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Biden and Democrats take control despite Trump protesters

INVESTMENT TALKS

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- ***Georgia runoffs results****: The 2020 US general elections ended on 6 January 2021 with a Democratic sweep of two critical Georgia Senate seats, giving Democrats a slim majority and control of government until at least the next round of Congressional elections in two years. The stunning developments on Capitol Hill will not change the significance of the Georgia election, which will have far-reaching implications for Biden's policy agenda and financial markets.*
- ***Political implications:*** *The election of two liberal Senators could embolden the progressive wing of the Democratic Party, leading to pressure on the President-elect to pass a more progressive agenda and expose tensions between the progressive and mainstream wings of the Democratic Party, and a governor on the scope of policy change. President Trump may be losing his position as the most popular political figure in the Republican party. This could widen the fissure in the Republican party between the Trump wing that appeals to the working class with a populist appeal, and the traditional wing led by the Republican leadership in the Senate that has recently rediscovered its fiscal-prudence DNA.*
- ***Policy implications:*** *Democratic control of the Senate ensures that Biden will be able to get his cabinet approved. We could see another fiscal stimulus bill being passed in late Q1. We expect at least $600 billion in additional fiscal stimulus, which will include $1,400 stimulus checks for many Americans, continuation of enhanced unemployment benefits, and $160 billion of assistance to state and local governments. A hike in taxes to the highest tax bracket and a hike in corporate and capital gains taxes are on the table and will be negotiated heavily. Any infrastructure bill is likely to include some elements of the Green New Deal. There is likely to be a modest expansion of Obamacare. Biden wants to hike the minimum wage to help address income inequality, and Democrats are likely to attempt to pass legislation. But they will need broad bipartisan support to avert a filibuster that could block it in Congress.*
- ***Investment implications****: More fiscal stimulus and ensuing bond issuance, as well as a likely infrastructure bill, will put upward pressure on US yields. The curve should continue to steepen as expectations for stronger growth rise and the Fed Funds rate remains near zero. Corporate credit spreads may be supported initially by increased stimulus spending and pent-up demand for services. Later, they will face a headwind with weaker profitability associated with higher expenses from taxes, borrowing costs and regulation. Fed quantitative easing will stay supportive of agency mortgages. The risk of credit dislocations in state and local government finances is materially lower with Democrats driving allocation of additional stimulus. While productivity gains could serve to offset inflationary pressures in the medium term, ballooning deficits and a weaker dollar support the longer-term case for higher US inflation. The US dollar bear market is likely to gain momentum, as the ballooning budget deficit weighs on the greenback.*

"The stunning developments on Capitol Hill will not change the significance of the Georgia election, which will have far-reaching implications for Biden's policy agenda and financial markets going forward".

The 2020 US general elections ended on 6 January 2021 with a Democratic sweep of two critical Georgia Senate seats, capping what has been a tumultuous election season. While the United States waited for the final results in Georgia, an angry mob of pro-Trump protesters stormed the US Capitol building in a futile attempt to disrupt the largely ceremonial certification by Congress of Biden's hard-fought victory. **The stunning developments on Capitol Hill will not change the significance of the Georgia election, which will have far-reaching implications for Biden's policy agenda and financial markets going forward.** The Trump presidency officially ends at noon on 20 January, allowing Biden and the Democrats in control of both houses of Congress to begin pursuing their policy agenda.

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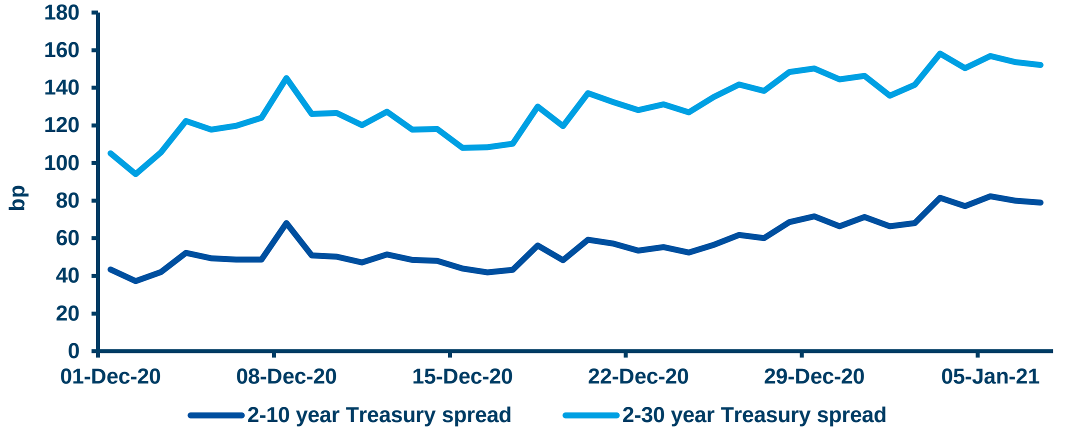
Prospects of a 'Blue wave' led cyclical assets to outperform due to prospects of a large fiscal package and inflation pick-up. The S&P 500 index opened strongly on 6 January but moderated somewhat following the occupation of Capitol Hill and closed the day up 0.6%. US Treasuries sold off, with ten-year US Treasury yield up 8 bp to 1.04%, above the 1.00% threshold for the first time since mid-March. Reflation expectations also led the US yield curve to steepen. The Dollar index was up 0.1% on the day.

US yield curve steepening



Source: Amundi, Bloomberg. Data as of 7 January 2021.

We examine political, policy and investment implications from the Georgia election, which resulted in a Democratic sweep of the US Senate, giving Democrats full control of government until at least the next round of Congressional elections in two years.

"The election of two very liberal Senators from Georgia could embolden the progressive wing of the Democratic Party. This could lead to more pressure on the President-elect Joe Biden to pass a more progressive agenda and expose tensions between the progressive and mainstream wings of the Democratic Party".

Political implications

- Chastened by the unexpected loss in House seats, **the election of two liberal Senators from Georgia could embolden the progressive wing of the Democratic Party**. This could lead to more pressure on the President-elect Joe Biden to pass a more progressive agenda and expose tensions between the progressive and mainstream wings of the Democratic Party.
- **President Trump remains the most popular political figure in the Republican party**. His shadow will loom large over the party, especially after the likely demotion of Senator Mitch McConnell from Senate majority leader to Senate minority leader. This could further aggravate a widening fissure in the Republican party between the Trump wing that appeals to the working class with a populist appeal, and the traditional wing led by the Republican leadership in the Senate that has recently rediscovered its fiscal-prudence DNA.

Policy implications

- Democratic control of the Senate ensures that Biden will be able to get his cabinet approved.
- **Biden will be able to get his judicial appointees through the Senate.** This is significant, since a Republican-led Senate was going to be an obstacle for many of Biden's appointees and will reverse a long-term trend of the Senate approving mostly conservative judges.
- **Democrats are likely to pass new fiscal policy using the reconciliation process,** which requires only a simple majority. We expect the reconciliation process to be used twice -- once on the spending side and the other on the revenue side. **We are likely to see another fiscal stimulus bill in late Q1**, most likely when the current policy expires on 13 March. We expect at least $600 billion in additional fiscal stimulus, which

will include $1,400 stimulus checks for many Americans, continuation of enhanced unemployment benefits, and $160 billion of assistance to state and local governments.
- In order to fund some of Biden's agenda there will be an element of tax financing. **A hike in taxes to the highest tax bracket and a hike in corporate taxes are on the table.** It is unclear if there will be enough votes to pass higher taxes. The Biden administration may have to settle for smaller tax increases.
- The Biden administration is likely to push for a **more modest infrastructure bill,** especially since the current five-year programme expires on 30 September 2021. Any infrastructure bill is likely to include some elements of the Green New Deal, such as electric vehicle charging infrastructure grants.
- There is likely to be a **modest expansion of Obamacare.** The Biden plan has called for tax subsidies, lower the eligibility age for Medicare, increase federal Medicaid funding and more Covid-19 funds for hospitals.
- **There will be limitations to many of the most progressive parts of Biden's agenda due to the 50/50 nominal Democratic control of the Senate**. A bipartisan group of Senators will have an outsized influence to shape policy.
- On non-fiscal issues such as minimum wage**, Biden wants to hike the minimum wage to help address income inequality, and Democrats are likely to attempt to pass legislation**. But they will need broad bipartisan support to avert a filibuster that could block it in Congress. Hiking the minimum wage enjoys broad-based support in the polls, which could put political pressure on Republicans to support it.

"More fiscal stimulus, including a likely infrastructure bill, will put upward pressure on US yields. The curve should continue to steepen as expectations for stronger growth rise and the Fed Funds rate remains anchored near zero".

Investment implications

- More fiscal stimulus, including a likely infrastructure bill, will put upward pressure on US yields. The curve should continue to steepen as expectations for stronger growth rise and the Fed Funds rate remains anchored near zero.
- Corporate credit spreads are likely to be supported initially by increased stimulus spending and pent-up demand for services. Later, they should be offset by weaker profitability associated with higher expenses from taxes, borrowing costs and regulation.
- Consumer- and housing-related credits should prove stable.
- Fed quantitative easing will stay supportive of agency mortgages.
- The risk of credit dislocations in state and local government finances is materially lower with Democrats driving allocation of additional stimulus. This sector represents more than 10% of GDP and 15% of employment.
- While productivity gains could serve to offset inflationary pressures in the medium term, ballooning deficits -- could hit as high as 25% of GDP -- and a weaker dollar support the longer-term case for higher US inflation.
- The US dollar bear market is likely to gain momentum, as the ballooning budget deficit weighs on the greenback.

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Definitions

- **Basis points:** One basis point is a unit of measure equal to one one-hundredth of one percentage point (0.01%).
- **Credit spread:** Differential between the yield on a credit bond and the Treasury yield. The option-adjusted spread is a measure of the spread adjusted to take into consideration possible embedded options.
- **GOP:** Grand Old Party, the US Republican political Party.
- **Quantitative easing (QE):** QE is a monetary policy instrument used by central banks to stimulate the economy by buying financial assets from commercial banks and other financial institutions.
- **Spread**: The difference between two prices or interest rates.
- **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.

Important Information

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