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US elections – Scenario analysis

Key messages

- The US presidential election will be held on 5 November. A Trump or Harris win without their party controlling Congress are the most likely scenarios.
- This would limit the ability of the new President to implement major policy changes, except for tariffs.
- Under a Harris presidency, we would not expect additional tariffs. The biggest impact on economic growth and especially inflation would come via higher tariffs especially in the event of a Red wave.
- The impact for the USD and interest rates should be moderate in the event of a split Congress. In the event of a Red wave, the USD and interest rates would lead to upside over the medium term relative to our current scenario.

The election and possible outcomes

The US presidential election will be held on 5 November. A number of seats in the US Congress will also be potentially renewed and could lead to a change in majorities.

As chart 1 shows, the race is extremely tight at this stage, and the outcome may not be clear on the election night or immediately afterwards. Pennsylvania is probably the key state to watch among the "swing states" (Pennsylvania, Georgia, Michigan, Arizona, Nevada, Wisconsin and North Carolina). Extreme scenarios with a low probability, but high impact, could materialise if no candidate secures an Electoral College majority or if results are subject to legal challenge. Such scenarios imply that markets could face post-election uncertainty for several weeks.

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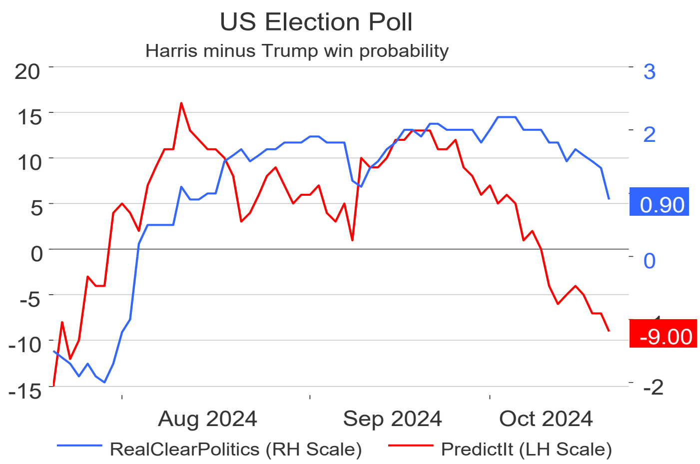
Chart 1: The election polls



Source: LSEG Datastream,PredictIt, RealClearPolitics, 21/10/2024

We see 4 scenarios:

(1) Red wave: Donald Trump wins the White House, and the Republicans win Congress (House of Representatives and Senate);

(2) Trump – divided: Trump wins the White House, but the Republicans do not control Congress;

(3) Harris – divided: Kamala Harris wins the White House, but the Democrats do not control Congress;

(4) Blue wave: Harris wins the White House and the Democrats win Congress.

The key issues related to economic growth and markets are:

1. Tariffs and trade

Whoever wins the US presidential election, the trend towards greater protectionism will remain. Trade barriers are one reflection of the broader shift away from the ongoing globalisation that has already led to higher tariffs and protectionism.

Under a Harris presidency we do not expect additional tariffs. We would, however, expect tariffs to be much higher under a Trump presidency. The extent of tariffs remains an open question. If we consider an extreme scenario, such as a policy of import tariffs of 10% globally and 60% on China, the impact on the US and the world economy would be quite substantial. The effect from the US imposing such tariffs on China would probably have a much larger and more persistent effect on inflation than on growth. The full impact on inflation would probably be seen later, in 2025 but the US central bank would probably be forced to stop cutting rates and even hike rates again. That would amplify the negative effect on growth, not only in the US. Whatever policy Donald Trump chooses could depend on the outcome of the elections for Congress. It is, however, very likely that the impact on the eurozone will be more negative if Trump wins. The recent business surveys in the eurozone, however, suggest that companies are expecting a negative outcome, and the current pessimism is probably exaggerated.

2. Fiscal policy, deficits and debt

The key issues are whether to extend the Tax Cuts and Jobs Act (TCJA) voted in 2017, which are scheduled to end at the beginning of 2026, and a potential change in the Federal Corporate Tax. We also consider public spending. We summarise the scenarios in table below.

Table 1: Fiscal Impact

	Individual tax	Child Tax Credit	Corporate tax rate	Deficit
Blue Wave	Extended for low earners under $450K a year. 25% minimum tax for households with net wealth over $100m	Expansion of the child tax credit, a Democratic party policy priority. Scale up by $105bn per year	Higher corporate taxes to 28%, capital gains taxes	widen the deficit by ~$2trn over the 10-year budget
Harris/divided Congress	Extended for low earners	Extended at TCJA levels	Coporate taxe rate remains at 21%	Elevated risk of govt shutdowns and debt-ceiling standoff
Red Wave	TCJA provisions all extended	Scale up from TCJA level by $50bn/year	Cut to 20% (15% is unlikely)	widen $4.4trn over the budget over the 10-year budget
Trump/divided Congress	More of TCJA individual provisions extended, but not in full	Scale up from TCJA level by $25bn/year	No change from current 21%	Elevated risk of govt shutdowns and debt-ceiling standoff

Source: BNP Paribas CIB.

As chart 2 and 3 show, the effects on growth and inflation are quite different depending the outcome of the elections.

Chart 2: Expected effects on economic growth

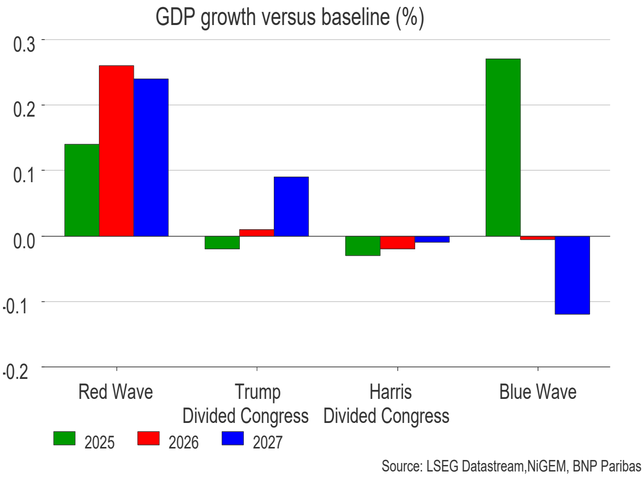
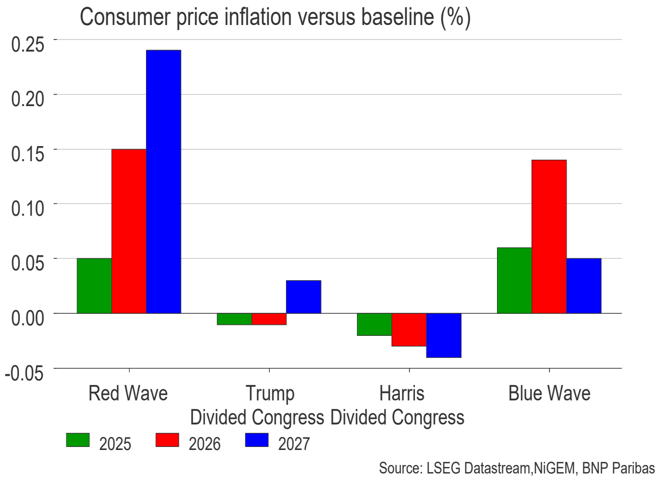


Chart 3: Expected effects on inflation



The impact on future deficits and thus public debt is expected to be biggest in the scenario of a Republican or Democratic wave. Obviously, this impact could grow over time, but it could increase the level of government bond yields in the longer term. A divided government is unlikely to impact the current path of deficits and debt.

Note that the existing debt ceiling deal has only suspended the debt limit until 1 January 2025. A scenario of a close-fought election and potential post-election dispute (as seen in 2000 and 2020) may force lawmakers to find common ground in a difficult environment. The Treasury should be able to use extraordinary measures until July 2025. This could add to the uncertainty in the first half of 2025.

3. Immigration

Whatever the US election outcome, we think that the positive impulse from higher immigration on growth and the labour market is likely to fall gradually. A faster immigration progress is unlikely, given Donald Trump's through stance on border issues and Kamala Harris's focus on other priorities. Mass deportation is a key downside risk. However, the probability of such scenario is limited by border-control capacity constraints. Under the most likely scenarios with divided Congress, immigration should continue supporting growth even if the flow of new arrivals slows considerably.

The impact on the USD and US bond yields

A Red wave would lead to the biggest upside for the dollar in the medium term. As discussed earlier, such scenario would probably imply higher inflation and higher policy rates. A Harris presidency with a divided Congress would imply more downside for the dollar in the medium term, lead to less uncertainty about the economic outlook, and reduce the appetite for safer currencies. Inflation uncertainty would also fall and support the Federal Reserve in cutting rates and keeping rates low.

Bond yields are not expected to deviate a lot from our current outlook in the event of either presidential candidate winning with a divided Congress. A Red wave would lead to the highest upside risk for yields in the medium term as it would imply higher inflation and possibly higher policy rates. A Blue wave would suggest somewhat less upside for bond yields relative to our current outlook.

Conclusion

The race will remain very tight, and the most likely outcomes are either Trump or Harris winning but without having their party control Congress. This would limit the ability of the new President to implement major policy changes, except for tariffs. Under a Harris presidency, we would not expect additional tariffs. The biggest impact on economic growth would come via higher tariffs in the event of a Trump win.

The main risk is a scenario with a policy of import tariffs of 10% worldwide and 60% on China. This should have a much larger and more persistent effect on inflation than on growth. The full impact on inflation would probably be seen later in 2025 and the US central bank would probably be forced to stop cutting rates and even hike rates again. That would amplify the negative effect on growth, not only in the US. Under a Trump – divided Congress, it is likely that the tariff changes would be more moderate. The impact of tariffs for the eurozone would be more negative under a Trump administration.

The impact for the USD, interest rates and yields should be moderate in the event of a split Congress. In case of a Red wave, the USD and rates have upside over the medium term relative to our current scenario.

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