

POLITICAL PULSE

What If Obama Wins?

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Close call worst of all -- if Obama thinks he has a mandate and the GOP thinks he doesn't.

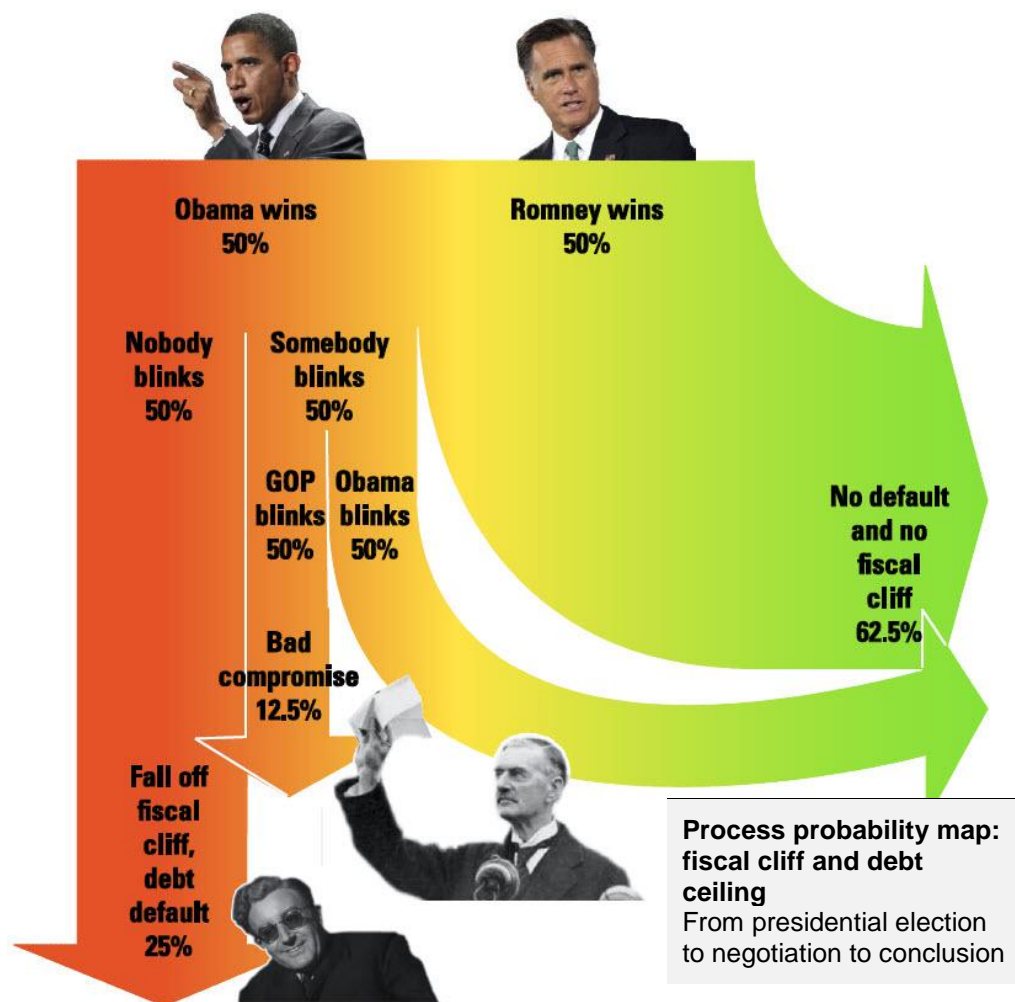
We think of the election as a toss-up where the coin is biased. Many of our conservative clients continue to insist that Mitt Romney will win. They have credible reasons (none has cited [the "Redskins rule"](#)). We continue to expect Barack Obama to be re-elected, based on our election model (see most recently ["On the October Jobs Report"](#) November 2, 2012), the [political futures markets](#) and [the preponderance of polls](#). [But anything is still possible](#). Nevertheless, just as we asked two weeks ago *what if Romney wins* (see ["What if Romney Wins?"](#) October 23, 2012), today we must ask: *what if Obama wins?*

Update to strategic view

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STOCKS: It's a close call, but it looks like Obama will win. Bipartisanship has emerged as a media narrative about both candidates at the finish. Surrogates seem to be making conciliatory noises about the fiscal cliff and the debt ceiling, but we read them as more narrative than reality. The key dynamic, if Obama wins, is whether or not he feels he has a mandate to take a hardline stance in negotiations about the cliff and the ceiling. If after a close election he feels he has such a mandate -- while the GOP feels he doesn't -- that's a set-up for the most risky negotiations, and a large volatility event for markets.

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We will only glance over the *long-term* implications today. Clients know well where we stand on this. We do not believe the Obama administration's policies and leadership style have been good for economic growth, and we don't have any reason to think they will improve in a second term. But as long as the House of Representatives stays in GOP control, the worst policy mistakes can be avoided.

The short term is the important part. We believe that if Obama is re-elected the negotiation in the lame duck session about the fiscal cliff and the debt ceiling will be far more contentious, leading to a major volatility event for markets (see, among many, "[Positioning for the Fiscal Cliff](#)" October 3, 2012). For this report on election day, we will review the most recent developments in that theme.

- In the run-up to election day, in what has been the most bitterly negative campaign we have ever seen, [suddenly it seems](#) that the media have seized on new narrative -- that both sides are presenting themselves to voters as reassuring, conciliatory and committed to working in a bipartisan manner.
- So over the last few days there has been a number of seemingly reassuring statements about the fiscal cliff and the debt ceiling. In reality, it's probably the case that these apparent reassurances are mostly the product of the media's narrative *du jour*.
- At the most grandiose level, yesterday the G20 concluded its meeting in Mexico by [issuing a communique](#) promising that "The United States will carefully calibrate the pace of fiscal tightening to ensure that public finances are placed on a sustainable long-run path while avoiding a sharp fiscal contraction in 2013."
- Closer to the real action, House Speaker John Boehner (R-OH) [told the National Journal](#) over the weekend that he expects decisions on the fiscal cliff to be pushed into 2013, and appeared to bow to a potential Obama mandate:

Lame ducks aren't noted for doing big things. And frankly I'm not sure that lame ducks should do big things. So the most likely outcome would be some type of a bridge... But the impact of the election is certainly going to have an impact on how this plays out.

- Senate Finance Committee Chair Max Baucus (D-MT) [told Politico](#) that Obama will shortly announce a grand compromise:

I expect that the president, soon after the election, is going to make a proposal to the Congress that's balanced, got some spending cuts and some revenue-raisers, and it's not too draconian because we can't stifle the economic growth that we're moving toward, that's being maintained... At the same time, we're getting that debt down.

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- From these statements, we urge clients to *not* uncritically accept the narrative that bipartisanship is breaking out in Washington. Boehner is *not* caving before the negotiations even begin. And Obama is *not* going to present anything other than his familiar plan to raise taxes on so-called "rich folks."
- As to Boehner's "bridge," it is hardly a new idea -- nor one likely to be embraced by the president, no matter how conciliatory he is said to be at this moment. When we first heard the bridge idea advocated [by Bill Clinton](#) and [by Lawrence Summers](#) months ago, the White House quickly forced both of them to recant (see "[Light at the End of the Cliff?](#)" June 11, 2012). The last time [we heard it, from](#) Assistant Senate Majority Leader Dick Durbin (D-IL), the White House [immediately said](#) it would veto any bill that extended the current tax rates for the highest earners.
- So Boehner's bridge would probably suffer the same fate. After offering it, Boehner went on say,

I think it's important that we avoid the fiscal cliff, but that doesn't mean I'm interested in raising tax rates and killing jobs.

- And Boehner brandished a negotiating weapon that is especially effective with Democratic senators from high-tax blue states. Picking up on a [widely circulated scare-story in Friday's Washington Post](#), Boehner warned:

One thing that nobody's quite recognized yet is that the AMT relief for this tax year has not been extended. That means instead of 4 million people getting hit by the AMT, alternative minimum tax, you're going to have 30 million Americans hit by the alternative minimum tax. And they're going to start filing by the end of January.

- Baucus, for his part, was just sounding off. Obviously Obama is going to present *something* after the election. But according to *Politico*, "Baucus was vague on the exact policy prescription, and he noted that he wasn't sure if the White House had a plan it was ready to present." That hasn't stopped several [versions of this story](#) from bouncing around the media echo chamber.

Yes, hints and emanations and trial balloons like these will be essential for navigating the risks of the coming negotiation. But none of *these* represents a tipping point in the process.

The most important work we can do now is understand the underlying game theory structure that this election will create. The new factor presenting itself now is the possibility that the outcome will likely be extremely close. There is a chance that Obama will win the Electoral College and Romney will win the popular vote. There is a chance that the

election results will be delayed while some battleground state -- [most likely Ohio](#) -- counts and recounts provisional or contested ballots.

- At stake here is whether Obama will come out of the election with a mandate. A strong win -- especially against the Romney/Ryan ticket that represents wealth and fiscal restraint -- would give Obama scope to take the most hardline positions on taxes and spending in the coming negotiation.
- Even without a split, a close election would deprive Obama of a strong mandate.
- It would be nice to think that, without a strong mandate, Obama would not make good on his repeated threats to veto any bill that includes extension of current tax rates for the highest earners, and would generally be more conciliatory in the coming negotiation. *Other than a Romney win, this is one of the better outcomes we could hope for.*
- But who's to say that Obama will feel he doesn't have a mandate just because the election is a close one? Surviving a near-death political experience for the first time in his career may embolden him all the more.
- If Obama really did get a resounding mandate here, then perhaps -- *perhaps* -- the GOP would have to be more conciliatory. *If our hope is to avoid the worst volatility of a chaotic negotiation with the risk of a catastrophic bargaining breakdown, this wouldn't be the worst outcome.*
- But we think that the GOP will not recognize as a mandate any but the most resounding one -- and maybe not even that. Such a thing doesn't seem to be in the cards, anyway. *If after a close election Obama feels he has a mandate at the same time the GOP feels he doesn't, it's a worst case recipe for the most volatile possible negotiation.*

Bottom line

It's a close call, but it looks like Obama will win. Bipartisanship has emerged as a media narrative about both candidates at the finish. Surrogates seem to be making conciliatory noises about the fiscal cliff and the debt ceiling, but we read them as more narrative than reality. The key dynamic, if Obama wins, is whether or not he feels he has a mandate to take a hardline stance in negotiations about the cliff and the ceiling. If after a close election he feels he has such a mandate -- while the GOP feels he doesn't -- that's a set-up for the most risky negotiations, and a large volatility event for markets. ▶