First Trust
Monday Morning OUTLOOK
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630-517-7756 • www.ftportfolios.com

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – *Senior Economist*
Strider Elass – *Economic Analyst*
Andrew Hull – *Economic Analyst*

Hysteria and the Debt Debate

Contrary to popular belief, the "debt ceiling" has turned into the investor's best friend. Professional politicians don't like it, because they don't want to limit their degrees of freedom. But the "limit" on debt, forces a debate about the size of government (and spending) before a country gets to the point of no return. In other words, the debt ceiling is a good thing.

Moody's (the rating agency) has said that the US should get rid of the debt ceiling altogether, but this has it exactly backward. Greece never had this debate and spent its way into oblivion. The debt ceiling could very well keep the US from that fate. Nonetheless, the professional political class (and this includes the ratings agencies), are trying to scare people with a forecast of Armageddon.

This is hysteria and politics. Remember the fears about Y2K? Cars won't start…elevators will stop…planes will fall out of the sky…ATMs will freeze. Well, none of it happened then, and a downgrade by ratings agencies, like Moody's and S&P, or a few days failure to pass a debt ceiling increase, will not make it happen now.

There is absolutely no chance that the United States will "default" on its debt. Every dime of interest will get paid and every penny of principal will be rolled over. The markets understand this and that's why the government can still borrow money at 3% or less for 10 years. The US is not Greece, it is not even close. The US does not need Germany and the IMF (like Greece did) to help it pay principal and interest. The US has more than enough tax revenue to pay interest on bonds.

The ratings agencies know this, too. But they say, even if the US pays its interest and even if the debt ceiling is raised, they could downgrade US debt for political dysfunction.

What are we missing, here? Democracy is chaotic and noisy. The US is not insolvent, nor is it illiquid. The ratings agencies, like many politicians, would like the whole thing to go away, but the Tea Party won't let it. A courageous group of politicians, including Michele Bachmann (R, MN) are forcing the government to debate its size and scope.

Don't be fooled. If it weren't for the November 2010 elections, and the rise of the Tea Party (which includes a huge number of Reagan Democrats and Independents), none of this would be happening. Status quo Republicans and Democrats would have voted on a clean increase in the debt ceiling, and the US would be happily spending its way into oblivion, which would not be noticed by the ratings agencies until a bond auction failed, or something dramatic happened.

Three things about this really bother us. First, where were the rating agencies when spending was ratcheted up so much? Why are they only speaking out now? Second, massive amounts of spending were done in the name of short-term economic stimulus. Forget whether it worked or not – how did this become permanent spending? And third, what about the economy? The huge increase in government spending has hurt the economy, cutting it back will boost growth.

Our models suggest that without the large increase in government spending that has occurred over the past five or six years, real GDP would be 3.2% larger today ($450 billion) than it is, the unemployment rate would be 7.6%, the US would have 2.5 million more jobs, and the stock market would be 24% higher (Dow 15,650 and S&P 1660).

The debt ceiling seems to be the only tool that might work. The benefits of using it, if successful in cutting the size of government relative to GDP, could be huge. Not only would jobs and growth pick up, but the stock market would rise, too.

What investors should be worried about is if this debate fails to limit the size of government, not that it leads to a pointless and unjustifiable downgrade by ratings agencies. Investors need to remain calm. Let the politicians be hysterical.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-26 / 9:00 am	Consumer Confidence - Jul	**56.0**	**54.6**		58.5
9:00 am	New Home Sales - Jun	0.322 Mil	**0.325 Mil**		0.319 Mil
7-27 / 7:30 am	Durable Goods - Jun	+0.3%	**-1.9%**		+2.1%
7:30 am	Durable Goods (Ex-Trans) - Jun	+0.5%	**-0.2%**		+0.7%
7-28 / 7:30 am	Initial Claims - Jul 23	410K	**415K**		418K
7-29 / 7:30 am	Q2 GDP Advance Report	+1.8%	**+1.3%**		+1.9%
7:30 am	Q2 GDP Chain Price Index	+2.0%	**+2.3%**		+2.0%
8:45 am	Chicago PMI - Jul	60.0	**61.1**		61.1
8:55 am	U. Mich. Consumer Sentiment	64.0	**65.0**		63.8