

# Policy Backgrounder: Record Debt Servicing Costs Weigh on US Fiscal Outlook

December 8, 2023

## Trusted Insights for What's Ahead™:

New analysis shows that annualized gross interest payments on US debt reached \$1 trillion at the end of October, doubling over the previous 19 months.

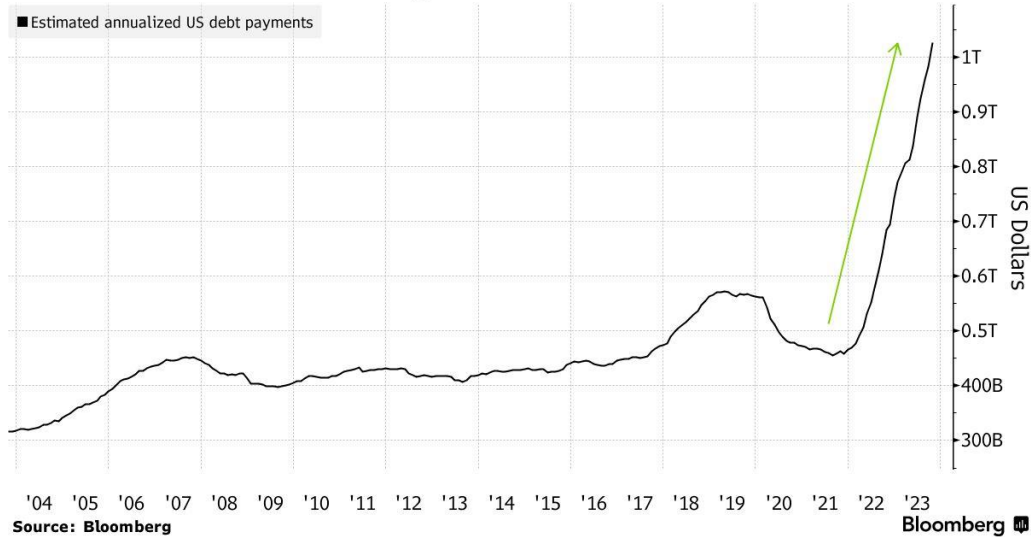
- The estimates annualize current costs of servicing debt, driven by rising outstanding debt balance and higher average interest rates paid by the Treasury as more debt is issued into today's higher rate environment.
- Interest costs are projected to increasingly strain the US budget if unaddressed, with CBO estimating that net interest costs will increase from 2.4% of GDP in FY2023 to 3.7% and 6.7% by 2033 and 2053, respectively.
- The US Treasury's increasing debt issuance to keep pace with surging deficits comes at the same time as interest rates on federal debt reach their highest levels since the global financial crisis and as the market composition for Treasuries is changing. This threatens to crowd out private investment by diverting investment dollars away from the private sector and toward US Treasury bonds, which are used to finance existing obligations of the government, not new private-sector initiatives.

## Annualized US Debt Servicing Costs Reach \$1 Trillion

The yearly cost that the US is paying on federal debt crossed \$1 trillion at the end of October, according to new [analysis](#). That projected figure has doubled in the last 19 months as the US fiscal outlook continues to deteriorate under the strain of deficits and higher interest rates. The new estimates annualize current interest payments, capturing the outstanding federal debt balance and average rates paid by the Treasury—both factors that continue to rise. If continued over the next year, gross interest payments would equal 3.7% of CBO's [projected](#) Fiscal Year (FY) 2024 GDP.

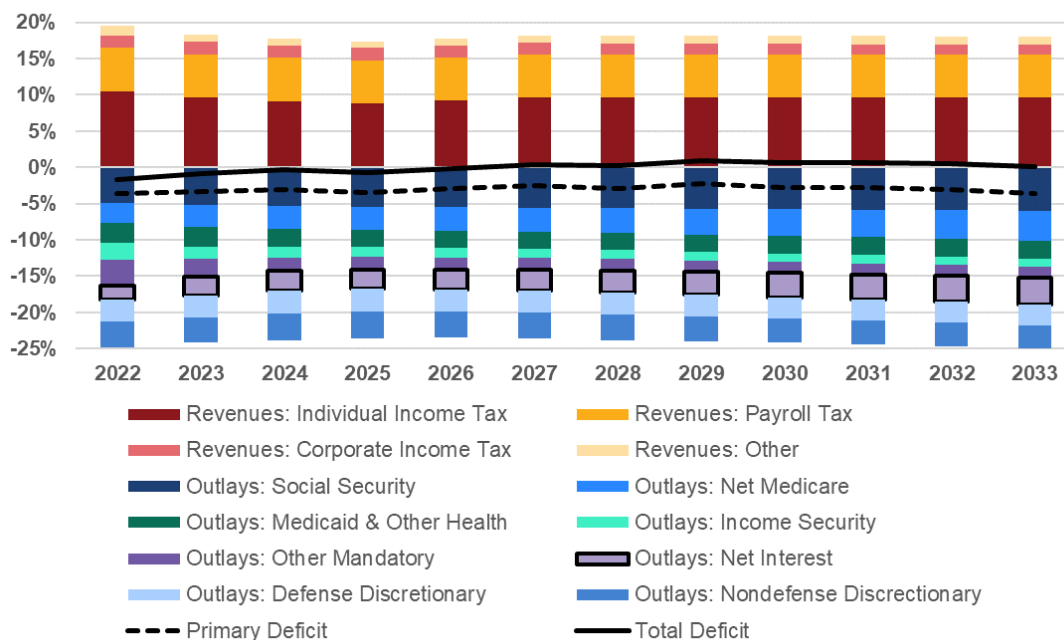
This estimate differs from the backward-looking \$879 billion gross interest the federal government paid over the [recently ended](#) FY2023, equal to roughly 3.3% of GDP and 14% of total federal outlays. That record level had risen \$162 billion (23%) from FY2022 and became the 3rd largest federal expenditure, exceeded annual spending on Medicare and on national defense for the first time.

## Cost of US Debt Pile Surges



In FY2023, the US budget deficit [grew](#) to \$1.7 trillion (6.3% of GDP), which CBO [projects](#) will reach \$2.5 trillion or 6.4% of GDP in 2033. At the end of CBO's long-term [projections](#) through 2053, the total annual deficit is expected to reach 10% of GDP, with interest costs as a significant contributor. The below figure depicts revenue and outlay contributions to the federal deficits through 2033. Net interest is expected to grow from 2.4% of GDP in FY2023 to 3.7% by 2033 and 6.7% by 2053. That projected growth in net interest payments is faster than the growth of the overall US economy and the growth of other government spending and revenues.

## Federal Budget Balance (Percent of GDP)



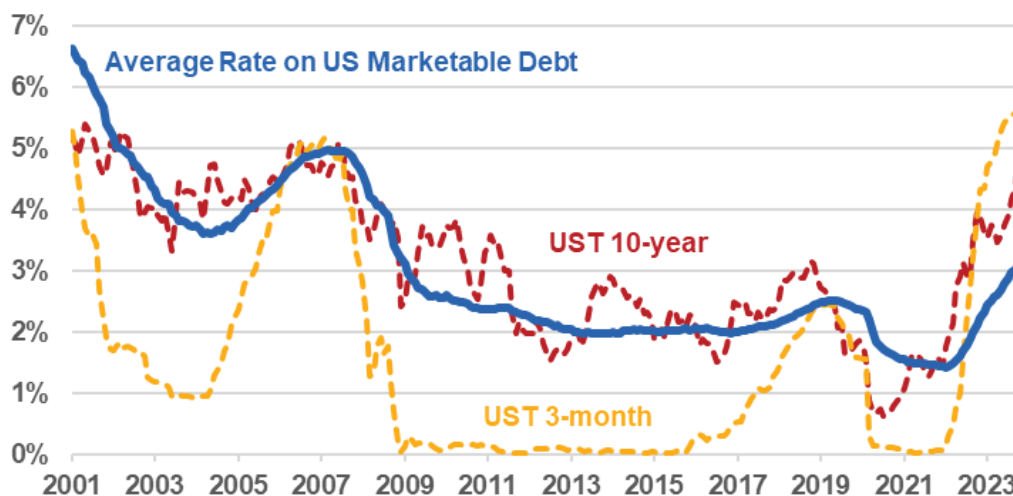
Source: Congressional Budget Office.

If left unaddressed, these projections indicate that net interest costs will become the largest federal expenditure (exceeding both Social Security and all discretionary spending) by 2051. This threatens to crowd out private investment by diverting investment dollars away from the private sector and toward US

Treasury bonds, which are used to finance existing obligations of the government, not new private-sector initiatives.

The US Treasury's need to [boost](#) debt issuance to fund surging deficits comes at a time when interest rates on federal debt have reached their highest levels since the global financial crisis and as the market composition for Treasuries is changing—raising serious concerns on the sustainability of the US fiscal outlook. As federal debt approaches 100 percent of GDP, the US is issuing debt at the highest interest rates it has in years. In October, the 10-year Treasury yield briefly [reached](#) 5 percent for the first time since 2007 as the Federal Reserve and other central banks have signaled their intention to hold policy rates higher indefinitely until inflation returns to its 2 percent target. That has led the average interest rate on all US marketable securities to [rise](#) above 3 percent—its highest level since 2009.

### Interest Rates on US Debt



Source: US Treasury Department, Federal Reserve Board of Governors.

In August, Treasury [increased](#) the size of its quarterly bond sales for the first time in two and a half years, and indicated that further increases would likely be needed in future quarters to fund surging budget deficits. That move had prompted Fitch Ratings to [downgrade](#) the federal government's AAA credit rating citing "fiscal deterioration" and governance concerns. Moody's Investors Services—the last of the 3 credit agencies holding the US at its top grade—[lowered](#) its outlook for the US to 'negative' citing similar concerns.

While each cited the US' long-term fiscal outlook, the long-term debt outlook this year had improved from 2021 and 2022. Instead, these moves highlight that the leading cause of declining investor appetite for US debt is the rising risk and uncertainty around Congressional brinkmanship over debt ceiling and budget negotiations. Many global investors have become wary that the US might fail to meaningfully address its fiscal imbalance and debt load, while risks are increasing of a self-inflicted default.

The market [composition](#) of Treasuries is also becoming an emerging threat to the government's ability to finance through continued debt issuance. The Federal Reserve is reducing its bond holdings at the same time as interest wanes from US commercial banks. In addition, foreign holdings of US debt have declined precipitously from its peak in 2009 when nearly 50% of outstanding US debt was held by foreign investors, including central banks. In early 2023, foreign holdings [fell](#) to 27 percent—the lowest level since 2002. China, which had held the most US debt of any foreign country [until](#) 2016, has continued to shed Treasuries to support the yuan, with Chinese holdings of Treasuries falling to a 14-year [low](#) in August. The collection of mutual funds, hedge funds, insurers, and pension funds that have taken their

place are more [active](#) in demanding premiums to buy US debt due to increased fiscal risks and growing deficits. If these trends persist, they will challenge the sustainability of the US fiscal trajectory and the country's ability to continue issuing increasing amounts of debt.

## Conclusion

The US fiscal outlook continues to deteriorate, with the deficit for FY2023 topping estimates at \$1.7 trillion. The rising debt level, now totaling \$33.6 trillion and higher interest rate environment have driven debt servicing costs in FY2023 \$879 billion—now larger than spending on national defense, a significant milestone for the federal budget. A signal of continued challenges in the coming year, annualizing current interest payments in today's market environment shows that yearly debt servicing has now reached \$1 trillion.

Addressing both federal revenues and spending to stabilize the country's fiscal outlook is increasingly crucial given these conditions and investors' risk assessments of US Treasury debt. Urgency is critical as the scale of policy action needed to correct the budget imbalance is growing. By one [estimate](#) by the Penn Wharton budget team, balancing the budget through 2050 to cover federal payments on promised spending and interest costs would require an immediate and permanent increase of 40% to tax revenues or reduction in spending of 30%, or some combination.

Support in Congress is [growing](#) for a bipartisan fiscal commission that would bring together Republicans and Democrats to find “solutions to the serious fiscal challenges facing our country” as interest payments on the nation's debts are expected to triple in the next decade. “For every dollar we borrow, 50 cents will go just to pay interest on this debt,” according to Rep. Jodey Arrington (R-TX), House Budget Committee Chair. The final FY2023 deficit figure, and its changing composition, adds to the urgency of establishing a commission.

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