

## US Midterm Elections: Change of Course?

- The upcoming US midterm elections appear likely to prompt a course-correction in Washington politics that will place limits on President Trump's economic and political agenda, with a hostile House of Representatives likely to challenge Trump on multiple fronts.
- Based on recent polls, as we enter final stretch of the campaign, there is a reasonably high probability that the Democratic Party will see a net gain of more than 23 seats and become the majority party in the House of Representatives.
- The very slim Republican majority in the Senate may be maintained as there are fewer vulnerable Republican seats up for re-election in the current election cycle. Various analyses of the Senate race assign higher odds that the Republicans will hold onto the Senate.
- From the legislative view point, partisan agendas are unlikely to go very far with a divided government as the House, Senate and President must agree. That leaves Congress likely on a spending path similar to its current budget spending caps for fiscal year 2019.
- A hostile Democratic House will demand much of the Administration's attention with investigations and subpoenas into the workings of the Administration and its policy agenda. Assuming the Senate remains under Republican control, President Trump would continue to make important nominations for vacant positions in the judiciary and the Federal Reserve.

### Summary

**The upcoming US midterm elections appear likely to prompt a course-correction in Washington politics that will place limits on President Trump's economic and political agenda, with a hostile House likely to challenge Trump on multiple fronts.** In this brief, we review the current state of play in front of the 6-November elections. We follow that with an analysis of the economic and market implications.

### Time to face the voters

The entire House of Representatives (435 seats) is elected every two years, with midterm elections falling halfway through the President's 4-year term. Roughly 1/3 of the Senate seats (35 out of 100) will also be contested in the 6-November 2018 elections.

**Republicans currently control both houses of Congress.** As of the beginning of September, the Republican majority in the House of Representatives consists of 236 seats vs 193 for the Democrats, with 6 vacant. Democrats would need to gain an additional 23 seats, at minimum, to take control of the House.

In the Senate, Republicans control 51 seats vs 49 for the Democratic caucus, which includes the 47 Democratic Senators plus Bernie Sanders and Angus King, who are independents but caucus with the Democrats. Here, the Democrats would need to flip 2 seats in their favor to take control (as flipping only one would leave a 50-50 tie with Vice President Pence acting as the tie-breaking vote if necessary).



**Michael Carey**  
Chief Economist US  
+1 212 261 7134  
michael.carey@ca-cib.com



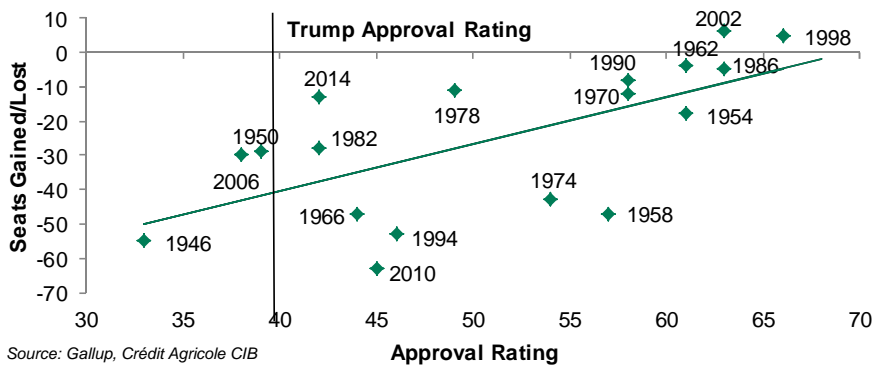
**Nicholas Van Ness**  
US Associate  
+1 212 261 7601  
nicholas.vanness@ca-cib.com

## Analysis of current polls suggests the Democrats will win the House

Based on recent polls and historical election results, there is a reasonably high probability that the Democratic Party will see a net gain of more than 23 seats and become the majority party in the House of Representatives.

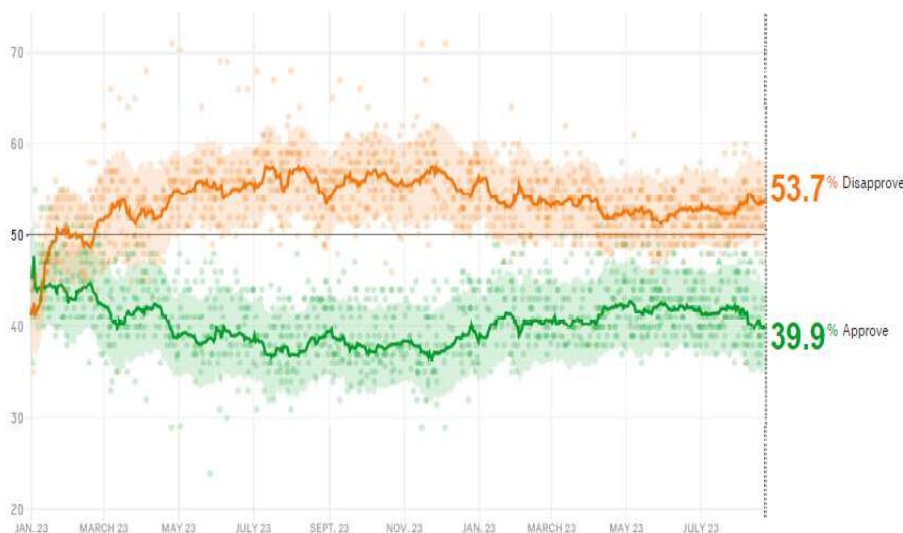
**The incumbent President's party generally loses House seats at the midterm election with the number of seats lost correlated with the popularity of the President.** The elections allow citizens to voice their opinion about the performance of the occupant of the White House half way through his four-year term. According to Gallup, since 1946 Presidents with approval ratings of less than 50% have seen their party lose an average of 36 seats in the House. Even Presidents with approval ratings of above 50% have seen an average loss of 14 House seats for their party, with only two instances of gains (Clinton '98 and Bush '02, who both had approval ratings above 60%; see below graph and table in appendix).<sup>1</sup>

### Presidential Job Approval vs. House Seats Gained/Lost in Midterms



**This does not bode well for Republicans, as Mr. Trump's approval rating has dropped below 40%** in the latest composite polls from Nate Silver.<sup>2</sup> This would imply a loss of over 40 seats based on historical trends, more than enough for the Democrats to retake control of the House.

### President Trump Approval Rating

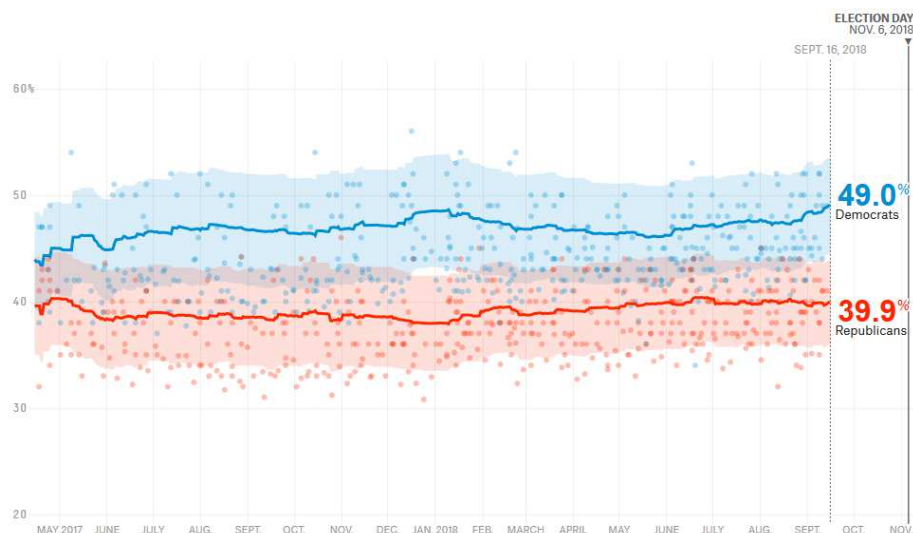


<sup>1</sup> See discussion at: <https://news.gallup.com/poll/141812/avg-midterm-seat-loss-presidents-below-approval.aspx>

<sup>2</sup> FiveThirtyEight.com

**Additional evidence of the Democrats' lead comes from so-called "generic congressional ballot" preferences.** In such polls, the Democrats' edge of 49.0% to 39.9%<sup>3</sup> suggests vulnerabilities for Republicans. However, Republicans have a districting advantage, discussed below, that suggests Democrats must overcome a 5-6 percentage point hurdle in the popular vote to win the House majority.

### Generic Congressional Ballot



Source: FiveThirtyEight

### Democratic strategies

**Democrats have the advantages in approval/poll numbers outlined above plus high voter enthusiasm.** Democrats are fielding candidates in nearly every congressional district (430). That's many more constituencies in which they have competed than in the past. In addition, there are many more "open seats" where the Republican incumbent is not running for re-election (44 for the Republicans vs 22 open seats with Democratic incumbents).

**Recent special elections have also shown that Democrats can successfully challenge Republicans where the Republicans have been traditionally favoured.** Trump's campaigning helped drive Republican voters in primaries, such as the gubernatorial race in Florida, which was won by the candidate he endorsed. However, Trump's record has been mixed in special elections pitting a Republican against a Democrat.

### Republican strategies

**Republicans hope to overcome the obstacles they are facing in the midterms with a focus on a strong economy, with GDP growth of over 4% in 2Q helped by tax cuts, a strong stock market and robust labor markets.**

**The Republican candidates have a districting advantage,** reflecting the fact that Democratic voters are more concentrated in urban core districts while Republicans are more widely distributed across districts. This explains why Trump could lose the popular vote by nearly 3 million in the 2016 election and yet win more congressional districts than his Democratic opponent. That means that the Democrats likely have to win the popular vote by a spread of 5-6 percentage points to translate into a Congressional victory.

In addition, Republicans have an advantage due to partisan gerrymandering of Congressional districts, although this advantage was likely lessened after a court-mandated redistricting in Pennsylvania, where polls suggest the Democrats are

<sup>3</sup> FiveThirtyEight.com

likely to flip some seats in the newly-drawn districts. The resolution of a similar court-mandated redistricting in North Carolina prior to the midterms remains unclear.<sup>4</sup>

**Trump's political base maintains its strong support for Republican candidates and Republicans have historically been able to motivate their supporters to vote more reliably than Democrats at midterm elections.** But that advantage is less significant when a Republican President is in power. Additionally, a survey conducted for the Republican National Committee shows that most Trump supporters don't think there is a risk that Democrats will take control of the House, suggesting that this complacency may diminish turnout amongst Republican voters.

**Our sense is that it will be moderate Republicans and independent voters that may determine the winner in many races, and Trump's polarizing style and policies have led to a loss of some support from these constituencies.** Moreover, Trump's support on the campaign trail could be counter-productive as it may increase Democratic voter anger and turnout on Election Day.

### House outlook

**Most forecasters have had the electoral map moving in favour of the Democrats in recent weeks, with a number of Republican districts seen as vulnerable.**

**Current forecasts have the Democrats as moderate to strong favorites to retake control of the House.** The three different methodologies from Nate Silver's FiveThirtyEight give the Democrats a chance of between 75-82% of winning control of the house, with average gains of between 35 and 38 seats.<sup>5</sup> Sabato's Crystal Ball at the University of Virginia Center for Politics has a 238-197 seat edge for the Democrats in the latest simulations from their model.<sup>6</sup>

Market betting sites such as *PredictIt* put odds of a Democratic House at 69 percent vs 31 percent for continued Republican control.<sup>7</sup>

### Predicted House Outcome from Generic Congressional Ballot

Democratic Outcome		
Popular Vote Margin	Projected Seat Gain	Chance of Winning House
10-11%	+46	>99%
9-10%	+41	>99%
8-9%	+36	98%
7-8%	+32	92%
6-7%	+27	78%
5-6%	+24	56%
4-5%	+20	29%
3-4%	+16	11%
2-3%	+13	3%
1-2%	+10	<1%
0-1%	+7	<1%

Source: FiveThirtyEight<sup>8</sup>, Crédit Agricole CIB

**While over three quarters of the races have a solid favorite, there are 102 competitive races identified by a WSJ analysis of political forecasters, with Republicans much more at risk as they currently hold 90 of these 102 seats.**

In the 60 races classified by the WSJ as highly competitive, a full 56 of the seats are currently held by Republicans. Among these seats, 38 leaned Republican by 5 points or less based on the past two presidential elections, 25 voted for Clinton

<sup>4</sup> See discussion at <https://www.vox.com/policy-and-politics/2018/8/29/17795920/2018-midterms-north-carolina-gerrymandering-case-supreme-court>

<sup>5</sup> See further info at (forecast updated daily so numbers may not match): [https://projects.fivethirtyeight.com/2018-midterm-election-forecast/house/?ex\\_cid=rrpromo](https://projects.fivethirtyeight.com/2018-midterm-election-forecast/house/?ex_cid=rrpromo)

<sup>6</sup> See further info at (forecast may be updated): <http://www.centerforpolitics.org/crystalball/>

<sup>7</sup> See further info at: <https://www.electionbettingodds.com/>

<sup>8</sup> <https://fivethirtyeight.com/features/election-update-democrats-are-in-their-best-position-yet-to-retake-the-house/>

in 2016 (5 by double digits), 28 had fundraising disadvantages for the Republican candidate, and 38 had Democratic opponents with significant cash on hand.<sup>9</sup>

**Additionally, there are a number of Republican districts affected by some of the more policy-specific vulnerabilities.** As identified in an analysis by the WSJ, of the 20 districts with the highest percentage taking state and local tax (SALT) deductions, 7 are currently considered vulnerable, all of which are held by Republicans. About one-third of vulnerable Republican seats are in districts in which 10% or more of local output has been affected by tariffs and a number of Republican controlled districts have lagged behind the national economy according to an economic health index created by the Institute for International Finance.<sup>10</sup>

## Senate Outlook

**The very slim Republican majority in the Senate may be maintained as there are fewer vulnerable Republican seats up for re-election in the current election cycle.** Various analyses of the Senate race assign 68%-71% odds that the Republicans will hold onto the Senate.<sup>11</sup> Market betting odds from PredictIt give the Republicans a 69% chance of holding on to the Senate compared to a 31% chance of the Democrats taking control.<sup>12</sup>

**Of the 35 races being contested in 2018 (including 2 special elections), Republicans only have to defend 9 seats as opposed to 26 for the Democrats.** According to the Cook Political Report, 11 of these races are currently rated as a “tossup” or as “leaning” Republican or Democrat. Focusing on those 11 races, 4 seats are currently held by Republicans and 7 by Democrats; hence, the Democrats have a larger number of vulnerable seats in the Senate than the Republicans.<sup>13</sup>

Of the 4 vulnerable Republican seats, all but one are in states that voted for Trump in 2016, with the only exception being Dean Heller in Nevada. Of the 7 vulnerable Democratic seats, all but one are also in states that voted for Trump, with the exception being Tina Smith in Minnesota, who was appointed to fill the vacant seat after the resignation of Al Franken and is now running in a special election.

For the Democrats to win the Senate, it would likely take a very large “blue wave” of Democratic voters in many counties.

## Implications for Democratic control of House of Representatives

**Legislative agenda:** We have had divided governments before. **Partisan agendas are unlikely to go very far, given the need for House and Senate to agree on and President Trump to sign legislation.** For example, the recently proposed House legislation to make permanent various tax provisions that are currently set to expire, such as the reduction in individual tax rates, is not expected to go anywhere.

The only obvious area where President Trump and the Democrats might share common ground would be infrastructure building projects. However, given the current prospects of rising trillion dollar deficits over the near-term horizon, funding such projects would be difficult.

**That leaves Congress likely on a spending path similar to its current budget spending cap agreement for fiscal year 2019.** Continuing resolutions will likely be passed along with debt ceiling increases to avoid partial government

<sup>9</sup> See discussion at: [https://www.wsj.com/graphics/house-seats-in-play-2018/?mod=article\\_inline?mod=hp\\_lead\\_pos6](https://www.wsj.com/graphics/house-seats-in-play-2018/?mod=article_inline?mod=hp_lead_pos6)

<sup>10</sup> See discussion at: <https://www.wsj.com/articles/in-battle-for-congress-rising-economy-doesnt-lift-all-districts-1535994483>

<sup>11</sup> See further info at (forecast updated daily so numbers may not match): [https://projects.fivethirtyeight.com/2018-midterm-election-forecast/senate/?ex\\_cid=midterms-header](https://projects.fivethirtyeight.com/2018-midterm-election-forecast/senate/?ex_cid=midterms-header)

<sup>12</sup> See further info at: <https://www.electionbettingodds.com/>

<sup>13</sup> See further info at (forecast may be updated): <https://www.cookpolitical.com/ratings/senate-race-ratings>

shutdowns. If there is any drama on that front it would more likely come from President Trump over funding for his border wall or other policy wants than from Congress.

**Federal Reserve: Assuming the Senate remains under Republican control, President Trump would continue to make nominations for vacant positions at the Federal Reserve.** Recently, the President expressed his displeasure with the current Fed policy projection for higher interest rates. We do not believe the President will influence current members of the Board of Governors to lean towards policies seen as favourable to Trump or the Republicans. His choices to fill the three current vacancies could have some impact depending on his nominations; however, so far President Trump's nominees have been from the economic mainstream. President Trump will have his choice of judicial nominees and would be expected to continue to appoint conservative jurists to the bench.

**With the Democratic majority heading various Congressional committees, we suspect many meetings to investigate the President, his policies and his cabinet.** A hostile House will demand much of the Administration's attention with investigations and subpoenas and the Administration's other policy agendas will suffer.

The Mueller investigation still looms large in the background. We believe that moves to impeach the President are only likely to move forward if Muller's investigation turns up significant wrongdoing on the part of Mr. Trump. Impeachment is tried in the Senate, which is expected to remain under Republican control.

**President Trump would continue to exercise power in international affairs in line with the Executive's constitutional prerogatives.** The House might take a more assertive role on international trade issues in line with its Constitutional purview, but President Trump will still likely have leeway to continue with his protectionist agenda. However, the president might well lose current "Fast Track" trade negotiation authority.

### Alternative Scenarios

In the event that Democrats were able to take control of the Senate in addition to the House, gridlock would likely also result. Even with control of both houses of Congress, Democrats would likely have only a slender majority in the Senate and would not have the 60 necessary votes to override a filibuster for any major piece of legislation; if they were able to pass budget legislation through the reconciliation process, necessitating only a majority (as the Republicans did for the 2017 tax cuts), they would also have to contend with a potential veto from President Trump. Investigations would be expected to pick up, with impeachment more likely, although still dependent on the Mueller investigation. There is a good chance Judicial nominations would stall but the Fed would likely see 3 new centrist members.

If the Republicans were to keep control of the House, we would remain in the status quo. Major pieces of legislation would remain unlikely as Democrats would have the ability to filibuster in the Senate, although President Trump would have more leeway in his judicial and Fed nominations. The Mueller investigation would continue, but impeachment would be less likely as it would be unlikely to move through a Republican controlled Congress outside of any findings of significant wrongdoing.

## Appendix

### *Presidential Approval Ratings and Midterm U.S. House Seat Change for President's Party*

Year	President/Political party	% Approval, final Gallup poll before midterm	Seat gain/loss in U.S. House for president's party
1998	Clinton/Democrat	66	+5
2002	G.W. Bush/Republican	63	+6
1986	Reagan/Republican	63	-5
1962	Kennedy/Democrat	61	-4
1954	Eisenhower/Republican	61	-18
1990	G.H.W. Bush/Republican	58	-8
1970	Nixon/Republican	58	-12
1958	Eisenhower/Republican	57	-47
1974	Ford/Republican*	54	-43
1978	Carter/Democrat	49	-11
1994	Clinton/Democrat	46	-53
1966	Johnson/Democrat	44	-47
1982	Reagan/Republican	42	-28
1950	Truman/Democrat	39	-29
2006	G.W. Bush/Republican	38	-30
1946	Truman/Democrat	33	-55

\*Ford took office in August 1974, about three months before the midterm elections, after President Nixon resigned (Nixon had a 24% approval rating at the time of his resignation).

### GALLUP

## Global Markets Research contact details

Jean-François Paren Head of Global Markets Research +33 1 41 89 33 95				
	Asia (Hong Kong & Tokyo)	Europe (London & Paris)		Americas (New York)
<b>Macro Strategy</b>	Kyohei Morita Chief Economist Japan +81 3 4580 5360	Louis Harreau ECB Strategist +33 1 41 89 98 95	Xavier Chopard Global Macro Strategist +33 1 41 89 13 45	Michael P. Carey ** Chief Economist US +1 212 261 7134  Nicholas Van Ness ** US Associate +1 212 261 7601
<b>Interest Rates</b>	Yoshiro Sato Economist / Strategist - Japan +81 3 4580 5337	<b>Mohit Kumar</b> <b>Global Head of Rates Strategy</b> <b>+44 20 7214 6651</b>  Orlando Green CFA Interest Rates Strategist +44 20 7214 7467	Afsaneh Mastouri Interest Rates Strategist +44 20 7214 6737  Marine Mazet Quant & RV Strategist +44 20 7214 5570	Jean-François Perrin Inflation Strategist +33 1 41 89 94 22
<b>Emerging Markets</b>	Dariusz Kowalczyk Senior Emerging Market Strategist +852 2826 1519  Samsara Wang Emerging Market Strategist +852 2826 1590  Gary Yau Emerging Market Strategist +852 2826 1553	<b>Sébastien Barbé</b> <b>Head of Emerging Market Research &amp; Strategy</b> <b>+33 1 41 89 15 97</b>  Guillaume Tresca Senior Emerging Market Strategist +33 1 41 89 18 47	Jakub Borowski Chief Economist - Crédit Agricole Bank Polska SA +48 22 573 18 40  Alexander Pecherytsyn Chief Economist – Crédit Agricole Bank Ukraine +38 44 493 9014	Italo Lombardi ** Senior Emerging Market Strategist +1 212 261 7994
<b>Foreign Exchange</b>	David Forrester FX Strategist +852 2826 1529	<b>Valentin Marinov</b> <b>Head of G10 FX Research &amp; Strategy</b> <b>+44 20 7214 5289</b>	Jennifer Hau FX Strategist +44 20 7214 7468	Manuel Oliveri FX Strategist +44 20 7214 7469

\*\* employee(s) of Crédit Agricole Securities (USA), Inc.

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10/08/18

## MiFID II contact details

**Yann Marhic**

 Global CACIB MiFID II contact  
[yann.marhic@ca-cib.com](mailto:yann.marhic@ca-cib.com)
**Audrey Thouvenin**

 MiFID II research contact  
[audrey.thouvenin@ca-cib.com](mailto:audrey.thouvenin@ca-cib.com)

Please send your questions on

 MiFID II to:  
[research.mifid2@ca-cib.com](mailto:research.mifid2@ca-cib.com)