Debt: A Problem in Perspective

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Overview

Burgeoning debt is an issue that's garnered many headlines, particularly in the wake of the financial crisis that came to a head in 2008. Over a three-decade span, most notably in the last 15 years, borrowing by individuals, companies and countries rose dramatically, often to unhealthy levels.

After the financial crisis and resulting recession, American consumers dialed back their use of borrowing and focused on paying down existing debt. Companies have also paid down debt and greatly improved their balance sheets. By contrast, government debt has risen significantly in the United States and in many other countries. This can be attributed in large part to reduced tax receipts caused by slower economic activity and increased spending as part of stimulus efforts.

A global debt scorecard

One way to compare debt among different countries is to measure the ratio of national debt in comparison to a country's Gross Domestic Product (GDP). This is referred to as the "debt-to-GDP" ratio. The following table illustrates how countries in Europe rank in early 2013.

Country	Debt-to-GDP ratio
Germany	50%
France	75%
United Kingdom	75%
Spain	90%
Italy	130%

For perspective, the consensus view is that when a country's debt-to-GDP ratio exceeds 90 percent, its economic growth tends to be impaired. If debt levels exceed 120 percent, the probability of a financial crisis is considerably higher.

Where does the United States stand?

The issue of debt has been in the news headlines and is a regular talking point for politicians in Washington. So just how serious is the debt problem for our own federal government? Is it creating a potential risk for our economy?

The headline number typically touted in the media is that the nation's "gross debt" is approximately $16.5 trillion. Using that number, the debt-to-GDP ratio for the United States today is approximately 104 percent. That is a higher level than Spain's debt in relation to its economy, and in the range that is considered a risk to future economic growth. That perspective understandably leads to a concern that the United States faces a significant economic risk due to its lofty government debt.

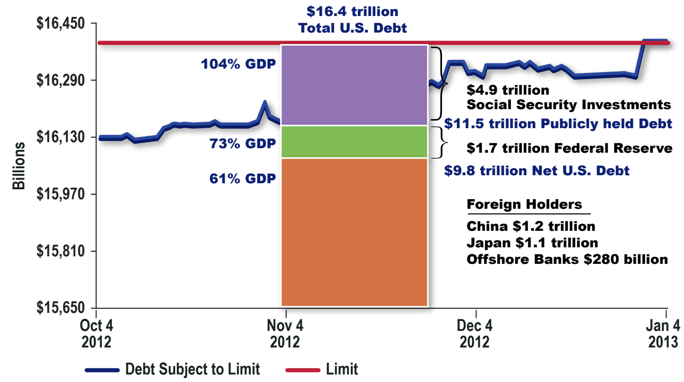
Along with the amount of outstanding debt, the conventional wisdom is that China is the largest holder of U.S. government debt. China currently holds approximately $1.2 trillion in U.S. debt — which is less than 10 percent of our total debt. The perception is that this creates an additional risk for the country's financial stability should China decide to cut back its financial commitment to U.S. debt securities.

Checking the facts on U.S. government debt

While the debt issue is a serious one, it is a topic where a great deal of misinformation has been circulating. To clarify, here are some facts that should help provide perspective:

- Of the $16.5 trillion in gross U.S. government debt, the largest holder is not China but ourselves. The Social Security trust fund has more than $5 trillion invested in U.S. government securities. It is fair to categorize this $5 trillion of the nation's debt as intergovernmental holdings, and therefore a relatively reliable source of ongoing investment in our nation's debt. By law, Social Security funds can only be invested in the safest securities. Debt issued by the U.S. government continues to be viewed as the safest investment in the capital markets.
- If we assume that the total debt "held by the public" amounts to $11.5 trillion, that results in a debt-to-GDP ratio of about 73 percent, much more manageable than the 104 percent top-line number associated with the "gross debt."
- The largest holder of our public debt is again not China but the Federal Reserve (Fed). The Fed holds approximately $1.7 trillion of U.S. government debt securities, which is 42 percent more than the amount held by China. This again can, for all practical purposes, be categorized as intergovernmental holdings.
- That brings the total value of publicly held debt to $9.8 trillion, or equal to a debt-to-GDP ratio of 60 percent, approaching the ratio in Germany, which is widely considered to be the most financially stable government in Europe.

Bumping up against the debt ceiling



Source: Bureau of Public Debt; January 2013

The challenge continues

These numbers should help provide perspective and temper the concern that the United States faces an imminent debt crisis, but it does not mean that the issue of dealing with the debt should be taken lightly. Sizeable annual federal budget deficits mean that our net debt has been growing at an alarming rate since the financial crisis. This is an important problem that needs to be addressed. Such high deficits cannot be sustained indefinitely without causing economic harm.

It is important that policymakers in Washington begin to better manage the nation's budgets to bring them more into balance. This is the only way to assure that future debt levels do not reach a danger point that could lead to structural economic issues. The risk today is manageable, but we can't assume that the problem will go away.

Contributed by:
Timothy J. Leach
Chief Investment Officer, U.S. Bank Wealth Management

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