First Trust
Monday Morning OUTLOOK
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Lengthen the Debt

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The U.S. national debt has exploded, doubling over the past seven years. Everyone agrees that this is unsustainable.

Meanwhile, interest rates have touched historic lows: the yield on the 10-year Treasury Note dropped as low as 1.4% back in July; the yield on the 30-year Bond as low as 2.5%.

Under these circumstances, one would think the US Treasury Department would be turning lemons into lemonade, using this period of persistent, ferocious, and what we believe is irrational risk aversion to reduce the exposure of US taxpayers to potential future funding problems with the national debt.

Instead, the US Treasury is doing future US taxpayers a great disservice. It is failing to seize the moment. And by doing so is compounding a potential risk. This is about how we finance the debt, not the size of our deficits, how much we spend, or how much we tax.

It's really very simple. Imagine a country that funds its whole national debt week to week. If interest rates ever spike upward dramatically, the government would have to borrow even more to pay interest, or immediately raise tax revenue or cut spending to meet its obligations.

By contrast, if the same country financed its debt with very long-term bonds (30-year, or perhaps even 100-year bonds), a sudden spike in interest rates would have very little meaning to taxpayers, because only a very small fraction of the national debt would be issued at higher interest rates each year.

None of this is rocket science. So, why in the world has the US Treasury Department not lengthened the maturity of the US debt? More importantly, why has the US Treasury Department allowed the average maturity of the debt to decline?

In July 2011, 10.4% of the US debt was in 10-year Notes or longer. As of March, the latest data available, that was down to 9.4%. Back in mid-2001, 20% of the debt had a maturity of 10 years or more. We should be heading back in that direction, and quickly.

All of these figures are for what is called the "private debt," which is the national debt held outside of government trust funds (think Social Security and Medicare) and the Federal Reserve. Obviously, with the Fed buying longer maturities as part of Operation Twist, that leaves more shorter-term securities for everyone else, hence the recent decline in the maturity of the debt since July 2011.

But interest rates are now lower than Operation Twist was supposed to push them and the Treasury Department is squandering a great opportunity. Yes, long-term debt carries a higher interest rate than short-term debt,…the yield curve is sloping upward. At current interest rates, for every $100 billion in debt issued as a 30-year Bond, it would cost taxpayers about $2.75 billion extra in interest for the next year compared to financing the same $100 billion with one year securities.

That's not chump change, but it's only one year's worth of saving, which is small compared to the safety gained by knowing the annual cost of that debt will stay the same for the next 30 years. We can only hope that the government is not ignoring this opportunity so that it can add more spending into the budget today and therefore threaten the future even more.

There's an old saying that the time to fix the roof is when the sun is shining. Right now, the sun is shining on Treasury securities. But instead of making sure future taxpayers are protected from a deluge that might eventually come, Treasury officials are just smiling at the hole in the roof.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-22 / 9:00 am	Existing Home Sales - Jul	4.520 Mil	**4.550 Mil**		4.370 Mil
8-23 / 7:30 am	Initial Claims – Aug 18	365K	**364K**		366K
9:00 am	New Home Sales – Jul	0.365 Mil	**0.360 Mil**		0.350 Mil
8-24 / 7:30 am	Durable Goods – Jul	+3.0	**+4.0%**		+1.3%
7:30 am	Durable Goods (Ex-Trans) - Jul	+0.5	**+0.8%**		-1.4%

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.