US Fiscal position as of January 2026

United States

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US Public Finances in early FY2026: Short-term improvements, however long-term structural debt pressures persist

The first four months of Fiscal Year 2026 (FY26) show an improvement in the US Federal fiscal balance. The federal deficit totaled US$697 billion (bn) between October and January, US$143bn lower than in the same period of FY25. Revenue growth, particularly from the income taxes and tariffs, outpaced spending growth, resulting in a narrower year-to-date deficit.

However, this early improvement does not alter the broader fiscal trajectory, at least not based on CBO long-term forecasts. Under the Congressional Budget Office (CBO) baseline economic projections for 2026 - 2036, the full-year deficit for 2026 is estimated at US$1.9 trillion (tn) and is expected to widen further over the coming decade. In terms of GDP, the public debt stands at approximately 100% of GDP and the CBO projects it rise to 120% by 2036. In this context, the key question is not whether the deficit narrowed in early FY26, but whether the current fiscal stance is consistent with medium term debt stabilization.

Fiscal performance in the first fourth months of FY26

Between October 2025 and January 2026, federal revenues rose by 11.8% year-over-year, while outlays increased by just 1.9%. This resulted in a smaller cumulative deficit compared to the same period of last year. The revenue strength was concentrated in individual income (+12.3%) and payroll taxes (+4.5%), reflecting stronger non-withheld payments, rising wage-based withholdings, and lower refunds. Customs duties (tariffs) more than quadrupled year-over-year, adding US$90bn relative to the same period of 2025. By contrast, corporate taxes declined by 16.4%, largely reflecting expanded investment deductions under the 2025 reconciliation act.

On the expenditure side, spending growth was modest in aggregate but uneven in composition. Social Security benefits rose by 7.6%, driven by cost-of-living adjustments and an increase in beneficiaries. Medicare outlays increased by 9.5%, reflecting higher enrollment and payment rates. Medicaid and other health spending rose by 5.3%, largely due to higher per-enrollee costs. In contrast, defense spending rose a mere 2.1%. This seems to be unsustainable given the Trump administration's uses of military force in the Caribbean and additional threats of its use on the Middle East. This interventionist policy outside of Europe helps to explain the administration's insistence on greater spending by NATO and unwillingness to increase pressure on Russia to make concessions in dealing with Ukraine. We would note that through December defense spending was actually down 3.1% while in

January alone it increased 20.8% vs. January 2025. Especially noteworthy was the 12.7% cutback in other primary spending. Whether these spending cuts are sustainable is also uncertain. One danger to the deficit is the possibility that in order to obtain a substantial increase in long-term defense spending the Trump administration might have to accept higher levels of discretionary expenditures. It also remains to be seen what level of DHS spending and when Congress will be able to authorize given the deadlock between Democrats and Republicans. As noted above, some temporary declines in discretionary and agency-level spending partially offset mandatory program growth. Nevertheless, entitlement spending and interest payments remain the main structural drivers of outlays. Details of income and expenses can be seen in Figure 1.

For their part, interest payments increased by 7.5% year-over-year, reflecting both a larger debt stock and elevated long-term interest rates. However, we estimate that on a LTM basis the effective interest rate on the average public debt fell to 3.28% through January vs. 3.50% through January 2025. Looking ahead, market expectations point toward a gradual convergence of policy rates toward neutral levels. A normalization of real interest rates would help moderate the effective cost of servicing public debt, partially mitigating near term pressures.

The early FY26 fiscal data provides evidence of near-term revenue strength and modest expenditure containment. As a result, primary deficit shrank relative to last year 32.2%. Yet the broader trajectory of US public finances remains defined by persistent deficits and accelerating interest costs.

Figure 1. Cumulative Fiscal Year Revenues and Outlays

	In Billions of USD					Annualized Change since:			
	Jan-22	Jan-23	Jan-24	Jan-25	Jan-26	Jan-25	Jan-24	Jan-23	Jan-22
Total Revenue	**1,517**	**1,472**	**1,585**	**1,596**	**1,785**	**11.8%**	**6.1%**	**6.6%**	**4.2%**
Individual Income Tax	825	767	809	823	924	12.3%	6.9%	6.4%	2.9%
Payroll Tax	469	504	534	554	579	4.5%	4.1%	4.7%	5.4%
Corporate Tax	112	126	170	134	112	-16.4%	-18.8%	-3.8%	0.0%
Custom Duties (Including Tariffs)	0	0	0	0	118	n.a.	n.a.	n.a.	n.a.
Other Revenue	111	75	72	85	52	-38.8%	-15.0%	-11.5%	-17.3%
Total Outlays	**1,776**	**1,933**	**2,116**	**2,436**	**2,482**	**1.9%**	**8.3%**	**8.7%**	**8.7%**
Social Security	387	424	469	502	540	7.6%	7.3%	8.4%	8.7%
Medicare	233	221	250	368	403	9.5%	27.0%	22.2%	14.7%
Medicaid & Other Health	183	196	195	321	338	5.3%	31.7%	19.9%	16.6%
National Defense	241	251	281	334	341	2.1%	10.2%	10.8%	9.1%
Other Primary Outlays	592	643	630	589	514	-12.7%	-9.7%	-7.2%	-3.5%
Primary Outlays	**1,636**	**1,735**	**1,825**	**2,114**	**2,136**	**1.0%**	**8.2%**	**7.2%**	6.9%
Net Interest	140	198	291	322	346	7.5%	9.0%	20.4%	25.4%
Primary Deficit	**-119**	**-263**	**-240**	**-518**	**-351**	**-32.2%**	20.9%	n.a.	n.a.
Total Deficit	**-259**	**-461**	**-531**	**-840**	**-697**	**-17.0%**	**14.6%**	**14.8%**	**28.1%**
Public Debt	44,562	44,927	45,292	45,658	46,023	0.8%	1.6%	0.8%	0.8%
Public Debt to GDP	98.1%	93.8%	96.9%	98.3%	99.9%	n.a.	n.a.	n.a.	n.a.
Primary Deficit to GDP (LTM)	-7.77%	-2.31%	-3.45%	-3.95%	-2.23%	n.a.	n.a.	n.a.	n.a.
Net Interest to GDP (LTM)	1.83%	2.26%	2.87%	3.33%	3.15%	n.a.	n.a.	n.a.	n.a.
Total Deficit to GDP (LTM)	-9.60%	-4.57%	-6.32%	-7.28%	-5.38%	n.a.	n.a.	n.a.	n.a.
Nominal GDP (LTM)	23,938	26,217	27,935	29,409	30,951	5.24%	5.26%	5.69%	6.63%

Source HR Ratings with budget information from the CBO, GDP data from the BEA and CPI data from the BLS. Debt information from the US Treasury.

US debt sustainability

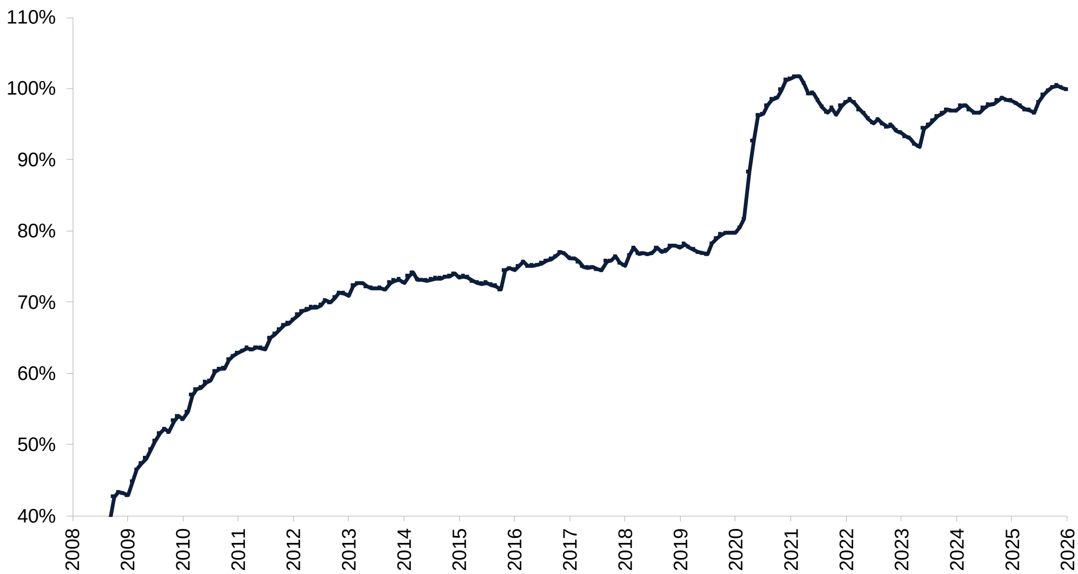
Despite near-term deficit improvement, the medium-term fiscal trajectory remains subject to structural pressures. As shown in Figure 2, public debt in the United States has been on a persistent upward trajectory. We estimate that Debt held by the Public now stands around 100% of GDP and according to the CBO is projected to rise to 120% of GDP by 2036. This upward trend reflects structural imbalances embedded in the fiscal framework.

Importantly, this debt accumulation has occurred during a period of relatively strong economic performance. Unemployment remains low (around 4.0%), real GDP growth has been positive, and the economy has operated near- and at times above- its estimated potential. For fiscal sustainability to be achieved, periods of strong economic growth should be accompanied by fiscal consolidation, or at least, a moderation in deficits. The compounding effect of higher interest payments on an already elevated debt stock is now the central structural vulnerability in US public finances.

Despite these fiscal pressures, several structural factors continue to support US credit fundamentals. The United States remains the world's largest economy, with a diversified production base and deep capital markets. A significant share of recent economic momentum has been driven by investment in technology and productivity-enhancing sectors, which could support potential output growth over the medium term, helping to limit the growth in the debt-to-GDP ratio.

Moreover, the US dollar retains its role as the dominant global reserve currency. There is currently no alternative economy with the scale, liquidity, and institutional depth required to replicate the US Treasury market's role in global finance. This status continues to anchor demand for US public debt.

Figure 2. Public Debt as Percent of GDP (LTM)



Source: HR Ratings with information from the CBO. Including HR Ratings estimate for 3Q25 GDP

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