First Trust
Monday Morning OUTLOOK

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We're All Keynesians Now

"We are all Keynesians now," is a phrase that caught on in the late 1960s and early 1970s, variously attributed to Milton Friedman and President Richard Nixon. Uncle Milty was commenting on the general political/economic environment, not saying he was a Keynesian. Richard Nixon, on the other hand, actually said "I am now a Keynesian."

We bring this up because it's happening again. While we won't explain the entire theory of economics proposed by John Maynard Keynes, it was a "demand-side" belief system. A key tenant was using government spending, budget deficits, and loose money to let bureaucrats exert control over the economy.

After its failure in the 1970s, Ronald Reagan and Margaret Thatcher changed the world by moving it back toward a supply-side, small government mentality. The U.S. and U.K. moved from high inflation, high unemployment, and slow growth, to low inflation, low unemployment, and strong growth.

But, since the crisis of 2008, the commanding heights of economic control have once again shifted toward big government. Quantitative easing, zero percent interest rate policy (ZIRP), negative interest rate policy (NIRP), TARP, infrastructure spending, minimum wages, and new ideas for wealth taxes, free healthcare,…etc., have all been either proposed or tried.

The result? Ever since government assumed the high ground, global growth has slowed. Especially when compared to what it was in the 1980s and 1990s when government was reducing its role in the economy.

Does the consistent failure to create growth matter to those who are proposing bigger government? Absolutely not. They ignore it and call for even more government intervention.

Just this past week, Mario Draghi, in his last action as head of the European Central Bank, cut the interest rate it pays on excess reserves to -0.5% from -0.4%. But negative interest rates have been little short of a disaster. European and Japanese banks are suffering. Their loans and economic activity haven't budged. There is zero evidence that negative interest rates help economic activity, but plenty of evidence they hurt.

Draghi, himself, called for "fiscal" policy help for the economy, but he wasn't suggesting tax cuts and regulatory relief, he meant more government spending – a purely Keynesian prescription.

Here's the problem. Demand-side, Keynesian policies don't work. Growth comes from the supply-side – from inventions, innovation, and entrepreneurship. In fact, between 2009 and 2016, without the tremendous tailwinds from the likes of fracking, smartphones, apps, and 3-D printing, it is easy to believe that two major tax hikes, increases in regulation and spending, and massive fines on financial institutions would have pushed real GDP growth negative.

Government is bigger and tax rates and regulation more burdensome in Europe. That's why it's lagged U.S. growth for decades. What the world learned in the 1980s was quickly forgotten by Europe, and now it's being forgotten by thought leaders in the U.S.

These old ideas have also transfixed investors, who cannot think about the economy without coming at it from a government policy point of view. How much new QE will the ECB propose? And what about President Trump's tweet that the U.S. should have negative interest rates?

This is all dangerous for long-term economic growth in both the U.S. and abroad. People will suffer to the extent these policies are followed. The good news is that, in the near-term, corporate tax cuts in the U.S. and a continued reduction in regulation are positives for the supply-side, more than offsetting the cost of trying to bring China in-line with global norms. Thanks to these supply-side policies, the U.S. does not face a recession. New technology is continuing to lower costs, increase profit margins, and boost earnings.

None of this positive news is from government spending. In fact, government spending only crowds out the private sector and reduces investment and opportunity. If the U.S. does not change course, and follows Europe through the Keynesian looking-glass, it will eventually pay a price. A damaging price. But for now, it's just words and fear. And profits and growth beat out words and fear every day.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
9-16 / 7:30 am	Empire State Mfg Survey – Sep	4.0	**5.4**	2.0	4.8
9-17 / 8:15 am	Industrial Production – Aug	+0.2%	**+0.1%**		-0.2%
8:15 am	Capacity Utilization – Aug	77.6%	**77.5%**		77.5%
9-18 / 7:30 am	Housing Starts – Aug	1.247 Mil	**1.255 Mil**		1.191 Mil
9-19 / 7:30 am	Initial Claims – Sep 14	212K	**212K**		204K
7:30 am	Philly Fed Survey – Sep	11.0	**15.5**		16.8
9:00 am	Existing Home Sales – Aug	5.370 Mil	**5.440 Mil**		5.420 Mil