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Four key conclusions from the US midterm elections

"Market update"

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Summary

- Fiscal policy is set to become a modest drag on US growth, as political gridlock constrains federal spending through FY28.
- Political constraints may delay, rather than derail, AI infrastructure spending, creating greater uncertainty around the timing of 2027 capex.
- Inflation remains a key political and policy risk, potentially reinforcing a more hawkish Fed response while increasing political pressure to contain energy prices.

A broad Democrat victory

Although the full results from the US midterm elections are not final as we write (6.30pm Singapore time (SGT)), the broad Democrat victory allows us to draw four key conclusions.

- First, although the Democrats have won majorities of both the House of Representatives and the Senate, **they do not have the 2/3 majority that is required to override a Presidential veto of any legislation that they pass**. **This means that there are unlikely to be changes in Trump's authority to impose tariffs or to engage in military action.**

- Linked to this, **US fiscal policy is likely to swing from being a slight boost to economic growth in FY26 to being a modest drag on growth over the next two years** as the Democrats and Republicans are unlikely to be able to agree on a bipartisan budget. Democrat attempts to pass a budget that includes tax hikes or greater healthcare funding via reconciliation would likely be met by a Presidential veto. This implies that Federal spending through FY28 will likely be constrained to FY26 levels through continuing resolutions.

- Another conclusion we draw is that the **political impediments to AI infrastructure spending are likely to rise**. Essentially all of the elections at

both the Congressional level and the local government level we identified in this week's CIO Views as having implications for the regulation of data center development – Ohio, Michigan, Texas, Georgia, and Arizona just to identify the most notable races - were won by Democrats who favour moratoria or other constraints on development.

We expect this to delay some AI capex spending otherwise planned for 2027, but not necessarily permanently cancel it. The political debate across all these races is predominantly about requiring data centers to pay for their impact on local level utilities costs, pay higher taxes to local governments, and to give local governments ultimate authority over the approval of new developments**. Few politicians are arguing for outright bans on new data centers.**

- A fourth conclusion is that inflation and cost of living are currently key flashpoints across the political spectrum. We see two implications:

  - Political pressure to end the Iran war to facilitate lower energy prices is likely to rise. Ultimate authority for military action and agreement to any truce or peace deal still lies with President Trump. As such, we see a high chance of renewed US attacks on Iran in the near term. However, Republican support for any such action is likely to be short-lived and internal pressure on him to end the war is likely to escalate.

  - We believe the Federal Reserve (Fed) will have to be sensitive to this message from the public that current rates of inflation are too high. This may shift the bias in the Fed toward a more aggressive response to higher-than-expected inflation prints and any signs that wage growth is rising than the 60bps of hikes the market currently has priced.

At a broad level, the results of the election are a clear public rebuke of President Trump. All three of his hand-picked candidates, Darline Graham, Michael Whatley, and Ken Paxton lost as did Jon Husted whom Trump had promoted heavily, just to name the most prominent candidates. We expect Republican legislators to gradually shift support away from Trump's more extreme policy preferences in preparation for the 2028 elections.

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