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Could the U.S. presidential election endanger an investment boom?

Potential impact of stimulus and risks from November's election

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Key points

- President Joe Biden's administration enacted three policies across 2021 and 2022 which provided a fiscal boost of around $1.5trn, creating incentives for long-term investment.

- Recent investment spending has remained robust, defying usual cyclical patterns and the impact of higher interest rates. It is difficult to disaggregate investment intentions from trade and geopolitical tensions and supply chain security, but corporate investment intention surveys are consistent with a boost to investment from these policies.

- We illustrate the scale of the investment increase and show how overseas investors have also increased investment in the U.S., likely in part a response to these policies.

- November's election may affect this outlook. Yet, we believe a second Biden term would not see material adjustment. Equally, a Donald Trump administration may not necessarily repeal all these policies, at least to the extent expected by some.

An investment boost but could politics extinguish it?

The onset of the pandemic saw the U.S. endure a period of remarkable economic turbulence, but it has since transitioned to a phase of unexpectedly strong growth. One factor underpinning this trend has been the somewhat unusual, acyclical nature of investment spending. Far from exacerbating broader swings in the economy and falling sharply in the wake of higher interest rates – the traditional response – investment spending has remained solid. Several factors have likely contributed to this, including a post-COVID-19 rebound, the need to strengthen supply chain security, and a broader desire to onshore, nearshore or indeed, *friendshore*. But we believe part of this marked improvement in U.S. investment spending is the $1.5trn of infrastructure spending set out across 2021 and 2022 by President Joe Biden's administration.

In this paper, we attempt to quantify the scale of improvement we have seen in investment spending over recent years. We identify a material boost to investment in structures, with a large share of construction spending associated with growth in the computer and electronics sector. We then consider whether this increase is endangered by the upcoming presidential election. We consider the impact that different electoral outcomes could have on the outlook for investment spending.

A story in three acts

Between November 2021 and August 2022, Biden's administration passed three acts that steered around $1.5trn towards U.S. infrastructure investment, notably with a bias towards green financing, to help the world's largest economy decarbonize and improve its environmental outlook. The three acts included:

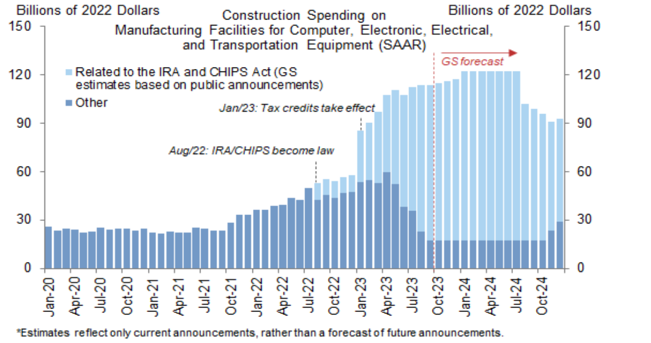
The Infrastructure Investment and Jobs Act (IIJA, November 2021). This was the first broad-based, bipartisan infrastructure policy act aimed at delivering $550bn in infrastructure spending across transport, broadband, water, and energy infrastructure, boosting resilience and reducing emissions and environmental impact. It includes specific funds earmarked for climate, energy and the environment ($58bn), and transport ($18bn).[1] The Congressional Budget Office (CBO) estimated the legislation would cost $256bn over a decade. [2]

The Creating Helpful Incentives to Produce Semiconductors Act (CHIPS, July 2022). The CHIPS Act focused on providing incentives to boost U.S. domestic semiconductor manufacturing after the acute chip shortages resulting from pandemic-driven supply chain disruptions that brought many other industries' production to a standstill. The act provides $52bn (over five years) of public funds as grants for chipmaking facilities. The injection of public funds has spurred on private investment, with the White House announcing $50bn in private spending initiatives by September 2022[3] (including $40bn from Micron[4] and $4bn from Qualcomm[5]). Subsequently, Taiwan semiconductor manufacturer TSMC announced $65bn of investment in three facilities in Phoenix, Arizona.[6] More recently, Intel has received $8.5bn in funding to support a $100bn five-year investment proposal.[7]

Inflation Reduction Act (IRA, August 2022). This third act aimed to boost investment to support clean energy and address climate change[8]. CBO and Joint Committee on Taxation analysis forecast a total of $891bn in spending commitments, including $783bn towards climate change. With tax increases totalling $738bn, the CBO estimated a net deficit reduction of $237bn over the decade.[9] The act included tax credits (raised to up to 30%) for solar, wind, battery storage and other renewables investment, as well as household tax credits for improved efficiency and renewable energy. In the first 12 months, the White House announced private sector investment of $115bn in new clean energy (including $70bn in electric vehicle (EV) supply chain investment and over $10bn in solar). [10] Advocacy group Climate Power estimated $278bn in new investments in July 2023.[11]

Since then, there has been a rush of announcements from firms committing to new investment projects citing the incentives provided by one or more of these acts. Exhibit 1 illustrates the number of corporate investment announcements, including those that mention IRA and CHIPS, since the enactment of these policies. At face value, this suggests a marked increase in investment.

Exhibit 1: Announced investment intentions



Source: Department of Commerce, Jack Conness, Company data, Goldman Sachs Global Investment Research

Evidence of increased investment

It is beyond the scope of this paper to demonstrate that investment has increased because of the Biden administration's $1.5trn spending boost. There are several other drivers that could plausibly have culminated in rising domestic investment intentions independent of the investment incentives associated with these acts. These include a period of post-pandemic catch-up and a drive to onshore, nearshore or friendshore by domestic and global investors looking to mitigate trade tensions or boost supply chain security. We will go on to show that some of the investment boost we have seen appears in areas we would not consider directly impacted by the three acts. Moreover, investment spending more generally has historically been a function of broader economic activity (Exhibit 2) and interest rate policy (Exhibit 3).

[1] The White House (7/28/21): FACT SHEET: Historic Bipartisan Infrastructure Deal

[2] Congressional Budget Office (8/9/2024): Senate Amendment 2137 to H.R. 3684, the Infrastructure Investment and Jobs Act, as Proposed on August 1, 2021/ The White House(7/28/2021): FACT SHEET: Historic Bipartisan Infrastructure Deal

[3] U.S. Department of Commerce (9/6/22): Biden Administration Releases Implementation Strategy for $50 Billion CHIPS for America program

[4] CNBC (8/9/22): Micron to invest $40 billion in U.S. chip manufacturing

[5] Just Auto (8/5/23): Qualcomm reveals collaboration with automakers

[6] Investment Monitor (4/10/24): TSMC plans third facility in Arizona after securing $11.6bn in funding

[7]Financial Times (3/20/24): Intel to receive $8.5bn in US funding for high-end chip manufacturing

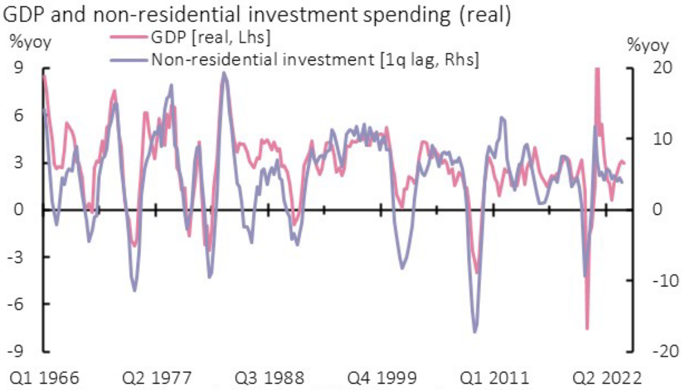
[8] Despite its name, which derives from the view that the policy would usher in a "new era of American innovation and ingenuity to lower consumer costs," The White House.

[9] Congressional Budget Office (8/16/22): Estimated Budgetary Effects of Public Law 117-169, to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14

[10] U.S. Department of Treasury (8/20/23): FACT SHEET: How the Inflation Reduction Act's Tax Incentives Are Ensuring All Americans Benefit from the Growth of the Clean Energy Economy

[11]energypost.eu (9/19/23): U.S. Inflation Reduction Act: one year on, a summary of impressive progress in the energy transition

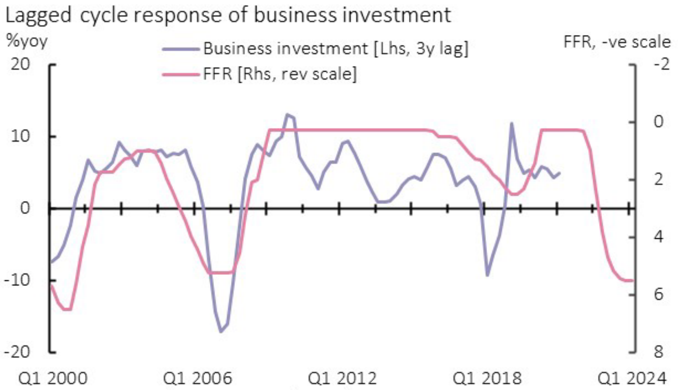
Exhibit 2: Investment spending a function of broader activity



Source: Bureau of Economic Analysis and AXA IM Research, April 2024

We also show that investment spending has increased in specific areas far more than would be historically associated with economic performance and in most cases in areas which can reasonably be expected to be directly boosted by the three acts. Together with the announced investment intentions associated with specific incentive schemes, we think this provides reasonably compelling evidence that investment has been meaningfully boosted by these initiatives.

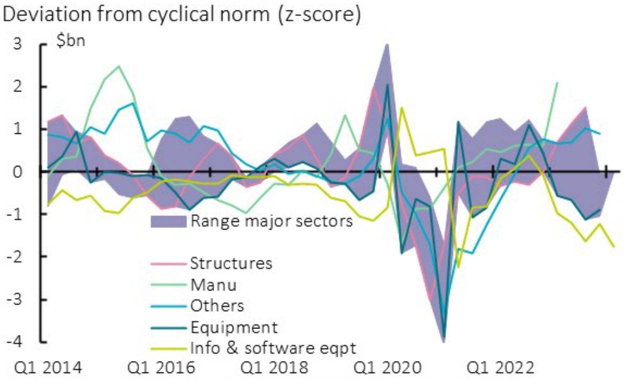
Exhibit 3: Investment spending has lagged monetary policy changes



Source: FRB, BEA and AXA IM Research, April 2024

To illustrate this, we look at investment spending by type and compare this growth historically with broader GDP growth. We estimate a very simple model for each type of investment based purely on broader economic activity and then standardize the residuals for each sector, so for each sector we are tracking the degree of divergence from the historical trend. We then compare these residuals on a standardized basis using a z-score, which measures each score's relationship to the mean (Exhibit 4). The blue area in the chart maps the range of the major sectors; we separately identify the key sub-sectors that form the extremes of the range.

Exhibit 4: Cyclical divergence in investment spending by sector



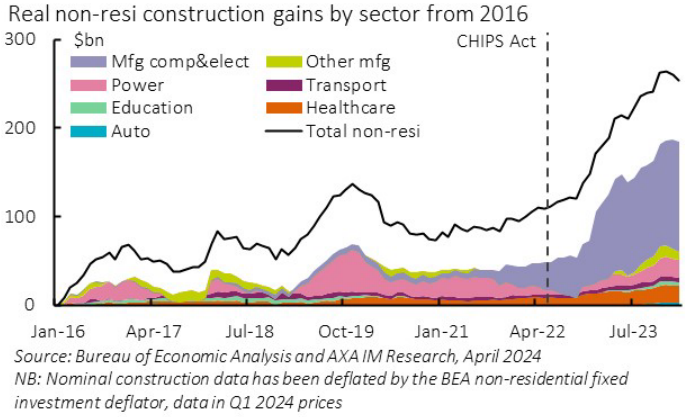
Source: Bureau of Economic Analysis and AXA IM Research, April 2024

Our analysis illustrates a sharp divergence in investment spending trends. Investment in structures appears to be rising sharply in aggregate but is also being driven by manufacturing (and "other" structures). This is both in straightforward annual growth terms, where broad structure sector investment rose by an annual 9.4% in the first quarter (Q1) of 2024, manufacturing by 37.6% and other by 9.0%[12], and in terms of variation from historical behavior. This is consistent with increased investment spending incentivised by the acts.

Exhibit 5 takes a closer look at the source of structure investment, cross-referencing with sectoral construction spending. Non-residential construction gains since the 2016 level show no growth over the pandemic period until shortly after the announcement of the CHIPS Act, when construction in computer, electronics, and electricals manufacturing began to surge – up around $100bn (0.4% of GDP) over the two years to February 2024. This drove most of the increase in construction spending, with small gains also in power, healthcare, and other manufacturing, consistent with some boost from other infrastructure programs. The visibly dominant increase in the computing subsector – recently taking overall construction in this sector to more than 5% of total non-residential construction spending in the U.S. – could suggest that most of the boost to spending has been a result of the CHIPS Act.

[12] This is the preliminary estimate; we note that estimates of Q4 2023 were revised up over the quarter and currently stand at 16.9%

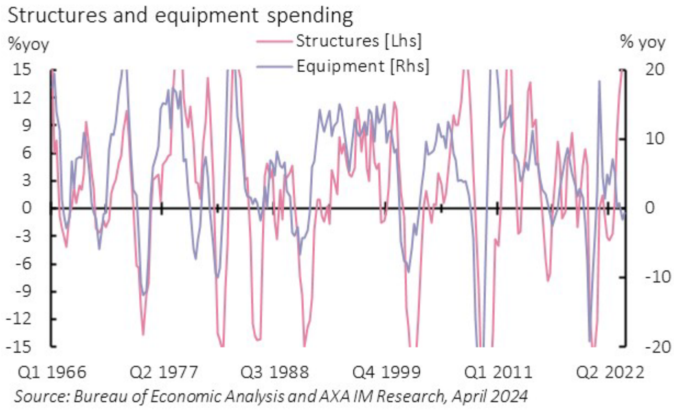
Exhibit 5: Construction boosted by computer and electronics



Source: BEA, AXA IM Research, Apr 2024
NB. Nominal construction data has been deflated by the BEA non-residential fixed investment deflator, data in Q1 2024 prices.

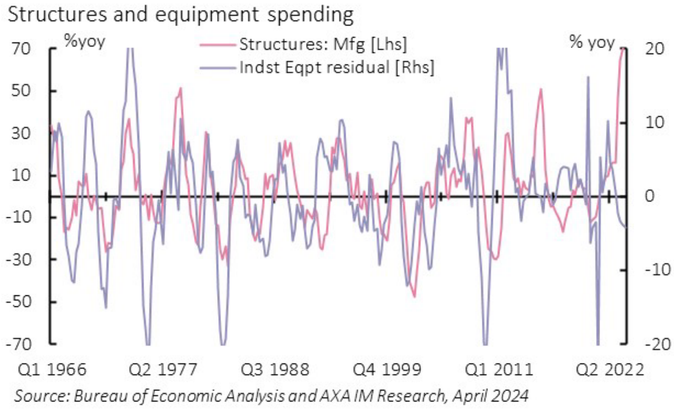
However, total non-residential investment spending overall does not look so buoyant given the relative weakness in equipment spending of just 1.0% on the year in Q1 2024 and investment in this sector being broadly twice as much as in structures. Yet, the outlook for equipment investment may not remain soft as the latest quarterly gains in computer and industrial equipment suggest. We investigate the assumption that once structures have been built, they need to be filled with capital equipment. Exhibit 6 shows annual growth rates of structures and equipment investment. There is no obvious "build it, fill it" relationship here and in fact from the late 1980s onwards, equipment spending appears to lead structures investment, more consistent with similar external factors impacting both at the same time but with equipment investment able to react faster than longer lead-time structures investment.

Exhibit 6: Structure investment doesn't seem to lead equipment



Once we allow for cyclical commonality and look at equipment investment residuals not explained by basic GDP growth, we can see a clearer relationship – especially for manufacturing structures and industrial equipment (Exhibit 7). This suggests that equipment investment may see a tailwind over the coming years, suggesting outperformance over usual cyclical outcomes.

Exhibit 7: Build it, fill it appears firmer in industrial space

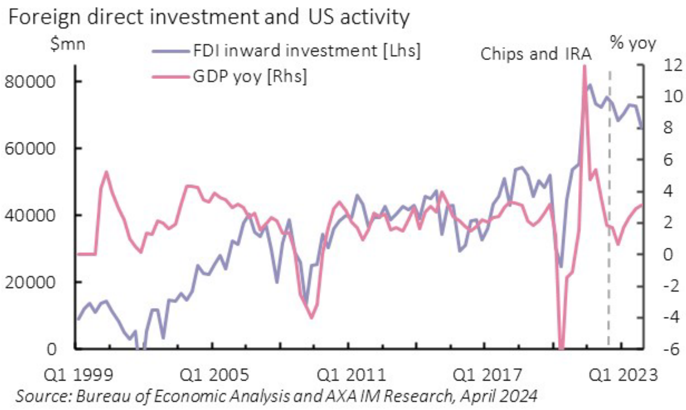


Finally, we note that research and development (R&D) investment has also been weak, down 0.2% on the year to Q1 2024. Part of this could reflect a normalization after sharp gains during the pandemic: R&D spend averaged 13.5% per annum growth over 2021 to 2022.[13]

An investment boost from overseas

Coinciding with stronger domestic investment, the U.S. has seen a significant pick-up in inward foreign direct investment (FDI) since the pandemic (Exhibit 8). FDI's outperformance started before these policies were enacted, with a modest premium visible from 2017. This would be consistent with other factors also influencing FDI, including former President Donald Trump's protectionist policies, geopolitical tensions more generally, and a post-pandemic period of catch-up.

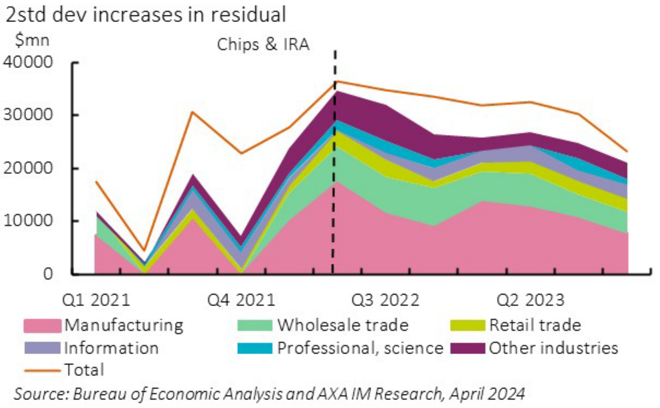
Exhibit 8: Foreign direct investment exceeds cyclical trends



13 AXA IM Research, May 2024

While it is difficult to define by intention, looking at the type of FDI shows an unusually sharp[14] rise, driven by sectors beyond those we would expect to benefit from the investment policies (Exhibit 9). For example, we would not expect FDI in retail or wholesale trade to have risen because of these policies.

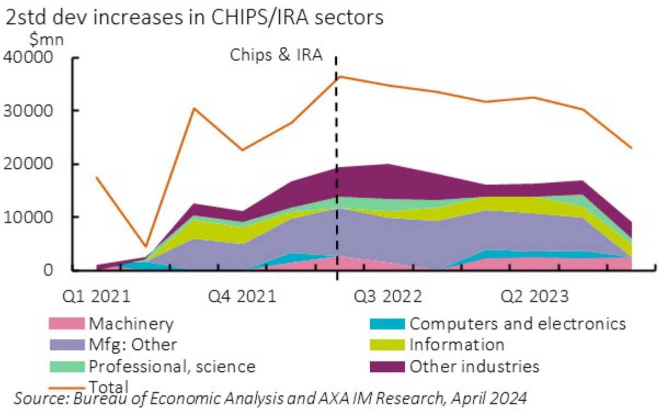
Exhibit 9: FDI increases beyond investment policy targets



Source: BEA, AXA IM Research, Apr 2024

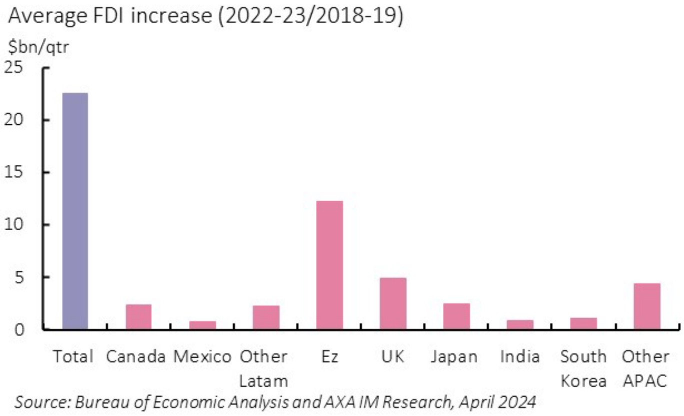
By contrast, Exhibit 10 highlights sectors we would expect to have benefitted, which account for about half of total FDI gains since the CHIPS/IRA Acts. It is also difficult to define the intention of FDI, not least as the increases preceded the enactment of the policies, although they have persisted more strongly thereafter. Yet, qualitatively, we suggest that FDI appears to have been attracted to the U.S. because of the tax incentives on offer under these schemes.

Exhibit 10: Sharp increases in FDI in policy benefitting sectors



It is also important to note the sources of this increased FDI. The average quarterly increase in FDI in 2022-2023 from 2017-2019 is $22bn (0.3% of GDP). Of this total, European countries have provided over three-quarters (54% from the Eurozone and 22% from the UK). Other significant investors have been trade partners, with Canada providing 10%, Mexico and South Korea 3%-5%, while Japan added 10% and other Asia-Pacific countries members just below 5%[15] (Exhibit 11). We think it is telling that European investors, with a longstanding focus on climate-related investment, have been responsible for such a marked increase since tax incentives were realigned to boost investment in the U.S. as well as energy-intensive producers possibly looking to benefit from lower electricity prices.

Exhibit 11: Foreign direct investment exceeds cyclical trends



Investment incentives after the election

Evidence suggests the infrastructure policies enacted over the past three years could have provided a boost to investment spending defying more usual cyclical patterns and have led to an increase in investment from overseas. These have therefore boosted economic activity, supporting U.S. exceptionalism. However, it is also estimated that of the $1.5trn in combined fiscal announcements only around $185bn of that has been spent from the IIJA and IRA Acts with a further $29bn announced under the CHIPS Act[16]. It is therefore important to determine whether these policies could be materially changed by the upcoming presidential election.

We believe it is too early to call with any certainty this year's election outcome with key developments in the economy, broader global developments, and other events in general still likely to shape the eventual result over the coming months. Typically, we expect polling to be a more accurate guide only over the summer months. For now, we acknowledge that betting markets suggest the outcome is tight, although they currently suggest the expected probability for Trump to win is

[14] We define 'unusually sharp' divergences from historical trends in a similar fashion to before: we identify two standard deviation divergences in FDI residuals allowing for broader economic activity

[15] Percentages exceed 100% as countries reducing FDI, including China, are not included

[16] "Biden's big bet hits reality", Blaeser, J., Storrow, B., Tamborrino, K., Colman, Z. and Ferris, D., Politico, 8 May 2024

marginally greater[17]. Given this uncertainty, we consider both outcomes of a Biden win or a Trump win.

In the event of a Biden victory, we anticipate infrastructure investment policies would roll out broadly as expected today. Given fiscal constraints, we see limited scope for a second Biden term to extend these policies further, even if he was to enjoy a unified Congress – an outcome we believe is unlikely. Most attention therefore is focused on what might happen to these policies under a second Trump administration.

A lot of Republican rhetoric has been supportive of the CHIPS Act, which aims to build up U.S. manufacturing capacity, fulfilling both protectionist and security ambitions. We see little scope for any changes to this act. However, the IRA has been the focus of criticism from Republican quarters. At this stage there is little certainty surrounding a Trump manifesto – something that may take more time to emerge. However, since the IRA's enactment there have been multiple Republican-backed bills – presented, passed and/or enacted – that have targeted clawback of some areas of the IRA. These are likely to form the basis of future Republican policy and include:

Limit, Save, Grow Act (House Bill, April 2023, not enacted). The bill proposed to repeal the High Efficiency Electric Homes Rebate ($4.3bn); the state-based home energy efficiency training grants ($0.2bn); and the zero-building energy code ($1bn). But its main thrust was the suggested adjustment of green tax credits, reducing their scale and expiration date (the total tax credit would provide $265bn).[18]

Fiscal Responsibility Act (June 2023, enacted). This provided cuts to the original IRA of just $1.4bn. [19]

House Appropriations Bills (enacted)

- Department of State and others: $11bn cut to Environmental Protection Agency Greenhouse Gas Reduction Fund (41% of total IRA allotment).
- Energy and Water Development Act rescinded $5.6bn of IRA funds.
- Agriculture, rural development and Food and Drug Administration rescinded $3.25bn from Rural Electric Co-operatives and $2bn from the Farm Service Agency.
- Financial Services Act aiming to cut $10.2bn from Internal Revenue Service funding. [20]

Reverse the Curse Resolution (House Bill, proposed September 2023). This aimed to reduce spending from the Infrastructure Investment and Jobs Act, including $6.4bn from the Carbon Reduction Program, $7.5bn from EV charging infrastructure, $5bn from electric and low emission buses and ferries and $5.6bn from low/no emission buses. [21]

Taking these into account, if the IRA was estimated to add $783bn in climate spend over the decade, $33bn has been cut since in subsequent policy enactments. A further $30bn reduction was planned in bills that have not been passed, with a further reduction planned from the $265bn in tax credits the IRA proposes. [22]

Finally, the Heritage Foundation provides a blueprint for fiscal policy ahead of each presidential election and has done so again with its Project 2025. It targets key aspects of the clean investment program from both the IIJA and IRA. Specifically, it suggests a reduction to the Grid Deployment Office of $20bn (part of the IIJA), an office created to facilitate grid development and green energy integration, a reduction to the Office of Clean Energy Demonstration of around $20bn and to the Clean Energy Corp, an institution set up to oversee around $62bn of investment for more equitable clean energy[23]. Although the total reduction in funding is no different from the scope suggested by previous Republican bills, the targets of these reductions are key facilitators of broader policies. Clean energy could struggle to be deployed without grid development and the Clean Energy Corp could provide a material boost from overseas investors. A reduction in funding in these areas may have a disproportionate impact in the roll-out of clean energy investment.

All of this suggests that a new Republican administration may repeal many of the incentives enacted in recent years, which could add to the uncertainty and could reduce the investment appetite buoying U.S. growth for now.

However, several factors suggest the scale of Republican pushback may be less aggressive in office than in opposition. First, these policies appear to have lifted investment, lifting actual and potential growth, while increasing state competitiveness and security – all things we could expect President Trump to support. Moreover, these policies appear popular. Yet, in fairness, one survey[24] found that 57% of the American public knew little (24%) or nothing (33%) about the policies. However, when explained, 68% liked the policies. This may echo with the Affordable Care Act (ACA), which despite

[17] Oddschecker shows Trump at 11/10 and Biden at 5/4, suggesting probabilities of 45% and 44% respectively, as of 13 May 2024

[18] Congress.Gov (2023-2024): H.R.2811 - Limit, Save, Grow Act of 2023

[19] Congress.Gov (2023-2024): H.R.3746 - Fiscal Responsibility Act of 2023

[20] Congress.gov(2023-3024): H.R.4366 - Consolidated Appropriations Act, 2024

[21] Chair Jodey Arrington House Budget Committee: Reverse The Curse FY2024-FY2023 Budget Blueprint

[22] AXA IM Research, May 2024

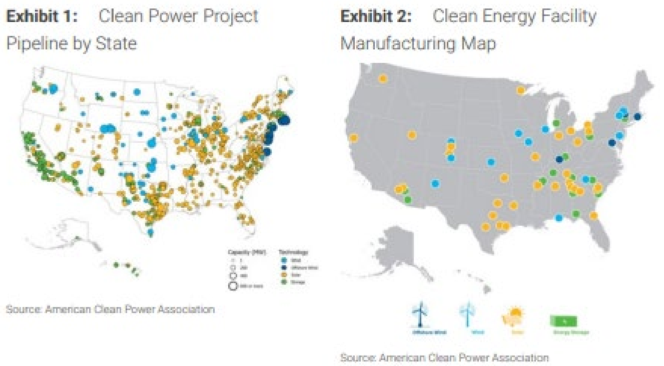
[23] The Heritage Foundation (2023): Mandate For Leadership Project 2025

[24] "Who is most supportive of the Inflation Reduction Act?", Yale University, 30 March 2023

much Republican rhetoric was not repealed under President Trump due to its grassroots popularity.

Finally, the American Clean Power Association found that of the investments announced to date, most tax credits could be paid out in Republican states (Exhibit 12). This could make any repeal of these credits unpopular within the party.

Exhibit 12: Republican states benefit most from tax credits



Source: BEA and AXA IM Research, April 2024

Taking lessons learned from the ACA, we suggest that despite the heated rhetoric, the degree of scale back to the IRA and clean energy aspects of the IIJA is likely to prove less than suggested by Republican opposition to date. We see three key areas as the most likely to face adjustment:

- Tax credits are likely to be reduced to some extent. We would then expect a Republican administration to work with the U.S. Treasury to reduce the scale and duration of credits paid.
- Tightening within the scope of the Foreign Entity of Concern clauses, likely to tighten restrictions on any investments that appear to benefit China directly or indirectly, with some risk that this is broadened.
- Certain components of these policies look likely to be targeted – we would particularly highlight the boost to IRS funding that was part of the package and plausibly the facilitation roles, which could hold back investment more broadly.

IRA not likely to go away

U.S. investment has seen a sharp and unusual boost since the start of the decade, differing from typical cyclical patterns. It is difficult to disentangle the causes of this increase against a backdrop of deglobalization, the pandemic, and geopolitical tensions. However, investment has surged in areas that have been supported by the three significant investment incentive policies enacted over the past three years, i.e., the Investment in Infrastructure and Jobs Act, alongside the CHIPS and Inflation Reduction Acts. These policies appear to have played a material part in boosting investment – particularly the CHIPS Act – and are likely to provide further tailwinds to equipment investment over the coming years. This has provided an additional boost to growth and likley encouraged overseas investors.

We ask then how this outlook might change in an election year. Under a second term for Biden, we could expect the policies to roll out as designed, seeing little scope for additional boost given a likely Congressional gridlock and limited fiscal space. Under a second term for Trump, there could be more scope for repeal of these acts, particularly targeting clean energy investment, an area that has already been the focus of Republican draft legislation since the IRA was enacted. However, we could also forsee that the scale of such repeal may not be as great as current Republican rhetoric suggests. As demonstrated in economic activity, these policies have boosted areas of the economy that are likely to appeal to the more protectionist elements of a new Republican administration. They are also broadly popular and many of the tax credits are paid out in Republican districts. In total, we see modest adjustment to current polices but believe policy will continue to support long-term investment.

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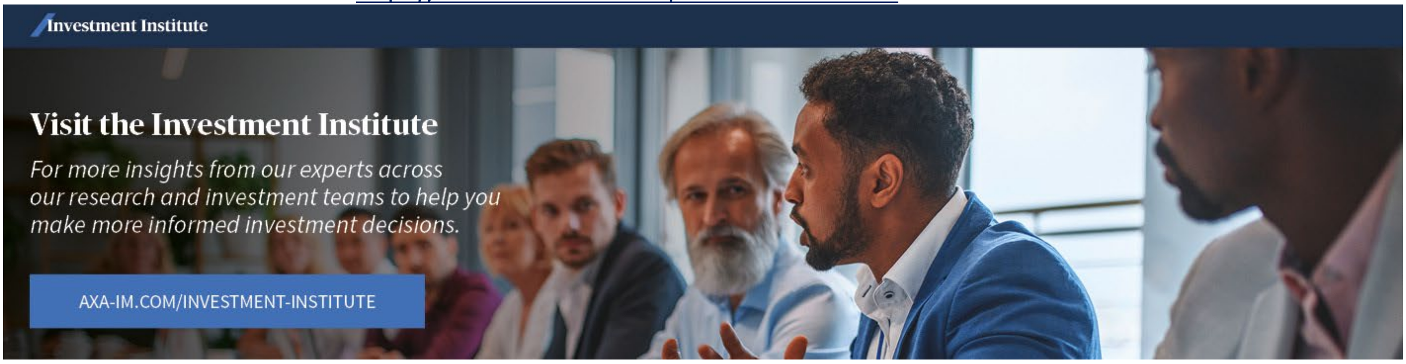
Our Research is available online: https://www.axa-im-usa.com/investment-institute



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