

[Measuring Fiscal Risk: Evidence From a Century of Data](#)

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Government debt in advanced economies such as the US and the UK is often referred to as a safe asset. We test the extent to which this characterisation is justified using a definition of safety from asset pricing theory: government debt returns should have a non-negative beta with the stochastic discount factor (SDF), a key theoretical object that determines asset prices across the economy. This requires the government debt portfolio to deliver real returns that are either uncorrelated with the state of the world or high in bad states, such as recessions or financial crises.

In a simple, frictionless model, we demonstrate that the sign of the covariance between the return received by an investor holding the government debt portfolio and the SDF is a sufficient statistic for the prevailing monetary-fiscal regime. Under the monetary regime, deficits are backed, in net present value terms, by future surpluses and inflation is kept under control. Government debt is consequently a safe asset, exhibiting zero or positive covariance with the SDF. Under the fiscal regime, deficits are not fully backed by the net present value of additional future surpluses. Inflation therefore responds to fiscal shocks, and government debt is a risky asset with a negative beta with the SDF.

We then estimate this key covariance empirically by constructing the SDF from the cross-section of asset returns. This allows us to remain relatively agnostic about the underlying asset pricing model that generates the SDF. For the US, we find that the covariance exhibits clear sign changes over the past century that align with previously identified shifts between monetary and fiscal regimes. US government debt was risky during the 25-year period preceding the Treasury-Fed Accord of 1951 but became clearly safe immediately afterwards. It became risky again in the mid-1960s, when the Johnson administration undertook a large, unbacked fiscal expansion through the Great Society programme and the Vietnam War. This expansion was accompanied by considerable pressure on the Federal Reserve, which continued under the Nixon administration.

This regime ended in the mid-1980s, when government debt became safe again, potentially because the Volcker shock brought about a return to more active monetary policy and passive fiscal policy. We find that this safe-debt regime persisted until 2020, after which US government debt became risky again during the pandemic and post-pandemic period. We estimate that, by the end of 2024, the associated risk premium was adding around 100 basis points to the annual cost of government borrowing.

Repeating the exercise for the UK, we find that the gilt portfolio has generally been safe over the past century. We identify three exceptions: (i) the interwar period; (ii) the mid-1970s; and (iii) the 2022-2024 period.