US election update: clarity, but not certainty

President-elect Biden to face a divided Congress

David Page,
Head of Macroeconomic Research,
Core Investments

Chris Iggo,
AXA IM Chief Investment Officer,
Core Investments

Key points

- With results continuing to trickle in as initial vote counts conclude, multiple news agencies declared Pennsylvania for Biden over the weekend, taking him over the 270 votes needed for an electoral college vote majority.
- President Trump has refused to concede defeat, pursuing recounts and legal challenges. The former appears unlikely to change the outcome, but the process of the legal challenges is more uncertain.
- The House appears on track for a Democrat majority.
- But the Senate is more uncertain and looks unlikely to be certain until early January. We expect a Republican majority in the Senate.
- A new President facing a divided Congress has not been seen in over 20 years.
- This will likely result in policy gridlock, blocking plans for fiscal stimulus in the short and medium-term and requiring more protracted monetary policy support.
- Yet President-elect Biden looks set to pursue a more multilateral approach on health, with the WHO, trade, with the WTO, and climate, with the Paris accord.

Prolonged vote count delivers President-elect Biden

Developments continue since the US Presidential Elections last Tuesday, but over the weekend a wide range of news agencies have declared Joe Biden to be the winner in Pennsylvania, a state carrying 20 electoral votes. This announcement has made President Trump's route to 270 impossible as things stand. It has also given Biden the greater-than-270 votes he needs to become President-elect. The exact number remains uncertain with different agencies awarding different states. Nevada (with six votes) has been declared for Biden. However, there is still some dispute over Arizona (11 votes) and Georgia is yet to be declared, although Biden currently holds a slim lead 49.5% vs 49.3% (99% of votes counted) in this state. Biden could conceivably end up with an electoral vote in excess of 300. Joe Biden also holds a 3-point lead in the national vote at 50.7% vs 47.7%, although with turnout in this election the highest since 1900, President Trump's national vote share was larger than Clinton's in 2016. Many international leaders communicated their congratulations to Biden on his victory over the weekend.

However, Republican leaders have in the main withheld their own reaction (exceptions include Senators Romney and Murkowski and President George W Bush) and President Trump has so far refused to concede defeat. In a large part this awaits the passage of recounts and legal proceedings. A re-count has been requested in Wisconsin, where Biden's lead of 0.7% is below the statutory level of 1.0% required for recount. In Georgia, the vote is also likely to fall within the margin allowing for a formal recount later this month. Recounts alone are unlikely to turn this election result.

First, we assume that any recount will be unbiased i.e. it is as likely to increase as reduce Biden's lead. Second, historic recounts have only delivered changes in the hundreds, not the thousands. Third, given Biden's electoral vote count, Wisconsin and undeclared Georgia would not reverse Biden's electoral college victory. The prospect of legal challenges is more uncertain. President Trump's team have launched a number of legal challenges across five different states. These could increase further as recounts progress. As yet, there is little evidence to support any of the Trump-team claims of infringement and a couple of lawsuits were immediately rejected. However, there is still a possibility that legal challenges could have some impact on the vote count – although with Biden ahead by several thousands across multiple states, the likelihood of these legal challenges reversing the overall majority that Biden now holds in electoral college votes remains slim, leaving him President-elect.

The outlook for the Congressional race is also not certain but appears clearer. The House of Representatives looks set to remain in Democrat majority, with 215 declared for Democrats (218 for majority) versus 196 for Republicans. The Senate is much closer. Currently Democrats have 46 seats declared versus 48 Republicans (2 independent seats caucus with the Democrats). This leaves four seats undecided. These were Republican seats in Alaska, North Carolina and Georgia. The seats in Alaska and North Carolina look likely to remain Republican, leaving the Republicans with 50 seats. Republicans would need 51 seats for a majority as in the case of a 50-50 outcome the Vice President would have the casting vote. However, despite the fact that both Georgia seats appear likely now to face a run-off election in early January, in both seats Republicans have a small lead (although Republican Senator Purdue could yet achieve more than 50%). The Senate outcome looks likely to be only decided in January, but at this stage it appears difficult for Democrats to win both of these run-off elections, which would thus deliver a Republican majority Senate.

Policy implications under divided Congress

At the time of writing then, our base case is for President Biden to be the first President since George Bush (snr) to face a divided Congress at inauguration. This will have material implications for three key areas of policy for the new Biden government.

- Short-term fiscal support package. The ongoing tug-of-war over a further near-term support package for the US remains in the balance. While Senate leader McConnell last week surprised with suggestions of a stimulus package over the coming weeks in the traditional "lame duck" session, his offer continues to be for a package materially below Democrat ambitions. House speaker Pelosi was quick to re-buff such an offer still holding out for broader support. The lack of a clear Democrat victory in the Senate means that Democrats will have to continue to seek compromise and a fresh stimulus package looks likely to be delayed until next year.

- New appointments. An opposition-led Senate may make Biden's cabinet appointment process more complicated, particularly if Biden wanted to appease the left wing of the Democrat party with key appointments that the Senate may now not approve. This may extend the appointment-making phase, delaying other priorities.

- Biden's progressive manifesto. The Biden manifesto was the most progressive since the early-1960s proposing around $4trn in tax increases to fund large spending increases in infrastructure, healthcare, social care and education. This looks impossible with a Republican led Senate. We do not expect Biden to be able to pass tax increases on corporates and high net wealth individuals'; we do not expect the Senate to back unfunded spending on education, healthcare and social security. And even in areas where compromise is plausible, for example infrastructure, we expect the Senate to reject the clean energy initiatives and significantly scale back other plans. Joe Biden's manifesto promised considerable fiscal stimulus over the medium term that would have gone a long way to boost GDP growth and reduce the need for monetary policy support. This now looks unlikely and likely will leave the US economy reliant on monetary policy support for longer.

But a Biden Presidency is still likely to materially change the course of policymaking. President and Vice President elect Biden and Harris have suggested four areas that they will focus on in the short term: the pandemic response, the economy, racial injustice and climate change. On the first, the sharp rise in Covid-testing positivity rates in recent weeks suggests that the US is heading into another outbreak of the virus that could exceed this summer's relapse in Southern states. As such, we suggest that the US is likely to once again see a piecemeal, state-led increase in restrictions over the coming weeks, long before inauguration day on 20 January. Steps on the economy are likely to focus on a short-term stimulus bill, which we expect for next year. However, we do expect Biden to swiftly lead the US to rejoin the Paris accord, marking a significant step-forward for climate change response. We also expect the US to return to support a multilateral approach to global policy, including support for the WHO and the WTO. On trade, we have argued that President Biden is unlikely to swiftly reverse the Trump-era tariffs. We continue to expect the new administration to continue to address concerns of unfair practice in trade from China, particularly around tech. However, we do expect Biden to follow a more multilateral approach. He may use the removal of tariffs as a key path to re-engage with China over specific issues.

Financial market reaction to the unfolding developments has been material and orderly. In the main, financial markets have progressed in an orderly manner to embrace the new likely outlook for US activity. Prior expectations for a Democrat sweep have been priced out and seen 10-year US Treasury yields retreat some 10bp to 0.80% from the closing yields last Tuesday night as markets have priced less reflation (5y-5y breakeven rates fell 6bps to 1.77%) and a greater expectation of persistent monetary policy support as fiscal stimulus expectations have fallen back. However, equity markets have risen sharply, the S&P 500 index up 4% and the Nasdaq outperforming this up 6.6%, as fears of corporate tax increases have faded – outweighing the prospective boost from fiscal stimulus. Finally, the expectation of less fiscal and more monetary support has impacted the dollar, which is currently 1.2% lower against a basket of currencies.

CIO Comment

"Equity markets had already responded to the removal of electoral uncertainty before Monday's encouraging news on a coronavirus vaccine. The evolution of the virus and the potential for therapeutic remedies were the next focus for market participants following the election as the global health situation will to some extent determine the size and type of additional fiscal and monetary policy stimulus. For the US, the fact that the Senate - at this point in time - remains with a small Republican minority is seen to work against very progressive taxation and spending policies being implemented in 2021. Investors are likely to welcome both the removal of electoral uncertainty (which will be cemented when and if President Trump concedes) and better news on the pandemic. This should translate into strong investment performance by stocks in those sectors most impacted by shutdowns in recent months – travel, leisure, hospitality and real estate amongst others. A more cyclical and value drive market with slightly higher bond yields could boost overall equity markets into year-end."

Chris Iggo, AXA Investment Managers CIO, Core investments

Our Research is available online:

DISCLAIMER

AXA Investment Managers SA
Tour Majunga – La Défense 9 – 6 place de la Pyramide 92800 Puteaux – France
Registered with the Nanterre Trade and Companies Register under number 393 051 826