First Trust
Monday Morning OUTLOOK

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October 16, 2023

Big Government Weighing on Growth

At the end of October we will get our first look at real GDP growth for the third quarter and it looks like it was very strong. We'll have a more exact estimate a week from now – after this week's reports on retail sales, industrial production, and home building – but it looks like the economy grew at about a 4.5% annual rate.

Even if that turns out right, however, the underlying pace of growth is much slower than what happened in Q3. From the end of 2019 through the third quarter, the average rate of growth would be 1.9%. From the end of 2007 – right before the Great Recession and Financial Panic – through the third quarter, the average growth rate would be 1.8%. Both these figures pale in comparison to the growth of the 1980s and 1990s.

Raising the long-term growth rate of the US economy ought to be a key focus of policymakers. Unfortunately, we seem to be moving in the opposite direction, with the government expanding, which means more redistribution.

According to the Congressional Budget Office, federal spending should total $6.131 trillion in the fiscal year that ended on September 30. But that includes the effects of the Supreme Court striking down much of President Biden's plan to forgive student loans. That decision created a $333 billion "negative outlay" for Fiscal Year 2023. Without that decision, which didn't affect the government's cash flow, total federal spending would have been $6.464 trillion. We estimate that would translate to 24.0% of GDP, in a year when the jobless rate averaged 3.6%.

Let's put that in historical perspective. In FY 2019, the last year prior to COVID, the jobless rate averaged 3.7% and federal spending was 21.0% of GDP. Back in 2000, at the peak of the first internet boom, federal spending was 17.7% of GDP. Some of this increase is due to higher interest costs, but most of it is not and the trend is not good.

In turn, this reminds us of one of our fundamental ways of thinking about the economy. Imagine ten people stranded on an island, living at subsistence, each person using a spear or even her hands to catch two fish each per day, barely surviving. Then two of them decide to risk it all and build a boat. They go out one day and bring home twenty fish. Hallelujah! Enough to feed everyone.

With this bounty, the others use their talents to find easier ways to get their two fish. Some of them climb the trees, bring down coconuts, and trade for fish. Others build fires to cook the fish just right. Others build better huts. And so on and so forth. In other words, the innovation of making that boat and net didn't just help those original two; it helped everyone. Life is better.

But one of those islanders isn't happy. He watches all that trading and realizes that the two owners of the boat and net who took the big risk are better off than the rest. It wasn't like it was before, where all everyone had was two fish per day, barely eking out survival, but at least they were equal.

The unhappy islander – let's call him Sernie Banders – comes up with a plan to bring "equity" to the island. He gets them to impose an 80% tax on the "rich" boat/netmakers! That way when the boaters bring in their haul of twenty fish, the rest of them get their "fair share" of sixteen (two fish per person, eight other people), with no extra work.

Common sense tells us what happens next. The inventors have little incentive to maintain or repair the boat or fix the net. Why waste your time or take a risk when the rest of the islanders are just going to seize the extra value you've created? In the end, the islanders are eventually back where they started. Or maybe worse, because they forgot how to fish.

The US isn't at 80%, yet. But Federal, State and Local spending are already roughly 42% of GDP. If we don't get spending under control, tax rates will eventually go much higher. Bigger government means less innovation, less investment in and maintenance of capital, and less economic growth.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-16 / 8:15 am	Empire State Mfg Survey – Oct	-6.0	**-5.1**	-4.6	1.9
10-17 / 7:30 am	Retail Sales – Sep	+0.3%	**+0.4%**		+0.6%
7:30 am	Retail Sales Ex-Auto – Sep	+0.2%	**+0.4%**		+0.6%
8:15 am	Industrial Production – Sep	0.0%	**-0.1%**		+0.4%
8:15 am	Capacity Utilization – Sep	79.6%	**79.5%**		79.7%
9:00 am	Business Inventories – Aug	+0.3%	**+0.4%**		0.0%
10-18 / 7:30 am	Housing Starts – Sep	1.380 Mil	**1.390 Mil**		1.283 Mil
10-19 / 7:30 am	Initial Claims – Oct 14	210K	**210K**		209K
7:30 am	Philly Fed Survey – Oct	-6.9	**-11.7**		-13.5
9:00 am	Existing Home Sales – Sep	3.890 Mil	**3.190 Mil**		4.040 Mil