October 14, 2022

Brian Gardner
Chief Washington Policy Strategist
bgardner@stifel.com

WASHINGTON POLICY STRATEGY

Potomac Perspective

The September Consumer Price Index (CPI) report could create headwinds for Democrats and tailwinds for Republicans heading into next month's elections. The inflation report increased chances of the GOP flipping the Senate and winning more House seats than previously expected. This note looks at what the election could mean for proposals from businesses to increase legal immigration as well as implications for the lame duck session of Congress (more confusing than ever).

CPI IMPACT ON THE ELECTION

The September CPI report, which showed inflation rising by 0.4% month over month (and 8.2% year over year), higher than expectations, was among the last of the major economic data releases before the November 8 midterm elections and likely boosted Republicans' prospects and dented the Democrats' chances. The October employment report will be released on Friday, November 4, but inflation is voters' main concern, and the jobs report is unlikely to significantly impact the election. Today's release, coupled with the previous month's inflation report, was bad news for the party in power.

In the House, Republicans need a five-seat net gain to win control. That has always seemed likely given the historical average of a 27-seat loss for a president's party in first-term midterm elections. Republicans might not reach the historical average because of the GOP's unusual 13-seat gain in the 2020 election, so a more modest 15-25 seat pickup this year has seemed likely. Today's CPI report increased the probability of Republican gains at the upper end of this range and opened the door to possibly exceeding them.

In the Senate, the number of competitive seats has been shrinking, and the range of outcomes has been narrowing. The possible outcome scenarios have ranged from a Democratic gain of one (remember, Democrats lost two seats in 2018 despite winning 40 House seats) to a Republican gain of two seats. Following today's CPI report, Republican gains seem more likely. Republican candidates will have the wind at their back as they attack Democrats on inflation and the economy, while Democrats will struggle to break through the narrative on the economy. The Republicans' best chance of a gain has been in Nevada, and this race increasingly looks like a challenge for Democrats. Republicans have struggled in their efforts to flip Arizona and Georgia, but the inflation numbers could help GOP campaigns there, especially in Arizona where immigration is also a huge issue and because the Republican candidate there, Blake Masters, does not carry the same baggage as Hershel Walker does in Georgia. Also, watch Colorado where Democrats have been favored to retain that seat, but the race there could tighten. Democrats' best pick-up opportunity has been in Pennsylvania, where John Fetterman has led Dr. Memet Oz in most polls. The CPI report could hurt Fetterman's chances. Similarly, Democrats have trailed in races to flip North Carolina and Ohio. Although the races in both states are close, today's inflation report will make the uphill fights in those states even steeper for Democrats.

NOTE ON GEORGIA: Neither candidate polls above 50 percent and Georgia law requires a runoff if no candidate wins a majority. Thus, there could be a repeat of the 2020 election when Georgia held two runoffs (one of those races was a special election to fill the unexpired term of Senator Johnny Isakson (R) who has resigned for health reasons). Control of the Senate might not be known until December 6 when Georgia would hold a runoff.

2023 AGENDA IMPLICATIONS – IMMIGRATION AND LABOR MARKETS

The CPI report and a continued strong labor market are likely to lead to additional pressure by the private sector to raise the caps on immigration visas. While a compelling argument can be made for the need of more skilled workers in the U.S., there has been growing skepticism toward increased legal immigration among some conservatives and Republicans. The GOP has morphed into a populist party from its free-market, capitalist roots. Thus efforts to increase legal immigration could receive significant resistance from the Republican base, which is less supportive of even legal immigration than it used to be. In turn, the GOP base could pressure Republican lawmakers to oppose legislation to raise the caps on work visas such as H-1B visas. The business lobby in Washington will push for more work visas, but given the pressure from the GOP base plus frosty relationships between Republicans and Big Business, these efforts face high hurdles.

LAME DUCK IMPLICATIONS

If control of Congress flips, especially the Senate, it could impact legislation that Congress will consider during the lame duck session of Congress.

On the budget, a Republican sweep could embolden GOP lawmakers to pressure their leadership to reject a full-year spending bill (aka the Omnibus) that does not sufficiently reflect Republican priorities. This in turn could lead to Congress passing another short-term spending bill (probably into February), at which point a Republican Congress would need to pass yet another short-term bill or an Omnibus bill for the rest of the fiscal year. A stream of short-term Continuing Resolutions (CRs) increases the odds of a government shutdown at some point.

Congress must also pass the National Defense Authorization Act (NDAA), which could be a vehicle for the SAFE Banking Act and a credit card payments bill authored by Senator Richard Durbin (D-Illinois). If control of the Senate flips, there could be some lingering bitterness among Democrats as well as a desire among retiring senators (as well as senators who lost their reelection bids) to leave Washington ASAP. That makes handicapping the contents of the NDAA even more challenging than usual.

In addition, Congress might consider a tax extenders bill, which is an annual bill that reauthorizes expiring sections of the tax code (many of these items are related to energy tax credits). There have been negotiations to suspend the five-year amortization of research and development expense and allow for immediate expensing as well as to delay the scheduled change in the way the business interest deduction is calculated. The Trump tax cut limited the business interest deduction to 30 percent of EBITDA (earnings before interest, taxes, depreciation, and amortization) with a further reduction to 30 percent of EBIT starting in 2023. A change in control of Congress could complicate passing the extenders bill or whether these items will even make it into the broader bill.

Lame duck sessions are often unproductive and only pass the most pressing legislation. Should control of the Senate flip, then Democrats could prioritize the confirmation of judges since they would no longer control the confirmation process for the next two years. This could mean that Congress might punt the tax extenders bill to 2023 and might drop controversial items like SAFE and the Durbin bill from the NDAA in the interest of expediency. It is too early to handicap the prospects for these issues with any confidence, but they could be impacted by the election results and bear watching.

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