CUSTOMER TREASURY SERVICES

Economist's Weekly Market View

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US fiscal credibility facing scrutiny as election season nears

It was a relatively quiet week on markets, with activity across the main asset classes remaining muted. The lack of macro data releases meant there was no new information to provide directional impetus. Notably, the largest-ever US Treasury 10-year auction took place, with a size of $42 billion. Demand was strong, resulting in a bid-to-cover ratio of 2.56 and a yield of 4.093%. However, this auction, along with newly published long-term fiscal forecasts, highlights the sustainability of the federal deficit in the long run as we enter the Presidential election season.

This week, the independent Congressional Budget Office published its annual forecasts for the US federal balance and debt up to 2034. These forecasts indicate a further $1.4 trillion deterioration in the expected size of the US federal deficit compared to last year's projections. By 2034, the deficit is expected to reach 6.1% of GDP, up from 5.6% in 2024. Debt-to-GDP is set to rise from 97% in 2024 to 116% by 2034. Just a few years ago, in 2016, the deficit was running at 3.2% of GDP per annum, and debt-to-GDP stood at 75%. Interest payments on US government debt will account for three-quarters of the rise in the deficit between now and 2034, reaching 3.9% of GDP in 2034. With long-term US GDP growth projections falling below 2%, the interest rate-growth differential, or the 'snowball effect', is expected to push up deficit spending and debt in the long term.

Under both recent US administrations the deficit has ballooned due to a confluence of policy and external factors. Trump's 2017 Tax Cuts and Jobs Act and Biden's 2022 Inflation Reduction Act were signature policies that contributed to the increase in the federal deficit. Emergency measures during the Covid-19 pandemic have also pushed the debt ratio onto a higher trajectory. However, policymakers, including Fed Chair Powell, are now raising concerns about the current "unsustainable fiscal path" as an economic risk. This will likely bring both presidential candidates' tax and spending plans into focus in the coming months.

On the main currency markets over the past week the dollar held onto the bulk of the gains made last week. EUR/USD briefly traded below its recent support level of $1.07 last week, before strengthening to $1.076 by Monday. Bond yields were broadly higher on the week both Stateside and in Europe,

rising 10-15 basis points across the curve, while market-implied rate cut expectations firmed marginally through the week.

This week, attention will turn to a raft of UK macroeconomic data which should give a firmer steer on the recent path of the economy and inflation, and near term path for interest rates there.

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