Markets and Economy | Municipal Bonds

Georgia runoffs give Democrats a small majority in the US Senate

By: Schuyler Hooper, CFA | & Craig R. Brandon, CFA | January 6, 2021

Boston - With the results of the January 5 runoff elections in Georgia coming in, the Democrats appear poised to take a slim majority in the Senate. While President-elect Biden's party would loosely control both chambers of Congress, we believe he would still face constraints in enacting significant portions of his largely progressive agenda.

The Democrat's lead in the House of Representatives is extremely thin, as evidenced by the narrow re-election of Speaker Pelosi at the first meeting of the 117th US Congress on January 3. There are also dueling coalitions of moderate and progressive Democrats who could disagree on many issues.

And with only 50 votes in the Senate, the Democrats would have no margin for dissension. West Virginia's Joe Manchin, who is often called a "Conservative Democrat," has already said that he will not support some of the Democratic agenda's progressive elements. Montana's Jon Tester, who is more of a moderate, hails from a fairly red state and would likely face criticism in his next election for backing highly progressive measures. Other Senators from swing states such as Arizona, Michigan and Pennsylvania may also feel constrained in how they can vote given their narrow election margins.

Clearing the path for more fiscal stimulus and tax policy reform

Nevertheless, the Senate runoff results would clear the path for more stimulus in the near term and the potential for some additional spending, as well as changes to tax policy through the budget reconciliation process.

We expect the $2,000 additional stimulus checks to be passed. After all, they have fairly bipartisan support. And Biden has mentioned that the $900 billion aid program passed in late December is just a down payment, with more stimulus coming under his watch.

Biden has also pledged to roll back some of the Trump tax cuts, raising rates for high income earners, corporations and capital gains. We think this part of his plan may be stymied, especially while the economic recovery is still very tenuous. The more moderate members of his party would probably push back against such large increases as well.

To accomplish their spending and tax objectives, the Democrats will likely use the budget reconciliation process in the Senate, which both parties have done in recent years. This process has some odd quirks but essentially allows a budget-related bill to pass the Senate once a year with a filibuster-proof simple majority, instead of the normal 60 votes.

The flip side of this coin is that to pass a bill through budget reconciliation, it must not increase the deficit after 10 years. So to meet Biden's lofty spending goals, the Democrats would need some form of increased revenue generation. However, this constraint has been pretty weak in the past — easily got around with creative accounting — as evidenced by some of Trump's budgets that were clearly not deficit neutral.

Likely beneficiaries: Democrats have been pushing for more aid to state and local governments, along with more funding for education. Green energy and infrastructure projects are likely to be a large part of the Democratic spending package. So we could eventually see greater issuance of green bonds. Raising the corporate tax rate to 28% from 21% would make municipal bonds more attractive for banks, life and property & casualty insurers, who account for about a quarter of tax-exempt muni holders.

Smoothing the path for Cabinet and judicial appointments

So far, Biden has largely announced a more moderate Cabinet that he deemed able to get through a Senate confirmation process — even if the Democrats did not win the two seats in Georgia. However, that process has often been messy and drawn out when the President's party doesn't control the Senate. With the Democrats holding 50 seats, the Cabinet position confirmations could go much more smoothly. With his team in place quickly, Biden's regulatory policy could probably resemble something closer to what he had originally hoped.

The Trump administration purged a lot of regulation from the books, and the Biden administration has pledged to reinstate many of those provisions and to add new ones. Some of these policies could be a surprise to risk markets, so this may be the most underrated conclusion from the election —with the potential for an outsized impact on specific companies, sectors and even asset classes at various points over the coming months.

Bottom line: In terms of financial market impacts, we could see inflation expectations continue to rise on the back of more fiscal spending. The federal government would also keep running large budget deficits, requiring a lot of US Treasury (UST) issuance. Coupled with inflation, that would put some pressure on interest rates, all else equal.

However, that ignores any action taken by the Federal Reserve, which may step in with some sort of Yield Curve Control policy if the UST curve steepens too much or if rates start to back up so much that they negatively impact stocks and other asset markets. The Fed recently adopted a longer-run average inflation targeting framework, so we suspect that a little inflation in the near term is unlikely to frighten them into tightening monetary policy too soon.

Schuyler Hooper, CFA
Analyst
Global Income
Eaton Vance Management

Craig R. Brandon, CFA
Co-Director of Municipal Investments
Eaton Vance Management

> "The Senate runoff results would clear the path for more stimulus in the near term and the potential for some additional spending, as well as changes to tax policy through the budget reconciliation process."