# WILL THE U.S. HAVE A DEBT CRISIS?

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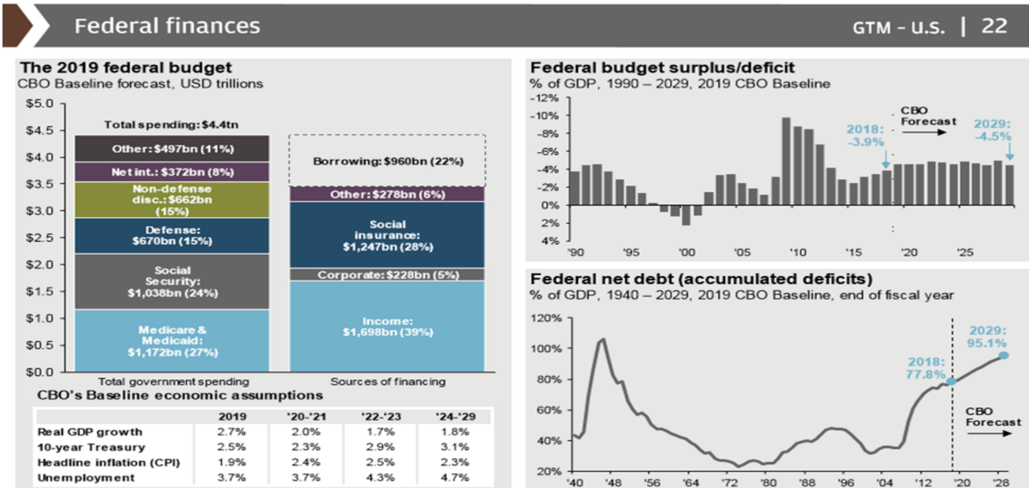
***"We believe that high and growing government debt will eventually become a burden on economic growth. The needed steps to address this issue may negatively impact the financial security of retirees."***

*McCarthy Asset Management, Inc. is an independent, fee-only investment advisory firm that has been helping people invest wisely for over fifteen years. Our mission is to help you better understand and improve your financial situation. We specialize in* Retirement Planning, Portfolio Management and Tax Planning.

The federal deficit for the budget year ending September 30th surged 26% from 2018 to 2019, reaching $984.4 billion—its highest level in seven years. The deficit is widely expected to top $1 trillion in the 2020 budget year and likely remain there for the next decade. The year-over-year widening in the deficit reflects revenue lost from the 2017 Trump tax cut and a budget deal that added billions in spending for military and domestic programs.

The left portion of the J.P. Morgan chart on the next page displays the breakdown of the $4.4 trillion in government spending based on the budgeted amounts for 2019. With the fiscal year now over, the actual amounts for 2019 were government receipts (revenue) totaling $3.4 trillion, 3.8% higher than the previous year, while federal spending rose 8.2% to $4.4 trillion. The three biggest spending increases were recorded in the Medicare program, Defense Department and net interest on the national debt. The Medicare program saw spending rise 10% to $783 billion, the Defense Department experienced an increase of 8% to $654 billion; and net interest on the national debt rose almost 16% to $376 billion.




| | 2019 | '20-'21 | '22-'23 | '24-'29 |
|---|---|---|---|---|
| Real GDP growth | 2.7% | 2.0% | 1.7% | 1.8% |
| 10-year Treasury | 2.5% | 2.3% | 2.9% | 3.1% |
| Headline inflation (CPI) | 1.9% | 2.4% | 2.5% | 2.3% |
| Unemployment | 3.7% | 3.7% | 4.3% | 4.7% |

Source: CBO, J.P. Morgan Asset Management; (Top and bottom right) BEA, Treasury Department.
2019 Federal Budget is based on the Congressional Budget Office (CBO) August 2019 Baseline Budget Forecast. CBO Baseline is based on the Congressional Budget Office (CBO) August 2019 Update to Economic Outlook. Other spending includes, but is not limited to, health insurance subsidies, income security and federal civilian and military retirement. Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Economic projections as of August 2019.
*Guide to the Markets – U.S.* Data are as of September 30, 2019.

J.P.Morgan Asset Management

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Deficits have now increased 68% from when President Trump took office, despite his campaign pledge to eliminate the federal debt in eight years. The massive tax cuts from the 2018 Tax Act is a significant reason for the increase. Trump isn't the only one to blame. Federal spending has continued to rise significantly under Democrats and Republicans, and lawmakers have shown little appetite for reining in federal spending or raising taxes. Meanwhile, investors are unfazed by the rising government red ink.

More concerning is that these huge deficits are occurring while the economy is in a record-long economic expansion. By comparison, the last time the jobless rate was below 4%, in 2000, the U.S. ran a budget surplus of 2.3% of GDP. And in 1969, when the jobless rate last touched 3.7%, the U.S. ran a budget surplus equal to 0.3% of GDP. *If the U.S. is running trillion-dollar deficits during an economic expansion, how high will deficits go during the next recession?*

**Long-Term Budget Outlook:** Under current law, large budget deficits over the next 30 years are projected to drive the federal debt from 78% of Gross Domestic Product in 2019 to 144% by 2049. That projection incorporates the Congressional Budget Office's (CBO) estimates of various factors, such as productivity growth and interest rates on federal debt.

CBO projections are rarely accurate, but neither are anyone else's. In this forecast, there are no expectations of a war, a severe recession or high inflation. With the expected increase in the total Federal debt, interest payments on the national debt are projected to grow inexorably from 1.4% of GDP now, to 5.8% in 30 years. Even if the non-interest portion of the deficit as a percentage of GDP stays around 3.0%, the total annual deficit as a percentage of GDP will grow from 4.4% for 2019 to 9.0% by 2049.

**Will This Become a Problem?** We believe that high and growing government debt will eventually become a burden on economic growth. This is in contrast to a new school of economic theory known as the "modern monetary theory." It argues that major economies such as the United States and Japan don't have to worry about running deficits because their central banks can print as much money as they need. Fortunately, this erroneous thinking remains a distinct minority view among economists. Most still correctly believe that while the huge deficits are not an immediate threat, at some point they can become a big problem. They will crowd out borrowing by consumers and businesses, which could elevate interest rates to levels that ignite a recession.

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**Our Services**

Investment Management Services:

- MAM creates and manages customized investment portfolios based on each client's investment objectives, timeframe and risk tolerance.

Financial Planning Services:

- The Net Worth Analysis (NWA) tracks the accumulation of Invested Assets for pre-retirees and the retention of Invested Assets for retirees. Updated annually.
- "Retirement Analysis" a comprehensive analysis of your retirement goals, which produces easy-to-read, interactive working plan, stored in the cloud. Updated as needed for life events.

Tax Services:

- Clients have the option of utilizing the income tax services provided through the firm Stephen P. McCarthy, CPA. These services are offered at an hourly rate and may include:
    - Tax Return Preparation
    - Income Tax Projections
    - Tax Minimization Ideas
    - Tax Authority Representation

Other Services:

- MAM has retained several outside experts, whose services are available at no cost to our clients:
    - Medicare Planning– Eileen Hamm of Superior LTC Planning Services, Inc.
    - Long Term Care Planning– Allen Hamm of Superior LTC Planning Services, Inc.

**What Can be Done?** Unfortunately, there are no easy answers. The policies that would be required to address the growing deficits are very difficult, if not politically impossible, at this point. Concerns about rising deficits and debt have been absent from the presidential campaign trail, in contrast to previous election cycles. Instead we hear a debate about "Medicare for All" that would likely cause the deficit to skyrocket. While we don't view the rising deficits as a short-term issue, eventually (perhaps in 10 or 20 years), it could become more of a crisis. Probably only then will politicians take action.

**Implications for MAM Clients:** Just to be clear, we don't see rising deficits as having a negative economic impact in the foreseeable future. Eventually, though, politicians will need to finally start addressing the issue. In so doing, it is likely that income taxes will increase and there could be entitlement reform that reduces Social Security and Medicare benefits. Also, soaring government debt could motivate the Federal Reserve to increase inflation by increasing the money supply. Any and all of these steps may negatively impact the financial security of retirees, and therefore should be factored in when estimating the long-term rate of return for portfolios and the assumed rate of future inflation for retirement spending.

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