First Trust
Monday Morning OUTLOOK

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January 8, 2024

Low Quality Growth

Last Friday's jobs report showed nonfarm payrolls up 216,000 in December, beating the consensus expected 175,000. Many are arguing that this was a huge number proving that the economy is not going into recession. But digging deeper into the data brings some doubt. In fact, it looks like the US is seeing low quality growth.

For example, yes, nonfarm payrolls came in better than expected in December, but not after adjusting for downward revisions of 71,000 to prior months. These downward revisions have now happened in ten out of the eleven past months. Over the past three months, private payrolls have increased a moderate 115,000 per month, tying for the slowest three-month pace of job gains since the COVID reopening started back in 2020.

What's more, average hours worked by employees also fell by 0.2% in December. Despite more workers, we worked less in December than we did the month before, which is a headwind to growth. Losing 0.2% total hours of work is the equivalent to losing 228,000 jobs.

More importantly, the kind of jobs being added are of lower quality than we want. In 2023, nearly half of all jobs added were in the government and health care (which is heavily funded by government). Compare this to 2015 - 2019 (before COVID) when these two sectors accounted for a fifth of new jobs added.

Where else is the quality of growth low? Construction. Many people are talking about onshoring as manufacturing comes back to the US. Manufacturing facility construction is up 59.1% from a year ago and up 123.5% from two years ago. But this isn't all private money. The government is funding many new projects, with the CHIPS Act and Inflation Reduction Act, artificially boosting spending in areas like manufacturing construction. But this deficit spending can't last forever.

Real (inflation-adjusted) government purchases, which feed directly into the GDP numbers, are up 4.8% in the past year versus an average of 1.0% in the past twenty years. Meanwhile, recent government programs have been structured to multiply private-sector investment in politically-favored sectors, like "clean energy." That, in turn, helped prop up economic performance last year – pushing out a recession that had looked likely to arrive at some point in 2023. But it's low-quality growth that comes at a price. In order to spend on government favored projects, we must tax profitable entities in other areas. This redistribution does not add to growth, it just shifts it from one sector to another.

In fiscal year 2023, the U.S. government spent over $6.1 trillion dollars and ran a budget deficit of nearly $1.7 trillion dollars. That is fiscal madness. And it understates the true spending because the government was credited with a $333 billion "negative outlay" when the Supreme Court struck down President Biden's plan to forgive student loans. Strip that out, and government spending in fiscal year 2023 represented roughly 24.0% of GDP. An incredibly high number for peacetime, especially for an economy that wasn't in recession and had an unemployment rate below 4.0%.

It's only a matter of time before low quality growth stalls out. There are consequences to taking short term gains rather than fixing structural problems. Just ask California, Illinois, or New York.

In the meantime, the Federal Reserve is tasked with navigating treacherous terrain. Inflation is moderating but is still too high. The Fed's choice to move from a scarce reserve system to a system of abundant reserves makes battling inflation that much tougher. And they are navigating with blinders on, willfully ignoring changes to the M2 money supply, down 3.0% in the past year.

We haven't lost faith in the U.S. economy. Far from it. But we need to take an honest view on the sustainability of the current growth. For the sake of future progress, the government needs to stop digging the hole deeper and face issues head on. We will never beat China by trying to be like China. Government can never create wealth in the long run.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-8 / 2:00 pm	Consumer Credit – Nov	$9.0 Bil	**$5.0 Bil**		$5.1 Bil
1-9 / 7:30 am	Int'l Trade Balance – Nov	-$64.9 Bil	**-$64.7 Bil**		-$64.3 Bil
1-11 / 7:30 am	Initial Claims – Jan 6	210K	**208K**		202K
7:30 am	CPI – Dec	+0.2%	**+0.3%**		+0.1%
7:30 am	"Core" CPI – Dec	+0.3%	**+0.3%**		+0.3%
1-12 / 7:30 am	PPI – Dec	+0.1%	**0.0%**		0.0%
7:30 am	"Core" PPI – Dec	+0.2%	**+0.2%**		0.0%