**Will DOGE Derail Growth?**

*Growth concerns have grabbed the market's attention due to fears of federal cutbacks in spending and employment. We don’t see evidence yet that DOGE will derail growth (i.e., cause a recession or even a substantial slowdown).*

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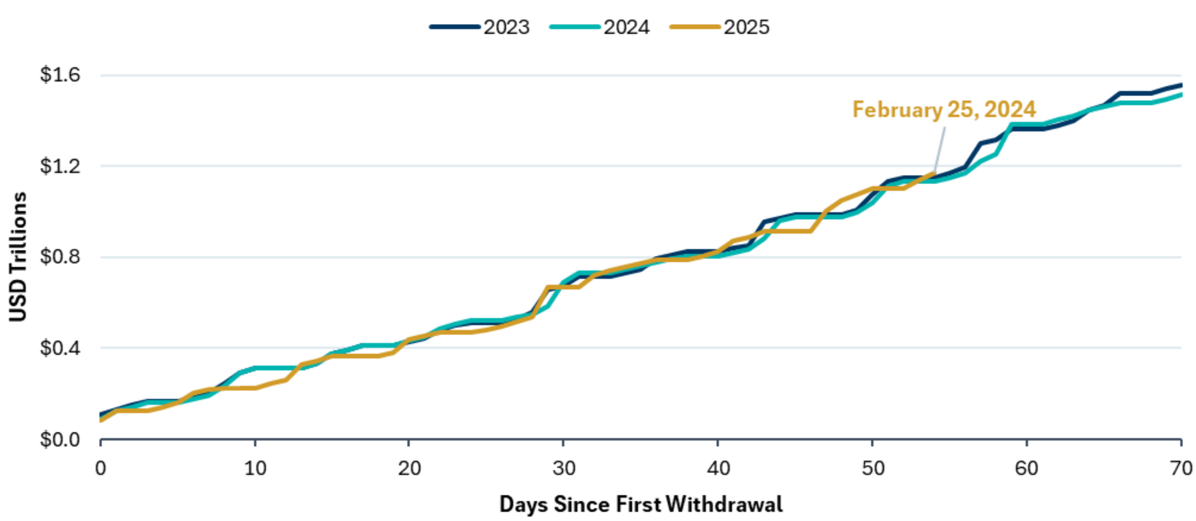
After months of focusing on inflation risks, the bond market re-awakened to the possibility of economic growth risks amid the Department of Government Efficiency (DOGE) headlines.

We’re also concerned about downside risks to growth, primarily due to the side effects of tariffs and policy uncertainty. We recently reduced our probability of a trend-like growth scenario from 65% to 50% and raised the risk of a sub-par growth scenario as well as a garden-variety recession scenario (See our note on tariffs *For Whom The Tariff Tolls,* published 2 February 2025, and our U.S. macro deck update note *(Still!) On Track For Rate Cuts Later This Year*, published 12 February 2025).

That said, talk is cheap, and DOGE's actual economic impact might be more muted than investors think for several important reasons.

First, **the actual pace of Federal spending hasn’t slowed at all**. We closely track government spending through real-time payment data from the U.S. Treasury. So far, DOGE has yet to dent the actual government spending trend compared to 2023 and 2024 (***see Figure 1***).

**Figure 1 - DOGE Has Yet To Make A Dent!**
Cumulative Sum Of Daily Treasury Statement Withdrawals Excluding Debt*



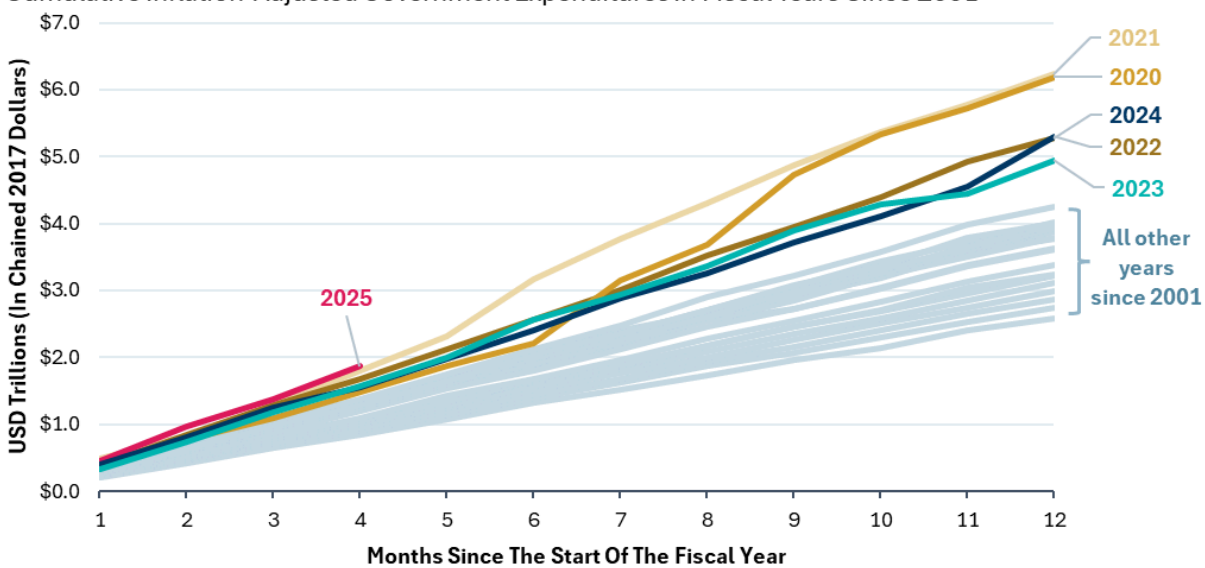

**Net fiscal spending equals gross withdrawals minus gross deposits; Real-time government spending data that excludes debt issuance and payments*

*Source: U.S. Treasury, Fiscal Data*

In fact, at its current pace, *nominal* Federal spending is on track to top $6 trillion for the sixth consecutive fiscal year in 2025! In *inflation-adjusted* terms, fiscal year 2025 expenditures are running even faster year-to-date than fiscal year 2021 (***see Figure 2***).

**Figure 2 - 2025 Government Spending Is On Track To Top 2024:**

Cumulative Inflation-Adjusted Government Expenditures In Fiscal Years Since 2001

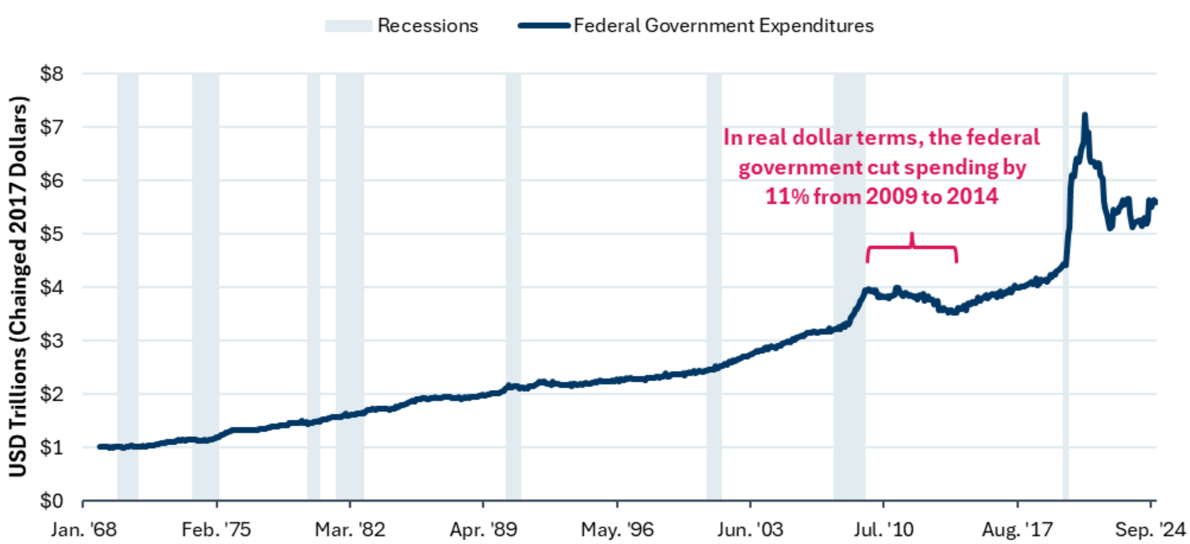



*Source: Bureau of Labor Statistics, U.S. Treasury*

Second, **real government spending cuts are rare**. In inflation-adjusted dollar terms, we've identified one phase when the government cut back spending: the 2010-2014 "fiscal austerity" period (***see Figure 3 below***).

**Figure 3 - Fiscal Austerity Is Rare:**

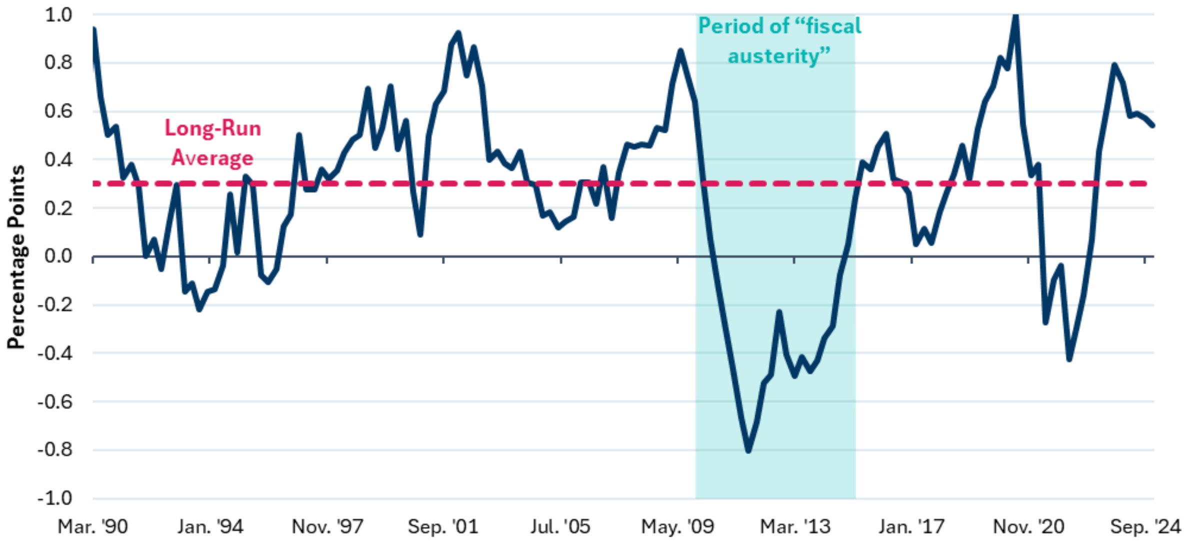
Inflation-Adjusted Government Expenditures, 12-Month Moving Sum




*Source: U.S. Treasury, BEA*

During that period, government expenditures and gross investment (the line item of government in GDP) actually detracted from the quarterly annualized GDP growth rate by 0.5 percentage points on average (***see Figure 4***).

**Figure 4 - Government Detracted From Growth In The Early 2010s:**
Government Expenditures Contribution To Real GDP Quarterly Annualized Rate

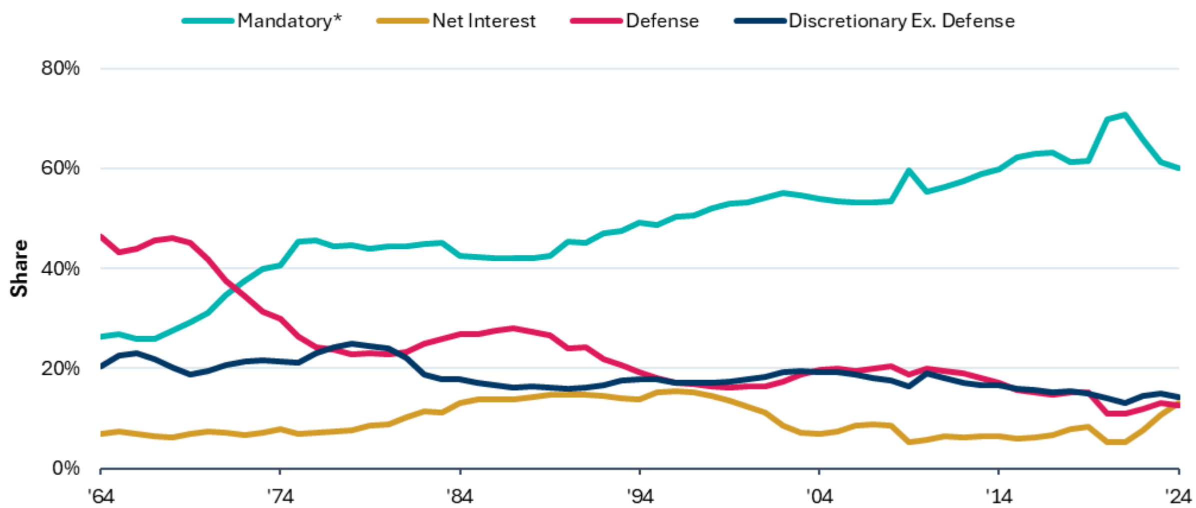



*Source: Bureau of Economic Analysis*

However, the U.S. avoided a recession from 2010 to 2014, as the U.S. consumer contributed +1.5 percentage points to quarterly GDP growth from 2010 to 2014, offsetting the austerity drag.

Third, **"discretionary spending" totaled $1.8 trillion in fiscal year 2024, accounting for only 14% of annual government expenditures. Thus, it is difficult politically to make substantial cuts** (***see Figure 5***). Significant spending cuts will require cuts to "mandatory" expenditures.

**Figure 5 - Government Spending Is Becoming Less Discretionary:**
Government Spending By Type




**Mandatory spending includes social security, medicare, medicaid, income security, fed civilian and military retirement, veterans' program, other programs*

*Source: CBO*

Fourth, **Congress—not DOGE nor the President—determines spending.** Executive orders are not a durable method for changing the U.S. fiscal situation. Interestingly, although Trump has signed 72 executive orders year-to-date, 92 lawsuits have also been filed challenging executive actions.[1] If DOGE wants to achieve its proclaimed "$2 trillion goal" in spending cuts, it will require Congressional action, not just the stroke of the Presidential pen.

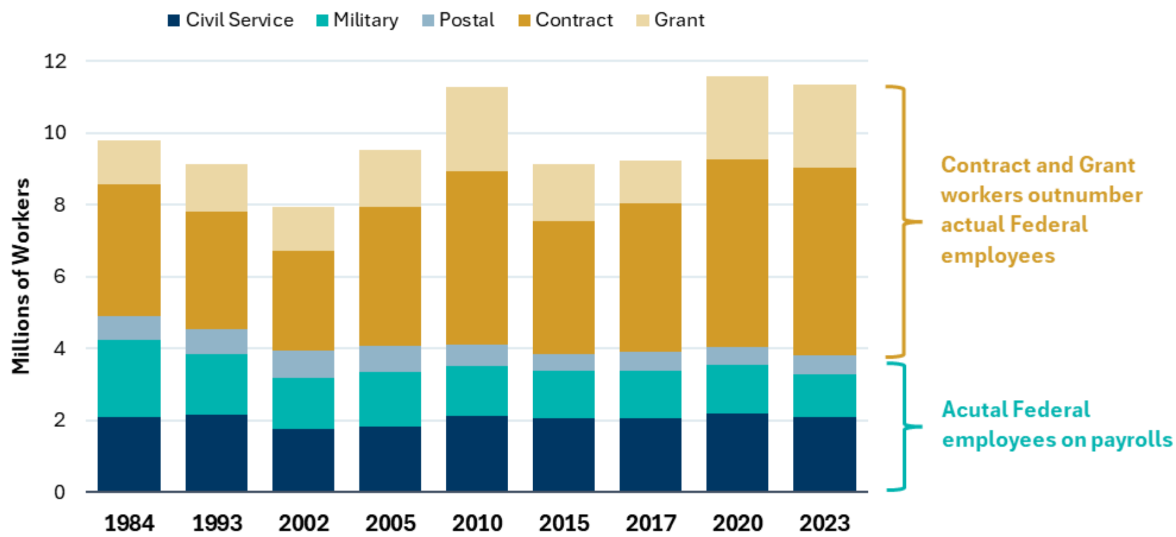
On a related note, the House passed a budget bill on Wednesday (it will now need to be taken up by the Senate). Interestingly, the bill is not nearly as bold as headlines suggest. While the bill outlines $2 trillion in cuts *over the next 10 years*, mostly to mandatory spending, it also proposes a $300 billion *increase* in military spending and $4.5 trillion in forgone revenue from the tax cuts proposed. So, all else equal, if passed in its current form, the budget bill would reduce the annual expenditures by ~$200 billion a year, but also decrease revenue by ~$700 billion every year in the next 10 years, leading to larger budget deficits and a bigger debt-to-GDP ratio—not exactly a budget that would derail growth or even restore fiscal rectitude.[2]

Fifth, **government-related labor market data don't portray a worrying picture—yet.** In 2024, total government jobs accounted for around 8% of net nonfarm payroll employment gains. However, 72% of those government job *gains* were at the state and local government level (think: your teachers and school bus drivers, not IRS agents).

Further, Federal employment has been shrinking as a share of the total employment, now making up only 2% of the workforce, compared to 4.3% in 1960. Most Federal employees work in defense and security-related departments, which account for about 49% of the total Federal workforce as of September 2024.[3]

There's a catch: Federal contractors. Since 1984, the number of contractors employed by the Federal government has grown and now outnumbers Federal employees (***see Figure 6***). The share of contractors grew even more in 2023, and the number of contractors employed is now double that of Federal employees on payrolls.[4] As such, a cutback in contractors could pose a larger threat to the labor market than Federal firing alone.

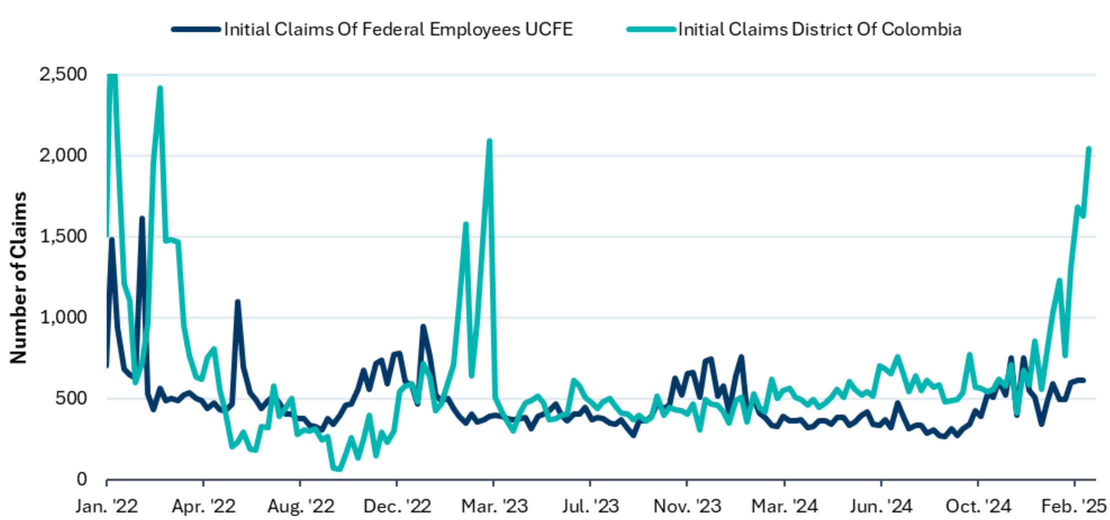
**Figure 6 - The Federal Government Employs More Contractors Than Federal Workers:**
Estimated Full-Time Equavlent Federal Employees




*Source: Brookings Institute*

The complicated structure of Federal employment may explain why DC-area unemployment claims have surged in recent weeks (albeit from low levels) even though actual Federal employee layoffs remain subdued (***see Figure 7***).

**Figure 7 - Actual Federal Layoffs Remain Low, But Initial Claims In D.C. Spiked:**
Weekly Initial Jobless Claims Of Federal Employees Versus Initial Claims In D.C.




*Source: U.S. Department of Labor*

Finally, considering there are roughly 1.7 *million* new layoffs *per month* in the U.S., the cumulative 6.7 *thousand* layoffs recorded in D.C. plus the 2.3 *thousand* layoffs of all Federal employees over the last four weeks, all else equal, would only push the unemployment rate up by 0.005 percentage points.

The bottom line is that while we think the bond market spent too much time focused on inflation and ignoring growth risks in the past few months, investors are now likely too focused on DOGE-related downsides that may not materialize.

The Payden Economics Team

## Endnotes

1. Litigation Tracker: Legal Challenges to Trump Administration Actions
2. https://budgetmodel.wharton.upenn.edu/issues/2025/2/27/fy2025-house-budget-reconciliation-and-trump-tax-proposals-effects
3. Federal workers in th department of air force, army, defense, homeland security, and navy accounts for 49% of total Federal government jobs. Source: FedScope - Federal Workforce Data - OPM.gov
4. https://www.brookings.edu/articles/is-government-too-big-reflections-on-the-size-and-composition-of-todays-federal-government/#omb-circular-a-76-362