

US Macroeconomics

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The Red Ripple

Expectations of a Republican “red wave” were dashed. While the outcome of yesterday’s midterm elections may not be known for another few weeks, the results were more in line with a “red ripple”.

Going into the midterms, the Republicans needed a net gain of 5 seats as the breakdown was 222 Democrats to 213 Republicans. The GOP may achieve this based on the New York Times’ latest projection which is showing 224 Republicans to 211 Democrats. However, this is a net swing of just 9 seats, which was well below “expectations”. As we can see in the nearby table, excluding 1934 (The Great Depression) and 2002 (post-9/11), **the average loss of House seats for the first term Presidential incumbency over the last century is 38.** And the median loss is even larger at 48 seats.

Admittedly, the Republicans were starting with a much higher number of seats compared to the last two red waves of 1994 (176) or 2010 (178). Nevertheless, Tuesday’s results were significantly below what many polls showed going into the midterms.

Moreover, **the Senate is still in play at 48 to 48,** running counter to expectations the Republicans could net up to 4 seats. The Republicans need to pick up three of the four undecided races in Arizona, Georgia, Nevada, and Wisconsin. But **we may need to wait into Georgia’s likely runoff on December 6th to learn which party controls the Senate.**

In the recent past, gridlock has been good for financial markets regardless of policy affiliation because the Executive branch pivoted back toward the center. Generally, this has been good for the economy, as well. But **history is unlikely to provide us with a good roadmap because of the Fed,** which has been tightening monetary policy at a record fast pace. The economy could enter into a recession next year.

Two other observations worth making. One, the much better than expected showing by Democrats lowers the probability that President Biden announces he will not seek reelection or that Vice President Harris declares she will not seek the 2024 nomination. Two, the larger than expected win by Governor DeSantis arguably raises him to front-runner status, setting up an inevitable clash with former President Trump who is expected to announce his candidacy next Tuesday, November 15.

Midterm House Results During First Four Years

| Year | Net Pickup |
|---------------------|------------|
| 1910 | -57 |
| 1914 | -60 |
| 1922 | -77 |
| 1926 | -9 |
| 1930 | -52 |
| 1934 | 9 |
| 1946 | -54 |
| 1954 | -18 |
| 1962 | -4 |
| 1966 | -47 |
| 1970 | -12 |
| 1974 | -48 |
| 1978 | -15 |
| 1982 | -26 |
| 1990 | -8 |
| 1994 | -54 |
| 2002 | 8 |
| 2010 | -63 |
| 2018 | -41 |
| Average --> | -33 |
| Ex. 1934 & 2002 --> | -38 |

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