

Senate Budget Committee: Economic and Fiscal Outlook

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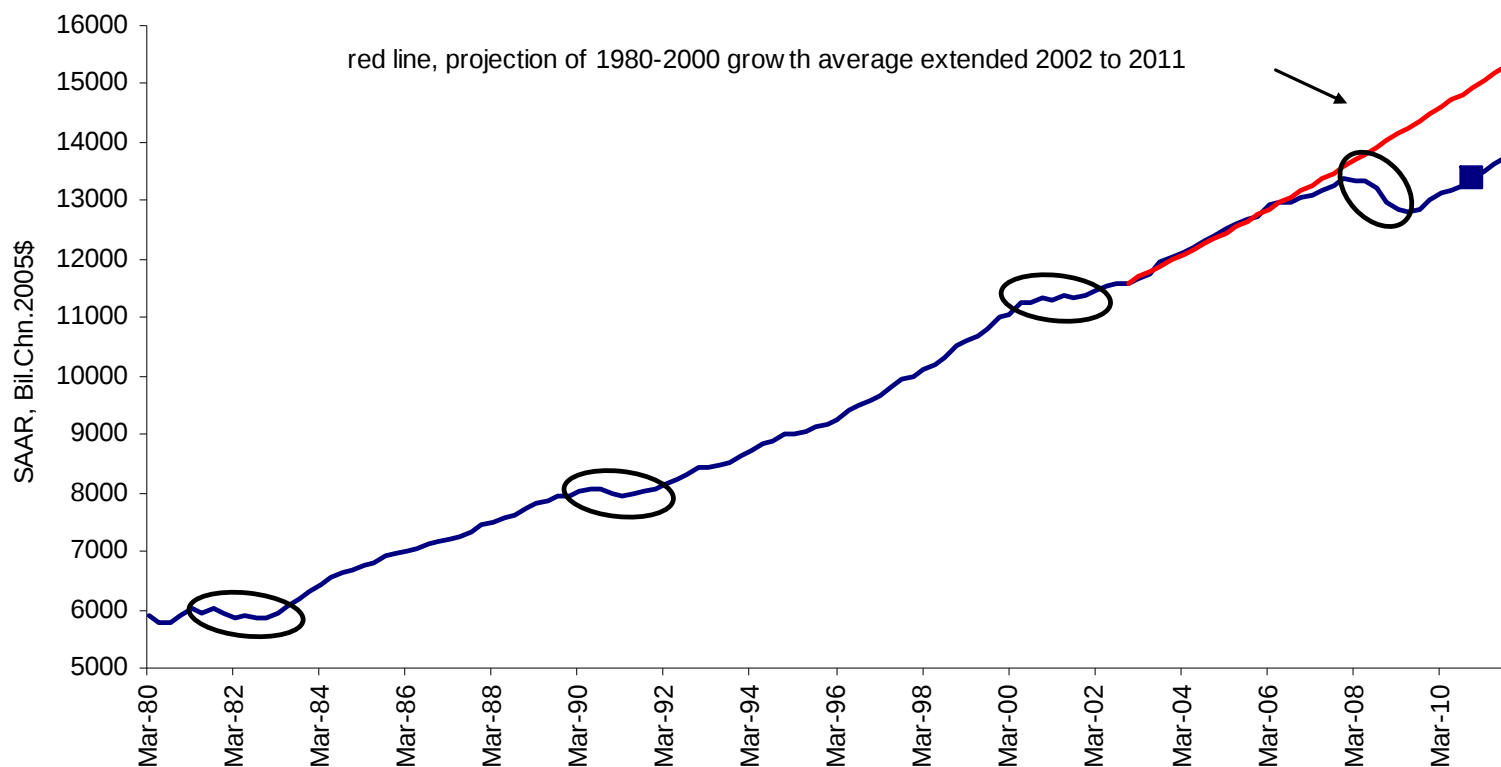
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Economic and Fiscal Outlook

- **The economic outlook is for moderate U.S. growth after the deep 2008 collapse, weighed down by the increasing reliance on the government for the allocation of capital and credit as its debt expands.**
- **The current fiscal trend is for continued mega-deficits and a marketable debt-to-GDP ratio reaching 100%, well above sustainable levels. The statutory debt limit, now \$14.3 trillion, is headed toward a staggering \$31 trillion in the latest CBO outlook.**
- **My testimony addresses the risk of a catastrophic tipping point due to our enormous federal debt and the growth in spending. Adding to the risk, the maturity of the national debt is dangerously short, made worse by the Federal Reserve's buyback of long-maturity debt.**

Real GDP Growing From a Low Base

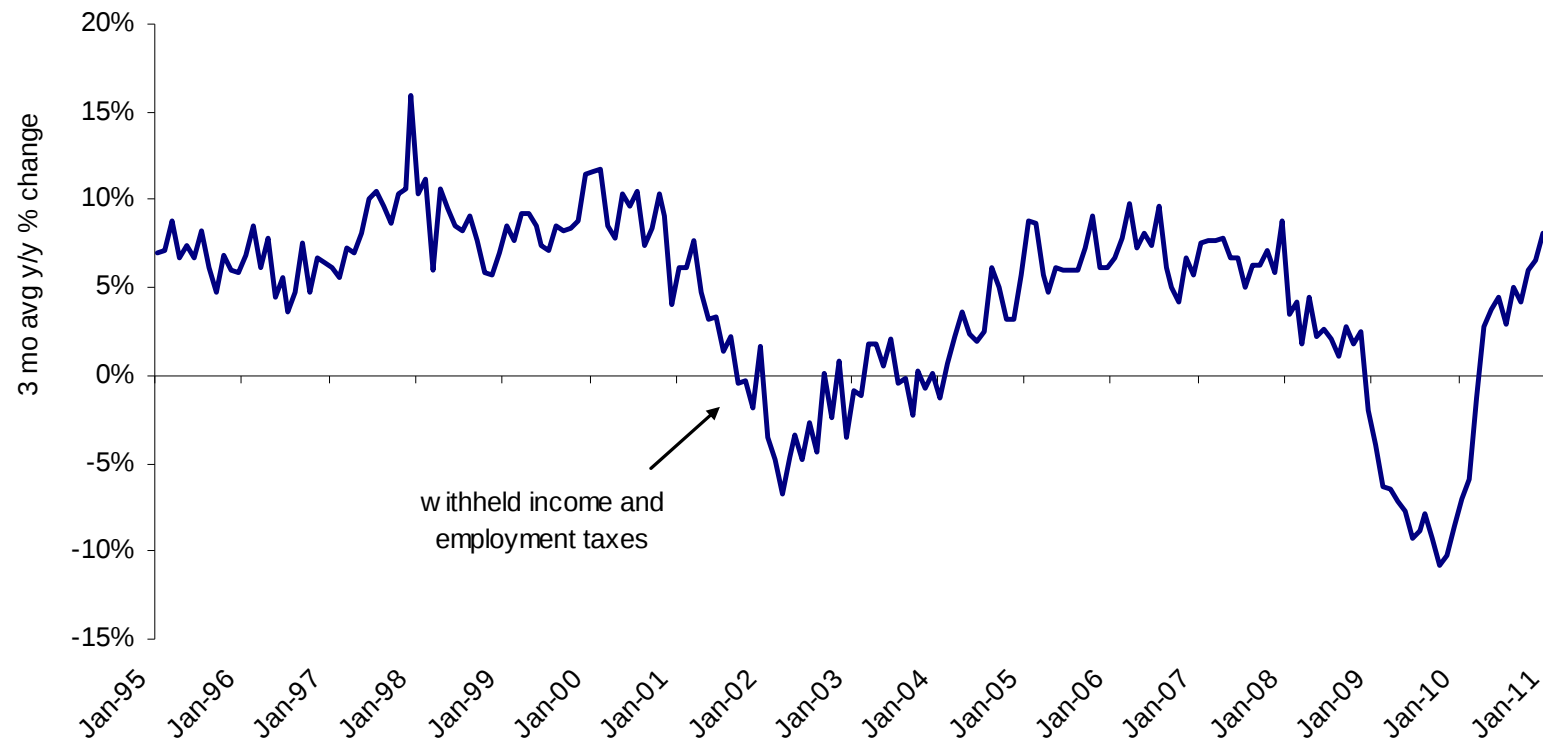
(last obs. blue square Q4 2010, projected to Q4 2011)



Source: Bureau of Economic Analysis; Encima Global

Federal Withheld Income and Employment Taxes

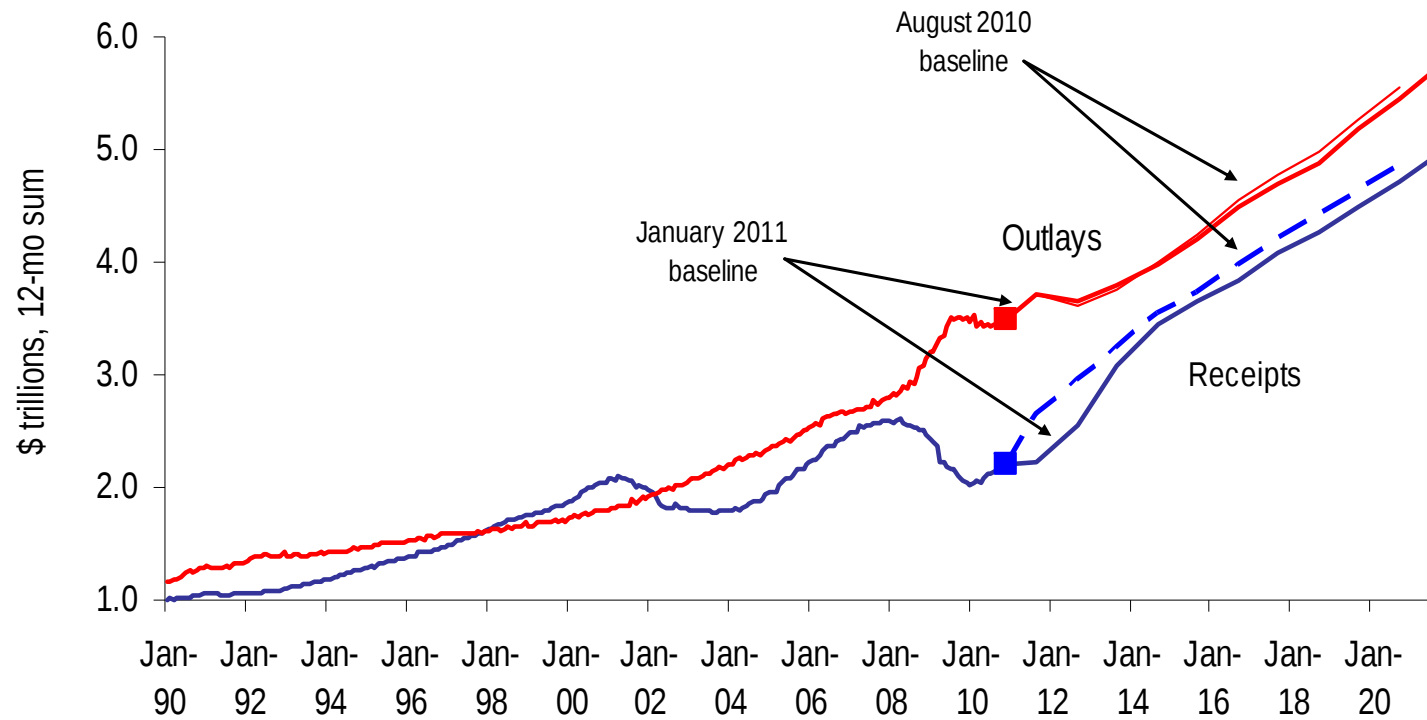
(year-ver-year, last obs. December 2010)



Source: U.S. Treasury; Encima Global

Federal Government Receipts and Outlays

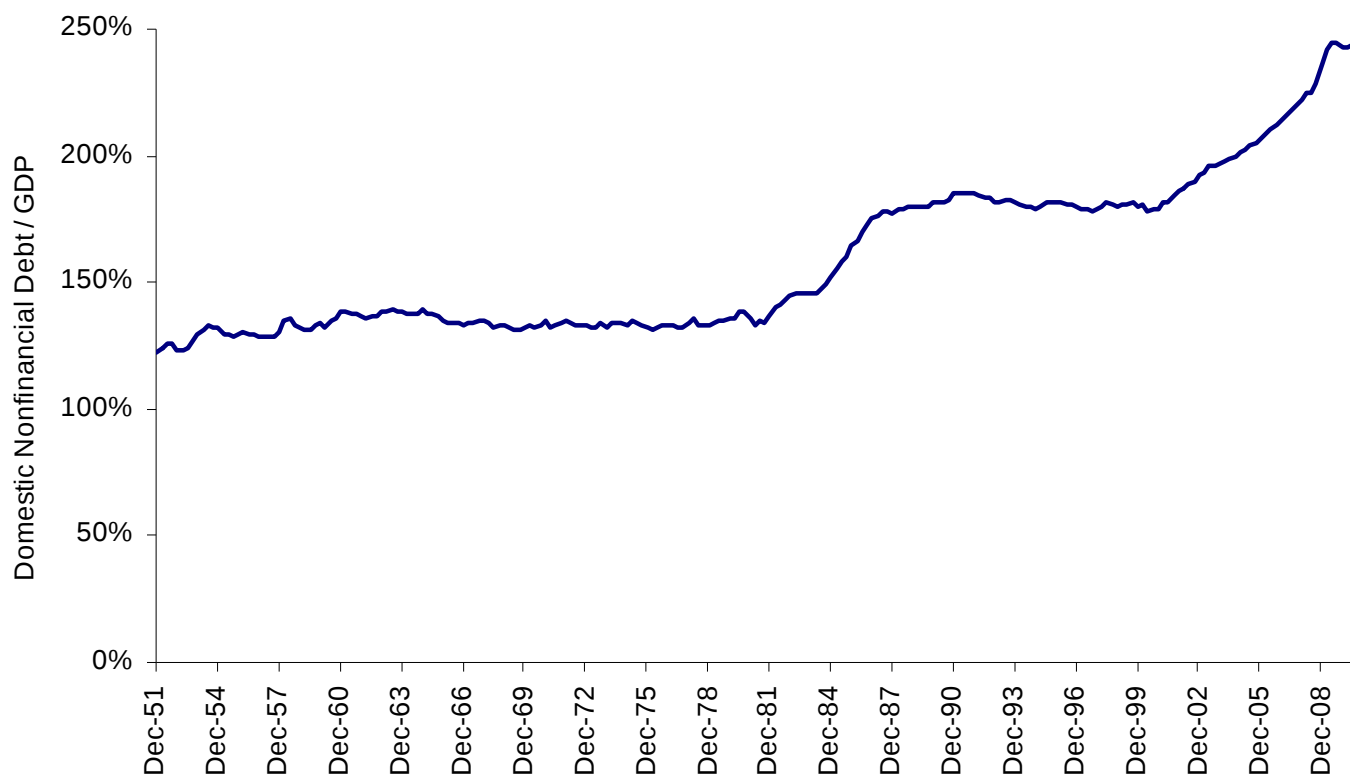
(\$ trillions, last obs. December 2010, CBO projected to 2021)



Source: CBO; US Treasury; CBO; Encima Global

Total U.S. Nonfinancial Debt / GDP

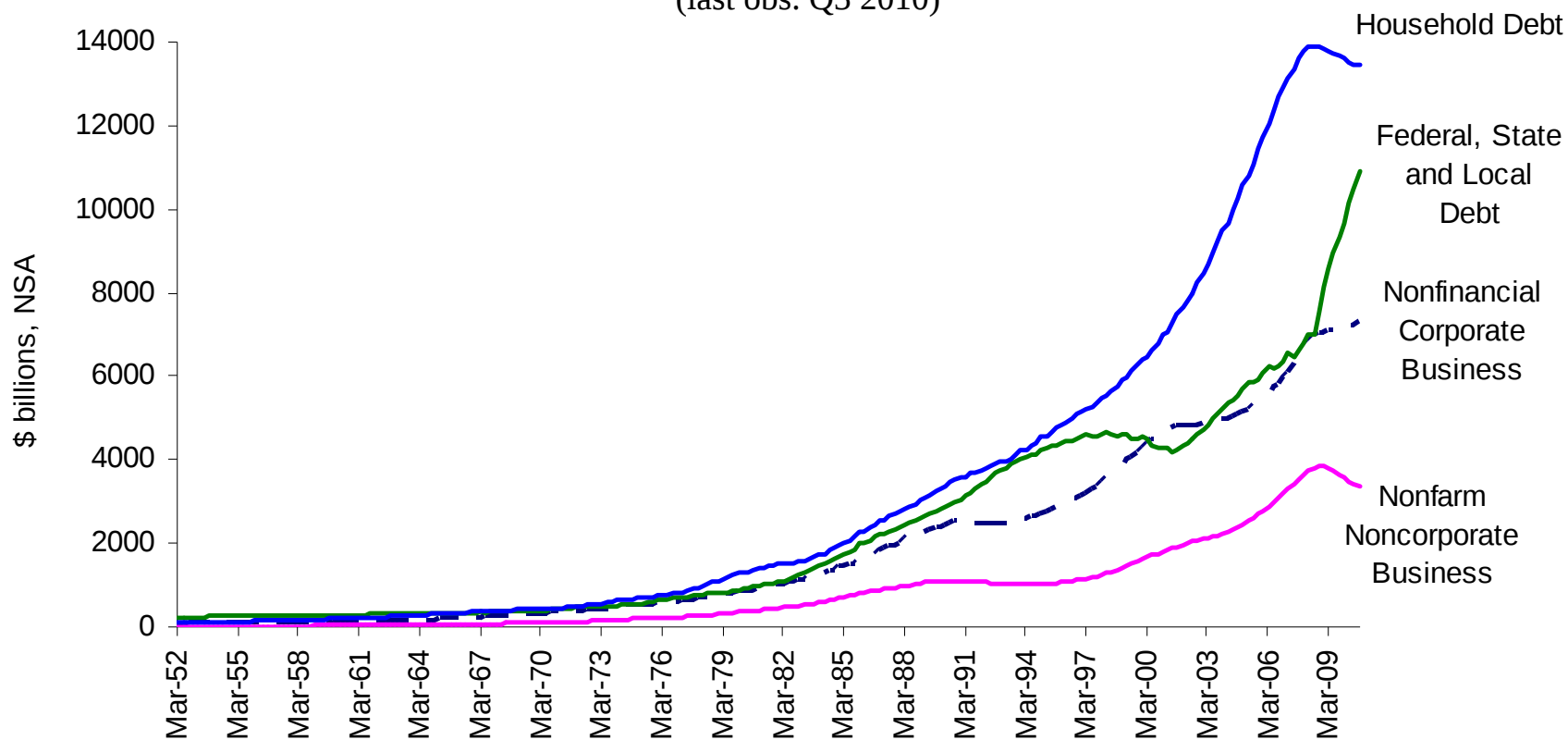
(includes household, gov't and non-financial corporate debt; last obs. Q3 2010)



Source: Federal Reserve; Encima Global

U.S. Debt in \$Billions by Category

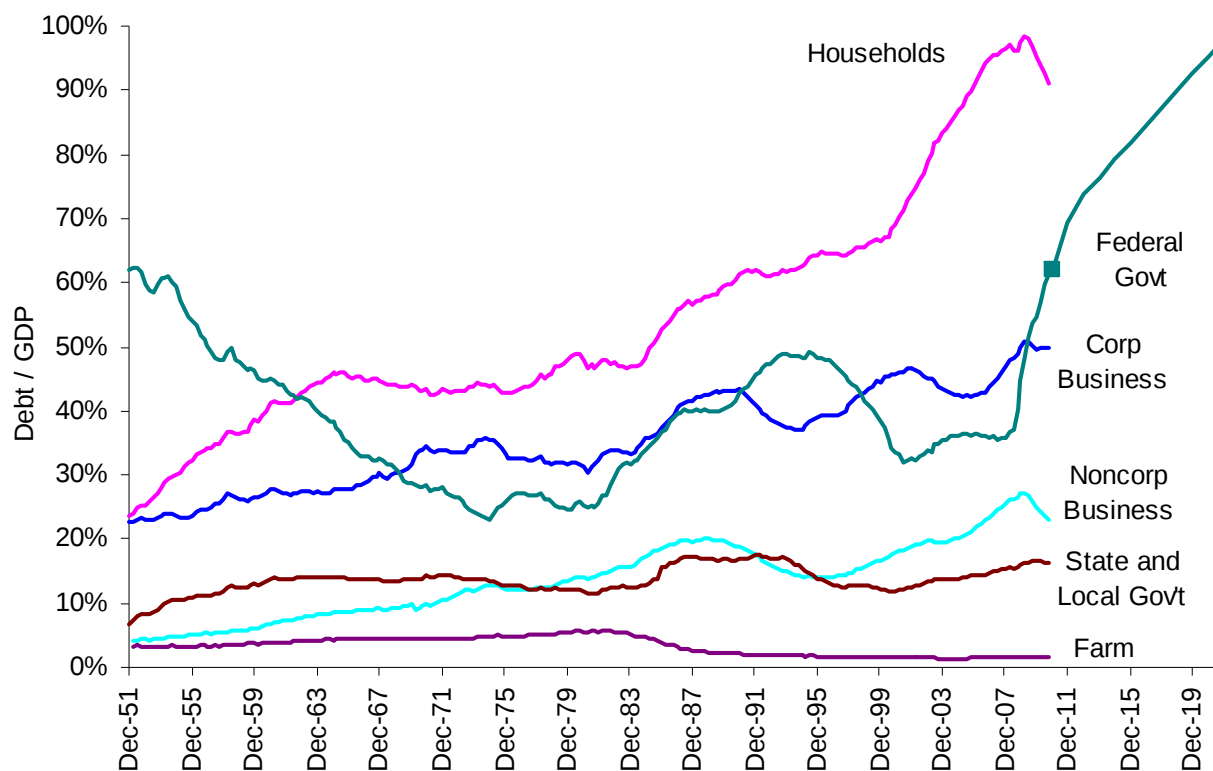
(last obs. Q3 2010)



Source: Federal Reserve: Encima Global

U.S. Debt per GDP

(CBO-based projection of federal debt through 2021)



Source: Federal Reserve; CBO; BEA; Encima Global

\$35.8 Trillion in Credit Market Debt Outstanding

(last obs. Q3 2010)

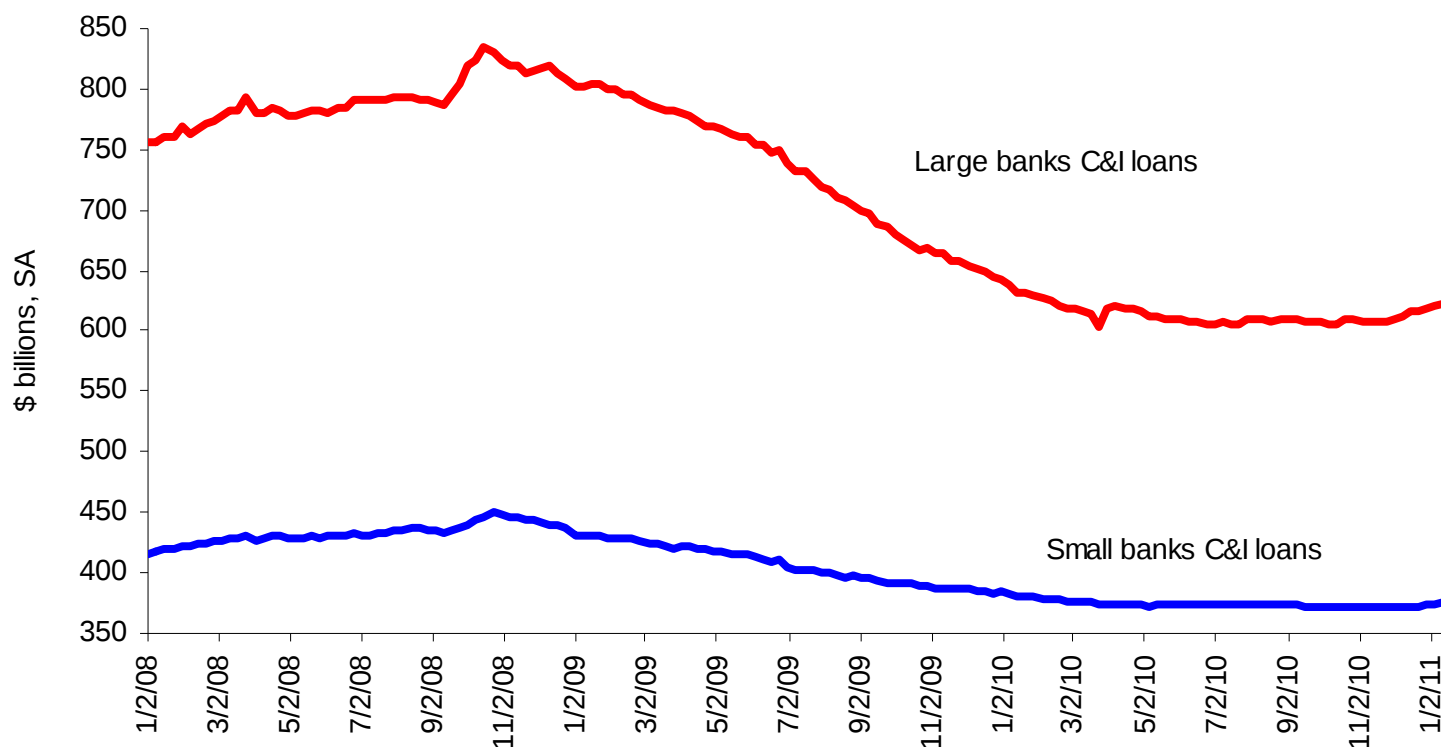
	2010 Q3 (\$ trill)	2010 Q2 (\$ trill)	Yr/Yr % chg 2010 Q3	Yr/Yr % chg 2009 Q3	Yr/Yr % chg 2008 Q3
Domestic Nonfinancial Sectors	\$ 35.8	\$ 35.3	3.7%	4.3%	6.5%
Households	\$ 13.4	\$ 13.5	-1.8%	-1.7%	2.2%
Corporate Business	\$ 7.3	\$ 7.2	3.4%	0.3%	8.3%
Noncorporate Business	\$ 3.4	\$ 3.4	-7.5%	-4.8%	8.7%
Farm Business	\$ 0.2	\$ 0.2	0.3%	0.6%	2.2%
State & Local Govts	\$ 2.4	\$ 2.4	3.3%	3.7%	4.4%
Federal Government	\$ 9.0	\$ 8.6	19.5%	30.1%	15.3%
of which Fed Holds	\$ 0.8	\$ 0.8	5.5%	61.4%	-38.9%
as of Q4 \$1.01 trillion					
memo:					
Federal Govt Trust Funds	\$ 4.6				
of which Soc Sec	\$ 2.6				

Not counting contingent liabilities from GSEs or underfunded trust funds

Source: Federal Reserve: OMB; Encima Global

Bank Lending Through Commercial & Industrial Loans

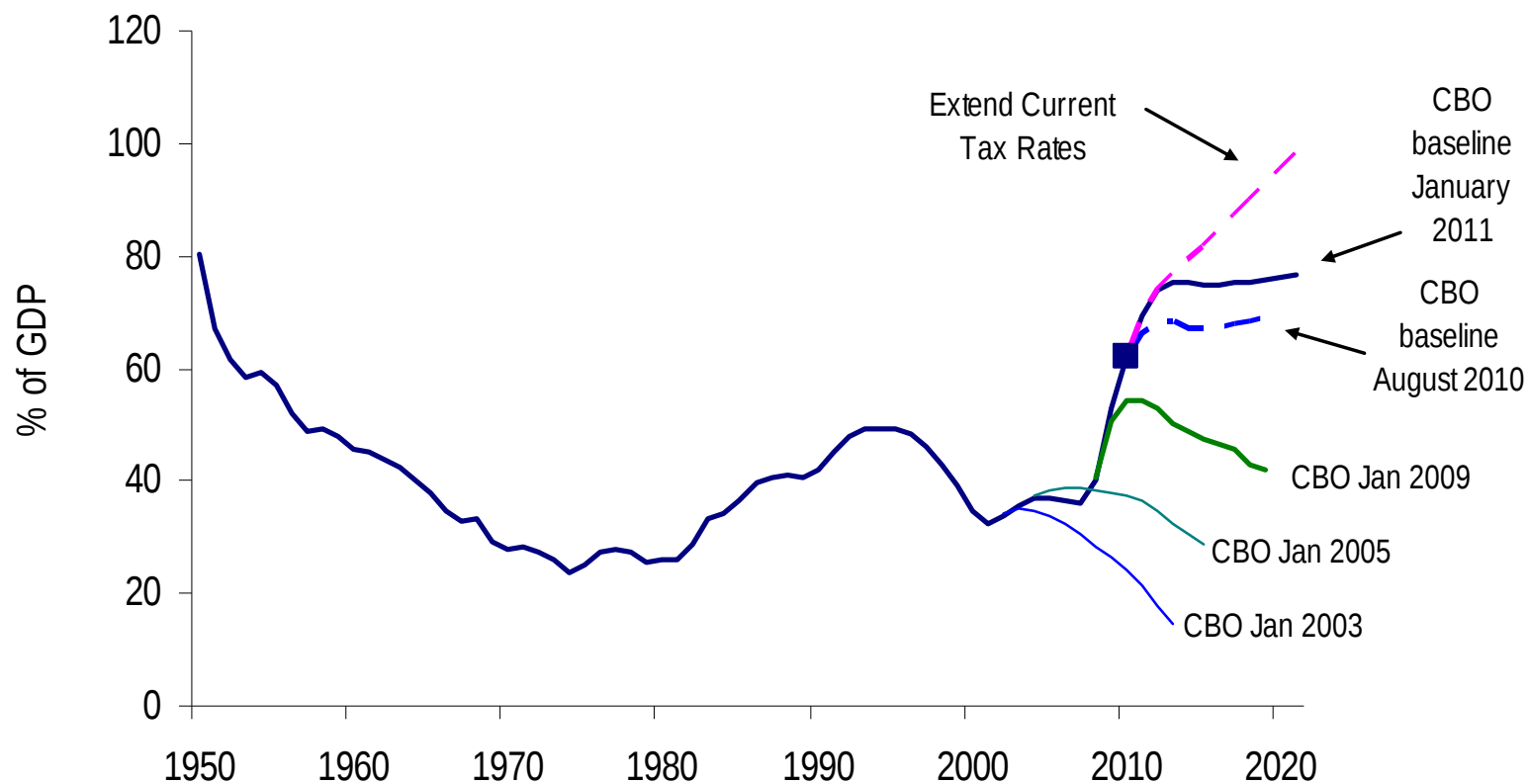
(\$ billions, last obs. January 19, 2010)



Source: Federal Reserve; Encima Global

CBO Forecasts of Federal Debt Per GDP

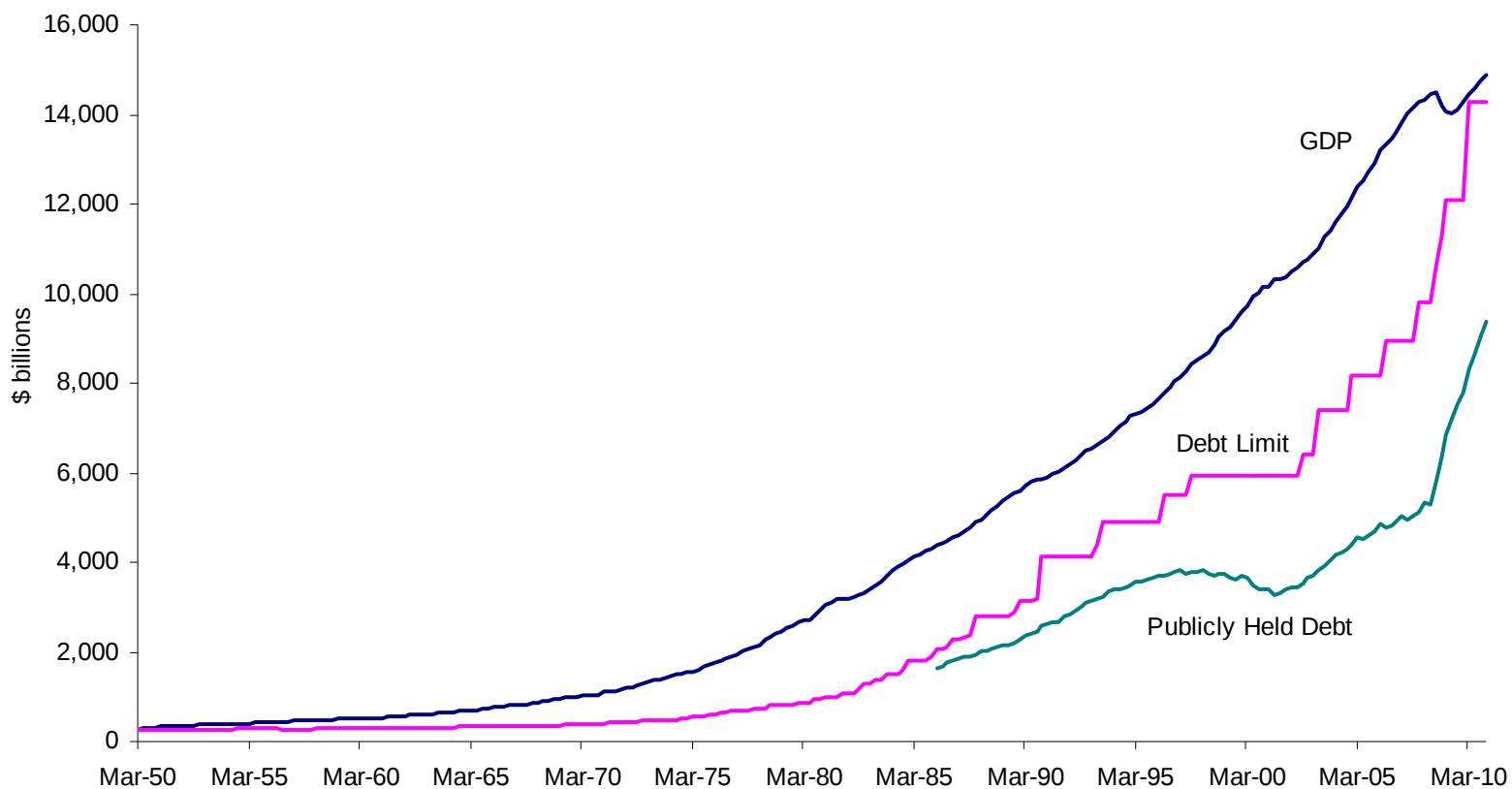
(square is last obs. 2010, forecasts to 2021)



Source: CBO; OMB; Encima Global

National Debt Limit At \$14.3 Trillion

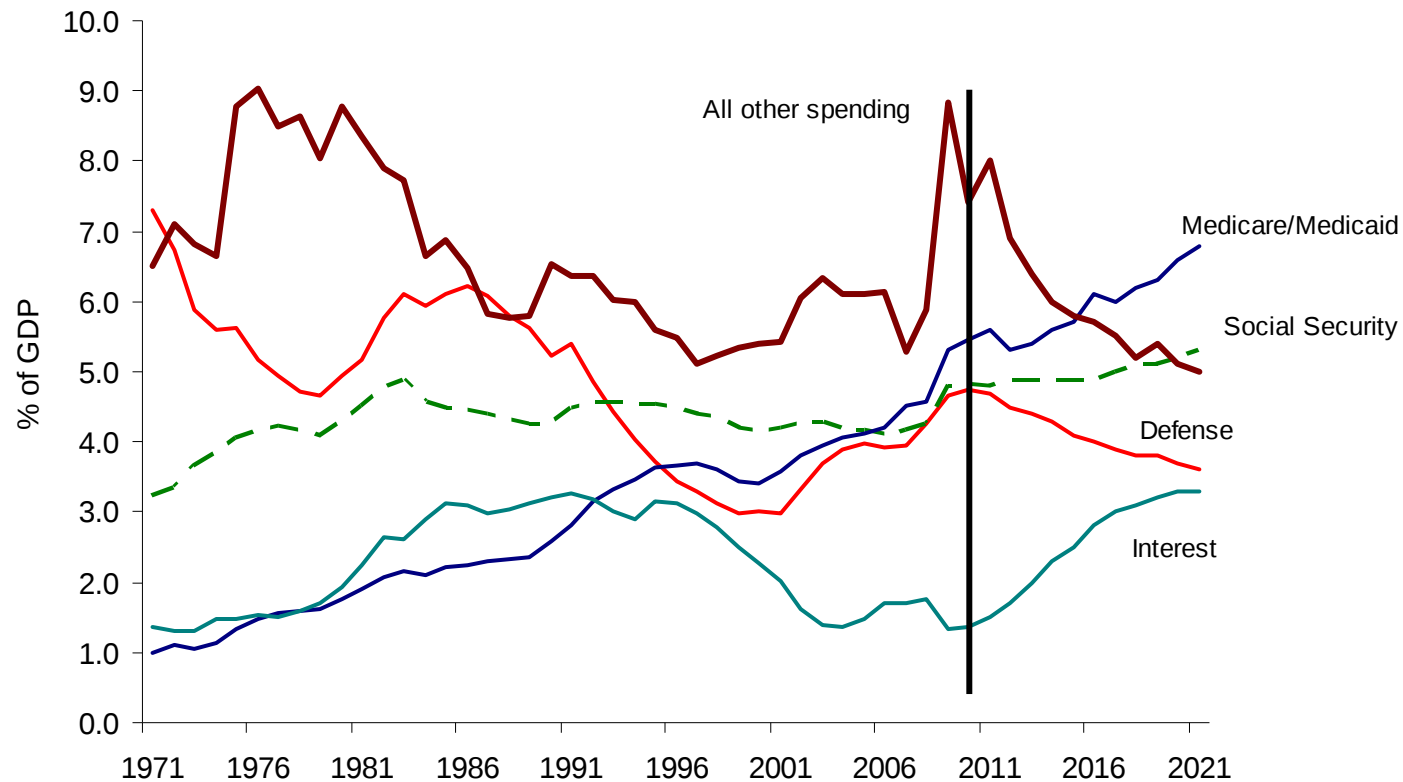
(last obs. Q4 2010)



Source: Bureau of Economic Analysis; U.S. Treasury; Wikipedia; Encima Global

Expenditures as a Percent of GDP by Major Category

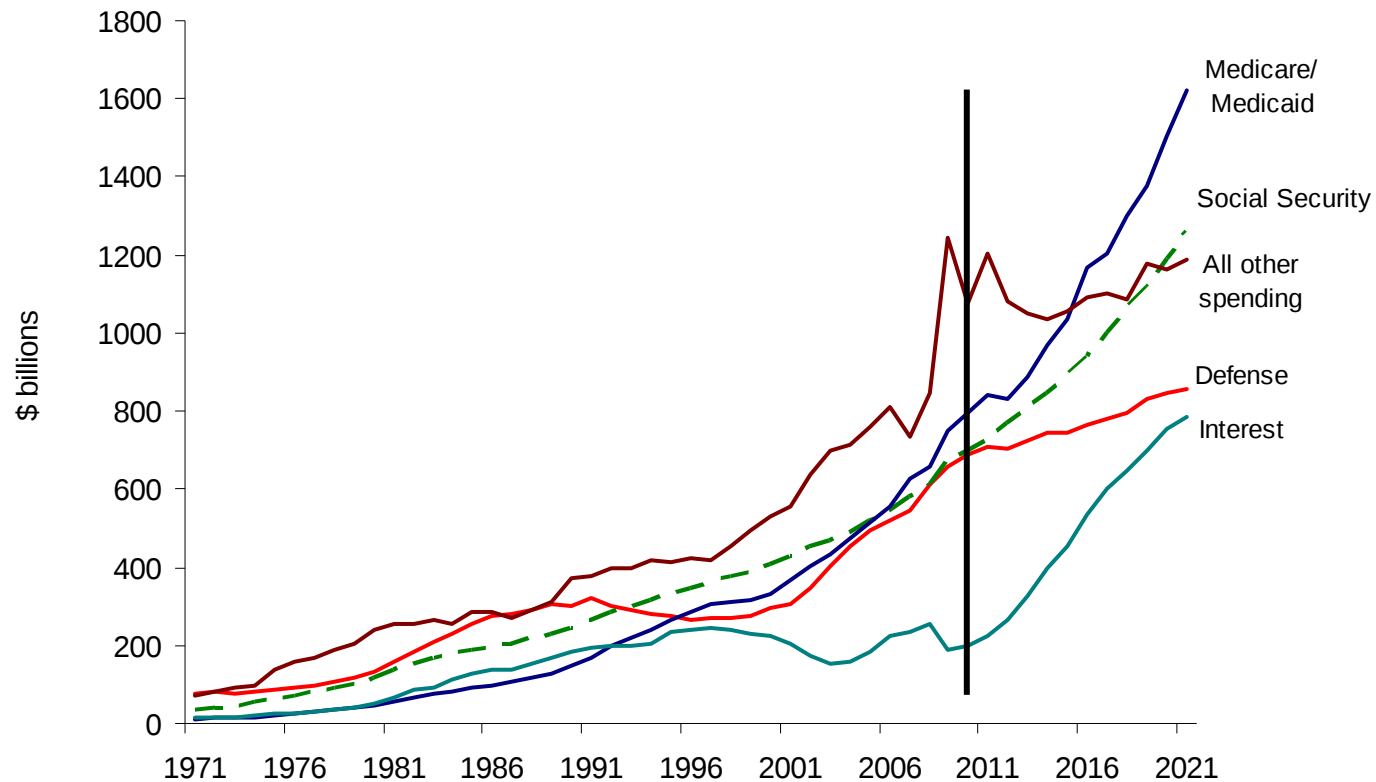
(last obs. 2010, CBO projections to 2021)



Source: CBO; Encima Global

Expenditures in \$ billions by Major Category

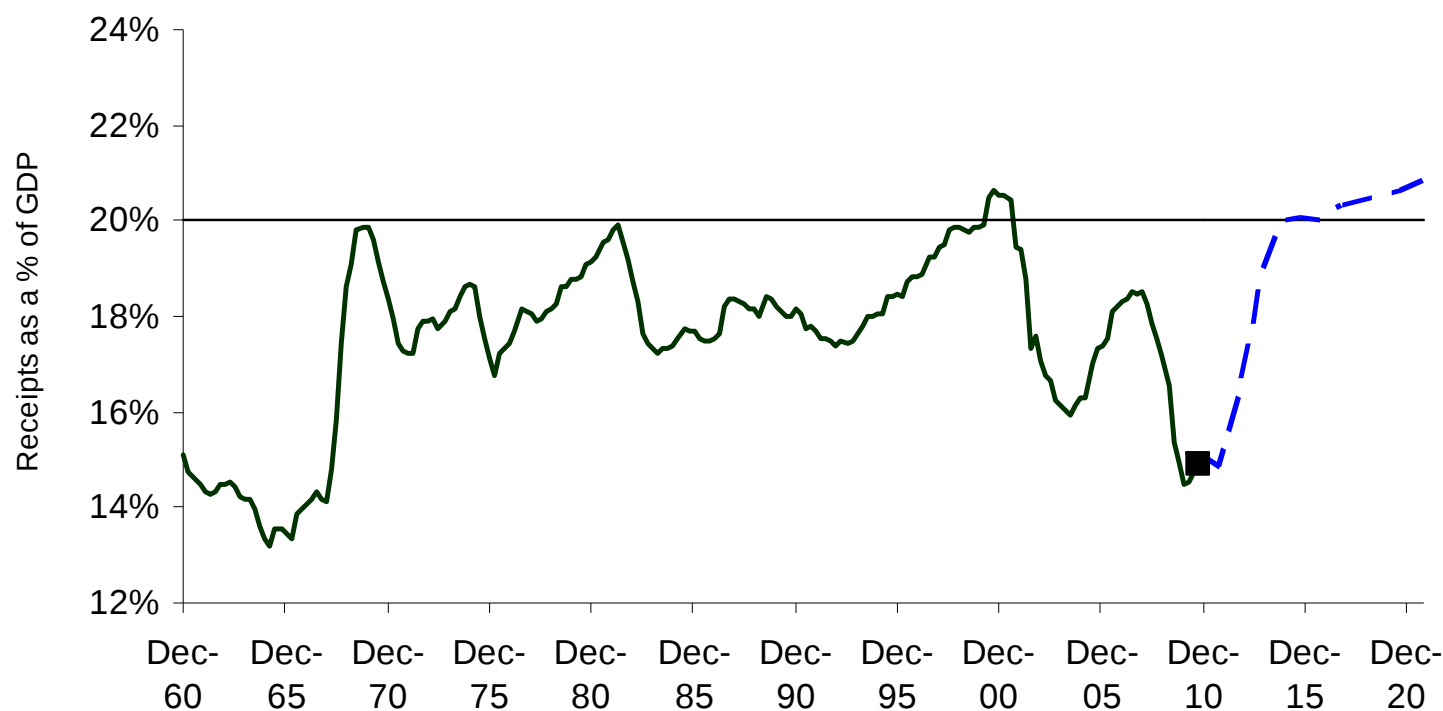
(last obs. 2010, CBO projections to 2021)



Source: CBO; Encima Global

Federal Receipts as a Percent of GDP Exceed 20% in CBO Baseline

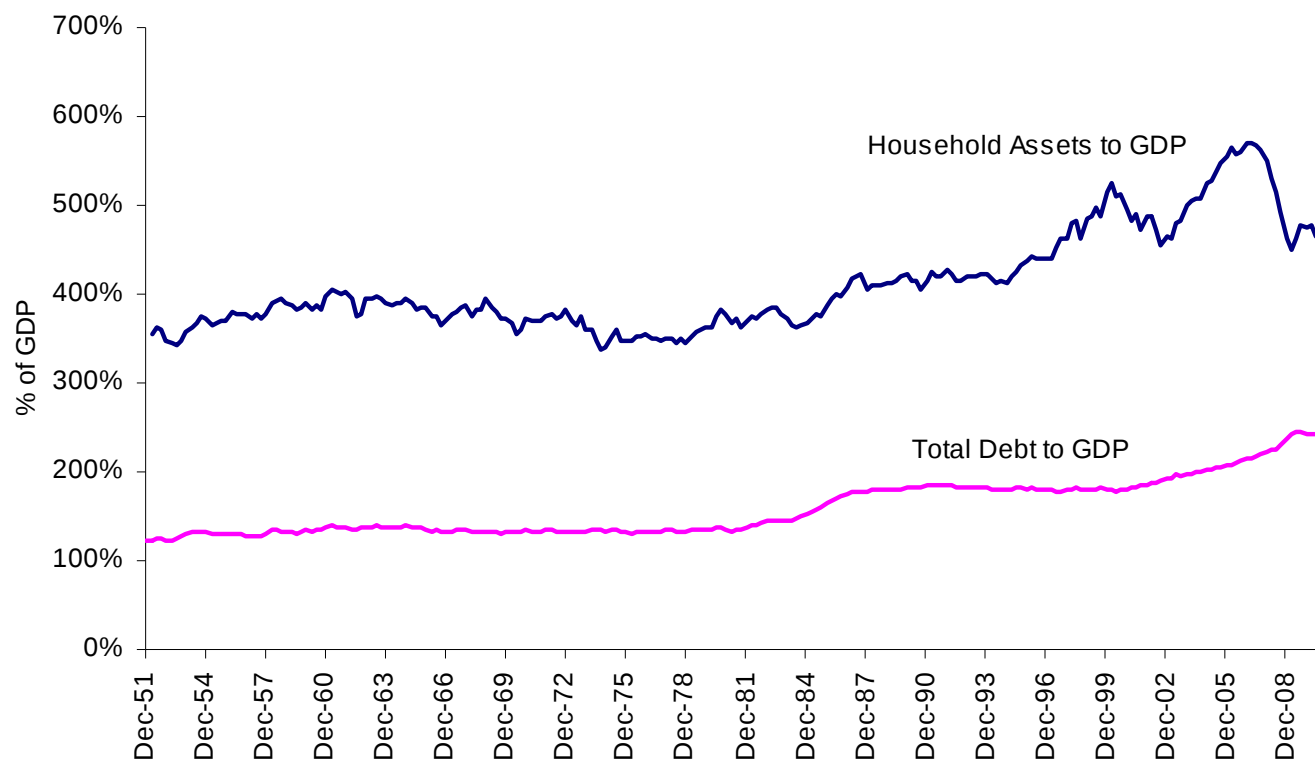
(last obs. 2010, CBO projections to 2021)



Source: CBO; US Treasury; BEA; Encima Global

Household Assets and Total Debt / GDP

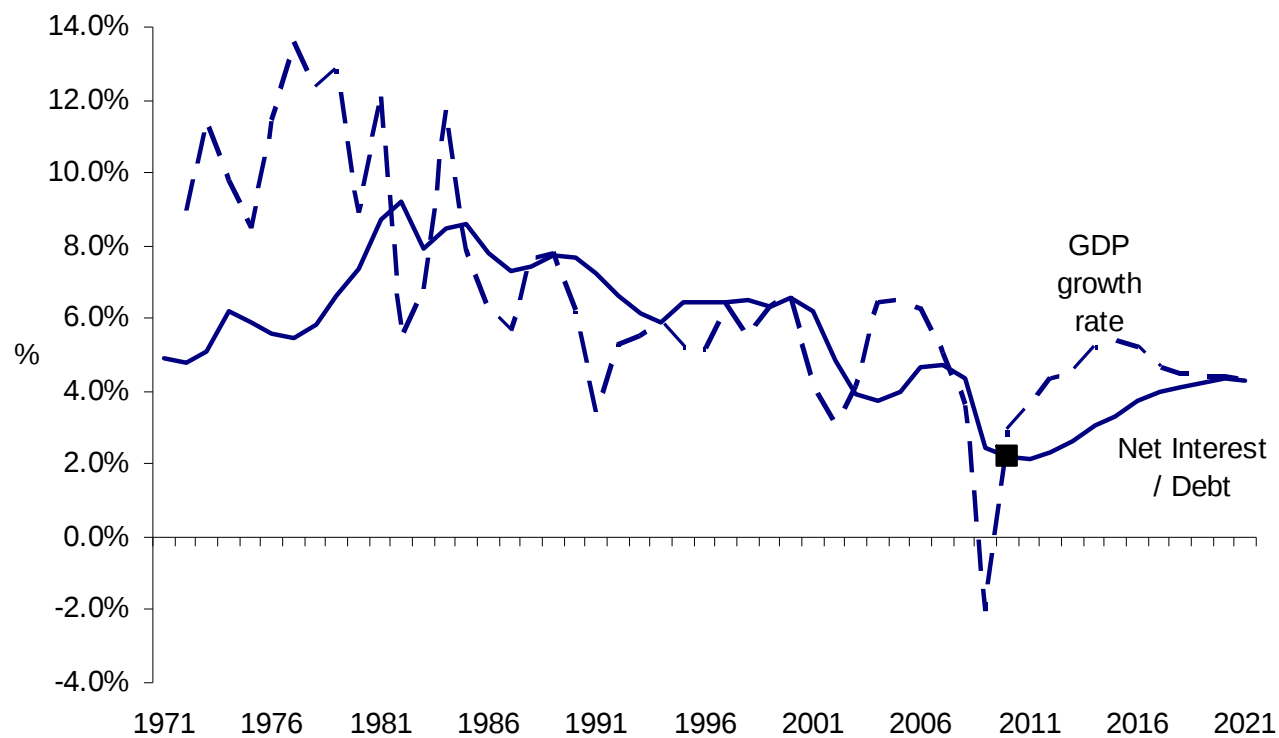
(last obs. Q3 2010)



Source: Federal Reserve; BEA; Encima Global

Nominal GDP Growth vs. Interest Rate Paid

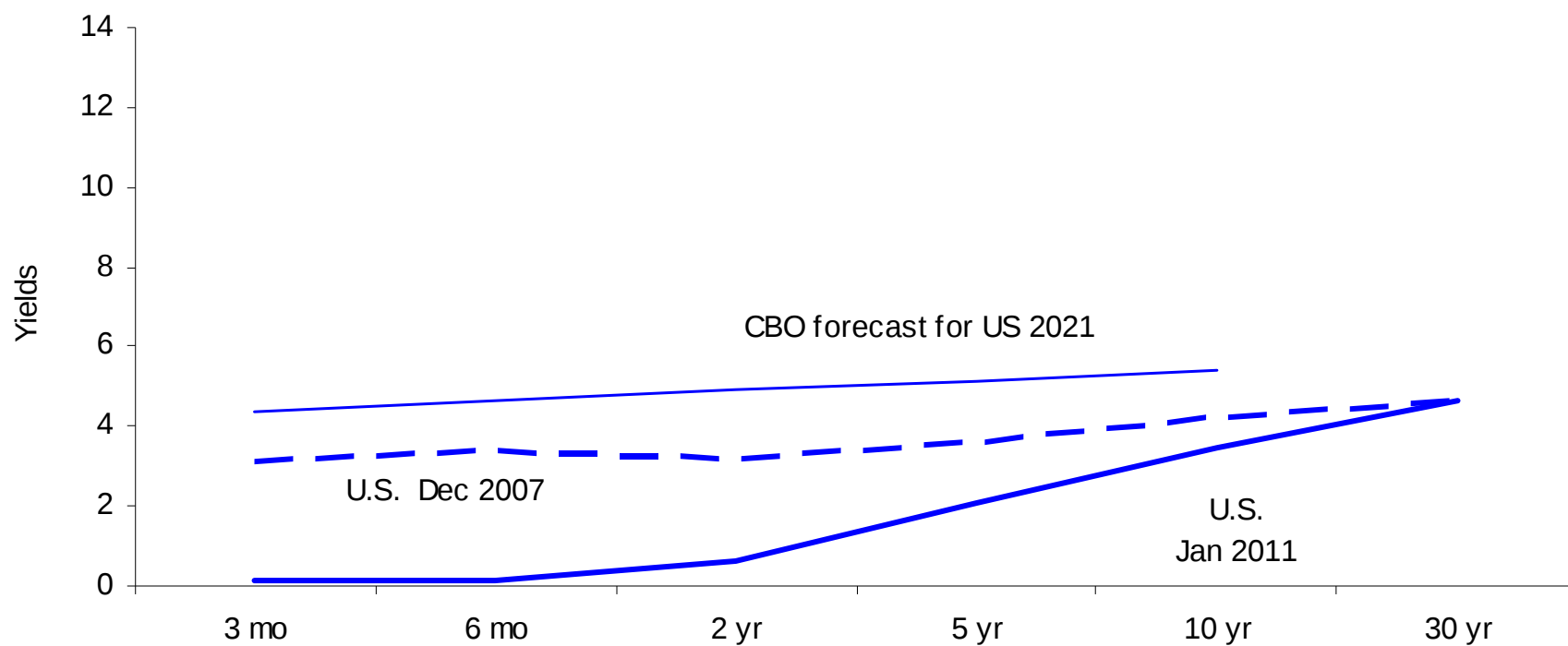
(last obs. 2010, CBO projected to 2021)



Source: CBO; Encima Global

Yield Curve for US

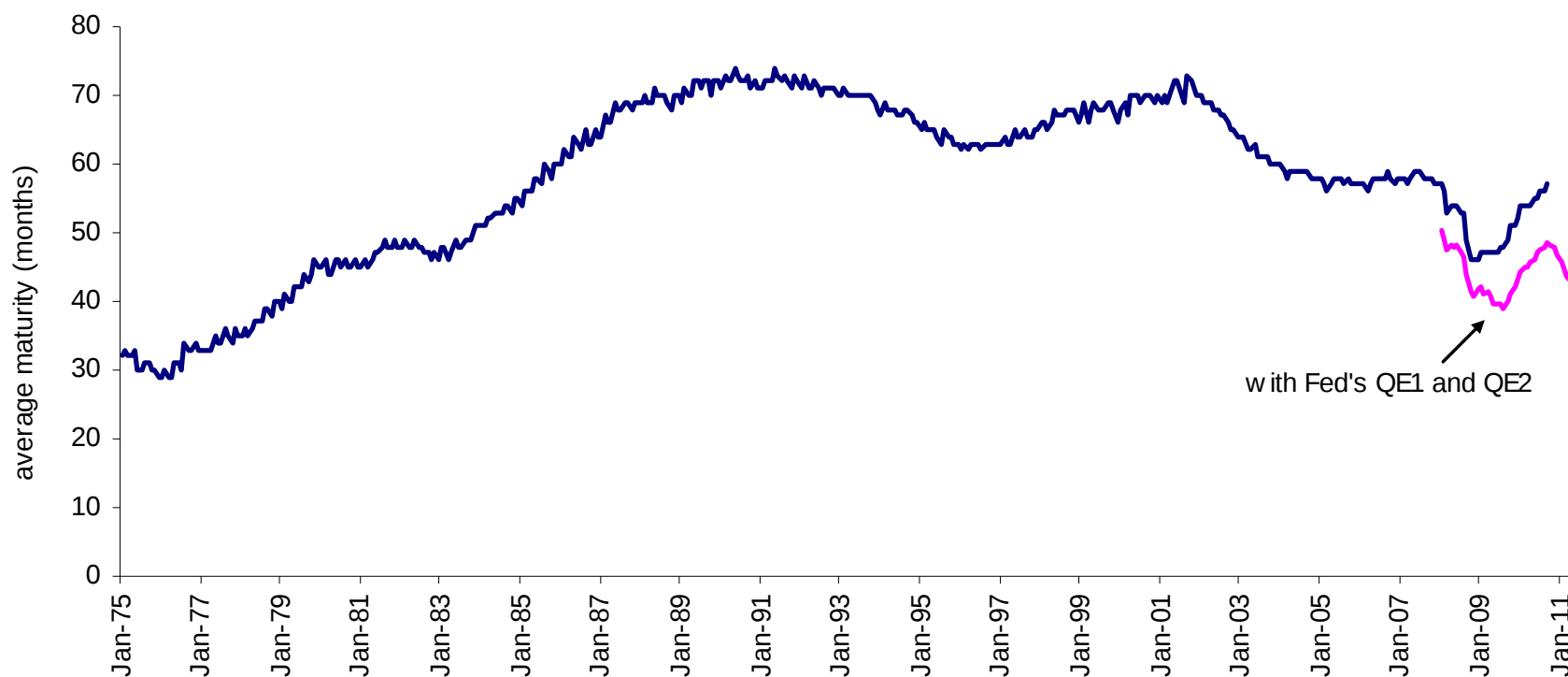
(last obs. January 27, 2010)



Source: Bloomberg; CBO; Encima Global

Average Maturity of Treasury Debt; Effective Maturity with Fed's QE

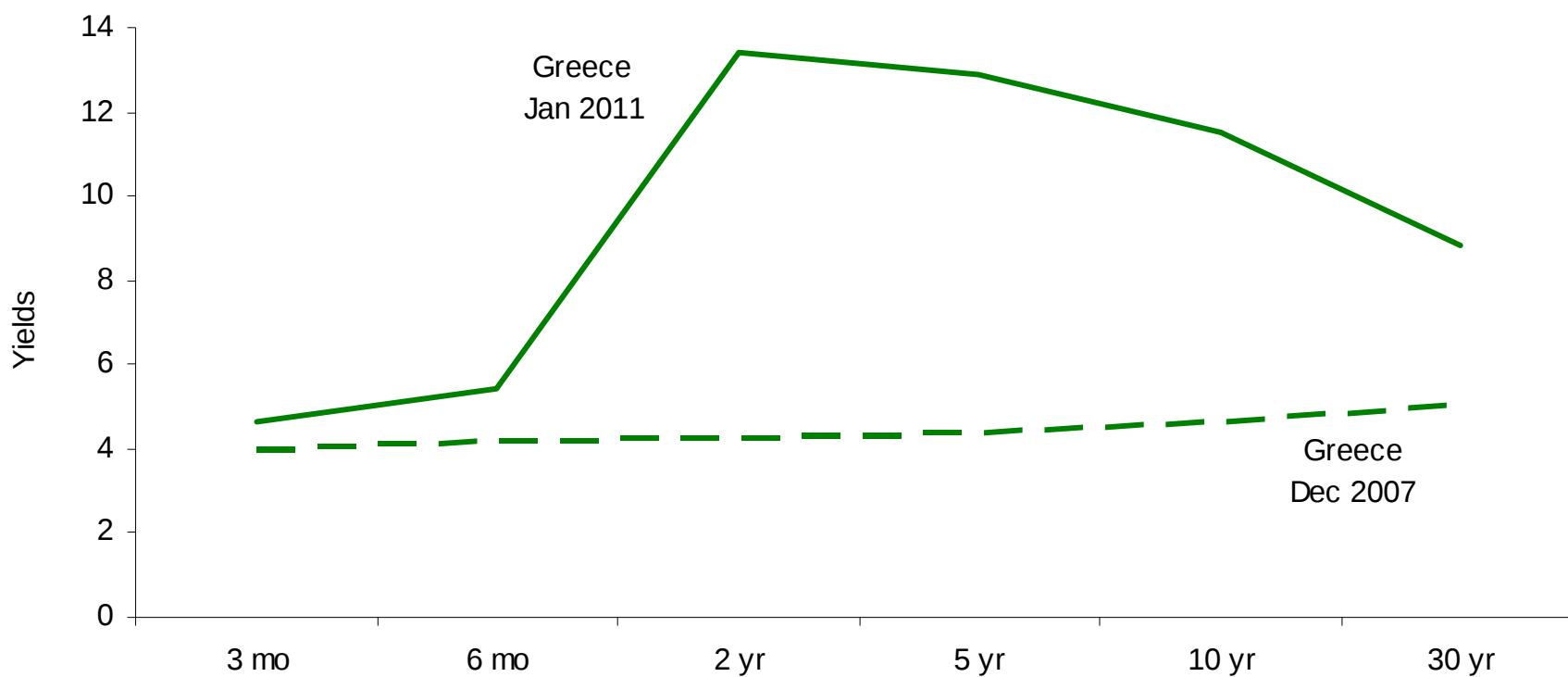
(in months, last obs. Sept 2010; QE2 projected through June 2011)



Source: US Treasury; Federal Reserve; Encima Global

Yield Curve for Greece

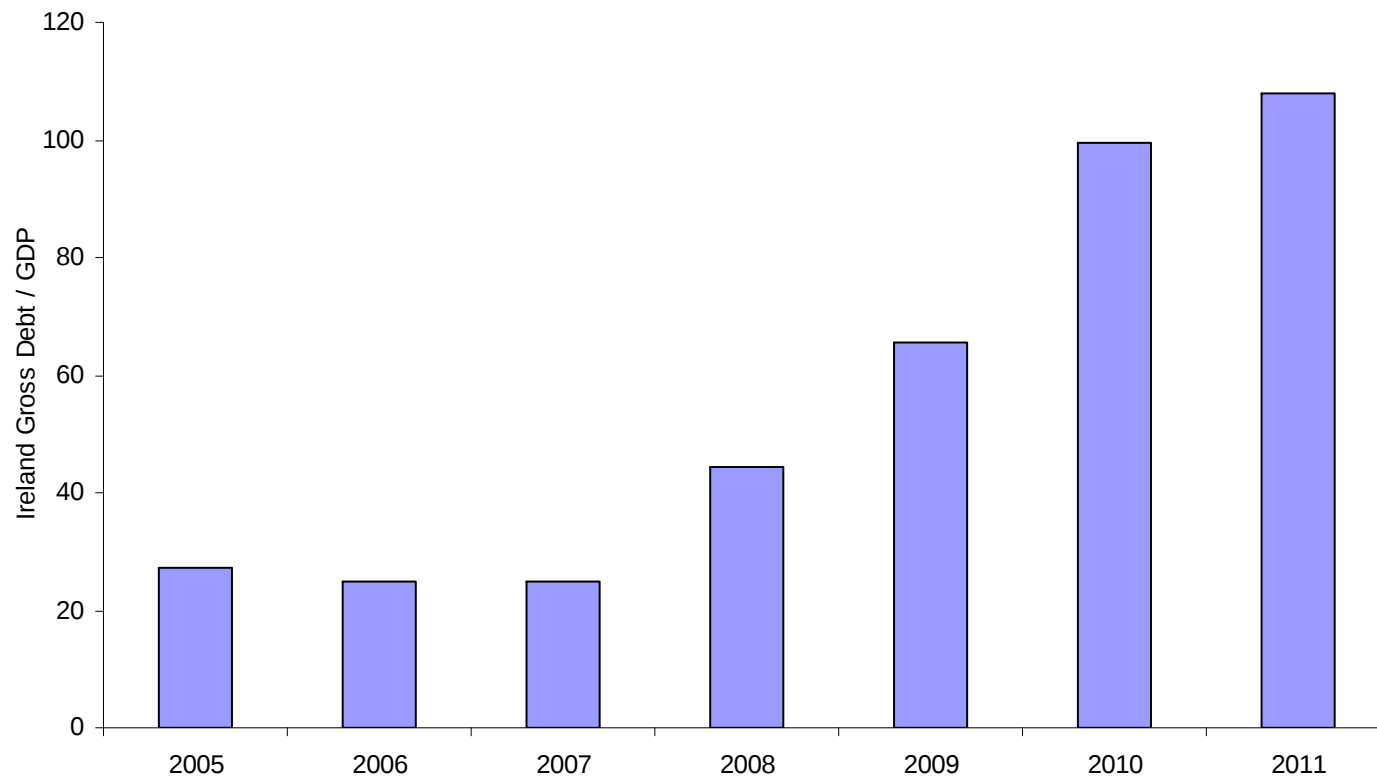
(last obs. January 27, 2010)



Source: Bloomberg; Encima Global

Ireland's Debt To GDP Ratio Hit A Tipping Point at 90%

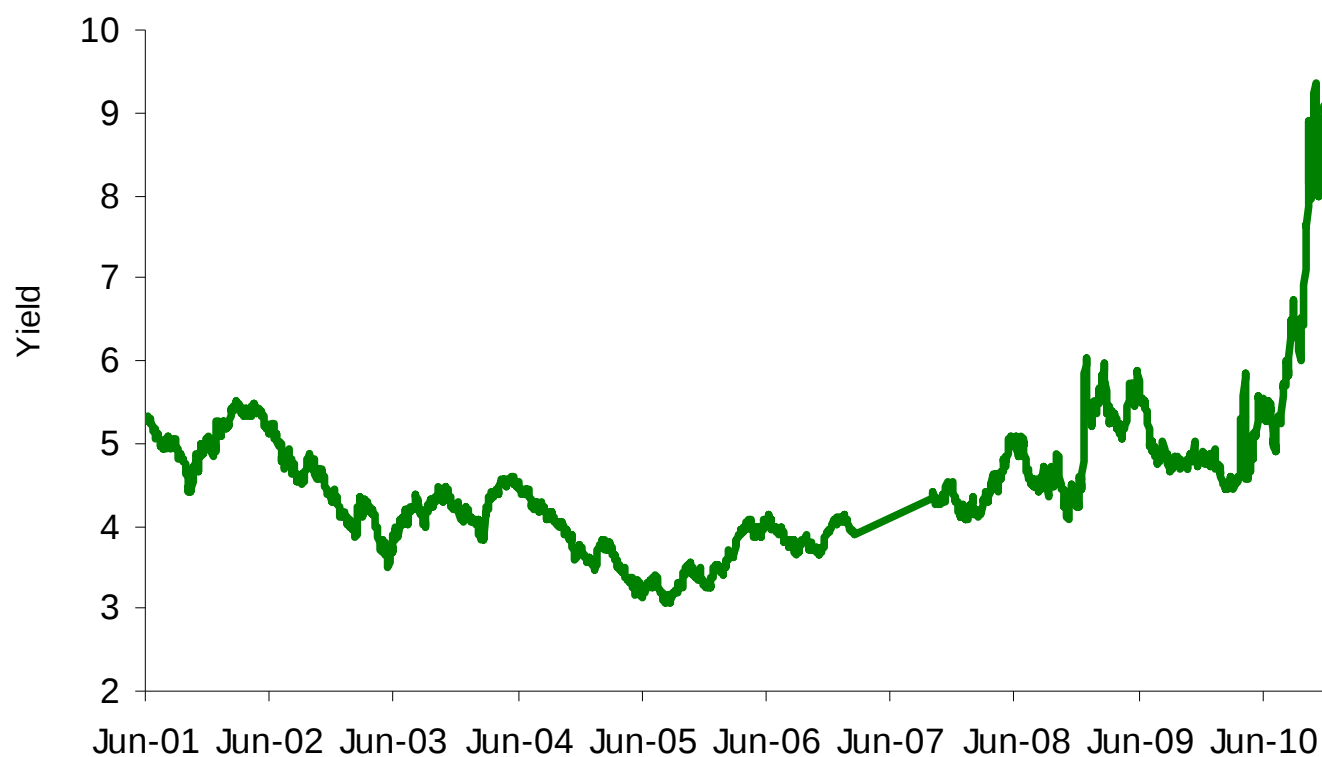
(last obs. 2010, IMF forecast for 2011)



Source: IMF; Encima Global

Ireland's Ten Year Bond Yield

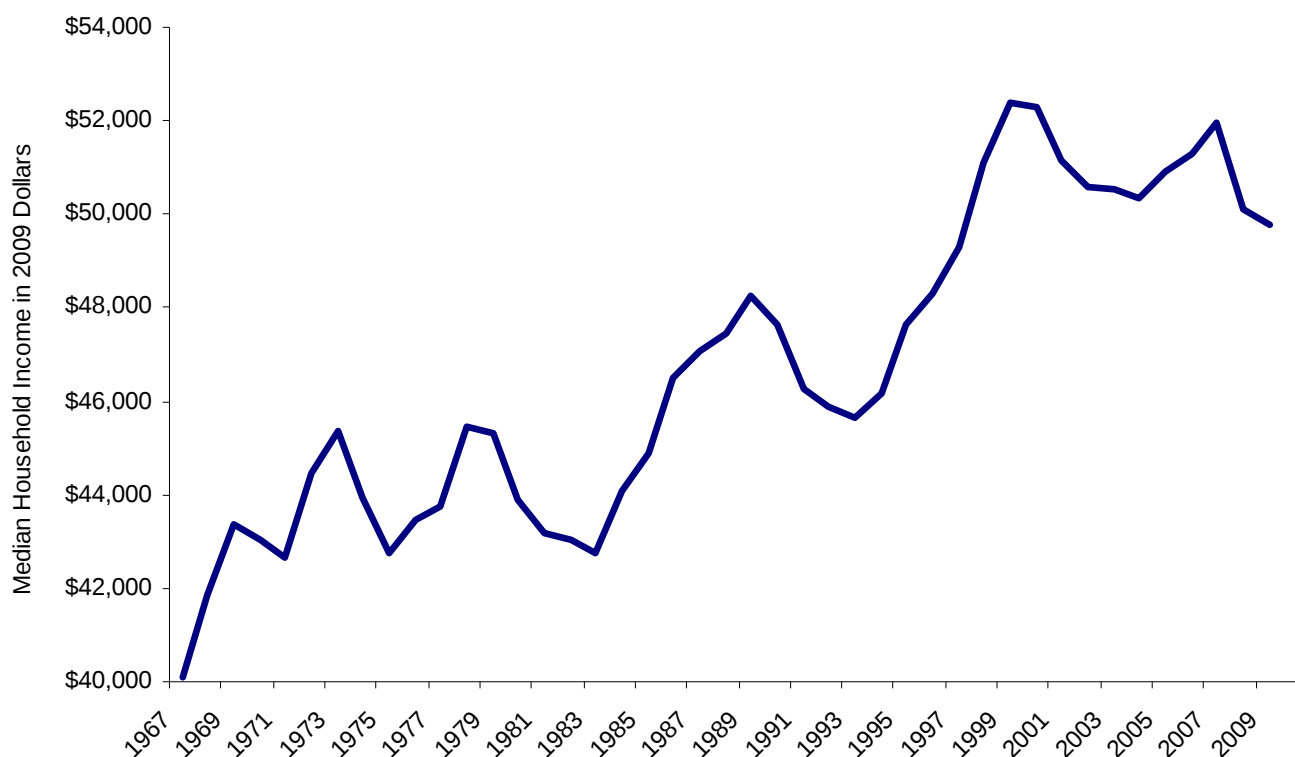
(last obs. January 28, 2011)



Source: Bloomberg; Encima Global

Median Household Income, Inflation-adjusted

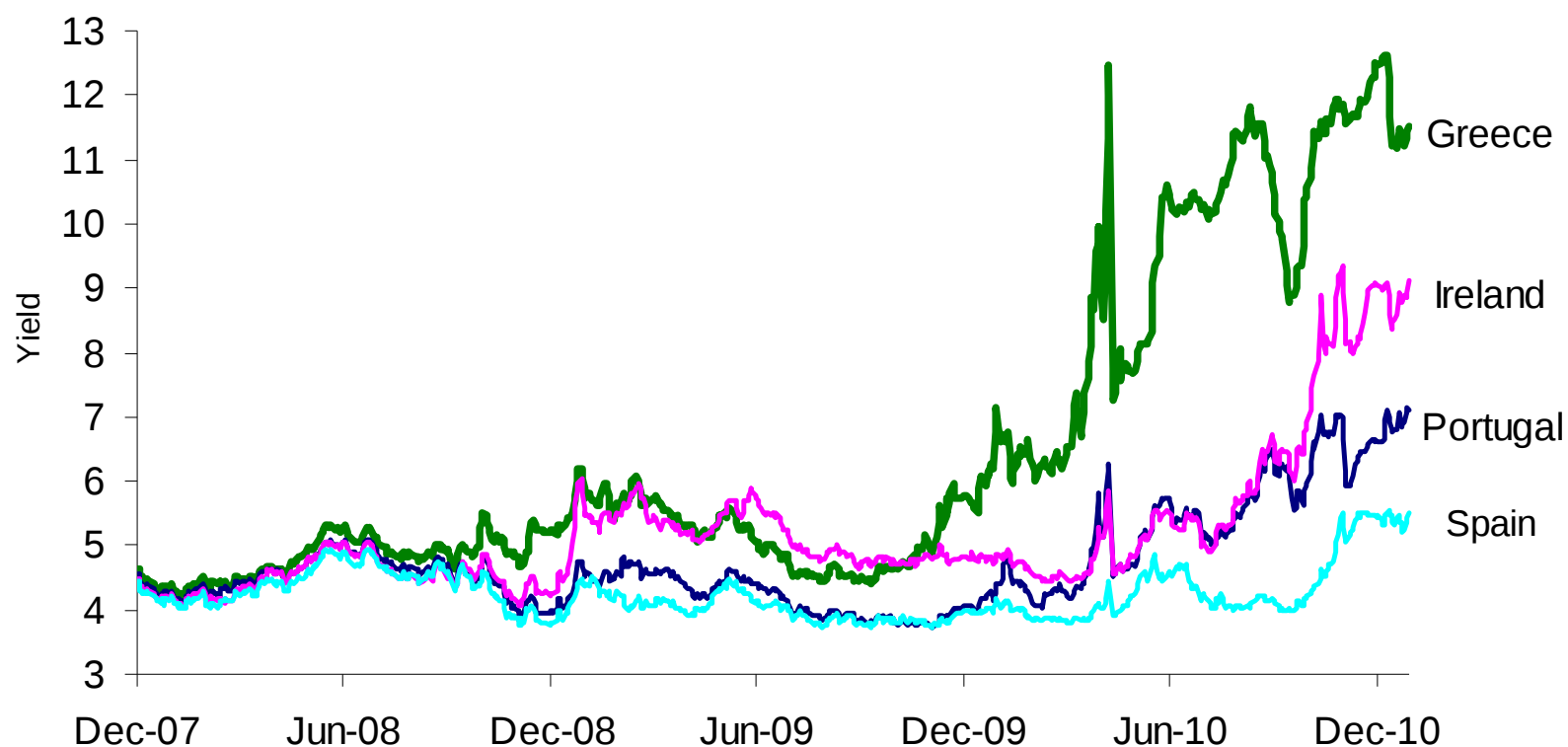
(2009\$, last obs. 2009)



Source: Bureau of the Census; Encima Global

Select European 10 Yr Yields

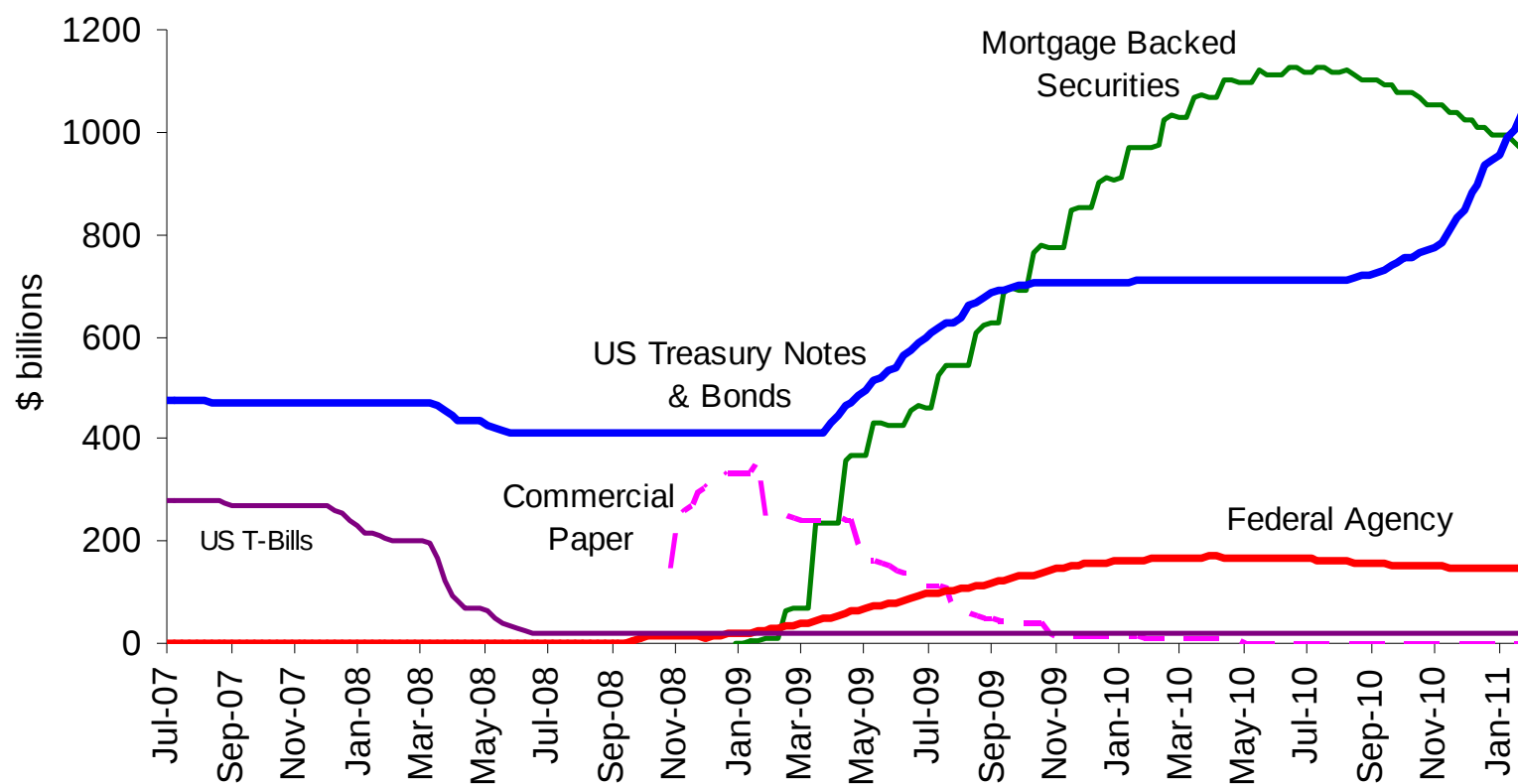
(last obs. January 28, 2010)



Source: Bloomberg; Encima Global

Federal Reserve Assets

(last obs. January 26, 2011)



Source: Federal Reserve; Encima Global

Policy Views

- The expiration of the continuing resolution on March 4 should be used as an opportunity to make numerous spending cuts now -- to put Washington on a diet where it shrinks day by day. Waiting for a deficit reduction package ducks responsibility and is a recipe for continued out-of-control deficit spending.
- The debt limit increase should be used to install a lasting limitation on the U.S. marketable debt-to-GDP ratio, enforced by escalating penalties on Washington. There should also be a minimum maturity for the debt to stop the government from artificially lowering near-term interest costs.
- By buying long-term assets, the Federal Reserve is conducting fiscal policy. QE2 should be wound down. It is shortening the effective maturity of the national debt and is causing substantial market distortions.
- Tax reform is a high priority. I favor including permanent extensions of current tax rates in the baseline to facilitate growth-oriented tax reform and modifying scoring rules to stop the practice of temporary tax rates.
- I believe these policy approaches would give new confidence to American businesses and financial markets, causing an inflow of capital and jobs to the U.S. private sector.