MEGATRENDS 2025

# Trust or bust:

## the next era of global debt sustainability

# Special thanks

Debt sustainability is a limitless subject. Many of the world's best economic thinkers have spent a lifetime tackling the topic with qualitative and quantitative rigor. We leaned heavily on this work and cite it extensively. We, therefore, thank and acknowledge the broader body of research aiming to provide guidance on near-term risks and long-term possibilities relating to debt management.

We also humbly thank our business partners. Our fellow practitioners at Apogem, Candriam, MacKay Shields, Tristan Capital Partners, New York Life Investors, and NYLI Multi-Asset Solutions enriched this work with their skilled research and productive debate. The investment takeaways of this research reflect the breadth and depth of the New York Life Investments platform.

We owe gratitude to our parent company, New York Life Insurance, including its Actuary organization, whose partnership allows us to expand our vantage point when considering long-term themes.

Finally, we thank our rotating analyst, Ryan Thatch, who has enriched this project with diligent research and data analysis.

# Global Market Strategy at New York Life Investments

Our team of market strategists connects macroeconomics to asset allocation. Leveraging proprietary research alongside the breadth and depth of the New York Life Investments platform, we provide actionable insight into market-driving events, structural themes, and portfolio construction to empower investment decision-making.

**Lauren Goodwin, CFA**
Chief Market Strategist

**Julia Hermann, CFA**
Global Market Strategist

**Michael LoGalbo, CFA**
Global Market Strategist

# Introduction: **the next era** of global debt sustainability

We've created us a credit card mess
We spend the money that we don't possess
Our religion is to go and blow it all

**Shania Twain**
*Ka-Ching!*, 2002

Debt has been around since the barter system—before money itself. Over millennia, the ability to borrow and lend evolved into a system of credit that, in many ways, has become the lifeblood of the global economy. Debt is everywhere—and whether that debt is "good" or "bad" depends on the answer to this question: can you pay back your debt, or can't you?

This question implies that debt carried *un*sustainably will, at some point, face a reckoning. For households and small businesses, these mechanics hold: if you borrow more than you can pay back, you face a default, a seizure of collateral and a hit to your creditworthiness. Large corporations have additional tools, via public and private credit markets, to "extend and pretend" via restructuring. But even for those with a wider variety of debt management options, eventually the piper must be paid.

The story is different at the sovereign level, for which debt sustainability has taken on an almost mythical nature. Societies rely on an undercurrent of government spending, and sovereign debt accrues rapidly in times of crisis—often sparing households and businesses the most painful parts of the economic cycle. Investors have tried and failed to consistently discern between sustainable and unsustainable government debt levels. There is even less evidence that over-leverage consistently culminates in default and its painful consequences. The larger and more systemically important the sovereign, the greater the inclination of the investment community to say "it's a problem for tomorrow, not for today."

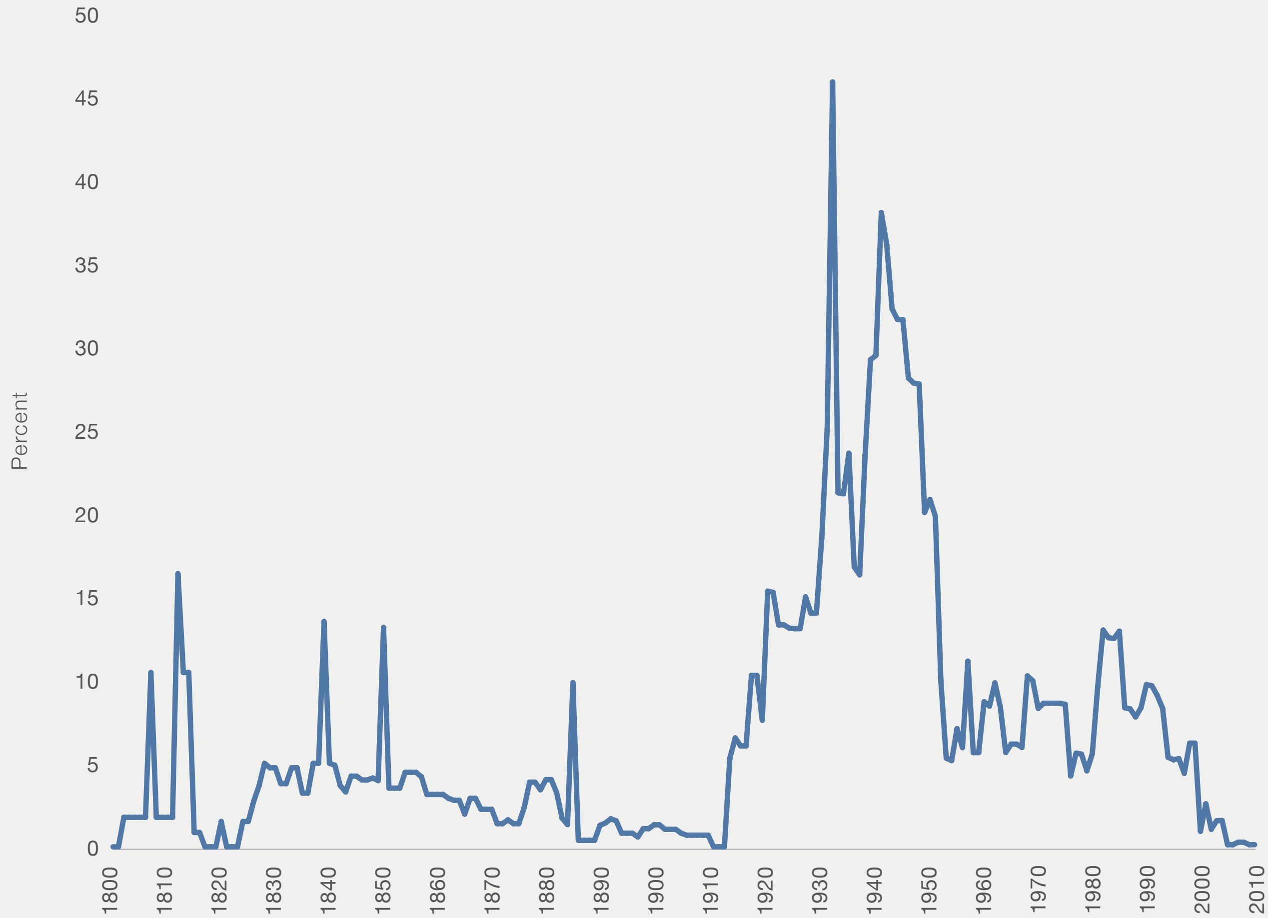
Many a book, academic thesis, and article of financial journalism have attempted to pinpoint when the proverbial "can" of national debt can no longer be "kicked down the road." And because sovereign debt is so pervasive in global economic functioning, discussions about debt branch into everything from currency behavior to financial system plumbing to geopolitics. It is a daunting lane to drive in.

**The reality of sovereign debt sustainability is simple: debt is sustainable at any level if there is demand for it. Specifically, sovereign debt is sustainable if investors maintain demand for the debt *at interest rates the borrower can afford*.**

In the post-war era, demand for sovereign debt has generally been strong and sovereign defaults have been increasingly rare – a dynamic all the more notable given seismic economic shifts throughout this time period: the fall of communism in the former Soviet Union; the rise of China; the rise and fall of the Bretton Woods gold peg; and ever-rising global debt levels. Underpinning debt sustainability is a symbiotic relationship between the federal debt of the United States and global savings: U.S. Treasuries offer a moderate, risk-free yield that has become a sink for the excess savings of other countries. In the last 20 years in particular, the relationship between Treasuries and savings has enabled and benefited from globalization: as the world has integrated, demand for the reserve currency has broadened. We will explore these dynamics in more detail throughout this research.

## The post-war era has marked a normalization toward sovereign debt sustainability

*Percent of countries in sovereign external debt default or restructuring, 1800-2012*




Sources: New York Life Investments Global Market Strategy, Carmen M. Reinhart and Kenneth S. Rogoff: *This Time is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009), Lindert and Morton (1989), Macdonald (2003), Maddison (2003), Purcell and Kaufman (1993), Reinhart, Rogoff and Savastano (2003), Suter (1992), and Standard and Poor's (various years).

The backdrop of relatively sustainable global debt has lasted over 70 years, but we believe the time is now to have a new conversation about the next era of global debt management. Governments' obligations to their citizens are evolving, and we see near-term disruptions to the status quo stemming from aged populations, climate and tech adaptation, and a broader definition of national security.

**We believe many major economies, including the U.S., Europe, Japan, and China, are each grappling with an inflection point in their economic path, and therefore their debt management.** The options countries have in managing their debt load ahead – austerity, growth, inflationary financial repression, and financial engineering – have dramatically different consequences for global asset allocation.

Up to now, even very long-term investors have struggled with how to take debt sustainability into account, and many end up ignoring it. We, however, see concrete investment opportunities in how specific countries adapt to their growing debt burdens, and we envision investable themes stemming from global trends in debt management.

We believe the time is now to have a new conversation about the next era of global debt management.

# Safe or sorry: the debt sustainability legacy

Big money goes around the world
Big money give and take
Big money done a power of good
Big money make mistakes
Big money got a heavy hand
Big money take control
Big money got a mean streak
Big money got no soul

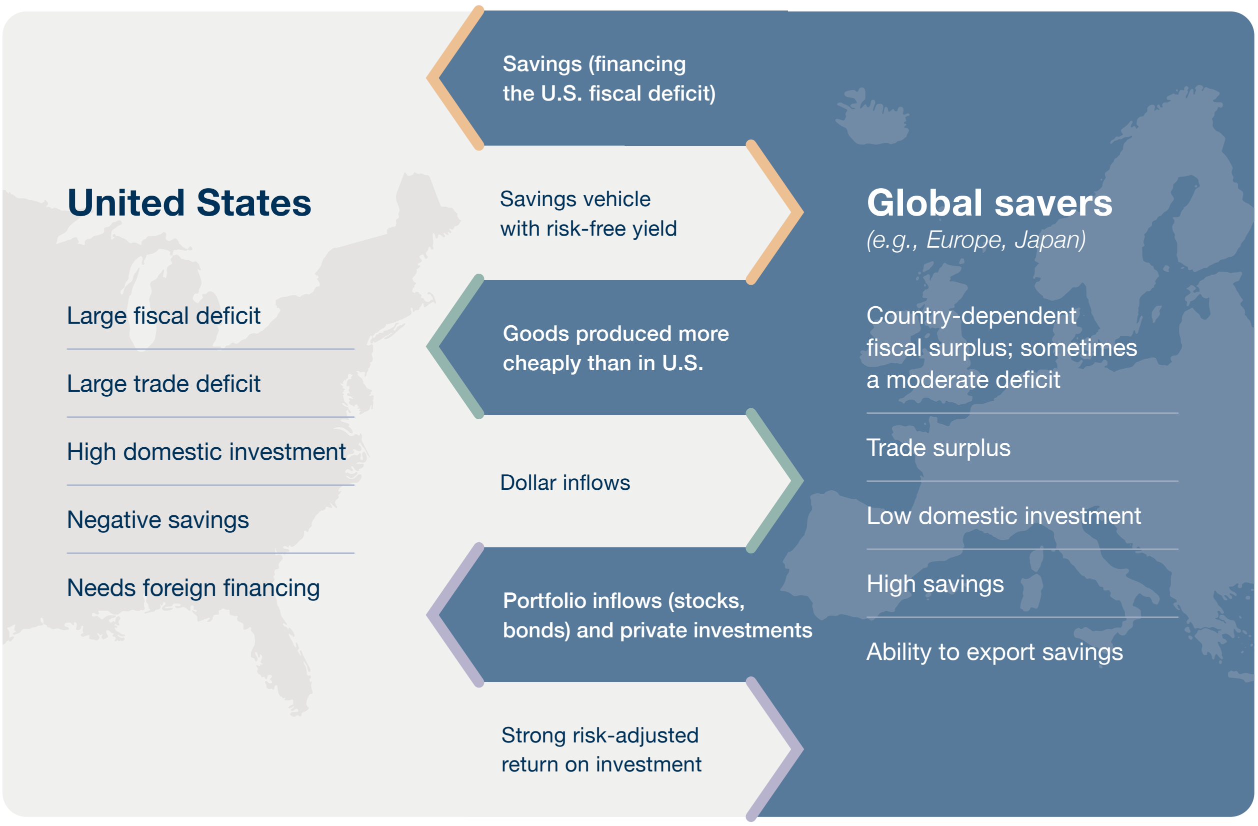
**Rush**
*The Big Money,* 1985

Debt is sustainable as long as there is demand for it. When we consider what major economies' debt management will look like and how it will shape investment outcomes over the next decade, we must start with the provider of the world's risk-free rate, and the ultimate influencer of global capital markets dynamics: the United States.

In the post-war era, global debt, investment, and savings dynamics have been driven by a symbiosis in the flow of global savings: **dissaving in the U.S. enables excess saving by other major economies.** In other words, U.S. Treasuries and other assets provide sources of return the rest of the world relies on.

## Debt sustainability has stemmed from symbiosis between savers and dissavers

*Stylized flow of global savings, debt, and investment*




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

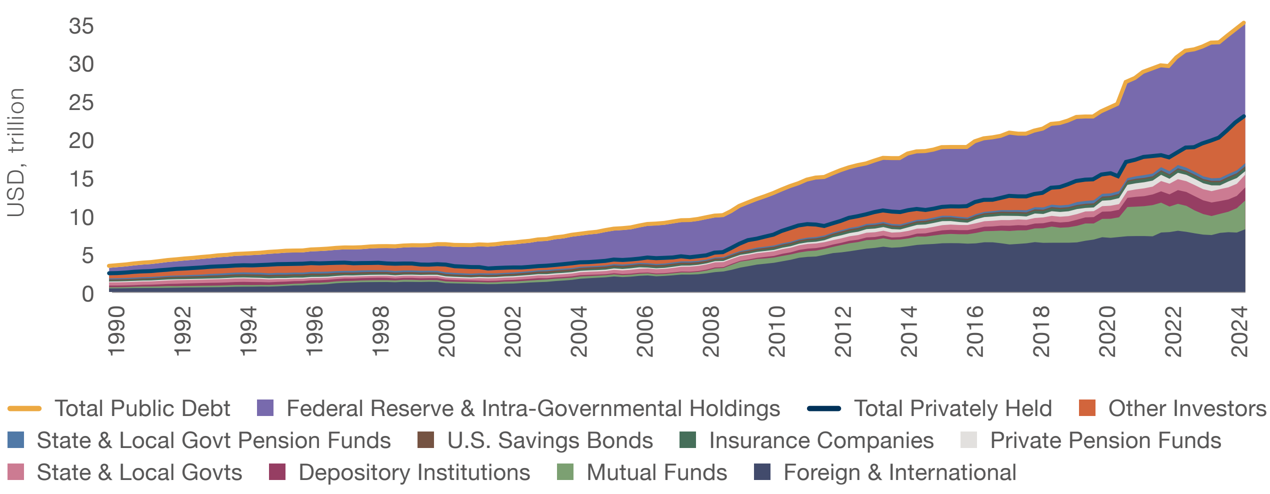
The economist credited with identifying the early days of this symbiotic dynamic was Dr. Robert Triffin, a Yale economics professor who in 1959 and 1960 warned Congress of an unsustainable trend he had spotted in the international monetary system. The then-gold-backed U.S. dollar was held in reserve by trade partners for foreign exchange. Triffin posited that as global trade grew, so too would demand for dollars. And to meet this demand, the U.S. would need to supply liquidity—effectively limiting its ability to accumulate savings. In other words, providing the world's reserve currency would require the U.S. to run persistent balance of payments deficits, ultimately undermining the U.S. dollar's peg to gold. This contradiction, later called *Triffin's Dilemma,* came to a head in 1971 when the Bretton Woods system collapsed.

If Triffin's original dilemma was a monetary one, a fiscal framing fits today's financial system better: what we might call the *neo-Triffin dilemma.* The mechanics: with the exception of four years since 1970,[1] the U.S. has run persistent twin—fiscal and current account—deficits,[2] fueling the accumulation of federal debt. To finance these deficits, the U.S. Treasury issues ever-growing volumes of government bonds, backed by the full faith and credit of the United States government. Credit rating downgrades in 2011, 2023, and 2025 that resulted in the loss of its AAA status notwithstanding, this debt is treated as the risk-free base of the global financial system. Global savers, from central banks to households and institutional investors to corporate treasury departments, gobble up this debt and rely on its moderate, guaranteed returns as a sink for their excess savings.[3,4]

## Foreign investors comprise nearly a quarter of U.S. public debt holders

*U.S. public debt by holder*

**Per the Federal Reserve Bank of New York, foreign Treasury holdings are split nearly equally between the official sector—mostly central banks and sovereign wealth funds—and the private sector, which includes institutions such as banks, insurers, hedge funds, and pension funds. Foreign and international holdings include holdings of offshore branches of U.S. firms.**



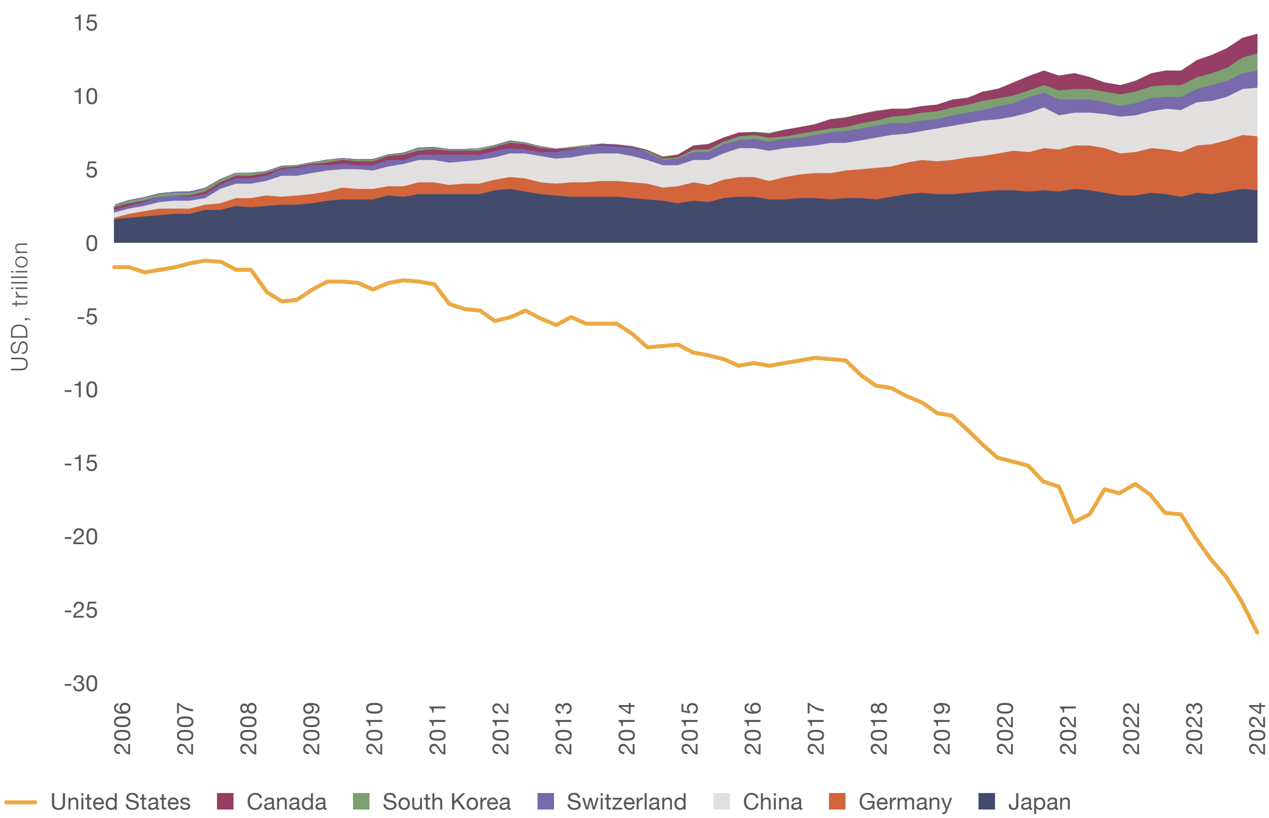

Sources: New York Life Investments Global Market Strategy, U.S. Department of the Treasury, Macrobond, June 2025. Private Treasury holdings refer to those held by all holders, excluding Federal Reserve and intragovernmental holdings.

1. The U.S. ran a federal budget surplus from 1998-2001.
2. Twin deficits refer to both fiscal and current account deficits. A fiscal deficit results when a government spends more than it earns in tax revenues. A current account deficit results when a country spends more on imports than it earns from its exports.
3. The savings identity of an open economy is: S=I+(G-T)+(X-M), or savings=investment+(government spending less tax revenues)+(exports less imports). The U.S. has a high investment rate, but steep fiscal and trade deficits, which results in a very negative savings rate. The U.S. services these negative savings with debt issuance. Demand for these debt instruments comes from a mix of the Federal Reserve, domestic investors, and public and private entities in major economies that have a high rate of savings, including many European countries, Japan, and China.
4. Even with excess savings, major savers the including many European countries and Japan still face their own debt sustainability concerns. However, these economies often have a trade surplus that exceeds the fiscal deficit and invest relatively little at home, resulting in exported savings to the U.S.

## The U.S. is the largest capital importer in the world

*Net International Investment Position (NIIP) of major economies*

**Net International Investment Position (NIIP) measures the difference between a country's foreign financial assets and liabilities, providing an aggregate view of the net financial position of a nation in relation to the rest of the world. While financial assets and liabilities can include both equity and debt instruments, a negative NIIP indicates a net debtor; a positive NIIP indicates a net creditor.**




Sources: New York Life Investments Global Market Strategy, U.S. Bureau of Economic Analysis (BEA), Bank of Japan, State Administration of Foreign Exchange of China, National Bank of Switzerland, Central Bank of Germany, Bank of Korea, Statistics Canada, Macrobond, June 2025.

**If the Triffin dilemma has so reliably underpinned the workings of the global financial system, why is it considered a dilemma? The paradox is one and the same as the debt sustainability question: at what point does all this debt stop serving global savers—and start breaking things?**

## Pillars upholding the status quo

While the Triffin dilemma ultimately reflects basic supply and demand dynamics, its durability over the past 70 years owes much to three mutually reinforcing features of the global financial system. These structural supports have enabled the U.S. to run persistent deficits while maintaining the confidence of global investors.

1

### Exorbitant privilege

Nearly all commodities are priced in dollars. Aircraft, regardless of the maker or buyer, are priced in dollars. 54% of all foreign trade is priced in dollars. 58% of international payments, other than those intra-eurozone, are made in dollars.[i] 57% of all global reserves are dollars, triple those of the euro, the next largest provider. These statistics are the tip of the iceberg in proving just how far exorbitant privilege,[5] or the special demand for the U.S. dollar as the world's reserve currency, permeates into the global financial system.

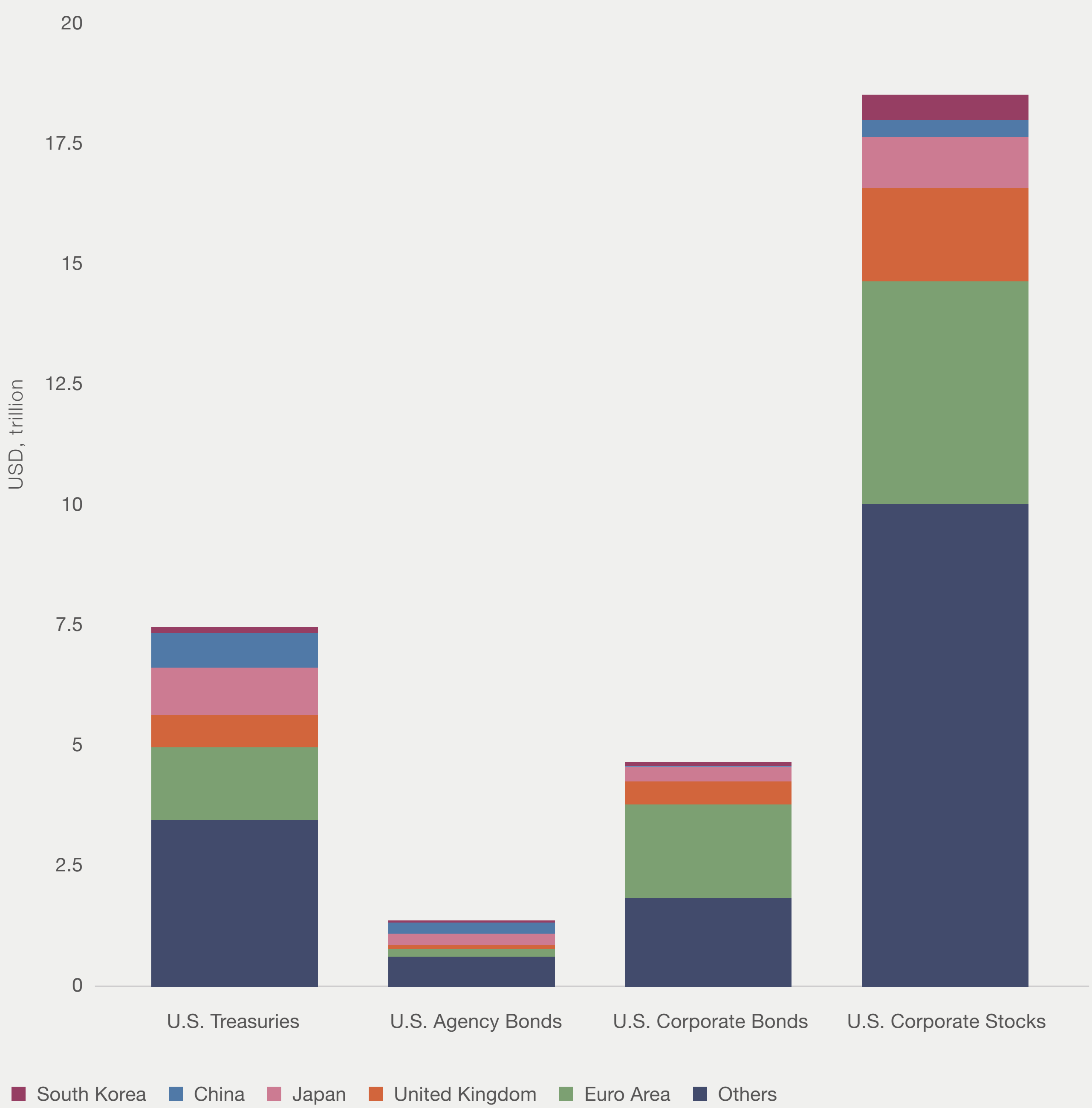
Exorbitant privilege is inseparable from conversations about Treasury demand and debt sustainability. To accommodate the dominance of the dollar in all manner of financial dealings, global central banks, multinational banks, and companies must hold large quantities of dollars in reserve. Rather than sit on physical cash that yields nothing, global actors commonly reach for U.S. Treasuries—an asset class so deep, liquid, and historically safe that short-term Treasuries are colloquially referred to as cash itself. In other words: **the first and foremost benefit of exorbitant privilege is structural demand for U.S. debt, which allows the Treasury to issue debt at lower interest rates than it could otherwise.**[6,ii] Research from economists affiliated with the National Bureau of Economic Research suggests exorbitant privilege could add as much as 22% of GDP[iii] to the sustainable debt level the U.S. can carry.[7]

Treasuries aren't the only assets benefiting from dollar dominance. Broader U.S. capital markets –the largest and deepest in the world[8,iv]—also attract global savings.

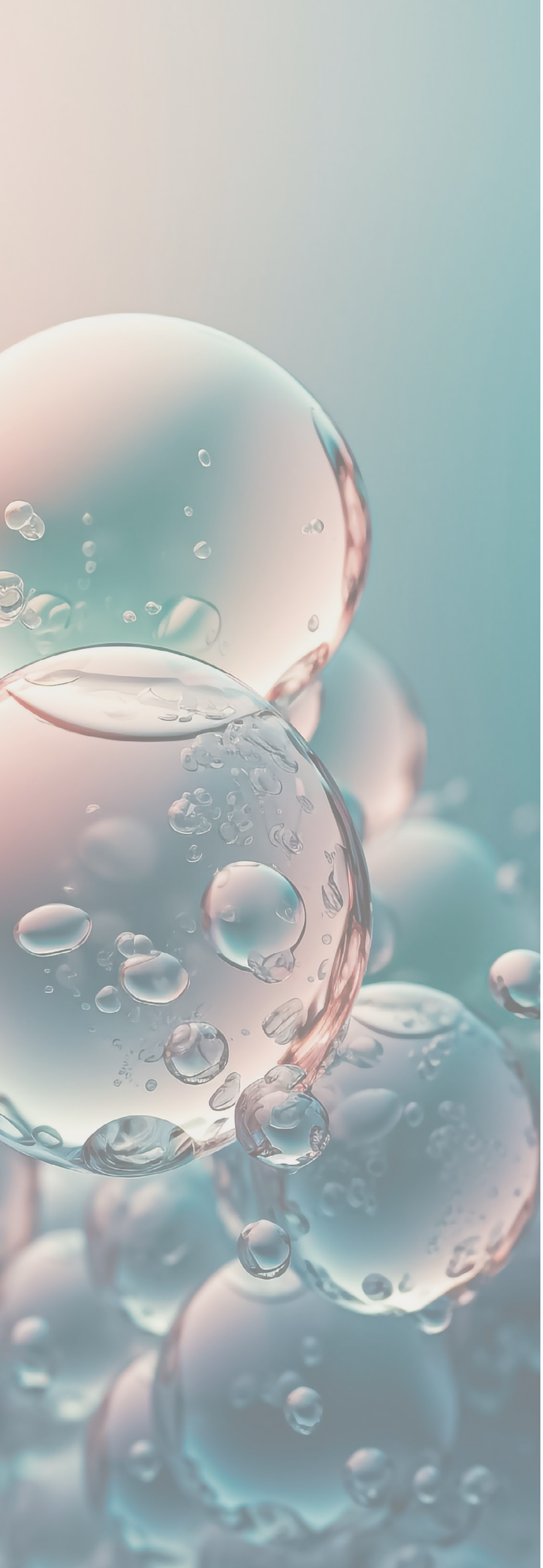
5. The term "exorbitant privilege" was first coined in 1960 by Valéry Giscard d'Estaing, who was then the French Minister of Finance and later became President of France. He used the phrase to criticize the special advantages the U.S. enjoyed because the U.S. dollar served as the world's primary reserve currency.
6. In exchange for the liquidity and safety of Treasuries, investors forego a sizeable amount of yield, called the convenience yield. The convenience yield is equal to the spread between Treasury yields and those of investment grade corporate bonds of the same duration.
7. The Laffer curve posits that past a 100% debt-to-GDP ratio, economic output falls. Per NBER research, exorbitant privilege could increase the threshold of sustainable U.S. public debt to 122% of GDP. As of Q4 2024, U.S. total public debt was 121.85% of GDP.
8. As of 2024, U.S. equity markets represent 42.6% of the $115.0 trillion in global equity market capitalization; this is 3.9x the next largest market, the European Union. U.S. fixed income markets comprise 39.3% of the $140.7 trillion securities outstanding across the globe; this is 2.1x the next largest market, the EU.

## Foreign participation in U.S. instruments extends far beyond Treasuries

*Total foreign holdings of long-term securities: U.S. Treasuries, agency bonds, and corporate stocks and bonds*




Sources: New York Life Investments Global Market Strategy, Federal Reserve, U.S. Department of the Treasury, Macrobond, June 2025. All securities are reported at current market value. Treasuries: debt securities issued directly by the U.S. Department of the Treasury, including Treasury bills, notes, and bonds. U.S. agency bonds: debt securities issued or guaranteed by U.S. government agencies and government-sponsored enterprises (GSEs), such as Fannie Mae, Freddie Mac, and Ginnie Mae, including agency mortgage-backed securities (MBS) and other obligations. U.S. corporate stocks: equity securities issued by U.S. corporations, representing ownership interests. This includes common and preferred stocks of publicly traded and privately held companies. U.S. corporate and other bonds: debt securities issued by U.S. corporations and other entities, including municipal securities. Country-level holdings include holdings by central banks, sovereign wealth funds, private banks, insurers, hedge funds, and pension funds.



2

### Quality of spending

In an ideal world, the U.S. would run deficits to fund high-quality, productive investments in technology, infrastructure, and more that support both domestic growth and global economic capacity. Given the flow of global savings into U.S. markets, the U.S. federal government would, in effect, be investing on behalf of global savers.

In reality, however, U.S. public spending has grown inefficient, and the return on investment has diminished over time.[9] Still, with a potential growth rate of roughly 2.0% vs 1.0% in Europe and Japan, the U.S. continues to offer relatively more productive opportunities than most major saving economies.

The U.S. also does an excellent job of protecting its private sector from "crowding out." Crowding out can occur when interest rates on government securities rise, reducing the risk-adjusted appeal of private capital, or in periods of bloated public spending, which can weigh on potential growth and limit the overall investment capacity of an economy. Conversely, a country can "crowd in" its private sector with productive public spending that encourages private investment. While government policy need not explicitly crowd in its private sector to stay productive, it does need to provide a constructive operating environment (stability in interest rates, inflation, taxes, regulation, etc.) that allows the private sector to flourish on its own.

9. This is difficult to prove directly, as a key metric for determining the efficacy of fiscal policy on economic output – the fiscal multiplier – is specific to each government intervention and not comparable across countries or time horizons. On a broad scale, GDP growth has decelerated relative to federal debt growth in major economies over time.

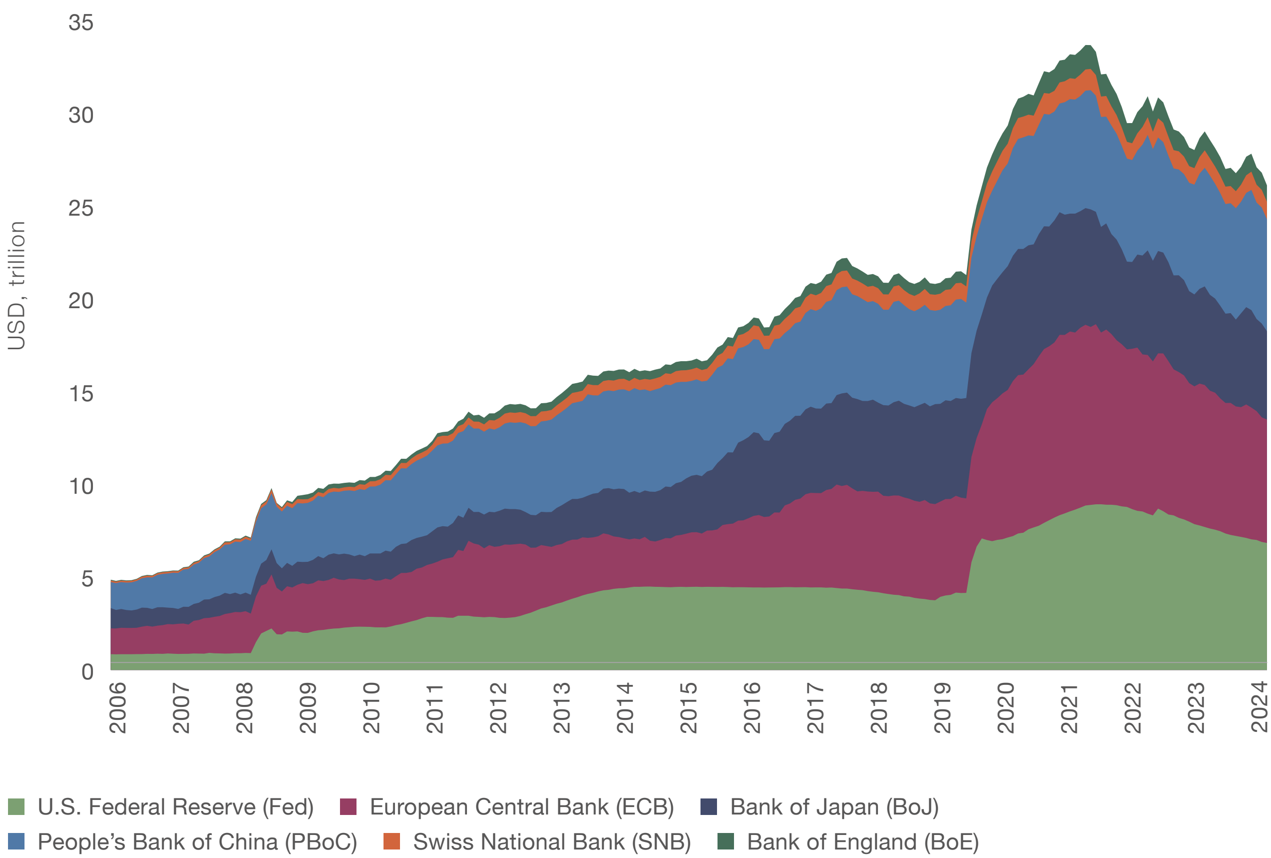
3

## Central bank backstop

Given the importance of central banks in markets today, it's easy to forget how recent certain aspects of their role really are. Though the Bank of Japan was the first to engage in quantitative easing (QE) back in 2001, it was not until the Global Financial Crisis (GFC) that global central banks, facing the collapse of financial and banking systems, began purchasing government securities at scale. The resulting stabilization of financial markets was accompanied by a ballooning of central banks' collective balance sheets from about $5 trillion in 2006 to a peak of nearly $34 trillion in 2022. Bond purchase programs have helped suppress sovereign yields in times of stress, but with central banks now holding such large portions of public debt, the question of how much they can—or should—continue to absorb has become central to the debt sustainability debate.

### The central bank awakening: absorbing sovereign debt since the GFC

*Combined balance sheets of major global central banks*




Sources: New York Life Investments Global Market Strategy, ECB, BoJ, BoE, Federal Reserve, SNB, PBoC, Macrobond, June 2025

# **Haven or hell:** the inflection point of debt management

Money talks and we're the living proof,
There ain't no limit to what money can do
Money talks, money talks.

**The Kinks**
*Money Talks,* 1974

## The Triffin tradeoff can persist…

In line with our view that global savings and U.S. risk-free debt exist in symbiosis, we believe U.S. Treasury debt can remain sustainable so long as both sides of the relationship hold up. For the current debt equilibrium to persist, we must see:

1. **The U.S. government maintains its commitment ("full faith and credit") to repay its debts**
2. **Other major economies continue to save in excess**

If these conditions are in place, perpetually rising sovereign debt levels need not cause mounting fears of a global debt crisis.

The problem is that either of these factors can force a change in the other. If U.S. policy explicitly or implicitly disrupts investor confidence in its treatment of Treasury holders, global savers are incentivized to reduce their exposure to what may no longer be considered a risk-free asset. Savings could move home. Conversely, should major savers decide to save or invest more at home, U.S. Treasuries lose a key source of demand. In both cases, Treasury yields would need to rise to attract investors, possibly to a level the U.S. cannot afford. The Federal Reserve could step in as a demand backstop, but eventually, this intervention would be likely to create inflation and a negative spiral of eroded investor confidence and higher interest rates.[10,v]

Such seismic shifts wouldn't happen overnight. The depth of U.S. capital markets and the diversity of global Treasury and dollar holdings could create a significant cost to all global actors if Treasury guarantees and global investments in U.S. assets are disrupted. Much more likely, in our view, is that greater and reprioritized spending needs will chip away at the pillars upholding the status quo: exorbitant privilege (in general, demand for any given country's debt), government spending quality, and targeted use of the central bank backstop.

10. Rising interest rates on government securities may cause the central bank to become unprofitable because it must pay out more on its obligations than it collects from its assets. While this has not yet had an impact on central bank operating ability, it may contribute to a deterioration of investor confidence, which can prompt interest rates higher.

## …but the pillars of debt sustainability are primed for disruption

DISRUPTIONS TO PILLAR 1

### Exorbitant privilege takes a (self-imposed) hit

Russia, after its invasion of Ukraine, was heavily sanctioned and exiled from the SWIFT[11] international payments system, effectively making its dollar holdings worthless overnight. Both prior to and after this shock, Russia replaced its dollar reserves with gold and Chinese renminbi. China, for its part, has been steadily reducing the dollar's share in the global basket to which its currency is pegged, freeing up gradual space to diminish its holdings of dollar reserves.[12,vi]

This is just one recent example of a broader reality: the more onerous it is to interact with the dollar,[13] the more workarounds to the dollar are incentivized. Accordingly, geopolitical risk can certainly erode exorbitant privilege and disrupt the symbiosis of global savings. *But without a viable alternative to U.S. Treasuries and capital markets, this risk will likely be very slow to develop.*

Such an alternative—and therefore the greater geopolitical threat to Treasury demand—could come from friend, foe, or innovation. We offer one example of each below.

First is Europe's "call option" on its own savings. Europe's sovereign credit and broader capital markets are not integrated, and therefore not ideal as a vehicle for savings and coordinated investment. But geopolitical strife or threats to the Treasury guarantee could prompt Europe toward credit market integration, providing itself and the world a savings alternative that would gradually deteriorate a structural backstop of Treasury demand.

Second is China's option to liberalize its capital markets. For the past 20 years, China's export profits have provided the country with a reliable source of dollar inflows. These flows have enabled China to keep its currency value managed, its capital account closed, and its onshore capital markets largely foreign-investor-free. China has recognized the slow decline of its export-led growth model, and has tried to foster growth led by domestic consumption. Increasingly fragmented global trade relationships and steep tariff policy between the U.S. and China could speed this transition. Should this convince China to go through the tumult of opening its capital account, rebasing or free-floating its currency, and opening its markets to greater foreign investment, many countries in the "global south" may jump at the opportunity to diversify outside of dollar and Treasury exposure.

Finally, innovation could present an alternative to the dollar. Stablecoin, for example, has received much attention as a cryptocurrency that could provide a reliable store of value. Given the decentralized nature of cryptocurrencies, such a system would be truly global, allowing a work-around to sanctions and dollar dependence.

11. The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a global messaging network used by banks and financial institutions. The U.S. dollar accounts for over 50% of payments processed through this network.
12. As of April 2025, the USD comprises 18.9% of the China Foreign Exchange Trade System (CFETS) basket against which its currency is managed, down from 26.4% in 2016.
13. Difficulty interacting with the dollar can come from high costs (strong dollar; expensive hedging costs) or high constraints (sanctions; threats of excommunication from international payments and trade relationships).

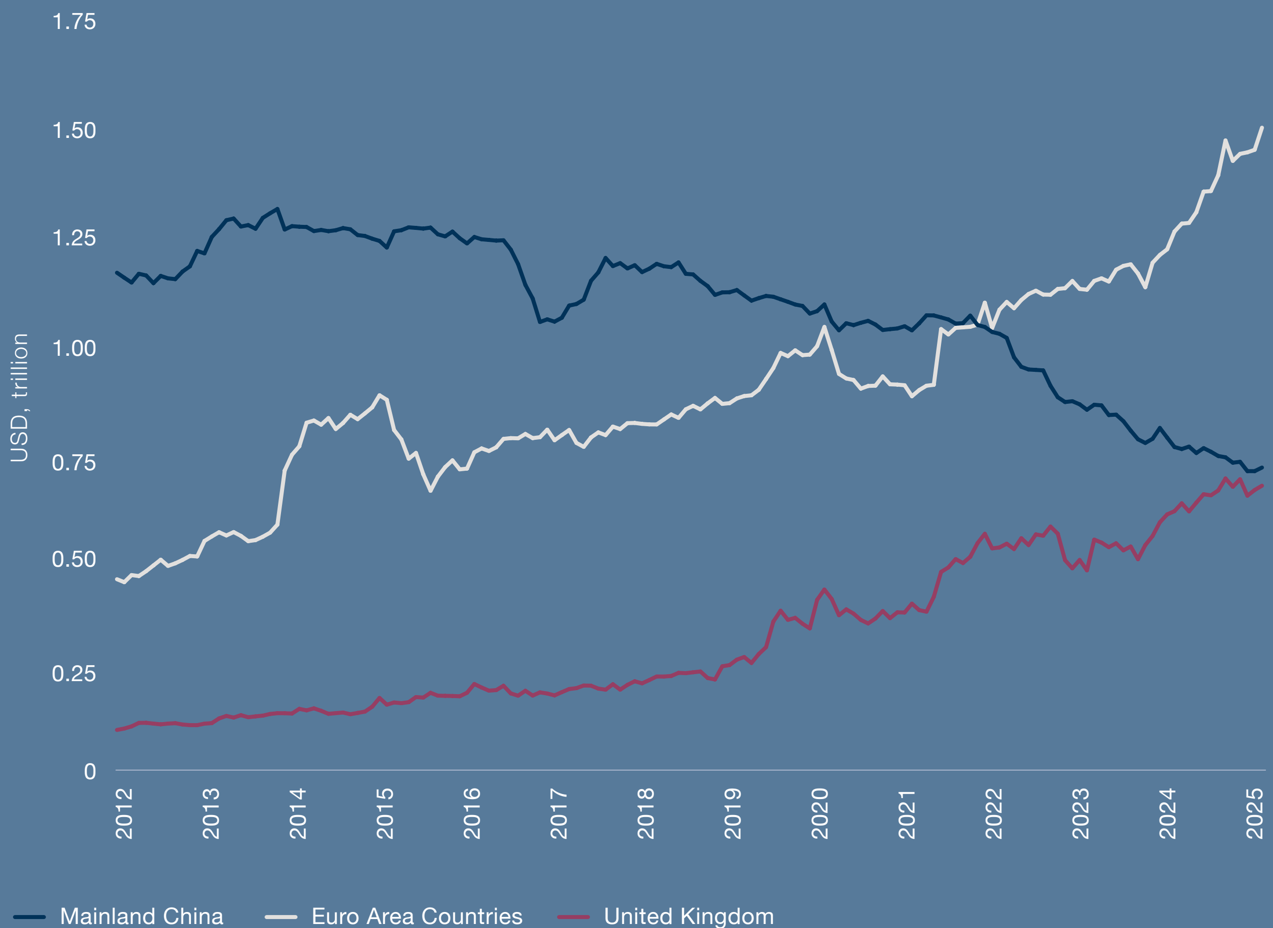
# How much can China disrupt the Treasury market?

As geopolitical tensions have increased between the U.S. and China, questions about the degree of financial integration between the two countries have become louder. In this context, the possibility of China "dumping" its Treasury holdings has gained traction, but in our view this is an overblown risk.

In 2011, China comprised 30% of foreign ownership of Treasuries. Today, it owns 10%. But this shift is marginal in U.S. terms: China has moved from 9% to 2% of total public Treasury ownership[14]—no longer a large enough share of Treasury demand to send U.S. yields soaring in the event of decoupling. This move has also been compensated for, namely by Treasury buying from the euro area, which now holds 8% of U.S. public debt (nearly 38%[vii] of foreign Treasury ownership), as well as the UK.

## Gradual runoff in Chinese Treasury holdings has been compensated for by European and UK buying

*Select foreign holdings of U.S. Treasuries*




Sources: New York Life Investments Global Market Strategy, Federal Reserve, Macrobond, June 2025. Country-level holdings include holdings by central banks, sovereign wealth funds, private banks, insurers, hedge funds, and pension funds.

14. The Chinese Treasury holdings discussed here are those held by Mainland China. Brad Setser of the Council on Foreign Relations has provided some evidence that China has been increasingly utilizing U.S. agency bonds and offshore custodians, potentially maintaining greater dollar reserves and demand for dollars than onshore Treasury holdings show directly. Because China's indirect holdings are estimates, we have focused on China's direct holdings.

DISRUPTIONS TO PILLAR 2

## Investors are increasingly likely to reward quality spending

More productive sovereign spending can improve debt sustainability—especially when returns on that spending exceed the cost of capital. Markets increasingly play a role in determining which investments are seen as efficient in key areas:

**"Aging populations" are becoming "aged populations,"** shortening the duration of a key liability for many countries. The old-age dependency ratio in Europe is expected to reach 54% by 2070, lagging Japan by 15-20 years.[viii] The U.S. OMB and UK OBR[15] each cite age-related costs as reasons behind staggering deficit forecasts over the coming 50 years.[ix]

Governments may need to play a greater role in **adapting economies to rapid technological change**—particularly if AI proves disruptive at scale. This could involve support for worker retraining, employment-linked subsidies, or even Universal Basic Income,[16] should labor displacement become widespread. In this framing, public policy doesn't crowd out private investment—it enables it, by absorbing the adjustment costs.

Climate-related events are already forcing large-scale spending on **disaster recovery and mitigation**. In 2023, natural catastrophes caused $280 billion in losses globally, only 39% of which were insured.[x] Future infrastructure needs for mitigation and recovery run into the trillions of dollars. As with supply chain shifts, climate adaptation may be economically redundant in a traditional sense—but is still essential to reduce long-run vulnerability.

A string of global shocks—from COVID-19 to Russia's invasion of Ukraine—has **broadened the definition of national security** for many nations. Strategic resilience now includes access to health care, food, semiconductors, and critical raw materials. It is becoming more politically acceptable and increasingly necessary to shift supply chains to ensure domestic capacity, even at a higher cost. The resulting investment will likely span governments, corporations, and households—pushing spending structurally higher over the coming decade.

DISRUPTIONS TO PILLAR 3

## Countries may be forced to lean on central bank buying

Ultimately, the central bank is the buyer of last resort, absorbing volumes of government securities that other investors cannot manage. New waves of investment may be productive, but ultimately add to spending needs and may increasingly force central banks into the position of absorbing excess supply of government debt securities.

Increased spending needs, along with potential threats to global preference for the dollar, add to an already notable burden on central banks, which are expected to cushion the economic cycle for households and corporations in crisis periods. In the U.S., the "Fed put" has been effective, allowing households to de-lever outright since the GFC[17] and supporting cyclical de-levering among corporations.[18] The reduction of debt burden on households and businesses, at the expense of the central bank, aligns with the debt management tools each has available. However, excessive use of the central bank backstop could create a negative cycle of inflation, higher interest rates, and damage to investor confidence, as discussed previously.

Proper debt management will require a constrained central bank: one that is willing to provide shelter in crisis, but not an ongoing source of artificial demand for national debt.

15. U.S. Office of Management and Budget; UK Office for Budget Responsibility.
16. Universal Basic Income would provide citizens with direct payments, intended to ensure a basic standard of living in a country.
17. Household debt to GDP declined from 101% in 2007 to 74% in 2023.
18. Non-financial U.S. corporate debt-to-GDP declined in the mid 1970s, early 1990s, early 2000s, early 2010s, and early 2020s.

# Paths to more sustainable debt

Managing sovereign debt through economic cycles has always required adaptability. Today, that flexibility matters even more, as shifting policy priorities introduce structural uncertainty alongside traditional cyclical risks. The choices governments make will shape long-term capital markets assumptions around inflation, interest rates, and potential growth; and will influence asset allocation.

Below, we outline four examples of debt management approaches likely to be used by major economies. **While not exhaustive, they represent our view of the most relevant non-default pathways for the current global environment.**

## Countries have choices when it comes to debt management

*Examples of sovereign debt management approaches*

### Austerity

Cutting government spending

Austerity focuses on sustained, broad-based spending cuts—not just trimming deficits (flow), but driving down overall government debt (stock).

**Examples**

**Eurozone debt crisis management:**
Greece, Ireland, Portugal, Spain (post-2011)

### Growth

Driving productivity to reduce debt

Growth-led strategies use investment and reforms to expand GDP faster than debt, improving sustainability.

**Examples**

**South Korea (post-1997):** rebound from Asian debt crisis with rapid industrialization

**China (2000-2021):** export-led growth offsetting rapid pace of domestic credit creation

### Financial repression

Inflating debt away

Financial repression combines warm inflation with interest rate suppression—often via both regulatory and financial engineering. This approach erodes the real value of debt ("inflating the debt away"), but earns the term "repression" because it forces domestic investors to cope with negative real rates of return.

**Examples**

Global approach led by the U.S. and UK post-WWII through late 1970s

### Financial engineering

Tinkering with financial conditions

Financial engineering refers to the artificial control of interest rates and debt instruments to shape financial conditions and keep debt service manageable. Actors are typically central bank and ministries of Finance, or Treasury departments.

**Examples**

QE by Fed, BoJ (2008-2021)

BoJ yield curve control (2016-2024)

U.S. Treasury issuance shifts (2023)

Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

# **Bend or break:** a framework for debt sustainability

Money, it's a crime
Share it fairly
But don't take a slice of my pie

**Pink Floyd**
*Money,* 1973

We believe many major economies have reached an inflection point in debt management, and will have to be more intentional in their policies moving forward. To assess viable policy choices, we have created a debt sustainability framework that accounts for a country's current fiscal health and potential disruptions to it.

We frame debt sustainability in terms of its central pillars: demand for a country's debt (exorbitant privilege, for the U.S.), quality of government spending, and how a country uses its central bank backstop. Each pillar has distinct characteristics that create a mutually reinforcing cycle of debt sustainability, or lack thereof.

There are two caveats to this view. First, nowhere in this framework do we discuss an optimal amount of government debt or pace of government spending. Our research supports our view that **any debt level is sustainable as long as a country fosters demand for its debt, spends in a high-quality manner that supports private sector investment, and uses its central bank backstop prudently.** Second, as investors, it is not our role to provide policy prescriptions. Rather, our debt sustainability analysis informs our view on the most viable debt management options available to global actors.

# Assessing global debt sustainability

## Demand for debt

**Policy credibility:**
Investor demand depends on trust in sovereign creditworthiness and consistent, transparent policies relating to debt issuance, interest repayment, and equal treatment of domestic and foreign investors.

***Consider:*** *de jure and de facto central bank independence; clear policy commitment to interest and principal repayment across political leadership types; sovereign credit rating, credit default swap activity*

**Interest burden affordability:**
As we've said, debt is sustainable if it is demanded at interest rates the borrower can afford. Total interest burden —the result of both interest rates and the amount of debt— must grow only as fast as the borrower can repay.

***Consider:*** *interest payments relative to government revenues: level and trend; effective interest rate on government debt*

**Capital markets depth and liquidity:**
Deep, liquid markets attract diverse investor interest, from sovereign credit to private equity.

***Consider:*** *turnover ratio of government bond market; market capitalization and trading volume of public equity and public credit markets; active private markets that allow investors to realize gains per previously agreed terms*

## Balanced use of central bank

**Healthy mix of debt demand:**
At its most sustainable, a country's debt is held across a broad base—households, corporations, financial institutions, and, when needed, the central bank. When the majority of debt is held domestically, it is more sustainable because it is not vulnerable to foreign capital flight—but in the same vein, a lack of foreign participation in a country's bond market may signal a lack of foreign confidence.

***Consider:*** *government securities held by a broad base of both foreign and domestic investors; central banks should not comprise the majority of government security holdings*

**Targeted use of central bank buying:**
Outside of crisis periods, continuous central bank purchases create artificial demand.

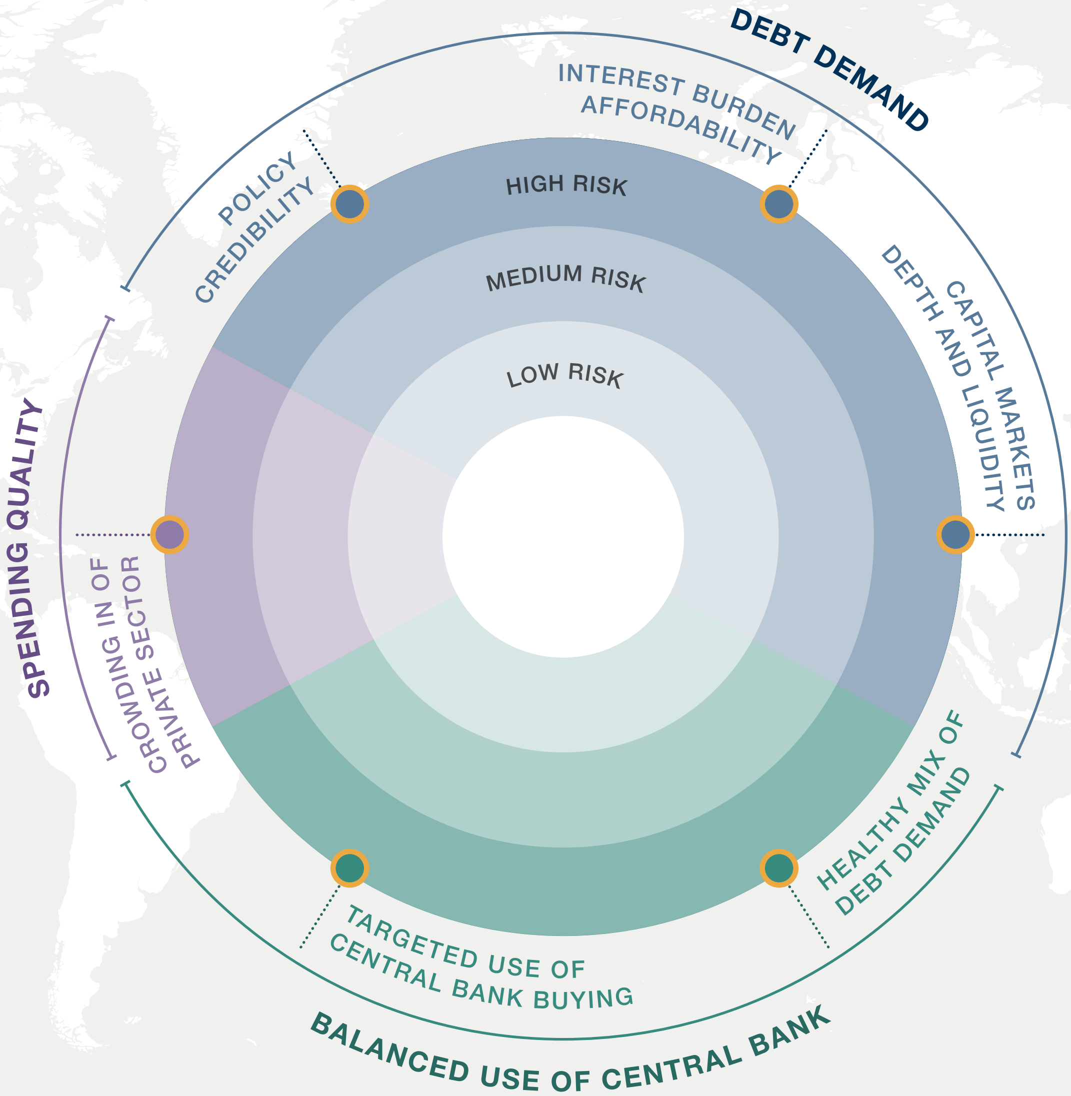
***Consider:*** *quantitative easing and liquidity support should be used only during crisis and recovery periods; sustained central bank purchase programs suggest a structural lack of demand*

## Quality of spending

**Crowding in of the private sector:**
Productive government spending should support—or at least not hinder—private sector investment. A stable, growth-friendly policy environment can enable private sector dynamism, while excessive sovereign borrowing risks crowding it out.

***Consider:*** *private sector credit to GDP outpacing sovereign issuance; private gross fixed capital formation measures productive private investment*

## A global debt sustainability framework




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

We apply this framework to four major economies in the following pages:

## United States

U.S. debt is sustainable as long as robust global demand for Treasuries holds up, but restoring policy credibility and addressing the exponential rise in interest expense are critical in the immediate term. Long-term challenge: reckoning with entitlements spending to free up productive investment.

### Legacy
(past 20 years)

- Strong policy credibility
- Affordable interest rates (temporary Zero Interest Rate Policy, or ZIRP)
- Deepest, most liquid capital markets in the world
- Healthy debt demand mix
- Time-bound reliance on central bank buying (QT)
- Private sector moderately crowded in

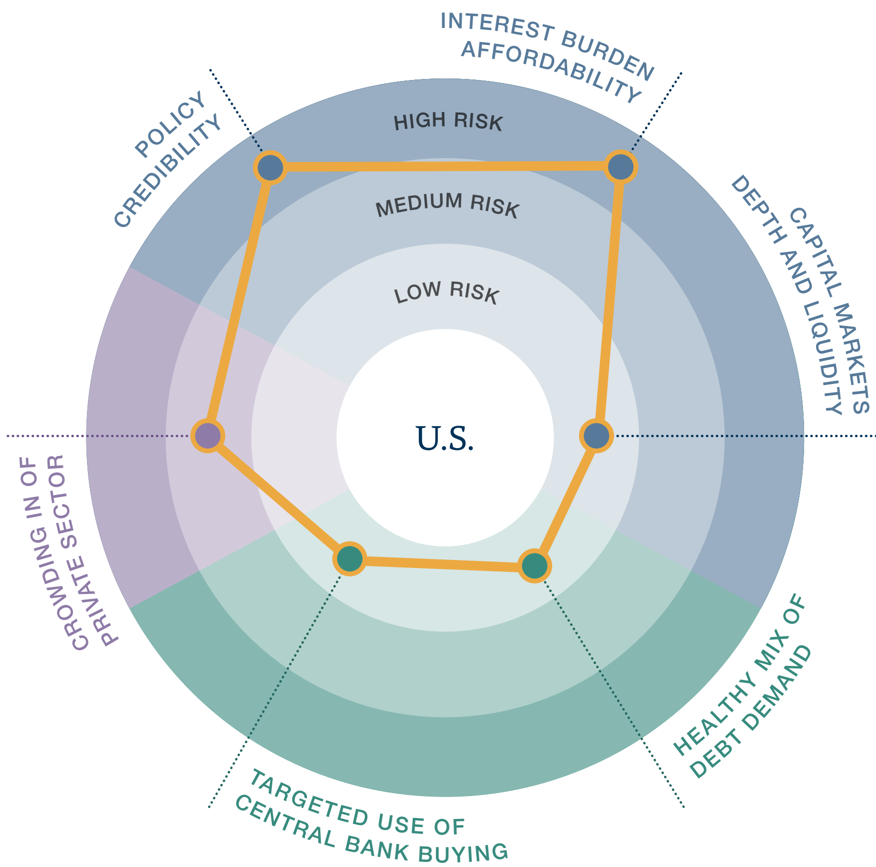
### Inflection questions

- **Is the full faith and credit of the U.S. as powerful as it used to be?**
- **How can exponential growth in interest expense be contained?**

### Debt management choices

- Growth
- Financial engineering

### U.S. debt sustainability framework




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

## U.S. debt sustainability today

U.S. debt sustainability has two Achilles heels. First, interest expense on the national debt is rapidly becoming unaffordable, growing exponentially due to both higher financing costs and a larger stock of debt. Second is a recent, dramatic deterioration in policy credibility. Both threaten U.S. exorbitant privilege.

However, the other pillars of U.S. debt sustainability look healthy. Its capital markets remain the most deep and liquid in the world. It has a healthy mix of foreign and domestic ownership of its debt, and its central bank provides a selective rather than sustained demand backstop. Private sector investment is robust; today's policy uncertainty notwithstanding.

## The path forward

Global investor confidence in U.S. assets has been shaken by policy uncertainty. Should this environment persist, gradual capital flight from the U.S. would erode Treasury demand and likely lead to higher interest rates, making U.S. debt sustainability concerns more urgent.

We expect U.S. policymakers will want to continue the country's legacy of moderate economic growth and strong capital markets returns. A mix of debt management approaches can support these goals.

The most urgent issue facing U.S. debt sustainability is the exponential growth of its interest burden. Containing this may require spending cuts to narrow the annual fiscal deficit. The Fed and Treasury may also use their tools to hold down interest rates, simply to contain the pace of interest burden growth in the immediate term.

Medium-term debt sustainability may be aided by policymakers' acceptance of a moderately higher inflation environment in the post-pandemic era.

Longer term, desire to pivot spending away from mandatory programs (Social Security, Medicare) and toward productive investment will likely be hindered by political dysfunction and a need to care for an aging population.

# Anything but austerity: why the U.S. won't—and shouldn't—take the hard road

Austerity has an excellent track record in getting countries out of a debt crisis, but **we do not believe austerity is a feasible option for the U.S.** The U.S. does need to cut its federal spending, but true austerity would not be tolerable—politically at home or by savers abroad.

A bit of history: for all the quibbling about its debt, the U.S. has never attempted holistic fiscal austerity. Perhaps the closest it came was the Reagan administration's experiment with supply-side economics theory,[19] in which tax cuts spark economic activity, paid for by cuts to federal spending. The tax cuts materialized, but the spending cuts did not,[xi] and the Reagan years witnessed the fastest pace of federal debt accumulation seen yet and since.[20] Today, the U.S. has surpassed the 100% debt-to-GDP level often cited as a growth drag,[xii] yet neither party has a plan to address the $34+ trillion debt stock. This likely reflects voters' low tolerance for economic pain.

We also see an implicit constraint on U.S. austerity coming from abroad. Austerity would reduce the supply of Treasuries and depress Treasury interest rates, disrupting the global savings flow that relies on the U.S. bond market. The combined effect on Treasuries, paired with pressure on growth stemming from lower U.S. government spending, could usher in a new global "lower for longer" era of interest rates and inflation. A less attractive Treasury market could also erode exorbitant privilege: it could prompt savers to redirect their savings toward domestic or otherwise ex-U.S. investment, accelerating the slow decline of global dollar prevalence.

# Reflections on current U.S. policy

In 2025, U.S. policy appears increasingly willing—perhaps even eager—to challenge the status quo of Treasury demand and dollar dominance. We see some room for global diversification from dollar reliance, and believe the market serves as an important check on sudden policy disruptions.

Concerns about U.S. dominance go beyond any single administration. The dollar's role in reserves, trade, and finance remains unmatched, but its share has been gradually declining. This trend reflects a broader evolution. For example, emerging markets, once heavily dollar-reliant, have reduced that dependence through local capital markets development and regional trade integration—especially across Asia. *We find this dynamic not concerning, but constructive.* *The global economy of today is diverse: its financial workings no longer need to be held by a monopoly, even if that monopoly has helped foster stability and global integration.*

If policy goes too far too quickly, the U.S. bond market may step in. "Bond vigilantism" captures the risks of market backlash, but we see this "check" as more comprehensive. An administration willing to ignore market signals can undermine both voter and investor confidence, particularly given America's long legacy of wealth-building through a combination of the housing, equity, and bond markets. The pace of policy change matters: gradual transitions allow markets to adjust, reducing the chance of disruptive re-pricing.

19. Supply-side economics is often referred to as "trickle-down economics."
20. From 1981-1992, under the Reagan and H.W. Bush administrations, U.S. federal debt grew by 347%, or a 13.3% compound annual growth rate (CAGR). No other administrations have exceeded a 9% CAGR of federal debt accumulation. The years of balanced budget under the Clinton White House came not from austerity-style spending cuts, but from a strong growth tailwind, tech boom-related tax windfalls, and natural reductions in defense spending post-Cold War.

# Europe

Though its individual members have taken heterogeneous approaches to debt management, Europe as a whole has the most fiscal space of the major economies—and is starting to show a willingness to use it. Use of austerity to manage debt crises in Europe has been effective, but with the painful side effects of lower economic growth and chronic underinvestment. We expect to see a continued, gradual shift toward greater infrastructure, defense, and technology spending, requiring a greater tolerance for inflation.

### Legacy
(past 20 years)

- Strong policy credibility, within limits of un-integrated fiscal policy and capital markets
- Affordable interest rates (temporarily negative)
- Large but fragmented corporate credit markets
- Moderate sovereign debt demand mix
- Time-bound reliance on central bank buying (QT)
- Low public investment contributed to low domestic private investment

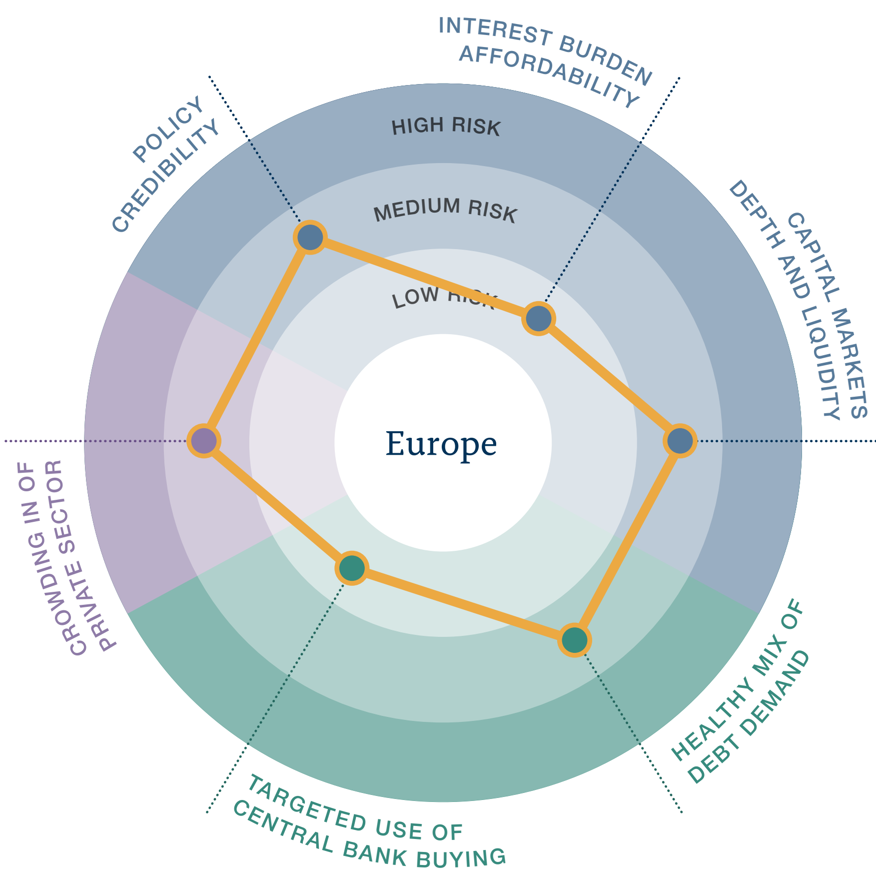
### Inflection questions

- **Should there be more or less intra-European integration in policy and capital markets?**
- **What is the tolerance for greater government spending and investment at home?**

### Debt management choices

- Growth
- Financial engineering

## Europe's debt sustainability framework




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

## European debt sustainability today

Europe features a range of fiscal approaches among its members, but has broadly been prudent with its debt management in the wake of the 2011 crises. However, it faces one obstacle that detracts from its policy credibility, capital markets depth and liquidity, demand mix for its sovereign debt, and private sector productivity: the incredible legal, financial, and political difficulty of integrating its capital markets. This fragmentation has contributed to crises of confidence that have been resolved by strong leadership (Mario Draghi's "whatever it takes" moment) and severe policy adjustments (the Greek economy shrunk by a quarter amid post-2011 austerity).

## The path forward

Europe, as a whole, has two interrelated legacies it may be ready to shake off: exporting its savings (and investing relatively little at home) and austerity. Germany's recent moves to relax fiscal rules in favor of greater defense and infrastructure spending kicked off a series of commitments to increase defense spending across the continent. However, a holistic approach to promote investment and economic growth may require a greater degree of capital markets integration. It would likely take a greater external shock—such as credible threats to the Treasury guarantee or strong competition from China—to push Europe toward the political and regulatory challenge of integration.

Europe's debt management evolution may include greater emphasis on productive government spending to promote private sector activity, and will require a greater tolerance for moderately wider fiscal deficits. Like the Fed, the ECB has been a selective—not continuous—buyer of government securities when needed. Targeted central bank buying may support Europe's push for greater domestic investment, containing any bumps in the road toward moderately higher interest rates, inflation, and growth.

## Japan

Japan's answer to debt sustainability concerns has been to hold its gargantuan debt pile domestically—eliminating outright default risk, but suffering a secular growth stagnation. Today, Japan shows signs it is ready to change its legacy, but will need to look beyond fiscal and monetary policy to find a fix.

### Legacy
(past 20 years)

- Policy credibility questioned by unprecedented use of QE, negative rates
- Affordable interest rates (often negative)
- Moderate capital markets depth and liquidity
- Moderate sovereign debt demand mix
- World's foremost reliance on central bank (prolonged QT)
- Low private investment

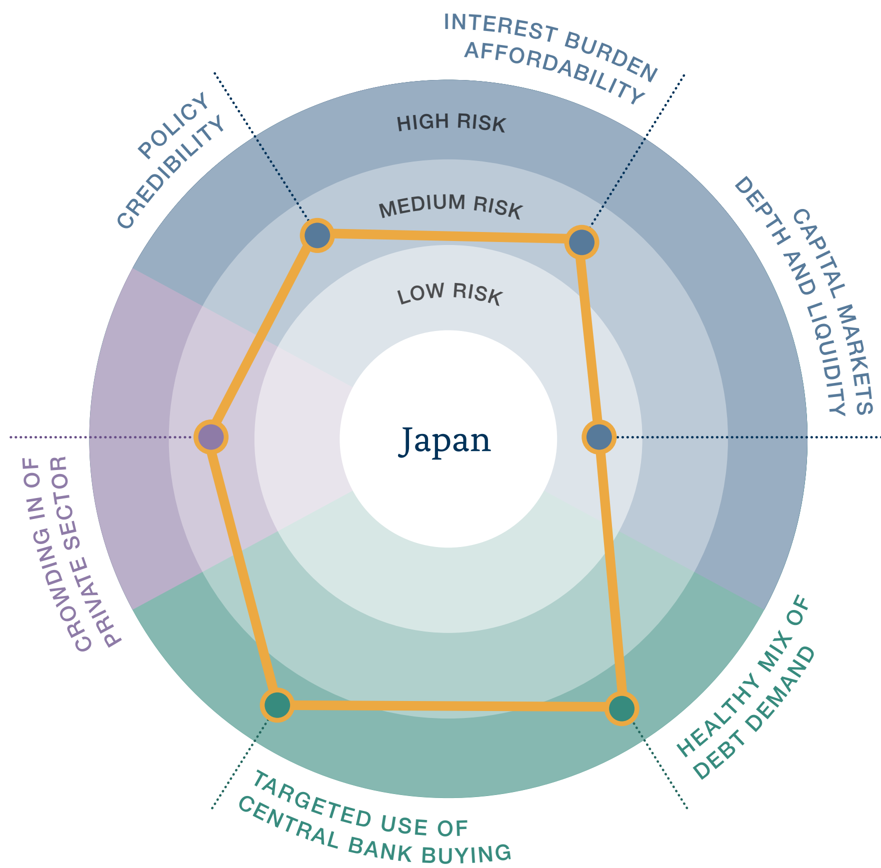
### Inflection questions

- **What is the tolerable growth rate?**

### Debt management choices

- Growth
- Financial engineering

### Japan's debt sustainability framework




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

## Japanese debt sustainability today

No other country has leveraged its central bank balance sheet like Japan. The BoJ owns over half of all Japanese government bonds, and stopped its two-decade QE program only in 2024. While BoJ prevalence allows interest rates to be near-zero and prevents an outright default, Japan's structurally low growth rate has come from a lack of government investment, private sector unwillingness to take on leverage, and a very aged population. The inflationary post-pandemic era may have been a godsend for Japan: import-led inflation has allowed for the strongest wage negotiations in decades and enabled BoJ to normalize policy.

## The path forward

Japan's challenge will be to continue its policy normalization, ensuring that strengthening endogenous growth justifies the return of inflation and positive nominal interest rates. One policy approach to this goal is beyond the reach of fiscal or monetary policy: facing an aged population and a cliff in the population replacement rate, Japan becoming more open to some degree of immigration may be inevitable.

We expect Japan's debt management priorities to mostly mirror those of Europe, but requiring a steeper policy adjustment. Japan may need an updated version of Abenomics that relies less on policy easing, and more on direct infrastructure and technology spending to crowd in private sector investment. Japan has yet to return to a positive real interest rate environment, and with such a strong legacy of central bank use, policymakers may need to be mindful to avoid financial repression: allowing inflation to run warm, but keeping a lid on interest rates to prevent interest payment from becoming unruly.

We are encouraged by recent private sector reforms that incentivize companies to deploy corporate cash in favor of investment.

## China

A closed capital account prevents China from facing external default—but in a secular growth decline, it will need to be prudent to avoid a disinflationary spiral. A mix of austerity and capital markets liberalization could allow China to truly compete with the U.S. and Europe for foreign capital, but we believe austerity without liberalization is the most likely policy path.

**Legacy**
(past 20 years)

- Moderate policy credibility: centralized rather than incentive-based
- Affordable interest rates
- Shallow capital markets depth and liquidity for both domestic and foreign investors
- Closed capital account: poor sovereign debt demand mix
- High reliance on central bank
- High private investment

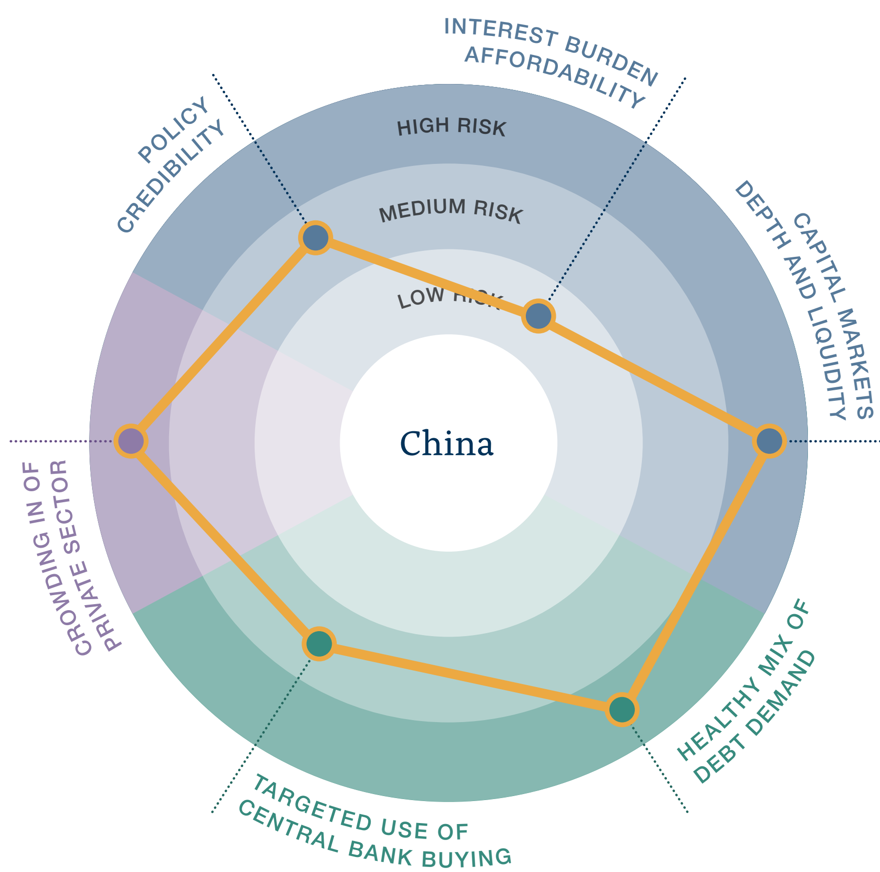
**Inflection questions**

- **How to transition from an export-led economy to a consumer-led economy?**

**Debt management choices**

- Austerity
- Financial engineering

### China's debt sustainability framework




Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

## Chinese debt sustainability today

China still retains a strong degree of command and control in policy, meaning it relies less on market mechanics (e.g., interest rates, tax policy) to incentivize behavior, and can instead direct the flow of capital—albeit imperfectly.

A closed capital account means that China can easily avoid (external) default. However, a lack of foreign participation in Chinese capital markets allows for inefficiencies to build: onshore markets often reflect the policy backdrop, not fundamentals. Without properly functioning broader capital markets, the private sector is easily crowded out by policy priorities.

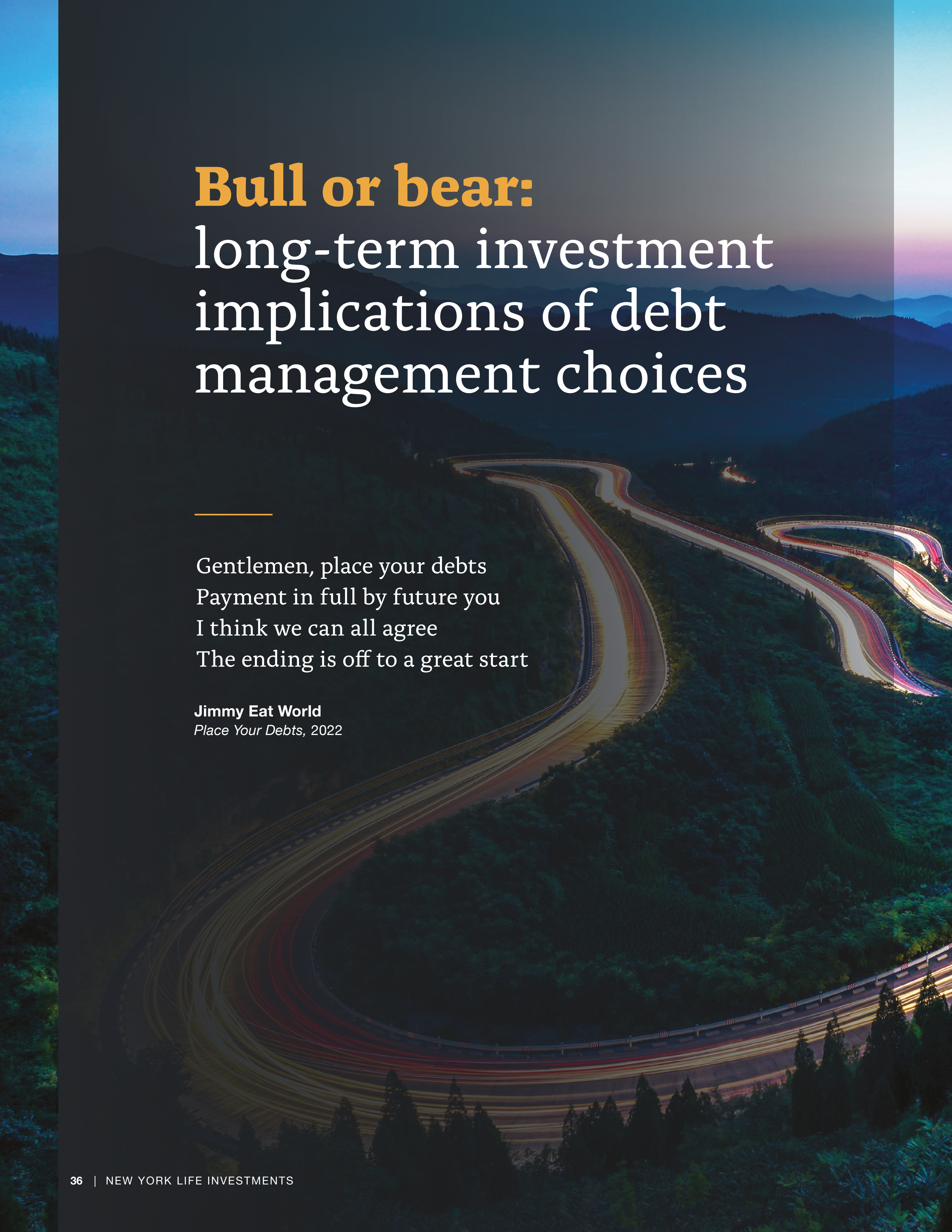
## The path forward

China has been facing a reckoning in its export- and credit-led business model for some time, but rising tension with the U.S. may, in turn, increase the urgency of this reckoning.

Stepping back from its legacy of high growth, high investment, and high debt will require China to move in the opposite direction of the U.S., Europe, and Japan: toward a more austere public spending environment. Its challenge lies in lightening the flow of government support without allowing for a disinflationary spiral akin to Japan's experience.

One way to offset a transition toward more limited government spending and a less export-led growth engine is with foreign capital. If foreign inflows from trade slow—gradually, as supply chains evolve, or more suddenly, if a U.S.-China embargo sticks—China could allow for more foreign portfolio investment inflows.

However, capital markets liberalization and the opening of China's capital account would invite capital flight and a currency shock; we expect China to continue avoiding this choice. The result may be restrained government spending without a counterbalance, bolstering the case for a secular growth slowdown in China.



# **Bull or bear:** long-term investment implications of debt management choices

Gentlemen, place your debts
Payment in full by future you
I think we can all agree
The ending is off to a great start

**Jimmy Eat World**
*Place Your Debts,* 2022

## A converging global path—with one exception

What's next for debt sustainability? When we consider each major economy's debt management legacy, inflection points, and constraints and preferences in future choices, we land on their most likely path of debt management. A clear global trajectory has emerged: the U.S., many countries in Europe, and Japan appear poised to manage debt through policies supporting moderate, sustained growth and long-term investment. This will likely demand a more constructive public-private relationship, higher tolerance for moderate inflation, and—only when necessary—targeted use of central bank balance sheets to stabilize markets.

This is easier said than done. In addition to political and cultural constraints, the U.S., Europe, and Japan will need to be careful not to slip into the post-WWII era of financial repression. When overall debt levels are onerous, it can be easier to exert control than to incentivize domestic and foreign investors. Early signs of financial repression can include consistently above-target inflation and mandates for domestic pension funds to hold a certain amount of government debt.

This glidepath has one critical exception. China has rapidly evolved into a developed economy, and now faces a structural slowdown in its potential growth rate. Its overleveraged real estate market has provided a near-term pain point that constrains China's ability to reach for credit when growth slows. In short: China is likely to be forced toward some manner of ongoing austerity while other major economies encourage growth. **We see this divergence in debt management paths as a compelling addition to the argument that the U.S. and China are nearing a more holistic decoupling.**

The investment implications of different debt management approaches below can help an investor build a playbook for country-level and relative global allocation.

## Diverging debt management approaches will have a material impact on asset allocation

*Sovereign debt management approaches and resulting capital markets implications*

### Austerity

Cutting government spending

Austerity focuses on sustained, broad-based spending cuts—not just trimming deficits (flow), but driving down overall government debt (stock).

**Capital markets implications**

- Growth slows; economy may shrink outright
- Disinflation or deflation
- Lower interest rates from both reduced fiscal risk and weak growth
- Earnings pressure favors value and defensive equities
- Strong high-quality bond valuations
- Strong opportunities in asset classes, notably private markets, that can deliver a-cyclical growth

### Growth

Driving productivity to reduce debt

Growth-led strategies use investment and reforms to expand GDP faster than debt, improving sustainability.

**Capital markets implications**

- Stable or accelerating growth
- Moderate inflation; ability of market to digest higher inflation depends on productivity of spending
- Interest rates rise; market reaction also dependent on productivity
- Boost to earnings growth: growth equities shine; small caps benefit from cyclical upswings
- Total return in bonds stays flat as higher income potential offsets lower valuations; lower-quality credit outperforms
- Private markets must deliver on illiquidity premium to justify allocations in a strong return environment

### Financial repression

Inflating debt away

Financial repression combines warm inflation with interest rate suppression—often via both regulatory and financial engineering.

**Capital markets implications**

- Moderate growth
- High inflation
- Artificially low interest rates
- Negative real yields suppress returns across asset classes, particularly cash. Staying invested is critical. Higher risk-taking is likely as a way to find growth in a lower return environment
- Secular bear market conditions for bonds as prices stay flat but inflation erodes real return
- Private markets can benefit from low interest rates and potentially generate returns exceeding inflation
- Gold, commodities, and real assets serve as key inflation hedge

### Financial engineering

Tinkering with financial conditions

Financial engineering refers to the artificial control of interest rates and debt instruments to shape financial conditions and keep debt service manageable.

**Capital markets implications**

- Growth is biased to the upside given lower interest rates
- Ambiguous inflation impact
- Lower interest rates
- Lower rates support bond valuations, but income generation potential suffers
- Inflation risk steers investors toward growth and dividend-yielding equities
- Private markets and real assets serve as diversifiers

Source: New York Life Investments Global Market Strategy, June 2025. For illustrative purposes only.

### Debt management can drive long-term asset allocation

The cumulative effect of global debt management choices has clear through-lines for investors in the coming decade:

1. Because debt is sustainable as long as investors demand it at interest rates the borrower can afford, **every country's top debt sustainability goal should be protecting and fostering domestic and foreign demand for its credit.**
2. In all but the smallest economies, outright external default risk is extremely low. **What matters for investment allocation is not how large debt levels become, but the quality of government spending and intentionality of debt management.**
3. The U.S., Europe, and Japan are moving toward a greater desire for growth, involving greater tolerance for moderately higher interest rates and inflation. This adds to our existing belief in the next ten years, the **global economy is headed for a "moderate for the medium term" era of interest rates, a clear secular departure from the "lower for longer" era.**

### Navigating the inflection point

Debt sustainability questions have been around for decades, but now is the time for these questions to begin influencing asset allocation decisions. We see meaningful potential disruptions to the flow of global savings and investment, creating a unique inflection point in how major economies handle their respective debt burdens.

Both the country-level and cumulative impacts of these debt management choices can meaningfully alter long-term capital markets assumptions for interest rates, inflation, and economic growth; relative global risk preference; and even asset class selection. We encourage investors, particularly those with long-term investment or liability horizons, to begin incorporating these implications into their investment theses. It is time for investors to take a view on what the next era of debt sustainability looks like—and allocate accordingly.

It is time for investors to take a view on what the next era of debt sustainability looks like—and allocate accordingly.

**References**

i. Eswar Prasad: The changing role of the US dollar. Brookings Institution, 2021.
ii. Arvind Krishnamurthy, Annette Vissing-Jorgensen: The Aggregate Demand for Treasury Debt. Journal of Political Economy, 2012.
iii. Jason Choi, Duong Dang, Rishabh Kirpalani, Diego Perez: Exorbitant Privilege and the Sustainability of US Public Debt. National Bureau of Economic Research Working Paper No. 32129, 2024.
iv. SIFMA: 2024 Capital Markets Fact Book, 2024.
v. Ray Dalio: How Countries Go Broke – Principles for Navigating the Big Debt Cycle, Where We Are Headed & What We Should Do. 2025.
vi. China Foreign Exchange Trade System (CFETS), Macrobond, as of April 2025.
vii. U.S. Federal Reserve, U.S. Department of Treasury, Macrobond, as of April 2025.
viii. Katalin Bodnár, Carolin Nerlich: The macroeconomic and fiscal impact of population ageing. European Central Bank Occasional Paper Series No. 296, 2022.
ix. Office for Budget Responsibility: Fiscal risks and sustainability. 2024.
x. Swiss Re Group: New record of 142 natural catastrophes accumulates to USD 108 billion insured losses in 2023, finds Swiss Re Institute. 2024.
xi. Steven Ricchiuto: Deconstructing credit cycles. Greenleaf Book Group Press, 2023.
xii. Austan Goolsbee: Evidence on the High-Income Laffer Curve from Six Decades of Tax Reform. Brookings Papers on Economic Activity, 1999.

## For related insights, and all global markets coverage, visit: newyorklifeinvestments.com/2025-megatrends

NEW YORK LIFE INVESTMENTS