

Americas New Presidency

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With Barack Obama's historic presidential win on 4th November 2008, the US Democratic Party will have control of both houses of the legislature and the executive for the first time since 1995. Obama's team will be facing one of the worst economic downturns since the Great Depression 1929 due to spill-over effects from the global financial crisis 2008. Government spending is expected to increase as the democrats pursue an ambitious stimulus and reform package and the regulatory environment for businesses is projected to tighten.

Issue

The USA was the first nation to see its financial markets collapse in 2008 due to its exposure to sub-prime mortgages. The democrats will be taking over the government at an inopportune time:

The US consumer confidence index based on consumer ratings of the labour market and business conditions was the lowest level recorded in October 2008, falling from 61.4 in September 2008 to 38.0 in October;
 The unemployment rate was 6.1% in September 2008, up from 4.7% in September 2007;
 In August 2008 house prices in US metropolitan areas dropped 16.6% while foreclosure rates were up 27% from August 2007;
 The economy shrank in the third quarter of 2008 as real GDP fell -0.3% from the previous quarter and consumer expenditure fell -3.1%.

Importance

Obama's priority will be returning stability to financial markets and encouraging growth:

In September 2008 the government approved a US\$700 billion bail-out package to help buy up toxic mortgage-related assets;
 The democratic congress has proposed a US\$150 billion stimulus package, which has received support from the Federal Reserve Bank.

Obama's team has proposed a US\$190 billion package which will likely supplement the congressional plan;
 Obama will try to stimulate GDP growth and employment through government spending on infrastructure and renewable energy projects;
 During the election Obama ran on a pro-worker platform and is pro-union. He has defended labour protections such as the right to strike and has proposed increasing the federal minimum wage which is US\$6.55 per hour in 2008;
 The Obama team plans on increasing the marginal income tax rate for top earners from 35.0% to the pre-Bush level of 39.6% while middle-income families will get a tax break of about US\$2,200 per year. Under his 'Making Work Pay' plan, low-income families will get a tax credit of US\$1,000 and individuals US\$500. Obama has not announced changes to the corporate tax rate but has proposed a tax on "excessive profits" for big oil companies;
 He has also proposed more financial-sector oversight, in particular to address predatory mortgage and credit card lending;
 Obama's campaign rhetoric was somewhat protectionist in terms of trade policy. He does not support the Central American Free Trade Agreement (CAFTA) and wants to reform the North American Trade Agreement (NAFTA). He also wants reforms to the tax code to remove incentives for companies to move operations overseas and wants to encourage companies to employ American workers.

Implications

Planned expansionary fiscal policies are likely to put further pressure on government finances:

Under unified governments, when one party has control of both the legislature and executive, there tends to be less fiscal discipline. In periods of unified government in the USA, spending has increased by an average 5.3% annually compared to an average annual increase of 1.7% during periods of divided government;
 The budget deficit, which was estimated at US\$219 billion (1.6% of GDP) in 2007 rose to US\$708 billion (5.0% of GDP) in the second quarter of FY2008. The economic stimulus plans will push the deficit higher;

Job losses will reduce income tax revenues for the government while unemployment compensation will rise;
 Tax breaks for middle-income earners will further limit budget receipts but they should boost consumption. Private

consumption accounted for approximately 70% of GDP in 2007;

Although the democrats advocate withdrawal from Iraq, the budget is further constrained by the extent of military spending as the USA continues to fight a two-front war in Iraq and Afghanistan;

Large-scale infrastructure projects will help boost employment, however, through job creation and productivity growth in the long-term. Investment in renewable energy research will drive innovation and help insulate the economy against oil price volatility;

The regulatory environment for business is expected to tighten particularly in the financial sector as the government pursues more oversight of lending practices and restrictions on financial instruments;

The trade environment may tighten as Obama is expected to take a protectionist stance, which will worry countries dependent on exports to the USA. However, the dollar is gaining strength and this should keep imports attractive to American consumers.

Future Scenarios

Obama's win is historic as the first African American to become President in US history. However, although the new government is pursuing economic stimulus policies, the recovery from the 2008 financial crisis is expected to be an uphill journey. Unemployment rates are expected to worsen and real GDP growth is forecast to drop from 2.0% in 2007 to 1.6% in 2008 and 0.5% in 2009.

The Federal Reserve Bank cut interest rates on October 29th by one-half percentage point to 1.0% to address the slowing economic climate. Pre-election polls suggested that Americans feel Obama is better equipped to handle the economic crisis. Businesses will likely see a stiffer regulatory environment but benefit from incentive packages for innovation, particularly in manufacturing and renewable energy sectors.

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