

THE IMPACT OF DEBT ON GROWTH IN THE ECONOMY

BY DAVID L. BAHNSEN

A TALE OF TWO NATIONS

- DEBT
- DEMOGRAPHY
- RESULTS
- REMEDIES

A CONCLUSION BEFORE THE CASE

HOW WE GOT HERE

- An asset bubble forms for whatever reason – policy errors, a prolonged period of easy money, investor euphoria, human nature, business cycle, etc.
- The bubble bursts and great economic damage is done – profits collapse, wages collapse, jobs collapse – and in very serious situations, a debt-deflation spiral forms
- Governments use Keynesian tool of fiscal spending to offset damage (a "counter-cyclical fiscal punch"), and central banks use monetary policy to soften the pain

A CONCLUSION BEFORE THE CASE

HOW WE GOT HERE

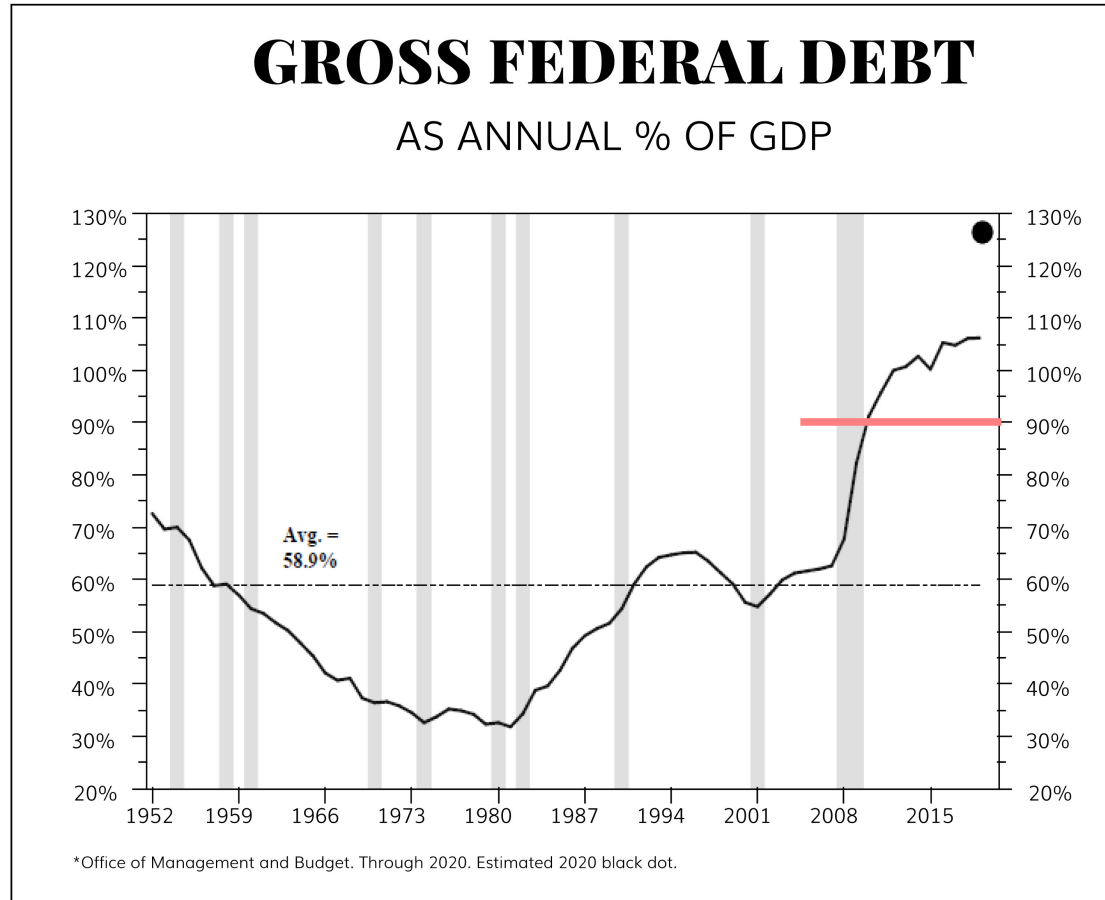
- The lower cost of capital incentivizes more borrowing
- The additional borrowing puts more of a drag on growth
- More borrowing and spending means less savings and investment
- All of these things facilitate downward pressure on growth, and all of them have their roots in excessive debt and leverage

U.S. DEBT

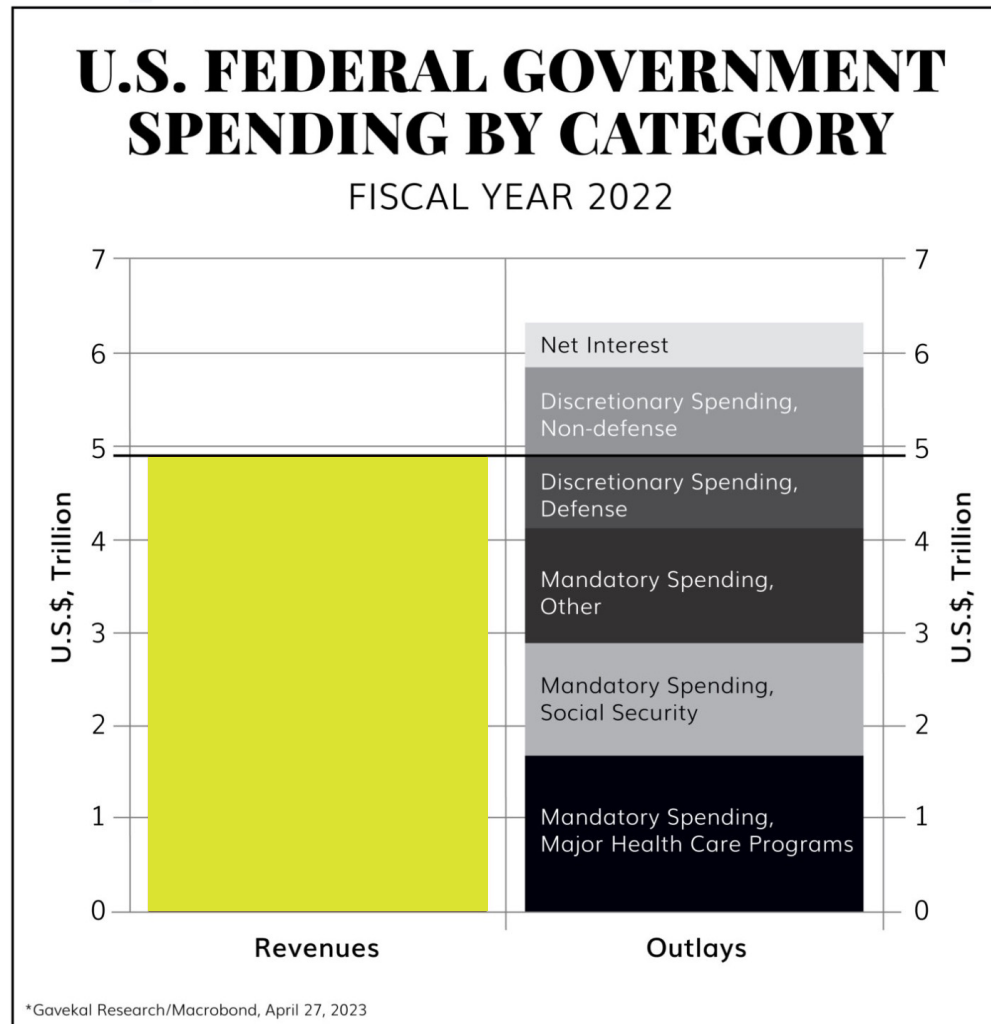
YEAR	FEDERAL DEBT HELD BY PUBLIC AS PERCENTAGE OF GDP
2006	36%
2011	66%
2019	79%
2021	108%+

*Stratagas Research, June 17, 2023

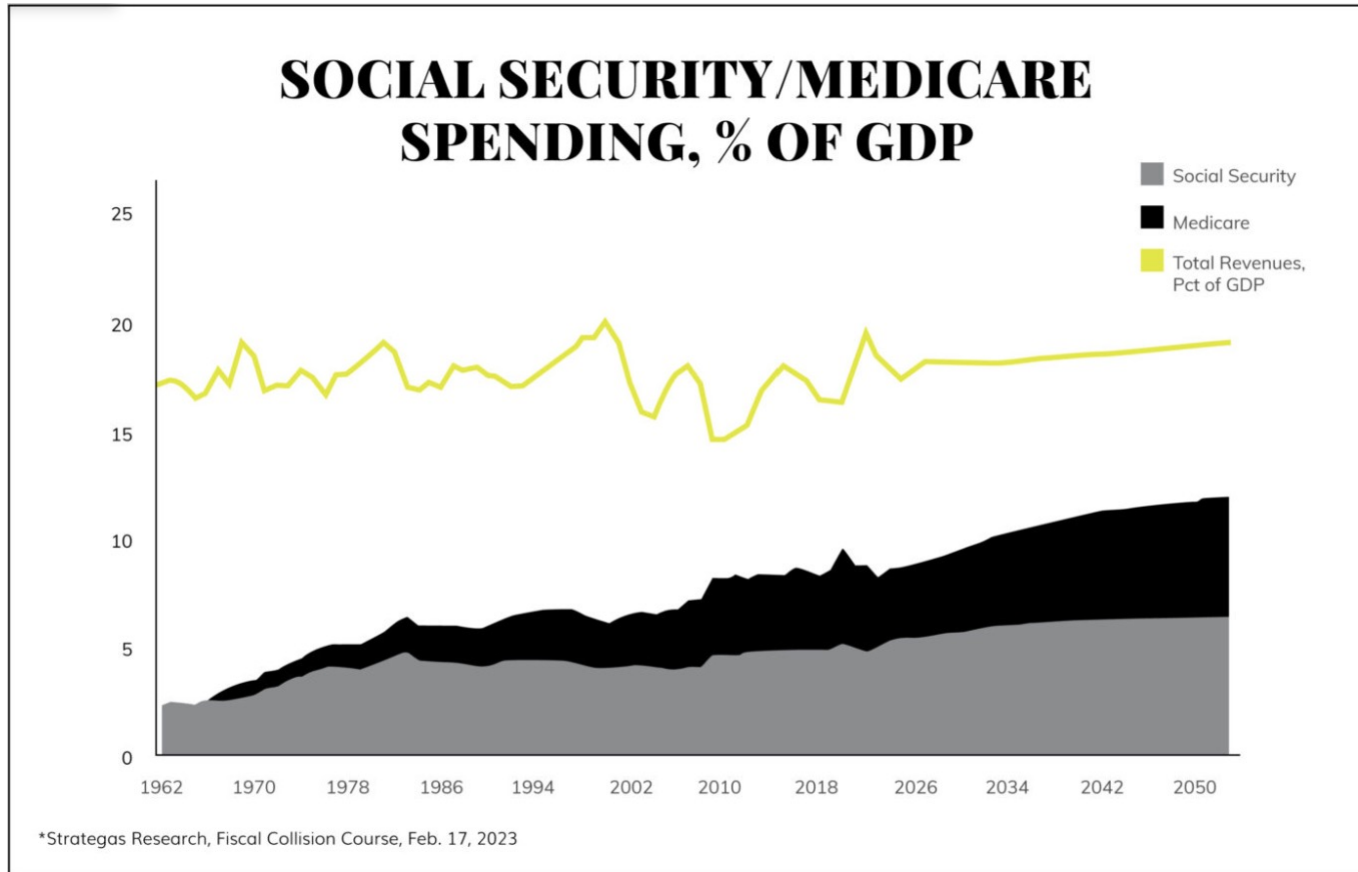
WHERE ARE WE NOW?



WHAT TO CUT?



ELEPHANT IN THE ROOM

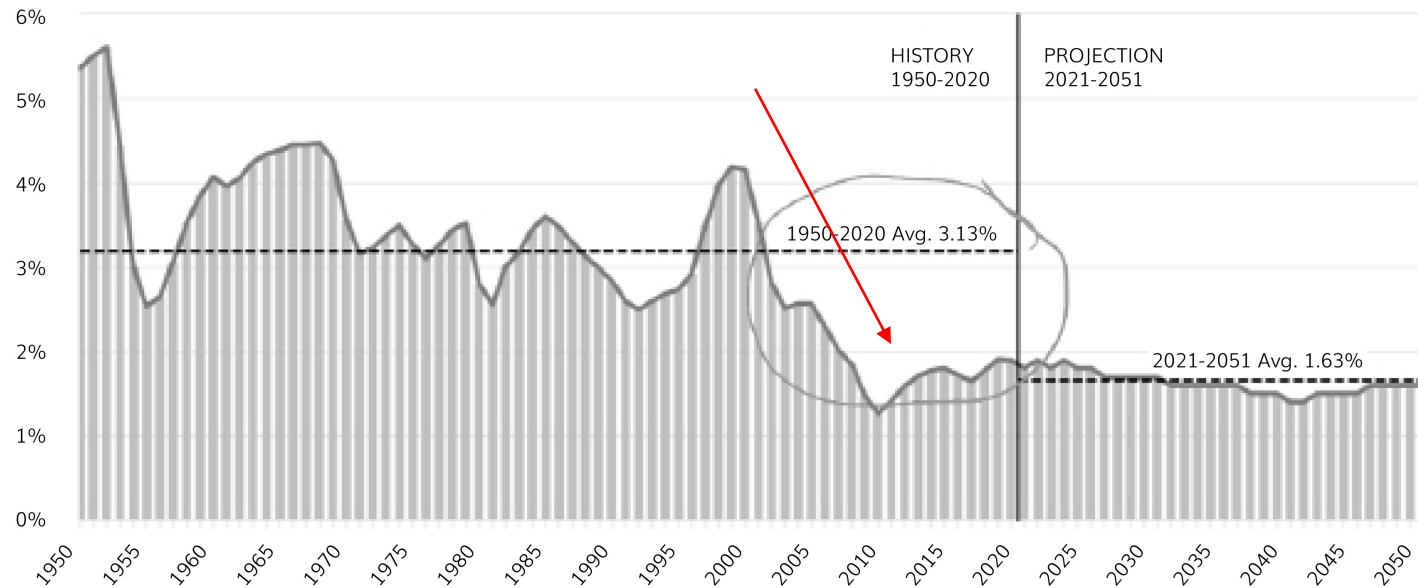


**MAKING
GROWTH THE
SACRIFICIAL
LAMB**

CAUSE & EFFECT

REAL GDP GROWTH

HISTORY 1950-2020; & CBO PROJECTIONS 2021-2051

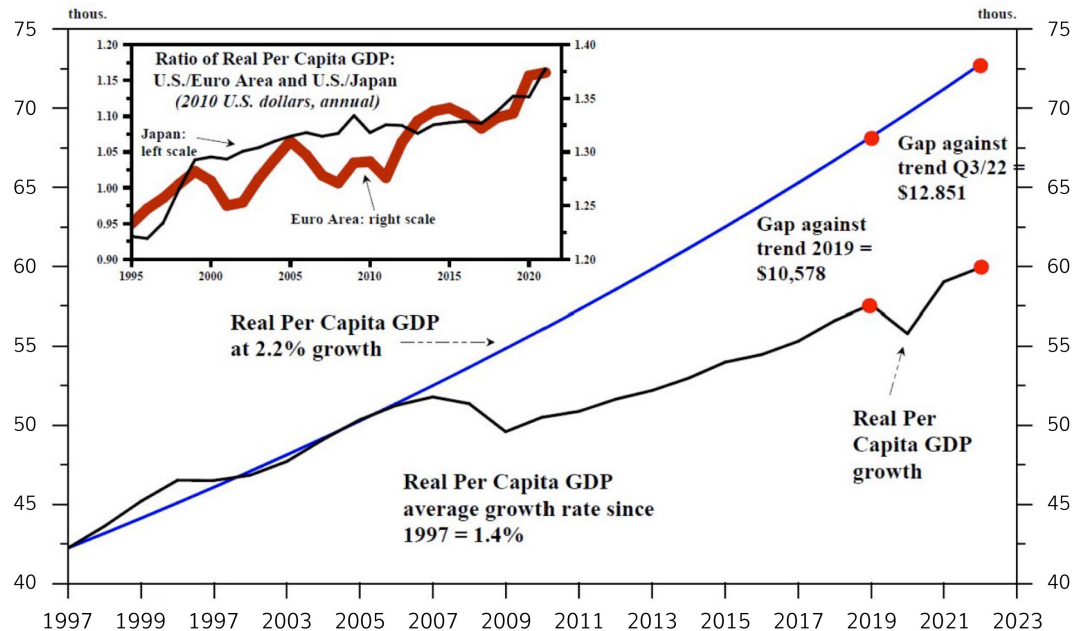


*Strategas Research, Investment Outlook, Oct. 12, 2022

CAUSE & EFFECT

REAL PER CAPITA GDP VS PRE 1997 TREND

ANNUAL

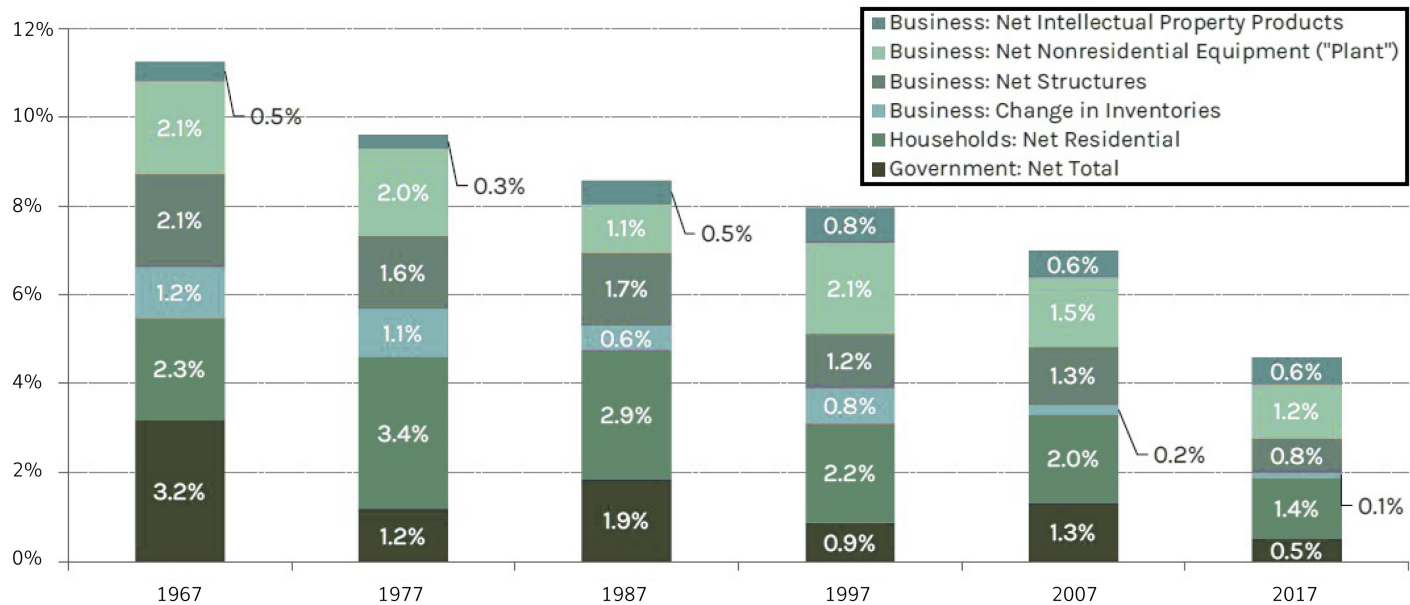


*Bureau of Economic Analysis. Through Q3 2022. Last plot is Q1-Q3 avg., June 21, 2023

CAUSE & EFFECT

NET DOMESTIC INVESTMENT

AS % OF GDP, BY TYPE

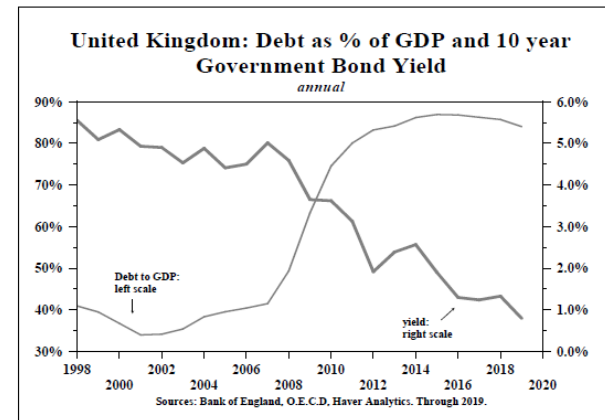
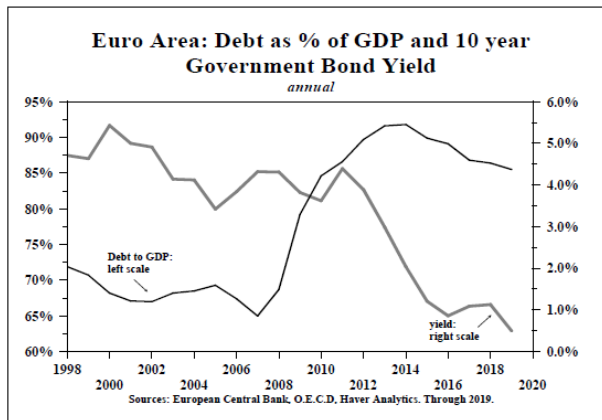
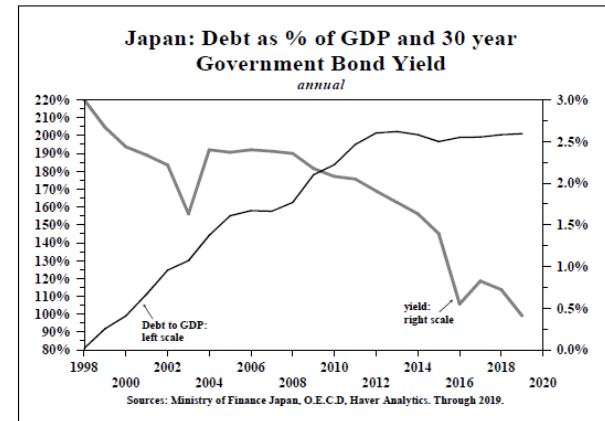
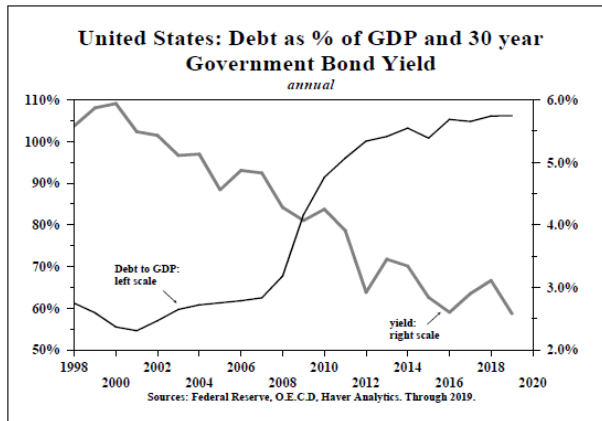


*Hedgeeye, Oct. 10, 2021

I KNEW ALGEBRA WOULD COME IN HANDY

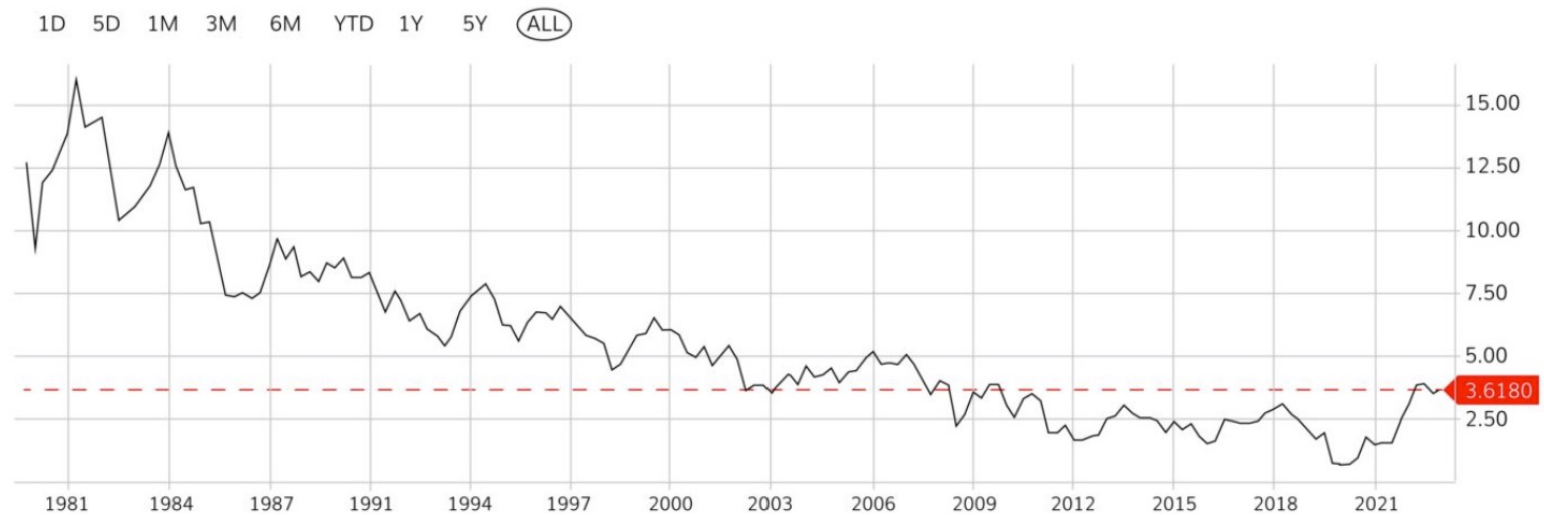
- $I = S_p + S_g$
- Investment = National Saving (household + government)
- Less aggregate savings = less investment
- Less investment = less productivity
- Less productivity = less growth

NOTHING IS MORE CONSISTENT THAN WHAT INCREASED DEBT HAS DONE TO BOND YIELDS



10 YEAR TREASURY YIELD SINCE 1981

3.616% ▼ -0.021

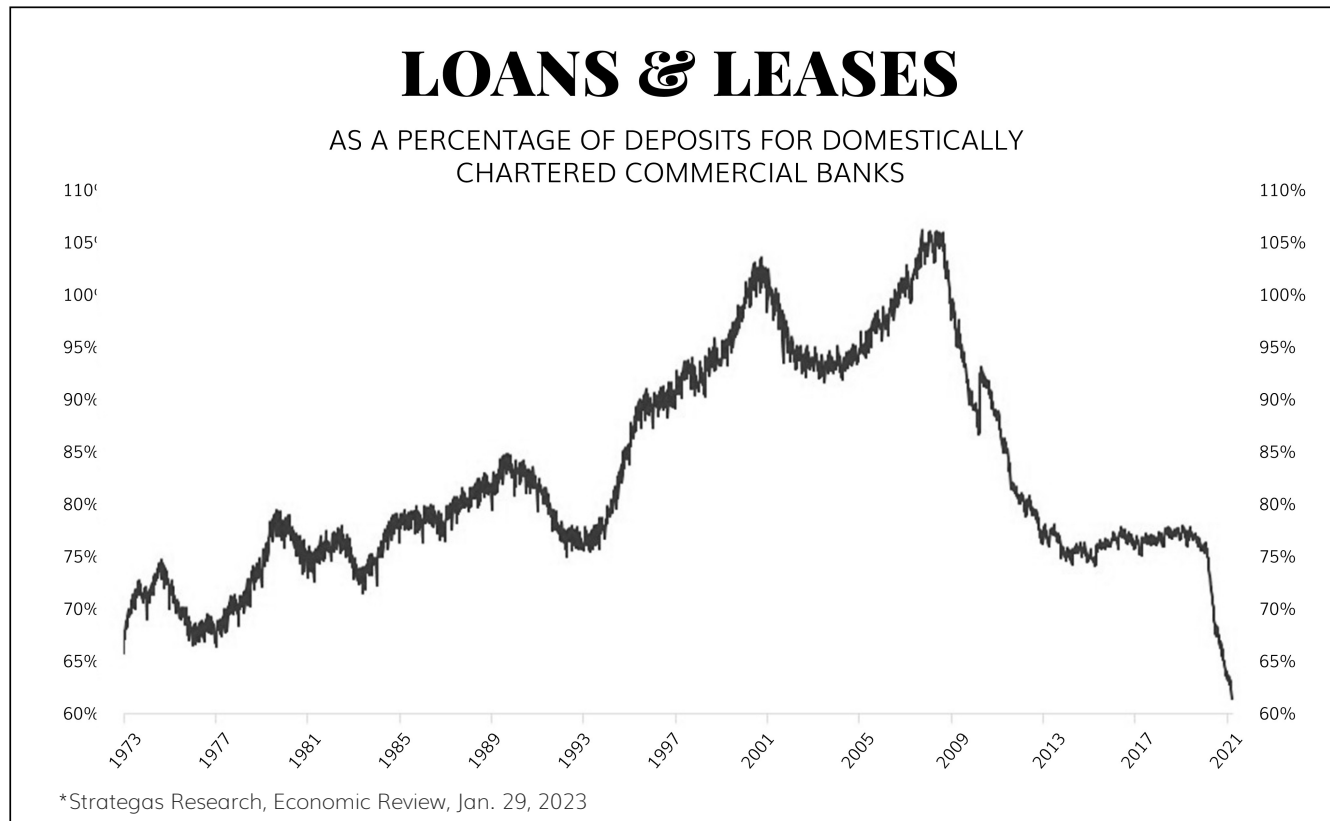


*Bloomberg, Apollo Chief Economist, June 1, 2023

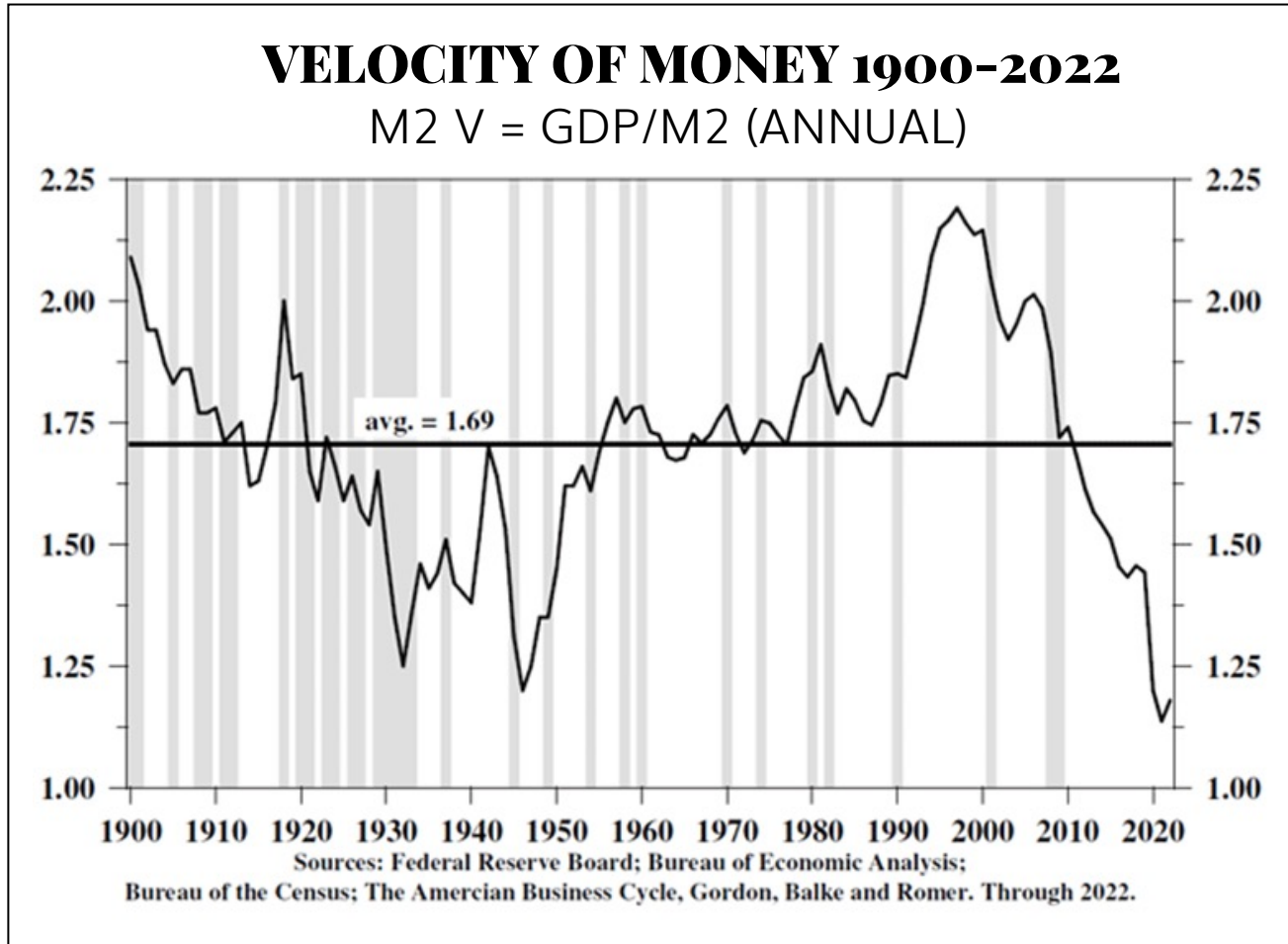
PLAN B: MONETARY MEDICINE

- Facilitate the fiscal
- Stimulus tool in its own right

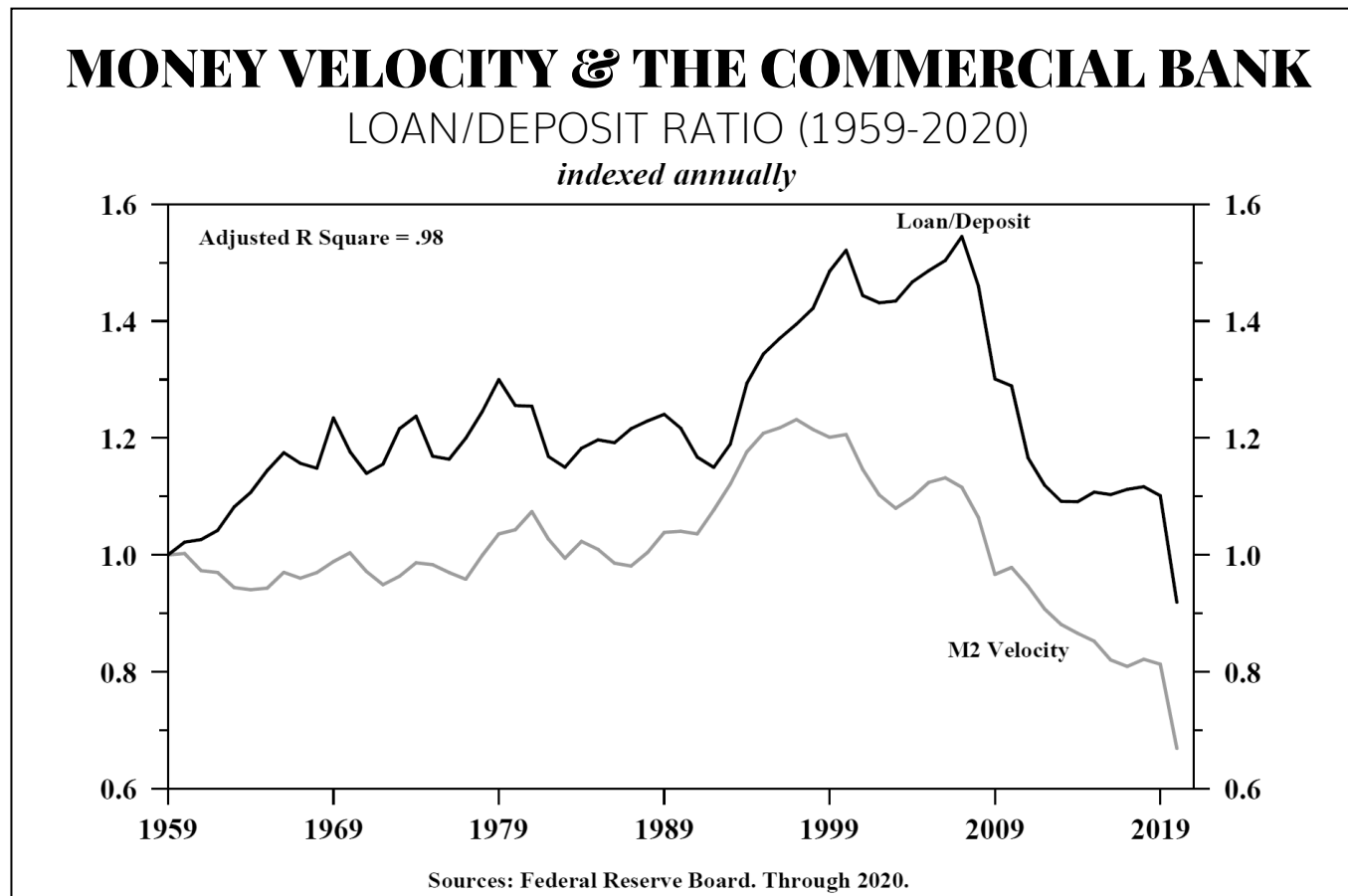
LOAN DEMAND HAS COLLAPSED



$MV=PT$



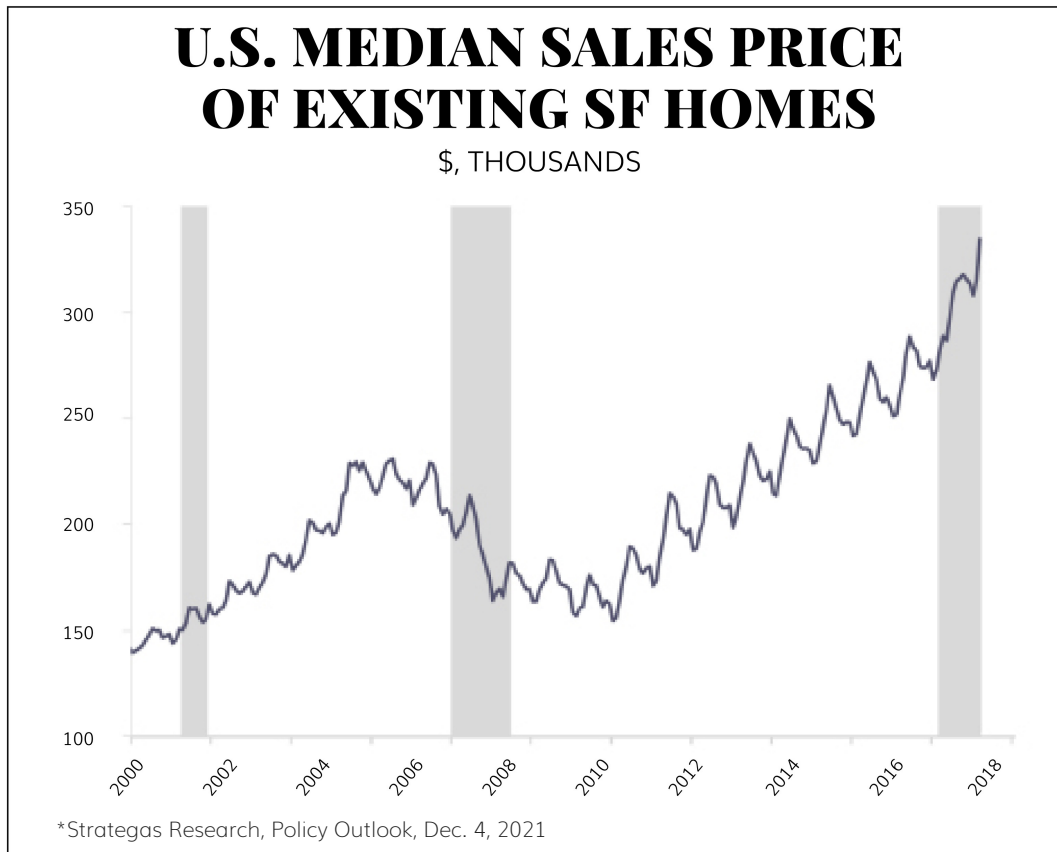
WHY HAS IT DONE THIS? CHICKEN OR EGG?



THE SIN OF MONETARY INTERVENTION:

- Malinvestment
- Distortion
- Speculative Frenzy
- NOT Inflation

MARKET DISTORTIONS



Something looks
unsustainable
here

FOSTERING INSTABILITY

- Interest rates that are unnaturally high slow economic growth as resources are diverted from productive activity to interest payments
- Interest rates that are unnaturally low create rampant speculation
- The natural rate is that which neither slows nor accelerates economic activity and is found in the growth rate of nominal GDP
- Central banks favor unnatural looseness, not unnatural tightness
- And this leads to financial instability

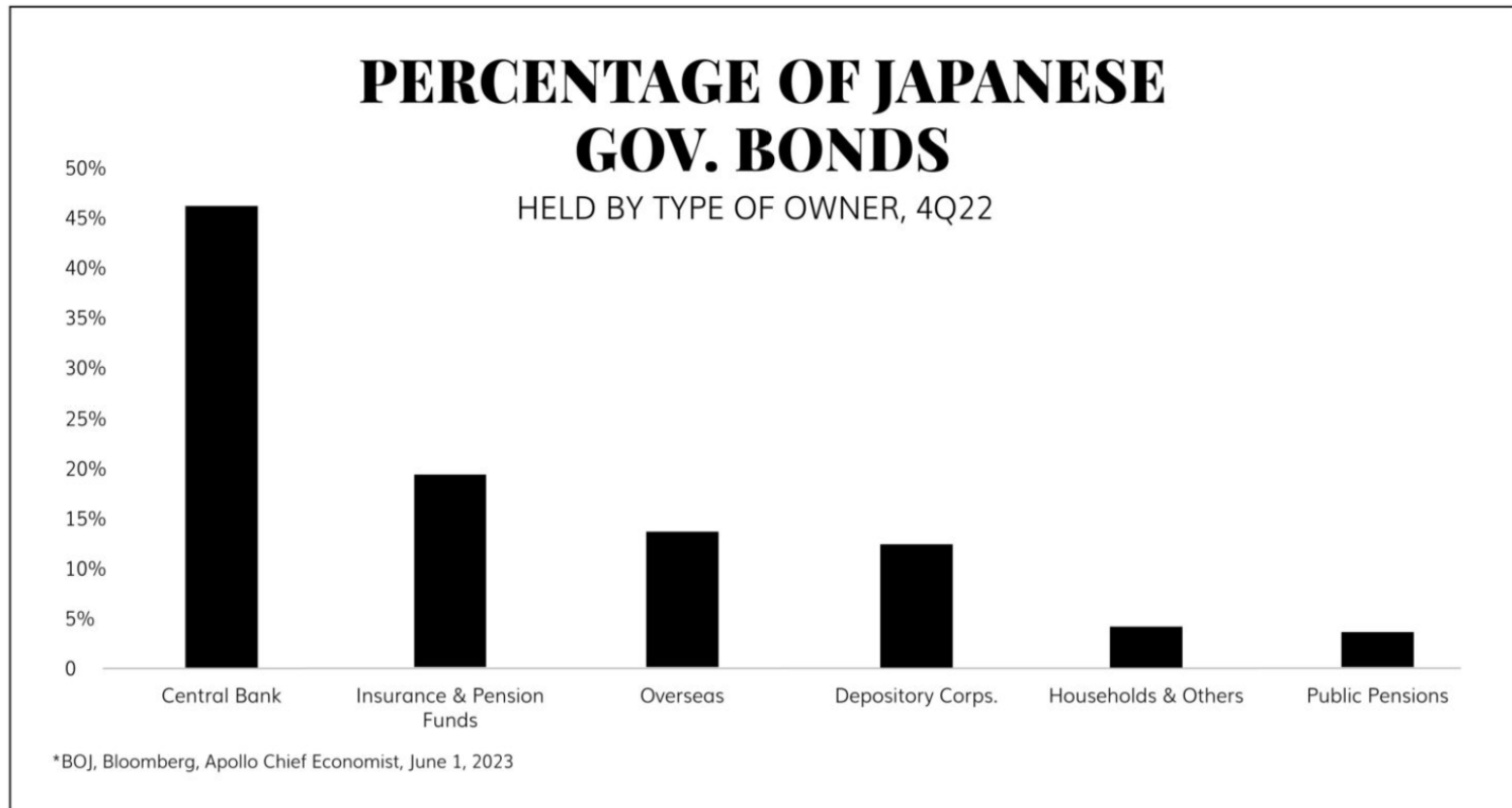
**WHAT CAN WE
LEARN FROM
JAPAN IN ALL
OF THIS?**

JAPAN'S TRACK

- The government has borrowed so much money they need very low rates on the debt
- Very low rates on bonds keep foreign investors and/or domestic savers away
- A lack of foreign investors and domestic savers to fund the bond market makes the central bank have to do more
- The more the central bank does, the more interest rates are kept near zero
- A lack of capital flows means a lack of investment, a lack of productivity, and a lack of growth
- A lack of growth means more government spending and borrowing
- More government spending and borrowing means the need to keep rates low, which means ... (start this chart all over again)

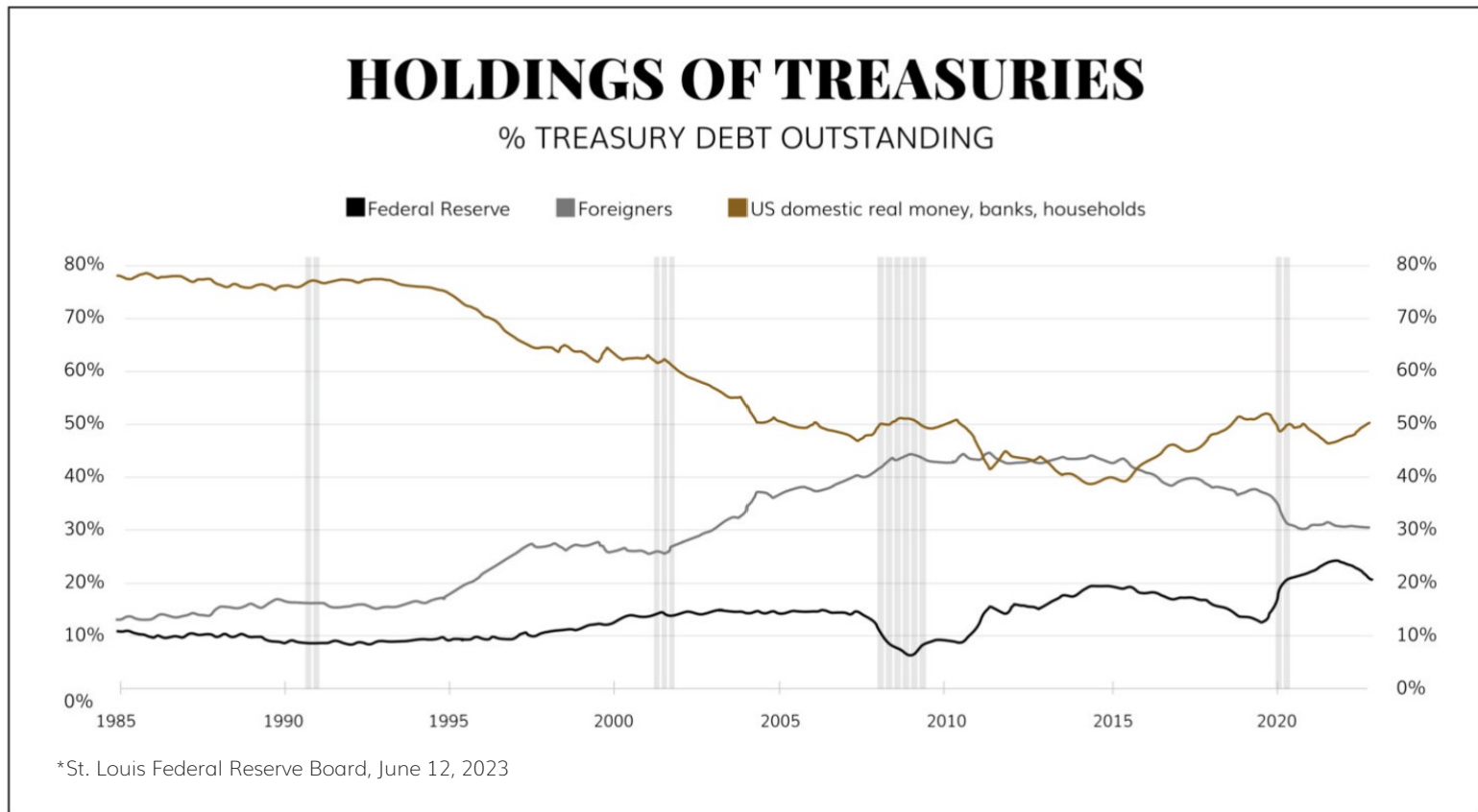
JAPAN VS U.S.

ALL A MATTER OF TIME?



JAPAN VS U.S.

ALL A MATTER OF TIME?



INFLATION NOW?

10-YEAR BREAKEVEN INFLATION RATE

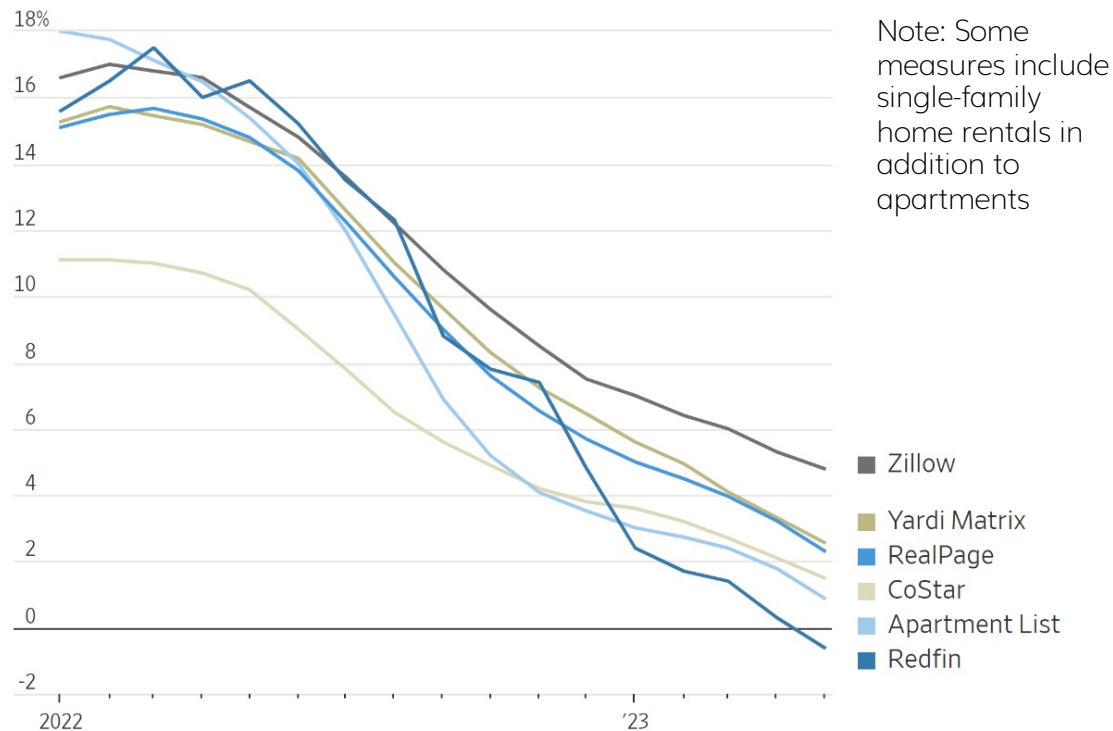
JAN 2018 - JAN 2023



*BoJ, Bloomberg, Apollo Chief Economist, June 1, 2023

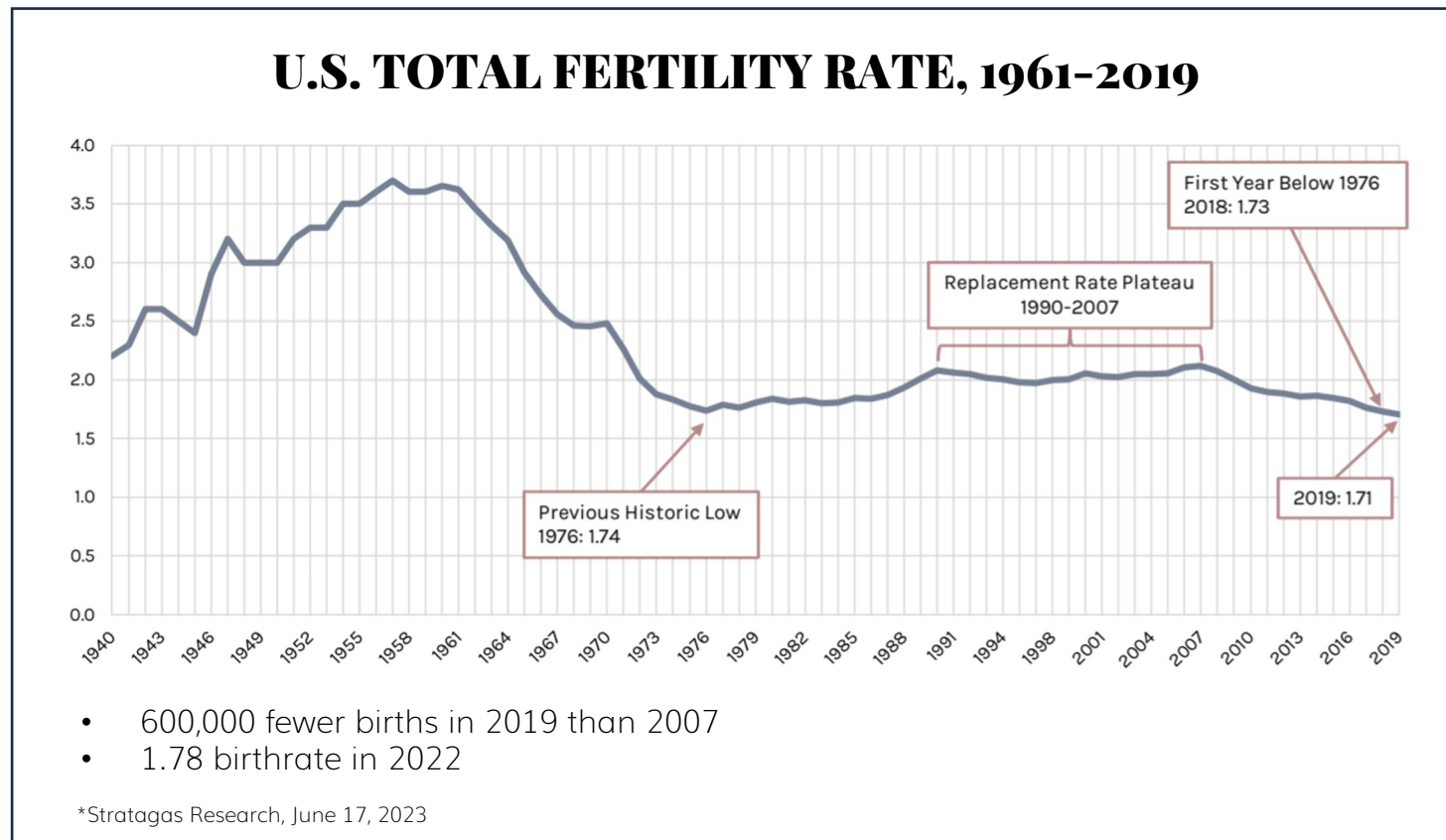
INFLATION NOW?

MONTHLY NEW-LEASE ASKING RENTS, PERCENTAGE CHANGE FROM A YEAR EARLIER

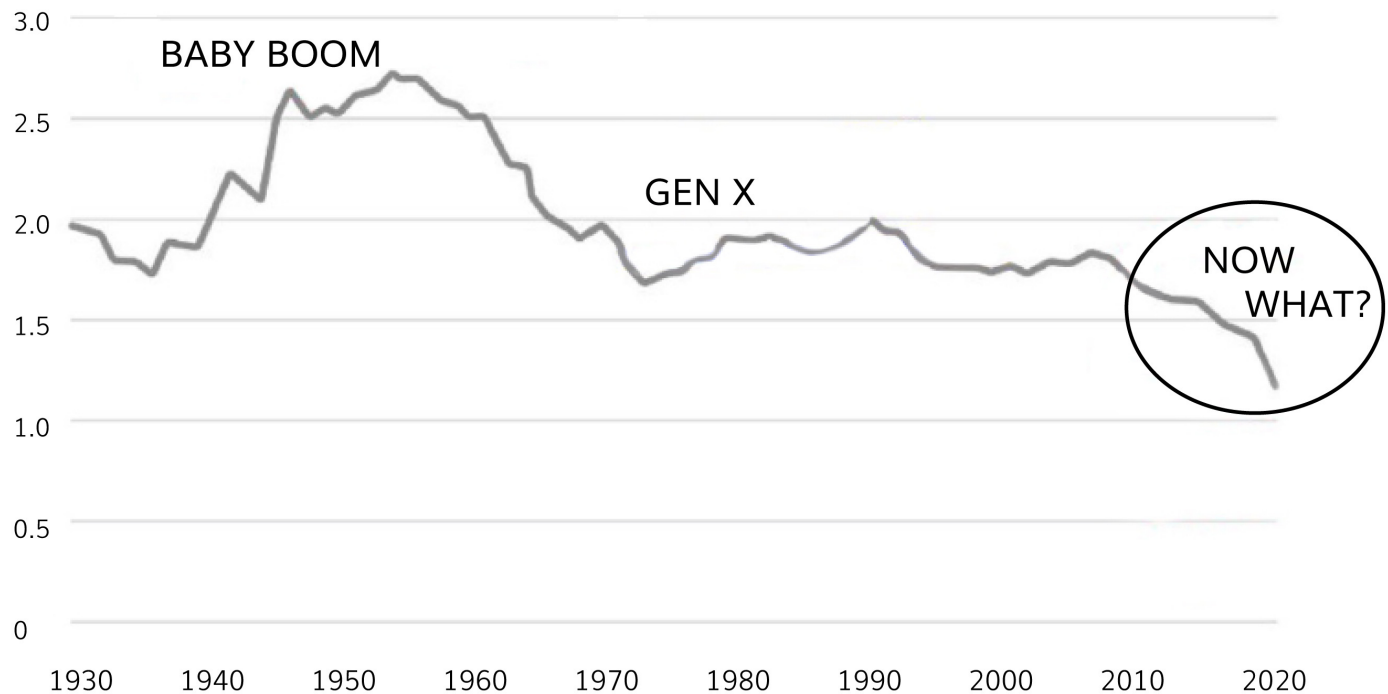


*American Enterprise Institute, December, 2020

FERTILITY: DROPPING TO ALL-TIME LOWS



U.S. NUMBER OF BIRTHS PER DEATH



*Wall Street Journal, CDC, June 14, 2023

IN SUMMARY

WHAT A MESS!

- Excessive indebtedness leads to policy actions that put more downward pressure on growth
- Which leads to more fiscal and monetary measures that exacerbate further...
- Debt = Low Growth = Policy Actions that create more debt and lower growth

WHAT WILL BE DONE?



WHAT CAN BE DONE?

- Repentance
- Living within our means – a balanced budget
- Fed as lender of last resort vs doctor of business cycles
- A Congress that does its job
- Strong self-government creates a less expensive federal government with a direct inverse relationship



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