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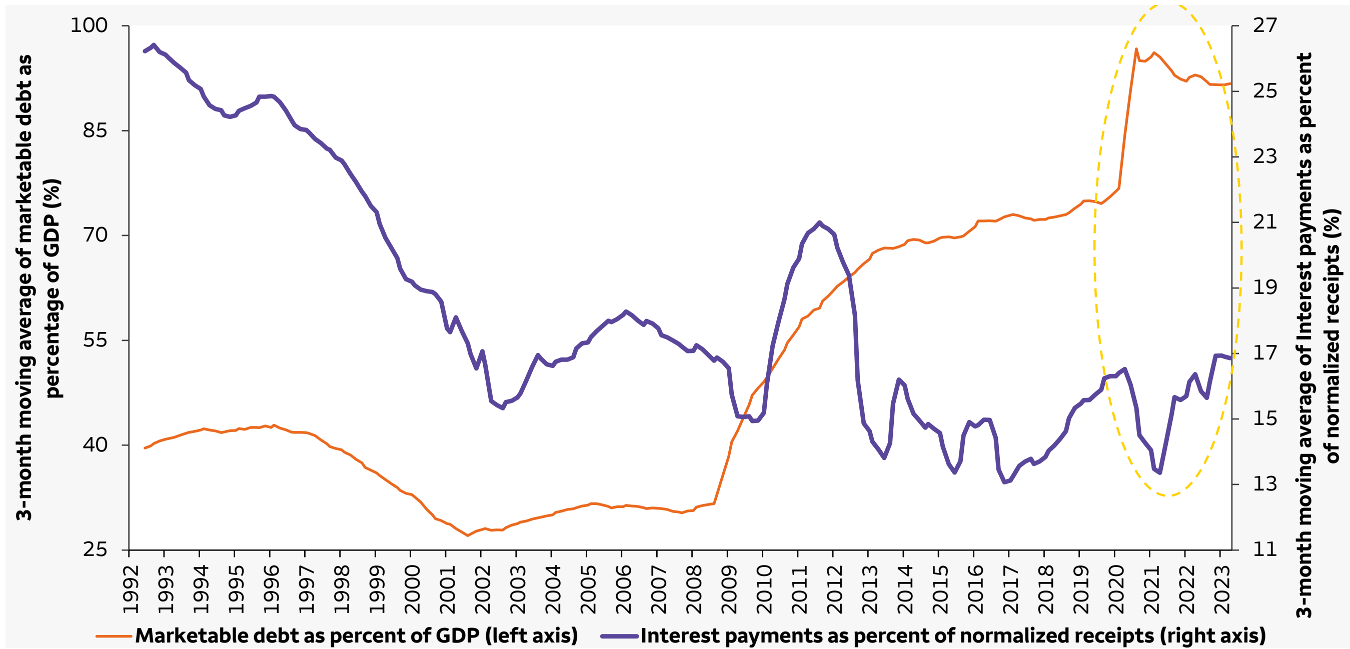
Chart of the Week

Weekly market analysis on key market indexes | May 16, 2023

Rising interest payments and the debt ceiling debate



Sources: Bloomberg, U.S. Treasury Department, and Wells Fargo Investment Institute. Monthly data from January 1, 1992 to April 30, 2023. Normalized receipts are based on rolling 10-year moving average. GDP = gross domestic product.

Elevated debt and rising interest rates take their toll on Treasury interest expenses

The U.S. hit its $31.4 trillion debt ceiling on January 19, triggering a series of extraordinary measures to fund spending. These include a cash drawdown from the government's Treasury General Account and a temporary halt to pension-fund contributions for federal employees.

The risk is that the U.S. Treasury Department may run out of funds if the debt ceiling is not lifted, due to weakening tax revenues and an accelerated rise in interest expenses tied to higher interest rates and outsized debt. The chart shows that interest payments as a percent of normalized receipts (thick purple line) have increased to nearly 17%, while debt as a percentage of gross domestic product (thin orange line) is just below 30-year highs.

What it may mean for investors

Historically, lawmakers have managed to avoid a default on the federal debt, despite having reached the debt ceiling 78 times since 1960. We believe the government has strong incentives to reach resolution on the debt ceiling, although it may not happen until the 11th hour. For long-term investors, we prefer a defensive allocation approach that looks through what could be a volatile summer. We favor reducing U.S. Mid Cap and Small Cap equity exposure in favor of Developed Market ex-U.S. Equities, and we favor reducing the overweight to U.S. Large Cap Equities in favor of additional allocations to U.S. Short Term Taxable Fixed Income.

Chart excerpted from *Market Charts* (Second quarter, 2023); text was excerpted from *Policy, Politics & Portfolios* (February 28, 2023).

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