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Economics Group

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Federal Budget Deficit Widens in FY 2018

With fiscal year 2018 officially in the books, the federal government ran a $779 billion deficit for the year, just $4 billion higher than the forecast we have maintained since March. Tax collections rose just 0.4%.

Deficit Widens Despite Faster Economic Growth

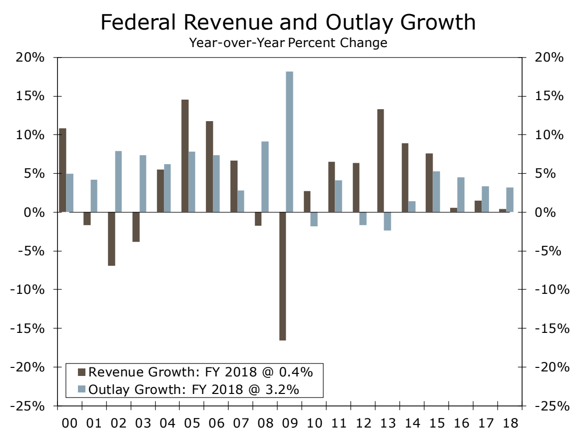
Way back in September 2017, as the tax bill debate was beginning to heat up, we revised our FY 2018 federal budget deficit forecast to $750 billion on the assumption that across-the-board tax cuts would be passed in the coming months. We stuck with that number until March 2018, when we revised to $775 billion in the wake of the federal budget deal reached around that time.

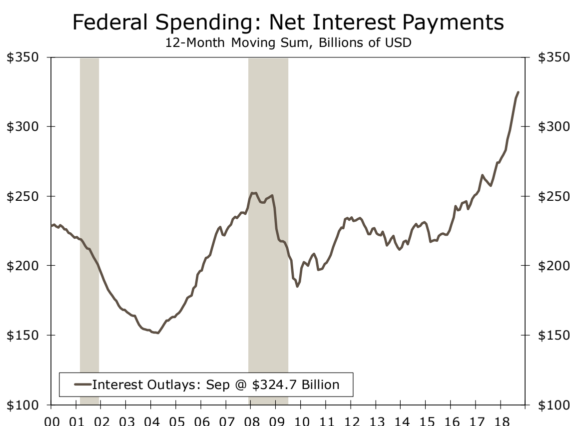
Fast forward to today and the U.S. Treasury announced a deficit of $779 billion for fiscal year 2018, $4 billion larger than our forecast and up from $666 billion in FY 2017. Total revenue growth was just 0.4% despite nominal GDP growth that was roughly 5% over that period (we will not have official Q3-2018 GDP until October 26). Individual tax collections were up a robust 6.1%, boosted by the surge in nonwitheld tax collections seen earlier this year. Withheld individual income tax collections were up a much smaller 1.2% for the year. Corporate income tax receipts fell by 31%, from $297 billion in FY 2017 to $205 billion in FY 2018. Interestingly, customs duties, which count tax collections related to tariffs, were up nearly 20%, though at $41 billion they represented just 1.2% of U.S. tax collections.

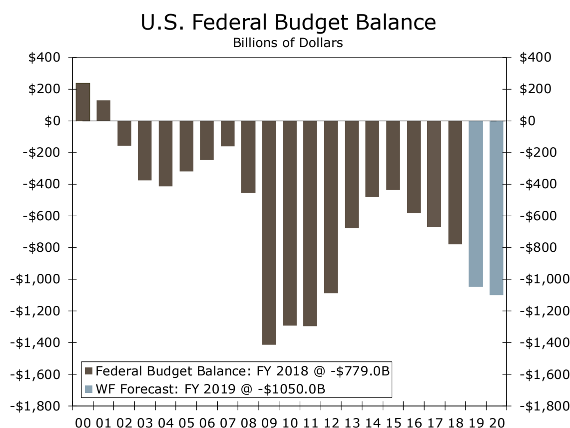
On the spending side, defense outlays rose about 8%, as the budget deal earlier this year helped propel higher defense and non-defense discretionary spending. Net interest costs were among the fastest growing categories of the budget, rising nearly 24% over the year (middle chart). Rising rates in a widening deficit environment presented a recipe for more pressure on the deficit, as did higher inflation adjustments to Treasury Inflation-Protected Securities (TIPS). Medicare spending actually fell on the year, though this was in part due to some timing issues related to the calendar. Social Security spending was up 4.5%.

What do we expect going forward? We expect the federal budget deficit to widen once again in FY 2019 to just north of $1 trillion (bottom chart). The tax cuts were only in effect for about two-thirds of FY 2018, whereas they will be in effect for all of FY 2019 barring an unexpected change in policy. Furthermore, the increase in discretionary spending as a result of the budget deal reached earlier this year has occurred at a slower pace than initially anticipated. As a result, more of the newly granted budget authority will likely be spent in FY 2019 than initially expected.

Thus, we expect steady growth in federal consumption and investment to help propel real GDP growth higher over the next couple quarters before a deceleration in spending takes hold. In addition, the tax cuts should provide a tailwind to disposable income growth and corporate profit growth in the near-term. With deficits likely to keep rising, net Treasury issuance should continue climbing, with more debt issuance across the entire Treasury curve. We expect the deficit to widen much more modestly in FY 2020, though there is inherently more uncertainty around that forecast so far out.







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

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