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Putting a brand-new president in his place

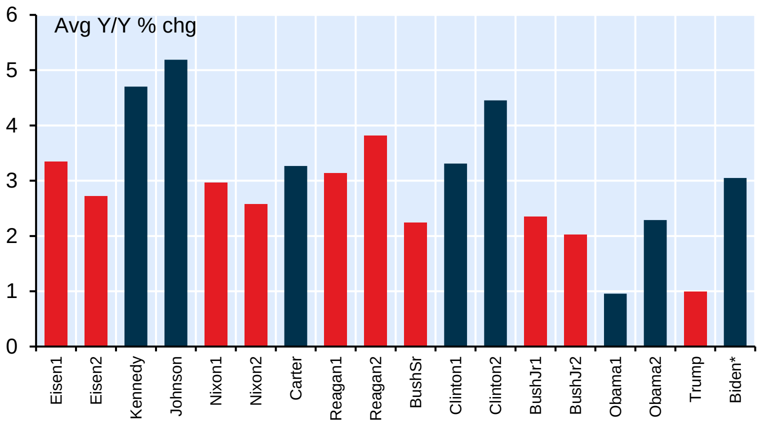
By Warren Lovely/Taylor Schleich, with assistance from Camille Baillargeon

Joe Biden has been President of the United States for all of two weeks. A bit early to be thinking about legacies don't you think? Probably. For financial markets, however, it's never too early to think about how the economy and the fiscal/monetary policy backdrop could evolve under this new president. So here we present a multi-faceted, chart-heavy take on how things could play out over the coming four years. There's no political motive here. Rather, think of this as presidential-themed study of absolute and relative economic, fiscal and financial market performance that is both backward- and forward-looking. In this way, we aim to assess how Biden's nascent presidency might ultimately stack up to his predecessors. Warning: In the following pages, we humbly offer up working assumptions for a variety of indicators, acknowledging: (a) long-term forecasting is a dicey proposition at the best of times, but even tougher today given elevated virus-related uncertainty; (b) many policies and administrative priorities of the Biden-Harris regime are still being developed and/or negotiated, which could seriously alter the economic and fiscal trajectory of the U.S. (the current debate around fiscal stimulus a good example); (c) mid-term elections in two years' time could impact the balance of power in Congress and thus influence Biden's ability to implement his legislative agenda; (d) the U.S., despite its enormous influence on the global stage, doesn't operate in a vacuum, so comparative measures (vs. Canada for instance) can and will be impacted by how other players act.

Economic, fiscal & financial market context / outlook for Joe Biden, 46th President of the United States of America

Chart 1: Biden enters as recovery from virus takes hold

Average annual U.S. real GDP growth by presidential term

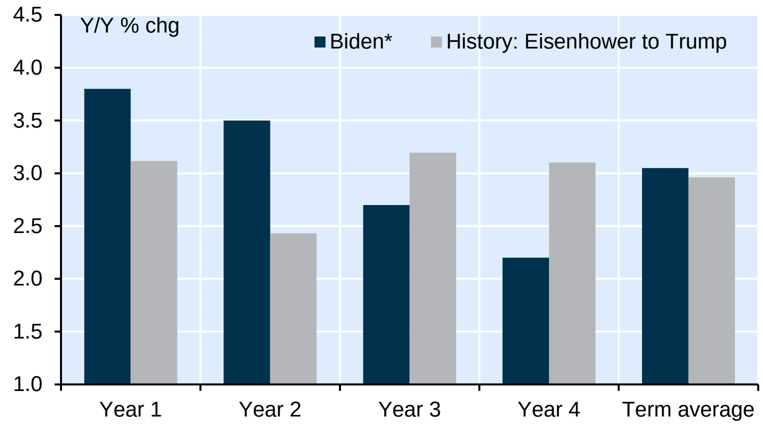


Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

After 2020's 3.5% contraction, which seriously dented Trump's economic legacy, we see real growth averaging 3.1%/year under Biden. That pace, the strongest since Clinton, would leave real GDP above potential by 2024.

Chart 2: Recovery will erase a lot of slack in coming 2 years

Annual U.S. real GDP growth by year of term: Biden vs. predecessors

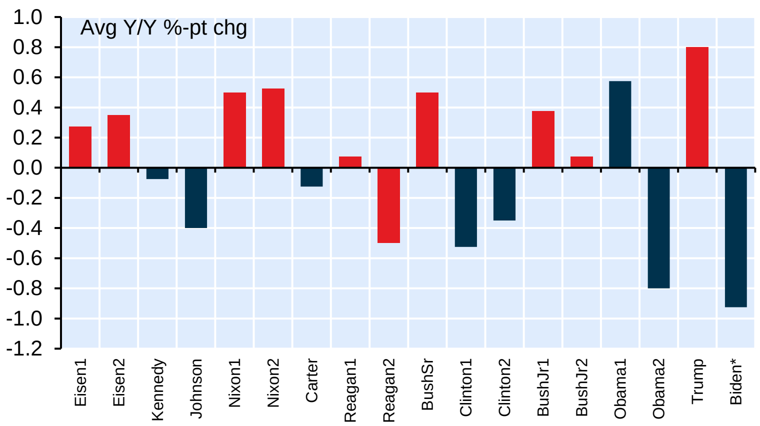


Source: NBF, Bloomberg | Note: NBF working assumptions for Biden; Biden Year 1=2021

Much slack will be taken up in Biden's first two years. His first half average, at 3.7%, could be biased higher assuming effective deployment of large-scale fiscal stimulus (including enriched income supports and infrastructure).

Chart 3: Labour market to undo virus damage over term

Average annual change in U.S. jobless rate by presidential party affiliation

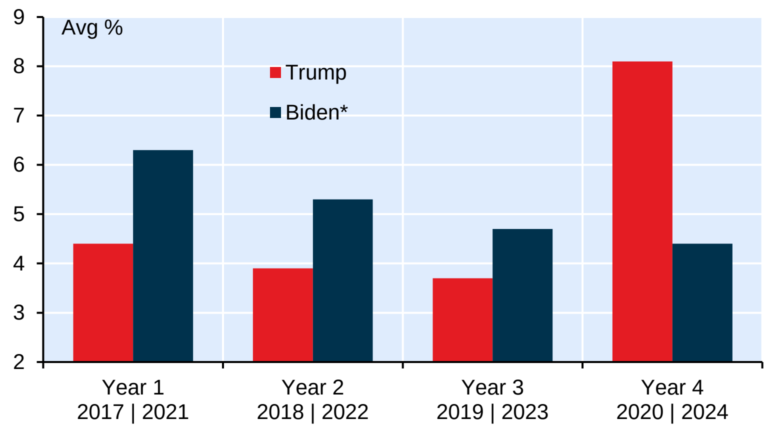


Source: NBF, Bloomberg | Note: NBF working assumptions for 2021-24 (Biden)

Democratic presidents have built a track record of labour market performance vs. Republican rivals and relative to Canada. Job one for Biden: re-attaching displaced Americans to the labour market, limiting virus-related scarring.

Chart 4: Jobless rate likely taking aim at ~4% by 2024

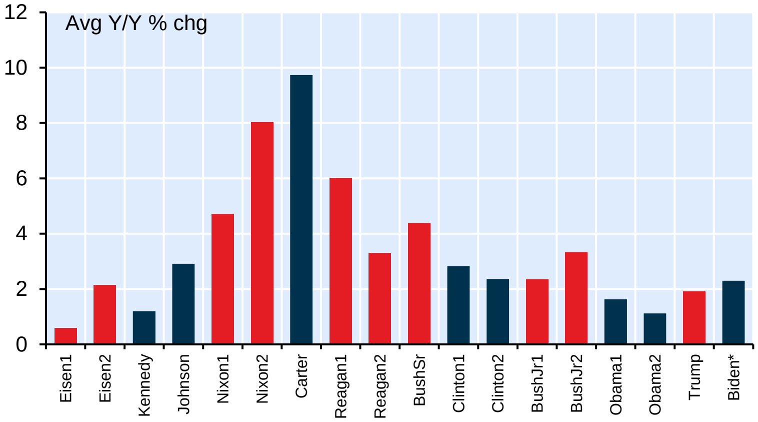
Annual U.S. unemployment rate by year of term: Biden vs. Trump



Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

Unemployment, which averaged 8% last year due to the virus, should take aim at ~4% by the end of Biden's current term—not quite as low as the middle stages of Trump's presidency, but nonetheless implying little to no slack.

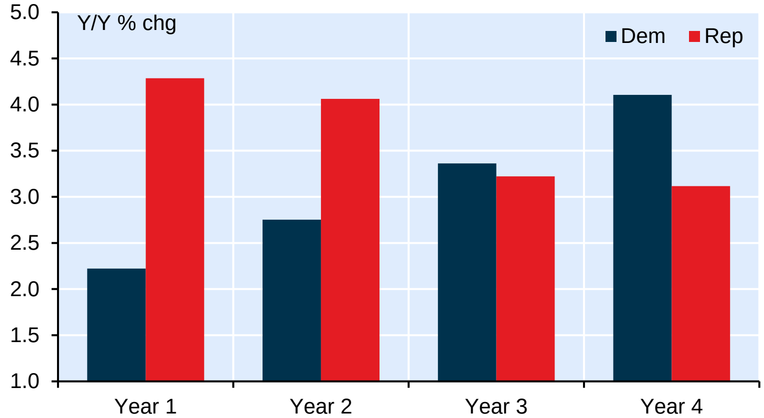
Chart 5: Putting inflation fears in perspective
Average annual U.S. CPI all items inflation by presidential term



Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

With significant slack set to be taken up in the next two years, inflation is set to build—something the market hasn't really had to deal with under the past few presidents. The Fed's mandate allows for (encourages?) an overshoot.

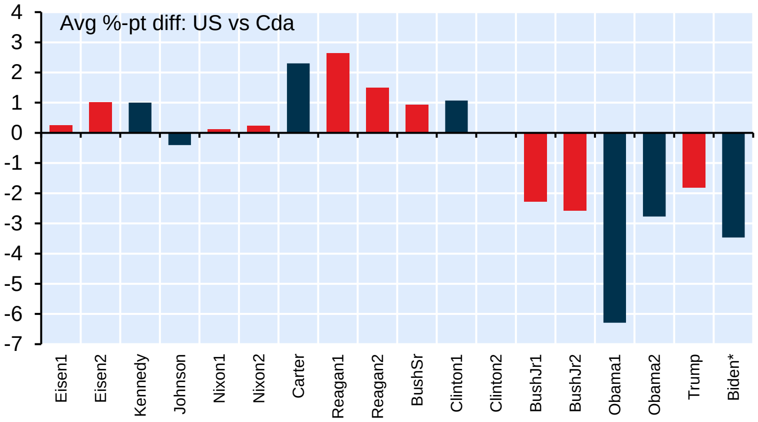
Chart 6: Inflation tends to build under Democrat presidents
Average U.S. CPI all items inflation by year of term & party affiliation



Source: NBF, Bloomberg | Note: Covers 17 terms since 1953 (Eisenhower to Trump)

There's a tendency for inflation to build as the term of Democratic presidents lengthens. That finding survives exclusion of the Carter presidency, when inflation went to the moon (averaging 13.5% his final year in office).

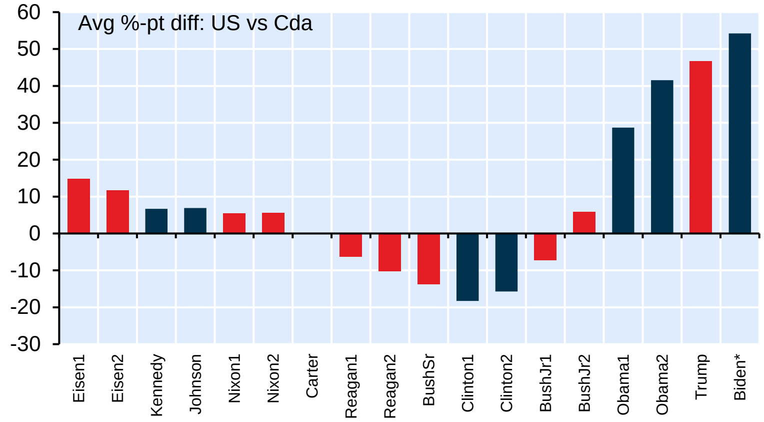
Chart 7: More red ink in U.S. than Canada… nothing new here
Average annual budget balance: U.S. vs. Canada by presidential term



Source: NBF, Bloomberg, CBO, Finance Canada | Note: Based on latest projections, subject to change as fiscal plans are finalized

There's no shortage of red ink in Canada, but Biden looks to extend a 20-year trend of relative fiscal largesse in the U.S. Biden could trail only Obama's first term when it comes to relative budgetary underperformance vs. Canada.

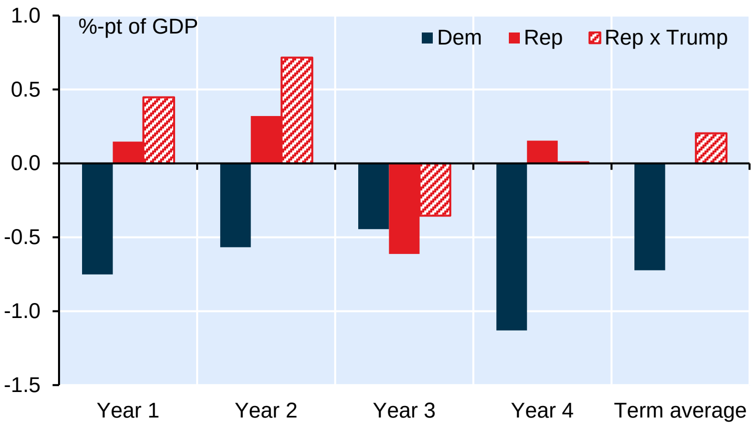
Chart 8: Increasingly heavier debt burden down south
Average debt burden: U.S. vs. Canada by presidential term



Source: NBF, Bloomberg, CBO, Finance Canada | Note: Based on latest projections, subject to change as fiscal plans are finalized; U.S. publicly held debt; Cda net debt

As a legit safe haven, the U.S. can get away with a heavier debt load than Canada. An already large debt gap will continue to grow through 2024, implying proportionately larger net funding needs for the Treasury vs. GoC.

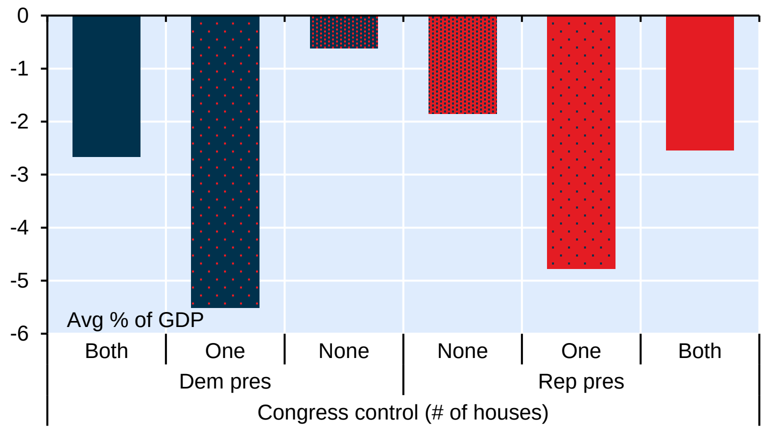
Chart 9: Dem presidents tend to run looser fiscal policy
Average budget balance: U.S. vs Canada by year of term & party affiliation



Source: NBF, Bloomberg | Note: Covers 17 terms since 1953 (Eisenhower to Trump)

Biden's fiscal outlook echoes history. Democratic presidents tend to run relatively weaker budgetary positions vs. Canada. Mind you, Republicans have had no trouble running deficits, even excluding 2020's virus-driven carnage.

Chart 10: Haven't needed full control of Congress to spend
Average annual U.S. budget balance by party control: White House, Congress

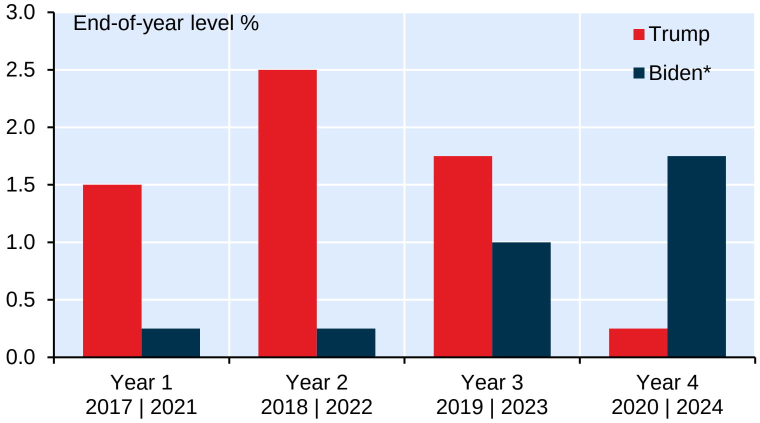


Source: NBF, Bloomberg | Note: Covers 17 terms since 1953 (Eisenhower to Trump)

Both Dem and Rep presidents have run large deficits without full control of congress, something to think about as mid-terms near. Until then, outsized deficits (inherited and driven by new spending plans) are the order of the day.

Chart 11: Removal of slack will see Fed hiking in 2023-24…

Fed funds target rate (upper bound) by year of term: Biden vs. Trump

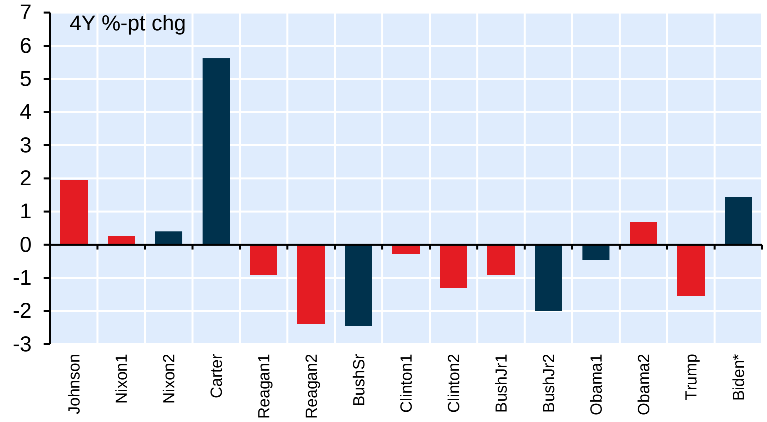


Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

At the ELB, there's only one way to go on the policy rate. We see the first Fed hike coming in early 2023, with persistent inflation pressure requiring an overnight rate of 1.75% by the end of Biden's term—still negative in real terms.

Chart 12: … so bond market to see larger selloff under Biden

Cumulative change in average U.S. 10-year bond yield by presidential term

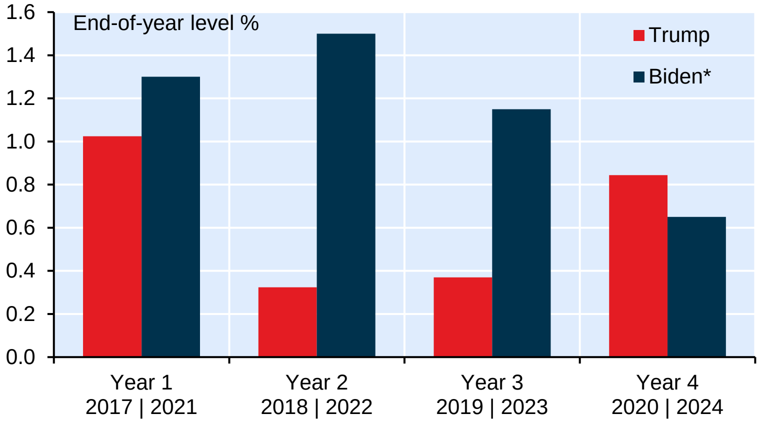


Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

Biden looks to buck the decades-long trend of presidents leaving office with lower rates. Though >2% inflation is a driver, don't lose sight of the low base effect. No president has taken office with lower rates after all.

Chart 13: Prospective yield curve dynamics under Biden

U.S. 3M-10Y yield curve by year of term: Biden vs. Trump

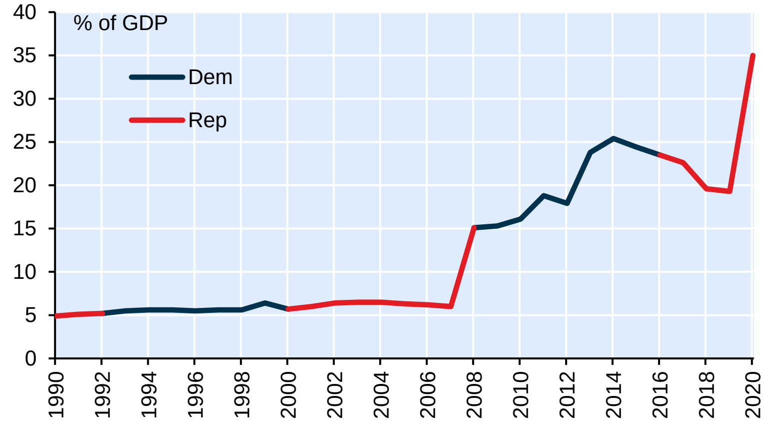


Source: NBF, Bloomberg | Note: NBF working assumptions for Biden

Consistent with our expectations for inflation, the Treasury curve should continue to steepen (modestly), with 3M-10Y ending 2022 at 1.5% (+50bps from current). An eventual Fed tightening leads to a bear flattening thereafter.

Chart 14: Fed balance sheet management a major wild card

U.S. Federal Reserve Board assets by presidential party affiliation

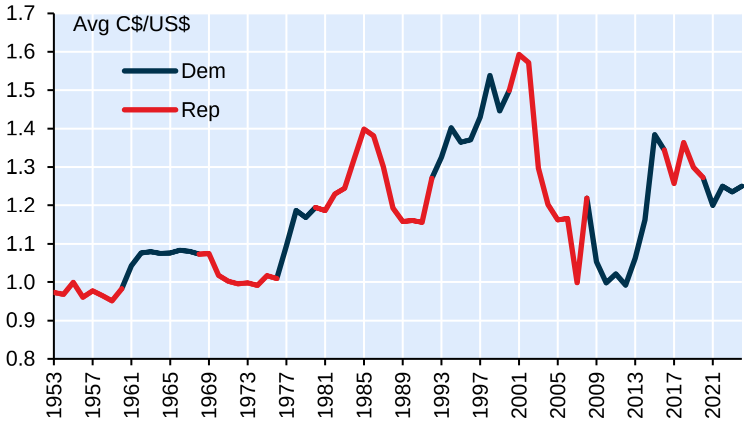


Source: NBF, Bloomberg

Most of the balance sheet run-up is behind us. Relative stability is the theme for now, given economic fragilities/uncertainty. As for the eventual taper, expect principal/coupon reinvestment (i.e., no major or rapid decline in assets).

Chart 15: Bucking trend, stronger CAD expected under Biden

Average annual USDCAD level by presidential party affiliation

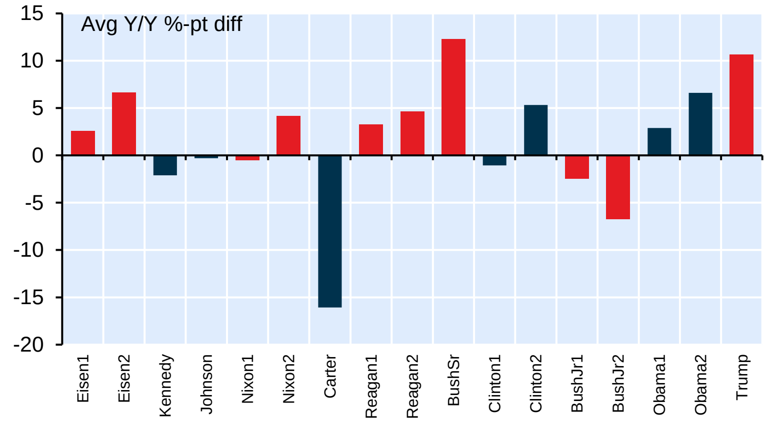


Source: NBF, Bloomberg | Note: NBF working assumptions for 2021-24 (Biden)

Confidence in the recovery has sparked CAD appreciation, with more to come. Under Biden, tighter environmental restrictions and potential tax reforms could help level the playing field, easing competitiveness fears north of the border.

Chart 16: Stocks fared relatively better under Rep presidents

Average annual performance: S&P 500 vs. S&P TSX by presidential term



Source: NBF, Bloomberg

Few presidents saw as much relative equity outperformance vs. Canada as Trump. While Biden's term is likely to be characterized by solid growth, we're overweight Canadian equities in our current asset allocation.

Summary conclusions

Some key takeaways based on NBF working assumptions for 2021-24

- Real GDP set to average 3.7%/year during first half of Biden's current term, as the U.S. recovers from COVID-19 (with the aid of ongoing loose monetary policy and new fiscal supports);
- Growth can be expected to moderate in second half of term, but the U.S. output gap should be fully closed by 2024 (based on fresh potential GDP projections from the CBO);
- America's labour market looks to heal meaningfully in the coming years, although re-attaching the permanently unemployed left in the virus' wake will take time and effort. For what it's worth, Canada appears to have done a relatively better job keeping people attached to the labour market, as evidenced by higher participation rates across key age cohorts and for both sexes;
- So-called 'soft data' (e.g., surveys) and market-based measures show inflation expectations are building appreciably in the U.S. This is an accurate assessment in our view. Price pressure is set to build steadily as the recovery unfolds. We're not exactly turning back the clock to the 1970s to 1980s, but inflation will be more of an issue during Biden's term than the past few presidents. The Fed's new policy mandate will permit an inflation overshoot without requiring an immediate policy response but…
- Rate hikes, in our view, look to arrive well before consensus FOMC thinking. Our expectation for three rate hikes in 2023 (followed by additional tightening in 2024) contrasts notably with the Fed's 'dot plot' from Dec-2020, as the majority of FOMC members saw the policy rate at the effective lower bound through 2023. Just one of seventeen 'dots' implied a more bearish view on the target for fed funds through 2023 than our current working assumptions;
- An ultra-low starting point (for yields), combined with mounting inflation pressure and a still-patient Fed, is a recipe for continued bear steepening in the first half of Biden's term. As accommodation is gradually removed, a bear flattening looks to take hold in later years. Longer-term rates will remain relatively low by longer-term historical standards (e.g., U.S. 10s ending 2024 at 2.35%), consistent with a structurally lower neutral rate of interest and a Fed continuing to reinvest coupons and maturities in Treasuries;
- The Canadian dollar has the wind at its back, as recovery prospects weaken the U.S. dollar more generally and lend support to key commodity prices. Refer to our detailed FX forecast here, including our call for 1.2 USDCAD by the end of this year. Assuming Biden re-tightens regulation and implements material tax reforms, Canada could reverse some of the competitiveness losses experienced under the prior administration;
- Overall, we're cautiously optimistic on equities and risk assets more generally. With U.S. equities having outperformed the S&P TSX (both recently and over the past decade plus), a valuation gap has emerged that could close under Biden. Buoyed by a strong and resilient Canadian household sector, and further emboldened by a firming in key commodities, our current asset allocation is overweight Canadian and emerging market equities (at the expense of U.S. equities and fixed income, where we remain short duration on an anticipated further back-up in rates).

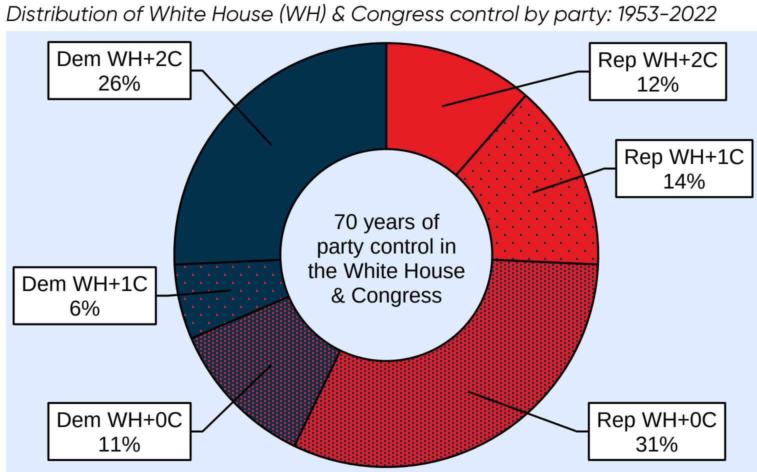
Table 1: Political control heat map (Dem=blue; Rep=red)

Control of White House & both houses of Congress for our sample period

Election Year	Sworn In	Party control / leader: White House	Congress: Senate	Congress: House
1952	1953	Eisenhower	Bridges	Martin
1954	1955		Johnson	Rayburn
1956	1957	Eisenhower	Johnson	Rayburn
1958	1959		Johnson	Rayburn
1960	1961	Kennedy	Johnson	Rayburn
1962	1963	(Johnson from '63)	Mansfield	McCormack
1964	1965	Johnson	Mansfield	McCormack
1966	1967		Mansfield	McCormack
1968	1969	Nixon	Mansfield	McCormack
1970	1971		Mansfield	McCormack
1972	1973	Nixon	Mansfield	Albert
1974	1975	(Ford from '74)	Mansfield	Albert
1976	1977	Carter	Mansfield	Albert
1978	1979		Byrd	O'Neill
1980	1981	Reagan	Baker	O'Neill
1982	1983		Baker	O'Neill
1984	1985	Reagan	Baker	O'Neill
1986	1987		Byrd	O'Neill
1988	1989	GHW.Bush	Byrd	Wright
1990	1991		Mitchell	Foley
1992	1993	Clinton	Mitchell	Foley
1994	1995		Dole	Michel
1996	1997	Clinton	Lott	Gingrich
1998	1999		Lott	Gingrich
2000	2001	GW.Bush	Lott/Daschle	Hastert
2002	2003		Lott	Hastert
2004	2005	GW.Bush	Frist	Hastert
2006	2007		Reid	Pelosi
2008	2009	Obama	Reid	Pelosi
2010	2011		Reid	Boehner
2012	2013	Obama	Reid	Boehner
2014	2015		McConnell	Boehner
2016	2017	Trump	McConnell	Ryan
2018	2019		McConnell	Pelosi
2020	2021	Biden	Schumer	Pelosi
2022	2023		TBD	

Chart 17: A visual representation of political control

Distribution of White House (WH) & Congress control by party: 1953-2022



Source: NBF, U.S. National Archives, 270towin.com, Wikipedia | Note: 0C to 2C refers to houses of congress controlled by president's party; assumes current congressional control extends to 2022, when mid-term elections are scheduled

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