

ECONOMIC VIEWPOINT

Improvement or Illusion? A Closer Look at the US Federal Government's Fiscal Position

By Francis Généreux, Lead Economist

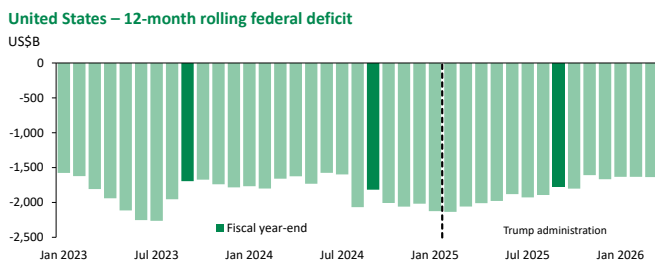
The US government's fiscal position has started looking somewhat stronger over the past year, but this improvement merits further scrutiny. The recent reduction in the deficit was mainly caused by temporary factors like tariffs and drastic cuts to certain government programs. The lagged effects of tax cuts, upward pressure on military spending and geopolitical uncertainty could quickly cut short any decline in the deficit. This Economic Viewpoint reviews the state of the US federal government's finances, the budgetary impacts of the Trump administration's key policies and the risks threatening this apparent improvement.

Now that Canada's provincial and federal governments have released their budget updates and revised their projections for the next few years, let's take a look at the finances of our neighbour to the south after the turmoil of 2025.

The Current State of Affairs

The US federal government ended its fiscal year in September 2025 with a deficit of US\$1.78 trillion, less than the US\$1.82 trillion deficit recorded in fiscal 2024. But a more up-to-date picture can be drawn using monthly data from the U.S. Treasury. The 12-month rolling federal deficit fell to US\$1.64 trillion in March of this year. That means public finances continued to improve in the first half of the current fiscal year, which ends this September (graph 1).

Graph 1
Deficits Shrank Slightly

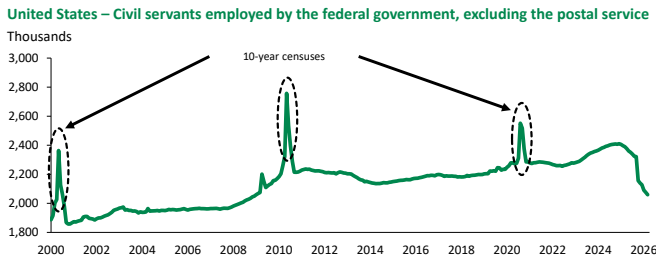


U.S. Treasury and Desjardins Economic Studies

When compared to January 2025, the very beginning of President Trump's second term, the numbers look even better. Back then, the 12-month deficit was US\$2.13 trillion. So between January 2025 and March 2026, the deficit shrank by nearly 23%, which is nothing to scoff at. That said, most of that US\$488 billion improvement in the deficit came from higher revenues (+US\$527 billion), while spending went up by US\$40 billion. It's also important to remember the rather unique circumstances affecting the US public sector in 2025: a government shutdown of record-breaking length that held back federal spending last fall, the budget cuts by Elon Musk's DOGE, and an administration determined to scale down departments like health and education.

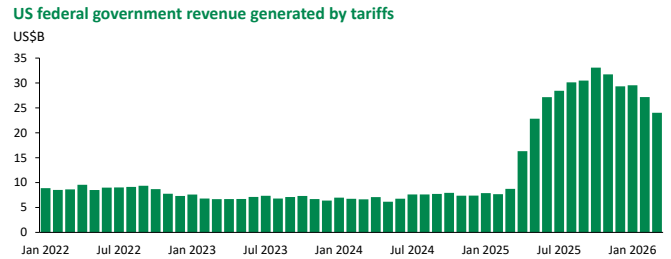
Spending on major entitlement programs has climbed by 7.4% since January 2025, while spending on debt servicing and defence has risen by 7.5% and 3.5% respectively. But non-military discretionary spending fell 17.0%, a US\$304 billion decrease from the start of President Trump's second term. The new administration had a particularly heavy impact on certain departments, including environmental protection (-51.4%), international aid (-58.5%) and education (-90.6%). The federal public service has obviously been affected by all this. Monthly data from the Bureau of Labor Statistics showed that, in March, the federal government employed 2,059,400 civil servants (excluding the postal service). That's down by 346,300 (-14.4%) from January 2025 (graph 2 on page 2).

Graph 2
The Federal Workforce Hasn't Been This Small Since 2008



Bureau of Labor Statistics and Desjardins Economic Studies

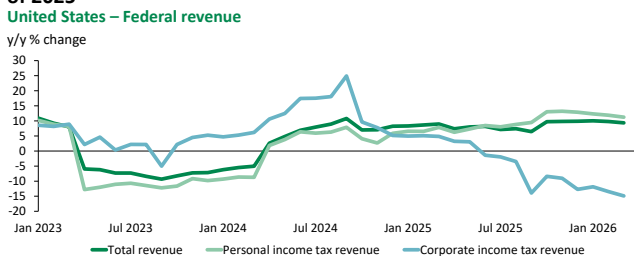
Graph 4
After a Sharp Spike, Federal Revenue from Tariffs Has Fallen



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The increase in the federal government’s revenues came mainly from personal income taxes, which went up by 13.2%. In contrast, corporate income tax revenues have gone down by 14.1% since January 2025. The decline started in September 2025, when businesses began implementing the tax cuts passed last summer (graph 3). Higher tariffs also boosted government revenues, especially after April 2025, sending an additional US\$243 billion to federal coffers compared to January 2025.

Graph 3
Corporate Income Tax Revenue Has Been Shrinking Since the Summer of 2025



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The Impact of Key Republican Policies

Our assessment of US public finances since January 2025 shows that **tariffs** have helped improve the federal government’s financial position. Revenue from President Trump’s protectionist policies peaked in October 2025, when monthly tariff inflows reached US\$33.1 billion. They have since declined, in part because some tariffs were walked back (especially on food starting in November) and trade patterns shifted (graph 4). In addition, the Supreme Court upended the whole situation when

it struck down the reciprocal, fentanyl and border security tariffs. In March, tariff revenues amounted to only US\$24 billion, the lowest since May 2025. And the government will have to refund the tariffs that were ruled illegal. A [document](#) submitted to the United States Court of International Trade claimed that, as of March 4, 2026, nearly 330,000 US importers had paid around US\$166 billion in duties before the tariffs were overturned by the Supreme Court. This money will eventually have to be paid back, and a process for claiming these refunds was recently put into place. This means that some of the improvement in the federal budget was illusory and will be reversed.

The other flagship policy affecting US public finances was the **One Big Beautiful Bill Act** (OBBBA), which was signed into law on July 4, 2025. [We commented](#) on the OBBBA shortly before it was given final approval by Congress. Its impact could already be seen in fiscal 2025, as corporate income tax revenues plummeted. The Congressional Budget Office (CBO) estimated that the OBBBA reduced corporate tax inflows by US\$100 billion in 2025, which will be followed by annual declines of US\$152 billion in both fiscal 2026 and fiscal 2027. The estimated impact of personal income tax cuts was relatively modest in 2025 (US\$32 billion), but will increase substantially in 2026 (US\$326 billion) and subsequent years. However, the decline in tax inflows seen in 2025 was offset by higher revenues that were also generated by the OBBBA, particularly its provisions on student loan repayment. Based on a conventional analysis (excluding any second-round effects on the economy), the CBO estimated that the OBBBA narrowed the deficit by US\$21 billion in fiscal 2025, but will expand it by US\$487 billion in fiscal 2026 and US\$602 billion in fiscal 2027. Consequently, the federal government’s financial position would be considerably stronger if the OBBBA hadn’t been passed. The boost to growth expected from the OBBBA in 2026 slightly mitigates its negative effect on the deficit.

The Latest CBO Projections

In February, the CBO published its most recent federal budget outlook. Based on the legislation in effect at that time, including the OBBBA, the CBO’s forecast showed the deficit worsening slightly over the next several years. It would grow from US\$1.78 trillion at the end of fiscal 2025 to US\$1.85 trillion in September 2026 and then US\$1.89 trillion in 2027 (graph 5). As a percentage of GDP, that’s actually fairly stable, amounting to 5.8% in 2025, 5.8% in 2026 and 5.7% in 2027. Debt held by the public would rise from 99.4% of GDP in 2025 to 100.6% in 2026, and climb all the way to 120.2% in 2036 (graph 6).

The Cost of War

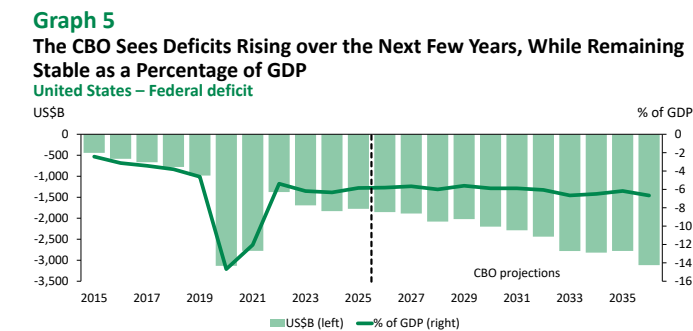
The current conflict in the Middle East could also change the outlook over the very short term. The Department of Defense notified members of Congress last week that the war with Iran has so far cost approximately US\$25 billion. Most of this was apparently spent on munitions, but some also went to operations, maintenance and equipment replacement. Additional costs may follow, and it was reported that the White House was about to ask Congress for US\$200 billion in immediate additional funds for the war in Iran. Other, smaller figures ranging from US\$80 billion to US\$100 billion have also been floated.

The economic consequences of the war in Iran are not yet clear. Confidence has been affected by higher prices for energy, especially gasoline, but so far the negative repercussions on economic growth and the labour market have been limited. If year-over-year inflation were to rise by 0.50 percentage points, with nominal interest rates increasing by an equivalent amount, the annual deficit would swell by approximately US\$30 billion. And if economic growth were to slow by 0.30 percentage points, the deficit would expand by around US\$15 billion. Our baseline scenario does not anticipate a sharp decline in real GDP growth or runaway inflation. But a prolonged conflict would heighten the risk of economic conditions that would adversely affect public finances, along with the probability that Congress or the White House would introduce new measures to support households or businesses.

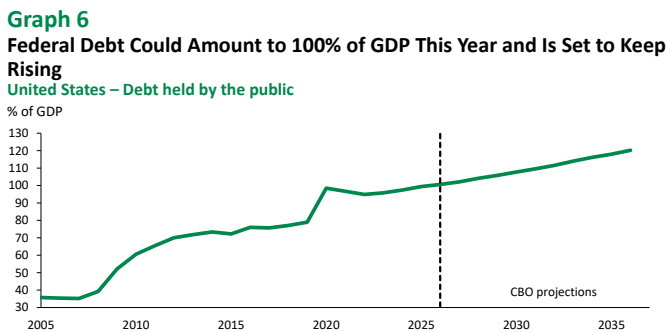
President Trump’s Latest Budget Proposal Revealed a Voracious Appetite for Military Spending

On April 3, the Trump administration released its budget proposal for fiscal 2027, which starts in October. It’s worth noting that budgets submitted by the White House are rarely implemented as is. According to the Constitution, Congress holds the purse strings. However, the annual budget gives some insight into the administration’s priorities and intentions.

The most striking feature of this proposal is its determination to significantly expand defence spending. The Peace Through Strength policy advocated by the President and the Secretary of Defense requires a 42.1% increase from the military budget approved for fiscal 2026. This would raise defence spending from US\$850 billion in 2025 to US\$1.01 trillion in 2026 and US\$1.45 trillion in 2027. The combined budget for all other discretionary items (excluding entitlement programs) would shrink by US\$73 billion (-10.0%). The largest cuts would be made to the Departments of State (-US\$15.5 billion or -30.4%), Health and Human Services (-US\$15.4 billion or -12.2%) and Housing and Urban Development (-US\$10.7 billion or -12.7%).



CBO: Congressional Budget Office
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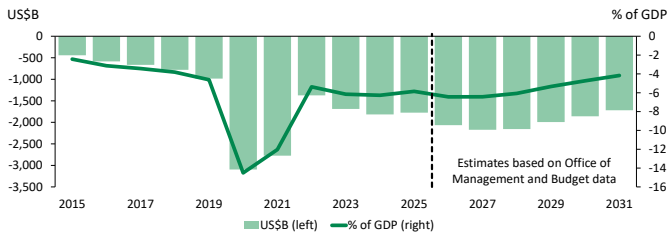
That said, the CBO’s projections were based on the assumption of higher tariffs and did not anticipate the Supreme Court’s ruling on emergency tariffs. The CBO now estimates that the elimination of these tariffs would increase the 10-year rolling deficit by US\$2.0 trillion, including the impact on debt servicing. But that estimate does not take into account the temporary replacement tariffs implemented under Section 122 of the *Trade Act*, nor does it include any additional trade measures that may eventually be introduced.

Unlike most other White House budget proposals, this year’s plan does not provide figures for projected deficits or debt. But changes to total spending and revenues, which can be found in the supporting documents, suggest that the deficit would exceed US\$2.0 trillion in 2026, rising to US\$2.17 trillion in 2027. And that’s based on strong projected real GDP growth of 3.1% in both 2026 and 2027. The same data show that deficits as a share of nominal GDP would increase from 5.9% in 2025 to 6.4% in 2026 and 2027 (graph 7). Since these growth projections are well above the consensus forecast (and our own), the Trump administration’s requested budget increases, especially for defence, would likely produce significantly higher deficits, both in dollar amounts and as a percentage of GDP.

In the End, Public Finances Have Improved, but Not by Much

Public finances improved slightly from fiscal 2024 to fiscal 2025 and in the first six months of fiscal 2026. That said, once we consider the various efforts to cut costs, the extended government shutdown and revenues from tariffs, the reduction in the deficit remains relatively modest. Meanwhile, public debt is continuing to grow rapidly. In the very short term, we’ll need to consider the budgetary and economic impacts of the conflict in the Middle East, as well as any changes to the administration’s trade policy. There isn’t much room to manoeuvre in the event of a sudden and unexpected economic downturn. The recent rise in global uncertainty has renewed the appeal of the US dollar and Treasuries. But the risk that foreign investors will once again start to turn away from US assets remains.

Graph 7
The Trump Administration’s Requested Increases Would Inflate the Deficit, Despite the Assumption of Relatively High GDP Growth
 United States – Federal deficit



White House and Desjardins Economic Studies

Another caveat is that revenue projections rely on very high tariff revenues of around US\$600 billion per year. This seems unlikely in light of recent tariff data and the Supreme Court ruling.

The White House’s budget plan therefore seems unrealistic. On the face of it, it would be surprising if Congress approved such a large permanent increase in defence spending. Doing so would require legislative measures to prevent Democrats from blocking it in the Senate. But a temporary budgetary increase could still be approved to pay for the continuation of the conflict in Iran and replenish stocks of munitions and equipment.

Until recently, Congress was busy finalizing approvals for the remainder of fiscal 2026, particularly for the Department of Homeland Security, which was under a partial shutdown. Policymakers are also debating funding for Department of Agriculture programs, including food assistance, that would amount to US\$162 billion over 10 years, including US\$34 billion for 2026. Although Congress has begun work on the 2027 budget, it’s quite possible that it won’t be completed before fiscal 2027 starts on October 1. Short-term budget extensions may therefore be required to avoid another government shutdown during the midterms.