Federal tax receipts surged 26% in April 2005 compared to April 2004, putting the budget almost $58 billion in surplus. Although the surprisingly strong tax receipts were good news, given the volatility of this series, particularly in April, the best that can be said is that receipts could signal that the federal budget deficit will not again set a record this fiscal year. The strong receipts provide further evidence that the budget deficit may have bottomed out for the cycle; the 12-month moving average has been improving since April 2004.

Before getting too optimistic about the budget prospects, we should note that a great deal of spending pressure remains. Defense and health outlays have been in the forefront, and few observers expect spending in these areas to slow, let alone decline. In a recent development, interest outlays rose slightly last year after falling since 1997. Budget surpluses drove this figure down in the late 1990s; falling interest rates continued to cut the cost despite the budget deficits that returned in April 2002. With continued deficits and the rise in short-term rates, interest outlays now appear to be on an upward path.

Last year, despite these spending pressures, federal outlays as a share of GDP eased down 0.1 percentage point to 19.8%. Federal receipts’ share of GDP, which has been falling sharply since 2000, continued to fall (albeit only slightly) and now stands at 16.5%. The net result is that the 2.4% of GDP budget surplus in 2000 has become a –3.6% of GDP deficit. At some point, policymakers must reconcile the nearly 20% of GDP they want to spend and the only 16.5% of GDP they seem willing to tax.

**SOURCES:** U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of the Treasury; and Office of Management and Budget.