WINTHROP WEALTH

AUGUST 2026 CLIENT QUESTION OF THE MONTH

FEDERAL DEBT

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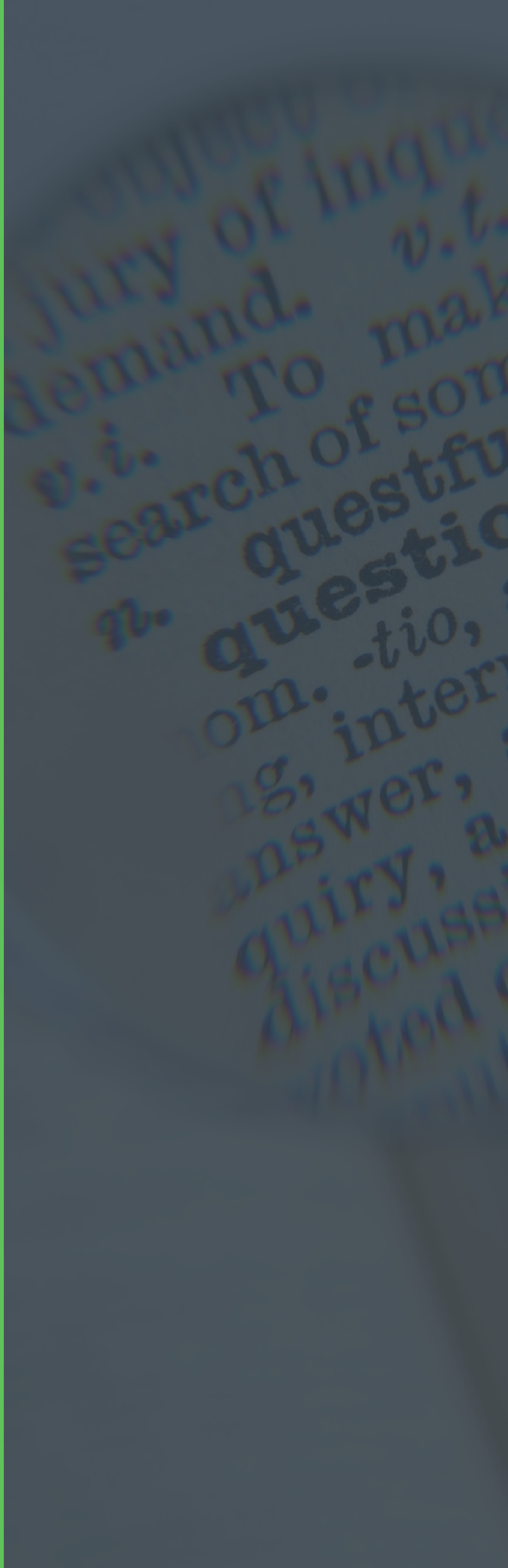


The federal debt continues to be a contentious issue as elevated budget deficits have persisted well beyond the pandemic. Federal debt held by the public now stands at nearly $32 trillion after increasing by more than 80% since 2019 and more than doubling over the past decade. In this Client Question of the Month, we revisit some of the most common questions associated with the federal debt.

What is the Federal Debt?

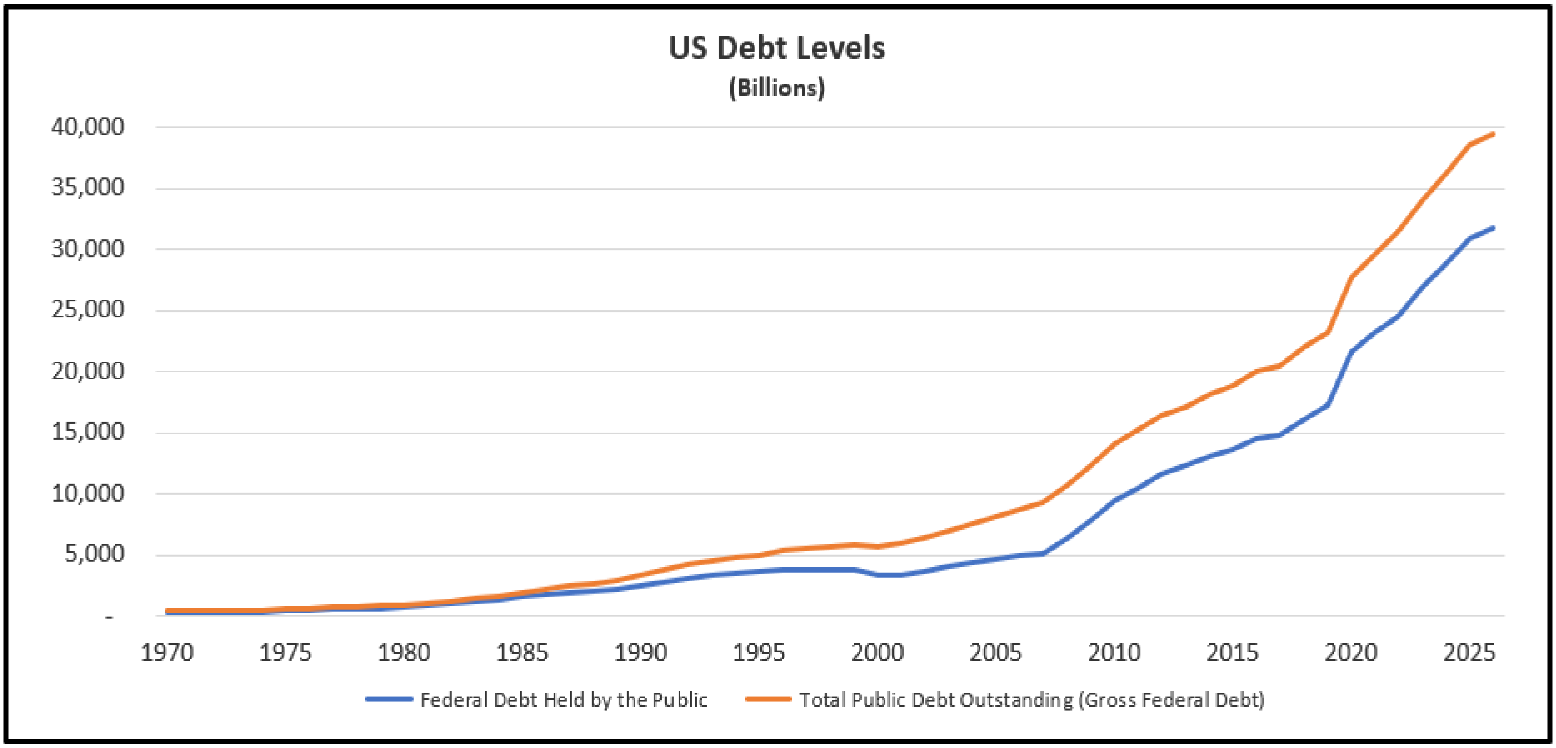
The federal debt is the total amount of money that the United States federal government has borrowed and not yet repaid. When the government runs a budget deficit, it finances the shortfall by issuing Treasury securities — including bills, notes, and bonds — through the US Department of the Treasury. These securities are purchased by a range of investors, including individuals, institutions, foreign governments, and other parts of the federal government.

Treasury securities ("Treasuries") are backed by the full faith and credit of the United States, meaning their principal and interest payments are effectively assured by the government. Treasuries are issued in a wide range of maturities, are exempt from state and local income taxes, and are typically very liquid. *Treasuries are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and principal value.*

The two basic measures of federal debt are debt held by the public and total public debt outstanding:

Federal Debt Held by the Public: This is the most commonly used measure of federal debt and includes debt held by individuals, institutional investors, the Federal Reserve, state and local governments, and international investors. As of June 30, 2026, the total amount of federal debt held by the public was approximately $31.7 trillion.

Total Public Debt Outstanding (Gross Federal Debt): This is the sum of debt held by the public plus debt held by federal trust funds and other government accounts, commonly referred to as intragovernmental holdings. The Social Security trust funds comprise the largest portion of intragovernmental holdings. As of June 30, 2026, total US federal debt was approximately $39.5 trillion.



Source: Federal Reserve Bank of St. Louis

What Drives the Federal Debt Level?

The growth of federal debt is driven primarily by the federal budget deficit. When federal spending exceeds revenue, the government runs a deficit. To finance this gap, the US Treasury issues securities and uses the proceeds to fund government operations. Over time, federal debt primarily reflects the accumulation of past budget deficits. Deficits typically widen during periods of economic weakness and narrow during expansions, although the debt can continue to rise even when the annual deficit declines.

The federal budget deficit reached record levels of $3.1 trillion in 2020 and $2.8 trillion in 2021, largely due to the massive fiscal response to the COVID-19 pandemic. According to the Congressional Budget Office's February 2026 baseline, annual deficits are projected to total approximately $1.9 trillion in 2026 and 2027 before rising to approximately $2.1 trillion in 2028.

	2018	2019	2020	2021	2022	2023	2024	2025	2026 Est	2027 Est	2028 Est
US Government Deficit	-$779	-$984	-$3,132	-$2,775	-$1,376	-$1,694	-$1,831	-$1,775	-$1,853	-$1,887	-$2,080

Source: Congressional Budget Office (CBO). Figures in billions of dollars.

What are the Risks of Too Much Debt?

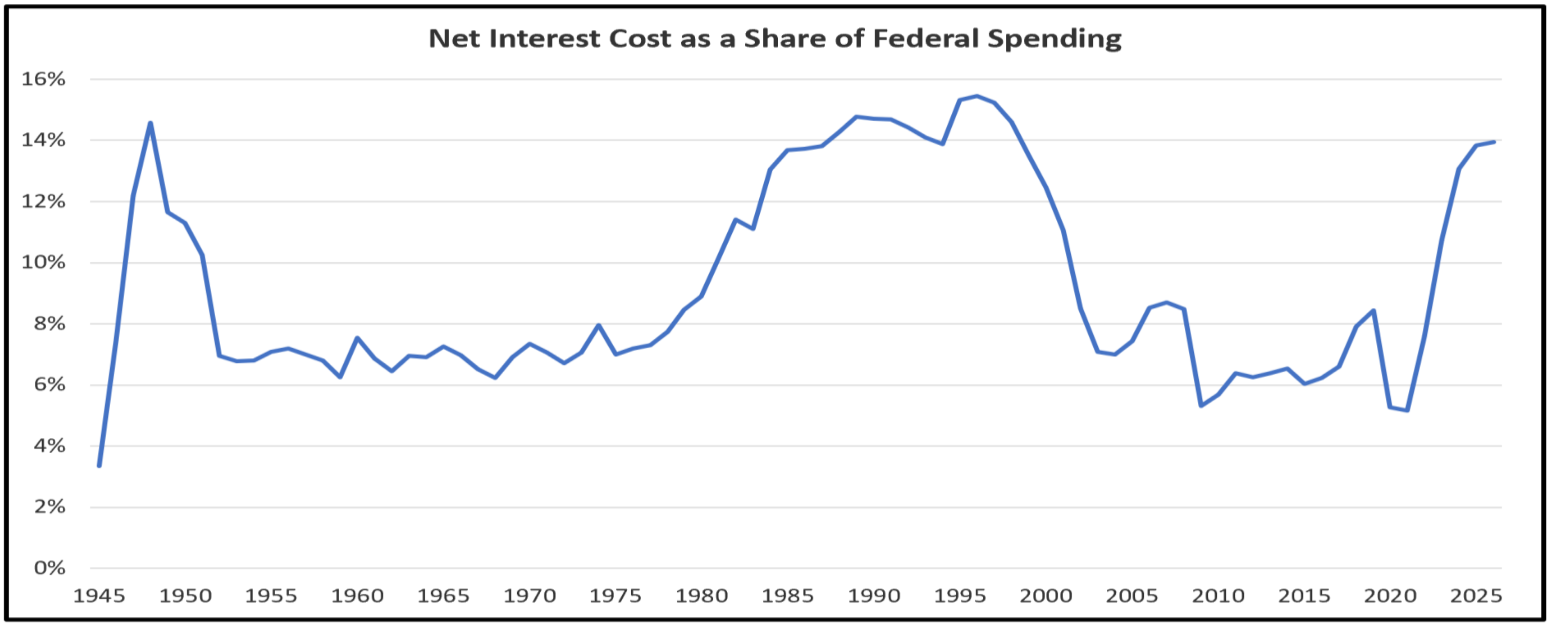
The CBO notes that high and rising federal debt can have several adverse long-term consequences:

- Slower Economic Growth: As debt rises, the government must devote a larger share of its budget to interest payments, which can crowd out discretionary spending on areas that support future productivity and growth.
- Reduced National Income: Interest payments made to foreign holders of US debt send income overseas rather than to US households, businesses, or institutions.
- Heightened Risk of Financial Instability: Rising debt levels elevate the risks of a fiscal crisis, surging interest rates, persistent inflation, or a loss of confidence in the dollar and US creditworthiness.
- Less Fiscal Flexibility: High debt may limit policymakers' ability to respond to future recessions or emergencies with deficit-financed stimulus, making the US economy more vulnerable during crises.

Does the Debt Need to be Paid Off?

The federal debt does not need to be paid off in full, but individual Treasury securities must be repaid as they mature. In practice, the government generally issues new securities to repay maturing debt, effectively refinancing the balance.

In the federal budget, net interest represents interest paid on debt held by the public, offset by interest income received by the government. Net interest costs are driven primarily by two factors: the amount of debt outstanding and the average interest rate paid on that debt. In fiscal year 2025, net interest totaled $970 billion, exceeding spending on defense ($893 billion) and Medicaid ($668 billion), while falling only slightly below Medicare ($988 billion). In 2026, CBO projects net interest costs of approximately $1.0 trillion, equal to nearly 14% of total federal spending and well above the historical average of 9.2%. That share is expected to continue rising as debt grows and maturing securities are refinanced at higher rates.



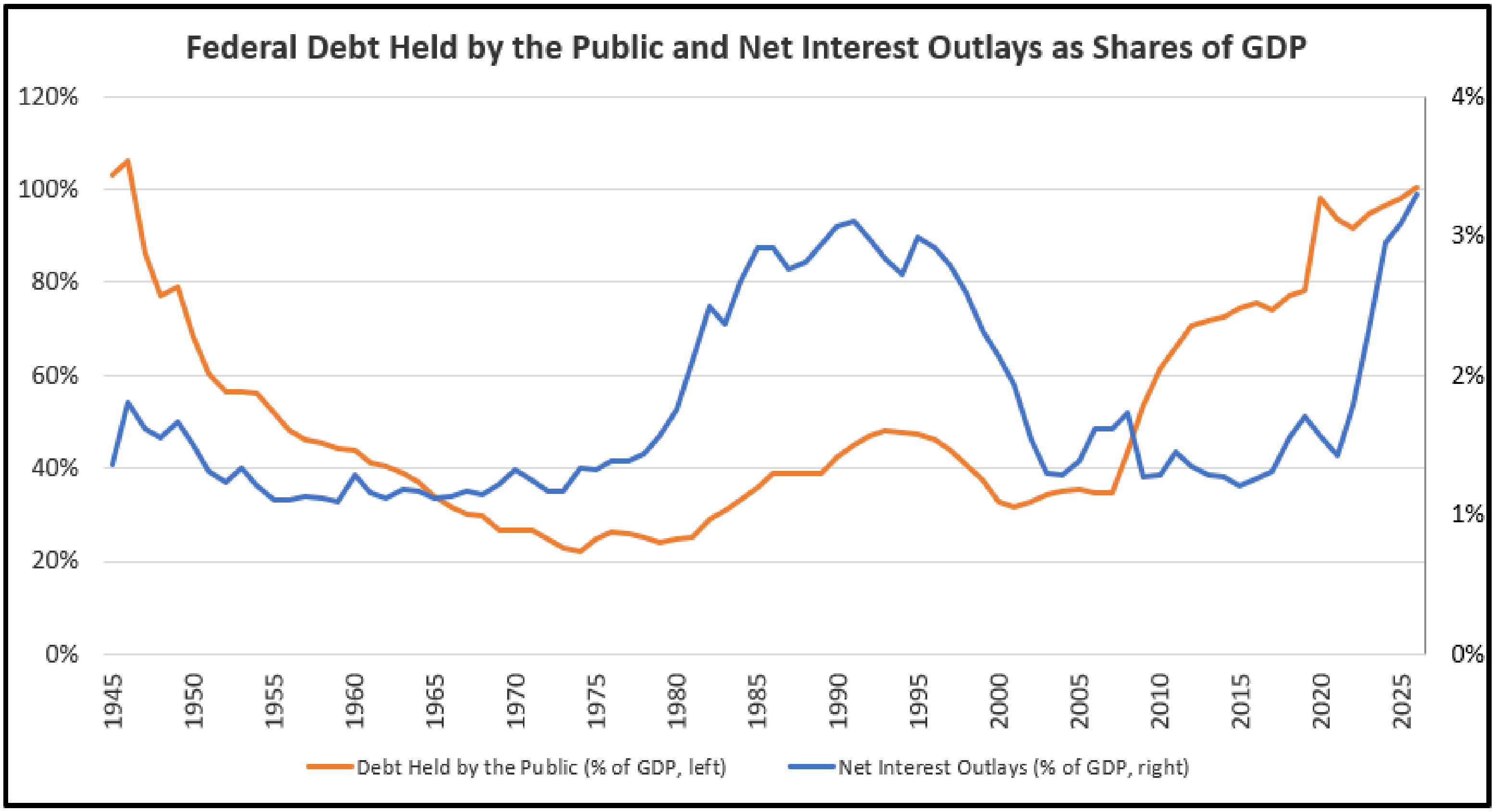
Sources: Federal Reserve Bank of St. Louis through 2025; Congressional Budget Office estimate for 2026.

Can You Put the Debt Level in Context?

To provide meaningful context for today's debt levels, we plotted federal debt held by the public and net interest outlays as shares of GDP. Debt-to-GDP is shown in orange and net-interest-to-GDP in blue.

After peaking at 106% in 1946 because of World War II, the debt-to-GDP ratio declined for decades as economic growth outpaced borrowing. Since the 2008 financial crisis, debt has risen significantly and is projected to reach approximately 101% of GDP in 2026. The CBO expects the ratio to continue climbing to approximately 120% by 2036.

Net interest outlays reached a previous high of approximately 3.1% of GDP in 1991 before declining alongside interest rates. The ratio is projected to rise to 3.3% in 2026, exceeding its prior peak and remaining well above its long-term average of approximately 1.8%. The CBO projects net interest outlays will reach 4.6% of GDP by 2036.



Sources: Federal Reserve Bank of St. Louis through 2025; Congressional Budget Office estimate for 2026 and projections through 2036.

What Factors Have the Biggest Impact on Future Deficits and Federal Debt Levels?

The following four factors will have the biggest impact on the deficit and federal debt: government revenue (mainly tax policy), government spending, economic growth, and interest rates.

In a vacuum, each of the following events would increase or decrease federal deficits and debt levels:

Increase Federal Debt Level
Lower Government Revenue
Higher Government Spending
Slower Economic Growth
Higher Interest Rates

Decrease Federal Debt Level
Higher Government Revenue
Lower Government Spending
Faster Economic Growth
Lower Interest Rates

What Could Force Washington to Act?

The US federal government is on an unsustainable fiscal path. And that just means that the debt is growing faster than the economy. … I don't think that's at all controversial. And I think we know that we have to get back on a sustainable fiscal path. … It's probably time, or past time, to get back to an adult conversation among elected officials about getting the federal government back on a sustainable fiscal path.

- Former Federal Reserve Chair Jerome Powell (February 2024)

The national debt is complicated, and there is no clear answer as to when it becomes unsustainable. As the CBO notes, no specific debt-to-GDP ratio can be identified at which a crisis becomes likely or imminent, nor is there a fixed level at which interest costs become unsustainable. This marks our seventh annual update to the Federal Debt Client Question. Despite continued economic growth, annual deficits remain close to $2 trillion, federal debt continues to grow faster than the economy, and net interest costs are projected to reach record levels as a share of GDP. Both Democrats and Republicans share responsibility. The constant is that the party in power spends freely, while the minority party suddenly pretends to care about balancing the budget.

Government officials continue to take a "kick the can down the road" approach because the current trajectory is not causing an immediate crisis. There is little political incentive to make difficult decisions involving taxes, entitlement programs, or other government spending when those choices could cost politicians their jobs. Meanwhile, mandatory spending and net interest are projected to consume virtually all federal revenue in 2026, leaving little revenue available to fund defense and other discretionary programs without additional borrowing. Even so, the current approach could continue for years as long as investors remain willing to absorb growing Treasury issuance at manageable interest rates.

The debt and deficit dilemma will probably go largely unattended until something breaks, perhaps through further credit-rating downgrades or a spike in interest rates if investors become less willing to absorb the growing supply of Treasury securities. Market pressure, rather than a sudden political embrace of fiscal discipline, may ultimately be what forces Congress to act.

How Should Investors Respond?

The difficult question for investors is what, if anything, they should do about it. There is no simple or reliable way to hedge against the federal debt. Assets commonly viewed as hedges against currency debasement, such as gold or bitcoin, may perform well under certain conditions, but both can be volatile and may not provide protection when expected. Stocks represent ownership in productive businesses and have historically helped investors build wealth, but US stocks are not immune to economic and policy headwinds, while international stocks carry currency, political, and economic risks of their own. We do not believe investors should build a portfolio around one prediction about how or when the debt problem will ultimately be resolved.

Instead, we believe the appropriate response is to focus on what can be managed through our Total Net Worth Approach, which integrates comprehensive financial planning, tax mitigation strategies, and disciplined investment management. Within portfolios, our **DODM** framework emphasizes remaining **D**isciplined, acting **O**pportunistically, staying **D**iversified, and **M**itigating unnecessary taxes, fees, and expenses. This includes maintaining sufficient liquidity, emphasizing quality, avoiding excessive concentration, and preserving the flexibility to adjust as economic and market conditions evolve. No single asset can reliably prepare investors for every possible outcome. A comprehensive financial plan and diversified portfolio will not eliminate fiscal risk, but they can reduce the likelihood that long-term financial goals depend on one economic forecast, one market scenario, or one speculative hedge.

Conclusion

Our view remains that the trajectory of the federal debt is the most important long-term issue facing the US economy. The current path may continue for years without an obvious breaking point, but that does not make it sustainable. We would welcome meaningful bipartisan action before financial markets force policymakers to respond. Until then, we will continue to monitor the risks and manage portfolios for a range of possible outcomes rather than pretend we know precisely how or when the issue will be resolved.

Citations

The Budget and Economic Outlook: 2026 to 2036. Congressional Budget Office. https://www.cbo.gov/publication/61882

The Long-Term Budget Outlook: 2025 to 2055. Congressional Budget Office. https://www.cbo.gov/publication/61187

The Federal Budget in Fiscal Year 2025: An Infographic. Congressional Budget Office. https://www.cbo.gov/publication/61950

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