Flash note
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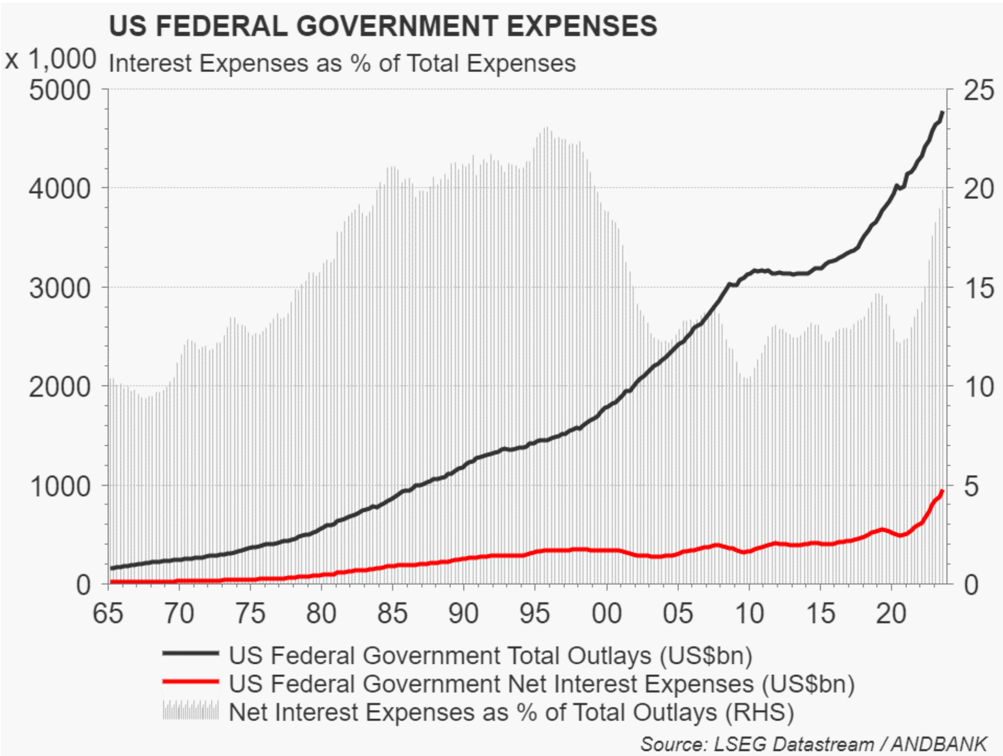
My Preferred Charts: Deficits that have a favorable impact on profits, and deficits that do not. What kind is this?



Federal interest expenses in the US went parabolic over the past two years, and this has altered the composition of total federal spending (as gross interest expenses now represents nearly 20% of all federal spending), and that should entail a series of effects.

It should be remembered that interest spending is a procyclical element. In recession (or soft landing) yields fall, partly due to the search for a safe haven asset, partly due to the Fed's easing. In contrast, spending on automatic stabilizers (unemployment and subsidies) is countercyclical. That is, it increases in recession or soft landing.

What are the implications of this in terms of the dynamics of the deficit?

When interest spending occupies a high portion of total spending, the dynamics of debt and deficit are altered, so that any increase in discretionary spending now has less impact on budget and makes it difficult to worsen the deficit. Instead, the impact of a rate cut (as is expected) will overwhelm the effect of the rest of the spending (especially when debt issuance has been concentrated in the short end of the curve) making it relatively easy to reduce the deficit. This logical sequence is relevant and should be remembered at a time when the narrative about debt sustainability dominates most headlines, and most of our fears. And although sharper minds could easily anticipate this predictable sequence, consensus sometimes forgets these subtleties.

Will an expansion of the deficit have a limited or amplified effect on business profits?

Deficits can impact business profits to a greater or lesser extent. In today's case, and given the new composition of total federal outlays, **the only way** to expand the deficit in a time of rate cuts (and the subsequent decline in interest expenses) is by significantly increase non-interest expense. That is, a quantitative leap in public consumption of goods and services from the private sector. By the way, an exercise that governments are willing to practice once we have passed the late cycle stage, especially if we are in an election year. So, under current circumstances, deficit expansions could cause an exceptionally favorable impact on business results. The question is: Will the current government act as they usually do in an election year and will expand the deficit?

Of course, some sectors will act as a counterweight. Specifically, those sectors and companies that will earn less interest on their balance sheet assets. But overall, the net result will presumably be favorable for businesses.