Changes in the US Congress: a castling until the presidential elections?

In the midterm elections on November 8th, a red wave was anticipated, with the Republican Party hoping to control the House of Representatives and the Senate and thus gain full control of Congress. High inflation, the somewhat gloomy economic outlook for 2023, and Joe Biden's low approval ratings (at 37% compared to 55% in early 2021) filled the Republican Party with optimism. Yet the final outcome of the vote produced a somewhat different scenario to what members of the «Grand Old Party» (GOP) had expected.

In the House of Representatives, where 100% of the seats were put to the vote, the Republicans gained control of the House, albeit by a narrower margin than anticipated in the polls. But in the Senate, where 35 out of the 100 seats were up for election, the Democrats managed to take the Pennsylvania vote from the Republicans and thereby secure a majority in the upper house with 51 of the 100 seats (assuming that the two independent members elected in Vermont and Maine continue to caucus with the Democratic vote plus the tie-breaking vote of the president of the Senate, Kamala Harris).

The Biden administration may have difficulty passing new laws and fiscal plans

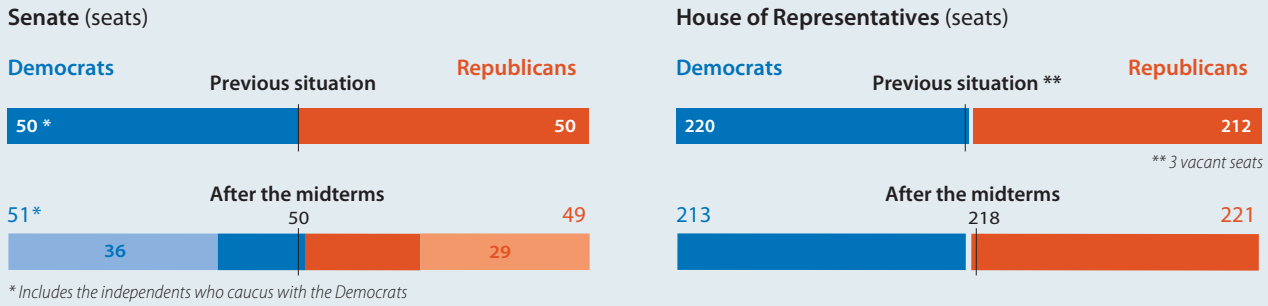
With a divided Congress, and in a highly polarised political environment, it seems unlikely that Joe Biden's government will be able to push through proposals that drift far from the centre of the political spectrum. Not only that, it could also have difficulties in pushing through basic measures such as raising the debt ceiling – the limit above which the country's Treasury cannot issue new debt to finance the federal government, which could potentially be binding in Q3 2023. If this figure is reached without Congress raising the ceiling or suspending the requirement to comply with it, then the administration will have no choice but to call a government shutdown. It would not be the first time, and the experience of the last shutdown between December 2018 and January 2019 suggests that it would have a clear negative impact on economic growth, as well as generating financial reverberations that would be most undesirable at such a delicate time in the financial markets.[1] However, previous experiences also show that a will among both parties to avoid such consequences ends up steering the situation to be unblocked when an increase in the debt ceiling is agreed upon in exchange for concessions in other areas. Also, should the US economy fall into recession, which is not our central scenario, one would expect the two parties to reach some sort of agreement, however minimal, in order to mitigate the adverse impact on households, while also saving face for the presidential elections in November 2024.

Other aspects in which this division of the chambers could have an impact include the presidential appointment of public officials and the supervision of the president's executive branch. In relation to the first aspect, Democratic control of the Senate will most likely facilitate the process of the presidential appointments that must be made over the next few years, which are particularly important in the judicial sphere. On the other hand, Republican control of the House of Representatives, while not allowing the GOP to introduce new laws, could be used to further scrutinise the Biden administration. While this supervision is not expected to paralyse what has already been approved in the houses, it could slow some procedures down, although the impact of this would likely be more cosmetic than substantive.

Despite the absence of major plans looking ahead, Biden's term in office will still have been active in a context of high inflation and public debt

In the nearly two years he has been in the White House, President Joe Biden has been active in implementing

US: result of the midterm elections



** Includes the independents who caucus with the Democrats*

Source: *CaixaBank Research, based on data from the Associated Press.*

1. According to estimates by the Congressional Budget Office, GDP in Q4 2018 and Q1 2019 was 0.1% and 0.2% lower than it would have been in the absence of the government shutdown.

fiscal and stimulus plans, even though Democratic control of both houses was no guarantee of a smooth path to passing them. Therefore, a divided congress represents more of a gradual change than a disruptive one relative to the previous situation. Some of the most significant plans he has introduced include the American Rescue Plan, approved in Q1 2021, which allocated 1.9 trillion dollars (the majority disbursed in 2021) to help cushion the impact that the pandemic was still having on many households. Most of the measures included in this package were direct expenditure, such as stimulus checks for vulnerable households or increased unemployment support. However, the implementation of this programme was a source of much criticism due to its potentially inflationary impact.[2]

Another major programme presented by Joe Biden, and approved in November 2021, was the Infrastructure Investment and Jobs Act, with a budget of 1.2 trillion dollars to be spent over the next five years on projects for improving classic infrastructure (such as roads, bridges and the railway network), public transport and internet access, with environmental considerations incorporated into most of the investments. However, of this 1.2 trillion total, only just under half represents new expenditure, as the rest will be financed through other existing infrastructure programmes. After one year of the programme, according to data from the White House, 185 billion dollars have already been disbursed.

Finally, the Biden administration wanted to present a highly ambitious plan to tackle climate change. Under the name Build Back Better, this package did not gain the necessary support in Congress. Nevertheless, half a year later in August 2022, and renamed the Inflation Reduction Act, it did. In addition to the name, a key difference between the two plans is the fact that the original one involved an increase in the budget deficit in order to finance the investments, whilst the second one incorporates fiscal savings and tax-collection measures (such as imposing a minimum corporation tax rate of 15%). Thus, the investments in energy security and support measures to curb climate change (such as tax credits to finance investment in clean energy) are less than the fiscal savings and the increase in revenues envisaged under this plan. In total, the Biden administration expects to invest 433 billion dollars over the next 10 years and raise some 739 billion, which represents a saving of over 300 billion dollars in the budget deficit over the next decade. However, the outstanding disbursements under all these plans could be subject to changes in the framework of a divided Congress[3] and given the pending negotiations on matters such as the debt ceiling.

After all, reducing the budget deficit will not only help to ease the inflationary pressures, but it will also help to achieve more sustainable public finances. As can be seen in the last chart, the US has a structural budget deficit which causes its debt-to-GDP ratio to increase year after year. Thus, according to estimates by the Congressional Budget Office, this ratio will most likely continue to rise over the next decade, and in an environment of higher interest rates, the cost for American citizens will be higher.

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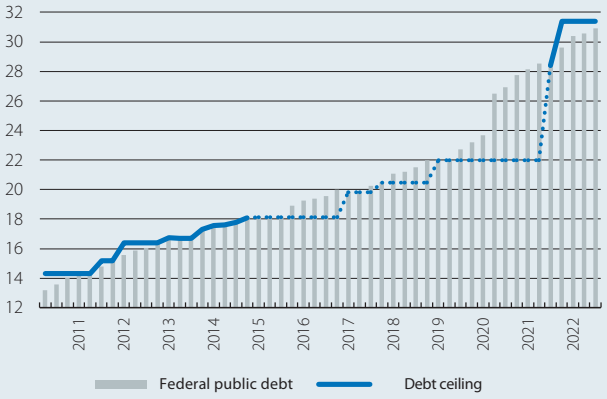
US: public debt and the debt ceiling

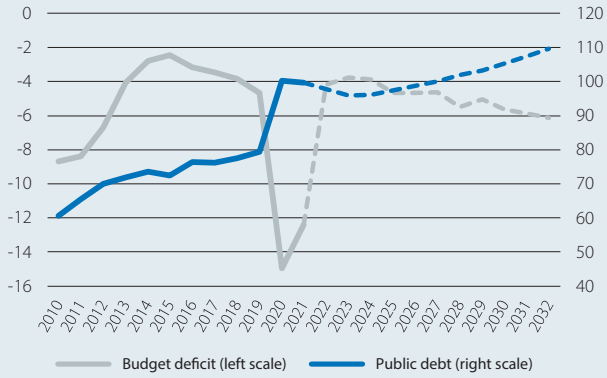
(USD trillions)



Note: *The dashed line shows periods when the debt ceiling was suspended.*
Source: *CaixaBank Research, based on data from the US Treasury.*

US: public debt and budget deficit

(% of GDP)



Note: *The dashed line shows the latest forecasts by the Congressional Budget Office.*
Source: *CaixaBank Research, a partir de datos del Congressional Budget Office.*

2. At the time, prior to the outbreak of the war in Ukraine, headline and core inflation stood at 1.7% and 1.3%, respectively, but GDP had just reached the pre-pandemic level. Although the high inflation observed since then can be attributed to multiple factors (such as the global energy shock,the bottlenecks exacerbated by China's zero-COVID policy, or a highly dovish monetary policy throughout 2021), direct fiscal aid measures certainly played a role.

3. These support measures have raised some suspicions in Europe, as leaders in the region consider it could constitute subsidies for US industry, damaging European exports.