



Fiscal Issues

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Passion to Perform

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Some fiscal issues

US fiscal performance and prospects

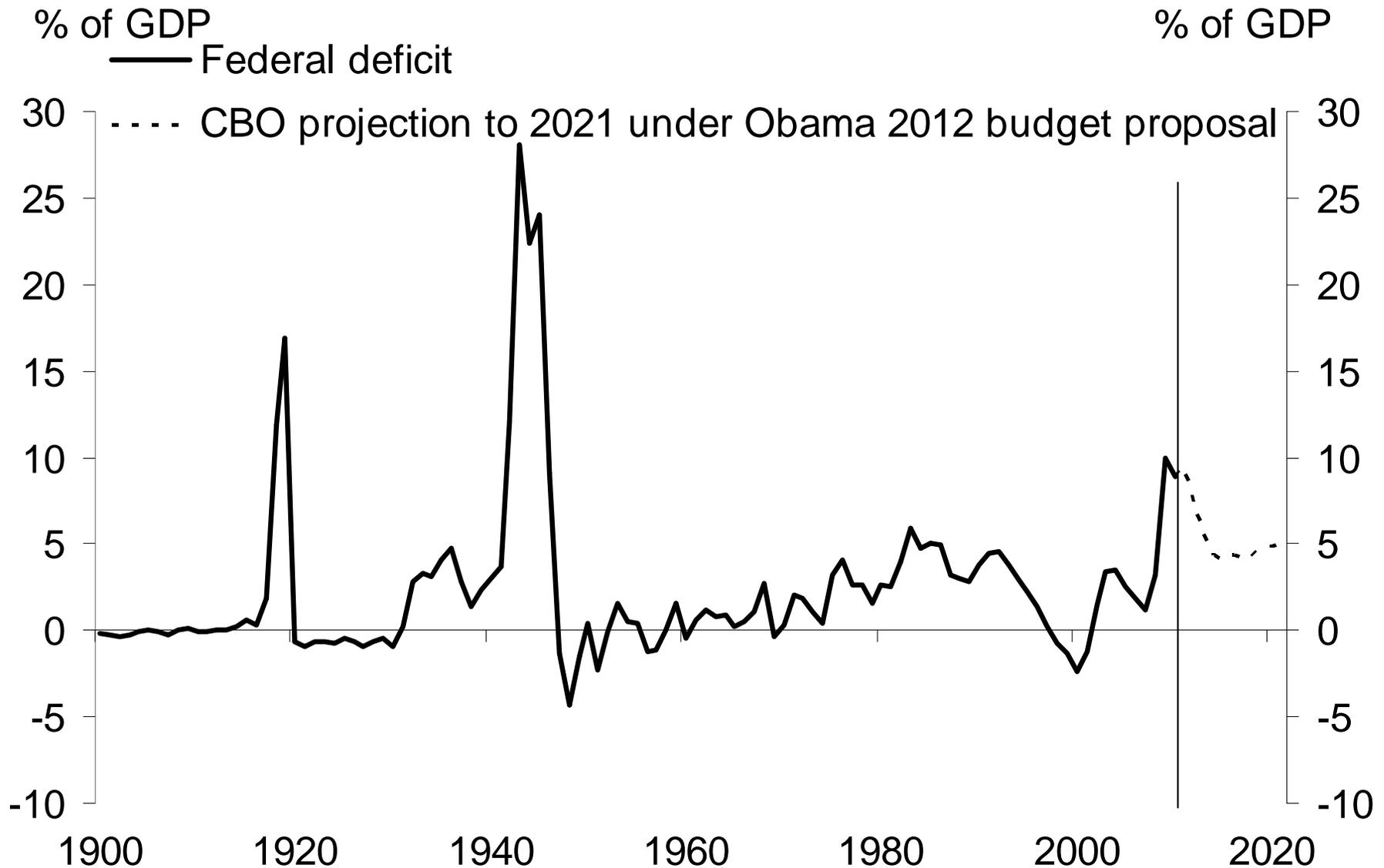
International comparisons

Emerging markets get it on fiscal policy, but not monetary policy.

Source: *usgovernmentspending.com, CBO, DB Global Markets Research*



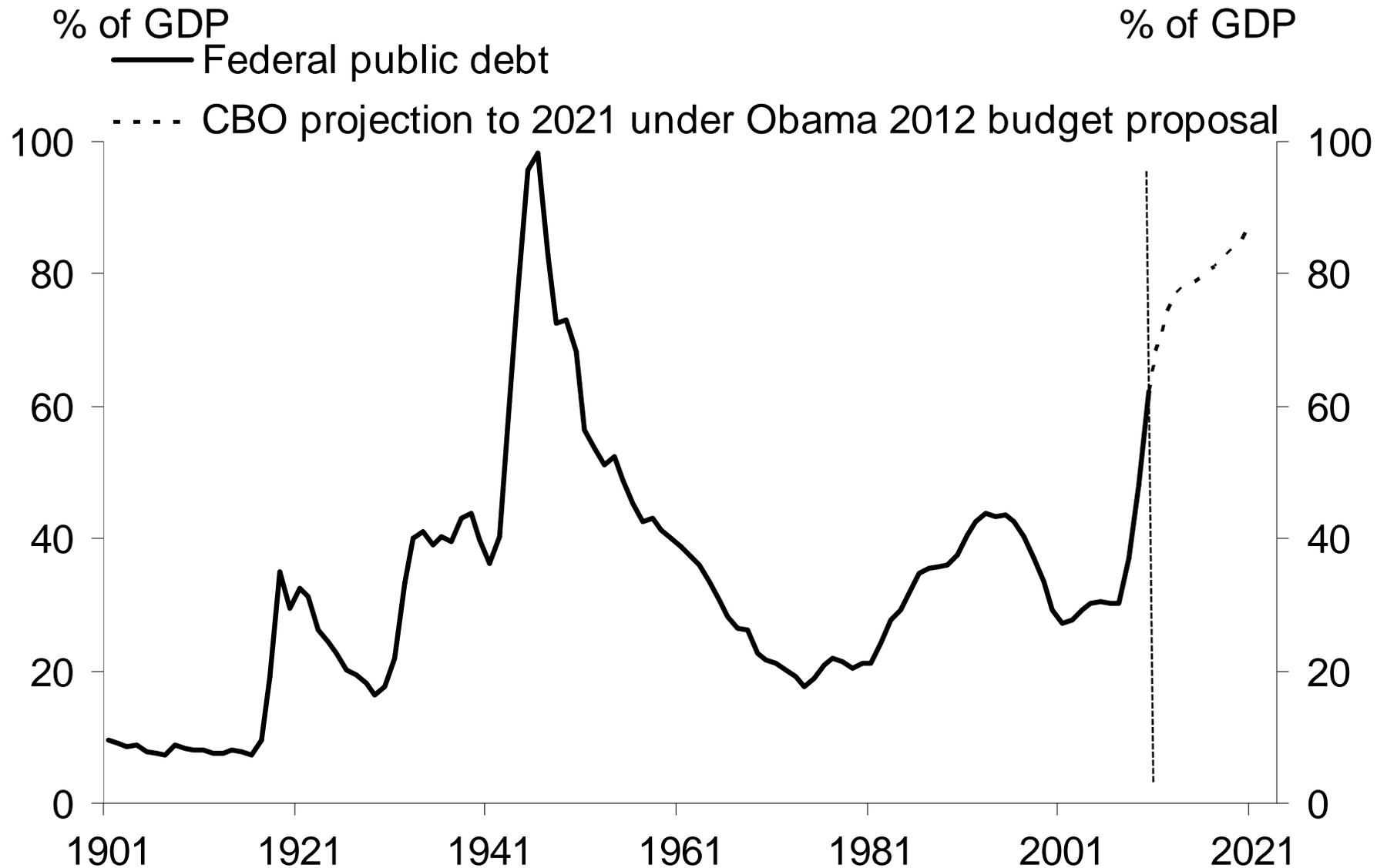
Unprecedented US peacetime deficit



Source: usgovernmentspending.com, CBO, DB Global Markets Research



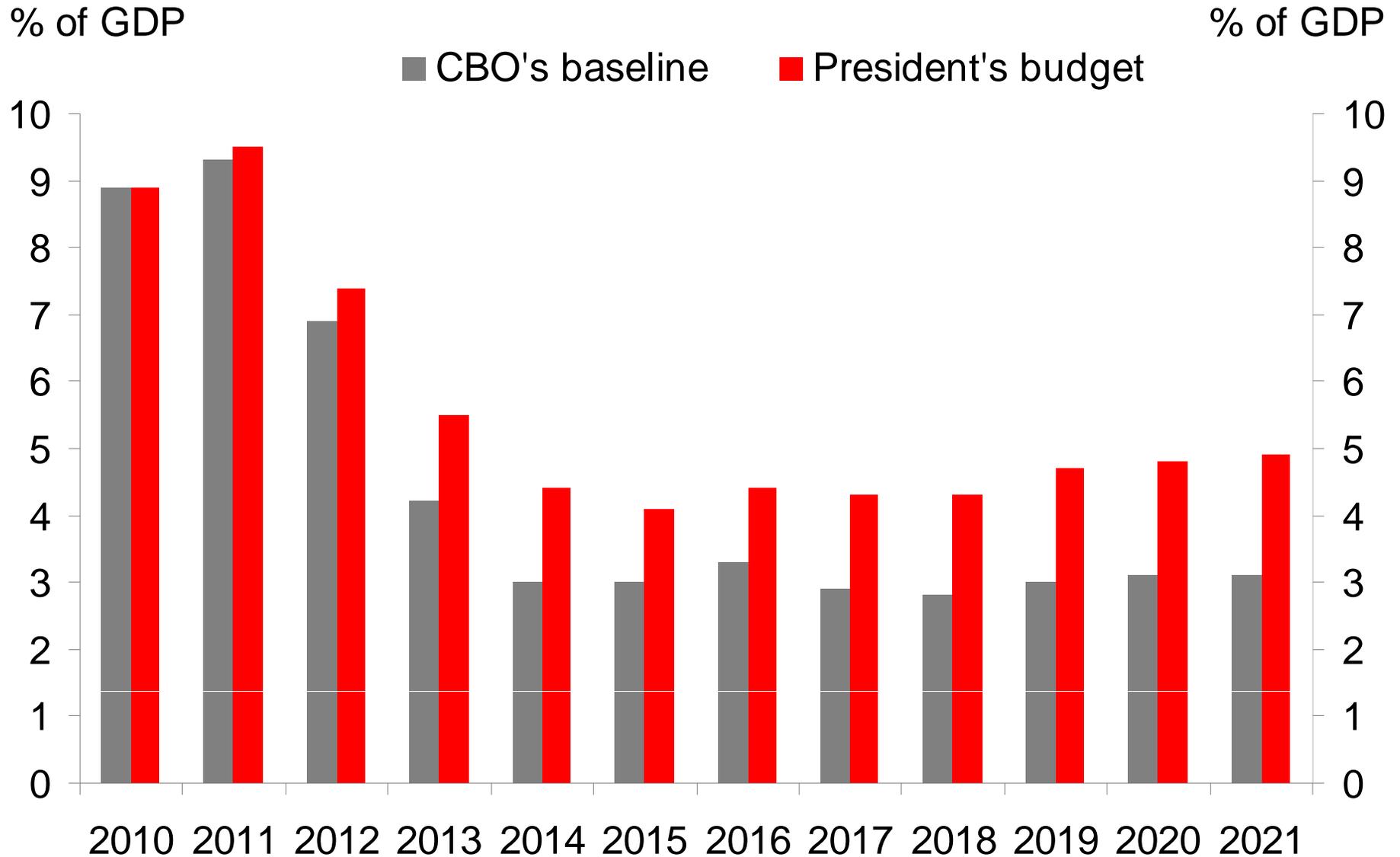
Unprecedented US peacetime public debt of Fed



Source: usgovernmentspending.com, CBO, DB Global Markets Research



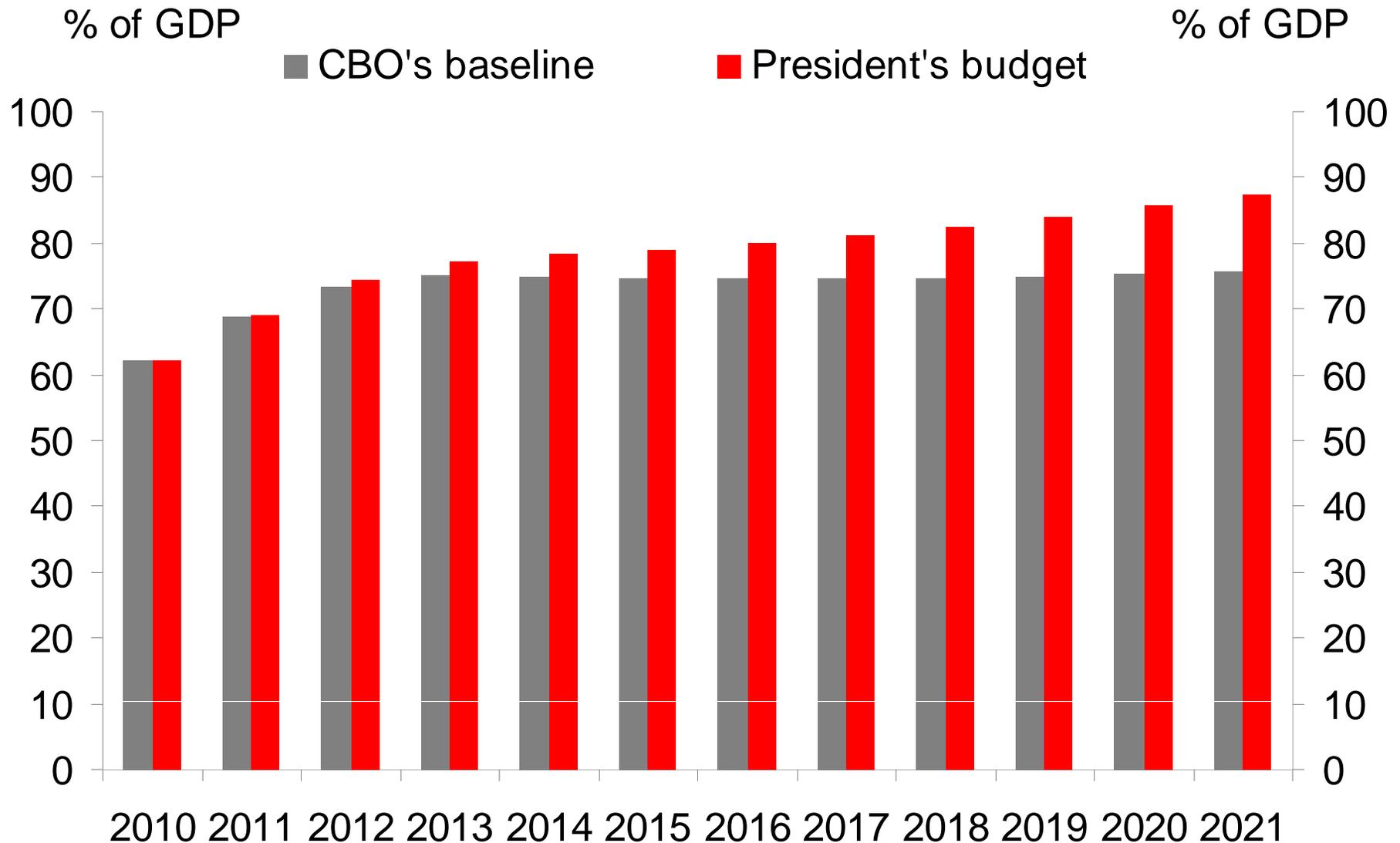
Federal Budget Projections



Source: CBO, DB Global Markets Research



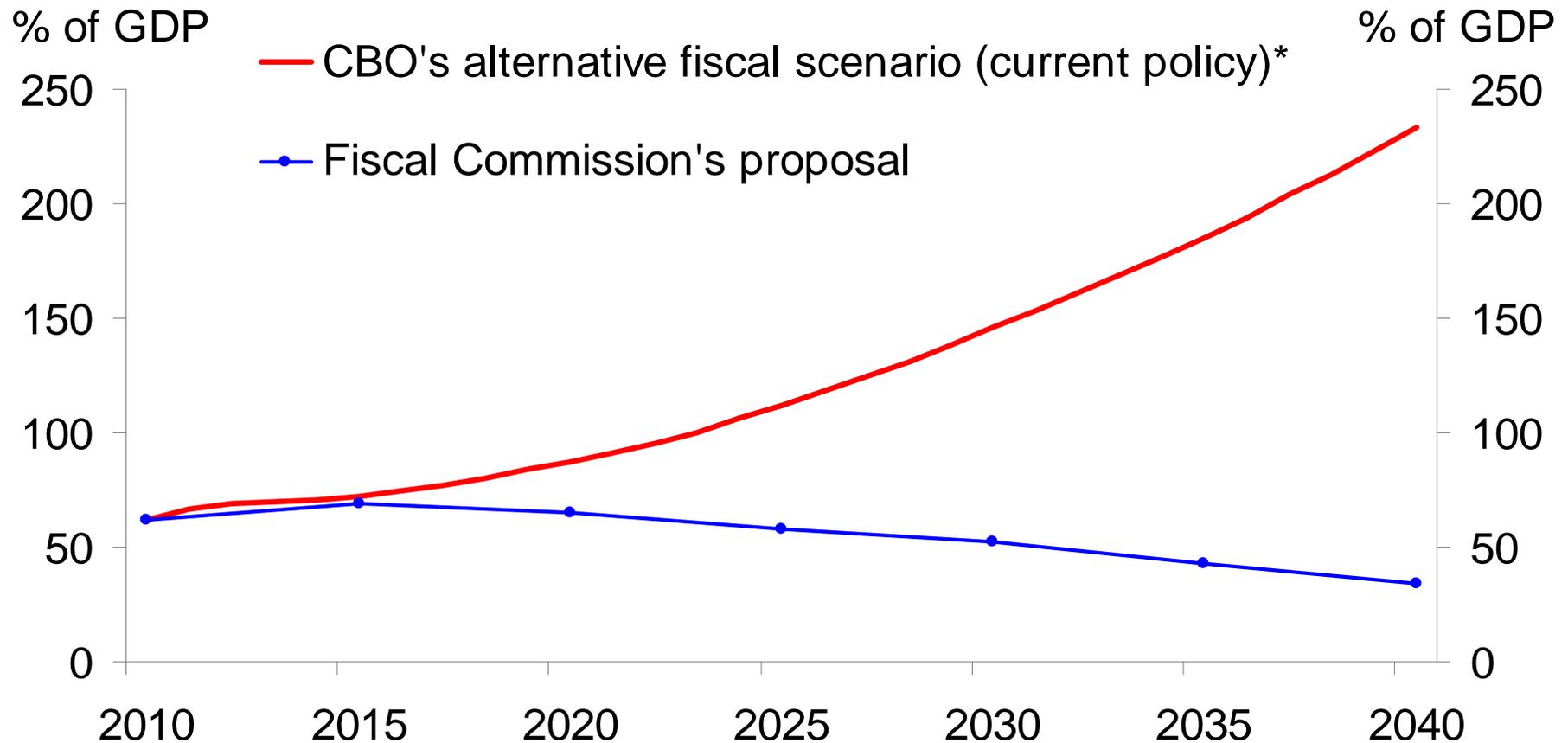
Absent reform, debt is headed up



Source: CBO, DB Global Markets Research



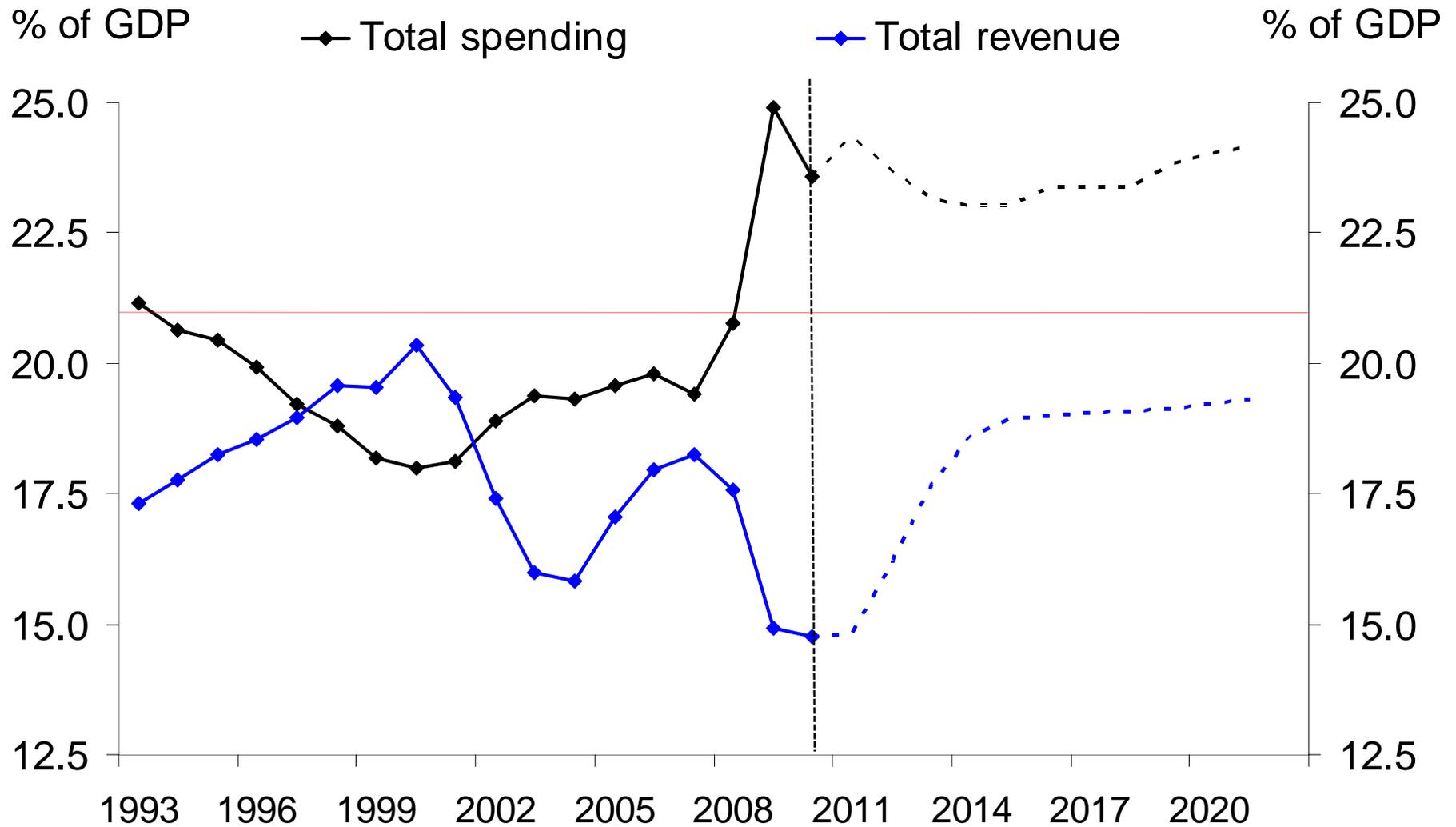
Wide gulf between current policy and what needs to be done



* The Alternative Fiscal Scenario incorporates several changes to current law considered likely to happen, including the renewal of the 2001/2003 tax cuts on income below \$250,000 per year, continued AMT patches, the continuation of the estate tax at 2009 levels, and continued "Doc Fixes". The Alternative Fiscal Scenario also assumes discretionary spending grows with GDP (as opposed to inflation) over the next decade, that revenue does not increase as a percent of GDP after 2020, and that certain cost-reducing measures in the health reform legislation are unsuccessful in slowing cost growth after

Source: CBO, Fiscal Commission, DB Global Markets Research

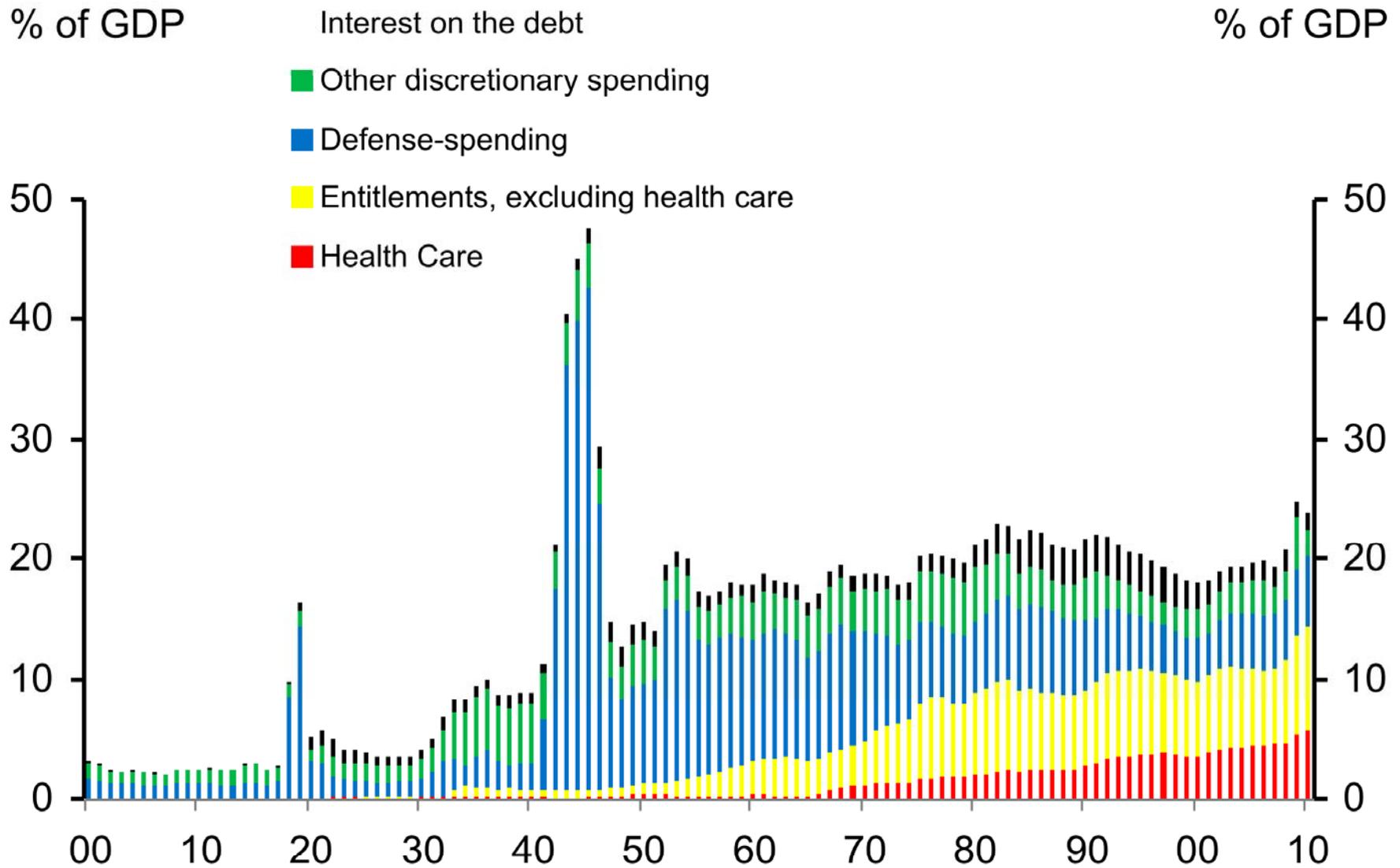
Fiscal commission compromise



Source: CBO, DB Global Markets Research



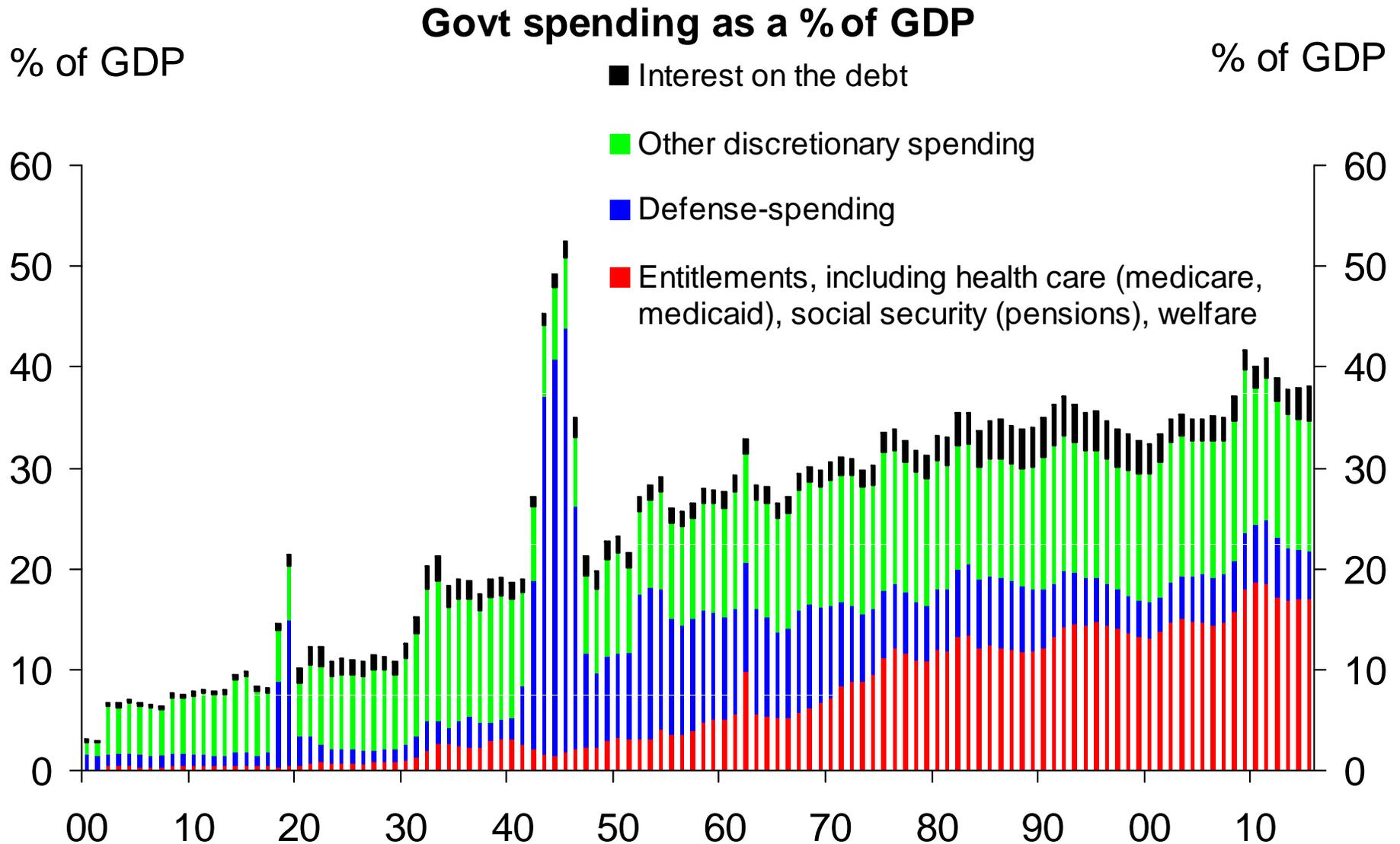
Federal spending



Source: usgovernmentspending.com, CBO, DB Global Markets Research



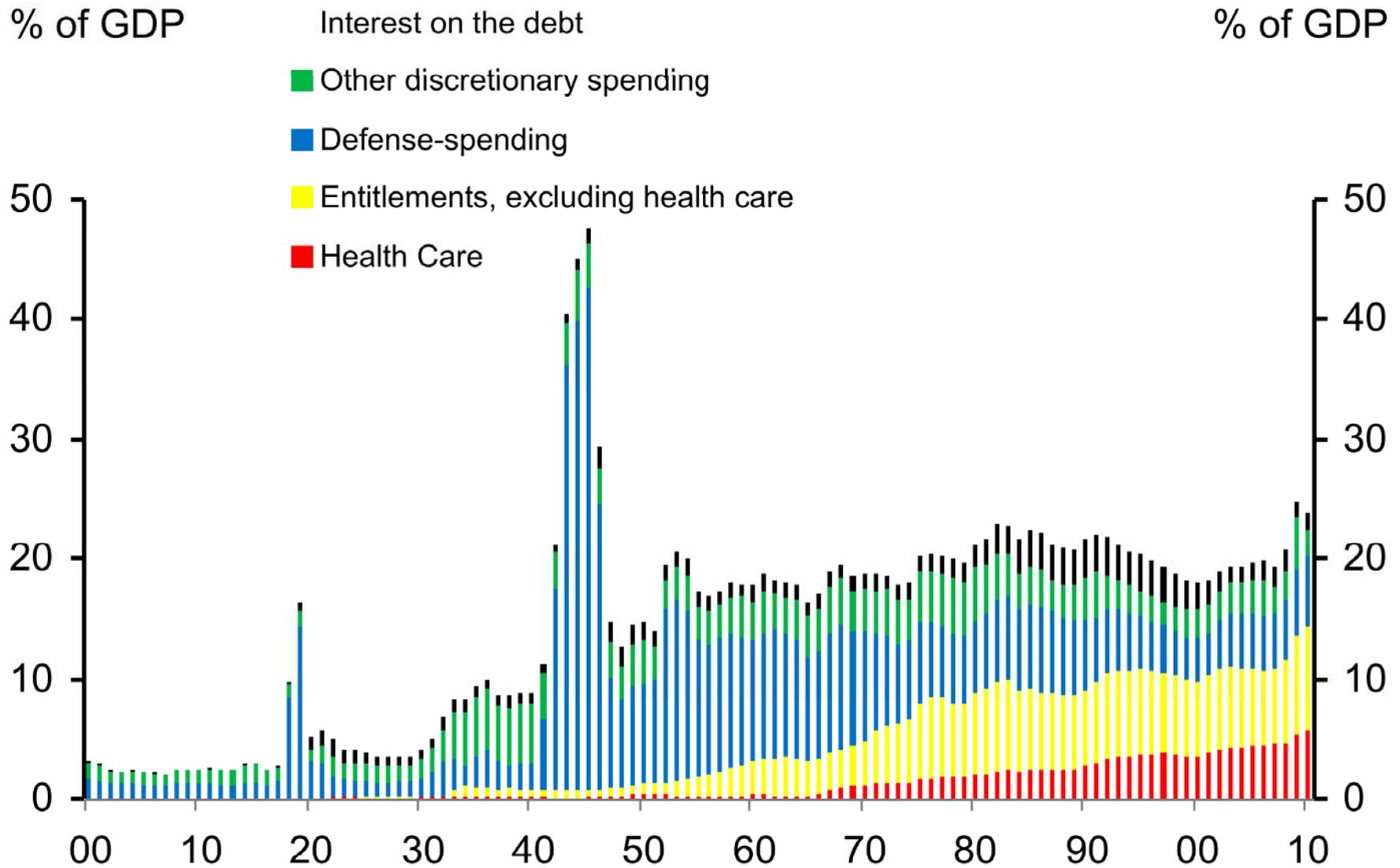
Federal, State, and Local Spending



Source: usgovernmentspending.com, CBO, DB Global Markets Research



Federal spending

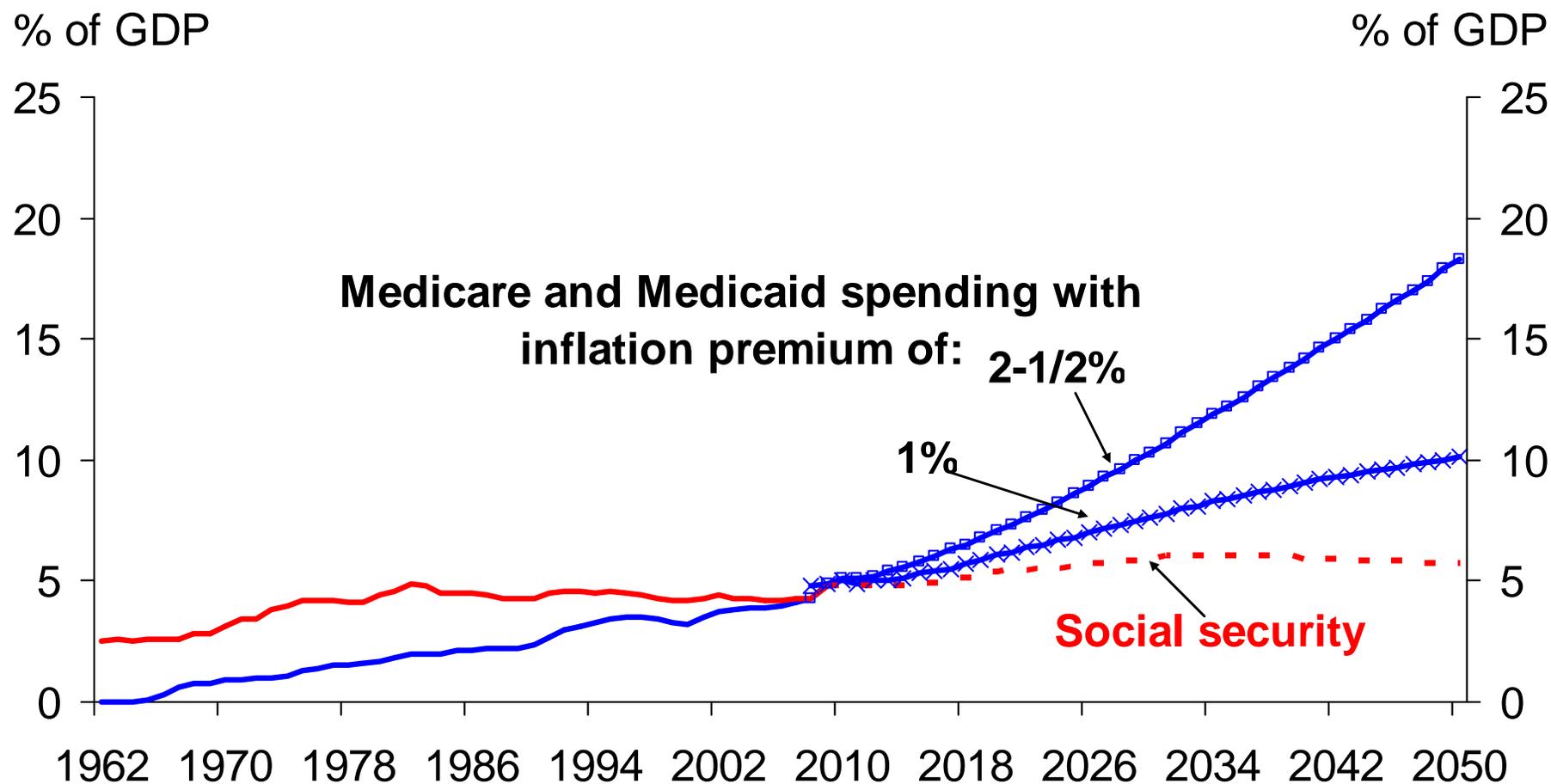


Source: usgovernmentspending.com, CBO, DB Global Markets Research

Health care inflation premium at core of debt problem



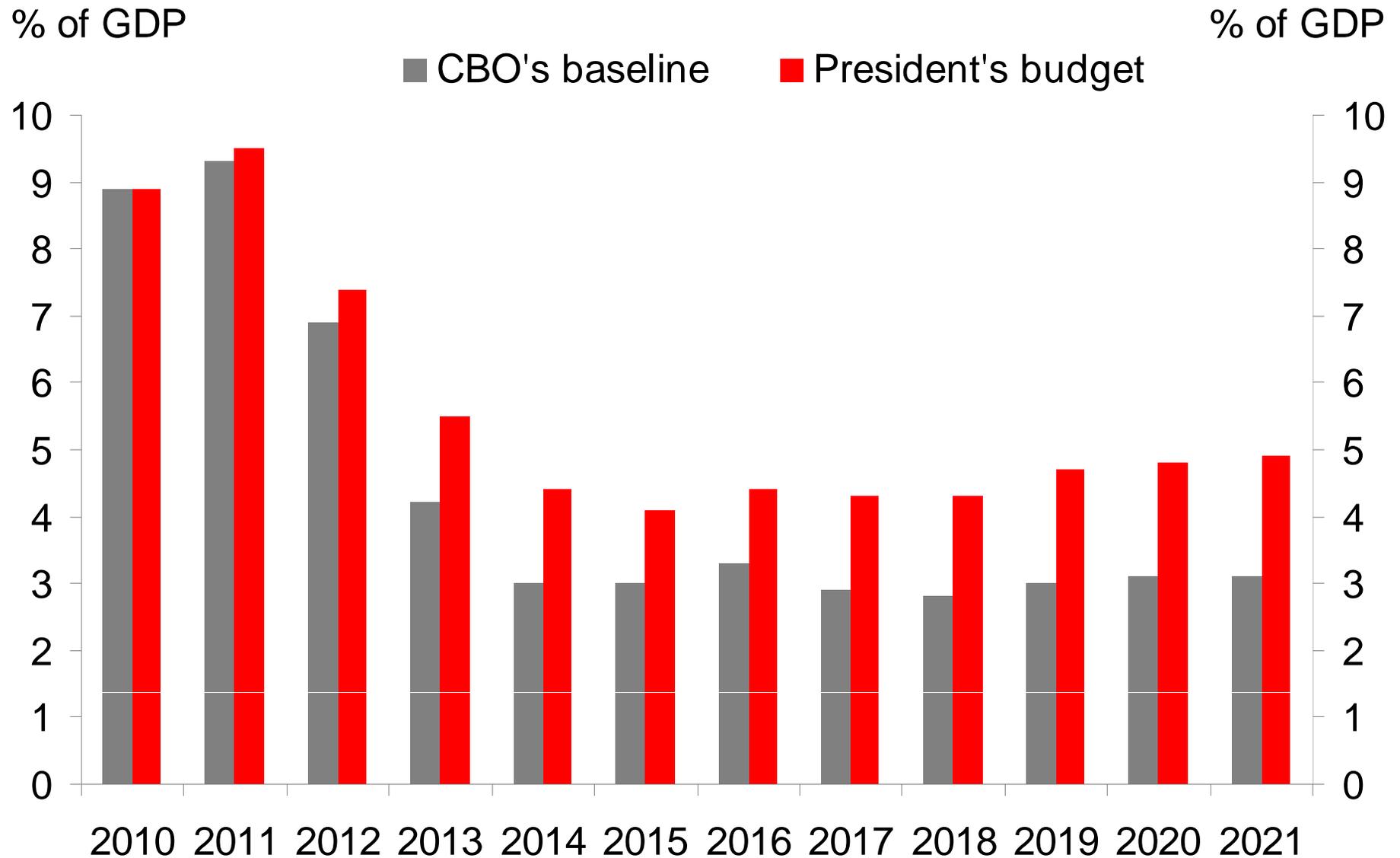
CBO projections under current policies



Source: CBO, DB Global Markets Research



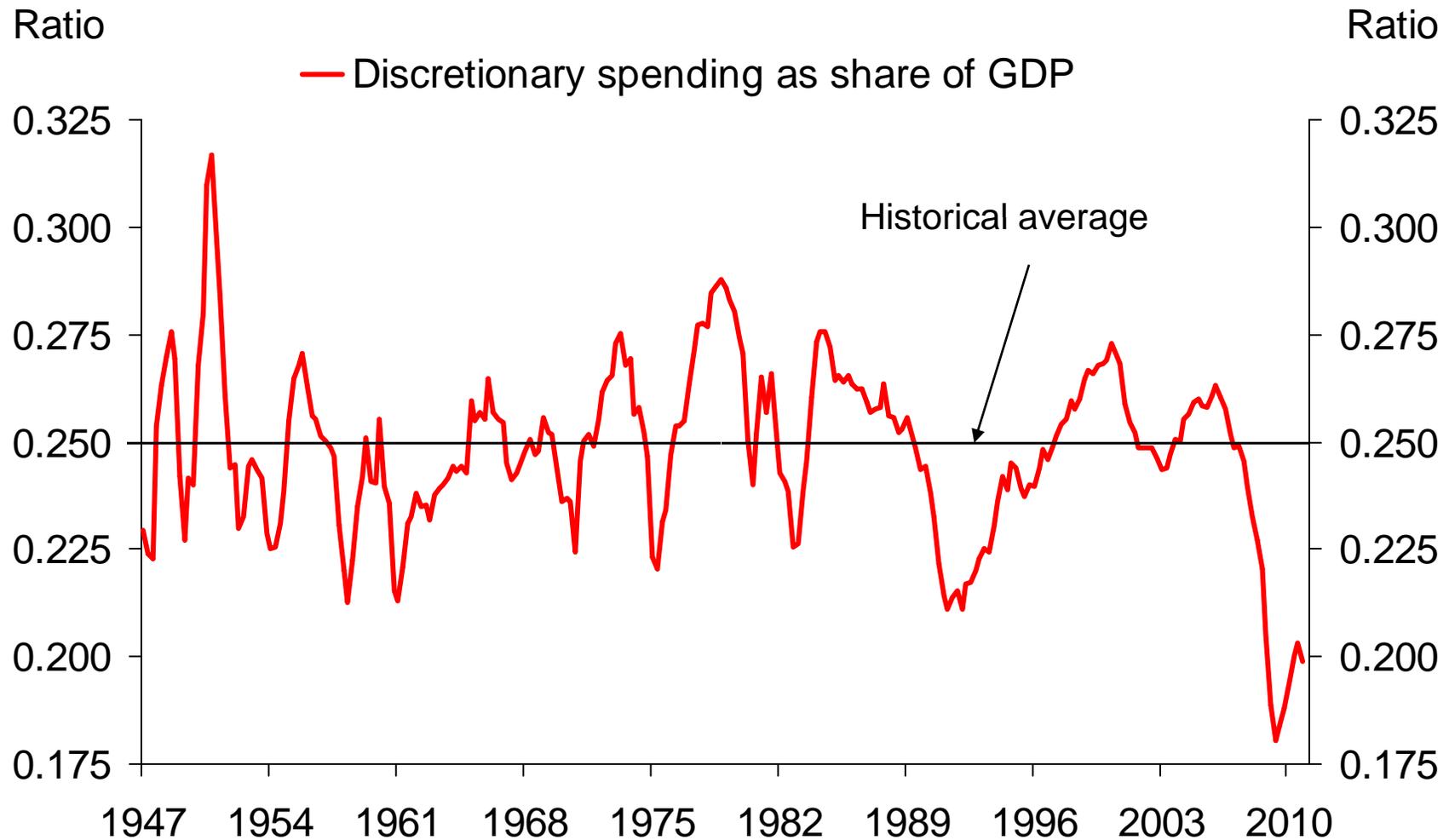
Substantial fiscal drag in store



Source: CBO, DB Global Markets Research



Private discretionary spending gap has room to offset fiscal drag



* Discretionary spending here includes personal consumption expenditure on durable goods and gross domestic private investment.

Source: BEA, DB Global Markets Research



Near-term prospects for fiscal policy

2011 budget, Still in limbo. Expect deal w/\$30-40bn cuts to keep the government operating through Sept 30. But chances of shut-down growing.

Expect a debt limit increase to be enacted by end June. Likely to involve some cuts/reforms.

But cuts involve chipping away at 14% of the budget in non-security discretionary spending. Congress and President unlikely to agree on anything with much longer-term budget effect.

Rep Ryan proposing 5.8bn cuts over 10 years, incl 2.2bn in Medicaid and Medicare (Rivlin voucher system).

President unlikely to let fiscal drag increase much further in election year.

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Source: usgovernmentspending.com, CBO, DB Global Markets Research



Slightly longer-term prospects for fiscal policy

The longer-term budget outlook depends crucially upon health care costs. CBOs scoring of last year's Patient Protection and Affordable Care Act (PPACA) sees cost savings and modestly budget positive, but cost savings per patient largely offset by addition of 31 million Americans onto health insurance policies.

Optimistic scenario for budget: Republicans likely to take the Senate in 2012 and with economy recovering, President Obama likely to be reelected. 2nd term opportunity; also parallels to 1993, when President Clinton faced a GOP Congress after failed health reform cost him the House in the 1992 election. The 1993 budget deal put US on path to a balanced budget FY98-FY01.

But if Republicans unwilling to put revenue increases on the table, it will be very hard to reach fiscal balance. Difficult to achieve via spending cuts alone. Revenues 15%-18% of GDP. Plus, Obama may have to make commitments on spending side to be reelected.

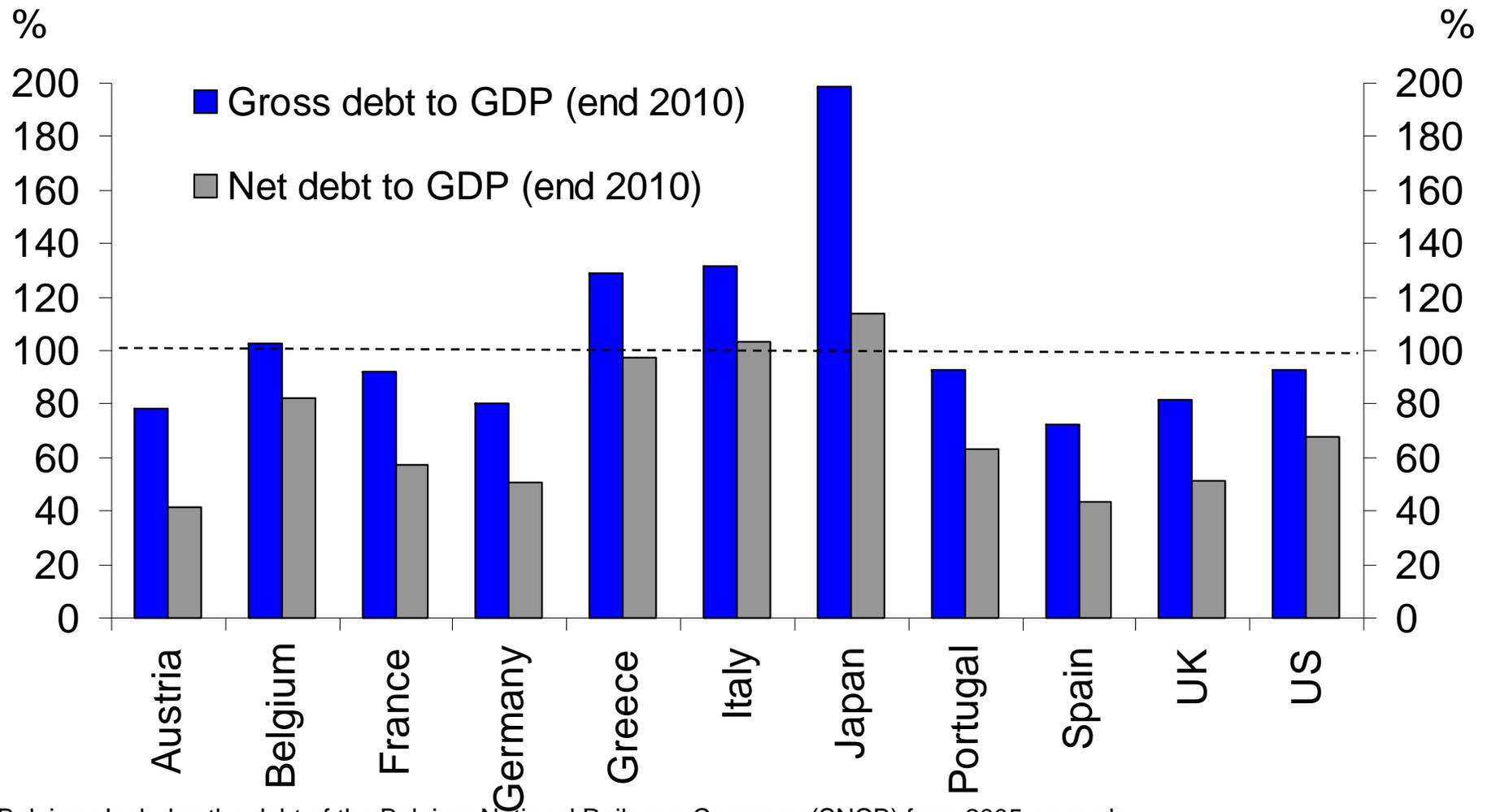
Bond market vigilantes may have to bring pressure to bear to force action.

Source: usgovernmentpending.com, CBO, DB Global Markets Research

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International comparisons of public debt/GDP (OECD)



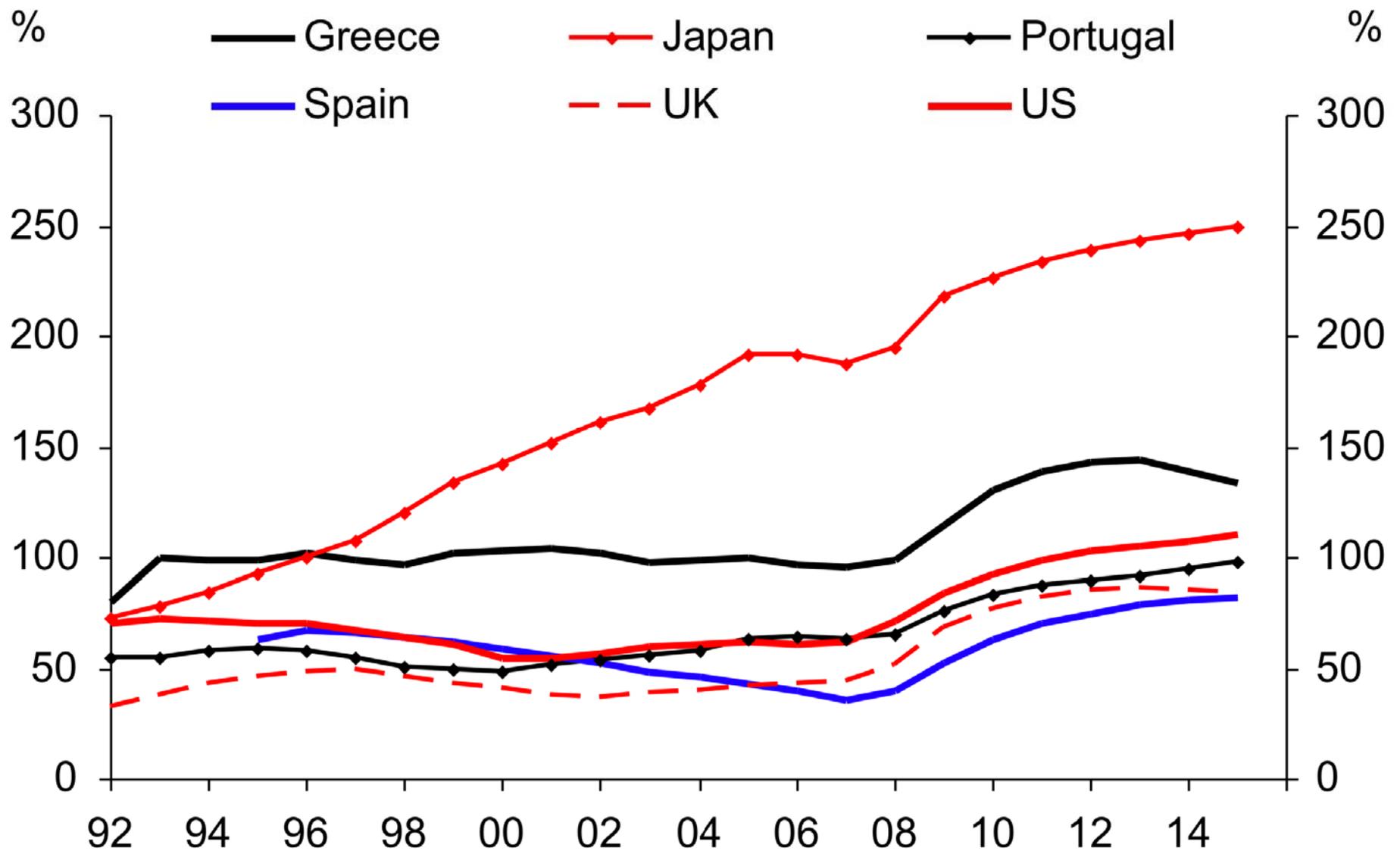
1. Belgium: Includes the debt of the Belgium National Railways Company (SNCB) from 2005 onwards.

2. Germany: Includes the debt of the Inherited Debt Fund from 1995 onwards.

3. Japan: includes the debt of the Japan Railway Settlement Corporation and the National Forest Special Account from 1998 onwards.

Source: OECD, DB Global Markets Research

Gross federal debt to GDP projections (IMF, WEO)



Source: IMF, WEO, DB Global Markets Research

US public debt stress ranking projected to rise



		2009		2011
1	Greece	6	Greece	8
2	Italy	15	Ireland	14
3	Portugal	15	Italy	15
4	Belgium	16	US	17
5	France	19	Japan	18
6	Ireland	20	Portugal	18
7	Japan	22	France	19
8	UK	22	UK	21
9	US	23	Belgium	22
10	Germany	29	Germany	31
11	Spain	30	Netherlands	32
12	Austria	33	Spain	33
13	Netherlands	33	Austria	34
14	Canada	34	Canada	44
15	Denmark	48	Denmark	44
16	Australia	48	Sweden	46
17	Finland	51	Finland	49
18	Sweden	53	Australia	51
19	Switzerland	55	Switzerland	55
20	Korea	58	Korea	59

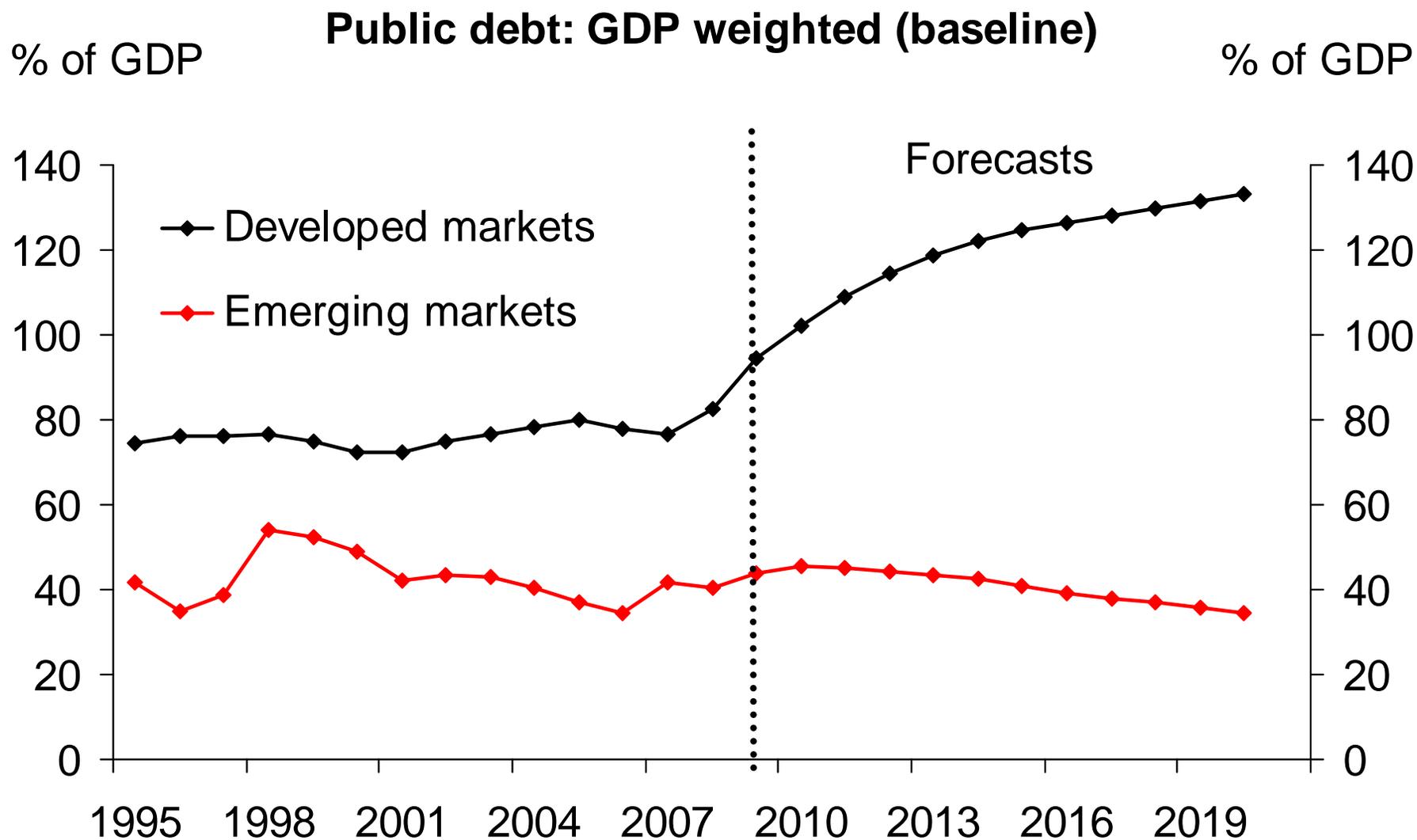
Public debt stress ranking combines:

- public sector debt levels
- public sector deficits,
- public sector net interest payments as a % of GDP

into a single measure by taking the ranking of each country for each measure and summing them.

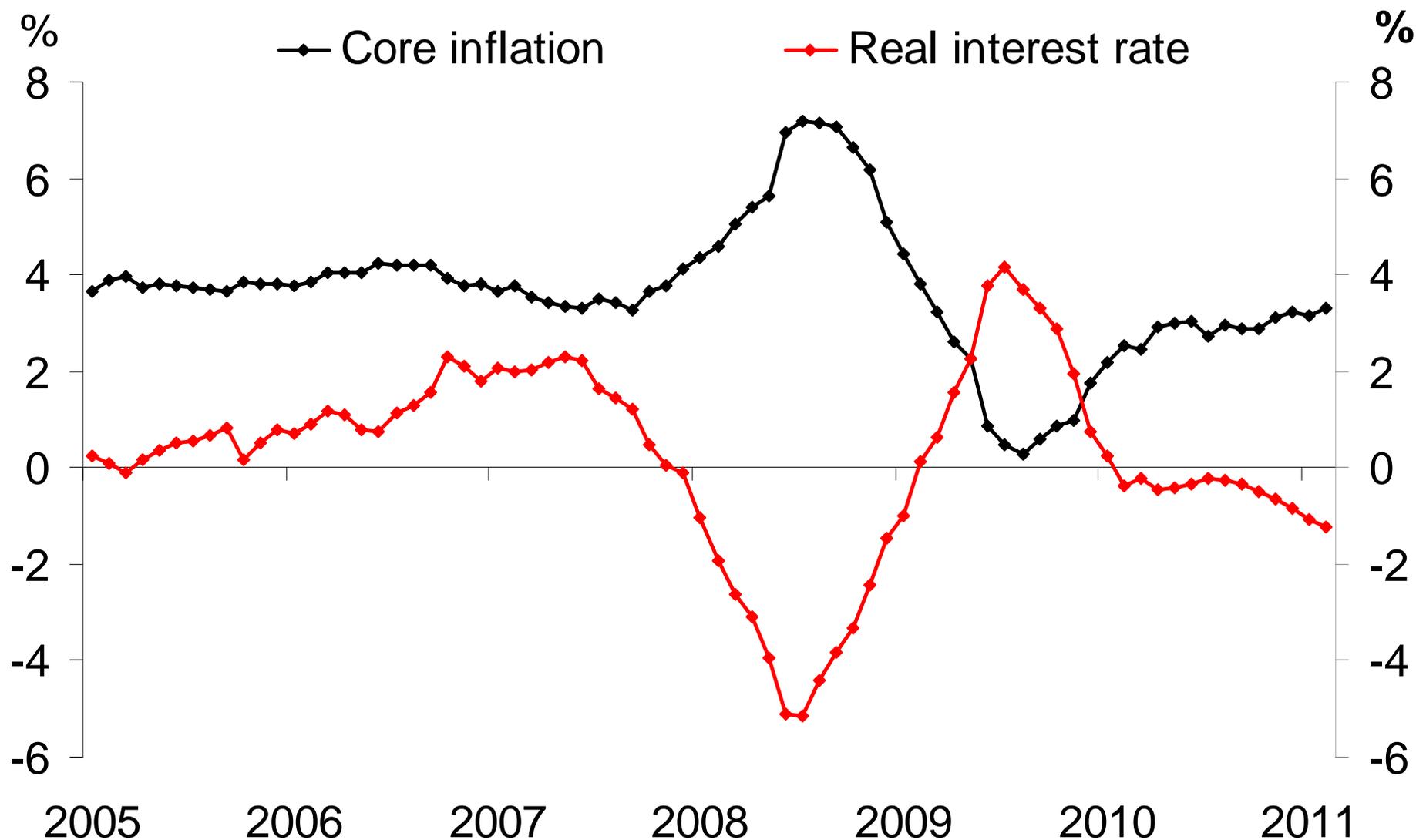
Source: OECD , DB Global Markets Research

Emerging Markets have Learned their Fiscal Lessons



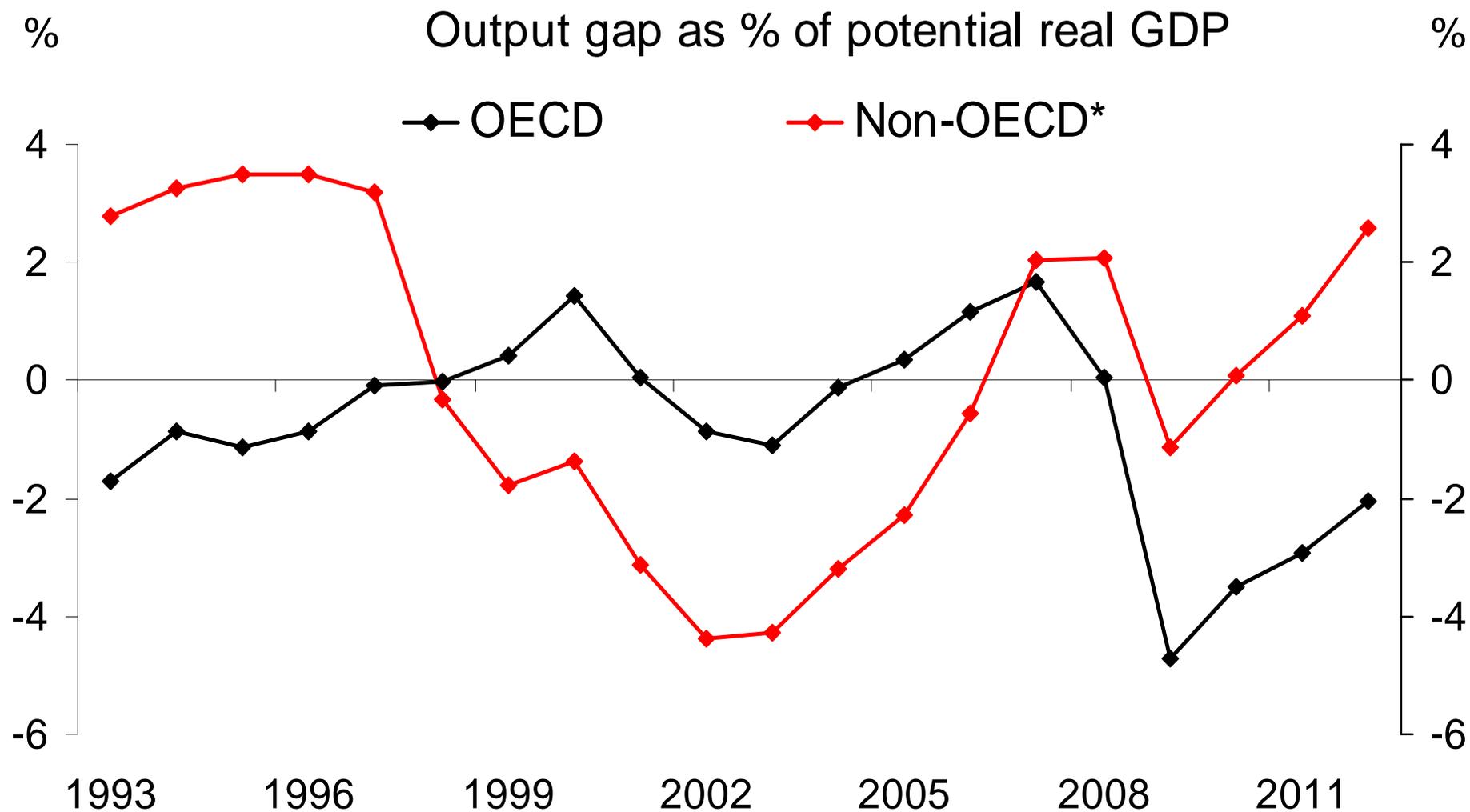
Source: DB Global Markets Research

Real interest rates in Asia running negative



Source: Bloomberg Finance LP, Haver Analytics, DB Global Markets Research

EM output advancing above potential

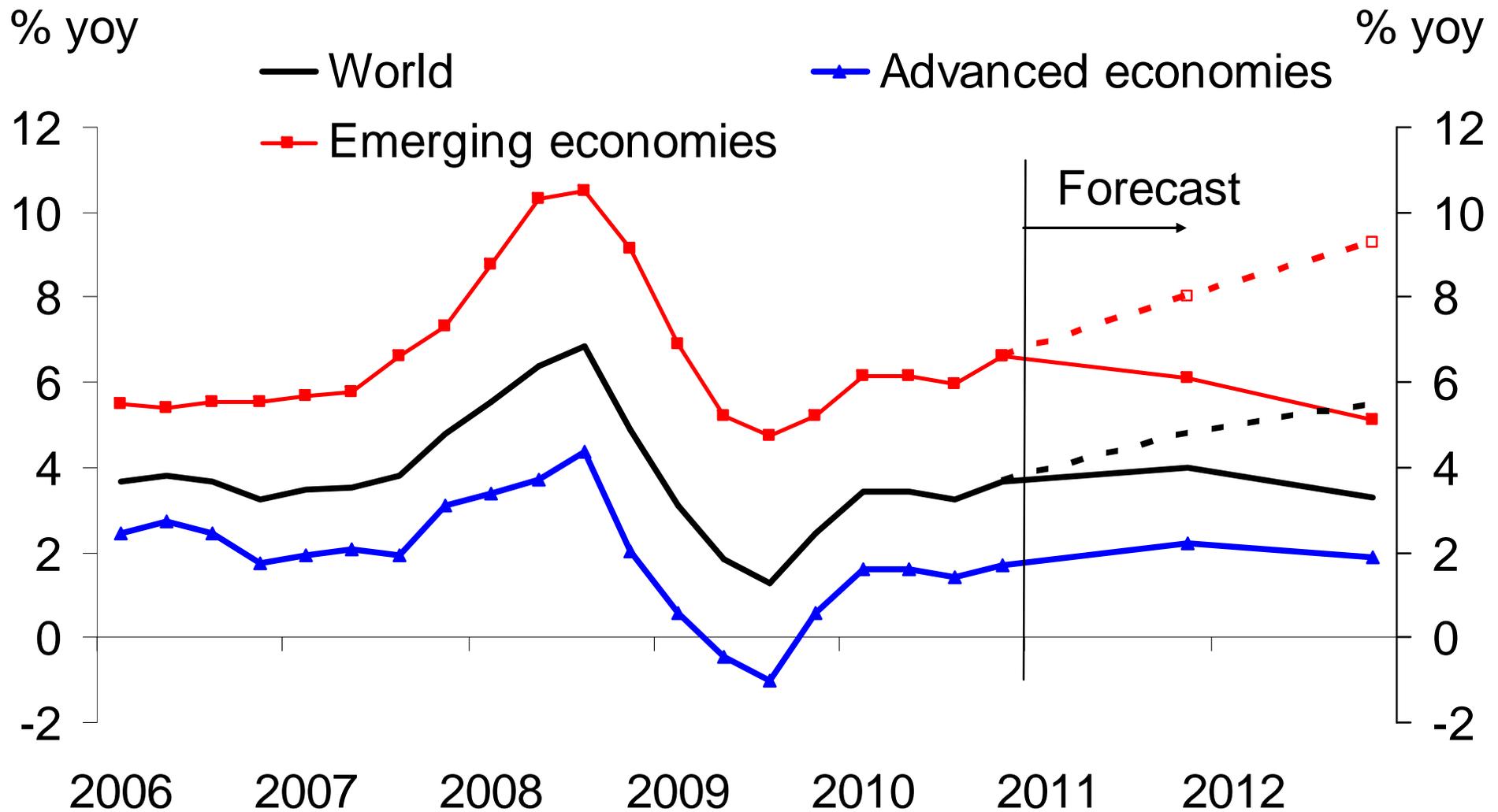


* Based on H-P filter estimates of potential real GDP

Source: OECD, Haver Analytics, DB Global Markets Research



Global inflation risk rising



Source: IMF, Haver Analytics, DB Global Markets Research



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Peter Hooper oversees a team of economists that analyze and forecast developments in the US economy and financial markets. Dr. Hooper joined Deutsche Bank Securities in the fall of 1999 as Chief US Economist, and was appointed Chief Economist in 2006. Dr. Hooper frequently comments on US economic and financial developments in the news media.

Prior to joining the firm, Dr. Hooper enjoyed a distinguished 26-year career at the Federal Reserve Board in Washington, D.C. He held numerous positions at the Fed, including as an economist on the FOMC and as Deputy Director of the Division of International Finance. In doing so, he developed an informed view of the Fed's policy making process.

Dr. Hooper earned a BA in Economics (cum laude) from Princeton University and an MA and Ph.D. in Economics from University of Michigan. He has published numerous books, journal articles, and reviews on economics and policy analysis.



APPENDIX I

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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor that is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which the coupons to be received are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.



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