630-322-7756
www.ftportfolios.com

FIRST Trust ADVISORS L.P.

Apr 17, 2006

Monday Morning Outlook

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-17 / 7:30 am	Apr Empire State Mfg Survey	24.0	25.0	**15.8**	29.0 - r
4-18 / 7:30 am	Mar Housing Starts	2.04M	2.05M		2.12M
	Mar PPI	+0.4%	+0.4%		-1.4%
	Mar "Core" PPI	+0.2%	+0.3%		+0.3%
	Mar Leading Indicators	+0.1%	+0.2%		-0.2%
4-19 / 7:30 am	Mae CPI	+0.4%	+0.4%		+0.1%
	Mar "Core" CPI	+0.2%	+0.3%		+0.1%
4-20 / 7:30 am	Initial Unemployment Claims	303K	300K		313K
11:00 am	Apr Philadelphia Fed Survey	15.0	16.0		12.3

Deficits: Do They Matter?

With mid-term elections on the horizon and interest rates rising, a ratcheting up of concern about the federal government budget deficit will not be far behind. These fears are nothing new. Ever since the early 1980s, whenever deficits existed, forecasts of economic problems multiplied.

The fact that none of the dire forecasts has ever come true does not deter many economists or politicians from repeating them again and again. Deficits are a political lightning rod. As a result, the real underlying economic issues have been ignored or forgotten.

Deficits first became a serious macroeconomic issue roughly 75 year ago. John Maynard Keynes argued that consumers were helping to cause the Great Depression because they were saving too much. His prescription was deficit spending. If consumers would not spend, then the government should. He viewed deficits as a pro-growth tool and even thought that government spending had a multiplier affect, making it even more powerful than private sector spending. Typically, a Keynesian stimulus package called for increased spending, not tax cuts.

Sometime in the early 1980s, the thinking about deficits changed. They began to be viewed as a negative for the economy. During the Reagan years, deficits were attacked because they would "crowd out" private investment, push up interest rates and inflation, and hurt the economy. This 180-degree reversal in the theory behind deficits and the economy took place following a shift toward supply-side policies. Supply-siders think entrepreneurs create wealth, not consumers or governments. Tax cuts stimulate work effort, saving and investment. As a result, tax cuts boost productivity, or supply.

One of the first things we learn about in Econ 101 is supply and demand. So, if tax cuts boost supply, then with any given monetary policy, inflation will be lower following tax cuts than without them. In the 1980s, monetary policy was tightened while tax rates were cut. This combination of policies led to lower inflation and interest rates, contrary to the dire warnings of those who thought budget deficits would crowd out private investment. And, even after recent increases, long-term interest rates are still below levels seen during the budget surplus years of 1999-2001.

Deficits, in a supply-side world view, are not an effective macroeconomic policy tool. It's not that deficits do not matter, but that they have no direct impact on the economy. What matters is how deficits are created. Every dollar the government spends must be either taxed or borrowed from the private sector. The larger the government sector, the smaller the private sector.

This leads us to recent developments. Tax rates have been cut, the economy and tax revenues are booming, government spending is soaring, budget deficits are large, the Fed has been accommodative, inflation is moving up, and so are interest rates.

Rising interest rates and higher inflation are the result of Fed policy, not budget deficits. Soaring tax revenues are a sign that lower tax rates stimulated growth in the supply side of the economy. The one worry we have is that government spending has soared – from 18.4% to 20.1% of GDP between 2000 and 2005. This spending represents resources shifted from the private sector to the public sector. With entitlement spending set to rise dramatically in coming decades, this spending is the real threat to the economy.

Week of April 24, 2006

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
4-25 / 9:00 am	Mar Existing Home Sales	6.70M	6.50M		6.91M
4-26 / 7:30 am	Mar Durable Goods Orders	+1.5%	+1.8%		+2.7%
9:00 am	Mar New Home Sales	1.11M	1.150M		1.08M
4-28 / 7:30 am	Q1 Real GDP:	+4.8%	+4.9%		+1.6%
	Q1 GDP Price Index	+3.0%	+2.8%		+3.3%
9:00 am	Apr Chicago PMI	58.5	60.0		60.4

Brian S. Wesbury; Chief Economist **Bill Mulvihill; Senior Economist**