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# In Focus

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## Midnight Train to a Blue Georgia? Implications if Democrats End Up Sweeping

by Avery Shenfeld

Market participants are eying Georgia today, as we wait to see if the all night counting ended up being a midnight train to a Senate sweep for the Democrats. As we write, one win for the blue side of the aisle has been declared by media sources, with the other too close to call. The interest lies in the fact that, should Democrats take both seats, they would tie the Republicans in seat count (including two independents who caucus with the Democrats in their camp), and in a 50-50 vote, VP Harris gets to break the tie.

But we would caution that not only is the result of the election still in doubt, but that on many fronts, first impressions on what a 50-50 Senate could easily overplay how much this will matter for economic policy and markets ahead.

### Blue Ripple, Not a Blue Wave

First, in terms of the overall election result, even if the Democrats take both Georgia run-off seats, this was a blue ripple, not a blue wave election. The Democrat's House majority has narrowed relative to where we were pre-election.

In the Senate, the main impact lies in the fact that the Majority leader, and committee chairs, will shift to the Democrats, giving them an edge in controlling what matters come to a vote. To understand how that works, one can look at how Mitch McConnell was able to kill a proposed \$2,000 stimulus payment by packaging it in with other measures that wouldn't

garner support. It's quite possible that, on a straight up vote on only the \$2,000 payment, Democrats and a handful of Senate Republicans would have approved it given Trump's own blessing of that measure.

But controlling 50 seats would hardly give the Democrats carte-blanche. In countries governed by parliamentary systems, a bill tabled by a cabinet member from a party with majority control will almost certainly get all of its members on board to pass it. Not so in the US, where although bloc voting along party lines has increased, there are still defectors on final votes, and many more cases where a bill has to be amended by the majority party in order to either bring some of its own members on board, or gain support from the minority party.

As well, with a few exceptions (including budget reconciliation), bills can be subject to a filibuster that requires a vote of 60 Senators to overcome. That's a Senate rule that could be changed by a majority vote in the Senate, but the rule change would itself be subject to filibuster, and the GOP is unlikely to concede to it now.

Finally, don't forget that there's a third branch of government, the judiciary, that is now decidedly in the hands of Republican appointees. The Supreme Court can constrain the White House's hands on a number of fronts, particularly in limiting the ability of the administration to act on its own without Congressional approval.

## Fiscal Policy: Taxes, Spending and Overall Net Stimulus

A lot of the focus on the Senate result has been on what it might mean for fiscal policy, and through that, for growth and inflation. Clearly, looking at the Democratic Party's election platform, it leaned towards higher taxes on corporates and high income earners, but also greater spending.

First up, of course, would be an attempt to add to December's stimulus package, including a larger payment to households and support for state and local governments. As we noted above, the payment to households would have reasonable prospects for passage, and give a near term lift to growth in the process.

Further out, Congress might be more willing to take up an infrastructure spending package that, if designed to spread across enough states, might gain support. Indeed, infrastructure equities have had the most visible reaction in trading this morning.

We see that as an overreaction, in terms of how much an extremely narrow Senate win could mean for infrastructure spending. Recall that there was already a fair bit of bipartisan support for infrastructure spending initiatives. That we didn't see such a move at least in part owed to the fact that the Trump White House never issued its own detailed proposal to get the ball rolling, despite talking favourably about "getting infrastructure done". Biden will no doubt do so, and its fate in the Senate will, regardless of the Georgia outcome, depend on garnering bipartisan support. So yes, a much needed lift to America's infrastructure is likely, but the result might not vary as much as some think with how the final vote in Georgia plays out.

As well, that needn't imply higher deficits or Fed policy rates than what we would observe if the Senate stays red. Note that Biden's election planks included tax hikes that were estimated by the independent Tax Policy Center to yield an additional \$2.1 tn in the coming decade, reversing some of the impact of the rate cuts under Trump. True, the passage of such measures is in doubt given the lack of a large Senate majority, but other revenue raising measures could still come forward.

Under Trump, tax cuts enacted before the Covid crisis already had deficits sharply on the rise. Republicans can't really claim to wear an anti-deficit mantle based on their track record. Moreover, infrastructure spending, if well

done, can lift the economy's capacity for non-inflationary growth, providing additions to government revenue over the medium term, and also weighing against the need for earlier rate hikes at any given level of GDP.

With so many gray areas in terms of the details of tax and spending programs favoured by each party, estimates for net fiscal impact of a Democratic or Republican led administration by the Committee for a Responsible Federal Budget showed a very wide range of scenarios, but with their central base case not showing a material difference in deficit outlooks between the two parties.

If a Democratic sweep in Georgia is confirmed, markets will be tempted to lift bond yields on the notion that a blue win in Georgia means larger deficits or higher inflation. In the near term, greater odds of a follow-up stimulus bill should rightly give some impetus towards the gradually higher bond yields we were forecasting. But as noted, the tie to deficits in the medium term is not as obvious, both because of the lack of a filibuster-proof majority, and the potential offsets on the tax side. The deficit outlook isn't pretty, but its not clear that budget balances will be worse if the Democrats have indeed swept Georgia.

For foreign exchange rates, the impacts are even muddier. Greater stimulus in the near term might be seen as a boost to risk assets, and these days, "risk-on" trades favour a move out of the greenback. But if the US operates a more stimulative fiscal policy than other countries, it could end up hiking rates first, a move that should support the US dollar further out.

In other policy areas, a 50-50 Senate might also mean less than meets the eye. As we saw during the Trump administration, the White House can engineer significant regulatory changes on environmental issues without Congressional oversight. Biden has already pledged to recommit to the Paris accords.

But when it comes to the details, looking back at the Obama era, remember that Presidential edicts can sometimes be challenged on constitutional grounds, and the Supreme Court is now decidedly conservative, limiting the ability of the Biden team to act on its own, and facing the prospect of Senate filibusters on aggressive measures.

Biden's cabinet and sub-cabinet appointees have been drawn heavily from the centerist side of the Democratic Party, leaning on those who he worked with during the Obama administration. So in addition to the constraints

against radical changes posed by the GOP still having at least 50 Senate seats after Tuesday's vote, the administrations own biases aren't aligned with the more left-leaning wing of his own party.

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