Few signs that economy helped Republicans

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Representative Jason Lewis of Minnesota, a Republican, lost his re-election bid, even though the unemployment rate in his district was just 2.5 percent.

Unemployment in the United States is abnormally low. Growth has sped up. A $1.5 trillion tax cut, signed by President Trump last year, is fueling consumer spending. Faced with strong Democratic enthusiasm and fund-raising and hindered by an unpopular president, Republicans were still counting on that economic strength to lift them at the voting booth, or at least to limit the damage.

It didn't. Republicans lost in House districts with low unemployment rates. They lost in districts that have gained manufacturing jobs. They lost in districts that got big tax cuts. And they lost overwhelmingly in the kind of affluent, educated suburbs that have experienced the strongest overall recovery — and that were once among the most reliable Republican districts.

Republicans had lost at least 32 net seats in the House as of Saturday morning on the American East Coast, and will probably lose a few more, once all the votes are counted. It is possible, of course, that Republican losses might have been even larger, were it not for the strong economy. But there was little sign of that in district-level results: Many of the Democrats' pickups came in places where the economy is strong.

All told, there was no apparent relationship between Republican candidates' performance in the House races on Tuesday and the strength of the economy in those districts, an analysis of economic and electoral data shows.

Republicans fared better in the Senate, but there is no sign that the economy was a major factor in those races, either. Kevin Cramer, a Republican, unseated Senator Heidi Heitkamp in North Dakota, which has the nation's lowest unemployment rate, 2.7 percent. But in neighboring Minnesota, where the rate is just a tenth of a percentage point higher, the Democratic incumbent, Amy Klobuchar, cruised to a 24-point victory.

Analyzing the role of the economy in elections is particularly difficult in the Senate, because there are fewer races and senators represent entire states, in which economic conditions can vary by area. But the results from Tuesday do not appear to align with measures of state economic health.

FALLING SHORT IN A HOT MARKET

If the economy were going to save Republicans anywhere, it should have been in Minnesota's Second Congressional District, where the unemployment rate was 2.5 percent in the third quarter of the year — down a percentage point in the past two years — and where the typical household earned more than $80,000 in 2017.

Yet the Republican incumbent, Jason Lewis, lost by more than five points to a local businesswoman, Angie Craig, whom he had beaten in a tight election two years earlier.

Ms. Craig wasn't the only Democrat who found success in a part of the country where the economy is exceptionally strong. Republican incumbents were defending eight seats that are among the 25 districts where unemployment is lowest. They lost five, including two districts each in Minnesota and Iowa, where the local unemployment rate is below 3 percent.

Republican incumbents fared better on average in districts with higher unemployment rates.

And while that partly reflects baked-in partisan dynamics — Republicans tend to do well in rural areas, where unemployment tends to be higher — the party's candidates also did better relative to past elections in districts where the jobless rate was higher than the national average. Of the 25 House districts with the highest unemployment rates heading into Election Day, 10 had Republican incumbents.

At least nine of those incumbents won, by an average of more than 30 points; in the 10th race, in California, the incumbent was unseated by a Democrat.

The unemployment rate, of course, is far from the only measure of economic strength. And Democrats may have had success in part because many voters — particularly women — weren't convinced that the economy was booming.

But Democrats also did well in parts of the country that are thriving under broader measures of economic health.

TAX LAW AS AN IMPEDIMENT

When Republicans passed a $1.5 trillion tax cut late last year, they envisioned it as a centerpiece of their sales pitch for the midterms. But they may have miscalculated how potent an electoral weapon the tax law would become against them.

Despite giving at least a modest tax cut to most households, the tax law has struggled to win majority support from voters. Several of its biggest champions lost their seats on Tuesday. They included four members of the House Ways and Means Committee, which wrote the law, most notably Peter Roskam of Illinois, the chairman of the tax policy subcommittee, and Erik Paulsen of Minnesota, the chairman of the Joint Economic Committee.

On average, Republican candidates did no better in districts where residents got larger tax cuts, as measured by estimates from the Tax Foundation, a conservative research group.

The law appears to have hurt Republicans in some high-income, high-tax districts, where many residents were angry about the law's $10,000 cap on the deduction for state and local taxes. In Virginia's 10th Congressional District, the Republican incumbent, Barbara Comstock, lost her seat. Her Democratic challenger, Jennifer Wexton, called the law the "Comstock-Trump tax scam."

NOT REALLY A SURPRISE

Republicans expressed hope before the election that the economy would help them in tight races. Days before the vote, Representative John Culberson of Texas said the strength of the economy in his district was "absolutely" resonating with voters. "It's something we're very proud of in West Houston," he said.

Mr. Culberson praised tax cuts and drew sharp contrasts with his Democratic opponent, Lizzie Pannill Fletcher, on economic issues. He said in an interview that voters "understand there is a profound philosophical difference between a free-market fiscal conservative like John Culberson, with a record of doing the right things for the right reason, and a liberal Democrat like my opponent."

Yet Ms. Fletcher won the district by nearly five percentage points.

History suggested that Republicans were being overly optimistic about the effect of the economy. In past midterm elections, economic conditions have mattered far less than presidential approval.

The president's party has lost large numbers of House seats even with low unemployment several times, including 1966 and 2006 during the administrations of Lyndon B. Johnson and George W. Bush.

Of course, things could have been worse for Republicans on election night if the economy had been weak. That would have been particularly likely if, say, a recession had depressed Mr. Trump's approval rating.

Markets can shift focus

Strategies

JEFF SOMMER

So much for the midterms.

Now the markets can start obsessing about gridlock, impeachment and the 2020 election.

And they can resume worrying about bread-and-butter issues like corporate earnings, interest rates and the threat of rising tariffs and recession.

Uncertainty about control of Congress has at last been lifted: Come January, the Democrats will run the House, while the Republicans will retain a slender majority in the Senate.

From the standpoint of the markets, that welcome clarity on Wednesday set off the biggest one-day midterm election rally since 1982. And while investors were relieved that the results conformed with Wall Street expectations, longstanding financial concerns were made even more visible while introducing a series of other political problems.

"The midterm results only highlight the ongoing political divisions within the country and the parties," John Raines, head of political risk at the business information service IHS Markit, and Lindsay Newman, a principal analyst there, wrote on Wednesday.

Sooner rather than later, the focus of financial markets is likely to shift to a new set of political and economic concerns.

On the political side, these include:

- The likelihood of investigations of the Trump administration in the House of Representatives and perhaps, down the road, impeachment proceedings.
- The prospect of congressional gridlock and vituperation.
- Rising partisan conflict as politicians prepare for 2020.

At the same time, the markets will refocus on the bread-and-butter concerns that have weighed on stock and bond returns for much of the year.

Among these worries are the possibilities that:

- The rate of corporate earnings growth, unusually robust right now, has already peaked, creating a benchmark that most companies won't meet next year.
- The Federal Reserve's interest rate increases will slow the economy, puncturing the prices of risky assets like stocks, which have already begun to lose altitude.
- The Trump administration's aggressive trade policy — and worsening foreign relations with allies and adversaries alike — will raise global tensions further and hurt the economy.
- After a long recovery, the economy will fall into a recession in the next two years, producing a deep bear market.

This may seem like an excessively glum list, right after elections that sent the stock market into a bout of euphoria. If the markets abhor uncertainty, then these midterm elections were wonderfully reassuring.

"The consensus was right," John Lynch, chief investment strategist for LPL Financial, wrote on Wednesday. Wall Street generally viewed the election's broad outcome as highly probable and fairly desirable, though not the outcome thought most likely to produce the highest stock returns.

That would have been a Republican sweep with a large majority in the Senate as well as the House, leading to a repeal of the Affordable Care Act and cuts in programs like Social Security and Medicare.

The UBS Global Wealth Management Chief Investment Office considered the various possibilities ahead of the election, concluding that such a sweep "should boost global stock markets, limit increases in long-term bond yields and support the U.S. dollar."

But the "base case" that UBS and most other analysts forecast ahead of the voting was what actually happened — a split decision producing gridlock. The real-world validation of the consensus tilted stock prices upward. The markets have generally prospered after the midterms, regardless of which party has won.

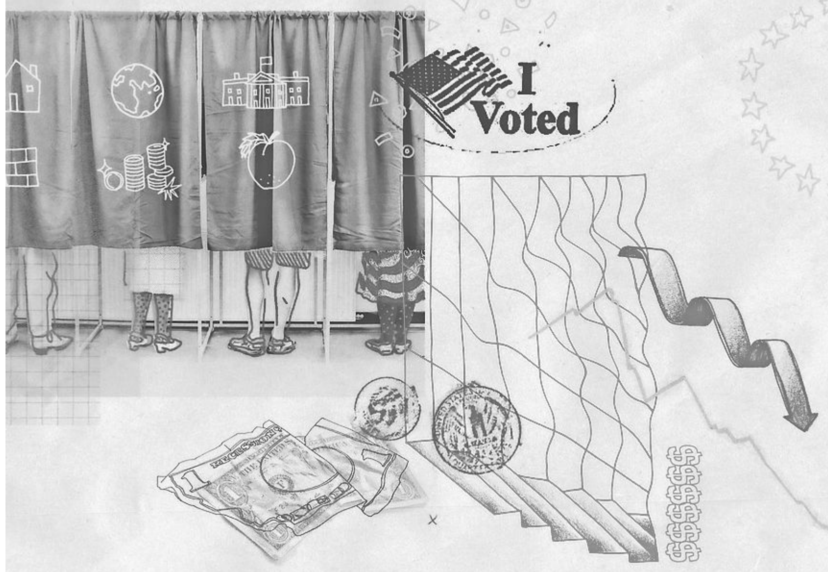
In addition, despite substantial evidence to the contrary, there is a deep, stock-bolstering belief on Wall Street that gridlock — defined as a period during which no single party controls all three branches of government — has been good for the market.

But the data bears this out only when a Democrat has been president and Republicans have held either the House or the Senate. Since 1901, in all such cases, the Dow Jones industrial average has outperformed its long-term average, an analysis by Bespoke Investment Group shows. If a Republican was president under such conditions, the market has lagged.

In the five previous congressional sessions since 1901 in which Republicans controlled the White House and the Senate while Democrats controlled the House — the political alignment in Washington starting in January — the annualized return has been a loss of 1.69 percent. That's not encouraging, though the data is too scanty to use "as a blueprint for what to expect this time around," Bespoke said.

The IHS Markit analysis predicted a "legislative impasse" in the new Congress but reserved the possibility of deals on big issues. And several analysts said these might be an infrastructure rebuilding program, measures to reduce prescription drug prices or an agreement to help the so-called Dreamers, the young undocumented immigrants who have benefited from an Obama-era program called Deferred Action for Childhood Arrivals but face the possibility of deportation under Trump administration policies.

The one sure thing in Washington appears to be a high level of political strife. That was underlined on Wednesday when Mr. Trump fired Attorney General Jeff Sessions and replaced him with Matthew G. Whitaker, a loyalist who has been critical of the special counsel investigation into Russia's election interference. House investigations into these matters could begin early next year, and, at some point, the start of impeachment proceedings is certainly possible.



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