Financial Markets This Week

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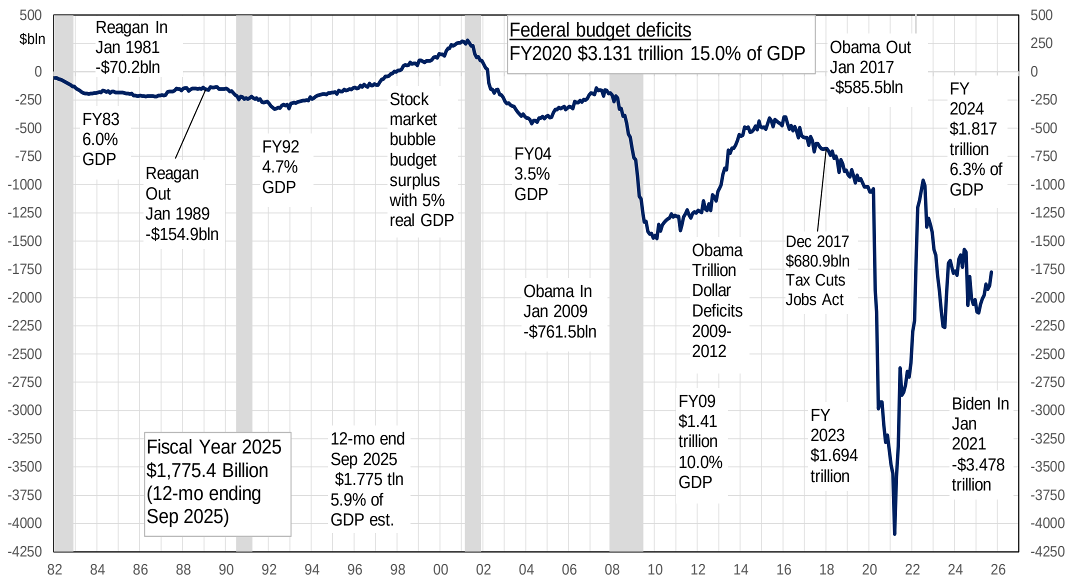
DEFICIT SPENDING



The FY2025 Federal budget deficit was released last week to little fanfare. It did not mean much to us, but maybe some in the Administration are embarrassed with the lack of progress. Maybe not. But not only is the country not paying down the National Debt, we can barely bring down each year's deficit, the deficit which by definition adds even more to the National Debt each year. The FY2025 deficit is $1.775 trillion down $41 billion from $1.817 trillion in FY2024. Customs duties were $194.9 billion this year versus $77.0 billion last year so the FY2025 deficit would have been $1.892 trillion without the Trump 2.0 trade war. Bessent always says it is not the deficit that matters, it is the deficit as a percent of nominal GDP. The idea that we can grow ourselves out of the deficit in theory over time. The deficit was 6.3% of nominal GDP last year, and if nominal GDP grows 6.0% in the third quarter, matching the increase in Q2 2025, then the Federal budget deficit will come down to 5.9% in FY2025. Now we're winning. Where else is the money coming from to keep too-much Government spending from wrecking the nation's finances? Overall Budget Receipts slowed to an increase of 6.4% this year, ending at $5.234 trillion. Tax deadlines were shifted for those in disaster areas in FY2023, making analysis tricky and will continue on a smaller scale into FY2026. Corporation taxes dropped 14.7% to $452.1 billion. July's 2025 reconciliation act, One Big Beautiful Bill if you are a corporation, allows the immediate expensing of certain capital investments, instead of writing the money off over several years. Payroll taxes are collected for Social Security and Medicare,

	Federal Government: Where's the Money Coming From?												
Fiscal Years $billons	Sep 2025	%	Sep 2024	%	Sep 2023	%	Sep 2022	%	Sep 2021	%	Sep 2020	%	Sep 2019
Budget Receipts	5,234.6	6.4	4,918.1	10.8	4,439.3	-9.3	$4896.1	21.0	$4046.0	18.3	$3420.0	-1.2	$3462.2
Income taxes	2,656.0	9.5	2,426.1	11.5	2,176.5	-17.3	2,632.1	28.8	2,044.4	27.1	1,608.7	-6.4	1,717.9
Corporation taxes	452.1	-14.7	529.9	26.3	419.6	-1.2	424.9	14.3	371.8	75.5	211.8	-8.0	230.2
Social Security/Medicare	1,685.6	2.0	1,653.0	6.1	1,558.1	10.4	1,410.7	12.7	1,251.9	-0.8	1,261.7	5.4	1,197.4
Unemployment insurance	54.0	12.7	48.0	-2.9	49.4	-25.7	66.5	17.5	56.6	31.3	43.1	5.4	40.9
Excise taxes	105.9	4.4	101.4	33.8	75.8	-13.6	87.7	16.5	75.3	-13.3	86.8	-12.3	98.9
Estate and Gift Taxes	29.5	-6.8	31.6	-6.1	33.7	3.4	32.6	19.9	27.1	54.0	17.6	5.5	16.7
Customs Duties	194.9	--	77.0	-4.1	80.3	-19.6	99.9	24.9	80.0	16.7	68.6	-3.2	70.8
Miscellaneous	47.9	11.0	43.2	10.8	39.0	-71.2	135.4	1.6	133.3	14.4	116.5	37.8	84.6

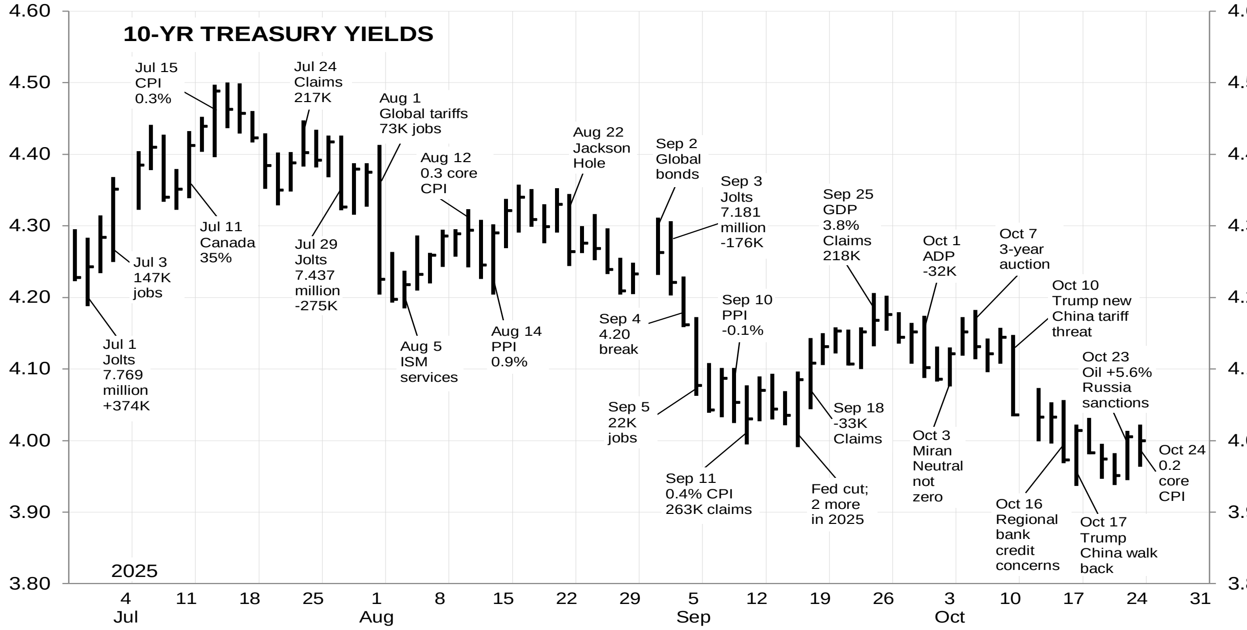
and these slowed, apparently reflecting slower jobs growth and wages.

Federal outlays rose 4.1% or $275.1 billion to $7.010 trillion in FY2025. There were some last minute September offsetting receipts from the public in September of $132.4 billion however that are related to the July 2025 reconciliation act's modifications to student loans made under the Department of Education. For all the talk of budget tightening down in Washington, it is not immediately apparent in the results so far.

Homeland Security is in the news and expenditures rose 29.1% to $115.3 billion this year, but not from border protection, or Immigration and Customs Enforcement (ICE). It was FEMA spending that increased 72.9% to $62.6 billion with Disaster Relief $51.9 billion and $7.4 billion from the National Flood Insurance Fund. Not sure any of that will ever get transferred to the states. State Department outlays did decline 23.4% to $28.4 billion; Global Health and Child Survival fell from $10.8 billion to $7.5 billion, and Migration and Refugee Assistance fell to $3.2 billion from $6.5 billion. New administration, new priorities, and the EOP did bring in a billion dollars of receipts from the public. Anyway it all adds up to $7 trillion of FY2025 Federal government spending. Though we don't want to forget the interest on the public debt climbed 7.3% to $1.215 trillon this year. Good thing the bond market doesn't care. 10-year Treasury yields fell to the 3.94% 2025 yield low again this week.

Federal Government Spending ($bln) Where to cut?	4 Qtrs FY25 Q4 24-Q3 25	4 Qtrs FY24 Q4 23-Q3 24	Fiscal Year Changes	Fiscal Year % chg
TOTAL BUDGET OUTLAYS	7,009.974	6,734.896	275.078	4.1
Legislative	7.233	6.835	0.398	5.8
Judicial	9.759	9.480	0.279	2.9
Agriculture	227.432	203.402	24.030	11.8
Fed Crop Insurance fund	13.805	9.768	4.037	41.3
Food Stamps	106.335	106.754	-0.419	-0.4
Child Nutrition	33.375	32.733	0.642	2.0
Commerce	29.712	14.831	14.881	100.3
Defense	868.412	826.277	42.135	5.1
Military Personnel	206.529	191.945	14.584	7.6
Operation Maintenance	342.398	332.047	10.351	3.1
Procurement	161.960	152.259	9.701	6.4
Research Development	141.429	137.960	3.469	2.5
Military Construction	13.152	12.068	1.084	9.0
Education	34.718	267.918	-233.200	--
Office of Federal Student Aid	111.227	160.258	-49.031	-30.6
Energy	52.292	49.315	2.977	6.0
Health Human Services	1884.277	1720.622	163.655	9.5
Medicare	1189.041	1052.675	136.366	13.0
Medicaid States Grants	668.139	617.517	50.622	8.2
Homeland Security	115.306	89.290	26.016	29.1
Housing Urban Development	50.533	51.976	-1.443	-2.8
Interior	22.402	17.085	5.317	31.1
Justice	44.948	43.995	0.953	2.2
Labor	50.383	65.040	-14.657	-22.5
State Unemployment Benefits	38.023	36.611	1.412	3.9
State	28.362	37.017	-8.655	-23.4
Transportation	127.583	117.389	10.194	8.7
FAA	24.806	23.096	1.710	7.4
Federal Highway Admin.	65.033	61.123	3.910	6.4
Treasury	1458.910	1316.852	142.058	10.8
IRS	234.015	183.566	50.449	27.5
Premium Tax Credit	129.260	110.195	19.065	17.3
Earned Income Credit	66.007	60.011	5.996	10.0
Child Tax Credit	26.567	26.247	0.320	--
Interest on Public Debt	1215.614	1133.037	82.577	7.3
Veterans Affairs	376.591	325.012	51.579	15.9
Corps of Engineers	12.124	11.345	0.779	6.9
Other Defense Civil Programs	76.488	66.220	10.268	15.5
Environmental Protection	36.976	13.706	23.270	169.8
Exec. Office of President (EOP)	-0.508	0.607	-1.115	-183.7
International Assistance	17.294	20.192	-2.898	-14.4
NASA	24.576	25.015	-0.439	-1.8
National Science Foundation	9.949	9.392	0.557	5.9
Personnel Management	128.239	126.173	2.066	1.6
Small Business Admin.	36.173	33.197	2.976	9.0
Social Security Admin.	1646.515	1519.734	126.781	8.3
Retirement Benefits	1411.167	1293.782	117.385	9.1
Federal Disability Payments	157.436	153.918	3.518	2.3
Other Independent Agencies	6.788	77.793	-71.005	--

INTEREST RATES



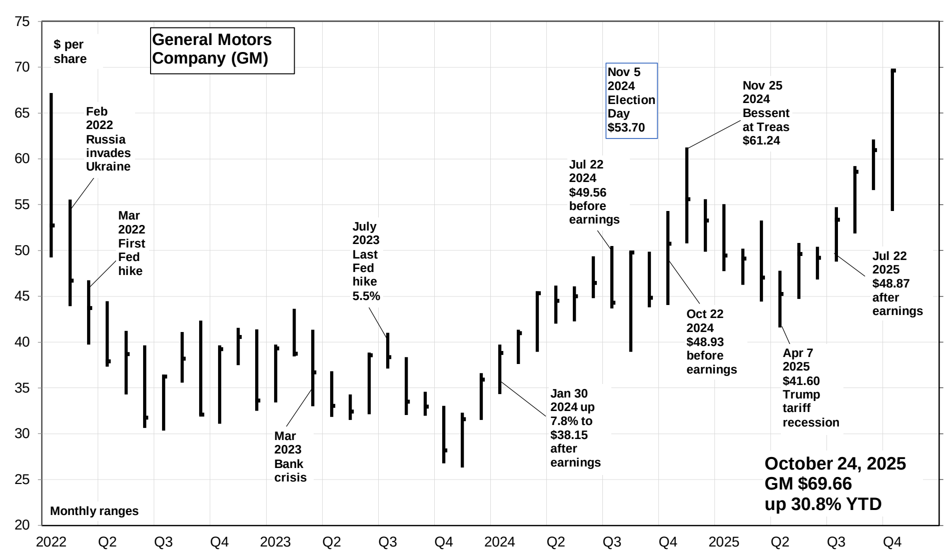
The trade threats against China, if not Canada, diminished somewhat this week so the stock market could continue to lift, helped along by better corporate earnings reports. Core CPI inflation was 0.2%, not 0.3%, and stocks jumped to record highs on Friday. It does not take much to keep the stock market from rallying higher and higher regardless of the news positive or negative in the Trump 2.0 era. No economic data is coming out with the Federal government still in lockdown, so the focus will be on another Trump plane trip this time to meet with good friend President Xi of China next week. Bond market reaction to "good, no-inflation" CPI report was a yield drop in minutes if not less from 4.02% to 3.97%, and then retracing that by 10am ET. Hopefully, the bond market did not trade on some PMI surveys before 10am ET. Some in the bond market questioned how accurate the CPI data were.

General Motors Company (GM) up 30.8% YTD

The company reported earnings before the bell on Tuesday, October 21 with the adjusted EPS of $2.80 beating the $2.26 estimate. The stock jumped 14.9% from $58.00 Monday to $66.62 on Tuesday. This was better than last quarter's results when the stock tumbled 8.1% on July 22. GM's share of US sales was steady at 17.0% in Q3 2025. Basically, the company on Tuesday raised its guidance for the year on expectations the tariff impact on its operations would be smaller than they thought.

	Sales and	Net	US Vehicle Sales		
Mln $	Revenue	Income	US	Total	Share
Q3 2025	48,591	1,327	710	4187	17.0%
Q2 2025	47,122	1,895	747	4297	17.4%
Q1 2025	44,020	2,784	693	4028	17.2%
Q4 2024	47,702	(2,961)	755	4323	17.5%
Q3 2024	48,757	3,056	660	4000	16.5%
Q2 2024	47,969	2,933	696	4181	16.6%
Q1 2024	43,014	2,980	594	3852	15.4%
Q4 2023	42,980	2,102	625	4021	15.5%
Q3 2023	44,131	3,064	674	4091	16.5%

Vehicle sales 000s



FEDERAL RESERVE POLICY

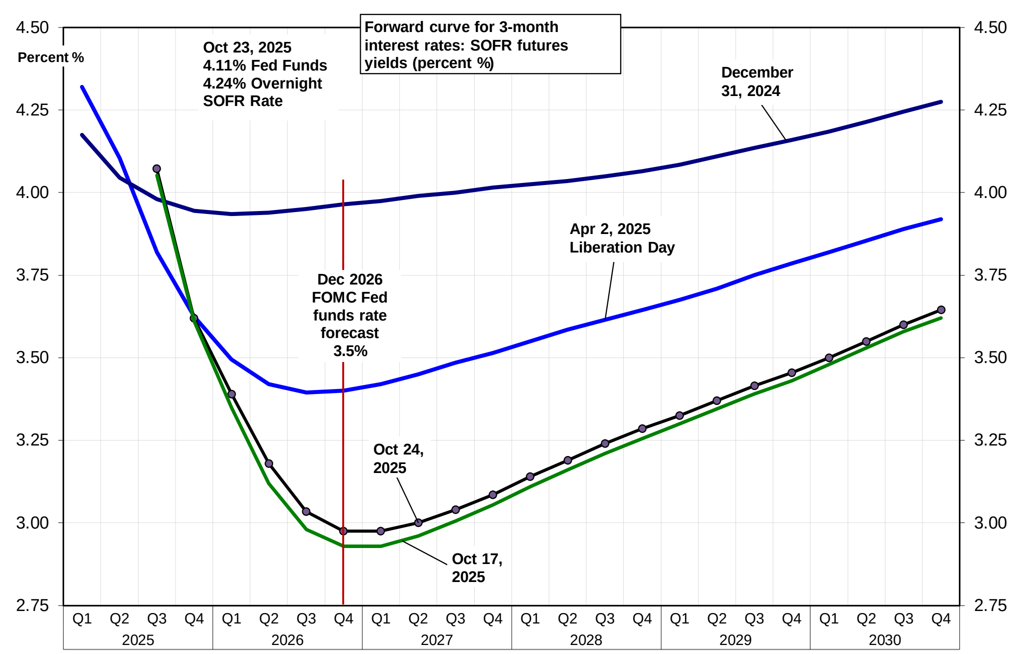
The Fed meets October 28-29, 2025 to consider its monetary policy. The first major economic data since the government shutdown at the end of September, and somehow a 25 bps Fed rate cut to 4% is still on track despite CPI inflation running 3.0% the last year. The Fed target is 2.0%. Many on the Committee have convinced themselves that the greater risk for monetary policy to address is weakness in the labor market, although there is no new recent economic data to point to. Aside from the economy, it isn't often that Fed officials cut interest rates when the stock market is at record highs. And indeed, 7 of the 19 participant "votes" on the September rates forecast did not want to cut rates again in 2025, and 9 out of 19 did not want to cut rates further than to 4.0%. But these are different times. Some in the White House are concerned about interest on the national debt, and cutting rates now would help lower the 4.187% interest paid on $6.4 trillion of Treasury bills at the end of September. The average interest on notes and bonds will continue rising slowly for now.

In addition to a second rate cut this year next week, Wall Street thinks the Fed will end quantitative tightening (QT) which somehow continues to run silently in the background, less for tightening and more for Fed officials not liking the size of their balance sheet. QT is only $5 billion per month for Treasuries which adds to the amount of Treasury auctions.

Selected Fed assets and liabilities Fed H.4.1 statistical release billions, Wednesday data	22-Oct	15-Oct	8-Oct	1-Oct	3/11/20*	Change from 3/11/20 to Oct 22
Factors adding reserves						
U.S. Treasury securities	4196.467	4196.270	4196.659	4196.385	2523.031	1673.436
Federal agency debt securities	2.347	2.347	2.347	2.347	2.347	0.000
Mortgage-backed securities (MBS)	2082.606	2085.996	2085.983	2085.983	1371.846	710.760
Repurchase agreements	0.001	6.751	2.098	0.000	242.375	-242.374
Primary credit (Discount Window)	7.349	6.018	6.243	7.170	0.011	7.338
Bank Term Funding Program	0.000	0.000	0.000	0.000		
FDIC Loans to banks via Fed	0.000	0.000	0.000	0.000		
Paycheck Protection Facility	0.072	0.074	0.075	0.075		
Main Street Lending Program	3.980	3.976	4.166	4.160		
Term Asset-Backed Facility (TALF II)	0.000	0.000	0.000	0.000		
Gold stock	11.041	11.041	11.041	11.041	11.041	0.000
Central bank liquidity swaps	0.037	0.030	0.045	0.040	0.058	-0.021
Federal Reserve Total Assets	6640.4	6647.2	6641.7	6637.4	4360.0	2280.387
~~3-month Libor %~~ SOFR %	4.21	4.29	4.12	4.20	1.15	3.060
Factors draining reserves						
Currency in circulation	2417.623	2419.358	2416.556	2412.488	1818.957	598.666
Term Deposit Facility	0.000	0.000	0.000	0.000	0.000	0.000
U.S. Treasury Account at Fed	905.074	851.952	794.054	819.378	372.337	532.737
Treasury credit facilities contribution	2.029	2.029	2.029	2.029		
Reverse repurchases w/others	4.005	5.484	5.231	10.179	1.325	2.680
Federal Reserve Liabilities	3710.776	3659.047	3607.814	3657.806	2580.036	1130.740
Reserve Balances (Net Liquidity)	2929.637	2988.202	3033.855	2979.594	1779.990	1149.647
Treasuries within 15 days	58.840	36.104	33.916	41.628	21.427	37.413
Treasuries 16 to 90 days	194.818	182.578	187.121	158.247	221.961	-27.143
Treasuries 91 days to 1 year	435.211	470.144	467.883	489.002	378.403	56.808
Treasuries over 1-yr to 5 years	1413.258	1413.223	1414.768	1414.656	915.101	498.157
Treasuries over 5-yrs to 10 years	506.782	506.755	506.004	505.977	327.906	178.876
Treasuries over 10-years	1587.557	1587.466	1586.967	1586.877	658.232	929.325
Note: QT starts June 1, 2022	Change	10/22/2025	6/1/2022			
U.S. Treasury securities	-1574.312	4196.467	5770.779			
Mortgage-backed securities (MBS)	-624.840	2082.606	2707.446			
**March 11, 2020 start of coronavirus lockdown of country						

Fed Policy-key variables	2025	2026	2027	2028	Long Term
Fed funds	3.6	3.4	3.1	3.1	3.0
PCE inflation	3.0	2.6	2.1	2.0	2.0
Core inflation	3.1	2.6	2.1	2.0	
Unemployed	4.5	4.4	4.3	4.2	4.2
GDP	1.6	1.8	1.9	1.8	1.8
September 2025 median Fed forecasts					

Sep 2025	Marketable Treasuries $trillion	Average Rate %
Bills	6.396	4.187
Notes	15.387	3.112
Bonds	5.133	3.327



25 bps rate cuts ahead? All but 3.5 bps is discounted for October 29. All but 1 bps is discounted for December 10.

Fed funds futures call Fed policy		
Current target: October 24 -- 4.25%		
Rate+0.17	Contract	Fed decision dates
4.035	Nov 2025	Oct 29*
3.760	Jan 2026	Adds Dec 10*
*Not strictly true, Nov 2025 and Jan 2026 contracts could be two days at a new rate		

OTHER ECONOMIC NEWS

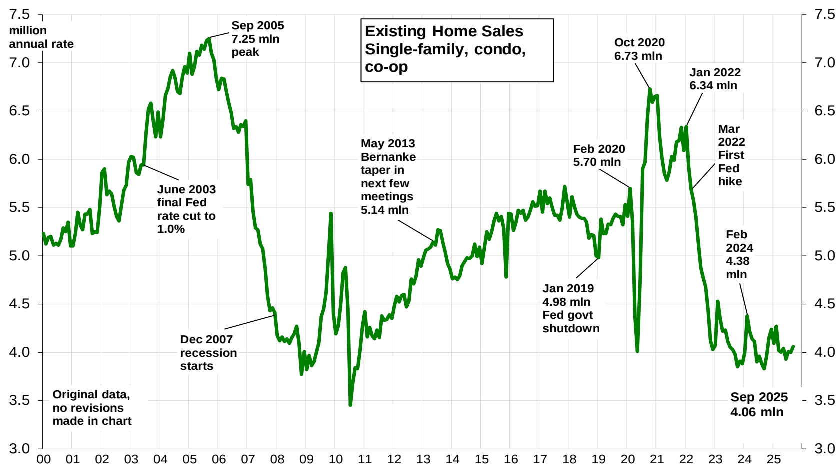
Existing home sales show modest improvement (Thursday)

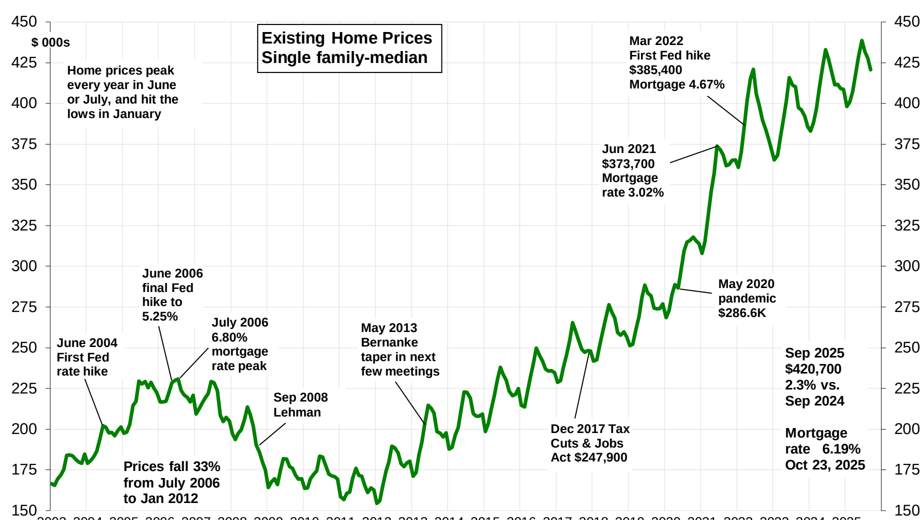
Breaking economy news. Existing home sales for September rose 1.5% to 4.06 million and are 4.1% higher than a year ago. Get out the microscope. Sales would have been up higher but for the 2.1% decline in the Midwest. The 4.06 million annual rate is the same level as 2024. On an annual basis sales dropped from 5.03 million in 2022 with the Fed's rate hikes and have yet to get up off the floor. Single-family home prices fell 1.6% to $420,700 and are down 4.1% from the June seasonal peak of $438,600. We are not sure the housing bubble is still exactly expanding, ahead of multiple Fed rate cuts expected over the next year from new Trump appointees, but prices are 2.3% above year earlier levels.

Existing Home Sales

Million	Total	Northeast	Midwest	South	West	Sum ck
2022	5.030	0.620	1.190	2.250	0.960	5.020
2023	4.090	0.490	0.980	1.880	0.740	4.090
2024	4.060	0.490	0.960	1.850	0.760	4.060
2025						
May	4.040	0.500	0.990	1.850	0.700	4.040
Jun	3.930	0.460	0.950	1.810	0.710	3.930
Jul	4.010	0.500	0.940	1.850	0.720	4.010
Aug	4.000	0.480	0.960	1.830	0.730	4.000
Sep	4.060	0.490	0.940	1.860	0.770	4.060

Net, net, sales turnover of existing homes improved slightly in September ahead of the Federal government shutdown. Affordability both on price and financing continues to keep existing home sales down at modest levels. Supply is a factor as well with homebuilders showing caution and existing home owners staying put as many bought homes during the decade of low interest rates from the Fed's easy money policies. The best one can say about the current market is that the Administration's radical economic policies have so far not led to a steeper downturn in sales. Homebuyers and sellers are not panicking, they are simply staying put for now. Home prices are heading lower as they normally do following the peak summer selling season although single-family home prices of $420,700 are up 2.3% from year-ago levels. Stay tuned. The markets are starved for economic data to see which way the wind is blowing, but today's existing home sales report is unlikely to provide much of a clue. If anything, the slow turnover rate in home sales is not reflecting the third quarter strength in real GDP and consumer spending which is likely running over 3%. The real question is why are home sales so cold when the overall economy is, dare we say hot?



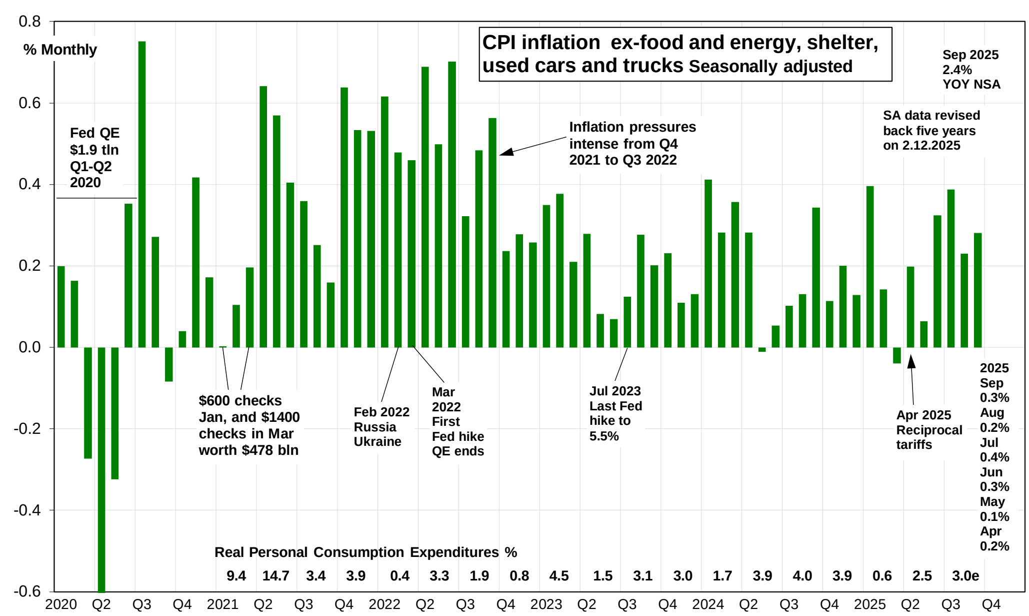


Where's the inflation (Friday)

Breaking economy news. Headline CPI inflation rose 0.3% in September and is 3.0% higher than last year. Core CPI inflation rose 0.2% (0.227) and is 3.0% higher than a year ago. Core inflation rising 0.227 instead of 0.251% made all the difference if you have money in the stock market. Core inflation minus shelter, used cars and trucks did rise 0.3%, and has been higher since the Trump 2.0 reciprocal tariffs announcement on April 2, 2025. If we look at goods that are most affected by the costs imposed by import tariffs, we find new vehicles increased 0.2% and is 0.8% year-year, apparel rose 0.7%, but is down 0.1% since last year, food at home up 0.3% and 2.7% year-year. Also tariff challenged is household furnishings and supplies up 0.2% in September and 3.0% higher than last year; Toys fell 0.1% and are 0.2% higher than a year ago. In the news lately is beef and veal that rose 1.2% in September and is 14.7% higher than last year. Electricity is up 5.1% from last year and gas is up 11.7%.

Jun 25		Monthly Percent Changes			YOY %
Weight	CPI inflation	Jul 2025	Aug 2025	Sep 2025	Sep 2025
100.0	Total	0.2	0.4	0.3	3.0
13.691	Food	0.0	0.5	0.2	3.1
7.988	Food at home	-0.1	0.6	0.3	2.7
5.646	Food away from home	0.3	0.3	0.1	3.7
6.453	Energy	-1.1	0.7	1.5	2.8
2.968	Gasoline	-2.2	1.9	4.1	-0.5
79.914	Ex-food & energy	0.3	0.3	0.2	3.0
4.320	New vehicles	0.0	0.3	0.2	0.8
2.421	Used cars/trucks	0.5	1.0	-0.4	5.1
2.493	Clothing	0.1	0.5	0.7	-0.1
1.513	Medical care goods	0.1	-0.3	-0.1	0.7
35.418	Shelter	0.2	0.4	0.2	3.6
26.167	Owner equiv. rent	0.3	0.4	0.1	3.8
6.305	Transportation	0.8	1.0	0.3	2.5
6.750	Medical care services	0.8	-0.1	0.3	3.9
	Special: Where inflation might come back down to				
60.602	Services ex-energy	0.4	0.3	0.2	3.5
19.311	Commodities (core)	0.2	0.3	0.2	1.5

Net, net, inflation pressures at the core level were better than expected in September which gives Fed officials the green light to lower rates at next week's meeting. To be sure, core CPI inflation is still 3.0% higher than a year ago, but the immediate danger from the Trump 2.0 tariff policies have not yet fed through to inflation overall. The market will likely hold their applause however as one reason inflation is held in check may be due to the economic slowdown seen in many labor market indicators. Economic demand and consumer spending were likely strong last quarter, but for how long is the question if companies continue to announce new layoffs every day and payroll jobs creation has slowed to a crawl. We live in extraordinary times, but Fed officials are experiencing something previous Fed officials have not. The Fed is about to lower interest rates with a red hot stock market and inflation of 3.0% the last year which is far away from the 2 percent target. Stay tuned. Inflation may not be under control, but the fire is not running out of control either. Bond markets have the right call and the CPI data today have led 10-yr Treasury yields to decline as investors look forward to an interest rate adjustment next week.



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