American Century Investments®

NOTHING'S CERTAIN BUT DEBT AND TAXES

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Biden's infrastructure bill may promote growth, but at what cost?

SETTING THE STAGE

In my previous Market Musings, I looked at the relative merits of the American Jobs Plan, President Biden's proposal to rebuild U.S. infrastructure. While we can see the case for refreshing America's vital infrastructure, the question that remains to be answered is, how will we pay for it? In this post, I'll explain why financing the project through debt alone would make it an unattractive proposition.

One of our biggest structural concerns with the U.S. economy is excess federal debt. This is a timely topic now because the Biden administration initially proposed more than $2 trillion of additional infrastructure spending. Intended to reinvigorate the economy, the plan would reduce the debt burden and fund future spending by promoting enduring growth. As originally proposed, the project would be financed through higher taxes on corporations and the wealthiest Americans. Our next piece will evaluate these proposed tax hikes.

The good news

On the one hand, the picture appears quite rosy. Consumers look quite healthy from a debt-to-equity perspective. And due to historically low interest rates, their debt service burden looks manageable relative to historic norms—we mean *really* good. Corporate balance sheets, too, are strong, while steady demand for corporate bonds means that their financing costs are low.

Separately, the banking system is robust thanks to reforms in the wake of the 2008-2009 financial crisis. Banks generally have plenty of capital and available loan capacity. What's more, credit trends are good.

NOW FOR THE BAD NEWS

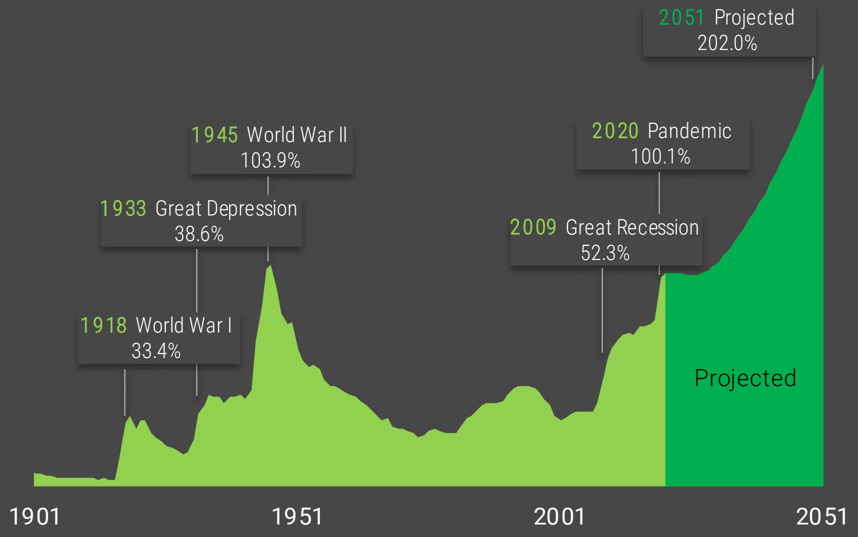
The federal government's balance sheet shows historic levels of debt relative to the size of the economy—and that's before considering the impact of President Biden's massive infrastructure plan.

Figure 1 shows the growth of federal debt over time, as well as the Congressional Budget Office (CBO) projection for where it would be in 2051 assuming no new taxes or spending—just projecting current conditions forward. While limited in scope, we believe this analysis nevertheless effectively makes the case that the current mix of federal debt, spending and revenues is unsustainable.

For debt levels to remain this elevated, it's crucial that interest rates remain low.

Figure 1 | Federal Debt Held by the Public

As a percentage of gross domestic product (GDP)



Actual data from 1/1/1901 – 12/31/2020. Projected data from 1/1/2021 – 12/31/2051.
Source: Congressional Budget Office.

WHAT HAPPENS IF RATES GO UP?

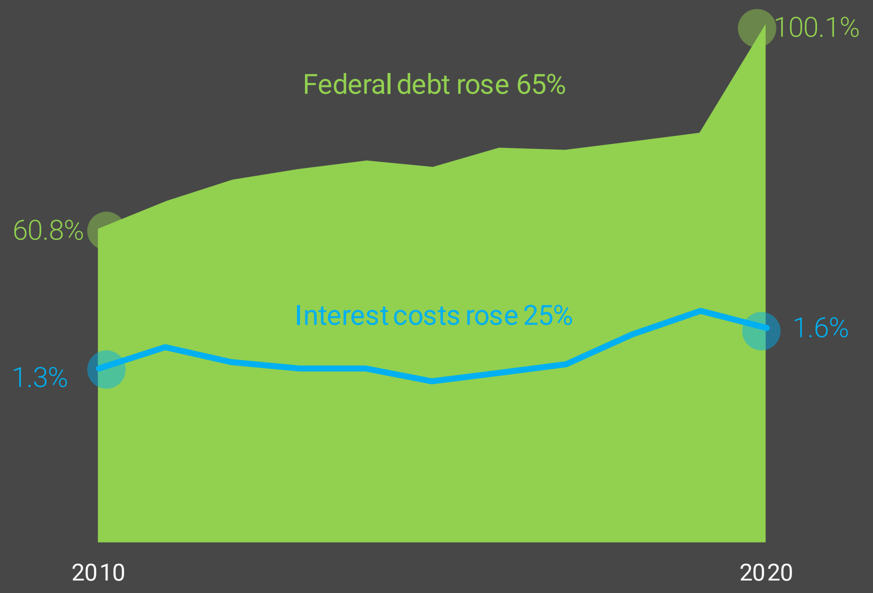
Even as debt surged in recent decades, historically low interest rates meant financing costs increased much more slowly. **Figure 2** captures this comparatively modest rise in interest payments. Federal debt rose 65% in the 10 years up to 2020, while net interest costs rose only 25%.

But we caution that this can also work in reverse—a meaningful increase in interest rates could result in serious challenges to our ability repay such sizable debts. To oversimplify, when evaluating companies for inclusion in our own portfolios, we look for companies with rock-solid financials who have shown themselves to be good stewards of capital. Right now, our government doesn't clear this hurdle, and corrective measures are required. This is why the tax question we'll cover next is so important.

The punchline? The bill always comes due. While consumers are healthier today than they were in the wake of the financial crisis, the federal government is much deeper in debt. Think of it like this—whether we stuff the bill in our right pocket (consumer) or our left (government), we're still wearing the pants.

Figure 2 | A Closer Look at the Last Decade

Federal Debt and Interest Outlays as a Percentage of GDP



Data from 2010 – 2020.
Source: "Federal Net Interest Costs: A Primer," Congressional Budget Office, December 2020.

ENDNOTES

[1] "Households' lightening debt load," The FRED® Blog, October 10, 2019.

[2] "Nonfinancial Corporate Business; Debt as a Percentage of the Market Value of Corporate Equities, Level," FRED® Economic Data, March 11, 2021.

[3] "Supervision and Regulation Report," The U.S. Federal Reserve, April 30, 2021.

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