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Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274

Should We Worry About American Debt?: Part I

Total debt in the United States is significantly higher than it was a few decades ago, but there are few signs of financial stress at present. Is this debt build-up sustainable?

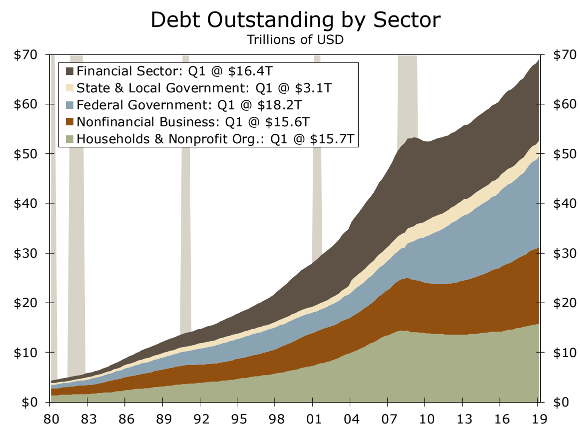
Debt Higher, But Few Signs of Financial Stress

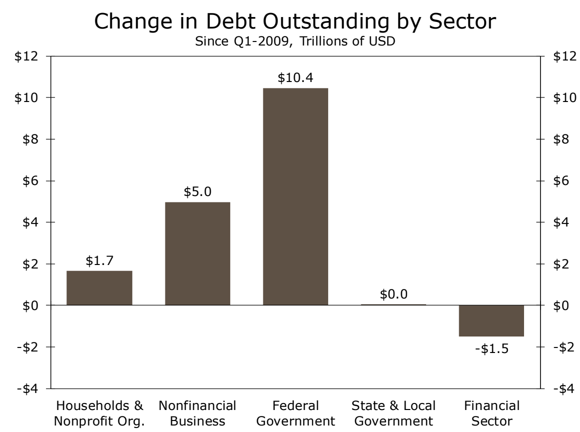
The U.S. economy is on the cusp of entering its longest expansion in the post-World War II era, but longevity often raises questions about sustainability. Moreover, the scarring experience of the financial crisis, which was triggered by an unsustainable build-up in mortgage debt, is still fresh in the minds of many market participants, and the rising level of U.S. debt in recent years is a source of concern among some observers. As shown in the top chart, the combined debt of the household, business, government and financial sectors in the United States totaled $4.3 trillion in 1980. Total American debt grew non-stop until early 2009, when it took a temporary breather. But it has resumed its upward trend and currently stands near $70 trillion. Indeed, every sector, with the exception of the financial sector, has more debt today than it did in Q1-2009 (middle chart). Notably, the outstanding debt of the federal government is more than $10 trillion higher today than it was ten years ago.

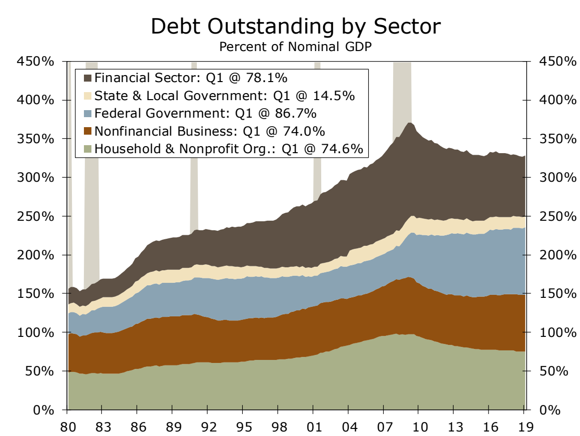
The upward trajectory of total debt over the past four decades may be disconcerting to some readers. But recall that the size of the U.S. economy was less than $3 trillion in 1980. Nominal GDP today exceeds $21 trillion. Just as a company can service more debt as it grows larger, everything else equal, so too can an economy handle more debt as it grows larger, everything else equal. So the correct way to think about outstanding debt in an economy is to measure it as a percent of GDP, which is shown in the bottom chart. The good news is that the overall debt-to-GDP ratio of the U.S. economy has receded to less than 330% at present from 370% ten years ago. The bad news, however, is that the ratio today is more than twice as high as it was four decades ago. The debt-to-GDP ratio of the federal government has mushroomed to nearly 87% today from 27% in 1980, but every other sector has also experienced an increase in its respective ratio over this period.

Although debt in the U.S. economy today is higher—in both absolute terms and relative to GDP—than it was a few decades ago, there are few signs of financial stress at present. The yield on the 10-year Treasury security is hovering around only 2%, corporate bond spreads are generally tight and the stock market stands near an all-time high. But how long can these generally benign financial conditions last? How sustainable is the build-up of debt that has occurred in the American economy over the past few decades?

We will endeavor to answer these questions in a series of reports in coming weeks. Using some previously published analysis and some new research we will drill down to look at debt sustainability issues in individual sectors of the U.S. economy. As noted previously, household debt, specifically mortgage debt, was the catalyst of the last recession. Therefore, we will start by analyzing the financial health of the U.S. household sector in the next report of our series.







Source: Federal Reserve Board, U.S. Department of Commerce and Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com

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