U.S. Treasury's Massive Problem: How to Fund Increasing Deficits

The national debt of the United States government jumped by $1.3 trillion during the fiscal year ending September 30. The gap between the government's spending and its income for that fiscal year was $779 billion, a jump of $113 billion over the year before. And now, the U.S. Treasury has announced how it's going to manage all this: It's going to issue new debt in the amount of $1.34 trillion, a 146 percent increase from 2017 and the highest amount of new debt issued since 2010.

Said the Treasury:

> Total net marketable securities issued in the fourth quarter will be a projected $425 billion, according to the Treasury report.
>
> That will bring total debt issued in 2018 to $1.34 trillion, the highest since $1.59 trillion was issued in 2010.
>
> 2018 debt issuance also jumped 146% from 2017, when just $546 billion was issued.

In 2010 the excuse used for the issuance of such massive (and incomprehensively large) amounts of debt was the "recovery" from the Great Recession. Under Keynesian theory, the best way to keep the banks from failing was to bail them out with taxpayer monies. Only the taxpayer didn't have the money so the Treasury borrowed it in their name, leaving them on the hook to pay it back later.

Now, however, it's "later," and instead of paying back what the Treasury borrowed, it's borrowing more, using a different excuse: tax reform, more government spending, and an aging population demanding their entitlements.

Add to that the Fed's plan to continue to sell off some of the U.S. Treasury securities it bought during the crisis, which is adding another $30 billion a month for the bond market to absorb, and one can see the challenge faced by the funding agency that is tasked with paying the government's bills.

They are a creative lot. The new offerings will focus on short-term securities in the range of five years or less. This keeps interest rates lower than what the government would have to pay out on longer maturities, as well as reducing default risk to investors nervous about the government's financial condition. Holding a five-year security backed by the "full faith and credit of the United States" is half as risky as holding the same piece of paper that pays off in 10 years.

It's also ginning up use of Treasury Inflation-Protected Securities (TIPS), which, according to the department, "provide protection against inflation. The principal of a TIPS increases with inflation and decreases with deflation, as measured by the Consumer Price Index. When a TIPS matures, you are paid the adjusted principal or original principal, whichever is greater."

TIPS do nothing about the underlying risk of default, of course, which is why, in the summer of 2011, the credit-rating agency Standard & Poor's cut the government's credit rating from AAA ("outstanding") to AA+ ("excellent") and its outlook to "negative." Said the agency at the time:

> The downgrade reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011.
>
> Since then, we have changed our view of the difficulties in bridging the gulf between the political parties over fiscal policy, which makes us pessimistic about the capacity of Congress and the Administration to be able to leverage their agreement this week into a broader fiscal consolidation plan that stabilizes the government's debt dynamics any time soon.

This was written seven years ago. Has anything changed since then? Answer: The government's deficits are approaching a trillion dollars a year, and the national debt is 50 percent larger. Aside from that, not much.

And yet, despite the greatly increased chance of default, neither of the other major rating agencies (Fitch and Moody's) have cut their AAA ratings. And at present, all three of them consider the financial outlook for the U.S. government "stable."

The U.S. Treasury is solving its short-term funding problem by tinkering with its debt offerings. In the long run, its challenge remains: How is it going to fund trillion-dollar deficits that are projected to continue, and increase, as far out as the eye can see?

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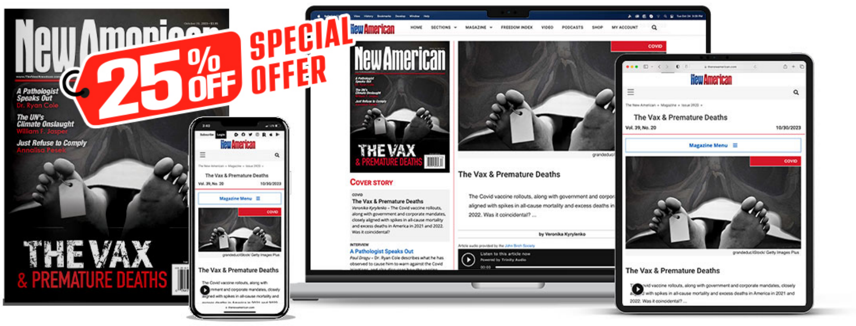

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