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Treasury Maturities: The Other Fiscal Problem

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The US fiscal situation is in even worse shape than conventional analysis suggests. Unfortunately, the deficit is only part of the fiscal problem.

The US budget alone is alarming. The deficit is slated to register a whopping 10.9% of GDP this year according to the OMB. Typically, fiscal deficits in excess of 4% of GDP raise early warning signs of concern. The US deficit is more than double the “safe” threshold.

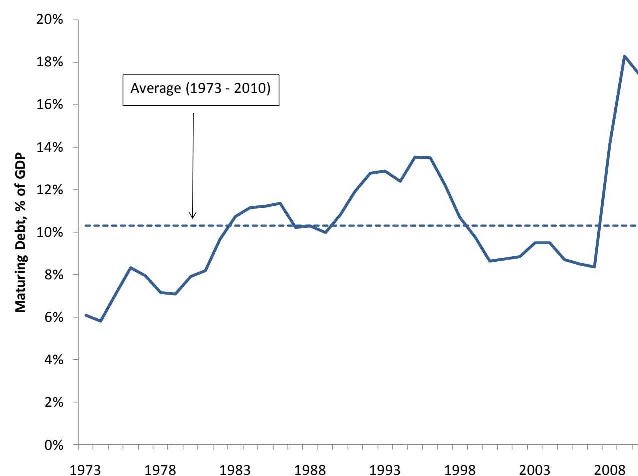
Despite legitimate concerns regarding the budget deficit, large refinancings of debt represent an equally severe – yet lesser known challenge. The experience of Emerging Markets and some advanced economies suggests that as budget deficits widen, **it is the repayment of principal that often triggers a crisis** rather than simply the size of the debt or deficit.

More attention must now be dedicated to Treasury debt financing operations and strategies that put the deficit on a credible trajectory to below 4% of GDP over time.

Perspective on Funding the US Budget Deficit

Our assessment suggests: 1) Treasury’s refunding requirement is 7% of GDP more than usual in 2011, 2) the US debt profile is unusually skewed to short-term refinancings relative to recent history, and 3) the maturity distribution of US Government debt is more heavily bunched in the short-term vis-a-vis 12 OECD nations.

Figure 1. US Government Debt Maturities Spike in the Coming Year



Note: Interest-Bearing Public Debt Held by Private Investors.
Source: US Treasury and Center for Financial Stability Inc.

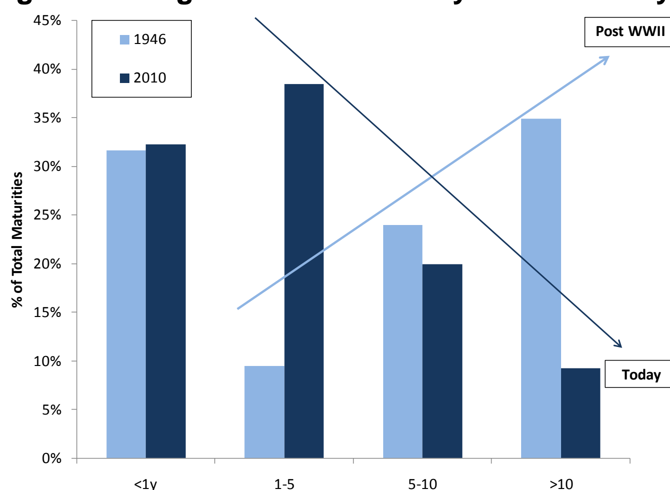
The Picture in 2011: Treasury will need to roll or refinance 17% of GDP to private investors alone in 2011 (see Figure 1). This represents a sharp jump from an average of 10% of GDP per

year between 1973 and 2008. So, Treasury will now need to tap domestic and international capital markets for 7% of GDP more than was normally the case. **This is an enormous jump in the US Government's reliance on capital markets. In order to keep the financing requirement constant, officials would need to either cut spending by 26% or boost revenues by 42%.** Budget revenues and expenses represent 16.6% and 26.3% of GDP, respectively.

The jump in recent funding requirements is even slightly higher relative to the average between 2000 and 2007, when maturing debt was only 9% of GDP per year.

Now versus Post World War II: Many cite the Post World War II period as evidence that the US economy can thrive despite unusually high levels of Government debt. This would be a mistake.

Figure 2. Dangerous Debt Maturity Profile: Today versus 1946



Note: Interest-Bearing Public Debt Held by Private Investors.
Source: US Treasury and Center for Financial Stability Inc.

Although the US exited World War II with substantial debts, Treasury employed a far more reasonable strategy by more evenly accessing funds across the yield curve (see Figure 2). In 1946, only 41% of the total marketable debt held by private investors fell due over the next five years. Today, a stunning 71% of the total marketable debt held by private investors will need to be refunded in the next five years. Similarly, the debt distributed over the subsequent 25 years is a scant 29% at present relative to 59% in the immediate post War period.

US Public Maturities versus OECD Member Nations: The US public debt maturity profile also compares unfavorably relative to many OECD member nations. For example, the US Government debt funding needs over the next five years is the largest among 12 advanced economies. Likewise, the extension of maturing debt beyond 10 years is the lowest among evaluated Advanced Economies with the exception of Finland – which maintains roughly the same 9% of total obligations falling due.

Figure 3. Skewed US Maturity Profile Relative to Other Nations

	<5yrs	5-10	>10
US (2010)	**71%**	**20%**	**9%**
Spain	66%	3%	31%
Germany	59%	25%	16%
Netherlands	54%	27%	19%
Finland	53%	38%	9%
Belgium	51%	30%	18%
France	49%	29%	23%
Greece	46%	27%	26%
Italy	45%	26%	29%
US (1946)	**41%**	**24%**	**35%**
Austria	40%	36%	23%
Portugal	39%	41%	21%
Ireland	36%	47%	19%
Average	**49%**	**31%**	**21%**

Source: US Treasury, Bloomberg, and Center for Financial Stability Inc.

Why fund short?

At present, Treasury understandably favors funding the deficit with shorter-term maturing obligations. Short-term interest rates are negligible with the Federal Funds rate near zero. However, this can quickly change when the Fed exits its Quantitative Easing (QE) policy.[1] At that stage, rates will increase and Treasury will need to roll sizeable debts under substantially less favorable conditions. The present approach is short sighted and dangerous.

Conclusion

With unprecedentedly large refinancing requirements, the US Government is now more reliant than ever on domestic and international market participants. In order to maintain and bolster the confidence of financial markets, officials must:

- Reduce the near-term budget deficit by a minimum of the $61 billion (a scant 0.4% of GDP) proposed by House Republicans. The Democratic alternative cut of less than $5 billion is rounding error on over $2.2 trillion in planned spending.
- Prioritize a bipartisan program to put the budget deficit on a long-term path toward sustainable levels, below 4% of GDP. The President's "National Commission on Fiscal Responsibility and Reform" or "Bowles-Simpson" is a good start.
- Slowly extend maturing US Treasury debt. We recommend initially targeting the average of OECD nations (see Figure 3) with a move over time to the more prudent US maturity profile of 1946.

With thanks to Robin Lumsdaine, Bruce Tuckman, and Yubo Wang for comments. Special thanks to Bruce for international government debt maturity profiles.

[1] Goodman, Lawrence, "A Strategic Approach to QE" – Center for Financial Stability, Inc., December 9, 2010.

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