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# The Carlyle Compass

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## The Boy Who Cried Wolf

The tax reconciliation package making its way through the House of Representatives has garnered its share of detractors. The portions of the bill that have been [scored](#) would increase the U.S. fiscal deficit by nearly \$600 billion, or 1.8% of GDP, in fiscal year 2027, up from a baseline deficit of \$1.75 trillion.

Some commentators—many of whom have been derisively referred to as “[budget scolds](#)” for their incessant hectoring about the deficit—[warn](#) that passage could result in a sovereign debt or currency crisis. On Friday,

Moody's entered the chat, downgrading the U.S. sovereign debt rating from Aaa to Aa1.

This isn't the first time we've heard such warnings. Fifteen years ago, when the fiscal deficit consumed a comparable proportion of national income, it was common to hear:

"The U.S. is headed for a Greek-style debt crisis."

"As a result of the federal government's enormous debt and deficits, substantial inflation could break out in America in the next few years."

"This trajectory is catastrophic. By the end of the decade, we will be spending 20 percent of our tax revenue simply paying *interest* on the debt – and that's according to *optimistic* projections."

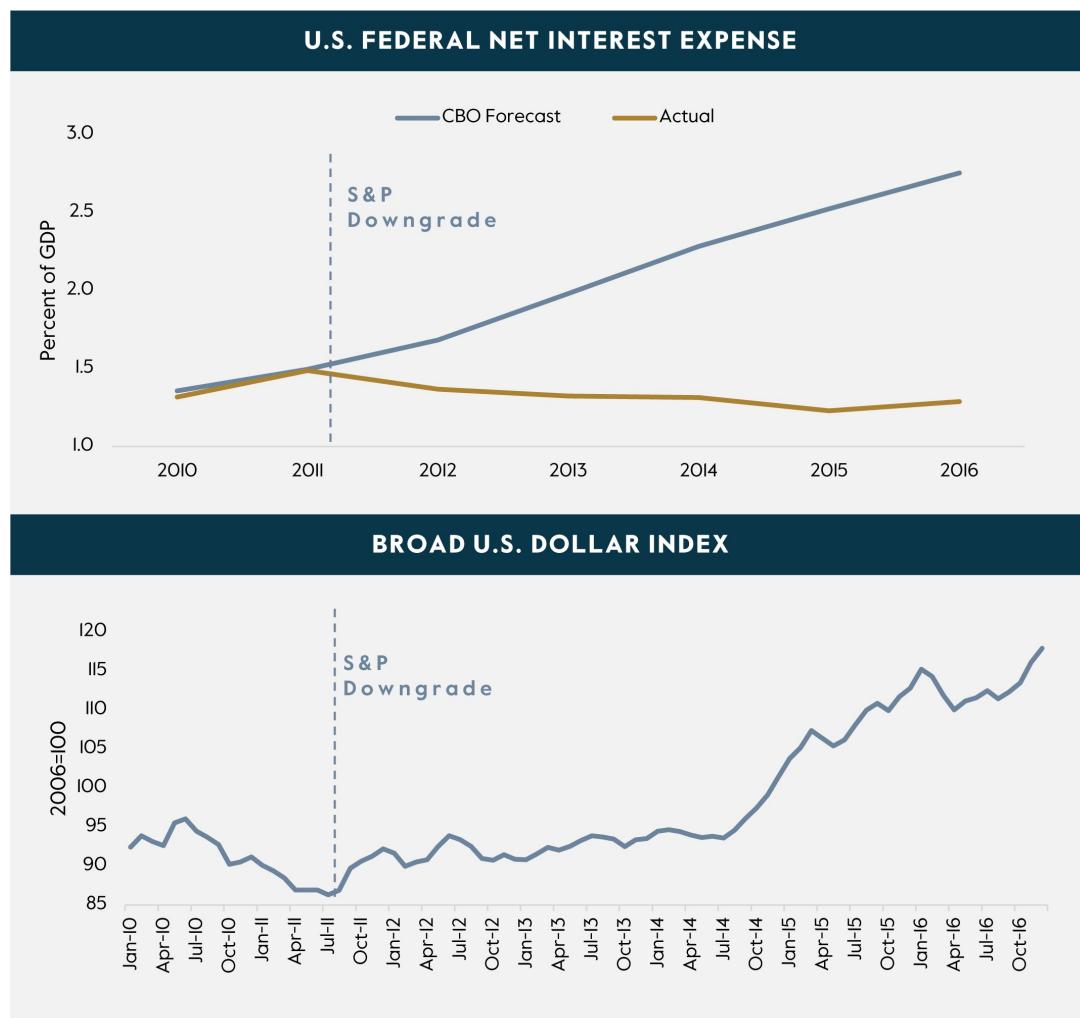
"Let's get real. The U.S. is bankrupt... Our country is in worse fiscal shape than Greece. When you look at the present value of all future obligations, the U.S. is functionally bankrupt."

"In order to continue to attract foreign capital, the United States needs to control its appetite for it... Fiscal adjustment is all the more urgent, as some sources of the dollar's reserve currency status may not last."

Credit rating agencies also weighed in back then, with S&P downgrading U.S. sovereign debt from AAA to AA+ in August 2011.

Not only was there no sovereign debt or currency crisis, the share of national income required to service outstanding debt *fell* by 17% and the foreign exchange value of the dollar *rose* by 40% in the five years following S&P's downgrade (Figure 1).

Figure 1: Not Much of a Crisis



Source: Carlyle Analysis; CBO, IMF WEO Database, Federal Reserve Data, May 2015. There is no guarantee any trends will continue.

What sort of heroic fiscal consolidation occurred to avert certain disaster? None. The annual fiscal deficit narrowed as the economy recovered, but that was already baked into the projections. By 2018, the outstanding debt held by the public was 2% *higher* than the CBO forecast at the end of 2010. The fiscal trajectory was unchanged; the Treasury was simply able to borrow at far lower interest rates than deficit hawks had anticipated.

Part of this was likely the result of the Fed's quantitative easing (QE) programs. [Fed researchers estimate](#) that QE reduced the term premium on 10-year Treasuries by 100bp. But with a weighted average maturity of less than six years, this explains less than one-third of the decline in the Treasury's borrowing costs.

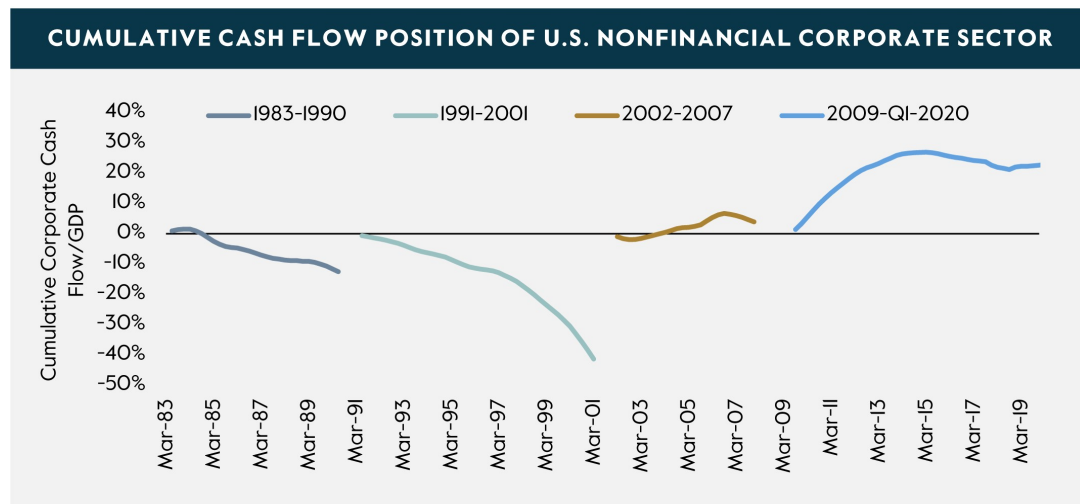
## Asset Light Businesses & "Deindustrialization"

The far bigger factor was the shift in the cash flow position of the corporate

sector. In the past, internally generated cash flow was insufficient to meet capital spending needs; businesses (in the aggregate) had to borrow from households, pensions, insurers, and other pools of capital (via banks and other intermediaries) to buy equipment and build the factories and logistics and communications networks necessary for their operations.

After 2009, something changed. Economic activity shifted decisively towards software, digital services, and “factory-less manufacturing” businesses that focused primarily on product design, software development, and branding. As intangible assets became more central to U.S. corporate operations, capacity constraints were relaxed; with little need for additional property, plant, and equipment to generate that next dollar of revenue, these “asset light” businesses often generated 5x to 8x as much cash from operations as they reinvested. Rather than *borrow* 15% of GDP from the rest of the economy, on net, as had been the average in prior expansions, the corporate sector *lent* 22% in the form of share repurchases, special dividends, and massive cash holdings (typically direct or indirect positions in Treasury notes and bills; Figure 2).

**Figure 2: Corporate Surpluses Absorbed Treasury Issuance**



Source: Carlyle Analysis; Federal Reserve Financial Accounts of the United States, May 2025. There is no guarantee any trends will continue.

Of course, there’s another way to describe this economic transformation: deindustrialization.

The decline in the capital intensity of the corporate sector has been commensurate with the rise in the U.S. trade deficit in manufactured goods. With the boom in AI-related spending ([see Question #4](#)) already diminishing corporate cash flow surpluses by 75% relative to the previous expansion, an

increase in domestic goods production would likely push the corporate sector back into a net borrowing position in the coming years. The corporate sector would once again be competing with the Treasury for capital rather than lending to it.

Those who've warned repeatedly of impending fiscal doom have a bad track record. But the AI capex boom and potential for policy-induced reindustrialization make their case more plausible. If the allegorical "wolf" in this case were defined as 6% bond yields, it might even be time to believe the boy.

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