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**Brian Gardner**  
Chief Washington Policy Strategist  
[bgardner@stifel.com](mailto:bgardner@stifel.com)



As of this writing, the final outcome of the 2022 midterm elections is still not known, but the national results have been shocking as a predicted red wave failed to materialize. Democrats have the advantage in the Senate, although the final outcome might not be known for a few weeks. Despite a disappointing night for Republicans, it appears the GOP has won the House by a narrow margin. Despite the markets' preference for gridlock, there could be some weakness in equities and bonds as the election failed to produce a clear check on the Biden administration. Investors might disapprove of the chaos that could descend on the capital.

**What It Means** – Although final tallies are unknown, gridlock is likely in Washington regardless of the remaining outcomes. The Senate will likely be 50-50 again or 51-49. Republicans appear to have won the House, but badly underperformed pre-election expectations. It could be several days before results in several key House races are known. Even if Democrats retain the House (unlikely), they will likely lose seats and have an even narrower majority than they currently do. The House majority will likely be 10 seats or less for either party, which makes governing challenging at best. The midterms have essentially resulted in gridlock.

Investors might like gridlock, but a negative reaction from the markets is possible, since results failed to meet expectations. A firm Republican check on the Biden administration looks less likely. Chaos in Washington could be the result and that chaos could become evident in the coming weeks as House Republicans hold leadership elections for the next Congress. The leading candidate for Speaker, Rep. Kevin McCarthy (R-California) appears vulnerable and might have to cut deals with his right wing to secure the speakership.

As of this writing, Adam Laxalt leads the Nevada Senate race by three points. If he wins and flips the seat to Republicans, then it appears that a runoff in Georgia on December 6 will determine control of the Senate.

Given the coming divide, passing government spending bills and increasing the debt ceiling will be even more challenging than previously expected. This could lead to politically induced market volatility in 2023. If Republicans ultimately win the House, they will do so with a narrow majority and, given factions within the GOP that often buck the party's leadership, the House could be almost unmanageable and the odds of government shutdowns will increase.

If the U.S. enters a recession in 2023, a divided Congress will struggle to pass a fiscal stimulus bill which will leave the Federal Reserve as the main institution responsible for setting economic policy in the country.

**On to the Lame Duck** – Congress will return to Washington next week for a lame duck session aiming to finish up business before the end of the year. The lame duck session will be more complicated if a Georgia Senate runoff is needed to determine the Senate majority in 2023. If Georgia is to determine control of the Senate, the passage of some key legislation might be delayed until after December 6 (the date of the possible runoff), as each party would jockey for position ahead of this vote. Among the items on the lame duck agenda are:

- *Spending bill* – An omnibus spending bill to fund the government for the remainder of the fiscal year (through September 30, 2023). If Congress fails to pass a bill for the entire fiscal year, it will likely pass another temporary bill (aka a Continuing Resolution or CR) that funds the government into early 2023. A government shutdown in December is highly unlikely. Some have suggested that the debt ceiling could be raised as part of an omnibus (or in a separate bill). Chances of increasing the debt ceiling now rather than in the early months of 2023 are low. Also, it is possible that energy permitting legislation that was dropped from the September CR could be revived. Prospects for the energy permitting bill passing now are poor, but Republicans could try to pass a version of the legislation in 2023.
- *National Defense Authorization Act (NDAA)* – The House passed its version of the NDAA earlier in the year, but the Senate has yet to consider a bill. Negotiations have been ongoing between key lawmakers in both chambers, and a compromise bill could be ready for the House and Senate votes in the coming weeks. The NDAA could also be a vehicle for unrelated legislation including the SAFE Banking Act and a credit card payments bill sponsored by Senator Richard Durbin (D-Illinois).

Chances of passing the SAFE Act, which would allow depositories to bank cannabis companies in states where cannabis has been legalized without violating federal anti-money laundering laws, are the highest they have been in several years. There is still some risk that SAFE could be dropped from the NDAA.

The Durbin bill will probably be left out of the NDAA. Republicans, who would typically oppose legislation that intervenes in inter-industry fights (financials v. merchants), might be tempted to support the Durbin bill in order to punish credit card companies who have implemented codes on sales at gun shops. This angers Republicans who see the move as an unwarranted intervention into social policy. Most Republicans will likely oppose the Durbin bill which should be enough to block it, but a Republican vote against the Durbin bill is not the foregone conclusion it would have been in the past.

- *Tax extenders bill* – Congress might consider a tax bill that would extend a series of expiring tax codes that are largely clean energy related. The tax extenders bill could include a delay in the changes to the research and development deduction which changed to a five-year deduction in 2022. Also, the bill could delay the change in 2023 to the business interest deduction which would further limit the deduction from 30 percent of EBITDA to 30% of EBIT. Democrats might push to expand the child tax credit in exchange for support of the two business-related items mentioned above.

## **ON TO 2024**

The 2024 presidential election started last night.

While Republicans massively underperformed nationally, Florida Republicans had one of their most successful elections ever. In a state where statewide races are typically close, Governor Ron DeSantis (R) won by almost 20 points, and Republicans gained several seats in the House of Representatives. The contrast between DeSantis's triumph and the failure of numerous candidates backed by former President Donald Trump is stark.

Prior to the election, it appeared that Mr. Trump was well positioned to win the GOP's 2024 nomination, but yesterday's outcome undermines that thinking. The results will probably lead some Republican voters to question their future support for Mr. Trump. Governor DeSantis is, for now, the presumptive frontrunner for the GOP nomination.

Democratic overperformance (compared to expectations) could embolden President Biden if he decides to seek a second term. If he decides to run again, Democrats who would prefer a younger candidate would have a tough time knocking off a sitting president in the primaries.

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