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Markets & Economies

U.S. Economy: Debt, Deficits, and the Implications for Investors

The ratio of U.S. government debt outstanding to GDP is expected to exceed 100% in 2024 and move higher thereafter. Here's what the trend could mean for the markets.

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Investors are increasingly focused on the consequences of getting U.S. fiscal policy back into balance—and the risks that may be associated with a failure to do so. The concerns have materialized as aggressive fiscal stimulus to offset the threat to the U.S. economy from the onset of the COVID-19 pandemic, on top of an already unbalanced budget position, has resulted in a sharp increase in government-issued debt. U.S. Congressional Budget Office (CBO) projections show that, under current law, debt outstanding will continue increasing steadily as a percentage of gross domestic product (GDP), absorbing a greater share of U.S. and global savings.

For most of U.S. history, the federal government has been a model of fiscal probity, running large deficits only to fight major wars. When the conflicts ended, economic growth and large cuts in military spending brought the fiscal accounts back into balance. As a result, large increases in outstanding public debt were temporary, and the burden of financing the federal government became lighter as the economy returned to a peacetime footing.

That started to change in the early 1980s, and following a period of reform, chronic deficits, and rising debt, i.e., the cumulation of past deficits, became the norm from the early 2000s (see Figure 1).

Figure 1. U.S. Debt Levels, Already High, Appear to Be Headed Higher

U.S. federal debt held by the public as a share of U.S. GDP, 1790-2054 (projected for 2024–2054)

Source: U.S. Congressional Budget Office (CBO) reports on “Historical Data on Federal Debt Held by the Public,” July 2010 (covering 1790-2010), “Historical Budget Data,” February 2024 (2001-2023), and “Long-Term Budget Projections,” March 2024 (long term projections from 2024 onward). Federal debt held by the public excludes intragovernmental holdings. GDP=Gross domestic product. For illustrative purposes only.

Aggressive fiscal stimulus to counter the Global Financial Crisis in 2008–09 was offset by only partial rebalancing of government finances in its aftermath, leaving debt outstanding uncomfortably high even before the sharp increases triggered by efforts to limit the economic damage of the pandemic.

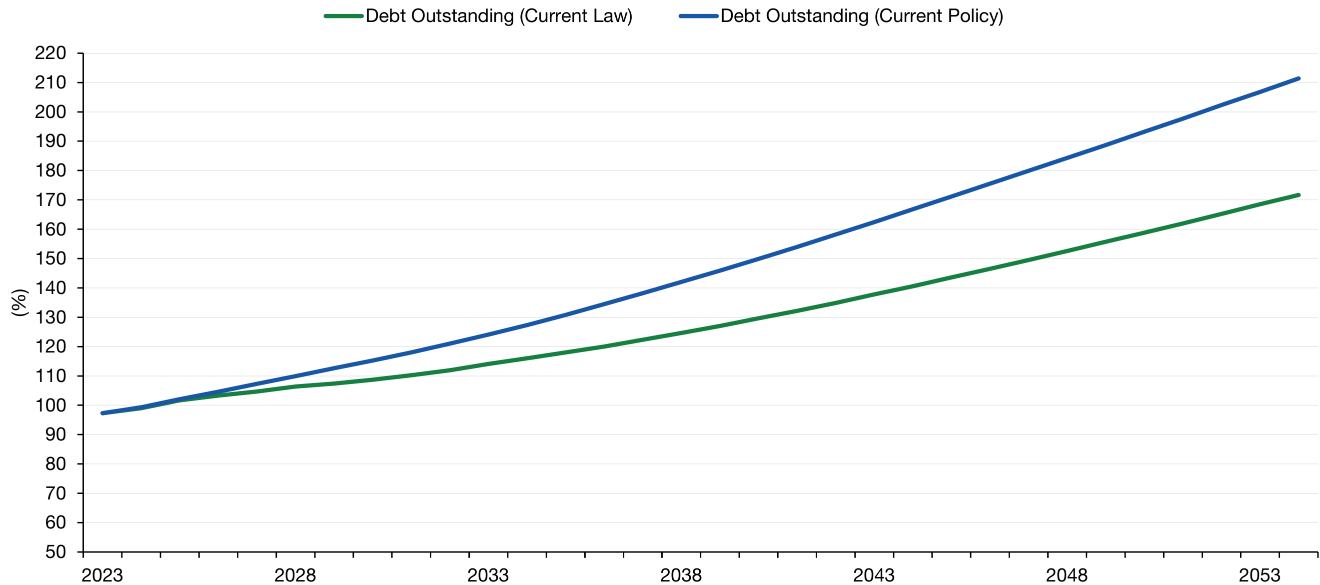
Rising Debt and Deficits

Where do things stand in mid-2024? Federal debt outstanding was just below 100% of GDP (as per a June 2024 CBO report) and is projected to pass that level in mid-2025, an unprecedented occurrence during peacetime. Meanwhile, the budget deficit is on track to reach of 6% of GDP—3% excluding interest payments—when the economy is at full employment. These are the starting points from which the CBO projects that, under current law, deficits will widen to 9% of GDP, and debt outstanding will grow to 170% at the end of the forecast horizon in the mid-2050s.

Figure 2 shows the projected path of U.S. debt under two scenarios. Under the “current law” assumption, the tax cuts for individuals and families contained in the 2017 Tax Cuts and Jobs Act will “sunset” at the end of 2025. But if the current tax policy is extended, and the 2017 tax provisions remain in place (“current policy”), debt outstanding is expected to rise to more than 210% of GDP at the end of the forecast horizon.

Figure 2. A Closer Look at Projected U.S. Debt Levels in the Coming Decades

Projected U.S. debt outstanding as a percentage of U.S. GDP under current law and current policy, 2023-2054



Source: Auerbach, Alan J. and Gale, William G., "The Federal Budget Outlook: Update for 2024," Brookings Institution, March 7, 2024. Budget projections, drawn from U.S. Congressional Budget Office data, are based on current laws (green line) and "current policy" projections (blue line) that incorporate what the authors consider more realistic policy choices than those required by the baseline calculations, e.g., if Congress makes temporary tax provisions permanent, and making plausible assumptions about future discretionary spending. GDP=Gross domestic product. For illustrative purposes only.

The CBO's long-term debt projections are, by statute, driven by assumptions that current law concerning revenues and expenditures will be implemented and that economic growth, inflation, and financing costs will evolve according to expectations. The United States has implemented successful bipartisan fiscal reform in the past—most notably in the 1990s—when projections indicated that debt outstanding was on an unsustainable path. The result, after eight years of stringency, was a federal budget surplus for fiscal 2000, with debt outstanding dropping below 40% of GDP.

Successful fiscal reform may be more difficult now because federal government spending is dominated by "mandatory" programs and interest payments (see Figure 3). Rising expenditures for mandatory spending programs—mostly Social Security, Medicare, Medicaid, and other health-related spending—is driven almost entirely by an aging U.S. population.

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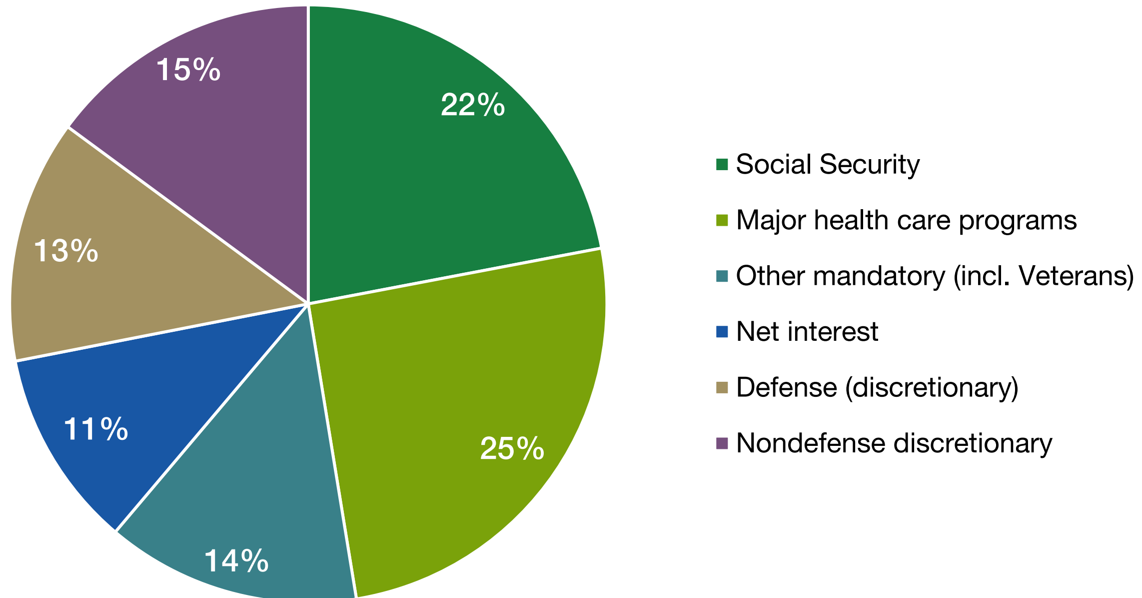
Figure 3. Mandatory Government Programs Account for the Majority of Federal Spending
Percentage share of U.S. government spending by program in 2023



Source: U.S. Congressional Budget Office, "An Update to the Budget and Economic Outlook: 2024 to 2034," June 2024, and Lord Abbett.
For illustrative purposes only.

Cutting spending will require reducing benefits under these programs, including raising the age at which individuals become eligible for benefits under Social Security and Medicare, and increasing taxes on benefits. Meanwhile, pressure to raise discretionary spending on national defense, energy transition, and economic security is increasing in response to a fraught global security and climatic environment

Investors are concerned that polarization between the major U.S. political parties means the chances of implementing painful cuts to popular mandatory spending programs are low. In the absence of major reforms, rapid economic growth could rebalance the fiscal accounts by delivering higher than expected revenues. While some believe that an artificial intelligence (AI)-driven acceleration in productivity growth will come to the rescue, that is more of a hope than a concrete strategy to deal with the issue at hand.

Potential Investment Implications

In the meantime, worries over the potential harmful effects of rising debt may increase. These include the "crowding out" of private investment, as rising public debt drives interest rates up, and the inflationary effects of a large primary budget deficit in a full-employment economy.

Another threat arises from a potential increase in the term premium—the extra yield paid over and above expected future short-term interest rates—on longer-maturity U.S. Treasury debt (see Figure 4).

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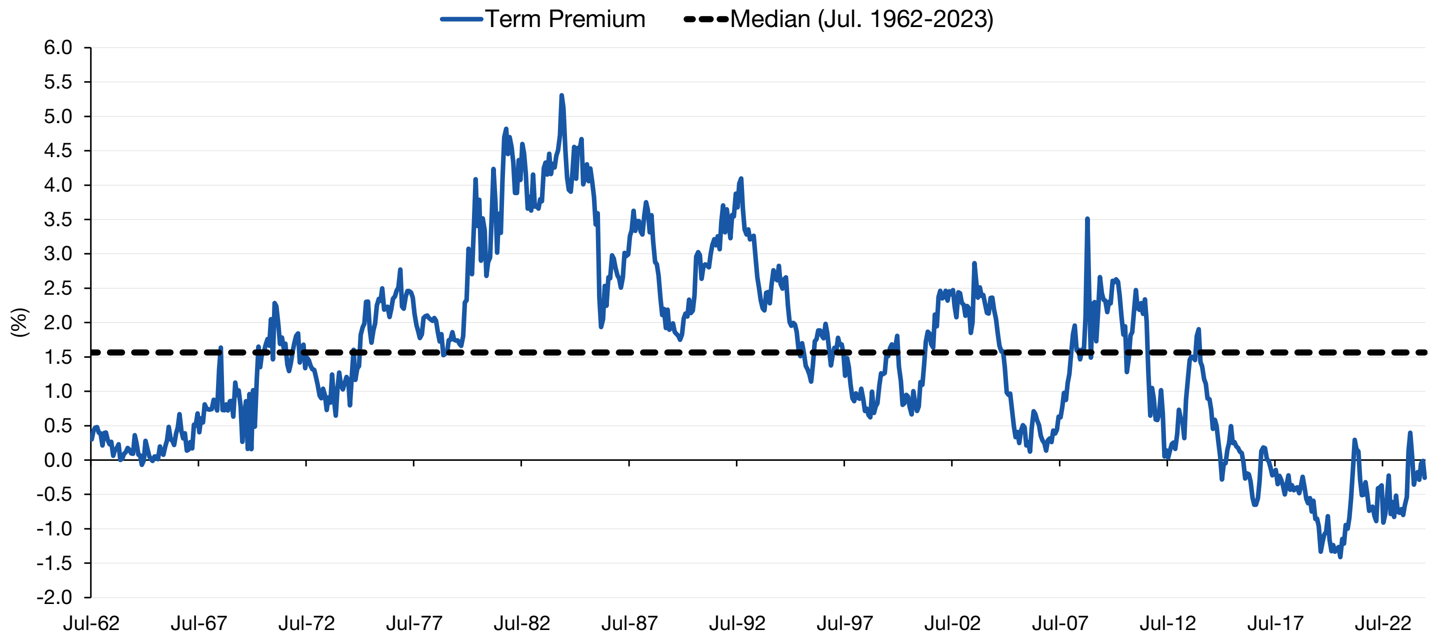
Figure 4. Term Premium May Be Set to Rise from Low Levels of Recent Years

Estimated term premium on 10-year U.S. Treasury debt, July 1962–June 2024



Source: Bloomberg and Lord Abbett. Data as of June 21, 2024. Term premium is defined as the compensation that investors require for bearing the risk that interest rates may change over the life of a bond. Term premia are estimated, most often from financial and macroeconomic variables.

Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment.

While the term premium has been estimated to have been unusually low in recent years, as investors have been more than willing to absorb burgeoning debt at unusually low yields—perhaps assuming that measures to stem future deficits will be forthcoming—a repricing in response to a chronically worsening fiscal position could easily take place. Inasmuch as Treasury securities are the benchmark for pricing credit instruments and other risk assets, a higher-equilibrium risk premium would put pressure on asset prices across the board.

Global investors may also worry about the implications of the fiscal situation for the role of the U.S. dollar as the world's preeminent reserve currency. While much of the dollar's special position stems from the unparalleled breadth and depth of U.S. financial markets and the dominant global position of the U.S. economy, it cannot be taken for granted that these will be enough to overcome the strain arising from deficits that, in the absence of rising domestic saving, will require ever higher capital inflows from abroad and increasing foreign ownership of U.S. assets.

A Final Word

While the U.S. fiscal position is highly unbalanced, it does not mean that a crisis is imminent. Perhaps paradoxically, the fact that there are no clear thresholds beyond which deficits and debt outstanding can be sustained means that it is impossible to know when these circumstances will trigger a definitive, and sizable, market reaction that forces legislative and policy measures to redress the underlying problems.

But if imbalances are permitted to fester and grow, or if actions are taken that could worsen the problems in the medium term, it is likely that amid rising anxiety and uncertainty, markets will be forced to reprice risk assets to reflect potential spillovers. Moreover, the longer these problems are left unattended, the more painful they will become to address against a backdrop of continued increases in debt levels and a population that is aging relentlessly.

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Glossary & Index Definitions

Equilibrium risk premium represents the extra yield that compensates investors for holding a longer maturity security as opposed to rolling a series of shorter ones.

Fiscal policy is the use of government spending and taxation to influence the economy. Governments typically use fiscal policy to promote strong and sustainable growth and reduce poverty.

The **Federal Reserve (Fed)** is the central bank of the United States. The federal funds (fed funds) rate is the target interest rate set by the Fed at which commercial banks borrow and lend their excess reserves to each other overnight.

Gross Domestic Product (GDP): The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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