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Who's Afraid of the Big, Bad Blue Wave?

Insight from sub-adviser Wellington Management

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Key Points

- Conventional wisdom says Democrats are less "market-friendly" than their Republican counterparts, but this isn't just any election cycle.
- A large dose of fiscal stimulus has already been injected into the economy, but there's likely more to come under either new president.
- From an economic growth and market perspective, fiscal policy might be more supportive under a blue-wave scenario.

WITH THE US ELECTIONS ONLY A FEW WEEKS AWAY AND FORMER VICE PRESIDENT JOE BIDEN, THE DEMOCRATIC NOMINEE, HOLDING ONTO A COMFORTABLE LEAD IN MOST POLLS, the prospect of a so-called "blue-wave" scenario—where Democrats win the White House and seize control of both houses of Congress—looks more and more plausible with each passing day. (Granted, polls are notoriously fickle, and a few weeks is an eternity in politics; anything could still happen between now and November 3.)

Many investors are wary of a blue-wave outcome, fearing it could spell bad news for the US economy and markets. But would it really? After taking a closer look at some of the details, I'm not so sure.

Conventional wisdom says Democrats are less "market-friendly" than their Republican counterparts, but this isn't just any election cycle. A distinguishing feature of today's extraordinary environment is the role of fiscal policy to help combat the COVID-19 crisis. A large dose of fiscal stimulus has already been injected into the economy, but there's likely more to come under either new president. The difference lies in how stimulative fiscal policy would be.

A Closer Look

We now have more granularity around fiscal policy proposals from both President Trump and Biden, and potential implications for the economic outlook in 2021 under each candidate. Of course, not everything being proposed will necessarily become reality. (Trump's proposals in particular, especially the tax cuts, are unlikely to be fully implemented because Republicans are a long shot to take the House of Representatives.) And context is important here: The prevailing growth and public-health backdrop will affect the timing and magnitude of fiscal measures.

But, it's at least possible now to set some parameters around what to expect post-election (**FIGURE 1**):

- Trump might slash spending by about 0.3% of US gross domestic product (GDP) and try to push through further tax cuts amounting to 0.9% of GDP, leaving fiscal policy stimulative, but only by about 0.5%.
- Fiscal policy should be more stimulative following a blue wave than with Trump and divided government. Biden could up spending by around 3.4% of GDP per year (mainly on infrastructure, healthcare, and education), offset with a 1.9% of GDP tax increase.
- That said, the policy mix resulting from a Democratic sweep may be less market-friendly, as corporate, individual, and capital-gains taxes could rise, along with greater regulation.

FIGURE 1

Fiscally Speaking: Biden vs Trump Proposals

	Biden		Trump	
Component	(US$ bil, 2021 - 2030)	GDP%	(US$ bil, 2021 - 2030)	GDP%
Infrastructure	2,390.0	1.1	1,084.0	0.5
Education	1,906.4	0.9	-170.0	-0.1
Social safety net	1,498.5	0.7	-485.0	-0.2
Healthcare	1,475.0	0.7	-928.0	-0.4
Spending	**7,269.9**	**3.4**	**-737.1**	**-0.3**
Individual	963.1	0.4	-1,517.6	-0.7
Payroll	997.6	0.5	-172.0	-0.1
Corporate	2,138.5	1.0	-200.5	-0.1
Taxation	**4,099.2**	**1.9**	**-1,890.3**	**-0.9**
Net fiscal	**3,170.7**	**1.5**	**1,153.2**	**0.5**

Sources: Moody's Analytics, Biden and Trump presidential campaigns, JTC, PTC, US Treasury, CBO, DOL, SSA, CRFB, OMB

Final "Blue Wave" Thoughts

From an economic growth and market perspective, I believe fiscal policy would be more supportive under a blue-wave scenario. And I think the US Federal Reserve would have a similar interpretation of a Democratic sweep, which in turn could influence monetary policy going forward. The economic impact of additional fiscal stimulus could also be a catalyst for higher long-end bond yields on a medium-term basis.

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