US Election Preview

With VP Biden leading, what major economic impacts are likely?

The obvious area of disagreement is regarding climate policy.

We have written on this topic previously – **Pres Trump was infuriated at the one-sided nature of the Paris Agreement deal**.

Pres Obama faced an unenviable choice. Pres Xi was on the record that **China would <u>never</u> agree to CO_2 emission limitations**.

Without the largest emitter (the largest population, and largest manufacturing economy), Paris negotiations would have fallen apart. The calculation was that **having China agree to a symbolic target (which they would certainly beat) was better for the world** than no deal at all.

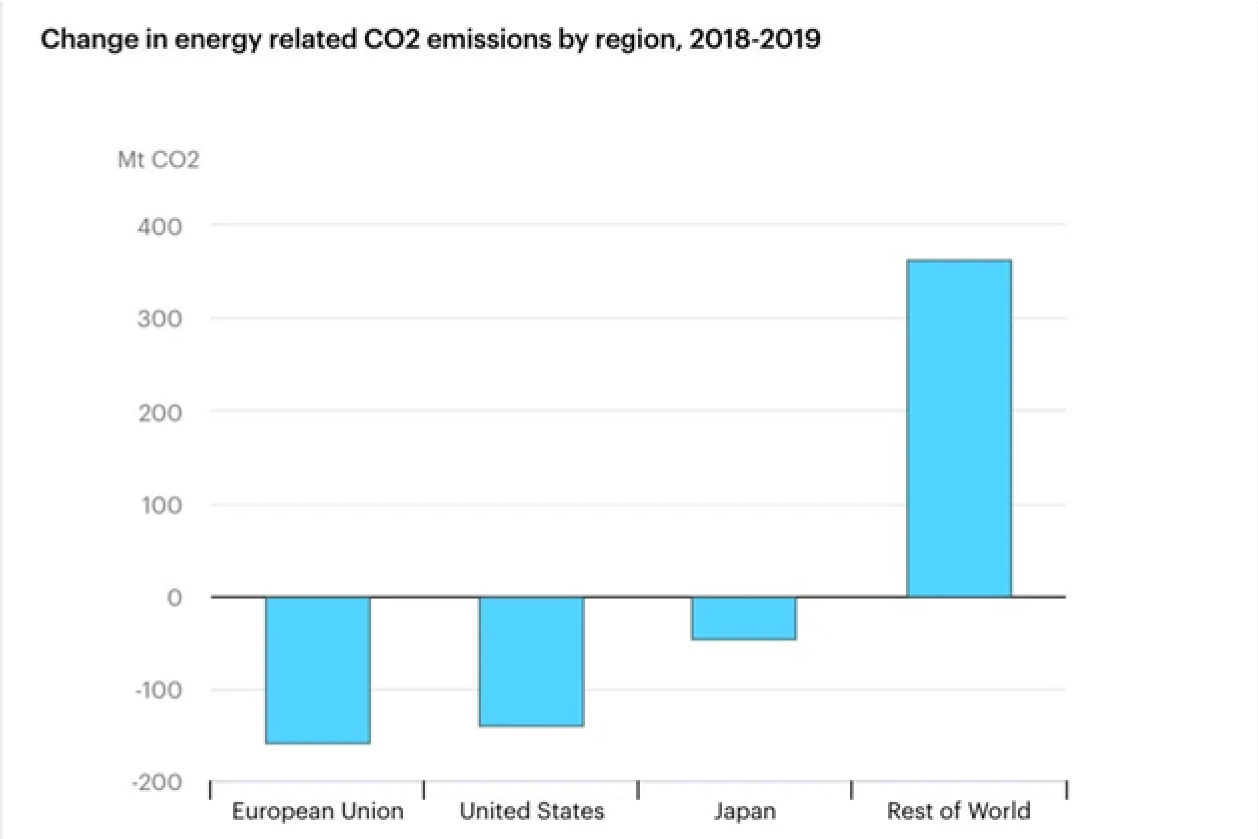
And while dressed up in nice language about "*emission intensity relative to 2005*" that sounds imposing, the raw data shows **China agreed to *increase CO_2 emissions by not more than 145%, peaking in 2030*** (after a generation of one-child policy means their population will already be falling).

World Bank data shows that **China had <u>already</u> met their 2030 targets *at the time of signing***!

Year	GDP (curr $tr)	CO2E (Mt)	low case	Intensity Reduction
2005	$2.29	5,790		(*vs* 2005)
2013	$9.61	10,249		58%
2015	$11.07	10,249		63%
2016	$11.82			
2020	$15.20	23,103	21,178	40-45% target
		225%	*207%*	
2030	$24.76	25,089	21,953	60-65% target
		245%	*214%*	

Did this matter? By 2015, China had largely completed its massive fleet modernisation of its steel and other smelting industries, particularly the energy-intensive aluminium. **It was physically impossible <u>not</u> to meet Paris targets.** In 2020, China will emit roughly 10Gt of CO2E, <u>in line</u> with 2015 rather than 225% of 2015.

If we conclude that China's targets do not matter, it would similarly follow that *<u>US targets do not matter either</u>*. In what could be the last full year of membership, US emissions fell – **by the most in the world**:



Source: IEA

(The EU's population was 50% larger than the US for pre-Brexit data.)

Obama's other twist was to impose a 3-year minimum lock-in period, **expiring 1 year less 1 day before the US election**. And the notice period is 1 year. It now appears likely that as a result of COVID-19, the result of the election will not be known by November 4th, as counting of postal votes continues.

We therefore assume that:

- USA will allow its notice to lapse, and **formally exit the Paris Accord on Nov 4th** regardless of the election result
- There being no mechanism to reset targets, **China's non-targets will not be revised**
- An incoming Biden Administration would see USA a new entrant to the Paris Agreement in 2021, with **stronger targets than the 2015 ones**

On the assumption that there will be a Democratic President elected in one of 2020, 2024 or 2028, withdrawal will enable the US to reset its Paris targets.

But is this negative for energy prices?

The US will very likely be consuming less energy, and less carbon-intensive energy. ***But price is the interaction of supply and demand***. In the primaries, Biden was adamant: *He will abolish fracking.* He was equally adamant in Pennsylvania this week: *He will not abolish fracking.*

Fracking techniques produce two thirds of US gas. And shale gas depletes very quickly – over 2 to 3 years. ***We forecast a Biden Administration would increase energy prices, by impacting US supply more than demand.***

Secondly, we consider the **aggregate taxation base**.

A talking point of the Trump campaign is that Biden would "increase taxes by $4tr."

The US convention is to have the Congressional Budget Office cost policies over 10 years. So the $4tr number is likely accurate – but **$400bn p.a. is a drop in the bucket compared to a deficit of perhaps $4tr p.a.** this year.

We assume that COVID-era deficits are not only incomprehensible large, but that governments have no idea of the path out of them.

<u>Ultimately, whoever wins will raise taxes – a lot.</u>

Finally, the most important question is *whether they will try more radical approaches.*

Stephanie Kelton was the Chief Economist for the Minority Senate Budget Committee during the Obama Administration, and then an advisor to the Sanders campaign. Dr Kelton is the best-known proponent of Modern Monetary Theory (MMT), and the theory has significant support amongst the "progressive wing" led by Sanders. ***We expect MMT to have strong support in a Biden Administration post-COVID.***

MMT seeks to take advantage of low inflationary pressures during periods of high unemployment; proponents feel even extreme policy measures are much less inflationary than thought. ***Governments can do virtually anything*** – fund a Green New Deal, create jobs (even "make work" jobs), or even give the money away. **They can never "run out of money" provided they can print a currency**, or more specifically a reserve currency.

Until full employment is restored, even massive stimulus may not be particularly inflationary. And should aggregate demand increase enough to create supply constraints and start to drive up price, only then would fiscal policy (taxes) be used to manage demand.

MMT may be accurate – if not, the consequences of a failed experiment may be dire.

We expect a Biden Administration to be dominated by MMT advocates. **Initially, any implementation would likely be scaled** – a pilot programme to see how inflation responds.

China policy beyond 2020 has seen few specifics. **Both candidates have postured as being tougher on China**, and described their opponent as weak.

The idea of a Biden Administration more hawkish on China after years of criticising trade wars seems far-fetched. More likely, they will go after China proxies – **notably North Korea, already accidentally flagged for regime change**.

More broadly, a Biden Administration would favour multi-lateral trade deals, probably including reactivating US participation in the Trans Pacific Partnership (TPP). **A globalist approach will probably ease protectionist pressures** including pressure on Australian producers.

Leading Markets

The US S&P500, Dow Jones and NASDAQ soared +7.19%, +7.92% and +9.70% respectively on hopes of a COVID-19 vaccine, as cases passed 25m. The S&P and NASDAQ set records. Daily case and death counts peaked mid-August.

MSCI World ex-AUS gained +6.35% in local terms. Emerging Markets rose +2.17% in $US, led by China.

US 10-year bonds slumped to 0.72% (+17bp) on the Fed's revised inflation policies. Japan's 10-year reached +5½bp, *vs* -29bp a year earlier.

High yield traded through +500bp, closing +502bp (-14bp firmer), a post-COVID low.

Other Highlights

Japanese PM Abe retired after a record tenure. Both parties confirmed their nominations for the US 2020 election. Betting markets are even, as VP Biden's lead in key states narrowed. Who voters punish for riots may determine the result.

The US Federal Reserve formalised its "through the cycle" approach, confirming higher inflation would be tolerated for years after past long-term undershoot.

US 10-month budget deficit was -$2.8tr.

YTD GDP contractions included 22% (Spain, UK), 15%+ (Eurozone, Philippines, Malaysia, Mexico), 13% (Canada, Singapore, Chile) and 10% (USA). Australia is expected to join Japan, Switzerland, Scandinavia and HK as developed economies to avoid -10% falls. -9.1% in Q2's second estimate took USA just through -10% CYTD.

US July unemployment eased to 10.2% (-0.9%) after +1.76m jobs. CPI rose to +1% YoY (from +0.6%) after a large +0.6% month. Retail sales rose+1%.

Japanese retail sales soared a record +13.1% in July.

EU prices declined -0.4% in July.

US consumer savings fell to 17.8% in July.

China is punishing slights through trade, including anti-dumping sanctions on Australian wine while openly campaigning for Biden and escalating skirmishes on multiple fronts.

Domestic

The ASX200 gained +2.83%, with Smallcaps +7.24%. The 10-year bond closed at 0.98% (+17bp), trading through 1% intra-month.

Victoria planned its exit from stage 4 lockdown but flagged a longer state of emergency.

Economists now believe no GDP recovery will commence until Q4. International flights are heavily restricted.

Average wages paradoxically soared +5.4% YoY, from the loss of low-end jobs. The wage index provided a better picture, at a record low +1.8%.

The RBA released a paper about the record household debt to income. They attribute this to underlying factors (lower rates, wealth effects) and do not see higher risk.

They consider the AUD at fair value. Risk spreads are low.

Q2 capex fell -5.9% in Q2 to be -11.5% YoY; equipment capex fell -13.8% YoY. Residential construction fell -12.1% YoY after declining another -5.5% in Q2.

Retail sales jumped +3.3% in July.

Building approvals rose +6.3% in July.

Unemployment rose to 7.5% (+0.1%) despite +114.7k jobs in July – it has probably not peaked, with subsidised jobs still to end. Participation rose to 64.7% (+0.6%) and underemployment fell -0.5% to 11.2%. Hours works gained +1.3%.

Business confidence plunged to -14 in July while consumer confidence dropped to 79.5 (-9.5%).

Australia's trade surplus slumped to +$3.3bn from +$8.2bn as exports fell -6% but imports soared +11%.

Commodities and Currency

WTI oil rose to $US42.92/bbl (+6.6%). Gold traded through $2000/oz for the first time before closing $1985 (+0.5%). Iron ore soared +12.5% to $122.53.

Base metals rose: Nickel (+12.05%), Zinc (+10.02%), Aluminium (+4.54%) and Copper (+4.37%) were all higher while Tin was relatively flat (-0.44%)

The $A closed at a 12-month high US73.54c (+1.96%).

KEY FINANCIAL MARKET DATA – AS AT 31ST AUGUST 2020 (UNLESS SPECIFIED)

Interest Rate Markets

Index Performance	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
AustBond Bank Bill Index	0.01%	0.03%	0.18%	0.66%	1.24%	1.44%	1.66%

Key Rates	Aug-20	Jul-20	Jun-20
Australian Cash Rate	0.25%	0.25%	0.25%
90 day BBSW	0.09%	0.10%	0.10%
3 Yr Commonwealth Bonds	0.28%	0.28%	0.26%
10 Yr Commonwealth Bonds	0.98%	0.82%	0.87%
CDX North American 5 Yr CDS	65bp	69bp	76bp
iTraxx Europe 5 Yr CDS	54bp	60bp	66bp
iTraxx Australia 5 Yr CDS	64bp	76bp	88bp
US Fed Funds Rate	0-0.25%	0-0.25%	0-0.25%
US 10 Yr Bond Rate	0.72%	0.55%	0.66%

Equity Markets

Domestic	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
S&P/ASX 200 Acc. Index	2.83%	6.04%	-4.48%	-5.08%	1.74%	6.10%	7.47%
S&P/ASX Small Ord Acc. Index	7.24%	6.61%	4.58%	2.07%	1.50%	8.02%	10.48%
S&P/ASX 200 A-REIT Acc. Index	7.89%	7.04%	-15.54%	-17.69%	-0.86%	4.42%	5.82%

International	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
US: S&P 500 ($US)	7.19%	15.48%	19.63%	21.94%	12.03%	14.52%	14.46%
US: NASDAQ ($US)	9.70%	24.34%	38.10%	49.33%	21.76%	23.63%	21.10%
MSCI World Acc. (Local Currency)	3.45%	2.99%	0.93%	6.40%	7.01%	12.41%	9.49%
MSCI World Acc. (AUD)	6.27%	12.47%	13.45%	14.39%	7.64%	9.74%	10.17%
FTSE 100 (₤)	1.75%	-0.90%	-7.87%	-14.32%	-6.77%	-3.27%	3.11%
MSCI Emerging Markets ($US)	2.21%	19.53%	11.23%	14.49%	4.64%	2.83%	8.66%

Fixed Interest Markets

Bonds	1 month	3 months	6 months	1 year	2 year p.a.	3 year p.a.	5 year p.a.
BarCap Global Agg Acc. (Hgd AUD)	-0.71%	0.79%	0.82%	2.52%	6.20%	4.38%	4.60%
AusBond Composite Bond Acc.	-0.42%	0.26%	0.26%	1.61%	6.30%	5.47%	4.36%
ICE BoAML High Yield TR ($US)	0.98%	6.84%	2.34%	3.71%	5.13%	4.51%	6.28%

Data*	Current Period		Previous Period	
Employment Data				
Employment Growth	July	12,461	June	12,329
Unemployment Rate	July	7.50%	June	7.40%
Participation Rate	July	64.70%	June	64.00%
Lending Finance				
Housing Finance	June	6.20%	May	-11.60%
Personal Finance	June	5.20%	May	14.50%
Business Finance	June	57.30%	May	3.60%
Other				
Balance on goods and services	June	8,202m	May	8,025m
Retail Sales	June	2.70%	May	16.90%
Building Approvals	July	6.30%	June	-15.80%

*All data is seasonally-adjusted.

Median Fund Manager Returns (Morningstar)	1 month	3 month	6 month	1 year	2 year p.a.	3 year p.a.	5 year p.a.
Australian Equity Large Cap	4.06%	6.99%	-7.62%	-9.71%	-2.53%	3.55%	5.70%
Australian Equity Small Cap	7.02%	10.28%	5.64%	2.12%	1.63%	6.85%	9.17%
Global Equity Large Cap	1.89%	1.96%	-1.08%	3.15%	4.84%	9.87%	7.70%
Global Equity Small Cap	2.18%	1.30%	-2.32%	-1.02%	-3.10%	4.69%	5.05%
Australian Fixed Income	-0.38%	0.80%	0.18%	1.47%	5.86%	5.08%	4.05%
Global Fixed Income	-0.65%	1.39%	0.80%	2.32%	5.89%	4.00%	3.92%
Australian Listed Property	7.73%	6.73%	-15.90%	-18.26%	-1.67%	3.18%	4.96%
Australian Cash	0.01%	0.05%	0.16%	0.53%	0.98%	1.15%	1.38%
Conservative[1]	0.16%	1.11%	-1.07%	-0.25%	2.55%	3.02%	2.88%
Moderate[2]	0.59%	1.82%	-1.09%	-0.50%	2.51%	3.29%	3.33%
Balanced[3]	1.22%	2.92%	-1.55%	-0.90%	2.11%	3.91%	4.46%
Growth[4]	1.96%	3.60%	-1.85%	-1.18%	1.64%	4.45%	5.00%
Aggressive[5]	2.64%	5.15%	-1.93%	-0.97%	1.52%	5.50%	6.00%

[1] Growth Assets 0% - 20%
[2] Growth Assets 21% - 40%
[3] Growth Assets 41% - 60%
[4] Growth Assets 61% - 80%
[5] Growth Assets 80%+

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