Presidential elections not only have major implications for the future path of fiscal policy and the macroeconomic outlook, but they also impact the economy during the election year itself, albeit modestly. Elections create uncertainty around fiscal policymaking – our analysis suggests the most significant, negative impact occurs in Q4 of the preceding year. This timing is consistent with our expectations based on historical movements in political betting markets.

Given recent events on Capitol Hill, we also gauged the economic impact of heightened partisan rancor during election years. We based our assessment on the Partisan Conflict Index, which captures the frequency of newspaper articles reporting political disagreement about public policy within and between national parties. Our modeling shows that increased partisan conflict is a drag on the economy over time.

Fiscal policy often loosens during presidential election years, and history may repeat itself with the recent passage of a bipartisan tax deal in the House of Representatives. The tax bill is revenue-neutral over a 10-year budget horizon, but the stimulus it would provide to the economy is highly front-loaded. Based on simulations of the Oxford Global Economic Model, we estimate the tax deal would boost real GDP growth by roughly 0.1ppt in 2024 and in 2025.

Our historical analysis suggests that beliefs that the election will affect monetary policy are overdone. Most of the apparent inaction of the Federal Reserve in advance of an election is driven by two cycles: in 2000, when the Fed began an easing cycle shortly after the election, and in 2016, when the Fed began its hiking cycle in December. We doubt the upcoming presidential election will be a barrier to rate cuts this time as the Fed has signaled since 2022 its intention to shift its tack this year.

*Chart 1: Animal spirits struggle ahead of the first presidential primary contests*

Source: Oxford Economics/Haver Analytics
Presidential elections play an important role in determining the future path of fiscal policy. This time looks no different, given the wide range of post-election fiscal scenarios depending on the balance of power in Washington DC, but elections also affect the economy in the run-up to polling day. This occurs though the uncertainty generated around the selection of the eventual presidential nominees, an intensification of partisan conflict, historically looser fiscal policy, and political campaign spending.

**A long nomination process creates uncertainty early on**

Presidential election cycles are much longer in the US than in many other countries that impose limits on the length of campaigns. The upshot is that businesses and households begin contemplating the policy implications of the upcoming presidential election several months in advance, as candidates vie to become their party’s nominee, launch advertising campaigns, and attempt to distinguish themselves from other candidates in televised debates. The fundamentals matter most for financial markets and the economy, but uncertainty around the eventual presidential nominees seems to weigh on animal spirits ahead of the first presidential primary elections (Chart 1).

To determine when the US presidential election cycle causes the most uncertainty, we created a dummy variable to equal one in the quarter of the general election and zero in all other periods and regressed it on the annualized percentage change in the S&P 500 and real final sales to domestic purchasers – the engine of the economy. Besides controlling for recessionary periods, the S&P 500 regression accounts for changes in corporate profits and real interest rates, while the other regression with final sales to domestic purchasers as the dependent variable controls for movements in the unemployment gap. In both cases, the most significant, negative impact associated with post-WWII presidential election occurs in Q4 of the year preceding that of the presidential election (Charts 2 and 3).

**Chart 2: Stock markets feel the uncertainty most in Q4 of the year before the election...**

Source: Oxford Economics
This timing was consistent with our expectations based on historical movements in political betting markets. Over the past several election cycles, prediction markets have coalesced around the eventual presidential nominee of both parties following the first primary contests, which usually occur in January or February. As a result, uncertainty around the final lineup of candidates and the policies on the table for the next presidential term largely dissipates as soon as Q1 of the election year.

This time, uncertainty around the presidential nomination process is probably much less than it has been in our post-WWII sample. For several months, President Biden and former President Donald Trump have been the overwhelming favorites to become their parties’ nominees in the general election.

Policy debates turn heated in election years

A wealth of academic research has found evidence that elevated policy uncertainty prompts businesses to postpone or mothball plans for capital investment and hiring and weighs on household consumption. This matters for our analysis, as US policy uncertainty typically increases in the months leading up to a presidential election. Previously, our analysis focused on the Economic Policy Uncertainty Index, but given recent events on Capitol Hill, here we use the Partisan Conflict Index (PCI). This index captures the frequency of newspaper articles reporting political disagreement about public policy within and between national parties. In this way, the PCI isolates uncertainty around which policies will be acted upon at a given point of time.

Heightened partisan conflict has been on full display in 2024 and is unlikely to die down soon. In January, lawmakers scrambled to avert a partial government shutdown. However, the short-term funding bill that federal agencies are operating under will expire in early March, setting Congress up for another showdown over the federal budget. The longer the federal government runs on a stopgap budget, the greater the risk that automatic budget cuts – equivalent to 0.2% of GDP – will kick in this spring, with domestic nondefense programs bearing the brunt of the sequestration. This month, politicians are wrangling over border security and aid to Israel and Ukraine, and the Senate is weighing a $78 billion bipartisan tax deal.

Partisan conflict tends to increase before presidential elections, which is unsurprising as research shows that politicians are inclined to engage in political posturing and assume contentious positions when they are up for election. Moreover, this tendency is most noticeable when a national election is close according to the polls and the electorate is polarized, which will be the case in 2024 (Chart 4).
Chart 4: Partisan rancor is becoming more pronounced in election years

US: Partisan Conflict Index

Source: Oxford Economics/Haver Analytics

Partisan conflict and policy uncertainty do not always move in tandem, as the volatility in the two-year rolling correlation between the two shows (Chart 5). This is not surprising, as the PCI is not responsive to either financial shocks or monetary policy, which can separately generate significant policy uncertainty. Not capturing these events is intuitive in the PCI, as they are generally unrelated to government policy. Partisan conflict and policy uncertainty have also diverged during periods of war and recently during the pandemic.

Chart 5: Partisan conflict and policy uncertainty do not always move in tandem

Source: Oxford Economics/Haver Analytics

Partisan conflict can, at times, be a positive factor for the economy by causing brinkmanship and in certain cases preventing fiscal policy from doing harm to the economy. In addition, bad economic policies often benefit groups with political influence, meaning that positive reforms can be politically contentious. These situations do not often occur, but they do highlight the difficulty in assessing the net costs of partisan conflict to the economy.

To gauge how long a sudden increase in partisan conflict would impact the economy we used a vector autoregressive model. Consistent with our a priori assumptions, a sudden increase in political conflict has only a minimal impact on the economy, as proxied by monthly GDP.
Breaking out the presidential election-year playbook

Chart 6: Partisan conflict is a small drag over time

The initial increase in monthly GDP around the shock from political conflict could be attributed to the idea that gridlock is good for stability in fiscal policy, but over time, it becomes corrosive for the economy – brinkmanship over ‘must-pass’ legislation unnerves consumers and businesses alike. Overall, partisan conflict has a smaller negative effect on economic data – including GDP, private employment, and industrial production – than policy uncertainty.

Could this year’s fiscal drag be less than expected?

Fiscal policy has historically turned accommodative in presidential election years (Chart 7). In a previous briefing, we outlined the reasons we think this will not be the case this year. Though we have nudged our projection of the FY2024 deficit higher since the publication of that briefing, we still expect the budget shortfall to shrink to $1.6tn in FY2024 from $2tn in FY2023, excluding the distortions from President Biden’s student loan forgiveness proposal.

Chart 7: Fiscal policy typically loosens in a presidential election year

But a legislative wild card has emerged – the bipartisan tax deal, which could reduce the fiscal drag we long anticipated for this year. We estimate the deal would add more than $100bn to the FY2024 deficit (Chart 8). Known as the Tax Relief for American Families and Workers Act, the bill recently passed the House, and though it has hit some inertia in the Senate, it could become law.
Breaking out the presidential election-year playbook

**Chart 8: Front-loaded stimulus under bipartisan tax deal**

US: The Tax Relief for American Families & Workers Act

<table>
<thead>
<tr>
<th>Static budget deficit effect, % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2024</td>
</tr>
<tr>
<td>0.5</td>
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- Employee Retention Credit
- Other tax cuts
- 100% bonus depreciation
- Looser limit on interest deductability
- Deduction for R&E expenditures
- Child Tax Credit
- Net effect

*Source: Oxford Economics/Joint Committee on Taxation*

The tax bill is revenue-neutral over a 10-year budget horizon, but the stimulus it would provide to the economy is highly front-loaded. Based on simulations using our Oxford Global Economic Model, we estimate the tax deal would boost real GDP growth by roughly 0.1ppt in 2024 and 2025 on an annual average basis.

The bulk of the tax cuts are targeted at businesses with research and development spending, capital expenses, and interest payments. Therefore, the impact is most pronounced in real private fixed investment, which would grow by nearly 0.5ppt faster in 2024 and 0.7ppt in 2025. There are two key business tax cuts in the bill – the first relates to R&D spending, whose tax treatment turned less favorable under the Tax Cuts and Jobs Act (TCJA) of 2017.

Historically, companies have been able to deduct the full cost of their R&D expenses immediately. However, the TCJA scheduled that policy to end after 2021. The TCJA also ended a long-standing rule of administrative convenience that enabled businesses to immediately expense the cost of software development. The 2017 tax act amended the language to explicitly recognize software development as R&D. Since 2022, businesses have had to amortize R&D expenses and the cost of software development over a five-year period.

The bipartisan tax deal would reinstate the immediate deduction of US-based R&D spending, delaying when companies would have to amortize such costs over a five-year period until after 2025. After the TCJA was passed, the Congressional Budget Office (CBO) estimated that the 2017 tax law would reduce the level of intellectual property (IP) investment by 0.9% in 2024 and 2025. Based on our model simulation, the tax deal would eliminate this hit to IP investment from the TCJA by next year.

The next major business tax cut in the deal is the extension of 100% bonus depreciation, or the full and immediate expensing for investments in machinery, equipment, and vehicles. At the time, the TCJA increased the share of an investment in new tangible equipment that businesses could immediately expense from 50% of the acquisition cost to 100%. Under the 2017 tax law, 100% bonus depreciation was only in effect through 2022 but was then scheduled to be phased out between 2023 and 2027 in 20ppt increments. The tax agreement currently on the table would extend 100% bonus depreciation through 2025. Bonus depreciation lowers a firm’s tax liability, raising the after-tax return on an eligible capital investment, and should therefore induce businesses to invest more quickly. We estimate that the bipartisan tax deal would boost growth in real equipment spending by 0.7ppt in 2024 and 1ppt in 2025.

Regarding the personal tax code, the most important change under the tax agreement would be to temporarily expand the Child Tax Credit (CTC) by enhancing its refundability and adjusting the credit for inflation, among other tweaks. Low-income families with a higher marginal propensity to consume an extra dollar of income would benefit from the CTC expansion, underpinning the estimated sub-0.1ppt boost to real consumer spending growth during the next two years under the tax deal.
We will continue to monitor the news around the tax deal’s progress, or lack thereof, in the Senate, given its implications for the near-term outlook. If enacted, it would push our US GDP forecast for 2024 further above the economy’s estimated potential growth rate.

Political campaigns and data trails

The Bureau of Economic Analysis estimates the gross operating expenses of political organizations, not donations to them. This is captured as part of professional advocacy spending within overall personal consumer expenditures. Political organization expenditures are based on data on contributions to candidates from the Federal Election Commission and the Campaign Finance Institute, as well as state and local election spending from the National Institute for Money in State Politics.

Chart 9: Big gains in election years but a tiny share of GDP

Unsurprisingly, growth in spending on professional advocacy surges during election years, averaging 20% since the 1960s. It is also strong during midterm election years, rising by an average of 17%, whereas it drops by an average of 4.1% per annum in non-election years (Chart 9).

However, professional advocacy makes up an extremely small share of GDP, so these swings are not enough to move the needle on growth and the direct boost to GDP from election cycles is modest, at best.

Elections and monetary policy

The Fed is a political lightening rod because the economy is always an important issue for American voters. However, we doubt the upcoming elections will deter the central bank from setting what it believes is the appropriate stance for monetary policy. Some commentators have argued that the presidential election will force the Fed to sit on its hands this year. We find no evidence that this has been consistently the case in the past.

Looking at the historical record since 1983, covering most of the modern era of a politically independent, inflation-targeting Fed, the central bank is only marginally less active in the months running up to a presidential election compared to non-election years (Chart 10). There is a more pronounced tendency for the Fed to be more active in the months after an election.

This does not mean that the election will not be part of policy discussions. The transcripts from the Fed’s 2016 November meeting made a few references to the upcoming election. For example, then Vice-Chair William Dudley said, “...the lack of urgency implies that there is not a good case for moving at this meeting. To do so with the election a week away, the outcome uncertain, and no scheduled press conference would imply an urgency to move that I just don’t think is consistent with the incoming information or the economic outlook.” Even though the election is referenced, the economic data still trumped the justification of whether to alter interest rates. There was a more intense discussion of the election outcome at the
December 2016 Federal Open Monetary Committee meeting in the context of the implications for financial markets, prospects for fiscal stimulus, and the economic outlook.

Chart 10: The Fed has not been idle in past election years

US: Fed funds target (upper bound)

![Chart showing Fed funds target and election years]

Source: Oxford Economics/Bloomberg LP

Most of the apparent inaction of the Fed in advance of an election is driven by two cycles: in 2000, when the Fed began an easing cycle shortly after the election, and in 2016, when the Fed began its hiking cycle in earnest in December.

We do not think that this year’s elections will be a barrier to rate cuts by the Fed. Officials have consistently indicated that they would cut rates in 2024 as far back as in their June 2022 projections. Following through on those forecasts would not be controversial against the backdrop of moderating inflation.