

# Georgia Senate runoffs to determine future of Biden presidency



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- *While the title sounds dramatic, what happens in Georgia on 5 January is critical to US policy over the next four years. Following the 3 November elections, it was looking like a divided government, with Joe Biden elected President and the Republicans holding the US Senate. But as the trickle in counting occurred in Georgia, it became evident **that there will be runoff elections on 5 January for both Georgia Senate seats**, after no candidate received the 50% majority mark required to avoid a runoff. This has paved the way for potential Democratic control of the Senate by the barest of majorities. A Republican sweep in Georgia would ensure a divided government and gridlock, with much of the Biden legislative agenda likely stalling in the Senate. However, a Democratic sweep would give the Democratic party control of the Senate. With a 50-50 split between Democrats and Republicans, Vice President Kamala Harris will have the tie-breaking vote.*
- **There is a third alternative that does not get the recognition it deserves:** each party could pick up one seat. This could have a more nuanced effect on the Biden agenda, despite Republicans having nominal control of the Senate, given the presence of a small number of moderate Republicans.
- **Currently, the markets are expecting a divided government.** A Democratic win of both seats is not priced in: it will increase the odds of much easier fiscal policy, an infrastructure bill, a hike in corporate taxes and an expansion in Obamacare. This could inject some volatility to the current 'Nirvana' situation in financial markets and add a key risk to the markets going forward.

## A tight race expected

Republicans are favoured to retain control of the Senate seats by a 69% to 31% odds, according to the political betting site PredictIt as of 14 December 2020. The site gives incumbent Republican Senator David Perdue a 65% to 35% probability of being re-elected. Recently appointed Senator, Republican candidate Kelly Loeffler, has 63% to 37% odds to win election as of 14 December 2020. **Despite the comfortable odds given by PredictIt, voter polls indicate a much tighter race.** As of 14 December, the FiveThirtyEight poll of polls gave Democratic challenger Jon Ossoff a tiny 1.0% lead over Senator Perdue in the regular Senate election, while indicating a 1.6% edge for Democratic challenger Raphael Warnock over Senator Loeffler. These polls remain well within the margin of error, suggesting both races may be a toss-up.

Given the tightness of the November election results, this election will not be about persuading voters because there are few remaining undecided voters. Instead, these races will be decided on how many Georgians turn out to vote. Historically, voter turnout in run-off elections is far lower than major elections. Our examination of the November 2020 presidential and senatorial exit polls indicate this election will hinge on three key constituencies: affluent suburban voters ringed around Atlanta, African American voters, and Latino voters.

***“The result of this election is very relevant for the measures that Biden can implement.”***

## Future of the Biden presidency: three scenarios

The ability for President Biden to pass his ambitious legislative agenda will hinge on which party controls the Senate. There are three potential scenarios:

- **GOP maintains control.** The odds of legislative gridlock remains the likely base-case scenario. It will require President Biden to work out deals with a Republican Senate, assuming there is mutual interest to compromise. **In this scenario, there is a low**

***“Markets are positioned for a divided Congress, which limits Biden agenda, especially in areas like taxation that can have a strong impact on corporate earnings.”***

**probability of another pandemic fiscal stimulus.** President Biden’s agenda for an infrastructure bill, expansion of Obamacare and hike in corporate taxes would be likely to suffer a blow in the Senate.

- **Democratic party takeover.** Biden will be able to pass much of his fiscal, healthcare and tax agenda. **However, he has little room for error in a 50-50 Senate.** He will need to compromise with moderates in the Democratic party and perhaps need a few moderate Republicans in the Senate.
- **Split verdict. Under this scenario, both parties win a seat.** While this intriguing scenario gets little attention among the media and political pundits, it is not implausible, since recent voter polls are well within the margin of error. Republicans would maintain control of the Senate by a 51-49 majority, **but their ability to control the agenda may be stymied by a small group of bipartisan or moderate Senators that may push certain parts of the Biden agenda that may be viewed in the best interest of the country.** There could also be instances when one to four ‘swing’ Republican Senators may vote for certain Biden bills, such as expansion of Obamacare or a modest infrastructure bill, to name a few. Senator Murkowski of Alaska, Senator Romney of Utah, Senator Collins of Maine, and Senator Toomey of Pennsylvania -- who is retiring at the end of his term in 2022 -- are the most likely senators who might vote for Biden’s agenda on an issue-by-issue basis.

#### **Investment implications**

**Currently, the markets are broadly expecting a divided government.** The prospect of no tax increases and, more importantly, exuberance over the vaccine, are the two most important factors driving recent market positioning. **However, the markets do not appear to be factoring in a potential Democratic takeover of the Senate.** The market appears to have embraced PredictIt odds, but the polls are showing another very tight race. **A Democratic win of both seats will increase the odds of much easier fiscal policy, an infrastructure bill, a hike in corporate taxes and an expansion in Obamacare.** This could inject some volatility to the current ‘Nirvana’ situation in financial markets and add a key risk to the markets going forward.

A split verdict may not be negative for the markets, or lead to a prolonged sell-off, since Biden will still be somewhat constrained in passing some of his most progressive agenda, such as Medicare-for-all and his modified plan for a Green New Deal. **With Republicans controlling the Senate, it remains likely that the Biden tax agenda is a non-starter.** However, the ability for Biden to pass key parts of his agenda would require just one Republican Senator. **The markets have been responding favourably to the prospects of fiscal stimulus deals and should be receptive to an infrastructure bill.**

While the base case remains for Republican control of the Senate, we believe the markets are too complacent on the prospects of a Democratic Senate. However, it is the prospect of a split verdict that could have the largest surprising impact on the markets.

***“A democratic win could inject some volatility to the current “Nirvana” situation in financial markets and add volatility going forward.”***

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### Definitions

- **GOP:** Grand Old Party, the US Republican political Party.
- **Volatility:** A statistical measure of the dispersion of returns for a given security or market index. Usually, the higher the volatility, the riskier the security/market.

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