US: "Misery index" favors Biden '24, but tailwind fading

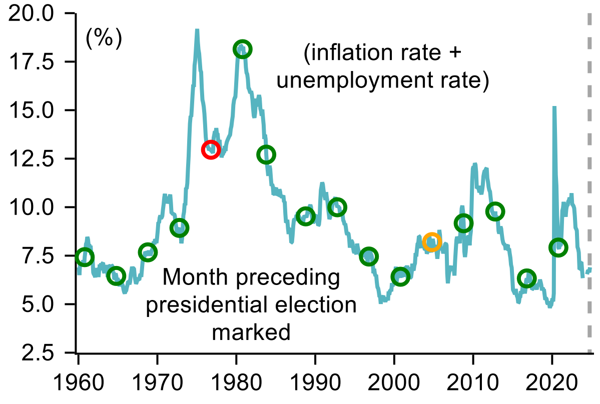
KEY MESSAGES

Economic conditions – specifically inflation and unemployment – have a strong track record of predicting presidential election outcomes since 1960.

Our "economic misery" indicator currently suggests a tailwind for incumbent Joe Biden, thanks to falling inflation and relatively stable labor conditions.

Yet uncertainty is high, and it might take only a moderate stall in inflation progress or rise in unemployment to tip the scales toward Republicans and presumptive candidate Donald Trump.

Fig. 1: "Economic misery" index has predicted 14 of 16 elections since 1960



Note: Circles represent successful (green), failed (red) and inconclusive (yellow) election predictions based on our indicator.
Sources: BEA, BLS, Macrobond, BNP Paribas

Kitchen table economics matter in the voting booth: US presidential election outcomes and voter sentiment depend on many factors, but history shows economic conditions feature prominently among core issues. The combination of just two variables – inflation and unemployment – boasts an impressive track record of predicting election outcomes, as discussed in greater detail below.

If this relationship holds true in 2024, economic developments along the lines of our house forecast (or that of the Bloomberg consensus of forecasters or the baseline of Fed officials) would be historically consistent with Democrats retaining control of the White House. A soft, or even soft-ish, landing for the US economy is likely to resonate favorably with voters based on the last 16 presidential election cycles, as we show in our scenario analysis below.

Conversely, with the consensus putting recession odds near 50% at the time of writing – according to a Bloomberg survey – economic conditions could easily flip toward a regime change (i.e. pro-Republican) scenario. Recessions in close proximity to a presidential election are an ominous development for the incumbent party, as demonstrated in 2020, 2008, 1992, 1980 and 1960 – all of which saw the executive branch change parties.

To be clear, this analysis is not an endorsement of any candidate or party. Rather, it is an agnostic effort to show the relevance of economic data in predicting election outcomes in the modern era. It also allows us to consider the implications for the upcoming presidential race under various labor and inflation scenarios.

The current cycle could be the exception to the rule: Presumptive nominees Biden and Trump face obstacles including their ages, legal woes, geopolitics, third-party candidacies and a general sense of heightened politicization. These issues seem to matter more now than in prior cycles, in our assessment. The Ford-Carter matchup of 1976 is a clear example of a time when voter sentiment toward non-economic issues, in that case an anti-Republican backlash following the Watergate scandal, overshadowed improving economic fortunes.

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Economic conditions resonate with voters

Furthermore, the dynamic of a former president running against an incumbent is very unusual – something last witnessed in Theodore Roosevelt's third-party challenge in 1912 and Grover Cleveland's successful challenge to Benjamin Harrison in 1892. In other words, there is no clear modern precedent for a Biden-Trump rematch.

Regardless of the candidates, we note economic factors yield a meaningful signal of the degree to which voters favor regime change.

Prosperity a priority at the polls: Our survey of key economic variables from the late 1950s to present reveals an impressive track record of the US electorate rewarding (or punishing) incumbents and their respective parties based on economic wellbeing.

For the purpose of this analysis, we use the so-called "economic misery" index, which is the sum of unemployment and inflation. The thought is that in an environment of either rising unemployment or inflation, or both, households experience increasing economic misery. In turn, they are prone to punish the incumbent (or, as was the case in 1960, 2000, 2008 and 2016, the incumbent party). Similarly, voters reward incumbents during periods of sound economic performance, i.e. a declining misery index.

Economic well-being resonates on the campaign trail: In the 1980 presidential debates, Republican nominee Ronald Reagan famously asked voters whether they were better off relative to four years prior. The electorate resoundingly answered "No" after the economic stagflation of the late 1970s, limiting Jimmy Carter to one term and delivering the presidency to Reagan. Riding the tailwinds of a strong economy and falling inflation, Reagan won re-election by a wide margin in 1984.

Importantly, economic performance does not clearly favor one party over another, as Bill Clinton demonstrated in 1992. Voters who seemingly did not yet perceive the economy as having exited the recession of 1990-91 passed the reins from the Republican incumbent to the Democrat challenger.

Notably, while the misery index's track record is impressive in presidential races, we have found it to be less definitive in congressional elections.

Fig. 2: "Economic misery" index and presidential elections

Election	Misery index indicator (U3 and PCE)	Alternative versions: U3 & Core PCE	U3 & CPI	U3 & Core CPI	Winning candidate	Losing candidate	Incumbent party loses?	Misery index correctly predicted outcome?
1960	0.5		0.7	-0.6	**Kennedy [D]**	Nixon [R]	Y	✓
1964	-0.3	-0.4	-0.5	-0.4	**Johnson [D]**	Goldwater [R]	N	✓
1968	1.3	1.2	1.4	1.1	**Nixon [R]**	Humphrey [D]	Y	✓
1972	-1.5	-2.1	-1.6	-2.0	**Nixon [R]**	McGovern [D]	N	✓
1976	-3.4	-2.8	-4.0	-3.0	**Carter [D]**	Ford [R]	Y	✗
1980	3.3	3.6	3.6	4.6	**Reagan [R]**	Carter [D]	Y	✓
1984	-2.7	-3.0	-0.7	-0.3	**Reagan [R]**	Mondale [D]	N	✓
1988	-0.1	0.4	-0.6	-0.3	**H.W. Bush [R]**	Dukakis [D]	N	✓
1992	0.2	0.2	-0.2	-0.4	**Clinton [D]**	H.W. Bush [R]	Y	✓
1996	-0.2	-0.6	-0.2	-0.6	**Clinton [D]**	Dole [R]	N	✓
2000	0.8	0.2	1.0	0.3	**W. Bush [R]**	Gore [D]	Y	✓
2004	0.0	-0.2	0.2	-0.2	**W. Bush [R]**	Kerry [D]	N	*Indeterminate*
2008	2.5	1.3	3.4	1.5	**Obama [D]**	McCain [R]	Y	✓
2012	-2.2	-0.9	-2.8	-0.7	**Obama [D]**	Romney [R]	N	✓
2016	0.5	0.1	0.8	0.1	**Trump [R]**	Clinton [D]	Y	✓
2020	5.5	5.5	5.2	5.2	**Biden [D]**	Trump [R]	Y	✓
2024	***-0.4***	***-0.9***	***-0.1***	***-0.7***	***Misery index leaning Democrat***			

Notes: Misery index indicator constructed as 6mma of y/y change in (unemployment rate[%] + inflation[%y/y]). Values in yellow are times the indicator has failed to predict the outcome or been indeterminate. Positive values historically unfavorable to incumbent president's party, and negative values favorable.
Sources: BEA, BLS, BNP Paribas

Economic soft landing would favor Biden

It's the economy … Biden to benefit from "soft landing": A survey of various iterations of the "economic misery" index from 1960 to present shows a critical relationship with election outcomes, as illustrated in the summary table (Fig. 2). Note that a positive misery index value denotes increasingly unfavorable economic conditions, implying poor re-election prospects.

To account for slow dissemination of economic news to the general public, we use a six-month trailing average of changes in the index. Similarly, we found voter sentiment to be more sensitive to recent changes, i.e. the change over the year leading up to an election, as opposed to the change over a full four-year term. Reagan asked voters to compare their status to the prior presidency, but our analysis suggests a shorter time horizon is more relevant. In other words, voters seem to have shorter memories.

The summary table displays results based on a misery index using the headline PCE deflator as the inflation input, but comparable indices constructed using headline CPI and core measures of both show broadly similar performance. Note the figures highlighted in blue in the bottom row are projected changes in the misery index ahead of the election based on BNPP forecasts.

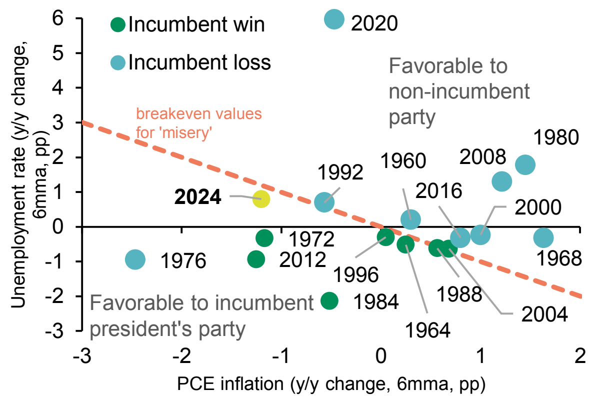
Economic trends are poised to provide a favorable tailwind for the incumbent Democratic party based on most economic forecasts (including our own) at present. Inflation is falling swiftly and unemployment is still low, resulting in the current misery index running at 6.8%, or about -3.2 points below year-ago levels. In other words, voters should be feeling less "economic misery."

Hardly a done deal for Democrats: We expect the misery index signal to fade over the course of 2024 as the disinflation impulse diminishes and labor slack increases in a slowing economy. By October, we see the measure running closer to -0.4, not far from the zero threshold that would suggest conditions are on the cusp of tilting in favor of the Republican nominee (Fig. 4).

The six-month trailing average of the index was 7.2 in October 2023, so some combination of unemployment and inflation around 4% and 3% respectively would put conditions close to a toss-up. If our headline inflation forecast of 2.2% is realized, then unemployment around 4.9% (again, on a six-month trailing average basis) would signal trouble for Democrats.

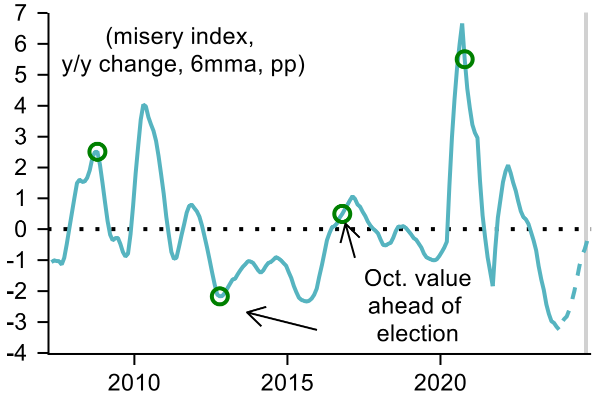
We illustrate this in Fig. 5, with the dotted green line representing values of inflation and unemployment that would result in our misery index indicator having a breakeven value of 0.0 this October.

Fig. 3: Incumbent party fortunes linked to misery index



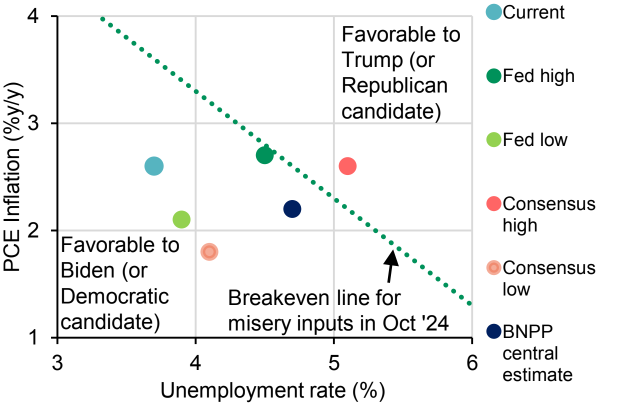
Sources: BEA, BLS, BNP Paribas forecast for October 2024

Fig. 4: Voters feeling less misery now, but tailwind to abate ahead of election



Sources: BEA, BLS, Macrobond, BNP Paribas

Fig. 5: Some forecasts show trouble for incumbent Biden



Notes: Green dotted line denotes values of inflation and unemployment in Oct. 2024 that would result in our misery index indicator having a breakeven value of 0. Fed values are high- and low- end of estimates in the Dec FOMC SEP projections, assuming straight-line convergence to Q4 2024. We trim the top and bottom five estimates in consensus.
Sources: BEA, BLS, Bloomberg, Federal Reserve, BNP Paribas

Economic wobble would be boon to Republicans

For example, values in line with the high end of Fed officials' projections for Q4 2024 (4.5% for unemployment and 2.7% for inflation) would put conditions near a toss-up (the dark green dot).

Consensus estimates show a wider range of potential outcomes (the dark pink and light pink dots), with the upper end of inflation and unemployment forecasts putting the misery indicator in territory that favors Republicans.

Admittedly, it may be unfair to pair the high end of inflation forecasts with the high end of unemployment projections, as the two tend to be inversely related. But over short horizons – e.g. 2008 – the two can indeed be quite positively correlated (inflation rose along with unemployment at the time). That added to pressure in the direction of a regime shift away from Republicans at the time.

High uncertainty: An even wider range of 'misery' indicator outcomes is very possible. To illustrate that, we use the Fed's median estimates for inflation and unemployment as a base case, and apply projection error bands described in the FOMC's Summary of Economic Projections (note in Fig. 6).

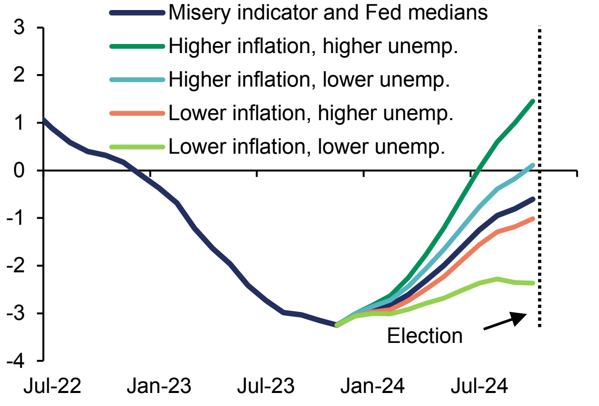
The dark blue line in Fig. 6 shows the monthly evolution of our election outcome signal indicator according to the Fed's median estimates for year-end 2024 for inflation (2.4%) and unemployment (4.1%). The alternative paths show what would happen if high- and low-end outcomes for inflation and unemployment were to occur. With unemployment currently at 3.7%, we constrain the low end of the unemployment rate range to 3.4%, the latest cycle low, instead of allowing a drop to 3.0% in Q4 2024.

In short, though economic tailwinds may be sufficient for Democrats to retain the presidency, it would not take unusual forecast misses to instead flip those forces in favor of the challenger.

Economic data only part of the story: We have focused on a very narrow set of salient economic indicators in this note – inflation and unemployment. Voters will of course consider a much wider slate of issues, economic and otherwise, not addressed here.

That said, the price and jobs dimensions have yielded meaningful signals in the past, notably foreshadowing the regime changes in 2016 and 2020. Regardless of the eventual nominees, our historical survey corroborates the importance of economic conditions in influencing voter sentiment.

Fig. 6: Misery index "flip" within bounds of normal forecast error distribution



Note: Lines around central median estimate are alternative paths corresponding to error range for historical projections made by private and government-sector forecasters. At a 1-year horizon, about 30% of actual outcomes fall outside a +/- 1.6pp range for inflation and +/- 1.1pp for unemployment rate, according to the FOMC Summary of Economic Projections. Lines assume linear convergence to end-2024 estimates from current levels.
Sources: BEA, BLS, Federal Reserve, BNP Paribas

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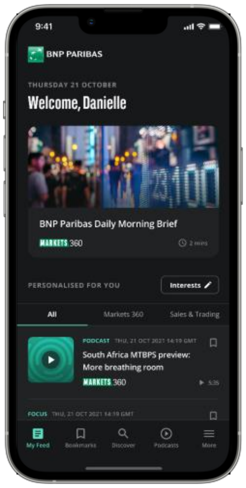

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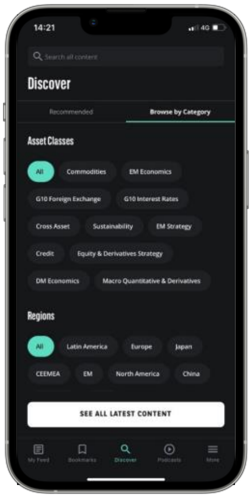

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In addition, there is a mitigation measure to manage conflicts of interest for each transaction with controls put in place to restrict the information flow, involvement of personnel and handling of client relations between each transaction in such a way that the different interests are appropriately protected. Gifts and Entertainment policy is to monitor physical gifts, benefits and invitation to events that is in line with the firm policy and Anti-Bribery regulations. BNPP maintains several policies with respect to conflicts of interest including our Personal Account Dealing and Outside Business Interests policies which sit alongside our general Conflicts of Interest Policy, along with several policies that the firm has in place to prevent and avoid conflicts of interest.

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