

Allianz Global Investors Capital

# Burden of Debt

The Future of Deficit Spending, the Dollar and its Impact on Portfolios

National Conference on Public Employee Retirement Systems  
May 3, 2010

**Allianz**   
Global Investors

# Burden of Debt

The Future of Deficit Spending, the Dollar and its Impact on Portfolios

## Agenda

U.S. Debt and Deficits  
History and Projections



Policy Outcomes  
Taxes and Currencies



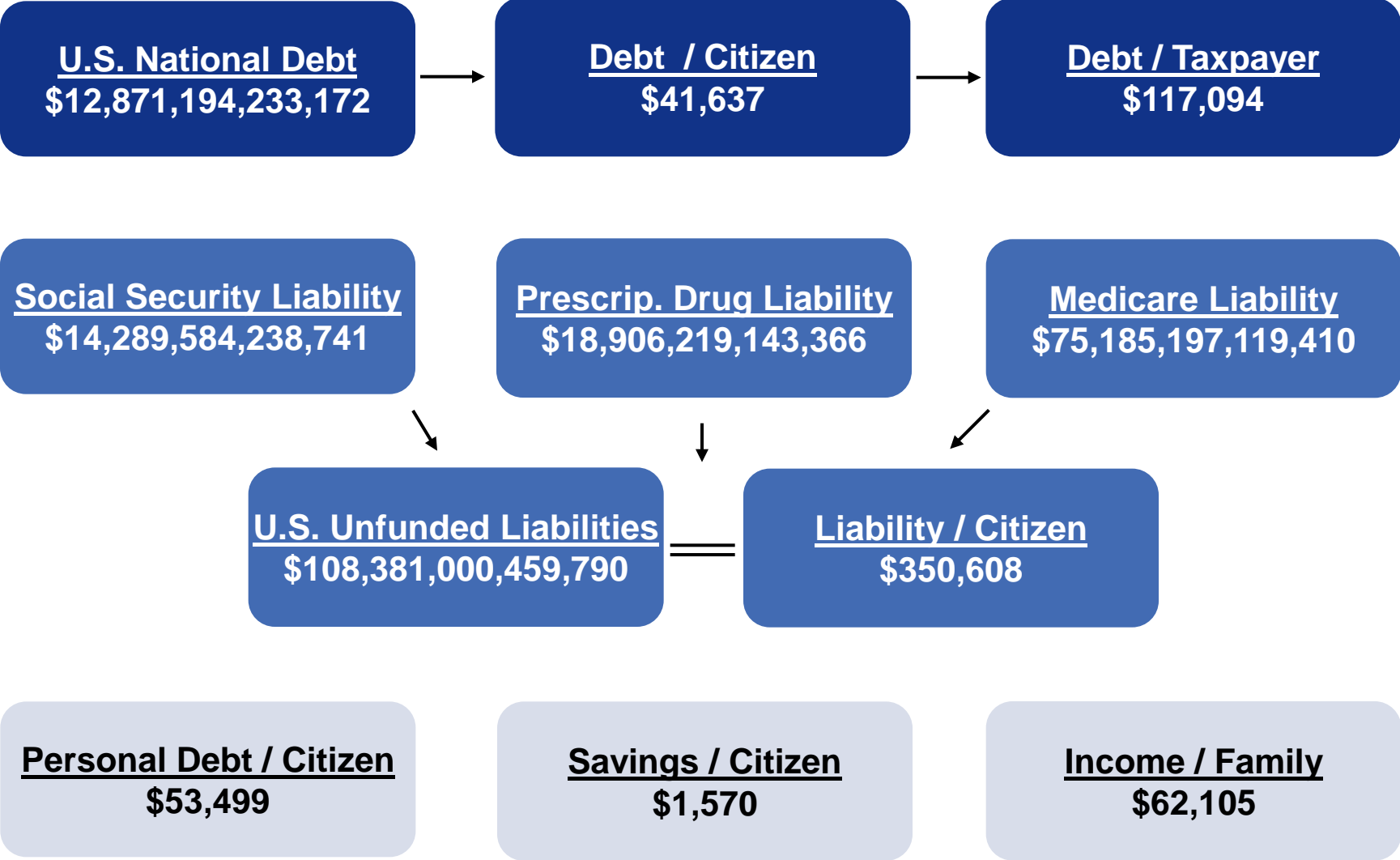
Managing the Future  
Where Do We Go  
from Here?

# The U.S. Balance Sheet



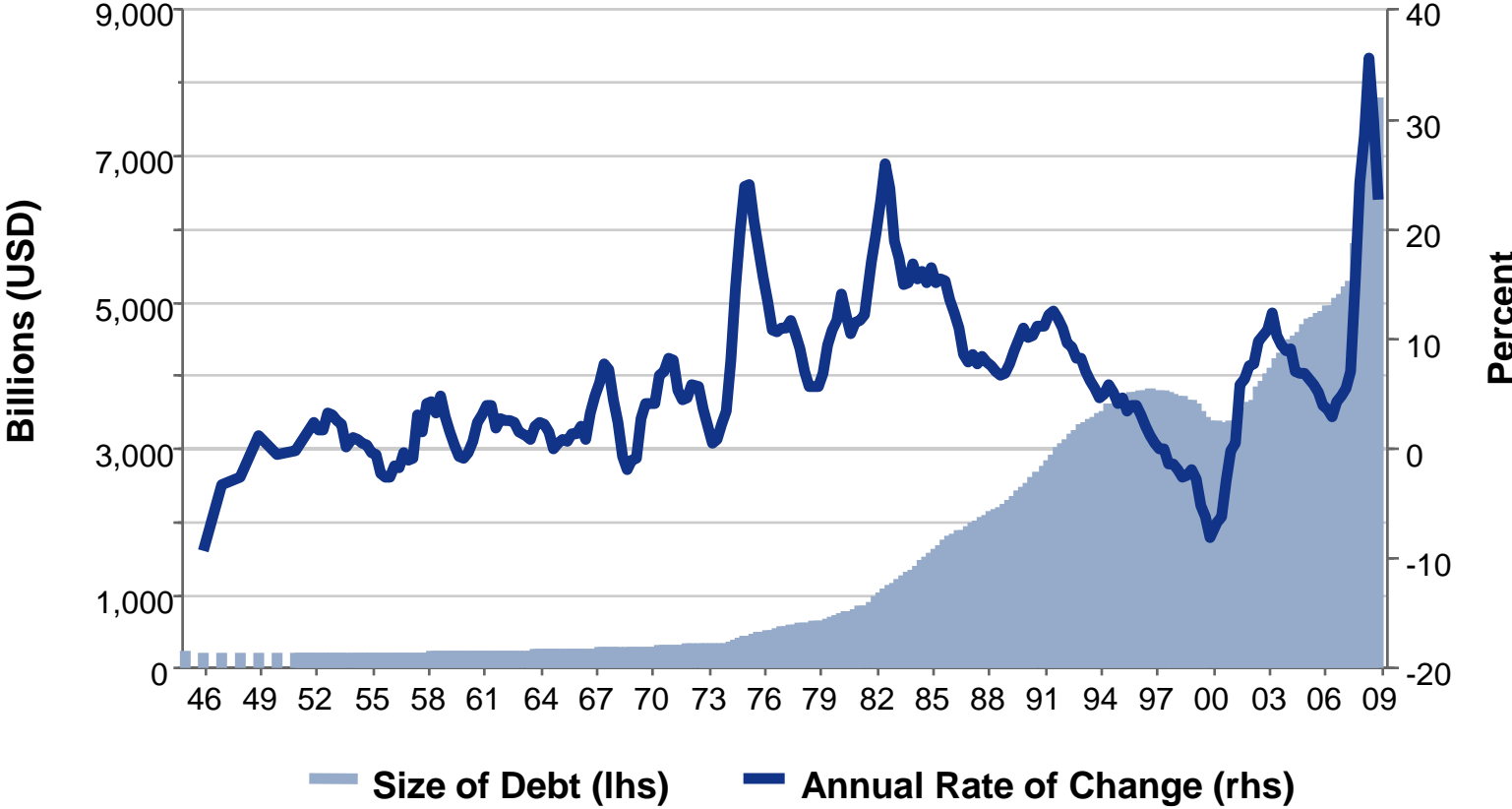
Source: usdebtclock.org; Allianz Global Investors Capital; As of 23-Apr-10

# The U.S. Balance Sheet



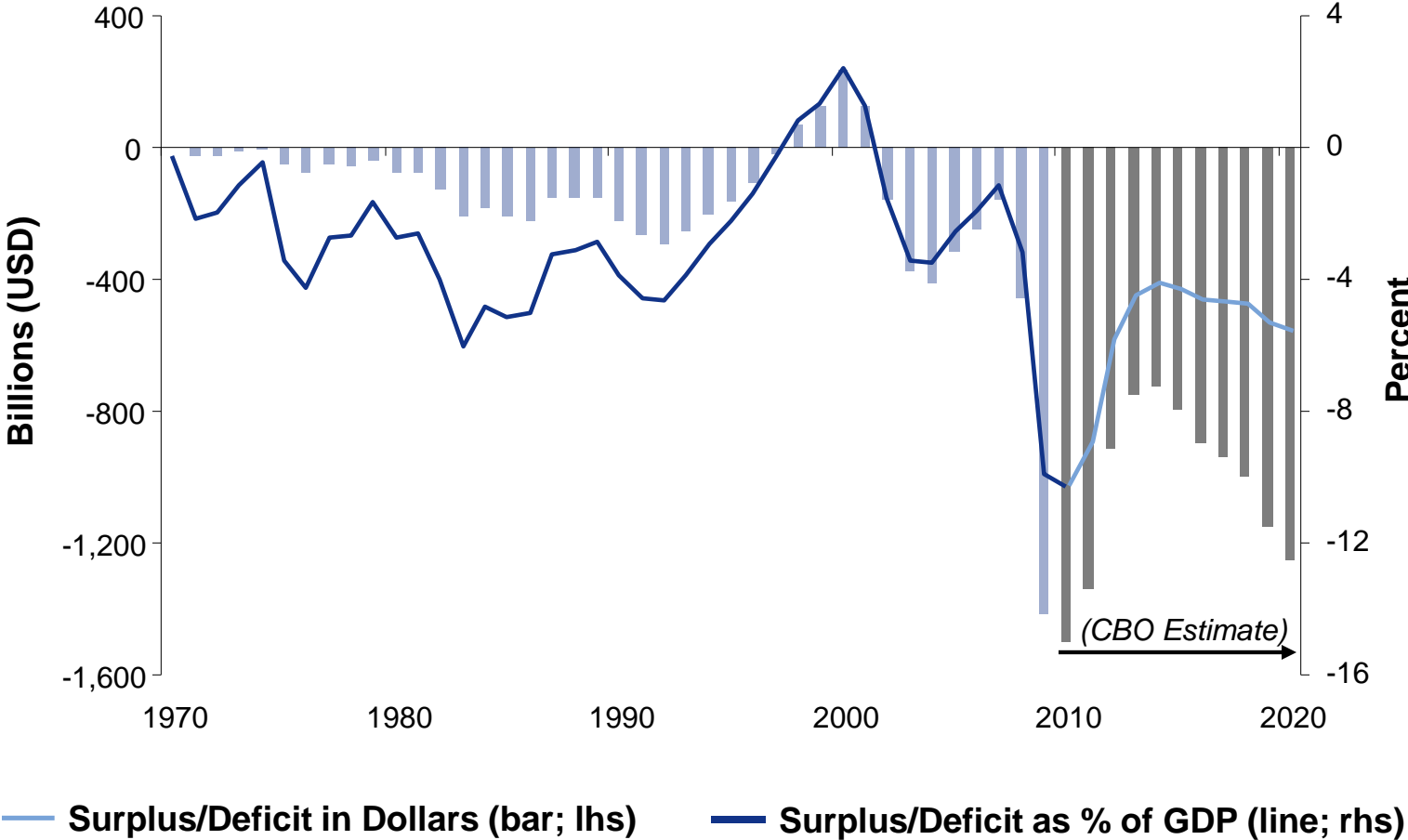
Source: usdebtclock.org; Allianz Global Investors Capital; As of 23-Apr-10

# U.S. Federal Debt Outstanding and Annual Growth Rate



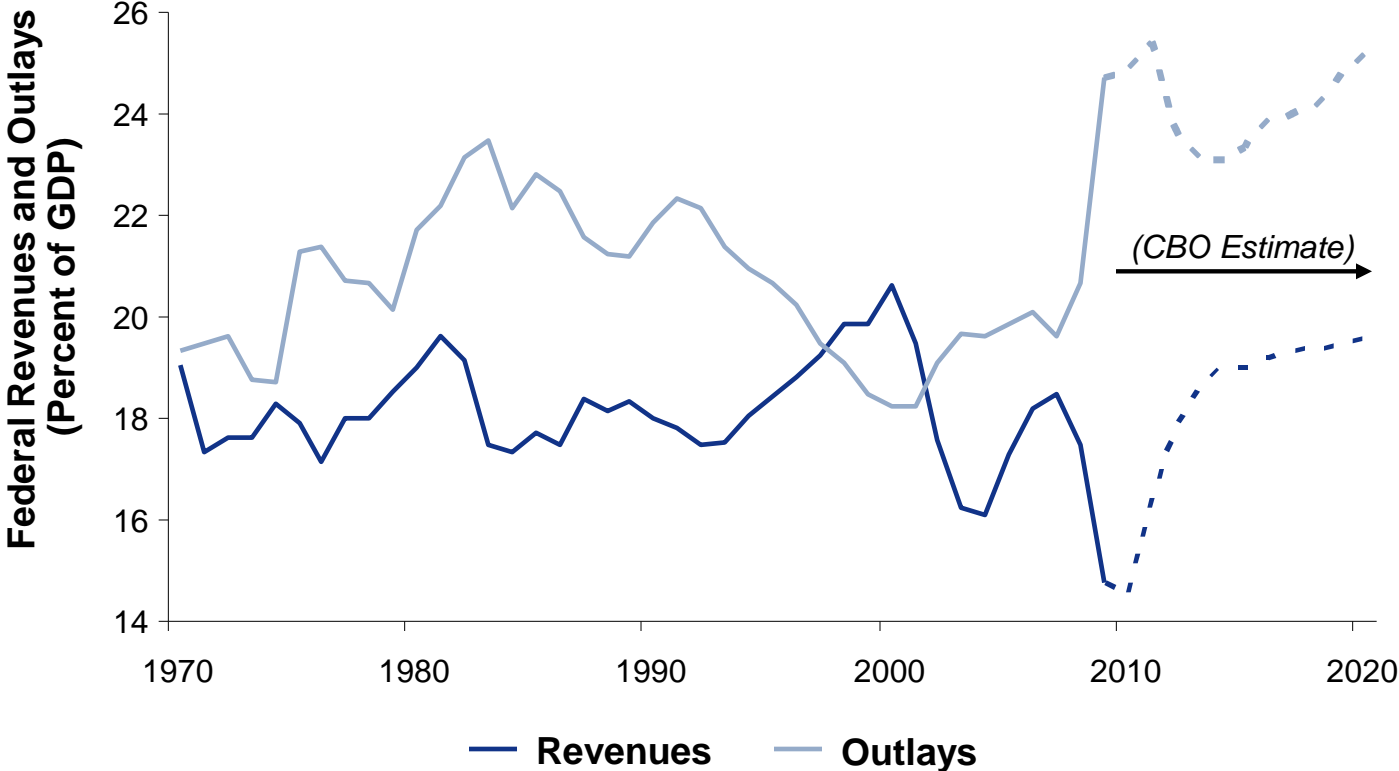
Source: U.S. Treasury; U.S. Bureau of Economic Analysis; White House; Allianz Global Investors Capital; As of 2-Feb-10

# Projection: U.S. Federal Budget Surplus / Deficit Spending



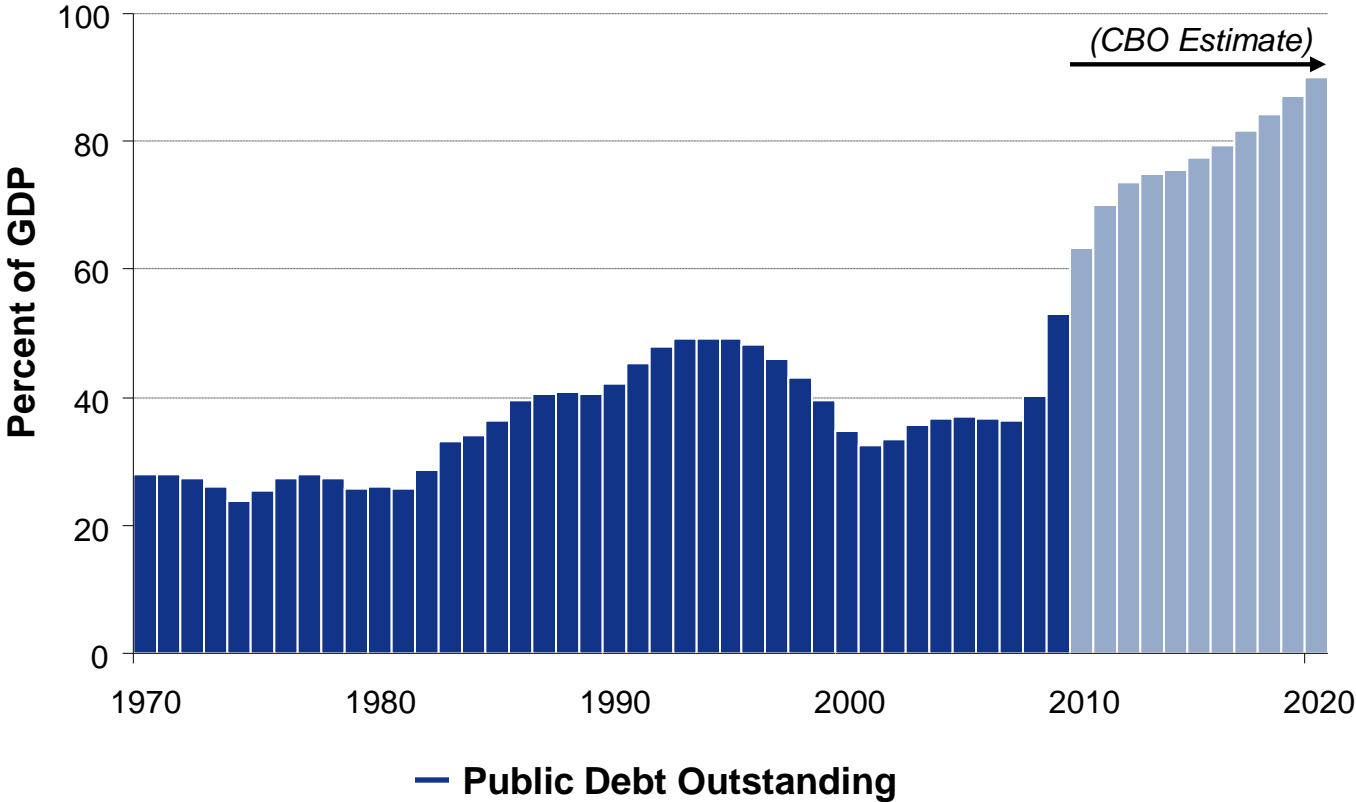
Source: Congressional Budget Office; Allianz Global Investors Capital; As of 24-Mar-10

# Projection: U.S. Federal Budget Revenues and Outlays



Source: Congressional Budget Office; Allianz Global Investors Capital; As of 24-Mar-10

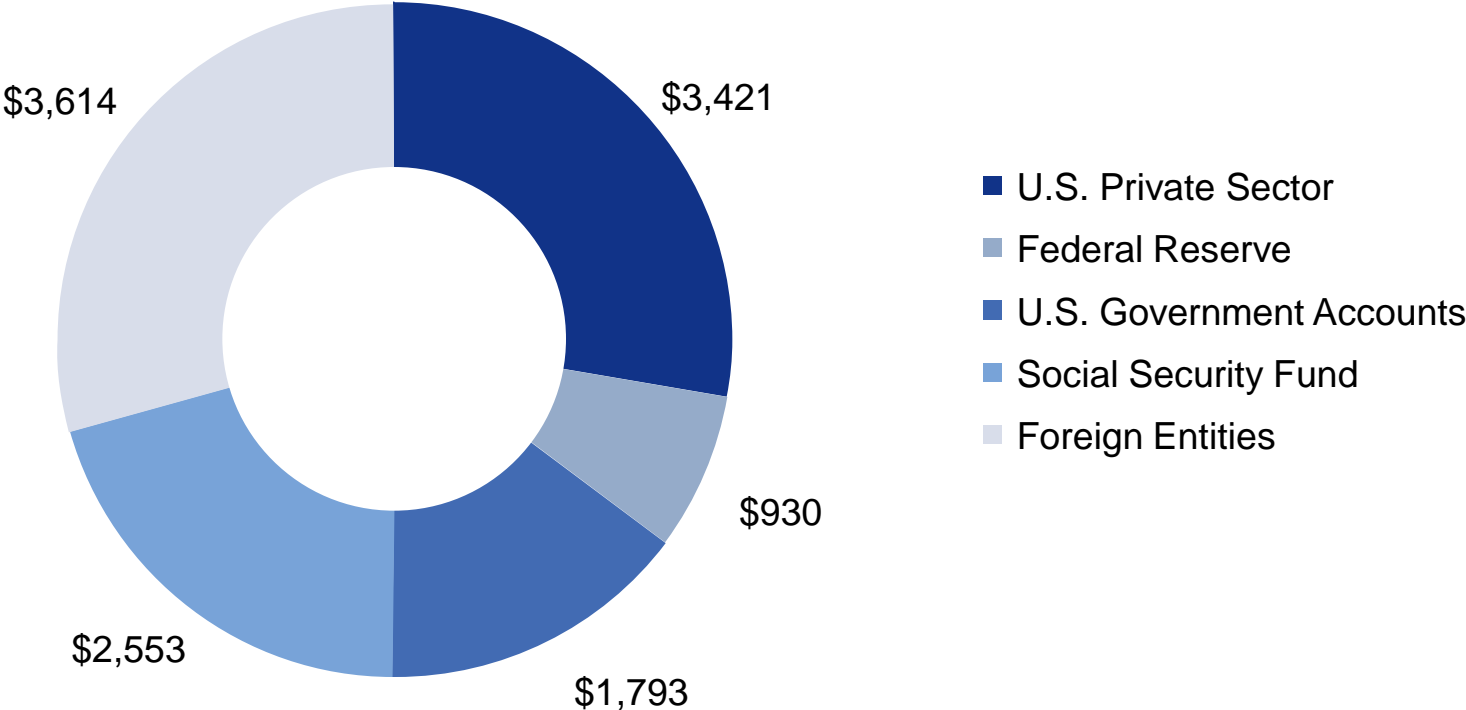
# Projection: U.S. Federal Debt Held by the Public



Source: Congressional Budget Office; Allianz Global Investors Capital; As of 24-Mar-10

# U.S. Government Debt Ownership

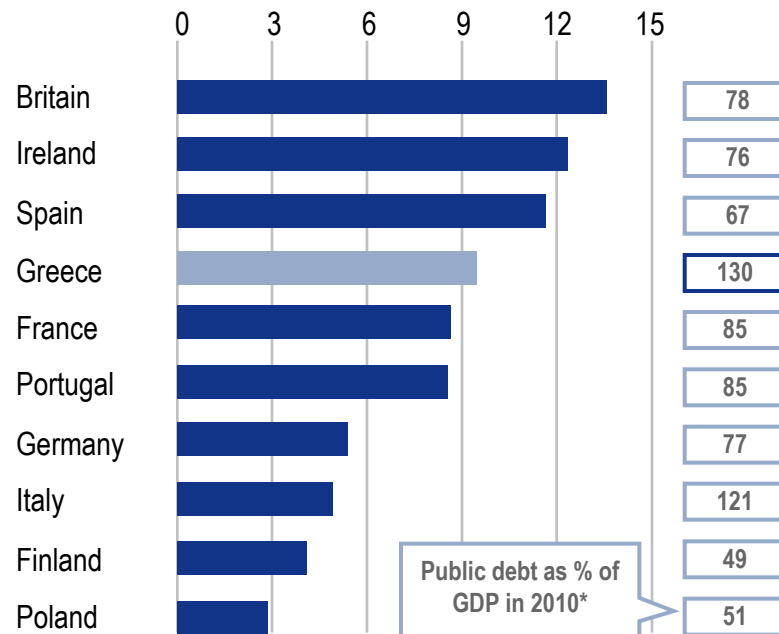
**Total: \$12,311 Billion (USD)**



Source: Bank of America – Merrill Lynch; U.S. Treasury Department; Allianz Global Investors Capital; As of 5-Apr-10

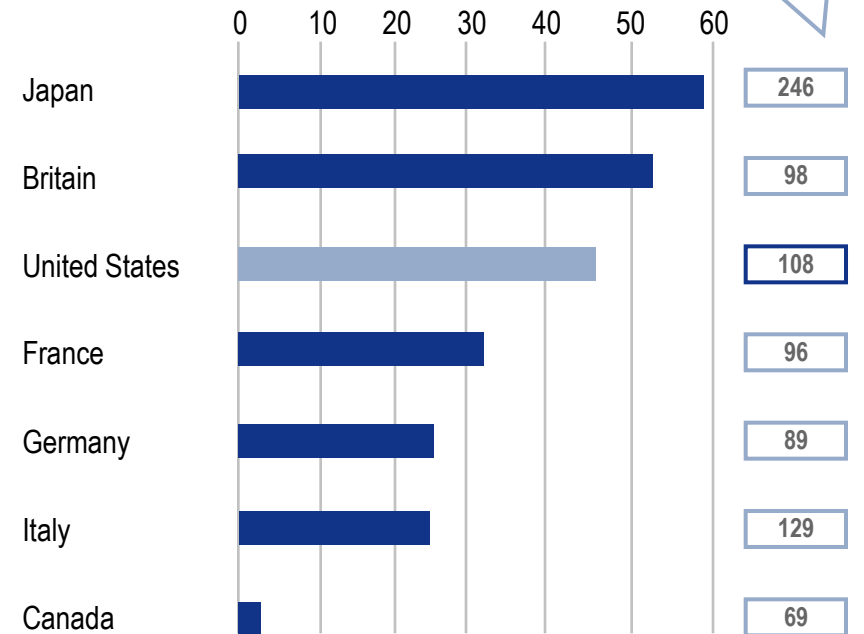
# Global Government Deficits and Debt Levels

**Budget deficit, % of GDP, 2010\***



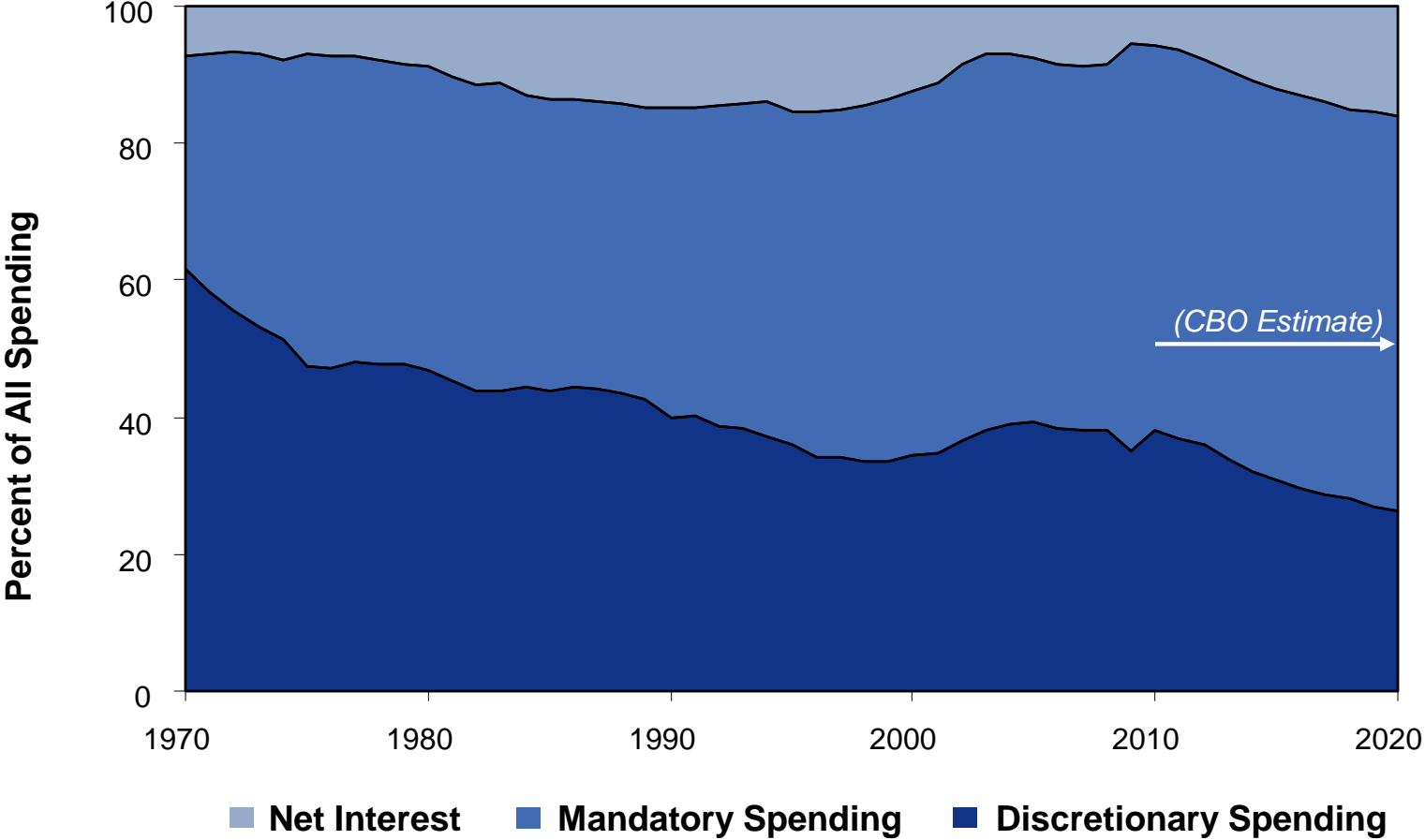
**Government debt as % of GDP**

Percentage point increase  
2007-14, forecast



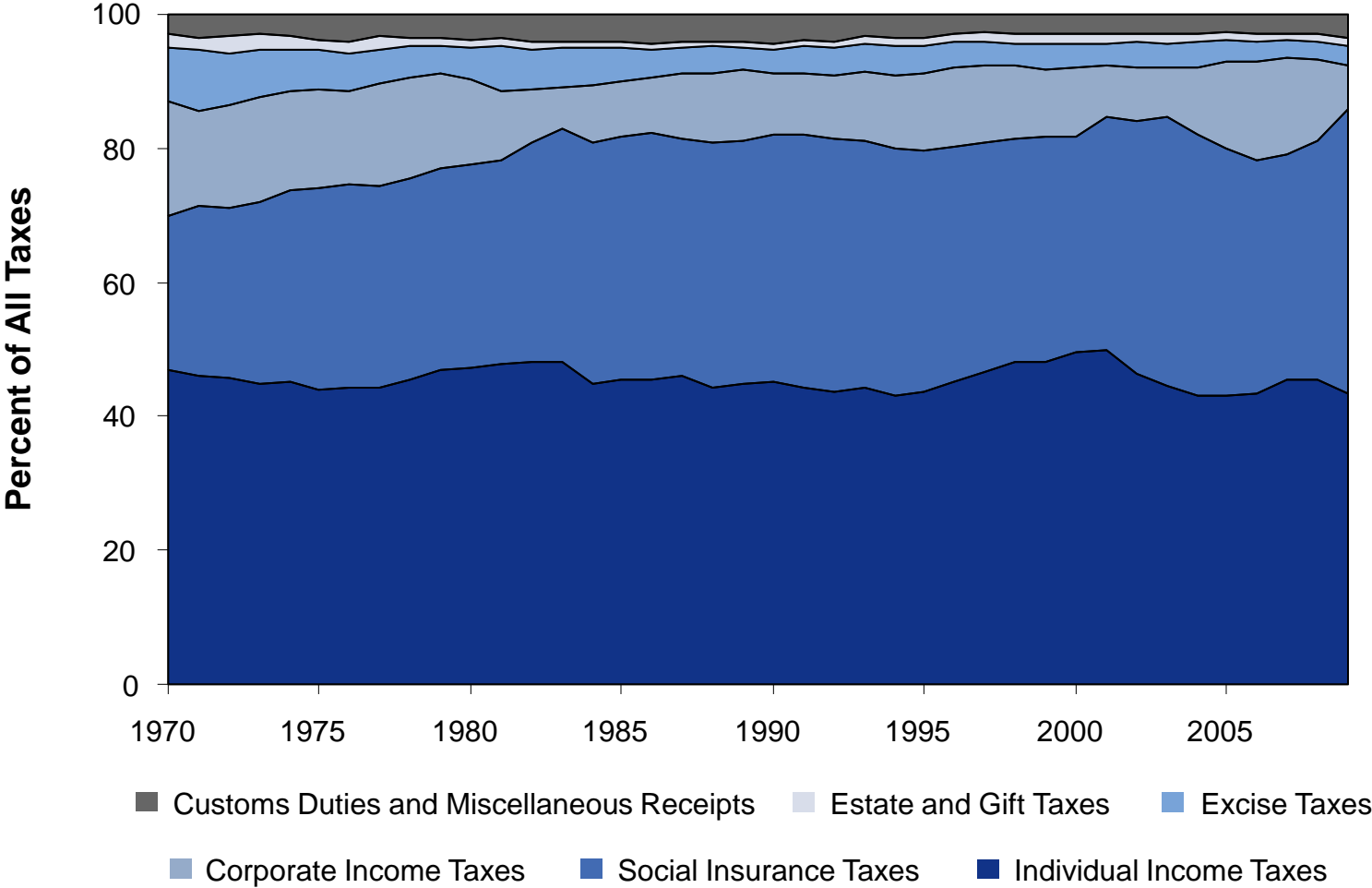
\*Forecast (Economist Intelligence Unit)

# Components of U.S. Federal Outlays (Spending)



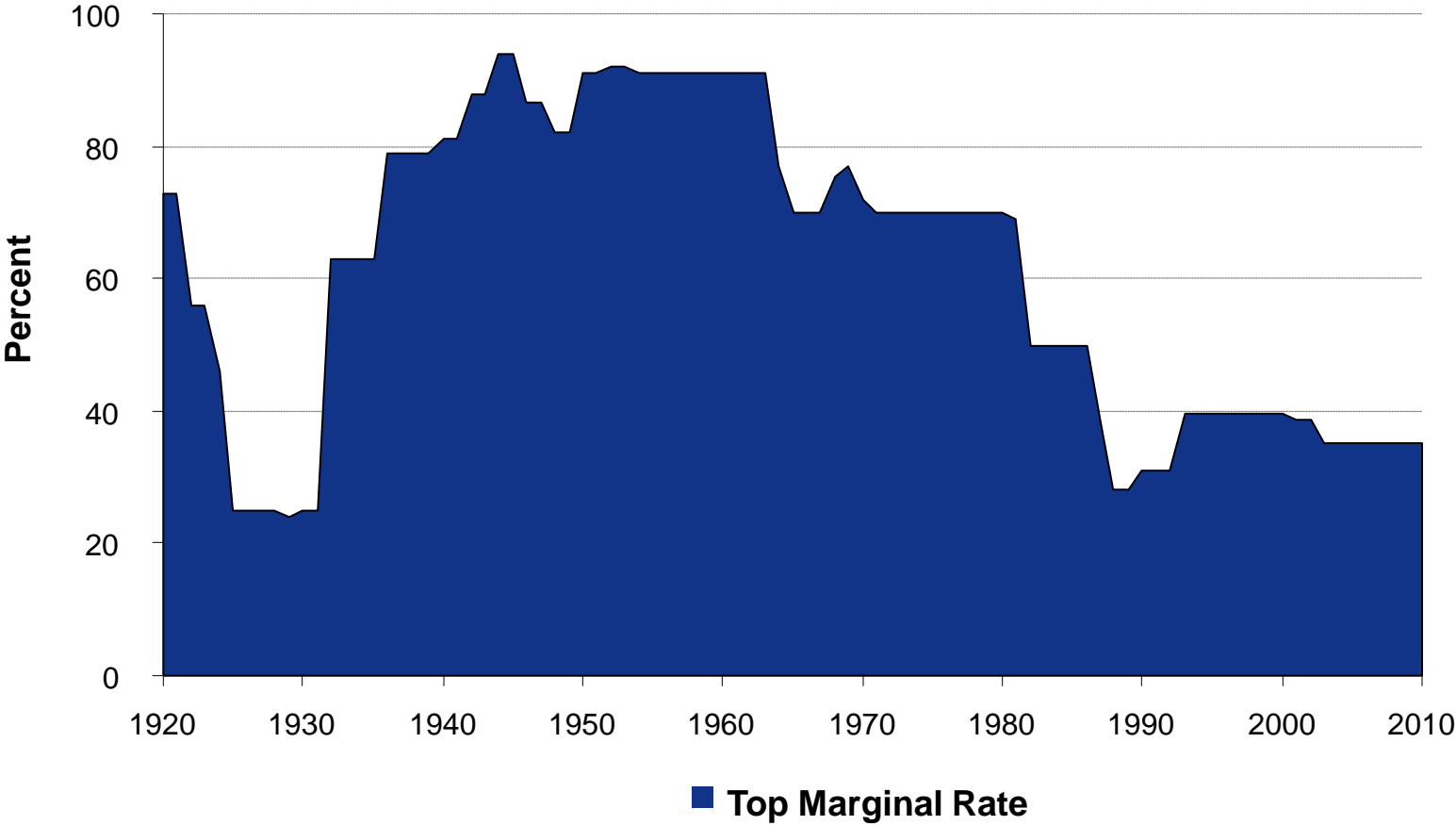
Source: Congressional Budget Office; Allianz Global Investors Capital; As of 26-Jan-10

# Components of U.S. Federal Revenues (Taxes)



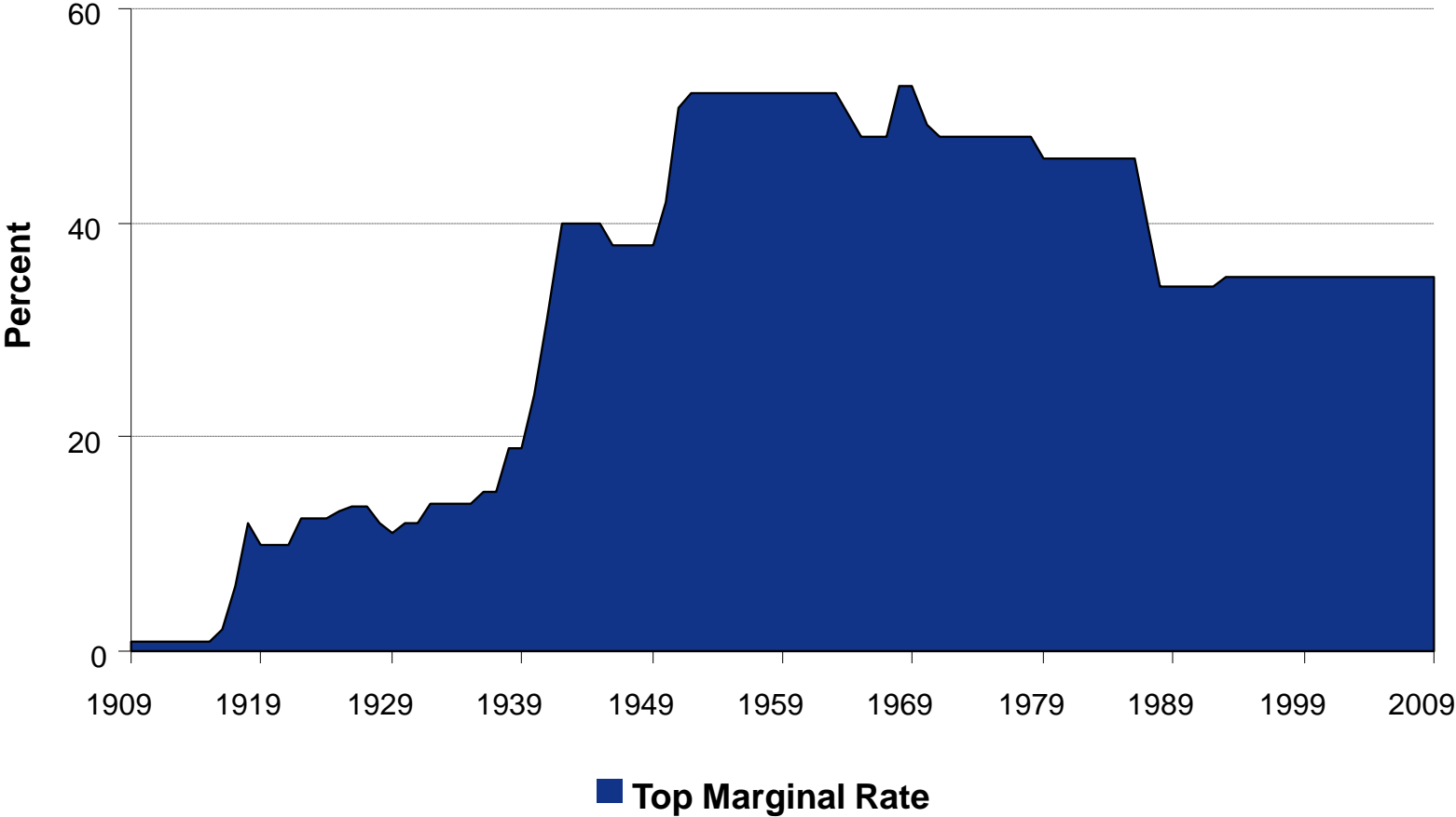
Source: Congressional Budget Office; Allianz Global Investors Capital; As of 26-Jan-10

# U.S. Personal Income Tax Rates



Source: Tax Policy Center; Allianz Global Investors Capital; As of 26-Oct-09

# U.S. Corporate Income Tax Rate (Federal)



Source: Tax Policy Center; Allianz Global Investors Capital; As of 12-Apr-10

# Global Corporate Tax Rates

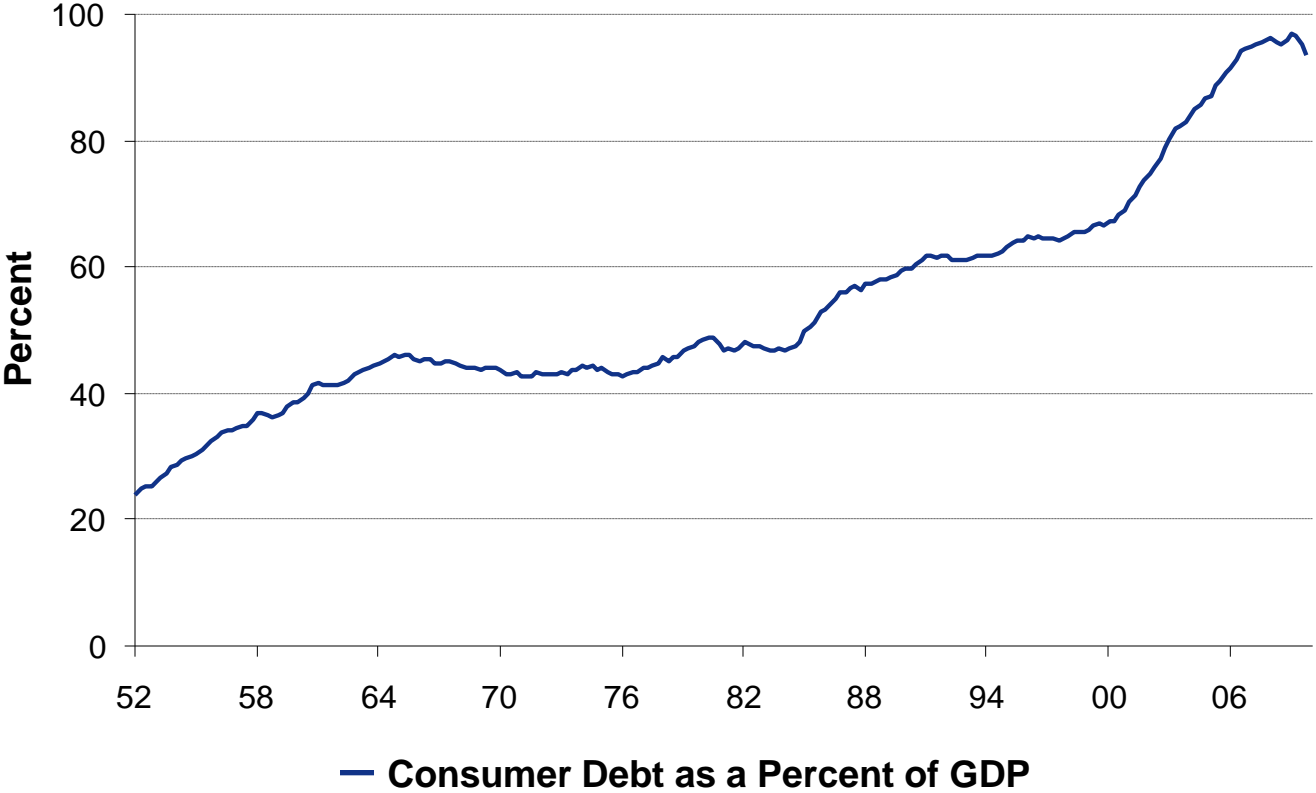
Country	Adjusted Central Government Corporate Tax Rate	Sub-Central Government Corporate Tax Rate	Combined Corporate Tax Rate
Ireland	12.5		12.50
Poland	19.0		19.00
Slovak Republic	19.0		19.00
Czech Republic	20.0		20.00
Hungary	20.0		20.00
Korea	22.0	2.2	24.20
United Kingdom	28.0		28.00
Australia	30.0		30.00
Germany	15.825	14.35	30.18
Canada	19.0	12.30	31.32
France	34.43		34.43
<b>United States</b>	<b>32.8</b>	<b>6.30</b>	<b>39.10</b>
Japan	27.99	11.55	39.54

Note: United Kingdom rate effective as of 5-Apr-09; Australia rate effective as of 1-Jul-09; all other countries effective as of 1-Jan-09  
Source: Organisation for Economic Co-operation and Development; Allianz Global Investors Capital; As of 10-Apr-10

# Global Value Added Tax Rates

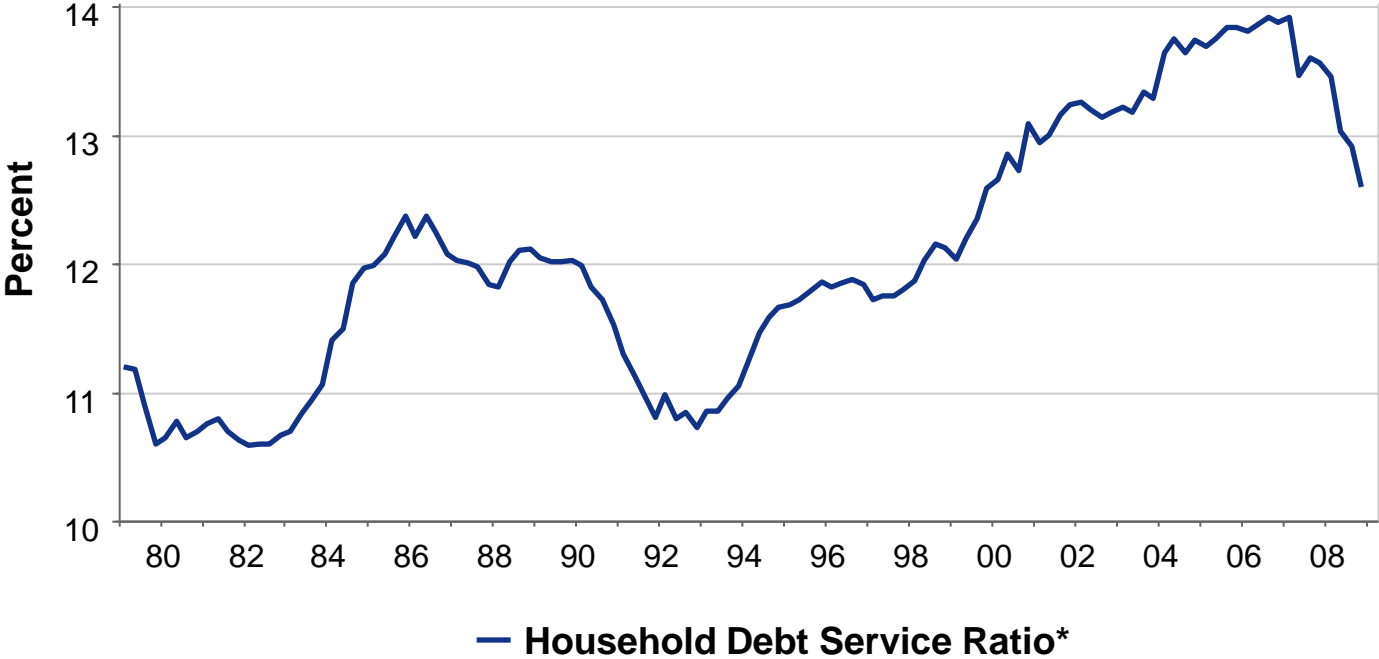
VAT/GST rates in select OECD member countries																				
	Implemented	Standard rate																		
		1976	1980	1984	1988	1990	1992	1994	1996	1998	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Australia	2000	-	-	-	-	-	-	-	-	-	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Canada	1991	-	-	-	-	-	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	6.0	5.0	5.0
Czech Republic	1993	-	-	-	-	-	-	23.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	19.0	19.0	19.0	19.0	19.0
France	1968	20.0	17.6	18.6	18.6	18.6	18.6	18.6	20.6	20.6	20.6	19.6	19.6	19.6	19.6	19.6	19.6	19.6	19.6	19.6
Germany	1968	11.0	13.0	14.0	14.0	14.0	14.0	15.0	15.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	19.0	19.0	19.0
Greece	1987	-	-	-	16.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	19.0	19.0	19.0	19.0
Hungary	1988	-	-	-	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	20.0	20.0	20.0	20.0
Ireland	1972	20.0	25.0	23.0	25.0	23.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	21.5
Japan	1989	-	-	-	-	3.0	3.0	3.0	3.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Korea	1977	-	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Poland	1993	-	-	-	-	-	-	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0	22.0
United Kingdom	1973	8.0	15.0	15.0	15.0	15.0	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5	15.0
<b>Unweighted average</b>		15.6	16.6	17.8	17.2	16.8	16.5	17.6	17.8	17.9	17.8	17.8	17.9	17.8	17.8	17.7	17.6	17.7	17.7	17.6

# U.S. Consumer Debt as a Percent of GDP



Source: U.S. Bureau of Economic Analysis; U.S. Federal Reserve; Allianz Global Investors Capital; As of 31-Dec-09

# U.S. Household Debt Service Ratio



\*Definition: debt payments as a percent of disposable personal income. Debt payments include outstanding mortgages and consumer debt  
Source: Federal Reserve; Allianz Global Investors Capital; As of 31-Dec-09

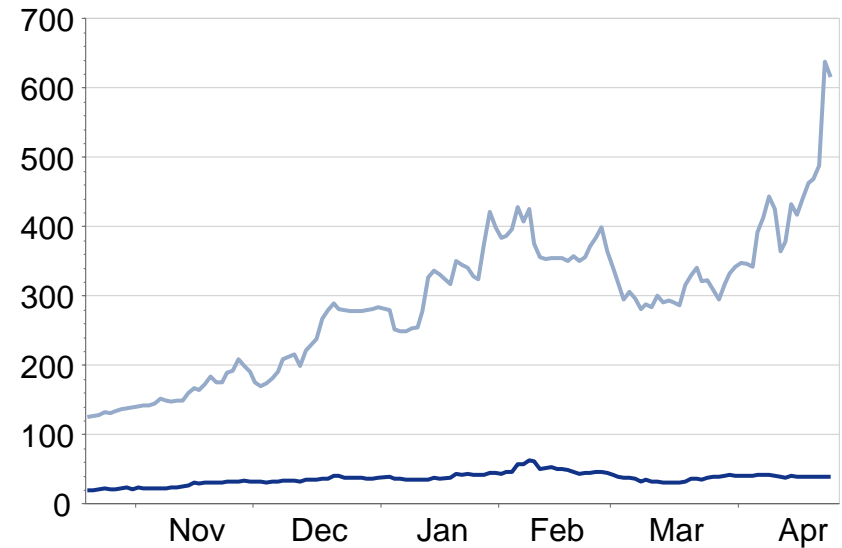
# Markets Can Force Fiscal Discipline

**Performance: Greek Stocks and the Euro**



— \$/EUR Exchange Rate  
— Greece ATHEX Composite

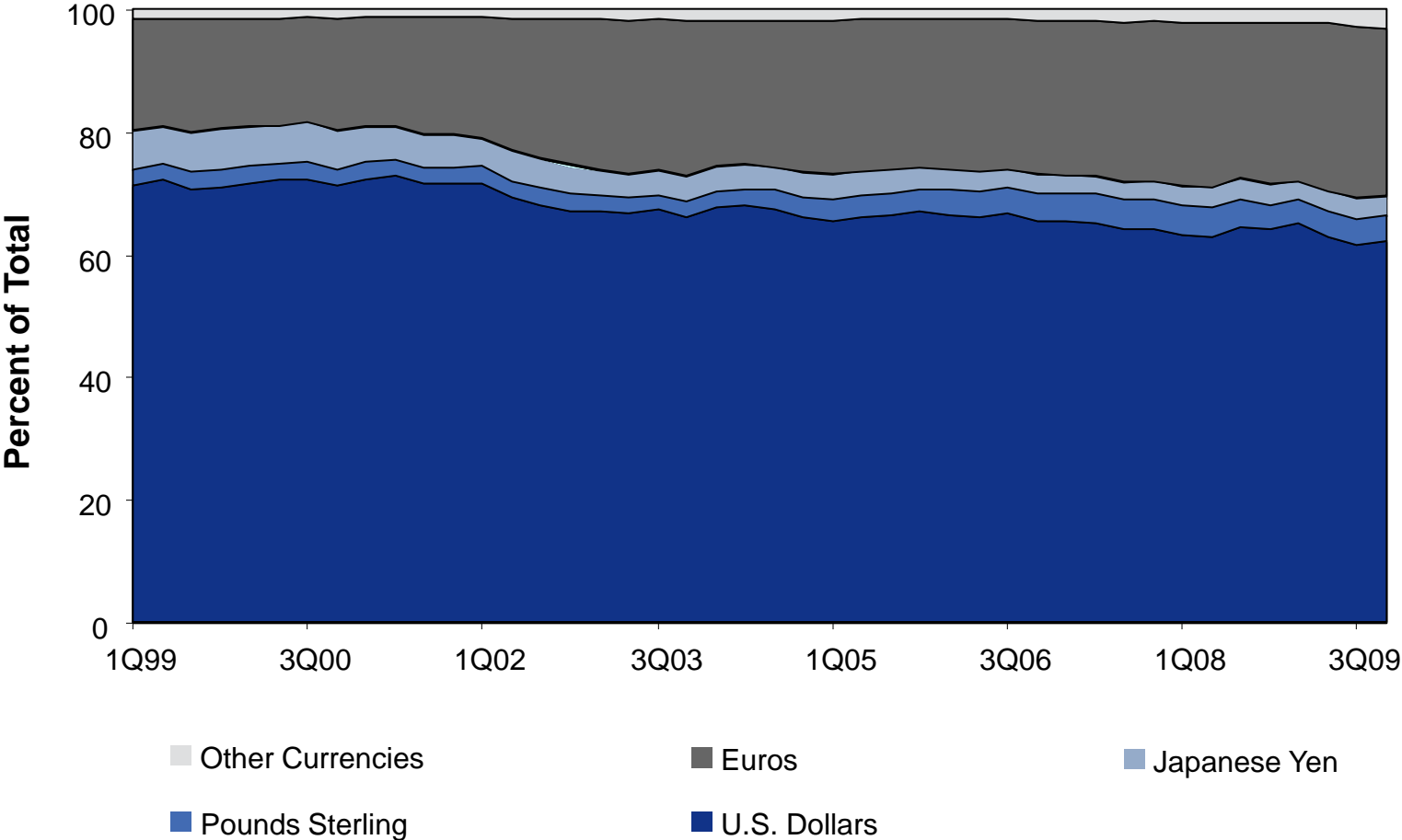
**Performance: U.S. and Greek Credit Default Swaps**



— U.S. 5-year CDS Yield  
— Greece 5-year CDS Yield

Note: All data for period 20-Oct-09 through 26-Apr-10; stock and currency performance indexed to 100; ATHEX performance in euros  
Source: FactSet; Allianz Global Investors Capital; As of 26-Apr-10

# Global Foreign Exchange Reserves



Note: Allocated reserves  
Source: International Monetary Fund; Allianz Global Investors Capital; As of 31-Dec-09

## Where Do We Go from Here?

- **The U.S. debt problem is surmountable**
  - Solving it requires difficult decisions
- **Four ways to fix:**
  - Increased taxation
  - Entitlement reform
  - Government spending reform
  - Economic growth outpacing spending growth
- **If we stay on this path, look out!**
  - U.K.
  - Greece
  - Latin America
  - Rome?
- **We are all poorer than we think!**

# The Road Ahead: Taxation

## **Facts:**

- 47% of taxpayers pay no tax
- Top 1% in income pays 37% of all personal income tax
- Corporate tax is relatively small, approximately 8% of total government revenues

## **Government Options:**

- Raise taxes on everyone and everything
- Raise corporate taxes
- Value Added Tax – very regressive, breaks campaign promises

# The Road Ahead: Government Spending

## Facts:

- **Discretionary spending is only 35% of all government spending**
  - Military spending is considered discretionary
- Largest budget deficits in history
- Government is assuming a larger role in the economy

## Government Options:

- Spending and program cuts
- Elimination or reform of entitlement programs
- Continue borrowing from our grandchildren – leaving the problem to them

# Managing the Future: How Will This Affect Pension Plans?

## **Possible Outcomes:**

- Modified benefits for new workers
- Reduced contributions
- Lower future returns as taxes and government participation increase
- Fewer counter-cyclical options during economic downturns
- Increased market volatility
- Potential insolvency

## **Actions You Can Take:**

- Match assets and liabilities
- Adjust your asset allocation
- Redesign plans
- Reduce future employment