US Debt Default and Your Investments

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A potentially devastating financial crisis is looming on the horizon for investors. The United States is at risk for defaulting on its sovereign debts. According to folks at Moody's, a true default on US debt would cost 6 million jobs and the GDP would fall by at least 4%. This blow to the economy would be similar to what happened in the Great Recession. The problem would then be that the US got out of the **Great Recession** largely because the Federal Reserve dropped interest rates to near zero and poured money into the economy by purchasing bonds. If the US has defaulted on its debts the government will not be able to step in and lend a hand. If that were to be the case, we could be looking at another **Great Depression**. The connection between a US debt default and your investments would be such that many would lose substantial portions of their portfolios.

Why Would the US Not Pay Its Debts?

Ever since the end of the Clinton Administration in 2000 the US government has run a deficit. Before that the last time the US balanced its budget was during the early Nixon Administration in 1969. Because of well founded fears of ever-increasing debt, Congress set a debt ceiling back in the 1930s so that both Houses of Congress need to vote to increase the amount that the US Treasury can borrow by issuing bonds.

Every time this has come up for a vote it has eventually passed although things got so tense during the Obama Administration that Standard and Poor's downgraded the United States' perfect AAA credit rating! This time around the US has exceeded the debt ceiling and is only still paying its bills because of "**extraordinary measures**" by the US Treasury where they are shifting money from one account to the other. These measures will no longer work by around June 2023. Members of the House of Representatives, now controlled by Republicans, want to see substantial budget cuts in return for their votes to increase the debt ceiling so that the Treasury can sell bonds and keep financing the US debt.

What Happens If the US Does Not Pay Its Bills?

If the US Treasury does not have the money to **pay the bills**, Treasury Secretary Yellen told Congress that military salaries, tax refunds, national debt interest, salaries for the military, Social Security, and Medicare benefits would not be paid or payments would be reduced. Because bond holders would not be paid interest on their bonds with the US Treasury, the damage to US credit would be severe and likely permanent. Interest rates that the US would need to pay in the future to borrow money would skyrocket. Likewise, interest paid by consumers for mortgages, car loans, or credit card interest would also rise substantially. And the **stock market would plunge** as the economy sank.

Why Does the US Not Balance Its Budget?

In the current debt ceiling crisis scenario the Republicans are blaming the Democrats for spending too much money. However, there is plenty of blame to go around. After President Clinton and Congress compromised in the late 1990s the US balanced the budget. Then the second Bush Administration pushed through tax cuts with the argument that they would stimulate the economy and pay for themselves but that did not happen and the US went back into deficit spending mode. The same argument was used to push through the Trump tax cuts and, again, it did not work to balance the budget.

As this plays out, Republicans will demand cuts in Social Security, Medicare, and a host of social programs while Democrats will demand higher taxes for high wage earners. Those who are skilled at trading the news and using the "buy the rumor and sell the news" approach may make money in the short term. A problem this time around is that a debt ceiling crisis is being superimposed on an inflation crisis, rising interest rates, and even a potential **banking crisis**, not to mention war in Ukraine.

If worse comes to worst and the US defaults on its debts, stocks will fall as the economy tanks. As with other recessions, consumer goods stocks may be the best place to hide until the recession is resolved. One might be tempted to convert all assets into cash but the **dollar would also collapse** along the standard of living for Americans and probably in all nations with dollar-based economies. Home ownership has been a bedrock investment for Americans but buying a home would become impossible with excessive interest rates not to mention banks having gone out of business. Gold could make a comeback but cryptocurrencies would likely follow the stock market down. The bottom line is that there are no good scenarios for a US debt default.

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