Government and Military Spending Fuel U.S. Growth

Faster government spending accounted for nearly half of acceleration in economic growth since mid-2017 ***By Kate Davidson*** **Oct. 25, 2018 5:30 a.m. ET** *(The Wall Street Journal)*

A stark pickup in government spending, particularly in defense, has helped fuel a broad acceleration in U.S. economic growth in the past year and a half, according to a Wall Street Journal analysis of Commerce Department data.

The U.S. economy has expanded at a 2.9% annual rate since April of 2017, according to the Commerce Department's tabulations of the nation's gross domestic product, or output. That growth rate is faster than the 2.2% annual growth rate between mid-2009—when the expansion started—and April 2017.

Faster government spending accounted for nearly half of the acceleration, according to The Wall Street Journal analysis.

The Commerce Department breaks down various contributors to economic growth, including government spending, business investment, consumer outlays and exports.

Defense shifted from contracting at a 2.1% annual rate between June 2009 and March 2017, to growing at a 2.9% rate since April 2017. The turnaround added 0.21 percentage points on average to the nation's overall economic growth rate, according to Commerce Department figures.

When including faster spending on nondefense items and spending at the state and local levels, increased government spending accounted for 0.34 percentage point of the 0.7 percentage point increase in the growth rate since April 2017, or nearly half.

Other factors are at play. Faster business investment, due in part to energy investing, has contributed 0.3 percentage point to the growth rate, while faster consumer spending accounts for about a third of the pickup. A slowdown in home building has subtracted about 0.2 percentage point from the growth rate.

The Commerce Department will provide its first estimate of third-quarter growth Friday morning, with new numbers on which sectors are contributing most.

Economic growth is an important point of debate in the midterm elections. President Trump and Republicans say tax cuts and less regulation have accelerated growth. Democrats say faster growth is uneven and unsustainable. The role of government spending has gotten less attention from either side.
"There really had been some pent-up demand within the Department of Defense for modernization, for training, for maintenance," said Todd Harrison, a senior fellow and defense budget analyst at the Center for Strategic and International Studies. "Now [with] the sudden increase in the budget in fiscal year 2018 and fiscal year 2019, you see some of that pent-up demand being unleashed in the market."

Defense outlays grew 6% in the fiscal year that ended Sept. 30, thanks in part to a bipartisan budget agreement to boost government spending this year and next by nearly $300 billion above limits set in a 2011 law, including $165 billion more for military.
From fiscal year 2010 to fiscal year 2015, the defense budget was declining after Congress implemented discretionary spending caps to help curb the deficit. Congress increased the caps slightly between 2013 and 2017, but not by much, Mr. Harrison said.

A Republican-controlled Congress, with support from Mr. Trump, moved this year to raise the caps as part of a new two-year budget deal that began to take effect at the end of March.

That led to a surge in defense outlays over the spring and summer. The gains are expected to continue into 2019 and 2020, as funding makes its way out of the Pentagon.

Big projects such as building aircraft carriers require long lead times and likely won't show up in military spending for several more quarters, Mr. Harrison said. Spending on services, such as maintenance and personnel, move through the system faster.

"I would expect that, with the increase in the defense discretionary caps, that its contribution is going to increase, and in fact it will be leading overall GDP growth by mid-2019," said Gus Faucher, chief economist at PNC Financial Services Group.

The budget increase has been a boon for defense companies, as the military replaces worn-out equipment and updates technology.
Lockheed Martin Corp. , the world's largest defense contractor, said Tuesday it expects revenue to increase up to 6% in 2019 as it boosts production of missiles and F-35 combat jets. The company reported a $1.47 billion profit for the quarter ending Sept. 30, compared with $963 million a year earlier. Its order backlog rose to $109 billion.
Boeing Co. , the world's largest aerospace company by sales, raised its revenue and profit outlook for the year, thanks in part to strong demand for defense projects. The company won a trio of Pentagon contracts in recent weeks, after four years of sales declines in its defense unit.

"This is the first year (in this decade) that we're going to see mid-single-digit growth on average from the major defense companies," said Seth Seifman, an aerospace and defense analyst at JPMorgan Chase. "As we look forward, the fact that you've got these budgets that have already been passed, those are going to fuel growth in 2019 and 2020."
It is rippling out to smaller businesses. Adam Crouse said business has picked up over the past two years at J & R Tools Inc., a machine shop in Loogootee, Ind., which works mainly as a contractor to the Navy, Army and Marine Corps.
"We've hired three people in the past couple months," Mr. Crouse, the shop's co-owner, said last month at a White House economic summit for small-business owners. "The defense budget helped out."
Douglas Holtz-Eakin, a Republican economist and former director of the Congressional Budget Office, cautioned that the return of higher military spending might not last forever. The current budget agreement expires in September 2019, and the next Congress might not go along with more spending, Mr. Holtz-Eakin said.
—Jon Hilsenrath contributed to this article.