



Deep Dive Webinar – US politics and policy: to the midterms and beyond

Introduction

The US economy entered a recession in the second quarter of 2022 and inflation rose above 9% in the middle of the year. However, the labour market has stayed firm, with wages rising and the unemployment rate close to a 50-year low. This provides a mixed economic context for campaigning ahead of the November midterm elections, in which President Joe Biden's Democratic Party faces an uphill battle to protect its narrow majorities in the Senate and House of Representatives. The governing party tends to lose ground in midterm elections; Biden's difficulties in passing legislation since coming to office, partly because of intra-party divisions, plus rampant inflation, do not augur well for his chances of beating the trend.

In this webinar, brought to you by FrontierView and Oxford Analytica, we will examine recent economic trends and short-term forecasts for inflation, employment and wages as the context in which the election is likely to take place. We will identify some of the regional and sectoral outliers that could have a bearing on the election. From there we will consider polling trends and other data to identify where the elections are likely to be won and lost. Finally, we will consider what new majorities in the House and Senate could mean for policymaking and economic management in 2023.

Elizabeth Rust, Senior Analyst, FrontierView

Three topics are front and centre in the US political debate ahead of the midterm elections: inflation, the labour market and the recession. We have seen a negative trend since the beginning of the year, especially since the Russian invasion in Ukraine. But there has been a little bit of an easing, with some evidence that inflationary pressures have turned. This could suggest that Democrats will not fare as badly in this midterm cycle. US headline CPI inflation eased year-on-year from 9.1% in June to 8.5% in July, and a month-on-month basis prices did not rise at all from June to July. Headline CPI inflation numbers usually get most of the attention in the inflation debate, but it is worth highlighting other things affecting American households, influencing political views and voting intentions. The easing price pressures mainly come from the drop in gasoline prices (from close to USD5 a gallon a few months ago to USD3.72 now). But on the flip side, food inflation remains the strongest ever month-on-month, and we will likely see inflationary pressures on core services, particularly those affected by the pandemic (e.g., leisure, tourism). So overall, there is a mixed picture on the inflation front. Now the US headline inflation may have peaked, particularly if we continue to see downward pressures on oil prices. But is it unlikely that a big drop in inflation would happen between now and November, so the issue will remain politically salient. CPI numbers might encourage optimism, but people will continue to feel the effects of inflation.

The labour market continues to look strong, with unemployment reaching the historically low rate of 3.5% and monthly payroll gain continues to look strong. There is little evidence that things would change by November. Wage growth is running between 6.5% and 7% year-on-year, which is still lower than the headline inflation rate of 8.5%, but there is no real reason to see a deterioration between now and the elections.

Regarding the recession, the US economy has not really been in a recession if one considers consumption growth and investment growth, which have remained relatively resilient in the first half of 2022, and the labour market, which remains strong. We are however expecting the US economy to enter a recession later this year, and going into 2023. The GDP growth reading for the third quarter of the year will be published mid-October; another quarter of negative growth could put a damper on the overall outlook and influence the political debate. Several factors could also create the impression that the US economy is heading for more trouble, notably the European energy outlook, which will hit the United States in the form of higher energy prices, and hurt the US economy growth prospects. Despite the fact that the overall economic environment looks unpromising, it is unclear whether it is so bad that it would hurt Democrats, as the Republican party does not really have a unified message on the economy to counter what the Democrats are offering.

Giles Alston, Senior Analyst, Oxford Analytica

Although the midterm elections are officially held on November 8, early voting in person starts in less than a month in some states. In 2020, the year of the pandemic, there was a record turnout, and 70% of the voters used either early voting in person, or cast their ballots via mail. This is up from 42% in the midterms in 2014. Regarding demographics, in 2018 compared to 2014, there was a 70% increase in young voters participation. The extent to which voters are going to take advantage of early voting will have some impact on the campaigns. The issue of where people vote will also be of importance: 2022 will be the first set of elections taking place after the redistricting process that followed the 2020 census. Last year we saw states redrawing the borders of the congressional constituencies. This is done by state legislatures, and it is not an unpartisan process. It will be interesting to see how this process will play out in 2022. The main worry behind this process, which takes place every ten years, is that it provides us with less competitive seats (around 5 to 7% of all seats).

According to a poll carried out by Ipsos and FiveThirtyEight at the end of July, inflation and cost of living are the primary issues that voters are worried about (60%). The next most worrying issue for voters is crime or gun violence (30%). Lower on the list are abortion, economic inequality, taxes, election security, and education. But the main takeaway from this poll is that the economy issue will crowd out other issues.

The turnout will be crucial. Over the past four months, the projected turnout gap between Republican and Democrat voters has grown, in terms of the number of self-identifying party supporters who are very likely or almost certain to vote. In May, there was a gap of three points, now it is up to eight. Democrats have always had an issue in generating turnout. In a sense, this is partly linked to the decline in union membership. Union organisations have already been key to getting out the Democratic vote, and we have seen a decline in union membership. There is also a question of whether a centrist-leaning party could draw the unions' support.

There are a few states to watch more closely where Democrats are increasingly counting on a series of relatively inexperienced Republican candidates in Senate races. We're beginning to see this in Arizona, where Democrat Mark Kelly has only been there since 2020. He looks 6 points ahead of a very-well backed Republican— but new to politics— candidate. We are seeing the same thing in Georgia. In Pennsylvania, a very successful social media campaign got the Democrat candidate about 9 points up against the Republican candidate.

Meghan Milloy, member of the Oxford Analytica expert network

This election so far has been interesting for both parties, with surprising results in primary races. Republicans were feeling pretty secure a few months ago, but now they have doubts regarding their ability to take back the Senate. To many political strategists' surprise, the abortion debate has not had a big impact on voters intentions. Republicans have steered away from it and tried to focus on inflation, gas prices and cost of living. They are also playing into the rhetoric that the Biden administration and the Democrats have had a year and a half to act and still have to not produced the promised results.

The most likely scenario so far is that Republicans would win the House of Representatives, leaving the Senate to the Democrats. This scenario has significant ramifications. First, in the event of the Republicans winning the House, Kevin McCarthy, current House minority leader, is likely to become speaker of the House. He has no relationship with President Joe Biden or any Senate majority leaders, and in a divided government, such relationships are crucial. The other significant factor is by how much Republicans would win the House, and who gets elected. Indeed, a speaker coming in with a margin of fifteen to twenty would be a lot stronger. What is more, the Republican newcomers are likely to be pro-Trump candidates who won partisan primaries. So, there is a high probability that the House Republicans will try to impeach Joe Biden, and other senior officials. Kevin McCarthy is already under pressure to do so, although this might not be something that he or other senior Republicans would want to do. Republicans are likely to use the Hunter Biden controversy, the border crisis or the White House response to the pandemic as means to justify the impeachments. But none of these impeachments will mean anything, particularly if the Democrats win a majority in the Senate.

On the legislative side of things, there will be no room for compromise. Kevin McCarthy will have a majority which is partly anti-government, and anti-moderation, with another part made of moderate Republicans. House Republicans will pass bills, but President Biden and his Senate majority will block everything, and the reverse is true. House Republicans will have a lock on tax and spending initiatives. The question of government funding will be a challenge with a split Congress. There is likely going to be an omnibus spending bill after November, even if Democrats lose their majority, and an annual defence authorisation bill. Then the government

will continue to be funded until the end of Biden's term by continuing resolutions, instead of doing one spending and funding package. There is a possibility of shutdown, as with every split Congress, but it would be a bad tactic for the Republican party. Many in Washington are also worried about the issue of debt limit. The federal government will not hit the debt limit until the summer of 2023, but using a debt limit debate to force changes in taxes and spending is very risky.

If the Republicans win both the House of Representatives and the Senate, they will pass bills that won't go anywhere, and the Senate won't have enough of a majority to override the veto, as any bill requires a two-third majority. But in any case, much of the Republican agenda and policy prioritisation is done at the state level, and although Republicans in Washington won't be able to carry out a lot of policies, states will have the opportunity to do a lot more.

Q&A

Moderator: *How do you see some of the dynamics that Meghan Milloy mentioned playing out?*

Giles Alston: It's a fairly bleak outlook, if you want government to accomplish anything. Even if we get the slight surprise of Democrats holding on to both Senate and House of Representatives, we have not witnessed a true dynamic government over the past couple of years. On top of that, the Supreme Court has been pushing a lot of issues back into the states' hands. Do you see what is coming out of the states in the next two years being the most important factor for setting the stage for 2024?

Meghan Milloy: I would not say 'most important', but it will certainly set the tone for what sort of candidate we will see in 2024. State parties are recruiting and funding those candidates. So, in those states where social issues have been key, such as the complete abortion ban in Texas, we will see more campaigning focused on those issues in 2024.

Moderator: *With regional economic trends potentially mattering as much as national trends, given there is a finite number of competitive races, how does that change the picture?*

Elizabeth Rust: Good point, things are playing out at the state and local district level. But overall, national level trends are what are featuring prominently in the media and the public debate. You do have regional variations in the economic trends. Inflation rates vary depending on regions, and states. The Sun Belt area of the country has a higher inflation rate for instance. At the same time, a lot of variations have to do with the strength of recovery in those regions. A lot of the Sun Belt area has seen soaring shelter costs because of migration there, driving up rent prices etc; as a renter in Phoenix, you might be hurting more, and that might affect your voting intentions. But it is quite nuanced because even if there is higher inflation, it coincided with higher growth as well. So regional trends might not matter so much for these elections.

Moderator: *Pollsters have been struggling with correctly gauging the Republican level of support. How comfortable are you with the predictions showing they might not make it as Senate majority?*

Meghan Milloy: In this instance, I would trust Senate Republican leader Mitch McConnell—who has expressed his uncertainty over the Republican party winning the Senate— more than any of these polls. It is tricky because a lot can change in a week in politics. You need to take polls with a grain of salt, and look at the bigger trend.

Moderator: *If the Democrats were to win a narrow majority, what might they do?*

Giles Alston: They are likely to be pushing the human capital side of things. If we go back a year, there was an attempt to put the entire agenda into a single omnibus spending bill, including the human capital measures, and there will be a push for those issues to get to the front of the queue. There might also be electoral reasons why that makes sense for 2024.

Moderator: *How much confidence do you have in the Fed's plan to keep raising rates for the rest of 2022 and then largely hold in 2023? How do you think this could play out?*

Elizabeth Rust: The Fed is in a bind. We are in an environment we have not seen in 40 years, in which growth is slowing, likely going negative, and yet our view is that inflation will remain high, even in a recession. A lot of these pressures are entrenched enough, you still have a global commodity market tightening, relating to the war in Ukraine, and strong wage pressures persisting in the near term.

There is widespread evidence that companies are going to continue raising consumer prices on their products through next year and that is what the Fed is looking at, and unlike in previous recessions, it is not clear that a recession will be enough to bring price pressures down quickly and easily. So, if this is the environment the Fed is looking at, recession plus inflation still in the 5% range, my view is that they'll try to straddle that by raising and holding. They are raising now for as long as they can, and then as recession starts to set in, they will have to hold rates, if inflation remains high. That relates to this question of fiscal policy response. That likely divided government means less ability for the Congress to act if the United States enters a recession, in the form of a stimulus package. But at the same time, we had a divided government at the beginning of the pandemic, and the Congress managed to mobilise the most expansionary fiscal policy in memory. Who knows exactly what compromises will be made? But it is a worrying outlook to see this divided government just as the United States is likely entering a recession.

Moderator: *What are the odds that Trump will announce he is running for president before the midterm elections? How would that impact the races? What do you think the Trump calculus is?*

Meghan Milloy: I don't think he is going to announce it before the midterms. First because he has millions of dollars in his Save America PAC. The moment he announces his candidacy, he will not be allowed to use it how he wants. Number two, the Mar-a-Lago investigation is going on, and although he personally might not care, it will be time consuming for him and his possible campaign staff. Third, a number of Republicans are probably telling him to wait because of close races, some of which would be negatively impacted by this. It could happen, but there are more reasons against it.

Giles Alston: I agree, for the same reasons, but would just add that he is likely to calculate that he can only declare once but can be on the verge of doing so, and collect the attendant publicity, for an extended period.
