Insights, Tacit Thought | Weekly Investment Insights

US Treasuries

Published on: 13 June, 2025 | Author: Investment Team

Recent headlines about a possible US government debt default are dramatic, but a default—while unlikely—cannot be ruled out. Given its far-reaching consequences, we think it's useful to clarify the arguments and implications for clients.

The current focus on default risk stems from the Mar-a-Lago Accord, a proposed economic strategy developed during Donald Trump's second term. While not official policy, it aims to reduce the US trade deficit, restore manufacturing, and realign global economic relationships by weakening the US dollar but maintaining its reserve currency status.

A key feature is potential debt renegotiation. The Accord's architects see US sovereign debt and an overvalued dollar as barriers to competitiveness and fiscal health. Instead of raising taxes or cutting spending, the proposal suggests:

1. Reducing Government Debt Costs: Foreign-held US Treasuries could be converted into ultra-long-term, non-tradable bonds, lowering annual interest payments and easing fiscal pressure.
2. Weakening the Dollar: Restructuring debt would make the dollar less attractive, boosting US export competitiveness.
3. Shifting Burden to Foreign Creditors: About 30% of US debt is foreign-owned. Renegotiation would shift some adjustment costs abroad.
4. Avoiding Austerity or Tax Hikes: Debt restructuring and devaluation are seen as preferable to politically unpopular spending cuts or tax increases.
5. Geopolitical Leverage: The Accord links economic policy to national security, using tariffs or reduced security guarantees to pressure trade partners into accepting new debt terms.

A US government default—failing to pay obligations on time—would have severe consequences. The most immediate reaction would be sharp declines in stock and bond markets, with the S&P 500 potentially falling 20% or more. US Treasuries, long viewed as the world's safest asset, would lose that status, triggering a global sell-off.

Credit rating agencies would likely downgrade the US, raising borrowing costs for the government, businesses, and households. Mortgage, car loan, and credit card rates would rise, making credit less accessible. The government might delay or cut Social Security, military pay, tax refunds, and other benefits, causing hardship for many Americans.

A default would almost certainly tip the US into recession, with millions of jobs at risk and trillions in household wealth potentially wiped out. The dollar's central role in global finance means a default would send shockwaves worldwide, undermining confidence in US assets and disrupting trade and investment flows.

Most damaging would be the loss of trust: the US has never defaulted, and doing so would shatter its reputation, making future borrowing much more expensive for everyone.

While a default remains unlikely, the threat itself is being deployed as a powerful negotiating tool for the US in talks with major creditors like China. The more the possibility is discussed, the more leverage it provides in securing better terms for the US, or so the theory goes.

For our strategies, this remains a tail risk, but one which we actively monitor through our analysis as the undermining of the status of the ultimate risk-free asset in the world will have major implications for investments. No one can accurately predict how this will play out but hopefully this explanation provides you with an overview of the issue at hand and shows that although w