



STICKY NOTES BY THE IIF

U.S. Mid-term Election Edition

Welcome back to Sticky Notes, the IIF's review of this week's events in international economics and politics.

We love hearing from our readers, so please send us your thoughts by emailing us at stickynotes@iif.com. Thank you to those readers who sent questions and comments ahead of this week's Note.

In advance of U.S. mid-term elections Tuesday, November 6th, today we are issuing an "all politics" edition of Sticky Notes, where we break down some of the factors that may impact this year's election. Before we begin, it's worth noting that this is an election with lots of twists and turns. For example, over the course of the 10 weeks between August 9th and October 18th, the [Tennessee Senate race](#), one of the key battlegrounds, flipped by 13 percentage points, partially because of voter opposition to Democratic tactics during the Kavanaugh hearings. We don't discount the possibility of additional shifts in the 12 days remaining.

As of today, Real Clear Politics is [showing](#) a solid lead for Republicans in Senate races, in part because of the strong structural advantage for Republicans this cycle; only 9 Republican seats are up for reelection, whereas Democrats are defending 26 seats. Polls are still [showing](#) a slight Democratic edge in the House, suggesting that Speaker Pelosi may take back the gavel in January.

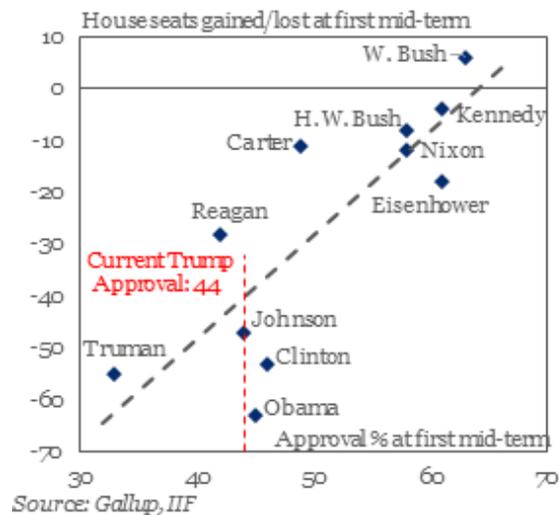
House Likely to Flip

In general, there are two categories of House swing seats: 1. Districts which voted for Obama in 2008 and 2012, but voted for Trump in 2016. 2. Traditionally Republican districts in the suburbs with more moderate Republican and women voters who have been turned off by Trump's style of leadership. Polls point to historically low percentages of women expressing a GOP-Congressional preference. The latter group of suburban voters is the focus of many of the expert predictions that the House will flip. Of the 46 GOP-held districts the Cook Political Report rates as [most vulnerable](#), 33 (70%) are in suburban areas. Democrats need to flip 23 seats to gain control of the House. As Dave Wasserman [noted](#), "Democrats are doing really, really well anywhere that's within a 20 minute drive from a Whole Foods Market."

Presidential Approval Ratings

For purposes of understanding the general political climate in the U.S., one perennially important barometer is Presidential approval ratings. Issues vary from election to election, but the party out of the White House typically makes the mid-term a “referendum on the President.” Historic averages would suggest that Trump’s approval in the mid-40’s could lead Republicans in the House to lose about 40 seats, though we tend to think they will lose fewer, in part because Trump’s approval rating in competitive House seats is higher than his national average, and in part because many voters disapprove of Trump’s personal qualities rather than policies they associate with Republicans in Congress.

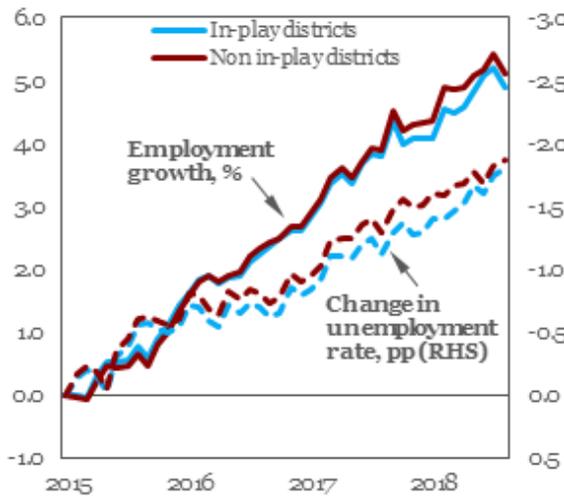
Approval Ratings vs. House Seats at First Mid-term



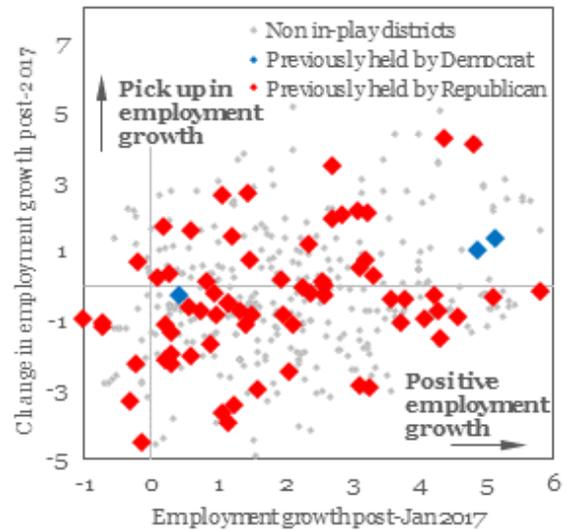
Impacts of the Economy

One of the interesting questions we’ve debated internally is the role the economy will play this round. On the one hand, the U.S. economy is going gangbusters – the lowest unemployment rate in decades, strong economic growth, and a stock market at record highs until a few weeks ago should provide strong tailwinds for the party in power. Although there are slight divergences, employment is strong even in most of the competitive House races.

Aggregate Look at Employment Growth and Unemployment Rates across House Districts



Employment Growth Across House Districts



Historically there is no clear correlation between the mid-term outcome and overall economic performance. In some elections, specific economic issues – gas prices or inflation – play a key role, but the overall economic performance doesn't correlate closely. In fact this year, voters mentioning economic issues as the nation's most important challenge is at a [20-year low](#), although they continue to cite health care as a key issue.

First Mid-term Election: House Seats Gained/Lost, Approval Ratings, and Economic Data

President	House Seats Gained/Lost	Approval Rating	Real GDP Growth ¹	U/E Rate ²	Real Weekly Earnings ³	Change in Mortgage Rates ⁴	Inflation ⁵	Change in gas prices ⁶	S&P 500 from prior all-time high
Trump (2018)	?	44%	3.0%	3.8%	2.2%	0.9%	2.3%	36.5%	-6.9%
Obama (2010)	-63	45%	3.2%	9.5%	8.3%	-0.7%	1.2%	25.0%	-23.9%
W. Bush (2002)	+6	63%	2.2%	5.7%	4.3%	-0.5%	2.0%	13.0%	-42.5%
Clinton (1994)	-53	46%	4.3%	6.0%	0.8%	2.1%	2.6%	2.2%	-1.9%
H.W. Bush (1990)	-8	58%	1.7%	5.7%	-10.6%	0.2%	6.3%	15.0%	-14.8%
Reagan (1982)	-28	42%	-2.6%	9.9%	-4.4%	-3.8%	5.1%	-6.9%	-2.2%
Carter (1978)	-11	49%	5.3%	6.0%	-3.1%	0.9%	8.9%	1.6%	-15.1%
Nixon (1970)	-12	58%	0.4%	5.2%	-5.6%	0.3%	5.6%	2.9%	-20.8%
Johnson (1966)	-47	44%	6.0%	3.8%	0.3%	0.7%	3.8%	3.2%	-17.3%
Kennedy (1962)	-4	61%	6.0%	5.6%	N/A	N/A	1.3%	0.1%	-21.7%

¹ y/y real GDP growth in Q3 of first midterm election year. ² Average headline unemployment rate in Q3.

³ y/y real average weekly earnings growth for production & non-supervisory workers in Oct. of election year.

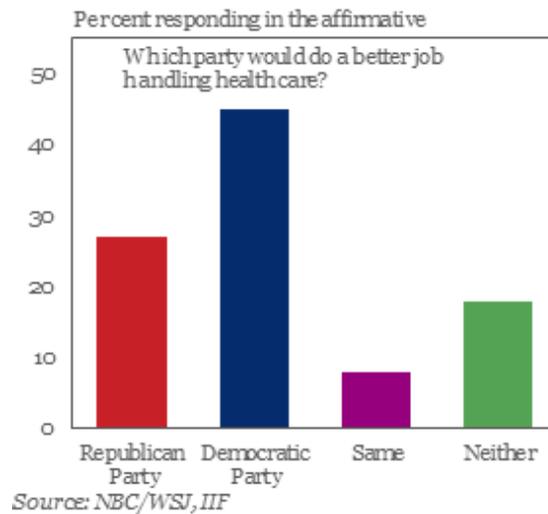
⁴ y/y change in national average 30-year fixed mortgage rate (contract rate) in Oct. of election year in percentage points.

⁵ y/y inflation based on headline consumer price index in Oct. of election year.

⁶ y/y change in national average retail, regular-grade gasoline prices in Oct. of election year.

Source: Gallup, BEA, BLS, Freddie Mac, EIA, Haver, IIF

Party Handling of Health Care



Moreover, as we've pointed out [previously](#), trade policy is having an interesting impact. Tariffs from China and other countries have purposely targeted GOP states and constituencies, with an outsized impact on agriculture exporters. Of the most agriculture-oriented House districts – many of which are currently controlled by Republicans and strongly supported Trump in 2016 – nearly 20 are considered vulnerable by Real Clear Politics.

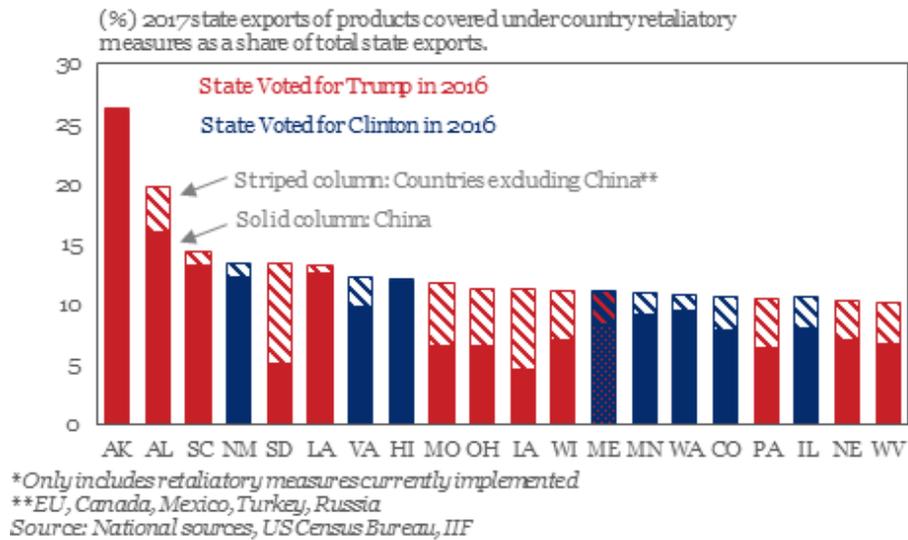
Tight Races in Agriculture-Oriented* House Districts

State-District	Current Party Control	Trump 2016 Net Vote %	Real Clear Politics Score
AZ-1	Dem	+1.1	Leans Dem
CA-10	GOP	-3.0	Toss Up
CA-21	GOP	-15.5	Leans GOP
IA-1	GOP	+3.5	Leans Dem
IA-3	GOP	+3.5	Toss Up
IL-13	GOP	+5.5	Leans GOP
KS-2	GOP	+18.4	Toss Up
MI-6	GOP	+8.4	Leans GOP
MI-7	GOP	+17.0	Leans GOP
MN-1	Dem	+14.9	Toss Up
MN-2	GOP	+1.2	Leans Dem
MN-7	Dem	+30.8	Leans Dem
MN-8	Dem	+15.6	Leans GOP
MT-1	GOP	+20.6	Leans GOP
NC-13	GOP	+9.4	Toss Up
NM-2	GOP	+10.2	Toss Up
NY-27	GOP	+24.5	Leans GOP
PA-10	GOP	+8.9	Leans GOP
WA-5	GOP	+13.1	Leans GOP

*Districts are in top quartile of agricultural production by value

Source: USDA, Real Clear Politics, IIF

Republican states targeted more by retaliatory tariffs



In other words, the strength of the overall economy won't shield Republicans from the impacts of a president with dismal approval ratings, individual economic issues like health care are working to the benefit of Democrats, and trade policy may work to Democratic advantage in some key swing seats.

Less-Important Factors

There are a few frequently cited factoids we, on the Sticky Notes team, are under-weighting for purposes of election analysis.

- First, we don't think the "generic ballot" tells us much at this point. The generic ballot asks voters, "If the election were held today, would you vote for the Republican candidate or for the Democratic candidate?" According to Real Clear Politics' [average of polls](#), the Democrats have held a 4-8% advantage on the generic ballot for most of the past year. Historically, a double-digit gap in the generic ballot correlates strongest with a "wave" outcome, but a smaller gap is less revealing. What's more, although the national generic ballot has signaled a sustained Democrat advantage, generic ballot polls conducted in competitive House districts are [virtually tied](#), and President Trump generally enjoys a higher approval rating in those districts than his national average.
- Second, in most mid-terms, experts assume a Republican advantage because of the nature of the electorate. Voter turnout in mid-terms has been around 40% in the past few decades, about 20% lower than in Presidential election years, and mid-term voters, particularly in 2010 and 2014, tend to be older, whiter, and more male than the rest of the electorate, which skews outcomes to more conservative candidates. However, interest in this year's election is generally higher across the board – markedly for younger, minority, and female voters. Initial early voting numbers [suggest](#) Republican-affiliated voters have shown up in stronger numbers than Democrats, but we expect higher Democratic turnout this round than in the

average mid-term. Gubernatorial races in 36 of the 50 states, along with local office races and ballot referenda, may also factor into voter interest.

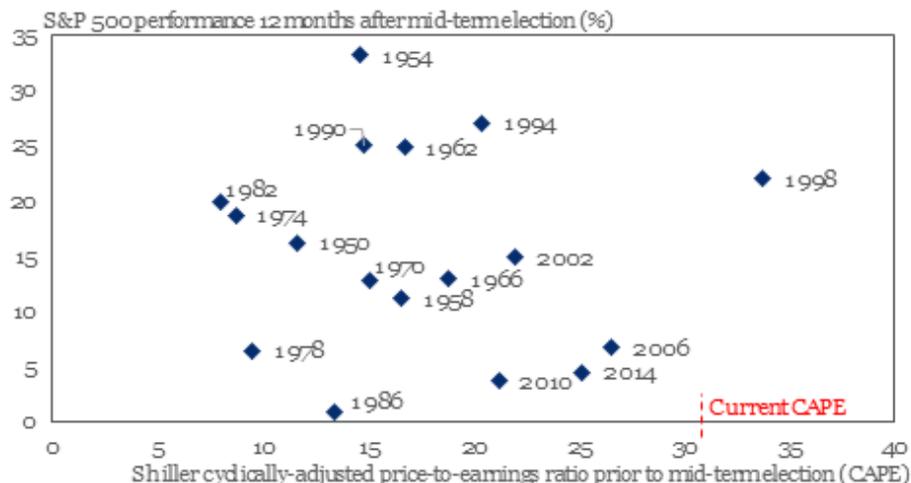
Implications of a Democratic House

If the current trajectory holds and Republicans keep the Senate but lose the House, there are a few broad implications:

First, some things will stay the same. President Trump will have votes in the Senate to confirm judges and the vast majority of his executive branch nominees. Trade policy generally, which is largely granted to presidential discretion, will not be impacted, though President Trump will have to work harder to get the votes for his new USMCA. Free trade agreement votes are typically close in Congress, as we discussed [previously](#).

However, the House will dramatically increase oversight activities – hearings and subpoenas. This will preoccupy an already disorganized Administration. And we can be assured of more policy gridlock and attention on the upcoming 2020 election. This environment has historically been positive for markets, but will be particularly problematic around debt ceiling negotiations next spring.

S&P 500 Performance is Historically Positive Following Mid-Term Elections Despite Varying Valuations



Source: Strategas Research Partners; Mehman Castagnetti Rosen & Thomas, Robert Shiller, Haver, IIF

The Bipartisan Budget Act of 2018 suspended the statutory debt limit until March 1st, 2019, after which the debt limit will be reestablished at the current level of debt. Without an agreement to raise the debt limit, Treasury will begin using “extraordinary measures” – as it has done more frequently in recent years – to ensure the limit is not breached while still fulfilling the government’s financial obligations. The use of “extraordinary measures” usually lasts around six months before the need for action becomes critical, leading to market-upsetting debt ceiling crises such as in 2011, 2013, and nearly again in 2017.



Tweet of the Week

This week's Tweet of the Week sheds light on some of the issues with polling availability in key Congressional districts. You can find the underlying article [here](#).



Nathaniel Rakich

@baseballot

Follow



There are still lots of competitive districts (and states) with little polling! I identified the places where we're in most desperate need of new data:



Election Update: Some Competitive Races Have Little To No Polling. That's A ...
Welcome to our Election Update for Tuesday, Oct. 23! It feels like every time you hit "refresh," Democrats' prospects in the House tick up. The Classic version ...
fivethirtyeight.com

Lots of close House races are underpolled

Lean and toss-up House races by amount of polling according to FiveThirtyEight's aggregate poll weights, as of Oct. 22

DISTRICT †	538 RATING †	AGGREGATE POLL WEIGHT †
CO-3	Toss-up	0.00
IN-9	Lean R	0.00
NY-2	Lean R	0.00
WI-6	Lean R	0.00
MI-7	Toss-up	0.36 
NV-3	Lean D	0.52 
MN-1	Toss-up	0.60 
OH-12	Lean R	0.74 
AZ-8	Lean R	0.77 
FL-25	Lean R	0.79 
PA-10	Lean R	0.91 
WA-5	Lean R	0.96 
NY-22	Lean D	1.10 
KS-2	Toss-up	1.31 
VA-5	Toss-up	1.34 
IL-14	Toss-up	1.43 
IL-6	Toss-up	1.45 
IL-13	Lean R	1.58 
FL-6	Lean R	1.58 
NY-24	Lean R	1.59 