Macro Roundup Article

Headline: The Growth Dividend and Excess Interest

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Tweet: .@dannyyagan notes that in CBO projections, GDP growth exceeds the average interest rate until 2040, making medium-run projections of debt/GDP less alarming, but highlighting the critical importance of primary surpluses for long-run debt sustainability.

Summary: The deficit as a share of GDP increasingly exceeds each year's change in the debt-to-GDP ratio. The debt ratio change equals the deficit plus the growth dividend: the amount by which GDP growth shrinks the debt ratio, equal to last year's debt ratio times −y/1+y where y is the nominal GDP growth rate. The growth dividend has more than doubled since the Great Recession because the debt ratio has more than doubled. Adding a growth dividend row to CBO's main budget table enables readers to exactly decompose America's debt ratio path. Current debt increases the debt ratio each year by the amount that interest payments exceed the growth dividend. This excess interest remains negative in CBO baseline's projection. Hence, America's current debt is sustainable in the CBO baseline despite currently high interest payments. Projected primary deficits – i.e., future tax revenue failing to cover future non-interest spending – entirely drive America's unsustainable debt ratio path. The primary deficit provides a good guide to how the debt ratio is projected to change, while the deficit does not.

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Primary Topic: Fiscal Deficits

Topics: Academic paper, Financial Markets, Fiscal Deficits, Fiscal Policy, GDP, Government Spending, Weekly

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