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ECONOMIC TALKING POINTS

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A Cautionary Note: Can This Business Cycle Survive The Political Perils Ahead?

Before I begin, it is necessary to preface my comments by saying our firm conducts its economic analysis and forecasts in a non-partisan manner. We're determined stay on the 50-yard line politically. So let's get that out of the way up front.

Why open up with such a statement? Because politics threatens to become so dangerously confrontational in the weeks and months ahead that it could shove the economy off course.

Let's start with the upcoming presidential campaign, which promises to be a uniquely bizarre one. In the past, the economy and financial markets have been mostly unaffected by the political brawls that precede a major national election. The verbal jousting and saturation of often shameless campaign ads have become part of America's messy democracy. Investors and business leaders usually take them in stride. It all becomes white noise leading up to the election.

But there is something palpably different this time. The economy, I believe, may be far more vulnerable as the 2024 presidential race gets underway. Why? I'll put it bluntly. All the elements seem to be in place for this presidential battle to degenerate into political gang warfare, and I mean that both in a metaphorical as well as literal sense. We can't rule out anything, not massive social unrest, nor a crippling cyber attack against the US to sway the election, or even political operatives using artificial intelligence to create disinformation and distort reality on an unprecedented scale.

Can the US economy, which we project will average close to a 2% growth rate thru 2024, withstand such mayhem?

Take another example that is even more immediate. Tensions appear to be especially high within the Republican Party, where one major conservative faction is totally consumed with impeaching President Biden, while GOP centrists are gearing up for tough negotiations with Democrats to avoid a government shutdown this October. Given the vitriol and fierce political divide in Congress, I have to say the odds are better than 50% that Congress will fail to prevent a closure of government this time.

Yes, we've been at the edge of fiscal cliffs before and both parties have more often than not managed at the last minute to work out at least some short-term patches to keep the government functioning. However, it's difficult to see that happen this time because the climate in Washington is so much more corrosive.

A lengthy shutdown this time could be the kind of exogenous shock that will impact not only financial markets but also greatly complicate how the Federal Reserve conducts interest rate policy.

A cascade of questions thus follows. Will investors be so unnerved by the deep disfunction in Washington over the budget and the utter chaos of this presidential campaign that it triggers a sharp fall in stock prices? Could we see another major downgrade in US treasury debt? Might global creditors be so weary of the paralysis in the US that they rush to place their capital elsewhere in the world? Will such an outflow of funds drive up markets rates to a level where it chokes off economic activity?

I raise these issues because we are now six weeks from that budgetary precipice and days away from the first Republican presidential debate.

Everyone, of course, hopes sanity will prevail in Washington. But that may be asking too much this time. There is a growing sense of unease that the economy will need to navigate through a particularly toxic backdrop: one of intense national political tribalism that may erupt into violence, a new fiscal year that could be devoid of a budget, and/or a 2024 Presidential race that makes a mockery of American exceptionalism.

The question from an economist's point of view is how ugly will domestic politics get and how severely can it impact the macroeconomy? The US has already been pounded by multiple once-in-a-lifetime series of shocks the last three years, and one has to be impressed by the economy's resilience so far. Nevertheless, the economic and political risks ahead must not be discounted. They are real and should be taken seriously. Nothing less than the preservation of this business cycle is at stake.