

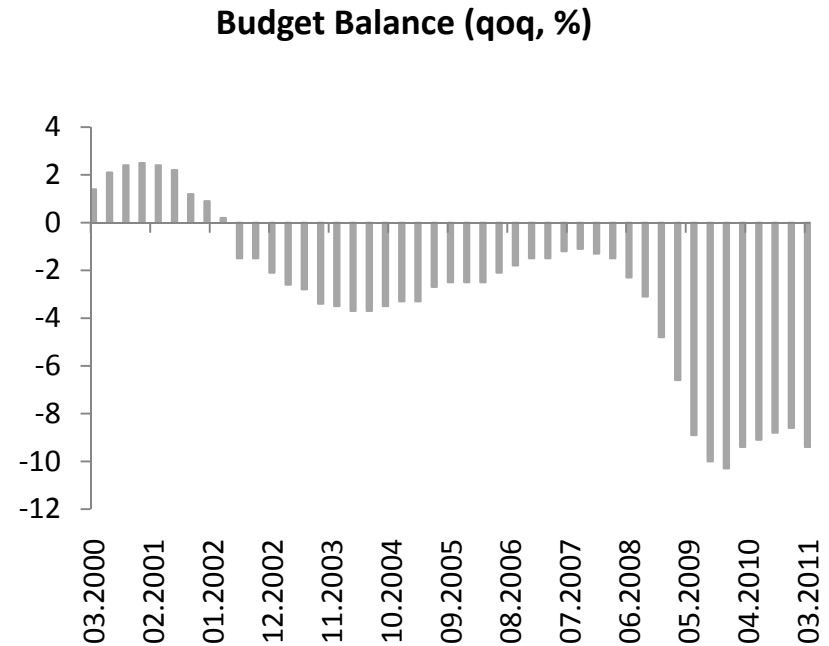
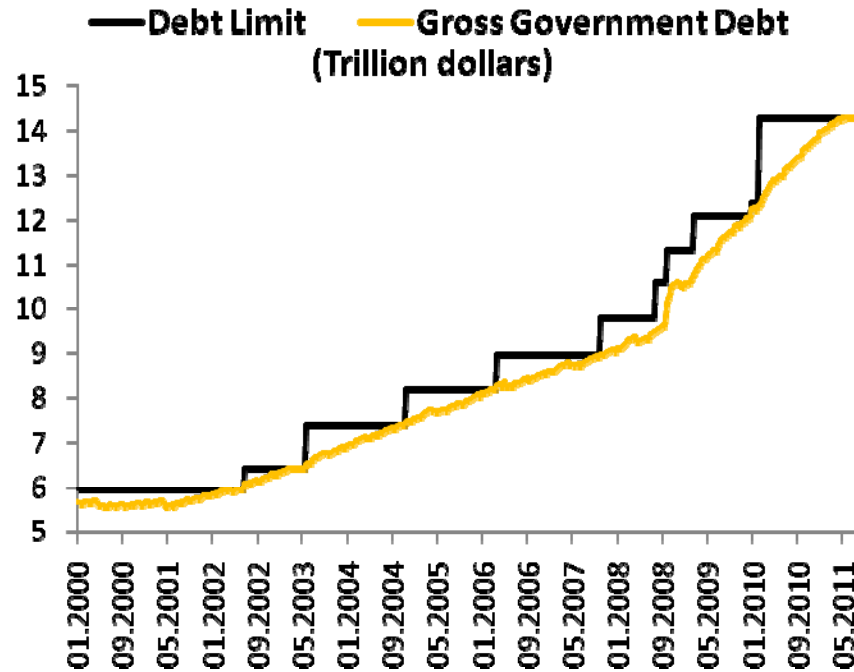
VAKIFBANK GLOBAL ECONOMY WEEKLY



**Details of the debt ceiling agreement
and the effects on the economy**



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While there has been a gradual increase in the debt limit until 2010, debt limit was increased by \$1.9 trillion at a time in 2010...



-  The average annual increase in the US debt stock was \$ 400-500 billion between 2002-2007. But after the crisis, the average annual increase in the US debt stock has reached \$ 1.5 – 2.0 trillion.
-  This rapid increase in government debt stock raises the question of debt limit and the government debt has reached the debt limit which was \$ 14.3 trillion in May.

Debt ceiling bill was approved by the Congress...

Components of the plan

 *The debt ceiling bill was approved after long discussions between the government and opposition party. This decision eliminated the concerns about defaults in US and a possible fall in US credit note.*

➤ *The government plan which estimates \$2.1 trillion reduction on spendings in the coming ten years, has four main components.*

- 1. Debt limit increase,**
- 2. Spending caps,**
- 3. Setting up a committee to reduce the deficit,**
- 4. Automatic spending cut mechanism.**

Four main components of the package...

1. Debt limit increase...

US government decided to raise the debt limit by a total of \$2.1 to \$2.4 trillion over the current level of \$14.294 trillion. This package has three main steps:

- ✓ Firstly, package triggers an initial increase of \$400 billion which has put into practice. Hence, the debt limit reached to \$14.694 trillion from \$14.294 trillion.
- ✓ If congress has not passed, or the President has vetoed, a second installment of \$500 billion would take effect.
- ✓ Lastly, a third installment in borrowing authority would add another \$1.2 trillion. This installment would be maximum \$1.5 trillion, but in order to affect the debt limit increase, its recommendations must become law.

2. Spending caps...

The package predicts a total reduction on spending of \$756 billion for the next ten years. On the other hand according to some estimates, this savings would reach \$917 billion with the decrease in interest expense and a few other smaller policy changes.

3. Setting up a committee to reduce the deficit...

The agreement, which raises the debt limit, allowed to establish a new Committee. The committee recommends increasing debt limit until the end of 2012, cutting spending more than \$1.5 trillion over 10 fiscal years and reducing budget deficit more than \$ 1 trillion.

4. Automatic spending cut mechanism

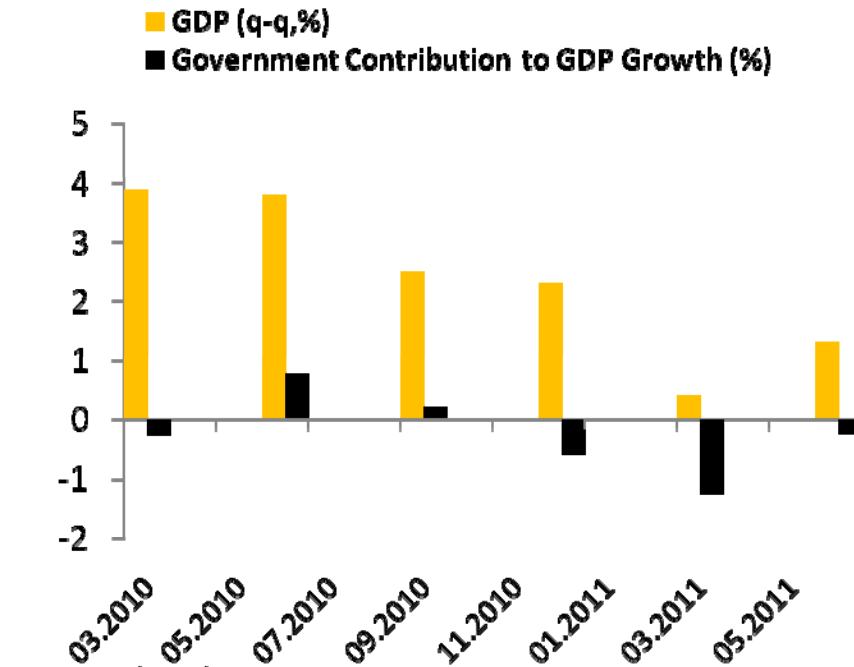
To ensure that the Committee achieves its savings goal, an enforcement mechanism will be used, which would impose spending cuts of up to \$1.2 trillion if it fails to produce savings of at least that amount.

Automatic cuts would be shared equally between defense and civil defense spending.

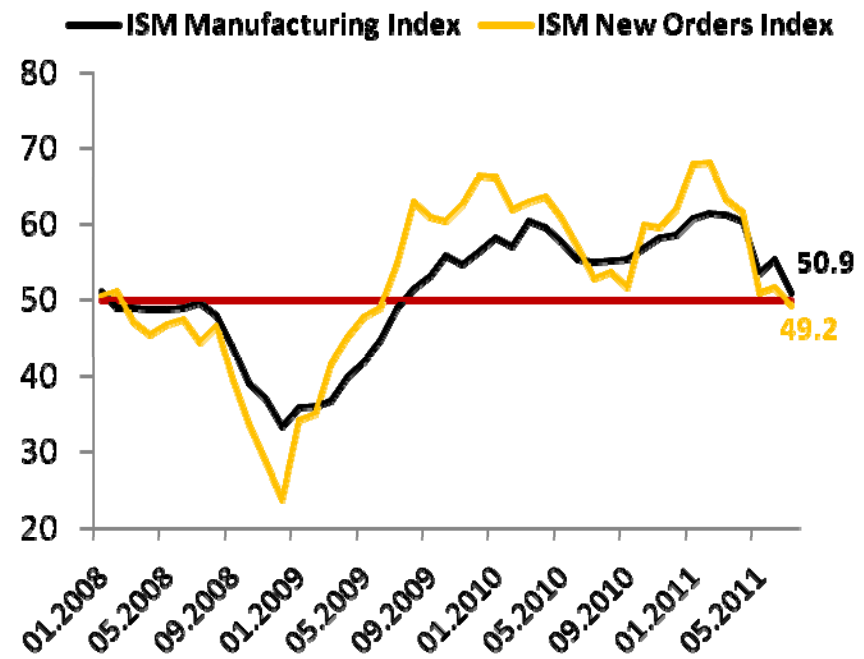
If it is not enough, other cuts would be shared among social security, medicaid, low-income related programs, veterans' programs, financial stability programs, net non-interest programs and domestic appropriations.

If the Committee has not compromise on spending cuts, cuts of \$109 billion will be implemented in 2013.





Growth concerns have increased in US...



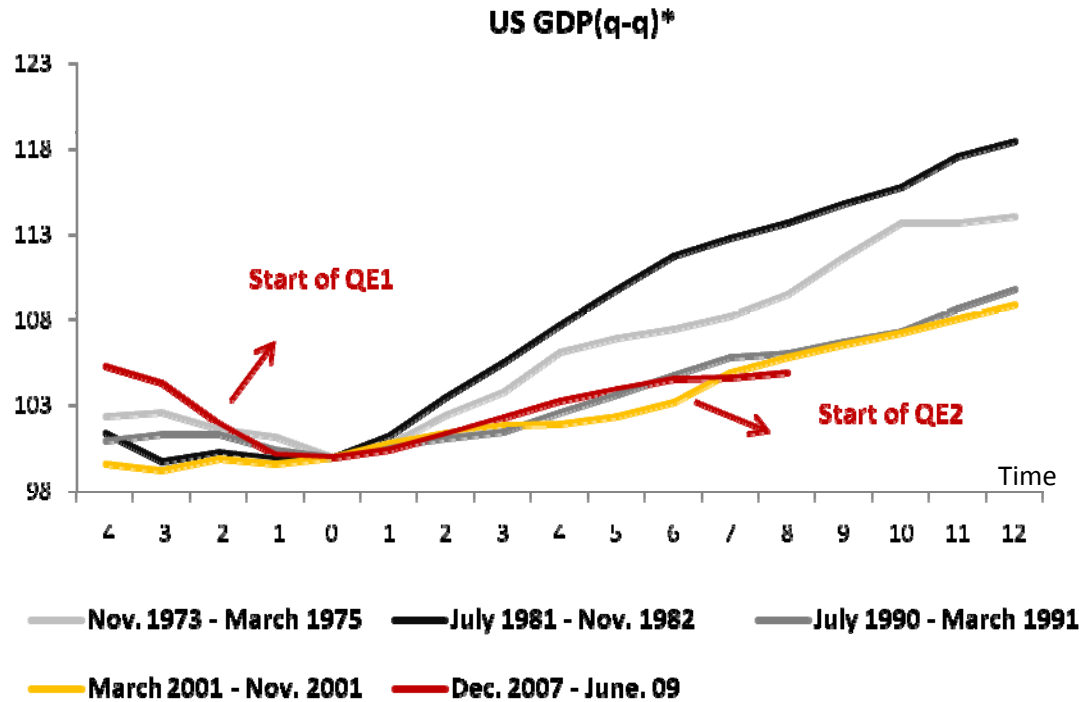
Source: Bloomberg



Source: Bloomberg

-  The US economy grow under at a rate of 1% in the first half of 2011, which indicates the weak growth performance.
-  The gradual end of financial supports, which were given in 2009 and 2010, also negatively affects growth and the government's contribution to growth has been negative for three quarters.
-  The last legislation related to reduction in spending for the next ten years also pose a risk for the growth performance in the coming periods.
-  Moreover in July, ISM manufacturing index as a leading indicator of the growth has approached to 50 which is critical level and this indicates negative outlook for the growth.

QE3 may be possible for the US economy...



* The end crisis period GDP is taken as 100 .

Source: Bloomberg

In order to analyze US growth, an index is composed for each recession period. In each index the end of recession date is accepted as zero and US growth performance in the 4 quarters before and in the 12 quarters after the end of each recession period are compared (seen in LHS graph).

It is observed that, after the last global crisis in 2008, pace of economic recovery seperated from previous ones and especially in 2011 growth has been losing its momentum.

Although US economy grow lower than expectations in the first half of the 2011, FED's QE programmes had positive effects on growth. If QE's were not applied, the economy would be worse than this situation .

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