First Trust
Monday Morning OUTLOOK
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# Deficit? What Deficit?

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Hope that title caught your attention, but, you should know, we are only half joking. In June, the federal government recorded a $116.5 billion surplus! Yep, you read that right – surplus! – the largest surplus for any June ever. Government spending fell to $170 billion for June, 47% below last year.

Don't get to thinking Ronald Reagan and Bill Clinton have returned - they haven't. Deficits will return in the months, quarters, years, and decades, ahead. Nonetheless, the size of the surplus surprised analysts and created a brighter near- to mid-term outlook for the budget. In the long-term there are still major – really major – issues looming, mainly entitlements.

Also, we don't want you thinking the June numbers were completely kosher. Some big one-off factors played a large role. Fannie Mae made a $59 billion payment to the Treasury, or should we say to the taxpayers. And in the arcane world of federal budget accounting this counts as *negative* spending. Go figure. Meanwhile, with June 1 on a Saturday, $34 billion in monthly payments were sent on May 31, instead of June. Add those two back into spending and the picture looks different.

Still, some good things are happening. Tax receipts rose 10% from a year ago on the back of a recovering economy. While some will say it's tax rate changes from earlier this year, tax receipts have risen for four consecutive years.

Spending growth, even adjusting for the one-off factors, has slowed sharply – with total federal spending basically flat the past four years. Federal spending has dropped from 25% of GDP back down to 21% since 2009.

We say that with some enthusiasm because we want spending as a share of GDP to be falling. Lower spending as a share of GDP mean higher P-E ratios and stronger economic growth. But don't get too excited. Federal spending is still way too high. At 21% of GDP it's higher than any year from 1947 through 1974, or 1995 through 2008.

But the slower spending trend, combined with higher tax revenues, will contain the deficit. The deficit should be about 4% of GDP this year, down from over 10% in 2009. In 2014, it should be more like 3%, and then lower still in 2015. With deficit shares of GDP this low, the debt-to-GDP ratio will start heading south.

None of this alleviates our long-term problem with entitlements from eventually turning the ship back toward rougher and colder waters. Nothing looks like it will get done on this front anytime soon. The Obama Administration would rather declare victory with smaller deficits and avoid serious long-term budget negotiations. There's no money – we mean votes – in it for the Democrats – the party that supports these programs of redistribution.

As a result, we are left with a situation in which we have to content ourselves with recent gradual progress, hope spending hawks can maintain the sequester as long as possible, and lay the groundwork for entitlement reform under the next president, whether a Republican or a Democrat.

You read that right: whether a Republican or a Democrat. In fact, because politics is backwards, we may need a Democrat in power to actually fix these programs. The reason: people view Republicans as mean-spirited and un-caring. It's not true, but Nixon went to China, Carter deregulated airlines and trucking, and Clinton reformed welfare. Bush was more protectionist than Obama. If our next president wants to boost economic growth, the only way is by reforming entitlements.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 7-15 / 7:30 pm | Retail Sales – Jun | +0.8% | **+0.6%** | +0.4% | +0.6% |
| 7:30 am | Retail Sales Ex-Auto – Jun | +0.5% | **+0.4%** | 0.0% | +0.3% |
| 7:30 am | Empire State Mfg Survey – Jul | 5.0 | **7.8** | 9.5 | 7.8 |
| 9:00 am | Business Inventories – May | +0.0% | **+0.0%** | 0.1% | +0.3% |
| 7-16 / 7:30 am | CPI – Jun | +0.3% | **+0.3%** | | +0.1% |
| 7:30 am | "Core" CPI – Jun | +0.2% | **+0.2%** | | +0.2% |
| 8:15 am | Industrial Production – Jun | +0.3% | **+0.2%** | | +0.0% |
| 8:15 am | Capacity Utilization – Jun | 77.7% | **77.7%** | | 77.6% |
| 7-17 / 7:30 am | Housing Starts – Jun | 0.960 Mil | **0.958 Mil** | | 0.914 Mil |
| 7-18 / 7:30 am | Initial Claims – July 13 | 341K | **345K** | | 360K |
| 9:00 am | Leading Indicators – Jun | +0.3% | **+0.3%** | | +0.1% |
| 9:00 am | Philly Fed Survey – Jul | 7.8 | **9.4** | | 12.5 |

*Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*