

TRENDMACRO LIVE!

On the 2014 Midterms

Wednesday, October 5, 2014

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It's a "wave." Now we wait to see how the GOP will govern: for growth, or brinksmanship?

As we predicted over a year ago during the darkest hours of the government shutdown -- when the conventional wisdom was that the Republican brand had been destroyed forever (see "[On the Shutdown and Debt Limit Deal](#)" October 17, 2013) -- the GOP has increased its House majority by 13 seats, and taken control of the Senate by at least two seats. Two was exactly our baseline prediction (see "[Mid-term Cliffhanger](#)" September 24, 2014). *But it's not over yet. The majority may ultimately be by five.*

Several key races thought to be too close to call just days ago -- such as Georgia and Kansas -- turned out to be GOP landslides. Further, the GOP won key gubernatorial races in Wisconsin, Florida, Kansas, Massachusetts and Illinois. *This was a "wave."*

We'll talk about what it means for the economy and the markets in a moment, but first a quick analysis.

- Looking at each of 14 competitive Senate races reveals the extent to which this was a "wave" (please see the table below). The GOP

GOP Senate mid-term performance in competitive races, by difficulty

Very easy for GOP		Hard for GOP	
Open Dem seats in red states		Open Dem seats in blue states	
MT	✓	IA	✓
SD	✓	MI	✗
WV	✓	Dem incumbents in red state	
GOP incumbent in red states		AR	✓
KY	✓	AK	✓* <i>Awaiting count</i>
KS	✓	LA	✓* <i>Run-off Dec 6</i>
Easy for GOP		NC	✓
Open GOP seat in red states		Very hard for GOP	
GA	✓	Dem incumbent in blue states	
		CO	✓
		NH	✗

Source: Cook Political Report, TrendMacro calculations

Update to strategic view

US MACRO: It's a "wave." The GOP extended its majority in the House, won key gubernatorial races, and took control of the Senate by the two seats we predicted -- with the strong possibility of three more over the coming weeks. Markets have already sharply rallied over the last week, while the polls had all swung toward the GOP. From here, markets will have to wait to see how the GOP congress governs. With the Obama administration adrift, we expect the GOP congress to carefully demonstrate its competence by passing bi-partisan bills for win-win pro-growth initiatives such as green-lighting the Keystone XL pipeline and repealing the medical devices tax in Obamacare -- which Obama may very well sign, marking the first pro-growth legislation in years. Alternately, the GOP could revert to the brinksmanship that brought us the S&P downgrade and the government shutdown, as McConnell has indicated it would in public statements which were hopefully hollow campaign promises.

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not only didn't lose a single "easy" race, but won -- or is highly likely to win -- six out of eight "hard" races. [Stop and appreciate this -- it is always hard to unseat an incumbent \(the GOP bagged four\), and all the more so in a state that voted for the other party's candidate for president last time \(the GOP bagged one\).](#)

- The first of the GOP's potential three further seats -- extending altogether its majority to five -- is Alaska, where it always takes several days for all the votes to be collected from far-flung non-urban districts. [Republican Dan Sullivan is far ahead with most votes counted, but as of this writing Democratic incumbent Mark Begich has not conceded.](#)
- The second of three will likely come in the December 6 runoff in Louisiana, where in yesterday's "jungle primary" neither Democratic incumbent Mary Landrieu nor her main Republican opponent Bill Cassidy exceeded the required 50% vote-share. [Though Landrieu with 42.1% of the vote narrowly outpolled Cassidy with 41.0%, it is still highly likely that Cassidy will ultimately win. He and two other Republicans on the ballot yesterday, Rob Maness and Thomas Clements -- neither of whom will be on the ballot in December's one-on-one face-off -- together earned 55.8%.](#)
- And making three, Maine's Angus King, an independent who presently caucuses with the Democrats (and who was not up for election this year) [has hinted](#) he may caucus with whomever wins the majority.

We're not expecting any particularly strong immediate reaction from markets. A GOP win, if not this "wave," has been generally predictable from polls and publically available models over the last week (a week during which stocks have already rallied quite sharply). [We think markets will, quite sensibly, wait to find out how the new GOP congress intends to govern. There are two ways it could go, one very bullish and one very bearish.](#)

The bullish path is that the GOP builds on the very factors that helped it win this election -- [reining in its most extreme elements](#), and exploiting the growing dissatisfaction with the Obama administration as corrupt and incompetent. [The GOP will likely try to show that it is a sensible party that can competently govern. It will pass, with a few Democratic votes in the Senate, some simple bipartisan win-win legislation such as green-lighting the Keystone XL pipeline, liberalizing energy exports and repealing the medical devices tax in Obamacare, or other elements of Obamacare already blunted by executive order.](#) President Obama would be hard-pressed not to sign such bipartisan bills, and they would have some pro-growth impact -- all the more so considering that there hasn't been a pro-growth piece of legislation to come out of the US congress for at least six years.

The bearish path is that the GOP, flush with victory, misinterprets its mandate and reverts back to the politics of brinksmanship that led to two near-misses with Treasury default, a Standard & Poor's downgrade, and a government shutdown.

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It would be harmless, and perhaps even useful, for the GOP to send partisan bills for Obama to veto as mere demonstrations -- such as one to repeal Obamacare, which the Senate could pass without out a single Democratic vote (the Supreme Court having declared the "mandate" to be a tax, repeal would be a tax bill subject to filibuster-proof reconciliation procedures).

But Mitch McConnell (R-KY), who in January will likely be Senate Majority Leader, has said repeatedly that he will take it beyond mere demonstrations. He [said last month](#) that he would attach riders to must-pass spending bills to achieve controversial conservative goals such as repealing Environmental Protection Agency authority to regulate carbon as a pollutant. Such bills would surely draw Obama vetoes, and would set up confrontations that would threaten government shutdowns or Treasury defaults.

Such brinksmanship would have grave consequences for markets -- remember the outright bear market in stocks that occurred in 2011 during the debt ceiling crisis, which ultimately resulted in the S&P Treasury debt downgrade.

We think McConnell's threats are just talk -- hollow campaign promises from a man in a tight race in a conservative state, who had been tagged a traitor for in fact pulling the GOP and the nation back from disaster over and over, through the debt crisis of 2011, the fiscal cliff of 2012, and the shutdown of 2013. *But he did say it -- and markets are going to have to wait and see if he meant it.*

Bottom line

It's a "wave." The GOP extended its majority in the House, won key gubernatorial races, and took control of the Senate by the two seats we predicted -- with the strong possibility of three more over the coming weeks. Markets have already sharply rallied over the last week, while the polls had all swung toward the GOP. From here, markets will have to wait to see how the GOP congress governs. With the Obama administration adrift, we expect the GOP congress to carefully demonstrate its competence by passing bi-partisan bills for win-win pro-growth initiatives such as green-lighting the Keystone XL pipeline and repealing the medical devices tax in Obamacare -- which Obama may very well sign, marking the first pro-growth legislation in years. Alternately, the GOP could revert to the brinksmanship that brought us the S&P downgrade and the government shutdown, as McConnell has indicated it would in public statements which were hopefully hollow campaign promises. ▶