# U.S. Flash

## Budget deal reached to avert government shutdown

Congressional negotiators have reached an agreement to fund the federal government for fiscal years 2014 and 2015 and thus avoid another government shutdown at least until October 2015. The House could vote as early as Thursday while the Senate could vote next week.

The deal comes as a welcomed surprise, considering past negotiations have come down to the last minute as both Republicans and Democrats have stood strong and been unwilling to cede any ground. According to our preliminary estimates, the deal could boost GDP growth by 0.2% to 0.3% next year and 0.1% in 2015.

- **The deal pushes both sides to make compromises and find middle-ground**

  The current proposal raises total spending for 2014 to $1.01tn, above the $967bn that would have been passed under current law. The plan sets defense spending at $520bn, an increase of $18bn in 2014 and $9bn in 2015. Non-defense is set at $492bn, an increase of $20bn in 2014 and $8bn in 2015. In addition, the deal reduces the budget deficit by $20bn to $23bn over next 10 years. The increase in total spending is funded with several measures: Extends 2% Medicare sequester by an additional two years to FYs 2022 and 2023; increases new civilian federal employee contributions to their pensions by 1.3%; slows growth in military retirement benefits to CPI minus 1%; raises Pension Benefit Guaranty Crop fees to guarantee private pensions; and sets higher Transportation Security Administration fees for airline passengers.

  To entice broader support from both parties, the deal also includes some additional measures such as more stringent enforcement of unemployment insurance overpayments, greater flexibility to states to recover Medicaid costs, and an easier process to identify and exclude prisoners from benefit programs in cases where they are not eligible. Other measures limit reimbursable compensation of federal contractors and repeal the Ultra-Deepwater and Unconventional Natural Gas and Other Petroleum Resources Research Program. Approval of the U.S.-Mexico Transboundary Hydrocarbons Agreement, a cap on the amount of interest payable on oil and gas royalty overpayments and a repeal of federal authority to accept oil through the royalty-in-kind program to fill the Strategic Petroleum Reserve round out the proposal.

- **Another failed opportunity**

  Members of the House and Senate have yet to weigh in, and while there has already been vocal backlash by some hardliners, both president Obama and GOP leadership have spoken favorably of the budget terms, which is an encouraging sign that both party sides are closer to an agreement than during previous negotiations. In fact, the deal leaves out the extension of emergency unemployment compensation as democrats demanded, and does not include a deal on the debt ceiling which would still have to be resolved separately.

- **Final passage would increase risks to the upside**

  Notwithstanding the importance of this deal, negotiators once again failed to reach a long-term solution to the looming fiscal pressures resulting from an aging population, increasing entitlement spending and a complex tax system jam-packed of loopholes. Still, the display of bipartisanship in Washington is a positive sign for the economy. In this context, the Fed may be more likely to begin tapering its bond buying program in the wake of a more stable U.S. economy, lower policy uncertainty and reduced fiscal drag.

  Our GDP growth estimate for 2014 in our baseline scenario stands at 2.3% but does not account for the potential upside risks from a two-year fiscal deal, and the positive spillover effects on financial markets, private investment and job growth. Therefore, passage of this could require us to revisit our GDP growth forecast for both 2014 and 2015.

Michael Soni
Michael.Soni@bbvacompass.com