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## POLITICAL UPDATE: US ELECTIONS

### Berenberg Macro Flash

With eight weeks to go until the US elections on 8 November, the most market-friendly outcome remains the most likely result: Hillary Clinton becomes US president while the Republicans maintain control of the House of Representatives. Donald Trump does not win the White House and Clinton will have to compromise with mainstream Republicans around House Speaker Paul Ryan. This is my base case.

Such an outcome would likely be much more palatable for markets than either a Trump presidency or a Democratic victory across the board. Nobody knows what a president Trump would really do. But the risk of foreign policy upsets and a trade war with China would loom large. Trade-dependent Europe could be more vulnerable to that than the US itself. Conversely, a Clinton victory coupled with a Democratic majority in both houses of Congress could also be a concern. It could result in a swing towards tax-and-spend policies and allow Clinton to implement a domestic agenda shaped too much by the regulatory inclinations of the more left-wing parts of the Democratic Party.

### THE RACE FOR THE WHITE HOUSE

In the presidential race, Clinton seems to be well ahead. For example, the bets placed on the Iowa electronic market imply a 69% probability for a Clinton win versus 31% for Trump. Nathan Silver's well respected [www.fivethirtyeight.com](http://www.fivethirtyeight.com) analytical website puts the probabilities at 68.6% for Clinton versus 31.4% for Trump (see chart below).

### How the odds have changed



Probabilities of winning the US presidential race on 8 November based on a polls-plus-forecast model. Source: [www.fivethirtyeight.com](http://www.fivethirtyeight.com)

However, we need to treat such probabilities with a lot of caution.

- As the strength of Trump and Bernie Sanders in the primaries has shown, this US election season is unusual. The rule that candidates who are ahead at this stage of the campaign usually go on to win may be less reliable than in the past.



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- On average, opinion polls give a lead for Clinton over Trump of just 3 percentage points (see for example [www.realclearpolitics.com](http://www.realclearpolitics.com)). That is not a huge margin. Also polls have tightened somewhat in the last five weeks, on the national level as well as in many of the “battleground states” that will determine the composition of the electoral college.
- Both candidates are seen by many voters as divisive. Small incidents may suffice to sway some voters one way or the other, or to mobilise supporters and/or antagonists. The widespread attention that the media gave in the last two days to a Clinton health issue may be an example for that.
- Remember Brexit? Although betting odds had strongly favoured the “remain” side just ahead of the referendum on 23 June, the “leave” campaign did win. In votes shaped very much by upstart populists who defy previous patterns of behaviour and discourse, the outcome seems to be more difficult to predict than usual. On the Iowa electronic market, the bigger bets are placed on Clinton. But in terms of the number of bets, the split is more even, with some advantage for Trump lately, similar to smaller bets favouring the “leave” side just ahead of the Brexit vote.

In brief: Clinton leads the race and is likely to win. But the risk of an upset victory for Trump is probably not as low as many observers in Europe seem to believe.

### THE CONGRESSIONAL CAMPAIGN

Analysing the Congressional campaign seems more straightforward. The big number of small regional campaigns should be much less affected by the vagaries of the newsflow about individual candidates than the one national presidential election. For the **House of Representatives**, where all 435 seats are at stake, RealClearPolitics currently projects a minimum of 226 seats and hence a majority for the Republicans versus 187 for the Democrats and 22 seats too close to call. The Republicans look set to maintain control of the House. In the **Senate**, where the Republicans currently have 54 out of 100 seats versus 44 for the Democrats and two independents, 34 seats are at stake. The results for swing states that will determine which party will control the Senate seem to be a toss-up. RealClearPolitics gives a minimum of 47 seats in the Senate for the Democrats and 46 for the Republicans, with 7 seats too close to call.

### WHAT IF TRUMP WINS?

Discussing risk scenarios is part of our job. We looked at [President Trump? A European perspective](#) in our Chart of the Week on 27 May 2016. The key points have not changed:

**Trump is an unusual candidate:** His various campaign promises lack detail, depth and coherence, as Mickey Levy has pointed out in his outstanding analysis of the [candidates' platforms](#). In the fiscal sphere, Trump's numbers do not add up. In his case, it is even more difficult than usual to assess what policies he may actually propose and pursue as president.

**Checks and balances:** The US political system constrains the power of the chief executive. Tax and spending decisions are shaped at least as much as Congress, forcing all sides to compromise and leave behind whatever wilder plans they may have had. The president, however, wields significant power over foreign policy, the domestic regulatory regime and some aspects of trade policy.

**A stronger or weaker US economy?** Trump's pronouncements do not offer sufficient detail and cohesion to gauge their potential economic impact. While some aspects (deregulation, tax reform) contain pro-growth elements, his strong objections to immigration and his protectionist “America first” rhetoric suggest potential economic harm that might weaken trend growth in Europe's major external trading partner. Also, Trump may not want Janet Yellen to stay at the helm of the US Fed, adding an extra element of uncertainty.



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**Foreign policy upsets?** Trump cultivates the image of a dealmaker. However, diplomacy is different from commercial bargains. Europe faces a risk that an inexperienced president Trump could upset established alliances or strike a deal with, say, Russia's Vladimir Putin at the expense of Europe. As a hypothetical example, recognising Russia's annexation at gunpoint of Crimea in a deal with Putin might not look too dangerous from Washington. But from a European perspective, it would shatter the iron rule that countries shall not invade their neighbours and snatch territory by force, which has underpinned the peace in Europe for the last 70 years. It could send political and economic tremors all the way down from the Baltics to the Balkans and far beyond.

**Trade war?** Both Trump and Clinton are opposing free trade agreements with Asia and Europe. However, the nationalistic tone of Trump's trade rhetoric on the campaign trail is particularly troubling. Following up on various campaign pronouncements, a president Trump could label China a "currency manipulator" and impose a flurry of "anti-dumping" sanctions on China, Mexico or other countries. That he would ratify the TPP trade agreement with Asia and negotiate a TTIP agreement with Europe looks unlikely. Even the mere risk of a trade war with China could be especially disruptive for European economies which are much more orientated towards international trade than the US and which often export capital goods that are very sensitive to the ups and downs of global business confidence. US politics pose the most significant event risk for the remainder of this year and possibly beyond.

For a more general discussion of the "[politics of anger](#)", see the link attached.

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