First to Market

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THE CASE FOR THE FEDERAL RESERVE TO HOLD STEADY

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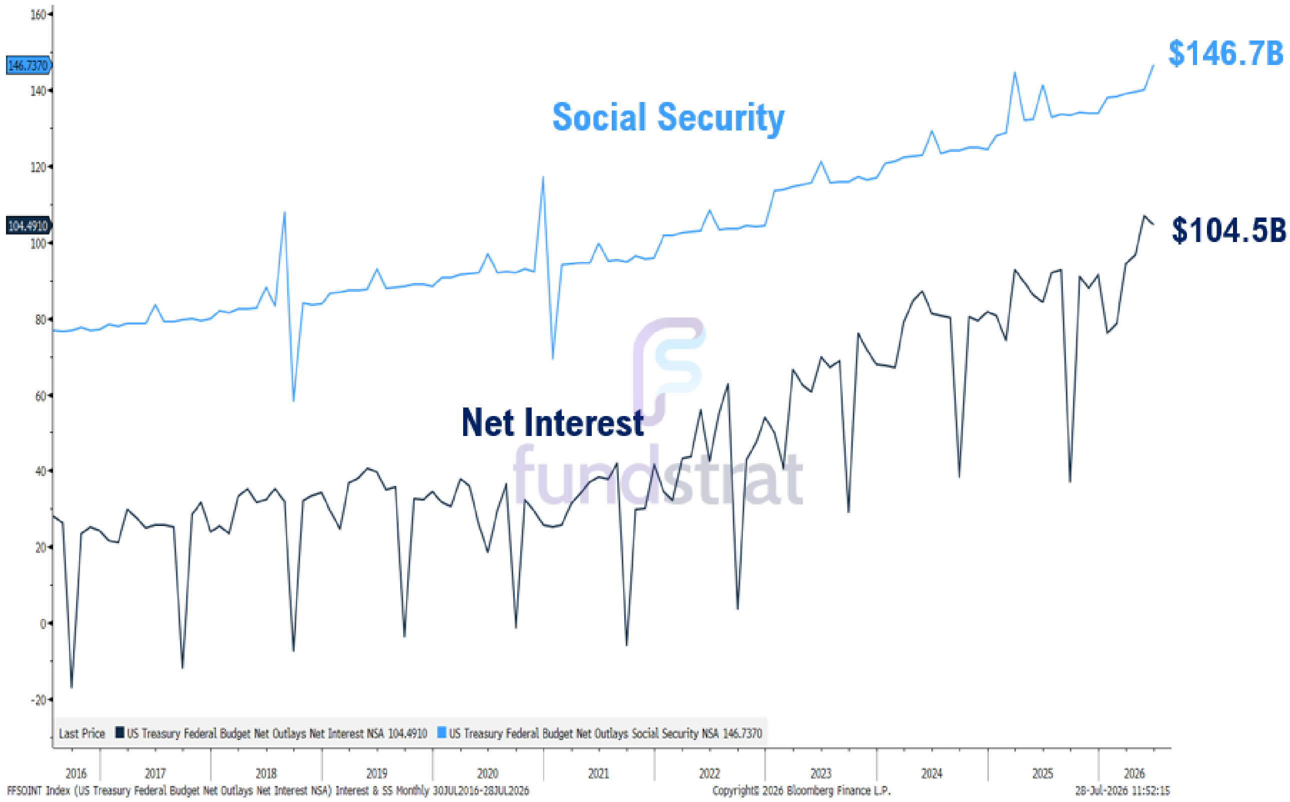
Chart of the Day

US government monthly outlays for Social Security and Net Interest
Last 10 years



Source: Fundstrat, Bloomberg, Treasury Department

Good morning!

America's monthly net interest costs have risen above $100 billion for the first time ever. To me, the silver lining is that this makes it unlikely that the Federal Reserve will raise interest rates, at least until late 2026.

Let me explain.

Investors are becoming convinced that the Fed will need to raise interest rates at least once this year to tackle inflation, even if it's not at the conclusion of today's meeting. For the U.S. government, higher rates would mean that the record sums paid in interest will go up even more, raising concerns about the sustainability of the budget.

The government paid $106.95 billion in net interest in May, when it first crossed the $100 billion mark, while spending $140.03 billion in social security, according to the U.S. Treasury data on Bloomberg going back to 1986. The monthly gap between the two categories was the narrowest since January 2016. (By the end of June, the gap widened again. Last month, $104.49 billion was paid in interest, and $146.73 billion in social security.)

If the Fed hikes, then it would mean interest costs surge, as the government would issue new Treasuries at higher yields. When short-term Treasury bonds mature, they would be refinanced at higher rates, as well, so until the midterm elections are over, the rising interest costs are a good reason for the Fed to hold steady.

As it is, the government is expected to spend 3.4% of gross domestic product on interest payments this year. The average from 1976 to 2025 was 2.1%. Costs could reach 4.6% of GDP by 2036 when the deficit is projected to expand to $3 trillion.

The bigger problem is that there’s no easy way to lower the interest category budget. The government has to issue more bonds to make its payments, dragging down bond prices, which could push investors to demand higher yields — and they would be well within their right to do so. But to pay off those higher rates, the government is forced to borrow more, which grows the deficit even more in a self-perpetuating cycle. You can’t exactly raise taxes or cut spending on social insurance programs without pushbacks.

This year alone, the U.S. budget deficit is forecast to be $1.85 trillion. Spending on the Medicare and Medicaid categories are bigger than social security, while defense spending ranks at the bottom.

On the surface, this might be dismissed as not the Fed's concern and, thus, not a factor in the FOMC's decision-making process. After all, overseeing the federal government's budget deficit is not part of its dual mandate.

However, one of the big critiques with a growing budget deficit is that it can decrease the value of your dollar, aka reduce purchasing power. Another is that it can contribute to lower economic growth because interest rates for everything from mortgages to student loans to credit-cards will move higher. That can, in turn, add pressure on asset prices, as well.

At the same time, it's important to understand that the Fed can't hesitate to raise rates either if the data outrightly suggests so because that's a reputational risk. The Treasurys are the most liquid and most transparent asset in the world, and the dollar is the world's reserve currency, so if investors perceive there to be even a smidge of interference, they will send yields on long-term bonds climbing.

So far, deficit worries haven't typically affected markets because of "stonks." Though I should add that the Nasdaq composite hovered near correction territory this week, due to a combination of rising rates and worries about AI overspending. I view 10% declines from highs every now and then to be healthy.

The budget remains in the back of investors' minds and every so often threatens to add economic pressure and lower skyhigh asset prices.

Share your thoughts

Do you think the Fed should raise interest rates? Click here to send us your response.

✍Here's what a reader commented ✍

Q: What are your expectations for this Big Tech earnings season?

A: We are all on a great glide path right now but eventually the weather will change.

Catch up with Fundstrat

We would be surprised if the Fed hikes in the July meeting (Wed). There is a possibility the Fed might again resume QT, but this is something Warsh discussed earlier this year. As for the sell-off in AI bottlenecks, the fact that Micron Technology now trades at 5.3X P/E, vs 6.5X LT avg and 12.6X in Nov 2025, tells us a lot of “risk” is priced in.

Technical

Fundstrat Head of Technical Strategy Mark Newton is off.

Crypto

While the probability of the Clarity Act passing before the Senate’s August recess remains low, today brought a couple of incremental developments that could ultimately help move negotiations forward.

News We're Following

Breaking News

- Iran Gambles on Escalation With Surprise Attack on U.S. Forces WSJ

Markets and economy

- Fed meeting today: Warsh’s second meeting raises unusual uncertainty over interest rates MW
- Kevin Warsh can’t reopen the Strait of Hormuz CNN

Business

- How Blackstone Put Jersey Mike’s on a Fast Track to This Week’s IPO WSJ
- Even $64 Billion in Quarterly Profit Is a Disappointment for Chip Investors WSJ
- Mark Zuckerberg Says U.S. Should Accelerate AI Development, Not Restrict It WSJ
- Procter & Gamble revenue misses estimates as volume stays unchanged CNBC

Politics/U.S.

- A Small Band of Socialists Is Sowing Panic in the Democratic Party WSJ

- Trump’s Tariffs Are Sending Some Companies Back to China NYT
- The Whiplash War NYT

Overseas

- Why Europe’s Wildfires Are So Intense This Year WSJ
- How China Went From Dream Customer to a Nightmare for Big Oil WSJ

Of Interest

- A.I. Companies Are Recruiting Electricians and Carpenters by the Thousands NYT

Overnight	
S&P Futures	+16 ▲ point(s) (+0.22% ▲)
overnight range:	-27 ▼ to +36 ▲ point(s)

APAC	
Nikkei	-1.49% ▼
Topix	+0.26% ▲
China SHCOMP	+0.40% ▲
Hang Seng	+1.96% ▲
Korea	-5.98% ▼
Singapore	+1.73% ▲
Australia	+1.02% ▲
India	+1.13% ▲
Taiwan	-3.76% ▼

Europe	
Stoxx	50 -0.55% ▼
Stoxx	600 -0.28% ▼
FTSE	100 -0.01% ▼

DAX	-0.38% ▼
CAC	40 -0.74% ▼
Italy	-0.22% ▼
IBEX	-1.60% ▼

FX	
Dollar Index (DXY)	-0.06% ▼ to 101.35
EUR/USD	+0.08% ▲ to 1.1396
GBP/USD	+0.09% ▲ to 1.3301
USD/JPY	+0.16% ▲ to 163.59
USD/CNY	+0.08% ▲ to 6.7650
USD/CNH	+0.08% ▲ to 6.7660
USD/CHF	-0.05% ▼ to 0.8195
USD/CAD	+0.06% ▲ to 1.4098
AUD/USD	-0.43% ▼ to 0.6945

UST Term Structure	
2Y-3M Spread widened	0.2bps to 43.3bps
10Y-2Y Spread narrowed	-0.4bps ▼ to 31.3bps
30Y-10Y Spread narrowed	-0.2bps ▼ to 48.0bps

USD HY OaS	
All Sectors	-4.2bps ▼ to 314bps
All Sectors ex-Energy	+2.1bps ▲ 308bps
Cons Disc	+4.3bps ▲ to 512bps
Indu	+1.7bps ▲ to 266bps

Tech	+5.6bps ▲ to 230bps
Comm Srvcs	+1.0bps ▲ to 289bps
Materials	+2.5bps ▲ to 267bps
Energy	+0.2bps ▲ to 291bps
Fin Snr	+1.9bps ▲ to 205bps
Fin Sub	+0.6bps ▲ to 288bps
Cons Staples	+4.8bps ▲ to 469bps
Healthcare	+1.5bps ▲ to 326bps
Utes	+3.2bps ▲ to 220bps *

DATE	TIME	DESCRIPTION	ESTIMATE	LAST
7/29	2:00 PM	Jul 29 FOMC Decision	3.75	3.75
7/30	8:30 AM	Jun PCE m/m	-0.1	0.4
7/30	8:30 AM	Jun Core PCE m/m	0.2	0.32
7/30	8:30 AM	Jun PCE y/y	3.7	4.1
7/30	8:30 AM	Jun Core PCE y/y	3.3	3.41204
7/30	8:30 AM	2Q A GDP QoQ	2	2.1
7/31	8:30 AM	2Q ECI QoQ	0.8	0.9
7/31	10:00 AM	Jul F UMich 1yr Inf Exp	4.3	4.2
7/31	10:00 AM	Jul F UMich Sentiment	54	54.4
8/3	9:45 AM	Jul F S&P Manu PMI	n/a	53.8
8/4	8:30 AM	Jun Trade Balance	-71	-77.585
8/4	10:00 AM	Jun JOLTS	n/a	7594
8/4	10:00 AM	Jun F Durable Gds Orders	n/a	0.3

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