March 28, 2019

Economics Group

Jay H. Bryson, Global Economist
jay.bryson@wellsfargo.com • (704) 410-3274
Michael Pugliese, Economist
michael.d.pugliese@wellsfargo.com • (212) 214-5058

Federal Spending to Boost GDP Growth Through the Summer

The federal government component of GDP decelerated during the winter amid the government shutdown. Government spending should boost growth in the coming months, but the outlook past the summer is uncertain.

Federal Spending Stimulus Still Flowing

In February 2018, federal fiscal policymakers reached an agreement to increase discretionary spending at a much faster pace than had taken place over the past several years. Though this deal was perhaps overshadowed by the tax cuts, it also played a key role in pushing real GDP growth to roughly 3% in 2018. Federal defense spending growth for instance, has surged over the past year to the fastest pace in a decade (top chart).

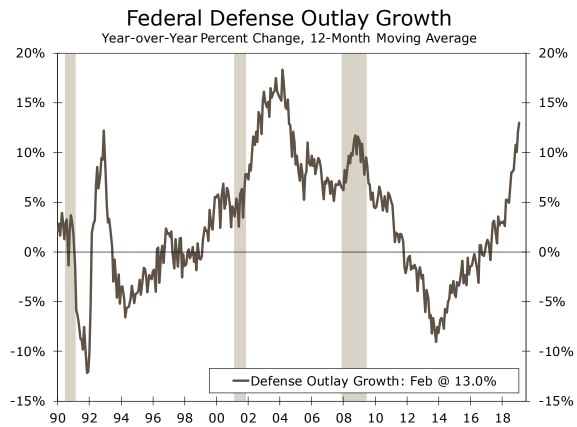
Late last year, however, the partial federal government shutdown interrupted the acceleration in discretionary spending. Revised GDP data released today showed real federal government consumption and investment grew at just a 1.1% annualized pace in Q4-2018, the slowest pace of growth since Q3-2017 (middle chart). This weakness is likely to carry into Q1-2019, as the partial federal government shutdown did not end until January 25. If real GDP growth comes in soft in the first quarter (our current forecast is for annualized growth of 1.3%), the direct shutdown effect is likely to account for a few tenths of a percentage point of that weakness, in our view.

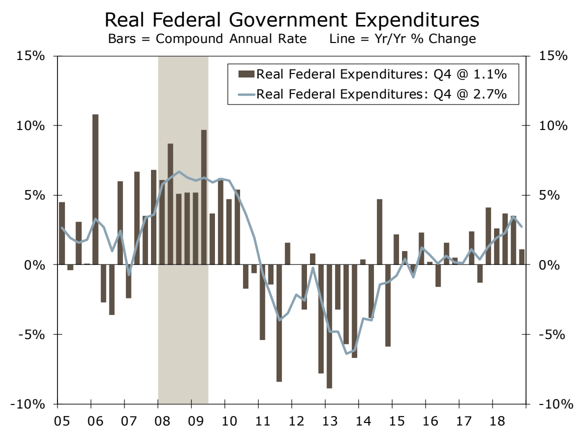
The upshot, however, is that the government is now fully funded through September 30. The combination of a shutdown-related bounce back and the resumption of the stimulus-led spending increases should cause the federal component of GDP to be an outsized contributor to growth in the middle quarters of 2019. At present, our forecast projects federal spending to add about half a percentage point to economic growth in Q2-2019, with the risks tilted to the upside. This outsized boost is unlikely to be as large in Q3, but federal spending growth should remain robust heading into the end of the fiscal year. <u>Although the federal line is not large enough to single-handedly stave off a slowdown in the coming quarters, its expected strength does make negative quarterly GDP growth less likely through the summer.</u>

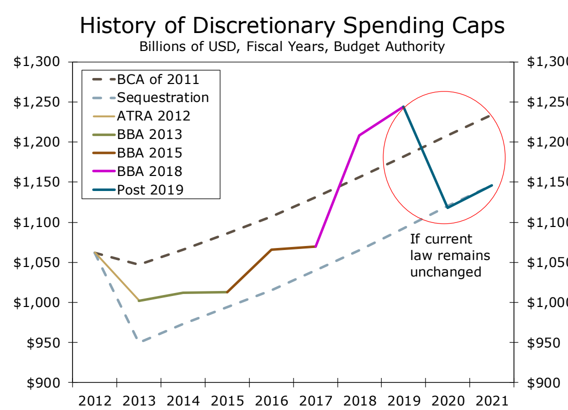
FY 2020 Outlook Far More Uncertain

Past Q3, however, the outlook is murkier. Under current law, discretionary budget authority is set to fall about 10% in FY 2020, which begins in Q4 (bottom chart). In addition, a hard deadline to lift the debt ceiling is also looming in the late summer/early fall. Our forecast assumes the debt ceiling is eventually resolved before the "X date" deadline, and that policymakers keep spending levels roughly steady in real terms so that federal discretionary spending has a more neutral impulse to growth in 2020.

Given how the first round of divided government budgeting went earlier this year, it is not too hard to imagine another bout of drama later this year, this time with potentially more serious economic consequences. With concerns about an economic slowdown swirling, government spending could go from hero to zero rather sharply and at an inopportune time.







Source: U.S. Department of the Treasury, Congressional Research Service, CBO and Wells Fargo Securities

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Global Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Dawne Howes	Administrative Assistant	(704) 410-3272	dawne.howes@wellsfargo.com

WELLS FARGO SECURITIES