Market View
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What's US$2 trillion between friends?

By Warren Lovely & Taylor Schleich

It was with seeming indifference that markets greeted the CBO's latest update on the U.S. fiscal situation Tuesday. What news was that? Well, in less-technical parlance, an already ugly U.S. budget outlook turned even uglier. At this juncture you might not have even thought that possible, America's central government already miles deep in the red and over-burdened by outstanding debt. Yet with the proverbial 'stroke of the pen' the CBO tacked more than US$2 trillion in fresh debt onto the 10-year fiscal forecast extending through 2034 (relative to their prior thinking presented back in February).

What's US$2 trillion between friends some may ask? For markets fairly yawned in response, USTs holding onto gains generated earlier in the day (on weak retail sales, reassuring Fed speak and, believe it or not, a sturdy 20-year Treasury auction). The curve flattened, term premia remaining effectively MIA. Gains in the long end even outstripped those in the far-less-fiscally fraught Canadian market. (While thinking about Canada, fresh CBO revisions would be akin to adding over *C$20 billion/year* to Ottawa's deficit, where the merits/perils of even a couple billion dollars are strenuously debated.) Back to Tuesday's reaction, equities rallied (again) and credit remained snug. But from a fiscal perspective if nothing else, America's trajectory is alarming.

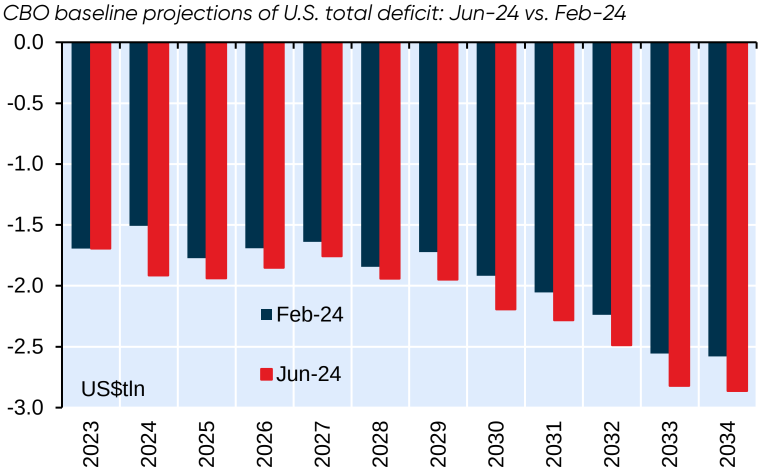
In deconstructing their latest forecast, the CBO traced/blamed much of the US$2.1 trillion in extra red ink from 2025 to 2034 on legislative and technical changes. That included fresh discretionary spending, inflation adjustments, reduced corporate income tax proceeds, extra Medicaid outlays and some additional interest, among other things.

From a bit more than US$1.9 trillion in 2024, the budgetary hole could grow to US$2.9 trillion by 2034. At ~7% of GDP, the scale of future deficits could be nearly double the prior half-century average. And that's despite an expectation of continued economic growth, alongside the presumption that certain tax cuts expire. We're almost afraid to look at adverse scenarios where growth disappoints, revenues are hobbled and spending pressures mount. And what of fresh stimulus that could be offered on the campaign trail?

As for the federal debt burden, the picture remains downright troubling. Debt held by the public is already at roughly 100% of GDP and will require even less time to establish a new all-time high, the debt burden now pointed at 122% by 2034 (vs. 116% in February). Sustainable this is not, though near-term prospects for saner/more prudent budgetary policies look limited to us.

Chart 1: U.S. budget balance even deeper in the red

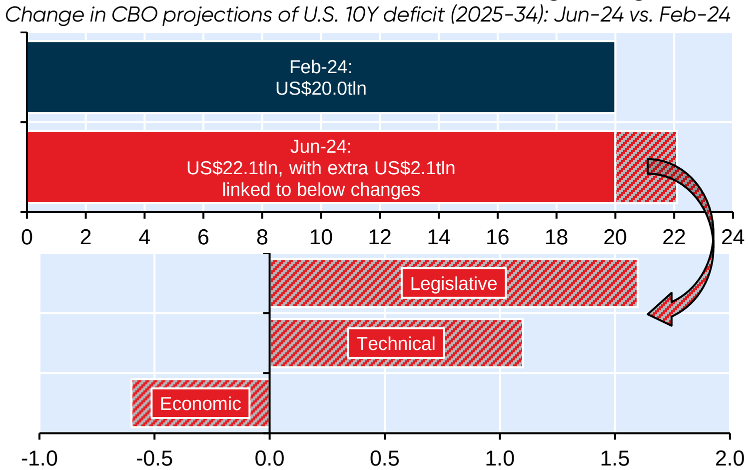
CBO baseline projections of U.S. total deficit: Jun-24 vs. Feb-24



Source: NBF, CBO

Charts 2-3: How has the CBO's fiscal thinking changed?

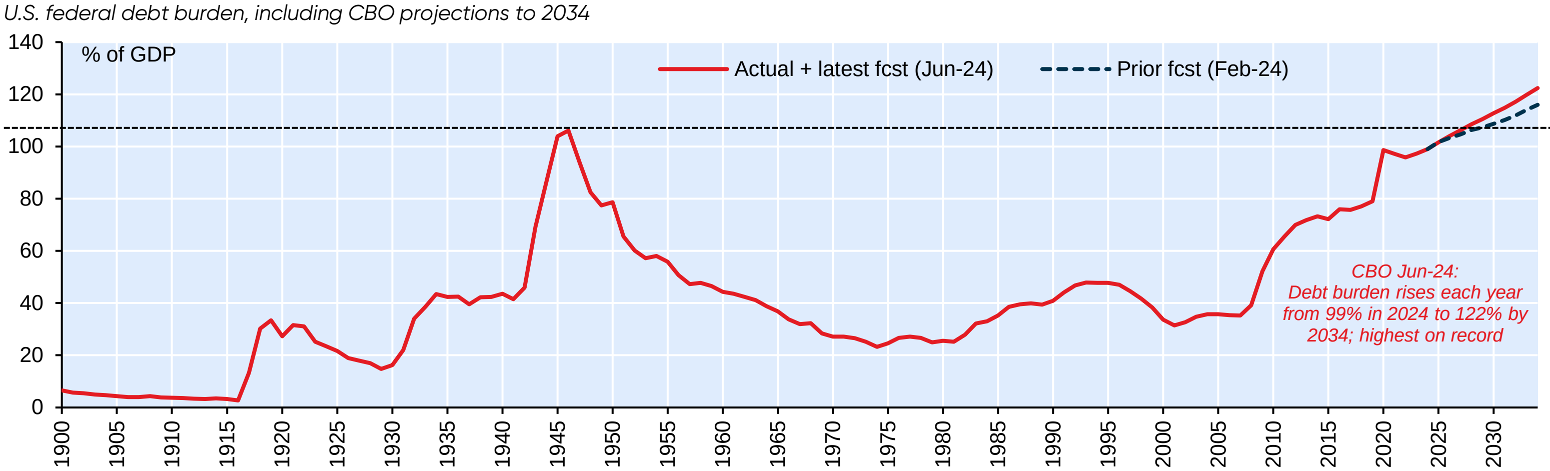
Change in CBO projections of U.S. 10Y deficit (2025-34): Jun-24 vs. Feb-24



Source: NBF, CBO | Note: Refer to CBO for full details on forecast change

Chart 4: Alarmingly, the U.S. federal government requires even less time to set a new, dubious debt record

U.S. federal debt burden, including CBO projections to 2034



Source: NBF, CBO | Note: Refers to federal debt held by the public

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Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

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