

## Biden's economic options just got a whole lot more limited

Pollsters indicated the US mid-term elections were all about the economy and inflation, but a focus on social issues resonated and helped Democrats outperform expectations. They could even remain in control of the Senate, but the likely loss of the House will make President Biden's job more challenging and will limit his economic policy options



President Biden and his wife, Jill, campaigning at a Democrat rally in Maryland earlier this week

### Closer than thought, but Republicans still likely to win the House

Heading into the mid-term elections there was lots of focus on crime, health care, abortion rights and the future of democracy, but polls repeatedly showed that it was inflation and the impact on household finances that was at the top of voters' minds. It was also thought that President Biden's personal approval rating, at just 40% it's the lowest of any incumbent President heading into their first mid-term election, would be toxic for the Democrat vote. Commentators and betting markets had the Republicans taking control of the House of Representatives by a healthy margin while the Senate could also have come under their control.

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The results so far suggest it is much closer. While the Republicans are still favoured to win control of the House, it will be by a much smaller margin than envisaged – NBC's Decision Desk is projecting 222 Republican House seats to 213 for the Democrats. In the Senate, the Democrats managed to flip Pennsylvania after John Fetterman defeated Donald Trump-backed Mehmet Oz. This means for the Republicans to win the Senate they need to take two of the “toss-up” seats from the Democrats in Nevada and Georgia – in Nevada the Republican candidate is narrowly ahead, but in Georgia, the Democrat incumbent Raphael Warnock is ahead. That said, it could be several days for a winner to be declared in Nevada given “floods” of mail-in ballots, while Georgia’s election law requires the winner to take 50%+1 vote, meaning a run-off on December 6.

One of the key takeaways is that there doesn't appear to be a high success rate for the Donald Trump-endorsed candidates and given the Republicans' strong showing in Florida this could give the state's Governor Ron DeSantis' campaign to be the Republican candidate in 2024 a major boost.

## **A President constrained**

So what does this all mean? Well, President Biden struggled to pass legislation when he had a Democrat majority in both the House and the Senate (via Vice-President Kamala Harris's deciding vote). Without a majority in Congress, as seems likely, it is nigh on impossible. Intense partisanship with just two years to go until the next presidential elections means major legislation is unlikely to pass unless there is a national emergency.

President Biden's legislative actions are therefore likely going to be limited to the use of executive orders and actions to circumvent Congress, where allowed. This is a much more limited form of government. For example, the president cannot use an executive order to change taxes because that power is held by Congress. Consequently, President Biden's focus may have to focus on tinkering with social policy via Executive Orders with a broader shift towards international relations and trade policy where the president is less constrained by Congress.



Republican Ron DeSantis celebrates his second election win as Governor of the State of Florida

## The economic implications

It appears that investors were positioning for a stock market rally in recent days, but this has been undermined by the latest negative crypto headlines. A rally typically has happened after mid-term elections which result in a split Congress, largely on the rationale that it diminishes the prospect of painful new regulations and leaves corporates to focus on what they do best. But with the recessionary forces building, any bounce might not last long.

Moreover, given that the fear of recession is rising, there would typically be an expectation of some government efforts to support households and businesses, but the President will have less scope to offer fiscal support given the requirement of having Republican legislators on board. This suggests that once inflation is under control, the onus is going to be on the Federal Reserve to offer stimulus to the economy. This is consistent with our base case forecast for interest rate cuts from the second half of 2023 onwards.

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### *A split Congress will raise issues about what happens surrounding the debt ceiling*

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Perhaps more significantly for fiscal policy, a split Congress will raise issues about what happens surrounding the debt ceiling, which is currently \$31.381tn and is on track to be breached at some point in the third quarter of next year; to read up on the background, click [here](#). This is the “limit on the total amount of money the United States government is authorised to borrow to meet its existing legal obligations”. Failure to raise the limit in time would cause the government to default and would have dire consequences for global markets and the global economy.

In the absence of an agreement, we can expect to see the government take extraordinary measures to delay default, including putting non-essential Federal government workers on furlough with key parts of the government shut down until sense prevails and an agreement to raise the limit is reached.

Republicans may use a House majority (and potential Senate majority) to push for tough policy concessions from President Biden before they sanction the debt limit's increase. Many Republicans have argued that government needs to contribute to directly lowering inflation with several pushing for government spending and hiring freezes and some demanding outright spending cuts.

This is not something President Biden will readily accept. We could see extreme brinkmanship, economic disruption and higher government borrowing costs at a time when the economy is potentially in recession next year. Together with our expectation for Federal Reserve interest rate cuts, this would likely lead to the dollar coming under some significant downward pressure in the second half of 2023.

## What it means for 2024

The likely loss of the House may lead some Democrats to question whether President Biden is the best person to lead the party into the next election, although those calls will be muted given the better-than-expected Democrat vote so far. Moreover, only three out of the last 22 mid-term elections have seen the incumbent president's party make gains in the House with the median loss since 1934 being 28 seats. At the time of writing it appears this mid-term election will see the best performance for an incumbent President's party since George W Bush's Republicans made a gain of eight seats in 2002.

The lack of a credible alternative favours Biden standing again and defeating any Democrat challenger. The last time an incumbent President was seriously challenged by someone within his own party was in 1992 when President George HW Bush convincingly saw off Pat Buchanan.

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Donald Trump has strongly hinted that he will formally announce he is running for president on November 15, setting us up for a re-run of the 2020 contest. That won't deter other Republicans from throwing their hat into the ring with Florida Governor Ron DeSantis' very strong performance in his gubernatorial contest boosting his credentials while the mixed showing for Trump's favoured picks in the mid-terms could raise doubts over whether he is the candidate most likely to win. However, at this very early stage polls amongst Republican supporters suggest Trump is well out in first place (on just under 50% versus DeSantis's mid-20s polling for the Republican Presidential candidate).

With control of the House, Republicans gain congressional investigative powers, with some on the right already proposing looking into the president's son, Hunter Biden's, business dealings. They can also stall or disband other inquiries, including the committee investigation into the 6 January insurrection. President Trump's backers could also call for investigations into the FBI search at Mar-a-Lago, all of which could cause major headaches/distractions for President Biden

Also, over the coming days, we should watch for how some of the "election denier" Republican candidates do in some of the key local state official races. Some of these roles have influence over election processes and the certification of results so if you thought the 2020 election was angry and contentious, just wait for 2024...

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