Perspectives

Biden rides a small blue wave to the presidency, and into likely gridlock

from **MacKay Shields Global Fixed Income Team**

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Assuming any recounts or litigation brought by the Trump campaign do not change the outcome, former Vice President Joe Biden has emerged the victor in the presidential election. However, control of the Senate will not be determined until early January following two run-off elections in Georgia. Given this uncertainty, this note explores the likely path of the Biden administration's policies should Republicans indeed maintain Senate control. In this scenario, Democrats would have limited ability to implement their policy priorities, including expansionary fiscal policy. In addition, partial reversal of President Trump's 2017 tax cuts would be a non-starter. Still, a bipartisan infrastructure spending program remains a possibility.

With a path towards meaningful legislative changes effectively blocked, a Biden presidency would instead focus on environmental regulation, immigration policy, and trade- and technology-related issues with China.

In the near term, we still expect a follow-up to the CARES Act that provides support to the economy as it recovers from the COVID-19 shock. But the need for bipartisan support suggests a more modest package.

Limited fiscal support presents some downside risk to the outlook, but it should not derail the recovery. As such, we maintain our current risk positioning in portfolios.

After a bruising campaign in the midst of a pandemic, former Vice President Joe Biden has emerged the victor in the presidential election. At the time of writing, Biden has won the popular vote and secured at least 290 of 538 electors to the Electoral College.[1] However, Democratic prospects for implementing their policy agenda appear limited – Republicans will retain control of the Senate unless both Democratic candidates win run-off elections for Georgia's Senate seats in early January.[2] Without full Democratic control of the legislative branch, President-elect Biden would need to seek bipartisan support to move forward with his spending plans. Such an outcome is not impossible for infrastructure spending, but extremely unlikely for Biden's health care, education, and housing initiatives.

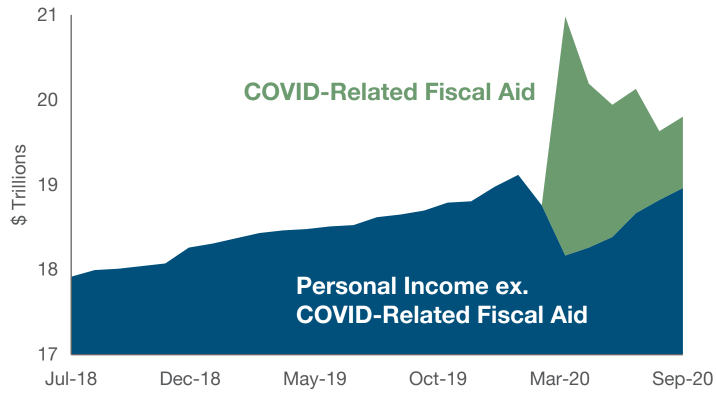
As for infrastructure, any proposal to pay for the program through a partial roll-back of President Trump's signature 2017 tax cuts would derail a bipartisan effort. Without "pay-fors", the Senate would not likely support any infrastructure bill that comes close to the $2 trillion-plus package that the Biden campaign put forward. Most Republicans would also object to the clean energy and sustainability proposals of the Biden infrastructure plan. All of this suggests that any bipartisan infrastructure legislation would be fairly limited in scope, for example less than $500 billion over ten years.

Near-term priorities: Additional COVID-19 relief

If not accomplished during the lame duck session, the immediate priority of a Biden administration will be to secure passage of a fiscal support package to help the economy weather the ongoing COVID-19 crisis. New legislation will likely have many of the same components as the CARES Act, such as supplemental and expanded unemployment insurance benefits and funds for small and medium enterprises. Passage of this legislation is far from certain. To overcome a filibuster and move on to a final vote on legislation, Democrats would need to win the support of some Republic senators. However, as we have learned during the current Congressional stalemate, Republican appetite for another large-scale fiscal support package appears limited. The political calculus may change now after the election, but Democrats will need to limit the scale and scope of the legislation to secure passage.

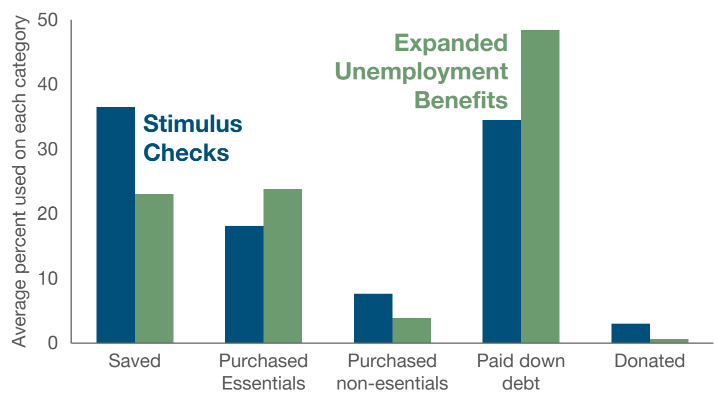
This political reality presents some downside risk to the outlook next year. As seen in **Figure 1**, the CARES Act provided a generous offset to lost household income this year, allowing for strong household spending despite a weak labor market. Households also used the funds to pay down debt and increase savings, thereby strengthening balance sheets (**Figure 2**). In a best-case scenario, where a vaccine or highly effective treatments allow for a return to more normal household and business activity in the first half of next year, a limited fiscal support package may prove more than adequate to cushion household incomes in the short run. But in less optimistic scenarios, where the recovery follows a weaker trajectory, sizeable fiscal support may be necessary to prop up cash flow for households and businesses. Thus with divided Congress, there is the risk that fiscal support over the course of next year proves inadequate and halting. A scenario where Congress passes a modest short-term support measure, only to have to re-engage in negotiations later in the year when that support package runs dry, is not hard to imagine.

Figure 1: Household income



COVID-related fiscal aid includes expanded and increased unemployed insurance benefits, Payroll Protection Program loans, farm support, increased Medicare reimbursement rates, household stimulus checks (Economic Impact Payments) and the Lost Wages Assistance Program. Source: Bureau of Economic Analysis, MacKay Shields, as of 9/30/20.

Figure 2: Household use of stimulus checks and unemployment insurance benefits



Source: Federal Reserve Bank of New York, as of 9/30/20.

Increased regulation ahead

With the path to most of his legislative priorities blocked by a Republican-controlled Senate, Biden may instead focus on the regulatory landscape for the environment and financial sector. For example, we anticipate a ban on new permits for drilling on federal lands as well new restrictions on pipeline permitting. Regulatory powers may also be used to accelerate a transition to clean energy. As for the financial sector, a key signal will come from the Biden administration's decision on whether to re-appoint Trump nominee Randall Quarles as Federal Reserve Vice Chair for Supervision when his term expires next October. However, even if Vice Chair Quarles is replaced by someone who supports a more robust regulatory framework, implementing any changes would take some time given the Board of Governor's deliberative and consensus-oriented decision-making process.

Governing in the post-Trump era

President Trump's economic legacy may very well be his rewriting of the script on free trade and deficits. Over the past 30 years, both the Democratic and Republican establishment had embraced the benefits of free trade while paying scant attention to the costs borne by manufacturing firms and their employees. That changed with President Trump. In reaction to the 2016 election, Democrats have attempted to reclaim the mantle of protecting workers from the forces of globalization. This remains highly unsettled ground, as a national consensus on how best to balance the benefits and costs of free trade has yet to emerge. In the meantime, the Biden administration is unlikely to reverse President Trump's policy thrusts in this area, including WTO reform, technological decoupling from China, and skepticism towards multilateral trade deals. The Biden administration's political touch may be softer, but the mantra of "free but fair trade" is now part of the political mainstream. In this environment, even reversing remaining tariffs could prove challenging.

President Trump also has had a profound impact on how the electorate views deficits. Ironically, his administration, along with a Republican Congress, repurposed an idea long popular with left-of-center economists and policymakers — low interest rates open the door for more expansionary fiscal policy that could shock the economy out of its low-growth path. The longer-term economic impact of President Trump's tax cuts remains unclear, but nonetheless, arguments about the pernicious effects of persistent deficits now carry much less weight than they did before Trump took office.

Portfolio implications

Beginning in the spring, the Global Fixed Income Team began increasing and diversifying risk in portfolios on the view that a new economic expansion would soon take hold, aided by significant monetary and fiscal policy support. Since then, we have had little reason to question the commitment of the Federal Reserve to provide sustained policy accommodation. However, our level of confidence in fiscal policy had always been more tenuous, given conflicting views among Democrats and Republicans about the level and types of support that households, businesses and state governments might require. With government likely to remain divided, there is the risk that fiscal support for the economy next year could be halting or insufficient. In this event, however, we would anticipate that market pressure would eventually compel a sufficient policy response. Here, our point of reference is the initial failure to pass the Emergency Economic Stabilization Act in late September 2008. The significant fall in equities and intense strains in credit markets after that legislative failure served to motivate Congress to reach agreement in short order. Given this background, any market volatility stemming from Congressional gridlock may provide opportunities to lean into our investment thesis. For the time being, we maintain our current positioning in portfolios while remaining mindful of valuations and macro developments.

Figure 3: Key policy proposals of the Biden campaign

Policy area	Key proposals	Link for additional analysis
Fiscal policy	Significant spending initiatives include "sustainable infrastructure" and clean energy, education and health care, partially funded by raising the corporate tax rate from 21% to 28%, instituting a minimum 15% tax on global income over $100 million, and increasing the top individual tax rate to 39.6%	The US Presidential Election and the Outlook for Fiscal Policy
Financial regulation	Strengthen oversight of larger banks and non-bank financial entities such as insurance companies, asset managers, and private equity	US Presidential Election and the Outlook for the Financial Services Sector: Regulation Reflation not Expected
Health care	Expand access and lower costs through the Affordable Care Act and a public insurance option	Health Care Sector Implications of the Presidential Candidates
Technology	Enhance antitrust scrutiny of Big Tech; potential for stricter data privacy standards	US Election Implications - Technology
Energy	Ban new permits for drilling on federal land and impose new restrictions on pipeline permitting; accelerate clean energy transition	US Election Implications - Energy

Source: MacKay Shields, as of 11/9/20.

Footnotes and references

[1] Electoral vote tally as of Monday, November 9, per the Associated Press. Final tally may differ.

[2] Prices of contracts trading on the prediction market Predictit.org imply roughly one in four odds of Democrats winning control of the Senate.

Important disclosures

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