# WisdomTree Minds on the Markets



**Kevin Flanagan**
Head of Investment and Fixed Income Strategy



**Bradley Krom**
Director, Investment Strategy

**Mind the $2 Trillion Gap**

**Week of October 26, 2026**

With the recent movements in both the stock and bond markets, there was some noteworthy news that got kind of lost. Indeed, the U.S. government posted a $1.99 trillion budget deficit for fiscal year (FY) 2026. While technically it is not a record amount of red-ink, it represented the largest non-COVID-related shortfall ever recorded in modern history.

The key question to ask is how much it actually matters for the bond market in the grand of schemes. That is certainly a fair query to ponder. We have opined on many occasions that budget deficits are not typically the primary driver of where interest rates are headed. To be sure, macro forces, such as the economy, inflation and any monetary policy decisions are the primary drivers for rates. That being said, budget deficits and attendant supply considerations can have secondary effects and can either add to or delete from an existing trend.

Against this backdrop, let's dive a little deeper into the nation's balance sheet. Here are the most pertinent facts:

- The FY deficit rose by $217 billion, or +12.2% to $1.99 trillion
- Total revenues rose +3.2%, led by an increase of almost $190 billion in individual income tax receipts
- For those keeping track, the tariff-related customs duties category actually fell by roughly $22 billion
- Total outlays increased +5.5%, more than eclipsing any gains on the revenue side of the ledger

On the spending side, two of the more non-interest related culprits behind the higher total were Department of Defense and Department of Health and Human Services (HHS). Increased outlays for Defense should not come as a surprise given the war in the Middle East. With respect to HHS, the overall year-over-year increase was centered in Medicare and Medicaid.

Obviously, one of the more talked about areas within total outlays is interest on the public debt. While some of the focus is on the 'net' interest figure, we believe the 'gross' amount is what we should be looking at because that is the actual amount of interest the Treasury is paying on the public debt. With that in mind the total figure for FY 2026 came in at $1.4 trillion, up nearly 12% from the prior fiscal year. The aspect of interest outlays that receives the lion's share of attention is what percentage does that make up for total outlays, and that figure is 18.4%, a full percentage point above the FY 2025 number.

So, that brings us to the question of where the deficit will be headed and the potential implications for the Treasury (UST) market. The beginning point to keep into consideration is that the baseline red ink total for the U.S. going forward is $2 trillion. Based on estimates from the Congressional Budget Office (CBO), this shortfall will be going in an ascending trajectory, and certainly not the other way around.

Against this backdrop, it has now become a matter of when, not if, the nation's debt managers have to increase coupon auction sizes. As we mentioned earlier, deficits and supply may not be a primary driver for future interest rate trends, but the budget-related backdrop will definitely not be a 'rate-friendly' one looking ahead.

**For more information, contact your WisdomTree representative or visit WisdomTree.com/us.**

**Please see the WisdomTree Glossary for definitions of terms and indexes.**

**Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before investing. For a prospectus or, if available, the summary prospectus containing this and other important information about the Fund, call 866.909.9473 or visit WisdomTree.com/us. Read the prospectus or, if available, the summary prospectus carefully before investing.**

Past performance does not guarantee future results.

Important Risk Information:

There are risks associated with investing, including the possible loss of principal. Foreign investing involves currency, political and economic risk. Funds focusing on a single country and/or sector and/or funds that emphasize investments in smaller companies may experience greater price volatility. Emerging markets, real estate, currency, fixed income and alternative investments include additional risks. Please see the prospectus for a discussion of risks.

This material contains the opinions of the authors, which are subject to change, and should not be considered or interpreted as a recommendation to participate in any particular trading strategy or deemed to be an offer or sale of any investment product, and it should not be relied on as such. There is no guarantee that any strategies discussed will work under all market conditions. This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This material should not be relied upon as research or investment advice regarding any security in particular. The user of this information assumes the entire risk of any use made of the information provided herein.

Kevin Flanagan and Jeff Weniger are Registered Representatives of Foreside Fund Services, LLC.

WisdomTree Funds are distributed by Foreside Fund Services, LLC.

