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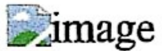
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Markets Shine Spotlight on Deficits

Stocks keep hitting records, but the past includes episodes of market unrest

BY JACK PITCHER AND SAM GOLDFARB

Worries about government deficits are making one of their periodic tours of Wall Street.

Investors say the prospect of bigger budget imbalances in the second Trump administration is a factor behind the recent climb in Treasury yields, which help set borrowing costs throughout the economy. This year's projected budget deficit of $1.9 trillion is already likely to reach more than 6% of economic output, a threshold crossed previously only during World War II, the 2008-09 financial crisis and the Covid-19 pandemic. Yet stocks keep hitting records.

With President-elect Trump's proposed tax cuts— and soaring Social Security and Medicare costs—projected to keep annual deficits at a historically high level, the debate over deficits is raging anew. Here's a look at how fiscal policy has affected investments during some recent administrations:

Ronald Reagan 1981-89

President Ronald Reagan's 1981 tax cuts contributed to a sharply higher federal deficit by the midpoint of his twoterm administration. It reached as high as 5.7% of GDP in 1983—enough to prompt concern among investors. In that year, economist

Edward Yardeni coined the term "bond vigilantes" for investors who will demand higher rates to buy Treasurys to compensate for the risks tied to budget imbalances and inflation.

"The idea of the bond vigilantes is that they intervene and maintain law and order if monetary and fiscal policy aren't going to do it," he said in a recent interview. "In the '80s, I think it actually had more to do with a fear that inflation would make a comeback than it had to do with the deficit."

The 10-year Treasury yield peaked above 15% in Reagan's first year, because of the Paul Volcker-led Federal Reserve's inflation fight. The combination of high rates and expansive fiscal policy attracted overseas money. The dollar got so strong that a group of developed countries agreed to deliberately weaken it during a 1985 meeting in Manhattan's Plaza Hotel.

George H.W. Bush 1989-93

Deficit reduction then became a priority in Washing--ton, D.C. President George H.W. Bush reneged on his "no new taxes" pledge after concluding that any agreement to cut the national deficit would need both spending cuts and tax increases.

"In '81 we passed the giant tax cut. And by '82 it was pretty clear they had gone way too far. And so from '83 to '97, across three administrations, all we did was deficit reduction," said Marc Goldwein, senior policy director for the Committee for a Responsible Federal Budget.

The deficit as a share of GDP peaked around 4.4% after the 1991 recession before falling to 3.7% by the end of 1993. The 10-year Treasury yield fell nearly 2.5 percentage points to around 6.4% at the end of Bush's term.

Bill Clinton 1993-2001

Entering the White House in 1993, Bill Clinton was caught between campaign promises to reduce the deficit and to deliver a middle-class tax cut. Economic advisers including Robert Rubin persuaded him to give priority to deficit reduction to help bring down longer-term Treasury yields. That prompted political adviser James Carville's quip that he would like to be reincarnated as the bond market because "you can intimidate everybody."

It wasn't a c o m p l e t e l y smooth ride: the 10-year yield surged above 8% in 1994 when the Fed was aggressively raising short-term rates. But yields retreated again afterward, as the Clinton- era boom briefly turned the deficit into a surplus.

"The world actually behaved the way economists think it should—you cut deficits, interest rates fall, you get more investment," said David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution.

George W. Bush 2001-09

Deficits grew to records after the Bush administration's 2001 and 2003 tax cuts and a major increase in military spending that followed the Sept. 11 terrorist attacks in 2001. Stocks mostly rebounded from the dot-com collapse, and short-term rates topped 5%.

Then the collapse of the housing market fueled the financial crisis of 2008-09. Stocks plunged, and the Fed cut short-term rates to zero.

Barack Obama 2009-17

Deficits soared again when the Obama administration, seeking to help the economy revive, launched early stimulus packages. But tighter fiscal policy followed, which some economists blame for a slow recovery.

Rates stayed near zero and the Fed bought bonds to ease strains on the banking system. That helped support stocks, while easy borrowing conditions helped fuel the technology boom. P o l i t i c a l brinkmanship around the debt ceiling in 2011, however, led to fears of a missed payment on Treasurys, the world's safest i nvestment, and sparked a credit downgrade of the U.S.

Stocks fell and investors sheltered in Treasurys before a deal was reached.

Donald Trump 2017-21

The Trump administration's early tax cuts put the deficit as a share of GDP back on the rise. Shares of banks, industrials and smaller companies soared along with bond yields, in what investors called the "reflation trade." Stocks hit records.

The unprecedented response to the Covid-19 pandemic in Trump's final year then widened the deficit again. A multitrillion-dollar bipartisan spending package kick-started a furious economic recovery, and sent the deficit as a share of GDP to the highest level since World War II.

Stocks recovered quickly after the Fed cut rates to near zero. Treasury yields hit rock bottom.

Joseph Biden 2021-present

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The Biden administration kept the spending rolling. The Fed began rapidly raising interest rates to combat inflation, driving up the government's interest costs. Meanwhile, tax revenues slipped.

The government sold more bonds to cover the gap, exacerbating a bond rout that raised the 10-year yield to 5%. Officials shifted the mix of borrowing a little toward debt with shorter maturities, helping calm markets.

Wall Street has since had little trouble absorbing the government's borrowing binge.

Continuing economic strength—and the prospect of bigger deficits under the next Trump administration—have helped drive bond yields higher in recent months. But some investors said that could still boost markets for some time.

"Generally speaking, deficit spending adds to corporate profits," said Sonu Varghese, global macro strategist at Carson Group. "Where things could get hairy is if the bond market feels like now rates have to be higher for longer, and that starts to crimp investment spending."

Note: Asset performance provided by Dow Jones Market Data except the S& P 500 total return for Reagan's presidency, which was provided by S& P Dow Jones Indices. Total returns for Treasurys are based on the Bloomberg US Treasury Index. Both Treasurys and the Reagan-era total stock returns are based on monthly readings and don't correspond precisely with inaugurations. Asset performance refers to either fouryear or eight-year periods, depending on the presidency. —Peter Santilli and Mike DeStefano contributed to this article.

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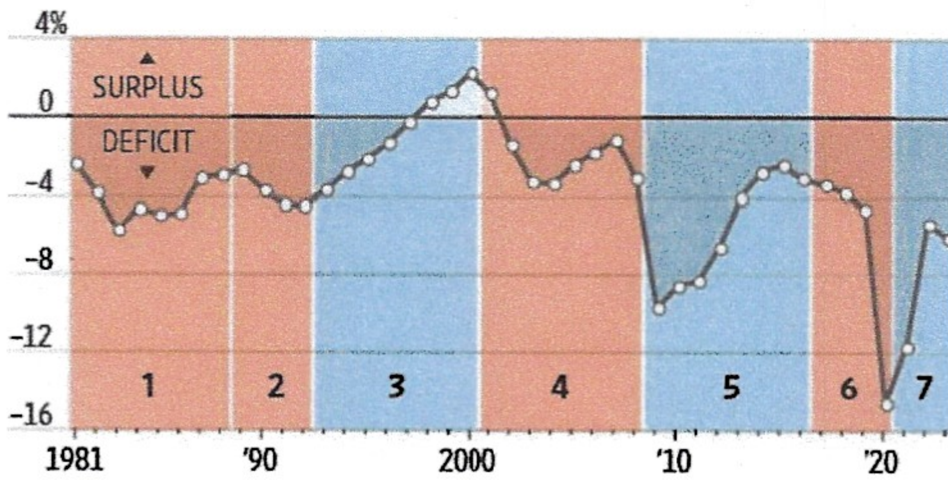
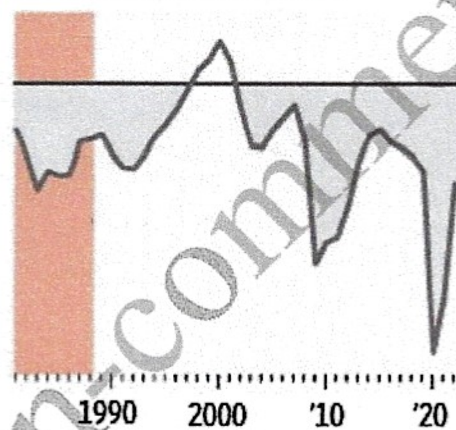
How Federal surplus/deficit as a percentage of GDP evolved, from 1981 to 2023



1 RONALD REAGAN



Asset performance

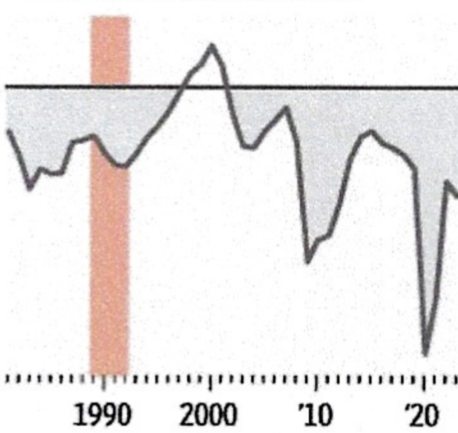
S&P 500
+223% total return

TREASURYS
+161% total return

DOLLAR
+5.3% U.S. Dollar Index

GOLD
−29% Front-month futures

2 GEORGE H.W. BUSH



Asset performance

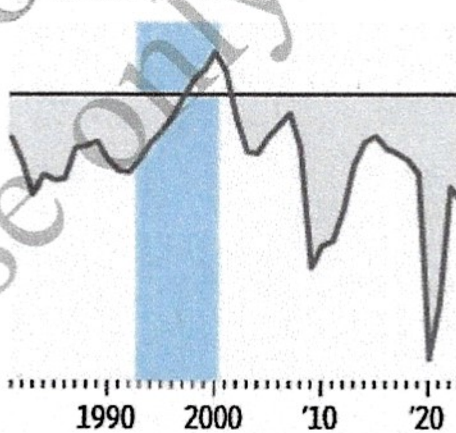
S&P 500
+73% total return

TREASURYS
+53% total return

DOLLAR
−3.2% U.S. Dollar Index

GOLD
−20% Front-month futures

3 BILL CLINTON



Asset performance

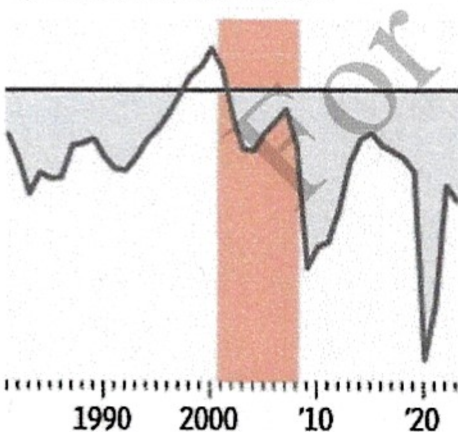
S&P 500
+264% total return

TREASURYS
+73% total return

DOLLAR
+21% U.S. Dollar Index

GOLD
−20% Front-month futures

4 GEORGE W. BUSH



Asset performance

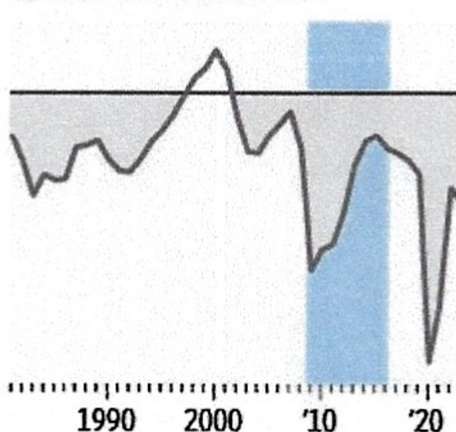
S&P 500
−20% total return

TREASURYS
+66% total return

DOLLAR
−23% U.S. Dollar Index

GOLD
+218% Front-month futures

5 BARACK OBAMA



Asset performance

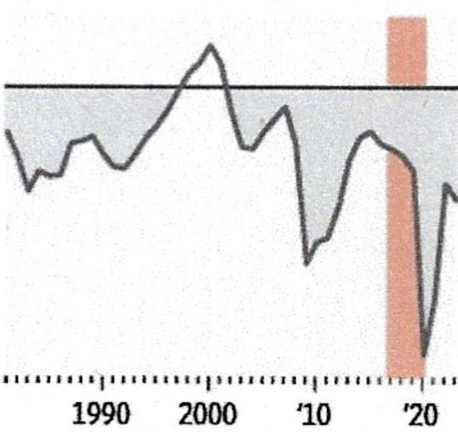
S&P 500
+234% total return

TREASURYS
+19% total return

DOLLAR
+17% U.S. Dollar Index

GOLD
+41% Front-month futures

6 DONALD TRUMP



Asset performance

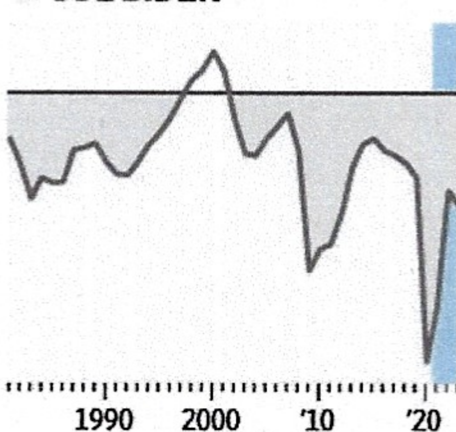
S&P 500
+81% total return

TREASURYS
+19% total return

DOLLAR
−10% U.S. Dollar Index

GOLD
+53% Front-month futures

7 JOE BIDEN



Asset performance*

S&P 500
+63% total return

TREASURYS
−10% total return

DOLLAR
+18% U.S. Dollar Index

GOLD
+42% Front-month futures

*Performance data are through Nov. 20, 2024.

Sources: U.S. Office of Management and Budget via Federal Reserve Bank of St. Louis (surplus/deficit); Dow Jones Market Data (assets)

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