



By: Daniel Lacalle

# The looming U.S. debt crisis warning signals



Foreign ownership of American debt is a clear signal of the United States' fiscal nightmare. Since January 2021, national debt has **increased** by \$7.3 trillion to \$35.6 trillion.

However, foreign ownership of U.S. government debt has increased by only \$1.2 trillion. Foreign demand for Treasury securities has slumped from 90% of net issuances in 2005 to 10% in the 2021-2024 period, according to the Congressional Budget Office.

It is also substantially below the average from 2019 to 2016, which was close to 50%.

Furthermore, the status of safe assets in U.S. treasuries has declined significantly. Between 2008 and 2009, foreign investor demand exceeded 100% of net issuances. It barely reached 80% in recent crises, including the 2020 pandemic.

Central banks and investors globally are increasingly less confident about the fiscal responsibility and solvency of the United States government. I remember when holding U.S. Treasury securities was an unquestioned strategy in any investment portfolio.

Now, investors and central banks perceive that the U.S. debt is not the safest asset, and the fiscal irresponsibility of the government will make it less attractive.

This is evidence of the gradual loss of the currency's reserve value status, and the erosion of confidence has been steady and consistent, even with a stubborn Federal Reserve disguising the reckless indebtedness of the government and a global monetary system that still uses the U.S. dollar as a relatively safe collateral.

## Three alarm bells

Central banks all over the world are adding gold to their reserves instead of more U.S. dollar-denominated sovereign debt. In the past five years, many global central banks, including the Chinese and Indian ones, have

rebalanced their U.S. dollar reserve holdings in favor of gold.

For several years, while China **reduced** its U.S. debt holdings, Japan was purchasing more, offsetting the Chinese purchase slowdown. However, Japan has also reduced its portfolio of U.S. treasuries, trying to maintain the yen afloat.

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If we look at the fiscal multiplier of U.S. debt, it is simply atrocious. In the past twenty years, every new dollar of government debt yielded less than 60 cents of nominal GDP, according to the Bank of America.

With accumulated inflation of 20.4% in the past four years, an annual government deficit of \$2 trillion in a record tax receipt year, and a rising interest expense bill that now surpasses the \$1 trillion mark, the United States is signing the three alarm bells of debt sustainability: the economic, fiscal, and inflationary limits of debt accumulation.

**Economic limit:** less return on debt. Each dollar of new debt brings less than 60 cents of nominal GDP growth, and the bloated administration and constant deficit spending create a crowding out effect that harms small businesses and families, who suffer the rate hikes and credit limits while the Treasury has the temerity of forecasting \$16 trillion of new debt between 2024 and 2034 even if there is no recession. Massive accumulation of debt brings secular stagnation.

**Fiscal limits:** despite record tax receipts, elevated deficits, and accelerating debt. The deficit will not fall below \$1.9 trillion per annum and the bill of interest expenses will only rise in the 2023-26 period, according to the Treasury's own estimates.

Even if rates remain low and financial repression keeps real interest rates in negative

territory, interest expenses and deficits will be astronomical.



*High taxes are not a tool to reduce debt; they are an excuse to justify rising fiscal indiscipline - Daniel Lacalle*

High taxes are not a tool to reduce debt; they are an excuse to justify rising fiscal indiscipline. France has the world's highest taxation system, as well as an unsustainable deficit and debt to GDP. If you want to copy France, be prepared for stagnation, high unemployment, and rising social discontent.

Governments always think they can increase taxes further, but the United States fiscal limit is also obvious when we look at revenues in growth periods. No amount of tax hikes will generate sufficient funds to eliminate the deficit, let alone reduce debt. Furthermore, tax hikes lead to reduced investment and stagnation. Copy France, get French decline.

**Inflationary limit:** Despite record domestic oil production and the presence of highly efficient and competitive industries, the rapid erosion of the currency's purchasing power in four years has left Americans impoverished and struggling to make ends meet.

If you think that socialism and more government intervention will bring prosperity and fiscal sustainability, look again at France. Inflation is another warning signal when CPI

remains above an annualized 2% and services, shelter, and non-replaceable goods and services rise at an annual 4-5%. This is the real-time destruction of the currency's purchasing power.

## Unlimited repressive power

You may have read a few times that a monetary sovereign government can issue all the debt it needs because it has unlimited capacity to raise taxes and print money.

When you read that, they are literally telling you that the government has unlimited repressive power to take away your money and make the currency worthless. Issuing public debt means printing currency and making you poorer.

**Central banks and investors all over the world are losing confidence in the U.S. government debt**

Central banks and investors all over the world are losing confidence in the U.S. government debt, which is also abandoning gradually the confidence in the currency.

When politicians promise more spending and taxes to the rich, Americans should be extremely concerned. You will get less bang for your buck while paying higher taxes. Always.