

ECONOMIC VIEWPOINT



United States: Midterm Elections and U.S. Economy

Will the November 6 Congressional Elections Influence the Economy?

The U.S. midterm elections will be held on November 6. Americans will vote for all members of the House of Representatives and one third of the Senate. There will also be many regional and local elections. Will the results of the Congressional elections be influenced by economic conditions, or will it be the other way around: will the voters' choices have an impact on the U.S. economy? To the first point: the economy seems to have less influence on votes for Congress than votes for the President. To the second point: there is a risk that U.S. economic policy will be paralyzed, with little room for compromise between the White House and a possibly divided Congress.

Current Congress and Midterm Elections

U.S. voters go to the polls every two years to elect members of Congress.¹ The midterms are the congressional elections that do not coincide with elections for the President of the United States. Right now, we are halfway through Donald Trump mandate, since he was elected in 2016. All 435 members of the House of Representatives are to be elected for a 2-year mandate. One third of the Senate (33 seats out of 100) are also to be elected for a 6-year mandate. Beside federal Congressional elections, there will also be contests for a number of State and local positions, including 36 State governors.

The Republicans have been in the majority in the House of Representatives since the 2010 elections. Right now, there are 235 Republican Representatives versus 193 Democrats, with 7 vacant seats.

There has been a Republican majority in the Senate since the 2014 elections. Currently, there are 51 Republican Senators and 47 Democrats, plus 2 Independents who caucus with

the Democrats. That means the Republicans do not have the super majority of 60 seats needed to easily push through their legislative agenda, including some presidential appointments.

Polls and Possible Results

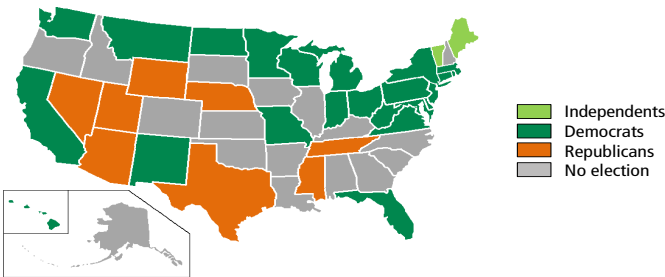
Thus far, most polls indicate greater support for Democratic candidates at the national level. Democrats have a lead of about 7% in the popular vote, although a majority vote would not guarantee the Democrats a majority in the House of Representatives. In 2012, buoyed by the presidential election that gave a second mandate to Barack Obama, the Democrats won the popular vote by 1.2%, but got only 201 seats in the House, compared to 234 for the Republicans. There are a number of reasons for that: the way voters are grouped in federal districts and, especially since 2010, the manipulation of electoral maps for partisan advantage (gerrymandering). It is estimated that the Democrats would have to win the popular vote by no less than 5.5% to get back a majority in the House of Representatives. If the Democrats are indeed leading by 7.0%, as the polls indicate to this point, they could get over 218 seats and have a majority.

In the Senate, the Republicans still seem to be ahead for the November 6 vote. The 33 seats that are up for grabs this year seem to be going their way. Of those seats, 25 are currently held by Democrats or their Independent allies, while only 8 Republican seats are in play (graph 1 on page 2). The Democrats therefore have far fewer chances to make inroads than the Republicans.

¹ Congress, which sits in Washington, exercises the U.S. federal government's legislative powers. Congress has two Chambers with equal legislative powers: the Senate, which has two seats per State, and the House of Representatives, where the number of seats is proportional to the State's population.

GRAPH 1
It will be hard for the Democrats to make gains in the Senate

Senate seats up for election on November 6, by party



Sources: cnn.com and Desjardins, Economic Studies

This year there are votes in a number of midwestern States, a region that generally supported Donald Trump in 2016.

That said, poll analyses should be viewed with caution. The last presidential election turned most of the predictions upside down. However, election forecast models often add in the results of special elections (held to fill vacant seats). All the special elections held since the beginning of 2017 (nine in the House of Representatives and one in the Senate) have substantially cut the Republican vote compared to previous elections (the median is -13.1%). That trend also favours the Democrats. Now we just have to wait and see how the U.S. vote will swing next month.

Why Aren't the Republicans Stronger?

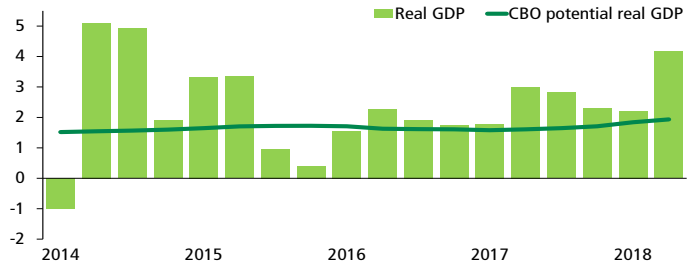
Polls and special election results tend to favour the Democrats over the Republicans in the November 6 vote. Why would that happen, especially in light of current economic conditions?

Right now, the economy is doing very well. After 2.2% growth in Q1 2018, real GDP increased an annualized 4.2% in the spring and is expected to grow almost 4.0% in Q3. Average real GDP growth has been 2.7% since Donald Trump's investiture in the winter of 2017; that is higher than the Congressional Budget Office's 1.7% estimate for potential real GDP growth in the United States (graph 2). The economic cycle which began in summer 2009 is therefore moving along nicely. Average monthly hires since January 2017 account for 193,000 jobs, and the jobless rate fell to 3.7% in September, the lowest it has been since December 1969. Most of the confidence indexes are also very high. The Conference Board's index of household confidence reached an 18-year high last month.

Perceptions of the economy vary widely, however, depending on Americans' political leanings. The Bloomberg weekly confidence index illustrates how confidence varies by political allegiance (graph 3). It shows very clearly how Republicans' confidence spiked after Donald Trump was elected in fall 2016, while the Democrats' confidence stagnated or even dropped. More

GRAPH 2
U.S. real GDP has accelerated since 2017

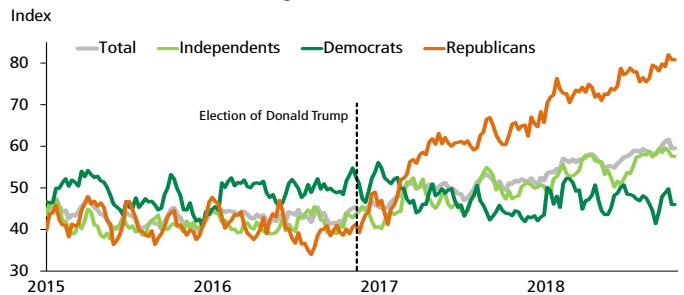
Quarterly annualized variation in %



CBO: Congressional Budget Office
Sources: Bureau of Economic Analysis, CBO and Desjardins, Economic Studies

GRAPH 3
Greatly increased confidence among Republican supporters

Bloomberg consumer confidence index



Sources: Bloomberg and Desjardins, Economic Studies

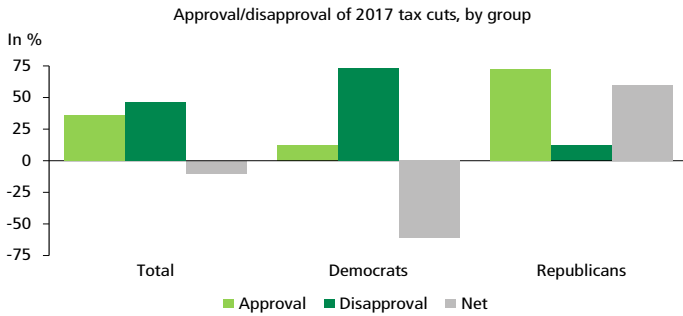
political polls show the same cleavage. According to Gallup, 68% of Republicans are satisfied with the current situation in the United States, in contrast to only 12% of Democrats.

In the past, economic issues seem to have been less of an issue in the midterm elections than in presidential elections. The President is often judged on his economic record, but that is not the case for members of Congress, who are often up against more local issues. The economy does not seem to be a major issue for voters in this year's elections. Again, according to Gallup, only 12% of respondents felt the economy was a major issue: the lowest response for that issue since it was first raised in 1991. Voters' primary concerns right now are political leadership (29%) and immigration (12%). As things stand now, the downplaying of economic issues for the November elections puts the President's party at a disadvantage.

What is more, one of that party's main accomplishments, the tax breaks that came into effect at the very end of 2017, is unpopular. According to the Pew Research Center, only 36% of the adults consulted approve of that policy, compared to 46% who do not. On that issue too, partisan differences speak

volumes. The approval rate among Republicans is 72%, while for Democrats it is only 12% (graph 4).

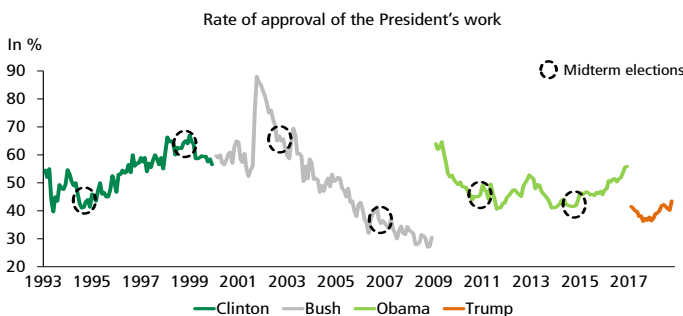
GRAPH 4
In total, the majority disapprove of the tax cuts made by President Donald Trump and the Republicans



Sources: Pew Research Center and Desjardins, Economic Studies

The past history of midterm elections shows that a sitting President's party will not do well. Since 1950, except for two instances, it has always been the opposition that gained seats in the House of Representatives. The first exception was the 1998 midterm when Bill Clinton was the President with a popularity rating of 66% in the midst of an economic boom. The second was 2002, when George W. Bush coasted on a popularity rating of 65% due to the U.S. response to the 9/11 attacks in 2001. President Donald Trump's current popularity rating is around 43%, which is not likely to translate into any Republican gains in Congress (graph 5). That rating falls somewhere between what Barack Obama had in 2010 (45% and a loss of 63 seats) and what George W. Bush had in 2006 (37% and a loss of 30 seats).

GRAPH 5
President Donald Trump's approval rating is relatively low



Sources: University of California and Desjardins, Economic Studies

What Could the Economic Consequences Be, Based on the Results?

If the Republicans Maintain Their Majorities in Both the House of Representatives and the Senate

Obviously, if the Republicans keep the majority in Congress despite the forecasts, President Donald Trump's agenda will be able to go through as it has done so far.

The tax cuts introduced at the end of last year included measures that would end at the start of the 2020s, so the extension of these should go ahead easily. The President and Congress may try to limit federal government spending in an attempt to put the country's fiscal house in order. They are hinting at reforming social programs like Medicaid (health care for people with low incomes), Medicare (health care for seniors) and social security (old age pensions). As a candidate, the President was reluctant to alter those programs, but the idea has been mentioned by many members of his entourage, including his Budget Director and Republican leaders in Congress. However, unless they get a super majority of 60 Senate seats, it will be hard to avoid the legislative obstacles the minority Democrats could make use of. Budget deadlocks should be rare, however.

If the Democrats Regain Control of at Least One of the Two Chambers

If the Democrats make enough inroads to get a majority of either the 435 seats in the House of Representatives or the 100 Senate seats, Washington politics will swing widely the other way. There will have to be compromises between the White House and the Democrats, otherwise there is a risk that the federal government would be paralysed. **That may look a lot like the Obama years starting in 2011.** If the Democrats can dominate at least one of the Chambers, they will be able to take control of the federal legislative agenda, budget issues in particular. The risk of a shutdown of the federal government will be much greater.

But the Trump administration will not be completely powerless.

All Presidents can make decisions by way of executive orders or presidential proclamations and memoranda, and the U.S. Constitution gives them other powers, including veto power. President Donald Trump has made a number of decisions without going through Congress, on such matters as immigration, health care, the civil service, trade agreements and regulations (environmental and other). That could continue, and even speed up.

If the Republicans keep their majority in the Senate, the President could continue to see his appointments getting through Congress. Some appointments require majorities of 60 Senators, while others (including judicial appointments) need only a simple majority.

Democratic control over a part of Congress would not necessarily lead to a Democratic economic agenda. The President could easily use his veto power to countermand any policies from Congress. The majority Republicans in the House of Representatives passed several budgets between 2011 and 2016, but President Barack Obama did not approve any of them. Even if the Democrats carry both Chambers, they will not be able to push their own policies (including reversing the tax cuts) forward without White House endorsement. They would need 66% of the seats in both the House and the Senate to overturn a presidential veto. As things stand now, especially in the Senate, that will not happen.

There is very little likelihood of a Democratic Congress impeaching the President. The impeachment process requires a simple majority of the House to pass an impeachment resolution, and then, after a trial, two thirds of the Senate must vote to convict. We cannot entirely rule out the possibility that such proceedings will be initiated, but they would never make it through the Senate; that is what happened in Bill Clinton's time.

There might be some compromises between a Democratic Congress and President Donald Trump. That did happen recently with the bipartisan bill on the opioid crisis. It might happen on the economic front for an infrastructure improvement program, one of Donald Trump's 2016 election promises. During the Obama years, the Democrats often tried to promote those kinds of policies, only to be stopped short by the Republican majority in Congress. President Donald Trump's pet project of a wall between the United States and Mexico, a bogeyman for the Democrats, could represent a major stumbling block.

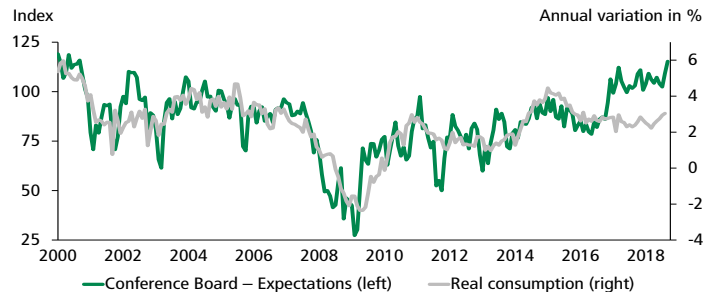
We will probably see more of the kind of obstructionist policies that have been prevalent since the 2010 elections under Barack Obama. The risks of deadlock and budget crises would be high, however, and we could be heading for more shutdowns like the one in 2013.

Indirectly and without reversing federal economic policy, **elections could have an influence on the economy through confidence.** As we have seen, both household and business confidence have been high since the 2016 elections. If the Democrats succeed in partially reversing some of the 2016 results this November, this will raise concerns among consumers and business owners, especially those who favour the Republicans. However, as graphs 6 and 7 show, actual consumption and GDP results have not kept pace with the upswing of confidence. If the risk materializes, its impact on the actual state of the U.S. economy will not be that drastic.

Impact on the Financial Markets

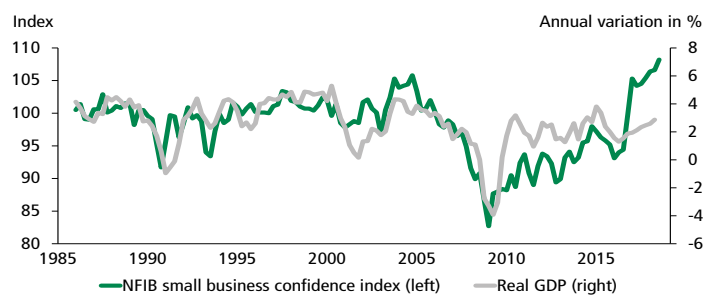
Midterm election results rarely have significant consequences for the financial markets. There may be short-term fleeting movements, but they will largely depend on how concerned or

GRAPH 6
Increased consumption does not quite reflect the high level of household confidence



Sources: Conference Board, Bureau of Economic Analysis and Desjardins, Economic Studies

GRAPH 7
The growth of U.S. real GDP has not kept pace with the increased confidence of small businesses



NFIB: National Federation of Independent Business
Sources: NFIB, Bureau of Economic Analysis and Desjardins, Economic Studies

reassured investors feel. In contrast to what can happen with presidential elections, the federal government's economic policy will not be turned around right away. However, risks of budget deadlock could trouble the markets for brief periods for the rest of the mandate, as they did between 2010 and 2016.

It is difficult to see a real issue for the **stock market**, though. The last 18 midterm elections since 1946 brought 9 gains (additional seats) for the Republicans and 9 for the Democrats. After a year, the S&P 500 rose 12.38% on average when the Republicans were ahead and 16.63% when the Democrats were. However, the standard deviation was 8.82% in the former case and 11.31% in the latter. Consequently, those results are not very significant. The markets will be affected by the current U.S. or global economic situation, trends in corporate earnings and monetary policy, regardless of the midterm results.

Regardless of what happens on November 6, President Donald Trump will still be able to continue implementing his deregulation policy by way of executive orders in a way that greatly favours business.

Public finance issues may become significant for the **bond markets**, however, with the midterm results potentially having an impact. As we have seen, a rift between Congress and the White House can paralyze the federal budget process. Little by little, that could lead to the fiscal house being set back in order. But there is also the risk that a budget crisis could threaten the federal legal debt ceiling, as we saw in 2011 and 2013. The risk of default could come back to haunt the markets. Conversely, if President Donald Trump and a Democratic Congress do manage to agree on budgetary issues, it could be at the cost of accelerated public spending. We saw an example of that last winter with the bipartisan budget agreement.

The same risk elements could affect the **U.S. dollar**. A confrontational attitude between the White House and Congress could weaken the greenback, as we saw during the debt ceiling crisis in 2011 and the shutdown in fall 2013. However, the current economic situation is favourable to the United States, and **Federal Reserve** (Fed) rate hikes should continue to shore up the dollar.

President Donald Trump's relationship with the Fed is somewhat ambiguous. He has criticized the Fed's monetary policy management in public a number of times, even going so far as to say "my biggest threat is the Fed." On the other hand, Donald Trump's Fed appointments have been quite well received, and the new appointees have demonstrated the proper skills for working in that critical institution. Of Donald Trump's seven appointments, five were passed easily by the Senate and two are awaiting confirmation, with one in difficulty. The next time there are vacancies at the Fed, if Donald Trump appointees are at the same level, even a Democratic Senate would be able to endorse them.

Conclusion

Economic issues do not seem to be highly important in these midterms. It is also hard to foresee what short-term effects could alter the current course of the U.S. economy. The November vote could have more medium-term consequences, however. If the Democrats carry both Chambers, they will be able to countermand part of the Trump administration's economic program.

In the longer term, it will be interesting to see how the various U.S. political powers react to an economic reversal, which is bound to happen sooner or later. In 2008, at the beginning of the economic and financial crisis, George W. Bush needed support from the Democratic majority in Congress to introduce aid measures, the bank bailout in particular. If another difficulty of that magnitude arises, will Donald Trump and a Democratic Congress be able to agree on a solution?

Lastly, it would be a good idea not to rely on the 2018 midterm results as a predictor of the upcoming election results in November 2020. Midterm elections are rarely good signposts for the presidential elections that follow them. After his party lost ground in 1994, Democratic President Bill Clinton was easily re-elected in 1996; the same thing happened to Barack Obama in 2012 after the Democrats lost many seats in 2010, and to Ronald Reagan in 1984 after his Republican party fared badly in the 1982 midterms.

The 2018 midterm elections may turn out to be a significant political event, but the Democratic gains forecast by the polls would only be a replay of all elections that are not about the presidency. It is the 2020 election that could have real consequences for economic policy.

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