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The Impact of Debt on Growth in the Economy

By David L. Bahnsen

A tale of two nations:

Debt

Demography

Results

Remedies

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 really 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

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

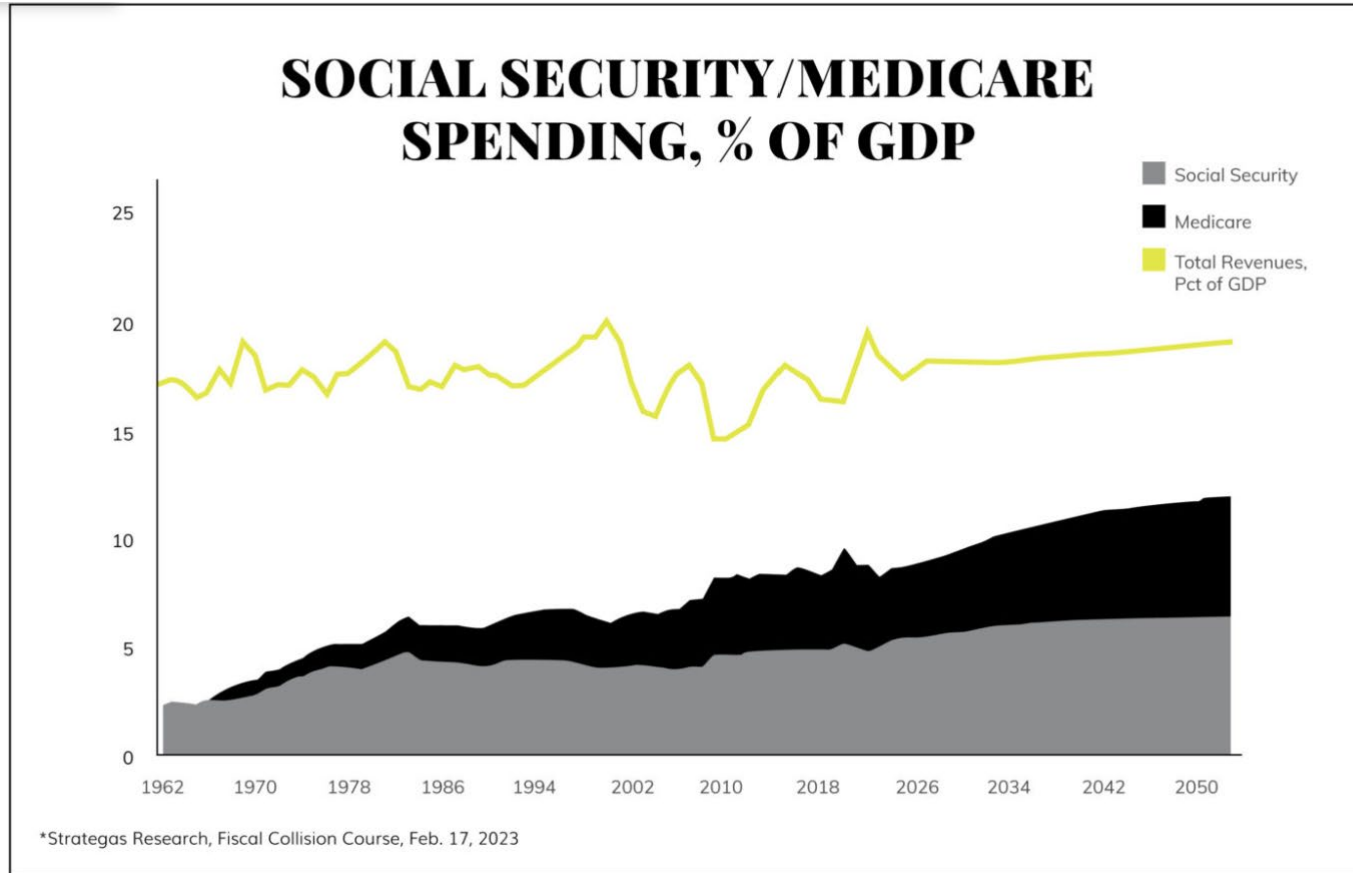
Where are we now?

Year	Federal Public Debt as % of GDP
2006	36%
2011	66%
2019	79%
2026	101%

What to cut?

U.S. Federal Govt Spending by Category	
Fiscal Year 2025	
7tn	Interest Expense
6tn	Discretionary non-defense
5tn	Defense spending
4tn	Mandatory Spending: Social Security, Health Care Programs, Medicare
3tn	
2tn	
1tn	
Revenues	Outlays

Elephant in the room

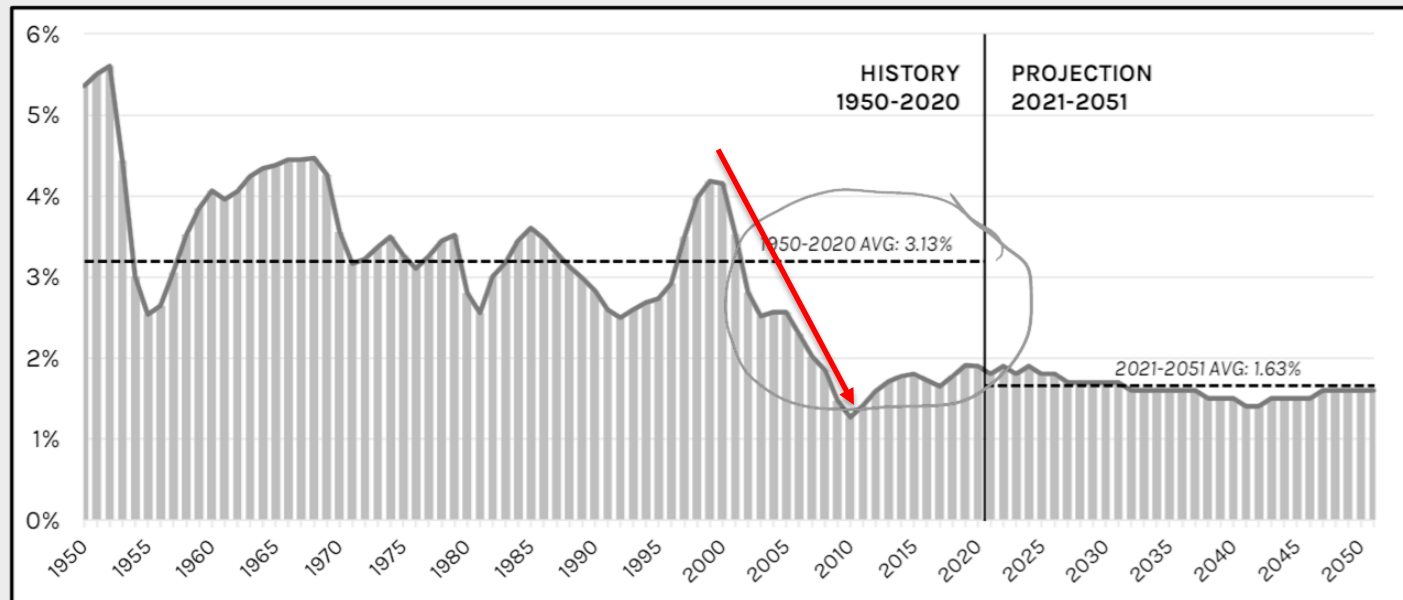


Making Growth the Sacrificial Lamb



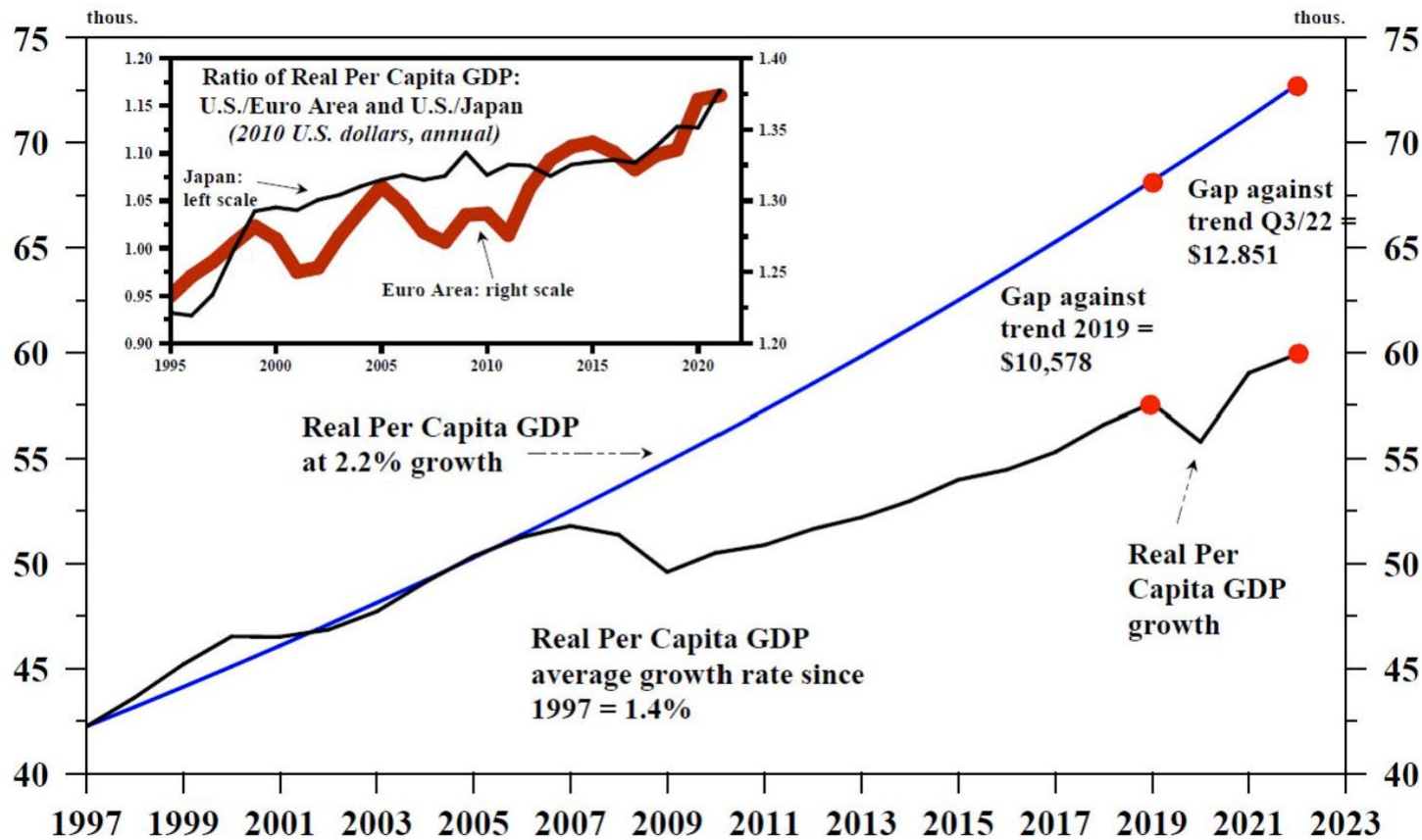
Cause & Effect

Real GDP Growth:
History, 1950-2020; and CBO Projections 2021-2051



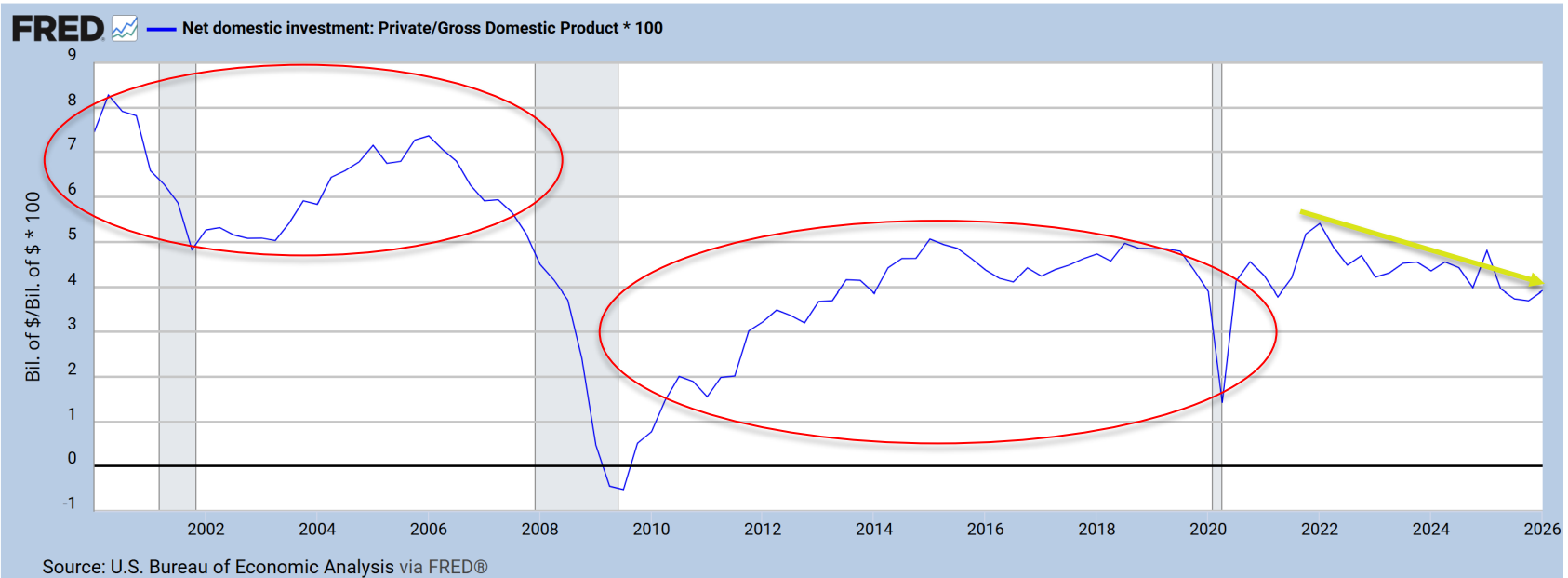
Cause & Effect

Real Per Capita GDP vs. Pre-1997 Trend *annual*



Sources: Bureau of Economic Analysis. Through Q3 2022. Last plot is Q1-Q3 avg.

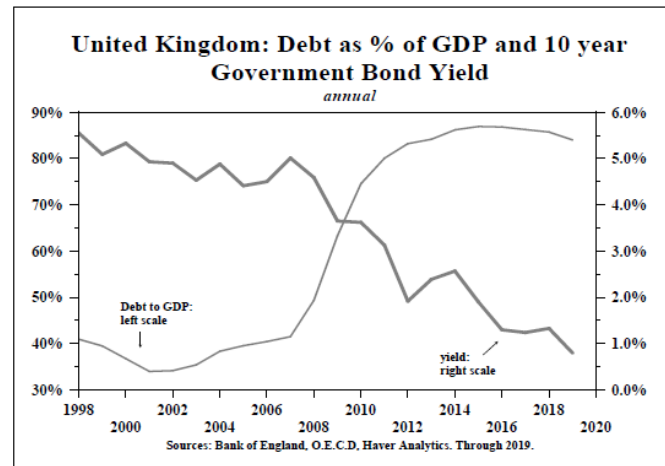
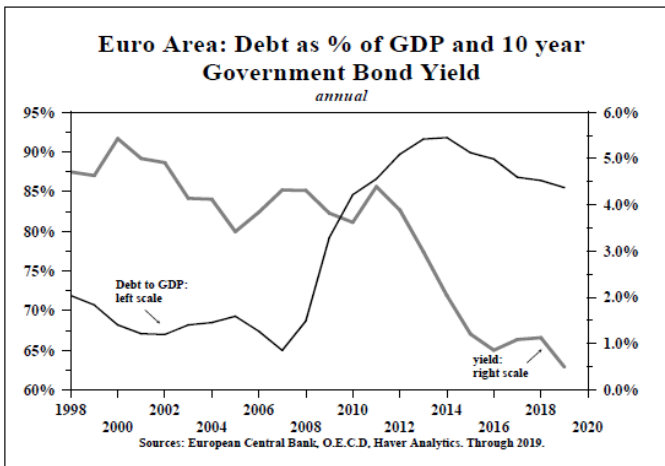
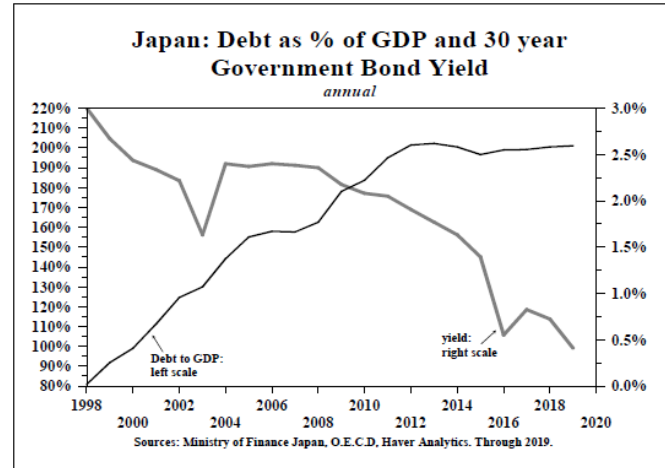
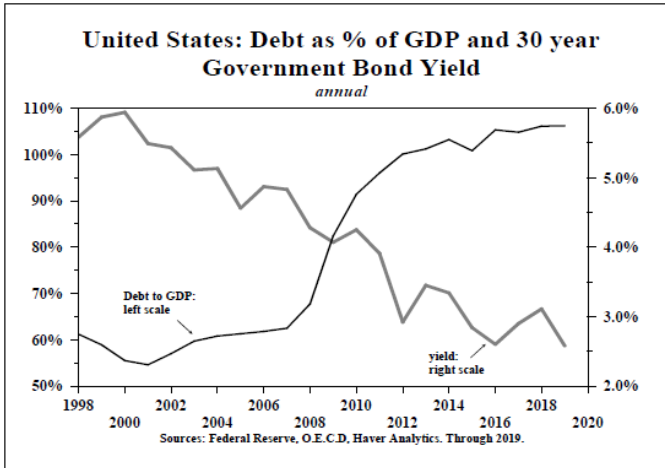
Business Investment as % of GDP



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 more consistent than what increased debt has done to bond yields



10 Year Bond Yield Since 1981



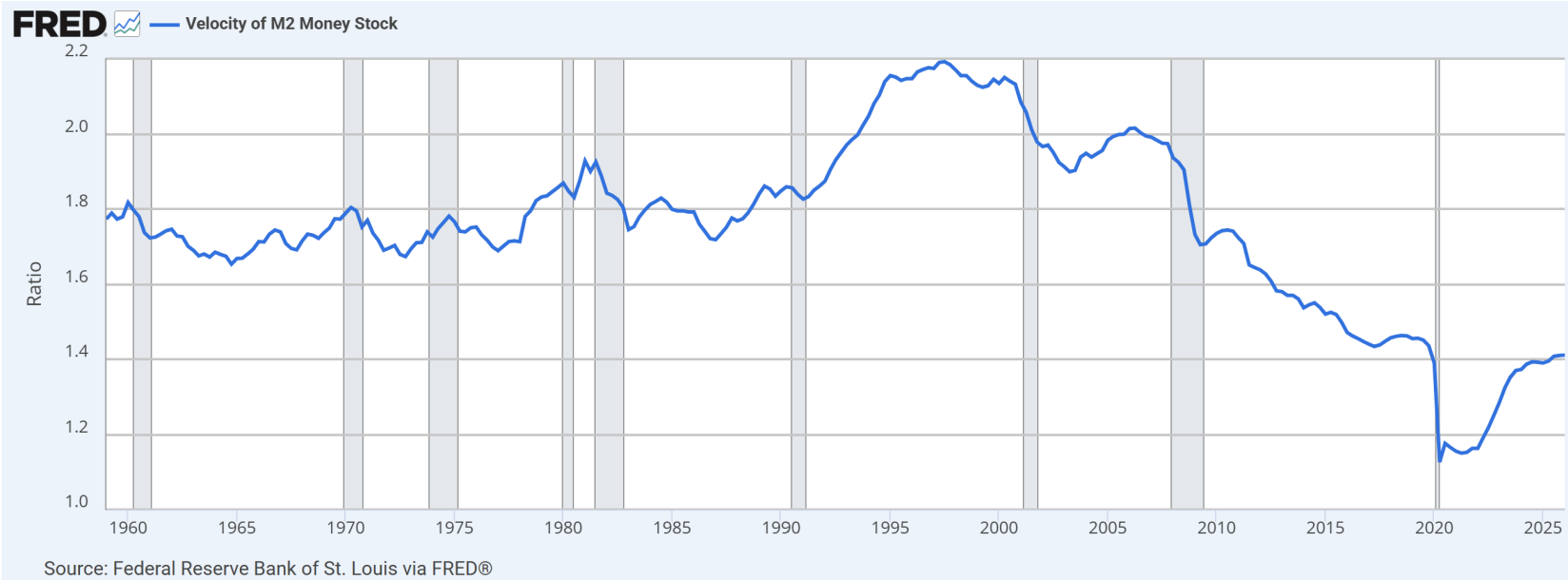
Plan B: Monetary Medicine

- (1) Facilitate the fiscal
- (2) Stimulus tool in its own right

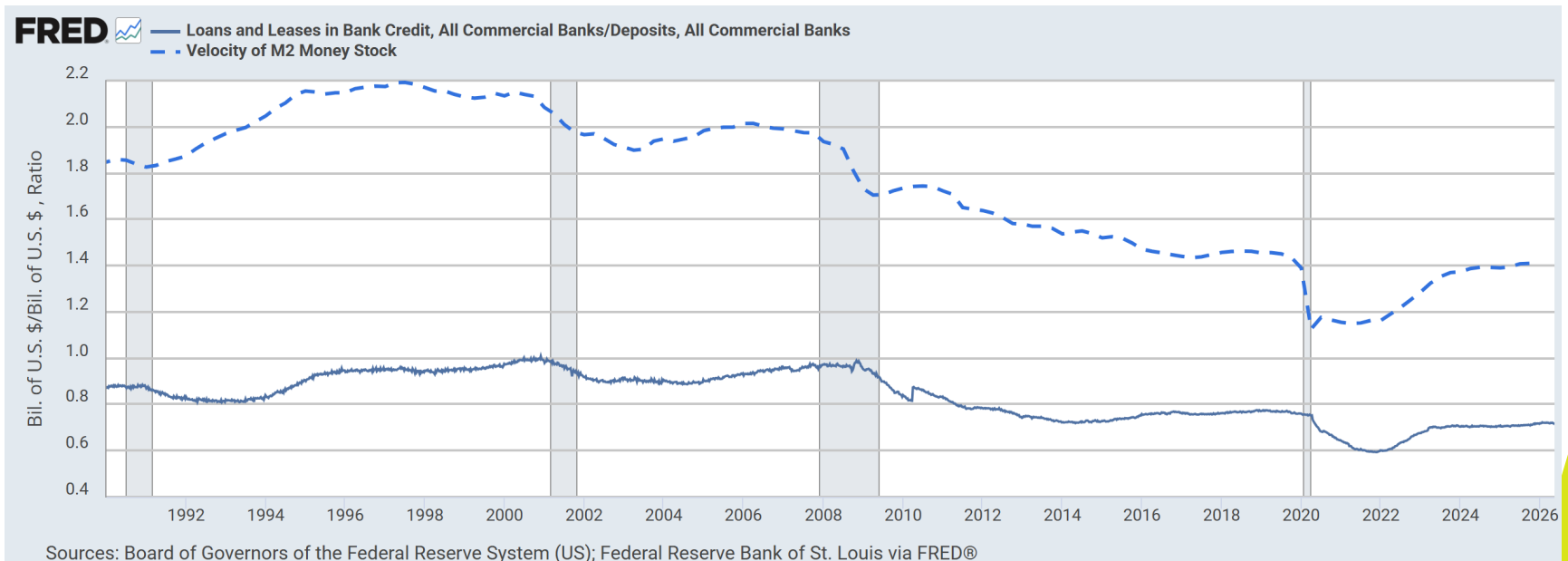
LOAN DEMAND HAS COLLAPSED



$$MV=PT$$



WHY HAS IT DONE THIS? CHICKEN OR EGG?



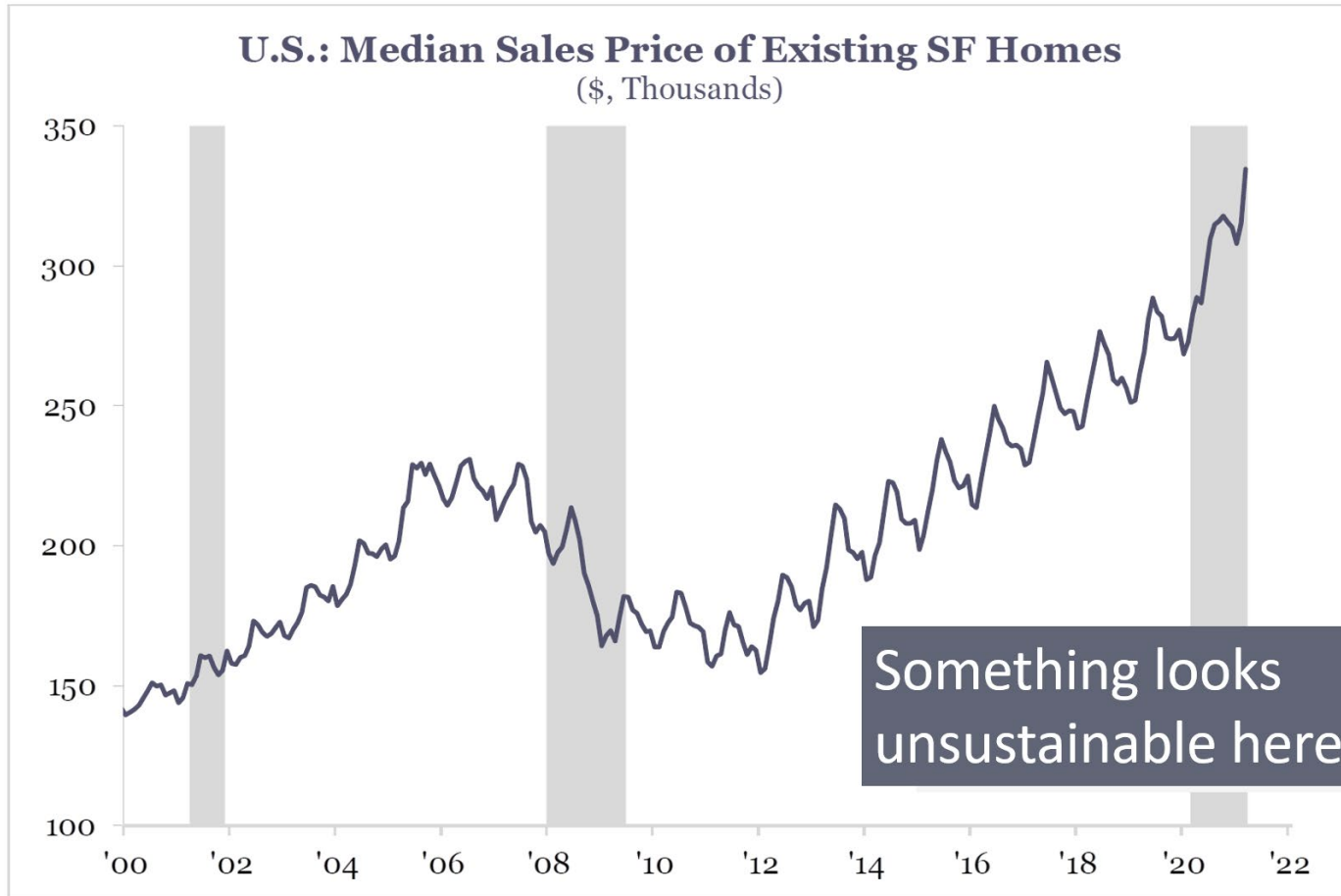
The sin of monetary intervention:

**Malinvestment
Distortion
Speculative Frenzy**

But NOT Always

Inflation

Market Distortions



Fostering Instability

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

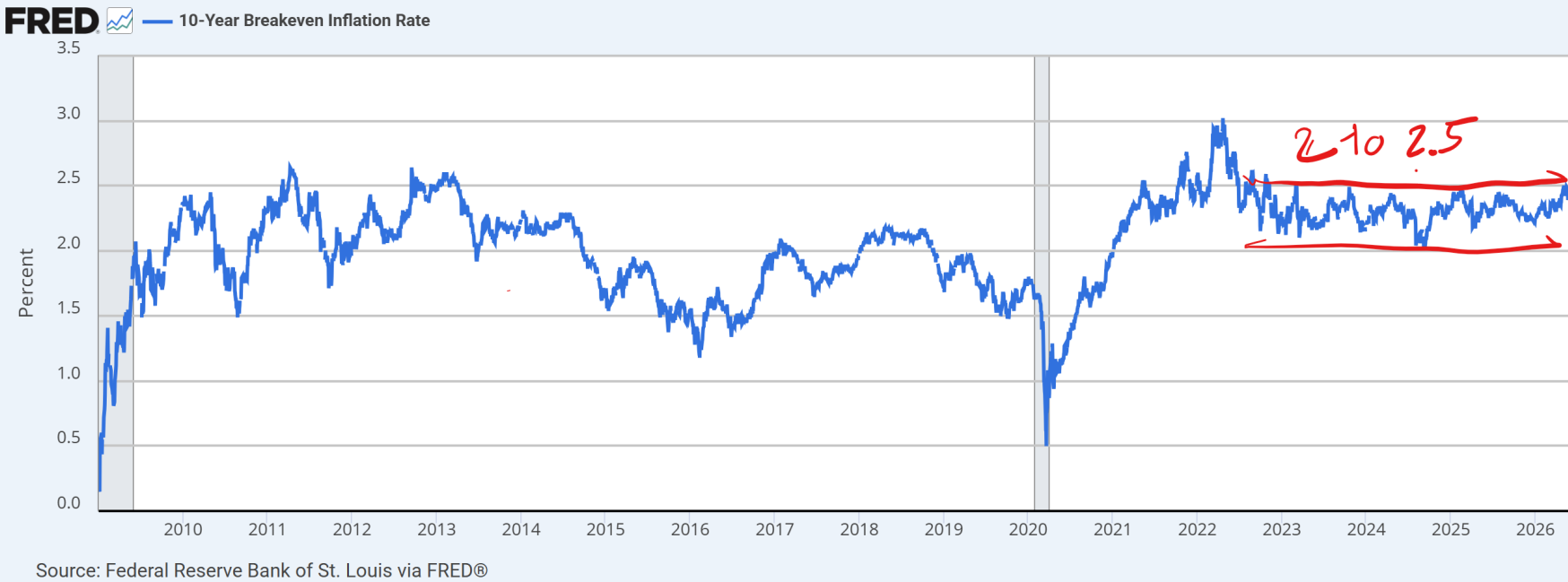
**What we learn from
Japan in all this**

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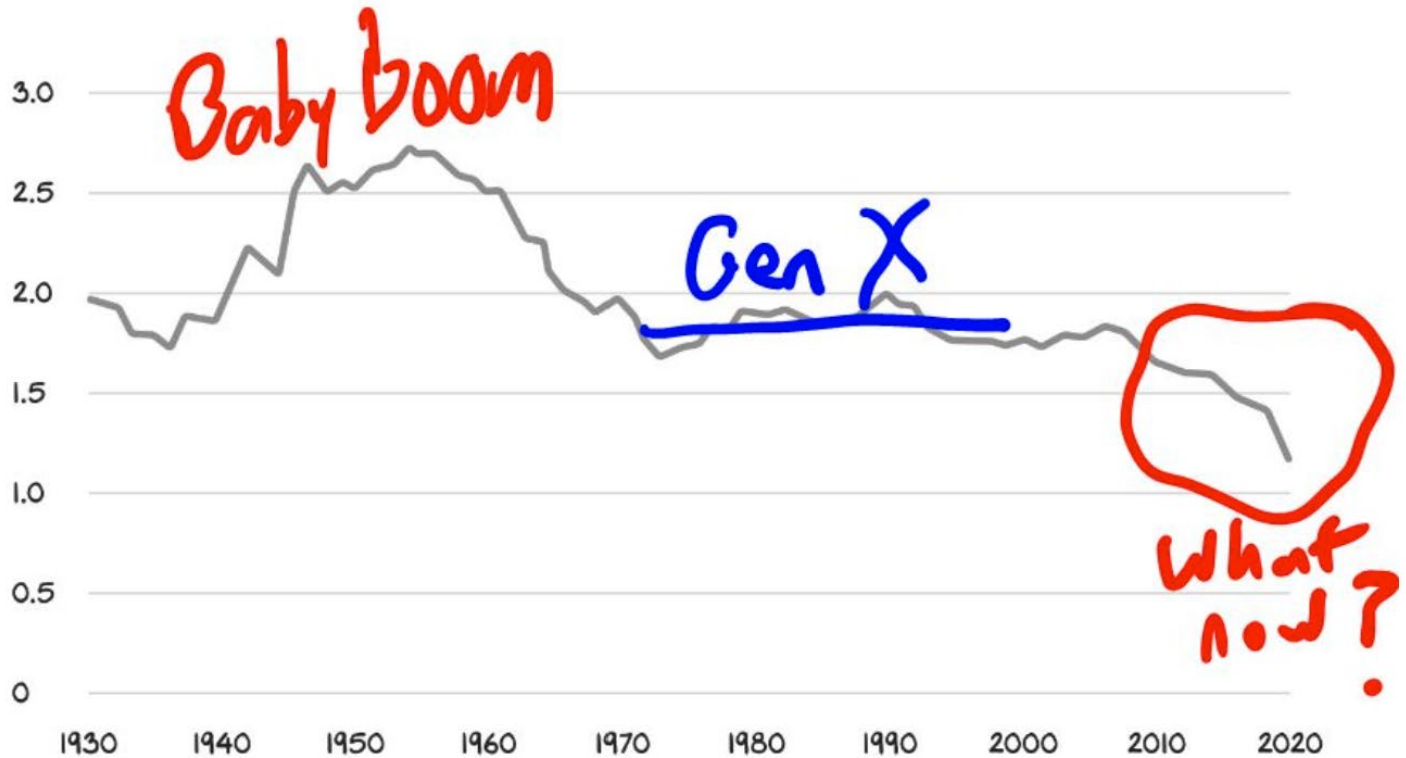
Japan's Track

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

Inflation now?



NUMBER OF BIRTHS PER DEATH U.S.



SOURCES: WALL STREET JOURNAL, CDC

In summary:

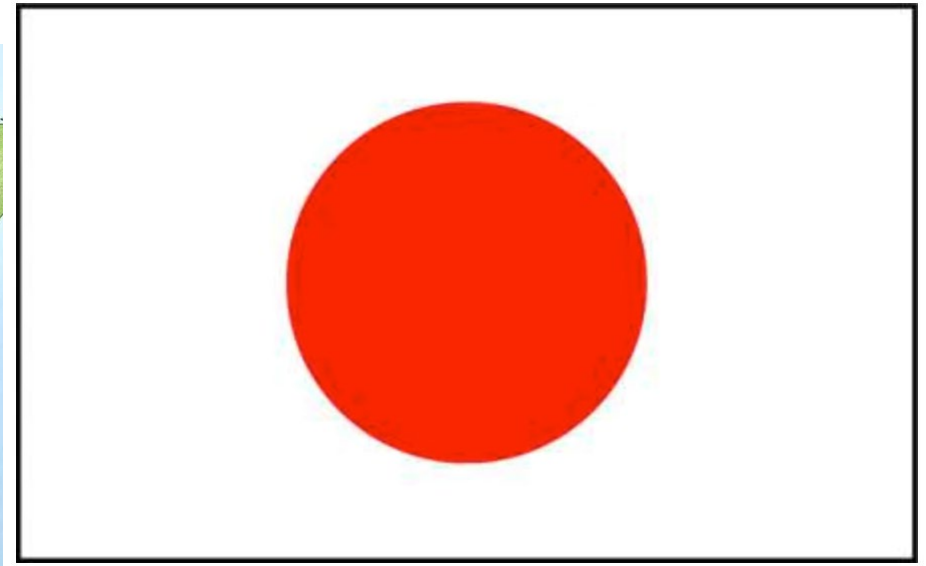
It is a mess!!

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 – balanced budget
 - Fed as lender of last resort vs doctor of business cycles
- 
- A large yellow triangle is positioned in the bottom right corner of the slide, pointing towards the top right.

What can be done?

- A Congress that does its job
- Strong self-government creates less expensive federal government with direct inverse relationship

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Q&A