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Monday Morning Outlook

Brian S. Wesbury - Chief Economist
Robert Stein, CFA - Senior Economist

Deficit Rising, But Tax Hikes Not Warranted

Later today the Treasury Department will announce federal budget figures for April (the month when tax payments are due). We expect the figures to show a $161 billion surplus in April, which would leave the federal budget, after the first seven months of the 2008 Fiscal Year, with a $150 billion deficit. For comparison, the deficit for the same period last year (in FY 2007) was $81 billion.

Trouble is, those rebate checks most taxpayers have just started receiving – the bulk of which will be distributed in May, June, and July – are going to make a large dent in the federal budget this year. The Congressional Budget Office anticipates a deficit of $357 billion for all of FY 2008 – roughly $200 billion more than last year.

However, even at this supposedly lofty level, the deficit would still be only 2.5% of total US Gross Domestic Product. To put this in perspective, the deficit has averaged 2.5% of GDP since 1970. Moreover, the deficit will shrink rapidly after FY 2008 because future stimulus packages are unlikely.

Despite the probable decline in the deficit in the next few years, there are some policymakers who advocate higher taxes as a way to fix today's rising deficit, while others view rising long-term entitlement costs as a reason to hike tax rates.

But let's step back and think about these issues in an accounting or financial sense. US Treasury borrowing costs are low – the 30-year bond is at 4.5% and the 10-year is at 3.8%. At the same time the average return on investment for publicly traded US companies is slightly over 10%. From a financial engineering, or portfolio, perspective, it is more efficient to have the government borrow to finance its activities, while private companies continue to grow assets and earnings at a faster rate. In other words, the US government would be better off in the long run, using debt to finance itself, not the equity of the nation's businesses.

Taking resources away from private business, and accepting lower overall returns from a less efficient financial structure, will actually make the problems associated with long-term entitlement costs worse, not better. Current models do not take into account the efficiency of the financial structure, and as a result often underestimate the costs to the economy of raising taxes in an environment of higher private returns.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-12 / 1:00 pm	Treasury Budget - Apr	$159.0 Bil	**$161.0 Bil**		-$48.1 Bil
5-13 / 7:30 am	Retail Sales - Apr	-0.1%	**+0.2%**		+0.2%
7:30 am	"Core" Retail Sales - Apr	+0.3%	**+0.4%**		+0.1%
7:30 am	Import Prices – Apr	+1.7%	**+1.5%**		+2.8%
7:30 am	Export Prices - Apr	+0.6%	**+0.8%**		+1.5%
7:30 am	Business Inventories - Mar	+0.4%	**+0.5%**		+0.6%
5-14 / 7:30 am	CPI - Apr	+0.3%	**+0.3%**		+0.3%
7:30 am	"Core" CPI - Apr	+0.2%	**+0.2%**		+0.2%
5-15 / 7:30 am	Empire State Mfg Index - May	0.6	**5.0**		0.6
7:30 am	Initial Claims – May 3	370K	**362K**		365K
8:15 am	Industrial Production - Apr	-0.3%	**-0.3%**		+0.3%
8:15 am	Capacity Utilization - Apr	80.1%	**80.1%**		80.5%
9:00 am	Philly Fed Survey - May	-20.0	**-21.2**		-24.9
5-16 / 7:30 am	Housing Starts - Apr	0.940 Mil	**0.930 Mil**		0.947 Mil
8:45 am	U. Mich. Consumer Sentiment	62.2	**63.0**		62.6