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Economics Group

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Federal Budget Deficit Widens Again in FY 2017

The federal government capped FY 2017 with a small surplus of $8 billion in September, bringing the full-year budget deficit to $666 billion, a nearly 14 percent increase from FY 2016.

Red Ink Rises in FY 2017

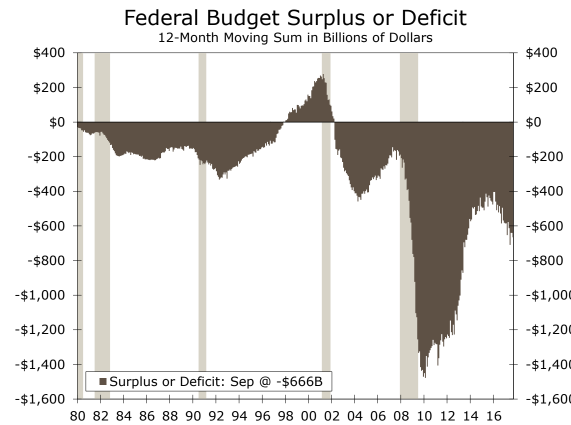
Data released from the U.S. Treasury showed the federal government incurring a small surplus of $8 billion in the month of September. The federal fiscal year runs from October 1 through September 30 of the following year, making the September surplus the final chapter in FY 2017. The federal government ran a $666 billion deficit in FY 2017, $80 billion (or 13.7 percent) more than the deficit in FY 2016 (top chart).

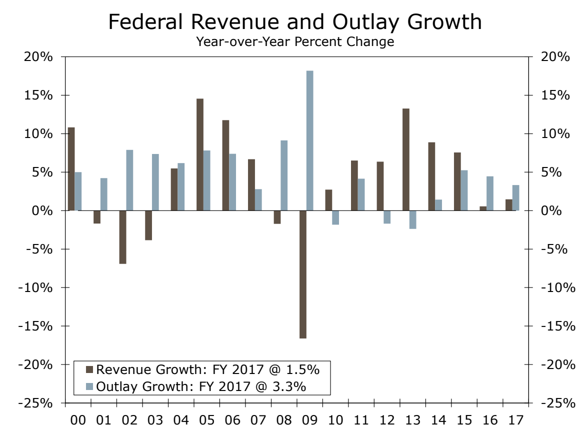
For the second consecutive year, federal spending growth outpaced revenue growth (middle chart). Revenue growth has been particularly slow, averaging just 1.0 percent over the past two fiscal years. The drivers of this slowdown have been broadly-based. Corporate income tax collections have been essentially flat for the past couple years. Federal Reserve earnings remitted to the Treasury have declined as the interest paid on excess reserves has moved higher in step with the fed funds rate. Employment growth has slowed as the labor market has tightened, while wages have failed to meaningfully accelerate. Furthermore, as we have written previously, nonwitheld individual income tax receipts have been particularly soft over the past year. It appears that individuals have delayed realizing capital gains in the hope that they might be able to do so at a lower tax rate should Republicans successfully pass a tax code overhaul.

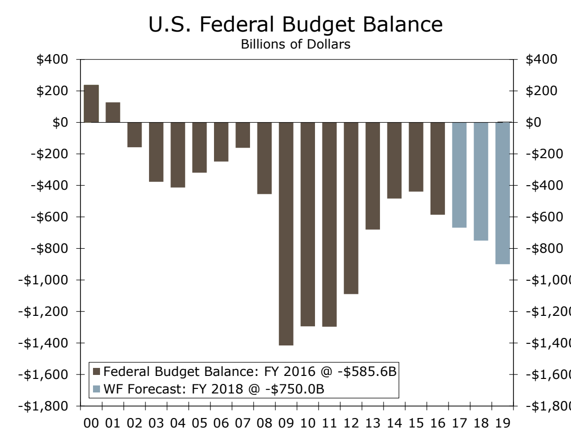
On the outlay side, spending growth has been faster than revenue growth but still relatively tame. After accounting for timing of payment issues, growth in the three largest mandatory spending programs (Social Security, Medicare and Medicaid) was 3 percent in FY 2017. Defense spending growth was about 1 percent, while net interest spending was one of the few major categories that saw a large surge in FY 2017, climbing 9.2 percent.

Outlook: More Red Ink Ahead

As the bottom chart illustrates, the trend of narrowing budget deficits and decelerating net Treasury issuance that dominated the early part of this expansion bottomed in FY 2015. The past two years have each seen an increase in the deficit, and we expect more of the same ahead. Federal spending will continue to see steady growth as the aging of the population drives faster entitlement spending. Federal Reserve remittances continue to decline and policymakers weigh increasing the restrictive discretionary budget caps, particularly for defense spending. On the revenue side, the outlook has brightened somewhat, as an improvement in corporate profit growth should drive faster receipts collections. It also seems plausible that the build-up in delayed capital gains realizations could begin to unwind in 2018. The prospect of deficit-financed tax cuts, however, may end up offsetting these tax collection catalysts. Our forecast is for a federal budget deficit of $750 billion in FY 2018.







Source: U.S. Department of the Treasury and Wells Fargo Securities

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