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Budget Cuts Raise Doubt on Course of Recovery

By BINYAMIN APPELBAUM

WASHINGTON — The budget deal struck last week amounts to a bet by the Obama administration that the loss of $38 billion in federal spending will not be the straw that breaks the back of a fragile economic recovery.

Economic conditions can determine the outcome of elections, and growth remains tepid and tentative just 18 months before voters decide if the president gets a second term.

The proposed federal spending cuts, which were decided late Friday, do not amount to much by themselves, about 0.25 percent of annual domestic activity. But they join a growing list of minor problems impeding growth, economists said, including higher fuel prices and bad weather, Europe’s creeping malaise and the effect of the Japanese earthquake.

The impact of those problems, combined with growing cuts in spending by federal, state and local governments, has led some experts who had forecast that the economy would expand by more than 4 percent in 2011 to retreat toward a 3 percent growth rate. And it raises the question of how many more small cuts the president can afford.

Diane Swonk, chief economist at Mesirow Financial, a Chicago investment firm, said she had cut her forecast for 2011 to 3.3 percent, from 4.2 percent. And if growth falls below 3 percent, she said, “You’re just running on a treadmill. You’re not getting anywhere.”

There are reasons for optimism. The Federal Reserve and private forecasters say that the economy’s vital signs are getting steadily stronger. Factories are expanding production; people are buying more cars. Leading forecasters like the firm Macroeconomic Advisors of St. Louis to predict that growth will accelerate after the first quarter.

Moreover, supporters of the cuts say that reduced government spending will stimulate economic growth, not damp it — and that the president could be among the political beneficiaries.

As the government spends less it borrows less, and companies can borrow more. As the government collects less money in taxes, companies may increase spending and investment.

“This cut combined with other cuts in entitlement reform will give the economy and businesses and investors some positive news on the fiscal front in Washington,” said Chris Edwards, director of tax policy studies at the Cato Institute, a libertarian think tank that favors even larger reductions in the federal spending.

There is also the potential that the budget deal will serve as a precedent for a broader deal on long-term spending. Economists say that such a deal would have immediate economic benefits, soothing the nerves of foreign investors who may be fretting about the government’s ability to confront its problems.

“I think the cuts are perfectly digestible in the context of the current expansion,” said Mark Zandi, chief economist of Moody’s Analytics. “And if out of this process it appears that we’ve made a good step toward fiscal discipline and laid out a mechanism for the main event, then it could be a plus.”

Mr. Zandi warned this year that a Republican plan for about $60 billion in cuts would do significant damage to the economy. He said that his views had moderated not just because the parties agreed to make smaller cuts, but because of recent declines in unemployment, to 8.8 percent in March, and 12 consecutive months of private sector job growth.

But the International Monetary Fund took a bleaker view Monday, predicting that the American economy would expand by a lackluster 2.8 percent in 2011, and a barely better 2.9 percent in 2012.

The I.M.F., which provides financing to governments, said in its annual report on the world's economic outlook that the United States was at risk of cutting government spending too quickly.

It said that the cuts proposed by the Obama administration for 2012 and 2013 "will be challenging to implement, especially in an environment of weak growth and unemployment." Cuts should be made more gradually, it said.

The report also said the United States needs to increase exports and that, in turn, depended on the willingness of other nations to let their currencies float freely.

"It has to come from exports for the United States to be able to sustain growth," said Olivier Blanchard, one of the authors of the report. "Something needs to happen in the rest of the world, and it is not happening, or it is not happening fast enough."

The I.M.F. warned that the world economy was growing on an unsustainable basis because developed nations were borrowing too much and developing nations were relying on exports paid for with that borrowed money, rather than taking steps to build sustainable domestic consumption.

"We are warning the emerging market countries that they may be getting to the point where things are too good," Mr. Blanchard said.

The Obama administration has made increasing exports a central tenet of its economic strategy, and it has pushed for efforts by the I.M.F. and other international bodies to loosen the monetary policies of nations like China.

Natalie Wyeth, a Treasury Department spokeswoman, said the administration also was committed to reducing the federal debt.

“We will meet our commitments to the G-20 in Toronto and look forward to working with Congress to establish a credible, multiyear path to ensure our fiscal sustainability while delivering strong economic growth,” Ms. Wyeth said.