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Is the United States' external debt justifiable and sustainable?

When comparing the external positions of the world's largest economies in terms of income (the United States, the Euro zone, India, Japan and China), it is clear that the United States has a substantial net external debt, that India has a low net external debt, and that Europe, Japan and China have very large net external assets.

India's low per capita income would normally imply that the marginal productivity of capital is high there, which would normally attract international capital. Conversely, the external positions of the United States, Europe, Japan and China cannot be explained by their level of per capita income (the United States should have net foreign assets and China net foreign debt) nor by their demographics (the faster demographic ageing in Europe, Japan and China compared to the United States should imply that the United States accumulates foreign assets in anticipation of ageing and that the other three countries reduce their foreign assets).

The only possible explanations for the structure of external debts and assets are therefore:

- The dollar's role as the dominant reserve currency (which gives rise to a 'Triffin paradox' in the United States);
- The high profitability of US companies.

We can examine the composition (direct investment, outstanding Treasury holdings by the rest of the world, portfolio investment) of US external debt to assess the validity of these explanations and the risk of global financial instability arising from US external debt.

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Net external liabilities or assets

We compare the **United States, the Euro zone, India, Japan and China**. **Charts 1A to 1D** show the **net external debt or net external assets of these five countries** (regions).

Chart 1A
Net foreign assets or liabilities (as % of nominal GDP)

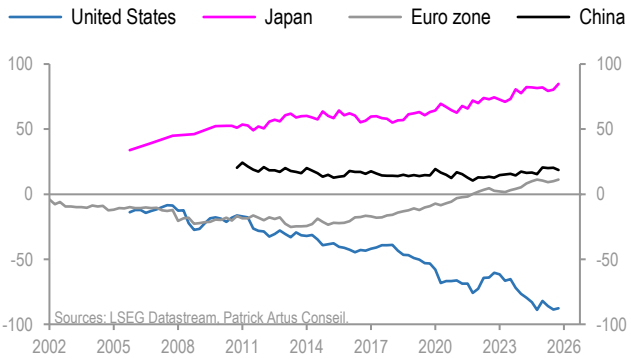


Chart 1B
India: Net foreign liabilities (as % of nominal GDP)

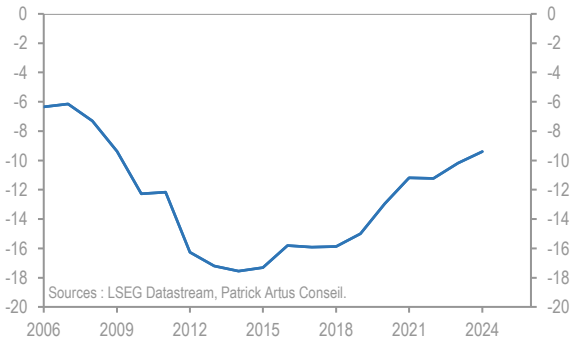


Chart 1C
Net foreign assets or liabilities (USD bn)

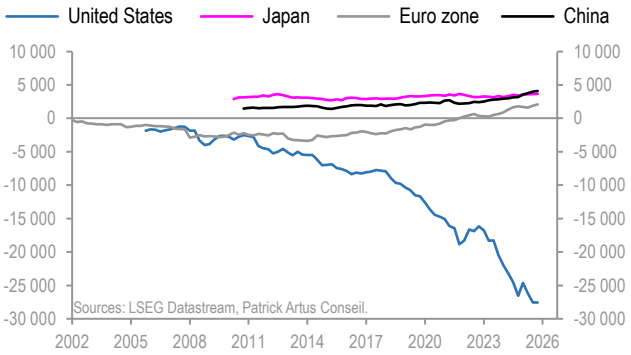
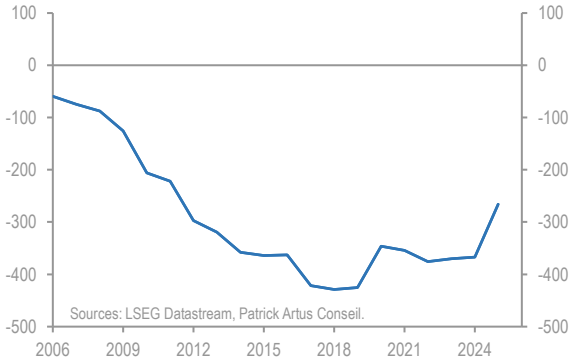


Chart 1D
India: Net foreign liabilities (USD bn)



We can see:

- Very high net external debt in the United States;
- Low net external debt in India;
- Relatively low net external assets in the Euro zone;
- Very high net external assets in Japan and China.

It should be noted straight away that **India's situation is not unusual**. India has a **low per capita income** (**Charts 2A/B**), which normally implies that the marginal productivity of capital in India is high, and this explains why India attracts foreign capital (and accumulates external debt).

Chart 2A
GDP per capita (USD)

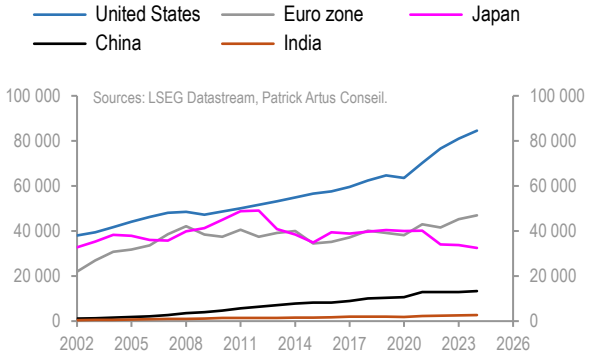
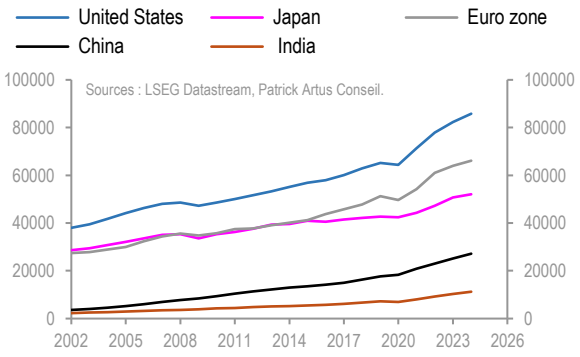


Chart 2B
GDP per capita (PPP USD)



The usual explanations for the presence of foreign assets or liabilities do not apply to the United States, Europe, Japan or China

The two common explanations for the presence of foreign assets or liabilities are

- The **level of development** ; as we saw in the example of India, a country with a low level of per capita output attracts foreign capital, resulting in net foreign debt. Conversely, a country with a high level of per capita output normally implies that the marginal productivity of capital is low (assuming diminishing marginal productivity), so that country has an incentive to invest in the rest of the world, which normally results in net foreign assets;
- **Demographics** ; as long as the population is young, the country accumulates foreign assets, so that it can sustain its consumption by drawing on these foreign assets when the population begins to age.

The pattern of external debt and assets is not consistent with either of these explanations. Per capita income is high in the United States and low in China (see **Charts 2A/B above**), which would suggest that the United States lends to China, yet the opposite is true. **Population ageing is more advanced in China, Japan and Europe than in the United States** (**Charts 3A/B**), which should imply that the United States continues to accumulate external assets and that Europe, Japan and China are reducing their external assets, yet the opposite is observed.

Chart 3A
Fertility rate (births per woman)

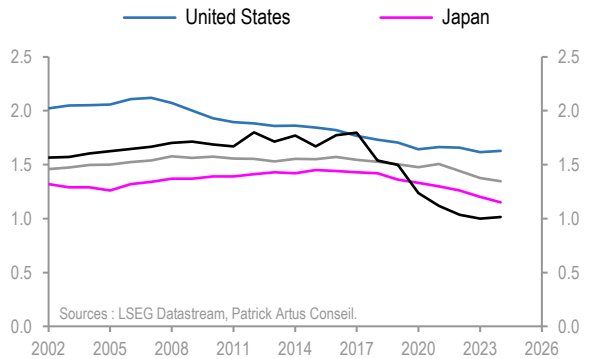
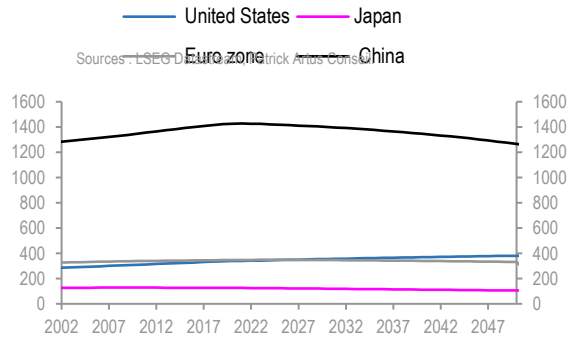


Chart 3B
Population (in millions of inhabitants)



Two explanations for the observed pattern

Two possible explanations for the pattern observed are:

- **The dollar's role as the dominant reserve currency**;
- **The high profitability of US companies**.

The dollar is the **dominant international currency**. This is evident from the dollar's share of central banks' foreign exchange reserves (**Chart 4**), but also from its share of international trade invoicing (74% in the Asia-Pacific region, 79% globally excluding the European Union and North America), of international debt issuance (61% compared with 26% for the euro), and of international bank lending (56% compared with 20% for the euro).

Since the United States issues the international currency, demand for the dollar is strong, as can be seen, for example, in the holdings of US Treasury securities by non-residents (**Chart 5**).

Chart 4
Currency shares in global foreign exchange reserves (as %)

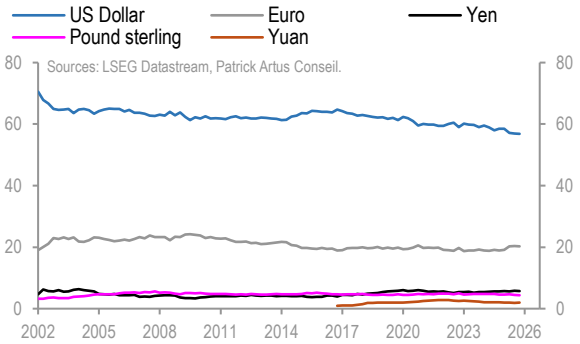


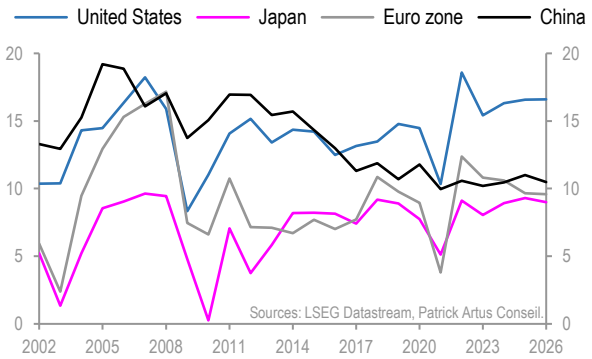
Chart 5
United States: Treasury securities held by non-residents (USD bn)



Here we see the risk of a **Triffin paradox** emerging. In the early 1960s, Robert Triffin demonstrated that when a country issues the international reserve currency, it naturally runs a current account deficit (since it must supply international liquidity in its own currency); it therefore accumulates external debt, which, in the long run, can undermine confidence in the soundness of its currency and cause it to lose its role as the dominant reserve currency.

The second reason why the United States has a high and growing external debt is the **high level of profitability among American companies** (**Chart 6**).

Chart 6
RoE



This high profitability of US companies stems from several factors: an income distribution that favours employers over employees, the significant size of the information and communications technology sector, and the ease of financing innovation in the United

States. This high profitability of US companies attracts capital to the United States (in the equity market and the corporate debt market).

We can see, for example, that although China has stopped buying US Treasury bonds, it is investing heavily in the US (in digital technology, energy infrastructure, ports, etc.), as shown by data from AidData (William and Mary University), with outstanding loans from China to the US totalling $202 billion by the end of 2023.

What is the nature of the United States' external debt?

Chart 5 above shows non-residents' holdings of Treasuries. Chart 7 shows the stock of foreign direct investment received by the United States and made abroad by the United States. Chart 8 shows the stock of portfolio investment received by the United States and made abroad by the United States.

Chart 7
United States: International investment position, direct investment (as % of nominal GDP)

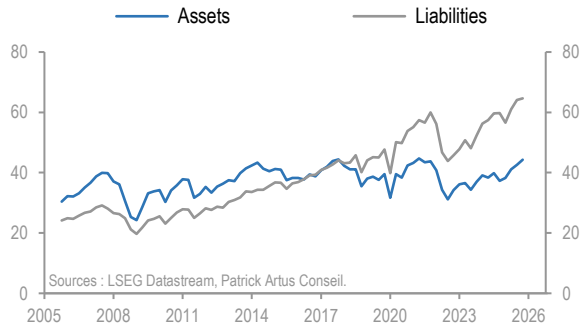
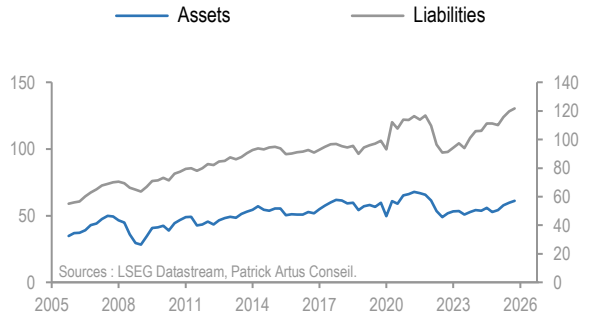


Chart 8
United States: International investment position, portfolio investment (as % of nominal GDP)



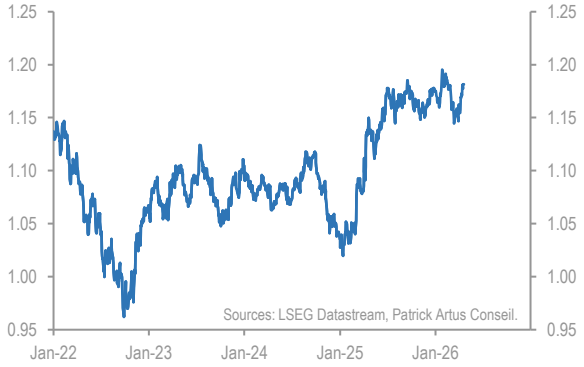
It is clear that the United States' net external debt (Chart 1A above) is now the result of both a negative net stock of FDI and a stock of foreign portfolio investment in the United States that is increasingly greater than the stock of US portfolio investment abroad.

Risk of financial instability in the United States due to external debt

The accumulation of US external debt exposes the United States to the risk of a financial crisis if non-residents stop lending to the US or even withdraw their loans from the US. Such a financial crisis would lead to a decline in the US stock market, a rise in long-term interest rates on the dollar, and a depreciation of the dollar. This could result from:

- A geopolitical crisis leading to financial sanctions against the United States by a number of countries. It must be acknowledged that even the war in the Middle East in March 2026 did not produce such a reaction, with the dollar instead acting as a safe-haven currency, as shown by the trend in the dollar exchange rate (Chart 9);

Chart 9
Euro/dollar exchange rate (EUR 1 = USD...)



- **A financial crisis**, a likely candidate today being a **private debt crisis in the United States** (with private debt funds – Blue Owl, Apollo, Ares – facing redemption requests from investors). The private debt market has an outstanding balance of $3 trillion, with high default rates (5.8% today) and significant leverage among borrowers;
- **A crisis in the equity market**, where valuations are very high. **Chart 10A** shows the P/E ratio (price-to-earnings ratio) of the S&P 500, whilst **Chart 10B** shows the Shiller CAPE (price-to-earnings ratio based on 10-year smoothed earnings adjusted for inflation) of the S&P 500.

Chart 10A
S&P 500 P/E ratio



Chart 10B
CAPE / Shiller PE Ratio



The Shiller CAPE ratio in particular highlights the current high valuation of US equities, which is driven by investor optimism regarding future profits linked to the development of artificial intelligence. **A significant downturn in the US equity market would lead to a withdrawal of non-resident investors**.

Summary: What are the implications of the structure of external debt and net foreign assets?

We have seen:

- That the structure of external debt and assets (in the United States, the Euro zone, Japan and China) cannot be explained by either the level of development or demographics;
- That two possible explanations for the fact that the United States borrows from other countries are the dollar's role as an international reserve currency and the high level of corporate profitability in the United States;
- That the US's net external debt stems essentially from both net direct investment debt and net portfolio investment debt, including US Treasury securities. This supports the two explanations for US external debt outlined above: the dollar's role as an international reserve currency and the high level of capital returns in the US;

- That the risk associated with US external debt may stem from a hostile reaction by other countries to US policies, a private debt crisis, or a sharp fall in US stock market indices, caused, for example, by disappointment regarding the expected profits from the development of artificial intelligence.

The attractiveness of the United States to international capital explains the country's external debt; and, as capital flows into the United States, this explains the presence of foreign assets in Europe, Japan and China. The flow of capital into the United States explains the low level of investment in other countries, which in turn leads to current account surpluses. The explanation of international imbalances in terms of external debts and assets is, of course, consistent with the explanation based on current account balances.

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