

AUGUST 22, 2023

## ARS Investment Management Webinar

# What Matters Now: The Fitch Downgrade, Geopolitics, and the 2024 Election

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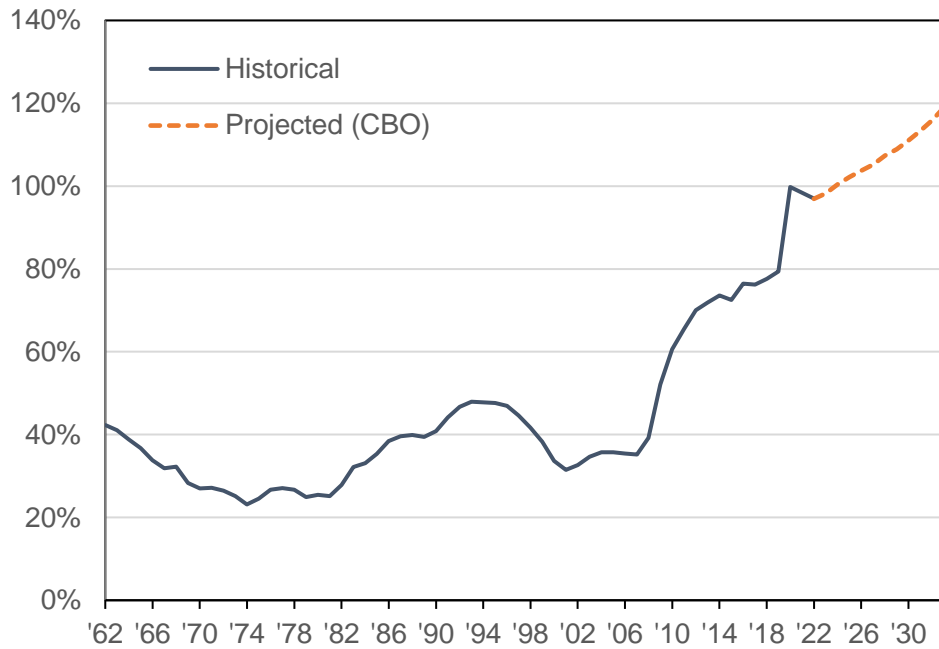
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## Key Points

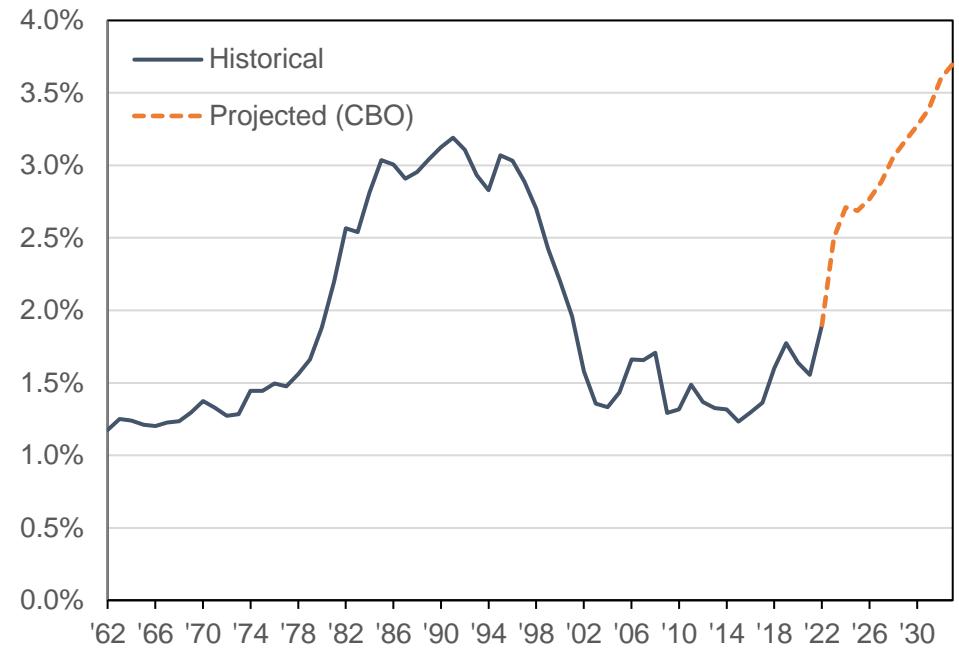
- Legislative activity over the next year will be limited to the bare minimum due to divided government, a rancorous budget process, and the upcoming election.
- The Fitch downgrade likely understates the severity of the medium-term and long-term deficits and the dysfunction of America's political system. The federal budget deficit will likely total \$2 trillion in FY23, far above last year's \$1 trillion deficit. Most of the increase in the deficit, though, are due to factors (lower cap gains receipts, higher interest costs) that do not represent "stimulus" to the economy. These higher deficits have helped change the fiscal policy debate.
- There is broad bipartisan support for the tariffs on China, restrictions on Chinese investment in the US, and restrictions on exports of high-tech equipment. There is broad bipartisan support for continuing to arm Ukraine.
- Both Joe Biden and Donald Trump remain highly unpopular with the general public but Biden faces no significant primary opposition and Trump starts with an enormous lead in the GOP primary. Biden probably beats Trump but would likely lose badly to most of the rest of the Republican field.

# High Debt And Interest Rates Have Changed The Budget Debate

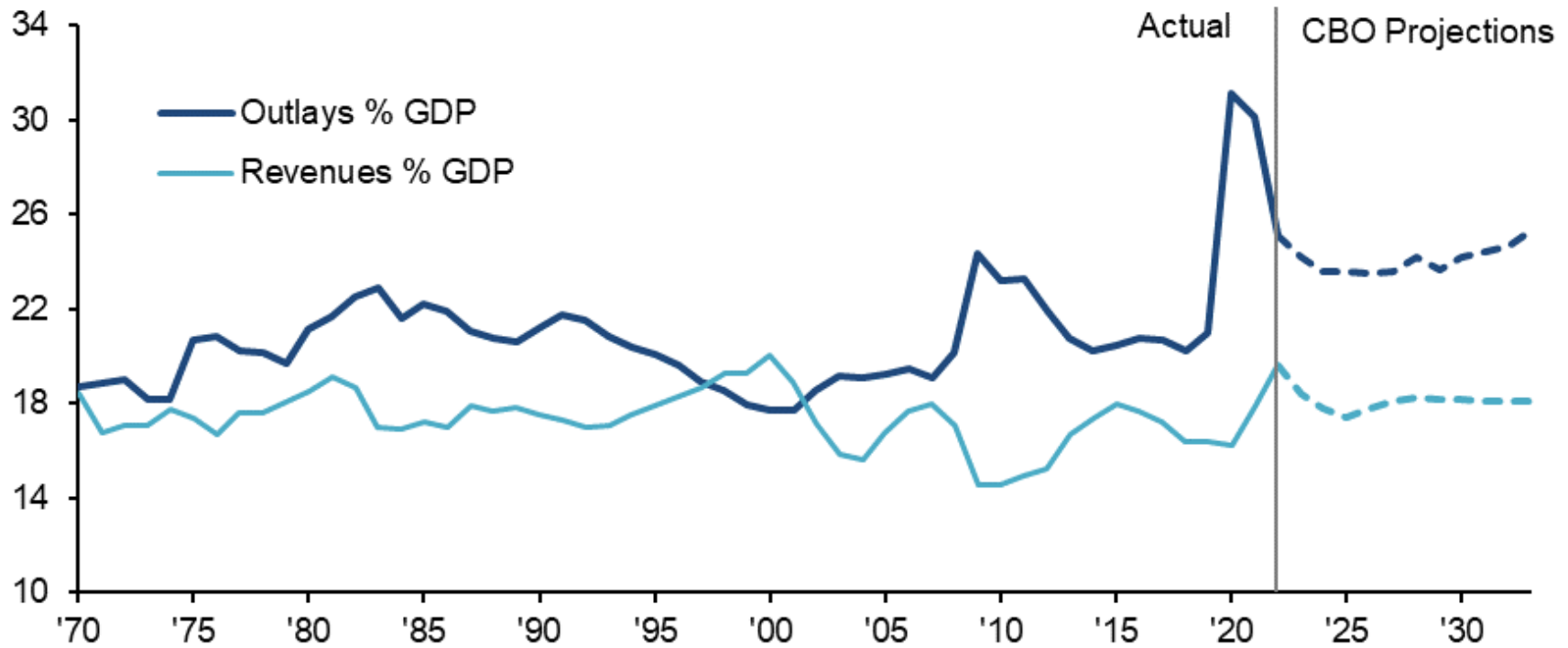
Debt Held by the Public as % GDP, 1962 to 2033



Net Interest as % GDP, 1962 to 2033



# Massive Deficits As Far As The Eye Can See



## Over \$1 Trillion Increase In Deficit This Fiscal Year

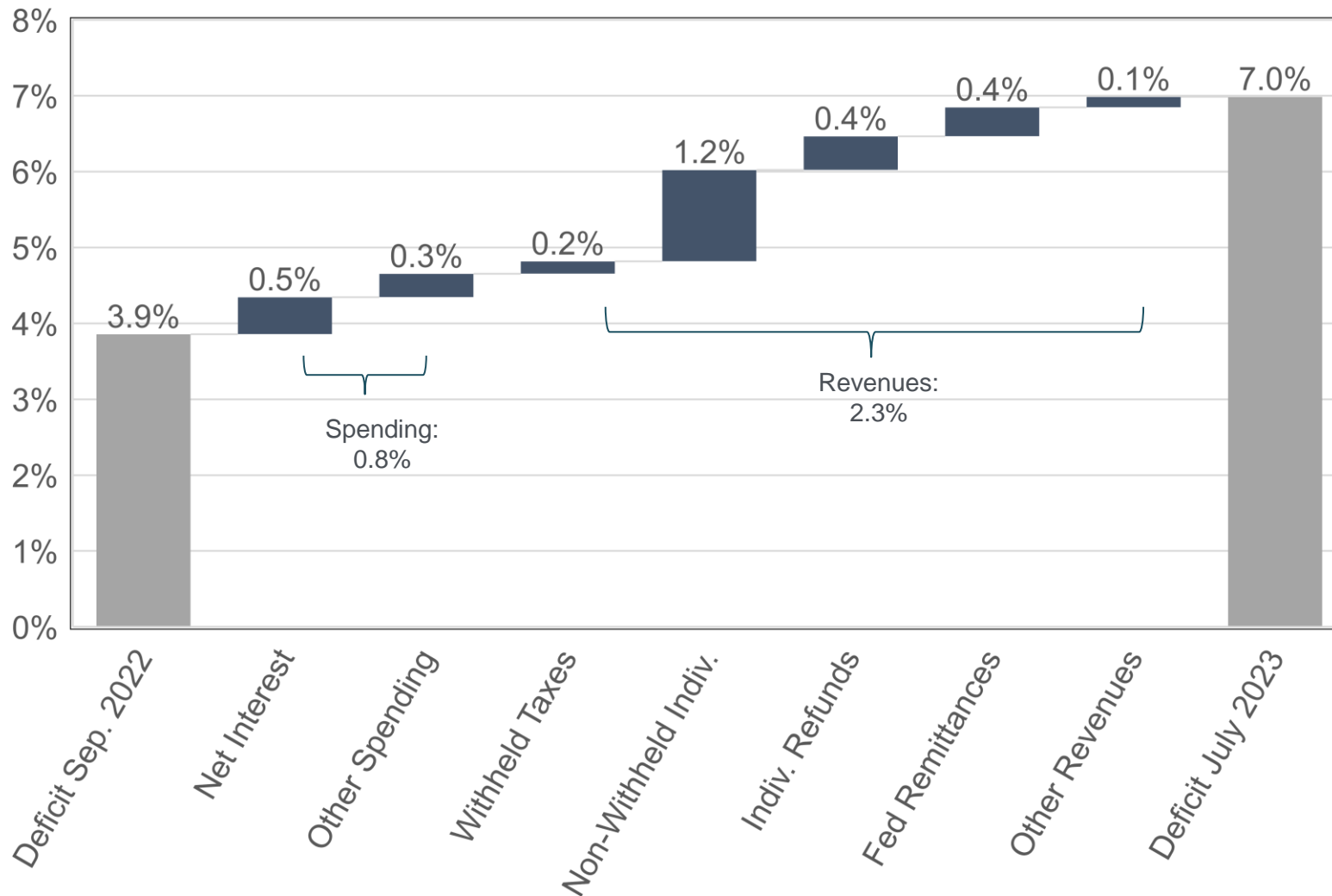
### FY 2022 & 2023 Deficits, Actual Versus Forecast (\$BN)

	Actual	Excluding Debt Cancellation	CBO May 2023 Forecast	CBO August 2023 Forecast*	CBO August 2023 Forecast Excluding Debt Cancellation	Change, Excluding Debt Cancellation
	FY22	FY22	FY23	FY23	FY23	FY23
<b>Revenues</b>	4,897	4,897	4,815	4,415	4,415	-483
<b>Outlays</b>	6,273	5,894	6,354	6,154	6,484	590
<b>Deficit</b>	<b>-\$1,376</b>	<b>-\$997</b>	<b>-\$1,539</b>	<b>-\$1,739</b>	<b>-\$2,069</b>	<b>-\$1,072</b>

Notes: CBO didn't produce a new forecast in August as the table above suggests, but in its July "Monthly Budget Review" document CBO states that spending and revenues will come in roughly \$200 and \$400 billion below expectations, respectively. We remove the \$379 billion cost of student debt cancellation recorded in September 2022 and subtract the recorded savings of \$330 billion from its reversal which will be recorded sometime in FY23.

# What Is Driving The Big Change In The Deficit This Year?

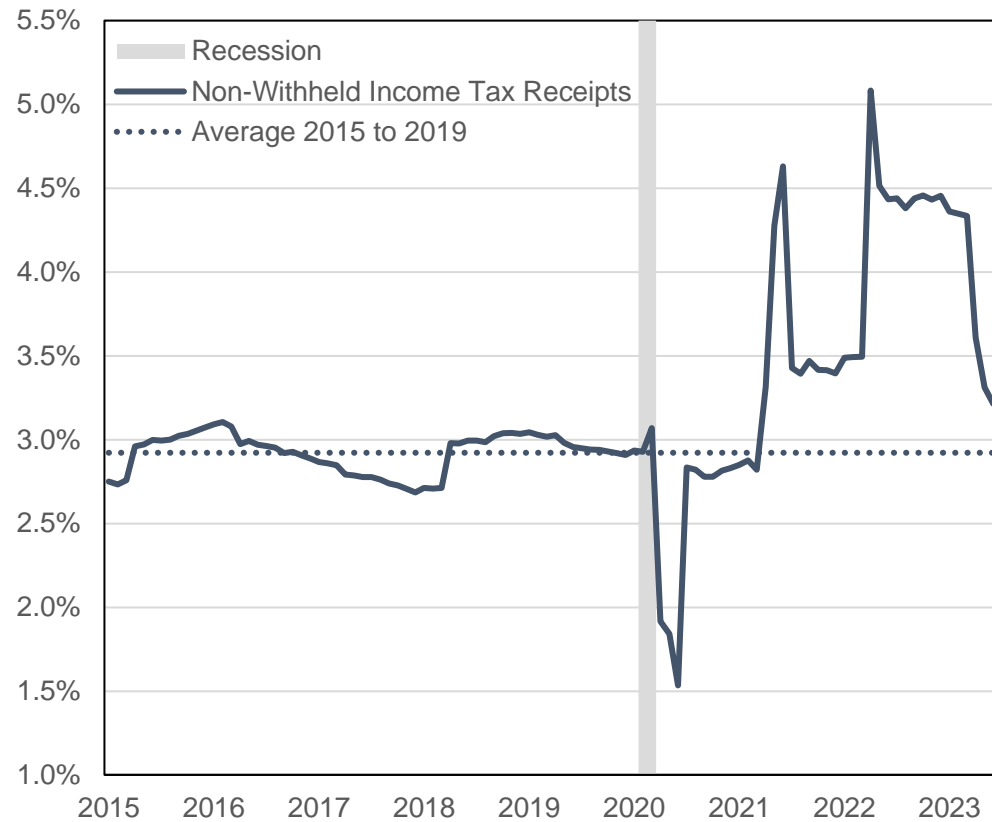
Decomposition Of Change In Deficit From September 2022 To July 2023, As % GDP



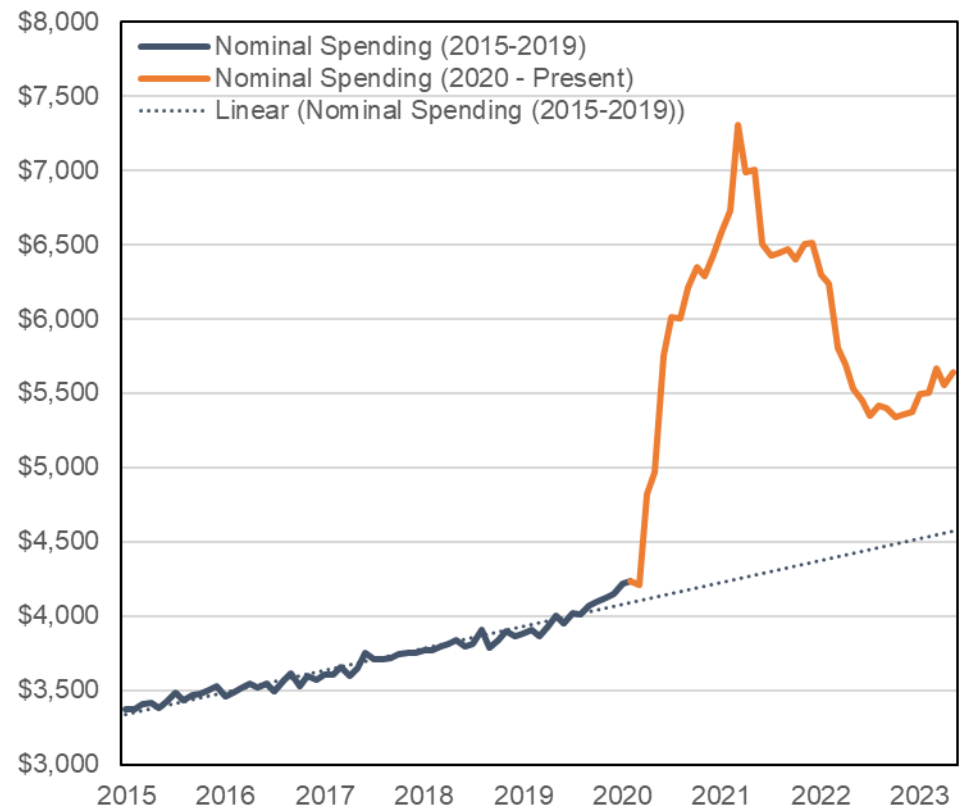
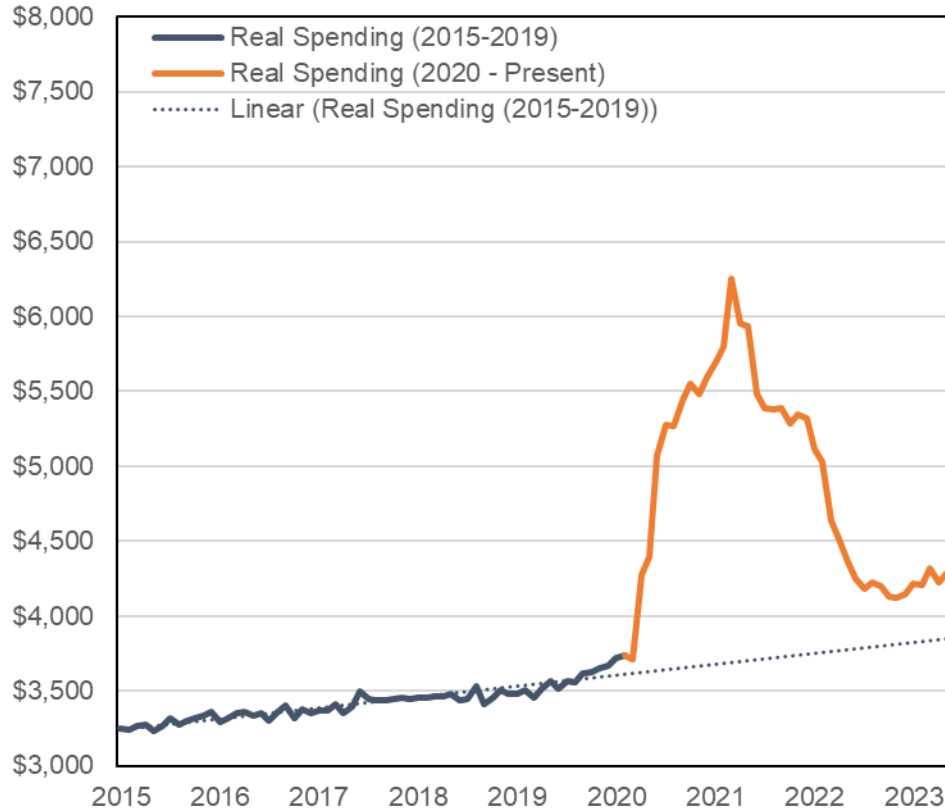
Sources: Treasury Department, S&P Global, and Piper Sandler. Notes: Deficit calculated as a 12 month trailing sum, excluding the cost of student debt cancellation, divided by monthly NGDP.

# Non-Withheld Receipts Return To Normal After Bubble Levels

## Non-Withheld Individual Income Taxes As % GDP, 2015 To 2023



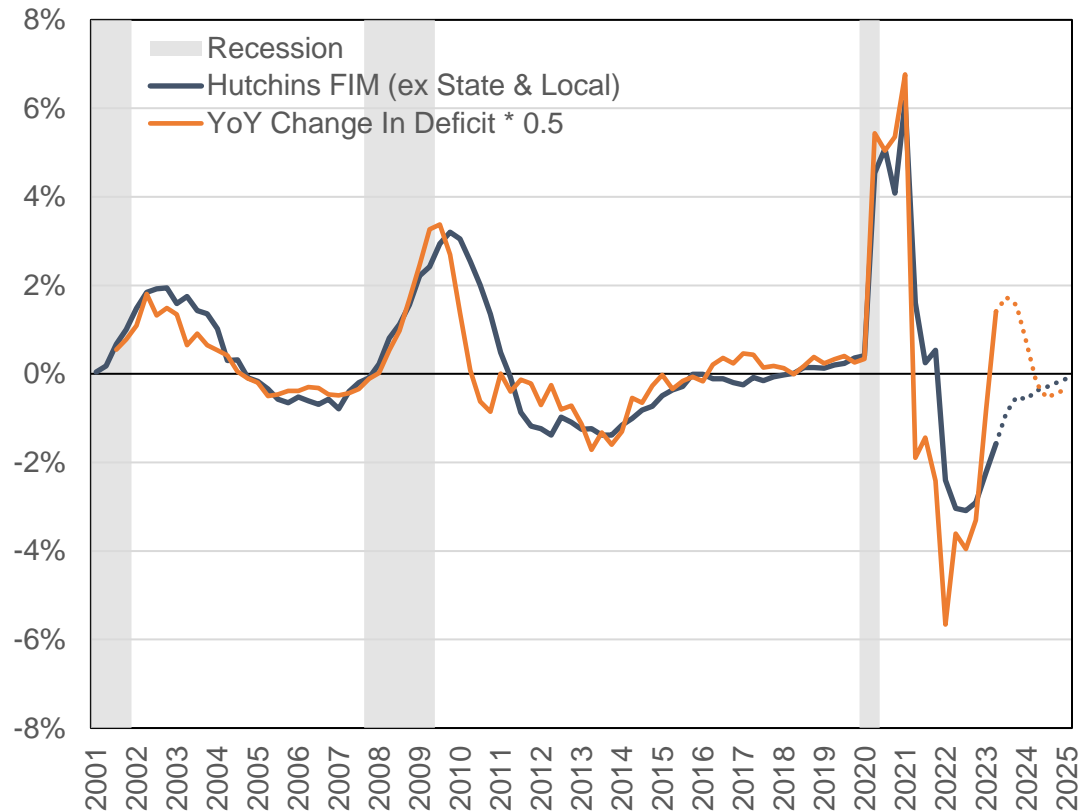
# Spending Not Nearly As Elevated After Adjusting For Inflation





# Is The Fiscal Impulse Positive, Negative, Or Neutral?

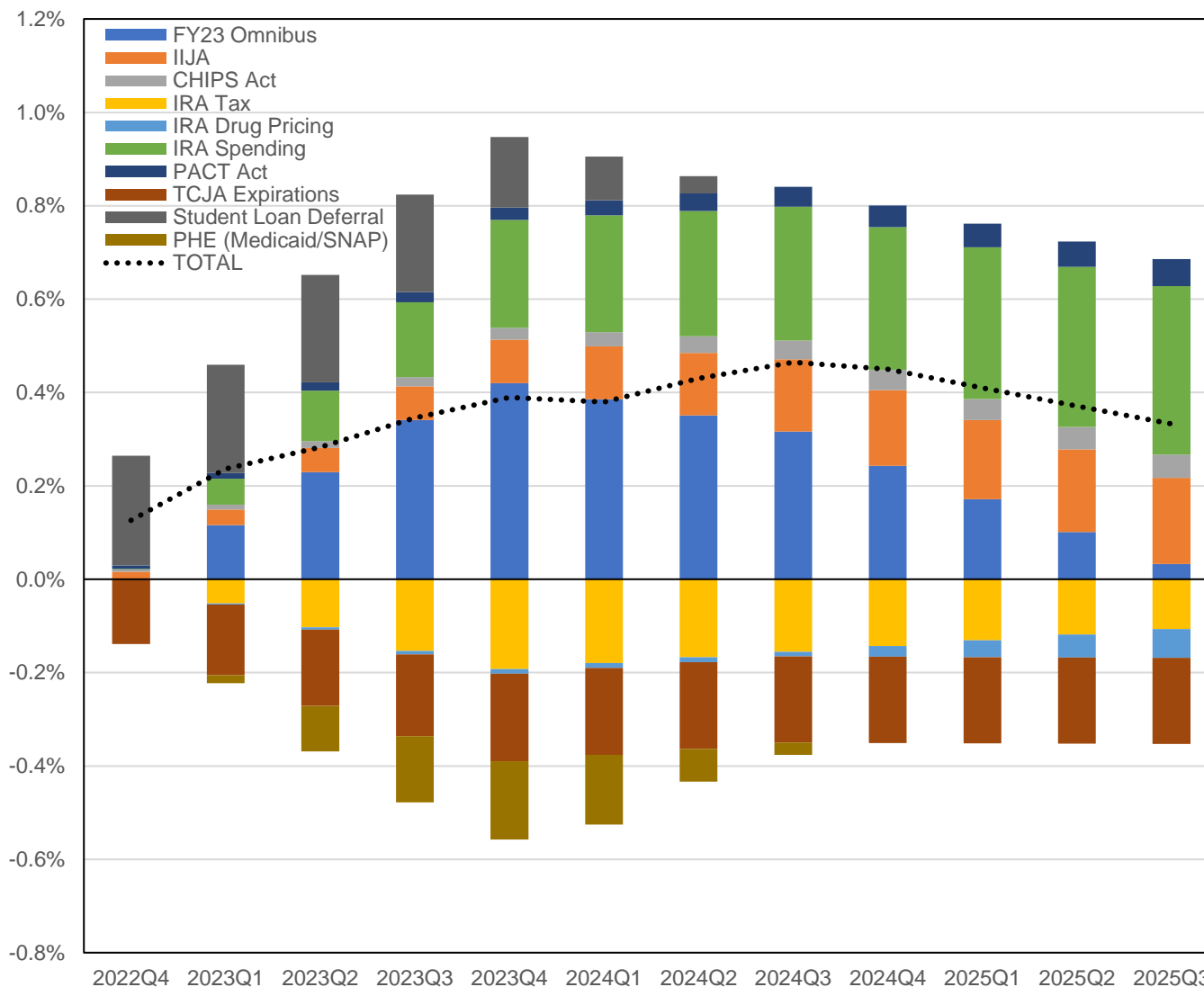
## The Fiscal Impulse: Impact On Year-Over-Year Real GDP



Notes: Deficit is calculated as the four-quarter trailing sum of deficits, excluding debt cancellation, as a share of GDP. The chart assumes a FY23 deficit of \$2 trillion and FY24 deficit of \$1.75 trillion, interpolated linearly. We multiply the change in the deficit by 0.5 to proxy for fiscal multipliers and because it rescales the data to be similar to the Hutchins FIM

# Recent Changes In Fiscal Policy Are Modestly Positive For Deficit

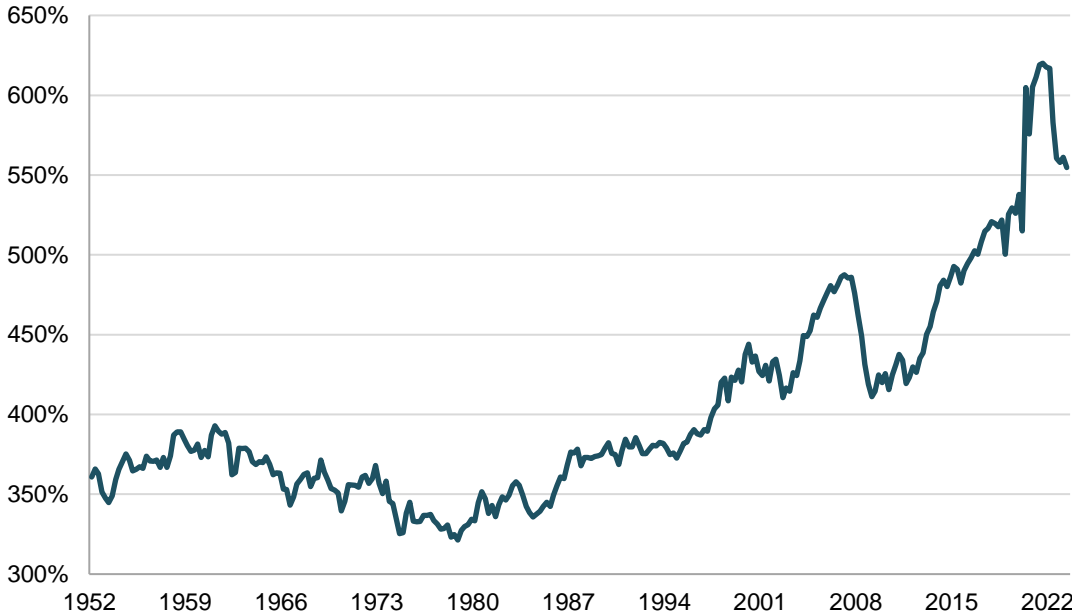
Policy Contribution To Deficit (% GDP), 4Q Moving Sum



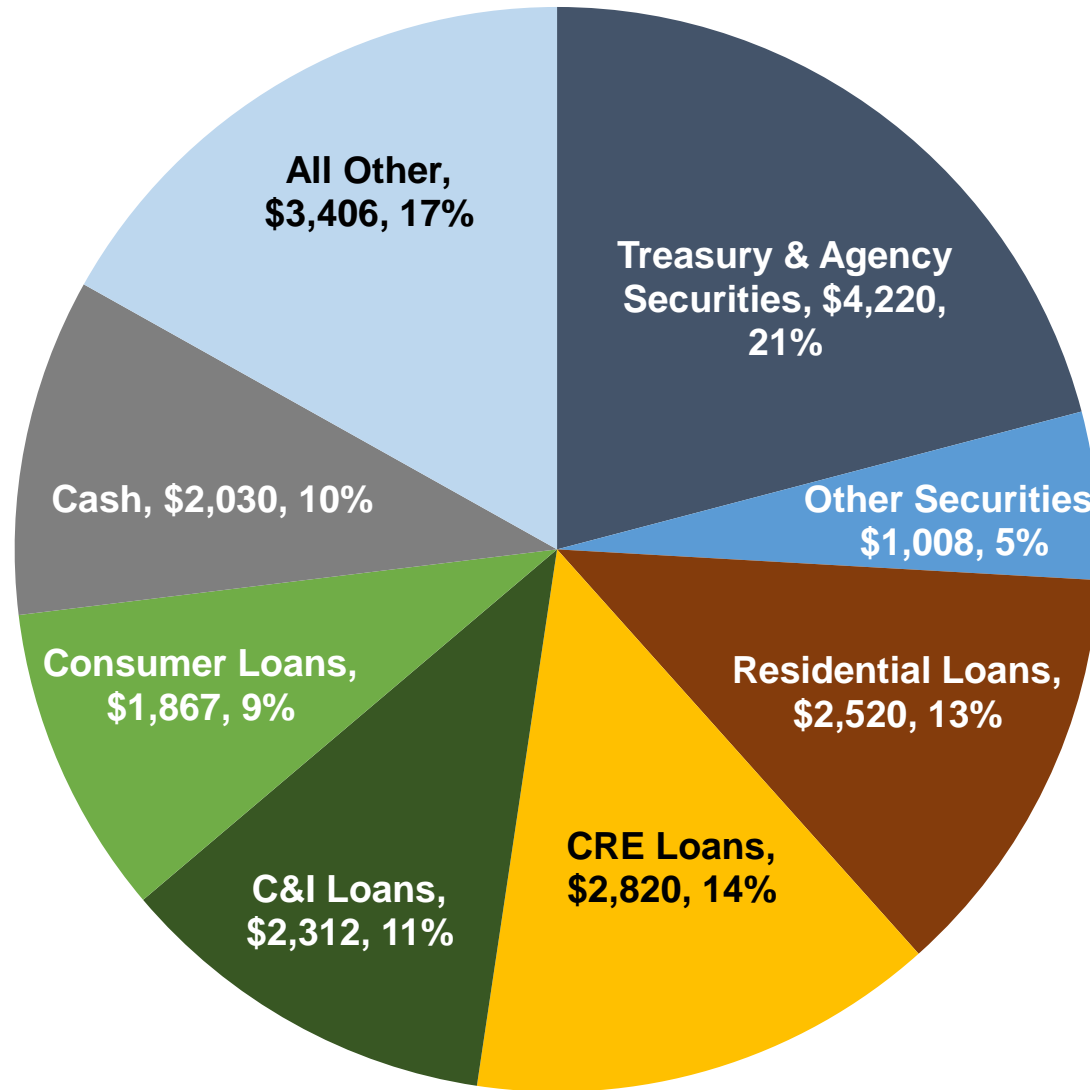
Sources: CBO and Piper Sandler. Note: Data not yet adjusted for forthcoming student loan relief or additional growth in the employee retention credit take up rate.

# Inflated Asset Prices

## Household Net Worth As Share Of GDP



## U.S. Banks Full Of Low-Yielding Assets (\$BN)



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## The Rest Of The Agenda

- Energy permitting
- PBM/drug legislation
- Reversing corp tax hikes
- Banning TikTok
- SAFE Banking Act
- Pillar 2 tax hikes
- Crypto regulation
- Student loan debt relief

# Ukraine War: No End In Sight

## Congress Approved Aid To Ukraine

	Authorized \$ bn
Drawdown Replenishment	27.2
Ukraine Security Assistance Initiative	18.0
United States Military	15.2
Foreign Military Financing Program	4.7
Other Defense	2.0
<b>Subtotal, Defense</b>	<b>\$67.1</b>
Economic Support Fund	26.9
International Disaster Assistance	7.9
Assistance for Refugees	6.6
Assistance for Europe, Eurasia, and Central Asia	1.5
Other Nondefense	3.1
<b>Subtotal, Nondefense</b>	<b>\$46</b>
<b>Total</b>	<b>\$113.1</b>

Source: Committee for a Responsible Federal Budget.



Source: Institute for the Study of War.

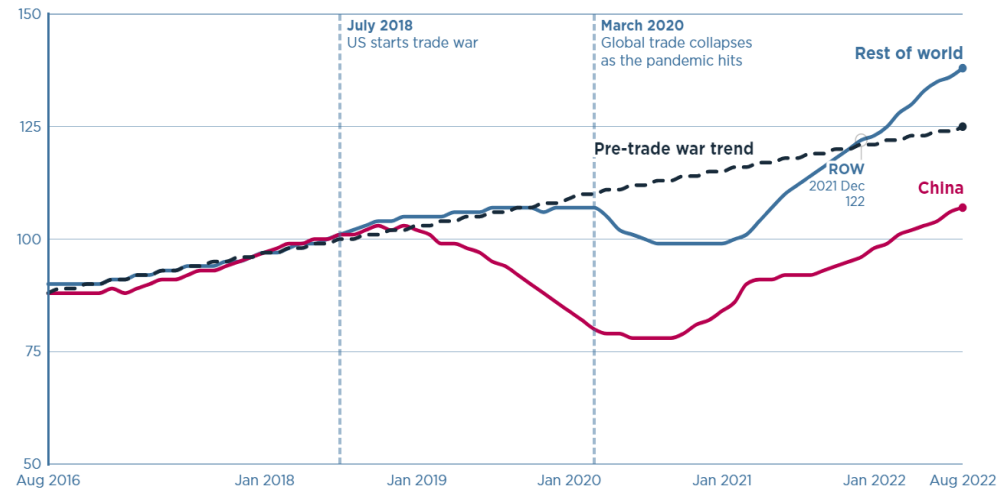
# China Trade Decoupling

## Good Imports From China % Of Total Imports



Sources: Census and Piper Sandler.

Value of US goods imports from China and rest of world, 2016-2022 (June 2018 = 100)

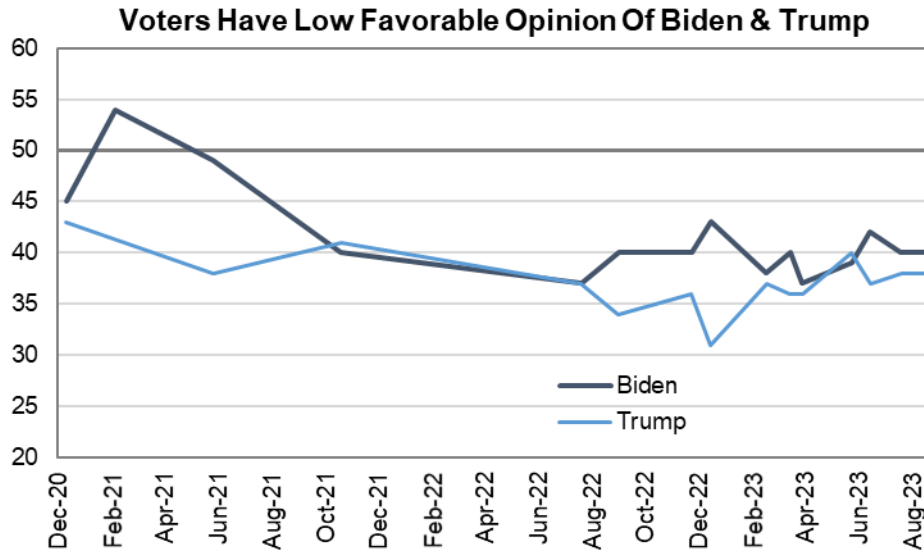


**Notes:** Indexed value of US monthly imports, not seasonally adjusted, 12-month trailing sums. Pre-trade war trend based on US imports from the world from August 2016 through June 2018.

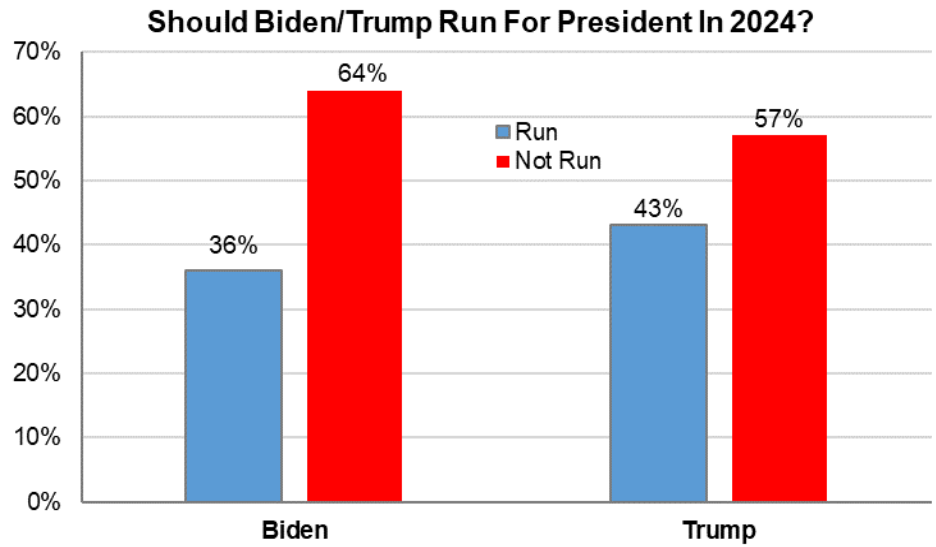
**Source:** Constructed by the author with US import data from US Bureau of the Census.

Source: Peterson Institute for International Economics.

# Trump And Biden Are Unpopular



Source: Quinnipiac (August poll).



Source: Harvard Harris (July poll).



# What Are Betting Markets Predicting For 2024?

## Who will win the 2024 Republican presidential nomination?

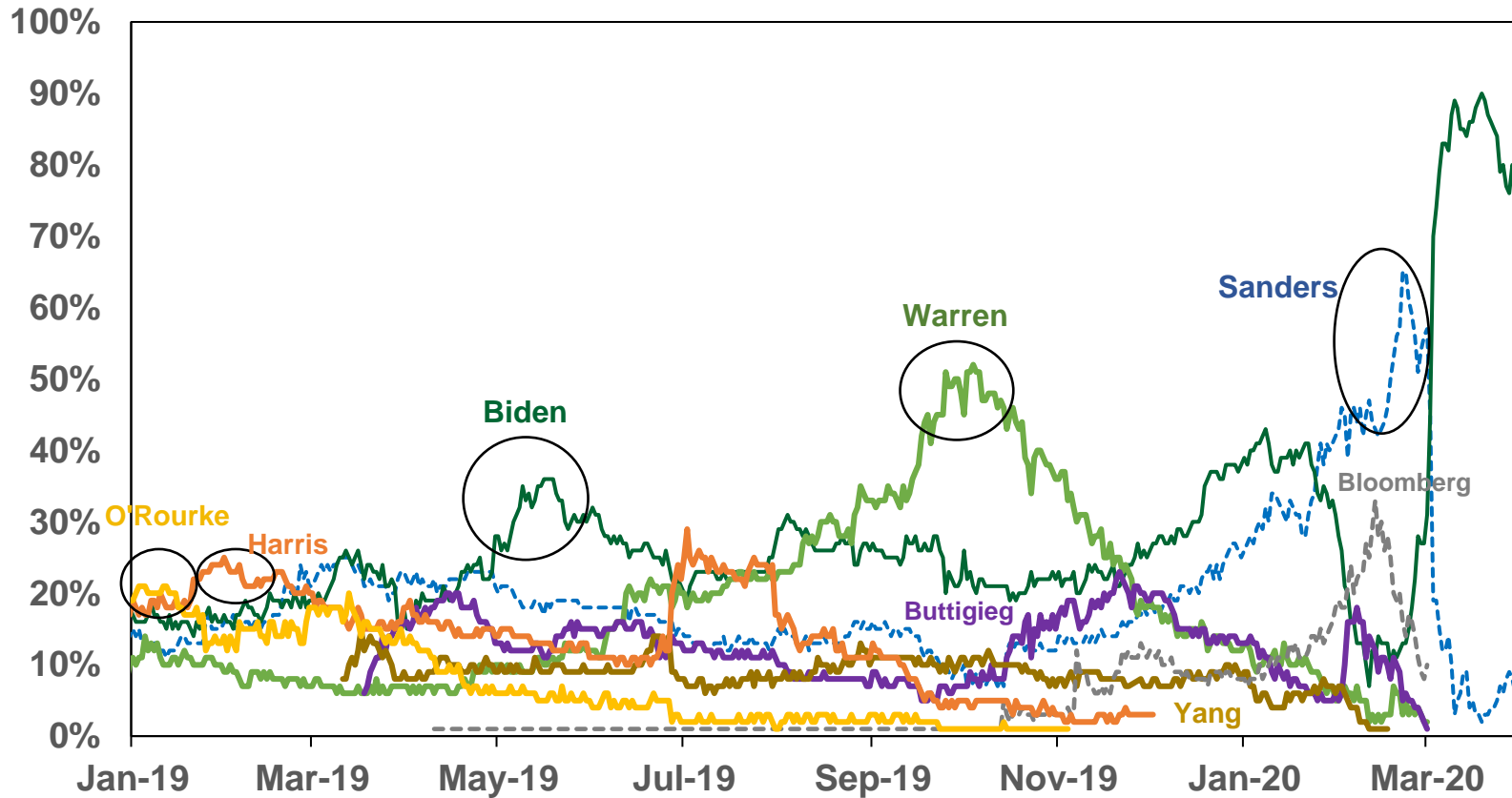
<b>Trump</b>	<b>57%</b>
<b>Ramaswamy</b>	<b>20%</b>
<b>DeSantis</b>	<b>14%</b>
<b>Scott</b>	<b>9%</b>
<b>Christie</b>	<b>7%</b>
<b>Youngkin</b>	<b>5%</b>
<b>Haley</b>	<b>4%</b>
<b>Pence</b>	<b>2%</b>

## Who will win the 2024 US presidential election?

<b>Biden</b>	<b>44%</b>
<b>Trump</b>	<b>30%</b>
<b>Newsom</b>	<b>11%</b>
<b>Ramaswamy</b>	<b>9%</b>
<b>DeSantis</b>	<b>8%</b>
<b>Harris</b>	<b>4%</b>
<b>Scott</b>	<b>3%</b>
<b>Buttigieg</b>	<b>1%</b>

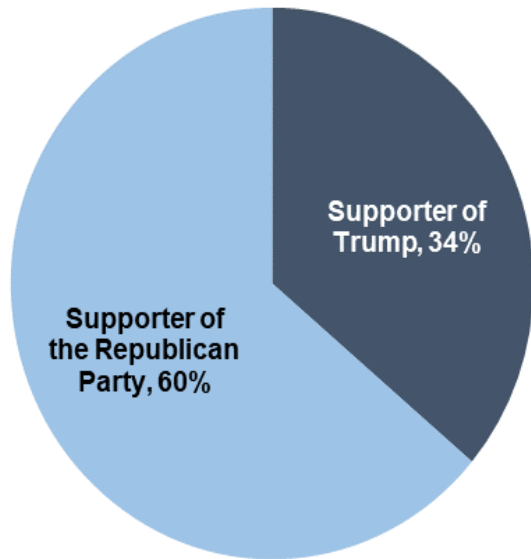
# Primaries Are Hard To Predict...

## Five Different Democrats Led In Betting Markets In 2019/2020

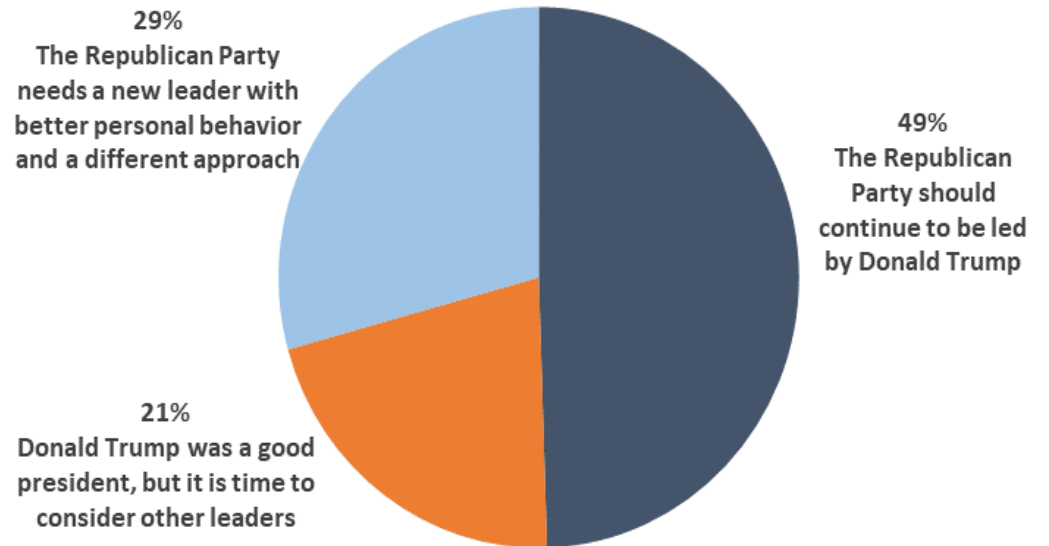


# It's Party First, But Half Of GOP Voters Still Want Trump

Do you consider yourself to be more of a supporter of Trump or Republican Party?

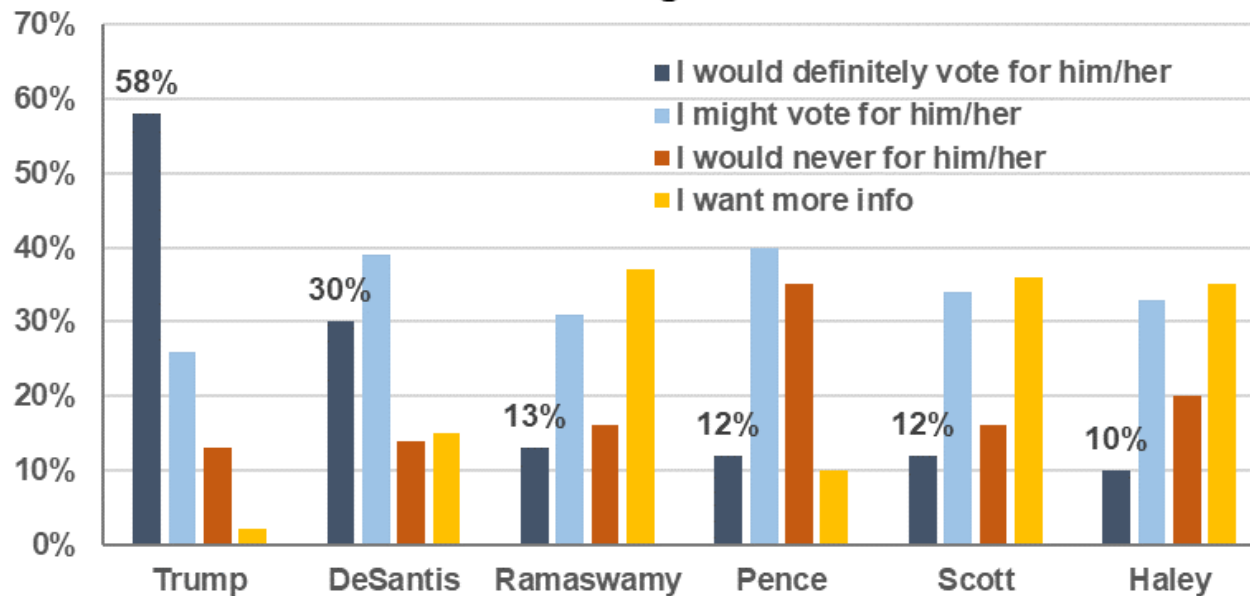


Which comes closest to your opinion?



# Most Republican Voters Open To All The GOP Candidates

Which of the following best describes how you feel about voting for...



## Two-Man Race With A Big Lead For Trump

	National	Iowa (Jan 15)	New Hampshire (Jan 23)	South Carolina (Feb 24)
<b>Trump</b>	55.9	43.2	44.3	45.7
<b>DeSantis</b>	14.6	17.2	13.3	15.0
<b>Ramaswamy</b>	7.1	5.2	6.0	3.3
<b>Pence</b>	4.3	3.8	1.8	3.0
<b>Haley</b>	3.3	4.6	3.8	10.0
<b>Christie</b>	3.1	3.4	8.0	4.0
<b>Scott</b>	3.0	10.2	7.5	11.3
<b>Hutchinson</b>	0.9	0.4	0.5	0.7
<b>Burgum</b>	0.5	2.4	4.5	-
<b>Johnson</b>	0.5	-	2.0	-
<b>Elder</b>	0.5	0.3	-	-
<b>Hurd</b>	0.4	0.3	1.0	-
<b>Suarez</b>	-	-	-	-

## The Primary Could Change Rapidly

### Past Iowa Winners

Election Year	Iowa Winner	National Aug Poll	Iowa Aug Poll	Iowa Result
2008	Obama	21.4	20.0	37.6
2008	Huckabee	2.0	3.5	34.4
2012	Santorum	2.0	3.8	24.6
2016	Clinton	55.0	50.5	49.9
2016	Cruz	5.8	8.0	27.6
2020	Buttigieg	5.2	7.0	26.2
2024	Trump?	55.9	43.2	-

# Dems Unlikely To Hold Senate In 2024 Unless GOP Self-Destructs

