

Throughout history, there have been sovereign debt crises when individual countries found themselves unable to meet liabilities as they came due. Significant sovereign debt crisis in recent history include the Latin American debt crisis which lasted from 1982 to 1989, and the Euro-zone debt crisis which began in 2008 and lasted until 2015.

The Latin America debt crisis dated back to the 1960s as countries began to turn away from protectionist policies and embrace modernization, industrialization and international trade, funded by loans from foreign banks and governments. Authoritarian regimes that controlled many Latin American countries were more concerned with short-term economic gains instead of sound fiscal management and took on substantial amounts of debt. By the end of 1978, total outstanding debt from all sources had skyrocketed by more than 400% to \$159 billion. By 1982, the debt level doubled again to \$327 billion. As central banks raised interest rates in an attempt to bring global inflation under control during the 1970s, Latin American countries suddenly found their debt burdens ‘unsustainable’ as banks began to shorten re-payment periods and charge higher interest rates for loans.

One by one, countries notified lenders that they were unable to meet interest payments on their debts, and by the end of 1982, sixteen Latin American countries had rescheduled the terms of their debts with lenders. Eventually, it became clear that these countries would never be able to repay their loans and between 1989 and 1994, private lenders forgave \$61 billion in loans, about one third of the total outstanding debt. In exchange for the debt forgiveness, countries agreed to economic reforms which included raising taxes, reducing government spending and devaluing their currency.

Sources: Latin American Debt Crisis of the 1980s; Federal Reserve History | Forty Years of Latin America’s Economic Development; National Bureau of Economic Research White Paper, July 2009

The Euro-zone debt crisis was precipitated by the bursting of the ‘housing bubble’ in 2007 and the subprime mortgage crisis and financial crisis that followed. Trillions of dollars in ‘subprime’ loans were sold to borrowers with lower and in many instances, no credit, that could not qualify for a conventional mortgage from banks and lenders. These subprime loans typically had low initial interest rates which reset to much higher rates at a future date, leading to widespread defaults and foreclosures. The initial lenders sold the loans to investment banks, which bundled them with hundreds or thousands of other subprime loans into “mortgage-backed” securities, which were then purchased by investors for the higher returns the subprime mortgages would produce.

As the Federal Reserve began to raise interest rates in 2004 and the housing market began to slow down, borrowers with subprime mortgages could no longer refinance at lower rates. Housing prices declined dramatically, and many borrowers now owed more on their homes than what they were worth, so selling was no longer an option either.

By September 2012, approximately 1.4 million homes, or 3.3% of all homes with a mortgage, were in some stage of foreclosure in the U.S. alone. The contagion spread to countries around the world as global banks all owned “toxic” debt securities. Central banks printed money in response to bank failures and the economic downturn that followed. In 2009, Greece’s budget deficit more than doubled and its sovereign debt soared to 113% of Gross Domestic Product (GDP). In exchange for the bailout, the government unveiled an austerity plan which would reduce Greece’s budget deficit, including tax increases and a freeze on public-sector wages. Portugal, Spain, Ireland, Cyprus, Italy and other EU countries followed Greece into crisis situations, requiring hundreds of billions of dollars in central bank bailouts, budget cuts, wage freezes, unemployment rates as high as 27% in Greece and Spain, and increases in poverty and income inequality. After a period of stability, sovereign debt soared again following the COVID-19 pandemic, reaching a high of \$320 trillion at the end of 2024, a 50% increase from 2011.

Sources: Financial Crisis of 2007-2008; Britannica Money | European Sovereign Debt Crisis; Wall Street Oasis Academy, December 23, 2024

The United States has had short-term debt-ceiling crises as the statutory debt limit, or debt ceiling, was reached in 2011 and again in 2023. In both cases, the federal government had reached the limit of money it was allowed to borrow and needed Congress to increase the ceiling to fund further government spending. The Republican led Congress approved an increase in the debt ceiling in both situations, in exchange for spending caps or cuts in future years. (more on this later) The debt ceiling issue hit again in December 2024, when it was projected that the federal government would reach the current federal debt limit of \$36.1 trillion in January 2025 and run out of cash to pay its bills sometime between mid-August and September unless Congress acted to raise the ceiling. On July 8, Congress agreed to a \$5 trillion increase, bringing the new statutory limit to \$41.1 trillion. These crisis situations and the inability of Congress to cut spending, led to rating agency Moody’s to downgrade the United States’ sovereign credit rating from Aaa to Aa1. For the first time ever, all three major credit rating agencies rated U.S. debt *below* the top-tier AAA status, which could increase the cost of borrowing money from investors to fund government spending.

Additional References on debt issuance, debt accumulation and federal budget effects on the U.S. economy; A Clear and Present Danger, Threat #3 – The Great Reset; Ch. 8 Sovereign/U.S. Debt & Ch. 9 Modern Monetary Theory | Addenda #19 – March 2024

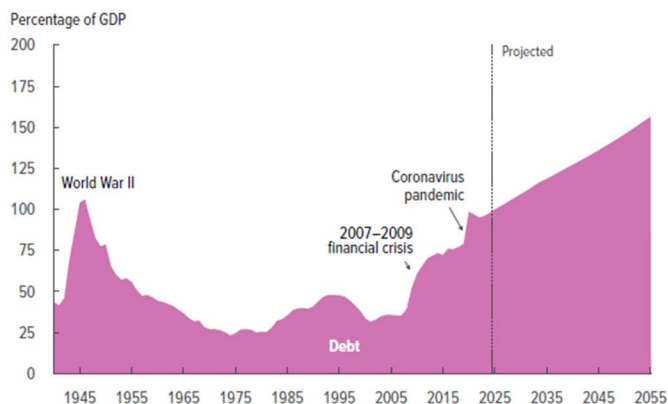
How America's Debt Spiral Could Spark The Next Crisis, is a YouTube video about the current debt situation in the U.S., created by CNBC from independent analyses done by the Wharton School of Business, Yale University and the Congressional Budget Office. The video features special guest speakers including former Treasury Secretary Robert Rubin, macro investor Ray Dalio and Former Chairman of the Joint Chiefs of Staff Mike Mullen. Kent Smetters, professor of Business Economics and Public Policy at the Wharton School of Business flat out says that U.S. fiscal policy is unsustainable, and there is so much debt that bond markets will collapse within the next 20-years. Smetters says that the U.S. won’t default on its debts, like Latin America did in the 1980s. Instead, it will resort to “printing” more dollars to pay for that debt, which will result in higher inflation.

Reference on money printing; Chapter 9, *Modern Monetary Theory – Fueling Unlimited Debt and Dependency, and Control*

Ray Dalio of the investment management firm Bridgewater Associates believes that there is more than a 50% chance that there will be a crisis in as little as three years. Dalio believes the crisis will occur when investors finally become concerned about the amount of debt the U.S. Treasury must borrow to cover government deficit spending, *and* the ability of the U.S. to repay that debt. When investors start getting “jittery” about too much debt flooding the bond markets and the risk of higher inflation, they’ll insist on get paid higher rates to buy our debt. This has already happened here in the U.S. In the mid-1980s, when investors were concerned about the \$200 *billion* budget deficit, the yield on 10 and 20-year Treasury bonds exceeded 13.5%. Today, levels of debt are ten times that, which could result in another spike in bond yields which could cause a recession.

Individuals, banks, institutions and foreign governments buy U.S. Treasuries as an investment for the interest they pay. The amount of interest is determined by the rate, or yield, the bond is assigned when it is issued for sale. The higher the rate, the more interest the investor earns. *Credit quality* plays a significant role in determining bond yields. Bonds issued by a corporation or agency with a higher credit rating are considered to be less risky and have lower yields. Bonds issued by a corporation or agency with lower credit ratings are considered higher risk and have higher yields to compensate investors for this risk. These higher yields, demanded by investors, are exactly what will cause the bond market to crash according to Smetters and Dalio.

The Congressional Budget Office noted in *The Budget and Economic Outlook: 2025 to 2035*, that deficit spending will continue to grow over the next ten years, driven by the growth in spending on Social Security and Medicare and increased interest payments on the debt. Deficit spending was already projected to grow from \$1.9 trillion in 2024 to \$2.7 trillion in 2035. This will be even larger now that provisions of the Tax Cuts and Jobs Act of 2017 were extended. Net interest paid to finance deficit spending will grow by more than 100% over the next ten years, crowding out other discretionary spending.



Federal Debt Held by the Public; CBO Report, January 2025

Debt held by the public, the debt we owe to investors who bought Treasury bonds, will increase from 100 percent of GDP to 118 percent—an amount greater than at any point in the nation’s history. The federal government will have to issue even more bonds to finance increased deficit spending and convince investors to buy that debt.

The United States is in a ‘debt spiral’, a situation in which ever increasing levels of debt and debt interest eventually become unsustainable and lead to a default crisis. Mandatory spending programs; Social Security, Medicare, Medicaid, federal government pensions and a handful of other programs, are responsible for 60% of all government spending. Net interest payments are responsible for another 13% of all government spending. Combined, mandatory spending is 73% of all government expenditures. There is little political will to announce cuts to those mandatory programs or restrictions on eligibility, yet maintaining these levels of spending just pushes us closer to a default crisis.

Note: The disability and retirement trust funds in Social Security and the Postal Service Fund are “off-budget” programs that cannot be cut without Congressional legislation.

Over the next ten years, mandatory programs and net interest payments will be responsible for 78% of all government spending and the budget deficit will increase by 42% to \$2.7 trillion by 2035. As Ken Smetters and Ray Dalio describe in *How America's Debt Spiral Could Spark The Next Crisis*, there will come a point when investor concern about U.S. debt will result in investors demanding higher rates for the risk they are taking. Higher rates would be bad enough, but the possibility that they will refuse to buy more of our debt would be even worse.

In both prior debt ceiling crises, Congress passed bills to deal with the budget deficits. The Budget Control Act of 2011 and the Fiscal Responsibility Act of 2023 cut or capped spending, resulting in a combined \$2.4 trillion reduction in long-term deficits. But these were reductions in discretionary spending only. Mandatory spending continues to drive deficit spending to levels that will eventually result in a debt crisis in the U.S. The longer politicians take to address the spending problem and the deficit, the worse the crisis will be and the more painful the fix will be.

- * Spending cuts will have to be deeper, hurting the most vulnerable.
- * Inflation will rise (as it did in 2022), hurting middle-income households the most.
- * Businesses will have less money to invest, resulting in slower wage growth and layoffs.
- * Unemployment will rise, hurting all workers.
- * Interest rates will rise, affecting mortgage rates, auto loans and credit card payments.
- * Taxes will have to be increased, hurting middle-income households the most.

The result of all will result in reduced economic growth and a reduced standard of living for all Americans for generations to come.

In the meantime, Republicans continue to push for tax cuts while Democrats continue to push for more spending. Neither party will acknowledge the severity of the problem or propose any meaningful solutions for it, and most voters have no idea how deeply in debt the U.S. really is. No one wants programs or services reduced. No one wants to see taxes increased or tax credits reduced or eliminated. No one wants to see their retirement benefit of medical coverage cut. But this is what will happen when we finally reach that tipping point and enter a debt crisis. A debt crisis is inevitable; the question is not if, but when...