

Financial Commentary

The Crescent Group at RBC

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Management

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You've probably heard by now that at the end of April, U.S. federal government debt reached an amount equal to our nation's annual GDP.

Comparing a nation's debt to its GDP is a common practice in economics. In a simplistic way, it's sort of like comparing a person's mortgage balance to their annual income. Like me, you probably don't find it very insightful to look at a number like "100% of GDP" without some context. So, let's compare it to other countries, and also look at how this ratio has changed over time.⁽¹⁾

According to the International Monetary Fund (IMF), public debt to GDP averages out to 93% across the entire world. Meanwhile, the IMF pegged U.S. public debt to GDP at 121%. The 121% figure differs from the headline 100% number reported in April because the headline number excludes government borrowings from other government agencies. Our purpose in looking at these numbers is to compare the U.S. to other countries, so we will use the IMF numbers.⁽²⁾

So, the U.S. government debt to GDP ratio is about 30% larger than the global average. What about comparison to specific countries? The IMF estimates that China – which has the world's second largest economy – has a government debt to GDP ratio of 88%. This is of interest because China is the closest economy in size to the U.S. (Germany is a distant third), and this means China is the closest to challenging the U.S. reserve economy status. Additionally, at 121%, the U.S. government debt to GDP ratio is approaching the level of countries that have faced economic challenges with managing their debt loads (Italy 135%, Greece 151%, Venezuela 164%, Japan 237%). In fact, the U.S. has the fifth largest debt / GDP ratio on the list of 88 countries.⁽²⁾

Despite the high U.S. government debt load, the rest of the world continues to lend money to the U.S. because it perceives that the U.S. does not pose a significant credit risk at current debt levels. The all-important question is at what point does that perception change? At what point would other countries demand higher interest rates to lend to the U.S., or reduce their willingness to lend to the U.S.? Higher interest rates on a higher debt load could lead to an economic crisis. The single best example of this in the modern era is the U.K. debt crisis following World War II. Prior to the 1940s, the British pound was the world's reserve currency. But the cost of fighting two world wars and attempting to manage a sprawling empire led the U.K. to accumulate a national debt that reached 270% of GDP. This led to a U.K. debt crisis and the 1944 Bretton Woods Agreement, which formalized the U.S. dollar's newfound status as the world's reserve currency.⁽³⁾⁽⁴⁾

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What's interesting to note about the U.K. debt crisis and loss of reserve currency status is that it didn't lead to economic disaster for the U.K. economy. Over the ensuing decades through the early 2000s, the U.K. debt to GDP ratio fell to 50%. Meanwhile, going back as far as the data does to 1955, the U.K. economy has grown at an annual rate of 7.6% for the past seventy years following their debt crisis and loss of reserve currency status. The U.K. was able to reduce their debt to GDP ratio through a combination of low interest rates, high GDP growth, and higher taxation.⁽⁵⁾⁽⁶⁾

Similar to the U.K., I would expect the U.S. to muddle through a potential debt crisis, should one occur. And similar to the U.K., I wouldn't expect it to be a disaster. It would, however, likely be quite a change from the freewheeling spending of the past several decades. If our government's ability to continually borrow and spend more were limited, our society as a whole would likely feel less well-off. It's also not known which country or countries might step into a global economic leadership role, and how that might change things for the U.S.

The U.S. has been here before. Our debt / GDP ratio reached 100% of GDP after World War II due to the cost of fighting the war.

Over the following decades, we reduced that down to 30%. Of course, it's important to realize that the demographics of the U.S. are quite different today from what they looked like the last time we reduced our debt to GDP ratio down from 100% after World War II. At that time, we had the benefit of the baby boom, and the tremendous economic growth it ushered in. Today, our nation's birth rate is about a third of what it was at that time, so we won't necessarily have the demographic boost to economic growth that we had at that time.⁽⁵⁾

It also strikes me that the post-WWII generation had much more of a mindset of personal sacrifice and service, which seems quite different from today's mindset. Despite the knowledge that our nation's spending isn't sustainable, there seems to be little appetite for doing the difficult things we must do to right the ship. This can certainly make our task more difficult.

Probably one of the biggest risks to investors in U.S. markets is that market valuations are sensitive to changes in economic conditions and investor sentiment. Diversification across asset classes and geographies may help mitigate U.S.-specific risk.

While some investors might understandably view the U.S.

debt level with fear, and allow that fear to steer them towards conservative, fixed income investments, such as bonds and cash, I actually think doing the opposite makes sense. One of the most expedient ways of servicing and paying down debt is through printing money. For this reason, I expect the value of currency to decline in purchasing power over time, as it has in the past: for example, a U.S. dollar currently buys you 22% less than it did 6 years ago, due to the inflation which was largely driven by government stimulus funds. Go back one hundred years, and the U.S. dollar purchasing power has fallen by 95%. In my view, rather than fearing temporary market setbacks from government fiscal challenges that we'll get past, investors should fear permanent loss of purchasing power from inflation. Historically, equity investments have provided returns that outpaced inflation over extended time periods. However, suitability depends on individual risk tolerance, time horizon, and financial goals. Investors should consult with their advisor regarding appropriate asset allocation for their circumstances.⁽⁷⁾

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Forbes Best-in-State Wealth Management Team 2024, 2025, 2026*

Sources: (1) [The Wall Street Journal 4/30/26](#). (2) [International Monetary Fund](#). (3) [Office for Budget Responsibility 7/2013](#). (4) [Council on Foreign Relations 7/19/23](#). (5) [Board of Governors of the Federal Reserve System](#). (6) [Warwick University 7/1/20](#). (7) [Bureau of Labor Statistics](#).

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