WEEKLY ECONOMICS

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THOUGHTS OF THE WEEK

Why Don't We Fix the Fiscal Deficit? That Will Start Fixing Our Trade Deficit

Let's be blunt. Some of the reasons, but not the only ones, why our trade deficits are so large is because government expenditures are too high and/or we are not collecting enough taxes. That is, the US economy is growing too fast for our own good. Having said this, there is no reason to believe that large trade deficits are inherently bad for the economy, which is what the current administration and some of their most influential advisors are arguing. We have a large deficit in the trade of goods, but we have a large surplus in the trade of services. Should other countries impose large tariffs on our exports of services? Think about that until it sinks in!

The first part of our argument above, government expenditures are too high, should appeal to Republicans, so they can go ahead and do what they always say they are going to do but seldom do, that is, lower government spending. The second part, which is not collecting enough taxes, should appeal to Democrats, so they can go ahead and increase taxes, which they are always arguing in favor of.

We have been very clear, over the last several years (see our white paper "Debunking the US National Debt Problem") about our position that we should do both, slow down government spending and increase tax collections, be it by improving collections and/or raising taxes. We wrote a *Weekly* on July 12, 2024, in which we compared US tax collections as a percentage of GDP to France. This comparison showed that tax collections as a percentage of GDP in the US, including federal government, state government, local government, and social security tax receipts, amounted to 26.5% in 2021 versus France's 44.9% of GDP. Of course, we are not arguing that we should go down France's path, but just an increase in tax collections as a percentage of GDP of about 1% point should do the trick. That is, there is plenty of space, compared to France, for the US to increase tax collections and stabilize the rate of growth of the US debt.

However, the fact of the matter is that none of our political parties are even trying to lower our fiscal deficit. According to the Peter G. Peterson Foundation, the current fiscal proposal in the Republican plan could add $9 trillion to the US debt over the next ten years.[1] The Trump administration is justifying the tariffs as an instrument to increase tax revenues. On the flip side, the Republican plan is to lower taxes and make our fiscal issues worse. Furthermore, there is an easier way to lower the fiscal deficit without shocking the US and global economy by engaging in a trade war. As we said above, either slow down the rate of growth of government spending and/or increase tax collections and/or increase taxes or do a combination of all of the above.

We have a bold proposal.[2] Here goes. During the Pandemic recession, our debt increased by about $6 trillion as both the Trump and Biden administrations transferred monies to households and businesses. Since the economy is doing well today, let's pay that money back! Let's make a payment plan over, let's say, 10 or 20 years, for households and businesses, to pay that money back. Let's not call it a tax; and let's make it temporary, not permanent. Let's decrease the US debt by $6 trillion in 10 or 20 years' time. Of course, we must also slow down the growth rate of government expenditures. Again, as we argue in the footnote below, this is the reason why we are not politicians!

[1]"Full Array of Republican Tax Cuts Could Add $9 Trillion to the National Debt," The Peter Peterson Foundation, March 31, 2025. https://www.pgpf.org/article/full-array-of-republican-tax-cuts-could-add-9-trillion-to-the-national-debt/

[2]Our proposal just confirms the reason why we are not politicians, i.e., we will never be elected!

Once again, let's throw a lifeline to our political class. We actually don't need to go as far as what we argued in the previous paragraph. In fact, we don't even need to bring down the debt at all. We just need to slow down its rate of growth. This is why we need to lower the fiscal deficit, fast. Once we stabilize the growth rate of the debt through the lowering of our fiscal deficits, then economic growth will take over and the debt as a percentage of GDP will start to go down.

We still don't know why we have chosen to increase tariffs (a tax on American consumers) to lower our fiscal deficit. Tariffs are highly regressive taxes, affecting those in the lower income levels more. At the same time, tariffs are highly distortionary taxes that affect production, productivity, and economic efficiency, which threatens the ability of the economy to grow at potential output.

We have written extensively, during the last year or so, on why we do not like tariffs. For example, see the *Weekly* for February 21, 2025; the *Weekly* for February 7, 2025; the *Weekly* for May 24, 2024, just to get a sample of the reasons for our opposition to tariffs. But using tariffs to justify lowering taxes (or just keeping taxes low) and increasing spending/or even not slowing down spending enough, as has been proposed by the Republican Congress makes absolutely no sense.

Although markets celebrated, on Wednesday, the lowering of tariffs on all the countries to 10% with a 90-day pause on the higher tariffed countries while at the same time increasing tariffs on China to a punitive, 145% level, the fact of the matter is that with such a move, the tariff levels will not change much from what it was originally estimated after the announcements on April 2, 2025. That is, we will have the highest effective tariffs in more than 100 years.

In summary, the first step in lowering our trade in goods imbalance is to put our fiscal house in order. While we do that, we can take measures to castigate countries that manipulate their currency and keep it undervalued in order to export more, etc.

Way To Make Good Inflation Numbers Go to Waste

As we have been expecting, inflation is (was?) getting closer and closer to the Fed's target. This week's Consumer Price Index report confirmed our expectations by showing a 0.1% decline in prices, month-over-month, while the year-over-year rate slowed down to 2.4% in March, from 2.8% in February. Furthermore, at the end of this month, we expect the PCE price index, which is the rate of inflation used by the Federal Reserve for inflation targeting, to be even closer to the 2.0% target, at 2.2%. However, this is probably water under the bridge and with what is happening to the markets, and what is expected to happen with the implementation of tariffs, this 'inflation-target-closeness' will probably be a reminder of what could have happened if we had not embarked on this trade war.

Forecast Table

	Actual				Forecast								Actual		Forecast	
	1Q24	2Q24	3Q24	4Q24	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26	2023	2024	2025	2026
Real Gross Domestic Product [1]	**1.6**	**3.0**	**3.1**	**2.4**	**0.8**	**0.0**	**0.4**	**0.9**	**2.1**	**2.1**	**2.0**	**2.2**	**2.9**	**2.8**	**1.3**	**1.5**
Real Gross Domestic Product [2]	2.9	3.0	2.7	2.5	2.3	1.6	0.9	0.5	0.8	1.4	1.8	2.1	2.9	2.5		
Consumer Price Index [2]	**3.2**	**3.2**	**2.7**	**2.7**	**2.7**	**2.9**	**3.7**	**3.8**	**3.5**	**3.3**	**2.6**	**2.4**	**4.1**	**3.0**	**3.3**	**2.9**
Ex-food & energy [2]	3.8	3.4	3.3	3.3	3.1	3.1	3.8	3.8	3.6	3.4	2.7	2.4	4.8	3.4	3.4	3.0
PCE Price Index [2]	**2.7**	**2.6**	**2.3**	**2.5**	**2.4**	**2.5**	**3.3**	**3.5**	**3.3**	**3.1**	**2.5**	**2.2**	**3.8**	**2.5**	**2.9**	**2.8**
Ex-food & energy [2]	3.0	2.7	2.7	2.8	2.6	2.7	3.5	3.5	3.4	3.1	2.4	2.2	4.1	2.8	3.1	2.8
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.1**	**4.1**	**4.3**	**4.4**	**4.6**	**4.5**	**4.4**	**4.3**	**4.3**	**3.6**	**4.0**	**4.3**	**4.4**
Fed Funds Rate [3]	4.00	5.50	5.00	4.50	4.50	4.25	4.00	3.75	3.75	3.50	3.50	3.50	5.1	5.1	4.1	3.6

[1] Annualized Quarter-Over-Quarter Growth
[2] Year-Over-Year SA Percentage Change
[3] Upper Bound of the Federal Funds Target Range

Economic Releases

Consumer Price Index: The better-than-expected CPI inflation numbers, both headline and core, are good news for the Federal Reserve and for the economy. However, this is probably going to be the last disinflationary year-over-year print this year as the increase in tariffs start to affect prices going forward. The very positive news is that the recent decline in petroleum prices and the continuing disinflationary trend in shelter costs will temporarily mitigate the upward pressure on prices due to the implementation of tariffs. The Consumer Price Index (CPI) was weaker than expected in March, declining by 0.1% versus expectations for a 0.1% increase while the core CPI also increased by a less than expected 0.1% (versus expectations for a 0.3% increase). On a year-over-year basis, the headline CPI slowed to 2.4% from 2.8% in February while the year-over-year core CPI slowed down to 2.8%. Food prices increased by 0.4%, prices for food at home increased by 0.5% while food away from home increased by 0.4%. Energy prices fell by 2.4% during the month as gasoline prices plunged 6.3% and fuel oil prices fell by 4.2%. However, energy services increased another strong 1.6% after doing so by 1.4% in February. This was due to an increase in electricity prices, up 0.9%, and a surge in utility (piped) gas service, which was up 3.6% during the month. The core CPI was weaker than expected, increasing by 0.1% as commodities less food and energy commodities declined by 0.1%, new vehicle prices increased by 0.1% and used cars and trucks prices declined by 0.7%. Apparel prices, on the other hand, increased by 0.4%, month-over-month. Medical care commodities' prices declined by 1.1%. The prices of services less energy services increased by just 0.1% as shelter prices slowed down further, up 0.2%, while transportation services prices declined by 1.4%. Finally, medical care services increased by 0.5%. The better than expected news on inflation is a positive for markets but it is probably going to be the last of the disinflationary months if prices from tariffs start making their way into the economy.

Producer Price Index: The PPI was much better than expected in March, showing a deflation of 0.4%, month-on-month. The weakness was both in goods as well as services prices. While energy prices were a big factor in the decline, foods prices were also very weak. This trend, if sustained, is good news for inflation, as tariffs start to show in the goods side of these indices. The weakness in services price inflation is also good news. The Producer Price Index for final demand was much lower than expected in March, declining 0.4% on a month-on-month basis. On a year-earlier basis, the PPI for final demand increased by 2.7% versus expectations for a 3.3% increase. The PPI for final demand less foods, energy, and trade services increased by 0.1%, month-on-month, while the year-over-year rate was 3.4%. The PPI for final demand in goods declined by 0.9% as foods prices declined 2.1% while energy prices went down by 4.0%, month-on-month. The PPI final demand for services were also lower, down 0.2%, as prices for services, trade, declined by 0.7%, prices for transportation and warehousing declined by 0.6% while PPI prices for services other increased by 0.1%. The PPI was much lower than expectations. Expectations were for an increase of 0.15% but it recorded a deflationary month. Almost all of the components of the index were in deflation with the exception of final demand goods less foods and energy and final demand services other. This was the reason why the PPI for final demand less foods, energy, and trade increased by 0.1%, month-on-month.

Economic Releases

Michigan Sentiment: The preliminary release for the Consumer Sentiment Index showed another large decline in sentiment across all income levels, age levels, education, geography, and political affiliation. At the same time, inflation expectations continued to increase, with the one-year ahead reading increasing to the highest since 1981, according to the release. Longer- term inflation expectations increased but not as much as short-term inflation expectations. However, longer-term inflation expectations were the highest since June of 1991. This is not good news for the Federal Reserve. However, we need to wait until the final report is issued at the end of the month as the survey was conducted before the pause in higher tariffs was announced on April 9. The preliminary Consumer Sentiment Index published by the University of Michigan Surveys of Consumers sank to 50.8 in April compared to a reading of 57.0 in March. The index declined by 34.2% compared to April of last year, according to the release. Both components of the index were much lower in April, with the Current Economic Conditions Index at 56.5 compared to a 63.8 print in March. The Index of Consumer Expectations dropped to 47.2 from a reading of 52.6 in March. Inflation expectations one-year ahead surged further, from 5.0% in March to 6.7% in April. This was the highest year-ahead inflation expectations since 1981. while five-year ahead inflation expectations increased to 4.4% in April compared to 4.1% in March. According to the release, the "decline was…pervasive and unanimous across age, income, education, geographic region, and political affiliation." The share of consumers expecting an increase in the rate of unemployment surged to 67%, the highest since the Great Recession. The interviews on this preliminary "release were conducted between March 25 and April 8, closing prior to the April 9 tariff partial reversal.

Disclosures

Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers’ confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

Employment cost Index: The Employment Cost Index (ECI) measures the change in the hourly labor cost to employers over time. The ECI uses a fixed “basket” of labor to produce a pure cost change, free from the effects of workers moving between occupations and industries and includes both the cost of wages and salaries and the cost of benefits.

US Dollar Index: The US Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA HPI is a broad measure of the movement of single-family house prices. The FHFA HPI is a weighted, repeat-sales index, meaning that it measures average price changes in repeat sales or refinancings on the same properties.

Disclosures

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

The ISM Manufacturing Index: The The Institute of Supply Management (ISM) Manufacturing Measures the health of the manufacturing sector by surveying purchasing managers at manufacturing firms. The survey asks about current business conditions and expectations for the future, including new orders, inventories, employment, and deliveries.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households.

Producer Price Index: A producer price index(PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

Conference Board Coincident Economic Index: The Composite Index of Coincident Indicators is an index published by the Conference Board that provides a broad-based measurement of current economic conditions, helping economists, investors, and public policymakers to determine which phase of the business cycle the economy is currently experiencing.

Conference Board Lagging Economic Index: The Composite Index of Lagging Indicators is an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

New Export Index: The PMI New export orders index allows us to track international demand for a country's goods and services on a timely, monthly, basis.

Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

Source: FactSet, data as of 4/4/2025

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