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The 2022 midterms were very tight. Republicans are expected to gain control of the House, though by smaller margins than the consensus expected, and Democrats have taken the Senate. As a result, Congress will likely be closely divided in 2023, increasing the need for compromise to enact policy.

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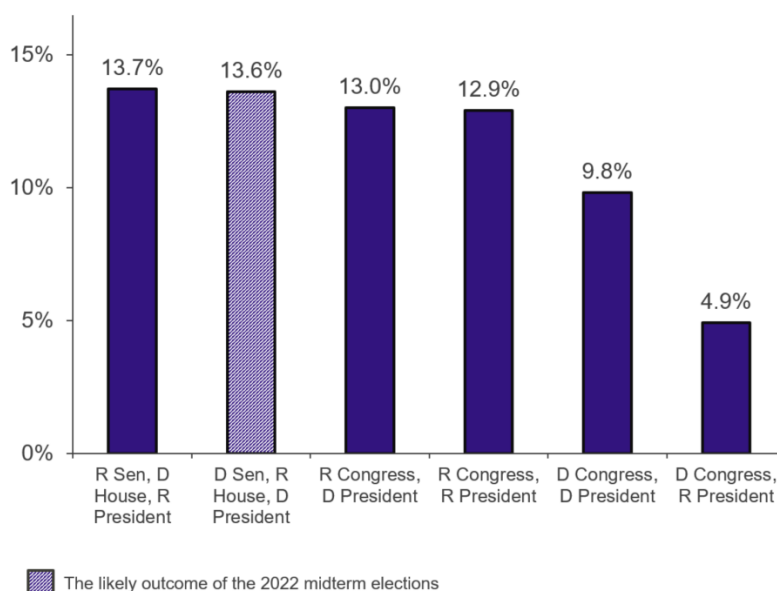
POLICY IMPLICATIONS OF THE 2022 MIDTERM ELECTIONS

With the results coming in, Republicans appear set to take control of the House of Representatives, though by a smaller margin than the consensus had expected, while Democrats were declared the winner of the Senate with one outstanding race on Dec. 6 in Georgia. Generally, midterm elections have been referendums on the president's first two years of office, but despite President Biden's approval rating near just 40%, the election was less of a referendum and more of a choice between the two parties. This allowed Democrats to overcome historical precedent in the number of House seats lost by the president's party. The red wave did not materialize because Independent voters split evenly between the two parties.

Regardless of the outcome of the Senate, Republicans taking control of the House means that we will have a gridlock scenario in Washington in 2023. **Notably, a Republican House takes tax increases off the table for the next two years.** Democrats maintaining control of the Senate creates opportunity for bipartisanship, but it will remain an uphill battle for a divided Congress to find areas of compromise. Much of the coming two years will be defined by disagreements as both parties try to get their priorities enacted through the budget. Narrow majorities in the House and Senate will increase the appetite of members of Congress to pass policy priorities in the "lame duck" session (i.e., before the new Congress is seated in January).

Congress will look to enact the FY23 budget and the National Defense Authorization Act (which outlines US defense priorities). Members will also push to attach additional legislative items to those must-pass bills, such as an extension of expensing for the R&D tax credit, some extension of a child tax credit or low-income housing tax credit, retirement legislation, and health care legislation (including avoiding cuts to Medicare and health care providers).

Average Annual S&P 500 Returns based on Partisan Control
1933-2019 (excl. 2001-02 due to Sen. Jeffords changing party mid-year)



Putting it all together, an active "lame duck" session of Congress could amount to a modest boost in fiscal policy by the end of the year. It will be up to the market to decide whether that boost is inflationary (and therefore, makes the Fed's job to rein in inflation harder) or whether it might offset a potential recession. Once we move into 2023, it will be harder for Congress to provide a fiscal boost as net interest costs on the US debt will increase significantly, putting pressure on accommodative fiscal policy. Should Congress fail to raise the debt ceiling in the post-election "lame duck" session, much of 2023 will be focused on a narrowly divided Congress trying to figure out how to get the votes to raise the debt ceiling.

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