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United States

Economics

US Economic Perspectives

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Little relief for capex as uncertainty pivots from trade policy to election

- In recent weeks, optimism has grown about the US economic outlook, as key data have been more resilient than feared and trade negotiations showed progress. While it may be possible that trade tensions may be past the peak, another source of uncertainty looms over the outlook: the 2020 elections. Economic performance over the next year will depend in part on the handoff from uncertainty driven by trade policy to that from the election.
- Our analysis shows that presidential election years tend to see weaker capex and softer business sentiment but elections usually do not have a material impact on payrolls growth, consumer sentiment, or spending behavior. Recent trends of soft business investment offset by solid consumer spending therefore looks set to continue into 2020.
- We also consider the performance of a few key market indicators during election years. The uncertainty generated by presidential elections tends to coincide with flatter yields curves early in the year and a stronger dollar.

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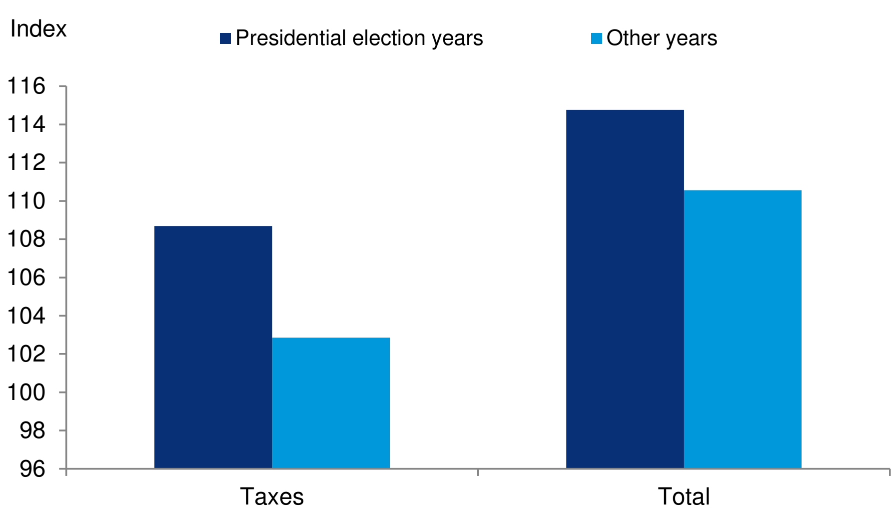
Figure 1: Economic policy uncertainty tends to be higher during presidential election years



Source : policyuncertainty.com, Haver Analytics, Deutsche Bank

Introduction

In recent weeks, optimism has grown about the US economic outlook, as key data have been more resilient than feared and trade negotiations showed progress towards avoiding further escalation. While trade tensions may be past the peak – it is not a done deal that this is in fact the case – another source of uncertainty looms over the outlook: the outcome of the 2020 elections. The distribution of risks around growth over the next year depends critically on this handoff from uncertainty driven by trade policy to that generated by the election.

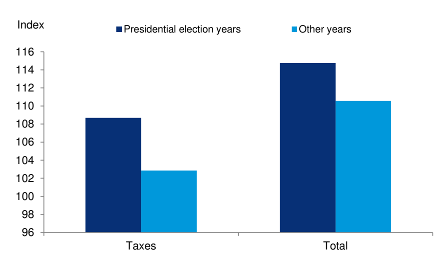
In this note, we document the historical experience of key economic variables around past presidential elections and compare them to typical non-election years. While a number of interesting conclusions come out of this analysis, the most important is likely that election years tend to see weaker capex and softer business sentiment but have little material impact on payrolls growth or aggregate consumer spending. The dichotomous economic performance of the past year, which has been punctuated by lackluster business investment and solid consumer spending, thus looks set to continue well into 2020. Narrow growth drivers in the absence of solid capex should in turn keep the outlook fragile and the Fed with a dovish bias.

Our approach

To identify the historical impact of elections on various features of the economy we construct spider charts that trace out the difference in the average experience between years with and without a presidential election. Because the financial crisis coincided with the 2008 election, we construct an additional data series that excludes that year. We consider the median experience rather than the mean, as historical outliers can skew the results. The difference in the typical experience in election years versus non-election years is then considered a proxy for the election impact on the data.[1] We consider the experience from March of the election year until February of the following year so as to capture enough data before and after the election month.

The logic for why presidential elections could impact economic activity is multi-faceted but depends primarily on the idea that these events could mark turning points that generate uncertainty about key economic variables, for example tax policy, government spending plans, and regulations. This uncertainty, in turn, can lead to delays in private sector spending activity, particularly on big ticket items, until the election passes and clarity is gained about the economic policy landscape. There is some evidence that presidential election years do in fact coincide with higher economic policy uncertainty. According to the Baker, Bloom and Davis measure, economic policy uncertainty is about 4% higher in presidential election years compared to non-election years, and tax policy uncertainty is nearly 6% higher (Figure 2). Some, but not all, of the higher uncertainty during presidential election years is driven by the financial crisis. Conversely, if we excluded the past two years, which have had historically high levels of uncertainty driven primarily by trade policy, the gap between years with and without presidential elections would be considerably wider.

Figure 2: Economic policy uncertainty – overall and related to taxes -- is on average higher during presidential election years



Source : policyuncertainty.com, Haver Analytics, Deutsche Bank

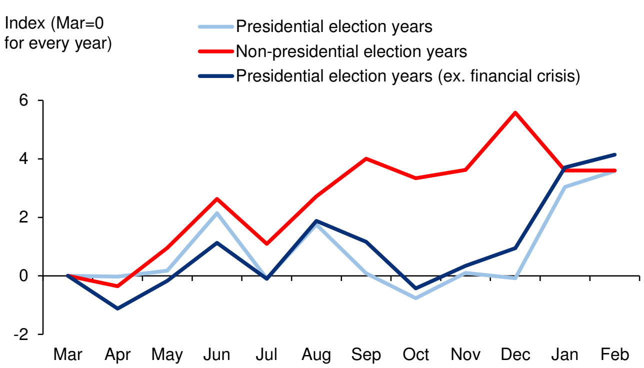
1 An additional caveat is that analysis such as this is necessarily conducted on a relatively small set of data points. This is especially true for some data series, such as durable goods orders or the ISM non-manufacturing index, for which we do not have a longer history of data.

Businesses spending plans put on hold ahead of elections

Our analysis for business-related variables indicates that the lead-up to elections tends to have depressing effects on capex activity and business sentiment. For example, while core durable goods orders are typically up around 3% between March and October in a non-election year, they are basically flat according to the median experience during election years (Figure 3). That is a 3% underperformance. As shown in the chart, this is not due to distortions from the financial crisis, as the experience is pretty similar if we include or exclude 2008. Interestingly, core durables orders then increase more sharply in the months following the election, converging back to the average experience of non-election years, suggesting there could be some pent-up demand for orders that is let loose as election uncertainty is resolved.

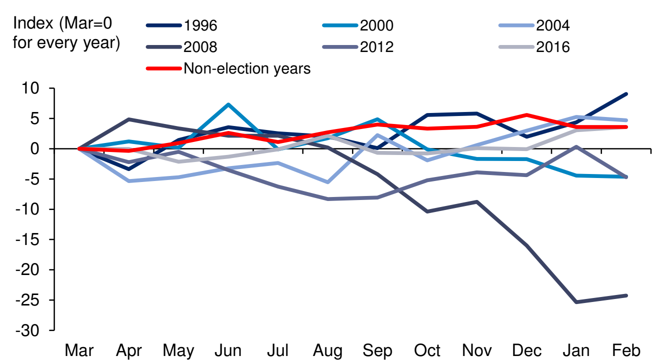
A look at the individual election years shows decent dispersion in the performance of core durable goods orders depending on the election year (Figure 4). However, no election years since 1996 have clearly outperformed the typical non-election year. Core shipments data also tend to lag during election years until the uncertainty is resolved, although the extent of this underperformance is more limited than the orders data indicate (Figure 5).

Figure 3: Core durables orders softer during election years



Source : Census, Haver Analytics, Deutsche Bank

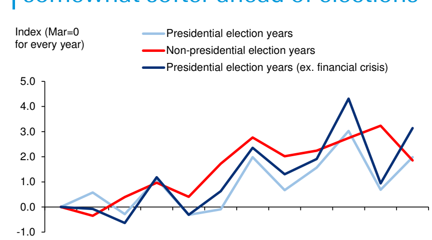
Figure 4: Experience varied across election years, but mostly weaker than non-election years



Source : Census, Haver Analytics, Deutsche Bank

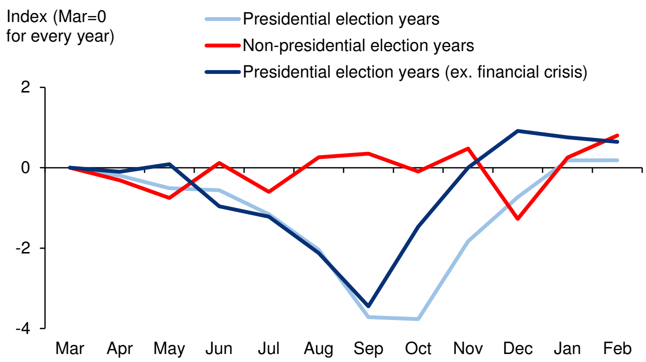
There is also evidence that business sentiment tends to be softer during the lead up to an election. In contrast to a typical non-election year, where the ISM manufacturing index is roughly flat, manufacturing sentiment tends to decline through September / October during election years (Figure 6). The median decline is also significant, about four index points from the level in March of that year. Across elections there is more dispersion in the ISM manufacturing experience relative to the more uniform underperformance of durable goods orders (Figure 7). In fact, in some election years ISM manufacturing clearly outperformed the typical experience in non-election years. Greater dispersion should coincide with greater uncertainty about the direction and magnitude of the election impact on ISM manufacturing sentiment even if the average experience indicates that sentiment should soften.

Figure 5: Core durables shipments somewhat softer ahead of elections



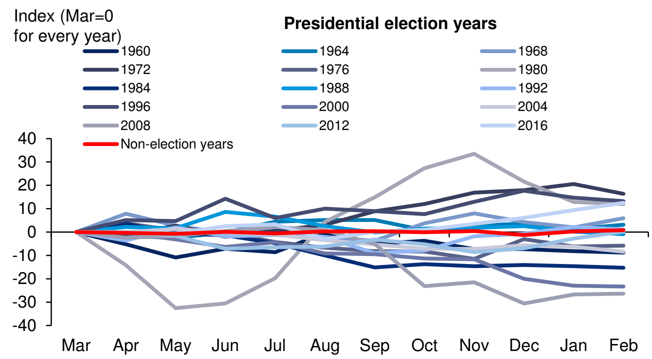
Source : Census, Haver Analytics, Deutsche Bank

Figure 6: ISM manufacturing tends to weaken ahead of presidential elections



Source : ISM, Haver Analytics, Deutsche Bank

Figure 7: Experience across elections is more varied for the ISM

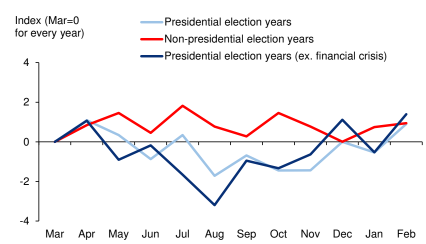


Source : ISM, Haver Analytics, Deutsche Bank

There is also evidence that ISM non-manufacturing sentiment tends to be more subdued during election years, though the magnitude of this underperformance is somewhat less severe than for manufacturing (Figure 8). The underperformance is, however, more uniform, with no election year since 2000 clearly outperforming the typical experience for non-election years in the ISM non-manufacturing data.

Together, the preceding results indicate that election years tend to coincide with weaker durable goods orders and softer sentiment, both for manufacturing and non-manufacturing industries. With business activity recently depressed due to trade policy uncertainty, this analysis indicates that a resolution of trade tensions may not be sufficient to inspire a sharp rebound in capex as firms are faced with the looming uncertainty from what looks set to be a particularly close election featuring two ideologically polarized candidates.

Figure 8: ISM non-manufacturing also tends to soften ahead of presidential elections

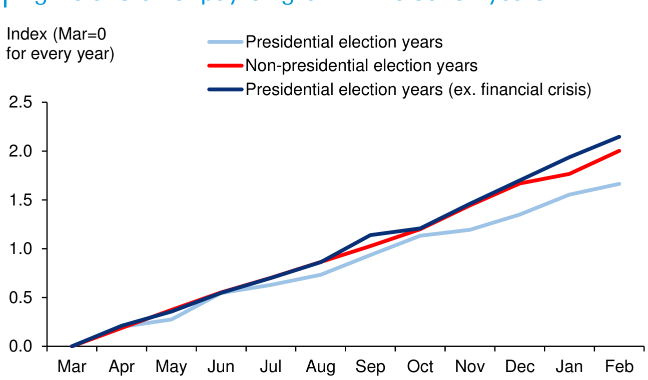


Source : ISM, Haver Analytics, Deutsche Bank

Labor market does not seem to be different in election years

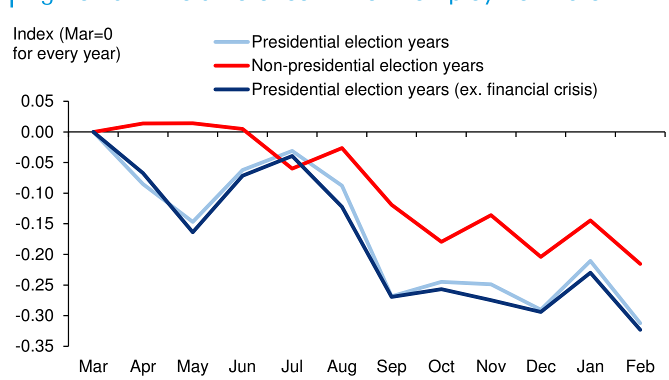
While business sentiment seems to soften in election years, this does not appear to translate into a slower pace of hiring (Figure 9). In fact, if anything, the labor market tightens slightly, with the unemployment rate falling by a tenth more in a typical election year compared to a typical non-election year (Figure 10). This is not too surprising given that changes in administrations do not seem to occur at any particular point in the business cycle (Figure 11).

Figure 9: Slower payroll growth in election years



Source : BLS, Haver Analytics, Deutsche Bank

Figure 10: Little difference in the unemployment rate

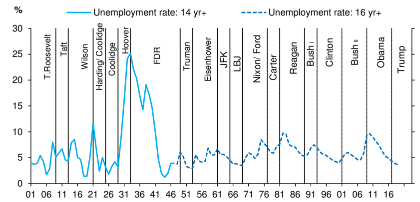


Source : BLS, Haver Analytics, Deutsche Bank

Consumers tend to shrug off election uncertainty

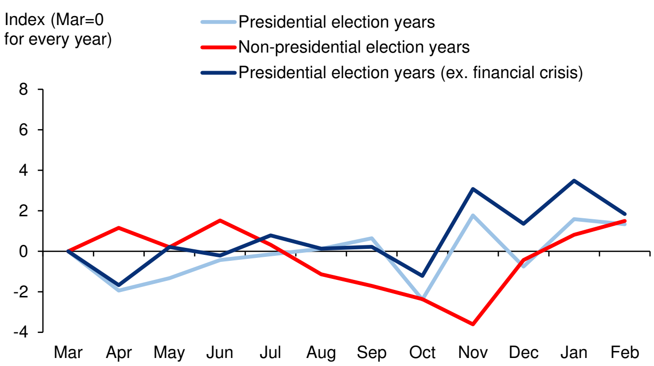
In contrast to businesses, our analysis suggests that consumer activity and sentiment is relatively unaffected by the presence of a presidential election, likely because of the relatively small impact that elections seem to have on the labor market shown in the previous section. The two main measures of consumer confidence from the University of Michigan and Conference Board demonstrate only marginal effects from an election, as both measures track the experience of consumer confidence from March through about September of non-election years (Figures 12 and 13). There is then some tentative evidence that consumer confidence improves slightly around the resolution of election uncertainty around October or November of the election year, and this modest outperformance carries through to the end of the election year and into the first months of the following year.

Figure 11: Administrations do not begin at any particular point in the business cycle



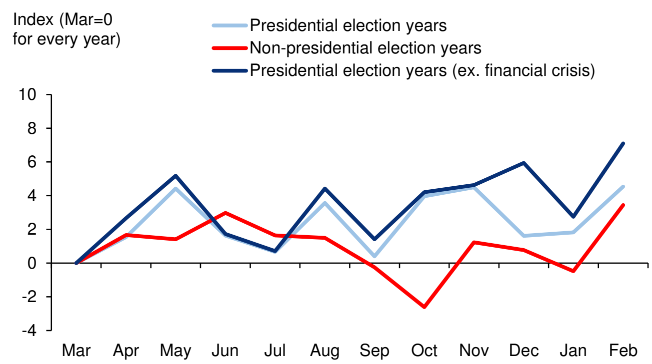
Source : BLS, Haver Analytics, Deutsche Bank

Figure 12: U Michigan consumer sentiment shows little election year effects...



Source : University of Michigan, Haver Analytics, Deutsche Bank

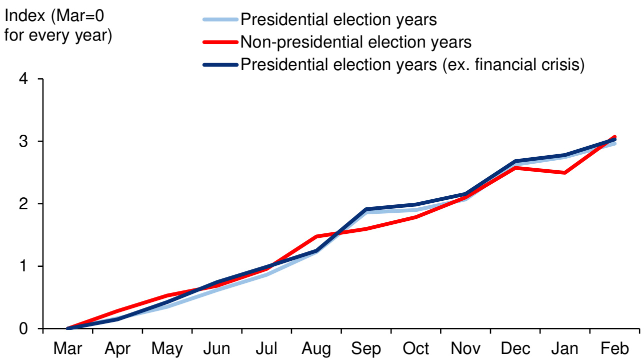
Figure 13: ...The same is true for the Conference Board's consumer confidence data



Source : Conference Board, Haver Analytics, Deutsche Bank

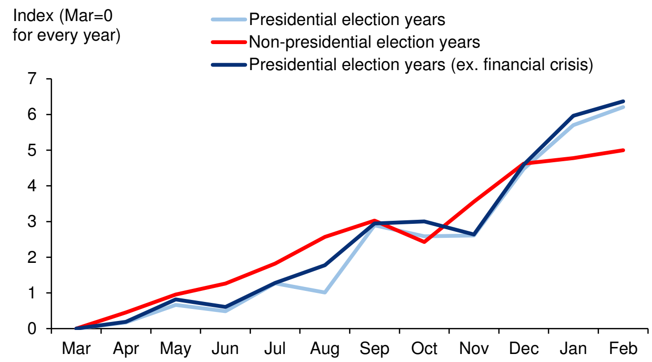
While consumer confidence data show some modest election year effects, the same is not true for the broad aggregate of consumer spending data. For instance, there is no discernible difference in the evolution of real personal consumer spending in election versus non-election years (Figure 14). The same is true for retail control (not shown). However, there is some tentative evidence that real consumer spending on durables lags prior to the presidential election and rebounds more sharply as the election passes and uncertainty dissipates (Figure 15). This would be consistent with election uncertainty leading to some hesitancy by households when making larger purchases.

Figure 14: Real consumer spending unfazed by election uncertainty



Source : BEA, Haver Analytics, Deutsche Bank

Figure 15: Some modest evidence that real spending on durables lags prior to the election and then picks up post-election

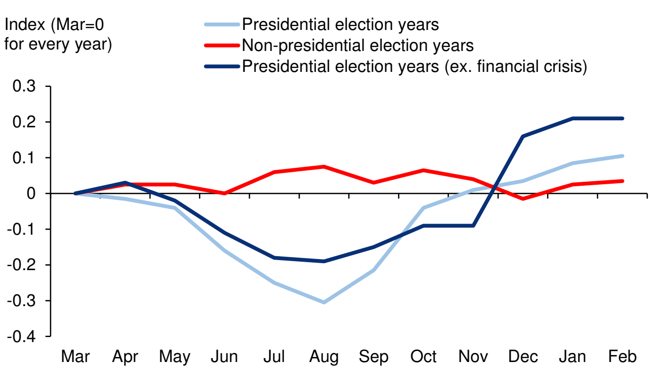


Source : BEA, Haver Analytics, Deutsche Bank

Markets

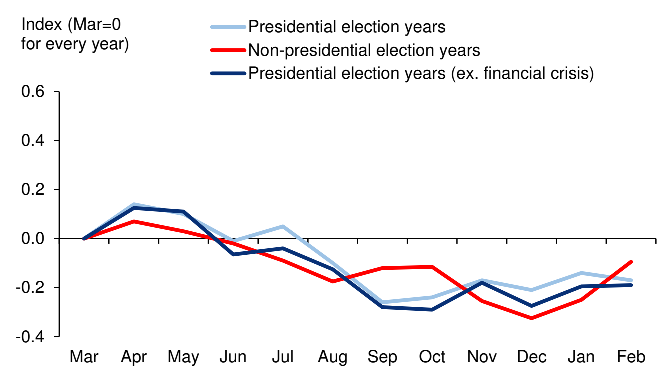
Finally, we consider how a few key financial market variables evolve around presidential elections. First, the yield curve slope as measured by the gap between the 10-year yield and 2-year yield, which is a popular yield curve recession indicator, tends to flatten sharply in the months ahead of the election (Figure 16). Including the financial crisis this metric flattens by nearly 30bps on average ahead of elections through August and by around 20bps excluding the 2008 episode. The curve then begins to steepen especially as election uncertainty is resolved. This flattening and subsequent steepening of the curve could be driven by higher demand for the safety of bonds and duration during periods of heightened uncertainty. Conversely, there is little compelling evidence of election effects in the 3m10s spread, which is another popular recession signal based on the yield curve slope (Figure 17).

Figure 16: 2s10s yield curve slope flattens ahead of election



Source : FRB, Haver Analytics, Deutsche Bank

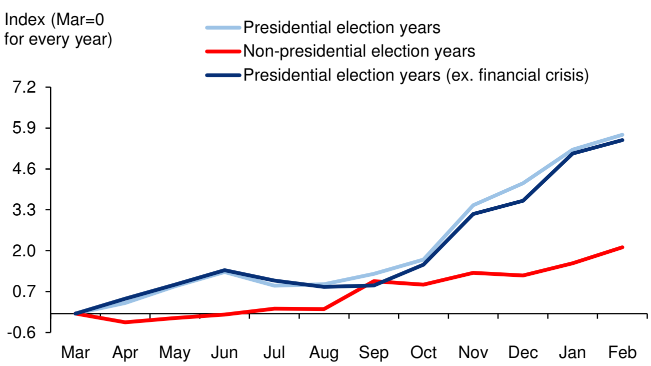
Figure 17: 3m10s yield curve slope not affected by



Source : FRB, Haver Analytics, Deutsche Bank

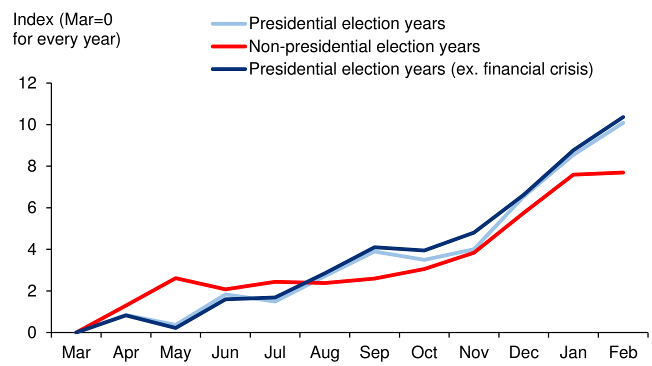
Other key financial market indicators show mixed evidence of election year effects. On the one hand, the trade-weighted US dollar tends to outperform during election years, rising more than 3% between March and November compared to a typical gain of around 1% over similar time frames in non-election years (Figure 18). Similar to the finding of a flatter curve in the run up to presidential elections, a stronger dollar could be rationalized by demand for US assets and a modest flight to safety during periods of uncertainty, even if that uncertainty emanates from a US election. Our colleagues in FX strategy have documented similar performance for the broad trade-weighted dollar across historical elections (see " A President Trump vs. Warren US dollar match-up ").

Figure 18: Trade-weighted US dollar tends to outperform around elections



Source : FRB, Haver Analytics, Deutsche Bank

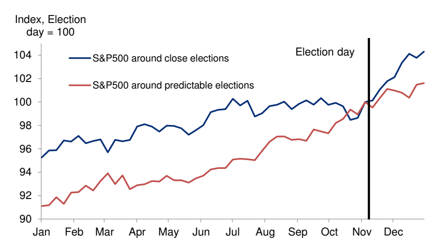
Figure 19: S&P 500 outperforms after election uncertainty is resolved



Source : S&P, Haver Analytics, Deutsche Bank

On the other hand, there is limited evidence of election year effects on equities in the months prior to the election. That being said, the resolution of uncertainty as an election concludes does seem to drive a larger rise in the S&P 500 (Figure 19). The latter conclusion can be seen by the sharper upward trajectory in equities between November and February of the following year around elections compared to years when no presidential election is present. Our colleagues in equity strategy have documented how equities tend to be flat in the months ahead of a close election followed by a relief rally as the uncertainty premium dissipates, dynamics that are not present in elections with wide margins (see Figure 20 adapted from their piece " Positioning for the election ").

Figure 20: Evidence of a relief rally after close elections



Source : S&P, Haver Analytics, Deutsche Bank. Note: Close elections are 1952, 1960, 1968, 1976, 2004, 2012, and 2016. Predictable elections are 1956, 1964, 1972, 1980, 1984, 1988, 1992, and 1996.

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Appendix 1

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