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Status Quo of Debt Dynamics

The safest road to hell is the gradual one - the gentle slope, soft underfoot, without sudden turnings.

C.S. Lewis

- **Role swap between the US and Germany: While the new US government is using DOGE to cut costs, Germany has put on its spending pants.**
- **Nevertheless, the US deficit is on course for a negative record. For the first time, there could be a deficit of more than 6% for three years in a row.**
- **The US reached the Ferguson limit as interest spending exceeded defense spending for the first time in fiscal year 2024. Previous great powers went under when they violated the Ferguson limit.**
- **In emerging and developing countries, an average increase in debt of 2 percentage points was required to increase GDP by 1 percentage point. In the OECD countries, the ratio was 5:1.**
- **With the proposals of Stephen Miran and Zoltan Pozsar, the issue of debt restructuring has finally moved from the periphery to the center.**
- **Financial repression will return, especially in the EU, where a productivity miracle to sustainably solve the high national debt seems almost impossible. Some parties will also continue to attempt to centralize EU debt.**

The Titanic was warned six times about icebergs. It didn't change course.
Based on historical records of the Titanic disaster of 1912

Usually, analyzing government debt data is a rather unspectacular task. The spending increases during the Covid-19 pandemic and the subsequent inflation crisis have provided some variety, albeit for two extremely unpleasant reasons. In recent weeks, however, there has been some real movement on the national debt issue.

When the ship has sunk, everyone knows how she could have been saved.
Italian Proverb

It was not just a slight course correction; a real U-turn occurred in Germany at the end of February. With a single sentence, Friedrich Merz (CDU) initiated this U-turn in the very country that had previously kept its national debt ratio under control thanks to a constitutionally enshrined debt brake. This forced governments at the federal, state, and municipal levels to consolidate continuously. The result was a national debt ratio slightly above the 60% Maastricht limit.

Either the nation must destroy public credit, or public credit will destroy the nation.
David Hume

The phrase uttered by Friedrich Merz is well known: "Whatever it takes!" With this one sentence, Friedrich Merz increased the German national debt by at least an additional EUR 900bn, or more than a third of the current German national debt. In total, the volume of expenditure is therefore likely to be more than double the amount of Aufbau Ost, the investments in the new federal states after reunification, which amounted to 1% of GDP.

On the one hand, a *special fund* (Sondervermögen) for infrastructure is being set up, although it would be better to speak of *special debt*: EUR 500bn is to flow into infrastructure and climate protection. **This means that the debt potential of all 30 German special funds combined has almost doubled.**

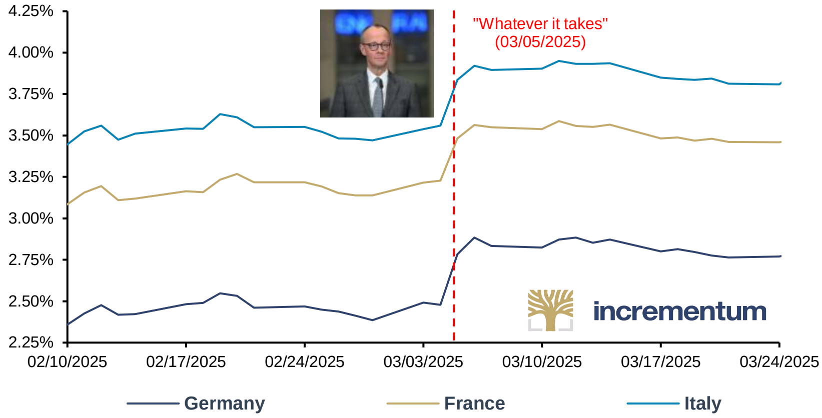
In view of the threats to our freedom and peace on our continent, the rule for our defence now has to be 'whatever it takes'.
Friedrich Merz

In 2012, Mario Draghi added the important, usually omitted, restriction "within our mandate" to his "whatever it takes" to calm financial markets. Merz, on the other hand, does not seem to want to impose any restrictions on himself, except that he needs the necessary majorities in the German Bundestag for this project. **The fact that he had opened the debt Pandora's box with his advance became apparent only a short time later.** As the CDU/CSU and SPD needed the support of the Greens to pass the bill, the Greens demanded the earmarking of EUR 100bn for climate protection measures and the stipulation that these investments should ensure Germany's climate neutrality by 2045. The EU has set 2050 as its target, which is unrealistic anyway.

We are not swimming in money, we're drowning in debt.
Wolfgang Schäuble

Markets responded to the announcement of the expansion of German government debt with the sharpest rise in German bond yields since 1990. On the day of the announcement, March 5, the 10-year German government bond rose by almost 30 basis points or 12% to just over 2.80%. The yields of many countries also rose in its wake, and not even the government bond heavyweights, the US and Japan, were able to escape this shock. This at least confirms that German government bonds have not yet lost their status as the gold standard on the bond market as a result of this announcement. However, this is bad news for the countries that are much more heavily indebted, as their financing costs have also risen significantly.

10 Year Government Bond Yield, 02/10/2025–03/24/2025



Source: Berliner Morgenpost, LSEG, Incrementum AG

The question is: If German government bonds lose their anchor function, what asset will take their place?

We shouldn't elect a President. We should elect a magician.
Will Rogers

The second U-turn – only this time in the other direction – is on the horizon in the US. Just a few months before his first election triumph in 2016, Donald Trump described himself as the "King of Debt". On March 6 – just one day after Merz's U-turn – US Treasury Secretary Scott Bessent made the following comment at an event organized by the NY Economy Club:

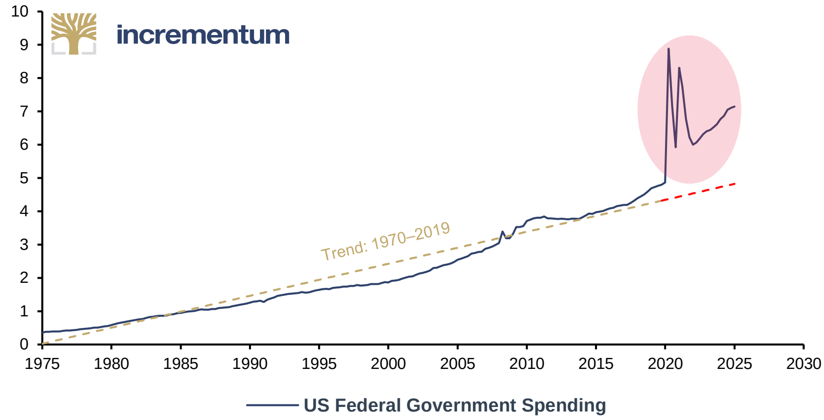
> *The first time I went to see President Trump, he looked at me and said, "How do we get this debt and deficit down without killing the economy?" I've been thinking about this for 18 months, and [the way to do it is] the transition from a public sector to private sector [-driven economy]... 25 percent of GDP goes through [Washington DC] area code 202.*

History shows that once an enormous debt has been incurred by a nation, there are only two ways to solve it: one is simply to declare bankruptcy – repudiate the debt. The other is to inflate the currency and thus to destroy the wealth of the ordinary citizen.
Adam Smith

Now the words must be followed by deeds and, given that the US is in a permanent election campaign – the midterms are just 1½ years away and the next presidential election is 3½ years away – it remains to be seen whether the Trump administration will succeed in turning the debt tide. Doing so would have serious consequences because of the enormous importance of the US dollar for the global economy. **During the election campaign, Scott Bessent had already set a target of reducing the US budget deficit to 3% by the end of Donald Trump's term of office as part of the 3-3-3 plan. That would be more than a halving.**

The reason for the significant departure from the long-term trend growth in nominal government spending in the US was the Covid-19 policy, first under Donald Trump and then under Joe Biden. Covid-19 spending opened the fiscal floodgates, and they have not yet been closed.

US Federal Government Spending, in USD trn, Q1/1970–Q1/2025



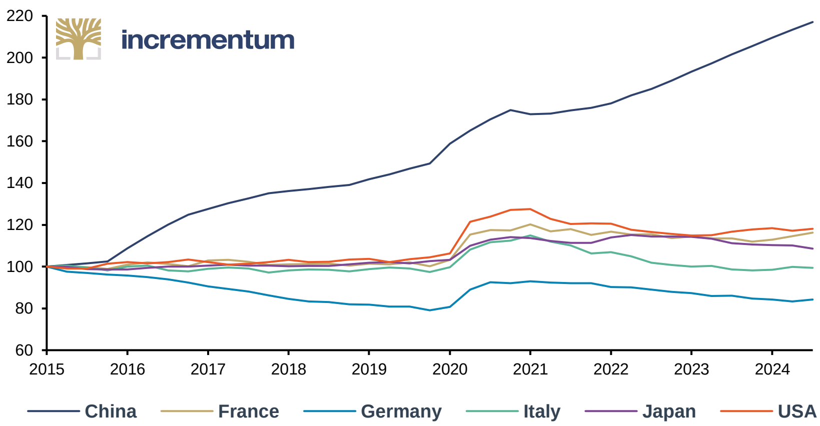
Source: BofA, Federal Reserve St. Louis, Incrementum AG

Safe debt is rapidly becoming an oxymoron.
Willem Buiter

Verbally, at least, the US wants to descend – in a positive sense – into the league in which Germany currently finds itself, while Germany wants to ascend – in a negative sense – into the league in which the US finds itself. And in the latter league, the markets are slowly but surely beginning to have fundamental concerns about the development of sovereign debt in the industrialized nations. **One thing is certain: The issue of overindebtedness is increasingly moving from the periphery to the center.**

By 2024, global government debt levels had normalized, and for most countries, this marked a sobering return to the daily grind. The temporary reduction in debt ratios driven by the inflation surge had not only run its course but was now giving way to renewed upward momentum. **As emphasized in the *In Gold We Trust* report 2023 in the chapter "The Status Quo of Debt Dynamics", the debt-reducing effect of inflation is overestimated because government spending also begins to rise more strongly, with a slight time lag due to inflation.**

Public Debt, as % of GDP, 100 = Q1/2015, Q1/2015–Q3/2024



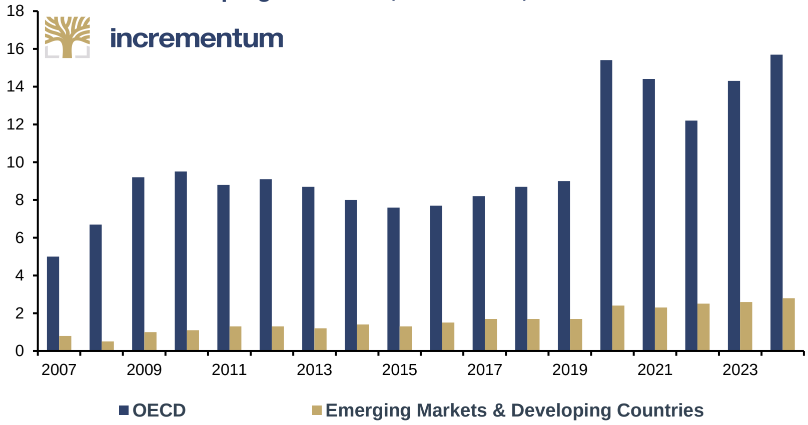
Source: BIS, Incrementum AG

Based on the growing spiral of debt, only quantitative growth thrives, not qualitative growth.
Rahim Taghizadegan

It therefore comes as little surprise that, according to the *OECD Global Debt Report 2025*, the issue volume of government bonds in OECD countries has almost doubled in the last 10 years, from USD 8trn in 2014 to USD 15.7trn in 2024. For 2025, the OECD expects a further increase to

USD 17trn. During this period, the emerging markets doubled their debt issuance from USD 1.4trn to USD 2.8trn. However, their economic output grew by over 50% in these 10 years, while GDP growth in OECD countries increased by only 19.7%. In other words, in the emerging and developing countries, an average increase in debt of 2 percentage points was required to increase GDP by 1 percentage point. In OECD countries, the ratio was 5:1, and in the US, it was as high as 5.8:1. Such growth is, of course, as sustainable as an electric car powered by electricity generated from lignite.

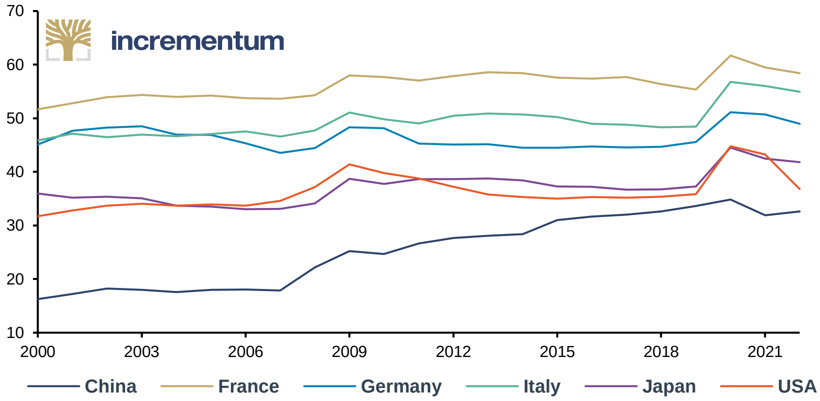
Issuance of Government Bonds in OECD Countries and Emerging Markets & Developing Countries, in USD trn, 2007–2024



Source: OECD, Incrementum AG

The Covid-19 pandemic and the energy crisis have confirmed it once again: After crises, the government/private spending ratio is higher than before the crisis. **In other words, real or imagined crises strengthen the state and weaken the private sector.**

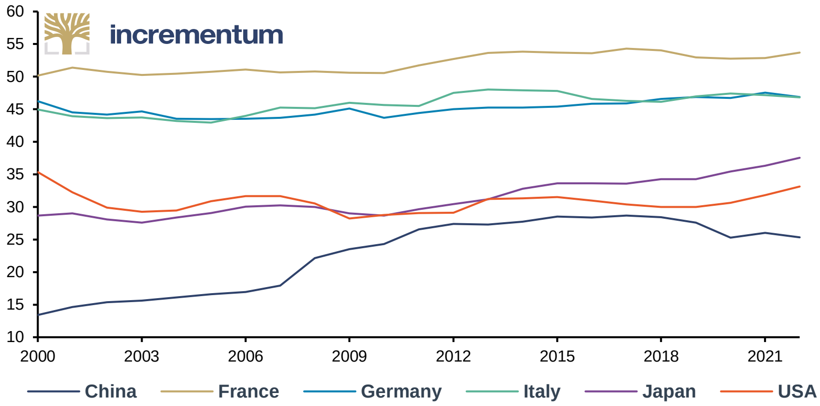
Government Spending, as % of GDP, 2000–2024



Source: IMF, Incrementum AG

On the revenue side, tax ratios well in excess of 40% are now commonplace in Europe's leading economies.

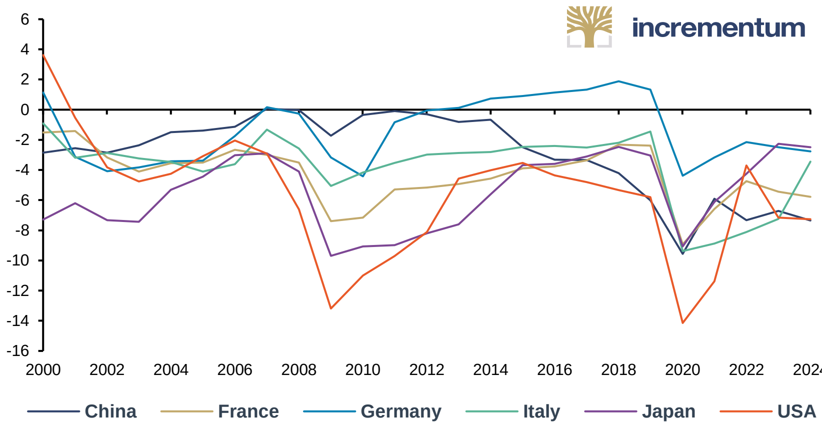
Government Revenue, as % of GDP, 2000–2024



Source: IMF, Incrementum AG

And despite historically high tax ratios in many cases, national budgets are still clearly in the red. The break in the Covid-19 pandemic is undoubtedly visible, with Germany as an exception thanks to the debt brake.

Budget Balance, as % of GDP, 2000–2024



Source: IMF, Incrementum AG

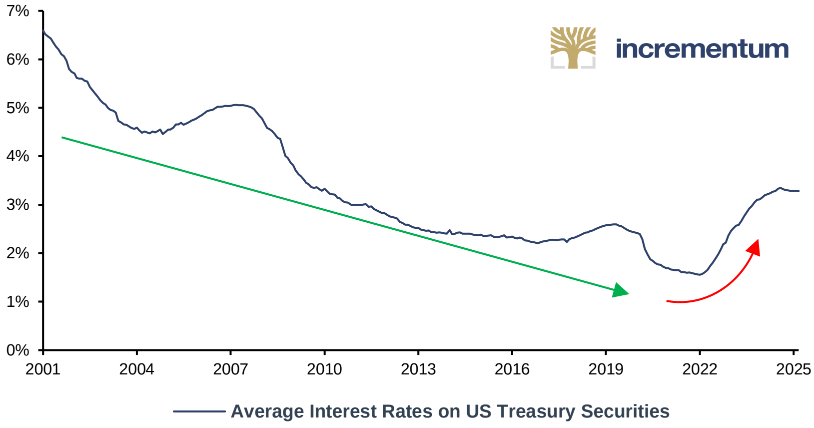
What the debt does is it's death by slow strangulation. It just grinds the economy down. The extreme over-indebtedness is pulling the trend rate of growth below the historical average.
Henry Hazlitt

After all, the main drivers of expenditure are of a structural nature. Above all, demographic change is increasingly taking its toll. The worsening ratio between working and retired people is not only leading to higher pension and healthcare expenditures but also to slower economic growth as a result of labor shortages, and thus to lower revenues for the state. The sometimes still very high immigration figures are also reflected in structurally higher government spending. This is particularly the case in countries with a strong welfare state culture. In the US, illegal immigration into the labor market has been massively reduced under Trump. And finally, since the end of the zero and low interest rate phase, the rising cost of servicing interest has also been a burden on government budgets, exacerbated by the increase in government debt.

The yield on maturing government bonds is usually lower than the capital market interest rates for new government bonds to be issued. In the US, the yield curve was above 3.7 % at the end of April. By comparison, at the end of March, the average interest rate on US government debt was 3.35%, a level not seen since the end of 2009. **In addition to its horrendous budget deficit**

of almost USD 2trn, the US will have to refinance more than USD 7trn or more than 25% of its national debt this year. If the more than USD 9trn were to be issued entirely as 10-year US Treasuries, every 1 basis point drop in bond yields would reduce the interest burden by around USD 1bn per year. A drop of 0.5 percentage points would save Washington USD 500bn in interest over the entire term.

Average Interest Rates on US Treasury Securities, 01/2001–03/2025

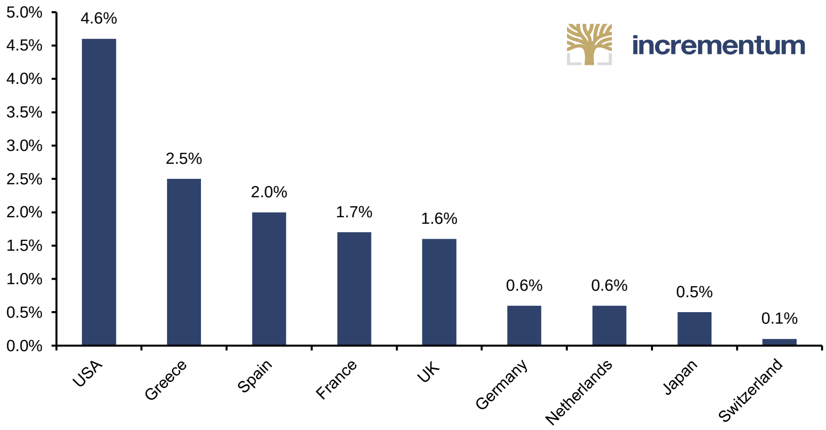


Source: US Treasury, Incrementum AG

He who goes borrowing, goes sorrowing.
Benjamin Franklin

Regarding interest expense, the US is far and away the leader among the leading economies. The significantly higher interest rates in the US compared to the euro area, Japan, and Switzerland, combined with the high level of national debt, have a negative impact.

OECD Estimates for Net Interest, as % of GDP, 2025

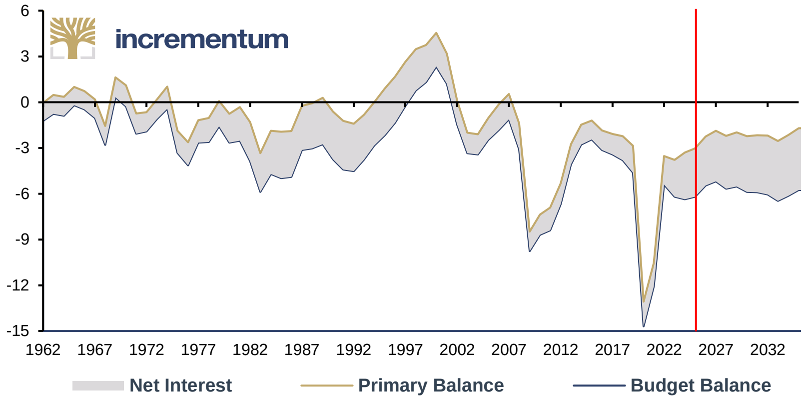


Source: OECD, Crescat Capital, Incrementum AG

The burden of the national debt consists not in its being so many millions, or so many hundred millions, but in the quantity of taxes collected every year to pay the interest.
Thomas Paine

The following chart, using the United States as an example, illustrates the extent to which interest expenses are now a burden on the national budget. **The gap between the primary balance and the budget balance is widening.** The area between the two values corresponds to the interest expense. And according to the CBO's long-term forecast, the US – as a pars pro toto – is only at the beginning of this development.

US Net Interest, Primary and Budget Balance, as % of GDP, 1962–2035e

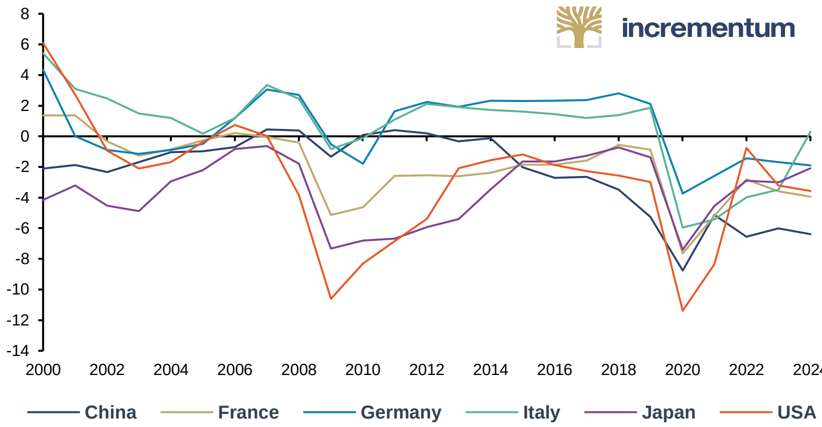


Source: CBO, Incrementum AG

...sooner or later, too much credit always turns into a giant debit as borrowers crumple under the burden of escalating interest payments.
Melchior Palyi

The alarming state of the budgetary situation in many countries is evident in the fact that the primary balance, i.e., the budget deficit excluding interest payments, is showing little improvement. Even excluding the interest expense for old debt, most countries would run a considerable deficit. Contrary to public perception, Italy had its public finances well under control before the Covid-19 pandemic, based on its primary balance.

Primary Balance, as % of GDP, 2000–2024



Source: IMF, Incrementum AG

Deep Dive US

The US budget deficit remains deep in the red

The methylamine keeps flowing no matter what. We are not ramping down. We are just getting started. Nothing stops this train. Nothing.
Walter White, Breaking Bad

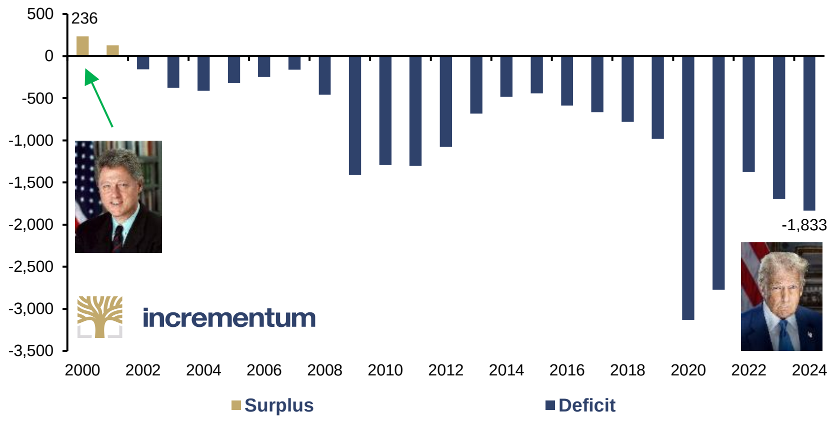
In 2023 and 2024, we saw only the third time since the Second World War that the US recorded a deficit of more than 6% in two consecutive years. However, there was a key difference compared to the first two instances: In 2023 and 2024, the US achieved GDP growth of just under 3.0% annually, whereas in 2009/2010 the aftermath of the global financial crisis and subsequent recession, and in 2020/2021 the fiscal burden of measures to combat the Covid-19 pandemic, weighed heavily on the budget. **We are not taking a significant risk by predicting that 2025 will be the first time since the Second World War**

that there will be a third consecutive year with a US deficit exceeding 6%.

The Budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance of foreign lands should be curtailed lest the Republic become bankrupt. People must again learn to work, instead of living on public assistance.
Cicero, 55 BC

In the first half of the new fiscal year (10/2024–03/2025), the US budget was again in deep red territory. **The deficit amounted to USD 1.3trn and was thus more than 20% higher than in the previous year, particularly because spending increased by almost 10% yoy.** Apart from 2020 and 2021, this was the first time the US had a budget deficit of more than USD 2trn. The CBO's current forecast, a projected deficit for the fiscal year ending in September of USD 1.9trn or 6.2% of GDP, is only slightly below this negative threshold. By way of comparison, over the past 50 years, the US federal budget has averaged – equally impressive – -3.8%. Notably, the deficit of USD 306bn in February was higher than Washington's revenue of USD 296bn. **In other words: 51% of all expenditure in February was debt-financed.**

US Federal Government Budget Balance, in USD bn, FY2000–FY2024



Source: Federal Reserve St. Louis, Wikimedia, Incrementum AG

Like many other countries, the US suffers from a spending problem. In the 10-year period 2015–2024, federal tax revenues rose 58% while Washington's spending increased by 93%. As a result, state debt doubled during this period. **Spending pants are now the favorite garment of many politicians.**

The US and Ferguson's Law

We have war finances, but no war yet.
Niall Ferguson

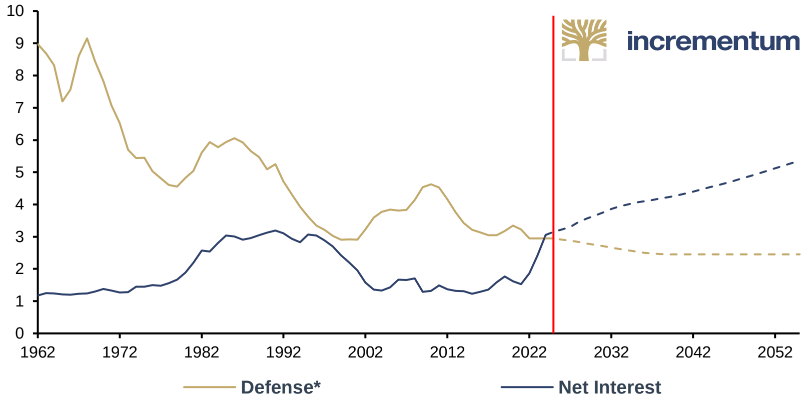
In an article published a few months ago titled "Ferguson's Law: Debt Service, Military Spending, and the Fiscal Limits of Power", historian Niall Ferguson expands on his argument regarding the fall of great powers triggered by fiscal excess. **The main thesis of *Ferguson's Law* is that as soon as a great power spends more on interest payments than on defense, this state is threatened with decline as a great power.** Exceeding the *Ferguson limit*, i.e. the point at which interest payments equal defense spending, is a reliable predictor of the loss of great power status.

In 2024, that moment arrived in the US, as it broke through the Ferguson limit. **In the 2024 fiscal year, the US spent USD 881bn on interest, slightly more than on the military at USD 855bn.**

The US isn't fighting a war, a crisis or a recession. Yet the federal government is borrowing as if it were.
Wall Street Journal

However, the overshoot in the past fiscal year was not an isolated incident. For the current fiscal year, the CBO is forecasting interest expenses of USD 952bn, which corresponds to an increase of 8% compared to the previous year. In the two previous years, the increases were 30% and 32% respectively. For the same period, the defense budgets passed by Joe Biden and the old Congress provided for spending of only around USD 850bn. The prospects speak for themselves. Not only will Ferguson's limit be continuously exceeded, but the difference between interest expenditure and defense spending will continue to grow over time, based on current spending profiles.

US Government Spending by Category, as % of GDP, 1962–2055e



Source: CBO, Incrementum AG
*Defense spending for 2025–2055 = 48% of discretionary spending (average of 2014–2024)

Courtesy of Hedgeye

Against the backdrop of the Ferguson limit, Trump's announcements on budget consolidation appear in a new light: namely, as an attempt to escape the fate of past great powers, such as Habsburg Spain, the Ancien Régime in France, the Ottoman Empire, and the British Empire.

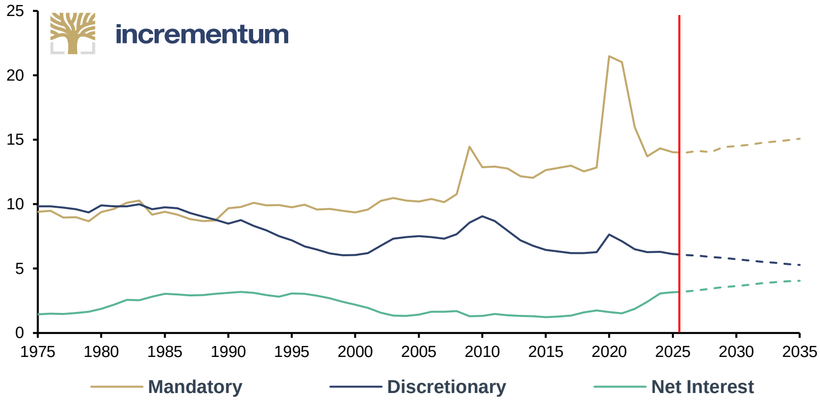
The DOGE illusion

USD 500bn to 2trn is to be cut by DOGE by 2026. This is the ambitious, if not lofty, target that has been set. In 2024, total expenditure at the federal level amounted to just under USD 7trn.

The market and the economy have become hooked, become addicted, to excessive government spending, and there's going to be a detox period.
Scott Bessent

To achieve Musk & Co.'s savings targets, spending must be reduced by 7% (to eliminate USD 500bn) or by nearly 30% (to eliminate USD 2trn). However, the overwhelming total of government spending at federal level is made up of legally binding social spending (approx. two thirds), interest spending dictated by markets (approx. 13%) and defense spending that cannot be reduced in the short term (also approx. 13%), in total more than 80%. An initial draft budget at the beginning of May only envisaged savings of around USD 160bn, or slightly more than 2% of spending for the next fiscal year. Contrary to initial announcements, defense spending is expected to increase significantly by 13%.

US Government Spending by Category, as % of GDP, 1975–2035e



Source: CBO, Incrementum AG

Inflation consists of subsidizing expenditures that give no returns with money that does not exist.
Jacques Rueff

If social spending is cut sharply, there is likely to be considerable resistance from within the government's own ranks. Spending on healthcare programs such as Medicare and Medicaid as a proportion of US GDP increased from 3.7% to 5.6% between 2004 and 2024. That is an increase of more than 50%. Pension spending rose from 4.1% to 5.0%, an increase of almost 25%. This is because all members of the House of Representatives and around a third of the Senate will be up for election in early November 2026, i.e. in less than two years. Many Republican-governed states also benefit from federal subsidies.

Tariffs as an additional source of government income?

The system of duties which has been already adopted, is in its principle, a system of revenue; and it is to be hoped, that by a due attention to the interests of trade, it may be made to produce all the revenue which the public exigencies may require, without any material inconvenience to the community.
Alexander Hamilton

Donald Trump's favorite economic policy instrument is clearly tariffs. With these, Trump aims to revive a source of revenue that played a crucial role in financing the United States for nearly 150 years of its history, until the introduction of the income tax in 1913. After all, under the Articles of Confederation, the US federal government was prohibited from collecting taxes directly. The new government had to solicit funds from the 13 states at the time – a situation very similar to the current one in the EU. Just as today, the EU aims to increase customs revenue to reduce its dependence on member states. Similarly, the US had to rely on customs duties as a source of revenue until the introduction of a federal income tax. Customs duties could be collected with comparatively little bureaucratic effort, unlike a federal income tax, which the federal government would have been allowed to collect after adopting the US Constitution in 1789.

During Trump's first term in office, his newly introduced tariffs led to a doubling of customs revenue. However, the increase of around USD 40bn was just a drop in the ocean of debt. In the first 3 years of Trump's first term in office – the 3 years without the Covid-19 pandemic state of emergency – the deficit increased from USD 665bn to USD 984bn, or from 3.4% to 4.6% of economic output. The additional revenue from higher customs duties did not play a role back then. This is now set to change.

We're going to take in hundreds of billions of dollars in tariffs, and we're going to become so rich, you're not going to know where to spend all that money. I'm telling you, you just watch. We're going to have jobs. We're going to have open factories. It's going to be great.
Donald Trump

Estimates are difficult, indeed almost impossible, in the current dynamic environment of the tariff conflict. **One estimate, by *Capital Economics*, is around USD 700bn. This would correspond to around 10% of Washington's revenue and would therefore be of a relevant order of magnitude.** Tariff revenues nearly doubled in April to just under USD 18bn compared to March, and more than quadrupled compared to the period before Trump's first term. However, the same estimate also expects significantly higher inflation and higher interest rates, which would result in higher social spending and higher interest payments.

Deep Dive Euro Area

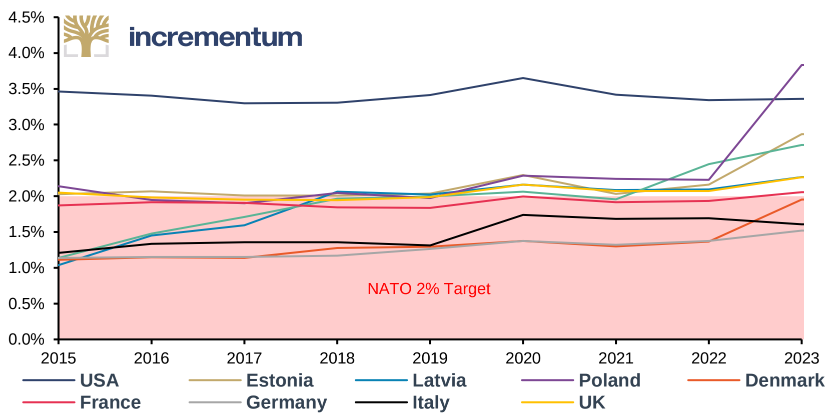
Rearmament – as if debts weren't debts

The situation in Europe is different. Leading NATO states and those that see themselves as particularly threatened by Russia have already substantially increased their defense spending in recent years. President Trump's repeated questioning of NATO membership has led to panicked reactions from some of the European alliance partners. Calls for an additional increase in defense spending became ever louder in the first weeks of Trump's second term in office.

A country always has an army in its territory. Either its own, or that of the country next door.
Finnish proverb

However, Donald Trump has also made it unmistakably clear to the Europeans that he is no longer willing to accept free-riding. The internal NATO target of increasing military spending to at least 2% by 2024 had been achieved by around two thirds of countries by 2024. However, only one major NATO country, Poland, has significantly increased its defense spending since the outbreak of the war in Ukraine and is expected to spend 4.7% of its GDP on defense this year. In his first days in office, the new US Secretary of Defense, Pete Hegseth, had already called on the European NATO states to increase their defense spending to 5%. After all, according to the Trump administration, the Europeans will bear the brunt of the Ukraine war and its consequences for the European security architecture in the future.

Defense Spending, as % of GDP, 2015–2023



Source: SIPRI, Incrementum AG

Ultimately, it makes no difference whether increases in military spending are financed through savings in other areas, through higher taxes, or by taking on additional debt. **All three approaches reduce real disposable income.** In the case of savings, the loss of income is apparent, as transfer payments are reduced, as is the case with a higher tax rate. In contrast, debt financing is painless at first glance. **However, as additional money flows into the economy through the expansion of debt and causes additional price increases, the most pernicious of all taxes, the inflation tax, strikes.**

It is unreasonable to expect 300 million Americans to defend 500 million Europeans against 140 million Russians.
Donald Tusk

***Economically*, it is also irrelevant whether debts are *legally* treated as such or not.** As part of the ReArm Europe plan, which was later renamed Readiness 2030 following protests, the European Commission is considering whether to activate the national escape rule for additional defense spending of up to 1.5% for four years, potentially preventing an otherwise imminent excessive deficit procedure. At the beginning of May, it became known that at least 12 of the 27 EU states intend to make use of this rule; all of them are NATO members. However, this *legal* concession does not change the *economic* consequences of higher deficits. A side note: In the first days of the customs conflict, Italy demanded the suspension of the EU stability package to cope with the economic consequences of the customs conflict.

The longing of EU centralists for a Hamilton moment

Whether it is the euro sovereign debt crisis, the Covid-19 pandemic, or the war in Ukraine, Brussels uses every severe crisis to generate a *Hamilton moment*. In 1790, the US Secretary of the Treasury, Alexander Hamilton, proposed in his "First Report on Public Credit" that the union should assume the debts incurred by the then 13 states during the War of Independence. Thus, the assumption of joint EU debt to combat the consequences of the Covid-19 pandemic was sometimes referred to as a Hamilton moment, including by then German Finance Minister and later Federal Chancellor Olaf Scholz (SPD) at the beginning of the Covid-19 pandemic.

We must be clear about the fact that today, our Europe is mortal. It can die. It can die, and it all depends on our choices. These choices have to be made now.
Emmanuel Macron

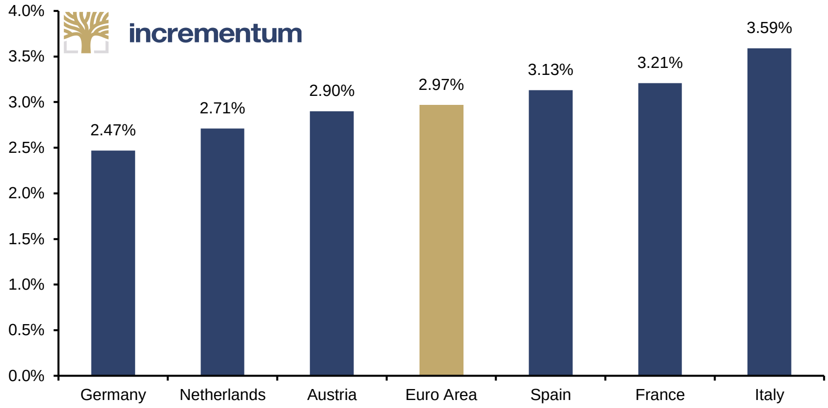
Another example is Emmanuel Macron's speech "Europe – It Can Die. A New Paradigm at The Sorbonne", which the French president delivered seven years after his first programmatic speech at the Sorbonne in September 2017, under the title "Initiative pour l'Europe – Discours d'Emmanuel Macron pour une Europe souveraine, unie, démocratique". It is up to the reader to clarify what Macron wants to achieve – the appropriation of the EU for French state objectives (i.e. an EU strongly controlled from Paris), or the establishment of an EU central state, or merely the ending of the French debt malaise through common EU debt or the securing of the current EU elite's prerogative of interpretation.

The EU net contributor countries will have to pay the bill

***NextGenEU* was the first time that joint EU debt was issued on a large scale, in 2020.** This undertaking succeeded and failed at the same time. It succeeded because it was decided to take on joint debt of more than EUR 700bn. However, the net contributor countries saw this only as a one-off concession to the special circumstances. However, the war in Ukraine immediately led to the next exceptional situation, which was exacerbated by the tensions among the major European states following the scandal in the White House involving Donald Trump, J. D. Vance, and Ukrainian President Volodymyr Zelensky. **With ReArm Europe/Readiness 2030, a further EUR 150bn is now to be raised by the EU Commission.**

Countries with reasonably sound public finances naturally pay the comparatively high bill for joint EU debt, as the EU bonds demand higher interest rates than the corresponding promissory bills of these states. This approach is economically and politically significant as long as the EU is (fiscally) a federation of states and not a centralized federal state.

European 10 Year Bond Yields, 04/24/2025



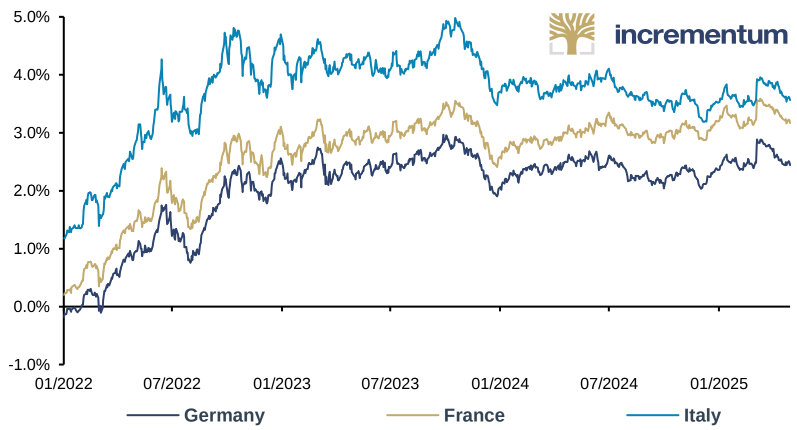
Source: mtsmarkets.com, Incrementum AG

Joint EU debt is popular for another reason. As the EU is not a central state, EU debt does not yet appear anywhere on the records.

The Italianization of France

An interesting development has been observed in bond markets since the end of 2023. **The spread between the second- and third-largest economies in the euro area has narrowed significantly. In other words, France is increasingly converging with Italy.**

10-year Government Bond Yield, 01/2022–04/2025



Source: LSEG, Incrementum AG

France is always above the 3% deficit limit. It's a French tradition.
Jean-Claude Juncker

There are fiscal and political reasons for this development. For example, Italy's budget forecast is significantly better than France's. **According to the European Commission, Italy should be able to reduce its budget deficit to below 3% in 2026, after reaching 3.4% in both 2022 and 2023. By contrast, the deficit figures for France for the same three years are 6.2%, 5.3% and 5.4%.** In both cases, it can be assumed that the forecasts are too optimistic. In absolute terms, France's national debt is already significantly higher than Italy's.

We're all better off because Italy makes the pasta and Switzerland makes the watches.
Howard Marks

In 2020, France surpassed Italy as the largest debtor in the European Union. At the end of 2024, France already had public debt of more than EUR 3.3trn, while Italy had "only" EUR 3.0trn. Relative to GDP, France remains in a significantly better position, at 113%, compared to Italy, at 135%. However, both countries are miles away from the Maastricht limit of 60% as Liechtenstein's national soccer team is from successfully qualifying for the World Cup. Together, France and Italy alone account for almost 50% of the euro area's total national debt, and more than 40% of the debt of the EU.

The problem is not the rise of populism. The problem is the economic policies that make people so desperate that they turn to it.
Yanis Varoufakis

Politically, France is an entirely different heavyweight to Italy. Italy, which used to be politically unstable – in Italy, governments used to change faster than Borussia Dortmund's coaches – is now politically stable. In France, on the other hand, one government after another has taken over. France's political instability has been further exacerbated by the hastily called parliamentary elections in June 2024. The conviction of presidential candidate Marine Le Pen at the end of March, and the immediately effective five-year withdrawal of her right to stand for election, will further increase political instability. The combination of significant budget deficits and increasing political uncertainty is also reflected in credit ratings. **In May 2024, S&P downgraded its rating from AA to AA-, and the outlook was lowered to negative at the end of February. Compared to France, S&P upgraded Italy's debt rating on April 12 to BBB+ from BBB.**

Conclusion

One of the greatest mistakes is to judge policies and programs by their intentions rather than their results.
Milton Friedman

Industrialized countries are slowly but surely facing challenges that they have previously only known as creditor states engaged in restructuring the sovereign debt of overindebted emerging or developing countries. Ultimately, there are three ways of getting government debt ratios under control:

- A productivity miracle
- Debt restructuring
- Financial repression

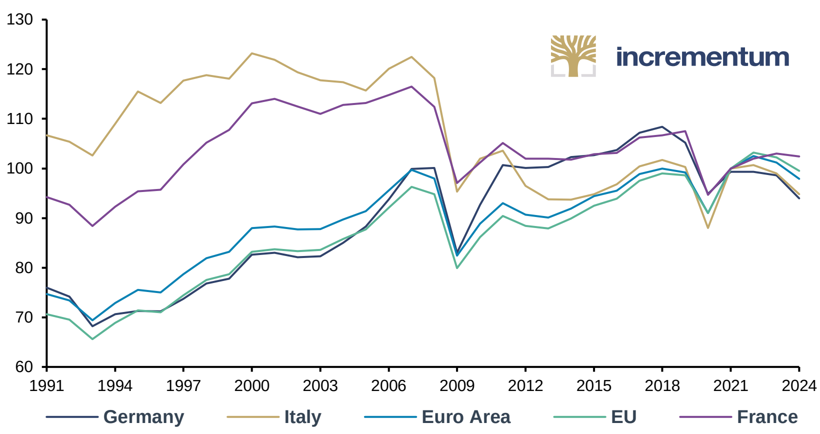
Productivity miracle

A productivity miracle seems almost impossible for the euro area under the current political framework. Although the EU Commission is backtracking on some bureaucratic monsters such as the Supply Chain Act, CO2 fines for car manufacturers, and the Deforestation Regulation (EUDR), this is ultimately only a small step – deadlines are being extended, implementation dates postponed, and turnover limits for the applicability of regulations raised. Nothing has changed in terms of the fundamental direction.

The EU reached an agreement – except it was the kind of agreement only the EU can reach; an agreement about which everybody involved disagrees.
Grant Williams

The publication of the Draghi Report on strengthening EU competitiveness generated little attention outside of Brussels. Many observers probably remember that the EU's Lisbon strategy was a failure. The aim was to make the Union "the most competitive and dynamic knowledge-based economy in the world" by 2010. This was followed by the – largely unknown – "Europe 2020" strategy, which set itself the goal of "intelligent, sustainable and inclusive growth". However, dirigisme demands and promotes dirigisme, so it is unlikely that the third attempt at dirigisme stimulus for the EU member states will be crowned with success. **The impact on industrial production in the big three, Germany, France, Italy, and the EU-27 speaks volumes.**

Industrial Production, 2021 = 100, 1991–2024



Source: Eurostat, Incrementum AG

Source: Stern.de

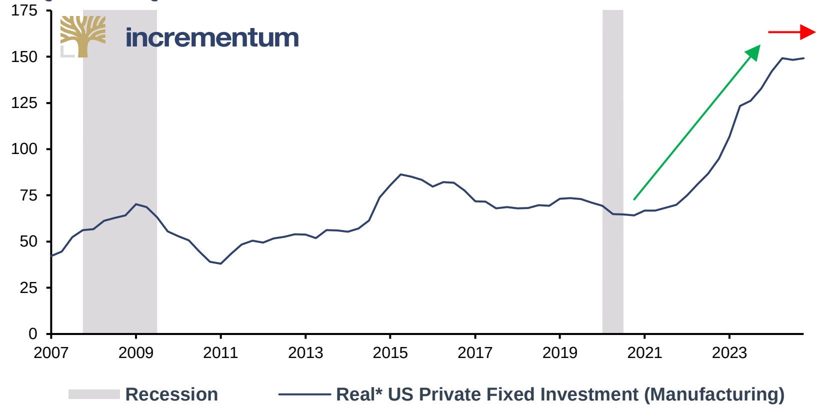
A short-term *flash in the pan* in the event of a deficit-financed rearmament would hardly change the structural imbalance in economic development. The problems around national defense are also structural. An investment gap has existed in most countries for many decades. As a result of demographic change, the population that can defend itself is declining, and an increasing number of people have their roots abroad, potentially also shifting their loyalties. In addition, the mental willingness to fight is often low. In Germany, only 27% of men would "definitely" defend Germany, 46% "definitely not". Reinstating compulsory military service in Germany for more soldiers would fail in the short term due to a lack of barracks. In this respect, the question arises as to whether a willingness to defend Germany could even be achieved in a realistic time horizon.

Never bet against America.
Warren Buffett

The medium- and long-term growth outlooks for the US are somewhat different. Despite a sideways movement from Q2/2024 to Q4/2024, real private investment in manufacturing in the US has risen significantly. **Compared to 2019, investments have doubled in real terms.** Apple, TSMC, Nvidia, Honda, IBM, and Johnson & Johnson have announced notable investments in the

US in recent months. **This could be an initial indication that Trump's hope that the tariffs will attract significant investment in the US may be justified.**

Real* US Private Fixed Investment (Manufacturing), in USD bn, Q1/2007–Q4/2024



Source: Federal Reserve St. Louis, Incrementum AG
*Base Year 2017

Demography is destiny.
Auguste Comte

Even though deporting illegal immigrants may shrink the workforce in the short term and stricter immigration policies could slow labor force growth in the long run, the US faces less severe labor shortages than Europe. The US also faces an aging population, but the issue is more pronounced in Europe. America's lower life expectancy (4.1 years less than similar countries) plays a role. Additionally, US immigrants must join the workforce quickly, while in Europe, generous welfare systems can discourage work. Despite this, the US unemployment rate remains low at 4.2% (March 2025). Still, a limited labor supply could challenge Trump's plans to revive US industry.

Debt restructuring

For the US, the proposals by Zoltan Pozsar and Stephen Miran have brought the issue of debt restructuring into the public eye. However, the Trump administration has not yet made an official move.

The accumulation of debts is perhaps the natural disease of all governments.
Alexander Hamilton

Scott Bessent could take inspiration from his eldest predecessor, Alexander Hamilton, the first US Secretary of the Treasury, who left big shoes to fill when it came to consolidating the national budget. He too was faced with the situation of getting the horrendous debt under control after the War of Independence and proposed a restructuring of the national debt. A stabilization and legal anchoring of debt repayment through a *limited redemption clause* was intended to restore the confidence of creditors and encourage them to exchange promissory bills with an interest rate of 6% for securities with an average interest rate of just over 4%. In this way, the debt burden would be reduced further and further in the long term due to the compound interest effect. This plan was tantamount to a hidden redemption fund, for which a dedicated source of revenue is required. This is where tariffs come into play again. **They could provide a suitable incentive for a debt swap and also provide a steady stream of revenue for the state coffers, which could be used for the long-term repayment of century bonds.**

In the euro area, EU centralists in Brussels will continue to try to reduce national debt burdens by increasing the use of EU debt. However, this would not be restructuring in the traditional sense, but essentially, it would be a balance sheet cosmetic. The bill in the form of relatively higher interest rates would be paid by the less heavily indebted countries, whose bond yields are lower than for the (Covid-19) debt issued by the EU Commission.

Particularly in the case of government bonds that act as an anchor for the financial system, such as those of the US or Germany, a debt restructuring would not only have a significant impact on the bond yields of these countries, but the entire financial system would also lose its anchor. Considerable distortions would be expected, not only in the bond markets but in financial markets in general. **Gold, as an anchor of stability, would likely benefit in these turbulent seas.**

Financial repression

Financial repression moves wealth from savers to debtors, and from old to young people.
Russell Napier

Debt reduction through structurally higher inflation rates only works with broad-based financial repression. In recent years, we have noted that a wave of inflation, either without financial repression or with automatic or discretionary indexation of social spending, particularly does not lead to a sustainable reduction in government debt.[18] Only the loss of purchasing power due to the time lag between the onset of the inflationary wave and the inflation-induced increases in expenditure causes a reduction in government debt ratios. However, if the inflation rate subsequently falls sharply, the original delay-related effect of reducing government debt is reversed. By capping interest rates in the *Treasury-Fed Accord* of March 3, 1951, the US got rid of its World War II debt in this way – at the expense of the bondholders.[19]

The surveillance state turns every citizen into a transparent subject, where every action, every transaction, is recorded and analyzed.
Julian Assange

The EU Commission's legislative proposal on the planned and already highly controversial asset register is still a long time coming. The results of a study examining the legal and logistical feasibility of this project were expected in the fall of 2024. Which assets are to be included is still the subject of speculation. Real estate and company shareholdings are to be included in any case, but it remains to be seen whether gold, cryptocurrencies, and works of art will also be covered. Good motives, including the fight against money laundering, are naturally justifying the possible introduction of the register. The asset register is therefore likely to be located at the EU anti-money laundering authority, AMLA. The fact that a large number of innocent citizens are to be officially registered to combat criminals is already causing unease, for understandable reasons. **Such an EU-wide asset register could significantly facilitate the implementation of financial repression measures.**

How governments use regulatory tricks to conceal their creditworthiness

A key instrument of financial repression is legislators' regulatory preference for government bonds. In an interview with The Pioneer, Oliver Bäte, CEO of Allianz, one of the world's largest insurance companies, based in

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18 See "The Status Quo of Debt Dynamics", In Gold We Trust report 2023
19 For an in-depth-analysis of Treasury-Fed Accord of March 3, 1951, see "The Status Quo of Gold," In Gold We Trust report 2021

Munich, addressed this aspect with rare candor. When asked whether government bonds are bought voluntarily or whether regulatory provisions force the purchase of government bonds, Bäte replied:

> *The politicians have come up with a very clever regulation for the financial sector. They define investing in government bonds as "risk-free". This means that if I am a Greek insurance company and I invest in Greek government debt, it is just as low-risk as the investments Allianz makes in German government debt – which is the only triple-A country in the G7. In other words, we completely ignore the real situation of the issuing state institution.*

We are being systematically driven into holding government debt – and deliberately so.
Oliver Bäte, CEO Allianz

When asked whether the government bonds of highly indebted countries, in particular, were fairly priced, Bäte replied:

> *If the question is whether they are actually paying a sufficiently high premium for the potential worst-case scenario, then I can only say: No. To put it bluntly, we would like to hold as little government debt as possible. Because we believe that this risk is very poorly priced.*

Always borrow money from a pessimist. He won't expect to get it back.
Oscar Wilde

The remarkable thing about this interview is not the content of the statement but the blunt openness. Bäte also mentions the – obvious – reason for this regulatory preference: "The refinancing costs for those who take on debt are artificially lowered." In other words, the default risk for government bonds is higher than the yield suggests. This also means that alternative hedging and investment products perform worse due to the structural preference for government bonds. Bäte mentions that today only around 11% of the investment volume managed by Allianz is invested in equities, compared to 25 to 30% in earlier times. As a result, policyholders are missing out on considerable opportunity costs.

If credit expansion, protectionism, and government spending were a path to prosperity, mankind would have long ago created heaven on earth.
Lew Rockwell

In conclusion, it is clear that the sovereign debt crisis has firmly taken hold at the core of the industrialized world, no longer confined to the periphery. Economic stagnation, demographic change, significantly higher capital market interest rates, and the cost of armaments are structural challenges that will persist for some time. The reorganization of the global political order is also playing its part, even if this seems to be developing a different dynamic following Donald Trump's return to the US presidency. **Either way, even the industrialized nations are slowly but surely having to deal with the spectre of debt restructuring.**

About Us

Ronald-Peter Stöferle, CMT

Ronnie is managing partner of Incrementum AG and responsible for Research and Portfolio Management.

He studied business administration and finance in the USA and at the Vienna University of Economics and Business Administration, and also gained work experience at the trading desk of a bank during his studies. Upon graduation, he joined the research department of Erste Group, where in 2007 he published his first *In Gold We Trust* report. Over the years, the *In Gold We Trust* report has become one of the benchmark publications on gold, money, and inflation.

In 2014, Ronnie co-authored the international bestseller *Austrian School for Investors*, and in 2019 *The Zero Interest Trap*. He is a member of the board of directors at Tudor Gold Corp. (TUD), and Goldstorm Metals Corp. (GSTM). Moreover, he is an advisor to *Von Greyerz AG*, a global leader in wealth preservation in the form of physical gold stored outside the banking system. He is also a Member of the Advisory Board at *Monetary Metals*.

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