

# Economic Watch

United States

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Economic Analysis

United States  
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## 2012 Election Preview

### Economic Improvements boost Obama's chances

- Romney, Republican Candidate with strong public and private resume

With Newt Gingrich announcing his campaign suspension as of May 2 2012, it appears the Republican nomination is for all intents and purposes Mitt Romney's. Mitt Romney is Harvard-educated (MBA/JD), was a highly successful executive at Bain Capital, was one-term governor of Massachusetts, and acted as the chairman of the 2002 winter Olympic committee.

- Near-term political imperatives to shape election strategy, possibly at the neglect of structural reforms

Given the continuing economic underperformance, it is likely that both parties will target jobs, growth, and energy policies in the 2012 campaigns. Furthermore, the growing deficit and widening debt will likely be a focal point that requires both candidates to provide fiscally constrained pro-growth policies that appeal to key electoral regions.

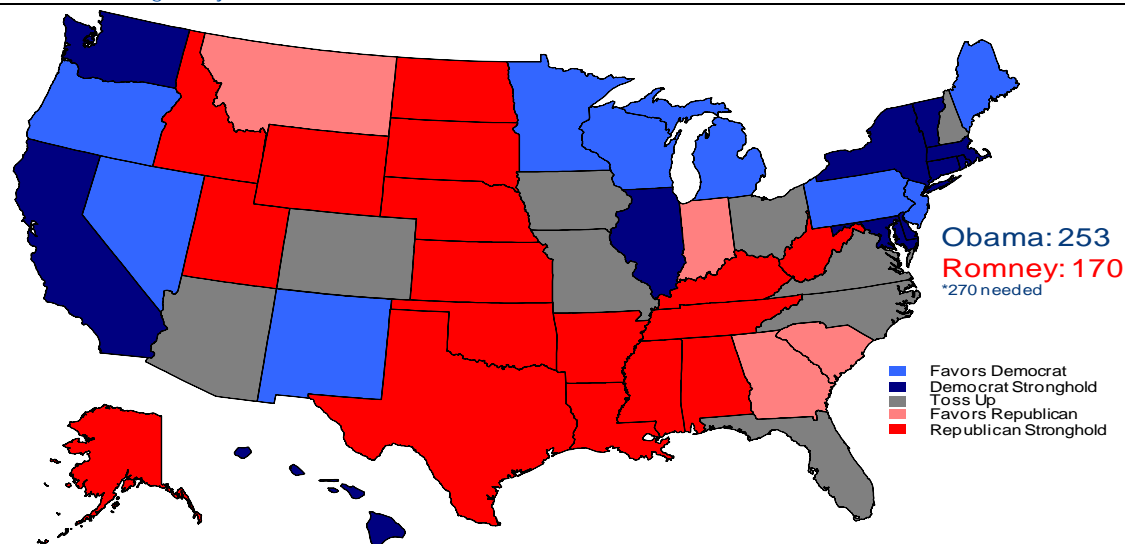
- A Robust Structural Agenda unlikely to come from either candidate

While President Obama has publicly supported a robust structural agenda, congressional roadblocks or what some suggest is ineffective politicking have lead to limited success. In addition, Mitt Romney has stated he would support large deficit reduction initiatives yet other structural weakness would be left to the states.

- President Obama chances improve

Our presidential probability model ([link to article](#)) and Intrade probabilities suggest that President Obama's chances for re-election have improved since our last publication

Chart 1  
Electoral College Projections\*



Source: Real Clear Politics and BBVA Research  
\*Predictions based on t

## Romney to be Republican Nominee

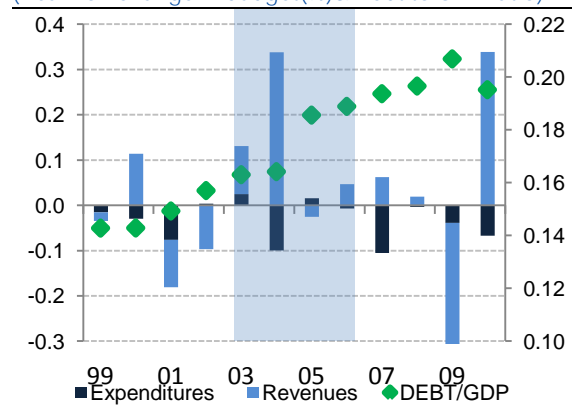
With Newt Gingrich announcing his campaign suspension as of May 2 2012, it appears the Republican nomination is for all intents and purposes Mitt Romney's. While Ron Paul, whom adheres to libertarian ideologies but caucuses with the Republican Party, has stated that he will remain in the race. However, his delegate support will never reach a level to challenge Romney's nomination.

### Romney will bring a strong a strong public and private resume

Mitt Romney brings an impressive resume to the upcoming election. He is Harvard educated (MBA/JD), was a highly successful executive at Bain Capital, was one-term governor of Massachusetts, and acted as the chairman of the 2002 winter Olympic committee. Furthermore, he has familial ties to the White House, as his father was the US Secretary of Housing and Urban Development. Thus, it appears his qualifications are sufficient and therefore the Democrats will target his policy inconsistencies and elitist background rather than his personal and professional accomplishments.

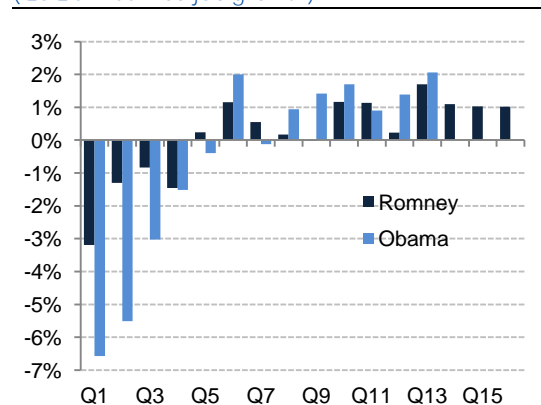
Mitt Romney's conservative track record as governor of Massachusetts, generally considered one of if not the most liberal states in the country, is unclear. For example, during his tenure as governor Mitt Romney signed into law a bill that extended universal healthcare to all Massachusetts residents. In actuality, the reform served as a benchmark for the affordable care act (dubbed "Obamacare"), in that Massachusetts residents were now required to obtain insurance or pay a penalty (tax). Romney now stands firmly opposed to universal healthcare laws enacted last year; he defers to a 10<sup>th</sup> amendment argument of states' rights or enumerated powers and budgetary effects. Mitt Romney also increased many licensing fees, including fees on guns, in addition to closing tax loopholes. These policies were targeted approaches to closing the deficit of the state of Massachusetts, which were moderately effective in a state which generally struggles with annual deficits. Mitt Romney slowly progressed to the extremes of the ideological spectrum throughout his term as governor. For example, in his early years as governor, he preferred expenditure based reductions but at times allowed de facto tax increases. Now he stands with the conservative right in that he vehemently opposes tax increases – Norquist pledge. In essence, he will likely be challenged by Democrats and the President to explain the contradictions between now and his gubernatorial term.

Chart 2  
**Romney's Budget Dynamics**  
(Real YoY change in budget(%)& Debt to GDP ratio)



Source: Haver and BBVA Research

Chart 3  
**Job creation Comparison\***  
(QoQ annualized job growth)



Source: Haver & BBVA Research  
\*Gubernatorial term v. 1st presidential term

On social policy, as governor of Massachusetts he tended towards the middle and in some instances spilled over into what are traditional liberal policy positions. Now, much like his fiscal platform, he embraces all of the socially conservative platforms. As governor of Massachusetts, he supported or

remained neutral on socially liberal policies such as gay marriage and pro-choice. However, towards the end of his gubernatorial term in Massachusetts, Romney's adopted a more conservative disposition.

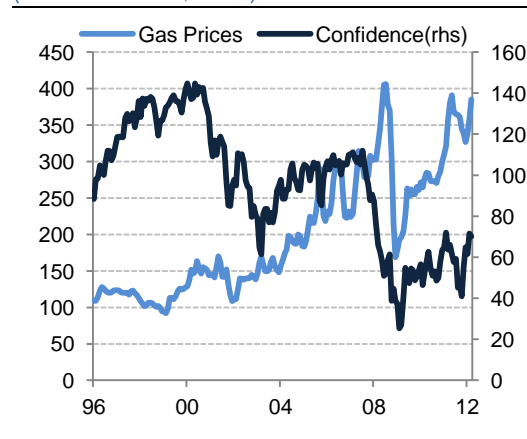
Now, as he enters the presidential campaign season, he will be challenged to defend his ideological shift. Some suggest his ephemeral policy stance is a reflection of his pragmatic approach to problem solving. Others might argue it is pandering to the masses. Whether or not this quality is taken as a fluid management or insincerity will be central to how voters perceive him. Edward Glaser suggests that "Romney should give up on contorting himself to please voters, for America and the Republican Party desperately need a leader who will put truth above popularity". If he heeds the advice of Glaser, improves his approval in swing states, maintains a consistent policy, and effectively manages the conservative right, he will pose a strong challenge to president Obama's incumbency.

## Near-term political imperatives to shape election strategy, possibly at the neglect of structural reforms

Given the continuing economic underperformance, both parties will target jobs, growth, and energy policies in the 2012 campaigns. Furthermore, the growing deficit and widening debt will likely be a focal point that requires both candidates to provide fiscally-constrained pro-growth policies. Current forecasts also suggest a contested race and thus implicit regional guarantees— e.g. manufacturing subsidies which benefit Ohio Pennsylvania or Medicare guarantees for Florida— will increase as candidates fight for key electoral votes in swing states. However, broad-based long-term reforms appear less probable given the President's current effectiveness at implementing policy reform and the stated positions of Mitt Romney, which suggest a state-centric approach.

## Job creation over the coming months

Chart 4  
Consumer Confidence v Gas Prices  
(Index 1985=100, cents)



Source: Haver and BBVA Research

Employment and job creation will be a focal point of the 2012 election. In a Gallup survey, respondents were asked what worries you most about the economy, 26% responded jobs/unemployment, which was 10pp above the second response, debt/deficit. Obama, on the one hand, will be able to boast that the unemployment rate has either declined or remained unchanged for ten months and the 3mma of nonfarm payrolls is above 200k in 2012. Romney, on the other hand, will be able to challenge job growth during the past four year and suggest that improvements are insufficient and an unemployment rate well above NAIRU (5.5%, according to the Fed) is unacceptable. However, chart 3 shows that Romney's gubernatorial employment creation is comparable to that of president Obama under similar budgetary constraints and partisan opposition. Sector employment creation will also be essential to the level of swing state support. Other influential employment statistics include the rate of unemployment for the marginally

attached worker, which is currently 14.5% and real wage growth which has not changed (0.2%) for the total working population but increased for earners in the 90% percentile (4.9%). Thus, middle-class job creation will also be a point of contention.

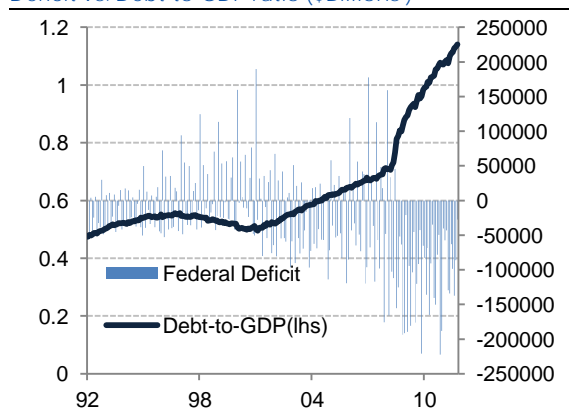
## Debt and Deficit

Fiscal responsibility and debt/deficit reduction, the second most pressing concern according to Gallup opinion polls, will be a key determinant in the upcoming election. The need for fiscal prudence will not be easily accomplished in the next presidential term given multiple factors which include the need for

near-term growth, imperatives of structural reform, and the bloated entitlement system. These structural weaknesses will be confounded by either President Obama's ineffectiveness, Congress's uncompromising stance on taxes or Mitt Romney's no tax increase pledge.

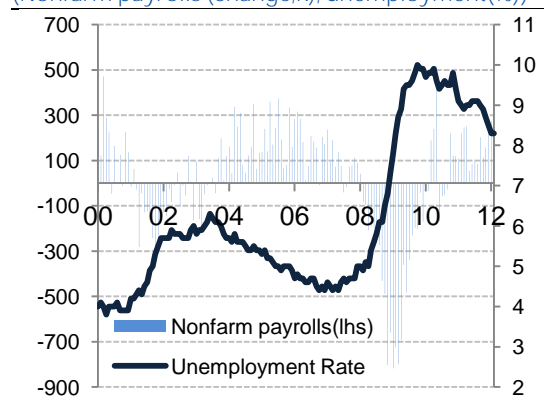
Romney's jawboning the fiscal situation suggests a private equity approach. The themes would be cuts at the federal level, attrition in federal agencies (2 for 1 policy), and state centric management of education, healthcare, and infrastructure with no checks on retiree entitlements. Specifics are unclear however; current reports suggest Romney's approach to fiscal reform would focus on bringing Federal spending to historically consistent levels of 18-20% of GDP by cutting "500 billion per year in 2016". Cuts would come from non-security discretionary spending. Thus, his fiscal management is, in general, non-revenue-based and reflect Reaganomic principles. For example, if elected some suggest he will be a fiscal pragmatist much like his gubernatorial tenure, where revenues and expenditures were above and below the series average by 7.5pp and 1.4pp, respectively, in real terms. Nevertheless, during his tenure, he faced strong legislative opposition to spending cuts and thus state debt increased 4.3 3.4, 11.2, and 2.6% in 2003-2007, respectively. Moreover, his shift to a more conservative platform suggest he would support a more conservative budget and insofar as congress remains Republican controlled, it is likely that structural inefficiencies will be addressed.

Chart 5  
Deficit vs. Debt-to-GDP ratio (\$Billions)



Source: Haver and BBVA Research

Chart 6  
Employment  
(Nonfarm payrolls (change,k), unemployment(%))



Source Haver & BBVA Research

Large deficit reductions in the short-to-medium run are less likely to come under the President's second term. It could be argued that the inability to tackle fiscal reform is as much a stain on Congress record as is the President's. Nevertheless the President has not accomplished what he has promised. In addition, President Obama, through various communications and policy proposals does not support expenditure-based fiscal reform and alluded to an expansion of the Federal bureaucracy and expansion of Federal subsidization. This discretionary deficit spending is arguably needed given the economic slack and weak job creation. Nevertheless, these policies will likely add to the deficit in the near-term. On structural reform and the deficit, the President's stated positions suggest that to maintain current spending levels, taxes will have to increase, which seems impossible given Congressional effrontery.

## Energy policies will be important given growth objectives and consumer sentiment

Any targeted approach to job creation will necessarily need growth to sustain it. Assuming current industry trends, growth will have to come from high-tech or energy sectors in the near-term. On the one hand, high-tech industries provide high value-added jobs that increase wealth for highly-educated and generally higher income earners. However, the high-tech sector is most often a regional job

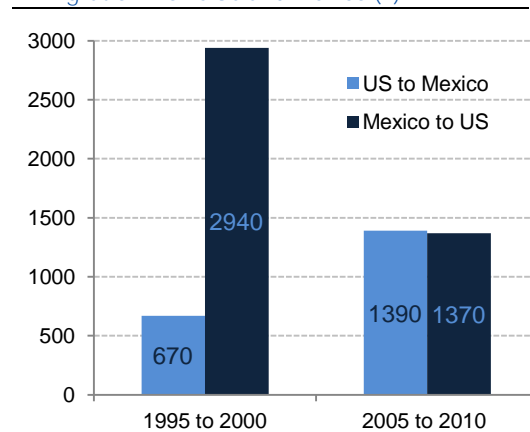
creator whereas recent technological achievements in crude oil and natural gas drilling have created expansive opportunities across great swaths of the country including North Dakota, Ohio, Louisiana, Texas, Pennsylvania, Colorado, and Wyoming. On mining job creation, the industry has added 71.5K jobs since the job loss nadir on January 2009 (-818KMoM), whereas net private job creation for the country is -1 mn. Thus, the broad-based employment gains and growth discussed in either campaign will likely involve a significant focus on energy. Rising gasoline prices appeared to be a campaign platform for Republicans given the impact to consumer sentiment. However, the recent softening of crude oil prices and weak global demand suggest gasoline prices will ease and thus not capture the conscience of the average voter.

The energy policy positions of both Mitt Romney and President Obama are largely consistent in terms of exploration. For example, Mitt Romney throughout the primary seasons has suggested that he will increase exploration activity, in essence promoting true laissez-faire market approach; President Obama has acted recently to expand drilling activity. In addition, he has alluded to changing in regulatory and bureaucratic oversight of certain federal agencies, in this instance the EPA. On taxes, the impact is less clear. The proposed corporate flat tax, of Mitt Romney, could be a de facto tax increase for oil and gas companies. President Obama on the other hand has stated he prefers clean energy projects and some suggest he may reduce non-clean energy based subsidization. Although long-term energy regulation is unclear, it is apparent through recent regulatory allusions that drilling activities will receive greater oversight in the near future, which will likely increase shadow costs.

### Obama likely to support structural agenda Romney unlikely

Without an overwhelming shift in consensus, structural programs are more likely to be cut than expanded during the next presidential term. First, the probability that president Obama faces a Republican controlled congress is high. Thus, it will likely prove difficult to progress what will almost necessarily involve spending increases. Second, given the tensions between the White House and Congress it is unlikely to see significant legislation creation or implementation, outside of policies already enacted like the Affordable Care Act (ACA). Romney, on the other hand, does not support an expanding Federal government and thus programs not currently provided will not likely be adopted. His approach suggests states would be given carte blanche with Federal dollars. Thus, programs such as energy reform, infrastructure and healthcare (dependent upon Supreme Court) are likely to be cut, underfunded, or left to the states in either a Romney or Obama campaign. Education reform, however, while approved of by both candidates is unlikely to be robust given that neither candidate has put forth a comprehensive platform.

Chart 7  
Immigration Flows US and Mexico (k)



Source: Pew Hispanic Research Center

Assuming the State of the union is substance rather than an attempt to cajole voters, the President strongly supports a ubiquitous structural reform agenda, which would include human capital improvements, healthcare overhaul, and technology and energy R&D. These reforms would likely come at the cost of higher taxes for higher-income individuals and corporations. The feasibility of the aforementioned is less clear given the unrelenting opposition in the House to tax increases and general effrontery shown towards the president. The added complexity of implementing a structural agenda with strong partisan opposition and limited budget flexibility suggests a decreased probability of implementing structural reform for president Obama.

Romney, surprisingly, given the threats to US competitiveness, is not campaigning on a platform of structural reform at the Federal level. He has proposed a removed, state-centric approach that provides block grants to state that in decentralized management structure. This approach will sufficiently and necessarily exclude a healthcare overhaul

or infrastructure investments at the federal level. On immigration, Romney would promote a pro-growth immigration policy that placed punitive damages upon illegal immigrants as well as improving protections against increased flows ("high-tech fence"). The investment in a high-tech fence may be counterproductive given that recent study that suggests flows, between the US and Mexico was effectively zero in 2005-2010. On education, His policies are in line with consensus in that he believes improving high-quality students' access to tertiary education while also expanding applied programs improving worker skills.

## Statistics suggests Obama's chances improved; however, republicans could gain a majority in Senate

Our presidential probability model ([link to article](#)) and Intrade probabilities suggest that President Obama's chances for re-election have improved since our last publication. Strong 1Q12 data, and what appeared to be easing global tension, improved the President's probability for re-election. Furthermore, the squalid debates between Mitt Romney and the other Republican primary candidates exposed Mitt Romney's weaknesses which could retrace as he gears up to take on President Obama. Thus, barring a downside economic risk scenario, and drastic shift in approval of Mitt Romney, the President will be elected for a second term.

On Congressional and Senatorial races, the current opinion polls suggest the Republican caucus has a slight edge in key districts. The presumption that the Republicans gain majorities in both legislative bodies suggests that the gridlock between the Whitehouse and congress will endure if he is re-elected. Although Republicans could improve their majority in the House and regain control of the Senate, the probability that the Republicans gain the 60 seats necessary for a vote of cloture (block of filibuster) is low and thus policy creation will be lacking.

## Election Landscape 2012: A fight for demographics and swing-states

Table 1  
Our Model Forecasts

Scenarios	GOP	Democrats
Current	48.2	51.8
BBVA Baseline	49.2	50.7
Oil Shock	46.2	53.8
Europe Malaise	51.6	48.3
Regional Stimulus	48.1	51.9

Source: BBVA Research

Our vote-share model that uses financial and economic statistics to model the share of the popular vote that each party receives, predicts that given current economic conditions, President Obama is the favored to win the election. The result reflects a stabilizing inflation trend, stronger manufacturing data, an uptick in the Dow Jones and slight easing volatility. Under our baseline scenario, which is slightly less optimistic than current conditions, the margin is razor thin, suggesting that Electoral College votes will be more important than the popular vote. Of note, only a contagion like shock from Europe would suggest a Romney victory. Implied market probabilities reflect this as the probability of an Obama re-election increased 8.6pp since January.

Moreover, opinion polls and improving favorability suggest the national level statistics may underestimate the advantage Obama currently enjoys. For example, according to the most recent Gallup polls, women view Obama more favorably than men (7pp), over 65% of Hispanics approve of Obama's policies, and 57% of those aged 18-25 approve of Obama. The latter of the aforementioned statistics has a historically lower voter participation rate. However, last election this trend reversed and helped president Obama secure the White House. Grassroots social media focused campaigning was suggested as the key to raising the participation rate in the age group 21-34 by 2.8%. This increase translated into 1.6M or 0.7% more voters.

Even though the President's approval rating has improved over the past 8-12 months, prior to this year, his mismanagement of the BP oil spill and debt ceiling negotiations, and lack of effective policy creation, led to a free fall in his approval rating (38% as of October). Given the recent uptick in the



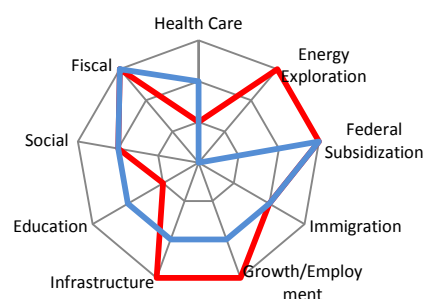
overall economic environment—jobs and gasoline prices— republican strategist will likely rehash these negative events during their campaigning. The Dodd-Frank Act and Affordable Care Act are examples of failed attempts at structural reform. To most, it is clear that the failure to implement the legislation is not entirely his fault given the strong private and congressional opposition. Nevertheless, it is likely that the Republican's will attack his ineffectiveness as a reformer and manager. Moreover, his mismanagement of the BP oil spill and debt ceiling negotiations over the summer will also serve as examples of his inability to manage or politic for support. Thus, Republican strategist will focus on his inability to “manage”, which will stand in contrast to the blue-chip management experience of Mitt Romney.

Chart 8  
Implicit Probability of Obama Winning Election  
(light blue= probability, dark blue= volume(k))



Source: Haver and BBVA Research

Chart 9  
Candidate Ideological Web Chart  
(Center represents centrist ideologies)



Source Haver & BBVA Research

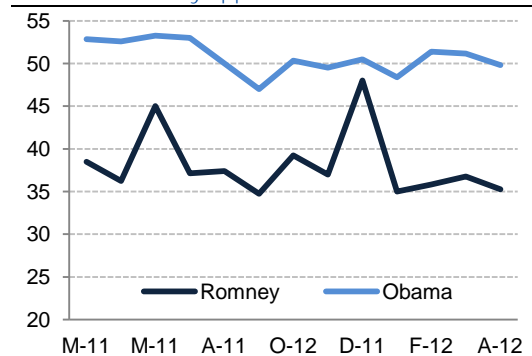
On regional campaigning in key electoral states, the most recent state-level opinion polls show that neither candidate has enough electoral college votes to win the. For example, as of April 27, president Obama is projected to win 270 votes, Romney 170, and the remaining 141 are too highly contested to predict. Of the 141 remaining, Florida (29), Ohio (18), Pennsylvania (20) and North Carolina (15) comprise 58.1% (82) of the contested votes. In essence, these states will have two major impacts on the 2012 election campaign. First, candidates will do the majority of their campaigning activities in the aforementioned states insofar as they do not alienate their moderate base—Romney in the south and President Obama in states such as New Hampshire, Colorado and some of the historically split states in the Midwest. Second, the policy platforms of each candidate will likely reflect the needs of these states such as Medicare (Florida), energy policies (Ohio and Pennsylvania), and manufacturing (North Carolina and Ohio). The President has already begun a regionally focused campaign which includes Colorado (9) and Mitt Romney, now that the Republican primary is effectively over, will likely follow suit.

### Bottom Line

The 2012 presidential election is set to be a highly contested race. In the preliminary campaign season it appears that voters currently favor president Obama more so than Romney. Nevertheless, President Obama has not had to endure a gruelling primary campaign and thus this balance could shift in the coming months. Therefore, under current conditions and taking current opinion polls and probability models as static, President Obama will win the 2012 election.

Chart 10

## Obama v. Romney approval



Source: Real Clear Politics and BBVA Research

## Election 2012:

- Regional campaigning and region-specific policy formulation will be key to candidates success
- To win, Romney will have to defend his ideological shift since leaving the Massachusetts governor's office and elitist background
- For President Obama, the task of defending his initiative will prove vital. After running on a campaign of change, for procedural reason or not, some suggest his effectiveness has been questionable.
- In total, whether president Obama or Mitt Romney win, the likelihood of ubiquitous long-term structural reform is low.



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