PIMCO

# Global Fiscal Policy and Debt Sustainability

Peder Beck-Friis

**IMPORTANT NOTICE**

Please note that the following contains the opinions of the manager as of the date noted, and may not have been updated to reflect real time market developments. All opinions are subject to change without notice.

As of June 2025

# Summary

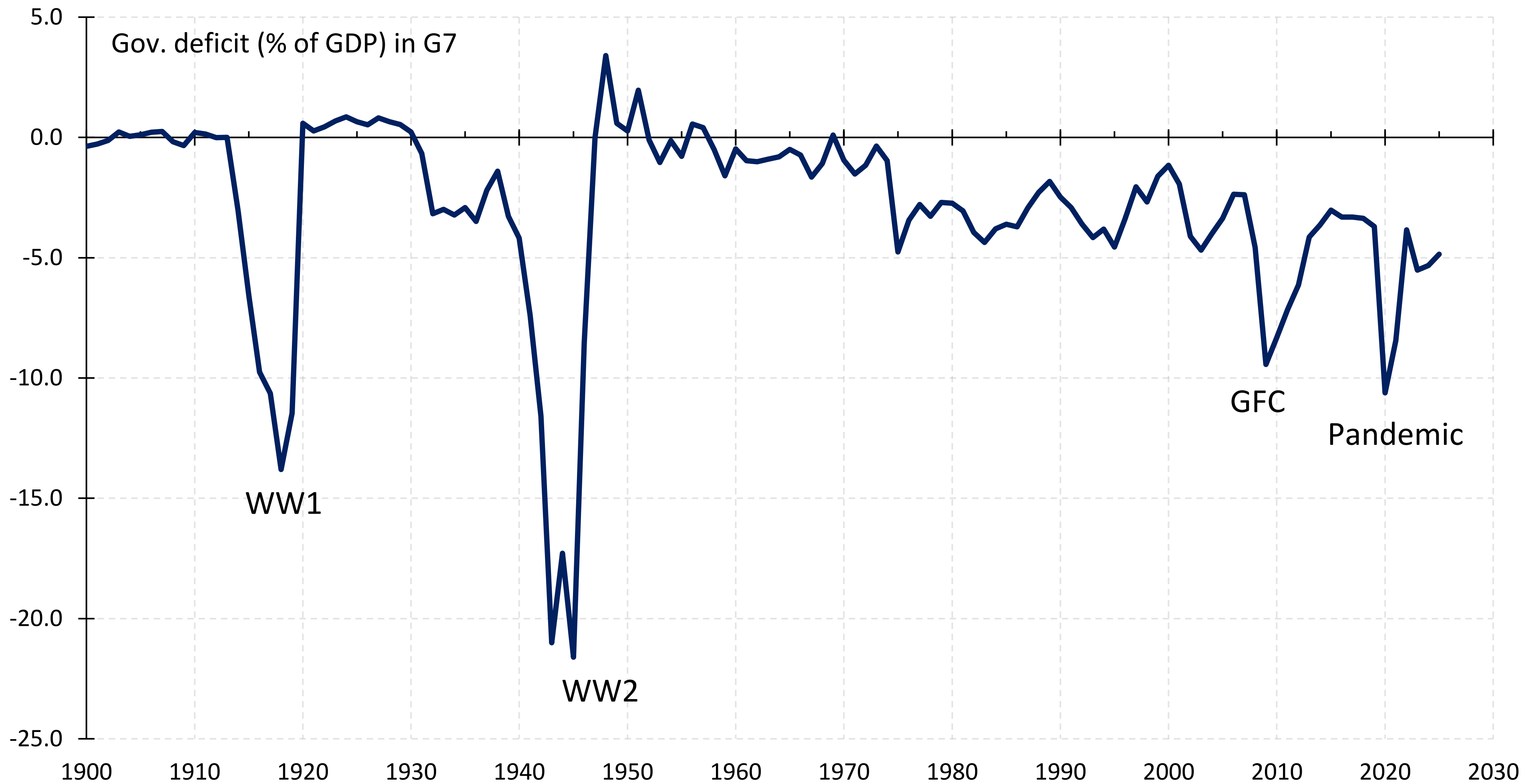
- The fiscal outlook has become more uncertain, but the big picture remains mostly unchanged. Debt remains near record highs, and deficits will likely stay above pre-pandemic levels, partly due to rising interest costs.
- Nonetheless, debt remains sustainable in most developed countries. Countries with more fragile positions generally plan to tighten. The three notable exceptions are the US, France, and Belgium, where debt is rising unsustainably, even more so than last year.
- In our baseline outlook, fiscal policy is broadly neutral ahead. The US structural deficit is likely to stay at 6-7%, with risks of more easing. In the euro area, Germany eases but other countries tighten, keeping the overall deficit at 3-4% in a neutral stance. Meanwhile, the UK runs the tightest policy.
- With deficits already elevated, future downturns will likely push them to historically high levels, potentially ~10% in the US. This may constrain active fiscal easing during recessions, shifting more burden to central banks. In the decade before the pandemic, fiscal space was ample and monetary policy space limited; now, fiscal space is limited and monetary policy space ample.
- We outline five scenarios for US debt, unchanged from last year. In the baseline, debt continues to rise but credibility remains intact given loose Laffer Curve constraints and the dollar's continued (albeit perhaps dented) reserve status. Tail risks – a debt crisis or financial repression – have increased under Trump but remain unlikely.
- Some form of fiscal consolidation is likely beyond the Secular horizon. While political willingness for that is currently low, the interest burden is rising sharply and may change attitudes over time – as in previous episodes of significant fiscal consolidations in the US.
- ***Market implications***: Steeper curves. US fiscal concerns raise the risk of a higher term premium. Less active fiscal policy in future downturns makes front-end rates more attractive.

*Source*: PIMCO as of June 2025

# Fiscal deficits and the policy outlook

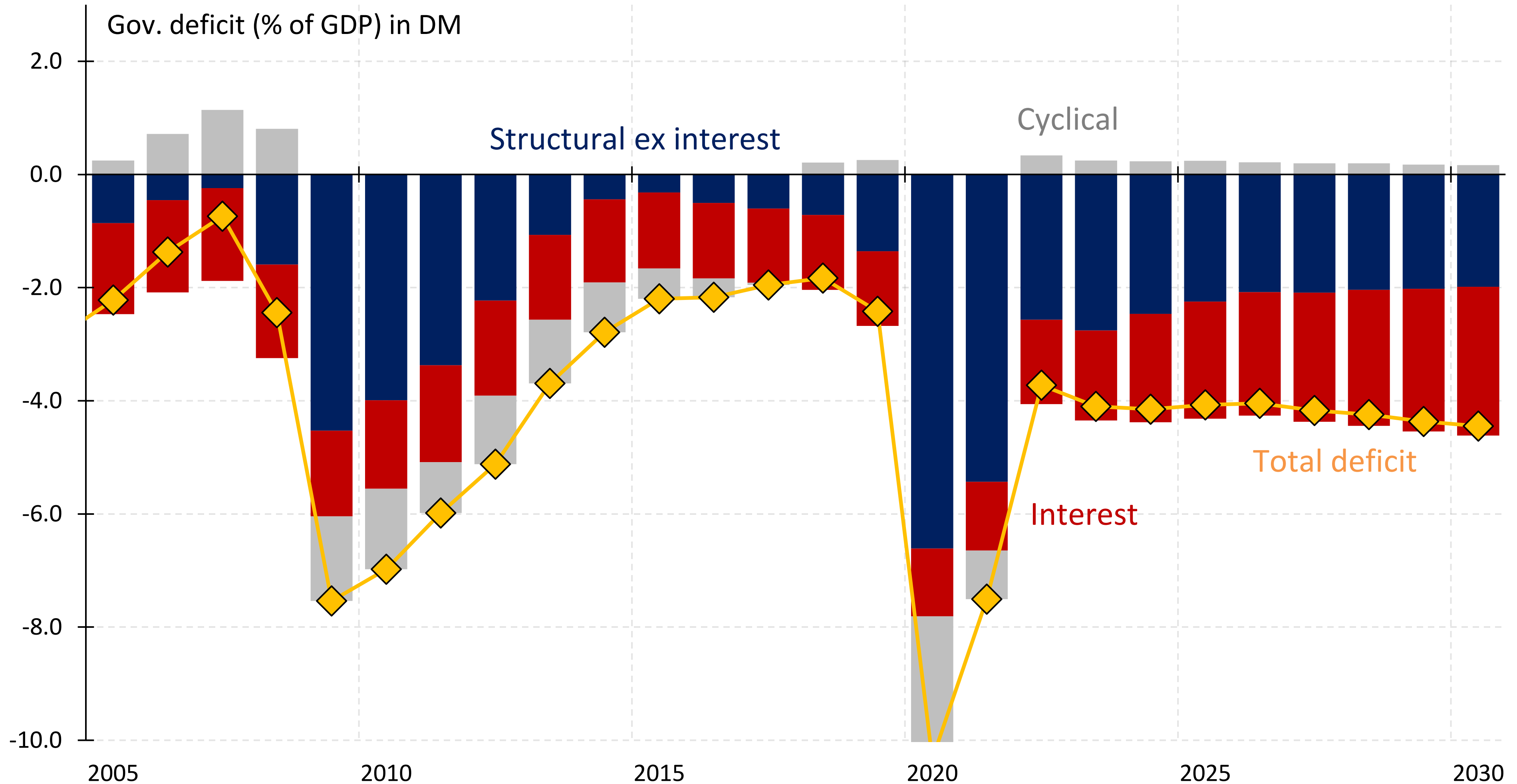
As of June 2025

# Deficits remain high, at least outside wars and other crises…



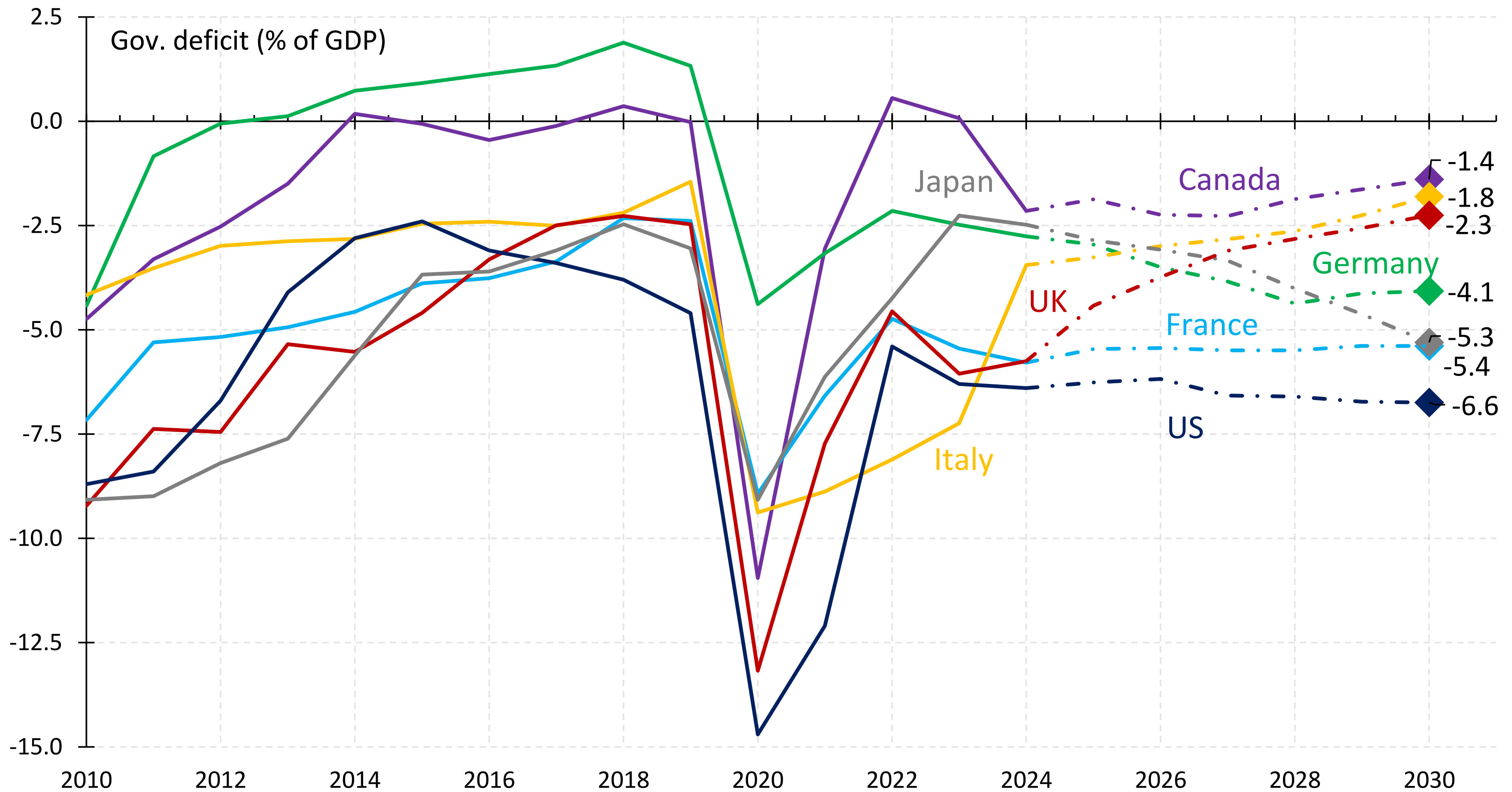

*Source*: IMF Public Finances in Moderns History, JST macro-history database, IMF WEO as of April 2025, PIMCO calculations. *Note*: Chart plots deficit-to-GDP across G7 countries, GDP-weighted. Last data point is 2025. Refer to Appendix for additional outlook and risk information.

# …and will likely stay higher than pre-pandemic, because of higher interest costs and other spending



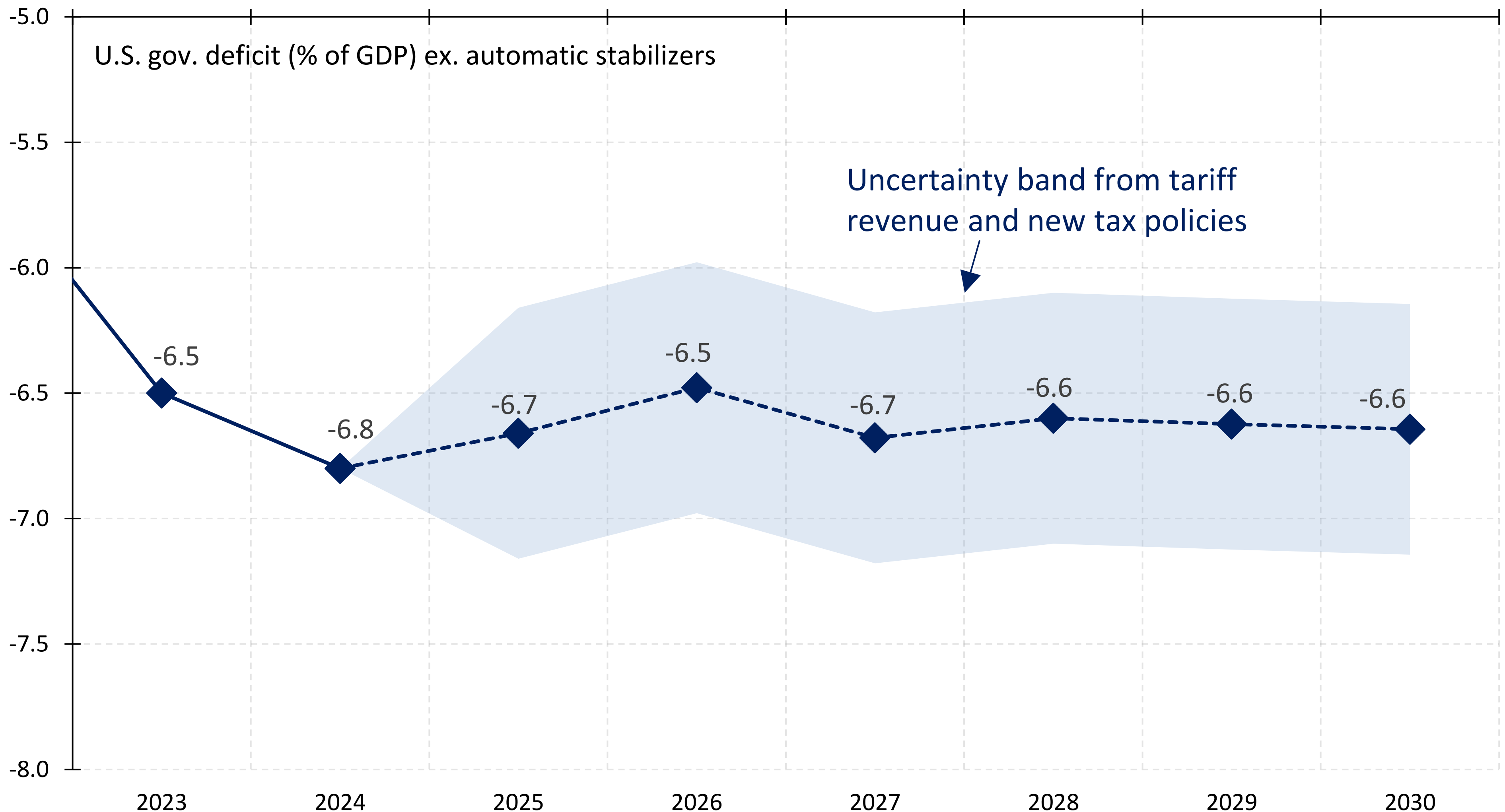

*Source*: IMF WEO as of April 2025, CBO as of March 2025, PIMCO calculations. *Note*: Chart shows GDP-weighted average of the largest 33 DM countries. All projections are from IMF, apart from the US (CBO, adjusted for the extension of the 2017 Trump tax cuts) and CAD (IMF, adjusted for the Liberal Partly election platform). Refer to Appendix for additional forecast, outlook and risk information.

# The deficit outlook is particularly concerning in the US and France



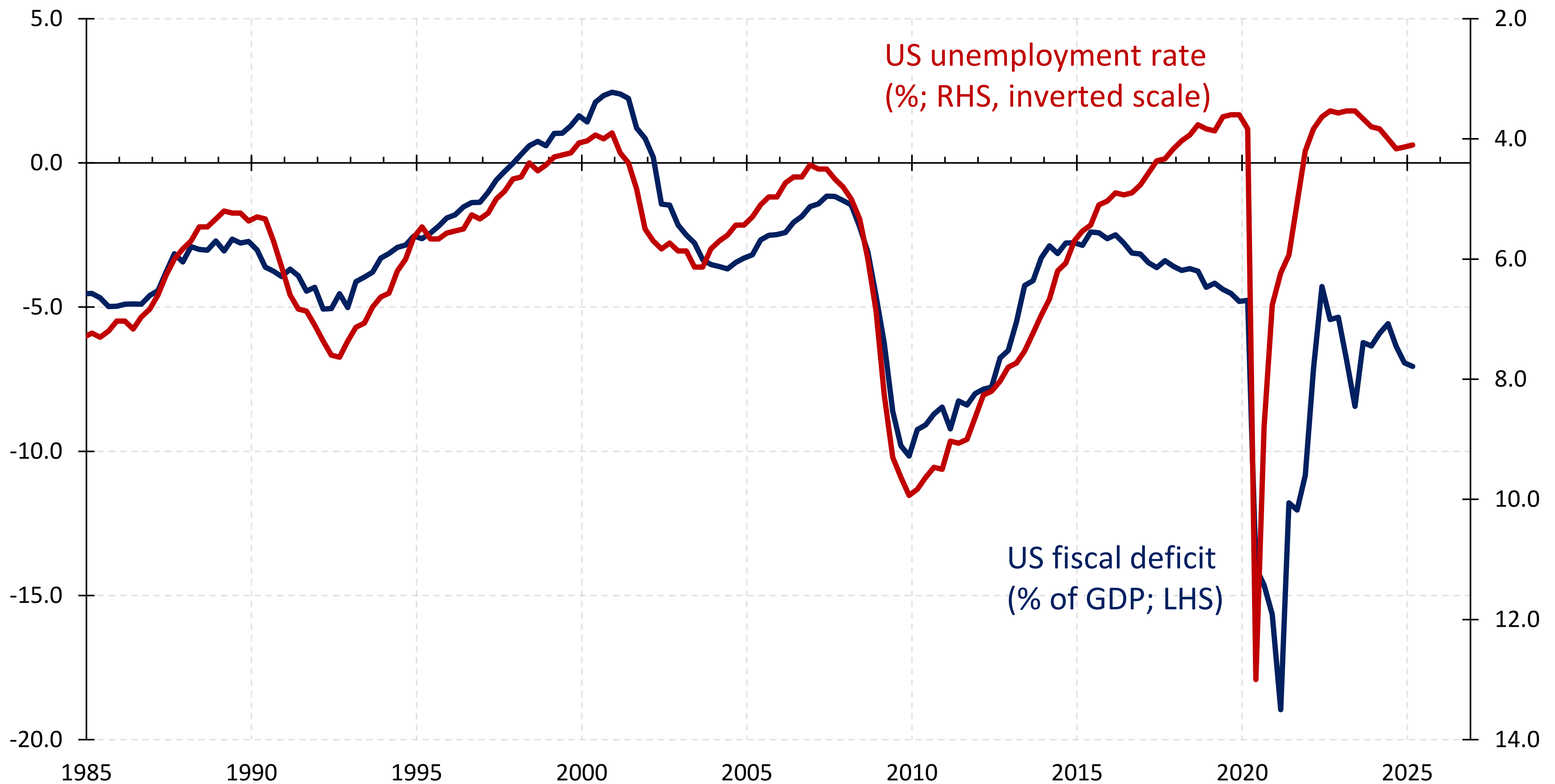

*Source*: IMF WEO as of April 2025, CBO as of March 2025, PIMCO calculations. *Note*: Chart plots government deficit-to-GDP across G7 countries, plus projections in dashed lines. The US is the federal deficit and projections are from CBO (adjusted for 2017 Trump tax cut extension). For Canada, the numbers are from the Liberal Party election platform. The remaining country deficits are PIMCO projections. Refer to Appendix for additional forecast, outlook and risk information.

# In the US, the structural deficit looks to stay at 6-7%, with two-sided risks from Trump policies…



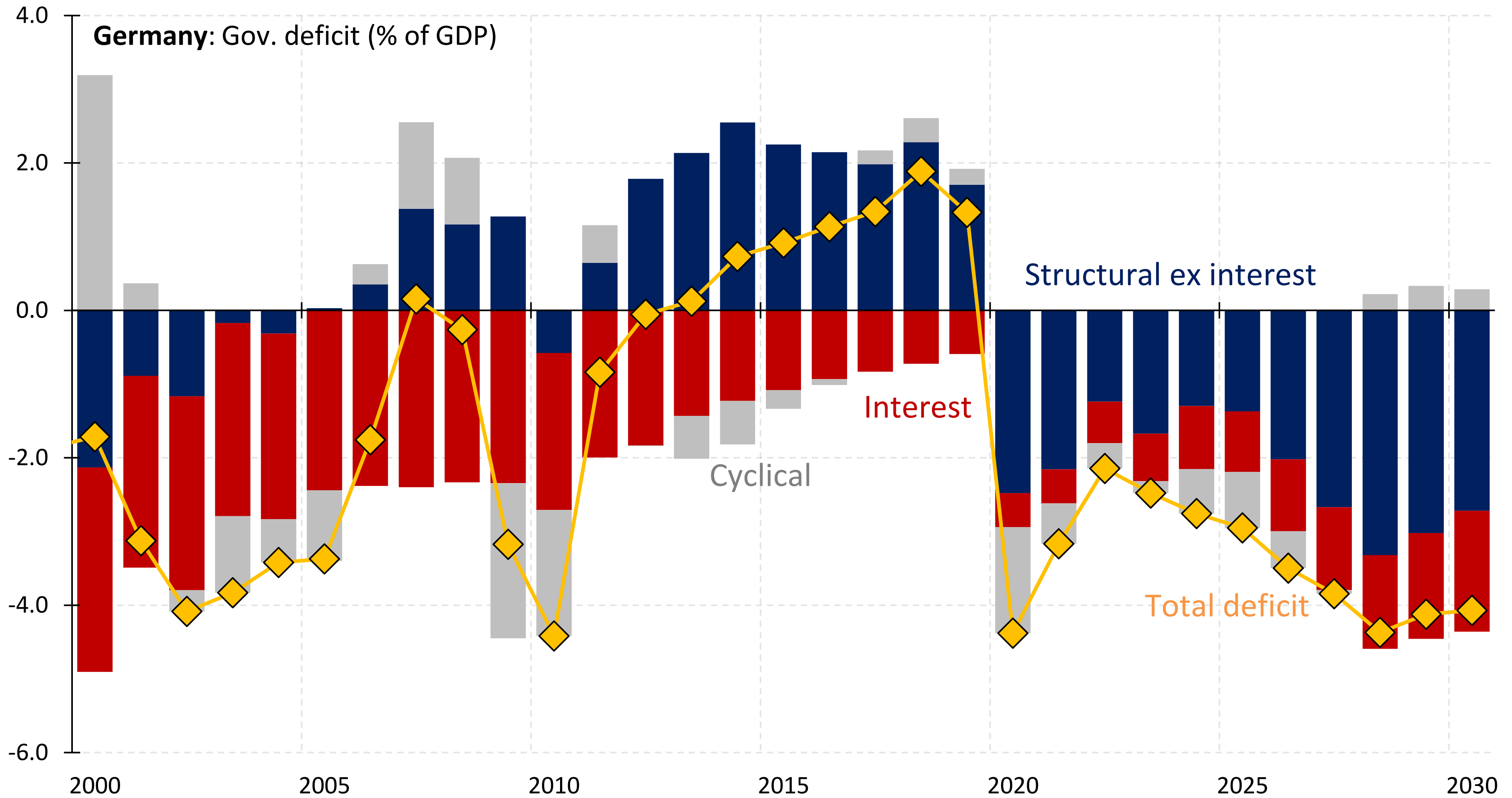

*Source*: CBO as of March 2025, PIMCO calculations. *Note*: Chart plots federal structural deficit (% of GDP). Projections are from CBO, adjusted for the extension of the 2017 Trump tax cuts. Refer to Appendix for additional forecast, outlook and risk information.

# …but future downturns could cyclically push the deficit close to 10%



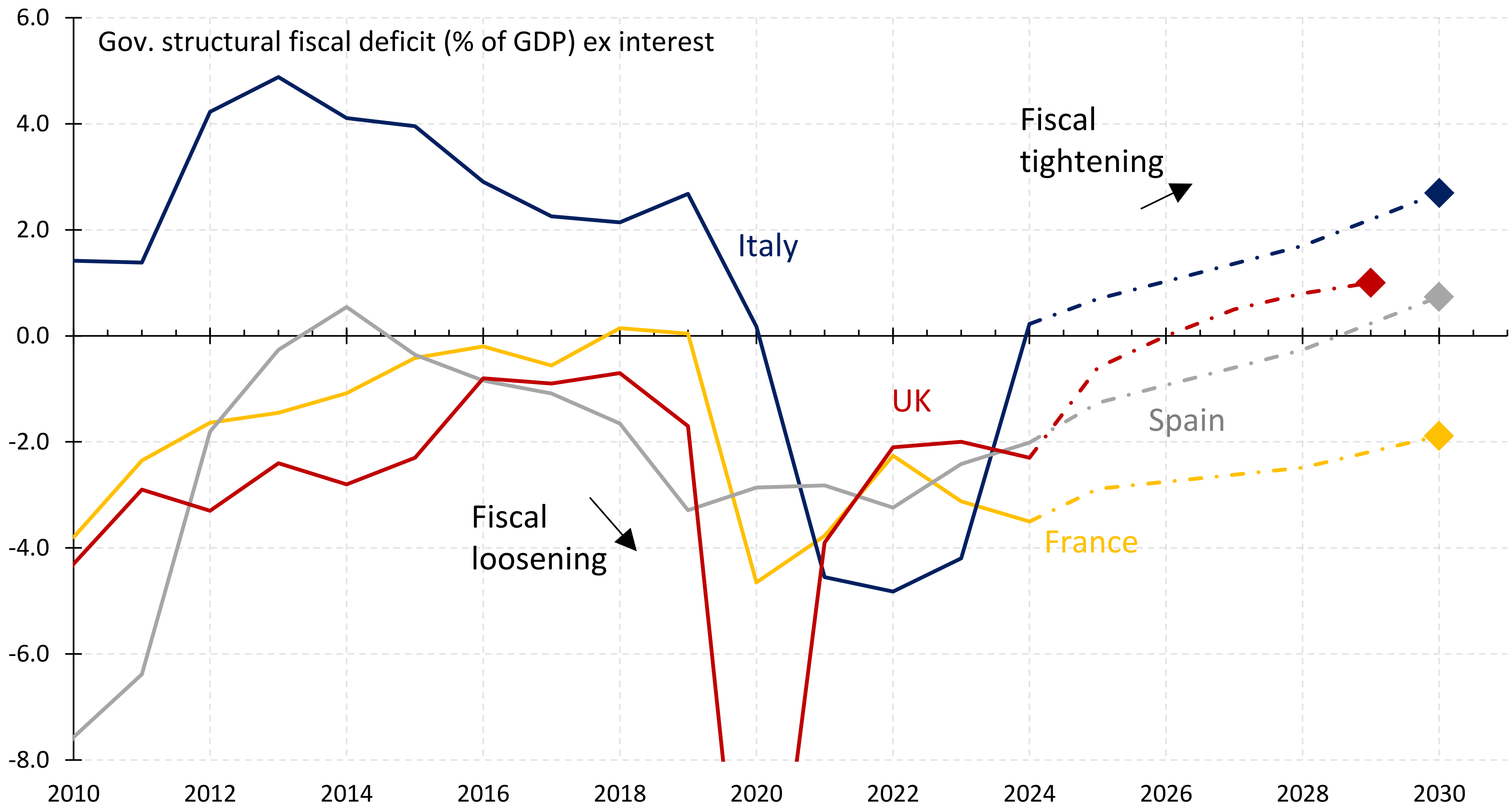

*Source*: BEA, US Treasury, BLS as of April 2025, PIMCO calculations. *Note:* The deficit is for the federal government. Refer to Appendix for additional forecast, outlook and risk information.

# Germany looks set to ease and its deficit may reach ~4%



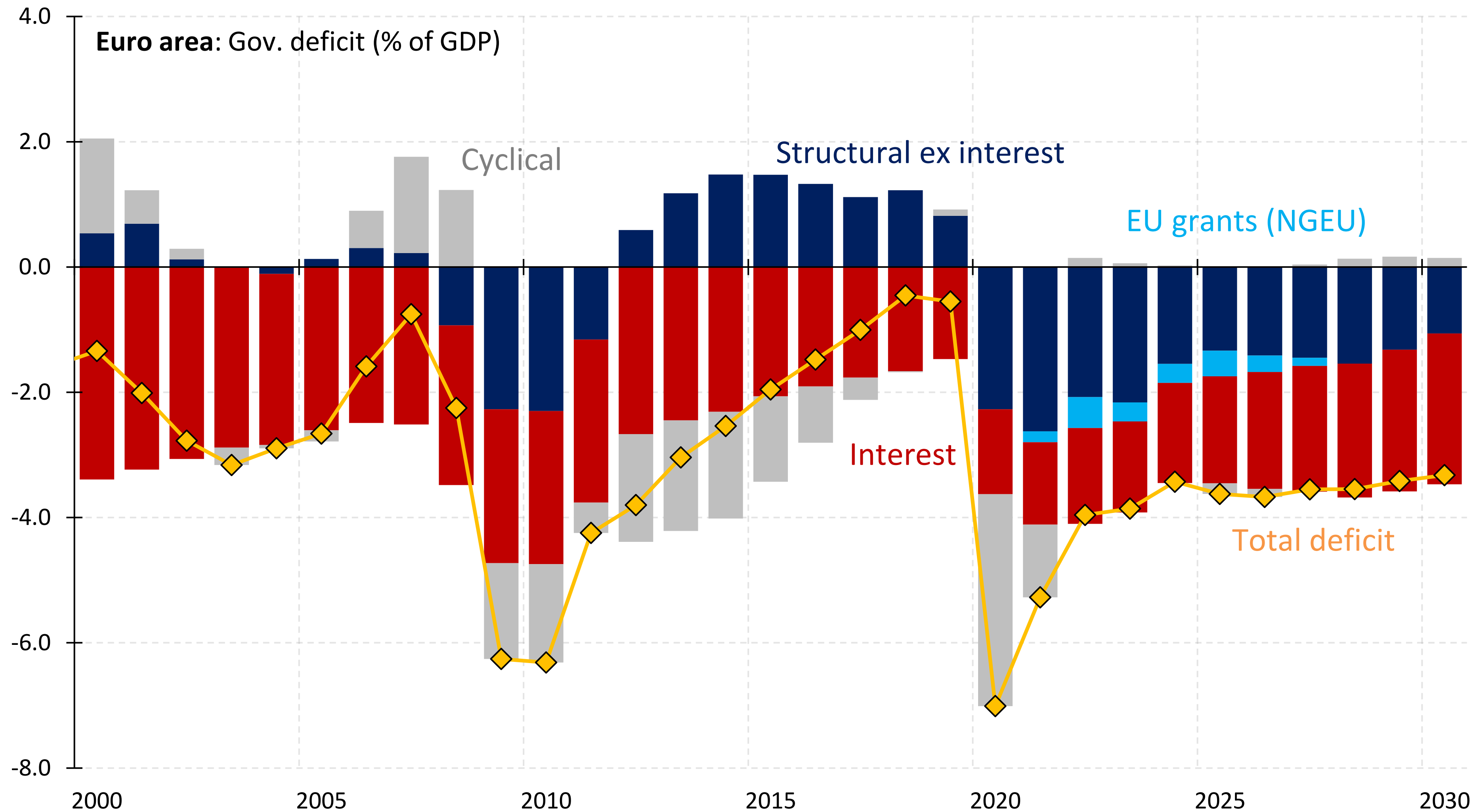

*Source:* IMF WEO as of April 2025, PIMCO projections. *Note*: We assume the government: (1) increases investment spending by 1% of GDP by 2028; (2) increases defence spending to 3.5% of GDP by 2028; and (3) tightens elsewhere by 0.3% of GDP annually. Refer to Appendix for additional forecast, outlook and risk information.

# But don’t confuse Germany with Europe: other euro area countries have limited space and will likely tighten…



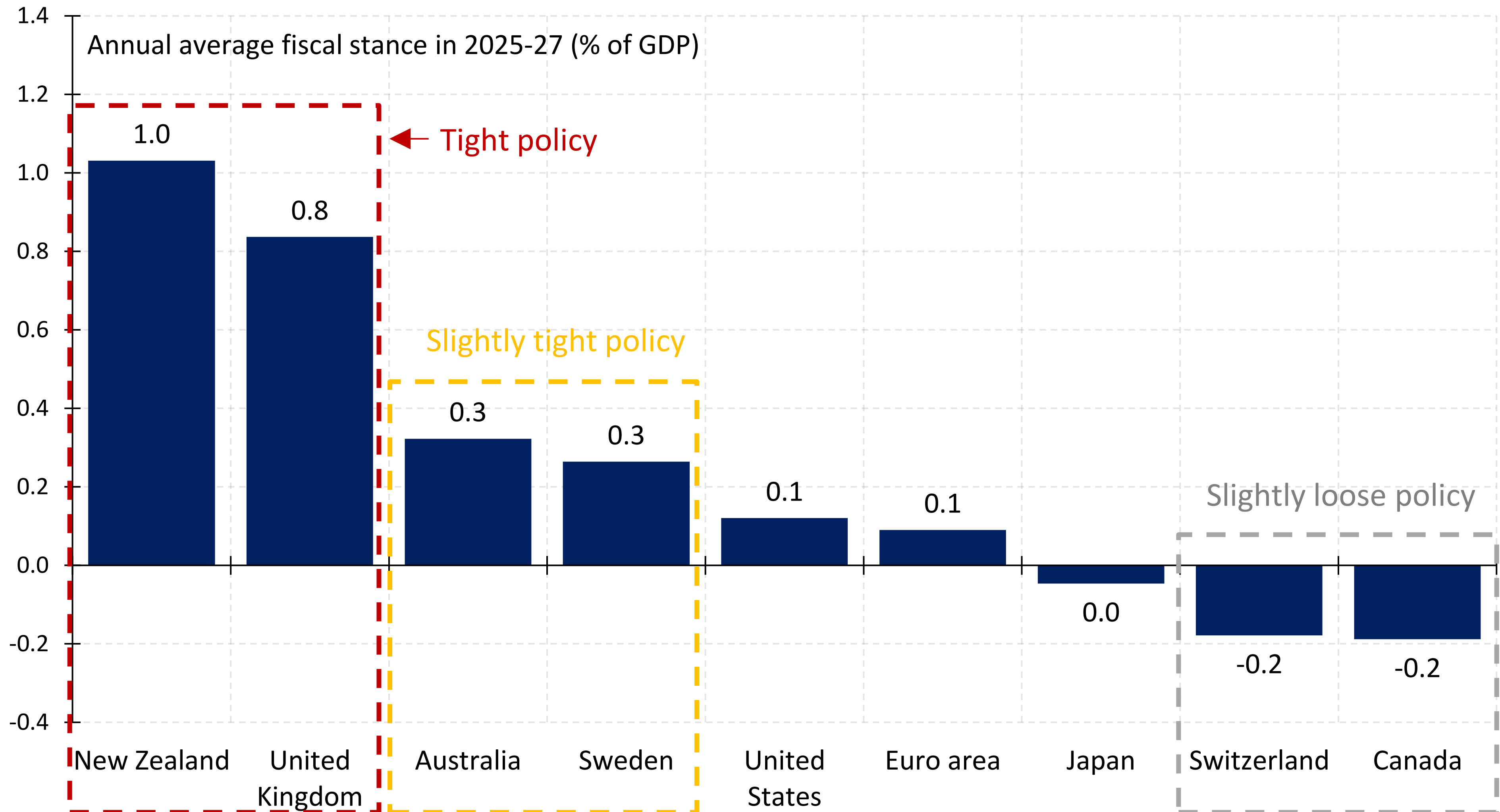

*Source:* IMF WEO as of April 2025, OBR (UK), PIMCO projections. *Note*: The structural fiscal deficit excludes automatic stabilizers. Refer to Appendix for additional forecast, outlook and risk information.

# …leaving the euro area's fiscal stance broadly neutral, in part as EU pandemic grants expire




*Source:* IMF WEO as of April 2025, PIMCO projections. Refer to Appendix for additional forecast, outlook and risk information.

# Overall, fiscal policy looks to be broadly neutral in most major regions, except the UK (tight) and Canada (loose)

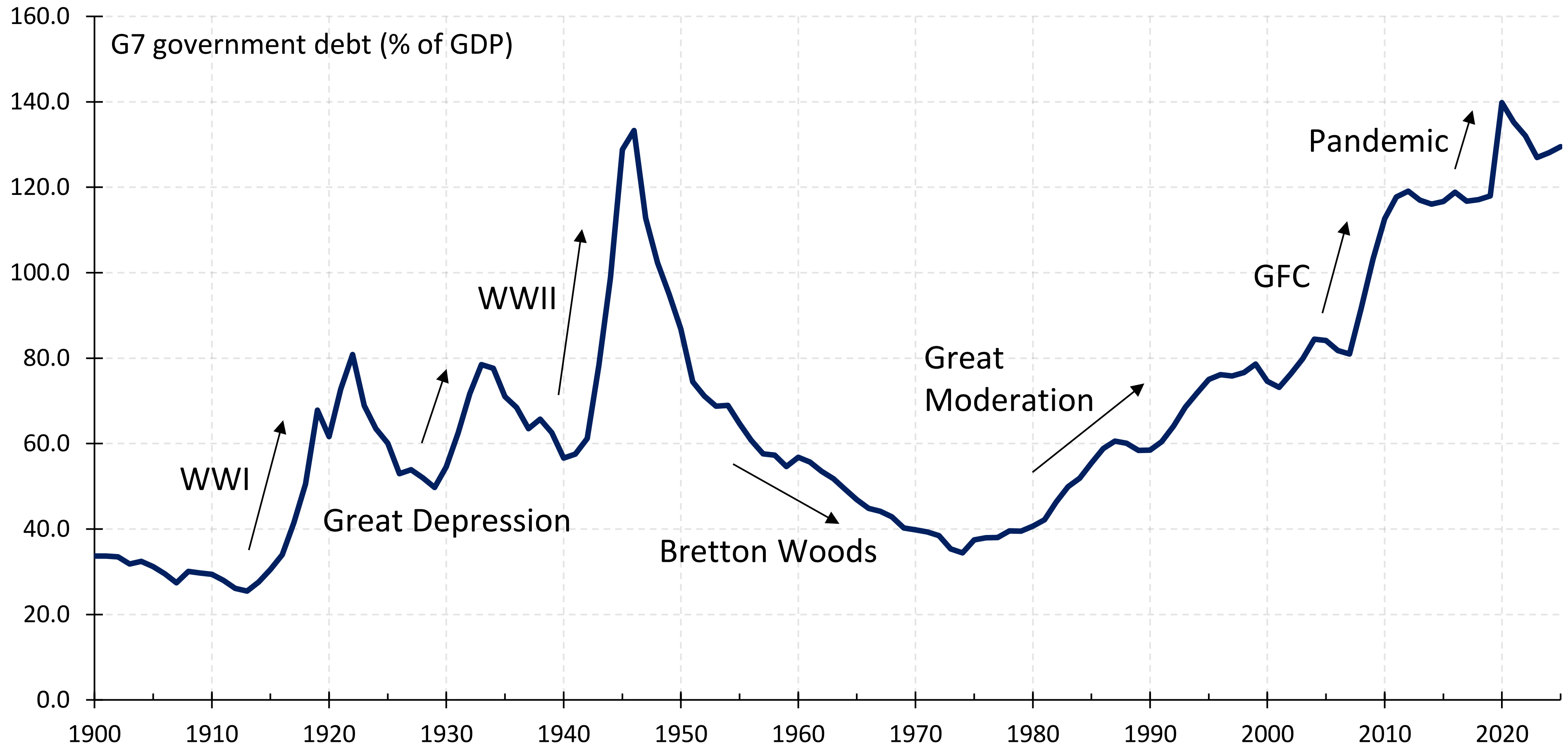



*Source*: IMF WEO as of April 2025, CBO as of March 2025, PIMCO forecasts. Refer to Appendix for additional forecast, outlook and risk information. *Note*: Countries are the nine largest DM currency blocs. The fiscal stance is calculated as the annual average change in the structural primary balance in 2025-27. IMF WEO projections for NZ, AU, UK, SE, JP, SW, and CAD (adjusted for Liberal Party election manifesto). PIMCO forecasts for EMU. CBO forecast for the US, adjusted for the extension of the 2017 Trump tax cuts.

# Is government debt sustainable?

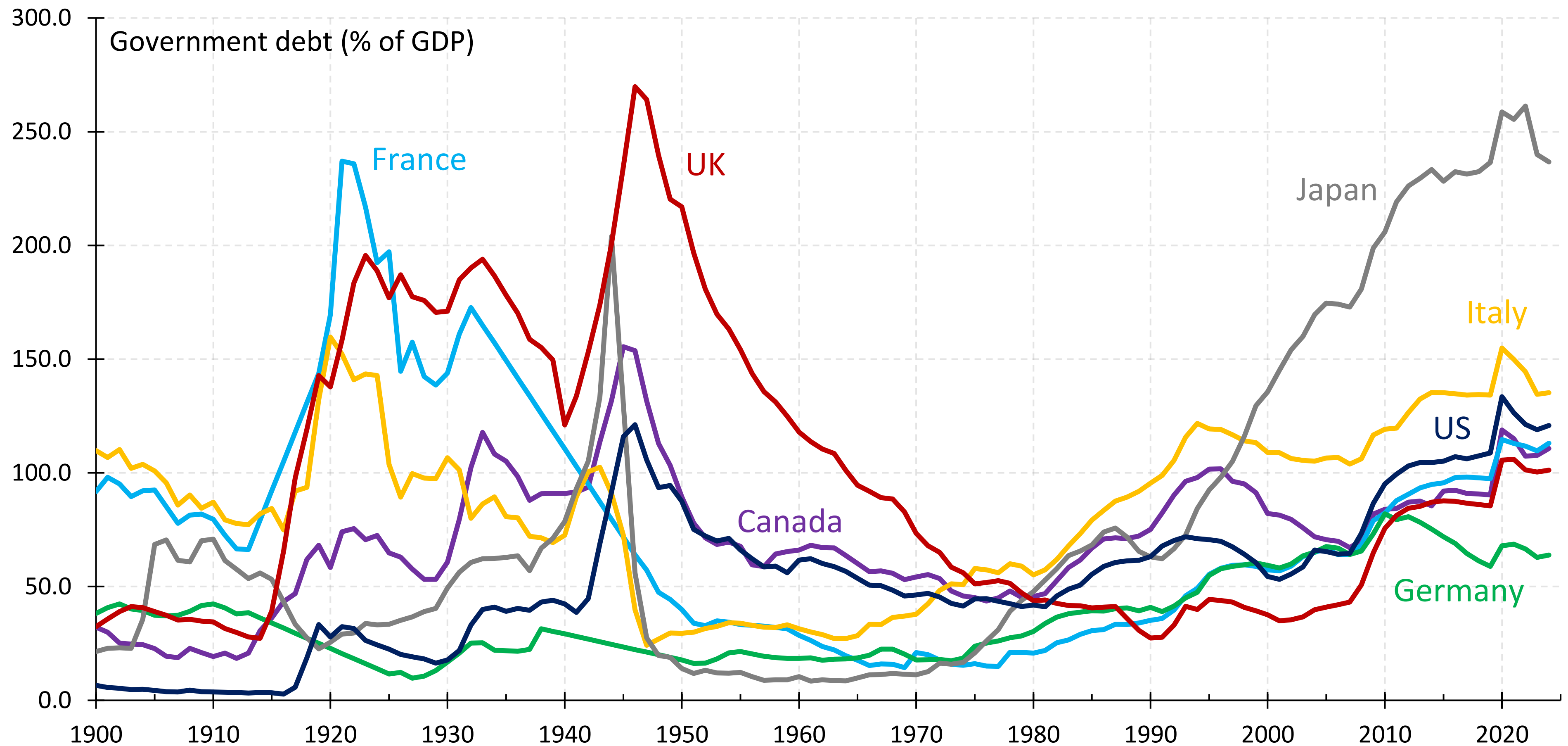
As of June 2025

# Public debt levels are close to record highs…



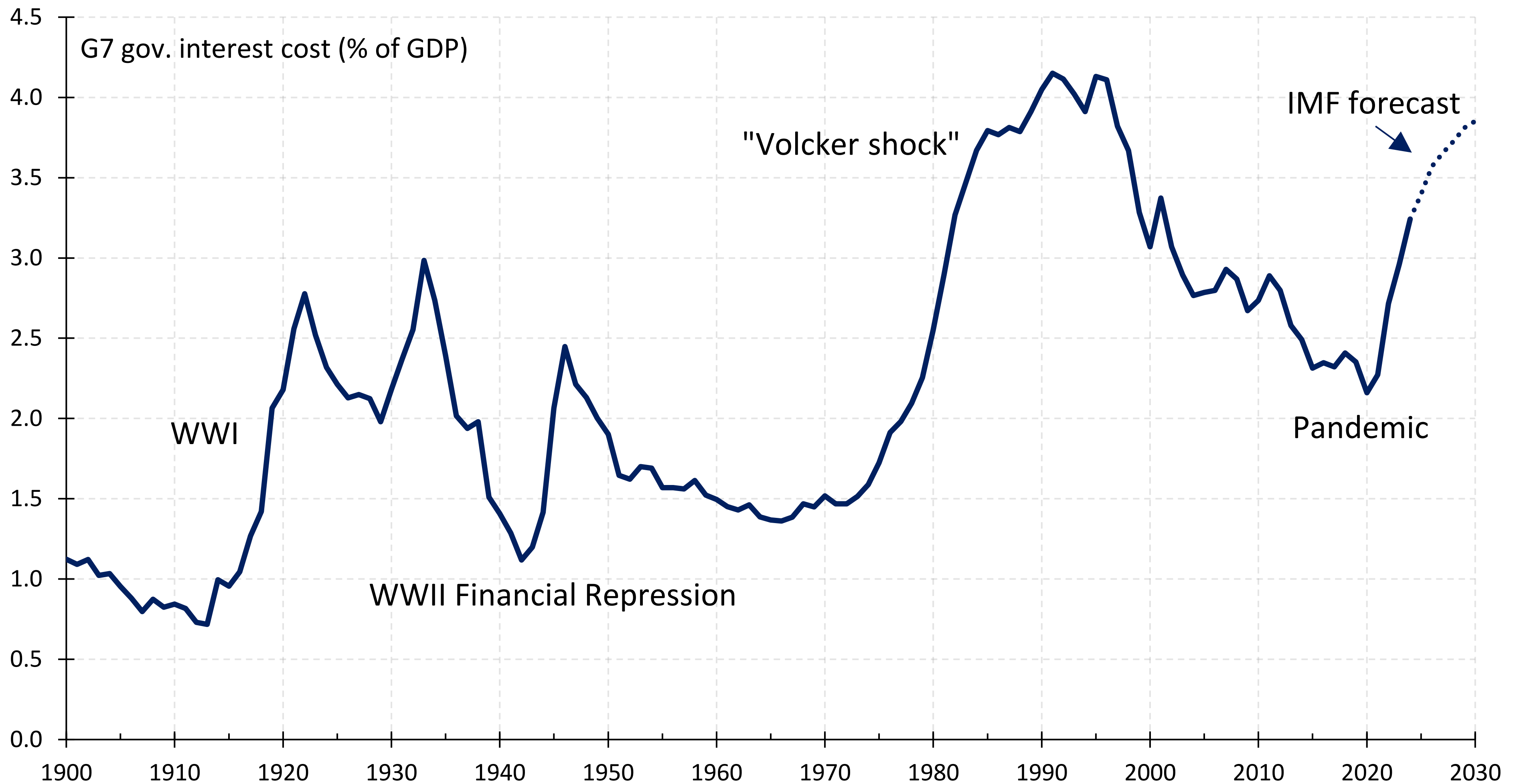

*Source*: IMF Public Finances in Modern History, JST macro-history database (GDP weights), IMF WEO as of April 2025, PIMCO calculations as of June 2025. *Note*: Chart plots debt-to-GDP across G7 countries, GDP-weighted. Last data point is 2025.

# ...but still way below the peak seen in many European countries last century



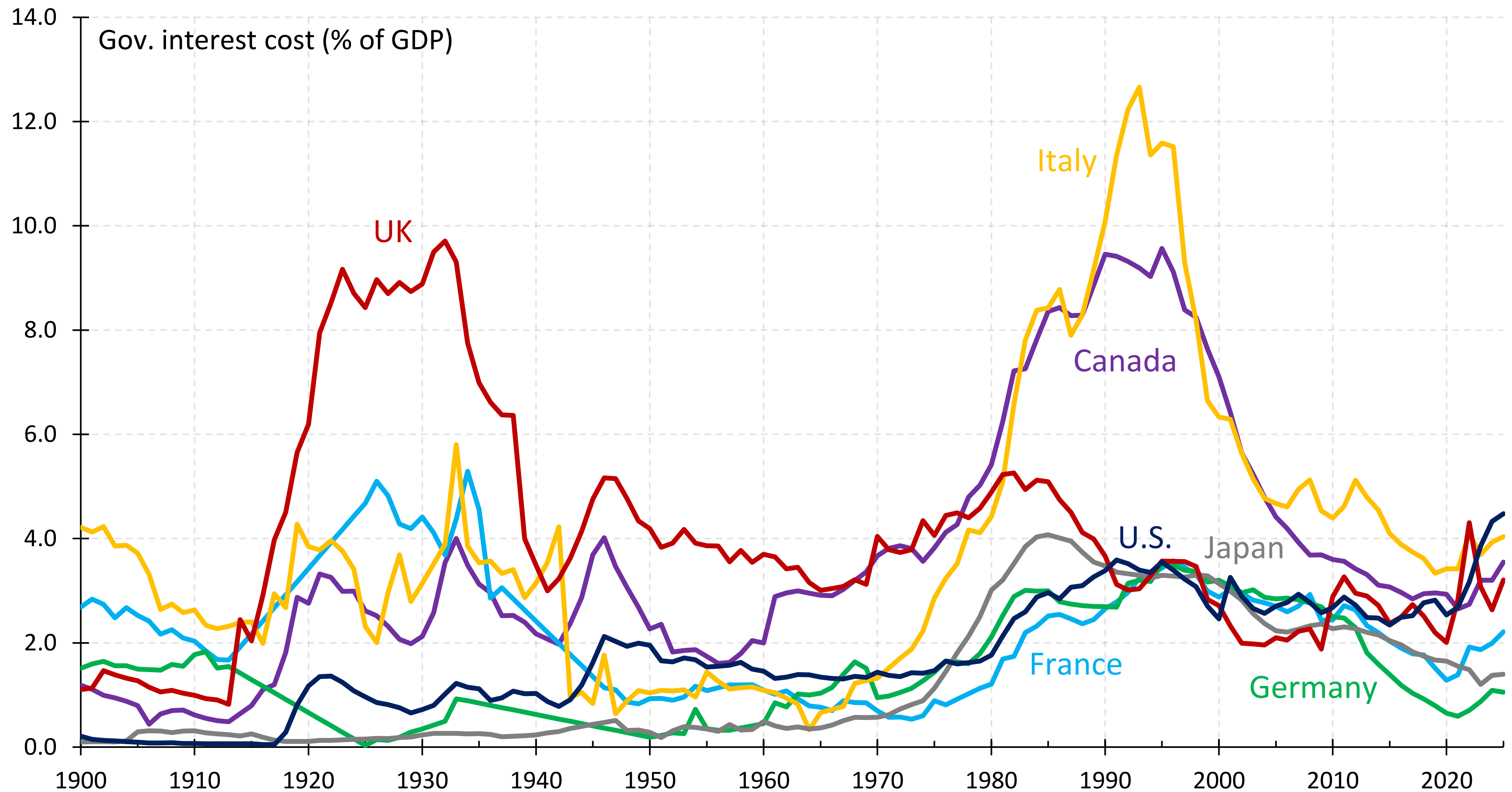

*Source*: IMF Public Finances in Moderns History, IMF WEO as of April 2025, PIMCO calculations as of June 2025. *Note*: Chart plots debt-to-GDP across G7 countries, Last data point is 2025.

# Interest costs are rising but remain lower than in the 80s and 90s, for now



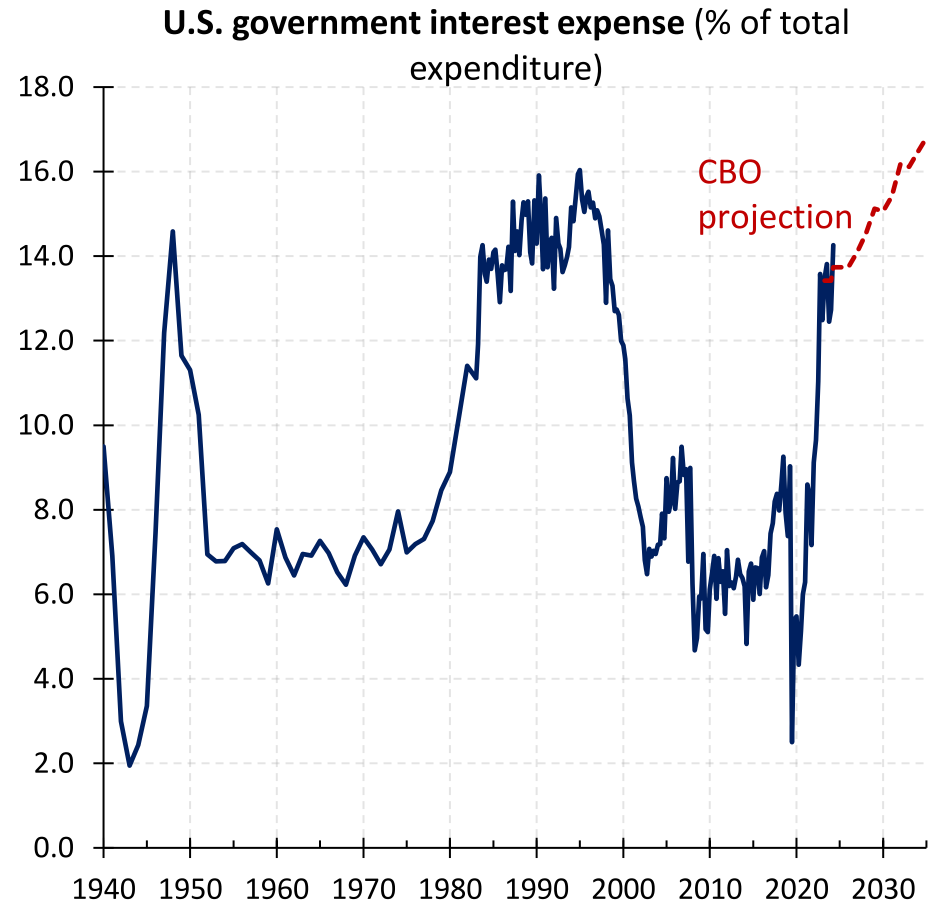

*Source*: IMF Public Finances in Modern History, JST macro-history database, IMF WEO (for 2024-30) as of April 2025, PIMCO calculations. *Note*: Chart plots government interest cost (% of GDP) across G7 countries, GDP-weighted. Last data point is 2024; dotted line show forecast based on IMF projections.

# And some countries have dealt with a *much* higher interest burden in the past




*Source*: IMF Public Finances in Modern History, IMF WEO (for 2024-25) as of April 2025, PIMCO calculations. *Note*: Chart plots government interest cost (% of GDP) across G7 countries. Last data point is 2025.

# But in the US, the interest burden is rising sharply and is now close to a record high




*Source*: US Treasury, CBO as of March 2025, PIMCO calculations as of June 2025. *Note*: Actual data (quarterly) up until 1Q25. Annual projections thereafter. Refer to Appendix for additional forecast, outlook and risk information.

# Debt sustainability depends in large part on the interest-growth differential ("R-G")

*Debt-to-GDP*

*Avg. nom. interest rate on debt*

$$\Delta D_t = D_t - D_{t-1} \approx (r - g)D_{t-1} - S_t$$

*Nom. GDP growth*

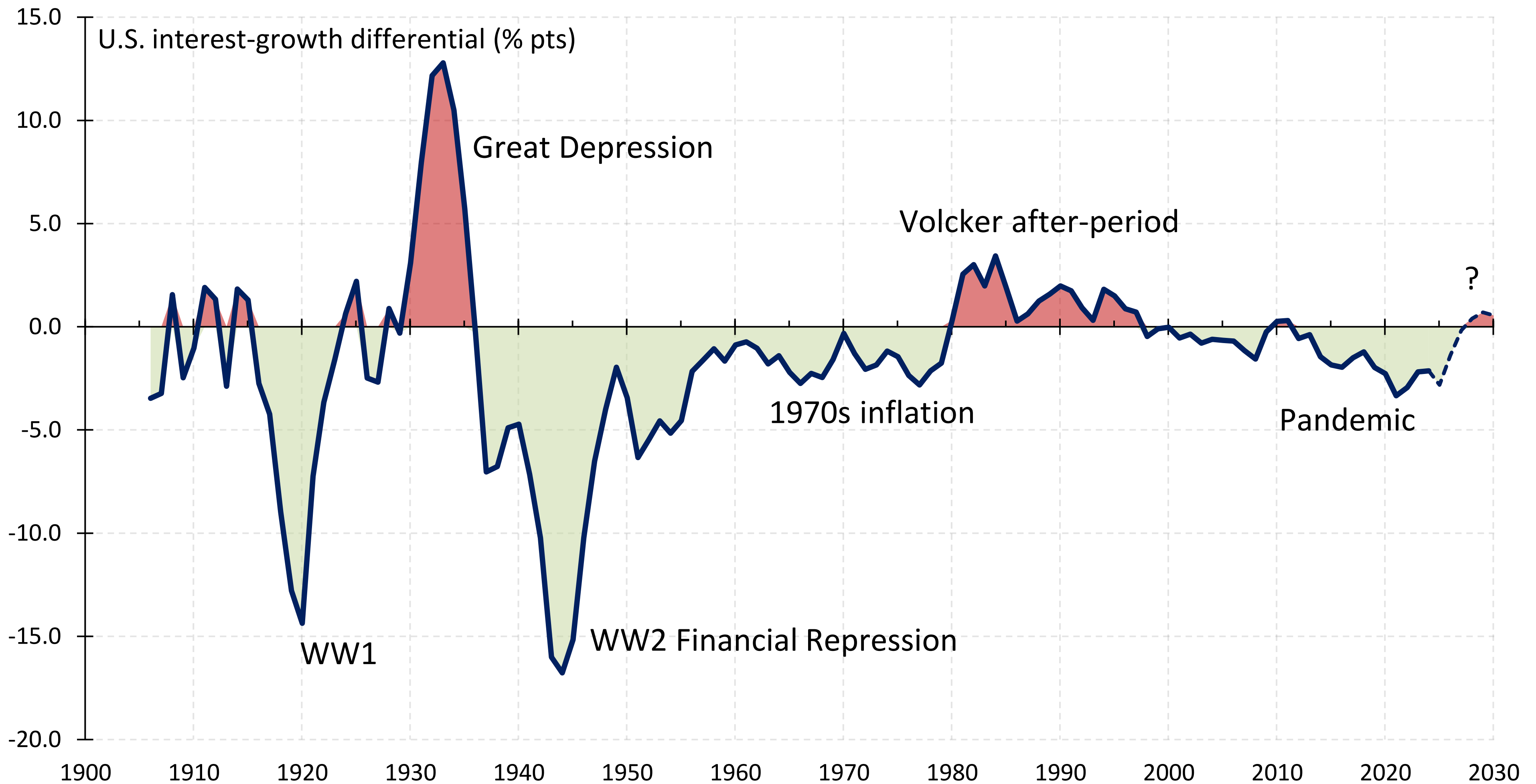
*Primary surplus-to-GDP*

*Steady state*

$$D \approx S/(r - g)$$

*Source:* PIMCO as of June 2025. For illustrative purposes only.

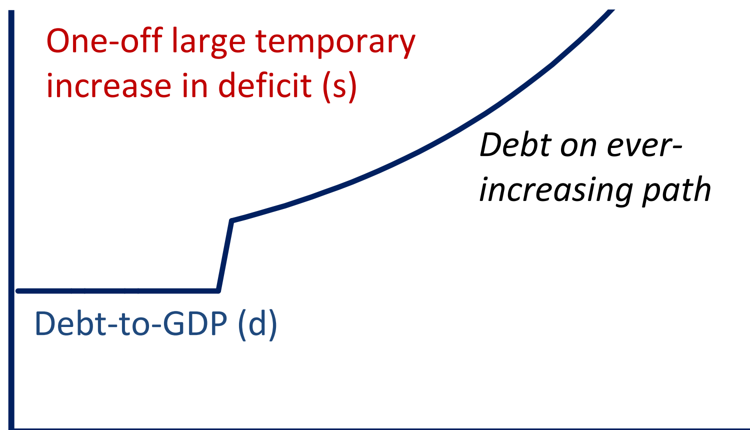
# And interest rates ("R") may soon exceed GDP growth ("G") in the US, for the first time since the '90s

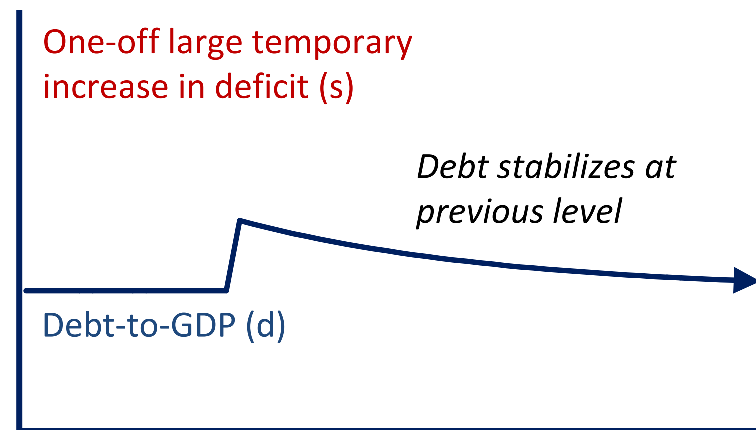


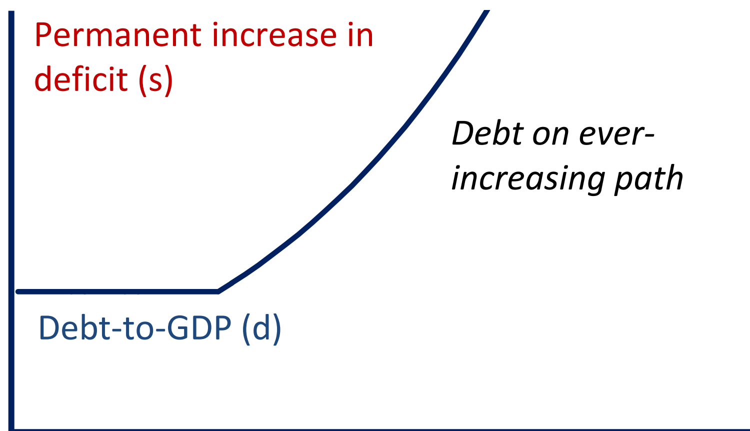

*Source*: BEA, Historical Statistics of the US, OECD as of April 2025, PIMCO calculations. *Note*: The line plots the difference between US 10y yield (%) and GDP growth (%, 5yma). The dotted line shows a projection in which 10y yield stays at the current level (4.3%) and GDP growth returns to trend (3.75% = 1.75% real + 2% inflation). Refer to Appendix for additional forecast, outlook and risk information.

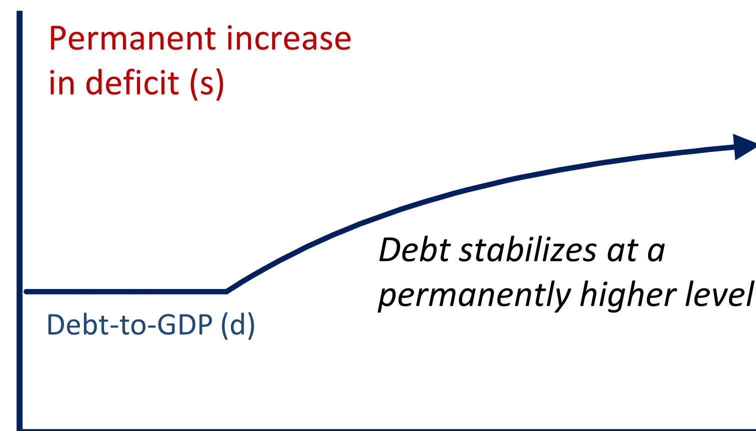
# In such a world ("R>G"), the cost of running deficits is much higher

| **R > G** (unstable debt dynamics) | **R < G** (stable debt dynamics) |
|---|---|



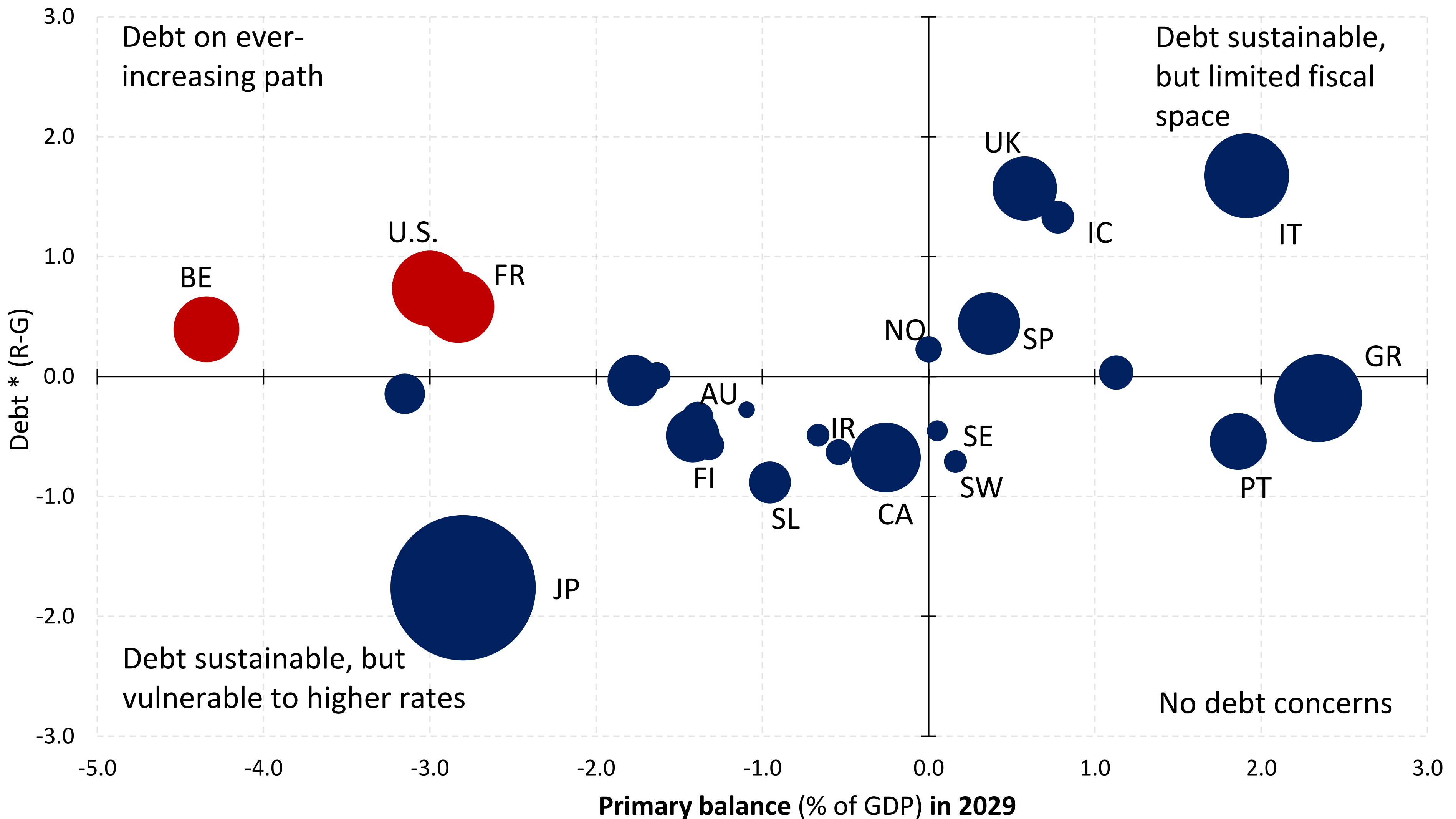



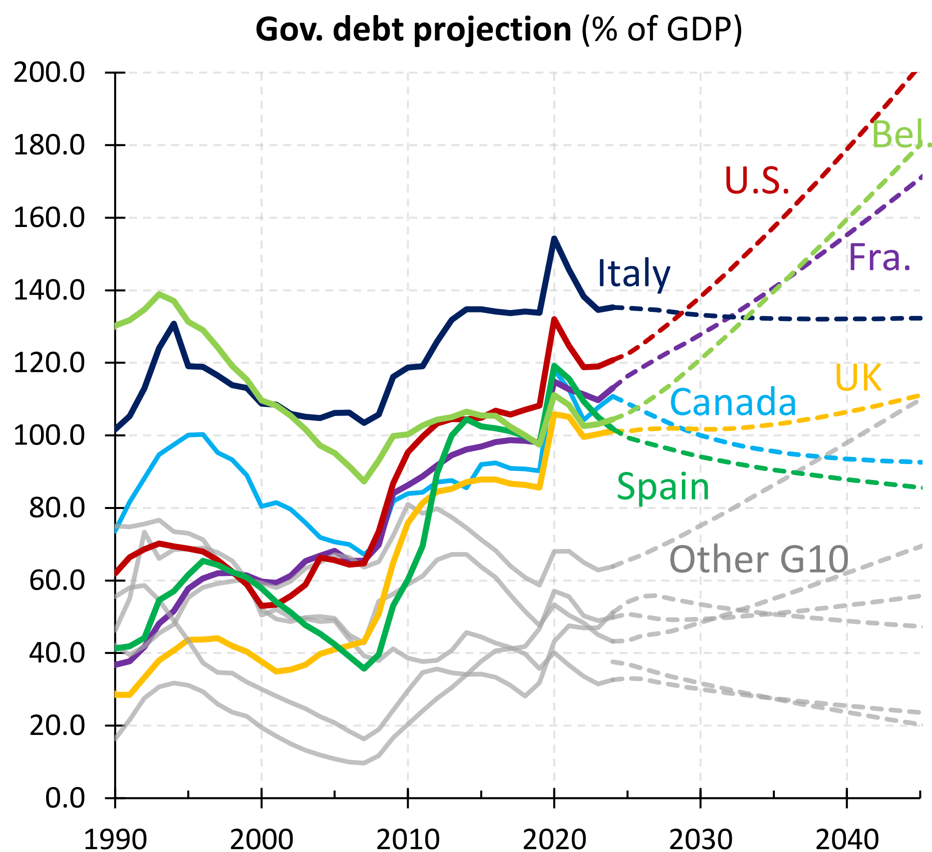

*Source:* PIMCO as of May 2025. For illustrative purposes only, *holding* everything else equal. Hypothetical scenario in top panel involves a one-off temporary increase in the deficit, which is not paid for by raising future primary surpluses.

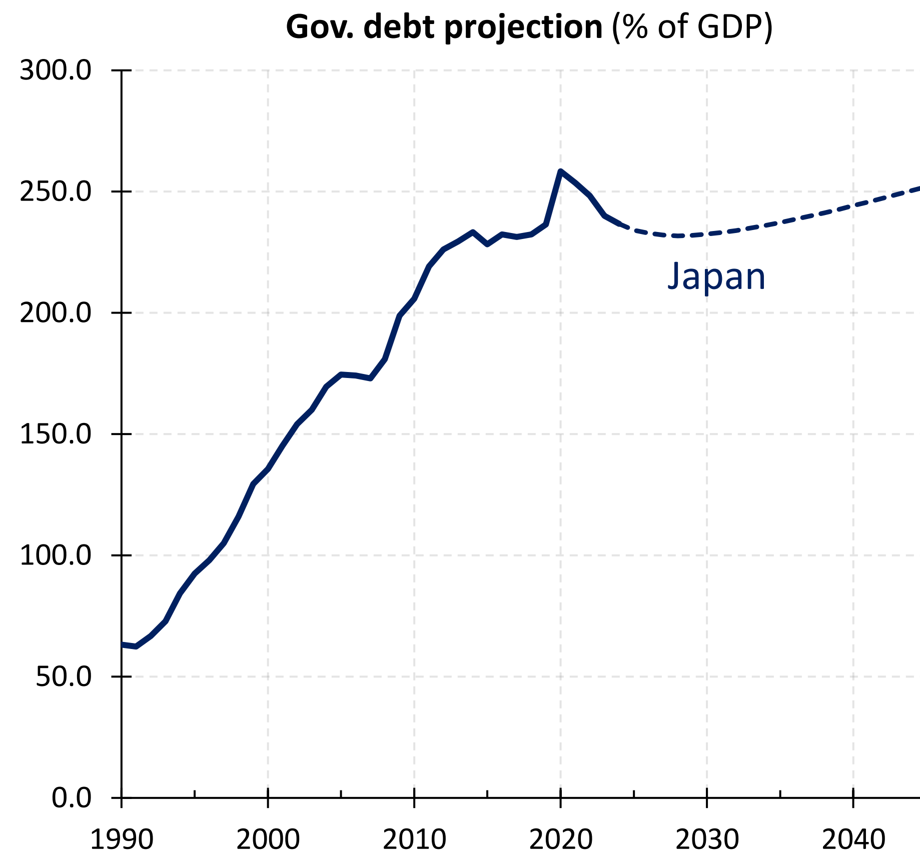
# Most government either borrow at low rates or (plan to) run primary surpluses. Not the US, France, and Belgium.




*Source*: PIMCO calculations, BBG, IMF WEO as of April 2025. Debt size corresponds to debt-to-GDP. X-axis is primary balance projection in 2029 by IMF WEO (PIMCO forecast for the US). Y-axis is debt times the difference between 10y interest rate (as of May 6) and trend nominal GDP growth (real potential GDP growth plus inflation at target).

# Taken together: Debt is sustainable in most countries, but explosive in the US, France, and Belgium




*Source*: PIMCO calculations, BBG, IMF WEO as of May 2025. *Note*: The charts show a simple debt-to-GDP projection across G10 countries (+ Australia, New Zealand, Spain, Belgium). The projection assumes that the primary balance evolves as in IMF projection (up until 2029, after which it stays static), inflation is at target, real GDP growth at trend, and interest rates evolve along the forwards priced into financial markets (on May 6), assuming WAM of 7y across countries for simplicity. We adjust the IMF's forecast for the US to include the 2017 Trump tax cut extension. Refer to Appendix for additional forecast, outlook and risk information.

# Taken together: Debt is sustainable in most countries, but explosive in the US, France, and Belgium

| Low debt (<90%) | | High debt (100<130%) | | | Very high debt (>130%) | | |
|---|---|---|---|---|---|---|---|
| - | - | *Decreasing* | *Vulnerable* | *Explosive* | *Decreasing* | *Vulnerable* | *Explosive* |
| Australia | Netherl. | Canada | **UK** | **US** | Greece | **Japan** | - |
| Austria | N. Zeal. | Spain | | **France** | | **Italy** | |
| Denmark | Norway | | | **Belgi.** | | | |
| Finland | Portugal | | | | | | |
| Germany | Slovakia | | | | | | |
| Iceland | Slovenia | | | | | | |
| Ireland | Sweden | | | | | | |
| Latvia | Switzerl. | | | | | | |
| Lithuania | | | | | | | |

*Note*: PIMCO as of May 2025. For illustrative purposes only. The list includes all developed countries.

# Secular outlook for US debt: Five scenarios

As of June 2025

# Summary: Five scenarios for US debt over next five years

Debt higher

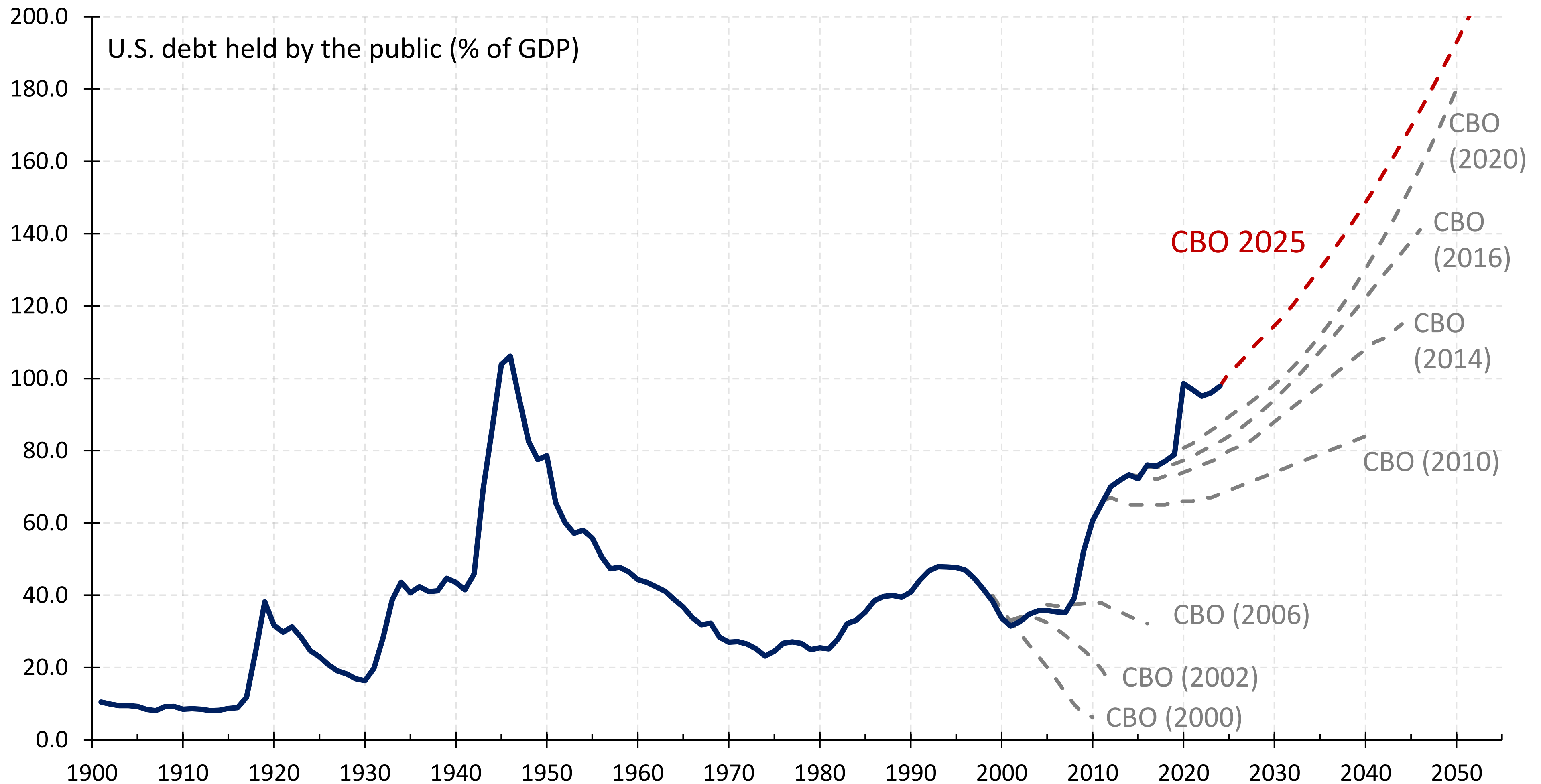
- **Scenario 1**: "*Status Quo*". Debt trends higher with no/modest (and orderly) rise in the term premium. Fiscal credibility is intact. *Example*: *US post-GFC*. ***Very likely***
- **Scenario 2**: "*Crisis*". Debt trends higher with a sharp disorderly rise in the term premium. No fiscal credibility. *Example: UK under Truss*. ***Unlikely, though a bit higher under Trump***

Debt stable/ falls

- **Scenario 3**: "*Fiscal consolidation*". Debt stabilizes because of fiscal tightening. *Example*: *US mid-90s*. ***Unlikely near term; likely further out***
- **Scenario 4**: "*Financial repression*". Debt stabilizes because of high inflation + low interest rates. No monetary policy credibility. *Example: Post-WW2*. ***Unlikely***
- **Scenario 5**: "*Growth revival*". Debt stabilizes because of rising real GDP growth. *Example*: *Australia 1930s*. ***Unlikely***

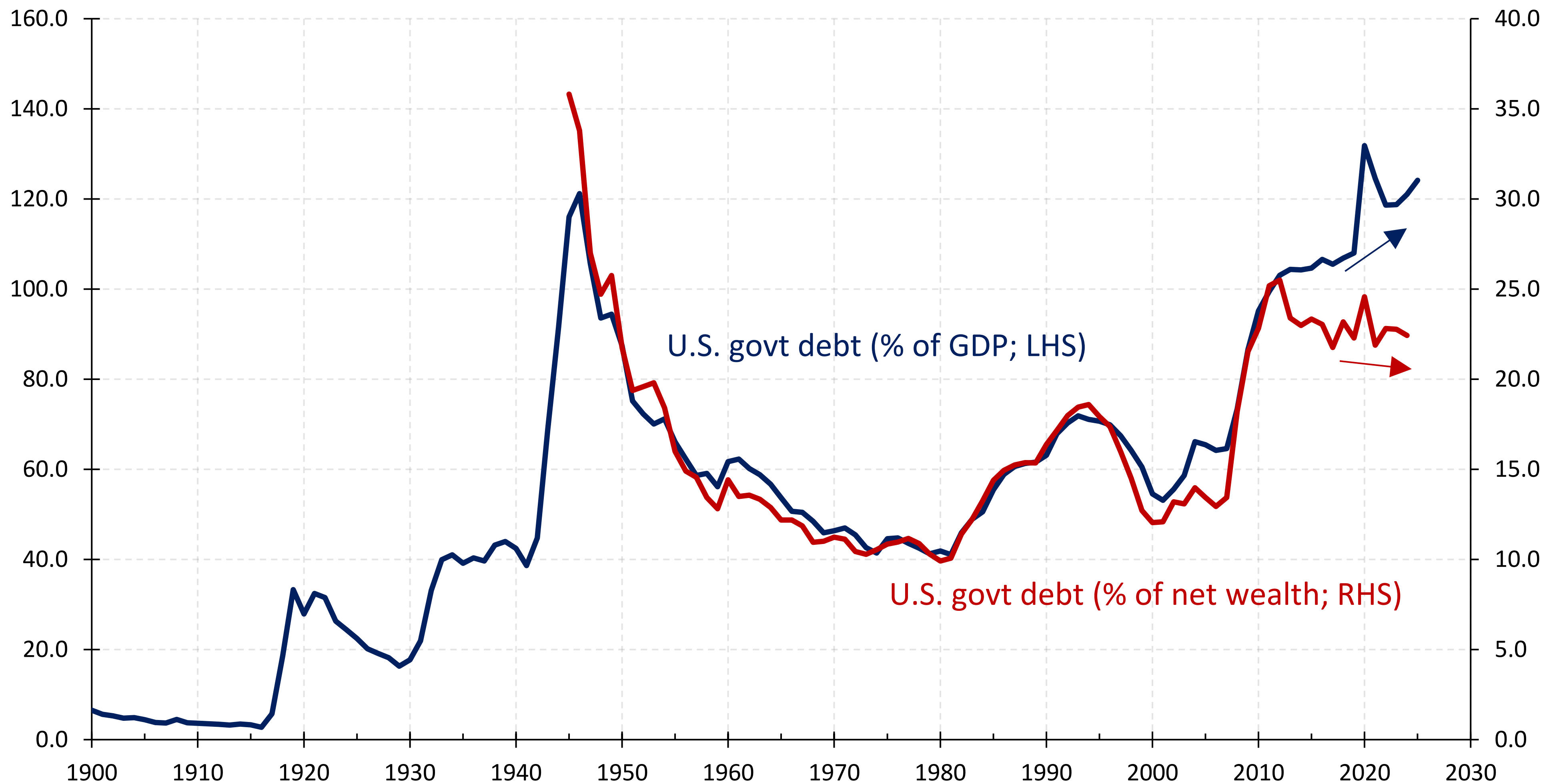
*Source*: PIMCO as of June 2025. Refer to Appendix for additional forecast, outlook and risk information.

# The US debt has been "explosive" for over a decade, and the market has been largely undisturbed



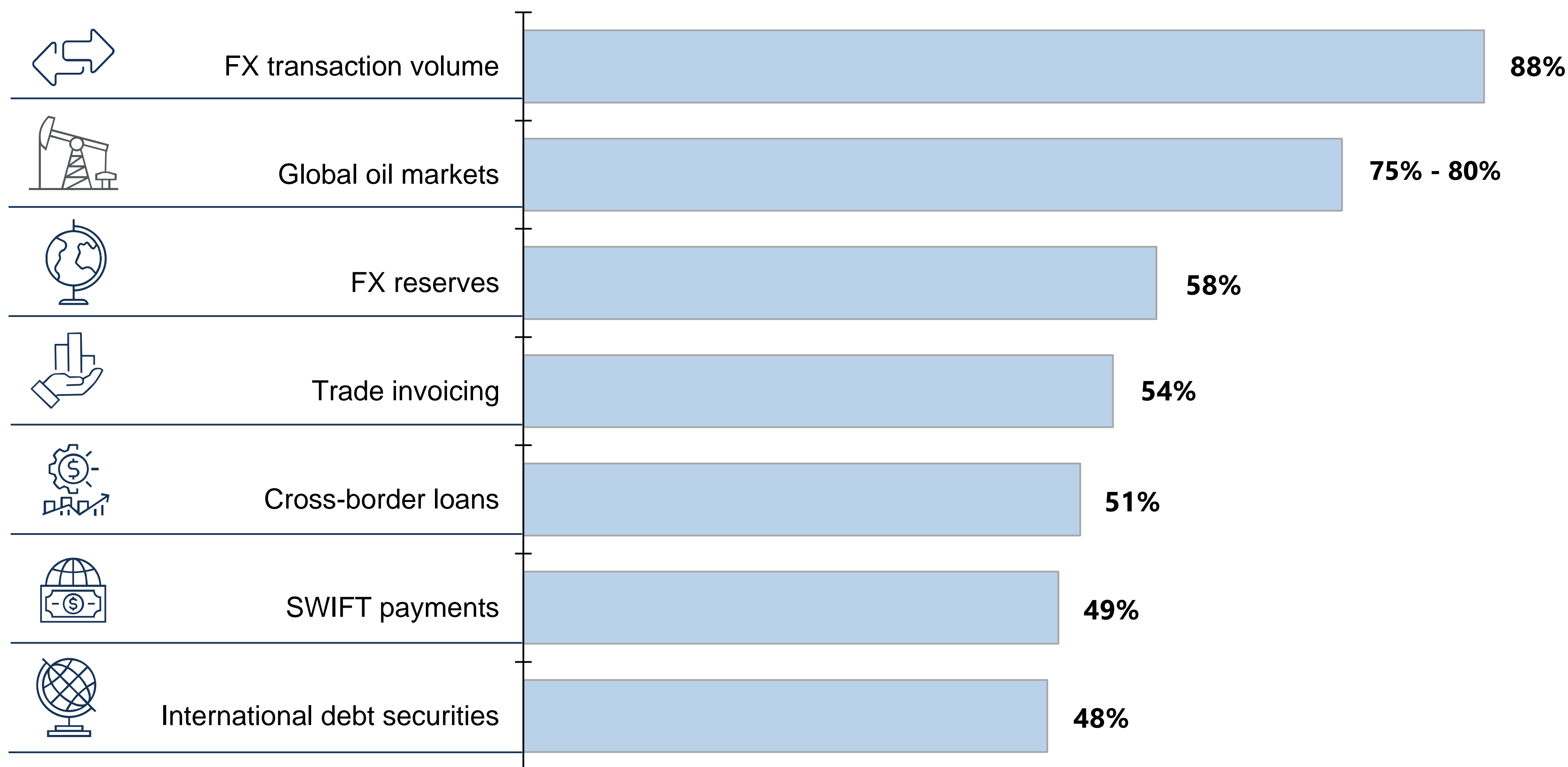

*Source*. CBO Long-Term Budget Outlook as of March 2025 adjusted for the extension of the 2017 Trump tax cuts, PIMCO calculations as of June 2025. Refer to Appendix for additional forecast, outlook and risk information. *Note*: Chart plots CBO projections of US debt at different times. US debt held by the public is smaller than total government debt.

# Plus: While US debt is rising relative to GDP, the picture is far less alarming relative to national wealth



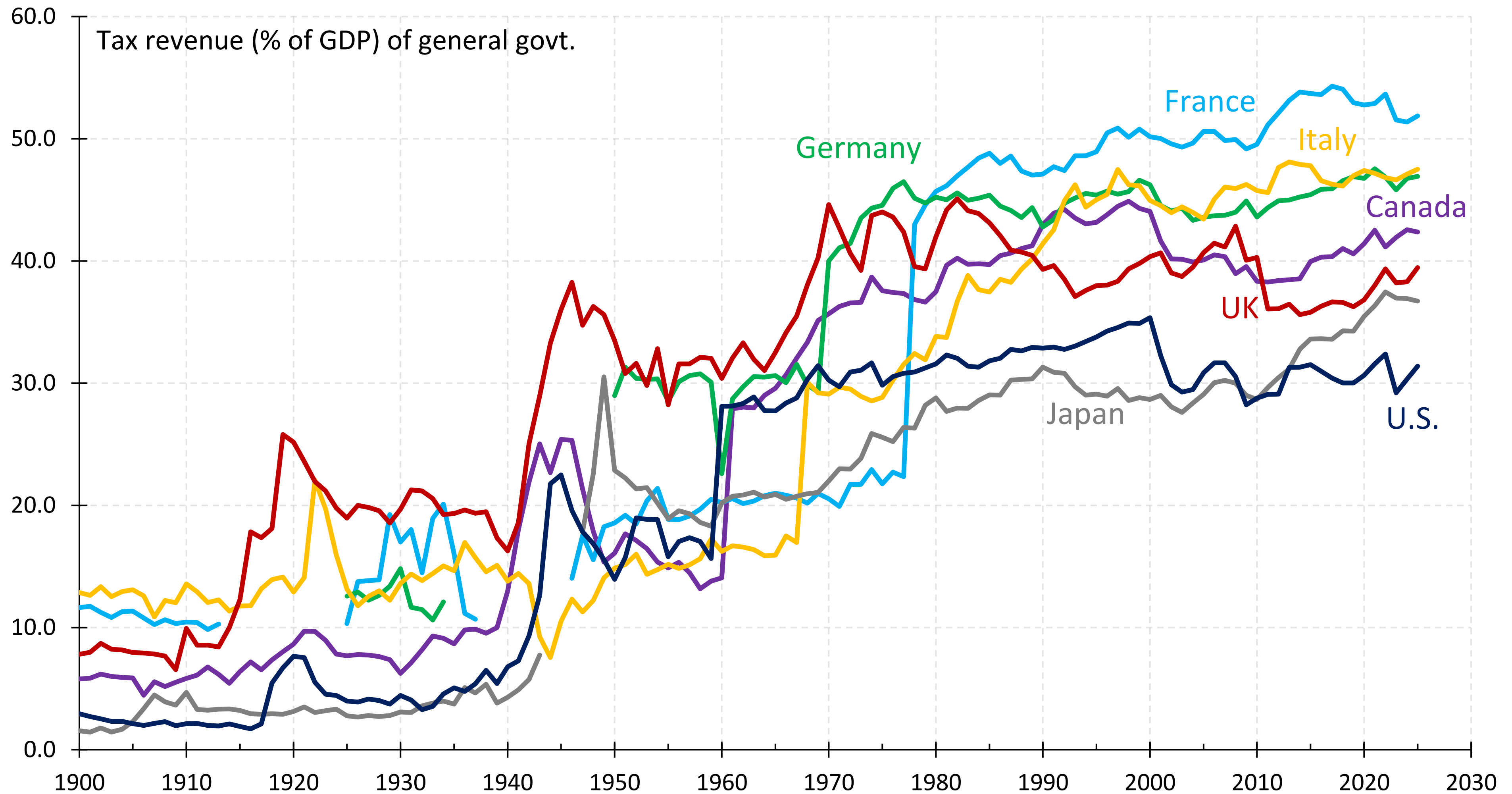

*Source*: IMF Public Finances in Modern History, IMF WEO, Federal Reserve as of April 2025, PIMCO calculations. Last data point is 2024. *Note:* US net national wealth is the sum of non-financial assets of households, corporates, the government, plus net financial claims on the RoW.

# Trump raises risks, but the dollar is likely to stick around as the reserve currency for the foreseeable future



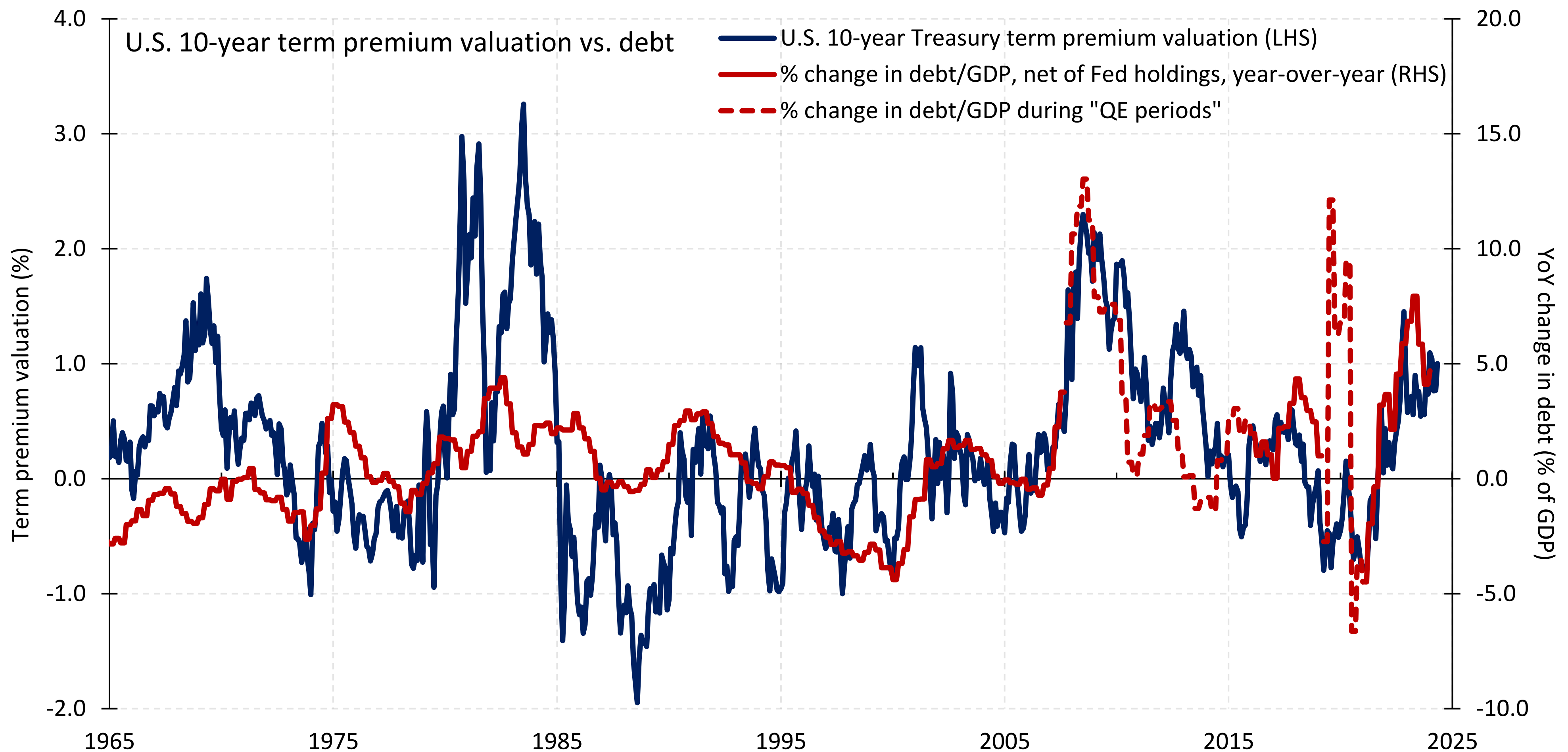

*Source*: In order from top to bottom, the source (and latest data in parentheses) is: BIS Triennial Central Bank Survey (2022); PIMCO estimate (2024); IMF's Currency Composition of Official Foreign Exchange Reserves (3Q24); BIS "Revisiting the international role of the US dollar" (2022); BIS Locational Banking Statistics (4Q24); Swift (Mar 2025); BIS Debt Securities Statistics (4Q24), as of December 2024

# And fiscal credibility is high: Unlike in Europe, the US tax burden is far from facing "upper bound" constraints



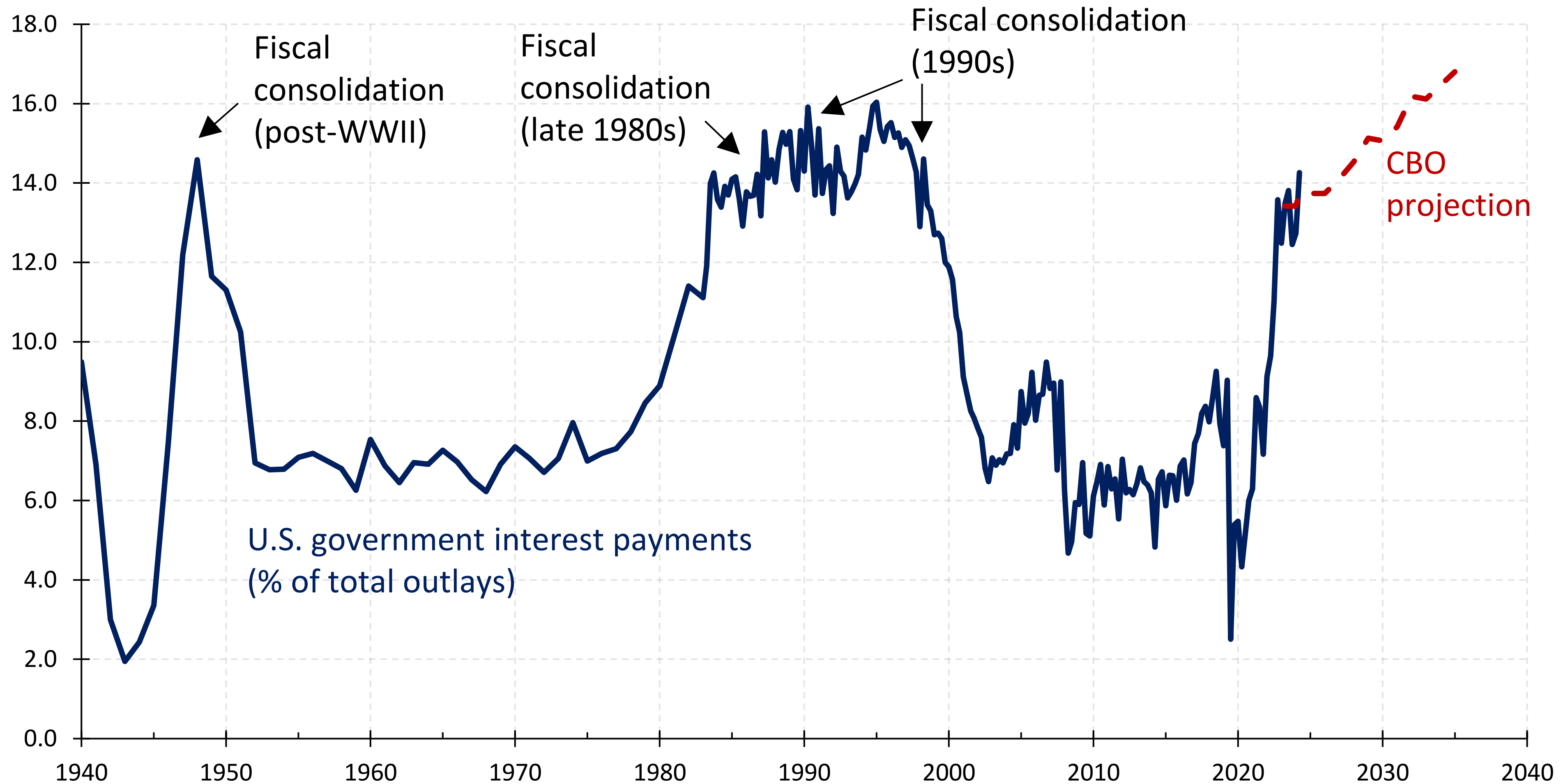

*Source*: IMF Public Finances in Modern History, IMF WEO (for 2024-25) as of April 2025, PIMCO calculations. *Note*: Chart plots government revenue (% of GDP) across G7 countries. Last data point is 2025.

# Nonetheless, deficits tend to be (loosely) associated with the term premium



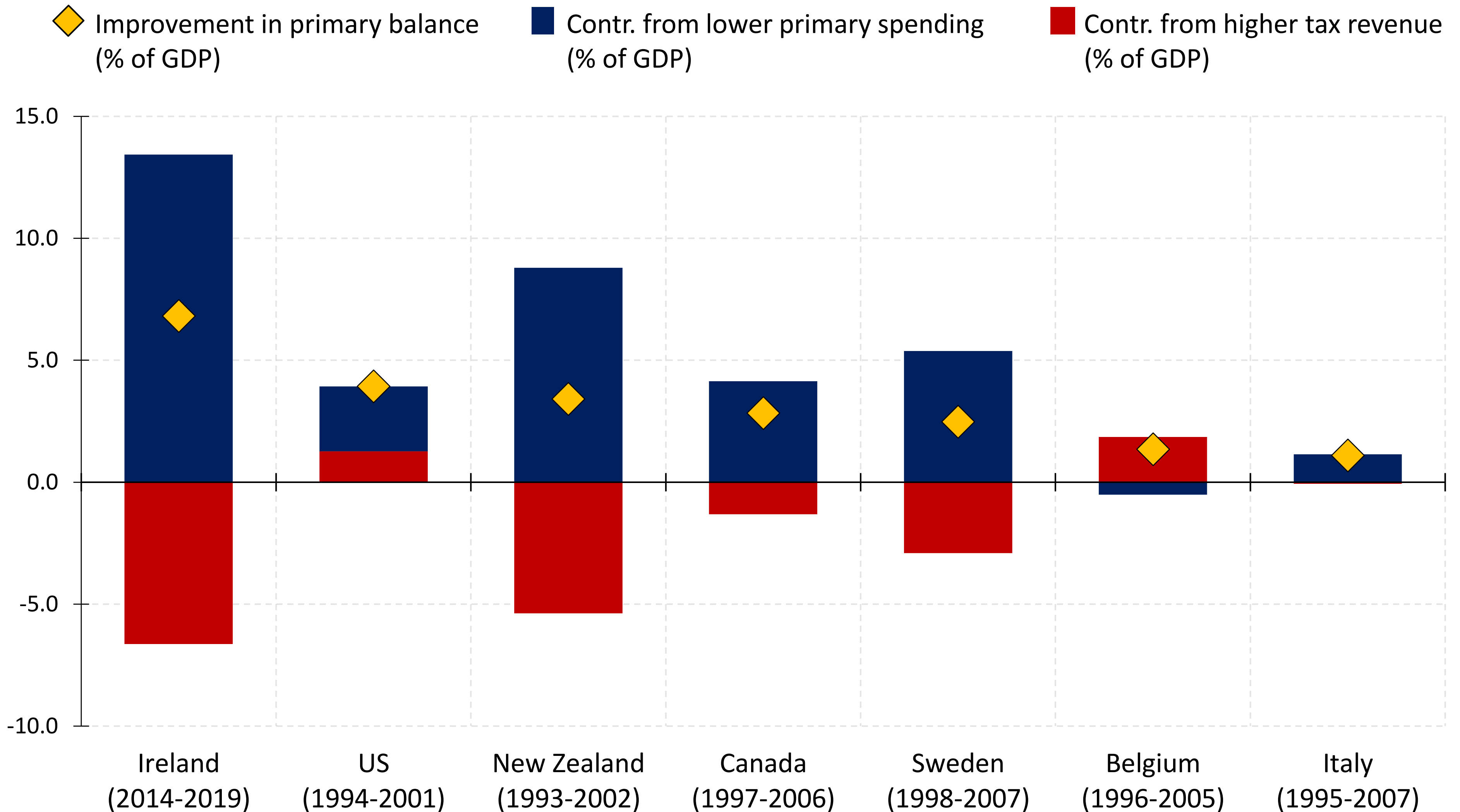

*Source*: PIMCO calculations as of June 2025. *Note*: U.S. 10-year term premium valuation equals the difference between the 10-year U.S. Treasury yield and its fair value. The fair value of the 10-year Treasury equals expected inflation [Bloomberg survey, converging to Fed target] + expected real rate [Taylor rule, converging to 1% r* over time] + fair term premium [Higher with higher bond-equity covariance]. Refer to Appendix for additional forecast, outlook, and risk information.

# Rising interest payments may eventually prompt tighter fiscal policy, as seen before



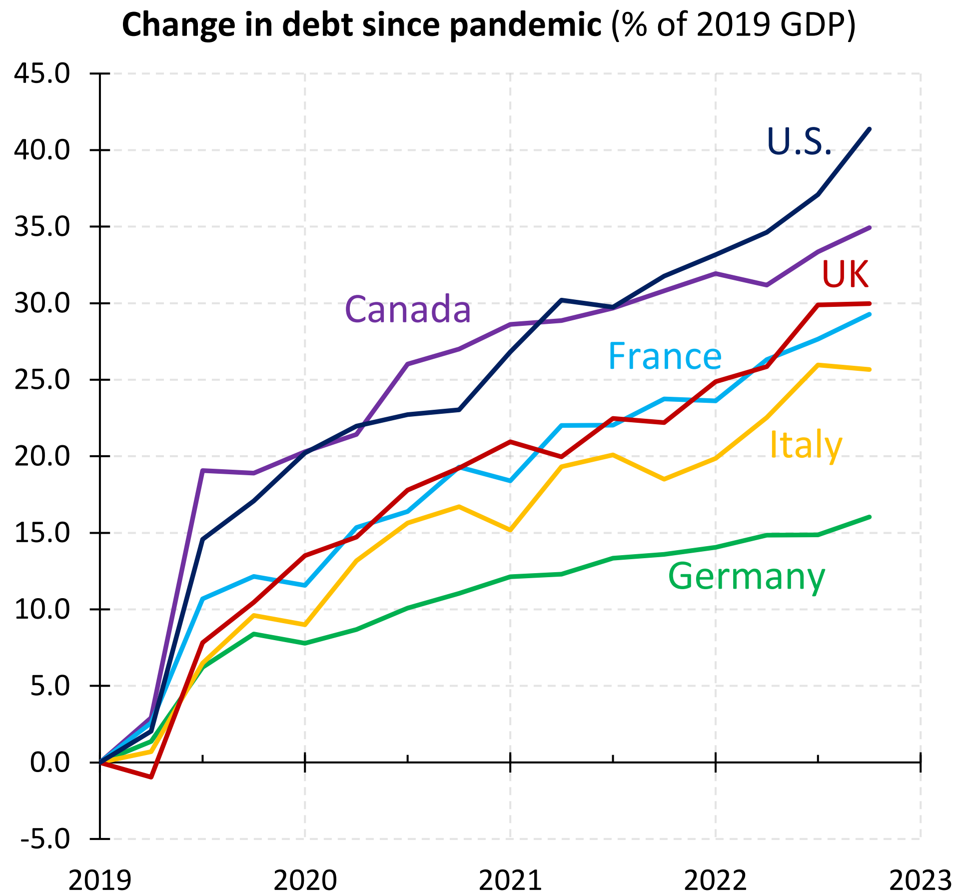

*Source*: US Treasury, CBO as of March 2025, PIMCO calculations as of June 2025. *Note*: Actual data (quarterly) up until 1Q25. Annual projections thereafter. Refer to Appendix for additional forecast, outlook and risk information.

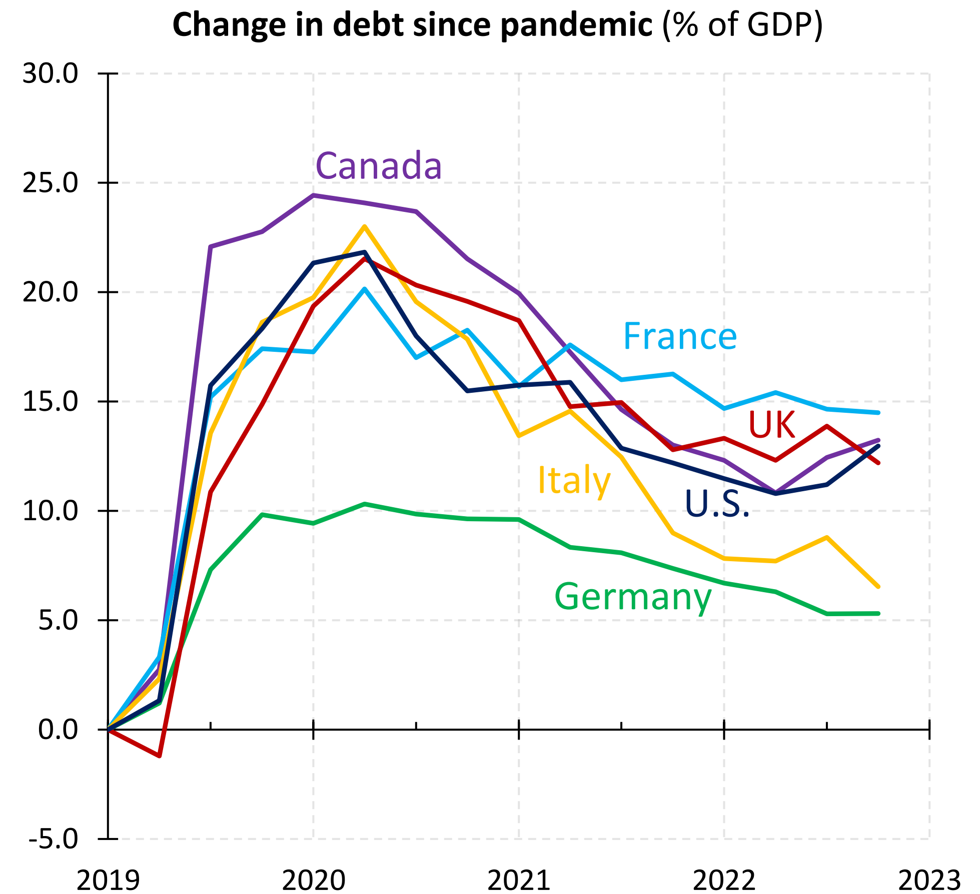
# US austerity in the ‘90s driven by lower spending *and* higher taxes. Other countries have focused on the former.




*Source:* IMF as of April 2025, PIMCO calculations. Chart plots recent episodes of large fiscal consolidations in DM. The change is defined as the average over the specified period relative to the 3y preceding average.

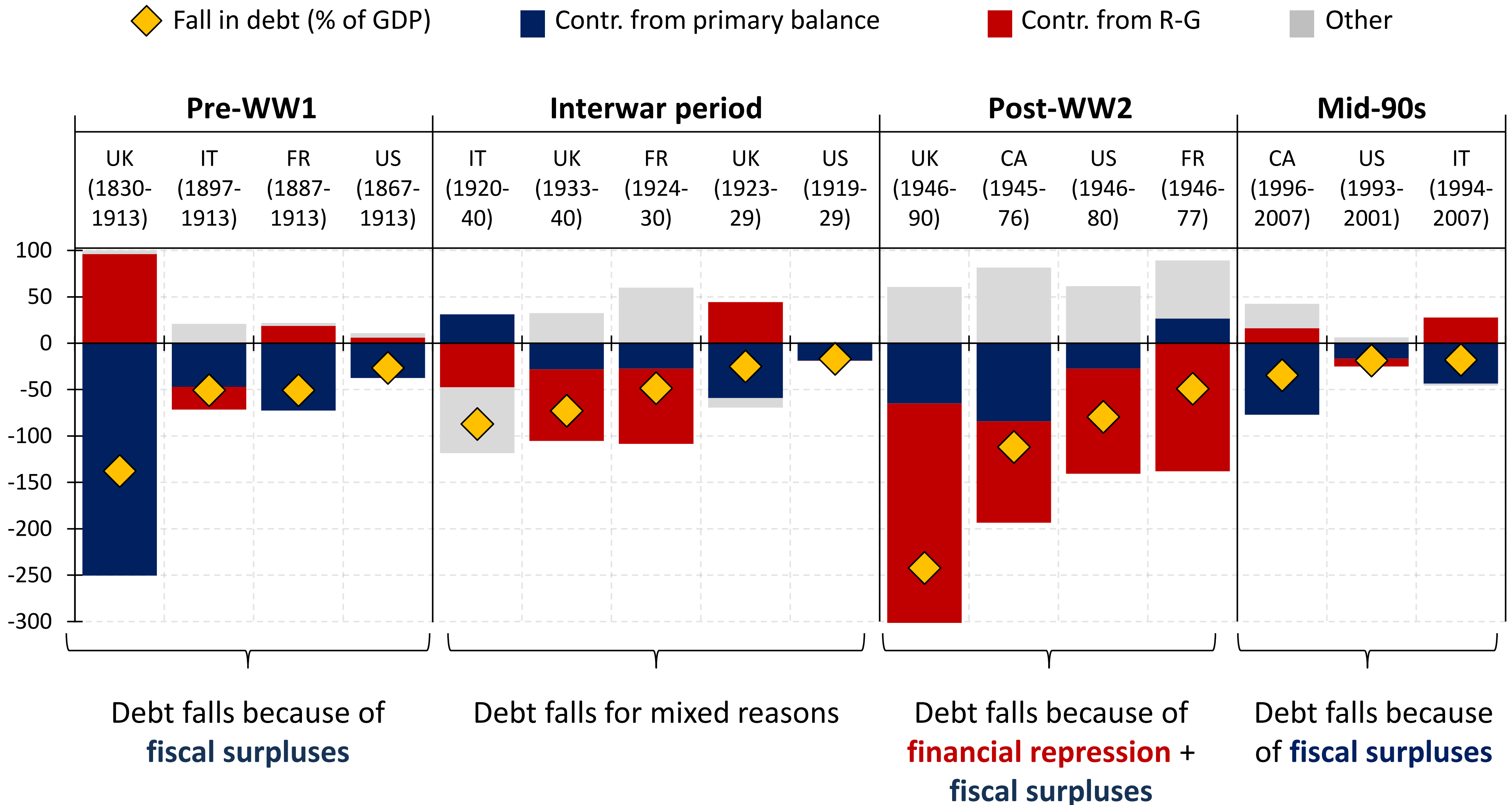
# Surprise inflation can erode debt – think: the pandemic – but anticipated inflation cannot w/o financial repression



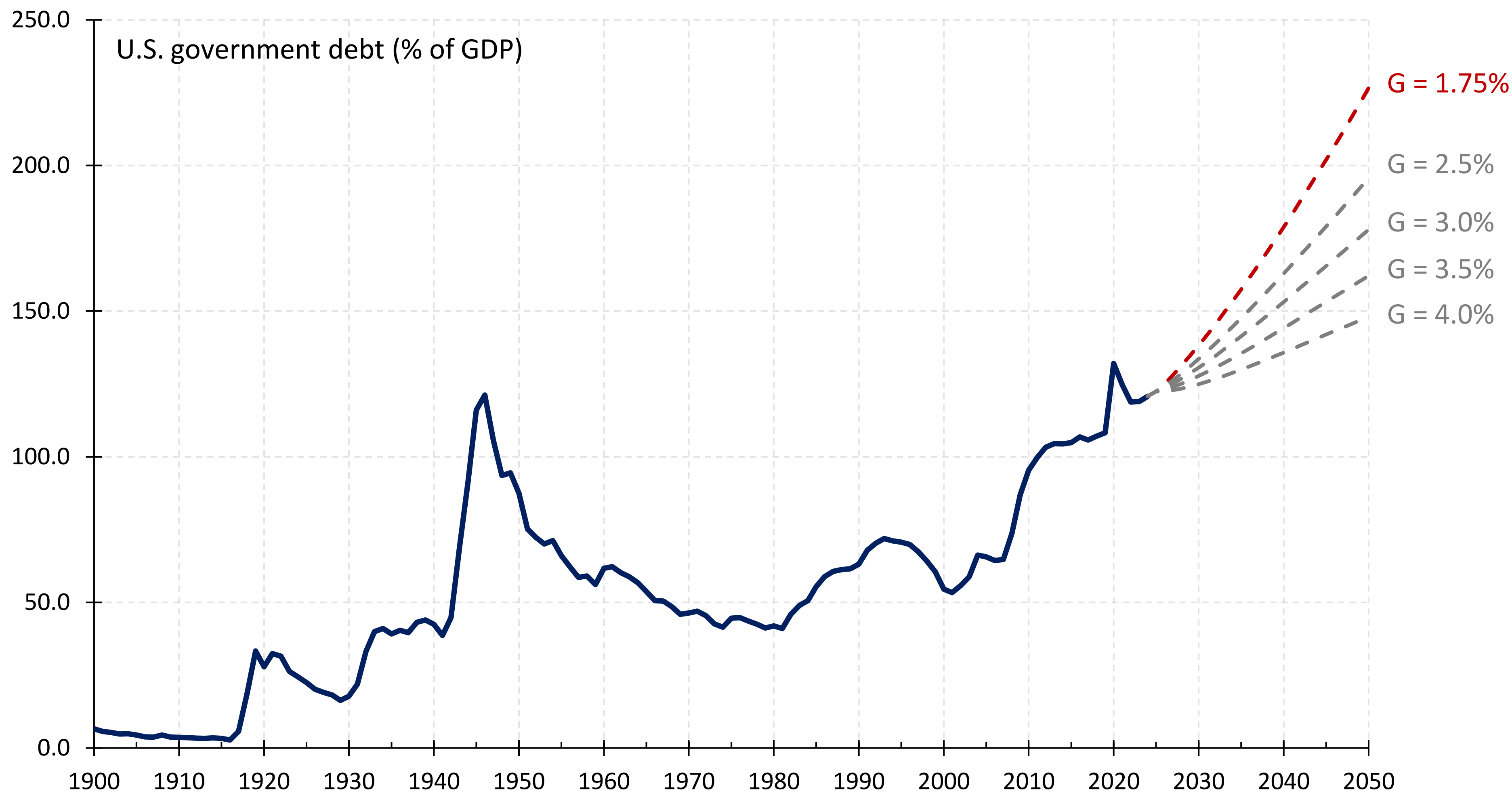

*Source*: OECD, as of April 2024, PIMCO calculations. *Note*: Chart plots change in public debt since 4Q19. Last data point is 3Q23. Debt is defined as securities plus loans.

# Financial repression common in the 1950-80s – but even then, successful debt reductions involved budget cuts




*Source:* PIMCO calculations, IMF Public Finance in Modern History, JST macro-history database as of April 2025. Chart shows contributions to decline in debt-to-GDP across G7 countries, wherever data is available and for all episodes in which debt-GDP has fallen by >15% of GDP in the last 200 years.

# Even for the AI optimists, higher real trend growth ("*G*") alone is unlikely to make debt sustainable




*Source*: PIMCO calculations, BBG, IMF WEO as of April 2025. *Note*: The charts show a simple debt-to-GDP projection for varying real trend GDP growth (G) holding everything else constant, including R. The projection assumes that the primary balance evolves in line with CBO forecast adjusted for the 2017 Trump tax cut extension (up until 2029, after which it stays static), inflation is at target, real GDP growth at trend, and interest rates evolve along the forwards priced into financial markets (on May 6). Refer to Appendix for additional forecast, outlook and risk information.

# Disclosures

**Past performance is not a guarantee or a reliable indicator of future results.**

**CREDIT QUALITY**

The credit quality of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. The quality ratings of individual issues/issuers are provided to indicate the credit-worthiness of such issues/issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody's, and Fitch respectively.

**FORECAST**

Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. There is no guarantee that results will be achieved.

**HYPOTHETICAL ILLUSTRATION**

Hypothetical illustrations have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve results similar to those shown. In fact there are frequently sharp differences between hypothetical results and actual results subsequently achieved by any particular trading program.

One of the limitations of hypothetical results is that they are generally prepared with the benefit of hindsight. In additional, hypothetical scenarios do not involve financial risk, and no hypothetical illustration can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or to adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation if any specific trading program which cannot be fully accounted for in the preparation of a hypothetical illustration and all of which can adversely affect actual results.

**INDEX**

It is not possible to invest directly in an unmanaged index.

**INVESTMENT STRATEGY**

There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market.

# Disclosures

**OUTLOOK**

Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest for the long term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

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