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First Trust

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Monday Morning Outlook

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"Rosy Scenario" Hides Irresponsible Spending

In 2007, the federal budget deficit was $162 billion (or, 1.2% of GDP). For 2009, the budget deficit is projected to be eleven times larger: $1.752 trillion. This World War II-like deficit (12.3% of GDP), is not all on President Obama. Much of it is due to policies put in place by President Bush, Hank Paulson, and last year's Congress. President Obama's "stimulus" bill will certainly lift the deficit, but, to be fair, it is not the predominate force behind this year's large fiscal hole.

Nonetheless, contrary to the spin of big government-types, these deficits are not just temporary. In fact, the Obama Administration uses every trick in the book to convert an understandable and potentially temporary budget lapse this year into a structural lack of fiscal responsibility.

Despite the rosiest economic projections we have possibly ever seen, and one of the largest tax hikes in history, President Obama's budget fails to achieve balance at anytime in the next decade. The smallest deficit (at least as far as the eye can see) will be $533 billion in 2013. This is amazing, especially when the economic growth forecast is considered. Team Obama suggests that real GDP will grow significantly faster in the years ahead than it has in the past.

To top it off, that $533 billion deficit in 2013 assumes we have largely withdrawn our military from Iraq. In other words, if we look at just domestic spending, the budget deficit is growing even faster.

It is impossible to blame tax cuts for this situation. By 2013, the Bush tax cuts enacted in 2001 and 2003 would no longer be in place. In the Obama budget, tax revenue is expected to be 19% of GDP in 2013 – a higher share of GDP than in 2007. It doesn't take a rocket scientist at this point to understand that every dime of the increase in the deficit between 2007 and 2013 is due to higher spending, not excessively low taxes on the rich.

And one thing to remember about all of these numbers is that they are based on a very "rosy" economic scenario. If the economy falls short of the optimistic assumptions, the deficit will be substantially larger than projected.

The forecast is rosy from the get go. The budget forecasters assumed that the economy would grow at a 3% annual rate starting in April, and that real GDP would fall just 1.2% in 2009, from 2008. Then, from 2010 through 2013, the administration assumes that real GDP will grow at a 4.0% annual rate. To put this in perspective, it is twice as fast as the economy's 2.0% annual rate of growth between 2004 and 2008. This is not impossible, but the only other periods that came close to this 4% growth rate for such a prolonged period of time were in the late-1990s and mid-1980s. Forgive us for pointing this out, but both of these periods followed major shifts toward freer markets, and tax cuts, not bigger government and tax hikes.

There is no period in US history where tax rates and the size of government both increased, and yet real GDP growth accelerated as sharply as the Obama team forecasts.

If real GDP grows 1% slower on an annual basis, federal spending would be 23% of GDP in 2013, not 22%. The last time government spending was anywhere near this level, was in 1982-83, in the wake of the worst recession in post-war history with unemployment at 9.7%. But by 2013, according to the Obama forecast, the US will be in the fourth year of recovery, with an unemployment rate at 5.2%.

In other words, it is the Obama team's shift to an expanded government role in the economy and society that is boosting spending, not just spending to stimulate the economy. Deficits will remain extremely large because spending is so much above any historical ability of the economy to pay for it. And, the more taxes are lifted to pay for it, the slower the economy will grow and the less likely any economic data even remotely resembling the Obama Administration's rosy scenario will come to pass.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-11 / 1:00 pm	Treasury Budget - Jan	-$205.4 Bil	**-$203.1 Bil**		-$83.8 Bil
3-12 / 7:30 am	Retail Sales - Feb	-0.5%	**-0.3%**		+1.0%
7:30 am	"Core" Retail Sales - Feb	-0.1%	**+0.3%**		+0.9%
7:30 am	Business Inventories - Jan	-1.1%	**-0.8%**		-1.3%
7:30 am	Initial Claims - Mar 7	644K	**635K**		N/A
3-13 / 7:30 am	Int'l Trade Balance - Jan	-$38 Bil	**-$43.9 Bil**		-$39.9 Bil
7:30 am	Import Prices - Feb	-0.8%	**-0.7%**		-1.1%
7:30 am	Export Prices - Feb	-0.1%	**-0.1%**		+0.5%
8:45 am	U. Mich. Consumer Sentiment	55.0	**55.0**		56.3