The Weekly Market Update – 10/16/23: Budget Deficit Grows as Tax Receipts Drop

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,327.78	0.45%	0.93%	12.72%	20.70%	4,796.56	10.8%
Dow Jones Industrial Average	33,670.29	0.79%	0.49%	1.58%	17.21%	36,799.65	9.3%
NASDAQ Composite	13,407.23	-0.18%	1.42%	28.10%	26.77%	16,057.44	19.8%
Russell 2000	1,719.71	-1.48%	-3.66%	-2.36%	3.30%	2,442.74	42.0%
MSCI EAFE (USD)	2,012.68	0.96%	-0.91%	3.54%	21.14%	2,398.71	19.2%
MSCI Emerging Markets (USD)	951.31	1.49%	-0.15%	-0.53%	8.62%	1,444.93	51.9%
Bloomberg Commodity Index	105.29	2.64%	0.43%	-6.66%	-5.56%	237.95	126.0%
Barclays U.S. Aggregate Bond	85.99	0.97%	-0.39%	-3.25%	-1.96%	112.07	30.3%

Source: FactSet

The U.S. federal deficit increased in fiscal 2023 as tax receipts declined year-over-year (Y/Y), missing government estimates released in May. According to the Congressional Budget Office (CBO, released 10/10/23), the U.S. fiscal 2023 (FY23) deficit (the federal fiscal year concluded on 9/30/23) totaled $1.69 trillion (T) compared to a FY22 deficit of $1.38T. This exceeded the CBO's May 2023 deficit estimate of $1.54T as tax receipts from individuals and corporations ended the year below those estimates. For the fiscal year, federal revenue totaled $4.44T, down $455 billion (B), or -9%, Y/Y. Although Y/Y withheld income tax and payroll taxes increased (not surprising given the growth in jobs), the CBO speculated (more data pending) that lower capital gains tax receipts were the culprit (in 2022, equity markets were largely lower). In addition, lower-than-expected corporate tax receipts (still modestly higher Y/Y) were attributed to higher employee retention tax credit payments and other government relief programs. In order of magnitude, federal revenue was comprised of Individual Income Tax (49%), Payroll Tax (36%), Corporate Tax (10%), and Other (5%). FY23 federal outlays totaled $6.13T, down $141B, or -2%, Y/Y. More than $300B was saved as several programs tied to COVID relief expired, but other key spending categories were higher. This included Social Security +11% (cost of living adjustments), Medicare +18%, and Medicaid +4%. In addition, defense spending increased +7% to $774B and interest on the public debt grew +33% to $711B. Spending on Social Security, Medicare and Medicaid totaled $2.80T (46% of spending), while defense and interest comprised 13% and 12%, respectively. All other spending programs, feeding most of the Congressional budget debates, represented 29% of FY23 outlays. The CBO's accounting treatment of FY22's proposed student loan forgiveness program (which was disallowed by the Supreme Court) created an accounting anomaly. In FY22, it added $379B to the deficit, and in FY23 it lowered the deficit by $333B. Since the program was not adopted, the adjusted (more appropriate) deficits for FY22 and FY23 would have been $996B and $2.02T, respectively. Looking ahead to FY24, in May, the CBO estimated a deficit of $1.57T with a likely rebound in capital gains and corporate tax receipts. At the same time, spending is expected to increase, and we believe that estimates for interest expense and defense spending will likely move higher.

Higher federal debt levels create increased Treasury issuance, helping to keep interest rates elevated. According to the U.S. Treasury (fiscaldata.treasury.gov), as of 10/12/23, total federal debt totaled $33.5T, or $26.4T excluding intragovernmental holdings. In August, the Treasury said that it would gradually increase the size of its debt auctions in the months ahead, to finance new spending and maturing securities. At that time, third quarter (3Q23) and 4Q23 borrowing was estimated at $1.00T and $852B, respectively. This reflected an increase to the May estimate and correlated with higher long-term interest rates in August and September. The U.S. 10-year Treasury yield is 4.72% (10/16/23), up from 3.95% on 7/31/23. We look for elevated debt supply to place continued upward pressure on long-term interest rates.

It's a busy week for economic data as 3Q23 earnings season warms up. Key September data for retail sales and industrial production (Tuesday), housing starts (Wednesday), and home sales (Thursday) will feed into quarterly GDP (gross domestic product) estimates, with the FactSet consensus estimating the U.S. economy grew +3.1% in 3Q23. According to FactSet, earnings are estimated to increase +0.5% on a Y/Y basis, ending three consecutive quarters of Y/Y declines. This week, 55 S&P 500 companies (11%) are reporting.

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