A DEBT OF RECKONING

"A billion here, a billion there, sooner or later it adds up to real money." Everett Dirksen

We all know Covid-19 induced governments in Canada, USA and many countries worldwide to incur unprecedented budget deficits as they struggle to offset the effects of shutting down economies. **Thus, the question I get asked most, when discussing the economic world, is how will governments ever pay back the vast increase in debt?**

Short answer – They won't, ever, ever, ever!!! So, the real key question is: Does it matter? A quick review of the facts to ponder in this context:

Deficit – the difference between expenditures exceeding revenue (generally taxes) of a country, province etc. on an annual basis. Canada's 2020 deficit is expected to be over $381 billion; pre Covid it was projected around $30 billion. (Gasp)

Debt – the total accumulated amount of borrowed funds. The lenders can be foreign **governments,** banks and investors, Central Banks, pensions funds, insurance companies, savings bonds etc.

What can make comparisons challenging is that many different variables can be used. In Canada, there is a Federal debt, but also provincial Debt, plus Government sponsored agencies, such as Export Development Canada.

For pondering purposes, a review of our southern neighbour, however no smugness please, Canada's ratios are not much better and our economic taxing base is much less diverse.

The only way to reduce the debt is to run an annual budget surplus, but history shows Governments have a pathetic record of actually achieving that. The 2020 Federal spending deficit is about $3.13 trillion or about 15% of GDP (Gross Domestic Product, or a countries annual economic output), the highest ever. Going forward, not much improvement is expected and the numbers do not include potential forgiveness of student debt or losses on Federal housing insurance programs.

DEBT: It now exceeds 100% of the annual GDP, even the past economic recessions it was never above 50%. Only in WW2 did it exceed 100% as the war effort ramped up. Post war the US was able to shrink the debt to about 20% via tax revenue from its dramatically expanding economy and, **this is key,** there were no federal mandated entitlements. Today, outlays on Social Security, Medicare etc. now make up 75% of the annual budget and politically there is a slim chance of reducing them.

So, to actually enable an annual budget surplus extensive cuts must be made in defense, public works and so on and/or huge tax increases. **Thus, perhaps the real question is for how long can Governments borrow as much as they want?** The simple answer is as long as lenders are confident the borrowing government has the taxing powers to ensure the interest will be paid and the value of the currency remains stable. An inflation revival would erode the value of those interest payments and the balance owed, and cause higher rates and a possible collapse of the currency. Just think of Argentina or, close to home for me, Zimbabwe.

As for financial markets, another week of impressive gains with Asian markets, again, being the notable standout. There were a few losing sectors and the majority of those were related to the bond market. As I've noted before, an expectation of higher interest rates or inflation is bad for bond holders.