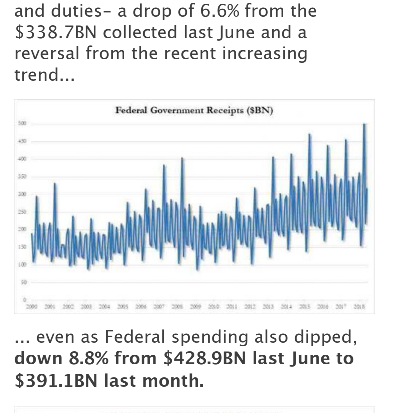
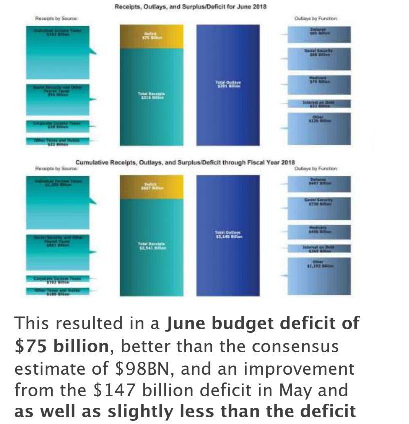
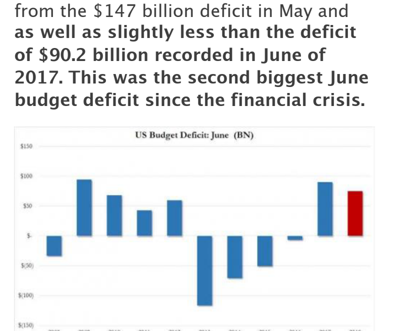
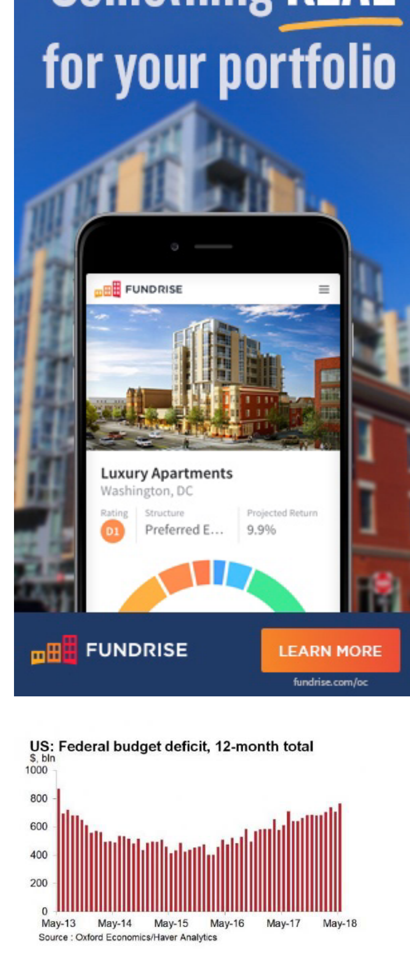
US Budget Deficit Hits $607 Billion In 9 Months, As Spending On Interest Explodes

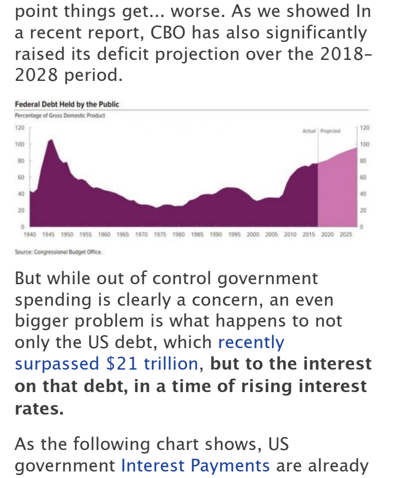
by Tyler Durden



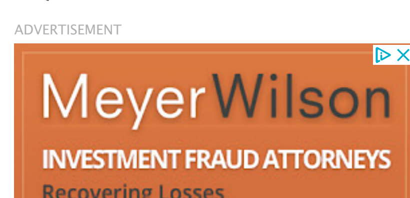







Source : Oxford Economics/Haver Analytics

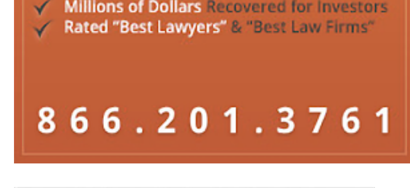
Most Wall Street firms forecast a deficit for fiscal 2018 of about $850 billion, at which point things get... worse. As we showed In a recent report, CBO has also significantly raised its deficit projection over the 2018-2028 period.



Source: Congressional Budget Office.

But while out of control government spending is clearly a concern, an even bigger problem is what happens to not only the US debt, which recently surpassed $21 trillion, **but to the interest on that debt, in a time of rising interest rates.**

As the following chart shows, US government Interest Payments are already rising rapidly, and just hit an all time high in Q1 2018.

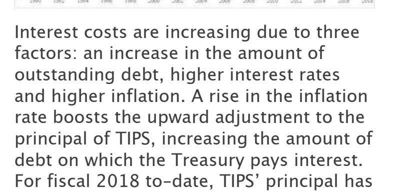


Interest costs are increasing due to three factors: an increase in the amount of outstanding debt, higher interest rates and higher inflation. A rise in the inflation rate boosts the upward adjustment to the principal of TIPS, increasing the amount of debt on which the Treasury pays interest. For fiscal 2018 to-date, TIPS' principal has been increased by boosted by $25.8 billion, an increase of 54.9% over the comparable period in 2017.

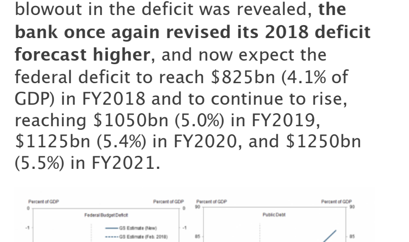
The bigger question is with short-term rates still in the mid-1% range, what happens when they reach 3% as the Fed's dot plot suggests it will?

* * *

In a note released by Goldman after the blowout in the deficit was revealed, **the bank once again revised its 2018 deficit forecast higher**, and now expect the federal deficit to reach $825bn (4.1% of GDP) in FY2018 and to continue to rise, reaching $1050bn (5.0%) in FY2019, $1125bn (5.4%) in FY2020, and $1250bn (5.5%) in FY2021.



Goldman also notes that it expects that on its current financing schedule **the Treasury still faces a financing gap of around $300bn in FY2019, rising to around $750bn by FY2021, and will thus need to raise auction sizes substantially over the next couple of years to accommodate higher deficits**.

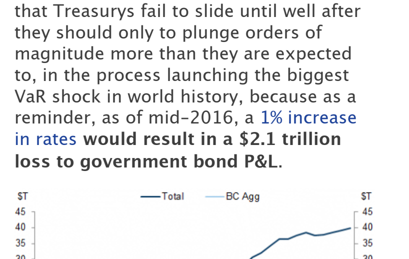


What does this mean for interest rates? The bank's economic team explains:

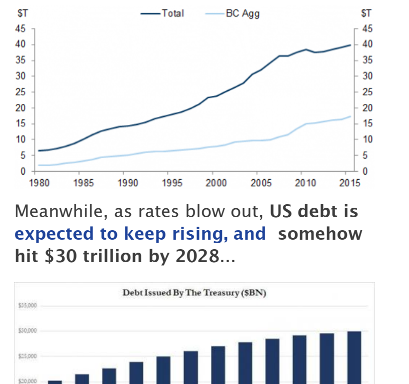
> *The increase in Treasury issuance and the ongoing unwind of QE should put upward pressure on long-term interest rates. On issuance, the economic research literature suggests* ***as a rule-of-thumb that a 1pp increase in the deficit/GDP ratio raises 10-year Treasury yields by 10-25bp.*** *Multiplying the midpoint of this range by the roughly 1.5pp increase in the deficit due to the recent tax and spending bills implies a 25bp increase in the 10-year yield. On the Fed's balance sheet reduction, our estimates suggest that about 40-45bp of upward pressure on the 10-year term premium remains.*

And here a problem emerges, because while Goldman claims that "the deficit path is known to markets, but academic research suggests these effects might not be fully priced immediately... the balance sheet normalization plan is known too, but portfolio balance effect models imply that its impact should be gradual" the bank also admits that "**the precise timing of these effects is uncertain.**"

What this means is that it is quite likely that Treasurys fail to slide until well after they should only to plunge orders of magnitude more than they are expected to, in the process launching the biggest VaR shock in world history, because as a reminder, as of mid-2016, a 1% increase in rates **would result in a $2.1 trillion loss to government bond P&L.**



Meanwhile, as rates blow out, **US debt is expected to keep rising, and somehow hit $30 trillion by 2028...**



... without launching a debt crisis in the process.

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Spike those interest rates, FED bitchez! Bring on the Acrapolypse!

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but but but higher interest rates means the economy is strong. So by extension, higher interest payments must be bullish. This is what MSNBC tells me. Now excuse me, I need to go buy some TESLA.

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The next recession will be real rough on credit, 'cuz people still gonna buy gov paper.

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People? LOL. No, the FED will monetize the debt.

See Japan...

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Ut oh! No duh! The mathematically perfected, wealth transfer and the People's wages & Treasury plunder of the Olde World Order, American Globalist World Reserve Paper Debt system. MAFFA! Make American Fiat Fraud Free Again!
1694-1766-1913

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This is not Trumptard Boner material.

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Just buy FANG.
It is the can't lose trade because "they" can't let it go down

Stupid Valuation...
Since when has that ever mattered

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Fed needs to purchase more assets at the rate of 70-80B a month to full this gap. Net financing costs to the UST should be slightly less than zero.