PICTET WEALTH MANAGEMENT

How do US elections impact monetary policy?

Rate cuts, fiscal policy, and the Fed Chair

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FLASH NOTE

SUMMARY

- As the November election approaches, two common perceptions we hear often from investors are 1) **The Fed will try to frontload rate cuts** to avoid changing policy too close to the election in November, which could appear political, and 2) **The Fed is biased to ease policy** more than usual this year to help the incumbent.
- Neither of these claims is unfounded, and the **Fed has been caught in political crosshairs before**. However, the 2024 presidential **election does not change our expectation for monetary policy based on economic fundamentals**. We expect the Fed to start lowering rates in June, and at every meeting thereafter this year.
- **The Fed has both tightened and eased policy in close proximity to elections in November, and we find no easing bias**. If data are strong enough to prevent the Fed from cutting policy rates until November, they may very well consider refraining from making their first policy move at the November meeting (two days after the election) **so as not to signal great urgency**.
- Elections do matter, because of the economic uncertainty they generate, and potential policy changes. Policy proposals from leading presidential candidates are both **fiscally expansionary**. More restrictive trade and immigration policies **under Trump** could be **perceived as more inflationary**.
- Elections can also impact monetary policy through the president's nomination of the Fed Chair. The **risk of an unorthodox candidate**, whose policy-making could be directly influenced by the president, exists. But the Senate has the final say in nominating the Chair, and there is a common understanding among Senators that Fed independence shall be preserved.

POLITICAL INTERERENCE

The Federal Reserve has enjoyed monetary policy independence, but it is not immune to political interference. Even the great inflation fighter, former Fed Chair Volcker, recounted in his memoir that he was being privately ordered by President Reagan's chief of staff not to raise interest rates in the run up to the 1984 election, while Reagan was in the room. Former president Trump berated Chair Powell and called for lower rates during the 2019 trade wars, breaking with a tradition since the 1990s where presidents avoided commenting publicly on Fed policy.

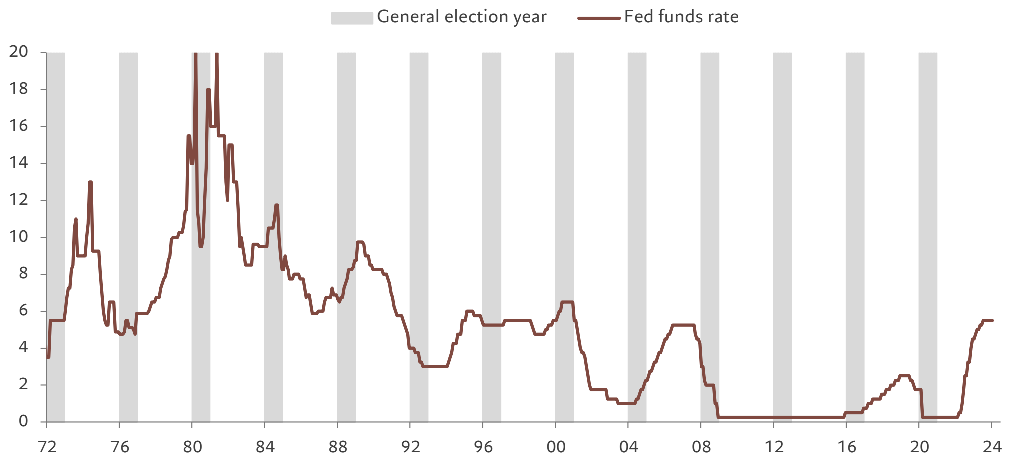
However, the 2024 presidential election does not change our expectation for monetary policy based on economic fundamentals. We expect the Fed to start lowering rates in June, and at every meeting thereafter this year.

ELECTION YEARS HAVE SEEN FREQUENT RATE MOVES, WITH NO EASING BIAS

The FOMC has not shied away from adjusting monetary policy in election years (chart 1). In our sample of 13 general election years since 1971, the Fed has eased policy six times (measured as the change in the fed funds rate from Jan to before the election in Nov), hiked five times, and kept rates unchanged twice (chart 2). The magnitude of policy rate changes is similar across general election and non-election years, shown as the absolute average of interest rate changes (chart 3 left).

There also doesn't seem to be an easing bias (chart 3 right). In fact, if anything, there's a slight hiking bias in election years, but it is not statistically significant. Importantly, inflation remains the top economic issue for voters, so to favour the incumbent is as much about keeping policy tight to fight inflation and about loosening policy to boost growth. The Fed is already walking that fine balance between its dual mandate.

Chart 1: Fed funds rate, with US general election years shaded; %



Source: Pictet Wealth Management, Federal Reserve Board, as of 08.02.2024

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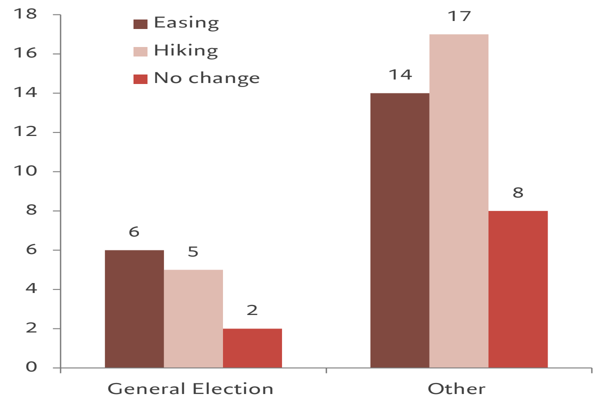
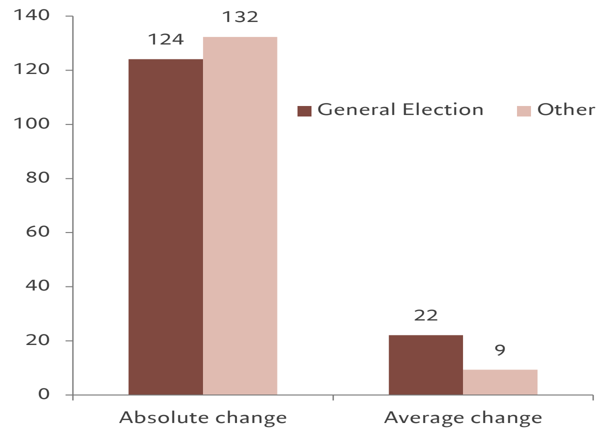
Chart 2: Frequency of Fed policy changes in general election years, and others



Source: Pictet Wealth Management, Federal Reserve Board, Sample starts in 1972, including 13 general elections years and 39 others. As of 08.02.2024

Chart 3: Magnitude and direction of Fed policy changes in general election years, and others; bps



Source: Pictet Wealth Management, Federal Reserve Board, as of 08.02.2024

The FOMC has both tightened and eased policy close to elections in November (Table 1). For example, they carried on hiking rates in September and November 2004, right before and after the re-election of George W. Bush. The Fed eased policy by cutting rates and doing QE3 close to the elections in 2008 and 2012, during the GFC. In the 1970s and 80s, the FOMC changed policy numerous times in October, right before the elections.

Table 1: Fed policy changes in close proximity to general elections

ELECTION YEAR	LAST MOVE BEFORE THE NOVEMBER ELECTION	DIRECTION	SIZE OF LAST MOVE
1972	March	Tightening	2.0%
1976	October	Easing	-0.125%
1980	October	Tightening	1.75%
1984	October	Easing	-1.50%
1988	August	Tightening	0.50%
1992	September	Easing	-0.25%
1996	January	Easing	-0.25%
2000	May	Tightening	0.50%
2004	September	Tightening	0.25%
2008	October	Easing	-0.50%
2012	September	Easing	QE3
2016	None	None	0.25% hike in December
2020	March	Easing	-1.00%

Source: Pictet Wealth Management, Federal Reserve Board

The only exception here is November 2016, when the Fed had been on hold for almost a year after hiking in December 2015 for the first time since the GFC. Then NY Fed president Dudley argued against moving at the November 2016 meeting (six days before the election), suggesting that doing so would **give the**

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perception of unwarranted urgency. The FOMC chose instead to raise rates at the following meeting in December 2016.

"So the lack of urgency implies that there is not a good case for moving at this meeting. To do so with the election a week away, the outcome uncertain, and no scheduled press conference would imply an urgency to move that I just don't think is consistent with the incoming information or the economic outlook."

If inflation and/or growth data are strong enough to prevent the Fed from cutting policy rates until November, they may very well consider refraining from making their first policy move at the November meeting (two days after the election) meeting (two days after the election) **so as not to signal great urgency**. Otherwise, if the Fed was **already in an easing cycle, we would expect the committee to be able to carry on.**

ELECTIONS MATTER DUE TO ECONOMIC UNCERTAINTY AND POLICY CHANGES

Although the Fed does not try to influence election outcomes or be influenced by politics, monetary policy does not operate in a vacuum.

Studies have shown **economic uncertainty has a clear tendency to rise in the months leading up to elections, and more in cycles where presidential elections are polarized**, which has been increasingly the case in recent years. Households and especially businesses may delay big-ticket purchasing/investment plans until after the election, creating a near-term headwind to growth.

Meanwhile, **fiscal and trade policy changes, both before and after the election, could impact growth and inflation trajectories**. For example, the 2012 fiscal cliff, the 2017 Trump tax cuts, the 2019 US-China trade war, and the various rounds of pandemic fiscal stimulus have profound impact on sentiment and macro variables. Past transcripts of FOMC meetings show participants have discussed the impacts of these changes on monetary policy.

Although the fiscal deficit is unusually large for an economy near full employment, **significant fiscal consolidation seems unlikely after the election.** In fact, both candidates are keen to extend some or all of the 2017 Trump tax cuts, which are set to expire at the end of 2025, with compensations likely coming from higher taxes under Joe Biden and lower welfare spending under Donald Trump. **Both policy proposals are fiscally expansionary. More restrictive trade and immigration policies under Trump could be perceived as more inflationary.**

As we wrote in our 2024 outlook, we don't expect fiscally significant legislation to be passed **before** the election given that Congress is divided. The recent $78bn bipartisan bill aimed at boosting childcare credit and increasing business expensing, which has yet to pass Congress, presents an upside risk to near-term growth and budget deficit.

THE RISK OF AN UNORHTHODOX FED CHAIR

Elections can potentially impact monetary policy through the president's nomination of the Fed Chair. Former President Trump has said, if elected, he would not renominate Chair Powell when his term expires in 2026.

The risk of an unorthodox candidate, whose policy making could be directly influenced by the president, arises in that scenario. But the Senate has the final say in nominating the Chair, and there is a **common understanding among senators that Fed independence shall be preserved**. In fact, in 2019 and 2020, a Republican Senate refused to advance the nomination of a few controversial candidates supported by Trump.

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