Rodney's Take

June 12, 2023

The Great Crowd-Out Begins

The debt-ceiling debate is over, which means congress members are traveling back to their districts to tell people what an awesome job they did. They averted a (self-inflicted) catastrophe and demanded (almost meaningless) concessions from the other side. None of it matters. They were arguing over a percentage or two of spending while Washington, D.C., burns. The flames of debt were lit decades ago, and when nothing happened, it seemed harmless to add more. That was then.

It was harmless in the current budget cycle to add more debt when money cost nothing. It was harmless when the Fed kept its thumb on the interest rate scale and stood ready to print trillions of dollars. But the time of no-cost cash has ended, and it looks like it will go out with a bang, not a whimper. This is going to be expensive, especially for Uncle Sam and taxpayers.

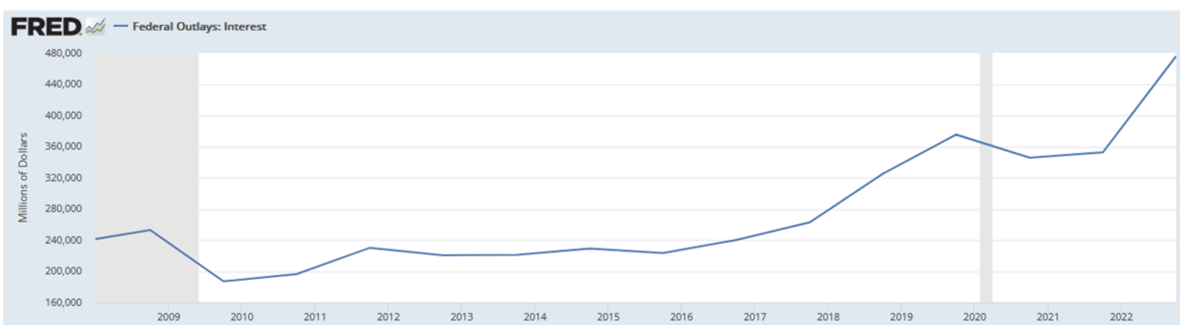
Fed Chair Ben Bernanke pushed overnight rates to nearly zero and used quantitative easing to weigh on long rates. This went on for nine years, until Chair Powell started raising rates and reducing the Fed's balance sheet at the end of the 2010s, but it didn't last long. At the first sign of pain in 2019, Powell reversed course, and during the pandemic he went into survival mode. Now, with inflation elevated and the Fed balance sheet still above $8 trillion, he and his compadres have vowed to get our national financial house in order.

We'll see.

The accompanying chart shows the interest costs paid by the federal government from 2008 through the end of last fiscal year. You'll notice that from 2008 through the 2010s our net interest expense was flat, which implies that our debt remained constant. It didn't. From 2008 through 2016, our debt ballooned from $9.4 trillion to just over $19 trillion but because interest rates fell, our interest costs remained more or less flat. Those days are over.

As the chart shows, our interest costs walked up from 2017 to 2019 before dropping during the pandemic and now are marching higher. We paid twice as much in interest last year as we did in 2016.

U.S. Government Interest Paid on Debt
2008–September 2022



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Worse than that, we're slated to pay almost twice as much in interest this year as we did just last year, pushing up this expense from $475 billion to $850 billion, as long interest rates march higher and stay there. While rates should fall with a weaker economy and eventual Fed rate cuts, I don't think we're going back to near-zero rates on the overnight and 0.50% on the 10-year Treasury, or at least not for long.

And since we continually run a deficit, we should expect to pay our interest costs by borrowing even more money. A greater portion of private investment that would have gone to productive projects now will be used for nothing more than to pay our interest. The result will be slower economic growth just as our nation struggles to pay for social services for the Boomers. It's been more than a decade, but now looks like a good time to lock in some yield for yourself before everyone realizes what potentially lies ahead.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.