Beneath the Surface

May 2024

SIGNET

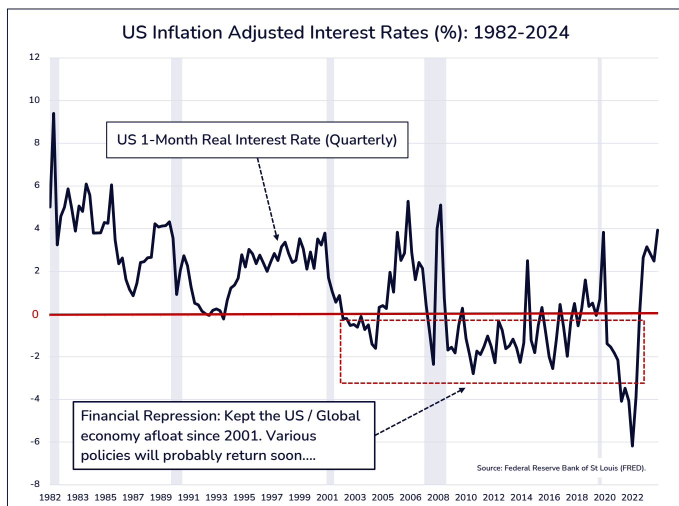
To Exit a Debt Trap.

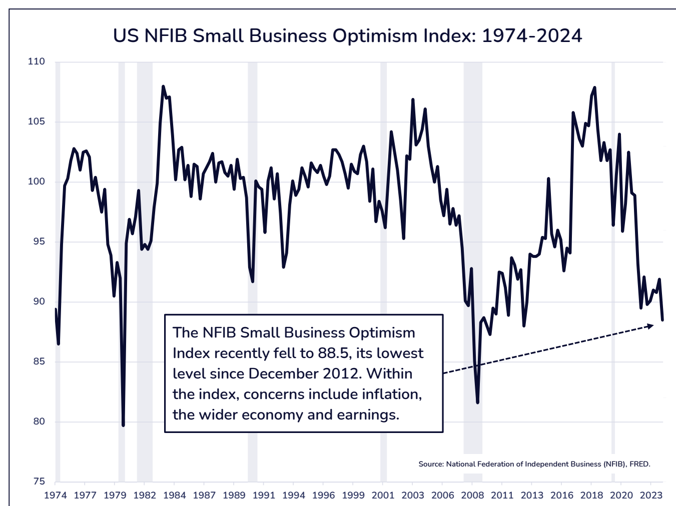
- The US economic growth we are now experiencing has been deficit funded, much as it has been around the world. The US Federal Budget Deficit-to-GDP is currently at 6.3% - a number rarely seen outside recession or war. Critically, with elevated interest rates, the federal interest expense has now risen to $1.06 trillion and is expected to soar to $1.60 trillion by the end of 2024 (federal receipts total $4.4 trillion). Someone must fund this, and it is becoming increasingly apparent that foreigners are reluctant to step in. US federal debt held by foreigners has fallen from 34% of the total in 2014 to 23% now. With negative US net national savings, the US Treasury is now competing with everybody else for its funding ($34 trillion), potentially crowding out private investment and growth.

- The IIF Global Debt Monitor reports that global debt has just reached a new record of $315 trillion, up from $260 trillion in 2020. Of that, $100 trillion belongs to the US, up from $77 trillion in 2020. Within that, US private debt (household and non-financial corporate) now stands at $41 trillion, up from $25 trillion in 2014 (up 64%). The financialised economy requires continuous debt refinancing, which might be a major problem if the current monetary policy hits home. Most of this debt was issued at significantly lower rates; the Effective Federal Funds Rate (EFFR) has averaged 1.3% since 2014, against the EFFR at 5.3% now. The impact on the US private sector, on smaller US businesses and on the international, Eurodollar community (EM), is perhaps the greatest concern for financial stress.

- Perhaps an anxiety, simmering beneath the surface in the price of gold, relates to the concern of a monetary or geopolitical ‘event’. If it is monetary and it’s a low-growth debt trap, let’s recall the solutions. The preferred exit from a debt trap is growth. Unfortunately, self-sustaining growth under the current secular conditions, and estimated through the Fed’s HLW R-Star, may be about to disappoint. Another exit from a debt trap is to prioritise a fiscal surplus, typically with tax hikes or government spending cuts. However, austerity doesn’t win the popular vote at the best of times, and especially in election years. Default – or a ‘jubilee’ – isn’t an option, yet. That leaves the last course for exiting a debt trap: financial repression. Financial repression is politically palatable and comprises a range of interventionist policies designed to depress real interest rates and enforce government debt holdings. We have witnessed its extensive use since 2008, up until 2022, and it was associated with quantitative easing, aggressive nominal interest rate cuts and regulatory imposition (such as the Basel III Liquidity Coverage Ratio). If governments choose this course, we can expect to see these policies rolled out again – financial repression redux. Under excessive and fragile global debt dynamics, US real rates are arguably too high (chart, below left) and they should be lowered.

- We can see many real-time concerns in the US NFIB Small Business Optimism Index (chart, below right). It hit 88.5 in March, the lowest since 2012. US small businesses employ 48% of all workers and make up 44% of US GDP. America’s small businesses are concerned about inflation, declining sales and profits. To understand what this all means for asset allocation and investment selection, please contact us.





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