ALLIANZ RESEARCH

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

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Research Assistant <u>Emily.Chiang@eulerhermes.com</u> 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 programs¹ 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%.

Total to date

Virginia

North Carolina

Texas

California

0% 20% 40% 60% 80% 100%

Sanders "Warren Biden Bloomberg "Gabbard

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
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 ooards 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% oy elliminating all corporate tax breaks and oopholes Break up too-big-to-fail banks and end the oo-big-to-jail doctrine Against NAFTA, USMCA and TPP, and instead negatiate trade deals that strengthen rights of workers in the U.S. and abroad	of profit above \$100mn, the corporataion will pay a 7% tax 8an the practice of government officials trading individual stocks while in office • Reinstate a modern Glass-Steagall Act that would wall Gf 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	Increase the corproate tax rate to 28% Roise minimum wage to \$15 an hour Finsure "sig 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 organizir 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,	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	

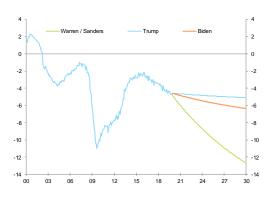
Sources: Candidate campaign websites, Euler Hermes, Allianz Research

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

Extend the Tax Cuts and Jobs Act Enact New Initiatives Enact highway and other infrastructure spending Establish Education Freedom Scholarship Provide paid parental leave Increase other spending Reduce Discretionary Spending Enact specific non-defense reductions Assuming further non-defense savings through "two-penny plan" Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense voice in the spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after 2025 and reduce OCO spending Freeze defense spending after growth gro	Policy	Cost/Savings (-)
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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	Reduce Other Mandatory Spending	-520
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	Reform higher education loans and spending	-170
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	Modify federal employee health and retirement benefits	-90
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		-95
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		-50
Reform disability programs and reduce Social Security improper payments Enact other savings -35 Increase Revenue and Receipts 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 Raise other revenue -25 Net interest -290 Total Plolicy Savings in Budget -3170		
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		
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		
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	Increase Revenue and Receipts	-285
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		
Raise PBGC, GSE, and other Premiums -60 Increase various user fees and sell government assets Raise other revenue -25 Net interest -290 Total Plolicy Savings in Budget -3170		
Increase various user fees and sell government assets -45 Raise other revenue -25 Net interest -290 Total Plolicy Savings in Budget -3170	•	
Raise other revenue -25 Net interest -290 Total Plolicy Savings in Budget -3170	, ,	
Net interest -290 Total Plolicy Savings in Budget -3170		
Total Plolicy Savings in Budget -3170	Raise other revenue	-25
	Net interest	-290
include cost of TCJA extension in baseline (including interest) -1455	Total Plolicy Savings in Budget	-3170
	include cost of TCJA extension in baseline (including interest)	-1455
Claimed Deficit Reduction -4625	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.

FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.