

US elections game changer for the economy

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2020 promises to become anything but boring. While we foresee the slowdown of the global economy to bottom out over the course of 2020 and pick up in 2021, there are a number of events and issues that are crucial to keep an eye on. The most important one being the US Presidential elections in November, as the outcome will be an important factor for most of the other issues and risks we monitor in the coming years.

Return to- or turn away from our global liberal order?

The one event that has the potential to become a game changer for the direction in which the global economy is faring is the US Presidential election on November 3rd. If a Democratic candidate wins the election from the current President, the international liberal order that has shaped our world in the past 30 years could be restored. If the current President is to be re-elected, the disentangling of our multilateral system will continue, meaning that commodity chains will shift, technological integration comes to a halt and the provision of global public goods are endangered as support for institutions that uphold them erodes.

We have come to know President Trump as a President wary of the international global order. Whether it is about trade deals through the WTO, the climate agreement in Paris or even institutions that serve the aim of stabilizing the economy such as the Fed, President Trump has taken systematic attempts to undermine these arrangements. Trump does not really recognise the benefits of global institutions, he is mainly interested in concrete deals using a transaction-based approach.

While some of the institutions under attack have remained more resilient (Fed or the Paris agreement) than others (WTO), it is likely that another four years political withdrawal or disruption by President Trump might become too much for the institutions that uphold the international global order. The appellate body of the WTO for example, where unfair trade practices are eventually settled, has already dissolved last December due to President Trump's refusal to appoint judges. Also, the rather novel practice of installing tariffs on the grounds of national security has since Trump been copied in at least 6 other cases.

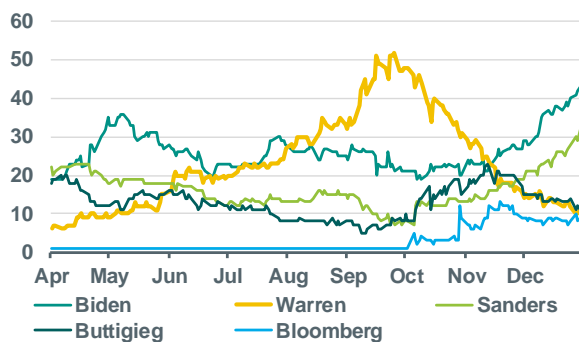
Who will run America?

At this point in time we think that the re-election of Trump is slightly more likely than a Democratic candidate winning the election. This is mainly because historically, failing to win a re-election only occurs when the economy is in recession. As we do not expect a recession this year, we expect Trump to have slightly better chances. The nominee on the Democratic side is not chosen yet, so things could change. Joe Biden, who is considered the strongest opponent to Trump, is currently leading the polls, with a 43 percent probability of winning the nomination.

While the state of the economy has been a strong predictor of election results in history – a 1 percent increase in the consumer sentiment index predicted a half percentage point increase in the President's approval rate – this connection is completely absent since 2008. If that is still true today, current high levels of consumer confidence don't tell us much about the election outcome.

Joe Biden looks most likely to win the nomination

Implied probability of each Democrat winning Presidential nomination, %



Source: *PredictIt*.org, Bloomberg, ABN AMRO Group Economics

Trump's approval ratings have improved a little

Net approval rating, %



Source: *RealClearPolitics*, Bloomberg, ABN AMRO Group Economics

Global trade effects

The outcome of the American election has great impact on the course of global trade and trade conflicts. If President Trump wins the election, the trade conflict continues to be high on our watchlist, despite the Phase One deal. While the fragile start of a deal is certainly positive, we see the news more as a lowering of downside risks to growth, compared to an alternative scenario of a further escalation. This is partly because the policy of protectionism, of which the escalating US-China tensions was just one symptom, is still there. Unpredictable tweets or actual attacks on trading partners creates uncertainty, erodes global business confidence and slows investment spending, hence global trade and global growth. Further, the most difficult parts of the trade negotiations with China – on technological trade practises – is still to come.

A Democratic President would greatly reduce the risk of trade tensions with China and ensure the absence of a future trade conflict with Europe. For financial markets we see a short term risk if Democratic candidates Elizabeth Warren or Bernie Sanders would be nominated, let alone would win the election. Markets would likely react negatively due to the likelihood of higher taxes and increased regulation under such Presidents. This looks a relatively low probability scenario at this stage, but it is still early days.

China has more than trade to worry about

For China, a re-election of President Trump would mean that the uncertainty of a potential re-escalation in tensions looms large. Even without a re-escalation of the trade conflict, China has domestic problems to worry about. For China, the issue is whether it can strike the right balance between keeping its debt levels under control without cooling growth beyond what it can handle and apply sufficient stimulus to the economy if necessary. At the same time, China aims at a structural shift away from exports and investment toward domestic consumption and services. Partly this shift is driven by the demographic challenge of an even more rapidly ageing society than ours is.

And finally, in the case of strong headwinds from a trade war re-escalation, the recovery of Chinese growth would be more difficult now compared with the previous two cyclical upswings in 2010-11 and 2016-17. This is because China's

stimulus is more piecemeal now compared to previous easing episodes, given that there are still longer-term constraints such as the need to keep overall debt levels in check and to prevent a housing bubble.

China: M1 money supply



Source: Bloomberg

Assuming that the trade war does not really re-escalate in the coming year, and that the government keeps adding piecemeal easing targeting the private sector, we expect economic growth to stabilise this year. Meanwhile, overall debt levels have started to rise again, although China is not leveraging up as fast as it did in the past (also see our [China Outlook 2020, Growth to stabilise in Year of the Rat](#)).

Both in the US and in the Eurozone, we have seen how the services industries have stayed remarkably resilient, while manufacturing activities showed steep declines (mainly in Europe) as the trade war unfolded. A continued weakness in manufacturing will eventually drive a renewed slowdown in jobs growth, thereby denting consumer confidence, consumption and the broader economy including services.

Eurozone PMI

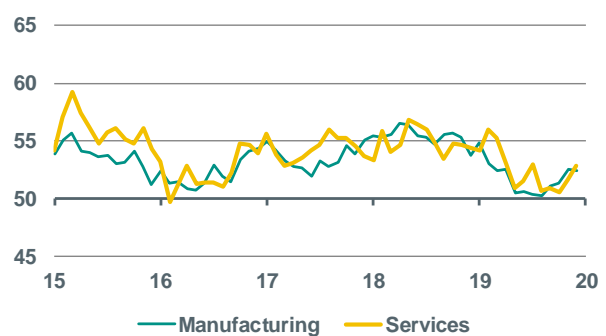
Index, 50=neutral



Source: Thomson Reuters Datastream

US PMI

Index, 50=neutral



Source: Thomson Reuters Datastream

If services prove to cushion or at least delay the effect of a conflict induced manufacturing slowdown, it might matter less than we think who becomes the next US President. As such the resilience of the services sector is something to keep an eye on.

ECBs fundamental rethink more urgent under Trump's presidency

The outcome of the upcoming election is also relevant for the ECB and its policy evaluation. If economies perform poorly due to trade uncertainty if Trump is re-elected, the ECB will have to step up its policies. This situation increases the relevance of the questions that the ECB is asking itself in its policy evaluation. Think for example of questions like: how low can rates go before they become contractionary instead of stimulating? (The so-called 'reversal rate') How should the ECB deal with the systematic undershoot of inflation? Would a bandwidth target be an option, and could previous undershooting allow overshooting?

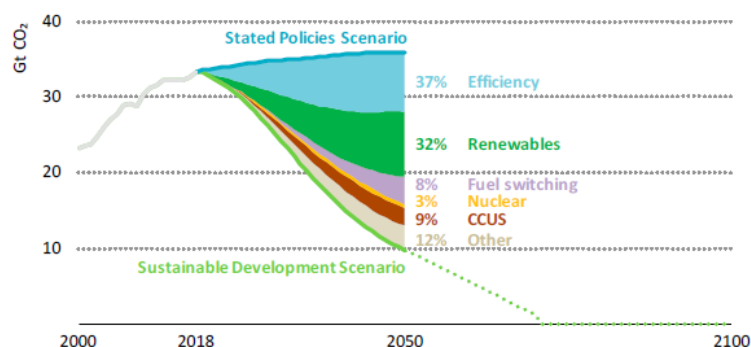
Another issue is that a re-election might imply the continuation of political pressure by President Trump to stimulate the economy in order to increase his popularity. This could potentially undermine the public perception of central bank independence.

Finally, the issue of whether the ECB should take account of climate policy in its asset purchase programme is also more relevant if governments are becoming reluctant. The American withdrawal from the Climate agreement in Paris has meant a huge setback in this regard, and will keep doing so if the current President is re-elected.

Could denial and delay turn into disruptive climate action?

Another four years under the Presidency of Trump would lead to insufficient or no national climate policies in the US, as the President takes the stance that human induced climate change does not exist. With the US freeriding on climate action, the incentive for many other countries to do the same increases. The result will be an increasing divergence between policies necessary to keep global warming below 2 degrees, and policies that are actually taken.

CO2 emissions reductions by measure in the Sustainable Development Scenario relative to the Stated Policies Scenario, 2010-2050



Source: IEA, 2019

A long delay of necessary policies, followed by a sudden catching up of policies can cause economic disruption. This 'too late too sudden' scenario has been identified by the European systemic risk board as a scenario that could have significant adverse effects on the European financial system (see text box).

What would a too late too sudden scenario look like?

It would occur as a late and abrupt transition away from fossil fuels, exacerbated by relatively low investment in alternative energy infrastructure and R&D. In such a scenario, the underlying political economy leads to a late and sudden implementation of constraints on the use of carbon-intensive energy. This would imply a sharp spike in energy costs; temporarily inadequate energy supply; sudden economic obsolescence of the capital stock; sudden revaluation of fossil fuel reserves; and a revaluation of the market value of firms according to their exposure to carbon-intensive resources, inputs or technologies (ESRB, 2016). The effects of a hard landing would be amplified by the macroeconomic and financial market feedback loops.

We believe that in 2020, the combination of delay and divergence between promises and action taken on the one hand, and climate litigations becoming more successful on the other, is a looming risk that we need to keep our eye on.

Delay in Europe

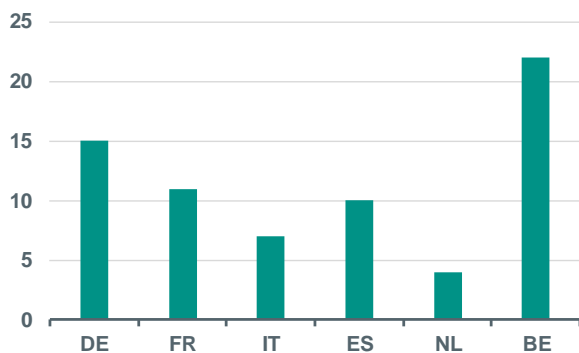
Also in Europe, the deviations between targets and current policies are striking. On the one hand, there are the ambitious and binding targets for the reduction of greenhouse gas emissions (-40% in 2030 vis-à-vis 1990). On the other hand, we see projections based on current policies deviating substantially.

Already in the coming year (2020), the EU28 is estimated to be 6% behind target in its energy consumption reduction if it meets its current policy objectives. As the table below shows, these gaps between targets and what current policy would achieve (if fully implemented) are projected to grow rapidly after 2021 (see also:

<https://insights.abnamro.nl/en/2020/01/euro-watch-green-bond-issuance-to-explode/>)

EC's assessment of draft National Energy and Climate

Greenhouse gas emission non-ETS (% reduction target)
Gap between projections based on existing policy measures and EU-obligations (pps)



Source: European Commission

We see at least two factors that are likely to cause more delay in the near future:

The first is that policy initiatives that would help to curb emissions in a regulated manner such as the Emissions Trading Scheme cannot be easily implemented, due to divergent interests of individual countries. In 2019, EU ETS prices stabilized around EUR 25/tonne. If the EU wants to stimulate a further increase in carbon emission prices within the ETS sectors, and thus a faster path of carbon emissions reduction, it needs to adjust its ETS policy. Since not all countries are aligned, this may take much longer than is ideal.

A second factor of delay is coming from capacity constraints. In several places within the EU we see that the scaling up of solar and wind energy results in congestion of the electricity grid. In fact, scaling up renewable energy is outpacing the investments in the electricity grid and could therefore lead to suboptimal solutions or the temporary switching off for some of the renewable energy sources. At the same time, we see that the rise in renewable energy capacity is still being outpaced by the rise in energy demand.

Sudden policy action

Is it likely that in a situation of delayed and insufficient policy action, governments - especially in the Eurozone – will catch up suddenly and introduce policies that could cause an economic or financial shock? One would think that the same arguments of economic hardship that had prevented policy action earlier would still apply in a later stage. There are however two push-factors that could initiate such a radical shift in policy stance: 1) observed climate change (eg.

natural disasters) causing voters to demand radical action immediately, and/or 2) climate litigation, i.e. legally forcing governments to catch up with and fulfil earlier promises.

While climate change is more of a long term phenomenon and if anything, causes politicians to be more inactive than they perhaps should be, climate litigation is already an increasing trend. Just this last year, hundreds of NGOs have been suing their respective governments in Italy, Ireland, Germany and the Netherlands for not doing enough to protect citizens from the consequences of climate change. In the case of the Netherlands, the government appealed the decision as it claimed that climate policy is a political and not a legal matter. On the 20th of December, the Supreme Court however upheld its decision. Earlier in 2019, the European Commission decided that the Dutch government is responsible for the preservation of its environment even if that means restrictions on construction and transportation. This triggered the Dutch 'nitrogen crisis', which we estimate is causing at least a quarter percentage GDP growth reduction. ([See Outlook Netherlands 2020 - Growth under pressure/](#))

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