23 July 2024

Research US

Bye then, Biden

- **Kamala Harris replacing Joe Biden as the Democratic candidate has limited implications for markets in the near-term. Trump remains the favourite for now.**
- **In the prediction markets, Republican 'clean sweep' remains the most likely election outcome, even if the odds have moderated over the past week. Especially House elections remain difficult to call for now.**
- **Over the coming weeks, we think that the fading 'Trump trade' and not-so-dovish Fed could set the tone for shakier risk sentiment and stronger USD FX.**

While the Democratic National Convention is still four weeks away, Kamala Harris has already secured a firm majority of the delegates (2668 out of 3979, according to *Associated Press*) with no one contesting her bid for now. She was the clear runner-up in the latest democratic primary polls before Biden's announcement and was able to gather impressive $81 millions of campaign funding within only the first 24 hours with strong support from the grassroot level (see *BBC*). For context, the sum nearly matches the level of remaining funds from Biden's campaign ($96M, which she will also get to use).

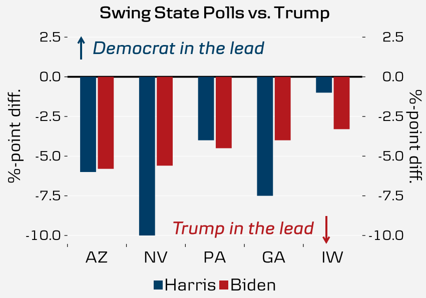
In the limited number of swing state polls including Harris, her performance in July has been generally on par with Biden, which helps explain the rather modest reaction in the markets, but also leaves her firmly behind Trump. Predictions markets price her odds of winning the presidential elections around 40%, which is close to Biden's odds seen before the 1st debate.

Harris' low approval rating has been a constant concern for Democrats already before last weekend. During her relatively short career in mainstream politics (she was only first elected for US Senate in 2016), she has struggled to build a convincing public image with firm views on key issues.

Republicans have accused her of mishandling the border during her vice presidency as immigration has rebounded over the past two years. She has also lacked presence in discussions regarding past years' key foreign policy questions (see *Politico*). On the other hand, she has taken a stronger stance on key questions for liberals, such as protecting abortion and minority rights, but critics have pointed out conflicts with her earlier more conservative stance as the attorney general of California (see *NY Times' in-depth article* from 2020). While Harris was initially seen as a potential candidate already for the 2020 presidential elections, her campaign sizzled out well before Iowa caucuses.

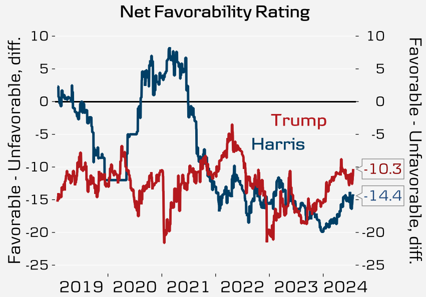
When it comes to economic policies, Harris is seen as left-leaning centrist, whose administration would likely continue on Biden's footsteps. She would likely protect the key cornerstones of 'Bidenomics', such as investments subsidies for green transition, and support issues such as tax credit for families. Harris has openly criticized Trump's earlier tax policies, and especially the corporate tax rate cut of 2017. In the past, we have argued that US fiscal policy stance is likely to remain supportive for growth irrespective of the election result, even if policy focus areas could change, which could also help explain the rather muted market reaction to the announcement.

Harris' performance in swing state polls has been on par with Biden



Sources: RealClearPolitics. According to RCP's polling averages gathered from polls published in July. Data only for swing states where such polls are currently available.

Harris suffers from low approval ratings (but so does Trump)



Sources: RealClearPolitics. Calculated as the %-point difference between 'favourable' and 'unfavourable' responses

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Stars aligning for USD rebound?

Before last week, July was characterized by two key market themes, 1). The notion of growing growth concerns and stronger disinflation aiding Fed cuts and 2). The ‘Trump Trade’ of more inflationary tax policies driving equity sentiment and curve steepening.

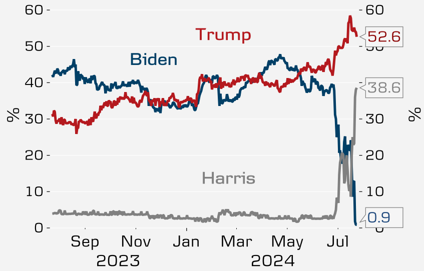
Prediction markets have not only seen Trump as the clear favourite to win the presidential election but have also priced a republican ‘clean sweep’ as the most likely election outcome. We will have to wait for the first swing state polls collected after Biden’s announcement to gain a clearer picture of where Harris stands relative to Trump, but for the time being, we like to emphasize that especially House elections still remain largely undecided. Republicans are the favourites to retake control in the Senate as majority of the seats up for grabs are currently held by Democrats or independents voting with Democrats (23/33), but consensus on House remains very much undecided (see *270toWin*).

UST 2s10s curve has steepened around 21bp over the past month, largely driven by higher term premium in the long-end according to the New York Fed’s ACM-model. This could suggest that the rising likelihood of republican sweep has somewhat increased markets debt sustainability fears, but at the same time, the level of term premium still remains very low in historical context. If Trump’s odds continue to improve as the election date looms closer, we would expect to see further bearish steepening on the UST curve, and vice versa, if Harris manages to close the current gap in swing state polls.

More generally, looking 1-3 months ahead, we see several potential themes that could drive shakier risk sentiment and further USD strengthening ahead. 1). Tightening race could tamper markets’ hopes for looser tax policies. 2) As we discussed in last week’s *US Labour Market Monitor*, 18 July, the US economy is cooling but not collapsing. Weaker signals in some leading indicators are balanced by still supportive fiscal policy, low number of layoffs and strong consumer spending, meaning that **the Fed is likely to opt for a more gradual pace of cuts than markets are currently pricing**. And 3). the Fed’s QT is now draining liquidity from the US banking system after the balancing support from ON RRP has faded, which leaves market sentiment more vulnerable for setbacks. We expect the Fed to cut rates twice this year and four times in 2025, and see EUR/USD at 1.07 in 3M and 1.03 in 12M.

Harris’ odds in prediction markets have quickly risen close to Biden’s pre-debate levels. Trump remains firmly on the lead, however.

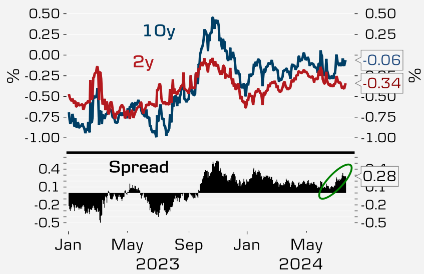
Prediction Markets: Presidential Election Winner?



Source: PredictIt

Higher term premium in the long end of the curve has driven the steepening since the 1st debate. In historical context, term premium remains low

UST Term Premium



Source: NY Fed’s ACM Model

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