The Investment Institute
by UniCredit

Coffee Break

Coffee Break is our daily publication, offering topical insights as an intellectual ingot to start the day.

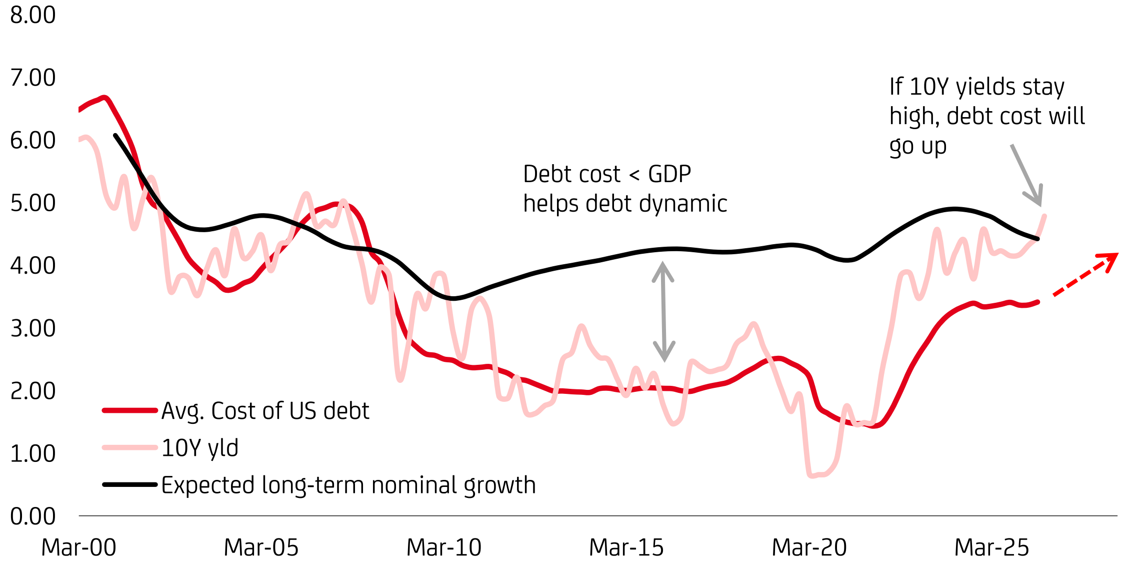
US debt: low average cost, high refinancing yields

9 September 2026

The high US deficit is a risk factor, but it is unlikely to pose an immediate threat, as the average cost of debt remains below nominal GDP growth, supporting debt sustainability. However, if 10Y yields remain high, debt-servicing costs could eventually outpace GDP growth. Investors are understandably nervous, and reducing the deficit is the best way to address the issue.

AVERAGE US DEBT COST IS LOW, BUT COST OF REFINANCING IS A RED FLAG

AVERAGE COST OF US DEBT, 10Y YIELD AND GDP GROWTH (%)



Source: Bloomberg, The Investment Institute by UniCredit
Note: Expected long-term nominal growth is calculated as real GDP potential growth provided by CBO plus the median level of GDP deflator since 2000.

THE CONTEXT

In recent months, two developments in US public finances have attracted significant attention. First, interest expenditure has reached USD 1tn, equivalent to around 3% of GDP, and now exceeds spending on either defence or Medicaid. Second, gross federal debt surpassed the USD 40tn threshold in August. These milestones have reignited concerns about the sustainability of US public finances, particularly given the persistence of large fiscal deficits despite the resilient economy. The large volume of Treasury issuance and the possibility that the Fed will hike rates are likely to keep upward pressure on the government's interest burden. Recent initiatives by US Treasury Secretary Scott Bessent suggest that yields may have reached a politically and economically sensitive threshold. With no credible plan for deficit reduction in sight, investors may reasonably ask whether mounting public debt could eventually undermine market confidence and trigger market volatility.

THE DATA

Our chart shows the average cost of US government debt. After benefiting from a prolonged period of exceptionally low interest rates, it reached a trough in 2022 before rising during the Fed's 2022-23 tightening cycle. It currently stands at around 3.5%. The chart also plots the 10Y US Treasury yield, a broad proxy for the marginal cost of government funding, given that the average maturity of gross Treasury issuance is approximately seven years.

We also include a measure of long-term nominal GDP growth, calculated as the sum of the Congressional Budget Office's estimate of potential real GDP growth and the median US GDP deflator over the past 25 years. This measure is around 4.5%. While comfortably above cost of debt, it has been trending lower in recent years.

The gap between the cost of debt and nominal GDP growth (r-g) is a key determinant of debt dynamics. As long as the government's borrowing cost remains below the economy's growth rate, the debt/GDP ratio can remain stable even with persistent (but small) primary deficits. As the chart illustrates, the average cost of US public debt has been below nominal GDP growth for most of the past 25 years, including today. This differential became particularly large in the aftermath of the pandemic and has helped contain the increase in the debt-to-GDP ratio despite elevated borrowing needs.

OUR VIEW

A fiscal crisis in the US does not appear to be a realistic near-term risk. As the chart highlights, the average cost of government debt remains comfortably below nominal economic growth. Second, USTs benefit from the lack of a sufficiently deep and liquid alternative bond market. Hence, USTs have remained resilient despite persistently large primary deficits of 3.3% of GDP on average over the past four years.

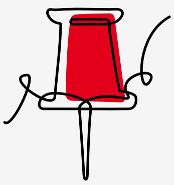
However, the marginal cost of funding has risen substantially in recent months and is now close to nominal GDP growth. If this situation persists, the gap between interest rates (r) and economic growth (g) will shrink and eventually turn negative, leading to a less favourable environment for debt dynamics.

Notably, the US debt stock has a relatively short average maturity (around six years). Roughly 30% of outstanding bonds will need to be refinanced over the next two years, and close to 60% over the next five-years. If yields remain at current levels, average cost will rise quickly. The prospect of Fed hikes adds further pressure as around 25% of the overall debt is in T-bills and reprices rapidly.

The prospect of rising debt/GDP is likely to remain a source of concern for investors and could trigger a repricing of the term premium. Financial markets are forward-looking and tend to price in future developments well before they materialise. An increasingly price-sensitive investor base strengthens the case for occasional episodes of market volatility.

A significant AI-driven boost to productivity and trend growth would substantially improve US debt dynamics. Unfortunately, the extent to which this occurs is uncertain and is largely beyond policymakers' control. On the other hand, a scenario of growth deterioration, possibly as AI underdeliver, would worsen debt dynamics. At the same time, fiscal support would likely widen deficits further, putting upward pressure on the long end of the curve.

Against this backdrop, reducing the fiscal deficit remains the most direct and effective way of improving the long-term sustainability of public finances. By contrast, attempts to contain yields by shifting issuance towards shorter maturities or introducing regulatory measures are unlikely to prove effective over the medium term.



OTHER THINGS TO NOTE

Chancellor Friedrich Merz takes centre stage in budget debate

Yesterday, Finance Minister Lars Klingbeil (SPD) formally presented the government's 2027 federal budget to the Bundestag. The draft, which was approved by the cabinet at the beginning of July, foresees a federal deficit (including special funds) of more than EUR 200bn, or more than 4% of 2027 GDP. The political highlight comes today with the Bundestag's general debate starting at 9:00 CET, including a speech by Chancellor Friedrich Merz. Formally linked to the chancellery budget, the debate traditionally ranges across the government's broader political and economic agenda, which is likely to include the implications of the Saxony-Anhalt election. Parliamentary discussion of the budgets of individual ministries will continue until Friday, after which the budget will be sent to the Bundestag budget committee for detailed negotiations. The final Bundestag vote on the federal budget is scheduled for late November. (A. Rees)

TODAY'S DATA RELEASES

Time (CET)	Country	Data	Period	UniCredit	Consensus	Previous
-	PD	NBP announces key rate (%)	-	3.75	3.75	3.75

Source: Bloomberg, The Investment Institute by UniCredit

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