

# US ELECTION PREVIEW: ALL OR NOTHING



## KEY POINTS



- Based upon his opinion poll lead, Biden is the clear favourite to win the election; time is running short for Trump to make a big comeback.
- Biden's policy platform includes fiscal stimulus, tax increases on high earners and companies to help fund bigger government including in infrastructure and healthcare. But the ability of a President Biden to turn these ideas into reality will depend upon Democratic control of Congress. Without it, these initiatives will in all likelihood die.
- The new policies Trump would pursue in a second term could focus on foreign policy, trade and sector-specific deregulation. But without control of the House – which is highly likely to stay Democratic – passage of another big tax cut looks remote.
- The Federal Open Market Committee's (FOMC) new policy framework means the monetary response to a major fiscal stimulus will be much slower than it was in the wake of Trump's tax cuts. Instead of responding to stronger growth and lower unemployment, the FOMC plans to wait until inflation pressures emerge before tightening.



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### THE POLLS SAY BIDEN IS THE FAVORITE:

With little time to go until the election, Biden has a substantial edge over Trump in the national polls, of around 10 percentage points. Biden has led throughout the campaign but his advantage has increased since the first Presidential debate and Trump's Covid diagnosis. Ten points is a large lead in the national polls, particularly given how polarized the US electorate is, so it makes Biden the favourite to win on 3 November.

However, as is always the case under the US electoral system, the size of a candidate's lead in the nationwide polls is much less important than his or her lead in the small number of states that are most likely to decide the Electoral College. The set of states in focus in this Presidential election – Florida, Arizona, Pennsylvania, Wisconsin and Michigan – is very similar to those at the centre of attention in 2016. Currently Biden leads across these states (Table 1).

**Table 1: Biden's lead in national and swing state polls**

Date	National average lead	Average lead in selected swing states	Florida	Pennsylvania	Wisconsin	Michigan	Arizona
1st July	9.4	6.3	6.4	7.0	6.5	7.5	4.2
1st August	7.4	5.7	6.2	6.0	5.0	7.8	3.7
1st September	6.0	3.4	3.5	4.7	4.0	2.6	2.2
1st October	7.2	4.3	1.4	6.3	5.8	5.0	3.0
12th October	10.2	5.4	3.5	7.3	6.3	7.0	2.7

Source: RealClearPolitics.com, BNPP AM, 13 October 2020

In 2016, despite receiving fewer total votes nationwide than Clinton, Trump was victorious in states accounting for 306 Electoral College votes to Clinton's 232. That was 36 more than the 270 he needed to win. If Trump is to be re-elected in 2020, and he fails to gain any of the states that voted for Clinton in 2016, he cannot reach the 270 threshold needed for victory unless he wins at least three of the five key swing states in Table 1: Once again Florida is going to be the topic of intense scrutiny on election night.

### TIME IS RUNNING VERY SHORT FOR TRUMP TO TURN THINGS AROUND

At the time of Trump's admission to hospital there was an open question about how it would shape his campaign strategy and how public opinion would respond. Could this "October surprise" upend the race? Would Trump pivot to a more serious, less dismissive approach to the coronavirus; and would he be the recipient of public sympathy and a rally-to-the-flag effect?

Perhaps inevitably given his political style, his infection and illness did not prompt Trump to change course. If anything, he reinforced it, choosing to be driven past banks of his supporters while still a hospital patient and still potentially infectious. After he was released from hospital, he returned to his twitter tirades that energise his most ardent supporters, once again comparing Covid to the flu<sup>1</sup>, but there was little evidence of a new approach to change minds and win over undecided voters. That seems to be costing him.

When pollsters ask voters what is the most important factor in determining how a person expects to vote, the economy and Covid are usually the most cited issues. With over 200 000 casualties from the coronavirus, the further attention the media has placed on the subject following Trump's hospitalisation is unlikely to have helped the President's poll numbers. Indeed, one explanation for Biden's increased opinion poll lead is Trump's infection has set a few more voters against Trump, worried that if even his own infection and that of his family and colleagues is not enough to convince him to address the virus more seriously, nothing will be.

<sup>1</sup> <https://twitter.com/realDonaldTrump/status/1313449844413992961>

With so little time left until Election Day, it now looks unlikely that a switch in campaign strategy could pull public opinion around for Trump. If he is re-elected, the most likely reasons for it are some other kind of surprise event in the final days of the campaign, or there is a sizeable error in the opinion polls in the swing states that means they have been undercounting Trump support, or a large number of votes putatively supporting Biden are ruled inadmissible.

In 2016, the opinion polls overstated Clinton's support in a number of the swing states by several percentage points. Biden's poll lead is narrow in Florida and Arizona and close to the typical margin of error in an opinion poll, but it is somewhat larger in Pennsylvania, Michigan and Wisconsin. Taking those rust belt states seems to be the easiest route for Biden to win the election.

### **IF HOUSE STAYS DEMOCRAT, TRUMP LIKELY TO FOCUS ON FOREIGN POLICY, TRADE AND SECTOR-SPECIFIC DEREGULATION IN SECOND TERM**

Trump ran a somewhat unconventional campaign in 2016, but he did have several signature policies that resonated with voters. His rallies echoed to cries of "build that Wall" and other slogans that somewhat set him apart in the minds of many voters.

Like most Presidents, Trump was only able to actually implement part of his agenda, but the underlying thrust of his 2016 platform did give a broad-brush approach to many aspects of his Administration. The Wall has not been built, and Mexico certainly didn't pay for it, but immigration, border security and a singular "America first" approach to international relations have been prominent themes over the last four years. Similarly, one can debate whether the new USMCA trade deal with Canada and Mexico fulfils all Trump's campaign pledges about bringing back manufacturing jobs from abroad. But as President, Trump has engaged in a fierce trade war with China and been prepared to levy tariffs on a wide range of countries, a clear break from past American free trade policies.

In 2020 by contrast, the Trump platform<sup>2</sup> is much lighter. It lacks much in the way of policies or strategies that could achieve the goals he sets out, such as creating one million new small businesses. Other hints about the focus of a Trump second term have come from his advisors. One topic that has come up repeatedly is the prospect of additional tax cuts, building on the substantial changes made in the Tax Cuts and Jobs Act that Trump signed in late-2017.

In the first two years of his Presidency, Trump was supported by full Republican control of Congress. The Republican Party used that opportunity to pass a major tax cut, a bill that did not get any Democratic Party support. But a repeat of that situation looks quite unlikely. The Democrats are well ahead in the Congressional opinion polls<sup>3</sup>, as they were in 2018<sup>4</sup> when they swept the House. The 2020 elections would have to deliver an even bigger surprise than in 2016 to result in Trump being re-elected and the GOP flipping the House. Consequently, the odds of President Trump getting re-elected and signing off on another sizeable tax cut look very low.

More generally, the ability of any President to enact their agenda hinges upon the willingness of Congress to pass supporting legislation. With very deep divisions separating Democrats and Republicans, finding common ground – even on issues where there are some shared interests – tends to be very difficult, as shown by the failure of talks between Democrats and the Administration last year to produce a major infrastructure bill.

Without ideological support from both chambers of Congress, a Trump second term could look quite similar to the last two years; focused on foreign policy, trade and sector-specific deregulation. These are all policy areas where the President and the Administration have considerable latitude to manoeuvre without the explicit permission of Congress.

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2 <https://www.donaldjtrump.com/media/trump-campaign-announces-president-trumps-2nd-term-agenda-fighting-for-you/>

3 <https://projects.fivethirtyeight.com/congress-generic-ballot-polls/>

4 <https://projects.fivethirtyeight.com/congress-generic-ballot-polls/2018/>

## WHAT BIDEN WANTS TO DO AS PRESIDENT

Biden's policy agenda is broad, but at its simplest, the most market-relevant parts can be boiled down to:

- A commitment to handle Covid more seriously
- Emergency fiscal stimulus to support those segments of business and society that have suffered in the recession
- Redistribution through higher taxes on businesses and upper income individuals to help pay for better access to healthcare
- Addressing some of the infrastructure and climate change challenges the country faces.

Biden's campaign has produced quite a lot of detail about how it sees policy in these areas, which would see a significant increase in the role of the government in the economy.

Campaign policy proposals like these should be taken seriously, but not literally, as the last four years have demonstrated. Arguably, Trump has governed in the manner his 2016 campaign indicated. He has clearly invested a lot of energy into issues that he highlighted back then: Border security and immigration, problems posed by free trade, the importance of a conservative judiciary, deregulation, strengthening the military and lower taxes.

Similarly, the Biden 2020 policy platform is primarily a signalling device, to indicate priorities to voters. It is the starting point for constructing policies to address the underlying challenges to society that Biden is focused on: Dealing with the pandemic, the struggle of the middle classes, racial injustice, poor infrastructure and the challenge of climate change.

The combination of political opposition, constraints on Congressional time and simply being overtaken by events results in most Presidents leaving office with only a small number of major legislative achievements to their name. For example, prior to the rush of action in the spring sparked by Covid, Trump's most substantive legislative action was his late-2017 tax reform. Likewise, Obama in eight years managed just three high profile pieces of new law: A fiscal stimulus, healthcare reform and financial sector regulation. With that in mind, it would not be surprising if parts of Biden's campaign platform fall by the wayside; the odds are he will have to prioritise and focus on some policies at the expense of others.

One area where there is potentially more clarity about how policy might evolve is fiscal stimulus. In October, House Democrats passed an expansive and extremely expensive (USD 2.4 trillion<sup>5</sup>) stimulus package. Unless the current negotiations between Speaker Pelosi and Treasury Secretary Mnuchin result in a deal that can pass the Republican-controlled Senate, that bill will almost certainly form the bedrock of a fiscal stimulus package in the event of a Democrat clean sweep. Fiscal stimulus on that sort of scale – around 10% GDP - will lift growth and should lead to the American economy performing better than many others around the world.

But legislation is not the only way a President can achieve his objectives. In certain areas of the economy and society, substantial change can be achieved through the use of executive orders and decisions by the people in charge of government agencies. Sector specific regulations and immigration rules are some of the clearest examples of this. And in foreign policy – an area Biden specialised in during his long career as a Senator – the President has a wide range of power and influence, a step back from Trump's America First doctrine toward a more traditional role of American international leadership looks likely under a Biden presidency

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<sup>5</sup> <https://www.cbo.gov/system/files/2020-10/hr925.pdf>

### **THE RACE FOR CONTROL OF THE SENATE, WHY IT MATTERS FOR BIDEN AND THE MARKET REACTION TO THE ELECTION**

Many of the ambitious, potentially market moving, parts of Biden's agenda, from fiscal stimulus to infrastructure investment, would require the permission of Congress; he could not accomplish them simply by executive order. With the parties so far apart, the odds that Congressional Republicans would support Biden's initiatives are low. Consequently, if Biden is going to be able to deliver the sort of change his campaign has promised, Democrats will need to retain the House – which they are widely expected to do – and take control of the Senate.

The Senate currently has 53 Republicans and 47 Democrats. But unlike in the House, only a portion of the seats are up for election this year; 12 held by Democrats and 23 held by Republicans. Many of these seats are extremely safe and so attention is focused on a subset, of around 10 races, that will determine the overall outcome. However, the current polling in the Senate races is tighter than in the Presidential contest; Mitch McConnell as leader of the Senate Republicans has a better chance of remaining in the control of the Senate than Donald Trump does of staying on as President.

One Democratic senator – Doug Jones representing Alabama – looks very likely to lose his position in these elections. That would mean the Democrats would need to flip at least four Republican held seats to take overall control of the Senate. Based on current polling, Republican incumbent senators in Colorado, Arizona, Maine and North Carolina look vulnerable to being replaced. Beyond that it becomes harder for Democrats to capture seats, but Iowa, South Carolina, Georgia and Montana are all potential possibilities and the better Biden does, the more likely it is to drag down ballot races into the Democratic column.

If Biden wins the Presidential election and Democrats make a net gain of three Senate seats, the resulting 50-50 tie in the Senate could be resolved in the Democrats' favour by Vice-President Harris using the casting vote allocated to her. But that would leave potentially every single vote on a knife edge for Democrats. On any issue, a sole defection by a moderate Democrat Senator, such as Joe Manchin (W. Virginia), would result in defeat. This sort of environment would make policy making challenging, as Republicans found in 2017 when their attempts to Repeal and Replace Obamacare stumbled on opposition from a very small contingent of Republican Senators.

Consequently, the larger any Democratic Senate majority is, the greater the prospect that significant legislation will pass, even if it can only do so via the reconciliation process.

### **THE ROLE OF THE FILIBUSTER AND RECONCILIATION**

Current Senate procedure allows for any Senator to filibuster almost any bill unless 60 Senators vote to end debate. De facto this allows the minority party in the Senate to block the vast bulk of legislation other than particular fiscal-related measures that can be passed on a standard majority basis through a process known as reconciliation (which is how the 2017 Trump tax cut was enacted, and would be a route for an early 2021 Democrat fiscal stimulus).

Since it is very unlikely the Democrats will do so well that they reach 60 Senate seats, the filibuster rules pose a serious obstacle to policies supported by many Democratic activists. Among others, civil rights, competition policy, parts of healthcare reform, increasing the federal minimum wage, labour/union rules, gun control and clean energy might all be ensnared by the filibuster – and so there is pressure from the left of the party for Democrats to commit to changing these rules, which can be done by a simple majority of Senators. Centrist Democratic Senators, and probably Biden himself, hope that the mere threat of change to these rules will persuade Republicans to moderate their opposition to the broad sweep of the Democratic policy agenda. But Senate Republicans are not led by someone who bends to opposition pressure easily; Mitch McConnell has in the past described himself<sup>6</sup> as the 'Grim Reaper' for socialist legislation.

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6 <https://edition.cnn.com/2019/04/22/politics/mitch-mcconnell-grim-reaper-green-new-deal/index.html>

### **THE LIKELY REACTION OF THE FEDERAL RESERVE TO FISCAL STIMULUS**

In the aftermath of Trump's election and alongside the Republican sweep of Congress, the US fixed income market sold off as the market began to consider the possibility of a new wave of pro-growth policies, particularly tax cuts. This reaction accelerated as the tax cut worked its way through Congress in late 2017.

An important driver behind that market reaction was a presumption about how the Fed would react when faced with the prospect of a stronger economy. When Trump won in 2016, the unemployment rate already quite low by historical standards (it was 4.7% in November 2016, close to the lowest rate seen in the pre-GFC expansion) and with monetary policy believed to be very expansionary (the Fed thought that the neutral policy rate was around 3%) adding expansionary fiscal policy to the mix was viewed as likely to push up on inflation, an outcome the Fed would seek to avoid by raising rates. Which is what it did.

The Fed hiked three times in 2017 and another four times in 2018, a tightening of monetary policy that, with the benefit of hindsight, looks less warranted than was believed at the time. Although growth did accelerate after the Trump tax reform passed, helping push unemployment lower, the pick-up in inflation was much less tangible, with core inflation just touching 2% in 2018 before slipping back again in 2019.

The FOMC has learnt from that experience and its thinking about the proper conduct of monetary policy has changed in the last few years, culminating in the new strategic framework for monetary policy<sup>7</sup> released in August. No longer will the Fed raise rates simply in response to low unemployment or strong growth, unless it is also accompanied by stronger inflation. Given how flat the Phillips curve is thought to be, there is little immediate prospect of fiscal stimulus stoking up inflation.

The combination of aggressive fiscal stimulus under a Biden Administration and very inertial monetary policy should lead the American economy to outperform its counterparts elsewhere in the world for a time.

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<sup>7</sup> <https://www.federalreserve.gov/newsevents/pressreleases/monetary20200827a.htm>

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