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Economics Group

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Capitol Hill Update: The President's FY 2018 Budget

This week the Trump administration released its proposed budget for fiscal year 2018 and beyond. The proposal calls for balancing the federal budget over the next decade through $3.6 trillion in spending cuts.

Budget Framework: Deep Spending Cuts and Tax Cut Stimulus

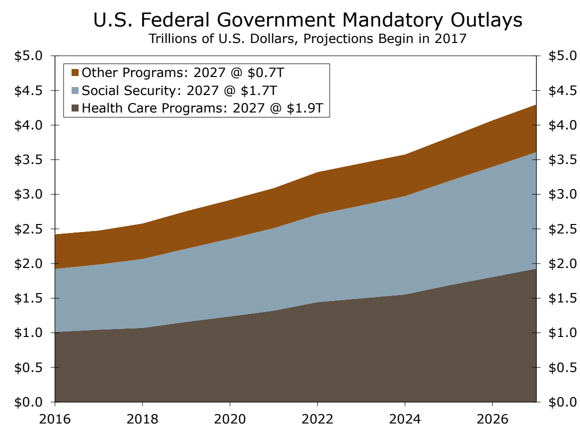
This week the Trump administration released its budget for fiscal year (FY) 2018 and the following decade. The administration's projections show publicly held debt will be reduced to 60 percent of GDP by the end of the 10-year window. This goal is achieved through $3.6 trillion in spending cuts and (assumed) faster economic growth spurred by the president's policies. With respect to the 2018 fiscal year, the administration is requesting a slight increase in outlays relative to FY 17 and expects revenues to rise 5.6 percent in FY 18. The proposal recommends a 2.9 percent reduction in non-defense discretionary outlays relative to the current fiscal year and an increase of 8.2 percent in defense discretionary spending. In addition, the administration recommends a 1.5 percent reduction in mandatory (entitlement) spending.

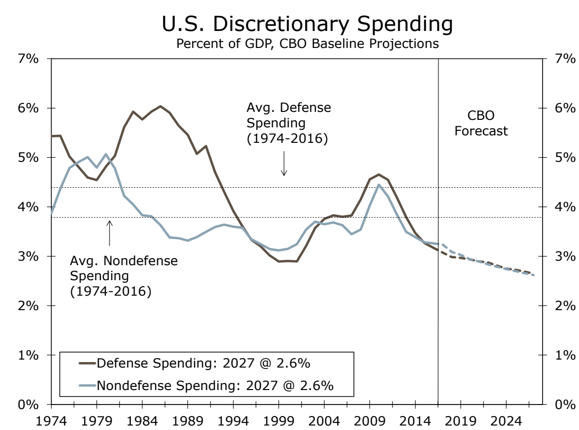
It should be noted that while the president's budget request often garners political attention, rarely does Congress enact all or even some of a sitting president's proposed budget. The next major step is for Congress to assemble and pass its own budget proposal, the FY 2018 budget resolution, which will establish the spending and deficit levels for the next year and beyond. This process will also help get the legislative ball rolling on tax reforms/cuts. We expect the deficit to rise in FY 2018 related to some backfilling of scheduled Budget Control Act cuts, which are set to resume during the next fiscal year.

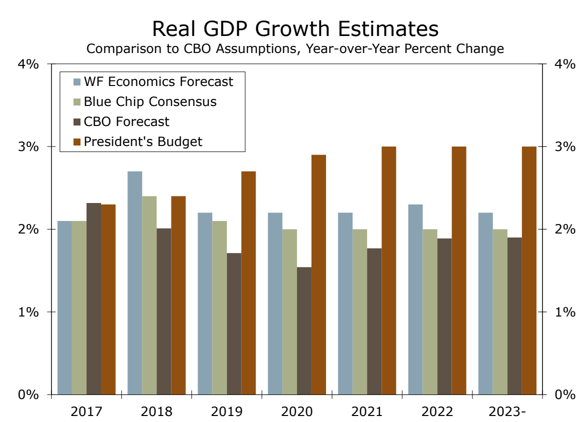
Administration's Economic Assumptions Differ from Consensus

One of the most important aspects of any set of budget projections over the next 10 years is the economic assumptions used. The bottom chart compares the GDP growth assumptions contained in the president's budget relative to our forecast, the Congressional Budget Office's (CBO) and the Blue Chip Consensus forecast.

While assumptions for growth are roughly consistent in the near term, the administration's growth assumptions are much greater than our forecast as well as those of the Blue Chip Consensus and CBO. In addition, the unemployment rate in the Trump administration's projections is expected to only rise slightly to 4.7 percent from its current 4.4 percent, while inflation is expected to remain near 2.3 percent over the next 10 years. We find these assumptions to be inconsistent with both our estimate of potential GDP growth and the estimated size of the labor force in the coming years, and fails to account for a likely downshift in the rate of annual economic growth related to a likely economic downturn sometime over the forecast horizon. Even if the proposed tax cuts are able to support greater economic growth, in the absence of stronger labor force growth we see the potential rate of growth of the economy as slowing rather than speeding up. As the budget debate moves forward, we will continue to update our readers on key fiscal policy developments as they occur.







Source: Congressional Budget Office, Office of Management and Budget and Wells Fargo Securities

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