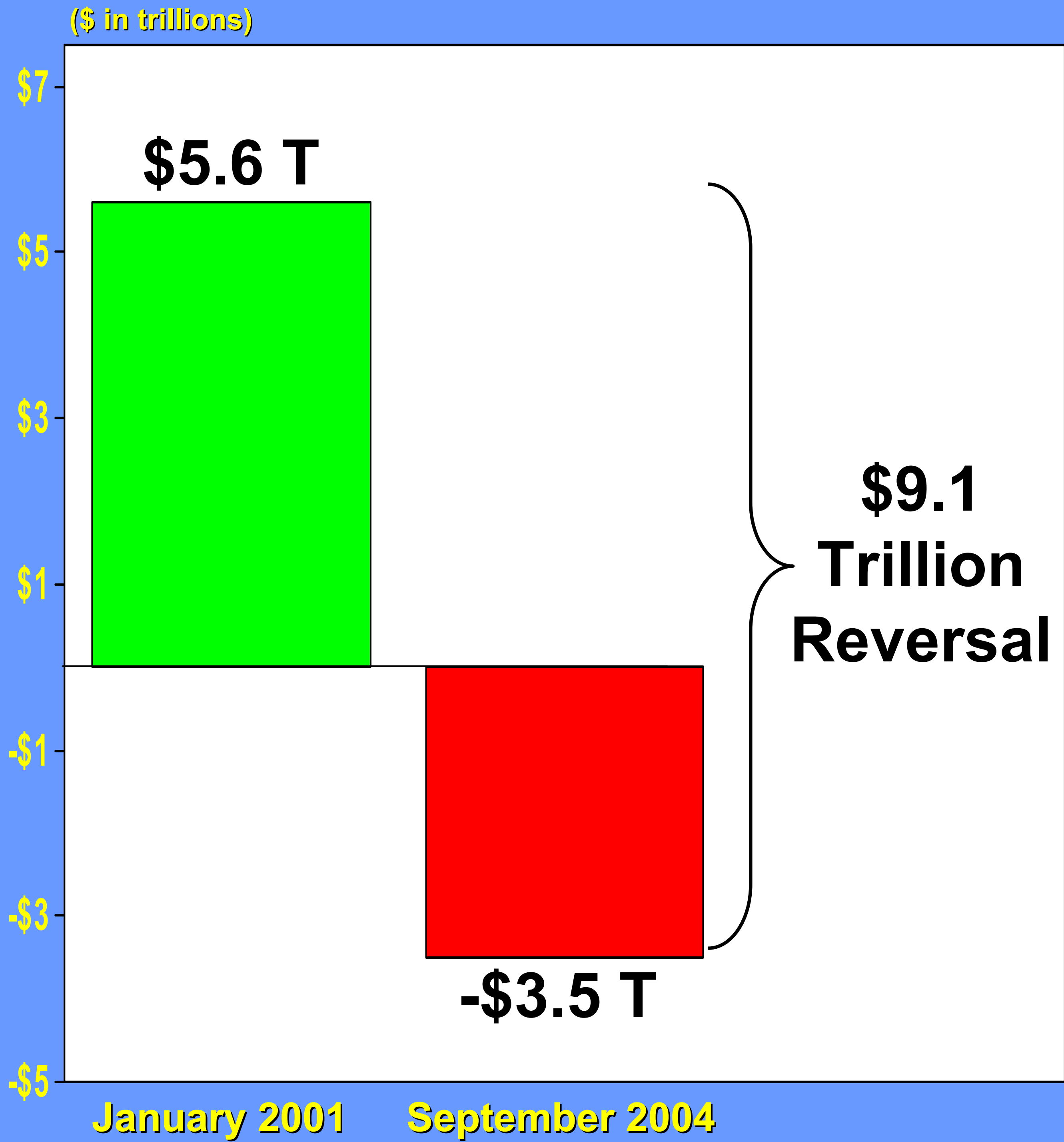
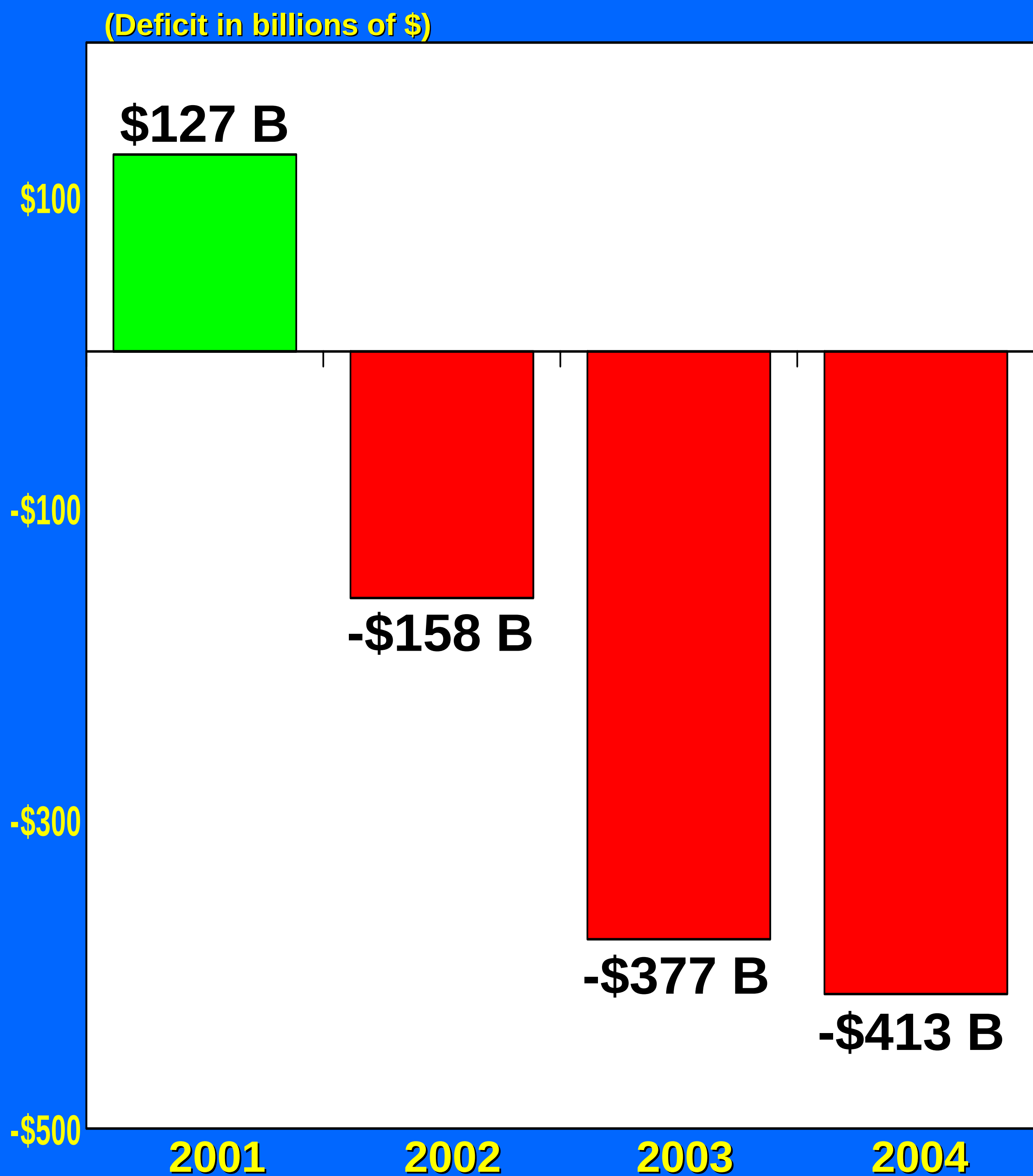
$5.6 Trillion Surplus Projection Turned Into $3.5 Trillion Deficit Projection (FY 2002-2011)



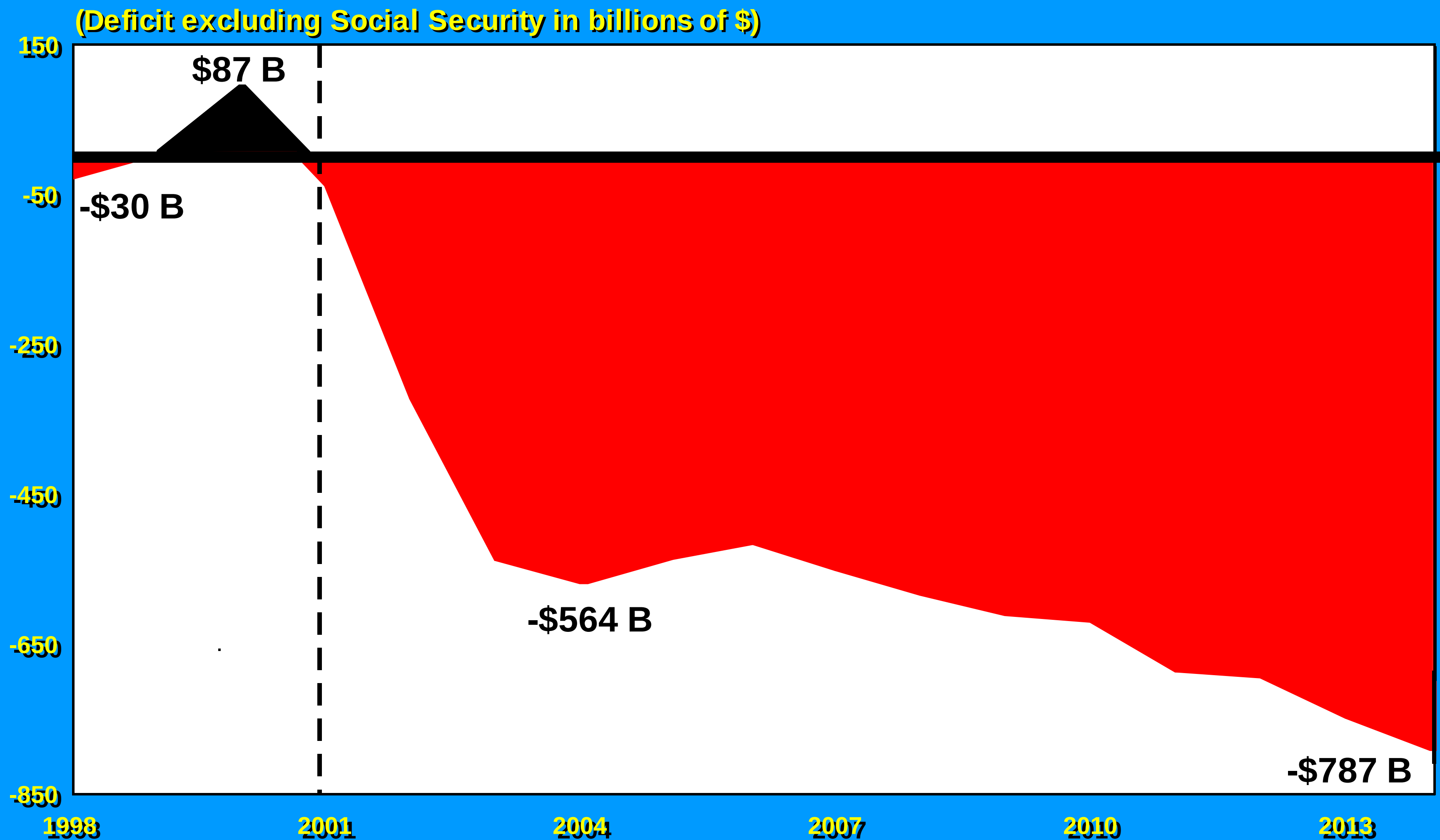
Source: CBO January 2001 baseline and CBO September 2004 baseline with Bush budget policies, AMT reform, and ongoing war costs.

Deficits Have Worsened in Each of the Last Four Years



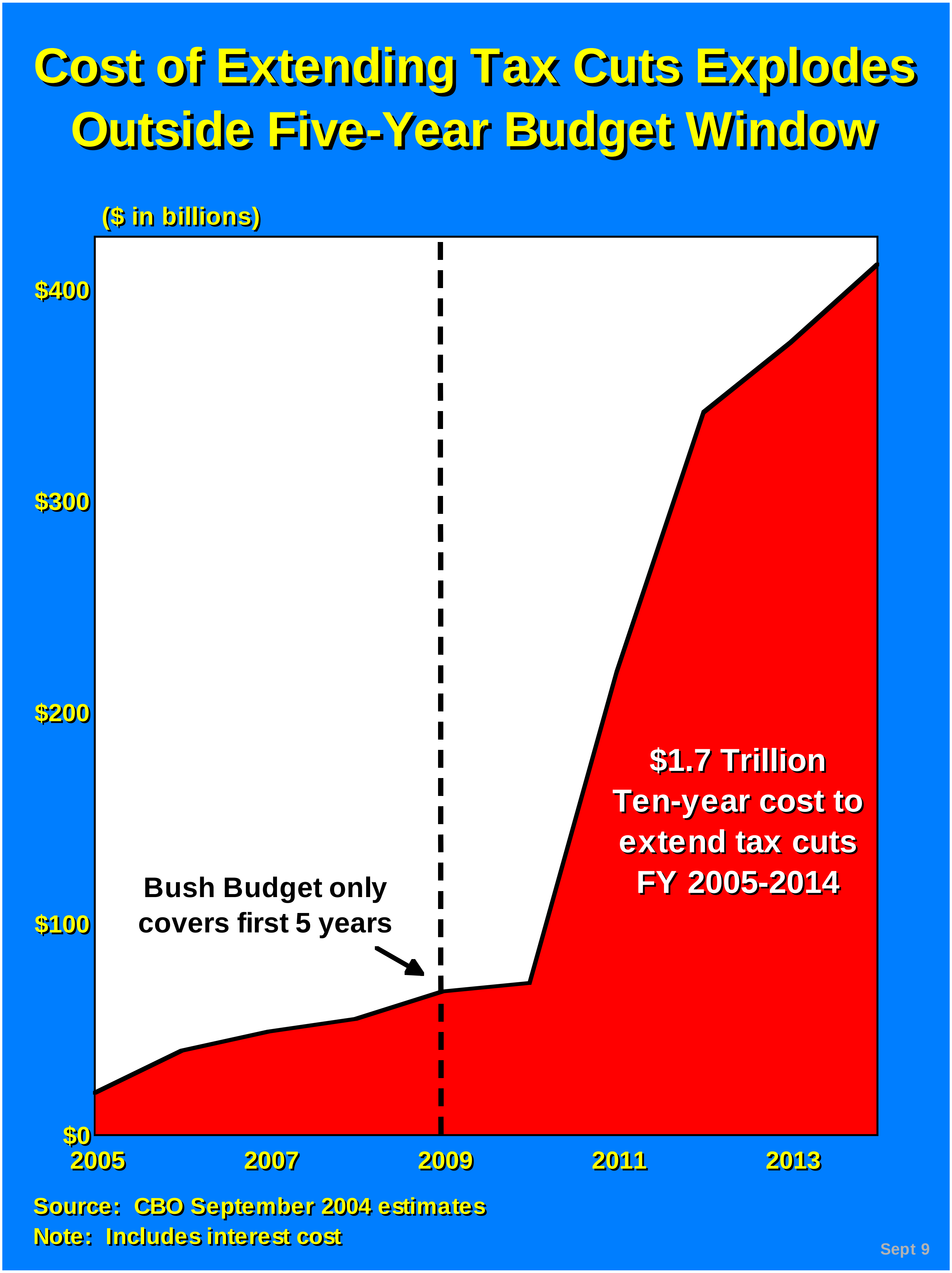
Source: OMB, U.S. Department of Treasury

Deficits with Bush Tax Cuts Made Permanent, Bush Defense Buildup, AMT Reform, and Ongoing War Costs

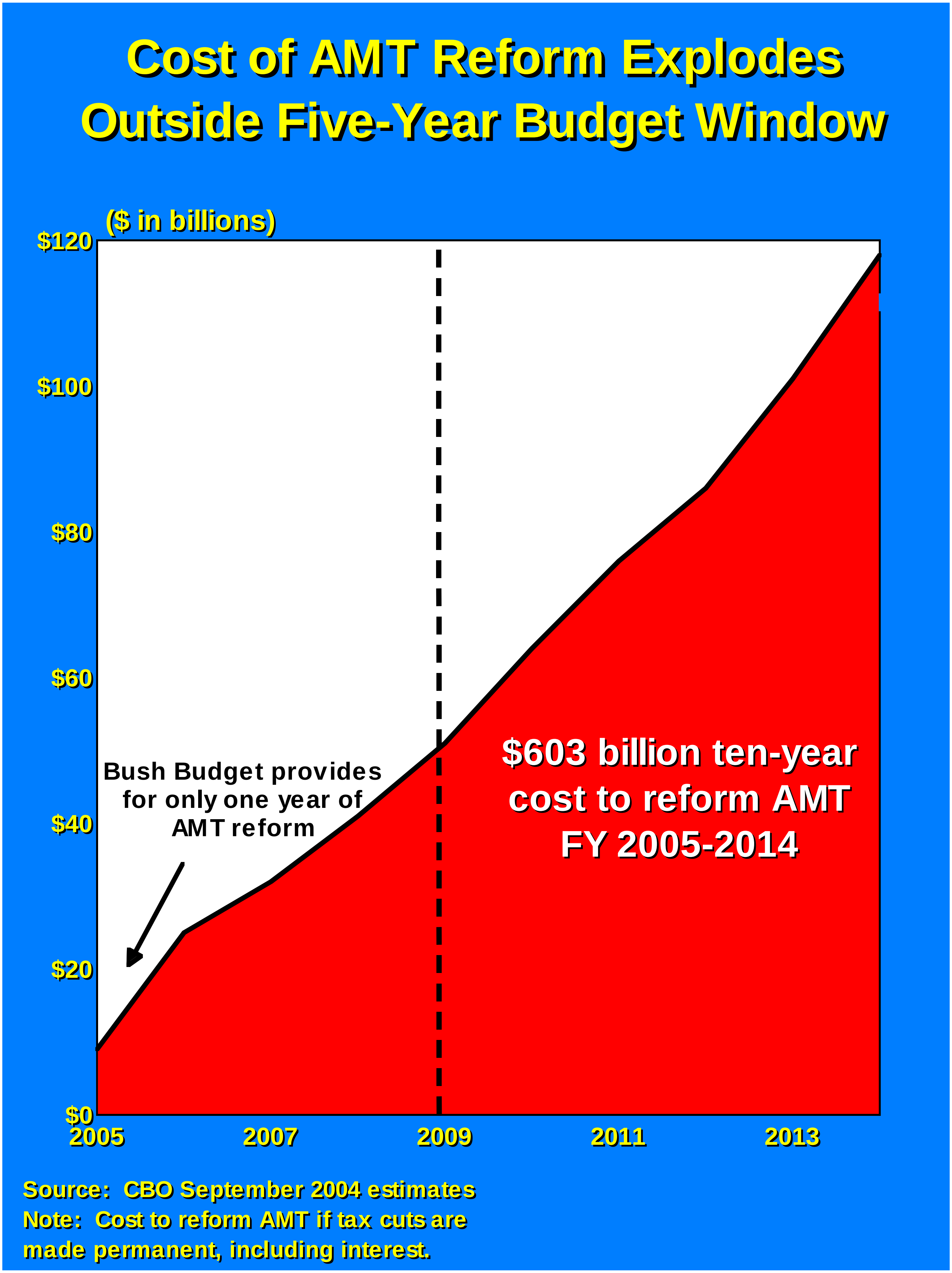


Source: U.S. Department of Treasury, CBO, and SBC

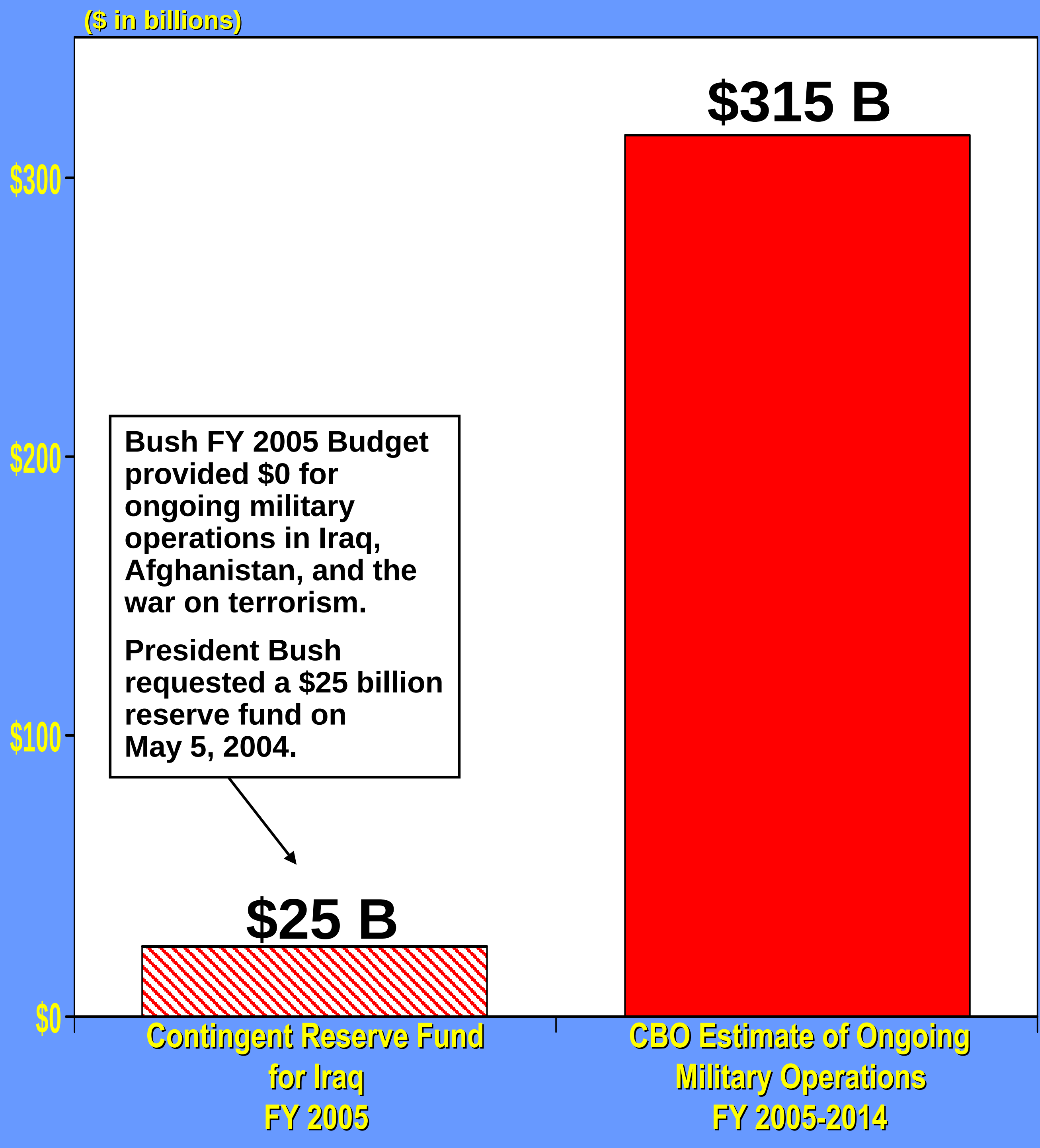
Note: CBO September 2004 estimate with Bush tax cuts made permanent, Bush defense buildup, AMT reform, and ongoing war costs.



Cost of Extending Tax Cuts Explodes Outside Five-Year Budget Window
($ in billions)
$400
$300
$200
$100
$0
2005
2007
2009
2011
2013
Bush Budget only covers first 5 years
$1.7 Trillion
Ten-year cost to extend tax cuts
FY 2005-2014
Source: CBO September 2004 estimates
Note: Includes interest cost
Sept 9


Cost of AMT Reform Explodes
Outside Five-Year Budget Window
($ in billions)
$120
$100
$80
$60
$40
$20
$0
2005
2007
2009
2011
2013
Bush Budget provides for only one year of AMT reform
$603 billion ten-year cost to reform AMT FY 2005-2014
Source: CBO September 2004 estimates
Note: Cost to reform AMT if tax cuts are made permanent, including interest.

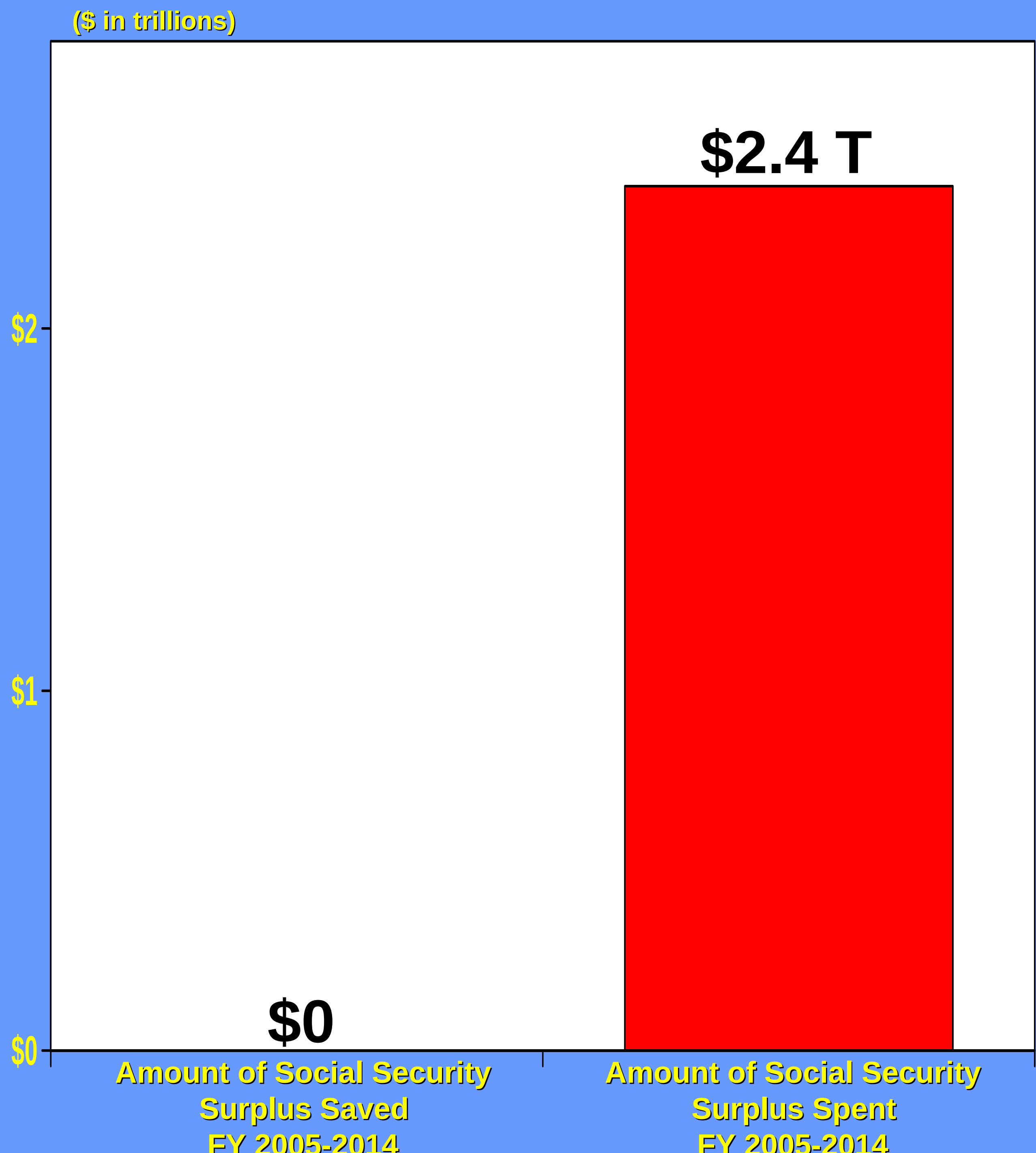
Long-Term Costs Underfunded for Ongoing Operations in Iraq, Afghanistan, and Continuing War on Terror



Source: OMB and CBO September 2004 estimates

Note: Contingent Reserve Fund available upon enactment in August 2004

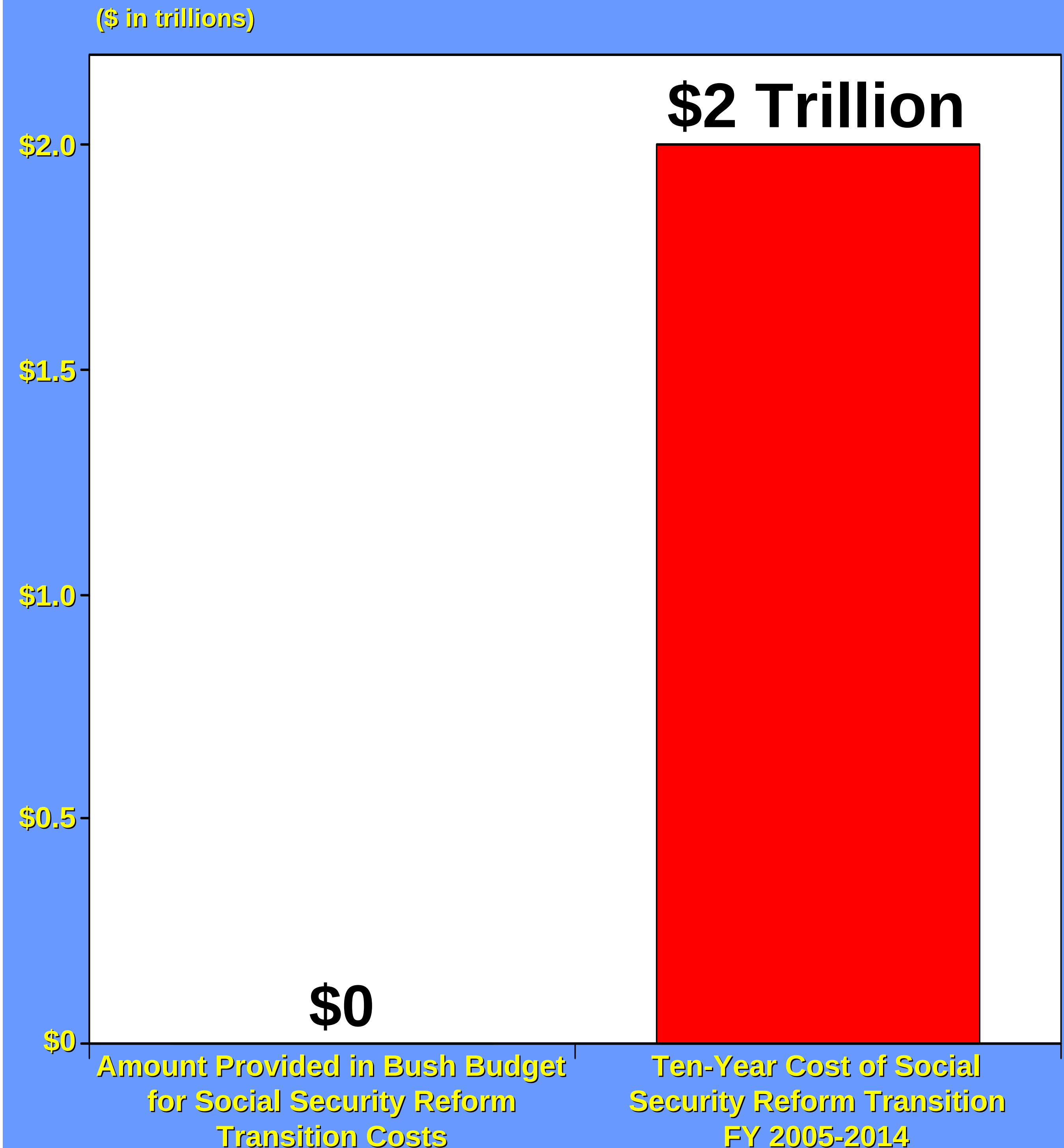
Under Bush Budget, Every Penny of Social Security Surplus Spent



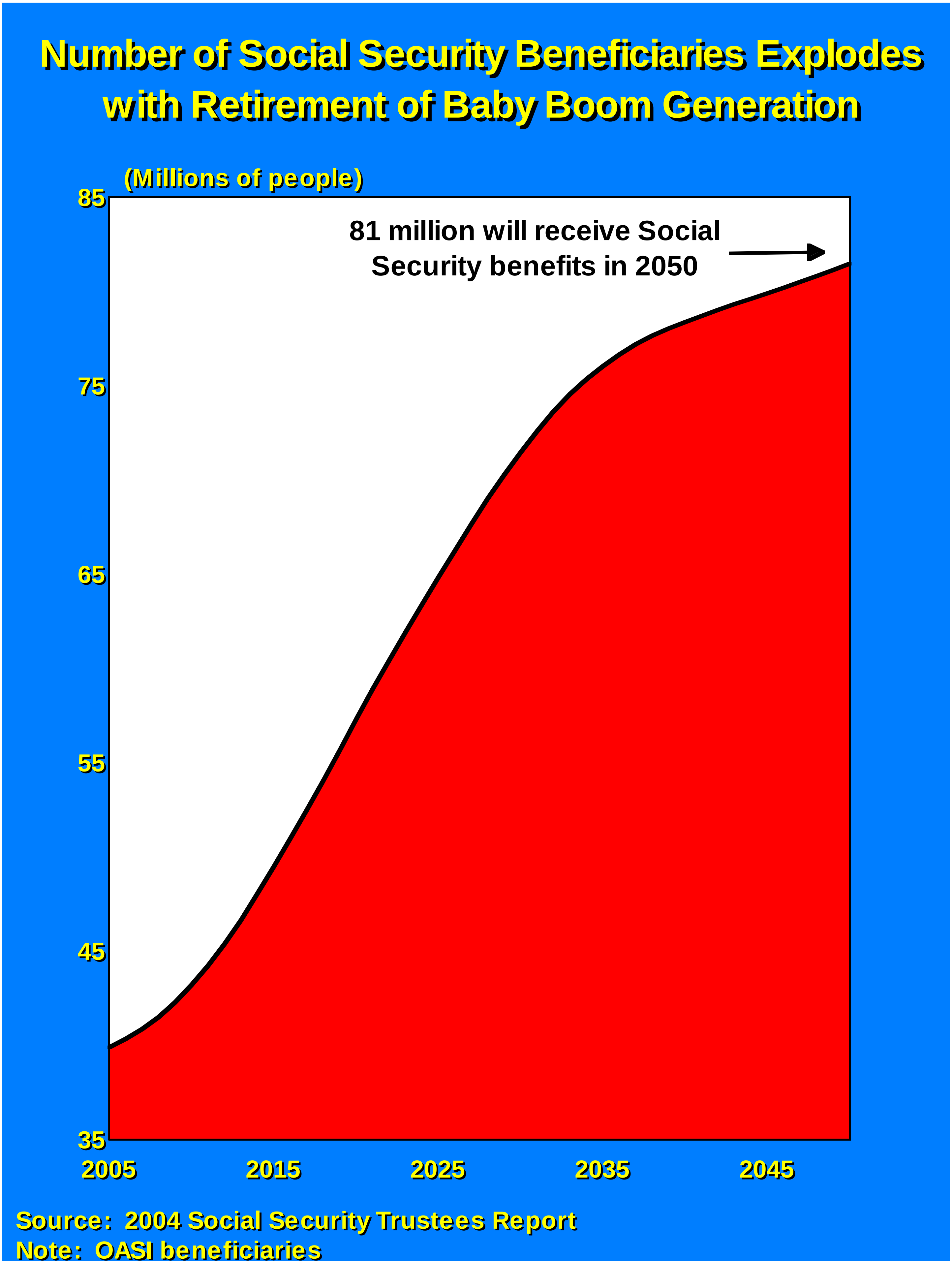
Source: CBO

Note: Amount of Social Security surplus spent on tax cuts and other things, instead of saved to prepare for retirement of baby boom generation.

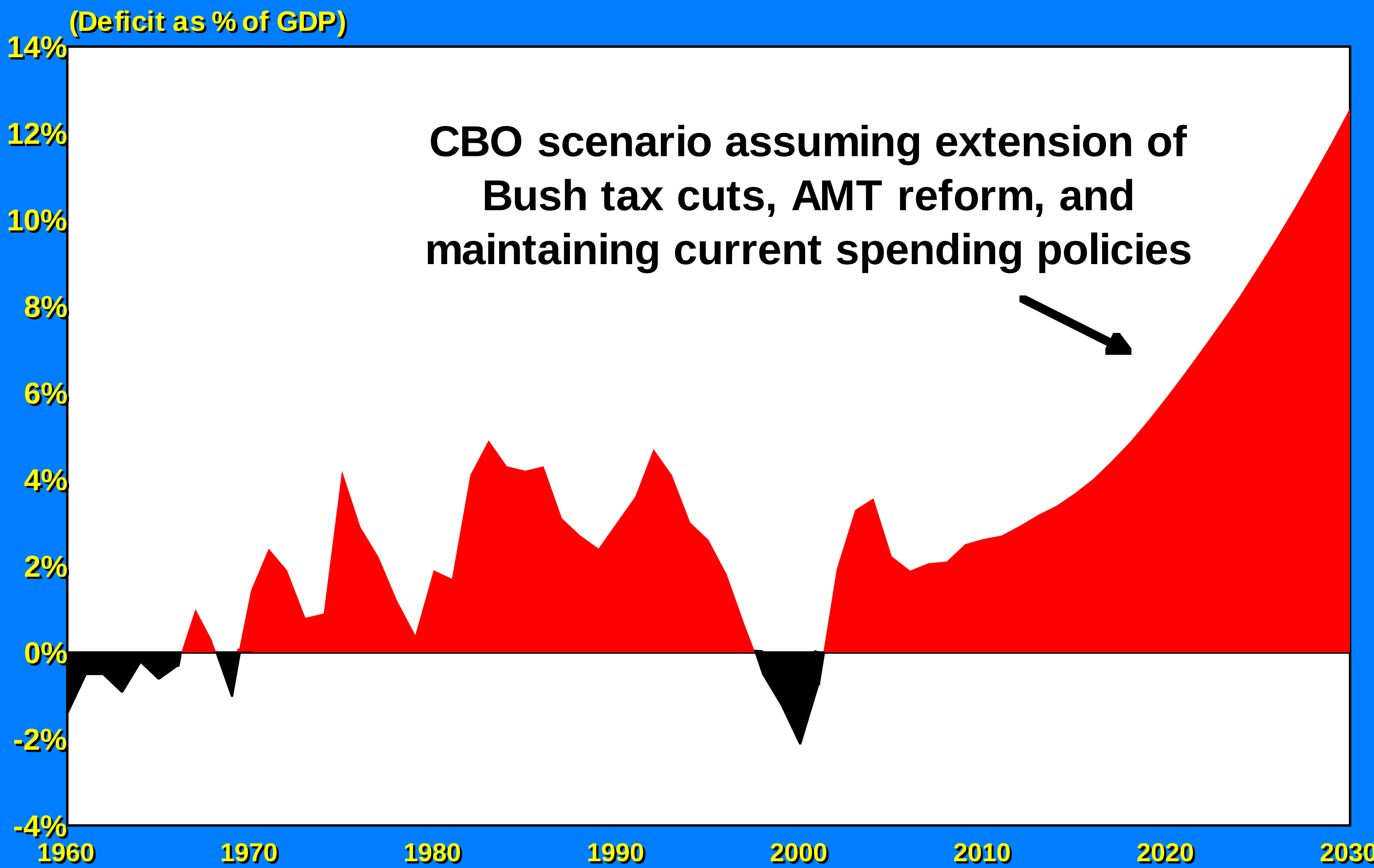
Bush Budget Provides No Funding for Social Security Reform Transition Costs



Source: OMB, Report of the President's Commission to Strengthen Social Security
Note: Including debt service, in 2004 dollars


Number of Social Security Beneficiaries Explodes with Retirement of Baby Boom Generation
(Millions of people)
85
75
65
55
45
35
81 million will receive Social Security benefits in 2050
2005
2015
2025
2035
2045
Source: 2004 Social Security Trustees Report
Note: OASI beneficiaries

CBO Report on Long-Term Budget Outlook Shows Bush Tax Cuts Exploding Deficit

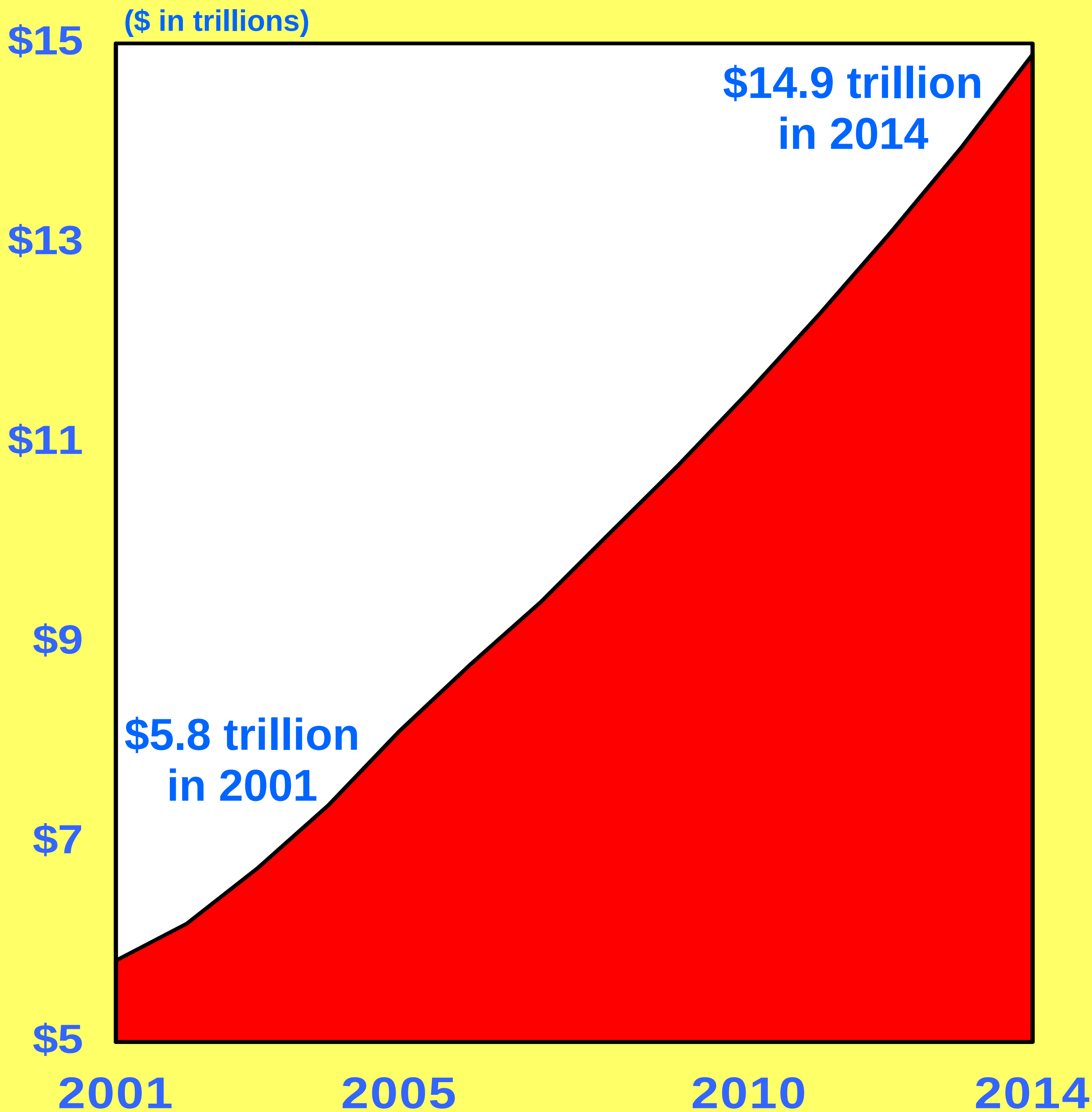


Source: CBO report, "The Long-Term Budget Outlook," December 2003

Note: CBO scenario #1.

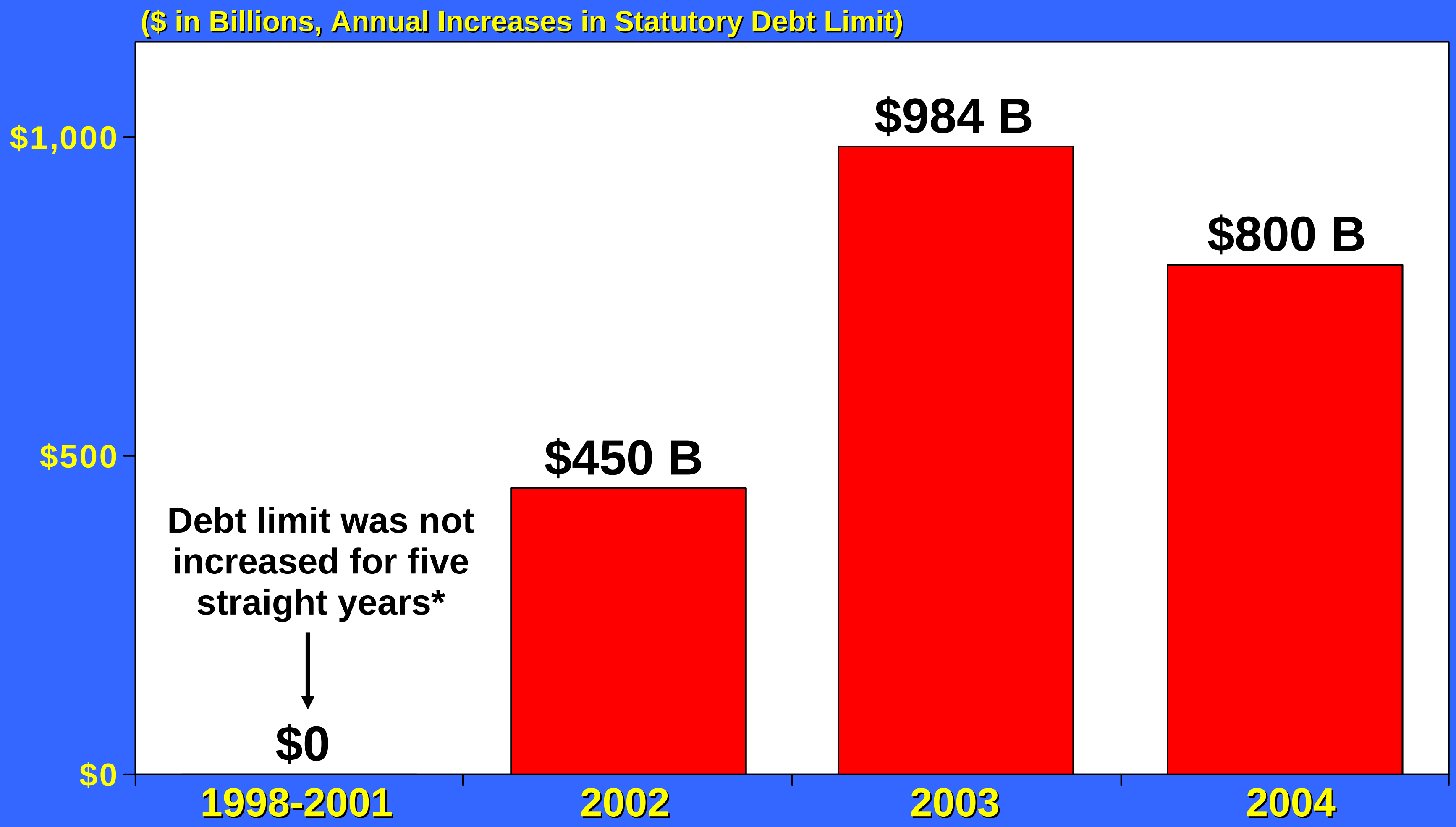
Gross Federal Debt

Assuming Bush Tax Cuts Made Permanent, Bush Defense Buildup, AMT Reform, and Ongoing War Costs



Source: CBO, SBC, and U.S. Department of Treasury
Note: CBO September 2004 estimate with Bush tax cuts made permanent, Bush defense buildup, AMT reform and CBO estimate of ongoing war costs.

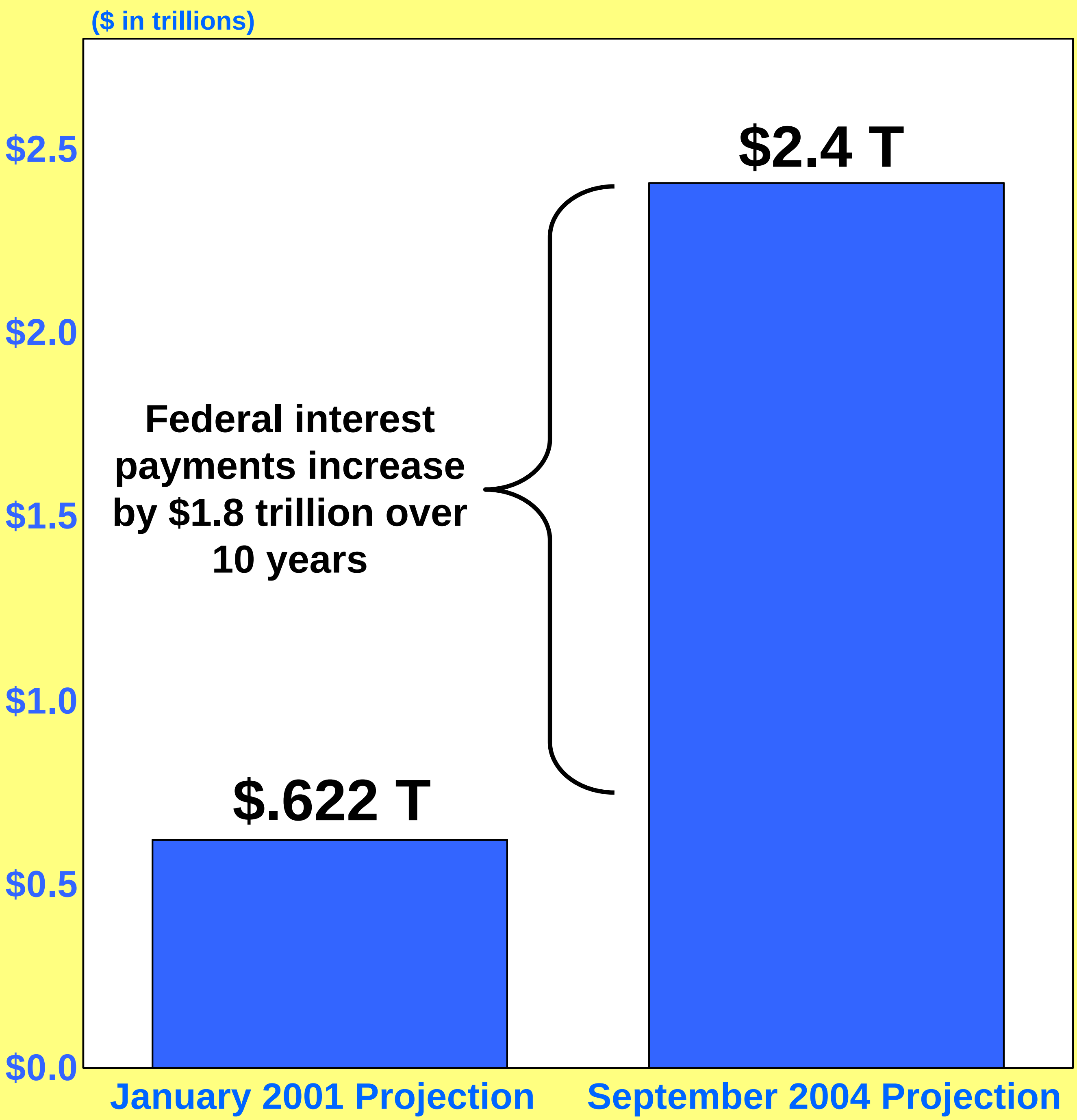
Debt Limit Increases More Than $2.2 Trillion Under President Bush



*Debt limit was not increased between August 1997 and June 2002.
Source: OMB and SBC

Total Federal Interest Costs Soar Under Bush Policies

FY 2002-11



Source: CBO, U.S Department of Treasury
Note: CBO September 2004 estimate with Bush tax cuts made permanent, Bush defense buildup, AMT reform, and ongoing war costs

Deficits and Debt Will Slow Economic Growth

“To the extent that going forward we run large sustained deficits in the face of full employment, it will in fact crowd out capital accumulation and otherwise slow economic growth.”

–CBO Director Douglas Holtz-Eakin
Testimony before the Senate Budget Committee
September 3, 2003

Higher Interest Rates Will Burden Families

For the typical American family, a one percent increase in interest rates will raise the payment on a 30-year home mortgage of $150,000 by <u>$1,200 per year</u>.

Paying Down Debt is Also a “Moral Values” Issue

“Future generations shouldn’t be forced to pay back money that we have borrowed. We owe this kind of responsibility to our children and grandchildren.”

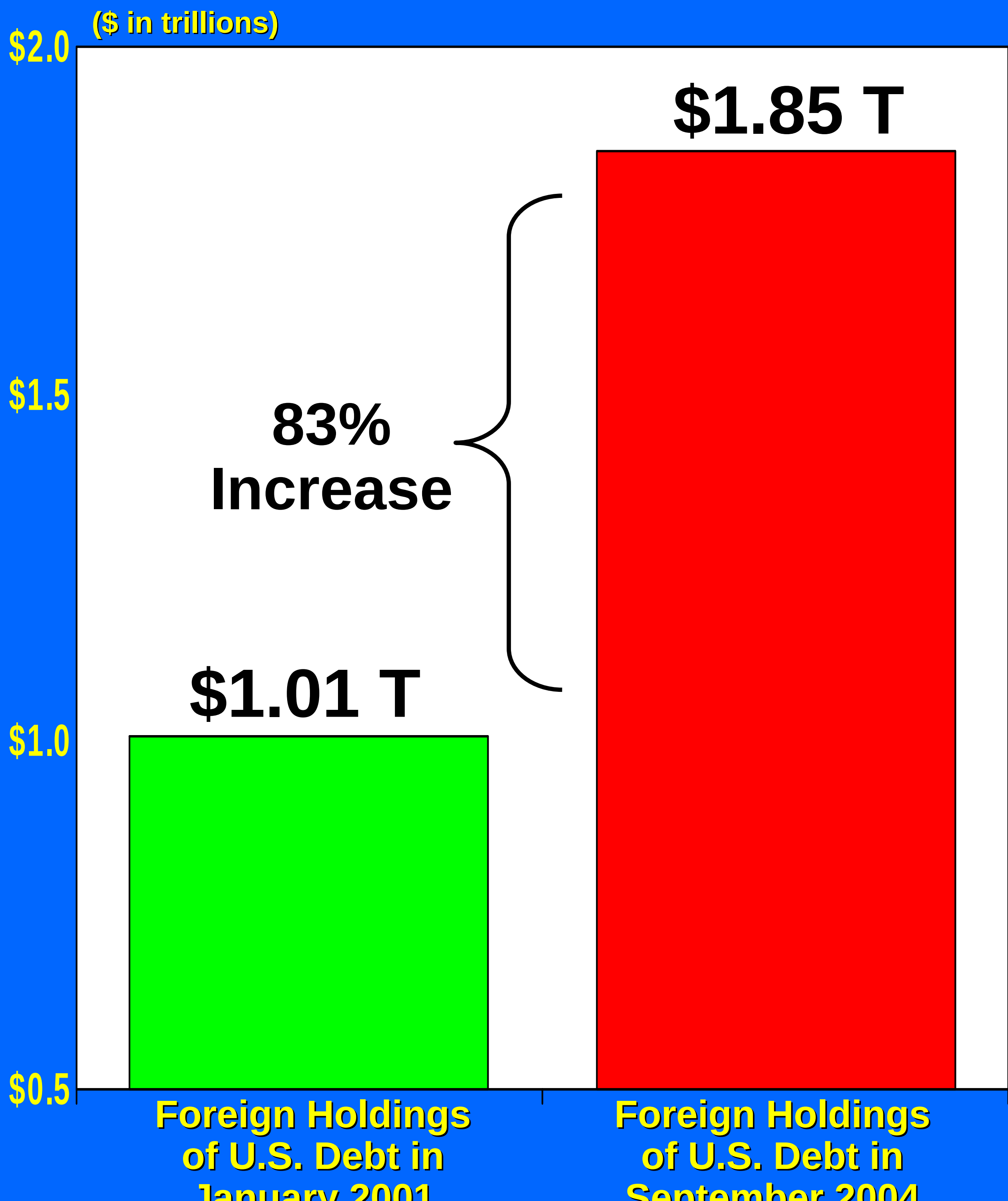
–President George W. Bush
Radio Address
March 3, 2001

Top Ten Countries Holding Our National Debt

Japan	$720 B
China	$174 B
United Kingdom	$135 B
“Caribbean Banking Centers”	$100 B
South Korea	$67 B
Taiwan	$57 B
Germany	$51 B
Hong Kong	$50 B
Switzerland	$48 B
OPEC	$43 B

Source: Department of Treasury
Note: As of September 2004

Foreign Holdings of U.S. Treasury Debt Have Increased 83 Percent Under President Bush



Source: U.S. Treasury

The New York Times

TUESDAY, OCTOBER 19, 2004

Private Investors Abroad Cut Their Investments in the U.S.

By EDUARDO PORTER

The flow of foreign capital contracted in August as private investors lost some of their appetite for American stocks and bonds, underscoring the United States' increasing dependence on financing from central banks in Asia.

The Treasury Department reported yesterday that net monthly capital flows from the rest of the world fell for the sixth time this year, declining to $59 billion from $63 billion in July.

Private investment from abroad fell by nearly half — to $37.4 billion in August from $72.9 billion the month before. Investors appear to be concerned over cooling growth and a rising American trade deficit.

Asian central banks bail out America, a nation of spenders rather than savers.

The only reason that the contraction was not more pronounced was that official financing, mainly from Asian central banks, jumped to nearly $23 billion in August from just over $6 billion in July.

Washington has demanded that China end a policy of buying dollars to reduce the value of its currency, the yuan, and make its exports more competitive in American markets. But the new data accentuated how dependent the United States has become on purchases of dollar securities by the Chinese and other Asian governments with links to the dollar.

"Foreign central banks saved the dollar from disaster," said Ashraf Laidi, chief currency analyst of the MG Financial Group. "The stability of the bond market is at the mercy of Asian purchases of U.S. Treasuries."

Net foreign purchases of United States Treasury bonds fell 35 percent, to roughly $14.5 billion, an 11-month low. Foreign governments left a particularly large footprint in this market, stepping up their net purchases to about $19 billion even as private investors sold about $4.5 billion worth.

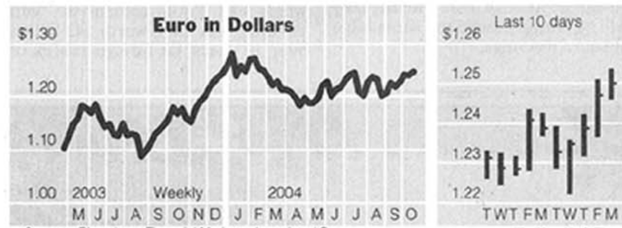
Holdings of Treasury bonds by Japan, where the central bank has also been intervening to keep the value of its currency from rising, increased by $26 billion in August, to $722 billion. Chinese official holdings rose more than $5 billion, to $172 billion.

The decline in foreign investment seems to have unsettled some investors in the bond and currency markets, who have been on tenterhooks as the American trade deficit has soared to nearly 6 percent of the nation's economic output, requiring foreign investment to finance it.

Through the first quarter of the year, financial flows into the United States exceeded the trade deficit by well over 50 percent. Last month, they barely covered the $54.2 billion deficit.

As private capital flows declined, the American financial balance has been poised precariously. As private financing dwindled, most of this coverage has been provided by foreign government finance.

"If all we have funding our current account imbalance is the good graces of foreign central banks, we are on increasingly thin ice," said Stephen S. Roach, the chief economist at Morgan Stanley. Of Washington's call for China to stop interfering in currency markets, he cautioned, "That could come back and bite us."



Sources: Bloomberg Financial Markets; Associated Press

The New York Times

CURRENCY	YESTERDAY CLOSE	CHANGE	YEAR TO DATE	52 WEEKS
British pound (in U.S. dollars)	1.7992	− .0042	+ .89%	+ 7.41%
Canadian dollar (per U.S. dollar)	1.2558	+ .0040	− 2.52	− 4.39
Euro (per U.S. dollar)	.7999	− .0014	+ .57	− 6.85
Japanese yen (per U.S. dollar)	109.27	+ .08	+ 1.78	− .09
Mexican peso (per U.S. dollar)	11.4480	− .0070	+ 1.97	+ 2.03
South Korean won (per U.S. dollar)	1145.48	+ .08	− 3.95	− 2.30
U.S.DOLLAR INDEX	87.12	− .04	− .16	− 6.05

Not all economists are that worried about the growing shortfall in the current account, the broadest measure of trade, pointing out that it is sustainable as long as Asians continue on a path of export-led growth that requires cheap currencies against the dollar.

Many economists stress, however, that this symbiotic balance between Asian and American economies will eventually come to an end.

Jeffrey Frankel, an economics professor at Harvard University, said: "The Asians are going to go on buying Treasury securities for a while, preventing the dollar from depreciating and helping keep U.S. interest rates low, which is a good thing. But not forever."

Morris Goldstein of the Institute for International Economics remarked, "This can be a story for one year or two years, not for 10 years."

If the United States were to temper its appetite for foreign money, the Chinese and Japanese could curtail their purchases of American securities without causing financial havoc. The dollar could then drift lower against Asian currencies, benefiting American exporters and manufacturers that compete with Asian imports.

But this would require Americans to increase their rate of savings. Household savings have plummeted to only 1.5 percent of personal income, from 11 percent 20 years ago. With the federal government running a budget deficit of 3.5 percent of the nation's output, the public sector hardly contributes to savings.

A disorderly situation would occur if foreign money dried up suddenly when the United States still needed it. Then, the adjustment in American savings might happen involuntarily. Interest rates would rise sharply, and the dollar could fall abruptly. This could induce a sharp economic contraction, even stagflation.

"The longer we wait," Mr. Goldstein said, "the more likely we'll have the adjustment anyway. But the adjustment will be more chaotic and sharper."

U.S. Increasingly Reliant on Financing from Asian Governments

"...[N]ew data accentuated how dependent the United States has become on purchases of dollar securities by the Chinese and other Asian governments with links to the dollar. 'Foreign central banks saved the dollar from disaster,' said Ashraf Laidi, chief currency analyst of the MG Financial Group. 'The stability of the bond market is at the mercy of Asian purchases of U.S. Treasuries.'"

–*New York Times*, "Private Investors Abroad Cut Their Investments in the U.S."
By Eduardo Porter
October 19, 2004

Large Amount of Foreign-Held Debt Could Lead to Economic Turmoil

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–*New York Times*, “Private Investors Abroad Cut Their Investments in the U.S.”
By Eduardo Porter
October 19, 2004

THE WALL STREET JOURNAL.

MONDAY, NOVEMBER 8, 2004

Dollar Lacks Backers as Deficit Worries Dominate

By SILVIA ASCARELLI
And TOM SIMS

What is going to prop up the sliding dollar?

Despite unexpectedly strong job creation and another jump in the stock market, the dollar dropped against key currencies on Friday, breaking through the record low against the euro set nine months ago.

FOREX VIEW

Currency strategists say the dollar's inability to capitalize on news of 337,000 jobs created in October reveals the market's skepticism about whether a second term for President Bush will reverse deficit spending and a record current-account deficit, the broadest gauge of the nation's balance of payments.

Many outside the U.S. fear that last week's election results, which returned Mr. Bush to the White House and gave Republicans firm control of Congress, will give the government even more latitude to spend, worsening the deficit.

Investors are keeping a wary eye out for government moves to support the U.S. currency. Actual central-bank intervention in foreign-exchange markets doesn't appear imminent. And the lack of actual intervention "is going to make any verbal intervention less scary," said Stephen Jen, a currency strategist at Morgan Stanley.

European officials haven't appeared overly concerned about recent exchange rates. And there is the perception among currency traders that the U.S. is happy with a weak dollar and the competitive advantage it brings for U.S. industry.

That could leave it to Japan to take a stand to protect its exporters from being priced out of U.S. markets by the rising yen. Japanese Finance Minister Sadakazu Tanigaki repeated his warning that he is ready to take action against the yen's strength if needed.

On Friday in New York, the euro hit a record of $1.2968 and ended at $1.2966, up from $1.2872 late the previous day. Two months ago, the euro traded at about $1.20. The euro had slipped below parity with the dollar soon after its launch in 1999. The euro's previous record—$1.2925—was set in February.

The dollar also slid against Japan's currency, ending in New York at a 6½-month low of 105.59 yen, down from 106 yen late Thursday.

Currency experts warn that, with no end to the slide in sight, even traditional buyers of U.S. stocks and bonds such as foreign central banks and international money managers may be becoming less willing to finance the U.S. current-account deficit. As the current-account deficit expands, it effectively requires foreigners to purchase U.S. assets to help redress the balance. But some observers caution that the traditional buyers of those assets could demand higher interest rates, a cheaper dollar (so the assets are cheaper to buy) or a combination of the two.

The dollar selloff "is becoming increasingly broadly based," said Mansoor Mohi-uddin, chief currency strategist at UBS in London. "It's not just short-term speculators but also medium-term asset allocators," said Mr. Mohi-uddin, who predicts the euro will trade at $1.40 within 12 months.

In coming weeks, investors will look for indications regarding how Mr. Bush plans to run the country's finances in his new four-year term.

But few expect a turnaround in the dollar's fortunes anytime soon. "What needs to happen to make people more positive about the dollar can only happen slowly," said Aziz McMahon, a senior currency strategist at ABN Amro in London.

Indeed, when the dollar fell sharply during an 18-month period a decade ago and hit a record low against the German mark, considered the anchor of what became the euro, it took about two years for the dollar to recover. As now, investors worried about U.S. budget and current-account deficits. Only after investors saw that the U.S. government curbed its spending did the dollar turn around convincingly. It continued to surge into late 2000.

The euro went through its own confidence crisis a few years ago. It was valued at less than $1 for about 2½ years between 2000 and mid-2002.

Value of Dollar Falls as Foreign Investors See Deficits Climbing

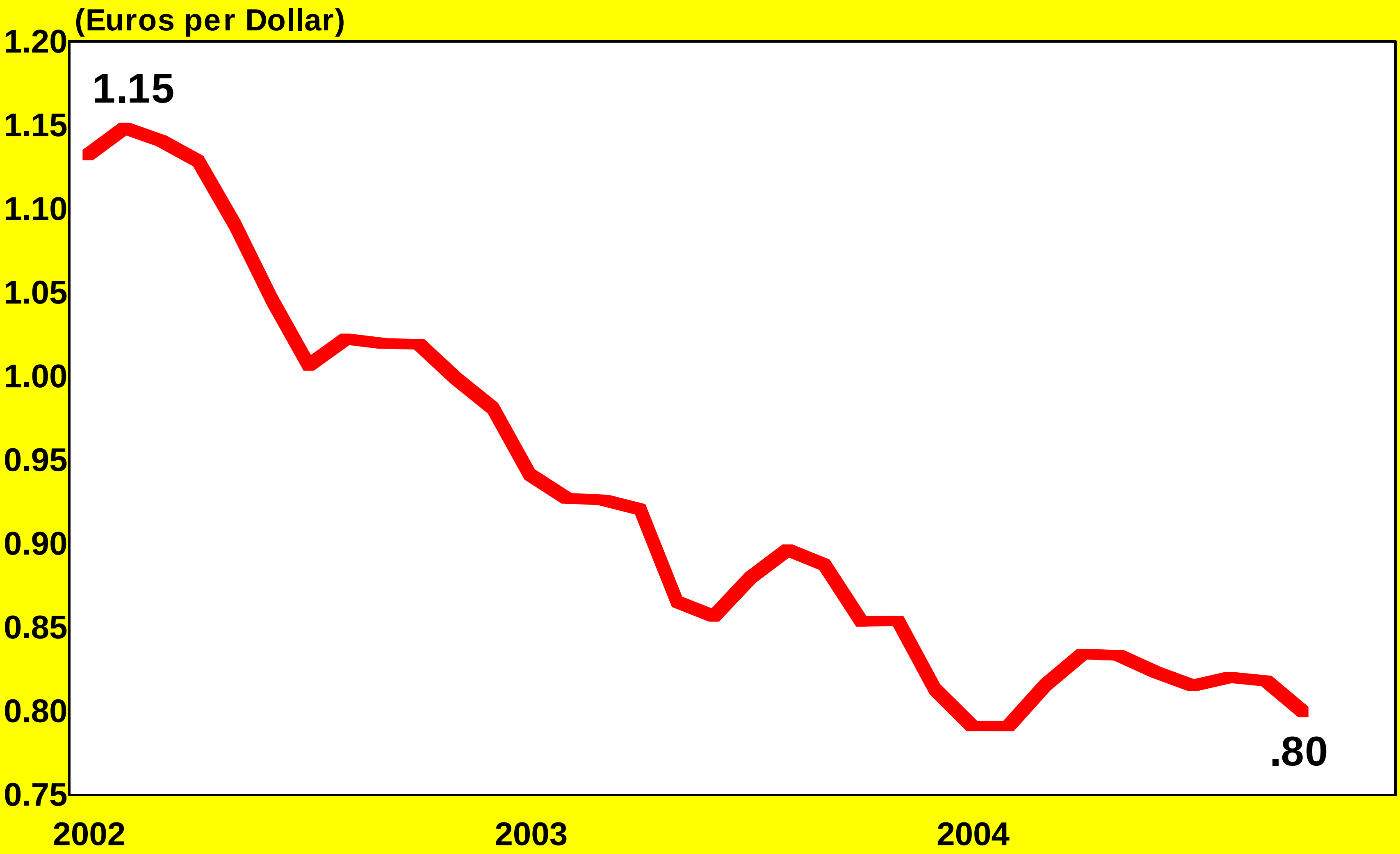
"What is going to prop up the sliding dollar?

"… Currency strategists say the dollar's inability to capitalize on news of 337,000 jobs created in October reveals the market's skepticism about whether a second term for President Bush will reverse deficit spending and a record current-account deficit, the broadest gauge of the nation's balance of payments.

"Many outside the U.S. fear that last week's election results, which returned Mr. Bush to the White House and gave Republicans firm control of Congress, will give the government even more latitude to spend, worsening the deficit."

–*Wall Street Journal*, "Dollar Lacks Backers as Deficit Worries Dominate"
By Silvia Ascarelli and Tom Sims
November 8, 2004

Dollar Declines More Than 30 Percent Against Euro



Source: Federal Reserve Board

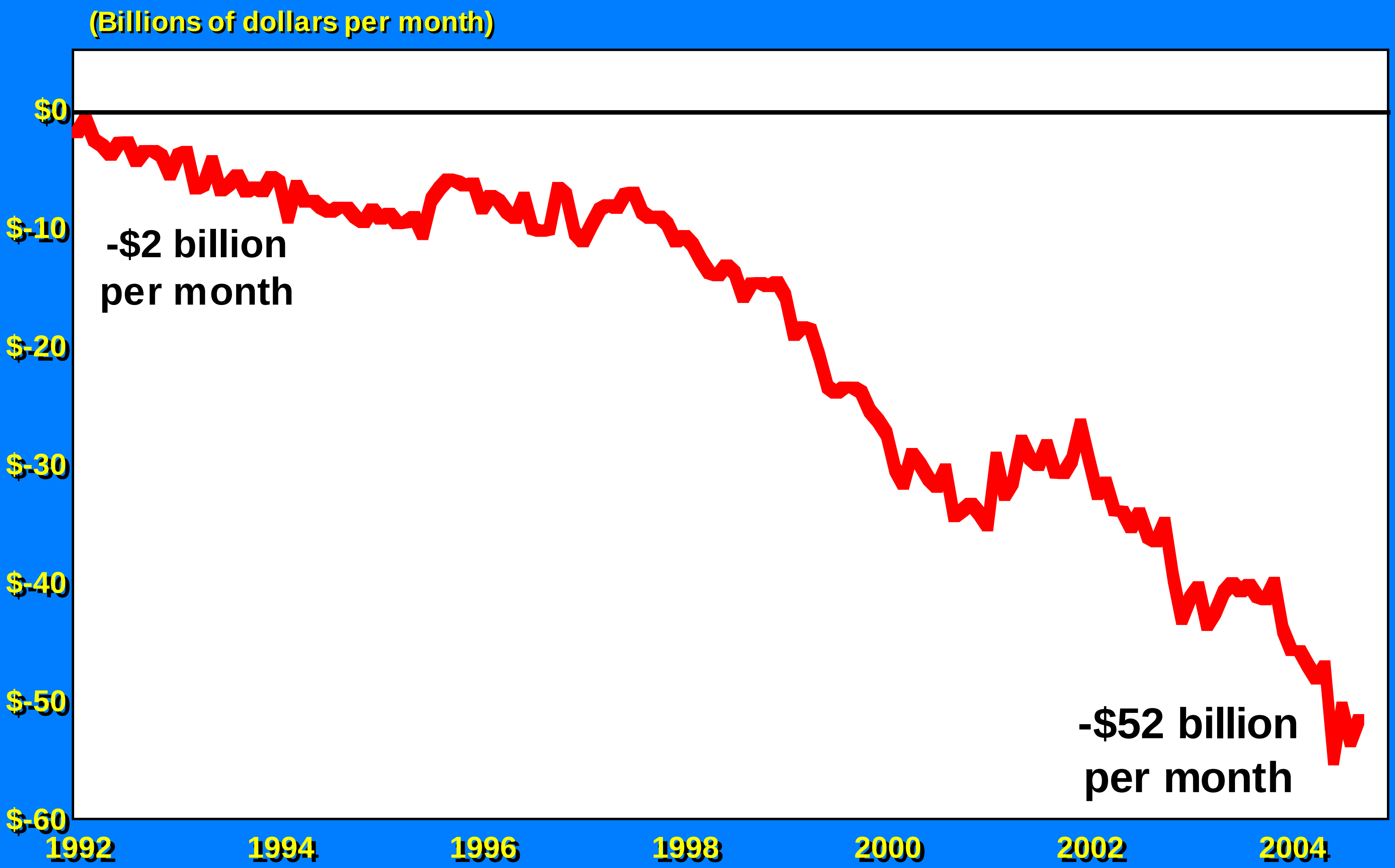
Nov 8

CBO Director Holtz-Eakin Believes Deficits Can No Longer Be Blamed on Weak Economy

"Policy choices will determine where we go. We will not grow our way out of this. It is no longer the case that we can blame everything on the economy."

– CBO Director Douglas Holtz-Eakin
As quoted in *New York Times*
November 4, 2004

U.S. Trade Deficit



Source: Department of Commerce

The Washington Post
Wednesday, November 17, 2004

Robert J. Samuelson

The Dangerous Dollar

George Bush hasn't much discussed what could be his biggest economic problem. It's not budget deficits or jobs. It's the possible crash of the dollar on foreign exchange markets. Even if Bush understood it, he would be hard-pressed to explain it to the public. Worse, there are no obvious ways to prevent it. Nor is it certain how big the threat is. Little wonder Bush hasn't said much. If John Kerry had won, the situation would have been the same. But a dollar crash, if it occurred, could trigger a terrifying global slump.

The dollar lubricates the world economy, having replaced gold as the major international currency. Huge amounts of trade and cross-border investment are conducted in dollars. In some form, a "dollar problem" has long existed. After World War II there was a "dollar gap": Europe and Japan didn't have enough dollars to import the food and machinery needed for recovery. The United States filled the gap with foreign aid and policies encouraging multinational American firms to invest abroad. These policies provided dollars, although the United States still ran big trade surpluses. Actually, foreigners often used the dollars to buy American goods.

The problem now is similar and different. As in the 1950s, today's outflow of dollars stimulates the global economy. Unlike the 1950s, it involves huge U.S. trade and current account deficits. (The "current account" includes trade plus other "current" overseas payments, such as travel, freight costs and dividend payments.) In 1990 the U.S. current account deficit was $79 billion, or 1.4 percent of gross domestic product. In 2004, it's expected to hit an unprecedented $665 billion, or 5.6 percent of GDP, says economist Nariman Behravesh of Global Insight. The ballooning deficit has two basic causes.

First, the American economy has grown faster than other advanced economies. Since 1990 U.S. economic growth has averaged 3 percent annually, compared with 2 percent for the European Union and 1.7 percent for Japan. America's higher growth sucks in imports; Europe's and Japan's slower growth hurts U.S. exports.

Second, the global demand for dollars props up its exchange rate, making U.S. exports more expensive and U.S. imports cheaper. Indeed, many countries, particularly in Asia, fix their currencies to keep their exports competitive in the U.S. market. Instead of allowing surplus dollars to be sold on foreign exchange markets—lowering the dollar's value—government central banks in Japan, China and other Asian countries have purchased more than $1 trillion of U.S. Treasury securities. Private investors have also bought lots of U.S. stocks and bonds. All told, foreigners own about 13 percent of U.S. stocks, 24 percent of corporate bonds and 43 percent of U.S. Treasury securities.

Up to a point, this arrangement benefits everyone. The world gets needed dollars; Americans get more imports, from cars to clothes. But we may now have passed that point. Hazards may outweigh benefits. The world may be receiving more dollars than it wants. A sell-off could spill over into the stock and bond markets and cause a deep global recession. Here's how.

Foreign traders and investors sell dollars on foreign exchange markets. The dollar declines in relation to the euro, the yen and other currencies. The dollar's decline means that the value of foreigners' investments in U.S. stocks and bonds—measured in their own currencies—is also dropping. So foreigners stop buying U.S. stocks and start selling what they have. The stock market drops sharply.

Presto: the makings of a global recession. The stock market slide causes American consumer confidence and spending to weaken. If foreigners also flee the bond market, long-term interest rates on bonds and mortgages might rise. Higher currencies make Europe's and Japan's exports less competitive. Their industries stagnate. The United States, Europe and Japan constitute about half the global economy. Their recessions would hurt the Asian, Latin American and African countries that export to them. Markets interconnect; weakness spreads. It's grim.

Note, however, that the dollar's vulnerability is a symptom of something else: the addiction of Europe and Asia to exporting to the United States. If their economies grew faster on their own, the massive U.S. payments deficits wouldn't have emerged. The dollar would have quietly drifted down. Foreigners would have invested less in the United States, because they'd have more investment opportunities at home. But Europe suffers from suffocating taxes and regulations. Japan has long favored export-led growth. And about 35 percent of China's exports go to the United States, says economist Nicholas Lardy.

There's a stubborn contradiction. The world may be getting more dollars than it wants, but it likes the source of those dollars: large U.S. trade deficits. China has resisted U.S. pressure to raise the value of its currency; Europeans and Japanese deplore the recent increases in their currencies. Because the dollar's vulnerability reflects other countries' weaknesses, no American president can cure it alone. Contrary to popular wisdom, for example, U.S. budget deficits don't cause U.S. trade deficits. In the late 1990s, trade deficits widened even though budget deficits declined.

No one knows what will happen. The massive U.S. payments deficits could continue for years, with foreigners investing surplus dollars in American stocks and bonds. Gradual shifts in currency values might reduce the world's addiction to exporting to the United States. Or something might cause a dollar crash tomorrow. In that case, massive intervention by government central banks (buying unwanted dollars) might avert a calamity. Or it might not. We're in uncharted waters. If we hit a shoal, it will be bad for everyone.