Danske Bank

Research US
Election dominated by COVID-19 and Fed policy

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Key takeaways part 1

Election

- Joe Biden is our favourite to win the US presidential election (60% vs. 40% for Trump). Biden is ahead in the national and swing states polls. Among the swing states, the most important to follow is Florida, as it is very difficult for Trump to get re-elected without Florida. Texas has also become more competitive.

- Prediction markets believe the probability of a Biden victory is around 55%, so we are slightly more downbeat on Trump's re-election probability.

- Trump and the Republicans are rebounding somewhat in the polls and approval ratings. Both have suffered from a combination of the handling of COVID-19, the economic crisis and George Floyd protests. The law and order strategy seems to be working well. Given the current situation, we believe things may change quickly in the coming months if COVID-19 gets under control and the economic recovery gets stronger.

- Whether the new president can get his policy agenda through Congress depends on the Senate and House elections. The Democrats are clear favourites to win the House of Representatives, while the Senate is more or less 50/50 at this point.

- The deadline for solving any election disputes in case the election is too close to call is 8 December.

Economic policy

- A divided Congress would make it difficult for either Trump or Biden to change economic policy.

- Biden has a progressive economic policy both in terms of tax increases and more spending (around USD4,000bn over 10 years, or 1.8% of GDP), which should be neutral for the government deficit overall but slightly positive for growth given fiscal multipliers are higher for spending than tax changes. We would also like to stress that policy proposals are usually watered down eventually.

- Trump wants to continue deregulation and extend tax cuts but his chances are slim of winning both the House and the Senate...

Key takeaways part 2

US-China relationship

- Tensions are here to stay regardless of the election results.

- While Biden is likely to roll back tariffs on imports from China, he is keen on investing more in US technology and putting pressure on China to follow free market standards.

- Trump would be more of the same including the risk of a renewed trade war.

US-EU/NATO relationship

- Joe Biden would mean a normalisation of the US-EU and US-NATO relationships.

- Trump would mean a continuation of the current uncertainty although the US-EU relationship has moved slightly in the right direction recently after the agreement on tariff reductions for a few items.

Monetary policy

- We expect Fed chair Powell to be reappointed regardless of the outcome.

- How the Fed will implement average inflation targeting in practice is a very important market theme in the coming months.
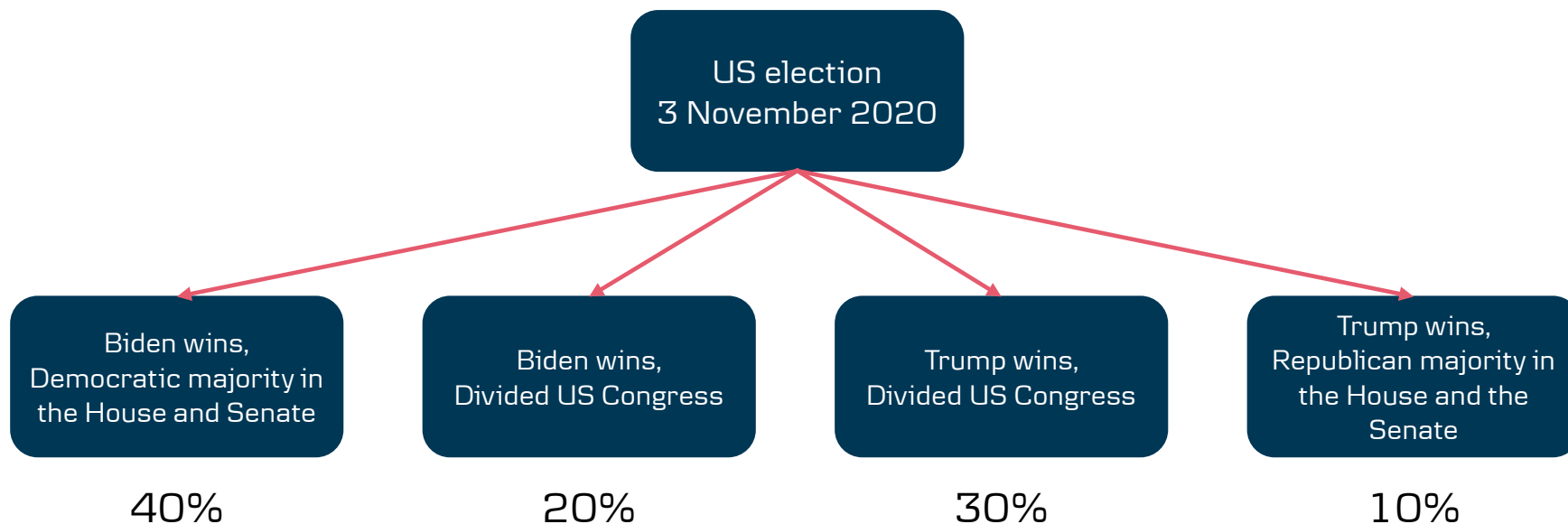
Tech regulation

- A big unknown is future tech regulation. We lean towards expecting tighter regulation but that companies will not split up. The Democrats are probably more likely to tighten regulations than the Republicans are.

Key takeaways part 3

<u>Markets</u>

- Overall, we believe the election is less important than the COVID-19 situation (including short-term fiscal support and vaccine/treatment news) and Fed policy with its new average inflation targeting regime. Hence, we expect the market impact across markets to be muted.

- **<u>Equities</u>:** The business cycle is much more important for markets than the president. The "Trump trade" has been widely used as an explanation for the strong returns 1-6 months after the previous election. However, the prime reason was the global synchronised recovery, which took place even before Trump was elected.

- **<u>FX</u>:** For currencies, the US presidential election essentially has two key dimensions: tax and trade (China). A clear Democratic victory (winning both the presidency and both chambers in Congress) would be the most USD-negative scenario, while a clear Republican victory would be the most USD-positive outcome.

- That said, we think there are more important drivers for EUR/USD near term: the September FOMC meeting, the ECB's view on EUR strength, global activity, equity markets and the potential for US fiscal easing.

- **<u>Fixed Income</u>:** We do not see the election as a main driver for the US government bond market in the short term or in the medium to long term. The high issuance of US Treasuries will likely continue due to high deficits and the Federal Reserve will continue its QE programme.

Our scenarios – Biden victory is our base case but don't be surprised if Trump does it again
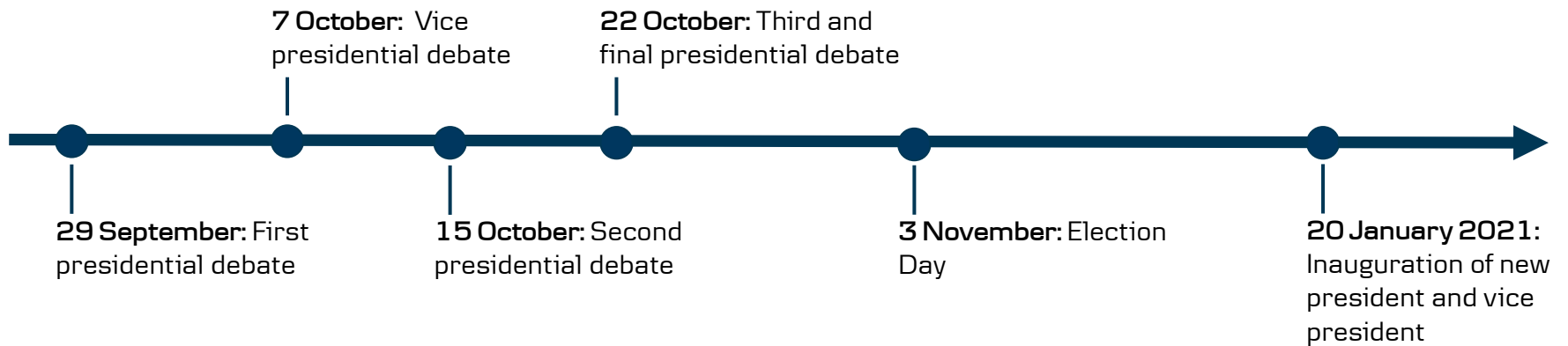
US election
3 November 2020

Biden wins,
Democratic majority in
the House and Senate

Biden wins,
Divided US Congress

Trump wins,
Divided US Congress

Trump wins,
Republican majority in
the House and the
Senate

40%   20%   30%   10%

We are having a hard time seeing how Biden could win the
presidency with a Republican-controlled Congress and vice versa

Remember: The election is <u>not</u> only about who becomes the next president.

If the next president's party does not control both the House and the Senate, he will be a "lame duck" in
many aspects, as we have seen with Trump in the past two years and Obama over 2011-17.

Important background material
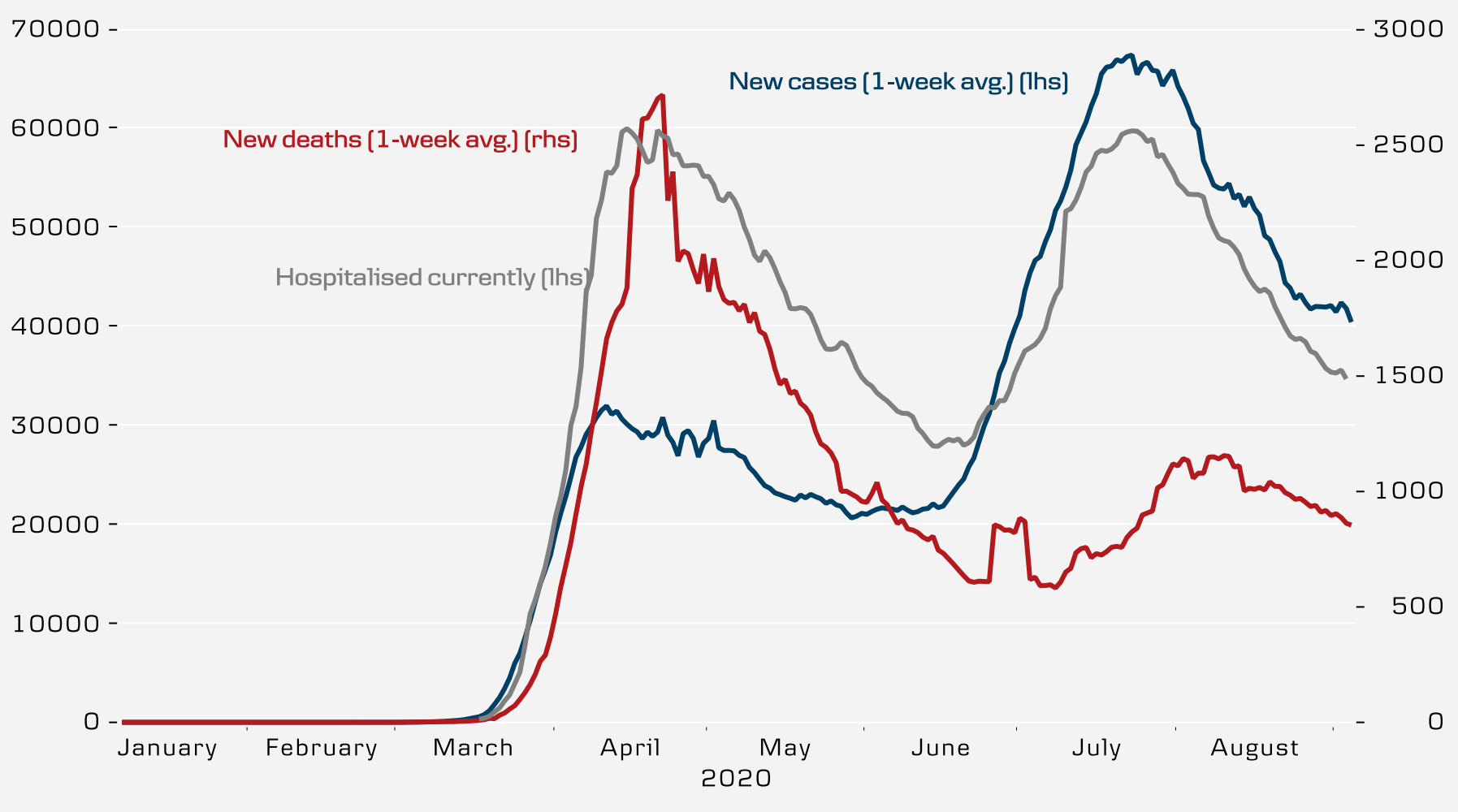
Presidential election – timetable

7 October: Vice presidential debate

22 October: Third and final presidential debate

29 September: First presidential debate

15 October: Second presidential debate

3 November: Election Day

20 January 2021: Inauguration of new president and vice president

Source: Politico

Too close to call? Disputes must be solved no later than 8 December 2020

- <u>3 November 2020</u>: Election day

- **<u>8 December 2020</u>: Deadline for resolving election disputes. All state recounts and court contests over presidential election results must be completed by this date.**

- <u>14 December 2020</u>: Meeting of the electors. The electors meet in each state and cast their ballots for president and vice president.

- <u>23 December 2020</u>: Deadline for receipt of ballots. The electors' ballots from all states must be received by the president of the Senate by this date.

- <u>6 January 2021</u>: Counting of the electoral ballots. The US Congress meets in a joint session to count the electoral votes.

- <u>20 January 2021</u>: Inauguration day. The president-elect becomes the president of the United States.

Economic policy without being filibustered

- **Normally, it is quite complicated to pass legislation, as a minority in the Senate can filibuster legislation (one or more senators delay/block a vote on a bill by extending the debate).** Senators are allowed to speak for as long as they wish, unless a super majority decides otherwise, see Wikipedia. This makes it difficult to pass legislation even if one party wins both the presidency and both chambers.

- **However, there is one way to get around this on economic policy, using a legislative process called reconciliation, which prevents filibusters.** This is how President Trump and the Republican Party were able to pass their tax cuts.

- Reconciliation bills can be passed on economic policy and only one bill is possible on spending, revenue and the debt limit (i.e. three in total) but in practice only one is passed affecting both revenue and spending.

- **Policy changes are limited by the so-called Byrd Rule, which prohibits increased federal deficits beyond a 10-year period (i.e. many policies have sunset clauses) and making changes to social security.**

- For more details see Wikipedia.

COVID-19 has peaked, with new cases, hospitalisations and deaths declining

New cases (1-week avg.) (lhs)

New deaths (1-week avg.) (rhs)

Hospitalised currently (lhs)

2020

Presidential election: Trump is rebounding in polls

Trump's approval rating is rebounding

Trump approval rating
(likely or registered voters)

Disapprove (1m MA)

Approve (1m MA)

53.8

42.6
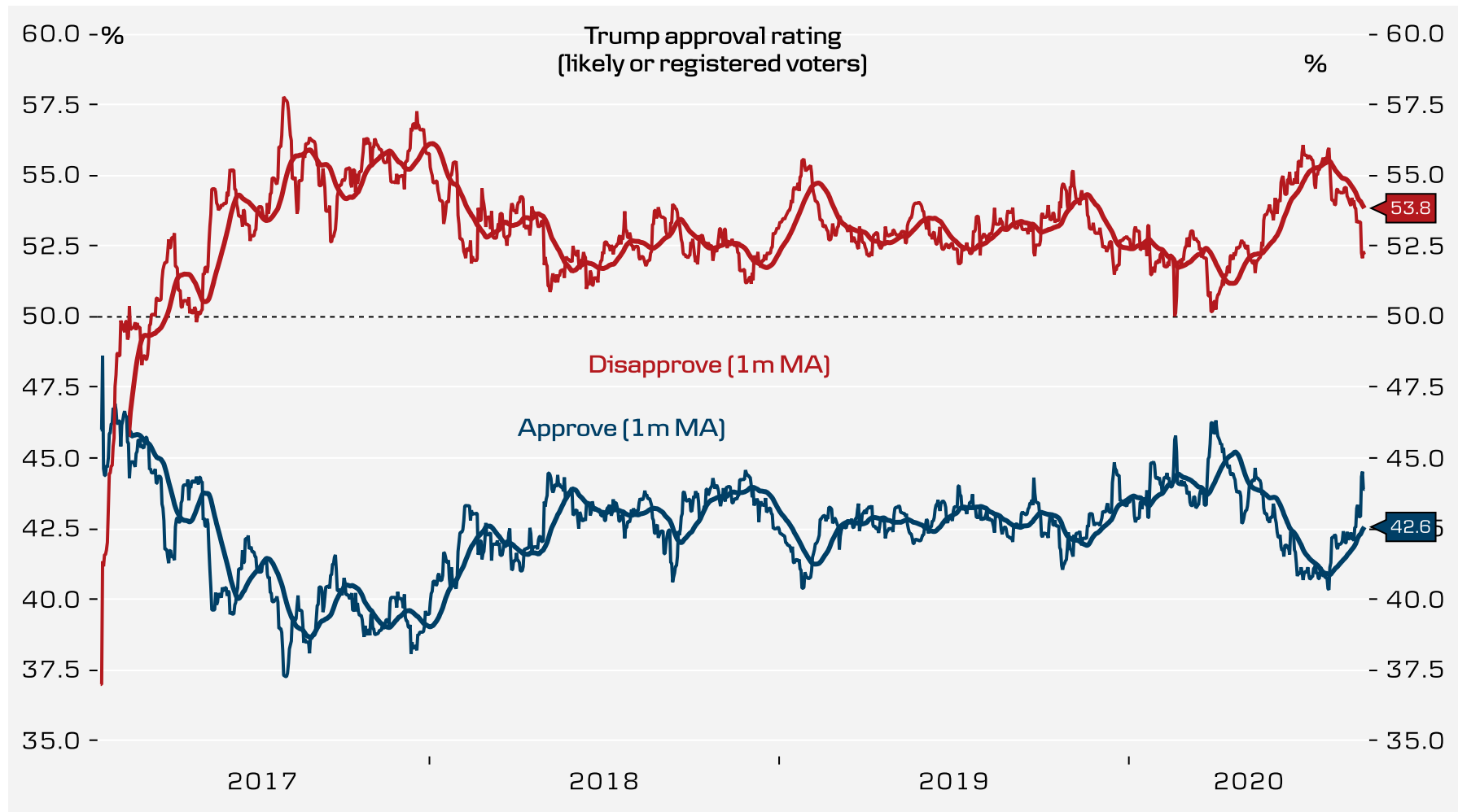
Source: FiveThirtyEight, Macrobond Financial

Trump's approval rating on the economy and COVID-19 have declined significantly

Job approval has declined a lot due to the major crisis
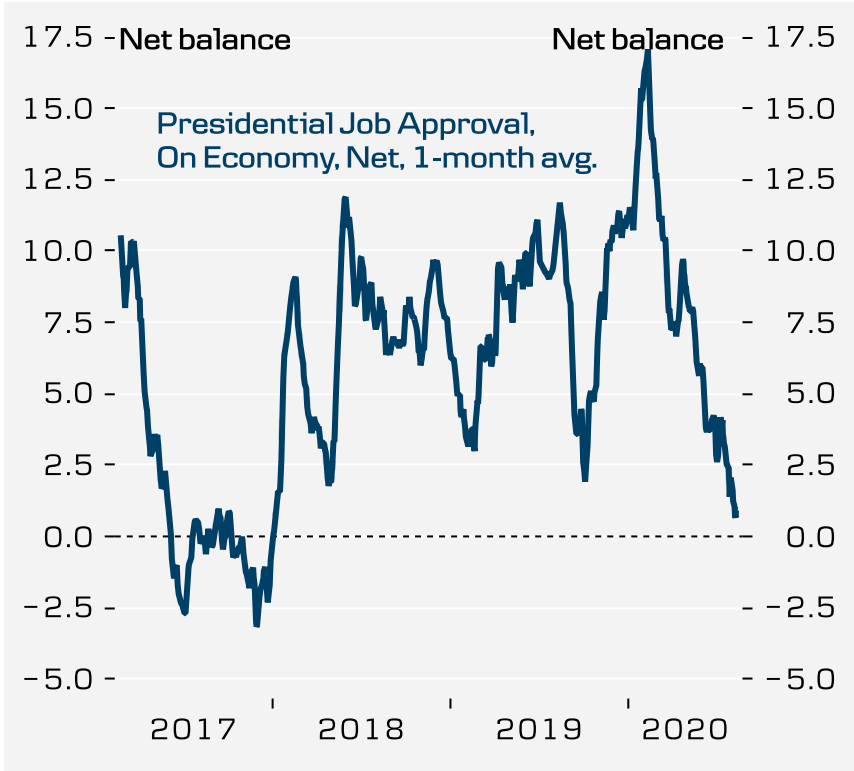
Source: RealClearPolitics, Macrobond Financial

Americans disapprove of Trump's handling of COVID-19
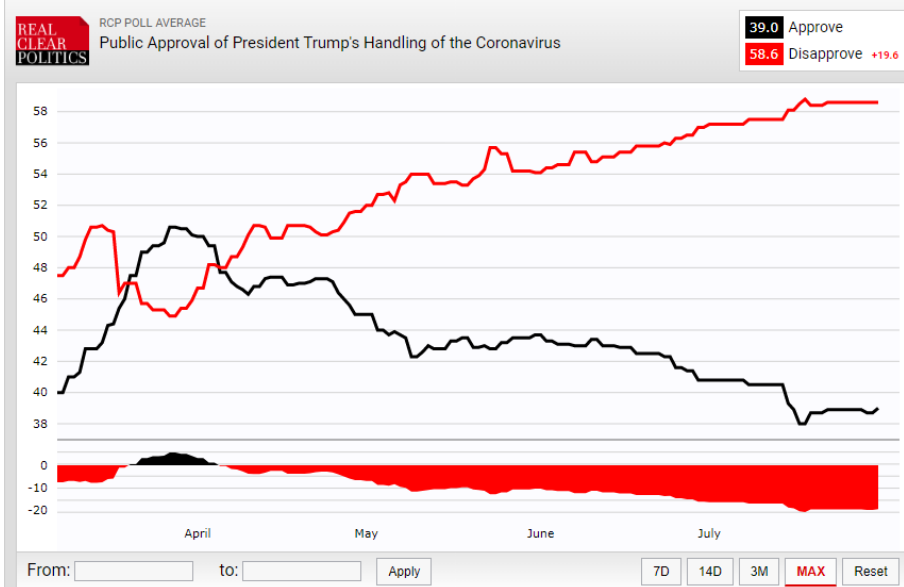
Source: RealClearPolitics

https://www.realclearpolitics.com/epolls/other/public_approval_of_president_trumps_ha ndling_of_the_coronavirus-7088.html

Biden is running close to 50% in polls, something Clinton only did briefly in 2016 – Trump is moving higher again

Opinion polls (RealClearPolitics average)

49.6

42.4

2020

Trump (vs Biden) ▬▬ Biden (vs Trump) ▬▬ Trump (vs Clinton) (dashed) – – Clinton (vs Trump) (dashed) – –
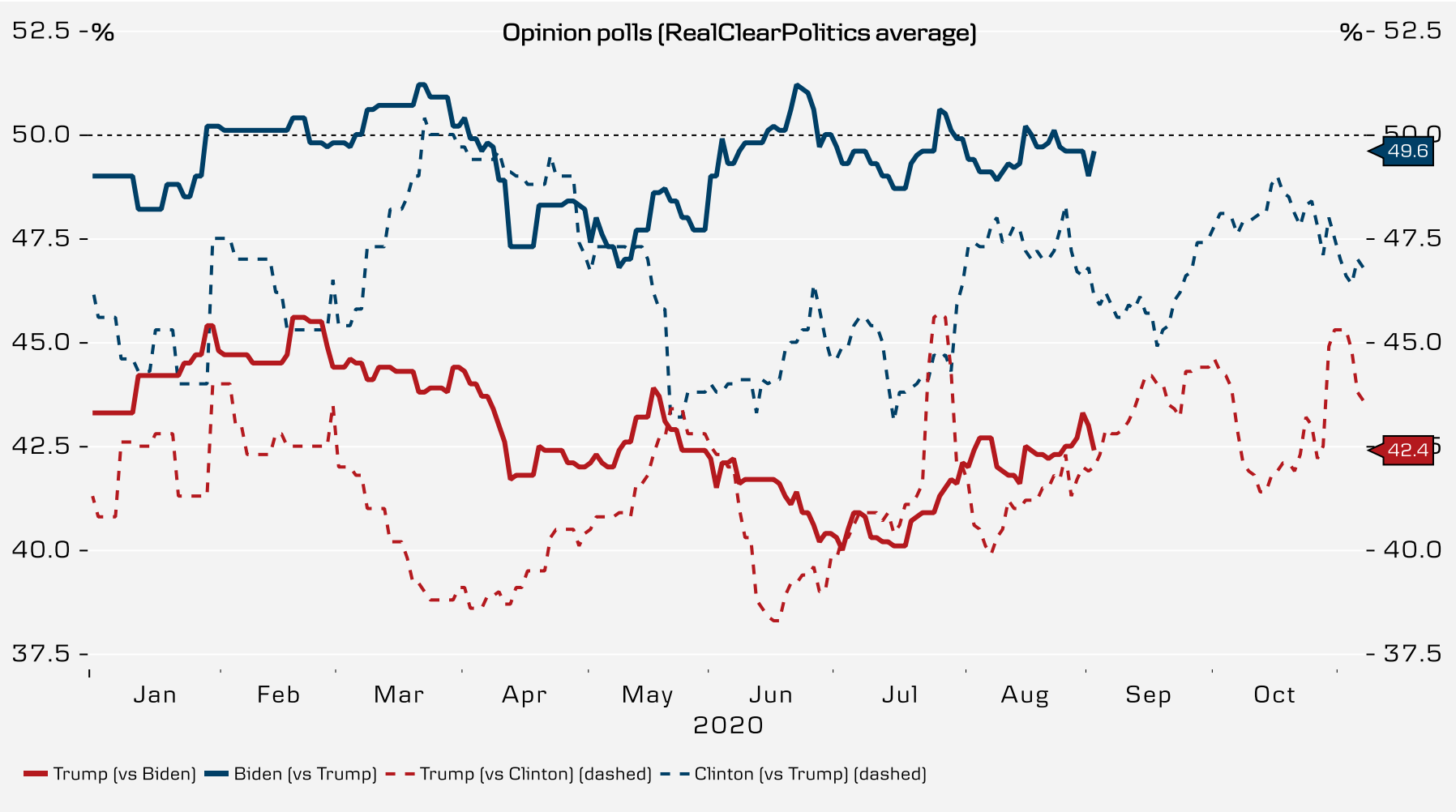
Trump's chances of getting re-elected are rising, according to prediction markets

Biden ahead in polls

Trump vs. Biden

> 50: Trump wins

7 obs avg.

41.4
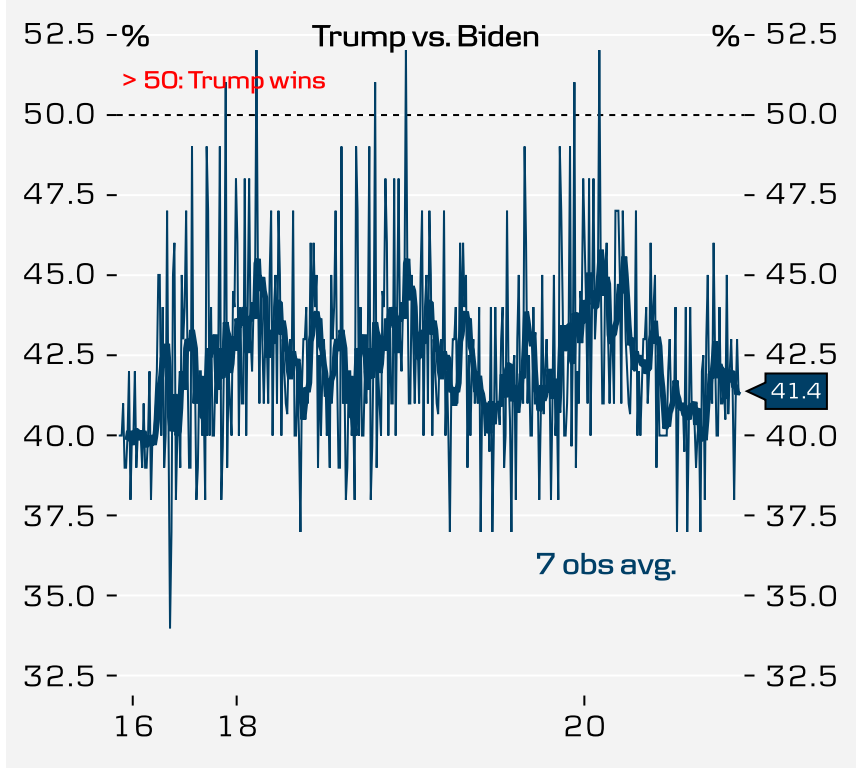
Source: RealClearPolitics, Macrobond Financial

Closer race according to prediction markets

PredictIt, Trump wins 2020 election

45.0
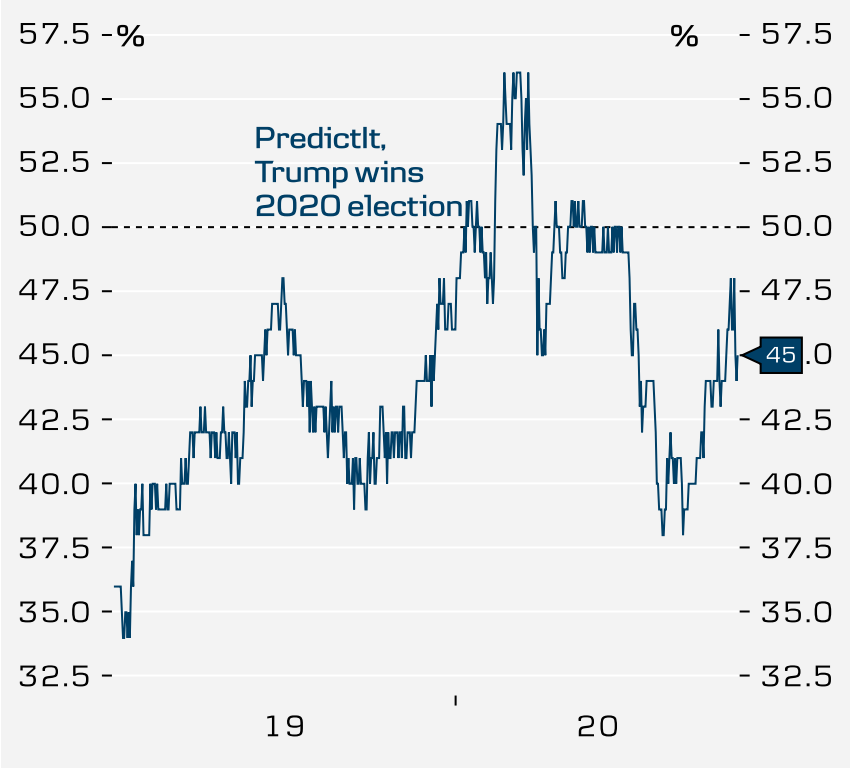
Source: PredictIt, Macrobond Financial

211 toss up electoral votes including those in big states such as Texas and Florida

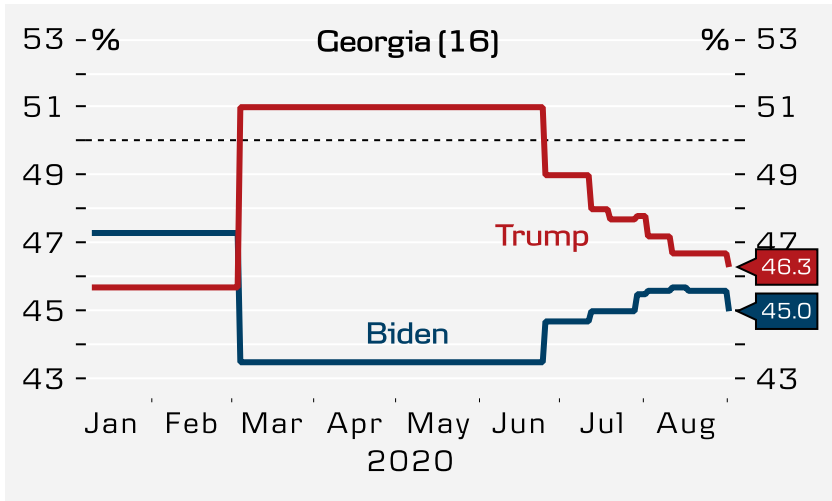# *Trump's net approval has declined significantly in most swing states, even in those he won in 2016*
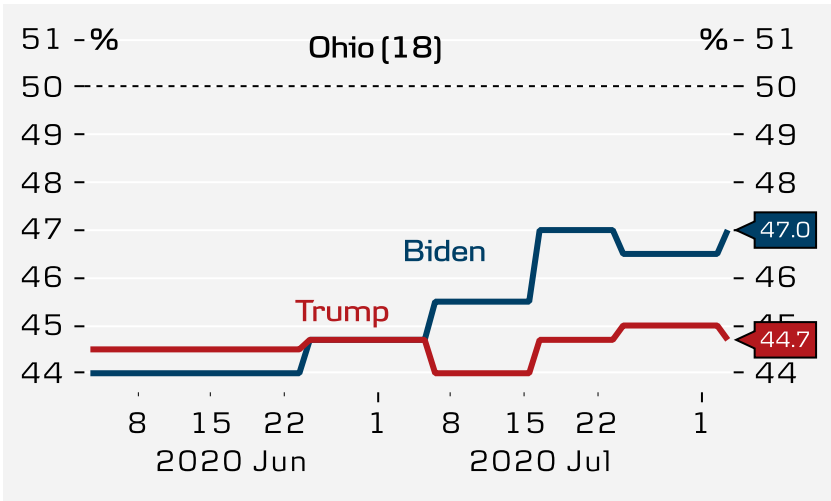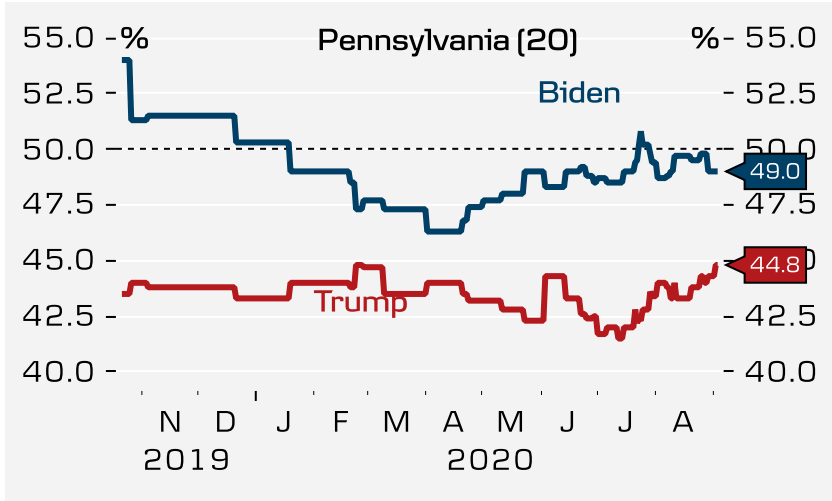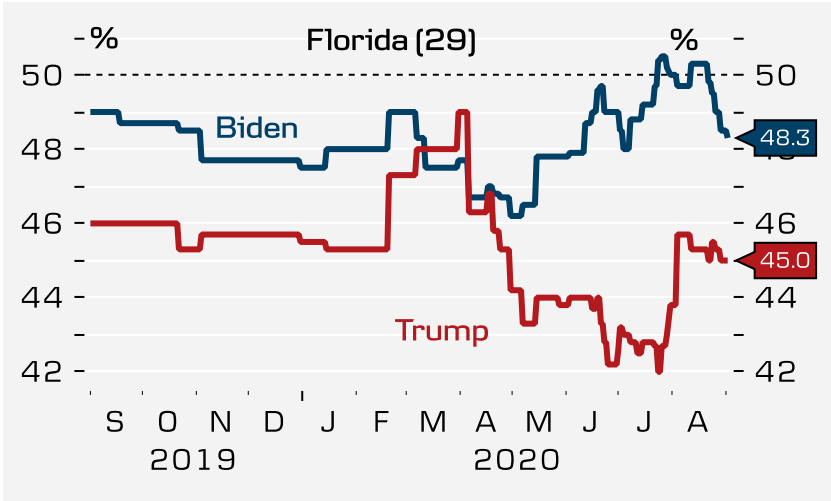
State	% of votes in 2016 election		2016 election, Trump vs Hillary (net)	Trump net approval rating (Aug 2020)	Change since Trump took office, points	Electoral Votes in state	
	Trump	Hillary					
Ohio	52.1	43.5	8.6	-4	-15	18	Farm state
Iowa	51.8	42.2	9.6	-8	-14	6	Farm state
Georgia	51.3	45.6	5.7	-8	-16	16	
North Carolina	50.5	46.7	-3.8	-7	-13	15	
Arizona	49.5	45.4	4.1	-12	-19	11	
Florida	49.1	47.8	1.3	-7	-19	29	
Pennsylvania	48.8	47.6	1.2	-14	-11	20	
Wisconsin	47.9	46.9	1.0	-11	-17	10	Farm state
Michigan	47.6	47.3	0.3	-15	-18	16	Auto state
New Hampshire	47.2	47.6	-0.4	-25	-19	4	
Nevada	45.5	47.9	-2.4	-25	-21	6	
Minnesota	45.4	46.9	-1.5	-20	-8	10	Farm state
Maine	45.2	47.9	-2.7	-26	-14	4	
Virginia	45	49.9	-4.9	-19	-13	13	
Colorado	44.4	47.2	-2.8	-24	-14	9	

Sources: Morning Consult, Wikipedia, Politico

FUN FACT: Since 1964, Ohio and Florida have voted for the winning candidate every time, except in 1992 when Florida had a Republican majority and Bill Clinton won.
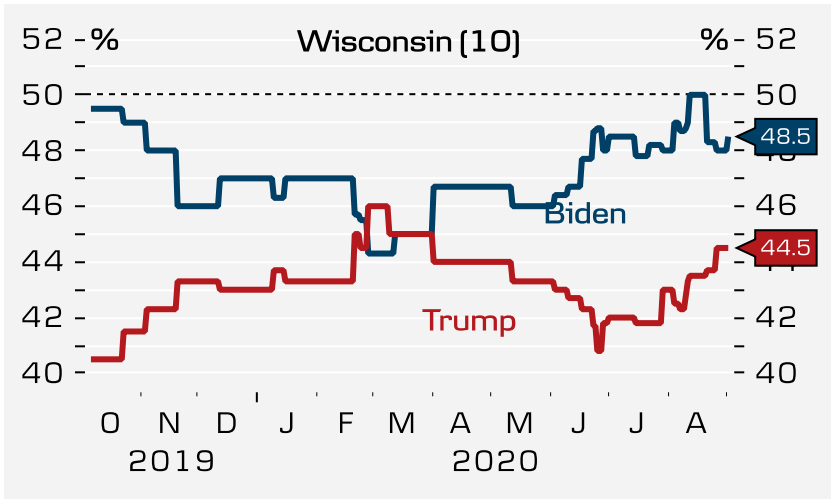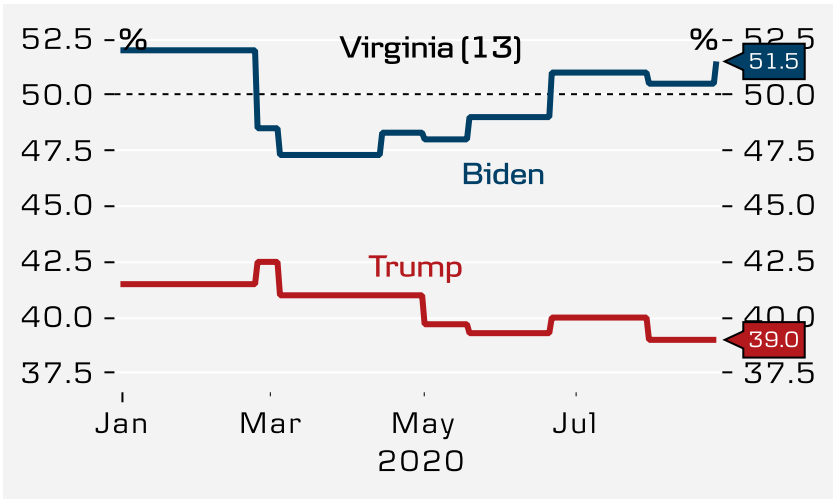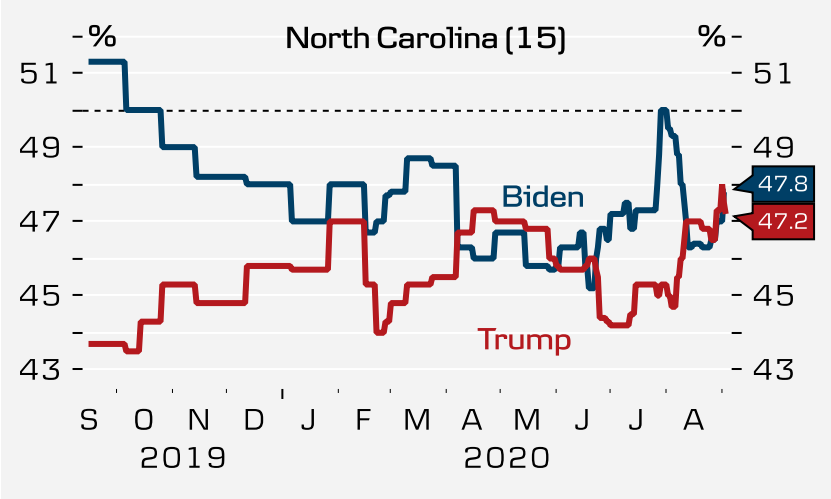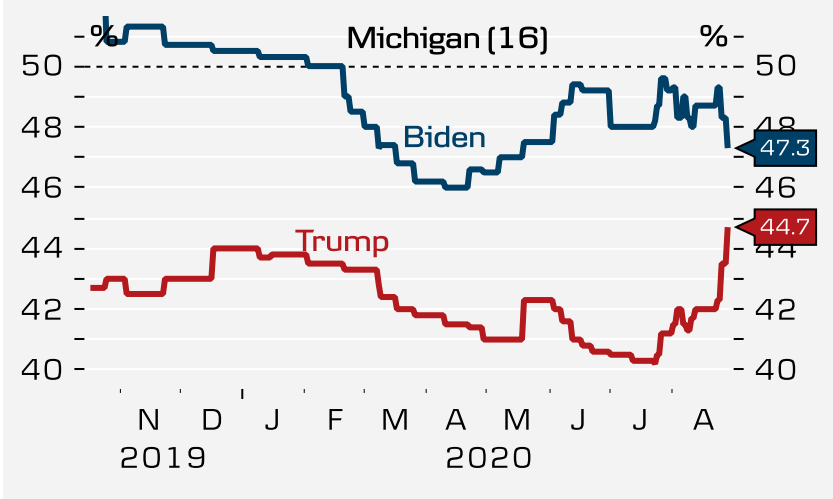
FUN FACT 2: No Republican president has won without Florida since 1924.

Swing states Trump won in 2016: No Republican president has won without Florida since 1924

Florida (29)

Biden 48.3

Trump 45.0

S O N D J F M A M J J A
2019 2020

Pennsylvania (20)

Biden 49.0

Trump 44.8

N D J F M A M J J A
2019 2020

Ohio (18)

Biden 47.0

Trump 44.7

8 15 22 1 8 15 22 1
2020 Jun 2020 Jul

Georgia (16)

Trump 46.3

Biden 45.0

Jan Feb Mar Apr May Jun Jul Aug
2020

Swing states Trump won in 2016: Trump is also behind in some of the smaller swing states

Michigan (16)

Biden 47.3
Trump 44.7

N D J F M A M J J A
2019 2020

North Carolina (15)

Biden 47.8
Trump 47.2

S O N D J F M A M J J A
2019 2020

Virginia (13)

Biden 51.5
Trump 39.0

Jan Mar May Jul
2020

Wisconsin (10)

Biden 48.5
Trump 44.5

O N D J F M A M J J A
2019 2020

If Texas swings to the Democrats, Trump will be unable to win the election

Texas (38)

Trump (vs Biden) (RCP Average)

Biden (RCP Average)

46.8

43.3

Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug

2019

2020
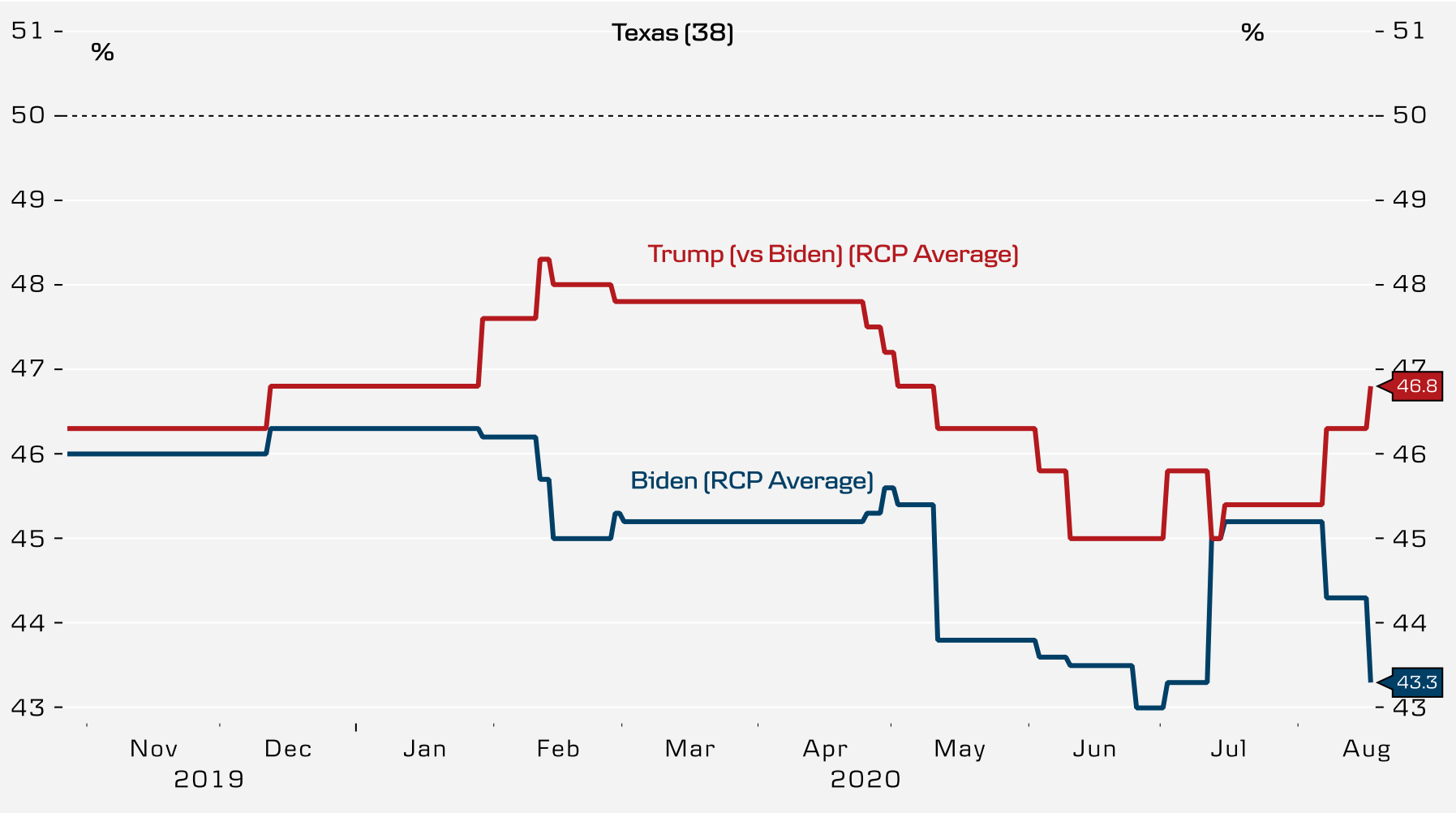
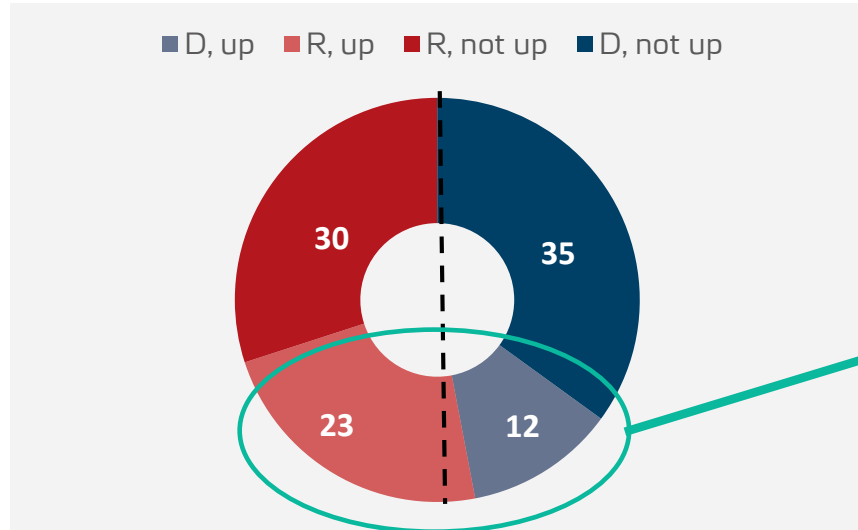*Congress: Democrats are clear favourites to win the House, the Senate is a close race*
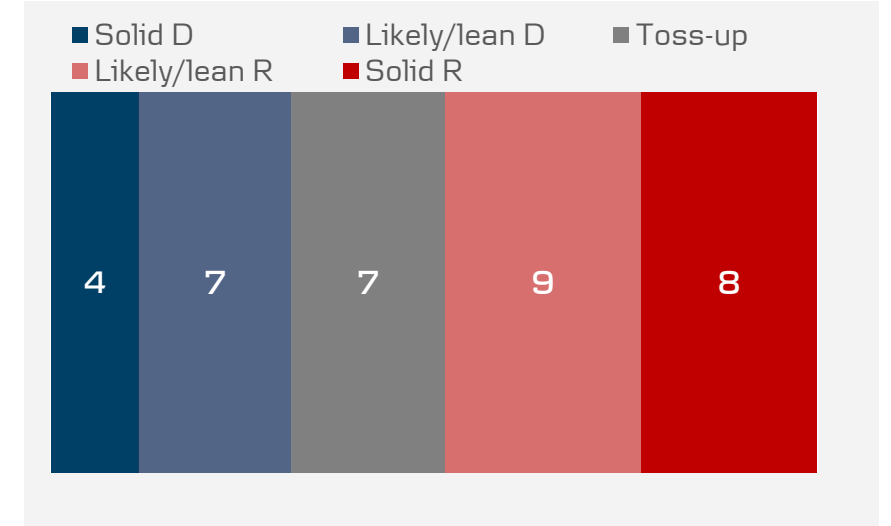
The Democrats significantly ahead in generic ballot polls

Congress - generic ballot polls

Legend: Republicans, Democrats, 1 month moving average, 1 month moving average
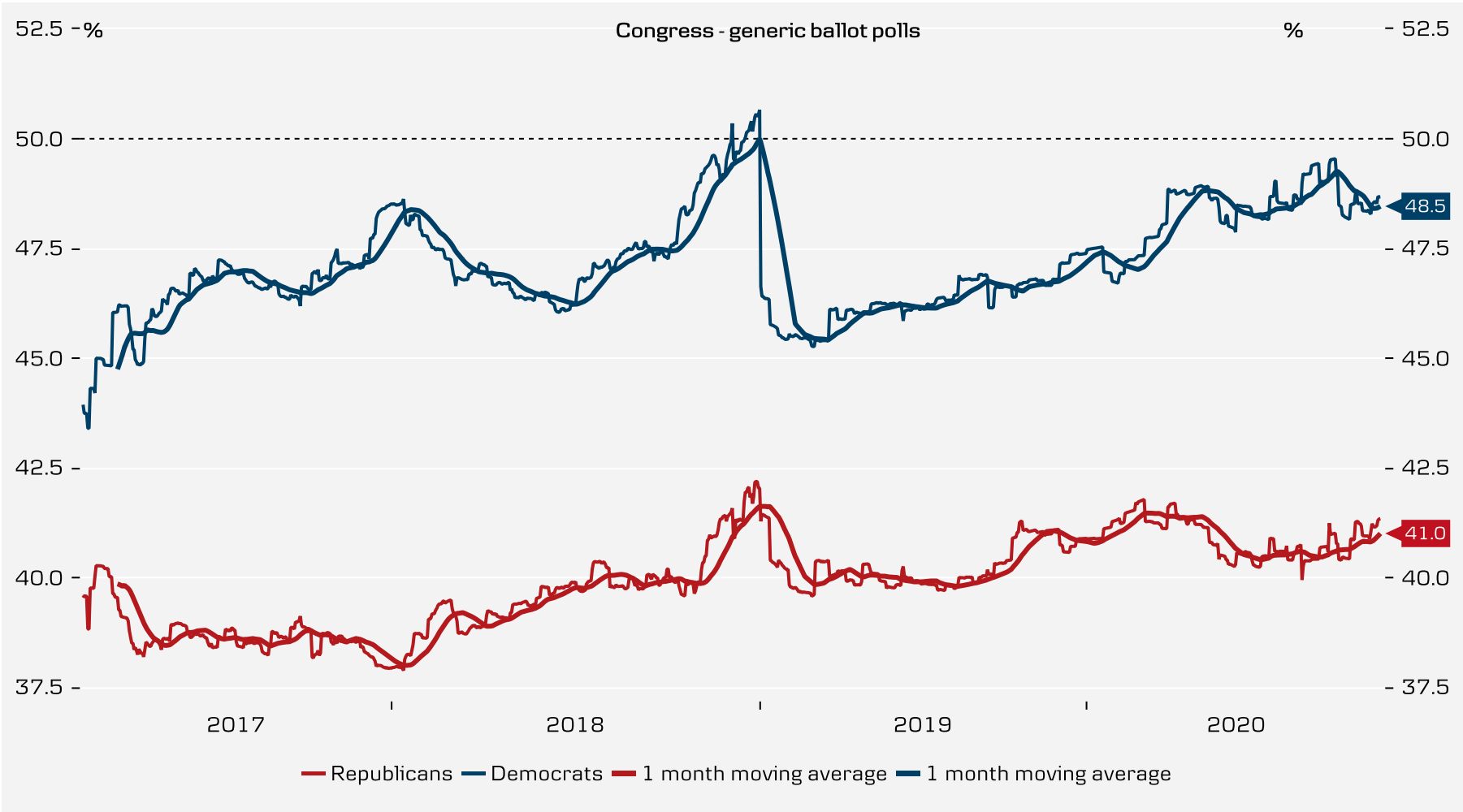
The Senate is a close race

Republicans hold 23 of the 35 seats up for election

Legend: D, up · R, up · R, not up · D, not up

Donut chart values: 30, 35, 23, 12

For a majority, Democrats need 16, Republicans 21

Legend: Solid D · Likely/lean D · Toss-up · Likely/lean R · Solid R
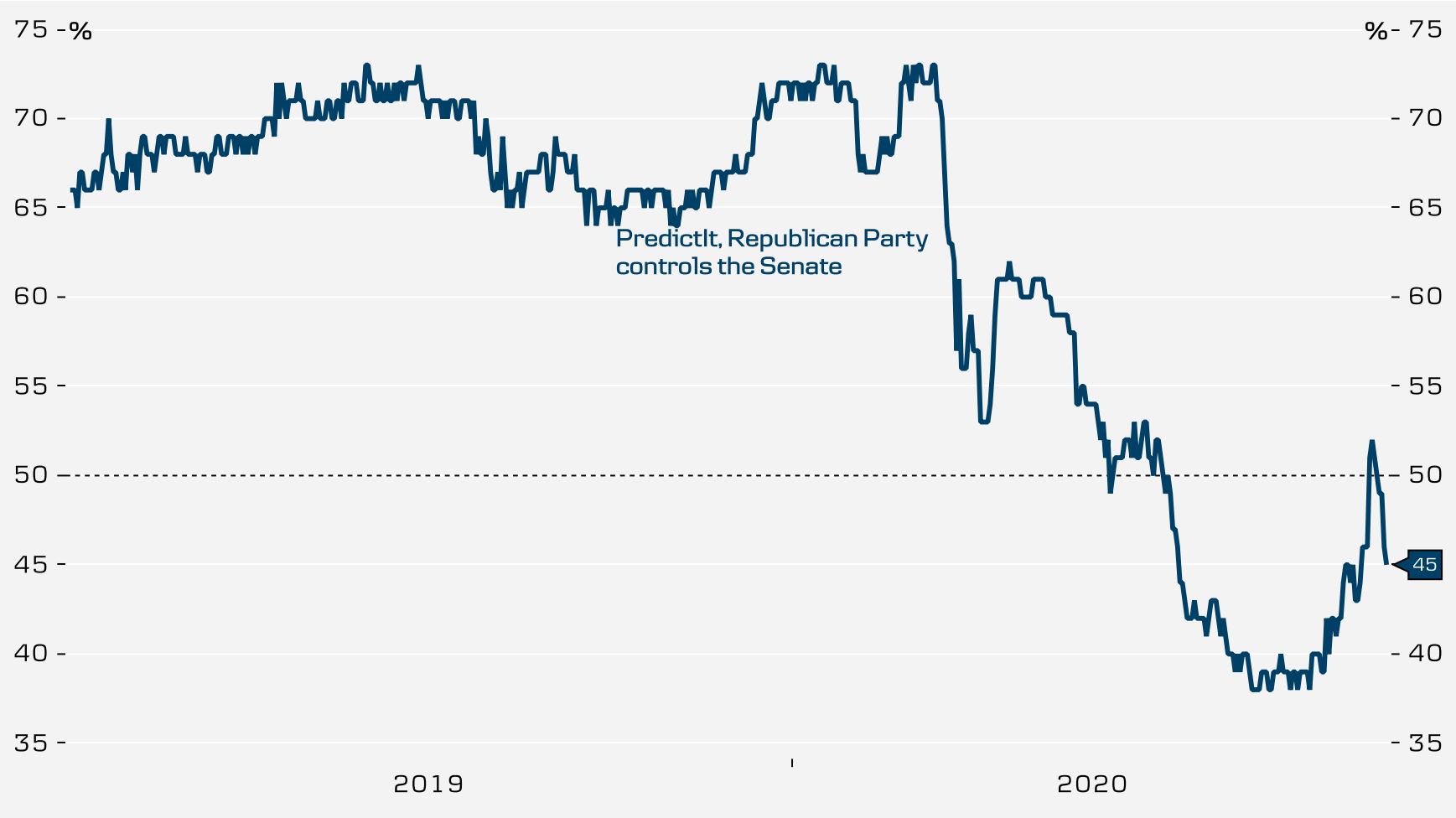
Bar values: 4, 7, 7, 9, 8

- One hundred seats, two from each state. Republican majority currently. Thirty five seats up for election.

- Among the 35 seats up for election, 23 are held by Republicans and 12 are held by Democrats.

- There is still a long way to the so-called super majority of 60 seats, which makes the legislation process easier (prevents filibustering).

- Democrats need to win 16 seats out of 35 to get a majority, Republicans need 21.

- The Democrats are so far expected to win 17 seats, i.e. win the majority, despite the Senate map looking difficult just six months ago.

- This increases the likelihood of a divided Congress, which complicates legislation.

Sources: RealClearPolitics, Wikipedia

Fifty-fifty who wins control over the Senate, according to prediction markets

PredictIt, Republican Party controls the Senate

45

2019

2020

Democrats on track to retake the House

- There are 435 seats in the House of Representatives, distributed among states relative to population size.

- All 435 seats up for election every other year but re-election ratio is high.

- Need 218 seats for a majority.

- The Democratic Party currently has the majority in the House.

- According to RealClearPolitics, the Democratic Party is expected to regain control of the House (see chart bottom-right).
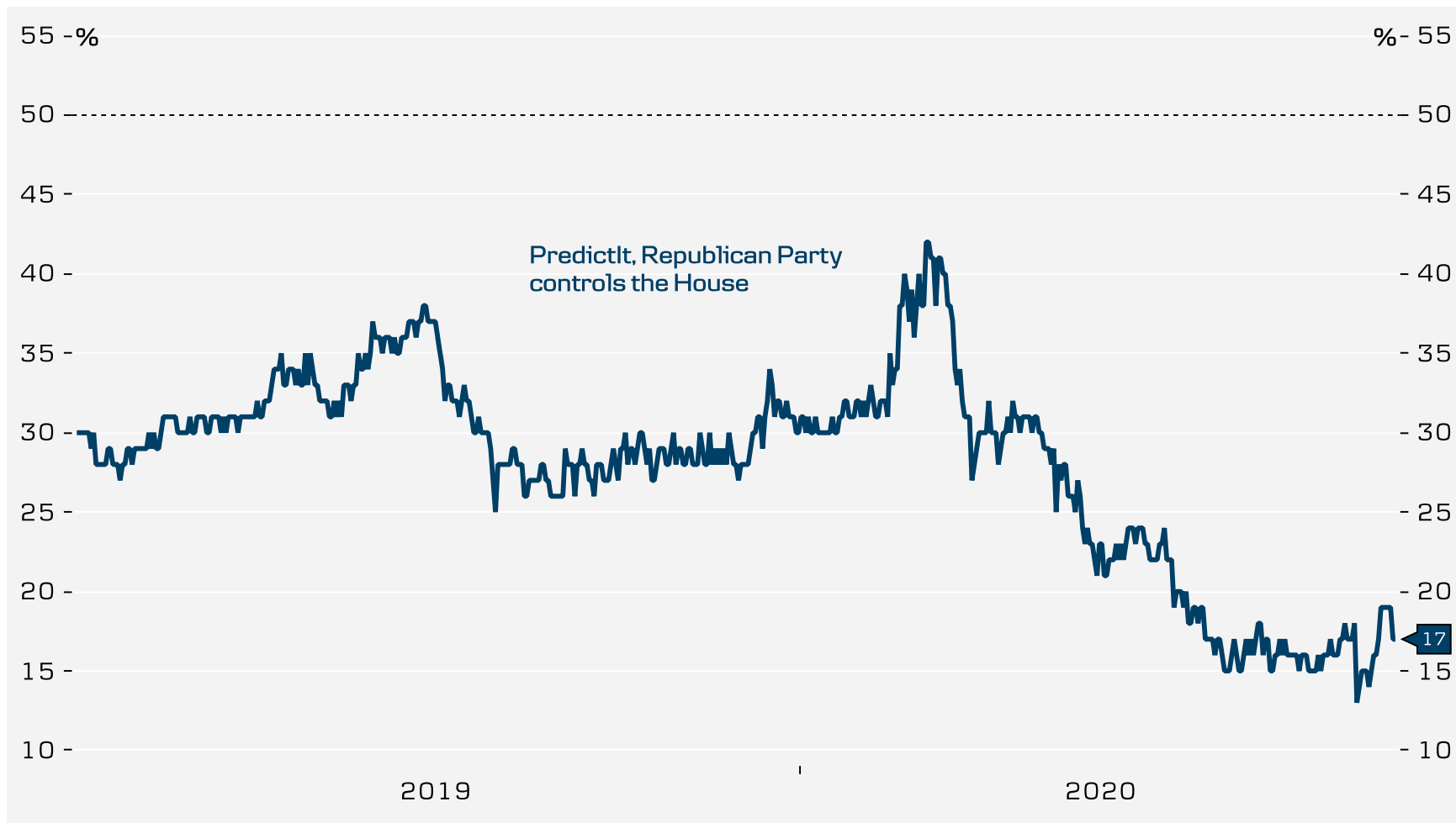
Democrats have the majority in the House
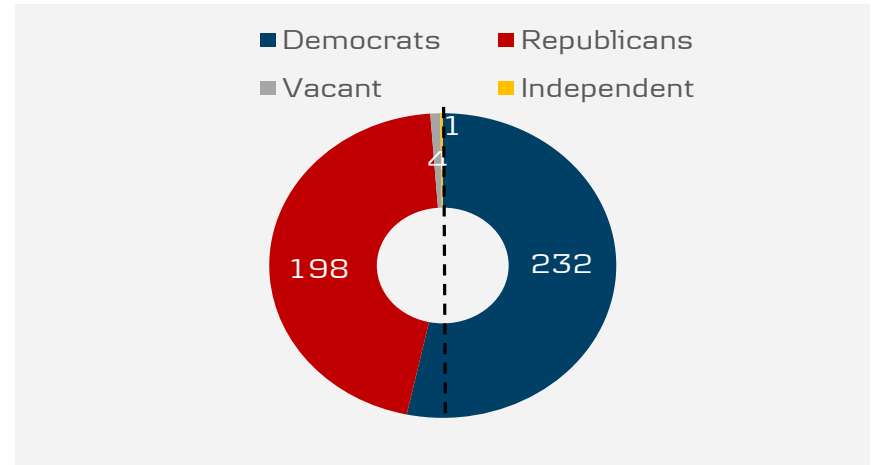
Source: 270towin, Wikipedia

Democrats likely to retake the House
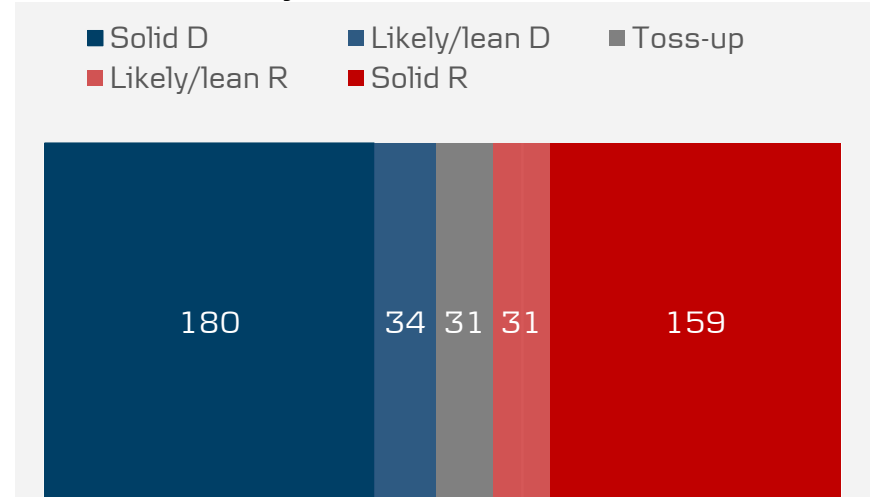
Sources: RealClearPolitics, Wikipedia

The Democrats are very likely to regain control of the House, according to prediction markets

PredictIt, Republican Party controls the House

17

2019
2020

Source: PredictIt, Bloomberg, Macrobond Financial

Policy views: Biden has a progressive economic policy but will stick to hawkish stance towards China

Trump versus Biden

Topic	Trump	Biden
Fiscal policy	- Extend tax cuts (USD1,500bn over 5 years) and deregulation - Does not mind higher federal debt, at least in practice - USD2,000bn spending on infrastructure over 10 years	- "Restart package" to support economy after COVID-19 - Higher taxes for high-income earners and corporates (including 21% repatriation tax rate), higher capital gain taxes (USD4,000bn in revenue over 10 years) - Supporting higher tax credits for low-income earners - Increase minimum wage to 15 dollars per hour - Buy American products when spending federal money (USD400bn) - More spending on infrastructure and clean energy (USD2,00bn over 10 years) - Expanding short-time compensation schemes
Monetary policy	- Has criticised the Fed for too tight monetary policy - Has praised recently policy actions - Expected to reappoint Fed chair Powell nonetheless	- Critising Trump for abusing power by putting Fed under pressure - Expected to reappoint Fed chair Powell - Fed should focus more on inequality (e.g. report more frequently on inequality measures)
Foreign policy	- More spending on military, weapons and space programmes - Supporting more cooperation with Russia - Pulled US out of Iran deal - Met with North Korea previously but no nuclear deal yet - Criticising NATO allies for not spending enough money on military	- Deal with Iran through diplomacy - Will not meet with North Korea unless certain preconditions are met - Strengthening NATO and keeping troops abroad - Tough line on Russia - Supported some wars but skeptical whether the US can change foreign countries structurally through military power

Trump versus Biden

Topic	Trump	Biden
US-China relationship	- Boost US manufacturing - 50-50% probability of renewed trade war	- Criticising Trump's tariffs for being expensive for US consumers and farmers - Less dependent on China-trade by boosting US manufacturing - Hard line on intellectual properties - Cooperation with allies
Technology	- Wide-ranging antitrust probes	- Proposed minimum federal tax on big tech - Looking into whether splitting up big tech companies is a good idea or not - USD300bn investments in R&D
Racial topics	- Law and order to prevail - More social workers in the police force to deal with drug problems and homelessness	- Pledged that appointments will reflect US diversity - Disagree on defunding the policy and instead wants the policy to hire more diverse officers - Easier to sue over discrimination
Health care	- Reduced coverage of Affordable Care Act ("Obamacare") - Reduced health care spending of USD1,350bn over 10 years in last budget proposal - Wants cheaper medical prices by linking Medicare prices to foreign prices - Imposing work requirements and other limitations on Medicaid eligibility	- Improving Affordable Care Act ("Obamacare") including potentially a public option, not supporting "medical for all" policies - Lower medical prices by allowing Medicare to negotiate prices with drug companies and importing drugs from other countries - Lowering the Medicare eligibility age from 65 to 60 - USD750bn over 10 years

Trump versus Biden

Topic	Trump	Biden
Climate change	- Climate change sceptic, starting process of leaving Paris agreement - Supports oil and coal production - Roll back regulations - Supports nuclear energy - Eased auto emission standards	- Rejoin Paris agreement - USD2,000bn investment in renewal energy, 100% clean energy by 2035 ambition - End new oil and gas leases - Carbon emission tax - Supports nuclear energy - Tightening auto emission standards

# *Biden's economic policy is slightly expansionary despite tax increases*

- Biden has proposed tax increases for a total of USD4,000bn over 10 years (i.e. 1.8% of 2019 GDP).

- The personal tax hikes (accounting for around 50% of the tax increases) are mainly targeted at high-income earnings and hence should not have a big impact on growth in the short term. We know fiscal multipliers for high earnings are low, as they generally have a low marginal propensity to consume (see next slide).

- **Higher corporate taxes are, all else equal, negative for investment growth. However, as we argued in connection with Trump's tax cuts, we think other factors are more important for investment decisions (in particular, future growth expectations),** at least in the short run. Business investments did not increase much on the back of Trump's tax cuts. As we argued in The Big Picture: Global economy still on a roll, 4 December 2017, this makes sense, as investments were subdued despite easy and cheap credit. This also means a reversal should not have a big impact the other way around.

- **Biden also wants to spend a lot of money over 10 years (USD3,450bn in total):** USD2,000bn on infrastructure and clean energy, USD400bn on buying American products, USD300bn on research and development and USD750bn on broader medicare coverage. **We do not know all the details but Biden has also made it clear he wants to spend more money in the short run to restart the economy after COVID-19.**

- **At least on paper, Biden seems to have financed the increased spending one-to-one by higher tax revenues and hence it should not lead to higher deficits. From a growth perspective, it should be slightly positive overall in the short run, as fiscal multipliers on spending are higher than fiscal multipliers on tax changes** (see next slide).

- **We note that policy proposals usually get watered down during negotiations due to different priorities**. This means that both spending and tax revenues may not be as large as suggested. **It is also a real possibility that spending will exceed tax revenues, i.e. even higher deficits. This was what happened with Trump's tax reform.**

- Biden needs to win the majority in both the House and the Senate to change economic policy.

Fiscal multipliers are larger for spending than tax changes

	Low Estimate	High Estimate
Government consumption	0.5	2.5
Government investment in infrastructure	0.4	2.2
Tax cuts for lower- and middle-income people	0.3	1.5
Tax cuts for higher-income people	0.1	0.6
Corporate tax cuts	0.0	0.4

Note: Total effect accumulated over several quarters

Source: CBO's analysis of the American Recovery and Reinvestment Act of 2009

Trump's tax cuts did not have a big impact on investments, as other things are more important for investments in the short run
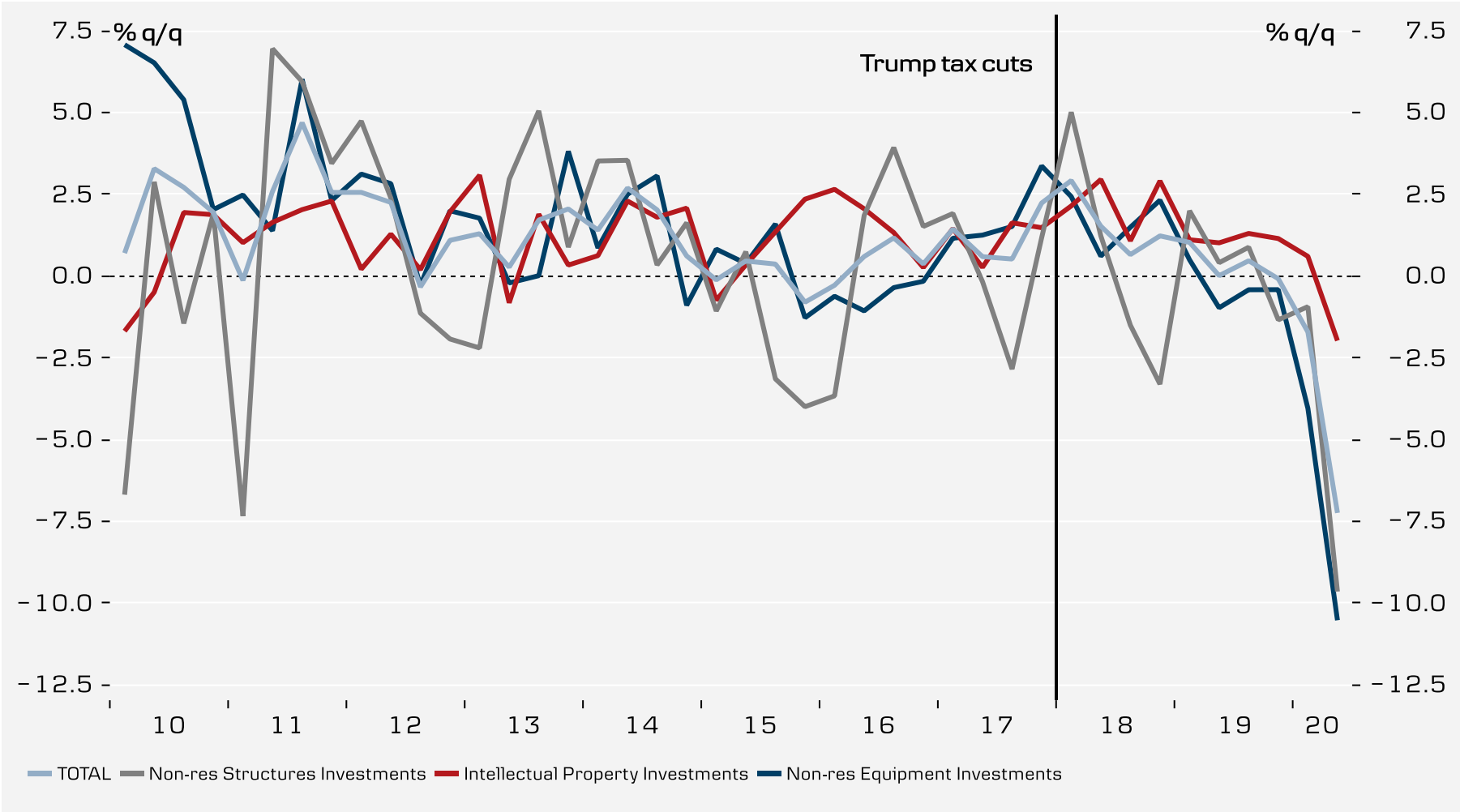
Room for more fiscal support despite ballooning deficits

Short-term: Relief package or not?

- **In the short run, we are monitoring closely the negotiations on another relief package**, not least on the expired higher unemployment benefits, which means many Americans are experiencing a significant negative income shock. Unfortunately, the negotiations are not moving forward at this point. As a result, the economic recovery is not as strong as it could have been and in a worst case it may imply a setback.

- If the politicians agree on, let's say, a USD1,000bn relief package and we assume USD750m is spent this year and USD250m next year, the government deficit may be as big as 20% this year and nearly 10% next year.

- The current government funding bill expires on 30 September and, without an extension, there will be a government shutdown on 1 October. Luckily, **House Speaker Nancy Pelosi and Treasury Secretary Steven Mnuchin have agreed to pass a short-term spending bill to avoid a government shutdown ahead of the election.**

- **According to the IMF, the US should stimulate the economy by an additional 10.5% of GDP through 2023.**

- The IMF argues low borrowing costs and strong demand for US Treasuries make room for more easing.
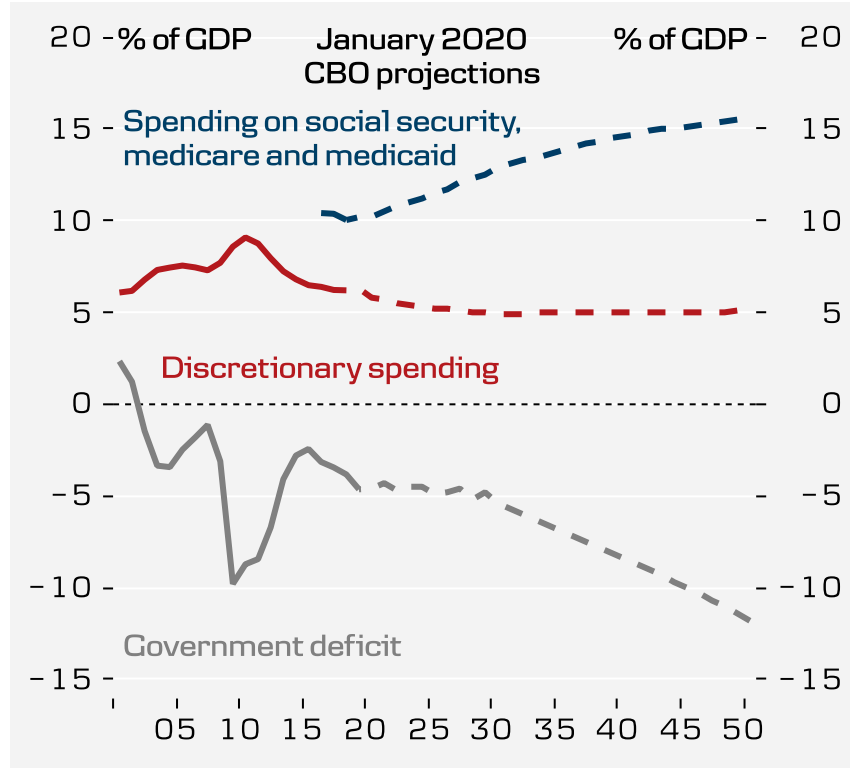
Large government deficits

Legend:
- Including new USD1,000bn package
- Government deficit CBO projection
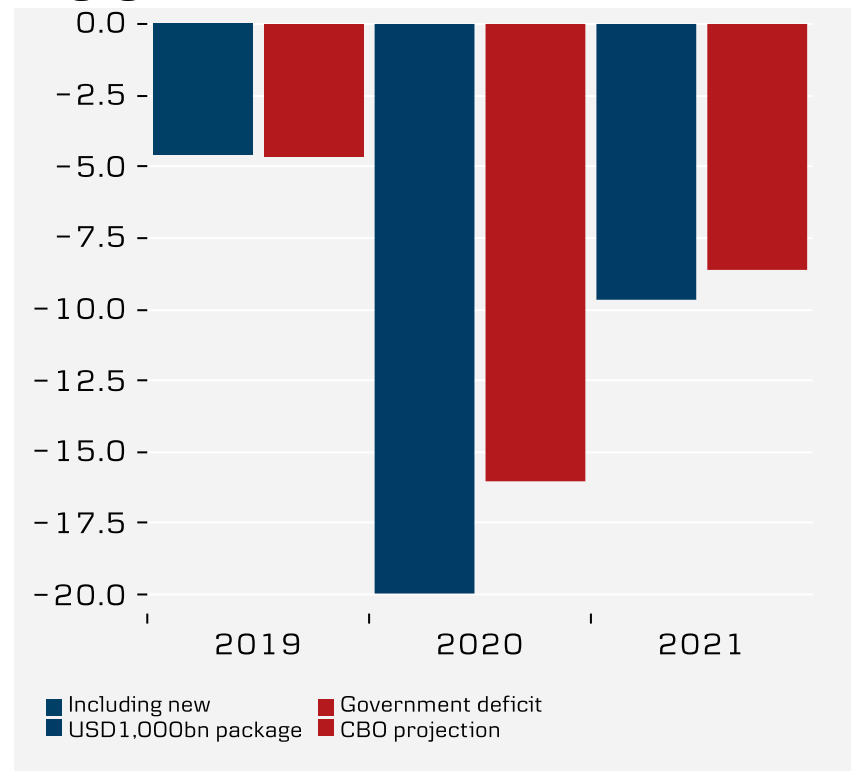
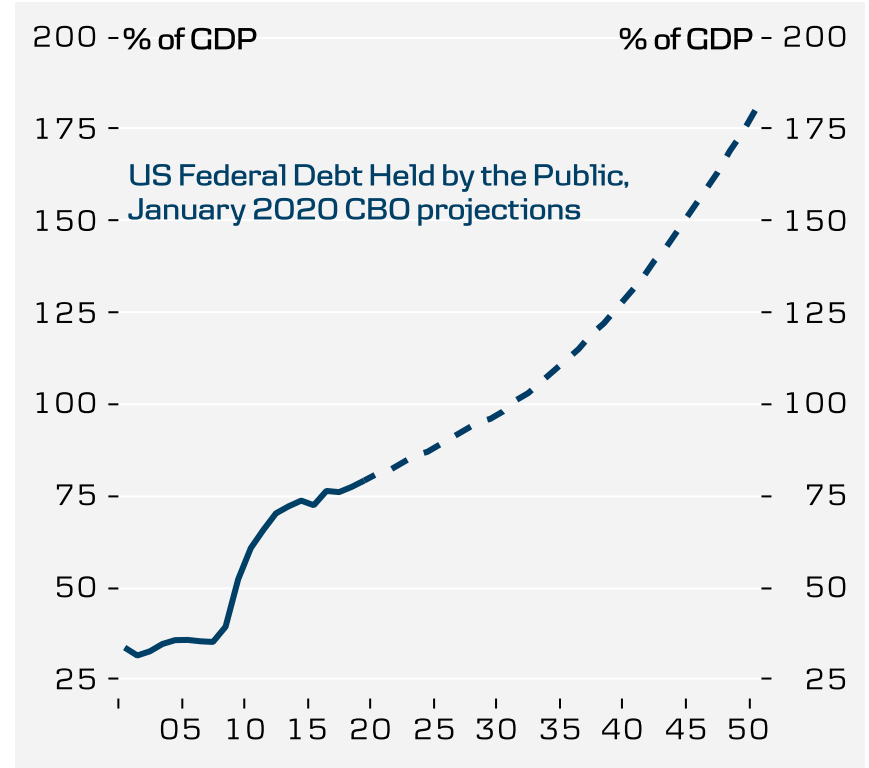Source: CBO, Macrobond Financial, Danske Bank illustration

US government debt was on an increasing path pre-corona

Demographic factors put pressure on US public finances over the coming decades

Sources: CBO January 2020 long-term projections, Macrobond Financial

Debt was expected to increase significantly over the coming decades even without corona


Sources: CBO January 2020 long-term projections, Macrobond Financial

US-China tensions are here to stay – "one world, two systems" going forward

- **We believe the US-China tensions are here to stay regardless of the election outcome.** The US's attitude towards China has shifted significantly during the Trump presidency but **the anti-China sentiment is bipartisan and increasingly widespread across the population**, in the media and in academia. Hence, **we would not expect a big change if Joe Biden wins.**

- **The trade war fears could decline if Biden wins**, as he thinks tariffs hurt US consumers and businesses. If Trump wins, we still think there is a real risk of renewed trade tensions (50% probability).

- However, **we expect a further decoupling between the US and China in terms of technology, investments and human-to-human exchanges**.

- A new cold is set to lead to two technological systems developing side by side (bifurcation) and many companies may have to develop two sets of products – one for the Chinese market and one for the rest. "**One world, two systems**".

- The new technology race and more government support for technology and R&D in the West could lead to more innovation and higher productivity. On the other hand, a need to develop two different technological systems would come at a cost and reduce productivity gains. The net result is not obvious.

- **Fears that the "cold tech war" could tip into a hot war eventually have been on the rise and the South China Sea and Taiwan are primary concerns for a possible military confrontation.**

- For more, see Research China: At the foothills of a new cold war – and what it implies, 31 July.

Anti-China sentiment has risen significantly

Opinion of China

Last observation: July 2020

Unfavorable

Favorable

73

22
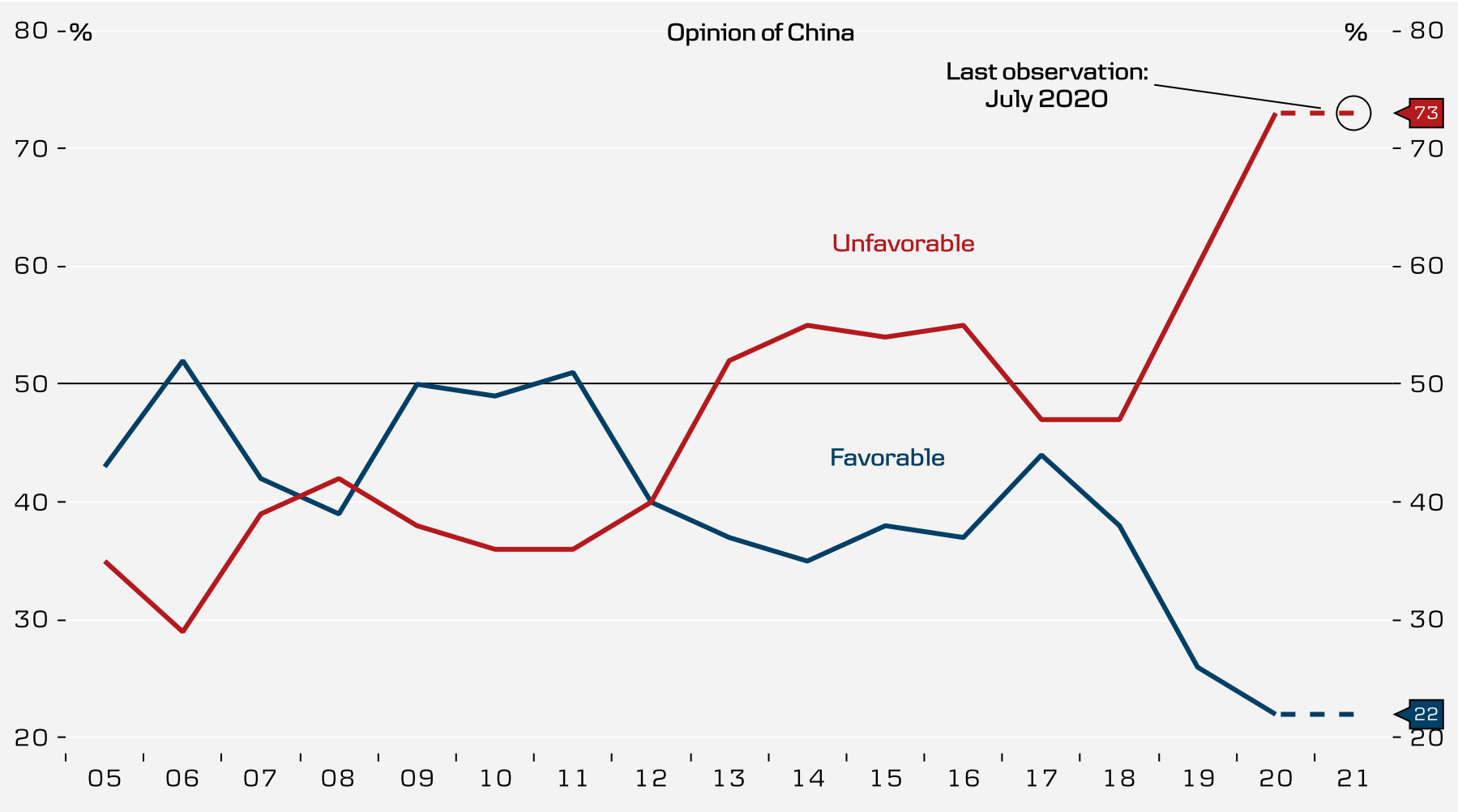
Biden would mean a normalisation of the US-EU relationship, uncertainty is set to remain in case of a Trump victory

Trump

- Increased threat of tariffs on EU cars and car parts imports and gradual evolving into US-EU trade war.

- Souring relationship with European NATO partners.

- New US tariff actions against EU digital taxation efforts and carbon border adjustment mechanism.

- That said, US Congress has a much more friendly attitude towards its European allies, which limits how far Trump will go, compared to the US-China situation.

- Also, we note that the US-EU relationship has moved slightly in the right direction recently after the US-EU agreement on reducing tariffs for a few items.

- **Overall, more of the same as the past four years.**

Biden

- Renewed impetus for EU-US trade deal on industrial goods.

- Improving ties with European NATO partners.

- Remove threat of US tariffs on EU cars & car parts and might even roll back current steel & aluminium tariffs.

- Re-engage with OECD on work about a framework for taxation of big digital companies.

- **Overall, more or less "back to normal".**

Future tech regulation is a big unknown but we lean towards believing big tech companies won't split up

- **Future tech regulation will be extremely important in the coming years.** On one hand, there is a political wish to change current regulation. On the other hand, the US is in the middle of a "cold tech war" with China.

- In particular, there is focus on antitrust and whether to break up tech companies right now. Unfortunately, we do not know much about either Trump's or Biden's views here.

- Biden has said he wants further investigation before making up his mind. We find it noteworthy that Biden's campaign includes many people who previously worked at some of the big tech companies.

- Trump has criticised tech companies on several occasions but so far has not done much.

- **We lean towards thinking that politicians will tighten regulations on tech companies eventually but not break them up at this point. However, this is not a high conviction call. The Democratic Party is likely to be more hawkish on this than the Republican Party.**

Fed policy independent of election outcome – Powell is set to be reappointed as Fed chair

- **We expect Trump to reappoint Jerome Powell as Fed chair**, as he has become more satisfied with him after the Fed cut interest rates to 0.00-0.25% and restarted significant QE buying.

- **We also expect Joe Biden to reappoint Jerome Powell,** as he is a safe pair of hands. Biden wants the Federal Reserve to focus more on (racial) inequality, which are topics that Powell has increased focus on. The new average inflation targeting regime also reflects this, as the Fed is now allowing the economy to run hot.

- **There are still two vacant seats at the Fed.** While Trump may continue to nominate more controversial candidates (who are usually rejected in the Senate), we think Joe Biden will nominate more "traditional" candidates.

- The question is whether a Republican-dominated Senate would block Biden's pick, like we saw under Obama. This should not have a big impact, however. It is always preferable to have a full board but the Fed has shown it is fully operational anyway.

- Overall, **we think the Federal Reserve has shown that the institution is strong despite the unprecedented political pressure under Trump's presidency** and, hence, we believe the Federal Reserve will continue to do what it thinks is necessary given the economic situation.

- **The Federal Reserve's focus in the coming months will be on implementation of its new average inflation targeting regime and how to make it credible**. We discussed this in detail in Fed Monitor: Forward guidance linked to inflation outcomes and faster QE buying on the cards, 2 September.

Markets: Election dominated by COVID-19 and new Fed regime

Equities: US election set to be secondary for equities

- History suggests that the US elections will have a small impact on equities relative to the media coverage. Why should it be different this time around?

- Before the 2016 election, many top-down analysts expected a negative market reaction in the event of a Trump win. The opposite happened.

- 'Sell the rumour and buy the fact' could be the case again this time around, as many could fear a corporate tax increase if Biden wins. We believe this risk is overdone.

- The business cycle is much more important for markets than the president is. The "Trump trade" has been widely used as an explanation for the strong returns 1-6 months after the previous election. However, the prime reason was the global synchronised recovery, which took place even before Trump was elected.

US presidential election and S&P500 returns

Year	Winner	Party	+1M	+3M	+6M	+12M
1948	Truman	Democrat	-9%	-8%	11%	-3%
1952	Eisenhower	Republican	4%	6%	1%	0%
1956	Eisenhower	Republican	-2%	-8%	-3%	-15%
1960	Kennedy	Democrat	2%	13%	21%	28%
1964	Johnson	Democrat	-1%	3%	5%	8%
1968	Nixon	Republican	4%	1%	3%	-6%
1972	Nixon	Republican	4%	1%	-5%	-6%
1976	Carter	Democrat	-1%	-1%	-4%	-11%
1980	Reagan	Republican	6%	0%	1%	-3%
1984	Reagan	Republican	-4%	6%	6%	13%
1988	Bush	Republican	1%	9%	11%	22%
1992	Clinton	Democrat	2%	6%	6%	12%
1996	Clinton	Democrat	4%	9%	14%	32%
2000	Bush	Republican	-6%	-7%	-12%	-20%
2004	Bush	Republican	5%	6%	4%	6%
2008	Obama	Democrat	-16%	-16%	-10%	4%
2012	Obama	Democrat	-1%	6%	14%	24%
2016	Trump	Republican	5%	7%	12%	21%

Median Returns						
All elections			2%	5%	5%	5%
Democrat winner			-1%	5%	9%	10%
Republican winner			4%	4%	2%	-2%

Sources: Bloomberg, Danske Bank calculations

Higher stock prices in 2016-18 were mainly driven by the global synchronised recovery
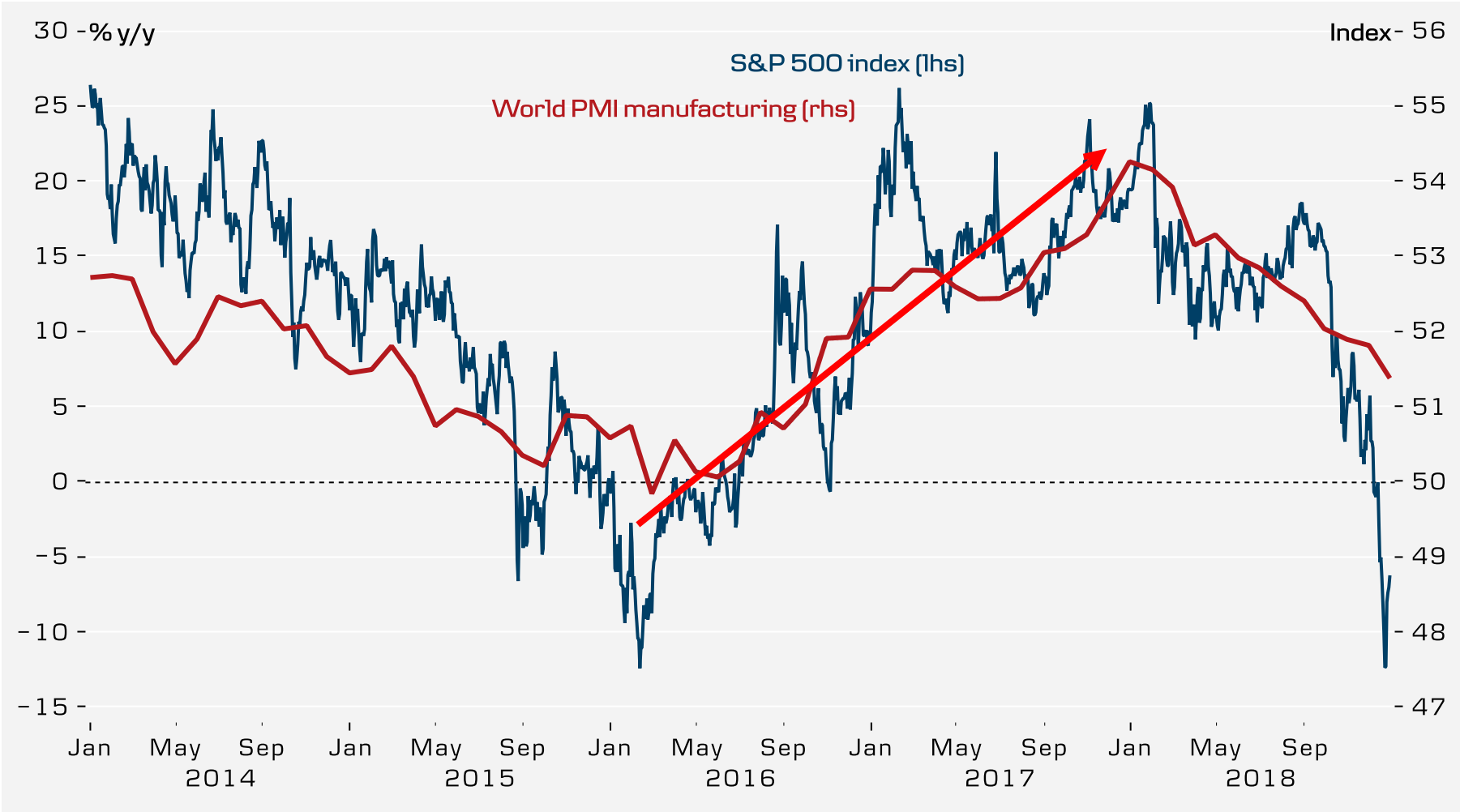
S&P 500 index (lhs)

World PMI manufacturing (rhs)

Note: Past performance is not a reliable indicator of current or future results
*Source::Bloomberg, IHS Markit, Macrobond Financial, Danske Bank.*

FX: USD – an election in two dimensions: tax and trade

- For currencies, the US presidential election essentially has two key dimensions: **tax and trade** (China).

- In case **Biden wins and there is a Democratic-controlled Congress, there could be**:
  - i.) a 'restart' of the US economy but notably financed by higher taxes down the road (net USD negative),
  - li.) but we would <u>not</u> expect Biden to go light on China, but for rhetoric to get less confrontational and a smaller risk of a scrapped trade deal (USD negative).
  - → That is, on a net basis, **the most USD-negative scenario** (but also the one currently priced with the largest probability).

- By extension, **the most USD-positive outcome should be Trump win with a Republican Congress majority.**

	tax plan (Congress majority key)	trade (presidency key)
Biden	USD negative	small USD negative
Trump	USD positive	small USD positive

Source: Danske Bank

- **We think there are more important drivers for EUR/USD near-term:** The September FOMC meeting, ECB's view on EUR strength, global activity, equity markets and the potential for US fiscal easing. Further ahead, Europe is (still) in ample supply of internal challenges that are likely to matter on a 12M horizon - but not today.

USD during Trump presidency: changing monetary backdrop key - but fiscal/trade stance might have *triggered* dollar shifts
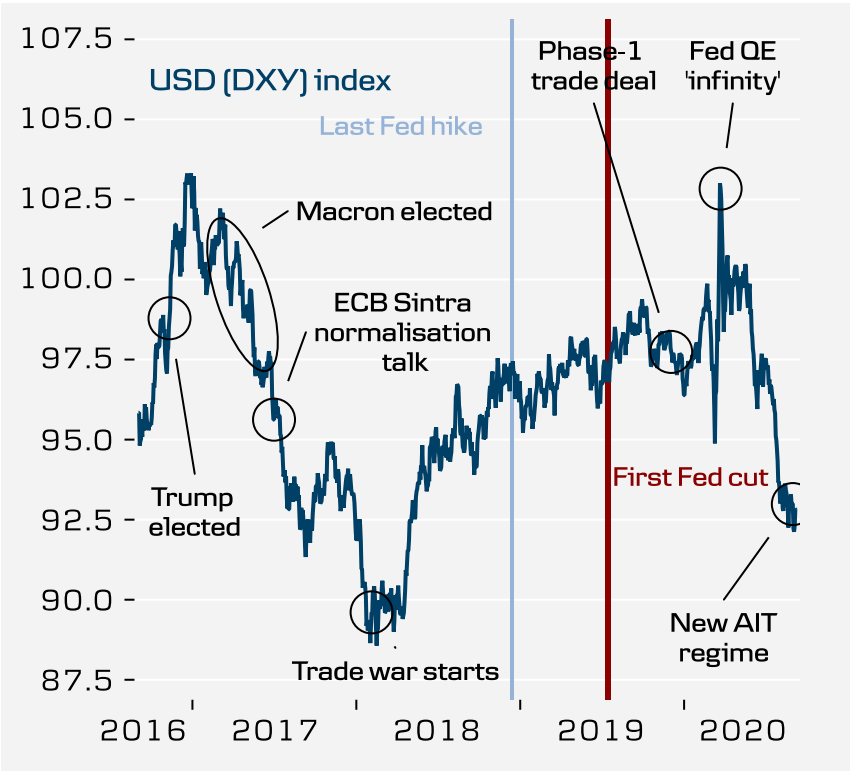
Note: Past performance is not a reliable indicator of current or future results
Source: Bloomberg, Macrobond Financial, Danske Bank

Fixed Income: Little impact on US treasury market

- **We do not see the election as a main driver for the US government bond market in either the short term or medium to long term**

- Any immediate effect from the US election on US fixed income would primarily come from an impact on risk appetite.

- It seems likely to us that both candidates in the coming years would continue the current loose fiscal policy and that the financing need would continue to be elevated. Biden might be seen as more fiscally prudent given he is ready to raise taxes but he would also spend more money on areas like climate change.

- However, on the other side, the Fed is expected to continue its open-ended QE for an extended time to balance the Treasury market.

- We do not expect that the election would change the probability of a downgrade from Fitch, which put the US on a negative outlook on 31 July.

- **We expect 10Y treasury yields to stay close to the current level for the rest of 2020. Main drivers are likely to be economic and virus data.**

10Y yield to stay close to the current level for the rest of 2020 no matter who wins the election, %
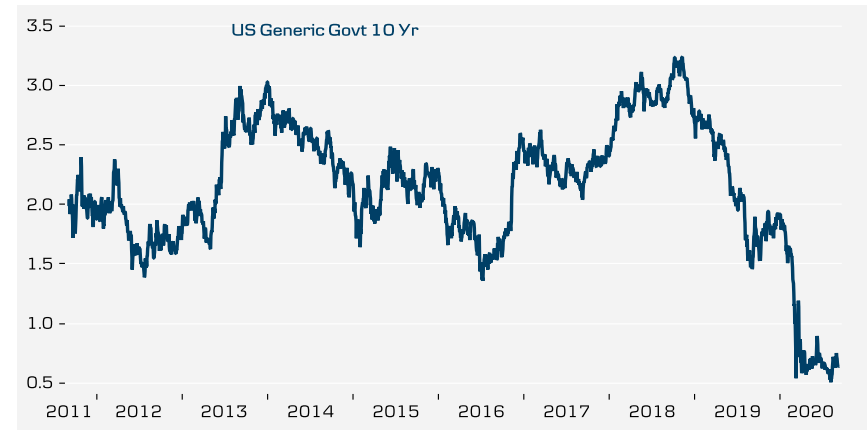
Steep budget deficits to finance in the coming years, %
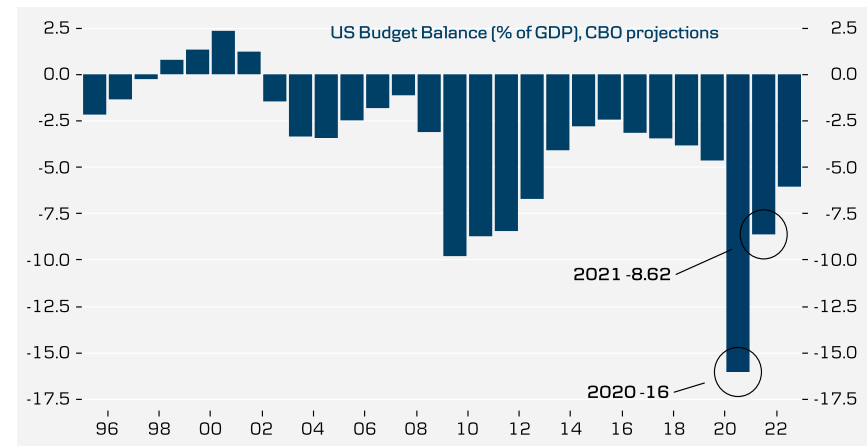
Source both charts: Bloomberg, Danske Bank
Note: Past performance is not a reliable indicator of future results

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Appendix – a short guide to the US political system

Presidential election: 538 electoral votes – 270 to win

Current US electoral map according to RealClearPolitics
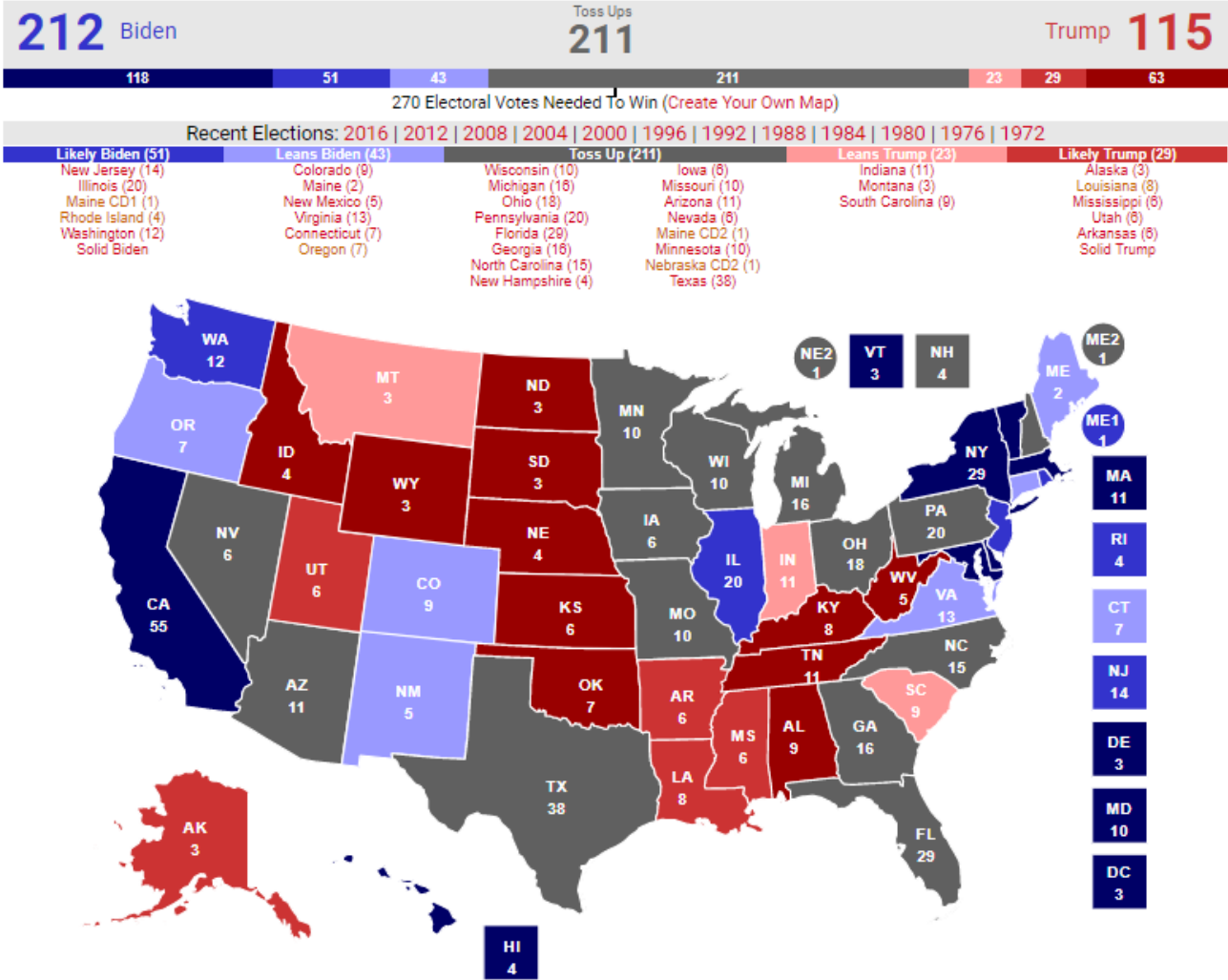
- There are 538 electoral votes in total ('mostly winner takes it all' across states).

- A candidate needs at least 270 electoral votes to become president.

- We already know the outcome of many states, which are either solid blue or red states. Focus is on the swing states.

US political system – 'checks and balances'

Confirms or rejects appointments by executive (including judges)

Can veto legislation

Appoints judges

CONGRESS
Senate & House of Representatives

WHITE HOUSE
The President

SUPREME COURT

Legislative
Writes laws

Executive
Enforces laws

Judicial
Interprets laws

Can declare acts of legislative or executive branch to be unconstitutional
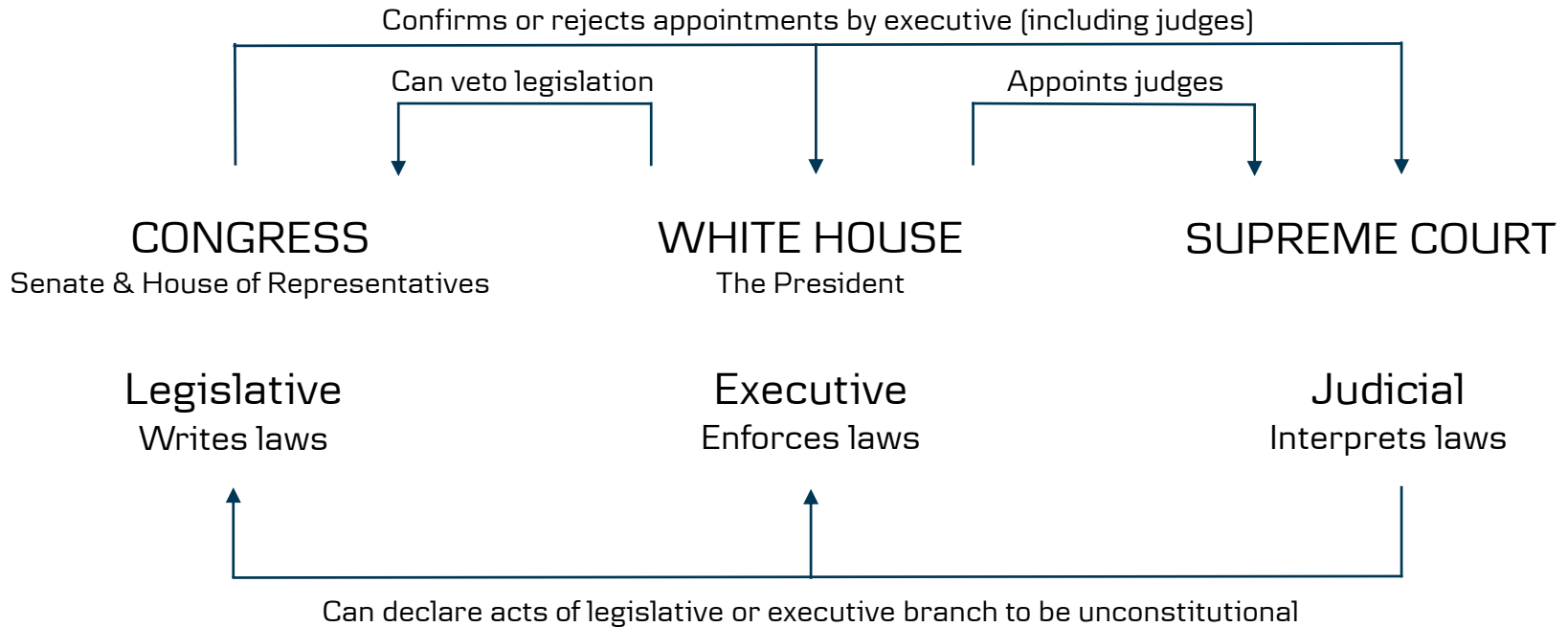
Check-and-balance system:
- Constitution set up to ensure that none of the branches becomes too powerful.
- Each branch can *check and balance* the operations and powers of the other two.

Powers of the president – legislation

- Sign or veto legislation (return to Congress with a veto message suggesting changes – must approve all of a bill or none of it, cannot veto selectively). Veto can be overridden by two-thirds vote in both chambers (difficult and rare).

- Can issue executive orders (have the full force of a law but without Congressional approval) – subject to judicial review. Executive orders are not defined in the US constitution but are implied in Article II of the constitution. Executive orders cannot appropriate any new funds from the US Treasury.

- Congress has the power to overturn an executive order by passing legislation in conflict with it, which, however, the president can veto (unless the executive order is overturned by a super majority in Congress). The latter explains why this is extremely rare. Executive orders remain in force until they are cancelled or revoked.

- Responsible for preparing the US budget although Congress must approve it.

- Can recommend legislation.

- State of the Union speech to a joint Congress (and the American people through television/media coverage).

Powers of the president – foreign affairs

- Commander in Chief of the armed forces (defence budget set by Congress).

- Congress holds the power to declare war but as Commander in Chief the president can send troops without declaration (or make an executive order).

- The president holds summits with other world leaders.

- The president negotiates treaties with other countries, which need to be ratified by two-thirds of the Senate.

New president needs support from Congress to pass legislation

- New president needs support from Congress to pass legislation – complicated if the House and the Senate have different majorities.

- **The House of Representatives:** 435 seats distributed among states relative to population size.

- All 435 seats up for election every second year but re-election ratio is high.

- Currently, the Democratic Party has the majority in the House.

- **The Senate:** One hundred seats, two from each state. Republican majority currently. Thirty five seats up for election.

- Among the 35 seats up for election, 23 are held by Republicans and 12 are held by Democrats.

- There is still a long way to the so-called super majority of 60 seats, which makes the legislation process easier (prevents filibustering).

Democrats have the majority in the House

Legend: Democrats, Republicans, Vacant, Independent

1, 4, 198, 232
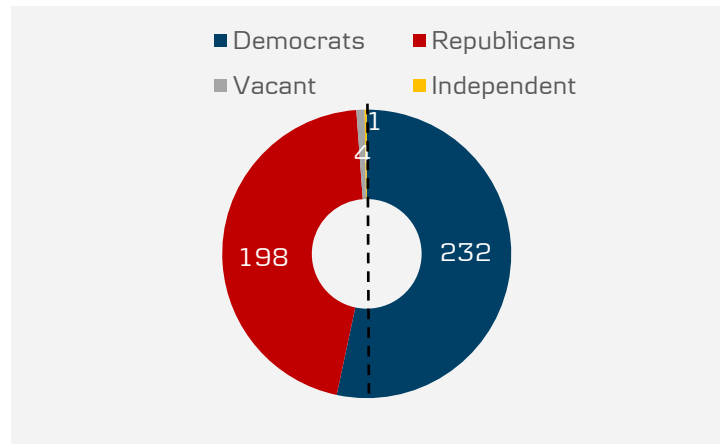
Source: Wikipedia

Republicans have the majority in the Senate

Legend: D, up; R, up; R, not up; D, not up

30, 35, 23, 12
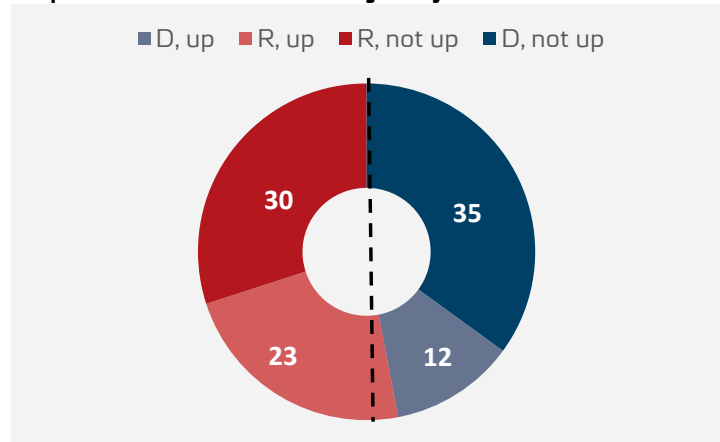
Source: Wikipedia

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