From the desk of Chief Economist Beth Ann Bovino

Government debt: Mind the gap

As lawmakers dig their heels in, the government remains closed. The shutdown, approaching its longest in U.S. history this week, already has cost U.S. taxpayers over 0.7% in Q4 GDP according to our calculations. But while some of what was lost in Q4 will be regained in the Q1 GDP, as postponed contract work and vacations restart, lost productivity from furloughed workers are never regained. Moreover, estimates may be higher given the possibility that furloughed workers may not be given backpay and may be laid off during the shutdown as the White House has threatened. Finally, the lack of economic data needed by the Fed to chart the U.S. interest rate path increases risks of a monetary policy mistake, at a time when their two mandates, stable prices and maximum employment, are at tension for the first time since the Volker years.

The fight to cover the Affordable Care Act (ACA) premium tax credits, which has kept the government closed, masks a bigger issue: the huge government debt that is expected to only grow in the coming years.

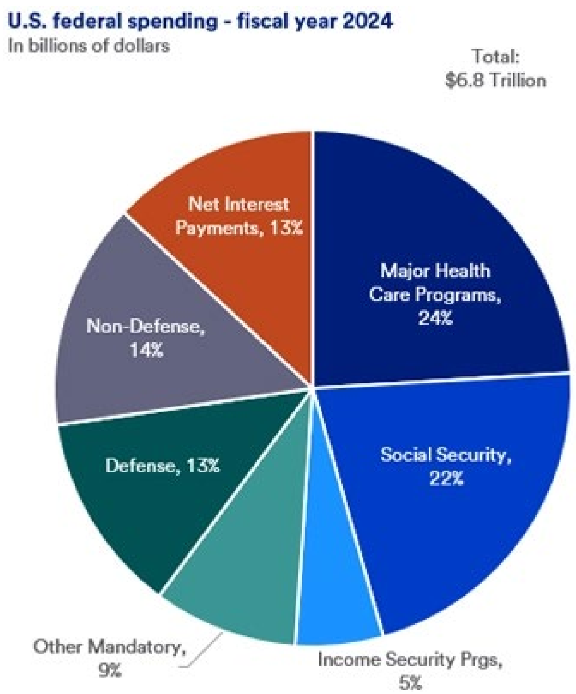
Long the reserve currency of the world, the U.S. government is considered sufficiently creditworthy to manage its costs and has been given latitude on the size of debt it can hold.

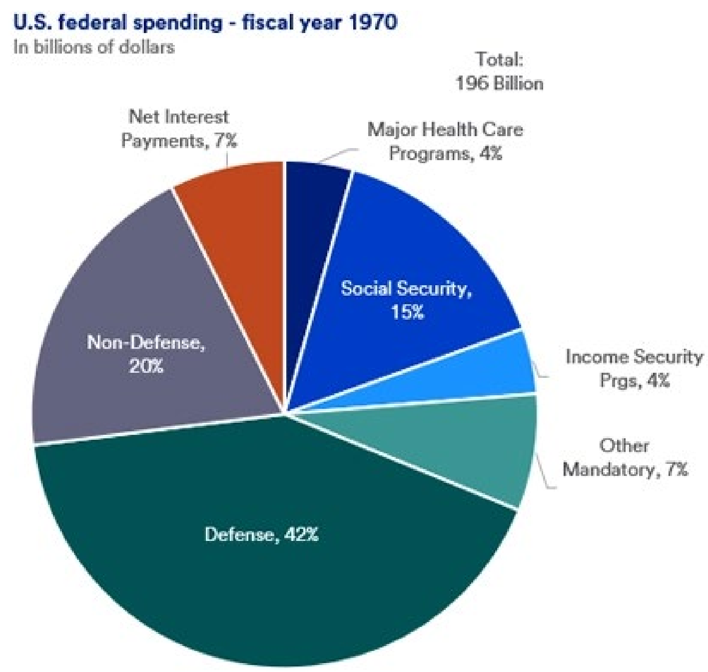
But when is enough, enough?

U.S. federal debt is now about 100% of GDP and is projected to grow to almost 123% of GDP by 2034 by the Congressional Budget Office (CBO) – factoring in the 2025 tax deal, also called the One Big Beautiful Bill Act. Without OBBBA, federal debt had previously been projected to grow to 117% of GDP by 2034. That adds $3.4 trillion to the primary deficit through 2024. With interest costs, it climbs to $4.1 trillion.

With federal government debt rising, where can the U.S. government find the money, especially since the majority of government payments are mandated by law? Medicare and Social Security payments now account for 46% of total federal spending, ballooning from 19% in 1970. Other mandatory spending, such as military pensions and healthcare, push the overall number to 55% of federal spending (was 26% in 1970). Military operations are hard to touch, given heightened geopolitical risk. That leaves non-defense spending. Once 20% in 1970, it now makes up just 14%, leaving little to left to cut.

The share of federal spending on interest payments, at 13% of total spending, twice what was seen in 1970, is a reminder of how large U.S. government debt has grown.





With that said, I have one consolation. We are not alone.

Government debt is growing everywhere! In a comparison of general government debt as a percent of GDP, the U.S. is neck-to-neck with its trading partners. Japan leads the way with 134.2% of GDP in 2025 (sources: IMF, Bloomberg, The Economist), but at 98%, the U.S. is not far behind. The U.S. trading partners are expected to catch up over the coming years.

Why? Because we are all getting old.

In 2010, the share of Americans over 65 accounted for 13% of the total population. But by 2050, it climbs to 22%. Japan's elderly population is the largest, at 23% of the total population in 2010, to balloon to 36% by 2050. The stories are the same for the other countries in the chart. In the U.S., Medicare and Social Security already account for 46% of federal government spending, which will only increase in later years. Our trading partners will need to address the same issues, growing spending costs to cover elderly care in later years.

"We expect consumer inflation to trend higher this year, when and by how much remains to be seen. We are betting on a moderate lift in consumer prices through the fourth quarter with the Fed likely able to cut rates starting in September."

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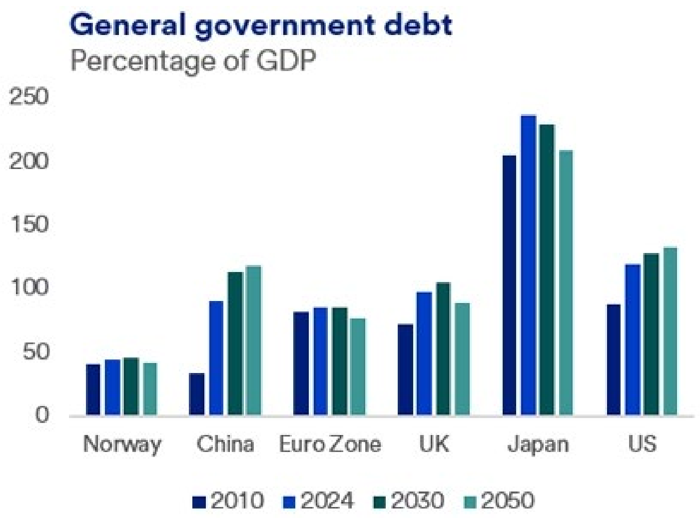
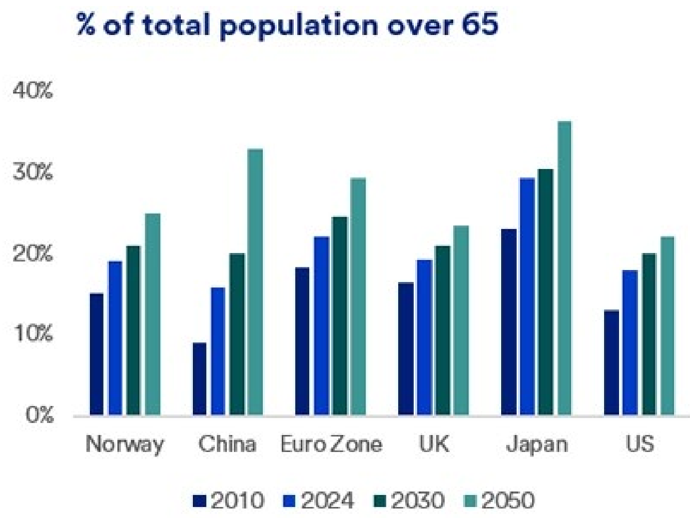
Beth Ann Bovino, chief economist, U.S. Bank





There were earlier attempts to address these costs, with no luck.

Some tried to raise the age for retirement benefits, currently at 65, to 67. The age of retirement was set in 1935 when Social Security was enacted. That was when the lifespan of a person in the U.S. was around 65. Today people live on average around 80 years. That's 15 years of retirement payments. It failed.

Another option targeted the inflation index used to determine retirement spending each year. Currently CPI (consumer price index) is used to calculate costs. If the government switched to a chained index, which allows for substitution for cheaper items, the cost-of-living adjustment (COLA) calculation would be more precise, with significant savings for Social Security. Another possible option would be to raise the dollar amount of wage income taxed by social security, currently $176,100. Finally, adjusting immigration visas toward an employment-based framework would also help grow taxable income. All of these options have failed in the past.

The government policy makers will eventually come to an agreement to open the government, perhaps this week. Don't forget, these bigger issues remain unsolved.

Disclosures