

February 27, 2024- (Vol. VIII, No. 19)

Get out (of the way of) the vote?

By Warren Lovely & Taylor Schleich

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

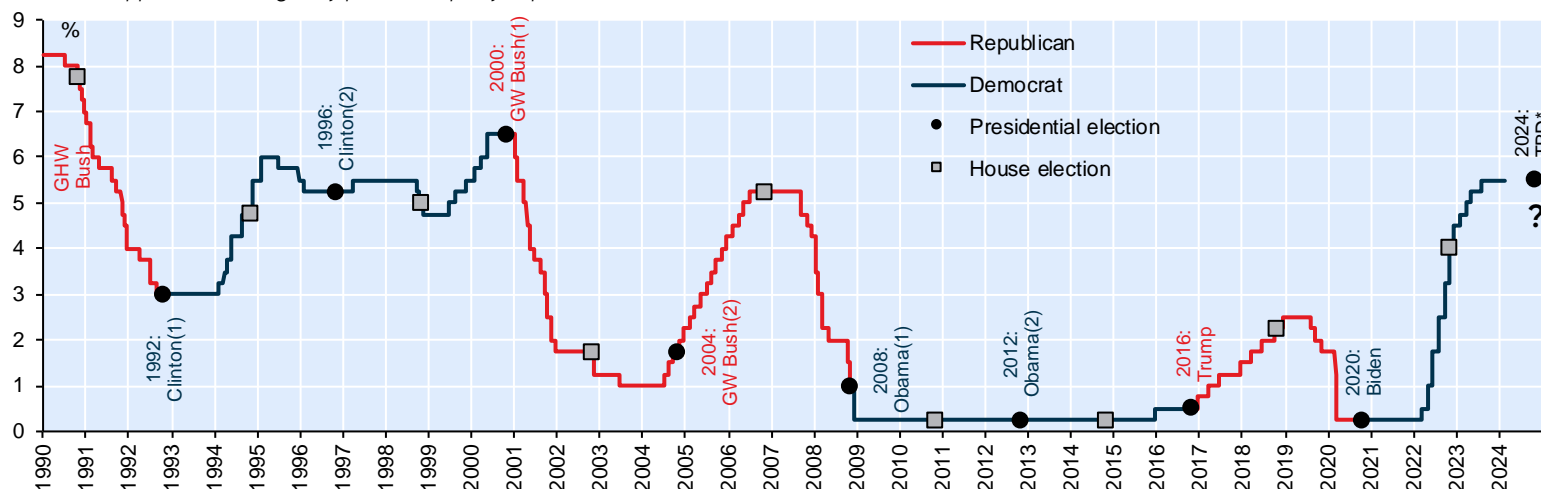
impossibility these days. Is there any evidence that the Fed has kept its target policy rate relatively stable in/around past presidential elections? Sure... although that may be down to sample bias more than anything. Is there an apparent tendency towards catch-up policymaking in the aftermath of a 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

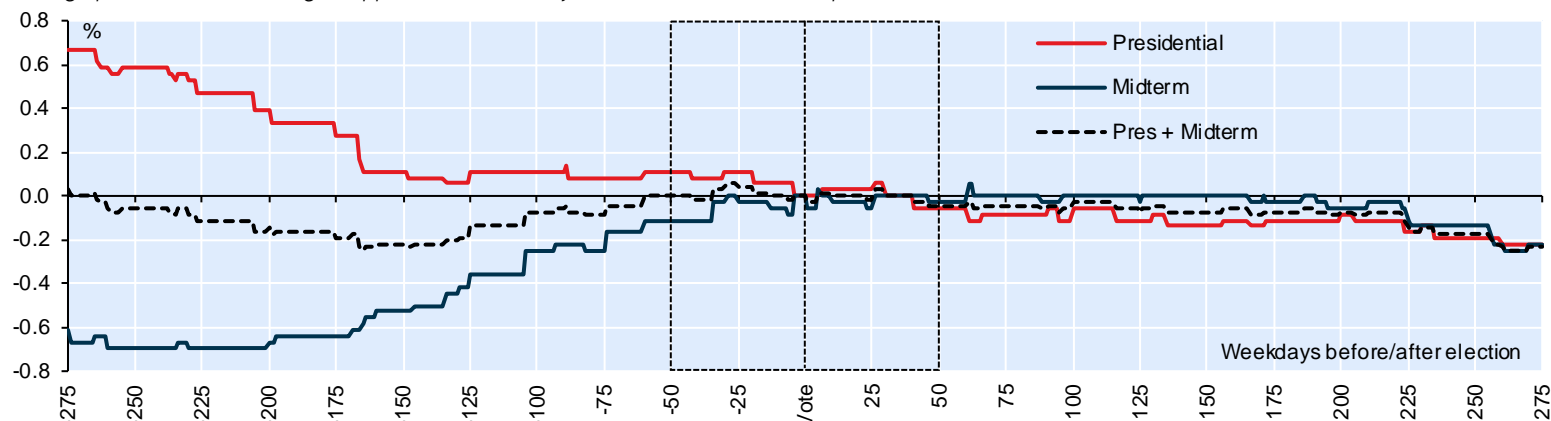


Source: NBF, Bloomberg, FRB | Note: Colouring on the basis of election date not inauguration date.

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

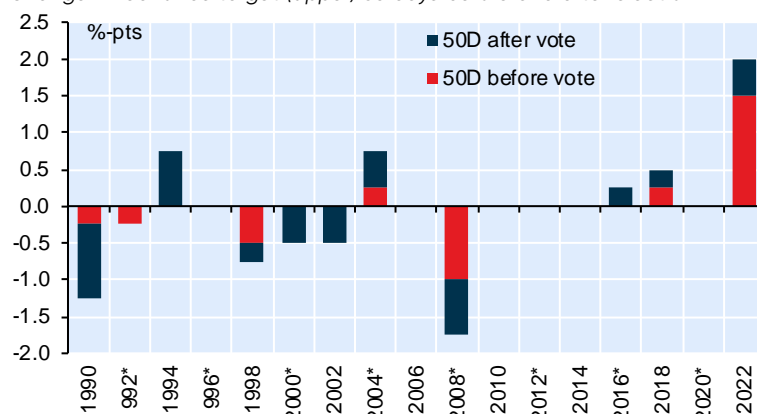


Source: NBF, Bloomberg, FRB | Note: Fed funds upper indexed to election day level; sample includes last 8 presidential & last 9 midterm elections (i.e., since 1990)

'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

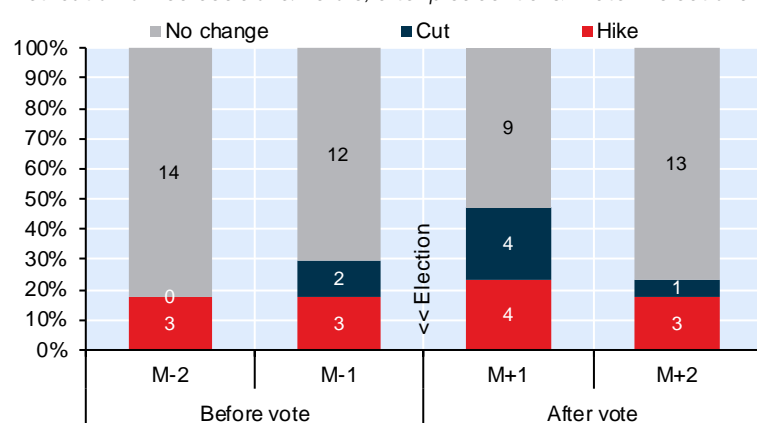


Source: NBF, Bloomberg, FRB | Note: Asterisk refers to presidential election

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

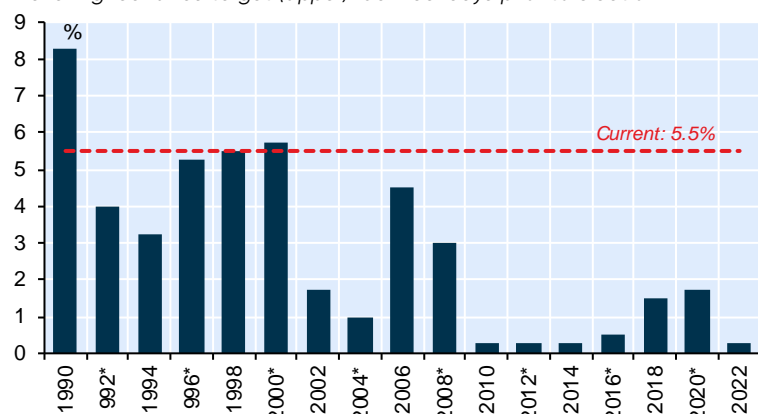


Source: NBF, Bloomberg, FRB | Note: Since 1990; unscheduled decisions not included

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 4: Naturally, ZIRP era saw elections without rate moves

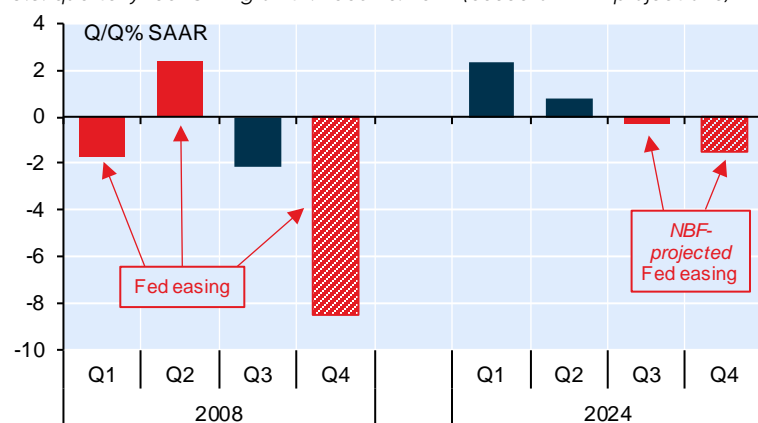
Prevailing fed funds target (upper) 180 weekdays prior to election



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

Chart 6: An economic contraction in Q4 to outweigh 'optics'

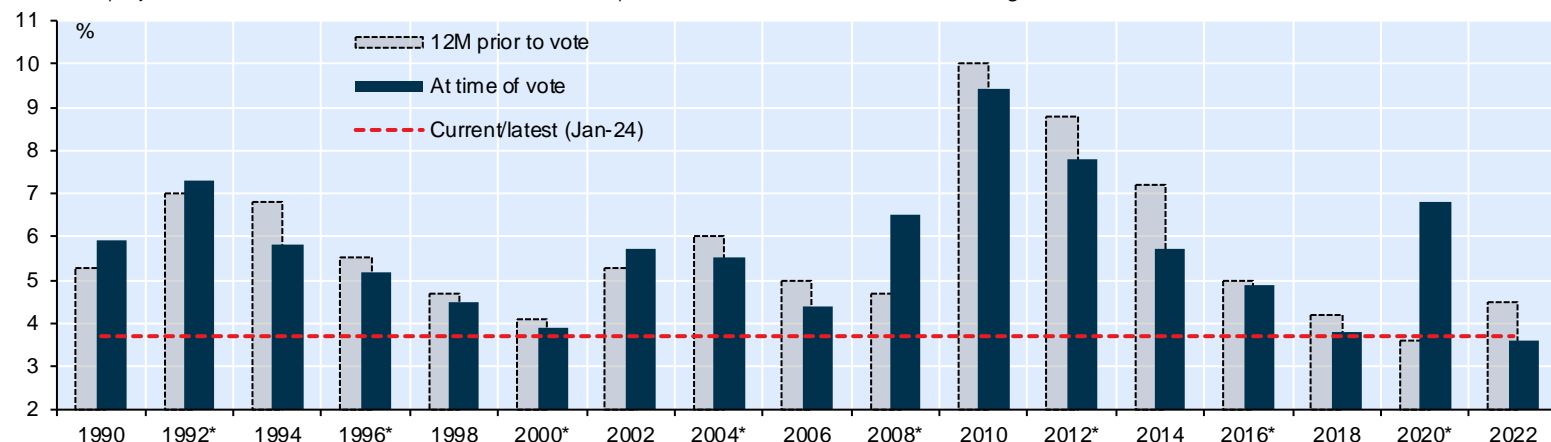
U.S. quarterly real GDP growth: 2008 vs. 2024 (based on NBF projections)



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

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

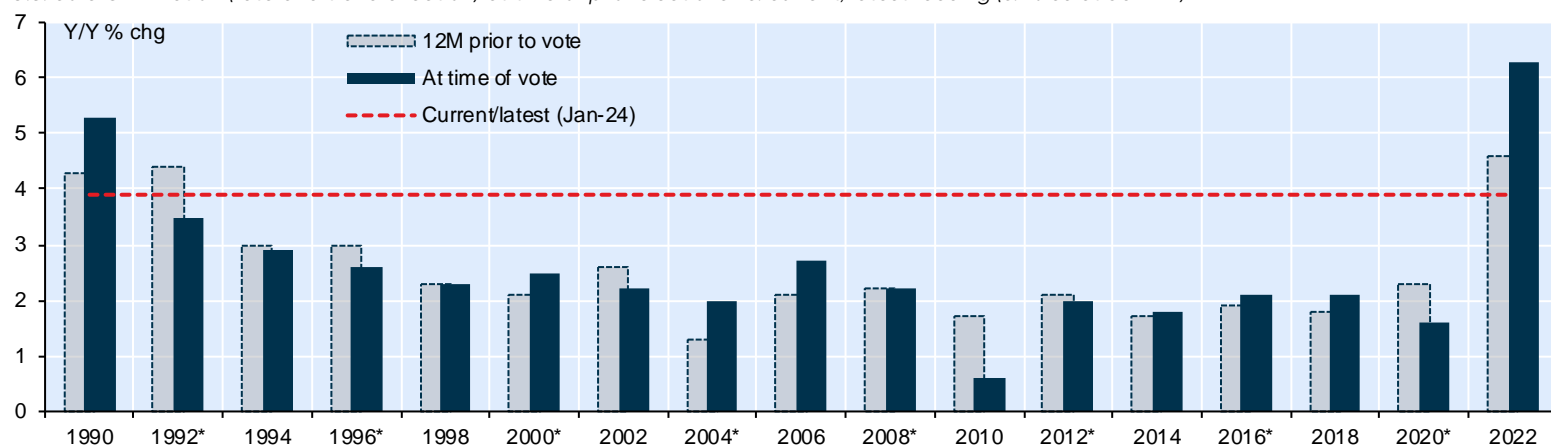
U.S. unemployment rate (level and trend direction) at time of prior elections vs. current/latest reading (3.7% as at Jan-24)



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

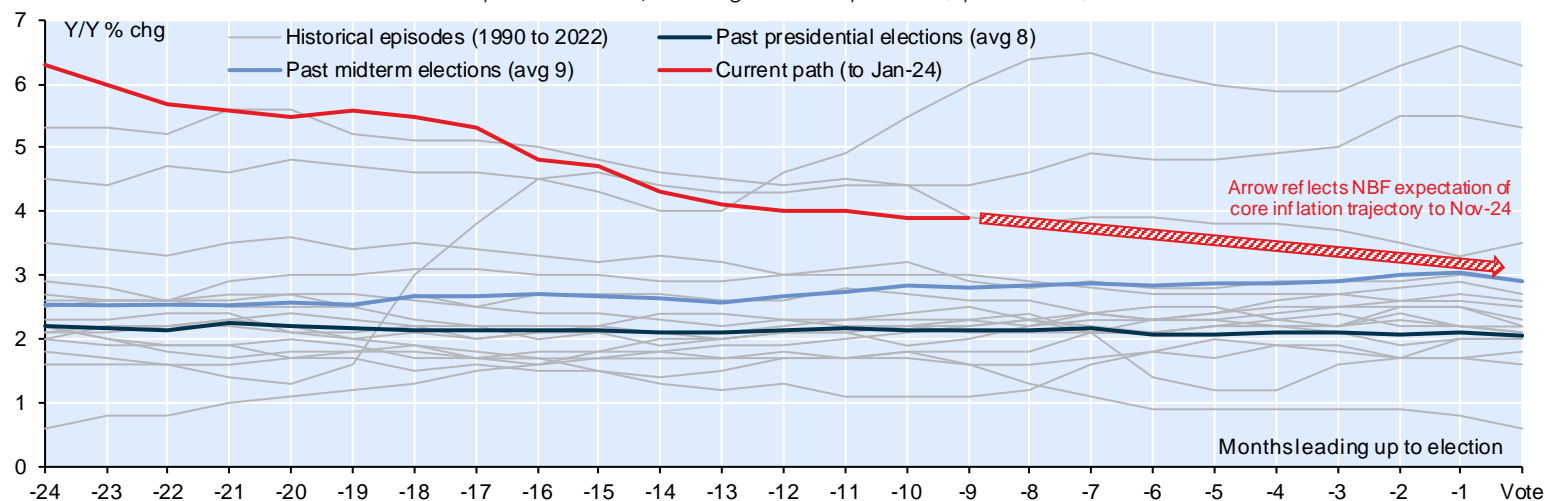
U.S. core CPI inflation (rate and trend direction) at time of prior elections vs. current/latest reading (3.9% as at Jan-24)



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.



Montreal Office 514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Alexandra Ducharme

Economist
alexandra.ducharme@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Daren King, CFA

Economist
daren.king@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Toronto Office 416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.

UK Residents



This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

US Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major US Institutional Investors only.

This report is not subject to US independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc., is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.