



Unsustainable debt: Is there a path for policymakers and investors?

Fidelity's Dirk Hofschire and Irina Tytell on solving the U.S. debt problem

Key takeaways

- U.S. debt levels are already at record peacetime highs, creating unprecedented challenges for fiscal and monetary policymakers with no simple solutions.
- Institutions in this environment may want to reconsider their strategic asset allocation, with greater diversification across asset classes, geographies, and strategies.

Fidelity has been researching the potential economic and investment implications of rising global debt levels for many years. What has changed in 2025?

DIRK HOF SCHIRE: In 2020, we conducted proprietary research based on historical case studies of highly indebted countries and determined that easy fiscal and monetary policies would become the catalyst for a shift to a higher inflationary regime. We found that this structural shift would warrant greater portfolio diversification and more exposure to inflation-resistant assets.

Today, we appear to be through the first innings of this regime change, according to our latest research focused on the U.S. economy and markets. The acceleration in inflation from 2022 to 2023 helped contain debt/GDP levels despite still-large fiscal deficits. However, by 2025, persistently high interest rates and fiscal deficits raised the cost of debt servicing and put debt on an upward path. U.S. government debt levels are already at record peacetime highs.

Consider some sobering data: the CBO projects that debt will rise from 98% of GDP in 2024 to 118% by 2035.¹ Interest payments on debt were 3.1% of GDP in 2024, more than double the level in 2021—and are on pace to rise to 17% by 2035.¹ Only about 14% of the entire U.S. expenditure budget is considered non-defense, “discretionary” spending.²

In this environment, enacting stricter fiscal policy has proven politically unattainable. I would note that the CBO projects that increased tariff revenues could materially reduce primary deficits by more than \$3 trillion over the next 10 years, but also that the One Big Beautiful Bill Act approved in July would increase deficits by a roughly equal amount.¹

As we discussed in our 2020 research, there is no magic threshold that provokes a public debt crisis. But no country has ever increased debt/GDP indefinitely, and financial and economic risks increase as the level and cost of debt goes higher.

Can government and central bank policymakers solve the debt problem?

IRINA TYTELL: The debt backdrop is creating a more challenging fiscal-monetary policy dynamic. The rise in yields over the past three years marked the early innings of this new regime, a break with the decade that followed the Global Financial Crisis (GFC). Today's regime is defined by greater supply-side pressures (demographics, deglobalization, climate) that make a return to steady, low inflation and interest rates difficult. The challenges (and connection) of fiscal and monetary policy in this environment are the defining feature of this regime for financial markets.

Such complex dynamics imply that policies may be more challenged to respond to economic or financial shocks. Policy swings may generate bouts of financial-market volatility. With no simple solution to prevent debt levels from rising further, policymakers may be motivated to attempt forms of financial repression to expand the gap between nominal growth and interest rates.

"Financial repression" is the term commonly used to describe when policymakers actively attempt to set interest rates at artificially low levels in order to service the debt. For example, the United States successfully held 10-year Treasury yields around 2% during and in the years immediately following World War II in order to finance wartime expenditures.

What are the implications for the U.S. bond market?

HOFSCHIRE: The upward adjustment in long-term Treasury bond yields puts them closer to what we would consider fair value, but if debt keeps rising over the medium term, yields may need to go higher to attract the more price-sensitive private investors that now make up the vast majority of Treasury ownership.

The challenge is that government policy has to remain credible—and investors satisfied with the bond yields being earned—for this policy to be sustainable. If bondholders perceive that the government is attempting to inflate away its debt or offering insufficient yield compensation, they may become discouraged from holding government bonds. This can then result in higher interest rates, a weaker currency, and in a worst-case scenario a crisis of confidence that would devastate debt consolidation efforts.

Our long-term study of highly indebted countries highlighted several examples of financial repression efforts that ended with bouts of runaway inflation, including Germany after World War I. Having said that, we do not believe a catastrophic loss of confidence in the U.S. is the most likely scenario.

What are some possible scenarios that would make the debt sustainable?

TYTELL: History has shown that fiscal austerity is not only difficult to achieve but unlikely on its own to achieve successful debt consolidation. Instead, debt sustainability typically requires nominal GDP growth (often through higher inflation, and sometimes also through higher real growth) to be above the rate of interest paid on the debt.

According to Fidelity analysis, using CBO's baseline forecast, three possible scenarios could stabilize debt/GDP over the next 10 years: interest rates average 1.5%, inflation averages 4.0%, or real GDP growth averages 3.8%.¹ This would assume that in each case the other variables would remain at the CBO baseline, discussed in greater detail in our latest research.

Any of these scenarios would require significantly different outcomes from CBO's forecasts and a major sustained divergence between interest rates and economic fundamentals. Higher tariff revenue, higher growth, or much lower interest rates could improve the debt outlook, though the odds of them completely resolving the fiscal challenges seem unlikely. For example, U.S. real growth on a rolling 10-year basis hasn't reached 3.8% (the level needed to stabilize debt/GDP discussed above) since the late 1960s to mid-1970s. Higher growth or inflation would presumably push up interest rates, not lower them.

What steps can institutions take to better prepare for the current landscape?

HOFSCHIRE: Given the unprecedented backdrop, we believe institutions should reconsider their approach to diversification across asset classes, geographies, and strategies. Maximum diversification within a strategic asset allocation is warranted, something that with perfect hindsight we know was not as necessary during the past several decades of falling rates, low inflation, and lower debt levels.

This diversification may include inflation hedges (commodities, real assets, or TIPS); global assets denominated in non-U.S. currencies (to hedge against the potential for U.S. dollar weakness); and other hedges that offer exposure to a greater variety of conditions, such as alternatives (including liquid alternatives), gold, or bitcoin, which may have lower correlations with traditional stocks and bonds.

We also suggest funding diversification from both fixed-income and equity positions. Today's long-term valuation starting point is more favorable for U.S. bonds than U.S. equities due to fair-valuation bond yields and historically high equity PE ratios. This is a notable change from our prior research, which was written when rates were at historically low levels. In this new era, bonds will likely prove to be a crucial portion of long-term allocations, and increased diversification will need to be a "whole of the portfolio" exercise.

For more on Fidelity's global debt research, see ["Unsustainable debt: Strategic asset allocation for a new era"](#) and ["Unsustainable global debt: Roadmap for strategic asset allocation."](#)



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In this role, Mr. Hofschire leads the Asset Allocation Research Team, which conducts fundamental and quantitative research to develop asset-allocation recommendations for Fidelity's portfolio managers and investment teams. AART generates insights on macroeconomic, policy, and financial-market trends and their implications for strategic and active asset allocation.



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In this role, Ms. Tytell leads a team of research analysts for the Asset Allocation Research Team, which conducts economic, fundamental, and quantitative research to develop asset allocation recommendations for Fidelity's portfolio managers and investment teams. AART is responsible for analyzing and synthesizing investment perspectives across Fidelity's asset management unit to generate insights on macroeconomic and financial market trends and their implications for asset allocation.



Endnotes

¹ Source: Congressional Budget Office (CBO), as of June 30, 2025. Debt/GDP is CBO baseline. Does not reflect the impact of the One Big Beautiful Bill Act. <https://www.cbo.gov/publication/61187>

² Source: Center for Medicare and Medicaid Services, 2025 Annual Report of the Board of Trustees. <https://www.cms.gov/oact/tr/2025>.

About CBO forecasts and other government debt estimates

The CBO was established by the Congressional Budget Act of 1974 to provide objective, nonpartisan information to support the Congressional budget process and to help the Congress make effective budget and economic policy. The CBO is among a number of government agencies and organizations that provide estimates and analyses on the impact of policy to debt levels, which can differ based on the assumptions used and over what time periods. Other forecasts have been prepared by the Council of Economic Advisers (CEA), an agency within the Executive Office of the President established by Congress in the 1946 Employment Act, and the Committee for a Responsible Federal Budget, a non-profit, bipartisan organization. For more, please see: cbo.gov; whitehouse.gov/cea; and crfb.org.

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In general the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Unlike individual bonds, most bond funds do not have a maturity date, so avoiding losses caused by price volatility by holding them until maturity is not possible. Lower-quality bonds can be more volatile and have greater risk of default than higher-quality bonds.

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