

US Elections: Biden has the edge, but no Blue Wave

The election is far closer than polls had suggested. Joe Biden looks a narrow favourite to win the Presidency, but there was no "Blue Wave". Animosity and the threat of legal challenges argues against a swift fiscal support package which, with the growing threat of Covid, will be a concern for markets as activity becomes increasingly constrained



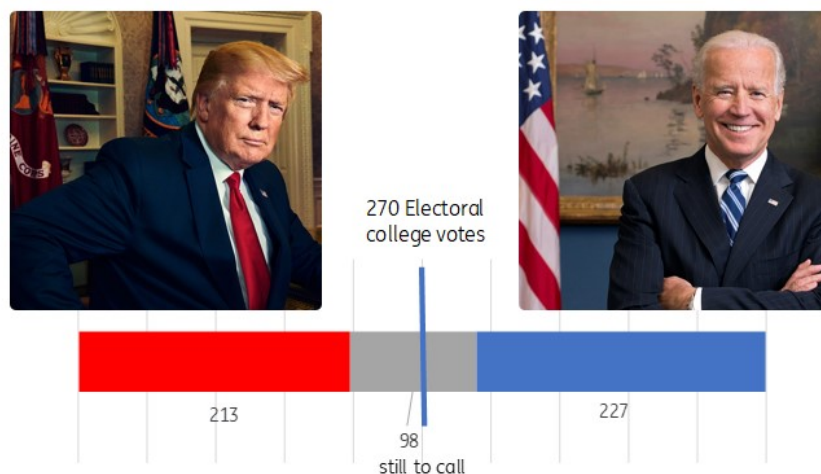
Election outcome casts doubt on stimulus

It was certainly 'risk-on' heading into election night on anticipation of a relatively 'clean' outcome that could not only lead to a substantial fiscal stimulus in 2021, but also open the door to talks on another near-term support package. Those hopes have been dashed, for the next few days at least. The results so far seemingly show Joe Biden has a very slight edge, but it certainly isn't going to be a convincing knockout victory accompanied by a Blue Wave. It looks as though there will be a smaller Democrat majority in the House and the chances of Democrats regaining the Senate appear slim at this point.

Unsurprisingly, risk sentiment has been somewhat mixed with the Treasury yield curve flattening at lower levels and the dollar outperforming on the prospect of a less reflationary fiscal environment. However, equities are less downbeat, presumably on the prospect that either a

Trump Presidency or a more constrained Biden would diminish the likelihood of significantly higher taxes and more regulation.

Electoral College position as of 5:30am ET



Source: NY Times, ING

Arguments and rancour ahead

The focus is on Wisconsin, Pennsylvania and Michigan, with the vote tallies favouring Biden over Trump right now. Voting will extend well into today and possibly longer due to counting for mail-in ballots, while the clear threat of legal challenges and potential court cases, already raised by President Trump, could further delay the result.

This is not a good outcome for the economy since the headwinds from rising Covid cases, troubled state and local government finances (that risk further spending cuts and job losses) and falling incomes as unemployment benefits expire, are growing in strength.

Federal Reserve Chair Jerome Powell is certain to repeat calls for additional fiscal support after tomorrow's FOMC meeting, but those calls may fall on deaf ears if a contested election leads to more animosity and distrust between Democrats and Republicans. There seems little prospect of them sitting around a table and hammering out a deal in the next couple of weeks at least.

Moreover, a prolonged legal battle risks allowing grudges to fester between the two parties that could make getting legislation passed through Congress more difficult even after the dust settles on the eventual election outcome. This is especially so given the numbers pointing to a Democrat House and a likely Republican-controlled Senate.

Covid-19 remains the key battle

In any case, we suspect that attention will soon switch to the rising number of Covid cases and the prospect of accelerating hospitalisation rates, just as we have seen in Europe. Already we are seeing curfews and other containment measures being reintroduced in some localities, but they could broaden out and become more restrictive.

Even if we see only limited action, health fears could mean consumers vote with their feet and not go to shops, restaurants and gyms. While manufacturing and construction would likely be less

constrained this time around, falling consumer spending through December and January could still drag GDP into negative territory. This could see the Fed potentially stepping in with more asset purchases and liquidity injections in an effort ensure smooth market functioning and shore-up sentiment.

Such a development would likely be the catalyst for bringing politicians together to work on a fiscal support package, but it could take much longer than if we'd had a decisive election outcome. And the battle between House Democrats and Republican Senators over recent weeks suggests that any stimulus we do get is likely to be smaller in size than would have been probable under the Blue Wave scenario, which the market had seemingly been anticipating.

Obviously, if we do indeed get a vaccine in the next few months this would be a huge boost to sentiment and would allow businesses to plan for the post pandemic future, with economic activity rebounding once the rollout gets underway. Then the actual election outcome will be much more of a factor on the speed of the recovery for late 2021 and beyond.

The scenarios facing us

As we outlined [here](#), we continue to believe that a Biden Presidency with a Democrat Blue Wave in Congress would deliver the strongest growth in 2021/2022, but this looks much less likely given the results so far.

It would be the scenario that achieves the swiftest, most substantial 2021 fiscal stimulus (that would initially focus on front-loaded support for household incomes and support for hard-pressed state and local governments) and would lead to less unpredictable trade relations. Given the focus on getting the economy back on track, tighter regulations and higher taxes are likely to be delayed.

A Biden victory, with the Democrats retaining the House and the Republicans the Senate, would likely mean weaker fiscal stimulus, focused more on infrastructure, with the quid pro quo being less aggressive tax hikes down the line. While less reflationary, it could still support sentiment through improved trade relations and less disruption for supply chains relative to what businesses have faced in the past few years.

If the result eventually swings in Trump's favour, possibly after legal challenges, and the Republicans do indeed retain the Senate while Democrats hold the House, tensions surrounding a prolonged legal dispute over the election would sour relations. It is difficult to imagine the Democrats setting aside differences with President Trump and the Republican party and be willing to sit down and quietly wave through policy proposals focused on tax cuts and deregulation. This could lead to a stifling of key parts of President Trump's domestic agenda.

There is certainly room for a deal on fiscal stimulus. However, the Republican party's reticence to back a package of the magnitude proposed by House Democrats in recent months means it is likely to be more modest than under both Biden scenarios outlined. Consequently, the growth outlook and corporate profits may not be as vigorous as hoped and there is a risk that Trump doubles down on his aggressive trade rhetoric and actions.

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