ECONOMIC
MARKET UPDATE

Aug 2024

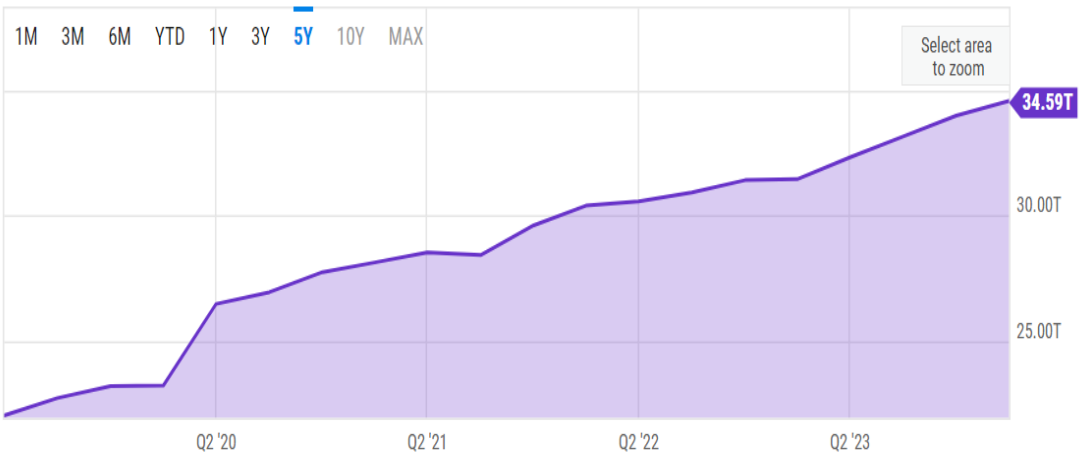
Paladin

Does the Deficit Matter?

In 2024, the United States federal deficit is projected to be approximately $1.6 trillion, which is almost 5.6% of the country's GDP adding to the total public debt of the United States of approximately $34.59 trillion as of March 2024

- The annual budget deficit, defined as Budget Deficit = Total Expenditures - Total Revenues, is expected to increase to $1.8 trillion in 2025 and then stabilize around $1.6 trillion again by 2027 (Congressional Budget Office "CBO")
- The United States 2023 GDP was $27.36 Trillion and long-term projections indicate that the annual budget deficit will continue to grow, reaching $2.6 trillion by 2034, with public debt expected to continue to rise from the current levels
- Rising expenditures on health programs and Social Security, along with increasing interest payments, are significant factors contributing to this trend

- CBO projects that interest costs in 2024 will total $870 billion
  - A jump of 32 percent from the previous year and following increases of 35 and 39 percent in each of the two years before that
  - This year's high interest bill isn't a one-year phenomenon, it's part of a trend that stretches out into the future, as debt continues to climb and relatively high interest rates push up the cost of federal borrowing



United States Public Debt
Source: Ycharts US Treasury

Does any of this matter? Budget Deficit? Total Debt? Rising interest costs eating into revenue?

— Two quotes come to mind.....

- "Inflation is the one form of taxation that can be imposed without legislation" and
- "No major institution in the US has so poor a record of performance over so long a period as the Federal Reserve, yet so high a public reputation." Milton Friedman

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— The United States Government has one thing our clients do not have.....the ability to PRINT MONEY

— The ability to print money allows for the USA risk-free rating and is always used to bail itself out of a jam

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— In the end the Federal Reserve will finance the deficit

— However, the consumer bears the brunt of this strategy, as inflation is the price they pay. This situation is likely to worsen as the money supply expands and more money is printed

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— Stopping inflation is difficult, almost circular. One thing for sure, historically, bringing down inflation has involved a recession or a credit crisis, which we all know includes higher taxes, interest rates, and unemployment, resulting in a contraction in the money supply and a credit crisis

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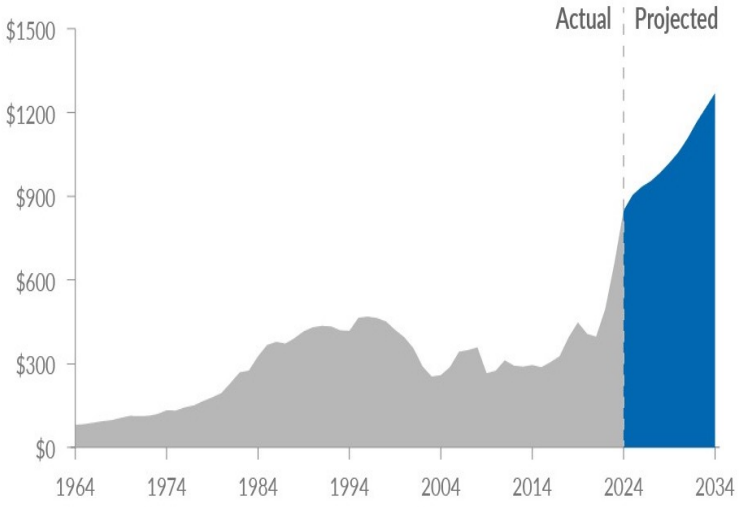
— With the national debt growing at about $1 trillion every 100 days, mostly due to higher interest costs, let's dig deeper.....

> The mounting debt and escalating interest costs have not only burdened the nation but also significantly inflated the cost of federal borrowing

How do WE pay for all the interest on the OVERALL debt load?

- Recent projections from the CBO indicate a grim future or, better said, an unsustainable path for America as it relates to its deficit and overall debt load
- Mounting debt and escalating interest costs have burdened the nation and significantly inflated the cost of federal borrowing
- In 2023, interest costs on the national debt totaled $659 billion — surpassing most other components of the federal budget
- CBO projects, on an inflation-adjusted basis to 2023, net interest costs would rise from $848 billion in 2024 to nearly $1.3 trillion in 2034
- Outside of the past couple of years, the previous inflation-adjusted high was $468 billion in 1996

Interests Costs on US Public Debt

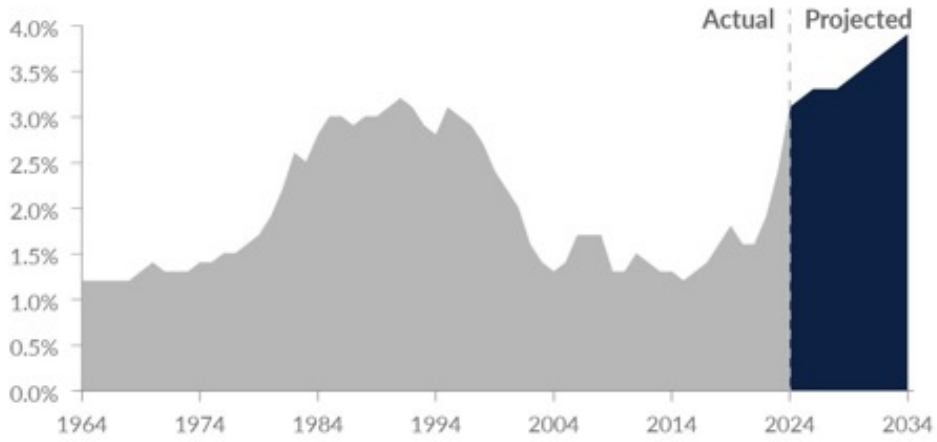


Source: PGP Foundation

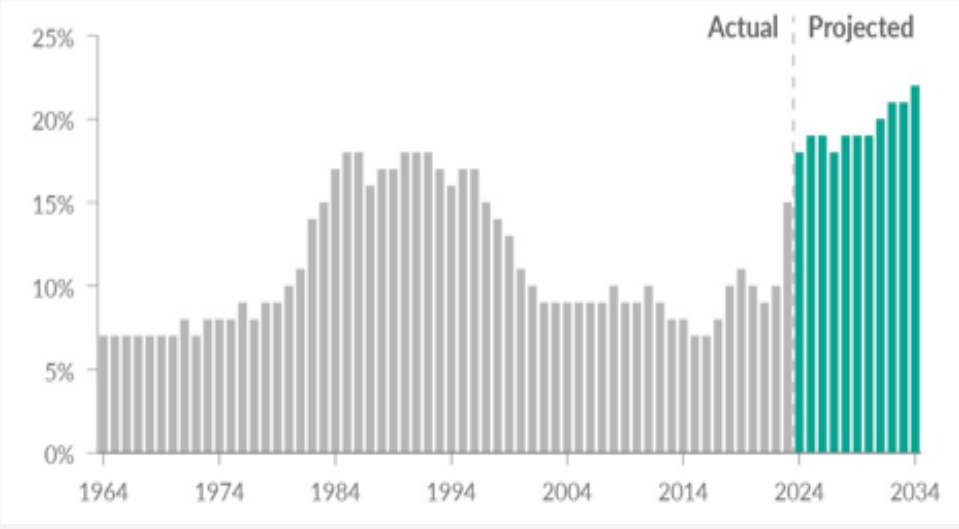
Interest is taking its toll.....by pretty much any measurement, interest on the national debt will soon grow beyond its highest level since 1940 .....

- As a % GDP, it is expected that interest costs will reach 3.2 percent of GDP in 2025, eclipsing the previous high set in 1991
- Interest costs would climb to 3.9 percent of GDP by 2034
- Compare to the previous high of 18 percent in 1991, federal interest payments are projected to rise to 19 percent of federal revenues by 2025 and further to 22 percent by 2034, marking a significant shift in the economic landscape

Interest costs as a % of GDP



Interest costs as a % of all Federal Revenues



- As a percent of total spending, interest costs would reach 15.7 percent by 2032, eclipsing the previous high of 15.4 percent set in 1996
- Over the next decade, the U.S. government's interest payments on the national debt are now projected to total $12.4 trillion — the highest dollar amount for interest in any historical 10-year period and more than double the total spent in the past two decades

Throughout history, deficits have mattered!

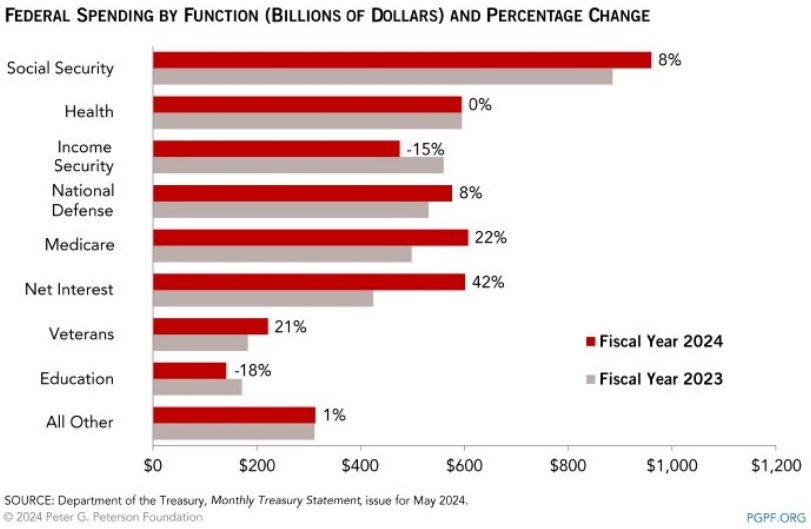
How and when markets react is anyone's guess, but undoubtedly it will create work for the restructuring community as the cost of interest and debt levels continue to rise

Why this all matters:

- Higher interest costs put our future at risk by taking more of the revenue that otherwise could be spent on education, infrastructure, research, and development that fuel the economic growth of America

- Rising debt slows economic growth as it increases expectations of higher rates of inflation and erosion of confidence in the U.S. dollar

Spending through the first 8 months of FY 24 was generally up compared to last year



- With large deficits and national debt, the USA is not as flexible in responding to crises. Not only does the larger deficit and higher interest burden expose America to crisis United States leave its policymakers with much less flexibility to deal with unexpected events. If the country faces another major recession like that of 2007–2009, it will be more difficult to recover

- Protecting the essential safety net. The unsustainable fiscal path threatens the safety net and the most vulnerable in American society. If the government does not have sufficient resources, essential programs like Medicaid and Social Security could be jeopardized

Loan Market Update: leveraged loan market is heating up again and volume is rising

Leveraged Loans

Leveraged loan retail funds continue to have week-on-week inflows with the 18th straight week bringing the streak total to ~$10.3 billion

This 18-week run is the largest inflow of capital in two years

This large inflow of funds, it is creating a supply-demand imbalance to the point that the market is starting to see the issuance of second-lien deals

YTD LBO volume is up 108% from $13.3 Billion in 2023 to $27.7 Billion

YTD M&A (Non-LBO) is up 98% from $12.3 Billion to $24.3 Billion

The large majority of deals getting done in 2024 are refi's:

- YTD up 145% from $64.2 Billion in 2023 and $157.3 in 2024

Dividend activity is up, but volume does not match that of refi's:

- YTD up 489% from $6.4 Billion in 2023 to $37.7 in 2024

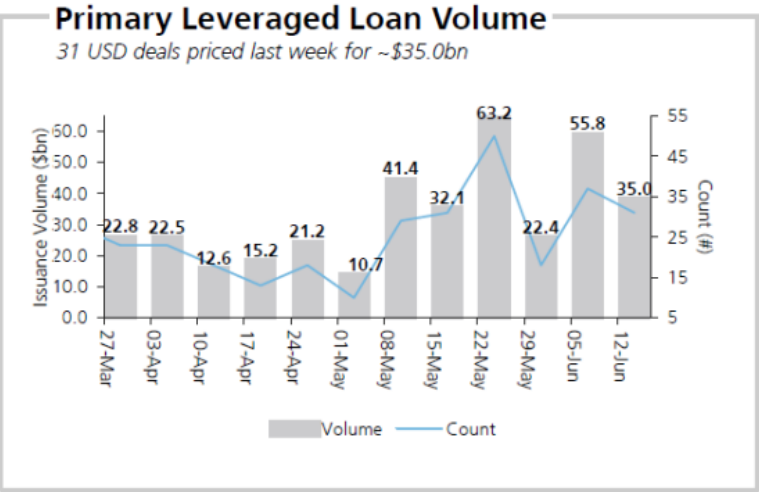
High Yield

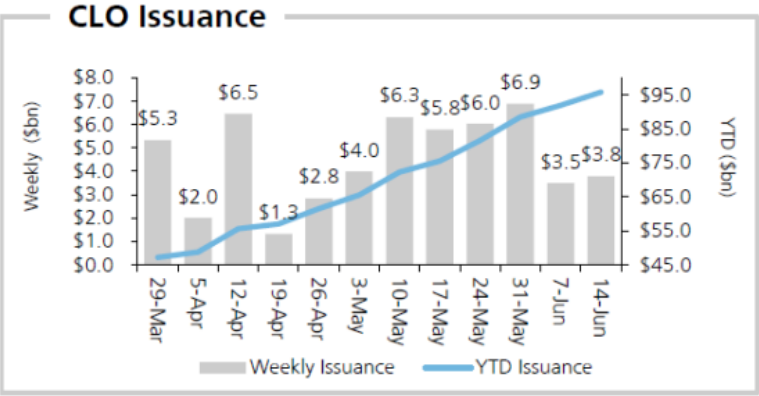
Although the YTD high yield primary volume is up in 2024 compared to 2023, high yield is not as robust as the leveraged loans market

- $154.3 billion in 2024
- $83.2 billion for the same period in 2023 (+79%)

The leverage loan market is making a strong comeback in the half of 2024

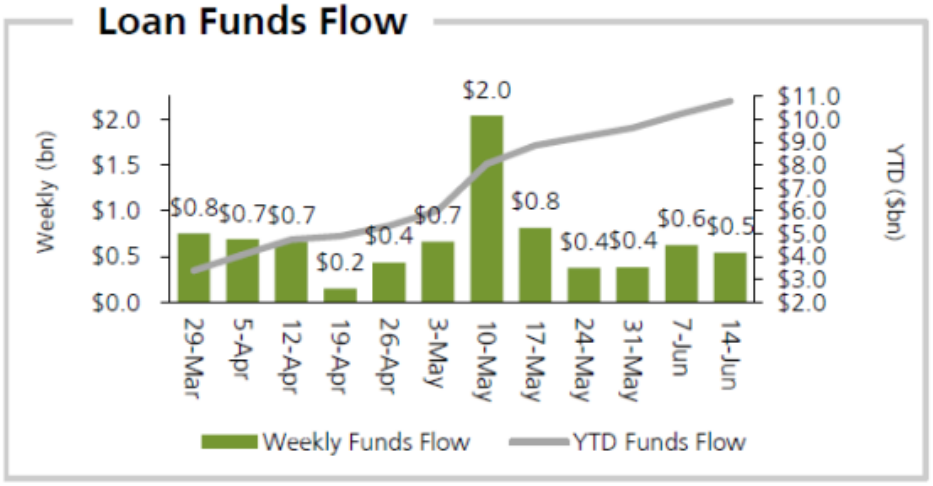
- As detailed below, the primary leverage loan market has been gaining steam in the second quarter of 2024, with some weeks topping $63 billion in volume.
- Most recently the week of June 12th saw $35 billion of new issue loans price
- YTD institutional leveraged loan primary volume – excluding repricing and amend-and-extend transactions – stands at ~$260.2 billion, compared to ~$99.4 billion seen for the same period in 2023 (+160%)

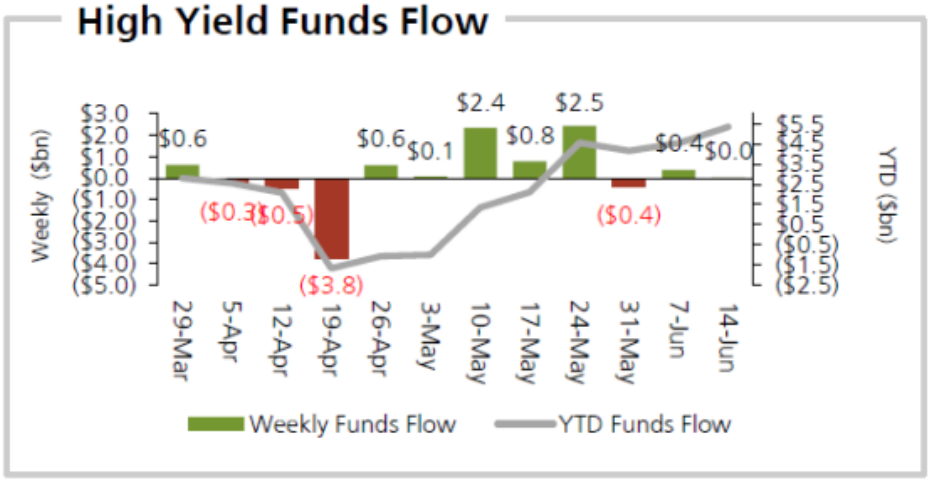




Sources: UBD, Factset, Federal Reserve, LCD

Loan funds flow remains consistent and positive, and High-Yield funds flow is more sporadic, indicating investors are choosing senior debt over more subordinate high-yield bonds





Sources: UBD, Factset, Federal Reserve, LCD

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