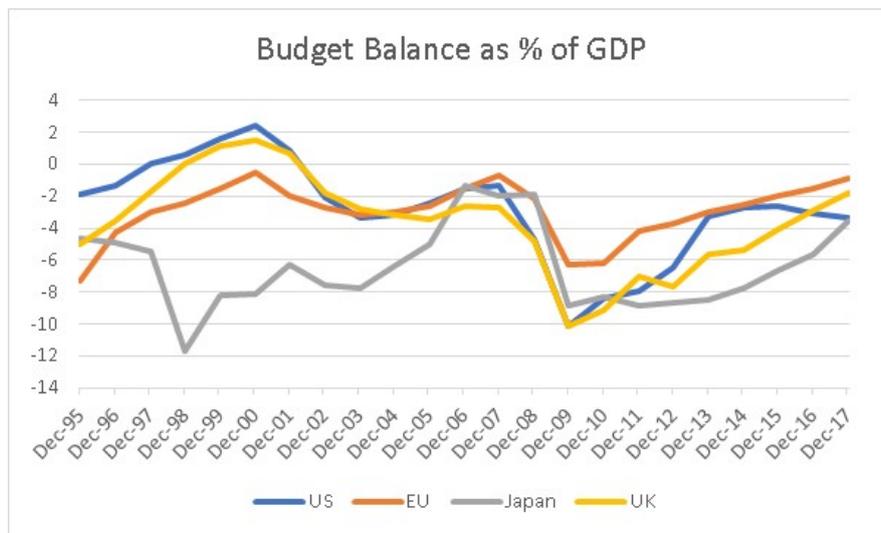


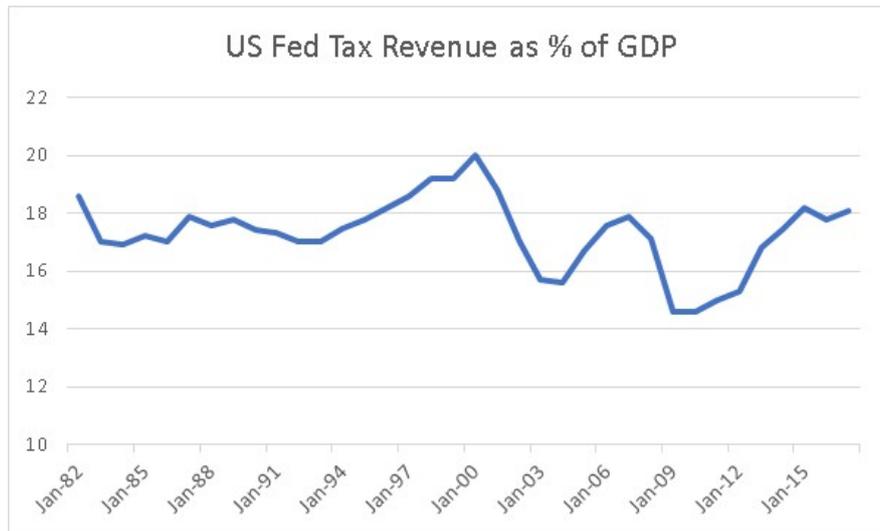
HOW LARGE IS THE US STRUCTURAL BUDGET DEFICIT?



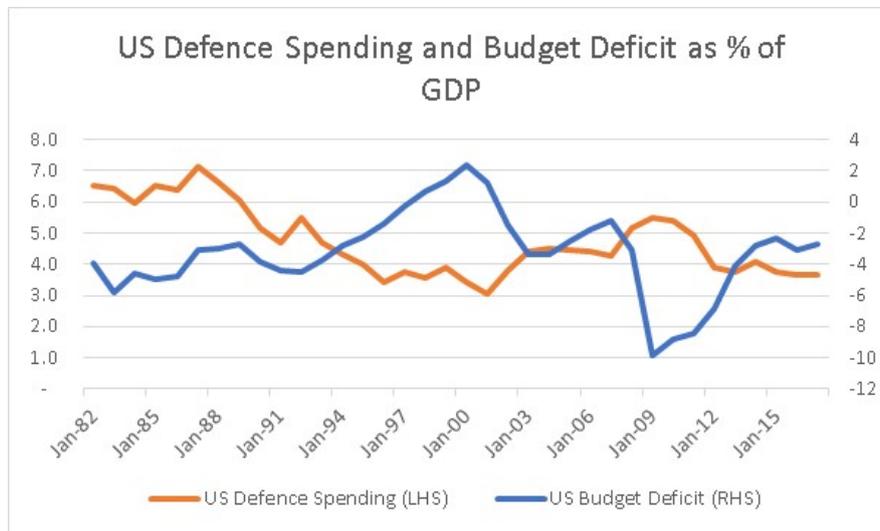
The US currently runs the largest budget deficit among the developed markets. This is in stark contrast to the US typically having a stronger fiscal position. It is also noticeable that US fiscal deterioration began in 2014, even as UK, Japan and EU fiscal positions have all improved.



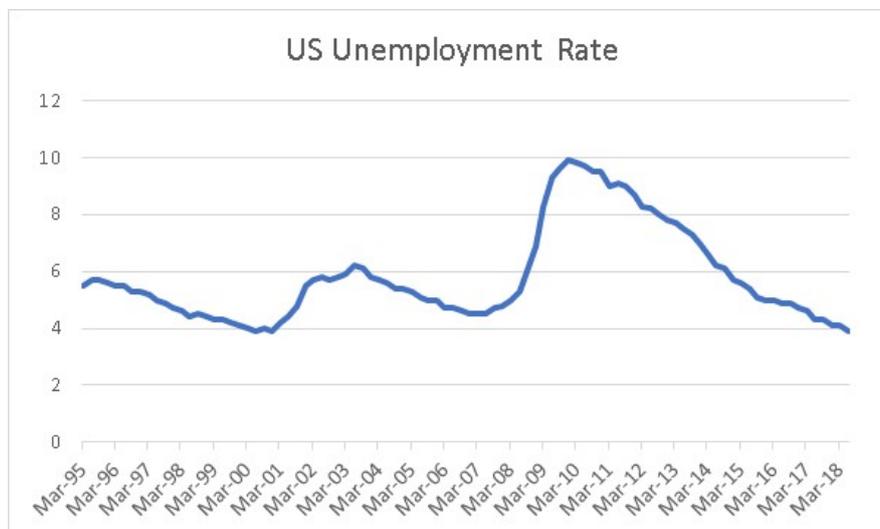
There are two main drivers of the US budget balance; one is cyclical, where tax received by the government will rise in an economic expansion. Rising profits and wages increase taxes, and reduce entitlement spending. Looking at US tax revenue as percentage of GDP we can see that this tends to oscillate around economic cycles, with a peak of 20% in 2000 and a low of 15% in 2009. Currently, it is around 18%. This could increase further, but given tax cuts, would seem unlikely.



The second driver is defence spending. This peaked at 7% of GDP in the late 80's and then declined to 3% in the late 90's after the collapse of the Soviet Union. The Iraq and Afghanistan Wars pushed spending back to 5% of GDP, but in recent years has fallen back to less than 4% of GDP.

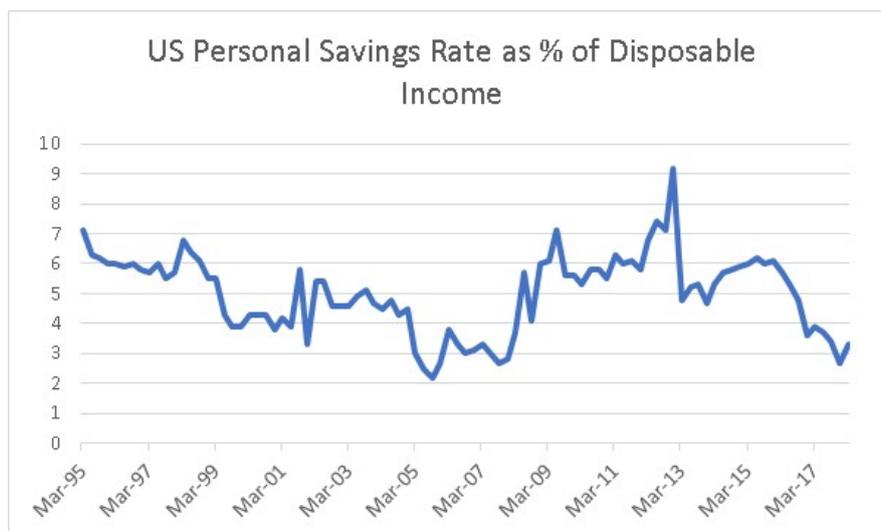


So, how large is the US structural deficit? We can use the unemployment rate to gauge changes in US Federal Tax Revenue's receipt of tax as the cycle adjusts. The 'mild' recession from 2000 to 2003 and the Global Financial Crisis, saw the tax revenue fall by 4% of GDP. Using this information, we can assume 4% of GDP fall in a tax collection in a recession seems reasonable.

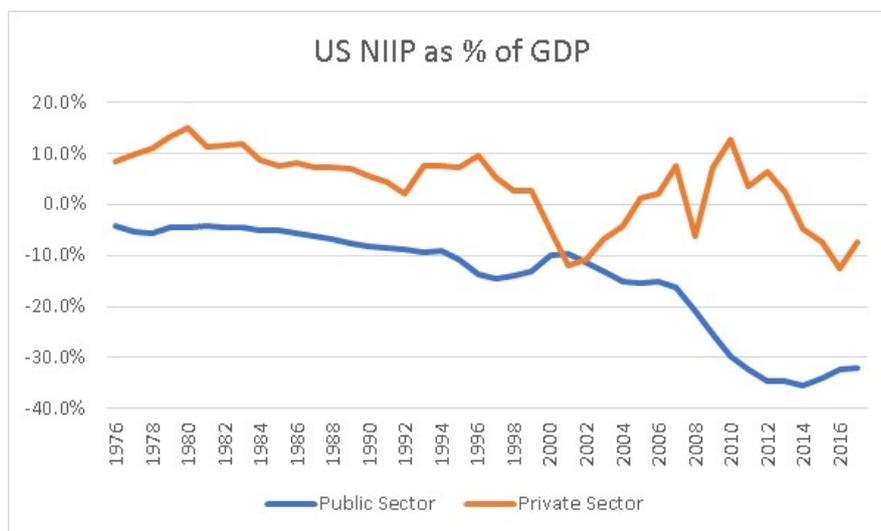


The Trump administration has asked for defence spending to be increased, so it would be safe to assume that there would be little chance of a fall in defence spending from here in my view. As recessions also increase entitlement spending, it is likely that even a mild recession would see tax take decline by 4%, so a budget deficit of 8% in a recession is likely.

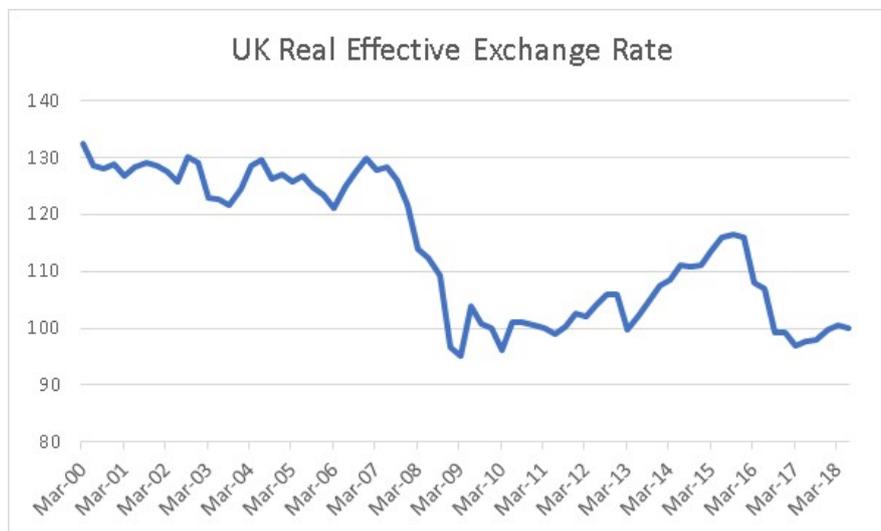
Currently US savings rate as percentage of personal disposable income is close to all time lows of 3%. US consumer would either have to reduce consumption to increase savings, which would be negative for growth, or the US dollar would need to fall to help balance the current account.



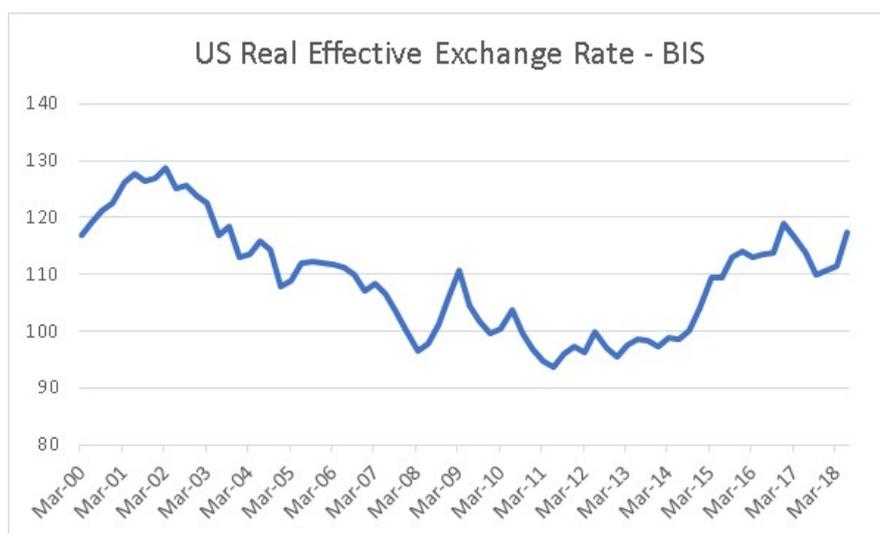
As shown in a [recent note on the Yen](#), the net international investments position (NIIP) for the US as a percent of GDP is already at all time highs, for both public (i.e. government debt) and private assets.



In 2014, the UK had a similarly large fiscal deficit and negative NIIP. With the Brexit shock, sterling subsequently fell back to its post financial crisis lows.



The US dollar has been strong over the last few years, and in recent months.



Source: BIS

However, given the US budget position, and very negative NIIP, I suspect the US dollar, like sterling will revisit the post financial crisis lows.

## INFORMATION

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 Source: Bloomberg, unless otherwise stated  
 Investor Relations: Samantha Dunn  
 Email: [info@russellclarkim.com](mailto:info@russellclarkim.com)  
 Telephone: +44 (0)20 7838 7580  
 Website: [www.russellclarkim.com](http://www.russellclarkim.com)

Business and registered address: Russell Clark Investment Management Limited, 9 Chester Close, London SW1X 7BE, United Kingdom. Registered in England and Wales - Company number: 04034280

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