

Economic Analysis

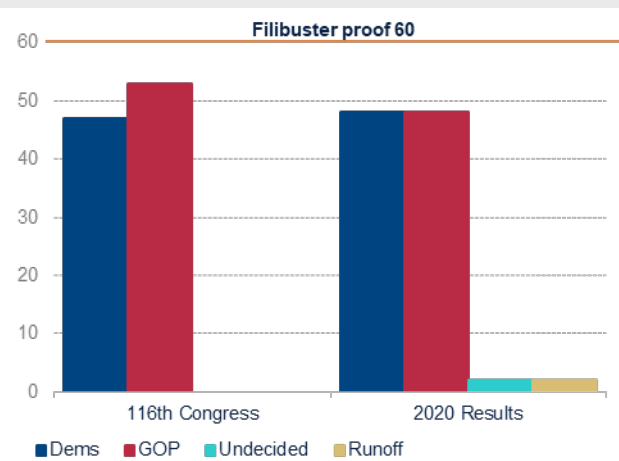
Difficult road ahead for Biden administration, but light at the end of the tunnel

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After a grueling election cycle and a year overshadowed by Covid-19, it appears based on preliminary results from the 2020 election map, Democrats have narrowly flipped the “blue wall”¹ states that went to Trump in 2016 and created a buffer by winning Nevada, Arizona and Georgia. Specifically, assuming Biden maintains his margins in those states, he would have won 306 electoral votes; two more than the president was able to win in 2016. Moreover, Biden is on track to secure nearly 51% of the popular vote as opposed to the president who is likely to secure slightly less than 48%, implying a gap of nearly 5 million votes. Yet, as in 2016, pre-election polls and pundits failed to accurately predict the results while the highest turnout since 1900 failed to manifest a “blue wave” of popular Democratic support.

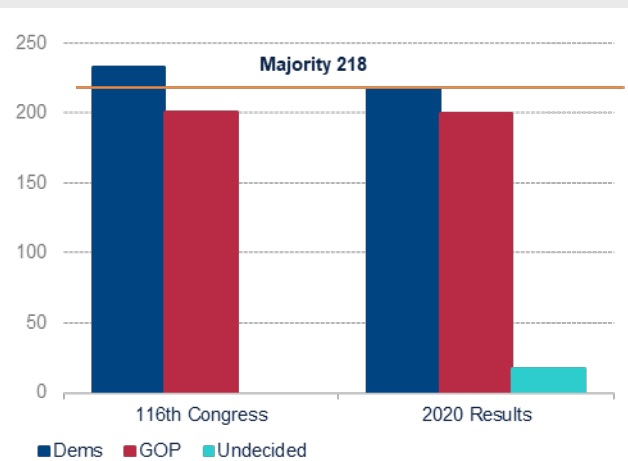
Interestingly, exit-polls complicate the narratives associated with ideology and the expected voting outcomes. For example, 62% of Florida voters approved an increase in the minimum wage from \$8.6 to \$15 an hour, a traditionally unpopular idea among conservatives, despite the fact that president Trump carried the state. In California a \$200 million campaign to classify app-based drivers and delivery services as independent contractors rather than employees was approved; a regressive labor measure which won a 17% margin in a state which handed Joe Biden a supermajority of its votes.

Figure 1. SENATE SEATS



Source: BBVA Research, Politico, 270 to Win, FOX, NBC, CBS and CNN

Figure 2. HOUSE SEATS



Source: BBVA Research, Politico, 270 to Win, FOX, NBC, CBS and CNN

1: “Blue wall” states which voted for Donald Trump in 2016 are Wisconsin, Michigan and Pennsylvania

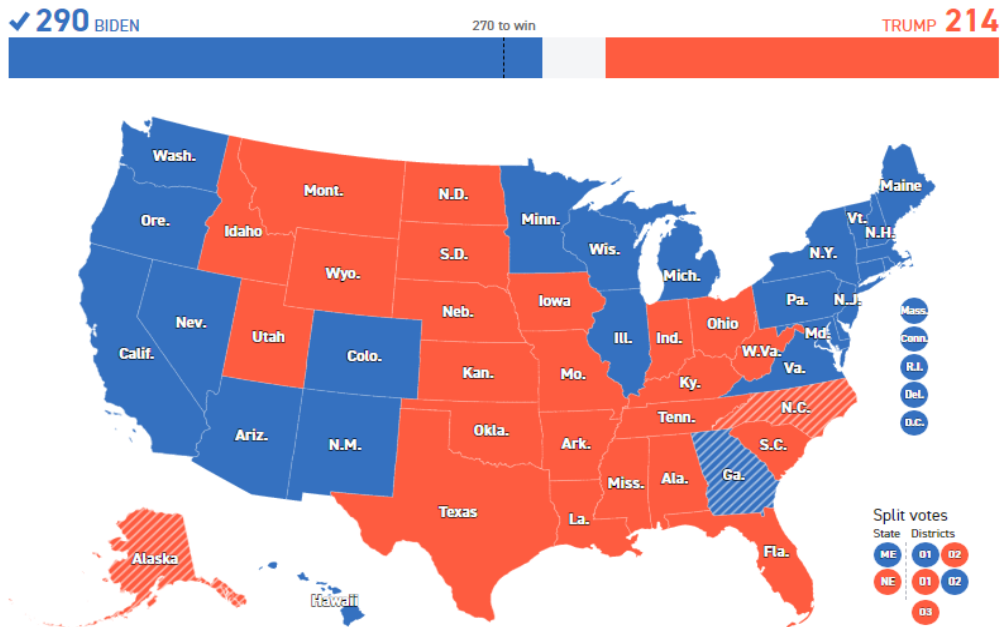
While Democrats netted a loss in the House, they gained at least one seat in the Senate. As it stands, Democrats need to win both seats in Georgia’s special election in January, or have a surprise outcome in North Carolina or Alaska based on current trends, to gain control of the Senate. If not, Republicans will retain control, and represent a major obstacle for the new administration’s progressive agenda.

Although incoming results suggest that Biden’s electoral vote margin may be nontrivial, the President and the GOP have signaled that they are not planning to concede, implying that uncertainty will remain high, as the legal challenges and recounts proceed. According to FairVote, out of 4,687 statewide elections between 2000 and 2015, there were 27 recounts, of which 15 were consequential and in 3 occasions the results were reversed. In other words, the probability of an election result inverting after the initial results is less than 0.07%.

At the presidential level, recounts are unusual but not unprecedented. In 2016, Wisconsin and Nevada carried out a recount, after Trump beat Clinton by more than 20,000 votes in Wisconsin, and Clinton beat Trump by 27,000 in Nevada. After the recount the results changed by 131 in the former and less than 10 in the latter. In Florida and Michigan the original results stood.

In terms of presidential legal challenges, in 2000, Vice-President Gore challenged the results of Florida vote count, which had the power of determining the presidency. After a series of legal challenges, the Supreme Court decided that counting inconsistencies across counties would violate voters rights and therefore would be unconstitutional, requiring a uniform recount. However, the constitutionally mandated time for completing the vote- first Monday after the second Wednesday- was not feasible and would also be unconstitutional, effectively ending the possibility for a fair recount.

Figure 3. **ELECTORAL COLLEGE**



Source: BBVA Research, Politico, 270 to Win, FOX, NBC, CBS and CNN

With no clear signal from the electorate of a desire for a “Blue Wave” and with current projections suggesting a divided government, the likelihood of a major fiscal package in the lame duck session is remote. That said, we continue to expect modest fiscal support in 2021 of around \$500bn-\$1Tn in 1Q21, which remains a part of our baseline scenario, implying no major changes to our medium term outlook given the election results. The other major uncertainty relates to how the Biden team will be able to prepare for the transition with the election hanging in the balance and with an elevated risk of an economic slowdown amid rising Covid-19 cases. This may require immediate fiscal support, if the economy is to reach a self-sustaining path and avoid the long-lasting and damaging economic scars that the U.S. has largely been able to avoid up to this point.

In terms of the response to Covid-19, related legislative or executive actions are the most likely to occur in the first 100 days, but the scale and scope remains uncertain given the makeup of Congress and lack of appetite and ability to force through additional fiscal stimulus. Nonetheless, Biden has said that he will rely more on public health experts and enhance transparency and information surrounding the virus. If the pandemic continues to exert downward pressures on the recovery, both parties may be willing to reach an agreement on near-term but limited fiscal stimulus to at least support the healthcare sector and industries that have been battered by the pandemic. Adding aid to states would test Biden’s ability to negotiate, although the amount would also be significantly lower than what Democrats have put on the table in recent months.

Although aspects of the incoming administration’s agenda are aligned with voters’ priorities, the solutions remain divided. Healthcare remains a top issue for a majority of voters, followed by jobs and the economy, climate change and civil rights and civil liberties. Moreover, voters favor public spending towards infrastructure and climate change, a path to citizenship for undocumented migrants and fixing race relations in policing. However, although most voters support free trade to advance U.S. interests abroad, they remain skeptical of multilateral trade deals and support measures to disincentivize U.S. companies to relocate operations to foreign countries. As a result, the most likely approach to addressing these issues will be through executive orders, an approach that has gained in popularity among recent presidents facing insurmountable legislative roadblocks and high levels of polarization.

Resetting diplomatic and trade relations would be workable early in the administration given that much of the authority rests with the President. Biden calls on the U.S. to “lead the world” and is a strong supporter of diplomacy and development. The agenda aims to have the U.S. to rejoin the Paris Climate Accord, restore funding to the WHO, pressure China on carbon-emissions and human rights, develop a comprehensive plan to support economic growth in Central America, strengthen cooperation with Western democracies, re-enter the nuclear deal with Iran, and take a tough stance with Russia and North Korea. In addition, given the strong protectionist bias within the Democrats, joining the TPP seems like a long-shot, at least in the near term.

Reinstating DACA and undoing the most unpopular immigration measures implemented during the Trump administration also have a higher likelihood of occurring. However, these actions would fall short of the high bar of structural reforms proposed in the past by bi-partisan groups such as the “Gang of Eight”.

In addition there could be bipartisan support to close tax loopholes on foreign profits, buy American provisions, reduce prescription drug pricing and regulatory changes to the tech sector.

In contrast, with the GOP in control of the Senate, the Biden tax plan and structural reforms targeting affordable housing, minimum wage, trade unions, bankruptcy, and environmental regulation will be dead-on-arrival. However, Biden could ban oil production on federal lands and use the Clean Air Act to reduce greenhouse gas emissions.

Although both parties agree on the need to invest in infrastructure, support small businesses and boost innovation, there is little agreement on how to pay for it and what would be the top priorities. In addition, sustainability will remain a focus of the administration whether through executive order or multi-lateral coordination. However, the Green New Deal promoted by the progressive wing of the Democratic party will be hard to move through Congress with the high level of polarization and division in Washington despite the fact that a majority of voters believe addressing climate change is an important goal. Once again, this would test Biden's ability to reach across the aisle.

Although unlikely, if the Democrats clinch a majority in the Senate there is a possibility that they could eliminate the filibuster, paving the way for a broader, more expansive and progressive agenda, with the potential for far-reaching reforms on healthcare, immigration, labor, energy, housing, education and other areas. While controversial, this path could positively impact both supply and demand-side conditions if structured in a way that improves labor market engagement and productivity while avoiding unnecessary regulations, subsidies and frictions that could discourage people from working and firms from investing. But even in the best case scenario, many of these reforms would not have a significant impact on potential GDP in the short-run.

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