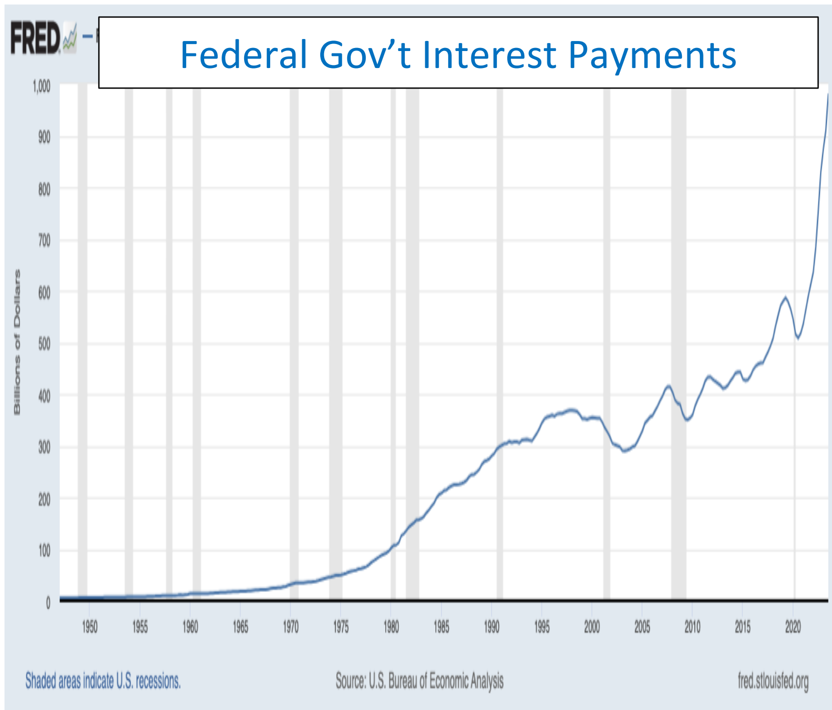
## The Impact of Higher Interest Rates:

According to the International Monetary Fund, governments are expected to spend over $2 trillion in interest on their debt this year, which is up +10% year-over-year. Of this massive amount, the US represents roughly 1/3rd of total net interest payments. Debt levels are spiraling higher, with the cost of interest payments nearly doubling over the last two years.

We have discussed looming US debt levels and annual government deficits, but those were all occurring in a low-rate environment. Now, with inflationary pressure, the Fed was forced to materially increase rates and the impact will be felt in 2024 and beyond.

According to the bi-partisan CBO (Congressional Budget Office), the gap between spending and revenue was $1.7 trillion in fiscal year 2023, equating to $300 billion of annual deficit growth - even as the economy was expanding. With debt levels growing, on August 1st, Fitch Ratings downgraded the US government's credit rating from AAA to AA+.




The chart from the US Bureau of Economic Analysis clearly shows the troubling and soaring interest payments the government must make on its debt (over the last 70 years).

Higher interest payments will compound the debt and deficit problem, and this will ultimately hurt our economy. The question is when, not if. Their analysis of $1 trillion in interest payments, referring to fiscal year 2024, is based on outstanding gross debt and the average interest rate on the debt.

However, we believe a more accurate calculation would consider outstanding net debt, which removes debt owned by the US government (about $7 trillion). On net debt, the US government would owe interest on $26 trillion of debt, at an average interest rate of 2.97%. This is roughly $800 billion in 2024 interest payments or 18% of the $4.4 trillion in revenue the US government collected this year. If tax revenues next year are higher, this percentage would decline slightly.

We feel it is important to mention that interest expenses as a percentage of tax receipts were in the high teens for most of the 1980s and 1990's. There is no doubt that rising deficits amid higher interest rates are a headwind to economic growth, but it also could force the US government to reign in some of its recent fiscal spending.

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