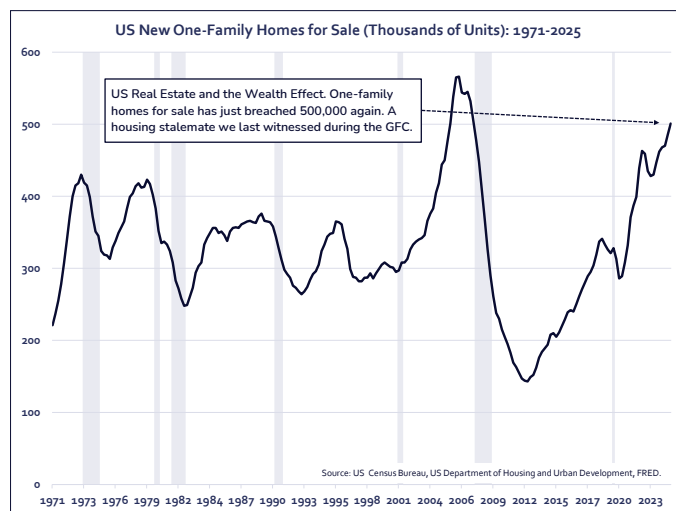
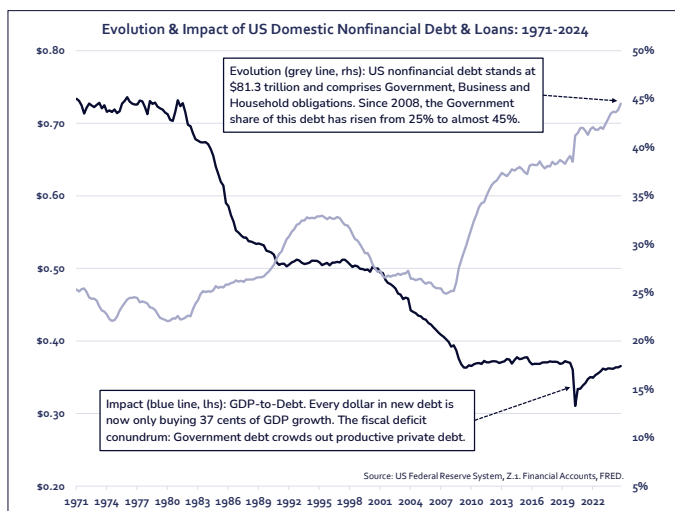


The Fiscal Hangover

- The US fiscal deficit, as a share of GDP, was estimated to be 6.9% in April 2025, compared to 5.8% in April 2024. The deficit has averaged 9.45% per annum since 2020, helping us understand exactly where the robust US economic growth has materialized from in recent years – fiscal profligacy. Keynesian countercyclical policy was always an economics concept and not a political one. US Federal debt currently stands at \$36.91 trillion and it has risen by \$13.69 trillion since 2020, and by \$26.88 trillion since 2008. “The problem of our society is too much government, not too little,” Milton Friedman exclaimed in 1990; his opinion looks more relevant now than ever before. At a higher level of observation (chart, bottom left), the evolution and impact of this debt pile is worth analysing. US nonfinancial debt stands at \$81.3 trillion and the government’s share of this debt has risen from 25% in 1971 (and 2008) to 45% currently. Government debt crowds out productive private debt. The impact of this structural shift can be seen in the GDP-to-Debt statistics: with more efficient debt levels in the 1970s, every new dollar of debt was effectively ‘buying’ 70 cents of GDP growth. Now, with elevated and more unproductive debt levels, every new dollar of debt is only ‘buying’ 37 cents worth of GDP growth, and it has taken all the exceptional post-2008 fiscal and monetary intervention to maintain that 37 cents level. This multi-decade dynamic has been an important element within the secular stagnation debate since 2015. What is needed is fiscal rectitude. More realistically, the authorities will carefully manage the demand and supply sides of the Treasury market, especially if there’s fear of a bond market tantrum or an international buyers’ strike against US Treasuries. We monitor the possibility of amendments to the regulatory constraints limiting the capacity and willingness of banks to support the Treasury market, specifically the Supplementary Leverage Ratio (SLR). We also monitor the maturity profile of debt issuance in the US and the supply pressures maintaining the ‘long end’ of the curve. Irrespective, the fiscal hangover in the US, and elsewhere, is likely to be long and painful.
- The higher government debt goes, relative to GDP, the more likely disinflationary pressures will eventually follow. Economic demand is cooling, and this will put downward pressure on the major inflation drivers: employment, energy, housing and food. The latest Supercore PCE inflation statistic has just turned negative in the US, for the first time since Covid, and there is now a real concern that the Fed is caught behind the rate cut curve. We monitor key real estate statistics closely because of the sector’s significant impact on the economy and because ‘shelter’ represents 36% of US CPI inflation. The data is starting to flag caution: recent Redfin analysis highlights approximately \$698 billion worth of homes currently for sale in the US, up 20.3% from a year ago and the highest dollar amount ever. Their analysis also identifies nearly 500,000 more home sellers than home buyers in the current market. The stalemate in housing is confirmed by the US Department of Housing and Urban Development (chart, below right), which identifies One-Family Homes for Sale at levels we witnessed only during the GFC. There’s not enough stress – yet – to lower house prices and clear the market, and new buyers are also deterred by elevated interest rates. And valuations? The median household ‘qualifying’ income (\$125,000) now required to purchase the median priced home (\$417,000) is 58% higher than the actual median household income of \$79,000. Is this the most unaffordable housing market in US history? Household equity in real estate currently stands at \$34.7 trillion, up \$26.45 trillion, or 320%, since 2012. Animal spirits in the real estate and equity markets have driven the wealth effect – watch out for any reversal.



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