

Chairman Issa, Ranking Member Cummings, subcommittee Chairman Jordan and Ranking Member Kucinich, thank you for the opportunity to participate in today's hearing and to share my views regarding the American Recovery and Reinvestment Act of 2009 and, specifically, the results two years after its enactment on the economy and the financial markets.

As you may know, I am the Bank of Montreal's Global Currency and Public Policy Strategist. I have worked in the financial markets since 1984. My role is to analyze the factors influencing the financial markets and provide guidance to our global clients on the potential outcomes of policy. I have had the distinct pleasure of writing commentary on a daily basis since 1999 and wrote daily throughout the crisis of 2008.

Reform and oversight of our nation's programs to create economic growth and financial stability are critically important. Bank of Montreal thanks you, Mr. Chairman, and all the members of the Committee for their upcoming work on these topics over the next two years. To reclaim its position of financial and economic leadership, the United States needs understand the short term and long term impacts from the American Recovery and Reinvestment Act of 2009.

For the financial markets, the American Recovery and Reinvestment act was at best an economic disappointment and at worst a potential fiscal disaster. In the fall of 2008, the economy and the financial markets were in the midst of turmoil generated from the failure of Lehman Brothers, the federal government take-over of Fannie Mae and Freddie Mac and the collapse of the subprime loan markets.

This created an environment of fear and uncertainty in the financial markets that led to investors pulling their funds out of risky assets and placing them into the safe havens of US Treasury securities. By the end of 2008, both the Dow Jones industrial average and the yield of the US Treasury 10 year note fell nearly 50 percent.

The extreme panic led to spreads between US Treasury securities and other market securities such as high yield, investment grade debt or large bank debt to widen significantly and rapidly. As an example of the panic, the commercial paper market

nearly froze completely when the Primary Reserve Fund broke the \$1 barrier. At this time, many large corporations lost the ability to fund themselves using this critical market. The entire financial system appeared to be at risk of seizing up and was in need of stabilization. The economy was deteriorating rapidly as businesses were unable to either receive credit from their bank or tap the debt markets for funding.

One of the key questions before President-elect Obama and Congress was how to stimulate the economy in the most efficient and timely way. In late December of 2008, the financial markets reacted positively upon hearing news that a large stimulus package was being discussed and debated in Washington, D. C.

At that time, the news flow varied from a package between \$500 billion to \$700 billion which included tax cuts and new spending programs. Contributing to the market optimism was the description of the package by then Chair-Nominee-Designate, Council of Economic Advisers Christine Romer and Office of the Vice President-elect Jared Bernstein (The Job Impact of the American Recovery and Reinvestment Plan).

In their report of January 10, 2009, Romer and Bernstein laid out their findings and expectations for economic growth for a \$775 billion program. It is critical to understand that the market's expectations for economic and employment growth from the plan were raised due to these findings. They estimated that the aggregate effect of the recovery package on Q42010 GDP would be to increase it from \$11,770, 133,876 to \$12,203,137,550,000. They stated that the effect of the package would increase GDP by 3.7% and increase jobs by 3,675,000.

They went further to predict that the plan would make the unemployment rate 7.0% by Q4 2010 from the 8.8% that would result in the absence of the plan. The authors predicted a 678,000 increase in construction jobs using calculations and estimates of effects by industry from economist Mark Zandi ("The Economic Impact of a \$600 Billion Fiscal Stimulus Package," Moody's economy.com, November 28, 2008.) Since the housing sector was a key variable in the financial crisis, the return of jobs to this sector was particularly optimistic and appealing for the markets. At that time, there were many factors influencing the financial markets. However, this outlook was one of the

contributing factors toward the rally in U.S. stock markets that took the Dow up almost 13%.

Subsequently, the markets became skeptical of the predicted outcomes by Romer and Bernstein as newspapers, bloggers and research began to break down the sections of the plan, the costs and the potential increase in fiscal deficits. The sovereign United States credit default swap price rose from 20 in October to a high of 59.7 in February: a stunning 300% increase. The honeymoon for the stock markets was over and they slid until March when Federal Reserve chairman appeared on 60 Minutes and stated that no major financial institution would fail.

Ultimately, the American Recovery and Reinvestment Act of 2009 did not meet its predicted goal for unemployment. It failed to return the unemployment rate to 7.0% and ended 2010 at 9.4%. While this is disappointing and disheartening to the eight million people who have lost their jobs in this recession, a major issue is yet to come: how to pay for the program when the US is currently borrowing approximately forty cents for every dollar it spends? One of the key points not addressed by Romer and Bernstein was the negative impact on the federal budget deficit and the increase in debt by the US government.

Had the financial crisis occurred in 2001-2003, the potential fallout from enacting a \$787 billion bill would not have been nearly as detrimental as the US federal budget deficit/GDP ratio was 3.5% (fiscal year 2003-04). However, this bill and its spending helped create the largest multi-year deficits in our nation's history. The US federal budget deficit/GDP ratio was 9.9% in FY2009 and 10.6% in FY2010. ARRA has also contributed to the national debt rising to nearly 100% of GDP. This 100% level is critical as research by Carmen Reinhart and Kenneth Rogoff has shown that when a country reaches 90% debt-to-GDP that economic growth begins to suffer.

Aside from the safe haven status, the attractiveness of the nation's debt for investors begins to decline as well due to questions over the ability to service that debt. The European debt crisis has been a wake-up call for sovereign debt issuers that investors will punish those that over-spend. In 2010, Portugal, Ireland, Italy, Greece and Spain

have all seen their debt shunned by the international markets and seen their debt servicing costs soar. It is likely that Greece would have defaulted on their debt had they not been assisted by the ECB, the EU and the IMF. The ratings agencies are now turning their focus to the United States and have grown increasingly concerned over the deficits and debt levels.

On January 28th, Moody's Investors Service said it may need to place a "negative" outlook on the Aaa rating of U.S. debt sooner than anticipated as the country's budget deficit widens (Bloomberg). "Although no rating action is contemplated at this time, the time frame for possible future actions appears to be shortening, and the probability of assigning a negative outlook in the coming two years is rising," wrote Steven Hess, a senior credit officer in New York and the author of the report. The rating remains "stable," according to the report."

While the American Recovering and Reinvestment Act is not the sole contributor to the budget deficit and debt increases, it certainly has helped create the conditions by which a ratings agency is now indicating a downgrade to its outlook for the country. If not addressed, this would potentially begin a downward spiral of negative investor sentiment, higher US borrowing costs, higher debt, a run on the US dollar and lower economic growth.

Mr. Chairman, Americans are justifiably questioning the efficiency and efficacy of the American Recovery and Reinvestment Act to create jobs and economic growth. The targets for 7.0 unemployment and adding \$0.5 trillion to the nations GDP were missed. Worse, the \$787 billion plan had to borrow heavily to finance it. This has increased the US budget deficit and increased the debt load of the country. In turn, this is calling into question the nation's Aaa rating and could create a negative spiral downwards for the economy. While current US CDS is relatively low, the United States credit default swap price has risen from a low of 36 in October to a high of 50.7 at the beginning of February as investors increased by almost forty percent the cost of insuring risk of a country default.

More fundamentally, the goal of stimulating the economy via government spending should be viewed skeptically as modeling is “subject to substantial margins of error” according to footnote number 2 in Romer and Bernstein.

Again, thank you for the opportunity to appear before the Committee today.

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Andy is the Global Currency and Public Policy Strategist for BMO Capital Markets' Investment Banking Division in Chicago. He is a senior fellow on economic issues for the Illinois Policy Institute and an American Action Forum Expert. Mr. Busch consults with the staffs from the US Treasury, Congress, and the White House on economic and financial market issues.

He was an adviser on the economy and the financial markets to US Republican Presidential candidate John McCain. Andy met recently with all the most senior staff at the US Treasury. He has met and advised the last three US Treasury Secretaries including Tim Geithner.

He is a recognized expert on the world financial markets and how these markets are impacted by political events. Andy recently spoke at the Pacific Economic Conference in Russia on the global credit crisis. He met and consulted with the governor of Primorsky Territory and the mayor of Vladivostok over the future direction of the Russian economy.

On February 25th, Andy will join CNBC's new program "Money in Motion." He has appeared for the last seven years on The Kudlow Report and other various CNBC shows. He is a CNBC contributor and his blog is number one for the website. He is regularly quoted in the following press: Wall Street Journal, Reuters News Services, Dow Jones News Services, Associate Press, Agence France-Press, Australia's Au., UK's Guardian, and the Globe and Mail.

Andy is a prolific writer. Daily, his views appear in his newsletter, the Busch Update. [Bi-weekly](#), he writes Fantastic FX 4. Lastly, his book, "World Event Trading: How to Analyze and Profit from Today's Headlines", is available on Amazon and was translated into Mandarin in 2008 and into Japanese in 2009.

Andy joined BMO Financial Group in 1990 in the foreign exchange trading room of Harris Trust and Savings Bank, which merged with Bank of Montreal's room in 1995. Prior to joining Harris, he traded foreign exchange at Northern Trust Company. He

graduated Phi Beta Kappa with a BA in Economics from Ohio Wesleyan University in 1983, and received his MBA from the University of Chicago in 1988.

1. No contracts.

2. I will be speaking as the Global Currency and Public Policy Strategist of BMO Capital Markets, which is a part of BMO Financial Group.

Established in 1817 as Bank of Montreal, BMO Financial Group (TSX, NYSE: BMO) is a highly diversified financial services organization. With total assets of \$412 billion as of October 31, 2010, and 38,000 employees, BMO provides a broad range of retail banking, wealth management and investment banking products and solutions.

We serve Canadian clients through BMO Bank of Montreal<sup>®</sup>, our personal and commercial banking business, BMO Nesbitt Burns<sup>®\*</sup>, one of Canada's leading wealth management firms, and BMO Capital Markets<sup>™</sup>, our North American investment and corporate banking division.

In the United States, clients are served through Harris, a major U.S. Midwest financial services organization with a network of community banks in the Chicago area and wealth management offices across the United States, as well as BMO Capital Markets<sup>™</sup>, our North American investment and corporate banking division.

3.

Harris NA, a national bank headquartered in Chicago and wholly-owned by Bank of Montreal, received in 2010 under the Bank Enterprise Award Program an award of \$600,000 from the Community Development Financial Institutions Fund of the Department of the Treasury, to be used to provide credit, capital and financial services to underserved populations and communities. I am not aware of any other federal contracts, subcontracts, grants or subgrants received since October 1, 2008. I also note, however, that Bank of Montreal and its affiliates conduct a variety of banking, securities and other regulated financial businesses in the U.S., and may as a result have direct or indirect arrangements or agreements with federal regulatory agencies due to the regulated nature of such businesses or as a customary part of such businesses. For example, BMO Capital Markets Corp. has entered into a "Management Agreement" with Straight-A Funding LLC dated February 6, 2009. Without taking a position as to whether that Management Agreement constitutes a "subcontract" under a Federal contract, please note that the Management Agreement relates to contractual relationships which Straight-A Funding LLC has with the Federal Government concerning the Federal Funding Education Loan Program in connection with the ABCP Conduit Program announced by the Department of Education, the Department of Treasury, and the Office of Management and Budget. With respect to the "amount" of the Management Agreement, we consider that amount to be confidential and proprietary information; we can provide that information, if the Committee so desires, with the understanding that, consistent with Rule XI(2)(g)(5), such information will not be publicly disclosed.



Committee on Oversight and Government Reform  
Witness Disclosure Requirement – "Truth in Testimony"  
Required by House Rule XI, Clause 2(g)(5)

Name:

Andrew B. Busch

1. Please list any federal grants or contracts (including subgrants or subcontracts) you have received since October 1, 2008. Include the source and amount of each grant or contract.

2. Please list any entity you are testifying on behalf of and briefly describe your relationship with these entities.

3. Please list any federal grants or contracts (including subgrants or subcontracts) received since October 1, 2008, by the entity(ies) you listed above. Include the source and amount of each grant or contract.

I certify that the above information is true and correct.

Signature:

Andrew B. Busch

Date:

2/14/2011