Money Talks by Dave Helscher

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It is almost déjà vu all over again. Just a few months ago, Washington was debating an increase in the federal government's debt ceiling. A compromise was agreed to and we moved on, right? Not exactly as in the aftermath of this continuing debate and upcoming federal budget debate, Fitch, one of the major debt rating services, lowered the credit rating of the United States to AA+ from AAA.

Congress has returned to Washington following the August recess to face consideration of a new budget for next fiscal year. The federal government's fiscal year ends on September 30, 2023 and any new budget would control expenditures for the new fiscal year beginning October 1. The budget consists of 12 separate appropriation bills, none of which have received approval. With no budget or resolution, there will be at least a partial government shut down at midnight September 30.

Some of the same arguments used in the debt ceiling debate will be made during budget negotiations. By one estimate, the amount under dispute is $100 billion. This is a lot of money but is relatively small when compared to the overall size of the U.S. government budget which spent $6.27 trillion in fiscal year 2022. Neither political party wants to decrease Social Security payments or health care benefits for retirees, nor do they want to implement tax increases for businesses or households. Many analysts believe that both are needed to make a dent in the national debt. Complicating the debate is that we are headed into an election year.

The national debt and annual budget have also become increasingly politized, with fiscal policy being used to prolong expansions. This has taken the form of tax cuts, such as in 2018, pandemic emergency spending, or industrial subsides through infrastructure spending. Fiscal policy is being used to control the business cycle rather than relying on monetary policy in the form of the Federal Reserve. The Congressional Budget Office expects the deficit to expand to 6% of gross domestic product (GDP) this year and continue to do so over the next 10 years.

There is another wrinkle to add to this debate and that is the increase in interest expense on the national debt. Monetary and fiscal policy comingle at this point, as fiscal spending exceeds revenues the difference is made up by issuance of debt. The Federal Reserve has dramatically raised interest rates over the past 18 months and new government debt is issued at current market rates. An estimate of net interest payments on the federal debt comes in above $600 billion a year. That accounts for about 14% of tax revenues. Maturities on already issued Treasury debt have gotten shorter with about one-third of the national debt needing to be rolled over in the next year, at interest rates higher than when the debt was originally issued.

Our national debt issue is not just a problem for the U.S. Most large advanced economies have debt ratios higher than what they were pre-pandemic. The U.S. has some unique advantages as possessing the global reserve currency, the dollar. We can borrow in our own currency which conveys the ability to just print more money. In addition, global financial markets still recognize U.S. Treasury obligations as the strongest of global safe haven assets, despite Fitch's downgrade. There is not imminent danger of collapse but the trajectory is unsustainable over time.