Goldman Sachs | Economics Research

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## US Economics Analyst

# The Fiscal Outlook: Not Good, But a Little Better (Phillips/Krupa)

- The federal budget deficit looks likely to settle at around $1.8 trillion this year, $100bn more than our prior estimate. However, this slight deterioration masks modest improvement under the surface. If fiscal year-to-date trends remain intact, the primary (ex-interest) deficit will shrink by 2% of GDP from last year, when the deficit was driven wider by a number of one-off factors. At around 3%, this would put the primary deficit at the lowest level since 2019.
- However, two factors offset this improvement. First, interest expense has risen substantially. We expect interest expense this year to rise to nearly $900bn, topping 3% of GDP. Second, accounting for student lending policies looks likely once again to complicate budget accounting. While the underlying deficit excluding student loan-related changes is likely to have declined by around $300bn (or 1.5% as a share of GDP each year), the official deficit measure, which includes those changes, now looks likely to exceed last year's total.
- This has limited implications for the fiscal impulse, however. As there have been relatively few discretionary policy changes lately, much of the gains relate to endogenous increases in corporate taxes and personal taxes related to capital gains realizations in 2023, for example. Overall, we estimate a neutral to slightly negative (-0.2pp) fiscal impulse for 2024.
- Over the next few years, the primary deficit looks likely to drift slightly lower, on average, while interest expense continues to climb. The two should roughly offset, leaving an overall deficit of just over 6% of GDP—we estimate $1.9trn (6.4%) for FY2025 and $1.9trn (6.1%) for FY2026. This assumes no changes to entitlement programs, full extension of the tax cuts expiring at the end of 2025, and discretionary spending growth that keeps pace with inflation.
- The election could change the medium-term fiscal outlook, though potentially less than one might imagine. While a Republican sweep would involve an extension of the expiring tax cuts, for the most part this would simply extend current policy (and the current effect on the deficit). While a Democratic sweep would likely involve tax increases, much of this would likely go toward new spending. We continue to think a divided government scenario would mean slightly smaller deficits than other scenarios. However, under no scenario does entitlement (i.e., Medicare or Social Security) reform seem likely in the near term.


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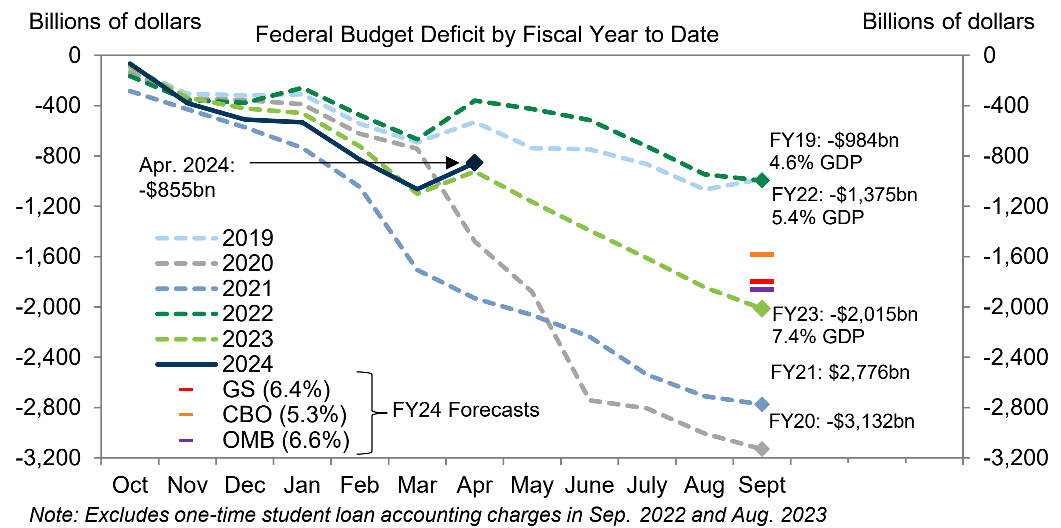
# The Fiscal Outlook: Not Good, But a Little Better

## How Is the Deficit Shaping up This Year?

The fiscal year to date (Oct.-Apr.) gap between spending and outlays stands at $855bn and is tracking slightly narrower than last year over the same period (Exhibit 1). Last year's reported deficit was $1.7 trillion but would have been roughly $2 trillion (7.4% of GDP) excluding the effect of non-cash savings related to student loan changes, as discussed below.

**Exhibit 1: A Slightly Smaller Deficit**




Source: Treasury, Goldman Sachs Global Investment Research

With the April tax season behind us, non-withheld tax collections look slightly higher than expected. Non-withheld tax receipts—i.e., payments with tax returns or extensions around the April tax filing deadline—had looked a bit lower than expected shortly after the filing deadline, but after a late catch-up they ultimately came in 16% ($60bn) higher for the April filing season as a whole (through early May).

At the same time, individual tax refunds have run $24bn lower so far this fiscal year. This is likely due to a moratorium on processing of claims for the Employee Retention Tax Credit (ERTC), a COVID-era program that has resulted in around $250bn in payments to small businesses, far exceeding the original expected cost of $85bn. The IRS has announced that the moratorium will end in "late spring", with more than 1 million claims pending. At an average refund of $70k, this could result in payments of around $70bn once the moratorium lifts and is one of the more uncertain aspects of the near-term fiscal outlook.

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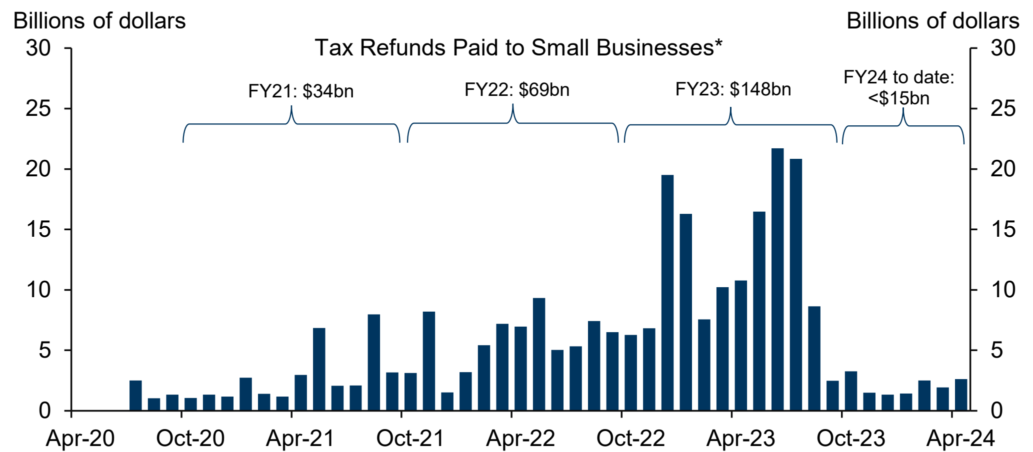
**Exhibit 2: A Moratorium on Processing Claims for the Employee Retention Tax Credit, for Now**

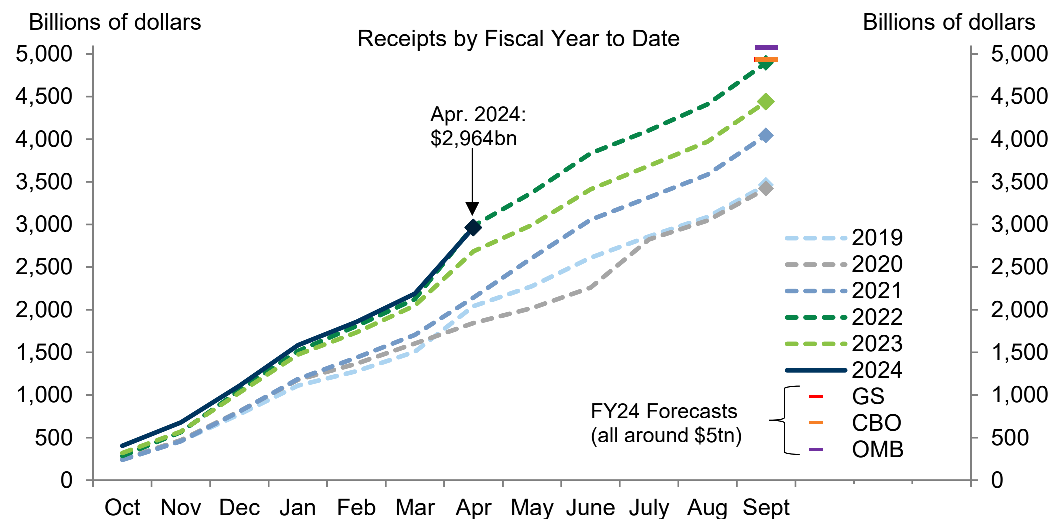



** Difference between "Business" refunds reported in the Daily Treasury Statement and "Corporate" refunds reported in the Monthly Treasury Statement, scaled to align with COVID-19 credit payment totals reported by IRS.*

Source: Treasury, Goldman Sachs Global Investment Research

Growth in overall tax receipts (i.e., including withheld personal taxes, corporate taxes, etc.) through April looks to be around 10% yoy, slightly ahead of our assumption (9%) for the year as a whole but slower than CBO's (11%) and OMB's (12%). While this reflects solid income growth, it also reflects the delay of around $60bn of tax payments due earlier in 2023 to October 2023—and therefore into the next fiscal year—due to various disaster declarations. Overall, revenues are up $278bn over the same period last year.

**Exhibit 3: Strong Tax Receipts**




Source: Treasury, Goldman Sachs Global Investment Research

On the spending side, Medicare and Social Security spending has grown slightly faster than had been expected so far this fiscal year, at around 10% combined. Defense spending year-to-date has also risen faster than expectations (9% yoy vs. 2% expected).

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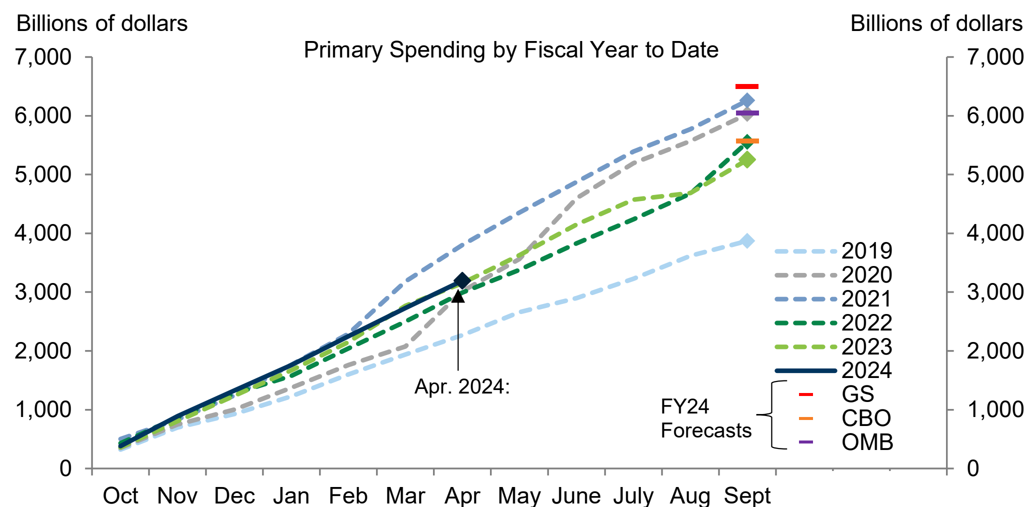
There is no obvious single explanation for this, though it is unlikely to be the latest round of foreign aid (including military aid) for Ukraine, Israel, and other purposes, as only 10-15% of those funds would be spent in the current fiscal year and the legislation was only recently enacted by Congress. Put differently, despite wars in Ukraine and the Middle East, defense spending is nevertheless growing slightly slower than Medicare and Social Security.

Spending in the rest of the federal budget has risen much less, however. Medicaid spending is slightly below last year's level, though this is still above an expected 10% drop due to eligibility changes that took place March 2023. Other benefit programs are roughly flat year-on-year in real terms, with the rest of the budget quite a bit smaller than it was over the same period a year earlier. Overall, primary spending is running only $57bn higher than last year.

**Exhibit 4: Slightly Higher Primary Spending Than Last Year**




Source: Treasury, Goldman Sachs Global Investment Research

This suggests a narrowing in the primary (ex-interest) deficit of $220bn (0.8% of GDP) for the first seven months of the fiscal year, or roughly double that for the fiscal year as a whole. However, the overall budget deficit is unlikely to shrink this much, for two reasons.

First, interest expense will be substantially higher than last year. Correcting for calendar effects, interest on coupon securities is running about 28% higher this year than over the same period last year. Interest on Treasury bills has risen much more and looks likely to come in around 50% higher for fiscal year 2024. Together, interest expense looks likely to offset around half of the decline in the primary deficit, reducing the overall deficit by around 1.2% of GDP.

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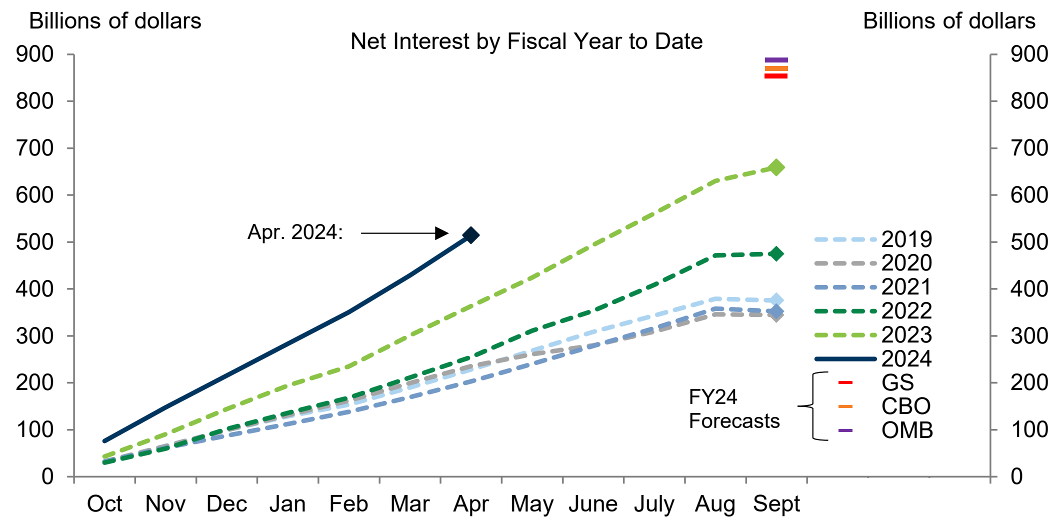
**Exhibit 5: Substantially Higher Interest Expense**




Source: Treasury, Goldman Sachs Global Investment Research

However, the official deficit figures are likely to move in the other direction. Last year, the Biden administration recorded $330bn in budgetary savings—this shows up as negative spending—from rescinding its student debt forgiveness proposal, which the Supreme Court blocked. This reduced the reported deficit to around $1.7 trillion for FY2023. This year, accounting for federal loan policies is likely to move in the other direction. The administration looks likely to record costs of student loan and small business loan policies in coming months that would add $107bn to the reported deficit total. In addition, the administration released a proposed student loan relief program in April that, once finalized, would add $136bn more to the reported deficit. It is unclear whether the costs of that plan will be recorded before the end of fiscal year 2024, but they are likely to add to the reported deficit either this year or next. So while the primary deficit has clearly declined, the official deficit is likely to have grown over last year, clearly in nominal terms and probably slightly as a share of GDP. The upshot is that with recent tax and spending data in hand we are raising our deficit estimate to $1.8 trillion deficit (6.4% of GDP) for this year (FY 2024).

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**Exhibit 6: We Estimate a $1.8tn Deficit (6.4% of GDP) This Fiscal Year**

| | FY23 Actual | | FYTD Change | FY24 Implied | | Implied Change FY23 to FY24 | |
|---|---|---|---|---|---|---|---|
| | $bn | % GDP | % | $bn | % GDP | $bn | % GDP |
| Withheld inc. taxes | 1695 | 6.3 | 5% | 1780 | 6.2 | 85 | 0.0 |
| Nonwithheld inc. taxes | 855 | 3.2 | 14% | 974 | 3.4 | 118 | 0.2 |
| Corp taxes | 457 | 1.7 | 25% | 572 | 2.0 | 115 | 0.3 |
| Payroll taxes | 1621 | 6.0 | 7% | 1728 | 6.1 | 107 | 0.1 |
| Other receipts | 223 | 0.8 | -4% | 214 | 0.8 | -9 | -0.1 |
| Fed remittances | 1 | 0.0 | - | 1 | 0.0 | 0 | 0.0 |
| Indiv. tax refunds | -373 | -1.4 | -9% | -339 | -1.2 | 34 | 0.2 |
| Corp tax refunds | -38 | -0.1 | 2% | -39 | -0.1 | -1 | 0.0 |
| **Total, receipts** | **4441** | **16.5** | **10%** | **4899** | **17.2** | **459** | **0.7** |
| Social Security | 1348 | 5.0 | 9% | 1463 | 5.1 | 115 | 0.1 |
| Health | 1533 | 5.7 | 7% | 1640 | 5.8 | 107 | 0.1 |
| Refundable tax credits | 87 | 0.3 | 3% | 89 | 0.3 | 2 | 0.0 |
| Other benefits | 650 | 2.4 | 2% | 661 | 2.3 | 11 | -0.1 |
| Defense | 806 | 3.0 | 9% | 879 | 3.1 | 73 | 0.1 |
| Education* | 307 | 1.1 | -21% | 241 | 0.8 | -65 | -0.3 |
| FDIC/PBGC | 132 | 0.5 | -26% | 97 | 0.3 | -35 | -0.1 |
| Other spending | 944 | 3.5 | -12% | 749 | 2.6 | -195 | -0.9 |
| **Total, outlays** | **5806** | **21.5** | **0%** | **5819** | **20.4** | **13** | **-1.1** |
| Calendar adjustments | -11 | 0.0 | | 75 | 0.3 | | |
| **Primary deficit** | **-1377** | **-5.1** | | **-845** | **-3.0** | **532** | **2.1** |
| Interest | 659 | 2.4 | 34% | 881 | 3.1 | 222 | 0.6 |
| **Deficit** | **-1706** | **-6.3** | | **-1833** | **-6.4** | **-127** | **-0.1** |
| Remove student loan cost/savings | -330 | -1.2 | | 107 | 0.4 | 437 | 1.6 |
| **Deficit excl. one-time student loan charges** | **-2036** | **-7.5** | | **-1726** | **-6.1** | **310** | **1.5** |

Source: Treasury, Goldman Sachs Global Investment Research

## What Does All of This Mean for the Fiscal Impulse?

Despite the swing in the primary deficit, the fiscal impulse this year should be only slightly negative. There are two main reasons for this. First, the spending that contributes directly to GDP is growing more slowly than federal spending overall. We continue to expect the contribution to GDP from federal spending to be roughly flat in real terms this year and next, as the caps on discretionary spending (i.e., congressional appropriations) that Congress agreed to in last year's debt limit deal would imply a slightly negative path in real terms, but overall spending growth looks likely to be closer to flat as a result of delayed spending of funding from prior years as well as emergency spending outside the caps.

Second, while tax receipts came in slightly stronger than expected, this was likely due to greater capital gains realizations last year that boosted non-withheld tax receipts, rather than legislated policy changes. There are no major tax or benefit changes over the remainder of the year nor at the start of 2025, leaving the expirations of the 2017 personal tax cuts at the end of 2025 as the next big potential shift. The boost to incomes from indexation of tax thresholds and benefit payments has also run its course, as cost-of-living adjustments have now mostly caught up with realized inflation.

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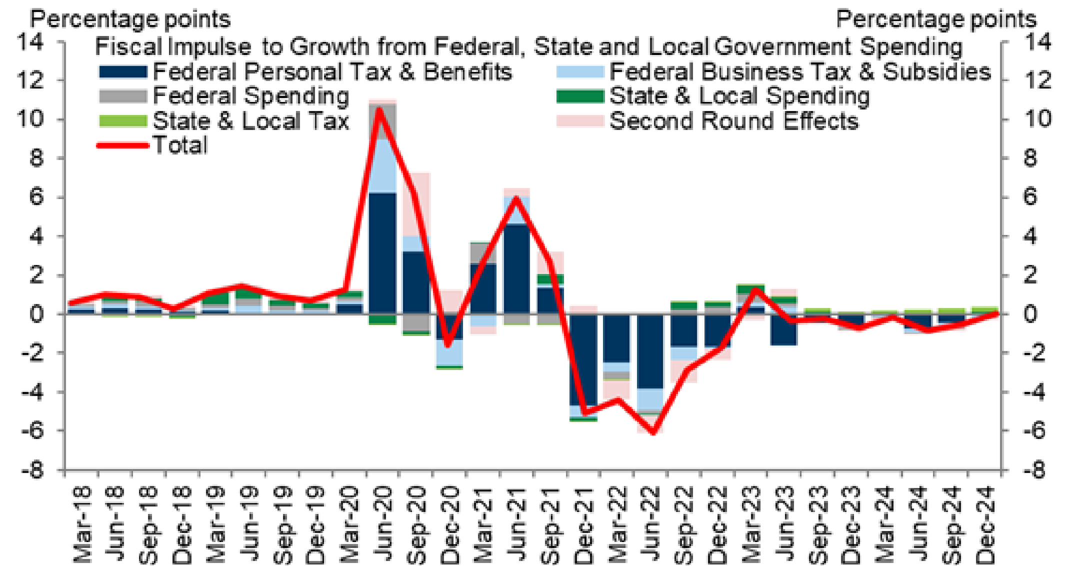
**Exhibit 7: A Neutral to Slightly Negative Fiscal Impulse**




Source: Goldman Sachs Global Investment Research

The state and local (S&L) government sector is still likely to be a positive influence on growth, but a minor one. We continue to expect growth in real S&L spending to settle at a 1% pace, down from an average of 4% since 2022H2. States have also enacted modest further net tax increases of around $11bn, on top of $19bn in mostly permanent tax increases last year. Slower state revenue growth—mainly unrelated to those tax cuts—has slowed, leaving states to rely on "rainy day" funds and balances carried over from prior years. Those funds are still substantial—enough to cover around 25% of a year's spending—but are more likely to be an insurance policy against procyclical spending cuts in the event of recession than they are a source of spending growth in the near-term.

## Could the White House Make the Fiscal Impulse More Stimulative Ahead of the Election?

Probably not much. Historically, there is little evidence of any trend toward higher real spending growth in the quarters preceding the election. More importantly, this is not up to the White House alone. Congress appropriates most of the funding that results in federal spending contributing to GDP—defense and non-defense consumption and investment—so it would be difficult for the administration to spend extra without leaving a shortfall in another quarter. However, laws governing the pace of spending—the anti-deficiency act and anti-impoundment act—limit the discretion the administration has to slow or quicken the pace of spending, even within a year.

This doesn't mean that fiscal policy would be completely out of play ahead of the election. The timing of grant awards under the Inflation Reduction Act (IRA) and CHIPS Act, for example, involves more discretion. There is also no set dollar limit for tax credits under the IRA and CHIPS legislation, so in theory the administration could try to increase uptake of these incentives over the election. Certain changes to mandatory spending programs—e.g., student debt relief—could also be timed to kick in around the

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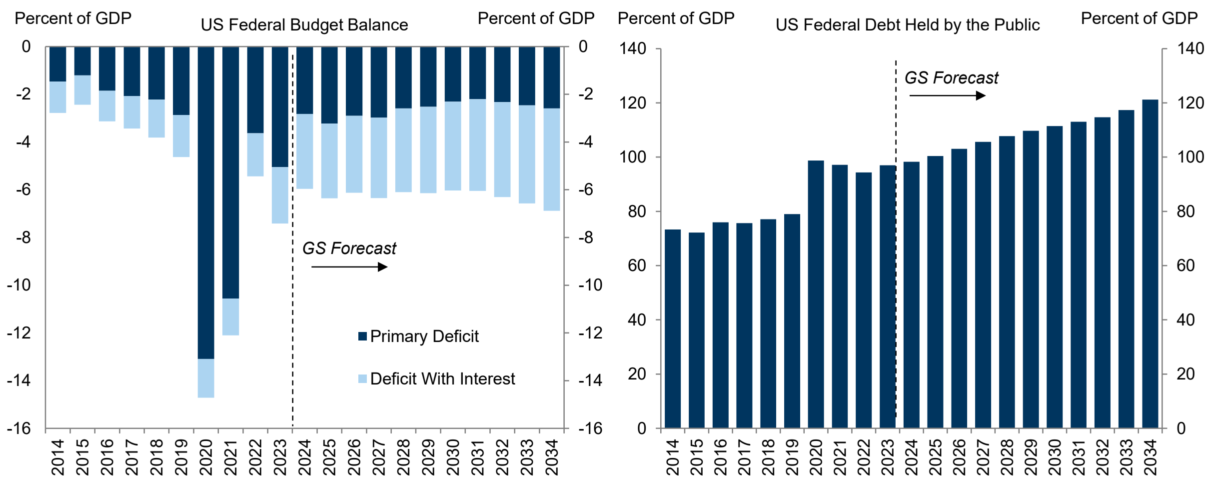
election.

## How Do the Next Few Years Look?

This year's trend should hold over the next few years: the primary deficit looks likely to drift slightly lower, on average, while interest expense continues to climb. The two should roughly offset, leaving an overall deficit of just over 6% of GDP—we estimate $1.9trn (6.4%) for FY 2025 and $1.9trn (6.1%) for FY2026. This assumes no changes to entitlement programs, full extension of the tax cuts expiring at the end of 2025, and discretionary spending growth that keeps pace with inflation. While the latter is more budget-friendly than we have assumed in the past—we have traditionally assumed discretionary spending growth in line with GDP growth—we expect that elevated debt and chronic primary deficits will restrict spending growth in this segment.

**Exhibit 8: Chronic but Stable Primary Deficits Means a Rising Debt Load**




Source: Treasury, Goldman Sachs Global Investment Research

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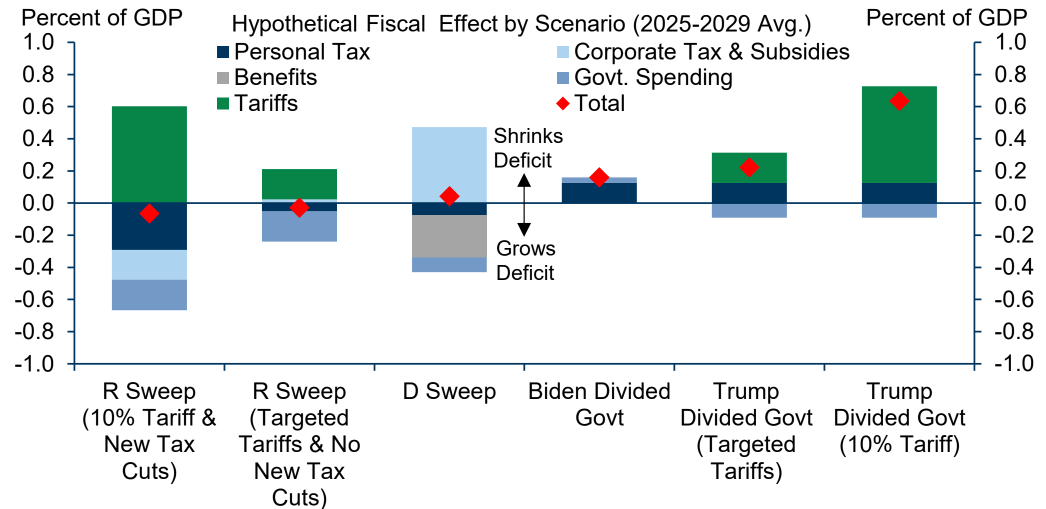
## How Could the Election Affect the Deficit Outlook?

In a recent report we estimated the potential impact of different fiscal policy combinations under different election outcomes. The starting point for the analysis is the assumption that current policies are maintained—e.g., that all expiring tax and benefit provisions are extended, and that spending follows current projections. Exhibit 9 summarizes the various scenarios and their fiscal effects over the next five years.

**Exhibit 9: Fiscal Effects by Election Scenario**




Source: Goldman Sachs Global Investment Research

While the scenarios average out to modest deficit reduction, we expect a substantial primary deficit to remain under any scenario. First, there is no scenario in which benefit spending slows substantially. Biden and Trump have both pledged to keep Medicare and Social Security cuts off-limits. In a Republican sweep, cuts to other benefit programs might be possible but prior instances of full Republican control have resulted in little change and, more importantly, it would likely be a political challenge to cut these programs while also extending upper-income tax cuts.

Second, the odds seem low that taxes would increase meaningfully solely for deficit reduction purposes. While it seems likely that a divided or Democratic sweep scenario would lead to expiration of some expiring tax cuts, it seems less likely that Congress would enact substantial new tax increases solely for deficit reduction, which limits the amount of deficit reduction that could come through tax increases. Counterintuitively, a scenario that could involve more substantial deficit reduction through new taxes would be under a Trump administration with divided government, as the president could raise tariffs unilaterally but, in a divided government scenario, Congress would be less likely to agree on new spending.

That said, the odds of policy changes that substantially further increase the deficit also appear fairly low. While a Republican sweep would likely result in extension of expiring tax cuts, this would mainly continue current policy—and the current deficit level—rather than increasing it further. And while President Biden outlined a substantial spending

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program in his recent budget, the experience of the IRA suggests that Democrats would likely offset the cost of new spending with new tax increases (the IRA is likely to cost more than originally expected and, as a result, will probably add to the deficit, but at the time Congress believed it was offsetting its cost).

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# The US Economic and Financial Outlook

**THE US ECONOMIC AND FINANCIAL OUTLOOK**

(% change on previous period, annualized, except where noted)

| | 2022 | 2023 (f) | 2024 (f) | 2025 (f) | 2026 (f) | 2027 (f) | 2023 Q1 | 2023 Q2 | 2023 Q3 | 2023 Q4 | 2024 Q1 | 2024 Q2 | 2024 Q3 | 2024 Q4 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **OUTPUT AND SPENDING** | | | | | | | | | | | | | | |
| Real GDP | 1.9 | 2.5 | 2.9 | 2.3 | 2.0 | 2.0 | 2.2 | 2.1 | 4.9 | 3.4 | 1.6 | 3.4 | 2.5 | 2.4 |
| *Real GDP (annual=Q4/Q4, quarterly=yoy)* | 0.7 | 3.1 | 2.5 | 2.1 | 1.9 | 2.0 | 1.7 | 2.4 | 2.9 | 3.1 | 3.0 | 3.3 | 2.7 | 2.5 |
| Consumer Expenditures | 2.5 | 2.2 | 2.7 | 2.3 | 2.0 | 2.0 | 3.8 | 0.8 | 3.1 | 3.3 | 2.5 | 3.0 | 2.5 | 2.5 |
| Residential Fixed Investment | -9.0 | -10.6 | 5.9 | 3.3 | 3.0 | 2.4 | -5.3 | -2.2 | 6.7 | 2.8 | 13.9 | 2.2 | 5.0 | 4.0 |
| Business Fixed Investment | 5.2 | 4.5 | 3.1 | 3.6 | 3.8 | 3.7 | 5.7 | 7.4 | 1.5 | 3.8 | 2.9 | 2.3 | 2.8 | 3.5 |
| Structures | -2.1 | 13.2 | 3.5 | -0.5 | 2.9 | 3.0 | 30.3 | 16.1 | 11.2 | 10.9 | -0.1 | -0.5 | -3.0 | -3.5 |
| Equipment | 5.2 | -0.3 | 1.8 | 5.5 | 3.8 | 3.2 | -4.1 | 7.7 | -4.4 | -1.1 | 2.1 | 2.6 | 5.0 | 7.0 |
| Intellectual Property Products | 9.1 | 4.5 | 4.0 | 4.1 | 4.3 | 4.5 | 3.8 | 2.7 | 1.8 | 4.3 | 5.4 | 3.5 | 4.3 | 4.5 |
| Federal Government | -2.8 | 4.2 | 1.4 | 0.0 | 0.0 | 0.0 | 5.2 | 1.1 | 7.1 | 2.4 | -0.2 | 0.5 | 0.0 | 0.0 |
| State & Local Government | 0.2 | 4.0 | 3.2 | 1.1 | 1.0 | 1.0 | 4.6 | 4.7 | 5.0 | 6.0 | 2.0 | 2.8 | 1.0 | 1.0 |
| Net Exports ($bn, '17) | -1,051 | -928 | -990 | -1,029 | -1,046 | -1,038 | -935 | -928 | -931 | -919 | -973 | -992 | -994 | -1,002 |
| Inventory Investment ($bn, '17) | 128 | 44 | 68 | 78 | 60 | 60 | 27 | 15 | 78 | 55 | 35 | 75 | 80 | 82 |
| Nominal GDP | 9.1 | 6.3 | 5.6 | 4.4 | 3.8 | 4.1 | 6.3 | 3.8 | 8.3 | 5.1 | 4.8 | 6.9 | 4.6 | 4.4 |
| Industrial Production, Mfg. | 2.7 | -0.6 | 1.1 | 3.6 | 3.3 | 3.3 | -0.3 | 0.4 | -0.5 | -0.9 | -0.3 | 3.8 | 3.6 | 3.8 |
| **HOUSING MARKET** | | | | | | | | | | | | | | |
| Housing Starts (units, thous) | 1,551 | 1,423 | 1,466 | 1,540 | 1,584 | 1,590 | 1,385 | 1,450 | 1,371 | 1,485 | 1,415 | 1,457 | 1,483 | 1,511 |
| New Home Sales (units, thous) | 637 | 667 | 767 | 840 | 848 | 885 | 638 | 691 | 693 | 644 | 667 | 777 | 807 | 818 |
| Existing Home Sales (units, thous) | 5,087 | 4,101 | 4,208 | 4,583 | 4,658 | 4,856 | 4,317 | 4,187 | 4,020 | 3,880 | 4,190 | 4,089 | 4,213 | 4,341 |
| Case-Shiller Home Prices (%yoy)* | 7.5 | 5.6 | 5.5 | 4.4 | 4.9 | 4.9 | 2.3 | -0.2 | 2.5 | 5.6 | 7.6 | 7.4 | 6.4 | 5.5 |
| **INFLATION (% ch, yr/yr)** | | | | | | | | | | | | | | |
| Consumer Price Index (CPI)** | 6.4 | 3.3 | 3.3 | 2.5 | 2.3 | 2.2 | 5.7 | 4.0 | 3.6 | 3.2 | 3.2 | 3.5 | 3.3 | 3.3 |
| Core CPI ** | 5.7 | 3.9 | 3.5 | 2.6 | 2.3 | 2.3 | 5.5 | 5.2 | 4.4 | 4.0 | 3.8 | 3.6 | 3.7 | 3.6 |
| Core PCE** † | 4.9 | 2.9 | 2.7 | 1.9 | 2.0 | 2.0 | 4.8 | 4.6 | 3.8 | 3.2 | 2.9 | 2.7 | 2.7 | 2.7 |
| **LABOR MARKET** | | | | | | | | | | | | | | |
| Unemployment Rate (%)^ | 3.5 | 3.7 | 3.8 | 3.7 | 3.6 | 3.6 | 3.5 | 3.6 | 3.8 | 3.7 | 3.8 | 3.8 | 3.8 | 3.8 |
| U6 Underemployment Rate (%)^ | 6.5 | 7.1 | 7.3 | 7.0 | 6.9 | 6.9 | 6.7 | 6.9 | 7.0 | 7.1 | 7.3 | 7.3 | 7.3 | 7.3 |
| Payrolls (thous, monthly rate) | 377 | 251 | 186 | 94 | 75 | 75 | 305 | 274 | 213 | 212 | 269 | 175 | 150 | 150 |
| Employment-Population Ratio (%)^ | 60.1 | 60.1 | 60.2 | 60.1 | 59.9 | 59.8 | 60.4 | 60.3 | 60.4 | 60.1 | 60.3 | 60.3 | 60.2 | 60.2 |
| Labor Force Participation Rate (%)^ | 62.3 | 62.5 | 62.6 | 62.4 | 62.2 | 62.0 | 62.6 | 62.6 | 62.8 | 62.5 | 62.7 | 62.7 | 62.6 | 62.6 |
| Average Hourly Earnings (%yoy) | 5.4 | 4.5 | 3.9 | 3.4 | 3.2 | 3.2 | 4.6 | 4.6 | 4.5 | 4.3 | 4.2 | 4.0 | 3.8 | 3.7 |
| **GOVERNMENT FINANCE** | | | | | | | | | | | | | | |
| Federal Budget (FY, $bn) | -1,376 | -1,695 | -1,800 | -1,900 | -1,900 | -2,050 | -- | -- | -- | -- | -- | -- | -- | -- |
| **FINANCIAL INDICATORS** | | | | | | | | | | | | | | |
| FF Target Range (Bottom-Top, %)^ | 4.25-4.5 | 5.25-5.5 | 4.75-5 | 3.75-4 | 3.25-3.5 | 3.25-3.5 | 4.75-5 | 5-5.25 | 5.25-5.5 | 5.25-5.5 | 5.25-5.5 | 5.25-5.5 | 5-5.25 | 4.75-5 |
| 10-Year Treasury Note^ | 3.88 | 3.88 | 4.25 | 4.10 | 4.10 | 4.10 | 3.48 | 3.81 | 4.59 | 3.88 | 4.20 | 4.30 | 4.25 | 4.25 |
| Euro (€/$)^ | 1.07 | 1.11 | 1.05 | 1.15 | 1.15 | 1.15 | 1.09 | 1.09 | 1.06 | 1.11 | 1.08 | 1.07 | 1.05 | 1.05 |
| Yen ($/¥)^ | 132 | 141 | 154 | 130 | 125 | 120 | 133 | 144 | 149 | 141 | 151 | 155 | 155 | 154 |

* Weighted average of metro-level HPIs for 381 metro cities where the weights are dollar values of housing stock reported in the American Community Survey. Annual numbers are Q4/Q4.
** Annual inflation numbers are December year-on-year values. Quarterly values are Q4/Q4.
† PCE = Personal consumption expenditures. ^ Denotes end of period.
Note: Published figures in bold.
Source: Goldman Sachs Global Investment Research.

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# Disclosure Appendix

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