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Q&A: Assessing the Macroeconomic Impact of Biden's Economic Policies

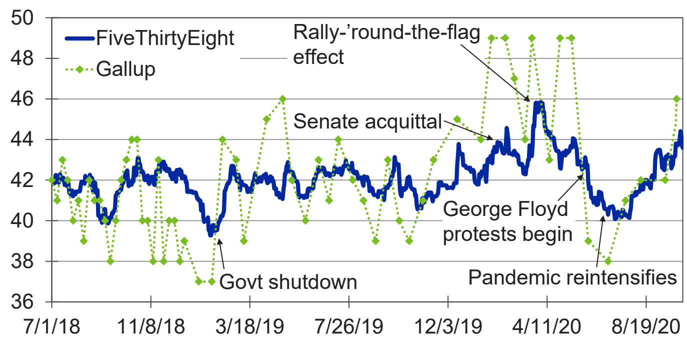
Because of the large number of questions we received, we have combined many. If you have further questions, please email us at help@economy.com.

Question: Is there any variable in the election model that captures the recent racial protests and police-reform movement?

Answer: Our Gallup approval rating variable is the only one that would be able to capture the effect of recent racial justice protests on the election. We observe that President Trump's approval fell sharply, according to Gallup and FiveThirtyEight's approval tracker, around the time that George Floyd's death sparked nationwide protests (see Chart 1). However, it coincided with mounting criticism toward the president's handling of the COVID-19 outbreak and the reintensification of new daily confirmed cases in midsummer, so it is tough to disentangle the effect of racial protests and the pandemic.

Chart 1: Ups and Downs

President Trump's approval, %, according to…



Sources: FiveThirtyEight, Gallup, Moody's Analytics

Q: Since these election-based scenarios are premised on the August baseline forecast, how would they change if they were based on the September baseline?

A: Our election-based scenarios would not change meaningfully if they were based on the September baseline. Most important, both vintages of the Moody's Analytics baseline forecast assume passage of a $1.5 trillion federal rescue package, which is critical to prevent a double-dip recession from occurring later in the year. Changes from August to September are not overly significant for key U.S. macroeconomic series.

The peak-to-trough decline in real GDP is a little smaller in the September baseline, 10.2%, compared with 10.5% in the August baseline. We revised our forecast higher for third-quarter GDP and predict a 26.6% annualized increase, compared with the approximately 23% gain in the August baseline.

The September baseline has the unemployment rate averaging 9.1% in the fourth quarter of this year and 7.8% in the final three months of 2021. This compares with an average fourth-quarter unemployment rate of 9.5% in the August baseline and 8.1% in the final three months of 2021.

Q: What do you see as the path for additional stimulus given the most likely election scenario of a Biden win and a split Congress?

A: Prospects for another round of stimulus dropped significantly on October 6 as President Trump tweeted that he has "instructed my representatives to stop negotiating until after election" to pass stimulus. If Trump wins re-election, stimulus is likely after the election, but if former Vice President Joe Biden wins, stimulus wouldn't be passed until late January or February at the earliest. The assumption in our August and September baseline forecasts was that fiscal stimulus would have been passed by now, but it's clear that we will have to modify this when we update our October baseline.

Q: Do you see President Trump being able to get a Supreme Court nominee in before the election?

A: Previously, the White House and Senate Republicans seemed to be on a glide path to confirming Amy Coney Barrett prior to the election. However, the recent infections of three Republican senators—Mike Lee of Utah, Thom Tillis of North Carolina, and Ron Johnson of Wisconsin—are an obstacle to a speedy confirmation of Barrett. Lee and Tillis both serve on the Senate Judiciary Committee. In addition, growing concerns among lawmakers about their health and safety on Capitol Hill amid the outbreak of COVID-19 in the White House could further slow the confirmation process. Nevertheless, with stimulus negotiations dead until at least after the election, Senate Republicans will largely focus their time and energy on getting Barrett confirmed by November 3.

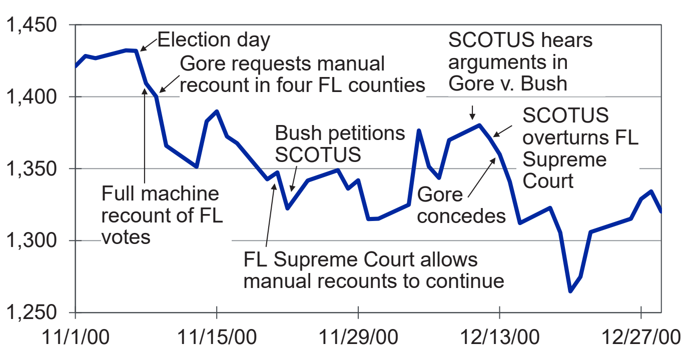
Q: Which scenario would be best and worst for Wall Street? What is your thinking on postal voting?

A: In the medium term, the stock market would perform worse under Biden than Trump. If you raise taxes on corporations, this reduces after-tax earnings, and at the same price-to-earnings ratio, this hurts stock prices as well. In 2021 and 2022, the S&P 500 will be roughly 1% lower under Biden than Trump. However, in the long term, stock investors are left roughly in the same place under either candidate. Despite the higher corporate income tax rate, stocks will still benefit from Biden's policies, which lift the economy's potential and, in turn, corporate profits.

Ultimately, we believe that the best scenario for Wall Street is that we have a clear-cut winner after Election Day, no matter which party wins. Investors abhor uncertainty, and a fiercely contested election in which disputes over mail-in ballots in key swing states drag on for weeks on end would weigh on stock prices as was observed during the 2000 Florida recount showdown between Al Gore and George W. Bush (see Chart 2). The impact of a contentious election result on financial markets could be even more pronounced this time around, given the much greater partisan rancor today than in 2000.

Chart 2: 2000 Election Chaos Hurt Stocks

S&P 500 Index

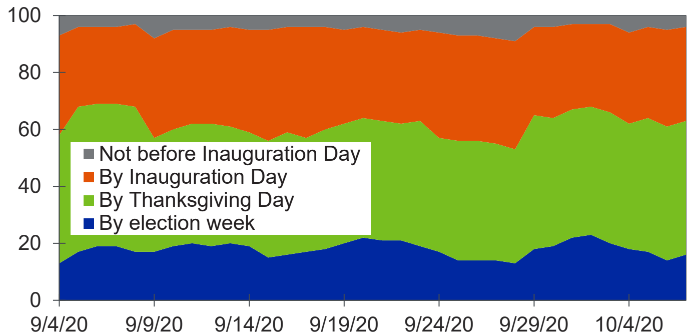


Sources: S&P Dow Jones Indices LLC, Moody's Analytics

The longer it takes for a winner to emerge, the more volatile stocks will become. According to the Good Judgement Project, there is a greater than 60% probability that a major party presidential candidate concedes defeat by Thanksgiving, which would be a faster outcome than in 2000 (see Chart 3). Nevertheless, there is still a greater than 30% probability that we will not know the eventual winner until after Thanksgiving Day and before Inauguration Day, which could be too much uncertainty for financial markets to bear.

Chart 3: When Will We Know Who Won?

Probability, %, major party presidential campaign concedes defeat



Sources: The Good Judgement Project, Moody's Analytics

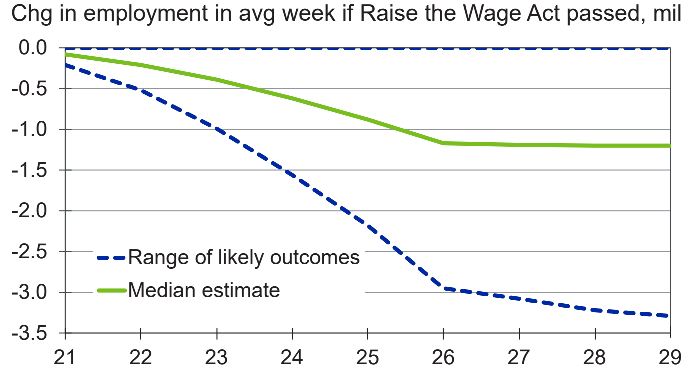
Whether we will know the outcome of the presidential election by Thanksgiving Day will depend on how swiftly battleground states can process the deluge of mail-in ballots. According to the U.S. Elections Project, voters have requested nearly 70 million mail-in ballots, and as of October 7, more than 5 million voters—equivalent to nearly 4% of total votes counted in the 2016 election—have already returned their mail-in ballots or availed themselves of in-person early voting. It is tough, if not impossible, to handicap how smoothly mail-in ballots will get counted during election week and beyond, since a lot could depend on the legal fights that ensue after November 3.

Q: Do you project how many jobs would go away if the minimum wage was increased? What are the trickle-down impacts of raising the minimum wage?

A: We estimate that a higher price of labor under a $15 minimum wage would reduce employment by 500,000 to 700,000 workers by the second half of the decade. This is in line with the Congressional Budget Office's own research. According to the CBO's median estimate, if Democrats were to implement a phased increase of the federal minimum to $15 per hour in line with the Raise the Wage Act of 2019, 1.2 million workers, who would have otherwise been employed, would find themselves without a job. However, the range of likely employment outcomes under the Raise the Wage Act is very wide, stretching from no effect at all to as much as a 3.3 million employment reduction, with a two-thirds probability that the actual outcome ends up within this range (see Chart 4). While workers, who

Chart 4: Effects of $15 Minimum Wage

Chg in employment in avg week if Raise the Wage Act passed, mil



Sources: CBO, Moody's Analytics

would have otherwise earned less than $15 per hour, would be directly impacted by this proposal, the CBO estimates that the wages of many of the 10 million workers whose wages would be just above the new federal minimum would also increase.

Q: How many workers are earning $15 per hour or less? How many wage and salary workers fall below the federal minimum?

A: Estimates put the share of American workers earning less than $15 per hour at just over 40%. The Fair Labor Standards Act allows for the employment of certain classes of workers at wage rates below the prevailing federal minimum. The FLSA authorizes a youth minimum wage, which permits employers to pay workers under 20 years of age at least $4.25 per hour for 90 calendar days after they are first employed. Employers can also apply for special certificates from the Wage and Hour Division of the Department of Labor to pay individuals with disabilities less than the minimum wage. Finally, employers of tipped workers, who are defined as receiving more than $30 per month in tips, are only required to pay $2.13 per hour in direct wages if that amount, along with tips received, equals at least the federal minimum. As of 2019, there were 1.6 million wage and salary workers earning hourly wage rates at or below the federal minimum. Of these, 392,000 workers were paid the federal minimum, while the remaining 1.2 million were paid subminimum wage rates. The Raise the Wage Act, which we assume Biden's minimum wage plan would emulate, would phase out and repeal these three subminimum wage arrangements.

Q: If Biden wins, how would you evaluate the path for U.S. monetary policy should he choose to not reappoint Jerome Powell?

A: We believe that Biden would most likely keep Powell as chairman of the Federal Reserve. If he didn't reappoint Powell, he would pick a dovish Fed chairman. The Fed's new policy framework will not be ripped up if a new chair comes in.

Q: Does the brunt of Biden's tax increases falling on the top 1% of households mean that tax loopholes, which currently reduce taxes paid by the wealthy, are targeted? What does the percent decline in after-tax income for the top 1% of households equate to in dollars?

A: The brunt of Biden's tax increases falling on the top 1% of households reflects both a higher effective tax rate for high-income individuals, as well as the closing of certain tax loopholes that disproportionately benefit wealthy households. Individual income tax rates would return to their pre-2017 tax law values for taxable incomes above $400,000, while the 12.4% Social Security payroll tax would apply to earnings above $400,000. Further, the Biden plan would curb itemized deductions and tax capital gains and dividends at the same rate as ordinary income for individuals with more than $1 million in income. Wealthier households are more likely to itemize their deductions rather than take the standard deduction to lower their tax bill. The Tax Policy Center estimates that the top 1% of taxpayers would experience a 17% decline in after-tax income in 2021. This equates to an average tax increase of nearly $300,000.

Q: How would the regulatory environment be under Biden? His rhetoric has been a return to the Obama era. Does this imply labor productivity growth moves back to the 0.6% average rate experienced from 2010 through 2016?

A: While regulatory and antitrust policies may have significant impacts on specific industries or companies, they are not expected to have meaningful macroeconomic impacts. The baseline forecast calls for nonfarm business output per hour to rise at an average annual pace of 1.6% over the next decade. In particular, the forecast pencils in a sharp acceleration in labor productivity over the next year just as we observed after the Great Recession. In the second quarter, output per hour surged by an annualized 10.1%, since nonfarm business output fell to a lesser extent than hours. Such rises in productivity around a downturn could be attributable to higher-productivity workers retaining their jobs or workers simply working harder. Past research by economists at Stanford University and the University of Utah suggests that the rise in productivity during recent recessions had more to do with workers putting in more hours.

Q: Has Biden presented any policies regarding liberalizing labor immigration, or are you assuming that a more lenient policy on undocumented immigrants may result in stronger employment growth?

A: Biden's immigration plan contains several provisions that would liberalize labor immigration. He would seek to fast-track the naturalization process for qualified green card holders; streamline the visa process for temporary workers in select industries that depend on seasonal workers; and expand the number of high-skilled visas and remove the caps on employment-based visas by country, among others.

Q: You assume more immigration under a Democratic sweep. Does that mean the per capita gains are smaller?

A: Even though we assume greater immigration under a Democratic sweep, real GDP per capita over the 10-year horizon will still be higher.

About the Author

Bernard Yaros is an assistant director and economist at Moody's Analytics focused primarily on federal fiscal policy. He is responsible for maintaining the Moody's Analytics forecast models for federal government fiscal conditions and providing real-time economic analysis on fiscal policy developments coming out of Capitol Hill.

Besides fiscal policy, Bernard covers Virginia and Puerto Rico and develops forecasts for Switzerland. He regularly advises clients and policymakers of all levels on the Puerto Rico economic outlook after Hurricane Maria. He has been featured in a number of print media outlets from Bloomberg to Bond Buyer for his work on Switzerland and Puerto Rico.

His most recent research has ranged from U.S. fiscal multipliers to the regional impacts of the 2018-2019 government shutdown and federal disaster relief in Puerto Rico. Bernard has performed research on other subjects including stress-testing U.S. state budgets and forecasting the 2018 midterms.

Bernard holds an MSc in international trade, finance and development from the Barcelona Graduate School of Economics and a BA in political economy from Williams College.

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