November 22, 2024

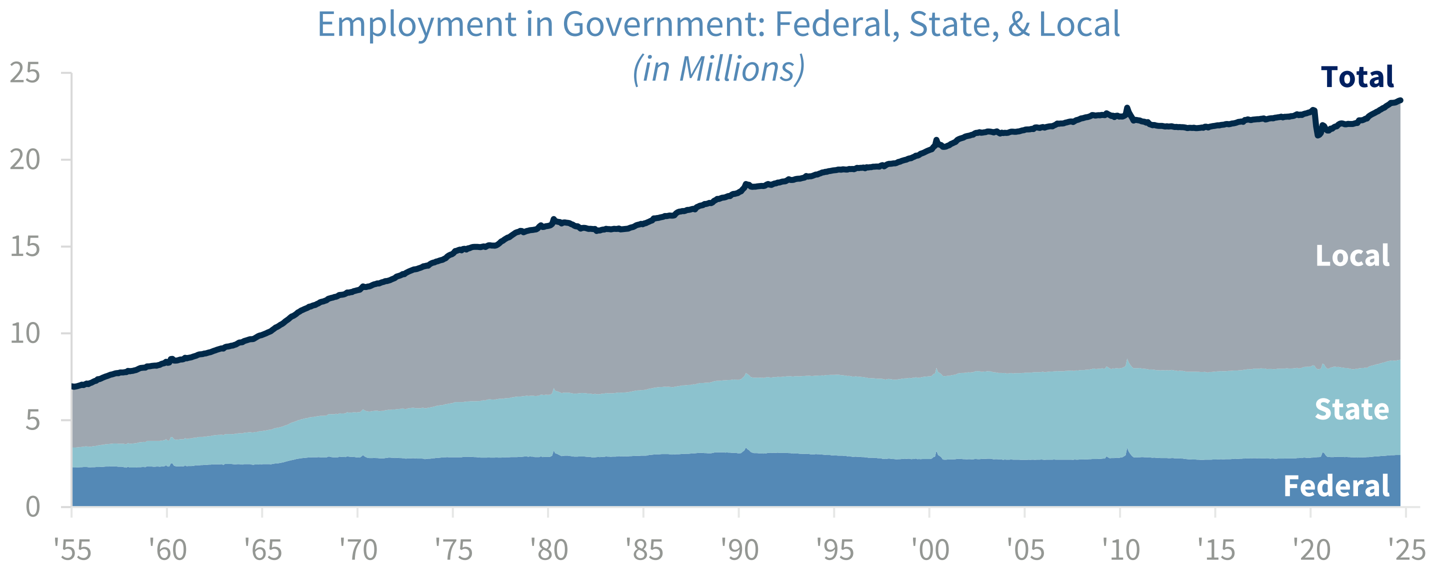
Eugenio J. Aleman, *PhD, Chief Economist*
Giampiero Fuentes, *CFP®, Economist*

Looking for Efficiencies in Government Spending: Look Elsewhere!

There has been a lot of talk about (in)efficiencies in government spending, both before and since the election. Much of the conversation has been driven by Elon Musk, who will co-head the Department of Government Efficiency (DOGE, not an actual government agency). Musk has boasted he could find $2 trillion to cut from the federal budget. He has also complained about what he views as excess regulations. In the Musk narrative, blame for government inefficiency has fallen on federal employees.

So there is no misunderstanding, one of us was a federal government employee for one year and two months. Furthermore, we agree with Mr. Musk that there are lots of regulations that do not make sense—some may be the same as the ones Mr. Musk is talking about, but others may not be. It would be very inefficient to mention some of them in this write-up. But most of the issues with regulations have to do with the fact that regulations are, typically, time-dependent and/or stuck on time. That is, governments pass regulations to try to 'fix' a particular issue, and these regulations, sometimes, outgrow their useful life, or were implemented to fix something that is no longer a problem. However, those regulations remain on the books, and government employees are responsible for enforcing them. Blaming federal government employees for doing their job doesn't seem the most efficient way to fix the problem.

These issues happen more times than we are typically willing to accept but the political system has serious problems making the necessary changes to the regulatory environment as the economy changes. This is also true with other issues in politics. But we hear today that the problem is because there are "too many federal government employees," which seems to be a politically charged argument. However, by analyzing the numbers, and as we always say, we live and die by the numbers, the story is very different from what many politicians say. The number of federal government employees today is almost the same as back in the 1960s while the US economy is 4.4 times larger than in the 1960s.

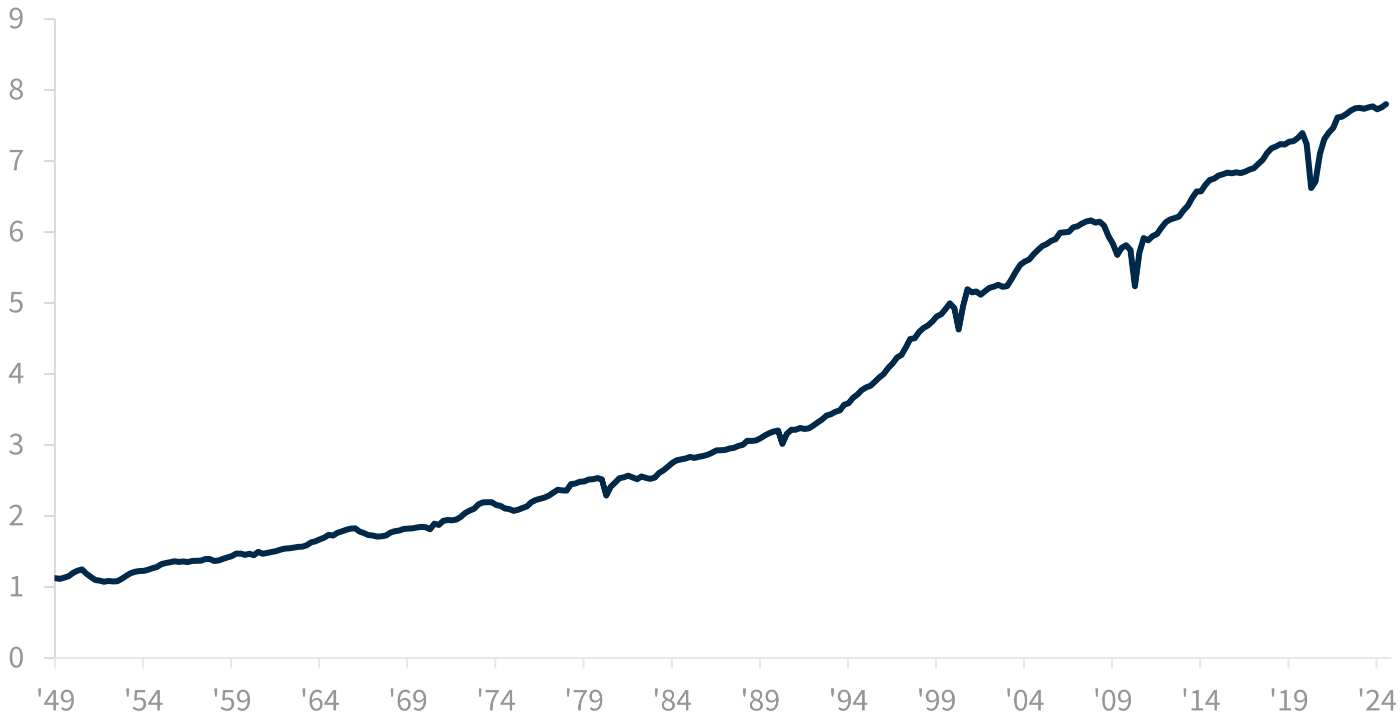


Source: FactSet, RJ Economics

Today, total government employment is about 23.4 million (or about 14.7% of total nonfarm payrolls), but that includes federal, state, and local government employees. Federal government employees are 'only' about 3 million out of the 23.4 million. Furthermore, out of these 3 million workers, about 610 thousand are US Postal Service workers. As a percentage of total nonfarm employment, federal government employees represent only 1.9% of total nonfarm employment. If we exclude postal workers, the percentage falls to 1.5%.

Another way of looking at this is measuring real GDP over the number of federal workers, which could be thought of as a measure of efficiency. That is, does the number of federal workers increase as the economy grows? We already saw that this is not the case, as the number of federal workers has remained almost unchanged since the 1960s but the graph below shows that federal workers are extremely efficient. That is, because the number of federal workers has remained almost unchanged since the 1960s, the US economy has required fewer and fewer federal government workers per unit of output. This means that federal workers have become more and more productive (as shown in the graph below). Certainly, technological advances have played a role in this trend, and we expect AI and newer technologies to put further pressure on the total number of federal government employees. However, it's important to note that only 10% of current workers are in administrative roles that are most susceptible to AI replacement. In contrast, almost 70% of workers hold at least a Bachelor's Degree and are employed in occupations that require formal training/education and therefore are less likely to be replaced by AI.[1]

Real GDP Over Number of Federal Employees



Source: FactSet, RJ Economics

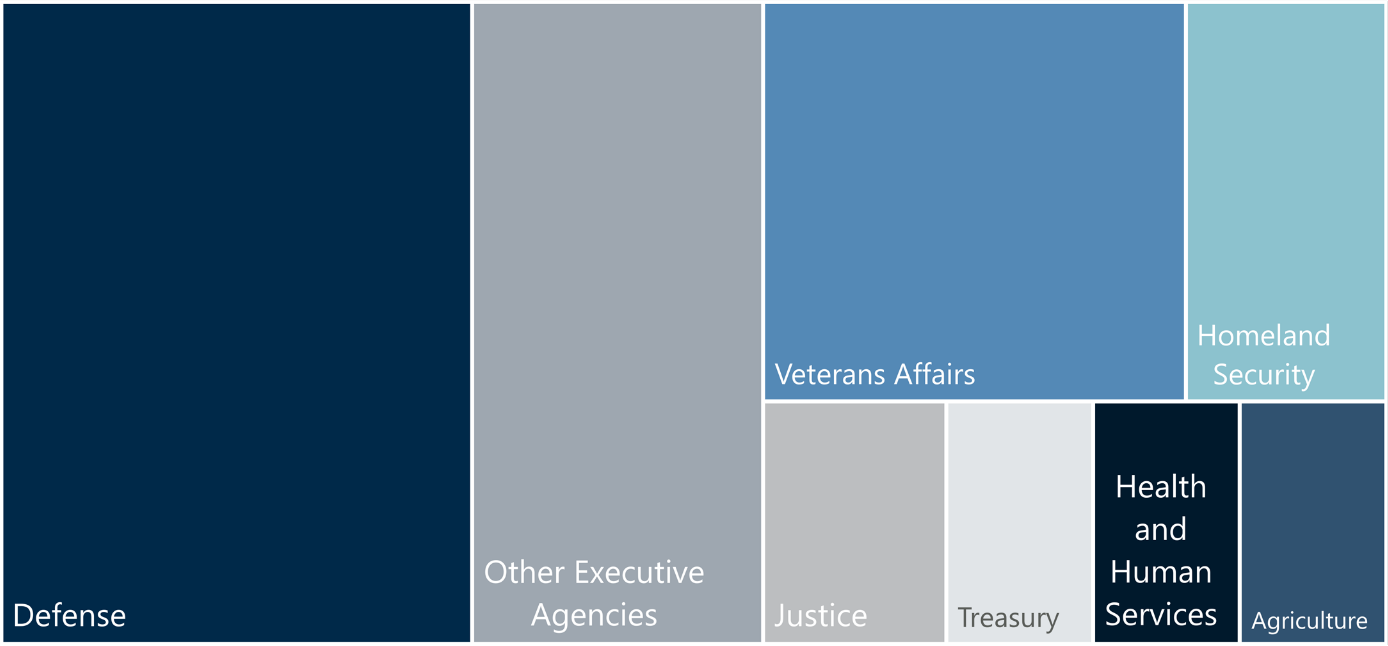
1: https://www.cbo.gov/publication/60235

Thus, if politicians want to punish federal workers for doing their job to enforce the regulations in place today, then we are worried that this is another attempt of lip-syncing from our political class while doing nothing to actually change anything (did anybody hear anything about the fiscal deficit?). In fact, not only are federal workers very efficient given the tasks they are dealing with today, but there are economic series they used to produce that they no longer produce because of cuts to statistical agencies' funding (for example, the BEA discontinued real Retail and Food Services Sales). Some of these series are highly important series on the health of the US economy, series that we have been using for more than 30 years and that would allow us to do a better job as economists.

From a budget perspective, if we remove the 610,000 postal workers from all government employees, we are left with ~2.4 million employees among the Department of Defense, Veterans Affairs, Homeland Security, and other federal agencies. In 2022, compensation for these ~2.4 million employees amounted to $271 billion, which represents only about 4% of the $6.75 trillion federal spending budget. While we acknowledge that somebody may find some inefficiencies within this group, it is important to note that their compensation constitutes a relatively small portion of the overall budget, insignificant in the grand scheme of the serious fiscal issues we face as a country. In contrast, interest expenses, which account for approximately 13% of the budget and are growing, represent a much larger financial burden. However, there is little the government can do to reduce this burden, which is why economists talk about cutting costs and/or increasing tax receipts to improve the primary deficit, which is the deficit less interest payments on the debt.

Federal Civilian Employment by Branch

(Excluding Military Personnel)



Source: Congressional Budget Office

Addressing the fiscal deficit is undoubtedly a complex task, but at some point, our political system will have to address it by a combination of a slowdown in government expenditures as well as an increase in tax receipts as a percentage of GDP. Unfortunately, most estimates suggest that in 2024 and 2025 the deficit will approach $2 trillion which would be the highest it has ever been if we exclude the $3+ trillion deficit of 2020 in response to the COVID-19 pandemic.

At the same time, the federal government is experiencing a historically large baby boomer retirement binge that is crippling the ability of the statistical institutions to perform as they should. Furthermore, some people argue that the federal government pays too much. Well, the US government needs to attract the best of the best and needs to compete with the private sector, which also pays a lot of money to attract the best. Thus, this seems like a moot point, used with political underpinnings.

We hope the government efficiency commission is efficient enough to correctly determine what the real issues are and proceed to try to fix these issues. However, starting the discussion by blaming the messenger does not bode well for the future of such a commission or the future of the economy.

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**	**2.8**	**1.6**	**1.7**	**2.2**	**2.3**	**2.5**	**2.0**	**2.0**	**2.0**	**2.2**	**2.9**	**2.7**	**2.1**	**2.2**
Real Gross Domestic Product [2]	2.9	3.1	2.6	2.2	2.3	2.1	1.9	2.2	2.2	2.2	2.1	2.0	2.5			
Consumer Price Index [2]	**3.2**	**3.2**	**2.6**	**2.6**	**2.2**	**2.1**	**2.3**	**2.2**	**2.2**	**2.2**	**2.2**	**2.2**	**4.1**	**2.9**	**2.2**	**2.2**
Ex-food & energy [2]	3.8	3.4	3.2	3.2	2.8	2.5	2.5	2.2	2.2	2.2	2.2	2.2	4.8	3.4	2.5	2.2
PCE Price Index [2]	**2.7**	**2.6**	**2.3**	**2.4**	**2.0**	**1.9**	**2.1**	**2.1**	**2.1**	**2.1**	**2.1**	**2.1**	**3.8**	**2.5**	**2.0**	**2.1**
Ex-food & energy [2]	3.0	2.7	2.7	2.8	2.4	2.3	2.3	2.2	2.2	2.2	2.2	2.2	4.1	2.8	2.3	2.2
Unemployment Rate	**3.8**	**4.0**	**4.2**	**4.2**	**4.4**	**4.5**	**4.5**	**4.5**	**4.4**	**4.4**	**4.3**	**4.3**	**3.6**	**4.0**	**4.5**	**4.4**
Fed Funds Rate [3]	5.50	5.50	5.00	4.50	4.25	4.00	3.75	3.50	3.50	3.50	3.50	3.50	5.1	5.1	3.9	3.5

[1] Annualized Quarter-Over-Quarter Growth

[2] Year-Over-Year Percentage Change

[3] Upper Bound of the Federal Funds Target Range

Economic Releases

NAHB/WF Housing Market Index: Although the improvement in the Housing Market Index (HMI) is good news for the new home sales market, it is clear that builders have continued to use incentives, including lower prices, to incentivize sales. Industry members continued to complain about shortages of labor as well as buildable lots. On the positive side, they were upbeat that a Republican sweep would help the industry by reducing regulatory burdens for the industry. However, this seems like wishful thinking as housing market regulatory issues are dependent on state and local governments rather than at the Federal government level. The NAHB/Wells Fargo National Housing Market Index (HMI) was higher than FactSet expectations in November, at 46.0, compared to 43.0 in October and expectations for a 44.5 reading. The index remained in contraction territory but was 7 points higher than the 39.0 recorded in August of this year. The Single Family Sales: Present moved higher, from a reading of 47 in October to a reading of 49 in November, while the Single Family Sales: Next 6 Months surged from 57 in October to 64 in November. Finally, the Traffic of Prospective Buyers increased slightly from 29 in October to 32 in November but remained depressed. Regionally, the HMI was mixed, with two regions reporting improvement and two regions reporting declines. The Northeast continued to improve and remained in expansion territory, at 59 in November compared to 52 in October, while the Midwest improved from 43 in October to 49 in November but remained in contraction. The South saw the HMI declining slightly, from 43 in October to 42 in November while the West saw the HMI declining from 44 in October to 39 in November. This was the third consecutive increase in the HMI and its highest level since a reading of 51.0 in April of this year. According to the Chief Economist of the NAHB, “While builder confidence is improving, the industry still faces many headwinds such as an ongoing shortage of labor and buildable lots along with elevated building material prices.” The release also added that “…while the stock market cheered the election result, the bond market has concerns, as indicated by a rise for long-term interest rates. There is also policy uncertainty in front of the business sector and housing market as the executive branch changes hands.” According to the release, 31% of home builders cut prices during the month while 60% of them used some type of incentive in November.

Economic Releases

Housing Starts: Market expectations were for an increase in building permits and a slight decline in housing starts in October. However, as we argued last week, higher mortgage rates were probably going to put downward pressure on both of these numbers in October. Furthermore, the large decline in home completions is probably going to put upward pressure on home prices as well as downward pressure on inventories. These things are not good news for residential investment at the start of the last quarter of the year. Housing starts of privately owned units declined by 3.1% in October, to a seasonally adjusted annual rate of 1.311 million compared to the 1.353 million units reported in September, according to the US Census Bureau and the US Department of Housing and Urban Development. On a year-earlier basis, housing starts were down by 4.0%, when they were 1.365 million. Single-family housing starts were 970,000 or 6.9% lower than the 1.042 million reported in September. By region, the Northeast saw housing starts plunge by 32.9% in October compared to September of this year, mostly due to a 28.7 percent decline in single-family housing starts. However, compared to last year, housing starts in the Northeast were up 39.2% while single-family unit housing starts were up 9.8%, year-over-year. In the Midwest, housing starts were up 9.4%, month-on-month, while they were down on a year-earlier basis by 7.1%. Housing starts of single-family units were up 4.6%, month-over-month, and by 19.1% on a year-earlier basis. The South, which is the largest region in the country, saw housing starts decline by 8.8%, month-over-month and by 7.8% on a year-over-year basis. Single-family housing starts in the South were down 10.2%, month-over-month, and by 1.8% on a year-earlier basis. Finally, the West saw housing starts up by 21.2%, month-over-month, but down 4.0% compared to a year earlier. Housing starts of single-family units were up 4.6%, month-over-month, but down by 9.1% on a year-earlier basis. Building permits of privately-owned housing units were 1.416 million in October, or 0.6% lower than the September seasonally adjusted annual rate of 1.425 million. On a year-earlier basis, building permits were down by 7.7%. Single-family building permits were 968,000 in October, down 0.5% compared to the previous month. By region, building permits were up 13.4% in the Northeast, month-over-month, but down by 5.9%, year-over-year. The Midwest saw building permits down 4.0%, month-over-month, but up 10.9% on a year-over-year basis. The South saw building permits down by 1.8%, month-over-month, and by 12.8% year-over-year. Finally, the West saw building permits down 1.2% month-over-month, and by 5.2% year-over-year. Housing completions dropped by 4.4% in October to a seasonally adjusted rate of 1.614 million compared to the September reading of 1.688 million. Housing completions had been one of the few positive developments on the new home construction market and the large decline in October will probably put more upward pressure on new home prices.

Economic Releases

Existing Home Sales: A strong print in existing home sales in October pushed the supply of homes slightly down during the month, but this number is not seasonally adjusted. However, it remained higher compared to October of last year. The increase in existing homes sales was broad based and across all regions of the country. The Chief economist of the National Association of Realtors (NAR), Lawrence Yun, indicated that "The worst of the downturn in home sales could be over, with increasing inventory leading to more transactions." Still, very high mortgage rates may dampen the continuous strength of this housing sector. Existing home sales increased slightly more than expected in October according to the National Association of Realtors. Existing home sales were up by 3.4% in October to a seasonally adjusted annual rate of 3.96 million. Compared to a year-earlier, existing-home sales were up 2.9%. The Northeast saw a 2.2% increase in existing home sales in October, month-on-month, while it was flat on a year-earlier basis while sales in the Midwest surged by 6.7%, month-on-month while increasing by 1.1% versus October of last year. The South saw existing home sales up by 2.9%, month-on-month, and by 2.3% on a year-earlier basis. Finally, the West saw existing home sales increase by 1.3%, month-on-month, and by 8.5% compared to a year earlier. The median price of existing homes increased 4.0% compared to October of last year, to $407,200. This was the 16th consecutive year-earlier increase in the median price of existing homes. Existing homes months in supply declined to 4.2 months in October compared to 3.6 months in supply in October of last year. However, the inventory of existing homes increased by 0.7% during the month, month-on-month, and by 19.1% compared to a year earlier. According to the release, the year-over-year increase in existing home sales was the first annual increase since July of 2021.

Leading Economic Indicators: The Leading Economic Index remained in contraction during the month of October, pushed down by the weakness in the US manufacturing sector with both manufacturing new orders as well as the average weekly hours in manufacturing pushed the index lower. However, financial components continued to help ameliorate the decline of the overall index. As we have said before, the LEI seems to have lost its ability to predict the path of US economic activity. The US Leading Economic Index (LEI) published by The Conference Board declined by a more than expected 0.4% in October, but the original 0.5% decline in September was revised up to a 0.3% decline, according to the release. Two of the financial components of the LEI were up while one was slightly down in October while most of the non-financial components were either down or flat during the month. The only non-financial components that were up were manufacturers' new orders, consumer goods & and materials, but the increase was very small—up 0.01%. The largest contributor to the decline was a decline in the ISM New Orders Index followed by a decline in Average Weekly Hours in manufacturing. The Coincident Economic Index (CEI) remained unchanged in October, according to the report. The Lagging Economic Index (LAG) was lower by 0.1% during the month of October. As the Conference Board has said over the last several months, the LEI remains weak, but it is no longer pointing to an impending recession.

Disclosures

Economic and market conditions are subject to change.

Opinions are those of Investment Strategy and not necessarily those of Raymond James and are subject to change without notice. The information has been obtained from sources considered to be reliable, but we do not guarantee that the foregoing material is accurate or complete. There is no assurance any of the trends mentioned will continue or forecasts will occur. Past performance may not be indicative of future results.

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.

Certified Financial Planner Board of Standards Center for Financial Planning, Inc. owns and licenses the certification marks CFP®, CERTIFIED FINANCIAL PLANNER®, and CFP® (with plaque design) in the United States to Certified Financial Planner Board of Standards, Inc., which authorizes individuals who successfully complete the organization's initial and ongoing certification requirements to use the certification marks.

Links are being provided for information purposes only. Raymond James is not affiliated with and does not endorse, authorize or sponsor any of the listed websites or their respective sponsors. Raymond James is not responsible for the content of any website or the collection or use of information regarding any website's users and/or members.

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.

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.

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 11/22/2024

RAYMOND JAMES®

INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863 // RAYMONDJAMES.COM