First Trust
Monday Morning OUTLOOK
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Don't Fear the Sequester

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The double dip that never was, is certain this time…right? When automatic federal spending cuts – the sequester – takes place on March 1st, just say Sayonara to economic growth.

That's the conventional wisdom these days. And, by the way, this is the third time these spending cuts have hit the pouting pundits' radar screen. Back in August 2011, politicians made a deal to raise the debt ceiling, which set up a special "super committee," made up of six Democrats and six Republicans, which was supposed to make a deal to cut the deficit. Standard and Poor's cut the US debt rating to AA+ from AAA, but the super committee failed. Big surprise, right? As a result, across-the-board spending cuts were scheduled to go into effect on January 1, 2013 – the spending sequester.

But, of course, that didn't happen either. As part of the "fiscal cliff" deal at the start of the year, they agreed to postpone the sequester until March 1st.

Since then, Republicans have allowed the debt ceiling to rise again, thinking it was a loser politically, and instead have focused on the sequester as the appropriate vehicle to gain leverage on Democrats. They want to use the sequester as a tool to get broader spending reduction, especially reform of entitlement programs that are really at the core of our long-term budget problems. But this will not happen, and the sequester is highly likely to go into effect, as scheduled, on March 1.

The first thing to realize is that implementing the sequester is not the end of the world. Not by a long shot.

According to the Congressional Budget Office, if the sequester goes into effect as scheduled, it will reduce spending from its current path by $43 billion over the last seven months of this fiscal year – March to September. While this is 2% of all federal spending over that timeframe, it's only 0.5% of GDP and it's not an actual cut in the level of spending.

Many pundits throw around a figure of $85 billion in "cuts" for the remainder of this year, but that refers to "budget authority," not outlays. (Budget authority is what an agency *can* spend, outlays are what it *actually* spends.) Yes, if the sequester stays in place, outlay cuts would catch up to cuts in budget authority. And, contractors could lay-off people today if they don't see the authority for future spending.

But the reduction in planned spending increases of just $43 billion will not be as catastrophic as many fear. The phase-out of the payroll tax cut of the last two years, all by itself, is supposed to raise revenue by more than $100 billion per year. And, so far, we've yet to see evidence of a downturn.

Most importantly, this whole argument about spending cuts is based in Keynesian economics and misses the point. Federal spending is way too high. And every dime the government spends must be paid for by the private sector, in the form of taxes or debt (which is just taxes at a later date). The bigger the federal government, the smaller the private sector, the less dynamic the economy is and the fewer jobs are created.

As a result, we believe the sequester could be good for the economy and job creation. Unfortunately, a large share of the sequesters' budget cuts fall on the military (particularly defense procurement) instead of the entitlement programs that are driving our long-term spending problems. But, hey, this is what they agreed to and maybe it will force some lawmakers to get serious about actually fixing our problems rather than just kicking the can down the road.

Our biggest worry is that after March 1, President Obama makes a simple request to add back to military spending without finding budget cuts elsewhere to pay for it – or worse, with tax hikes – and Congress goes along. That would reverse the positive impact of the sequestration.

The bottom line is that the supposed negative impact of spending cuts is a figment of the exaggerated and fearful nature of the punditry. Don't fear the sequester; lean into the wind and pray that someone in DC is willing to do the right thing.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-20 / 7:30 am	PPI – Jan	+0.4%	**+0.2%**		-0.2%
7:30 am	"Core" PPI – Jan	+0.2%	**+0.3%**		+0.1%
7:30 am	Housing Starts – Jan	0.920 Mil	**0.925 Mil**		0.954 Mil
2-21 / 7:30 am	Initial Claims – Feb 16	355K	**352K**		341K
7:30 am	CPI – Jan	+0.1%	**+0.1%**		+0.0%
7:30 am	"Core" CPI – Jan	+0.2%	**+0.1%**		+0.1%
9:00 am	Existing Home Sales – Jan	4.900 Mil	**4.940 Mil**		4.940 Mil
9:00 am	Leading Indicators - Jan	+0.2%	**+0.2%**		+0.5%
9:00 am	Philly Fed Survey – Feb	1.0	**1.2**		-5.8