

Wallace's Daily Policy Debrief

Today:

- 1) Fiscal – Kim Wallace
- 2) Policy Calendar

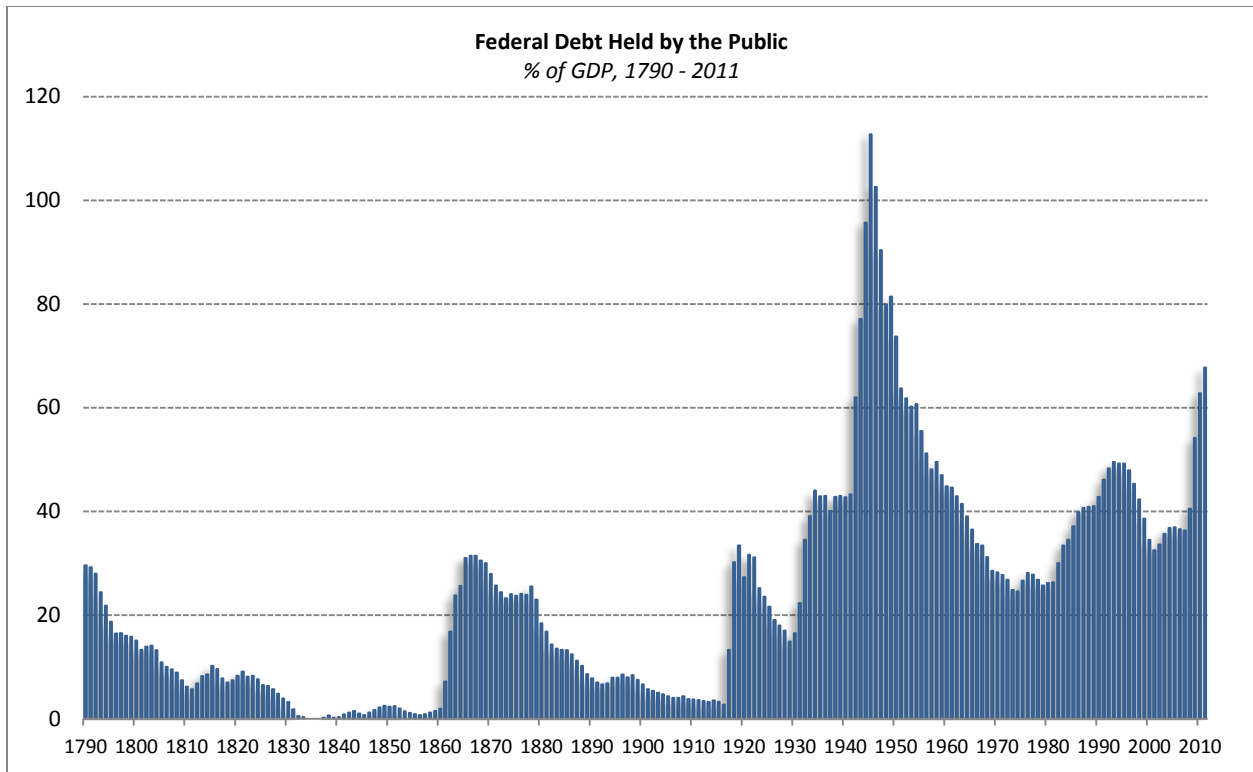
Fiscal: Skinny, Full, or Just Late?

Discussions between President Obama and Speaker Boehner, along with public statements from members of their parties, indicate Washington is likely to vote on a fiscal package before closing down the 112th Congress later this month. **We continue to believe a package will be negotiated to include legislation designed to avert the bulk of fiscal drag implied by current law, language that removes the debt limit from credible concerns for the next calendar year or longer, and money for states and households rebuilding after Superstorm Sandy.**

Each of these provisions on their own very likely would produce sufficient momentum to spur action; together, the package seems bigger, stronger, more compelling than do reasons or excuses for inaction. **If Washington is able to agree to a package, its size is one of many uncertain variables that will factor into markets' and other stakeholders' perception of value.**

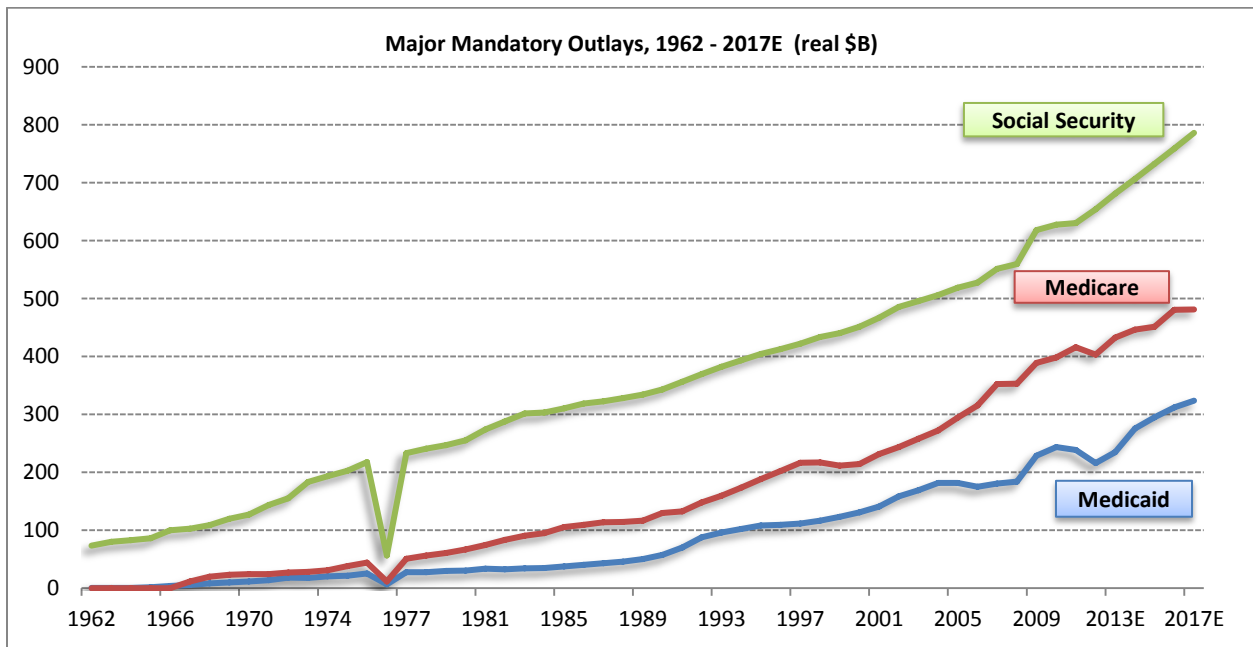
We opined last week about a deal that might commit Washington to \$4.0 - 4.5T of multi-year fiscal consolidation. **We haven't seen anything yet to dissuade us away from thinking a deal is coming. We have seen comments and spoken to negotiators in the past few days that imply the chance of a smaller deal.** The current term of art is "skinny" or "full" in reference to a fiscal package. In this context, skinny looks about half as slim as the potential deal we described last week, with spending cuts or new revenue (including some tax increases) comprising 55% of the program, depending on to whom you speak.

Paying down the recent spike in debt-to-GDP is one of the policy drivers of a deal in the near term. Growth in debt also is increasingly driven by demography as fewer taxpayers are supporting more retirees. The following graph shows federal debt as share of the economy since the inception of the Department of the Treasury (one year after Hamilton's First Report on Credit). The long story is that all spikes in the ratio have been paid down, irrespective of cause.



Source: CBO, Treasury, Federal Reserve, Census Bureau

The accompanying graph demonstrates over 2x real growth in major mandatory spending outlays over approximately the past two decades. The boomer generation is just beginning to fuel this rise, necessitating a reconciliation of our aging population and key entitlement spending programs.

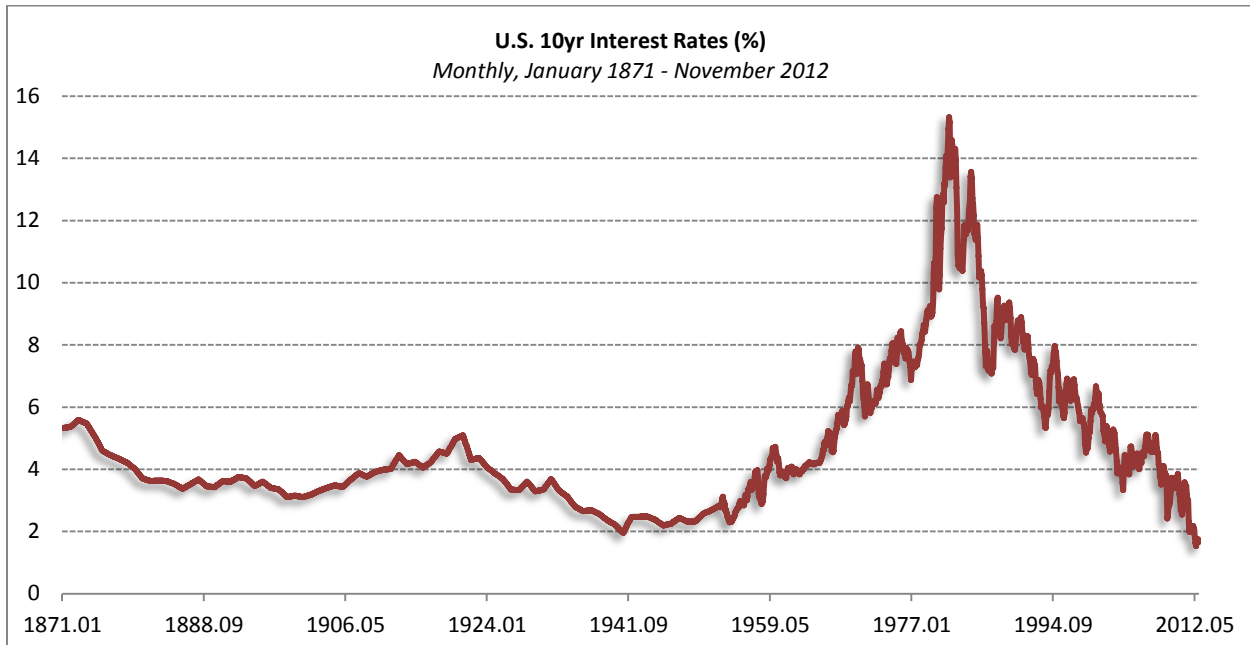


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Source: CBO

Another near-term fiscal policy driver is public finance. Exporters, banks, and governments are primary beneficiaries of abnormally low rates. Returning closer to a more common yield curve serves wider stakeholder interests in a post-recession environment. Debt service costs will become an unwelcome tradeoff when the 10-yr begins to edge up.



Source: Robert J. Shiller, Federal Reserve

'Skinny' would not sate anyone's appetite for necessary serious fiscal rebalancing, and all but assures Washington would remain under relentless pressure next year to achieve more. **Political and fiscal pressures augur for a 'full' December Deal if any deal is possible.**

- Kim Wallace

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Policy Calendar

Tuesday

- 5am EST, ZEW measure of German economic confidence for December came in at 6.9 versus expectations of -12.0
- 2pm, Canada's central bank head Carney takes questions from the press after speech to financial analysts in Toronto

Wednesday

- 4am EST, Italy's Monti scheduled to address Italian carmaker trade group
- 5am, ECOFIN meeting to continue unified European banking supervisor discussions
- 8am, OPEC press briefing
- 10am, House subcommittee hearing on implementation of Dodd-Frank derivatives rules
- 11am, ECB issues semi-annual Financial Stability Review
- 12:30pm, FOMC statement released; 2:15pm Bernanke press conference

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