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U.S. PRIMARY ELECTIONS: SUPER TUESDAY, AND THE WINNER IS… PUBLIC DEBT IN AMERICA

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Fourteen states (Alabama, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont and Virginia) and two other constituencies voted in the Democrat primary to nominate their party presidential candidate. Five candidates remained in the competition after Klobuchar, Buttigieg and Steyer dropped out and recently turned to endorse fellow moderate Biden in an attempt to unite the centrist voters. Biden (51.2% of delegates to date) was the clear winner (see Figure 1) of this Super Tuesday, while Sanders remains in the race (40% of delegates to date). The lessons of this Super Tuesday are the following:

- Joe Biden and Bernie Sanders have cemented themselves as the front runners for the Democrat nomination
- As expected, Biden won a clear victory in the southern states. He continued to build on the momentum he started in South Carolina and appeared to have won 10 of the 14 states
- Sanders appeared to have won the grand prize of the evening, the liberal state of California with the most delegates (we caution that it will take several days to actually apportion all of the delegates from California)
- Bloomberg and Warren (she finished third in her home state tonight, but claims she will be staying for the chance at a brokered convention) are almost certainly out as they respectively have 4.3% and 3.2% of delegates to date.
- While the night's outcome almost certainly makes it a two-man race, there are many more big states to go, such as New York, Pennsylvania, Florida, Ohio, and Michigan. It's far from over, but it appears to be over for everyone except Biden and Sanders

And the real winner is…public debt

No matter who wins the Democrat nomination (see Figure 2 for the economic programs of Democrat candidates), or even the general election in November, it is certain that U.S. national debt will continue to grow. In fact, even with no changes to the current law, the Congressional Budget Office (CBO) projects that public debt would increase from $17.9T or 80.8% of GDP at the end of 2020 to $31.4T or 98.3% of GDP at the end of 2030. The rising debt is largely because of the major entitlement programs, Social Security, Medicare, Medicaid, and Income Security (welfare), which currently take up 2/3rds of all budget outlays and are projected to rise further. These programs suffer from an inexorably increasing demographic of an aging population benefiting from the programs, without enough younger people paying into them. On top of that, it is political suicide to try to change those programs, so they are unlikely to be cut in any material way. The two most likely candidates, will add on to that debt, even though they do show a marked difference in their platforms and fiscal plans.

Biden's plans, simply put, include an increase in spending of $3.2T over the next ten years, on top of CBO's projection of $60.7T. In theory, he also has enough tax hikes to pay for it. Under his plans, the debt would rise only a bit more than current projections. Any increase in the debt load is to be avoided, but Biden's plans seem like they would have little effect on top of the already planned increases.

Sanders' plans aim at making enormous changes to the federal government in line with his "social democrat" moniker. He effectively wants to increase government spending by around 70%. He has proposed massive new social programs, including "Medicare for All", which would cost $17.5T; the "Green New Deal", which would cost $16.3T; free college tuition, and many more line items. The total is around $40T above current spending over 10 years. Sanders plans to pay for his platform with a plethora of massive new taxes and tax increases, yet it seems that they would fall far short of paying for the spending. If we assume that taxes go up $10T over the 10-year period, Sanders' programs would add a huge amount to the national debt, making it effectively double to around $60T, or 196% of GDP. This policy would place an unsustainable burden on the U.S. economy.

The last fiscal orientations of the White House, as mirrored by the recent release of its FY 2021 Budget, advocate for a deficit reduction by USD 4.6 trillion by 2030. However, underlying assumptions of growth in those projections are probably over-optimistic as they bet on average real GDP growth performance of +2.8% y/y. In a context of muted productivity growth and the aging of the population, this is highly unlikely. There are obviously significant differences between budgetary options contained in these new budget proposals (see **Figure 3**) and the Democrat proposals. The White House proposes cuts in healthcare, social and education spending in favor of higher military spending and further extension of the 2017 Tax Cuts and Jobs Act (TCJA) beyond 2025.

However, when looking at different programs[1] and combining them with assumptions of the CBO in the baseline scenario (corresponding to the current administration's orientations), we realize that the current level of public deficit will remain persistently high (**Figure 4**), whoever wins presidential election. U.S. public debt is likely to remain on an unsustainable path.

The U.S. economy will have to withstand a persistently high level of uncertainty in 2020

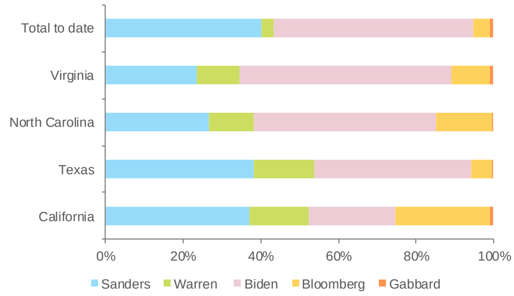
The recent years saw the level of uncertainty significantly increase after President Trump decided to opt for a more protectionist stance in his trade policy. The deterioration of trade relations between the U.S. and China triggered a significant deceleration of global trade. The U.S. economy was not immune to the impact of this shock as large U.S. companies remain dependent on foreign demand. As a result, the U.S. investment cycle has

[1] We integrate in our calculation the incremental tax hikes planed by all the candidates over a horizon of 10 years, the full incremental increase of public expenditures for Biden (82% for Warren and 52% for Sanders).

progressively lost some momentum despite the resilience of domestic demand. With the impact of the Covid-19 outbreak considered now as high in the election year,we expect the U.S. economy to remain under pressure with a huge level of uncertainty. This is the reason why we expect only +1.6% y/y of growth in 2020 compared with +2.3% y/y in 2019.

On 04 March, the Federal Reserve decided to cut interest rates by half a percentage point in an emergency move designed to bolster the U.S. economy amid the risks posed by the Covid-19 outbreak. This is the first emergency cut since the financial crisis of 2008-09. We expect a further rate cut of 25bp in June, to 0.75%.

Figure 1 – Results of the Democrat Primaries (% of total delegates)



Sources: National exit polls, Euler Hermes, Allianz Research

Figure 2 – Key economic programs proposed by the candidates

Economic Policy		
Sanders	**Warren**	**Biden**
• Raise federal minimum wage to at least $15 an hour • Double union membership within first term • Establish Dmocratic Employee Ownership Funds that would guarantee workers eventually take control of 20% of stakes in corporations with at least $100mn annual revenue/balance sheet total through issuance of new stocks • Democratize corporate boards by mandating employees to directly elect 45% of corporate boards of directors, similar to the 'employee co-determiniation' in Germany • Propose a federal 'tax on extreme wealth' applying to net worth of $32mn and above • Restore corporate tax rate to 35% from 21% by eliminating all corporate tax breaks and loopholes • Break up too-big-to-fail banks and end the too-big-to-jail doctrine • Against NAFTA, USMCA and TPP, and instead negotiate trade deals that strengthen rights of workers in the U.S. and abroad	• 'Ultra-millionaire tax' plan that wiould impose a 2% tax on households with networths of more than $50mn and an additional 1% levy on wealth above $1bn • Promote competition and break up big tech monopolies such as Facebook, Google, Apple and Amazon, and advocated legislation that would make Amazon Marketplace and Google search into utilities • 'Real Corporate Profits tax' - for every dollar of profit above $100mn, the corporataion will pay a 7% tax • Ban the practice of government officials trading individual stocks while in office • Reinstate a modern Glass-Steagall Act that would wall off commercial and ivnestment banking to stabilize the financial system • Raise wage to $15 an hour for all workers and extend labor rights to all workers • Trade plan commits to using America's leverage to press for international coordination on tax evasion • Trade approach endoreses a carbon tax for imported goods made using "carbon-intensive processes"	• Restore the 39.6% individual income tax rate for the wealthiest earners • Increase the corproate tax rate to 28% • Raise minimum wage to $15 an hour • Ensure "gig economy" workers receive legal benefits and protections with a federal standard modeled on the ABC test for all labor, employment and tax laws • Create a cabinet-level working group that will solely focus on promoting union organizing and collective bargaining in the public and private sectors • Express support for future trade deals but need to ensure labor and environment representatives have a greater voice in negotiations
Bloomberg	**Gabbard**	
• Raise the federal minimum wage to $15 an hour • Restore the household tax top rate to 39.6% • Place a 5% surtax on incomes (capital and labor) above $5mn a year to fund infrastructure, education and healthcare, affecting less than 0.1% of taxpayers • Raise corporate tax rate to 28% and increase minimum tax on foreign income • Launch a major R&D initiative to create up to 30 new growth hubs in regions that need food jobs most • Increase the budget for Small Business Investment Company program which licenses private providers of capital and offers financing for small businesses • Oppose protectionism and support free trade deals such as the TPP, and would de-escalate trade tensions with China	• Raise minimum wage to $15 an hour • Reinstate Glass-Steagall and break up big banks to get the economy back to working for the benefit of all Americans • Oppose TPP and Trump administration's trade war against China that damaged the economy	

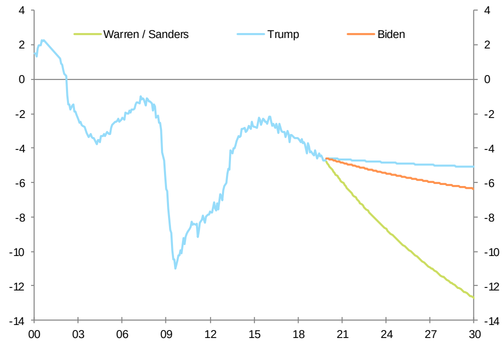
Sources: Candidate campaign websites, Euler Hermes, Allianz Research

Figure 3 – Fiscal spending and revenues (USD bn) in FY 2021 White House Budget

Policy	Cost/Savings (-)
Extend the Tax Cuts and Jobs Act	1370
Enact New Initiatives	355
Enact highway and other infrastructure spending	275
Establish Education Freedom Scholarship	45
Provide paid parental leave	20
Increase other spending	15
Reduce Discretionary Spending	-1950
Enact specific non-defense reductions	-370
Assuming further non-defense savings through "two-penny plan"	-1180
Freeze defense spending after 2025 and reduce OCO spending	-400
Support the President's Vision for Health Reform	-485
Reduce Medicare and Medicaid Costs	-785
Equalize hospital and physician payments for similar services	-165
Enact Comprehensive Drug Pricing Reform	-135
Move GME and DSH spending out of Medicare and cap their growth	-140
Reduce and reform Medicare post-acute care payments	-115
Reform other Medicare provider payments and other changes (net)	-60
Enact medical malpractice reform	-40
Enact Medicaid and other health changes	-130
Reform Welfare Programs	-220
Reduce and reform SNAP ("food stamps")	-180
Reduce and reform other means-tested programs	-40
Reduce Other Mandatory Spending	-520
Reform higher education loans and spending	-170
Modify federal employee health and retirement benefits	-90
Reform the Postal Service	-95
Reduce farm subsidies	-50
Promote return-to-work for workers with disabilities	-45
Reform disability programs and reduce Social Security improper payments	-35
Enact other savings	-35
Increase Revenue and Receipts	-285
Reduce the "'tax gap"	-80
Require Social Security number for most tax credits	-75
Raise PBGC, GSE, and other Premiums	-60
Increase various user fees and sell government assets	-45
Raise other revenue	-25
Net interest	-290
Total Plolicy Savings in Budget	-3170
include cost of TCJA extension in baseline (including interest)	-1455
Claimed Deficit Reduction	-4625

Sources: Committee for a Responsible Federal Budget

Figure 4 – US fiscal deficit (% of GDP)



Sources: Allianz Research

These assessments are, as always, subject to the disclaimer provided below.