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Get out (of the way of) the vote?

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The U.S. political situation is (choose your preferred adjective): fascinating, momentous, unbelievable, scary? However you classify America's current political backdrop, it's neither boring nor static. Between Donald Trump's ongoing accumulation of delegates (via Republican primaries) or congressional brinkmanship/dysfunction (that could lead to a partial government shutdown) or U.S. interventions in key geopolitical hot-spots or Washington's enormous budgetary shortfalls (requiring no-little-amount of debt financing), there's something for everyone (and not necessarily in a good way).

The main event of the 2024 political season is undeniably November's presidential election. While this critical vote is still roughly 180 weekdays (or over 8 months) away, we're using this *Market View* to tackle one specific issue we've been increasingly questioned on: the extent to which November's election could influence FOMC policy rate setting. [Note: NBF's geopolitical specialist, Angelo Katsoras, will have much to say on issues and implications as the vote gets closer.]

While we're hesitant to label this an outright 'conspiracy theory', more than a few we've come across believe the November 5th election will sideline Jay Powell and his FOMC colleagues, lest the Fed be seen as 'influencing' the vote. You might hear this theory expressed loosely as: 'If the Fed can't get going on rate cuts soon, then they're going to be in world of trouble, 'cuz clearly they won't be able adjust policy once the election gets close'. How much stock do we put in this supposition? Not a whole lot really.

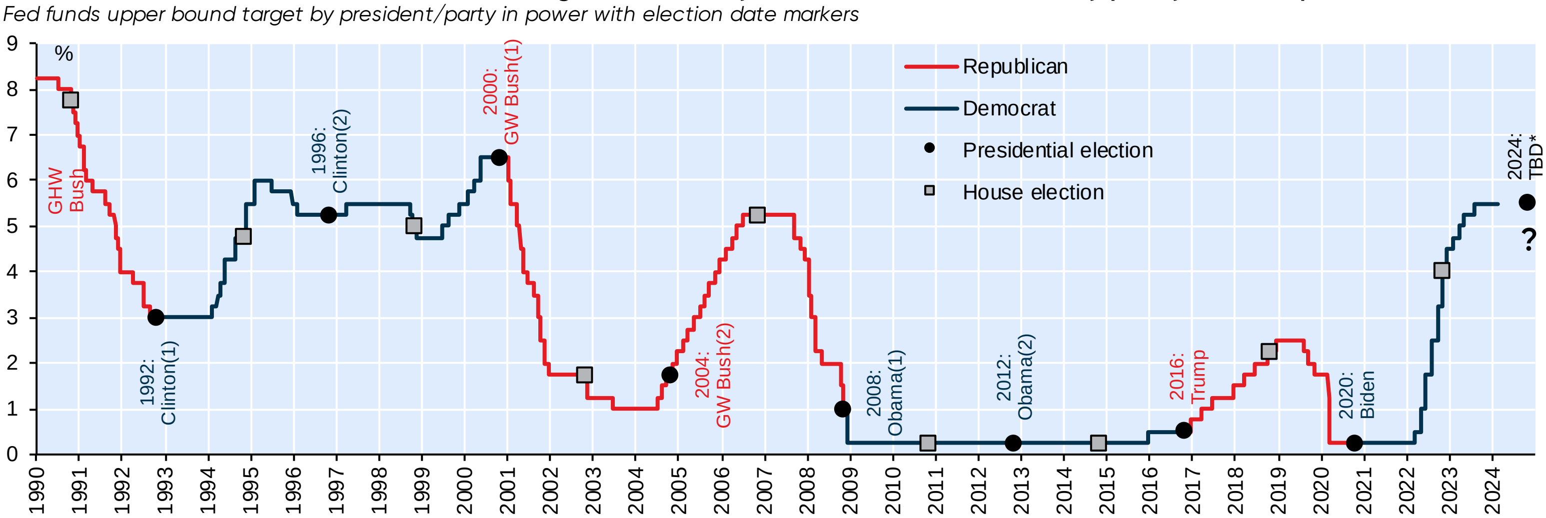
Before anyone labels us 'naïve', let's get a couple things out of the way. Are we suggesting that the Fed wants to deliberately influence things via high-profile policy decisions in the days or weeks ahead of the vote? Of course not… Powell would surely prefer FOMC policy choices fly under the political radar, even if that's seemingly an impossibility these days. Is there any evidence that the Fed has kept its target policy rate relatively stable in/around past presidential elections? Sure… although that may be down to sample bias more than anything. Is there an apparent tendency towards catch-up policymaking in the aftermath of a vote? Perhaps… but here again we'd offer some caution when interpreting the empirical record.

The way we see it, past elections (either the big presidential contests or congressional midterms) have not prevented the U.S. central bank from doing what was needed. While admittedly not a *presidential* election, 2022's vote did not interrupt policy tightening. It was a similar story in 2018 (midterm)… and 2004 (presidential)… and 1994 (midterm). More interestingly (and arguably more relevant to today's situation), a looming vote did not prevent the Fed from easing policy when that relief was genuinely deemed necessary. You would have seen this in 2008, which was of course something of a financial disaster and NOT what we're living through today. Further back, the Fed was easing policy in the lead up to the 1998 (midterm) and also in 1992 (presidential) and again in 1990 (midterm).

As should be apparent, we simply don't have a huge sample to really study. More to the point, U.S. elections have rarely intersected with recessions or serious economic downturns. But when they have, the Fed doesn't let an election—even a potentially contentious one—stay its hand. Whether or not the Fed is cutting (and if so, by how much) is really going to be a function of how resilient the economy proves to be, and how much progress towards price stability can genuinely be secured. To us, these are the real issues driving Fed policymaking, carrying much more weight than the scheduled democratic process. In our view, the combination of contracting GDP and tamer inflation in the second half will give Powell and Co. cover to cut rates both before and after November's election.

Chart 1: Past U.S. elections have occurred against a variety of economic and monetary policy backdrops

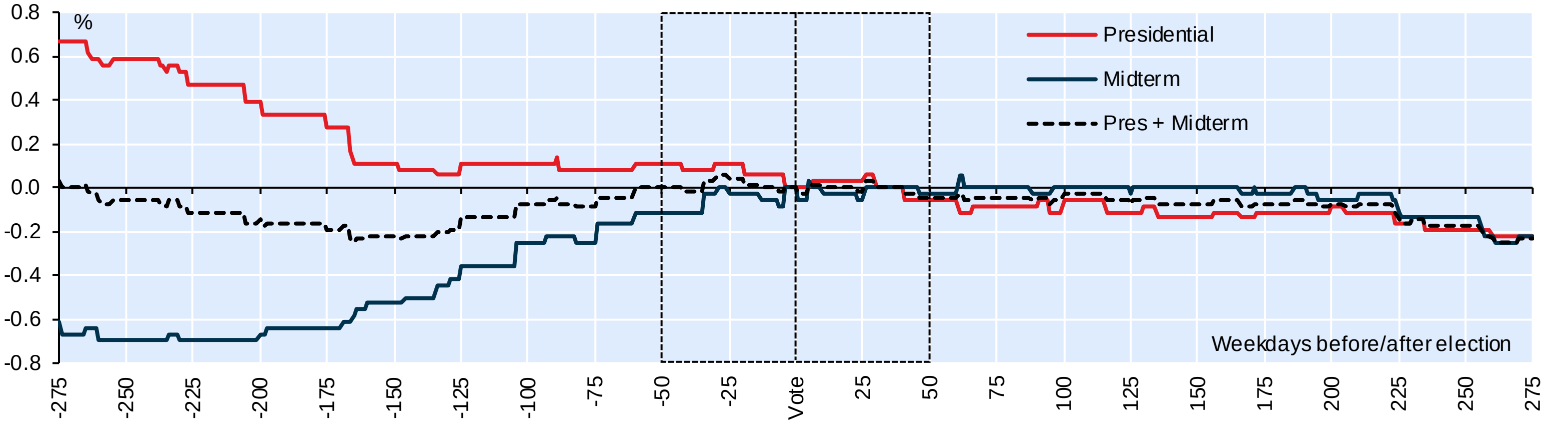
Fed funds upper bound target by president/party in power with election date markers



Source: NBF, Bloomberg, FRB | Note: Colouring on the basis of election date not inauguration date.

The Fed's policy stance has varied in/around past elections, there be cases of tightening, easing and neutrality. Homing in on a single episode might allow one to support a preconceived narrative. In 2016, the FOMC was on hold for the first 11 months of the year. Then, in the very first meeting after November's election, the Fed hiked (and tightened steadily over the next two years). Did policymakers delay the start of the tightening cycle to get through the election? Some may draw that conclusion. Other examples show politics holding less sway. Back in 2004, a tightening cycle began in the summer, just a handful of months before the election. Policymakers had no problem hiking shortly before and after that vote. On the policy flip side (i.e., instances of easing), a 2008 presidential campaign didn't prevent Fed officials from slashing rates immediately before and after the vote, as a financial crisis demanded strong action. Economic weakness likewise led to rate relief in the run-up to the 1992 presidential vote. We are NOT genuinely comparing the current situation to past painful recessions, but the economy's trajectory should nonetheless justify cuts before and after this year's vote.

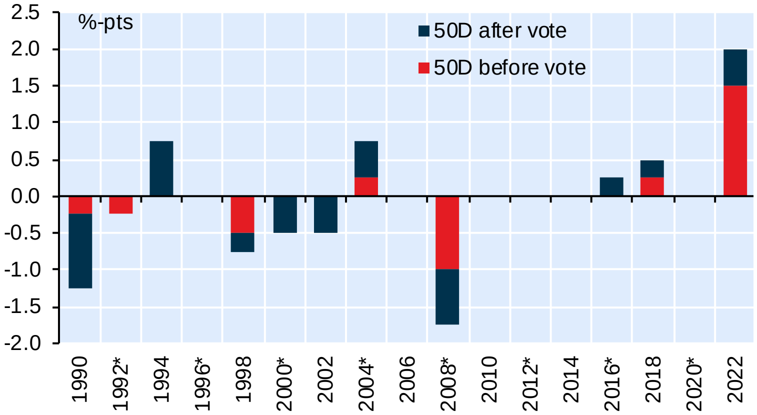
Chart 2: There appears to be have been some relative policy rate stability in and around past U.S. elections (or was there?)
Average path of fed funds target (upper) in 275 weekdays before and after federal presidential/midterm election



Source: NBF, Bloomberg, FRB | Note: Fed funds upper indexed to election day level; sample includes last 8 presidential & last 9 midterm elections (i.e., since 1990)

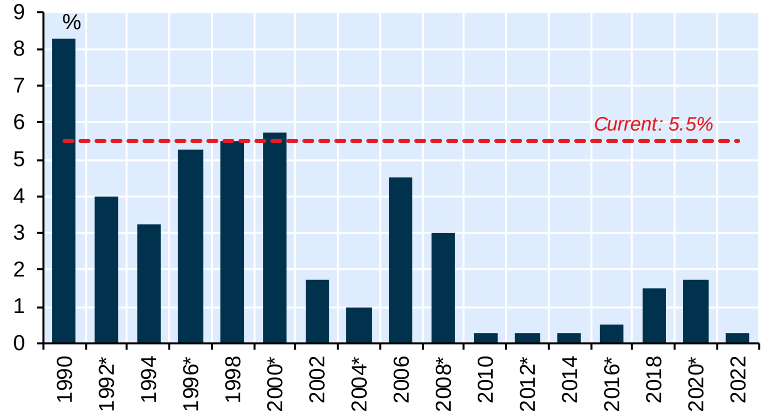
'On average', fed funds has declined into presidential elections. But given the small sample, outliers have major sway. For what it's worth, the opposite is true of the lead-up to midterm elections. Visually, there appears to be rate stability in the weeks before/after presidential elections. However, notice how far back the red line in the chart above flatlines. If that's evidence of the Fed sidelining itself to be 'apolitical' then it's nearly time to start shorting 2024 SOFR futures, as it implies little-to-no rate changes starting ~160 weekdays from the vote. Note: We're 180 weekdays from 5-Nov-24.

Chart 3: If warranted, the FOMC adjusts policy near votes
Change in fed funds target (upper) 50 days before and after election



Source: NBF, Bloomberg, FRB | Note: Asterisk refers to presidential election

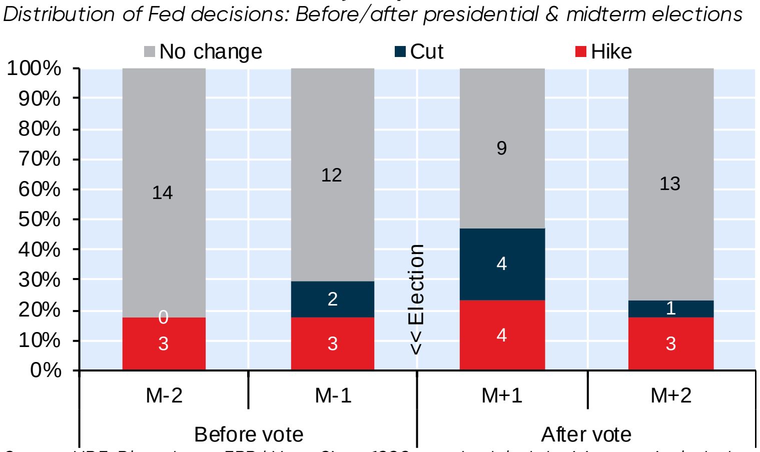
Chart 4: Naturally, ZIRP era saw elections without rate moves
Prevailing fed funds target (upper) 180 weekdays prior to election



Source: NBF, Bloomberg, FRB | Note: Asterisk refers to presidential election

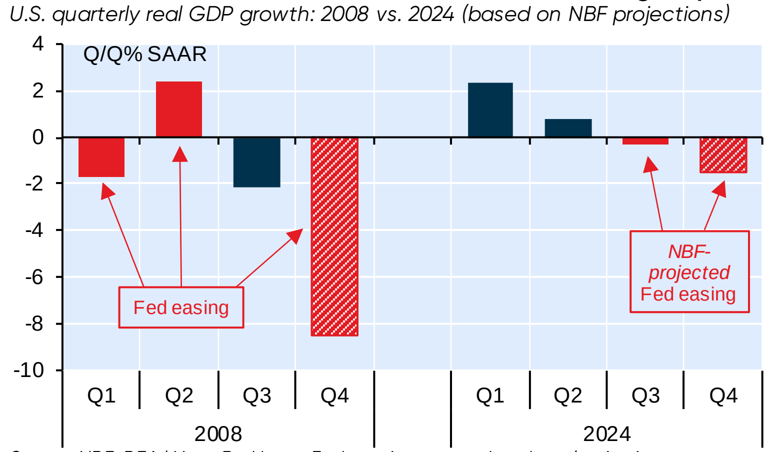
Historically, the FOMC hasn't had a problem cutting (or hiking) before/after elections. There's been a near-vote rate change 5 of the last 8 presidential elections. Perhaps a belief the Fed will 'stay out of it' has a certain latency effect, since policy was more stable during more recent presidential contests. Vitally, some of the more recent presidential votes occurred during a sluggish post-GFC recovery, which saw the Fed maintain a de-facto ZIRP for years. Back in 2020, COVID carnage drove rates to near zero well in advance of the vote. Today, a restrictive/high policy rate = higher cut probability.

Chart 5: Is there a tendency to push moves *after* elections?
Distribution of Fed decisions: Before/after presidential & midterm elections



Source: NBF, Bloomberg, FRB | Note: Since 1990; unscheduled decisions not included

Chart 6: An economic contraction in Q4 to outweigh 'optics'
U.S. quarterly real GDP growth: 2008 vs. 2024 (based on NBF projections)

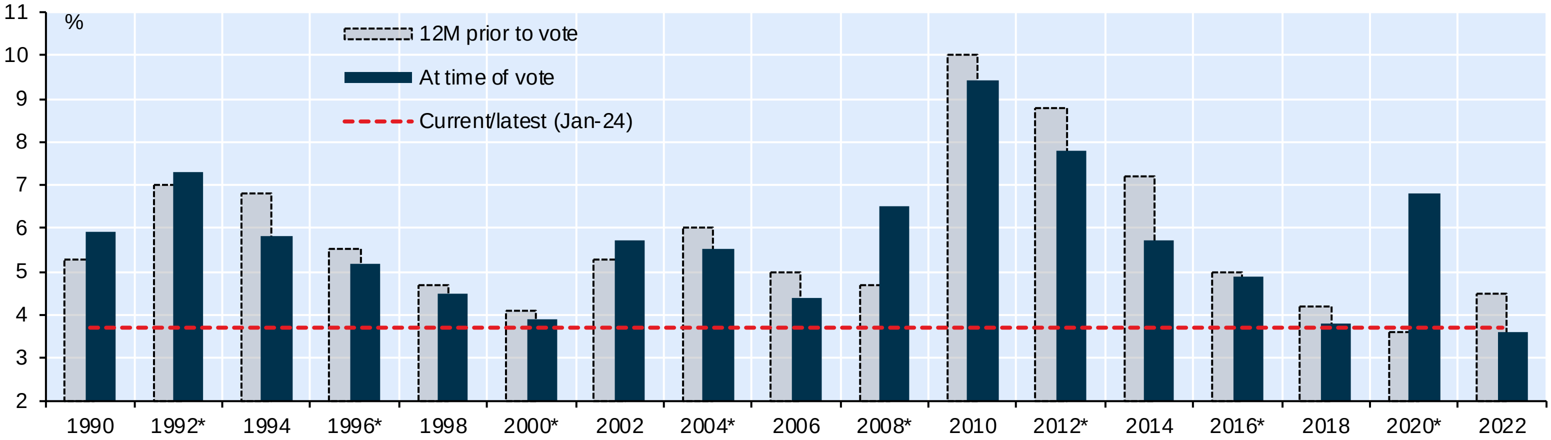


Source: NBF, BEA | Note: Red bar = Fed cuts in qtr; crosshatch = election in qtr

If one were to pick a single chart to illustrate an FOMC election bias, Chart 5 might be it. There's a lower incidence of policy rate changes prior to the vote vs. immediately after. Given the small sample size, we're hesitant to call this a legit 'smoking gun'. Even if there were situations where the Fed *might* delay a policy move due to a looming vote, we don't see 2024 as necessarily qualifying. First, the last meeting before the election is in mid-September. With a non-trivial gap of 48 calendar days (or almost 7 weeks), this might not constitute extreme proximity to the election. More to the point, our base case forecast has U.S. GDP contracting and inflation falling at election time. This might not be a full-on crisis but perceived 'optics' shouldn't stop the Fed from supporting a weakened economy.

Chart 7: Current conditions not exactly 'normal', either in U.S. labour market…

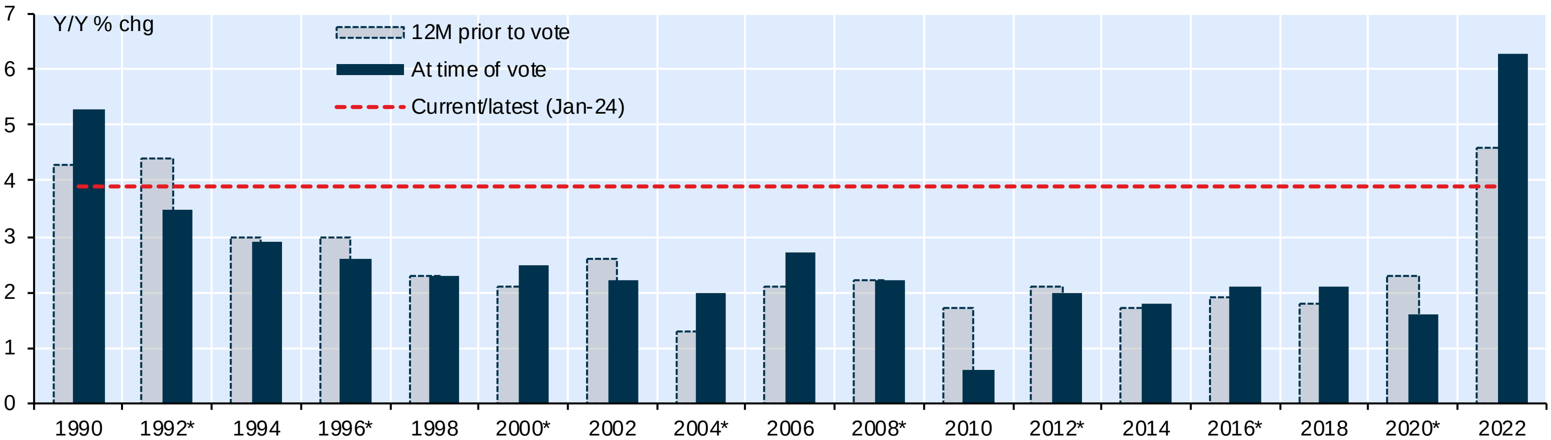
U.S. unemployment rate (level and trend direction) at time of prior elections vs. current/latest reading (3.7% as at Jan-24)



Source: NBF, Bloomberg | Note: Unemployment rate data lagged 1 month vs. election (i.e., at time of vote & 12M prior to vote both refer to October); asterisk is presidential election

Chart 8: … or more importantly, with respect to U.S. consumer price inflation backdrop

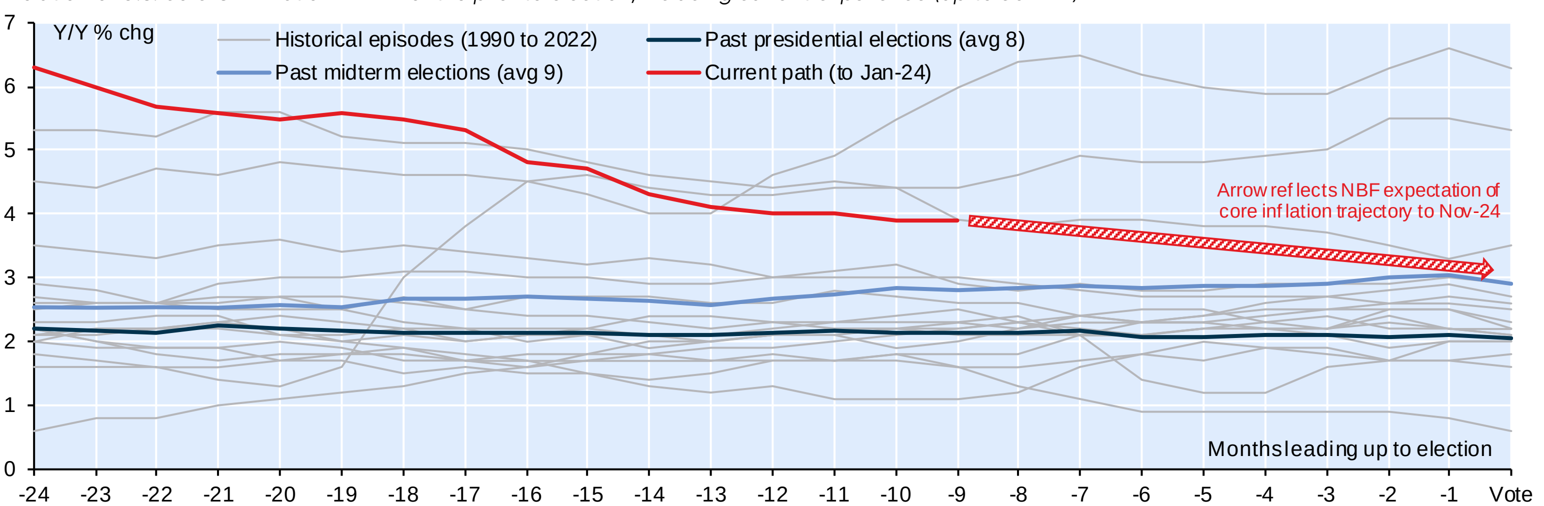
U.S. core CPI inflation (rate and trend direction) at time of prior elections vs. current/latest reading (3.9% as at Jan-24)



Source: NBF, Bloomberg | Note: Core CPI inflation data lagged 1 month vs. election (i.e., at time of vote & 12M prior to vote both refer to October); asterisk is presidential election

Chart 9: Since 1990, core inflation hasn't really behaved like this going into an election… with more relief by second half

Evolution of U.S. core CPI inflation in 24 months prior to election, including current experience (up to Jan-24)



Source: NBF, Bloomberg | Note: Red arrow is rough approximation; refer to Monthly Economic Monitor for NBF's detailed U.S. core CPI inflation forecast (link)

In closing, the current U.S. economic 'condition', with respect to labour markets and inflation, is both unusual and fluid. Most critically, underlying consumer price inflation has rarely, if ever, traced out a pre-election arc like the one we're seeing now (at least in the policy rate era). If, as we expect, U.S. growth is contracting, labour market slack is accumulating and core inflation is cooling further in the second half of the year, it would be appropriate for the Fed to engineer less-restrictive policy, cutting before and after November's vote. The marking of ballots (on its own) isn't a sufficient condition to stay the Fed's hand. Ironically, the U.S. political situation could influence the setting of monetary policy at the Fed, perhaps delaying cuts. But not necessarily the way some seem to believe. Fiscal largesse, highlighted by a yawning U.S. structural deficit, has spawned more growth yet but and stickier inflation too (all else being equal). Any amplification of U.S. fiscal stimulus (either delivered or promised on the campaign trail) could influence central bank thinking. This is true in other locales, including Canada, where fresh stimulus (more than pure election timing) is a monetary policy wildcard.

Market View

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