

ISSUER COMMENT

17 October 2018



Contacts

William Foster +1.212.553.4741
VP-Sr Credit Officer
 william.foster@moody's.com

Gabriel Agostini +1.212.553.8882
Associate Analyst
 gabriel.agostini@moody's.com

Mauro Leos +1.212.553.1947
Associate Managing Director
 mauro.leos@moody's.com

Government of United States of America

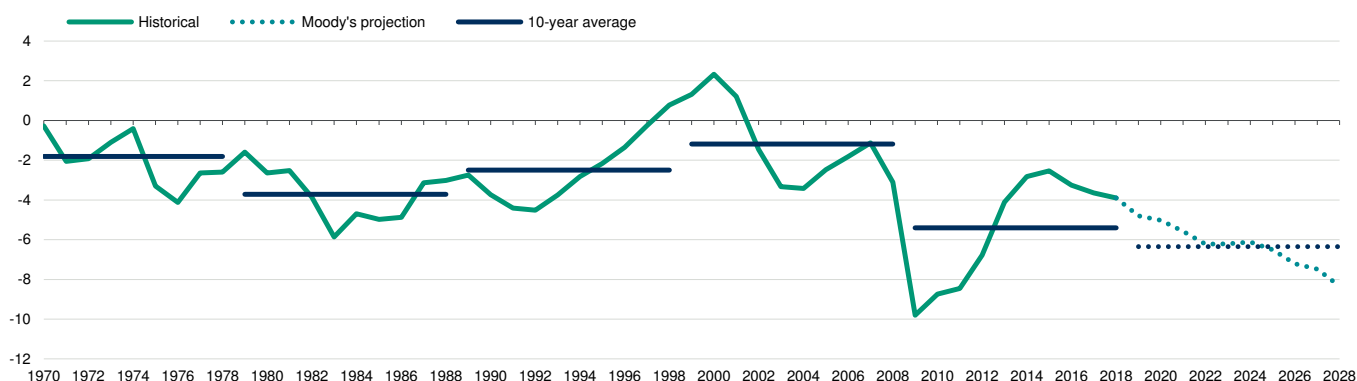
Widening federal budget deficit foreshadows gradual longer-term decline in US fiscal strength

On 15 October, the [US \(Aaa stable\)](#) Department of the Treasury reported that the federal budget deficit increased to \$779 billion, or 3.9% of GDP, in the fiscal 2018, which ended 30 September 2018, up from \$666 billion, or 3.5% of GDP, the previous fiscal year. The fiscal 2018 budget deficit is the largest since 2012 relative to GDP and reflects the beginning of what we expect to be a continued widening of US fiscal deficits over the next decade. Recent tax cuts and increased expenditures, combined with ageing-related entitlement spending and higher debt-service payments, will drive deficits in the coming years. In the absence of policies to offset adverse fiscal dynamics, the federal debt burden will continue to rise and debt affordability will decline, resulting in an overall weaker fiscal position for the US sovereign, a credit negative.

According to the Treasury's report, nominal receipts increased by only 0.4% relative to fiscal 2017, resulting in a decline in the receipts-to-GDP ratio to 16.5% from 17.2% in fiscal 2017. Total receipts were driven by higher individual income tax revenues (up 6.1%) that were largely offset by a fall in corporate income tax (down 31%). Meanwhile, nominal outlays increased by 3.2%, resulting in an expenditure-to-GDP ratio of 20.3% compared with 20.7% in fiscal 2017. Outlays were driven by a 23.6% increase in net interest costs, a 2.5% increase in spending on major entitlement programs (Social Security, Medicare and Medicaid) and substantial disaster relief.

We expect rising funding costs, mounting entitlement spending and [increases in military spending](#) to cause federal outlays to rise in fiscal 2019. Absent at least partially offsetting measures, these expenditure trends, combined with our assumption that tax provisions set to expire in 2025 would likely be made permanent, would cause the federal deficit to exceed 8.0% of GDP by fiscal 2028. This is a level that has not been reached since the 2008-09 global financial crisis (see exhibit).

The US' fiscal deficits will widen in the absence of policies to offset rising entitlement and funding costs
Federal budget deficit as a percent of GDP



Sources: Congressional Budget Office and Moody's Investors Service

Increases in future expenditures will be driven largely by rising interest payments on federal debt, which will rise materially because of rising interest rates, and the rising cost of social security and major healthcare programs. We expect debt service to account for more than half of the deterioration in the fiscal deficit by fiscal 2028. As a result, on the basis of current policy settings, we estimate that the federal debt trajectory will rise by around 30 percentage points by fiscal 2028, to surpass 100% of GDP, and the ratio of interest payments to revenue will rise by about 15 percentage points from about 8% in 2017.

The 6 November midterm elections will determine control of the US Congress, with polling data suggesting that the Democratic Party could regain control of the House of Representatives from the Republican Party, an outcome that would leave Congress divided provided the Republicans maintain control of the Senate, as most political analysts expect. We do not expect the midterm elections to materially affect US fiscal policy, given that neither party is currently proposing a viable policy response to longer-term fiscal challenges, including rising ageing-related entitlement spending.

Despite these fiscal pressures, the US continues to stand out as a sovereign with an unusually high ability to carry a large government debt burden, owing to its exceptional economic strength and the unique and central roles of the US dollar and US Treasury bond market in the global financial system, which will help counterbalance the gradual decline in fiscal strength.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Moody's related publications

- » **Credit Opinion:** [Government of United States - Aaa stable: Regular update](#), 16 October 2018
- » **Issuer In-Depth:** [Government of the United States: Rising income inequality will likely weigh on credit profile](#), 8 October 2018
- » **Sector In-Depth:** [Cross-Sector - US: High healthcare costs strain governments, businesses and households, with ripple effects across the economy](#), 18 September 2018
- » **Sector Comment:** [Cross-Sector - China and US: New round of US tariffs is credit negative for Chinese and US companies](#), 27 August 2018
- » **Issuer In-Depth:** [Key credit drivers supporting Moody's recent affirmation of the US's Aaa rating \(slides\)](#), 4 May 2018
- » **Issuer In-Depth:** [Government of United States – Aaa stable: Annual credit analysis](#), 3 May 2018
- » **Ration Action:** [Moody's affirms United States' Aaa rating; maintains stable outlook](#), 25 April 2018
- » **Sector Comment:** [Trade - US and China: Rising uncertainty will magnify credit effects of weaker trade relations](#), 5 April 2018
- » **Issuer Comment:** [High steady-state defense spending contributes to adverse fiscal dynamics](#), 27 March 2018
- » **Sector In-depth:** [Cross-sector - US and Canada: NAFTA exit would weigh on states and provinces more than national economies](#), 15 March 2018
- » **Issuer In-depth:** [Preeminent financial, economic position offsets weakening government finances](#), 9 February 2018
- » **Sector In-depth:** [Cross-sector - US: FAQ on the credit impact of new tax law](#), 24 January 2018
- » **Country Statistics:** [United States, Government of](#), 30 May 2018
- » **Rating Methodology:** [Sovereign Bond Ratings](#), December 2016

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1146181