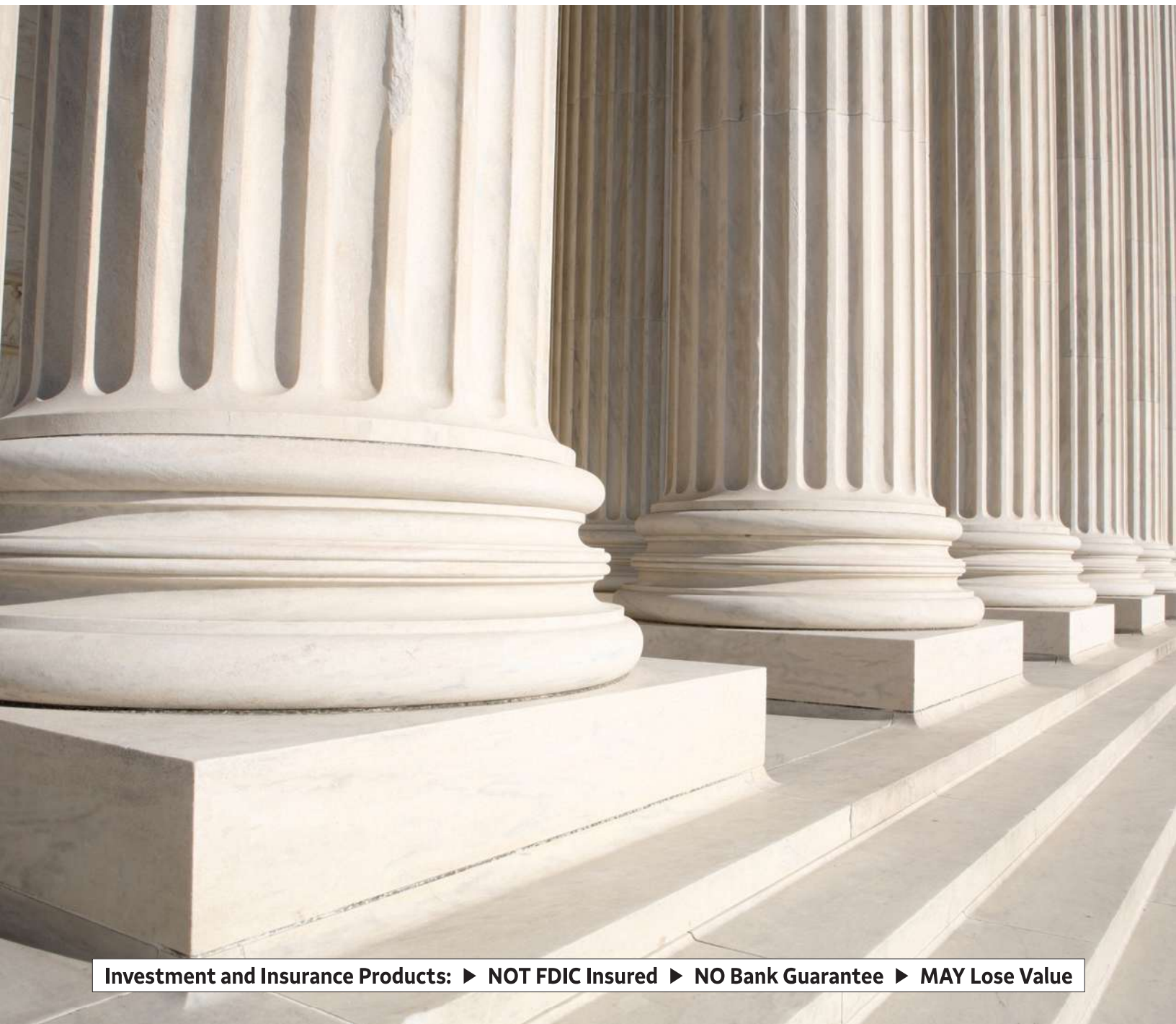


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# Paying America's bills

What investors should know about how the  
U.S. government manages its finances





# Key takeaways

- At over \$38 trillion, the federal debt is staggering but currently manageable. What's troubling is the prospect for its continued growth over the long term.
- We believe the Treasury has done a good job of managing the debt expense, and investors at home and overseas continue to buy Treasury securities. Lower rates over the past decade helped keep funding costs low, but higher interest rates are likely to cause interest expense to grab a bigger bite of the budget.
- Procrastination by Congress is likely to make the ultimate adjustments larger and more dramatic, but some repercussions have already started to trickle down to financial markets. Wells Fargo Investment Institute (WFII) is already factoring near-term impacts into our investment guidance.



# A factual look at U.S. debt, deficits, and entitlements

The Congressional Budget Office (CBO) estimates that the budget deficit was \$1.8 trillion in fiscal year 2025 and projects an increase to \$3.1 trillion in 2036.<sup>1</sup> The CBO projects that interest costs and greater spending for programs that provide benefits to elderly people will increase the deficit to 6.7% of gross domestic product (GDP) by 2036 — significantly more than the 3.7% that deficits have averaged over the past 50 years, according to the CBO.

The bottom line, we believe, is that many of the current trends are unsustainable over the long run (10+ years). The necessary changes are likely to be more drastic the longer the U.S. waits to act. However, there is a precedent for Congress to take action on the national debt and deficits. Hence why we believe there is still time to make corrections.

Our country is not alone in facing these challenges; the U.S. is unique, however, in that we remain in a position of strength globally. Our economy is the world's largest and most diversified, and the U.S. dollar is the globe's primary reserve currency and the main currency used for international transactions. While that's still the case, can our political parties work together to enact sweeping changes to correct our long-term trajectory?

Any discussion of America's debt and budget is often politically charged. In the following pages, we provide a nonpartisan presentation of our nation's fiscal trends. At the conclusion, we look at how we have adapted our investment guidance as a result of these trends and make some portfolio suggestions for you to consider.

**\$38.5<sup>2</sup>**  
trillion

Total U.S. debt

**\$7.7<sup>2</sup>**  
trillion

Portion of U.S. debt  
borrowed from  
government sources

**\$56<sup>1</sup>**  
trillion

Projected total  
U.S. debt in 2036

**\$3.3<sup>1</sup>**  
trillion

2025 spending  
on Social Security  
and major health  
care programs

**3.32%<sup>2</sup>**

Current average  
rate government  
pays to finance  
the debt

1. "The Budget and Economic Outlook: 2026 to 2036," Congressional Budget Office, February 2026. Federal debt held by the public excludes debt held by government entities.

2. "Debt Position and Activity Report," TreasuryDirect.gov, December 31, 2025

# Cutting through the federal budget fog

## Why doesn't the federal budget balance?

Like any budget, the federal budget is merely a plan for revenues and expenditures for the fiscal year. While that may sound simple enough, there's often a cloud of confusion around the federal budget.

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Lawmakers have little wiggle room to reduce expenditures. Although cutting federal spending to help balance the budget is frequently a matter of intense debate, the fact is only about one-quarter of government expenditures are discretionary — meaning they can be easily reduced. These comprise spending that lawmakers control through annual appropriation acts and can be broken down somewhat evenly between defense and nondefense expenditures.

The bulk of government spending is actually considered “mandatory,” which is somewhat of a misnomer. These “entitlement” expenditures can, in fact, be reduced, but doing so would be extremely difficult (and probably unpopular). We believe that these are ultimately where Congress will compromise.

The U.S. government will have to choose some combination of higher taxes and lower spending to reduce the large and rising deficits implicit in the CBO's projections. As overall debt levels and interest expenses grow, the U.S. government will see net interest costs consume a larger percentage of gross domestic product (GDP) and likely would weigh on economic growth absent offsetting forces such as productivity gains or policy adjustments. Fortunately, there is history for just such adjustments.

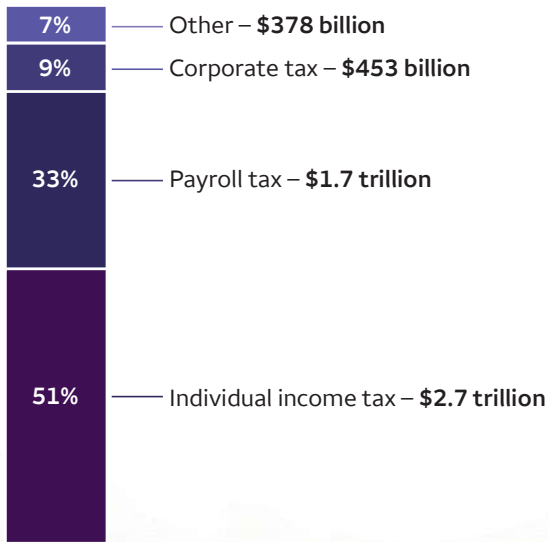
Rapidly growing deficits between 1981-1988 lifted the interest payments as a percentage of federal revenue to over 18%. What followed was roughly a decade of adjustments, until the budget ran a surplus in 1997.

## Government spending exceeds revenue

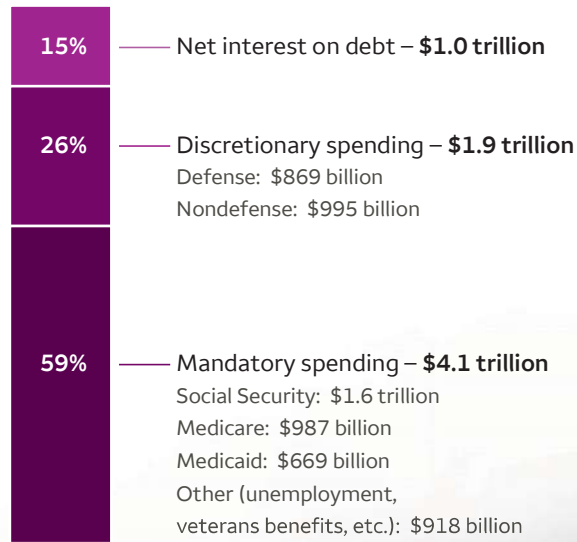
When a business or family does budgeting and subtracts expenditures from revenues, the goal is usually to end up in positive territory. When the federal government does it, the result often is a negative number, or a deficit.

While politically unpopular, “entitlement” expenditures can, in fact, be controlled by lawmaker action. However, we see no real intention from our leaders to tackle these issues in the near term. At the current pace, by 2036, outlays for Social Security, the major health programs, and interest will account for 70% of projected spending, according to the CBO.<sup>3</sup>

2025 revenue: **\$5.2 trillion**



2025 spending: **\$7.0 trillion**



Source: Congressional Budget Office, “Monthly Budget Review: September 2025,” October 8, 2025.

3. “The Budget and Economic Outlook: 2026 to 2036,” Congressional Budget Office, February 2026.

Revenue                      Spending                      Deficit

**\$5.2 trillion — \$7.0 trillion = \$1.8 trillion**

## Social Security's future holds uncertainty

Because it is an income source for at least a portion of most Americans' retirement, Social Security deserves a closer look.

When the program was signed into law, the average life expectancy was about 62 years, and Social Security was intended to provide income security to those who lived beyond their years. It was not originally meant to be a retirement plan as many think of it today.

Currently, the Social Security Administration projects that the Old-Age and Survivors Insurance (OASI) Trust Fund is projected to be depleted in 2033. This would not spell the program's end, but the Social Security Administration would be limited to paying no more per year than received in annual revenues.

It is very unlikely, in our opinion, that politicians would allow a sudden significant reduction in benefits, but the fact remains that if the program is left unchanged, benefits would be reduced by an estimated 29% starting in 2034.<sup>4</sup>

4. "The 2025 Annual Report from the Board of Trustees," June 2025.

### Did you know that...

**72.9 million**

people received benefits from programs administered by the Social Security Administration (SSA) in 2024.

**6.0 million**

people were newly awarded Social Security benefits in 2024.

**84%**

of Supplemental Security Income (SSI) recipients received payments because of disability or blindness in 2024.

**55%**

of adult Social Security beneficiaries in 2024 were women.

**56**

was the average age of disabled-worker beneficiaries in 2024.

Source: "The 2025 Annual Report from the Board of Trustees," June 2025.



# Taking a closer look at spending

## Why is the shift in spending a concern?

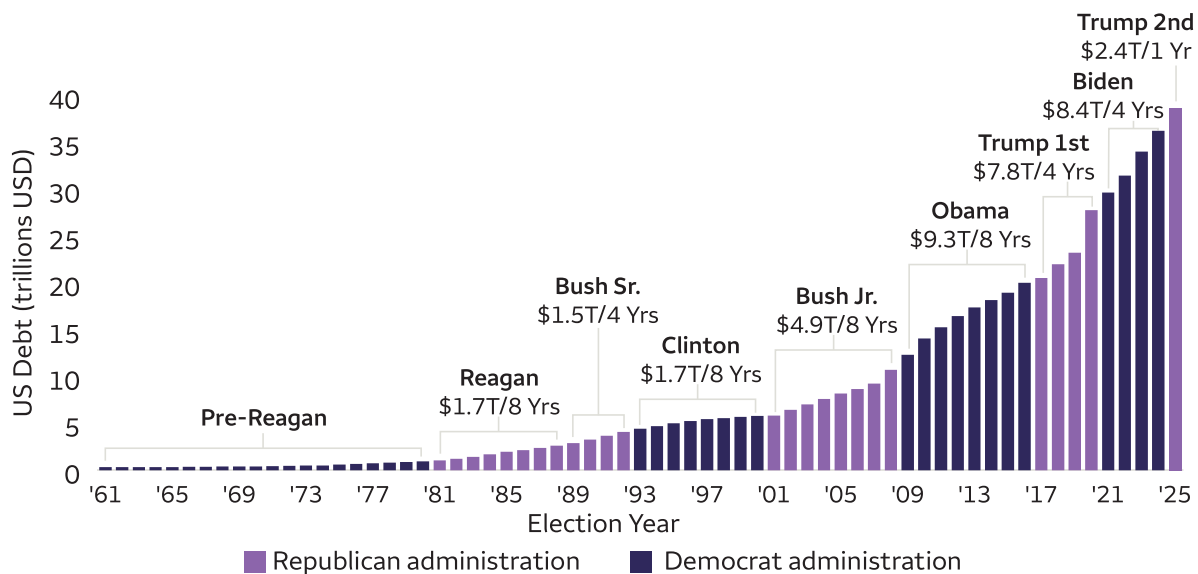
With a greater proportion of spending going toward mandatory expenses, policymakers could face challenges down the road.

For some historical perspective, the government spent 4.5% of GDP on mandatory expenses in 1966. In 2025, the CBO projected that mandatory spending approached 13.7% of GDP and may rise toward 15.0% of GDP in 2036 if entitlement program payout formulas remain unchanged. Two underlying trends account for that increase, the rising average age of the population and growth in federal health care costs per beneficiary.

The significant increase in mandatory expense outlays over time presents the possibility that the government may lack fiscal flexibility when it comes to dealing with future economic challenges. Legislators seem adamant to increase deficit spending in both good and bad economic environments. On July 4, 2025, Public Law 119-21, officially known as the “One Big Beautiful Bill Act” (OBBBA) was enacted. The OBBBA included major changes to tax policy, federal spending, and entitlement programs. CBO and the staff of the Joint Committee on Taxation estimate that over the 2025 – 2034 period deficits will increase by \$3.4 trillion for the legislation as enacted, excluding any macroeconomic or debt service effects.

As the population ages, a greater burden will likely be placed on the government budget and resources — resources which may have otherwise supported economic growth to support increased costs for social programs. The challenge we foresee is to find legislative solutions to prevent mandatory spending from widening the deficit faster than the economy can grow over the next 10 years.

## The rise of national debt



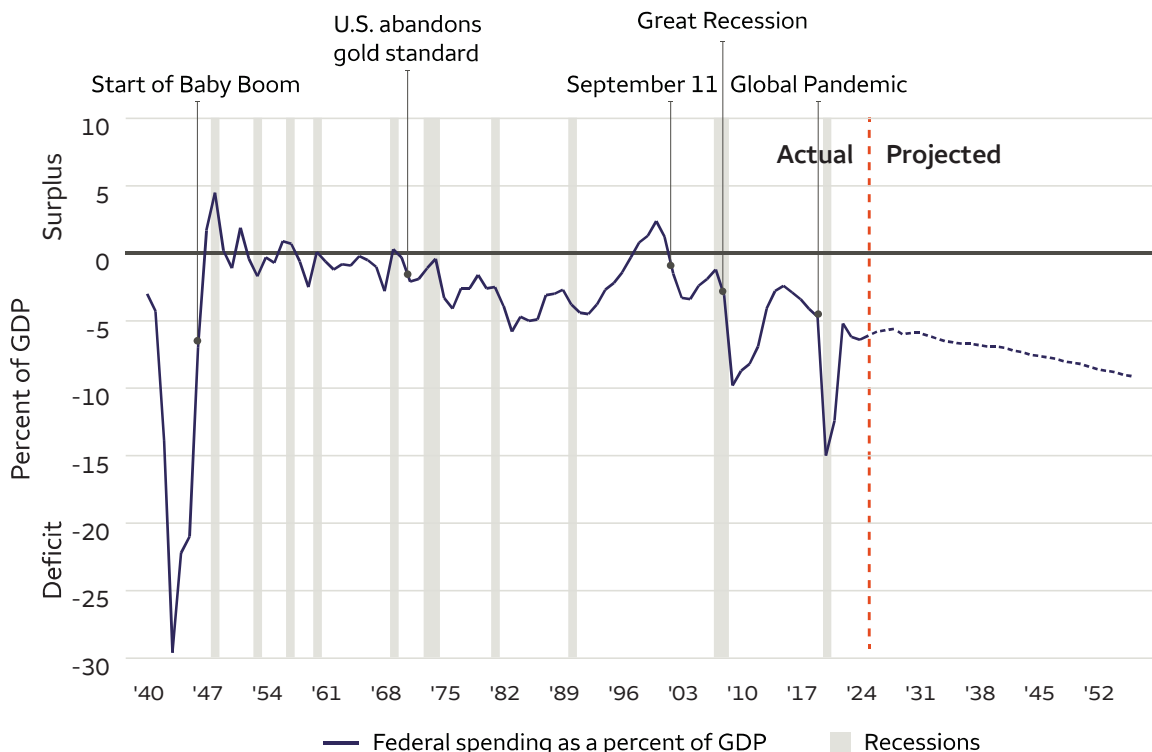
Source: Bloomberg and Wells Fargo Investment Institute, as of December 31, 2025.

## Deficits — not necessarily a bad thing

While federal deficits are definitely a concern, keep in mind that they are an important part of managing through economic cycles. In theory, deficits grow during recessions as the government increases spending to help stimulate economic activity while tax receipts decline. During better times, the opposite should occur, potentially resulting in surpluses. However, as the chart shows, the government has run deficits on a fairly consistent basis — in both good times and bad — going back to 1940.

The chart's periods of surpluses came while amid sustained multiple, consecutive years of above average U.S. economic growth. Two of these periods, 1947-52 and 1994-1999, corresponded to eras of significant innovation and productivity growth. The first came as businesses applied WWII transportation innovations to move goods. The second came with the emergence of the personal computer and the Internet. Looking ahead, a wider technological transformation to much wider use of automation across industries is catalyzing rapid growth in private spending that we are already starting to see increase economic efficiency. If households and businesses continue to adopt these transformational technologies, we expect to see faster economic growth that should narrow deficits beyond what the CBO projects. Equally important, we believe the U.S. has no peer in this development.

## Deficits and surpluses as a percentage of GDP



**Sources:** The Long-Term Budget Outlook: 2026 to 2036. Congressional Budget Office, February 2026. Forecasts are not guaranteed and are based on certain assumptions and on views of market and economic conditions, which are subject to change.

# Going behind the debt numbers

## Why is there so much talk about the debt?

The federal debt’s size is indeed staggering. But keep in mind that the raw numbers do not tell the full story.

When consuming debt statistics, investors should understand how debt numbers are being calculated. Total debt numbers often include debt the government owes itself. Government-owned debt is similar to you taking a loan from yourself — a default on a loan to yourself would not result in a default to your creditors and does not need to be financed in the public debt markets.

The U.S. government holds its own debt in various trust funds, such as the Social Security and Medicare trust funds. We have included Treasury debt held by the Federal Reserve (Fed) in debt owned by the public to align with how the CBO calculates its debt growth projections and statistics (such as the debt as a percent of GDP).

## Who owns the debt?

### U.S. investors hold the largest portion of debt (latest available data as of December 2025)

Owned by the U.S. government		Owned by the public	
20.8%		U.S. investors 55.2%	Foreign countries 24.8%
Social Security trust fund	\$2.3T	Federal Reserve	\$4.2T
Medicare trust fund	\$168B	Depository institutions	\$2.1T
Other trust funds	\$5.5T	State and local governments	\$1.7T
		Private pensions	\$590B
		Mutual funds	\$4.8T
		Others	\$7.9T
<b>Total: \$8.0 trillion</b>		<b>Total: \$21.3 trillion</b>	<b>Total: \$9.3 trillion</b>
		<b>Total owned by public: \$30.5 trillion</b>	
<b>Grand total: \$38.5 trillion</b>			

The government currently owes more than \$30 trillion to public investors. Out of the total held by public investors, foreign investors hold over \$9 trillion in Treasury securities — a level that increased dramatically throughout the past two decades.

Source: "Treasury Bulletin," U.S. Department of the Treasury, Bureau of the Fiscal Service, March 2026. Data as of December 31, 2025.



## How does U.S. debt measure up?

A country's public debt-to-GDP ratio is one measure of its government's ability to pay its debt. If a country's debt was equal to its annual GDP, the ratio would be 100%. According to CBO projections, the U.S. is expected to reach public debt-to-GDP ratio of 101% in 2026, 120% in 2036, and 175% in 2056. A dramatic increase from the 50-year average of 48%.

We believe a high debt-to-GDP ratio increases the risk that investors might, at some point, begin to demand significantly higher interest rates and drastic spending (austerity) measures being necessary to maintain creditor support of the government's debt.

But debt-to-GDP does not tell the full story regarding creditworthiness — after all, Japan's debt-to-GDP is estimated to be over 250%, yet it still enjoys some of the lowest borrowing costs in the world. Other factors to consider include:

- **Who are the bond buyers?** When a country's own citizens purchase the majority of the government's debt, the likelihood that selling pressures or a buyers' strike could materialize is small. As a result, a higher debt-to-GDP level may be manageable and perhaps sustainable.
- **How healthy is the economy?** Countries with higher economic growth and more diverse economies historically have had a greater ability to pay back debt, and the market may bear higher debt-to-GDP ratios.
- **How is the debt being managed?** Countries with high debt-to-GDP levels that have implemented reforms such as those listed below may gain investors' support:
  - Cutting spending
  - Raising revenues through higher taxes
  - Implementing policies to increase economic growth

*While the U.S. currently has a debt level that's very high from a historical perspective, we feel the danger zone is not in the near term but over the long term, given that the debt burden is projected to continue to grow.*

# What does it cost to finance the debt?

Net interest outlays are expected to rise toward roughly 19% of the federal budget in 2036.<sup>5</sup> This increase reflects both a larger stock of outstanding debt and higher interest rates relative to the prior decade.<sup>6</sup>

Importantly, these projections do not imply an abrupt loss of fiscal control. The U.S. Treasury has taken steps to actively manage borrowing costs, including increasing the share of Treasury bills relative to longer-dated, coupon-bearing securities since 2023. This approach has helped limit near-term interest expense and provides flexibility as market conditions evolve.

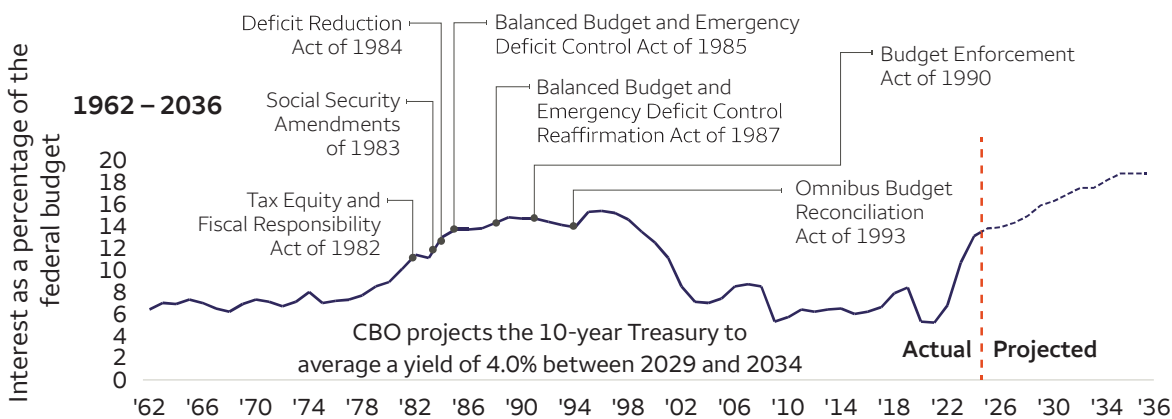
In addition, federal borrowing needs have been partially offset by stronger-than-expected revenue sources, including tariff-related receipts, which have reduced net issuance requirements relative to what would otherwise have been necessary. These factors help explain why rising interest costs do not translate mechanically into immediate fiscal stress.

History offers perspective. In the mid-1980s, interest costs rose to levels similar to those projected today as a share of the federal budget. Rather than triggering a fiscal breakdown, that period ultimately coincided with bipartisan efforts to restrain deficits and moderate debt growth. Rising interest costs can create incentives for policy adjustments, particularly when they begin to constrain the discretionary spending priorities of Congress.

**\$1.1 trillion**

Estimated additional cumulative interest expense over 10 years.

## U.S. net interest as a percentage of the federal budget



Sources: The Budget and Economic Outlook: 2026 to 2036, Congressional Budget Office, February 2026.

5. The Budget and Economic Outlook: 2026 to 2036, Congressional Budget Office, February 2026.

6. Assuming all other economic variables remain unchanged. Forecasts are not guaranteed and are based on certain assumptions and on views of market and economic conditions, which are subject to change.

## Dealing with the debt ceiling

Even as debt costs remain manageable, markets with some regularity concern themselves with the debt ceiling. The Treasury can issue debt only if Congress and the president have given it authority to do so; this authority has become synonymous with the debt ceiling. Failure to raise the debt ceiling when necessary could result in the U.S. government defaulting on its obligations, which it has never done. Currently, Public Law 119-21 raised the debt limit by \$5 trillion to \$41.1 trillion.

Raising the debt ceiling does not directly alter federal spending going forward — debt is issued only when the Treasury needs funds to cover spending that Congress has already authorized. Legislative uncertainty over raising the debt ceiling has, at times, forced the Treasury to take extraordinary measures and brought about market uncertainty, rating agency downgrades, and intense political wrangling.

Political brinkmanship is likely to continue to dominate future debt-ceiling deadlines, yet we expect the U.S. government will continue to take the steps needed to pay its bills in a timely manner. Investors should not be overly concerned as this inevitable deadline once again approaches. Maintaining investment exposure and taking advantage of any market dislocations should be investors' focus.

### Debt ceiling through the years

**1917** Congress establishes the debt ceiling

**2011** Debt-ceiling issues, in part, lead to the very first credit-rating downgrade

**2025** In July 2025, a joint resolution from Congress (Public Law 119-21) raised the debt limit by \$5 trillion to \$41.1 trillion.

**78x** Since 1960, the debt ceiling has been raised 78 times\* — 49 times under Republican presidents and 29 times under Democratic presidents

\*Source: Treasury Department, July 4, 2025.



# Looking ahead

## Addressing the challenges

To put the federal budget on a sustainable long-term path, lawmakers would have to make major changes to tax policies, spending policies, or both. However, when it comes to these issues, Congress typically finds itself stuck between a rock and a hard place.

On the one hand, these are politically challenging positions to advocate for in legislation given a politician's incentive to be popular and electable during election cycles. On the other hand, the sooner these issues are addressed, the less drastic the size of such changes would be required. The ultimate size and scope of the changes that would be required would depend on the amount of federal debt that lawmakers consider appropriate. Given the choice between taking potentially unpopular action and "kicking the can down the road," Congress has generally opted for the latter.

When, if ever, our lawmakers do act, there are several schools of thought, overviewed below, for them to debate regarding debt management and appropriate fiscal policies.

### What can be done?



#### Spending cuts

Given the budget's makeup, a significant portion of any cuts would likely need to come from popular social programs, which would be politically challenging.



#### Tax increases

Much like spending cuts, tax increases would likely be unpopular — at least with some segments of the population. In addition, they would go counter to recent policy, which is to simplify the tax code and to extend tax cuts.



#### Higher economic growth

Arguably the best way to reduce debt-to-GDP is to grow GDP. But based on CBO estimates, it appears unlikely the U.S. will be able to reach and maintain a growth rate in excess of mandatory spending increases over the next five years.



#### Negative real rates

An inflation rate greater than the interest rate paid on the debt could help manage an increasing debt load and aid in any deficit reduction efforts. While the Fed can help manage interest rates, there is no guarantee that the Fed would allow inflation levels to be above its long-term target for an extended period of time.



#### Inflation or debt renegotiation

Printing dollars to pay off maturing debt or renegotiating outstanding bonds would likely erode investors' and citizens' savings and make it difficult to borrow again and should be used only as a last resort.

Waiting to act will likely compound the problem and necessitate more significant measures in the future. We believe acting sooner rather than later by implementing slow, planned spending-reduction and revenue-growth policies would help the U.S. reduce its reliance on unsustainable debt trends.

## Potential warning signs of a debt problem

It is likely that the U.S. can support a higher debt level than today given the country's dominant global economic position and the U.S. dollar's stance as the world's primary reserve currency.

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Even if the U.S. Treasury can sustain a higher debt level, projected increases remain concerning, especially for the path of long-term yields. Considering the political polarization in Congress, it's impossible to predict how much longer the deficit may outpace the economy. In the meantime, there are compensating factors, such as considerable tariff revenue and Treasury policy that emphasizes issuing Treasury bills.

Even if a crisis does not seem imminent, the consequences of a significant national debt size are likely to be real and far-reaching for citizens and investors. The political polarization could still create budget impasse and volatility in yields. Other economic implications may include the following:

### Crowding-out effect

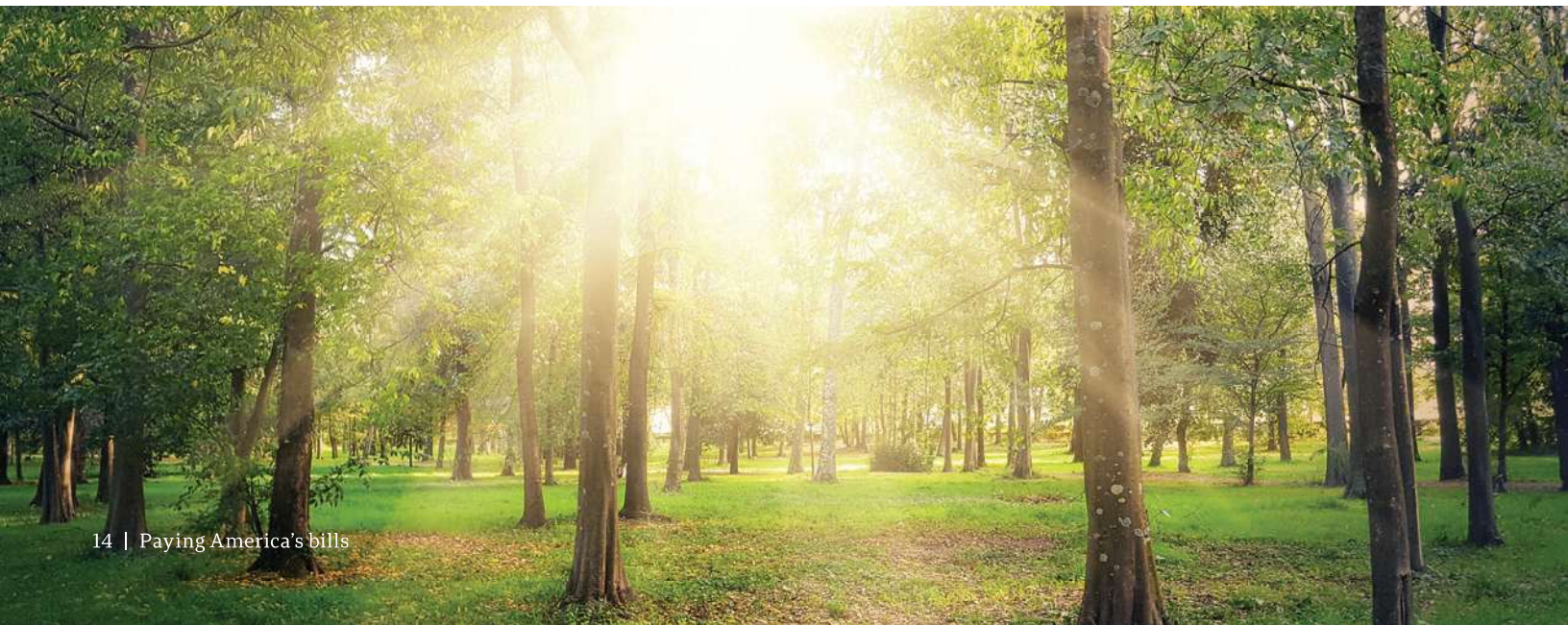
Sustained increases in federal debt issuance could divert savings toward Treasuries and away from private investment, creating a potential headwind to long-term growth. The impact depends on economic conditions; however, productivity gains and technological adoption can expand productive capacity and help absorb higher debt without materially constraining private investment.

### Higher borrowing costs

In the longer term, the laws of supply and demand imply that an increase in debt supply will lead to lower bond prices and higher interest rates — assuming all else remains equal. If rates rise materially, the added cost would require increasing government revenues, reducing spending, or implementing some combination of the two.

### Decreased fiscal flexibility

An increasing debt level would restrict policymakers' ability to respond to unexpected events. Future shocks may have a more significant negative economic impact as lawmakers might lack flexibility to deal with them fiscally.



# Implications for investors

## Economic trends factor into our investment guidance and strategy

Although it's unlikely that America's fiscal challenges are imminent, some repercussions have already started to trickle down to financial markets. We have been factoring near-term impacts into our investment guidance.



### Modest inflation assumptions

High government debt levels historically have had a deflationary effect as funds that may have otherwise been used toward investment and consumption must be diverted to service a growing debt burden. However, we believe that long-term inflation levels will trend slightly above the Fed's 2% target level, and with periods when the rate fluctuates around that level by more than in past decades.

- When building your investment plan, keep in mind that bouts of rising inflation can increase your expenses but also can increase investment returns and vice versa.



### Higher yields (lower bond prices) and more Treasury issuance

Firmer inflation along with more Treasury issuance will cause longer-term rates to remain higher than they were over the prior decade. Some restraint on yields may come from increased demand for fixed-income securities by an aging population, insurers, and pension plans, but it won't be enough to outweigh the interest burden.

We continue to create and offer innovative income-oriented strategies to help replace traditional income sources.

- Talk to your investment professional to determine whether our diversified income approaches are right for you.



### Lower return assumptions

Fiscal trends and an aging demographic make it more likely that asset-class return expectations will be lower in the future than we have experienced historically. We do not anticipate that interest rates will fall abruptly, except in the case of an outright economic recession or crisis.

- Lower long-term return assumptions may require that you revisit your investment plan to help ensure that you are on track to meet your goals.

## Investment actions to consider



### Fixed income

Higher-for-longer and more volatile interest rates and mounting debt to pay for benefits such as Social Security will most likely cause the Treasury to increase issuance over the next decade. The issuance increase over the past five years has already impacted many fixed-income indexes, which now include a larger percentage of government debt.

- Corporate bonds and securitized bonds should continue to pay a premium over U.S. Treasuries. Moving down the credit spectrum is a viable strategy to increase yield but must be done so with caution. We recommend investors use active management when purchasing lower-quality investments.
- Investors may consider holding emerging market fixed-income securities. The higher yield available in this asset class would be attractive, especially those issues denominated in local currency should markets be concerned with U.S. fiscal trends and the resulting impacts of a weaker U.S. dollar down the road.



### Equity markets

Equities are likely to remain volatile as investors question the outlook of future economic and earnings growth in a challenging fiscal environment. However, we believe equities may remain a better source of return than bonds.

- Fiscal and monetary support are likely to be implemented congruently should a future crisis arise. These actions tend to lift financial asset prices, with equities markets being a significant beneficiary.



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Investments in fixed-income securities are subject to interest rate, credit/default, liquidity, inflation and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. This risk is higher when investing in high yield bonds, also known as junk bonds, which have lower ratings and are subject to greater volatility. If sold prior to maturity, fixed income securities are subject to market risk. All fixed income investments may be worth less than their original cost upon redemption or maturity.

Although Treasuries are considered free from credit risk they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

U.S. government securities are backed by the full faith and credit of the federal government as to payment of principal and interest. Unlike U.S. government securities, agency securities carry the implicit guarantee of the U.S. government but are not direct obligations. Payment of principal and interest is solely the obligation of the issuer. If sold prior to maturity, both types of debt securities are subject to market risk.

Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. Investments in equity securities are generally more volatile than other types of securities.

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