

Why Budget Deficits Matter

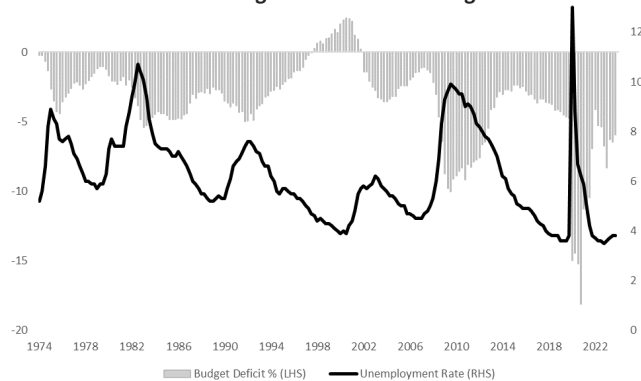
This week, investors will digest a litany of economic data, including updates on the U.S. job market and on manufacturing and service activity. These releases come amid a busy week of corporate earnings releases and a meeting of the Federal Reserve. Potentially lost in this deluge of data is the U.S. Treasury’s announcement of its forthcoming borrowing needs and expected bond auctions.

While this last announcement may not generate many headlines, bond investors will nonetheless pay close attention to it. Last July, the U.S. Treasury surprised markets by announcing that it would borrow \$1 trillion over the ensuing three months to finance an increasing budget deficit. That borrowing resulted in a growing supply of U.S. Treasury bonds, which helped push bond prices lower and thus bond yields higher. It is no coincidence that 10-year Treasury yields reached their high last year following increased scrutiny of growing debt supply.

That scrutiny will continue in the years ahead. While budget deficits are nothing new, an expanding deficit in a period of historically low unemployment is new. Health-care costs, military expenditures, and a growing interest burden—these factors, among others, signal that the demand for federal spending will continue. For much of the past four decades, bond yields fell as the deficit grew. Whether that continues now seems to be in question.

CHART OF THE WEEK

U.S. Federal Budget Deficit as Percentage of GDP



Source: Bloomberg, as of April 30, 2024.

Index Returns (%)							Index Characteristics				
Equities	Level	1 Week	QTD	YTD	1 Year	3-Year Ann.	NTM P/E	NTM P/E (20Y med)	NTM P/S	NTM P/S (20Y med)	Div. Yld
S&P 500	5048	0.75	-3.85	6.30	25.92	8.08	20.9	16.7	2.7	1.6	1.4
Russell 1000 Growth	3242	-0.17	-4.43	6.47	35.71	8.02	27.3	19.8	4.2	2.0	0.7
Russell 1000 Value	1705	2.12	-3.34	5.34	16.28	5.60	16.4	14.8	1.7	1.4	2.2
FTSE High Dividend Y	408	2.26	-2.89	5.95	14.41	7.83	12.0	14.4	1.5	1.6	4.2
S&P Small and Mid C _o	15998	2.28	-5.18	2.03	18.22	1.99	16.2	19.1	1.2	1.2	1.7
MSCI EAFE	2266	1.00	-3.23	2.52	9.25	2.81	14.8	14.6	1.5	1.1	3.0
MSCI EM	1029	1.01	-1.28	1.11	9.73	-6.19	12.5	12.6	1.3	1.2	2.7

* Bloomberg U.S Large Cap Dividend Yield Total Return Index used as substitute for index characteristics.

Fixed Income							Levels				
	Yield	1 Week	QTD	YTD	1 Year	3-Year Ann.	Currencies	Last	1 Wk Ago	Prev YE	3 Yrs Ago
U.S. Aggregate	5.31	-0.22	-2.69	-3.44	-1.89	-3.63	DXY	105.75	105.68	101.33	91.28
U.S. Int. Gov/Credit	5.13	-0.03	-1.44	-1.59	0.34	-1.71	\$ per €	1.07	1.07	1.10	1.20
U.S. Corporates	5.75	-0.16	-2.83	-3.22	0.47	-3.25	\$ per £	1.25	1.24	1.27	1.38
High Yield	8.21	0.45	-1.29	0.17	8.97	1.42	¥ per \$	156.90	154.83	141.04	109.31
Municipals (1-10)	3.41	-0.24	-0.92	-1.28	1.50	-0.53					

Key Rates							Levels				
	Last	1 Wk Ago	Last Qtr	Prev YE	1 Yr Ago	3 Yrs Ago	Commoditie	Last	1 Wk Ago	Prev YE	3 Yrs Ago
2-yr Treasury	5.00	4.93	4.62	4.25	4.01	0.16	Oil (WTI)	82.77	83.36	72.12	53.62
10-yr Treasury	4.70	4.60	4.20	3.88	3.43	1.63	Gasoline	3.66	3.66	3.12	2.90
30-yr Treasury	4.81	4.73	4.34	4.03	3.68	2.30	Natural Gas	2.64	1.81	2.51	2.93
3-mo. LIBOR	5.66	5.59	5.56	5.59	5.30	0.18	Gold	1924	2322	2063	1769
6-mo. CD rate	5.77	5.39	5.35	5.28	5.37	0.10	Copper	8350	9602	8464	9829
Prime Rate	8.50	8.50	8.50	8.50	8.00	3.25	Wheat	604	585	628	743
30-yr fixed mortgage	7.56	7.47	7.25	6.99	6.85	3.11	BBG Index	102.89	102.95	98.65	90.36

LAST WEEK IN REVIEW

- **1Q '24 GDP (Mar.):** 1.6%, lower than consensus expectations of 2.4%. Inventories and trade were primary detractors. Excluding these factors, real domestic final sales increased 2.8%. Core price index increase of 3.7% indicates that inflation picked up over the quarter.
- **PCE Inflation (Mar.):** 0.3%/0.3%. (Headline and Core). Upward revisions to January core PCE inflation shows that inflation pressures picked up in the first quarter.

THIS WEEK

- **Employment Cost Index (1Q):** 4/30
- **JOLTS (Apr.):** 5/1
- **ISM Manufacturing (Apr.):** 5/1
- **FOMC Rate Decision):** 5/1
- **ISM Services (Apr.):** 5/3
- **Payrolls (Apr.):** 5/3

S&P SECTOR RETURNS

