# US PRESIDENTIAL ELECTION

## US ECONOMIC UPDATE – 22 OCTOBER 2020

National Australia Bank

*Sustained large budget deficits likely regardless of the victor, with Biden the frontrunner*

- Polling points to former Vice President Biden winning the 3 November Presidential election. Democrats may also take control of both houses of Congress which would make a further large COVID-19 support package in early 2021 likely (assuming it is not passed pre-election), as well as further net stimulus down the track with large tax increases being offset by larger spending increases. Mr Biden is also likely to take a less aggressive tack on trade/foreign policy issues, and while pressure on China over trade & technology issues will remain, it will probably be less confrontational.
- If Mr Biden wins but Republicans retain control of the Senate then the risk of on-going budget stalemate is high. The chances of a further COVID-19 package (if nothing happens pre-election) would be uncertain. This would leave Mr Biden to pursue goals which can be achieved through executive action (foreign policy, including trade, regulatory interpretations).
- Of course President Trump defied the polls last time; like Mr Biden he also wants to spend more, but would like further tax cuts as well. With it very unlikely that the Republicans can reclaim the House of Reps, getting this agenda through would be problematic, although there is still a deal that could be done on COVID-19 stimulus (again assuming something doesn't occur pre-election).
- Regardless of who wins, the Fed is set to keep rates low for an extended time and the USD is likely to weaken in 2021.
- Delays in counting early (in person or mail) ballots may mean that the result is not known until after 3 November. It is believed that these votes are more likely to support the Democrats, meaning that President Trump may have an early lead in the count, that may be overtaken later by Mr Biden. There is the possibility that legal action (similar to the 2000 Florida count) may delay the final result, which could create additional volatility in financial markets.


## CONTACT

Alan Oster, Group Chief Economist
+61 (0) 414 444 652

## AUTHORS

Tony Kelly, Senior Economist

Gerard Burg, Senior Economist

Ray Attrill, HO FX Strategy

Skye Masters, HO Fixed Income Research

# THE SCENARIOS

*The interaction of the Presidential/congressional elections is important*

**Biden wins**

- **Dems take Congress (possible)**
  - Increases in federal spending and in corporate and income tax. Large immediate (early 2021) COVID stimulus*
  - Less confrontational approach to trade & use of existing trade dispute mechanisms, at least excl. China
  - More migration, focus on green energy
- **GOP control one house of Congress (possible)**
  - Budget stalemate likely; further COVID stimulus uncertain
  - Less confrontational approach to trade & use of existing trade dispute mechanisms, at least excl. China
  - More migration, focus on green energy using existing regulations

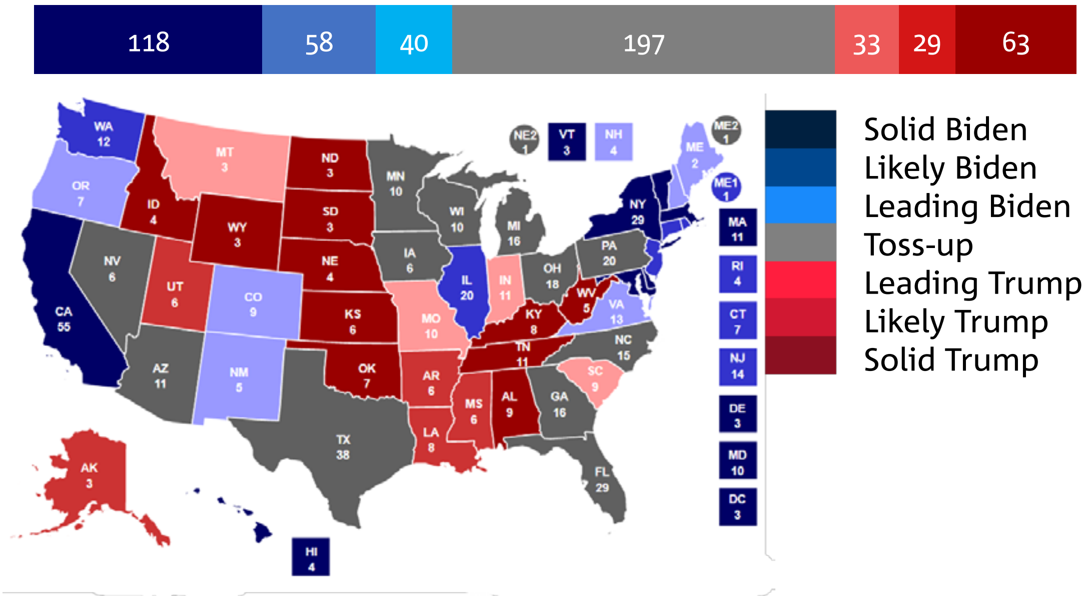
**Trump wins**

- **GOP take Congress (very unlikely)**
  - Selected fiscal measures – may include limited COVID stimulus, some infrastructure spending & tax cuts,
  - Aggressive trade policy actions likely, including to pressure US firms to on-shore
  - Tightening of immigration laws/enforcement
- **Dems control one house of Congress (possible)**
  - Budget stalemate likely; further COVID stimulus package uncertain
  - Aggressive trade policy actions likely, including to pressure US firms to on-shore
  - Tightening of immigration enforcement

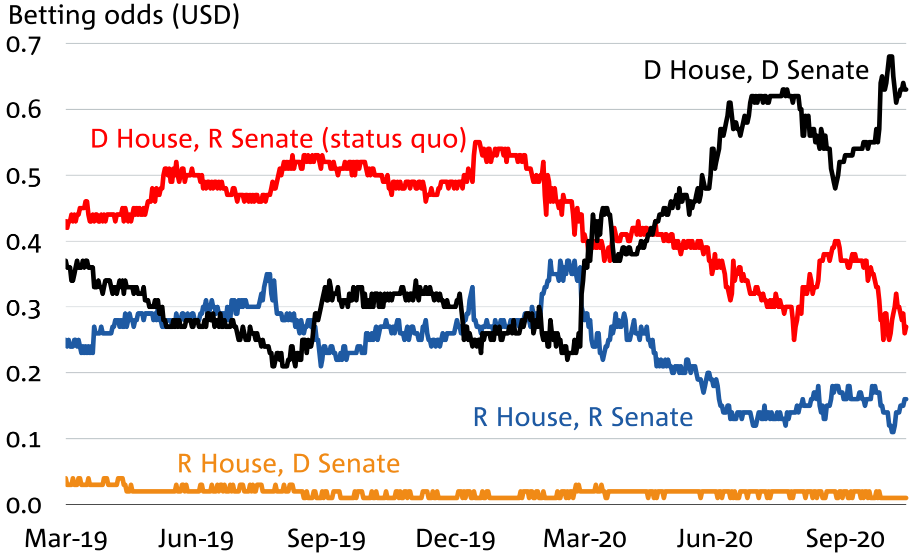
* Note: it is possible a stimulus package is passed pre-election. Assumes not blocked by Republicans in Senate using filibuster or, in that event, Democrats remove the filibuster (only requires simple majority, but overcoming filibuster requires 60%). Even if this is not the case, there is scope to pass stimulus using the budget reconciliation process, but as it requires no deterioration in the budget outside a 10 year window, it limits options and so potentially the scale and scope of the stimulus.

# WHAT DOES THE POLLING TELL US? *Biden leads the popular vote, though 2016 shows that nothing can be taken for granted*

## RealClearPolitics Electoral map (as at 14 October)




## Results in Congress are also very important




- National polls currently show Democratic candidate Joe Biden leading President Donald Trump in the popular vote – a position the former Vice-President has consistently held since in head-to-head polls since early 2017. It is important to note that this does not indicate a likely victory – President Trump lost the popular vote in 2016, but won critical "battleground" states, which handed him an electoral college victory.
- According to RealClearPolitics, neither Biden (at 226 electoral votes) nor Trump (at 125 votes) have enough states within their solid, likely or leading categories to win an outright majority (270 votes). This leaves 187 votes up for grabs – of which Texas (a traditionally Republican state) has the largest number of votes (38) currently polling a Trump victory, along with Georgia (16 votes), while Iowa (6 votes) is currently tied. The remaining states have Biden leading.
- It is worth noting that the accuracy of some state polls are questionable – this was observed in 2016 when many polls under-estimated support for Donald Trump. Polls can also struggle to match actual voter turnout, given that voting is not compulsory in the United States.
- Turnout in 2020 could be impacted by the COVID-19 pandemic, albeit demand for early voting – either in person or via post – has been particularly strong. Reports in mid October suggest that over 26 million early votes (either postal or in person) have already been cast (around 6 times the level at this point in 2016). President Trump has repeatedly criticised mail in voting, claiming it is prone to fraud.
- Delays in counting early/postal ballots and likely legal action to contest the outcome in a range of jurisdictions (reminiscent of Florida in the 2000 election) could mean that the outcome may not be known for some time after November 3.
- Beyond the Presidential election, the outcome of Congressional elections are also critical – particularly having the capacity to constrain the President's agenda if control of houses differs from the Executive branch.
- The House of Representatives is currently under Democratic control, and is thought likely to remain that way following the election. In the Senate, 35 seats up for election, however RealClearPolitics considers just 8 of these seats to be up for grabs. Of these seats, 7 are currently filled by Republicans – increasing the potential for Democrats to gain control of the chamber. Betting markets currently favour Democrats to control both chambers following the election. Neither side is likely to hold the 60 seats necessary to avoid filibusters delaying legislation.

Sources: Realclearpolitics, Fivethirtyeight,PredictIt, NAB Economics



National Australia Bank

# CAMPAIGN PLATFORMS

## *Both agree to spend more; China still a target (but approach differs), tax a sharp contrast*

| Trump | Biden |
|---|---|
| Tax:<br>Cut Taxes to boost take-home pay and to 'keep jobs in America' (income tax and capital gains tax cuts, tax credits, a permanent extension of the individual income and estate tax provisions that were included in the Tax Cuts and Jobs Act), expand opportunity zones (lower tax rates on certain investments in low income areas), payroll tax cuts, expanding child care tax credits | Numerous tax measures, including: increasing the income tax rate from 37% to 39.6%, raising corporate tax from 21% to 28%, set long-term capital gains tax for those earning \$1m plus at the same level as income tax, minimum 15% tax on company book income, double the minimum tax on US firms foreign subsidiaries (to 21%), eliminate the income cap on social security taxes & cap itemised deductions at 28%. Tax credits aimed at child and aged care, first homes, health insurance. |
| Infrastructure: Build the 'World's Greatest Infrastructure System', Establish a national high-speed wireless internet network | \$2.0 trillion in new spending over ten years (incl. on water, transport & green infrastructure, expanded 5G/broadband access). \$300 billion, over 4 years, on R&D and breakthrough tech (AI, 5G). |
| China/trade: Tax Credits for bringing back jobs from China, impose tariffs on any company that leaves America to produce jobs overseas, no Federal contracts for companies who outsource to China, hold China fully accountable for spread of COVID-19, Prohibit American companies from replacing US citizens with lower-cost foreign workers | Take aggressive trade enforcement actions against China or any other country using unfair practices, confront cyber espionage and efforts by China to steal US IP. Multilateral approach. "… set forth clear demands and specific consequences if [China] does not cease cyber espionage against US businesses, and will develop new sanctions authorities against Chinese firms that steal US technology…". Re-evaluate China tariffs on taking office. Carbon adjustment fee for countries that fail to meet environmental obligations. |
| Manufacturing: "Made in America" Tax Credits, 100% expensing deductions for essential Industries like Pharmaceuticals and Robotics who return their operations to the US | \$400b procurement investment (Buy American), assistance to mfg (incl. a 10% 'Made in America' tax credits and a credit facility). Establish a "claw-back" provision to force a company to return public investments and tax benefits when they close down jobs here and send them overseas. 10% surtax on foreign income if import to US from offshored business activity, 10% tax credit aimed at onshoring. |
| Energy: expand energy development, keep America Energy Independent, and further deregulation | Carbon pollution-free power sector by 2035, battery technology R&D, Establish ambitious fuel economy standards, promised to end fracking during primaries but current position is no new oil and gas drilling on federal lands, rescinding the Keystone XL pipeline permit, clean energy infrastructure spending. |

- Democratic candidate Joe Biden has laid out a detailed campaign platform. By one count his campaign website has 48 different (but often overlapping) plans with more than 800 individual proposals. In contrast President Trump's platform is a series of dot points with some specific measures but is often more aspirational. This may in part reflect personality, but also the reality that he is campaigning as the incumbent and will be largely judged by his record.
- Despite the partisan rancour, there are at least three broad similarities between the two candidates. Firstly, they would like to increase spending even if the amounts, priorities and details differ (but infrastructure is important to both). However, it is less clear whether Republicans in Congress are as supportive of the President's spending plans, as the Democrats would be of Mr Biden's. Both candidates have been supportive of additional COVID-19 related stimulus, with the President supporting a larger package than senate Republicans, and it is still possible something will be passed before the election.
- Secondly, they are both promising to continue to pressure China around trade and technology issues, although Mr Biden would likely take a less confrontational approach. (See page on US-China relations.)
- A Biden Presidency may also lessen trade tensions with countries other than China (e.g. the tariffs threatened by the President on European cars will be a thing of the past). That said, a third area of agreement is the aim to have American companies bring back home some of their overseas operations. This is through a combination of carrots (tax credits) and sticks (tariffs/taxes/regulations) which essentially represent trade barriers even if they are not always called 'tariffs'.
- A stark difference between the two is in taxes. Mr Biden is promising a substantial increase in taxes, particularly targeted at high income earners and corporations. This would include an increase in the corporate tax rate from 21% to 28%, partially unwinding the Trump cut (from 35%).

Sources: https://www.donaldjtrump.com/, https://joebiden.com/, media reports, Tax Foundation

# CAMPAIGN PLATFORMS

## *Some Biden promises negative for supply-side; big tech may feel the heat whoever wins*

| Trump | Biden |
|---|---|
| Labour markets/minimum wage: Focus in the past has been on driving wage gains through a strong economy | Minimum wage of at least $15/hour (double Federal minimum of $7.25. Universal paid sick days and 12 weeks of paid family and medical leave. Legislation to make it easier to organize a union and collectively bargain with employers |
| Health care: Cut Prescription Drug Prices, lower Healthcare insurance premiums, end 'surprise billing', cover all pre-existing conditions | A public health insurance option, Increasing the value of tax credits to lower insurance premiums, allow Medicate to negotiate prices with drug companies, various price controls for drugs (e.g. inflation indexing for some categories, price setting arrangements). |
| COVID: Develop a Vaccine by the end of 2020, return to normal in 2021; shelter those at highest risk while allowing lower-risk to return to work and school. Make all critical medicines and supplies for healthcare workers in the US | Bring together experts, party leaders to chart a way forward. Federal financing of short-time compensation programs (wage subsidies), state & local government aid. Widespread testing (and free), free treatment, follow health official guidance, accelerate the development of vaccines, increase surge capacity, "spend whatever it takes" to provide relief to families and stabilise economy, temporary small business loan program. |
| Migration/other: Protect Social Security and Medicare<br><br>Focus on school choice<br><br>'Illegal immigrants' not eligible for tax funded welfare, healthcare, college tuition, new immigrants required to be able to support themselves financially | $640b housing (over 10 years), $290b social security, over $2 trillion on education and childcare.<br><br>Unspecified increase in number of visas for employment-based immigration (but a lower number when unemployment high), bigger refugee intake, less deportations, provide a roadmap to citizenship for nearly 11 million 'undocumented immigrants'.<br><br>Bankruptcy reform (easier to get relief for individuals, close 'loopholes' for corporates, wealthy) |

- Even if the net increase in taxes promised by Mr Biden were to go through, the spending plans, particularly coupled with further COVID-19 stimulus along the lines being promoted by House Democrats ($2 trillion plus) would suggest a substantial boost to aggregate demand in the economy, possibly as soon as early 2021.
- Mr Biden may also support stricter controls to limit the spread of COVID-19 although much of the power sits at the state & local level. Moreover, what approach he would adopt, if he were to take office in January, would depend on the spread of COVID-19 at the time.
- However, on the supply side of the economy the Biden platform is more negative offering the prospect of increased regulations, constraints on energy development (outside 'green' energy) as well as the substantial tax increases noted earlier. There is a clear tension in the promises to bring overseas operations back to the US and boosting investment while increasing taxes on US corporates. It is not all one-sided however, a more pro-immigration stance, the likely reduction in trade tensions (outside China) could help the economy's productive capacity.
- While supply-side issues can be important for an economy's potential over time, at a macro level, the impact on investment and labour supply of tax and regulatory restrictions can be hard to detect. In other words, the demand-side impacts will be more important in the short-term. Moreover, how well any spending measures are targeted will also be important, particularly if focussed on highly productive infrastructure.
- The Biden campaign has also proposed doubling the Federal minimum wage to $15/hour (although many states set a minimum wage above the Federal one). A CBO calculator estimates that a phased introduction of this proposal could increase unemployment by over 1 million over time although there is wide range of possible outcomes around this central estimate.
- Big tech may also feel the heat whoever wins. Criticisms of Big Tech's market power and claimed abuses by Mr Biden (and many other Democrats) suggest that Apple, Google, Amazon, Facebook and the like may come under increasing regulatory scrutiny and pressure, possibly including anti-trust investigations. Heat is also likely to come if the President is returned to office; there is already an anti-trust investigation into Google and Tech's 'liability shield' could be examined given a widespread perception of bias by Republicans.

Sources: https://www.donaldjtrump.com/, https://joebiden.com/,

# US BUDGET POSITION AND OUTLOOK

*Getting the US budget under control is not a priority for either candidate*

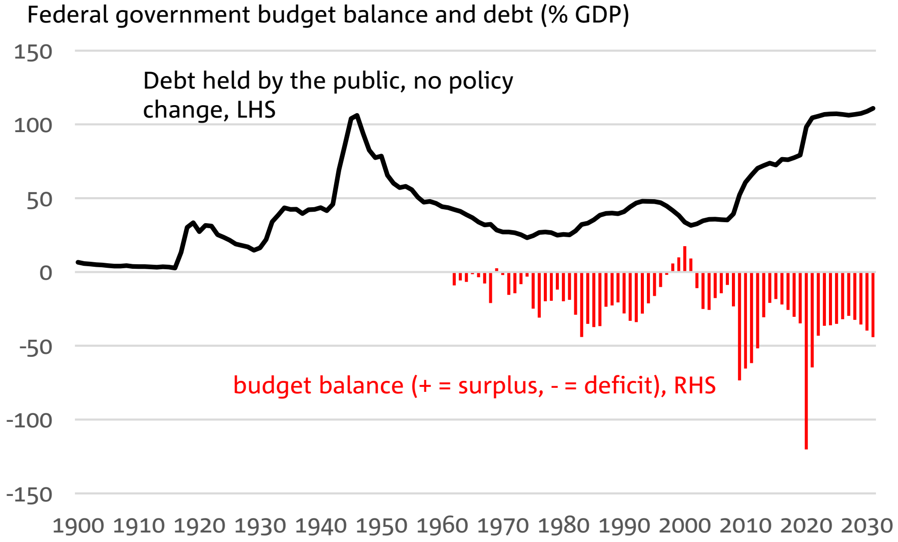
## Campaign costings (trillion, 10yr horizon)

| Biden | Tax | Spend | Deficit |
|---|---|---|---|
| Penn Wharton | +3.4 | +5.4 | +2.0 |
| WSJ | +4.7 | +7.8 | +3.1 |
| CRFB | +4.3 | +9.9 | +5.6 |
| Tax Foundation | +3.1 | | |

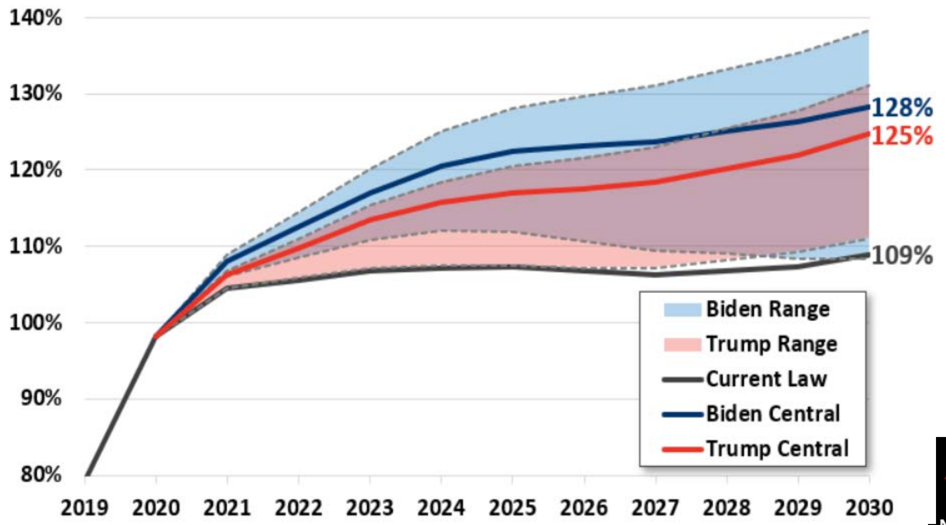
| Trump | Tax | Spend | Deficit |
|---|---|---|---|
| CRFB | +1.7 | +3.3 | +5.0 |

- While we still have to wait to find out who will be elected President, and which party will control the two houses of Congress, one thing is already clear; there is little appetite in either party to rein in the US budget deficit. While deficit/debt reduction in the short-term would not be advisable given the US economy is still recovering from the COVID-19 shock – indeed further fiscal support would aid the recovery – it is hard to see any signs that the longer term issue is being seriously addressed.
- Even under current law, budget deficits are likely to be of sufficient magnitude to see further expansion of Federal government debt (as a % of GDP), which is already at record levels for peace time. Even before the election (or inauguration day in January), a further COVID-19 stimulus package may be passed by Congress, although the chance of this occurring is unclear.
- Estimates of the costs of both campaigns point to an increase in the budget deficit over the 10 year window. This is without making allowance for an additional COVID-19 stimulus package (either ahead of, or after, the election). As a result the level of US debt to GDP is likely to continue to rise. Further, policy makers won't be limited to what was promised and in coming years Congress will seek to address other issues and events. What is most revealing about the campaigns of both candidates is the willingness to accept ongoing large deficits.
- Of course what is promised by a Presidential campaign and what is delivered can be substantially different, given the need to get legislation through Congress. The experience of both the Obama and Trump administrations, even when their respective parties controlled Congress, is that some policies will be prioritised while others will fall by the wayside.

## US budget and debt outlook already in poor shape




## CRFB projections of net debt (% GDP)

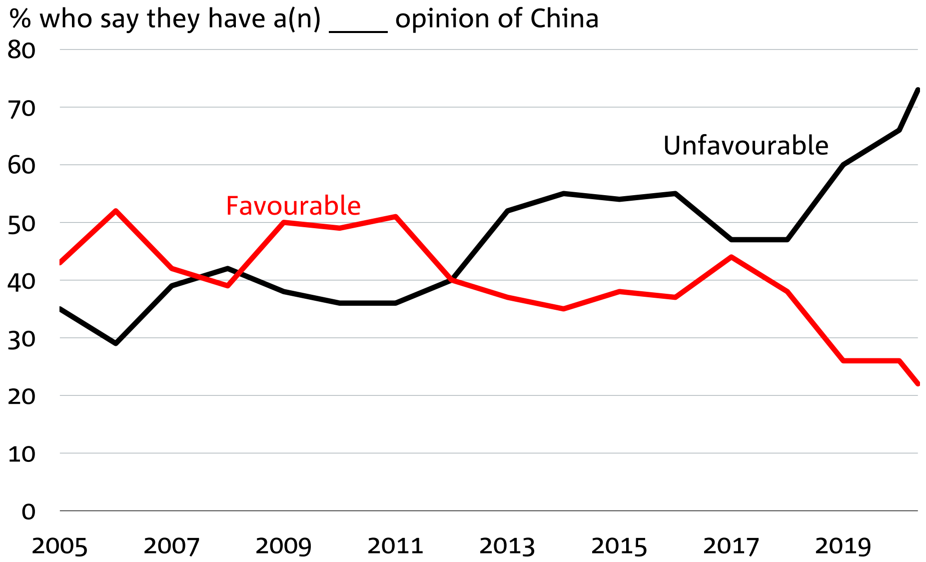



Sources: CBO, Tax Foundation, Penn Wharton Budget Model, Committee for a Responsible Federal Budget (CRFB)

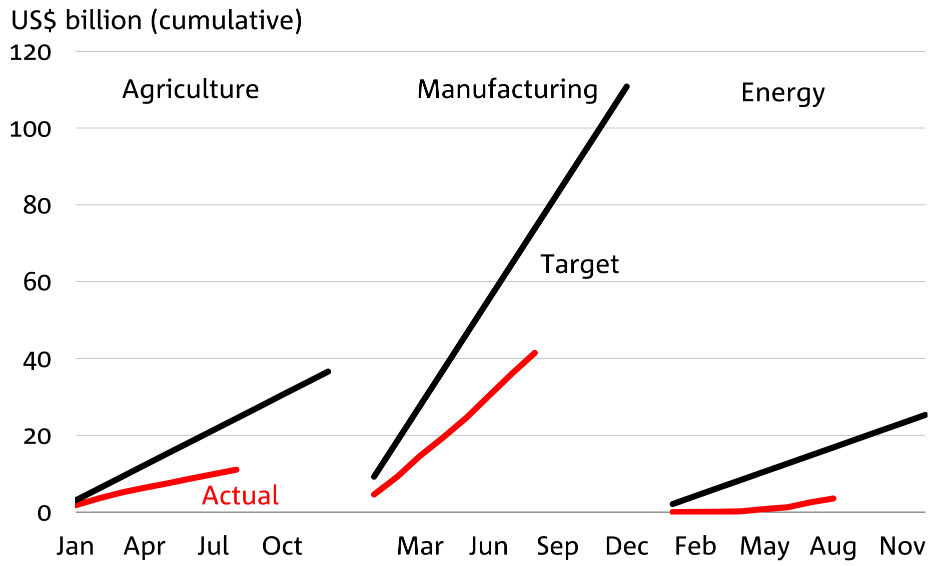
# US-CHINA RELATIONS

## *Different approaches, but relationship unlikely to return to pre-Trump norms*

### US sentiment towards China has deteriorated




### China (so far) falling short of Phase One requirements




- A change in the US Administration is unlikely to return to earlier foreign policy regarding China. According to Pew Research, the sentiment of the American public regarding China has deteriorated in recent years and became more unfavourable over the course of the trade war and the COVID-19 pandemic.
- In mid-2020, 73% of respondents stated that they have an unfavourable view towards China, the highest reading since polling began in 2005. This view is relatively bi-partisan, with 68% of Democrats and 83% of Republicans holding this opinion.
- That said, there are differences in opinion by party alignment when it comes to economic and trade policy with China. Overall, a slight minority of respondents favour "getting tough" with China (46%) – a view held by two-thirds of Republicans but just one-third of Democrats. That said, both party affiliations responding this way rose significantly when compared with 2019.
- A Biden Administration would likely take a different approach to its Chinese trade policy than that seen over the past four years. Most notably, this would mean a multi-lateral approach (in contrast to the Trump Administration's unilateral action against China), with a greater role for the World Trade Organization (including a wider remit into services and technology transfers) and the potential for a renegotiated Trans Pacific Partnership (which Trump abandoned early in his Presidency).
- Tariffs are less likely to be a feature of Biden trade policy, and existing tariffs may be reduced or removed to facilitate greater access for US service firms into China's economy.
- It is also expected that a Biden Administration would broaden the focus of Chinese foreign policy away from trade, including human rights and environmental protection. A large majority of respondents (73%) to the mid-2020 Pew Research survey favoured prioritising the promotion of human rights in China over economic relations, with bi-partisan support.
- A second term Trump Administration would likely continue its antagonistic approach towards China. Despite concluding the Phase One trade deal in January 2020 and having touted the benefits for the US economy from a future Phase Two deal, Donald Trump has more recently spoken about decoupling the two economies.
- The possibility of a resumption of the trade war is more likely under a Trump Administration – with China (so far) failing to meet its requirements under the Phase One deal.



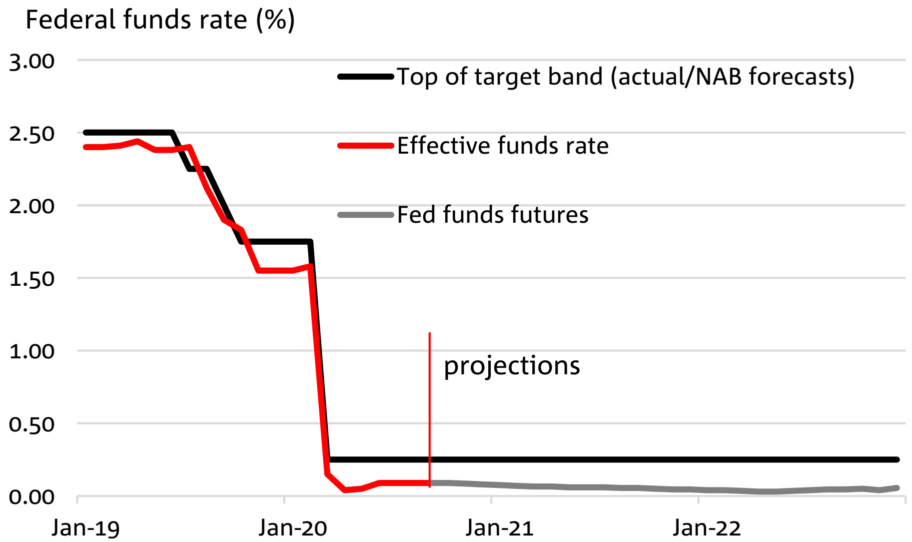
Sources: Pew Research, Peterson Institute for International Economics, NAB Economics

National Australia Bank

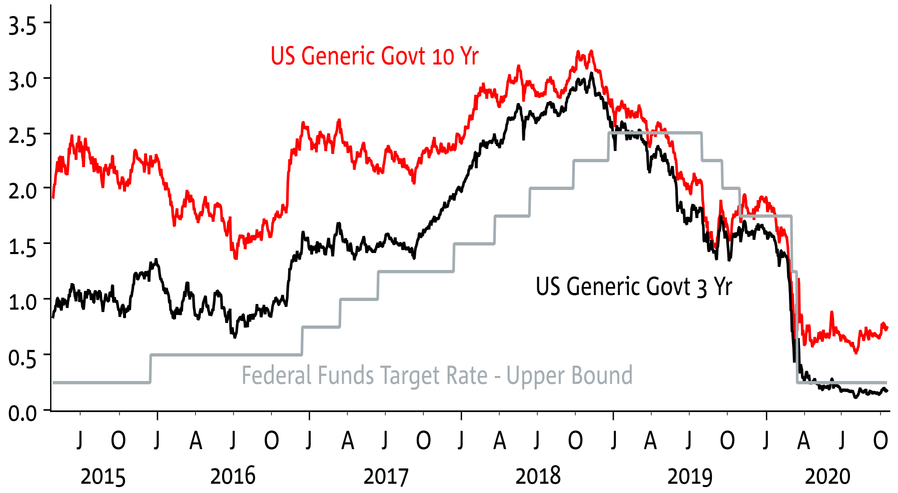
# IMPACTS ON FINANCIAL MARKETS (1)

## *Regardless of the election, Fed to keep rates low for a long time and the USD is likely to weaken in 2021*

### Election unlikely to shift monetary policy settings with rates set to stay low




### US treasury yields and the Fed Funds rate




Source: National Australia Bank, Macrobond

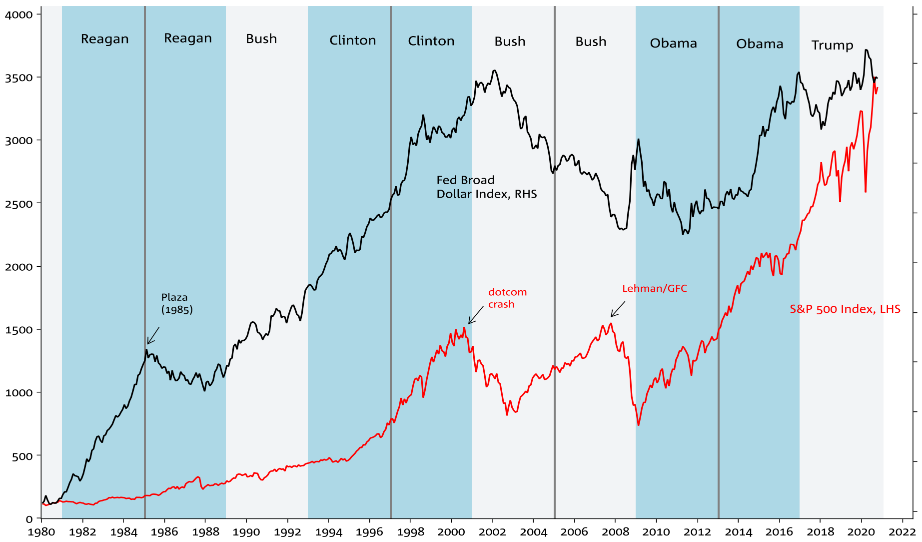
- With two current vacancies on the board of Governors (although these could potentially be filled by the current senate) and the roles of Chair and the two vice-chair's set to expire within the next few years, the next President will potentially shape the Fed for many years to come.
- President Trump has openly been critical of Fed policy in recent years on the basis that rates were too high, but this is not an issue now. While his early nominees were pretty mainstream, some of his more recent ones have been more controversial to the point where they have been unable to get through a Republican controlled Senate. With his criticisms extending to Chair Powell, the President's re-election would suggest that he would be unlikely to retain the role when it ends.
- Nominees from Mr Biden are likely to be more mainstream which would also tend to confirm existing policy settings.
- As a result, it is unlikely in the current environment, and given our expectation that a full recovery from the recession will take time and be somewhat deflationary, that there would be any major shift away from current policy settings in the next few years regardless of who is appointed to the Fed. Both our own and market expectations are for the fed funds rate to remain around its current level for the foreseeable future.
- The outlook for the US Treasury market over the coming months and year(s) will not be driven by which party wins the US election but will be whether there is a successful vaccine and the success of both monetary and fiscal policy.
- While uncertainty may prevail post the election, ongoing large budget deficits are likely, particularly given the possibility of a large stimulus package post election if Mr Biden wins and the Democrats control Congress. As noted previously, under other possible results, while Congressional gridlock might act against further COVID-19 stimulus package (if not done pre-election), neither candidate is advocating fiscal restraint and so ongoing large budget deficits are likely.
- A larger US budget deficit would translate into increased bond supply but this will only have a sustainable impact on bond yields if the market is confident that the spending will be successful in boosting growth and ultimately higher inflation (which would mean real yields would stay very low).
- Quantitative Easing (QE) may cap the rise in yields, but this will depend on how aggressive the Fed will be in its bond purchases.
- Yield curve steepening is inevitable if the macro backdrop improves as we know the Fed will be keeping the Funds rate unchanged for an extended period.


Sources: NAB, Bloomberg

# IMPACTS ON FINANCIAL MARKETS (2)

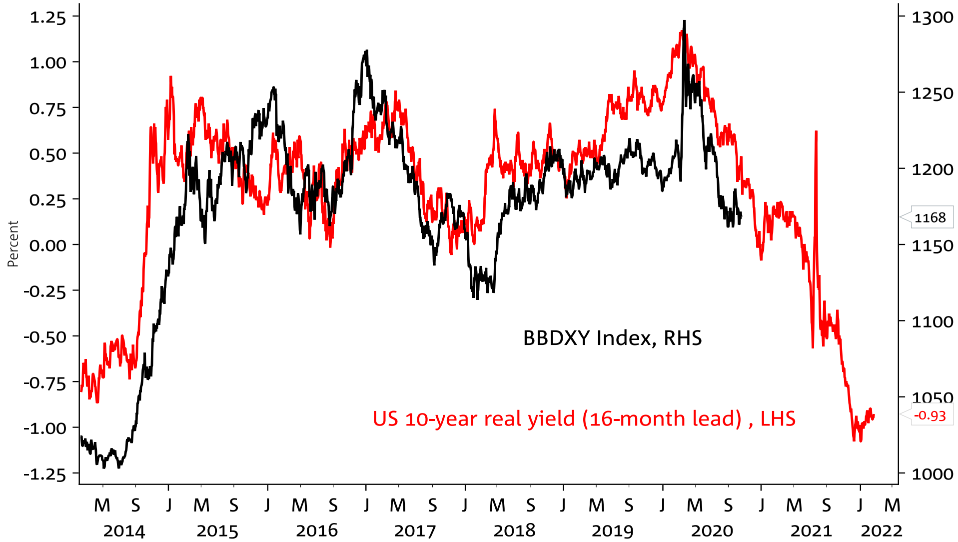
## *US dollar historically impervious to US Presidential cycles*

### Historically US elections don't matter for the US$




Source: National Australia Bank, Macrobond

### Fall in US real yields argues for much weaker US$




Source: National Australia Bank, Macrobond

- A glance at the historical performance of the USD through US Presidential cycles suggests that the outcome of this election should not mark an inflection point. Relative US economic and central bank policy cycles are traditionally what matters for currencies and these have invariably transcended 4-year US political cycles.
- The sharp decline in US interest rates, particularly in real (inflation expectations-adjusted) terms, that commenced in early 2019 but accelerated due to the Fed's policy responses during the early stages of the pandemic, argues strongly for a continuation of the weaker USD trend that began in March this year. Significant changes in US interest rates – and interest rate differentials – typically work their way through to currencies only with lengthy lags. Hence there is nothing unusual about the delayed response of the USD to past US rate declines. This process likely has a lot further to run and is a key reason why NAB's FX Strategists contend that the AUD/USD exchange rate is likely to strengthen in 2021 and beyond.
- Very near term, there is potential for more USD volatility and potential strength if risk sentiment is hurt by doubts about the election outcome and the potential for a contested election – uncertainty usually proves bad for equity markets and good for the USD.
- Under an assumption of a Biden victory and Democrat clean sweep, expectations of highly expansionary fiscal policy beginning in early 2020 – potential tax rises notwithstanding – are apt to support risk appetite and in doing so, allow the USD downtrend to continue. This is even though US growth expectations are likely to rise. While the prospect of higher corporate taxes and more regulation in certain sectors of the economy are potential negatives for equity markets – and if so at times USD supportive – they are not expected to countermand an overriding USD downtrend.
- President Trump's policy ambitions in the event he is returned to power are much less concrete, but still envisage expansionary fiscal policy (with more emphasis on tax cuts). However, given the very high probability that the House remains in Democrat control, legislating his plans, on taxation in particular, will be nigh on impossible. Ditto under a Biden presidency lacking Democrat control of Congress.
- Under any of the above scenarios, substantial US fiscal deficits in the years ahead are likely to lead to a significant rise in debt (slide 6), representing an ongoing 'twin deficit' structural USD headwind.

## Group Economics

Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Dean Pearson
Head of Behavioural & Industry Economics
+(61 3) 8634 2331

John Sharma
Economist
+(61 3) 8634 4514

### Australian Economics and Commodities

Gareth Spence
Senior Economist – Australia
+(61 4) 36 606 175

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

### Behavioural & Industry Economics

Robert De Iure
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Behavioural & Industry Economics
+(61 3) 8634 3837

Steven Wu
Economist – Behavioural & Industry Economics
+(613) 9208 2929

### International Economics

Tony Kelly
Senior Economist
+(61 4) 77 746 237

Gerard Burg
Senior Economist – International
+(61 4) 77 723 768

## Global Markets Research

Ivan Colhoun
Global Head of Research
+61 2 9237 1836

Ray Attrill
Head of FX Strategy
+61 2 9237 1848

Skye Masters
Head of Fixed Income Research
+61 2 9295 1196