



World-wide demand

Buyers of U.S. debt come in many shapes and sizes.

By Jim Reber, ICBA Securities

I think we can all agree that there has been plenty to be concerned about in the last, say, five years. Some are environmental issues, some are social and, for community bankers, plenty are economic. What gets a lot of play in the business and even mainstream media is our growing national debt. There's no doubt that the mountain of borrowings that keeps our federal government liquid and solvent is greater than ever before. It's not surprising to me that there's spirited debate about debt limits, or if Congress will ever in our lifetimes find a way to slow our dependence on deficit spending.

Related to this conversation is the concern that, to paraphrase Blanche DuBois, we have always depended on the kindness of strangers. It seems self-evident that foreign central banks have propped up our debt market for decades, buying dollar-denominated securities by the trillions, thereby keeping our borrowing costs manageable, and potentially even encouraging our bad behavior by going ever deeper in debt. But is any of this true?

Walked, then ran

First, let's try to get our minds around the situation. The Federal government first borrowed money before there *was* a Federal government, when the Dutch and the French loaned money to the Continental Congress to help finance the Revolutionary War. Treasury borrowings, as we know them today, sort of date back to World War I, with the issuance of "Liberty Bonds," which was just after the creation of the Federal Reserve Bank. As we have seen, the Treasury and the Fed have a long history of collaboration.

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Even at the start of the 21st century, total Treasury debt was “only” \$3 trillion, at a very manageable 30% of GDP. Just four years ago, our borrowings were about \$17 trillion, at 77% of GDP. Today? We’re over \$24 trillion, nearly 100% of GDP. While it would be tempting to blame a lot of the more recent growth on COVID and the fiscal response to that, the reality is each administration of the last quarter century has contributed to the current debt stockpile. And, now that rates are at a 15-year high, our interest payments alone are now over \$900 billion per quarter. As Craig Dismuke, market strategist for Stifel, is fond of saying, “Interest is an expenditure that doesn’t create jobs.”

Bedrock option

Now, for some hopeful commentary. The owners of our Treasuries are a diverse lot, with diverse objectives. Investors include the savings bond/retail buyers, institutional money managers who run mutual funds, depositories, our central bank, and yes, other sovereign central banks. What’s interesting to note is that the percentage of our debt owned by China, Japan, Germany and the rest of the foreign investors has declined substantially in the last decade, from about 42% to less than 30%. The Federal Reserve, meanwhile, has picked up the pace, and has essentially absorbed the pro-rata share of the pie in the last decade. So it would be wrong to conclude we’re hostage to foreign governments’ largesse. Still, that leaves around half of our total debt in the hands of private investors.

Who are these people? Most are names you’ve heard of, and maybe even invested your personal or retirement moneys with. Large mutual fund families, state-sponsored retirement funds and life insurance companies are examples. In aggregate, they have owned nearly half of the total debt pie for most of this century, so their collective appetite for full faith and credit investments has mirrored Uncle Sam’s appetite for more borrowing. A lot of this can be attributed to the aging of the population, and the advent of “targeted date” funds.

Keeps the wheels turning

If you're of a certain vintage, you may already be invested in these vehicles. Targeted date funds are built for individuals who have an eye on a retirement date, whether it's five or fifteen years from now. Each fund will gradually reallocate its assets out of riskier sectors (e.g., equities) and into debt securities (including Treasuries) as the target date approaches. Collectively, retirement funds (and individuals acting on their own) that gradually, systematically, add more Treasuries to their portfolios may continue to keep up demand to absorb the ever-increasing supply.

So how does this rubber hit the road for Main Street? For starters, demand for U.S. debt helps keep a lid on our Federal deficit by subsidizing interest costs. It probably also keeps community banks' net interest margins a bit lower than otherwise, even if most banks' portfolios contain no Treasuries at all. Still, the global need for Treasury bills, notes and bonds may just possibly sync up with our growing deficit, and ultimately be supportive, long-term, of commerce as we know it. Unlike DuBois, the U.S. Treasury doesn't depend on the kindness of strangers; rather, the global need for safe, liquid debt securities.

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