Daiwa Capital Markets

U.S. Economic Comment

- 2020 elections: implications for the economy
- The electoral college: an explanation

Michael Moran
Daiwa Capital Markets America
212-612-6392
michael.moran@us.daiwacm.com

The Senate Races

The presidential election, naturally, is capturing most of the attention of the public and the media, but results for the 35 Senate seats under contention will have a strong bearing on the fate of potential economic legislation.

If Republicans maintain control of the upper chamber, we would expect only modest changes in fiscal policy over the next few years. We would look for another anti-pandemic support package if the current Congress is unable to reach an agreement before it adjourns, but beyond that, prospects seem dim. If Joe Biden were to win the election, the Republican Senate would probably block most of his major proposals. If President Trump is reelected, the Senate might not see many serious proposals, as the President has offered only hints of what he might pursue on the economic front. It seems as though the President does not have an agenda. If he were to put forth serious proposals, they would probably stall in the House of Representatives (where Democrats most likely will retain their majority).

If Democrats were to take control of the Senate, we most likely would see little fiscal action if Trump remained in the White House. Congress no doubt would have an easy time passing legislation with Democrats controlling both chambers, but the President could exercise his veto power. The situation would be more interesting under a Biden presidency, as Democrats would control both the legislative and executive branches of government. We most likely would see significant changes in taxes and spending (the Biden agenda is discussed below).

Democratic control of Congress and the White House could well occur. Mr. Biden is leading in most polls, and Democrats have some distinct advantages in Senate races. As shown in the table, Republicans have almost twice as many seats to defend as Democrats do. More important, seven of the Republican seats are viewed by pundits as vulnerable. If Democrats can capture three of these seats, they would have an effective majority with Biden in the White House (Mr. Biden's vice-president would break any 50-50 tie votes); capturing four seats would give the Democrats a majority regardless of who occupies the White House. Various analysts have suggested that the probability of Democrats winning the Senate is in excess of 60 percent (see the 538 blog page, the Economist Magazine, and Real Clear Politics).

Senate Races

	Republicans	Democrats
Current Seats	53	47*
Number of Races	35	
Number Defending	23	12
Likely Wins	14	4
Leaning	2	7
Toss Up	7	1

** 45 Democrats and two independents that typically vote with Democrats*
Source: Real Clear Politics (www.realclearpolitics.com)

The Presidential Race

Joe Biden seems to have a comfortable lead in the presidential race, as the latest national polls are showing an average advantage of 9.6 points (table, next page). However, national polls only provide information on the likely outcome of the popular vote, which is irrelevant in deciding the presidency. A review of state-by-state polls (or polls in battleground states) provides better insight into the number of electoral votes captured by the candidates, which will determine the next president. The average spread in battleground states still favors Biden, but his lead is much less comfortable than that suggested by the national polls. Also, and perhaps more important, the results in 2016 showed that polls are far from perfect (even good) predictors of election outcomes. Thus, it is too soon to conclude that Joe Biden is heading for the White House. (For those confused about the electoral process in the U.S., an explanation is provided below.)

Polling for the U.S. Presidential Race

	Trump	Spread	Biden
National Average*	42.0%	9.6	51.6%
Max Spread		11.8	
Min Spread		4.0	
Battleground Average**	44.9%	3.3	48.2%

** The national average poll is the average of numerous polls tabulated by Real Clear Politics.*

*** The battleground average is a weighted average of The Guardian's poll tracker of eight swing states (Arizona, Florida, Iowa, Michigan, North Carolina, Ohio, Pennsylvania, and Wisconsin). The totals reported by The Guardian are 14-day moving averages. Weights for the averages shown in the table are based on the electoral votes allocated to each of the eight swing states as a share of the total allocated to those states.*

Source: The Guardian (www.guardian.com/us); Real Clear Politics (www.realclearpolitics.com); Daiwa Capital Markets America

Although President Trump could still prevail in the election, it is difficult to assess what another term might involve for the economy and financial markets, as Mr. Trump has provided only a thin outline of his agenda. His campaign has published a scant set of bullet points with only vague descriptions of possible policy proposals, such as cut taxes to boost take-home pay, enact fair trade deals, bring back one million manufacturing jobs from China, create 10 million jobs in 10 months. His outline represents empty rhetoric more so than a serious platform.

Joe Biden has advanced a platform involving numerous tax and spending changes. He also is likely to be active on the regulatory front, especially with regard to environmental issues.

Analysts working with the Penn Wharton Budget Model have provided a detailed review of Mr. Biden's various proposals. The table below shows the estimated dollar amounts of revenue raised or funds spent as estimated by the Penn Wharton analysts. Individual items listed below the revenue and spending totals represent a sample of the provisions noted by Mr. Biden.

The dollar amounts are hefty, but the figures represent estimates over a 10-year horizon. Also, the estimates are moderate if scaled by GDP (using the GDP projection of the Congressional Budget Office from 2021-30). Many of Mr. Biden's provisions will be front-loaded, which will skew receipts and outlays toward the early years, but the influence in any single year will still be less than the total shown.

The program involves net stimulus to the economy (outlays exceed new taxes), which would be expected to boost growth and employment. The push would not be overwhelming because of the moderate size relative to that of the economy, but front-loading and multiplier effects should enhance its influence. The program also could involve second round effects in coming years, as much of the spending (infrastructure and education) could boost

The Biden Economic Proposal*

	Amount	% of GDP
Personal Taxes	$1.9 trillion	0.7%
Raise top marginal rate		
Raise capital gains rates		
Raise Soc. Security rates		
Limit deductions		
Corporate Taxes	$1.4 trillion	0.5%
Raise tax rate		
Alter foreign source rules		
Spending	$5.4 trillion	2.1%
Education		
Infrastructure		
Health care		
Net Stimulus	$2.0 trillion	0.8%
(spending minus taxes)		

** The share of GDP was calculated using the CBO's GDP forecasts for 2021-30.*
Source: The Penn Wharton Budget Model; The Congressional Budget Office

productivity and thereby increase potential economic growth.

Thus, at first blush, the program seems favorable from an economic perspective. However, we have some misgivings. The tax increases fall exclusively on corporations and upper-income individuals, which leads us to wonder about incentives to invest and innovate in the private sector. In addition, although not overwhelming in size, the program involves a widening in the underlying budget deficit at a time when Congress and the administration should perhaps be focusing on steps to reduce the burden from the explosion of federal debt generated by the pandemic. Finally, Mr. Biden (understandably) has not emphasized the regulatory steps he has in mind, but regulation, while undoubtedly generating benefits, also involves costs that must be absorbed somewhere in the economy.

In terms of the influence of the Biden administration on the financial markets, we find it difficult to be enthused about the equity market given a hike in corporate taxes and an increase in regulation. Admittedly, the corporate tax rate will still be less than it was before the Tax Cuts and Jobs Act, but it will be higher than the current rate that has helped fuel the rally in the past few years. Similarly, regulation to contain environmental damage and limit global warming is necessary, but placing most of the burden on the corporate sector is likely to have some influence on the equity market. The explosion in federal debt in the past year has not pushed interest rates higher, but we wonder about the sustainability of this situation, especially once the Federal Reserve ends its quantitative easing program. The Fed's effort has been striking, as its purchases of Treasuries and mortgage-backed securities have offset approximately three-quarters of the debt issued by the Treasury Department since March.

The Electoral College

The Electoral College is a collection of 538 individuals selected every four years to determine the outcome of the presidential election. Electors come from all 50 states and the District of Columbia. The number of electors from each state is equal to the number of individuals representing that state in Congress. The House of Representatives has 435 members and the Senate 100; thus, 535 electors come from the 50 states. The District of Columbia, which is not formally represented in Congress, is assigned three electors, bringing the total number to 538. States decide individually the method for selecting electors. However selected, electors pledge to cast their vote in accordance with the popular vote in their state.

In 48 of the 50 states and DC, the winner of the popular vote in those states captures all the electoral votes. In Maine and Nebraska, two electors will cast their vote for the winner of the popular vote in these states; the balance is allocated by Congressional district – the winner of the popular vote in a district receives the vote of the elector selected for that district. A majority of the electoral votes (270 or more) is needed to win the presidency. If a candidate does not receive a majority of electoral votes (which is possible if a third-party candidate is able to win electoral support), The House of Representatives will select the president, with each state receiving one vote and the representatives deciding how to cast that vote. The Senate will select the vice president, with each senator receiving one vote.

Although the popular vote is taken in early November (the formal rule is the Tuesday after the first Monday in November), the electors do not cast their votes until mid-December (the first Monday after the second Wednesday). However, because electors pledge to cast their votes in accordance with the popular vote, the outcome of the election (in most cases) can be determined by the end of election day or soon thereafter.

Review

Week of Oct. 5, 2020	Actual	Consensus	Comments
ISM Nonmanufacturing Index (September)	**57.8% (+0.9 Pct. Pt.)**	**56.2% (-0.7 Pct. Pt.)**	Although the ISM nonmanufacturing index increased only moderately in September, the change occurred from an elevated level and was enough to move the measure above the pre-pandemic reading of 57.3% in February. The new orders component led the advance with a jump of 4.7 percentage points to 61.5%. The measure was already at a solid level in August, and the change pushed it above 60 percent for the third time in the past four months, including a record level of 67.7 percent in July. Strong order flows have led to a good pace of business activity, with this component increasing 0.6 percentage point to 63.0%. The change was small, but it occurred from an elevated level and left the index above 60% for the fourth consecutive month. The employment index, which had been struggling with sub-50 readings since March, crossed the expansion/contraction threshold with an increase of 3.9 percentage points to 51.8%.
Trade Balance (August)	**-$67.1 Billion ($3.7 Billion Wider Deficit)**	**-$66.2 Billion ($2.6 Billion Wider Deficit)**	Both exports and imports rose for the third consecutive month in August, continuing to recover from pandemic-related declines in the spring. Imports have made much more progress than exports have, retracing 74% of the ground lost during the spring versus 44% for exports. With imports showing the stronger performance, the trade deficit has surged far beyond other recent results (an average of $48 billion last year and $42 billion in Q1 of this year). The deterioration in trade will probably constrain economic growth in Q3, with figures in hand suggesting a drag in excess of 2.5 percentage points.

Sources: Institute for Supply Management (ISM Nonmanufacturing Index); Bureau of Economic Analysis (Trade Balance); Consensus forecasts are from Bloomberg

Preview

Week of Oct 12, 2020	Projected	Comments
CPI (September) (Tuesday)	**0.2% Total, 0.2% Core**	The price of gasoline was little changed in September, but it could dip after seasonal adjustment. Prices of food for home consumption are likely to be tame after jumping earlier in the year, but the cost of food away from home will probably continue to move along its upward trend. Core prices jumped in July and August as some pandemic-related discounting was reversed, but that influence should begin to fade in September, leaving a moderate advance ex-food and energy.
Federal Budget (September) (Tuesday) (Possibly Postponed)	**$125.0 Billion Deficit**	Available data suggests that federal revenues fell again in September, but the expected drop of approximately 1.0% represents a better showing than the average decline of 2.9% in the prior five months. Federal spending in August was only slightly larger than normal after hefty outlays from April through July, and September also is likely to involve moderate results because of light pandemic-related spending. The expected deficit is far smaller than those in other recent months, although it still represents a sub-par performance, as September typically registers a surplus because of estimated tax payments by individuals and businesses. September is the final month of the government's fiscal year, and the expected budget results would leave the annual deficit at $3.132 trillion, versus $984 billion in fiscal year 2019.
PPI (September) (Wednesday)	**0.2% Total, 0.2% Core***	Available quotes suggest that the prices of food and energy are likely to show modest changes. Prices of core goods are starting to move higher after showing a net decline from February through June, but the volatile service category is likely to settle after jumps of 0.5% in both July and August.
Retail Sales (September) (Friday)	**0.3% Total, 0.1% Ex-Autos**	A jump in activity at motor vehicle dealers is likely to lead to firm results in the auto component of retail sales, and more driving as individuals venture out could stir the gasoline component. Elsewhere, sales in key areas have already moved above pre-virus levels (general merchandise, building materials, food, sporting goods), and a cooling in activity at these vendors is likely to lead to soft results outside of autos and gasoline.
Industrial Production (September) (Friday)	**0.5%**	A jump in factory employment in September suggests that the manufacturing component of industrial production will remain on a recovery path, registering its fifth consecutive increase. Prospects for mining activity also seem favorable, as employment in September ended a six-month slide and the rotary rig count increased for the first time since November 2018. Because of comfortable weather, the utility component could provide a small offset to gains in manufacturing and mining.
Consumer Sentiment (October) (Friday)	**81.0 (+0.6 Index Pt.)**	The improvement in the stock market in late September might brighten moods, but a slower rate of improvement in the labor market could work in the opposite direction, leaving little change in consumer sentiment.

** The core PPI excludes food, energy, and trade services.*
Source: Forecasts provided by Daiwa Capital Markets America

Economic Indicators

October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
ISM NON-MFG INDEX Index / Prices July 58.1 57.6 Aug 56.9 64.2 Sept 57.8 59.0	**TRADE BALANCE** June -\$53.5 billion July -\$63.4 billion Aug -\$67.1 billion **JOLTS DATA** Openings (000) / Quit Rate June 6,001 1.9% July 6,697 2.1% Aug 6,493 2.0%	**FOMC MINUTES** **CONSUMER CREDIT** June \$16.9 billion July \$14.7 billion Aug -\$7.2 billion	**UNEMPLOYMENT CLAIMS** Initial / Continuing (Millions) Sept 12 0.866 12.747 Sept 19 0.873 11.979 Sept 26 0.849 10.976 Oct 03 0.840 N/A	**WHOLESALE TRADE** Inventories / Sales June -1.3% 9.0% July -0.2% 4.8% Aug 0.4% 1.4%
12	13	14	15	16
COLUMBUS DAY	**NFIB SMALL BUSINESS OPTIMISM INDEX (6:00)** July 98.8 Aug 100.2 Sept -- **CPI (8:30)** Total / Core July 0.6% 0.6% Aug 0.4% 0.4% **Sept 0.2% 0.2%** **FEDERAL BUDGET (2:00) (POSSIBLY POSTPONED)** 2020 / 2019 July -\$63.0B -\$119.7B Aug -\$200.1B -\$200.3B **Sept -\$125.0B** \$82.8B	**PPI (8:30)** Final Demand / Core* July 0.6% 0.3% Aug 0.3% 0.3% **Sept 0.2% 0.2%**	**INITIAL CLAIMS (8:30)** **IMPORT/EXPORT PRICES (8:30)** Non-petrol. Imports / Nonagri. Exports July 0.2% 0.9% Aug 0.7% 0.8% Sept -- -- **EMPIRE MFG (8:30)** Aug 3.7 Sept 17.0 Oct -- **PHILLY FED INDEX (8:30)** Aug 17.2 Sept 15.0 Oct --	**RETAIL SALES (8:30)** Total / Ex.Autos July 0.9% 1.3% Aug 0.6% 0.7% **Sept 0.3% 0.1%** **IP & CAP-U (9:15)** IP / Cap.Util. July 3.5% 71.1% Aug 0.4% 71.4% **Sept 0.5% 71.6%** **CONSUMER SENTIMENT (10:00)** Aug 74.1 Sept 80.4 **Oct 81.0** **BUSINESS INVENTORIES (10:00)** Inventories / Sales June -1.1% 8.6% July 0.1% 3.3% **Aug 0.4% 0.6%** **TIC DATA (4:00)** Total / Net L-T June -\$69.8B \$113.0B July -\$88.7B \$10.8B Aug -- --
19	20	21	22	23
NAHB HOUSING INDEX	**HOUSING STARTS**	**BEIGE BOOK**	**INITIAL CLAIMS** **EXISTING HOME SALES** **LEADING INDICATORS**	
26	27	28	29	30
CHICAGO FED NATIONAL ACTIVITY INDEX **NEW HOME SALES**	**DURABLE GOODS ORDERS** **FHFA HOME PRICE INDEX** **S&P CORELOGIC CASE-SHILLER 20-CITY HOME PRICE INDEX** **CONSUMER CONFIDENCE**	**U.S. INTERNATIONAL TRADE IN GOODS** **ADVANCE INVENTORIES**	**INITIAL CLAIMS** **Q3 GDP** **PENDING HOME SALES**	**PERSONAL INCOME, CONSUMPTION & PRICES** **EMPLOYMENT COST INDEX** **CHICAGO PURCHASING MANAGERS' INDEX** **REVISED CONSUMER SENTIMENT**

Forecasts in Bold. * *The core PPI excludes food, energy, and trade services.*

Treasury Financing

October 2020

Monday	Tuesday	Wednesday	Thursday	Friday
5	6	7	8	9
AUCTION RESULTS: Rate Cover 13-week bills 0.095% 2.81 26-week bills 0.110% 2.91	**AUCTION RESULTS:** Rate Cover 52-week bills 0.140% 3.15 3-year notes 0.193% 2.44 42-day CMB 0.090% 3.30 119-day CMB 0.105% 3.13 **ANNOUNCE:** $30 billion 4-week bills for auction on October 8 $35 billion 8-week bills for auction on October 8 $25 billion 105-day CMBs for auction on October 7 $30 billion 154-day CMBs for auction on October 7 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs	**AUCTION RESULTS:** Rate Cover 10-yr notes 0.765% 2.47 105-day CMB 0.100% 3.45 154-day CMB 0.110% 3.17	**AUCTION RESULTS:** Rate Cover 4-week bills 0.090% 3.34 8-week bills 0.090% 3.45 30-yr bonds 1.578% 2.29 **ANNOUNCE:** $105 billion 13-,26-week bills for auction on October 13 $30 billion 43-day CMBs for auction on October 13 $30 billion 119-day CMBs for auction on October 13 **SETTLE:** $105 billion 13-,26-week bills $34 billion 52-week bills $30 billion 42-day CMBs $30 billion 119-day CMBs	
12	13	14	15	16
COLUMBUS DAY	**AUCTION:** $105 billion 13-,26-week bills $30 billion 43-day CMBs $30 billion 119-day CMBs **ANNOUNCE:** $30 billion* 4-week bills for auction on October 15 $35 billion* 8-week bills for auction on October 15 **SETTLE:** $30 billion 4-week bills $35 billion 8-week bills $25 billion 105-day CMBs $30 billion 154-day CMBs		**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 19 $22 billion* 20-year bonds for auction on October 21 $17 billion* 5-year TIPS for auction on October 22 **SETTLE:** $105 billion 13-,26-week bills $52 billion 3-year notes $35 billion 10-year notes $23 billion 30-year bonds $30 billion 43-day CMBs $30 billion 119-day CMBs	
19	20	21	22	23
AUCTION: $105 billion* 13-,26-week bills	**ANNOUNCE:** $30 billion* 4-week bills for auction on October 22 $35 billion* 8-week bills for auction on October 22 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $22 billion* 20-year bonds	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $17 billion* 5-year TIPS **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on October 26 $26 billion* 2-year FRNs for auction on October 28 $54 billion* 2-year notes for auction on October 27 $55 billion* 5-year notes for auction on October 28 $53 billion* 7-year notes for auction on October 29 **SETTLE:** $105 billion* 13-,26-week bills	
26	27	28	29	30
AUCTION: $105 billion* 13-,26-week bills	**AUCTION:** $54 billion* 2-year notes **ANNOUNCE:** $30 billion* 4-week bills for auction on October 29 $35 billion* 8-week bills for auction on October 29 **SETTLE:** $30 billion* 4-week bills $35 billion* 8-week bills	**AUCTION:** $26 billion* 2-year FRNs $55 billion* 5-year notes	**AUCTION:** $30 billion* 4-week bills $35 billion* 8-week bills $53 billion* 7-year notes **ANNOUNCE:** $105 billion* 13-,26-week bills for auction on November 2 $34 billion* 52-week bills for auction on November 3 **SETTLE:** $105 billion* 13-,26-week bills	**SETTLE:** $17 billion* 5-year TIPS

**Estimate*