First Trust
Monday Morning OUTLOOK

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The Budget Blowout

With only one week left in the fiscal year, it looks like the budget deficit for the federal government for Fiscal Year 2024 is going to come in at about $1.9 trillion, which is 6.7% of GDP.

To put this in historical perspective, we know of no other year in US history where in the absence of a major full-mobilization war (like World War I or II) or a major recession and its immediate aftermath when the budget deficit was so large. Some may point out that the budget gap was this large in FY 2012, a few years after the Financial Panic and Great Recession of 2008-09. However, the unemployment rate averaged 8.3% that year, more than double the average jobless rate of 4.0% this year. In other words, the economy in 2012 was still far from a full GDP and job-market recovery.

You may not remember, but Democrats hammered Ronald Reagan for deficits in the 1980s. Well, looking back the largest deficit we ever had under Reagan was in 1982, when the unemployment rate was 10% and we were fully funding the Pentagon at the height of the Cold War.

In other words, there is simply no excuse for running a deficit this large given the lack of a major war and the absence of a recession.

And yet here we are. What's amazing is how much the budget situation has changed in only the past five years. When looking at the budget it's important to compare apples-to-apples, so we like to use the budget at the same point in the business cycle. In 2019 the economy was at a pre-COVID peak and 2024 is, so far, a peak business-cycle year as well. (It remains to be seen if 2025 is an even higher peak, in which case we will be happy to make a 2019 versus 2025 comparison a year from now).

Five years ago, in FY 2019, the deficit was 4.6% of GDP, so with this year at 6.7% it is 2.1 percentage points higher. Is it higher because of less revenue? Not at all. In the past five years revenue as a share of GDP has risen to 17.2% from 16.3%. They were $3.5 trillion in 2019, this year they are $4.9 trillion, $1.4 trillion higher.

Instead, the problem with the growing deficit is on the spending side. And while many just chalk it up to Social Security and Medicare because of our aging population, this just isn't true. There are three major factors: (1) net interest on the federal debt, (2) "other" mandatory spending, and (3) major health care programs, such as Medicare (for senior citizens) and Medicaid (for those with lower incomes).

The growth in the net interest on the federal debt has been astounding and we plan to write more about the major political and policy implications of that change in the months ahead. Back in 2019, net interest was 1.8% of GDP; this year it will clock in at 3.1% of GDP, the highest share since 1995.

Meanwhile, "other" spending is up because the Biden Administration has been busy finding ways to forgive as many student loans as it can legally get away with (as well as ways that may end up being illegal, like with policy changes announced in 2022 and later overturned by the Supreme Court). When loans are forgiven, the Department of Education calculates present value of less future repayments, and factors that into the current budget year. As a result, "other" spending, which was 2.7% of GDP in 2019 is 3.8% this year.

Then there are the health care programs, which cost 5.3% of GDP five years ago, but 5.8% this year, with Medicaid growing much faster than Medicare. With population aging and barring major reforms to these programs, this share should only grow in the decade ahead.

The bottom line is that the US faces big structural budget challenges in the years ahead, particularly on the spending side. With low interest rates in the past fifteen years, we had the chance to avert our eyes from the problem, but we are soon to run out of time. No matter who we elect in November, we expect getting our fiscal house in order to eventually become a major policy theme of the next Administration as well as those beyond.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-25 / 9:00 am	New Home Sales – Aug	0.700 Mil	**0.708 Mil**		0.739 Mil
9-26 / 7:30 am	Initial Claims – Sep 21	225K	**223K**		219K
7:30 am	Q2 GDP Final Report	+3.0%	**+2.9%**		+3.0%
7:30 am	Q2 GDP Chain Price Index	+2.5%	**+2.5%**		+2.5%
7:30 am	Durable Goods – Aug	-2.8%	**-2.5%**		+9.8%
7:30 am	Durable Goods (Ex-Trans) – Aug	+0.1%	**+0.2%**		-0.2%
9-27 / 7:30 am	Personal Income – Aug	+0.4%	**+0.4%**		+0.3%
7:30 am	Personal Spending – Aug	+0.3%	**+0.3%**		+0.5%