

'It's still the economy, stupid'

Next US election could be even more contentious than the last

by James Knightley and Mark Cliffe in London

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Donald Trump's 2016 election campaign tore up the rulebook on how to win the US presidency, and he has challenged convention ever since. The US is just 18 months away from the next election, which has the potential to be even more contentious and unpredictable than the last. Already, over a dozen different candidates have announced their intention to run, giving rise to a broad range of scenarios with varied potential political and economic outcomes.

In the first scenario, Trump retains the White House and retrenches his views on international trade and multilateral institutions. He promises a renewed push for infrastructure spending, reliant on significant state financing and expanded use of localised energy policies to support fossil fuels. US healthcare policy would remain largely unchanged, while regulation of technology firms would rely on congressional action.

Second, it is possible, if improbable, that a non-Trump Republican wins the presidency. This would probably lead to another round of tax legislation, along with establishing protections for privacy. The leadership would re-engage with international institutions and take a less antagonistic stance towards external trade relationships. Fiscal conservatism would probably return to the forefront in national and congressional politics, lowering the likelihood of fiscally expansive budgets.

The third scenario, from the other side of the aisle, is the victory of a centrist Democrat consensus builder like Joe Biden or Kamala Harris. Such a president would probably increase federal spending on both infrastructure and healthcare, as well as renew efforts to establish a national single payer service. Climate change would emerge as a key item on the political agenda, with government support for renewable energies increasing significantly. Technology companies would face increased regulatory oversight.

The fourth concerns the possibility of a populist Democrat becoming president and promising a new 'New Deal'. Increased corporate tax rates would fuel significant fiscal expansion, including support for environmental projects as well as redistributive spending. Technology giants would become subject to antitrust action, and while trade protectionism as seen under Trump would continue, the White House would offer strong support for international agreements on climate change.

The campaign mantra it's 'the economy, stupid', first coined by President Bill Clinton's strategist, James Carville, has ruled US electoral politics for more than a quarter-century, and remains critically important. Other issues will of course come into play, such as healthcare and identity politics, but if the US economy remains strong between now and November 2020, the Democrats will find it hard to unseat Trump.

A Trump victory raises prospects of a potential boom-bust economic scenario, particularly if Republicans also win control of Congress. More fiscal stimulus could initially boost growth, equity markets and the dollar, but would also generate inflation and result in a more aggressive response from the Federal Reserve that would lead to an eventual slowdown.

A non-Trump Republican president is likely to change course and be less confrontational on the international stage and may seek a return to a more fiscally conservative stance. This would provide a more stable platform, resulting in a more modest, less volatile economic and market performance.

Given the likelihood that a weaker pre-election economy would contribute to a Democrat presidential victory, a centrist Democrat would be looking to create a platform that allows growth to rebound. This means that after initial dollar and equity market weakness, financial markets could move into recovery. Inflation would be low due to economic softness, implying relatively low interest rates.

A populist Democrat would most probably win if the economy had experienced a prolonged and significant period of weakness. This would see a large fiscal stimulus package focused on spending, with pressure on the Fed to respond aggressively. Massive stimulus would mean an eventual turnaround in the economy. But longer-term issues over trade protectionism, higher wealth, income and corporate taxes, plus more intervention in markets and key industries, could become a focus for financial markets.

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