Chart of the week

The latest U.S. fiscal stimulus is quite unique, in some important ways

Never look a gift horse in the mouth. That's how equity markets celebrated the U.S. tax cuts at the turn of the year. By now, nobody seems to be worrying any longer about the many blemishes some companies were fretting about before the cuts were enacted. One thing is clear by now: In terms of corporate earnings, it was worth the wait. For the S&P 500 as a whole, we are expecting an earnings boost of 7% for 2018, even assuming that a quarter of the tax savings eventually gets passed on to employees and consumers.

Assessing the longer-term impact is harder. The latest fiscal stimulus is quite unique, in some ways, as our "Chart of the Week" shows. "Outside of wartime, it is virtually unprecedented to see rising deficits of this magnitude at a time when the economy is near full employment and growing above potential", notes Josh Feinman, our U.S. Chief Economist. Normally, federal deficits come down in these economic circumstances; that was true for much of this cycle, as the deficit declined from 9.8% of GDP in fiscal 2009 (after the Great Recession) to 2.4% by fiscal 2015. But then, uncharacteristically, it began to edge up again, to 3.2% and 3.5% in the next two years, as revenues disappointed a bit, spending restraint slackened, and the longer-term pressures from entitlements and demographics continued to build. Given the recent fiscal changes (the tax legislation and the spending package), we are expecting the federal deficit this fiscal year to rise to 4.25% of GDP, and to 4.75% for fiscal 2019. This is when more of the recently enacted legislation will come into force and, of course, the longer-term fiscal challenges, in terms of entitlement spending, remain unaddressed.

None of this makes some kind of fiscal crisis or day of financial reckoning probable any time soon. Such dire warnings rarely materialize in countries, which can borrow in their own currency. As U.S. president Ronald Reagan used to joke, "I am not worried about the deficit. It is big enough to take care of itself."[1] The real problem is less attention-grabbing, even mundane. The more the government borrows during times of full employment, the fewer resources are available for other, potentially more productivity-enhancing things. Interest rates rise and growth of the nation's capital stock slows. And all this limits the scope for fiscal stimulus during the next recession.

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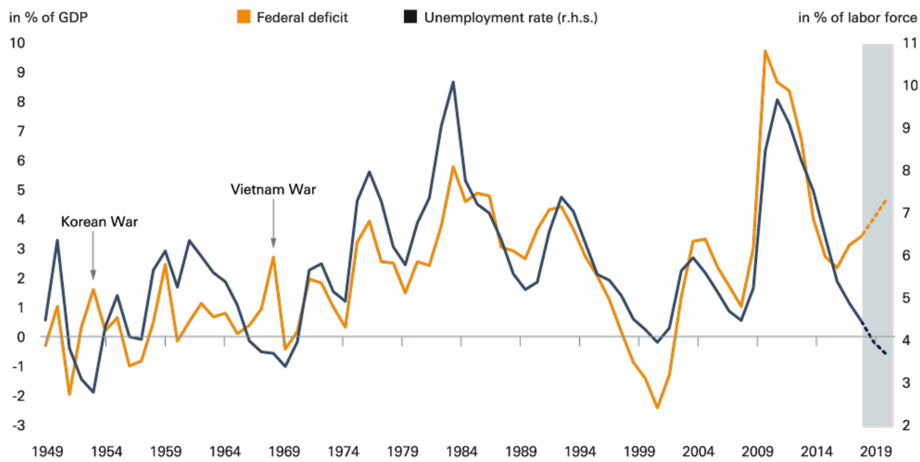
[1] Ronald Reagan in the Gridiron Club, March 24, 1984.



Sources: Bloomberg Finance L.P., Deutsche Asset Management Investment GmbH, as of 2/27/18

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DWS

Glossary

Great Recession

The **Great Recession** refers to the prolonged economic downturn in much of the world after the financial crisis of 2007-08.

Gross domestic product (GDP)

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

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