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Before the US mid-term elections

Market Comment, October 2022

The American mid-term elections take place two years after the most recent US presidential election and see the re-election of the US Congress (Senate and House of Representatives). The elections for the US House of Representatives are set to be particularly important: Should the Republicans prevail in the House of Representatives but the US Senate remain in the hands of the Democrats, it would prove more difficult to pass legislation together. This could reduce political stability and increase volatility in the US markets, including the US dollar.

At the start of November this year, the US Congress, i.e. the US parliament comprising two chambers (the Senate and House of Representatives), will be partially re-elected. Until now, both chambers have been dominated by the Democratic Party of the incumbent US President Joseph Biden, meaning that it has been relatively easy to pass laws in line with the President's wishes. This could all be about to change, especially when you take into account that on average the Democratic Party has lost 25 seats in the US House of Representatives and three in the Senate in the mid-term elections that have been held since 1950. Interestingly (and not surprisingly), it is apparent that the state of the economy is particularly important to Americans as a general factor in their voting behaviour at US elections.

In view of the economic slowdown that has already begun and historically high inflation in the US, it would thus come as no surprise if the Democratic Party were to suffer losses. This is also true when we consider the hit taken to the US President's popularity, which is certainly also related to the marked rise in American consumer prices, a development that has led to a clear deterioration in the inflation-adjusted income situation of the average US household and thus also a decline in their purchasing power. Although it is difficult to make any predictions, a defeat of the Democratic Party in the House of Representatives would be no shock. The Democrats may fare better in the US Senate, where not all seats have to be re-elected. To win a majority in the House of Representa-

tives, the Republican Party would have to gain four seats, while in the Senate just one additional seat would suffice.

“In light of historically high US inflation, losses by US President Joseph Biden's ruling Democratic Party would come as no surprise.”

Gérard Piasko, Chief Investment Officer

The market consensus favours two scenarios: (1) A Republican victory in both chambers of Congress appears increasingly probable. (2) A Republican victory in the House of Representatives and the retention of a Democratic majority in the Senate is forecast as even more likely. This means that a Republican victory is expected in the larger parliamentary chamber.

Control of the US Senate is particularly significant for important changes to fiscal legislation, with this being especially true for any necessary economic stimulus in the event of a recession in the next one to two years.

Should the Republicans prevail in both parliamentary chambers (1), initiatives aimed at providing significant new government spending would likely have less chance of success in the future due to the Republican Party's preference for less spending. If the Republicans win the House of Representatives but not the Senate (2), it may be difficult to push through legislative changes due to the subsequent division of political power. It is thus likely to be difficult to provide fiscal economic stimulus.

In the event that the Democrats were to win both chambers, this would be easier to accomplish. Nevertheless, given the massive expansion of US national debt since the coronavirus pandemic, a further strong package of fiscal economic stimulus is less likely. This is due to the fact that the negotiations between the hardened fronts of both parties would be complicated. If a package of eco-

conomic stimulus were to materialise (in the event of a possible recession in 2023 or 2024), the Republicans would likely favour tax cuts over higher government spending, which the Democrats have often given preference to historically. It would therefore be virtually impossible to avoid a discussion about the US debt ceiling.

As a legislative change, the regulation of Internet platforms may be discussed. However, such a move would require more than a simple majority in the Senate, as 60 votes in favour would be needed rather than just 51. Legislation aimed at reducing drug prices would also be more difficult to achieve if the Democrats fail to come out on top in both chambers.

Overall, an increasingly complex domestic political environment is to be expected in the US, a situation that would continue to argue against cyclical equity sectors and in favour of defensive investments.

Finally, it should be noted that the results of US mid-term elections in the past did not yet provide a signal as to how the US presidential election to be held two years later would pan out. Looking back, it has always been the state of the US economy immediately before this that has proved most important. As US President Bill Clinton put it in the 1990s: "It is the economy – stupid."

Gérard Piasko

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Editorial deadline: 6 October 2022

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