



The US budget battle

Overview

The recent negative watch of S&P on the US debt, and the particularly accommodative tone of the Fed have pushed the Dollar to record low, raising once again the question of privileges of foreign investors. The US recovery could seriously be endangered in case of a too lax approach of budgetary issues or political blockage on the question.

Focus: The US budget battle

The Republican and Democrat are engaged in a battle determining the future of US public finances, the quick deterioration of which during and after the crisis had led the opposition to accuse the US president of laxity in budgetary issues. The victory of the Republican in mid-term elections had re-equilibrated the American political landscape, resulting in a continuous rejection of Obama's budgets, which is to be voted by the Congress. Recently, the government was on the verge of a shutdown due to the lack of consensus on the funding of 2011 budget. The need to increase the public debt ceiling ignites other disputes and the vote of 2012 budget has been controversial. This climate of uncertainty made S&P to cut on 18 April the outlook on US debt from stable to negative, showing that there is now an urgent need to find a solution. The Republican Congressman Paul Ryan proposed a budget strategy cutting public expenditures by more than USD 6 tn over 10 years in comparison with Obama's project. The US president counterattacked in extending austerity measure with a reduction of public deficit over 12 years by a further USD 4 tn in comparison with the initial 2012 budget draft.

The major difference of the two proposals will shape the debates before the 2012 presidential elections and the path of public debt in the coming years. On one hand, the Republican adopts a traditional conservative position consisting of controlling and limiting the role of the state, and encouraging private initiative via low tax rates and less assistance in health and social security. On the other hand, Obama advocates a more redistributive approach which is visible in higher tax rates for the wealthiest and strong state interventionism in health. In his view, the rationalization of health expenditures and tax system coupled with a net reduction of military expenditures would allow debt stabilization. But both programs focus on boosting the growth potential of the US economy. The target is the same but the means to reach the goal are very different.

We believe the Obama's approach would be more favorable to the potential growth than that of the Republican, mainly due to

- The more redistributive approach of the Democrat is more adapted to a post-crisis period. The US economy is still convalescent and the US debt needs maintain confidence of its foreign investors.
- The cut of taxes would make the Republican optic more favorable to growth via promoting investment home and overseas. Nonetheless, a strong presence of the state is needed in a context of the US economic restructuring, which requires a reasonable level of tax.
- Obama advocates investment in infrastructures for boosting the potential of growth, which is truly needed in the US especially during the restructuring period.

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Performance of stock or sector relative to MSCI-China over next 6 months after research publications

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	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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