Fiscal Issues

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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

% of GDP

- Federal public debt
- CBO projection to 2021 under Obama 2012 budget proposal

Source: usgovernmentspending.com, CBO, DB Global Markets Research
Federal Budget Projections

% of GDP

CBO's baseline

President's budget

Source: CBO, DB Global Markets Research
Absent reform, debt is headed up

% of GDP

CBO's baseline

President's budget

% of GDP

Source: CBO, DB Global Markets Research
Wide gulf between current policy and what needs to be done

% of GDP

CBO's alternative fiscal scenario (current policy)*

Fiscal Commission's proposal

% of GDP

* 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 2020.

Source: CBO, Fiscal Commission, DB Global Markets Research
Fiscal commission compromise

% of GDP

Total spending

Total revenue

% of GDP

Source: CBO, DB Global Markets Research
Federal spending

% of GDP

Interest on the debt
- Other discretionary spending
- Defense-spending
- Entitlements, excluding health care
- Health Care

% of GDP

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

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Federal, State, and Local Spending

Govt spending as a % of GDP

% of GDP

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

% of GDP

Interest on the debt

- Other discretionary spending
- Defense-spending
- Entitlements, excluding health care
- Health Care

% of GDP

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

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Health care inflation premium at core of debt problem

CBO projections under current policies

Medicare and Medicaid spending with inflation premium of: 2-1/2%

Social security

Source: CBO, DB Global Markets Research
Substantial fiscal drag in store

% of GDP

CBO's baseline
President's budget

Source: CBO, DB Global Markets Research

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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.

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: usgovernmentspending.com, CBO, DB Global Markets Research
International comparisons of public debt/GDP (OECD)


Source: OECD, DB Global Markets Research
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

Public debt: GDP weighted (baseline)

% of GDP

- Developed markets
- Emerging markets

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

Output gap as % of potential real GDP

- OECD
- Non-OECD*

* 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 1

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