

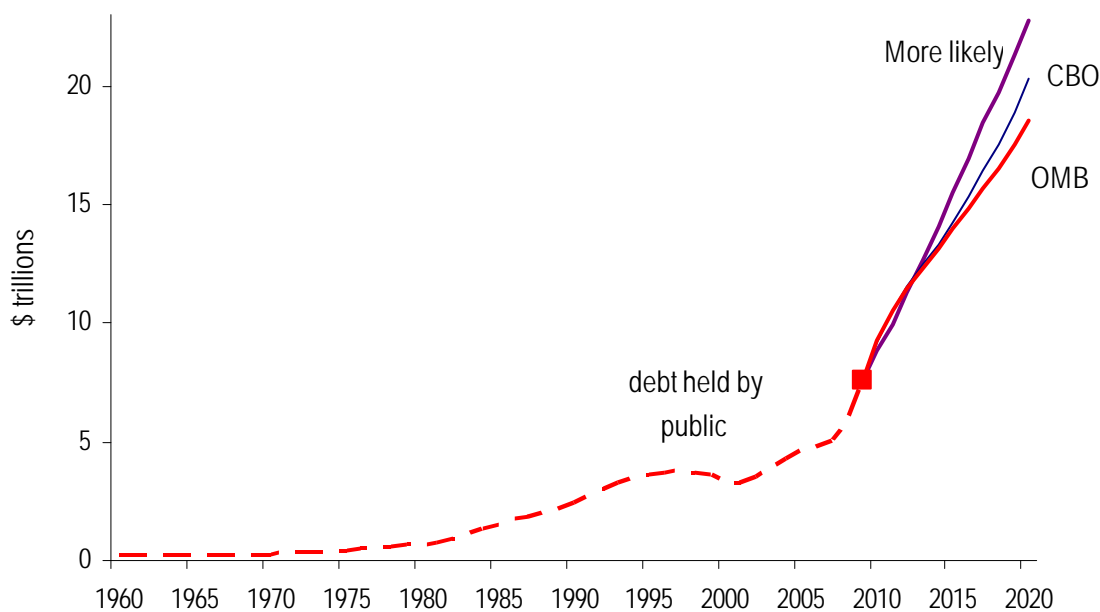
March 8, 2010

Debt Estimate Continues to Rise; Federal Spending 25% of GDP

On Friday, the Congressional Budget Office released its initial re-estimate of the President's budget for FY2011. Under that budget, CBO's first estimate is that national debt for 2020 would reach \$20.3 trillion, up from \$15.0 trillion in the January CBO outlook.

- The initial re-estimate does not consider the impact of higher debt on GDP or economic activity. Even with optimistic growth assumptions, debt would reach 90% of GDP in 2020. CBO writes "As a result, net interest would more than quadruple between 2010 and 2020 in nominal dollars (without adjustment for inflation); it would expand from 1.4 percent of GDP in 2010 to 4.1% in 2020."
- CBO expects to do a full re-estimate of the President's budget, including economic effects, later in March, which we think will add further to debt. Even Friday's initial re-estimate is getting close to our \$21 trillion debt expectation for 2019 (see Much More National Debt, October 22, 2009.)

US Government Debt (last obs. 2009, estimated to 2020)

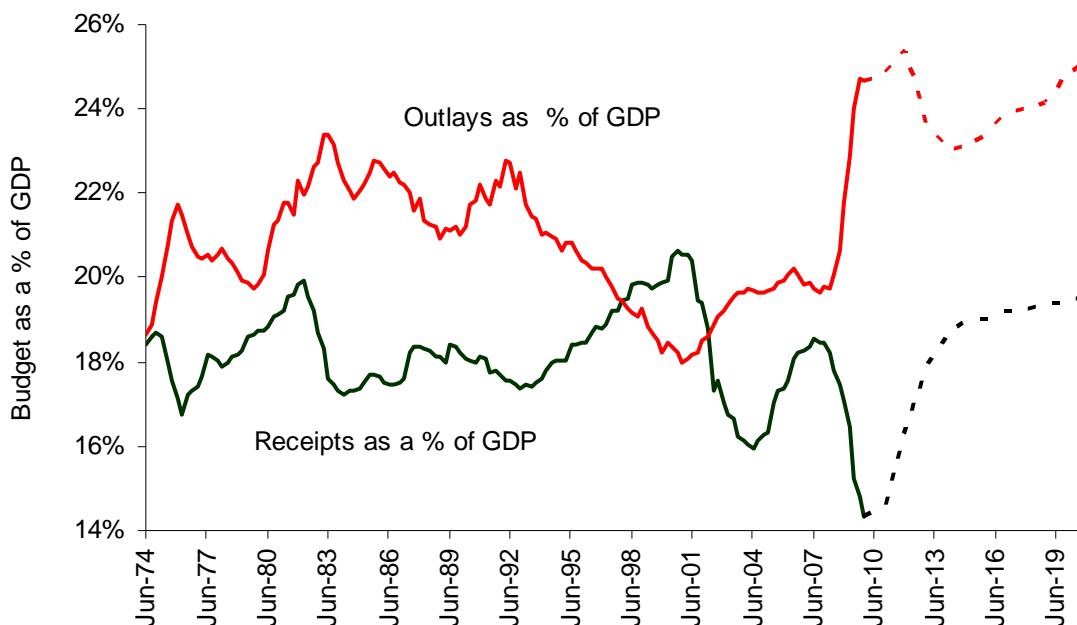


Source: CBO; Encima Global

In President Obama's first year in office, federal spending accelerated at a pace not seen since World War II. In 2008, spending represented roughly 20% of GDP, consistent with the 30-year average.

- The CBO re-estimate of the President's budget shows spending at over 25% of GDP in 2011. The average for 2011 to 2020 will be 24.1%.
- The OMB FY2011 \$3.8 trillion budget proposal projected that the spending percentage of GDP will fall modestly over the next several years, to 22.9% in 2014 and 2015. But this is based on an overly rosy assumption that the spending multiplier would help propel real GDP growth averaging nearly 4% for the next five years.

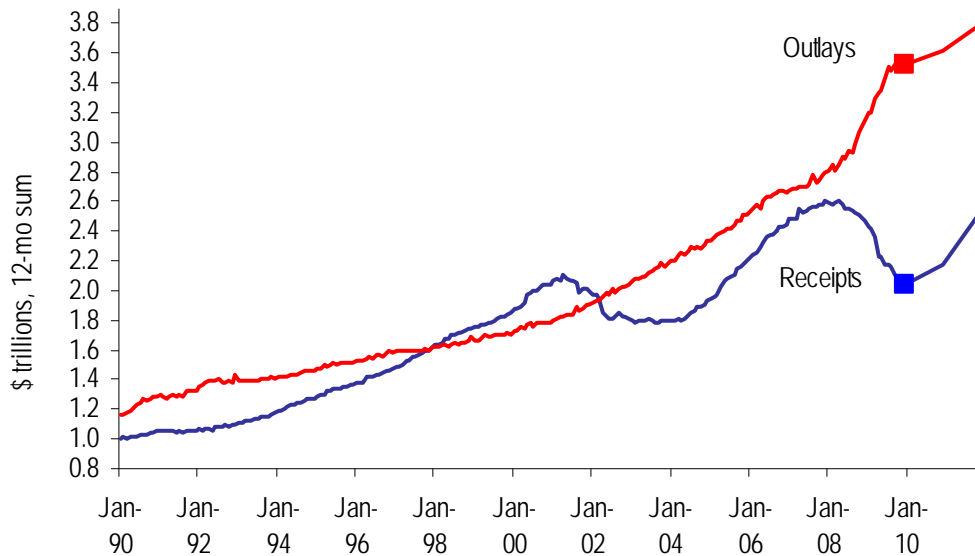
CBO Initial Re-estimate of Administration's FY2011 Budget (last obs. Dec 2009, estimated to 2020)



Source: US Treasury; CBO; Encima Global

- CEA chair Christina Romer cites conventional economic models as showing a spending multiplier of 1.6 – every new dollar spent results in 60 cents of additional economic activity. In Keynesian doctrine, increased federal spending has a “multiplier” effect. JM Keynes wrote: “If the Treasury were to fill old bottles with banknotes, bury them at suitable depths in disused coal mines which are then filled up to the surface with town rubbish, and leave it to private enterprise on well-tried principles of *laissez-faire* to dig the notes up again...there need be no more unemployment.”
- We don't think the growth in federal spending improves the outlook for GDP growth even in the near term. The \$3.5 trillion in FY2009 federal outlays, representing growth of \$540 billion over the previous year, had little demonstrable impact on employment. Nearly five million jobs were lost in 2009.

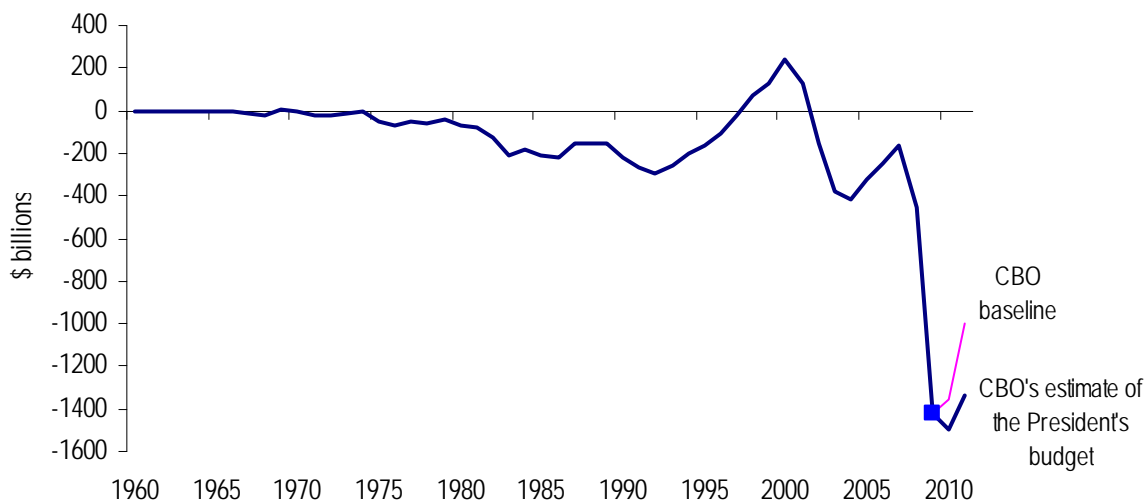
Federal Receipts and Outlays (last obs. January 2009, estimated to 2011)



Source: CBO; Encima Global

- The government's massive borrowing needs – per the CBO re-estimate, the federal deficit is now expected to be \$1.5 trillion in FY2010 representing 10.3% of GDP, up from 3.2% in 2008 – absorbs resources that would otherwise be available to the private sector.

Federal Deficit (last obs. 2009, estimated to 2011)



Source: CBO; Encima Global

- In addition, an expansive government claim on resources detracts from the relative contribution of entrepreneurship and innovation in driving economic growth. Whether government spending adds to growth or not, it shifts the economy toward a government-led allocation of resources, reducing income and wealth over time.
- This colossal expansion of the government's role in the economy comes as the entrepreneurial sector is already struggling mightily to escape from the clutches of the recession. Only 5% of respondents to the January NFIB small-business survey characterized the current period as a good time to expand their businesses, near an all-time low. Only a net one percent expected business conditions to improve in the next six months, a severely depressed reading.

Notes: This email and attachment are confidential and intended solely for the use of the individual to whom they are addressed. Encima Global LLC does not accept liability for the content, or for the consequences of any actions taken on the basis of the information provided. The information is not necessarily complete, and we make no warranty as to its accuracy.