

Pedro Schneider and Bernardo Dutra

US Fiscal: still risk-free?

April 2024

US Fiscal: still risk-free?

1) Historical: US deficit decoupled from unemployment since 2015 and debt is at concerning level and trends

- Deterioration after revenue reductions and with increase in spending post-pandemic.
- Few moments of fiscal adjustments in history (90s), usually (r-g) predominates.
- Decision in 2025 on tax cuts renovation (0.8 p.p. of GDP) is a key point.
- Long-term primary deficit of 3% of GDP vs -1%/+1% to stabilize debt: challenge of 2-4 p.p. of GDP.

2) Crisis? Despite the bad dynamics, a crisis seems unlikely

- Shortening at the margin, but no signs of USD flights or search for inflation protection.
- Marginal buyer shifting from foreigners (who didn't keep up with issuance increases) to households.
- No apparent deliberate sale of Treasuries by China: not reducing overall exposure in the US amid a global trend of more domestic financing in public debts.
- Issuance increase is a pressure factor for rates: in 12M, ~35% of GDP in maturities (85% GDP considering very short term).

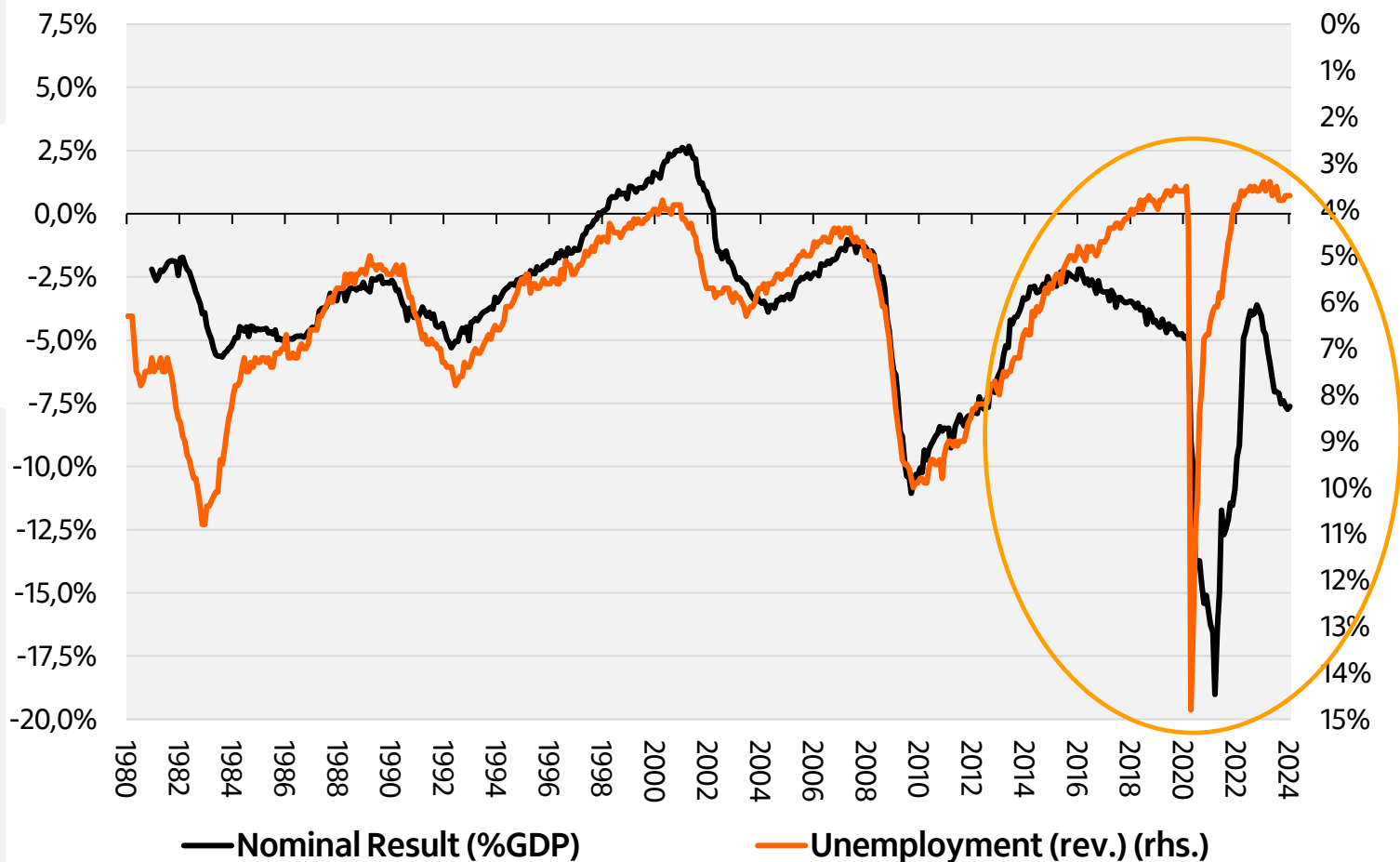
3) Fiscal impulse explains strong activity? Not clear by several metrics

- Fiscal stimulus at the margin is not going to households (despite having recently helped with savings surplus), but to companies.
- But activity resilience suggests higher neutral interest rate.

US nominal deficit decoupled from unemployment since 2015

(~7.5*% of GDP in 23; 5.5% in 24F ; interest expense: 2.7% GDP in 23 ; 3.2% in 24F)

US: Nominal deficit and unemployment



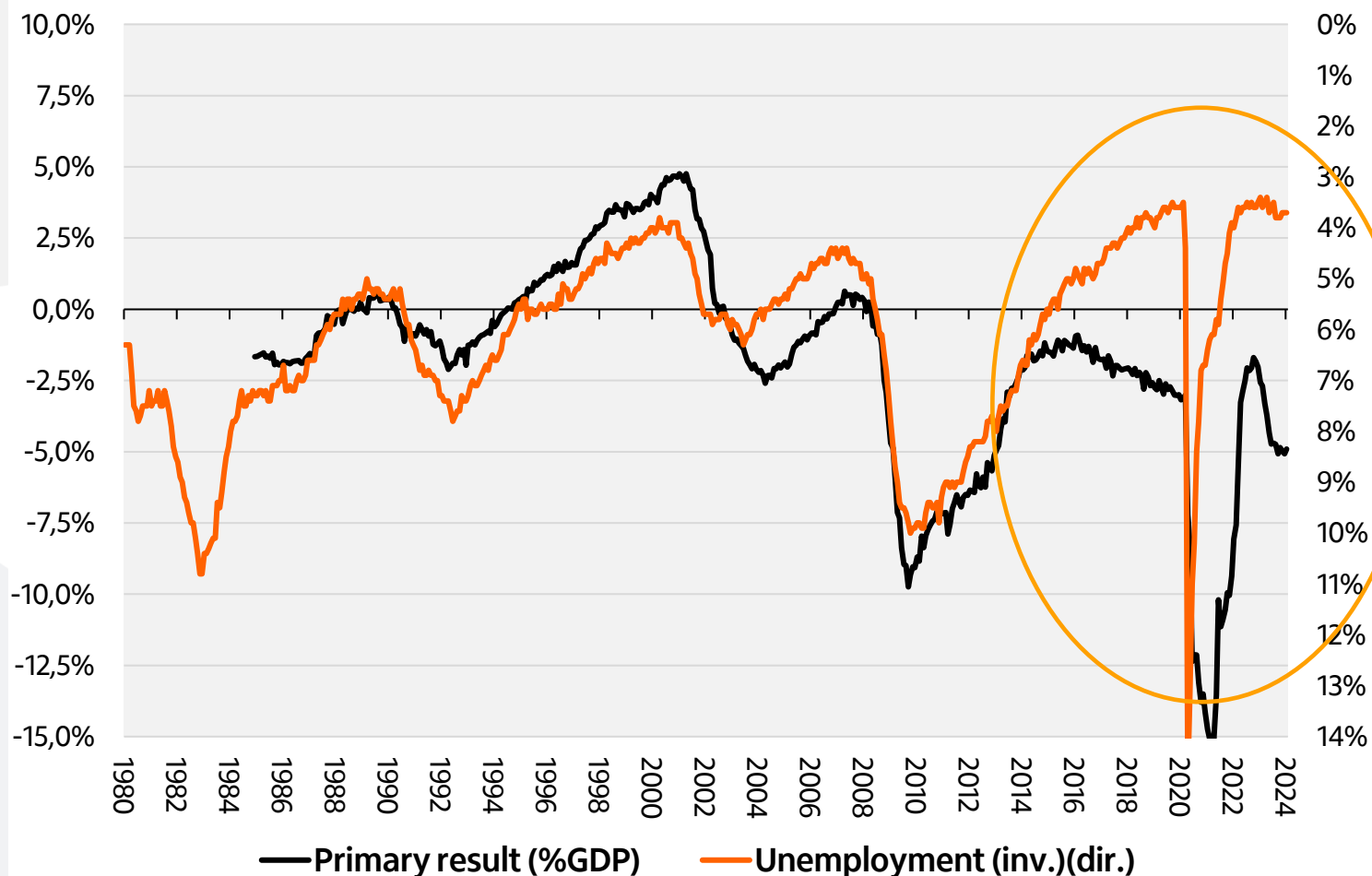
Source: Haver and Itaú

Obs: Series excludes 1.2% of GDP (USD 333 bi) in student loan forgiveness cancellation in aug/23 (accounted as negative spending). Nominal "headline" in ~6.3% of GDP

Primary deficit also decoupled

(~5% of GDP in 23 and 2.5% in 24F)

US: Primary deficit and unemployment

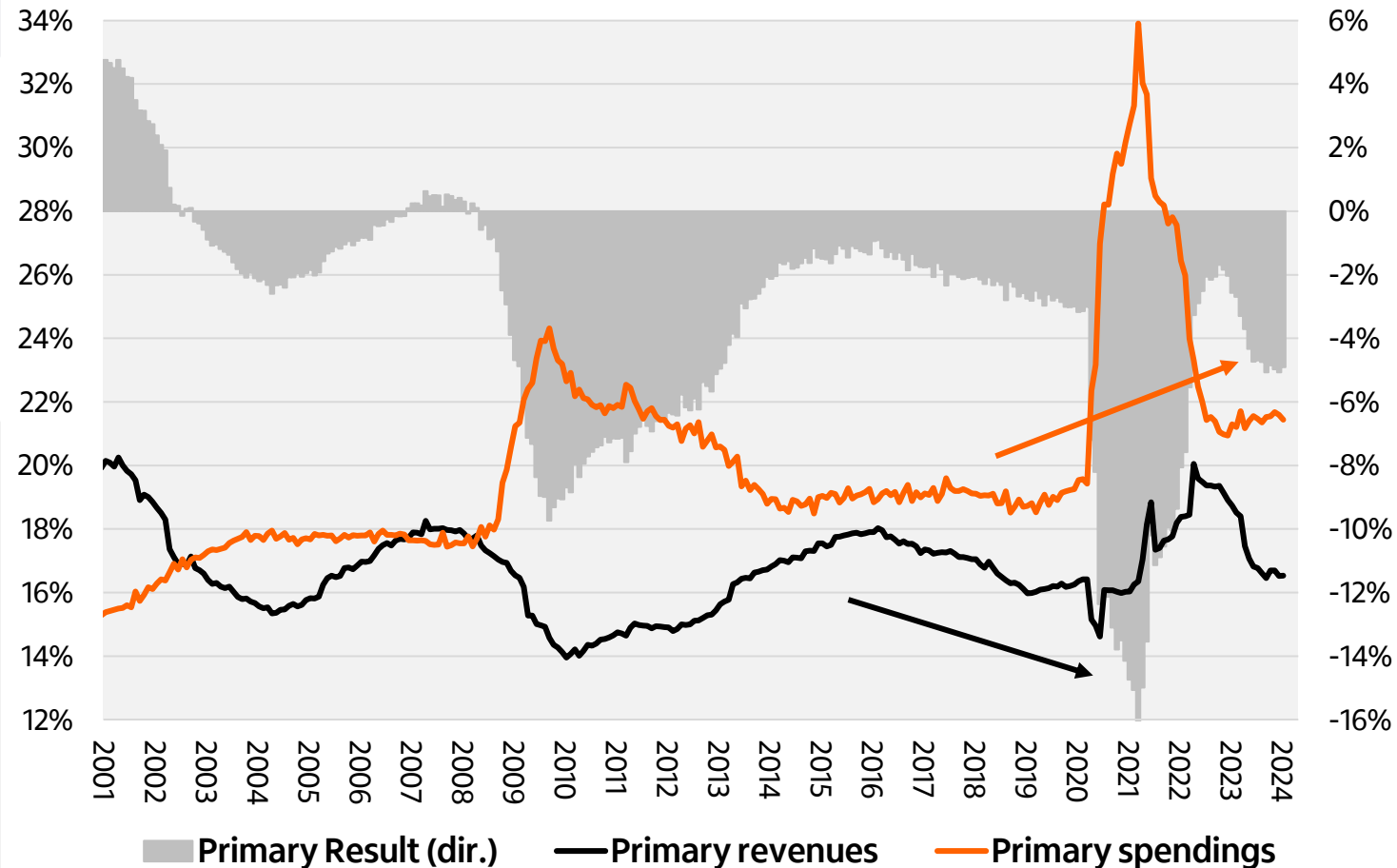


Obs: Series excludes 1,2% of GDP (USD 333 bi) in student loan forgiveness cancellation in Aug/23 (accounted as negative spending). Primary "headline" in 3,8% of GDP

Two clear moments of deficit worsening:

Revenue reduction (2017-20) and post-pandemic/spending increase (2021-23)

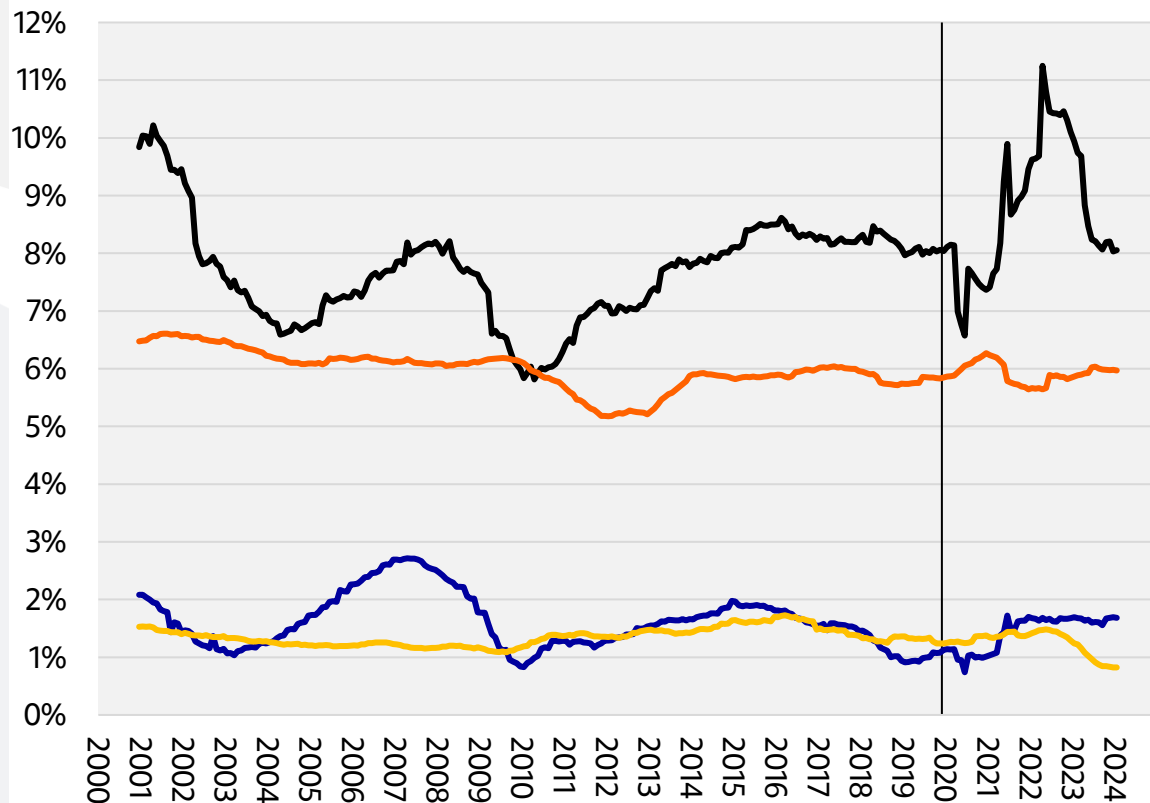
Revenues and spendings (% GDP)



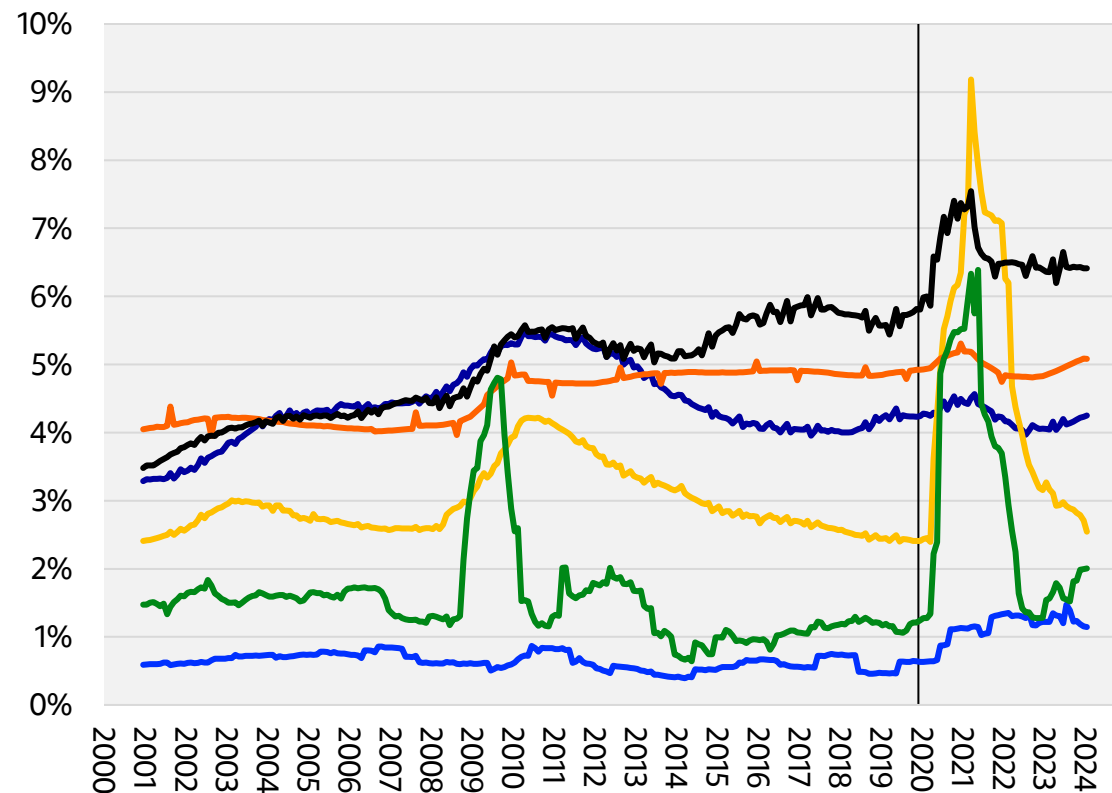
Revenue reduction (2017-21) driven by a decrease in corporate and excise (regulatory) tax and transf. Fed. Expense increase (2022-23) driven by medicare, education, FDIC (bank and deposit recovery).

- Income security returned to pre-pandemic levels

Revenues (% GDP)



Spending (% GDP)



Individual income taxes
Individual insurance taxes

Corporate income taxes
Others (Excise tax+ Estate and gift taxes + Customs)

Defense+Veterans
Medicare + Health

Income security
Education

Social security
Other spendings

3.6 p.p. worsening in the primary since 2014, with 1.0 p.p. revenues e 2.6 p.p. spendings

Fiscal US (% GDP)	Share	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	2023-19	2023-14
Nominal Result		-2.8%	-2.6%	-3.1%	-3.5%	-4.2%	-4.7%	-15.7%	-10.9%	-4.0%	-7.7%	-3.0%	-5.0%
Interest		1.3%	1.2%	1.3%	1.4%	1.6%	1.7%	1.6%	1.6%	2.0%	2.7%	0.9%	1.4%
Primary Result		-1.5%	-1.4%	-1.8%	-2.1%	-2.6%	-3.0%	-14.1%	-9.4%	-2.0%	-5.1%	-2.1%	-3.6%
Total net revenues	100%	17.5%	17.9%	17.2%	17.0%	16.1%	16.3%	16.0%	18.2%	18.9%	16.5%	0.3%	-1.0%
Individual Income Taxes	53%	8.1%	8.5%	8.2%	8.3%	8.1%	8.0%	7.4%	9.5%	10.1%	8.0%	0.0%	-0.1%
Corporation Income Taxes	9%	2.0%	1.8%	1.5%	1.5%	0.9%	1.1%	1.0%	1.7%	1.7%	1.7%	0.6%	-0.3%
Social Insurance Taxes	31%	5.8%	5.9%	6.0%	6.0%	5.7%	5.8%	6.3%	5.6%	5.8%	6.0%	0.1%	0.1%
Other (Excise + Estate and Gift + Customs)	7%	1.6%	1.7%	1.5%	1.4%	1.4%	1.2%	1.4%	1.4%	1.3%	0.8%	-0.4%	-0.8%
Total Primary Spending	100%	19.0%	19.3%	19.0%	19.1%	18.7%	19.3%	30.2%	27.6%	20.9%	21.6%	2.3%	2.6%
Defense + Veterans	19%	4.3%	4.1%	4.1%	4.0%	4.2%	4.2%	4.5%	4.2%	4.1%	4.2%	0.0%	-0.1%
Social Security	23%	4.9%	5.0%	4.8%	4.9%	4.8%	4.9%	5.3%	4.7%	4.8%	5.1%	0.2%	0.2%
Income Security	15%	2.9%	2.8%	2.7%	2.6%	2.4%	2.4%	6.3%	7.1%	3.2%	2.7%	0.3%	-0.2%
Medicare + Health	31%	5.4%	5.7%	5.8%	5.8%	5.6%	5.8%	7.4%	6.5%	6.4%	6.4%	0.6%	1.0%
Education	6%	0.5%	0.7%	0.6%	0.7%	0.5%	0.6%	1.1%	1.3%	1.2%	1.2%	0.5%	0.6%
Other spending	6%	1.0%	1.0%	1.1%	1.2%	1.2%	1.2%	5.5%	3.7%	1.3%	2.0%	0.7%	1.0%
Memo: Student Loan Debt Effect		-	-	-	-	-	-	-	-	1.5%	-1.2%		

In 2024, the following distortions may come out (+1.0 p.p. of GDP in revenues and -1.6 p.p. of GDP in spendings):

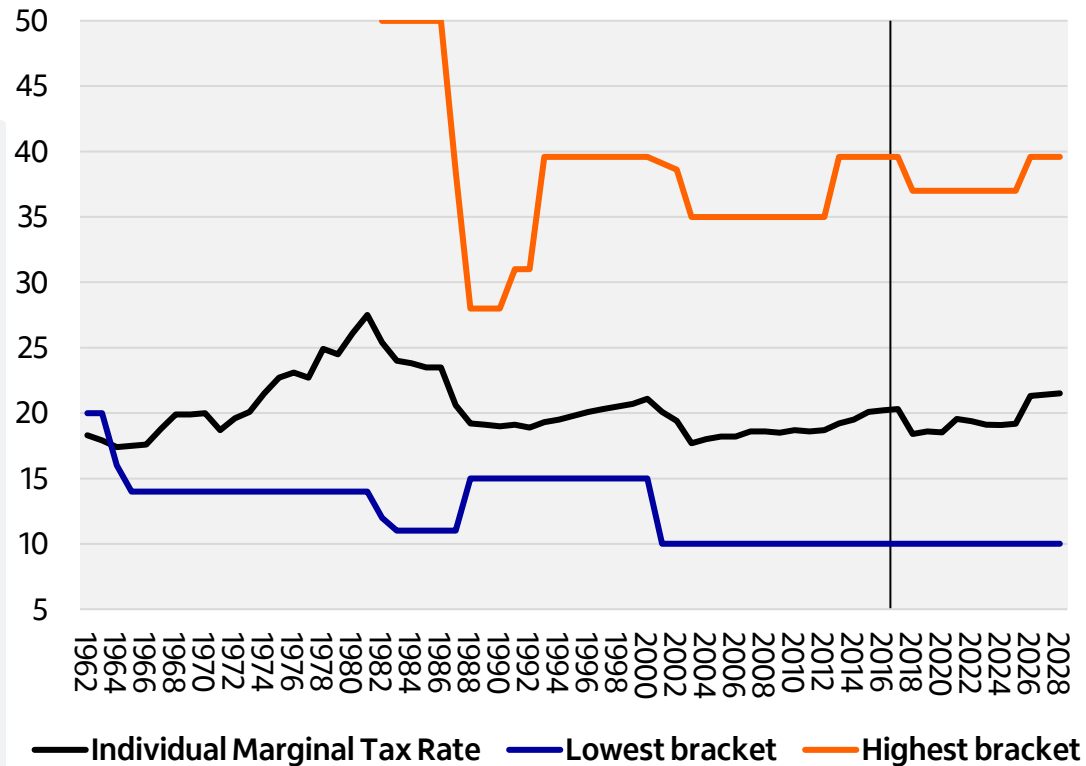
- Individual Income Tax: lower capital gains, some term payment distortion in the short term (natural disasters).
- Corporate Tax: some term payment distortion in the short term (natural disasters).
- Other: lower Fed transfers (increased interest spending), reduction in imports and donations.
- Income security: expanded child tax credit has expired.
- Other spending: (+) FDIC, (+) Coronavirus Refundable credits, (+) Employee Retention Tax Credit, (-) Coronavirus relief to governments.

2017 tax act (TCJA) temporarily reduced individual taxes until 2025 and corporate taxes permanently

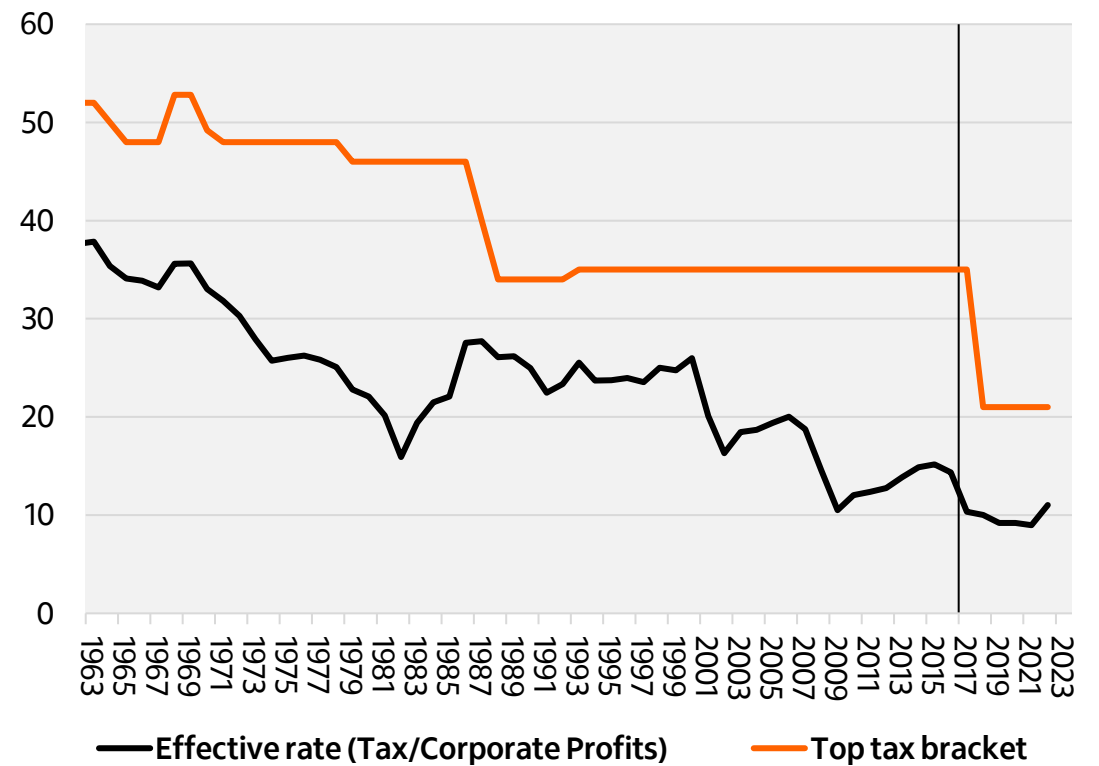
Non-renewal would increase revenues by 0.8 p.p. of GDP from 2026

- **Individual Income Tax** : tax rates decrease, deductions increase (standards and per dependent).
- **Estate Tax**: (Heritage): exemption has doubled.
- **Others**: 20% deduction of corporations' income pass-through; changes in the taxation of international corporate income.
- **Corporate Tax**: tax rates reduction from 35% to 21% (permanent).

Individual income tax



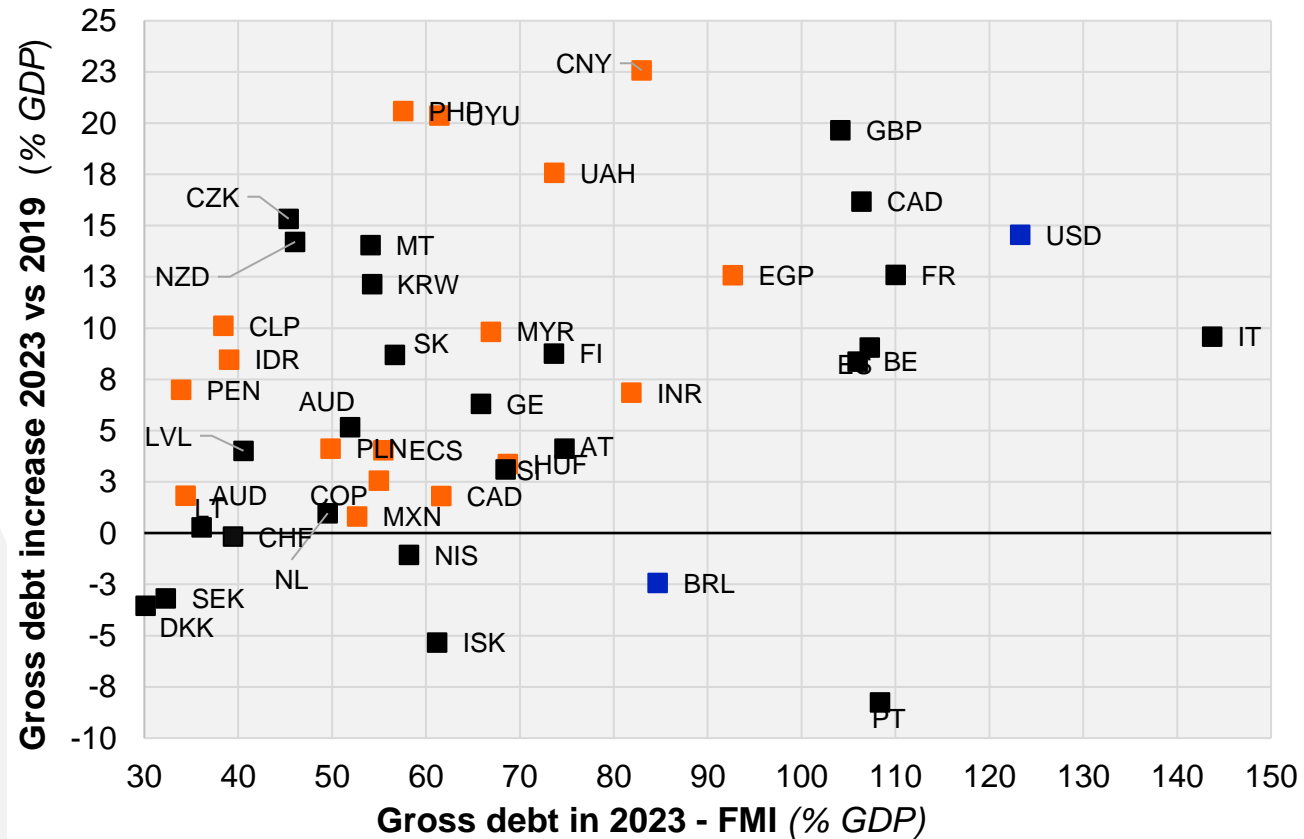
Corporate tax



International comparison:

US on a concerning recent debt growth dynamic (Brazil positive highlight, Italy negative).

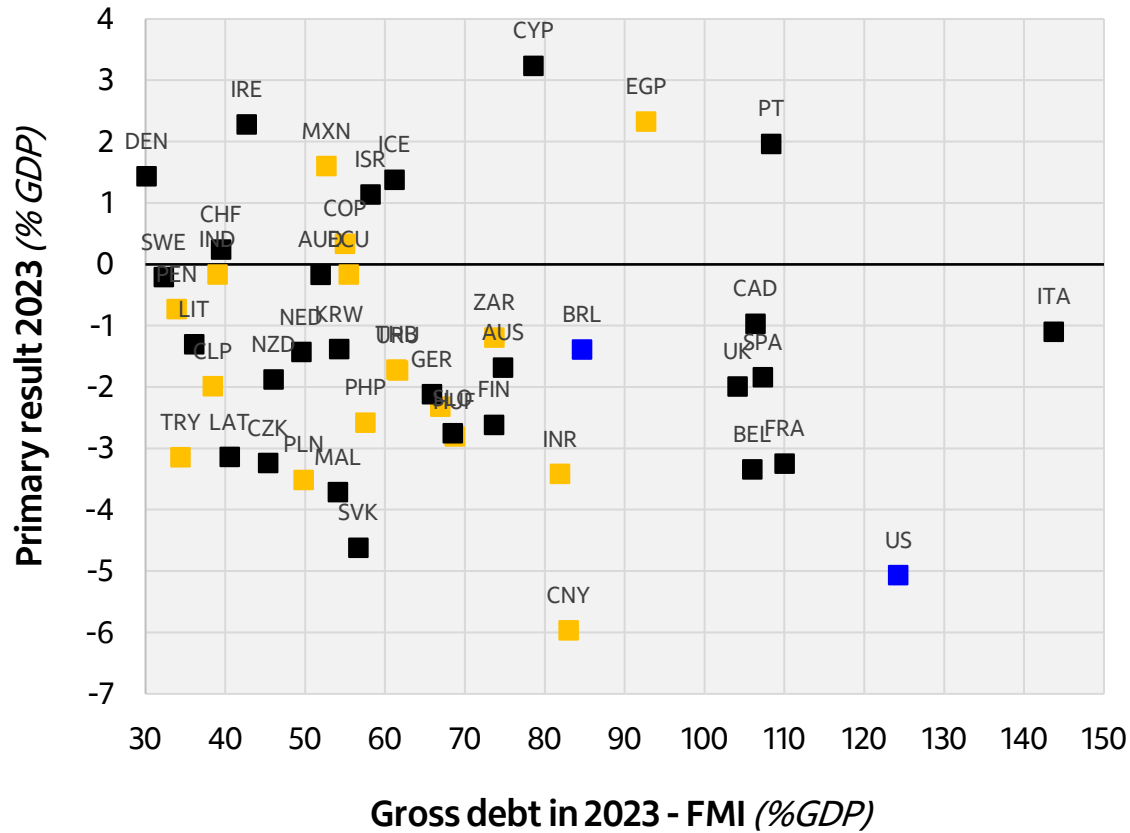
US: high debt and worsened since pandemic



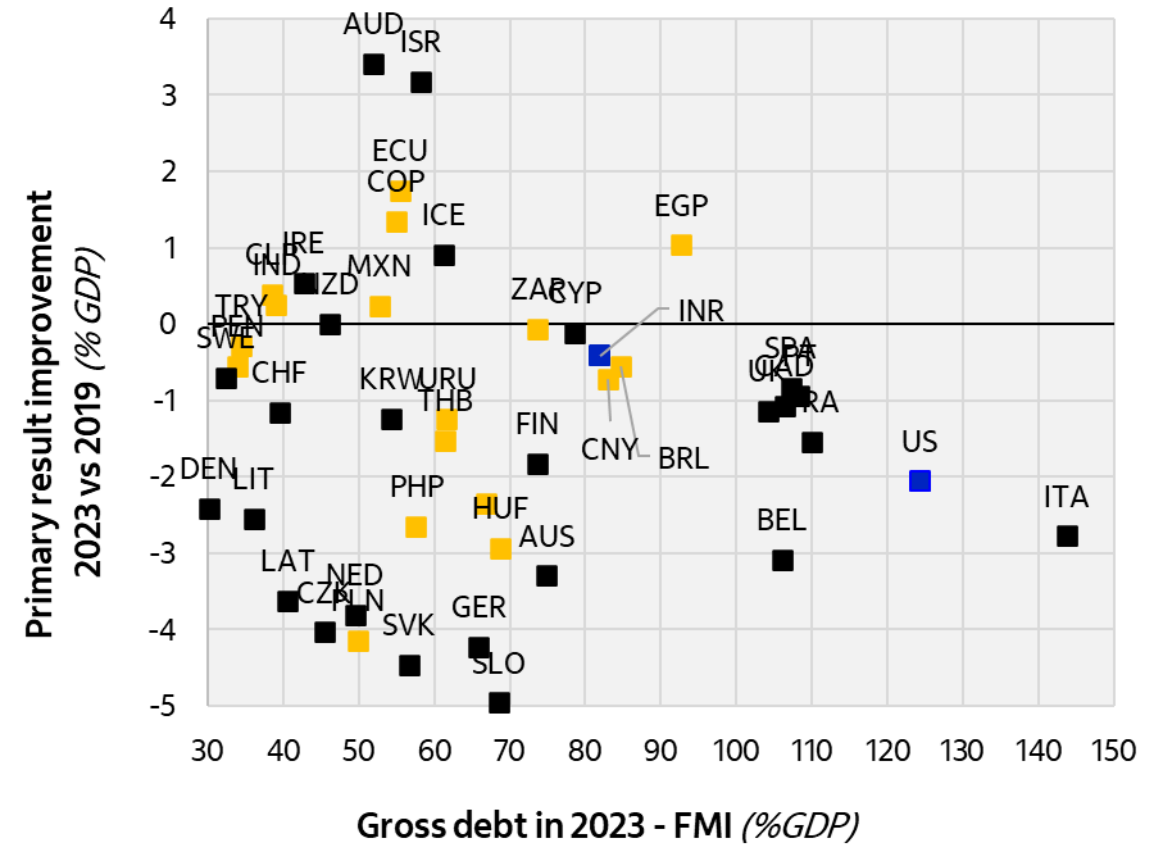
International comparison:

US: bad level and primary dynamic

US: very large primary deficit



US: primary worsening trend

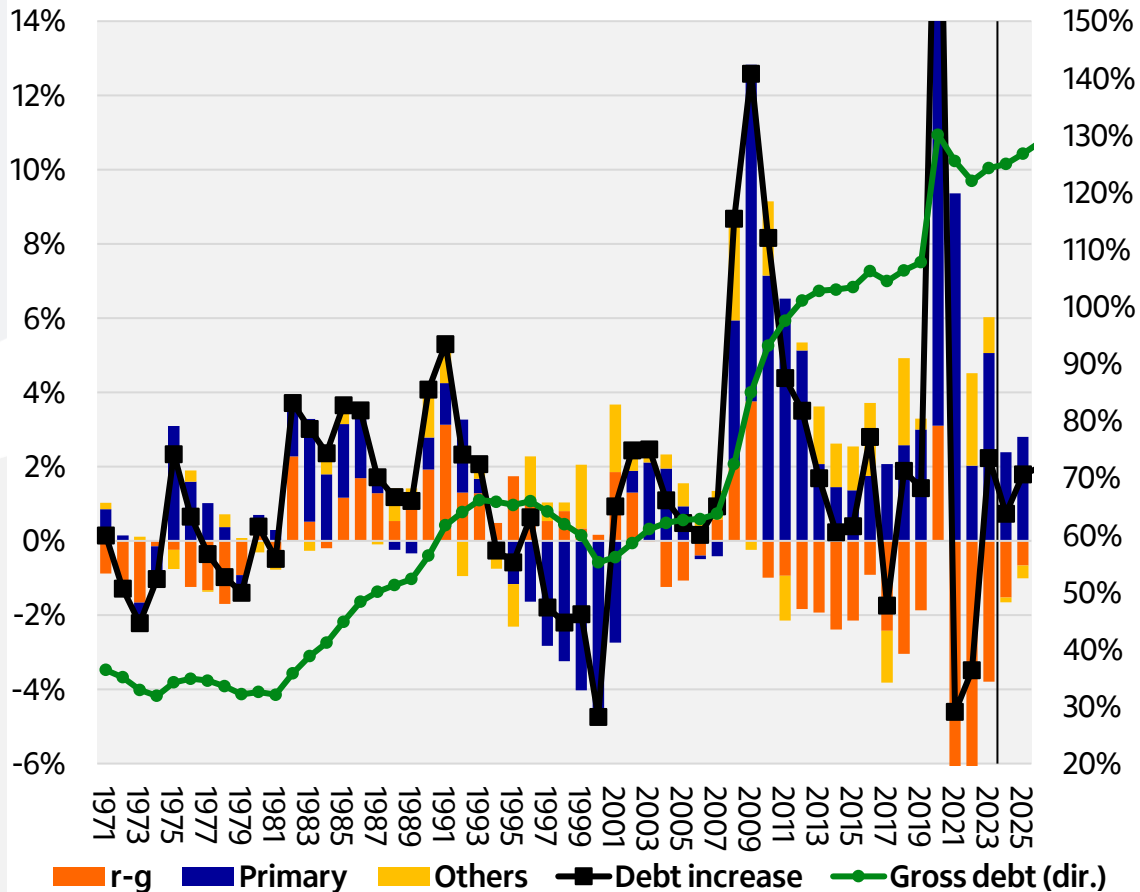


Historically, few moments of fiscal adjustment, (r-g) dominates

But elevated deficits at the margin

$$\Delta Debt = (r - g) * Debt + Primary\ deficit$$

Public debt increase (p.p. of GDP)



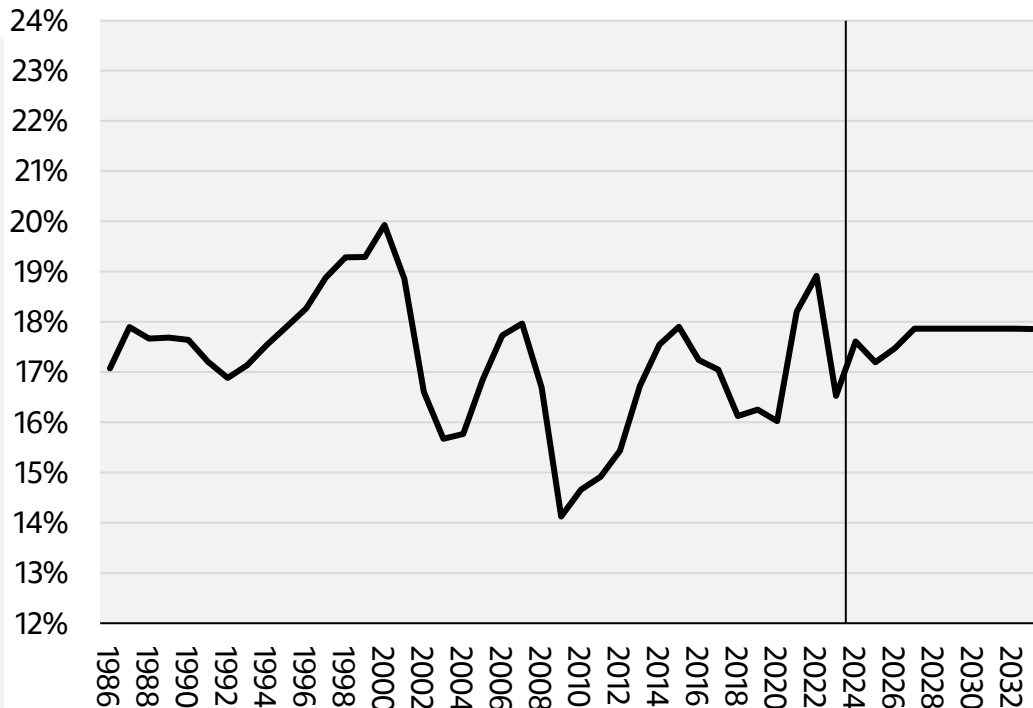
Fiscal stories		D debt per year	Real rates (r)	GDP (g)	(r-g)*D	-Primary (-S)	Residual
1970-1980	Low rates, high inflation	-0,5%	0,2%	1,3%	-1,1%	0,6%	0,0%
1980-1990	Disinflation effort	2,0%	2,2%	1,4%	0,8%	1,0%	0,2%
1990-2000	Primary surplus	0,8%	3,3%	2,1%	1,3%	-0,9%	0,4%
2000-2019	(r<g), 'easier to pay debt', Obama promised debt reduction after GFC	2,4%	1,2%	1,8%	-0,6%	2,2%	0,8%
2021-22	Pandemic, inflation starts to rise from the dead Yellen (21): 'with interest rates at lows, smartest thing is act big'	4,7%	-2,8%	2,5%	-5,3%	8,5%	1,6%
2023-25	High rates, high deficits	1,6%	0,9%	2,9%	-2,0%	3,4%	0,2%

In the long term, revenues may help (2025 decision is key);

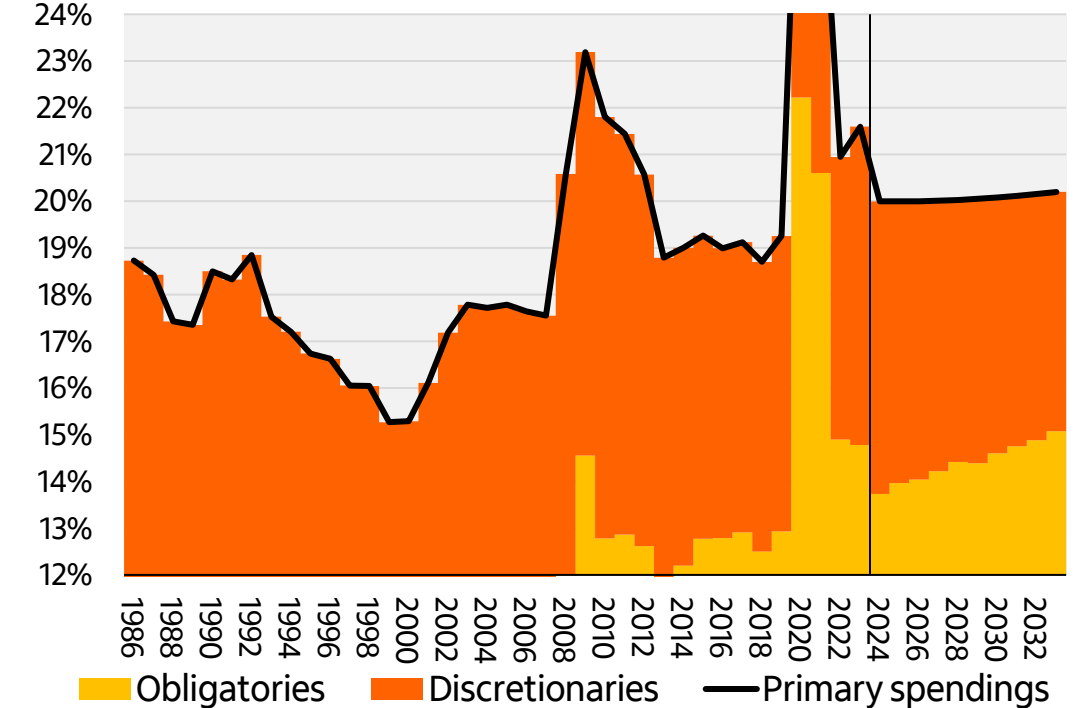
spending is a risk (CBO assumes constant as % of GDP)

- Revenues may increase 1.4 p.p. of GDP vs 2023 to ~18% of GDP for:
 - (i) non-renewal of the 2017 tax act (TCJA) in 25 (0.8 p.p. GDP);
 - (ii) indexation of IRPF just to inflation and not to GDP (0.4 p.p. GDP);
 - (iii) 23 deferral distortions of natural disasters (0.2 p.p. GDP).
- Spending expected to remain at ~20% of GDP, but with a rising increase in mandatory spending (0.15 p.p. of GDP /year on average) for social security and Medicare.

Primary revenues (% GDP)

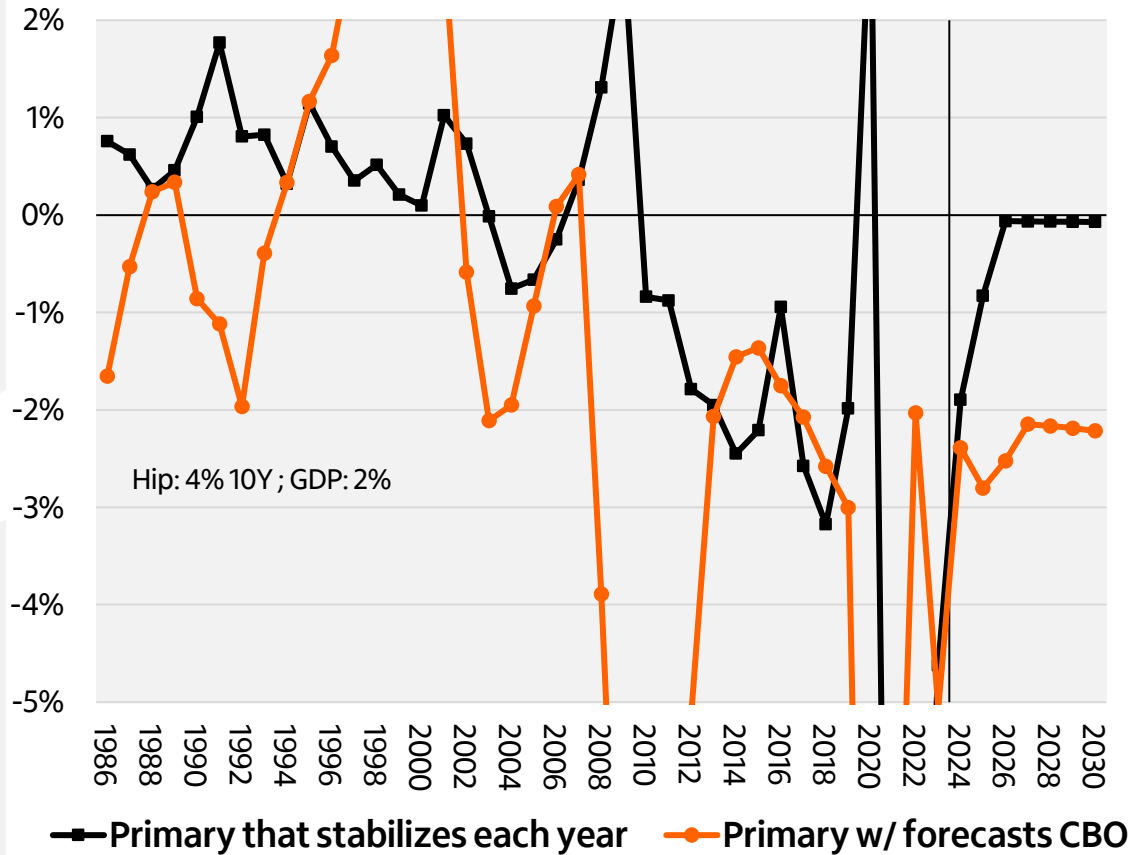


Primary spendings (% GDP)



Debt stability requires an adjustment of ~2-4 p.p. of GDP

Primary and primary that stabilizes debt (% GDP)



US: primary result that stabilizes debt (% GDP)

Total Public Debt (% GDP) current 124%

Primary result (% GDP) current -5.1% Long run CBO -3.0%

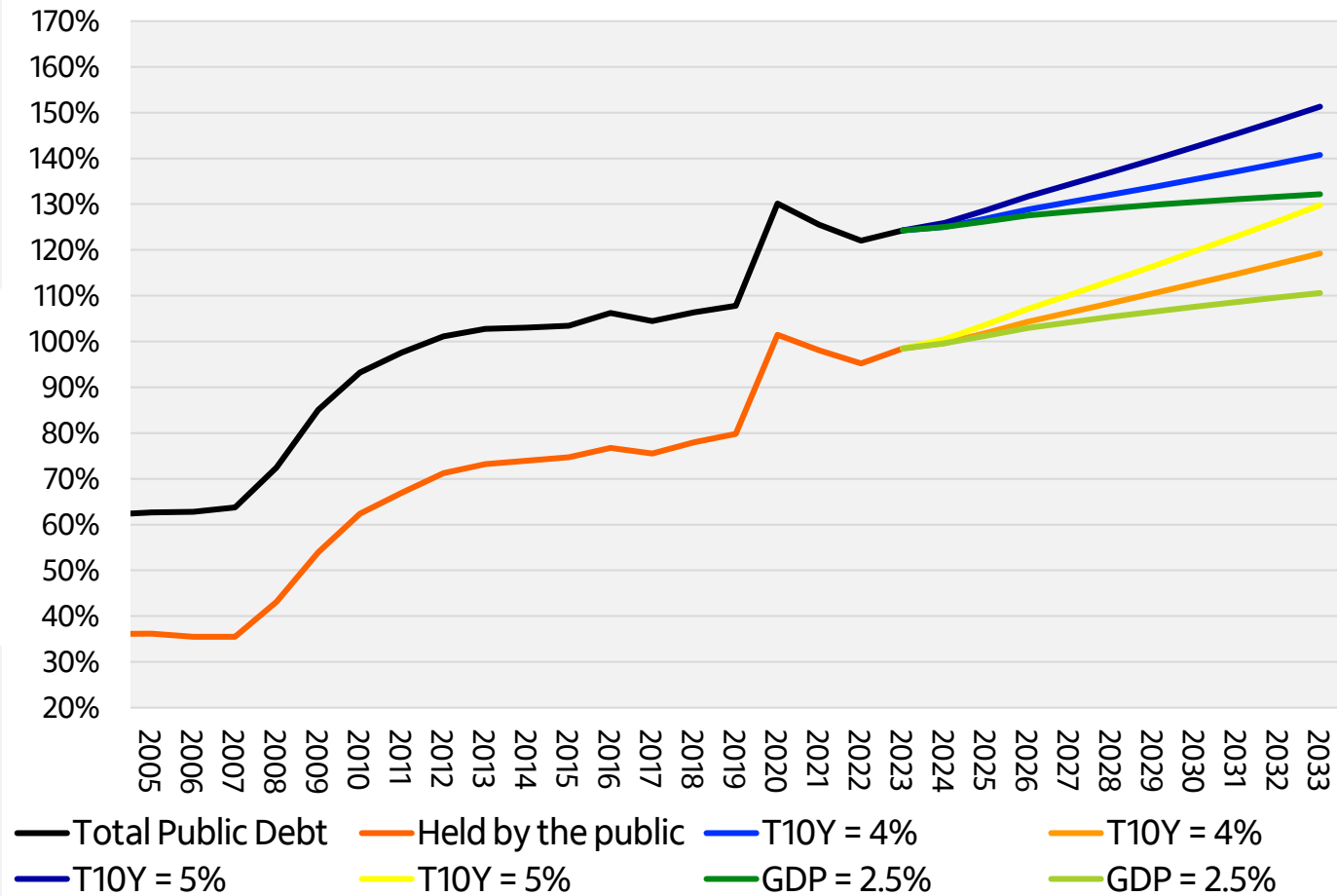
		Real rate (r)					
		0.0%	1.0%	1.5%	2.0%	2.5%	3.0%
GDP (g)	0.0%	0.0%	1.2%	1.9%	2.5%	3.1%	3.7%
	1.0%	-1.2%	0.0%	0.6%	1.2%	1.9%	2.5%
	2.0%	-2.5%	-1.2%	-0.6%	0.0%	0.6%	1.2%
	2.5%	-3.1%	-1.9%	-1.2%	-0.6%	0.0%	0.6%
	3.0%	-3.7%	-2.5%	-1.9%	-1.2%	-0.6%	0.0%

US: Necessary adjustment vs projection CBO (% GDP)

		Real rate (r)					
		0.0%	1.0%	1.5%	2.0%	2.5%	3.0%
GDP (g)	0.0%	3.0%	4.2%	4.9%	5.5%	6.1%	6.7%
	1.0%	1.8%	3.0%	3.6%	4.2%	4.9%	5.5%
	2.0%	0.5%	1.8%	2.4%	3.0%	3.6%	4.2%
	2.5%	-0.1%	1.1%	1.8%	2.4%	3.0%	3.6%
	3.0%	-0.7%	0.5%	1.1%	1.8%	2.4%	3.0%

1 p.p. of real rate = 0.5 p.p. of GDP = +/- 10 p.p. of GDP in 10 years debt

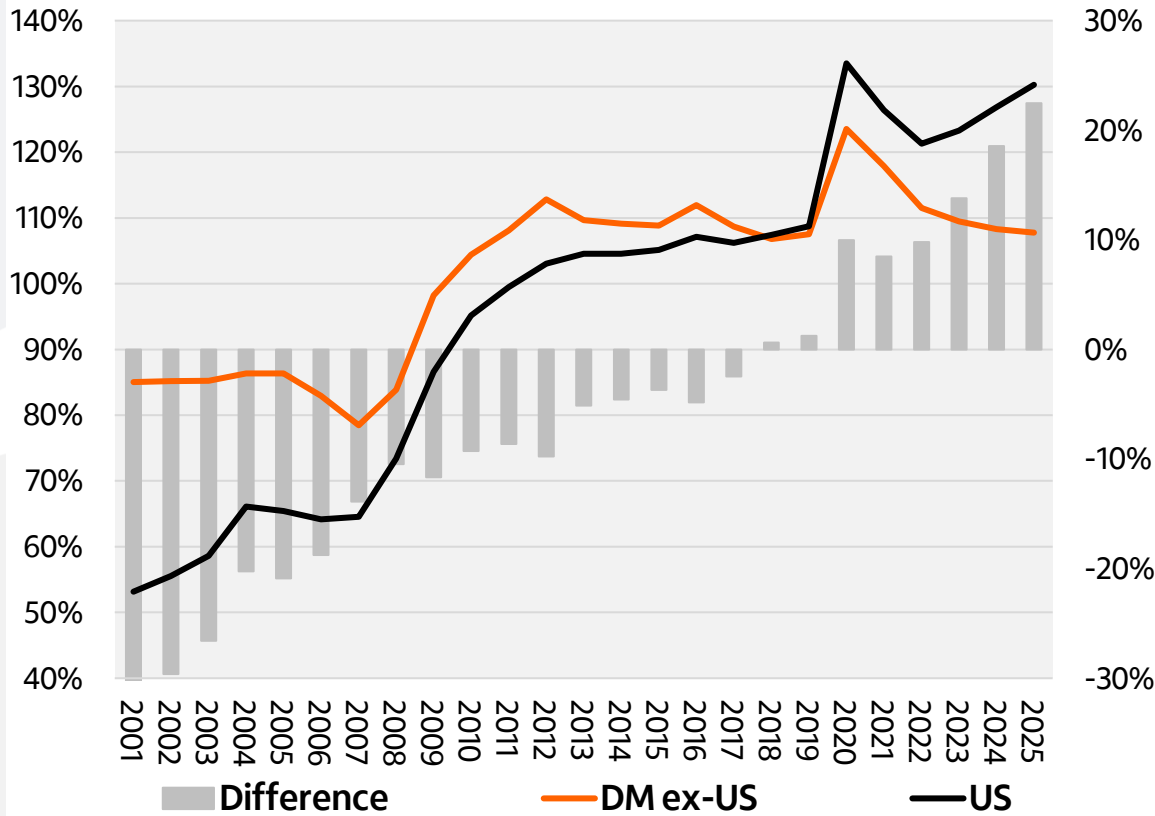
US public debt paths (% GDP)



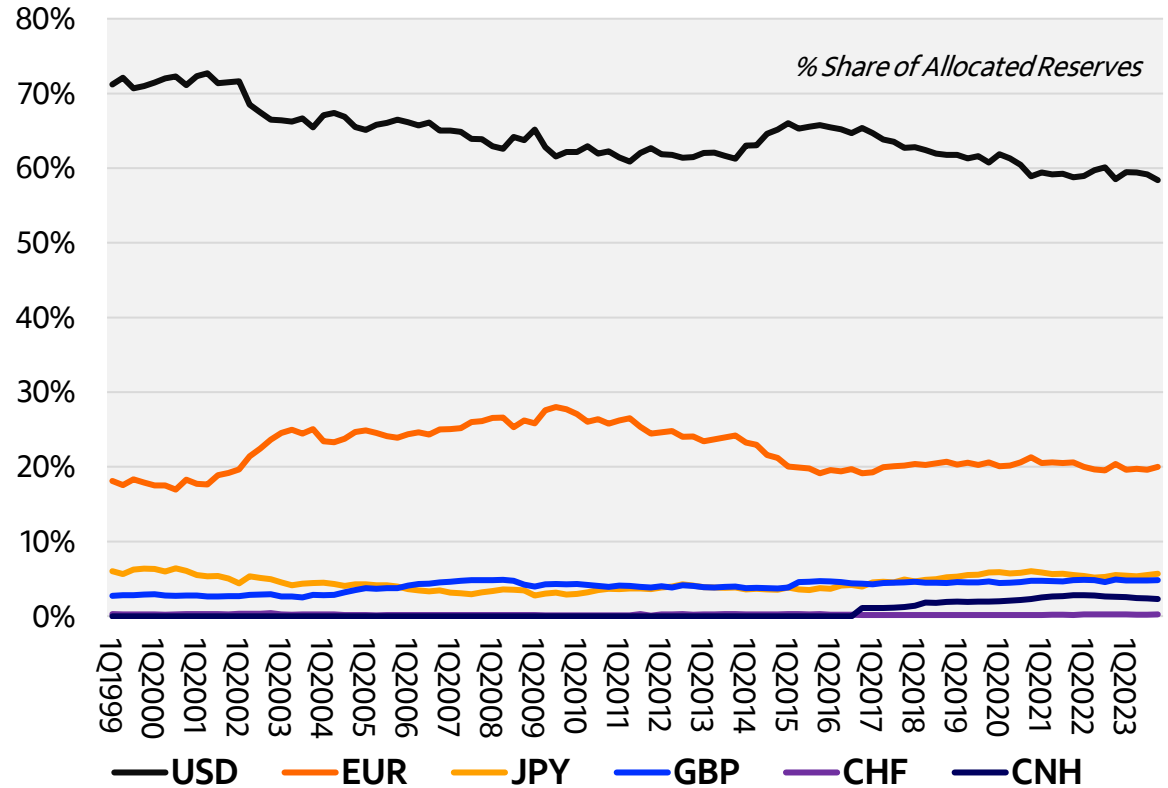
Fiscal crisis seems unlikely:

although bad dynamic, there are no signs of USD flights

Gross debt US x other DM's



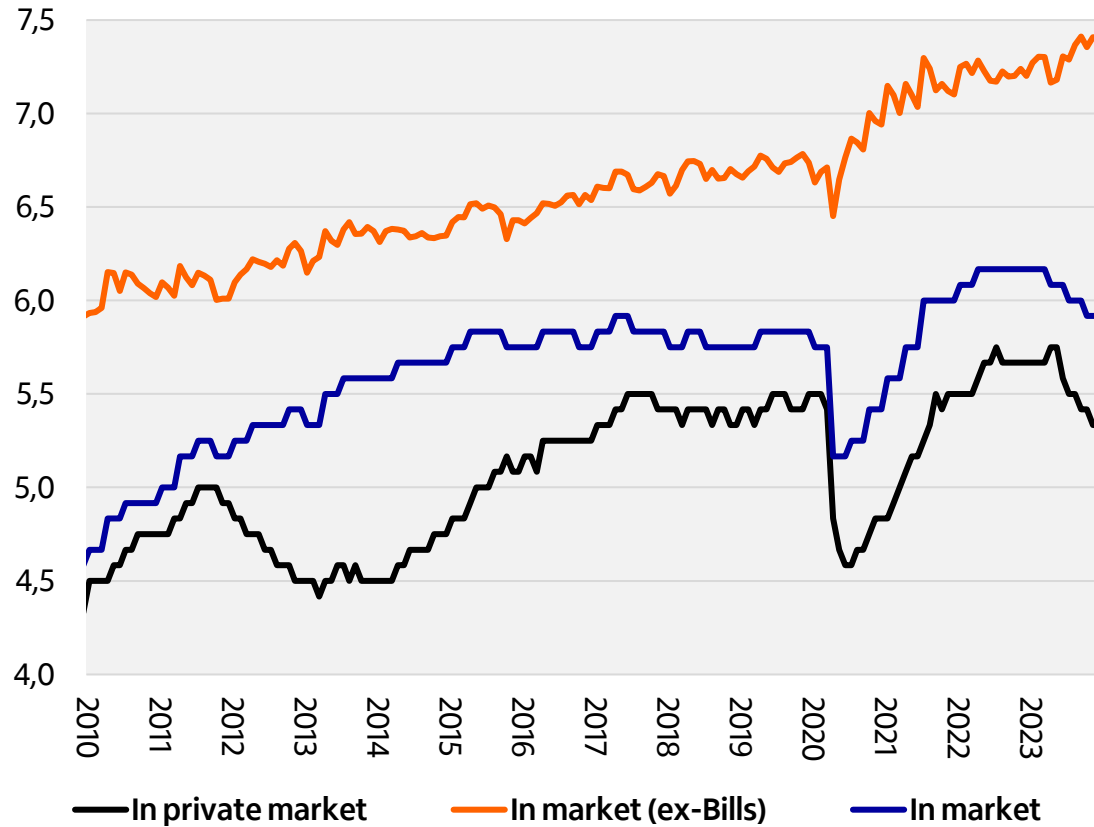
Global Foreign Exchange Reserves



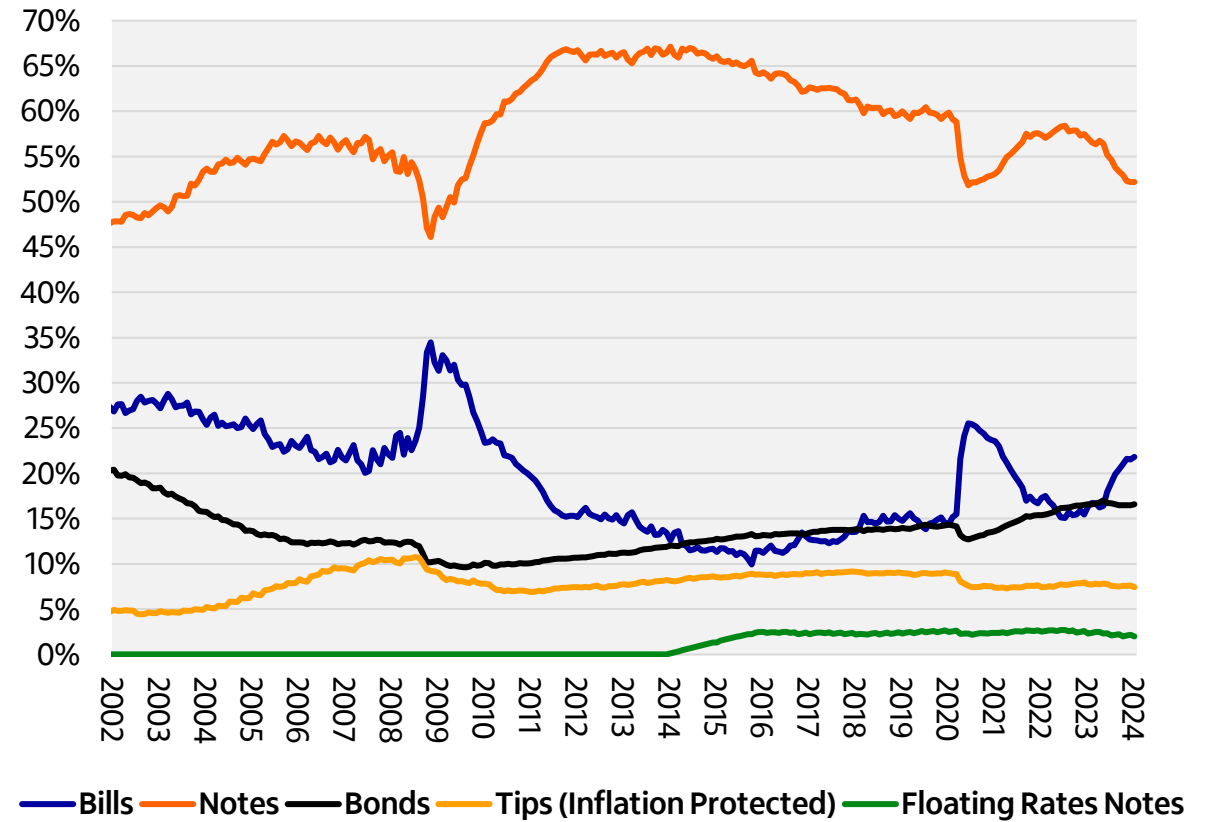
Source: COFER IMF

Shortening at the margin, but with no signs of search for inflation protection

Average Debt Maturity (years)



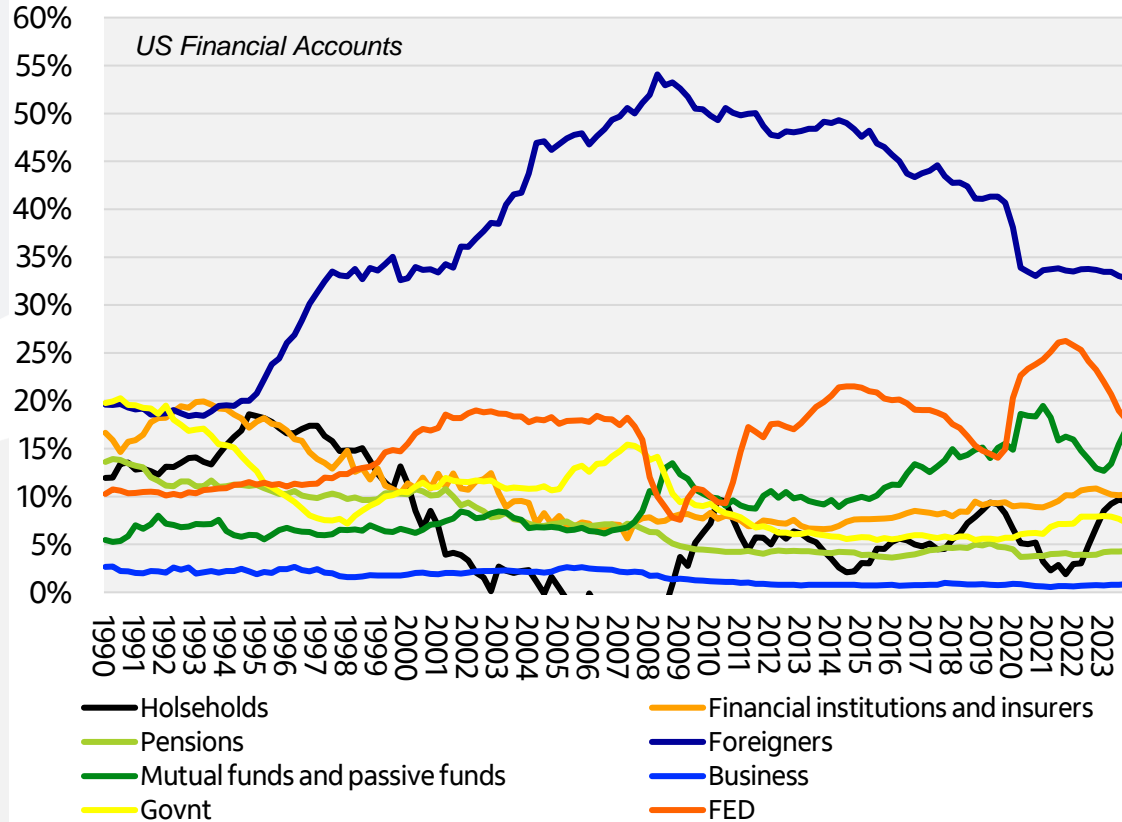
Composition of public debt securities held by the public



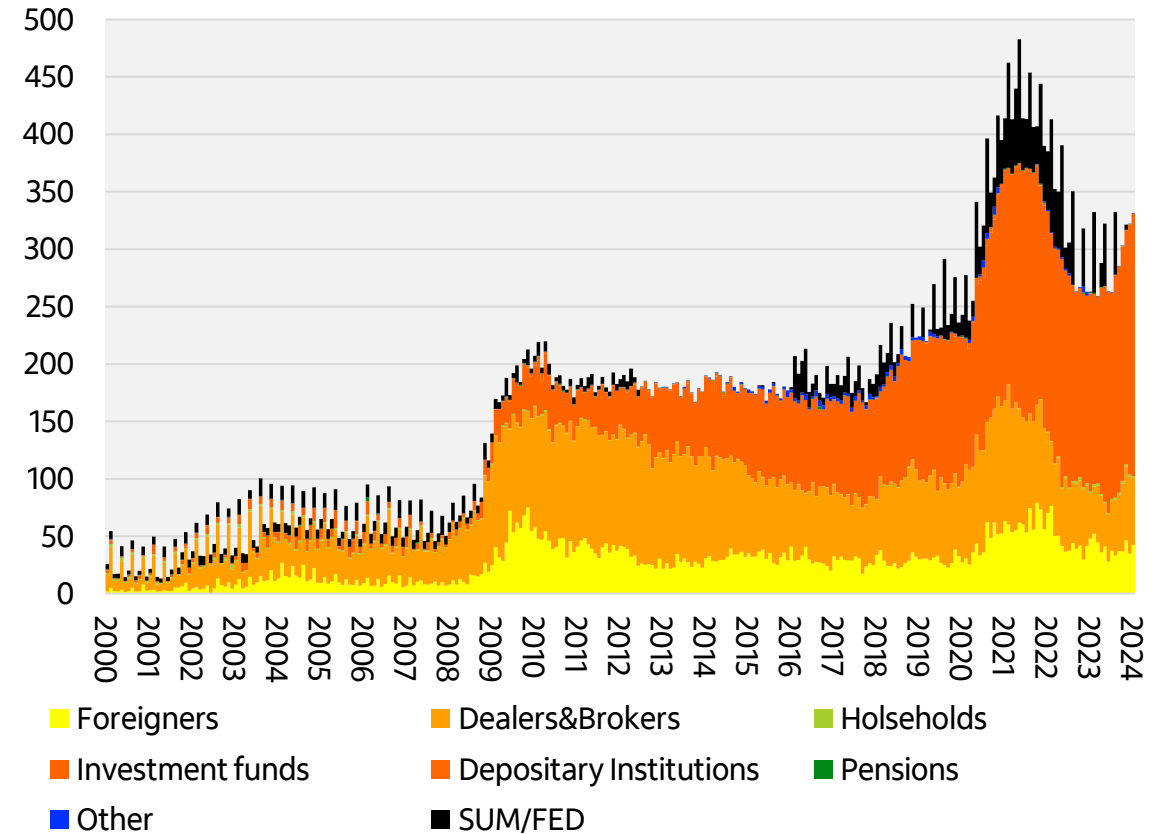
Foreigner lower participation in Treasuries holdings:

Foreign didn't keep up with increasing issuance

US Treasuries securities holders

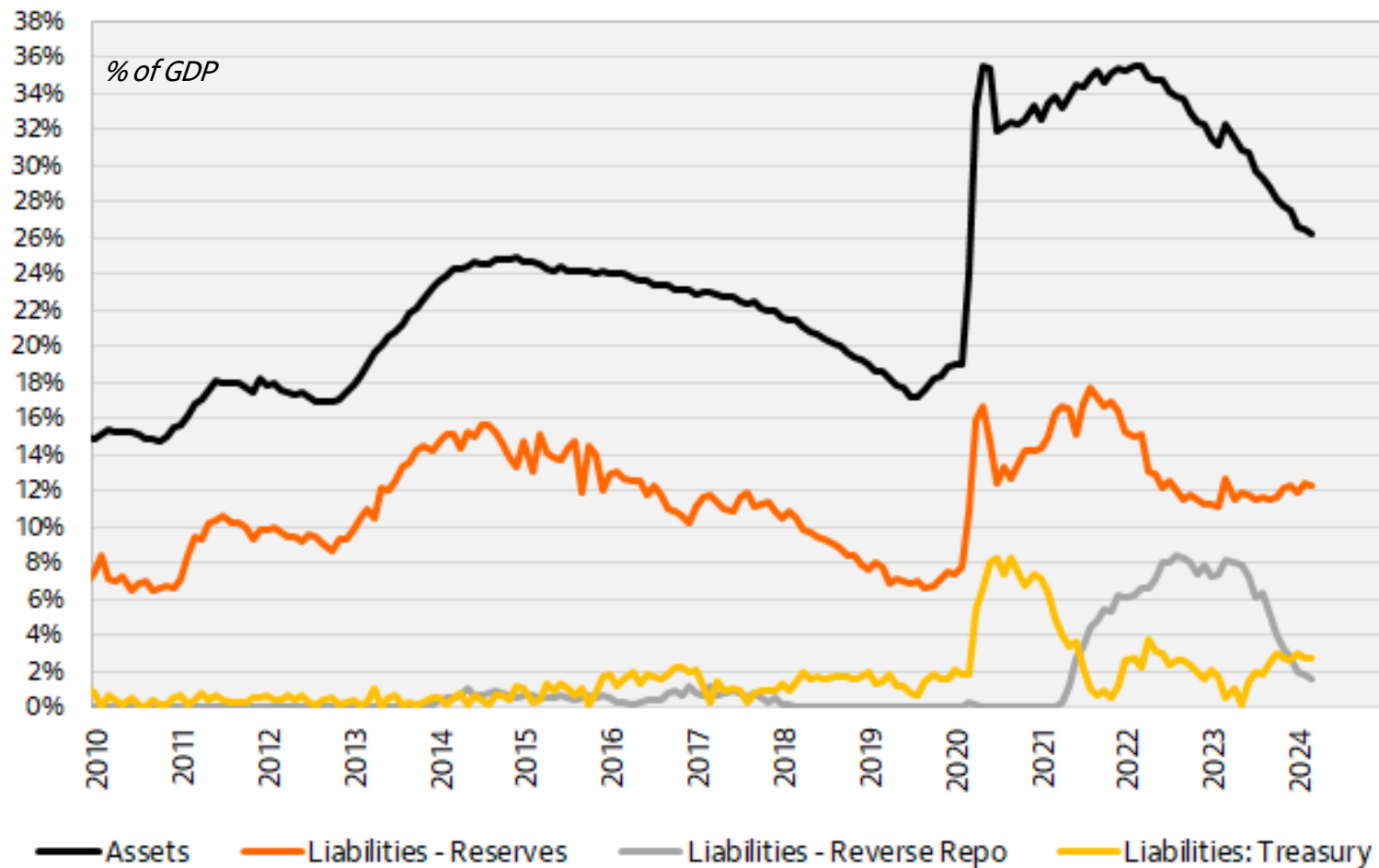


Participation in primary auctions (ex-bills)



Decrease in the Fed's balance sheet

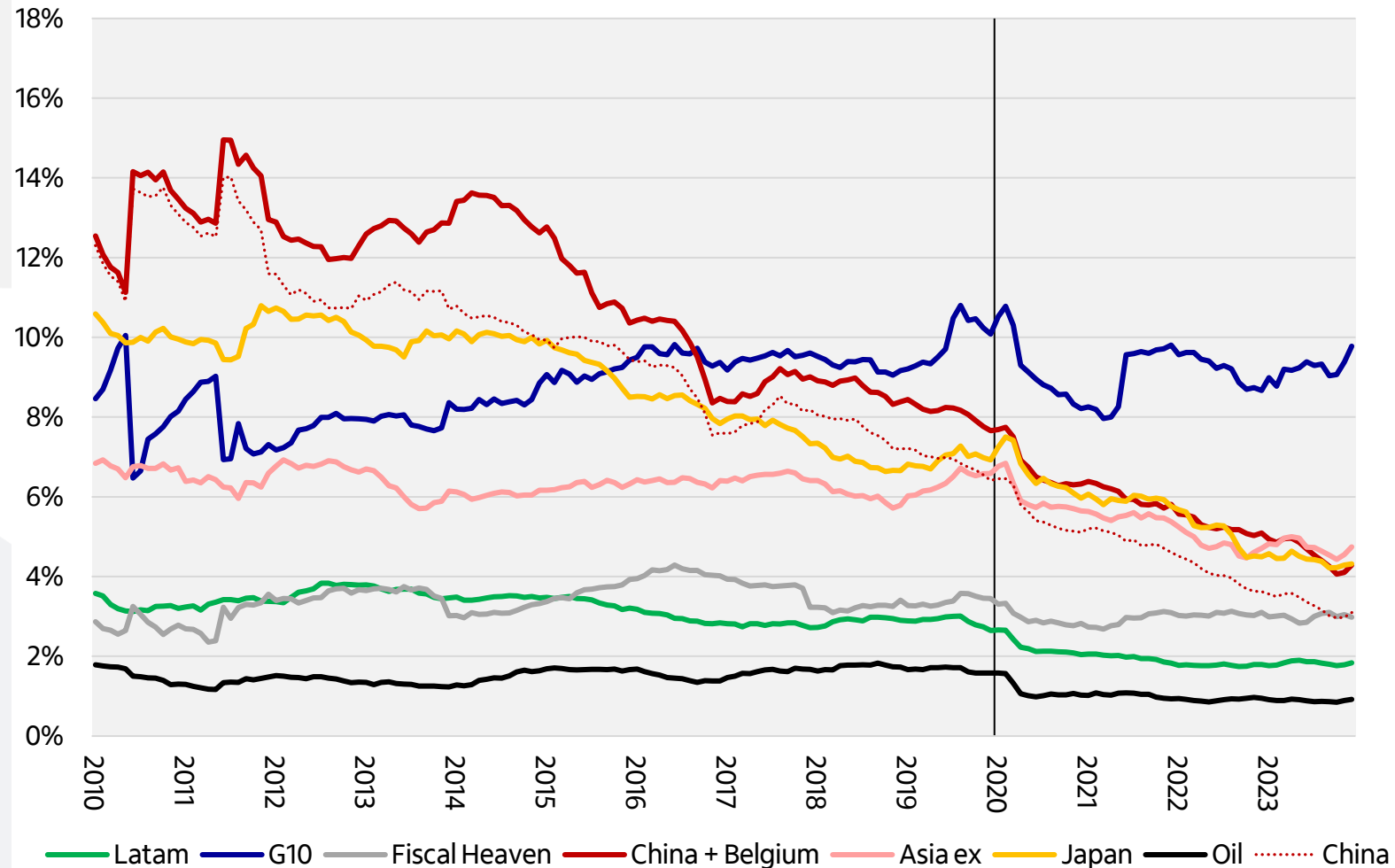
Fed balance sheet: assets, reserves and reverserepo



Any geopolitical influence?

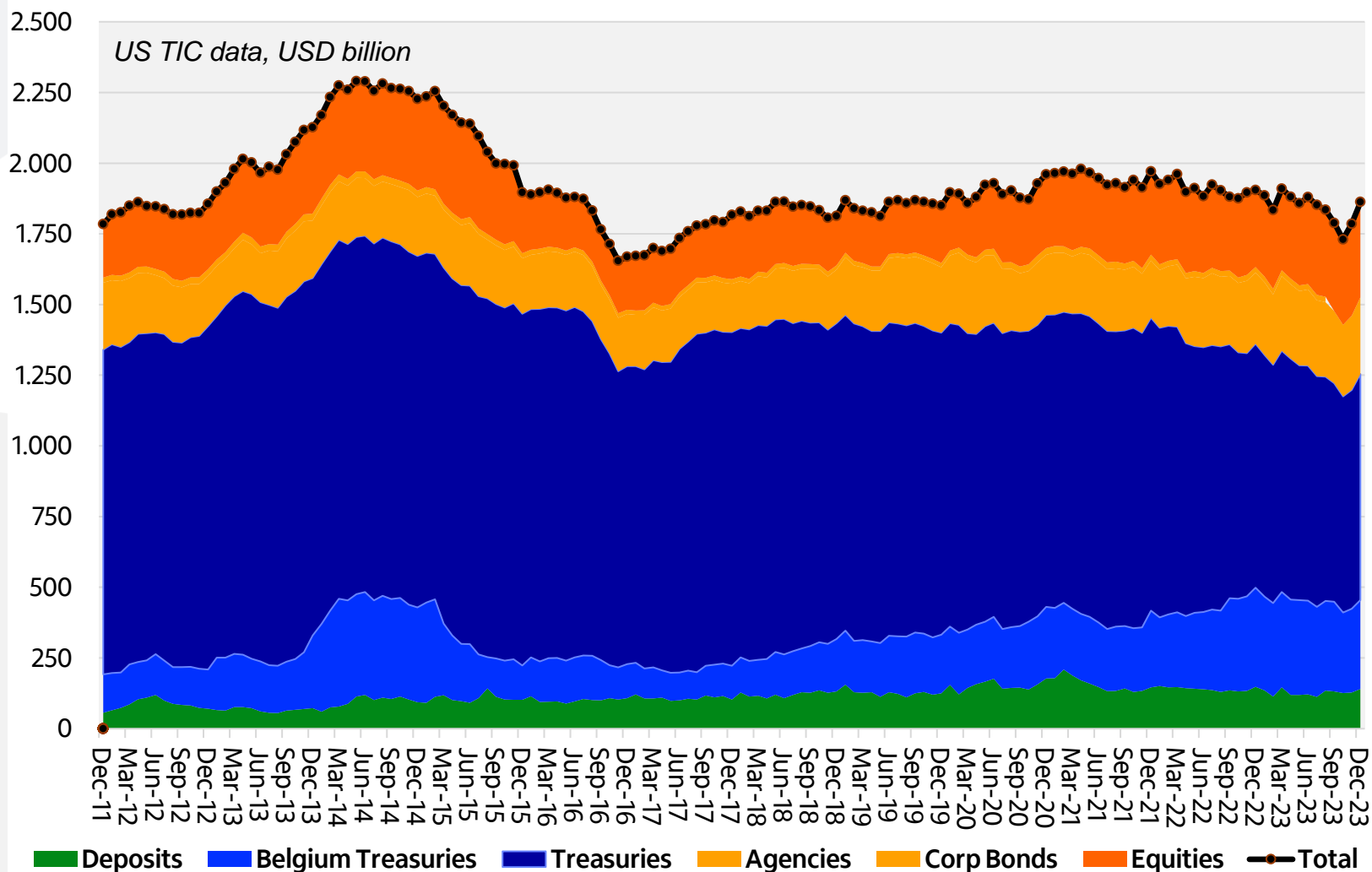
Recent data is not showing deliberate selling from China

Share by country (% securities debt ex-FED)



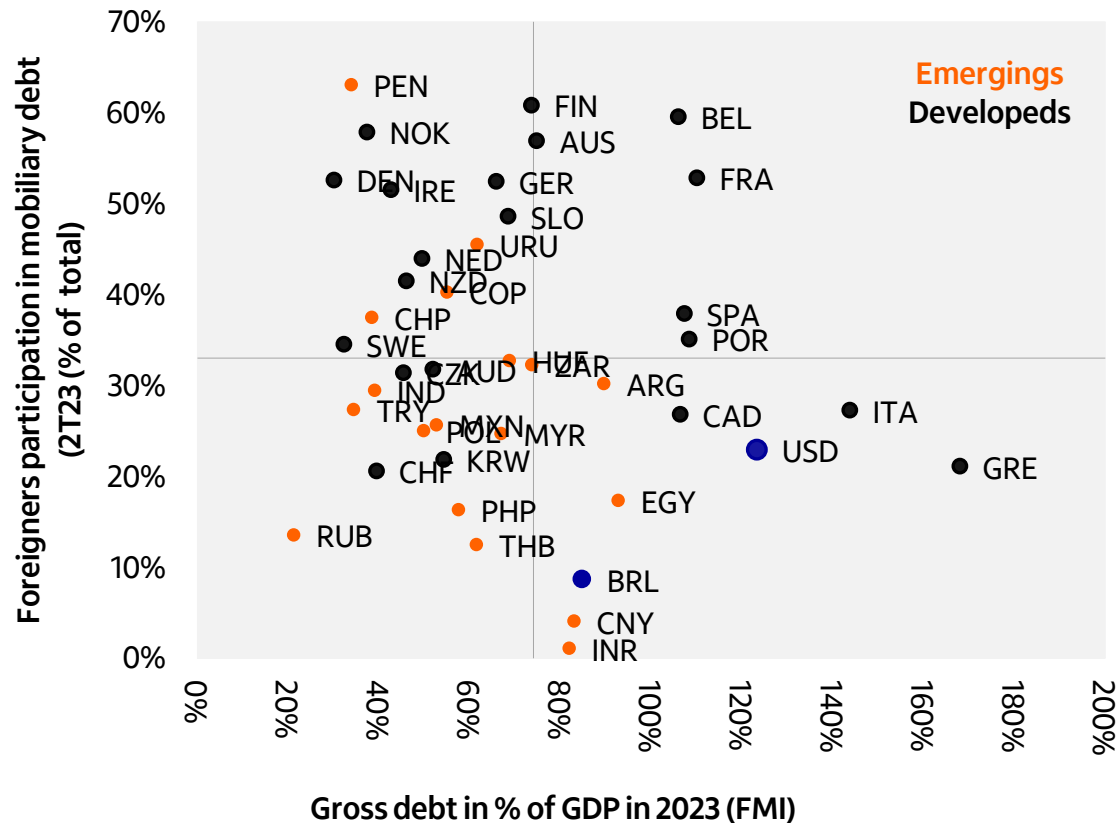
When all assets are aggregated together, China is not reducing total exposure to the US

Chinese holdings of US assets in the US monthly survey

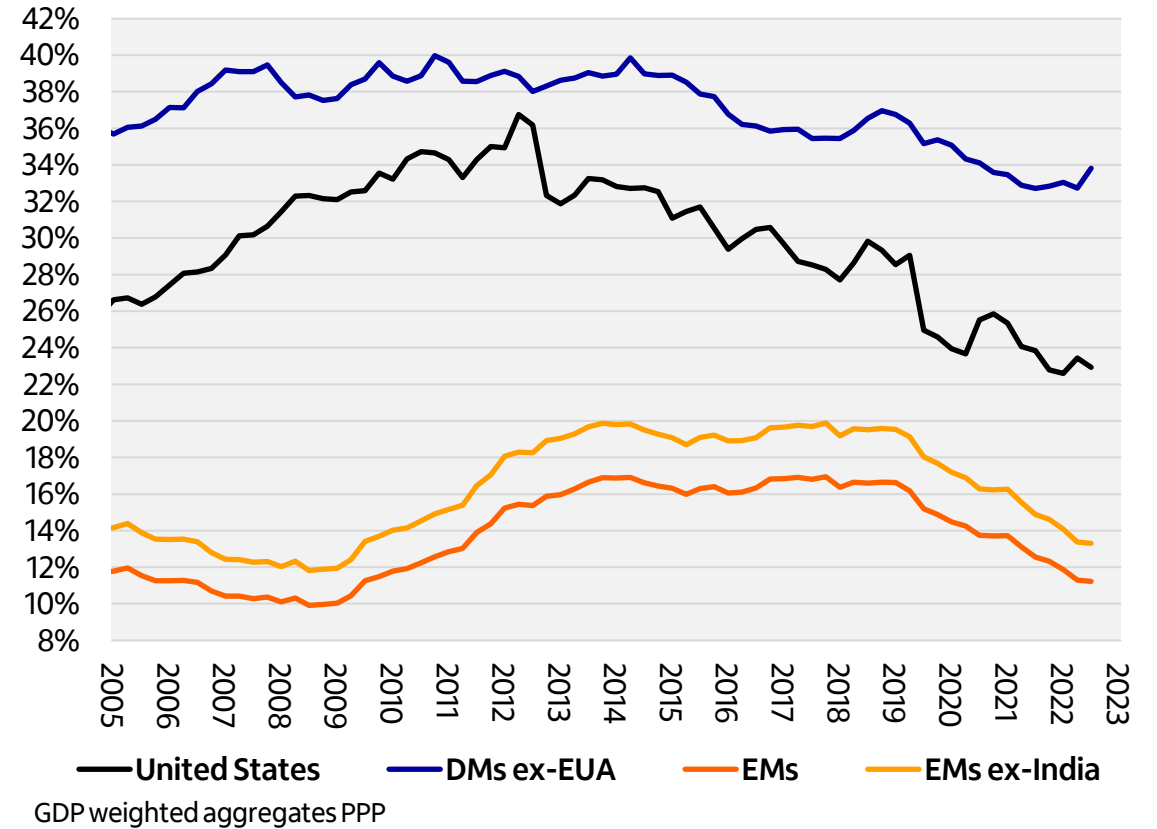


Foreign participation: lower than DMs, but a global downward common trend

Foreigners participation and debt

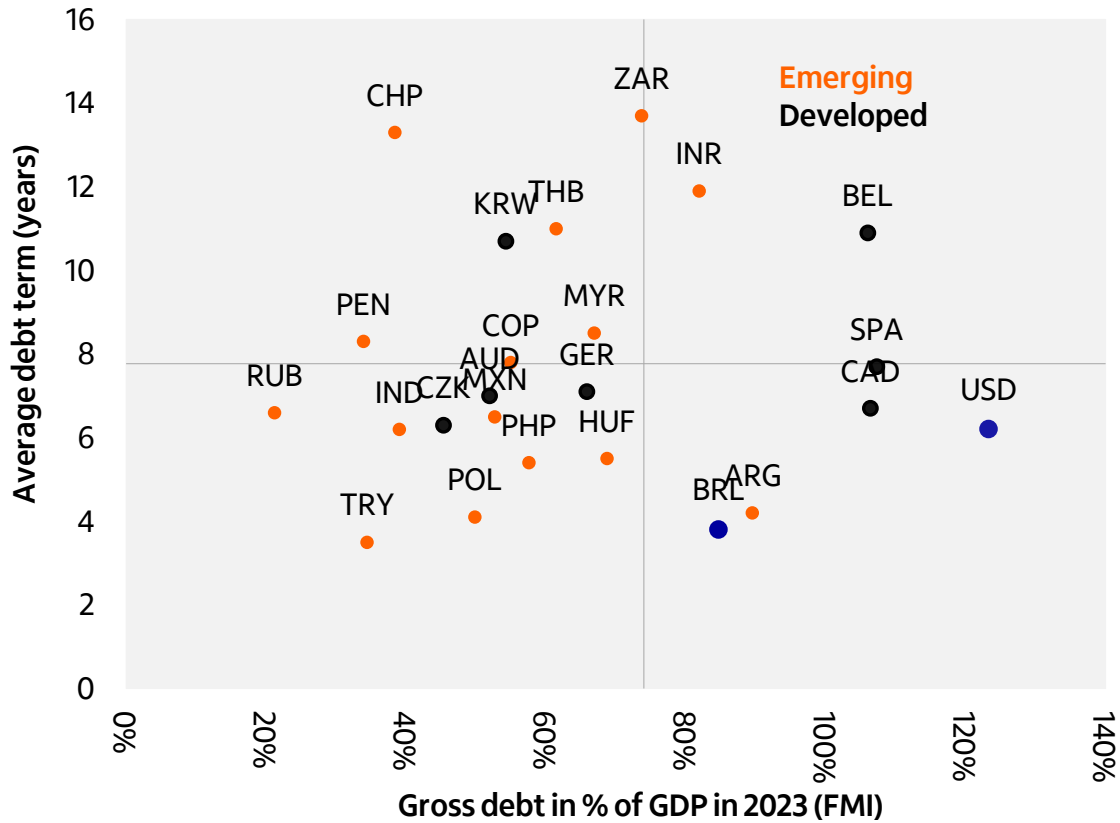


Foreigners participation in securities debt (%)

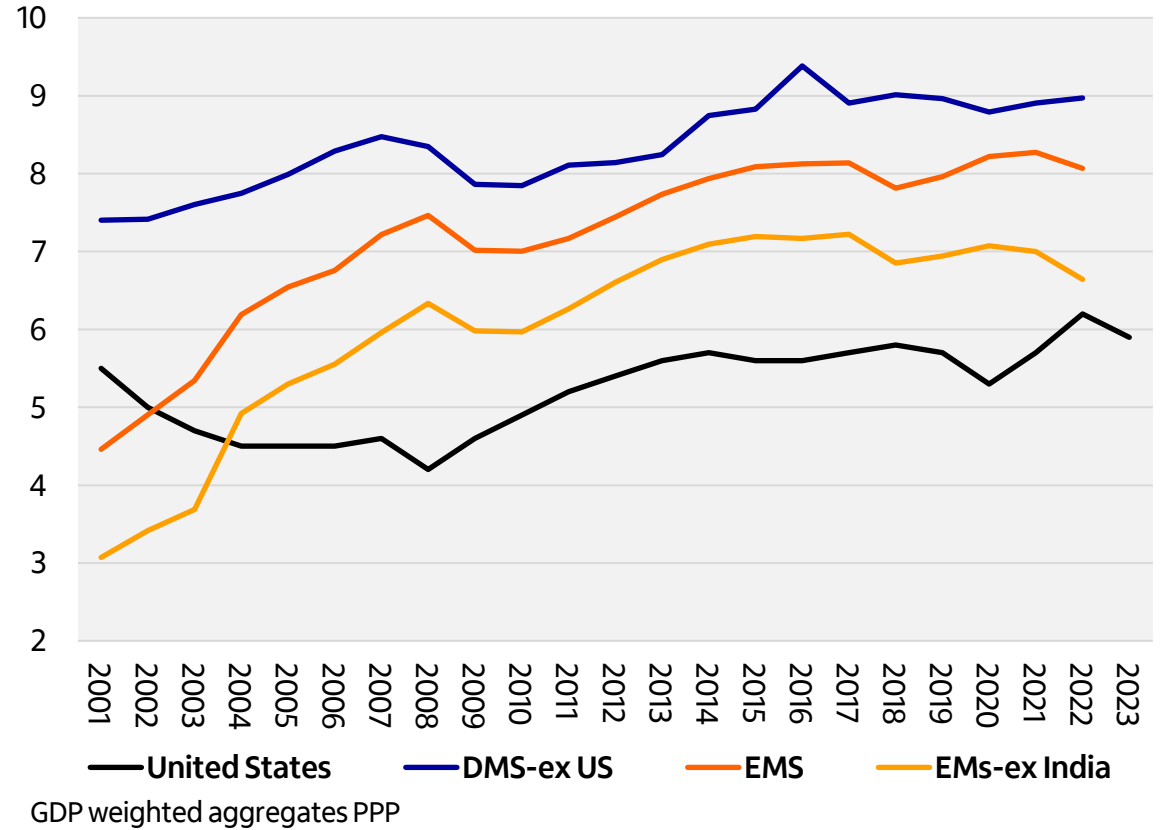


Low average debt maturity compared to developed countries, but not worsening

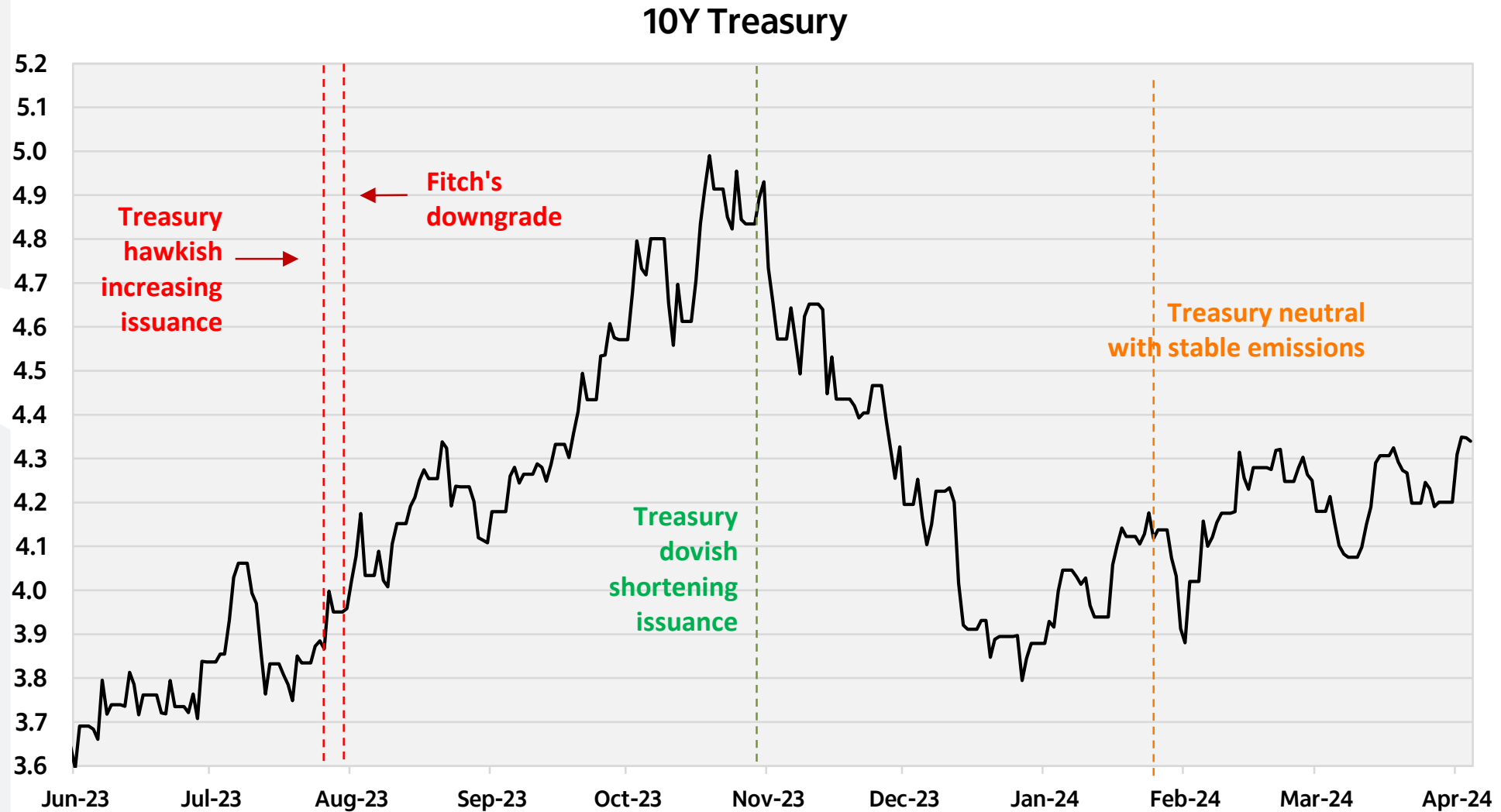
Average debt term



Average debt term (in years)



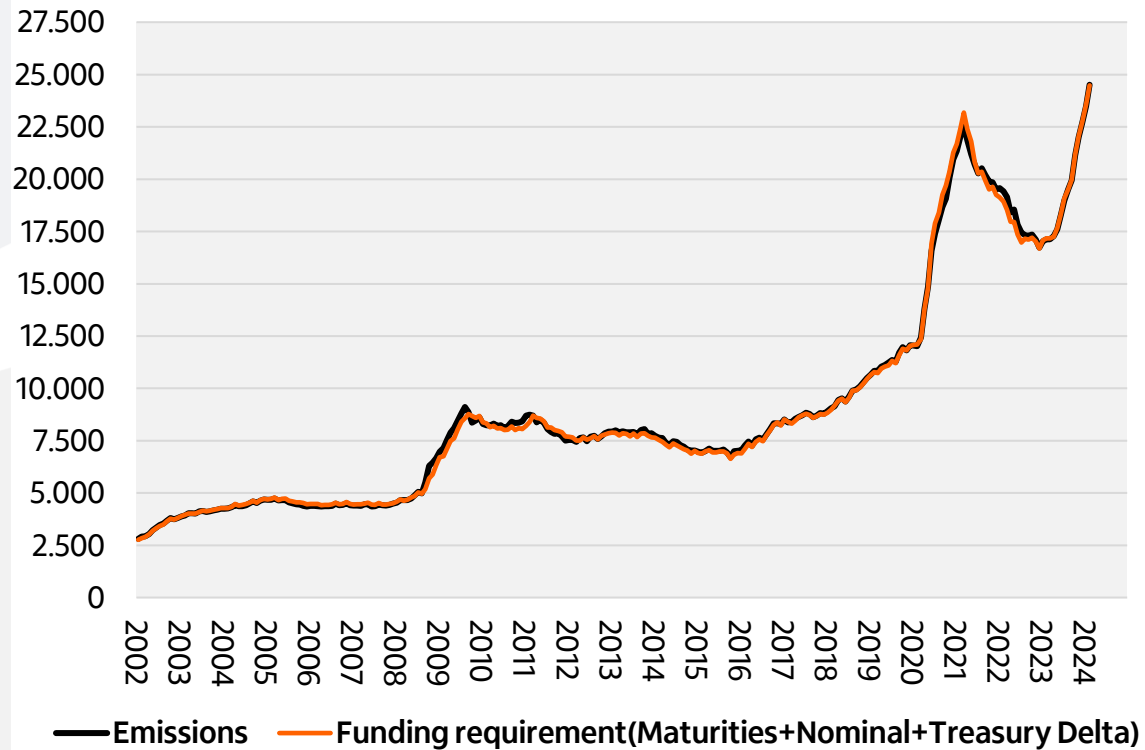
Yet, fiscal events impacting asset prices recently



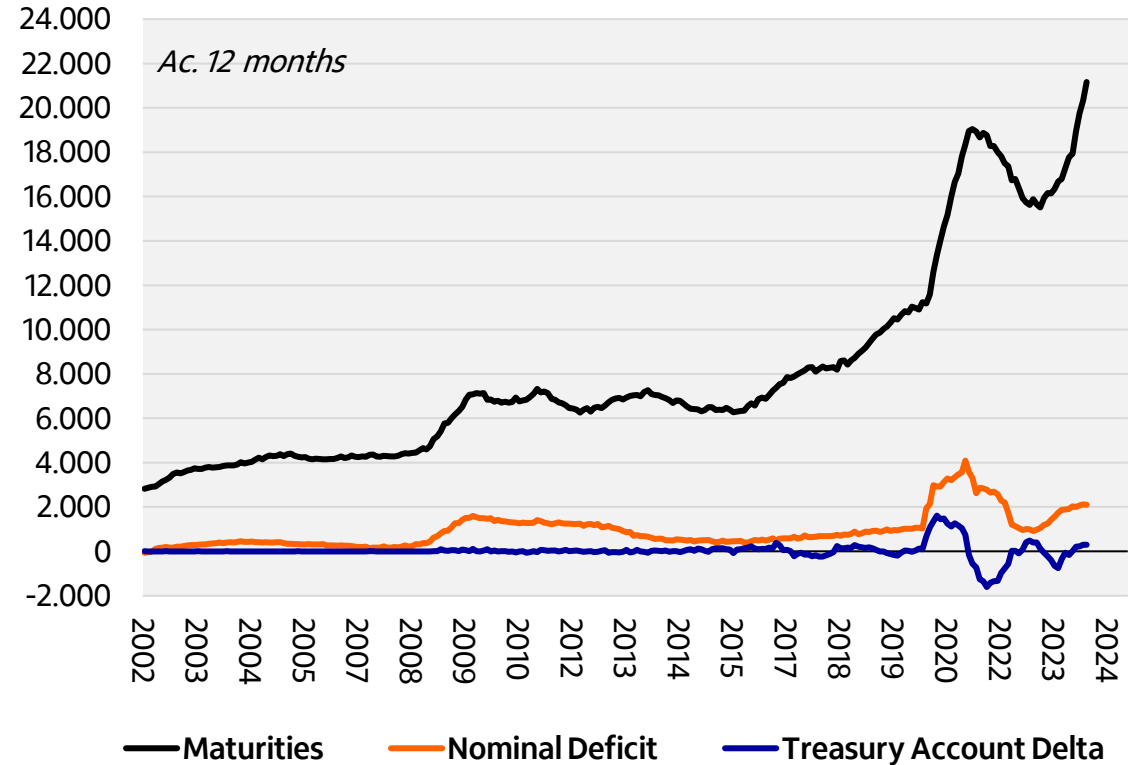
Issuance increasing

In USD 25 tri (85% GDP) (nominal 2 tri (8% GDP) + earnings 21 tri (77% GDP) (short term including) + delta Treasury account 0 tri)

Emissions and proxy borrowing requirement (USD bn)

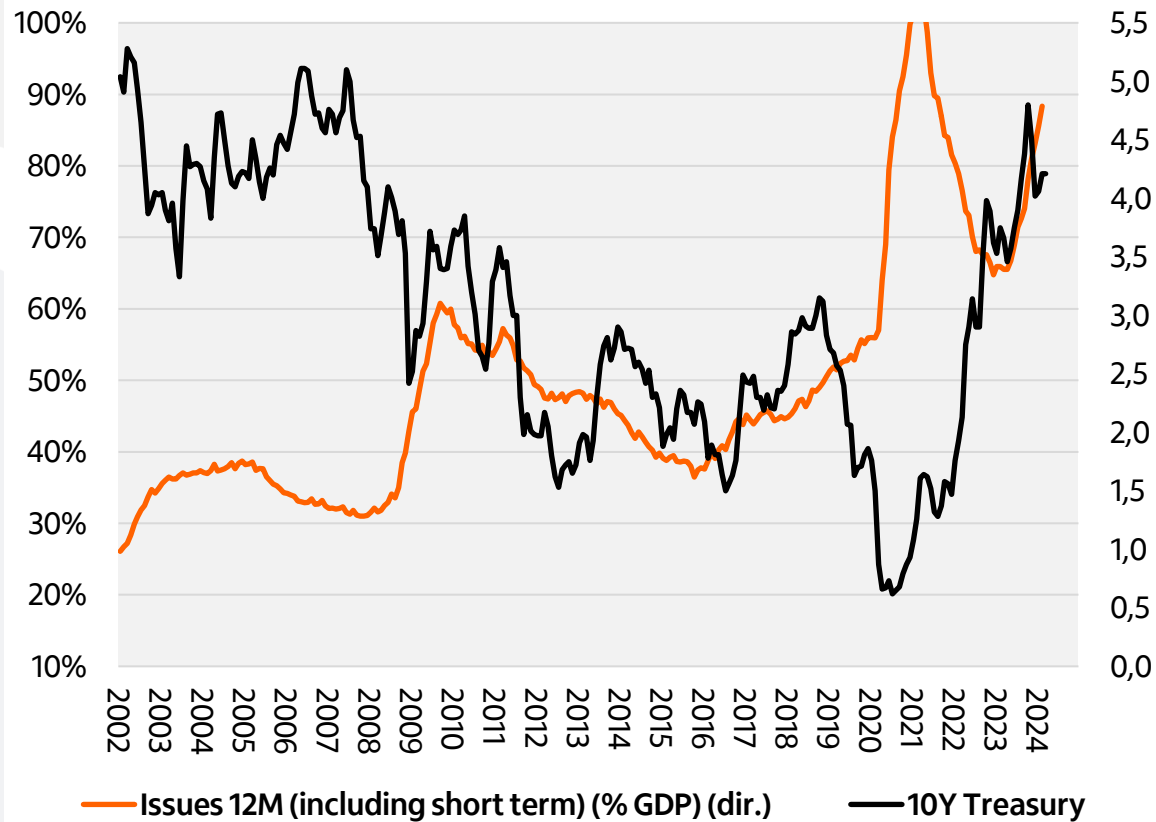


Borrowing requirement (USD bn)

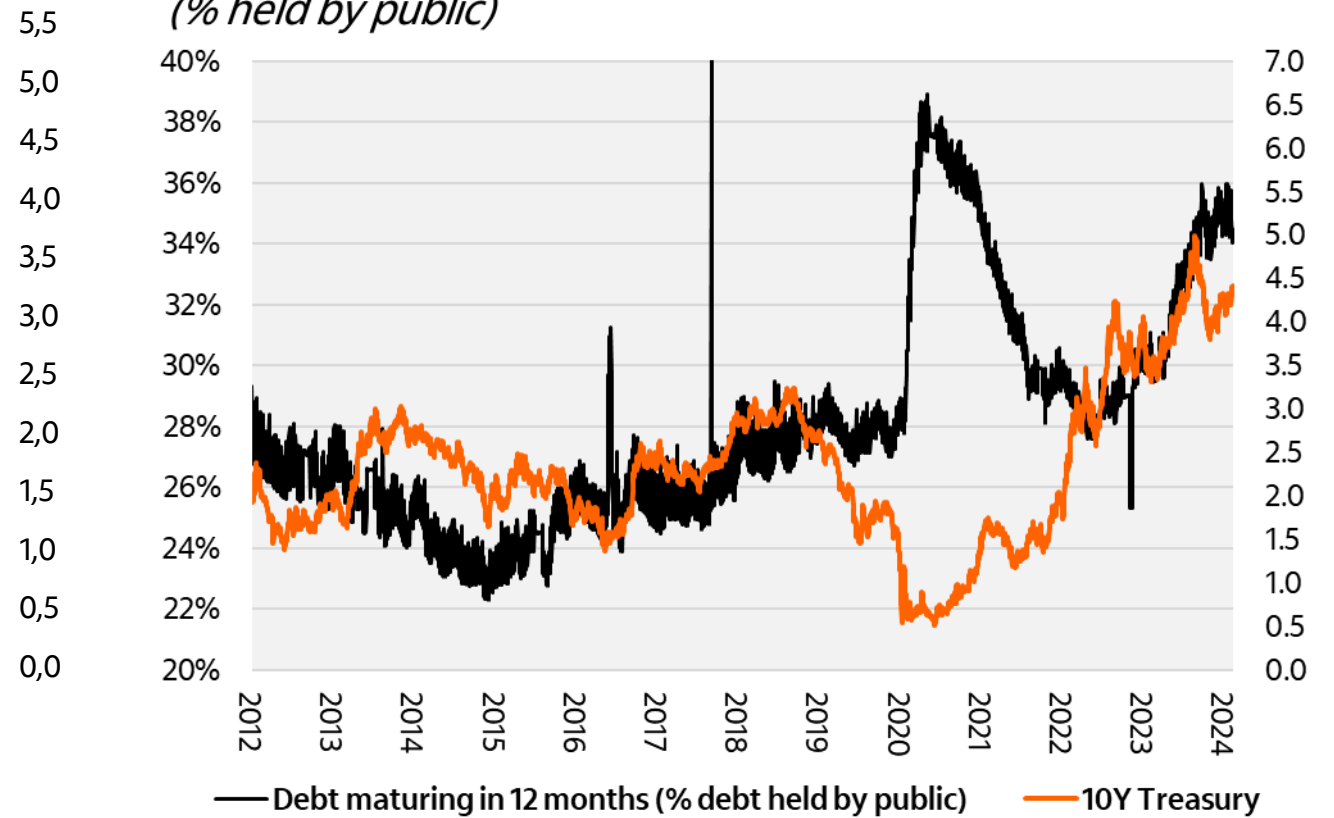


Issuance increase is pressuring rates

Treasury 10Y and Issues in 12m (% GDP)

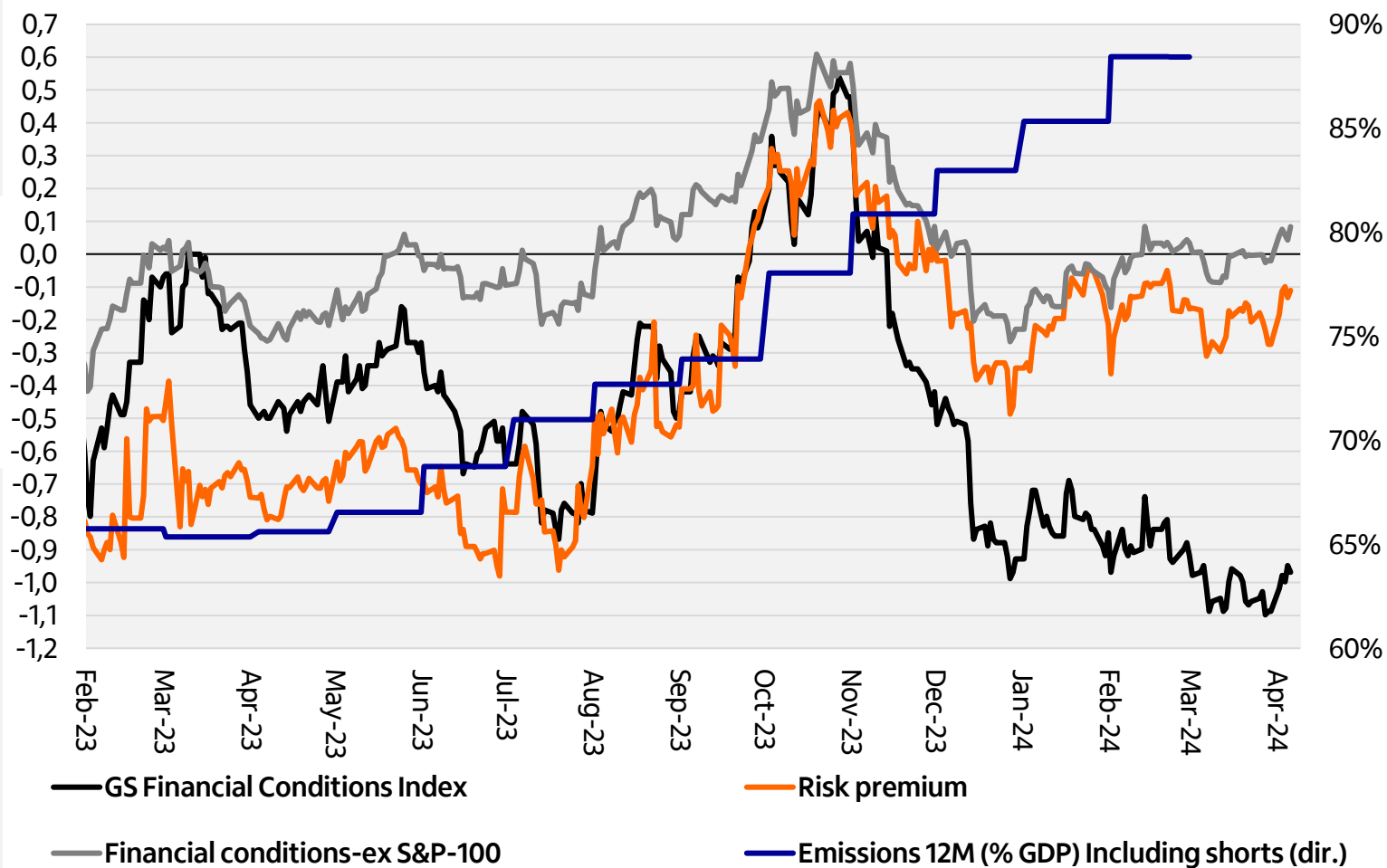


Treasury 10Y and debt maturing in 12m (% held by public)



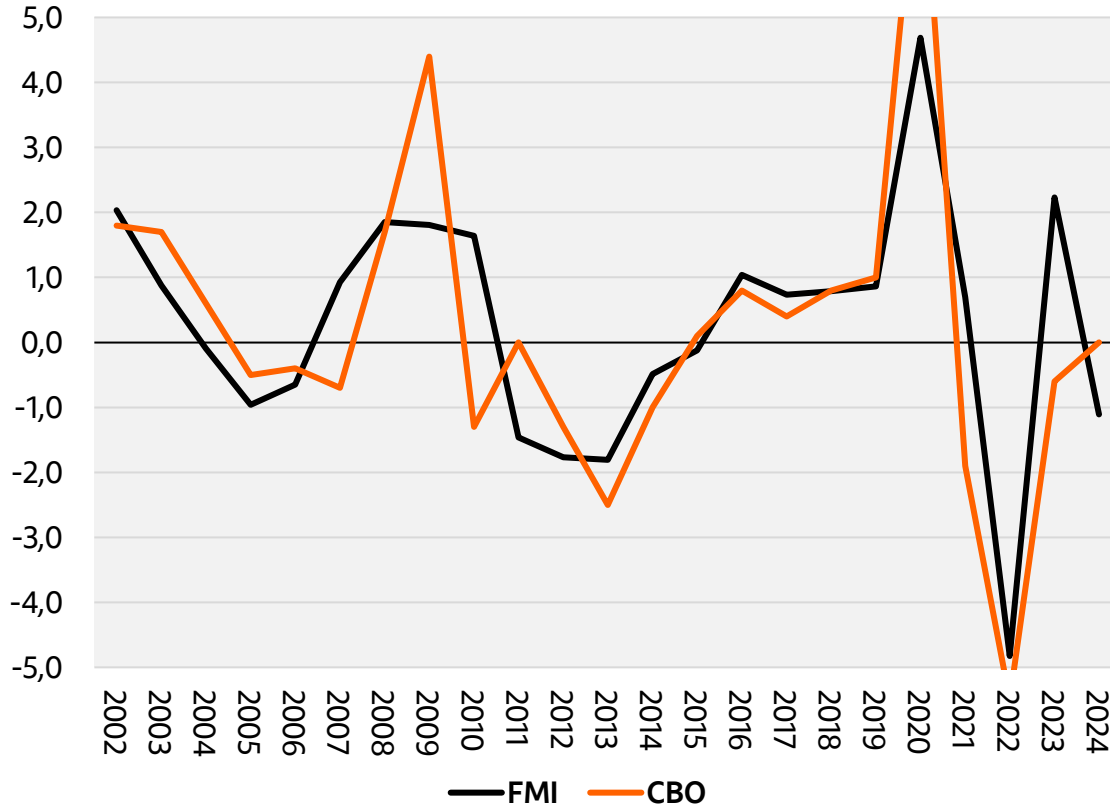
Issuance increase pressured financial conditions in 2H23

Financial conditions and risk premium

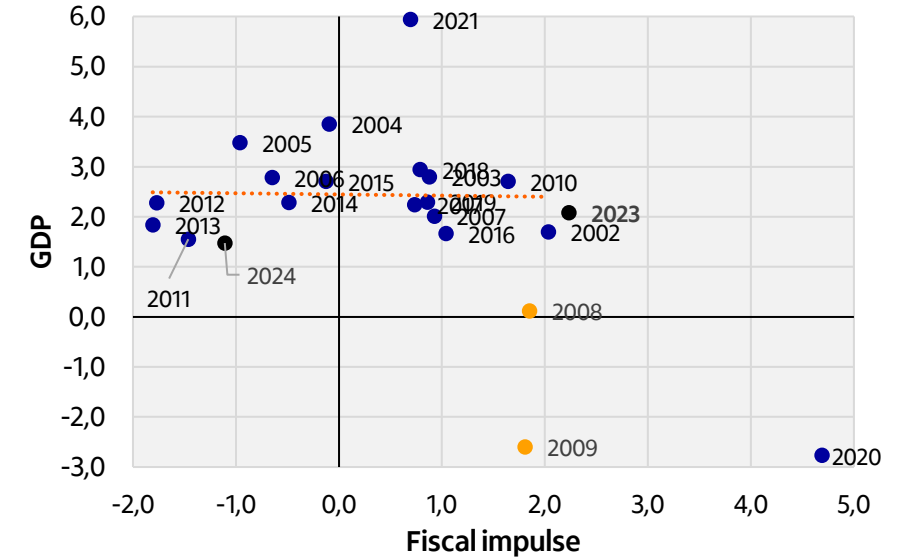


Fiscal deterioration impact on activity is not clear in fiscal impulse metrics (FMI/CBO)

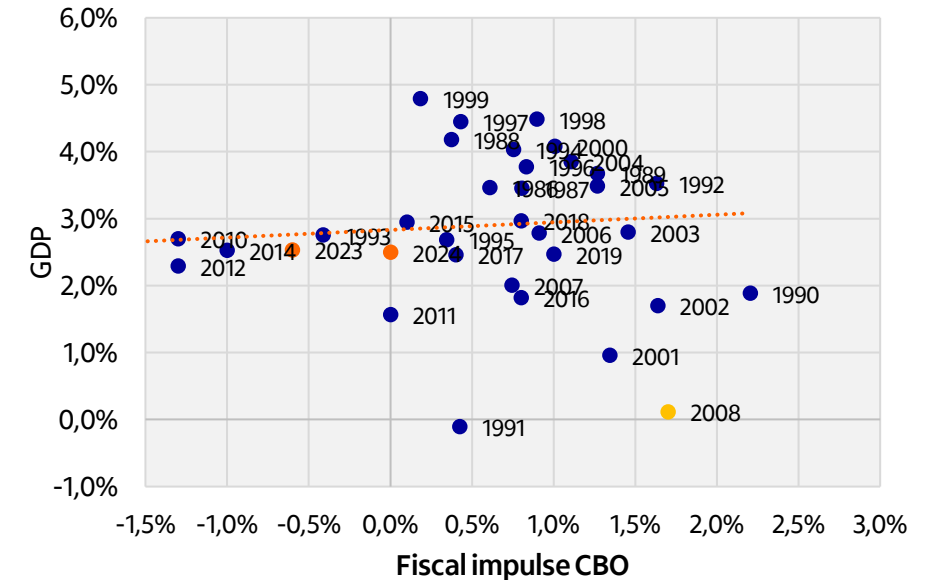
Fiscal impulse



GDP and fiscal impulse FMI

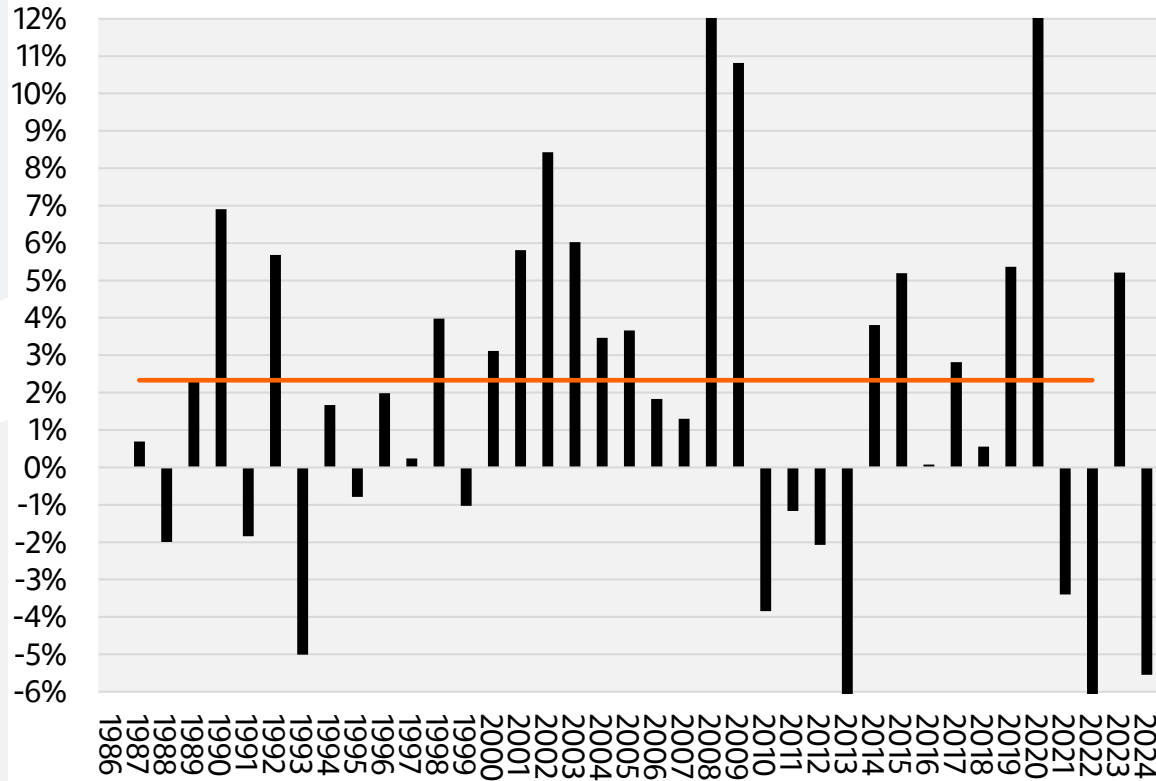


GDP and fiscal impulse US CBO

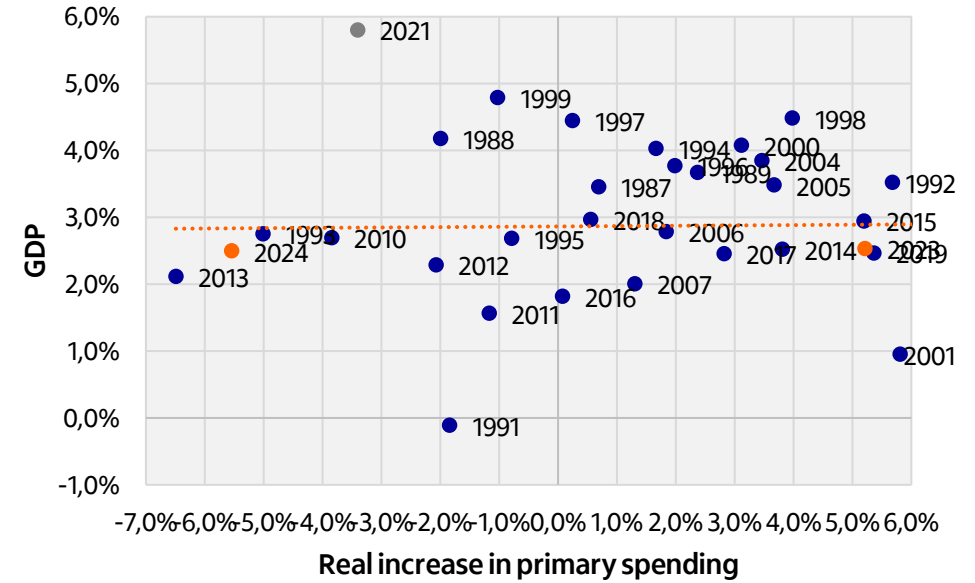


Fiscal deterioration impact on activity is not clear in real spending growth metrics

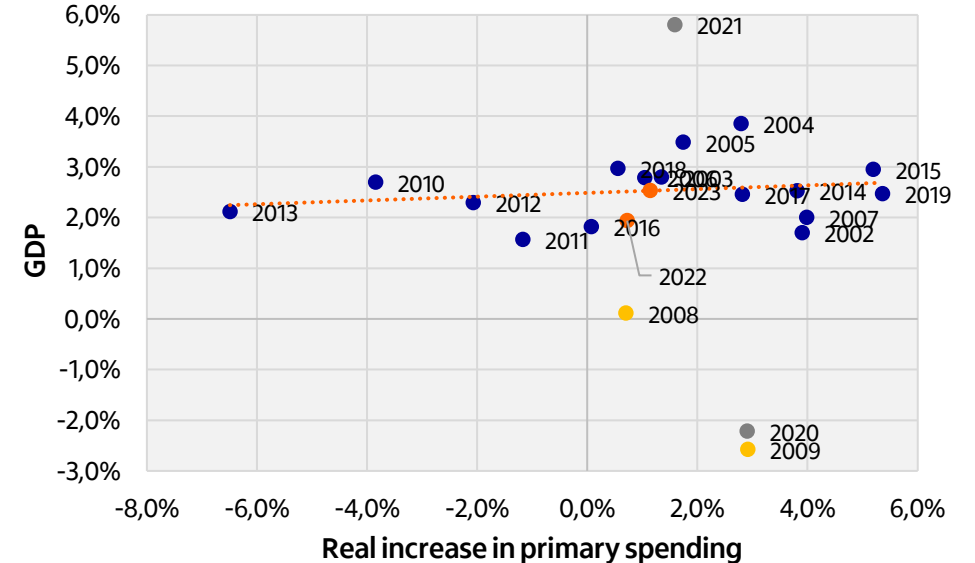
Real increase in federal primary spending (% yoy)



GDP and real increase in federal primary spending



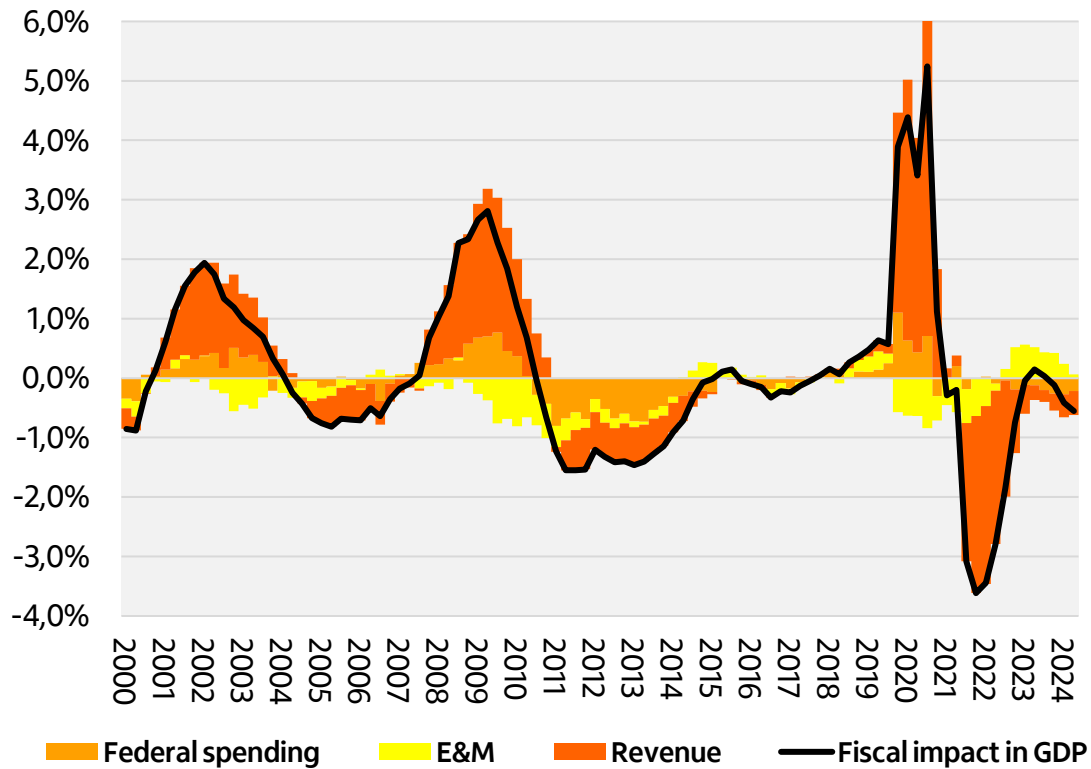
GDP and real increase in primary spending E&M



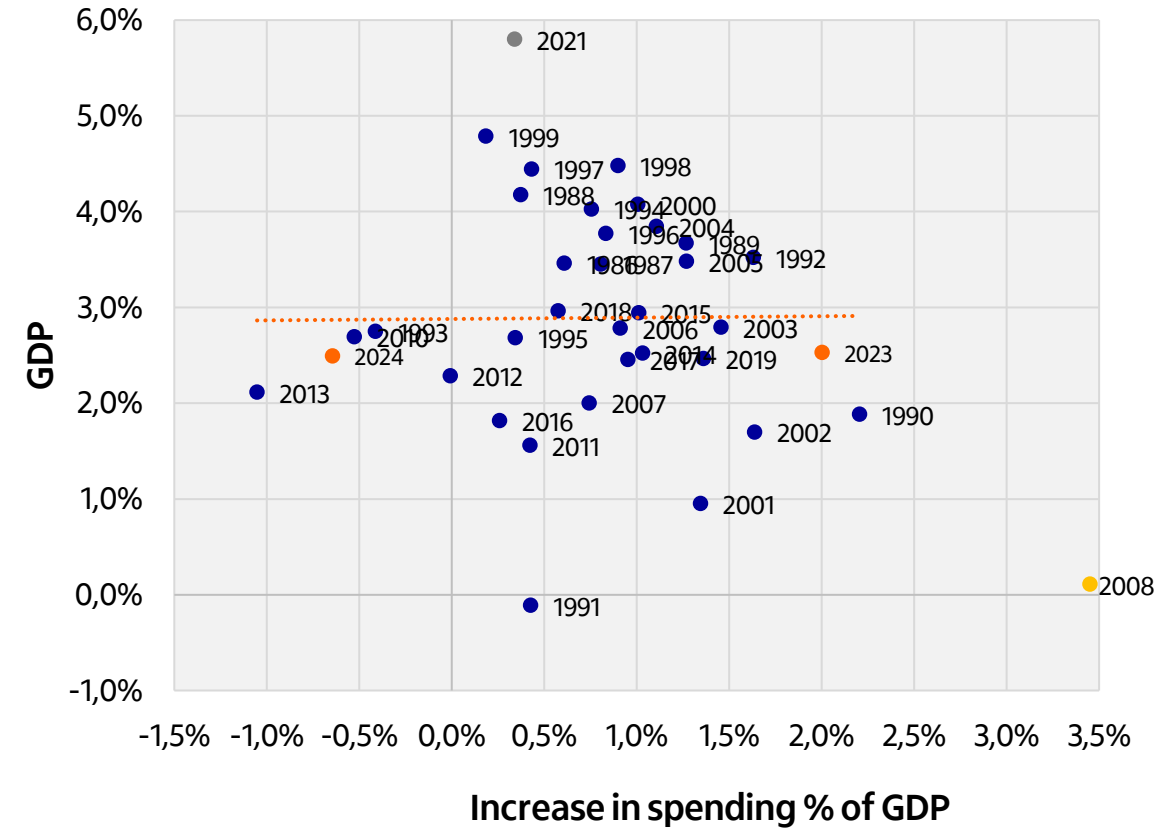
Fiscal deterioration impact not clear in Hutchins Center impulse and in spending increase as % of GDP

Fiscal impact in GDP - Hutchins Center

(Deviation of GDP from potential)

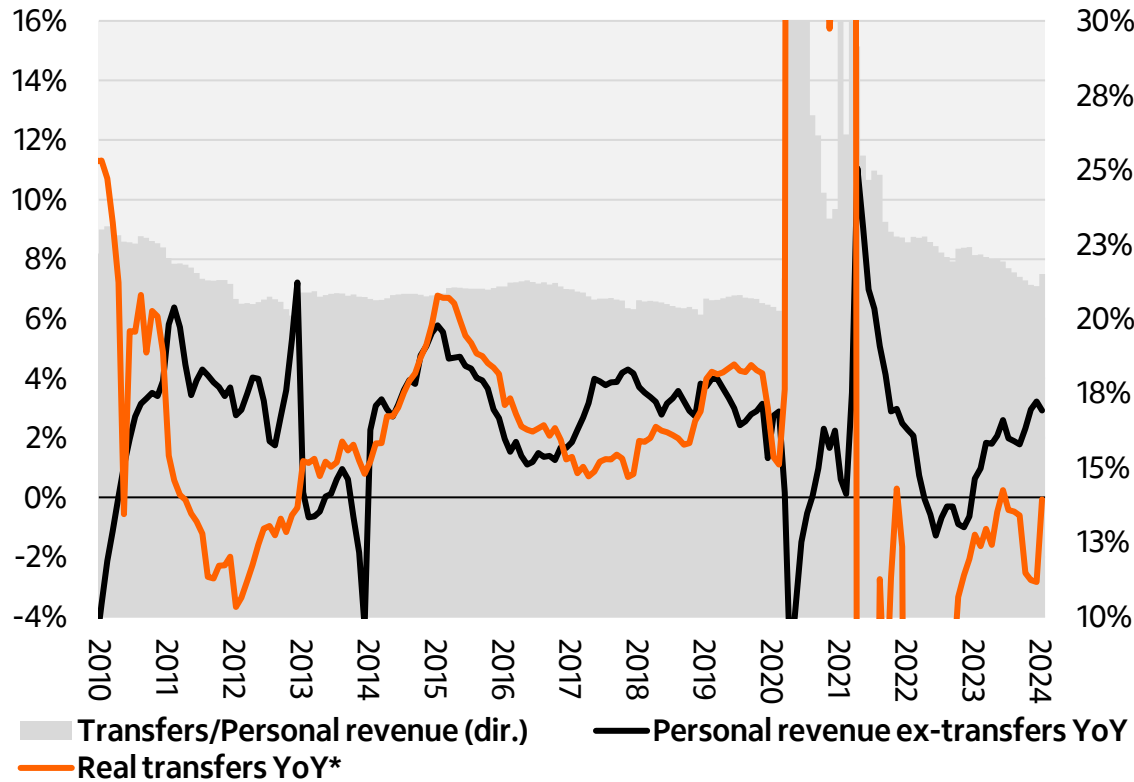


GDP and impulse primary spending



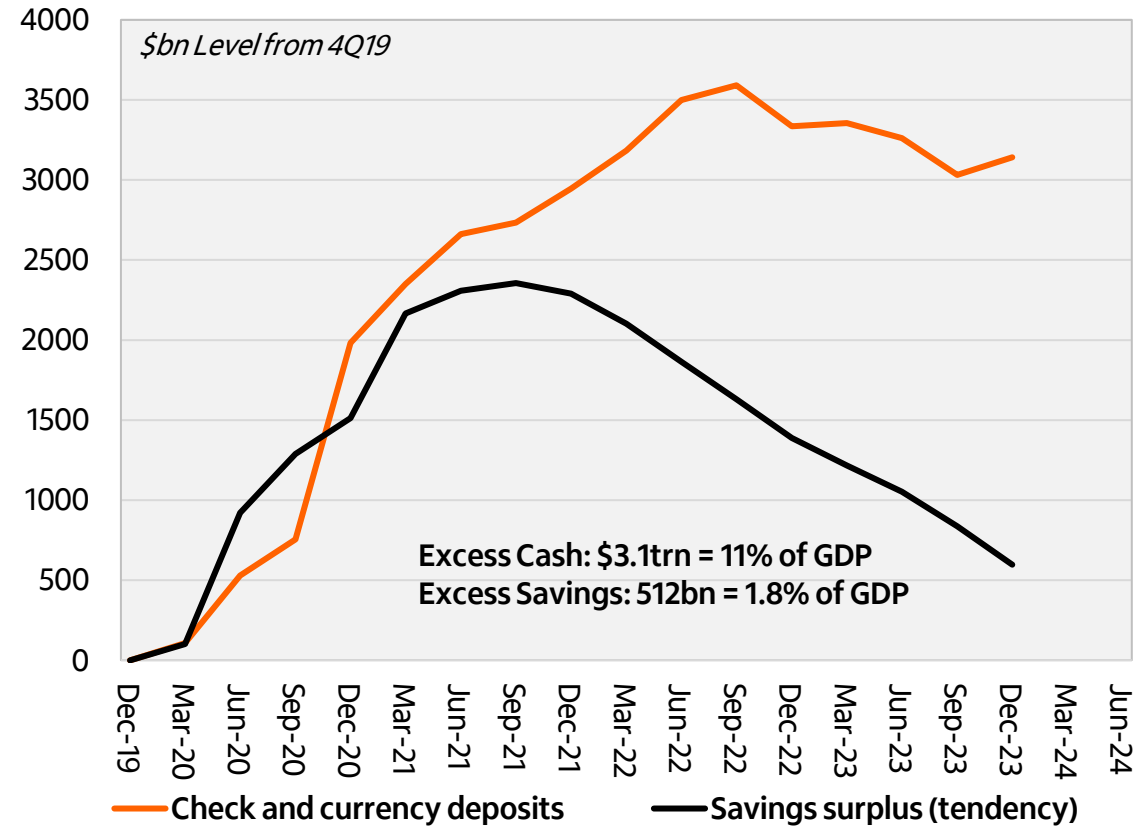
Fiscal stimulus at the margin is not going to households, but balance sheet assets/cash from pandemic stimulus remains high

Household's real revenue and transfers



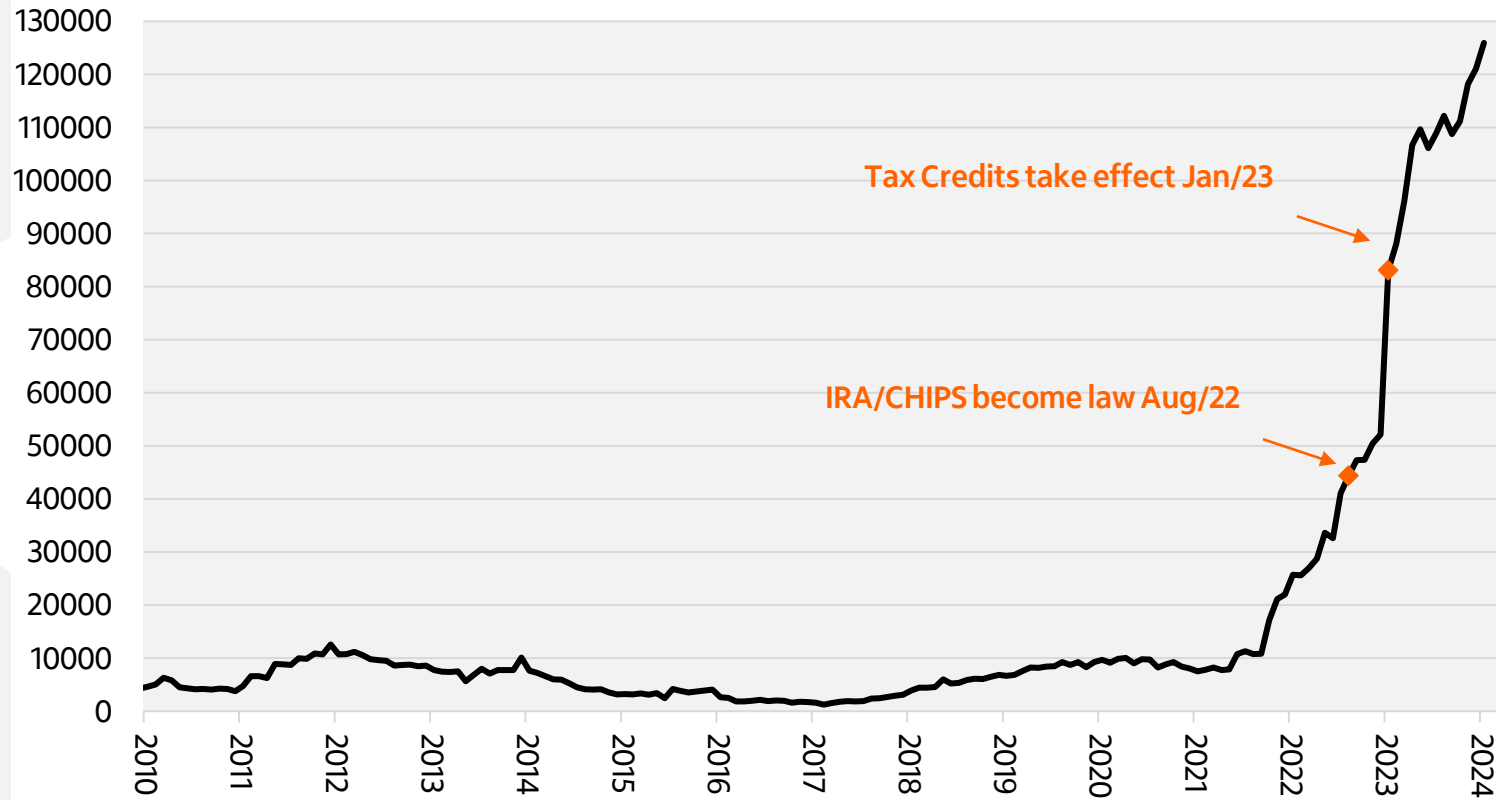
Transfers = Social Security + Medicare/Medicaid + Unemployment Insurance + Others

Households: Cash and Excess Savings



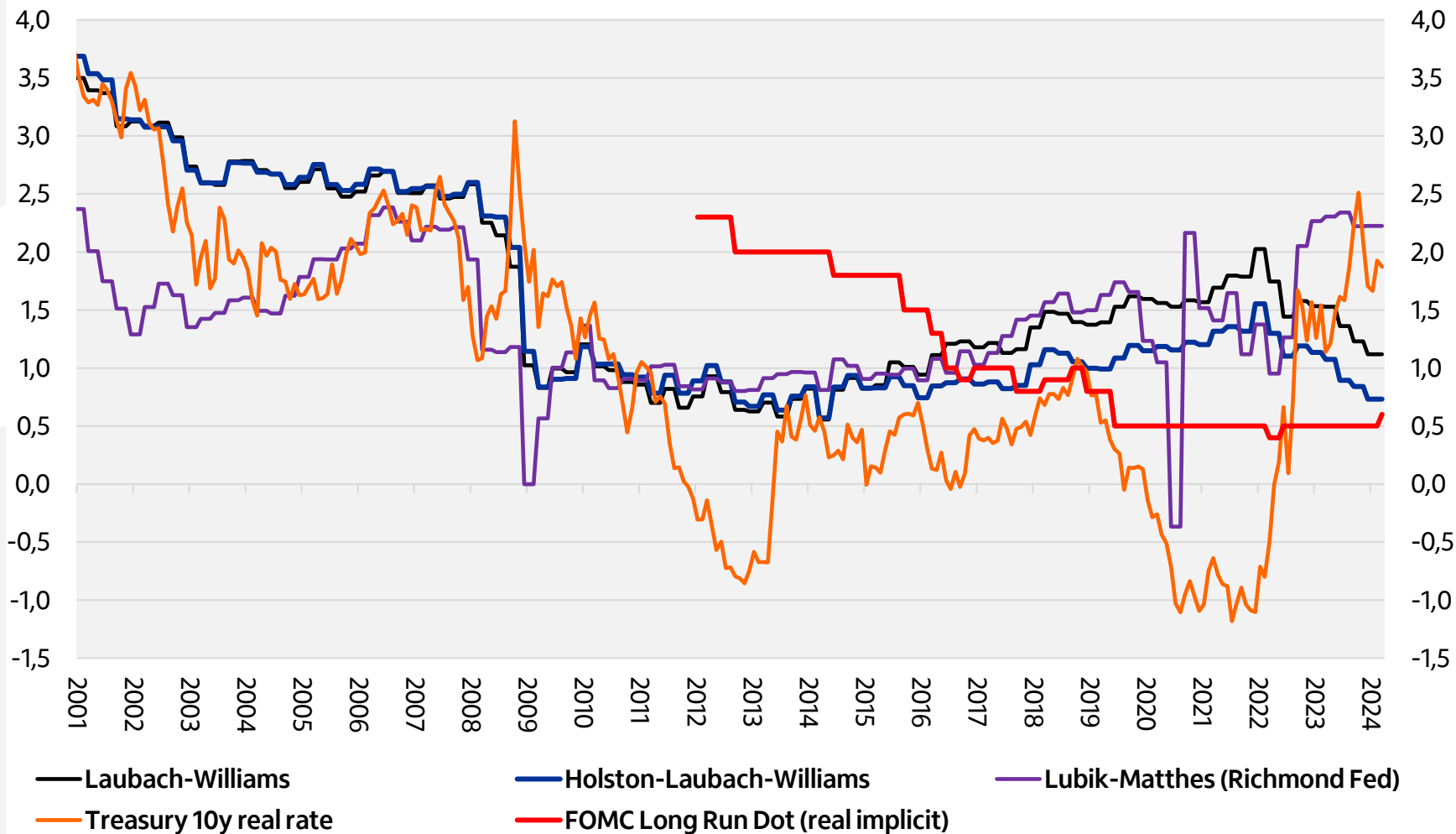
Fiscal stimulus benefiting companies (IRA/Chips Act)

Private Construction Spending - Computer/Electronic/Electrical Equipment
(USD Bil. SAAR)



Higher neutral rates?

Neutral Real Rate Estimates





Thanks!

Relevant Information

1. This report has been prepared and released by the Macro Research Department of Itaú Unibanco S.A. (“Itaú Unibanco”). This report is not a product of the Equity Research Department of Itaú Unibanco or Itaú Corretora de Valores S.A. and shall not be construed as a research report (“relatório de análise”) for the purposes of Article 1 of the CVM Instruction NR. 20, dated 2021.
2. The exclusive purpose of this report is to provide macroeconomics information and it does not constitute and shall not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial product, or to participate in any particular trading strategy in any jurisdiction. The information herein is believed to be reliable as of the date on which this report was released and it has been obtained from public sources believed to be reliable. However, Itaú Unibanco does not make any explicit or implied representation or warranty as to the completeness, reliability or accuracy of such information, nor does this report intend to be a complete statement or summary of the markets or developments referred to herein. Itaú Unibanco has no obligation whatsoever to update, modify or amend this report and inform the reader accordingly.
3. The opinions contained herein reflect exclusively the personal views of the analyst responsible for this report and were prepared independently and autonomously, including in relation to Itaú Unibanco, Itaú Corretora de Valores S.A. and any other companies within their economic group.
4. This report may not be reproduced or redistributed to any other person, in whole or in part, for any purpose, without the prior written consent of Itaú Unibanco. Additional information on the financial products mentioned in this report may be available upon request. Itaú Unibanco and/or any other company within its economic group is not and shall not be liable for any investment decisions (or otherwise) based on the information provided herein.

Additional Note: This material does not take into consideration the objectives, financial situation or specific needs of any particular client. Clients must obtain financial, tax, legal, accounting, economic, credit and market advice on an individual basis, based on their personal characteristics and objectives, prior to making any decision based on the information contained herein. By accessing the material, you represent and confirm that you understand the risks related to the financial instruments described in this material and the laws in your jurisdiction relating to the provision and sale of financial service products. You acknowledge that this material contains proprietary information and you agree to keep this information confidential for your exclusive use.

For inquiries, suggestions, complaints, criticisms and compliments, talk to Itaú’s CSCC: 0800 728 0728. Or contact us through our portal <https://www.itaú.com.br/atendaitau/para-voce/>. If you are not satisfied with the proposed solution, please contact the Itaú Corporate Ombudsman: 0800 570 0011 (on weekdays from 9 AM to 6 PM) or our PO Box 67.600, São Paulo-SP, Zip Code 03162-971. Hearing impaired, every day, 24h, 0800 722 1722.

