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MARKETWRAP

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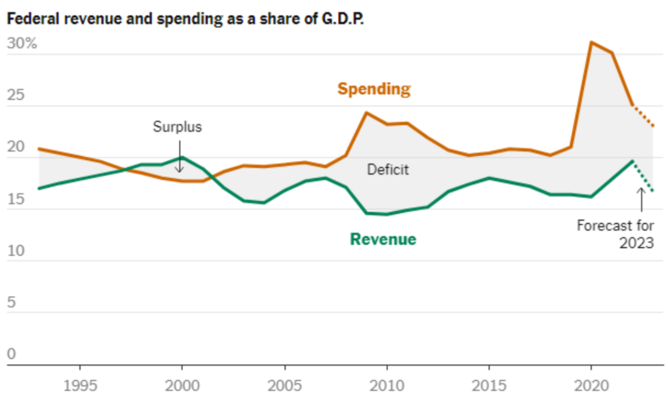
U.S. ECONOMY

Deficit Drama

Can we - and should we - reduce the federal deficit?

By Zachary Li



A visualization of U.S. spending and revenue since 1990. Source: NYT

$1.7 trillion. That's roughly the GDP of Australia, the 12th largest economy in the world. That number is also on par with the market capitalization of Google parent Alphabet and could fund 100 NYUs for a year, Langone included.

It's also the federal deficit for FY 2023, according to the U.S. government on Friday. At approximately 6.3% of U.S. GDP, the deficit has reached its highest level in history outside of COVID-19.

According to the Congressional Budget Office, part of the sudden jump in the federal deficit was a 2.7% reduction in revenues as a share of GDP, from 17.7% to about 15%. This drop was driven by lower capital gains tax, unexpectedly high (and potentially fraudulent) use of the pandemic-era employee retention credit, and a tax filing extension in California. On the other side, outlays were unchanged, with increases in social spending canceling out continuing drops in pandemic-related spending. On top of that, interest on the US debt also increased from 2.0% to 2.4% of GDP, spurred by high global interest rates.

Given this, we need to ask ourselves two questions: firstly, whether we can reduce the federal deficit, and secondly, whether we should.

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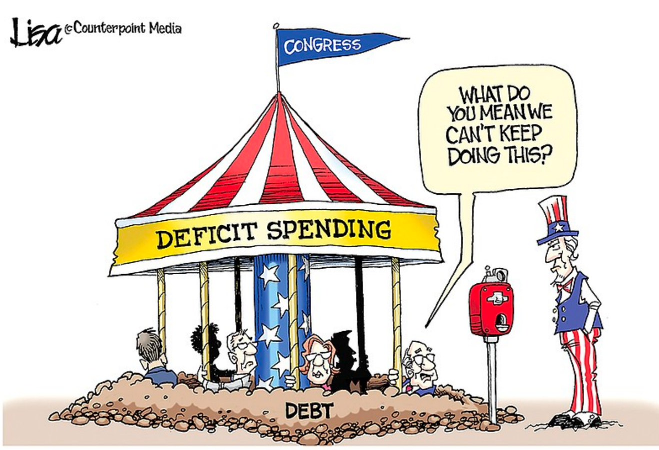
LOOKING FURTHER INSIDE

The former is easy to answer, and it's a resounding yes. Many of these changes, particularly the revenues and the interest on the U.S. debt, will return to more normal levels and reduce the deficit in the near future. However, any substantial budget reduction would be much harder to achieve. A combination of tax hikes, reductions in critical programs like Social Security and Medicare, and discretionary spending eliminations would be all but necessary for real change.

The more important question is whether we should even want to reduce the deficit. Obviously, if we had the power to keep taxes and spending the exact same while running a surplus, we would. Unfortunately, that's impossible. If the U.S. embarks on what would be a monumental spending adjustment, tens of millions of people might lose their livelihoods, and the United States would be immediately headed toward a recession. Yes, reducing the deficit will reduce debt in the long term, encourage private investment, and potentially reduce inflation; however, the current path to get there is simply unthinkable.



INTERNATIONAL RELATIONS

Balancing Act

Painting a Global Landscape in Crisis

By Mira Dasgupta

An image released by Russian state media shows President Vladimir V. Putin of Russia with President Xi Jinping of China in Beijing. The countries have refused to condemn Hamas after its attacks on Israel.

Earlier this week, the world witnessed Xi Jinping, China's leader, and President Vladamir Putin of Russia reuniting in Beijing for China's Belt and Road Forum conference, flaunting their strength and demonstrating their "no-limits" partnership against the Western powers, especially the United States of America. This visit and a subsequent showcase of cooperation and "friendship", along with the direct swipes at President Biden and the United States, aims to portray Russia and China as a "fairer, multipolar world", especially in the midst of the crisis in Gaza.

The Belt and Road Initiative, founded by Xi in 2013, is an infrastructure project that uses China's finances to further its influence in developing countries, mainly in Asia and Africa.

Working to counter the presence of the United States, spending reaches nearly $1 trillion in loans to such countries to build roads, airports, power plants, etc. Through this project, China's role has been rendered more important in global development, directly countering the U.S. While the project has worsened debt levels for most countries involved, it has surely boosted China's soft power.

The Belt and Road Forum called for leaders of almost 150 developing countries, such as Nigeria, Chile, Ethiopia, Cambodia, Thailand, etc., to gather in Beijing, where Xi and Putin strategically presented themselves as the alternative to the Western powers. The absence of any European countries, except Hungary, and the overwhelming presence of the Global South shows how the global landscape has shifted post-Russia's invasion of Ukraine. Despite the West trying to isolate Russia, this Forum is a pronounced reminder of how important Russia truly is, with Asia and the Global South clearly showing their interest in doing business and trade with Russia, not concerned about Ukraine.

Moreover, China and Russia's stances on the Gaza crisis, as opposed to America's, further consolidate this objective. Beijing and Moscow have decidedly avoided condemning Hamas for its attack on Israel and have criticized Israeli airstrikes, calling for a revival of talks for a Palestinian state. China's stance of criticizing Israel is an illustration of it trying to fill the vacuum left by the U.S. in the Middle East and further its soft power in the region. Furthermore, this is a manner to signal to the Global South that they shouldn't expect the West or the U.S. to support them, especially in times of crisis, and instead, China would.

Russo-Chinese relations have only further consolidated since Russia's invasion of Ukraine as China became Russia's largest oil importer, providing Russia with crucial war funds and allowing China to receive discounted Russian oil. Their alignment on the Israel-Hamas conflict reflects their common geopolitical goals, and their ambition to diminish the "American hegemony" has only brought them closer together.

However, it is crucial to note that China is the senior partner in this relationship as Russia remains undeniably dependent on China's implicit support in its war with Ukraine. Nevertheless, U.S.-China's deteriorating relations, as seen with the recent restrictions on investments in China, the shift in semiconductor production, along the numerous multilateral security deals in the U.S. bloc, only pushes China closer to Putin's Russia.

POLITICS

The Kennedy Factor

Robert F. Kennedy, Jr.'s independent candidacy

By Tim Panagoplos

Presidential candidate Robert F. Kennedy, Jr. announces his third-party 2024 Presidential bid in Philadelphia on October 9. Source: Matt Rourke/AP

Three years removed from the tumultuous presidential 2020 election, an election that broadened American political divides and weakened the fabric of society, Americans find themselves one year away from yet another presidential election. Republican primary voters in Iowa have just begun casting their first absentee ballots beginning on October 18, and the caucus is set to be held on January 15.

The primary season will culminate in mid-July at the GOP convention in Milwaukee, but polling indicates that the race is out of reach. According to the RealClearPolitics poll aggregate, Donald Trump is currently polling with 58.8% of Republican support nationally, with Ron DeSantis holding a distant second position at a mere 13% of national Republican support. It is safe to say that 2024 will be a remake of 2020, with one important caveat.

The return of a significant third-party candidate is a concern of both the Trump and Biden campaigns, considering major third-party opposition was not a factor in 2020. With Robert Kennedy, Jr. announcing his independent candidacy in Philadelphia on October 9, the current polling aggregate has him receiving 15.3% of the national vote. To put this in historical perspective, Ross Perot received 8.4% of the popular vote nationally in 1996, handing Bill Clinton a landslide reelection because of Perot's appeal to the populist right.

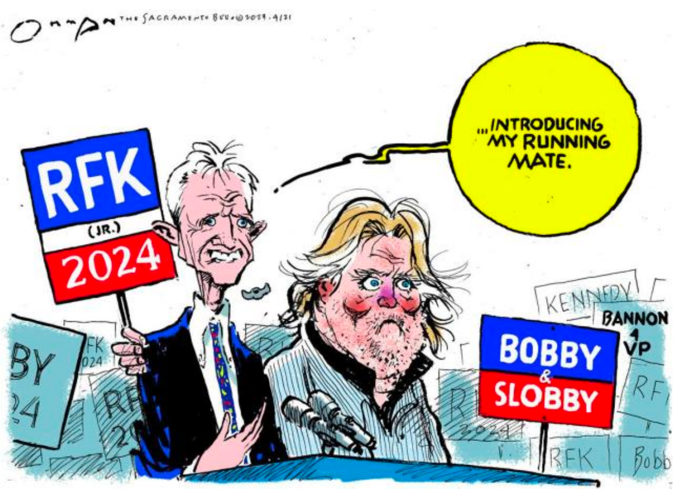
The dynamics are different in Kennedy's case. Although he hails from an iconic Democrat family and holds economically and socially liberal positions, his mistrust of COVID vaccines and criticism of mainstream media broadens his appeal to potential Trump voters. Unlike Perot in 1996, Kennedy has found support across the ideological spectrum.

According to the current 2024 general election data, Kennedy's position in the race has a minimal impact on the margin between Biden and Trump. The current two-way aggregate between Biden and Trump shows Trump maintaining a 0.5% lead over Biden nationally, while polls that include Kennedy indicate that Trump extends his lead over Biden to 3.5% nationally.

In perspective, Hillary Clinton earned a 2.1% advantage over Trump in the national popular vote in 2016 yet lost the Electoral College by a considerable margin. A small margin in the popular vote should worry Democrats, as history indicates that these margins can result in an increase in Trump support in key swing states.

A year ahead of the 2024 election, Trump is not only keeping the national vote close, but he is holding a small lead over Biden. In addition, Bloomberg/Morning Consult state polls published this week show Trump sustaining leads over Biden in Arizona, North Carolina, Georgia, Pennsylvania, and Wisconsin. The Biden campaign certainly has ground to make up by next November.

It is important to remember that polls are a snapshot in time. Robert Kennedy's influence in the race can grow or decline between now and election day. New events out of the volatile situations in Eastern Europe and the Middle East can change voter sentiments rapidly. Although Trump is currently polling better than he had at any point during the 2016 and 2020 cycles, he must remain diligent and on message to maintain this support through the finish line.

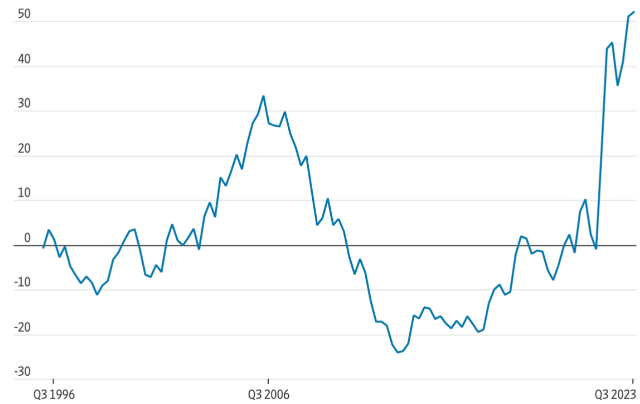


U.S. DOMESTIC AFFAIRS

Time of Uncertainty

Mortgages are rising in a speedy fashion, but consumers are managing to hold on

By Riya Khosla



Discount to buying a home versus renting it in the US
Source: CBRE Research

Since the pandemic, the Fed has attempted to restabilize the economy by increasing the federal fund rate. Through this, the hope is that the economy slows down to a point where inflation can be brought under control. However, the labor market has remained strong, and consumers have been able to spend more money than what typically occurs in similar economic times.

One significant area that is impacted by these attempts is the housing market. The housing market serves as a prominent measure of economic activity and accounts for nearly 17% of overall GDP, contributing in two ways. Around 5% is from the construction of establishments, ranging from remodeling to fixed investment. The remaining percentage can be accounted for with spending on housing services, such as utilities and rent.

After the pandemic and the rise of remote work, many consumers who typically would live with their parents or roommates are now looking to purchase a place of their own. This phenomenon has increased consumer demand for housing. However, coupled with the Fed's influence, it has created a crisis for the housing market.

Since at least 1996, the scales have tipped in favor of renting, with the discrepancy recently reaching an alarming 52% due to steadily increasing mortgage rates. This situation is reminiscent of the 2008 housing crash, resulting in cause for concern for both myself and many economists. The increase in the Funds rate and the lack of cooling in the housing market reflects how the market balance will most likely not be restored unless there is a recession, which would cause further problems for consumers.

When the Federal Reserve's rate increases, it exerts upward pressure on mortgage interest rates, making it more costly to purchase a home. This relationship has been particularly salient since 2012, with mortgage rates surpassing nominal peaks in 2016. I believe this will most likely hurt investors who have invested in US rental property, for many consumers are unable to put down the 10% payment or sustain the increasing mortgage costs, which currently have reached 8%. Additionally, many consumers are unwilling to sell their homes to retain their cheaper mortgages compared to the current rates today. Additionally, to compensate for this, debt in America will continue to increase, for mortgage debt accounts for around 70% of all household debt.

Overall, the rising house prices typically result in additional construction spending, which increases economic growth and reflects higher confidence in the economy. However, this should be unusual in these circumstances. Considering historical predictions, in my opinion, our current trajectory does not seem to be a sustainable state for the housing market, and there is a looming possibility of values melting down. This could hurt not only national GDP but also foreign investment in the future. If this occurs, it could have devastating consequences for the nation. To combat this, we must take another strategy to curb the momentum of the housing market.