Macro Roundup Artcile

Headline: Putting America's Debt in Its Place

Article Link: https://www.project-syndicate.org/commentary/house-gop-debt-ceiling-narrative-wrong-facts-by-barry-eichengreen-2023-02

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Tweet: .@B_Eichengreen argues that projected debt levels are sustainable, noting that CBO's real GDP growth rate of 1.7% over the next ten years exceeds their 1.2% real interest rate forecast (3.6% ten-year bond rate less 2.4% inflation forecast).

Summary: Interest costs are not exploding. To be sure, inflation remains elevated, which pushes up short-term interest rates. But, because the US Treasury issues long-term bonds, debt-servicing costs depend on long-term rates, which have risen by less. Currently, the interest rate on ten-year government bonds is 3.6%, while the CBO's inflation forecast for that horizon is 2.4%, so the real (inflation-adjusted) interest rate relevant for calculating the interest burden is still only 1.2%. What matters is the difference between the real interest rate and the growth rate of the economy. If the real interest rate is lower than the growth rate of inflation-adjusted GDP, then the debt ratio can fall even when the government runs budget deficits. The CBO's forecast for growth over the next ten years is 1.7% – higher than the real interest rate. This is not a license to engage in unlimited spending. But it implies that, given a debt-to-GDP ratio of 100%, the federal government can run deficits of 0.5% of GDP (the difference between 1.7% and 1.2%) over and above its interest payments without causing the debt ratio to rise.

Primary Topic: Fiscal Deficits

Topics: Factoid, Fiscal Deficits, Fiscal Policy, News article, Sell-by Date

Permalink: https://www.edwardconard.com/macro-roundup/b_eichengreen-argues-that-projected-debt-levels-are-sustainable-noting-that-cbos-real-gdp-growth-rate-of-1-7-over-the-next-ten-years-exceeds-their-1-2-real-interest-rate-forecast-3-6-ten?view=detail