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TRENDMACRO LIVE!

On Ryan as VP Nominee

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If this gambit works, the fiscal cliff goes away. If it fails, the risk is even greater.

As we have been predicting to clients for the last two weeks, Mitt Romney has named Paul Ryan (R-WI) to be his vice presidential running mate.

- This would appear to be an uncharacteristically bold move by Romney, to excite the conservative GOP base which has been cool to him, and to establish himself with the influential Tea Party wing.
- We don't want to diminish how positive a development we think this can be for Romney's election chances -- and ultimately for better pro-growth policy. But it remains to be seen whether it is truly a bold masterstroke signifying a more energetic and risk-embracing Romney, or only a hedge against poor turn-out in November. It may be little more than a necessary next step in Romney's upside-down version of Richard Nixon's advice to run to the right in the primaries, and then to the center in the general election.
- If it's merely a tactical gesture, it will backfire -- and we'll find out soon. The Democrats will paint Ryan as an economic extremist, and Romney will have to decide whether to stand by Ryan and his ideas or shove him into the background.
- Presidential candidate Robert Dole took the latter course in the 1996 election, emasculating his running mate Jack Kemp -- like Ryan, a superstar among fiscal conservatives (Ryan was a speechwriter and researcher for Kemp, by the way). If Romney does that to Ryan, it will alienate the conservative base more than if he had simply picked a conventional centrist like Portman or Pawlenty to begin with.

Ryan's selection by Romney heightens the risk to the economy and the markets from the year-end fiscal cliff -- in the sense that it enlarges the "tail" probabilities of the best *and* the worst outcomes.

- If Romney's Ryan gambit pays off, the risk of the fiscal cliff goes away entirely. Even if we fall off it on December 31, as soon as Romney is sworn on next January 20 the GOP House can extend Bush-era tax rates and it would ratified by the Senate with 50 GOP votes and Vice President Ryan casting the tie-breaker.
- If Romney and Ryan lose in November, the GOP likely wouldn't gain control of the Senate, but it wouldn't matter if it did. It will have

Update to strategic view

US MACRO, US STOCKS: Ryan on the Romney ticket is a bid to excite the conservative base that has been cool to Romney so far. But making it work requires Romney embracing Ryan's economic philosophy in the face of inevitable strong criticism, else he risks the fate of the disastrous Dole/Kemp ticket in 1996. If Ryan helps Romney win, the risk of the year-end fiscal cliff goes away. If Romney and Ryan lose, the fiscal cliff becomes riskier than ever, with a radicalized Obama believing he has a mandate to tax the so-called "rich" and increase government spending, and the GOP believing it must fight back by refusing to raise the debt ceiling. Stocks have recovered since June on hopes that Romney can win, but the upside from here is limited until there is more visibility on the election and the fiscal cliff dependent on the election.

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been a campaign radicalized and enriched by Ryan's presence on the GOP ticket -- fiscal reform and growth will have been substantively and hotly debated. An Obama win would produce a mandate for him to follow through on his threat to veto any extension of the Bush-era tax rates that includes the so-called "rich." There is no way a GOP Congress could override it.

- In that world, the GOP would be utterly unwilling to compromise by extending the Bush-era tax rates only for the so-called "middle class." And the GOP would impose impossible conditions on Democrats for agreeing to raise the statutory debt ceiling.
- If in the face of that, if Obama still wouldn't sign a complete extension of the Bush-era tax rates, then there would be a bargaining failure resulting in a collapse in disposable personal income at the same time as a default on US Treasury debt.

As we talk to clients about all this, we face a near-complete consensus that somehow it will all work out just fine -- in the sense that the downside of a bargaining failure is so self-evidently great, the Bush-era tax rates are very likely to get extended for another year or two, and the debt ceiling is likely to get raised. We don't really disagree with that as a central tendency, but we see more tail risks around it than clients do.

Stocks would seem to agree with our clients, having recovered most of their correction losses since the April top. Or maybe stocks are forecasting our best tail outcome, in which Romney is elected and the GOP takes control of the Senate. After all, the correction bottom coincided exactly with a major political event pointing to a Romney win -- Ryan's fellow GOP Wisconsinite, Governor Scott Walker, surviving his recall election by a landslide (see "Light at the End of the Cliff?" June 11, 2012).

We've maintained all along that this has just been a correction. But as stocks have recovered, we have become cautious about how much upside there can be until there is more clarity on the election and the fiscal cliff that depends on the election. Ryan's addition to the GOP ticket is a strong potential positive. It remains to be seen whether Romney has the conviction to turn that potential into reality.

Bottom line

Ryan on the Romney ticket is a bid to excite the conservative base that has been cool to Romney so far. But making it work requires Romney embracing Ryan's economic philosophy in the face of inevitable strong criticism, else he risks the fate of the disastrous Dole/Kemp ticket in 1996. If Ryan helps Romney win, the risk of the year-end fiscal cliff goes away. If Romney and Ryan lose, the fiscal cliff becomes riskier than ever, with a radicalized Obama believing he has a mandate to tax the so-called "rich" and increase government spending, and the GOP believing it must fight back by refusing to raise the debt ceiling. Stocks have recovered since June on hopes that Romney can win, but the upside from here is limited until there is more visibility on the election and the fiscal cliff dependent on the election.

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