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U.S. Watch: Bond market anticipating sweep by the Democrats?

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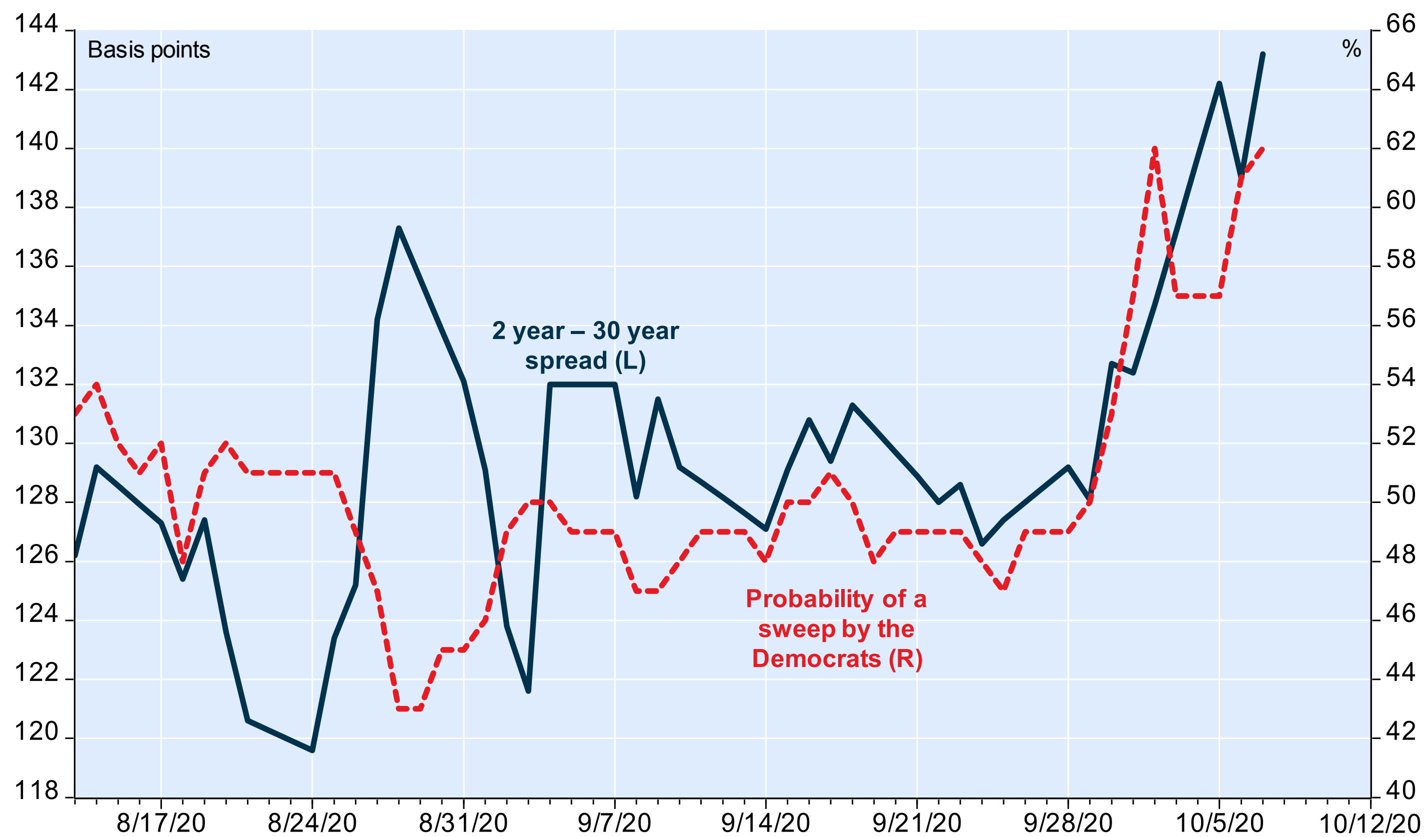
Judging from the economic data released so far, U.S. GDP growth is expected to be very impressive in Q3 (north of 30% annualized by our estimate). To some extent, a strong rebound could be anticipated given the gradual reopening of several sectors of the economy during the quarter and latent demand accumulated during the first wave of COVID-19. That said, even if our growth scenario materializes in Q3, the US GDP will remain 3.5% below the level it reached in Q4 2019. This is a substantial gap. By comparison, the peak-to-trough decline during the Great Recession of 2008-09 was 3.9%. So, there is still a long way to go, and from now on, the pace of expansion promises to be a lot slower. This is all the more reason for Congress to go ahead and come to an agreement on a new set of stimulus measures to support income. In this regard, the latest news has been mixed. After announcing the complete cessation of negotiations until the U.S. election, President Trump did an about-face and stipulated that he would be prepared to support a "big deal". In any case, the probability of U.S. consumers/businesses having to wait until after November 3 for a new round of fiscal stimulus is increasing.

The outcome of the election could, therefore, determine the size of the envelope. The Democrats' proposal has shrunk from $3.4 trillion in May to about $2.2 trillion. The Republicans, meanwhile, pledge aid in the order of $ 1.5 trillion. The two parties agree on the need for a further increase in unemployment insurance (in the range of about $400-$600 per month) and on a new round of checks to households. Aid to states and municipalities, on the other hand, is a point of contention. The plan presented by the Democrats last month allocated $436 billion to these entities, a figure that raised eyebrows among many Republicans.

A Democratic victory could therefore translate into more assistance being rolled out. Should Joe Biden's party achieve a clean sweep (winning the White House and both chambers in Congress), the current plan could even be enhanced. The bond market appears to be reacting to the growing possibility that such a scenario could occur. The interest rate curve has indeed become steeper in recent weeks, as Democrats' budget plans are more conducive to a pick-up in inflation and an increase in government bond issuance in the long end.

United States: Bond market anticipating sweep by the Democrats?

2-30 year spread vs. probability of seeing the Democrats capture the White House, the Senate and the House



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