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GLOBAL PERSPECTIVES

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THE SHOCK-RESISTANT US ECONOMY: STATES IN THE BLACK, HOUSEHOLDS FLUSH — AND A HEAVIER FEDERAL TAB

- ▶ The pandemic effectively shifted leverage onto Washington, leaving households, companies, and state & local governments with sturdier balance sheets — which is one reason growth has proved hard to slow.
- ▶ Consumers and firms still sit on sizable cash and equity cushions, supporting spending and hiring, though pressure is building at the lower end of the credit spectrum.
- ▶ The trade-off is a heavier federal interest bill: As borrowing costs rise, the Treasury's tab becomes the economy's new "speed limit" and a growing constraint on policy.

HIGHLIGHTS

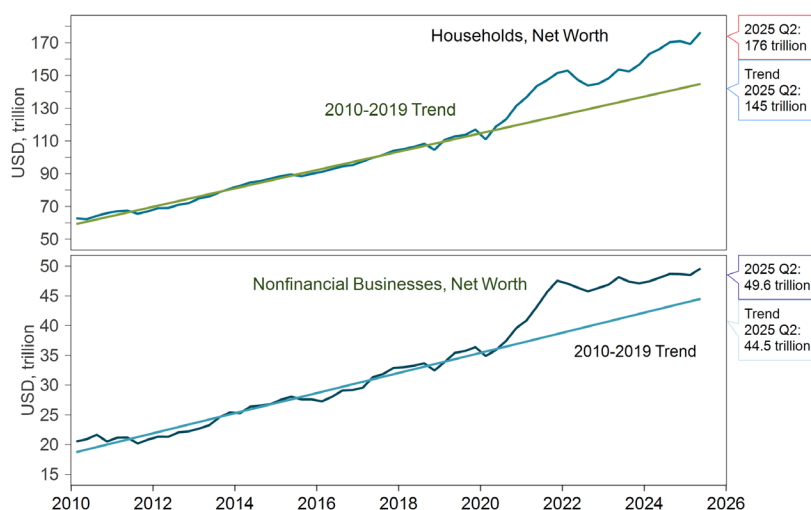
BALANCE-SHEET TRENDS EXPLAIN US ECONOMIC RESILIENCE

The US enters late-2025 with an unusual mix of strengths and constraints.¹ Households, companies, and state and local governments look sturdier than they have in years. Yet the federal government's balance sheet — after financing the pandemic response and its aftermath — carries far more leverage, and a rising interest bill that now shapes the outlook. One way to read the recent data: Resilience was bought with red ink, and the bill is increasingly visible in Washington's interest line.

Start with the cushion. The best single explanation for why growth has been so resilient despite higher interest rates is simple: Private balance sheets are fat with assets and cash. As of mid-2025, household and business net worth stood roughly \$31 trillion and \$5 trillion above their pre-pandemic trends, respectively — an enormous buffer that taps into both the housing boom and a recovery in equity values (**Figure 1**). Cash hasn't disappeared either. Household money balances are about \$4.2 trillion above trend, and business money holdings about \$1.6 trillion above trend, leaving ample liquidity to smooth shocks (**Figure 2**).

FIGURE 1

Households and Businesses: Net Worth versus Pre-Pandemic Trend



Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

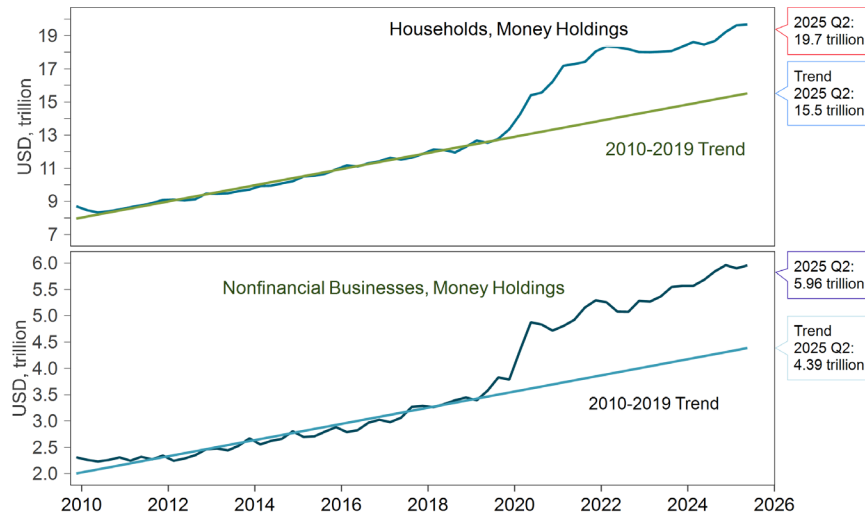
Despite 2022's bear markets in stocks and bonds, by mid-2025 the net worth of households and businesses are now respectively \$31 trillion and \$5 trillion above their pre-pandemic trends.

The same story shows up in traditional debt metrics. Mortgage debt has drifted back to roughly its late-1990s share of GDP, far below the 2000s peak; consumer credit's share is near multi-decade lows — a starting point very different from 2007 (**Figure 3**). In aggregate, household debt-to-GDP has fallen for 16 straight quarters to the lowest in more than 25 years. Perhaps more surprising, the household debt-service ratio is about 11.2% — slightly below its 2019 average — despite higher rates, reflecting the prevalence of fixed-rate mortgages and solid income growth (**Figure 4**).

¹ This piece updates data and analysis from W. Sterling, "Leverage Revisited: Assessing US Debt amid Recession Fears," *GW&K Global Perspectives*, April 2023.

FIGURE 2

Households and Businesses: Money Holdings versus Pre-Pandemic Trend

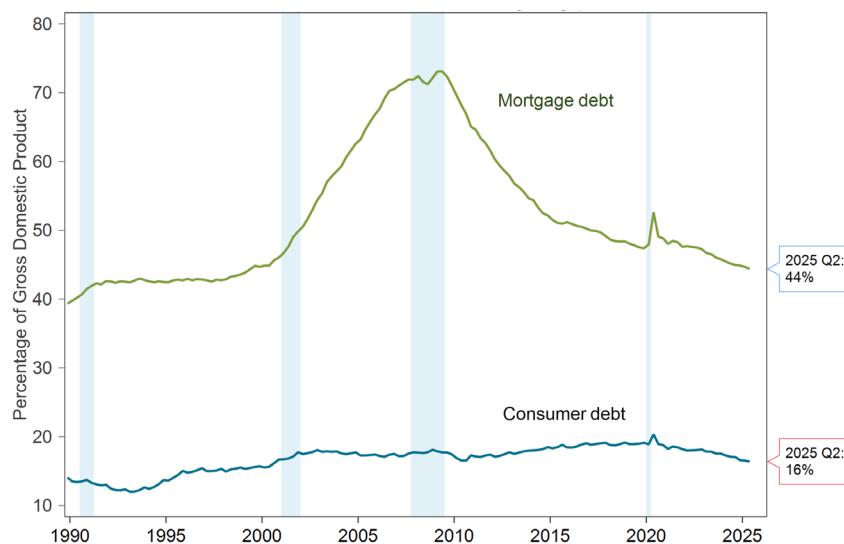


Note: Money holdings include total currency, bank deposits, and money market shares.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

Households and businesses are also flush with cash, with respective money holdings as of mid-2025 that are \$4.2 trillion and \$1.6 trillion above their pre-pandemic trends. That is massive “excess liquidity.”

FIGURE 3

Household Debt by Type

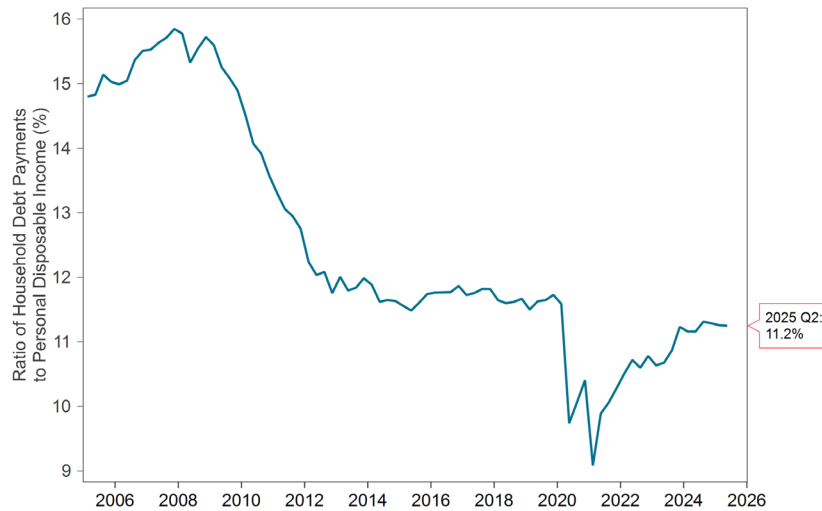


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

After a brief spike in 2020, mortgage debt is back to 44% of GDP, which is back to its 1999 level and far below its peak of 73%. Consumer debt at 16% of GDP is at its lowest level since 2000.

FIGURE 4

The US Household Debt Service Ratio Remains Below Its Pre-Pandemic Level



Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

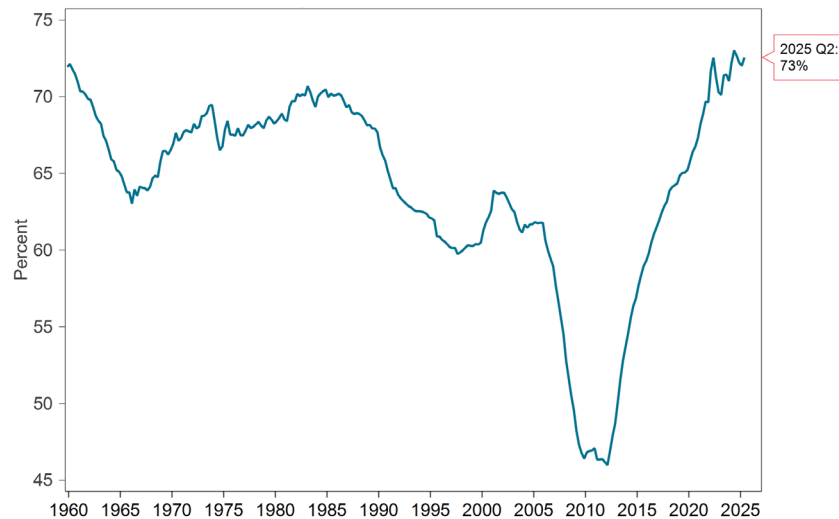
Despite higher rates, the household debt-service ratio is below its 2019 average, reflecting the prevalence of fixed-rate mortgages and solid income growth.

WHY CONSUMERS HELD UP

The post-pandemic consumer looks very different from the pre-GFC borrower. Owners' equity in real estate has hovered around 72% – 73% of home value — the highest since the late 1950s (**Figure 5**). That equity cushion, paired with locked-in mortgage rates, has insulated most households from the rate shock even as credit conditions tightened.

FIGURE 5

US Owners' Equity in Real Estate as a Percentage of Household Real Estate



Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

Relative to home values, owners' equity in real estate has returned to the highest level since the late 1950s. Paired with locked-in mortgage rates, that equity cushion has helped insulate households from tighter credit conditions.

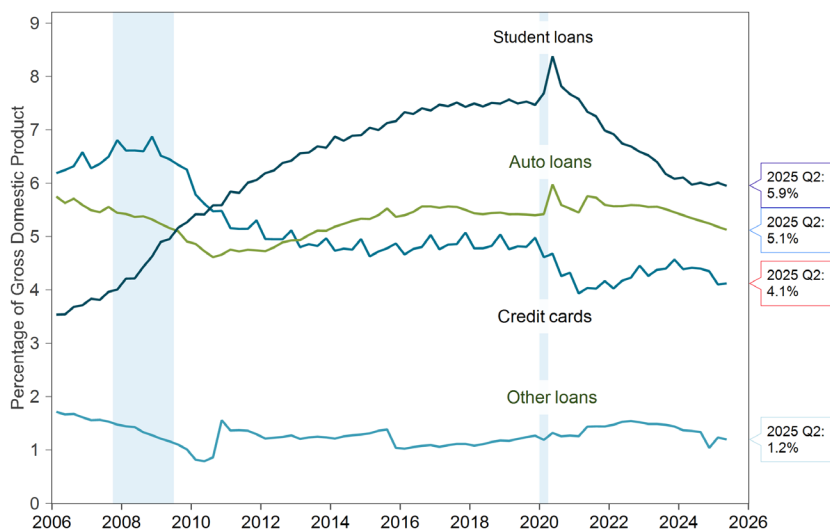
None of this denies pockets of strain. Credit-card delinquencies among major servicers remain below pre-COVID readings, but auto-loan delinquencies sit near their highest since the financial crisis, and FHA mortgage delinquencies have risen, underscoring stress at the lower end of the income distribution. Analysts at J.P. Morgan add that cracks are emerging in non-prime consumer credit, prompting downgrades of several specialized lenders — important for those firms but unlikely to be “material” for prime lenders in a still-robust economy.² The distribution matters: Higher-income households, cushioned by equities and home equity, are driving a bigger share of spending; lower-income cohorts feel the pinch of higher prices and floating-rate borrowing.

One structural residual from the past 15 years is student debt. Student loans’ share of GDP climbed from 3.5% in 2006 to 8.4% by 2020 (**Figure 6**). That surge helped cap credit-card borrowing for a time and remains a pinch point for younger households now that pandemic forbearance has ended. It’s not large enough to overturn the aggregate story, but it explains some of the cross-currents in spending and credit quality by age and income.

Corporate credit looks steady rather than crisis-prone, with many Chief Financial Officers having termed out debt at low coupons and built cash. Still, the recent blowups at subprime auto lender Tricolor and auto parts supplier First Brands show that pockets of stress remain — especially in non-prime and opaque private-credit niches. With debt service largely fixed for now, profits continue to cover interest comfortably for most investment-grade names, reducing the risk of a near-term default wave. The maturity calendar may pose some challenges in 2026 – 2027, but firms start from higher equity and cash levels, which helps them manage higher refinancing costs.

FIGURE 6

Consumer Non-Mortgage Debt by Category



Note: Shaded areas denote Nber recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

From 2006 to 2020, student loans rose from 3.5% of GDP to 8.4%, crowding out growth in credit card debt and becoming a sensitive political issue in the process.

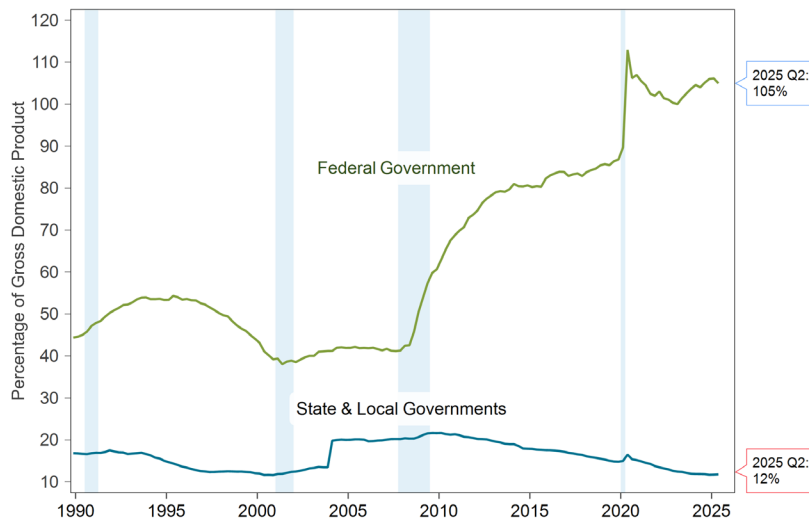
² Richard Shane, et al., “Consumer Finance Q325 Preview,” J.P. Morgan North American Equity Research, October 7, 2025.

STATES IN THE BLACK, FEDS IN THE RED

Another important shift since 2020 is in public finance. State and local debt has fallen to about 12% of GDP — the lowest in decades — while federal debt sits near 105% of GDP (**Figure 7**). The chart makes it clear: Federal transfers during the pandemic helped sub-national governments repair and fortify their books. That's a crucial difference from the post-2008 cycle, when state and local austerity was a drag on growth. Today, sturdier municipal ledgers, including record rainy-day funds in many states, help stabilize services and investment even as growth cools.

FIGURE 7

Outstanding Domestic Debt by Government Category



Note: Shaded areas denote Nber recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

State and local debt has fallen to about 12% of GDP — the lowest in decades — while federal debt has resumed its long-term uptrend and now sits near 105% of GDP.

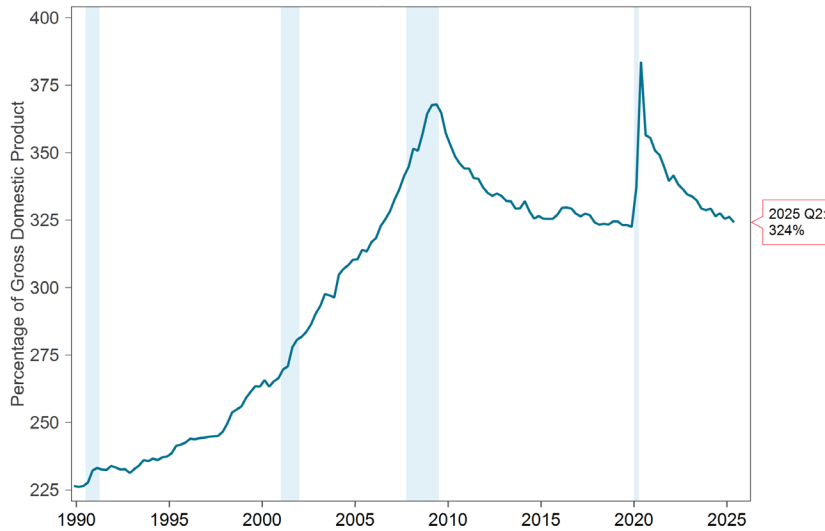
Considering all types of debt, the economy didn't lever up as much as feared. At the height of the COVID shock, total outstanding debt spiked to a record share of GDP. But as inflation and real growth lifted nominal GDP, the economy-wide debt-to-GDP ratio receded toward its 2019 level — another reason private-sector credit hasn't looked "crowded out" (**Figure 8**). The composition matters, too: Financial-sector debt now remains below pre-pandemic levels and far below 2008, while non-financial debt sits only slightly above pre-COVID and well off its peak (**Figure 9**).

In other words, concerns about the high level of overall debt may overlook the fact that the most systemically risky part of the last crisis — the financial sector — has not been the driver this time. The speed limit: federal interest. The trade-off for all this private-sector and municipal resilience is that more leverage now sits at the federal level, where interest costs are rising fastest. The Congressional Budget Office projects net interest near \$1.8 trillion by 2035 — roughly 4% of GDP — a budget headwind large enough to shape taxes and spending for years (**Figure 10**).

That doesn't imply an imminent crisis; the US still benefits from deep Treasury markets and reserve-currency status. But it does create a policy tension: the Fed has been able to keep rates higher

FIGURE 8

Outstanding Domestic Debt

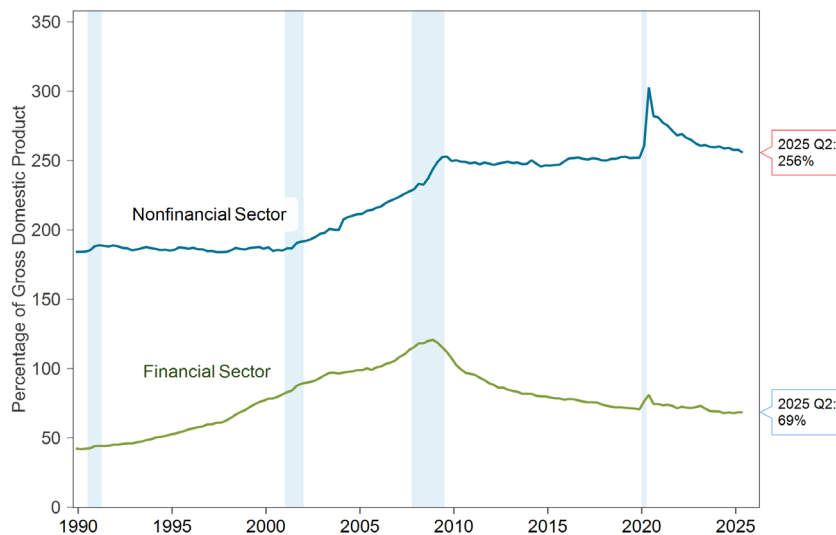


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

America's total outstanding debt jumped to an all-time record of about 384% of GDP in the second quarter of 2020. The total debt ratio has since fallen back to its 2019 level of 324% of GDP as growth in nominal GDP has since eclipsed debt growth.

FIGURE 9

Outstanding Domestic Debt by Sector

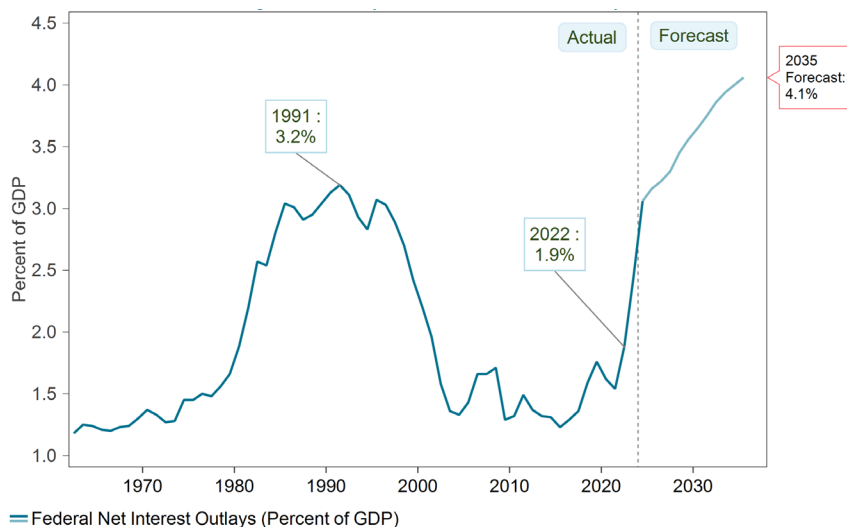


Note: Shaded areas denote NBER recession periods.
Sources: GW&K Investment Management, Federal Reserve, and Macrobond.

Financial-sector debt at 69% of GDP is below its pre-pandemic level and far below its 2008 peak of 121%. Nonfinancial debt at 256% of GDP is well off its peak level and only slightly higher than its pre-pandemic level of 252%.

FIGURE 10

CBO Projects Record Federal Interest Expense by 2035 (Percent of GDP)



Sources: GW&K Investment Management, CBO, and Macrobond.

The Congressional Budget Office (CBO) recently forecast that the federal government's net interest expense would grow to \$1.8 trillion by 2035, a record 4.1% of GDP.

for longer precisely because private balance sheets are strong, yet higher rates raise the Treasury's interest bill, narrowing fiscal room and eventually putting upward pressure on the term premium.

A SHOCK-RESISTANT ECONOMY

Putting the pieces together, the US outlook looks constructive. Private-sector cushions (wealth, cash, debt locked in at low rates) and stronger municipal ledgers have made the economy more shock-resistant. That resilience is why rate hikes didn't torpedo growth, why the labor market bent but didn't break, and why consumption slowed rather than slumped. At the same time, the center of gravity for leverage has shifted to Washington, where net interest is becoming the macro speed limit. If growth cools and inflation fades before interest costs crowd out, the economy can normalize without surrendering its balance-sheet gains. If not, fiscal arithmetic could demand harder choices.

For investors, the practical takeaways are straightforward. Consumer demand should decelerate, not collapse, with prime credit performing and non-prime requiring sharper underwriting.

Corporate credit looks steady rather than crisis-prone, with the 2026 – 2027 refinancing hump the key test for weaker balance sheets. Municipal credit remains supported by leaner debt loads and healthier revenues. The real asset-allocation question lives out the curve: How much term premium is needed to absorb a steady stream of Treasury supply as net interest marches higher?

The pandemic era didn't simply add debt. It rearranged it. The result is a sturdier private core and a heavier federal anchor. Navigating that trade-off — keeping the resilience without letting the anchor dig in — will define the next phase of the cycle.

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